

**Economic and Social Commission for Asia and the Pacific****Seventy-fourth session**

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Item 3 (a) of the provisional agenda\*

**Review of issues pertinent to the subsidiary structure of the Commission, including the work of the regional institutions: macroeconomic policy, poverty reduction and financing for development****Summary of the Economic and Social Survey of Asia and the Pacific 2018****Note by the secretariat***Summary*

The average growth in gross domestic product of the Asia-Pacific region continues to increase steadily on the back of firmer global demand, while inflation remains stable. The key tasks at hand are to ensure that such economic performance is sustained over time, that it benefits everyone, and that the environmental implications are minimal. However, financial risks and protectionist trade measures weigh on the near-term macroeconomic outlook, while the medium-term challenges of lifting the region's potential economic growth and reducing poverty on a sustained basis continue. Furthermore, while rapid technological advancements promise immense opportunities, they also pose considerable challenges in terms of job polarization as well as income and wealth inequalities. The pursuit by China of innovative, inclusive and sustainable economic growth could also have important regional impacts through trade, investment and other channels.

Member States are advised to make the most of current favourable economic conditions to enhance the resilience, inclusiveness and sustainability of economic growth.

The implementation of several policy initiatives needed for these objectives will require not only the channelling of existing financial resources, from both the public and the private sectors, towards sustainable development, but also additional financial means. The *Economic and Social Survey of Asia and the Pacific 2018* contains an examination of how Governments of countries in the Asia-Pacific region could increase domestic public financial resources and leverage private capital to strengthen the long-term prospect of economies. Complementing the analyses contained in previous issues of the *Survey*, it contains illustrative estimates of how much additional finance countries may be able to mobilize from such measures as reforms in tax administration and tax incentives, the introduction of carbon taxes, prudent sovereign borrowing from financial markets, and an enabling environment for public-private partnerships.

The Commission may wish to take note of the key messages and findings of the 2018 *Survey* as contained in the present document. The Commission is invited to consider the issues analysed, along with policy suggestions, and provide the secretariat with guidance for its future work on mobilizing development finance to enhance the prospects of achieving sustained, inclusive and sustainable economic growth.

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\* ESCAP/74/L.1/Rev.1.

## I. Introduction

1. Sustainable Development Goal 8 calls for the promotion of sustained, inclusive and sustainable economic growth. These three aspects of economic growth correspond to the three dimensions of sustainable development: economic resilience, social inclusiveness and environment sustainability. The well-being of societies increases if progress is made on all three fronts. In the *Economic and Social Survey of Asia and the Pacific 2018*, these issues are analysed and policy options that can help countries to effectively pursue these objectives are discussed.

2. Building on the assessments in previous issues – inter alia, on making growth inclusive (2015), nurturing productivity (2016) and enhancing governance and fiscal management (2017) – the 2018 *Survey* contains an exploration of the importance of financing for development and an examination of how the Governments of Asia-Pacific countries could increase domestic public financial resources and leverage private capital to strengthen the long-term prospect of economies.

3. According to that assessment, average growth in gross domestic product (GDP) in the developing economies of the Asia-Pacific region continues to improve steadily while inflation remains stable. However, protectionist trade measures and financial risks weigh on the near-term macroeconomic outlook while various medium-term challenges include low productivity and inadequate growth of decent jobs, against the backdrop of demographic transitions and new technologies. Reducing poverty on a sustained basis, mitigating inequality, and internalizing environmental costs and climate risks are other challenges that the region faces.

4. In view of such challenges, the 2018 *Survey* contains advice to Governments to consider the following policy measures:

(a) Monetary and financial policy should focus on supporting a smooth transition to the pickup in inflation and financial tightening prompted by stronger global growth while tackling systemic risks in the financial system through appropriate macroprudential measures. The latter are important in view of high private debt and distressed bank loans that are constraining robust investment;

(b) Fiscal policy should be focused on supporting the medium-term objectives of lifting productivity growth and reducing inequalities as the need for near-term stimulus diminishes. Beyond allocating more resources to education, health, social protection and infrastructure, greater progress is needed to enhance expenditure efficiency and ensure equal access to public services. Progressive taxation could help increase fiscal space;

(c) While there are sector-specific ways to improve expenditure efficiency, a cross-cutting factor is good governance. One of the ways in which Governments could improve fiscal governance is by leveraging technology; for instance, countries that proactively use e-government tools tend to perform better in terms of corruption perception;

(d) Parallel efforts are needed to foster innovation and ensure that the benefits are widely shared. Leading innovative countries take a whole-of-government approach and invest in the relevant skills and infrastructure, but efforts are needed to leave no country behind. Competition policy, labour market policy and fiscal policy should be calibrated to support inclusive innovation. Universal basic income could be considered as well;

(e) Without improving the quality of economic growth, economic resilience, too, will be compromised. Governments should strengthen social protection as a strategic way of enhancing economic resilience and economic dynamism, not least in view of demographic transitions (risk of skills shortage among youth on the one hand, and risk of old-age poverty on the other) and labour market disruptions associated with reforms and technological innovations;

(f) At the same time, Governments should mainstream resource-efficiency targets into national plans and budgets as well as into sectoral policies, and establish appropriate legal and regulatory measures to enforce standards and to promote awareness. Carbon tax and emissions trading systems could play a critical role in transitioning to a low-carbon, climate-resilient economy.

5. Given the comprehensive nature of the 2030 Agenda for Sustainable Development, there is considerable need to step up investments to achieve the Sustainable Development Goals. Thus, the 2018 *Survey* examines how countries could mobilize development finance by focusing on three areas:

(a) Strengthening of tax revenues, primarily by improving tax administration, rationalizing existing tax incentives and introducing new tax instruments: through various quantitative exercises, the 2018 *Survey* demonstrates that the potential impact of these policy changes on tax revenue is substantial, and the success of these policy changes would be greatly enhanced by regional cooperation and integration;

(b) Prudent sovereign borrowing from financial markets: public debt sustainability analysis suggests that many Asia-Pacific economies could afford higher public debt, which would be appropriate insofar as it focuses on public goods and services that enhance the supply side of the economy and make it more efficient, inclusive and sustainable; to increase the role of public bond issuance in enhancing public finances, maintaining an effective institutional framework is important;

(c) Leveraging of private capital, primarily by enhancing a policy environment where public-private partnerships are a viable option, to increase investments in sustainable infrastructure.

6. The document is structured as follows. Section II contains an updated assessment of the economic performance and outlook of the Asia-Pacific region. In section III, macroeconomic risks and medium-term challenges are discussed. In section IV, the policies needed for sustained, inclusive and sustainable economic growth are analysed, while in section V the financing for development aspects that can support the range of policy options are delved into. Section VI contains concluding remarks.

