Changing Scenario in Asia and Pacific since Strategy 2020
ABBREVIATIONS

ADB – Asian Development Bank
ADF – Asian Development Fund
CWRD – Central and West Asia Department
DMC – developing member country
EARD – East Asia Department
FCAS – fragile and conflict-affected situation
GCI – Global Competitiveness Index
GDP – gross domestic product
GNI – gross national income
HDI – Human Development Index
HIC – high income country
ICT – information and communication technology
IMF – International Monetary Fund
LIC – low income country
LMIC – lower middle income country
MDG – Millennium Development Goal
MIC – middle income country
OCR – Ordinary Capital Resources
ODA – Official Development Assistance
PARD – Pacific Regional Department
PRC – People’s Republic of China
RCI – regional cooperation and integration
SARD – South Asia Regional Department
SERD – Southeast Asia Regional Department
UMIC – upper middle income country
UNDP – United Nations Development Programme

NOTE

In this supplementary appendix, "$" refers to US dollars
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I. INTRODUCTION

1. Strategy 2020 was formulated in 2008 against a backdrop of two decades of record economic growth in Asia, and a positive outlook for development. This background report examines how the region has evolved since then, in terms of its challenges and opportunities. Section II examines recent development trends, and shows that prospects remain generally favorable in a baseline scenario. Section III identifies the key risks and challenges facing the region that can derail the achievement of favorable development outcomes. It finds that the nine challenges originally highlighted in Strategy 2020 still remain largely valid. In addition, the region—including the expanding group of middle income countries (MICs)—now has to sustain growth and achieve structural transformation in a more uncertain global environment. Section IV examines how the aid architecture and development dialogue have evolved recently.

II. GROWTH, POVERTY AND HUMAN DEVELOPMENT: RECENT TRENDS AND FUTURE PROSPECTS

2. The Asia-Pacific region has witnessed significant development progress since the formulation of Strategy 2020. Looking ahead to 2020, prospects for growth and reduction of income and non-income poverty are largely favorable in a baseline scenario.

A. Economic Growth

3. The post-Strategy 2020 years saw continued rapid economic growth in the region, with a slowdown during the global crisis. Growth slowed in Asia-Pacific in 2008–2009, albeit less than in other regions (Figure 1). This was followed by a rebound in 2010. While the average masks country-wide variations, large economies including People’s Republic of China (PRC), India, Indonesia, and Bangladesh weathered the global crisis well—helped, in part, by strong and sustained domestic and regional demand. Overall, regional economies have performed better than the rest of the world during 2008–2013. As the world economy grew at less than 3% a year, ADB’s developing member countries (DMC) averaged annual real growth of above 6% (Figure 1). However, the small Pacific Islands grew at an average real rate of only around 2.5% in this period, reflective of economic constraints imposed by size and fragility.

![Figure 1: Real Growth in Developing Member Countries, 2007–2013](image-url)

ADF = Asian Development Fund; OCR = Ordinary Capital Resources.
Source: Real GDP-weighted growth for ADF OCR countries computed from ADB, Key Indicators for the Asia and Pacific. The ADF and OCR classification used is as on 15 October 2013. Real average annual growth rates for the world economy from IMF; World Economic Outlook.

India and Indonesia have been subject to recent financial volatility, which has resulted in a growth slowdown in 2013.
4. Agriculture’s share of gross domestic product (GDP) has continued to shrink, although it still accounts for the highest sectoral share of employment in Asia-Pacific. This is reflective of continued structural transformation in the region, as industry and services sectors lead the growth process. On average, more than half the growth in aggregate value added in DMCs during 2008–2012 can be attributed to the services sector, and another third to industry. However, while the share of agriculture in GDP has declined since the 1970s at 2.5% per annum, the share of employment in agriculture has declined at only 1.7% per annum. Agriculture contributed about 11% of Asia-Pacific’s GDP but accounted for about 43% of employment in 2012, reflective of low productivity in the sector.

5. A majority of ADB’s DMCs are already middle income countries, aided by more than two decades of strong growth. Only seven of 40 non-graduate DMCs are currently low income countries (LIC) (Table 1). However, while 33 DMCs are classified as MICs based on gross national income (GNI) per capita, there is significant heterogeneity between them in terms of achievements, opportunities, and challenges, which are critical to shaping policy discussions.

<table>
<thead>
<tr>
<th>LIC (Per Capita GNI &lt;$1,036)</th>
<th>LMIC (Per Capita GNI $1,036-$4,085)</th>
<th>UMIC (Per Capita GNI $4,086-$12,615)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Afghanistan, Bangladesh, Cambodia, Kyrgyz Republic, Myanmar, Nepal, Tajikistan</td>
<td>Armenia, Bhutan, Georgia, India, Indonesia, Kiribati, Lao PDR, Federated States of Micronesia, Mongolia, Pakistan, Papua New Guinea, Philippines, Samoa, Solomon Islands, Sri Lanka, Timor-Leste, Uzbekistan, Vanuatu, Viet Nam</td>
<td>Azerbaijan, PRC, Cook Islands, Fiji, Kazakhstan, Malaysia, Maldives, Marshall Islands, Nauru, Palau, Thailand, Tonga, Turkmenistan, Tuvalu</td>
</tr>
</tbody>
</table>

DMC = developing member countries; GNI = gross national income; Lao PDR = Lao People’s Democratic Republic; LIC = low income countries; LMIC = lower middle income countries; PRC = People’s Republic of China; UMIC = upper middle income country


6. Growth in the region is forecast to ease marginally in 2013–2014 due to global and regional events. Developing Asia-Pacific’s GDP grew 6.6% annually in 2011–2012. Regional growth is expected to slide marginally to 6.0% in 2013, before picking up to 6.2% in 2014. First, some deceleration is expected in the Asian giants, PRC and India. Efforts to forge a more balanced and sustainable growth path in PRC than the recent path led by exports and investment will lead to moderation of growth. Inadequate infrastructure and insufficient structural reforms continue to weigh on industry and investment in India, hampering growth. Second, prospective tapering of quantitative easing in the United States (US) has also destabilized emerging economy financial markets, including in developing Asia. In parallel, while there has been nascent recovery in advanced economies, this has not yet been sufficient to lift emerging markets.

7. In general, growth prospects remain broadly favorable for the remainder of Strategy 2020. Medium term baseline growth forecasts for 2015–2020 are derived from a model in which real GDP is determined by three factors: labor input, physical capital input, and

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3 According to the World Bank, as a country crosses a (2012) per capita gross national income threshold of $1,035, it moves from the category of “low income” to “lower-middle income”. As it further crosses $4,085, it is classified as “upper-middle income.” Finally, at $12,616, it crosses into the “high income” group.
total factor productivity growth. Developing Asia-Pacific is projected to grow at 6.4% on average during 2015–2020 in the baseline scenario, while the world economy is projected to grow at 3.0%–4.0%. Based on projected growth, Cook Islands, Kazakhstan and Malaysia will become high income countries (HICs) by 2020, while only Nepal and Afghanistan will remain LICs.

