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Review of the implementation of the 2030 Agenda for Sustainable Development in Asia and the Pacific: macroeconomic policy, poverty reduction and financing for development

Economic policies for inclusive recovery and development in Asia and the Pacific

Note by the secretariat

Summary

The Asia-Pacific region has led global economic growth over the past few decades. However, economic growth has slowed since the global financial and economic crisis of 2008 and the socioeconomic crisis of 2020–2021 induced by the coronavirus disease (COVID-19) pandemic. The challenge of high and rising inequality is at the forefront of the economic policy agenda in the region. Therefore, this is an opportune time for a fresh and comprehensive reflection on how to create more inclusive economies and societies.

With a focus on the role of economic policies in supporting inclusive recovery and development, the present document contains an analysis of the importance of effective government actions and the role of fiscal, central banking and structural policies in enhancing inclusiveness. Given that the fiscal space has contracted in many developing economies in the Asia-Pacific region, maintaining spending in key priority areas, such as health care, education and social protection, can support inclusive development while efficient spending and improved revenue mobilization can increase the fiscal space. Policy options include using digitalization to increase the efficiency of tax collection and fiscal spending, bringing the digital economy under the tax purview and making greater use of progressive income taxes. With regards to central banking policies, central banks and financial supervisory agencies can and should do more to contribute to inclusive development, for example, by analysing the distributional impact of monetary policymaking, allocating part of official reserves to socially oriented financial instruments, understanding the potential of central bank digital currencies and promoting the issuance of thematic bonds. In terms of structural policies, Governments can manage emerging global trends, including the digital, robotic and artificial intelligence revolution, by guiding the direction of future structural transformation towards greater equality by enacting proactive policies, such as policies promoting technologies that complement labour; ensuring appropriate education, labour and competition; and establishing social protection floors and reskilling to manage labour displacement.

The Economic and Social Commission for Asia and the Pacific may wish to review and deliberate on the policy recommendations contained in the present document and provide guidance to the secretariat on its forthcoming analytical work as well as its planning and preparation of technical assistance and capacity-building projects.

* ESCAP/78/L.1/Rev.1.

I. Introduction

1. The Asia-Pacific region has led global economic growth over the past few decades. However, rapid economic growth without sufficient inclusiveness is now constraining the future economic and broader development prospects of the region. The coronavirus disease (COVID-19) pandemic and the subsequent socioeconomic crisis that affected poor and vulnerable groups the most has revealed the vulnerability of the region due to the lack of inclusiveness.

2. Going forward, concerns over a K-shaped economic recovery¹ within and across countries and the desire to ensure that the post-pandemic recovery is consistent with long-term inclusive development are broadly shared among policymakers. Additionally, international commitments to support inclusive development, as contained in the 2030 Agenda for Sustainable Development, are pushing distributional issues to the forefront of the global policy agenda. The increased focus on inclusiveness is found in the report of the Secretary-General entitled “Our Common Agenda” and the emphasis on people in the agenda of the Group of 20 Presidency, led by Indonesia in 2022.²

3. Therefore, this is an opportune time for a fresh and comprehensive policy reflection on economic inclusiveness. “Building forward fairer” will need to be at the core of post-pandemic economic recovery efforts to enhance the resilience of the region to future shocks and its prospects for achieving the Sustainable Development Goals.

4. With a focus on the role of economic policies in promoting inclusive development, the present document serves to highlight the importance of effective government actions and fiscal, monetary/financial and structural policies in enhancing inclusiveness, keeping in view the considerable impacts of COVID-19 on poverty and inequality. In terms of fiscal policy, government expenditures should be maintained in areas that are critical for mitigating inequalities, namely health care, education and social protection. Given that fiscal constraints are unlikely to ease soon, continued fiscal spending in these areas will require improving the overall efficiency of spending and revenue collection. This could be done, for instance, through accelerated deployment of digital technologies allowing for better monitoring, evaluation and calibration of fiscal policies, and lowering operational costs and reducing unnecessary administrative burdens. At the same time, fiscal authorities will need to improve revenue mobilization to ensure fiscal sustainability, such as by bringing the digital economy within the tax purview and accelerating the implementation of progressive personal income taxes.

5. Meanwhile, central banks and financial supervisory agencies can also step up their roles in promoting inclusive development. For example, central banks could consider the distributional implications of their monetary policy actions and allocate part of official reserves to socially oriented financial

¹ A K-shaped economic recovery refers to the differential prospects of recovery across different sectors and segments of the population within an economy, and differential policy and structural features across countries. For example, it could refer to hospitality and transportation sectors and informal workers and vulnerable groups that had inadequate access to government support even before the pandemic. Some countries have a higher rate of vaccination and more fiscal resources and thus potentially stronger supportive measures or better access to the Internet and thus more learning and teleworking opportunities than others.

² See <https://g20.org/g20-presidency-of-indonesia/>.

instruments. Central banks and/or capital market regulators can also promote the issuance of thematic bonds through regulatory changes. The issuance of central bank digital currencies can also support inclusive finance and thus inclusive development.

