

Asia In The World Economy Roundtable 2018

"Growth and Inclusion in Asia"

29th – 30th November 2018

Lee Kuan Yew School of Public Policy,
National University of Singapore



 Lee Kuan Yew
School of Public Policy
National University of Singapore



Center
for Inclusive
Growth

Table of Contents

01

Introductions

About	03
Professor Danny Quah	04
Dr Yuwa Hedrick-Wong	05

02

Perspectives

Alan Beattie	06
Professor Yang Yao	08
Professor Razeen Sally	10
Dr Ganeshan Wignaraja	12

03

The Asian Economic Outlook

Summary	14
Bright spots/ Risks	16

04

Focus Issues

Asian Trade & Investment	18
The Future of Global Value Chains	23
Asian Infrastructure Connectivity	28
Inclusive Growth in Asia	33

About This Report

This report was produced by the Lee Kuan Yew School of Public Policy for the 2018 Asia In The World Economy Roundtable. It was written by Blake Berger, an associate of the School's Centre for Asia and Globalisation, and James Crabtree, who is co-organiser of the Roundtable and an Associate Professor in Practice. The authors are grateful to Byron Chong for his help researching the report.

Asia In The World Economy Roundtable



The Asia In The World Economy Roundtable will be held at the Lee Kuan Yew School of Public Policy in Singapore on 29th-30th November 2018, in association with the Mastercard Center for Inclusive Growth.

The Roundtable is a high-level forum discussing Asia in the global economy, bringing together academic experts and other policymakers from both Asia and the West.

The event involves a series of closed-door roundtable discussions for around 50 participants, followed by a public panel at the School, revolving around critical contemporary policy issues and economic developments. 2018 marks the second occasion on which the Roundtable has been held, and our intention is to make this an annual event, involving an exclusive network of scholars, policymakers and business leaders.

This year's Roundtable theme is "Growth and Inclusion in Asia", reflecting our partnership with the Mastercard Center for Inclusive Growth. However, the Roundtable's discussions will range widely, covering everything from the ongoing United States (US)-China trade war to the future of economic governance in Asia and globally.

This briefing document provides useful background material to the Roundtable on contemporary issues, as well as a series of provocative perspectives from those attending the discussions.

James Crabtree, Roundtable Co-organiser and Associate Professor in Practice

Razeen Sally, Roundtable Co-organiser and Visiting Associate Professor

Introductions



Professor Danny Quah

Dean and Li Ka Shing Professor in Economics, Lee Kuan Yew School of Public Policy at the National University of Singapore

The 2018 Asia In The World Economy Roundtable is happening at a critical juncture in our region's history. In the modern era, Asia has never been more important to global economic output than it is today. In the future, as Asia continues to grow, that importance will only grow too.

True, for the last year, much of the world's attention has still been focused on Washington DC, as President Donald Trump pushes forward with further trade restrictions targeted at China.

But this should not disguise the fact that the US is gradually becoming a less dominant part of our global system. As more of the world's growth and trade stem from Asia, Trump's successors will find themselves less able to shape the world's economic and financial rules.

This creates an important opportunity. In China and India, our region already boasts two of the world's three largest economies in terms of purchasing power parity. Many of the most globalised economies are here too, from industrial nations like Singapore to developing exporters like Vietnam, whose trade-to-GDP ratio topped 200 percent last year.

But as Asia's influence rises, its policymakers have a chance to shape a new kind of global economic order, and also a responsibility to play a greater role in running that same system.

This is not to dismiss the seriousness of our current moment. The trade war remains a major challenge. So is defending and reforming our existing open trading system. Both America and Europe must continue to play an important role in this process, as well as in shaping the future rules of the global game for the foreseeable future.

But economists and policymakers in Asia also need to do more, from finding ways to push economic integration in our region to articulating a coherent vision for Asia's global economic role.

This will not be easy. It requires a comprehensive analysis of the causes of our current disruptions, from public dissatisfaction over the pace of globalisation in the West, to demands for more inclusive growth in the East.

It also requires new determination to push the kind of structural reforms that can help developing economies reach the technological frontier, while finding new ways to invest in infrastructure and critical public goods.

Most importantly, Asia and its partners need to think afresh about how to build a regional and global economic system that is fast-growing, inclusive and sustainable — a new rules-based order which reflects the way the world economy operates today, not the way it used to.

It is for this reason above all that I am delighted that the Lee Kuan Yew School is once again able to host the Asia In The World Economy Roundtable, with support from the Mastercard Center for Inclusive Growth.

This event fills an important gap, both in building our understanding of the changing role Asia is playing in the world economy, and in creating a new intellectual dialogue between leading thinkers in Asia and the rest of the world.

Both this year and in the years to come, I believe this Roundtable can help to articulate a better vision of our future global economic order — one which works for great powers and small states alike.



Dr Yuwa Hedrick-Wong

Chief Economist and Chair of Academic Advisory Council Mastercard Center for Inclusive Growth.

This year's Asia In The World Economy Roundtable comes at an opportune moment.

On the one hand Asia has of late enjoyed a sustained recovery in growth, leaving behind lingering memories of the 2008 financial crisis. Multiple years of rising prosperity has in turn helped tens of millions of people to move out of poverty around the region.

But on the other we clearly face a range of growing economic risks, not least the increase in trade tensions between the US and China — a conflict that has the potential to escalate quickly in the immediate future.

Moments such as these make it all the more important to look again at our basic economic assumptions, and to think creatively about ways to enhance future global economic cooperation, while also focusing on the kind of growth our economies are actually producing.

Mastercard set up our Center for Inclusive Growth to develop new visions of sustainable and equitable growth around the world, including here in Asia.

Established as an independent subsidiary of Mastercard, our centre promotes this agenda through a mixture of cutting-edge economy research and practical programmes.

We believe that high and sustained growth is a critical part of the battle to spread opportunity and reduce poverty.

But sustainable poverty reduction over the long-term also requires new policies to ensure growth is widely shared, not least by promoting new ways to advance social and economic mobility and ensure access to an expanding middle class.

Countries around Asia have a strong historical record of producing growth that is both fast and inclusive. The risk today, however, is that the growth enjoyed by the region's lower and middle economies shares fewer of the inclusive characteristics which marked our earlier periods.

Indeed, the ongoing and intensifying trade war only makes this agenda even more important.

Over the coming years, inclusive growth can become an ever-more important means for driving stronger domestic demand, which could in turn help to offset some of the negative effects of the ongoing trade issues.

More inclusive patterns of growth should also allow Asia's emerging markets, and especially their most vulnerable people, to better withstand a generally more uncertain and volatile global economic environment.

For this reason, we at the Center for Inclusive Growth are delighted to work with the Lee Kuan Yew School of Public Policy to support this year's Roundtable, on the theme of "Growth and Inclusion in Asia". We look forward to a constructive series of discussions as we all try to build a new and inclusive economic agenda for our entire region.

Perspectives



Asia's Trade War Task: Minimising the Damage

Alan Beattie

European Editorial Writer, Financial Times

For trading powers like the European Union (EU), having to delicately navigate between the US and China during President Donald Trump's trade war is a somewhat novel and unsettling experience. For many countries in East and Southeast Asia, it is only an intensification of a diplomatic battle for regional hegemony over the trading regime that has been going on for more than a decade.

The two trading superpowers have spent years laboriously planting and pulling up thickets of abbreviations in the hope of establishing themselves as the regional leader. The US sought to fashion the Asia-Pacific Economic Cooperation (APEC) into a free trade area of the Asia-Pacific (FTAAP), and more concretely drove forward the Trans-Pacific Partnership (TPP) with narrower country coverage but much deeper treatment of regulations, IP, data and other behind-the-border issues. Meanwhile China went broad and shallow, pushing the Regional Comprehensive Economic Partnership (RCEP) which essentially knitted together the ASEAN bloc and its existing bilateral trade agreements – and which excludes the US.

But tensions over this skirmishing for influence have rapidly escalated in the form of Trump's extraordinary deployment of bilateral ordnance against China. With the US having abandoned the TPP – which in any case covers only part of the region – and RCEP being nowhere deep enough to substitute for the multilateral system, the theatre of combat has somewhat enlarged. At stake in the game of triangulating between Washington and Beijing is now the defence of the entire global trading order.

The power of the US to bully even substantial economies in Asia was evident early on in Mr Trump's crusade. South Korea was one of the first countries to give in to the threat of Section 232 steel and aluminium tariffs and agree to change

its existing bilateral deal with the US, accepting quantitative US import quotas on steel that looked like a relic of the protectionism of earlier decades.

To its great credit Japan, by contrast managed to hold out against US pressure and continue to support collective processes for longer than most economies – including even the EU. Most obviously Tokyo revived and completed the TPP after the US's departure, ditching some of the more restrictive provisions on intellectual property but maintaining the relatively substantial treatment of data flows.

More importantly from the point of view of coaxing the US back into the multilateral system, Tokyo also convened the trilateral initiative with the EU and the US to try to direct Trump's anger at China down multilateral channels. The US is, at least, engaging in the process, while not abandoning its preferred route of bilateral force. It, Japan and the EU brought a World Trade Organisation (WTO) action against Chinese technology transfer earlier this year, despite Washington starving the WTO appellate body of judges.



At the same time, while they have both been pressured into direct bilateral talks with the US, Japan and the EU have also opened up conversations with China to demonstrate even-handedness – in Japan's case in particular as part of a general rapprochement across a number of policy areas.

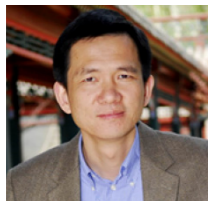
For the other economies in the Asia-Pacific, it would seem likely that the best they can do is to take similar positions and swing behind initiatives already under way. The EU and Canada have led a process of reforming the WTO to placate US concerns about the dispute settlement system and its weak disciplines on subsidies.

Pushing that conversation forward without alienating China to the point that it refuses even to participate in the discussion will be helped by a critical mass of countries joining in.

New Zealand, Australia, South Korea and Singapore were part of the recent ministerial meeting in Ottawa to discuss initial WTO reform proposals. Since China does not want to be the only (self-defined) developing economy involved in the conversations, it would be helpful at some point for other emerging market economies to come on board.

Living in the shadow of two rival hegemonies is never going to be easy, and minimising damage to themselves rather than striking out positively to end the US-China trade war is likely to be the most that the majority of Asian economies can realistically achieve. But those constructive initiatives are underway, led by the bigger powers like Japan and the EU, can do with all the support they can get.





China Risks Misreading Trump on Trade

Professor Yang Yao

China Center for Economic Research, Peking University

In China, most analysts and government officials misread President Donald Trump's trade war as a well-orchestrated plan to stop their second centennial goal of building a strong, modernised country. Many of them believe this approach stems from US fears that China will soon become the world's primary power. There is no doubt this fear is indeed shared by some segments of the American establishment. But it is a misunderstanding to think that Trump's trade plan is primarily about containing China's rise.

In fact, the trade war is in large part designed to appease America's silent majority: low-income white voters. Trump's win in 2016 tells us how badly this majority dislikes their country's establishment, a point that American liberals, or "white leftists" --- as they are sometimes called by Chinese Americans --- do not fully grasp.