B. Poverty and Inequality

8. Poverty has declined in all ADB DMCs post Strategy 2020. Aided by rapid growth, the share of the population in ADB DMCs living in extreme poverty (below $1.25/day) fell from 26.9% in 2005 to 20.7% in 2010, as the number of people in extreme poverty declined from 902 million to 733 million. In parallel, the $2.00/day poverty headcount rate fell from 53.5% in 2005 to 45.7% in 2010, as the number of $2.00/day poor declined from 1794 million to 1615 million.

9. Poverty is projected to decline further, but will still remain substantial in 2020 on the $2.00/day threshold. The poverty headcount rate based on the $1.25/day and $2.00/day poverty lines are expected to decline to 4.3% and 23.5% respectively in 2020 under baseline growth (footnote 5). Accordingly, 173 million people are projected to remain below $1.25/day and 950 million are projected to remain below $2.00/day. About three-quarters of the $1.25/day poor and almost two-thirds of the $2.00/day poor will be in DMCs in the South Asia region (Figure 2).

Figure 2: Projected Baseline Number of Poor People in Developing Member Countries by Region, 2010–2020

10. Inequalities within some DMCs have gone up, and can widen further under the baseline growth scenario. The Asia-wide Gini coefficient increased from 39% in the mid-1990s to 46% in the late-2000s. Increasing inequalities in several countries—including

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6 World Bank. 2013. Povcalnet online database.

7 Poverty projections were generated from the base-year (2010 or closest) household expenditure distributions from the World Bank’s PovcalNet. The expenditure distributions for the subsequent years (2011–2020) were estimated by applying the projected GDP per capita growth rates to the base-year expenditure distribution.
Bangladesh, Georgia, India, Indonesia, PRC, and Sri Lanka—have contributed to this. The income/consumption inequality worsened in countries accounting for over 80% of the population in DMCs between the early 1990s and the late 2000s. The ratio of the income/consumption of the richest quintile to that of the poorest quintile increased in 10 of 24 DMCs in this period. Data on inequality across countries is not consistently available after Strategy 2020 was formulated. However, it is of concern to note that, of 23 DMCs with comparable data, 13 are likely to have a higher Gini coefficient in 2020 under baseline growth projections than they do at present.

11. **Inequalities between countries groups have also widened.** The Ordinary Capital Resources (OCR) (generally middle income) countries have grown faster than ADF (generally lower income) countries (Figure 1), exacerbating inequalities between country groups. Moreover, the growth pattern forecast for the region suggests that income inequalities between DMC groups will widen, as the ADF and blend countries are projected to grow at rates below that of the OCR countries (Table 2).

<table>
<thead>
<tr>
<th>Year</th>
<th>Group A (ADF only)</th>
<th>Group B (Blend)</th>
<th>Group C (OCR only)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2011-12</td>
<td>6.4</td>
<td>5.7</td>
<td>7.8</td>
</tr>
<tr>
<td>2013-14</td>
<td>6.0</td>
<td>5.2</td>
<td>7.1</td>
</tr>
<tr>
<td>2015-20</td>
<td>6.8</td>
<td>6.9</td>
<td>6.8</td>
</tr>
<tr>
<td>2010-20</td>
<td>6.6</td>
<td>6.3</td>
<td>7.1</td>
</tr>
<tr>
<td>2010</td>
<td>786</td>
<td>1,318</td>
<td>4,246</td>
</tr>
<tr>
<td>2012</td>
<td>864</td>
<td>1,434</td>
<td>4,860</td>
</tr>
<tr>
<td>2015</td>
<td>992</td>
<td>1,635</td>
<td>5,819</td>
</tr>
<tr>
<td>2020</td>
<td>1,289</td>
<td>2,155</td>
<td>7,843</td>
</tr>
</tbody>
</table>

ADF = Asian Development Fund; GDP = gross domestic product; OCR = Ordinary Capital Resources.

Source: ADB. Projecting per capita GDP, Income Poverty, Non-Income Poverty and Income Inequality towards 2020. Unpublished staff calculations, 2013. Averages for each group are weighted by GDP.

C. **Human Development**

12. **Human development has improved since Strategy 2020, although DMCs are still to catch up on more advanced countries.** Available time series data on the Human Development Index (HDI) shows gradual improvement. However, convergence on the more advanced economies has been slow (Figure 3). On average, ADB DMCs can presently be considered medium HDI (i.e., in the third quartile by 2012 country rankings), although East and Central Asian DMCs are generally in the high HDI group (i.e., in the second quartile by 2012 country rankings).

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9 These are Armenia, Bangladesh, Cambodia, India, Kyrgyz Republic, Lao PDR, Nepal, Pakistan, Philippines, Tajikistan, Thailand, Timor-Leste, and Viet Nam.
10 The Kuznets curve provides the foundation for modeling the inequality trend. Projections are derived Gini estimates combined to form an unbalanced panel of 214 observations from 21 economies of the Asia-Pacific region. Countries with three Gini estimates or less are excluded at the modeling stage. The Gini estimates are then regressed on GDP per capita, and inequality projections are derived from a log linear form with fixed effects.
11 The United Nations Development Programme’s HDI is a composite index measuring average achievement in three basic dimensions of human development—a long and healthy life, education and a decent standard of living.
13. **Progress towards Millennium Development Goals (MDGs) is uneven.** Although ADB DMCs as a group have met or are on target to meet several MDGs by 2015, an unfinished agenda remains. No country will fail on all MDGs, but none will meet all targets either. The 1990 MDG of halving poverty by 2015 has already been achieved in ADB DMCs, on average. DMCs are generally on track to meet the primary education MDGs in terms of enrollment and completion rates. However, despite improvements in outcomes related to child health and maternal mortality, MDGs on these indicators will not be reached. DMCs as a group are also off track on environmental goals related to enhanced access to sanitation, which is related to weak health outcomes. While gender parity has been achieved for education, progress on women’s empowerment is lagging.

14. **The projected robust and sustained economic growth is likely to contribute to further reduction in non-income poverty.** Using a regression model estimated from historical data, with per capita GDP as the explanatory variable, levels of several non-income poverty indicators can be predicted for future years. For developing Asia-Pacific as a whole, varying degrees of improvement are expected across all dimensions of non-income poverty (Table 3).

