

TECHNICAL NOTE



**Poverty Reduction in the New Asia and Pacific:
Key Challenges of Inclusive Growth for the Asian Development Bank**



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Michael Walton

The views expressed in this paper are those of the author and do not necessarily reflect the views and policies of the Asian Development Bank (ADB), its Board of Governors, or the governments they represent. Michael Walton of the Centre for Policy Research in Delhi, India and of the Kennedy School of Government in Harvard University delivered this paper as his keynote address during the Forum on “Inclusive Growth and Poverty Reduction in the New Asia and the Pacific” on 8–9 October 2007, ADB, Manila.

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ABBREVIATIONS

ADB	–	Asian Development Bank
EPG	–	Eminent Persons Group
GDP	–	gross domestic product
PPP	–	purchasing power parity
PRC	–	People's Republic of China

Note:

In this technical note, "\$" refers to US dollars.

FOREWORD

Results of the Forum on Inclusive Growth and Poverty Reduction in the New Asia and Pacific

The international Forum on “Inclusive Growth and Poverty Reduction in the New Asia and Pacific” was held in Manila on 8–9 October 2007 with over 150 participants, including 70 influential policy makers and experts from government, academe, civil society, and international and bilateral aid organizations. The Forum discussed issues such as pro-poor infrastructure needs, the role of urban and rural development, the financing and delivery of social services including social protection, environmental poverty, geographical targeting, and how the Asian Development Bank (ADB) can address social exclusion.¹ The Forum also launched the *2007 Update on the Millennium Development Goals*² and discussed the findings of special poverty funds with ADB,³ to be closed at the end of the year.

The Forum’s overall conclusion was that there is a pressing need for transformation within ADB and better alignment of inclusive growth as a strategic goal with its operational activities and internal capabilities so that the institution can continue to play an important role in supporting Asia’s socioeconomic development. Participants suggested that a better alignment could be achieved if ADB’s operations were particularly focused in development areas where markets and governments fail, and where ADB has or can develop capacities to make a difference.

- In poorer countries, this will often involve continued support to central governments in the provision of infrastructure and social services.
- However, in emerging market countries, this will increasingly involve a mix of financial and knowledge-related services that tackle the more complex challenges of inclusion of lagging regions or groups in both social and economic development, developing comprehensive mechanisms for managing security, financial inclusion, and the management of environmental concerns.
- The contribution can be through support, knowledge, or helping shape the strategic interactions that lie behind the design of policies and economic institutions. The bundling of knowledge with finance is often important to its effectiveness.
- The Forum also suggested that increasing attention be given by ADB to supporting development activities at the supranational and subnational levels to have greatest development impact.

Key to the success of the Inclusive Growth Forum was the keynote address by Michael Walton. This paper is a revised version of his presentation, taking into consideration the discussions during the Forum. Michael Walton is professor at the Kennedy School of Government at Harvard University and at the Centre for Policy Studies in Delhi. Dr. Walton worked more than 20 years for the World Bank in various functions in Latin America, Africa, and Asia. He was the

¹ More information can be found under the conference website: www.adb.org/Documents/Events/2007/Inclusive-Growth-Poverty-Reduction

² This is a joint publication as part of an ADB, United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP), and United Nations Development Programme partnership. The report is available at www.adb.org/Documents/Reports/MDG-Update-2007/MDG-Update-2007.pdf. The book launch was widely covered in the international press.

³ The National Poverty Reduction Strategy fund was financed by the Government of the Netherlands. The Poverty Reduction Cooperation Fund was financed by the Government of the United Kingdom of Great Britain and Northern Ireland. For more information on ADB’s poverty reduction funds, view www.adb.org/poverty/special-funds.asp.

deputy leader for the *1990 World Development Report: Poverty*, economic adviser to two chief economists of the World Bank, the director for the *1995 World Development Report* on labor, the chief economist for the East Asia and Pacific Region from 1995 to 1997, and the director for poverty reduction from 1997 to 2000. He also wrote the *2006 World Development Report 2006 on Equity and Development*.

We thank Mr. Walton and all forum participants for their stimulating thoughts and suggestions. We are particularly pleased with the frank assessment of ADB's role in the new Asia and Pacific, and the polite and strategic suggestions for change and persistency. We are confident that the forum's outcomes, summarized in his paper, will contribute to the ongoing review of ADB's Long-Term Strategic Framework and discussions concerning the replenishment of the Asian Development Fund.

Sonomi Tanaka and Armin Bauer
Regional and Sustainable Development Department
(Manila Forum on "Inclusive Growth and Poverty Reduction in the New Asia and Pacific")

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ABSTRACT

The international Forum on “Inclusive Growth and Poverty Reduction in the New Asia and Pacific” was held in Manila on 8–9 October 2007. The forum’s overall conclusion was that there is a pressing need for transformation within the Asian Development Bank (ADB) and better alignment of inclusive growth as strategic goal with the operational activities and internal capabilities so that the institution can continue to play an important role in supporting Asia’s socioeconomic development. The conference is of strategic importance for ADB’s new long-term strategic framework discussions.

This paper summarizes the strategic discussion as highlighted in the keynote address by Michael Walton. It argues that growth needs to be inclusive to be sustainable and to be accepted by the population. The Asia and Pacific region, with its rising inequalities, has somewhat lost the inclusive growth path of its past. This gives new opportunities for ADB as the regional development bank to bundle knowledge and finance in areas where both the governments and markets fail. In poorer countries, this will often involve continued support to central governments in the provision of infrastructure and social services. In emerging market countries, this will increasingly involve a mix of financial and knowledge-related services that tackle the more complex challenges of inclusion of lagging regions or groups in both social and economic development, developing comprehensive mechanisms for managing security, financial inclusion, and the management of environmental concerns. However, to remain relevant for the region, ADB urgently needs to transform itself quickly to better align the strategic development goal of poverty reduction through making growth inclusive with its internal capacities.

I. INTRODUCTION

1. The current phase of growth in Asia is the most remarkable period of rapid, sustained growth in history. Each of the past several decades has affected more of the region's—and so the world's—population. This paper is concerned with the nature of this growth, its links with poverty and equity, and what this implies for the strategy of the Asian Development Bank (ADB).⁴

2. Let's start with two questions around this impressive growth.

3. First, the pattern of growth matters. The title to the conference for which this paper has been written is “Inclusive Growth and Poverty Reduction in the New Asia.” There is an apparent ambiguity here. Yes, reduction in absolute income poverty has been as unprecedented as the growth rate. It is now making substantial inroads in India and in the large East Asian countries. On current trends, severe, absolute income poverty will mostly become a concern for small pockets of the Asian population by 2020. Many of the other Millennium Development Goals that were designed primarily for poor countries will also have been met. Does this mean the region can soon declare victory and just focus on aggregate growth? Will markets and governments automatically make social development and further poverty reduction occur? In fact, the opposite is the case: there is widespread and growing societal concern within the region over the nature and pattern of growth, with respect to the distribution of incomes and social indicators, insecurity, and environmental conditions.

4. Second, most rapid growth episodes are not sustained for several decades. A few countries in Asia have indeed succeeded in moving to upper middle or high income status—Republic of Korea, Malaysia, and Thailand, and, of course, Japan. But most, including the bulk of Asia's population, are still low or lower middle income. The People's Republic of China (PRC) has a gross domestic product (GDP) per capita of some \$6,600 in purchasing power parity (PPP) terms, and India less than \$3,500 (and both much less in current dollars). Brazil and Mexico had miraculous growth periods before things came to a sudden stop with the 1980s debt crisis. Brazil now has about the same income as Thailand, and Mexico around the same as Malaysia (Figure 1). What is required to sustain the process of rapid growth and development?