However, for the US, the trade war is not actually about balancing the trade. It would be simplistic to believe that Trump and his team, including trade advisor Peter Navarro, would think Sino-American trade imbalances can be eliminated in this way. Instead, as well as aiming to bring jobs back to the US, the trade war serves two other fundamental purposes.

The first is to level the playing field for US businesses competing with Chinese companies. Over recent decades the US government tolerated China's mercantilist approach because its elites believed bringing China into the global system would draw it closer to the US. But this belief had already begun to wither during the Obama administration.

America's change of heart was reflected during negotiations for a possible Bilateral Investment Treaty, when the US made clear it wanted either a "platinum" agreement or nothing. China found the conventional bargaining chips it used to win round the US — gradually cutting tariffs and opening domestic markets, or purchasing more American goods — no longer worked.

Trump has merely accelerated this approach, despite often blaming Obama for failing to deal with trade imbalances.

The trade war's second purpose is to compensate for a kind of regret. US elites long wished to draw China into the American sphere. The years following the global financial crisis proved this was unrealistic. China has benefited from its distinctive economic model, while its political system has become stronger.

It is an unspoken regret among American elites that the US treated China "too nicely" in the past. To compensate, now they want a correction. America's moves against China are not geared so much to stop China's bid for supremacy, because not many American elites actually believe the US will lose its supremacy in the near future. Rather, it is to correct its own past "mistakes".

Unfortunately, most Chinese analysts and government officials do not understand this. Instead they believe the trade war marks the start of a new era of explicit competition between China and the US.



Accordingly, China shows no signs of giving ground to US demands for substantial economic changes, especially regarding subsidies to state-owned enterprises, industrial policy, and opening of domestic markets. This leads the trade war into a dead end.

The best strategy for China is instead to focus on policies that can be positive for both the Chinese economy and its people. If tariffs are bargaining chips on the negotiation table, China should simply take steps gradually to get rid of them. If state-owned enterprises are inefficient, China should not resist reforming them simply because the US asks for it. If industrial policy implies wasteful subsidies, China should review it and comply with international practices. If protecting domestic markets no longer improves domestic capacity, China should not be shy about removing protections only because the US has also asked it to do so.

With Trump in office, there is little hope that there will be any change of direction on the US side. His first one and half years in office have shown that President Trump is not someone who just wants to cut deals. He wants real changes, be it bad or good. To unlock the deadlock of the US-China trade war, China needs to take the lead.





International Trade: A Bleak Outlook

Professor Razeen Sally

Visiting Associate Professor, Lee Kuan Yew School of Public Policy at the National University of Singapore

A new protectionist era began earlier this year, following a decade of stalled liberalisation after the global financial crisis, and unprecedented liberalisation and globalisation in the quarter-century before.

US actions, especially tariffs aimed at China, have sparked tit-for-tat retaliation. Other developing countries are starting to copycat this — note India's recent imposition of import controls on balance-of-payments grounds. The World Trade Organisation (WTO) is in existential crisis, with its dispute-settlement mechanism close to collapse.

The causes of this new protectionism are threefold: first, what has been until recently a depressed post-crisis global economy; second, an anti-globalisation backlash in the West (although not so far in the Rest); and third, China's predatory industrial policies, which have spilled over into protectionism and distorted world markets.

In the short-term protectionism will probably accelerate, especially in US-China relations, spilling over from tariffs to regulatory restrictions and sanctions on high-tech goods and services. More copycatting protectionism can be expected, starting with India, Brazil, Indonesia and South Africa. The WTO's dispute settlement system may well collapse.

If this happens international trade will slow down markedly, and possibly derail the current global economic recovery. Trade uncertainty will dampen already low global productivity growth, making global growth prospects even bleaker.

Global value chains will be disrupted and reoriented. Multinational enterprises will shorten and regionalise production networks. The big losers will be developing countries, especially smaller and poorer ones, which will lose labour-intensive niches as multinationals automate production and concentrate on major national and regional markets.

What can be done to prevent this protectionist spiral?

Damage limitation is imperative, with two priorities. First, a US-China accommodation, or at least a truce, which would discourage others from more copycatting protectionism. Second, WTO reform of the dispute system, to persuade the US to remove its block on appointing new members to the Appellate Body.

These are crisis flashpoints, however, so there are no easy answers. If that damage limitation succeeds, what else might be done to revive a more liberal trading system?

First, governments must find ways to revive unilateral liberalisation, meaning bottom-up liberalisation outside of trade negotiations and trade agreements. Coupled with domestic market reforms, this was the motor of globalisation before the crash.

This might seem unlikely in today's climate. But constituencies with a strong stake in it — for instance multinationals, small and medium-sized enterprises plugged into global value chains, as well as cities and sub-national regions seeking to be magnets for investment — all have incentives to act.



Second, WTO rules need to be reformed to catch with up twenty-first century trade. Existing agreements should be strengthened, for instance on services, state-owned enterprises, subsidies and China's market-economy status. New agreements are needed too, especially on digital trade and foreign direct investment.

This can only be done in "coalitions of the willing", meaning subsets of WTO members that account for the bulk of trade and investment. There are potential trade-offs and deals in sight, not least between the US and China. But it requires negotiating will, and about ten other WTO members (counting the EU as one).

Third, most free trade agreements actually will do little to liberalise trade. In Asia, the Regional Comprehensive Economic Partnership, if concluded and ratified, will be incremental. It is "trade-lite", removing most tariffs but not tackling non-tariff barriers that are bigger obstacles to cross-border trade. China's Belt and Road Initiative will make more of a difference — good and bad — to intra-Asian trade.

The renamed Comprehensive and Progressive Agreement for Trans-Pacific Partnership is the one trade deal that would give trade a big boost, especially, were the US to join it at a future date. It is a "deep-integration" agreement, whose rules tackle regulatory barriers while also addressing new issues such as digital trade.

Finally, in an even larger frame, consider the link between trade, geoeconomics and geopolitics. A new era of competition between rival economic systems has begun. During the Cold War, the West faced off against the Soviet Union. Now the rivalry is between varieties of liberal-democratic, market-led capitalism, on the one hand, and authoritarian, state-led capitalism in China, on the other.

The rules of the game for trade in Asia will inevitably be shaped and reshaped by this new Great Game. Understanding how a new era of geopolitical competition can ruin or rescue our existing liberal trading system is now an urgent priority.



Asia's New Middle Income Challenge

Dr. Ganeshan Wignaraja

Executive Director of the Lakshman Kadirgamar Institute of International Relations and Strategic Studies

Decades of sustained economic growth has left the Asia-Pacific region with very few lower income countries. In the future absolute poverty will keep falling too. This is a cause for celebration. But it also requires a new policy agenda to respond to the specific development challenges that arise as Asia becomes a firmly upper middle-income continent.

The scale of this change in Asia is immense. In 1990, more than 80 percent of those around the world living in extreme poverty — estimated at \$1.25 per day, measured by purchasing power parity — lived either in East Asia and the Pacific, or South Asia. Today that number is far smaller, and getting smaller still. By 2030, just 0.1 percent of the population of East Asia is expected to live below the extreme poverty line. In South Asia the figure will be only 2 percent.

Put another way, half of the world's population in 2025 will likely live in Asian middle-income countries. Today, almost all of the region's nations already enjoy middle income status. Ever more of them are now moving beyond the threshold of around \$4,000 per capita that signifies a shift from lower middle-income to upper middle-income status. By 2025, only Afghanistan and Nepal are expected to remain officially poor.

This improved status is obviously positive. Many millions have been lifted out of extreme poverty over the past decade alone, with just as many now able to benefit from improved social services, notably education and health facilities. But it also requires a rethink both of the kind of policy obstacles that emerging Asian countries must now overcome, and also the way in which they interact with development institutions.

For starters, middle income status does not mean development gets suddenly easier. Although the growth of many Asian countries post-global financial crisis has been robust, many regional middle-income economies continue to suffer from persistent pockets of poverty, while their people remain vulnerable to income shocks.

Viewed on broader measures of human development, Asia today still ranks lower than the average for regions like Latin America and the Caribbean. Taken together, Asia-Pacific nations also lie below the global average for the Human Development Index, a measure often used by the United Nations.

Some countries also continue to confront fragile situations associated with long-term and often subnational conflict. An ageing population is another challenge particularly in China and East Asia. This will translate into rising dependency ratios, increasing old age care costs and probably higher taxation.

Moving nations out of extreme poverty also tells us relatively little about the extent to which their people are vulnerable to falling backwards. This vulnerable share is rising around Asia, meaning those who hover precariously above the poverty line but do not advance quickly towards the middle class. In countries from India to Indonesia to the Philippines and Bangladesh, this category now covers hundreds of millions of citizens.



Finally, although growth has lifted millions above the breadline, the quality of that growth has also not always been pro-poor. In particular, recent decades have often exacerbated income inequality levels within many Asian countries including Bangladesh, Cambodia, India, Sri Lanka, Vietnam and Papua New Guinea.

All of these changes require different policies by governments, both to continue to push growth but also to make it more equitable. Yet Asia's new middle-income era also poses searching questions for global development institutions too, as I argued in a recent co-authored report published by the Overseas Development Institute.

Improved income status means important aspects of Asia's development finance landscape are now quickly changing. As countries become wealthier the sources of finance and financial instruments available to them change too, as will the volume of aid they receive and the conditions attached to it. Borrowing from international capital markets will become more important, with rating agencies influencing the terms on which they can do so.

Middle-income status is often considered a signal for a successful development trajectory, hence the rationale for bilateral and multilateral development partners to play a progressively smaller role.

But development bodies in Asia should not move from an aid relationship simply to no relationship at all, however. Instead, they need to create a new and different kind of relationship, based at first on a mixture of aid and trade, and, eventually, trade and private investment alone — in the process finding new ways to help transform Asian nations whose development journeys are only at most mid-way complete.

The Asian Economic Outlook

Summary

Global growth remains resilient, with the world economy enjoying its strongest period of sustained expansion since the financial crisis ten years ago. However, early signs suggest that a range of risks, most prominently the escalating trade tensions between the US and China, are beginning to weigh on that expansion, prompting the International Monetary Fund (IMF) to trim its global growth forecasts for this year and next to 3.7 percent.

Asia, the world's fastest growing region, shows similar trends. Its recent period of expansion continued in the first half of this year, while the Asian Development Bank (ADB) maintains its forecast for 6 percent growth in 2018. Relatively robust trade and investment, booming middle class consumption and resilient domestic demand emerged as bright spots supporting regional growth.

For all the positive numbers, a range of risks still needs to be addressed, from rising protectionism and monetary tightening to rising debt and inequality levels. Recent surveys suggest global growth, while strong, is also becoming unbalanced, depending on a main US motor but with potential slowdowns looming elsewhere, including in the Asia-Pacific. There are also questions about the sustainability of US growth, if its fiscal stimulus peters out and debt-servicing worries resurface.

