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Macroeconomic policies and other development strategies in support of the 2030 Agenda for Sustainable Development

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Note by the secretariat

Summary

Recent economic growth performance in Asia-Pacific economies, although steady, is modest compared with its recent historical trend amid relatively weak external demand, subdued private investment and increasing trade protectionist measures. Household spending has become the engine of economic growth, supported by low inflation, low borrowing costs and spending by the rich as a result of greater wealth accumulation. However, these factors cannot sustain domestic demand in the long run as they have led to a build-up of private debt and increased financial vulnerability in the region.

Sustained economic growth requires increased attention to raising productivity and increasing resilience against external shocks. In this regard, countries should strengthen domestic demand by promoting productive investments in such areas as infrastructure, innovation and social protection. Such investments, together with structural reforms, would also help to revive the region's productivity growth, which has declined in recent years. Productive investments and structural reforms in turn require better and effective economic governance. Indeed, better governance affects all aspects of sustainable development by, for instance, improving investment prospects, equitable access to public social services and environmental safeguards. A priority in this regard is to improve transparency and accountability in public administration.

Several Asia-Pacific countries have witnessed a sharp increase in income inequality, and many people remain in extreme poverty and lack access to basic public services. Inclusive economic growth will require, inter alia, an expansion of decent jobs, social protection and education, as well as redistributive measures such as progressive taxation. At the same time, environmental degradation, carbon emissions and air pollution are undermining the sustainability of economies. To address these social and environmental issues, which are covered by the 2030 Agenda for Sustainable Development, Governments will require adequate fiscal space and fiscal policy that is geared to support medium-term development priorities. However, fiscal resources remain limited in many countries. This situation calls for tax reforms, reprioritization and efficiency measures on the expenditures side, and effective debt management.

The Committee on Macroeconomic Policy, Poverty Reduction and Financing for Development is invited to consider the issues analysed in the present document, share experiences and provide guidance on the future regional policy agenda for inclusive and sustainable development.

* E/ESCAP/CMPF(1)/L.1.

I. Introduction

1. In the present document, recent progress, risks and challenges with respect to achieving sustained, inclusive and sustainable economic growth in the Asia-Pacific region are examined,¹ and policy options are highlighted, with a focus on the role of fiscal policy, structural reform and governance issues. Most of these issues are analysed in detail in the flagship publication of the Economic and Social Commission for Asia and the Pacific (ESCAP), the *Economic and Social Survey of Asia and the Pacific*, produced by the Macroeconomic Policy and Financing for Development Division. In the document's conclusion, substantive and operational issues are laid out for the consideration of the Committee on Macroeconomic Policy, Poverty Reduction and Financing for Development.

2. Sustained economic growth in the region requires increased attention to raising productivity and increasing resilience against risks. While the Asia-Pacific region continues to outperform the rest of the world on economic growth, more attention is needed to boosting productivity growth, while buffering the region against external shocks and vulnerabilities. Global economic uncertainty remains high, coupled with a weakened international trade outlook and increasing protectionist sentiments, while private investment has been anaemic, shifting the engine of economic growth towards domestic consumption. This situation has led to a build-up of private debt, increasing the region's financial vulnerability. Natural disasters and climate change are adding to existing risks and vulnerabilities. Countries should strengthen domestic demand by promoting productive investments, through both public and private channels, in such areas as infrastructure, innovation, social spending and social protection. Such investments, together with structural reforms, would also contribute to increased productivity gains, without which sustained economic growth cannot be achieved in the long run.

3. Inclusive and sustainable economic growth requires a comprehensive set of targeted policy measures. Several countries have witnessed a sharp increase in income inequality and in the concentration of wealth, while many people across the region remain in extreme poverty and lack access to basic services. Inclusive economic growth will require, inter alia, an expansion of decent jobs, social protection, education and training, as well as distributive and redistributive measures such as minimum wages and/or progressive taxation. At the same time, environmental degradation, carbon emissions and air pollution are reducing social welfare and undermining the sustainability of economies. Despite recent progress, the region is falling behind the rest of the world in terms of levels of energy and carbon intensity. Sustainable economic growth will require, inter alia, a balanced policy framework based on the polluter pays principle, with a mix of incentives and regulations, and an enabling financing system.

4. Fiscal space continues to act as a constraint on the investment needed to effectively pursue the 2030 Agenda for Sustainable Development. Developing Asia will need to invest \$26 trillion from 2016 to 2030, or \$1.7 trillion per year, if it is to maintain its growth momentum, eradicate poverty and respond to climate change (climate-adjusted estimate).² In addition to supporting short-term economic growth, wherever there is fiscal space, fiscal policy must be further

¹ Sustainable Development Goal 8 of the 2030 Agenda for Sustainable Development is to promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all.

² Asian Development Bank, *Meeting Asia's Infrastructure Needs* (Manila, 2017).

geared to support medium-term development priorities in line with the 2030 Agenda. Fiscal policy across the region has been broadly countercyclical and expansionary in recent years, but this has also increased debt levels in some cases, and even where debt levels are relatively low, the debt trajectory has reversed. To rebuild and expand fiscal space, policy priorities should include tax reforms on the revenue side, reprioritization and efficiency measures on the expenditures side and effective debt management. Fiscal space and sustainability discussions should also consider the potential spillover effects of social and infrastructure investments on the economy, such as crowding-in of private investment.

