OECD/ESCAP/ADB REGIONAL CONSULTATION ON INCLUSIVE GROWTH IN SOUTHEAST ASIA

9 June 2015

ESCAP Headquarters, Bangkok, Thailand
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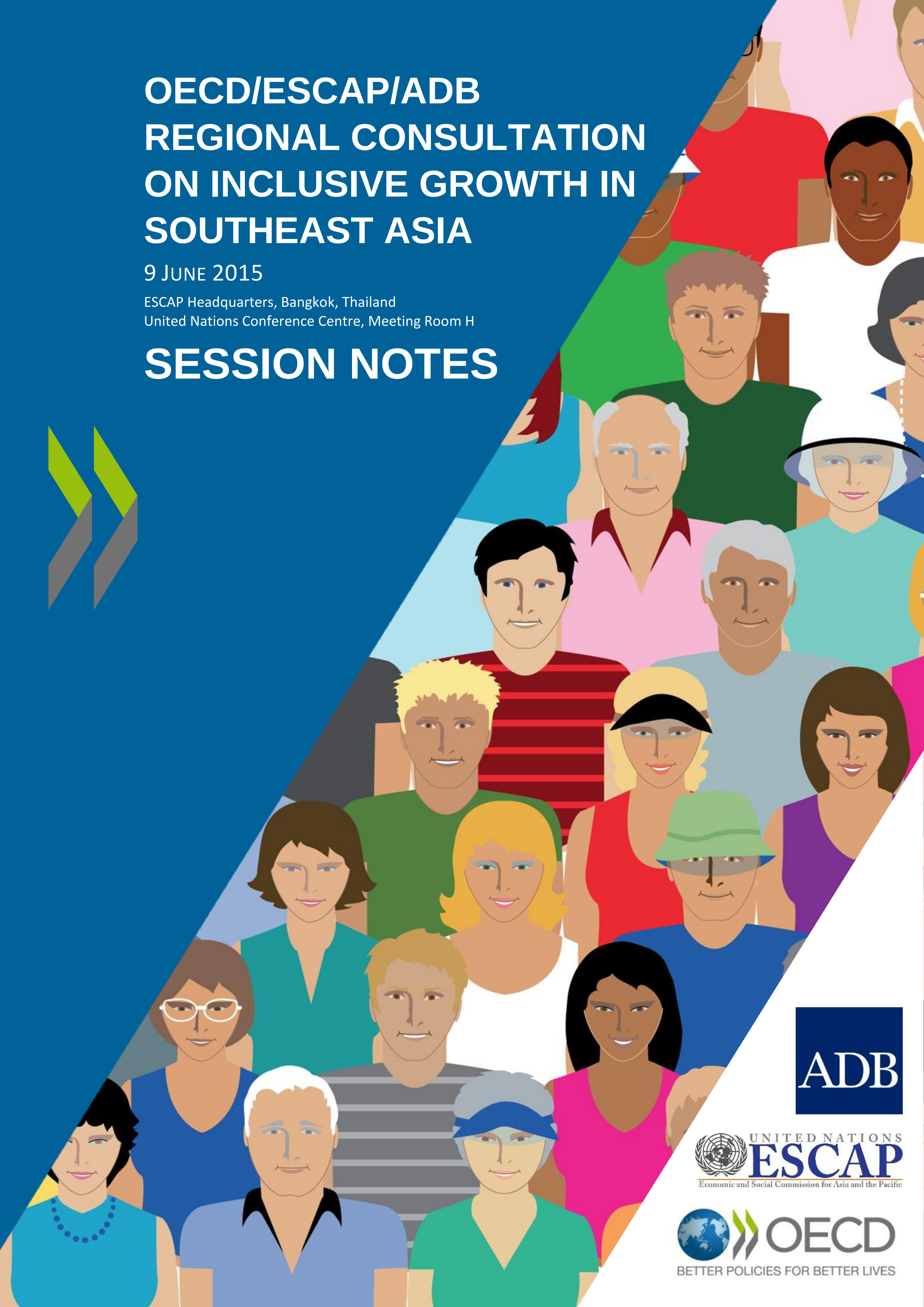
SESSION NOTES