China shows signs of a slowdown, with the ADB cutting its forecast next year to 5.8 percent. A recent survey of financial analysts and forecasters from Focus Economics, a consultancy, also suggested that growth across larger emerging Asia nations would dip to 5.8 percent next year, its lowest level in nearly two decades.

Regional Growth

Despite worries about geopolitical turbulence, most of Asia's component regions remain fairly stable. East Asian growth will remain upbeat during 2018 at 6 percent, according to the ADB. Southeast Asia will grow by 5.1 percent and South Asia by 7 percent.

China slowed to 6.5 percent in the third quarter, a level that is expected to decline slightly to 6.3 percent next year, pushed down in part by the impact of tariffs. If tensions intensify and structural reforms move slowly, growth projections may fall further.

Trade tensions are also worrying for South Korea, where China and the US accounted for 25 percent and 12 percent of the country's exports last year 2017. Forecasts for South Korea's GDP growth for 2018 range between 2.7 and 3.0 percent, and between 2.9 and 3.2 percent for 2019.

Driven by growing exports, business investment, and private consumption, Japan's economy is slated to grow by 1.25 percent in both 2018 and 2019. Rising debt and trade tensions also pose significant risks, raising further concerns over the limitations of Prime Minister Shinzo Abe's 'Abenomics' reform programmes.

In Southeast Asia, Vietnam and the Philippines lead regional projected GDP growth, with 7.1 percent and 6.8 percent respectively. Growth in Singapore, Indonesia, and Malaysia is expected to ease in 2018, while the smaller economies of mainland Southeast Asia continuing to display robust growth.

South Asia continues to show the region's fastest growth, with India set to maintain its position as the world's fastest growing major economy. Driven by higher government spending and consumption, it is set grow at 7.3 percent and 7.6 percent in 2018 and 2019. By contrast, the outlook for smaller South Asian economies may dip slightly, with growth projected to slow slightly across Nepal, Bangladesh, Bhutan, and Afghanistan this year.





Bright Spots

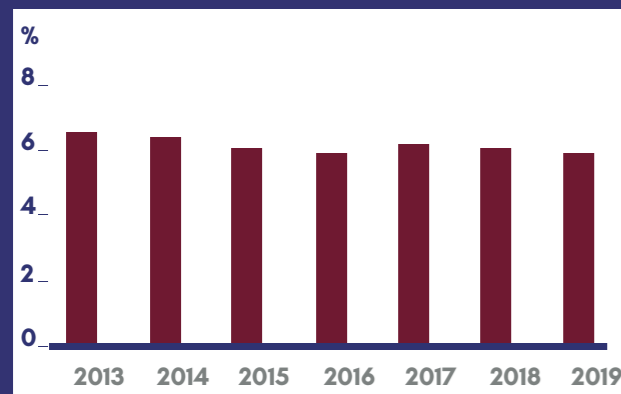
An investment-led recovery has bolstered trade growth over recent years, stemmed capital outflows, and increased commodity prices. Although trade moderated between 2015 and 2016, it is still expanding more quickly than growth overall.

In 2017, global trade grew by 4.5 percent, boosted by machinery, electronics, and semiconductors, while recovering commodity prices boosted exports for commodity exporters. This helped sustain growth in China, Malaysia and the Philippines, all of whom are leading for semiconductors and integrated circuits.

Rising domestic demand has been an important factor supporting Asian growth in the decade following the financial crisis. Consumer and producer confidence remain strong, boosted by robust private sector investment, tight labour markets and accommodating government policies.

Increases in middle class consumption have helped to sustain growth too: 90 percent of the next billion members of the global middle class will be from Asia, according to academic estimates: 350 million Chinese, 380 million Indians, and 210 million other Asians.

Growth Outlook for Developing Asia



Source: Asian Development Bank

Unemployment rates have generally fallen throughout Asia along with growing wages, while poverty rates have continued to decline. Looked over the last decade and a half, World Bank data suggests these reductions have seen the size of the economically secure and middle-class more than triple across the region.

Risks

Despite positive recent growth figures, significant risks are likely to weigh on future Asian growth, the most obvious being rising protectionism stemming from the Trump administration's trade policies, to which many Asian economies are vulnerable.

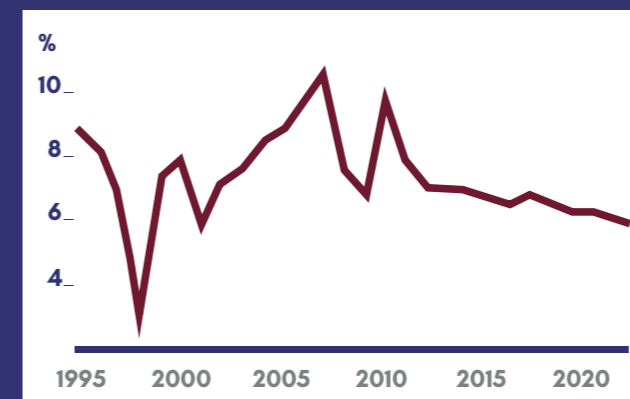
The US-China dispute began in February with tariffs on solar panel and washing machine imports, followed by waves of new restrictions on both sides, which the US justified in part as response to protectionism on the Chinese side. Further escalation may hit emerging Asian economies, raising consumer prices and production costs, while also hitting the global value chains upon which Asian exporters depend.

The danger is now of a rolling cycle of tit-for-tat retaliation among the major powers, beginning with the US and China, and copy-catting by other developing countries, for instance India, which introduced limited tariffs earlier this year and recently justified a series of import restrictions in order to protect its balance-of-payments.

Policymakers have tried to ameliorate these risks by pushing new trade deals, seeking to finalise both the renamed Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) and Regional Comprehensive Economic Partnership (RCEP). CPTPP is now concluded and could be in force by next year. RCEP could see a breakthrough after many years of negotiations, but concerns remain over its scope, depth, and implementation.

Advanced economy monetary normalisation is also likely to challenge emerging Asia's economic stability, prompting capital outflows, pressuring regional currencies and exposing weak corporate sector balance sheets. In this scenario

Growth Outlook for Asia-Ex Japan



Source: Focus Economics/ Financial Times

corporate spending is likely to be constrained, forcing financial institutions to prepare for rising solvency risks. Global liquidity reduction could also lower imported demands, pressuring trading nations.

Global monetary tightening may also expose problems linked to rising debt levels, which have been increasing across the region for the last decade, as low global interest rates encouraged high borrowing by households, companies and states.

Although most of the world's debt is held by advanced economies, increases in China have been a particular worry, contributing 43 percent to total increases in global debt since 2007, according to the International Monetary Fund (IMF). Standard and Poors estimates that debts across the Asia-Pacific will grow by \$67.4 trillion in 2018.

Rising government debt-to-GDP ratios have also sparked anxieties. China's government debt is expected to top 51 percent in 2018, with India's ratio forecast to hit 70 percent. Household debt has ballooned too, reaching 95 percent of GDP in South Korea, 68 percent in Malaysia, and 70 percent in Thailand.

Although poverty rates around Asia have continued to fall dramatically over recent years, the same cannot be said for inequality. Income inequality, as measured by the Gini coefficient, has risen by over five percentage points across the Asia-Pacific over the last 20 years.

The advent of the "fourth industrial revolution" could compound some of these trends towards rising inequality, in particular as technological advances and automation hit regional labour markets. The International Labour Organization estimates that more than half of jobs in lower middle income economies such as Cambodia, Indonesia and Vietnam may be at risk due to automation over the next several decades.

New communication technologies may however hold out the possible promise of creating new labour-intensive niches, allowing companies in early developing countries to find new opportunities as part of global value chains in both manufacturing and services, potentially compensating for other job-reducing effects.



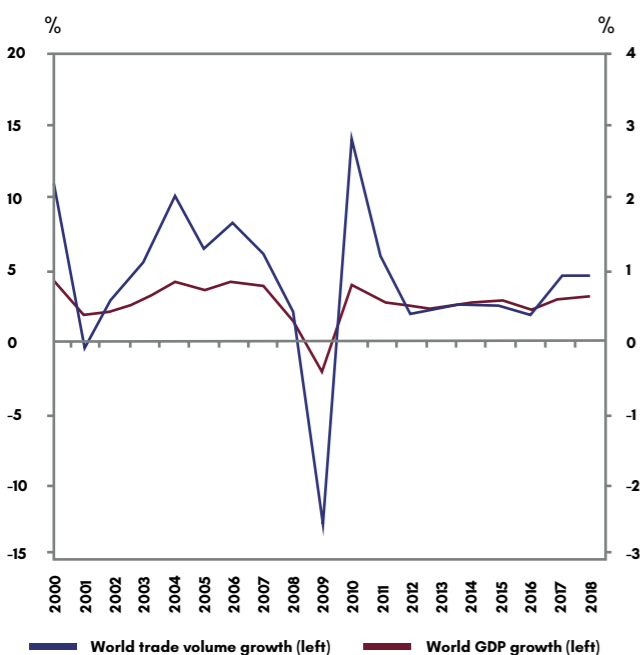
Focus Issue (1)

ASIAN TRADE & INVESTMENT

Summary

The world trading system faces its most severe challenge in decades, in the form of escalating restrictions placed by the US upon China in response to alleged Chinese protectionism, and the risk that further measures will hit global growth. A full-blown trade war looks at least conceivable, with growing US protectionism mixed with tit-for-tat retaliation from China, and potentially other major economies including the EU, India, Indonesia and Brazil. Even if that scenario is avoided, rapid steps will be needed to protect the global trading system and arrest a drift towards protectionism.

Global GDP vs Trade Growth



Source: World Trade Organisation

State of Play

The US-China trade war shows no signs of slowing, as both sides raise the stakes through reciprocal rounds of tariffs. As of September, the US has levied \$200 billion in tariffs against Chinese imports, while China had retaliated with \$60 billion in return. President Donald Trump has threatened further rounds of restrictions. The WTO's most recent projection cuts trade growth next year to 3.7 percent, citing both existing trade restrictions introduced between the US and China and the climate of uncertainty they have created.

These restrictions come at a paradoxical moment, given that 2017 represented the strongest expansion in global trade since the financial crisis, with global merchandise trade expanding by 4.7 percent. This remains well below the peak of the pre-crisis decades, when trade often expanded at twice the rate of global growth. Nonetheless, it has represented a marked recovery from the immediate aftermath of the crash.

As the US pushes its new protectionist agenda, Asia has also shown signs of building new partnerships to sustain the global trading system. Despite the Trump administration's withdrawal from the TPP, the deal's remaining 11 members formally signed the treaty in March. In July, Japan and the EU also signed a new trade deal, while ASEAN and its six partners continue gradually to advance negotiations on the RCEP.

The recent picture on foreign direct investment (FDI) has been less positive with global investment flows falling 23 percent in 2017 to \$1.43 trillion. Asia's position was brighter, however, increasing its share of worldwide inflows from 25 percent in 2016 to 33 percent in 2017, regaining its status as the largest regional FDI recipient. New FDI restrictions may soon be targeted at China, however, with both the US and the EU pondering measures citing national-security and industrial concerns about Chinese appropriation of technology.

