

Session 2: Challenges and Risks to Development in Asia

Session Overview Paper

Future Scenarios: Prospects and Challenges for Asian Development

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1. Introduction

By any standards, Asia's growth story in the past two decades has been remarkable. In the 1980s and 1990s, real *per capita* gross domestic product (GDP) growth in East Asia² was sustained at over 6 per cent per annum, while in South Asia *per capita* growth rates of over 3 per cent per annum were achieved. In contrast, other developing regions struggled to increase *per capita* income at all in this period (World Bank 2005: 17). All the more impressive has been the acceleration of this growth in the first few years of the twenty-first century and the spread of rapid growth to an increasing number of countries in the region.

This outcome was not dependent solely on the poverty reduction achievements of China. Rapid growth is spreading across Asia. As the *Asian Development Outlook 2005* notes, 'In 2004, developing Asia achieved its best growth performance since the Asian financial crisis of 1997–8. In fact, with the notable exception of the Pacific developing countries, nearly all developing Asian economies grew by more than 5 per cent in 2004' (Asian Development Bank 2005a: 3). The breadth of the growth achievement in Asia is shown in Table 1. This shades years for which growth falls below 5 per cent. The only country to show growth below 5 per cent in 2004 is Nepal, which has been affected by internal conflict. Projections for 2005–7 suggest sustained growth across the 11 countries in the table, with the exceptions of Cambodia and Nepal.

Table 1: Real growth rate of GDP (% per year)

Country	Outcomes					Projections		
	2000	2001	2002	2003	2004	2005	2006	2007
China	8.0	7.5	8.3	9.5	9.5	8.5	8.7	8.9
Cambodia	7.0	5.6	5.5	5.2	6.0	2.3	4.1	4.7
Indonesia	–	3.8	4.3	5.0	5.1	5.5	6.0	6.5
Lao	5.8	5.8	5.9	5.9	6.5	7.0	6.5	5.8
Philippines	4.4	1.8	4.3	4.7	6.1	5.0	5.0	5.0
Vietnam	6.1	5.8	6.4	7.1	7.5	7.6	7.6	7.5
Bangladesh	5.9	5.3	4.4	5.3	5.5	5.3	6.0	6.0
India	4.4	5.8	4.0	8.5	6.5	6.9	6.1	7.0
Nepal	6.0	4.8	–0.4	2.9	3.3	3.0	3.7	4.3
Pakistan	3.9	1.8	3.1	5.1	6.4	7.0	7.0	7.5
Sri Lanka	6.0	–1.5	4.0	5.9	5.5	5.2	5.8	5.9

Source: Asian Development Bank (2005a: 303).

¹ Based on a longer paper by Professor John Humphrey, IDS.

² East Asia will be used as shorthand for East Asia and Pacific.

This rapid and sustained growth has led to substantial reductions in income poverty across the region. However, substantial variations in performance between countries remain. Within countries not only are the benefits of growth distributed unevenly, but the negative impacts of rapid growth (pollution, depletion of natural resources, strain on infrastructure, etc.) are also distributed unevenly.

This creates a double challenge for policy. High rates of growth need to be sustained to continue reducing poverty and improving human welfare. This means addressing risk factors that could undermine growth. And growth alone is not enough. The quality of growth – in generating decent jobs, productively bringing poor people into the growing economy, and supporting social cohesion – matters too.

This paper outlines the structural transformation of the Asian economies and the past and projected impacts of rapid growth on the poverty headcount in the region.

It then considers four specific areas where there are particular challenges for sustaining growth and poverty reduction. These are widely recognised in the region as important; their severity arises in part from rapid growth; and how they are addressed has clear and direct consequences for poverty and inequality. *These challenges are:*

- *Financial stability.* The Asian financial crisis in 1997 had serious consequences for growth and poverty reduction. Are the measures already taken to strengthen financial systems sufficient to avoid further crises?
- *Infrastructure.* Can Asia meet the challenge of investment in the infrastructure needed to underpin growth, while ensuring that the needs of the newly urbanised poor and lagging regions are met.
- *Energy.* How can energy supplies be secured, energy efficiency improved and electricity generation expanded to meet rapidly growing demand?
- *Environment.* The ‘grow first, clean up later’ paradigm³ is increasingly discredited. Its consequences have been felt most acutely by the poor. How can issues of resource depletion and environmental degradation be addressed in ways that are compatible with continuing growth?