5. Long-term prosperity will depend on productivity growth and improved governance. As the region moves up the income ladder, future economic growth will rely more on productivity gains than factor accumulation. In the light of the declining trend in productivity growth, greater efforts are needed to bolster education, skills and innovation and increase infrastructure and financial access. Structural reforms, including measures to enhance the allocation of resources and improve market efficiency, could also support productivity growth. These in turn require effective institutions, more transparency and better governance, in both public and private spheres. In fact, better governance affects all aspects of sustainable development by, for instance, improving investment prospects, equitable access to public social services and environmental safeguards. In the context of fiscal management, governance also critically impacts the way public revenues are raised and used. A priority in this regard is to improve transparency and accountability in public administration, including through participatory e-government platforms.

II. Macroeconomic performance, outlook and risks

A. Economic growth in Asia and the Pacific and outlook for 2017 and 2018

6. Recent economic growth performance in Asia-Pacific economies, although steady, has been modest compared with its recent historical trend amid prolonged weak external demand, subdued private investment and increasing trade protectionist measures. In line with the region's growing purchasing power, domestic private consumption has been the major driver of economic growth in the region, facilitated by low inflation, ease of borrowing at low interest rates and spending by the rich as a result of greater wealth accumulation and concentration.

7. These factors, however, are unlikely to support a sustained expansion of domestic demand as inflation gradually increases, the capacity to repay borrowing weakens in the wake of slower growth in employment and incomes, and the currently favourable liquidity conditions tighten.

8. Economic growth in the region is underpinned by stable economic conditions in China despite a gradual moderation from ongoing deleveraging and restructuring efforts. The Chinese economy continues to be driven by higher value added sectors. In India, the services sector supported an economic expansion, although demonetization and the roll-out of a new nationwide tax constrained private consumption and manufacturing activity somewhat. The recovery in net commodity-exporting economies and public investments in some net commodity-importing economies are also contributing to the positive outlook for the region. Looking forward, economic growth in the developing Asia-Pacific economies is expected to gain mild momentum, with average economic growth projected to rise to 5.2 per cent in 2017 and 5.3 per cent in 2018, from an estimated 4.9 per cent in 2016.

9. Nevertheless, private investment has not been forthcoming in many countries despite low interest rates. For instance, in India, the contribution of investment to growth in gross domestic product (GDP) was negative and credit growth was at a record low in 2016 despite reductions in the policy interest rate in 2015. Weak private investment is explained in part by global factors, such as weak aggregate demand and heightened uncertainty. For instance, global growth forecasts were repeatedly revised downward for several years before stabilizing more recently. A related factor is excess capacity and low capacity utilization in certain industrial sectors such as energy, utilities and real estate. A third reason is balance sheet pressures due to debt overhang in the corporate and banking sectors in some of the major economies, although there are also reasons for relative optimism.

10. While large public infrastructure outlays in major economies, such as China, have partially offset the slowdown in private investment, this has not been the case in most countries. Although global factors may be difficult to address, countries can take measures to ease domestic constraints to private investment. In both China and India, excess capacity and leverage have impaired banks' balance sheets. In China, addressing excess capacity in certain sectors, deleveraging and creating a level playing field between State-owned enterprises and private firms remain key priorities. In India, a priority is to improve banks' balance sheets, especially those of public sector banks. Banking supervision has been strengthened recently in China and India through more rigorous reviews of asset quality, while such schemes as debt-equity swaps have been introduced to resolve private corporate debts.

11. For all countries, increasing investments in infrastructure and enhancing the business environment can stimulate private investment in the medium term. However, least developed countries face various challenges in this regard, owing, for instance, to limited access to financial markets.

12. An alternative to weak domestic investment is foreign investment. Foreign direct investment (FDI) into the region has been relatively robust, and can contribute to expanding the productive capacity of economies and creating decent jobs, including in the least developed countries. For example, greenfield FDI inflows to the region rose further to nearly \$400 billion in 2016.

13. Non-FDI capital flows, such as portfolio flows and cross-border bank loans, although less volatile over the past year, are subject to rapid reversals, and their potential effects on, for instance, corporate balance sheets and domestic private investment need to be carefully assessed. The strengthening of the dollar has recently moderated, and since late 2016, most regional currencies have been appreciating bilaterally, including the Indian rupee (5.3 per cent), Thai baht (4.9 per cent), Malaysian ringgit (3.8 per cent), Chinese renminbi (1.8 per cent) and Indonesian rupiah (0.1 per cent). In China, the foreign currency and bond markets went through substantial swings at the end of last year. With the introduction of new capital control measures in December 2016, though, outflows slowed in 2017.

B. Inflation, commodity prices and monetary policy stance

14. Although still modest, inflationary pressures have increased in some countries owing to recovering oil and other commodity prices and stronger economic conditions. Some net commodity exporters saw inflation subside after large currency realignments. Although global commodity prices have largely stabilized since 2016, upside and downside risks depend on whether a country is a net commodity exporter or importer. The closing of output gaps has also contributed to an uptick in inflation in some countries, although core

inflation remains generally stable. Average inflation in developing Asia-Pacific countries is projected to be broadly stable at 3.4 per cent in 2017 and 3.6 per cent in 2018 relative to 3.5 per cent in 2016.