Recent Developments

As the US and China continue their tit-for-tat dispute, the potential for adverse spillovers around Asia are significant. Even if other countries do not choose to introduce tariffs, the effect of existing trade restrictions is likely to hit business confidence, lower investment levels and force companies to considering altering supply chains.

China is especially vulnerable, given 30 percent of its total exports in 2018 were processed and assembled products that included other countries' components and inputs. Other trade-dependent nations could also be affected: estimates from DBS, a bank, suggest that trade restrictions could see a 0.8 percent reduction in Singapore's growth in 2018.

While the trade war threatens growth throughout Asia, it may still offer opportunities for some Asia countries, especially those positioned to benefit if global companies move production out of China. However, the possibility of such short-term benefits needs to be balanced against the potential impact of rising cost of trade more generally, which could cause global manufactures to reduce production and relocate facilities outside Asia altogether.

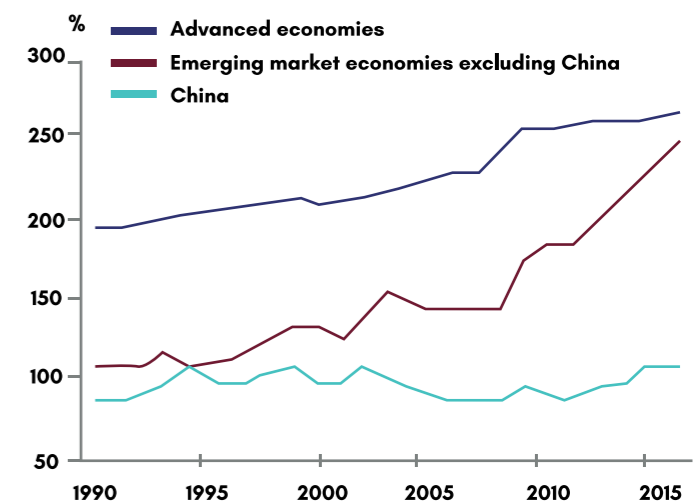
Despite these protectionist worries, Asia has made progress on regional trade agreements. The TPP, initially begun by a small group of Pacific-rim countries, was agreed in early 2016 following 19 rounds of negotiations. Despite the subsequent US withdrawal, those remaining signed the renamed Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) earlier this year.

Heralded as a template for modern trade agreements, the agreement aims to remove an estimated 95 percent of tariffs on goods traded between its members. CPTPP members account for around 14 percent of global GDP and world trade, respectively. More important, the agreement is both wide and deep, tackling non-tariff barriers as well as tariffs in goods, services, investment and other areas. As of October 2018, Australia, Mexico, Japan, Singapore and New Zealand have ratified the agreement, although other members are expected to do so soon.

Launched in November 2012, RCEP is a planned trade agreement between the ten members of ASEAN, Australia, China, New Zealand, India, Japan, and South Korea. Although less far-reaching than the CPTPP, a future RCEP deal would nonetheless help its members rationalise various bilateral trade deals, sometimes known as the "Asian noodle bowl".

So far its members have held 22 rounds of negotiations, although only four areas are understood to have been agreed on, covering economic and technical cooperation, small and medium enterprises, customs procedures and trade facilitation, and government procurement.

Rising Debts in China



G20, emerging market and Chinese gross debt to GDP ratios (percent)

Source: International Monetary Fund

Key Questions

Is Asia facing a protectionist surge?

Protectionist pressures are clearly rising globally. The risk is that new US restrictions will now increase pressure for retaliatory measures, not just from China but from others around the region, most likely in form of new unilateral tariffs and nontariff barriers (NTB). Even before the present trade war, recent years have seen a steady increase in both non-tariff barriers and other anti-trade measures.

Growing trade disputes could also include further appeals to the WTO, although these would arrive at a time of near paralysis at the global trade body, whose disputes settlement mechanism stands in limbo, following the US decision to veto new appointments at its appeals court.

However, there remain reasons for optimism. Unlike other regions, Asia has made some progress developing new plurilateral trade deals. There is also evidence that regional integration around Asia is increasing too: the ADB suggests trade within Asia rose to 60 percent of the regional total, overtaking North America's total of 56 percent, although much of this is supply-chain trade remains heavily dependent on demand from the US and EU.



What is the future of mega-regional trade agreements in Asia?

While the CPTPP has yet to be fully ratified and RCEP has not concluded its negotiations, there are concerns that the two competing agreements could add complexity to the region's trade regime, potentially hindering trade facilitation as businesses have to contend with the respective agreements and their differing rules.

Although RCEP members hope to complete the agreement next year, the deal is likely be modest in terms of coverage, while reducing fewer tariffs and non-tariff barriers than other comparable agreements. On the other hand, both mega-regionals, if and when in force, could facilitate trade and investment through tariff removal, lessen red tape, and reduced NTBs.

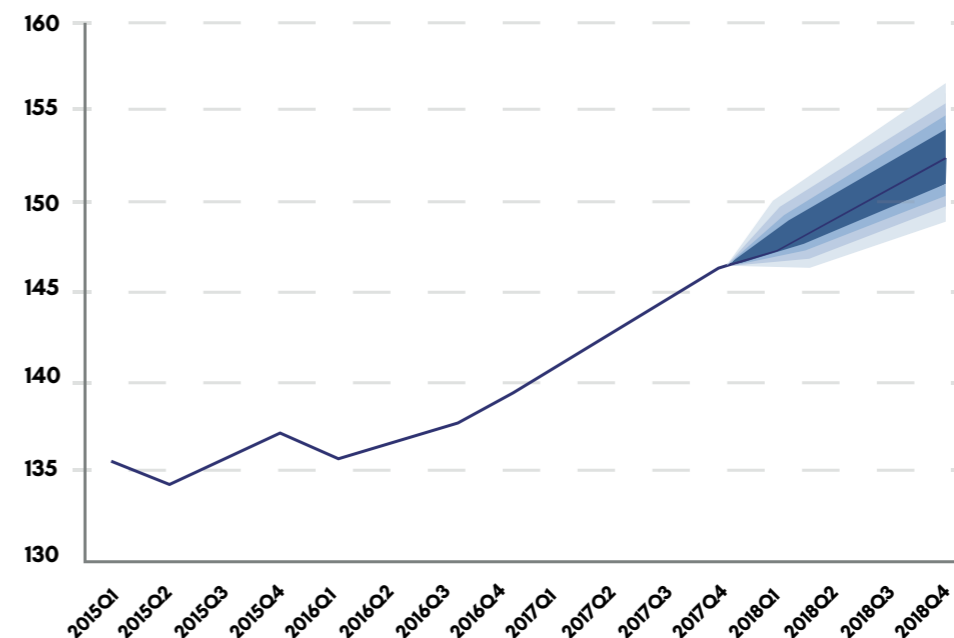
CPTPP, once ratified, may in time enlarge to include countries like Thailand, Indonesia, South Korea, and Taiwan, all of whom have expressed interest in joining the multilateral pact. As Brexit continues to raise uncertainty in the UK, Japan and Australia have stated that Britain would be welcomed to join the CPTPP.

How can Asia shape regional and global trade governance?

Asian nations now face a choice as to whether they gradually mimic some of the protectionist measures introduced by the US and China, or argue for steps to strengthen the existing international multilateral trade regime and liberal order. Recent actions by the US also leaves the field open for China to assume trade leadership in Asia, which would complement its leadership in regional cross-border infrastructure.

There remains plenty of measures that could bolster trade dynamism, from ratifying the CPTPP and RCEP to other measures enhancing regional integration and improving trade facilitation, for instance by eliminating non-tariff measures. Asian nations might also make the case for social policies capable of buttressing public support for liberalisation, for example by examining carefully-targeted and well-designed policies to help workers and businesses affected by changing trade and macroeconomic patterns.