## **II. Economic performance and outlook**

### **A. Global context: stronger growth and associated challenges**

7. In 2017, there was a broad-based recovery in global manufacturing, investment and trade, resulting in the fastest output expansion in five years. The upturn was evident in the United States of America, the euro area and Japan, along with continued strong performance in China and gradual recovery in major commodity exporters. This momentum is expected to be largely sustained. Global output is projected to grow by 3 per cent and 3.1 per cent in

2018 and 2019 respectively, on a par with an estimated 3 per cent in 2017.<sup>1</sup> Global trade volumes, which rebound in 2017, are expected to moderate only slightly in the forecast period.

8. This upturn, however, comes after an extended period of weak investment and low productivity growth; making up for it will take time.<sup>2</sup> The belated but stronger than anticipated recovery brings its own challenges. The expectation of a faster rise in interest rates could trigger financial market volatility, as seen recently. Global oil prices reached \$70 per barrel at the beginning of the year, from \$30 per barrel two years ago. While some easing is expected, large oil importers such as India could face higher inflation and wider current account deficits.

## **B. Economic growth: a broad-based upturn and stable outlook**

9. Developing Asia-Pacific economies benefited from the global tailwind, growing by an estimated 5.8 per cent in 2017, compared to 5.4 per cent in 2016.<sup>3</sup> About two thirds of the region's economies achieved faster growth in 2017. In China, strong global demand, resilient private consumption and service activities continued to drive economic growth, but investment moderated amid efforts to curb pollution and overcapacity in certain industries. In India, the recently introduced goods and services tax as well as weak corporate and bank balance sheets resulted in subdued economic growth, but signs of recovery have emerged in the second half of the year. The Russian Federation resumed growth after a two-year recession on the back of higher oil prices and more stable inflation and credit conditions. Least developed countries in the region grew by 6.8 per cent, the fastest in a decade, supported by stronger trade and investment flows, although they remain vulnerable to terms-of-trade shocks and natural disasters and face skills and infrastructure bottlenecks.<sup>4</sup>

10. Developing Asia-Pacific economies are projected to grow by 5.5 per cent in both 2018 and 2019, with slight moderation in China offset by a recovery in India and steady performance in the rest of the region. Recently firmed economic activities in China could provide the authorities with more room to continue deleveraging and rebalancing towards a services-and consumption-driven economy, which suggests that the region's largest economy would have steadier but slower economic growth.

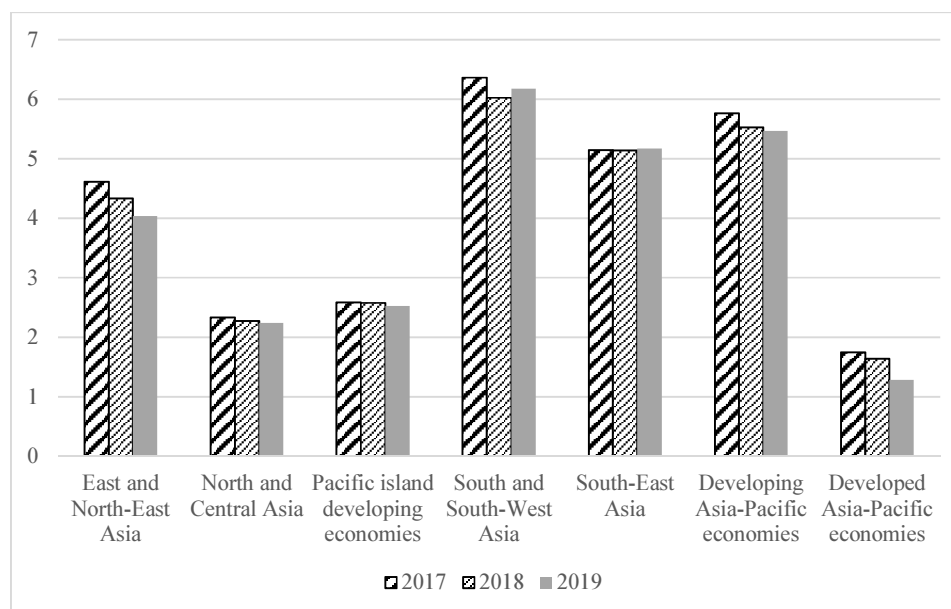
<sup>1</sup> International Bank for Reconstruction and Development/World Bank, *Global Economic Prospects: Broad-based Upturn, but for How Long?* (Washington, D.C., 2018). Available from [www.worldbank.org/en/publication/global-economic-prospects](http://www.worldbank.org/en/publication/global-economic-prospects).

<sup>2</sup> *World Economic Situation and Prospects 2018* (United Nations publication, Sales No. E.18.II.C.2).

<sup>3</sup> Aggregate growth rates were calculated using 2015 GDP at 2010 United States dollars as weights, a change from previous calculations using 2010 GDP at 2010 prices. The update better reflects the current structure of economies. Largely reflecting the increase in the weight of China, the shift in the base year resulted in increased aggregate growth by approximately 0.2 percentage points compared with the previous base year.

<sup>4</sup> *Asia-Pacific Countries with Special Needs Development Report 2017: Investing in Infrastructure for an Inclusive and Sustainable Future* (United Nations publication, Sales No. E.17.II.F.9).

Figure I  
**Economic growth in the Asia-Pacific region**  
 (Year-on-year percentage change)



Source: Economic and Social Commission for Asia and the Pacific (ESCAP).

Notes: Data for 2017 are estimates, and data for 2018 and 2019 are forecasts. Developed Asia-Pacific economies comprise Australia, Japan and New Zealand.

### C. Inflation: picking up but still low

11. In line with higher global oil prices and strong aggregate demand, consumer price inflation in developing Asia-Pacific economies is projected to rise to 3.5 per cent in 2018 and 2019, compared with 3.2 per cent in 2017, with inflation accelerating in about 60 per cent of the countries. In China, the Republic of Korea and Japan, recovering producer prices are expected to contribute to higher consumer price inflation. However, inflation has subsided in North and Central Asia, from 7.8 per cent in 2016 to 4.5 per cent in 2017, and is expected to remain stable in the forecast period.

