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Inclusive Growth toward a Prosperous Asia: Policy Implications

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Ifzal Ali is Chief Economist, and Juzhong Zhuang is Assistant Chief Economist of the Economic Analysis and Operations Support Division, Economics and Research Department, Asian Development Bank. The authors thank Rana Hasan and Hyun H. Son for offering valuable ideas, suggestions, and comments throughout the preparation of the paper; Rhoda Magsombol for yeoman technical assistance; Franklin De Guzman and Anneli S. Lagman-Martin for research assistance; and Cherry Lynn T. Zafaralla for copy editing. The authors are solely responsible for the views expressed and the remaining errors.

Asian Development Bank
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1550 Metro Manila, Philippines
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FOREWORD

The ERD Working Paper Series is a forum for ongoing and recently completed research and policy studies undertaken in the Asian Development Bank or on its behalf. The Series is a quick-disseminating, informal publication meant to stimulate discussion and elicit feedback. Papers published under this Series could subsequently be revised for publication as articles in professional journals or chapters in books.

CONTENTS

ABSTRACT

Developing Asia is embracing inclusive growth as a key development goal in response to rising inequalities and increasing concern that these could undermine the very sustainability of Asia's growth. This paper argues that inclusive growth emphasizes creation of and equal access to opportunities; and that unequal opportunities arise from social exclusion associated with market, institutional, and policy failures. A development strategy anchored on inclusive growth is outlined, consisting of two mutually reinforcing strategic pillars of high and sustainable growth to create economic opportunities, and social inclusion to ensure equal access to opportunities. This will enable developing Asia to accomplish the agenda of eradicating extreme poverty and, at the same time, address the development challenge brought about by rising inequalities. It is argued that the Asian Development Bank (ADB) should respond to the emerging needs of developing Asia by adopting inclusive growth as its overarching goal. This goal, if adopted, will require ADB to modify its corporate strategy, including its vision, mission, strategic pillars, and core operational priorities. Implications for ADB's country and regional operations are discussed.

I. INTRODUCTION

Developing Asia's stellar gross domestic product (GDP) growth rates have masked rapidly rising *relative* and *absolute* inequalities, leading to two faces of Asia. A "shining Asia", which is competing internationally and benefiting from the forces of globalization, technological change, and economies of scale, has grabbed the attention of the media and the world. In contrast, a "suffering Asia", not as well publicized but even more important, has unacceptably wide swatches of its population who are poor and vulnerable. These two faces of Asia are both a beacon of hope and a symbol of despair. Merging these two faces will be the development challenge over the next generation for the region.

In addressing this challenge, inclusive growth with its focus on creating economic opportunities and ensuring equal access to them will play a pivotal role. More and more countries are adopting it as the goal of development policy. India, which had poverty reduction as the central focus of its development strategy over the last 50 years, has recently switched to a new strategy focusing on two objectives: raising economic growth and making growth more inclusive (Planning Commission of India 2006). In the People's Republic of China (PRC), the government has made the creation of a "harmonious society", a concept very closely related to inclusive growth, as the top priority in its 11th Five Year Plan (State Council of China 2006). In Thailand, growth with equity is one of the elements of its "Sufficiency Philosophy", which underpins the government's development efforts (UNDP 2007). A similar theme can be found in Viet Nam's socioeconomic development strategy, which advocates "quick and sustainable development, economic growth in parallel with implementation of initiatives, social equity, and environment protection" (The Central Committee of the Communist Party of Viet Nam 2001). Inclusive growth as a development concept is also being embraced by many development partners of developing countries including bilateral and multilateral aid agencies, international organizations, nongovernment organizations, and civil society.

In the Asian Development Bank (ADB), "contributing to the harmonious growth of the region" is mandated by its Charter (ADB 1966). The importance of "inclusive growth" and "inclusiveness" has been recognized in many of its strategic documents. For instance, "inclusive social development" is one of the strategic pillars of the Enhanced Poverty Reduction Strategy (PRS) (ADB 2004b). "Strengthening inclusiveness" is one of the strategic priorities of the Medium-Term Strategy II 2006–2008 (ADB 2006c). More recently, a panel of eminent persons commissioned by ADB's President to provide insights on the region's future and on how it will affect the future role of ADB, called on the institution to expand its strategic role from poverty reduction to inclusive growth (ADB 2007b).

This paper examines policy implications of adopting inclusive growth as the overarching development goal for developing Asia and for ADB. More specifically, the paper (i) looks at why developing Asia is embracing inclusive growth; (ii) discusses the concept of inclusive growth as a development goal; (iii) examines policy ingredients of a development strategy anchored on inclusive growth; and (iv) examines implications for ADB if it is to adopt inclusive growth as its overarching goal.

II. WHY IS DEVELOPING ASIA EMBRACING INCLUSIVE GROWTH?

The attention to and recognition of the relevance and importance of inclusive growth in developing Asia have been triggered by a rising concern that the benefits of spectacular economic growth have not been equitably shared (Ali 2007). This section explains why many countries of developing Asia are embracing inclusive growth and putting it at the heart of their development policy and strategy.

Developing Asia experienced rapid economic growth during the last two decades. For developing Asia as a whole, per capita GDP at 2000 constant prices increased from $424 to $1,030 between 1990 and 2005, growing at an annual rate of 6%, a pace with few parallels in history (Table 1). Across the region, growth was most pronounced in East Asia at over 9%, driven largely by the PRC. Southeast Asia grew at an annual rate of 3.2% despite interruptions marked by the 1997 financial crisis. South Asia grew at 3.8% annually; this level of growth, although low, nevertheless represents a significant improvement from its past, in particular, in view of the more recent acceleration in growth in several countries including India and Pakistan.

Table 1
Income per Capita and Poverty Incidence in Asia

Economy	GDP per Capita, Constant 2000 US$ 1990	GDP per Capita, Constant 2000 US$ 2005	Average Annual Growth Rate (%)	Headcount Ratio $1-a-day (%) 1990	Headcount Ratio $1-a-day (%) 2005	Change	Headcount Ratio $2-a-day (%) 1990	Headcount Ratio $2-a-day (%) 2005	Change
PRC	392	1449	9.11	32.50	7.10	–25.40	71.50	29.40	–42.10
Mongolia	451	483	0.47	27.30	10.51	–16.79	69.94	42.37	–27.57
East Asia	***392***	***1447***	***9.10***	***32.50***	***7.10***	***–25.40***	***71.50***	***29.40***	***–42.10***
Bangladesh	283	433	2.86	34.40	36.04	1.64	85.70	81.70	–4.00
India	317	588	4.20	43.50	35.00	–8.50	86.50	79.80	–6.70
Nepal	176	234	1.93	45.70	26.02	–19.68	84.33	65.45	–18.88
Pakistan	461	596	1.72	47.76	10.24	–37.52	87.87	59.42	–28.45
Sri Lanka	577	1002	3.74	3.82	2.04	–1.78	40.58	32.85	–7.73
South Asia	***330***	***573***	***3.75***	***42.40***	***31.90***	***–10.50***	***85.80***	***76.90***	***–8.90***
Cambodia	--	402		32.50	12.67	–19.83	76.30	54.52	–21.78
Indonesia	612	942	2.91	20.51	7.43	–13.08	70.92	50.31	–20.61
Lao PDR	228	396	3.75	52.74	21.35	–31.39	89.60	67.68	–21.92
Malaysia	2547	4437	3.77	0.09	0.00	–0.09	23.38	9.77	–13.61
Philippines	914	1129	1.42	20.20	10.86	–9.34	55.48	40.29	–15.19
Thailand	1452	2441	3.52	10.16	0.00	–10.16	43.05	16.17	–26.88
Viet Nam	227	538	5.93	50.66	6.48	–44.18	87.00	39.73	–47.27
South East Asia	***784***	***1256***	***3.19***	***23.80***	***7.20***	***–16.60***	***65.60***	***43.20***	***–22.40***
Total Regions	424	1030	6.10	34.60	18.00	–16.60	75.00	51.90	–23.10

Note: Headcount ratio is poverty headcount ratio, at either $1-a-day or $2-a-day (percent of population). Totals for regional groupings include only those countries listed.
Sources: World Bank Povcalnet database and East Asia updates for 1990 poverty estimates; poverty projections for 2005 and 2020, staff estimates; per capita GDP figures from *World Development Indicators Online* (World Bank 2007).