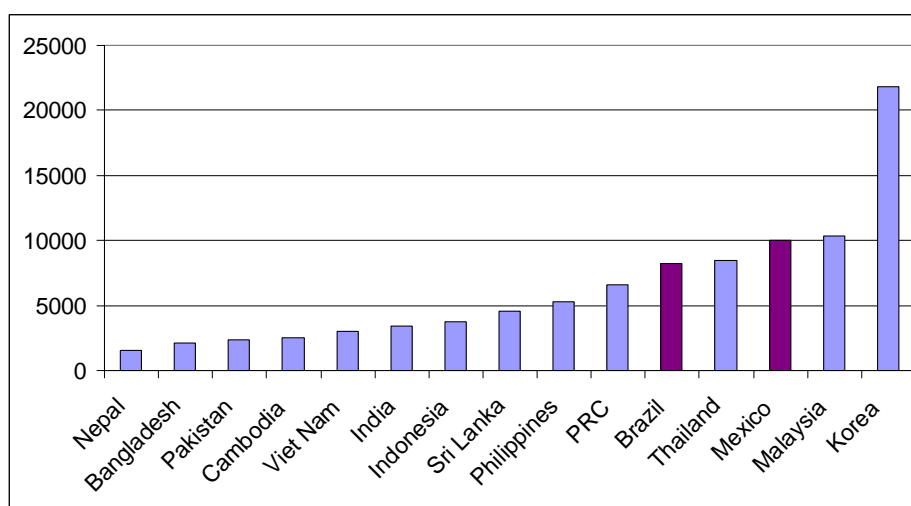
5. The first part of this paper focuses on the growth process and its interactions with various dimensions of inequality and well-being. It suggests that a broader conception of development accurately represents societal concerns in Asia. “Inclusive growth” is not a bad headline phrase to capture this, though what this means needs to be carefully specified. In particular, recognizing that this is more consonant with the concerns and aspirations of Asian societies need not in any way undermine the priority given to severe, absolute deprivation. It also argues that there are connections between the two questions: the pursuit of “inclusive growth” is not only intrinsically desirable but is, in many areas, also a necessary requirement for a sustainable growth process. The issue is not only adding inclusion to growth, but achieving inclusion for growth.

6. The second part of the paper then turns to the role of ADB in the next phase of Asia's development, say, to 2020. Here, the key question is what difference ADB can make to development processes in Asia, given both the broad conception of development, and the large

⁴ The paper is intended to draw out policy-relevant themes from the extensive academic literature on the issues addressed. It draws in particular on major recent syntheses by the multilateral development banks: see in particular ADB (2007b), World Bank (2005), and Gill and Kharas (2007).

and growing access to private finance in the region. The main message is that ADB should focus on areas in which both markets and governments are failing and ADB has, or can develop, the capacity to contribute. The contribution can be through support, knowledge, or helping shape the strategic interactions that lie behind the design of policies and economic institutions. The bundling of knowledge with finance is often important to its effectiveness.

**Figure 1: Per Capita Income in Asia in 2005, Selected Countries
(\$ per capita at Purchasing Power Parity)**



PRC = People's Republic of China.
Source: World Development Indicators.

7. In poorer countries, this will often involve continued support to central governments in governmental provision of infrastructure and social services. However, in emerging market countries—including the PRC, India, and Viet Nam—this will increasingly involve a mix of financial and knowledge-related services that tackle the more complex challenges of inclusion of lagging regions or groups in both social and economic development, developing comprehensive mechanisms for managing security, financial inclusion, and the management of environmental concerns.

8. For all countries, there is a case for increased involvement in regional or intercountry projects, but for declining involvement in the traditional mainstays of ADB engagement—large-scale infrastructure with national governments, and (for the private sector arm) investment in the large-scale enterprise and financial sector.

9. While there are strong parallels with the overall diagnosis of the Eminent Persons Group (EPG) Report (ADB, 2007a), there are significant differences in the operational implications. These are discussed below.

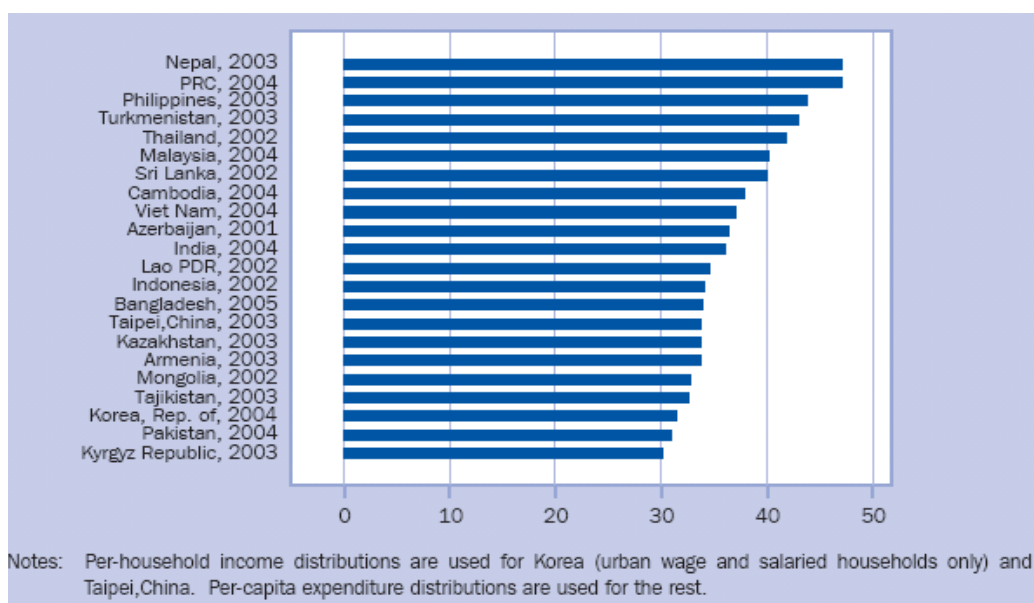
II. INEQUALITIES, POVERTY, AND THE GROWTH PROCESS

10. A lot has been written about Asia's growth. (See ADB, 2007c, for a recent update; and Gill and Kharas, 2007, for a longer-term interpretation.) I focus on how a variety of inequalities interacts with the growth process

A. What is Happening to Distribution in Asia?

11. Asia has traditionally been thought of as a low inequality region: East Asia used to be characterized as an exemplar of “growth with equity,” and, before the 1980s takeoff in India, South Asia was thought of as experiencing modest growth with low levels of inequality.⁵ Both regions contrasted with Latin America’s “high inequality with crisis and slow growth.” In fact, in terms of income differences, Asian countries range from moderately unequal to quite unequal by international standards (Figure 2).

Figure 2: Income Inequality in Asia
(Gini coefficients of per capita expenditure or income inequality)



Lao PDR = Lao People’s Democratic Republic, PRC = People’s Republic of China.

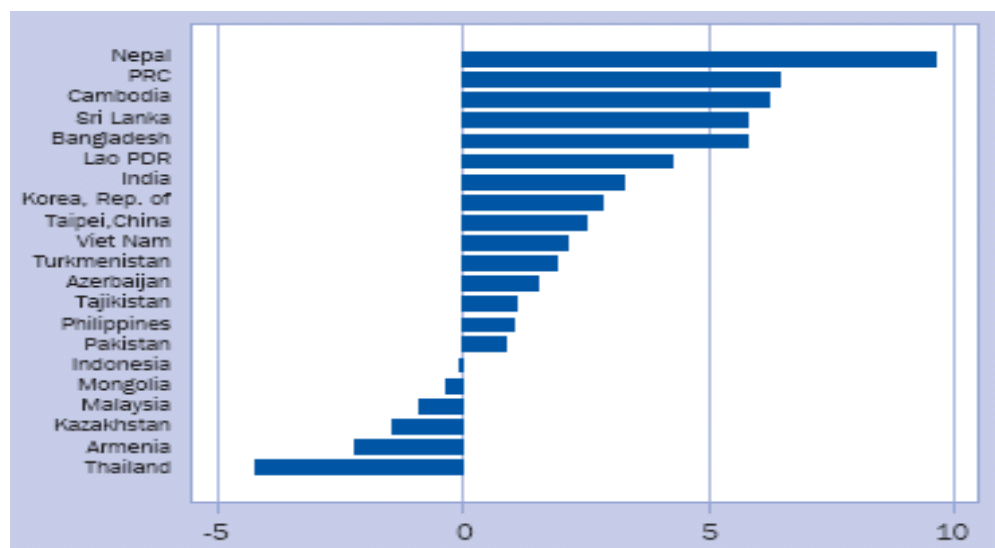
Source: Asian Development Bank. 2007.

12. Countries such as Malaysia, Philippines, and Thailand have for some time had levels of inequality comparable to many Latin American countries. The PRC has experienced a rise in inequality that is even higher. Mexico’s Gini coefficient for per capita expenditures is now 46, for example, close to the PRC’s level of inequality. This remains below Brazilian or South African levels of inequality, but is hardly equal by this yardstick. Moreover, the dominant trend is of rising inequality in income differences, especially in the lower-inequality countries (Figure 3). These are nontrivial changes, especially since this measure of income inequality tends to move only slowly.

13. The household surveys that the above numbers are based on do a good job of capturing the bulk of the distribution, but do not catch the rich in their net. It is interesting to note that many East Asian countries had substantial billionaire wealth before the East Asian crisis: as Figure 4 shows, the ratio of billionaire net worth to GDP was much higher in Indonesia, Malaysia, Singapore, and Thailand than in Latin American countries, the United States (US), or Japan. Even in the Republic of Korea, this ratio was higher in 1996 than in the US. Now these ratios fell significantly in Indonesia and Thailand with the crisis, but more recently, the ratio of net worth to GDP of Indian billionaires has shot up to over 15% of GDP.

