Toward Inclusive Growth in Asia

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Introduction

It is a great pleasure to have the opportunity to make one of the keynote speeches here at the Global Think Tank Summit 2017 marking the 50th anniversary of the Asian Development Bank (ADB). Over the next couple of days, a number of key topics related to growth and sustainable development will be discussed. All the discussions today can be orientated more or less to the same goal: "inclusive growth." "Inclusive growth" has become a key objective for global policy makers including the G20.

"Inclusive growth" is typically defined as economic growth in which growth opportunities and benefits will be delivered to all people, regardless of their various socio-economic and gender attributes. Today, I would like to shed light upon an economic attribute; that is, income level. I do so because poverty remains in Asia, in spite of the remarkable growth in per capita GDP over the past 50 years. This fact points to the necessity for Asian economic growth to enhance its inclusiveness. Financial inclusion can contribute greatly in this regard.

I. Economic Growth and Inclusiveness in Asia

During the 50-year history of the ADB, many of the ADB's Asian member countries transformed from low-income countries to middle-income countries. Indeed, a few member countries have succeeded in joining the category of high-income countries.

As the status of Asian countries has improved in terms of per capita GDP, the standing of Asia in the global economy has been enhanced. The percentage share of world GDP accounted for by the ADB's Asian members, excluding Japan, Australia, and New Zealand, increased from 8 percent in 1966 to 25 percent in 2015.1 Furthermore, the increase in per capita GDP in Asia has been accompanied by a 20-year extension of Asian people's life spans. Comparing 2014 with 1964, the average life span increased from 49 to 74 years in the East Asia and Pacific region, while in South Asia it increased from 45 to 68 years.2

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1 See the first chapter of ADB (2016). ADB through the Decades: ADB's Fifth Decade (2007-2016). Mandaluyong City, Philippines: ADB.

2 The source of data on life spans is the World Bank's World Development Indicators. High-income countries are excluded for the East Asia and Pacific region.
In the past few decades, Asia's economic growth has accelerated. Asian economies appear to have benefitted from the strengths of globalization. Dating back 50 years, Asian developing countries' participation in world trade was quite modest. The mode of their trade participation was simple in many cases -- exporting primary products. In the following years, companies in advanced countries expanded their international operations and some of them grew to become giant multinational companies. Since then, they have developed global value chains with a geographic focus upon the Asian region. This is one reason why per capita GDP grew at a faster pace in Asia than in other developing regions. Comparing 2015 with 1996, per capita GDP in developing countries increased by a factor of five in Asia, while this was two and three in Latin America and sub-Saharan Africa, respectively.³

Economic growth in Asia has been accompanied by a narrowing income gap between developing countries in Asia and high-income countries around the world. Specifically, 50 years ago, real GDP per capita was about 50 times larger in high-income countries than in developing countries in the East Asia and Pacific region. It was about 45 times larger in high-income countries than in developing countries in South Asia. Recently, such scaling factors have decreased to 7 times and 26 times respectively, in these two regions.⁴

There is no doubt that the ADB has made a significant contribution to economic growth and the extended life span in Asia. This contribution can be compared to the weaving of a cloth by the ADB. The warp is the financial capital that the ADB has provided for member countries to finance their development projects. The ADB’s loans and grants have long continued to make those projects successful, even in the face of wide-ranging differences in developmental needs and circumstances among the members. What has made this possible?

This is where the woof becomes important. The woof is the ADB’s intellectual capital, consisting of underlying thought, specific knowledge, and creative ideas. The ADB has offered this type of capital to individual member countries so that their development projects

³ The source of the scaling factors is the first chapter of ADB (2016). ADB through the Decades: ADB's Fifth Decade (2007-2016). Mandaluyong City, Philippines: ADB.
⁴ The scaling factors in this paragraph are calculated using the World Bank's World Development Indicators. They compare 2015 with 1966.
are carefully planned and well-managed. An indispensable part of this woof has been the ADB Institute, co-host of this symposium. In addition, based on my experience at the ADB, this long-standing adaptive weaving has been made possible by the ADB’s organizational and operational flexibility.