Asia's rapid growth has led to dramatic reduction in the level of extreme poverty. Using the $1-a-day poverty line established by the World Bank in 1990,[1] the incidence of extreme income poverty declined from 34.6% to 18% between 1990 and 2005 (Table 1), with each percentage point of growth associated with an almost 2-percentage point decline in poverty incidence on average

[1] The $1-a-day poverty line represents the median poverty lines of the 10 countries with the lowest poverty lines at that time. It focuses on extreme deprivation and represents a very conservative measure of poverty.

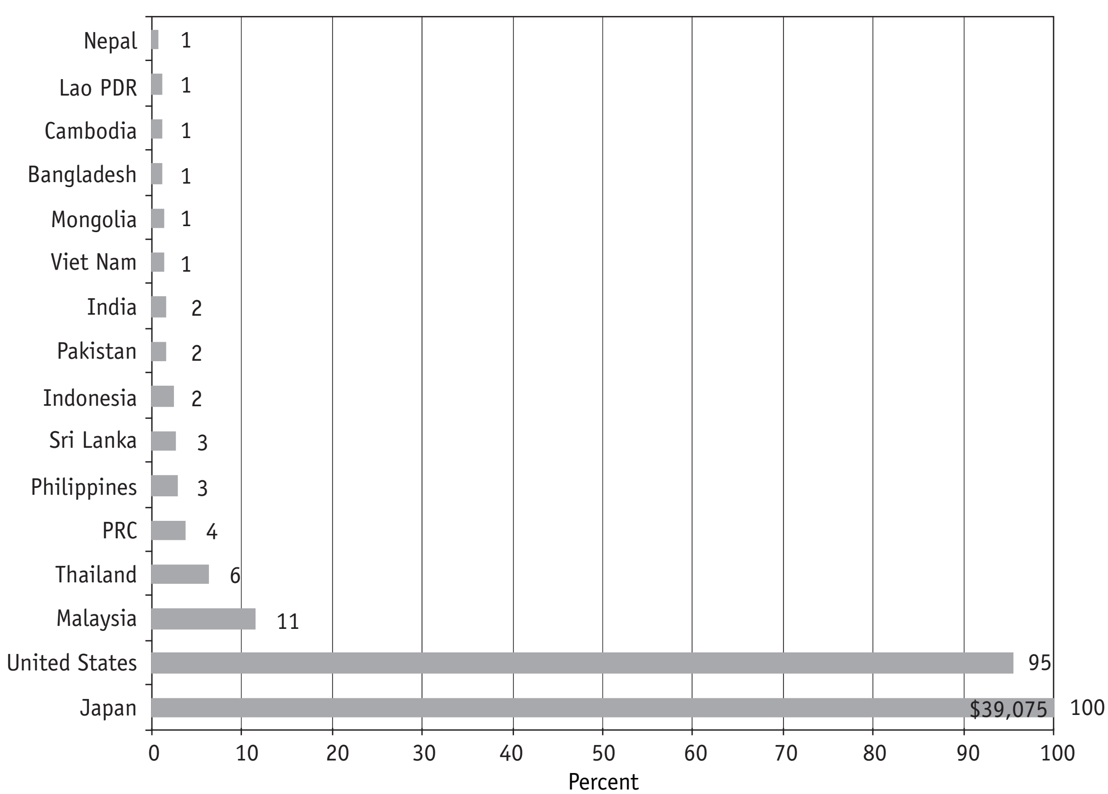
(ADB 2004c). The income poverty target of the Millennium Development Goals (MDGs) had been met by 2005 for most Asian countries except those in South Asia. The decline in the number of the extreme poor from 945 million in 1990 to 604 million in 2005 is largely attributable to the achievement in the PRC and Viet Nam. In South Asia, with the exception of Pakistan and Sri Lanka, the incidence of extreme poverty and its magnitude in 2005 were still very significant.

However, poverty incidence measured by $2-a-day is still very high. Using the $2-a-day poverty line,[2] the level of poverty only declined from 75% to 51.9% between 1990 and 2005 for developing Asia as a whole (Table 1), suggesting that more than half of developing Asia still live in very poor conditions, are vulnerable to shocks, and may easily slip into extreme poverty. The decline in this measure of poverty between 1990 and 2005 was more pronounced in Viet Nam, PRC, Pakistan, and Mongolia, and by 47.27, 42.1, 28.45, and 27.57 percentage points, respectively. The reduction in most South Asian countries, however, was more limited.

Despite rapid growth, developing Asia's income gap with the developed world remains astonishingly wide. In 2005, the average per capita GDP at 2000 constant dollar terms for developing Asia as a whole was less than 3% that of Japan and the United States. Even for the PRC, which experienced a 9% growth rate for more than 20 years, per capita GDP in 2005 was only 3.7% that of Japan and 3.9% that of the United States (Figure 1). These suggest that developing Asia has a long way to go to catch up with the income level of the developed world. Even in terms of purchasing power

[2] The $2-a-day poverty line reflects poverty lines more commonly used in low-middle-income countries.

FIGURE 1
GDP PER CAPITA AS A PERCENT OF JAPAN'S, 2005 (2000 CONSTANT US DOLLARS)



Source: *World Development Indicators Online* (World Bank 2007).

parity, which is considered as more appropriate for cross-country comparisons, it would take 27 years for the PRC, 40 years for Thailand, 48 years for Viet Nam, 51 years for India, and 84 years for Bangladesh to catch up with Singapore's 2005 per capita GDP level under the benchmark growth rates (the average of the annual growth rates of GDP per capita between 2002 and 2006). Thus, even within Asia, there is a lot of catching-up left.

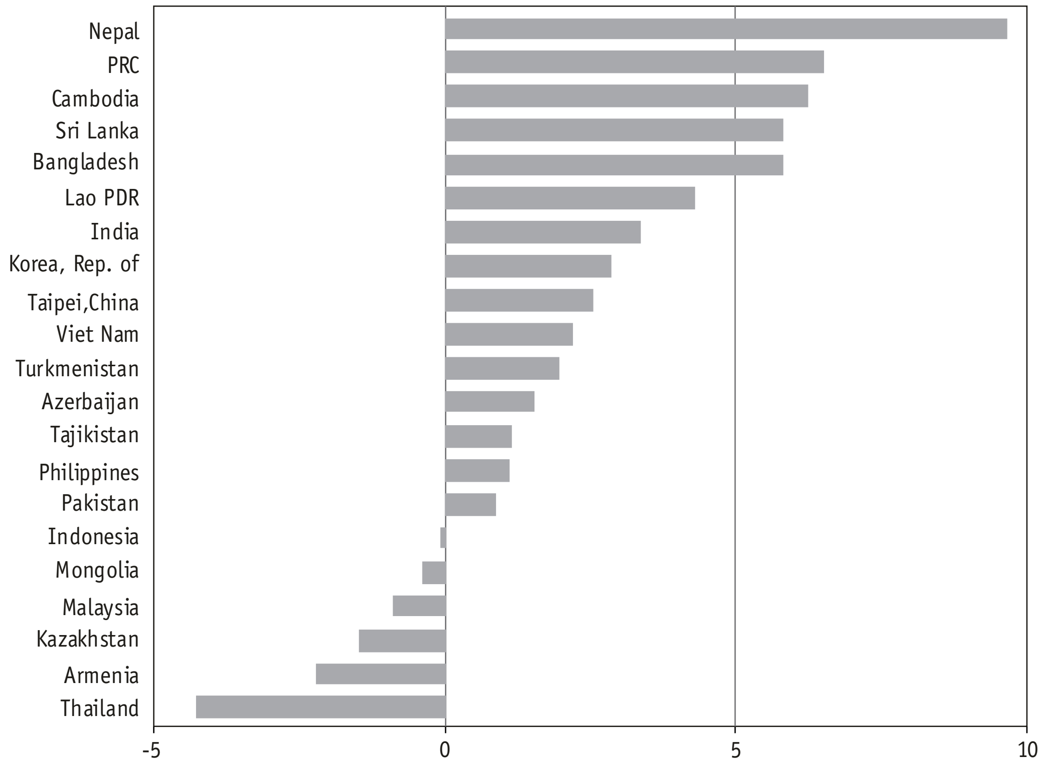
A more pressing issue for developing Asia is rapidly rising inequalities leading to an increasing concern that benefits of its spectacular growth have not been equally shared. Using the Gini coefficient, a commonly used measure of inequality, except for those severely hit by the Asian financial crisis (Indonesia, Malaysia, Thailand) and Mongolia, income inequality has increased between 1990 and 2005 in all countries, with the largest jumps occurring in Bangladesh, Cambodia, PRC, Nepal, and Sri Lanka (see Table 2 and Figure 2). What is more disturbing is the increase in absolute inequalities as measured by differences in mean consumption of the top quintile relative to the bottom quintile. The ratio of expenditure growth of the top to the bottom quintile is 2.1 for PRC, 2.3 for India, 6.9 for Sri Lanka, and 4.8 for Bangladesh during 1999–2005 (Figure 3). These increases in the absolute gaps between the rich and poor and very visible changes in the consumption patterns and lifestyles of the rich are leading to a perceptible increase in social and political tensions, undermining social cohesiveness.