⁵ See World Bank (1993) for a mainstream analysis in this spirit.

Figure 3: Changes in Inequality Between the 1990s and 2000s
(percentage point changes in the Gini coefficient)



Notes: Years over which changes are computed are as follows: Armenia (1998–2003); Azerbaijan (1995–2001); Bangladesh (1991–2005); Cambodia (1993–2004); People's Republic of China (PRC) (1993–2004); India (1993–2004); Indonesia (1993–2002); Kazakhstan (1996–2003); Republic of Korea (1993–2004); Lao People's Democratic Republic (1992–2002); Malaysia (1993–2004); Mongolia (1995–2002); Nepal (1995–2003); Pakistan (1992–2004); Philippines (1994–2003); Sri Lanka (1995–2002); Taipei, China (1993–2003); Tajikistan (1999–2003); Thailand (1992–2002); Turkmenistan (1998–2003); and Viet Nam (1993–2004). Income distribution for Republic of Korea and Taipei, China; expenditure distribution for the rest.

Source: Asian Development Bank. 2007.

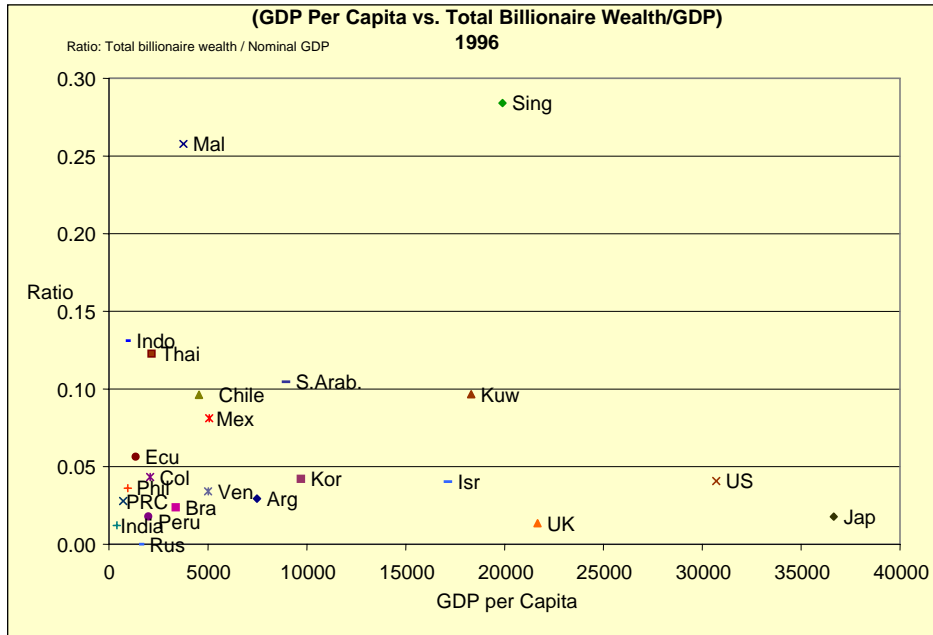
14. Beyond interpersonal distribution of income and wealth, a range of other inequalities are salient in Asia. In some countries, especially in South Asia, differences in health and education status are very large by international standards, and correlated with measures of household assets.

15. In many countries of Asia, gender differences remain large, and larger than in Latin America. This is vividly illustrated by the low sex ratios of infant girls to boys in parts of India (including the relatively better-off Punjab and Haryana), PRC, and Republic of Korea (Figure 5).

16. Spatial differences are also large across many dimensions of well-being. There have always been substantial differences between rural and urban areas, in terms of incomes, social conditions, and access to services. Migration has been an important source of poverty reduction, but has also led to new challenges in cities, with dismal living conditions for poorer city dwellers (both in metropolitan areas and, even more, in small and mid-sized cities), and severe pressures on service delivery.

17. Also of concern is the persistence and often rising importance of spatial differences between regions. Almost all the major countries have major regions that are growing more slowly, and often from a poorer base—for example Bihar, Orissa, and Uttar Pradesh in India; some inner provinces of the PRC; and eastern Indonesia. While migration is leading to some amelioration of these differences, they remain stubbornly persistent.

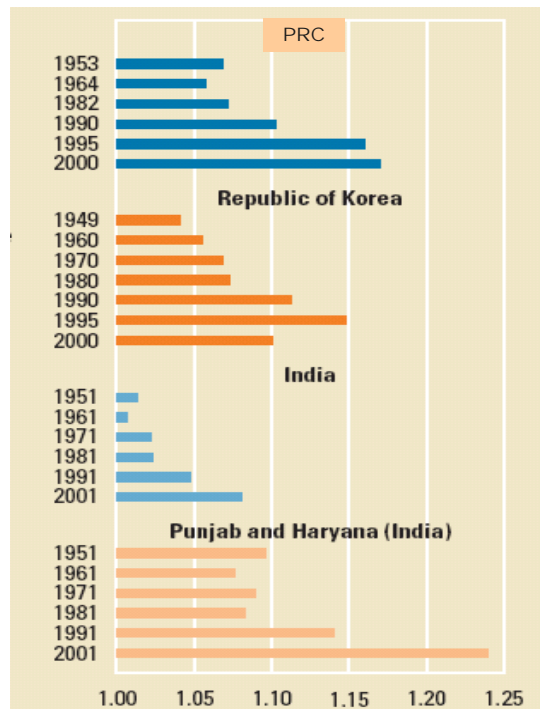
Figure 4: The Ratio of Billionaire Wealth to GDP before the East Asian Crisis



Arg = Argentina, Bra = Brazil, Col = Colombia, Ecu = Ecuador, Indo = Indonesia, Isr = Israel, Jap = Japan, Kor = Republic of Korea, Kuw = Kuwait, Mal = Malaysia, Mex = Mexico, Phil = Philippines, PRC = People's Republic of China, Rus = Russian Federation, S.Arab = Saudi Arabia, Sing = Singapore, Thai = Thailand, UK = United Kingdom, US = United States, Ven = Venezuela.

Source: Forbes.com and World Development Indicators.

Figure 5: Juvenile (birth to 4 years old) Sex Ratios, 1950–2000



PRC = People's Republic of China.

Source: World Bank. 2005.

18. I would finally highlight the salience of group-based differences in many countries, notably scheduled castes in India and Nepal, and ethnic minorities (“tribes” in India) in many countries in the region.

B. The Changing Structure of Deprivation

19. The combination of growth with inequality is changing the structure of deprivation. I highlight two aspects of this here.

20. First, severe deprivation is becoming increasingly concentrated in particular geographic areas in the region. A direct corollary of the spatial and group-based inequalities just noted is a spatial concentration of poverty. This is illustrated in Figure 6 for East Asia, using the PPP\$1 a day yardstick, that also shows how some of the high incidence areas lie in geographic areas that cut across national boundaries.

21. Large differentials in poverty incidence are also a marked feature of India: the headcount ratio varies from less than 10% of the population in Himachal Pradesh and the Punjab, to over 40% in Bihar and Orissa (Debroy and Bhandari, 2007).

22. The group-based differences in overall well-being lead to higher poverty incidence among minority ethnic groups and, in India, scheduled castes. These are sometimes overlaid on geographic areas with low levels of economic development: as Figure 7 shows, both minority status and mountain residence contribute to higher poverty incidence in the PRC. A similar association is found between location and ethnic status for tribal (*adivasi*) groups in India. Scheduled caste status, by contrast, is more dispersed across regions of India.

23. Spatial poverty concentrations are often linked to environmental fragility. This is most striking in the semi-arid and flood-prone areas that are a feature of many parts of the region. Vulnerability to weather-related economic shocks can be severe, and sometimes calamitous, in these areas. The effects of climate change are likely to make environmental poverty worse, with particularly sharp losses in the frozen water-holding capacity of the Himalayas that could dramatically threaten the livelihoods of large parts of Bangladesh, northern India, and Pakistan (ADB, 2007d).

24. The second change concerns what counts as deprivation. As average living standards rise with growth, so does the meaning of deprivation also change. The average levels of income per person shown in Figure 1 imply that in much of the region (outside the Republic of Korea) the majority of the population would be considered poor, in income terms, by developed country standards. In an increasingly globalized world, being equipped with the skills, infrastructural access, and communications to participate effectively in global markets is a requirement to avoid deprivation by the standards of the aspirations of growing societies. This will increasingly be the yardstick used as Asian countries move into middle income status and become more integrated into global economic and cultural interactions. Moreover, issues of insecurity are pervasive—as dependence on global markets rises—that bring increased risks and greater rewards. This is doubly the case for integrating lower income societies, since these continue to have significant parts of the population also dependent on the state of the weather.