### Table 3: Projected Trend in Non-Income Poverty

<table>
<thead>
<tr>
<th>Year</th>
<th>Tuberculosis prevalence rate (per 10,000 population)</th>
<th>Infant mortality rate (0-1 year, per 1,000 live births)</th>
<th>Proportion of population not using improved sanitation facilities (%)</th>
<th>Children under 5 moderately or severely underweight (%)</th>
<th>1 year old children without immunization against measles (%)</th>
<th>Proportion of population not using improved drinking water resources (%)</th>
<th>Maternal mortality ratio (per 10,000 live births)</th>
<th>School-age children out of primary school (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>23.8</td>
<td>22.3</td>
<td>19.6</td>
<td>12.9</td>
<td>12.8</td>
<td>9.7</td>
<td>6.3</td>
<td>4.8</td>
</tr>
<tr>
<td>2015</td>
<td>22.4</td>
<td>20.7</td>
<td>18.1</td>
<td>12.0</td>
<td>12.2</td>
<td>8.8</td>
<td>5.1</td>
<td>4.4</td>
</tr>
<tr>
<td>2020</td>
<td>20.5</td>
<td>16.5</td>
<td>16.1</td>
<td>10.7</td>
<td>11.4</td>
<td>7.6</td>
<td>3.3</td>
<td>3.8</td>
</tr>
</tbody>
</table>

Source: ADB. *Projecting per capita GDP, Income Poverty, Non-Income Poverty and Income Inequality towards 2020.* Unpublished staff calculations, 2013. Averages for each group are weighted by GDP.

### III. EVOLVING DEVELOPMENT CHALLENGES FACING THE REGION

15. **Although baseline development prospects are bright, it is important to ensure that Asia-Pacific is able to consolidate and build on recent progress.** First, projected growth has to be realized in the face of significant regional and global downside risks which have emerged since the formulation of Strategy 2020. Only then will the prospects for improvement arising from growth be translated into reality—especially for the growing group of MICs, some of which
are at risk of middle income traps. Second, Strategy 2020 identified nine leading challenges facing the region in 2008 which could derail development progress.\textsuperscript{12} While these challenges still remain largely valid, their intensity has evolved. This section examines the key impediments that the region must overcome in order to achieve its full potential and realize the vision of an Asian century, with a particular focus on changes since Strategy 2020 was formulated.

A. Emergence of New Challenges

\textit{Sustaining rapid and robust growth will be particularly challenging, in the more risky and fragile economic environment.}

16. \textbf{While baseline growth prospects for developing Asia-Pacific are favorable, there are significant downside risks.} The remaining years of Strategy 2020 will likely see challenges including continued uncertainties in advanced economies, weak recovery of the euro area, increasing competition for export markets, and the potential resurgence of inflation. Asia-Pacific’s development will be constrained as growth in the advanced economies is softer than during the pre-crisis years, and the regional economic giants also face slowdown (para. 6). Growth rates of 8.0\%–9.0\% achieved in 2000–2007 are unlikely, although the region is still projected to grow faster than the rest of the world (para. 7).

17. \textbf{Gradual recovery is evident in advanced economies, but this needs to be strengthened and sustained.} Following emergence from the global crisis in 2010, advanced economies—including US, Japan, and the euro area—have experienced slowdown and even periods of recession during 2011–2013. However, these economies are showing signs of turning the corner. There was moderate expansion in the US in the first half of 2013 as fixed capital investment, inventories, and exports picked up, private consumption remained strong, and consumer optimism increased. The euro area emerged from recession in the second quarter of 2013, and while recovery has been weak, growth in 2014 is forecast to be modestly positive. In Japan, a package of monetary and fiscal reforms has boosted the economy, which has now achieved three consecutive quarters of growth. Advanced economies are expected to grow at 2.0\%–3.0\% during 2013–2020.

18. \textbf{Developing Asia-Pacific may have to rely on domestic and regional sources of growth, to minimize destabilizing effects of policies in advanced economies.} Slow recovery in the advanced world has yet to translate into revived exports from the region. Even with recovery, mature economies are expected to adopt more cautious fiscal and monetary policies. Recently, regional financial markets were destabilized by prospects of tapering quantitative easing in the US. The sharp reactions of financial markets in emerging economies indicated their vulnerability to monetary policy shifts in advanced countries. Capital flows reversed as investors turned from emerging economies, affecting stock markets and reversing asset price increases. In this scenario, it is important to enhance intraregional trade and promote domestic consumption in the region.

19. \textbf{Overall, fears of an economic crisis in Asia appear unwarranted at present, but vigilance is needed.} The region is now in a stronger position to weather any global downturns than it was before the Asian financial crisis in 1997. Several economies have current account surpluses and hold large foreign reserves. The reforms instituted since 1997 have strengthened macroeconomic management, financial regulation, and corporate governance. At the same

time, given the recent financial volatility in Asian markets such as India and Indonesia, the need to preserve financial stability is particularly important.

As more economies reach middle income status, there is increasing awareness that they have specific development issues to be addressed.

20. A key emerging challenge for ADB is to cater to the special needs of its growing number of middle income DMCs. While emergence of MICs is not a new phenomenon, there is increasing awareness since the formulation of Strategy 2020 that development needs facing MICs may require special attention. A majority of DMCs are already middle income, and this trend is expected to continue during the remaining years of Strategy 2020 (para. 5). As ADB’s clients evolve, ADB needs to keep up with their demands while making best use of their strengths.

21. ADB’s MICs are an extremely diverse group in terms of income and development levels, indicating that a “one-size-fits-all” approach for them is unwarranted. The MICs cover a wide spectrum of countries: in terms of population, they range from around 10,000 (Nauru and Tuvalu) to more than 1.2 billion (India and PRC); in terms of per capita gross national income, they range from below $1,300 (Lao PDR and Pakistan) to above $9,700 (Cook Islands, Kazakhstan, and Malaysia); in terms of HDI ranking, they range from 52nd (Palau) to 156th (Papua New Guinea); in terms of Ease of Doing Business ranking, they range from 9th (Georgia) to 169th (Timor-Leste); in terms of the Worldwide Governance Indicators government effectiveness percentile rankings, they range from bottom 10% (Marshall Islands and Turkmenistan) to top 20% (Malaysia); in terms of extreme poverty rates, they range from practically zero (Azerbaijan, Kazakhstan, Malaysia, Maldives, Thailand, and Turkmenistan) to almost a third (India); and in terms of income inequality, they range from Gini coefficients of below 30 (Kazakhstan and Pakistan) to above 40 (Fiji, Malaysia, PRC, Philippines, and Thailand).