Table 2
Recent Trend in Income/Expenditure Inequality
Gini Coefficients (percent)

	Gini Coefficients			
Economy	Initial Year		Final Year	
Bangladesh	28.3	1991	34.1	2005
Cambodia	31.8	1993	40.7	2004
PRC	40.7	1993	45.5	2004
India	32.9	1993	36.2	2004
Indonesia	34.4	1993	34.3	2002
Lao PDR	30.4	1992	34.7	2002
Malaysia	41.2	1993	40.3	2004
Mongolia	33.2	1995	32.8	2002
Nepal	37.7	1995	47.3	2003
Pakistan	30.3	1992	31.2	2004
Philippines	42.9	1994	44.0	2003
Sri Lanka	34.4	1995	40.2	2002
Thailand	46.2	1992	42.0	2002
Viet Nam	34.9	1993	37.1	2004

Sources: Staff estimates using grouped/tabulated data from World Bank's PovcalNet database, WIID2a database (World Institute for Development Economic Research 2007), selected national statistics offices, and unit record data.

Figure 2
Recent Trend in Income/Expenditure Inequality
Change in Gini Coefficients (percent)

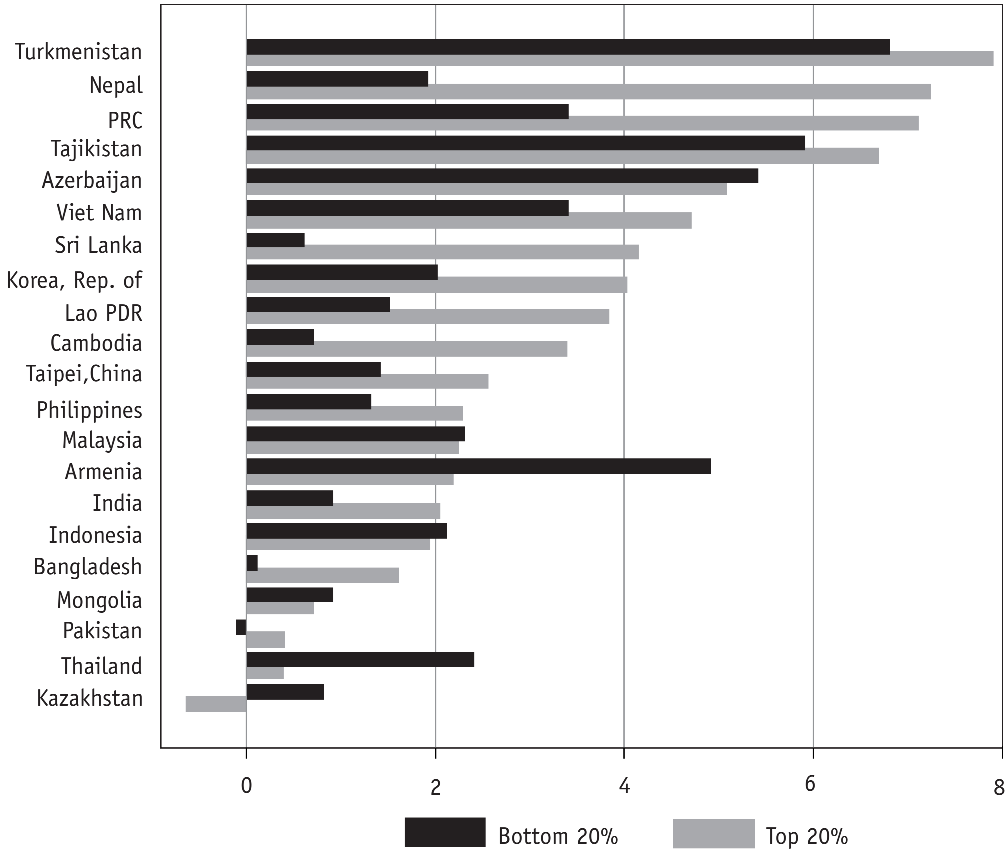


Sources: Staff estimates using grouped/tabulated data from World Bank's PovcalNet database, WIID2a database (World Institute for Development Economic Research 2007), selected national statistics offices, and unit record data.

Persistent and growing inequalities in access to social services such as education and health, exacerbated by income inequalities, are also a significant concern for developing Asia. It is widely believed that even though Asia and the Pacific region is on track to meet the MDG target of reducing by half the proportion of people living on less than $1-a-day, it is unlikely to meet the goals of reducing nonincome poverty (Table 3). In many countries, primary-school-age children from households of the poorest quintile are almost three times more likely to be out of school than those from the richest quintile; and child mortality rates for the poorest quintiles are two to three times higher than those for the richest quintiles. In the Philippines, the situation with primary enrolment and measles immunization, which significantly impact on child mortality, is worse today than in 1990 (Ali 2007). Even in the PRC with its spectacular economic growth, rising disparities in health outcomes between urban and rural populations have triggered a slowdown of improvements in health in the last two decades (Tandon and Zhuang 2007).

If the trend of the rising inequalities continues and is left unchecked, developing Asia would have a considerable share of its population under extreme poverty even by 2020. Scenario analysis suggests that with a benchmark growth rate (the average of the annual growth rates of GDP per capita between 2002 and 2006) and neutral distribution assumption (with per capita GDP growing at

Figure 3
Annualized Growth Rates of Per Capita Expenditures of Bottom 20% and Top 20% Income Quintiles (percent)



Note: Annualized growth rates are for the following period: 1998–2003 for Armenia, 1995–2001 for Azerbaijan, 1991–2005 for Bangladesh, 1993–2004 for Cambodia, 1993–2004 for China, 1993–2004 for India, 1993-2002 for Indonesia, 1996–2003 for Kazakhstan, 1993–2004 for Korea, 1992–2002 for Lao PDR, 1993–2004 for Malaysia, 1995–2002 for Mongolia, 1995–2003 for Nepal, 1992–2004 for Pakistan, 1994–2003 for Philippines, 1995–2002 for Sri Lanka, 1993-2003 for Taipei,China, 1999–2003 for Tajikistan, 1992–2002 for Thailand, 1998–2003 for Turkmenistan, and 1993–2004 for Viet Nam.

Sources: Staff estimates using grouped/tabulated data from World Bank's PovcalNet database, WIID2a database (World Institute for Development Economic Research 2007), selected national statistics offices, and unit record data.