Figure 6: The Spatial Distribution of Poverty in East Asia

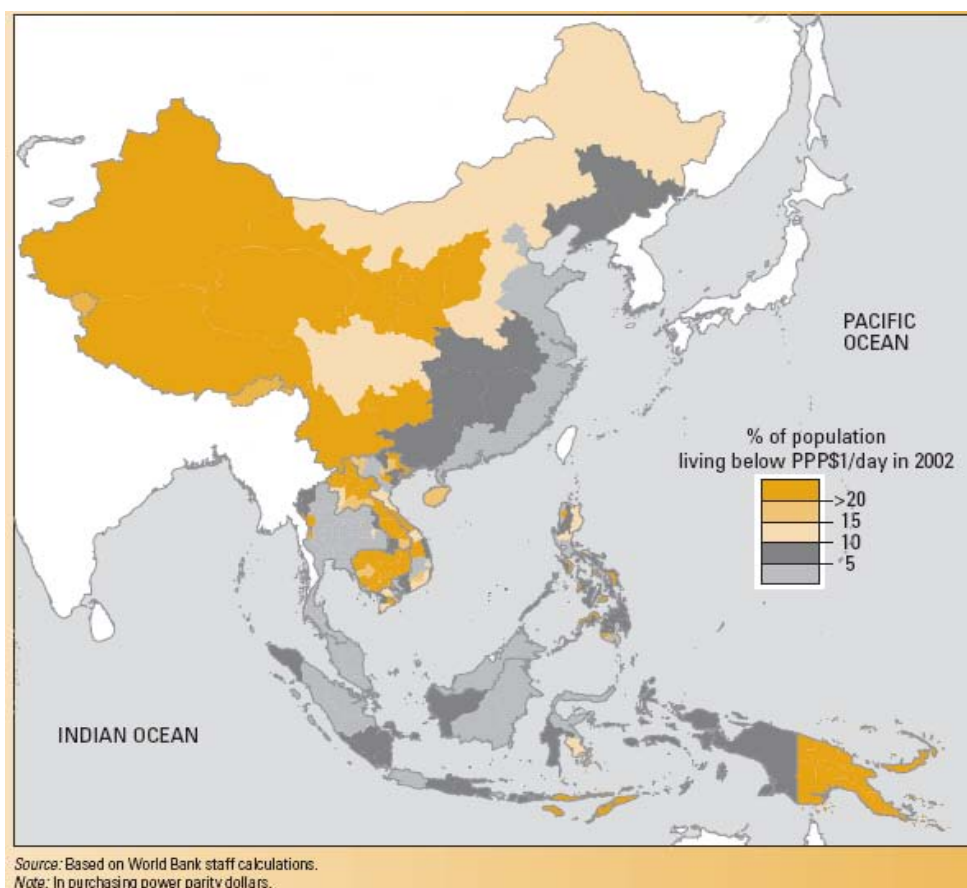
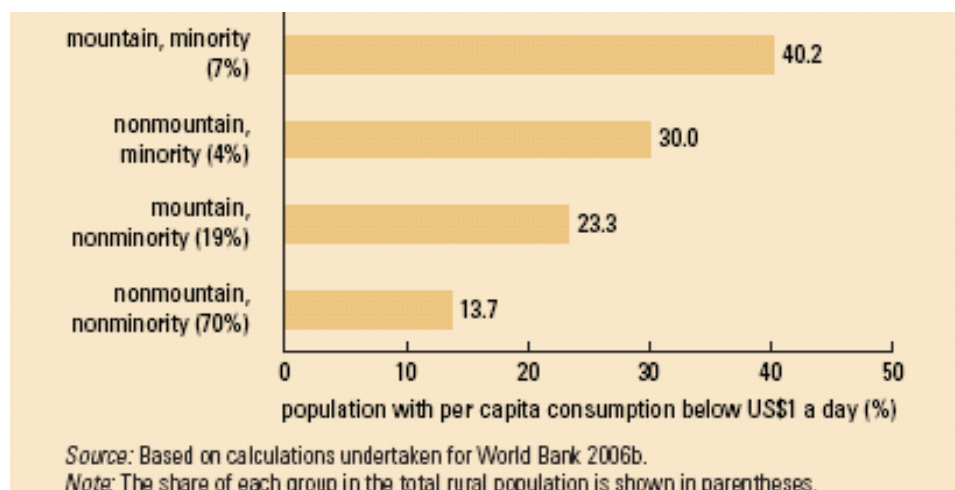


Figure 7: Poverty, Location, and Ethnicity in Rural PRC, 2003



C. How Do Inequalities and Growth Interact, Now and in the Future?

25. Let us now turn to interactions between the growth process and inequalities—in wealth, incomes, human capital, security, status, and power.

26. While Asia has never been as equal as it has sometimes been characterized, part of the “growth with equity” story did apply to the pattern of expansion, especially in East and Southeast Asia (including the PRC in the 1980s). Poor and middle groups participated amply in the growth process. However, this was by no means a product of a mere trickle-down of growth; it rather reflected key features of the growth process that were effectively supported by policy and institutional design. I highlight four:

- Rapid growth in rural productivity, driven by technological change; input provision; intensification of rural infrastructure, interacting with “reasonably” equal land ownership, that supported growth both in agricultural productivity; and higher-return nonfarm activities.
- Broad-based gains in education that involved building the educational pyramid from the bottom up, with near-universal access to basic education laying the basis for subsequent broad-based secondary education expansion. In most countries, this kept ahead of the rising demand for skills that is a common characteristic of the growth process.
- Insertion into the international economy in ways that worked broadly along lines of comparative advantage in unskilled and semiskilled labor in manufacturing (where “unskilled” typically meant “at least primary education”). This occurred because countries were essentially inserting themselves into international trade at the bottom of the prevailing international wage hierarchy, and doing so sequentially, in “flying geese” pattern, across the region. Countries further up the hierarchy steadily upgraded their production patterns as skills and wages rose and capital deepened.
- A relatively moderate degree of dualism in labor and product markets that supported steady expansion in the formal sector, and the absence of large discontinuities in employment conditions between the formal and informal sectors.

27. Crucially, these economic patterns were supported by political processes that favored broad-based inclusion. This was in particular manifest in two features of the societies in this period:

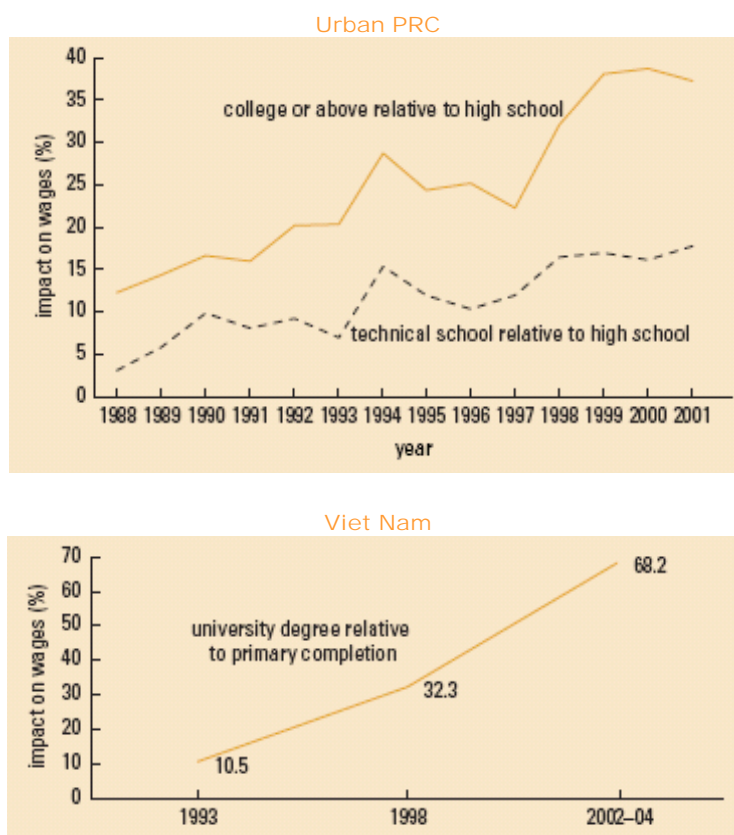
- **The Political Necessity to Include Mass Groups.** While many regimes were authoritarian for extended periods, they had a strong political need to deliver economic and social progress to the peasantry, owing to the rural landholding structure and rural revolution threats. Over time this gradually shifted to a need to deliver to urban labor.
- **Management of Special Interests.** Concentrations of wealth were surely created, with tight links to state behavior. As seen in Figure 4, East Asia has plenty of billionaires, many of whom are associated with family-controlled business pyramids. Rent-creation and acquisition has been relevant to this, and “crony capitalism” was retrospectively judged to be one of the factors behind the 1997/98 East Asian financial crisis. But incumbent capture of policy design was held in check for extended periods by strong executives and the export performance requirements.