12. Despite some pickup, inflation remains at historically low levels. Aside from country-specific factors such as good harvest and stable food prices, there are a number of global reasons relating to commodities, currencies, capacity and technology. First, despite the agreement among member countries of the Organization of the Petroleum Exporting Countries (OPEC) plus a group of non-OPEC members to cut oil production, oil prices are not expected to rise further given the reduced cost of extracting shale oil in the United States of America (where oil output exceeded 10 million barrels per day for the first time in 48 years) and the dramatic decline in renewable energy prices. Second, currency appreciation in several economies has eased price pressures through cheaper imports. Third, economies may still be operating below potential, with slack capacity as mirrored in subdued growth in real wages and formal employment. Fourth, global value chains and e-commerce may be meeting demand at lower costs, while the increased use of robots in production processes places downward pressure on wages and prices.

## **D. Consumption, investment and trade dynamics: strengthening the drivers of economic growth**

13. In line with the region's growing purchasing power and as is visible in high consumer confidence, domestic private consumption has been the major economic growth driver in recent years. It has been supported by low inflation, low interest rates and stable labour market conditions. The recovery in remittances, especially in North and Central Asia, also supported consumption. However, consumption-led economic growth may be fragile over time without consistent increases in real wages backed by rising productivity. Such growth can lead to debt accumulation and financial vulnerability. Moreover, society's welfare depends on the inclusivity of consumption growth. Since the 1990s, the consumption share of the top quintile has increased while the other quintiles have seen their share decrease. Recent data also reveals that in nearly half of the countries in the region, consumption by the bottom 40 per cent, already substantially low, grew at a slower pace than the average household.<sup>5</sup>

14. Robust investment is critical for sustained income growth, on which consumption ultimately depends. However, investment performance was relatively weak in recent years amid heightened global uncertainty and weak corporate and bank balance sheets. Thus, simply lowering policy interest rates was not enough to revive investment. Over the past year, there has been a welcome recovery in investment on the back of firmer global demand and stronger trade. Public infrastructure outlays have supported investment in countries such as Indonesia and Pakistan.

15. While leading indicators such as the Purchasing Managers Index and national budget decisions are encouraging, sustained investment recovery could be undermined by protectionist trade measures, tighter financial conditions and uncertainty over the domestic legal and regulatory environment. Investment slowdowns associated with balance sheet problems tend to be more persistent and require policy support. Moreover, attention is needed to determine whether investment is effectively supporting the 2030 Agenda. Generally, the social, environmental and economic impacts of investment, including foreign direct investment (FDI), should be considered.

16. Developing Asia-Pacific economies experienced a trade recovery in 2017. Contributing factors included stronger demand in China and the global rebound in the electrical and electronics trade, which makes extensive use of regional production networks. In 2018, growth in export and import volumes is projected to moderate, to 3.5 per cent and 3 per cent respectively.<sup>6</sup> The uptick in 2017 was measured against the previous year's weak performance; thus, a high base effect will kick in. Growth moderation in China could be reflected in its import demand, especially for metals and related goods.

17. Trade has contributed to the region's rapid economic growth and poverty reduction in recent decades, but has come under increased scrutiny amid rising income and wealth inequality. Trade liberalization measures, pursued in a multilateral manner, are needed. However, the debate over the benefits of trade is getting diluted in dealing with rising inequalities. Efforts are also needed to address the social and environment impacts of trade,

<sup>5</sup> World Bank, Global Database of Shared Prosperity. Available from: [www.worldbank.org/en/topic/poverty/brief/global-database-of-shared-prosperity](http://www.worldbank.org/en/topic/poverty/brief/global-database-of-shared-prosperity) (accessed 12 March 2018).

<sup>6</sup> *Asia-Pacific Trade and Investment Report 2017: Channelling Trade and Investment into Sustainable Development* (United Nations publication, Sales No. E.17.II.F.22).

including complementary domestic measures to help affected workers and firms through their transition.<sup>6</sup>

### **III. Macroeconomic risks and medium-term challenges to economic outlook**

#### **A. Global uncertainty, trade protectionism and financial risks**

18. High policy uncertainty continues to cloud the prospects for world trade, orderly migration and climate targets, and may delay a more broad-based rebound in global investment and productivity.<sup>2</sup> For trade, protectionism casts a shadow on its consistent revival. Since the global financial crisis of 2008, the use of trade-restrictive measures has risen considerably, including non-tariff measures (which are less transparent and more harmful). The rise in trade barriers may disrupt cross-border production networks, affecting trade and provoking retaliatory measures. While fears of a trade war may not be realized, rising uncertainties could preclude long-term investment and trade.<sup>6</sup>

19. Given the recent economic recovery in the United States of America and the euro area, faster than expected increases in interest rate cannot be ruled out. This could dampen capital flows to the Asia-Pacific region and result in asset price corrections and exchange rate volatility. A key source of financial vulnerability is the high and rising private debt in some economies, both at the corporate level, such as in China and India, and at the household level, especially in Malaysia, the Republic of Korea and Thailand. Rapid increases in private debt can affect whole financial systems, as during the Asian financial crisis.<sup>7</sup>

20. The combination of the weaker United States dollar and higher oil prices over the past year also poses risks. Historically, the two have shown an inverse relationship, as oil is a dollar-denominated asset. While the baseline projection is that the dollar will strengthen and that the oil price rally will subside from the levels seen at the beginning of 2018, there is considerable uncertainty over their trajectories and net impact. Dollar strength has implications for trade competitiveness but also for dollar loans and dollar-denominated debt. Oil prices have macroeconomic implications, with the effects roughly the opposite for oil exporters versus importers.<sup>8</sup>

#### **B. Potential economic growth, technology and the future of work**

21. In the medium term, sustained poverty reduction and improvement in living standards will require the lifting of potential economic growth, which is on a downward trend in several countries owing to population ageing, slower capital accumulation and modest productivity growth. Notably, the potential growth rate in China fell sharply from around 10 per cent during the period 2003–2007 to around 7 to 8 per cent during the period 2013–2017,<sup>9</sup> with further declines projected through to 2030.<sup>10</sup> Potential growth has declined

<sup>7</sup> *Economic and Social Survey of Asia and the Pacific 2017: Year-end Update*. (ST/ESCAP/2808).

<sup>8</sup> The potential impacts of higher oil prices on various macroeconomic indicators are estimated in the full *Survey*.

<sup>9</sup> International Bank for Reconstruction and Development/World Bank, *Global Economic Prospects*.