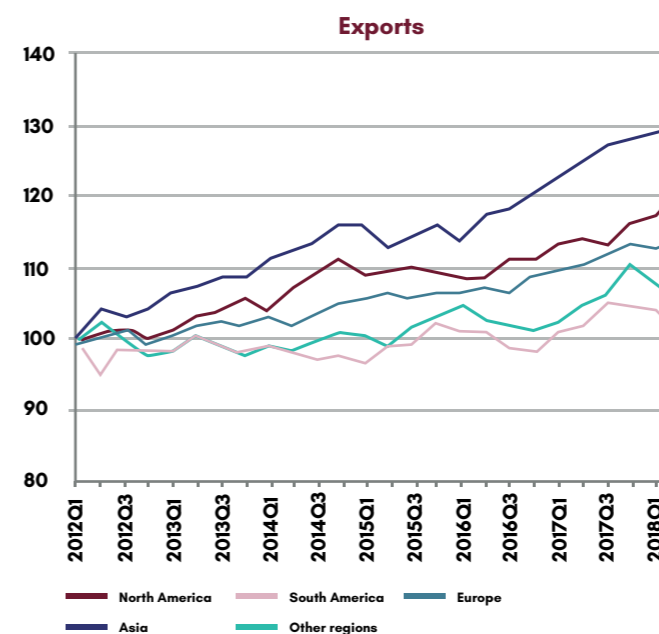
Global Trade Growth Outlook



Volume of world merchandise trade seasonally adjusted volume index, 2005=100

Source: World Trade Organisation

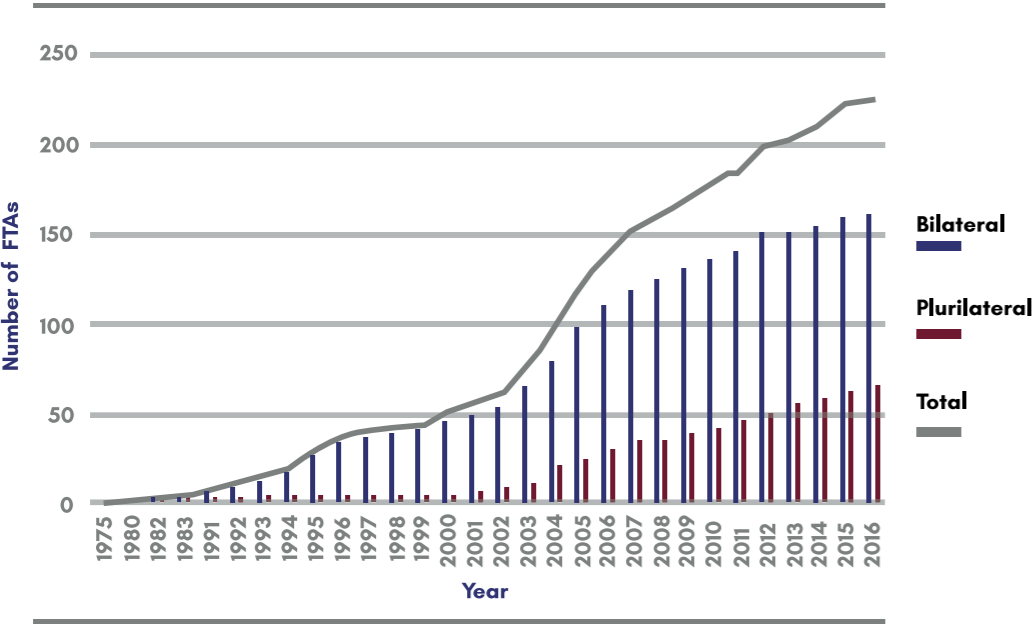
Trade Export Growth by Region



Volume index, 2012Q1=100

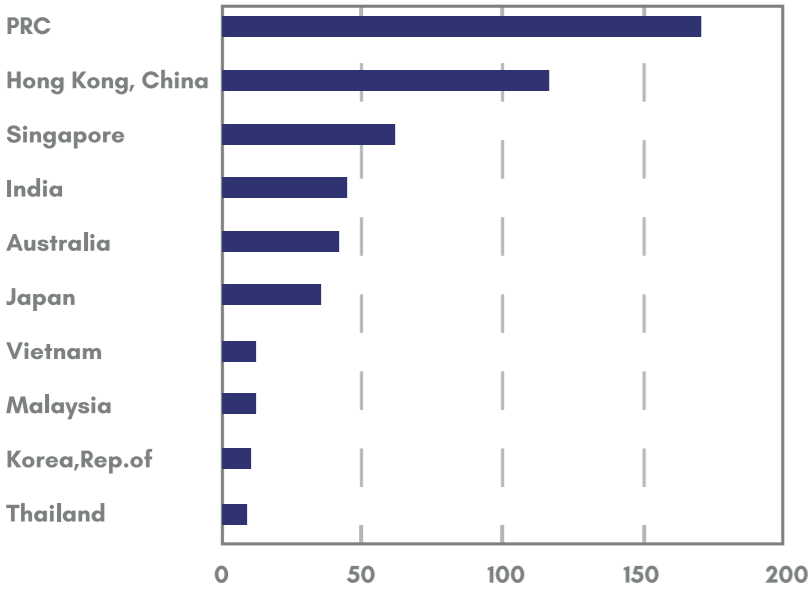
Source: World Trade Organisation

Growth of Free Trade Agreements in Asia



Growth of Free Trade Agreements (FTAs) in Asia, 1975 - 2016
Source: Asian Development Bank, CNBC

Top Asian FDI recipients



Top 10 economies in Asia and the Pacific in term of net inflows of foreign direct investment, latest year (\$ billion)
Source: Asian Development Bank

Focus Issue (2)

THE FUTURE OF GLOBAL VALUE CHAINS

Summary

Global value chains (GVCs) have transformed international trade over recent decades, creating complex cross-border flows of components and services, many of which run through emerging Asia. The ongoing trade war now raises questions about the future of these GVCs, alongside the more basic supply chains that underpin them. In a new world of higher trade costs and policy uncertainty, multinational companies may choose to move some production closer to western markets, potentially damaging growth in Asia.

State of Play

The expansion of international supply chains has been a major factor in Asia’s economic development. In the early stages of the region’s emergence, basic supply chains helped to facilitate trade in goods. More recently, GVCs have connected Asian producers to more sophisticated networks of intermediate inputs and services.

Access to supply chains helps many Asian firms participate in global trade, while also underpinning regional economic integration, raising corporate productivity and helping to upgrade infrastructure and logistics. The United Nations Conference on Trade and Development (UNCTAD) estimates that 80 percent of global trade in exports is now directly linked to goods traded by multinational corporations in this way.

Other research suggests that access to supply chains can help smaller economies and companies take a first step into global-scale production, then in turn facilitating entry into higher value-added activities. This is especially important for economies at an earlier stage in their development, as they seek to build export volumes and raise domestic productivity.

If the current trade war continues to escalate, contagion effects could ripple along Asia’s supply chains, hitting countries with links to China in particular. Any moves by the US or China to disrupt one another’s supply chains could have a chilling effect on trade growth. But even more limited actions, such as the imposition of further tariffs, now risks pushing global producers to restructure and shorten their existing supply chains.

Global value chains are also developing in new ways due to digital technology, for instance with the regional and global ecosystems that revolve around big tech companies such as Facebook, Amazon, Alibaba and Tencent. These platform-based value chains could also be badly affected if the trade war spills over into greater services barriers and digital protectionism.





Recent Developments

New trade restrictions between the US and China have already had far-reaching effects upon particular sectors. Soybean exports from the US have declined sharply in response to Chinese tariffs, for instance, while exports from Brazil to China have increased in response. Similar pattern has been seen in seafood, where tariffs have hit Chinese fish exports, and Chinese consumers have begun to import lobsters from Canada rather than the US.

So far, however, there have been fewer signs of significant restructuring of GVCs in more complex areas like electronics and smartphone production. Although 60 percent of American businesses polled recently by the American Chamber of Commerce stated that tariffs have affected their business in China, nearly two-thirds reported they had neither plans to relocate production nor were they considering such a move.

The US administration has expressed hopes that domestic companies operating abroad in sectors like electronics and automobiles could pull production back home, with President Trump calling on businesses in September to make products “in the United States instead of China”. So far few have done so, given the cost and capacity constraints involved.

If the US-China dispute escalates, some multinationals could reduce reliance on Chinese production, potentially developing more regionally-based manufacturing networks, in an attempt to shorten supply chains and mitigate risks posed by escalating tariffs. This could benefit some Asian economies, although it would likely reduce economies of scale and eventually raise costs for consumers.

Rising tensions between the US and China pose wider threats to supply chains, for instance as concerns over intellectual property and data security grow. Recent allegations published by Bloomberg concerning allegations of Chinese espionage have prompted some global technology companies to review their manufacturing operations.

In a Reuters poll in October, 40 percent of Japanese businesses reported the trade war would disrupt supply chains over the next three years, citing fears that prices for raw materials and parts would increase as goods ended up being produced in more expensive countries with more costly inputs.

Moves to shorten GVCs could also affect the future development of lower-middle income Asian states, such as India, Myanmar and Vietnam. All of these states hope in the future to integrate their domestic economies into international supply chains, in part by exporting finished products but also through “backward participation”, meaning importing intermediate inputs which can be included in these exports.

There are still countervailing forces that could protect GVCs from the current period of turbulence, not least the fact that those seeking to unwind international production face complex choices about where exactly to relocate. Companies like Apple with sophisticated production ecosystems in eastern Asia may simply be unable to find alternative facilities to produce comparable components in more expensive locations. If they did manage to do so, they and other industrial world producers would suffer higher prices and reduced profits.

Although unrelated to trade policies, trends in information and communication technologies are likely to continue to underpin new GVCs. Further improvements of these technologies in the future are likely to continue to tempt companies to move production in ways which will lower costs and raise productivity.

Information technologies revolving around automation will likely shorten value chains by cutting out labour-intensive tasks and stages of production. Communication technologies such as telemedicine and telerobotics will create new labour-intensive niches in developing countries in new services value chains.

Key Questions

Will global companies move production out of China?

Although further rounds of tariffs between the US and China are likely to cause global companies to consider relocation, leaving China is not easy. Even for American companies subjected to the tariffs, China is often their sole source of supply, with no obvious alternatives, according to the US National Retail Federation.

Companies could consider moving production to Southeast Asia, although many emerging countries in the region lack China’s reliable infrastructure and well-established production capabilities. Other contributing factors could push producers to shift production, however, not least the fact that China’s manufacturing wages have tripled over the last decade, while productivity growth has declined.

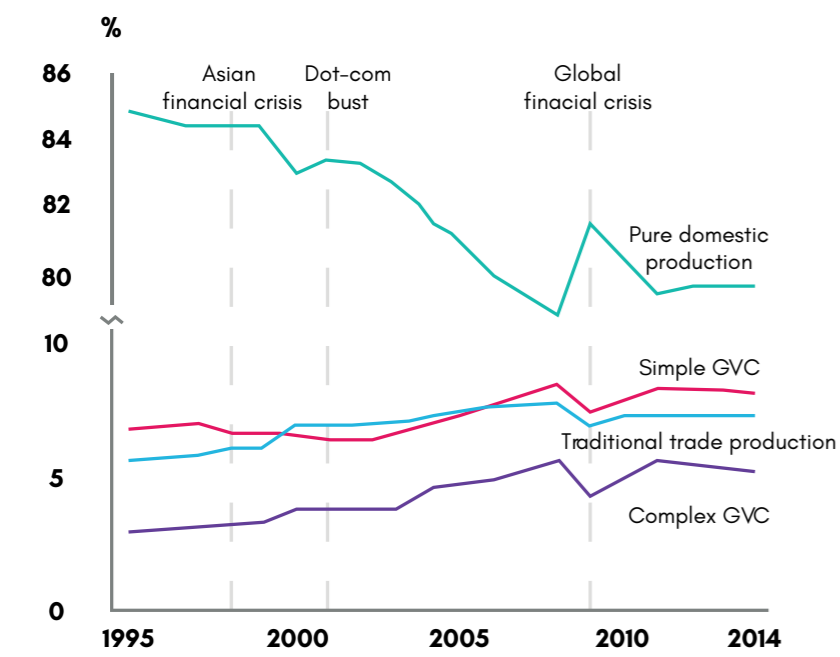
Where might the trade war hit supply chains elsewhere in Asia?

Trade disruptions will have different impacts around Asia, with the largest being felt by those with the greatest integration into supply chains directly connected to China. Any moves to shorten GVCs would be felt in particular across East Asia, whose prosperity has been closely linked to its integration into the world markets, helping to facilitate technological spillover, better inputs, learning externalities, and a more efficient division of labor.

Countries vulnerable to trade contagion include Japan, South Korea, Taiwan, Singapore and Malaysia, all of which are trade-dependent production hubs intricately interlinked with China. Earlier developing states like Vietnam and Cambodia could benefit in the short-term if firms relocate production, but would also be harmed if trade costs rose around the region.