22. Moreover, many MICs are characterized by fragility and conflict. In 2013, 9 DMCs were categorized as fragile and conflict-affected situations (FCAS), of which 7 are MICs located in the Pacific.13 These are small and geographically isolated, with scattered populations, underdeveloped markets, and particular vulnerabilities to climate change effects. Limited or no private credit ratings and investment climate constraints increase the cost of doing business in such countries. At the same time, governments in FCAS DMCs are often unable to respond consistently and equitably to societal demands due to inadequate capacity.

23. However, MICs share some features in common. While there are individual exceptions, they are generally superior to LICs in terms of human development and poverty, access to infrastructure, development of financial markets, private sector participation in development, and ability to tap diverse sources of finance. Institutional capacities in MICs are usually higher than in LICs (Figure 4), presenting greater scope for the use of country’s own systems and expertise.14 On the other hand, environmental degradation as a cost to growth tends to present greater challenges in MICs.

13 These include the Federated States of Micronesia, Kiribati, Marshall Islands, Nauru, Solomon Islands, Timor-Leste, and Tuvalu. Afghanistan and Nepal are the two LICs characterized as FCAS.

14 Global Competitiveness Index data for most Pacific MICs is not available.
DMC = developing member countries; LIC = low income countries; LMIC = lower middle income countries; PRC = People’s Republic of China; UMIC = upper middle income country.


24. **ADB’s diverse group of MICs must avoid the middle income trap and make the transition into high income status.** Several DMCs are at risk of the MIC trap. Of 26 ADBs DMCs (with consistent available data) which are MICs in 2012, 14 were MICs back in 1993 as well (Figure 5). Indonesia, Pakistan, Philippines, and Sri Lanka may already be in MIC traps.\(^\text{15}\)

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Successful structural transformation will be critical for the transition from middle to high income status. There are lessons across ADB DMCs which highlight the importance of economic diversification and enhanced productivity in the transition.

- A first group of countries, including several East Asian HICs, successfully transformed into high income modern service-oriented economies, spurred by skill-biased technological change and rapid industrialization. In these economies, agriculture accounts for less than 5% of both output and employment. These economies have transformed both their output and employment shares away from agriculture to high productivity sectors.

- A second group, including upper middle income countries (UMICs) like Malaysia, PRC, and Thailand, has industrialized more slowly, although industry’s share of GDP now exceeds 40%. These economies are already reasonably diversified and have developed institutional capabilities. However, some UMICs—notably PRC and Thailand—still have agriculture as the largest employer.

- In a third group of LICs and lower middle income countries (LMIC) such as Bangladesh, India, Pakistan, and Philippines, structural transformation has appeared as a shift from agriculture into low-productivity services, without significant industrialization: while industry contributes less than a third of GDP in this group, the share of the services sector exceeds 50%. Agriculture remains the major employer in most of these countries. Unlike East Asian growth which was initially accompanied by upgradation towards high productivity manufacturing, much of the manufacturing output in the LIC/LMIC group comes from subsectors which are less technology intensive.

MICS that depend on low productivity sectors or currently bypass industrialization have to deepen and upgrade their economic base to make the transition to HICs. As a large share of the population in many MICS is still employed in agriculture, the sector has to “industrialize” by developing agribusiness and adopting modern methods to enhance productivity. The UMICs already have a substantial industrial base—and must focus on deepening and upgrading their industries to higher value products to avoid being caught in the middle income trap. In contrast, it may not be cost effective for small Pacific MICS to industrialize, and they will need to become competitive in certain service sector niche markets.

B. Evolution of Strategy 2020 Challenges

Poverty will remain a central challenge for ADB DMCs, even as vulnerability and food security are becoming greater concerns.

More than 733 million people in DMCs lived below $1.25/day in 2010, making the region home to 60% of the world’s poor. This is despite the decline in poverty since Strategy 2020 (para. 8). Large countries like India and Bangladesh still have more than 30% of their population in extreme poverty. There are concerns around food security and nutrition, as almost

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16 While services contribute almost 49% of GDP in Asia, the sector is heterogeneous—with traditional, low productivity services and modern, high-productivity services. The share of modern services such as finance and business is less than 15% of GDP in many economies, below the 20%–25% in advanced economies.

two-thirds of the world’s hungry live in the Asia-Pacific Region. Micronutrient deficiencies are high or extreme in all of South Asia and in many South East Asian countries.

28. **A key feature of recent development has been growing vulnerabilities, in the present global environment.** Despite declining poverty, the number of vulnerable people (with income between $1.25/day and $2.00/day) has remained virtually the same between 1999 and 2010 (Table 4). This group is at risk of slipping back into absolute poverty in case of fluctuations and volatility in their incomes. Reversing decades of low food prices, the last few years have seen sharp increases in the cost of food. As poor people devote between half and three quarters of their income to food, this is tantamount to a reduction in their income in the short run. Increasing urbanization, exposure to climate change effects, and the aging of the population have contributed to increasing vulnerabilities. However, social security systems are variable—being strongest in East Asia and weakest in South Asia and the Pacific.

<table>
<thead>
<tr>
<th>Year</th>
<th>Population (Million)</th>
<th>$1.25/day poverty</th>
<th>$2.0/day poverty</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Poverty Incidence (%)</td>
<td>Number of Poor (Million)</td>
<td>Share of World Poor (%)</td>
</tr>
<tr>
<td>1999</td>
<td>3,119.1</td>
<td>39.4</td>
<td>1,228.8</td>
</tr>
<tr>
<td>2005</td>
<td>3,355.8</td>
<td>26.9</td>
<td>902.0</td>
</tr>
<tr>
<td>2008</td>
<td>3,462.0</td>
<td>23.9</td>
<td>827.6</td>
</tr>
<tr>
<td>2010</td>
<td>3,534.1</td>
<td>20.7</td>
<td>733.1</td>
</tr>
</tbody>
</table>


29. **Even with robust growth as presently projected, the battle against poverty and vulnerability will not be over in 2020.** While extreme poverty is expected to decline substantially based on present trend, more than 173 million people will remain below $1.25/day in 2020 (para. 9). Four large MICs—Bangladesh, India, Pakistan, and PRC—will constitute more than 90% of the extreme poor in DMCs. With sustained growth, the incidence of extreme poverty is projected to drop to below 3% by 2022 in Asia and the Pacific, at which point extreme poverty would be considered to have been eliminated. However, almost 950 million people will still be living below $2.00/day in 2020—or 23.5% of the projected population in DMCs. Consequently, the number of vulnerable people in 2020 will be more than 775 million, indicating that this will remain an important agenda in the medium term.