<sup>10</sup> The Development Research Centre of the State Council of China projects economic growth to moderate to 4 to 5 per cent by the period 2025–2030. The full *Survey* contains an in-depth analysis of the economic transformation of China and its implications for other countries in the region.

over the past decade in India owing to a sharp slowdown in capital accumulation; recent estimates of its potential growth are within the range of 6 to 8 per cent.<sup>11</sup>

22. It is estimated that by 2050 one in every four people in the region will be aged 60 years or older. Among other implications, such a demographic transition could have a major effect on long-term economic growth. As population ageing progresses in the face of relatively low incomes in the region's economies, lifting potential growth will require higher productivity growth. Productivity growth in the developing countries of the Asia-Pacific region has been modest and has declined by more than half between the periods 2000–2007 and 2008–2014. Contributing factors include skills and infrastructure deficits, inefficient allocation of resources and weak technological innovation and diffusion. Addressing these weaknesses depends, among others, on good governance and effective institutions.<sup>12</sup>

23. Rapid technological advancements, while offering enormous opportunities, pose challenges as well. New technologies, such as three-dimensional printing, big data, robotization of production processes and artificial intelligence, are making rapid inroads and could induce a productivity-led economic growth spurt in the future.<sup>13</sup> Similarly, fintech and e-government applications are examples of technologies that could support sustainable development. However, technology and innovation favour skilled over unskilled labour and bias capital over labour, thus contributing to inequality of income and wealth. While there are differing views on whether new technologies will displace labour and result in downward pressure on wages, job polarization is likely to increase regardless. Moreover, increased automation in developed countries and in China could reduce the scope for industrialization in other developing countries and thus the ability to expand decent jobs.

### C. Impact of the economic transformation of China on Asia and the Pacific

24. The pursuit by China of innovative, inclusive and sustainable economic growth could have important regional impacts through trade, investment and other channels. If ongoing structural reforms in China are successful, total factor productivity would overtake capital formation to become the major driver of growth, and the service sector would account for 70 per cent of GDP by 2030, close to current levels in developed economies. Such changes will affect the trade structure of China.

25. As China moves up the value chain, such countries as Bangladesh and Viet Nam could enjoy greater opportunities to engage in low-skilled, labour-intensive manufacturing. Existing technology exporters could face increased competition, however. Commodity exporters could also be adversely affected in the near term. Nevertheless, the growing domestic market in China augurs well for regional trading partners in the medium term. At the same time, outbound investment by China in the region has steadily increased over the past decade. Going forward, the quality as well as the quantity of Chinese

<sup>11</sup> Barendra Kumar Bhoi and Harendra Kumar Behera, "India's potential output revisited", *Journal of Quantitative Economics*, vol. 15, No. 1 (March 2017), pp. 101–120.

<sup>12</sup> *Economic and Social Survey of Asia and the Pacific 2017: Governance and Fiscal Management* (United Nations publication, Sales No. E.17.II.F.8).

<sup>13</sup> Erik Brynjolfsson and Andrew McAfee, *The Second Machine Age: Work, Progress, and Prosperity in a Time of Brilliant Technologies* (New York and London, W.W. Norton and Company, 2014).



investments will be important for recipient countries' economic development and mutually beneficial trade relationships.

#### **D. Poverty and inequality**

26. The relatively high incidence of poverty and rising inequalities are adversely affecting the region's dynamism and economic outlook. Despite a considerable reduction in extreme poverty in the region, led by China, the incidence of poverty remains relatively high in several economies, especially in South Asia and in least developed countries. Across the region, large segments of the non-poor population remain vulnerable to falling back into poverty; they could be defined as constituting a transitional class rather than a middle class.<sup>14</sup>

27. Moreover, such factors as technological progress, globalization and market-oriented reforms that have supported rapid economic growth are contributing to wider inequality of income and wealth, which does not bode well for the inclusive development of the region. The Gini coefficient on income distribution in the region increased from 32.7 for the period 1990–1994 to 38.1 for the period 2010–2014. There is also wide inequality of opportunities across urban-rural and income lines. It is increasingly being recognized that high and rising economic inequality is detrimental to sustained economic growth.

### **IV. Economic policies for sustained, inclusive and sustainable economic growth**

#### **A. Monetary policy and financial stability**

28. In 2017, thanks to stable inflation, most countries in the region did not unwind the expansionary monetary policy stances adopted in recent years, and mostly kept the policy rates unchanged or even reduced them further as in the case of India, Indonesia, the Russian Federation and Viet Nam. Despite an overall stable inflation outlook, this trend may not continue given the recent uptick in oil prices, financial sector risks and faster than expected increases in interest rates in the United States of America and the euro area. Therefore, gradual increases in interest rates, as introduced by Malaysia and Pakistan recently, should not be ruled out.

29. The fundamental role of monetary policy in sustaining economic growth over long periods is to contribute to macroeconomic and financial stability. Central banks could step up deleveraging efforts to tackle systemic financial risks and assign high priority to strengthening macroprudential frameworks, regulation and supervision. Some countries in the region have introduced measures to curb excessive credit growth, increase asset quality and tighten mortgage rules in lending. Such measures are important in view of the high levels of private debt and distressed bank loans that are constraining robust investment.

#### **B. Fiscal policy**

30. Fiscal policy should be focused on lifting productivity growth and reducing inequalities, as the need for near-term stimulus diminishes. After widening to nearly 3 per cent of GDP in 2016, fiscal deficit has stabilized in

<sup>14</sup> *Economic and Social Survey of Asia and the Pacific 2016: Nurturing Productivity for Inclusive Growth and Sustainable Development* (United Nations publication, Sales No. E.16.II.F.10).

2017 and is expected to narrow in the forecast period on the back of stronger economic growth. Moreover, fiscal sustainability gap analysis by ESCAP suggests that government debt ratios will stabilize or decline in most countries in the baseline scenario. While these points are encouraging, greater attention is needed for the composition and quality of government expenditure. Education and health outcomes are important for labour productivity but combined education and health expenditure remains below 5 per cent of GDP in such countries as Bangladesh, Cambodia and Pakistan. There are positive examples in the region. Several countries have identified new sources of fiscal space to extend social protection coverage and benefits, including by reallocating part of their military expenditure or phasing out regressive energy subsidies.

31. In addition to budget reallocation, Governments could increase expenditure efficiency and ensure equal access to basic public services. Without such efforts, additional spending may not translate into better development outcomes. Estimation of public expenditure efficiency would suggest that many countries have ample room to improve. For instance, compared with regional peers at the frontier, Pakistan could decrease its public expenditure by some 33 per cent in education and 17 per cent in health to produce the same level of education and health outcomes. Similarly, it has been estimated that approximately 30 per cent of the potential benefits of public investments are lost owing to inefficiencies. While there are sector-specific ways to improve expenditure efficiency, a cross-cutting factor is good governance. One of the ways in which Governments could improve fiscal governance is by leveraging technology; for instance, countries that proactively use e-government tools tend to perform better in terms of corruption perception.