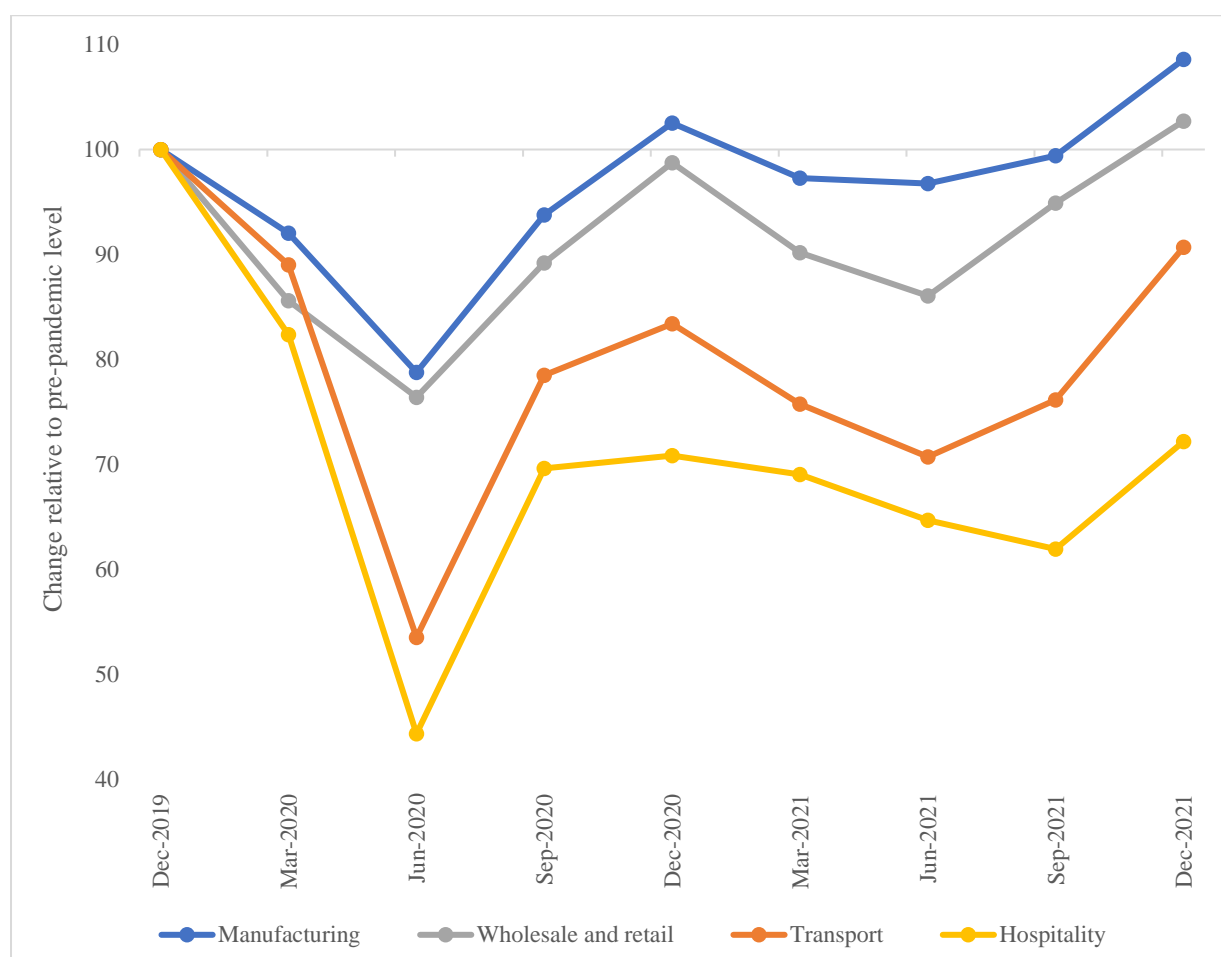
6. Structural transformation has a critical influence on long-term inequality trends in developing Asia-Pacific countries through its implications for predistribution inequality (i.e. inequality in income distribution before taxes and transfers).³ Looking ahead, the unfolding digital, robotic and artificial intelligence revolution may bring additional challenges for inclusive structural transformation. To address those challenges, the region will need balanced sectoral strategies for development and proactive policies to guide the direction of future structural transformation. This would help in shaping structural policies for more equally distributed economic gains and managing potential socioeconomic disruptions brought about by structural change. These include targeted policies promoting technologies to complement rather than replace labour; ensuring appropriate education, labour and competition; and establishing social protection floors and reskilling to manage labour displacement.

II. The pandemic and prospects of inclusive economic recovery

7. Most developing countries in the Asia-Pacific region are experiencing a K-shaped economic recovery, where progress has been uneven across different sectors and segments of the population and even across countries. While the manufacturing sector has benefited from the rising global demand for goods from the region and has seen sustained growth since mid-2020, mobility restrictions and border closures have had a severe impact on the transportation and hospitality sectors. Despite rising activity in both sectors, they have yet to return to their pre-COVID-19 levels (figure I). As of the end of 2021, marginal improvements were seen in tourism arrivals as some economies reopened their borders, however, tourist arrivals to Asia and the Pacific are still significantly below pre-pandemic levels.

³ Structural transformation refers to the transition of an economy from low productivity economic activities to higher productivity activities, such as from a rural economy based on agriculture to an urban economy led by industries and services.

Figure I
Sectoral recovery in developing countries in Asia and the Pacific



Source: Economic and Social Commission for Asia and the Pacific (ESCAP) calculations based on data from CEIC Data. Available at www.ceicdata.com/en (accessed on 28 February 2022).

Note: Median value of gross domestic product by sector for 13 developing countries for which data are available.

8. In addition, informal workers have been affected the most due to job insecurity and the lack of social safety nets, causing them to become unemployed or underemployed. Among countries of the region, the share of informal employment in total employment ranges from 23 per cent to as much as 95 per cent, for an average of 61 per cent in the region, and in many countries, women make up a higher proportion of informal workers.⁴ Typically, informal workers comprise a high share of employment in sectors such as food services, tourism-related services, wholesale and retail trade as well as construction. Informal workers are involved in low-skilled work that cannot be done remotely, and they suffered more during the pandemic. For instance, in Thailand, informal workers accounted for two thirds of job losses in small and medium-sized enterprises between May and June 2020, and 81 per cent of informal workers that lost their jobs were from the tourism

⁴ International Labour Organization (ILO), ILOSTAT. Available at <https://ilostat.ilo.org/> (accessed on 2 February 2022).

sector.⁵ As the tourism and services sectors have a higher proportion of women informal workers compared to men, women were more adversely affected by job losses or were more likely to leave their job to care for family and children during prolonged closures of businesses and schools. The disproportionate effects of the pandemic on women's employment have been called the "she-cession".