TABLE 3
DEVELOPING ASIA'S PROGRESS IN ACHIEVING MDGS BY 2015

GOAL	1		2			3			4		6			7							
	$1-A-DAY POVERTY	UNDERWEIGHT CHILDREN	PRIMARY ENROLMENT	REACHING GRADE 5	PRIMARY COMPLETION RATE	GENDER PRIMARY	GENDER SECONDARY	GENDER TERTIARY	UNDER-5 MORTALITY	INFANT MORTALITY	HIV PREVALENCE	TBC PREVALENCE	TBC DEATH RATE	FOREST COVER	PROTECTED AREA	CARBON DIOXIDE EMISSIONS	ODP CFC CONSUMPTION	WATER URBAN	WATER RURAL	SANITATION URBAN	SANITATION RURAL
Bangladesh	▼	■	▲	▼	▼	●	●	▼	▲	▲	▲	●	●	▼	●	▼	▼	▼	■	▼	▲
Cambodia		▼	●	▼	▲	▲	▲	▲	▼	▼	●	●	●	▼	●	●	●				
PRC	●	●				●	●	▲	●	●	▲	●	●	●	●	▼	●	▼	■	■	▲
India	▲	■	▲	▲	▲	▲	▲	■	■	■	▲	●	●	●	●	▼	▼	●	●	▲	▲
Indonesia	●	▼	■	▼	●	●	●	▼	●	●	▲	●	●	▼	●	▼	●	▼	■	■	■
Lao PDR	▼	■	▲	▲	■	▲	■	▲	▲	▲	▲	●	●	▼	●	▼	●				
Malaysia	●	●	▼	●	▼	●	●	●	●	●	▼	●	●	▼	●	▼	●	●	●	▼	
Mongolia	▼	▼	▼		●	●	●	●	▲	▲	▲	●	●	▼	●	●	●	▼	▼		
Nepal	▲		▲	■	▲	▲	▲	■	▲	■	▲	●	●	▼	●	▼	●	●	●	▲	▲
Pakistan	●	■	▲			■	▲	▼	■	■	▲	●	●	▼	●	▼	▼	●	●	●	▲
Philippines	▲	▼	▲	▼	●	●	●	●	●	●	▲	●	●	▼	●	▼	●	▼	■	▲	■
Sri Lanka	▲		●			●	●		●	●	▲	●	●	▼	●	▼	●	●	▲	●	●
Thailand	●					●	●	●	●	●	▲	●	●	▼	●	▼	●	●	●	●	●
Viet Nam	●	●	▼	▲	●	▼	●	■	●	●	▼	●	●	●	●	▼	●	●	●	●	▲

Keys: ● early achiever ▲ on track ■ slow ▼ regressing
Note: CFC means chlorofluorocarbons; ODP means ozone-depleting potential; TBC means tuberculosis cases.
Sources: ESCAP et al. (2006).

equal rates for the entire distribution), the incidence of extreme poverty for developing Asia would fall from 18.0% in 2005 to 2.3% in 2020, with the total number of extreme poor falling from 604 to 92 million (Table 4). However, at a lower growth rate (40% lower than the benchmark rate) and with a pro-rich distribution assumption (the top 40% of the distribution seeing its consumption grow 5 percentage points higher than mean growth), the incidence of extreme poverty would only fall to 9.9% in 2020, with the total number of extreme poor at 391 million and the bulk being in South Asia. These results suggest that the eradication of extreme poverty by 2020 is not pre-ordained. Countries must stay on a high growth trajectory and ensure that neutral or pro-poor distribution is attained.

Table 4
$1-a-Day Poverty Incidence and Magnitude of Poor in Developing Countries, Actual 1990 and Projected Levels in 2005 and 2020

	Headcount Ratio (percent)							
			2020					
			Benchmark Growth			Low Growth		
Economy	1990	2005	Pro-Poor Distribution	Neutral Distribution	Pro-Rich Distribution	Pro-Poor Distribution	Neutral Distribution	Pro-Rich Distribution
PRC	32.5	7.1	0.0	0.0	0.0	0.0	0.0	0.0
Mongolia	27.3	10.5	0.0	0.0	0.9	1.9	2.2	5.1
East Asia	***32.5***	***7.1***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***	***0.0***
Bangladesh	34.4	36.0	8.0	10.4	17.4	16.6	19.4	25.7
India	43.5	35.0	3.8	4.3	9.7	11.6	13.2	21.0
Nepal	45.7	26.0	22.6	25.0	33.2	23.1	25.5	33.6
Pakistan	47.8	10.2	0.0	0.0	0.6	2.2	2.2	4.1
Sri Lanka	3.8	2.0	0.0	0.0	0.0	0.0	0.0	0.1
South Asia	***42.4***	***31.9***	***4.2***	***4.8***	***9.8***	***11.2***	***12.7***	***19.6***
Cambodia	32.5	12.7	0.0	0.0	0.5	0.5	1.5	2.2
Indonesia	20.5	7.4	0.0	0.0	0.2	0.0	0.0	5.0
Lao PDR	52.7	21.4	7.1	9.0	16.0	12.2	13.5	19.2
Malaysia	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Philippines	20.2	10.9	1.1	2.5	11.1	4.3	5.5	13.7
Thailand	10.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Viet Nam	50.7	6.5	0.0	0.0	0.0	0.0	0.0	1.4
Southeast Asia	***23.8***	***7.2***	***0.3***	***0.6***	***2.3***	***1.0***	***1.2***	***5.2***
Total Regions	34.6	18.0	2.0	2.3	4.9	5.3	6.1	9.9
Poor Population (million)	945	604	78	92	195	211	240	391

Sources: *World Population Prospects: The 2006 Revision*, medium variant projections (United Nations 2006).
World Bank PovcalNet database and East Asia updates for 1990 poverty estimates.
Poverty projections for 2005 and 2020, staff estimates.

Moreover, rising inequalities will make a wide segment of population, about 30–40%, vulnerable to poverty**.** The same scenario analysis suggests that measured by the $2-a-day poverty line, even with the neutral distribution assumption, poverty would only fall to 25.7% in 2020 at the benchmark growth rate; at a lower growth rate assumption, it would only fall to 36.8% (Table 5). With a pro-rich assumption as implied by the currently rising income inequality, it would only fall to 29.3% under a benchmark growth rate and 39.8% under a lower growth rate. The combination of the lower growth and pro-rich distribution would mean that 1,567 million developing Asia's population live under the $2-a-day poverty line in 2020, with 72% being located in South Asia.

TABLE 5
$2-A-DAY POVERTY INCIDENCE AND MAGNITUDE OF POOR IN DEVELOPING COUNTRIES, ACTUAL 1990 AND PROJECTED LEVELS IN 2005 AND 2020

	Headcount Ratio (percent)							
			2020					
			Benchmark Growth			Low Growth		
Economy	1990	2005	Pro-Poor Distribution	Neutral Distribution	Pro-Rich Distribution	Pro-Poor Distribution	Neutral Distribution	Pro-Rich Distribution
PRC	71.5	29.4	2.0	2.6	7.9	11.3	12.1	16.0
Mongolia	69.9	42.4	14.0	15.3	19.3	22.9	24.3	28.2
East Asia	***71.5***	***29.4***	***2.0***	***2.6***	***7.9***	***11.3***	***12.1***	***16.8***
Bangladesh	85.7	81.7	59.0	59.3	59.5	67.9	69.7	70.5
India	86.5	79.8	46.7	47.5	49.2	62.0	62.5	63.8
Nepal	84.3	65.5	65.4	65.0	64.0	65.9	65.4	64.4
Pakistan	87.9	59.4	26.0	29.4	34.3	40.1	41.6	44.3
Sri Lanka	40.6	32.9	9.3	17.5	18.3	17.2	23.6	25.5
South Asia	***85.8***	***76.9***	***45.6***	***46.7***	***48.6***	***59.7***	***60.5***	***61.9***
Cambodia	76.3	54.5	11.7	13.2	19.1	26.8	28.3	32.5
Indonesia	70.9	50.3	23.9	26.6	31.8	34.4	36.2	39.9
Lao PDR	89.6	67.7	50.3	50.9	52.1	57.9	57.9	57.9
Malaysia	23.4	9.8	1.3	2.2	7.9	4.1	4.9	10.7
Philippines	55.5	40.3	25.9	27.3	32.1	31.1	32.3	36.3
Thailand	43.1	16.2	0.0	0.6	7.9	4.5	5.9	12.9
Viet Nam	87.0	39.7	9.9	11.2	16.0	19.5	20.8	25.3
Southeast Asia	***65.6***	***43.2***	***17.9***	***19.7***	***25.0***	***26.3***	***27.8***	***32.1***
Total Regions	**75.0**	**51.9**	**24.7**	**25.7**	**29.3**	**36.0**	**36.8**	**39.8**
Poor Population (million)	**2,046**	**1,740**	**973**	**1,012**	**1,154**	**1,415**	**1,450**	**1,567**

Sources: *World Population Prospects: The 2006 Revision*, medium variant projections (United Nations 2006).
World Bank PovcalNet database and East Asia updates for 1990 poverty estimates.
Poverty projections for 2005 and 2020, staff estimates.