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Inclusive Growth in Southeast Asia

United Nations Conference Centre, Meeting Room H
Rajadamnern Nok Avenue and Klong Phadong Krugkasem Road
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CONTEXTUAL BACKGROUND

WHY INCLUSIVE GROWTH? THE SEA EXPERIENCE

Over the past two decades, the ten member countries of the Association of Southeast Asian Nations (ASEAN)[1] have enjoyed vigorous economic growth of about 4.6% annually in per capita PPP terms, compared with 3.7% in Latin America, 3.8% for the world, and 4.3% in sub-Saharan Africa (IMF World Economic Outlook database, April 2015). Economic growth was accompanied by social gains and relative political stability. Between the early 1990s and 2012, the total population expanded by over 200 million, but the number of people living in acute poverty – less than USD 1.25 per day in PPP terms – fell by 75 million. Several countries have attained middle-income status. Their ability to capitalise on open global markets for goods and services has been crucial to their economic transformation and social improvement. They are also actively engaged on an ambitious path of regional integration, including through the formation of the ASEAN Economic Community.

The income gains from this strong economic growth within countries were not always evenly distributed, as is often the case during this kind of growth spurt. They accrued disproportionately to the owners of capital and to skilled workers. Although the proportion of those living in acute poverty has fallen steeply in most ASEAN countries, and virtually disappeared in some, about one-third of the approximately 600 million people living in the ASEAN countries live on less than USD 2 per day in PPP terms.[2] The forces that drove, and are still driving, rapid productivity and income growth — technological progress, globalisation and market-oriented reform — seem to have contributed to increasing inequalities of income in some ASEAN countries, and left it high in others, possibly exacerbating social exclusion. The children of poor parents tend to spend less time in education and are less likely to end up in secure well-paying formal-sector jobs, perpetuating a vicious cycle of inequality of income translating into inequality of opportunity. Those who could potentially contribute much to growth face barriers to doing so, because of socio-economic or ethnic background, gender, locality or institutional failings. Unless addressed, inequalities may pose real dangers to political stability and threaten to leave long-term economic potential unfulfilled

The future of Southeast Asia (SEA) looks promising. Nevertheless, SEA countries need to do more to meet their long-term potential by sustaining growth and tackling underlying inequalities in growth levels and household income within *and* among countries. To sustain economic progress over the long term and buttress continued improvements in broad-based living standards, it will therefore be increasingly necessary to ensure that all SEA citizens have the opportunity to pursue success in their own lives, and contribute to the success of their nations and the region as a whole. Making growth more inclusive will be better for societal well-being, but it will also help make growth more sustainable in the long term.

In the context of a sluggish global recovery combined with pressure on competitiveness that make exporting more challenging, there is a need to discuss what can be done for SEA to sustain robust economic growth over the long term with greater inclusiveness. In particular, if SEA countries were to move towards a more advanced stage of development and beyond the middle-income trap, this requires a fundamentally different approach to development – one based on raising productivity through investment in human capital and innovation and a shift

[1] In alphabetical order: Brunei-Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam. In the World Bank classification, Cambodia and Myanmar are Low Income, Malaysia and Thailand are Upper Middle Income, Brunei Darussalam and Singapore are High Income (non-OECD) and the remainder are Lower Middle Income.

[2] Brunei-Darussalam, Myanmar and Singapore are excluded from the calculation due to unavailability of data; Data based on 2011 data from PovcalNet (extracted on 12 January 2015).

towards an increasingly technology-intensive economy (OECD, 2013). This dialogue is particularly timely in light of the ongoing discussion on the Post-2015 development agenda, and emphasis of the Sustainable Development Goals on equity and inclusion.

The OECD/ESCAP/ADB Regional Consultation on Inclusive Growth will engage experts, policy makers, practitioners and civil society from Southeast Asia (SEA) in a dialogue on the trends and drivers of inclusive growth in the region, institutional approaches to inclusive growth, and policies to promote inclusive growth. Each of the three organisations has been actively involved in the Inclusive Growth agenda, and an objective of the conference is to share knowledge on the issue in the specific regional context of SEA.