9. Prolonged disruptions due to the pandemic are likely to exacerbate the K-shaped economic recovery and increase inequality, undermining progress towards the 2030 Agenda. Postponed border reopenings will delay recovery in the tourism sector on which many economies in the region are highly reliant. Moreover, services and consumer-facing sectors which also employ a high proportion of informal workers will be hampered by intermittent restrictions. This uneven and sluggish recovery has contributed to an estimated 83 million additional people falling into extreme poverty across the region by 2021.⁶

10. Furthermore, protracted labour market disruptions that cause a large number of workers to face sudden unemployment and a reduction in working hours following lockdown measures, may erode workers' skills and discourage them from returning to the workforce; a phenomenon known as "scarring". Youth have fewer job prospects at lower pay and fewer opportunities for skill development, all of which will impact future productive potential. Uncertain economic prospects and weak balance sheets of businesses may lead to less availability of credit and reduced incentives to invest in capital or research and development. This may lead to an extended period of low investment, thereby reducing productivity and exacerbating inequalities.

11. A unique effect of the COVID-19 pandemic is the learning and earning loss from prolonged school closures. The duration of full and partial closure of schools varied across the countries of the region, with the longest full closure reaching 63 weeks. With the move to online education, the digital divide means that those lacking access to the Internet will be deprived of learning opportunities. The impact of school closures and postponed or cancelled assessments and qualifications are likely to have long-term consequences on learning and earning potential. Thus, economic inequalities must be mitigated by fiscal policies as soon as possible, given that lost years of education cannot be recovered.

12. The pandemic has had long-term impacts on the inclusivity of economic growth, and the challenge of high and rising inequality is at the forefront of the policy agenda in Asia and the Pacific. The following paragraphs contain recommendations on the role of fiscal, central banking and structural policies in supporting inclusive recovery and development.

III. Role of fiscal policies in supporting inclusive recovery and development: spend smart and tax fair

13. Two years into the pandemic, the fiscal outlook for the region has grown more difficult with many countries being pushed into a fiscal bind. The need to spend remains elevated while the means to spend have been reduced, and debt burdens have risen rapidly (figures IIA and IIB). As Governments continue to implement crisis-mitigation fiscal policies to counteract rising

⁵ Based on a survey by Thomas Parks, Matthew Chatsuwan and Sunil Pillai, "Enduring the pandemic: surveys of the impact of COVID-19 on the livelihoods of Thai people" (Bangkok, Asia Foundation, 2020).

⁶ Based on the threshold of \$1.90 per day.

inequality and support inclusive recovery, they should enact measures to improve the efficiency of spending and explore avenues for increasing revenue.

Figure II A
Fiscal space in developing Asia-Pacific countries as a percentage of gross domestic product

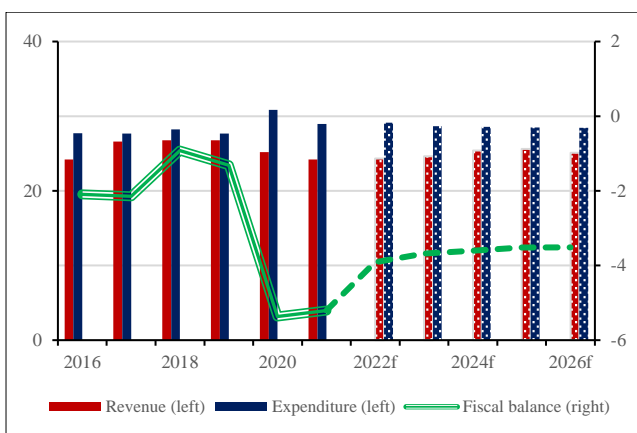
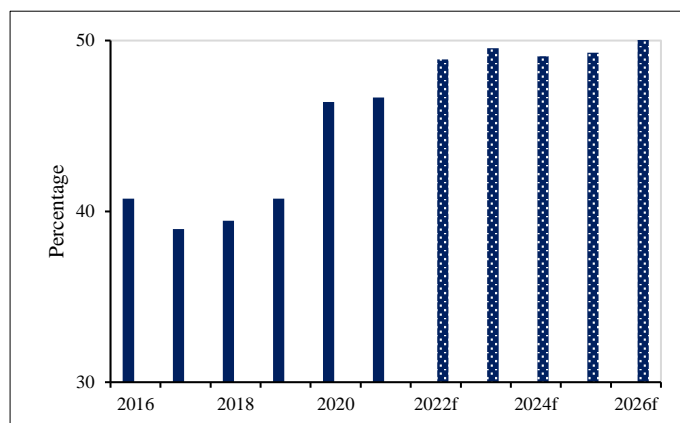


Figure II B
Median debt as a percentage of gross domestic product in developing Asia-Pacific countries



Source: ESCAP calculations based on data from the International Monetary Fund.

Note: f – forecasts, shaded.

A. Priority fiscal spending areas

14. While Governments should strive to support economic recovery through proactive fiscal policies for as long as possible, it may nevertheless become difficult given rising fiscal sustainability concerns. Eventually, fiscal consolidation must take place, and essential expenditures may be at risk of spending cuts during times of fiscal stress. Thus, Governments should focus on optimizing the return on their spending, ensuring that the most essential expenditures are maintained and improving the efficiency of delivery. Prime examples of fiscal spending that help to mitigate or determine long-term inequality trends, which are prioritized for inclusive development in the 2030 Agenda, but that are at risk of fiscal cuts are health care (Sustainable Development Goal 3), education (Goal 4) and social protection (Goal 1).