### **C. Structural reforms to enhance innovation and improve the quality of growth**

32. Lifting productivity will require a whole-of-government approach to foster science, technology and innovation, as well as investments in relevant skills and infrastructure. At the same time, Governments can consider a wide range of redistributive measures to mitigate the risks of technology-induced inequality and unemployment. Information and communications technology infrastructure is essential for supporting innovative growth and narrowing the existing digital divide. To develop the core skills necessary for people to be flexible and responsive to the rapid changes that are brought about by new technologies, more students, especially female students, should be encouraged to take courses related to science, technology, engineering and mathematics.

33. At the same time, to mitigate the potential adverse impacts on income distribution, Governments can consider progressive income taxes and wealth-related taxes. A more radical proposal is the universal basic income, whereby every individual receives an unconditional cash grant. A basic calculation suggests that the fiscal cost of the universal basic income (targeted at providing \$1.90 per day for the working-age population) in the Asia-Pacific region could be approximately 14 per cent of GDP on average.

34. Without improving the quality of growth, economic resilience, too, will be compromised. Governments could strengthen social protection as a strategic way of enhancing economic resilience, not least in view of the demographic transitions (risk of skills shortage among youth on the one hand, and risk of old-age poverty on the other) and labour market disruptions associated with reforms and technological innovations. At the same time, Governments could mainstream resource-efficiency targets into national plans and budgets as well

as into sectoral policies, and establish appropriate legal and regulatory measures to enforce standards and to promote awareness. Carbon tax and emissions trading systems could play a critical role in transitioning to a low-carbon, climate-resilient economy.

## **V. Mobilizing financing for sustained, inclusive and sustainable economic growth**

### **A. Potential policy options to mobilize development finance**

35. The implementation of several policy measures, discussed above, will require not only the channelling of existing financial resources, from both the public and the private sectors, towards sustainable development, but also additional financial means. A recent estimate shows that low and lower-middle-income countries need, on average, an additional \$1.4 trillion per year, or about 11.5 per cent of their combined GDP, during the period 2015–2030 to achieve the Sustainable Development Goals.<sup>15</sup> For all developing countries worldwide, it has been estimated that such additional investment requirements increase to \$2.5 trillion per year during the same period.<sup>16</sup> For infrastructure only, ESCAP estimated that annual infrastructure investment needs in least developed countries, landlocked developing countries and small island developing States in the Asia-Pacific region are about 10.5 per cent of GDP on average during the period 2016–2030.<sup>17</sup> Such needs far exceed current infrastructure spending of 4 to 7.5 per cent of GDP in those economies.

36. While these estimates are all indicative and not generally comparable, they all point to a need for a considerable boost to future investments to make economies resilient, inclusive and sustainable. The good news is that ample financial resources and savings, mostly in the private sector, are available in the Asia-Pacific region. For instance, the combined value of international reserves, market capitalization of listed companies and assets being held by financial institutions, insurance companies and various funds in developing Asia-Pacific economies is estimated at about \$56.2 trillion. Part of these private sector resources could potentially be mobilized for sustainable development. For example, the 2018 *Survey* shows that an appropriate policy environment could increase investments made by institutional investors in long-term infrastructure projects. Similarly, listed firms and commercial banks could directly support social inclusiveness and environmental sustainability through such initiatives as impact investment and corporate social responsibility.

37. Governments should lead the way to enhance needed investments and facilitate the leveraging of private capital. A multipronged strategy should be considered. First, efficient use should be made of available fiscal resources through effective expenditure management so that greater development impacts could be attained for the same amount of fiscal resources. Improving governance is the key in this regard. Second, the fiscal space should be enhanced through greater efforts to boost revenues and borrowings from the financial markets in a responsible manner. Third, the Sustainable Development Goals should be used to provide guidance for future private investments and

<sup>15</sup> Guido Schmidt-Traub, “Investment needs to achieve the Sustainable Development Goals: understanding the billions and trillions”, 12 November 2015. Available from [www.unsdsn.org/wp-content/uploads/2015/09/151112-SDG-Financing-Needs.pdf](http://www.unsdsn.org/wp-content/uploads/2015/09/151112-SDG-Financing-Needs.pdf).

<sup>16</sup> *World Investment Report 2014: Investing in the SDGs – An Action Plan* (United Nations publication, Sales No. E.14.II.D.1).

<sup>17</sup> *Asia-Pacific Countries with Special Needs Development Report 2017*.

identify areas where public resources are likely to flow and demand is likely to increase. Fourth, public financing should be used as a catalyst to attract private resources rather than replace private financing; initial public outlays pave the way for additional private investments. Fifth, appropriate regulations and institutional frameworks that would shape the space for private investments should be developed. Sixth, better indicators of systemic risk (risks associated with poor governance, weak contract enforcement and vulnerability to instability) that would capture progress on economic as well as social and environmental fronts should be developed. Government policies and public investments, such as those aimed at improving the judicial system, enhancing the productivity of the population and setting up effective natural disaster prevention, are de-risking; they should be taken into account when considering investments in the development endeavours of developing countries.

38. Building on previous work, the 2018 *Survey* focuses on three areas: (a) strengthening tax revenue collection by improving tax administration and expanding the tax base; (b) prudent sovereign borrowing from financial markets; and (c) effective leveraging of private capital, including by enhancing a policy environment for public-private partnerships and increasing the private sector's investments in sustainable development. These three areas are highlighted in greater detail below.

## **B. Strengthening of tax revenue collection**

39. Recent issues of the *Survey* have highlighted the need for Governments to steer the economic growth strategies of their economies. The role of strong fiscal positions is paramount in this endeavour. For instance, in the 2014 *Survey*, the tax potential in Asia-Pacific economies was estimated, based on each country's economic structure. Actual tax collection levels were shown to be below the potential levels in 17 economies with available data. Among other policy recommendations in the report, it was emphasized that there was a need to (a) enhance tax administration by streamlining procedures and increasing the use of information technology, and (b) expand the tax base by rationalizing existing tax exemptions and introducing new taxes. Against this background, in the 2018 *Survey* the analysis is expanded by examining the extent to which recommended tax policies, if implemented, would help narrow the gap.

40. Better tax administration helps enhance revenue collection efficiency by reducing tax avoidance and evasion, including by influencing people's willingness to pay taxes (tax morale). Literature on optimal taxation usually assumes that the capacity to implement complex tax schemes, including exemptions, exists and that tax morale is not an issue. However, in practice, that is not often the case in many developing countries, such as in South and South-West Asia. Tax systems need to be simple, transparent, progressive and fast.

