

ASIAN DEVELOPMENT OUTLOOK 2014

FISCAL POLICY FOR INCLUSIVE GROWTH



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Foreword

Developing Asia achieved steady economic growth in 2013 as the region adapted to a changing global landscape. Demand from the advanced economies picked up as recovery gathered momentum. Yet this improvement was tempered somewhat by moderated growth in the People's Republic of China (PRC) as it continued its shift toward more balanced growth. These two trends help shape the regional forecast. *Asian Development Outlook 2014* estimates that regional growth will edge up from 6.1% in 2013 to 6.2% in 2014 and 6.4% in 2015.

As the United States (US) continues to phase out its unconventional monetary policy, combined gross domestic product (GDP) growth in the US, the euro area, and Japan is expected to almost double to 1.9% in 2014 from 1.0% in 2013. Growth in these economies will strengthen more to 2.2% in 2015. While the US policy shift may bring further volatility in financial markets, the tightening of global liquidity can be mitigated by accommodative monetary policy in the euro area and Japan.

Reform is key to the outlooks for the region's two largest economies: the PRC and India. Growth in the PRC slowed to 7.7% in 2013 as credit growth tightened, wages rose, the currency appreciated, and the authorities continued implementing policies to promote economic expansion that is more equitable, sustainable, and balanced. As reform gathers pace, growth in the PRC is forecast to slow to 7.5% in 2014 and 7.4% in 2015. In contrast, India's outlook depends on its ability to successfully implement structural reforms and spark stronger growth. If successful, reform in India may accelerate economic growth from 4.9% in 2013 to 5.5% and 6.0% in the next 2 years.

Risks to the outlook have eased compared with the recent past, and policy makers in the region can manage them. Yet three areas continue to warrant close monitoring. First, another shock to global financial markets from changes in US monetary policy cannot be ruled out. Second, data on the recovery in advanced economies have been mixed, leaving the possibility that demand for developing Asia's exports may be softer than forecast. And finally, if efforts in the PRC to curb credit expansion are too abrupt or excessive, a deeper slowdown could drag down prospects for its trading partners.

As Asian governments manage these risks, they must also act to ensure that steady growth can continue in the decades ahead. The region's past economic growth lifted hundreds of millions of Asians out of poverty, but now widening inequality is undermining this success. During the 1990s and 2000s, more than 80% of the region's population lived in countries with worsening Gini coefficients, a common measure of inequality. The same market forces that enhanced growth—globalization, technological progress, and market reform—now exacerbate inequality.

International experience shows that public spending can reduce income inequality. Government spending on education and health care, for example, broadens access for the poor to these vital services and levels the playing field.

Pragmatic fiscal policy has endowed many economies in the region with scope to direct more public resources toward enhanced inclusion. But this opportunity may not last. Fiscal space will be squeezed in the coming decades by rising costs for health care and other needs common to rapidly aging societies. To ensure the ability to invest in inclusive growth, regional authorities must explore a wide range of options to raise revenue. These include broadening the base for personal income tax and value-added tax, enlarging corrective taxes and nontax revenues, and introducing naturally progressive taxes on property, capital gains, and inheritance. Improving tax collection is also important.

Fiscal policy can and should play a bigger role in promoting inclusive growth in the region. Asian governments need to actively target inclusion when formulating fiscal plans and thereby build economic growth on broadly shared benefits. Achieving inclusive growth is a long-term challenge. As regional growth stabilizes, now is the time to plan and act for a more inclusive future.

TAKEHIKO NAKAO

President

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