15. The boost from an accommodating monetary stance throughout 2016 has been smaller than expected, for various reasons such as weak response in private investment despite low interest rates, weak growth in real wages (partly because of productivity slowdown), policy uncertainty especially in major global economies, excess capacity and private sector debt overhang. The monetary policy stance within the region has recently shifted to neutral, as gradually increasing inflation limits monetary policy and the use of policy interest rates. Strengthened management of capital flows and macroprudential measures by central banks are helping to mitigate the effects of exchange rate depreciation and ensure financial stability. Central banks should continue to remain focused on inflation and financial stability, and thus provide a stable platform for sustained economic growth.

C. Trade and capital flows contributing to uncertainty

16. Despite a broadly positive economic outlook in 2017 and 2018, global policy uncertainty and increasing trade protectionism remain major downside risks. Shifts in policies in the United States of America on trade and immigration may impact the region mainly through channels such as exports of goods by China and exports of services by India, straining employment and productivity growth. Additional policy shifts in advanced economies may further undermine private investment, despite recovering external demand.

17. Increasing protectionist measures could shave off up to 1.2 percentage points from the region's baseline estimates through lower exports, higher risk premiums and lower market confidence. Such uncertainties come at a time of potential tightening of global financial conditions, where capital outflow pressures may re-emerge and bouts of financial volatility are possible.

18. On the upside, exports may benefit from recovering external demand, especially from the United States and Europe, though such a boost could be held back by protectionist measures. In the medium term, strengthening regional economic cooperation, connectivity and integration will be critical to enhance demand through intraregional trade and investment.

III. Enhancing the quality of economic growth

A. Improving prospects for employment and decent jobs

19. For the region, the creation of decent jobs remains a challenge. In 2016, average employment growth in developing countries of the Asia-Pacific region was modest, and remained steady, at 1.1 per cent. However, the share of vulnerable employment remained persistently high, at about 50 per cent, which is equivalent to more than 1 billion workers, who are often without access to social or legal protection. This is partly because of a slowdown in labour productivity; it remains low in agriculture and in small and medium-sized enterprises. At the same time, industry's capacity to absorb labour has been somewhat limited owing to an increasing tendency to upgrade technology in industrial processes. For example, since 2013, China has bought more

industrial robots each year than any other country, and by 2019, almost 40 per cent of the global supply will be installed in China.³

20. Encouragingly, real wage growth in Asia and the Pacific has outperformed the rest of the world. Between 2006 and 2015, real wages in the region grew by 44 per cent, although this performance was driven largely by China; wage growth elsewhere has been modest.

21. Looking forward, consistent growth in real wages should be driven by productivity growth and labour market policies, both of which require greater policy attention. Sustained productivity gains will require effective institutions and better governance in both the public and private spheres. Labour market policies with potential to ensure more inclusive economic growth include those related to minimum wages and the training of low-skilled workers. Fiscal policy can play an active role in boosting domestic demand and supporting development priorities. For instance, public infrastructure investments can be geared towards crowding in private investment to facilitate an industry-oriented structural transformation that promotes the creation of productive jobs.

B. Reducing poverty and mitigating income inequality

22. In most countries of Asia and the Pacific, poverty has decreased considerably in the past few decades. The proportion of people living in extreme poverty (on less than \$1.90 per day in terms of 2011 purchasing power parity) in the Asia-Pacific region declined from 29.7 per cent of the total population in 2000-2004 to 10.3 per cent in 2010-2013.⁴ However, there are signs of a slowdown in the pace of poverty reduction, partly owing to the moderation in economic growth over the last five years. Furthermore, large segments of the population remain vulnerable to falling back into poverty.

23. Another reason for the deceleration in poverty reduction is that fast economic growth has not translated into commensurate increases in decent jobs. However, poverty is much more than just economic growth and jobs, as it affects people's capability to achieve the lives that they value: it is therefore linked to such aspects as dignity, inclusion and participation.

24. The share of wages in national income has declined in many countries of the region, while wage inequalities have widened. For instance, in India, the Palma ratio increased from 2.88 in 2004 to 3.09 in 2011.⁵ Similarly, the population-weighted Gini coefficient, based on household income estimates, increased by almost 30 per cent in the region between 1990 and 2014. The region's economic success has led to fast accumulation of private wealth with a concentration at the top. For instance, the number of the region's high net worth individuals increased from 3 million to 5 million between 2009 and 2015, and their total wealth almost doubled, reaching \$17.4 trillion in 2015. In such countries as India, Indonesia, the Russian Federation and Thailand,

³ International Federation of Robotics, "Executive summary world robotics 2016 industrial robots". Available from https://ifr.org/img/uploads/Executive_Summary_WR_Industrial_Robots_20161.pdf (accessed 28 September 2017).

⁴ See E/ESCAP/CMPF(1)/2.

⁵ Organization for Economic Cooperation and Development, OECD.Stat database. Available from <https://stats.oecd.org> (accessed 28 September 2017). The Palma ratio is the income share of the top 10 per cent, people with highest disposable income, divided by that of the bottom 40 per cent, people with the lowest disposable income.

the top 1 per cent of the population in terms of wealth account for more than half of the total wealth pool.

