Economic Outlook for Southeast Asia, China and India 2016

ENHANCING REGIONAL TIES

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Foreword

The *Economic Outlook for Southeast Asia, China and India* is an annual publication on Asia's regional economic growth, development and regional integration processes. It focuses on the economic conditions of the Association of Southeast Asian Nations (ASEAN) member countries (Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam) and two large economies in the region, China and India. This publication evolved from the *Southeast Asian Economic Outlook*.

The Outlook was initially proposed at an informal reflection group on Southeast Asia in 2008 as a follow-up of the Council Meeting at Ministerial level (MCM) in 2007 and was accepted by ministers/senior officials from ASEAN countries at the occasion of the 2nd OECD-Southeast Asia Regional Forum in Bangkok in 2009. The Outlook project was officially launched in 2010 and each edition is regularly presented at the occasion of the ASEAN/East Asia Summit. It was included in the OECD's Southeast Asia Regional Programme (SEARP) at the Steering Group Meeting in Jakarta, Indonesia in March 2015, with its role of providing a horizontal view of activities, identifying emerging trends in the region and providing a backbone for the different streams of the Programme confirmed at the 2015 MCM. The Outlook serves as a strategic foresight and policy dialogue tool for the SEARP and includes summaries of recent developments in the region on issues related to the Programme's six Regional Policy Networks and three Initiatives.

The 2016 edition of the Outlook focuses on the importance that regional integration has had in Emerging Asia and sets out issues deserving of greater attention in strengthening future co-operation. In particular, it provides an overview of progress made in integration and discusses the importance of developing institutional capacities for achieving regional goals, the potential for co-operation in the use of renewable energy and the development of a more international private sector.

The OECD Development Centre is committed to working alongside governments of developing and emerging economies and regional actors to identify key areas of intervention in order to address these challenges. The Centre enjoys the full membership of three Southeast Asian countries, namely Indonesia, Thailand and Viet Nam, as well as India and China. This project also benefitted from the generous support of other Emerging Asian countries.

This edition of the Outlook is the result of policy dialogue and consultation at the regional level, at the *4th OECD-AMRO-ADB Joint Asian Regional Roundtable on Near-term Macroeconomic and Medium-term Structural Policy Challenges*, held in Tokyo, Japan, in May 2015. Like other regional economic outlooks produced by the OECD Development Centre, the report was prepared in collaboration with regional partners; UNESCAP and the Asian Development Bank Institute (ADBI) contributed to the 2016 edition. The Outlook also benefitted from discussions with the ASEAN Secretariat. The OECD is committed to supporting Asian countries in their efforts to promote economic and social well-being through rigorous analysis, peer learning and best practices.

Acknowledgements

The 2016 edition of the *Economic Outlook for Southeast Asia, China and India: Enhancing Regional Ties* was prepared by the Asia Desk of the OECD Development Centre, in co-operation with the United Nations Economic and Social Commission for Asia and the Pacific (UNESCAP) and the Asian Development Bank Institute (ADBI). The publication also benefitted from discussions with the ASEAN Secretariat.

The team was led by Kensuke Tanaka, Head of Asia Desk and overall guidance was provided by Mario Pezzini, Director and Nicola Harrington-Buhay, Deputy Director of the OECD Development Centre. This volume was drafted by a core team composed of Kensuke Tanaka, Masato Abe, Satoshi Kojima, Aladin Rillo, Prasiwi Ibrahim, Jingjing Xia and Derek Carnegie. Jingjing Xia contributed to statistical work related to this publication. Aaron Soans, Charles Pigott and Yoki Okawa provided significant inputs for the report. We thank Asnawi Kamis, Phouphet Kyophilavong, Shu Ling, Kong Ratha, Kadek Sutrisna and Nuyen Tu Anh for providing their valuable inputs and data related to the structural policy country notes for this publication. Useful comments were provided by Pornpinun Chantapacdepong. Laura Golden, Virginia Rico De la Viesca and Myriam Andrieux provided useful administrative support for this project. Elizabeth Nash, Delphine Grandrieux, Studio Pykha and Aida Buendia turned the manuscript into the publication.

The Outlook 2016 benefitted from discussions with OECD Delegations at three *Informal Consultation Group (ICG)* meetings in February, September and November 2015 in Paris and with experts in the region at the 4th *Asian Regional Roundtable on Macroeconomic and Structural Policy Challenges*, jointly organised by the ASEAN+3 Macroeconomic Research Office (AMRO), the Asian Development Bank (ADB) and the OECD, in Tokyo on 14-15 May 2015. Ambassador Pierre Duquesne, Ambassador Hans-Juergen Heimsoeth, Ambassador Kazuo Kodama and Ambassador Si-hyung Lee as well as Kang-hyeo and Jürg Schneider chaired sessions at ICG. The Outlook was launched at the occasion of the ASEAN/East Asia Summit in Kuala Lumpur, Malaysia in November 2015 in a joint session with Economic Research Institute for ASEAN and East Asia (ERIA). The authors are grateful to Rintaro Tamaki, Deputy Secretary-General of the OECD, Yoichi Nemoto, Director of the AMRO, Tomomi Tamaki, Director of the ADB Japan Representation office, Hidetoshi Nishimura, Executive Director of the ERIA, as well as Juan Paolo Hernando, Fianna Jurdant, Izuru Kobayashi, Iza Lejarraga, Arthur Minsat, Noriyuki Mita, Yumiko Murakami, Munenori Nomura, Donghyun Park, Mauro Pisu, Sundram Pushpanathan, Vicente Ruiz, Henri-Bernard Solignac-Lecomte, Sidqy Suyitno, Pattama Teanravisitsagool, Endy D. Tjahjono, So Umezaki and Joseph E. Zveglich, Jr.

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Acronyms and abbreviations

AADMER	ASEAN Agreement on Disaster Management and Emergency Response
ABMI	Asian Bond Market Initiative
ACCP	ASEAN Committee on Consumer Protection
ACIA	ASEAN Comprehensive Investment Agreement
ACTS	ASEAN Credit Transfer System
ADB	Asian Development Bank
ADBI	Asian Development Bank Institute
AEC	ASEAN Economic Community
AEGC	ASEAN Experts Group on Competition
AFAS	ASEAN Framework Agreement on Services
AFCC	ASEAN Multi-Sectoral Framework on Climate Change
AFSIS	ASEAN Food Security Information System
AFTA	ASEAN Free Trade Area
AHN	ASEAN Highway Network
AIFS	ASEAN Integrated Food Security
AIMO	ASEAN Integration Monitoring Office
AMRO	ASEAN+3 Macroeconomic Research Office
APEC	Asia-Pacific Economic Co-operation
ARF	ASEAN Regional Forum
ASEAN	Association of Southeast Asian Nations
ASEAN-5	Indonesia, Malaysia, the Philippines, Thailand and Viet Nam
ASEAN+3	ASEAN-10 countries plus China, Japan and South Korea
ASEAN+6	ASEAN+3 countries plus Australia, India and New Zealand
ASEAN-SAM	ASEAN Single Aviation Market
ASIPF	ASEAN Integrated Protocol for Fisheries
ASPEC	ASEAN Patent Examination Co-operation
ATIGA	ASEAN Trade in Goods Agreement
AUN	ASEAN University Network
AWGIPC	ASEAN Working Group on Intellectual Property Cooperation
BIMP-EAGA	Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area
BOT	Build-Operate-and-Transfer
BPJS	Indonesian Social Security Agency
BPO	Business process outsourcing
BPS	Statistics Indonesia
BRIC	Brazil, Russia, India and China
BRIS	Brunei Research Incentive Scheme
BSP	Philippine Central Bank
CATC	Common ASEAN Tourism Curriculum
CBTA	Cross-Border Transport Facilitation Agreement
CEPT	Common Effective Preferential Tariff
CLMV	Cambodia, Lao PDR, Myanmar and Viet Nam
CITES	Convention on International Trade in Endangered Species of Wild Fauna and Flora
CMIM	Chiang Mai Initiative Multilateralisation
COBLAS	Consulting-based Learning for ASEAN SMEs
CPC	Communist Party of China
CPI	Consumer price index
CQF	Cambodian Qualifications Framework
DepEd	Department of Education, Philippines

DOSM	Department of Statistics, Malaysia
EAS	East Asia Summit
EC	European Community
ECAP III	EU-ASEAN Project on the Protection of Intellectual Property Rights
EM-MNC	Emerging markets multinational corporation
EU	European Union
FAO	Food and Agriculture Organization
FDI	Foreign direct investment
FLEGT	Forest law enforcement, governance and trade
FPRI	Fiscal Policy Research Institute of Thailand
FTA	Free trade agreement
GATS	General Agreement on Trade in Services
GDP	Gross domestic product
GLC	Government-linked companies
GMS	Greater Mekong Subregion
GNI	Gross national income
GST	Goods and services tax
GVA	Gross value added
IAI	Initiative for ASEAN Integration
ICOR	Incremental Capital/Output Ratio
ICT	Information and communication technology
IDR	Indonesia rupiah
IEA	International Energy Agency
IFAD	International Fund for Agricultural Development
ILO	International Labour Organization
IMF	International Monetary Fund
IMS-GT	Indonesia-Malaysia-Singapore Growth Triangle
IMT-GT	Indonesia-Malaysia-Thailand Growth Triangle
IPR	Intellectual property right
ISO	International Organization for Standardization
JETRO	Japan External Trade Organisation
JICA	Japan International Cooperation Agency
LCS	Low carbon society
LDCs	Least developed countries
LPG	Liquefied petroleum gas
LSCI	Liner Shipping Connectivity Index
MADB	Myanmar Agriculture Development Bank
MP3EI	Master Plan for the Acceleration and Expansion of Indonesia's Economic Development
MPAC	Master Plan on ASEAN Connectivity
MPC	Malaysia Productivity Corporation
MPF	Medium-Term Projection Framework for Growth and Development
MRA	Mutual Recognition Arrangements
MRC	Mekong River Commission
MSME	Micro, small, medium-sized enterprise
MTBF	Medium-term budgetary frameworks
MTDP	Medium-term development plan
MTFF	Medium-term fiscal framework
MTPF	Medium-term performance framework
MYR	Malaysian Ringgit
NDGIs	Narrowing Development Gaps Indicators
NDRC	National Development and Reform Commission
NEDA	National Economic and Development Authority

NGO Non-governmental organisation
NPL Non-performing loan
NPM New public management
NSDC National SME Development Council, Malaysia
NTM Non-tariff measures
ODA Official development assistance
OECD Organisation for Economic Co-operation and Development
PDP Philippines' Development Plan 2011-16
PEFA Public Expenditure and Financial Assessment
PEM Public expenditure management
PFES Payments for Forest Environmental Services
PFM Public financial management
PHP Philippine peso
PISA Programme for International Student Assessment
PITA Petroleum Income Tax
PPP Public-private partnership
PPP Purchasing power parity
PRC People's Republic of China
QE Quantitative easing
R&D Research and development
RBI Reserve Bank of India
RCEP Regional Comprehensive Economic Partnership
RM Malaysia ringgit
RoRo Roll-on/roll-off
RTA Regional Trade Arrangement
SBV State Bank of Vietnam
SEAMEO Southeast Asian Ministers of Education Organization
SITC Standard International Trade Classification
SMEs Small and medium-sized enterprises
SOCB State-Owned Commercial Bank
SOE State-owned enterprise
SPA-FS Strategic Plan of Action on Food Security
TAT Tourism Authority of Thailand
THB Thailand baht
TMS Target Management System
TPP Trans-Pacific Partnership
TVET Technical vocational education and training
UN United Nations
UNCTAD United Nations Conference on Trade and Development
UNDP United Nations Development Programme
UNESCAP United Nations Economic and Social Commission for Asia and the Pacific
UNFCCC United Nations Framework Convention on Climate Change
UNSO United Nations Statistical Office
UNWTO United Nations World Tourism Organization
USD United States dollar
VAT Value-added tax
WEF World Economic Forum
WEN ASEAN-Wildlife Enforcement Network
WEO World Economic Outlook
WIPO World Intellectual Property Organization
WTO World Trade Organization

Editorial

Growth in Emerging Asia (Southeast Asia, China and India) is expected to moderate over the medium term but still remain robust, backed by solid macroeconomic fundamentals and domestic demand. GDP growth in the region is forecast to average 6.2% per year over 2016-20. However, several downside risks require careful attention. The effects of a growth slowdown in China are likely to be felt in economies in the region through trade and investment channels. Lower productivity growth risks damaging confidence and impeding recovery from the global slowdown. The prospect of monetary normalisation in the United States may also create negative impacts on the countries in the region.

This edition of the *Economic Outlook for Southeast Asia, China and India* highlights the importance of regional integration to boost growth in the region in the face of global uncertainty. I believe this is a timely discussion as the progress made toward the establishment of the 2015 ASEAN Economic Community is assessed. The *Outlook's* structural policy country notes also shed light on key country-specific policy challenges that need to be addressed, recent reforms that have been implemented and policy options to be considered in the ten ASEAN member countries as well as China and India.

The *Outlook* discusses how strengthening regional ties by accelerating the economic community initiatives is one of the best strategic responses to global uncertainty. While various regional initiatives of ASEAN, ASEAN+3 and ASEAN+6 show progress, additional efforts are required to meet integration targets. Greater institutional capacity will be required, particularly to co-ordinate regional initiatives and national agendas to avoid duplication and sustain integration efforts. Monitoring capacity will need to be strengthened to make regional initiatives more effective. Other policy options not adequately addressed by the ASEAN Economic Community also need regional solutions. For example, renewable energy shows great potential, but a lack of cross-border co-operation impedes its use. While Emerging Asia's private sector is becoming increasingly global, it could similarly benefit from a more supportive regional environment for business.

I hope that this latest edition of the *Outlook* serves as a useful tool to facilitate policy dialogue in the region and encourage a better understanding of the challenges at hand and the measures required to overcome them.

Mario Pezzini

Director

OECD Development Centre

Executive summary

The 2016 edition of the *Economic Outlook for Southeast Asia, China and India* focuses on three main areas: Chapter 1 examines the regional economic outlook up to 2020; Chapters 2 to 5 look at the prospects and challenges for regional integration; and Chapter 6 provides detailed country notes on the prospects for structural policy in the region.

Economic outlook from 2015 to 2020

Real gross domestic product (GDP) growth in Emerging Asia (the ten ASEAN members plus China and India) is expected to moderate to 6.5% in 2015, slipping to 6.2% over the medium term (2016-20). Private consumption will be the largest contributor to overall growth, while exports will contribute less than before.

The change in the pace of growth will not be the same everywhere. While China is set to slow to an annual average of 6% over the medium term, annual growth in India will reach 7.3%, among the highest in the region.

In the 10-member ASEAN area, annual growth is expected to be unchanged in 2015, hitting an average of 4.6%, and then rising to 5.2% over the medium term. Among the ASEAN-5 members, the Philippines and Viet Nam will be the strongest performers, helped by their improved macroeconomic fundamentals and infrastructure plans. Cambodia, Lao PDR and Myanmar (CLM) look set to be the strongest performers, with medium-term annual growth of between 7.3% and 8.3%. Recovery in agriculture and expansions in tourism and industrial output will boost Cambodia and Lao PDR while Myanmar will benefit from rising investment and economic reforms.

Risks to growth

The main risk to growth is the slowdown in China, which poses the threat of a demand shock, although the potential impact varies greatly. A slowdown in exports to China risks hitting Malaysia, Singapore and Thailand hardest. Similarly, a slowing in investment from China could be a worry for Malaysia and Thailand. The latter could also suffer from a decline in Chinese tourism.

Other potential threats include interest rate rises in the United States, which could put pressure on short-term rates in the region. However, while this may be a cause for concern in some cases, the impact is likely to be muted. Additional risks include a slowing in productivity growth across much of Emerging Asia since the global financial crisis – a trend that needs to be reversed.

Regional integration: Prospects and challenges

Regional integration in Emerging Asia has progressed since the 1980s, led by the countries of Southeast Asia. A number of frameworks for regional integration have emerged, including the ASEAN+3 (ASEAN, Japan, China and Korea) and ASEAN+6 (ASEAN+3, India, Australia and New Zealand) initiatives. In particular, the establishment of the ASEAN Economic Community by end-2015 is seen as a major milestone.

Progress made and remaining challenges in deepening regional integration vary across key policy areas: trade in goods; trade in services; investment and capital market liberalisation; competition and consumer protection; intellectual property;

infrastructure and connectivity; small- and medium-sized enterprises; food, agriculture and forestry; tourism; human and social development; and the Initiative for ASEAN Integration (IAI).

Strengthening regional ties is one of the best strategic responses to a changing global environment. But despite progress current efforts are still not enough to achieve integration targets. Countries in the region need to make additional efforts and take active steps to realise a single economic market by 2015 and beyond. Measures should include:

- **Improved co-ordination:** Existing institutions and regional frameworks could be used more effectively. There need to be greater efforts to co-ordinate between regional initiatives and national agendas to avoid duplication and ensure all are moving in the same direction;
- **Tackling regional disparities:** Some countries, notably Cambodia, Lao PDR, Myanmar and Viet Nam, face particular development challenges. Development gaps within the region create barriers to the implementation of uniform targets and approaches. As ASEAN works to create its next IAI plan, it has an important opportunity to rethink how it can facilitate integration of the region's least developed members.
- **Greater co-operation with non-ASEAN members:** Co-operation with partners outside of ASEAN, particularly those in the ASEAN+3 and +6 frameworks, has already proved useful, particularly in areas like financial stability, trade and investment promotion, and environmental and disaster risk management.
- **Improved monitoring:** Indicators on integration remain relatively underdeveloped in the region. There is a fundamental need for reliable indicators before monitoring, evaluation and analysis, and knowledge sharing can proceed.
- **Greater attention to green issues:** The enormous economic progress of the region has come at a high environmental price. The region needs to make more use of its large renewable energy resources and improve regional co-operation.
- **Addressing private sector development:** While foreign direct investment (FDI) inflows are growing, greenfield investments are declining particularly in the manufacturing sector. Mergers and acquisitions offer great potential to expand markets but remain concentrated in a limited number of sectors. Policies are required to address overly narrow domestic focus which restricts local firms, particularly small and medium-sized enterprises (SMEs), from achieving their potential as "ASEAN enterprises".

Prospects for structural policy

The structural policy priorities of countries in the region are diverse, but many have a clear focus on the need for more inclusive and sustainable development, which recognises the need for high-quality growth and improved quality of life. Improved competitiveness is also a priority for many, as well as reducing the impact of economic activity on the environment.

Topics to be addressed include rural development, social programmes, promoting investment, and taxation. Education and infrastructure are also common areas of concern: less-developed countries are seeking to provide the basic foundations for growth and to address troublesome bottlenecks; higher-income economies are looking to establish the conditions for more knowledge-based development in the future.

Overview: Promoting growth through structural reform and regional integration

Key messages

Outlook and general assessment

- Real growth in Emerging Asia (Southeast Asia, China and India) will experience mild moderation in 2015, at 6.5%, and is projected to moderate gradually over the medium-term (2016-20) to an average of 6.2% annually. Growth in China will continue to slow while growth in India picks up to one of the highest levels in the region. Growth in the ASEAN (Association of Southeast Asian Nations) region will be similar and is projected to average 4.6% in 2015 and 5.2% over 2016-20, led by growth in the Philippines and Viet Nam among the ASEAN-5 and the CLM (Cambodia, Lao PDR and Myanmar) countries. Private consumption will be a large contributor to overall growth, while exports will contribute less than during most of the prior decade.
- The region will have to cope with potential external and domestic risks to sustain its growth momentum. The slowdown in China's economy will continue to affect the growth prospects of the rest of the region as export demand drops and investment flows decline, though countries vary in their level of exposure to these risks. The prospect of United States monetary normalisation, beginning in the near future, is expected to have relatively more mild impacts on the region, but may also be a cause for concern in some cases. Much of Emerging Asia has seen slowing productivity growth since the global financial crisis. This trend will need to be reversed for growth to pick up.

Special focus for 2016 edition: Enhancing regional ties

- Regional integration efforts have intensified at varying levels over the years to implement the regional integration initiatives of ASEAN, ASEAN+3 and ASEAN+6. Current efforts are still not enough to achieve integration targets despite important and positive achievements. In particular, ASEAN countries need to take active steps to realise a single economic market by 2015 and beyond, and make additional efforts, including: *i)* co-ordinating between regional initiatives and national agendas, and regional and sub-regional initiatives, avoiding duplication and moving in the same direction; *ii)* reducing disparities in the region by supporting the further development of the CLM countries; *iii)* moving towards a "Global ASEAN" that is integrated in the global economy and stronger ties with the ASEAN+3 and ASEAN+6 frameworks; and *iv)* strengthening monitoring capacity through better indicators and peer learning to make the regional agenda more effective.
- Addressing important policy areas in the 2016-25 integration agenda that were not addressed adequately in pre-2015 agendas, is critical. This particularly pertains to the issues of green growth and renewable energy and private sector development. First, the region should tap into its considerable potential in renewable energy to meet growing demand. Tariffs and non-economic barriers slow integration and impede opportunities for improved efficiency in the renewable energy sector. Hydropower from the Mekong River, for example, is progressing and remains a promising source of future generating capacity to be exported throughout the region. Second, greenfield investments have declined, in particular, in the manufacturing sector and mergers and acquisitions (M&A) investment has been limited to specific sectors and specific countries in the region. Local business can take advantage of the changes related to the ASEAN Economic Community and expand their operations across ASEAN, transforming to be real regional entities or "ASEAN enterprises".

Structural policy country notes

- While the structural policy priorities for Emerging Asia countries are highly diverse, many of these countries have set goals for improving inclusive and sustainable development, recognising the need for high-quality growth. Formulating new development strategies will require adopting a comprehensive package of reforms for SMEs, finance, infrastructure, labour market, environmental policy and in the agriculture, education, social security and tourism sectors. Overall, the implementation of development plans in Emerging Asia needs to improve.

Outlook for 2015-20

Growth in the Emerging Asia region (Southeast Asia, China and India) shows mild moderation but will remain robust at an average rate of 6.5% real gross domestic product (GDP) growth in 2015. In the medium term, growth in the region is projected to average 6.2% per year over 2016-20, according to the most recent Medium-Term Projection Framework for this edition of the Outlook (MPF-2016) (Table 1). This is noticeably below the 7% rate of growth over 2011-13, due mainly to China's slowing growth. The growth slowdown in China will also place downward pressure on growth in the rest of the region. The ten ASEAN countries together are projected to grow at 4.6% in 2015 with an annual average rate of 5.2% over 2016-20. In general, the Southeast Asia region will maintain a favourable growth performance in the medium term.

Table 1. **Real GDP growth of ASEAN, China and India**

Annual percentage change

Country	2014	2015	2016	2016-20 (average)	2011-13 (average)
ASEAN-5					
Indonesia	5.0	4.7	5.2	5.5	6.2
Malaysia	6.0	4.6	4.6	5.0	5.2
Philippines	6.1	5.9	6.0	5.7	5.9
Thailand	0.9	2.7	3.1	3.6	3.2
Viet Nam	6.0	6.4	5.9	6.0	5.6
Brunei Darussalam and Singapore					
Brunei Darussalam	-2.3	-1.4	0.5	1.8	0.9
Singapore	2.9	2.1	2.4	2.6	4.1
CLM countries					
Cambodia	7.0	7.0	7.1	7.3	7.3
Lao PDR	7.4	6.9	7.0	7.3	8.1
Myanmar	7.7	8.2	8.2	8.3	6.9
China and India					
China	7.3	6.8	6.5	6.0	8.2
India	7.3	7.2	7.3	7.3	5.5
Average of ASEAN 10 countries	4.6	4.6	4.9	5.2	5.4
Average of Emerging Asia	6.7	6.5	6.4	6.2	7.0

Note: The cut-off date of data is 2 November 2015. Weighted averages are used for ASEAN and Emerging Asia. The results of China, India and Indonesia (2015 and 2016 projections) are based on the *OECD Economic Outlook 98*.
Source: OECD Development Centre, MPF-2016 (Medium-Term Projection Framework). For more information on MPF, please see www.oecd.org/dev/asia-pacific/mpf.htm.

Growth prospects in Emerging Asia

The Philippines and Viet Nam are projected to show robust growth at an annual average rate of around 6% over 2016-20. **Viet Nam**'s growth has been led by a rapid acceleration of fixed investment, strong foreign direct investment (FDI) inflows and robust consumption. Together, these components account for most of overall real growth, as net exports have restrained overall growth due to strong imports. In general, the private sector's performance has improved, with strong retail sales growth, although structural adjustments in the state-owned enterprise and banking sectors will weigh on growth somewhat. The **Philippines** has benefitted from strong momentum in domestic demand, buoyed by growing remittances. The Philippines is also benefitting from a significant improvement in its attractiveness as an FDI destination. Growth prospects reflect the countries' improved macroeconomic fundamentals and their plans to develop infrastructure. However, risks remain as job creation and the business environment need to be improved.

Indonesia, Southeast Asia's largest economy, has experienced mild moderation in its real growth with both domestic and external demand slowing to 5.5% in the medium term. Private consumption has expanded moderately. The government has attempted to boost investment by doubling the infrastructure budget for 2015, but execution has been delayed. While the Indonesian currency has depreciated considerably, partly due to falling commodity prices, export growth has been very weak on the back of stagnant external demand. Economic growth in **Malaysia** weakened during the first half of 2015. The weakness was caused by deteriorating external demand as a result of the economic slowdown in China, its major trading partner, and by the persistence of low international oil prices in the first half of the year. However, the ringgit's depreciation may support non-commodity exports in the future.

While political turmoil had a large negative impact on growth in **Thailand** in 2014, the country experienced modest GDP growth of 2.7% in 2015. While exports remain weak, the recovery in tourist arrivals that began in the summer of 2014 and continued into 2015 is a promising sign. However, the transition process to democracy must be monitored carefully to ensure that it does not lead to macroeconomic instability. Thailand's growth performance in the medium term should improve gradually from that of recent years.

Growth performance in Brunei Darussalam and Singapore is projected to improve considerably over the medium term despite the recent international oil price shock and weaker than expected global growth compared to the past few years. Rising oil prices will allow **Brunei Darussalam** to record positive growth. Labour shortages and slowing productivity growth will keep **Singapore**'s real growth noticeably below the pace of 2003-07. Singapore's weak performance is largely attributable to slowing domestic demand. While service-sector growth has declined compared to 2014, it continues to prop up overall growth, particularly due to strong contributions from finance, insurance and business services.

Growth in the CLM countries (Cambodia, Lao PDR and Myanmar) is projected to lead that of the ASEAN region, with real GDP growth rates of more than 7% over 2016-20. Recovery of the agricultural sector and development of the tourism sector and industry will underpin real growth in **Cambodia** and **Lao PDR**. Growth in **Myanmar**, which is now the fastest in the region, should continue to accelerate as FDI continues to rise and as economic reforms spur the private sector's rapid development. Prospects in these countries, however, will depend on maintaining adequate control of rapidly rising credit and, especially in Myanmar, on sustaining the momentum of economic reforms.

The growth prospects of China and India are expected to differ from past patterns as they face different internal conditions. China's economy slows while India's growth remains robust over the medium term. Continued investment in infrastructure in **China** is helping to support overall investment, though this stimulus is unsustainable in the longer term. Growth is slipping elsewhere as adjustments are underway in manufacturing to manage longstanding challenges from excess capacity. **India**, on the other hand, is seeing increased investment rates, thanks to public infrastructure development and private investment motivated by improvements in the business environment, though passing some key structural reforms is proving difficult. Private consumption is also increasing, thanks in part to higher wages and improved benefits for public sector employees. Domestic financial risks remain potential barriers to continued growth in India, particularly large non-performing loans and the high leverage ratios of some firms.

Key points of the economic outlook and assessment are as follows:

- Real growth in Emerging Asia will experience mild moderation in 2015, averaging 6.5%, and is projected to moderate gradually over the medium-term (2016-20) to 6.2% annually. Growth in China will continue to slow while growth in India picks up to one of the highest rates in the region. Growth in the ASEAN region will be similar and is projected to average 4.6% in 2015 and 5.2% over 2016-20, led by growth of the Philippines and Viet Nam among ASEAN-5 and the CLM countries. Private consumption will be a large contributor to overall growth, while exports will contribute less than during most of the prior decade.
- China and most of the ASEAN-5 countries will continue to record current account surpluses, although at a lower level relative to GDP than during 2003-07. This narrowing reflects the increased importance of consumption relative to investment in driving real GDP growth. The CLM countries will continue to run current account deficits, and India's deficit will increase modestly.
- Fiscal balances in relation to GDP are projected to remain stable. Sustaining sound fiscal positions while meeting development needs will depend on the success of further reforms to strengthen budget planning and implementation and to improve the effectiveness of tax administration. Recent subsidy reforms in some countries will contribute positively to their fiscal positions.

The region will have to cope with potential external and domestic risks to sustain growth momentum

- The **slowdown in China's economy** will continue to affect the growth prospects of the rest of the region as export demand drops and investment flows decline. Countries vary in their level of exposure to these risks.
- The prospect of **US monetary normalisation**, beginning in the near future, is expected to have relatively more mild impacts on the region, but may also be a cause for concern in some cases.
- Much of Emerging Asia has seen **slowing productivity growth** since the global financial crisis. This trend will need to be reversed for growth to pick up.
- Growth in the region could benefit from opportunities arising from the ongoing creation of the **ASEAN Economic Community and other regional integration initiatives**, such as ASEAN+3 and ASEAN+6. Further acceleration of the regional integration process would be key (see the thematic focus of this Outlook in Chapters 2-5 for a more detailed discussion).

The impact of China's slowdown on the region could be observed through various channels

- **Exports** are the primary channel through which the effects of China's slowdown are being transmitted to the ASEAN region. Merchandise exports to China as a share of GDP vary considerably among the ASEAN countries, ranging from about 12% for Malaysia and 6-8% for Singapore, Thailand and Viet Nam to as little as 3% for Indonesia and the Philippines. The exports of many ASEAN-5 countries are integrated with China through regional production chains. As a result, their aggregate ratios of exports to China with respect to GDP somewhat overstate their sensitivity to China's slowdown for two related reasons. First, the products exported to China from many ASEAN-5 countries make intensive use of parts imported from Japan, Korea and other Asian countries. Second, many exports of the ASEAN-5 and ASEAN countries to China are used to produce exports that go to other regions, not for domestic final use. Nevertheless, sensitivity is still substantial and greatest, for instance, for Malaysia, Singapore and Thailand.

- **FDI** is another potential source of exposure of the ASEAN region to China's slowdown. FDI inflows from China into a number of ASEAN countries have increased rapidly since 2009 and have become an important overall source of foreign investment, particularly in Malaysia and Thailand.
- The financial repercussions of China's slowdown may also impact domestic **financial markets** in ASEAN countries and could complicate their macroeconomic management.
- China's slowdown may also aggravate **capital outflows** from the ASEAN region as monetary policy in the United States is tightened. Increasing financial links among ASEAN countries and China may also increase the risk of spillovers from financial market fluctuations within China to financial markets within ASEAN.

The China slowdown could be primarily a demand shock to ASEAN countries that can, in principle, be at least partially mitigated by domestic macroeconomic policies. Most ASEAN countries have some room for monetary and fiscal stimulus to support growth in the near term. Over the longer term, China's slowdown and the conditions accompanying it are likely to affect **the structure of output in many ASEAN countries**. Rising wages in China have created incentives to shift the production of labour-intensive products, such as textiles, to lower income countries in Asia and other regions.

The impact of US monetary normalisation will be moderate, though it raises risks

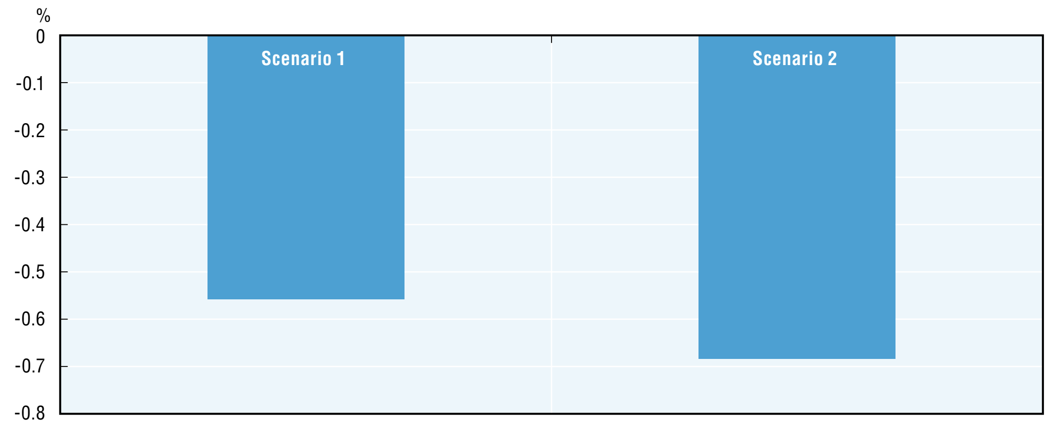
Monetary tightening in the United States will exert upward pressure on domestic interest rates and downward pressure on currencies *vis-à-vis* the US dollar across the world, including in Emerging Asia. The rise in US short-term interest rates will place upward pressure on short-term interest rates in Emerging Asia. The rise in domestic interest rates in Emerging Asia countries will tend to slow real GDP growth in the near term, while currency depreciation will tend to stimulate exports and real growth. The rise in US interest rates is also likely to slow further financial capital inflows into Asian emerging markets as their return advantage over US assets are diminished and international investors reduce the weight of riskier emerging-market assets in their portfolios. Reduced capital inflows may lead to further shocks to domestic financial markets through increased uncertainty, higher risk premiums and other channels. However, disruptions are more likely in countries where uncertainties about future economic prospects are comparatively high and/or where serious imbalances in external finances or in domestic financial markets exist. Countries with more developed and deep financial markets should be at less risk than those with less developed markets.

- There are good reasons to expect that US monetary tightening will not have such disruptive effects on Emerging Asia. The tightening has been anticipated and is unlikely to surprise markets, unless it turns out to be significantly larger than the increase of 25 basis points now expected. The criteria determining the timing of the rate rise are also widely understood. Long-term US interest rates may well rise somewhat as policy rates increase, but probably by considerably less initially than occurred during the 2013 taper tantrum.
- These considerations suggest that the onset of US monetary tightening is most likely to depress capital inflows to the ASEAN region moderately, but should not lead to widespread reversals or other major disruptions. Both short- and long-term interest rates are likely to rise somewhat and, unless offset by domestic monetary easing, are likely to produce some downward pressure on real growth in the near term. This will probably be less than that resulting from the growth slowdown in China.

- A simulation of the impact of the US monetary normalisation with a dynamic stochastic general equilibrium (DSGE) model indicates that higher interest rates in ASEAN-5 countries decreases domestic investment, though net exports will increase in the short run under a frictionless model setting. The net effect on GDP of these changes will be negative. According to the results of the simulation, such an outcome would lower the GDP of the ASEAN-5 as a whole by as much as 0.56%. The impact on the ASEAN-5 is likely to be much greater, at 0.68% of GDP, if the US tightening were to lead to increases in US long-term interest rates that are larger and faster than those during the 2013 taper tantrum (Figure 1).

Figure 1. **Impact of US monetary normalisation on GDP growth in ASEAN-5, 2015-17**

Percentage (annual average)



Note: Impacts are estimated by DSGE approach. Two scenarios for the speed of quantitative easing (QE) tapering are used. In scenario 1, we assume that QE tapering gradually starts at 2015 Q4 and completes at late 2018 when the US real interest rate reaches the historical average of 3.75%. In scenario 2, we consider faster QE tapering: namely, the US real interest rate reaches 3.75% at 2017 Q3.

Source: OECD Development Centre estimate.

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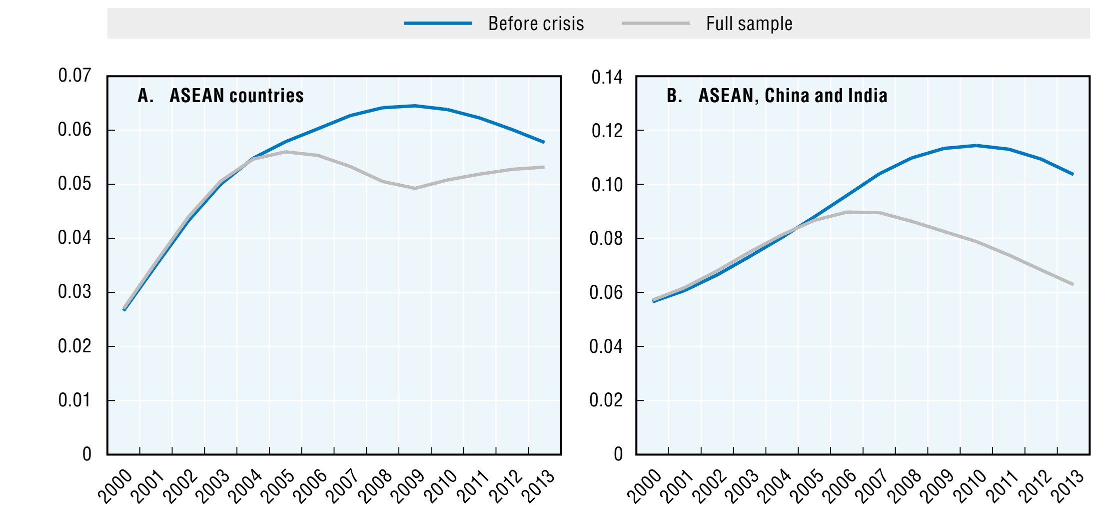
Productivity growth slows in Emerging Asia

The Emerging Asia region will face the challenge of slowing productivity growth. These trends showing a slowdown of growth in GDP and productivity are evident even from before the global financial crisis (Figure 2). At the aggregate level, potential GDP declines in ASEAN economies, China and India after the global financial crisis of late 2000s. The decline in productivity is one of the factors contributing to the slowdown. However, the extent of slowdown differs across countries and sectors.

Slowing productivity growth in the post-crisis period has not been spread evenly across all sectors of the Emerging Asia economies, with some areas more seriously affected than others (Figure 3). The financial sectors in particular of most of the largest economies in the region (ASEAN-5, Singapore, China and India) have been affected. With the exception of India and China, the productivity of financial activities relative to a country's average productivity has fallen between the periods before and after 2007. Construction sector productivity similarly has grown relatively slowly, except in the Philippines. Relatively poor growth rates have also been seen in agriculture, hunting, forestry and fishing, and in community, social and personal services in most countries. The manufacturing sectors of several countries, on the other hand, have been relatively resilient. Manufacturers' productivity growth has exceeded the national average growth rates of the region's largest eight countries with the exception of Indonesia and China. Results in other key sectors have been mixed.

Figure 2. **Potential GDP in Emerging Asian countries**

Logarithm of annual potential growth



Note: Potential output was estimated by DSGE approach.

Source: OECD Development Centre estimate.

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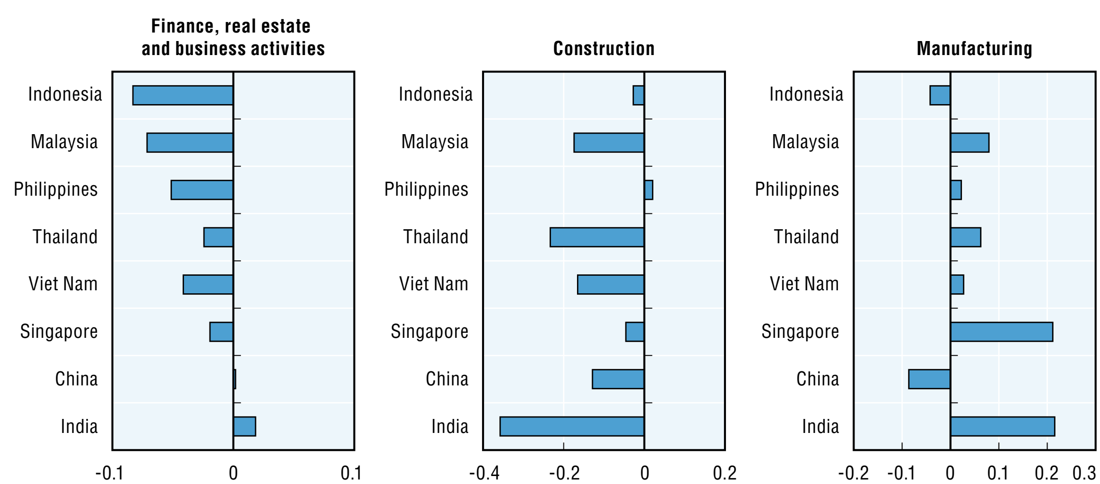
Figure 3. **Relative labour productivity by selected sectors in Emerging Asia**

Logarithm of relative labour productivity growth



Note: These numbers are differences of relative labour productivity between "before 2007" and "after 2007". It is positive when the sector productivity grows faster than other sectors within each country and negative when the sector productivity grows more slowly than other sectors.

Source: OECD Development Centre estimate.

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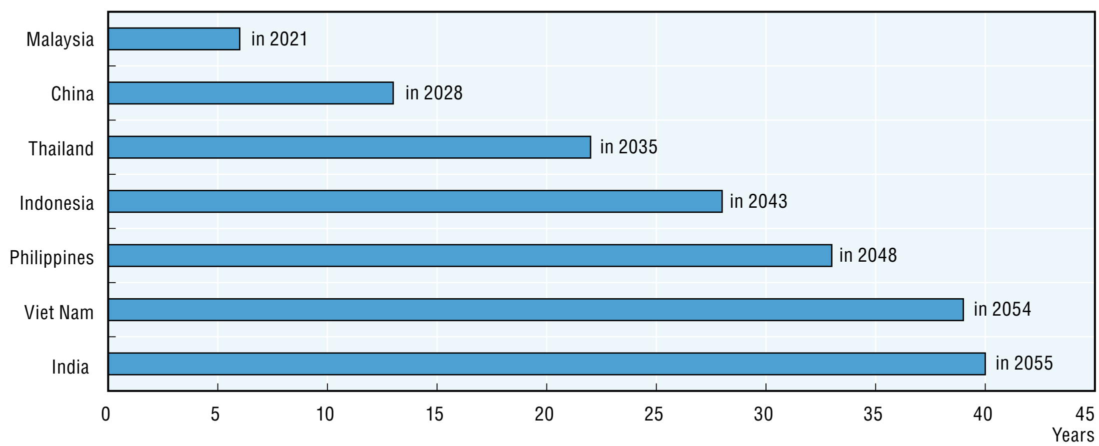
Improvements in productivity are essential to drive continued economic growth in Emerging Asia's wealthier economies. While their GDP growth rates have been impressive, many emerging economies around the world have seen slowing or stalled rates of growth as they have approached the levels of high-income countries. This so-called "middle-income trap" results from the difficulties faced by economies in transitioning from previous growth strategies – such as those based on structural transformation, demographic change and factor accumulation, which naturally face limitations – to more sustainable productivity-driven growth and the development of technologically intensive economies.

Estimates by the OECD Development Centre show that even in the best-case scenario, it will take some time for Emerging Asia's middle-income countries to reach high-income status (Figure 4). Malaysia is expected to be the first to join this group in 2021, followed by China in 2028. Reaching this status is expected to take longer for Thailand (2035), Indonesia (2043) and the Philippines (2048). These estimates place Viet Nam and India last among current middle-income countries in Emerging Asia to leave this group in 2054 and 2055, respectively.

Figure 4. **Updated best-case scenario simulation of estimated time required for middle-income countries in Emerging Asia to become high-income countries**



Note: Based on World Bank criteria for classifying economies, high-income countries are defined as having gross national income (GNI) per capita above 12 376 in 2014. Growth, consumer price index (CPI) and exchange rate prospects in this simulation are in line with MPF-2014. Population projections are based on United Nations data. Updated from the original estimate in the *Economic Outlook for Southeast Asia, China and India 2014*.

Source: OECD Development Centre's simulation, based on MPF-2016.

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Regional integration in ASEAN and Emerging Asia

Emerging Asia's progress in regional integration has been mixed

Regional integration in Emerging Asia is progressing within various frameworks since the 1980s, gradually expanding in geographic scope and depth of issues addressed. Attempts at regional economic integration in Asia started almost four decades ago with the countries in Southeast Asia leading the way. Various frameworks for regional integration, including those associated with ASEAN, ASEAN+3 and ASEAN+6 have been used to build co-operative solutions to a range of issues of shared concern. ASEAN+3 integration initiatives have been pursued in different areas, particularly in finance, tourism, agriculture and forestry, energy, minerals, the environment and social welfare. ASEAN+6 leaders stated their commitment to continue co-operation in many areas such as trade, investment, finance, environment and energy, education, global health issues, disaster management and connectivity. More recently, progress has been made in trade and investment, and the Regional Comprehensive Economic Partnership (RCEP) currently under negotiation is strengthening economic ties in the region.

The establishment of the ASEAN Economic Community is seen as a major milestone. Progress made and remaining challenges in deepening regional integration vary across key policy areas (Table 2): trade in goods; trade in services; investment and capital market liberalisation; competition and consumer protection; intellectual property; infrastructure and connectivity; small- and medium-sized enterprises; food, agriculture and forestry; tourism; human and social development; and the Initiative for ASEAN Integration (IAI).

Table 2. **Summary: Assessment of progress in integration in key policy areas**

Policy area	Assessment of progress
Trade in goods	Intra-regional tariffs are falling and intra-regional trade is increasing, trade agreements are being made, and trade facilitation is improving, but non-tariff measures remain a challenge.
Trade in services	Progress in facilitating services trade has been uneven, and deeper reforms are needed in some countries.
Investment and capital market liberalisation	Liberalisation has been uneven by country and sector, and investors remain concerned by high costs of doing business, weak intra-ASEAN banking facilities, though the Chiang Mai Initiative Multilateralisation and Asian Bond Market Initiative are promoting regional stability and financial integration.
Competition and consumer protection	ASEAN members are sharing best practices, but work remains to be done on policy harmonisation and the establishment of regional-level initiatives.
Intellectual property (IP)	Co-operation between IP offices has improved and work is being done to further develop local capacities.
Infrastructure and connectivity	Further improvements will be needed on road, rail and maritime connectivity, and institutional barriers are being addressed gradually.
Small- and medium-sized enterprises (SMEs)	Several major programmes offer support to SMEs in operating domestically or internationally, but access to finance and technology is a challenge for these firms in some countries.
Food, agriculture and forestry	Regional frameworks are improving food security, but more could be done to protect fisheries, forestry and wildlife.
Tourism	Co-operation is progressing on tourism promotion, the establishment of common standards and visa facilitation.
Human and social development	Education system harmonisation and collaborative research initiatives have been established, and co-operation through broader regional frameworks is progressing.
Initiative for ASEAN Integration (IAI)	A large number of projects are planned under the IAI, though implementation rates are low.

The greatest improvements in **trade** have been through the reduction of tariffs, which has helped to boost intra-regional trade. Overall, intra-regional tariffs have fallen rapidly over the last decade (to just 0.04% among the advanced ASEAN economies and 1.33% among CLMV countries in 2014), and intra-regional trade increased from 17% in 1990 to 24% in 2014, indicating the region's greater openness. While significant progress has been made on reducing tariffs, the presence of non-tariff measures (NTMs) continues to inhibit the free flow of goods. Trade facilitation has improved largely due to streamlined customs procedures through Mutual Recognition Arrangements (MRAs). Progress has been made in harmonising standards particularly in the automotive, electronics and cosmetics sectors, but some countries lag behind. Free trade agreements between the ASEAN+6 countries have facilitated a growth in trade among these countries, which should benefit further from the RCEP agreement currently being negotiated.

While **trade in services** plays an increasingly important role in the economies of Emerging Asia in general, more gradual progress has been made in facilitating such trade. Reforms such as the ASEAN Framework Agreement on Services (AFAS) and sectoral MRAs have made only limited progress. MRAs are most advanced in engineering and architecture and even then fall short of requirements for the ASEAN Economic Community (AEC). Regulatory and legislative reforms, such as to labour laws and professional regulations, would be needed to implement MRAs in some countries.

Since the implementation of the ASEAN **Investment** Agreement in 1998, ASEAN has been committed to strengthening its investment regime. While progress has been made, establishing the region as a single investment market is not easy. Liberalisation rates under the ACIA (ASEAN Comprehensive Investment Agreement) indicate that the relatively less developed ASEAN countries tend to be more open to investment in agriculture and mining while other ASEAN members tend to be more open to manufacturing. The region's high costs of doing business are still another concern for investors in ASEAN. Intra-ASEAN banking facilities remain weak, which is a particular concern for cross-border trade and investment. Reforms are underway through the implementation of the ASEAN Banking Integration Framework, and multilateral currency swap arrangements are in place to provide liquidity in times of need. Regional stability and **financial integration** are being improved through the Chiang Mai Initiative Multilateralisation (CMIM) and Asian Bond Market Initiative (ABMI), established by the ASEAN+3 framework. Reforms to the structure of the CMIM and increased monitoring are making the arrangement more useful to the region.

Competition policy – as a key component of establishing a competitive economic region – exists to prevent anti-competitive agreements such as cartels and collusion, abuses of dominant positions through predatory or exclusive dealings, and mergers or acquisitions that substantially reduce competition. ASEAN has taken a co-operative approach to addressing these problems. ASEAN members have sought to share experience and best practice through the ASEAN Experts Group on Competition and the development of regional guidelines on competition policy. Although non-binding, these guidelines serve as a benchmark for members to assess their progress. Currently, challenges remain as members have a long way to go until the eventual harmonisation of competition policies. Some countries continue to grant favourable treatment to state-owned enterprises, thereby undermining competition. Consumer protection initiatives at a regional level have mainly taken the form of information sharing, capacity building and awareness raising programmes. While the enforcement of consumer protection legislation has been quite weak, recent efforts have been made at strengthening the capacity of practitioners in the region.

ASEAN members have adopted a more flexible approach to co-operation in **intellectual property** (IP) since 1995 with the signing of the ASEAN Framework Agreement on Intellectual Property Cooperation. Co-operation between IP offices has improved. The legal and policy infrastructure of ASEAN countries that wish to accede to global IP agreements is being developed. Developing local capacity on patent and trademark registration and enforcement is also important. Patent Libraries, the ASEAN IP Portal and ASEAN TMview are new tools that provide easy access to information on patents, IP legislation and trademarks, respectively.

Progress is being made in implementing the Master Plan on ASEAN **Connectivity** (MPAC), which lays out the key strategies and essential actions required to connect the region through enhanced physical infrastructure, effective institutions and processes and empowered people. Road infrastructure is being developed through the ASEAN Highway Network Programme. The worst quality roads are being eliminated in most countries. However, more remains to be done to upgrade roads to a high-quality level. The Singapore-Kunming Rail Link, a long-running project to enhance rail connectivity, remains stalled in several places. Only the Thailand-Cambodia link is scheduled for completion in 2015. The pace of improving maritime connectivity is also slow due to large infrastructure gaps between countries and continuing use of restrictive policies. To reduce institutional barriers, facilitation agreements have been signed for goods, transport and aviation. However, they still await ratification in many member states. The formation of a Single Aviation Market has been progressing slowly. The signing of Passenger Air Services agreements with third parties prior to the formation of a single domestic market puts ASEAN carriers at a disadvantage.

The AEC Blueprint calls for equitable economic development to reduce inequalities both within and between member states. A key component of reducing inequalities within countries is strengthening **small- and medium-sized enterprises** (SMEs) as they account for almost all enterprises and employment in ASEAN member states. Several major programmes have been conducted to assist SMEs with access to information, support services and training. Facilitation services are provided in most member countries but vary in the type of services provided. Malaysia and Singapore offer fully fledged one-stop services while Thailand and Viet Nam offer a more limited range. Support services are provided by members to assist SMEs integrate into global value chains. However, those provided by CLM countries tend to suffer from budget shortfalls and can lack effective co-ordination. Access to finance appears to be more of a problem in some member states than in others. This is largely due to the lack of a well-developed regulatory framework, credit risk guarantees and central bureaus for credit information. Large gaps also remain between member states on policies to promote technology and technology transfer, as some countries are attempting to create technology networks by linking universities, research and development (R&D) labs, incubator services and government agencies.

While progress is being made in improving **food security** and in developing **fisheries** and **forestry** sectors, regional co-operation in managing the many shared challenges in these areas has been limited. Regional frameworks for co-operation on food security, such as the ASEAN Integrated Food Security Framework, are helping to reduce risks in periods of crises and improve food supply over the longer term. Although the region co-operated in developing the fisheries industry, fisheries management will need to address overfishing, illegal fishing, and safety and quality standards. Regional co-operation to implement international agreements to protect forestry and wildlife exists, and regional agreements have also been established, but could be more effective.

Tourism is a fast-growing sector in most ASEAN countries, with significant potential to act as a driver of growth and source of job creation. Regional initiatives, which have been successful in some areas, have room for more scope, though more work will be needed in integrating air travel and developing the growing ecotourism market. Regional tourism promotion, agreements on tourism-related labour and quality standards, and visa facilitation are helping to upgrade the tourism sector in ASEAN and facilitate travel. Ecotourism is being developed in the region and remains promising, with regional co-operation progressing under the ASEAN Ecotourism Strategic Plan.

The ASEAN Socio-Cultural Community implements specific initiatives on addressing the development gaps in **education, health and social protection** through regional co-operation. Regional initiatives are being pursued to integrate and harmonise education systems and promote collaborative research. Regional co-operation is also being used to promote entrepreneurship. ASEAN+3 and +6 co-operation are providing additional platforms for addressing regional concerns in education, where quality is limited, and poverty management, among other fields. Shared plans for responding to public health issues and natural disasters have been developed.

The **Initiative for ASEAN Integration (IAI)** was launched in 2000 to narrow the development gaps between ASEAN-6 and CLMV. It is guided by the IAI Work Plan II (2009-2015) that comprises 245 projects and 182 action lines. The AEC component of the IAI has the largest number of action lines, but overall progress and the level of implementation are very low. Policy areas addressed in the IAI appear to be unevenly distributed. The goods area for example has 9 projects for 19 action lines while the services area has 15 projects for only 4 action lines. Most projects within services are focused on training in tourism promotion and management. In the competitive economic pillar most action lines are devoted to infrastructure development with a large number of projects focusing on training in maritime and road safety. A few training courses were held on competition policy drafting procedures, consumer protection and intellectual property systems, but no projects were assigned to taxation and e-commerce. A handful of workshops have been held on food safety and disaster management.

Despite progress, post-2015 integration agenda must address remaining challenges

Strengthening regional ties – accelerating the economic community initiatives – is one of the best strategic responses to a changing global environment. Work has intensified at varying levels over the years to implement the regional integration initiatives of ASEAN, ASEAN+3 and ASEAN+6. Current efforts are still not enough to achieve integration targets despite important and positive achievements. Countries in the region need to take active steps to realise a single economic market by 2015 and beyond, and make additional efforts, including:

- **Co-ordinating between regional initiatives and national agendas, and regional and sub-regional initiatives**, avoiding duplication and moving in the same direction;
- **Reducing disparities** in the region by supporting the further development of the CLM countries;
- Moving towards a "Global ASEAN" integration in the global economy and **stronger ties with the ASEAN+3 and ASEAN+6 frameworks**;
- Strengthening **monitoring capacity** – which is currently still weak – to make the regional agenda more effective;
- Addressing important policy areas in the 2016-25 agenda that were not addressed adequately in pre-2015 agendas, particularly the issues of **green growth and renewable energy** and **private sector development.**

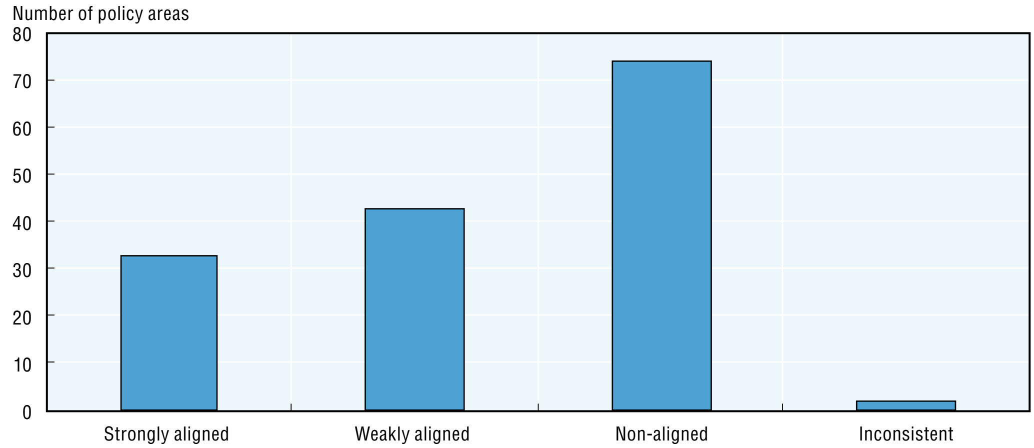
Stronger institutional capacities would facilitate further integration

Institutional capacities at national and regional levels are critical elements in achieving integration goals. Many of the challenges faced due to insufficient capacities can be addressed by carefully aligning planning and implementation at various organisational levels. In particular, incorporating national-level expertise in regional planning processes, holding regular consultations between regional and sub-regional initiatives, addressing underdevelopment in the CLM countries, and better monitoring and co-operation on implementation, such as through peer learning, offer benefits.

More can be done in aligning national, regional and sub-regional planning

The alignment of regional integration plans and national medium-term development plans can be used to signal national commitment to regional goals, such as those expressed in the AEC. In general, national and regional targets in Southeast Asia do not typically align, though this varies according to the country and sector considered (Figure 5). Loose patterns in alignment are visible between national plans and the AEC Blueprint. Some policy areas are similar but show little overlap with AEC targets and national plans for the implementation of specific regional integration goals. A greater degree of alignment with aspects of the AEC Blueprint is seen when domestic policy is central to implementation, and in the promotion of SMEs, priority integration sectors and other industries explicitly covered by the Blueprint. National plans often include goals beyond those of the AEC, such as an emphasis on sustainable development, which may complicate the achievement of regional goals.

Figure 5. **Alignment of national and regional targets in ASEAN**



Notes: The coverage and targets of recent national plans of eight ASEAN members (excluding Singapore and Brunei Darussalam, which do not produce comparable development plans) are compared with the targets of the AEC Blueprint, grouped into 19 policy areas as in the AEC Scorecard. National targets were compared against each category and defined as either having Strongly aligned (i.e. sharing at least part of an explicit target in the Blueprint), Weakly aligned (i.e. addressing a policy area identified in the Blueprint in a way consistent with the latter's targets) or potentially Inconsistent (i.e. explicitly or potentially contradictory to one or more targets in the Blueprint). Cases where national plans were silent on a policy area identified in the Blueprint were defined as Non-aligned and left blank. The mention of the AEC as a target overall was added as a 20th category of evaluation.

Source: OECD Development Centre.

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These trends suggest areas where future improvements could be made to facilitate the development of more mutually supportive targets at the national and regional levels. They also show that planners are willing to pay some attention to regional integration as a goal, and to national performance to reach this goal. Improvements could therefore be made in designing regional frameworks that facilitate deeper co-operation in the design and implementation of integration plans.

Several national plans place a strong focus on issues either not in the Blueprint or potentially conflicting with it, such as the pursuit of environmental goals. A divergence is also apparent in the tendency of national plans to place a stronger emphasis on integration with the global economy than with ASEAN economies. While this may be a lower priority for the region, the AEC Blueprint also calls for integration in the global economy. Building the ASEAN Economic Community as a priority goal does not feature prominently as an explicit target in many national plans. The national plans of Cambodia, Lao PDR and Myanmar show better alignment with regional targets. This may result partly from the straightforward ability of CLM countries to incorporate regional integration targets into their national plans due to their lower level of development and slower AEC implementation. In general, considerable alignment was often found in policy areas where the implementation of AEC targets has been lagging the most behind planned timelines.

Deeper co-operation at the regional level can improve the alignment of regional and national planning and the effectiveness of regional efforts, beginning with the design of targets for regional integration. For the greatest impact on national targets, the technical and country-specific expertise of national officials should be utilised to a greater extent in setting regional targets and plans for achieving them. Economic officers and planning staff could be more deeply involved in helping to set future goals for the ASEAN Economic Community. This would harness national expertise, improve capacities and provide insight into what is desirable and achievable at the national level. It is also likely to be more effective than efforts to improve national planners' familiarity with and appreciation of AEC goals.

In addition to fostering productive alignment of national and regional plans, regional and smaller areas within ASEAN and neighbouring countries have established alternative means of working together through sub-regional institutions and initiatives that can help to support ASEAN-wide integration. These sub-regional institutions – such as the Greater Mekong Subregion (GMS), Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA), the Indonesia-Malaysia-Singapore Growth Triangle (IMS-GT) and the Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT) – encompass all ASEAN member states as participants. Primarily concerned with connectivity, though also addressing other policy areas, these groupings of national and sub-national governments have the potential to spur growth, particularly in underdeveloped regions, and to support the achievement of AEC goals.

Sub-regional initiatives have had some success in identifying and promoting the development of key economic areas, but they still face difficulties in achieving many of their goals. A lack of clear comparative advantages or sufficient opportunities for economic co-operation may create challenges, but institutional constraints are the main issue for sub-regional groupings in Southeast Asia. It is important to address these constraints, as sub-regional efforts can directly contribute to regional connectivity projects and to strengthening integration more generally. In addition, these project-driven, bottom-up initiatives can prove constructive complements to ASEAN-wide integration efforts.

Changes could be made in the way sub-regional initiatives and ASEAN institutions relate to one another to improve co-ordination. Further work is needed to address areas of unnecessary overlap and possible synergies in deepening integration through the AEC Blueprint or the design of post-2015 ASEAN targets. Deeper co-operation could be achieved through the replacement of ad hoc co-ordination efforts with regularised mechanisms at the regional, sub-regional and in-country level. This may include the creation of additional ministry-level focal points or periodic consultation meetings on recent developments between representatives of the ASEAN and the sub-regional groups.

Management of development gaps is important in facilitating integration

Development gaps among ASEAN members create additional barriers to the implementation of uniform targets and approaches. These are being addressed with the help of regional and external partners through the Initiative for ASEAN Integration and other aid programmes. The IAI Work Plan II 2009-15 included projects and action lines in several areas, such as infrastructure, human resources, information and communication technology (ICT), tourism, poverty and regional economic integration. The aim was to narrow various development gaps within ASEAN and address development challenges, particularly in Cambodia, Lao PDR, Myanmar and Viet Nam. Based on the number and scale of IAI projects, a strong emphasis has been placed on civil service capacity building. While there are large gaps in human development and poverty rates among ASEAN members, and the gaps have implications for the lower-income economies and their ability to participate in the AEC, these issues have largely been left out of the IAI.

Both bilateral and multilateral external donors have been involved in financing development initiatives in the less-developed ASEAN member countries through the IAI as well, though they have been more active outside of this framework particularly in re-engaging recently with Myanmar. Official development assistance has been a significant source of development finance to the CLM countries, even if it is declining in importance.

ASEAN is now developing the post-2015 IAI Work Plan III. This provides an opportunity to rethink how the IAI can facilitate integration of the region's least developed members and support the narrowing of development gaps across and within member countries. Given the scale of challenges faced, co-operation in planning will need to continue to include ASEAN's dialogue partners and other donors while also acknowledging the priorities and capacities of the CLMV countries in receiving this assistance. Synchronisation and co-ordination are crucial among regional programmes and initiatives, bilateral assistance programmes for the CLMV countries and other sub-regional initiatives to avoid contradiction or duplication. Co-ordinating bodies such as the IAI Task Force and IAI Development Cooperation Forum (IDCF) could be critical tools in these design and implementation efforts.

Improved monitoring through better indicators and peer learning can help in implementing regional plans

With so many initiatives to implement by 2015 and beyond, a strong monitoring mechanism must be put in place at both national and regional levels. At the national level, a key challenge is to ensure that regional integration commitments are effectively transformed on the ground. This requires establishing effective monitoring systems, which may be challenging in the region due to capacity limitations. Existing regional frameworks can be better used to improve monitoring capacity. Yet, improved data and indicators of regional integration are also needed. Likewise, regular peer dialogue and peer learning could be used to help make use of national capacities and motivate additional efforts.

Co-operation with partners outside of ASEAN has been useful in addressing shared areas of concern that extend beyond the ten member states, such as financial stability, trade and investment promotion, and environmental and disaster risk management. These partners, particularly the participants in the ASEAN+3 and ASEAN+6 frameworks, offer additional institutional and financial capacities for facilitating regional co-operation. The East Asia Summit (EAS) participants represent an even greater pool of technical, financial and other capacities on which to draw. The additional institutional capacities of these larger economies could be called upon to strengthen monitoring for regional integration, particularly of the ASEAN+1 Free Trade Areas (FTAs) and the Regional Comprehensive Economic Partnership that may soon supersede them. Existing monitoring tools, such as the ASEAN+3 Macroeconomic Research Office (AMRO) or collective monitoring of EAS energy efficiency goals, may provide useful examples.

Reliable indicators are fundamentally needed for monitoring, evaluation and analysis, and knowledge sharing to proceed. Indicators on integration have been relatively underdeveloped in the region. The systematic measurement and dissemination of the results of regional integration are central to the peer monitoring process. Indicators could be based on regular evaluations of the integration process and its outcomes. Further work is needed to make regional integration indicators into a truly effective part of a monitoring system.

One way to enhance regional monitoring of the AEC is through regular policy dialogue and peer learning/peer review among officials engaged with integration. While legal and rules-based mechanisms have generally had limited scope in any framework for regional integration in Asia, clear rules and measures that participants agree to follow are required to maintain credibility and avoid unnecessary disputes. Peer review promotes co-operation by allowing policy dialogue, promoting transparency, facilitating capacity building and encouraging compliance. This exercise should allow countries to share information and discuss key policy issues. Policy dialogue and peer review are flexible in form, and could be tailored to the needs of member countries and available capacities. Peer learning and peer review can be challenging to implement, however. They work best when members share mutual trust, are committed to transparency and have access to sufficient analytical and administrative capacities, and when participants and evaluators are seen as legitimate by all involved.

Regional co-operation in renewable energy holds promise

Important policy areas in the 2016-25 agenda that were not addressed adequately in pre-2015 agendas will be the areas of green growth and renewable energy, and private sector development. While Emerging Asia has achieved remarkable economic growth in recent decades, the region's high economic growth also has been associated with serious environmental problems. Among the various aspects of regional integration, market integration may have received too much attention at the expense of other issues. To redirect the current development pattern to deliver shared well-being and improved equity without exceeding ecological limits, it is necessary to rebalance regional integration in East Asia from its focus on economic integration to broader sustainability objectives.

Increased use of renewable sources of energy, including through enhanced regional co-operation in generation, will need to be a central component of any green growth strategy that aligns multiple economic and environmental priorities. The region should therefore tap into its considerable potential in renewable energy to meet growing demand. Tariffs and non-economic barriers slow integration and impede opportunities for improved efficiency. Hydropower from the Mekong River is progressing and remains a promising source of future generating capacity to be exported throughout the region, though environmental challenges will need to be addressed and co-operative solutions found to cross-border concerns.

Renewable energy is likely to play a large role in Emerging Asia's future development

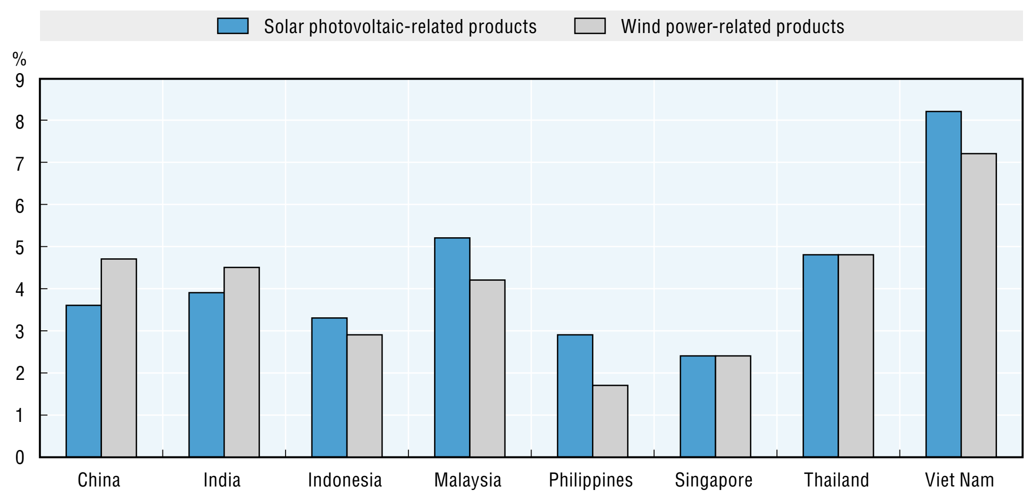
The region can experience an economic development boost through the responsible exploitation of its large renewable energy resources. In some ASEAN countries, such as Cambodia, Lao PDR, Myanmar, Indonesia and the Philippines, the low rate of access to electricity is a major development challenge. Even among populations with access to electricity, consumption per capita is significantly lower than the OECD average in most countries in the region. Between 2009 and 2030, total electricity demand across ASEAN is expected to increase by around 2 300 TWh. Meeting such a huge demand without devastating environmental consequences requires the large-scale utilisation of renewable energy for power generation.

The total renewable electricity potential of the ASEAN-5 plus Singapore has been estimated to exceed the total electricity demand of the ASEAN region in 2009 by a factor of 1.8. The majority of this huge renewable potential has been untapped. Hydropower and geothermal resources are relatively well exploited in the region, but other renewable sources, such as wind, solar and biomass, are almost untouched. Among Brunei Darussalam and the CLM, Cambodia, Lao PDR and Myanmar are endowed with major potential in renewable energy, notably hydropower and wind. In particular, the potential of wind power in Lao PDR and hydropower in Myanmar are very strong. Current hydropower generation exploits only a fraction of this huge potential.

Regional barriers play a significant role in constraining the development of renewable energy sources. Regional economic integration, including the liberalisation of trade in renewable technologies, and regional co-operation on innovation and technology transfers can play a key role in promoting renewable energy in the region. Effective tariffs on products related to renewable energy are still considerable in the ASEAN-5, Singapore, China and India. Regional economic integration in the form of tariff removal for these countries is expected to have a positive impact on promoting renewable energy. Additional administrative, technical/infrastructure and financing barriers also pose constraints.

An estimate of the impact of regional economic integration on reducing import tariffs on exports of renewable energy equipment and components further illustrates the potential for increased trade (Figure 6). Promoting regional trade in renewable energy technologies could help to tap into East Asia's huge renewable energy potential.

Figure 6. **Total impact of regional integration/co-operation on exports of renewable energy products in ASEAN-5, Singapore, China and India**



Source: OECD Development Centre estimate, based on Moinuddin and Bhattacharya (2013), "Towards an Integrated Renewable Energy Market in the EAS Region: Renewable Energy Equipment Trade, Market Barriers and Drivers".

StatLink http://dx.doi.org/10.1787/888933309366

Co-operation can boost hydropower development

The countries of the Mekong River Basin are endowed with abundant hydropower resources. In Lao PDR in particular, hydropower is a vital resource for pursuing economic development and universal electricity access. At the same time, the country's hydropower generation capacity is much greater than domestic demand for electricity, and electricity exports are a major source of foreign currency for Lao PDR. Lao PDR is the region's largest electricity exporter, while Thailand and Viet Nam are major electricity importers. Cambodia also imports a large quantity of electricity despite its rich hydropower potential.

Although 11 mainstream dams are expected to provide economic benefits for both the exporters and the importers of hydropower, there are serious environmental concerns, such as changing water flow patterns, loss of soil nutrients and reduction in capture fisheries. A holistic approach to capture the food-energy-water nexus is necessary given the trade-offs between the economic benefits from hydropower generation and its negative impact on the livelihoods of downstream countries through damage to ecosystems. For instance, assessing the economic, environmental and social impact of hydropower development finds that the economic benefits will fall to Lao PDR and the negative externalities on food security (e.g. through the impact on capture fisheries) will mostly fall to the other three countries.

Conflicts involving the national interests of neighbouring countries can pose serious challenges, but at the same time transboundary water issues, like those in this case, can catalyse regional co-operation. For example, the alternative dams located in Mekong's tributaries, not in mainstream Mekong, hold tremendous economic potential as do applying innovative systems such as partial in-channel diversion that do not require dams across the river channel's full breadth.

Regional co-operation for the common management of transboundary water resources has the potential to achieve win-win benefits for all countries involved along the river. An integrated approach, fully reflecting the water-food-energy nexus and effective regional institutions, is critical for riparian countries' development objectives and environmental sustainability. However, barriers currently impede progress on regional co-operation. Enhanced governance capacities, for instance through the Mekong River Commission, are needed to enable win-win co-operation.

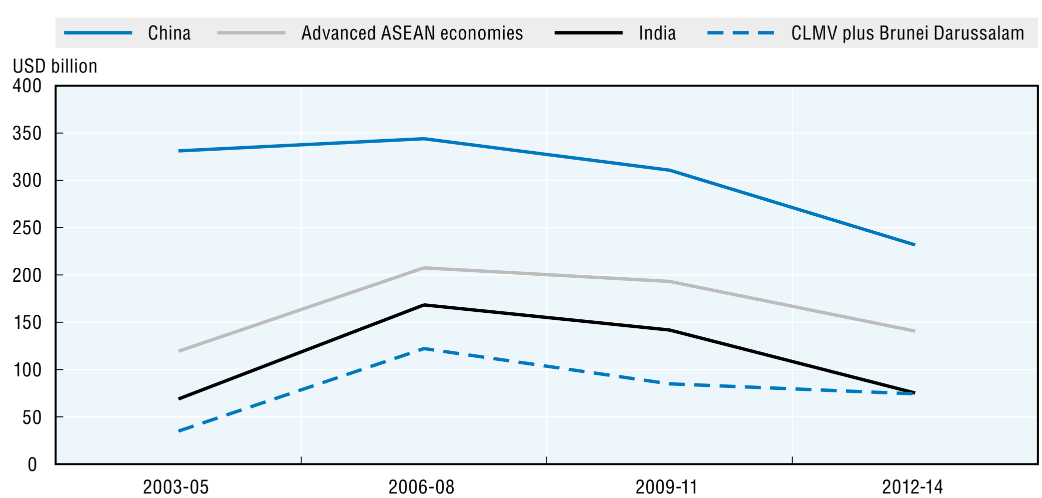
The private sector in Emerging Asia is expanding regionally and globally, though significant constraints remain

As in the case of renewable energy, issues related to private sector development were not appropriately addressed in the pre-2015 agenda, though the private sector is playing an increasing role in the region. Business growth in Southeast Asia, China and India has been supported by FDI inflows to the region.

While Emerging Asia's FDI inflows are growing, greenfield investments are declining, particularly in the manufacturing sector

While overall FDI inflows have increased in the region, greenfield investments display a worrisome trend. Greenfield investments to the region have been declining since the Lehman shock in 2008 (Figure 7). Detailed country data show that almost all ASEAN countries experienced a decline in the most recent period, from 2012 to 2014, in greenfield investments from around the world. The exception is Myanmar, which began long-awaited political and economic reforms in 2011 and has recently attracted more investments.

Figure 7. **World aggregate investment in Emerging Asia, 2003-14**

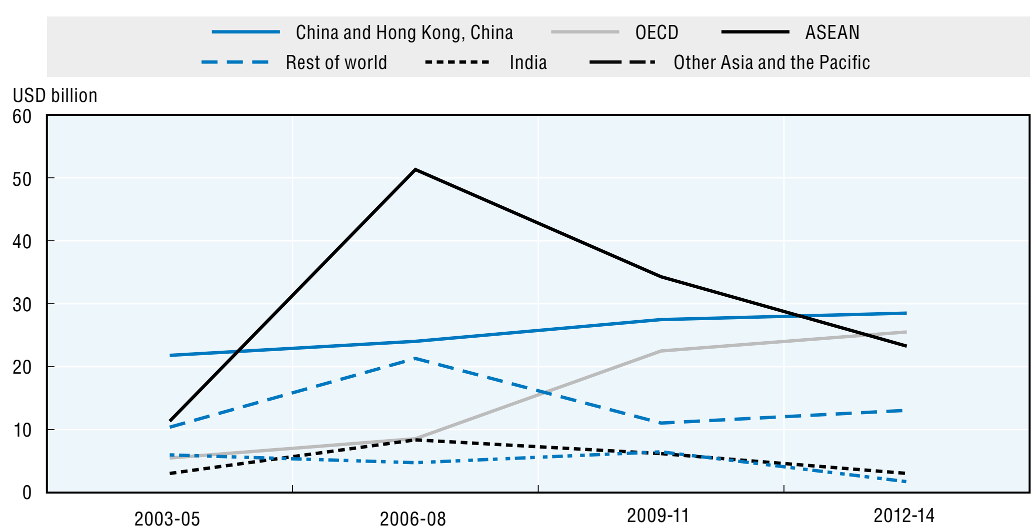


Note: Advanced ASEAN economy includes Indonesia, Malaysia, Philippines, Singapore and Thailand.
Source: OECD Development Centre calculations based on the dataset of fDi Markets (2015).
StatLink http://dx.doi.org/10.1787/888933309374

OECD member countries have been major investors in ASEAN countries but they significantly reduced their greenfield investments after the 2008 Lehman shock. ASEAN had quickly increased its own greenfield investments from 2006-08, but intra-ASEAN investments have decreased since then, falling below ASEAN investments to China and the OECD countries during the 2012-14 period (Figure 8). Intra-ASEAN greenfield investments were also diverted from ASEAN countries to China; Hong Kong, China and OECD countries after the Lehman shock.

The manufacturing sector received the highest share of greenfield investment in most of the region's countries, while the services sector dominates in Cambodia, Myanmar and Hong Kong, China. Other sectors that received significant shares of greenfield investment include extraction, power, construction, ICT infrastructure, sales and marketing, and banking and finance. The majority of intra-ASEAN greenfield investments have gone to the manufacturing, construction and power sectors. Within the manufacturing sector, the categories receiving most investment were chemicals, food and tobacco, coal, oil and natural gas, and metals. Intra-ASEAN investment in new manufacturing facilities has declined sharply after a sizeable jump in outflows from Thailand, Malaysia and Singapore. The growth of manufacturing, which is a backbone of the economy and the centre of the business community, plays an important role in the development of a nation. ASEAN firms' declining within-region greenfield investments in the manufacturing sector must be carefully investigated by policy makers.

Figure 8. **ASEAN aggregate greenfield investment by region, 2003-14**



Source: OECD Development Centre calculations based on the fDi Markets dataset (2015).
StatLink http://dx.doi.org/10.1787/888933309386

M&A deals have been limited to specific countries and sectors in the region

Mergers and acquisitions (M&A) are another component of foreign direct investment (FDI) and an important activity for business expansion or penetration into new markets and production bases. As an M&A investor, ASEAN is larger than the other countries (Hong Kong, China; China; and India). While intra-ASEAN investments make up the biggest part of M&A, ASEAN countries show balanced M&A investments to various regions of the world. Hong Kong, China is particularly active in the Chinese M&A market.

The M&A activities of both China and India are relatively small given the large size of their economies, and the OECD countries are the largest M&A destination for both of them. More than two-thirds of India's M&A investment goes to OECD countries.

The major M&A destinations of ASEAN member countries are other countries in ASEAN; the OECD; China; and Hong Kong, China. Singapore and Malaysia have dominated ASEAN's M&A investments for the past decade, with the majority flowing to ASEAN or OECD countries. The M&A activities of Thailand, the Philippines and Indonesia are relatively limited, while the activities of new ASEAN members such as Viet Nam, Brunei Darussalam and Cambodia are lower still. The M&A deals made by the advanced ASEAN economies have been conducted mainly in the manufacturing and services sectors. The largest intra-ASEAN M&A deals have mostly involved the region's advanced economies and have targeted firms in a variety of manufacturing sub-sectors, including food and beverage, consumer products, automobile components and materials (Table 3).

Table 3. **Top 20 intra-ASEAN M&A investments in the manufacturing sector, 2004-13**

No.	Year	Home country	Host country	Industry	Acquirer	Target
1	2012	Thailand	Singapore	Food and beverage	Thai Beverage PCL	Fraser & Neave Ltd
2	2007	Singapore	Malaysia	Food and beverage	Wilmar International Ltd	PPB Oil Palms Bhd
3	2013	Singapore	Indonesia	Automobiles and components	Gallant Venture Ltd	Indomobil Sukses Internasional
4	2012	Thailand	Singapore	Metals and mining	PTT Mining Ltd	Sakari Resources Ltd
5	2013	Singapore	Indonesia	Automobiles and components	Gallant Venture Ltd	Indomobil Sukses Internasional
6	2007	Singapore	Indonesia	Paper and forest products	Investor Group	LonSum
7	2011	Thailand	Indonesia	Chemicals	SCG Chemicals Co Ltd	Chandra Asri Petrochemical
8	2007	Singapore	Malaysia	Food and beverage	Wilmar International Ltd	PGEO Group Sdn Bhd
9	2012	Singapore	Malaysia	Chemicals	Reliance Global Holdings Pte	BP Chemicals(Malaysia)Sdn Bhd
10	2010	Thailand	Malaysia	Containers and packaging	Investor Group	Malaya Glass Products Sdn Bhd
11	2010	Singapore	Indonesia	Food and beverage	Asia Pacific Breweries Ltd	Multi Bintang Indonesia Tbk PT
12	2004	Singapore	Malaysia	Food and beverage	PPB Group Bhd	FFM Bhd
13	2008	Thailand	Indonesia	Consumer products	Central Agromina PT	Charoen Pokphand Indonesia PT
14	2005	Philippines	Singapore	Food and beverage	NutriAsia Pacific Ltd	Del Monte Pacific Ltd
15	2012	Thailand	Indonesia	Metals and mining	Electricity Generating PCL	Manambang Muara Enim Coal Mine
16	2012	Indonesia	Viet Nam	Construction materials	Semen Gresik (Persero) Tbk PT	Thang Long Cement JSC
17	2012	Singapore	Malaysia	Health-care equipment and supplies	Aspion Sdn Bhd	Adventa Bhd
18	2011	Thailand	Indonesia	Construction materials	SCG Building Materials Co Ltd	Keramika Indonesia Assosiasi
19	2008	Thailand	Malaysia	Chemicals	PTT Chemical PCL	Cognis Oleochemicals(M)Sdn Bhd
20	2006	Philippines	Singapore	Food and beverage	NutriAsia Pacific Ltd	Del Monte Pacific Ltd

Source: OECD Development Centre calculations based on the Thomson Reuters M&A database (2014), http://thomsonreuters.com/en/products-services/financial/company-data/deals-and-league-tables.html.

Reaping the benefits of regional integration

The ASEAN Economic Community is expected to enhance cross-border production linkages further and local businesses must be ready for upcoming challenges. At the same time, they can take advantage of the changes and expand their operations across ASEAN, transforming into real regional entities or "ASEAN enterprises". A conservative mindset amongst local firms, particularly SMEs, could result in a narrow focus just on domestic markets. Local firms often lack access to information about market characteristics and potential customers. Moreover, many small firms have limited ability to use existing data to develop business strategies. Regional solutions to these challenges will strengthen the private sector's role and deepen integration.

Structural policy prospects in Emerging Asia

The medium-term development plans of Emerging Asia countries show a clear understanding of the central concerns facing these economies (Table 4). Relatively more advanced countries have set goals for improving productivity and promoting more balanced growth essential for achieving high-income status. The plans of lower-income Emerging Asia economies tend to prioritise targets more fundamental to supporting development. Most include targets on topics including health and social development, equitable growth, environmental protection, and democracy and good governance.

Table 4. **Medium-term development plans of Southeast Asia, China and India**

Country	Period	Theme/Vision
ASEAN-5		
Indonesia	2015-19	Realising an Indonesia as a sovereign nation, self-reliant and strong personality that is based on mutual co-operation
Malaysia	2011-15	Charting development towards a high-income nation
Philippines	2011-16	In pursuit of inclusive growth
Thailand	2012-16	A happy society with equity, fairness and resilience under the philosophy of a sufficiency economy
Viet Nam	2011-20	A modern, industrialised country by 2020
Brunei Darussalam and Singapore		
Brunei Darussalam	2012-17	Knowledge and innovation to enhance productivity and economic growth
Singapore	2010-20	Highly skilled people, innovative economy, distinctive global city
CLM		
Cambodia	2014-18	For growth, employment, equity and efficiency to reach the status of an upper-middle-income country
Lao PDR	2011-15	Socio-economic development, industrialisation and modernisation towards the year 2020
Myanmar	2012-15	Development of industry, balanced development, improvements in education, health and living standards, and improved statistical capacities
China and India		
China	2011-15	Rebalancing the economy, ameliorating social inequality, and protecting the environment
India	2012-17	Faster, more inclusive and sustainable growth

Source: Compiled by OECD Development Centre based on national sources.