The persistence of inequality could lead to three outcomes. First, reforms would stall, resulting in lower growth and higher inequalities. Second, rising absolute gaps in income and consumption between the poorest and richest quintiles could trigger social and political tensions. Third, in its extreme form, these tensions could lead to armed conflict as is currently happening in parts of South Asia (Murshed and Gates 2006). Rising inequalities in Asia pose a clear and present danger to social and political stability and, therefore, the sustainability of the growth process itself.

Rising income and nonincome inequalities in Asia are associated with inequalities in the access to opportunities. Recent ADB studies identified a number of features of labor market outcomes in Asia (Felipe and Hasan 2006). First, corresponding to rapid output growth, employment growth has been far lower in recent years. Second, in both relative and absolute terms, the differences in real wages between the bottom and top quintiles of the labor force in urban areas increased significantly over the last two decades. At the same time, rural–urban differentials in real wages have also widened. Third, employment in the informal sector where productivity levels and wages are low is either on the rise or persistently high. Last, the nature of employment in the formal sector, which was historically associated with regular contracts and job security, is changing toward that of the informal sector. These studies suggest that market, institutional, and policy failures restrict access to opportunities.

In sum, developing Asia is now entering into a new stage of social, political, and economic development. While high GDP growth has resulted in a dramatic decrease in extreme poverty from 1990 to 2005, income and nonincome inequalities are rising rapidly and, if these are not addressed, there is a major risk to continued social and economic progress in developing Asia. To address this risk, the development agenda will need to be expanded to include not only the eradication of extreme poverty, but also improving living standards of a much larger group who feel disenfranchised by the real or perceived disadvantages associated with rising inequalities in opportunities. An inclusive growth strategy will enable developing Asia not only to accomplish its mission of eradicating extreme poverty but also address the legitimate concerns of this larger segment of the population.

III. WHAT IS INCLUSIVE GROWTH: CONCEPTUAL ISSUES

Although there is yet no widely agreed formal definition for inclusive growth, a consensus on what it entails is emerging from policy statements of various countries and their development partners, from discussions on development policies at international and regional forums, and from studies and reports of academic and policy researchers. Inclusive growth means growth with equal opportunities. Inclusive growth therefore focuses on both creating opportunities and making the opportunities accessible to all. Growth is inclusive when it allows all members of a society to participate in and contribute to the growth process on an equal basis regardless of their individual circumstances.

The importance of equal opportunities for all lies in its intrinsic value as well as instrumental role. The intrinsic value is based on the belief that equal opportunity is a basic right of a human being and that it is unethical and immoral to treat individuals differently in access to opportunities. The instrumental role comes from the recognition that equal access to opportunities increases growth potential, while inequality in opportunities diminishes it and makes growth unsustainable, because it leads to inefficient utilization of human and physical resources, lowers the quality of institutions and policies, erodes social cohesion, and increases social conflict.

Inclusive growth based on equal opportunity differentiates inequalities due to individual circumstances from those due to individual efforts (Roemer 2006). An individual's circumstances such as religious background, parental education, geographical location, and caste (in India) are exogenous to and outside the control of the individual, for which he or she should not be held responsible. Inequalities due to differences in circumstances often reflect social exclusion arising from weaknesses of the existing systems of property and civil rights, and thus should be addressed through public policy interventions. On the other hand, an individual's efforts represent actions that are under the control of the individual, for which he or she should be held responsible. Inequalities due to differences in efforts reflect and reinforce market-based incentives needed to foster innovation, entrepreneurship, and growth. Incentives should not be disregarded.

The differentiation of inequalities arising from efforts from those arising from circumstances leads to an important distinction between “inequalities of outcomes” and “inequalities of opportunities” (World Bank 2006). Inequalities of opportunities are mostly due to differences in individual circumstances, while inequalities of outcomes such as incomes reflect some combination of differences in efforts and in circumstances. If policy interventions succeed in ensuring full equality of access to opportunities, inequalities in outcomes would then only reflect differences in efforts, hence could be viewed as “good inequalities”, and these are inherent for any growth process (Chaudhuri and Ravallion 2007). On the other hand, if all individuals exert the same level of efforts while policy interventions cannot fully compensate for the disadvantages of circumstances, the resulting inequalities in outcomes are “bad inequalities.” While these two extreme cases are useful for analytical purposes, in reality, inequalities in outcomes would consist of both good or desirable, and bad or undesirable inequalities. Equalities in opportunities, which emphasizes eliminating circumstance-related bad inequalities so as to reduce inequalities in outcomes, is at the core of inclusiveness and at the heart of an inclusive growth strategy.

Although efforts-related inequalities are “good”, they can turn to bad if not properly managed (Chaudhuri and Ravallion 2007). This could happen if those who are rewarded by the market with considerable market/political power use some of the rewards to engage in rent-seeking activities and change the “rules of the game.” For instance, public investment and expenditure could be skewed to benefit the elite, or even the entire system of property and civil rights could be skewed in their favor (Bourguignon et al. 2006, Rajan and Zingales 2007). This suggests that good inequalities also need to be managed and cannot be completely ignored by policies. At a minimum, the state has to guard against the possibility of policy capture by these individuals. Bad inequalities can drive out good ones. In particular, persistence of bad inequalities—as when certain groups get left behind as a result of their residing in a neglected region—can reduce the tolerance for even good inequalities. The result can be social unrest.

Inclusive growth not only addresses the inequality issue, but also enhances the poverty reduction agenda. First, the impact of growth on poverty reduction is higher when the initial level of inequality is lower and/or inequality declines over time. Second, inclusive growth makes poverty reduction efforts more effective by focusing on creating productive employment opportunities and making them equally accessible for all, while addressing extreme poverty through social safety nets and, therefore, moving away from the targeting approach to development. There is now a broad agreement that an effective poverty reduction strategy consists of two prongs, the first being broad-based, pro-poor economic growth based on private sector incentives to create employment opportunities; and the second being public investment in basic education, health, and infrastructure. These two prongs should be supported by social safety nets to protect the very poor and vulnerable (Kanbur 2000).

In sum, an inclusive growth strategy encompasses the key elements of an effective poverty reduction strategy and, more importantly, expands the development agenda. A poverty reduction strategy based on a single and absolute income criterion ignores the issue of inequalities and the risks associated with them. In contrast, an inclusive growth strategy addresses circumstance-related inequalities and their attendant risks. Inclusive growth is not based on a redistributive approach to addressing inequality. Rather, it focuses on creating opportunities and ensuring equal access to them. Equality of access to opportunities will hinge on larger investments in augmenting human capacities including those of the poor, whose main asset, labor, would then be productively employed.

IV. WHAT ARE POLICY INGREDIENTS OF INCLUSIVE GROWTH?

Given that inclusive growth focuses on both creating economic opportunities and ensuring equal access to them, an effective inclusive growth strategy should have two anchors: (i) high and sustainable growth to create productive and decent employment opportunities, and (ii) social inclusion to ensure equal access to opportunities by all.

A. High and Sustainable Growth

High and sustainable growth is the key to creating productive and decent employment opportunities. The strategy for igniting growth and sustaining it at a high level may differ among developing Asian countries, depending on their current levels of incomes and extreme poverty. A central trait of the Asian growth experience has been that economies that successfully sustain growth do so by continuously adapting and changing their structure. Incrementally, but steadily, they latch on to and master new and more productive activities, reaping gains along the way. The transformations associated with sustained fast growth often entail a shift of output from agriculture to both industry and services. There has been no economy in developing Asia that has sustained fast growth and economic catch-up that has not also successfully industrialized. One reason for this is that industry has been where opportunities for productivity growth have been located. While services have played an important role in mopping up surplus labor from agriculture, this has often meant employment in low-productivity, informal activity (ADB 2007a).