TRENDS AND DRIVERS OF GROWTH AND INEQUALITIES IN SOUTHEAST ASIA

Over the past two decades, the ten ASEAN countries have experienced brisk economic growth, ranging from over 5% annually for Viet Nam, Lao PDR and Cambodia, and between 2.5%-3% for the others (World Bank Development Indicators, April 2015). This contributed to substantial poverty reduction even during the global economic slowdown, to which the region's economies proved to be remarkably resilient. Singapore now has a per capita income greater than any OECD country, Malaysia's per capita GDP is comparable with that of some OECD countries, and Thailand is well into the upper middle income classification, on a par with Brazil. Participation in global networks of production, trade and investment has created employment, raised incomes and helped spread knowledge and technology throughout the region. The region's economy also benefits from an expanding middle class and a young and dynamic population. If SEA were a country, it would have the third-largest labour force in the world, behind only the People's Republic of China (PRC) and India.

SEA countries are also actively engaged on an ambitious path of heightened regional integration – through the completion of the ASEAN Economic Community (AEC) – by the end of 2015, although some impediments to intra-regional trade and investment may remain. The AEC is one of the most far reaching programmes of economic co-operation in the developing world, with important potential gains. Creating a "single market and production base" will have positive effects on economic growth and employment. If viewed as a single unit, SEA would rank as the seventh-largest economy in the world. As much of the rest of the world struggles with sluggish growth, it is tempting to see SEA as a bright spot in the global economy.

Growth prospects indeed look favourable in SEA over the medium term, despite sluggish growth in OECD countries and slowing growth in the PRC. The ADB forecasts SEA GDP growth of 4.9% in 2015 and 5.3% in 2016 (ADB, 2015). The OECD projects the SEA region's growth rate to average 5.6% per annum over the 2015-2019 period (OECD, 2015a). Overall the OECD forecasts that the SEA will sustain its growth momentum in the medium-term, led by Indonesia and the Philippines with an average annual growth of 6% and 6.2% respectively. More rapid growth (exceeding 7% per year) is expected over the next five years in Cambodia, Lao PDR and Myanmar.

The Asian financial crisis of the late 1990s persuaded countries in the region to follow comparatively prudent and stable macroeconomic policies, which helped them to maintain sustained growth thereafter. Ratios of public sector gross debt to GDP are currently lower than in most OECD countries. They also built up important foreign currency reserves for self-insurance, SEA's surplus savings were invested largely in United States Treasury bills rather than in its own infrastructure development and other needs; central banks in the region hold reserves worth more than USD 700 billion (ESCAP, 2015). Sustained growth also created resources that can be used to finance social policies that aid the disadvantaged, and it helped support a rising middle class. Recent years, though, have witnessed increased household leverage and real estate speculation. Between 2008 and 2013, household debt as a percentage of GDP rose from about 60% to 87% in Malaysia and from 55% to 82% in Thailand (ESCAP, *op cit*). While largely manageable so far and unlikely to trigger instability, high debt can act as a drag on growth by constraining consumption in the years ahead and limiting the policy space with regard to interest rates. At present, though, the SEA countries (as a group) seem to have some room for manoeuvre in their macroeconomic policy settings.

In a context of rising prosperity on average, sizable income disparities exist within SEA countries (as well as regional disparities in these countries). As measured by the Gini coefficient, income inequality has moved in different ways in different countries over the past two decades (Table 1). It has fallen from comparatively high levels (over 40%) in Thailand, risen from comparatively low levels (around 30%) in Indonesia and Lao PDR, and remained broadly stable in other countries for which there are data. In Cambodia, it rose earlier this century before falling back more recently. In general, Gini coefficients in SEA countries are lower than in other LICs and LMICs in Africa and Latin America on average, but higher than those in advanced OECD countries[3] (World Bank data based on consumption expenditure rather than income, except for Malaysia).