15. Governments must make bold choices to continue strengthening health care and avoid potential reductions in health spending, especially given the underinvestment in health care before the pandemic. The Economic and Social Commission for Asia and the Pacific estimated that an additional annual investment of \$158 billion, or \$38 per person, would be needed on average during the period 2016–2030 to scale up health systems sufficiently towards achieving Sustainable Development Goal 3 targets.⁷ Improvements in health care are needed to achieve better quality of life, stronger economic performance and faster crisis recovery and to build more resilient and inclusive economies. Ensuring funding for basic universal health coverage or rolling out such coverage within health expenditures should be prioritized, as shortfalls in coverage have a decisive impact on labour force participation, income generation and overall quality of life, and thus overall prospects of inclusive recovery and development.

⁷ *Economic and Social Survey of Asia and the Pacific 2019: Ambitions beyond Growth* (United Nations publication, 2019).

16. The pandemic has had an unprecedented impact on children due to school closures and the deterioration in the economic environment. Despite severe setbacks, education budgets are not adjusting proportionately to the challenges of the pandemic, especially in poorer countries. The median expenditure on education remained at approximately 3.5 per cent of gross domestic product in the decade before the pandemic – below the 4–6 per cent level recommended to achieve Sustainable Development Goal 4. Failing on education may cause inequality to increase in the future, a trend that will be difficult to reverse. Therefore, policymakers should maintain education expenditures and ensure that the available resources support coverage, universal access and quality of teaching.

17. The availability of social protection has prevented millions from falling into poverty during the pandemic. However, coverage remains far from universal, leaving large numbers of informal workers and members of vulnerable groups without support. According to ILO, as of 2020 only 44 per cent of the Asia-Pacific population were effectively covered by at least one social protection benefit (excluding health care). Therefore, to accelerate progress towards Sustainable Development Goal 1 in Asia and the Pacific, fiscal priorities should be aligned with the need for universal social protection. Here, digital technologies may support the management and efficient delivery of social protection schemes, and thus should be implemented on a larger scale.

18. Beyond using fiscal spending in health care, education and social protection to recover from the pandemic and lay foundations for a more equal and resilient future, there is a need to spend smart. This means cutting wasteful expenditures across the board, such as on defence and fossil fuel subsidies, and redirecting resources to the most impactful sectors, in particular health care, education and social protection. An increased impact may also be achieved by redirecting part of fiscal expenditures in each of these sectors towards vulnerable and currently excluded groups, where significant change can be achieved at a relatively low cost. For example, the allocation of additional budgetary resources to basic health care procedures can be very impactful. Synergies between policies, such as linking cash transfers to participation in medical check-ups or ensuring proper nutrition through school feeding programmes which support education outcomes, may also increase the impact at relatively low cost. For example, social protection programmes may improve the financial situation of households with children and enable them to access the school system.

B. Fair taxation

19. In facing fiscal consolidation, it is advisable to avoid further accumulation of debt which weighs on long-term economic growth potential and can mask structural fiscal revenue shortcomings. At the same time, avoiding cuts in health care, education and social protection will require fiscal reforms on the revenue side. Fair taxation is a key principle which entails targeting persistent tax avoidance and evasion, improving multilateral cooperation in international taxation, taxing the emerging digital economy and reducing tax losses due to excessive informality of economic activities. It is time to accelerate the implementation of progressive personal income taxes to reduce long-term inequality. All of these reforms require strong political will for effective implementation. The pandemic has constrained fiscal revenue options, but it has provided a window of opportunity for redesigning the tax system to reduce inequality. This includes measures for paying the fair share of taxes and shifting the tax burden to high-income households:

(a) Ensure all individuals and companies pay their fair share of taxes under existing tax regimes and rates, and improve the effectiveness of tax collection to eliminate tax avoidance and evasion and thus increase tax revenues without further burdening law-abiding individuals and companies, for example, through the digitalization of tax reporting not only to lower administrative costs but also to improve control and management of tax systems;

(b) Shift the overall tax burden towards the top of the income distribution while striving to raise revenue, for example, through strengthening personal income tax collection and/or social contributions which support inequality reduction, rather than through indirect taxes.

C. Use of digital technologies

20. So far, the implementation of available solutions in many developing countries has been undermined not only by insufficient political commitment, but by administrative and operational barriers. However, the pandemic has accelerated the global transition towards digitalization, which has facilitated the deployment of digital tools to effectively manage expenditures and collect revenue and has brought much-needed savings and efficiency gains in the functioning of fiscal systems.

21. Digital cash transfers are a useful application of digital technologies for effective and efficient fiscal interventions that gained popularity during the pandemic. These transfers provided emergency social protection to low-income households impacted by losses of jobs and income-generating opportunities. Digital government-to-person transfers are particularly effective in emergency situations such as the COVID-19 pandemic because of their efficiency and speed. The lessons from the recent scale-up of digital government-to-person transfers in a variety of countries of the region suggest there are three key building blocks: a channel for digital delivery; a unique identification (preferably digital with biometrics); and socioeconomic databases that are linked to the unique identification.

22. With regard to channels for digital transfers, mobile money networks were widely used in the region due to social distancing and lockdowns. It was possible to scale up such transfers because vast mobile money networks were present in most countries and as were payment service providers who acted as agents. The use of agents is particularly important for members of low-income households who lack a bank account or a mobile wallet or who have low digital skills. In Cambodia, for example, recipients of digital government-to-person transfers are notified by text message to collect the cash at their nearest payment service provider, where they need only present their national identification and mobile number.