**Disparities in well-being remain wide, and may rise further unless addressed.**

30. **Rapid economic growth has not reached all segments of the population, and disparities can widen under the continuation of present growth patterns (paras. 10-11).** Several income and non-income measures of inequality corroborate the findings based on the conventional Gini coefficient of income distribution (para. 10). The Palma index shows that the richest 10% of the population in ADB DMCs enjoys income/consumption that is 1.7 times that of the poorest 40%—up from 1.2 times in the early 1990s. Within countries, urban-rural inequality

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20 The Palma Index is defined as the ratio of income/consumption share of the richest 10% of the population to that of the bottom 40%. This is based on data for 20 ADB DMCs, from which the Palma index was computed.
has gone up in PRC and India. Inequalities in incidence of maternal and child mortality, and underweight children have widened in Bangladesh, India, and Pakistan.

31. **The key drivers of Asia’s rapid growth—technological progress, globalization, and market-oriented reform—have had adverse distributional consequences in several countries in the last two decades.** Together, these factors behind Asia’s growth have favored skilled rather than unskilled labor, capital rather than labor, and urban and coastal areas (where it was less costly for industry and services to locate) over rural and inland regions. About 43% of aggregate employment in the region is still in agriculture, where productivity is generally lower than in the other sectors. The impact of the basic driving forces of inequality has been compounded by unequal access to opportunity caused by institutional weaknesses, market distortions and failures, and social exclusion in many DMCs.21

32. **Inequality can adversely affect the long run sustainability of growth and the impact of growth on poverty reduction.** Rising income inequality can affect growth through adverse effects on institutions, political stability, and private investments in human capital.22 Lower inequality generally goes together with long term efficient economic functioning, reduced conflict, greater trust, and better institutions, with dynamic benefits for investment and growth. There is evidence that growth associated with progressive distributional changes will have a greater impact in reducing poverty.23 Accordingly, inclusive growth must remain a priority.

**Demographic changes have been accompanied by declining employment ratios and increased urbanization, which have development implications.**

33. **Demographic shifts are adding to the working age population, which needs decent jobs and skills to avail new opportunities.** The potential labor force (aged 15-64) in the region has gone up about 210 million between 2005 and 2010, and will further increase by an estimated 280 million till 2020.24 This group will benefit from productive employment, and contribute to development. However, Asia has been characterized by jobless growth in the last decade. The average employment ratio for this age group has declined—from 64.9% in 2000, to 64.0% in 2008, and further to 62.6% in 2011.25

34. **Asia-Pacific has to manage risks from rapid urbanization.** More than 40% of the population already resides in urban areas, and approximately 44 million people are being added to the urban population every year.26 More than two-thirds of the region’s population will be urban by 2050. While this presents opportunities for higher productivity and better living standards, large countries like Bangladesh, PRC, India, Indonesia, Pakistan, Philippines, Thailand, and Viet Nam have 30%-60% of their substantial urban population residing in slums. Despite the region’s rapid economic growth, many cities have inadequate sanitation—especially

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22 Berg, A. and J. Ostry. 2011. *Inequality and Unsustainable Growth: Two Sides of the Same Coin?* IMF Staff Discussion Note SDN/11/08. Washington, DC. Evidence is divided on the effect of inequality on growth in the short run. Higher inequality may lead to faster growth in the short run due to: (i) investment indivisibilities, whereby wealth concentration could support large new investments; and (ii) dispersed wage structures that reward merit and enhance workers’ incentives to put in additional effort. Long run results, however, increasingly show that inequality can affect growth adversely.


in low-income areas—that leads to poor health conditions. Urban buildings and transport account for significant energy consumption and carbon emissions. Disparities in living conditions are severe in many Asian cities, and this can affect social cohesion. Integrated and effective urban planning must focus on managing urban sprawl, providing sustainable and affordable infrastructure, and basic services.

35. Meeting the needs of an ageing population will become important, although this is not an immediate concern in most DMCs. East Asia—including PRC—presently faces particular challenges from ageing. The old age dependency ratio in East Asia is expected to reach 42% in 2050, up from 13% in 2010. Other subregions will also see an increase in this ratio by 10–15 percentage points during 2010–2050. This necessitates a focus on enhancing social protection and social security measures, keeping in mind the needs of the elderly.

Environmental pressures resulting from rapid growth have intensified further, and threaten sustainability of development.

36. Pressures on energy security and environmental degradation have increased with robust growth. The region's share in world energy consumption is projected to rise from about 27% in 2007 to 40% by 2050 (footnote 26). Concurrent with economic growth, the share of ADB DMCs in global greenhouse gas emissions rose from less than 20% in 1991, to 35% in 2008, and to more than 40% in 2011. Per capita emissions have risen steadily since 2008 from about 3.0 metric tons in 2008 to almost 3.6 metric tons in 2011 (Figure 6).28

![Figure 6: Rising Carbon Dioxide Emissions in DMCs](image)

**Figure 6: Rising Carbon Dioxide Emissions in DMCs**

CO2 = carbon dioxide; DMC = developing member countries.

37. Developing Asia-Pacific is at considerable risk from environmental factors. Global warming and climate change (including increased natural disasters) threaten agricultural production, coastal population, and major urban areas. Significant reductions in crop yields from global temperature increases are expected in most countries under present growth patterns.

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27 Based on median age, during 2005–2010, the world population has aged 1.1 years, East Asia 2.5 years, Central Asia 1.1 years, South Asia 1.4 years, and West Asia 1.7 years.
28 However, carbon dioxide emissions per capita are much lower in Asia compared to 7.6 metric tons in the Euro Area and 10.4 metric tons among the Organisation for Economic Cooperation and Development members in 2011.
Climate change could lead to sea-level rises of up to 0.5 cm a year, which will threaten many Asian cities and Pacific Islands. The share of urban population living in low elevation coastal zones ranges from 15%–30% in PRC, India, Indonesia, and Philippines to more than 55% in Bangladesh, Thailand, and Viet Nam. Countries in Asia-Pacific are more prone to natural disasters than those in other parts of the world: 45% of the world’s natural hazards occurred in Asia-Pacific in the last three decades. Although it accounted for 25% of the world’s GDP, the region suffered from 42% of the total economic losses from disasters.29

38. **Preservation of natural capital will help safeguard ecological balance and provide for enhanced livelihoods.** The region is recognized as a global hotspot for biodiversity. However, populations of key indicator species have declined by 64% in the last 30 years, compared to a global rate of 30%. Natural ecosystems provide important services that support livelihoods, contribute to food, water and energy security, while supporting climate change mitigation and resilience.

*Infrastructure, while improving, remains a constraint for access to services and private sector development.*

39. **The region has seen continued expansion of infrastructure after Strategy 2020, but significant gaps are still evident.** Road density per 100 square kilometers has gone up from 70 km. to about 76 km. in the last five years alone, and this has helped populations access health and education services more easily. More than 82% of the population in DMCs presently has access to electricity—although about 620 million still lack access, making the region home to about half the global population without electricity. At the same time, financing gaps for infrastructure in the region are immense, estimated at almost $8 trillion between 2010 and 2020.30 Moreover, investments in infrastructure, which were already low, declined during the 2008–2009 global financial crisis and have not bounced back to pre-2008 levels. Policy and regulatory impediments, and weak governance constrain infrastructure investments, especially from the private sector.