For low-income developing Asian countries where the level of extreme poverty is still high, a key challenge during the next 10–15 years will be to eradicate extreme poverty by accelerating the process of transition toward a low-middle-income country status. In this process, these countries will transform their rural and agriculture-dominated economies into ones with higher agriculture productivity, and industry and services sectors playing a much greater role in terms of both output and employment. For these countries, international experiences have shown that particular attention is required to create and maintain hardware and software conditions that would facilitate their economic integration domestically, regionally, and globally. Integration with their regional counterparts and the global economy would enable them to participate in international production networks and benefit fully from their cost advantages. Exploring the potential of market integration as a powerful source of growth would require continued investment in physical infrastructure and in human capital and skills; and continued efforts in improving business environment conducive to private entrepreneurships, foreign trade, and foreign investment.

For low-middle-income countries where the level of extreme poverty is low and modern sectors (industry and services) already dominate, a key challenge during the next 10–15 years will be to accelerate the move toward a middle-income or high-middle-income country status. International experiences suggest that these countries would need to tackle three important transitions: (i) transition from diversification and producing a broader array of goods, to specialization and a focus on those goods in which a country has a global comparative advantage; (ii) transition from accumulation or investment that simply requires more savings and more buildings, to innovation that requires the ability to do things differently; and (iii) transition from basic skills or education to advanced skills or tertiary education, or one where the educational system delivers a much broader array of skills required for the labor force (World Bank 2007).

Economies of most low-middle-income countries are now well integrated with regional and global economies and have often become an integral part of international production networks, and this integration has been a major source of their recent growth. While this needs to be continued and deepened, these countries should pay more attention to domestic economic integration, including the integration between urban and rural sectors, not only as an effective means to reduce spatial inequalities, but also as a significant source of economic growth. Continued efforts are required in improving domestic and regional connectivity and expanding the capacities of urban cities and towns to accommodate migrant workers through public investment, public and private partnerships, and public policies. With climate change and global warming becoming issues of global concern, government intervention in environmental control is a necessary condition for sustaining economic growth in developing Asia, given its significant externalities.

High and sustainable growth that creates productive and decent employment opportunities must be driven by a dynamic private sector through market competition and market-based incentives. But markets can fail and are sometimes missing. The central role of the government is to develop and maintain an enabling environment for business investment and private entrepreneurships by eliminating impediments and distortions created by market failures, institutional weaknesses, and policy shortcomings. This would require the government to invest in physical infrastructure and human capital, build institutional capacities, maintain macroeconomic stability, adopt market-friendly policies, protect property rights, and maintain rules of law. In setting policy and reform priorities, the government should identify the binding constraints to growth and target its efforts and resources at relaxing the binding constraints.

B. Social Inclusion

Promoting social inclusion requires public interventions in three areas: (i) investing in education, health, and other social services to expand human capacities, especially of the disadvantaged; (ii) promoting good policy and sound institutions to advance social and economic justice and level playing fields; and (iii) forming social safety nets to prevent extreme deprivation. While (i) and (ii) are essential to equalize opportunities, (iii) is needed to cater to the special needs of people who cannot participate in and benefit from the opportunities created by growth for reasons beyond their control and to alleviate transitory livelihood shocks.

(a) Expanding Human Capacities

Expanding human capacities to participate in new opportunities means investing in education, health, and other social services and other social services such as water and sanitation. Growth provides resources to permit sustained improvements in human capacities, while expanded human capacities enable people to make greater contributions to growth. As education becomes more broadly based and equally accessible by all, people with low incomes are better able to seek out economic opportunities, and their children are less likely to be disadvantaged, leading to improved income distribution over time. Education is one of the most prominent determinants of movements out of chronic poverty. Improved health and nutrition have also been shown to have direct effects on labor productivity and individuals' earning capacities, especially among the poor. Health-related shocks are prominent drivers pushing people into poverty. Access to clean water and sound sanitation are not only basic means of living for human beings, but also ensure their good health.

Government—both central and local—has a critical role to play in investing in education, health, and other social services, because of their public goods nature and strong externalities, and in making these services equally accessible by all. The role of government is to ensure that these social sectors have adequate funding, good physical infrastructure, strong institutional capacities, sound policy frameworks, and good governance. In many countries, governments are often directly involved in public service provision. Although there are instances of effective public provision, more often than not, there is abundant anecdotal evidence on the failure of public services. This is often attributed to a host of factors, including budgetary constraints, corruption and governance problems, human resource problems, or a plethora of other forms of institutional weakness. Equally worrying, countries where public provision fails are often also the ones that are unlikely to effectively regulate and monitor alternatives, such as private provision of health and education services. Therefore, equal access to social services needs to be complemented by supply-side policies to ensure efficiency and quality of public services and demand-side policies to avoid moral hazard behavior and wastages.

(b) Good Policies and Sound Institutions

Promoting social inclusion requires good policy and sound institutions. The expansion of human capacities would not ensure equal opportunity for all if some people do not have access to employment opportunities because of their circumstances, face unfair returns on those capacities and unequal protection of their rights, and have unequal access to complementary factors of production (World Bank 2006). Such social and economic injustice is often reflective of bad policies, weak governance mechanisms, faulty legal/institutional arrangements, or market failures. In developing Asia, factor market (land and credit) failures are particularly acute. The central role of the government in promoting social and economic justice is to address all these market, institutional, and policy failures. Political, economic, cultural, and social freedoms ensure that members of a society would not be excluded from participating, contributing, and benefiting from the new economic opportunities because of their individual circumstances, or because they do not belong to certain power groups who control political and economic decision making (Rajan and Zingales 2007).

Many studies have shown that along with the number of jobs created in the growth process, it is equally important to look into the quality and decency of jobs (Felipe and Hasan 2006). It is now recognized that there is a strong linkage between productivity and decency of jobs. Decent jobs—which pay a fair wage rate, provide social security, offer good working conditions, and allow a voice at work—improve productivity. In developing Asia, a substantial share of poor people is already at work, that is, they are the “working poor”, particularly among migrant workers. For them, it is not the absence of economic activity that is the source of their poverty, but the lack of decency and low productivity of that activity. A key element of promoting social and economic justice should be to ensure that men and women can earn a fair level of income from their work and enjoy decent working conditions.

(c) Social Safety Nets

Promoting social inclusion also requires the government to provide social safety nets to mitigate the effects of external and transitory livelihood shocks as well as to meet the minimum needs of the chronically poor. Such shocks are often created by ill health, macroeconomic crises, industrial restructuring, and natural disasters. Developing and improving social safety nets through public actions is particularly important for developing Asia as markets for insuring such risks are often rudimentary and, even if they exist, only cover a small segment of population. Social safety nets serve two main purposes. First, by providing a floor for consumption, they are a coping mechanism for the very poor and the unfortunate. Second, they could provide insurance against risk to enable vulnerable people to invest in potentially high-return activities to lift themselves up by their bootstraps, i.e., social safety nets serve as springboards to enable vulnerable people to break out of poverty (World Bank 2001). By encouraging efforts, safety nets could contribute toward greater equality in outcomes.

Social safety nets typically take the following forms: (i) labor market policies and programs aimed to reduce risks of unemployment, underemployment, or low wages resulting from inappropriate skills or poorly functioning labor markets; (ii) social insurance programs designed to cushion risks associated with unemployment, ill health, disability, work-related injuries, and old age, examples being pensions, health and disability insurance, and unemployment insurance; (iii) social assistance and welfare schemes such as welfare and social services, and cash or in-kind transfers intended for the most vulnerable groups with no other means of adequate support, such as single-parent households, victims of natural disasters or civil conflicts, handicapped people, or the destitute poor; and (iv) child protection to ensure the healthy and productive development of children, examples being early child development programs, school feeding programs, scholarships, free or subsidized health services for mothers and children, and family allowances or credit (ADB 2007c).