These are by no means the only threats to growth. Many potential risks to growth in Asia have been highlighted.⁴ The growth prospects for the whole world could be blown off course by major problems such as turbulence in financial markets arising from global payments imbalances, high oil

³ As discussed in UN ESCAP (2005).

⁴ See *Asia Development Outlook 2005 Update* (Asian Development Bank 2005b) for the discussion of risk factors for Asian economies.

prices or an influenza pandemic.⁵ There are also more country- and region-specific risk factors, both economic and political. The World Bank (2004) highlights continuing problems with *fiscal deficits*, particularly in South Asia, and the continued *adjustment needed* in some countries to the phase-out of the Multi-Fibre Arrangement last year. Political risks in the region include armed conflict between states, terrorism and political instability, as highlighted by a recent report on South Asia (Strategic Foresight Group 2005). The World Bank noted that '*Political risks and uncertainties* also remain a concern, because of both internal and external factors. Heightened domestic and regional *instability* could undermine growth prospects and slow the pace of economic reforms' (World Bank 2004: 240).

2. Structural Transformation, Economic Growth and Poverty Reduction

The Asian economies have experienced profound and unprecedentedly rapid structural changes in the past two decades. One major change is the demographic and fertility transitions in the Asian economies, which are discussed in the paper by Cook (for Session 3 of this conference). The second major change is the transition from predominantly rural and agricultural to urban-based manufacturing and service activity.

The share of agriculture in national GDP fell by between one-third and one-half in the period 1975–2003 in the region's largest countries: Bangladesh, China, India, Indonesia, Pakistan and Sri Lanka. In all these countries, agriculture contributed less than 25 per cent of GDP in 2003. However, agriculture remains important in the region's poorer, slower-growing economies such as Cambodia, Lao and Nepal. And these falls in agriculture's contribution to GDP are not matched by falls in its share of employment. Agriculture's share of total employment is declining, but more slowly. Only one of the nine countries listed above had less than 35 per cent of its economically active population in agriculture.⁶ Improving the livelihoods of people living in rural areas remains a priority, in spite of rapid urbanisation.

Economic growth has been associated with rapid urbanisation and the development of dynamic regions, particularly in coastal areas across numerous countries. Levels of urbanisation have increased across Asia, and particularly in the most populous countries. The levels of urbanisation in the region's five largest countries – China, India, Indonesia, Bangladesh and Pakistan – have moved from the 10–25 per cent range in 1975 to the 25–45 per cent range in 2005 (Jack 2005). The motors of economic growth in the region are urban areas, as highlighted in Box 1.

In these urban areas, manufacturing and services have grown rapidly. In East Asia, the motor of growth has been export oriented manufacturing. Employment has been rising in both manufacturing and services, and the data suggest 'a structural break in the 1990s with an

⁵ An influenza pandemic would have a substantial impact on the global economy as a whole, both directly through its impact on health and also through its potential for 'freezing' travel and trade. In this respect, the experience of SARS in 2002 is salutary. Although the direct health impact of SARS was relatively limited and contained, it is estimated that it led to a 1–2 per cent dip in growth in the East Asian economies in 2002 (World Bank 2004: 234).

⁶ ILO data for latest available year.

acceleration of industrial output. This is consistent with the sharp rise in the trade to GDP ratio doubling from 36 percent in 1982 to 72 percent in 2002, and with East Asia as a hub of assembly and manufacturing activities' (World Bank 2005: 18). The same study emphasises the greater importance of the service sector in South Asia, but there are significant inter-country differences within the region.

Box 1: The contribution of urban areas to economic growth

Urban areas account for as much as 70 per cent of GDP growth in East Asia. In the Philippines, urban areas account for 75–80 per cent of GDP and 80 per cent of its economic growth. Vietnam's urban areas contribute 70 per cent of the country's economic growth. In South Asia, Mumbai on its own is estimated to generate one-sixth of India's GDP.

Source: Jack (2005).

2.1. Growth and Poverty Reduction

The success of the Asian region in reducing poverty is well known. Taking the region as a whole,⁷ the \$1-a-day headcount ratio (the proportion of the population with a consumption level of less than \$1-a-day) fell from 34.3 per cent in 1990 to 19.3 per cent in 2003. If growth continues until 2015 at the rates seen in the period 2000–5, the headcount ratio would fall much further – to *between 2.9 and 6.7 per cent for Asia as a whole* depending upon trends in income inequality in the region (Asian Development Bank 2005c). But for *South Asia* the latest forecast (World Bank, 2006) is of *12.8 per cent living below \$1-a-day in 2015*.