To continue with my analogy, the ADB will need to continue its work of weaving a cloth suitable and strong enough to wipe away the persistent problem of poverty. In contrast to the relative economic progress made in the international sphere, domestic income inequalities have increased in some Asian countries. Among the 30 countries with comparable Gini coefficients, income inequality has increased in recent decades in twelve countries, accounting for about 80 percent of their total population. In most of these countries, the top income group has increased its income share. A recent survey concludes that when a deterioration of income equality occurs by benefiting mainly the rich, it undermines the poverty-reducing effects of economic growth. Unfortunately, poverty remains in Asia.

There are a variety of possible explanations as to why Asian people in the bottom income group continue to live in poverty in spite of strong macroeconomic growth. One explanation is that it is more difficult for growth opportunities and benefits to reach people whose residential locations, industries, and skills have not been incorporated into global value chains. It will be essential for policy makers in Asia to continue to introduce domestic policies that can enhance the inclusiveness of their hard-earned economic growth.

II. Poverty in Asia

Nonetheless, the history of the Asian economy shows quite clearly that economic growth is a key driver of poverty reduction. In the past 50 years, extreme poverty has significantly decreased in Asia. Here, I refer to the World Bank's current definition of extreme poverty – living on less than 1.9 U.S. dollars a day. Looking at selective countries with comparable


data, averaged headcount ratios for extreme poverty decreased from 68 percent in the 1980s to 8 percent in the five-year period of 2010-2014 in South East Asia and China. In South Asia, the extreme poverty ratios decreased from 50 percent to 19 percent. However, poverty continues to be a considerable burden in Asia. People falling into extreme poverty still exist.

Furthermore, based on the definition of "multidimensional poor," which takes into consideration levels of education and health as well as living standards, the number of such poor people is globally 1.5 billion, and about 60 percent of them live in Asia. In South Asia, the number of the multidimensional poor is disproportionately large relative to its population.

Wide-ranging measures are beneficial for poverty alleviation. For example, providing the poor with education and employment opportunities has the potential to interrupt the vicious cycle of poverty. When poor parents cannot afford to provide their children with education, their children in turn grow up to be uneducated workers with the great risk of becoming poor parents themselves. Breaking such a negative cycle enables the accumulation of human capital, thereby strengthening the potential for economic growth in the long run.

A precondition of breaking this cycle of poverty is to push poor parents to recognize that the future benefits of enabling their children to receive education are significant, and that they will far surpass any immediate profit from using their labor in housework and part-time jobs.

III. Contributions of Financial Inclusion

Among a wide range of poverty-reducing policies, I would like today to focus on policies which promote financial inclusion. According to the Consultative Group to Assist the Poor housed at the World Bank, "financial inclusion means that households and businesses have access and can effectively use appropriate financial services. Such services must be provided responsibly and sustainably, in a well regulated environment." The G20 has been keen to

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7 Data for South East Asia consist of those for Indonesia, the Philippines, and Thailand.
8 The headcount ratios in this paragraph are calculated using the World Bank's Poverty and Equity Database.
advance financial inclusion with the dual aims of benefiting the poor and activating smaller businesses.

Regarding financial inclusion for individuals, many poor people engage in financial activities in their daily lives, such as saving and borrowing money, but they tend to lack access to well-regulated and appropriate financial services.

Getting such access helps the poor escape from poverty through a number of channels. The first channel is reducing the cost of obtaining and managing funds by low income households. Borrowing loans from regular financial institutions enables the poor to avoid obtaining funds from informal moneylenders at very high costs. By using a safe savings account, they would not need to worry about protecting their physical cash.

The second channel is stabilizing the daily lives of the poor. Deposits and loans make it possible for them to absorb negative financial shocks, including sickness and injury, as well as changes in the frequency and size of cash inflows. This shock-absorbing effect helps the poor smooth their consumption over time.

The last channel is exploiting growth opportunities. Absorbing negative financial shocks also helps poor parents allow their children to receive education rather than being incorporated into the labor force. In developing countries, some poor people are informal business owners. Access to financial services can enable them to invest in their own businesses.