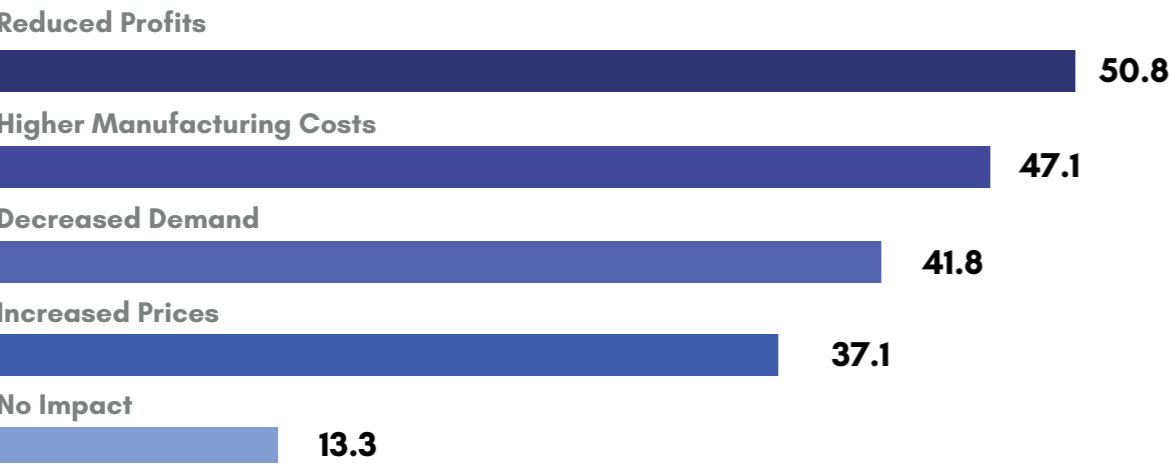


Global Value Chains and Global Growth



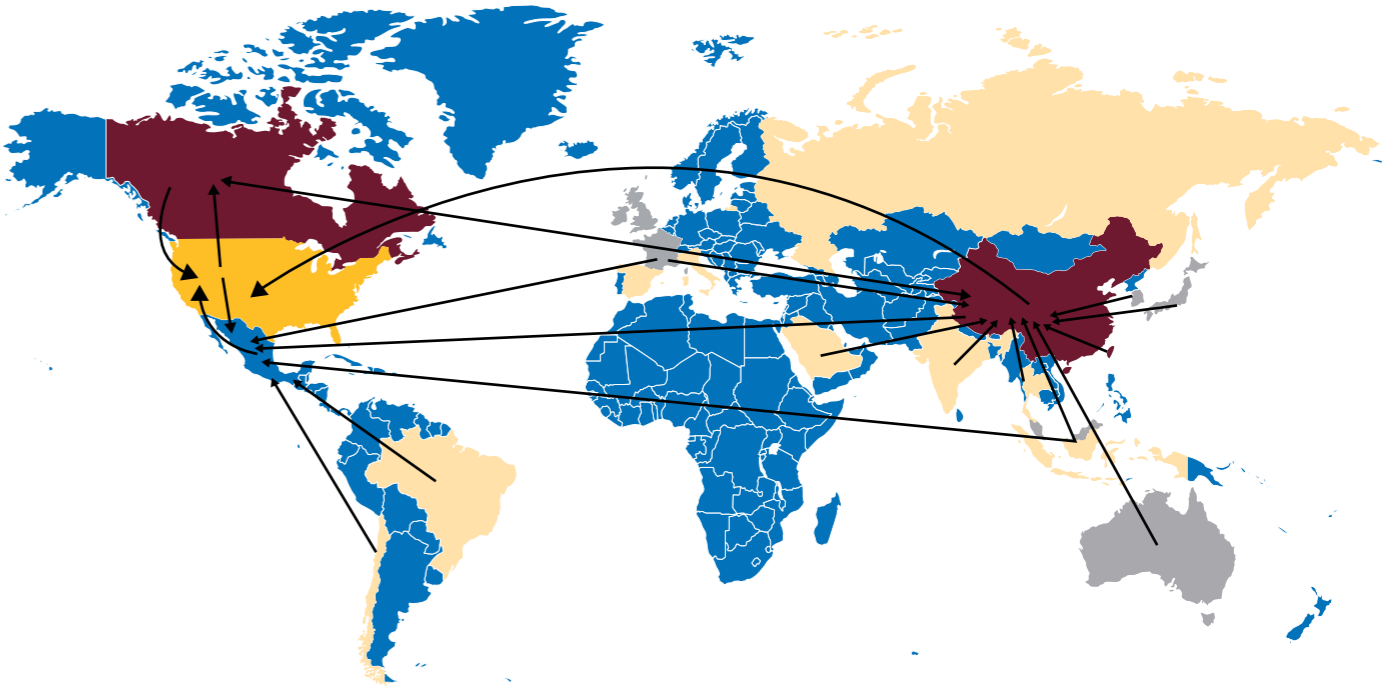
Trends in production activities as a share of global GDP, by type of value-added creation activity, 1995-2014
Source: World Bank / Dani Rodrik

Effect of Trade Tariffs on US Companies



Responses from September 2018 survey of 400 US businesses asked about effect of existing trade restrictions
Source: AMCHAM / Bloomberg

Global Supply Chains of Electronic Products



Final demand destination Originator of value-added (large)
Carrier of value-added Originator of value-added (small)

Source: AXA IM Research / South China Morning Post

Focus Issue (3)

ASIAN INFRASTRUCTURE CONNECTIVITY

Summary

Asia's infrastructure deficit remains a brake on future regional growth. Nonetheless, the advent of China's Belt and Road Initiative (BRI), along with potential funding from multilateral institutions and countries like Japan, suggest that a new era of infrastructure investment, and perhaps also geopolitical competition over infrastructure projects, may be underway.



State of Play

The ADB suggests Asia will require over \$26 trillion, or \$1.7 trillion per year between 2016 and 2030, both to fund infrastructure investment and combat climate change. In 2017, however, Asian infrastructure investment hit only \$881 billion, suggesting a sizable gap between demand and supply.

China launched its BRI infrastructure drive in 2013, beginning an ambitious push to develop projects across Asia, ranging from deep sea ports and special economic zones to high-speed railways and industrial parks. Although there is no reliable official figure for BRI's total investment so far, public estimates often give a figure of \$1 trillion.

Supplementing the BRI, China has also since helped to establish and develop two multilateral infrastructure financing institutions: the Beijing-based Asian Infrastructure Investment Bank (AIIB), launched in 2016, and the New Development Bank (NDB), often referred to as the BRICS Development Bank, the previous year.

The AIIB has since emerged as an important regional infrastructure financing institution, boasting 87 member nations by the middle of this year. As of March, the AIIB had extended loans to 24 projects in 12 countries totalling \$4.2 billion. These ranged from a broadband infrastructure project in Oman, the Bangalore metro railway project in India, a gas pipeline in Azerbaijan, and a power plant project in Myanmar.

Following suit, Japan unveiled its Partnership for Quality Infrastructure (PQI) in 2015, before expanding it the following year with a plan to invest \$200 billion over five years around Asia. Major PQI projects include the Mumbai - Ahmedabad High Speed Railway; the Thilawa Special Economic Zone in Myanmar; the Delhi - Mumbai Industrial Corridor; and Dawei Port and Special Economic Zone in Myanmar.

Major Developments

The size and scale of China's BRI's investment have the potential to support infrastructure development throughout Asia, boosting trade and growth in the process, as well as enhancing commercial ties between China and its partners.

However, the BRI reached its fifth birthday this year against a backdrop of growing concerns about the financing, implementation and sustainability of projects among its partner nations. Various controversies surrounding BRI projects have resulted in suspensions, renegotiations, and cancellation of projects, notably in Southeast Asia.

Malaysia provided one high profile example following its election this year, as the country's new government moved to cancel two energy pipeline projects and a major rail link. In September, Myanmar was reported to have negotiated the terms of another significant project, the Kyaukpyu port, reducing its budget from around \$7 billion to \$1.3 billion.

Issues of debt sustainability have become a further focus for BRI critics. In 2017, debt repayment issues forced Sri Lanka to hand control of a major Chinese-built port project in the southern town of Hambantota back to China. Debt concerns have also prompted Pakistan's new government to review a number of projects under its China-Pakistan Economic Corridor, a major series of BRI-linked projects slated to be worth \$62 billion.

Against a backdrop of concerns about China's growing regional infrastructure clout, Japan has also stepped up its infrastructure investment engagement. In June 2018, Prime Minister Shinzo Abe announced a new \$50 billion fund to boost investment around Asia. In October, Abe announced further plans to support projects in Thailand, Vietnam, Cambodia, Laos, and Myanmar.

Seeking to provide a potential alternative to Chinese funding, India and Japan joined forces in 2017 to launch the Asia-Africa Growth Corridor, an initiative focusing on maritime investments. India also continues to develop its "Act East" policy, which includes a range of initiatives in mainland Southeast Asia, from the India-Myanmar-Thailand Trilateral Highway to the Kaladan Multi-Modal Transit Transport project.

Despite their growing competition for influence, China and Japan have also at times sought to cooperate in some development projects. In September, the two countries announced plans to set up a new committee to develop joint projects, and Japan has also signalled it is likely to participate in some future BRI projects.



Key Questions

What is the future for China's BRI?

With its second Belt and Road Forum expected to take place next year, China appears to have no intentions of slowing down its expansion of the BRI, which has now grown well beyond Asia to cover projects in almost every region of the world. Around the time of its fifth anniversary this year, for instance, President Xi Jinping pledged to provide another \$60 billion in funding to new projects in Africa.

BRI faces a range of risks relating to the ability of its partner nations to repay their loans, as well as the potential reputational costs of being seen to tempt its borrowers into unsustainable financing arrangements. The project comes with potential domestic political costs, given early signs of discontent in China over the country's extensive foreign loans, as well as the risks of rising geopolitical competition with Japan, and potentially India and the US as well.



How can multilateral institutions address Asia's infrastructure deficit?

While the BRI's scale has prompted something of a backlash, by comparison the Chinese-led AIIB has been widely praised for its record of high quality governance and careful project development. However the AIIB, along with its fellow international development institutions, still faces many challenges trying bridge Asia's infrastructure gap.

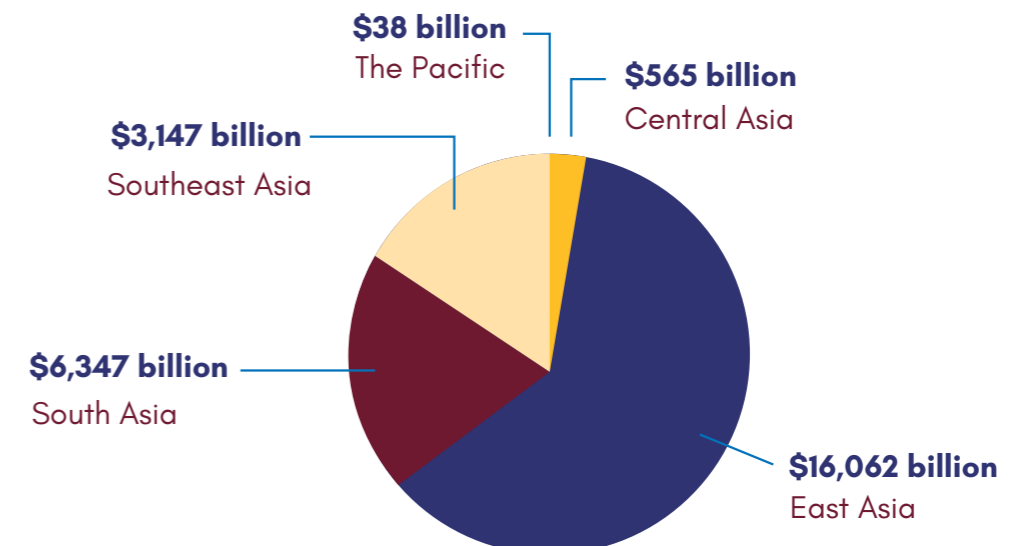
Higher private sector investment is often held out as one solution, in part via development of deeper local capital markets, which could in theory provide a channel through which regional savings might flow into new infrastructure. But development institutions have frequently struggled to find the right framework to support private involvement, especially in transnational projects. Attempts to use public private partnership models have also often proved troubled.

What should be Asia's infrastructure priorities?

Projections suggest investment is required across a range of sectors, with the largest focus being energy, followed by telecoms, transportation infrastructure and water – all of which are essential for the production of others goods and services, and underpin inclusive economic growth more broadly.