40. **Information and communication technology (ICT) related infrastructure is becoming more important in the present era.** ICT indicators have improved rapidly in the region since Strategy 2020—reflective of globalizaiton, user-oriented services, expansion of investments in ICT, and declining telecom rates. However, there are considerable regional variations (Table 5). As DMCs strive to diversify towards innovative products and sophisticated services, ICT will be a key instrument that can help them take advantage of globalization. Further spread of cost-effective quality ICT infrastructure is important for generation, transmission, and dissemination of knowledge, as well as for improved service delivery.

<table>
<thead>
<tr>
<th></th>
<th>Internet users (per 100 people)</th>
<th>Mobile cellular subscriptions (per 100 people)</th>
</tr>
</thead>
<tbody>
<tr>
<td>East Asia and Pacific (developing)</td>
<td>1.9</td>
<td>19.0</td>
</tr>
<tr>
<td>South Asia</td>
<td>0.5</td>
<td>4.4</td>
</tr>
<tr>
<td>OECD Members</td>
<td>28.0</td>
<td>64.0</td>
</tr>
</tbody>
</table>


Regional cooperation and integration are more important in a fragile global economy.

41. **As Asia-Pacific’s development is constrained by an uncertain global environment, regional partnerships are more important.** With the slow recovery of advanced economies (para. 17), regional cooperation and integration (RCI) will help cement Asia’s economic gains in the face of vulnerabilities to external shocks. Economies have to rebalance growth towards domestic and regional demand, and create a more integrated Asian market (para. 18). Pacific Islands need to be better connected to continental Asia, to benefit from regional development. In addition, cooperative management of regional public goods and coordinated geopolitical positions on global issues like terrorism and environment that affect the region will be particularly important for Asia’s long-term development.

42. **In general, RCI has improved in Asia, with East and South East Asia being more advanced than other subregions.** Trade integration within Asia, as measured by the share of regional trade to total trade, has shown good progress—increasing from 43.8% in 1990 to 57.2% in 2013. Financial integration has improved, with increasing bond purchases by Asian investors from Japan and PRC. In 2008–2010, intra-regional bond and equity holdings stood at about 25% and more than 6% of total Asian holdings respectively. Regional connectivity and intraregional remittances within Asia are also rising rapidly, indicating growing mobility within the region. Further deepening of RCI is important to sustain development.

43. **New opportunities to intensify RCI are emerging in the region.** With the opening up of Myanmar, pan-Asian regional integration has become a realistic agenda. Facilitating trade integration, intraregional supply chains, and stronger financial linkages with more developed neighboring countries will help smaller countries to develop faster towards a unified “One Asia”.

Preserving financial stability has become imperative, in view of the downside risks facing the region’s future prospects.

44. **The recent volatility that affected several DMCs has demonstrated the importance of financial stability.** Strategy 2020 was followed by a global downturn in 2008–2009, and the development process in the region now has to contend with downside risks. While there are no immediate threats of a financial crisis, it is important to be vigilant (para. 16–19). As DMCs seek a sustainable growth path, governments must guard against volatile capital flows and financial market disruption. They must also continue to pursue sound monetary policies that include stabilization measures.

45. **Banking indicators have improved since Strategy 2020, but should not be cause for complacency.** In general, banks underwent several reforms after the financial crisis, which has strengthened the banking sector. By 2012, capital adequacy ratios of banks in the region had generally improved relative to before the global financial crisis, while the ratio of nonperforming loans to all loans had fallen markedly (Figure 7). Despite being on a sound sectoral footing at present, the authorities should remain cautious. The decline in the ratio of nonperforming loans to all loans is largely due to increased bank lending in 2008–2009, as part of the monetary stimulus to counter the global financial crisis. Domestic credit to the private sector has grown in most DMCs, and while these loans do not look risky at present, they could go bad in a downturn.32

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46. **Efforts to align financial systems to economic needs must continue.** Financial systems continue to be dominated by banks. Stocks traded as a share of GDP have declined significantly between 2008 and 2012—from 73.3% to 28.6% in South Asia and from 125.5% to 73.4% in East Asia and Pacific. While the private sector’s access to credit has improved, it is generally constrained due to weak risk management, credit standards, and internal control procedures. The median ranking of ADB DMCs in terms of the World Bank’s Ease of Getting Credit indicator improved from 83rd of 185 countries worldwide in 2012 to 73rd of 189 countries in 2013. However, this compares poorly with advanced economies.

47. **DMCs must emphasize innovation, technology and higher education for structural transformation.**

48. **Developing Asia-Pacific has to achieve successful structural transformation to avoid potential income traps.** ADB DMCs cannot follow the export-oriented labor intensive growth strategies that worked so well for Japan and the East Asian tigers, particularly in their successful industrialization experience (paras. 25). The main reason is that the overall economic environment has changed substantially. Growth must be led by higher productivity, suited to domestic and regional markets. Overall productivity can be improved by enhancing productivity within sectors, and by reallocation of labor to more productive sectors.

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DMCs = developing member countries, PRC = People’s Republic of China.
Source: International Monetary Fund, Financial Soundness Indicators (accessed 26 October 2013).

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33 In parallel, stocks traded as a share of GDP in the world fell from 181.6% to 72.7% between 2008 and 2012.
34 The depth of credit information index score for ADB DMCs averages between 2 and 3 on a scale from 1 to 6, with a higher score indicating better information. This compares unfavorably to an index score of 5 for OECD countries and an index score between 4 and 6 for East Asian industrialized economies.
friendly environment are likely to be better off. Generally, UMICs have more innovation-friendly institutions, while LICs have the lowest innovation scores among DMCs (Figure 8).

Figure 8: Correlation between Innovation and Per Capita Income

<table>
<thead>
<tr>
<th>Global Innovation Index</th>
<th>GNI Per Capita in 2012 (Natural Log Scale)</th>
</tr>
</thead>
</table>
| ARM = Armenia; AZE = Azerbaijan; BAN = Bangladesh; FIJ = the Fiji Islands; GEO = Georgia; GNI = gross national income; IND = India; INO = Indonesia; KAZ = Kazakhstan; KGZ = Kyrgyz republic; MAL = Malaysia; MON = Mongolia; NEP = Nepal; PAK = Pakistan; PHI = Philippines; PRC = People’s Republic of China; SRI = Sri Lanka; TAJ = Tajikistan; THA = Thailand; UZB = Uzbekistan; VIE = Viet Nam. Source: Gross National Income per capita from World Development Indicators, 2013. Global Innovation Index from Cornell University, INSEAD, and WIPO. 2013. The Global Innovation Index 2013: The Local Dynamics of Innovation. Geneva, Ithaca, and Fontainebleau. The Global Innovation Index ranges from 0–100.