28. How does the more recent story of rising inequalities sketched above square with this earlier experience? The current pattern reflects differences in both structure and economic processes. I can relate these to the various features of the earlier period just outlined.

29. In some countries rural productivity growth has been low. The agriculture sector is well-established as a laggard in India's current growth dynamic. Agriculture and rural nonfarm employment—highly labor-intensive sectors relative to other sectors—are providing a weak contribution to labor demand (including the implicit demand in self-employed activities). Reasons for this slow growth are complex, but at least part of the story lies in inefficient distortions and ill-designed subsidies.

30. Educational expansion has lagged the rising demand for skills. This is especially the case for India, again, that historically created a highly skewed education system, with low enrollments and quality for basic and secondary education, combined with relatively high support in tertiary education, including a few islands of excellence (notably the Indian institutes of technology). But rising premia for skilled workers, especially at the tertiary level, is not only a feature of India, but also applies to other countries in the region. (See Figure 8 for the PRC and Viet Nam; and ADB, 2007b, for both India and the Philippines.)

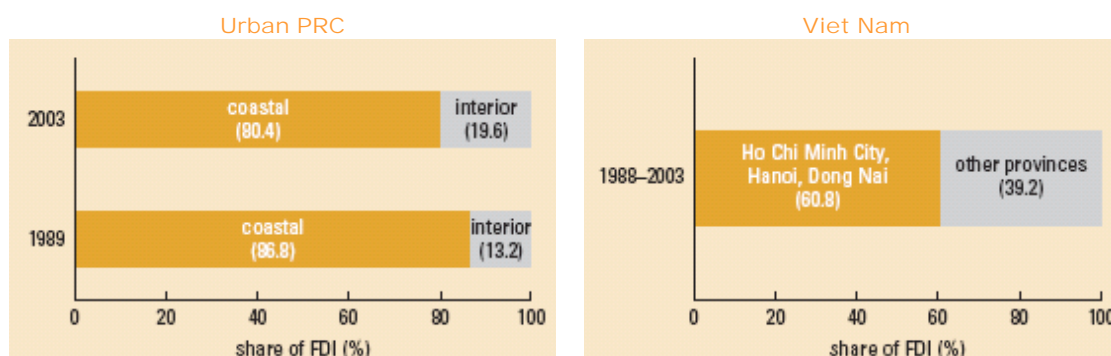
Figure 8: Rising Wage Premia for Tertiary Graduates in the People's Republic of China (PRC) and Viet Nam



Source: Gill and Kharas. 2007.

31. These demand-side pressures on skills—especially at the top of the distribution—are consistent with work on Latin America that found rising skill premia in the wake of opening to trade and foreign direct investments in the 1980s in 1990s. Careful empirical work on Latin American countries has attributed this to “skill-biased technical change” that was mediated by the opening.⁶ This is related to contemporary drivers of economic dynamism in the Asian region. As discussed in Gill and Kharas (2007), the primary drivers of long-run economic growth lie in the processes of innovation and exploitation of increasing returns to scale within and between industries. These processes intrinsically involve economic rents (notably to those who innovate), typically involve higher rewards to skills, and often involve path-dependent processes through reaping the rewards from agglomeration in cities, and the establishment of industrial capabilities, logistical connections, intra-industry supply chains, and service networks that flows from investment in particular production and trading lines. East Asia’s intensive integration has been a major driver of these processes. India’s striking success in some service industries—most notably in information technology—may have initially reflected traditional comparative advantage in its abundance of low-cost high-skilled engineers, but is now increasingly following a path-dependent course. One manifestation of these patterns is spatial concentration and the rising importance of cities. In India, Bangalore was the first city to achieve prominence in information technology (if now with some competitors) and Chennai has a successful concentration in the automobile industry. As Figure 9 illustrates, foreign direct investment is heavily concentrated in coastal PRC and just three Vietnamese cities in these two countries.

Figure 9: The Spatial Concentration of Foreign Direct Investments (FDIs) in the People’s Republic of China (PRC) and Viet Nam



Source: Gill and Kharas. 2007. Data from National Bureau of Statistics, various years, for the PRC; and from Leproux and Brooks, 2004, for Viet Nam.

32. A final area of difference from earlier phases lies in the labor market. In the PRC and Viet Nam, labor market liberalization is likely to have contributed to rising differentials as the private sector grew to dominate employment. In India, continued costly labor market restrictions are a source of bias against more labor-intensive industrial production.

33. These differences indicate that there are structural reasons for the greater pressures on inequality, and that these will not be a passing phenomenon. At the same time, there are rising social pressures for greater provisioning for economic security as societies urbanize, as the demographic transition proceeds, and as new forms of vulnerability grow in importance.

⁶ For empirical analysis of several Latin America countries, see Sánchez-Páramo and Schady (2002); and for other sources, see de Ferranti et al (2003).

34. The political context for the current phase of growth is also different. Most countries face a mix of economic forces for rising inequality with political pressures for greater inclusion. In the PRC, there is explicit concern with the rising inequalities, and political commitment to take action to reduce them. In India, there has long been a contrast between deep social exclusion of disadvantaged groups—especially scheduled castes and tribes—and a range of policies that sought to favor both these groups and to more broadly reach the rural poor. Caste-based political mobilization has become increasingly salient in the past 15 years, with mixed effects: sometimes positive, sometimes associated with patronage structures. In Indonesia, the consolidation of economic privilege and its links to corruption was an important source of the pressures that led to the transition to democracy. This is still in an early process of consolidation. In many of the poorer countries, inequalities are associated with latent or actual conflict. For example, Cambodia, Nepal, Pakistan, and Sri Lanka are struggling with the development of effective polities, often in the context of substantial social conflict.

35. For the future, all this suggests that the economic processes driving rising inequality are likely to continue alongside growing political demands for government action for greater inclusion and security. Increasing returns, agglomeration effects, the importance of economic rents, and rising demands to skills will all continue to be salient. Where they interact with slow-responding education systems and infrastructure bottlenecks, the pressures on inequality will be even higher—and even more so in countries that combine large rural populations and low agricultural and rural dynamism. This integration is an essential ingredient of sustaining rapid growth, but it implies paying full and careful attention to questions of inclusion. Inequalities in provisioning for security is an added dimension of the story, with large parts of the population outside formal mechanisms, leading to rising political pressures for action.

III. DOES INCLUSION MATTER? ECONOMICS, INSTITUTIONS, AND POLITICS

36. Does rising inequality matter? More broadly, do Asian societies need to give explicit attention to issues of inclusion, or can they focus entirely on growth, perhaps complemented by targeted programs for the declining numbers in severe absolute poverty? These questions lie at the heart of the discussion of both the overall orientation of public policy, and the future focus of ADB's action.

37. I argue that there are both intrinsic and instrumental reasons for placing inclusion at the center of policy design (see also Ali, 2007; and Ali and Zhuang, 2007). The intrinsic reason is that, in almost all societies, equity is valued in its own right. It can be argued that “equality of opportunity” is both more fundamental and more generally supported than equality of outcomes. However, the near-universal support across the world for action to tackle severe deprivation indicates that outcomes are of societal concern at the bottom of the distribution. For this reason, the World Bank, in its *2005/06 World Development Report*, argued that a normative conception of equity should include both equality of opportunity for all and reduction in severe deprivation in outcomes (World Bank, 2005). This broad approach is consistent with Amartya Sen's ethical position that all should be free to pursue a life of their choosing.⁷

38. An instrumental concern for equity, especially in the sense of equality of opportunity, flows from potential complementarities with the growth process itself. As ADB has itself said:

⁷ See Sen, 1999. Sen also uses the term “capabilities” to refer to this freedom.