Table 1. Gini coefficients in ASEAN countries

	1992	2002	2012
Brunei-Darussalem	*n/a*	*n/a*	*n/a*
Cambodia	*n/a*	29.3[c]	31.8[g]
Indonesia	29.3[b]	29.7	38.1[g]
Lao PDR	30.4	32.5	36.2
Malaysia	47.7	37.9[d]	46.2[e]
Myanmar	*n/a*	*n/a*	*n/a*
Philippines	43.8[a]	44.5[c]	43
Singapore	*n/a*	*n/a*	*n/a*
Thailand	47.2	42	39.4[f]
Viet Nam	35.7[a]	37.6	35.6

Source: World Development Indicators;
Note: a/ 1991 data, b/ 1993 data, c/ 2003 data, d/ 2004 data, e/ 2009 data, f/ 2010, g/ 2011 data

The Gini coefficient measures inequality over the entire income distribution, but does not give a precise guide to what is happening at the extremities. As measured by the ratio of incomes between the top and bottom deciles, the gaps between the richest and poorest segments of the populations have fallen significantly only in the Philippines and Thailand, albeit still remaining at high levels in both countries. They have risen appreciably in Indonesia, although not to high levels, and elsewhere they have remained broadly stable (calculations based on World Bank Development Indicators, April 2015). The forces and policies that have driven growth so far – i.e. technological progress, globalisation and market-oriented reform – should be allowed to continue in future, but they should be supported by flanking policies designed to address inequality. Otherwise, the phenomenon of the poorer segments of the population being left behind amid growing prosperity will likely continue; the drivers of economic growth have led to increasing skill premiums and returns to human capital, a falling share of labour income, and increasing spatial inequality (ADB, 2012).

Implementing successful flanking policies requires efficient and effective government with a solid tax base with which to finance such policies. An issue in the SEA countries is the importance of informal employment, defined either as workers not covered by labour market regulations, or the number of self-employed workers not officially working for a firm. Estimates by the ILO, quoted in OECD (2015a), of informal employment in the non-agricultural sector in 2008-2010 range from 70% of the total in the Philippines and Indonesia to around 40% in Thailand, and probably less than 20% in Singapore. Informal employment may result from a combination of onerous regulation of formal employment, tax avoidance or evasion, or lack of trust in government. Whatever the influences, the result is to reduce tax and social security revenues that could finance social policies targeted at inclusive growth: "Informality tends to be associated with inequality and underdevelopment and is generally widespread among the poor and less well educated workers who face exclusion from the formal sector" (OECD, *op cit*). Inequality of incomes has indeed gone hand-in-hand with unequal educational achievements, health status and access to other public services. Unequal access to opportunities – in education, public services, employment and other areas – often arises from differences in individual circumstances that are outside the control of individuals, such as their gender, ethnic origin, parental education or location of birth (Zhuang, Kanbur and Rhee, 2014). The children of the poorest families especially face barriers to contributing

[3] The population-weighted average of GINI coefficients in 26 low-income and lower-middle income countries, covering over 2 billion people, is 35.5%. The GINI average for those SEA countries for which data exist is 33.2% (World Bank Development Indicators database, April 2015).

to, and benefiting from, the kind of economic growth that has brought prosperity to other citizens. They are disproportionately likely to be from ethnic minority families living in remote rural areas. Public spending on social protection remains low, making families living just above the poverty line vulnerable even to small shocks. Overall public spending on social protection was more than 3% in Malaysia, Singapore and Viet Nam but only 1% in Cambodia, Indonesia and the Lao PDR. The ESCAP *Survey* of the region for 2013 contained an estimate that Indonesia and the Philippines would need to increase public health spending by 8% annually in order to raise total health spending to 5% of GDP in line with WHO recommendations laid down in “Health Financing Strategy for the Asia Pacific Region (2010-2015)” (WHO, 2009).