49. The type of innovation and technology required for successful structural transformation may vary across income groups. The region’s LICs and LMICs generally have more scope to imitate lessons and adapt technologies from the UMICs and HICs in their quest for structural transformation. However, since UMICs cannot always follow the lessons from HICs in the current global economic environment, they must focus on innovations for industrial upgradation and development of niche products to meet the needs of domestic and regional markets.

50. Education is particularly important in enhancing economic productivity. The capacity for knowledge absorption and innovation will depend on education. Provision of education, especially of high quality, can facilitate diversification. The process of diversification is “path dependent” as economies cannot readily jump from unsophisticated products to very sophisticated ones. Education achievement alone does not help countries leapfrog into significantly more sophisticated products, but the provision of good quality higher education will contribute to this transformation in incremental steps. There is evidence that years of schooling and diversification are positively related, and the quality of education matters more than the quantity. A key role of education in transforming economies is to help a workforce learn to perform new and unfamiliar functions.

See http://www.globalinnovationindex.org/. Five input pillars of the Global Innovation Index capture (1) institutions, (2) human capital and research, (3) infrastructure, (4) market sophistication, and (5) business sophistication. Two output pillars capture actual evidence of innovation outputs: (6) knowledge and technology outputs and (7) creative outputs.

Governance has improved in many countries, although there remain significant variations and gaps that can hamper development.

51. Governance reform is needed to sustain development momentum and ensure that the benefits of growth are widely shared. Structural and economic transformation requires public institutions with the ability to design and implement suitable policies. Asian countries that score higher in selected governance indicators have grown more quickly than others. In fact, there is recent evidence that good governance is directly correlated with better outcomes for human development and infrastructure.

52. While generalizations are difficult, some recent governance-related improvements in Asia-Pacific are notable. The Global Competitiveness Index (GCI) from the World Economic Forum shows that the average ranking of ADB DMCs has improved from 69th of 134 countries in 2008–2009 to 65th of 144 countries in 2012–2013. Several DMCs have taken measures to combat corruption, and most have already ratified the United Nations Convention against Corruption. Countries like Bhutan, Cambodia, India, Indonesia, Mongolia, and the Philippines have recently strengthened their legal regimes for combating money laundering and the financing of terrorism. Legal procedures addressing corruption have been enhanced, as many jurisdictions have established dedicated anticorruption agencies, including Bhutan, Indonesia, Malaysia, Thailand, and Timor-Leste.

53. Asia-Pacific countries have taken steps to enhance e-governance, although there are variations in outcomes. E-government has improved since 2008. The region as a whole is at a stage of e-government development close to the world average but below that of Europe—though East Asia performs significantly better. Within developing Asia, broad patterns are seen with UMICs generally having stronger e-government compared with LMICs and LICs (Figure 9). Most Pacific Islands lack comparable data.

Figure 9: E-government Index in 2012

<table>
<thead>
<tr>
<th>Country</th>
<th>Index Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Europe</td>
<td>0.75</td>
</tr>
<tr>
<td>World</td>
<td>0.70</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>0.60</td>
</tr>
<tr>
<td>Malaysia</td>
<td>0.55</td>
</tr>
<tr>
<td>PRC</td>
<td>0.50</td>
</tr>
<tr>
<td>Thailand</td>
<td>0.45</td>
</tr>
<tr>
<td>Fiji</td>
<td>0.40</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>0.35</td>
</tr>
<tr>
<td>Philippines</td>
<td>0.30</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>0.25</td>
</tr>
<tr>
<td>Indonesia</td>
<td>0.20</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>0.15</td>
</tr>
<tr>
<td>India</td>
<td>0.10</td>
</tr>
<tr>
<td>Micronesia</td>
<td>0.05</td>
</tr>
<tr>
<td>Pakistan</td>
<td>0.00</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>0.00</td>
</tr>
</tbody>
</table>

LIC=low income countries; LMIC=lower middle income countries; PRC=People’s Republic of China; UMIC=upper middle income country

Source: United Nations E-Government Survey online database 2012. The E-government development index is a composite index comprising the web measure index, the telecommunication infrastructure index and the human capital index. It ranges from 0 (low) to 1 (high).

54. Despite improvements, Asia-Pacific still has a significant governance gap with developed economies, which must be addressed through tailored approaches. Governance in the region has lagged its economic achievements, and Asia on average is behind even its developing economy peers in Latin America.\textsuperscript{38} Public service shortfalls mirror developing Asia-Pacific’s lagging governance, and undermine development outcomes. A multi-pronged approach is needed to address deficiencies, including empowerment of citizens, enhancement of accountability, and engagement of local governments and private sector in service delivery. The approach must be tailored to country circumstances. Broadly, growth-supporting aspects of governance should take center stage for LICs and LMICs. Strengthening government effectiveness, improving regulatory quality and the rule of law, and scaling up anticorruption efforts provide entry points to wider governance reform in these economies. UMICs must maintain an environment supportive of growth, but policy must also respond to the rising aspirations of the populace, and enhance citizens’ participation and public accountability.

IV. CHANGING ENVIRONMENT FOR DEVELOPMENT COOPERATION

55. The overall challenge facing ADB is to provide assistance competitively as DMCs—particularly MICs—access diverse sources of finance and knowledge, and the development agenda shifts. International development partners like ADB need to strengthen a ‘finance++ approach’—using own resources to leverage additional resources and knowledge—in order to stay relevant in the changing global environment. It is important to work with DMCs to address specific development constraints by providing tailored assistance, drawing on an array of knowledge services and financial products. Due to their diversity, there cannot be a “one-size-fits-all approach” to DMCs. Assistance must be geared towards a country’s demands, and be relevant and responsive, and add value.

A. Implications of the Post-2015 Development Agenda

56. As the period for achievement of MDGs draws to a close, a post-2015 development agenda is under formulation. The eight MDGs have been a milestone in global and national development efforts. The framework has helped to galvanize development efforts and guide global and national development priorities. To strengthen cohesive development efforts and forge a strong global partnership for development, a unified global development agenda for the post-2015 period, with sustainable development at its core, is under consideration.

57. The challenges facing the region are consistent with the post-2015 development agenda that focuses on five identified ‘global shifts’.\textsuperscript{39}

- Leave no one behind. It is important to achieve the original promise of the MDGs, and focus on attaining the missed targets—as in health and environment. Additionally, even where the first generation MDGs are largely met, there may be outstanding concerns to be addressed. For example, the poverty MDG has been achieved, but almost a fifth of the region still lives in extreme poverty, and this group needs to be targeted to be lifted out of poverty.