25. In the context of the region's structural transformation towards moderate economic growth, sustained poverty reduction will need to rely more on enhancing income distribution and addressing exclusion from access to basic services, including clean water and sanitation, energy, health and education. Comprehensive measures are needed to tackle inequality, including fiscal measures, such as progressive and more redistributive taxation and social protection; labour market policies, such as minimum wages, training of low-skilled workers and policies to increase women's labour force participation rate (box 1); and financial policies that can provide broader access to financial services.

Box 1

Boosting women's labour force participation in South and South-West Asia

Despite recent gains in economic growth momentum in South and South-West Asia, women's labour force participation remains below potential. Increasing participation rates can help to strengthen economic growth. Based on a global index of women's economic participation – capturing female labour force participation, gender wage equality and the presence of female professional workers – South and South-West Asian countries perform poorly in providing economic opportunities for women among the 145 countries covered. Across the subregion, the average female labour force participation rate (in the formal sector) stands at 43 per cent and decreased between 2000 and 2013. Participation rates in 2013 varied from below 30 per cent in Afghanistan and India to about 60 per cent in Bangladesh and Maldives, on a par with the global average. Participation rates in Bhutan and Nepal are well above 60 per cent, mainly owing to female workers in agriculture.

A combination of factors such as education, job characteristics and demands, childcare and economic and social infrastructure affect female workforce participation. Social norms and individual and household factors, whereby working women can be perceived as lowering their household's social status, or women are assumed to have more responsibility in domestic work and caregiving, are other factors that determine the participation of women in the labour market. Within the region, participation rates are higher in countries such as Bhutan and Nepal where there are generally fewer social restrictions on women to work, while poverty and the rise of certain sectors such as garments and tourism and the expansion of microfinance schemes have also boosted women's participation in the labour market.

Bold policies are needed to alter deep cultural roots that discourage role of women outside the household sector. Policies to overcome core barriers and offset disincentives for women could include parental and child-related benefits or tax frameworks that encourage mothers to work, applied successfully in Japan. Enhanced availability of and access to good-quality education, skill development and women's entrepreneurship programmes, basic services, childcare, conducive infrastructure and safe public transport to work could also promote female labour force participation. For example, electrification and improved access to water, as introduced in Bhutan, Bangladesh, Pakistan and Sri Lanka, have also increased women's time available for market work. Policies should also ensure equal rights and access to productive assets such as land and capital. Moreover, there is a need to address the land rights of female family members and labour and family laws such as flexible work arrangements, reduce gender pay gaps and ensure a safe work environment.

Though policy efforts to promote female participation in the labour force have been made to overcome core barriers and offset disincentives for women to work, the key question is whether such policies have been bold enough to alter social norms that discourage or even prohibit a role for women outside the household sector. Policy reform requires measures such as increased public spending, better access to basic and financial services, the amendment of laws and regulations, and the mainstreaming of gender equality into policy design, budgeting, monitoring and evaluation.

C. Enhancing social protection

26. A robust system of social protection can help to address poverty, inequality and vulnerable employment while contributing to raising domestic demand in an equitable and durable manner. The Asia-Pacific region currently falls behind the rest of the world in terms of social protection financing and coverage. Average total public social protection spending, including health expenditures, as a percentage of GDP increased from 3.5 per cent in 2000 to 5.3 per cent in 2010/11 (latest year) in the region, but it is still lower than the global average of 8.6 per cent. Coverage remains weak in most countries, although countries such as China, Thailand and Viet Nam have made notable progress since the 2000s. Effective coverage with unemployment benefits (contributory and non-contributory) is limited to 7 per cent of the population compared with the global average of 12 per cent.

27. To address the situation and enhance social protection, improving governance will be vital, in order, for instance, to nurture national ownership and support for the required reforms. The development of social protection floors is a multistep process that includes a national social dialogue, a financing strategy and delivery mechanisms. Thus, financing social protection schemes and improving their delivery rests critically on stable fiscal positions, and effective governance and institutions. The quality of governance affects the achievement of development goals, including by enhancing social protection, through its impact on the composition and efficiency of public expenditure. Similarly, weak governance partially explains the low levels of tax revenues in several countries of the region, as tax morale – the willingness to pay taxes – is affected by perceptions of how well those revenues are used.

D. Ensuring environmental sustainability

28. The region is highly vulnerable to climate change, the adverse effects of which can substantially undermine the economic development gains in the region and could force more than 100 million people from the region into extreme poverty by 2030.

29. Environmental damage and degradation is widespread in the Asia-Pacific region, fuelled by unsustainable economic growth patterns and greater competition over scarce resources owing to high population growth. This poses a threat to the region's water, energy and food security. Air pollution – a major cause of premature deaths – is on the rise, especially in China, India and South-East Asia, mainly caused by households burning coal and biomass for cooking and heating, and by fossil-fuel-based electricity generation.

30. Inefficient and unplanned urban expansion has resulted in the conversion and loss of forests, wetlands and other ecosystems and has increased the already high exposure to disasters, with poor and disadvantaged communities the most affected. Most urban dwellers in the region lack access to infrastructure and services such as sanitation, electricity and health care, and rely on the informal sector to meet their needs. Furthermore, rapid urbanization has raised the region's exposure to natural hazards, by exacerbating existing risks and creating new ones. As the stock of buildings is rapidly expanding and buildings account for about a third of energy consumption, there is huge potential for making energy efficiency improvements in the residential sector. These challenges require policy attention and legislation.