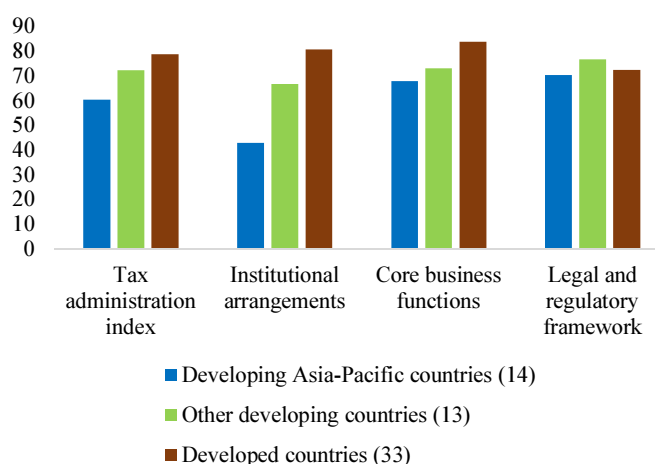
41. The quality of tax administration depends on factors such as the institutional set-up of tax authorities or the legal and regulatory framework in which they operate. Measures such as adopting a risk-based compliance control, training tax officials and consulting with relevant stakeholders can help improve tax administration. Some indicators of good tax administration include low cost-to-collection ratio, high actual-to-target tax revenue ratio and speedy tax services. In addition to higher tax revenue, better tax administration has economic benefits such as narrower productivity gaps between small and large firms because smaller companies typically face higher tax compliance costs.

42. In the 2018 *Survey*, a new composite index is proposed to measure the extent to which the institutional setting and policy environment enable tax

authorities to address tax avoidance and evasion, thus enhancing revenue collection efficiency. The tax administration index comprises three equally weighted sub-indices: (a) institutional arrangements that grant autonomy to tax authorities to, among others, design internal structure and exercise discretion over operating expenditure; (b) core business functions that manage compliance risk, such as the operation of a large taxpayer unit and the use of information technology; and (c) a legal and regulatory framework that enables tax administrations to obtain information on taxpayers' liabilities and to promote private sector development. The new index, which is primarily drawn from survey-based information of tax authorities, is available for 60 economies, of which 14 are developing Asia-Pacific economies.

43. According to the tax administration index, the quality of tax administration in developing Asia-Pacific economies appears worse than that in developed countries and in developing countries in other world's regions with available data (figure II). The region lags behind in all three sub-indices of the tax administration index.

Figure II  
**Tax administration index in developing Asia-Pacific economies and beyond**



Source: ESCAP analysis.

Note: The numbers in parentheses indicate the number of countries with available data.

44. Countries with better quality of tax administration exhibit stronger tax collection capacity. In the 2018 *Survey*'s explanation of the level of tax-revenue-to-GDP ratio across countries, the impact of the Tax Administration Index is estimated to be significant. A one-point increase in the index value is associated with an increase in tax revenue of 0.15 per cent of GDP. If the values of the Tax Administration Index in individual Asia-Pacific economies are assumed to match the average level being observed in member countries of the Organization for Economic Cooperation and Development, the potential revenue impact could be as high as 8 per cent of GDP in countries such as Myanmar and Tajikistan, and approximately 3 to 4 per cent of GDP in larger countries such as China, India and Indonesia.

45. Apart from improving tax administration, rationalizing existing tax incentives is another policy option to enhance public finances. In this regard, most countries in the region offer various types of tax incentives to attract FDI. In some countries, tax incentives are offered to compensate for deficiencies in infrastructure, burdensome regulatory framework and lack of political stability.

In other cases, tax incentives are provided in response to a race among regional economies to offer more generous benefits to foreign investors.

46. In the 2018 *Survey*, the size of tax expenditure relating to FDI tax incentives in developing Asia-Pacific economies is estimated. The revenue forgone is the difference between actual tax payments and tax liabilities under a hypothetical case in which FDI tax incentives are absent, so the statutory corporate income tax rate is applied to profit. While this approach does not take into consideration possible changes in firms' investment decisions due to changes in tax incentives, the estimate could still indicate the order of magnitude of tax revenues available if Governments wish to rationalize FDI tax incentives. On the basis of firm-level financial data of over 28,500 registered foreign companies in nine developing Asia-Pacific economies, the total tax expenditure related to FDI incentives is estimated at close to \$16 billion in 2014.<sup>18</sup> These economies are some of the major FDI destinations in the region. In some cases, the size of tax revenue forgone is up to 0.3 per cent of GDP.

47. In the 2018 *Survey*, it is emphasized that, while there is a need to rationalize FDI tax incentives, a policy priority is improving investment climate by, for example, offering a business-friendly regulatory framework and decent infrastructure. At the regional level, greater regional cooperation could help to avoid a race among regional economies to offer more generous FDI tax benefits.

48. In the context of expanding the tax base, the 2018 *Survey* also contains an estimate of the size of tax revenue that a carbon tax could generate. By considering a country's level of carbon emissions, the tax rate of carbon-pricing initiatives in developing countries worldwide and the extent to which introduction of a carbon tax could reduce tax revenues from other sources, it is shown in the 2018 *Survey* that the potential revenue of a carbon tax in the region is significant. As a whole, a carbon tax could generate approximately \$43.3 billion additional tax revenue per year in 38 developing Asia-Pacific economies. On average, the estimated increase in the total tax revenue is equivalent to 0.16 per cent of GDP, and increases to 0.21 per cent of GDP in a group of countries with higher carbon intensity, including Mongolia, Turkmenistan and Uzbekistan.

49. When the introduction of a carbon tax is being considered, one key implementation issue is its impact on income distribution. A carbon tax is generally regressive, as poorer households spend disproportionately more on electricity service, whose tariff may increase with a carbon tax. In this regard, Governments could consider reducing taxes in other areas to compensate for higher energy prices. The Government could also make the introduction of a carbon tax revenue-neutral in the short term by spending carbon tax revenue on schemes that promote the development of green technologies.

### C. Prudent sovereign borrowing from financial markets

50. Balancing the developmental role of fiscal policy with fiscal sustainability is a contentious issue. While public debt sustainability should be closely monitored and maintained, Governments should also ensure that meeting targeted fiscal outcomes and predetermined fiscal rules does not come at the cost of reducing spending on development objectives. The 2018 *Survey*

<sup>18</sup> The nine developing Asia-Pacific economies covered in the analysis are China, India, Indonesia, Malaysia, the Philippines, the Russian Federation, Thailand, Turkey and Viet Nam.

contains an examination of whether Asia-Pacific economies could make greater use of government borrowing from financial markets in a prudent manner. In general, Governments could afford a higher level of debt if development gaps remain wide, public debt is deemed sustainable and fiscal resources are spent effectively.