However there are other important priorities too, including investments to mitigate and adapt to climate change, with a particular focus on economically important coastal cities, such as Manila, Mumbai, Shanghai, Bangkok, Ho Chi Minh City, and Dhaka, all of which are vulnerable to rising sea levels and other climate change risks. Asia's infrastructure deployment also needs to find a regional balance, given the risk that infrastructure-poor areas, such as South Asia, are likely to receive lower investments than those with superior existing facilities, notably China.

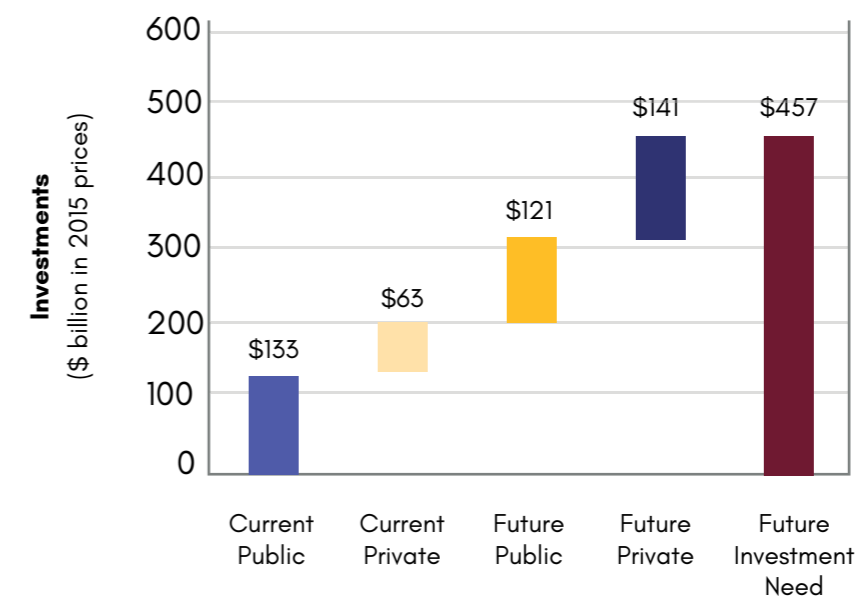
Asia's \$26 Trillion Infrastructure Requirement by 2030



Note: Data is for 2016 to 2030 and accounts for climate change

Source: Asian Development Bank / Bloomberg

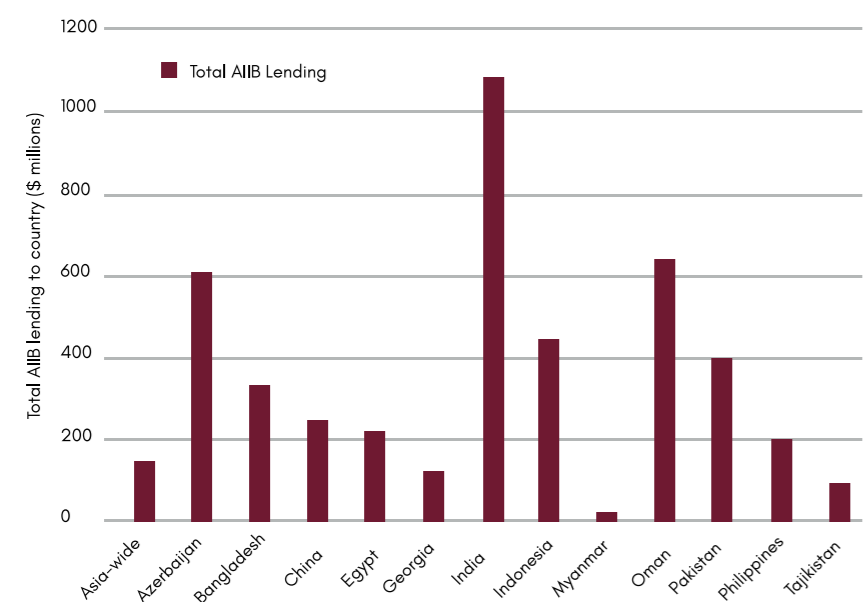
Asia's Infrastructure Gap



Baseline estimates

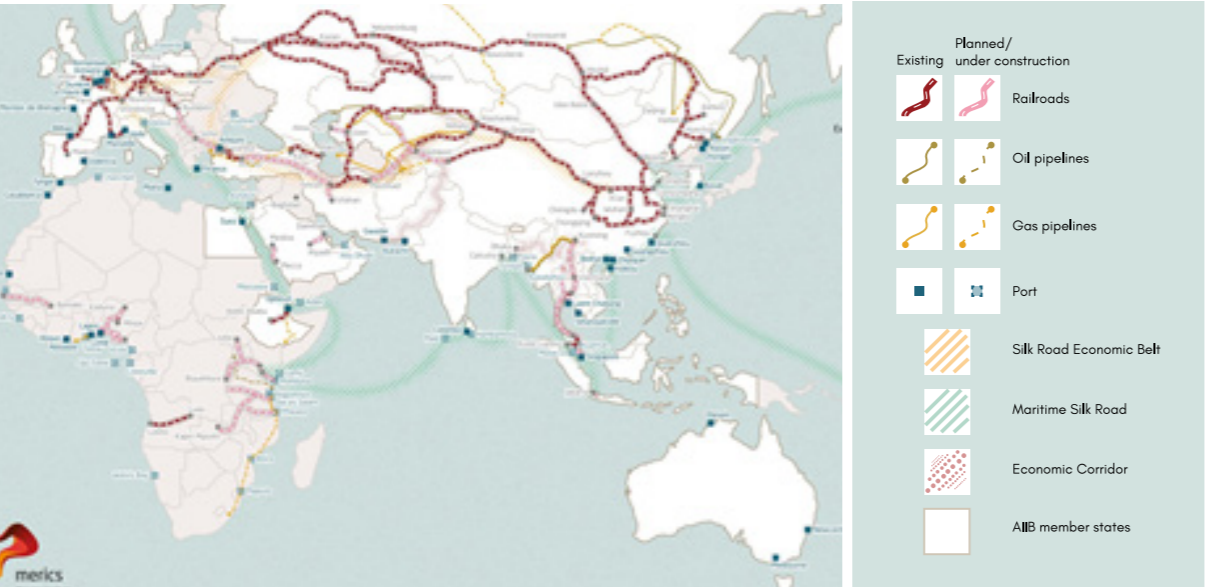
Source: Asian Development Bank

Asian Infrastructure Investment Bank Lending by Country



Projects cover the years 2016 and 2017
Source: AIIB / Forbes

Map of China’s Belt and Road Initiative



Source: MERICS

Focus Issue (4)

INCLUSIVE GROWTH IN ASIA

Summary

Asia’s rise since the Second World War is noted for its dramatic rates of poverty reduction. However, there are signs that some of the current crop of lower middle income nations are now struggling to match the kind of inclusive growth achieved by their predecessors, against a backdrop of rising inequality and challenges facing the region’s export-oriented development model.

State of Play

There are good reasons for optimism about inclusion in Asia, as the region continues to see sharp reductions in poverty alongside the rise of a economically-secure middle class. Less than two percent of people in East Asia and the Pacific now live in poverty, while the wider region’s middle class has tripled in size since 2002.

Robust expansion in trade has been closely tied with this record, as Asia witnessed rapid poverty reduction against a backdrop of export-oriented industrialisation since the 1960s. Most notably, between 1981 and 2013, China is estimated to have lifted more than 850 million people above the breadline.

Emerging Asia has a strong record on employment too: the unemployment rate for Asia and the Pacific is stable and low at around 4 percent, according to the International Labour Organisation. Policies that have helped to facilitate the expansion of the middle class include the promotion of labor-intensive growth and increased public spending on education, health, and family planning services.

There are signs that recent global changes, alongside a lack of domestic reforms, may be introducing a period of less inclusive growth. However, last year the World Bank published “Riding the Wave: An East Asian Miracle for the 21st Century,” a report arguing that the region’s historical successes “do not guarantee that inclusive growth – growth that reduces poverty and delivers upward mobility and economic security for all – is assured.”

The authors point out that the lives of significant portions of Asia’s population, especially in emerging lower middle economies, are vulnerable to income shocks, with persistent economic barriers faced by some minorities, for instance women and the elderly.





Major Developments

Poverty levels continue to fall around the region, with Asia's three most populous nations, China, India, and Indonesia, all projected to see continuing sharp declines. China is close to eliminating extreme poverty all together, with its rate set to fall to just 0.3 percent by 2020.

World Bank research suggests South Asia's poor population is also dropping quickly, falling from more than 500 million in 1990 to 216 million in 2015. India is making especially rapid progress: research from the Brookings Institution showed Nigeria overtaking India this year as home to the largest population of the world's extreme poor.

That said, hundreds of millions around Asia still suffer lives marked economic insecurity and a lack of access to basic social services. Evidence suggests that inequality has begun to rise around much of the region, threatening to stifle growth by curbing consumption while also potentially stoking social and political tensions.

Although some industrialised Asian countries remain highly egalitarian, income inequality, as measured by the Gini coefficient, has risen by over 5 percentage points around the Asia-Pacific as a whole over the last 20 years. Around four in ten of the region's countries have also witnessed income inequality growth, including China, India, and Indonesia.

One indicator of income inequality is the share of total national income accounted for by the top 10 percent of earners. India has grown to become one of the world's most unequal country over recent decades, with the top 10 percent of its earners making 54 percent of total national income. China's top 10 percent take in 41 percent.

Throughout the region, jobs continue to transition away from agriculture and into higher-paid sectors including manufacturing. Between the 1980s and 2012, agriculture's share of employment dropped from 50 percent to roughly 35 percent, while industry and services grew to 20 percent and 45 percent, respectively.

However, employment vulnerability also continues to be a problem, affecting nearly three quarters of workers in South Asia. Over 42 percent of workers in the Asia-Pacific are estimated to be in either extreme or moderate poverty, representing more than two-thirds of all working poor in the region.

Gender is an important focus for inclusive growth. Female participation in the labour market is still low in many countries. In 2017, India's female labour participation was just 27 percent, compared to 62 percent in China and 51 percent in Indonesia. Despite other technological and social advances, 1.7 billion people around Asia also lack access to proper sanitation and over 680 million do not have access to electricity, according to the ADB.



Key Questions

How does the current economic environment affect the case for inclusive growth?

Rising economic uncertainties, and in particular the present US-China trade war, arguably make the case for inclusive growth more important. Economic shocks flowing from increased protectionism will not only usher in a period of dampened growth, but also heighten the risk that vulnerable groups could slip backwards into poverty.

Governments throughout the Asia-Pacific may have to change policies if the trade war hits growth and investment, given the extent to which the previous era of prosperity relied on trade growth and global integration. In a period of economic uncertainty, more inclusive patterns of growth could help to underpin healthy domestic demand.

How can economic growth in Asia be made more inclusive?