Structural reforms need to be strengthened further

Improved competitiveness is necessary for Emerging Asia economies to benefit from the opportunities presented by deeper regional integration and integration with the global economy. At the same time, development will need to provide widely shared benefits and produce minimal negative impact on the environment. While the structural policy priorities for Emerging Asia countries are highly diverse, many of these countries have set goals for improving inclusive and sustainable development, recognising the need for high-quality growth and improved quality of life (Table 5). Topics to be addressed include rural development, social programmes, promoting FDI, and taxation. Education and infrastructure are common areas of concern, with less-developed countries in the region seeking to provide the basic foundations for growth and to address troublesome bottlenecks, and higher-income economies looking to establish the conditions for more knowledge-based development in the future. (For a more detailed discussion, please see the Structural policy country notes in Chapter 6 of the Outlook.)

Table 5. **Medium-term policy challenges and responses in Emerging Asia**

Country	Topics	Policy focus
ASEAN-5		
Indonesia	Infrastructure Social security Food security	Build infrastructure for maritime connectivity Reform the national social security system Improve food security
Malaysia	SMEs Education Urban green growth	Raise SME productivity Upgrade education to meet industry needs Promote urban green growth
Philippines	Job creation Infrastructure Disaster risk management	Encourage faster job creation Strengthen infrastructure and the transport sector Improve disaster risk management
Thailand	Macroeconomic performance Tourism	Use macroeconomic policies to revive growth Strengthen sustainable tourism
Viet Nam	Infrastructure SOEs Job creation	Improve infrastructure to support growth Reform and restructure SOEs Promote job creation and productivity growth
Brunei Darussalam and Singapore		
Brunei Darussalam	FDI Private sector Public finance	Encourage foreign direct investment inflows Reform the business sector to promote diversification Reform public finance
Singapore	Ageing population Infrastructure (land use)	Strengthen labour market and social policies for ageing population Leverage data to build a smart, energy-efficient city
CLM		
Cambodia	Education (TVET) Tourism	Improve competitiveness by strengthening TVET (technical vocational education and training) Address complex challenges in developing tourism
Lao PDR	Natural resources SMEs Tourism	Manage the natural resource boom Foster SME development Promote travel and tourism
Myanmar	Agriculture Education Finance	Upgrade and modernise agriculture Develop human capital Finance development
China and India		
China	Environment Education and skills Rural development	Strengthen environmental regulations to improve quality of growth Upgrade human capital to facilitate transition to a higher value-added economy Boost rural development to ensure robust growth of incomes
India	Financial education Education	Strengthen financial education initiatives Enhance education access and quality

Source: OECD Development Centre.

Outlook country notes discuss key structural policy challenges

ASEAN-5

Key challenges: Indonesia

- **Maritime infrastructure:** The Government of Indonesia has emphasised maritime development as part of its Pendulum Nusantara initiative or global maritime axis, which seeks to fully utilise the maritime power offered by the country's position as an archipelago. Superior port facilities are being developed such as the Tarahan Coal Port in South Sumatra and the Kalibaru Port in North Jakarta. However, greater attention is required on connecting existing ports and hubs to logistics networks and industrial zones. The Kalibaru Port, for example, was built seven kilometres away from the Tanjung Priok Port, meaning that it will use the same congested roads to transport cargo. In addition to the development of physical infrastructure and connections to international shipping lines, administrative barriers to trade will also need to be addressed. This will require greater co-ordination between relevant ministries, increased use of computerised facilities across all ports and improvements in the Indonesian National Single Window.
- **Social security:** The goal of achieving universal health coverage by 2019 is complicated by the difficulty of incorporating the large number of informal workers into the system. According to the government's Social Security Agency (BPJS), 53% of the population is registered in its programme. Beyond expanding membership, the government faces a serious financial issue. Financing reforms are needed for the BPJS, which is expected to face an increasing deficit over the medium term. While formal sector workers are the main priority, a programme expansion aims to reach 1.3 million new informal-sector participants in 2015. The domestic financial market requires adequate capacity to absorb and productively distribute the large supply of funds.
- **Food security:** Nutrition and access to food are improving in Indonesia, though food is increasingly imported. Indonesia's current account deficit in recent years is partly attributable to an increased trade deficit in food and live animals. National strategies to improve food self-sufficiency focus on improving the quality, resilience and productivity of food production through investment in irrigation and other areas. To attain these goals, the government intends to develop and improve the irrigation system and reduce land conversion by 600 000 hectares. In addition, the government intends to rehabilitate 1.75 million hectares of deteriorating irrigation infrastructure and to establish 132 000 hectares of swamp irrigation networks to balance economic, environmental and sustainability concerns. Reducing the risks posed by natural disasters and further limiting exposure to malnutrition remain important goals.

Key challenges: Malaysia

- **SME productivity:** Malaysia continues to have strong growth prospects and aims to reach high-income country status by 2020. Achieving this will require further gains in productivity, though broader development goals, such as promoting inclusive and sustainable growth, are also priorities. Through the SME Masterplan, the Government of Malaysia has set targets for an increased role by SMEs in the country's economy, at 41% of GDP, 62% of employment and 25% of exports by 2020. To boost productivity, the government is providing assistance to SMEs to access finance, exporting, business development and technical expertise. Worker training programmes have been established to address skill gaps, including technical and managerial skills, through skills development centres, a SME@university programme tailored for SME Chief Executive Officers, a SME university internship programme, and a SME mentoring programme. As all of these programmes are not always used by SMEs, improving awareness of and usefulness of these programmes is key. SMEs are also held back by under-investment in innovation and new technology, particularly ICT. Financing and training programmes should be designed to promote and facilitate technological upgrading by these firms.

- **Education:** The government's education plan has set ambitious targets for improving access to quality education throughout the country. Dropout rates tend to be higher in rural areas and among poor and marginalised students, despite focused efforts to improve literacy and other aspects of basic education in these areas. The government has attempted to narrow the urban-rural achievement gap through programmes such as the District Transformation Programme, the Orang Asli Education Transformation Plan and the Inclusive Education Programme, though further efforts are required on monitoring achievements and quality assurance. Recent policies have sought to increase the number of teachers employed and to lower student-teacher ratios. Improvements in teacher training and assessment of qualifications to ensure teacher quality are needed over and above financial inducements for excellence. As it is, teachers in Malaysia are relatively well paid with a ratio of teacher pay to GDP per capita of 3.9 compared to the OECD member countries range of between 1.5 and 2.0. Creating a knowledge-based economy will require further development of higher education in sciences and greater numbers of researchers, along with training programmes that help students enter the workforce.
- **Urban green growth:** Green growth is featured in the *Eleventh Malaysia Plan 2016-2020* through targets to: i) reduce greenhouse gas emissions intensity by up to 40% compared to 2005 levels by 2020; and ii) place at least 17% of terrestrial inland water areas and 10% of coastal and marine areas under national protection. Promoting green growth in Malaysia's growing urban areas by addressing issues such as air pollution will be a crucial component of the country's sustainable development. The Iskandar Smart City Project offers an opportunity to test the implementation of these green targets for cities in the areas of transport, green tourism, land use, ICT, safety and security, infrastructure and asset management, heritage and culture, and creative arts. Challenges exist in balancing economic expansion – particularly increased investment in industry – with environmental goals. Infrastructure development will also need to be accelerated to promote investment and to ease traffic congestion.

Key challenges: Philippines

- **Job creation:** Despite the economy's strong growth rates, job creation has been slow in the Philippines, posing challenges for continued and inclusive growth in a country with an expanding working-age population. Unemployment has remained higher than other ASEAN-5 countries at above 7%. Labour force participation remains low with around 40% of those aged 15 or older either unemployed or out of the workforce. The job situation may be even worse as underemployment is common among those employed. In 2013, 11.3% of the total workforce reportedly worked less than 40 hours per week but would have preferred to work more. SMEs hold promise for helping to drive growth, employment, local capacity development and provide resilience against volatile external fluctuations. However, SMEs face serious constraints that must be overcome including access to finance, skills, information gaps and maintaining product quality. The food processing industry, as a key component of the manufacturing sector, holds great potential as a source of job creation. Yet, to develop the industry further and improve market access, policies should focus on enhancing standards, rationalising rules and developing human capital.

- **Infrastructure:** Infrastructure development is a priority for the government with infrastructure expenditure set to increase considerably. While infrastructure expenditure was only about 1.7% of GDP in 2010, the government plans to expand it to 4% in 2015 and 5% by 2016. Low-quality ports and a lack of paved roads constrain competitiveness, though improvements are being made. Considerable investment has gone into port development in the past few years. Over 2010-12, 128 new domestic ports and 16 international ports were erected. By the end of 2009, 22 ports in the Strong Republic Nautical Highway (SRNH) network had been constructed or upgraded for roll-on/roll-off (RORO) operation. Public-private partnerships (PPPs) offer a means of financing and improving the efficiency of some infrastructure projects. The establishment of the Public-Private Partnership Center in 2010 and the legal and regulatory framework for PPPs have made the Philippines a suitable setting for PPP projects. Further work could be done to prevent delays in awarding projects, better manage the division of public and private sector risks, clarify the dispute settlement mechanism, and differentiate between national and regional responsibilities.
- **Disaster risk management:** The Philippines is highly exposed to the risk of natural disasters, which can have serious consequences for lives and livelihoods. Strong and effective disaster risk-management tools are therefore essential for promoting stable growth and development. Progress has been made recently in developing comprehensive preparedness and response strategies, and in strengthening risk mitigation and risk financing capacities. In 2005, the Philippines adopted the *Hyogo Framework for Action 2005-15*, which served as a guideline for reducing disaster risk and vulnerability to natural hazards. In 2009, the Senate of the Philippines ratified the *ASEAN Agreement on Disaster Management and Emergency Response* (AADMER), which binds ASEAN member states to promoting regional co-operation, collaborating in reducing disaster losses and intensifying joint emergency responses. After Typhoon Yolanda, the *Reconstruction Assistance on Yolanda* (RAY) was adopted. New technologies and tools for anticipating disasters and providing early warning are also being adopted. For example, the Philippines recently joined 16 other countries in adopting the Integrated Services Digital Broadcast-Terrestrial (ISDB-T) system that facilitates the transmission of early warning signals in the event of a natural disaster. Remote sensing technology is being used to produce detailed, high-resolution three-dimensional flood hazard maps that can be used to predict how storm surges will affect local communities.

Key challenges: Thailand

- **Macroeconomic performance:** Economic performance in Thailand has slipped as the country has gone through a period of political instability. With the rejection of the draft constitution in September 2015 and the resulting delay of elections, political uncertainty looks set to continue for some time. Annual growth was 0.9% in 2014, although it picked up in the first two quarters of 2015, to 3.0% in Q1 and 2.8% in Q2. The slowdown was felt across the economy, with a few exceptions in the services and utilities sectors; for example, growth reached 6.6% in financial intermediation and 3.8% in education in 2014. Household debt has been rising quickly, from around 40% of GDP in 2003 to 80% currently. The burden of this heavy debt ratio, one of the highest among Southeast Asian countries, may hinder private consumption. The Bank of Thailand cut interest rates from 2% to 1.5% in an effort to boost growth. A second recent stimulus package, valued at THB 206 billion or 1.6% of Thai GDP, is a promising option to revive growth. The package includes assistance to SMEs in the form of tax cuts and loan guarantees while newly registered start-up companies in targeted industries, such as food processing and high tech, will enjoy a five-year tax holiday. To date, the package appears to have had some success in boosting business sentiment as the Thai benchmark stock index hit a three-week high immediately after the announcement.

- **Tourism:** Although visitor arrivals declined in 2014, Thailand's sizeable tourism sector has proven to be relatively resilient during the current slowdown and is expected to contribute to future growth over the longer term. The Thai government has recognised the importance of tourism in its *11th National Economic and Social Development Plan (2012-2016)*. The plan envisages rehabilitating and increasing the quality of tourist attractions to improve market demand. Special attention has been focused on promoting Thai culture through the "Discover Thainess 2015" tourism campaign. Priorities for ensuring the sustainability of the sector should include addressing the leakage of tourism-related revenues outside the country and the community-level and environmental impacts of tourism. To develop sustainable tourism, the government has established the Designated Area for Sustainable Tourism Administration. This Administration is tasked to work with local authorities and communities and to promote best practices in the areas of human capital, access to finance and knowledge management. Regional integration offers opportunities to improve the quality of services in the sector and to promote travel collectively. The ASEAN countries have sought to ensure that regional integration boosts tourism through initiatives such as the ASEAN Mutual Recognition Arrangement on Tourism Professionals that establishes common standards for 32 job titles. Other measures include the ASEAN Tourism Qualifications Equivalent Matrix as a reference for the industry and the ASEAN Tourism Professional Registration System.

Key challenges: Viet Nam

- **Infrastructure:** A significant infrastructure gap is expected to arise as Viet Nam's growth continues and financing will be a challenge. Recent restructuring of public investment to improve the efficiency of investment allocation and to strengthen monitoring and assessment frameworks have helped to lay a better foundation for future infrastructure investment. The legal framework has been institutionalised through the Law on Public Investment that seeks to improve the effectiveness of public investment management; and the Law on Enterprises to regulate the use of state capital in manufacturing and business activities at enterprises. Domestic and foreign private investors are being encouraged to participate in pilot PPP projects through a measure adopted in 2010 that establishes regulations for PPPs. More could also be done to mobilise private savings in Viet Nam, for example through the issuance of government-guaranteed bonds for infrastructure development.
- **SOEs:** The reform of Viet Nam's state-owned enterprises (SOEs) will be another important challenge to improve competition and competitiveness. Reforms have been gradual and have mainly been carried out through the transformation of SOEs into joint stock companies and through mergers and consolidation. Since reforms began, Viet Nam has merged and consolidated 877 SOEs and dissolved 313 while 92 have gone bankrupt. This has reduced the number of SOEs and the range of sectors where they operate, while reinforcing the largest of these enterprises. Since 2012, market principles have had a greater influence in directing SOEs due

to the implementation of key measures to impose common business rules for SOEs and private enterprises. These rules aim at clearly defining accountability and supervision requirements, promoting equal treatment for small shareholders in majority state-owned enterprises, ensuring adequate information disclosure by SOEs, and enhancing the capacity and accountability of board members of SOEs. Despite these efforts, challenges remain as SOEs retain preferential access to finance, state budget capital, land and other resources. Further reforms should seek to ensure that SOEs compete fairly with the private sector and that SOE performance is monitored and evaluated. For example, the agency responsible for the state ownership function of SOEs must be independent from the agency that implements the SOE management function and the market regulation function.

- **Job creation:** Unemployment in Viet Nam has been low despite a large increase in the size of the labour force brought on by population growth. Labour productivity has remained relatively low, however, as a result of the low quality of human and physical capital, the small scale of production and misallocation of resources. FDI and the expansion of export production have been pursued to drive growth and boost productivity, but additional attention should also be paid to improving efficiency in SMEs. Any effort to improve employment prospects and productivity is complicated by the large informal sector. As of 2012, nearly 80% of the total workforce was employed in the informal sector. To promote job growth, Viet Nam has allowed employers in the informal sector to avoid paying value-added taxes, and social security and welfare contributions. The country needs to strike a balance between job creation and job improvement by encouraging businesses in the informal sector to formalise through initiatives such as tax holidays, tax reductions or credit subsidies.

Brunei Darussalam and Singapore

Key challenges: Brunei Darussalam

- **FDI:** Dependence on the oil and gas sector, which accounts for most of Brunei Darussalam's GDP, exports and government revenues, has allowed the country to reach the high-income level but leaves it highly vulnerable to energy price fluctuations. While national savings are large, FDI offers access to technology, managerial experience and international markets. However, the high concentration of economic activity in the oil and gas sector and in government has resulted in high unemployment which reached 9.3% in 2011. While oil and gas contributes approximately two-thirds to total GDP, it only accounts for 3.3% of total employment. The challenging business environment may discourage investment in non-energy sectors. For example, starting and running businesses, registering property, inadequate physical infrastructure and weak intellectual property protection pose difficulties. New measures are underway to attract investment by promoting R&D and ICT use. The Brunei Research Incentive Scheme (BRISc) is a cost-sharing grant programme where 70% of R&D funding can be obtained from the government. The government has also upgraded ICT infrastructure with fibre-to-the-home (FTTH) broadband services.
- **Private sector development:** A stronger private sector in general would promote the economic diversification process, and several services sectors stand out as potential areas of growth. These include financial and business services, tourism, Halal products, logistics, ICT and oil and gas downstream activities. Apart from identifying the specific sectors to be promoted, the main challenge will be to come up with effective execution plans to realise desired objectives. Administrative

burdens will need to be lessened to facilitate growth. Recent improvements include the replacement of the Miscellaneous Licence with the Business Licence in January 2015, which reducdes the days required for approval. It may also be appropriate to rethink sources of public finance, the composition of expenditure and use of PPPs in infrastructure development.

- **Public finance:** The country's public finances are enviable in many respects as the government has high revenues, large surpluses, low debt relative to GDP, large gross national savings and large fiscal buffers. However almost 90% of total revenue is received from the oil and gas sector. Brunei Darussalam should ensure the large annual budget surpluses are invested productively, perhaps in education to help diversify the economy and to increase potential output. Greater use of PPPs could increase spending efficiency and contribute to the development of various sectors, including construction, business services and financial services.

Key challenges: Singapore

- **Ageing population:** In high-income Singapore, improvements to the quality of life are particularly important. With an ageing population, more will need to be done to improve the employability of the elderly and to improve social programmes. Efforts have been made to encourage older workers to return to the workforce and to create incentives for employers to hire them. One such incentive is the Special Employment Credit (SEC), introduced in 2011, that grants a subsidy to employers who hire Singaporean employees over 50 years of age. The Tripartite Committee on Employability of Older Workers (TriCom) has been working since 2005 to support the employability of older workers by promoting job redesign, re-employment and public communication to promote positive perceptions of older workers. At the same time, health-care programmes for the elderly are being expanded and investments in health care generally are increasing. The Pioneer Generation Package has increased health subsidies for the elderly and the government has expanded facilities such as hospital beds and nursing home capacity.
- **Infrastructure:** Improvements in energy efficiency will be an important component of improved sustainability in Singapore. The Housing and Development Board (HDB) is taking steps to develop more energy-efficient housing and communities and to use sensors to create a "smart environment". A Smart HDB Town Framework has been developed to guide the use of technology in developing sustainable solutions. For example, HDB is encouraging the use of computer simulations and data analytics to guide its planning process. Improved data collection can help in achieving efficiencies, though it will be important to ensure that security and privacy remain protected as well. Singapore could consider harmonising national privacy legislation with OECD guidelines, which represent a consensus on basic principles that can be built into existing national legislation.

CLM

Key challenges: Cambodia

- **Education:** The development of human capital and expansion of sectors with the potential to drive growth are important challenges. The Cambodian technical and vocational education and training (TVET) system has traditionally been used as either an alternative to higher education or to address unemployment among youth and workers affected by economic restructuring. Increasingly, TVET is now also being used as a tool to support the development of a knowledge-based economy.

Strengthening the system, particularly to help students and workers develop advanced skills, requires a broad set of organisational reforms. TVET programmes should seek broader input from stakeholders and sources of funding, improve the quality of curricula, teaching and evaluation, consider developing public-private partnerships, and improve access to quality and relevant learning opportunities. Recent reforms have sought to address these challenges. The Cambodian Qualifications Framework (CQF) has introduced Competency Based Training and developed a labour market information and management system. However, greater emphasis is needed on implementing these systems and developing the capacity of staff to work within them.

- **Tourism:** Cambodia possesses natural and cultural assets that make it an attractive tourist destination and is drawing an increasing number of visitors. However, the underdevelopment of infrastructure and gaps in worker and managerial skills pose significant constraints to further development. The sector is not well connected to the rest of the Cambodian economy, relying largely on imports. Strengthening connections with local suppliers would help to improve gains from the sector and to benefit the poor. The management of tourist sites is complicated by the overlapping responsibilities of multiple government ministries. For example, temples are under the responsibility of the Ministry of Culture and Fine Arts, and eco sites may be under the Ministry of Environment or the Ministry of Agriculture, Fishery and Forestry while some other sites are managed by the Ministry of Culture and Religious Affairs. This fragmentation also makes the much-needed diversification of tourism destinations more complex. Regional solutions, particularly in promoting specific regions and facilitating travel (such as through the ASEAN single visa initiative), could be beneficial.

Key challenges: Lao PDR

- **Natural resources:** Significant contributions to growth have been made by natural resources, primarily hydropower and mining, but dependence on these resources posea a risk of Dutch disease and volatile growth. Due to strong appreciation of the currency, the growth of non-resource sectors such as manufacturing and agriculture has been slow. Sustained growth that creates jobs requires a broader-based economy. Policy priorities for responsible management of the natural resources boom include diversification of the economy by encouraging FDI in non-resource sectors and creating a more favourable business environment. The improvement of fiscal and monetary policy management is required for macroeconomic stability, particularly in using revenues from natural resources for long-term savings and investment. As the country faces large budget deficits and high external debt, it is important to balance the budget, reduce external borrowing, ensure rapid repayment of debt and establish a fund for future expenditure.
- **SMEs:** The development of SMEs is a critical component of economic diversification and plays an important role in generating employment, income and new technology for long-term development. A lack of access to finance and a skills shortage are among the top concerns of SMEs in Lao PDR. Domestic and international competition and relatively high energy prices in the country are also concerns for SMEs. Several laws and regulations have been issued in support of private-sector development including the Business Law and the Law on Promotion and Management of Foreign Direct Investment. However, supporting decrees and the regulatory framework required to implement the new measures remain lacking. In addition, more can be done to ease administrative burdens, improve access to credit and technology and facilitate exports.

- **Tourism:** While tourism has expanded rapidly in Lao PDR, it has the potential for greater growth by expanding arrivals from non-neighbouring countries and by increasing spending per visitor. Improved transportation infrastructure linking cities and tourist destinations and improved international connectivity are needed. Skill shortages and the need for standards and qualifications have been recognised with the establishment of the Lao National Institute of Tourism and Hospitality, though implementing ASEAN standards will take additional efforts. Future planning for the sector should consider how public-private collaboration, perhaps in destination marketing, could be useful to attract higher-spending tourists from a wider range of countries. The government has recognised the potential of ecotourism and community-based tourism in expanding the sector and in fuelling pro-poor growth. However, careful attention should be placed on protecting the country's cultural and environmental resources as any decline in biodiversity and natural resources is likely to harm the promotion of ecotourism.

Key challenges: Myanmar

- **Agriculture:** Agriculture in Myanmar is predominantly small-scale and subsistence-based, with 54% of farms less than 2 hectares, 4.3% between 8 and 20 hectares and only 0.3% larger than 20 hectares. However, the sector retains great potential to be a major contributor to export-led growth. Though recent reforms allow farmers to use their land as collateral in securing loans (through Land Use Certificates), access to finance and financial services is generally poor and acts as a constraint to increasing investment in the sector. The Myanmar Agriculture Development Bank does provide seasonal and some longer-term loans but faces serious funding constraints due in part to interest rate limits. The improvement of farmers' knowledge and skills, along with research and development, will also be central to raising farming productivity. Expanding agricultural exports may require reforms of constraining institutional factors, for example by better defining overlapping responsibilities of ministries and by expanding limited resources for health and safety inspections. Consideration of alternative organisational and marketing strategies may also be needed.
- **Education:** Improvements in the formal education system and other training programmes will be needed to prepare more of Myanmar's workers for jobs in the modern manufacturing and services industries that will expand with the country's growth. While basic levels of education are fairly high for the country's income level, access to education and quality of higher education need improvement. Reviews of selection criteria for teacher-training programmes and of incentives for teachers may help to attract better-qualified and more motivated teachers. TVET can play a role in arming workers with the skills demanded by employers, particularly in the use of technology. However, it is important for TVET systems to be designed by engaging with employers, unions, students and teachers familiar with the workplace. Labour exchange offices and worker training programmes are helping to bridge skill gaps to improve productivity, though the development of training strategies is complicated by the involvement of many ministries in the policy-making process. The National Education Committee co-ordinates education decision making, but another 11 ministries are responsible for various aspects of the education system. Reforms are underway through the Comprehensive Education Sector Review initiated in 2012 to develop a strategic plan for the education sector.
- **SME financing:** Given a history of underinvestment, growth and development depend on increased investment. The lifting of sanctions and Myanmar's increased openness to the world can be expected to lead to an increase in foreign investment

and development assistance, but these external sources of financing, along with remittances, are expected to be less important than domestic sources of financing. Reforms will be needed to maximise these domestic sources. Government revenues are insufficient as a result of the tax structure and difficulties in tax collection. Collection could be improved and burdens on business reduced through administrative reforms to tax administration such as a switch to self-assessments. The financial system remains at an early stage of development, but will be critical in mobilising financial resources for development. At present, formal financial institutions are largely confined to the commercial banks but their scope is limited, and formal financial markets are nearly non-existent. In the near term, regulatory constraints will need to be adjusted to improve firms' access to finance. Regulatory restrictions on the banking sector have been relaxed somewhat, such as those on interest rates, but work needs to be done in important areas, including establishing a credit bureau, which is currently underway.

China and India

Key challenges: China

- **Environment:** Rapid growth with lax pollution regulation has been accompanied by serious environmental degradation in China. Recognition of the environmental, human and economic costs has led to reforms. Measures taken recently to improve air quality are having an impact in reducing urban air pollution. For example, the average PM 2.5 (particulate matter less than 2.5 microns in diameter that can lodge in the lungs) concentration in ten polluted Chinese regions declined by 11.9% in 2014. Other recent reforms include an Environmental Tax Law, released for discussion in June 2015, that proposes fines for air, water, noise and waste polluters, though there are several exceptions. Recent reforms also extend the liability of persons responsible for environmental damage to beyond their term and retirement. Improved inspection of water pollution has been introduced as part of the Water Pollution Prevention and Control Law. The inspection identified the cities and towns that met national standards and since then the government has announced that water quality will be incorporated in the indicators used to assess local government officials.
- **Human capital:** Improvements in human capital will take on additional importance as China seeks to develop innovative and knowledge-based industries. Job seekers – even those with higher levels of education – do not currently have skills matching market demand. For example, soft skills such as management, communications and negotiation amongst others were found to be the most important for new jobs but are not acquired at higher education institutions. Recognising that vocational education offers a means of improving skills, the government is investing in expanded workplace-based training. Reforms affecting the autonomy and focus of universities have also helped provide opportunities for deeper collaboration with the private sector. National Technology Transfer Centres (NTTCs), for example, act as intermediaries between university and industry to diffuse inventions; and with greater autonomy, NTTC staff are able to market patented technology thereby increasing the utilisation rate of university-developed patents. New programmes to train and attract world-class researchers and other highly skilled workers are helping to address the need for further innovation. The *National Medium-and Long-term Talent Development Plan (2010-2020)* is a recent comprehensive initiative to attract and retain highly skilled individuals in six broad areas (political leaders and officials, business entrepreneurs, technical professionals, highly skilled industry staff, skilled workers in agriculture and rural areas, and skilled social workers).

- **Rural development:** Rural areas have not seen the same development as urban areas in China, although the income gap has narrowed somewhat. Higher rural productivity is critical for narrowing the urban-rural income gap, though temporary income supports may also be needed in some cases. Labour productivity in agriculture will need to be improved through mechanisation and investment. Assistance in access to finance and in facilitating the reallocation of land are laying the groundwork for making these productivity improvements. A recent attempt in this direction is the July 2015 issuance of the Guiding Opinion on Building an Agricultural Credit Guarantee System with Budgetary Support. Under this scheme backed by the provincial governments, at least 70% of guaranteed loans would go to crop farmers with sufficient scale. To preserve land fertility over the long run, unsustainable practices such as the overuse of chemical fertilisers will need to be changed. The government could encourage the use of new technology, improve farmer education and reduce subsidies for fertilisers.

Key challenges: India

- **Financial inclusion:** Fast and inclusive development will require stronger financial education initiatives and improved access to and quality of education in general. Financial access has been a policy priority for India, but financial education programmes will also be needed to ensure that people are aware of the services available and sufficiently informed about the opportunities and risks to make responsible decisions about personal and business finance. The areas of need have been studied through the 2014 Financial Literacy and Inclusion Survey, which found that respondents were comfortable with concepts such as division and interest on loans, had moderate knowledge of inflation, risk versus return, diversification and simple interest, and were least knowledgeable about the time value of money and compound interest. The National Strategy for Financial Education has been developed to guide efforts by schools, community outreach workers and financial sector representatives in this field.
- **Education:** Higher quality and more accessible education generally is important in a country like India with a young population. Enrolment in primary schools in rural areas and their results have improved considerably in the recent past. Over 98% of children were found to be enrolled in primary school in 2012. Even in rural areas, enrolment levels are over 96% for the 6-14 year age group. Less change has been seen at the secondary and tertiary levels, where more students will need to develop skills beyond basic literacy and numeracy. Uneven access to education by region, gender and socio-economic background across all levels of schooling will need to be addressed, possibly through the use of new diversity measures and incentives. Efforts to improve the quality of education should focus on teacher quality and upgrading school facilities.

Chapter 1

Economic outlook and assessments on macroeconomic and structural reforms in Emerging Asia

Growth in Emerging Asia will remain fairly robust, but look set to moderate somewhat in the medium term. Slowing or stable growth is forecast for most of the ASEAN-5 countries, though Thailand is expected to recover from recent sluggish growth and decline. Growth will also recover in Brunei Darussalam but will slow slightly in Singapore. The CLM countries will continue to be among the fastest-growing in the region. China's growth is expected to continue to slow as India's economy continues its strong performance. Consumption will become more important to growth in much of Emerging Asia, leading to narrower current account surpluses in China and the ASEAN-5. Fiscal balances will remain mostly stable. External and domestic risks are still facing the region and could negatively affect future growth. China's slowdown, US monetary policy normalisation and slow productivity growth are particularly important challenges. Addressing these issues and continuing to deepen regional integration will be critical in ensuring continued growth.

Introduction

Facing a range of external and domestic challenges, the growth prospects of the Emerging Asian economies (Southeast Asia, China and India) are expected to moderate in the medium term. Private consumption will make a large contribution to growth as exports decline in importance. Fiscal balances should remain moderate. The growth trajectories of individual countries in the region vary considerably, however; growth in the Association of Southeast Asian Nations (ASEAN) will continue to be led by the Philippines and Viet Nam among the ASEAN-5 and by the CLM countries (Cambodia, Lao PDR and Myanmar); while China continues to slow, India is expanding faster.

Recently, slowing inflation has provided additional space for monetary policy support and moderate fiscal stimulus efforts have been made in several countries. Increased risk sensitivity and external factors have resulted in financial capital outflows. The region faces a number of internal and external risks to its growth outlook. China's slowing growth and structural transformation and the anticipated US monetary policy normalisation are an important concern for much of the region. Domestically, much of Emerging Asia also faces the risk of slow productivity growth since the global financial crisis.

Overview and main findings: The economic outlook for 2016-20

Growth in the Emerging Asia region (Southeast Asia, China and India) shows mild moderation but will remain robust at an average rate of 6.5% real gross domestic product (GDP) growth in 2015. In the medium term, growth in the Emerging Asia region is projected to average 6.2% per year over 2016-20, according to the most recent Medium-Term Projection Framework for this edition of the *Outlook* (MPF-2016) (Table 1.1). This is noticeably below the 7% rate of growth over 2011-13, due mainly to China's slowing growth. The growth slowdown in China will also place downward pressure on growth in the rest of the region. The ten ASEAN countries together are projected to grow at 4.6% in 2015 with an annual average rate of 5.2% over 2016-20. In general, the Southeast Asia region will maintain favourable growth performances in the medium term.

The Philippines and Viet Nam are projected to show robust growth at an annual average rate of around 6% over 2016-20. **Viet Nam**'s growth has been led by a rapid acceleration of fixed investment, strong foreign direct investment (FDI) inflows and robust consumption. Together, these components account for most of overall real growth, as net exports have restrained overall growth due to strong imports. In general, the private sector's performance has improved, with strong retail sales growth, although structural adjustments in the state-owned enterprise and banking sectors will weigh on growth somewhat. The **Philippines** has benefitted from strong momentum in domestic demand, buoyed by growing remittances. The Philippines is also benefitting from a significant improvement in its attractiveness as a FDI destination. Growth prospects reflect the countries' improved macroeconomic fundamentals and their plans to develop infrastructure. However, risks remain as job creation and the business environment need to be improved.

Indonesia, Southeast Asia's largest economy, has experienced mild moderation in its real growth with both domestic and external demand slowing to 5.5% in the medium term. Private consumption has expanded moderately. The government has attempted to boost investment by doubling the infrastructure budget for 2015, but execution has been delayed. While the Indonesian currency has depreciated considerably, partly due to falling commodity prices, export growth has been very weak on the back of stagnant external demand. Economic growth in **Malaysia** weakened during the first half of 2015. The weakening was caused by deteriorating external demand as a result of the economic slowdown in China, its major trading partner, and by the persistence of low international oil prices in the first half of the year. However, the ringgit's depreciation may support non-commodity exports in the future.

Table 1.1. **Real GDP growth of ASEAN, China and India**

Annual percentage change

Country	2014	2015	2016	2016-20 (average)	2011-13 (average)
ASEAN-5					
Indonesia	5.0	4.7	5.2	5.5	6.2
Malaysia	6.0	4.6	4.6	5.0	5.2
Philippines	6.1	5.9	6.0	5.7	5.9
Thailand	0.9	2.7	3.1	3.6	3.2
Viet Nam	6.0	6.4	5.9	6.0	5.6
Brunei Darussalam and Singapore					
Brunei Darussalam	-2.3	-1.4	0.5	1.8	0.9
Singapore	2.9	2.1	2.4	2.6	4.1
CLM countries					
Cambodia	7.0	7.0	7.1	7.3	7.3
Lao PDR	7.4	6.9	7.0	7.3	8.1
Myanmar	7.7	8.2	8.2	8.3	6.9
China and India					
China	7.3	6.8	6.5	6.0	8.2
India	7.3	7.2	7.3	7.3	5.5
Average of ASEAN 10 countries	4.6	4.6	4.9	5.2	5.4
Average of Emerging Asia	6.7	6.5	6.4	6.2	7.0

Note: The cut-off date of data is 2 November 2015. Weighted averages are used for ASEAN and Emerging Asia. The figures for China, India and Indonesia (2015 and 2016 projections) are based on the OECD Economic Outlook 98.
Source: OECD Development Centre, MPF-2016 (Medium-Term Projection Framework). For more information on the MPF, please see www.oecd.org/dev/asia-pacific/mpf.htm.

While political turmoil had a large negative impact on growth in **Thailand** in 2014, the country experienced modest GDP growth of 2.7% in 2015. While exports remain weak, the recovery in tourist arrivals that began in the summer of 2014 and continued into 2015 is a promising sign. Thailand's growth performance in the medium term should improve gradually from that of recent years. However, the transition process to democracy must be managed carefully to ensure that it does not lead to macroeconomic instability.

Growth performances in Brunei Darussalam and Singapore are projected to improve considerably over the medium term despite the recent international oil price shock and weaker than expected global growth compared to the past several years. Rising oil prices will allow **Brunei Darussalam** to record positive growth. Labour shortages and slowing productivity growth will keep **Singapore**'s real growth noticeably below the pace of 2003-07. Singapore's weak performance is largely attributable to slowing domestic demand. While service-sector growth has declined compared to 2014, it continues to prop up overall growth, particularly due to strong contributions from finance, insurance and business services.

Growth in the CLM countries is projected to lead that of the ASEAN region, with real GDP growth rates of more than 7% over 2016-20. Recovery of the agricultural sector and development of the tourist sector and industry will underpin real growth in **Cambodia** and **Lao PDR**. Growth in **Myanmar**, which is now the fastest in the region, should continue to accelerate as FDI continues to rise and as economic reforms spur the private sector's rapid development. Prospects in these countries, however, will depend on maintaining adequate control of rapidly rising credit and, especially in Myanmar, on sustaining the momentum of economic reforms.

The growth prospects of China and India are expected to differ from past patterns as they face different internal conditions. China's economy slows while India's growth remains robust over the medium term. Continued investment in infrastructure in **China** is helping to support overall investment, though this stimulus is unsustainable in the longer term. Growth is slipping elsewhere as adjustments are underway in manufacturing to manage longstanding challenges from excess capacity. **India**, on the other hand, is seeing increased investment rates, thanks to public infrastructure development and private investment motivated by improvements in the business environment, though passing some key structural reforms is proving difficult. Private consumption is also increasing, thanks in part to higher wages and improved benefits for public sector employees. Domestic financial risks remain potential barriers to continued growth in India, particularly large non-performing loans and the high leverage ratios of some firms.

Key points of the economic outlook and assessment are as follows:

- Real growth in Emerging Asia will experience mild moderation in 2015, averaging 6.5%, and is projected to moderate gradually over the medium-term (2016-20) to 6.2% annually. Growth in China will continue to slow while growth in India picks up to one of the highest rates in the region. Growth in the ASEAN region will be similar and is projected to average 4.6% in 2015 and 5.2% over 2016-20, led by growth of the Philippines and Viet Nam among ASEAN-5 and the CLM countries. Private consumption will be a large contributor to overall growth, while exports will contribute less than during most of the prior decade.
- China and most of the ASEAN-5 countries will continue to record current account surpluses, although at a lower level relative to GDP than during 2003-07. This narrowing reflects the increased importance of consumption relative to investment in driving real GDP growth. The CLM countries will continue to run current account deficits, and India's deficit will increase modestly.
- Fiscal balances in relation to GDP are projected to remain stable. Sustaining sound fiscal positions while meeting development needs will depend on the success of further reforms to strengthen budget planning and implementation and to improve the effectiveness of tax administration. Recent subsidy reforms in some countries will contribute positively to their fiscal positions.
- Over the medium term the region is likely to have to cope with the effects of progressive monetary tightening in the United States, rebounding oil prices and the further slowing of growth in China. Slowing growth and restructuring in China are expected to have a relatively larger and longer impact on other Emerging Asian economies, compared with other external influences such as US monetary policy normalisation. China's slowing will be felt by the rest of the region through slowing demand for exports and reduced investment flows. However, China's shift towards consumption-led growth will also present new export opportunities. Negative impacts will vary by country and by sector, with Malaysia, Singapore and Thailand likely to be more affected than other ASEAN member countries. The risks related to US monetary normalisation should be manageable, particularly given the

strong macroeconomic and financial fundamentals that have helped to sustain the resilience of the Emerging Asia countries over the past several years.

- Productivity in Emerging Asia slowed following the global financial crisis, though potential growth is beginning to recover in ASEAN. While manufacturing productivity has grown faster than national averages in much of Emerging Asia, most countries have seen a relative deceleration in financial-sector productivity. Overall, structural reforms need to be further strengthened to meet the targets of medium-term development plans.
- There has been some progress under various regional integration initiatives of ASEAN, ASEAN+3 and ASEAN+6, but challenges remain for further integration. These challenges include: co-ordinating between regional initiatives and national agendas, and between regional and sub-regional initiatives; reducing disparities in the region by supporting further development of the CLM countries; strengthening monitoring capacity; addressing the issues of green growth and renewable energy; and private-sector development (See thematic focus of this Outlook in Chapters 2-5 for a more detailed discussion).

Recent macroeconomic developments and near-term prospects

Real GDP growth in most of Emerging Asia slowed in 2014, and data suggest that growth has remained subdued in the first half of 2015 (Table 1.2). Most countries in the region recorded slower growth in 2015 than in 2014 – the exceptions are Brunei Darussalam, Thailand, Viet Nam and India. China and the ASEAN region recorded their slowest growth since the start of the global financial crisis. The slowdowns partly reflect weak external demand from the advanced economies, including OECD economies. Internal conditions have accentuated the slowdown in many cases. Private consumption has remained relatively stable (except in Thailand) and has provided the main support for growth (Figure 1.2). Growth in gross fixed investment has generally been lacklustre due to structural bottlenecks, political uncertainties and the need for fiscal or prudential restraint in a number of countries. China's growth decline, to some extent, reflects an underlying longer trend toward slower growth in potential output arising from the structural transformations occurring in the economy.

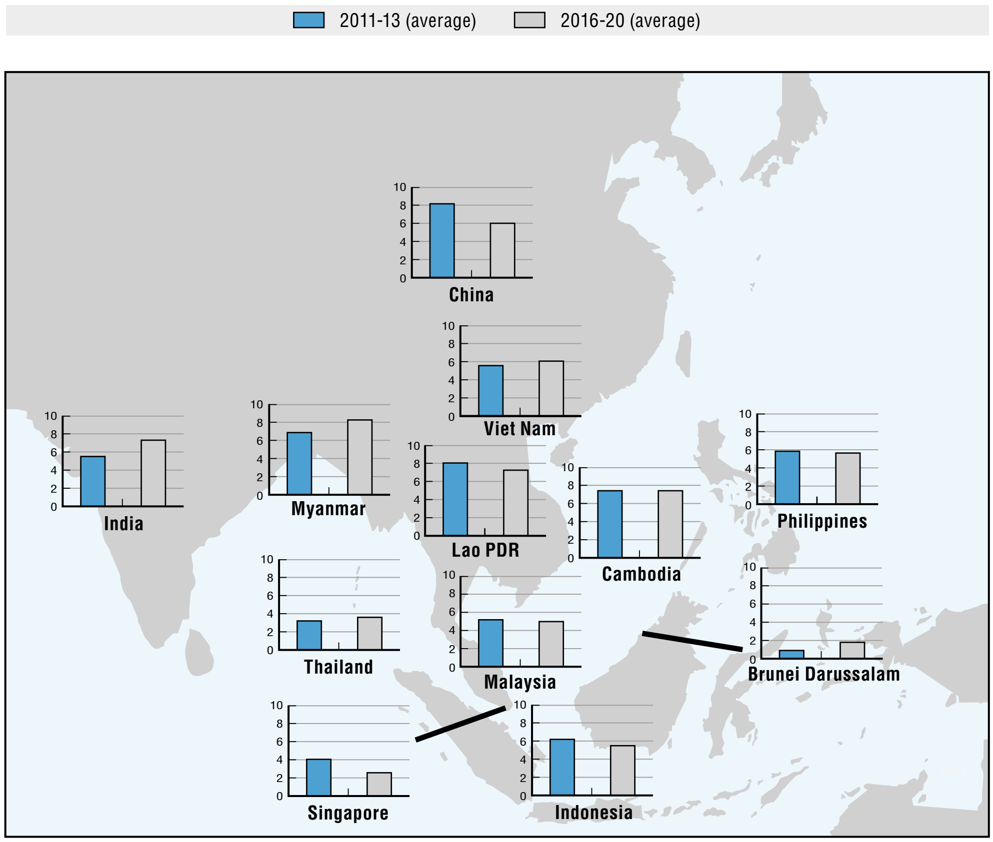
Table 1.2. **Real GDP growth of Q1 and Q2, 2015, in Emerging Asia**

Country	2014	2015 Q1	2015 Q2
ASEAN countries			
Indonesia	5.0	4.7	4.7
Malaysia	6.0	5.6	4.9
Philippines	6.1	5.0	5.6
Thailand	0.9	3.0	2.8
Viet Nam	6.0	6.0	6.4
Singapore	2.9	2.8	1.8
China and India			
China	7.4	7.0	7.0
India	7.3	7.5	7.0

Source: CEIC.

Figure 1.1. **Real GDP growth of Southeast Asia, China and India**

Percentage

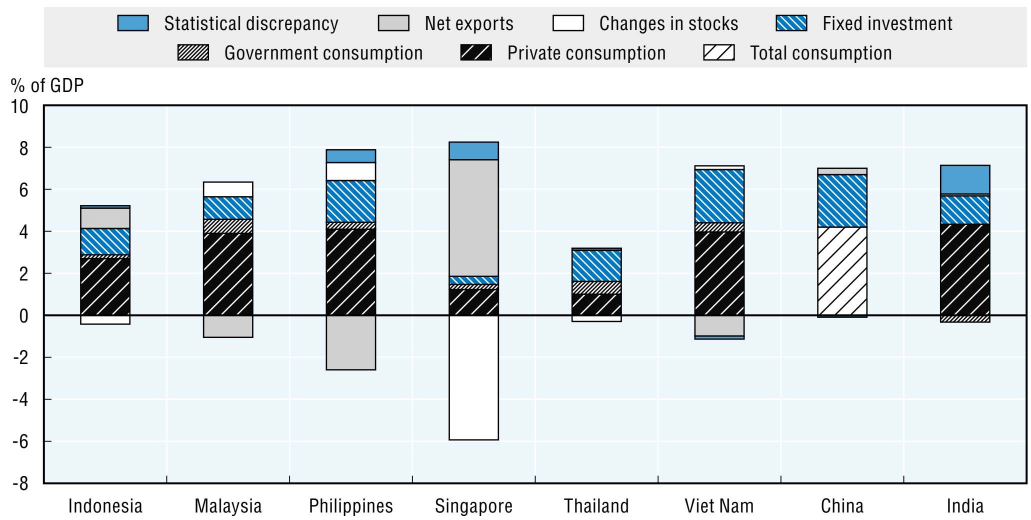


Source: OECD Development Centre, MPF-2016.

StatLink http://dx.doi.org/10.1787/888933309398

Growth in most of the region should pick up in the near term as economic activity revives in the advanced economies, declining oil prices boost consumption and investment growth revives. Economic fundamentals are broadly favourable to economic recovery. The fall in core inflation has given most countries more scope for supportive monetary policy. Current account and capital account balances have deteriorated somewhat but overall external positions remain sound. Financial markets in the region have shown relative resilience amidst declining net capital inflows and uncertainties linked to the prospects for monetary tightening in the United States and the slowing of growth in China. These uncertainties continue to pose downside risks to the outlook, with further risks posed by adjustments to the boom in real estate prices and in credit growth in a number of countries.

Figure 1.2. **Contributions to growth in Emerging Asia in the first half of 2015**



Note: Data for Viet Nam refer to 2014. Data for China are from the Asian Development Bank.
Source: CEIC.
StatLink http://dx.doi.org/10.1787/888933309407

The real growth slowdown has been tempered by robust consumption in the ASEAN-5 economies

Real GDP growth in **Indonesia** has been steadily declining since 2010, reaching 5.0% for 2014 as a whole, down from 5.6% in 2013, and slowing further to 4.7% in the first and second quarters of 2015. Most of the deceleration is attributable to a marked fall in gross fixed investment, which grew by only 4.1% in 2014 and by 3.6% in the second quarter of 2015, less than half the average growth of 8.7% over 2010-12. Contributing to deteriorating investment performance are bottlenecks that have impeded public infrastructure investment (Box 1.1) and uncertainties about the future course of economic policies. Growth has also been slowed by marked weakness in exports of goods and services (which grew by only 1.1% in 2014) and by anaemic growth in public consumption spending. Private consumption, which rose by a healthy 5.3% in 2014 and grew by 5% in the first half of 2015, has been the main support to real growth, contributing around 55% of the overall total. Private consumption has been buoyed by robust employment growth and falling unemployment. The reinvigorated reform programme pledged by the new Indonesian government offers the potential of higher growth in the medium term (see discussion of medium-term prospects in this chapter). However, there has been little sign of revival in the first half of 2015, with private consumption continuing to account for the majority of overall growth and only limited contributions from fixed investment and public consumption. Average growth in industrial production was marginally lower over the first quarter of 2015 than in the last quarter of 2014; merchandise exports fell by 8.3% year-on-year (YoY) in April 2015 and by 15.2% in May; and the business tendency survey deteriorated. Overall, real growth appears likely to recover slowly in the near term and could accelerate as (and if) planned increases in government infrastructure spending and other economic reforms take hold.

Box 1.1. **Impediments to infrastructure projects in Indonesia**

Indonesia's GDP growth slowed in the first half of 2015, with slow government spending contributing to the decline. Growth of government spending decreased to 2.2% YoY in Q1 2015 compared with 2.8% in Q4 2014 (Bank Indonesia, 2015) due to the 2015 budget revision, which was approved in mid-February 2015. Following fuel subsidy cuts in late 2014 and early 2015, the Indonesian government made plans to allocate more resources to other purposes, including facilitation of infrastructure development, which is essential to driving future economic growth.

In 2015, some major infrastructure projects were expected to start, but implementation was slow in the first half of the year. Several stages of smaller projects and tender processes were completed, but the implementation of larger infrastructure projects, including power plants, ports and roads, was expected to begin only in the second half of 2015. Infrastructure spending did pick up in the second half of 2015, but achieving the government's target could be difficult considering the long delays at the start of the year. As of mid-September 2015, only about IDR 90 billion (Indonesian rupiah), or about 31% of the total allocated infrastructure development funds set in the Revised State Budget 2015, had been spent, according to the Indonesian Ministry of Finance. This outcome continues a historical tendency of a low ratio of actual to budgeted outlays for infrastructure (DBS, 2015).

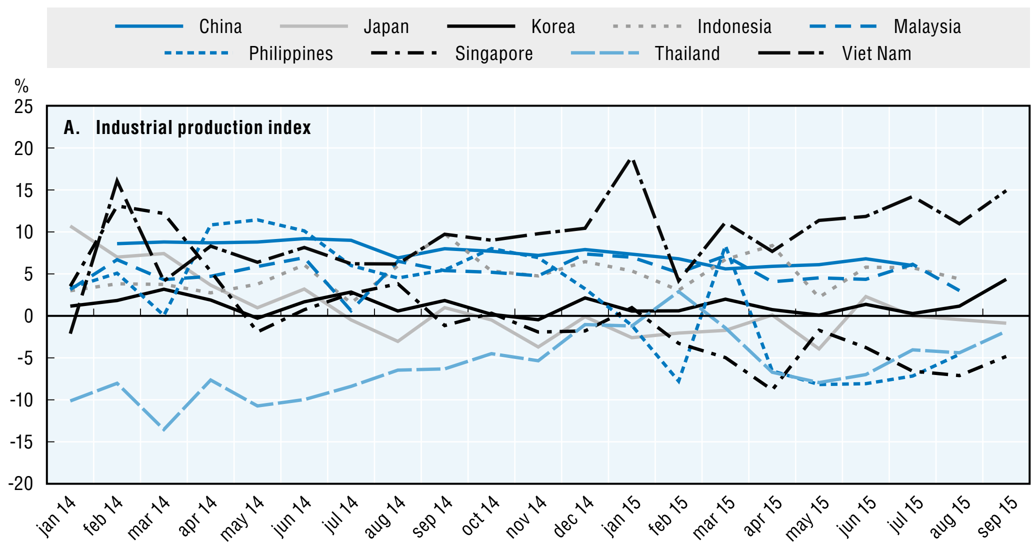
Despite the need for improved infrastructure in Indonesia, its development is often complicated or delayed by issues such as the difficulty of acquiring land for infrastructure projects, a lack of co-ordination between different agencies and levels of government, and the weak legal and regulatory framework in support of public private partnerships (PPPs). Recent government measures are helping to address these issues. The Law No. 2/2012 on land acquisition, enacted in January 2012, has improved clarity about the timeline of land acquisition for public projects. In March 2015, two new regulations were signed to further facilitate infrastructure projects. President Regulation No. 30/2015 amends the earlier regulation on land acquisition to facilitate government partnering with the private sector in the procedures and funding of land acquisition. Presidential Regulation No. 38/2015 expands the sectors eligible for PPPs from those originally eligible – transportation, roads, irrigation, water, sanitation and waste management, telecommunications, electricity, and oil and gas – to also include regional government, municipal government, education, energy conservation, health, public housing, sports and the arts, and tourism.

Source: Bank Indonesia (2015), *Monetary Policy Report Quarter I 2015*; Heath J. (2015), "Infrastructure in Indonesia: Will recent reforms make things easier?", www.corrs.com.au/thinking/insights/infrastructure-in-indonesia-will-recent-reforms-make-things-easier/; IMF (2015a), "Indonesia Staff Report for the 2014 Article IV Consultation", *IMF Country Report* No. 15/74; Coordinating Ministry for Maritime Affairs (2015), "Indonesia's Maritime Plans", www.iesingapore.gov.sg/~/media/IE%20Singapore/Files/Events/iAdvisory%20Series/Indonesia_29Apr15/320Indonesias20Maritime20vision.pdf; DBS (2015), "Indonesia Industry Focus: Indonesia Infrastructure".

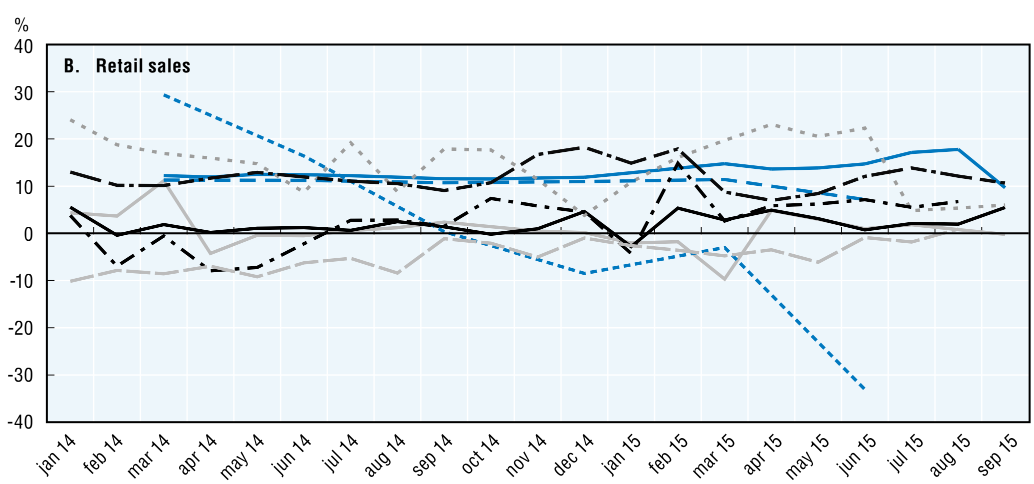
Malaysia was one of a few ASEAN countries to see a rise in real GDP growth in 2014, to 6% from 4.7% in 2013. Real growth moderated to a still respectable 5.6% in the first quarter of 2015 and declined to 4.9% in the second quarter. Growth has been driven by private consumption, which rose by 7.0% in 2014 and contributed more than half of the overall real growth through the first quarter of 2015. Robust employment growth, which has led to falling unemployment, along with rising wages and government transfers to households, have supported the strong consumption. Growth in 2014 was further boosted by a recovery in exports that led to the first positive contribution from net exports in four years. Exports have been boosted by rising sales of electrical products and increased shipments of oil and other commodities. In early 2015, exports of goods and services weakened noticeably and were down 3.7% YoY in the second quarter. Net exports made a negative contribution to overall growth in the first quarter of 2015. Declines in consumer and business confidence and in the index of leading indicators, which began in the fourth quarter of 2014 and continued into the second quarter of 2015, also suggest some moderation in growth. Private investment showed a similar weak trend in early 2015 due to political uncertainties and deteriorated business sentiment. Average industrial production growth (YoY) was lower in the first half of 2015 (5.4%) compared to the fourth quarter of 2014 (5.8%). Retail sales growth also decelerated to 7.2% in the second quarter of 2015, down from 11% in the last three months of 2014.

Figure 1.3. **Industrial production and retail sales in Asia**

Year-on-year percentage change



Source: CEIC; OECD (2015a), *Revisions Analysis Dataset-Infra-annual Indicators*, https://stats.oecd.org/Index.aspx?DataSetCode=MEI_ARCHIVE.

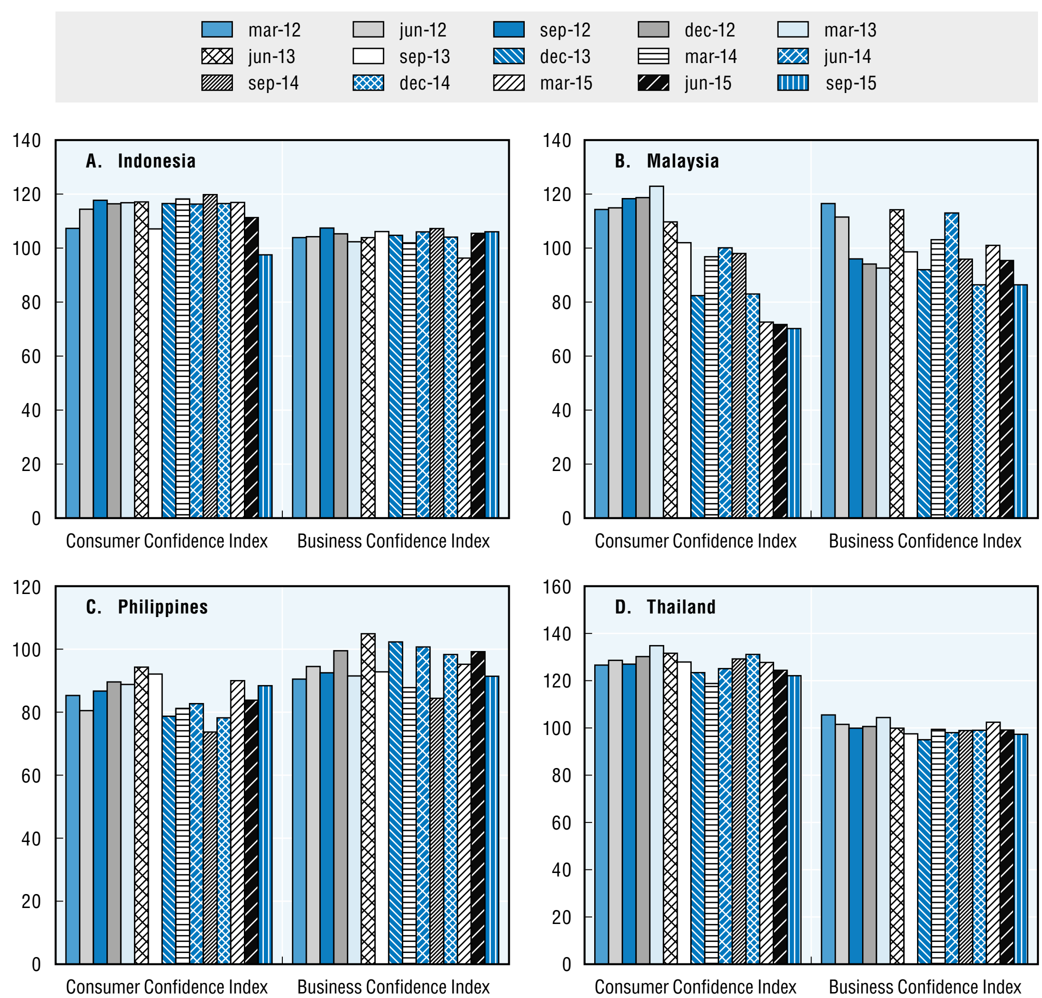


Source: CEIC.

StatLink http://dx.doi.org/10.1787/888933309417

After averaging 7.0% over 2012-13, real GDP growth in the **Philippines** fell to 6.1% in 2014 and declined further to 5.0% in the first quarter of 2015. Slowing government spending explains much of the deceleration in overall real growth. Public consumption expenditure contracted over the first three quarters of 2014 before recovering in the fourth quarter; and decelerating government investment expenditure led to a marked drop in overall investment growth, from 12.2% in 2013 to 6.8% in 2014. However, in the second quarter of 2015, the economy grew at an annual rate of 5.6% (YoY), up from 5% in the previous three-month period. While GDP growth has slowed in the Philippines, it remains one of the highest among the ASEAN-5 economies. Growth has been supported largely by domestic demand. Private consumption has been expanding steadily, driven by remittances from migrant workers. Public spending on infrastructure has picked up and private investment growth has strengthened due to increased FDI inflows. The high level of business confidence suggests continued strength in private investment. However, investor confidence could be adversely impacted by uncertainty surrounding the upcoming presidential elections in 2016.

Figure 1.4. **Business Sentiment Index and Consumer Confidence Index in selected ASEAN countries**



Note: All indices are adjusted to set 100 as the neutral confidence point.

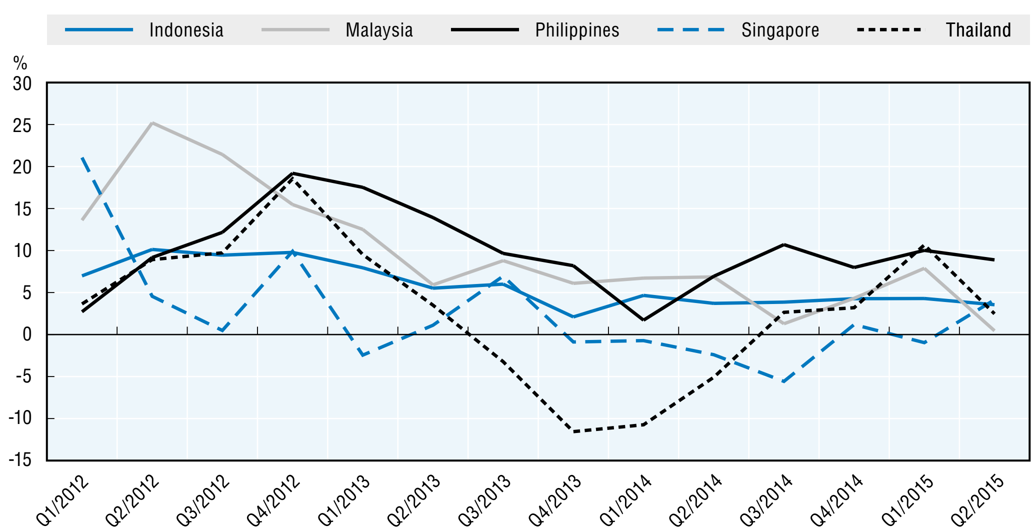
Source: CEIC.

StatLink http://dx.doi.org/10.1787/888933309429

Real growth in **Thailand** has been recovering from a downturn sparked by renewed political turmoil that began in late 2013. After contracting in the first quarter of 2014, real GDP growth resumed in the next three quarters to reach 0.9% growth for the year as a whole, despite virtually flat domestic demand. GDP growth accelerated further to 3.0% in the first quarter of 2015 due to the strong performance of public investment and exports of services. Fixed investment has undergone the biggest swing. It contracted by nearly 2.9% in 2014 as a whole, with legal controversies and street demonstrations pushing public investment down by more than 5%. Investment then rebounded in the first half of 2015 to contribute more than two-thirds of total growth for that period. Other indicators suggest that real GDP continued to recover in the first half of 2015 but that the pace weakened in the second quarter. Industrial production growth became positive (YoY) in February 2015 for the first time in two years, but turned negative afterwards. Retail sales recovered in December 2014, but remained below the level of a year earlier in the first half of 2015. Consumer confidence rebounded in mid-2014 but then levelled off and in early 2015 was still well below the peak achieved before the onset of the political turmoil. A more positive sign is the strong recovery in tourism arrivals that began in the summer of 2014 and continued into 2015. Overall, near-term prospects are for gradual recovery in real growth to levels that are likely to remain below potential for some time. Furthermore, the transition process to democracy poses risks that must be managed carefully.

Figure 1.5. **Fixed capital formation growth in selected ASEAN countries**

Year-on-year percentage change



Source: CEIC.

StatLink http://dx.doi.org/10.1787/888933309430

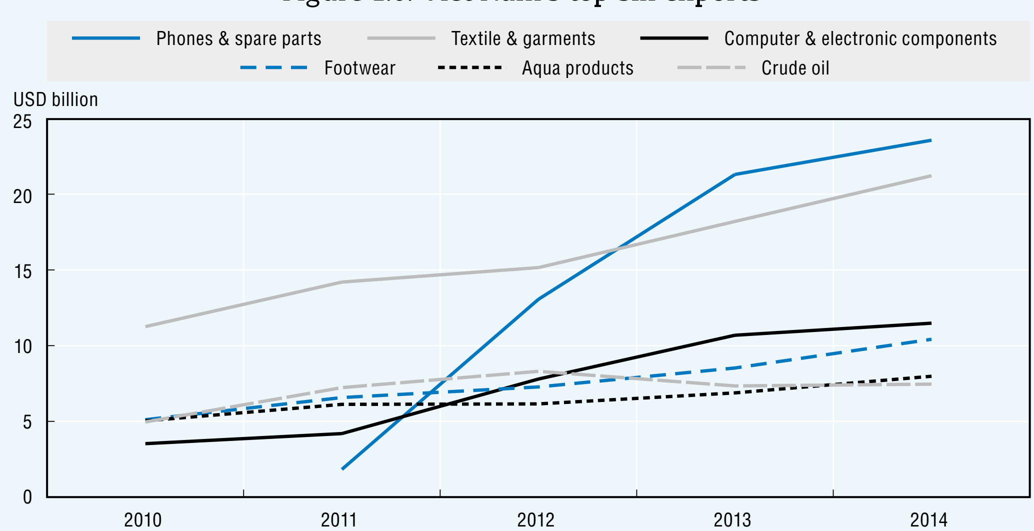
Real growth in **Viet Nam** rose to 6.0% in 2014 and accelerated further to 6.4% in the second quarter of 2015. Growth has been buoyed by accelerating activity in manufacturing and construction, which were up by 8.5% and 7.2%, respectively, in 2014. Growth in demand has been led by especially rapid growth in fixed investment, buoyed by strong FDI inflows, and by robust consumption. Together these components have accounted for most of the overall real growth, as very strong export growth has been more than offset by strong import growth (Box 1.2.). Strong industrial production and retail sales growth over the first half of 2015, along with an expansionary reading from the purchasing manager survey, suggest that real growth in the first half of 2015 sustained the pace of 2014. In general the performance of the private sector has improved with strong retail sales growth.

Box 1.2. Recent improvement in Viet Nam's economic performance

Viet Nam has recently shown increasingly strong economic performance. The economy grew by 6.5% YoY in the nine months from January to September 2015, according to the General Statistics Office of Viet Nam. Several elements contributed to the strong performance, including exports, the devaluation of the dong, monetary easing and the good performance of the private sector.

In 2014, exports grew by about 14% YoY. Exports increased by 9.6% during the first nine months of 2015 from the same period a year earlier, reaching USD 120.7 billion. The strong growth in exports was driven by the fast-growing manufacturing sector, led by clothing and apparel and by telecommunications. Most exports goods have come from sectors with large FDI, including telephones and components, which increased by 13.4% in 2014. While the textiles industry was long considered one of Viet Nam's main export industries, the electronics sector – including telecommunication devices such as telephones and information devices such as computers – has emerged as one of the country's major export areas (Figure 1.6). In the first nine months of 2015, minerals and manufacturing accounted for an estimated 45.9% of the total export turnover, followed by light industrial goods and handicrafts (39.6%). Main exported items include smart phones, computers, electronic devices, textiles and footwear. A surge in the manufacture and export of mobile phones by foreign-invested companies largely contributed to the country's strong exports. Exports increased to some of Viet Nam's major markets, including the United States, European Union, China and South Korea. Export turnover to the US, Viet Nam's largest export market, rose by 19.6% compared to the same period in 2014. Exports to the EU, China and South Korea also increased by 12.4%, 12.5% and 20.5% respectively. Further improvements in export performance are expected as a result of Viet Nam's participation in a number of free trade agreements, including the Trans-Pacific Partnership (TPP) and supporting government measures to simplify administrative procedures for foreign trade. In addition, following liberalising reforms, FDI flows to Viet Nam grew rapidly – from representing less than 1% of GDP through the 1980s to a high of 19% in 1994, followed by a drop after the 1997 Asian Financial Crisis

Figure 1.6. **Viet Nam's top six exports**



Source: CEIC.

StatLink http://dx.doi.org/10.1787/888933309440

Box 1.2. **Recent improvement in Viet Nam's economic performance** *(cont.)*

The several devaluations of the dong by the central bank in 2015 have also helped exports and contributed to growth, despite its potential burden on importers such as steel producers. In addition, the business environment has improved, supporting the good performance of the private sector. In January-September 2015, the number of new businesses and registered business capital increased by 29%, and registered capital by 31.4%, over the same period a year earlier, while the expected number of jobs in newly established enterprises grew by 25.7% compared to the same period in 2014, according to the General Statistics Office of Viet Nam. The business trend survey from 3 389 manufacturing enterprises reported a stable business and production situation for 43.5% of those surveyed, while 36.6% assessed the situation of business and production in the third quarter as more positive than in the second quarter. The economy has also benefitted from low inflation. Lower electricity costs and gasoline price cuts, which led to decreased transport prices, contributed to weak inflation in September, giving room to the central bank for further easing of monetary policy easing and continuation of an accommodative policy stance.

Real growth in **Singapore** – the most open economy and the one most dependent on services in the emerging Asian region – slowed to 2.9% in 2014 from 4.4% in 2013, and fell further to 2.8% and 1.8% in the first and second quarters of 2015 respectively. All of the major components of domestic demand slowed, while the contribution from net exports increased. Service sector growth continued to decline, falling to 3.3% for 2014 as a whole, slightly more than half the increase in 2013, with the strongest contributions from the finance, insurance and business services. Labour supply limitations and slowing productivity growth have constrained service sector growth. While overall activity slowed further in the first quarter of 2015, retail sales growth figures suggest some revival in private consumption, which is expected to be boosted by increases in government voucher payments to lower-income households and by higher subsidies for education. Together with a recovery in exports as external demand rebounds, and with increasing government spending focused on transport infrastructure and health, real growth into 2016 should be somewhat higher than in 2014. **Brunei Darussalam**'s real GDP contracted at -2.3% in 2014 due to a sharp decline in oil and gas output. In 2015, real GDP is expected to recover to -1.4%. The economy remains highly dependent on the oil and gas sector, which accounts for more than 60% of GDP. Falling oil and gas prices have negatively impacted government revenue and may push the budget into deficit this year. However the country is able to draw on its financial investments and reserves to smooth out temporary shortfalls. Consumer prices have continued to decline falling by 0.3% (YoY) in the first half of 2015.

The CLM countries continue to lead growth in the ASEAN region

The CLM countries continue to record the fastest growth in the ASEAN region. **Myanmar**'s real GDP is expected to reach 8.2% in 2015, the fastest pace in the Emerging Asia region, as the benefits of the country's political and economic opening become increasingly manifest. Growth has been buoyed by surging inflows of FDI, particularly into the garment sector, where an average of one new foreign-invested factory per week has been opening. Strong construction growth in the two major cities, surging tourist arrivals and rapidly expanding production and exports in the natural gas industry have further contributed to the strong growth. Manufacturing has also been boosted by increasing FDI inflows. The economy has benefitted from strong exports of natural gas over the last few years, but the prolonged decline in global prices could erode its fiscal and external positions. Real growth is likely to accelerate further in the near term as the effects of lower oil prices on real incomes come through. Other positive factors include the country's strengthening economic ties with the ASEAN region, continued development of the business sector and the budgeted fiscal expansion in FY 2015. However, prospects will also depend on Myanmar maintaining adequate control of rapidly rising credit and the development as well as the stability of the financial system (Box 1.3.). Major flooding and landslides in July and August 2015 displaced over a million people and caused more than 100 deaths. Aside from the human toll, the economic cost of this disaster will also be widely felt, with more than one million acres of fields submerged during the harvest season. This is likely to contribute to inflationary pressure as food supplies become strained. Political uncertainties surrounding the aftermath of the elections held in November 2015, and over a new constitution, pose some downside risks.

Box 1.3. **Mobilising financial resources for development in Myanmar**

Financial reform is one of the key challenges to sustaining growth momentum in Myanmar. The banking sector in particular has long been characterised by strict regulation, cumbersome loan procedures, high regulated interest rates and tight collateral requirements (OECD, 2013). Commercial loans are limited to a one-year term that is renewable, although longer-term loans of up to three years are available for certain purposes from the Myanmar Agricultural Development Bank and the Myanmar Small and Medium Industrial Development Bank (SMIDB). Until recently, commercial banks have been unable to process foreign exchange transactions, which prevented them from handling remittances. As a result of excessive regulation, a large informal banking system has emerged, creating additional risks.

Further efforts are required to strengthen the capability of the formal financial system: to extend outreach into the economy, to mobilise domestic savings and to offer a wider variety of products. Excessive regulations need to be trimmed, with less focus on regulatory limits and more on ensuring that financial institutions have the incentives and capabilities to operate in a financially prudent manner. Reforms of state-owned banks are required to convert them eventually into effective commercial entities. Recent reforms have allowed the entry of foreign banks, although they are currently prohibited from providing retail banking services. The nine foreign commercial banks that began operations in 2015 have a combined regulatory capital of 1 trillion kyat (or about USD 1 billion), bringing much needed capital into the domestic market. But the authorities must also put in place policies to prepare domestic banks for increased competition by upgrading regulatory and supervisory frameworks to allow banks to provide the more complex services and products that will be needed as the private sector develops.

Cambodia and Lao PDR registered real growth in 2014 of 7.0% and 7.4%, respectively, mildly slower than in 2013. The tourist industries in both countries were hit by declining arrivals from Thailand. Activity in **Cambodia** was further dampened by political tensions and labour unrest in the garment industry. These tensions depressed fixed investment in tourism and led to a drop in FDI inflows over 2014. Agricultural production remains subdued, with growth at 1.8% due to prolonged drought and flooding. The current account deficit, though still large, shrank to 12.5% of GDP in 2014 thanks to strong growth in exports of garments, footwear and milled rice. Prospects for real growth in late 2015 appear fairly good, given the easing of political and labour tensions and strong growth in exports of garments to the advanced economies. As long as domestic tensions remain subdued, FDI inflows should rebound, providing a further boost to growth. While growth momentum in **Lao PDR** slowed from 2014, it has remained strong at more than 7%, largely due to construction of major hydropower projects and an expansion of tourism. These large hydropower projects are expected to underpin growth over the near term due to their impact on the construction sector and on investment spending. Tourist arrivals grew by 11%, to 2 million, in the first half of 2015, helped by the construction of a new international airport in the south. Industry grew by 8.5% in 2014, supported by FDI in construction projects and in factories in special economic zones (Box 1.4.). Risk factors include a large fiscal deficit and weak agricultural growth due to the drought.

Box 1.4. **Special Economic Zones hold promise in promoting CLM development**

Special economic zones (SEZs) provide investors with preferential tax and regulatory treatment, often along with access to better connectivity, in a limited geographical area of a country. SEZs have a long history, but became particularly popular in Asia in the 1970s and 80s as a way of attracting investment. While these zones may represent a second-best alternative to broader reform to liberalise and improve the business environment, the SEZs may be more feasible politically. They provide testing grounds for gradual reform and can be used to foster clustering and economies of scale, including in the provision of infrastructure and services. The CLM countries are taking steps to establish more SEZs in an effort to boost growth and promote economic diversification. These zones have been established under specifically designed legal frameworks (Table 1.3). Investors in SEZs are offered tax breaks and other financial and regulatory incentives. Lao PDR has established ten SEZs across the country since 2003, each of which has attracted between USD 50 million and USD 1.6 billion in investment. Fifteen SEZs have been approved in Cambodia since they were first formally introduced in 2005. In Myanmar, in addition to 19 existing industrial zones and a further 7 under development, 3 larger SEZs are being established at Dawei, Tanintharyi Region; Kyauk Phyu, Rakhine State; and Thilawa, near Yangon.

Table 1.3. **Legal frameworks for SEZs in Cambodia, Lao PDR and Myanmar**

	Key elements of legal framework	Examples of incentives
Cambodia	• Sub-Decree No.147 on the Organisation and Functioning of the CDC (2005) • Sub-Decree No. 148 on the Establishment and Management of the Special Economic Zone (2005)	• Profit tax exemptions for nine years or a 40% special depreciation allowance • Income repatriation rights and investment guarantees
Lao PDR	• Law on Investment Promotion No.02/Na (2009) • Resolution of Standing Committee of the National Assembly on the Approval of the Decree on Special Economic Zone and Specific Economic Zone in the Lao PDR No.47/SC (2010) • Prime Minister's Decree on Special and Specific Economic Zone in the Lao PDR No.443/PM (2010); Approval on the Organisation and Administration of the Secretariat Office to Lao National Committee for Special Economic Zone No.01/NCSEZ (2010) • Decree on Implementation and Administration of the National Assembly Standing Committee for Special Economic Zone No.517/PM (2011) • Prime Minister's Decision on Roles and Function of NCSEZ No.34/PM (2012)	• Tax exemptions on equipment and raw materials for infrastructure construction • Reduced income and value-added taxes • Residency rights • Other promotion privileges indicated in laws and regulations • One-stop service in SEZs
Myanmar	• Special Economic Zone Law (2012) • Dawei Special Economic Zone Law (2011)	• Five-year tax holiday • 50% relief on income tax from overseas sales in the second five years • 50% relief on income tax from reinvestment obtained from export sales in third five years • Selected exemptions on customs duty

Note: Additional incentives are offered in some specific SEZs or for investments in specific sectors.
Source: Compiled by OECD Development Centre from national sources.

Box 1.4. **Special Economic Zones hold promise in promoting CLM development** (*cont.*)

Private firms have been active in developing SEZs in the CLM countries, helping to reduce burdens placed on public resources and to improve the efficiency of managing these spaces. Cambodia's SEZs have been developed by private firms, whose proposals are reviewed by the Cambodia Special Economic Zone Board and the Council for the Development of Cambodia. Lao PDR has pursued a mix of government- and private-led SEZ development strategies, with the government taking complete responsibility for the development of the Savan-Seno and Thakhek SEZs. The government is also working in co-operation with Chinese firms to develop the Golden Triangle SEZ, the Vientiane Industrial and Trade Area and the Saysetha Development Zone; the development of five other SEZs has been given entirely to Laotian or foreign firms, which have been granted long-term leases. SEZs in Myanmar are similarly being developed by both government and private firms. The Dawei and Kyauk Phyu zones are being developed by an Italian-Thai joint venture and a Singapore-led coalition, respectively, while the Thilawa Special Economic Zone is being developed jointly by the governments of Myanmar and Japan.

Good practices in SEZ policy include: equal treatment of foreign and local investors; provisions for catering to the domestic market and for purchasing from domestic suppliers in a way that is fair to the domestic market; open eligibility for benefits; labour policies consistent with international norms; and transparent and fair private zone development (OECD, 2014). Successful SEZs can attract investment and generate employment, though some potential government revenue may be lost to incentives for investments that would have been made regardless. By attracting foreign firms in new sectors, the zones can also be used to help boost workers' skills and the level of development. Ideally, strategies that prove successful in SEZs can be expanded to apply to the rest of the country, though adjustments – to tax and financial incentives in particular – may be needed to ensure that these policies do not place undue burdens on the government.

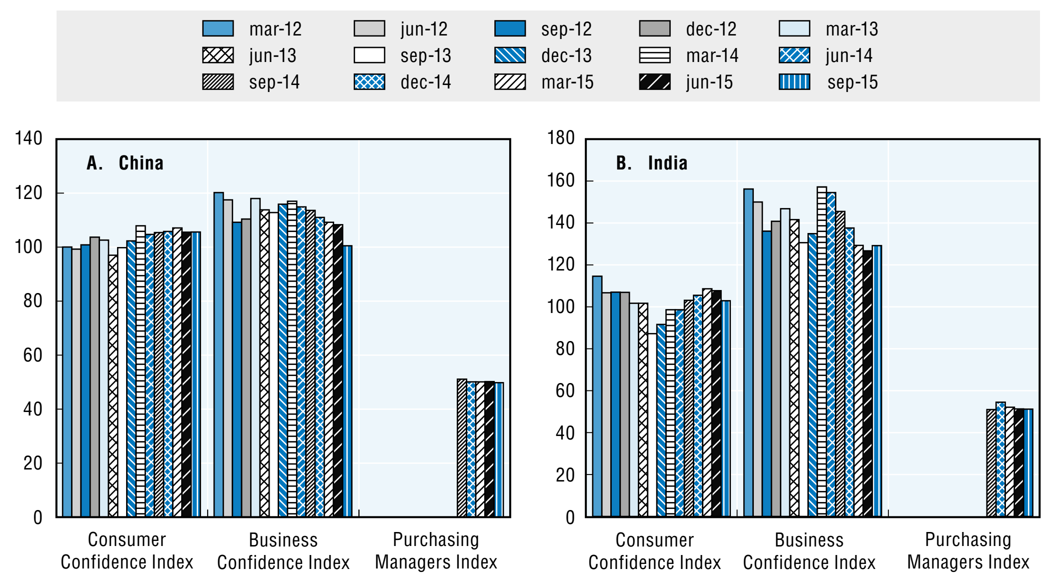
Source: OECD (2014), *OECD Investment Policy Reviews: Myanmar 2014*, http://dx.doi.org/10.1787/9789264206441-en.

The Chinese economy is slowing, while the Indian economy remains robust

Real GDP growth in **China** fell to 7.3% in 2014 from 7.7% in 2013 and dropped further to 7.0% in the first half of 2015. The slowing is a continuation of the longer adjustment toward a new normal that is increasingly reliant on services on the supply side, and on consumption relative to investment and exports on the demand side. The service sector grew by 8.1% in 2014, down slightly from 8.3% in 2013, and contributed more than half (63%) of total real GDP growth, while industry increased by 7.3% and was responsible for most of the job creation in urban areas (ADB, 2015). Private consumption, which grew by 7.5% in 2014, contributed more than half of total growth in that year and in the first half of 2015. Private consumption was buoyed by an 8% rise in household incomes in 2014, arising from robust increases in wages in both urban and rural areas and increases in government transfers. Rural wages rose more rapidly than those in urban areas for the fifth year in a row. In contrast to the relatively strong consumption performance, gross fixed investment (GFI) growth deteriorated. GFI increased by 7.2% for 2014 as a whole, compared to an average of just over 9% over the prior three years, and 12.2% over 2000-07. The weakening of investment growth has been most pronounced in the real estate sector, which is suffering from the reversal of the real estate bubble of prior years and a resulting oversupply, particular in smaller and medium-sized cities, as well as prudential and credit restraints applied by monetary authorities. Capital spending in industry has also been depressed by excess capacity in key sectors.

Economic indicators for the first half of 2015 suggest that GDP growth has levelled off, at least temporarily, due in part to policy interest rate declines and other measures taken by the government (see below). Real GDP growth in the second quarter, at 7.0%, was the same as in the first quarter. Industrial production continued to decelerate through April 2015, to 5.9% growth (YoY), but accelerated in May and June to reach a YoY increase of 6.8%. In the third quarter of 2015, the growth rate decelerated again, from 6.0% in July to 5.7% in September. Private consumption has remained robust, with growth in retail sales accelerating to an average of 13.8% during the first five months of 2015, compared to 11.7% growth in the fourth quarter of 2014. But fixed investment growth continued to decline through May 2015, led by the manufacturing and real estate sectors along with a milder deceleration in infrastructure investment. Overall, these trends suggest that real GDP growth will gradually decline from the pace of the first half of 2015 over the remainder of the year to record around 6.8 % for 2015 as a whole. Monetary and fiscal policies should accommodate the ongoing rebalancing of the economy. The announced infrastructure stimulus measures will help overall investment, but adjustments to excess capacity in several heavy industries are set to continue.

Figure 1.7. **Business Sentiment Index, Consumer Confidence Index and Purchasing Managers Index in China and India**



Note: Business Sentiment Index and Consumer Confidence Index are adjusted to set 100 as the neutral confidence point; Purchasing Managers Index sets neutral point to be 50.

Source: CEIC; Markit Economics (2015), *Purchasing Managers Index* (database), www.markiteconomics.com/Survey/Page.mvc/PressReleases

StatLink http://dx.doi.org/10.1787/888933309454

Real growth in **India** has steadily increased since 2011 and is expected to reach 7.2% in 2015, exceeding China's growth rate. The current account deficit is widening due mainly to increasing machinery imports, but is largely financed by rising FDI inflows. The surge in services activity – nearly half of India's total growth is attributable to services – has been led by the financial sector, which was buoyed by the government's "financial inclusion" reform to extend bank accounts and other financial services to poorer households (see Chapter 6, structural policy country notes). Private consumption grew by 6.3% in 2014 and contributed more than half of total GDP growth in that year and in the first quarter of 2015. Consumption growth has been buoyed by improving employment performance, strong consumer confidence and, more recently, falling oil and other commodity prices. Budget, administrative and legal bottlenecks continue to hamper investment despite some recent easing under the government of Narendra Modi. Public investment has picked up, partly due to key infrastructure projects.

Forward-looking indicators suggest that real growth in India will remain strong but stable in the near term. Industrial production accelerated in the first quarter of 2015, rising by 3.3% YoY from 2.0% in the fourth quarter of 2014, and this growth momentum continued into the second quarter (3.3%). Domestic orders rose during the first quarter of 2015 and automobile sales increased over the first half, although export orders peaked in February 2015 and then fell back over the following three months. Purchasing managers' indices continued to point to expansion, although the index for manufacturing showed little net change over the first half of 2015. Further structural reforms are critical to keep the growth momentum. In particular, public investment in energy, transport and social projects is critical (Box 1.5.).