V. INCLUSIVE GROWTH AS THE OVERARCHING GOAL: WHAT IT IMPLIES FOR ADB

A. Why ADB Should Make Inclusive Growth Its Overarching Goal

Under its Charter, ADB is mandated to foster economic growth and cooperation in Asia and the Pacific region and to contribute to the acceleration of the process of economic development in its developing member countries (DMCs). Starting primarily as a project lender supporting economic growth, ADB has expanded its approach to encompass a wide range of economic, social, and environmental concerns over the last four decades since its founding. In 1999, ADB introduced the Poverty Reduction Strategy (PRS) and declared poverty reduction as its overarching goal in response to the high level of extreme poverty in developing Asia and increasing calls from the international community to accelerate the pace of poverty reduction (ADB 1999). Subsequently, the PRS became the anchor of ADB's Long-Term Strategic Framework (LTSF) 2001–2015 (ADB 2001). In 2004, ADB adopted the Enhanced PRS (ADB 2004b), following a review of the implementation of the 1999 PRS. The enhancements were made to address a number of shortcomings of the PRS,[3] as well as to respond to the changing global and regional context[4] and a new, emerging global

[3] The major changes in the enhanced PRS include (i) refinement in strategic direction including greater country focus and alignment of ADB operations with a country's own PRS; (ii) increased attention to results, monitoring, and evaluation; (iii) greater emphasis on capacity development, adopting this as a thematic priority in addition to the original PRS thematic priorities of private sector development, gender, environment, and regional cooperation; (iv) revision of ADB's project classification to introduce the category of targeted intervention; and (v) removal of project category lending targets (ADB 2006c).

[4] This is exemplified particularly by the strong recovery in Asia from the 1997 financial crisis and increasing economic and political uncertainties.

architecture for development assistance.[5] The Enhanced PRS confirmed poverty reduction as ADB's overarching goal.

When more than 30% of developing Asia's population amounting to close to 900 million lived under extreme poverty in the late 1990s, supporting poverty reduction was no doubt the most effective way for ADB to assist its DMCs. In this sense the PRS, especially the Enhanced PRS, has served ADB well. ADB's success in implementing the PRS has been monitored at the sector/theme, country, and institution levels. In terms of its overall performance in reducing poverty, a 2006 multinational perceptions survey indicates that ADB is viewed as doing at least an average job, and often good or excellent (ADB 2006a). But there are lessons to learn. A recent ADB report on the basis of three country studies found that a great majority of the rural poor rose out of poverty by migrating to areas with dynamic growth. The report thus questioned the underlying assumptions and the effectiveness of household and geographical poverty targeting (ADB 2006d).

The changing regional context and emerging challenges of developing Asia highlighted in Section II make a strong case for ADB to revisit its long-term strategic directions and find a broader institutional role. First, the level of extreme poverty measured by $1-a-day declined from 34.6% in 1990 to 18% in 2005. If this trend is to continue, a corporate strategy narrowly focusing on eradicating extreme poverty would become less and less relevant. Second, the level of poverty using the $2-a-day poverty line only declined from 75% to 51.9% between 1990 and 2005 for developing Asia as a whole, suggesting that more than half of developing Asia's population still live in very poor conditions. But narrowly targeting at extreme poverty through the current PRS would not be effective in tackling this wider development problem. Third, rapidly rising inequalities have led to an increasing concern that benefits of Asia's spectacular growth have not been equally shared. This leads to increasing political and social tensions and, if left unchecked, could undermine the very sustainability of Asia's growth. The PRS is not designed to address the inequality issue.

Making inclusive growth its overarching goal would enable ADB to assist developing Asia to finish the unfinished agenda of eradicating extreme poverty and, at the same time, address the wider development issue of rising inequalities, by supporting the creation of productive and decent employment opportunities and making opportunities more equally accessible to all. Adopting this broader development approach is not only important for ADB to remain relevant and responsive, but would also help improve the outcome and impact of its interventions.

B. What Inclusive Growth Implies for ADB

Moving beyond poverty reduction and making inclusive growth the overarching goal would have significant implications for ADB. First, ADB may need to modify its corporate strategy, including its vision, mission, strategic pillars, and core operational and thematic priorities.

(i) *Vision and Mission*. ADB's current vision, first introduced in the PRS in 1999 and restated in the Enhanced PRS in 2004, is "*An Asian and Pacific region free of poverty*." To achieve this vision, ADB has a mission "*to help its DMCs reduce poverty and improve living conditions and the quality of life*." Making inclusive growth the overarching goal may require ADB to redefine its vision and mission. The key ingredients of inclusive growth are creation

[5] This refers in particular to the adoption of MDGs as the benchmark for monitoring progress on global poverty reduction; and new emphases on development partnerships, harmonization, results orientation, and capacity development within DMCs in support of national poverty reduction strategies.

of opportunities through high and sustainable growth, making opportunities equally accessible to all, and eradicating extreme poverty. A new vision for ADB, if considered, should therefore emphasize "equal opportunities", in addition to "free of poverty." In view of this, ADB could consider a new vision such as "*Asia and the Pacific—a region of prosperity, equal opportunity, and free of poverty*". Correspondingly, its new mission statement could be "*to promote inclusive growth in its DMCs*." [6]

(ii) *Strategic Pillars*. ADB's current PRS is built on three strategic pillars, namely, pro-poor sustainable economic growth, inclusive social development, and good governance. These are complemented by five thematic priorities: capacity development, private sector development, gender and development, environmental sustainability, and regional cooperation. Making inclusive growth the overarching goal would require ADB to redefine its strategic pillars. Corresponding to the two anchors of an inclusive growth strategy from the perspective of a DMC as detailed in Section III, ADB's strategic framework for supporting inclusive growth could adopt two pillars. The first is *Investing in Creating Opportunities* to support high and sustainable growth in DMCs. The second is *Investing in Broadening Access to Opportunities* to support social inclusion in developing Asia. The two pillars are mutually reinforcing. Improved social inclusion would help ignite growth, maintain its pace, and make it more sustainable by promoting equal opportunities. High and sustainable growth would contribute to the enhanced social inclusion by creating more productive and decent employment opportunities.

(iii) *Core Operational Priorities*. A number of factors should be considered in deciding core operational priorities under each strategic pillar of the proposed corporate strategy. The most important is developing Asia's development priorities. However, ADB has limited resources and cannot do everything. There are also other development partners operating in Asia and the Pacific region. ADB's competencies, its resources base, and partnerships with other development partners are also important considerations to ensure selectivity and aid effectiveness. While the final choices should be made through a process of extensive consultations—externally with DMCs and other development partners and internally within ADB at all levels—*Infrastructure, Energy and Environment, Financial Sector Development*, and *Regional Cooperation* are obviously among the natural choices for the first strategic pillar of *Investing in Creating Opportunities* to support high and sustainable growth. Meanwhile, *Education*, *Health*, and *Microfinance* are among the natural choices for the second pillar *of Investing in Broadening Access to Opportunities* to support social inclusion. This framework also needs a set of thematic priorities to address cross-cutting issues and to reinforce the impact of the core operational priorities. The following could be considered: *private sector development, good governance, knowledge management, and gender equality*.

The proposed corporate strategy anchored on inclusive growth, if adopted, would also have important implications for country and regional operations of ADB.

(i) Interventions for supporting high and sustainable growth, protecting the environment, promoting good governance and strong institutions, and facilitating domestic and regional integration, which are important under the Enhanced PRS, are likely to become more

[6] It is also possible to emphasize other priorities, such as "regional integration" and/or "environmental sustainability", in the vision and mission statements, if considered necessary.

prominent in ADB operations. This is because high and sustainable growth is the key to generate productive and decent employment opportunities; growth will not be sustainable without protecting the environment; bad policy and weak institutions are responsible for a large part of inequalities in opportunities; and spatial disparities are a major source of inequalities and poverty in many countries. The most effective way of reducing spatial disparity is to promote integration domestically, regionally, and globally.

(ii) The proposed strategy provides scope for greater selectivity. Poverty is multidimensional, and targeting at poverty reduction requires ADB to provide full-fledged services to DMCs, which often results in ADB stretching too far to be effective given its limited resources. Under the inclusive growth strategy, supporting high and sustainable growth and promoting social inclusion are the two mutually reinforcing strategic pillars. ADB could choose to focus mainly on supporting high and sustainable growth. To support social inclusion, ADB could choose to focus only on a few areas where ADB has competencies such as education, health, water and sanitation; and, through policy dialogue and policy-based lending, promoting good governance and strong institutions, while ensuring other areas will be adequately addressed by governments and other development partners.