Some widening of inequality may be “good” in the sense that it reflects rewards for enterprise and innovation and the incentives needed to apply resources to their most productive uses. But where widening inequality is a consequence of arrangements that restrict access to opportunity, that tolerate asset grabbing and rent seeking, and that perpetuate and widen social cleavages, it is more likely to be symptomatic of institutions that will also eventually stymie growth.” (ADB, 2007c, p. 31)

39. This quotation nicely captures the view that while tradeoffs between equality and efficiency do exist, a negative relationship between some forms of inequality and growth can also exist. Critical here is the idea that the nature of inequality matters: it is necessary to think of inequalities—in the plural—and especially inequalities of opportunity, as opposed to some generalized notion of inequality, least of all the Gini coefficient of income inequality.

40. The major theme of the World Bank’s *2005/06 World Development Report* on equity is precisely that some inequalities are bad for efficiency (and so for long-term growth) and so greater equity is an important complement to growth. The mechanisms can be organized into three categories.

41. **The Functioning of Markets.** I have just highlighted the way in which the growth process in Asia has innovation and increasing returns to scale as central elements (Gill and Kharas, 2007). These processes tend to favor those well-positioned in terms of skills, access to knowledge, and access to finance to take advantage of these possibilities. This is an example of a broader issue. Where markets fail—as they systematically do, and especially so, in developing countries—this typically has a distributional dimension. Poorer groups suffer most from incomplete or ill-functioning markets for credit, insurance, land, skills, or health services. Those with the wealth, status, or connections benefit disproportionately. This implies lost economic opportunities from underinvestment of poorer groups (and can lead to misallocation of capital to wealthier or higher status groups). Environmental problems can further interact with distribution here: environmental issues intrinsically suffer from market failures, whether at the local, national, regional, or global levels. As noted above, in many cases, these particularly hurt poorer groups—in resource-poor rural areas and in urban areas with high levels of pollution and inadequate water and sanitation services.

42. **The Influence of Powerful Incumbents.** Economic policies and institutions do not develop in the abstract, but emerge over time as products of underlying social and political forces. A major theme in recent economic work is that unequal power can lead to economic institutions that are well-designed to serve the interests of the few, but poorly designed to provide for broad-based protection of property rights, or widespread provisioning of social and economic infrastructure (Acemoglu, Johnson, and Robinson, 2001). Excluded groups have particularly limited influence over the design of economic policies and institutions. In the Latin American case, economic historians have put flesh on this view in their analysis of the formation of predatory and exclusionary economic, legal, and political institutions in the colonial period. These emerged as the product of the interactions between powerful elites, economic opportunities in labor-intensive mining and sugar production, and abundant supplies of subordinate labor—in indigenous populations and Afro populations imported via the slave trade (Engermann and Sokoloff, 2002). Countries, of course, have different histories. Indeed, I suggested above that East Asian dynamism was partly associated with political needs to deliver to the masses and provide at least some checks on the economically powerful. But the broad issue of incumbent power remains a concern, and especially so when economic rents are intrinsic to the process of growth, and where there are high concentrations of wealth (Figure 4).

Rajan and Zingales (2003) use the phrase “saving capitalism from the capitalists” to capture this pervasive issue of incumbent power.⁸

43. **Redistributive Backlash.** Finally, the combination of rising inequalities and rapid growth can lead to heightened demands for redistribution. While a shift to genuine equality of opportunity can often be a complement to efficiency—and so, growth—social pressures may get channeled via the workings of the political system into demands for greater access to rents, through clientelistic structures and populist measures, that can lead to sustained or increased subsidies, or protections for politically important groups. In India, for example, teachers’ unions are politically important and are likely to resist reforms of current compensation systems that provide effectively no incentives for quality teaching (Pritchett and Murgai, 2007).

IV. WHAT DOES THIS IMPLY FOR PUBLIC ACTION?

44. There is not enough space in this short paper to enter into details of policy design.⁹ I rather draw some broad implications.

45. First, explicit attention to inclusion is both intrinsically and instrumentally desirable in many fields of economic and social policy, in light of the complementary relationship between equity and growth-related economic processes. This should include continued attention to absolute poverty, especially in its most severe manifestations. But equity is much broader than absolute poverty, and so is by no means of declining concern as the (invaluable) progress in reducing severe absolute poverty proceeds. This is also important given the political salience of societal concerns. “Inclusive growth” is a reasonable name for the set of concerns, provided that the implications are fully specified, and this is not associated with diminished focus on absolute poverty.

46. Second, this has substantial implications for the design of economic institutions and policies. This relates to wide range of areas. Here are some:

- “Economic empowerment” of all groups, through access to finance, economic infrastructure, and markets to poorer groups.
- Provision of the means for all groups to acquire the human capacities to effectively participate in an increasingly globalized world.
- Broad-based risk-management mechanisms to deal with the insecurities that flow from both traditional (weather-related and health) and new (influences of global interactions) factors.
- Justice systems that work for all groups.
- Cutting across these areas are questions of action to deal with the economic and social inclusion of disadvantaged groups and attention to spatial issues, the latter including at one end making cities “livable,” in the interests of both competitiveness and well-being, and at the other, tackling the interlocking economic access, and social and environmental issues associated with economically “backward” geographic areas.

47. Third, it is necessary to understand the broader context in which economic decision making is undertaken, in terms of the functioning of political processes, the dynamics of group-based interactions, access to information, and accountability mechanisms. Major historical

⁸ Rajan and Zingales. 2003.

⁹ See World Bank (2005) and Ali and Zhuang (2007) for surveys of the issues.

transitions that favored both growth and equity have occurred when the political demands for change were supportive. Examples are the extraordinary and successful expansion of social provisioning in now-rich countries (Lindert, 2003); the breaking up of monopolies created by the robber barons of the US at the beginning of the 20th century (Robinson, 2007); and the role that structural change, the transition to democracy, and the opportunity to enter the European common market had on the opening to competition in Spain (Boix, 2007). Asia's political course will undoubtedly be different from these cases, but the issues involved are comparable.

V. IMPLICATIONS FOR ADB

48. What does the nature and pattern of Asia's growth process imply for the strategy of ADB in the next decade or so? I argue here that the "New Asia and the Pacific" is leading to fundamental changes in the nature of demands for ADB's services. In line with the EPG report, this implies the need for major change. Indeed, the general theme here is that ADB has a tremendous opportunity to effect a transformation to meet the changing pattern of demands and needs. Such a transformation is desirable; difficult, but feasible. But if there is not a transformation, ADB is on a path to irrelevance.

49. A central criterion for ADB involvement should be where it can make a difference, and this implies activities where both markets and governments fail. This will often imply a heightened focus on inclusion in the development process, both because that is where the most pressing demands of society will increasingly lie and because this is an important ingredient for sustained growth. While those living in severe income poverty (below \$1/day) should continue to be an important focus of ADB's work, increasingly the proportion of the population in this group will be small and the priority should shift to those who are relatively disadvantaged, or left out of the development process, whether in terms of productive capacities, social conditions, provisioning for risk, or other dimensions. It also implies a heightened focus on the environment.

50. What do current trends indicate that ADB should do less off? As Table 1 indicates, the most important sectors of operational activity are in infrastructure (energy, transport and communications, and water and sanitation) and finance, that together account for 74% of lending. Much of this is in relatively large-scale, national activities.

Table 1: ADB's Operations by Sector, 2006

Sector	Loans (\$ million)	%	Grants (\$ million)	%
Agriculture and Natural Resources	807.17	11	133.60	25
Education	250.90	3	46.66	9
Energy	1,369.50	19	3.00	1
Finance	1,787.00	24	72.05	13
Health, Nutrition, and Social Protection	—		71.99	13
Industry and Trade	10.00	0.1	0.50	0.1
Law, Economic Management, and Public Policy	220.00	3	8.30	2
Transport and Communications	1,433.20	19	131.40	24
Water Supply, Sanitation, and Waste Management	638.82	9	1.00	0.2
Multisector	879.70	12	69.90	13
Total	7,396.29	100	538.40	100

ADB = Asian Development Bank.

Note: Totals may not add up because of rounding.