Box 1.5. **Structural reforms in taxation and land management in India**

The Modi government came to power in May 2014 with an ambitious agenda of economic reforms. These included mesures for, among others, domestic and foreign investment promotion, job creation, food security, education and skills development, infrastructure, water governance and improving competitiveness, particularly in manufacturing. Implementation of reforms was always going to be challenging in India's federal structure, with its strict separation of powers between the centre and local governments. After almost 18 months in power, the government's attempted reforms in the key areas of taxation and land management are still being debated.

Reforming the **tax system** by replacing the complex system of indirect taxes with a comprehensive value-added tax (VAT) has been considered for more than 20 years (Chelliah et al., 1992). The problems associated with the current system are well known. Separate taxes on production are levied by the centre (federal excise) and states (state sales tax), resulting in the cascading of rates that bias production decisions and hinder inter-state trade. Reforms are therefore required to simplify the tax structure by rationalising the indirect taxes while preserving the fiscal autonomy of the states.

To address these issues, a dual Goods and Services Tax (GST) model has been proposed consisting of a central government component (CGST) and a state component (SGST), to be administered separately. These would replace various taxes currently levied by the centre and the states, such as the service tax, the VAT, the entertainment tax, the luxury tax, the state cesses, various surcharges and other levies including the central sales tax levied on inter-state transactions. Taxation of inter-state and cross-border transactions would now be determined by the Integrated GST (IGST) model. Under this model, inter-state transactions in goods and services would be subject to the central and state GST. An inter-state seller would pay the IGST on value additions after adjusting for credits of the IGST, CGST and SGST paid on purchases. The centre then acts as a clearing house, receiving tax credits from the exporting state and transferring them to the importing state as per the destination principle.

Replacing the current complex system of indirect taxation with a comprehensive value-added tax would greatly reduce compliance costs. Goods and services will be treated in the same manner, eliminating the need to distinguish between the two. Imports will be taxed at the same rate as domestic goods, ensuring neutrality of incentives. Indian domestic manufacturing will thus be promoted without the need to resort to protectionist policies. The transfer of input tax credits through the value chain incentivises tax compliance by traders.

Box 1.5. **Structural reforms in taxation and land management in India** (*cont.*)

Passage of the GST bill through parliament is complicated as it requires approval of a constitutional amendment with a two-thirds majority. Even after this is achieved, approval will be required from state parliaments, and this can be contentious. A key concern is the trade-off between simplicity of taxation and fiscal autonomy for the states. For example, requiring identical SGST rates would keep compliance costs low but reduce autonomy for the states. This consideration has been taken into account in the design of the GST, which grants the states a narrow band over and above the floor rates of the SGST. The bill also includes a provision for the centre to compensate the states for up to five years for any loss of revenue. Achieving a consensus, however, requires overcoming a trust deficit between the centre and the states.

The **acquisition of land** has been a long-running problem in India even as attempts have been made to balance the rights of agricultural labourers and landholders by enabling access to large tracts of land for infrastructure and industrial projects. For most of India's history, the acquisition of land was governed by the colonial era Land Acquisition Act of 1894 (amended in 1962 and 1984). This act allowed the government to compulsorily acquire land for public purposes or for companies if the land owners were fairly compensated. Due to the complexity of acquiring land, the corporate sector became dependent on the government's use of eminent domain to provide it with inexpensive land for large-scale commercial projects intended to generate jobs. However this system was abused by successive governments, who seized land from farmers, had it rezoned and then sold it on to property developers at several multiples of the value at which it was acquired. Original owners of the land were thus prone to litigate in order to receive higher compensation (Singh, 2012).

In an attempt to better balance the competing interest in the system, the Congress Party government in 2013 passed the Right to Fair Compensation and Transparency in Land Acquisition, Rehabilitation and Resettlement Act (LARR). This act required the state to obtain the consent of 70% to 80% of affected families, including property owners as well as those losing their livelihood, before acquiring land. It also mandated social impact assessments when rezoning land from agriculture to other uses. Compensation rates were raised to four times the market price for rural land and twice the market price for urban land, and included generous resettlement and rehabilitation packages for the displaced.

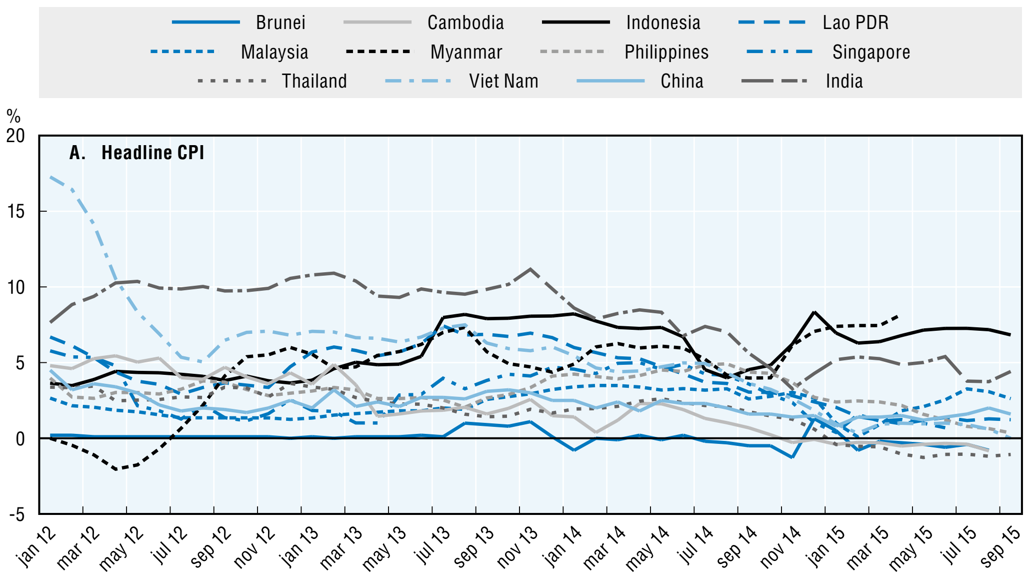
Source: Chelliah, R.J. et al. (1992), *Final Report of the Tax Reforms Committee*, Indian Ministry of Development; Singh, R. (2012). "Inefficiency and abuse of compulsory land acquisition: an enquiry into the way forward".

The scope for macroeconomic policy support has increased with falling inflation

Inflation rates in the Emerging Asia region have continued to decline, and in many cases had reached their lowest levels in several years by mid-2015, when headline inflation rates became negative on a YoY basis in Brunei Darussalam, Singapore and Thailand and were just above zero in Cambodia, Lao PDR and Viet Nam (Figure 1.8).

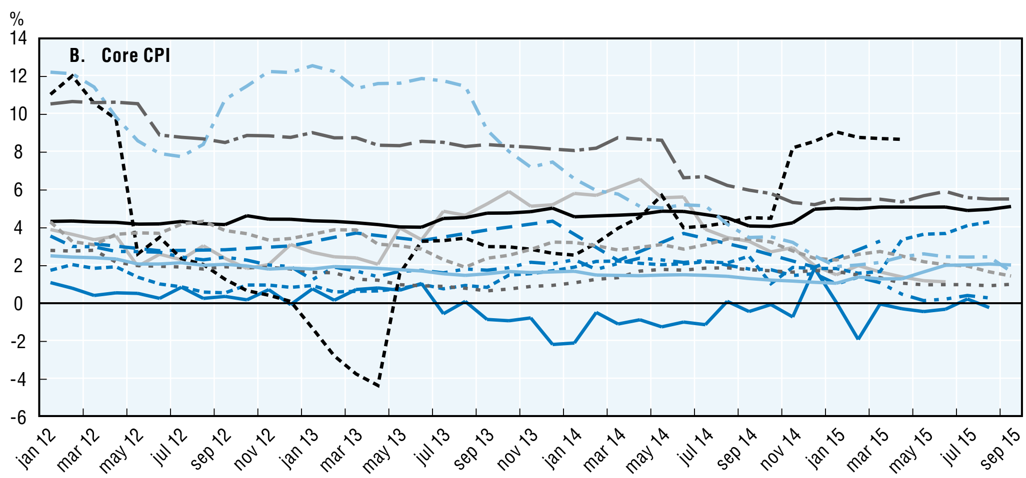
Figure 1.8. **Consumer price inflation in Emerging Asia**

Year-on-year percentage change



Note: Data of Cambodia refer only to inflation registered in Phnom Penh.

Source: CEIC.



Note: For Cambodia data refer to inflation as registered in Phnom Penh. For Brunei core inflation refers to the weighted average of prices on Non-Food & -Non Alcoholic beverages and Non-Housing, -Water, -Electricity, -Gas & -Other Fuels and Non-Transport consumer prices. For Cambodia core inflation refers to weighted average of Non-Food & -Non Alcoholic beverages and Non-Housing & -Utilities and Non-Transportation consumer prices. For Lao PDR core inflation refers to weighted average of Non-Food & -Non Alcoholic beverages and Non-Housing, -Water, -Light, & -Fuel Charges and Non-Transport & -Communications consumer prices. For Malaysia core inflation refers to weighted average of Non-Food & -Non Alcoholic beverages, Non-Housing, -Water, -Electricity, -Gas & -Other Fuels and Non-Transport consumer prices. For Myanmar core inflation refers to simple average of Non-Food and Non-Fuel & -Light and Non-Conveyance consumer prices. For Viet Nam core inflation refers to weighted average of Non-Food & -Foodstuffs and Non-Transportation consumer prices. For China the index of core inflation refers to same period of previous year=100 and it is the simple average of non-food (excluding transport & telecommunications) consumer prices. For India core inflation refers to weighted average of Non-Food & -Beverages & -Tobacco, Non-Fuel & -Light and Non-Transport & -Communication consumer prices.

Source: CEIC.

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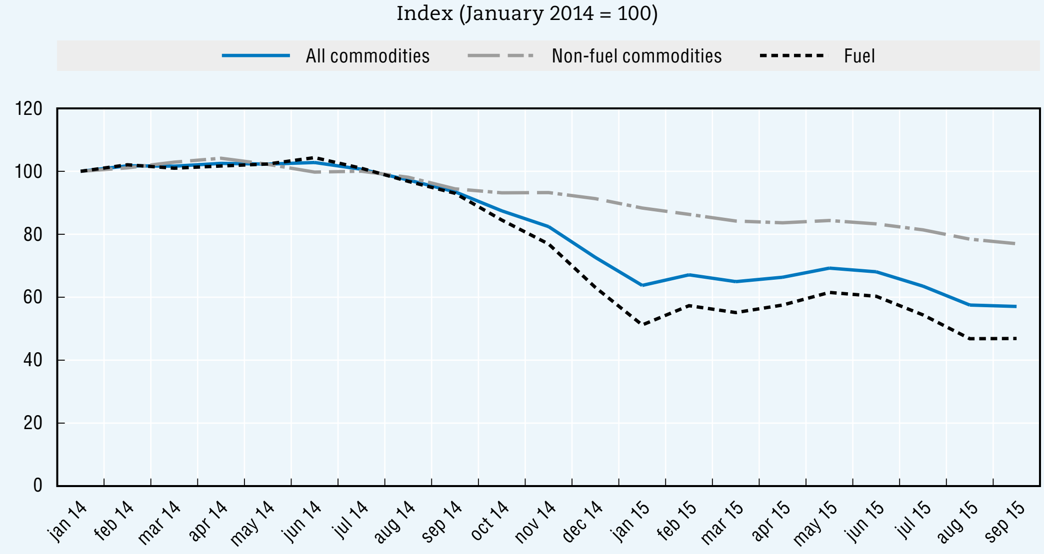
Headline inflation rates have been buffeted by a number of temporary pressures. Falling world prices of oil and some food and other commodities put downward pressures on CPI inflation in the latter months of 2014 and first half of 2015 (Box 1.6). The rebound in headline inflation in India and Indonesia beginning in the third quarter of 2014 largely reflects the effects of higher fuel and other subsidised commodities due to the reduction or elimination of subsidies and price supports. However, core inflation rates have shown more consistent declines. Core inflation in India has remained fairly stable at about 5% YoY, while there has been only a mild increase in core inflation in Indonesia. The declines in inflation in India, Singapore, Thailand, Viet Nam and Indonesia represent a continuation of longer and largely successful monetary restraint to bring inflation rates down to more desirable levels. There has, however, been a significant increase in both headline and core inflation in Myanmar, driven by rapid economic growth and surging credit growth.

Box 1.6. **Lower commodity prices in Emerging Asia**

Commodity prices in Emerging Asia declined by 44% between June 2014 and September 2015, dragged down by the drop in fuel prices in particular (Figure 1.9). The Brent Crude price fell from USD 115.19 per barrel at the end of June 2014 to a low of USD 45.87 in mid-September 2015, though most of the drop took place in the second half of 2014. Supply factors have contributed to the sustained oil price decline – among them, OPEC's November 2014 decision not to cut production in response to the shock – although the accompanying general decline in non-fuel commodity prices suggests that weak demand has also played a role. Oil prices are expected to rise in the medium and longer term, though they may not reach the same levels seen in the pre-crisis period, as growing demand is not expected to greatly exceed expanded supply (OECD, 2015).

Figure 1.9. **Global commodity price indices**

Index (January 2014 = 100)



Note: Non-fuel commodities price index includes food and beverages and industrial inputs. The fuel price index includes crude oil (petroleum), natural gas and coal price indices.

Source: IMF (2015), *Primary Commodity Price Data*, www.imf.org/external/np/res/commod/index.aspx.

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Box 1.6. **Lower commodity prices in Emerging Asia** (*cont.*)

These shocks have contributed to low inflationary pressures, particularly in oil-importing countries. The consequences for inflation of fluctuating oil prices have typically varied with country-specific factors, including its importance in consumption baskets, which would suggest a more significant impact in countries that are more intensive consumers of energy, and petroleum in particular, such as Singapore. Energy subsidies can also affect the pass-through of global oil prices.

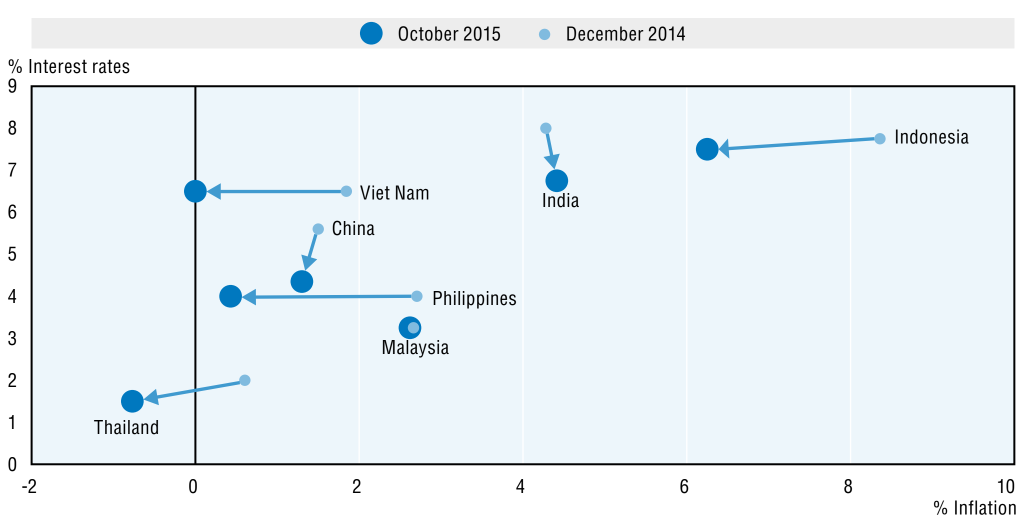
The broader consequences of lower commodity prices have varied across countries. The Emerging Asian countries that are net oil importers – all but Malaysia and Brunei Darussalam – have in general benefitted from improved terms of trade, with several seeing improved current account positions. Others in the region have also seen negative impacts in export revenues to varying degrees as a result of depressed prices for agricultural and mineral commodities.

Source: IMF (2015), *Primary Commodity Price Data*, International Monetary Fund, Washington, D.C., www.imf.org/external/np/res/commod/index.aspx; OECD (2015), *OECD Economic Outlook*, http://dx.doi.org/10.1787/eco_outlook-v2015-1-en.

The fall in inflation has led countries in the region to ease monetary policy or switch to a more neutral stance. Over the first nine months of 2015, Malaysia, the Philippines and Viet Nam left policy rates unchanged. Indonesia lowered its interest by 25 basis points in February 2015 but has since left the rate unchanged due to a resurgence of inflation. Thailand lowered its policy interest rates twice during March and April from 2% to 1.5%. India has engaged in monetary easing since the beginning of 2015 as economic prospects worsened. The central bank has lowered its benchmark repurchase rate from 8% to 6.75%, including a 50 basis point drop in September which is most significant (Figure 1.10). The People's Bank of China reduced its base lending rate six times, from 6.0% in November 2014 to 4.35% in October 2015. Despite the declines in policy rates, bank credit and money supply growth moderated in most countries, except Myanmar, due largely to the softening in demand (Figure 1.11).

Figure 1.10. **Evolution of inflation and policy interest rates in Emerging Asia**

Annual percentage change



Note: Inflation refers to headline inflation. Inflation data for Malaysia and India refer to September 2015.

Source: CEIC and national sources.

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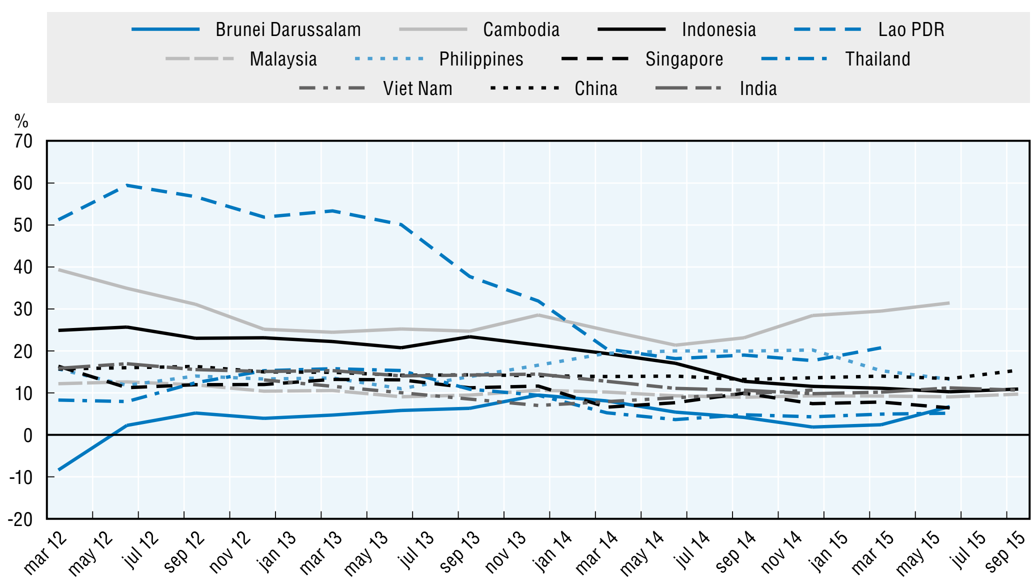
With inflation now at more acceptable levels, most countries should have some room for further easing of monetary policy in the event of unexpected negative shocks to real growth in the near term. The strengthening of monetary policy frameworks in much of the region over the past ten years has most likely helped to improve the clarity and credibility of commitments to contain inflation. This commitment was demonstrated by the rapid response of central banks in Indonesia, Malaysia, the Philippines and Lao PDR to signs that inflation pressure might be rising. The new monetary policy framework adopted by India in February 2015, which explicitly requires the central bank to pursue price stability while also taking into account real growth, is an improvement from the previous approach in which policy goals and responses to economic developments were less clear. The scope for further easing of monetary policy is probably limited in India and Indonesia, given that core inflation is still at or above 5%. The need to contain growth in credit to the real estate sector in China, particularly from non-bank lenders (the "shadow banking" sector), and the rapid growth in credit and declines in international reserves in Lao PDR are also likely to constrain the ability of monetary policy to stimulate real growth.

Figure 1.11. **Average credit growth in Emerging Asia**

Year-on-year percentage change



Note: Credit growth for Viet Nam is based on combined outstanding loans in Hanoi and Ho Chi Minh City.
Source: CEIC.
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Moderate fiscal stimulus efforts have been made recently

Slowing rates of growth and adverse external conditions have recently motivated several governments in Emerging Asia to implement fiscal stimulus measures, including through investment in infrastructure. In September 2015, the Thai government announced a number of stimulus measures with a combined value of USD 3.8 billion to be made over the last three months of 2015. These measures include the use of state agencies' investment budgets, short-term stimulus through repair and construction by *tambons* (local government units), other spending on small investment projects and other spending from the previous fiscal year's investment budget. Targeted spending, intended to boost growth to meet targets, would exceed that made over the same period last year (see Chapter 6, structural policy country note).

The government of China similarly authorised state-affiliated financial institutions to lend up to 300 billion yuan (USD 47.2 billion) to speed work on regional infrastructure projects for a period beginning in October and lasting until the end of 2015. Additional measures have been announced to promote growth in general and in struggling sectors, such as cuts to minimum down payments for first-time homebuyers in many cities in an effort to bolster the sluggish property market.

Malaysia's stimulus programme, on the other hand, targets the private sector. Prime Minister Najib Razak announced in September that the state equity investment firm ValueCap would invest 20 billion ringgit (USD 4.6 billion) in undervalued firms, targeting stocks most severely affected by recent difficulties. The country's main sovereign wealth fund soon followed suit by injecting more money into Malaysian financial markets. Manufacturers were also temporarily exempted from import duties on inputs unable to be sourced locally until the economy recovers, to promote growth and help compensate for the currency's weakening.

The governor of the Bank of Indonesia, Agus Martowardojo, announced in August that steps would be taken to optimise allocated spending in the budget in order to provide fiscal stimulus following earlier delays in disbursements. A range of structural reforms and fiscal measures have recently been announced to improve Indonesia's business environment and promote faster growth. Stimulus measures also include tax reforms, with value-added taxes removed for a number of transportation sectors.

Slowing export growth has contributed to a reduction in current account surpluses

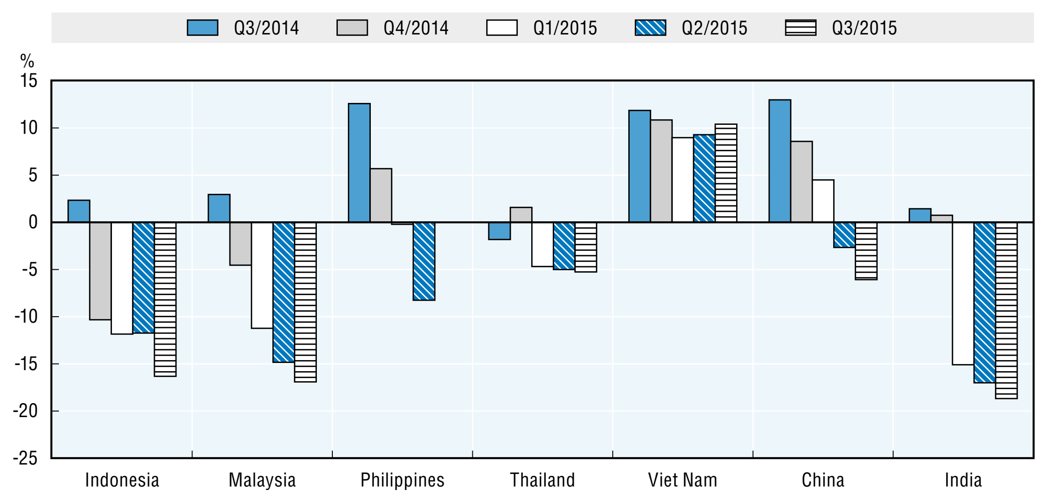
Exports of the Emerging Asian region in 2014 continued the pattern of the prior two years, with China, India, and the middle and upper income ASEAN countries recording much weaker export growth compared to the years just prior to and in the wake of the global financial crisis; while export growth of the CLMV countries (CLM plus Viet Nam) has remained considerably more robust. Merchandise exports of the ASEAN region as whole rose by 1.4% (in nominal terms) in 2014, by 2.3% in India, and by 6.1% in China. Average export growth in ASEAN and the other two countries over 2012-14 has been well below the pace of 2010-11 and the several years prior to the global financial crisis. This trend continued in 2015 as all ASEAN-5 countries except Viet Nam reported export contractions in the first three quarters. In Q3 2015, merchandise exports of Indonesia contracted by 16.3%, Malaysia exports contracted by 16.9%, and Thailand exports contracted by 5.3%, while the latest Q2 data indicate that exports of the Philippines also decreased by 8.3% compared to the same period one year ago. China and India are no exception with -6.1% and -18.7% export growth in Q3, falling from positive growth in 2014. Against strong headwinds, Viet Nam has maintained its export momentum and has achieved 9.0%, 9.3% and 10.4% export growth in the first three quarters of 2015 respectively, thanks in part to sustained inflows of FDI. The export slowdown in real terms has been as noticeable. Real exports of goods and services fell by 0.75% in India in 2014. They rose by 5.1% in China, the slowest rate since 2010 and, less than half the average rate over the prior decade. Real goods and services exports also slowed noticeably in Indonesia, Singapore, and Thailand, although there was a moderate pickup in growth in Malaysia and comparatively strong growth in the Philippines. The slowing in export growth in these countries has been paralleled by a marked slowing in the growth of imports of goods and services. In contrast, all the CLMV countries achieved double-digit growth in 2014 in (nominal) merchandise exports as well as, in Myanmar and Viet Nam, real exports of goods and services.

Much of the slowing in Emerging Asia's export growth can be attributed to the deceleration of demand from OECD economies and China. The slowing of real growth in the OECD region has particularly hit demand for electronics, automobiles and other products. Such demand tends to be relatively pro-cyclical, and these products are comparatively more important in the export mix of China and the middle- and upper-income ASEAN countries. Export growth in the region has also been depressed by two other factors. First, the increased importance of consumption as a driver of real growth tends to dampen growth in demand for imported products, since consumption is on average less import-intensive than either investment or exports (which, in the region, are heavy users of imported parts). In addition, the elaboration of regional supply chains has slowed ("maturation"), leading to a deceleration in trade in manufactured parts within Emerging Asia and with other Asian countries.

There is little sign yet of any substantial pickup in export growth in the region. Exports were generally still down on a YoY basis in the first three quarters of 2015 in much of Emerging Asia. (Figure 1.12) Exports should revive gradually with the expected improvement of growth in the OECD economies. However the growth of exports and imports is likely to remain low for some time compared with most of this and the prior decade.

Figure 1.12. **Export growth in Emerging Asia**

Year-on-year percentage change



Source: CEIC.

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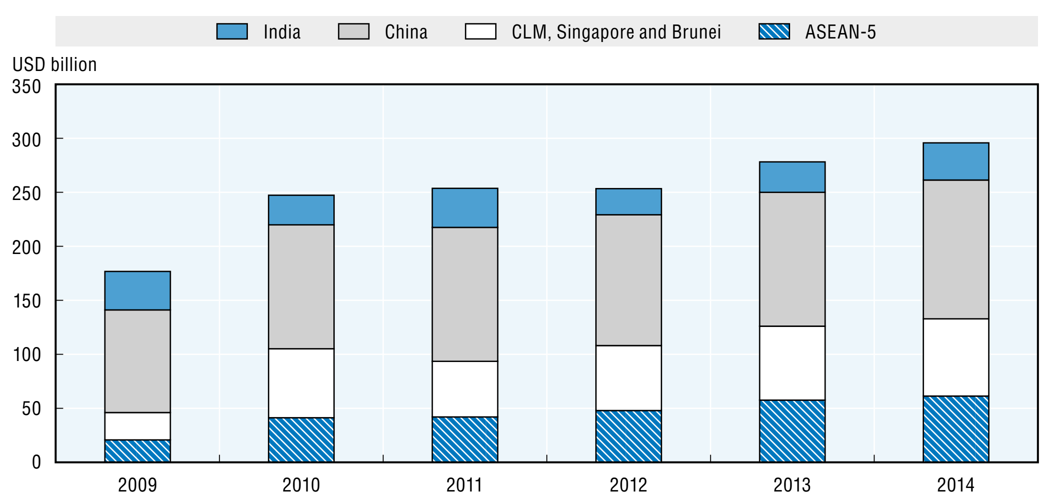
Current accounts in the Emerging Asia region and most of its individual countries continue to be in surplus, although their size relative to GDP has been noticeably lower than during 2010-11 and prior to the global financial crisis. The surplus for the ASEAN region as a whole was 1.6% of GDP in 2014 with all the middle- and upper-income countries except Indonesia recording surpluses, while the CLMV countries except for Viet Nam recorded deficits. Although moderately lower in 2014 than in 2013, the deficits of Cambodia and Lao PDR remain at unsustainable levels. China's surplus also rose slightly from 2.0% to 2.1% of GDP, while India's deficit fell from 1.7% to 1.3% of GDP. The general decline in the region's current account surplus is partly a reflection of the greater importance of consumption in demand growth, leading to a modest fall in national savings relative to domestic investment.

Financial capital inflows have weakened with increased international risk sensitivity and prospective monetary tightening in the US

Capital inflows into Asian and other emerging economies have been slowing since early 2014 due to slower near-term growth prospects, anticipation of monetary tightening in the United States and increased risk sensitivity of international investors in the wake of the Greek financial crisis. Inflows into Emerging Asia have held up somewhat better than in some other regions (notably emerging Europe), and the slowdown has been concentrated in financial capital flows more than FDI.

Direct investment inflows to Emerging Asia continued to rise in 2014, albeit at a somewhat slower rate than in 2013 (Figure 1.13). Inflows into Emerging Asia as a whole increased by 6.3% in 2014, while inflow into the ASEAN region rose by 5.4%. Most individual countries recorded increases, with the exception of Brunei and Malaysia, where inflows into the energy sector were depressed by falling oil prices, and Thailand and Cambodia. Indonesia and Lao PDR recorded the strongest increases, of 66% and 68.9% respectively, while India and Indonesia saw still impressive increases of 22% and 20%, respectively. Growth in FDI inflows into China and Singapore was still modestly positive in 2014, although the pace has been declining over the past several years. Available data for the first quarter of 2015 indicate that positive FDI inflows have resumed in Thailand and that inflows into India and Singapore are running at near or above their pace of 2014, while those into the Philippines and Viet Nam have decelerated.

Figure 1.13. **FDI inflows in Emerging Asia**



Source: UNCTAD (2015), *UNCTADstat*, http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx?sCS_ChosenLang=en.

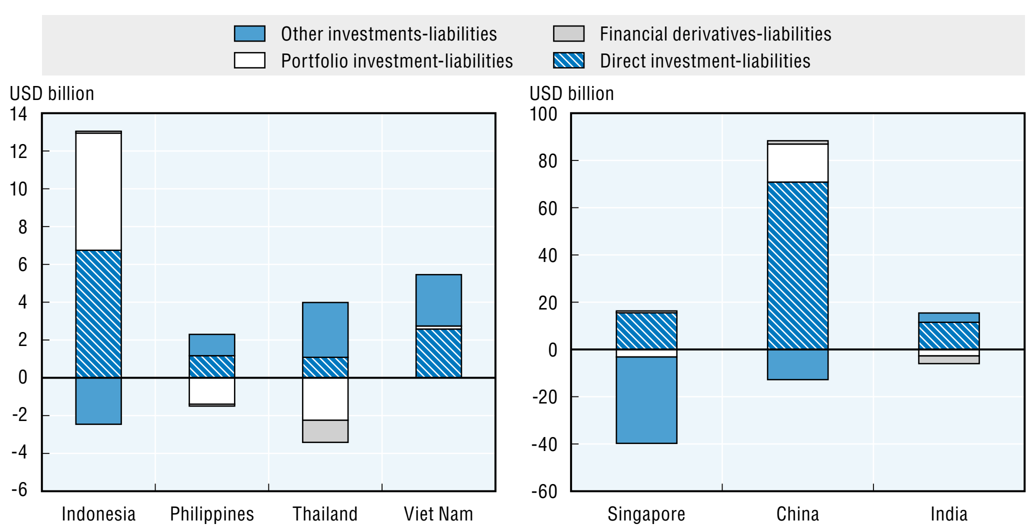
StatLink http://dx.doi.org/10.1787/888933309511

Direct investment into a number of countries in the region has been buoyed by improved perceptions about their economic prospects and by reforms to improve business climates. Moody's sovereign debt ratings of the Philippines and Viet Nam were both upgraded one notch in 2014 (to Baa2 and B1, respectively). Rankings in the World Economic Forum Global Competitiveness Index improved for the majority of ASEAN countries in the latest assessment (2014-15). Among international investors, the reputation of India has been buoyed by the Modi administration's announcement of its extensive economic reform agenda, while the status of the Philippines has improved with greater political stability and a reinvigorated economic reform programme.

Steps being taken in a number of countries to liberalise terms for foreign investments and to partially open up previously restricted sectors have improved incentives for FDI. India's government raised the ceiling on the share of foreign investment in a company to 100% in infrastructure and construction development and to 49% in defence industries (with the possibility of a higher share on a case-by-case basis); the government has also proposed allowing foreign investment in the insurance industry. Viet Nam adopted a law in November 2014 to allow foreigners to purchase real estate, including residences, beginning in July 2015. The newly enacted Investment and Enterprise Law relaxes and streamlines regulations on domestic companies, including those with foreign participation. In the Philippines, liberalisation of foreign participation in the banking sector is likely to encourage further foreign investment in that sector. The planned expansion of special economic zones (SEZs) in Lao PDR and the forthcoming liberalisation of capital controls in some SEZs in China should also improve the climate for FDI in those countries.

Financial capital net inflows into Emerging Asia (net purchases of equities and bonds, and lending by banks and by non-bank institutions) have fallen noticeably, especially in the first half of 2015, mainly for China and a number of ASEAN countries. These inflows are particularly sensitive to fluctuations in investor risk sensitivities, which have risen in the wake of the Greek debt crisis in Europe, uncertainties over the timing and pace of monetary tightening in the United States and, more recently, the stock market crash in China. After reviving somewhat in the first quarter of 2015, portfolio inflows for the region as a whole (equities and bonds) fell back in the second quarter. Slower growth, a narrowing of the interest rate differential with the United States, and diminished confidence that the currency will steadily appreciate following the widening of the permissible bands for the renminbi's fluctuation, have helped spark a marked acceleration in net financial capital outflows from China: capital outflows other than FDI rose to USD 209 billion in the first quarter of 2015 from USD 168 billion in the previous quarter. However, despite the recent deceleration in financial inflows into the region as a whole, foreign holdings of local currency bonds have continued to rise, particularly in Indonesia, where the foreign-owned share reached 39.6% in June 2015 (Figure 1.15).

Figure 1.14. **Breakdown of capital inflows to Emerging Asia, Q2 2015**



Source: CEIC.

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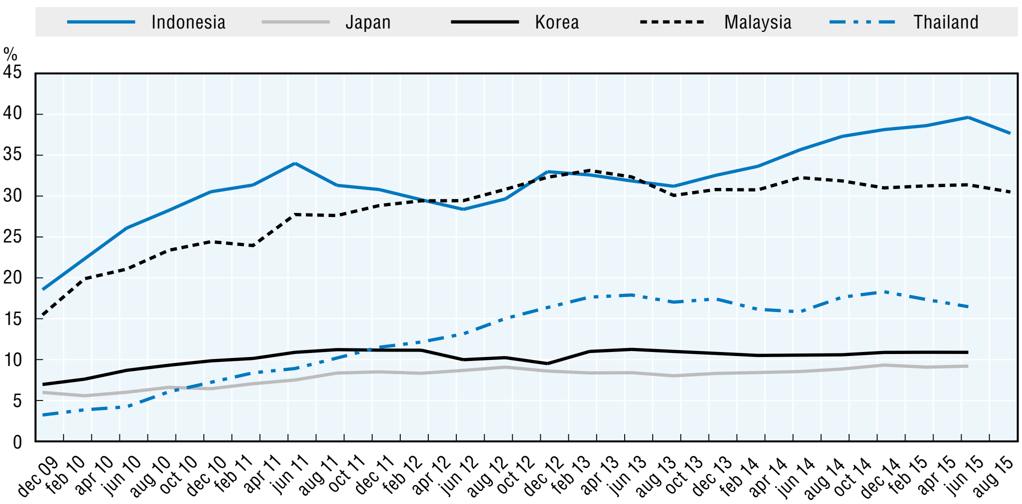
Figure 1.15. **Foreign holdings in local currency government bonds for selected Asian countries**

Percentage of total local currency government bonds

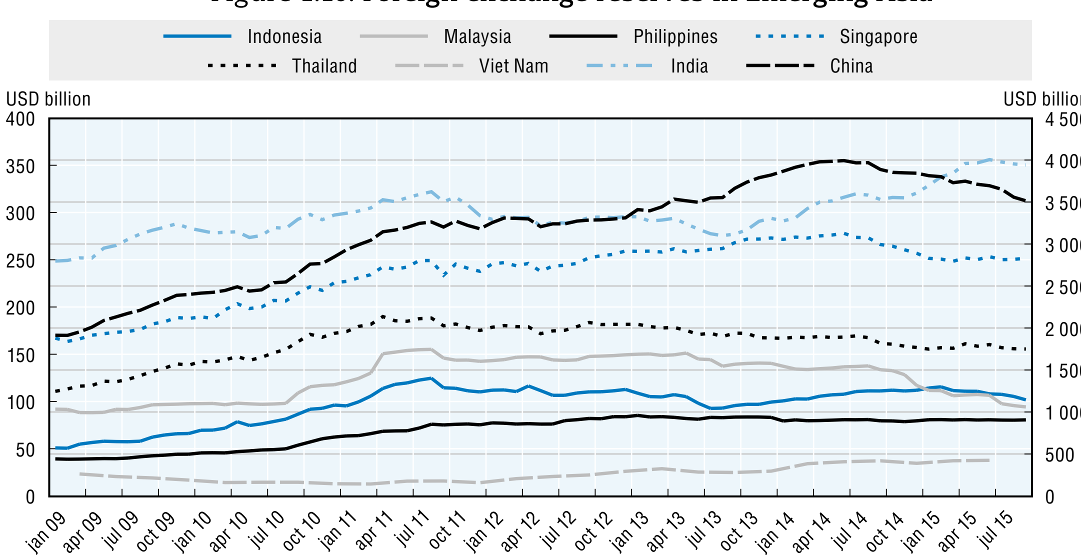


Source: ADB (2015), *AsianBondsOnline*, https://asianbondsonline.adb.org/index.php.

StatLink http://dx.doi.org/10.1787/888933309533

As a result of the narrowing of current account surpluses and tapering financial inflows, balance of payments positions deteriorated moderately in 2014 and the first half of 2015 in China and most of the ASEAN countries. This deterioration is reflected in a significant fall in international reserves for China, Malaysia and Singapore, milder drops for Thailand and Indonesia, and the levelling off of reserve accumulation in the Philippines and Viet Nam (Figure 1.16). India has been a noticeable exception: international reserves have increased by nearly 21% since the end of 2013, driven by the surge in FDI inflows and the narrowing of the current account deficit. Even where they have fallen, reserves remain at comfortable levels relative to imports and by international standards in China and the middle- and upper-income ASEAN countries. Reserves are less ample in Lao PDR (about 1.3 months of imports) and Viet Nam (3 months), and in India they are lower relative to imports compared to past historical standards.

Figure 1.16. **Foreign exchange reserves in Emerging Asia**



Note: Data for China correspond to right-hand side axis.

Source: CEIC.

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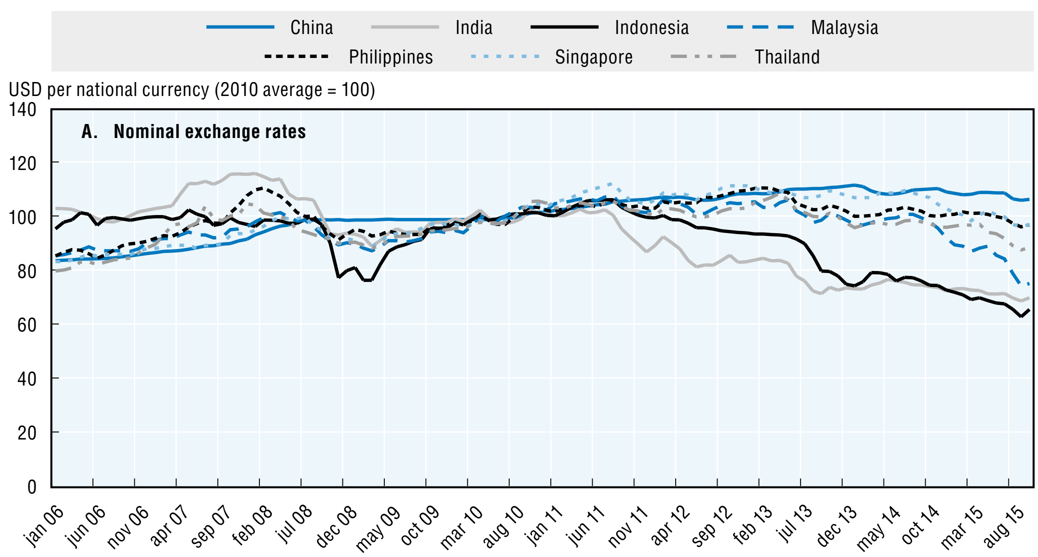
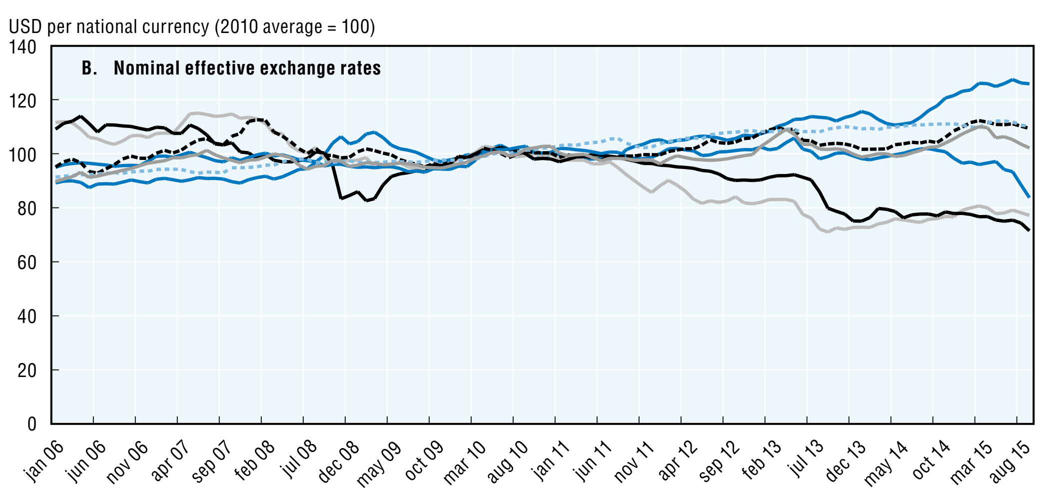
Currency exchange rates of the ASEAN countries and India continued to weaken in the first half of 2015, continuing the generally downward trend that has been underway since mid-2013 and that represents a departure from the appreciating trend over most of 2009-11 (Figure 1.17). After appreciating moderately from 2009 through 2013, the Chinese renminbi levelled off against the dollar over the first three quarters of 2014 and appreciated slightly in the first half of 2015. However, the renminbi subsequently has fallen sharply amid slowing economic growth, a sharp decline in exports, and the announcement by the People's Bank of China in August 2015 of a depreciation in the currency. The announcement was followed by depreciations of most other currencies in the Emerging Asian region. The Chinese government has since refrained from further depreciation, resulting in a calming of markets' concerns. By the end of October, most currencies in Emerging Asia have recovered to pre-August levels, except for the Malaysian ringgit.

Figure 1.17. **Nominal exchange rates and nominal effective exchange rates in Emerging Asia**



Source: CEIC.



Source: BIS (2015), *BIS Statistics*, www.bis.org/statistics/eer.htm.

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Exchange rate movements against a currency basket more representative of a country's trade (effective exchange rates) show a somewhat different pattern than their movements against the dollar. The trend is more diverse as the nominal effective exchange rates of countries such as China, the Philippines and Thailand have been on the rise between 2011 and 2014 while currencies of India, Indonesia and Malaysia have been depreciating in effective terms. China's effective exchange rate, notably, was nearly 10% higher in nominal terms in June 2015 compared to January 2014 and about 6.5% higher in real terms, due largely to depreciation of the euro against the dollar.

Financial markets have generally displayed resilience

Financial markets in the region have exhibited considerable resilience in the face of uncertainties arising from slowing growth in China, political tensions in some other countries, the timing of monetary policy tightening in the United States and the Euro area difficulties. The beginning of the expected tapering and, in some cases, reversal of capital inflows seems to have occurred with at most limited disruption to domestic financial markets and foreign exchange markets.

Box 1.7. **China's stock market volatility**

Beginning 12 June 2015 stock prices on the two major China exchanges, Shanghai and Shenzhen, began a three week crash. At the trough, on 8 July, the Shanghai composite index had fallen by nearly 32% and the Shenzhen composite index by 40%. The combined market capitalisation of the exchanges dropped by nearly USD 3 trillion. The decline was easily the sharpest drop recorded on the China exchange, or those of other major Asian exchanges, for more than a decade. In response to a series of actions by the authorities, stock prices rebounded from the trough by about 18% by the last week of July 2015 but were still well below their peak although above their level at the beginning of 2015.

In retrospect, the "crash" can be seen as a partial reversal of a classic speculative "bubble" over the previous year. After languishing with virtually no net growth since 2011, stock prices on the Shanghai and Shenzhen exchanges more than doubled between May 2014 and June 2015, far outstripping stock prices in the rest of Asia and despite clear signs of slowing growth of the Chinese economy and measures being taken by the authorities to cool speculation in real estate markets. There were several signs during the boom that prices were reaching unsustainable levels. Stock prices reached 70 times earnings at the peak, far above those in other markets, where P/E ratios average around 18. Companies whose shares are traded both on a Chinese exchange and in Hong Kong, China (H shares) saw the prices of their domestic (A) shares soar to nearly twice that of their equivalent Hong Kong share. Margin buying increased nearly five-fold between mid-2014 and mid-2015, with margin debt reaching 12% of all tradeable shares and nearly 3.5% of China's GDP – a nearly unprecedented level, even compared to the peaks of past bubbles in other countries. Despite the spectacular fall, the major stock price indices in the last week of July 2015 were still well above their levels in mid-2014.

The crash has highlighted the fact that despite impressive development over the past two decades, particularly in infrastructure and the regulatory framework, China's stock markets remain subject to some serious structural weaknesses. The market remains overwhelmingly dominated by retail investors with limited knowledge and capabilities to assess company fundamentals. Institutional investors, which typically have much better capabilities for assessing valuations and which play a key role in more advanced markets, are at an early stage of development and play a very limited role in China's stock markets. Authorities' tools to curb the margin trading that was driving the bubble proved to be woefully inadequate, in part because much of the financing was coming from non-bank funds that are outside the regulatory net.

Box 1.7. **China's stock market volatility** *(cont.)*

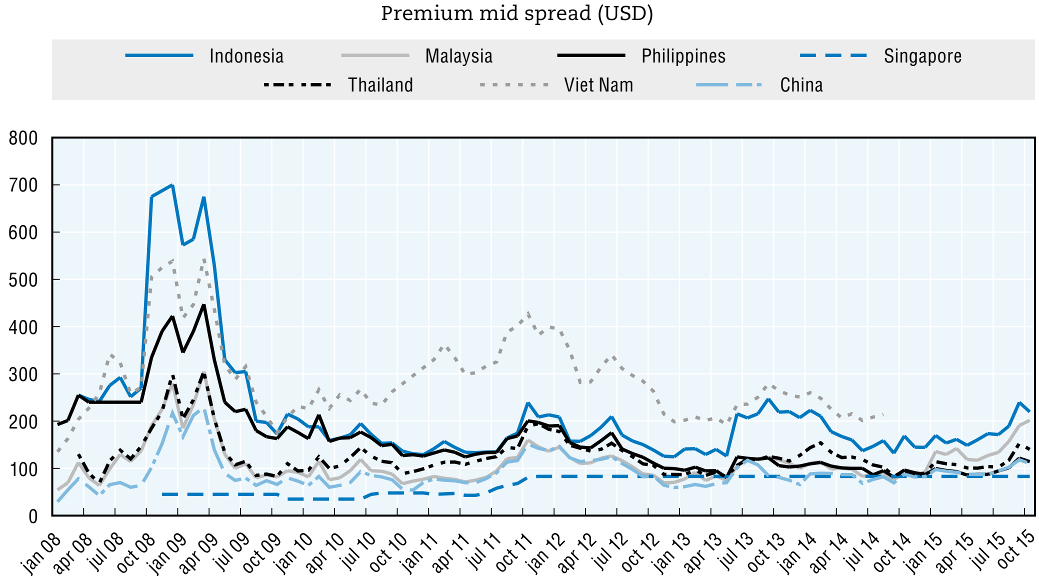
To stabilise the markets, Chinese authorities took a number of unusual steps including: a temporary ban on new initial public offerings; limits on short selling; and a temporary freeze on trading of nearly half the stocks listed on the exchanges. Collateral requirements which had been tightened during the boom were substantially relaxed to limit forced sales and to encourage purchases. In addition, the central bank lent RMB 260 billion (about USD 42 billion) to 21 brokerage firms to finance stock purchases and large pension funds and insurance companies (all of which are state owned) also increased their stock purchases. To further bolster confidence, the government announced a RMB 40 billion fiscal stimulus package in July, mainly comprising medium-term loans to state-owned banks to encourage financial support to weak parts of the economy.

Given the severity of the stock market crash and the potential damage posed to the broader economy, such extraordinary steps are understandable but they could pose some future risks. Direct interventions by the government in the markets could encourage perceptions that the government can "control" stock prices and that it will prevent large scale losses (moral hazard). Several past government interventions (if less drastic) during periods of market weakening have probably added to this risk. The changes in regulatory policies made to support the markets, although temporary and taken under extraordinary circumstances, are likely to create more uncertainty about how regulatory policies will be applied in the future.

Credit default swap (CDS) rates on sovereign debt have generally declined since 2013 (Figure 1.18). The rate for China's debt has remained among the lowest in the Emerging Asia region. The CDS rates of Indonesia and Thailand trended downward over most of 2014; in Thailand this largely reversed the run-up in the rate in the months prior to the May 2014 military takeover. Malaysia's rate also fell during 2014, although it rose again in January 2015 on concerns about the financial health of the state investment fund, 1Malaysia Development Berhad. The CDS rate for Viet Nam, although still the highest in the region, has also trended downward since the beginning of 2014. Sovereign debt yields have also been falling, and in Indonesia and Thailand were more than 1 percentage point lower in May 2015 than in January 2014.

Figure 1.18. **Credit default swap premiums in Emerging Asia**

Premium mid spread (USD)



Source: Datastream.

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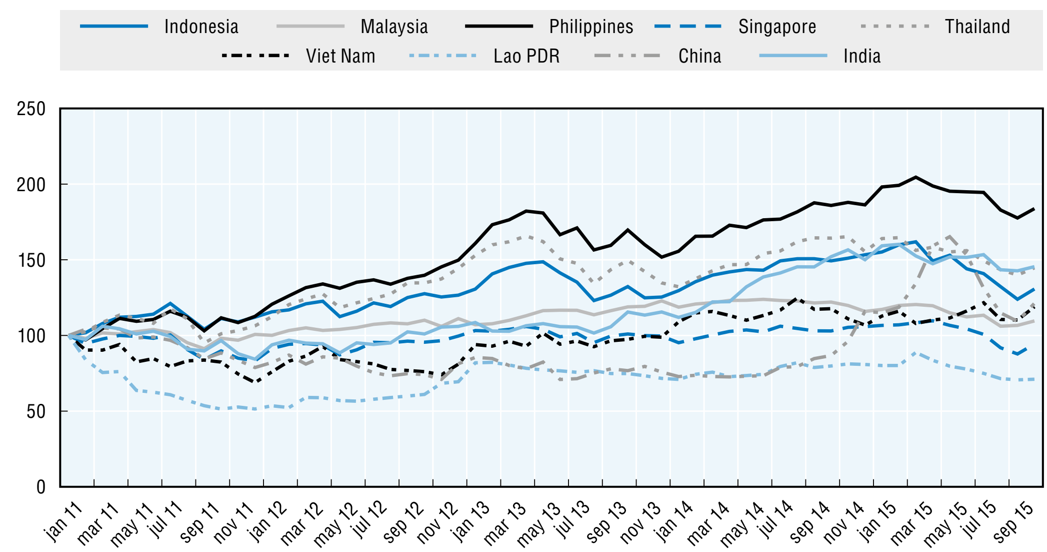
With the notable exception of China, stock prices in most countries either levelled off or weakened in 2014 as real growth slowed and softened further in the first half of 2015. However, the crash in China's stock markets in the first half of 2015 did not lead to any extended sell-offs in other regional markets. The declines in the major stock indices in India and the ASEAN countries between the peak and the trough of the China crash do not appear out of line with trends in the several months prior to that crash (Figure 1.19).

Figure 1.19. **Stock indices in Emerging Asia**

Index (January 2011 = 100)



Note: Data for Indonesia refer to Jakarta Composite Index, for Malaysia refer to Bursa Malaysia Composite Index, for Philippines refer to PSE Index, for Singapore refer to Strait Times Index, for Thailand refer to SET Index, for Viet Nam refer to HCMC Index, for Lao PDR refer to LSE Index, for China refer to Shanghai Composite Index, and for India refer to BSE Sensitive Index.

Source: CEIC.

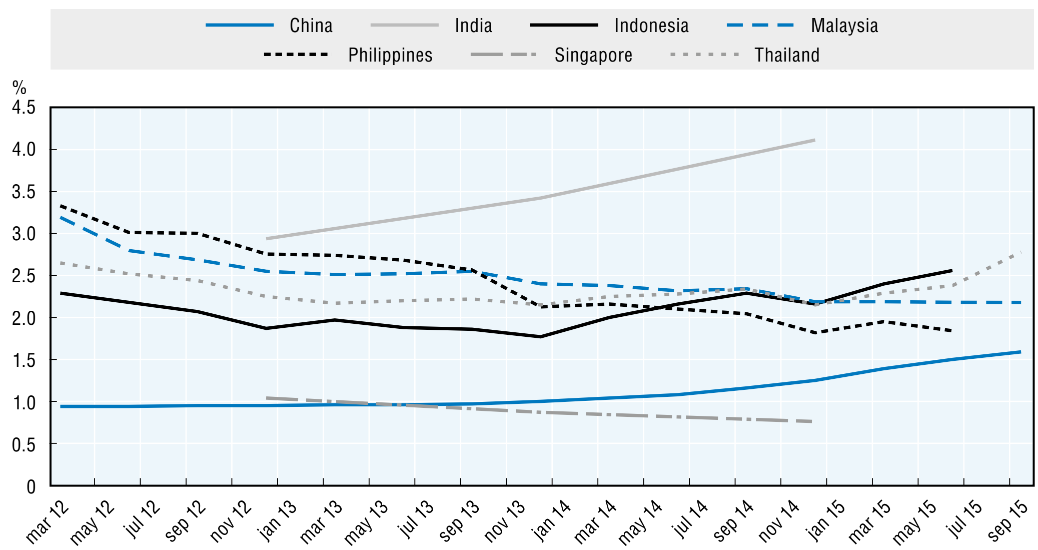
StatLink http://dx.doi.org/10.1787/888933309574

Generally sound, and in many cases improved, financial and macroeconomic fundamentals have helped to sustain the resilience of regional financial markets. Low inflation, reduced fiscal deficits, and moderate domestic and external government debt ratios in most cases have likely reduced the risk that upswings in international risk sensitivity will affect regional financial markets. The ongoing development of domestic financial markets and increased exchange rate flexibility in Indonesia and a number of other countries also have helped reduce vulnerability to external financial shocks.

Non-performing loan (NPL) rates in the ASEAN 5 have come down since 2010 and the rate in China has remained comparatively low, at about 1% (Figure 1.20). The Philippines has experienced the most significant improvement with the NPL rate dropping by almost half from 3.3% in early 2012 to 1.8% in June 2015. During the same period, Malaysia and Singapore have improved as well by reducing their NPL rates from 3.2% and 1% to 2.2% and 0.8% respectively. In Thailand and Indonesia, the percentage of non-performing loans to total loans fell in 2013 but the trend has been reversed since 2014, leading instead to a slight increase by 2015. Despite a relatively low NPL rate, China's situation actually worsened as its NPL share has grown from 1% in 2012 to 1.6% in September 2015. For India, the NPL rate has increased by 1% in the past three years although it is still below 5% in the aggregate for all banks. Banking indicators in some of the CLMV countries are less favourable, however. The large NPLs of state-owned banks in Viet Nam continue to be a major policy challenge. The Vietnam Asset Management Company acquired nearly USD 5.9 billion of NPLs in 2014. The precise modalities for disposing of the assets have yet to be determined and the authorities are having to deal with further risks posed by cross-holdings between banks and non-bank financial institutions (ADB, 2015).

Figure 1.20. **Non-performing loans in Emerging Asia**

Percentage of total gross loans



Note: Data refer to loans of commercial banks.

Source: CEIC.

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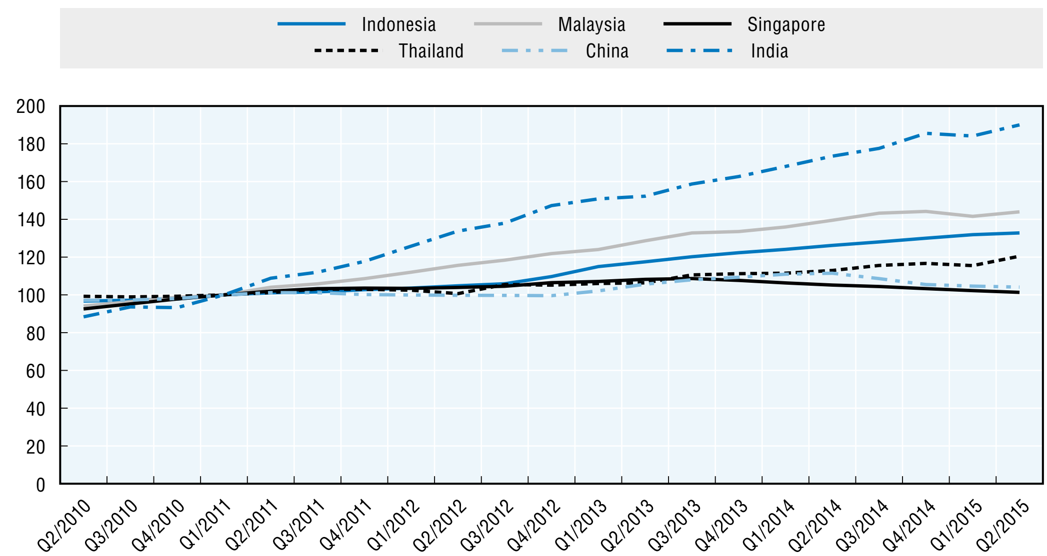
Some financial developments will need to be monitored

Despite the generally favourable financial fundamentals, several trends that could pose future risks bear watching. Financial development in Cambodia and Lao PDR has been driving very rapid expansion in domestic credit, which increased by over 30% in Cambodia in FY 2013. Controlling credit growth in both countries is greatly complicated by the extensive dollarisation of the economy. Ensuring that the credit expansion supports productive uses and does not lead to speculative excesses in real estate or other sectors will pose challenges to the prudential authorities in these countries. The likely rapid development of Myanmar's financial system over the next several years may well pose similar challenges.

Housing prices in India have been rising exceptionally quickly and more than doubled between 2010 and the first half of 2015 (Figure 1.21). Prices in Malaysia have increased by 57% over the same period. Rising incomes and the growing middle class are at least partly responsible for the increases. In India, however, substantial funds hidden from the tax authorities ("black money") are thought to have been invested in real estate and may be accentuating the property price boom. In these countries, and elsewhere in the region as necessary, the exposure of financial institutions to property markets and the adequacy of prudential requirements for real estate transactions will need ongoing monitoring by prudential authorities.

Figure 1.21. **Housing price indices in Emerging Asia**

Index (Q1 2011 = 100)



Source: Datastream.

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Emerging Asia has shared in the worldwide trend toward rising household and corporate debt ratios since the global financial crisis. In most countries in the region, the ratios are still below those found many advanced countries. However the household debt ratios in Malaysia and Thailand reached 141% and 126% of average household income, respectively, higher than levels before the financial crisis and above the ratio for the United States (MGI, 2015). Singapore's household debt has been rising more rapidly than did household debt in the United States in the several years prior to the crisis.

Medium-term growth prospects

According to the MPF-2016, real GDP growth rates of the Emerging Asia region are projected to be moderate, somewhat below the rates recorded during 2011-13 and in the several years prior to the global financial crisis but remaining robust in the medium term. The projections reflect the shift in longer-term prospects for India versus China. India's growth is projected to move above that of China, to become one of the most rapidly growing economies in the region. Growth in India is projected to average 7.3% annually over 2016-20 – more than 0.5 percentage point higher than the rate projected in the Outlook 2015. China's growth is projected to continue to slow to under 7%, its slowest medium-term pace since the beginning of the reform period in 1980. The slowing is largely due to the deceleration in productivity growth that has become increasingly evident and that occurs naturally as the development process matures. The CLMV countries are expected to lead growth in ASEAN, with Myanmar in first place, while the Philippines and Viet Nam will be the growth leaders among the ASEAN-5.

Box 1.8. **Key assumptions of the medium-term outlook to 2020**

- The output gap – the gap between actual and potential GDP – will converge to zero by 2020.
- Inflation-targeting countries will continue to pursue stability and to adjust monetary policies to support their targets.
- Regional economic integration initiatives and projects will advance at the same pace as before.
- The five-year plan of Emerging Asia countries will largely be implemented, subject to budgetary and other policy considerations (see Chapter 6).
- Unanticipated economic events and other external factors will not significantly alter the situation beyond the cut-off date.
- The cut-off date of data for projections is 2 November 2015. For more detailed information on the MPF, see www.oecd.org/dev/asia-pacific/mpf.htm.

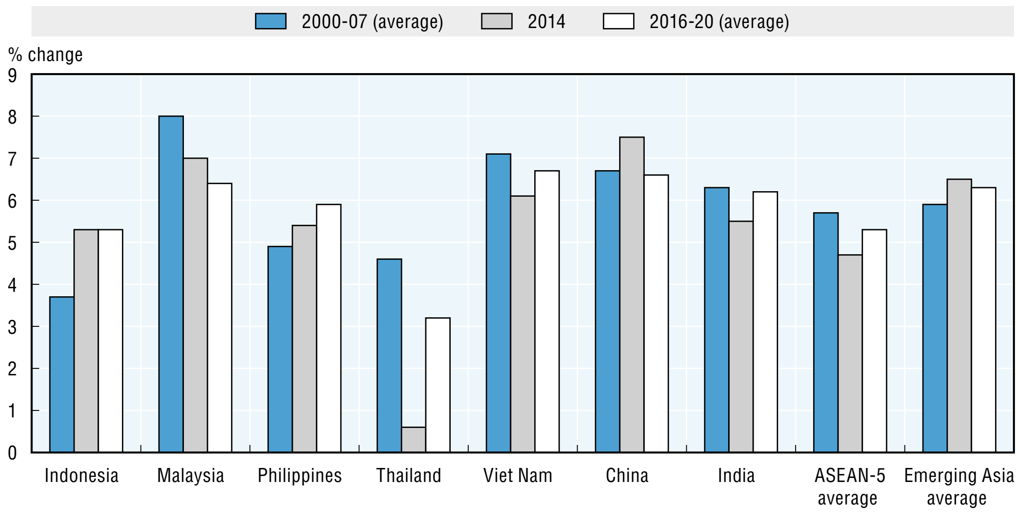
These growth outlooks are predicated on reasonable success in implementing reforms specified in the countries' medium-term development plans and other official commitments. This dependence poses both upside and downside risks to the outlooks. A key challenge in China is to improve resource allocation by allowing market forces greater scope and by improving the incentives and capabilities of economic actors to respond to those forces. Sufficient progress in meeting this challenge could partially mitigate the slowing in productivity growth. Conversely, substantial delay or failure in planned economic reforms, which for India, Myanmar and some other ASEAN countries are more ambitious than have been attempted in some time, could push their growth outcomes below those now projected. At the regional level, growth performances could benefit more than the projections imply from the opportunities arising from the ongoing creation of the ASEAN Economic Community.

The shift toward consumption-led growth will become increasingly apparent

The medium-term projections reflect the growing importance of consumption in driving real growth in the region. Consumption will contribute at least half of overall GDP growth in China and India, as well as in most of the ASEAN-5 countries and Viet Nam. Consumption growth over 2016-20 is projected to be faster than in the years prior to the global financial crisis (2000-07) in Indonesia, the Philippines and Emerging Asia as a whole, but somewhat lower in Malaysia, Thailand, Viet Nam, China and India. The growing reliance on consumption is a noticeable departure from past trends for those countries, which historically have relied heavily on fixed investment to drive growth.

Consumption growth will be supported by continuation of the rising trends in employment and wages. Employment growth is likely to accelerate somewhat as aggregate real growth recovers and labour slack is absorbed, particularly in Indonesia and the Philippines, where unemployment rates are still relatively high. Wages in the Asian developing region have been rising steadily, well above the pace in developing countries. Manufacturing wages in China have been rising particularly rapidly, averaging nearly 13.3% over 2012-14. Wage growth in India and the ASEAN countries has been more subdued: wage growth lagged behind productivity growth in the first two years after the global financial crisis but has picked up since 2011 (ILO, 2015). Wages have been boosted by increases in minimum wages, or their introduction or extension, in Thailand in 2013 and in Malaysia and Viet Nam. The rapid rise in wages in China will create further incentives to shift production to lower-wage countries in the Emerging Asia region and create further upward pressures on their wages.

Figure 1.22. **Private consumption in the ASEAN-5, China and India**



Note: The cut-off date for data is 2 November 2015. Weighted averages are used for the ASEAN and Emerging Asia averages.

Source: OECD Development Centre, MPF-2016.

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The acceleration of growth in rural wages in a number of Emerging Asia countries, if it continues, should provide a boost to consumption as poorer rural households tend to have relatively high propensities to consume. While rural wages are affected by fluctuations in crop prices, they are also being driven by longer-term trends of declining growth in rural work forces (due to declining fertility) and rising wages in manufacturing (Wiggins and Keats, 2014). As noted earlier, rural wage growth has exceeded urban wage growth in China for the past six years. Rural wages have accelerated in India since 2006 and have also picked up in the Philippines for workers engaged in rice cultivation, although not for those working in the sugar cane sector. Household income growth will be further supported by increasing demand for higher-paid skilled labour as countries move up the value chain into more technology-intensive industries, and with the development of information technology (IT) and other sophisticated services.

The degree to which robust consumption growth is sustained in the medium term will depend significantly on government policies. Policies to improve education and training and other reforms to better align labour market skills with industry needs and to raise human capital will help to improve the overall utilisation of labour and its productivity. Extensive reforms in these areas have become a key priority of development plans, especially in the ASEAN region (see the structural policy country notes in Chapter 6). Policies to facilitate the movement of rural workers to higher productivity jobs in urban areas will also help to boost household income growth.

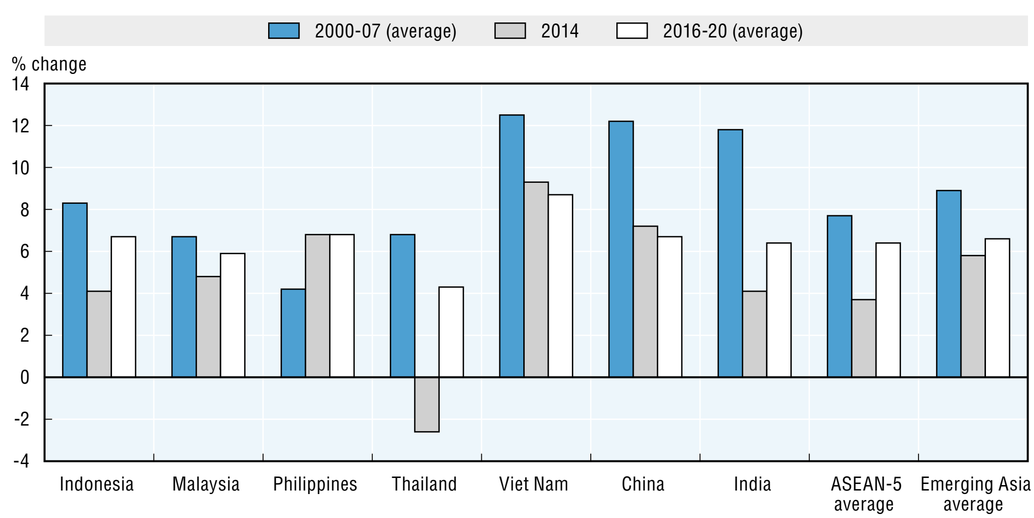
China's plans to relax residency requirements (hukou) for migrants to smaller and medium-sized cities by allowing them to obtain resident permits and to access urban services, announced by the government in November 2013 and in July 2014, represent an important step toward the government's goal of moving 100 million of its rural population to urban areas by 2020. But attainment of this goal is likely to require further reforms to allow rural migration to the largest cities. India's 2015 budget, released in February, proposed the creation of a universal social security system to provide the poor with access to subsidised insurance and pensions. In May, Prime Minister Modi launched the Pradhan Mantri Jeevan Jyoti Bima Yojana and Pradhan Mantri Suraksha Bima Yojana life insurance schemes and the Atal Pension Yojana for workers in the unorganised sector and not reached by formal pension programmes.

Government policies to promote stability in household income growth and to help cushion households against adverse developments will also help to support consumption growth by reducing the need for precautionary savings and avoiding prolonged periods of labour market slack. Particularly important are effective macroeconomic policies and policies to develop and extend sound and effective social safety nets. Policies to improve access to financial services for rural and poorer households, such as the financial inclusion initiative announced by the government of India in 2014 and efforts in Myanmar and some other ASEAN countries to improve rural micro and other financial facilities, can help to ease liquidity constraints and to allow a more even distribution of consumption over time.

Investment will contribute less to overall growth but will still be very important

The shifting composition of real growth is most evident in the marked projected slowing of growth in investment in Emerging Asia over 2016-20. Gross fixed investment (GFI) growth is projected to drop to about three-quarters of its 2000-07 average rate in the region as a whole. The deceleration is especially great for China, where GFI is expected to increase at about half the 2000-07 average rate, but it is also marked for India, Indonesia, Thailand and Viet Nam. The ratio of fixed investment to GDP will decline gradually in most of the countries, although in most cases it will remain high relative to other developing regions. The main exceptions to the decline in investment growth are the Philippines, where the investment ratio to GDP is the lowest in the region and where economic reforms have significantly improved the investment climate, and Myanmar, where economic opening and reform is expected to boost investment considerably.

Figure 1.23. **Gross fixed capital formation in ASEAN-5, China and India**



Note: The cut-off date of data is 2 November 2015. The weighted averages are used for ASEAN average and Emerging Asia average.

Source: OECD Development Centre, MPF-2016.

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Despite the slowdown in aggregate investment – much of which reflects decelerating outlays by the private sector – government investment is expected to remain strong in much of the ASEAN region and India. This strength reflects pent-up need for massive investment in infrastructure to relieve long-standing bottlenecks, to modernise facilities to allow for industrial upgrading and to accommodate growing urbanisation. Estimates by the ADB in 2012 imply that the ASEAN region will need to spend in the order of USD 60 billion annually through 2022 to meet its infrastructure needs (ADB, 2012). The Master Plan for the Acceleration and Expansion of Indonesia's Economic Development, the Philippines' medium-term development plan, and the Master Plan announced by Thailand's new government in 2014 all envisage very large investment in transport, energy and other facilities to improve infrastructure quality, which is typically ranked fairly low in international surveys such as the World Economic Forum's *Global Competitiveness Report*. Indonesia's fuel subsidy reform earlier this year helped free up government funds for more public investment in infrastructure projects, including the expansion of its port infrastructure to support its Sea Toll Road policy to make Indonesia a global maritime axis. The Port of Jakarta, or Tanjung Priok, is currently being expanded to facilitate the movement of large container ships travelling through and within the country. The entire expansion project is expected to be completed in 2023 and requires investment of about USD 2.5 billion. In the Philippines, the administration of Benigno Aquino has focused on the development of the country's road networks and travel infrastructure with assistance from the private sector under the Public-Private Partnership (PPP) scheme. There are nearly 60 projects in the pipeline and 10 have been awarded, including the extension and operation of the Light Rail Transit (LRT) Line 1, worth USD 1.44 billion; the recently concluded Cavite-Laguna Expressway project, worth USD 1.23 billion; and a new passenger terminal project in Mactan-Cebu International Airport, worth USD 389.3 million.

The Thai government in 2014 approved a USD 75 billion Infrastructure Development Master Plan in which the majority of the budget is to be devoted to transport infrastructure upgrades. Major planned projects include the development of high-speed rail lines connecting Thailand with China, Lao PDR, Malaysia and Singapore, along with investments in Bangkok's light rail system and upgrades to the country's ports. A number of major investments in infrastructure – particularly in rail transportation – have been planned for some time but repeatedly delayed. Higher cost than originally estimated – particularly those related to the planned construction of the Thailand-China double-track railway – and other factors have slowed or stalled progress on several of the most recent initiatives as well.

The economic agenda announced by the Modi government in the budget also specified a substantial increase in infrastructure spending, with an additional USD 11 billion committed to road, railway, port, power and other projects for the next year. This investment is to be largely funded by tax-free infrastructure bonds. The Singapore government's medium term economic plans call for a substantial increase in spending on education and health infrastructure as well as transport to bolster productivity growth in the face of increasingly scarce labour. The recently released *Eleventh Malaysia Plan, 2016-2020* similarly outlines plans for a range of investments in transport, energy, water and ICT infrastructure as well as the development of logistics.

Public investment in China, however, is likely to slow over the next several years, as prior booming investment by local governments is restrained and excess capacity in much of industry depresses investment by state-owned enterprises (SOEs). New and sizeable investments in infrastructure are still being identified, however. These include the USD 260 billion announced for railways construction and major water conservancy projects, which are also intended to help ease slowing growth in the country. The need to limit further increases in the budget deficit and to contain the rise in the public debt may also limit the scope for public investment increases in Viet Nam. The government has announced plans to seek funding from new sources, including the private sector, to achieve the estimated USD 48 billion in infrastructure investment needed between 2016 and 2020.

A number of issues that have hampered government investment in the past will need to be addressed if the ambitious public investment programmes are to be realised. Weaknesses in budgeting and coordination have led to long delays in implementation of planned projects in India, Indonesia and the Philippines. The Modi government estimated that the stock of approved but delayed public investment projects had reached 7% of GDP. Undershooting of infrastructure investment has been common in the Philippines, while political conflicts along with budget delays in Indonesia and Thailand have held up government investment projects on a number of occasions. Legal barriers to land acquisition have also slowed infrastructure projects in India and Indonesia. Measures to expedite land acquisition for key infrastructure projects have been included in the economic agenda of the Modi government in India. Implementation of planned public infrastructure projects also poses daunting financing challenges. To help meet these challenges, governments in a number of countries plan to make increasing use of PPPs and to adopt reforms to make them more attractive to private investors.

Despite the decline in its arithmetic contribution to aggregate growth, investment will remain critical to achieving productivity gains and economic transformation to higher value-added and technology-intensive activities. The efficiency with which investment is allocated will be of increasing importance. In countries with a legacy of heavy state intervention in the economy, more efficient investment will require expanding the scope for market forces to influence investment decisions, along with improvement in the commercial orientation of SOEs and in corporate governance of all enterprises. Public investment in China, for example, particularly that of local governments, has all too often resulted in unproductive and under-utilised facilities due to distorted incentives of government officials, failure to apply rigorous commercial criteria to loans to local governments and other distortions. Ongoing reforms to strengthen the capabilities of banks and other lenders, to develop capital markets and to improve access by non-traditional borrowers to credit will be important to ensuring that investment is efficiently allocated.

Box 1.9. **Public-private partnership challenges in Emerging Asia**

Countries in the region have recognised the urgent need to bridge their large infrastructure gaps. Greater co-operation with the private sector has been sought not only for financing but also for technological expertise, managerial capabilities and product innovation. However, the results of PPPs have been mixed as countries strive to cope with various challenges.

The Philippines, Indonesia and India in particular have attempted various reforms to encourage the use of PPPs. In the Philippines, the Aquino administration brought in major reforms in 2010 aimed at streamlining government processes to create a favourable business environment for investment in infrastructure. These included revisions of the Build-Operate-Transfer Law and the Joint Venture Guidelines. The PPP Centre was also created to act as a central co-ordinating and monitoring agency for all PPP projects, providing various advisory and facilitation services. The Indonesian government has demonstrated a strong commitment to increasing the involvement of the private sector in infrastructure development. Since 2005, several major reforms have been introduced, such as the creation of a legal framework for PPPs, encouragement of procurement through a competitive tender process, amendments to the Land Acquisition Law to ease the land clearing process and the provision of funding for feasibility studies through the government's Project Development Facility. India lacks a formal PPP-specific policy or law but projects are guided by various sector-specific acts. The PPP Cell at the Ministry of Economic Affairs acts as a nodal agency for national-level PPP projects. Long-term funding is being made available through an infrastructure development fund and viability gap funding.

In spite of these efforts, PPP projects have faced obstacles in these countries. In the Philippines, the government expects five education and road infrastructure projects to be completed by mid-2016. However the programme appears to have lost momentum as other projects face various delays. For example, the Mactan-Cebu International Airport, the Light Rail Transit Line and the Cavite-Laguna Expressway were held up due to legal disputes. Only a few PPPs in Indonesia have been able to finalise contract terms, with most others stuck in the preparation or transaction stages. The Ministry of National Development Planning, BAPPENAS, announced in 2013 that 48 PPP projects with a total value of USD 57 billion were being considered. But 26 of these remain at a preparatory stage and 21 are in a transaction stage. The performance of PPPs in India has been mixed, with some examples of success as well as failures. The Ahmedabad BRTS, a bus transit system, has been recognised by the National Institute of Urban Affairs for its success in increasing ridership while maintaining profitability. The City Bus Services of Vadodara and Surat are other examples of PPPs that have received high consumer satisfaction ratings while increasing revenue for local municipal bodies. On the other hand, projects such as the Delhi Airport Metro Express Line and the Mumbai Metro have suffered long delays and cost over-runs.

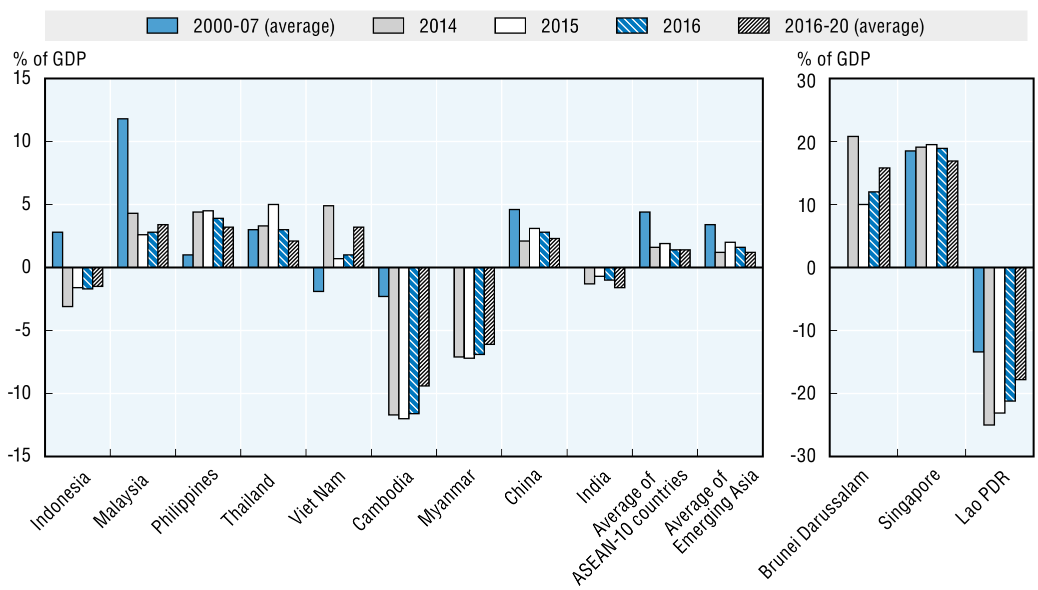
Countries in the region face similar challenges in overcoming the PPP gridlock. In the Philippines and India, particular attention must be paid to establishing an independent dispute-settlement mechanism. Long-term infrastructure projects sometimes require contract renegotiation due to unforeseen circumstances. Resolving these disputes through the court system can lead to lengthy delays. In Indonesia, more than 45 laws and regulations govern PPPs, with requirements for almost 40 permits and licences, increasing complexity and costs. While this is not uncommon in developing countries, Indonesia's decentralised structure adds additional complexity as sub-national government bodies could issue conflicting approvals. All countries in the region need to improve institutional capacity so that the authorities are sufficiently resourced and competent to implement the legal and institutional framework. In general, greater focus is needed on value for money when assessing projects, i.e. the optimal combination of quality, quantity, features and price calculated over the life of the project. Only projects that can demonstrate that the price paid justifies the quality and features over the life of the project should be conducted via PPPs (ASEAN-OECD, 2014).

Source: ASEAN-OECD (2014), *ASEAN Principles for PPP Frameworks*, www.asean.org/images/pdf/2014_upload/Attachment-ASEAN%20%20PPP%20Principles.pdf

Current account balances will fall as gaps between national savings and investment narrow

Current account surpluses in most of the region will continue to narrow, continuing the trend seen since the global financial crisis. All ASEAN-5 countries except Indonesia will remain in surplus through 2020, but their levels relative to GDP will be noticeably lower than in the years before the financial crisis (2000-07), except in the Philippines and Viet Nam. China's surplus is projected to fall from its average of 4.6% of GDP over 2000-07 to 2.3% by 2020. The current account deficit of India is projected to rise slightly from its 2014 level. Cambodia, Lao PDR and Myanmar will continue to run substantial deficits, although somewhat lower relative to GDP in Myanmar compared to 2014. Brunei's already large surplus will widen further as oil prices recover, and Singapore will also continue to run a large surplus.

Figure 1.24. **Current account balances of Southeast Asia, China and India**



Note: The cut-off date for data is 2 November 2015. Weighted averages are used for the ASEAN and Emerging Asia averages. The projections for China, India, and Indonesia for 2015 and 2016 are based on the *OECD Economic Outlook No. 98*). The 2000-07 averages do not include Brunei Darussalam and Myanmar.

Source: OECD Development Centre, MPF-2016.

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Both export and import growth will pick up as world GDP and trade accelerate through 2020. However, the growth rate of exports will be noticeably lower than in the years prior to the global financial crisis or during the subsequent recovery period. China's export growth is likely to slow as its industrial mix shifts toward home consumption and as the scope wanes for further market share gains in advanced economies. The slowdowns in Chinese exports and in import demand by Chinese consumers and businesses, and the deceleration in the expansion of regional value chains, will lead to deceleration in the intra-regional trade in industry inputs that have been a major element of overall trade in the Emerging Asia region.

Trends in the balances of "invisibles" trade (in services and in factor income from capital and labour services, and from non-factor income such as aid and remittances) will have an important effect on the evolution of current account balances in a number of countries. Rising tourism expenditures in the CLMV countries, and growing income from outsourced services in India and the Philippines, are expected to lead to improvement in their services balances. In the Philippines, this improvement, along with continued growth in remittances, helps to account for the projected increase in its current account surplus through 2020. In several other countries, notably Indonesia, Thailand and Viet Nam, increased repatriation of profits of foreign-invested businesses is expected to lead to a moderate deterioration in the factor income balance and to contribute to a decline in their overall current account surpluses.