• **Put sustainable development at the core.** Given the environmental costs of recent progress, further focus is needed to halt the alarming pace of climate change and environmental degradation, which pose major threats to the region.

• **Transform economies for jobs and inclusive growth.** The region has been generally characterized by ‘jobless’ and non-inclusive growth in recent years. It is therefore important to harness innovation, technology, and the potential of private business to create jobs and drive sustainable and inclusive growth.

• **Build peace and effective, open and accountable institutions for all.** Given mixed achievement in terms of institutional development and peace and prosperity in the region, it is necessary to promote freedom from fear, conflict and violence, and honest and accountable governments with the capacity to deliver on the development agenda.

• **Forge a new global partnership.** Solid partnership can improve the scope for technology transfer, capacity building, and regional cooperation initiatives in an uncertain world. The more institutionally developed DMCs can share knowledge and capacity with other countries, and help their economic and social transition.

58. **The perspectives emerging from regional consultations around the post-2015 developmental agenda highlight the importance of customizing targets to meet country-specific needs.** There is clear consensus that the post-2015 agenda should integrate economic prosperity, social equity, and environmental sustainability. Within this broad framework, subregional perspectives have varied. For example, Central and West Asian countries have prioritized natural resource management, Pacific countries regard climate change as a major challenge, and South and Southeast Asia put high importance on improving education, health and living standards.

B. **Implications of the Changing Architecture of Development Finance**

*There is continued need for development financing, despite diverse funding sources available to countries.*

59. **National governments in ADB MICs can access diverse sources of financing, including from the private sector.** Sovereign credit ratings have improved in several countries since Strategy 2020. Excluding ADB’s graduates, five DMCs (PRC, India, Kazakhstan, Malaysia, and Thailand) were rated investment grade by Standard & Poor’s in 2008. In 2013, Philippines and Azerbaijan were also rated investment grade. In addition, Indonesia was rated investment grade by Moody’s and Fitch Ratings in 2012. Countries that have successfully issued sovereign bonds in international markets since 2007 include Armenia, Georgia, Mongolia, Pakistan, Sri Lanka, and Viet Nam.40

60. **South-south cooperation is emerging as a complement to regular development financing.** In particular, assistance from emerging economies has surged in recent years, but remains significantly smaller than financial support provided by traditional donors. While

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40 Sovereign ratings have improved for Azerbaijan, Bangladesh, PRC, Georgia, Indonesia, Kazakhstan, and Philippines between 2008 and 2013—while they have declined for Cambodia, Cook Islands, Pakistan and Viet Nam.
assistance from emerging economies will not replace traditional donor financing, it will provide important complementarities—like strengthening regional trade linkages, boosting infrastructure, and promoting exports.

61. **Official Development Assistance (ODA) to ADB DMCs is low on average, relative to population and poverty.** During 2007-2011, ODA to ADB DMCs has been broadly stable between 19%–23% of total ODA to developing countries, with a peak during the growth slowdown in 2009 global crisis (Figure 10). The Asian DMCs had the lowest average ODA per capita among developing regions, at just over $7.1 per capita in 2011. On the other hand, the Pacific DMCs received more than $218.9 per capita. While the Asia-Pacific region was home to 60% of the world’s extreme poor in 2010, it received only 21% of world ODA flows.

![Figure 10: Official Development Assistance to DMCs](image)

DMC = developing member countries; ODA = Official Development Assistance.

62. **Substantial variation in institutional capacity and diverse development needs denote that the role of development financing will continue in the near term.** While sources of financing are expanding, LICs and most MICs are not considered investment grade. Most Pacific small islands—many of which are fragile states—are not rated for sovereign borrowing. This hampers DMCs in their search for commercial resources, and indicates continuing potential demand for development financing.

*The private sector must be encouraged to play a bigger role in development.*

63. **It is important to promote the private sector as a driver of change by removing constraints to its participation in development.** Institutional and financial capacity will limit the extent to which the public sector can lead a country’s development agenda. In DMCs, the private sector faces varying constraints that include cumbersome and expensive business regulations, weak legal institutions, small size of domestic markets, insufficient access to productive resources like finance and skilled labor, poor social and physical infrastructure, and instability (both political and macroeconomic). Among 189 countries worldwide, the 2013 Ease of Doing Business Rankings for ADB DMCs include top-20 rankings for UMICs like Malaysia, and Thailand—and bottom-third rankings for LMICs and LICs Bangladesh, Cambodia, India,
Indonesia, Lao PDR, Pakistan, and Philippines.\textsuperscript{41} Removing barriers to private sector participation can help leverage resources for development.

64. **Refining and enhancing market-based instruments can help catalyze additional financial resources.** Aside of direct lending, ADB also seeks to mobilize and channel private sector financing. Enhancing risk management tools, expanding non-sovereign, sub-sovereign, and private sector projects—based on an adequate risk assessment of the concerned entities, and additional focus on public-private partnerships are some mechanisms that can help channelize resources for development. Additionally, ADB should expand its private sector operations in ADF DMCs. However, this will also have the effect of exposing the private sector project portfolio to higher risk.

*Customized knowledge products and advisory services will be in increasing demand.*

65. **As DMCs access market-based funds from various sources, ADB’s value added must evolve towards the competitive provision of up-to-date knowledge.** New and more complex development challenges require expansion of global and regional knowledge. Given expanding sources of development assistance, ADB must remain relevant, efficient, and cost-effective. This may be achieved by producing, delivering and applying usable knowledge products and advisory services to DMCs to meet their specific needs.

66. **The demand for knowledge is likely to differ in DMCs depending on levels of income and stages of structural transformation.** On the one hand, LICs and many LMICs may require deeper knowledge and understanding of policies that can *ignite* growth (e.g., facilitate transfer of workers out of agriculture); *sustain* growth (e.g., improve the efficiency of the financial sector); and *promote* economic diversification (e.g., towards more productive sectors). Since they have more scope to emulate technologies from UMICs (para. 49), south-south knowledge transfers should help them to catch up. Capacity building will be particularly important for those LICs and LMICs still lagging in institutional development. On the other hand, UMICs generally have better institutional capacity and a fairly diversified industrial base—except those heavily dependent on natural resources. They may require specialized knowledge products and advisory services to help develop capabilities to upgrade production and export baskets—towards niche products, branded items, and sophisticated services. For UMICs which still have a large share of employment in agriculture, ADB can develop tailored knowledge services to “industrialize” agriculture (e.g., by developing modern agribusiness).

\textsuperscript{41} World Bank. 2013. \url{http://www.doingbusiness.org/rankings}. 