A strategy for more inclusive growth is needed in order for the region to ensure sustained growth and continued convergence in living standards towards the advanced economies. Disparities can be reduced or contained through a wide range of policy responses including, among other things, more efficient and future oriented fiscal policy, allocating more resources to health, education and skills development, especially for poorer families; interventions to bolster lagging regions, including infrastructure to improve physical connectivity; and measures to generate more employment-friendly economic growth, including policies to assist SMEs which account for the dominant shares of the region’s economy and employment. Barriers for particularly vulnerable groups must be specifically addressed as part of the policy mix, so that all members of society can benefit.

Some governments are responding to rising inequality: Indonesia, Myanmar, the Philippines, Thailand, Malaysia and Viet Nam seek social goals like inclusiveness. Targets for reduced poverty rates were set by Indonesia, the Philippines and Viet Nam and for income equality by Malaysia and Thailand. **Myanmar**’s 2012-15 Framework for Social and Economic Reforms prioritises necessary, achievable reforms in economic development, regulation and governance, the provision of public services, and infrastructure development. The **Philippines** medium-term development plan 2011-2016 specifically states that its aim is to “foster inclusive, sustainable growth” for example, by meeting macroeconomic, competitiveness, financial and social targets, among others. **Thailand**’s Eleventh National Economic and Social Development Plan (2012-16) targets inclusive, broad-based growth, education and other areas of human development, food and energy security, increased innovation and growth, trade, investment, and environmental protection. **Viet Nam**’s Socio-economic Development Plan (2011-15) emphasises development through upgrading, improving efficiency and competitiveness through targets for overall and sectoral economic performance, meeting social targets (e.g. job creation and poverty reduction) (OECD 2013).

ASEAN countries in general have made education a priority. The ASEAN 5-year (2011-2015) Work Plan on Education listed four priorities in this area, of which increasing access to quality primary and secondary education was key. Public spending on education now ranges from a high 6.6% of GDP in Viet Nam to 2.6% in Cambodia, where close to 100% of the relevant population enter primary schools. However, only 70% remain enrolled until their last year (ASEAN, 2014). Social protection systems in Viet Nam have mitigated risks associated with ill health, disability, work-related injury and old age, although Viet Nam still spends less than other lower middle-income countries (LMICs), and spending on pension is particularly low (OECD, 2014). Moreover, the, coverage of social insurance schemes is concentrated disproportionately among the better off.

Well-designed and predictable stability-oriented macroeconomic policies, together with openness to international trade and finance, helped SEA countries to create frameworks that fostered economic growth. They are powerful, albeit indirect, tools to reduce the incidence of poverty, but they do not in themselves promote inclusive growth. Social policies are needed, and need to be financed. For the poorer SEA countries, foreign donors and aid agencies have made substantial contributions to finance education (ASEAN, 2014) and have also helped to finance health services and infrastructure. In the longer term, though, the countries themselves must find the necessary resources through their taxation systems. As long as there are substantial numbers living below or just above poverty levels, transfers in cash or in kind will be needed; but in the longer term, social spending needs to focus on preventing poverty and promoting inclusion. There is some way to go. Public spending on education (as a percentage of GDP) for example, ranges from around 6% in relatively rich Malaysia to less than 3% in Cambodia, with most others in the 2.5%-3.5% range, despite their comparatively young populations (Viet Nam is an exception at over 6%). The World Bank puts the average for lower middle-income countries at about 4.5%. The equivalent figure for EU countries is over 5%. Bringing a higher proportion of the population into the taxation system, by persuading them that tax revenues enable them and their children to lead better lives is a priority.

Elements for discussion

This session will provide an overview of the trends and drivers of growth and inequalities in Southeast Asia.

- Is income inequality an inevitable consequence of vigorous economic growth in SEA countries? Why are different countries' experiences different in both respects?
- What have been the defining trends with regards to inclusiveness of growth in SEA countries, and what have been the countries' responses?
- How much fiscal margin for manoeuvre do different SEA countries for financing and implementing more ambitious social programmes?
- How much further scope is there for: (i) "static" fiscal policies (i.e. taxing the better-off and transferring income directly to the disadvantaged) and for (ii) "dynamic" fiscal policies (i.e. taxing the better off in order to finance health, education and other social policies targeted at the disadvantaged)?