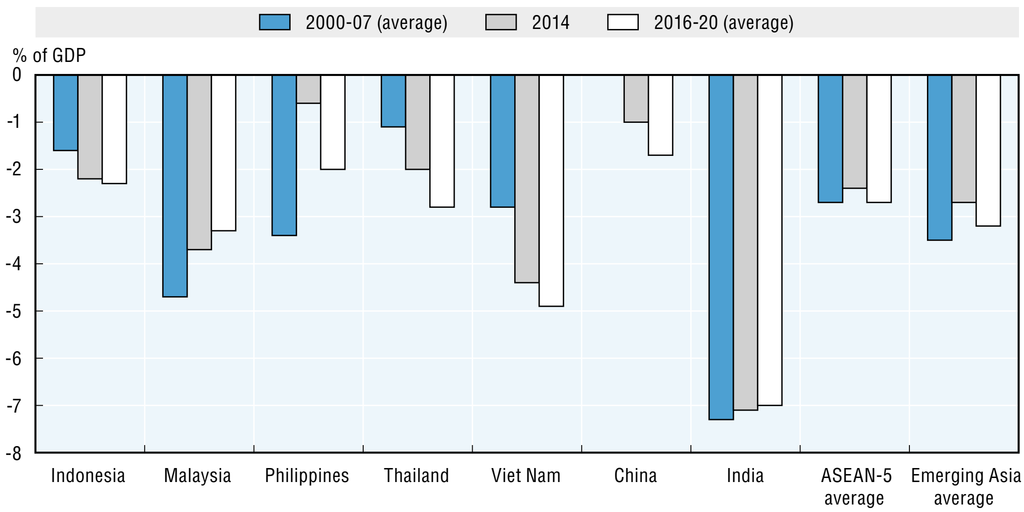
The declining current account surpluses and rising deficits in most of the region reflect the narrowing of previously substantial gaps between national savings – the sum of household, business and government savings – and national investment. Growth in private-sector savings is becoming more moderate in the ASEAN-5, China and India as consumption becomes the main driver of real GDP increases. In the CLMV countries, surging spending on infrastructure and other development, along with rapid private-sector development, is projected to raise aggregate investment relative to savings. The exceptionally large deficits projected for Cambodia and Lao PDR are not sustainable over the longer term, and the countries will need to attract substantial capital inflows if these deficits are to be financed. However, the deficits should decline to more manageable levels once the surge in development spending abates.

Fiscal balances should remain moderate in most cases

Trends in fiscal deficits in the emerging Asian region will be shaped by the balance between increasing government revenues as real GDP growth picks up and the need for infrastructure and other spending to meet development needs. The medium-term projections, which are based on the projected paths for real GDP and development and economic reform plans, point to a slightly higher average deficit ratio over 2016-20 compared to 2014 for China, Indonesia, the Philippines, Thailand and Viet Nam. The deficits for Malaysia and India are projected to fall somewhat. In the region as a whole, deficits are projected to be more or less the same size over 2016-20 – moderate in most cases or at most with a small rise in public debt ratios from the 2014 level. India's projected deficit of 7% of GDP over 2016-20 is below that maintained over 2000-07. Fiscal consolidation efforts in Cambodia and Lao PDR are likely to continue and result in a further decline in deficits relative to GDP. The limited development of financial markets in these countries constrains their capacity for non-inflationary financing of budget deficits. Given Myanmar's extensive planned development expenditures and its growing but still comparatively low tax-raising capacity, the country's deficit is likely to rise moderately in the medium term.

Maintaining sound fiscal balances while meeting growing needs for development and social spending – without imposing excessive tax burdens on the private sector – will require continued, and in some cases redoubled, fiscal reforms to better align budgeted expenditures with national priorities and to improve the effectiveness of budget and expenditure management and tax administration. The recent reductions and restructuring of fuel and food subsidies in India, Indonesia, Malaysia and Thailand represent very important steps toward freeing up revenues for other more productive uses and toward the achievement of more efficient and targeted support to the poorest households.

Figure 1.25. **Fiscal balances (central government) of ASEAN-5, China and India**



Note: Data refer to the consolidated public sector balance in Malaysia. The cut-off date for data is 2 November 2015. The weighted averages are used for ASEAN average and Emerging Asia average. 2000-07 average does not include China.

Source: OECD Development Centre, MPF-2016.

StatLink http://dx.doi.org/10.1787/888933309639

Energy subsidies had been taking a large share of the Indonesian government budget. In fiscal year 2014, around IDR 210 trillion and IDR 71 trillion were allocated to fuel and electricity subsidies, respectively. Energy subsidies accounted for around 15% of the state budget. The intention of fuel subsidy reforms introduced in Indonesia at the end of 2014 and beginning of 2015 is to give more room for the government to reallocate resources to other activities such as infrastructure development. Fuel subsidies have, however, been a sensitive issue. Some attempts to cut fuel subsidies taken under the previous administration were followed by national street demonstrations. In November 2014, the Indonesian government began implementing the subsidy reform, reducing fuel subsidies and thus significantly increasing the price of gasoline and diesel fuel. The reform continued in January 2015 when the government started to implement a new fuel subsidy policy: diesel is now subsidised under a fixed subsidy regime of IDR 1 000, while gasoline is no longer subsidised and the base fuel price fluctuates with international oil prices. Malaysia has implemented subsidy reforms by significantly cutting subsidies on sugar in 2013, and on fuel in 2014 following the fall in oil price. Starting from December 2014, a more flexible pricing system for RON 95 gasoline and diesel was employed, using an automatic managed float system based on market prices. Thailand started to adjust the liquefied petroleum gas (LPG) price in 2011. Through the reform, the Thai government gradually increased the LPG price: the price for industrial users of subsidised LPG rose by 65% in 2011; this was followed in 2012 by a 15% increase in the price of LPG used for transportation. LPG prices for household and transport were gradually increased in 2013 and throughout 2014. India has recently reformed subsidies on fuel, particularly by deregulating diesel and natural gas prices. In October 2014, the price of diesel was deregulated to allow movement based on market conditions. Prices of diesel are now market-determined at both the retail and refinery gate level for all consumers.

In the CLMV countries, reforms to modernise and strengthen budget, accounting and other systems in order to tighten control over spending and revenues and to improve the alignment of spending with national priorities will continue to be of higher priority in the medium term. These reforms will be very important to ensuring that fiscal deficits remain sustainable.

Many countries in the region are in the midst of significant reforms to their tax systems. In 2012, China began a major reform of its value-added tax, which will ultimately fully replace the antiquated business tax. The reform has already reduced the tax burden on services and export sectors (KPMG, 2015). The government of India is planning a major overhaul of its tax system, including reform of the goods and services tax (GST). The GST in India is set to be implemented from 1 April 2016. The country plans to implement a dual GST system, which includes a Central GST and a State GST. Malaysia has started implementing the GST from April 2015. The 6% GST in Malaysia has replaced the previous consumption tax and the Sales and Service Tax (SST). Reforms to property and inheritance taxes are on the economic agenda of the new government in Thailand. An array of tax reforms are also being undertaken in the CLM countries. Myanmar is planning to introduce a value-added tax regime by the 2018 fiscal year.

Revenues in much of the Emerging Asia region have long been depressed by extensive use of tax exemptions and preferences and by poor compliance arising from weaknesses in tax administration. The "efficiency" of revenue collection, defined as the ratio of revenues actually collected to those legally owed, has been chronically low in the region, especially for value-added and sales taxes. Past efforts to strengthen tax administration have met with some success but have left much to be done. The government of Indonesia is planning to continue and build on the comparatively successful tax administration reforms introduced in the 2000s through measures to strengthen collection of personal income taxes. Thailand's government plans to conduct a strategic review of its tax administration. Lao PDR is working on the creation of a large taxpayer unit within the tax administration as well as reforms to improve the flexibility and efficiency of excise taxes and to expand the use of electronic systems to improve tax compliance and to combat smuggling.

The need for reform of fiscal relations between central and sub-national governments has become increasingly apparent in a number of countries. In China, a succession of reforms have met with limited success in alleviating financing gaps at the sub-national level and improving local government accountability. In June 2015, the Chinese authorities announced a new set of reforms, including measures to bring off-budget spending onto the formal budget, and authorisation, under certain circumstances, for local governments to issue bonds to help finance the shortfall between revenues and their expenditure responsibilities. In India, a government commission has recommended increasing the share of tax revenues going to sub-national governments, from 32% at present to 42%, is under discussion; the commission also suggests that sub-national governments consider issuing bonds to help finance their spending. Myanmar is continuing its implementation of the fiscal federalism system introduced in the 2008 constitution.

Box 1.10. **Tax administration reform in Indonesia, Malaysia and the Philippines**

Tax administration reforms have been underway for some time in a number of Asian countries, including Indonesia, Malaysia and the Philippines. These reforms have often involved changes in the organisational structure of tax authority, including the creation of large taxpayers offices. More intensive use of ICT, such as electronic filing systems, is another common reform.

In **Indonesia**, efforts to modernise tax administration, including human resource management, IT systems and audit and filing processes, have resulted in significant growth in the tax revenue collected. Reforms of the Directorate General of Tax (DGT) of Indonesia's Ministry of Finance were implemented in 2002 to address issues including weak organisational structures, poorly trained tax officials, integrity problems and widespread noncompliance. Through these reforms, the DGT moved away from tax-by-tax approaches and towards function-based structures that have enabled taxpayer segmentation based on size. Between 2007 and 2009, the administrative reform also saw the creation of high-wealth individual offices, medium taxpayer offices and small taxpayer offices. Processes for tax filing and compliance have been improved through more intensive use of information technology, including simplified tax forms, electronic tax registration and filing, risk analysis and new audit policies and procedures. The introduction or strengthening of codes of conduct, internal control units and whistle-blower protection has improved the governance, integrity and overall reputation of the tax authorities. However, despite the reforms, Indonesia still faces the challenge of addressing low rates of registration and voluntary compliance and high rates of tax evasion. Strengthening enforcement activities and improving performance in the collection of tax arrears remain priority areas for the administration.

Issues such as a narrow tax base and overdependence on oil and gas revenues are some of the major challenges facing **Malaysia**. Major reform of the Malaysian tax authority was implemented in 1996, when the Department of Inland Revenue, a government department under the Ministry of Finance, became the Inland Revenue Board of Malaysia (IRBM), a separate statutory board with more autonomy and flexibility in terms of administration. The reform aimed to increase the efficiency and effectiveness of the tax administration. In addition, the government is trying to increase the number of taxpayers filing returns. With the Self-Assessment System for corporate taxpayers and individual taxpayers, the number of taxpayers has increased gradually. To support this system and increase tax literacy, the government has put in place some initiatives to educate taxpayers via awareness programmes, pamphlets, publications, seminars and field visits and to enhance government services for taxpayers. To help broaden the tax base and reduce dependence on oil and gas revenues, the Malaysian government started to implement a Goods and Services Tax from April 2015.

Through its Bureau of Internal Revenue (BIR), the **Philippines** has implemented some modernising reforms of tax administration to facilitate compliance by taxpayers and to improve bureaucratic efficiency within the BIR. In 2000, the agency conducted a major reorganisation with the creation of the Large Taxpayers Service, an office dedicated to collecting taxes from the major taxpayers that account for a large share of total revenues. The country also adopted a more taxpayer-focused approach that includes simplification of the tax system and online filing options through an Electronic Filing and Payment System. Programmes to address evasion and noncompliance have also been introduced, such as RATE (Run After Tax Evaders), which targets high-profile evaders through media campaigns, and the Stop-Filer Programme, which flags taxpayers that have filed in the past and then stopped. These and other initiatives have contributed to a 71% increase in the number of registered taxpayers in the Philippines in the six years between 2007 and 2013. However, tax yields remain constrained by a limited tax base, numerous exemptions and loopholes, and evasion. Efforts need to be made in the near term to further raise revenue on a sustainable basis.

Source: OECD (2015c), *Revenue Statistics in Asian Countries 2015: Trends in Indonesia, Malaysia and the Philippines*, http://dx.doi.org/10.1787/9789264234277-en.

Risks and policy challenges

Emerging Asia is projected to experience favourable growth until 2020, with slight moderations. To sustain the momentum of growth, the region is likely to have to cope with external and domestic risks.

- The **slowdown in China's economy** will continue to affect the growth prospects of the rest of the region as export demand drops and investment flows decline. Countries vary in their level of exposure to these risks.
- The prospect of **US monetary normalisatio**n, beginning in the near future, is expected to have relatively more mild impacts on the region, but may also be a cause for concern in some cases.
- Much of Emerging Asia has seen **slowing productivity growth** since the global financial crisis. This trend will need to be reversed for growth to pick up.
- Growth in the region could benefit from opportunities arising from the ongoing creation of the **ASEAN Economic Community and other regional integration initiatives**, such as ASEAN+3 and ASEAN+6. Further acceleration of the regional integration process would be key (see thematic focus of this Outlook in Chapters 2-5 for a more detailed discussion).

China's slowdown will continue to weigh on growth in the ASEAN region

ASEAN countries are likely to continue to face significant headwinds from the slowing of real growth in China. These headwinds are already manifest in the marked slowing over the past two years in export growth in ASEAN countries – an important factor in the deceleration of overall growth in the region. The impact on the ASEAN region will be greater than it would have been a decade or two ago as result of the substantial increase in China's share of world GDP and the rise in its economic integration with the ASEAN region. The share of exports to China in overall exports, and the amount of FDI flows between ASEAN countries and China, have risen significantly since the beginning of this century. These increases have fostered the development of increasingly integrated regional production chains for the production of automobiles, machinery, electrical products and, to a lesser extent, textiles. These chains facilitate the transmission of demand and supply shocks, and have led to increasing synchronisation of the economic activity of China and ASEAN and greater sensitivity of ASEAN countries to demand fluctuations in China (IMF, 2014; World Bank, 2015a).

The impact of China's slowdown on the ASEAN region is also magnified by its composition. Investment and, to a lesser extent, exports account for all of the projected slowdown over 2016-20, and both have slowed considerably more than aggregate GDP. Investment and exports are more import intensive, and thus have a larger impact on the exports of ASEAN trading partners than consumption, the pace of which is projected to pick up from its average over 2000-07.

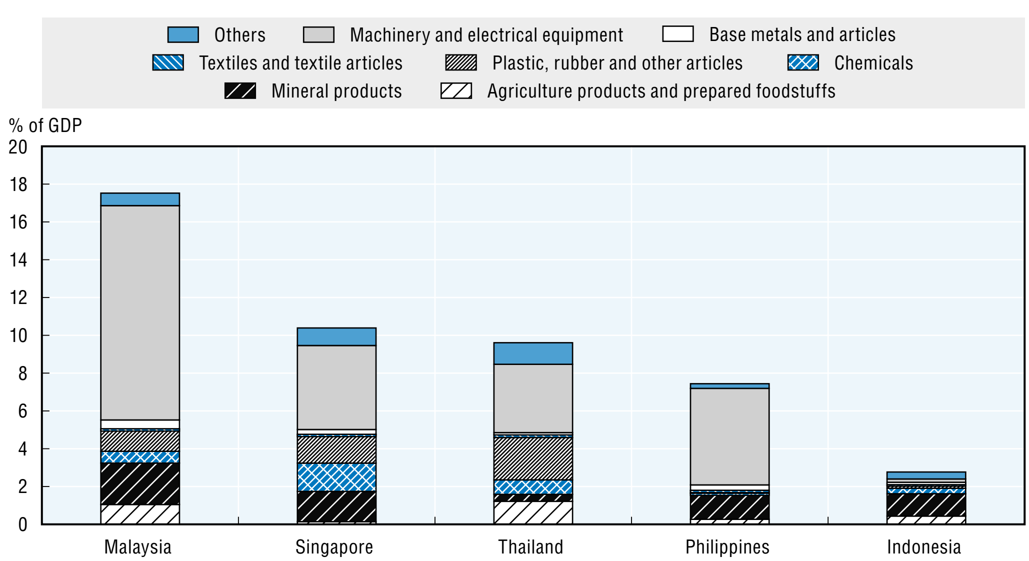
Overall, China's slowdown is likely to have a noticeable impact on growth in the ASEAN region. Separate estimates by the World Bank and IMF suggest that a reduction in China's real GDP growth of 1 percentage point (corresponding to a 2 percentage point fall in investment growth) could reduce real growth in ASEAN in the following year by 0.2-0.3 percentage points on average, and by 0.4 percentage points in the four countries of ASEAN (World Bank, 2014; IMF 2014). Other estimates suggest a somewhat smaller but still significant impact. The estimated impact of China's slowdown on the ASEAN region is considerably greater than its estimated impact on other regions.

The effects on individual ASEAN countries will vary significantly, however, due mainly to differences in the aggregate size and structure of their exports to China. Countries that are most extensively linked in regional production chains with China, notably Malaysia, Singapore and, to a lesser extent, Thailand, are especially sensitive to China's slowdown, as are primary commodity producers such as Indonesia. CLMV countries, especially Cambodia, Lao PDR and Myanmar are also vulnerable, but probably less so than ASEAN as a whole.

The impact of China's slowdown on the region will be observed through various channels

Exports are the primary channel through which the effects of China's slowdown are being transmitted to the ASEAN region. Merchandise exports to China as a share of GDP vary considerably among the ASEAN countries, ranging from about 12% for Malaysia and 6-8% for Singapore, Thailand and Viet Nam to as little as 3% for Indonesia and the Philippines (Figure 1.26). The exports of many ASEAN-5 countries are integrated with China through regional production chains. As a result, their aggregate ratios of exports to China with respect to GDP somewhat overstate their sensitivity to China's slowdown for two related reasons. First, the products exported to China from these countries, except Indonesia, make intensive use of parts imported from Japan, Korea and other Asian countries. The domestic value-added share of total exports in 2011 was around 60% for Malaysia, Singapore, Thailand and Viet Nam, 75% for the Philippines and 88% for Indonesia, as shown in Figure 1.27 (OECD Trade in Value-Added Database). But the value-added shares are probably less than indicated by these figures since China is at the apex of the regional production chains to which the other countries belong. Second, many exports of the ASEAN-5 and ASEAN countries to China are used to produce exports that go to other regions, and not for domestic final use.

Figure 1.26. **Exports to China by major product items in selected ASEAN countries, 2014**



Source: CEIC.

StatLink http://dx.doi.org/10.1787/888933309645

Figure 1.27. **Domestic value-added content of gross exports by end-use category in ASEAN-5 countries, 2011**

Percentage of total gross exports

Source: OECD (2015d), *Trade in Value Added (TiVA)* (database), www.oecd.org/sti/ind/measuringtradeinvalue-addedanoecd-wtojointinitiative.htm.

StatLink http://dx.doi.org/10.1787/888933309654

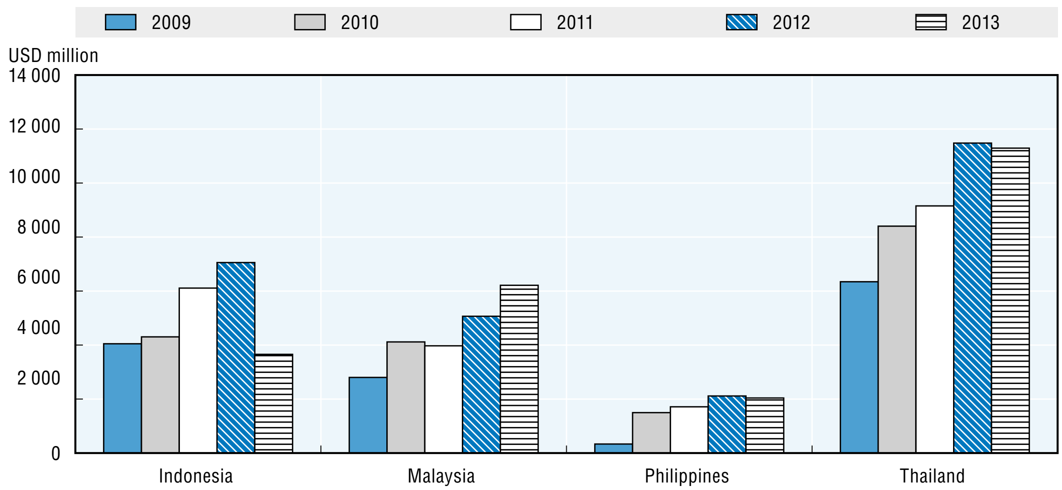
As a result, the sensitivity of the domestic value-added content of exports to China by these ASEAN countries to fluctuations in China's domestic demand is significantly less than the share of China in their overall exports would seem to indicate. Nevertheless, the sensitivity is still substantial and greatest for Malaysia, Singapore and Thailand. Moreover, the sensitivity has risen considerably since 1995, as indicated by an increased ratio of domestic value-added exports to China as a share of total exports of the ASEAN-5 except Indonesia (IMF, 2014).

China's economy, particularly domestic investment, is an intensive user of primary mineral and other products coming from Indonesia, Australia and other countries specialising in exports of primary goods. These countries, including Indonesia among the ASEAN countries, are comparatively highly exposed to the downturn in China's real GDP, particularly given that it reflects a much larger decline in China's investment growth.

Indonesia, as well as other major primary goods exporters such as Brunei Darussalam and (increasingly) Myanmar, are further exposed to the China slowdown through its downward pressure on world prices of oil and other minerals. China is the largest consumer of oil and second largest consumer of industrial metals, and its growth has become a key and increasingly important influence on these prices. Simulations by Inoue, Kaya and Oshige (2014) imply that a 1% decline in China's real GDP (relative to its baseline path) reduces world oil and metals prices by about 3% and 2.5%, respectively. China's slowdown has been significant factor behind the fall in these prices in 2014 and will continue to restrain oil and mineral prices as its growth slows further in the medium term.

FDI is another potential source of exposure of the ASEAN region to China's slowdown. FDI inflows from China into a number of ASEAN countries have increased rapidly since 2009 and have become an important overall source of foreign investment, particularly in Malaysia and Thailand (Figure 1.28). Reduced FDI inflows, in addition to slowing domestic investment, could also constrain the growth of exports from foreign invested facilities. China's slowdown may also depress the growth of tourism revenues in Thailand and other countries where Chinese nationals are a major share of overall foreign visitors.

Figure 1.28. **China FDI flows to selected ASEAN countries**



Note: China includes China (mainland), Hong Kong, China and Macau, China.
Source: IMF (2015), *Coordinated Direct Investment Survey* (database), http://data.imf.org/?sk=40313609-F037-48C1-84B1-E1F1CE54D6D5&sId=1390030109571.
StatLink http://dx.doi.org/10.1787/888933309662

The financial repercussions of China's slowdown may also impact domestic financial markets in ASEAN countries and could complicate their macroeconomic management. The recent depreciation of the renminbi, especially if it should continue, will adversely impact the export competitiveness of ASEAN countries. ASEAN authorities can limit this erosion of competitiveness by allowing their own currencies to depreciate in line with the renminbi, but will have to deal with the resulting increase in inflationary pressures. The depreciation of the renminbi will also provide a temporary boost to Chinese exports and growth in the Emerging Asia region as a whole. Moreover, greater scope for the renminbi to fluctuate with market forces could reduce the impact on China's growth of the coming tightening of US monetary policy.

China's slowdown may also aggravate capital outflows from the ASEAN region as monetary policy in the United States is tightened by adding to uncertainties about the growth prospects of its members. Increasing financial links among ASEAN countries and China may also increase the risk of spillovers from financial market fluctuations within China to financial markets within ASEAN. Singapore could be especially vulnerable to such spillovers given the increasing exposure of its banks to China (IMF, 2015a).

At least for the next several years, the China slowdown will be primarily a demand shock to ASEAN countries that can, in principle, be at least partially mitigated by domestic macroeconomic policies. As discussed earlier, most ASEAN countries have some room for monetary and fiscal stimulus to support growth in the near term. However, the already low interest rates in Thailand and the comparatively high budget deficits in Viet Nam, Myanmar and Cambodia limit the scope for such stimulus.

Over the longer term, China's slowdown and the conditions accompanying it are likely to affect the structure of output in many of the ASEAN countries. Rising wages in China have created incentives to shift the production of labour-intensive products, such as textiles, to lower-income countries in Asia and other regions. The shift of textile and other labour-intensive activities to Cambodia, Lao PDR and Viet Nam is already underway and is likely to continue and expand to Myanmar. This shift is likely to be accompanied by increased FDI inflows from China and other countries in the region into the CLMV countries. Regional production chains, whose expansion has been slowing, may well become less important in export and industrial structures in the ASEAN-5 and in China as domestic industries focus more on meeting domestic consumption demand and less on exports.

The impact of US monetary tightening should be moderate, but there are risks

The timing of US monetary normalisation will mainly depend upon the trend in real GDP growth and in inflationary pressures, especially labour costs. As indicated earlier, financial capital inflows into the ASEAN economies and China have been receding (partly) in anticipation of the tightening. The key questions are: how much further will capital inflows into emerging Asia decline once policy rates actually rise; how great will be the repercussions on regional financial markets; what risks are posed to financial stability in the region; and which countries are most vulnerable?

Monetary tightening in the United States will exert upward pressure on domestic interest rates and downward pressure on currencies *vis-à-vis* the US dollar across the world, including in Emerging Asia. The rise in US short-term interest rates will place upward pressure on short-term interest rates in Emerging Asia. Countries that allow their currencies to depreciate in response to the market pressures stemming from the US tightening, or which have significant restrictions on capital flows, should experience only small increases in short-term interest rates. However, longer-term interest rates on local currency bonds may well rise in any case, especially if long-term rates in the United States rise substantially. The rise in domestic interest rates in Emerging Asia countries will tend to slow real GDP growth in the near term, while currency depreciation will (after a somewhat longer time) tend to stimulate exports and real growth.

The rise in US interest rates is also likely to further slow financial capital inflows into Asian emerging markets as their return advantage over US assets is reduced and international investors reduce the weight of riskier emerging-market assets in their portfolios. Reduced capital inflows may lead to further shocks to domestic financial markets through increased uncertainty, higher risk premiums and other channels. These shocks will not necessarily lead to serious disruption of financial markets. However disruptions are more likely in countries where uncertainties about future economic prospects are comparatively high and/or where serious imbalances in external finances or in domestic financial markets exist. Countries with more developed and deep financial markets should be at less risk than those with less developed markets.

The experience with the "taper tantrum" of mid-2013 has raised concerns about the potentially disruptive impact of US monetary tightening on emerging market economies in Asia and elsewhere. Following statements by the chairman of the Federal Reserve in May 2013 that quantitative easing (QE) would soon begin to be withdrawn, US long-term rates rose by nearly 100 basis points and the dollar rose sharply. In response, financial capital inflows into Emerging Asia fell markedly, stock prices and currency exchange rates fell sharply in most ASEAN countries and CDS rates and sovereign bond interest rates surged upward. The experience with the taper tantrum highlights the critical role of expectations and the degree of market uncertainty surrounding policy moves in shaping their impact on financial markets. Markets appear to have been somewhat surprised by the announcement of prospective QE withdrawal and uncertain about its implications and rationale.

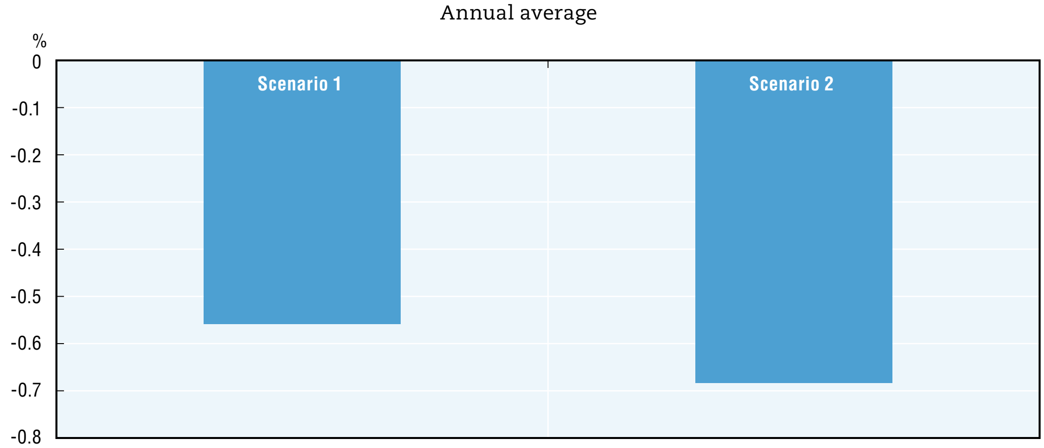
There are good reasons to suggest that US monetary tightening will not have such disruptive effects. The tightening has been widely anticipated and is unlikely to significantly surprise markets, unless it turns out to be significantly larger than the increase of 25 basis points now anticipated. The criteria determining the timing of the rate rise, namely that the US economy is continuing to grow at or near its potential growth rate and approaching full employment, are also widely understood. Policy rate increases under such "benign" circumstances, reflecting favourable or improved economic prospects, are far less likely to lead to severe reactions in other financial markets than those occurring in response, for example, to a realisation that inflationary pressures have risen more than expected (World Bank, 2015b). Long-term US interest rates may well rise somewhat as policy rates increase, but probably by considerably less initially than occurred during the 2013 taper tantrum.

These considerations suggest that the onset of US monetary tightening is most likely to depress capital inflows to the ASEAN region moderately but should not lead to widespread reversals or other major disruptions. Both short- and long-term interest rates are likely to rise somewhat and, unless offset by domestic monetary easing, are likely to produce some downward pressure on real growth in the near term, although probably less than that resulting from the growth slowdown in China.

A simulation of the impact of the US monetary normalisation with a dynamic stochastic general equilibrium (DSGE) model (Box 1.11) indicates that higher interest rates in ASEAN-5 countries decrease domestic investment, though net exports will increase in the short run under a frictionless model setting. The net effect on GDP of these changes will be negative. According to the results of the simulation, such an outcome would lower the GDP of the ASEAN-5 as a whole by as much as 0.56% of GDP. The impact on the ASEAN-5 is likely to be much greater, at 0.68% of GDP, if the US tightening were to lead to increases in US long-term interest rates that are larger and faster than those during the 2013 taper tantrum (Figure 1.29).

Figure 1.29. **Impact of US monetary normalisation on GDP growth in ASEAN-5, 2015-17**

Annual average



Note: Impacts are estimated by DSGE approach. Two scenarios for the speed of QE tapering are used. In scenario 1, we assume that QE tapering gradually starts at 2015 Q4 and completes at late 2018 when the US real interest rate reaches the historical average of 3.75%. In scenario 2, we consider faster QE tapering: namely, the US real interest rate reaches 3.75% at 2017 Q3.

Source: OECD Development Centre's estimation.

StatLink http://dx.doi.org/10.1787/888933309672

Box 1.11. **The impact of US monetary normalisation on Emerging Asian economies: DSGE approach**

Model setting

A modified version of the DSGE model of Aguiar and Gopinath (2007), of a small open economy, was applied to analyse the impact of US monetary normalisation (i.e. interest rate increase) on Emerging Asia economies.

Emerging Asia countries in this model receive permanent shocks to productivity growth. In addition, frequent regime switches motivated by the dramatic reversals in fiscal, monetary and trade policies are commonplace. Aguiar and Gopinath (2007) modelled these features by introducing a stochastic trend in the growth rate. Specifically, production is modelled as follows:

$$Y_t = e^{z_t} K_t^{1-\alpha} (\Gamma_t L_t)^{\alpha}$$
$$z_t = \rho_z z_{t-1} + \varepsilon_t^z$$
$$\Gamma_t = g_t \Gamma_{t-1}$$
$$ln(g_t) = (1-\rho_g) ln(\mu_g) + \rho_g ln(g_{t-1}) + \varepsilon_t^g$$

where Y_t is production, z_t is total factor productivity, K_t is capital, L_t is labour and Γ_t is the cumulative product of the “growth” shock, g_t.

In this model, the domestic interest rate is determined under the open economy. Moreover, domestic bond price is determined by the following Schmitt-Grohe and Uribe (2003) style equation:

$$\frac{1}{q_t} = 1 + r_t^* + \psi\left(e^{\frac{B_t}{\Gamma_t} - b} - 1\right)$$

where q_t is a bond price, r_t is the world interest rate, B_t is the level of debt, and Γ_t is the cumulative product of “growth” shocks. This equation says that domestic real interest rates increase when the world interest rate rises or the domestic debt increases. In this model, the world interest rate follows an AR(1) process with mean to consider the dynamics of global financial conditions, different from Aguiar and Gopinath (2007). Agents have perfect foresight about the path of interest rate.

Assumptions

We consider **two scenarios** for the speed of QE tapering. In scenario 1, we assume that QE tapering gradually starts at 2015 Q4 and completes at late 2018 when the US real interest rate reaches the historical average of 3.75%. In scenario 2, we consider faster QE tapering: namely, the US real interest rate reaches 3.75% at 2017 Q3.

Sources: Aguiar, M. & Gopinath, G.(2007), “Emerging Market Business Cycles: The Cycle Is the Trend”, *Journal of Political Economy*, 115, 69-102; Ireland, P.N. (2001), “Sticky-price models of the business cycle: Specification and stability”, *Journal of Monetary Economics*, 2001, 47, 3-18; Schmitt-Grohe, S. and M. Uribe (2003), “Closing Small Open Economy Models”, *Journal of International Economics*, 61, 163-185.

Some countries within Emerging Asia are likely to be more affected by the US monetary tightening than others. Simulations by the IMF and others suggest that Malaysia, Singapore, and Thailand are likely to experience the greatest impact on capital flows and real growth (IMF, 2015a; Dahlhaus and Vasishtha, 2014). The high portion of local currency bonds held by foreigners may expose Indonesia (as well as Thailand) to relatively larger reductions in net capital inflows and greater increases in interest rates from the US tightening (World Bank, 2015b).

The generally favourable economic and financial fundamentals in the Emerging Asia region should sustain the confidence of domestic and foreign investors and thus help to reduce the risks of major shocks to their financial markets from the US tightening. However, certain financial conditions in some countries have created fragilities that could make them more vulnerable to a decline in investor confidence, possibly resulting in disruptions to domestic financial markets. Capital controls imposed by China should help insulate its economy from the direct shock from US monetary tightening. However, the indirect adverse effects on domestic investor confidence and heightened uncertainties about future economic prospects pose additional risks to the already fragile stock markets and real estate markets. The risks of significant spillovers of China's financial turmoil to ASEAN financial markets could be increased in an environment of heightened uncertainties arising from China's slowdown and the US monetary tightening.

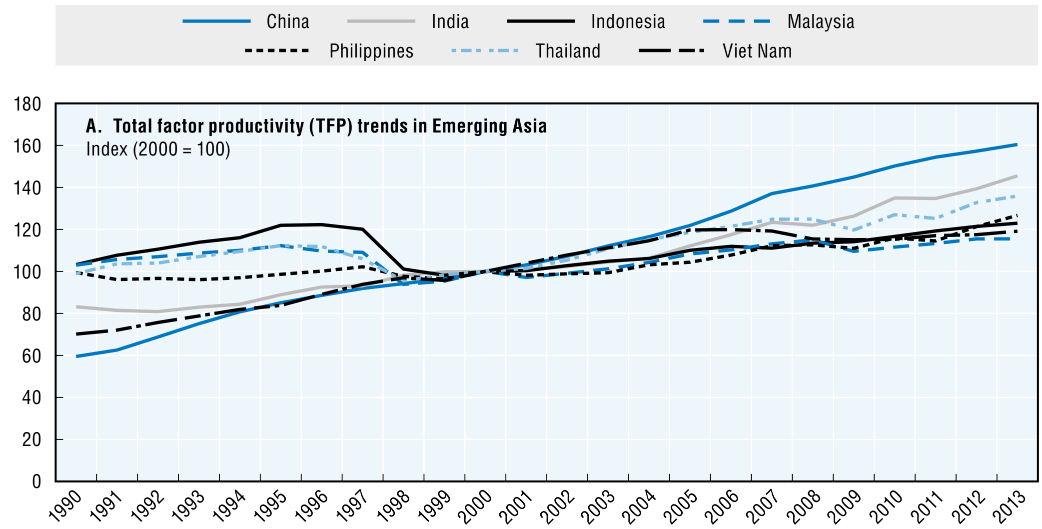
Indonesia's comparatively high dependence on portfolio capital flows and short-term borrowing to finance its current account deficit makes it vulnerable to a sudden decline in investor confidence should capital inflows decline substantially (World Bank, 2015b). The comparatively high levels of household debt in Malaysia and Thailand, and the real estate booms in India and Malaysia, could also pose heightened risks of adverse domestic financial market reactions to the US tightening. Housing markets in countries where prices have been increasing comparatively rapidly, notably Malaysia and especially India, could also be vulnerable in the wake of the US monetary tightening.

Productivity growth is slowing in Emerging Asia

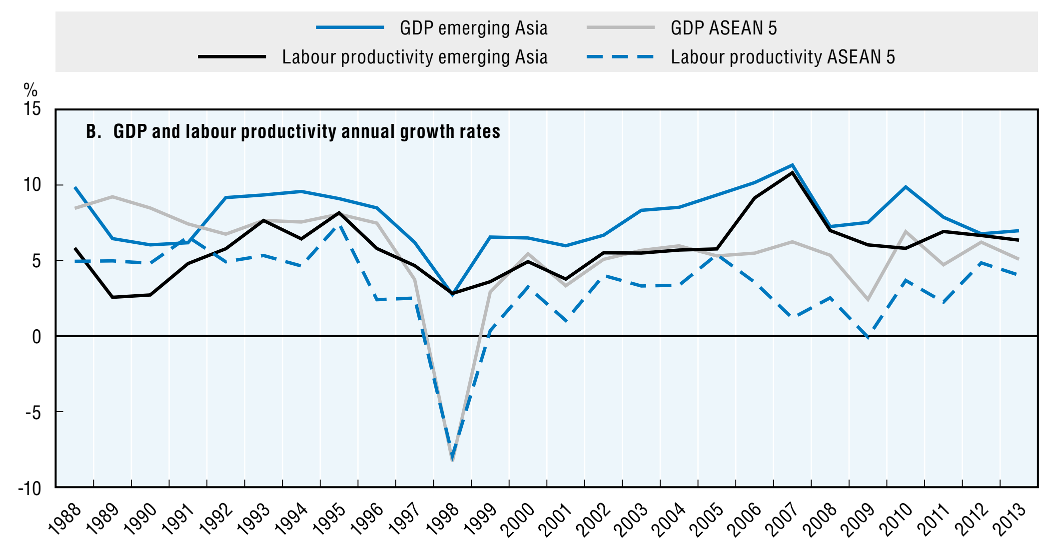
The Emerging Asia region will face the challenge of slowing productivity growth. The growth rate of productivity has been trending downward in most of the Emerging Asian countries, although a few countries have experienced some improvements in the trend (Figure 1.31A). Total Factor Productivity (TFP) growth fell to negative rates in most of the countries during the period following the Asian financial crisis at the end of the 1990s and during the global financial crisis at the end of the 2000s. China's TFP growth has decelerated sharply, from 5.2% in 1995 to 1.99% in 2013. TFP growth for Indonesia and Viet Nam slowed from 4.96% in 1995 to 1.25% in 2013 and from 6.1% in 1996 to 1.41% in 2013, respectively. Other countries have undergone somewhat milder slowdowns. India's TFP growth fell from 5.22% in 1995 to 4.34% in 2013, and in Thailand from 2.51% in 1995 to 2.32% in 2013. In the Philippines, though, TFP growth has risen, reaching a peak in 2012 (5.8%), although there was a moderate slowdown in 2013 (4.3%).

Labour productivity growth in emerging Asian countries also dropped sharply throughout both the Asian financial crisis of the late 1990s and the global financial crisis of the late 2000s, although the slowdown during the first crisis was much larger than during the second (Figure 1.30, B). The late-1990s drop was especially significant for the ASEAN-5 countries. Indonesia's labour productivity growth dropped from 8.72% in 1995 to -12.36% in 1998. Although labour productivity growth increased to 3.75% in 2013, it was still slower than the 1995 growth. Malaysia's labour productivity growth also dropped sharply from 7.89% in 1995 to -8% in 1998, and its 2013 growth of 1.39% was also still lower than during the Asian crisis. Negative productivity growth also appeared in Thailand with -6.88% in 1998. Some countries also experienced negative labour productivity growth in the wake of the global financial crisis. In 2009, Thailand's productivity growth was -4.66%, Malaysia's growth was -3.45%, and the Philippines' rate was -0.86%. This slowing pace of productivity growth has contributed to the lower trend of GDP growth in emerging Asia especially in the years following the global financial crisis of 2007.

Figure 1.30. **Productivity in Emerging Asia**



Source: APO (2015), *Online APO Productivity Database*, www.apo-tokyo.org/wedo/measurement.



Note: The figure does not include Brunei and the CLM countries (Cambodia, Lao PDR and Myanmar).
Source: IMF (2015d), *World Economic Outlook* (database), https://www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx; APO (2015), *Online APO Productivity Database*, www.apo-tokyo.org/wedo/measurement.

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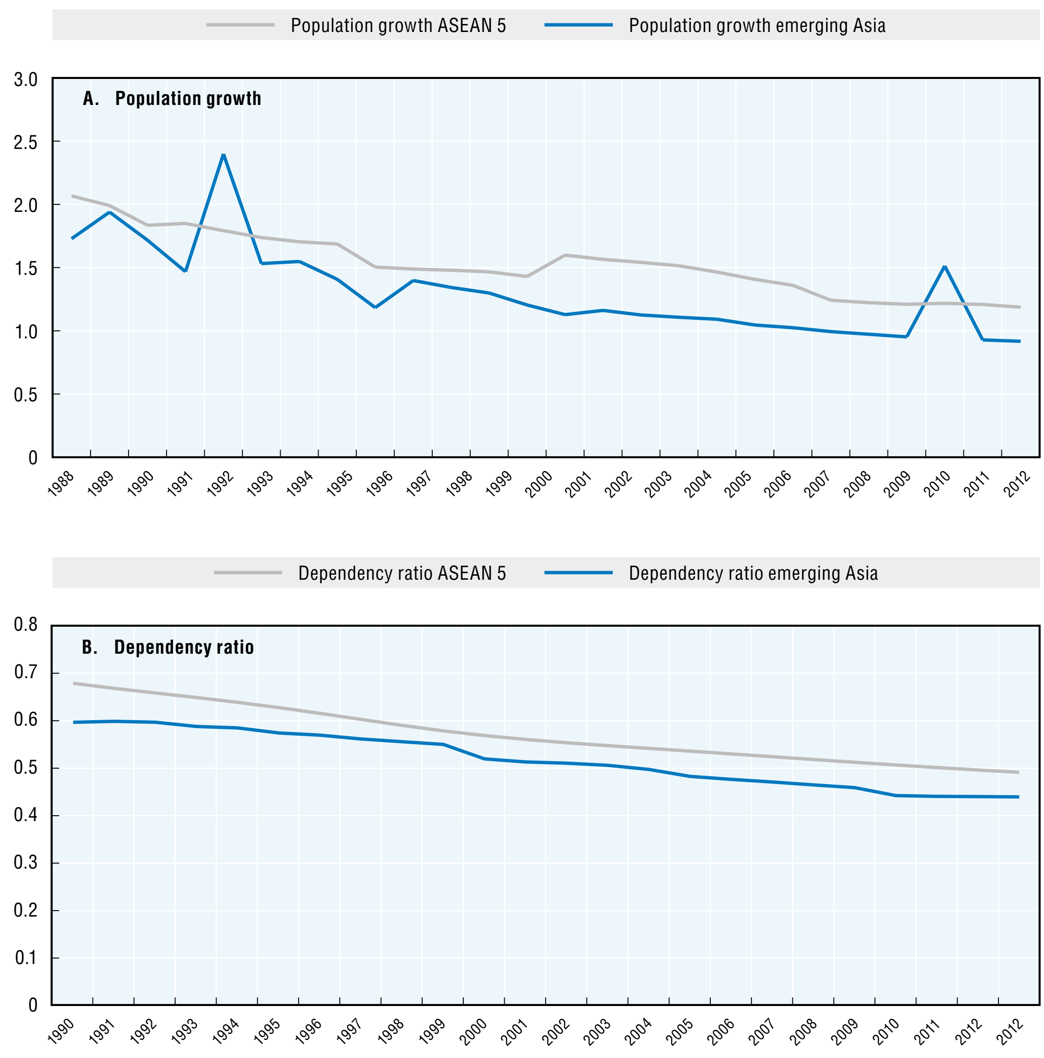
The components of labour supply need to be taken into account in assessing the implication of the productivity trends. Demographic challenges, such as slowing population growth and ageing populations, although not as severe as in more developed countries such as Japan, have also started to be a challenge in some Emerging Asian countries. Figure 1.31 shows that population growth in Emerging Asia as a whole is slowing, from 1.7% in 1990 to 0.9% in 2013. Labour force participation started to decline in Emerging Asia economies starting in the mid-2000s, although there have been increases in some ASEAN-5 countries.

On the whole, the countries of Emerging Asia are in a stage of demographic transition towards a lower dependency ratio as the young, pre-working age portion of the population falls. This trend has been especially noticeable in some large ASEAN countries. In China it is mainly due to strict family planning policies. Some countries in the region are moving towards the end of their demographic dividend, leading to demographic deficit.

Figure 1.31. **Labour supply components in Emerging Asia**



Source: APO (2015), *Online APO Productivity Database*, www.apo-tokyo.org/wedo/measurement.
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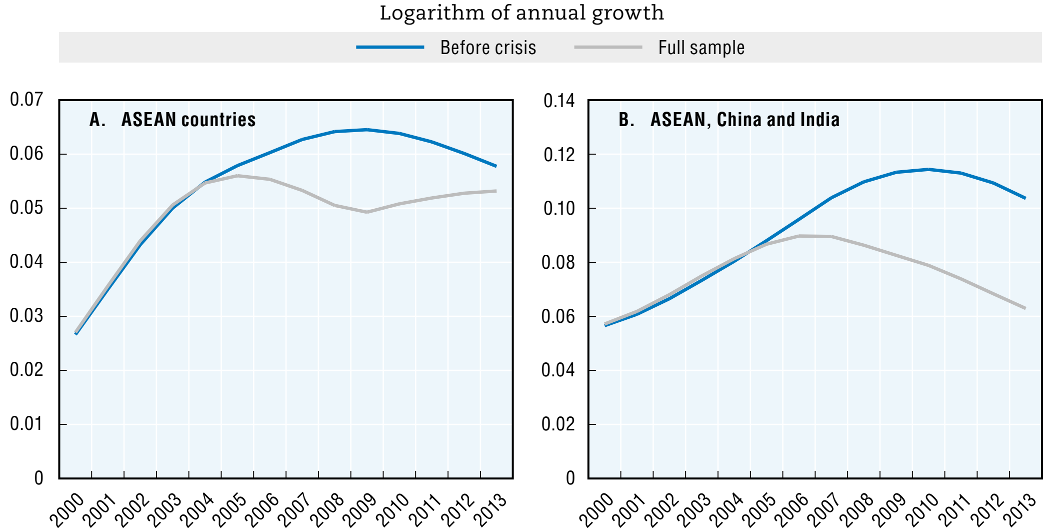
In some countries, demographic challenges from ageing populations will put a burden on efforts to boost productivity and growth. Some other countries have yet to face the challenges from shrinking working-age populations. For countries such as China, Thailand and Singapore, demographic trends are set to reverse, becoming a drag on growth instead of a positive driver of growth over the next decade. But in countries with young populations, such as Indonesia and the Philippines, demographics are more favourable (Standard Chartered, 2014). The impact of the demographic dividend in terms of an expanding workforce, although still positive in most of the ASEAN countries, will start to decrease, suggesting the urgency of productivity enhancement to boost growth.

These trends showing a slowdown of growth in GDP and productivity are evident even from before the global financial crisis. At the aggregate level, potential GDP declines in ASEAN economies, China and India after the global financial crisis of late 2000s. The decline of productivity is one of the factors contributing to the slowdown. However, the extent of slowdown differs across countries and sectors.

Figure 1.32. **Potential GDP in Emerging Asian countries**

Logarithm of annual growth



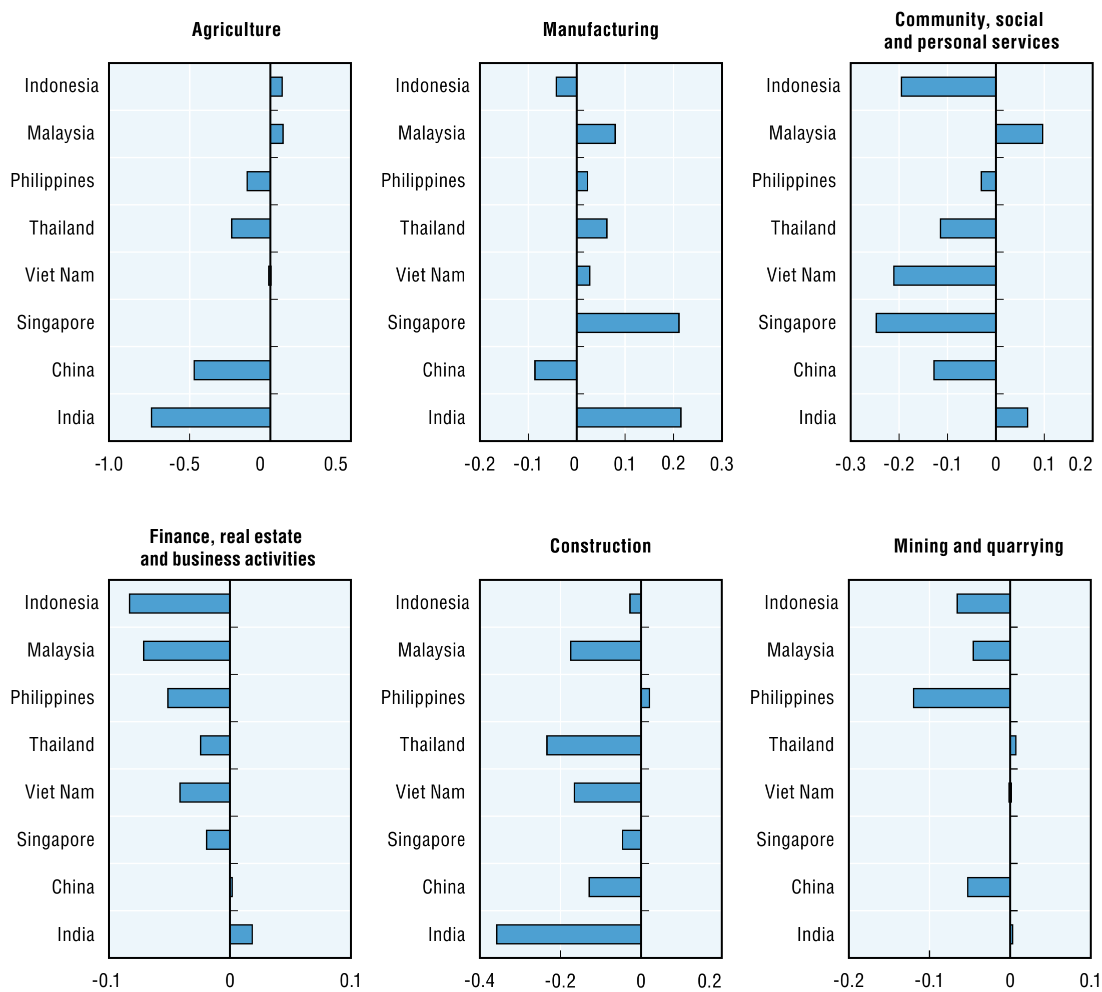
Note: Potential output was estimated by a DSGE approach. “Before crisis” refers to estimation results using data from before the global finanical crisis and “full sample” refers to estimation results based on all data.

Source: OECD Development Centre estimation.

StatLink http://dx.doi.org/10.1787/888933309700

Slowing productivity growth in the post-crisis period has not been spread evenly across all sectors of the Emerging Asia economies, with some areas more seriously affected than others. The financial sectors of most of the largest economies in the region (ASEAN-5, Singapore, China and India) have been particularly affected (Figure 1.33). With the exception of India and China, the productivity of financial activities relative to a country’s average productivity has fallen between the pre-2007 and post-2007 levels. Construction sector productivity has similarly grown relatively slowly, except in the Philippines, and relatively poor growth rates have also been seen in agriculture, hunting, forestry and fishing, and in community, social and personal services in most countries. The manufacturing sectors of several countries, on the other hand, have been relatively resilient; except for Indonesia and China, manufacturers’ productivity growth has exceeded the national average growth rates of these eight countries. Results in other key sectors have been mixed.

Figure 1.33. **Relative labour productivity by selected sectors in Emerging Asia**



Note: These numbers are differences of relative labour productivity between "before 2007" and "after 2007". It is positive when the sector productivity grows faster than other sectors within each country and negative when the sector productivity grows slower than other sectors.

Source: OECD Development Centre estimation.

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Box 1.12. **Measuring relative productivity of ASEAN: Trends after global financial crisis**

Based on the model of Dabla-Norris et al. (2015), the relative labour productivity is calculated by the following equation:

$$Relative\ Labour\ Productivity \equiv \frac{Sector\ MPL}{Average\ MPL} - 1$$

$$Relative\ Labour\ Productivity = \frac{Labour\ input\ of\ sector}{(Total\ labour\ input)\ (share\ of\ the\ sector\ in\ GDP)} \frac{1 - \alpha_{sector}}{1 - \alpha_{average}} - 1$$

where MPL is the marginal product of labour and α is a parameter in the Cobb Douglas production function:

$$y = K^{\alpha} L^{1-\alpha}$$

The relative labour productivity can be interpreted as the degree of under allocation of the labour force. When the relative labour productivity is high, a unit of labour input produces more outputs, considering the technology/capital intensity of the sector. The first part, $\frac{Labour\ input\ of\ sector}{(Total\ labour\ input)\ (share\ of\ the\ sector\ in\ GDP)}$, is the relative labour input of the sector. In the frictionless economy with identical technologies, it is unity for all sectors.

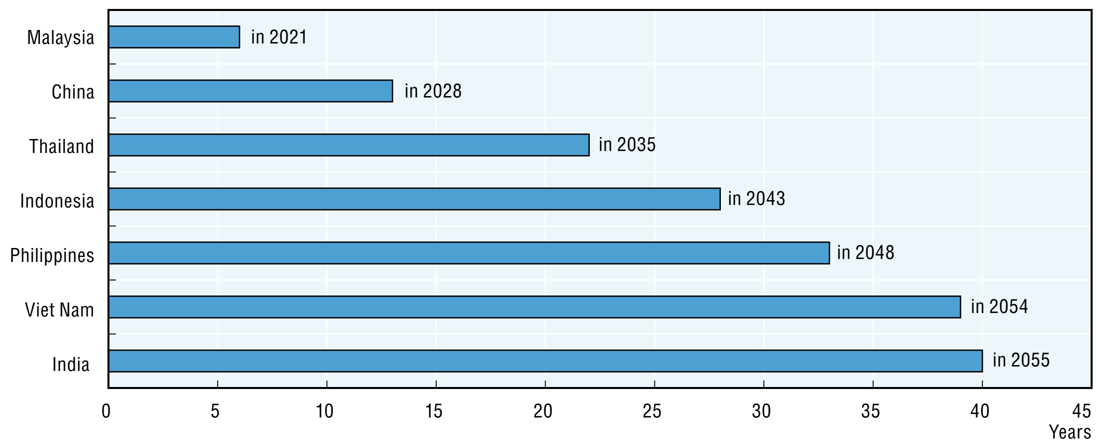
Note: *i)* The sector may employ more/less labour-intensive technologies than other sectors. In this setting, labour intensity is controlled by the second term, $\frac{1 - \alpha_{sector}}{1 - \alpha_{average}}$. *ii)* Labour is over/under allocated to the sector due to some frictions in the economy. The α was estimated based on US data.

Improvements in productivity are essential to drive continued economic growth in Emerging Asia's wealthier economies. While their GDP growth rates have been impressive, many emerging economies around the world have seen slowing or stalled rates of growth as they have approached the levels of high-income countries. This so-called "middle-income trap" results from the difficulties faced by economies in transitioning from previous growth strategies – such as those based on structural transformation, demographic change and factor accumulation, which naturally face limitations – to more sustainable productivity-driven growth and the development of technologically intensive economies.

Productivity is affected by a range of policies. Structural reforms that help to improve the quality of the factors of production, the use of technology and the quality of the business environment are needed to promote faster productivity growth. These issues are being addressed by recent initiatives in Emerging Asia. Education and the improvement of human capital generally are critical in improving productivity and allowing for technological upgrading. Expanded access and improved quality of schooling are receiving additional attention in Malaysia and India, while China is also expanding vocational and other training programmes that seek to improve workers skills. Infrastructure development is another priority area for many countries looking to improve efficiency and to boost growth, for example, with Indonesia addressing bottlenecks in maritime transportation and the Philippines planning to increase infrastructure. SMEs form a significant component of economic activity in the region, and stand to benefit from improved productivity. Malaysia has set targets for increasing the role of SMEs in the economy and is expanding worker training programmes to address skill gaps in the sector, along with other initiatives outlined in the SME Masterplan 2012-2020. Productive SMEs are also potential drivers of job creation in the Philippines. These country-specific policy issues are discussed further in the country notes of Chapter 6.

Estimates by the OECD Development Centre show that even in the best-case scenario, it will take some time for Emerging Asia's middle-income countries to reach high-income status (Figure 1.34). Malaysia is expected to be the first to join this group, in 2021, followed by China in 2028. Reaching this status is expected to take longer for Thailand (2035), Indonesia (2043) and the Philippines (2048). These estimates place Viet Nam and India last among current middle-income countries in Emerging Asia to leave this group, in 2054 and 2055, respectively.

Figure 1.34. **Best-case scenario simulation of estimated time required for middle-income countries in Emerging Asia to become high-income countries**



Note: The bars show the number of years from 2016 required to achieve high-income status, according to the World Bank's criterion for classifying economies. High income countries are defined as having GNI per capita above 12 376 in 2014. Growth, CPI and exchange rate in this simulation are in line with the MPF-2016. Population projections are based on UN data.

Source: OECD Development Centre's simulation, based on MPF-2016.

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Continued growth at rates assumed in the best-case scenarios is not assured, however, and new strategies are needed to promote continued productivity growth in Emerging Asia. Fostering the development of more productive and knowledge-based economies requires reforms to institutions, moving beyond traditional manufacturing activities, the expansion of modern services, an efficient financial system and regional co-operation. Strong institutions are needed to foster investments in human capital, infrastructure and innovation, and to provide a foundation for markets and for financial and macroeconomic stability. As rising wages and increasing competition challenge the "factory Asia" growth model, manufacturers will need to move into more sophisticated activities with more intensive use of technology. At the same time, modern services such as finance, business services and ICT can be expected to play a greater role in Emerging Asia. Sound financial systems and the provision of a wider range of instruments and services will help to meet changing needs and will provide opportunities for a dynamic SME sector. Finally, deeper regional co-operation and integration will help to improve competitiveness by facilitating the efficient allocation of labour and resources.

Structural policy prospects in Emerging Asia

The medium-term development plans of Emerging Asia countries show a clear understanding of the central challenges facing the economies (Table 1.4). Relatively more advanced countries have set goals for improving productivity and for promoting more balanced growth, that are essential for achieving high-income status. The plans of lower-income Emerging Asia economies tend to prioritise targets more fundamental to supporting development. Most include targets for health and social development, equitable growth, environmental protection, and democracy and good governance.

Table 1.4. **Medium-term development plans of Southeast Asia, China and India**

Country	Period	Theme/Vision
ASEAN-5		
Indonesia	2015-19	Realising an Indonesia as a sovereign nation, self-reliant and strong personality that is based on mutual co-operation
Malaysia	2011-15	Charting development towards a high-income nation
Philippines	2011-16	In pursuit of inclusive growth
Thailand	2012-16	A happy society with equity, fairness and resilience under the philosophy of a sufficiency economy
Viet Nam	2011-20	A modern, industrialised country by 2020
Brunei Darussalam and Singapore		
Brunei Darussalam	2012-17	Knowledge and innovation to enhance productivity and economic growth
Singapore	2010-20	Highly skilled people, innovative economy, distinctive global city
CLM		
Cambodia	2014-18	For growth, employment, equity and efficiency to reach the status of an upper-middle-income country
Lao PDR	2011-15	Socio-economic development, industrialisation and modernisation towards the year 2020
Myanmar	2012-15	Development of industry, balanced development, improvements in education, health and living standards, and improved statistical capacities
China and India		
China	2011-15	Rebalancing the economy, ameliorating social inequality, and protecting the environment
India	2012-17	Faster, more inclusive and sustainable growth

Source: Compiled by OECD Development Centre based on national sources.

Structural reforms need to be strengthened further

Improved competitiveness is necessary for Emerging Asia economies to benefit from the opportunities presented by deeper regional integration with the regional and global economies. At the same time, development will need to provide widely shared benefits and produce minimal negative impact on the environment. While the structural policy priorities for Emerging Asia countries are highly diverse, many of these countries have set goals for improving inclusive and sustainable development, recognising the need for high-quality growth and improved quality of life (Table 1.5). Topics to be addressed include rural development, social programmes, FDI promotion, and taxation. Education and infrastructure are common areas of concern, with less-developed countries in the region seeking to provide the basic foundations for growth and to address troublesome bottlenecks, while higher-income economies look to establish the conditions for more knowledge-based development in the future. (For a more detailed discussion, see Chapter 6, structural policy country note.)

Table 1.5. **Medium-term policy challenges and responses in Emerging Asia**

Country	Topics	Policy focus
ASEAN-5		
Indonesia	Infrastructure	Build infrastructure for maritime connectivity
	Social security	Reform the national social security system
	Food security	Improve food security
Malaysia	SMEs	Raise SME productivity
	Education	Upgrade education to meet industry needs
	Urban green growth	Promote urban green growth
Philippines	Job creation	Encourage faster job creation
	Infrastructure	Strengthen infrastructure and the transport sector
	Disaster risk management	Improve disaster risk management
Thailand	Macroeconomic performance	Use macroeconomic policies to revive growth
	Tourism	Strengthen sustainable tourism
Viet Nam	Infrastructure	Improve infrastructure to support growth
	SOEs	Reform and restructure SOEs
	Job creation	Promote job creation and productivity growth
Brunei Darussalam and Singapore		
Brunei Darussalam	FDI	Encourage foreign direct investment inflows
	Private sector	Reform the business sector to promote diversification
	Public finance	Reform public finance
Singapore	Ageing population	Strengthen labour market and social policies for ageing population
	Infrastructure (land use)	Leverage data to build a smart, energy-efficient city
CLM		
Cambodia	Education (TVET)	Improve competitiveness by strengthening TVET
	Tourism	Address complex challenges in developing tourism
Lao PDR	Natural resources	Manage the natural resource boom
	SMEs	Foster SME development
	Tourism	Promote travel and tourism
Myanmar	Agriculture	Upgrade and modernise agriculture
	Education	Develop human capital
	Finance	Finance development
China and India		
China	Environment	Strengthen environmental regulations to improve quality of growth
	Education and skills	Upgrade human capital to facilitate transition to a higher value-added economy
	Rural development	Boost rural development to ensure robust growth of incomes
India	Financial education	Strengthen financial education initiatives
	Education	Enhance education access and quality

Source: OECD Development Centre.

Outlook country notes discuss key structural policy challenges

ASEAN-5

Key challenges: Indonesia

- **Maritime infrastructure:** The Government of Indonesia has emphasised maritime development as part of its Pendulum Nusantara initiative or global maritime axis which seeks to fully utilise the maritime power offered by the country's position as an archipelago. Superior port facilities are being developed such as the Tarahan Coal Port in South Sumatra and the Kalibaru Port in North Jakarta. However, greater attention is required on connecting existing ports and hubs to logistics networks and industrial zones. The Kalibaru Port, for example, was built seven kilometres away from the Tanjung Priok Port, meaning that it will use the same congested roads to transport cargo. In addition to the development of physical infrastructure and connections to international shipping lines, administrative barriers to trade will also need to be addressed. This will require greater co-ordination between relevant ministries, increased use of computerised facilities across all ports and improvements in the Indonesian National Single Window.
- **Social security:** The goal of achieving universal health coverage by 2019 is complicated by the difficulty of incorporating the large number of informal workers into the system. According to the government's Social Security Agency (BPJS), 53% of the population is registered in its programme. Beyond expanding membership, the government faces a serious financial issue as the claim ratio of self-enrolled members is more than 645%. This high claim ratio arises as self-enrolled members typically register with BPJS only once they fall ill and stop premiums when they do not use the health services. Financing reforms are needed for the BPJS, which is expected to face an increasing deficit over the medium term. Social security for Indonesia's workers is managed by BPJS Employment and includes accident benefits, death benefits, old-age benefits and pensions. While formal sector workers are the main priority, a programme expansion aims to reach 1.3 million new informal-sector participants in 2015. The domestic financial market requires adequate capacity to absorb and productively distribute the large supply of funds.
- **Food security:** Nutrition and access to food are improving in Indonesia, though food is increasingly imported. Indonesia's current account deficit in recent years is partly attributable to an increased trade deficit in food and live animals. National strategies to improve food self-sufficiency focus on improving the quality, resilience and productivity of food production through investment in irrigation and other areas. To attain these goals, the government intends to develop and improve the irrigation system and reduce land conversion by 600 000 hectares. In addition, the government intends to rehabilitate 1.75 million hectares of deteriorating irrigation infrastructure and to establish 132 000 hectares of swamp irrigation networks to balance economic, environmental and sustainability concerns. Reducing the risks posed by natural disasters and further limiting exposure to malnutrition remain important goals.

Key challenges: Malaysia

- **SME productivity**: Malaysia continues to have strong growth prospects and aims to reach high-income country status by 2020. Achieving this will require further gains in productivity, though broader development goals, such as promoting inclusive and sustainable growth, are also priorities. Through the SME Masterplan, the Government of Malaysia has set targets for an increased role by SMEs in the country's economy, at 41% of GDP, 62% of employment and 25% of exports by 2020. To boost productivity, the government is providing assistance to SMEs to access finance, exporting, business development and technical expertise. Worker training programmes have been established to address skill gaps, including technical and managerial skills, through skills development centres, a SME@university programme tailored for SME Chief Executive Officers, a SME university internship programme, and a SME mentoring programme. As all of these programmes are not always used by SMEs, improving awareness of and usefulness of these programmes is key. SMEs are also held back by under-investment in innovation and new technology, particularly ICT. According to the 2011 SME Census, only 27% of SMEs used ICT in their business operation. Financing and training programmes should be designed to promote and facilitate technological upgrading by these firms.

- **Education:** The government's education plan has set ambitious targets for improving access to quality education throughout the country. Dropout rates tend to be higher in rural areas and among poor and marginalised students, despite focused efforts to improve literacy and other aspects of basic education in these areas. The government has attempted to narrow the urban-rural achievement gap through programmes such as the District Transformation Programme, the Orang Asli Education Transformation Plan and the Inclusive Education Programme, though further efforts are required on monitoring achievement and quality assurance. Recent policies have sought to increase the number of teachers employed and to lower student-teacher ratios. Improvements in teacher training and assessment of qualifications to ensure teacher quality are needed over and above financial inducements for excellence. As it is, teachers in Malaysia are relatively well paid with a ratio of teacher pay to GDP per capita of 3.9 compared to the OECD member countries range of between 1.5 and 2.0. Creating a knowledge-based economy will require further development of higher education in sciences and greater numbers of researchers, along with training programmes that help students enter the workforce.
- **Urban green growth:** Green growth is featured in the *Eleventh Malaysia Plan 2016-2020* through targets to (1) reduce greenhouse gas emissions intensity by up to 40% compared to 2005 levels by 2020; and (2) place at least 17% of terrestrial inland water areas and 10% of coastal and marine areas under national protection. Promoting green growth in Malaysia's growing urban areas by addressing issues such as air pollution will be a crucial component of the country's sustainable development. The Iskandar Smart City Project offers an opportunity to test the implementation of these green targets for cities in the areas of transport, green tourism, land use, ICT, safety and security, infrastructure and asset management, heritage and culture, and creative arts. Challenges exist in balancing economic expansion – particularly increased investment in industry – with environmental goals. Infrastructure development will also need to be accelerated to promote investment and to ease traffic congestion.

Key challenges: Philippines

- **Job creation:** Despite the economy's strong growth rates, job creation has been slow in the Philippines, posing challenges for continued and inclusive growth in a country with an expanding working-age population. Unemployment has remained higher than other ASEAN-5 countries at above 7%. Labour force participation remains low with around 40% of those aged 15 or older either unemployed or out of the workforce. The job situation may be even worse as underemployment is common among those employed. In 2013, 11.3% of the total workforce reportedly worked less than 40 hours per week but would have preferred to work more. SMEs hold promise for helping to drive growth, employment, local capacity development and to provide resilience against volatile external fluctuations. However, SMEs face serious constraints that must be overcome including access to finance, skills, information gaps and maintaining product quality. The food processing industry, as a key component of the manufacturing sector, holds great potential as a source of job creation. Yet, to develop the industry further and improve market access, policies should focus on enhancing standards, rationalising rules and developing human capital.

- **Infrastructure:** Infrastructure development is a priority for the government with infrastructure expenditure set to increase considerably. While infrastructure expenditure was only about 1.7% of GDP in 2010, the government plans to expand it to 4% in 2015 and 5% by 2016. Low-quality ports and a lack of paved roads constrain competitiveness, though improvements are being made. Considerable investment has gone into port development in the past few years. Between 2010 and 2012, 128 new domestic ports and 16 international ports were erected. By the end of 2009, 22 ports in the Strong Republic Nautical Highway (SRNH) network had been constructed or upgraded for Roll-on/roll-off (RORO) operation. PPPs offer a means of financing and improving the efficiency of some infrastructure projects. The establishment of the Public-Private Partnership Center in 2010 and the legal and regulatory framework for PPPs have made the Philippines a suitable setting for PPP projects. Further work could be done to prevent delays in awarding projects, better manage the division of public and private sector risks, clarify the dispute settlement mechanism, and differentiate between national and regional responsibilities.
- **Disaster risk management:** The Philippines is highly exposed to the risk of natural disasters, which can have serious consequences for lives and livelihoods. Strong and effective disaster risk-management tools are therefore essential for promoting stable growth and development. Progress has been made recently in developing comprehensive preparedness and response strategies, and in strengthening risk mitigation and risk financing capacities. In 2005, the Philippines adopted the Hyogo Framework for Action 2005-15, which served as a guideline for reducing disaster risk and vulnerability to natural hazards. In 2009, the Senate of the Philippines ratified the *ASEAN Agreement on Disaster Management and Emergency Response* (AADMER), which binds ASEAN member states to promoting regional co-operation, collaborating in reducing disaster losses and intensifying joint emergency responses. After Typhoon Yolanda, the *Reconstruction Assistance on Yolanda* (RAY) was adopted. New technologies and tools for anticipating disasters and providing early warning are also being adopted. For example, the Philippines recently joined 16 other countries in adopting the Integrated Services Digital Broadcast-Terrestrial (ISDB-T) system that facilitates the transmission of early warning signals in the event of a natural disaster. Remote sensing technology is being used to produce detailed, high-resolution three-dimensional flood hazard maps that can be used to predict how storm surges will affect local communities.

Key challenges: Thailand

- **Macroeconomic performance:** Economic performance in Thailand has slipped as the country has gone through a period of political instability. With the rejection of the draft constitution in September 2015 and the resulting delay of elections, political uncertainty looks set to continue for some time. Annual growth was 0.9% in 2014, although it picked up in the first two quarters of 2015, to 3.0% in Q1 and 2.8% in Q2. The slowdown was felt across the economy, with a few exceptions in the services and utilities sectors; for example, growth reached 6.6% in financial intermediation and 3.8% in education in 2014. Household debt has been rising quickly, from around 40% of GDP in 2003 to 80% currently. The burden of this heavy debt ratio, one of the highest among Southeast Asian countries, may hinder private consumption. The Bank of Thailand cut interest rates from 2% to 1.5% in an effort to boost growth. A second recent stimulus package, valued at THB 206 billion or 1.6% of Thai GDP, is a promising option to revive growth. The package includes assistance to SMEs in the form of tax cuts and loan guarantees while newly registered start-up companies in targeted industries, such as food processing and high tech, will enjoy a five-year tax holiday. To date, the package appears to have had some success in boosting business sentiment as the Thai benchmark stock index hit a three-week high immediately after the announcement.

- **Tourism:** Although visitor arrivals declined in 2014, Thailand's sizeable tourism sector has proved to be relatively resilient during the current slowdown and is expected to contribute to future growth over the longer term. The Thai government has recognised the importance of tourism in its *Eleventh National Economic and Social Development Plan (2012-2016)*. The plan envisages rehabilitating and increasing the quality of tourist attractions to improve market demand. Special attention has been focused on promoting Thai culture through the "Discover Thainess 2015" tourism campaign. Priorities for ensuring the sustainability of the sector should include addressing the leakage of tourism-related revenues outside the country and the community-level and environmental impacts of tourism. To develop sustainable tourism, the government has established the Designated Area for Sustainable Tourism Administration. This Administration is tasked to work with local authorities and communities and to promote best practices in the areas of human capital, access to finance and knowledge management. Regional integration offers opportunities to improve the quality of services in the sector and to promote travel collectively. The ASEAN countries have sought to ensure that regional integration boosts tourism through initiatives such as the ASEAN Mutual Recognition Arrangement on Tourism Professionals that establishes common standards for 32 job titles. Other measures include the ASEAN Tourism Qualifications Equivalent Matrix as a reference for the industry and the ASEAN Tourism Professional Registration System.

Key challenges: Viet Nam

- **Infrastructure:** A significant infrastructure gap is expected to arise as Viet Nam's growth continues and financing will be a challenge. Recent restructuring of public investment to improve the efficiency of investment allocation and to strengthen monitoring and assessment frameworks have helped to lay a better foundation for future infrastructure investment. The legal framework has been institutionalised through the Law on Public Investment that seeks to improve the effectiveness of public investment management, and the Law on Enterprises to regulate the use of state capital in manufacturing and business activities at enterprises. Domestic and foreign private investors are being encouraged to participate in pilot PPP projects through a measure adopted in 2010 that establishes regulations for PPPs (Decision No. 71/2010/QD-TTg). More could also be done to mobilise private savings in Viet Nam, for example through the issuance of government-guaranteed bonds for infrastructure development.
- **SOEs:** The reform of Viet Nam's state-owned enterprises (SOEs) will be another important challenge to improve competition and competitiveness. Reforms have been gradual and have mainly been carried out through the transformation of SOEs

into joint stock companies and through mergers and consolidation. Since reforms began, Viet Nam has merged and consolidated 877 SOEs and dissolved 313 while 92 have gone bankrupt. This has reduced the number of SOEs and the range of sectors where they operate, while reinforcing the largest of these enterprises. Since 2012, market principles have had a greater influence in directing SOEs due to the implementation of key measures to impose common business rules for SOEs and private enterprises. These rules aim at clearly defining accountability and supervision requirements, promoting equal treatment for small shareholders in majority state-owned enterprises, ensuring adequate information disclosure by SOEs, and enhancing the capacity and accountability of board members of SOEs. Despite these efforts, challenges remain as SOEs retain preferential access to finance, state budget capital, land and other resources. Further reforms should seek to ensure that SOEs compete fairly with the private sector and that SOE performance is monitored and evaluated. For example, the agency responsible for the state ownership function of SOEs must be independent from the agency that implements the SOE management function and the market regulation function.

- **Job creation:** Unemployment in Viet Nam has been low despite a large increase in the size of the labour force brought on by population growth. Labour productivity has remained relatively low, however, as a result of the low quality of human and physical capital, the small scale of production and misallocation of resources. FDI and the expansion of export production have been pursued to drive growth and boost productivity, but additional attention should also be paid to improving efficiency in SMEs. Any effort to improve employment prospects and productivity is complicated by the large informal sector. As of 2012, nearly 80% of the total workforce was employed in the informal sector. To promote job growth, Viet Nam has allowed employers in the informal sector to avoid paying value-added taxes, and social security and welfare contributions. The country needs to strike a balance between job creation and job improvement by encouraging businesses in the informal sector to formalise through initiatives such as tax holidays, tax reductions or credit subsidies.

Brunei Darussalam and Singapore

Key challenges: Brunei Darussalam

- **FDI**: Dependence on the oil and gas sector, which accounts for most of Brunei Darussalam's GDP, exports and government revenues, has allowed the country to reach the high-income level but leaves it highly vulnerable to energy price fluctuations. While national savings are large, FDI offers access to technology, managerial experience and international markets. However, the high concentration of economic activity in the oil and gas sector and in the government has resulted in high unemployment, which reached 9.3% in 2011. While oil and gas contributes approximately two-thirds to total GDP, it only accounts for 3.3% of total employment. The challenging business environment may discourage investment in non-energy sectors. For example, starting and running businesses, registering property, inadequate physical infrastructure and weak intellectual property protection pose difficulties. New measures are underway to attract investment by promoting research and development (R&D) and ICT use. The Brunei Research Incentive Scheme (BRISc) is a cost-sharing grant programme where 70% of R&D funding can be obtained from the government. The government has also upgraded ICT infrastructure with fibre-to-the-home (FTTH) broadband services.

- **Private sector development:** A stronger private sector in general would promote the economic diversification process, and several services sectors stand out as potential areas of growth. These include financial and business services, tourism, Halal products, logistics, ICT and oil and gas downstream activities. Apart from identifying the specific sectors to be promoted, the main challenge will be to come up with effective execution plans to realise desired objectives. Administrative burdens will need to be lessened to facilitate growth. Recent improvements include the replacement of the Miscellaneous Licence with the Business Licence in January 2015, which reduces the days required for approval. It may also be appropriate to rethink sources of public finance, the composition of expenditure and use of PPPs in infrastructure development.
- **Public finance:** The country's public finances are enviable in many respects as the government has high revenues, large surpluses, low debt relative to GDP, large gross national savings and large fiscal buffers. However almost 90% of total revenue is received from the oil and gas sector. Brunei Darussalam should ensure the large annual budget surpluses are invested productively, perhaps in education to help diversify the economy and to increase potential output. Greater use of PPPs could increase spending efficiency and contribute to the development of various sectors, including construction, business services and financial services.

Key challenges: Singapore

- **Ageing population:** In high-income Singapore, improvements to the quality of life are particularly important. With an ageing population, more will need to be done to improve the employability of the elderly and to improve social programmes. Efforts have been made to encourage older workers to return to the workforce and to create incentives for employers to hire them. One such incentive is the Special Employment Credit (SEC), introduced in 2011, that grants a subsidy to employers who hire Singaporean employees over 50 years of age. The Tripartite Committee on Employability of Older Workers (TriCom) has been working since 2005 to support the employability of older workers by promoting job redesign, re-employment and public communication to promote positive perceptions of older workers. At the same time, health-care programmes for the elderly are being expanded and investments in health care generally are increasing. The Pioneer Generation Package has increased health subsidies for the elderly and the government has expanded facilities such as hospital beds and nursing home capacity.
- **Infrastructure:** Improvements in energy efficiency will be an important component of improved sustainability in Singapore. The Housing and Development Board (HDB) is taking steps to develop more energy-efficient housing and communities and to use sensors to create a "smart environment". A Smart HDB Town Framework has been developed to guide the use of technology in developing sustainable solutions. For example, HDB is encouraging the use of computer simulations and data analytics to guide its planning process. Improved data collection can help in achieving efficiencies, though it will be important to ensure that security and privacy remain protected as well. Singapore could consider harmonising national privacy legislation with OECD guidelines, which represent a consensus on basic principles that can be built into existing national legislation.

CLM

Key challenges: Cambodia

- **Education:** The development of human capital and expansion of sectors with the potential to drive growth are important challenges. The Cambodian technical and vocational education and training (TVET) system has traditionally been used as either an alternative to higher education or to address unemployment among youth and workers affected by economic restructuring. Increasingly, TVET is now also being used as a tool to support the development of a knowledge-based economy. Strengthening the system, particularly to help students and workers develop advanced skills, requires a broad set of organisational reforms. TVET programmes should seek broader input from stakeholders and sources of funding, improve the quality of curricula, teaching and evaluation, consider developing public-private partnerships, and improve access to quality and relevant learning opportunities. Recent reforms have sought to address these challenges. The Cambodian Qualifications Framework (CQF) has introduced Competency Based Training and developed a labour market information and management system. However, greater emphasis is needed on implementing these systems and developing the capacity of staff to work within them.
- **Tourism:** Cambodia possesses natural and cultural assets that make it an attractive tourist destination and is drawing an increasing number of visitors. However, the underdevelopment of infrastructure and gaps in worker and managerial skills pose significant constraints to further development. The sector is not well connected to the rest of the Cambodian economy, relying largely on imports. Strengthening connections with local suppliers would help to improve gains from the sector and to benefit the poor. The management of tourist sites is complicated by the overlapping responsibilities of multiple government ministries. For example, temples are under the responsibility of the Ministry of Culture and Fine Arts, and eco sites may be under the Ministry of Environment or the Ministry of Agriculture, Fishery and Forestry while some other sites are managed by the Ministry of Culture and Religious Affairs. This fragmentation also makes the much-needed diversification of tourism destinations more complex. Regional solutions, particularly in promoting specific regions and facilitating travel (such as the ASEAN single visa initiative), could be beneficial.

Key challenges: Lao PDR

- **Natural resources:** Significant contributions to growth have been made by natural resources, primarily hydropower and mining, but dependence on these resources poses a risk of Dutch disease and volatile growth. Due to strong appreciation of the currency, the growth of non-resource sectors such as manufacturing and agriculture has been slow. Sustained growth that creates jobs requires a broader-based economy. Policy priorities for responsible management of the natural resources boom include diversification of the economy by encouraging FDI in non-resource sectors and creating a more favourable business environment. The improvement of fiscal and monetary policy management is required for macroeconomic stability, particularly in using revenues from natural resources for long-term savings and investment. As the country faces large budget deficits and high external debt, it is important to balance the budget, reduce external borrowing, ensure rapid repayment of debt and establish a fund for future expenditure.
- **SMEs:** The development of SMEs is a critical component of economic diversification and plays an important role in generating employment, income and new technology

for long-term development. A lack of access to finance and a skills shortage are among the top concerns of SMEs in Lao PDR. Domestic and international competition and relatively high energy prices in the country are also concerns for SMEs. Several laws and regulations have been issued in support of private sector development including the Business Law and the Law on Promotion and Management of Foreign Direct Investment. However, supporting decrees and the regulatory framework required to implement the new measures remain lacking. In addition, more can be done to ease administrative burdens, improve access to credit and technology and facilitate exporting.

- **Tourism:** While tourism has expanded rapidly in Lao PDR, it has the potential for greater growth by expanding arrivals from non-neighbouring countries and by increasing spending per visitor. Improved transportation infrastructure linking cities and tourist destinations and improved international connectivity are needed. Skill shortages and the need for standards and qualifications have been recognised with the establishment of the Lao National Institute of Tourism and Hospitality, though implementing ASEAN standards will take additional efforts. Future planning for the sector should consider how public-private collaboration, perhaps in destination marketing, could be useful to attract higher-spending tourists from a wider range of countries. The government has recognised the potential of ecotourism and community-based tourism in expanding the sector and in fuelling pro-poor growth. However, careful attention should be placed on protecting the country's cultural and environmental resources as any decline in biodiversity and natural resources is likely to harm the promotion of ecotourism.

Key challenges: Myanmar

- **Agriculture:** Agriculture in Myanmar is predominantly small-scale and subsistence-based, with 54% of farms less than 2 hectares, 4.3% between 8 and 20 hectares and only 0.3% larger than 20 hectares. However, the sector retains great potential to be a major contributor to export-led growth. Though recent reforms allow farmers to use their land as collateral in securing loans (through Land Use Certificates), access to finance and financial services is generally poor and acts as a constraint to increasing investment in the sector. The Myanmar Agriculture Development Bank does provide seasonal and some longer-term loans but faces serious funding constraints due in part to interest rate limits. The improvement of farmers' knowledge and skills, along with research and development, will also be central to raising farming productivity. Expanding agricultural exports may require reforms of constraining institutional factors, for example, by better defining overlapping responsibilities of ministries and by expanding limited resources for health and safety inspections. Consideration of alternative organisational and marketing strategies may also be needed.
- **Education:** Improvements in the formal education system and other training programmes will be needed to prepare more of Myanmar's workers for jobs in the modern manufacturing and services industries that will expand with the country's growth. While basic levels of education are fairly high for the country's income level, access to education and quality of higher education need improvement. Reviews of selection criteria for teacher-training programmes and of incentives for teachers may help to attract better-qualified and more motivated teachers. TVET can play a role in arming workers with the skills demanded by employers, particularly in the use of technology. However, it is important for TVET systems to be designed by engaging with employers, unions, students and teachers familiar with the workplace. Labour exchange offices and worker training programmes are

helping to bridge skill gaps to improve productivity, though the development of training strategies is complicated by the involvement of many ministries in the policy-making process. The National Education Committee co-ordinates education decision making, but another 11 ministries are responsible for various aspects of the education system. Reforms are underway through the Comprehensive Education Sector Review initiated in 2012 to develop a strategic plan for the education sector.