(iii) The proposed strategy allows ADB to move away from the direct poverty targeting approach. The PRS introduced in 1999 put a great emphasis on direct poverty targeting, by giving priorities to projects with greater poverty impact such as those located in poor areas or incorporating specific poverty reduction components; requiring projects classified as poverty interventions to disproportionately benefit the poor; and setting specific poverty intervention targets. These measures were soon found to be too rigid, often leading to individual and household targeting that many studies have shown to be ineffective in sustaining poverty reduction. Although ADB has moved away from this approach in a significant way under the Enhanced PRS, poverty targeting is still recognized as an important instrument.[7] Supporting inclusive growth with a greater focus on generating productive and decent opportunities would enable ADB to move further away from direct poverty targeting.

(iv) The proposed strategy requires ADB to significantly expand the scope of its analytical work to support operations. The Enhanced PRS requires country-focused poverty analysis. This begins with a comprehensive examination of the constraints and opportunities for poverty reduction in each country to assess the nature, intensity, and spread of poverty; its main causes; the effects of public policies; the focus and efficiency of public expenditures; and the effectiveness of government programs and institutions. Supporting inclusive growth would require ADB to go beyond poverty analysis and extend the analytical work to deepen the understanding of underlying causes of inequality in opportunities and binding constraints to inclusive growth.

(v) The proposed strategy requires ADB to pay greater attention to the identification of market and government failures that are often sources of the binding constraints to inclusive growth. This is because inequalities in opportunities are mostly reflective of social exclusion, which is largely associated with weaknesses in the existing systems of property and civil rights, market failures, and policy shortcomings. ADB interventions would

[7] During 2004–2006, about 45% of the Asian Development Fund lending in US dollars was classified as targeted inventions.

then be designed exclusively to assist DMCs in addressing these market and governance failures.

(vi) Supporting inclusive growth does not mean that all ADB projects and programs should have specific inclusiveness-enhancing components. This narrow-minded approach has in the past proven to be unworkable and has led to inefficient resource utilization and poor aid effectiveness. In many cases, the objectives of enhancing growth and broadening inclusiveness should be achieved through different interventions, and any attempt to achieve two policy objectives with one policy instrument will most likely turn out to be counterproductive. The overall outcome of inclusive growth is what matters.

VI. CONCLUDING REMARKS

Developing Asia is now embracing inclusive growth as a key development goal because of rapidly rising income and nonincome inequalities, leading to increasing concerns that the benefits of Asia's spectacular GDP growth are not being equitably shared, which could derail the growth process itself. This paper clarifies that inclusive growth is growth with equal opportunity that emphasizes both the creation of and equal access to opportunities for all. Inclusive growth differentiates inequalities due to differences in efforts from those due to differences in individual circumstances: the former reflects market-based incentives and should not be disregarded; while the latter is often reflective of social exclusion associated with market, institutional, and policy failures, and should be eliminated. Inclusive growth is not based on a redistributive approach. A development strategy anchored on inclusive growth as the overarching goal encompasses the key elements of an effective poverty reduction strategy and, more importantly, advances the development agenda significantly.

This paper argues that from the perspective of a DMC, a development strategy with inclusive growth as the overarching goal should have two mutually reinforcing strategic anchors: first, high and sustainable growth to create productive and decent employment opportunities; and second, social inclusion to ensure equal access to opportunities. High and sustainable growth should be driven by a dynamic private sector. The central role of the government is to develop and maintain an enabling environment for business investment and private entrepreneurships by addressing market failures, institutional weaknesses, and policy shortcomings through investing in infrastructure and human capital, building institutional capacities, maintaining macroeconomic stability, adopting market-friendly policies, protecting property rights, and maintaining rules of law. Promoting social inclusion requires public interventions in three areas: (i) investing in education, health, and other social services to enhance human capacities; (ii) promoting good policies and sound institutions to advance economic and social justice and level playing fields; and (iii) providing social safety nets to prevent extreme deprivation.

The paper further agues that ADB should respond to the emerging needs of developing Asia by adopting inclusive growth as its overarching goal to remain a relevant and responsive development institution. This shift, if adopted, would require ADB to modify its corporate strategy. The paper proposes that if the shift is adopted, ADB may consider changing its vision from "*an Asian and Pacific region free of poverty*" to "*Asia and the Pacific—a region of prosperity, equal opportunity, and free of poverty*"; and its mission from "*to help its DMCs reduce poverty and improve living conditions and the quality of life*" to "*to promote inclusive growth in its DMCs.*"

The paper also proposes a strategic framework for ADB to promote inclusive growth consisting of two strategic pillars, namely, (i) *Investing in Creating Opportunities* to support high and sustainable growth in DMCs; and (ii) *Investing in Broadening Access to Opportunities* to support social inclusion in developing Asia. While (i) focuses on investing in the economy, (ii) emphasizes the imperative of investing in people. In addition, a set of core operational priorities are outlined: *Infrastructure, Energy and Environment, Financial Sector Development,* and *Regional Cooperation* for the first strategic pillar; and *Education, Health,* and *Water and Sanitation* for the second pillar. Further still is a set of thematic priorities: *Private Sector Development, Good Governance, Knowledge Management, and Gender Equality*.

The paper points out that the proposed corporate strategy anchored on inclusive growth would have important implications for ADB's country and regional operations. The inclusive growth strategy would (i) lead to more interventions designed to support high and sustainable growth, promote good governance and strong institutions, and facilitate domestic and regional integration; (ii) provide scope for greater selectivity; (iii) allow ADB to move further away from the direct poverty targeting approach; and (iv) require ADB to expand the scope of analytical work for country/regional operations beyond poverty analysis to focus on identifying market and government failures that often constitute the binding constraints to inclusive growth. The paper argues that supporting inclusive growth does not mean that all ADB projects and programs should have specific inclusiveness-enhancing components. The objectives of promoting high and sustainable growth and broadening inclusiveness should be achieved through different interventions. Any attempt to achieve two policy objectives with one policy instrument will most likely turn out to be counterproductive. The overall outcome of inclusive growth is what matters.

The proposed inclusive growth strategy also embraces environmental protection and regional cooperation. Growth would not be sustainable if the environment is not protected. The proposed new vision of ADB that emphasizes prosperity refers to both intracountry and intercountry prosperity. Regional cooperation and integration will facilitate intracountry prosperity by contributing to creating higher demand for a country's goods and services through going beyond national boundaries; and by reducing supply costs through focusing on only those activities in which a country has a global comparative advantage. Intercountry prosperity will be facilitated by regional cooperation and integration through fostering the leveling of playing fields across countries. While the primary focus of inclusiveness is on domestic integration, efficient and high growth so essential in creating productive opportunities requires integration with regional and global markets. Thus the proposed ADB strategy for inclusive growth would contribute to integration within countries and across countries within Asia, and with the rest of the world.

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About the Paper

Ifzal Ali and Juzhong Zhuang examine policy implications of adopting inclusive growth as the overarching goal for developing Asia. They argue that this would not only enable developing Asia to accomplish the agenda of eradicating extreme poverty, but also address the development challenge arising from rising inequalities. Implications for the Asian Development Bank are discussed.

About the Asian Development Bank

The work of the Asian Development Bank (ADB) is aimed at improving the welfare of the people in Asia and the Pacific, particularly the 1.9 billion who live on less than $2 a day. Despite many success stories, Asia and the Pacific remains home to two thirds of the world's poor. ADB is a multilateral development finance institution owned by 67 members, 48 from the region and 19 from other parts of the globe. ADB's vision is a region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their citizens.

ADB's main instruments for providing help to its developing member countries are policy dialogue, loans, technical assistance, grants, guarantees, and equity investments. ADB's annual lending volume is typically about $6 billion, with technical assistance usually totaling about $180 million a year.

ADB's headquarters is in Manila. It has 26 offices around the world and has more than 2,000 employees from over 50 countries.

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