However, progress in financial inclusion for individuals appears to have been slow in developing Asia. In 2014, the percentage share of adults with savings accounts was 48 percent in developing East Asia and Pacific, and 44 percent in South Asia. In high-income countries around the world the figure was 108 percent, and in Latin America it was 70 percent.10

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10 The source of the figures on account ownership is the World Bank's Global Findex.
To encourage the poor to open savings accounts and make deposits, it is necessary to introduce hands-on policies that reflect the specific needs of individual countries. Economic factors are not the only reason why poor people often do not save money; there are also social constraints, regulatory barriers, low financial literacy, and psychological factors. A recent empirical finding shows that factors preventing poor people from opening savings accounts include high charges, distant bank outlets, weak legal rights, and political instability.\textsuperscript{11}

Even when the poor do open accounts, whether or not they actually save money in those accounts is a separate question. They need to have other incentives to do so. Such incentives may vary by country. For example, a field experiment in rural Kenya finds that effective incentives include earmarking the poor's deposits for emergency use, encouraging them to save money in a group setting, and providing them with credit conditional upon saving money.\textsuperscript{12}

Financial inclusion is important for small companies as well. In general, small companies are informationally opaque with regard to their business and financial conditions. Also, they are often short of collateral. Therefore, they are at a disadvantage when it comes to borrowing money. However, it is mainly small companies that create jobs for the poor. Their investments and innovations can support macroeconomic growth.

Also in the context of small businesses, progress in financial inclusion has been slow in developing Asia. The recent percentage share of small companies that borrow from banks was 15 percent in developing Asia, while it was 32 percent in non-Asian developing regions.\textsuperscript{13} One statistical finding clearly shows the benefits of reducing this gap. That is, the level of bank credit relative to GDP can positively explain an income increase for the bottom


\textsuperscript{13} See the first chapter of ADB (2013). \textit{ADB-OECD Study on Enhancing Financial Accessibility for SMEs: Lessons from Recent Crises}. Mandaluyong City, Philippines: ADB.
Efforts are on-going in developing Asia to enhance the accessibility of credit to small firms beyond their informational opaqueness. One approach is a centralized approach. An example is to establish a credit bureau for small companies. Such a bureau is an important financial infrastructure and is managed by a public agency in eight of the 20 developing Asian countries surveyed by the ADB. An additional example is to use a public credit guarantee scheme, which has been established in 16 of the 20 countries. These institutional supports have the potential to encourage banks to provide loans for small businesses, thereby promoting financial inclusion.

Another approach to deal with the informational opaqueness of small businesses is a more individual approach. A prominent example is microfinance. The ADB and other multilateral development banks have supported the rapid growth of microfinance institutions by providing them with loans, grants, and technical assistance. In terms of the number of borrowers, microfinance is more active in developing Asia than in any other developing region. Although further work is necessary, studies show that microfinance provides expanded access to credit which in turn increases business activity of microentrepreneurs. Results also suggest that it provides people with more flexibility in choosing their occupation and affords them the possibility of being more self-reliant.

Advances in information and communication technology, or ICT, have the potential to help financial inclusion continue to expand in developing Asia, in some cases beyond traditional banks. For example, crowd-funding schemes enable small businesses and poor individuals to

borrow money from the general public and even across borders.

On deposits and remittances, mobile phones and digital money enable companies and individuals at home and abroad to transfer funds, in some cases regardless of whether or not they have bank accounts. Financial inclusion in the digital economy has the great potential to help users enter new goods markets and new credit markets. I look forward to seeing the positive impact of such digital financial inclusion on poverty reduction and economic growth in the near future.

Financial inclusion has implications for the institutional foundations of banking and finance. To introduce new financial services, or to permit new entities to provide traditional services, the relevant financial business laws would need to be updated appropriately. The emergence of new service providers, including ICT companies, may call for improvements in monitoring and regulations. At the same time, financial policy measures would need to strike the right balance between dealing with possible issues regarding financial stability and consumer protection, and facilitating the innovation of service-providers.

**Concluding Remarks**

It is 50 years since the establishment of the ADB. In spite of the region's remarkable economic development, poverty does remain in developing Asia. We need to enhance the inclusiveness of Asia's economic growth, and financial inclusion can play an important role in tackling the stubborn poverty problem. Policy makers need to find and eliminate obstacles to such inclusion and create positive incentives, taking into consideration each country's specific circumstances. Enhancing financial literacy is also essential.

The ADB's revised "Strategy 2020" sets forth a vision of both poverty reduction and inclusive growth amongst its strategic priorities and financial inclusion is a key area. I am confident that the ADB will continue to lead work in this area by providing two kinds of capital -- financial and intellectual -- and through close collaboration with member countries.

Thank you.