Source: www.adb.org/About/glance.asp

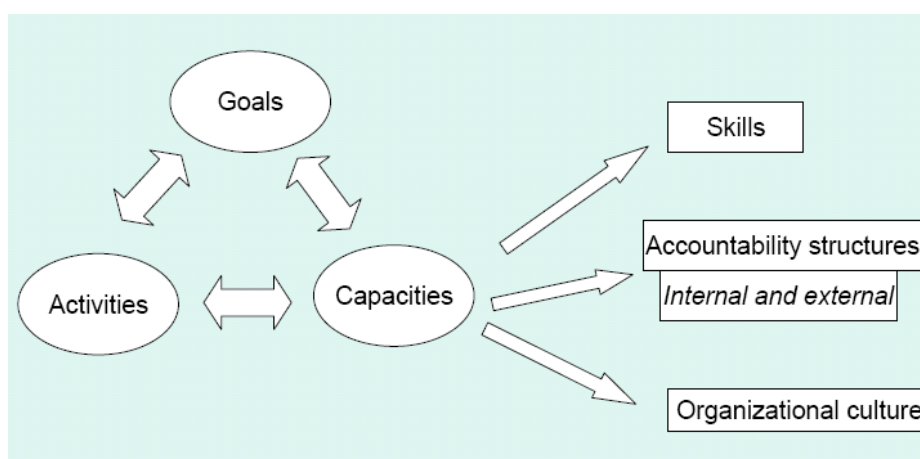
51. For countries with market access (that will also be middle income by 2020), there will be increasingly less need—and less demand—for such traditional support to large-scale infrastructure, the core financial system, and large-scale companies (for ADB’s private sector operations). In these areas there will be ample private finance, and government action will be increasingly effective. Indeed, sustaining a core engagement on these areas is likely to set the organization on a path of declining importance in the region. The cost of doing business with ADB will increasingly outweigh the benefits of lower financial costs as private lending margins come down, and the rationale for ADB engagement will decline if it is seen to be substituting for private involvement. However, the issue is not one of leaving infrastructure, a traditional area of strength of ADB. There will be areas where governments and markets alone will not deliver—infrastructure for inclusion at one end of the scale, and involvement in large-scale infrastructure at the other. These will occur where ADB can play a role in solving coordination problems—at local levels, between governments on regional activities, and, in some cases, between governments and the private sector.

52. In this part, I outline the argument for this general approach. I first introduce the notion of organizational alignment, and then look at ADB’s objective, the rationale for ADB’s engagement, implications for product design and the pattern of engagement, and the question of comparative advantage and capacity. These are all complex issues, and the intention is only to draw preliminary conclusions from the analysis in the first part on Asia’s current process of development. A key point of reference is the EPG report (ADB, 2007a).

A. The Issue of Organizational Alignment

53. The effectiveness of any organization depends on the extent to which its goals, its activities, and its capacities are aligned. A simple visual representation of this is given in Figure 10. This also highlights the complexity of organizational capacities: it certainly means skills, but also fundamental questions of accountabilities—within an organization and to outside stakeholders—and/or organizational culture. These themes are standard to thinking on the effectiveness of private sector organizations.¹⁰

Figure 10: Organizational Alignment



Source: The author.

¹⁰ See, for example, Tushman and O'Reilly (1997) as one example from the business organization literature.

54. This paper did not review ADB's capacities and history. But for the sake of sharpness, I suggest the following hypotheses on this key question of alignment in the past and future:

- The "old" ADB in the decades to the 1990s, with its core focus on large-scale infrastructure, had good alignment between goals, activities, and capacities.
- The addition of a poverty focus in the 1990s undoubtedly delivered a lot of value, but was not associated with a transformation in ADB's organization.
- The changed environment in the "New Asia" requires revised goals and this has generated a potentially major misalignment absent changes in activities and capacities.
- The EPG report is internally misaligned: it has sound and important recommendations on ADB's goal or "strategic directions," makes excellent general points on capacities, but its proposed activities are largely misaligned with the strategic directions.

55. The rest of this part expands on the last two hypotheses.

B. ADB's Goal

56. With respect to ADB's overall goal, the website says:

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.

57. This is a good overall position. It refers to "welfare" that captures the idea that ADB is concerned with overall well-being, and this "of the people in Asia and the Pacific" implies that all people are of concern. And it refers "particularly" to the poor, implying that disproportionate (but not exclusive) weight should be given to the most deprived.

58. While this stance is sound, the discussion in the first part would suggest interpreting this objective in terms of a broad conception of inclusive development. At the level of objectives, I like an approach that incorporates a conception of equity, that includes both equality of opportunity for all, and that avoids severe deprivation in outcomes. Ali and Zhuang suggest a crisp description of what this should mean: "growth with equal opportunities."¹¹

59. The EPG report proposed three shifts in ADB's strategic direction:

- *"from poverty reduction to inclusive growth,*
- *"from growth to environmentally sustainable growth, and*
- *"from a primarily national focus to a regional and global focus" (ADB, 2007a, p. 13).*

60. This is entirely in line with the discussion on goals here, but with the addition of an explicit treatment of the environment—beyond those that are directly linked to inclusion (of which there are many)—and an increased focus on regional and global issues. This is all plausible, but needs to be assessed against the next question.

¹¹ Bourguignon, Ferreira, and Walton (2007) discuss aspects of the objective and its links to the reproduction of inequalities more rigorously.

C. Where Can ADB Make a Difference?

61. This is a fundamental question that should drive the choice of ADB's activities. It depends on two things: first, on where a multilateral agency can potentially make a difference, and second, on ADB's capacities. We discuss capacities below, and here suggest the key criterion should be the following:

1. ADB Should be Engaged in the Region Where Markets and Governments Fail

62. This applies to both support for governments and action by private sector operations that directly support the private sector. It has large implications. In particular, the case for ADB's traditional core services is likely to decline substantially: international private financial markets will continue to thicken, countries will continue to become more creditworthy, and national governments will become more effective. Demand will also decline as the cost of doing business with a multilateral development bank will increasingly outweigh any financial cost advantages as spreads narrow. This is the essence of the EPG conclusion that ADB needs fundamental change to still be relevant in 2020.

63. Aspects of decline in demand are undoubtedly healthy, reflecting the maturation of the countries and the development of private markets. But I suggest that it is not desirable for ADB to fade away or retain relevance only for the remaining very poor and non-creditworthy countries in the region. There is a strong case for an ADB that works with both low and middle income countries, now and in the future. But this needs to be focused increasingly in areas where both governments and markets do a bad job. One way to look at this is in terms of a range of public goods. Here is a list:

- contributing to solving internal collective action and coordination problems where markets fail, and governments are weak, increasingly at subnational levels;
- sharing knowledge across the region (and potentially with other regions) and supporting discovery of how to solve development challenges through structured experimentation, evaluation, and knowledge sharing;
- contributing to providing a range of market-related public goods (regulations that underpin financial access, a supportive business environment, etc.) that will be typically underprovided by both the private sector and governments; here, ADB's private sector operations are key; and
- contributing to solving regional, or intercountry, collective action problems that require coordination across countries (e.g., on infrastructure and environmental management).

64. This seemingly abstract list actually corresponds well with a focus on inclusive growth and with the EPG's additional list. For it is precisely in a range of areas associated with inclusion, in managing the environment, and in regional interactions that markets fail, and governments also fail, at least partially. This takes us to questions of what activities ADB could be involved in.

2. Implications for Activities and Country Focus

65. This section outlines areas where there is a potential case for ADB action in terms of its overall objective and the possibility of making a difference, where markets and governments fail.

The next section turns to the question of ADB's capacities. The discussion is organized around the three strategic directions recommended by the EPG.

66. **Inclusive Growth within Countries.** Markets fail or can contribute to exclusionary growth patterns in a range of areas sketched in the preceding parts of this paper. While governments can, in principle, take action to offset features of market functioning, they often also fail precisely in areas that are most important for inclusion. Through its reach, official finance, knowledge, and expertise, ADB can potentially contribute effectively in these areas, focusing on where both markets and governments fail and, of course, where there is also political support for interventions. Here are some areas:

- infrastructural investments and associated governance structures that provide equitable access to services through focusing on integrating poorly served regions and groups into national systems, whether these fall in geographic regions or within cities;
- development and extension of financial products and institutions that efficiently provide credit, savings, and insurance products for the large proportion of systems, with the necessary regulatory support;
- where basic education systems have achieved universal reach, focusing on the tougher problems of raising quality, tertiary education reform, and links with innovation process and the labor market;
- development of risk-management systems for health, weather, old-age and employment risks;
- support for the design and implementation of institutional structures that make cities both livable and competitive; and
- integrated actions on incorporating poor areas and excluded groups into national processes of economic and social development.

67. Many of these will involve working at subnational levels, with state, provincial, or municipal governments, especially where these are institutionally weak.

68. There is much less of a rationale for the more traditional finance of public infrastructure and support for financial systems at a national level, and in well-developed subnational governments. Where there is a potential for ADB to make a difference in large-scale national infrastructure is in areas where private involvement makes sense, but public involvement or regulation is required to deal with monopoly power, standards, access or environmental access. ADB may be able to play the role of an interested third party, both providing finance and advice on regulatory and contractual options.

69. **Environmentally Sustainable Growth.** The case for support on how to achieve environmentally sustainable growth is strong, since these are often poorly handled by markets alone. For environmental effects that are relevant at a national level, this in principle should be internalized by national governments. However, this is an area where policy design and implementation is complex, and the pooling of regional expertise and experience will likely continue to play a valuable role.