51. Available data suggest that many Asia-Pacific economies can afford a higher level of public debt to increase development spending. Public debt levels in 2022 are expected to decrease from the 2017 levels in 11 out of 24 developing Asia-Pacific economies.<sup>19</sup> For this group of economies, the average debt level is considered moderate at 42.5 per cent of GDP in 2017 and is projected to decrease slightly to 42 per cent of GDP in 2022. Moreover, according to recent analysis of public debt sustainability, 22 out of 41 developing Asia-Pacific economies exhibit low risk of public debt distress, while eight countries exhibit high risk.<sup>20</sup>

52. While many Asia-Pacific countries should be able to maintain public debt sustainability under adverse macroeconomic shocks, such as slower economic growth or higher interest rates, public debt sustainability could weaken if contingent liabilities are taken into consideration. For example, countries in the Pacific are highly prone to natural disasters, which has led to large output loss and post-disaster fiscal support. Moreover, banking sector vulnerability in countries such as China and Viet Nam may have risen amid rapid domestic credit growth and the high bank loan-to-deposit ratios in recent years. As bank assets are equivalent to at least 200 per cent of GDP in both countries, the realization of a banking contingent liability could weaken public debt sustainability. In India, a high level of non-performing loans makes its banking sector vulnerable to adverse shocks.

53. In the 2018 *Survey*, an analysis is presented to explain why some Asia-Pacific economies have been relatively more successful than others in issuing government bonds, in both domestic and international markets. Factors that influence sovereign credit risk ratings, such as past economic growth record, macroeconomic stability, external account vulnerability, fiscal performance, government effectiveness and the quality of the legal and regulatory framework are explored. Overall, the results suggest that the countries that have been able to issue government bonds are those with lower debt stocks, a better regulatory framework and more favourable current account performance.

#### **D. Leveraging of private finance**

54. Public financial resources alone are unlikely to be sufficient in supporting policies that are needed to make economies resilient, inclusive and sustainable. There is therefore a need to effectively leverage private capital to enlarge the pool of development finance. One option is that of public-private partnerships for infrastructure projects. Infrastructure is not only the investment area with the largest financing gap, but also the one that exhibits

<sup>19</sup> International Monetary Fund (IMF), *Fiscal Monitor* (October 2017), IMF DataMapper. Available from [www.imf.org/external/datamapper/datasets/FM](http://www.imf.org/external/datamapper/datasets/FM) (accessed 12 March 2018).

<sup>20</sup> The eight countries with high risk of public debt distress are Afghanistan, Kiribati, the Lao People's Democratic Republic, Maldives, the Marshall Islands, Samoa, Sri Lanka and Tuvalu. Source: ESCAP, compiled from 41 reports on IMF Article IV consultations on developing Asia-Pacific economies released since 2016. Available from [www.imf.org/external/np/sec/aiv/index.aspx](http://www.imf.org/external/np/sec/aiv/index.aspx) (accessed 12 March 2018).

great potential for private investor participation given its expected steady revenue stream.

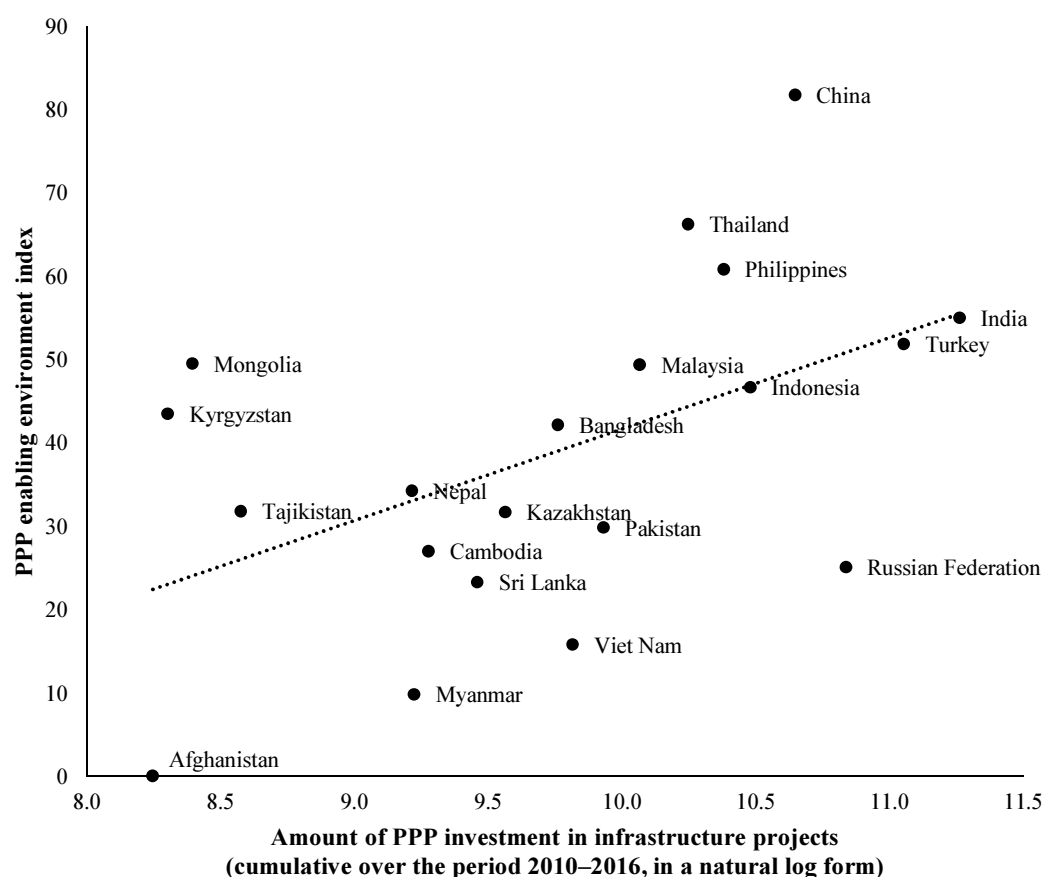
55. Public-private partnerships represent an alternative approach in providing much-needed public infrastructure. It is a contractual agreement between a public agency and a private entity on a long-term project aimed at providing a public service and infrastructure. Public-private partnerships are particularly useful when fiscal space is small and/or when State capacity to deliver large-scale infrastructure projects is limited. Even when fiscal resources are available and State capacity is adequate, public-private partnerships help shift certain risks relating to infrastructure projects to private investors. Such risks include macroeconomic risks (such as exchange rate fluctuations), operating risks (such as construction cost) and revenue risks (such as number of users).