31. Natural resource depletion measured as a decline in natural asset values is significant across countries in the region, ranging from 36 to 2 per cent of gross national income, showing the extent to which economic growth has been

achieved through a significant disinvestment in countries' natural assets.⁶ While some countries may have converted these assets into other types of savings, for instance through sovereign wealth funds or the recycling of resource income by State-owned companies back into domestic investments, the rates of resource depletion observed over time are not sustainable and raise the issue of intergenerational equity.

32. In the Asia-Pacific region, greenhouse gas emissions have increased dramatically, mainly caused by households burning coal and biomass for cooking and heating and by fossil-fuel-based electricity generation. The region already accounts for roughly half of global emissions, and the high growth path on which many of the region's economies find themselves means that this contribution will grow in the absence of fundamental policy interventions.

33. The region's efficiency of resource use – including energy, material and water – has been lagging behind much of the rest of the world. For example, energy intensity – the ratio of total primary energy supply to GDP – in the region is high, especially among the large oil producers and in China, although it is being steadily reduced over time. The region's material footprint grew by 20 per cent between 2000 and 2010, and it still had roughly double the world average footprint in 2010. Water intensity in the region's developing countries, albeit on the decrease owing to improvements in the agricultural sector and irrigation, is still very high and, for the region as a whole, exceeds the world average by a factor of two.

34. Policy instruments to address the current sustainability challenges include regulatory, market-based and even voluntary or information-based tools. In practice, a mix of these policy instruments is employed to achieve higher energy and resource efficiency and improve environmental outcomes. Regulation is typically used to control hazardous point sources of pollution, and its advantage lies in exerting direct control over the environmental outcome that it is seeking to address. However, it does not provide any incentives to the polluter to reduce emissions further and is inefficient in the sense that it does not direct pollution abatement towards the lowest-cost polluter. By contrast, economic instruments rely on prices or markets to function, and encompass taxes, emissions trading schemes and subsidies, including the removal of inefficient fossil fuel subsidies. The advantage of market instruments is related to their superior allocative efficiency, the positive incentives that they provide and their revenue-generating ability. Voluntary and information-based measures include toxic release inventories and pollutant release and transfer registers, or eco-labels, consumer awareness-raising campaigns and corporate sustainability reporting. One of the advantages of information instruments is the relatively low implementation cost, compared to the complex administration needed to implement regulatory or market-based approaches. However, voluntary measures often have limited coverage and are sometimes considered less effective.

⁶ Natural resource depletion is measured as the sum of net forest depletion, energy depletion and mineral depletion of a country for a given year. It reflects the decline in asset values associated with the extraction and harvest of natural resources, analogous to depreciation of fixed assets.

IV. Fiscal policy

A. Fiscal policy stances

35. Fiscal policy stances in the region have been broadly countercyclical and expansionary in recent years. Most countries had wider fiscal deficits (or narrower surpluses) and slower economic growth in the period 2014-2016 compared with the period 2011-2013. On average for the region, general government debt level is estimated to have increased to 42 per cent of GDP in 2015 compared with 36 per cent in 2007. China implemented large infrastructure projects and tax breaks, India adjusted its medium-term fiscal consolidation path to accommodate higher current expenditures, and the Republic of Korea and Thailand engaged in various stimulus measures. However, net commodity exporters have taken a more cautious approach given terms of trade losses that have negatively impacted public finances.

36. Beyond stabilization considerations, there have also been efforts to enhance the composition and quality of public expenditures in support of development priorities. Social spending on education, health and social protection have generally been on the rise, albeit gradually and from a low base, and many countries have ambitious infrastructure plans. For instance, Indonesia allocated 5 per cent of its 2016 national budget to health expenditure compared with 3 per cent in 2014, and Pakistan expanded its Benazir Income Support Programme to 5.3 million beneficiaries. Beyond financing, countries need to pursue broader public sector governance reforms to ensure that spending translates into better development outcomes.

B. Fiscal sustainability

37. Ensuring continued fiscal sustainability requires tax reforms and effective debt management. Tax collection remains relatively low in the Asia-Pacific region, and the scope for boosting revenues through improved compliance and base-broadening is particularly large (see box 2). In countries where domestic demand is depressed, some tax relief could be offset by debt finance, taking advantage of the relatively low government bond yields.

38. In assessing fiscal sustainability, countries should consider the potential long-term positive spillover effects of social and infrastructure investments on the economy, especially on productivity. If the spillovers are sufficiently large, for instance owing to the crowding-in of private investment, the ratio of public debt to GDP could even remain stable over the long term. At the same time, expenditure efficiency and revenue enhancement efforts – aspects influenced by better governance – could help contain the primary balance and make debt dynamics less sensitive to the differential between interest rates and nominal GDP growth.

Box 2**Challenges in mobilizing tax revenues**

Countries in the Asia-Pacific region have among the lowest tax-to-GDP ratios in the world. In 2014, Asia-Pacific developing countries mobilized 17.6 per cent of GDP in tax revenues, which is only half the average across countries of the Organization for Economic Cooperation and Development. While the “optimal” tax-to-GDP ratio depends on a country’s preference for public goods and the structural characteristics of its economy, current collection levels seem to be below what is desirable or feasible in many countries.