The extent of Asia's success in reducing poverty is shown in Box 2: this is a massive, historic improvement in human welfare. The extent to which growth reduces poverty does vary greatly, both between countries and in the same country at different periods of time, but growth is essential for poverty reduction. The challenge is to sustain growth rates while increasing the poverty reduction impact of any particular rate of growth.

Box 2: Growth and poverty reduction – the good news

Strong growth in many Asian countries between 1990 and 2003 has already led to substantial reductions in \$1-a-day poverty. By 2003, China, Indonesia, Malaysia, Thailand, Vietnam and Sri Lanka had already exceeded the target of reducing the \$1-a-day poverty headcount by half.

While progress has been slower in South Asia, all the countries in the region⁸ would reach the income target by 2015 *if* they were able to maintain from 2003 to 2015 the rates of growth sustained from 2000 to 2004 (Asian Development Bank, 2004).

Even better, if such growth were sustained for a further decade, absolute \$1-a-day poverty could be eradicated completely from Asia by 2025.

⁷ These figures are taken from Asian Development Bank (2004). The countries included in the calculations are in East Asia (China and Mongolia), South Asia (Bangladesh, India, Nepal, Pakistan and Sri Lanka), Southeast Asia (Cambodia, Indonesia, Lao PDR, Malaysia, Philippines, Thailand and Vietnam), and Central Asia (Azerbaijan, Kazakhstan, Kyrgyz Republic, Tajikistan, Turkmenistan and Uzbekistan). These figures correspond to the estimates given in the World Bank (2004).

⁸ Though data is unclear for Bangladesh and Afghanistan.

Sustaining recent growth *will not eradicate poverty by 2015*. The growth projections in Box 2 leave between 150 and 308 million people (depending upon trends in income distribution) below the \$1-a-day poverty line in 2015, while the absolute number of people below the \$2-a-day poverty line in 2015, in the Asian Development Bank's benchmark scenario, would be between 1.2 and 1.5 billion people. The great majority of these would be in South Asia.

More importantly, the poverty outcomes in 2015 (as highlighted in Box 2) are sensitive to both growth rates and income distribution. Changes in either rates of growth or income distribution would have a substantial impact on the numbers of people in poverty in 2015.

Box 3: Growth and poverty reduction – the caveat

Where growth turns out weaker or where distributional changes work against the poor, poverty will be higher than projected. For instance for Pakistan: on the basis of benchmark growth and a more equal distribution, poverty would be *3.5 per cent in 2015*. The same growth rate, but less equally distributed, would lead to 15.6 per cent of people in poverty in 2015 while 1 per cent slower, unequal, growth would lead to *20.4 per cent in poverty in 2015* (Asian Development Bank 2004: 113). Pakistan would still meet Millennium Development Goals (MDG) Target 1, but this outcome would leave 42 million people below the \$1-a-day poverty line.

This is why the challenge for Asia is not just one of sustaining growth. Sustaining growth in the face of both endogenous and exogenous risk factors is important. And even though the link between economic growth and poverty reduction is not simple and direct – particularly with respect to non-income measures of poverty and welfare – there is a strong, positive link observed in practice: growth is necessary for poverty reduction. Poor people need to be active participants in the growth process, contributing to higher productivity and wealth generation. Slower-growing countries, slower-growing regions within countries and social groups that have so far been marginalised or excluded from the process and benefits of growth, must be brought properly into the process for Asia to achieve its fantastic potential.

3. Conclusions

This paper has examined some of the challenges facing Asian economies in the coming years as they try to achieve the objective of sustaining current high rates of growth while at the same time extending the benefits of this growth both to a broader range of countries and to the groups who have yet to benefit least from what has been a remarkable story of sustained development and poverty reduction.

More of the complexity and depth of the challenges of maintaining financial stability, investing in infrastructure, meeting rapidly expanding energy needs and improving environmental outcomes are covered in other background papers prepared for the Asia 2015 conference.

Asian countries are keenly aware of the challenges that they face and are devising and adopting their own solutions to them. Asia's success brings benefits to people in many countries around the world. There is great scope for development partnerships to contribute to meeting the challenges of sustaining growth and ending poverty.

The conference discussion will discuss and identify priority areas for action in the fields of infrastructure, energy and the environment, and its aim is to work towards identifying how new partnerships for development between the public and private sectors and between Asian countries and the broader development community can contribute to improving the welfare of poor people in Asia.

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