Asia's record of poverty reduction has been fuelled largely by job creation and rising productivity, rather than redistribution. Although Asia is now almost entirely comprised of middle income economies, progress boosting economic mobility has been mixed, while remaining pockets of poverty are often dominated by vulnerable groups, including women and minorities.

A range of measures are likely to be needed to promote inclusion across Asia, including improving access to jobs and services, encouraging formalisation to improve the quality of jobs, and enhancing access to the financial system. If inequality continues to rise, strengthening social assistance programs, such as social insurance and cash-transfer programs, could facilitate inclusion and bolster resilience in the face of economic shocks.

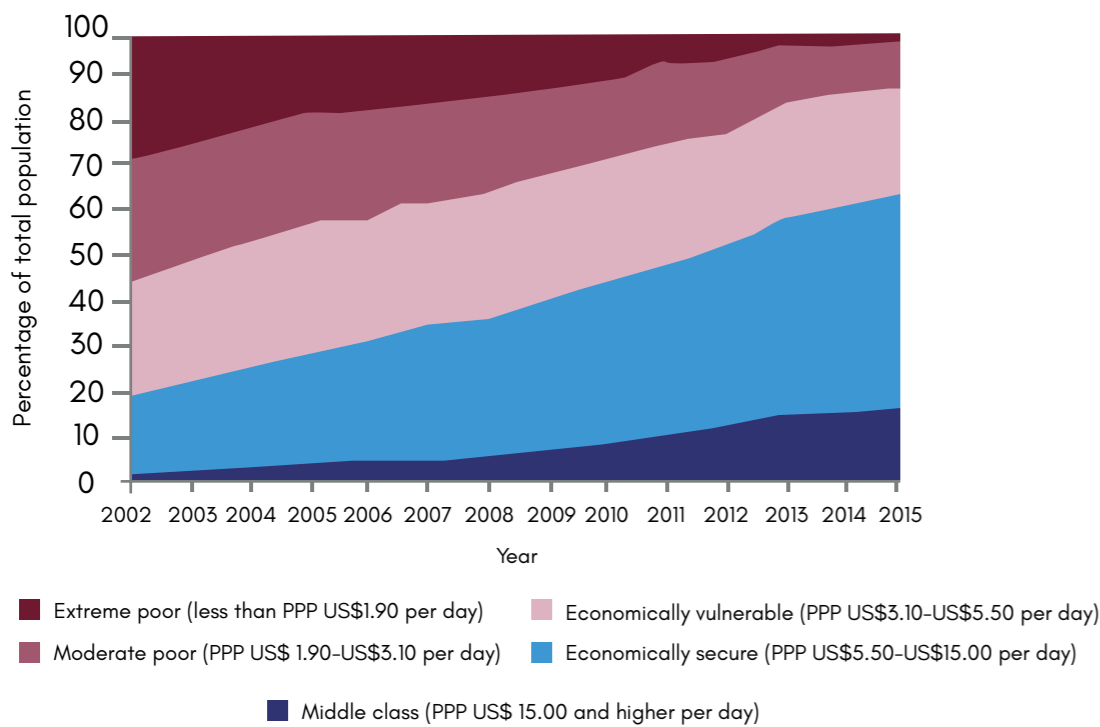
What are the challenges to inclusive growth in different parts of Asia?

As the structure of regional economies differ, there is no one size fits all approach to inclusive growth. The challenge of addressing Asia's remaining pockets of destitution remain considerable, especially in accelerating poverty reduction and developing basic social assistance programs. As poorer countries tend to remain largely agrarian, removing barriers to labor reallocation and facilitating access to education and financial inclusion are important measures to enhance inclusivity.

Lower middle income economies, most of which have made strides in reducing poverty, are likely to need to focus on securing upward economic mobility through competitive markets and access to basic social services. Domestic and international investment into infrastructure can also pay dividends for long-term economic prosperity. Even states that have transitioned into the middle-income status decades ago, like Thailand and Malaysia, need to improve economic security, narrow the rural-urban divide, and continue to strengthen and foster high-quality basic services such as healthcare, education and pension systems.

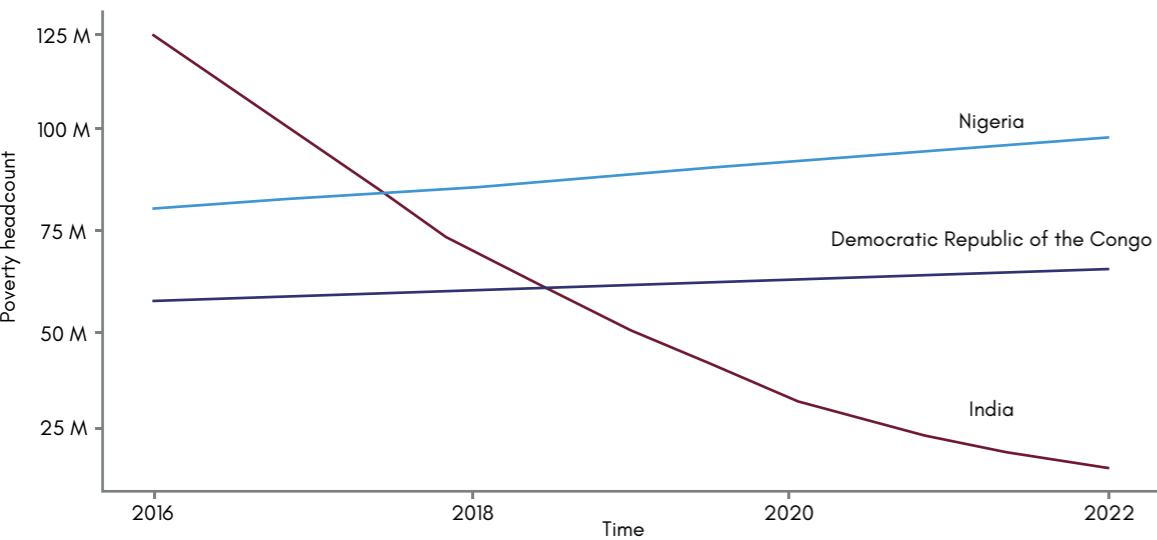


Declining Poverty across East Asia and the Pacific



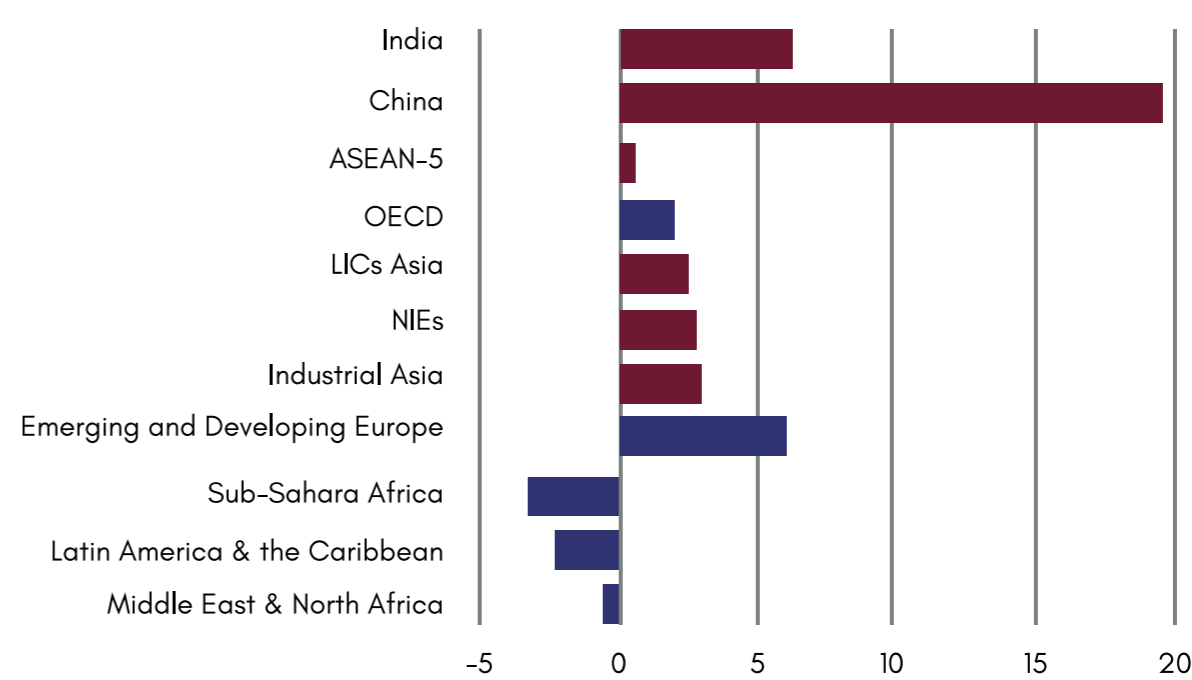
PPP = Purchasing Power Parity
Source: World Bank

India's Rapid Progress on Poverty Reduction



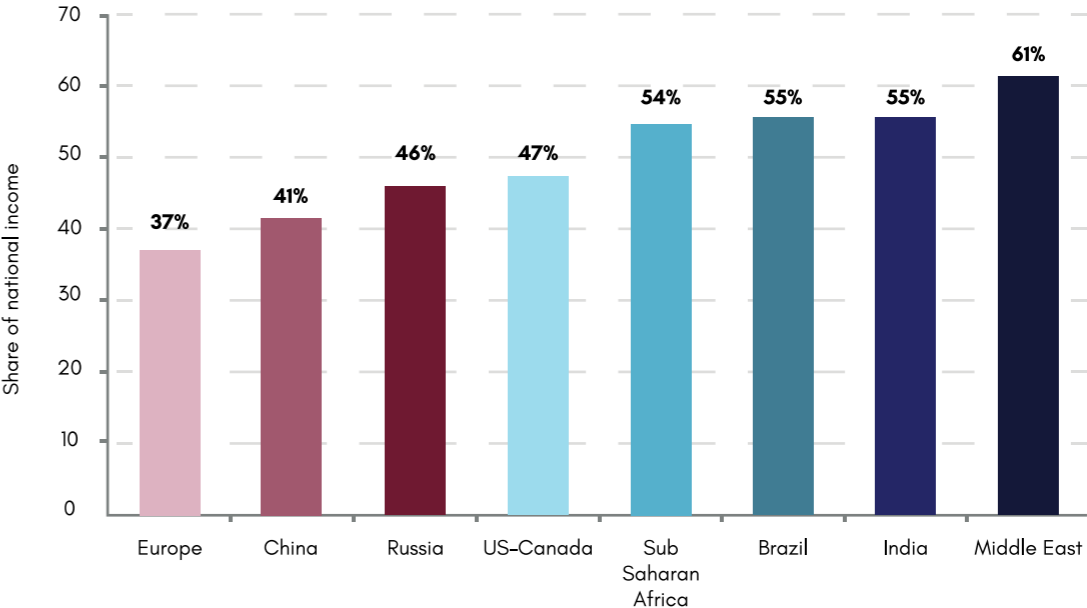
Source: Brookings

Changes in Income Inequality around the World



Net Gini Index, in Gini points, change since 1990, average across the region
Source: International Monetary Fund

Share of Income Held by the Top 10 percent



Source: World Inequality Report