The identification and registration of taxpayers is a critical first step in collecting taxes. Tax compliance should be enhanced through tax withholding and third-party information reporting as well as audits. Effective taxpayer services can minimize compliance costs for individuals and businesses and promote voluntary compliance.

A major factor behind the narrow tax base is wide-ranging and potentially redundant exemptions. For instance, agricultural income receives special tax treatment in several South Asian countries, without a proper distinction being made between poor and wealthy farmers. Tax holidays are also widely used in manufacturing and services sectors. Loose tax incentives can create opportunities for tax avoidance and evasion as investors funnel profits from an existing profitable company through the tax holiday company.

As a first step, Governments could publish tax expenditures to encourage proper cost-benefit analysis of tax exemptions and incentives. According to an open budget survey undertaken in 2015, there were 14 countries in the Asia-Pacific region whose Governments published at least some tax expenditures.

Aside from delivery revenues, an important objective of taxation is progressivity. Personal income taxes are typically progressive but currently play a disproportionately small role in more than half the countries in the region, contributing less than 2 per cent of GDP. In addition to income taxes, taxation of assets could enhance tax progressivity.

Another aspect of recent tax reforms concerns economic efficiency, or the question of how to raise adequate revenues without unduly distorting economic activities. Many countries have moved to value added tax to avoid the cascading effect of regular business and sales taxes. In 2016, China completed the transition to value added tax. Such reforms have been more difficult in India, but with marked progress over the past year, India is about to implement a unified, nationwide goods and services tax which may boost economic growth by as much as 1.5 per cent of GDP in the medium term.

V. Increasing productivity

A. Challenge of declining productivity

39. Steady productivity growth is key to the long-term prosperity of the Asia-Pacific region, especially in the wake of weak trade growth and increasing trade protectionism. In addition to factor accumulation, defined as increases in the labour force and the capital stock through investment, productivity gain is another factor that strengthens aggregate demand.

40. Nonetheless, available data suggests that productivity growth in developing Asia-Pacific economies has slowed notably in the aftermath of the 2008 economic and financial crisis. The average annual growth of total factor productivity decreased from 2.8 per cent during the period 2000-2007 to just 1 per cent during the period 2008-2014. There are many explanations put forward for the productivity slowdown. One is labour hoarding, where firms retain workers despite weaker sales performance, because of high firing costs. Labour hoarding results in poorer operational efficiency for firms and lower productivity for an economy in general. Another possible explanation is the

emergence of the service sector, which generally offers less potential for productivity increases than the industrial sector. A third explanation is subdued investment: as private sector firms are cleansing their balance sheets, they do not invest in innovative technologies that would make their production processes more efficient.

B. Labour productivity and wage dynamics

41. Similar to total factor productivity, growth of labour productivity, as measured by GDP per employed worker, has trended down in the region since the 2008 global financial crisis. At the same time, growth in real wages has not been commensurate with the increases in productivity levels, which is reflected in the declining proportion of the share of wage income in national output. The weak link between productivity and wages is mostly underpinned by large pools of surplus labour from the structural transformation across the region that is seeing agriculture shrink in value added while manufacturing and services expand. The inability of real wages to grow in line with productivity increases undermines countries' efforts to strengthen domestic demand and their progress towards more inclusive development.

42. To ensure that gains from increases in labour productivity are passed on to workers, Governments could seek to strengthen collective bargaining of workers and introduce or enforce minimum wages. Social policy tools, such as greater social protection and public employment guarantees, also support workers and economic growth driven by domestic demand. Nevertheless, to ensure sustained progress on these policies, Governments will need strong fiscal positions.

C. Agricultural productivity

43. Agricultural productivity growth in developing Asia-Pacific economies has also moderated. In these countries, the share of agriculture in GDP has declined much faster than its share in total employment, implying lower agricultural output per worker. This is partly driven by the skill bias of modern technology, which reduces the ability of the non-agricultural sector to absorb surplus, often unskilled labour from the agricultural sector. Moreover, in many countries, agricultural workers have become relatively poorer; GDP per capita has risen more rapidly than farm incomes. For example, in China, the ratio of agricultural value added per worker to GDP per capita decreased from 0.47 in the period 1990-2000 to 0.21 in the period 2011-2014.

D. Policies to increase productivity

44. Experience from developing Asia-Pacific economies shows that the main factors driving productivity levels in the region are labour quality, innovation, public infrastructure and access to finance. Each of these factors requires multifaceted policy efforts. For example, the quality of labour depends on public policies to promote healthy workers with technical skills that labour markets need. Similarly, a country's innovation capability is influenced by the degree of trade openness and participation in global value chains.

45. Governments should also consider structural reforms that help to raise economy-wide productivity, and can complement monetary and fiscal policies to help lift productivity and potential growth. These generally refer to policy, legislative and regulatory changes that increase the efficiency of factor markets (land, labour and capital) and product markets. Recent examples from the region include the liberalization of interest rates in China and the new national bankruptcy law in India, which are expected to support private investment.