- **SME financing:** Given a history of underinvestment, growth and development depend on increased investment. The lifting of sanctions and Myanmar's increased openness to the world can be expected to lead to an increase in foreign investment and development assistance, but these external sources of financing, along with remittances, are expected to be less important than domestic sources of financing. Reforms will be needed to maximise these domestic sources. Government revenues are insufficient as a result of the tax structure and difficulties in tax collection. Collection could be improved and burdens on business reduced through administrative reforms to tax administration, such as a switch to self-assessments. The financial system remains at an early stage of development, but will be critical in mobilising financial resources for development. At present, formal financial institutions are largely confined to the commercial banks but their scope is limited, and formal financial markets are nearly non-existent. In the near term, regulatory constraints will need to be adjusted to improve firms' access to finance. Regulatory restrictions on the banking sector have been relaxed somewhat, e.g. those on interest rates, but work needs to be done in important areas, including establishing a credit bureau, which is currently underway.

China and India

Key challenges: China

- **Environment:** Rapid growth with lax pollution regulation has been accompanied by serious environmental degradation in China. Recognition of the environmental, human and economic costs has led to reforms. Measures taken recently to improve air quality are having an impact in reducing urban air pollution. For example, the average PM 2.5 (particulate matter less than 2.5 microns in diameter that can lodge in the lungs) concentration in ten polluted Chinese regions declined by 11.9% in 2014. Other recent reforms include an Environmental Tax Law, released for discussion in June 2015, that proposes fines for air, water, noise and waste polluters, though there are several exceptions. Recent reforms also extend the liability of persons responsible for environmental damage to beyond their term and retirement. Improved inspection of water pollution has been introduced as part of the Water Pollution Prevention and Control Law. The inspection identified the cities and towns that met national standards and since then the government has announced that water quality will be incorporated in the indicators used to assess local government officials.
- **Human capital:** Improvements in human capital will take on additional importance as China seeks to move beyond manufacturing-based growth and develop innovative and knowledge-based industries. With a declining working-age share of the population, the content of education programmes will need to change. Job seekers – even those with higher levels of education – do not currently have skills matching market demand. For example, soft skills such as management, communications and negotiation amongst others were found to be the most important for new jobs but are not acquired at higher education institutions. Recognising that vocational education offers a means of improving skills, the government is investing in expanded workplace-based training. Reforms affecting the autonomy and focus of

universities have also helped provide opportunities for deeper collaboration with the private sector. National Technology Transfer Centres (NTTCs), for example, act as intermediaries between university and industry to diffuse inventions; and with greater autonomy, NTTC staff are able to market patented technology thereby increasing the utilisation rate of university-developed patents. New programmes to train and attract world-class researchers and other highly skilled workers are helping to address the need for further innovation. The *National Medium-and Long-term Talent Development Plan (2010-2020)* is a recent comprehensive initiative to attract and retain highly skilled individuals in six broad areas (political leaders and officials, business entrepreneurs, technical professionals, highly skilled industry staff, skilled workers in agriculture and rural areas, and skilled social workers).

- **Rural development:** Rural areas have not seen the same development as urban areas in China, although the income gap has narrowed somewhat. Higher rural productivity is critical for narrowing the urban-rural income gap, though temporary income supports may also be needed in some cases. Labour productivity in agriculture will need to be improved through mechanisation and investment in other areas. Assistance in access to finance and in facilitating the reallocation of land are laying the groundwork for making these productivity improvements. A recent attempt in this direction is the July 2015 issuance of the Guiding Opinion on Building an Agricultural Credit Guarantee System with Budgetary Support (Document Cainong No. 2015/121). Under this scheme, backed by the provincial governments, 70% of guaranteed loans would go to crop farmers with sufficient scale. To preserve land fertility over the long run, unsustainable practices such as the overuse of chemical fertilisers will need to be changed. The government could encourage the use of new technology, improve farmer education and reduce subsidies for fertilisers.

Key challenges: India

- **Financial inclusion:** Fast and inclusive development will require stronger financial education initiatives and improved access to and better quality of education. Financial access has been a policy priority for India, but financial education programmes will also be needed to ensure that people are aware of the services available and sufficiently informed about the opportunities and risks to make responsible decisions about personal and business finance. The areas of need have been studied through the 2014 Financial Literacy and Inclusion Survey, which found that respondents were comfortable with concepts like division and interest on loans, had moderate knowledge of inflation, risk versus return, diversification and simple interest, and were least knowledgeable about the time value of money and compound interest. The National Strategy for Financial Education has been developed to guide efforts by schools, community outreach workers and financial sector representatives in this field.
- **Education:** Higher quality and more accessible education generally is important in a country like India with a young population. Enrolment in primary schools in rural areas and their results have improved considerably in the recent past. Over 98% of children were found to be enrolled in primary school in 2012. Even in rural areas, enrolment levels are over 96% for the 6-14 year age group. Less change has been seen at the secondary and tertiary levels, where more students will need to develop skills beyond basic literacy and numeracy. Uneven access to education by region, gender and socio-economic background across all levels of schooling will need to be addressed, possibly through the use of new diversity measures and incentives. Efforts to improve the quality of education should focus on teacher quality and upgrading school facilities.

Conclusion

Emerging Asia's growth prospects over the medium term remain fairly resilient, though countries' growth patterns are changing. Sustaining growth, even at the more moderate pace expected in the medium term, will require reforms to address a number of important vulnerabilities. While external factors can have a large influence on growth rates and are beyond the control of policy makers in the affected countries, sound macroeconomic policies and responsible structural reforms will help to address risks to regional economies and to improve their resilience. Adjusting to changing growth in China, managing the effects of US monetary policy normalisation, boosting productivity growth and reaping the benefits of regional integration are among the policy priorities for the region.

- **Slowing growth and structural transformation in China will present challenges to the rest of the region.** Much of the effects will be felt through reduced and changed export demand. FDI flows from China, which have grown considerably in recent years, may also slow. Financial markets and other capital flows could also be affected in the rest of the region. As a demand shock, the slowdown could be at least partially mitigated by macroeconomic policies; most ASEAN countries have some room for monetary and fiscal stimulus to support growth in the near term. Over the longer term, different approaches will be needed. Lower income countries will see opportunities to attract investment to labour-intensive production as wages continue to rise in China.
- **US monetary policy normalisation could pose further challenges for financial flows.** The beginning of anticipated monetary tightening in the United States will exert upward pressure on interest rates and downward pressure on currencies around the world, including in Emerging Asia. This shift in US monetary policy may not be too disruptive in Emerging Asia, however, as it has been long expected. A greater-than-anticipated increase in interest rates could surprise markets, however. Regardless, US monetary normalisation can be expected to reduce capital inflows and drag on growth in Emerging Asia in the near term. Policy makers should pay attention to these developments and financial stability more generally. While financial markets have generally displayed resilience in the face of external shocks, such as the stock market crashes in China, attention will need to be paid to rising housing prices and increasing household and corporate debt ratios.
- **Productivity growth will have to recover faster to support higher rates of economic growth.** Sustained growth in per capita incomes depends on rising levels of productivity of the inputs in production, but productivity growth in Emerging Asia has slowed since the global financial crisis. While countries and sectors have been affected differently – with financial sector productivity growing quite slowly in many cases, for example – new policies are needed to foster productivity gains. Structural policy reforms will be important in improving the prospects for enhanced productivity and inclusive and sustainable growth over the medium and long term. The development of infrastructure, the upgrading of human capital and the development of a better environment for business are among the important factors to be addressed in achieving the higher productivity growth rates needed to support continued economic development.
- **Regional integration remains a particularly promising avenue for growth, providing opportunities to exploit economies of scale and to achieve greater efficiency in the allocation of resources.** Progress on integration has been made in a number of policy areas and frameworks have been established to support regional dialogue, decision making and co-operation on issues of shared concern. ASEAN, ASEAN+3

and ASEAN+6 have proven to be particularly effective in co-ordinating these aspects of integration, but better use could be made of existing arrangements. For example, many of the 2015 targets for the ASEAN Economic Community (AEC) will not be met and regional trade agreements have not been used to their full extent. Improved institutional capacities will be critical in implementing existing plans and developing new goals for the region. Policy areas not sufficiently addressed by past regional efforts will also need to be given additional attention in the future. Co-operation on the environment and development of renewable energy and the development of a regionally active private sector are among the most important areas to be addressed.

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Chapter 2

Assessment of progress in regional integration in Emerging Asia

Various frameworks for regional integration have been used to build co-operative solutions to a range of issues of shared concern. In particular, the establishment of the ASEAN Economic Community by end-2015 is seen as a major milestone. The progress made and remaining challenges in deepening regional integration, however, have varied across key policy areas: trade in goods; trade in services; investment and capital market liberalisation; competition and consumer protection; intellectual property; infrastructure and connectivity; small and medium-sized enterprises; food, agriculture and forestry; tourism; human and social development aspects of integration; and Initiative for ASEAN Integration (IAI). Further efforts in co-ordination, the reduction of disparities, global integration, monitoring, addressing new policy areas and reducing corruption at national and regional levels will be needed to realise current and future regional goals.

Introduction

Regional integration in Emerging Asia has progressed within various frameworks since the 1980s, gradually expanding in geographic scope and depth of issues addressed. Attempts at regional economic integration in Asia started almost four decades ago with the countries in Southeast Asia leading the way. It began in 1987 when the Preferential Trading Arrangement was established, a scheme designed to offer preferential tariffs for trade between Association of Southeast Asian Nations (ASEAN) countries and speed up trade liberalisation. In 1992 the ASEAN Free Trade Area was conceived as a comprehensive programme for removing tariff and non-tariff barriers in the region. This was followed by a common vision set in 1997 to create a stable region with "free flow of goods, services, investment, and free flow of capital". Since then the regional integration in ASEAN has come a long way, with the establishment of the ASEAN Economic Community (AEC) by end-2015 seen as a major milestone.

Work on wider regional integration is also progressing alongside these efforts among ASEAN members. ASEAN+3 (APT) integration initiatives have been pursued since they were agreed at the ASEAN+3 Summit in December 1997. Co-operation has expanded to different areas, in particular finance, tourism, agriculture and forestry, energy, minerals, the environment and social welfare. At the 2007 Summit, the APT adopted the Joint Statement on East Asia Cooperation and the APT Cooperation Work Plan (2007-2017) which provides strategic guidelines for APT co-operation. Financial initiatives have been pursued by the ASEAN+3 countries. In the framework of ASEAN+6, the ASEAN+6 leaders stated their commitment to continue co-operation in many areas such as trade, investment, finance, environment and energy, education, global health issues, disaster management and connectivity. More recently, progress has been made in the trade and investment area and the Regional Comprehensive Economic Partnership (RCEP) currently under negotiation is strengthening economic ties in the region.

While ASEAN and its neighbours are still far from a world in which markets for goods, services and factors of production are perfectly integrated, progress is being made in critical policy areas, including trade in goods, trade in services, investment and capital market liberalisation, competition and consumer protection, intellectual property, infrastructure and connectivity, human and social development, and the Initiative for ASEAN Integration (IAI). This broad-based integration is expected to boost the region's productivity, expand resources for investment and development, and increase resilience to external shocks through policy co-ordination. In addition, there will be spillover effects in terms of increased cross-border trade and capital flows, a rise in per capita GDP, and greater macroeconomic stability.

Regional integration in ASEAN

Despite this progress, realising the AEC is still a challenge, particularly with the uncertain global environment. As recent events show, the intensification of global risks has led to output volatility in many countries in the world due to significant trade and financial links. This also casts doubts on the region's ability to manage its own integration. This section provides an overview of the recent integration process in key policy areas, covering trade in goods, services, investment, capital markets, competition and consumer protection, intellectual property rights, infrastructure and connectivity, human capital and social development and narrowing the development gap (Table 2.1). These regional efforts – implemented through the ASEAN, ASEAN+3, ASEAN+6 and other frameworks – are an essential complement to the national-level progress also being made in addressing challenges in these policy areas.

Table 2.1. **Progress in Emerging Asia's integration in key policy areas**

Policy area	Assessment of progress
Trade in goods	Intra-regional tariffs are falling and intra-regional trade is increasing, trade agreements are being made, and trade facilitation is improving, but non-tariff measures remain a challenge.
Trade in services	Progress in facilitating services trade has been uneven, and deeper reforms are needed in some countries.
Investment and capital market liberalisation	Liberalisation has been uneven by country and sector, and investors remain concerned by high costs of doing business, weak intra-ASEAN banking facilities, though the CMIM and ABMI are promoting regional stability and financial integration.
Competition and consumer protection	ASEAN members are sharing best practices, but work remains to be done on policy harmonisation and the establishment of regional-level initiatives.
Intellectual property	Co-operation between IP offices has improved and work is being done to further develop local capacities.
Infrastructure and connectivity	Further improvements will be needed on road, rail and maritime connectivity, and institutional barriers are being addressed gradually.
Small and medium-sized enterprises	Several major programmes offer support to SMEs in operating domestically or internationally, but access to finance and technology is a challenge for these firms in some countries.
Food, agriculture and forestry	Regional frameworks are improving food security, but more could be done to protect fisheries, forestry and wildlife.
Tourism	Co-operation is progressing on tourism promotion, the establishment of common standards and visa facilitation.
Human and social development	Education system harmonisation and collaborative research initiatives have been established, and co-operation through broader regional frameworks is progressing.
Initiative for ASEAN Integration (IAI)	A large number of projects are planned under the IAI, though implementation rates are low.

TRADE IN GOODS

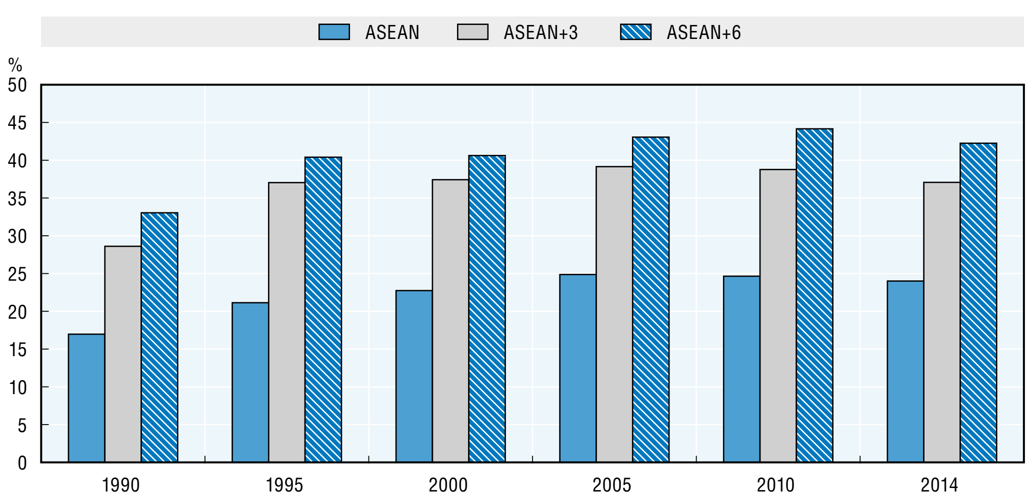
Assessment of progress in integration

- Overall, intra-regional tariffs have fallen rapidly over the last decade (to just 0.04% among the advanced ASEAN economies and 1.33% among CLMV countries [Cambodia, Lao PDR, Myanmar and Viet Nam] in 2014), and intra-regional trade increased from 17% in 1990 to 24% in 2014, indicating greater openness of the region. While significant progress has been made on the reduction of tariffs, the presence of non-tariff measures (NTMs) continues to inhibit the free flow of goods.
- Trade facilitation has improved largely due to streamlined customs procedures through Mutual Recognition Arrangements (MRAs). Progress has been made in harmonising standards particularly in the automotive, electronics and cosmetics sectors but some countries lag behind.
- Free trade agreements between the ASEAN+6 countries have facilitated a growth in trade among these countries, which should benefit further from the Regional Comprehensive Economic Partnership (RCEP) agreement currently being negotiated.

Declines in tariffs and other barriers to trade, along with trade facilitation efforts, have supported increased trade within Emerging Asia and with neighbouring countries. One important outcome of integration up to now is the deepening of trade as a result of various initiatives in the region. Despite the fact that ASEAN exports and imports have remained small relative to global exports and imports, total ASEAN trade has expanded significantly over the years. Trade-to-GDP ratios in most ASEAN countries increased from 112.4% in 1990 to 149.6% in 2014. Intra-regional trade has also increased from 17% in 1990 to 24% in 2014, demonstrating the greater openness of the region, though this growth has slowed in recent years. Intra-regional trade, between ASEAN and its dialogue partners has also grown in importance as a share of total trade, with trade within each of ASEAN, ASEAN+3 and ASEAN+6/East Asia equalling 24%, 37%and 42% of each group's respective global trade in 2014 (Figure 2.1).

Figure 2.1. **Intra-regional trade in ASEAN, ASEAN+3 and ASEAN+6, by country group, 1990-2014**

Total within-group trade as a share of groups' total world trade



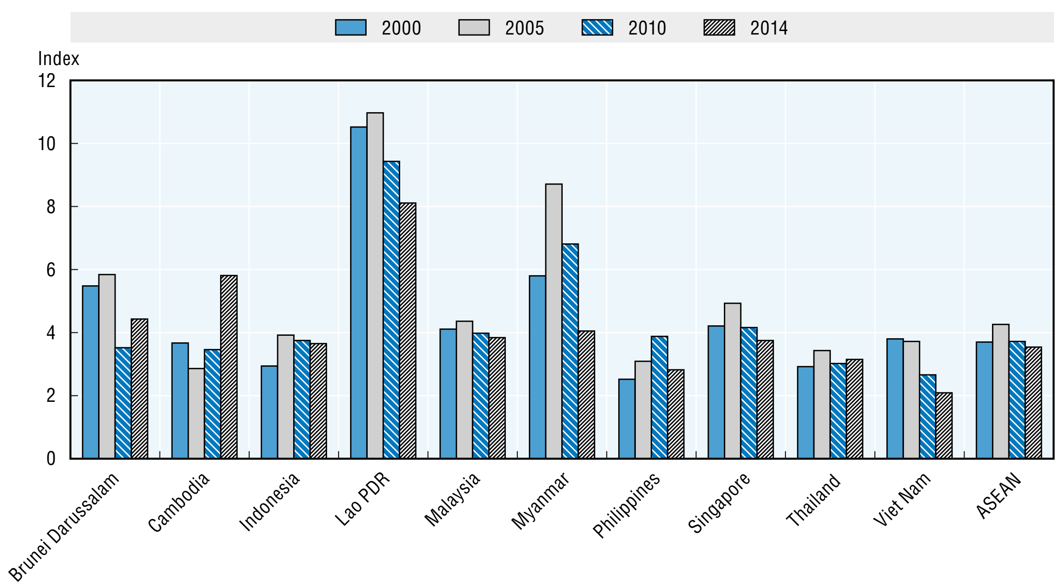
Note: ASEAN+3 includes ASEAN 10 countries plus China, Japan and Korea. ASEAN+6 includes ASEAN+3 plus Australia, India and New Zealand.

Source: OECD Development Centre's calculations based on data from IMF-DOTS.

StatLink http://dx.doi.org/10.1787/888933309738

Perhaps a better indicator is the intra-regional trade intensity index. An index of greater than 1 shows the growing importance of a region's trade with the rest of the world. While intra-regional trade share remains small compared to other regions, intra-regional trade in ASEAN has become more intense over the years. As shown in Figure 2.2, intra-regional trade intensity peaked around 2005 (4.8) before settling at an average of 3.5 during the last 15 years, which is higher compared with other regions such as NAFTA (North American Free Trade Association) and the European Union (with intra-regional trade intensity ranging between 1.8 and 2.5, respectively).

Figure 2.2. **ASEAN Intra-Regional Trade Intensity Index**



Note: An index of more than 1 indicates that trade flow within the region is larger than expected given the importance of the region in world trade.

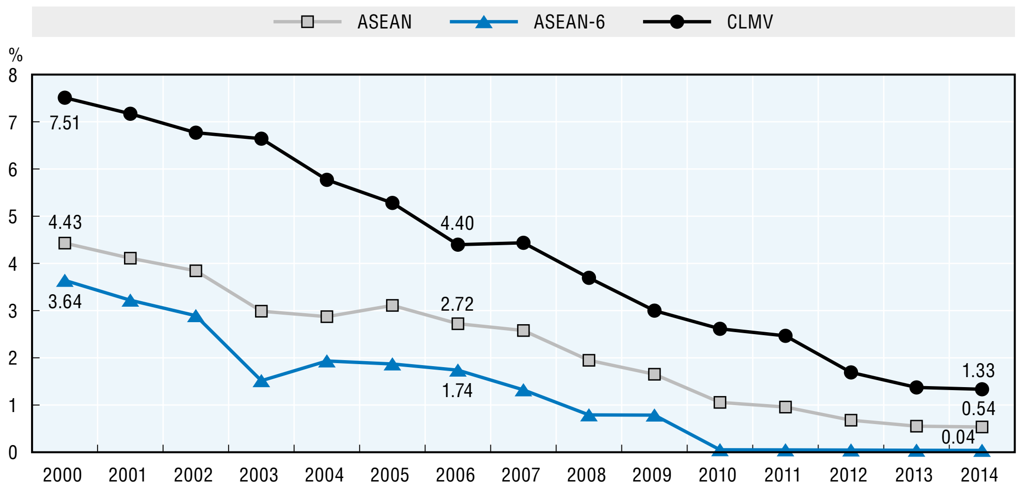
Source: ADB (2015a), *Integration Indicators* (database), http://aric.adb.org/integrationindicators.

StatLink http://dx.doi.org/10.1787/888933309742

Intra-regional tariffs have fallen rapidly over the last decade

The elimination of tariffs to enable the free flow of goods has been a long-running priority of the ASEAN region. Under the Common Effective Preferential Tariff (CEPT) scheme, member states agreed to gradually reduce intra-ASEAN tariffs to between zero and 5%. In 2003 the Protocol for the Elimination of Import Duties was adopted to further reduce intra-ASEAN tariffs to zero by 2010 for the ASEAN-6 members (Indonesia, Malaysia, the Philippines, Singapore, Thailand and Brunei Darussalam) while the CLMV countries (Cambodia, Lao PDR, Myanmar and Viet Nam) were given greater flexibility to reach these targets. Then in May 2010 the ASEAN Trade in Goods Agreement (ATIGA) was signed to consolidate the previous measures relating to goods and to drive the integration programme further. These measures have been broadly successful in reducing tariffs across the region. Figure 2.3 below shows the rapid decline in average CEPT rates in ASEAN. The CEPT for ASEAN as a whole fell from 4.4% in 2000 to 0.5% in 2014. The ASEAN-6 members have reduced their intra-ASEAN tariffs to just 0.04% while the CLMV countries have reduced tariffs most dramatically from an average of 7.5% in 2000 to 1.3% in 2014.

Figure 2.3. **Average CEPT rates in ASEAN countries, 2000-14**



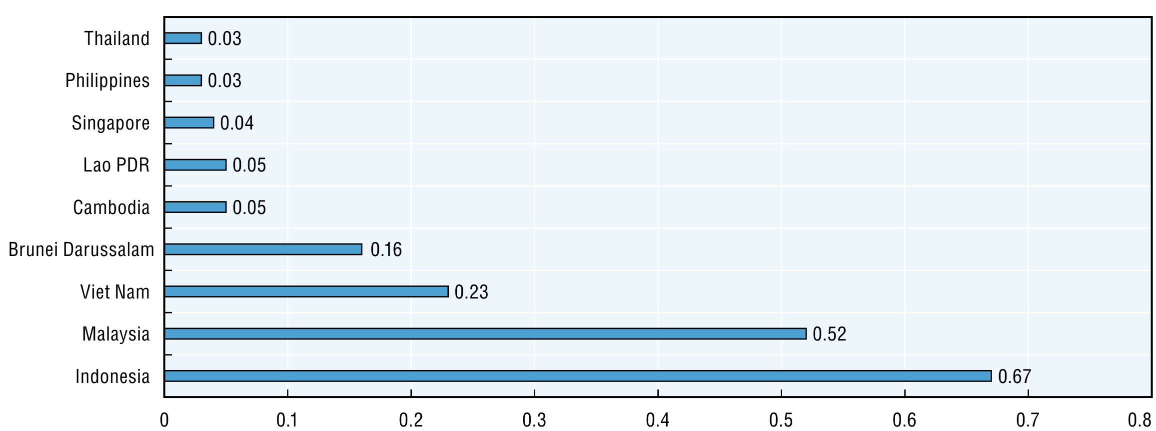
Note: ASEAN-6 includes Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand; CLMV includes Cambodia, Lao PDR, Myanmar and Viet Nam.

Source: ASEAN Secretariat.

StatLink http://dx.doi.org/10.1787/888933309757

Figure 2.4. **Core NTM Restrictiveness Index in ASEAN, 2009**

Index, higher number indicates greater restrictions



Source: ERIA (2012), "Mid-term review of the implementation of AEC Blueprint".

StatLink http://dx.doi.org/10.1787/888933309760

Non-tariff measures continue to impose costs on firms

While significant progress has been made on the reduction of tariffs, the presence of non-tariff measures (NTMs) continues to inhibit the free flow of goods. NTMs consist of a broad range of policy measures that may affect international trade even though their primary objective may concern public issues such as health, food safety or the environment. Though comprehensive and comparable data on NTMs are limited, the recent ASEAN NTM shows that Indonesia and Malaysia have the highest incidence of "core NTMs" (which are composed of non-automatic licensing; quantitative restrictions; prohibitions; enterprise-specific; single channel for imports; and foreign exchange market restrictions), while Thailand and the Philippines have the least (Figure 2.4). Core NTMs are those measures deemed to be particularly harmful to trade. ASEAN has relied on voluntary programmes to reduce non-tariff barriers, with limited success (Box 2.1). The ASEAN Secretariat has initiated other programmes such as the Matrix of Actual Cases on NTMs/Trade Barriers. Private sector surveys can be used to get information on the types of NTMs that are problematic and their effect on prices and costs. Narjoko (2015) provides evidence of the effects of NTMs on firms in all ten ASEAN countries. Most NTMs reported by firms relate to procedures for certification or export or import licences. However, the results have to be interpreted with caution as the sample consists of just five firms in each country. A general problem with information from surveys is that the sample tends to be small and therefore not necessarily representative. Moreover responses may be biased by firms looking for more favourable regulation (Cadot, Munadi and Ing, 2013).

Box 2.1. **Eliminating non-tariff barriers – toward a new ASEAN approach?**

Since the mid-1990s ASEAN has targeted the elimination of non-tariff barriers (NTBs) or the barrier component of non-tariff measures (NTMs) such as customs surcharges, restrictive product standards and other monopolistic measures. Under the AEC, quantitative restrictions were also targeted. In addition, new priorities were set for eliminating NTBs including adherence to protocols on notification procedures, standstill and roll-back of NTBs, enhancing transparency of NTMs, and adoption of regional rules and regulations in line with international standards.

ASEAN has so far relied on voluntary submissions of all NTBs that each country aims to eliminate. Under this approach, member states list the NTBs that they plan to eliminate through a national work programme. The lists are made available to all countries and uploaded at the ASEAN Secretariat. Industry consultations particularly in three priority sectors (automotive, electronics and textiles) were also pursued to identify NTBs that are harmful to business in the region. Newly introduced NTMs are reported regularly by countries along with updates on NTM-related activities at the national work plan. More recently countries also agreed to establish an inter-agency body to address NTMs in their respective jurisdiction.

Unfortunately, such a voluntary approach for elimination of NTBs has yielded very limited results and unless a new approach to NTM reform is pursued, eliminating NTBs in ASEAN is not likely to progress significantly. One approach is to streamline the NTMs instead of eliminating them, given the reality that NTMs are often complex and very diverse in nature. According to the World Bank in its joint report with the ASEAN Secretariat (World Bank/ASEAN, 2013), streamlining NTMs involves the process of regulatory improvement where concrete analysis and proposals are being implemented by governments to reduce the costs of doing business in each country and improve the competitiveness of domestic firms.

Another approach, as proposed by the World Economic Forum in its 2013 flagship report, involves a comprehensive review of all NTBs and all aspects of the supply chain in close consultations with industry associations including producers and downstream users. Among the report's key recommendations is to "create a focal point within government with a mandate to co-ordinate and oversee all regulation that directly affects supply chain efficiency" (WEF, 2013).

Sources: World Bank/ASEAN (2013), *ASEAN Integration Monitoring Report*; WEF (2013), *Enabling Trade: Valuing Growth Opportunities*, www3.weforum.org/docs/WEF_SCT_EnablingTrade_Report_2013.pdf.

Overly complex rules of origin (ROO) can also increase compliance costs and thereby inhibit trade in goods. The ASEAN members have developed a new set of product criteria for the ATIGA ROO, endorsed the revised product-specific rules and abolished the need to include the free on board price in the certificate of origin (ASEAN, 2012a). In order to streamline administrative procedures, the ASEAN Self-Certification System has been put in place which allows exporters to make an invoice declaration on the origin of goods rather than rely on government officials. This system began as a pilot project in 2010 between Brunei Darussalam, Malaysia and Singapore with Thailand joining in 2011. The programme has since been extended to Indonesia, Lao PDR and the Philippines which have begun a second self-certification pilot project in January 2014 (ASEAN, 2014a).

Trade facilitation has improved largely due to streamlined customs procedures

The AEC Blueprint agreed by ASEAN leaders has highlighted trade facilitation as an important tool to reduce transaction costs and promote trade. The ASEAN region has performed well over the last few years in reducing trade costs according to the World Bank Ease of Doing Business and Logistics Performance Index indicators. In terms of the time required to export or import, Lao PDR, Cambodia, Brunei Darussalam, Myanmar, Thailand and Malaysia have made great progress over the 2006-14 period (World Bank, 2014). The main reasons for this reduction include the requirement for fewer documents, improvements in the permit application process and a reduction in physical inspection rates.

The ASEAN Single Window programme has been launched to connect and integrate the National Single Windows of member states thereby facilitating the exchange of information (ASEAN, 2014a). The ASEAN Single Window has been implemented in Indonesia, Malaysia, the Philippines, Singapore and Thailand. However, it may not be fully functional in all these countries and may lack integration with customs and other departments. Brunei Darussalam and Viet Nam are at an earlier stage having only built their Customs Single Window while the CLM countries (Cambodia, Lao PDR and Myanmar) are still in the early stages of creating customs automation systems (ERIA, 2014).

Progress has been made in harmonising standards particularly in the automotive, electronics and cosmetics sectors but some countries lag behind

The AEC agenda also includes a reduction in trade costs through initiatives on standards and conformance. This is a particularly challenging task given the wide differences in development levels of the member countries. These standards are usually established through the signing of Mutual Recognition Arrangements (MRAs) in specific product categories. Prassetya and Intal (2015) conducted a survey of government officials and the private sector to evaluate the progress on standards and conformance initiatives. In the automotive sector, Indonesia, Lao PDR and Malaysia have fully adopted the regional standards. While Singapore imposes additional safety requirements, Viet Nam falls short due to infrastructure constraints and the lack of testing facilities. In the electrical and electronic equipment sector Singapore, Viet Nam, Malaysia, Indonesia and the Philippines have adopted more than 100 out of 121 agreed standards. Cambodia and Lao PDR report that they lack the financial and technical resources to implement these standards more quickly while other members are concerned that their domestic industries require more time to adjust to the higher standards. Six members have already ratified the ASEAN Cosmetics Directive into national law and regulation while in Brunei Darussalam, Cambodia, Lao PDR and Myanmar it has been partially ratified. All member states have agreed to the ASEAN Cosmetics Testing Laboratory Committee's (ACTLC) terms of reference and all except Cambodia and Lao PDR have appointed a test laboratory to be part of the ACTLC (Prassetya and Intal, 2015).

Trade ties with regional partners beyond ASEAN are being strengthened

A series of free trade agreements between the ASEAN+6 countries have improved the conditions for trade among these economies. In the past decade, five ASEAN+1 free trade agreements (FTAs) have been made between ASEAN and the +6 partners (the ASEAN-Australia-New Zealand Free Trade Agreement, the ASEAN-China Free Trade Agreement, ASEAN-India Free Trade Agreement, ASEAN-Japan Comprehensive Economic Partnership and ASEAN-Korea Free Trade Agreement). The institutionalisation of integration through agreements on trade, investment and finance was motivated by pre-existing economic interdependence within the region, a defensive response to European and North American integration, an alternative to stalled multilateral liberalisation efforts, and recognition of the need for shared growth and financial co-operation following the Asian financial crisis (Kawai, 2005).

Box 2.2. **Regional integration is being pursued through ASEAN+3 and ASEAN+6**

An external orientation has long been a central component of ASEAN integration. The ASEAN Charter clarifies the organisation's central position in regional co-operation and community building and the AEC Blueprint calls for ASEAN to look beyond its own borders and pursue integration into the global economy. This demonstrates the region's awareness of both its growing importance in terms of economic activity, trade and investment and also the deepening connections being built within the region. New institutions and discussion forums have been established between ASEAN and its partners, leading to commitments for co-operation on issues including energy and the environment, disaster management, connectivity, poverty and development, alongside agreements on trade and investment and financial integration. While considerable progress has been made in a relatively brief period in establishing these new frameworks, they remain in preliminary phases or have not been used to their full potential in many cases.

ASEAN Plus Three (APT or ASEAN+3) co-operation – bringing together the ten ASEAN member countries and China, Japan and Korea – began with a meeting alongside the ASEAN Summit in Kuala Lumpur in 1997, where the APT concept was formally accepted by the 13 heads of government. Against the backdrop of the Asian financial crisis, these countries agreed to institutionalise existing co-operation and formed in 1998 the East Asia Vision Group (EAVG) to plan future regional co-operation in the decades to come. In 2007 the 11th APT Summit adopted the Second Joint Statement on East Asia Cooperation and the APT Cooperation Work Plan (2007-2017). The Work Plan broadly outlines initiatives to be taken over a ten-year period in political and security co-operation; economic and financial co-operation; energy, environment, climate change and sustainable development co-operation; socio-cultural and development co-operation; and developing institutional support and follow-up mechanisms. The Work Plan was revised following a mid-term review in 2013 and the new plan, covering the 2013-17 period, was adopted at the 2014 summit.

Like the ASEAN+3 Work Plan, ASEAN+6 covers a wide range of policy issues, though the commitments made tend to represent the early stages of co-operation in many cases. The priority areas are energy, education, finance, global health issues including pandemic diseases, environment and disaster mitigation, and ASEAN connectivity. The East Asia Summit (EAS), a suggestion of the EAVG, was first held in 2005, bringing together the 16 ASEAN+6 countries (the 10 ASEAN member countries and Australia, China, India, Japan, Korea and New Zealand). The Kuala Lumpur Declaration on the East Asia Summit, which came out of this meeting, described the EAS as "a forum for dialogue on broad strategic, political and economic issues of common interest and concern with the aim of promoting peace, stability and economic prosperity in East Asia". This group expanded in 2011 to include Russia and the United States.

ASEAN's FTAs with neighbouring countries have provided comprehensive coverage for deepened economic integration, though challenges remain in implementing and facilitating the use of these agreements. Along with other Asian FTAs, the ASEAN+1 agreements have expanded coverage of trade in agricultural goods and services, while also addressing a number of deeper areas of co-operation and integration, including competition, intellectual property, investment, public procurement and trade facilitation. However, non-tariff barriers still need to be addressed, trade facilitation efforts continued, and barriers to trade and investment removed. Rates of FTA use have recently been estimated at 16% to 17% in Indonesia, 24% in Malaysia in 2012, 31% in Viet Nam in 2011 and 47.3% in Thailand in 2012. Given the low margins of preference offered by FTAs and administrative costs of complying with ROOs, firms appear to be willing to accept most favoured nation tariff rates to avoid the difficulties of FTA compliance or due to a lack of information about these alternatives (Tambunan and Chandra, 2014). These factors may be particularly challenging for small and medium-sized enterprises (SMEs), though their higher likelihood of only operating domestically or exporting to fewer markets may make them less concerned about difficulties in exporting (Kawai and Wignaraja, 2013).

The five ASEAN+1 FTAs may be superseded by the Regional Comprehensive Economic Partnership (RCEP), an agreement between all 16 ASEAN+6 participants. First proposed by ASEAN with the adoption of the ASEAN Framework for Regional Comprehensive Economic Partnership at the 19th ASEAN Summit in 2011, the agreement is intended to provide broader and deeper coverage than existing FTAs (ASEAN, 2013a). The Framework outlined the general principles of the agreement, including comprising economic and technical co-operation, along with trade and investment facilitation measures; offering "special and differential treatment" to ASEAN members and the CLMV countries in particular; ensuring consistency with the World Trade Organization (WTO); and providing for periodic review.

The agreement is intended to provide broader and deeper coverage than existing FTAs (ASEAN, 2013a). The Guiding Principles and Objectives for Negotiating the Regional Comprehensive Economic Partnership, endorsed by the ASEAN+6 leaders at the East Asia Summit (EAS) in Phnom Penh, Cambodia, in November 2012, outlined the plan for the negotiations, which were to begin in early 2013 and be completed by the end of 2015. This document outlined the scope of the agreement as encompassing at least seven policy areas:

- trade in goods, progressively eliminating tariff and non-tariff barriers on most trade in goods
- trade in services, removing restrictions and discriminatory measures that limit regional trade in services
- investment, covering the four pillars of promotion, protection, facilitation and liberalisation
- economic and technical co-operation, building upon the ASEAN+1 FTAs
- intellectual property, reducing barriers to trade and investment related to intellectual property rights through co-operation on their use, protection and enforcement
- competition, co-operating on promoting competition, economic efficiency and consumer welfare
- dispute settlement, providing an effective, efficient and transparent mechanism.

While progress is being made in the RCEP negotiations, they are not expected to be completed until 2016, later than originally envisioned. The tenth round of RCEP talks took place in October 2015.

Box 2.3. **Regional Comprehensive Economic Partnership and Trans-Pacific Partnership**

In addition to the Regional Comprehensive Economic Partnership (RCEP), the Trans-Pacific Partnership (TPP), an expansion of the Trans-Pacific Strategic Economic Partnership Agreement (signed by Brunei Darussalam, Chile, Singapore and New Zealand in 2005), was agreed to on 5 October 2015, following five years of negotiations, though it still requires ratification before coming into force. The agreement now includes 12 Asian, North American and South American countries, with 7 ASEAN+6 participants (Australia, Brunei Darussalam, Japan, Malaysia, New Zealand, Singapore and Viet Nam). Additional countries in the region have also stated their interest in joining the TPP, which would include broad provisions on trade and investment in addition to policy areas such as financial services, government procurement and intellectual property. The TPP and RCEP are both intended to cover a broad range of policy areas beyond those of traditional trade agreements, though they would differ significantly in the depths of commitments required of participants and their membership (Table 2.2).

Table 2.2. **Comparison of countries participating in the Regional Comprehensive Economic Partnership (RCEP) and Trans-Pacific Partnership (TPP), 2013**

Participating countries		Population		GDP		Average GDP per capita	Total trade (% of world total)	FDI inflow (% of world total)	FDI outflow (% of world total)
		Billion persons	% of world total	USD trillion	% of world total				
TPP	Australia, Brunei Darussalam, Chile, Canada, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States, Viet Nam	0.8	11	27.8	37	32 789	25	27	37
RCEP	ASEAN member countries, Australia, China, India, Japan, Korea, New Zealand	3.4	48	21.8	29	19 121	26	19	17

Note: Trade and FDI outflow data unavailable for Myanmar. Average GDP per capita is calculated as a simple average of national GDP per capita levels.
Source: Updated from OECD (2013) based on World Bank (2015), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators; UNCTAD (2015), UNCTADSTAT (database), http://unctadstat.unctad.org.

A comprehensive regional agreement, such as RCEP or TPP, could be important to the region as a whole and ASEAN members in particular. The breadth and depth of these agreements would facilitate enhanced integration among participants. The growing network of regional trade agreements in Asia – termed the "noodle bowl" – has created administrative complexity in various rules of origin, timelines, exclusion lists and other differences that could be addressed through consolidation. These agreements will also be important for ASEAN as a way to maintain its connections with regional partners as they pursue other trade agreements.

RCEP provides opportunities for rationalising rules of origin and origin certification procedures, as well as non-tariff measures, across the region (Fukunaga and Isono, 2013). It has been estimated that RCEP would provide a modest boost to the gross domestic product (GDP) of most Southeast Asian countries when compared with the status quo (e.g. Itakura, 2013; Rahman and Ara, 2015). The TPP offers other benefits, however, such as full tariff elimination.

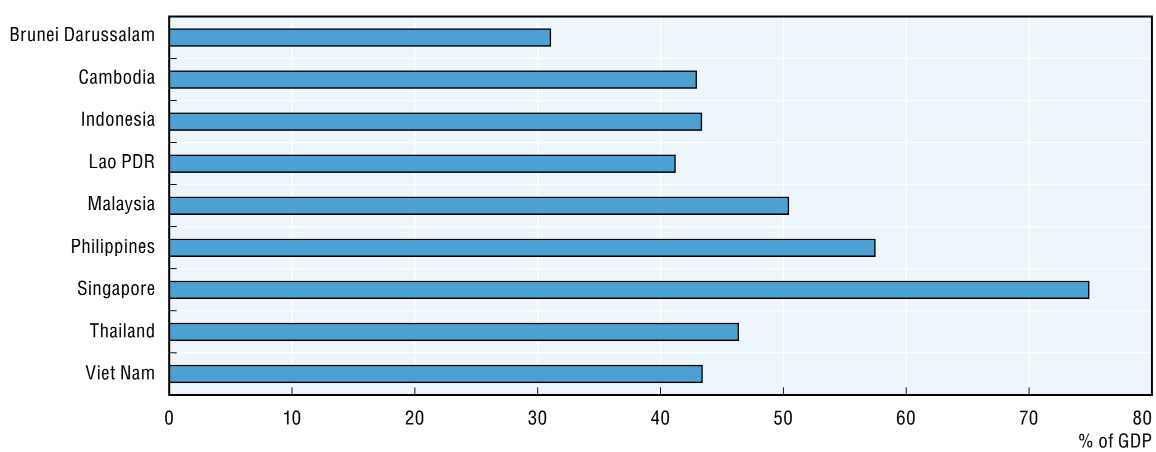
TRADE IN SERVICES

Assessment of progress in integration

- Reforms such as the ASEAN Framework Agreement on Services (AFAS) and sectoral MRAs have made limited progress. MRAs are most advanced in engineering and architecture and even then fall short of requirements for the AEC.
- Regulatory and legislative reforms, such as to labour laws and professional regulation, would be needed to implement MRAs in some countries.

Services play an increasingly important role in emerging Asia. As the ASEAN economies grow richer the demand for services is expected to grow rapidly. Services already make up a large proportion of the economy in some of the richest countries such as Singapore where they account for around 70% of GDP (Figure 2.5). In the Philippines services account for almost 60% of GDP while in most other ASEAN economies they make up less than 50%, with the exception of Malaysia. The services sector is also a strong and growing contributor to employment generation in ASEAN (Figure 2.6). Services are not just important in their own right but also as supports to manufacturing through the provision of finance, communication and transport facilities for example.

Figure 2.5. **Share of services sector in ASEAN, 2014**

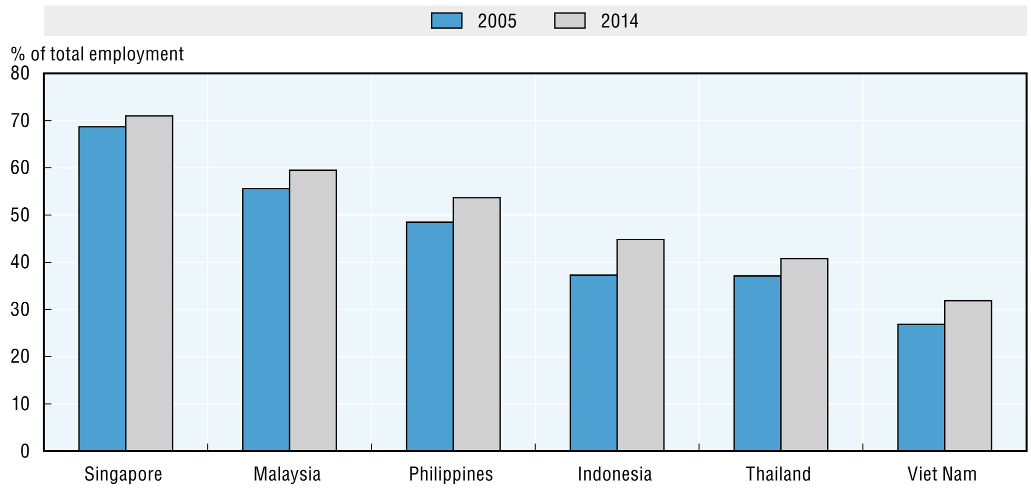


Note: Share of services for Brunei Darussalam and Singapore refers to 2013.

Source: World Bank (2015), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933309774

Figure 2.6. **Employment in the services sector for selected ASEAN countries**



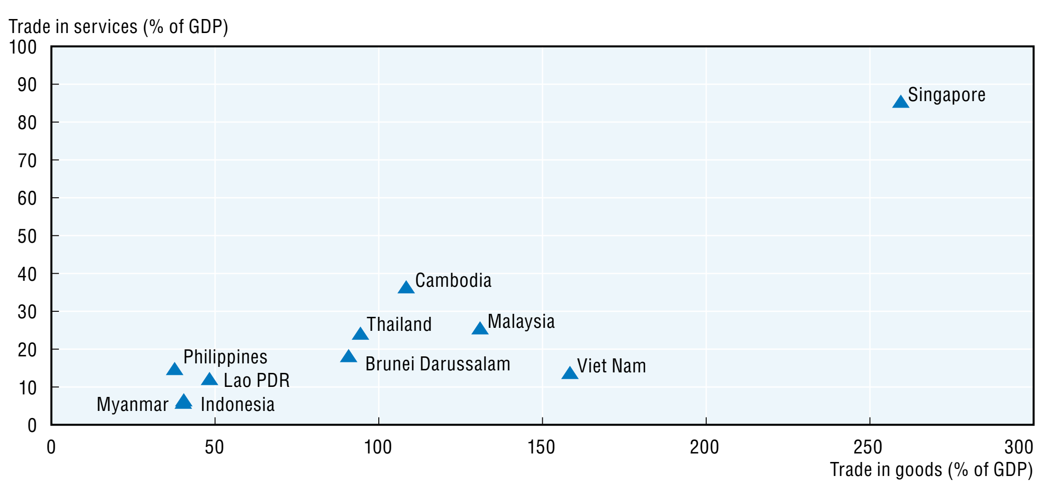
Source: CEIC, World Bank (2015), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933309782

Since 1995 ASEAN has embarked on an ambitious programme of service trade liberalisation and integration. Through the ASEAN Framework Agreement on Services (AFAS), ASEAN member countries have already agreed to liberalise and allow higher foreign equity ownerships in various service areas, such as business services, professional services, construction, health care and financial services. However, services trade integration is still limited and the potential of the sector to expand exports, enhance service competitiveness and efficiency, and improve the delivery of services are yet to be realised (Figure 2.7).

Figure 2.7. **Trade in services remains an untapped source of growth in ASEAN countries**

Trade in services share of GDP versus trade in goods share of GDP, 2014



Sources: UNCTAD (2015) *UNCTADSTAT* (database) http://unctadstat.unctad.org, UNSTATS (2014); *National Accounts Main Aggregates Database*, http://unstats.un.org/unsd/snaama/dnllist.asp.

StatLink http://dx.doi.org/10.1787/888933309799

The services sector in ASEAN is still underdeveloped compared with other countries in the world

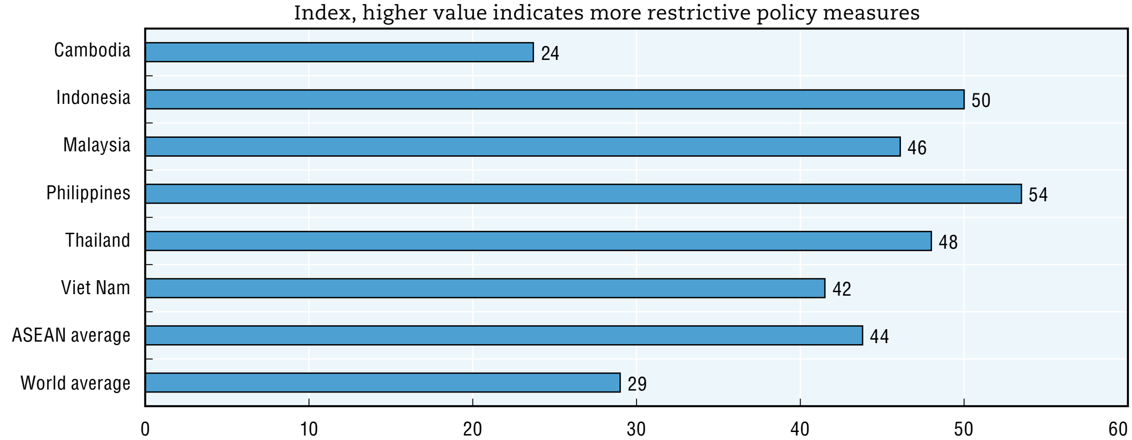
ASEAN services account for 5% of global services exports and around 56% of the region's foreign direct investment (FDI) inflows is from the services sector. Despite these opportunities, the share of services to regional GDP is smaller in ASEAN (47%) than other regions of the world such as Latin America and the Middle East (60%) and compared with other countries with similar income levels. Unlike merchandise exports, the share of regional services exports to total services exports has remained small over the years. The intensity of the services trade in the region is also quite low, suggesting that ASEAN countries do not trade in services among themselves as much as they do with countries outside the region. Despite the important role of services in generating forward linkages with other economic sectors in the region (that is, using services as critical inputs to other production sectors), the services sector remains underdeveloped. Most countries still concentrate on traditional services such as transport and tourism rather than high-value-added areas such as business-related services.

Services trade integration offers great potential but barriers remain high

One challenge in integrating the services sector in ASEAN is limited competition in services markets due to policy barriers and regulatory restrictions. Overall, services trade restrictions in ASEAN remain high. According to the Services Trade Restrictiveness Index, the ASEAN region imposes higher restrictions than the world average (Figure 2.8). Amongst the countries for which data are available, restrictions are highest in more developed economies like the Philippines, Indonesia and Thailand and lowest in less developed ones such as Cambodia and Viet Nam. The lower scores in the less developed countries may also be the result of an underdeveloped regulatory regime in these countries (World Bank/ASEAN, 2013) or because they lack domestic providers with vested interests.

Figure 2.8. **Overall Services Trade Restrictiveness Index in ASEAN, 2008-11**

Index, higher value indicates more restrictive policy measures



Note: ASEAN average includes Cambodia, Indonesia, Malaysia, Philippines, Thailand, and Viet Nam. Each country is covered in one year from within the 2008-11 range.

Source: World Bank (2011), *World Bank Services Trade Restrictions Database*, http://data.worldbank.org/data-catalog/services-trade-restrictions.

StatLink http://dx.doi.org/10.1787/888933309804

Table 2.3. **Relative sector coverage of AFAS compared with GATS**

(Ratio of GATS + AFAS coverage to GATS sectoral coverage)

Country	Sectoral coverage ratio
Brunei Darussalam	3.38
Cambodia	1.21
Indonesia	1.56
Lao PDR	n.a.
Malaysia	1.26
Myanmar	3.00
Philippines	3.03
Singapore	1.09
Thailand	1.35
Viet Nam	1.09
ASEAN average	1.58

Source: UNESCAP (2009), *Striving Together: ASEAN and the UN.*

ASEAN reforms under services agreements have made limited progress

Under the AFAS several rounds of negotiations were held to liberalise services with the goal of improving efficiency and competitiveness. The negotiations were based on the "request and offer" approach used for the WTO General Agreement on Trade in Services (GATS) where members offer commitments in response to requests from other members. This "positive list" approach has not been very successful at either the WTO or AFAS.

In the eight packages that have been negotiated over the last 20 years, liberalisation commitments have been minimal. The sectoral coverage ratio[1] for most ASEAN members is close to 1 indicating that commitments under AFAS do not differ much from those under GATS (Table 2.3). Only Brunei Darussalam, Myanmar and Philippines have ratios in excess of 3. However, Brunei Darussalam and Myanmar had made low commitments under GATS which means that only the Philippines has made real progress under the AFAS with respect to GATS. The liberalisation rate under the eighth package of AFAS commitments signed in October 2010 has increased by only 1% on average compared with commitments under the seventh package signed in February 2009. Liberalisation rates have increased for Brunei Darussalam, Cambodia, Malaysia and Singapore while the others have recorded decreases. Although there is progress in some sectors (notably air transport and financial services), there is, overall, space for improving the level of integration (World Bank 2015).

MRAs have established partial recognition of some professional services

In addition to AFAS, MRAs offer another way of establishing consensus amongst ASEAN members. The AEC Blueprint calls for MRAs in several professional services including engineering, architecture, accounting, surveying, medicine and dentistry (ASEAN, 2008). Most progress has been made on the MRAs for engineering and architecture with the harmonisation of standards and provision of recognition for registered ASEAN professionals (Fukunaga, 2015). The MRAs in other areas are not as ambitious and remain far from being implemented. Even the MRAs in engineering and architecture are limited to the temporary movement of professionals and do not exclude requirements for national immigration and work permits. As a result, uptake of this scheme has been low with only a few registered professionals in Viet Nam, Indonesia, Malaysia and Singapore and none elsewhere. In fact many professionals choose to work overseas by registering as consultants instead (Fukunaga, 2015).

One issue is the inability of countries to align MRAs with domestic regulations. Regulatory and legislative reforms, such as to labour law and professional regulation, would be needed to implement MRAs in some countries. In some cases, the incentive to implement the MRAs is diminished by a perceived lack of potential benefits. For example, in a survey conducted by the World Bank (2015), it is shown that in professional services such as engineering and architectural services policies applied in some countries are far more liberal than the MRA regime. As a result, even if countries have signed the MRA agreements, the overall incentive for them to implement the MRAs is low because existing regulations are far more liberal under their most favoured nation regime.

INVESTMENT AND CAPITAL MARKET LIBERALISATION

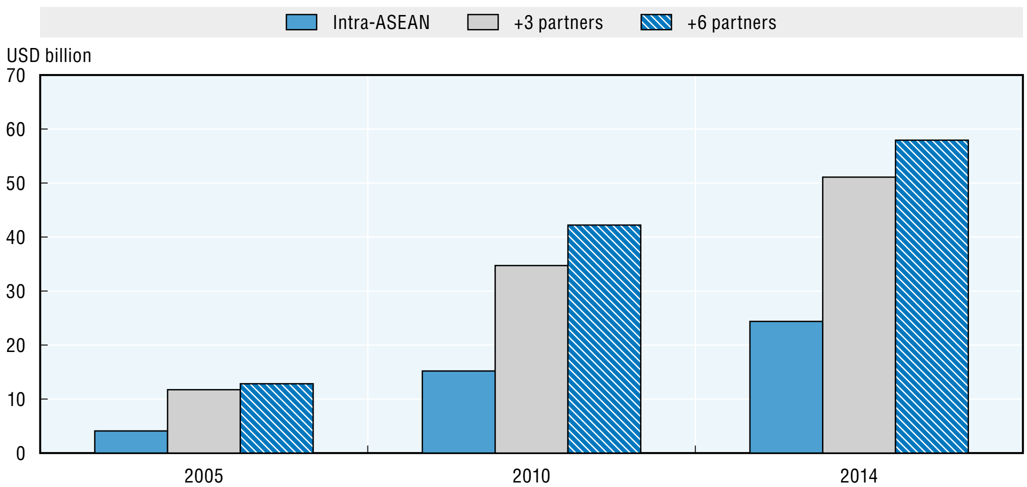
Assessment of progress in integration

- Liberalisation rates under the ACIA (ASEAN Comprehensive Investment Agreement) indicates that the relatively less developed ASEAN countries tend to be more open to investment in agriculture and mining while the other ASEAN members tend to be more open to manufacturing.
- One area that still concerns investors in ASEAN is the region's high costs of doing business, and providing a good business environment will be key.
- Intra-ASEAN banking facilities remain weak which is a particular concern for cross-border trade and investment. Reforms are under way through the implementation of the ASEAN Banking Integration Framework and multilateral currency swap arrangements are in place to provide liquidity in times of need.
- The Chiang Mai Initiative Multilateralisation and Asian Bond Market Initiative, established by the ASEAN+3 framework, are promoting regional stability and financial integration. Reforms to the structure of the CMIM and increased monitoring are making the arrangement more useful to the region.

Since the implementation of the ASEAN Investment Agreement in 1998, ASEAN has been committed to strengthening its investment regime. This commitment was further reinforced with the signing of the ASEAN Comprehensive Investment Agreement (ACIA) in 2009. Under the AEC, free flow of investment is targeted as a core measure to achieve an integrated single market and production base by 2015, along with free movement of goods, services, skilled labour and a freer flow of capital. While progress has been made, establishing the region as a single investment market is not easy. Broader regional co-operation with ASEAN+3 partners is helping to promote the stability and development of financial markets in the region.

ASEAN has benefitted from closer investment relationships with itself and its neighbours. FDI inflows from the +6 partner countries have increased to USD 58 billion in 2014, far outpacing the growth of intra-ASEAN FDI flows, which totalled USD 4.1 billion and USD 24.4 billion, respectively (Figure 2.9). Portfolio investment among ASEAN+3 and ASEAN+6 participants, has similarly increased considerably since the late 2000s, reflecting stronger financial ties within the region (Figure 2.10).

Figure 2.9. **FDI inflows to ASEAN members by source, 2005-14**



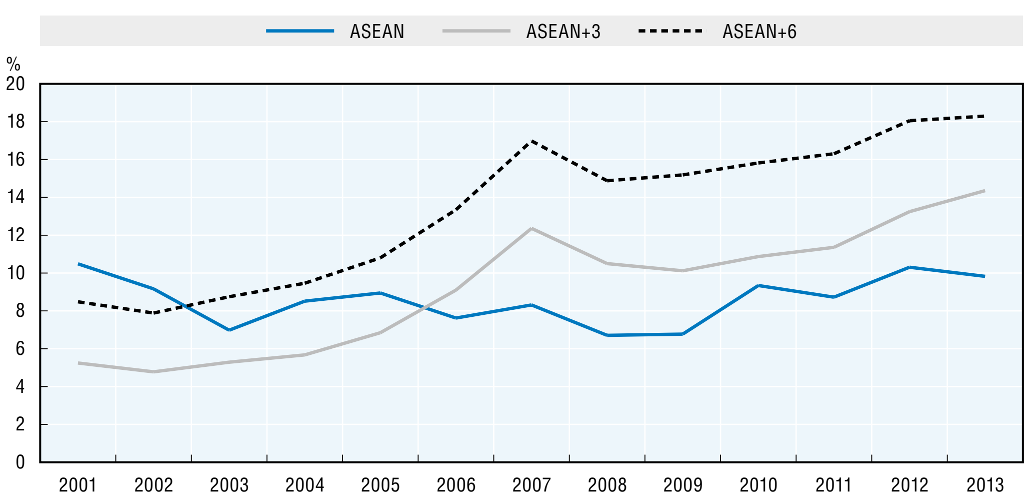
Note: +3 partners includes ASEAN 10 countries plus China, Japan and Korea. +6 partners includes ASEAN+3 plus Australia, India and New Zealand.

Source: ASEAN (2015a), *ASEANstats* (database), http://aseanstats.asean.org.

StatLink http://dx.doi.org/10.1787/888933309814

Figure 2.10. **Intra-regional investment in portfolio assets in ASEAN, ASEAN+3 and ASEAN+6, 2001-13**

Within-group holdings of foreign debt and equity securities as a share of total foreign holdings by group members



Note: ASEAN+3 includes ASEAN 10 countries plus China, Japan and Korea. ASEAN+6 includes ASEAN+3 plus Australia, India and New Zealand.

Source: ADB (2015a), *Integration Indicators* (database), http://aric.adb.org/integrationindicators.

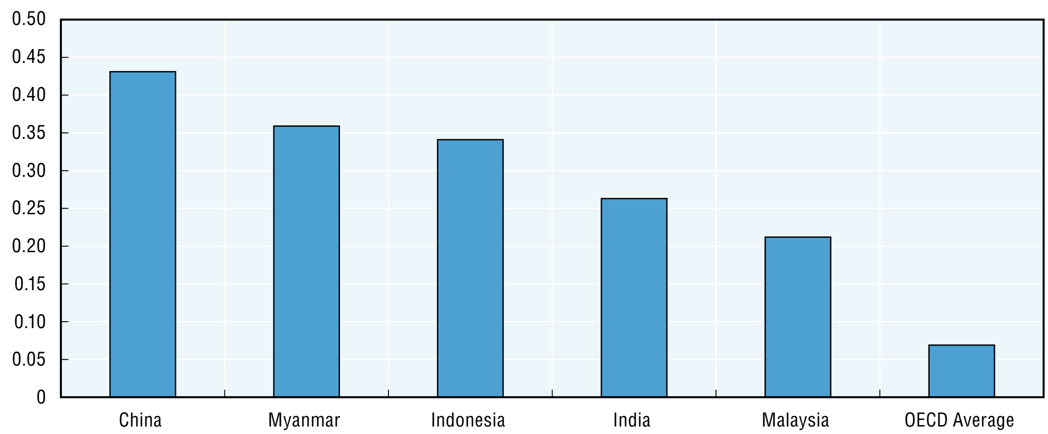
StatLink http://dx.doi.org/10.1787/888933309827

Intra-regional investment has increased but ASEAN still has a small share of developing world FDI

Intra-ASEAN investment grew 25.7% to USD 24.4 billion in 2014, accounting for 17.9% of total FDI. Since jumping rapidly in 2006 (USD 8.7 billion or 13.6% share), intra-ASEAN investment has continued to grow. Major FDI flows were recorded in Indonesia, Singapore and Malaysia. Although there is an upward trend in intra-ASEAN investment, the growth rate is still below the average rate of 48.5% over the last ten years (2001-10) and much lower than the 2001 peak. Given rising competition for foreign capital among emerging economies globally, ASEAN needs to develop domestic infrastructure and other economic conditions to increase its potential for greater intra-regional investment. Reduced regulatory restrictiveness on FDI would also be important in attracting investment (Figure 2.11).

Figure 2.11. **FDI restrictiveness in selected economies in Emerging Asia, 2014**

Index, higher values indicate greater restrictions

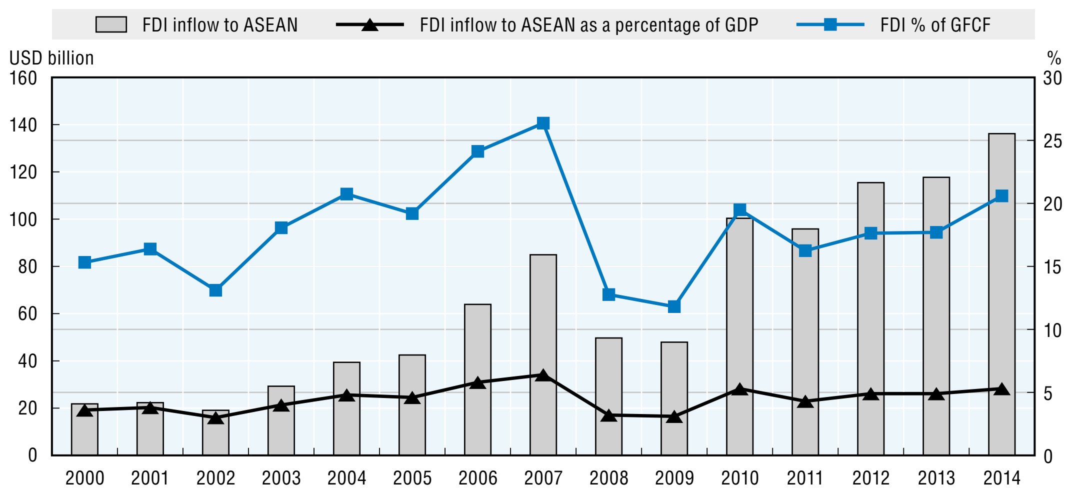


Source: OECD (2015a), *OECD FDI Regulatory Restrictiveness Index* (database), http://stats.oecd.org/Index.aspx?datasetcode=FDIINDEX#.

StatLink http://dx.doi.org/10.1787/888933309830

By end-2014, FDI inflows amounted to only 5.3% of ASEAN GDP (Figure 2.12), the same as the level over the last 15 years and still below the 2007 peak (when inflows reached 6.4% of GDP). This also raises concerns over the ability of FDI liberalisation to increase the level of domestic investment and/or its productive capacity. Domestic investment in ASEAN has remained sluggish and has been declining as a share of GDP since 1997. From 1998 to 2009, investment in the region averaged around 23% of GDP compared with a savings rate of 28% of GDP. To the extent that cross-border investors respond directly to country characteristics in making investment decisions, any deterioration in these conditions can adversely affect FDI flows. Hence it is crucial that ASEAN responds quickly to alleviate these investment constraints (i.e. low investment-to-GDP ratios and a declining contribution to growth) in order to make the region more attractive to FDI.

Figure 2.12. **ASEAN FDI inflows**



Note: GFCF: gross fixed capital formation.

Source: ASEAN Secretariat.

StatLink http://dx.doi.org/10.1787/888933309848

Progress in liberalisation varies between countries and sectors

As it stands, ACIA intends to simplify and clarify the investment environment in ASEAN by creating common standards and protection provisions. It is comprehensive in that it not only covers investment protection but also liberalisation, promotion and facilitation. Investment promotion is usually co-ordinated by a dedicated investment promotion authority which serves as a link between the private sector, government ministries and local government units (LGUs). Investment facilitation measures such as the ASEAN Single Window aim to reduce compliance costs and address investor concerns of excessive bureaucracy. Overall, however, ACIA is still an ongoing process.

While investment liberalisation, in terms of market access and national treatment, has progressed under ACIA there remain important differences between countries. Cambodia, Lao PDR and Myanmar – countries with low per capita GDP and rich in land and resources – are more open to investment in agriculture and mining (Intal, 2015). Meanwhile, Brunei Darussalam, Indonesia, Malaysia, Thailand and the Philippines – relatively richer countries – are more restrictive to agriculture and mining but are more open to manufacturing. Furthermore, surveys of firms investing in the region indicate that they are more concerned about the implementation of FDI facilitation measures rather than liberalisation. A high proportion of surveyed firms, even in major ASEAN economies such as Indonesia, Thailand, Malaysia and Viet Nam report experiencing complicated administrative procedures and delays (ADB, 2013).[2]

Strengthening the investment climate and facilitation in ASEAN remains challenging

One area that still concerns investors in ASEAN is the region's high costs of doing business that weigh on its overall competitiveness. According to the World Bank's 2014 *Doing Business* report, ASEAN ranked number 87th out of 183 countries for ease of doing business. Although this is higher than the rankings for the BRIC (Brazil, Russia, India and China) countries, the ASEAN position has not changed since 2007. Three ASEAN countries were in the top 20 globally – Singapore, Thailand and Malaysia.

These economies have implemented effective streamlined procedures for regulatory processes. They also periodically review and update business regulations and utilise new technologies through e-government initiatives. Nonetheless, improvements in the investment environment are still needed. Recently, there have been improvements in the regulatory environment in Indonesia and Malaysia, but deterioration in most indicators in Cambodia, the Philippines and Thailand. In particular, areas that remain problematic in many countries include regulations pertaining to starting a business, getting permits, registration, taxes, and resolving business insolvency.

Further reforms are required to harmonise domestic investment laws and treaty obligations

There has been some success in harmonising legal processes in spite of the large differences in the development level of member countries. Special provisions have been granted to CLMV countries to allow them to accede at their own pace while the other ASEAN members have gradually brought their domestic legislation in line with regional agreements. Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines and Viet Nam have incorporated various investment protection measures into their domestic legislation but further reforms are required to establish a common legal landscape within ASEAN (OECD, 2014a). The existence of bilateral investment agreements and related provisions in free trade agreements offer investors an additional layer of protection. The large number of treaties, however, can lead to inconsistencies, overlap and high compliance costs (OECD, 2014a). Further reforms are required not just to unify investment laws between countries but also to bring consistency between treaty obligations and domestic law provisions (OECD, 2014a)

Intra-regional banking facilities are increasing but from a low base

The availability of intra-regional banking facilities is beneficial to promote trade and investment in the region particularly for SMEs. In ASEAN, the level of banking integration remains weak compared with other Asian countries and the rest of the world. Foreign banks accounted for only 18% of total commercial bank assets in Malaysia, the Philippines and Thailand in 2009 (IMF, 2015a). The share of ASEAN-based banks is even lower at 8.5% for Malaysia, 0.4% in the Philippines and 3.7% in Thailand (IMF, 2015a). Reforms are under way through the implementation of the ASEAN Banking Integration Framework. A key initiative, recently approved by all ASEAN central bank governors, is the Qualified ASEAN Banks programme which allows any two ASEAN countries to enter into a reciprocal bilateral agreement giving some banks greater market access and treatment similar to domestic banks (ASEAN, 2015b). The agreed framework is yet to be implemented along with strengthened regulatory and supervisory co-operation arrangements (ASEAN, 2015b).

Capital market reforms have progressed as a result of the Chiang Mai Initiative Mutilateralisation and Asian Bond Market Initiative

Capital market liberalisation needs to be discussed alongside a prudential framework. There is an increasing need to strengthen buffers such as bilateral credit lines and regional safety networks. One such regional approach is the Chiang Mai Initiative Multilateralisation (CMIM) between the ASEAN members, Japan, China and Korea. The CMIM is a multilateral currency swap arrangement that replaced the previous bilateral swap lines of the Chiang Mai Initiative. The Asian Bond Market Initiative (ABMI) has been effective in fostering markets for local currency-denominated bonds. Other reforms include the ASEAN Disclosure Standards which have been adopted to harmonise standards for debt and equity issuance across the region. Currently only Malaysia, Thailand and Singapore are signatories to the scheme (ASEAN, 2015c). Scorecards are also being developed for corporate governance and bond market development to raise standards and monitor progress.

The CMIM grew out of a series of bilateral currency swap agreements among the ASEAN+3 countries, first discussed at a meeting in Chiang Mai, Thailand, in the aftermath of the Asian financial crisis. The agreement to multilateralise the Chiang Mai Initiative was signed in 2009. Voting power is determined by the combination of basic votes and national contribution shares, with the +3 countries of Japan, China (including Hong Kong, China since 2009) and Korea holding a combined 71.6% of the votes (Table 2.4). The ASEAN member countries are entitled to withdraw shares exceeding their contributions in times of crisis, however. Indonesia, Thailand, Malaysia, Singapore and the Philippines are allowed swaps of up to 2.5 times their contribution and the remaining five ASEAN members allowed swaps of up to five times their contributions to CMIM.

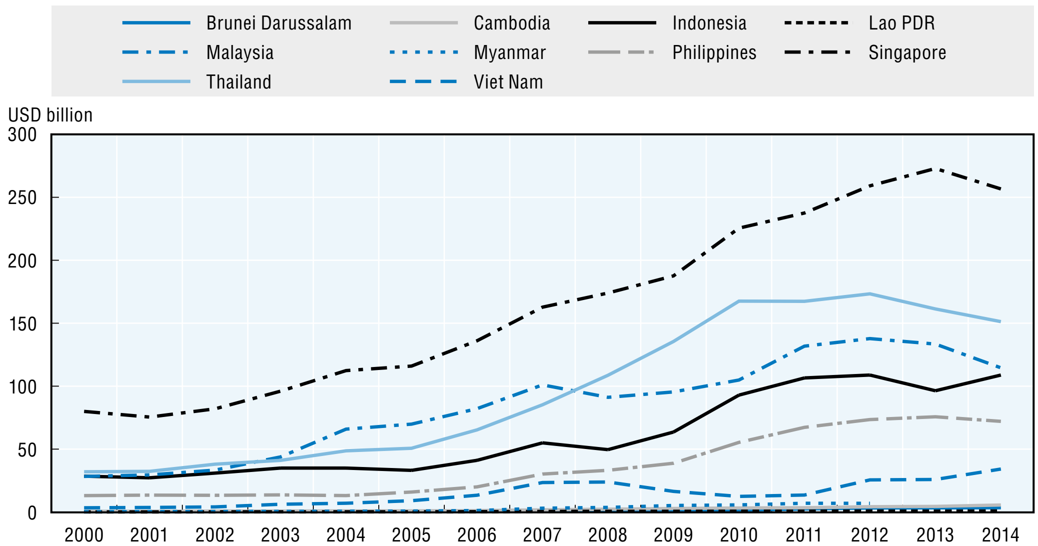
Table 2.4. **CMIM contributions, maximum swap amounts and vote shares, by country**

Country		Contribution (USD billion)	Contribution share (%)	Maximum swap amount (USD billion)	Maximum swap amount as share of pool (%)	Vote share (%)
Japan		76.8	32.00	38.4	15.77	25.43
China	China (excluding Hong Kong)	68.4	28.50	34.2	14.05	2.98
	Hong Kong, China	8.4	3.50	6.3	2.59	28.41
Korea		38.4	16.00	38.4	15.77	14.77
Indonesia		9.104	3.79	22.76	9.35	4.37
Thailand		9.104	3.79	22.76	9.35	4.37
Malaysia		9.104	3.79	22.76	9.35	4.37
Singapore		9.104	3.79	22.76	9.35	4.37
Philippines		9.104	3.79	22.76	9.35	4.37
Viet Nam		2	0.83	10	4.11	1.85
Cambodia		0.24	0.10	1.2	0.49	1.22
Myanmar		0.12	0.05	0.6	0.25	1.18
Brunei Darussalam		0.06	0.03	0.3	0.12	1.16
Lao PDR		0.06	0.03	0.3	0.12	1.16
Total		240	100.00	243.5	100.00	110.00

Source: AMRO (2012), "CMIM contributions, purchasing multiple, maximum swap amount and voting-power distribution", *Fact Sheet at AFMGM+3 in Manila*, May 2012, ASEAN+3 Macroeconomic Research Office, Singapore, www.amro-asia.org/wp-content/uploads/2012/05/Fact-Sheet-at-AFMGM+3-in-Manila.pdf.

The size of the fund has grown significantly, providing a strong defence against possible future crises. The pool of committed foreign reserves that could be used in managing regional short-term liquidity was doubled from USD 120 billion to USD 240 billion at the 15th APT Finance Ministers Meeting in May 2012. Finance ministers also agreed to increase the portion of this fund delinked from IMF lending from 20% to 30%. While the larger pool of pledged funds makes the CMIM a more useful and credible tool in crisis prevention, member countries continue to hold large foreign reserves, though their growth has slowed in recent years (Figure 2.13 and Figure 2.14). The CMIM remains untested however, so there is uncertainty of how it would operate in practice.

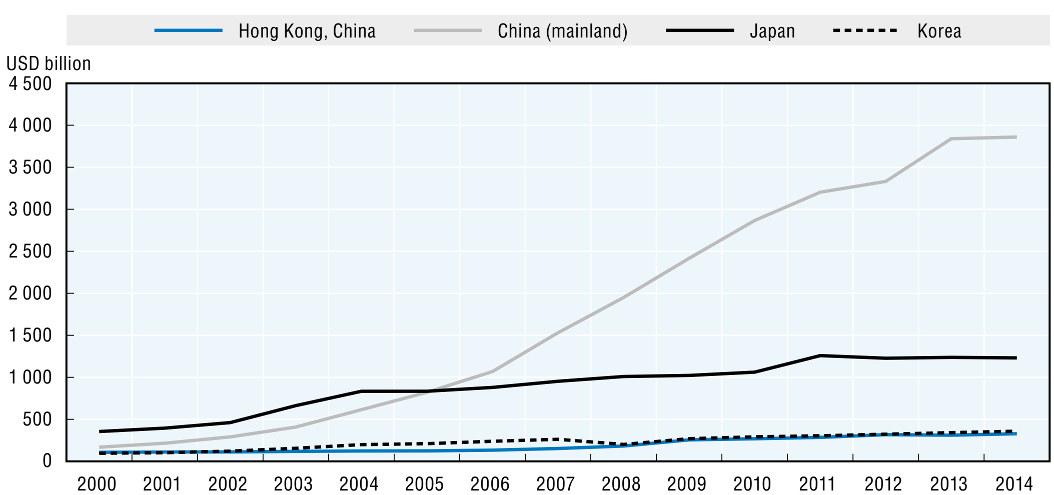
Figure 2.13. **Total reserves excluding gold in ASEAN countries, 2000-14**



Source: IMF (2015b), *International Financial Statistics* (database), http://data.imf.org/?sk=5DABAFF2-C5AD-4D27-A175-1253419C02D1.

StatLink http://dx.doi.org/10.1787/888933309851

Figure 2.14. **Total reserves excluding gold in China, Japan and Korea, 2000-14**



Source: IMF (2015b), *International Financial Statistics* (database), http://data.imf.org/?sk=5DABAFF2-C5AD-4D27-A175-1253419C02D1.

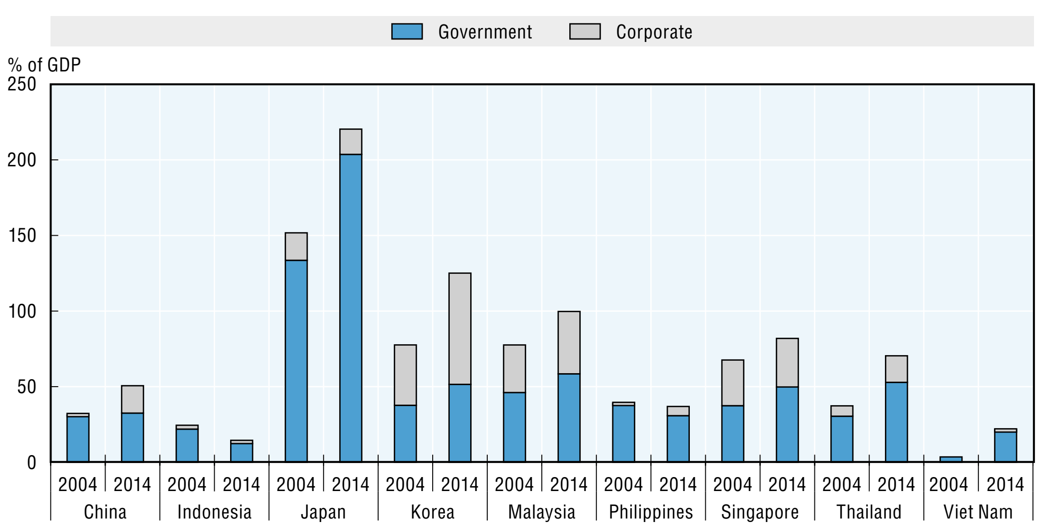
StatLink http://dx.doi.org/10.1787/888933309867

Nevertheless, the CMIM is demonstrating the potential for deeper co-operation and has served as an important forum for policy dialogue on regional and country-specific problems. Its institutional capacity has also been bolstered by the establishment of the ASEAN+3 Macroeconomic Research Office in 2011 to support CMIM decision making and monitor and analyse ongoing trends among regional economies. This capacity for independent analysis will be particularly important in strengthening the value of the CMIM to its members, particularly as a larger delinked share of the fund increases its flexibility and responsiveness to regional needs.

The Asian Bond Market Initiative, designed to support the development of local, national and regional bond markets, was formally agreed at the APT Finance Ministers Meeting in 2003. The New ABMI Roadmap, approved in 2008, aimed to further develop local-currency-denominated bond markets, as well as the development of a regional bond market. This is to be achieved through voluntary efforts by member countries to promote demand and supply of local-currency-denominated bonds, improved regulatory frameworks and related infrastructure. This was followed by the New Roadmap+ in 2013, which included in its priorities the launching of credit guarantee programmes of the Credit Guarantee Investment Facility (itself established to finance infrastructure investment across ASEAN), the development of infrastructure financing schemes and the establishment of the Regional Settlement Intermediary.

Work remains to be done on the ABMI, though it has already passed important milestones. It has led to investment in local-currency bonds and reforms to tax, accounting and regulatory barriers to cross-border investing. Issuance of local-currency-denominated bonds is growing slightly faster than GDP in many of the economies participating in the initiative (Figure 2.15). Despite considerable growth in several countries over this period – such as in corporate bonds in China, the Philippines and Thailand or government bonds in Viet Nam – bond markets remain underdeveloped in much of the region. Instead, financing is largely bank-based, with growth in bond markets often dominated by government bonds and state-owned enterprises. Securitisation and derivatives markets are emerging in the region, however. Capital markets have been held back by regulatory restrictions and the weakness of supporting infrastructure such as clearing, settlement and payment systems and benchmark yield curves, as well as the effects of insufficient scale and the importance of foreign-invested firms in many Emerging Asian economies (OECD, 2013).

Figure 2.15. **Local-currency-denominated bonds in ASEAN+3 countries, 2004 and 2014**



Note: Figure includes all ASEAN+3 countries with available data. Data refer to total local-currency-denominated bonds outstanding in December 2004 and December 2014.

Source: ADB (2015b), *Asian Bonds Online*, http://asianbondsonline.adb.org.

StatLink http://dx.doi.org/10.1787/888933309878

Box 2.4. **ASEAN outward investments – a new breed of multinational corporations?**

Emerging markets multinational corporations (EM-MNCs), particularly those based in Asia, are now an important force in international business. While EM-MNCs are driven by motives similar to their counterparts from developed markets (e.g. in terms of seeking ownership advantages of location and resources of other markets), it seems that they have different characteristics from which they can benefit. For example, they have "adversity advantages" (or the ability to survive challenging investment climates e.g. poor infrastructure, bad governance, regulatory uncertainties and weak educational institutions) which developed markets MNCs lack.

Are ASEAN countries ready to join the ranks of this new breed of MNCs? Rising trends of FDI outflows from ASEAN, particularly Singapore, Malaysia and Thailand since 2009, suggest good possibilities. In recent years, several MNCs based in Malaysia, Singapore and Thailand[3] have emerged that show the potential for ASEAN MNCs (AMNCs) to play a larger role. For example, UNCTAD's 2012 *World Investment Report* ranked the top 100 non-financial transnational corporations (TNCs) from developing and transition economies by foreign assets. TNCs from Singapore and Malaysia rose in the rankings in 2010. The highest ranked ASEAN TNC was Petronas – Petroliam Nasional Bhd from Malaysia. The rankings also included corporations from the telecommunications, food and beverages, consumer services, construction, electrical and electronic equipment industries. However, only Petronas made the top 100 in the global TNC ranking, coming in at number 83, with a Transnationality Index[4] of only 28.5%.

According to the "South-South" FDI model, one comparative advantage for the emerging MNCs is their ability to know their market well given that most of them operate in the same region. Using this experience, particularly from regional integration, ASEAN companies can offer products and services more suited to host countries' markets. They can also easily manage regulatory processes due to their familiarity with regional issues, not to mention the ability to reduce their cost structure due to locational advantages in sourcing raw materials and inputs. However, there are challenges in becoming AMNCs, such as dealing with business operations issues in different countries. From a policy point of view, it is crucial that ASEAN governments develop a good investment climate and implement policies and institutional infrastructure to support outward FDI.

Sources: Lee (2012), "Rising Tide of Global FDI in Asia," CIMB Macro Pulse; Battat and Aykut (2005), "Southern Multinationals: A Growing Phenomenon," https://www.wbginvestmentclimate.org/uploads/Southern%20Multinationals%20A%20Growing%20Fenomenon.pdf; UNCTAD (2012), *World Investment Report: Towards a New Generation of Investment Policies*, http://unctad.org/en/PublicationsLibrary/wir2012_embargoed_en.pdf.

COMPETITION AND CONSUMER PROTECTION

Assessment of progress in integration

- ASEAN members have sought to share experience and best practice through the ASEAN Experts Group on Competition and the development of regional guidelines on competition policy. Although these guidelines are non-binding, they aim to serve as a benchmark for members to assess their progress.
- Currently challenges remain as members have a long way to go until eventual harmonisation of competition policies. Some countries continue to grant favourable treatment to state-owned enterprises, thereby undermining competition.
- Consumer protection initiatives at a regional level have mainly taken the form of information sharing, capacity building and awareness-raising programmes. While the enforcement of consumer protection legislation has been quite weak, recent efforts have been made at strengthening the capacity of practitioners in the region.

Competition policy – as a key component of establishing a competitive economic region – exists to prevent anti-competitive agreements such as cartels and collusion, abuses of dominant positions through predatory or exclusive dealings, and mergers or acquisitions that substantially reduce competition. ASEAN has taken a co-operative approach to addressing these problems. The AEC Blueprint sets out the modest goals that countries seek to achieve by 2015.