23. The importance of having a national identification cannot be overemphasized. There is a correlation between having identification, a mobile connection and access to the payment system, and people without identification are most likely to be excluded from social transfer programmes. Unlike traditional forms of identification, digital identification can be authenticated through digital channels, facilitating access to essential public and private services that require personal identification. Digital identification can be used to open bank accounts, gain access to public services, or enrol in education programmes, and it is particularly important for vulnerable groups that lack access to traditional forms of identification.

24. A digitized national identification is particularly useful in that it can enable the integration of numerous social databases or registries, which in turn can ensure that digital government-to-person transfers are done correctly. In the absence of integrated socioeconomic databases, some households may receive benefits multiple times and the targeting may be inefficient, directing transfers to ineligible households while eligible households miss out on transfers they are entitled to.

IV. Inclusive central banking policies: beyond inflation stability and credit allocations

25. Given their functions as monetary policymakers, official reserve managers, currency issuers and financial sector regulators, there are various ways that central banks can promote inclusive development in Asia and the Pacific. Together with central banks, financial supervisory authorities can explore how thematic bonds, such as social bonds and sustainability bonds, can help to mobilize more financial resources for inclusive development.

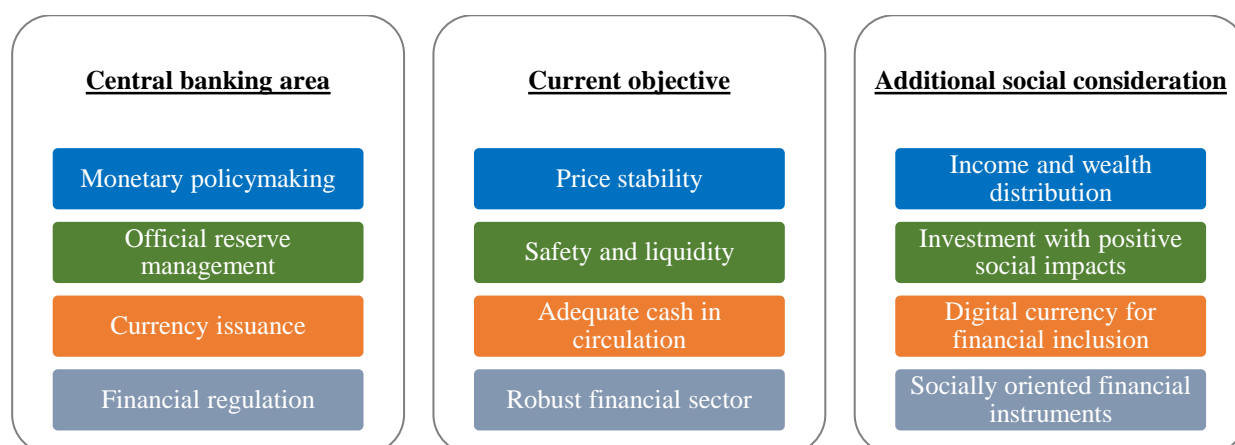
A. Central banking policies

26. While central banks have contributed to inclusive development by maintaining low and stable inflation rates, which benefit the poorer segments of society more than richer segments, central banks can step up their engagement as mounting fiscal pressure in the region limits the ability of fiscal policy to tackle rising inequality caused by the pandemic. Unlike the developmental role of central banking, which was pursued until the 1980s and benefited only a few economic sectors through credit allocation and special financing schemes, inclusive central banking benefits the society at large.

27. For instance, in response to the COVID-19 pandemic, Asia-Pacific central banks actively launched various measures to support the financial access and liquidity of households, small and medium-sized enterprises and government. For example, amid lockdowns, central banks in countries such as Bangladesh, Myanmar and Timor-Leste facilitated the use of digital financial services by reducing transaction fees and/or increasing transaction limits. For small and medium-sized enterprises, schemes to grant debt moratoriums, guarantee loans and/or provide financial assistance were introduced by central banks in countries such as China, India, Malaysia, Nepal, the Russian Federation and Sri Lanka. Central banks in countries such as Papua New Guinea and the Philippines provided direct lending to Governments, while those in Fiji, Indonesia, Thailand and Turkey purchased sovereign bonds in primary and/or secondary markets to inject liquidity.

28. Beyond these short-term measures, Asia-Pacific central banks can play an important, complementary role in promoting inclusive development. At a basic level, currently only half of central banks in the region have taken up inclusive finance issues, which is a missed opportunity given that financial access, financial education and consumer protection disproportionately benefit the poor. There are also other policy strategies and tools which are available when considering the functions of central banks as monetary policymakers, official reserve managers, currency issuers and financial sector regulators (figure III).

Figure III
Selected functions of inclusive central banking



29. Through its traditional role in monetary policymaking, central banks indirectly support economic equality by maintaining low inflation and macroeconomic and financial stability. High and volatile inflation hurts the lower income groups the most and thus exacerbates existing inequalities. Similarly, unstable macroeconomic performance and frequent economic downturns adversely affect the poor more than the rich, as their capacity to absorb such shocks is minimal. Thus, the contribution of central banks to inclusive development in maintaining low inflation and supporting macroeconomic stability should not be underestimated. This is certainly true of central banks in countries that struggle with high inflation and volatile macroeconomic conditions. Central banks should not try to address inequality as a separate objective through the use of monetary policy instruments. Rather, their main contribution to mitigating inequality should be to ensure low inflation and macroeconomic stability on a sustained basis.