Careful assessment is needed of the distributional and environmental impacts of such growth-enhancing reforms, so that appropriate compensating measures may be introduced.

46. Beyond economy-wide productivity, a dedicated effort could be made to enhance agricultural productivity, as the sector still accounts for one in four workers in the region. Moreover, more than half the region's population continues to live in rural areas where poverty remains endemic. There are various policy options that countries can implement to boost agricultural productivity. Examples of direct support to farmers include agricultural extension services, rural irrigation and transport systems and access to agricultural technologies. Governments should also aim to offer an enabling environment for agricultural development, such as through the development of value chains and market-based pricing of agricultural products. Lastly, rural industrialization can strengthen the production-consumption linkages within agriculture and between the agricultural and non-agricultural sectors.

VI. Improving governance

A. Definition and trends

47. Better governance and effective fiscal management can improve long-term economic prospects and facilitate better social and environmental outcomes. The quality of governance can be defined in different ways. In the 2017 edition of the *Economic and Social Survey of Asia and the Pacific*, governance is framed in terms of how power is exercised instead of how it is acquired, and is measured by analysing data on government effectiveness, regulatory quality, rule of law and control of corruption, four of the six worldwide governance indicators developed by the World Bank.

48. Based on this measure, a marginal improvement in institutional quality has been observed, on average, in the Asia-Pacific region over the past two decades. This trend primarily reflects improvements in East and North-East Asia and in landlocked developing countries, particularly in North and Central Asia. These improvements can be explained by the general increase in income levels, and the demand for better institutions that results from a rise in the middle class and a better-educated population. Furthermore, amendments to laws and regulations and their implementation have helped change the perceived quality of governance.

B. Governance and development outcomes

49. Better governance and effective institutions affect all three aspects of sustainable development. For instance, governance affects the capacities of an economy to have access to a skilled labour force, improve investment prospects and sustain innovation. All these factors in turn help enhance the level and pace of productivity. When institutions are weak, inequalities tend to increase and the pace of poverty reduction declines. This is owing in part to inequality in access to social services, particularly for women as well as for the poorest and most vulnerable segments of society. The quality of governance is also important for environmental outcomes, as reflected, for instance, in varying capacities to make and apply environmental rules and safeguards. At the same time, better and effective governance can provide opportunities to adopt new green fiscal instruments or to foster ecological innovation and technological transfer, which help to curtail environmental degradation.

C. Governance and fiscal management

50. In the context of fiscal management, governance impacts the way public revenues are raised by affecting tax morale. Taxpayers may shirk their tax responsibilities if they see a mismatch between tax liabilities and the public services that they receive. Low tax morale may also be linked to the perception that evasion of taxes is widespread, especially among those with higher incomes.

51. The quality of governance also affects the achievement of development goals through its impact on the composition and efficiency of public expenditure. For instance, corruption has been shown to distort the structure of public spending by reducing the portion of social expenditures. In contrast, better governance has been found to increase the impact of public health spending on child mortality rates, as well as making public spending on primary education more effective and leading to higher attainment in primary education.

D. Transparency and accountability: fiscal data and information and audits

52. Improving transparency and accountability in public administration is key to better fiscal management. Several Asia-Pacific countries require public officials at different levels to declare their financial assets to help increase the integrity of civil servants as well as public trust in them. This requirement has improved the efficiency of government expenditures and the overall quality of governance, though further improvements are needed in public access to and coverage of pertinent information, as well as in the monitoring and oversight of the implementation of such policies.

53. Ensuring access to meaningful fiscal information contributes to greater transparency. However, access to information on resources received by the various government units responsible for the delivery of services remains limited in several countries, even though such policies have yielded positive results in the cases of Georgia, the Republic of Korea, Samoa and Singapore. Furthermore, when information is published, the quality and utility of the published government financial data seems to be low, particularly in North and Central Asia.

54. At the same time, there is considerable room to strengthen internal controls and external and internal audit functions. For instance, there are issues related to the comprehensiveness, relevance and understanding of internal control rules and procedures. Similarly, the degree of compliance with rules for processing and recording transactions is weak. Concerning internal audit, Asia-Pacific countries face concerns related to the frequency and distribution of reports, and the extent to which management follows the ensuing recommendations. Concerning external audits, the major concerns are the audit scope, adherence to international standards and the timeliness of submission of reports.

E. Transparency and accountability: participation and e-government

55. In addition, the integration of the views and concerns of citizens is important as it allows the effectiveness of a policy to be checked and tax morale and revenues to be raised. Enhancing transparency and strengthening accountability requires effective feedback systems to be established, through which users are informed of the existence of such tools and can report wrongdoing by officials or assess the quality of public services.

56. The implementation of such policies can be optimized through information and communications technology and through wider use of financial products by beneficiaries of public services and taxpayers. Tax revenues can substantially increase through the deployment of an e-system for tax return and tax filing. Public expenditure efficiency can also increase through e-systems because government programmes can be better coordinated, as is the case with the Malaysian eKasih system, and funds can be tracked up to the final beneficiary, such as in India with the payment of social benefits and wages through bank accounts. While e-government systems present opportunities for public financial management and progress has been made during the last decade, Asia-Pacific countries could take greater advantage of those opportunities.