70. I would then particularly highlight the intersection with questions of inclusion: there are important overlaps between environmental resource depletion or pollution, and (relative and/or absolute) deprivation of particular areas and groups. Subnational governments are also likely to

be weak in these areas; ADB's involvement in helping bring design expertise and solve coordination problems thus has a dual rationale.

71. At the other end of the scale is also a direct case for external engagement where there are spillovers beyond national borders, for example, over water management and pollution. ADB has a potential for a particular role in regional interactions though this needs not exclude global environmental concerns, given the likely importance of climate change for national policy in the coming decades.

72. **A Growing Regional Focus.** Beyond the environment, there are likely to be many areas in which intercountry coordination will matter. Integration is already proceeding apace in markets (see Gill and Kharas 2007), so it will again be important to apply the criterion of making a difference. Infrastructure projects that involve complex negotiations between countries are an obvious candidate. I would again emphasize the potential intersections with inclusive growth, but now at a regional level. As Figure 6 suggests, increasingly geographic areas of relative deprivation cut across boundaries. ADB has a potentially major role in supporting action that integrates poorer areas into regional growth processes.

73. The case for increased involvement at a global level—also proposed by the EPG—also makes sense, not on the principle that ADB should be a global actor. It is, after all, a regional institution. But there is a range of issues, of which climate change and international trade arrangements are two major examples, where Asia's position with respect to global question is greatly important both for Asia's own development and for resolution of global interactions.

74. **Product Design, Bundling, and Transactions Costs.** ADB has two features that make it suitable for making a difference in line with its objective of improving the welfare (or opportunities) of all Asians. First, it has reach and development expertise across countries. This potentially allows the building of knowledge and associated technical capacities. Second, it is a "bank." There are gains from linking these attributes. In delivering on public good aspects of development, there are potentially large benefits from the "bundling" of knowledge and expertise with finance. This can increase effectiveness both within countries and in coordination between countries through increased credibility, risk sharing, and providing a range of additional instruments to solve decision-making problems. Of course, some governments may wish to have—and pay for—pure knowledge-based services. This should also form part of ADB's menu of services.

75. While bundling finance and knowledge is desirable, this is now high cost, owing to ADB's internal procedures and requirements, as the EPG emphasizes. For long-run effectiveness, transaction costs need to be significantly reduced through both streamlining of procedures and shifting to supporting the effective implementation, rather than application, of ADB standards in areas such as procurement, environmental, and resettlement safeguards.

76. **On Middle Income and Poor Countries.** Note that all the above arguments apply to both middle income and low income countries. However, other financing and knowledge-based actors differ in the different contexts and, consequently, so will the specifics of the nature of desirable involvement of ADB. For emerging market countries, the new agenda outlined above should dominate activities, based on the principle of making a difference. Continued involvement with this group is also central to the knowledge-sharing function and the building of expertise that is needed to support action in poorer countries.

77. In poor, noncreditworthy countries, there will also be a stronger case for more traditional forms of support for infrastructural investment by national governments. As the EPG suggests, over the long term, this will (hopefully) be a transitional form of engagement until these countries develop.

78. What of concessionary finance? This should be driven primarily by the creditworthiness of the borrower rather than the sector. In particular the range of “social” and “risk-management” areas of interventions are, in a broad sense, investments in inclusive and sustainable growth that middle income countries should be financing over the long term from their own expanding resources—and so, borrowing for.

79. **Governance.** In all countries, ADB’s current emphasis on governance is likely to remain important since it is a key driver of development processes in sectoral activities, from infrastructure to rural development. As noted in the first part, the functioning of policy and institutions is linked to overall political and social functioning. ADB cannot get involved in domestic politics, but it can support information disclosure and accountability mechanisms that facilitate more effective domestic processes.

D. ADB’s Capacities and Comparative Advantage

80. Does ADB have a comparative advantage in providing the knowledge and expertise-based services—bundled with finance—that would support engagement in these more complex questions of institutional design? This paper did not assess ADB’s capacities, but I do have some general comments. There is likely a misalignment between the potential new product lines that flow from effective pursuit of the new strategic direction and current capacities. Table 2 first gives a suggested list of potential activities from the considerations sketched above and a subjective view of current capacities. This is totally subjective, and the main point is that this needs to be assessed carefully by someone.

Table 2: The Issue of Aligning ADB’s Capacities with Potential Activities

Potential Activities	ADB’s Current Capacities
Infrastructure challenges where markets and governments fail	Partial?
Livable cities (for people and firms)	No?
Lagging regions and rural development	Partial?
Comprehensive risk management structures (health, old age, weather, employment?)	No?
“Competitive” education systems (quality/tertiary)	Partial?
Environmental management	No?
Financial inclusion	Partial?
Innovation systems	No?

ADB = Asian Development Bank.
Source: The author.

81. If Table 2 is at least partially right, then it carries an important message: capacities will need to be developed if ADB is to be effective in new areas. Or more broadly, the choice of activities needs to be made jointly with a decision to build new capacities. But note that there are questions on all areas. This is not a case for reverting to a traditional infrastructure and finance focus because the areas where markets and governments are failing are different. Making a difference in infrastructure, for example, will require sets of skills that can deal with the delivery of infrastructural services to excluded groups or areas on the one hand, or can manage

questions of strategic interactions and contract design with private parties, or between governments, at the other end of the scale.

82. These considerations apply with equal force with respect to two crosscutting areas where an effective ADB is highly desirable:

- becoming a genuinely knowledge-based organization, with all that that means in terms of bolstering the research function, linking research to operations, undertaking evaluations, and building a culture of sharing results; and
- developing the capacity to be an effective actor in intercountry interactions.

83. The period through 2020 is sufficiently long to consider the development or strengthening of capacities, if these are needed to reach ADB's long-term goals. However, some hard-headed assessment is needed on ADB's potential to develop capacities that is sufficiently cutting edge to be effective in such a dynamic region. As the EPG report suggests, this will involve action on the human resource side and could involve greater decentralization to other major intellectual centers in the region.

84. What of comparative advantage? ADB has an important potential comparative advantage vis-à-vis almost all organizations in the region, given its reach and regional character. In terms of other actors, probably the main competitor in the region now is the World Bank, which has less regional focus, but has greater knowledge-based capacity and the additional advantage of having global reach. There may be scope for considering some division of labor. But it is surely desirable for ADB to strengthen these capabilities, where this is feasible, to assure its longer-term capacity to make a difference, and to both compete and complement the activities of other knowledge-based institutions.

VI. CONCLUSION

85. The Asian region is going through a period of dramatic change. ADB's traditional lines of activity and ways of doing business will be of declining importance, except in the remaining very poor countries. An important feature of the change is the immensely important progress in reducing absolute poverty. I have argued that the shift to "inclusive growth" can provide an alternative broad frame for ADB's operational engagement. However, a focus on "inclusive growth" does not mean a primary focus on growth alone; quite the opposite. Asia faces a whole series of complex challenges around inclusion that are both of great intrinsic importance for the well-being of relatively deprived groups in the region, and need to be tackled to assure the sustainability of long-term growth. The issue is as much inclusion for growth as adding inclusion to growth. ADB, including its private sector operations, can potentially make a difference in a range of areas affecting inclusion, in addition to a rising involvement in environmental and regional activities, focusing on areas where both markets and governments fail. But this is likely to involve the phasing out of traditional areas and a hard-headed assessment of where ADB can develop the capacities to deliver in these new areas. This will require a process of organizational transformation that presents an exciting and important opportunity for ADB. But in the absence of a transformation, both the case, and demand for ADB's services will highly likely fade away by 2020.

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Poverty Reduction in the New Asia and Pacific: Key Challenges of Inclusive Growth for the Asian Development Bank

This paper summarizes the strategic discussion at the Forum on Inclusive Growth and Poverty Reduction in the New Asia and the Pacific, 8–9 October 2007, as highlighted in the excellent keynote address by Michael Walton. It argues that growth needs to be inclusive to be sustainable and to be accepted by the population. The Asia and Pacific region, with its rising inequalities, has somewhat lost the inclusive growth path of its past. This gives new opportunities for the Asian Development Bank to bundle knowledge and finance in areas where both governments and markets fail.

About the Asian Development Bank

ADB aims to improve the welfare of the people in the Asia and Pacific region, particularly the nearly 1.9 billion who live on less than \$2 a day. Despite many success stories, the region 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 their quality of life.

ADB's main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance. 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 more than 2,000 employees from over 50 countries.

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