56. The value of infrastructure investment under public-private partnerships varies significantly across the Asia-Pacific region. In India, the total public-private-partnership investment in infrastructure projects during the period 2010–2016 was about \$183 billion, followed by \$113 billion in Turkey, \$69 billion in the Russian Federation and \$45 billion in China. When compared to the size of the economy, infrastructure investment under public-private partnerships is relatively large in countries such as Cambodia, the Lao People's Democratic Republic and Maldives.

57. In the 2018 *Survey*, a new composite index that assesses a country's readiness to implement public-private partnerships in infrastructure projects in selected Asia-Pacific economies is proposed. The public-private-partnership enabling environment index comprises five sub-indices: (a) institutional arrangements for public-private partnership projects; (b) past experiences with public-private partnerships; (c) macroeconomic stability; (d) financial market development; and (e) the legal and regulatory framework. In countries with a more enabling environment, public-private-partnership infrastructure projects tend to receive higher risk-adjusted returns and are more commercially viable. Figure III depicts the positive relationship between the value of the new index and the cumulative amount of public-private-partnership investment in infrastructure in developing Asia-Pacific economies over the period 2010–2016.



Figure III  
Public-private partnerships in infrastructure projects and the public-private-partnership enabling environment index



Sources: ESCAP analysis; and World Bank, World Development Indicators database, available from <http://databank.worldbank.org/data/reports.aspx?source=World-Development-Indicators> (accessed 12 March 2018).

Abbreviation: PPP, public-private partnership.

58. The analysis shows that a one-unit increase in the value of the public-private-partnership enabling environment index is associated with a 5.1 per cent increase in the amount of infrastructure investment under public-private partnerships. Among the five sub-indices, the impact of the quality of the legal and regulatory framework is the most notable. The results also suggest that financial market development helps boost public-private-partnership investment only if it is accompanied by stable macroeconomic conditions. Within the context of institutional arrangements for public-private-partnership projects, the quality of project preparation and procurement practices are particularly important.

59. Despite significant potential benefits, public-private-partnership projects should be implemented carefully. A possible risk is increased contingent liability, as Governments may need to take over the projects that fail to be delivered by the private partner. Another caveat is potentially high user charges of infrastructure services.

60. To unleash the potential of public-private partnerships and support the issuance of sovereign bonds, financial markets need to be developed further in Asia and the Pacific. Developing financial markets is a long-term task that requires policy action on various fronts, such as: (a) an effective legal framework for the issuance process; (b) a sizeable investor base; (c) a diverse set of financial instruments and services; (d) knowledgeable financial intermediaries; and (e) an enabling market infrastructure, such as credit rating agencies and bond pricing agencies. As an illustration, the 2018 *Survey* contains analyses of two aspects: (a) widening the investor base by increasing the role of institutional investors, such as pension funds and insurance companies, to invest more in infrastructure-linked financial instruments like infrastructure bonds and funds; and (b) diversifying financial instruments by exploring the potential of Islamic finance. A case study of issues surrounding the development of local currency bond markets in the South-East Asian subregion is also presented.

61. The development of local currency bond markets is fundamental and there is room for improvement. Despite recent growth, local currency bond markets in South-East Asia are small and have few actors, low liquidity and relatively short time horizons, which does not favour long-run investments such as those in sustainable infrastructure. Higher volumes of bonds issuance would be positive, as they would complete the yield curve and increase the efficiency of the financial sector to channel savings towards viable sustainable investments. To develop local currency bond markets, countries need to recognize that often the government bond market precedes the corporate bond market. Market actors slowly develop the regulatory framework, infrastructure and know-how to issue and trade government bonds. Once those elements are available, firms can issue their bonds more easily. Legal and regulatory frameworks can also be enhanced by, notably, bringing accounting and taxation practices in line with international practices. Indeed, international cooperation can enhance local currency bond markets by addressing a key obstacle to their development: small economy sizes. Therefore, a promising policy option is to strengthen regional cooperation and integration, as seen in initiatives such as the Multicurrency Bond Issuance Framework of the Association of Southeast Asian Nations plus China, Japan and the Republic of Korea (ASEAN+3).

62. Recent breakthroughs in fintech also hold considerable potential in shaping the prospective role and impact of finance on economies and societies. Fintech has impacts on access to credit and equity (for instance, crowdfunding), financial inclusion (for instance, access to online banking in remote places), and money transfer (through incipient technological breakthroughs, such as blockchain or cashless payments). Such transformations affect the supply of credit and its demand, aggregate demand via easier payments and aggregate supply via innovation and investments. Some subregions of Asia and the Pacific are making considerable investments in fintech. In particular, East and North-East Asia is at the forefront of that transformation, as policymakers are managing its development via regulatory changes and preferential tax schemes, among others.

## **VI. Concluding remarks**

63. The Committee on Macroeconomic Policy, Poverty Reduction and Financing for Development, which held its first session in Bangkok in December 2017, recommended, among others, that the secretariat should enhance synergies in its analytical work on macroeconomic assessment, policies to reduce poverty and strategies to finance sustainable development in an integrated manner to effectively support the implementation of the 2030

Agenda for Sustainable Development. The 2018 *Survey*, with its sub-theme of mobilizing finance for sustained, inclusive and sustainable economic growth, is an attempt in that direction.

64. According to the 2018 *Survey*, of which the current document is an extended summary, the current strong economic performance in the Asia-Pacific region means that it is an opportune time for Governments to initiate policies that can make economies resilient, inclusive and sustainable. Examples of policy options range from ensuring financial and external sector stability, effectively using and expanding fiscal space, strengthening redistributive measures and social protection, and fostering science, technology and innovation and investments in the relevant skills and infrastructure. The implementation of several of these policies will require not only the channelling of existing financial resources, from both the public and the private sectors, towards the enhancement of the long-term prospects of economies, but also additional financial means.

65. The 2018 *Survey* contains an examination of several elements of such financing strategies that could increase domestic public financial resources and leverage private capital to support sustainable development. The central role of an effective legal and regulatory framework is highlighted. Such a framework is the backbone that helps enhance the three core elements analysed. It brings about efficiency gains in tax administration, favours the role of sovereign bond financing and attracts infrastructure investments under the public-private-partnership modality.

66. The bottom line is that the prospects for mobilizing financing for development purposes are promising. While improving tax administration seems feasible for most countries, the task of increasing the role of sovereign bond financing and attracting more public-private-partnership investment in infrastructure requires well-functioning capital markets and strong technical skills among government agencies. For less developed countries, the role of official development assistance and South-South cooperation remain critical.

67. The Commission is invited to consider the analysis provided in this document, which encourages the pursuit of economic resilience, social inclusiveness and environment sustainability in an integrated manner. The Commission may also wish to review the policy suggestions discussed and provide guidance to the secretariat on these issues.

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