30. Nevertheless, central banks can still pursue monetary policymaking that supports equality because high inequality could undermine the effectiveness of monetary policy. For example, in an economy where wealth is highly concentrated, the marginal propensity to consume will be lower. Also, when many people are unbanked, a change in the policy interest rate will have little effect on spending behaviour because they are not directly affected. At a basic level, more effort can be made to better understand and communicate the distributional impacts of monetary policy, including through changes in inflation and asset prices. When making monetary policy decisions, central banks can also consider the impact on income and wealth distribution. A more ambitious approach could be to introduce economic equality as a distinct secondary objective of central banks, especially in Asia-Pacific economies where the core mandate of maintaining price stability has been achieved. Lastly, several central banks recently introduced large-scale asset purchase programmes, part of which can be invested in domestic thematic bonds.

31. Central banks are also responsible for managing the official reserves of a country. By its nature, official reserve management tends to be risk averse, with priority given to ample liquidity and to acceptable risks over financial returns. As a result, the bulk of the estimated \$9.1 trillion in official reserves in Asia and the Pacific is being invested in bank deposits and money market instruments although these asset classes do not typically offer clear or direct social benefits. Legal amendments are needed to allow some central banks in the region to orient reserve management more towards social purposes and invest in socially oriented nontraditional asset classes. Central banks

themselves can adopt responsible investment strategies and consider changes in internal governance on reserve allocation to mobilize more reserves for social purposes. In several Asia-Pacific economies where official reserves are more than adequate, central banks can deploy part of their excess reserves as seed capital for local social projects.

32. Amid the emergence of private digital currencies and declining use of cash in financial transactions, many central banks around the world are exploring how central bank digital currencies can help them to maintain their leadership and relevance in the monetary system, increase the efficiency of payments, reduce the risk of financial instability and foster financial inclusion, among other potential benefits. In Asia and the Pacific, half of central banks are exploring central bank digital currencies primarily for the purpose of financial inclusion, and the central banks of China, Singapore and the Republic of Korea have reached the pilot stage. Where banking services are limited and the coverage of national personal identification systems is low, central bank digital currencies may improve financial access for citizens. However, central banks need a clear objective in issuing a central bank digital currency and they should examine whether other digital currency options are viable and carefully consider operational issues, such as legal and regulatory frameworks and risk mitigation. More broadly, central banks cannot act alone, as improvements in Internet networks and digital literacy are required to make central bank digital currencies work for financial inclusion.

B. Financial policies

33. To mobilize more financial resources for inclusive development, Asia-Pacific countries can tap the potential of innovative financial instruments. In recent years several countries in the region have turned to the bond market to mobilize capital for both COVID-19 recovery efforts and Sustainable Development Goals objectives, through the issuance of thematic bonds. Thematic bonds include green bonds, Sustainable Development Goal bonds, climate bonds, social bonds and sustainability and sustainability-linked bonds.

34. To facilitate the issuance of thematic bonds in the region, contribute to building back better and support inclusive development, the following four key actions are recommended: adopt recognized international standards or frameworks; identify eligible projects; establish a methodology to verify environmental and social impact of projects; and strengthen regional cooperation.

35. **Adopt recognized international standards or frameworks.** The choice of an appropriate standard or framework for a particular bond is essential for successful issuance, as it signals the aims of the bond issuer to the market and allows investors to identify the type of bonds that are being offered. It also provides guidelines for reporting and verification. This could be achieved through the adoption of recognized global standards such as those established by the International Capital Market Association. A bond taxonomy is a complementary element to help investors to understand how proceeds from a thematic bond issuance will contribute towards development objectives. Central banks and financial regulators in the Asia-Pacific region can work together to develop and/or harmonize taxonomies for socially oriented financial instruments. Such a common framework would enhance clarity and confidence among potential investors.

36. **Identify eligible projects.** As mentioned above, thematic bonds can be used to finance a range of initiatives under the condition that the proceeds are exclusively used for eligible environmental or social projects (or both in the case of sustainability bonds). This requires issuing countries to be able to select, design and implement bankable green or social or sustainability-linked projects. It is important to understand that bankability in the context of such projects goes beyond financial returns to encompass socioeconomic metrics, such as improvements in the resilience of communities. Therefore, governments wishing to access this kind of financing should develop a strategy to establish a portfolio of bankable green and social projects.

37. **Establish a methodology to verify environmental and social impact of projects.** Most thematic bond policy frameworks require the issuer to disclose and report on the use of proceeds, and all funds are tracked to provide investors with confirmation that the funds were used for the promised purpose to deliver the expected positive environmental and/or social impact. For these purposes, third-party verification plays an increasingly essential role in reducing information asymmetries. However, external verification can be quite costly. Thus, central banks and financial regulators can provide financial incentives to increase the feasibility of innovative socially oriented financial instruments. For example, under the Sustainable Bond Grant Scheme, the Monetary Authority of Singapore offers funds to cover expenses relating to independent review or rating of green bonds, social bonds and sustainability or sustainability-linked bonds that are issued and listed in Singapore.

38. **Strengthen regional cooperation.** Regional cooperation should be strengthened to support the technical and institutional capacity of developing countries to issue thematic bonds and develop the needed legal and policy frameworks. Despite the ongoing growth of thematic bond markets, taking advantage of their issuance may not be straightforward for all countries in the region. For example, countries that lack experience in dealing with capital markets and fixed income securities are also likely to lack the institutional capacity to develop the needed legal and policy frameworks in the short term. Furthermore, countries also need to assess their fiscal capacity to service new bond debt, especially in the aftermath of the COVID-19 pandemic, which reduced fiscal space considerably in many developing countries. All these aspects require considerable technical capacity, for which regional cooperation can help.