Competition laws are still being developed in many ASEAN countries

Although the ASEAN members have committed to introducing competition laws, they remain at various stages of development. At the time the AEC Blueprint was drafted only Indonesia, Singapore, Thailand and Viet Nam had in place domestic competition law and regulatory bodies (ASEAN, 2008). Since then Malaysia has introduced its Competition Act in January 2012 while draft competition laws remain under discussion at the ministerial level in Cambodia, Lao PDR and the Philippines. In Myanmar, the competition law was recently signed into force by the president in February 2015.

In the countries that lack a comprehensive competition law, regulations nonetheless exist in specific sectors. In Cambodia telecommunications and banking are regulated by the National Information Communications Technology Development Authority and the National Bank of Cambodia respectively. Brunei Darussalam has specific regulators for key sectors such as telecommunications, energy, banking and finance. The Philippines has over 30 industry-specific competition laws in addition to related provisions in the constitution (article XII), Revised Penal Code (article 186) and New Civil Code (article 28). In Lao PDR competition is regulated not by law but through the Trade Competition Decree (15/PMO). However, the Trade Competition Commission, which will be responsible for the enforcement of competition law, is yet to be established.

The ASEAN Regional Guidelines on Competition Policy has been developed as a non-binding reference tool for members as they endeavour to develop and implement competition policies in their respective countries (ASEAN, 2010a). The guidelines provide a general framework which individual ASEAN members can then adapt to their specific legal and economic context. The framework is sufficiently differentiated to allow countries to identify and adopt those measures that are suitable for their level of competition policy development. It is also intended to ultimately serve as a common reference guide for future co-operation in this area (ASEAN, 2010a).

The *Handbook on Competition Policy and Law in ASEAN for Business* was first launched in 2010 to provide the private sector with a basic understanding of substantive and procedural competition laws in the ASEAN member states (ASEAN, 2013b). It has since been updated in 2013 to reflect changes in regulation, legislation, implementation and the creation of competition authorities (ASEAN, 2013b).

The *Guidelines on Developing Core Competencies in Competition Policy and Law for ASEAN* were published in 2012 to provide recommendations on enforcement systems. While the Regional Guidelines described the types of competition policies available, the core competencies guidelines describe the attributes required for a competition authority. In particular, the powers and know-how required for a well-functioning competition enforcement system are elaborated (ASEAN, 2012b). In addition to advice, the report provides benchmarks against which ASEAN members can measure their progress in developing core competencies.

Capacity-building workshops and regional forums have been established to share experiences and best practices

The ASEAN Experts Group on Competition (AEGC) has been established as a regional forum to discuss and co-operate on competition policy. This group was responsible for publishing the guidelines and core competencies mentioned previously. Capacity-building workshops have been held on drafting competition law, training courses on investigation and case handling, and promoting competition compliance by businesses. However these workshops are usually conducted on an ad hoc basis when external sources of funding are available rather than on a regular basis.

In spite of having in place competition laws, some countries continue to restrict competition by granting favourable treatment to state-owned enterprises. In Myanmar the State-Owned Enterprises Law grants the government exclusive right to carry out major economic activities in extractive industries, fisheries, transport, finance, defence, broadcasting and electricity generation. In Viet Nam the interests of the State are protected by competition law which requires enterprises to abide by the principle of "non-infringement of the interests of the State". The presence of state-owned enterprises that restrict market access or obtain monopoly privileges is largely ignored in the discussion on competition. The creation of a competitive economic region in ASEAN will require these issues to be addressed.

Consumer protection initiatives on information sharing, awareness raising and capacity building have advanced

Consumer protection is an important element to strengthen a competitive environment in ASEAN. At present Brunei Darussalam, Indonesia, Lao PDR, Malaysia, Philippines, Singapore, Thailand, Viet Nam and recently Myanmar have put in place consumer protection legislation while Cambodia is expected to enact its consumer protection law by the end of 2015. The ASEAN Committee on Consumer Protection (ACCP), envisioned in the AEC Blueprint, serves as a focal point to implement and monitor regional consumer protection mechanisms. The ACCP facilitates the exchange of information on recalled or banned products notified by ASEAN members through the publication of a detailed list of products, their country of origin and reason for recall/ban.

While the enforcement of consumer protection laws in the region is generally quite weak, recent efforts have been aimed at increasing the competency of government personnel in relevant ministries. Training-for-trainers workshops have been held on consumer credit and banking, environment and professional services to inform participants of consumer-related issues, the corresponding consumer protection laws and dispute resolution mechanisms to be implemented. In 2014 the Consumer Protection Digests and Case Studies: A Policy Guide (Volume 1) was published to raise awareness of key consumer protection issues, laws and policy developments within ASEAN and internationally. Case studies were also included to provide in-depth investigation into online consumer markets and regulation of unfair contract terms.

Box 2.5. **SOE reforms will need to be strengthened in Emerging Asia**

State-owned enterprises (SOEs) are fairly common in a number of Emerging Asian countries and may pose barriers for integration where they produce market distortions and unfair conditions for competition. These firms may receive material benefits, including direct subsidies or favourable terms in accessing loans or export credit. In a number of countries, firms with close links to government, such as Brunei Darussalam's government-linked companies (GLCs) and military-owned firms in Myanmar under the Union of Myanmar Economic Holdings Ltd. (UMEH) and the Myanmar Economic Corporation (MEC), may also receive various forms of preferential treatment. These types of firms can pose challenges to the creation of environments for fair competition domestically and, with increasing integration, for the region.

While SOEs have been responsible for a declining share of economic activity in a number of Emerging Asian countries, they remain very important in a number of countries. Relative to GNI (gross national income), China and India have the largest SOE sectors among the BRIICs (BRIC countries plus Indonesia), by most measures (Table 2.5). Many of these firms operate in mining, construction and transportation industries, though they can be found in a range of economic activities (Kowalski et al., 2013). Recent reforms to SOEs have often done little to change their governance structures. Gradual reform in Viet Nam has been relatively modest in its goals, seeking to change these firms into joint-stock companies and improve accountability (OECD, 2014a). SOE reforms are currently being discussed in China, with the aim of increasing competitive pressures to improve profitability.

Table 2.5. **SOE sales, profits, assets and market value, as percentage of gross national income**

Country	Sales (%)	Profit (%)	Assets (%)	Market Value (%)
Brazil	12	1.70	51	18
China	26	2.90	145	44
India	16	4.30	75	22
Indonesia	3	0.30	19	12
Russia	16	3.00	64	28
South Africa	2	1.70	3	1

Source: Kowalski et al. (2013), "State-owned enterprises: Trade effects and policy implications", *OECD Trade Policy Papers*, No. 147, http://dx.doi.org/10.1787/5k4869ckqk7l-en.

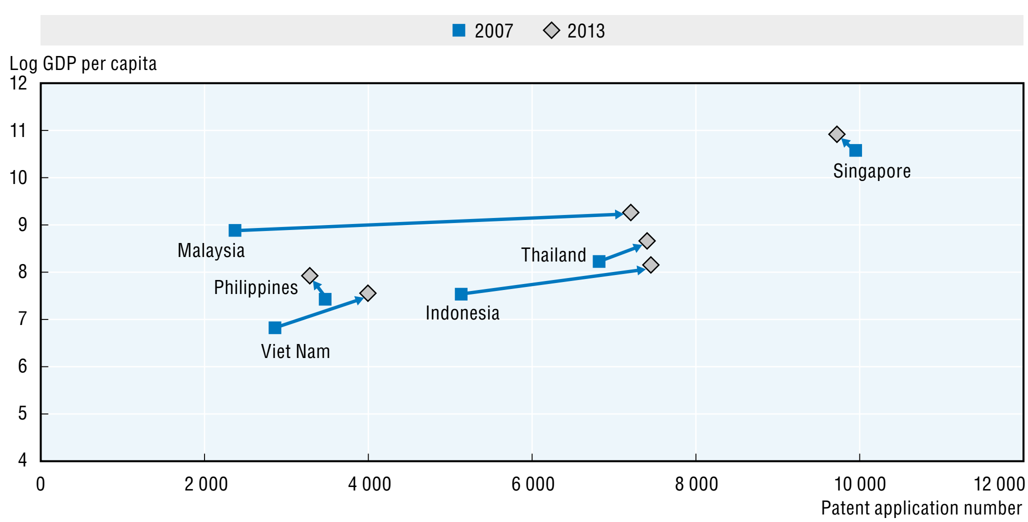
INTELLECTUAL PROPERTY

Assessment of progress in integration

- Co-operation between IP offices has been improved. The legal and policy infrastructure of ASEAN countries that wish to accede to global IP agreements is being developed. Developing local capacity on patent and trademark registration and enforcement is also important.
- Patent Libraries, the ASEAN IP Portal and ASEAN TMview are new tools that provide easy access to information on patents, IP legislation and trademarks respectively.

ASEAN members have adopted a more flexible approach to co-operation in intellectual property (IP) since 1995 with the signing of the ASEAN Framework Agreement on Intellectual Property Cooperation. The agreement recognised the importance of IP rights to stimulate investment and called for greater co-operation to develop a regional protection mechanism and align standards with those used internationally. Malaysia, Indonesia, Thailand and Viet Nam have seen notable increases in patent applications in the past years but other countries showed limited progress (Figure 2.16). Most ASEAN countries have also seen limited improvement over intellectual property protection (Figure 2.17).

Figure 2.16. **Patent applications vs GDP per capita in ASEAN**

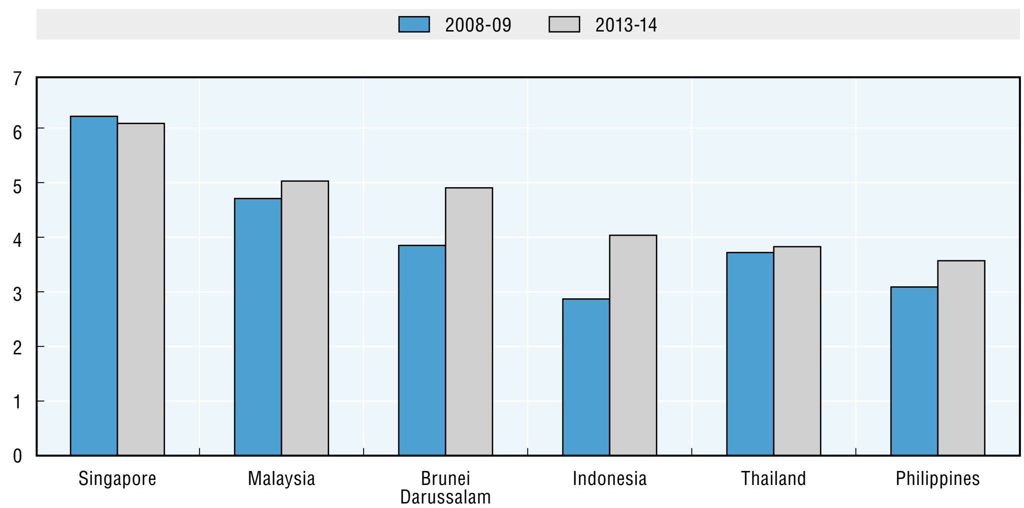


Source: CEIC.

StatLink http://dx.doi.org/10.1787/888933309882

Figure 2.17. **Intellectual property protection score in ASEAN-6 countries**

Index scale of 0-7 from lowest to highest protection



Note: The score is based on the view of firm executives interviewed in WEF's Executive Opinion Survey 2013-14.

Source: OECD (2014b), *Perspectives on Global Development 2014: Boosting Productivity to Meet the Middle-Income Challenge*, http://dx.doi.org/10.1787/persp_glob_dev-2014-en.

StatLink http://dx.doi.org/10.1787/888933309896

The ASEAN Working Group on Intellectual Property Cooperation (AWGIPC) was created in 1996 to develop, co-ordinate and implement all IP-related programmes in the region. The AWGIPC's work is currently based on the ASEAN IPR Action Plan 2011-2015 which aims to improve the efficiency of IP administration and enforcement; develop the necessary legal and policy infrastructure to integrate with global IP systems when required; raise awareness and promote the benefits of IP; and enhance co-operation with international partners to build capacity of the regional IP offices. Several initiatives are under way to achieve each of these goals.

Co-operation between IP offices improves service delivery and reduces costs

Improvements in administration are required to improve the quality of IP registrations in terms of their validity as well as the timeliness of service delivery. To this end, a mechanism for work sharing has been initiated in the form of the ASEAN Patent Examination Co-operation (ASPEC) programme. Launched in 2009 by nine participating ASEAN members, the purpose of the programme is to share search and examination results between patent offices to allow applicants to obtain patents in other countries more quickly. The search and examination work conducted by one ASEAN IP office is a valuable input into the decision-making process of another participating IP office providing them with access to prior art in local languages and databases that they might not have access to. Although this process is non-binding on national IP offices as they are not obliged to adopt the findings of other offices, it avoids unnecessary duplication of work effort and thereby reduces administrative costs.

The latest action plan on intellectual property rights (IPRs) gives ASEAN members the flexibility to decide which international agreements they wish to join. Nevertheless the AWGIPC has sought to develop the legal and policy infrastructure to enable accession to global agreements at the appropriate time. Currently, only Singapore and Viet Nam have signed the Madrid Protocol for the International Registration of Marks and only Singapore has signed the Hague Agreement for the Industrial Registration of Industrial

Designs. To increase capacity of interested members in joining these global agreements, ASEAN has received support from international partners. Through the EU-ASEAN Project on the Protection of Intellectual Property Rights (ECAP III), workshops were held in seven ASEAN members in 2013 to train IP officials on the basic features of the Madrid Protocol and the use of relevant IT support tools. In 2014 ECAP, in co-operation with the ASEAN-Australia-New Zealand Free Trade Agreement project, undertook missions in Cambodia, Indonesia, Myanmar and Lao PDR to develop pre- and post-accession implementation work plans for each IP office. Information seminars on the Hague Agreement were also held in 2014-15 for a wide range of stakeholders including scientists, entrepreneurs, government officials and legal experts on industrial design protection strategies and techniques.

New tools increase accessibility of IP-related information

ASEAN member states have recognised the need to spread awareness of the benefits of IP and to encourage its use as a tool for innovation. The Patent Libraries initiative, spearheaded by the Philippines, aims to provide easy access to patent documents for scientific researchers in academia and industry. These libraries, referred to as Innovation and Technology Support Offices, are housed in universities across the country and provide advice and assistance on patent search and drafting to applicants. The Philippines has planned to establish a network of 20 such facilities in ASEAN by 2015.

The ASEAN IP Portal was launched in 2013 to serve as a platform for all IP-related information in ASEAN. It enables stakeholders to easily access information on legislation in member countries, dispute resolution bodies, government incentives for Research and Development (R&D), technology transfer/licensing offices, rights management organisations and IP-related education to raise awareness. It is currently being updated by the Singapore government to link in with the ASPEC platform enabling electronic submission of patent applications.

ASEAN TMview is an online platform that allows users to freely access information on trademark registrations currently in effect in participating ASEAN countries. The platform was developed as a result of co-operation between the IP offices of the ASEAN member states and the ECAP III Phase II project administered by the EU Office for Harmonisation in the Internal Market.

Co-operation with the international IP community is being used to develop capacity

To achieve the goals set out in the latest IPR action plan, ASEAN members have sought to co-operate with international partners and learn from their experience. The World Intellectual Property Organization (WIPO) has co-operated with the Philippines government on their Patent Library project mentioned above. WIPO is also involved in several capacity-building workshops in ASEAN countries to highlight national IP success stories and run outreach campaigns to raise public awareness of IP. In January 2014 WIPO conducted an advisory mission to the Philippines to help develop a master plan on IP promotion and awareness campaigns.

Co-operation with dialogue partners has also intensified. EU-ASEAN co-operation on IP dates back to the early 1990s and has resulted in a series of initiatives. Specific projects are in place to strengthen administrative capacity and IP enforcement; enhance legal and policy frameworks to accede to global agreements; improve utilisation of IP protection tools by the private sector; and enhance IP capacity and co-ordination between the ASEAN Secretariat, AWGIPC and ASEAN IP offices. Within the ASEAN-Australia-New Zealand Free Trade Area economic co-operation work programme, workshops on protecting genetic resources, traditional knowledge and traditional cultural expressions have been organised. Under the ASEAN-Japan co-operation programme, the Japanese Patent Office (JPO) is building human resource capacity in ASEAN IP offices through training programmes for design and trademark examiners. The JPO is also assisting with awareness campaigns and strengthening the information technology system infrastructure of IP offices.

INFRASTRUCTURE AND CONNECTIVITY

Assessment of progress in integration

- Road infrastructure is being developed through the ASEAN Highway Network programme. The worst quality roads are being eliminated in most countries. However, more remains to be done to upgrade roads to a high quality level.
- The Singapore-Kunming Rail Link, a long-running project to enhance rail connectivity, remains stalled in several places. Only the Thailand-Cambodia link is scheduled for completion in 2015. The links in Myanmar, Viet Nam and Lao PDR lack adequate funding.
- The pace of improving maritime connectivity is slow due to large infrastructure gaps between countries and continuing use of restrictive policies.
- To reduce institutional barriers, facilitation agreements have been signed for goods, transport and aviation. However, they still await ratification in many member states. The formation of a Single Aviation Market has been progressing slowly. The signing of Passenger Air Services agreements with third parties prior to the formation of a single domestic market puts ASEAN carriers at a disadvantage.

The Master Plan on ASEAN Connectivity (MPAC) lays out the key strategies and essential actions required to transform the region into one that is connected through enhanced physical infrastructure (physical connectivity), effective institutions and processes (institutional connectivity) and empowered people (people-to-people connectivity) (ASEAN, 2010b). There is a great need for physical infrastructure to address poor quality roads, missing rail links, inadequate maritime and information and communications technology (ICT) infrastructure. Reducing non-tariff barriers that inhibit intra-regional trade requires institutions to harmonise standards and processes while connecting people helps promote tourism and cultural understanding. Major initiatives that have been prioritised in each of these areas are discussed here.

Road transport connectivity has improved but the pace is slow

The ASEAN Highway Network (AHN) was first initiated in 1999 at the fifth ASEAN Transport Minister's meeting in Hanoi. It comprises 23 designated routes covering 38 400 kilometres and intends to link together all ten ASEAN members by 2020. The MPAC sought to revitalise the project in 2010 by listing key priority actions that were to be completed in a strict timeframe. ASEAN members were required to upgrade all AHN sections below Class III to Class III (at least two lanes and double bituminous treatment) or above by 2012. Data on the Trans-Asian Highway which overlaps with the ASEAN Highway show that highways below Class III have been eliminated in the Philippines, Cambodia and Thailand while large sections remain in Myanmar (Table 2.6).[5] The goal of upgrading all Class II (two lanes and asphalt or cement concrete pavement) or Class III sections with high traffic volume to Class I (four lanes and asphalt or cement concrete pavement) by 2020 seems unlikely to be achieved given the slow pace of development in this area. Cambodia, Lao PDR, Myanmar and Philippines still retain a large volume of Class III highways while Indonesia, Philippines and Viet Nam still have mostly Class II highways.

Table 2.6. **Status of Asian Highway Network**

Country	Primary km	Class I km	Class II km	Class III km	Below Class III km	Other km	Total km	Status Year
Cambodia	0	0	610.00	1 347.70	0	0	1 957.70	2013
Indonesia	409.00	603.00	3 045.00	0	0	34.00	4 091.00	2010
Lao PDR	0	0	244.00	2 307.00	306.00	0	2 857.00	2010
Malaysia	795.00	61.00	817.00	0	0.00	0	1 673.00	2010
Myanmar	0	320.26	574.74	1 702.08	1 927.91	0	4 524.99	2015
Philippines	0	379.92	2 310.36	691.07	0.00	0	3 381.35	2015
Singapore	13.00	6.00	0	0	0.00	0	19.00	2015
Thailand	616.80	4 122.84	598.40	202.09	0.00	0	5 540.13	2014
Viet Nam	0	343.00	1 829.00	337.00	76.00	0	2 585.00	2013

Source: ESCAP (2015), "Status of the Asia Highway in Member Countries", www.unescap.org/resources/status-asian-highway-member-countries.

Projects related to the AHN such as the Mekong Bridge in Neak Loung and the installation of road and numbering signs along the Transit Transport Routes have been completed (Table 2.7). Projects that are yet to be completed include the construction of missing highway links in Myanmar; the highway from Kanchanaburi-Dawei; and the East West Economic Corridor.

Table 2.7. **ASEAN Highway Network projects**

Key actions	Progress
Complete 227 km of missing road links in Myanmar	Not completed
Upgrade more than 5 300 km of roads with below Class III quality	Not completed in Myanmar (1 928 km remaining) More recent data required for Lao PDR and Viet Nam
Build Mekong Bridge in Neak Loung	Completed
Upgrade Class II or Class III sections with high traffic volume to Class I	Significant Class III sections remain in Cambodia, Lao PDR, Myanmar, the Philippines. Thailand and Viet Nam contain smaller sections.
Build Kanchanaburi-Dawei highway	Awaiting parliamentary approval in Thailand and Myanmar
Build missing links in the East West Economic Corridor (EWEC) in Myanmar	Not completed
Installation of road and numbering signs along the Transit Transport Routes	Completed (ASEAN, 2014b).

Source: OECD Development Centre's compilation based on national sources and ASEAN Secretariat.

Upgrading roads in Cambodia, Lao PDR and the Philippines has been slow due to the lack of regular funding and low priority given by policy makers to repair and maintenance. Governments tend to focus more on building new roads without paying attention to the maintenance and upgrading of existing road assets. This is particularly important for rural roads as local communities are heavily dependent on them. In Myanmar the construction of road links had been slow due to the ongoing conflict. The large scale displacement of people complicates the acquisition of land and labour required for construction activities.

The Singapore-Kunming Rail Link is another key initiative to increase physical connectivity in the region. There are two main lines, an Eastern Line through Thailand, Cambodia and Viet Nam with a spur line between Lao PDR and Viet Nam, and a Western Line through Thailand and Myanmar. The MPAC highlighted several missing link sections that are to be prioritised. Table 2.8 provides an assessment of progress to date. Only the Poipet-Sisophon and Aranyaprathet-Klongluk lines between Cambodia and Thailand are on schedule for completion by the end of 2015. The feasibility studies for three separate links involving Cambodia, Thailand and Viet Nam have not yet been completed which makes their targeted completion by 2020 seem unlikely. While feasibility studies for links in Myanmar, Viet Nam and Lao PDR have been completed these projects have not yet started mainly due to a lack of funding.

Table 2.8. **Singapore-Kunming missing rail links**

Country	Missing link	Rail length	Feasibility study status	Target year	Implementation status
Cambodia	Poipet (Thailand border)- Sisophon	48 km	Completed	2013	Ongoing. Completion by 2015
Cambodia	Phnom Penh - Loc Ninh (Viet Nam border)	254 km	Ongoing	2015	Not commenced. Funding negotiation ongoing
Thailand	Namtok- Three Pagoda Pass (Myanmar border)	153 km	Ongoing	2020	Not commenced
Thailand	Aranyaprathet-Klongluk	6 km	Completed	2014	Ongoing. Completion by 2015 along with Poipet-Sisophon
Myanmar	Thambyuzayat-Three Pagoda Pass (Thailand border)	110 km	Completed	2020	Not commenced
Viet Nam	Loc Ninh (Cambodia border)- Ho Chi Minh City	129 km	Completed	2020	Not commenced. Funding negotiation ongoing.
Viet Nam	Mu Gia (Lao border)-Tan Ap- Vung Anh	119 km	Ongoing	2020	Not commenced
Lao PDR	Vientiane-Thakhek*	330 km	Completed	2020	Not commenced
Lao PDR	Thakhek-Mu Gia (Viet Nam border)*	136 km	Completed	2020	Not commenced

Notes: * Spur lines
Sources: ASEAN (2010b), "Master Plan on ASEAN Connectivity"; ASEAN (2015d), "Singapore-Kunming Rail Link".

Maritime connectivity requires further improvement

As sea transport is highly important for international trade, the ASEAN region has sought to create an integrated, competitive and efficient maritime transport system. This has been highlighted in Strategy 4 of MPAC as well as in the "Roadmap towards an Integrated and Competitive Maritime Transport in ASEAN" with a view to creating an ASEAN Single Shipping Market by 2015. However several obstacles prevent the achievement of this goal.

There remains a vast gap in shipping capacity between countries in the region. Countries such as Singapore and Malaysia have advanced capabilities and well-developed port facilities while the Philippines and Indonesia continue to have poor facilities in many isolated islands. The Philippines has made progress in developing a nautical highway using Roll-on/Roll-off (Ro-Ro) vessels which can load cars, trucks and buses laden with goods thus eliminating the need to shift cargo between vessels. This was found to have reduced transport costs by as much as 40% in some cases (Asia Foundation, 2010). Other countries in the region could also benefit from a similar approach to reduce infrastructure gaps.

ASEAN countries have made attempts to extend the Roll-on/Roll-off network across the region though progress has been slow. The Master Plan on ASEAN Connectivity called for a technical study on extending the network through sub-regional initiatives such as the Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT) and ASEAN as a whole. The report, released in March 2013, identified three priority routes: i) Penang-Belawan-Phuket, ii) Melaka-Dumai and iii) General Santos-Bitung (JICA, 2013). At the 19th IMT-GT Ministerial meeting, the countries requested a feasibility study for Penang-Belawan-Trang instead of Penang-Belawan-Phuket on account of greater cargo capacity at Trang compared to Phuket. Although this study was completed in December 2014, countries have not yet committed financial resources to developing this network. Ferry services between Melaka, Malaysia and Dumai, Indonesia are expected to be completed by December 2015 with the construction of a terminal at Tanjung Beruas, Melaka especially for Ro-Ro services.

Most countries in the region practise cabotage which prohibits foreign registered ships from operating domestically. This reduces competition and could make farmers and firms less competitive internationally due to higher transport costs. Many countries continue to maintain restrictions in terms of market access and ownership. Indonesia for example requires foreign shipping companies to appoint an Indonesian firm as an agent and limits foreign equity participation to 49% of total equity. Malaysia does not restrict foreign ownership in maritime services but does have restrictions for port ownership. Domestic shipping liners in the Philippines and Thailand continue to receive protection through reservation policies for government cargo. Singapore and Malaysia also grant preferential treatment to their domestic liners through the use of substantial subsidies. Creating an integrated shipping market by harmonising these policies is thus a formidable task.

The ASEAN members aim to create a single shipping market by 2015 however the large differences in infrastructure capacity and policies make this particularly challenging. An alternate approach would be to proceed in phases in a manner similar to the ASEAN Free Trade Agreement. Under this gradual approach the most developed countries – Singapore and Malaysia – would liberalise first, followed by Thailand, Indonesia and the Philippines after a few years with the rest of ASEAN following subsequently. Although this approach would take longer it has a higher chance of mobilising domestic support for integration.

Broadband connectivity has improved in several countries

The ASEAN Broadband Corridor project aims to develop ICT infrastructure to connect communities in the region. This project, which is included both in the MPAC and the ASEAN ICT Master Plan, sets out an agenda to develop locations with quality broadband connectivity to achieve seamless usage across ASEAN and promote access for all schools (ASEAN, 2011a; ASEAN, 2010b). In a recently conducted review of the ASEAN Broadband Corridor programme, it was found that the project has been mostly completed. Malaysia in particular completed a project in 2013 on increasing capacity to meet data demand over the next five years and is now working on the second phase (MICT, 2015). Viet Nam has focused attention on redesigning its 2G spectrum to incorporate mobile broadband (MICT, 2015). While broadband access to all schools may not have been met there have been several attempts to ensure that access is more widespread (MICT, 2015).

In addition to physical infrastructure, the MPAC calls for institutional mechanisms to reduce barriers and increase connectivity

The three framework agreements on transport facilitation have been signed by all member states but have yet to be ratified by many. The ASEAN Single Aviation Market, also known as the Open Skies Policy, has been progressing slowly. The Multilateral Agreement on the Full Liberalisation of Passenger Air Services is yet to be ratified in four member countries. ASEAN has signed an Air Transport Agreement with China in 2011 and has similar discussions ongoing with India, Korea and the European Union. However, as the ASEAN single market remains unfinished, local carriers will not gain as much as foreign carriers from any third-party agreements. This is because foreign carriers will be able to connect any point in their home country to any point in ASEAN countries while ASEAN carriers will only be able to fly from their home country (Tan, 2015).

The National Single Windows are at various stages of development. A pilot project as part of the ASEAN Single Window programme aimed to connect the national windows of seven AMS – Brunei Darussalam, Indonesia, Malaysia, Philippines, Singapore, Thailand

and Viet Nam. The project was found to have successfully shared data electronically on certificates of origin (ATIGA Form D) and the ASEAN Customs Declaration Document (ACDD) (Nathan Associates, 2013). (See also Tourism section.)

The final element of the MPAC calls for enhanced people-to-people connectivity

The plan falls short of advocating the free movement of people within ASEAN but more modestly calls for the removal of restrictions on the movement of skilled labour. A key challenge that was recognised in the MPAC was the need to reconcile national differences in the assessment of qualifications. To this end, the ASEAN Qualification Reference Framework was endorsed by the ASEAN economic and education ministers in August and September 2014, respectively (ASEAN, 2014c). MRAs have also been signed in several professional areas. However, they do not allow the free movement of recognised professionals as national restrictions such as licences and visas still apply.

Connectivity is also being addressed by ASEAN and its dialogue partners

Transport is highlighted as a main area of economic and financial co-operation in the ASEAN+3 work plan, and pledges of co-operation have been made to work together on infrastructure development and other aspects of connectivity. Among the EAS commitments made regarding connectivity is the *Declaration of the 6th East Asia Summit on ASEAN Connectivity*, which lacks specifics on the support offered to ASEAN, but raises the possibility of developing a "Connectivity Master Plan Plus" in the future that would incorporate both ASEAN and its EAS partners. Connectivity is also an aspect of regional co-operation on energy, an important topic in the East Asia Summit. EAS energy ministers have held meetings since 2007 and co-operation on energy issues has been organised through a number of initiatives, including the *EAS Energy Cooperation Work Plan* and the East Asia Low Carbon Growth Partnership, along with joint R&D on renewable and alternative energy.

SMALL AND MEDIUM-SIZED ENTERPRISES

Assessment of progress in integration

- Several major programmes have been conducted to assist SMEs with access to information, support services and training. Facilitation services are provided in most member countries but vary in the type of services provided. Malaysia and Singapore offer full-fledged one-stop services while Thailand and Viet Nam offer a more limited range.
- Support services are provided by members to assist SMEs integrate into global value chains. However those provided by CLM countries tend to suffer from budget shortfalls and can lack effective co-ordination.
- Access to finance appears to be more of a problem in some member states than in others. This is largely due to the lack of a well-developed regulatory framework, credit risk guarantees and central bureaus for credit information.
- Large gaps remain between member states on policies to promote technology and technology transfer. Countries are attempting to create technology networks by linking universities, R&D labs, incubator services and government agencies.

The third pillar of the AEC Blueprint calls for equitable economic development to reduce inequalities both within and between member states. A key component of reducing inequalities within countries is the strengthening of small and medium-sized enterprises (SMEs) as they account for almost all enterprises and employment in ASEAN member states.

Regional initiatives have been launched to support SMEs

Several major projects have been conducted under the ASEAN Strategic Action Plan for SME Development (2010-2015) to assist SMEs in the region with common problems such as access to information, support services and training. The ASEAN Business Incubator Network has been created to provide business-matching and support services. Thirty such business incubators and innovation centres have been established in the region. The ASEAN *SME Guidebook: Towards the AEC 2015* provides SMEs with information on financing facilities, national initiatives and support services. It also helps prepare SMEs for the AEC with information on customs procedures, rules of origin and ASEAN standards. The ASEAN Online SME Academy is expected to be launched in 2015 to not only provide business information and training resources but also to serve as a platform for networking with regional and global businesses, mentors, financiers, and policy makers.

The provision of facilitation support services is most advanced in Singapore and Malaysia and most lacking in Cambodia, Lao PDR and Myanmar (ERIA-OECD, 2014). Singapore and Malaysia both provide one-stop SME service centres to provide information, advice, training, networking and financing. Other members such as Thailand and Viet Nam also provide SME development centres but they offer a limited range of services and are also limited in number and locations. Cambodia and Lao PDR are in the process of developing an e-commerce law in order to promote their use.

Support services are provided to enhance the participation of SMEs in global value chains and regional production networks

The ASEAN member states have sought to actively promote the integration of SMEs into international markets. Most countries in the region offer export promotion services to facilitate access to information, markets, skills, technology and finance. There remains a great deal of variation in the quality of services provided between member states. Cambodia for example provides export promotion services but, due to budget constraints, these are restricted to the top ten most promising products (ERIA-OECD, 2014). Lao PDR has several programmes to assist SMEs with access to information such as the Lao PDR Trade Portal, Business Libraries, producer directories, trade fairs and exhibitions. However these programmes lack effective co-ordination, offer limited advisory services and can be confined to certain geographic regions (ERIA-OECD, 2014). Myanmar currently organises trade exhibitions but is yet to develop a promotion agency specifically for SMEs.

To promote entrepreneurship in the region, member states have called for the development of a common curriculum for entrepreneurship. The curriculum is based on the Consulting-based Learning for ASEAN SMEs (COBLAS) method in which MBA students are given the opportunity to integrate knowledge with practice by working as consultants for SMEs. The programme was originally developed in Japan and has been successfully replicated in Viet Nam, the Philippines and Myanmar (ASNEP, nd).

Remaining challenges include access to finance and technology

In the case of financing, countries such as Singapore, Malaysia, Thailand and Indonesia perform relatively well due to developed land use rights and protection of creditors. The remaining ASEAN member states tend to lack a well-developed legal and regulatory framework. Credit risk guarantee schemes and central bureaus for credit information are either not established or functioning in these member states. Policy makers must address both demand and supply factors that hinder access to finance. On the demand side, SMEs lack adequate collateral, borrow in small amounts and can lack transparency which makes them less attractive to lenders. On the supply side, lenders are often not geographically widespread to serve SMEs in isolated regions, they do not offer products suitable for SMEs, or they lack the incentives to lend small amounts due to the costs of monitoring and screening.

Technology support services are in need of improvement

The Strategic Action Plan calls for enhanced sharing of technology with SMEs and the development of support services to assist with commercialisation of new technology (ASEAN, nd). A large gap still exists between member states on policies to promote technology and technology transfer. This gap is largely due to the lack of a strategic approach to innovation policy and limited access to certification systems (ERIA-OECD, 2014). Recent advances have been made in the provision of support services such as business incubators. However, greater effort is required to improve technology support in universities and create linkages with SMEs. Singapore is by far the most advanced in this area. The Philippines performs moderately well as it has created a network consisting of universities, R&D labs, incubators, SMEs and the Department of Science and Technology (ERIA-OECD, 2014). In Cambodia, the Technology Incubator Centre was created in 2008 to develop R&D capacity and distribute new technologies. However, the centre lacks both linkages with universities and a formal framework to support technology development (ERIA-OECD, 2014).

FOOD, AGRICULTURE AND FORESTRY

Assessment of progress in integration

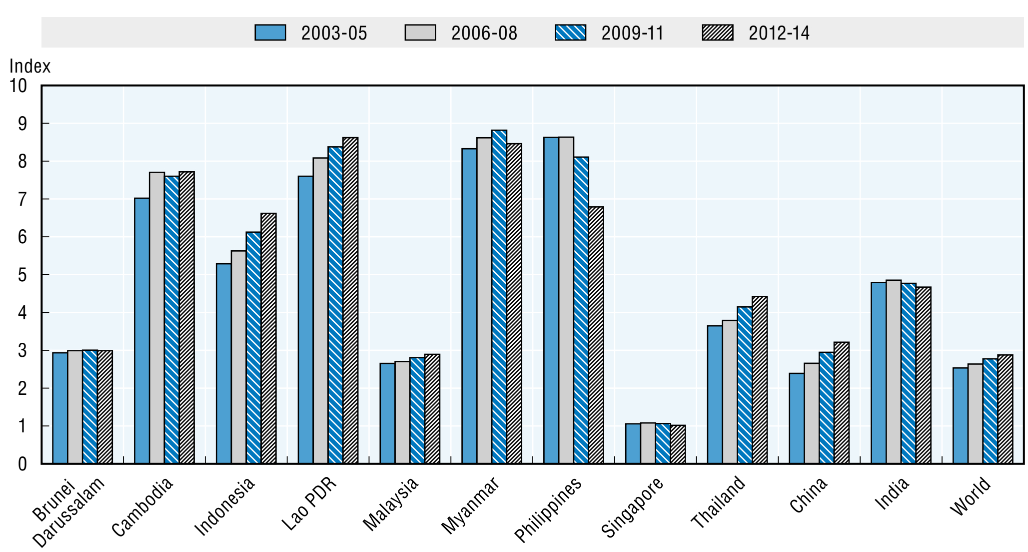
- Regional frameworks for co-operation on food security, such as the ASEAN Integrated Food Security Framework, are helping to reduce risks in periods of crisis and improve food supply over the longer term.
- Although there has been co-operation in the region in developing the fisheries industry, fisheries management will need to address over-fishing, illegal fishing, and safety and quality standards.
- There is regional co-operation in implementing international agreements to protect forestry and wildlife, and regional agreements have also been established, but could be made more effective.

While progress is being made in improving food security and in developing fisheries and forestry sectors, regional co-operation in managing the many shared challenges in these areas has been limited. More important initiatives have often been pursued at the national level or have been neglected by policy makers. Future regional plans will need to balance economic goals or development with ensuring the sustainable use of these resources.

Food security remains an important concern in the region

Over the last decade food prices have been increasing in most countries relative to the general price level (Figure 2.18). In Brunei Darussalam, Malaysia, Singapore and India prices have been relatively stable. Despite the challenges posed by rising prices for food accessibility, many countries in the region have made significant progress in reducing the prevalence of undernourishment over the last few decades. Viet Nam, Thailand and Lao PDR have made the most dramatic reductions while Brunei Darussalam and Malaysia both have rates of undernourishment below 5%. However the percentage of those undernourished remains relatively high in Lao PDR, Philippines and Cambodia. Increasing prices can reduce the availability of food to the poor and malnourished.

Figure 2.18. **Average Food Price Index in Emerging Asia**



Note: The Food Price Index is calculated as the ratio of food and non-alcoholic beverage expenditure to actual individual consumption relative to the United States purchasing power parity terms.

Source: FAO (2015), *Food Security Indicators*, http://bit.ly/14FRxGV.

StatLink http://dx.doi.org/10.1787/888933309903

Following the 2007-08 food crisis, the ASEAN region developed several initiatives on food security through the ASEAN Integrated Food Security (AIFS) Framework and the Strategic Plan of Action on Food Security (SPA-FS). There are four major components to the AIFS: (1) emergency/shortage relief, (2) sustainable food trade development, (3) integrated food security information system, and (4) agri-innovation for sustainable food production. To address component (1), the ASEAN +3 countries have established an Emergency Rice Reserve (AERR) to address any unforeseen shortfalls in the region (Box 2.6.). The system has been successful at distributing rice after natural disasters such as the 2011 flood in Thailand and typhoon Ketsana in Lao PDR amongst others. The ASEAN Food Security Information System (AFSIS) has been launched to address component (3). This system allows member states to distribute and acquire food security related information necessary for policy formulation and planning. However the pace of information gathering and dissemination is still slow with the database updated only once a year. AFSIS also produces an Early Warning Information Report and Commodity Outlook published twice a year. The Framework and Strategic Plan are currently in the process of being updated for the 2015-20 period to include nutrition, food safety, poverty alleviation and long-term food security issues. A key challenge in developing the new framework is to ensure the creation of a concrete design and monitoring framework with measurable indicators for outputs, outcomes and impacts.

Box 2.6. **Emergency Rice Reserve in ASEAN**

ASEAN attempts to address food security issues date back to 1979 with the establishment of the ASEAN Emergency Rice Reserve (AERR). At this time national food stocks were voluntarily designated to address emergencies, however the reserves were too small and procedures complex so they were never used. In 2003, a pilot project was launched by the ASEAN countries plus China, Japan and Korea, known as the East Asia Emergency Rice Reserve (EAERR). This programme was successful at providing emergency assistance on several occasions for floods and cyclones. Following the food price crisis in 2008, ASEAN members adopted the ASEAN Integrated Food Security (AIFS) Framework and developed a Strategic Plan of Action on Food Security (SPA-FS). As part of these plans a more permanent emergency rice mechanism was sought and so the EAERR pilot project was transformed into the ASEAN Plus Three Emergency Rice Reserve (APTERR).

The APTERR addresses problems that plagued its predecessor. The size of earmarked pledges has increased dramatically from 50 000 tons under AERR to 787 000 tons with the inclusion of the +3 members; day-to-day management has been placed under a professional secretariat; and a multilateral decision-making process has been developed (although bilateral negotiations on the release of reserves are also possible).

Nevertheless, the mechanism continues to face several challenges. APTERR must ensure that it is able to credibly respond to an emergency situation while also ensuring that large-scale withdrawals from reserves do not distort food markets. Greater co-operation with the ASEAN Food Security Information System (AFSIS) will be required to meet APTERR's information and monitoring requirements. Legal inconsistencies between members must be addressed so that rice transfers are not impeded. For example, rice transfer from Viet Nam to the Philippines was delayed by a few years due to legal obstacles on both sides. Operating procedures are still being developed by the APTERR Secretariat. It is important that an efficient request and delivery process is developed for APTERR to work effectively.

Fisheries management faces serious challenges to be overcome co-operatively

ASEAN plans relating to fisheries exist at three levels. At the regional level there is the AEC Blueprint. At the cross-sectoral level there are the ASEAN Integrated Food Security Framework (AIFS), ASEAN Multi-Sectoral Framework on Climate Change: Agriculture and Forestry towards Food Security (AFCC) and Cooperation in Food, Agriculture and Forestry (FAF SPA). At the sectoral level, for fisheries there is the ASEAN Integrated Protocol for Fisheries (ASIPF) and a Roadmap for Integration of the Fisheries Sector based on the AEC Blueprint. Although these plans are quite detailed, they are not well nested and so the activities at the sectoral level do not necessarily contribute to the cross-sectoral objectives and the ASEAN regional goals (Staples, 2014). This makes assessment of the progress made in these plans difficult.

There has been some progress on the removal of tariffs related to fisheries. Of the 177 product lines covered in the ASEAN fisheries integration agreement, 81 remain under various country's negative lists (identified for exclusion). However, four ASEAN Members – Brunei Darussalam, Lao PDR, Singapore and Viet Nam – did not submit a negative list for the Agreement implying that their markets are open to trade. Furthermore there has been some progress in the development of fisheries quality management systems but a lack of progress in developing harmonised sanitary and phytosanitary measures.

The ASEAN region faces several key challenges that it must address in its plans for the 2015-20 period: over-fishing; illegal fishing and poor food safety standards:

- Over-fishing is a common problem in ASEAN and other regions when free access is allowed to anyone willing to fish. This "tragedy of the commons" can be addressed through the creation of an appropriate system of access rights to ensure a balance between the livelihoods of fishing communities and the sustainability of fish stocks. These could take the form of territorial use rights that restricts access to members of a certain locality or through the grant of output rights such as quotas.
- Illegal fishing has long been recognised as a problem in the region for its negative effects on environmental and food sustainability. Regional initiatives to tackle this problem include the "Regional Plan of Action to Promote Responsible Fishing Practices including Combating IUU Fishing in the Southeast Asia Region" established in 2008. Proposals that have been debated include creating a registry of vessels and an ASEAN-wide catch certification scheme. However gaining agreement has been contentious as some countries have expressed difficulties in implementing these schemes especially in the case of small scale and inland/freshwater fisheries (SEAFDEC, 2013).
- Poor food safety and quality standards in the region have resulted in a high degree of post-harvest losses due to spoilage. Post-harvest production facilities for small-scale fisheries such as processing, preservation and transportation all require improvement. In addition to the environmental cost of wastage, poor standards also result in an economic cost as products are unable to meet the standards required for export to high-value foreign markets. HACCP hygiene certification, required for export to the EU, is particularly difficult for small-scale fisheries to acquire (SEAFDEC, 2013). Although the region has made some progress with the development of various guidelines such as Good Agricultural Practices (GAP) and Good Aquaculture practices (GAqP) on Food and Fish, they have not been adequately implemented.

Challenges are being faced in acting on agreements to protect forestry and wildlife

Many ASEAN members are co-operating with the EU on sustainable forest management initiatives such as Forest Law Enforcement, Governance and Trade (FLEGT) which aim to reduce illegal logging and its associated trade. Under this system the legality of the source of timber must be documented and reported throughout the supply chain until final use or export.

ASEAN members have been co-operating with the international community on the protection of endangered species through the Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES). The ASEAN-Wildlife Enforcement Network (WEN) has been created as an inter-agency and inter-governmental initiative to counter illegal trade in endangered flora and fauna. In 2012 the Network was responsible for 218 law enforcement actions which included recovery of over 2 million live animals and 8 000 dead animals or animal parts, the seizure of contraband to the value of USD 15 million and at least 231 arrests (ASEAN-WEN, 2012). While the WEN in Philippines has been functioning well, the networks in many other ASEAN members have lost forward momentum in both their internal and external co-ordination efforts. Greater support, financial as well as administrative, from central governments will be required to address these issues (Taylor et al., 2013).

ASEAN members have co-operated in the development of a Monitoring, Assessment and reporting system for Sustainable Forest Management. These included 52 indicators, for both the forest itself (outcome indicator) and forest management systems (process indicators). The system is however not operational on a regional basis but is expected to be relaunched shortly.

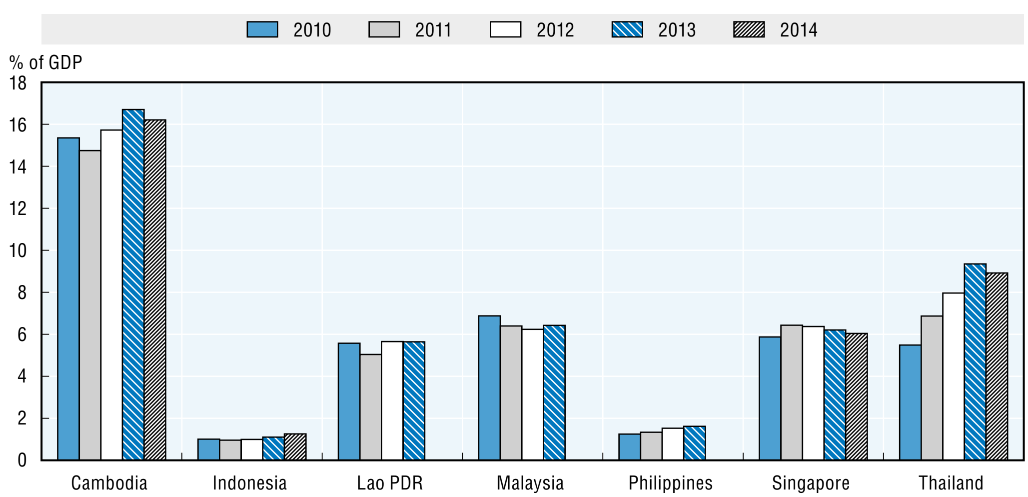
TOURISM

Assessment of progress in integration

- Regional tourism promotion, agreements on tourism-related labour and quality standards, and visa facilitation are helping to upgrade the tourism sector in ASEAN and facilitate travel.
- Ecotourism is being developed in the region and remains promising. Regional co-operation is progressing under the ASEAN Ecotourism Strategic Plan.

Tourism is a fast-growing sector in most ASEAN countries, with significant potential to act as a driver of growth and source of job creation (Figure 2.19). There is also much scope for regional initiatives, which have sought to market the region co-operatively, facilitate the movement of skilled workers in the sector, ensure quality standards are met, and reduce travel restrictions faced by visitors. More work will be needed in continuing the integration of air travel and developing the growing ecotourism market in particular.

Figure 2.19. **Tourism revenues in selected ASEAN countries**



Source: CEIC.

StatLink http://dx.doi.org/10.1787/888933309918

Agreements on tourism are supporting the sector's growth and facilitating travel within ASEAN

ASEAN began to take a regional approach to tourism promotion in 2002 with the signing of the ASEAN Tourism Agreement to increase co-operation between members in the tourism industry, reduce restrictions to tourism and travel services and enhance the development of the region as a tourism destination. This was followed by the Roadmap for Integration of Tourism Sector 2004-2010 which laid out several initiatives to upgrade tourism infrastructure, enhance the skills of tourism related personnel and encourage greater participation from the private sector. The region subsequently witnessed a boom in the number of tourists resulting in a positive effect on local economies in terms of demand for goods, services, jobs creation and inter-cultural understanding. However it was recognised that further efforts were required on the harmonisation of visa requirements, standardisation of tourism related services and facilitating the flow of tourists across the region. To this end the ASEAN Tourism Strategic Plan 2011-2015 was adopted to address these shortcomings. This latest plan has brought focused attention on three key issues: movement of tourism professionals, tourism standards and visa facilitation.

A MRA on Tourism Professionals was signed by ASEAN Members in November 2012. It provides a mechanism for countries to create common certification procedures and qualifications across ASEAN. The purpose is to create a free market for tourism-related labour across the region and thereby boost competitiveness and fill local skills shortages. However to be eligible to work in a host country, the tourism professional would have to possess a valid tourism competency certificate for a job title specified in the Common ASEAN Tourism Curriculum (CATC).[6] It is therefore important for countries to develop the necessary institutional capacity to assess qualifications and provide certifications. As of March 2015 only six countries (Indonesia, Malaysia, Myanmar, the Philippines, Singapore and Thailand) have completed requirements such as the establishment of a Tourism Professional Certification Board and National Tourism Professional Board (Fukunaga, 2015). The implementation of this MRA in the remaining four ASEAN members is still lagging behind.

To achieve the overall goal of ensuring that ASEAN is a quality tourism destination the region has attempted to create a set of standards to guide operators in a number of areas. The Task Force on ASEAN Standards has developed recommendations in six areas: homestay, green hotels, food and beverages services, public restrooms, ecotourism and tourism heritage. However these standards are not sufficiently developed to be used for a certification system. Disagreements between countries remain on measurable indicators to be used and the need for a third-party verification system. In the meantime an alternate approach that could be used is to encourage the development of higher standards through the use of prizes. For example the ASEAN Green Hotel Recognition Award is offered to hotels across the region that best meet the criteria stipulated in the ASEAN Green Hotel Standard. Similar awards in other areas such as ecotourism and tourism heritage could also help to improve standards across the region.

The ASEAN region has long recognised the importance of promoting tourism through facilitating the easy movement of ASEAN nationals within the region. In 2006 the ASEAN Members signed the Framework Agreement on Visa Exemption under which ASEAN nationals would be exempt from visa requirements for a period of stay of up to 14 days. This agreement has been implemented by all ASEAN members except Myanmar which still requires visas for nationals from Thailand, Malaysia and Singapore. While extensive progress has been made on enabling the free movement of ASEAN nationals within ASEAN, there has been less progress in facilitating the movement of nationals from other countries. In a bid to increase the number of foreign tourists ASEAN Members have been attempting to create an ASEAN Common Visa modelled on the European Schengen system. However negotiations are still ongoing as countries seek agreement on a revenue sharing model and address security concerns. Some countries have moved ahead with bilateral arrangements. Thailand and Cambodia, for example, offer a common visa which can be used to visit both countries. Another component of the AEC related to the tourism sector is the ASEAN Single Aviation Market (ASEAN-SAM), also known as Open Skies Policy. The Open Skies policy is expected to boost tourism in ASEAN member countries as increased competition would encourage more choices, a better quality of services and lower ticket prices. (See Infrastructure section of this chapter for more detailed information).

Ecotourism is a promising sector in Southeast Asia

ASEAN also started to give more attention to "sustainable tourism" (Box 2.7). The ASEAN Tourism Strategic Plan 2016-2025 will include commitment to promote sustainable tourism. Ecotourism is becoming more and more important in Southeast Asia. The ASEAN Ecotourism Strategic Plan has been developed to encourage nature-based tourism product. Through the plan, ASEAN has identified preliminary strategies such as product development, marketing and promotion, and human resource development, as well as prospects of potential ASEAN heritage and national parks for the development of ecotourism in the region.

Box 2.7. **Ecotourism is expanding in a number of ASEAN countries**

Tourism has contributed to the economic growth of many ASEAN countries through employment opportunities and revenues generated from tourist attractions and tourist consumption. Poorly managed mass tourism, however, can also have negative social and environmental impacts. To ensure sustainable development, ASEAN countries show growing interest in the idea of "ecotourism", which refers to all nature-based forms of tourism in which the main motivation of visitors is the observation and appreciation of nature as well as the traditional cultures prevailing in natural areas (UNWTO, 2002). Ecotourism places emphasis not only on the conservation of environment but also on the maintenance of natural areas through generating economic benefits for host communities. The potential benefits of developing ecotourism have been recognised by several ASEAN countries, including Malaysia, Thailand, Cambodia and Lao PDR.

Blessed with a variety of natural assets and distinct ecosystems, Malaysia is in an advantageous position to develop ecotourism. In the latest Eleventh Malaysia Plan (2016-20) ecotourism is highlighted as one of the modern services that will need to be developed as part of the transition into more knowledge-intensive and high value-added activities. Ecotourism locations in Malaysia include sites such as the Danum Valley Conservation Area in Sabah and Endau-Rompin National Park in Peninsular Malaysia, which is also one of the oldest tropical rainforests in the world.

In Thailand, the importance of sustainable tourism and ecotourism is acknowledged in the Eleventh National Economic and Social Development Plan (2012-16), where the expansion of services with low environmental impact such as ecotourism is prioritised. In order to promote ecotourism, the Tourism Authority of Thailand (TAT) implemented the "7 Greens Concept" in 2008, which aims to balance the development of tourism with environmental concerns through an inclusive approach with participation by the tourism industry, communities and visitors.

Cambodia is the heart of the Khmer culture that flourished in Southeast Asia for many centuries and is rich in both cultural and ecotourism destinations. Half of the more than 200 tourist sites in the country are suitable for ecotourism (Padeco, 2001). Currently, most tourists to Cambodia are from neighbouring and regional countries; it is less popular as a tourist destination for international travellers. Ecotourism development can help to attract more international tourists to Cambodia due to the popularity of this subsector among tourists from developed countries. Cambodia's national policy on ecotourism prioritises development in four regions, the Northeast Region, Tonle Sap, South Coast Region, and Southwest Region.

Low population density in Lao PDR has helped to preserve diverse ethnic lifestyles and traditions as well as one of the richest ecosystems in the region. Wildlife and natural areas have been less impacted by human activities compared to neighbouring countries. The government of Lao PDR places a high priority on the development of ecotourism and considers it a means of generating income for local residents, raising awareness of environmental conservation, encouraging local production, and protecting multi-ethnic cultures and traditions (ADB, 2008).

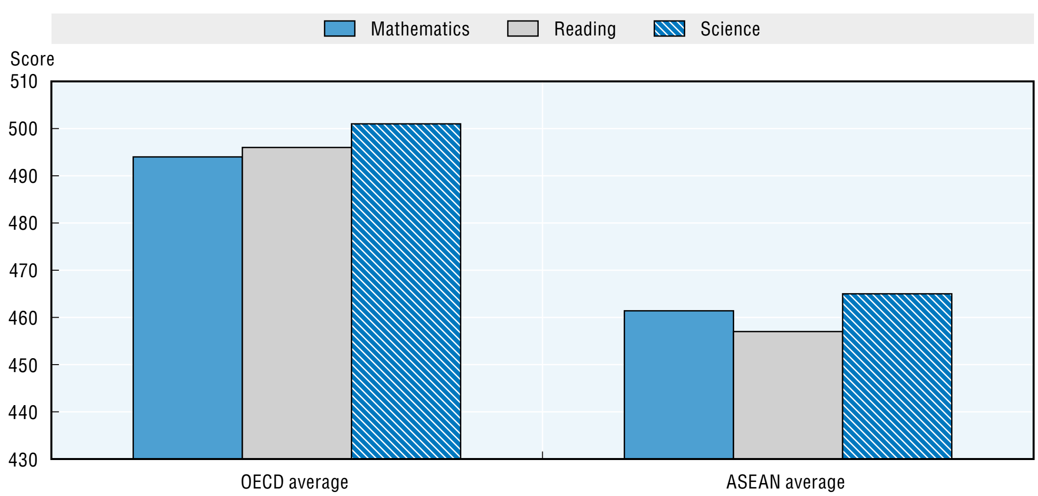
HUMAN AND SOCIAL DEVELOPMENT ASPECTS OF INTEGRATION

Assessment of progress in integration

- Regional initiatives are being pursued to integrate and harmonise education systems and promote collaborative research. Regional co-operation is also being used to promote entrepreneurship.
- ASEAN+3 and +6 co-operation is providing additional platforms for addressing regional concerns in education and poverty management, among other fields. Shared plans for responding to public health issues and natural disasters have been developed.

In Southeast Asia, enrolment rates have been increasing for the past ten years (OECD, 2013) but overall education quality is in need of improvement in many countries. For instance, in the OECD's Programme for International Student Assessment (PISA) 2012, Malaysia, Indonesia and Thailand performed well below the international and OECD average in all three areas – reading, mathematics, and science (Figure 2.20). Under the ASEAN Socio-Cultural Community (ACSS), specific initiatives on education, health and social protection were also implemented to address these development gaps, though regional co-operation in this area, in particular quality of education, is generally limited.

Figure 2.20. **OECD PISA score in Southeast Asia and OECD countries, by area, 2012**



Note: ASEAN average includes Indonesia, Malaysia, Singapore, Thailand and Viet Nam. The PISA scale was set such that approximately two-thirds of students across OECD countries score between 400 and 600 points.

Source: OECD (2012a), *PISA database*, www.oecd.org/pisa/.

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Efforts are being made to improve skills and job prospects, especially for youth

The ASEAN Socio-Cultural Community Blueprint has recognised the importance of providing human development opportunities in order to enhance the well-being and livelihood of all people in the region. The ASCC Blueprint lays out a comprehensive plan with several initiatives aimed at promoting education, skills and entrepreneurship. Less has been done at the regional level to address the important issue of improving teacher quality.

Several regional initiatives have been put in place to integrate education into the ASEAN development agenda. The ASEAN University Network (AUN) aims to strengthen the existing network of co-operation between 26 universities from ten ASEAN countries, promote collaborative research, conduct quality assessments and serve as forum for education policy in the region. The ASEAN Credit Transfer System (ACTS) promotes collaboration by allowing students and academics to easily move between AUN member universities. In March 2013 the ACTS was expanded in collaboration with Japanese Universities under the Re-Inventing Japan Project. A quality assurance system has been developed to monitor progress at both the programme and institutional level. As of May 2014, the AUN has conducted 28 quality assessments for 66 study programmes in ASEAN universities. The ASEAN Qualifications Reference Framework is another initiative that works towards harmonising educational qualifications and skills assessments in the region. MRAs have been signed in several professional categories to assist in the movement of skilled labour.

ASEAN member states have recognised the need to improve human resource capabilities through developing a skilled and competent labour force that is able to benefit from and cope with challenges of regional integration. The Southeast Asian Ministers of Education Organization (SEAMEO) has been involved in several projects to enhance regional co-operation in education and skills development. The SEAMEO College is a regional forum designed to engage with education leaders and to act as a support system for education ministers to respond to emerging challenges. The SEAMEO College, in co-operation with the Asian Development Bank (ADB), conducted an Education Leaders Innovation Forum in June 2014 to share experience, best practice and innovative approaches to teaching and learning. In October 2014 the Innovation Forum for Youth Leaders provided a platform for youth representatives to build leadership skills, creativity and innovative thinking (ADB, 2014). The ASEAN Skills Competition has been held biannually since 1993 to promote and upgrade skills in the region. The competition aims to promote the development of vocational and technical skills, foster co-operation between young people of member countries and develop high-skilled workers who can meet international standards.

Particular attention has been focused on increasing the participation of young people and women in the workforce by promoting entrepreneurship skills. The Young Southeast Asian Leaders Initiative was launched in 2013 to bring together young leaders aged 18-35 years to share innovative ideas for tackling the most pressing regional challenges such as economic development, environmental protection, education and civic engagement. The ASEAN Women Entrepreneurs' Network was launched in April 2014 to raise awareness of the needs of female entrepreneurs, build knowledge and capacity in business development and management and provide networking opportunities.

Social protection systems are underdeveloped in many countries

As regional integration brings with it great opportunities as well as challenges, ASEAN members have recognised the need to have in place strong social protection mechanisms to enable people to benefit from the opportunities and to protect them from the risks. Social security, unemployment and health coverage are of particular importance.

Social security coverage in the region remains varied as seen in Table 2.9. Myanmar, Cambodia and Lao PDR in particular have not yet ratified social protection laws in several areas. ASEAN member states have recognised the need for the adoption of social protection floors to protect against uncertainty by guaranteeing access to essentials and provide income security (ASEAN, 2013c). Cambodia, Indonesia, Lao PDR, Myanmar, the

Philippines, Thailand and Viet Nam have taken measures to implement these reforms but work is still under way (ILO, 2014). Unemployment schemes are not yet well developed in the region, with most countries relying on severance payments to compensate for the loss of a job. Unemployment insurance schemes are generally superior as they allow risks to be pooled and employees to be compensated even when employers become insolvent. Among the ASEAN members, only Thailand and Viet Nam have unemployment insurance schemes in place (ILO, nd). Other members offer employment support services but they are often not easily available and can lack up-to-date information and trained personnel.

Table 2.9. **Social security coverage in ASEAN countries**

	Branch of social security provided overall								
Country	**Medical care**	**Sickness**	**Unemployment**	**Old age**	**Work injury**	**Family**	**Maternity**	**Invalidity**	**Survivors**
Brunei Darussalam	●	●		●	●		●	●	●
Cambodia	○	○		○	●		○	○	○
Indonesia	●	●		●	●			●	●
Lao PDR	●	○	○	●	●	○	○	○	○
Malaysia	●			●	●			●	●
Myanmar	●	○	○	○	○	○	○	○	○
Philippines	●	●		●	●		●	●	●
Thailand	●	●	●	●	●	●	●	●	●
Singapore	●	●		●	●		●	●	●
Viet Nam	●	●	●	●	●		●		●

Notes: The hollow circle indicates that social security laws have been adopted though the implementing legal texts are still in draft form. The full circle indicates laws that have been adopted and implemented.
Source: ILO (2014), "Extension of social protection in ASEAN".

Total health-care expenditure as a percentage of GDP ranges from 3% in Indonesia to 6% in Viet Nam. Regional health-care systems will need to respond to the challenges arising from increased health expenditures resulting from an ageing population. Although health-care systems differ across countries, a common challenge is to expand health insurance coverage as well as to improve quality of health services while ensuring long-term financial sustainability (Table 2.10). Along with the rising share of elderly in the population, health insurance coverage is gradually increasing in the region, with universal coverage in Singapore and close-to-universal coverage achieved in Thailand. Currently coverage in many Asian countries is far lower than OECD countries.

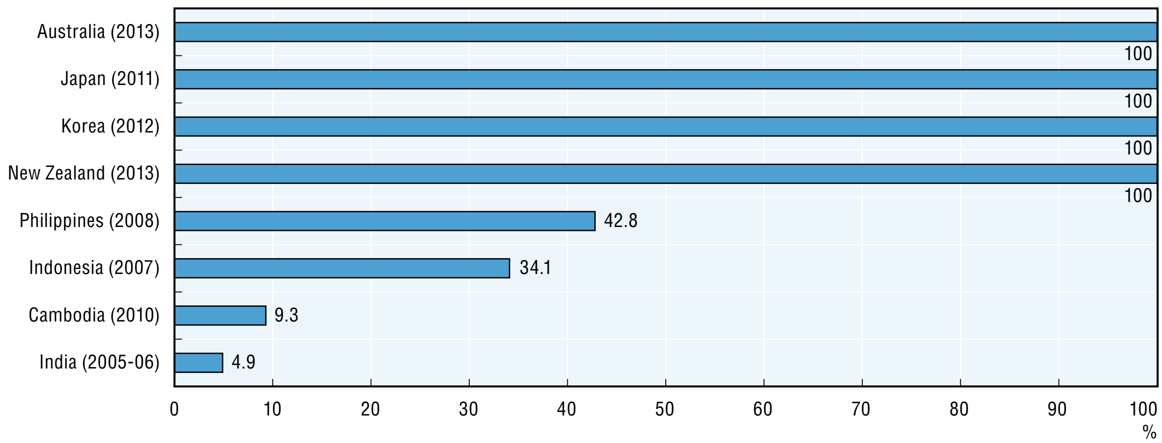
ASEAN countries have generally made good progress towards attaining universal health coverage. Figure 2.21 shows that although progress has been made on extending insurance coverage, significant gaps still remain (OECD/WHO, 2014). Indonesia has about 34% coverage though reforms are under way, with the government launching the Badan Penyelenggara Jaminan Sosial Kesehatan programme in January 2014. Further reforms are required in Lao PDR and Cambodia to increase coverage. Cambodia has been using health equity funds to increase access for the poor.

Table 2.10. **Health-care systems in Asia**

Country	System	Year started	Entitlement/ Voluntary/ Opt-out/ Compulsory	Financing of system: Tax	Financing of system: Contribution by Employer	Financing of system: Contribution by Employee	Expenditure on health as % of GDP (2013): Total	Expenditure on health as % of GDP (2013): Public	Public expenditure as a % of total
Six countries of Southeast Asia							4.43	2.13	47.88
Indonesia	Jaminan Kesehatan Nasional (JKN) is the new national health scheme that replaces the previous separate schemes for private (Jamsostek) and public (Askes) employees and extends coverage to poor and informal workers. The programme intends to provide universal coverage but allows users a choice of three levels of cover.	2014	Compulsory by 2019	x	x	x	3.07	1.2	39
	Community based micro-health financing schemes	Various	Voluntary			x			
Malaysia	Employee Provident Fund (EPF)	1991	Compulsory		x	x	4.03	2.21	54.83
	Social Security Organization (SOCSO)	1971	Compulsory		x	x			
Philippines	Philhealth, national health insurance	1997	Compulsory		x	x	4.4	1.39	31.64
	Co-operative based health insurance	Various	Voluntary			x			
Singapore	Medisave, compulsory individual medical savings account scheme	1984	Compulsory		x	x	4.55	1.81	39.81
	Medishield, low cost catastrophic medical insurance scheme (to be replaced by MediShield Life on 1 November 2015)	1990	Individuals can opt out		x	x			
	Medifund, medical endowment fund for the poor	1993	Entitlement (for the poor)	x					
	ElderShield, severe disability insurance	2002	Voluntary	x		x			
Thailand	Civil Service Medical Benefits Scheme (CSMBS), for all civil servants	1982	Entitlement	x			4.57	3.66	80.11
	Social Security Scheme (SSS) for private sector employees	1990	Compulsory	x	x				
	Universal Health Coverage scheme (UC) for the informal sector and others	2002	Entitlement	x					
Viet Nam	Viet Nam Social Insurance (VSS) for salaried workers in the public and private sector	1992	Compulsory	x	x	x	5.95	2.49	41.89
	Viet Nam Social Insurance (VSS) for students, farmers and informal sector workers	1994	Voluntary			x			
	Health Care Fund for the poor (HCFP)	2003	Entitlement (for the poor)	x					
Average of six countries of Southeast Asia							4.77	2.195	44.01
Emerging Asia									
China	Basic Medical Insurance system for Urban Dwellers for salaried employees	1998, reformed in 2009	Compulsory	x	x	x	5.57	1.68	30.14
	New Rural Cooperative Medical Scheme (NCMS)	2003	Voluntary	x		x			
	Medical Financial Assistance (MFA) programme to cover catastrophic health expenses for the poor		Entitlement (for the poor)	x					
India	Employees State Insurance Scheme (ESIS) for private sector workers	1948	Compulsory	x	x	x	3.97	1.28	32.22
	Central Government Health Scheme (CGHS) for central government employees and their families	1954	Compulsory	x		x			
	Community based health insurance schemes	Various	Voluntary			x			

Sources: OECD Development Centre compilation based on OECD (2012b), *Southeast Asian Economic Outlook 2011/12*, http://dx.doi.org/10.1787/9789264166882-en; Data for China are obtained from the *China Statistical Yearbook* 2014, http://apps.who.int/nha/database/ViewData/Indicators/en.

Figure 2.21. **Health-care insurance coverage in selected Asia-Pacific countries, latest year available**



Sources: OECD/WHO (2014) *Health at a Glance: Asia/Pacific 2014: Measuring Progress towards Universal Health Coverage*, http://dx.doi.org/10.1787/health_glance_ap-2014-en.

StatLink http://dx.doi.org/10.1787/888933309934

Pension systems in Southeast Asia, China and India show significant diversity (Table 2.11). The pension age is the most visible parameter of the retirement income system and significantly impacts financial incentives to retire at different ages and other retirement decisions. In general, pension ages (now normally between 55 and 60 years of age, except in the Philippines and Singapore where it is 65) have been set to ensure that average years in retirement, based on average life expectancy, are around 15 to 20 years. Countries in Southeast Asia use both defined-benefit (DB) schemes, in which payments received by individuals depend on the number of years of contributions, and defined-contribution (DC) schemes, in which individuals contribute each year and the accumulated balance earns a return that depends on the financial performance of the underlying assets. While the Philippines, Thailand and Viet Nam have DB pension schemes, DC schemes operate in Indonesia, Malaysia, Singapore and China. In the case of India, a hybrid retirement plan comprising both DB and DC schemes is in place.

Table 2.11. **Summary of pension scheme parameters and rules**

	China	Hong Kong, China	Indonesia	Malaysia	Philippines	Singapore	Thailand	Viet Nam	India	Pakistan	Sri Lanka
First tier											
(% average earnings)											
Resource-tested	-	8.3	-	-	-	-	-	-	-	-	-
Basic	40	-	-	-	3.1	-	-	-	-	-	-
Minimum	-	-	-	-	24.5	-	-	-	-	37.1	-
Overall entitlement	40	8.3	-	-	24.5	-	-	-	-	37.1	-
(full-career worker)											
Second tier											
Earnings-related											
Type	None	None	None	None	DB	None	DB	DB	DB	DB	None
Accrual rate	-	-	-	-		-	1.33/1.5	3		2	-
(% indiv. earnings)											
Earnings measure	-	-	-	-	max(f5,L)	-	f5	L	f1	f1	-
Valorisation	-	-	-	-	p	-	p	w	d	p	-
Indexation	-	-	-	-	p	-	p	w	d	p	-
Defined contribution											
Contribution rate	8	5	2	11	-	20	-		12	-	8
(% indiv. earnings)											
Ceilings											
(% average earnings)											
Public	-	117.9	-	-	-	112.8	-	546.9	32.4	82.3	-
Private/occupational	-	-	-	-	-	-	-	-	-	-	-
Pension age											
Normal	60	65	55	55	65	65	55	60	55	60	55
(women)	(55)							(55)		(55)	(50)
Early	55	60		50	60			55	50	55	
(women)	(50)							(50)		(50)	

Notes: Parameters are for 2012 but include all legislated changes that will take effect in the future. For example, some countries are increasing pension ages and extending the earnings measure for calculating benefits. Pension ages for women are shown only if different from those for men. Early pension ages are shown only where relevant. - = not relevant; [a] = varies with age; b = number of best years; d = discretionary indexation; DB = defined benefit; DC = defined contribution; f = number of final years; L = lifetime average; NDC = notional accounts; p = valorisation/indexation with prices; w = valorisation/indexation with average earnings; [w] = varies with earnings; [y] = varies with years of service.

Source: OECD (2013), *Economic Outlook for Southeast Asia, China and India 2014: Beyond the Middle-Income Trap*, http://dx.doi.org/10.1787/saeo-2014-en.

Regional frameworks are co-operating on social and other development issues

The ASEAN+3 *Cooperation Work Plan* (2007-17) includes a focus on socio-cultural and development co-operation – including a strong focus on capacity building in the region – addressing issues such as poverty alleviation, education, science and technology, public health, and disaster management and emergency response. Similarly, co-operation on education and training by East Asia Summit participants is outlined in the EAS *Education Action Plan* (2011-15) and associated projects in the regular education system and technical and vocational education and training. The first EAS Education Ministers Meeting was held in Yogyakarta, Indonesia, in July 2012.

The EAS has also made deeper commitments in working co-operatively on public health and disaster management issues. The need for a collective response to the Ebola outbreak was discussed promptly at the 2014 Summit, for example, where participants also committed to freeing the region of malaria by 2030. EAS commitments to co-operating in disaster management were given greater detail in the *Cha-am Hua Hin Statement on East Asian Summit Disaster Management* in 2009, which called for shared efforts in improving national capacities and work on developing integrated preparedness for cross-border risks. The *East Asia Summit Statement on Rapid Disaster Response* built upon this by outlining how EAS members should work together in the period immediately following a disaster, to ensure that assistance is delivered effectively (Box 2.8).

Box 2.8. **East Asia regional initiatives on disaster management**

The East Asia region is one of the most disaster-prone regions in the world, facing a wide variety of risks, including earthquakes, tsunamis, floods, hurricanes and typhoons. Disaster management and response is, therefore, one of the key priorities to be addressed by the East Asia Summit (EAS). The Cha-am Hua Hin Statement on East Asian Summit Disaster Management was adopted on the occasion of the 4th East Asia Summit (EAS) in Cha-am Hua Hin, Thailand in October 2009, identifying the need to improve rapid disaster response capability across EAS-participating countries. This statement included commitments to co-operate in capacity development; disaster preparedness; post-disaster management and recovery efforts; developing technical capabilities and early warning arrangements; and local, national, regional and international capacity-building programmes.

Despite such commitments and initiatives, some challenges remain, as mentioned in the *Indonesian-Australian Paper: A Practical Approach to Enhance Regional Cooperation on Disaster Rapid Response* document. Further efforts are needed to improve national preparedness and self-management of disaster responses, along with co-ordination of international assistance in a disaster situation. While the Cha-am Hua Hin Statement highlighted the importance of providing timely and reliable information as well as other elements of rapid disaster response, real-time information exchange in the immediate aftermath of disasters, however, remains challenging. A number of administrative bottlenecks also persist, including requirements related to licensing, visas, customs barriers, quarantine, taxation and privileges and immunities, which hinder the timely and effective delivery of support, and deployment of assistance personnel and supplies in response to disasters.

More recently, the East Asia Summit Statement on Rapid Disaster Response was adopted in November 2014 at the 9th EAS in Nay Pyi Taw, Myanmar, outlining commitments to further improve rapid disaster response. The EAS Rapid Disaster Response Action Plan provided the details of actions to be taken by at both the national and regional levels in terms of regional co-ordination arrangements, foreign medical team arrangements, sharing and building on existing arrangements, and implementing the action plan.

Other regional initiatives among ASEAN member countries and other external partners have been established to bolster preparedness. The ASEAN Agreement on Disaster Management and Emergency Response (AADMER), for instance, seeks to improve international co-operation to reduce disaster losses and respond jointly to disaster emergencies. Regional initiatives are also implemented under the ASEAN Regional Forum (ARF).[1] The ARF has undertaken initiatives on disaster relief, including the ARF Disaster Relief Exercises (DiREx), which is held every two years. The main focus of the ARF DiREx 2015 was to test civil-military co-ordination efforts, create synergy and synchronise efforts towards supporting the effective implementation of the AADMER as the common platform for disaster management of the region.

Box 2.8. **East Asia regional initiatives on disaster management** (*cont.*)

Stronger regional co-operation is still needed in various areas of disaster management, including the development of disaster risk financing systems and a regional centre for disaster risk data and modelling, as reliable data on exposure and disaster losses are unavailable in ASEAN countries (Sawada & Zen, 2014). Improved governance for disaster risk management is also needed, such as through clearer co-ordination roles for national governments and the establishment of flexible systems for co-operation among local governments (ADB and ADBI, 2013).

Note: 1. The current participants of the ARF include Australia, Bangladesh, Brunei Darussalam, Cambodia, Canada, China, Democratic People's Republic of Korea, European Union, India, Indonesia, Japan, Lao PDR, Malaysia, Mongolia, Myanmar, New Zealand, Pakistan, Papua New Guinea, Philippines, Republic of Korea, Russia, Singapore, Sri Lanka, Thailand, Timor-Leste, United States, and Viet Nam.

Sources: East Asia Summit (2013), "East Asia Summit Rapid Disaster Response Workshop Report and Action Plan", https://www.emknowledge.gov.au/resource/?id=4867; ASEAN (2011b), *Indonesian-Australian Paper: A Practical Approach to Enhance Regional Cooperation on Disaster Rapid Response*; and ASEAN Regional Forum official website: http://aseanregionalforum.asean.org/about.html.

INITIATIVE FOR ASEAN INTEGRATION (IAI)

Assessment of progress in integration

- The Initiative for ASEAN Integration (IAI) was launched in 2000 to narrow the development gaps between ASEAN-6 and CLMV. It is guided by the IAI Work Plan II (2009-2015) which comprises 245 projects that correspond to 182 action lines. The AEC component of the IAI has the largest number of action lines. However, overall, progress and the level of implementation is very low.
- Policy areas addressed in the IAI appear to be unevenly distributed. The goods area for example has 9 projects for 19 action lines while the services area has 15 projects for only 4 action lines. Even within services most projects are focused on training in tourism promotion and management.
- In the competitive economic pillar most action lines are devoted to infrastructure development with a large number of projects focusing on training in maritime and road safety. A few training courses were held on competition policy drafting procedures, consumer protection and intellectual property systems but no projects were assigned to taxation and e-commerce. A handful of workshops have been held on food safety and disaster management.

The Initiative for ASEAN Integration (IAI) was launched at the ASEAN Heads of State Summit in 2000 with the express purpose of co-ordinating collective action in efforts to narrow development gaps. The IAI is currently in the second phase of its Work Plan and is based on key programmes drawn from the three ASEAN Community Blueprints. The IAI Work Plan II (2009-2015) is a rather extensive programme consisting of 245 projects that correspond to 182 action lines in several areas including infrastructure, human resources, ICT, tourism, poverty and regional economic integration. According to a recent assessment, 216 out of 245 projects have been completed and 29 are in various stages of implementation (Mekong Institute, 2014). As of April 2015 the implementation rate stood at 37.4%, or 68 of 182 prescribed action lines (Table 2.12; ASEAN, 2015c). Further discussion of the consequences for regional integration of development gaps and the IAI can be found in Chapter 3.

The AEC component of the IAI has the largest number of action lines (94) and completed projects (82) though they appear to be unevenly distributed. The goods area for example has 9 projects for 19 action lines while the services area has 15 projects for only 4 action lines. Even within services most projects are focused on training in tourism promotion and management. In the competitive economic pillar most action lines are devoted to infrastructure development with a large number of projects focusing on training in maritime and road safety. A few training courses have been held on competition policy drafting procedures, consumer protection and intellectual property systems but no projects were assigned to taxation and e-commerce. Overall, 62 action lines remain unaddressed.

Only three projects have been completed to assist SMEs. These took the form of workshops on access to finance and quality control. Four out of six action lines remain unaddressed. External economic relations were improved through six completed projects on training in FTA negotiations and rules of origin. No projects were conducted to enhance participation in global supply networks.

Projects under the human development component of the ASEAN Socio-Cultural Community have been heavily concentrated in ICT and civil service capabilities which account for 21 and 37 projects respectively. Advancing education and entrepreneurship skills have only one project each and facilitating access to science and technology none.

Only six projects have been assigned to the social welfare and protection area. Poverty alleviation had only one project assigned but it has not been completed. A handful of workshops have been held on food safety and disaster management. No projects were assigned to social safety nets, access to health care, control of communicable diseases and illicit drugs.

Table 2.12. **Status of IAI projects**

	Number of total actions	Number of actions not addressed	Number of total projects	Completed projects	Under implementation/ ongoing
AEC	94	62	97	82	15
Single market and production base					
Goods	19	13	9	6	3
Services	4	1	15	15	0
Investment	6	3	11	8	3
Capital	5	2	12	11	1
Skilled labour	1	1	0	0	0
Priority integration sectors	2	2	0	0	0
Food, agriculture and forestry	11	7	14	11	3
Competitive economic region					
Competition policy	2	1	2	2	0
Consumer protection	3	1	4	3	1
Intellectual property	3	2	5	5	0
Infrastructure development	21	16	13	12	1
Taxation	3	3	0	0	0
E-commerce	2	2	0	0	0
Equitable economic development					
SME development	6	4	4	3	1
Integration into the global economy					
External economic relations	3	1	8	6	2
Enhanced participation in global supply networks	3	3	0	0	0
ASEAN socio-cultural community					
Human development					
Advancing and prioritising education	1	0	1	1	0
Investing in human resource development	2	0	6	2	4
Promotion of decent work	2	1	3	3	0
Promoting ICT	6	2	21	20	1
Facilitate access to applied science and technology	3	3	0	0	0
Strengthening entrepreneurship skills for women, young people, elderly and persons with disabilities	2	1	1	1	0
Building civil service capabilities	8	7	37	34	3
Social welfare and protection					
Poverty alleviation	3	2	1	0	1
Social safety net	2	2	0	0	0
Enhancing food security and safety	1	0	3	3	0
Access to health care and promotion of healthy lifestyle	2	2	0	0	0
Improving capability to control communicable diseases	3	3	0	0	0
Ensuring a drug-free ASEAN	4	4	0	0	0
Building disaster-resilient nations and safer communities	3	2	2	2	0

Source: OECD Development Centre's compilation based on Mekong Institute (2014), "Mid-term review of the implementation of the IAI Work Plan II for Equitable Economic Development and Narrowing the Development Gap".

Challenges for post-2015 integration

Strengthening regional ties – accelerating the economic community initiatives – is one of the best strategic responses to a changing global environment. Over the years work has intensified at varying levels to implement the regional integration initiatives of ASEAN, ASEAN+3 and ASEAN+6. While there have been important and positive achievements, it seems that current efforts are still not enough to achieve the integration targets. Countries need to make additional efforts and take active steps to realise a single economic market by 2015 and beyond. This section will touch on the following key challenges for post-2015 integration agendas in Asia.

- Co-ordination between regional initiatives and national agendas, and regional and sub-regional initiatives, avoiding duplication and moving in the same direction (see Chapter 3 for more detailed discussion).
- Reduction of disparities in the regions need to be more emphasised by supporting further development of the CLM countries (see Chapter 3 for more detailed discussion).
- Towards a "Global ASEAN" of integration in the global economy and stronger ties with the ASEAN+3 and ASEAN+6 frameworks.
- Strengthening monitoring capacity – which is currently still weak – to make the regional initiative agenda more effective (see Chapter 3 for more detailed discussion).
- Addressing important policy areas in the 2016-25 agenda that were not adequately addressed in pre-2015 agendas. In particular, the issues of green growth and renewable energy, private sector development (see Chapters 4 and 5 for more detailed discussion) as well as anti-corruption are important.

Co-ordination between regional initiatives and national agendas, and regional and sub-regional initiatives

Plans/blueprints for regional integration and medium-term national development plans both offer opportunities to communicate these goals to the actors responsible for their implementation and outsiders affected by their outcomes. As they are closely related (i.e. regional plans can reinforce shared national-level commitments and national plans can facilitate integration programmes), an effort focused on harmonising member countries' national development plans with the targets of the AEC would be important in helping to organise and prioritise regional integration at the national level and signalling, through explicit targets, countries' commitment to the AEC (OECD, 2008).

However, there is limited alignment of national and regional plans so far (see Chapter 3 for more detailed discussion). Countries in the region are urged to ensure that regional commitments are transposed into national commitments through appropriate domestic processes. This implies modifying domestic laws and aligning national political interests to long-term regional goals and ambitions. Sometimes lack of compatibility between national policies and regional approaches can hinder or slow the implementation of integration initiatives, which also face challenges in limited regional-level monitoring and implementation capacities. This is evident in a number of AEC agreements that have taken some time to be implemented because of countries' inability to ratify them. To overcome these legal constraints, a review of regional agreements is in order, particularly the provisions pertaining to their operability and entry into force. The design of regional initiatives can be done with additional national-level input to improve the alignment of national and regional planning. Planners in the region need to pay some attention to regional integration as a goal and to national performance, in terms of the implementation of this goal. Improvements could therefore be made in designing regional frameworks that facilitate deeper co-operation in the design and implementation of integration plans.

More emphasis is needed on disparities in the region, by supporting further development of CLM countries

Creating a competitive region with equitable development should continue to be a priority, particularly in ASEAN. To date, ASEAN has implemented programmes that address the narrowing of development gaps through such initiatives as the Initiative for ASEAN Integration (IAI), sub-regional economic programmes (for example, Greater Mekong Sub-region), development of small and medium-sized enterprises (SMEs), promotion of consumer protection, agriculture and food security, and capacity-building programmes for the less developed ASEAN economies.