57. Efforts are needed to improve information flows across relevant government departments. For instance, the tax-enforcement function depends on a central database and flow of information from different sources, particularly in the case of value added tax and income taxes. However, a typical approach in the organization of tax administrations in developing countries has been to establish separate revenue departments overseeing different tax bases. This results in little information-sharing among the departments and difficulties in reconciling data and information on taxpayers. Some countries, such as Maldives and the Philippines, have addressed this problem by reorganizing the tax administration along functional lines.

VII. Strengthening domestic and regional drivers of economic growth

58. Developing and deepening regional economic cooperation and integration in Asia and the Pacific – for example, through the Belt and Road Initiative – can offer solutions to the long-standing problems that the region is facing. For instance, by enhancing regional connectivity for energy, transport and information and communications technology, and promoting regional cooperation in trade, financing and shared vulnerabilities, regional economic cooperation and integration offers enormous potential to generate trade, growth and employment, enhance social capital and manage environmental risks and shared vulnerabilities.

59. Enhancing regional economic cooperation and integration is particularly important because the region's traditional export markets have decreased in importance since the 2008 global financial crisis. In the period 2001-2005, North America and the European Union accounted for 61.5 per cent of world GDP, compared to 27.1 per cent for Asia and the Pacific. But in the period 2011-2015, the share of world GDP accounted for by North America and the European Union dropped to 47.9 per cent while that of Asia and the Pacific increased to 36.1 per cent. The recent emergence of protectionist sentiments, as indicated for example by the rising number of trade-restrictive measures, is another reason why the region should further enhance regional economic cooperation and integration and boost intraregional demand.

60. With a combined GDP of \$27.25 trillion, which is growing fast, Asia and the Pacific is well on its way to becoming the most important market in the world, opening possibilities for further expansion of trade and investment within the region. This can contribute to job creation, poverty reduction and boosting of economic growth throughout Asia and the Pacific. There is also a role for better policy coordination and the propagation of better environmental and social policies across the region, as countries become increasingly linked.

61. The region is a major global destination for investment, which is reflected in both inflows to the region and flows between countries within the region. Asia-Pacific countries are quickly gaining global prominence as major outward investors. In 2015, investment outflows from developing Asian economies reached \$323 billion, representing 30 per cent of global FDI flows. However, the noodle bowl effect⁷ also affects FDI inflows, which are not always aligned with sustainable development principles. Countries should promote regional investment regimes that better balance investor rights with host country development needs. This will enable countries not only to attract more FDI to contribute to sustainable development, but also to achieve better market integration.

VIII. Matters for consideration

62. The report of the Secretary-General entitled “Repositioning the United Nations development system to deliver on the 2030 Agenda: ensuring a better future for all”, of 11 July 2017, contains a description of the functions of regional commissions such as ESCAP with respect to fulfilling their role as policy think tanks and providing analytical services and policy advice to address regional issues; providing platforms for the exchange of best practices and analysis of existing and emerging challenges; and strengthening the policy capabilities of United Nations country teams.

63. The main findings emerging from the analytical work relating to macroeconomic assessment conducted by the secretariat since the third session of the Committee on Macroeconomic Policy, Poverty Reduction and Inclusive Development suggest that there is a greater need to refocus analytical thinking away from simple expansion of economic output considerations and towards improvement of the quality of economic growth, along with the necessary policy reforms. This need is even more pressing given that the region’s economies need to cover considerable ground in terms of achieving inclusive and sustainable development.

64. Against this backdrop, the following issues are presented for the consideration of the Committee on Macroeconomic Policy, Poverty Reduction and Financing for Development:

(a) **Relevance of analytical work on macroeconomic policies by the secretariat.** Do policymakers in the region find the analysis in the *Economic and Social Survey of Asia and the Pacific* of interest in terms of learning about macroeconomic prospects, emerging socioeconomic challenges and available policy choices? Which aspects of the *Survey* could be improved, including in terms of promoting a fundamental rethink to strike an appropriate balance between economic, social and environmental considerations?

(b) **Future directions of the analytical work of the secretariat.** Given the need for a more proactive role for fiscal policy, as highlighted in the present document, and amid sizeable financing gaps to achieve the 2030 Agenda, the 2018 edition of the *Survey* will focus on strengthening public finance and leveraging private finance to enlarge the pool of development finance. The secretariat would welcome any guidance on the key issues that should feature in the 2018 *Survey*: on which areas and policies should the secretariat focus more?

⁷ The noodle bowl is a phenomenon created by the proliferation of preferential trade agreements among the same trading partners. See *Asia-Pacific Trade and Investment Report 2016: Recent Trends and Developments* (United Nations publication, Sales No. E.16.II.F.23).

(c) **A right mix of activities carried out by the secretariat.** The secretariat disseminates its macroeconomic-related analytical products through the *Survey*, working papers and policy briefs, and collaborates with Governments to conduct research studies, such as an ongoing study on the impacts on Asia and the Pacific of the economic transformation of China. At the same time, the secretariat carries out various capacity-building activities; this year, it will be carrying out a workshop on better macroeconomic management to support the 2030 Agenda. In this spirit, the secretariat would appreciate suggestions that could better link its analytical work and capacity-building efforts: to which capacity-building themes should the secretariat give more emphasis, keeping in view its work related to macroeconomic assessment?