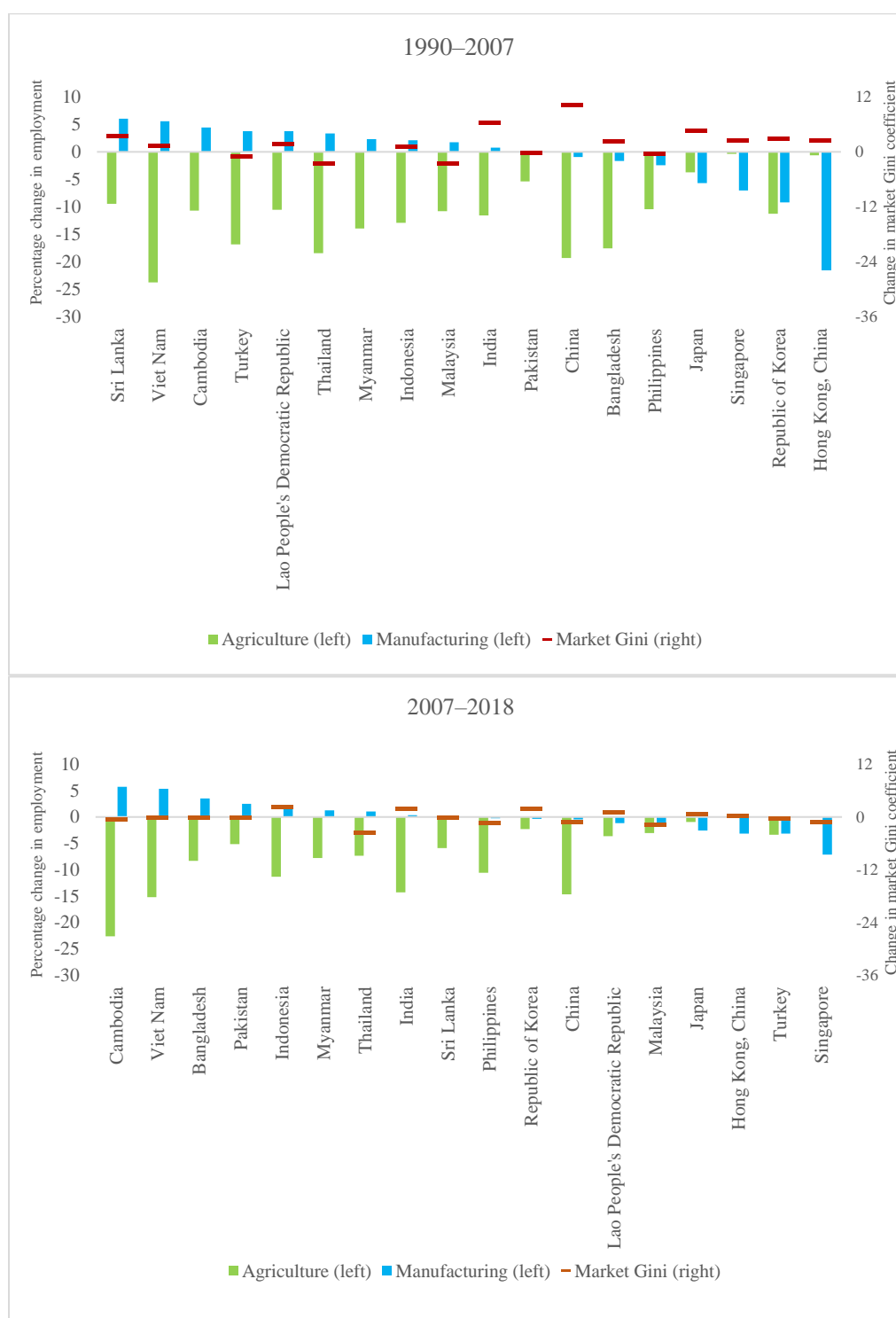
V. Structural transformations and inequality dynamics: policy choices matter

39. Structural transformation has been at the centre of the development of strategies for poverty reduction and economic catching-up in the Asia-Pacific region over the past few decades. Such efforts have contributed to the global reduction in between-country inequalities since the 1980s. Structural transformation has also, however, been a main driver behind the increase in within-country inequality in the three largest developing countries of the region (China, India and Indonesia) as well as in North and Central Asia (mainly in the 1990s), and in industrialized Asia-Pacific economies in the past three decades. In most of these cases, the trend of rising predistribution inequality played a dominant role, and redistribution through taxes and transfers was insufficient to compensate for it.

40. The linkage between structural transformation and predistribution inequality was historically viewed as a direct implication of labour reallocation from the low-productivity rural/agricultural sector to the high-productivity urban/industrial sector. It was assumed that such a transformation would initially result in an increase in inequality, followed by an eventual decline. However, contemporary research has expanded the discussion on four fronts: structural shifts of subsectors and activity composition within sectors; inequality implications of the open economy, including through global value chains; inequality in access to economic opportunities created by structural transformation; and the fundamental question of the aggregate labour demand effect of technological innovations and related structural transformation.

41. Globally, country-level experiences of structural transformation and predistribution inequality dynamics are characterized by diversity. This diversity is also observed in Asia and the Pacific but with more recognizable patterns (figure IV). During 1990–2007, rapid structural transformation had mixed and mild adverse implications for inequality in developing economies in East, South-East and South Asia, with the notable exceptions of China and India where inequality surged owing to a combined effect of structural transformation and economic liberalization. Predistribution inequality also surged in all the industrialized economies of the region during this period when they moved into the tertiary sector of modern services, including business services and finance. During 2007–2018, a period of structural transformation and economic growth with equity seems to have occurred in developing economies in East, South-East and South Asia, though predistribution inequality pressure continues to persist in India and Indonesia. In contrast, recent development experiences of countries in North and Central Asia and Pacific small island developing States have been generally characterized by structural stagnation with limited economic diversification into productive sectors.