Development gaps between ASEAN members create additional barriers to the implementation of uniform targets and approaches to implementation. The need to manage these issues appears to have been recognised. To ensure the benefits of economic integration are shared among the less developed markets, the existing regional initiatives should be managed well, made more focused and implemented effectively.

It is important that the adoption of new ways of co-operating amongst member countries in designing and implementing plans for ASEAN integration not come at the expense of selective flexibility in managing issues made challenging by either the policy area or country concerned. In particular, alternative processes for supporting integration may be needed regarding protectionist policies in public procurement and other areas. Sustainable growth and financial services in less developed members stand out as policy areas of potential conflict. Going forward, especially if ASEAN integration is to broaden in scope, flexibility motivated by practical considerations in the design and implementation of regional targets is likely to be increasingly important.

However, it must be emphasised that while the AEC will have a long-run development impact, regional economic integration *per se* is not a panacea to ASEAN's development challenges. Instead, AEC is just one of many options to address development needs in the region. For CLMV countries, for example, an immediate priority is to continue to focus on enabling their greater participation in the overall integration process through effective capacity-building programmes and technical assistance. ASEAN should move together as a region and as ten individual economies, to help build an integrated market and economic community. A collective and inclusive approach is needed, taking into account the synergies offered by other sub-regional groupings, for example, to address economic concerns by the CLMV countries (see Chapter 3 for more detailed discussion).

Towards "Global ASEAN", strengthening ties with the ASEAN+3 and ASEAN+6 frameworks

An external orientation has long been a central component of ASEAN integration, as emphasised in the Nay Pyi Taw Declaration on the ASEAN Community's Post-2015 Vision, signed at the ASEAN Summit in November 2014. The ASEAN Charter clarifies the organisation's centrality in regional co-operation and community building and the AEC Blueprint calls for ASEAN to look beyond its own borders and pursue integration into the global economy.

The ASEAN+3 framework began with a meeting alongside the ASEAN Summit in Kuala Lumpur in 1997 after the Asian financial crisis. Financial integration remains central to the ASEAN+3 project, through the Chiang Mai Initiative Multilateralisation

(CMIM) and Asian Bond Market Initiative (ABMI). The ASEAN+6 or East Asia Summit (EAS) framework is further tied together through a series of free trade agreements. The five ASEAN+1 FTAs may be superseded by the Regional Comprehensive Economic Partnership (RCEP), an agreement between all 16 ASEAN+6 participants.

The APT Cooperation Work Plan and the EAS cover similar policy areas to the AEC Blueprint, with addressing trade, investment and financial barriers and the facilitation of market transactions. In fact, the Work Plan and Blueprint share a number of specific targets, and the APT and EAS expand participation in ASEAN initiatives. Further collaboration and alliances could definitely be an asset for further integration in the region.

Strengthening monitoring capacity to make the regional initiative agenda effective is important

With so many initiatives to implement by 2015 and beyond, it is imperative that a strong monitoring mechanism be put in place both at the country and regional levels. In the absence of an effective and well-functioning mechanism to monitor outcomes, identify issues and address the risks of the integration process, the integration process will not progress significantly even if the region has a good plan. Hence, stronger monitoring of progress in the region is crucial.

One way to enhance regional monitoring of the AEC is through regular policy dialogue and a peer learning and review process among officials engaged with integration initiatives (OECD, 2008). To the extent that transparency is needed for the success of effective integration, such a peer review process should be further encouraged and enhanced. This exercise should allow countries to share information and discuss key policy issues pertaining to their respective trade and investment regimes. It is important to use already established institutions – the ASEAN Integration Monitoring Office (AIMO) and the ASEAN+3 Macroeconomic Research Office (AMRO). In addition to monitoring at the regional level, enhancing monitoring at the national level is a key challenge to ensure that regional commitments to an AEC are effectively transformed on the ground. This requires effective in-country monitoring of AEC measures based on actual implementation of integration initiatives. One way is to establish a network comprising all national monitoring offices.

Addressing important missing policy areas for the 2016-25 agenda which were not adequately addressed in pre-2015 agendas

Given the number of measures under the AEC, and the constraints faced by countries in implementing them, it is recognised that not all elements of regional integration could be concluded simultaneously and there is a need to prioritise. Hence, a new approach is needed to realistically assess what the AEC can deliver by 2015 and what to do under the 2016-25 integration agenda. Such an approach involves focusing on some priority areas for integration and advancing those areas where significant progress can be achieved. The Phnom Penh Agenda, approved by leaders in 2013, already sets the overall tone on this prioritisation. But to be effective, this exercise should be based on a realistic assessment of what kind of market integration the region should pursue after 2015, based on market conditions and countries' willingness and capacity to engage in the process. It also takes into account other initiatives in the region.

In addition, the region needs to focus on strengthening existing institutions and ensure that they can render effective support to market integration. One such institution is the dispute and settlement system within the AEC, which needs to be revitalised by convening regular meetings of the working committee and prescribing laws and standards to avoid/resolve conflicts in the future. A compliance system where governments and firms can adhere to their obligations under the AEC should also be developed. With strong institutions, the responsibility of implementing and enforcing community decisions will become clear, thus preventing countries circumventing their obligations and undermining integration initiatives.

It is crucial for the 2016-25 regional integration agenda to address important new issues such as green growth and renewable energy. There are various environmental co-operation mechanisms in the region, such as the ASEAN Environmental Programmes, the Northeast Asian Conference on Environmental Co-operation and the Acid Deposition Monitoring Network in East Asia, but these are hampered by a lack of clear objectives and/or mechanisms for effective implementation. In order to redirect the current development pattern so as to deliver shared well-being without exceeding ecological limits, it is necessary to rebalance regional integration towards broader sustainability objectives. The potential of regional integration for promoting green growth could be explored through exploitation of renewable energy resources. Hydropower development in the Mekong River Basin could provide an interesting example of regional co-operation in the area of green growth and energy (for more detailed discussion, see Chapter 4).

Equally important is the role of the private sector. To the extent that implementation of AEC agreements requires the understanding and confidence of the private sector, the active involvement of this sector is crucial. This aspect of the AEC should be further strengthened. Formal consultations with the private sector and regional authorities may be used, but there is a need to develop new and innovative strategies to maximise the dynamic contribution of the private sector to integration. Since the AEC is a market-driven process, markets should be well informed. Other stakeholders in the integration process should also be actively engaged. This requires more efforts, particularly at the country level, to communicate how the AEC works, which will also help to offer greater transparency on the process and secure greater buy-in from the population (see Chapter 5 for more detailed discussion).

Corruption will need to be addressed to promote regional development and to maximise institutional capacities that support integration processes. It remains a significant and widespread concern in much of the region; many Emerging Asian countries were ranked in the bottom half of Transparency International's Corruption Perceptions Index 2014. Not much change has been noticed, with corruption perceptions in most countries in the region having improved little since the mid-1990s, according to Transparency International's index.

Anti-corruption efforts can be challenging and complex, and there are few best practices or issues with widespread agreement, leading to debates on even fundamental matters such as whether these initiatives should be led by one or a group of agencies. National-level anti-corruption efforts in Emerging Asia have had a mixed record of success, though they tend to be more successful when their focus is deeper than legal and administrative enforcement and where there is sustained high-level commitment (OECD, 2015b). Regional frameworks can be used to secure commitments to implement reforms to increase accountability and transparency and share successful experiences in managing corruption.

Notes

1. Sectoral coverage ratio is defined as the ratio of GATS + AFAS coverage to GATS sectoral coverage.
2. These results should be interpreted with caution as the sample size was small and the survey was limited to foreign firms investing in ASEAN.
3. An interesting discussion of the characteristics of these "dragon multinationals" can be found in J. Mathews, "Dragon Multinationals: New Players in 21st Century Globalization", *Asia Pacific Journal of Management* (2006).
4. The Transnationality Index is calculated as the average of the following three ratios: foreign assets to total assets, foreign sales to total sales and foreign employment to total employment.
5. More recent data are required to assess progress in Lao PDR and Viet Nam.
6. The CATC consists of 32 job titles divided into 6 labour divisions: front office, housekeeping, food production, food and beverage service, travel agencies and tour operations.

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Chapter 3

Strengthening institutional capacity for integration in Emerging Asia

While limitations in regional institutional capacities can pose obstacles to integration efforts, effective co-ordination between regional, sub-regional and national targets is critical in designing and implementing regional initiatives. These initiatives are generally not closely aligned with national development priorities, suggesting that national expertise and sub-regional initiatives can be better used in constructing regional plans. The relative underdevelopment of the CLM countries poses an additional challenge to their contributing to co-operative efforts, though work is being done to narrow these development gaps. A practical solution to be pursued in the short term to help motivate and facilitate greater achievement of regional goals would be to improve monitoring efforts through the use of existing frameworks such as ASEAN+6, the creation of new indicators and policy dialogue through peer review and other tools.

Introduction

By its very nature, regional integration is a broad collective effort requiring sufficient capacities for involved actors to manage their own responsibilities and to co-ordinate shared and overlapping responsibilities with their partners. This work is the responsibility of institutions for regional integration, which can be defined as "arrangements and organisations, ranging from ad hoc and informal forums that lack an organisational core to formal standing bodies that serve a particular purpose" (ADB, 2010). Existing institutions and regional frameworks have the potential to be used more effectively, and many of the challenges faced due to insufficient capacities can be addressed through more careful alignment of planning and implementation at various levels of organisation.

Regional planning processes, for example, can better incorporate national-level expertise to improve capacities and develop plans that are better informed about national situations. Likewise, sub-regional initiatives, which hold promise for integration efforts, can be consulted more regularly by regional bodies on areas of shared concern. The particular challenges of integration efforts involving the less developed CLM countries (Cambodia, Lao PDR and Myanmar) have been recognised through frameworks such as the Initiative for ASEAN Integration (IAI), though these frameworks could be used more effectively. Monitoring and co-operation on implementation – potentially through enhanced policy dialogue and peer learning – can improve the integration process and make it more transparent.

Aligning national, regional and sub-regional planning

Deeper co-operation is needed in the design of targets

Regional integration and medium-term national development plans serve similar functions as opportunities to communicate goals to the actors responsible for their implementation and outsiders affected by their outcomes. They are closely related, as regional plans can reinforce commitments that are shared on the national level, and national plans can facilitate integration programmes. The alignment of member countries' medium-term development plans with the targets of the ASEAN Economic Community (AEC) would be beneficial in helping to organise and prioritise regional integration at the national level and in signalling, through explicit targets, the countries' commitment to the AEC.

While complete alignment between national and regional targets should not be expected, as they are produced separately with different intentions, and as co-ordination is no guarantee of successful regional integration in any case, there is less overlap between regional and national targets in the Association of Southeast Asian Nations (ASEAN) than might be expected. While there are few cases of explicit contradiction between these plans, they remain mostly disconnected from one another, largely as a result of the way in which regional targets are framed. Deeper co-operation in designing regional targets may therefore be beneficial. In addition to fostering stronger relationships between regional and national institutions in planning and implementation, the presence of sub-regional institutions and initiatives provides another layer of potentially useful activity in efficiently driving integration efforts, although deeper co-ordination with ASEAN will be needed to realise this.

The alignment of national and regional targets in Southeast Asia varies according to the country and sector considered, but loose patterns are visible in alignment between national plans and the AEC Blueprint (Table 3.1). Among the most apparent and important patterns are the following:

- There is some similarity in policy areas, but little overlap between AEC targets and national plans for the implementation of specific goals for regional integration.
- There is a greater degree of alignment with aspects of the AEC Blueprint when domestic policy is central to implementation, and in the promotion of small and medium-sized enterprises (SMEs), priority integration sectors and other industries explicitly covered by the Blueprint.
- National plans often include goals beyond those of the AEC, such as an emphasis on sustainable development, which may complicate the achievement of regional goals.

Box 3.1. **There are new opportunities to determine the direction of ASEAN integration**

ASEAN integration has proceeded gradually since the founding of the organisation in 1967 and the deepening trade and investment agreements in the 1990s. In 2003, ASEAN members began discussions for the establishment of the AEC by 2020. This date was later advanced to 2015, and plans were outlined in greater detail in the AEC Blueprint adopted at the 13th ASEAN Summit in November 2007 in Singapore. Expert groups have been established to lead discussions and co-operation on aspects of economic integration. These include the ASEAN Experts Group on Competition, which produced the *ASEAN Regional Guidelines on Competition Policy* and the *Handbook on Competition Policy and Law in ASEAN for Business 2013*, and the ASEAN Capital Markets Forum Group of Experts, who developed an implementation plan for integration of ASEAN capital markets. These groups were generally set up after finalisation of the Blueprint, rather than as participants in its creation.

New challenges will emerge in finalising the plans for the next phase of regional integration. After the 2013 Bandar Seri Begawan Declaration on ASEAN Community's Post-2015 Vision, the ASEAN Community Councils worked to develop this post-2015 vision, with the ASEAN Coordinating Council (ACC) developing its central elements. At the 25th ASEAN Summit in November 2014, the Nay Pyi Taw Declaration on the ASEAN Community's Post-2015 Vision outlined the post-2015 goals for the next phase of the regional integration project. This document calls for expediting the implementation of remaining elements of the original Blueprint and suggests a broader scope for the future of the ASEAN Economic Community. Its overarching elements include inclusive growth, sustainable development, productivity growth and good governance. But as a vision for the integration programme, it needs clearly defined measures and targets. The ACC also established a working group to oversee the process of developing the post-2015 vision by the 27th ASEAN Summit, with progress reports to be submitted at the interim summit.

These trends suggest areas where improvements could be made in future to facilitate the development of more mutually supportive targets at the national and regional levels. They also show that planners are willing to pay some attention to regional integration as a goal, and to national performance in terms of reaching this goal. Improvements could therefore be made in designing regional frameworks that facilitate deeper co-operation in the design and implementation of integration plans.

Table 3.1. **Alignment of national plans and AEC targets**

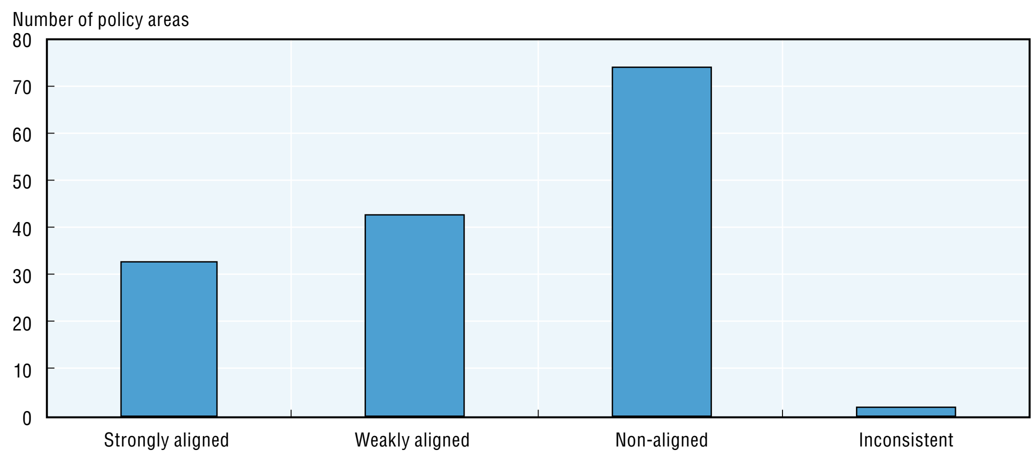
	Cambodia (2014-18)	Lao PDR (2011-15)	Myanmar (2012-15)	Indonesia (2015-19)	Malaysia (2016-20)	Philippines (2011-16)*	Thailand (2012-16)	Viet Nam (2011-15)
Free flow of goods	Strongly aligned	Strongly aligned	Strongly aligned		Inconsistent	Weakly aligned	Weakly aligned	Inconsistent
Free flow of services	Weakly aligned	Weakly aligned	Weakly aligned			Weakly aligned	Weakly aligned	Weakly aligned
Free flow of investment	Weakly aligned	Weakly aligned	Strongly aligned				Weakly aligned	Weakly aligned
Free flow of capital								
Free flow of skilled labour			Weakly aligned				Strongly aligned	
Priority integration sectors	Strongly aligned	Strongly aligned	Strongly aligned	Strongly aligned	Weakly aligned	Strongly aligned	Strongly aligned	
Food, agriculture and forestry	Strongly aligned	Strongly aligned	Strongly aligned	Weakly aligned	Weakly aligned	Overlapping targets; Inconsistent	Strongly aligned	Strongly aligned
Competition policy		Weakly aligned	Weakly aligned					Weakly aligned
Consumer protection			Weakly aligned					
Intellectual property rights							Weakly aligned	
Transport	Strongly aligned	Strongly aligned	Weakly aligned	Weakly aligned	Weakly aligned	Weakly aligned	Strongly aligned	Weakly aligned
Energy	Weakly aligned	Strongly aligned	Weakly aligned	Strongly aligned	Weakly aligned	Weakly aligned; Inconsistent	Strongly aligned	Weakly aligned
Mineral	Weakly aligned	Weakly aligned	Strongly aligned					
ICT	Strongly aligned	Weakly aligned	Weakly aligned		Weakly aligned	Weakly aligned		
Taxation	Weakly aligned	Weakly aligned	Weakly aligned			Weakly aligned		Weakly aligned
E-commerce								
SME development	Strongly aligned	Strongly aligned	Strongly aligned		Strongly aligned		Strongly aligned	
Initiative for ASEAN Integration		Strongly aligned						
External economic relations		Strongly aligned	Strongly aligned				Weakly aligned	
AEC implementation	Yes	Yes	Yes	Yes			Yes	

Note: * Based on the *Philippine Development Plan 2011-2016* and the *Philippine Development Plan 2011-2016 Mid-term Update*. The coverage and targets of recent national plans of eight ASEAN members (excluding Singapore and Brunei Darussalam, which do not produce comparable development plans) are compared with the targets of the AEC Blueprint, grouped into 19 policy areas as in the AEC Scorecard. National targets were compared against each category and defined as either having strongly aligned (i.e. sharing at least part of an explicit target in the Blueprint), weakly aligned (i.e. addressing a policy area identified in the Blueprint in a way consistent with the latter's targets) or inconsistent (i.e. explicitly or potentially contradictory to one or more targets in the Blueprint). Cases where national plans were silent on a policy area identified in the Blueprint were defined as non-aligned and left blank. The mention of the AEC as a target overall was added as a 20th category of evaluation.

Source: OECD Development Centre, based on national sources.

While the major policy areas of national medium-term development plans occasionally overlap with elements of regional integration, they are mostly disconnected and separate from regional goals. Out of 152 policy area intersections between the 19 major areas of the AEC Blueprint and the 8 national plans studied, there are overlapping targets or similar coverage in half; national plan targets overlap with at least some parts of AEC goals in 33 areas; and in 43 more they have similar coverage in addressing consistent but distinct goals in the areas covered by the AEC. Only four cases could potentially be interpreted as conflicting with the goals of regional integration; granting privileges to domestic producers, and agricultural and energy self-sufficiency. Often, national plans are silent on matters of regional integration; in 74 cases, there is no overlap (Figure 3.1).

Figure 3.1. **Alignment of national and regional targets in ASEAN**



Source: OECD Development Centre's compilation based on national sources.
StatLink http://dx.doi.org/10.1787/888933309945

The way in which AEC policy areas and integration measures are defined can have a large influence on their alignment with national plans, and can help explain why the priorities set in national plans often show more commonalities amongst themselves than with the AEC Blueprint. The implementation of the IAI, which is mentioned only in the plans of Lao PDR and Myanmar, requires "collective efforts to narrow the development gap" and is therefore relatively ill-suited to domestic and unilateral planning. Similar coverage is much more common in agriculture, transport, energy and SME development, in the form of planned investment and regulatory reforms that can be implemented at the national level, but these initiatives remain somewhat disconnected from regional plans. For example, planned transport infrastructure developments specifically designed to promote tourism in Lao PDR, Malaysia and the Philippines would help to support the achievement of priority integration sector goals. Likewise, planned improvements in electricity generation and transmission networks in Cambodia, Myanmar, Malaysia and the Philippines would address a policy highlighted in the Blueprint, although implementation would not directly help to achieve a regional target.

Differences in focus can hinder progress

Several national plans place a strong focus on issues either not in the Blueprint or potentially conflicting with it. Elements involving inclusive and sustainable growth figure among the targets of most national plans, and feature heavily as part of the overall vision of several. Aside from a few targets related to alternative energy use and more accessible economic opportunities, these issues are largely absent from the AEC Blueprint. They are, however, covered in greater detail by the ASEAN Socio-Cultural Community Blueprint, while the AEC is focused on the core aspects of integration, regulatory reform, the development of targeted sectors and narrowing the development gap among member countries. A fundamental difference in overall vision could create complications. The plans of Lao PDR, the Philippines, Thailand and Viet Nam, for instance, all call for a significant expansion of forest coverage. While this is not necessarily at odds with the AEC's target's for a well-managed forestry sector – and could even be supported by AEC measures to reduce illegal logging – there is the potential for conflict between ecological aims and the promotion of forestry.

A divergence is also apparent in the tendency of national plans to place a stronger emphasis on integration with the global economy than on ASEAN integration. This is not necessarily a problem, even in terms of the AEC Blueprint, which calls for integration into the global economy as a key aim. It does, however, indicate a lower priority for the region. Most national targets for infrastructure development outline planned trade infrastructure, though they largely ignore most of the transportation projects outlined in the Blueprint, such as the Singapore-Kunming Rail Link or the ASEAN Highway Network. An emphasis on global integration also risks impeding the development of a "coherent approach towards external economic relations" called for under the AEC (ASEAN Secretariat, 2008). Trade facilitation measures outlined in several national plans, such as the implementation of national single windows and customs reforms, can be expected to have positive regional impacts. However, global integration targets are sometimes still framed in terms of promoting domestic production. For example, Lao PDR, Malaysia, the Philippines and Viet Nam all set targets for total exports or trade balances.

Moreover, building the ASEAN Economic Community as a priority goal does not feature prominently in many national plans. To be sure, ASEAN or its initiatives are mentioned in all eight documents, but the AEC in particular is not mentioned by Malaysia or Viet Nam, and its implementation is included as a specific target only by Cambodia, Indonesia, Lao PDR, Myanmar and Thailand (with the most specific objectives outlined in Lao PDR's Seventh Five-Year National Socio-Economic Development Plan). Planners in the Philippines refer to the AEC only as a contextual factor. Similarly, the Thai National Economic and Social Development Plan refers to the AEC in terms of its expected influence on economic conditions in the country and its position internationally, though it also acknowledges the AEC as a broad development issue for which preparation is needed.

The national plans of Cambodia, Lao PDR and Myanmar show better alignment with regional targets. While Thailand's plan is also relatively well aligned, the incorporation of regional integration targets into national plans may be more straightforward in the CLM countries due to their lower level of development and slower AEC implementation. These members (and Viet Nam), in their gradual achievement of regional targets, have more work to be done than the ASEAN-5 countries, which tend to focus their national plans more on issues related to productivity growth (OECD, 2015). This is particularly true regarding less contentious reforms that may have already been accomplished by the more advanced countries, such as regulatory reform and capacity building in the mining sector; these elements are included in CLM plans, while mining is largely ignored in the plans of the other countries. As the three CLM countries are also the only ones explicitly to target the achievement of the AEC in their national plans, planners in these countries may also be more enthusiastic about the AEC's potential impact on their economies, and thus better disposed to prioritising regional goals.

The comparison of national plans and the progress made toward AEC targets may suggest that planners across the region are paying attention to regional goals in setting their own priorities. Considerable alignment was often found in policy areas where the implementation of AEC targets was identified by the ASEAN Economic Community Scorecard as most lagging (ASEAN Secretariat, 2012). The Scorecard's assessment of Phase I and II implementation – over 2008-11, a period overlapping with or immediately preceding several of the national plans studied here – shows the need for improvement in implementing AEC measures relating to regional openness and several important economic sectors. Compliance was found to be lagging at least somewhat in all countries in various categories: the free flow of goods, services and investment; consumer protection; transport; energy; IAI; and external economic relations. Of these areas, all but consumer protection and IAI had overlapping targets or similar coverage in at least four of the eight national plans. This alignment is, of course, limited; most targets set in national plans within these policy areas are only tangentially connected to the AEC targets. All seven national plans that address issues related to the free flow of services, for example, are concerned with the introduction of domestic reforms, usually to the financial sector, rather than with deeper regional integration.

National expertise should be harnessed in regional planning

Deeper co-operation at the regional level can improve the alignment of regional and national planning and the effectiveness of regional efforts, beginning with the design of targets for regional integration. For the greatest impact on national targets, the technical and country-specific expertise of national officials should be utilised to a greater extent in setting regional targets and plans for achieving them. Economic officers and planning staff could be more deeply involved in helping to set future goals for the ASEAN Economic Community. This would harness national expertise, improve capacities and provide insight on what is desirable and achievable at the national level.

The shared technical expertise of these participants could actually facilitate consensus building. Experts often speak a common language and perceive issues in similar ways; many similarities can be found in the focus areas and kinds of targets set in the national plans of ASEAN members. The involvement of additional stakeholders can facilitate implementation through enhanced "community-level buy-in" (Mathiaparanam, 2011).

On the other hand, efforts to improve national planners' familiarity with and appreciation of AEC goals are likely to be of more superficial relevance in facilitating regional integration, though minor efforts could be made at the national level to demonstrate commitment to AEC implementation. In several cases where national targets come close to endorsing those of the AEC, explicit alignment would be relatively easy to achieve and would help to make these national plans into signals of countries' AEC commitment. Most importantly, this commitment could be made clear by the three countries (Malaysia, the Philippines and Viet Nam) in which it is not mentioned or only discussed as a contextual factor for the implementation of the national plan. With more actors involved, the setting and monitoring of regional plans is also more complicated, whereas national planning officials would be well-positioned to lead the tracking of AEC implementation at the national level.

The ultimate impact of pressing for greater consideration of the AEC in national planning is unlikely to be significant, however, without additional changes to how regional targets are set and implemented. The reframing of national targets to better match approximate regional ones is a largely superficial improvement that would likely be of limited practical importance, particularly given the limitations in institutional capacity that have prevented many countries in the region from fully achieving the goals set out in their plans (OECD, 2015). National planners are also no doubt well aware of regional targets, but may not pursue alignment when elements of regional goals are ill suited to national plans, as discussed previously, or where the inclusive planning process makes direction impracticable or inappropriate. Pressing for the additional incorporation of AEC targets in national plans would therefore be incomplete without also introducing new forms of co-operation at the regional level.

Bringing sub-regional initiatives into the process

In addition to fostering productive alignment of national and regional plans, regional and smaller areas within ASEAN and neighbouring countries have established alternative means of working together through sub-regional institutions and initiatives that can help to support ASEAN-wide integration. These sub-regional institutions encompass all ASEAN member states as participants. Primarily concerned with connectivity, though also addressing other policy areas, these groupings of national and sub-national governments have the potential to spur growth, particularly in underdeveloped regions, and to support the achievement of AEC goals. To make the most of these opportunities, it is necessary to address the internal institutional constraints in these sub-regional initiatives and the lack of regularised channels of co-operation with ASEAN.

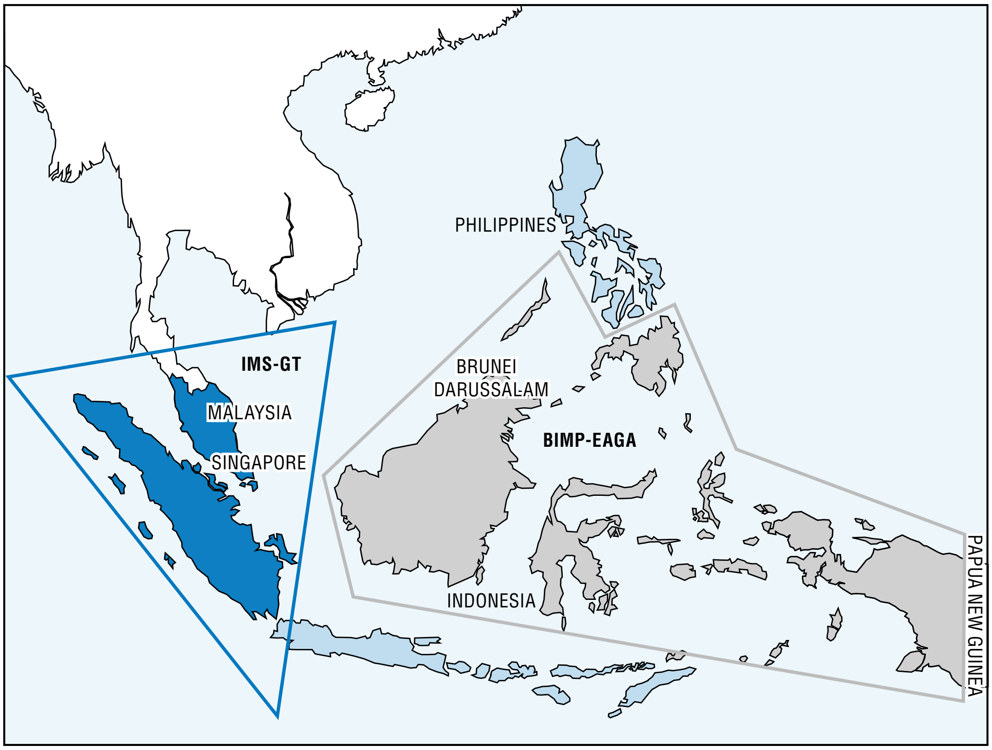
Sub-regional economic co-operation has spread among ASEAN members since the establishment of several initiatives among countries and sub-national regions in the early and mid-1990s (Table 3.2). The Greater Mekong Subregion (GMS) programme brings together Cambodia, Lao PDR, Myanmar, Thailand, Viet Nam and, from China, one province (Yunnan) and one Autonomous Region (Guangxi Zhuang). The programme, for which the Asian Development Bank (ADB) provides support and functions as the secretariat, aims to co-operate on shared priorities. It focuses on transport, trade facilitation, energy, agriculture, environment, human resource development, urban development, tourism, information and communications technology (ICT), and border economic zones. Sub-regional economic co-operation also takes place through growth initiatives, such as the Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area (BIMP-EAGA), the Indonesia-Malaysia-Singapore Growth Triangle (IMS-GT) and the Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT). These initiatives promote shared development based on geographical proximity and other ties (Figure 3.2). The ADB provides support and assistance to the IMT-GT and BIMP-EAGA. Several smaller sub-regional initiatives also aim to improve cross-border co-operation, particularly in less developed areas.

Table 3.2. **ADB-supported sub-regional initiatives in ASEAN**

Initiative	Year established	Participants	Economic corridors	Selected major infrastructure projects
Greater Mekong Subregion (GMS)	1992	• Cambodia • The Chinese province of Yunnan and Guangxi Zhuang Autonomous Region • Lao PDR • Myanmar • Thailand • Viet Nam	• Central Corridor (Lao PDR – Thailand and Cambodia) • East-West Corridor (Viet Nam – Myanmar) • Eastern Corridor (Viet Nam – China) • North-South Corridor (China – Thailand) • Northeastern Corridor (Viet Nam – Thailand) • Northern Corridor (China – Myanmar) • Southern Coastal Corridor (Viet Nam – Thailand) • Southern Corridor (Viet Nam – Myanmar) • Western Corridor (Myanmar)	• Yuxi–Mohan Railway (USD 7.4 billion) • Vientiane–Boten Railway (USD 7.2 billion) • Dali–Ruili Railway (USD 4.5 billion) • Bang Yai–Kanchanaburi Intercity Motorway (USD 2 billion) • GMS Ha Noi–Lang Son Expressway (USD 1.4 billion)
Indonesia-Malaysia-Thailand Growth Triangle (IMT-GT)	1993	• 14 Thai provinces (Krabi, Nakhon Si Thammarat, Narathiwat, Pattani, Phattalung, Satun, Songkhla, Trang, Yala, Chumphon, Ranong, Surat Thani, Phang Nga, and Phuket) • 8 Malaysian states (Kedah, Kelantan, Melaka, Negeri Sembilan, Penang, Perak, Perlis, and Selangor) • 10 Indonesian provinces (Aceh, Bangka-Belitung, Bengkulu, Jambi, Lampung, North Sumatra, Riau, Riau Islands, South Sumatra, and West Sumatra)	• Extended Songkhla-Penang-Medan Corridor • Straits of Melaka Corridor • Banda Aceh-Medan-Pekanbaru-Palembang Corridor • Melaka-Dumai Corridor • Ranong-Phuket-Aceh Corridor	• Development of Aceh highway facilities: Banda Aceh–Kuala Simpang (Toll Roads) (USD 2 billion) • Melaka–Dumai Economic Corridor Multimodal Transport (USD 875.2 million) • Most southerly section of the Eastern Highway from Bandar Lampung to Bakauheni and linked across to Java (USD 820 million) • Sumatra Toll Roads (USD 493 million) • Melaka–Pekanbaru Power Interconnection (USD 300 million) • Hat Yai–Sadao Intercity Motorway (USD 300 million)
Brunei Darussalam-Indonesia-Malaysia-The Philippines East ASEAN Growth AREA (BIMP-EAGA)	1994	• Brunei Darussalam • 4 Indonesian provinces (Kalimantan, Sulawesi, Maluku and West Papua) • 2 Malaysian states (Sabah and Sarawak) and the federal territory of Labuan • The Philippine province of Palawan	• East Borneo Economic Corridor • Greater Sulu Sulawesi Corridor • West Borneo Economic Corridor	• Enhancing the Manado–Bitung Link (USD 406.9 million) • Lahad Datu Palm Oil Integrated Cluster (USD 166 million) • Tanjung Selor Border Road (USD 130.6 million) • Trans Borneo Power Grid: Sarawak to West Kalimantan Link –Indonesia Section (USD 128 million) • Expansion of Mindanao Ports Program II (USD 46.45 million)

Source: Asian Development Bank.

Figure 3.2. **Sub-regional economic co-operation through growth initiatives (IMS-GT and BIMP-EAGA)**



Source: Based on UNICON International, http://unicon-international.com/index.php?id=292.

Sub-regional initiatives in ASEAN seek to build upon economic opportunities through a mix of public and private sector action to promote trade and investment. Connectivity is central to these arrangements, particularly through the development of stronger economic corridors: transportation and other links that are particularly important in the movement of goods and people within countries and across borders. The Greater Mekong Subregion Transport Sector Strategy (2006-15), for example, identified a network of major cross-border roadways that formed the basis of its nine economic corridors in the region. Co-operative efforts are made through sub-regional initiatives to develop the hard and soft infrastructure needed to facilitate these flows. Investment in infrastructure is therefore emphasised, with planned priority projects totalling an estimated USD 30.1 billion under the GMS, USD 5.2 billion under the IMT-GT and USD 1.2 billion under the BIMP-EAGA. Alternative means of financing are being explored, including the possibility of public-private partnership models for some infrastructure projects.

Sub-regional initiatives have had some success in identifying and promoting the development of key economic areas, but they still face difficulties in achieving many of their goals. A lack of clear comparative advantages or sufficient opportunities for economic co-operation may create challenges, but institutional constraints are the main issue for sub-regional groupings in Southeast Asia. Imbalances in power relationships among members and in commitment to joint projects have been identified as barriers to sub-regional co-operation in frameworks that are often loosely arranged (Henderson, 2001; Sparke et al., 2004).

These loose relationships can produce resource and capacity constraints at the institutional level although GMS and other initiatives seek to attract project-based technical assistance. Capacities for analysis, monitoring and reporting could be improved upon in general, though these vary across institutions. The work of the GMS, for example, is supported by the ADB and receives human resource development assistance through the Mekong Institute, an intergovernmental organisation focusing on rural development and livelihoods, trade and investment facilitation, and migration issues in the region. At the same time, the institutional design of these organisations may not appropriately reflect their goals. The IMT-GT Project Manual, for example, acknowledges that the institutional structure of this group, which is modelled on that of ASEAN, gives a privileged position to national-level actors, who dominate IMT-GT forums and meetings. This risks reducing space for the participation of sub-national governments and private sector participants.

These internal institutional constraints can make it difficult to reap the potential benefits offered by sub-regional integration initiatives. It is important to address these constraints, as sub-regional efforts can directly contribute to regional connectivity projects and to strengthening integration more generally. In addition, these project-driven, bottom-up initiatives can prove constructive complements to ASEAN-wide integration efforts. Sub-regional initiatives and growth zones have also been promoted within ASEAN as spaces for testing new approaches to economic integration that, if successful, could be scaled up to include the rest of the region. This is particularly true in efforts that may be easier to implement among smaller groups of like-minded countries with a longer history of co-operation (Nadalutti, 2015).

Changes could be made in the way these initiatives and ASEAN institutions relate to one another in order to improve co-ordination. A positive first step was made through an ADB-led mapping of links between ASEAN and the GMS, BIMP-EAGA and IMT-GT (ADB, 2013). Further work is needed to build upon this and to address areas of unnecessary overlap and possible synergies in deepening integration through the AEC Blueprint or the design of post-2015 ASEAN targets.

All sides have independently identified areas of overlap between ASEAN and sub-regional initiatives to some extent as well. The AEC Blueprint is largely silent on relations with sub-regional initiatives, aside from calling for the enhanced provision of technical assistance for public and private sectors, including these groupings, through the Initiative for ASEAN Integration. The Master Plan on Connectivity, which is concerned with a policy area central to co-operation through GMS and other initiatives, notes areas of overlapping goals with sub-regional projects, such as the study of a BIMP-EAGA roll-on/roll-off (RoRo) network that could form part of the ASEAN RoRo network. The plan calls for co-ordination with these initiatives and identifies lessons from sub-regional projects that may be relevant for ASEAN integration efforts, such as the border checkpoint reforms identified in the GMS Cross-Border Transport Agreement. Several sub-regional projects are likewise framed as potential components of ASEAN connectivity, such as the BIMP-EAGA's transportation projects, which form part of the ASEAN Highway Network, and the proposed BIMP-EAGA Rink submarine fibre optic cable, which could potentially contribute to the ASEAN Broadband Corridor.

As suggested in the ADB review, deeper co-operation could be achieved through the replacement of ad hoc co-ordination efforts with regularised mechanisms at the regional, sub-regional and in-country level. This may include the creation of additional ministry-level focal points or periodic consultation meetings on recent developments between representatives of the ASEAN Secretariat and the sub-regional groups. Modest changes such as these could help to compensate for capacity constraints by pooling resources for dealing with common issues. These mechanisms for regular information sharing could also help to inform a more systematic approach to identifying successes and lessons learned in smaller-scale co-operation and integration within ASEAN, and in deciding how these could be scaled up to be applied at the regional level.

The co-ordination and implementation of regional and sub-regional initiatives, of course, requires capacities at the national level to ensure their effective implementation. National planning agencies and sub-regional initiatives can work closely with line ministries to promote better alignment of national plans and cross-border development goals. This can also be facilitated through greater information sharing in the planning and implementation processes. National secretariats may have central roles to play in facilitating in-country co-ordination on ASEAN and sub-regional issues.

Promoting the development of the CLM countries

Regional institutions can help manage development gaps

Development gaps among ASEAN members create additional barriers to the implementation of uniform targets and approaches, though these are being addressed with the help of regional and external partners through the Initiative for ASEAN Integration and other aid programmes. Following the inclusion of flexible targets through the "ASEAN Minus X" formula for the CLMV countries (Cambodia, Lao PDR, Myanmar and Viet Nam) in the ASEAN Free Trade Area (AFTA) and, later, the AEC Blueprint, a more targeted approach was taken through the IAI, which was launched in 2000. The IAI Work Plan II 2009-15 included projects and action lines in several areas, such as infrastructure, human resources, ICT, tourism, poverty and regional economic integration. The aim was to address development challenges, particularly in Cambodia, Lao PDR, Myanmar and Viet Nam. External partners – both bilateral and multilateral donors – have been actively involved in financing development initiatives in the less-developed ASEAN member countries through the IAI as well, though they have been more active outside of this framework, particularly in re-engaging recently with Myanmar.

The IAI was established to narrow various development gaps within ASEAN and to promote accelerated development in the CLMV countries. Disparities within the region are significant and complex, and exist both among and within member economies. ASEAN members are very diverse and income levels vary widely in the region, from 78 958 international dollars in Singapore to 3 093 international dollars in Cambodia (on a purchasing power parity basis, in 2014). Large rural agricultural populations, with low-productivity and low-income work, contribute to higher rates of poverty in the lower-income countries. Other indicators highlight the gaps in human development that remain despite progress made. For example, Human Development Index scores are improving across the region, though significant gaps remain, from Singapore, in the "very high human development" category, to Myanmar, in the "low human development" category. Six ASEAN members (Indonesia, the Philippines, Viet Nam, Cambodia, Lao PDR and Myanmar) were ranked in the bottom 50% of the index, with the worst rankings for Cambodia, Lao PDR and Myanmar, in 136th, 139th and 150th positions, respectively. Similarly, recent reporting on progress towards achievement of the Millennium Development Goals shows that the countries performing least well, in terms of the number of categories in which they are "slow" or making "no progress/regressing", are Lao PDR (11 categories), the Philippines (11 categories), Myanmar (10 categories) and Cambodia (9 categories) (ADB, 2014).

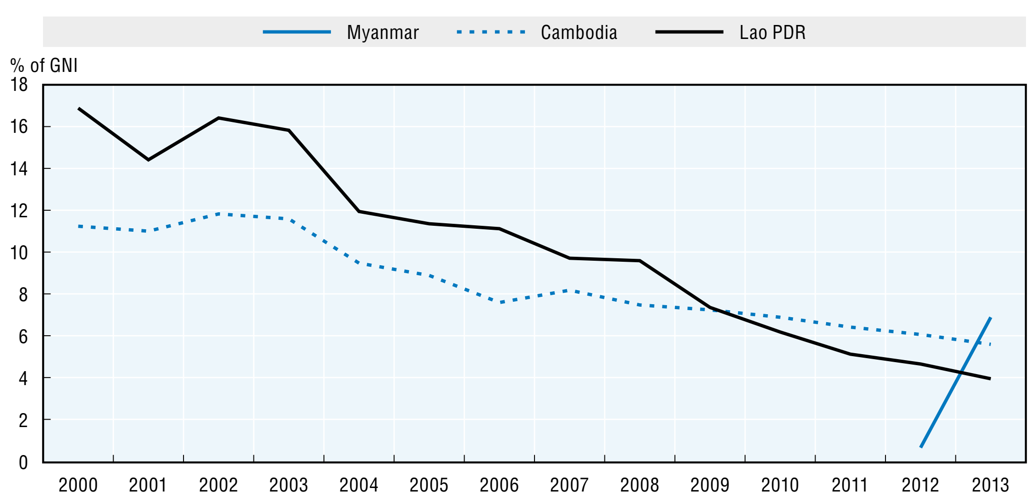
Based on the number and scale of IAI projects, a strong emphasis has been placed on civil service capacity building. While there are large gaps in human development and poverty rates among ASEAN members, and the gaps have implications for the lower-income economies and their ability to participate in the AEC, these issues have largely been left out of the IAI. The alleviation of poverty, despite its importance, had only one project assigned under the IAI Work Plan II, and it has not been completed. The project was related to poverty alleviation in CLMV, with due attention to female households in rural areas. Two other possible lines of action in this area have not yet been addressed: workshops for CLMV to review and assess the impact of internationally funded poverty reduction programmes and adapt best practices, and workshops on economic development at the grassroots level and in rural areas.

The area of social welfare and protection, which is important for alleviating the consequences of poverty and building human capital to limit future poverty, has received less attention than other areas, with only six projects in total. The two health-related projects are focused on enhancing the quality of herbal medicine, on the one hand, and capacity-building activities on healthy lifestyles, on the other. Education also receives relatively less attention, with only one project dedicated to advancing and prioritising education through training for CLMV countries in higher education management. Gaps in education performance among CLMV and other ASEAN countries can be seen in differences in school enrolment and completion rates, particularly at higher levels of education.

External aid is contributing to CLM development initiatives

Dialogue partners and donors have been closely involved in the IAI since its early stages. In 2002, the first IAI Development Cooperation Forum (IDCF) included these external participants in a dialogue on the IAI Work Plan. Three more forums have been held since then, focusing on generating interest in IAI projects and soliciting external views on the work plan. The first IAI Work Plan, covering 2002-08, included 134 projects and programmes at a total cost of USD 211 million. Most of this (USD 191 million) was provided by the ASEAN-6 countries, with USD 20 million coming from dialogue and external partners.

Figure 3.3. **Net ODA received by Cambodia, Lao PDR and Myanmar, 2000-13**



Note: Myanmar GNI data are not available from before 2012.

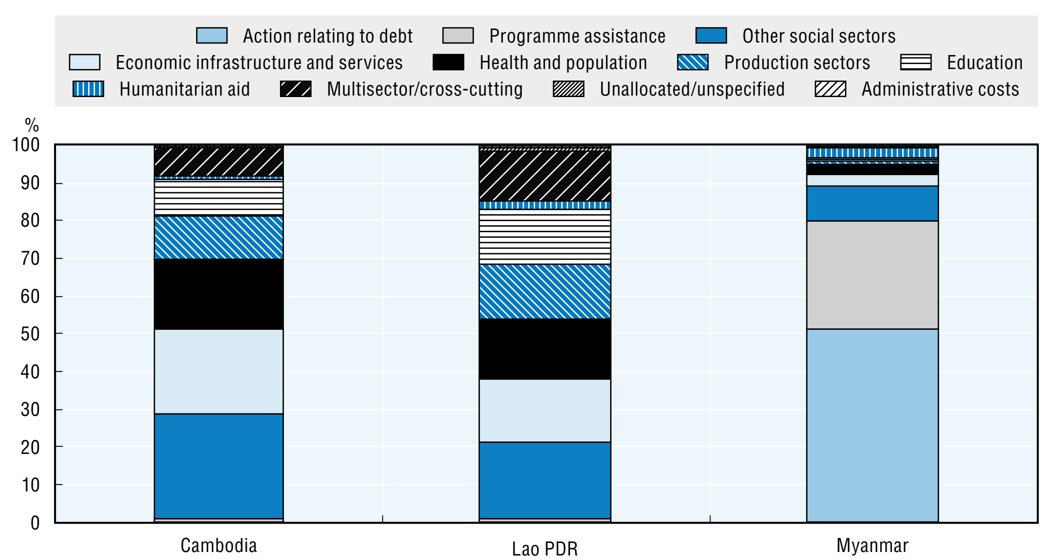
Source: World Bank (2015a), *World Development Indicators* (database), http://databank.worldbank.org/data/reports.aspx?source=world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933309957

External aid has been a significant source of development finance to the CLM countries, even if it is declining in importance. Official development assistance (ODA) to the CLM countries grew between 2000 and 2013, both in absolute terms (from USD 1.18 billion to USD 5.75 billion, in constant 2012 USD) and per capita. But as economic growth has improved, ODA has declined as a share of national income in all but Myanmar (Figure 3.3). Liberalising reforms in Myanmar led to the removal of limits on aid, resulting in a 789% increase in ODA received between 2012 and 2013, to USD 4.48 billion (in 2012 USD), higher than the amounts received by Cambodia or Lao PDR in absolute terms or relative to population or gross national income (GNI).

ODA from the Development Assistance Committee (DAC) totalled USD 5.7 billion in 2013, up significantly from USD 1.7 billion in 2012 as a result of the increase in aid to Myanmar. Japan was the largest DAC donor to the CLM countries in 2013, providing a total of USD 3.37 billion to these three countries, a total followed by USD 590.11 million from France and USD 203.28 million from Australia. China has consistently been a large donor to Myanmar and other low-income countries in the region, though it is difficult to distinguish between direct investments and concessional loans and additional support projects (OECD, 2014). Cambodia and Lao PDR used ODA in a similar way, dedicating it mostly to social sectors, economic infrastructure and services, and production sectors (Figure 3.4). Aid in Myanmar was structured very differently, with 51% used in action relating to debt and 29% used in programme assistance. Japan announced in January 2013 that it would be cancelling more than USD 3 billion in debt it was owed by Myanmar, while also assisting in clearing Myanmar's arrears with the ADB and the World Bank. Other lending countries offered to cancel debts as well, including Norway, which offered to cancel the USD 534 million it was owed.

Figure 3.4. **Uses of ODA in Cambodia, Lao PDR and Myanmar, by sector, 2013**



Source: World Bank (2015b), *AidFlows* (database), www.aidflows.org/.
StatLink http://dx.doi.org/10.1787/888933309966

Multilateral donors and NGOs are also active in the CLM countries. Commitments in 2015 by the World Bank's International Bank for Reconstruction and Development and International Development Association totalled USD 21 million for projects in Cambodia, USD 100 million for projects in Lao PDR and USD 700 million for projects in

Myanmar. Myanmar's re-engagement with the international community also permitted international financial institutions to restart their operations in the country. The World Bank and ADB had ceased country-specific operations in 1988, though the ADB remained involved indirectly through its contributions to initiatives such as the Greater Mekong Subregion. They reopened a joint office in Yangon in August 2012 and began lending for projects ranging from public health to reform of the telecommunications sector. Non-governmental organisations (NGOs) have of course been active in the region as well, and have contributed to the IAI. The Hanns Seidel Foundation contributed USD 1.04 million to the first IAI work plan, and projects have recently been submitted for IAI accreditation by government proponents with various NGOs as partners, including the Bill and Melinda Gates Foundation and Oxfam Australia.

ASEAN is now developing the post-2015 IAI Work Plan III. This provides an opportunity to rethink how the IAI can facilitate integration of the region's least developed members and support the narrowing of development gaps across and within member countries. Given the scale of challenges faced, co-operation in planning will need to continue to include ASEAN's dialogue partners and other donors while also acknowledging the priorities and capacities of the CLMV countries in receiving this assistance. To avoid contradiction or duplication, synchronisation and co-ordination are crucial among regional programmes and initiatives, bilateral assistance programmes for the CLMV countries and other sub-regional initiatives The IAI Task Force and IDCF will be critical tools in leading these design and implementation efforts.

Improving monitoring systems: Indicators and peer reviews

With so many initiatives to implement by 2015 and beyond, it is imperative that a strong monitoring mechanism be put in place at both the national and regional levels. At the national level, a key challenge is to ensure that regional integration commitments are effectively transformed on the ground. This requires the establishment of effective monitoring systems, which may be challenging in the region due to capacity limitations. Three ways of overcoming or mitigating these constraints would be worth considering:

- Existing regional frameworks can be better used to improve monitoring capacity, particularly ASEAN+6 framework as the Regional Comprehensive Economic Partnership (RCEP) proceeds.
- Reliable and transparent data and indicators of regional integration are needed to monitor progress in implementing regional goals and to monitor activities.
- Regular peer dialogue and peer learning can help to make better use of national capacities and motivate additional efforts in implementing reforms.

Co-operation with partners outside of ASEAN has been useful in addressing shared areas of concern that extend beyond the ten member states, such as financial stability, trade and investment promotion, and environmental and disaster risk management. These partners, particularly the participants in the ASEAN+3 and ASEAN+6 frameworks, offer additional institutional and financial capacities for facilitating regional co-operation. The Chiang Mai Initiative Multilateralisation (CMIM), for example, promotes stability in the region with strong support from the Plus Three Countries (China, Japan and Korea). The East Asia Summit (EAS) participants represent an even greater pool of technical, financial and other capacities on which to draw. These have already been used in the repeated commitments made to develop national capacities through the EAS priority areas (energy, education, finance, global health issues including pandemic diseases, environment and disaster mitigation, and ASEAN connectivity). The commitment to support ASEAN integration in particular is highlighted in the 2011 *Declaration of the*

6th East Asia Summit on ASEAN Connectivity, which states that implementation of the Master Plan on ASEAN Connectivity will be supported by EAS partners in mobilising resources and sharing information.

The additional institutional capacities of these larger economies could be called upon to strengthen monitoring for regional integration, particularly of the ASEAN+1 Free Trade Areas (FTAs) and the Regional Comprehensive Economic Partnership that may soon supersede them. Regional monitoring of economic developments and the integration process could take the form of a new organisation, similar to the role that the ASEAN+3 Macroeconomic Research Office (AMRO) plays for ASEAN+3 and in support of the CMIM in particular. Institutionalisation need not require the establishment of a new organisation, however; the East Asia Summit could also host a review of integration initiatives, particularly if this were included in the work plan or as a central policy focus of the EAS. Support for regional initiatives is already among the commitments made by the EAS; the 2012 *Phnom Penh Declaration on the East Asia Summit Development Initiative* calls for EAS collaboration in the financial sector during the global economic recovery and support for regional economic integration efforts, including the AEC, RCEP, proposed China-Japan-Korea FTA and ASEAN efforts in improving connectivity. So far, EAS members have explicitly committed to monitoring country-level progress toward common goals only in specific policy areas, however. At the 2007 Summit, for example, participants agreed to set energy efficiency goals and action plans that would be monitored collectively through the EAS framework. The experiences gained from such initiatives could nevertheless serve as examples for developing more comprehensive monitoring mechanisms.

There is a fundamental need for reliable indicators before monitoring, evaluation and analysis, and knowledge sharing can proceed. Indicators on integration have been relatively underdeveloped in the region. The ASEAN Economic Community Scorecard, published by the ASEAN Secretariat in 2012, provided some useful indicators of the progress made and gaps in achieving the first two phases (2008-11) of AEC targets. But after the mid-term review in 2012, the results were not made publicly available and Scorecard results were "self-reported by member countries". Results reported publicly in the Scorecard are also aggregated, so that measures of progress at the national level – which would be helpful in identifying areas potentially needing greater attention – are not clearly stated. The systematic measurement and dissemination of these results is central to the peer monitoring process. Indicators could be based on regular evaluations of the integration process and its outcomes. Further work is needed to make regional integration indicators into a truly effective part of a monitoring system.

Peer review should be encouraged and enhanced

One way to enhance regional monitoring of the AEC is through regular policy dialogue and peer learning/peer review among officials engaged with integration (OECD, 2008). The influence and pressure of peers and external actors, including the media, is critical to effecting change among members. In the OECD, which makes extensive use of peer review, the Secretariat plays a supportive role in facilitating and informing the review process. Other organisations employing this approach also use their analytical and administrative capacities to facilitate and inform peer review.

While legal and rules-based mechanisms have generally had limited scope in any framework for regional integration in Asia, clear rules and measures that participants agree to follow are required in order to maintain credibility and avoid unnecessary disputes. Peer review promotes co-operation by allowing policy dialogue, promoting transparency, facilitating capacity building and encouraging compliance. To the extent that transparency is needed for the success of effective integration, the peer review process should be encouraged and enhanced. This exercise should allow countries to share information and discuss key policy issues. Policy dialogue and peer review are flexible in form, and could be tailored to the needs of member countries and available capacities. Depending on circumstances, this monitoring may best be done either through OECD-style review and pressure or through more rigorous due diligence, as in the IMF Article IV country reports.

The non-adversarial nature of the peer review process, and the fact that it is based on trust and co-operation, may make it well suited to further use in the region. Peer learning and peer review offer participants the opportunity to seek support for policies they intend to pursue and to help convince participants to change course (OECD, 2008). These processes are appropriate for an organisation whose members rely on compromise and consensus-based decision making rather than a more formal and regulated process.

Peer learning and peer review can be challenging to implement, however. They work best when members share mutual trust, are committed to transparency and have access to sufficient analytical and administrative capacities, and when participants and evaluators are seen as legitimate by all involved (OECD, 2008). A supporting organisation facilitates the process by providing administrative and analytical assistance, within boundaries defined by the participants. Leadership and co-ordination of the peer monitoring process requires considerable capacity and should be given to an organisation best positioned to fill these roles. An enlarged and strengthened ASEAN Secretariat may be able to take on additional responsibility for co-ordinating and monitoring regional integration and the strengthening of members' ties with the global economy. It is important to use established institutions, such as the ASEAN Integration Monitoring Office and AMRO, although another regional body could be used to provide this support. Forums for discussion, such as the Asian Regional Roundtable (Box 3.2), can also be used as a basis for policy discussions and co-operative work on common challenges.

Box 3.2. **Enhancing regional policy dialogue through the Asian Regional Roundtable**

Policy dialogue and knowledge sharing within ASEAN could benefit from structured frameworks and the involvement of external perspectives and sources of technical expertise. The OECD-AMRO-ADB/ADBI-ERIA Asian Regional Roundtable on Macroeconomic and Structural Policy Challenges is an established event for regional policy discussion that could be useful in this regard. The Roundtable is an annual meeting of representatives of these international organisations, policy makers (from national planning agencies, finance ministries, central banks and other areas of government), business leaders and researchers. Its purpose is to discuss pressing issues facing the Emerging Asian economies. The Roundtable aims to promote knowledge sharing among participants and to provide opportunities for open dialogue on near-term macroeconomic policies and medium-term structural policies in the region. Since the first Roundtable in 2012 in Singapore, the annual event has also been held in Manila and Tokyo.

The structure of the Roundtable facilitates discussion on both emerging issues and perennial concerns, including topics related to the challenges of regional integration. Macroeconomic issues addressed in past Roundtables include the consequences of euro-area economic uncertainty, potential fiscal policy responses to US monetary policy normalisation, and the short-term risks and opportunities posed by the global oil price decline and moderating growth in China. Over a longer horizon, participants have also discussed structural issues such as the need to adopt productivity-driven growth models to overcome the middle-income trap, the importance of strengthening institutional capacities in the public sector, progress in ASEAN integration and financial development for inclusive growth.

Box 3.2. **Enhancing regional policy dialogue through the Asian Regional Roundtable** (*cont.*)

Regular meetings with frameworks open to dialogue on a broad range of issues, such as the framework used in organising the Roundtable, can offer valuable opportunities for the identification of shared areas of concern and for peer learning on the successes and challenges of designing and implementing policy responses. In addition, the participation of international organisations and others from outside government can bring new perspectives and additional monitoring and analytical capacity to these discussions.

Source: OECD (nd), *OECD-AMRO Joint Asian Regional Roundtable*, Paris, www.oecd.org/dev/asia-pacific/oecd-amrojointasianregionalroundtable.htm.

Conclusion

Constraints on institutional capacity pose a serious challenge to ASEAN integration efforts, but they do not represent an insurmountable obstacle. There is room to improve the alignment of regional goals with work being done through national plans and sub-regional initiatives, to promote synergies and to benefit from national-level knowledge and the potential for experimentation at sub-regional levels. The relative underdevelopment of Cambodia, Lao PDR and Myanmar hinder their full participation in the AEC. Flexible arrangements for the participation of the CLM countries, along with the IAI and support from external partners, can help to reduce the scale and influence of some of these development gaps. At a more fundamental level, the regional integration agenda will need stronger monitoring capacity to become more effective in the region. Particularly promising avenues will be leveraging existing frameworks, such as co-operation with ASEAN dialogue partners, the development of more reliable and transparent indicators, and regularising peer learning and review.

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Chapter 4

Integration and renewable energy in Emerging Asia

Regional co-operation in the green growth and energy area is limited in Emerging Asia. In particular, enhancing co-operation in renewable energies will be critical to ensure sustainable growth. Renewables are likely to become more important as demand for energy increases. While much of the region's potential remains untapped, barriers to trade in energy will need to be overcome to make the full use of these resources. Hydropower in the Mekong River Basin offers a useful example not only of the promise of power generation from renewable sources, but also the need for improved environmental and economic co-operation in managing these resources.

Introduction

East Asia has achieved remarkable economic growth in recent decades. Robust growth has also enabled East Asia to reduce absolute poverty faster than any other region. At the same time, many countries in East Asia have experienced growing inequality in terms of income distribution. High economic growth in the region has also been associated with serious environmental problems, such as a drastic increase in carbon dioxide emissions and the consumption of resources and materials, severe air pollution, a water crisis and rapid deforestation. The current pattern of development in East Asia may be focused too sharply on economic growth and is neither equitable nor sustainable.

The same observation may be applied to regional integration processes in East Asia. Among the various aspects of regional integration, market integration may have received too much attention at the expense of other fields. For example, by the end of 2015, the Association of Southeast Asian Nations (ASEAN) will have launched the ASEAN Community, consisting of three pillars: the ASEAN Economic Community, the ASEAN Political-Security Community and the ASEAN Socio-Cultural Community. But a concrete schedule has been set only for the Economic Community, with progress monitored according to a scorecard system (ASEAN Secretariat, 2009). Similarly, there are various environmental co-operation mechanisms in East Asia, such as the ASEAN Environmental Programmes, the Northeast Asian Conference on Environmental Co-operation and the Acid Deposition Monitoring Network in East Asia, but they have often been criticised for their lack of clear objectives and/or mechanisms for effective implementation (Takahashi, 2001). In order to redirect the current development pattern so as to deliver shared well-being and improved equity without exceeding ecological limits, it is necessary to rebalance regional integration in East Asia from its strong focus on economic integration to broader sustainability objectives. This chapter will illustrate the potential of regional integration for promoting green growth through the exploitation of renewable energy resources.

This chapter discusses the potential boost to renewable energy use in Southeast Asia offered by deeper integration. While green growth is a multi-dimensional process of aligning multiple economic and environmental priorities, the increased use of renewable sources of energy, including through enhanced regional co-operation in generation and distribution, will need to be a central component of any green growth strategy. Energy-related CO_2 emissions reached 1.2 Gt in ASEAN in 2011 and are expected to almost double, to 2.3 Gt in 2035 (IEA, 2013a). The region should therefore look to its considerable potential in renewable energy in its strategy for finding new sources of energy to meet growing demand. Tariffs and other, non-economic, barriers slow integration and impede opportunities for improved efficiency. Hydropower development along the Mekong River is progressing and remains a promising source of future generating capacity to be exported through the region, though environmental challenges will need to be addressed and co-operative solutions found to the cross-border concerns raised by these developments.

Harnessing the region's potential for renewable energy development

Energy poverty persists despite impressive renewable resources

Renewable energy development is expected to play a key role in achieving green growth in East Asia, for several reasons. The region has large renewable energy resources, and there is an opportunity to boost economic development through exploitation of these resources. In some ASEAN countries, such as Cambodia, Lao PDR, Myanmar, Indonesia and the Philippines, the low rate of access to electricity is a major developmental challenge (Table 4.1). In Indonesia, the Philippines and Myanmar collectively, more than 118 million people do not have access to electricity. Indonesia and the Philippines are large archipelagic countries; their geography makes it difficult to provide electricity for many remote islands. Myanmar is still at a lower stage of development, as are Cambodia and Lao PDR; this explains the low electrification rate, particularly in rural areas of these countries. In both cases, decentralised electricity systems using renewable energy could offer an attractive solution.

Table 4.1. **Electricity access in ASEAN countries in 2011**

Country	Population without electricity access (million)	Electrification rate (%)	Urban electrification rate (%)	Rural electrification rate (%)
Brunei Darussalam	0.0	100.0	100	99
Cambodia	9.4	34.0	97	18
Indonesia	65.7	72.9	85	60
Lao PDR	1.3	78.0	93	70
Malaysia	0.1	99.5	100	99
Myanmar	24.7	48.8	89	29
Philippines	28.3	70.2	89	52
Singapore	0.0	100.0	100	100
Thailand	0.7	99.0	100	99
Viet Nam	3.5	96.1	100	94

Source: IEA (2013b), *The World Energy Outlook 2013 Electricity Database*, www.worldenergyoutlook.org/resources/energydevelopment /energyaccessdatabase/.

Table 4.2. **Per capita electricity consumption in ASEAN countries in 2009**

Country	Per capita electricity consumption (kWh/capita)	Population in 2009 (million)	Total electricity consumption (TWh)
Brunei Darussalam	8 652	0.4	3.4
Cambodia	129	14.2	1.8
Indonesia	597	240.7	143.7
Lao PDR	388	6.3	2.4
Malaysia	3 912	27.8	108.8
Myanmar	105	52.8	5.5
Philippines	593	98.0	58.1
Singapore	7 789	5.0	39.2
Thailand	2 045	65.9	134.8
Viet Nam	917	88.6	81.2
ASEAN total	966	599.7	579.1

Source: IEA energy data compiled by IRENA (2013), *Renewable energy country profiles: Asia*, www.irena.org/DocumentDownloads/Publications/_AsiaComplete.pdf. Total electricity consumption estimated by the author based on population data of the International Data Base of the US Census Bureau, www.census.gov/ipc/www/idb/.

A comparison of per capita electricity consumption in the ASEAN countries also yields insights (Table 4.2). It is surprising that per capita consumption levels in Indonesia and the Philippines, relatively developed members of ASEAN, are very low, at less than 600 kWh/capita. Even if we exclude the population without access to electricity from this calculation, the estimated results, which correspond to per capita consumption of the population with access to electricity, are 819 kWh/capita in Indonesia and 845 kWh/capita in the Philippines. For reference, average per capita electricity consumption in the OECD member countries was 8 173 kWh in 2011 (World Bank, 2015). Judging from this figure, a significant increase in per capita energy consumption is required in the ASEAN countries, except Brunei Darussalam and Singapore.

Huge future demand will require large-scale use of renewables

To illustrate the scale of the expected increase in demand for electricity in the region, Table 4.3 provides a projection of anticipated electricity demand in 2030, based on the assumption that per capita demand will reach 4 000 kWh/capita (close to the current level of Malaysia) in the countries that are currently below that level, and that the remaining countries will maintain their current levels of per capita demand.

Table 4.3. **Projected increase in electricity demand in ASEAN countries by 2030**

Country	Per capita electricity demand (kWh/capita)	Population in 2030 (million)	Total electricity demand (TWh)	Electricity demand increase from 2009 (TWh)
Brunei Darussalam	8 652	0.4	3.7	0.3
Cambodia	4 000	17.2	68.7	66.8
Indonesia	4 000	284.2	1136.7	993.0
Lao PDR	4 000	7.6	30.2	27.8
Malaysia	4 000	33.8	135.0	26.2
Myanmar	4 000	67.8	271.4	265.8
Philippines	4 000	132.5	530.0	471.9
Singapore	7 789	5.8	45.2	6.0
Thailand	4 000	71.5	285.9	151.1
Viet Nam	4 000	107.0	428.1	346.9
ASEAN total	4 033	727.2	2 935.0	2 355.9

Source: Population projections are based on projections of population growth rates for 2009 – 2030 by Fouré, J., A. Bénassy-Quéré and L. Fontagné (2012). Population data in 2009 are from the International Data Base of US Census Bureau, www.census.gov/ipc/www/idb/.

Although this preliminary estimate of per capita demand may be rather modest (the current OECD average is more than 8 000 kWh per capita, as mentioned above), the estimated increase in electricity demand is huge – four times greater than electricity consumption in 2009. Meeting such a huge demand without devastating consequences for environmental sustainability requires the large-scale utilisation of renewable energy for power generation. Ölz and Beerepoot (2010) estimated that the share of renewables in the power mix for the ASEAN region must be doubled, from 16% in 2007 to 32% in 2030, under the 450 Scenario of the International Energy Agency (IEA). In addition to climate mitigation, large-scale utilisation of renewable energies can bring socio-economic benefits, including the development of green industry, job creation and improvements in energy security, all of which are vital components of green growth (OECD, 2011).

Two related topics will be discussed in the sections that follow:

- How economic integration can contribute to the deployment of renewable technologies in the region.
- How regional co-operation for sustainable energy infrastructure can be enhanced, based on the case study of a hydropower project in Lao PDR.

How integration can speed the deployment of renewable technologies

Much of the region's renewable energy potential remains untapped

The ASEAN region is endowed with huge potential in terms of renewable energy resources. An estimation of the renewable energy potential by 2030 of the six countries of ASEAN (i.e. Indonesia, Malaysia, the Philippines, Singapore, Thailand and Viet Nam) was made by Ölz and Beerepoot (2010), based on the IEA's concept of "realisable potential" (Table 4.4). As shown in the table, the realisable renewable potential is considerably larger than total electricity demand in 2009 in each of the countries except Singapore. The total renewable electricity potential of six countries of ASEAN exceeds the total electricity demand of the ASEAN region in 2009 by factor of 1.8. The majority of this huge renewable potential has been untapped. Table 4.5 shows current renewable electricity generation in six countries of ASEAN and the ratio of utilisation against realisable potential.

Table 4.4. **Projected realisable renewable electricity potential of ASEAN-6 countries in 2030**

(TWh)

Type of renewable	Indonesia	Malaysia	Philippines	Singapore	Thailand	Viet Nam
Wind	63.1	36.2	22.6	0.3	57.4	44.0
Solar photovoltaics	61.7	12.4	20.4	0.0	33.0	27.3
Biogas/biomass/waste	132.7	34.4	38.4	1.5	46.2	63.2
Hydropower	60.8	50.3	17.8	0.0	14.7	74.2
Geothermal	84.7	0.0	29.0	0.0	0.0	0.0
Others (solar heat etc.)	1.1	0.2	0.3	0.0	0.3	0.1
A. Total potential	404.1	133.5	128.6	1.8	151.5	208.7
B. Total demand in 2009 (TWh)	143.7	108.8	58.1	39.2	134.8	81.2
A/B	2.8	1.2	2.2	0.0	1.1	2.6

Source: Ölz and Beerepoot (2010), "Deploying renewables in Southeast Asia: Trends and potentials". Comparison with the total demand in 2009 was added by the author.

Table 4.5. **Renewable electricity generation in ASEAN-6 countries in 2007**

(TWh)

Type of renewable	Indonesia	Malaysia	Philippines	Singapore	Thailand	Viet Nam
Wind and solar PV	0.0	0.0	0.1	0.0	0.0	0.0
Biogas/biomass/waste	0.0	0.0	0.0	0.0	4.2	0.0
Hydropower	11.3	6.5	8.6	0.0	8.1	29.9
Geothermal	7.0	0.0	10.2	0.0	0.0	0.0
C. Total generation	18.3	6.5	18.8	0.0	12.3	29.9
Utilisation ratio (C/A)	4.5%	4.9%	14.7%	0.0%	8.1%	14.3%

Source: Ölz and Beerepoot (2010), "Deploying renewables in Southeast Asia: Trends and potentials". Comparison with the total realisable renewable potential in 2030 was added by the author.

Table 4.5 indicates that hydropower and geothermal resources are relatively well exploited in the region, but that other renewable sources, such as wind, solar and biomass, are almost untouched. Within six countries of ASEAN, the ratio of utilisation of renewables against realisable potential was 8.5% in 2007. Among the remaining four ASEAN countries, Cambodia, Lao PDR and Myanmar are endowed with major potential in renewable energy, notably hydropower and wind (Table 4.6). In particular, the potential of wind power in Lao PDR and hydropower in Myanmar is very strong. Current hydropower generation exploits only a fraction of this huge potential, as shown in Table 4.7.

Table 4.6. **Renewable energy potential in Cambodia, Lao PDR and Myanmar**

(GW or TWh)

Type of renewable	Cambodia	Lao PDR	Myanmar
Wind (GW)	26.0	182.0	NA
Hydropower (GW)	15.0	26.0	100.0
Total potential (TWh)	98.1	410.0	350.4

Source: Baardsen (2008) *Power Interconnection in the GMS Region* The total potential in terms of TWh was estimated by the author with an assumption of capacity factor of 20% (wind) and 40% (hydropower). Note that this assumption is conservative compared with the actual capacity factor of hydropower generation in Lao PDR in 2011, which was 57% according to the data of Electricité du Laos (EdL).

Table 4.7. **Hydropower generation in Cambodia, Lao PDR and Myanmar in 2007**
(TWh)

	Cambodia	Lao PDR	Myanmar
Generation in 2007	0.1	12.8	6.2
Potential (with 40% capacity factor)	52.6	91.1	350.4
Utilisation ratio	0.2%	14.0%	1.8%

Sources: ASEAN Centre for Energy (2013a), "Country Profile: Cambodia", http://aseanrenewables.info/wpcontent/uploads/2013/05/KH-Combodia_Rev02.pdf; *ASEAN Centre for Energy (2013b), "Country Profile*: Laos", http://aseanrenewables.info/country-profile/laos/; *ASEAN Centre for Energy (2013c), "Country Profile*: Myanmar", http://aseanrenewables.info/wpcontent/uploads/2013/05/MM-Myanmar_Rev02.pdf.

Overcoming barriers to renewable energy production

In considering how to increase renewable electricity in the region, it is clear that resource availability is not the limiting factor. Of the factors that do limit production today, many can be addressed by regional integration. According to the Asian Development Bank Institute (ADBI, 2013a), regional economic integration, including liberalisation of trade in renewable technologies, and regional co-operation on innovation and technology transfers can play a key role in promoting renewable energy in the region. In general, there has been far less trade and investment in low-carbon goods and services, including products related to renewable energy, than in carbon-intensive products in East Asia. As shown in Table 4.8, effective tariffs on products related to renewable energy are still considerable in six countries of ASEAN, China and India. Regional economic integration in the form of tariff removal for these countries is expected to have a positive impact on the promotion of renewable energy.

Table 4.8. **Effective tariffs for renewable energy-related products in ASEAN-6, China and India**
(percentage)

Country	All industrial goods, average	Solar photovoltaic related products	Wind power related products
China	8.57	4.16	7.65
India	9.74	5.41	7.28
Indonesia	5.84	5.93	4.81
Malaysia	5.91	7.51	4.39
Philippines	5.00	4.97	0.84
Singapore	0	0	0
Thailand	10.97	6.82	6.59
Viet Nam	11.68	14.91	11.8

Source: Mikic (2010), "Trade in climate smart goods: Trends and opportunities in Asia and the Pacific", adopted by Kalirajan (2012), "Regional Co-operation towards Green Asia: Trade and Investment".

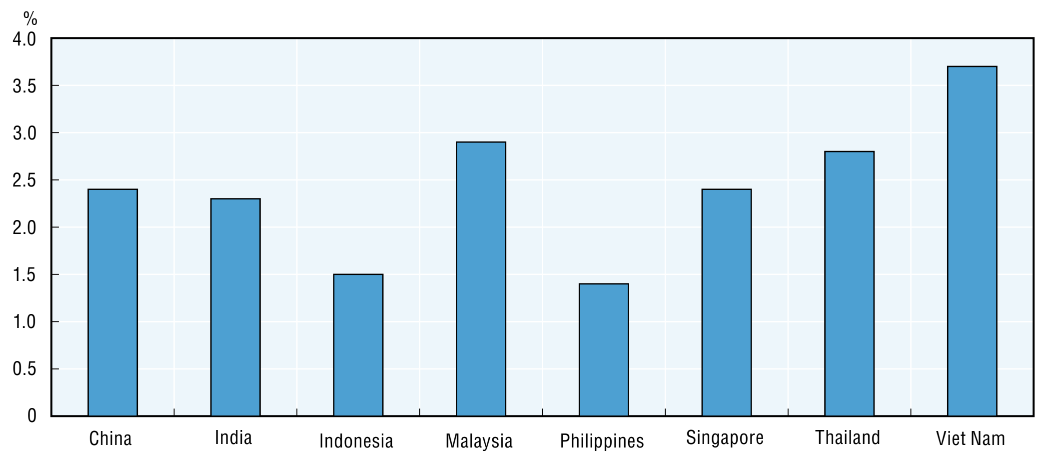
In addition to economic barriers such as tariffs, non-economic barriers are also important. These include administrative, technical/infrastructure and financing barriers (ADBI 2013a, Ölz and Beerepoot 2010). Steps toward physical integration, such as cross-border infrastructure development and/or regional co-operation to address administrative and institutional barriers, are also vital for harnessing the huge renewable resource potential in the region.

Increasing the export potential of green products and services

The impact of regional integration and co-operation on exports of renewable-energy-related products has been estimated by Kalirajan (2012) and Moinuddin and Bhattacharya (2013), using different methodologies. Kalirajan employed a stochastic frontier gravity model to estimate the impact of regional integration/co-operation on the export potential of low-carbon goods and services (Box 4.1). This study covers six countries of ASEAN plus China and India. Regional integration is represented by the ratio of foreign direct investment (FDI) received from Asia to non-Asian FDI, while regional co-operation is represented by a dummy variable of whether there are bilateral and multilateral trade negotiations to improve trade promotion and facilitation policies. Both the dummy variable and the FDI ratio become significant at the 5% level. It must be noted that tariff structure of the importing country is modelled, but the impact of tariff reduction is not included in the "grand regional coalition scenario" corresponding to the situation with regional integration and co-operation. Figure 4.1 shows the estimated impact of the grand regional coalition scenario on exports of renewable-energy-related products, which are expressed as changes from the stand-alone scenario that assumes neither regional integration nor regional co-operation.

Figure 4.1. **Impact of grand regional coalition scenario on export of renewable energy related products in Emerging Asia**

Percentage change from the scenario with no regional integration or co-operation



Source: OECD Development Centre estimate based on Kalirajan (2012), "Regional Co-operation towards Green Asia: Trade and Investment".

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Box 4.1. **Impact of regional integration on export potential of low-carbon goods and services**

The impact of regional integration on the export potential of low-carbon goods and services is estimated by a stochastic frontier gravity model based on Kalirajan (2012).

The model focuses on the effects of a "regional coalition" on exports of environmental goods and services (EGS), including renewable energy plants. The stochastic frontier gravity equation is as follows:

$$\ln EX_{i,j,t} = B_1 + B_2 \ln(GDP_{i,t}) + B_3 \ln(GDP_{j,t}) + B_4 \ln(DstPORT_{i,j}) + B_5 \ln(TARIFF_{i,j,t}) + B_6 \ln(FDI_{j,t-1}) + B_7 D\_TA_{i,j,t} + B_8 D\_YEAR_{i,j,t} - u_{i,j,t} + v_{i,j,t}$$

Box 4.1. **Impact of regional integration on export potential of low-carbon goods and services** (*cont.*)

where

B_1, B_2, etc.: coefficients,

$EX_{i,j,t}$: exports of EGS from country *j* to the importer *i* in year *t*,

$GDP_{i,t}$: per capita GDP of importing country *i* in year *t*,

$GDP_{j,t}$: per capita GDP of exporting country *j* in year *t*,

$Dst\_PORT_{i,j}$: distance between the ports of importing country *i* and the exporting country *j*,

$TARIFF_{i,j,t}$: the average tariff rate in the importing country *i* for the imports from *j* in year *t*,

$FDI_{j,t-1}$: the ratio of Asian FDI to total FDI in the exporting country *j* in year *t*-1 (one year lag),

$D\_TA_{i,j,t}$: a dummy variable representing whether there are trade agreements between countries (= 1) or not (= 0),

$D\_YEAR_{i,j,t}$: a year dummy which takes 1 when the relevant period is considered, otherwise zero,

$u_{i,j,t}$: negative influence of the combined "behind the border determinants (such as institutional and infrastructure rigidities)" that exist in the exporting country on which complete information is not known, and

$v_{i,j,t}$: normal statistical error term.

Among the independent variables, $FDI_{j,t-1}$ is used as a proxy of regional integration and $D\_TA_{i,j,t}$ is used as a proxy of regional co-operation.

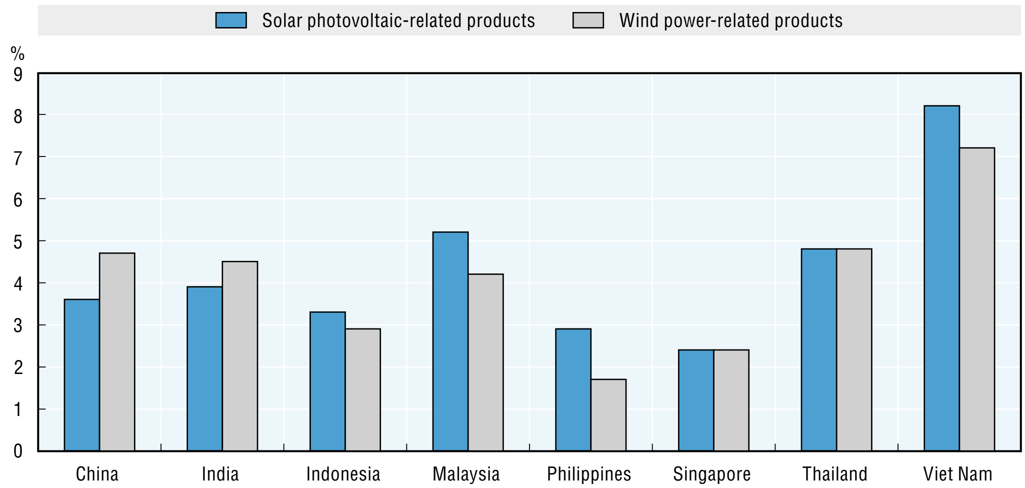
This model was estimated for the empirical data (including the United Nations COMTRADE database and World Investment Reports of UNCTAD covering 2000–2009) of eight countries (ASEAN-6, China and India) through the maximum likelihood estimation method. All the coefficients for individual countries are statistically significant at least at the 5% level.

The grand regional coalition scenario corresponds to the estimation of the above equation with an assumption that $u_{i,j,t}$ (negative influence of the behind the border determinants) is zero, while the stand-alone scenario corresponds to the estimation of the same equation with a different assumption that not only $u_{i,j,t}$ but also both B_6 (the coefficient of FDI) and B_7 (the coefficient of the trade agreement dummy) are zero. It must be noted that Kalirajan did not include hypothetical tariff removal as a part of the grand coalition scenario.

Moinuddin and Bhattacharya estimated the impact of regional economic integration, in terms of import tariff reduction, on exports of renewable energy equipment and components, using a least square regression model. The estimation concerns the 18 countries: ASEAN, Japan, China, Republic of Korea, Australia, New Zealand, India, the United States and Russia (Box 4.2). The tariff rate becomes significant at the 1% level, with a 1% decrease in import tariffs expected to increase exports of renewable energy equipment and components by 0.3%. To illustrate the potential impact of regional integration and co-operation, including economic integration, the previous two studies have been combined, with an assumption that import tariffs for solar photovoltaic-related products and wind power-related products, shown in Table 4.8, will be completely removed under the grand regional coalition scenario of Kalirajan (Figure 4.2). The impacts are expressed as export increase of renewable energy products in 2009 if regional integration/co-operation were to be realised.

Figure 4.2. **Total impact of regional integration/co-operation on exports of renewable energy products in ASEAN-6, China and India**

Percentage change from the scenario with no regional integration or co-operation



Source: OECD Development Centre estimate, based on Moinuddin and Bhattacharya (2013), "Towards an Integrated Renewable Energy Market in the EAS Region: Renewable Energy Equipment Trade, Market Barriers and Drivers".

StatLink http://dx.doi.org/10.1787/888933309984

Box 4.2. **Impact of regional integration on exports of renewable energy, regression model**

The total impact of regional integration/co-operation on exports of renewable-energy-related products, based on Moinuddin and Bhattacharya (2013). The model specified the following equation:

$$EX_{i,j,t} = \beta_0 + \beta_1\ SGDP_{j,t} + \beta_2\ TARIFF_{j,i,t} + \beta_3\ SRE_{i,t} + \beta_4\ PAT_{i,t} + \beta_5\ RND_{i,t} + \beta_6\ CWP_{i,t} + \beta_7\ D\_FIT_{i,t} + \beta_8\ D\_SUB_{i,t} + \beta_9\ D\_POL_{i,t} + u_{i,j,t}$$

where

β_0, β_1, etc.: regression coefficients,

$EX_{i,j,t}$: exports of renewable energy technology from country *i* to the importer *j* at time t,

$SGDP_{j,t}$: Importing country *j*'s share in the whole region's GDP at time t,

$TARIFF_{i,j,t}$: import tariff on renewable energy technology in the importing country *j* for the imports from i at time t,

$SRE_{i,t}$: The share of renewables in the energy grid in the exporting country *i* at time t,

$PAT_{i,t}$: % of inventions (represented by the share of a country in global registered patents) of the exporting country i at time t,

$RND_{i,t}$: Research and development budget of the exporting country *i* at time t,

$CWP_{i,t}$: Country-wide potential for renewable energy generation in the exporting country *i* at time t,

$D\_FIT_{i,t}$: a dummy on feed-in-tariff provided to renewables in the exporting country *i* at time t,

$D\_SUB_{i,t}$: a dummy for other subsidies (capital subsidy, grant, or rebate) in the exporting country *i* at time t,

$D\_POL_{i,t}$: a dummy on other renewable energy promoting policies focusing on regulatory framework in the exporting country *i* at time t, and

$u_{i,j,t}$: normal statistical error term.

Box 4.2. **Impact of regional integration on exports of renewable energy, regression model** (*cont.*)

This model was estimated for the cross-section data of 18 East Asia Summit countries for the year 2011 through a least square regression method. The test for multicollinearity among the variables shows that research and development (R&D) budgets and country-wide renewable energy potential have a moderately strong and positive linear relationship, and that the other coefficients in general show weak or negligible correlation. Based on White's general test for heteroskedasticity in the error distribution, the null hypothesis of no heteroskedasticity was rejected. The regression results show that all the dependent variables except for the dummy on feed-in-tariff (D_FIT) are statistically significant at the 1% level.