Figure IV
Snapshot of structural and inequality changes, 1990–2007 and 2007–2018



Sources: ESCAP calculations based on World Institute for Development Economics Research (UNU-WIDER), Economic Transformation Database, available at www.wider.unu.edu/project/etd-economic-transformation-database (accessed on 26 November 2021); and Standardized World Income Inequality Database, available at <https://fsolt.org/swiid/> (accessed on 26 November 2021).

Note: Green and blue columns indicate percentage changes in the share of agriculture and manufacturing in employment; red bars indicate changes in market Gini coefficient.

42. Case studies on the structural transformation experience of Bangladesh, China, India and the Republic of Korea suggest that policy choices matter with regard to inequality. In particular the following factors are conducive to inclusive structural transformation: a more equitable starting point⁸ of structural transformation; higher agricultural productivity growth relative to other economic sectors; swift industrialization and large public investments in infrastructure and productive assets; systematic improvements in broad-based access to education; and enhanced labour protection and social security cushions to ease structural shocks. In contrast, the following factors may increase inequality pressure during structural transformation: pre-existing structural inequality (such as discrimination and unequal access to public services); a premature economic move to the tertiary/services sector with stagnant manufacturing development; and limited and unequal access to education.

43. In view of the unfolding digital, robotic and artificial intelligence revolution, forward looking policies are necessary for inclusive structural transformation. It is likely that the job-creation potential of manufacturing and industrial upgrading opportunities would be squeezed by the combined challenges of automation and a trend towards shortened supply chains that are closer to end-markets and existing production bases. The latter is driven by the advantages of reacting quickly to changes in consumer preferences and using supply clusters and logistical infrastructure that are already in place. This trend implies that there will be fewer opportunities and greater entry barriers for countries, especially latecomers, to participate in global value chains. Although modern services can become more tradable and provide a second sectoral engine for economic growth and well-paid jobs in the digital age, the sector is also increasingly exposed to automation facilitated by artificial intelligence. Countries that have not made the structural transformation and that have younger populations are likely to face much greater difficulties, while industrialized or newly industrialized countries with ageing populations are in much better positions to cope with these emerging challenges.

44. Policy responses can work on three main fronts. First, targeted policies can guide future structural transformation to be based on technologies to complement rather than replace labour. Labour-intensive manufacturing, despite being challenged by the new technological revolution, still promotes development and provides the best chance for job-rich development in the near future. Creating a conducive environment⁹ and providing targeted facilitation¹⁰ of manufacturing development should remain a policy focus. Meanwhile, policies can also affect the technological choices of firms and the market, for example: public funding can support research and development of innovations to complement labour; industrial policies¹¹ can help to overcome coordination and first-mover failures to promote faster emergence of new economic

⁸ Starting point inequality reflects the development outcome of the previous period, which in turn is shaped by the socioeconomic structure and institutions of the time but it can be changed by policy interventions. For example, in a typical rural economy land reforms can change land ownership structure and thus initial inequality.

⁹ Such as a large and reasonably skilled labour force, decent utility and logistics infrastructure and a favourable business environment.

¹⁰ Such as investment incentives, credit support or providing upgraded infrastructure and an improved business environment through special economic zones.

¹¹ Such as public research and information sharing on emerging technology and emerging sectors, development planning and coordination, credit support and financial incentives for pioneering firms.

activities, sectors and jobs; and measures to address existing pro-capital distortions, such as a low effective tax rates on capital, can support a job-rich transformation. Public discourse on the future direction of technological innovation can also contribute to this shared journey.

45. Second, structural transformation pathways can be shaped by education, labour and competition policies. For example, increased aggregate supply of skills through broadened and equitable access to quality education can substantially reduce the cost and increase the productivity gains of using labour in production, thus changing firm-level choices. Strengthening the position of labour in compensation negotiations or promoting constructive labour participation in corporate decision-making (such as through co-determination) can also lead to greater adoption of innovations that complement labour and more inclusive distribution of the economic rewards. Regulating big capital, which has a natural monopoly or oligopoly position, is important as well.

46. Third, possible policy options to better manage the socioeconomic disruptions of structural transformation and its negative impact on equality include establishing social protection floors, significantly increasing investment in reskilling, providing proactive facilitation for job searching and job matching and implementing necessary regulations to manage the pace of labour displacement.

VI. Issues for consideration by the Commission

47. As outlined by the Secretary-General in “Our Common Agenda”, COVID-19 has created an opportunity to build a more equal and sustainable world. Efforts by Asia-Pacific policymakers towards an inclusive future should be based on a new social contract that creates equal opportunities for all. To this end, economic policies can play a leading role in supporting inclusive development through a combination of fiscal, central banking and structural policies.

48. The Commission may wish to review the policy recommendations contained in the present document and provide guidance on the future work of the secretariat, including the forthcoming analytical work of the secretariat as well as its planning and preparation of technical assistance and capacity-building projects.

49. Members and associate members of the Commission may wish to share national policies and experiences and deliberate on the following issues:

(a) Priority areas for government spending to address the risk of rising inequality and support inclusive development;

(b) Ways to create fiscal space for such spending given current fiscal constraints, and how digitalization can improve the efficiency of government spending and revenue collection efforts;

(c) Policy options central banks could consider to support inclusive development, in addition to maintaining low and stable inflation rates on sustained basis;

(d) Ways Governments can pursue structural transformation while ensuring that no one is left behind, and ways to deal with the unfolding digital, robotic and artificial intelligence revolution to ensure that inequality does not increase.