The information in Figure 4.2 assumes the complete removal of import tariffs for these renewable energy technologies in addition to Kalirajan's grand regional coalition scenario, which assumes regional integration, represented by a higher intra-regional FDI share, and regional co-operation, represented by ongoing bilateral and multilateral trade negotiations in the form of improvement in trade promotion and facilitation policies in both home and partner countries. The figure shows that such regional integration and co-operation could make a tangible impact on these exports among six countries of ASEAN, China and India. As noted by Moinuddin and Bhattacharya, promoting regional trade in renewable energy technologies could pave the way to tapping into the huge renewable energy potential in East Asia.

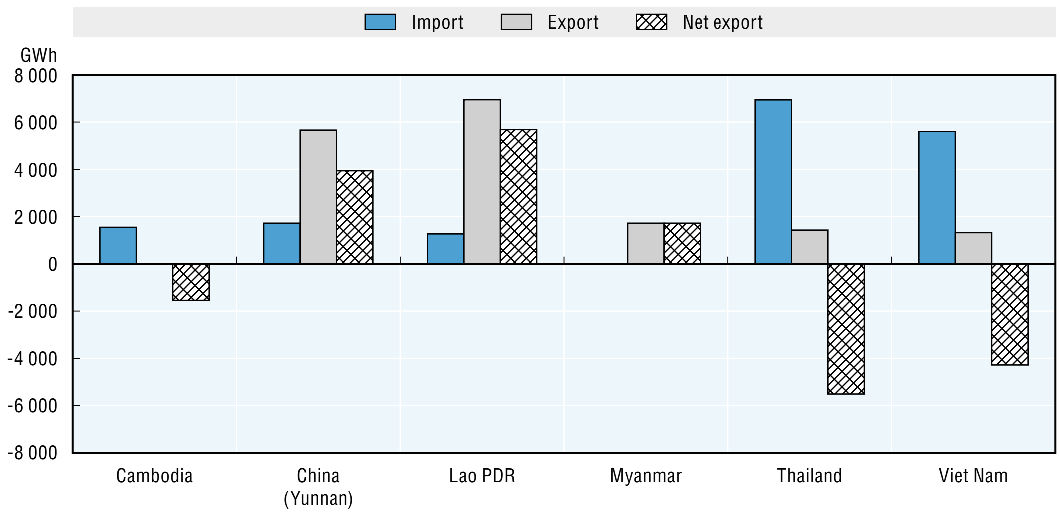
How co-operation can boost environment-friendly hydropower development

Hydropower exporters and importers in the Mekong River Basin

As mentioned above, the countries of the Mekong River Basin are endowed with abundant hydropower resources (Tables 4.6 and 4.7). In Lao PDR in particular, hydropower is a vital resource for pursuing economic development and universal electricity access. Electricity generation in Lao PDR depends almost exclusively on hydropower, but electricity shortages during the dry season necessitate cross-border power trade with neighbouring countries like Thailand, Viet Nam and China (ASEAN Centre for Energy, 2013b). At the same time, the country's hydropower generation capacity is much greater than domestic demand for electricity, and electricity exports are a major source of foreign currency for Lao PDR. Figure 4.3 shows cross-border electricity trade in the Mekong River Basin in 2010.

Lao PDR is the region's largest electricity exporter, while Thailand and Viet Nam are the major electricity importers in the region. Cambodia also imports a large quantity of electricity despite its rich hydropower potential, shown in Tables 4.6 and 4.7. Among 12 proposed hydropower projects for the Lower Mekong Basin mainstream, 10 are in Lao PDR (Mitra et al., 2015). Table 4.9 shows the status of major mainstream dams in Lao PDR, and Figure 4.4 shows their location. The total generation capacity of these dams is around 8.3 GW, which is equivalent to 32% of the hydropower potential shown in Table 4.6.

Figure 4.3. **Cross-border electricity trade in the Mekong River Basin in 2010**



Source: ADBI (2013b), Connecting South Asia and Southeast Asia – Interim Report, www.adb.org/publications/connecting-south-asia-southeast-asia-interim-report and Mitra et al. (2015), "Water-food-energy nexus approach: Towards green regional co-operation in Southeast Asia", http://pub.iges.or.jp/modules/envirolib/upload/6046/attach/IGESWhitePaperV2015_eng_web.pdf.

StatLink http://dx.doi.org/10.1787/888933309997

Table 4.9. **Status of mainstream dams in Lao PDR**

Name	Location	Capacity (MW)	Planned market	Investors	Status
Xayaburi	Luangprabang	1 285	Domestic, export to Thailand	Electricité du Laos (EdL) 20%, Ch.Kanchang (Thailand) 30%, EGCO (Thailand) 12.5%, Natec Synergy 25%, Bang KIK Expressway 7.5%	Under construction
Don Sahong	Champasak	360	Domestic, export to Thailand	EdL 20%, Mega First Corporation Berhad MFCB (Malaysia) 80%	Planning stage
Sanakham	Xayaboury	660		Government of Lao 19%, Datang Overseas Investment Co., Ltd. 81%	Planning stage
Phou Ngoy	Champasak	651	Domestic, export to Thailand	Charoen Energy and Water Asia Co., Ltd. (Thailand)	Planning stage
Pakbeng	Oudomxay	921		Government of Lao 19%, Datang Overseas Investment Co., Ltd. 81%	Planning stage
Ban Koum	Champasak	1 872	Domestic, export to Thailand	Italian-Thai Development Co. (Thailand) and Asia Corp Holdings Limited	Feasibility stage
Luangprabang	Luangprabang	1 200	Domestic, export to Viet Nam	Petro Vietnam Power Corporation (Viet Nam)	Feasibility stage
Pak Lay	Xayaboury	1 320	Domestic, export to Thailand	CEIEC+SINOHYDRO	-

Source: Department of Energy Business-Powering Progress (2014), "Data on hydropower plants in Laos – Update until March 2013", www.poweringprogress.org and Mitra et al. (2015), "Water-food-energy nexus approach: Towards green regional co-operation in Southeast Asia", http://pub.iges.or.jp/modules/envirolib/upload/6046/attach/IGESWhitePaperV2015_eng_web.pdf.

Figure 4.4. **Location of major Mekong mainstream dams**

Source: Development Centre composition, based on Save the Mekong website (www.savethemekong.org/admin_controls/js/tiny_mce/plugins/imagemanager/files/MMD.jpg).

Environmental concerns and the "food-energy-water nexus"

Although these mainstream dams are expected to provide economic benefits for both the exporters and the importers of hydropower, there are serious environmental concerns, such as changing water flow patterns, loss of soil nutrients and reduction in capture fisheries (Costanza et al., 2011) (Box 4.3). For example, construction of the Xayaburi dam will be associated with a significant reduction of nutrient-rich alluvial sedimentation in the Mekong Delta (Mitra et al., 2015). Construction of the Xayaburi dam will negatively affect the primary food source of 80% of the people of Cambodia, according to an estimation by Vannarith (2012). The Mekong River Commission (MRC) estimated that the construction of 11 proposed dams in the Lower Mekong Basin mainstream would lead to agricultural losses of up to USD 500 million per year, with a 30% reduction of protein intake in Lao PDR and Thailand (MRC, 2011). Because of these environmental concerns, multilateral financial agencies, including the World Bank and Asian Development Bank, do not support or invest in hydropower projects on the mainstream of Mekong River (Mitra et al., 2015).

Box 4.3. **Environmental concerns over hydropower development in Mekong River basin**

Though widely considered to be a source of renewable energy, large-scale, conventional hydropower projects, such as those constructed on the Mekong River, have nevertheless been subject to criticisms on environmental grounds. The operation of these plants can have undesirable effects on the emission of greenhouse gases from reservoirs, water quality, the flow of sediment and debris through rivers, and migratory species and biodiversity (OECD/IEA, 2012). The Mekong River nurtures a very rich aquatic ecosystem including megafauna such as the giant Mekong catfish and giant freshwater stingray and it is regarded as the greatest inland fishery in the world (Thorncraft et al., 2013). The seasonal fluctuation of its flow is very large, i.e. the flow in the dry season is about 30 times less than that in the wet season, and this massive change in the habitat condition makes fish in the Mekong very mobile and fish migrations more important than in other large rivers in the world (Baird, Shoemaker and Manorom, 2015). The proposed mainstream dams in Lao PDR are across the entire river channel and there are significant ecological concerns that these dams will block fish migrations and reduce river flow fluctuation (or reduce flood pulses) which play very important roles in nurturing the aquatic life of the river (Orr et al., 2012). For example, the Xayaburi Dam, which is currently under construction, will block the migration of the giant catfish and could result in its extinction (Zaffos, 2014). The assessments of the Xayaburi Dam conducted by the Lao government claimed that there will be no significant negative environmental impacts and that mitigation measures such as fish passage structures will enable fish migration, but a group of experts argue that fish passage devices have failed on large dams in Asia because of the difficulty in meeting the needs of the volume of fish as well as in mitigating the dam's effects on flood pulses (Zaffos, 2014).

The strategic environment assessment (SEA) commissioned by MRC concluded that "the mainstream projects would degrade the longitudinal connectivity of the Mekong ecosystem, compartmentalising it into smaller and far less productive units" (ICEM 2010, p.14). The SEA listed the associated ecological impacts including the following:

- Significant biodiversity losses for fish species, including local extinction of giant Mekong catfish from the Cambodian floodplains
- Reduced suspended load, which negatively affects the transport of nutrients crucial for the Tonle Sap system
- Extinction of the critically endangered Irrawaddy dolphin
- Loss of wetland due to inundation
- Coastal erosion including loss of mangrove habitat.

In particular the mainstream dams will significantly reduce river capture fishery which is not only economically important for riparian countries but also an important source of protein, accounting for 48% in Lao PDR and 79% in Cambodia of total animal protein consumption, respectively (Thorncraft et al., 2013).

Given the trade-offs between the economic benefits from hydropower generation and its negative impact on the livelihood of downstream countries through damage to ecosystems, a holistic approach to capture the food-energy-water nexus is necessary (Mitra et al., 2015). A study conducted by Portland State University in the United States and Mae Fah Luang University in Thailand demonstrates the importance of this holistic approach (Costanza et al., 2011). The study aimed to provide key stakeholders in the Lower Mekong Basin (the MRC's secretariat and member governments, bilateral and multilateral donors, etc.) with additional information on the economic, environmental and social impact of key policy decisions, including a Basin Development Plan developed by the MRC and a strategic environmental assessment (SEA) of the 11 planned mainstream hydropower projects. The study took up a cost-benefit analysis of the Basin Development Plan Phase 2 (BDP2), conducted by MRC, and strengthened the valuation of lost ecosystem services including lost capture fisheries and lost ecosystem services from wetlands (MRC, 2010) (Box 4.4). Table 4.10 shows the net present value of an 11-dam scenario, both the original estimate reported in the cost-benefit analysis of BDP2 which employed a 10% discount rate for a 50-year time frame, and the revised estimate by Costanza et al. (2011) with a discount rate of 1% for valuation of ecosystem services under an infinite time horizon.

The positive net present value of the original assessment by MRC stood at USD 33 billion. This becomes a gross negative value, with a loss of more than USD 270 billion. Costanza et al. warn that the coverage of ecosystem services was partial and the valuation of ecosystem services might be underestimated. Table 4.11 shows cross-country distribution of the net present value for four Lower Mekong countries.

Table 4.10. **Net present value of the 11-dam scenario**

(USD million)

	Original BDP2 estimate	Revised estimate by Costanza et al. (2011)
Hydropower generated	32 823	32 823
Irrigated agricultural production	1 659	1 659
Reservoir fisheries	215	78 175
Aquaculture production	1 261	4 010
Capture fisheries reduction	-1 936	-400 953
Wetland area reduction	101	10 610
Reduction in eco-hotspot/biodiversity	-415	-415
Forest area reduction	-372	-372
Recession rice	278	278
Flood damage mitigation	-273	-273
Mitigation of salinity affected areas	-2	-2
Losses in bank erosion areas	0	0
Navigation	64	64
Total	33 403	-274 396

Source: Costanza et al. (2011), *Planning Approaches for Hydropower Development in the Lower Mekong Basin*, http://web.pdx.edu/~kub/publicfiles/Mekong/LMB_Report_FullReport.pdf.

Table 4.11. **Distribution of net present value of 11-dam scenario**

(USD million)

	Original BDP2 estimate	Revised estimate by Costanza et al. (2011)
Lao PDR	22 604	15 546
Thailand	4 445	-128 934
Cambodia	2 628	-110 302
Viet Nam	3 727	-50 706
Total	33 403	-274.396

Source: Costanza et al. (2011), *Planning Approaches for Hydropower Development in the Lower Mekong Basin*, http://web.pdx.edu/~kub/publicfiles/Mekong/LMB_Report_FullReport.pdf.

Judging from the revised assessment, the economic benefits of hydropower development will fall to Lao PDR, while negative externalities on food security (reduction in capture fisheries) make the net present value of the 11-dam scenario significantly negative for the other three countries.

Box 4.4. **Valuation of changes in ecosystem services**

Costanza et al. (2011) employed the following two valuation methodologies to capture the values of ecosystem services affected by the MRC's Basin Development Plan:

(1) Replacement cost method to estimate the value of the loss of capture fisheries:

The value of the loss of capture fisheries was estimated based on the value of the least expensive alternative to replace this ecosystem service. Costanza et al. estimated how much it would cost to replace the capture fisheries using the net price of fish (fish price minus fishing effort, and the gain from reservoir fisheries was also extracted) and the reduction in fishery yields due to the Basin Development Plan. The net price of fish was set at USD 3.0 per kilogramme based on the current fish prices in Southeast Asia, along with an assumption that capture fishing by local fishers involves very low effort and transport costs relative to commercial fishing. In addition, the cost of alternative protein sources (such as chicken and pork) was considered. Costanza et al. contend that the employed replacement cost may be an underestimate of the true value, as it does not account for the cultural and social costs of lost fisheries.

(2) Benefit transfer method to estimate the value of wetlands lost, which includes a full range of ecosystem services:

Wetlands provide a wide range of ecosystem services including water supply, water flow regulation, waste treatment, floor protection, food production, raw material production, habitat refuges, recreational service and aesthetics. Costanza et al. took up three types of wetlands: flooded forests, marshes, and inundated grassland. The values of each type of wetland were derived from a study for the Mississippi Delta in the United States that used the benefit transfer of the estimated values of wetlands by a range of studies from around the world. The values transferred were all from climates and landscapes comparable to the Mississippi. The Mississippi study estimated the value of flooded forests at USD 3 353 per hectare per year, of marshes at USD 3 305/ha/year and of inundated grassland at USD 2 332 per hectare per year.

These values were applied to the wetland loss associated with the Basin Development Plan. In addition, Costanza et al. (2011) reviewed the issue of discount rate and time frame for the valuation. The original cost benefit analysis of the Basin Development Plan Phase 2 (BDP2) employed 10% discount rate for a 50-year time frame. Costanza et al. (2011) conducted a sensitivity analysis with three discount rates of 1%, 3% and 10% and employed an infinite time frame.

Enhancing regional co-operation

The holistic approach mentioned above identifies the potential tension between neighbour countries of the Lower Mekong Basin over the utilisation of water resources. Conflicts involving the national interests of neighbouring countries can pose a serious challenge, but at the same time there is an argument that transboundary water issues, like those in this case, can serve as a catalyst for regional co-operation (Wolf, Yoffe and Giordano, 2003; Turton, 2000).

For example, the revised net present value estimate shown in Table 4.11 manifests the potential huge economic benefits of alternative dams located in the tributaries of Mekong, not in the mainstream Mekong, or of application of innovative systems such as partial in-channel diversion which do not require dams across the full breadth of the river channel (ICEM 2010). Indeed, an extensive review of the hydro potential of Lao PDR indicates that the country has 18 GW of hydropower potential even without any mainstream dams, or more than twice the total generation capacity of the eight proposed mainstream dams listed in Table 4.9 (Mitra et al., 2015). Costanza et al. (2011) recommend a payment for ecosystem services (PES) to Lao PDR by the neighbour countries (and elsewhere) to compensate for the forgone economic benefits of mainstream dam construction. With benefit sharing among the countries along the river, such as the PES mentioned above, regional co-operation for the common management of transboundary water resources has the potential to achieve a win-win solution for all of these riparian countries (Bachurova, 2010; Sadoff and Grey, 2002; Sadoff and Grey, 2005). An integrated approach, fully reflecting the water-food-energy nexus and effective regional institutions, would seem to be crucial to realising this win-win situation, not only for the riparian countries but also in terms of the simultaneous achievement of developmental objectives and environmental sustainability (Mitra et al., 2015).

However, there are currently barriers to reaping the potential benefits of regional co-operation underpinned by the holistic approach. Enhanced governance of the MRC is needed to enable win-win co-operation, according to Mitra et al. (2015). At present, the MRC acts only as a co-ordinating advisory body and cannot enforce legally binding agreements (Tu, 2011). This governance structure makes it difficult to implement integrated planning, as resolution of conflicts of interest among riparian countries cannot be effectively co-ordinated without some sort of supra-national authority. For example, the primary interest of Thailand and Viet Nam in the Mekong River is as a source of agricultural water, while for Cambodia it is as a source for fisheries and for Lao PDR as a source of hydropower. These interests conflict, and their reconciliation without binding agreement seems very difficult (Gupta, 2005).

ASEAN has tried various environmental co-operation initiatives and is currently working towards the establishment of an ASEAN Socio-Cultural Community. It seems feasible to identify regional co-operation programmes or joint projects in the Mekong River Basin, in co-ordination with the MRC, in order to develop a spirit of co-operation and to establish trustful relationships among riparian countries. In particular, it might be useful to conduct a joint study to identify benefit-sharing potential among participating countries.

Conclusion

This chapter has sought to illustrate the potential of regional integration and co-operation in East Asia for safeguarding environmental sustainability and promoting green growth. With proper environmental safeguards, regional economic integration can significantly contribute to green growth. The current development pattern of East Asia is neither equitable nor sustainable. Regional co-operation and integration have the potential to empower countries to depart from such business-as-usual pathways and to promote green growth.

The cases explored above provide examples of green integration. With a proper objective of green growth, regional economic integration can contribute to an increase in exports of commodities related to renewable energy. We have estimated the potential impact for ASEAN-6, China and India of regional integration, represented by intra-regional FDI share and tariff removal for renewable-energy-related products, and of regional co-operation, represented by trade agreements on exports of renewable-energy-related products. These estimated impacts are not marginal, and are expected to be used in addressing barriers to the exploitation of the region's abundant renewable energy potential in order to promote green growth.

In the case of hydropower development in the Mekong River Basin, a step-by-step approach, starting from joint study or regional co-operation projects, can nurture a spirit of co-operation among riparian countries. This can gradually enable the conditions for deep regional integration, with legally binding agreements underpinned by supra-national regional institutions.

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Chapter 5

Reaping the benefits of regional integration in Emerging Asia: Private sector development

Emerging Asia's private sector is becoming increasingly global as its firms – its large firms in particular – expand their trade and investment relationships within the region and beyond. FDI inflows are growing and a number of large merger and acquisition deals highlight the strength of many of these international firms. Challenges remain at the same time, as these results are more mixed at the country and sector levels and greenfield foreign direct investment inflows have recently been declining. Firms also continue to see a number of major challenges emerging within the region that will have to be addressed by individual countries and by the region as a whole, including obstacles related to trade, infrastructure and logistics, policy and regulation, and labour markets. The ASEAN Economic Community is expected to enhance cross-border production linkages further.

Introduction

This chapter will examine the impact of regional economic integration on the development of the private sector in Southeast Asia, China and India. Although the private sector is playing an increasing role in the region, enterprises need to enhance their competitiveness and productivity. The emergence of global and regional value chains, usually operated by the region's manufacturing sector in co-operation with various service providers, will also be reviewed.

During the past decades, in a relatively stable political environment, the countries of the Association of Southeast Asian Nations (ASEAN) have pursued three development strategies: *i)* promotion of the export business while attracting foreign direct investment (FDI); *ii)* transformation and expansion of ASEAN as a dynamic single market and a competitive production base; and *iii)* development of a pro-business environment (ASEAN, 2008; 2014a). Such strategies have led to the liberalisation of trade and investment regimes and attracted export-oriented FDI to the region, eliminating tariffs in the majority of sectors, reducing non-tariff barriers, enhancing infrastructures and cultivating regional co-operation among the ASEAN member states and with neighbouring countries, such as China and India (ASEAN, 2014b). Advancement of information and communications technology (ICT) and the widespread use of multimodal logistics services (road, sea, air) have also helped businesses to lower their costs and integrate into the global economy (ESCAP, 2009). China and India have adopted similar development strategies focusing on export and FDI while leveraging their domestic markets, although India's movement in this direction lags behind the ASEAN countries and China (OECD, 2015).

This chapter will review the increasing role played by ASEAN, Chinese and Indian enterprises in the world economy. It will examine FDI, greenfield investments, and mergers and acquisitions (M&A) to provide a rich picture of current business activities in the region. Trade data will be analysed in terms of major export destinations and product categories. The implications of the ASEAN Economic Community (AEC) for business and the obstacles to business operations in the region will be presented, based on business indexes and surveys. The chapter will present policy implications and recommendations.

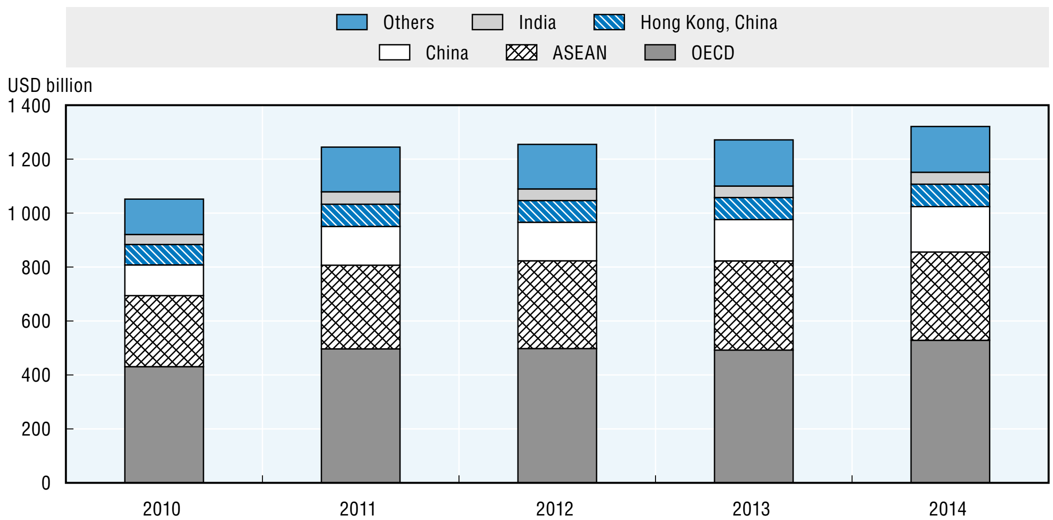
Recent trends of exports and FDI, with a special focus on greenfield investment and M&A

Exports trends and structure

The region's export business quickly recovered after a slump experienced during the global financial crisis. China saw the highest constant growth after a V-shaped recovery from 2008 to 2010, while the pace of growth in ASEAN was slower, with an export growth rate of 6.1% for the four years from 2011 to 2014. India and Hong Kong, China also increased exports, although rates have slowed recently.

OECD and ASEAN are by far the largest customer regions for ASEAN's exports, accounting for nearly two-thirds of all ASEAN exports in 2014, with low growth rates. ASEAN's exports to China; India; Hong Kong, China and other areas of the world have shown moderate growth, although they declined in 2012 due to the prolonged economic slowdown (Figure 5.1).

Figure 5.1. **Destinations of ASEAN exports, 2010-14**



Source: Authors' calculations based on the ITC (2015) *Trade Map*, www.trademap.org/.
StatLink http://dx.doi.org/10.1787/888933310001

Table 5.1 provides a detailed picture of the export destinations of the ASEAN countries, China; India; and Hong Kong, China in 2014. As noted above, the major export destinations are OECD countries, ASEAN countries, China and India, with a few exceptions. China; Hong Kong, China; and India have lower shares of exports to ASEAN countries (from 6.7% to 11.6%). While Lao PDR and Myanmar have higher export shares to other ASEAN countries (52.2% and 49.0%, respectively), Cambodia and Viet Nam record relatively low exports to other ASEAN countries (14.0% and 12.8%, respectively), with OECD countries, China and Hong Kong, China as their main export markets. Among advanced ASEAN economies, the Philippines has a relatively low export share with ASEAN (14.9%), while Indonesia, Malaysia, Singapore and Thailand record moderate export shares with ASEAN (from 22.5% to 31.2%). Brunei Darussalam also registered a moderate share of exports to ASEAN at 20.2%. China and Hong Kong, China are major export markets for the ASEAN countries. The structure of the region's export business in Annex 5.A1, displaying the top six net exports and net imports for each of the ASEAN countries, suggests three major export portfolios linked to: a) natural resource endowment (agricultural products, oil and natural gas, and minerals); b) light manufacturing (textiles, garments and footwear); and c) industrial products. Within this classification, Brunei Darussalam, Indonesia, Lao PDR and Myanmar are natural resource exporters, while Cambodia and Viet Nam are involved in light manufacturing exports. Malaysia, the Philippines, Singapore and Thailand have advanced to become exporters of value-added industrial products, as have China and India. Hong Kong, China is a middleman of international trade.

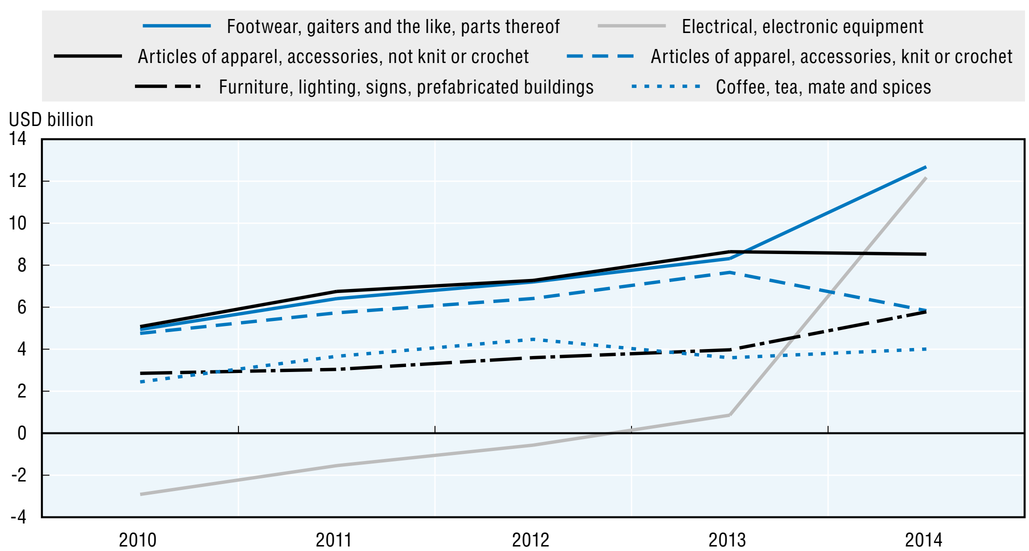
Table 5.1. **Emerging Asia's export destinations by country, 2014**

	1	2	3	4	5	6
China	United States	**Hong Kong, China**	**ASEAN**	Japan	Korea	Other
	17.0%	**15.5%**	**11.6%**	6.4%	4.3%	45.3%
Hong Kong, China	**China**	**United States**	**ASEAN**	Japan	**India**	Others
	57.3%	**8.4%**	**6.7%**	3.3%	**2.5%**	21.8%
India	United States	UAE	**ASEAN**	**China**	**Hong Kong, China**	Others
	13.4%	10.4%	**9.8%**	**4.2%**	**4.2%**	57.9%
Brunei Darussalam	Japan	**ASEAN**	Korea	Australia	Chinese Taipei	Others
	38.9%	**20.2%**	9.1%	8.0%	5.8%	18.2%
Cambodia	United States	**Hong Kong, China**	**ASEAN**	UK	Germany	Others
	23.5%	**17.2%**	**14.0%**	7.8%	6.7%	30.9%
Indonesia	**ASEAN**	Japan	**China**	United States	**India**	Others
	22.5%	13.1%	**10.0%**	9.4%	**6.9%**	38.0%
Lao PDR	**ASEAN**	**China**	Japan	Germany	UK	Others
	52.2%	**25.7%**	2.7%	2.3%	2.0%	15.0%
Malaysia	**ASEAN**	**China**	Japan	United States	**Hong Kong, China**	Others
	27.9%	**12.0%**	10.8%	8.4%	**4.8%**	36.0%
Myanmar	**ASEAN**	**Hong Kong, China**	**India**	**China**	Japan	Others
	49.0%	**21.1%**	**12.6%**	**6.2%**	2.8%	8.2%
Philippines	Japan	**ASEAN**	United States	**China**	**Hong Kong, China**	Others
	22.5%	**14.9%**	14.1%	**13.0%**	**9.0%**	26.4%
Singapore	**ASEAN**	**China**	**Hong Kong, China**	United States	Japan	Others
	31.2%	**12.6%**	**11.0%**	5.9%	4.1%	35.3%
Thailand	**ASEAN**	**China**	United States	Japan	**Hong Kong, China**	Others
	26.1%	**11.0%**	10.5%	9.6%	**5.5%**	37.2%
Viet Nam	United States	**ASEAN**	Japan	**China**	Republic of Korea	Others
	18.1%	**12.8%**	10.3%	**10.0%**	5.1%	43.9%

Note: % shows the export shares of left-hand-side countries to their trade partners
Source: Authors' compilation based on the ITC (2015) *Trade Map*, www.trademap.org/.

The countries of the region have developed diversified and specialised export structures. Indonesia, a major coal and oil exporter, also exports industrial goods such as electrical and electronic equipment, machinery and plastic goods, but it has yet to become a net exporter of these products. In Thailand, while sectors such as electrical and electronic equipment have stagnated, automobile exports have been steadily increasing, with the country establishing itself as a production hub of automobiles within ASEAN. The Philippines has also experienced export growth in electrical and electronic equipment and machinery, but these sectors are still net importers. While Malaysia has diversified its export business to the advanced electronics sector, its main exports are still mineral fuels, oils and distillation products. Cambodia and Lao PDR have begun exporting apparel and footwear. Singapore has already established a diversified structure for exporting goods, while oil represents nearly 90% of exports from Brunei Darussalam. Myanmar's exports are dominated by precious stones, metals and natural gas, which account for more than two-thirds of products exported. Hong Kong, China has kept its focus on light manufacturing and on its role as a trade intermediary, although exports of machinery have increased recently. China has a diversified export portfolio that includes machinery, electronic goods, construction materials, apparel and footwear. India's very different export structure includes cereals, pharmaceuticals, automobiles and apparel. Viet Nam has rapidly increased exports of greater-value-added manufactured goods, notably electrical and electronic equipment, indicating that it is transitioning to become an advanced manufacturing exporter. While it has continued the growth of exports in its traditional manufacturing sectors, such as footwear, apparel and garments, furniture and coffee, success in electronics manufacturing is one of the main reasons behind its rapid increase in exports. Electrical and electronic equipment accounted for nearly 30% of Viet Nam's overall exports in 2014 (Figure 5.2). The good performance of Viet Nam can also be attributed to steady and increasing investments from Japan, Chinese Taipei, Korea and the United States, which are major investors in the electronics sector. Their investments account for nearly 90% of greenfield investments in this advanced manufacturing sector (fDi Markets, 2015).

Figure 5.2. **Viet Nam's top six net export sectors**



Source: Authors' calculations based on the ITC (2015) *Trade Map*, www.trademap.org/.
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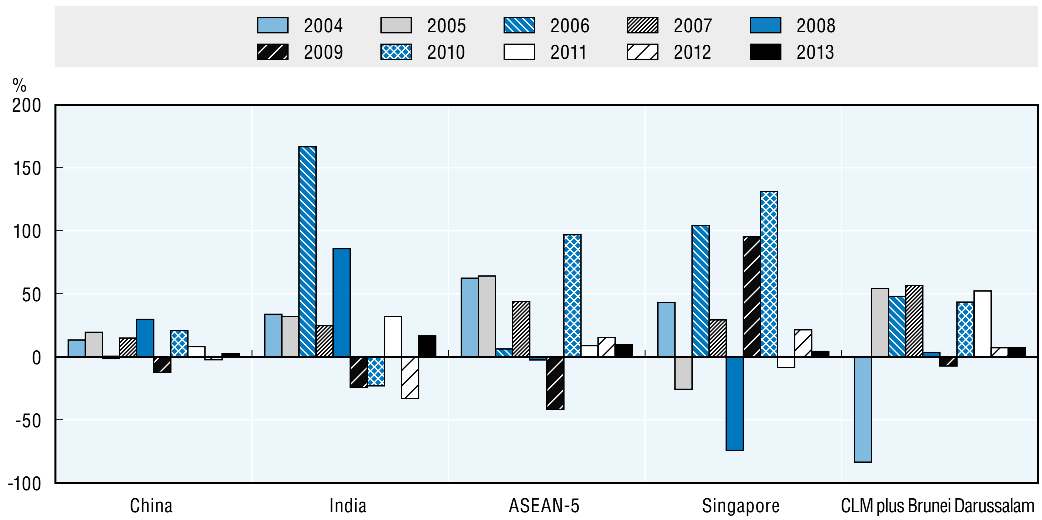
FDI flows to the region are growing[1]

Business growth in Southeast Asia, China and India has been supported by FDI inflows to the region. UNCTAD's FDI statistics (2015a) show this trend (Figure 5.3). Overall, FDI inflows to the region increased over the last decade, although the Lehman shock in 2008 had a negative impact on FDI. Accelerating growth was seen prior to the global financial crisis, particularly in Hong Kong, China, and India, though inflows to most countries began recovering in the years that followed. ASEAN countries also received increasing FDI inflows in the past decade, with Singapore and the ASEAN-5 countries experiencing more rapid growth than the CLM countries – and Brunei Darussalam.

Figure 5.3. **Annual growth in FDI inflows to Emerging Asia, 2004-13**



Note: ASEAN-5 includes Indonesia, Malaysia, Philippines, Thailand and Viet Nam.

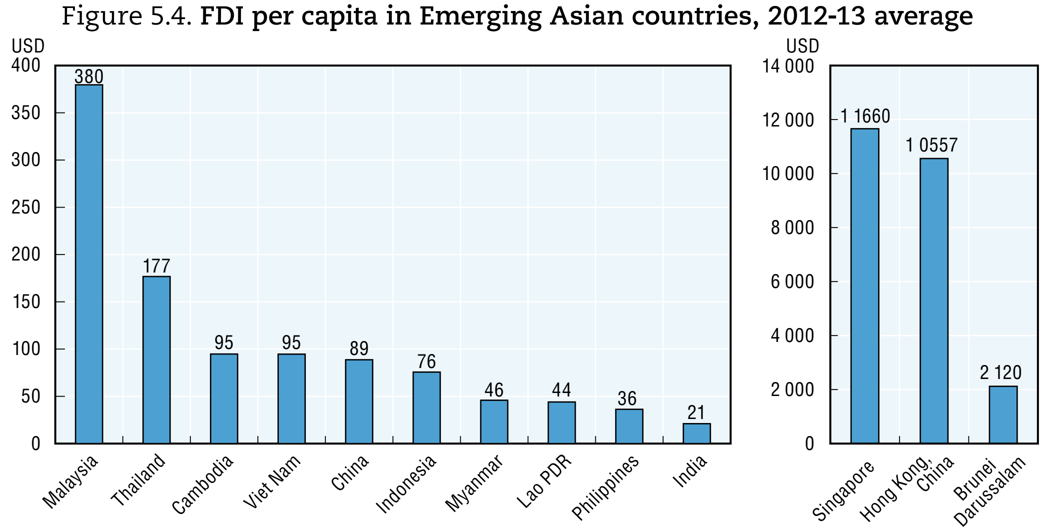
Source: Authors' calculations based on UNCTAD (2015b), *FDI database*, http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx.

StatLink http://dx.doi.org/10.1787/888933310025

Indonesia experienced a steady increase in FDI, while flows to Thailand, formerly the second largest FDI recipient, dropped during the 2009-11 period due to a combination of the Lehman shock and prolonged political unrest. Malaysia and Viet Nam attracted FDI increasingly over the past decade, while FDI inflows to the Philippines, Cambodia, Brunei Darussalam and Lao PDR are increasing but at the minimal level among the ASEAN states.

A review of FDI inflows per capita, however, tells a different story. As shown in Figure 5.4, Singapore and Hong Kong, China are by far the largest recipients of per capita FDI inflow, followed by Brunei Darussalam. Most other countries in the region – including two major FDI recipients, China and India – received annual per capita FDI inflows per capita of less than USD 100 during the 2012-13 period. Smaller states – Singapore; Hong Kong, China; and Brunei Darussalam – ranked high. While UNCTAD's dataset paints the big picture of FDI flows in the region, it cannot explain detailed flows among industrial sectors and their sizes.

Figure 5.4. **FDI per capita in Emerging Asian countries, 2012-13 average**



Source: Authors' calculations based on UNCTAD (2015b), *FDI database*, http://unctadstat.unctad.org/wds/ReportFolders/reportFolders.aspx.

StatLink http://dx.doi.org/10.1787/888933310031

Box 5.1. **Regulation and challenges for FDI in Emerging Asia**

In addition to challenging operating environments in some countries, direct limits on foreign ownership and administrative burdens – such as those imposed through investment screening and approval processes by government – can present serious disincentives to cross-border direct investment, including in M&A. These restrictions are relatively high in a number of Emerging Asian economies, though they are gradually being reduced through reforms. FDI restrictiveness varies considerably within the region, according to the OECD FDI Restrictiveness Index. Like OECD members, equity restrictions account for a large part of the total barriers to FDI. These limitations are typically applied to a list of sectors, as in China under the *Foreign Direct Investment Industrial Guidance Catalogue* and in Myanmar under the *Foreign Investment Law*. Screening and approval restrictions are also significant factors in China and Myanmar, where approval of investment is also required in some sensitive sectors. Preliminary (and aggregated) scores for ASEAN members minus Brunei Darussalam place the Philippines as more restrictive than China or Myanmar, and Singapore and Cambodia as the least restrictive economies in the region, scoring better than the OECD average (OECD, 2014).

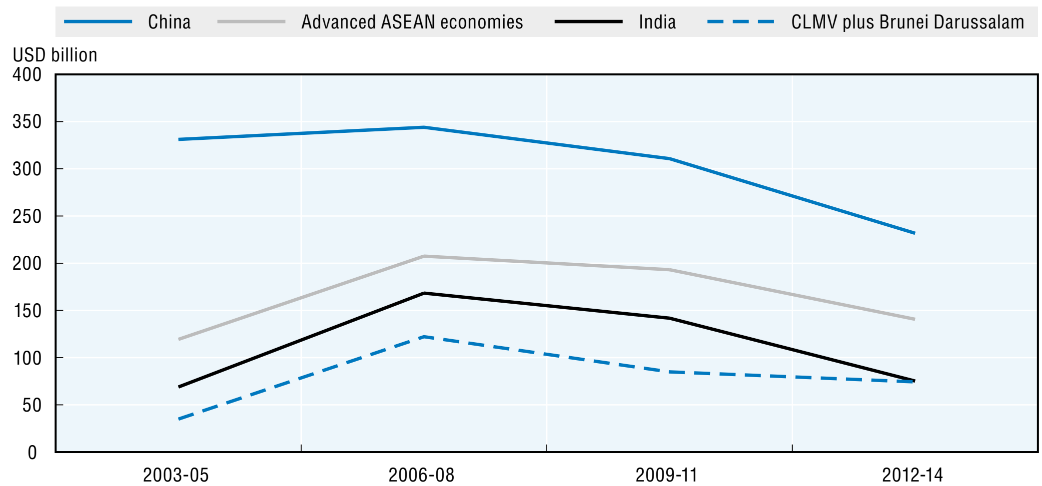
Recent reforms of investment regulations in the region have generally been liberalising. Viet Nam, for example, opened a number of sectors to full foreign ownership in January 2014. Recent legislative and regulatory reforms in India's business and financial sectors are helping to attract investors, such as through the 2013 *Companies Act*, which provides for fast-track mergers in some situations, among other reforms facilitating M&A. Reforms in China have been somewhat more mixed. Screening and approval in China is becoming less restrictive. The revision of the *Governmental Approval Index* in October 2014 shortened the list of investment projects requiring approval. Further reforms made to the *Foreign Direct Investment Industrial Guidance Catalogue* in March 2015 reduced the number of sectors in which limits were placed on foreign ownership. On the other hand, the new *National Security Law* may require additional reviews of some investment transactions.

Sources: OECD (2014), *Southeast Asia Investment Policy Perspectives*, www.oecd.org/daf/inv/investment-policy/Southeast-Asia-Investment-Policy-Perspectives-2014.pdf.

Greenfield investment declines

While overall FDI inflows have increased in the region, greenfield investments display a worrisome trend. Greenfield investment is defined as business investment for establishing new facilities or operations in a host country (fDi Markets, 2015). The dataset provided by the fDi Markets (2015) presents world greenfield investment flows to ASEAN countries, China and India, and the greenfield investments of these countries in other parts in the world. We shall examine both inflows and outflows of greenfield investments in the region as well as their status in various industrial sectors and their impact on job creation. The dataset suggests that greenfield investments to the region have been declining since the Lehman shock in 2008 (Figure 5.5).

Figure 5.5. **World aggregate greenfield investment in Emerging Asia, 2003-14**



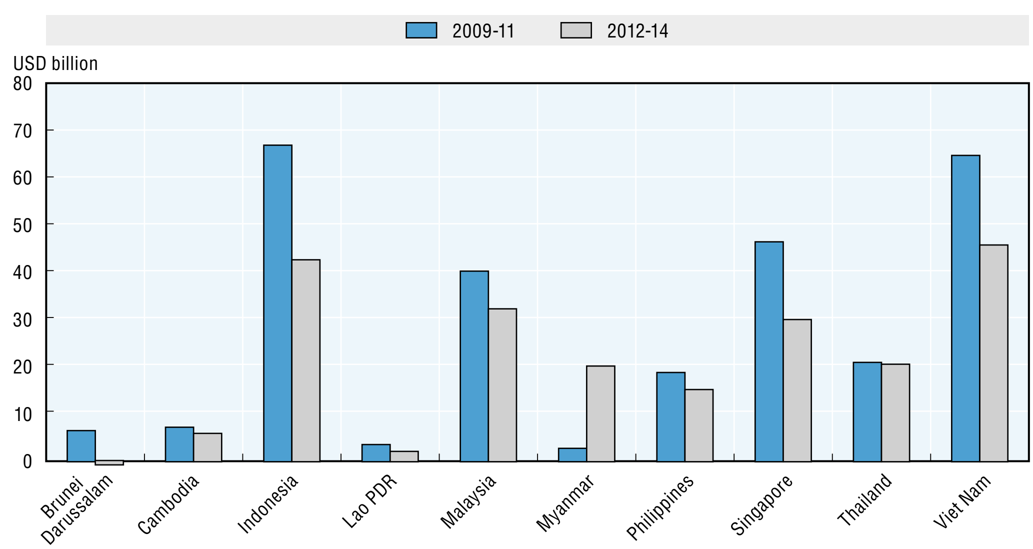
Note: Advanced ASEAN economy includes Indonesia, Malaysia, Philippines, Singapore and Thailand. CLMV countries are Cambodia, Lao PDR, Myanmar and Viet Nam.

Source: Authors' calculations based on the dataset of the fDi Markets (2015), www.fdimarkets.com/.

StatLink http://dx.doi.org/10.1787/888933310044

Detailed country data show that almost all ASEAN countries experienced a decline of greenfield investment from around the world (Figure 5.6). The exception is Myanmar, which began long-awaited political and economic reforms in 2011 and has recently attracted more investments. Although the ASEAN countries have maintained relatively stable political and economic environments for business, it is particularly worrisome that all of them, again except Myanmar, registered a decline in the most recent period, from 2012 to 2014.

Figure 5.6. **World aggregate greenfield investment in ASEAN, 2009-14**

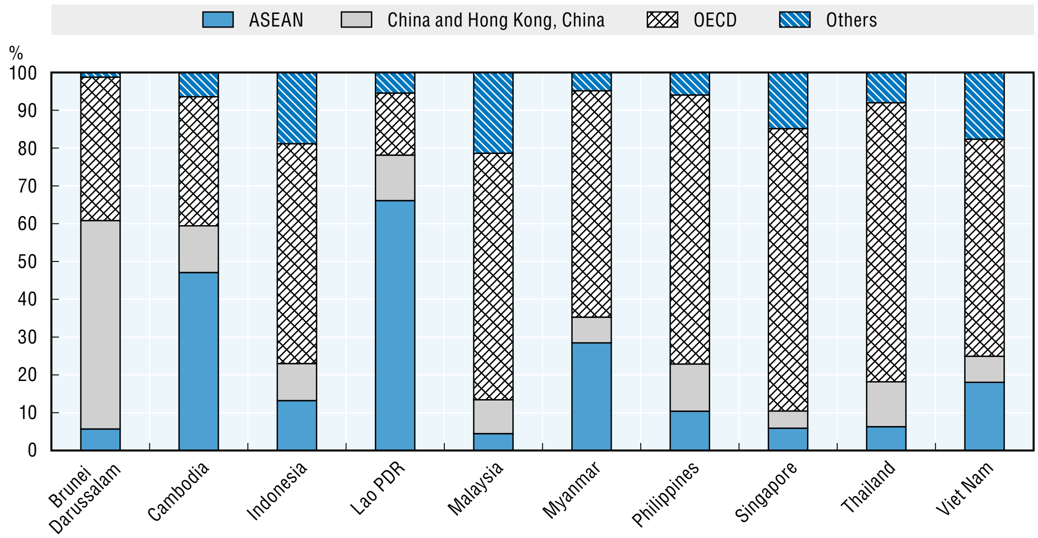


Source: Authors' calculations based on the fDi Markets dataset (2015), www.fdimarkets.com/.

StatLink http://dx.doi.org/10.1787/888933310053

As mentioned above, the OECD countries have been major investors in ASEAN countries but they significantly reduced their greenfield investments in ASEAN after the Lehman shock in 2008.[2] ASEAN has a relatively higher share of greenfield investment in the CLM countries; in particular, ASEAN countries are the biggest greenfield investors in Cambodia and Lao PDR. On the other hand, China and Hong Kong, China are the biggest investors in Brunei Darussalam (Figure 5.7).

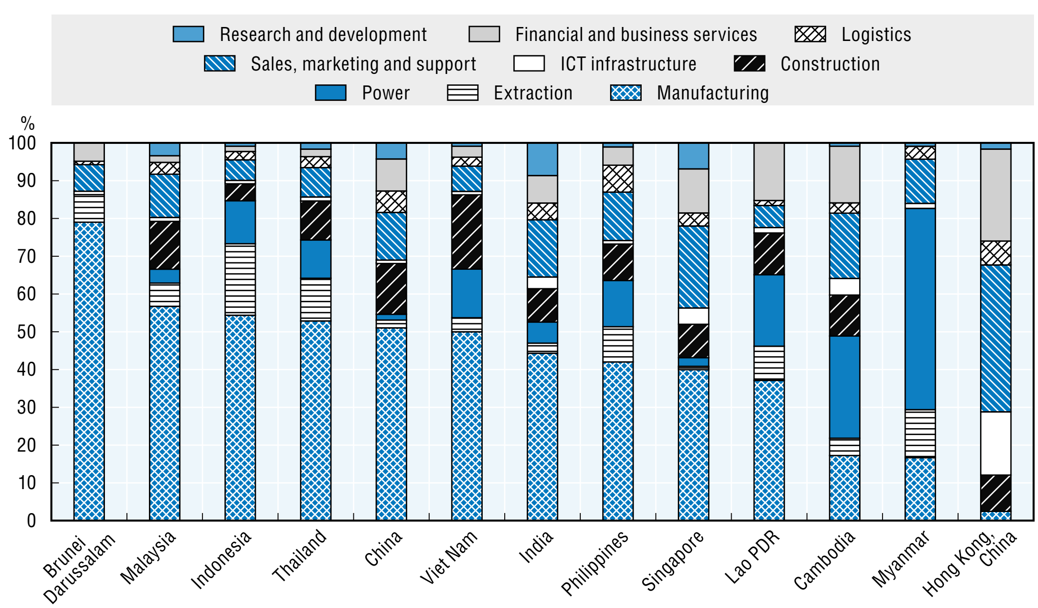
Figure 5.7. **Greenfield investment in ASEAN, by investor region, 2003-14**



Source: Authors' calculations based on the fDi Markets dataset (2015), www.fdimarkets.com/.
StatLink http://dx.doi.org/10.1787/888933310069

The manufacturing sector received the highest share of greenfield investment in most of the region's countries, while the services sector dominates in Cambodia; Myanmar; and Hong Kong, China. Other sectors that received significant shares of greenfield investment include extraction, power, construction, ICT infrastructure, sales and marketing, and banking and finance (Figure 5.8).

Figure 5.8. **Greenfield investment in Emerging Asia, by sector, 2003-14**



Source: Authors' calculations based on the dataset of the fDi Markets (2015), www.fdimarkets.com/.
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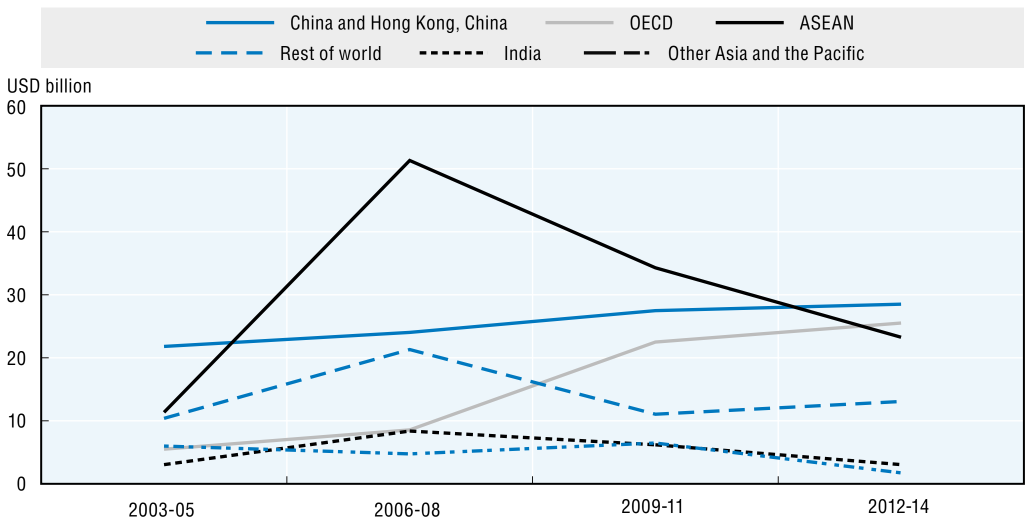
A review of ASEAN's own, or intra-ASEAN, greenfield investments uncovers an issue that warrants further investigation: intra-ASEAN greenfield investments were diverted from ASEAN countries to China; Hong Kong, China; and OECD countries after the Lehman shock. ASEAN had quickly increased its own greenfield investments from 2006 to 2008 period, but intra-ASEAN investments have decreased since then, falling below ASEAN investments to China and the OECD countries during the 2012-14 period (Figure 5.9). ASEAN investments in India, other Asia-Pacific countries and the rest of the world have also declined or stagnated.

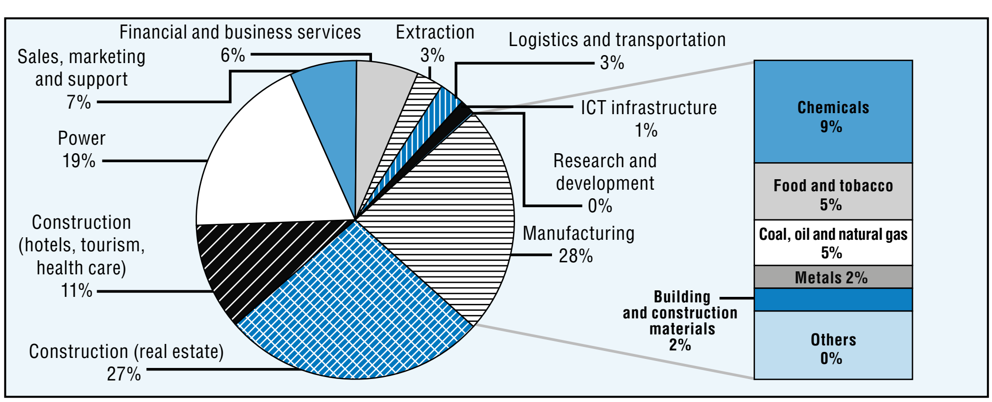
Figure 5.9. **ASEAN aggregate greenfield investment by region, 2003-14**



Source: Authors' calculations based on the fDi Markets dataset (2015), www.fdimarkets.com/.
StatLink http://dx.doi.org/10.1787/888933310083

The majority of intra-ASEAN greenfield investments have gone to the manufacturing, construction and power sectors (Figure 5.10). Within the manufacturing sector, the categories receiving most investment were chemicals; food and tobacco; coal, oil and natural gas; and metals. The construction sector can be broadly divided into two categories: *i)* real estate; and *ii)* hotels, tourism and health care.

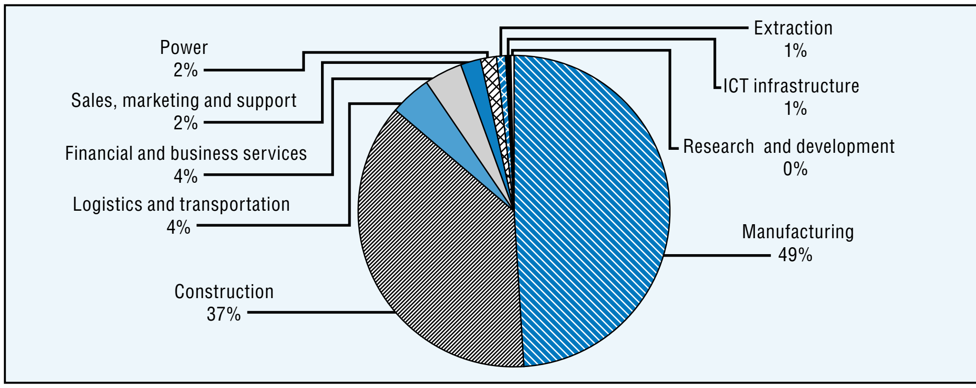
Figure 5.10. **Intra-ASEAN greenfield investment by sector, 2003-14**



Source: Authors' calculations based on the fDi Markets dataset (2015), www.fdimarkets.com/.
StatLink http://dx.doi.org/10.1787/888933310095

As for estimated job creation by the industrial sectors that received intra-ASEAN greenfield investment, the manufacturing and construction sectors dominate. More than 86% of new jobs were created in those two sectors (Figure 5.11).

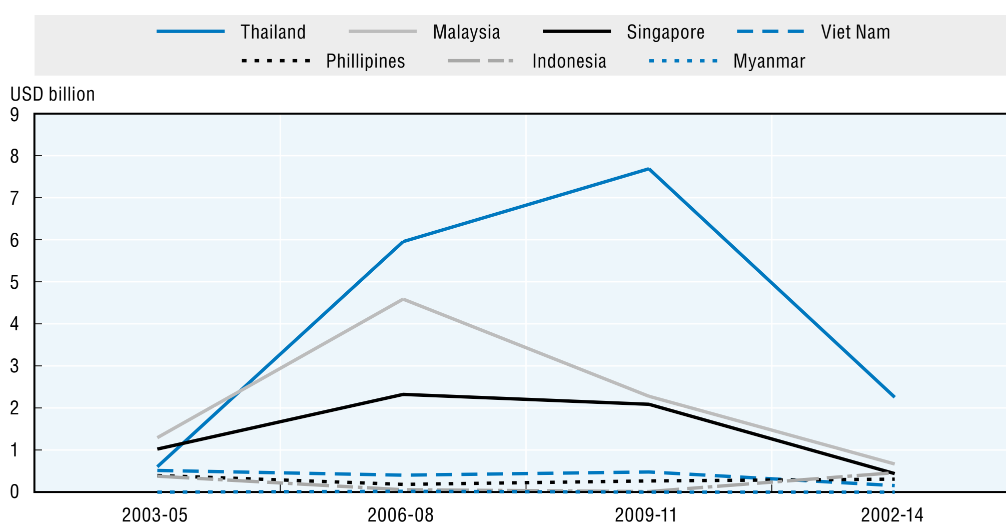
Figure 5.11. **Job creation by intra-ASEAN greenfield investment by sector, 2003-14**



Source: Authors' calculations based on the dataset of the fDi Markets (2015), www.fdimarkets.com/.
StatLink http://dx.doi.org/10.1787/888933310107

Intra-ASEAN investment in new manufacturing facilities has declined sharply after a sizeable jump in outflows from Thailand, Malaysia and Singapore. These three countries are leading investors in this important sector for development, but their contribution has declined significantly (Figure 5.12). Only Indonesia experienced a noticeable increase in greenfield investments in the manufacturing sector in the latest period (2012-14). The growth of manufacturing, which is a backbone of the economy and the centre of the business community, plays an important role in the development of a nation. ASEAN firms' declining within-region greenfield investments in the sector should be carefully investigated by policy makers.

Figure 5.12. **Intra-ASEAN aggregate greenfield investment in manufacturing, 2003-14**



Source: Authors' calculations based on the dataset of the fDi Markets (2015), www.fdimarkets.com/.
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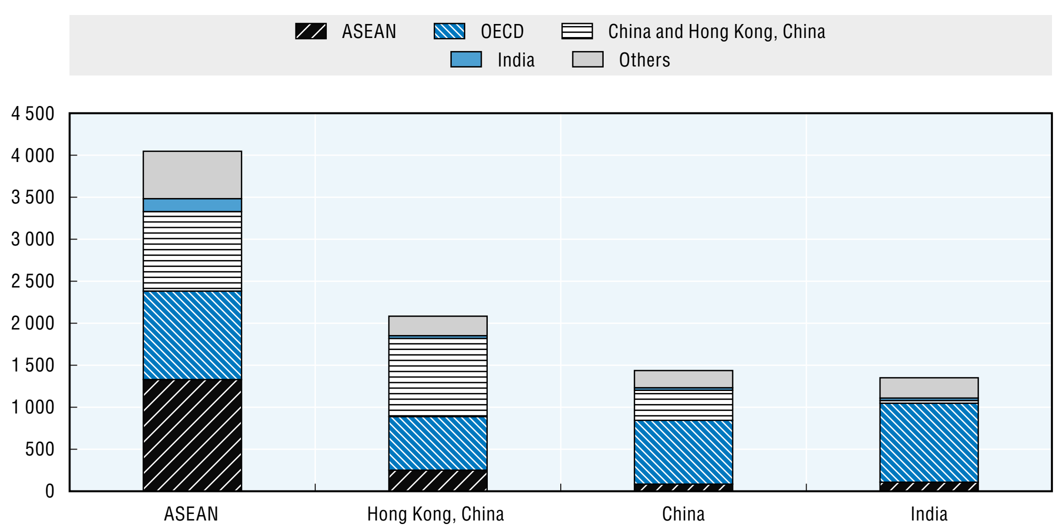
M&A present a mixed picture

Mergers and acquisitions are part of FDI and an important activity for business expansion or penetration into new markets and production bases, and allow the development of adequate governance over a business partner, or a competitor in exceptional cases (Cartwright and Schoenberg, 2006). M&A statistics are recorded as the total transaction amount of a particular deal at the closing time, although this amount is not necessarily paid out in a single year (UNCTAD, 2007). Figure 5.13, based on the M&A dataset for 2004-13 provided by Thomson Reuters (2014), illustrates the number of M&A deals among ASEAN countries; Hong Kong, China; China; and India. As an M&A investor, ASEAN is larger than the other countries (Hong Kong, China; China; and India). While intra-ASEAN investments make up the biggest part of M&A, ASEAN countries show balanced M&A investments to various regions of the world. ASEAN's other major M&A destinations include the OECD; China; and Hong Kong, China. Hong Kong, China is particularly active in the Chinese M&A market. The M&A activities of both China and India are relatively small given the large size of their economies, and the OECD countries are the largest M&A destination for both of them. In particular, more than two-thirds of India's M&A investment goes to OECD countries.

Figure 5.13. **Number of M&A deals by Emerging Asia, by destination country, 2004-13**

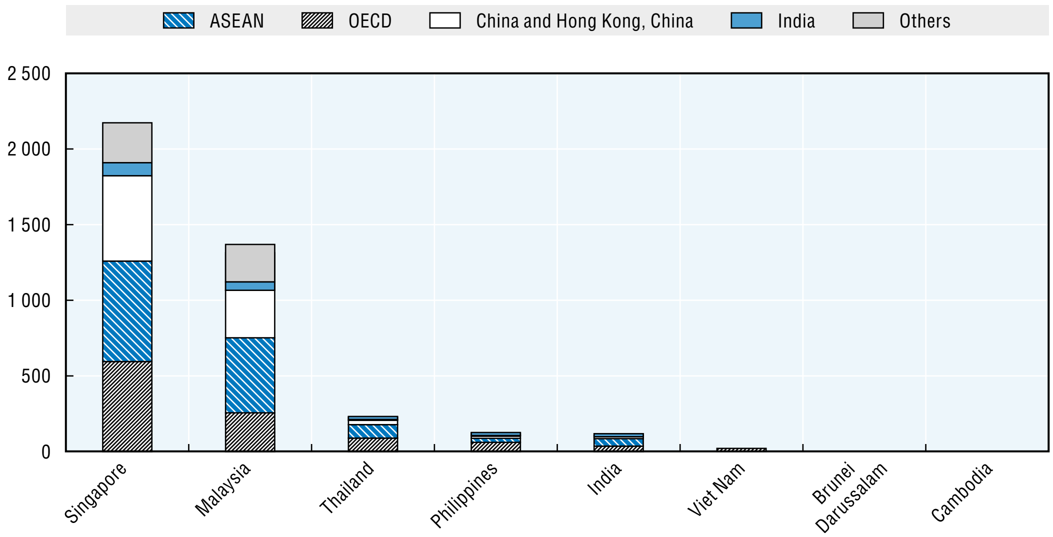


Source: Authors' calculations based on the Thomson Reuters M&A database (2014), http://thomsonreuters.com/en/products-services/financial/company-data/deals-and-league-tables.html.

StatLink http://dx.doi.org/10.1787/888933310128

Figure 5.14 displays the number of M&A deals of individual ASEAN countries by destination. The major M&A destinations are ASEAN; the OECD; China; and Hong Kong, China. Singapore and Malaysia have dominated ASEAN's M&A investments for the past decade, with the majority flowing to ASEAN or OECD countries. Singapore and Malaysia have also made a large number of M&A deals in China and Hong Kong, China. The M&A activities of Thailand, the Philippines and Indonesia are relatively limited, while the activities of new ASEAN members such as Viet Nam, Brunei Darussalam and Cambodia are still at the minimum level.[3]

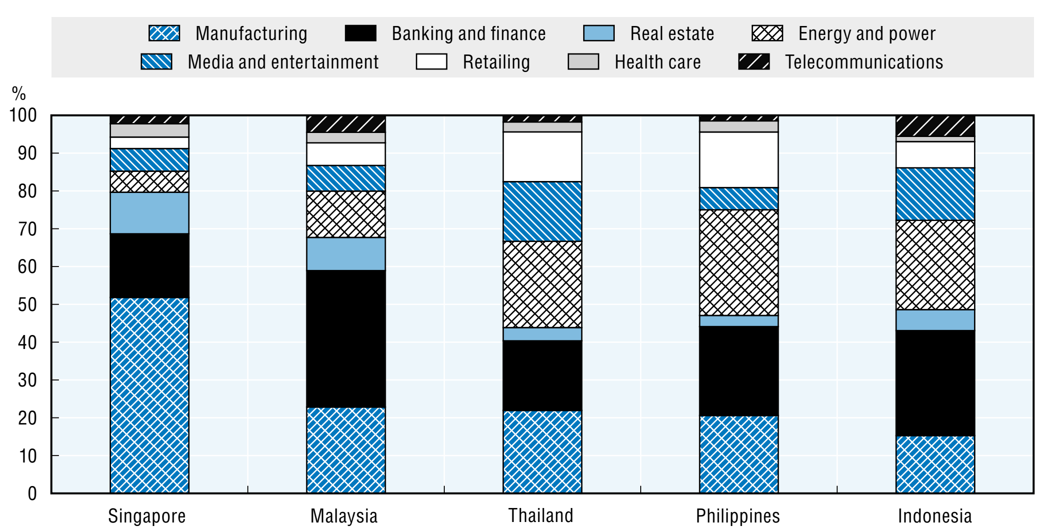
Figure 5.14. **Number of M&A deals by ASEAN countries, by destination country, 2004-13**



Source: Authors' calculations based on the Thomson Reuters M&A database (2014) http://thomsonreuters.com/en/products-services/financial/company-data/deals-and-league-tables.html.
StatLink http://dx.doi.org/10.1787/888933310134

The number of M&A deals by sector made by the advanced ASEAN economies are presented in Figure 5.15. The deals have been conducted mainly in the manufacturing and services sectors. Manufacturing sub-sectors include industrial equipment, materials, high technology and consumer products. Banking and finance is the largest sub-sector of the services sector, followed by real estate, energy and power, media and entertainment, retailing, health care and telecommunications. Singapore, ASEAN's largest M&A player, conducted more than half of its M&A deals in the manufacturing sector, while the deals of Malaysia, ASEAN's second biggest M&A player, are predominantly in banking and finance. Singapore and Malaysia dominated M&A in real estate. Thailand, the Philippines and Indonesia are relatively active as M&A players in energy and power, media and entertainment, and retailing.

Figure 5.15. **Share of M&A deals by advanced ASEAN economies, by sector, 2004-13**



Source: Authors' calculations based on the Thomson Reuters M&A database (2014), http://thomsonreuters.com/en/products-services/financial/company-data/deals-and-league-tables.html.
StatLink http://dx.doi.org/10.1787/888933310148

Table 5.2 lists the 20 largest M&A investments in the manufacturing sector within ASEAN from 2004 to 2013. Large intra-ASEAN M&A deals, dominated by the advanced ASEAN economies, have been concluded in a variety of manufacturing sub-sectors, including food and beverage, consumer products, automobile components and materials. It is apparent that M&A activities for the manufacturing sector within ASEAN focus mainly on less-value-added sectors, while business integration has been gradually enhanced by those deals in the region.

Table 5.2. **Top 20 intra-ASEAN M&A investments in the manufacturing sector, 2004-13**

No.	Year	Home country	Host country	Industry	Acquirer	Target	Estimated investment (USD million)
1	2012	Thailand	Singapore	Food and beverage	Thai Beverage PCL	Fraser & Neave Ltd	2 643
2	2007	Singapore	Malaysia	Food and beverage	Wilmar International Ltd	PPB Oil Palms Bhd	1 222
3	2013	Singapore	Indonesia	Automobiles and components	Gallant Venture Ltd	Indomobil Sukses Internasional	1 155
4	2012	Thailand	Singapore	Metals and mining	PTT Mining Ltd	Sakari Resources Ltd	748
5	2013	Singapore	Indonesia	Automobiles and components	Gallant Venture Ltd	Indomobil Sukses Internasional	689
6	2007	Singapore	Indonesia	Paper and forest products	Investor Group	LonSum	517
7	2011	Thailand	Indonesia	Chemicals	SCG Chemicals Co Ltd	Chandra Asri Petrochemical	389
8	2007	Singapore	Malaysia	Food and beverage	Wilmar International Ltd	PGEO Group Sdn Bhd	319
9	2012	Singapore	Malaysia	Chemicals	Reliance Global Holdings Pte	BP Chemicals(Malaysia)Sdn Bhd	231
10	2010	Thailand	Malaysia	Containers and packaging	Investor Group	Malaya Glass Products Sdn Bhd	222
11	2010	Singapore	Indonesia	Food and beverage	Asia Pacific Breweries Ltd	Multi Bintang Indonesia Tbk PT	218
12	2004	Singapore	Malaysia	Food and beverage	PPB Group Bhd	FFM Bhd	204
13	2008	Thailand	Indonesia	Consumer products	Central Agromina PT	Charoen Pokphand Indonesia PT	203
14	2005	Philippines	Singapore	Food and beverage	NutriAsia Pacific Ltd	Del Monte Pacific Ltd	200
15	2012	Thailand	Indonesia	Metals and mining	Electricity Generating PCL	Manambang Muara Enim Coal Mine	197
16	2012	Indonesia	Viet Nam	Construction materials	Semen Gresik (Persero) Tbk PT	Thang Long Cement JSC	157
17	2012	Singapore	Malaysia	Health-care equipment and supplies	Aspion Sdn Bhd	Adventa Bhd	155
18	2011	Thailand	Indonesia	Construction materials	SCG Building Materials Co Ltd	Keramika Indonesia Assosiasi	154
19	2008	Thailand	Malaysia	Chemicals	PTT Chemical PCL	Cognis Oleochemicals(M)Sdn Bhd	152
20	2006	Philippines	Singapore	Food and beverage	NutriAsia Pacific Ltd	Del Monte Pacific Ltd	141

Source: Authors' calculations based on the Thomson Reuters M&A database (2014), http://thomsonreuters.com/en/products-services/financial/company-data/deals-and-league-tables.html.

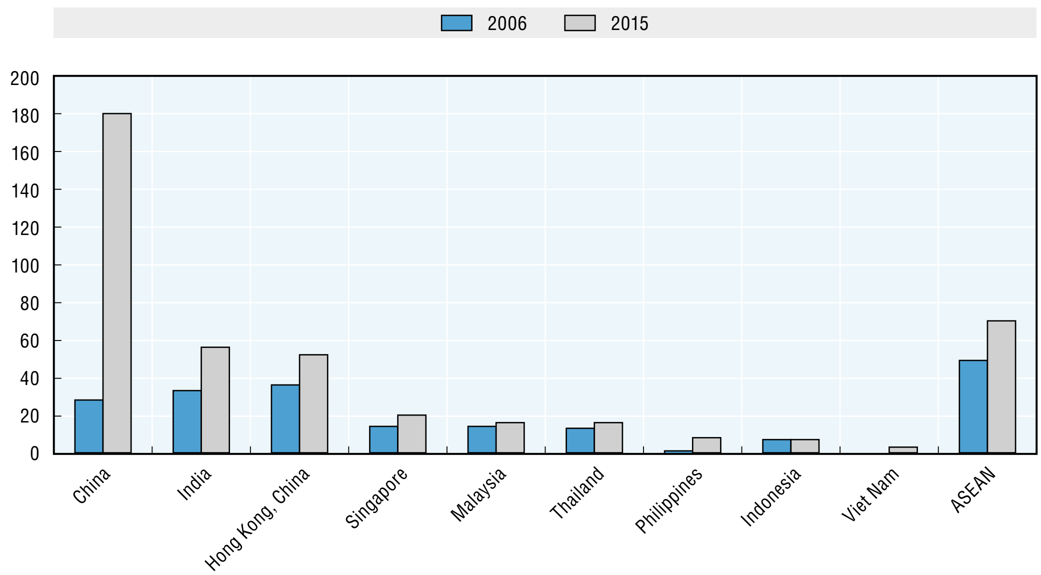
Corporate challenges

The rise of Emerging Asia's enterprises in the global economy

For the past decade, enterprises in Southeast Asia, China and India have played an increasingly significant role in the world economy. The Forbes Global 2000,[4] a global business ranking in terms of the size of firms, illustrates this trend. Figure 5.16 presents the number of large public enterprises in the ASEAN countries; China; India; and Hong Kong, China, as ranked in the Forbes Global 2000 in 2006 and 2015. The graph shows that the presence of the region's businesses in the world economy has increased significantly over the last decade. The number of enterprises in the region that ranked in the top 2000 global companies increased over the period from 146 to 358 (by 145%). China accounted for most of the progress, with the number of the global Chinese companies increasing more than six-fold – from 28 to 180 companies, a growth rate of 543%. Indian counterparts grew by 70% (from 33 to 56 companies), while those of ASEAN increased by 43%, from 49 to 70 companies. Hong Kong, China also exhibited an increase, from 36 to 52 companies (44%). In Southeast Asia, although advanced ASEAN economies dominate in the global company rankings, three Vietnamese firms entering the rankings for the first time in 2015.

Figure 5.16. **Global enterprises in Emerging Asia**

Number of large public enterprises listed in the Forbes 2000 rankings



Source: Authors' calculations based on the Forbes Global 2000 (2015), www.forbes.com/global2000/list/.

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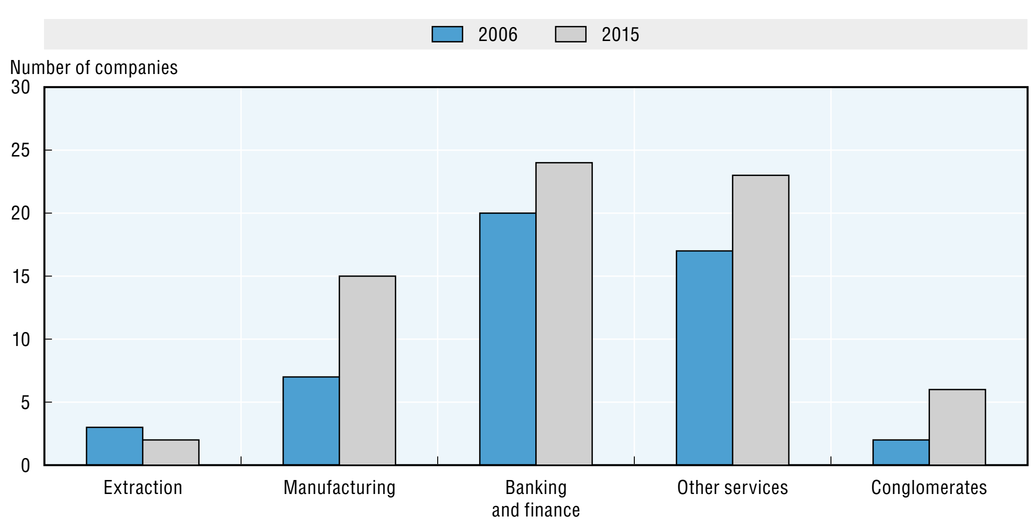
Figure 5.17 illustrates the distribution of global ASEAN companies by sector for 2006 and 2015, according to the Forbes Global 2000 rankings. The number of globally ranked ASEAN companies increased over the period in all sectors except the extraction industry. Among the 70 companies ranked in 2015, more than two-thirds are from the service sector; banks and financial institutes dominate, at 34.3%, while other services account for 32.9%. Although the number of manufacturing companies more than doubled from 2006 to 2015, the sector's share in 2015 is moderate, at 21.4%. Conglomerates represent 8.6% of the companies and are diversified in the manufacturing and service sectors. The extraction industry accounts for 2.9% of the companies in 2015.

Figure 5.17. **Sectoral distribution of global ASEAN companies**

Number of companies



Source: Authors' calculations based on the Forbes Global 2000 (2015), www.forbes.com/global2000/list/.

StatLink http://dx.doi.org/10.1787/888933310165

A willingness to expand investments in Southeast Asia

Although various international indices, such as World Bank's Ease of Doing Business Rank (World Bank, 2015) and World Economic Forum's Global Innovation Index (WEF, 2014) can provide data on the fundamental conditions of business operations in ASEAN countries, they lack detailed information for identifying the specific measures and actions taken by businesses in the region. With this in mind, it is interesting to review five industrial surveys conducted within ASEAN. The first three surveys were conducted in 2009, 2012 and 2014-15, by the Japan External Trade Organisation (JETRO). The fourth was conducted in 2012 by the United Nations Economic and Social Commission for Asia and the Pacific (ESCAP) and the Fiscal Policy Research Institute (FPRI) of Thailand. The fifth was conducted across ASEAN in 2014 by the American Chamber of Commerce (AmCham) Singapore with the US Chamber of Commerce and other AmChams in the region.

The first survey interviewed 103 Japanese investors and local enterprises, mainly in the manufacturing sectors, with operations in the CLMV countries (Cambodia, Lao PDR, Myanmar and Viet Nam) and Thailand. The aim was to identify corporate strategies and challenges in cross-border operations (JETRO, 2009). The second survey was conducted with 240 firms as a follow-up to the first and aimed to identify the major changes since 2009 in corporate strategies and challenges, including the quality of infrastructure and related policies and regulations (JETRO, 2012). In the third survey, conducted in 2014 and 2015, 116 ASEAN and Japanese companies operating in the CLMV countries and Thailand were interviewed about the management of their regional value chains (JETRO, 2015). The fourth survey, conducted by ESCAP and FPRI, looked into the specific strategies and challenges of selected industries in the CLMV countries – agri-business, automobiles, electronics, garments and apparel, and tourism – to complement the results of the first two JETRO surveys. In-depth interviews were conducted with 58 industrial agencies, business associations and enterprises in CLMV and Thailand (FPRI, 2012). The fifth survey was conducted by AmCham in 2014 and involved 588 executives representing American companies throughout ASEAN (AmCham, 2015). The first four surveys adopted the semi-structured interview method, while the AmCham survey used an Internet-based self-administered questionnaire, although some interviewees participated through telephone interviews and questionnaires. The five industrial surveys delivered the following major findings:

- A majority of the firms surveyed have expanded or intend to expand their operations in ASEAN through, for example, greenfield investment in new factories and upgrading of existing facilities.
- The motives for investment in ASEAN are: *i)* to seek greater access to the market; *ii)* to secure key factor inputs such as labour; and *iii)* to reduce operational costs through the pro-business policy framework in the host country.
- Investors tried to reap benefits from various free trade agreements, such as the ASEAN Free Trade Agreement (AFTA) and the ASEAN+6 framework, by sourcing parts and components from other ASEAN members and ASEAN+6 partners. Different manufacturing processes can be shifted from one country to another. For example, a firm in Thailand brings materials to Cambodia to be processed in a factory in the country and transports those processed products back to Thailand to finish the process.

- Similarly, business has increasingly moved to adopt a regional production-sharing strategy, that is, "the break-up of a production process into vertically separated stages carried out in two or more countries" (Athukorala and Menon, 2010). This strategy is to manufacture complex components and subassemblies in a central location (such as Malaysia, Singapore, Thailand or Viet Nam); to use lower-tier parts suppliers from low-cost countries in the region (e.g. Cambodia, Lao PDR or Myanmar); to distribute these components and subassemblies to the central location for integration; and to ship those intermediate products to final assembly plants.
- The Cross-Border Transport Facilitation Agreement (CBTA) (see Box 5.2) has significantly facilitated the movement of goods within CLMV. For example, trans-shipment between Thailand and Lao PDR has become unnecessary, saving time and reducing the risk of damage. Customs procedures were also improved significantly with the official introduction of e-customs and fast-track systems.
- Multinationals from outside ASEAN dominate the development of regional and global value chains, with a few exceptions.
- FDI to the ASEAN service sector increased rapidly from 2008 to 2013.

Box 5.2. **Facilitating cross-border transport**

To reduce the time and cost of cross-border land transport, the states of the Greater Mekong Subregion (GMS) – Cambodia, China, Lao PDR, Myanmar, Thailand and Viet Nam – have developed a Cross-Border Transport Facilitation Agreement (CBTA) with technical assistance from the Asian Development Bank (ADB). The agreement, ratified in December 2003 by the six member states, is designed to make it faster and easier for people, vehicles and goods to cross borders within the region and to eliminate intermediary stops and trans-shipment. The CBTA covers issues such as: harmonising and simplifying border/customs procedures and documentation; reducing obstacles for people crossing borders; easing and harmonising restrictions on goods crossing borders; and other measures (ADB, 2011).

However, the CBTA and its related bilateral and trilateral memorandums of understanding (MoUs) have been criticised for not making expected contributions to regional economic integration. The GMS countries have been asked for more pragmatic measures and actions, including single-window and single-stop customs inspections, mutual recognition of driver's licences and standardised vehicle registration (JETRO, 2015). Other suggestions include proper operations in accordance with the CBTA and MoUs, and dissemination of information on new regulations and operations pertaining to the CBTA.

Obstacles to regional integration persist

While these results indicate major improvements in the cross-border business environment, the five surveys also highlight a number of obstacles to the growth of cross-border production linkages within ASEAN. Those obstacles involve: trade liberalisation; trade and logistics facilitation; infrastructure; policy and the regulatory framework; and labour market (Table 5.3).

Table 5.3. **Obstacles to economic integration in ASEAN**

Trade liberalisation	• Different and stringent rules of origin across various free trade agreements (e.g. ASEAN-India FTA) • Different Harmonised System (HS) classifications among FTAs (even at the 6-digit level) and HS revisions • Differences in classification and understanding of the HS code among customs bureaus • Insufficient tariff reduction, including when caused by "reciprocity" among FTAs (ASEAN Trade in Goods Agreement [ATIGA] and ASEAN-China) • Lack of information on ongoing FTA implementation and negotiations • Required specific documentation (certificates of origin)
Trade and logistics facilitation	• Insufficient simplification and harmonisation in customs clearance systems • Time-consuming trade licensing • Original documents required at customs • Unofficial fees at customs • Higher import duties due to misclassification of the HS code and lack of transparent ruling systems • Low utilisation of ICT-based customs systems, particularly at the provincial level • High logistics costs of cross-border shipments due to monopolistic and limited logistics services • Lack of single-stop inspection at the borders • Inconvenient operation times at customs • Cumbersome procedures of certificate of origin (e.g. inspection in factories) • Insufficient deregulation of cross-border transportation (triple licence) • Trans-shipment at borders (Myanmar border; Cambodia-Thailand border) due to non-ratification/implementation of the CBTA • Increased number of permissions needed for cargo transportation • Lack of third-party international transport insurance • Inadequate customs and trans-shipment facilities • Inadequate linkage among logistical hubs (connecting routes, seaports and airports)
Infrastructure	• Poor road conditions and limited capacity and access • Instability and shortage of power supply • Insufficient water supply • Lack of railway networks (e.g. Bangkok-Phnom Penh-Ho Chi Min City railway) • Lack of adequate deep seaports and airports • Insufficient industrial estates, particularly in the border areas • Underdeveloped communication facilities (e.g. Internet access and speed)
Policy and regulatory framework	• Unfavourable investment law and land acts for FDI • Stringent regulations and cumbersome procedures • Frequently changing legislation and lack of consultation with the private sector • Lack of transparent policy decisions • High and complicated registration fees and taxes (e.g. the automotive sector in Viet Nam) • Inadequate protection of intellectual property rights (e.g. patents and trademarks) • Weak supporting industry and lack of policies for industrial development (poor SME cluster development) • Underdeveloped legal system and poor legal enforcement • High cost of foreign currency remittance • Corruption in public offices
Labour markets	• Increasing labour costs (e.g. Thailand and Viet Nam) • Shortage of skilled labour (e.g. engineers and technicians) • Low labour productivity • Low quality of national education systems, particularly lack of technical and engineering education (such as secondary vocational education)

Source: Compiled by the authors based on AmCham (2015), FPRI (2012), JETRO (2009; 2012; 2015), and interviews with the manufacturing sector in CLMV countries and Thailand.

The next step: An enabling business environment

The enterprises of Emerging Asia are increasingly present in the world economy, and the region has witnessed the important role that SMEs can play in economic development. FDI inflows to the region have grown steadily despite a brief slump during the global financial crisis. However, greenfield investments have declined for the past decade, in particular in the manufacturing sector, and M&A investments have mainly been limited to less-value-added sectors. More worrisome, such investments have been diverted from ASEAN to OECD countries and China. The ASEAN Economic Community is expected to enhance cross-border production linkages further by eliminating barriers and obstacles to trade and investment flows and local businesses must be ready for the coming changes; at the same time, they can also take advantage of the changes and expand their operations across ASEAN, transforming to be real regional entities: "ASEAN enterprises".

While the results of the business surveys indicate major improvements in the cross-border business environment, they also indicate a number of obstacles to the growth of international production linkages for firms in ASEAN. These include external barriers such as complex rules and procedures, poor infrastructure and logistics systems, and other non-tariff barriers. While ASEAN countries continue to work at eliminating these obstacles by progressing with the ASEAN integration plans, private firms could take the lead in overcoming internal barriers such as managerial mindset and organisational culture, information, financing and enterprise clusters.

A conservative mindset amongst local firms, particularly small and medium-sized enterprises (SMEs), results in a narrow focus on the domestic market. International markets are thought to be unnecessary. However with the onset of the AEC it is important for firms to expand their markets overseas as they face increased domestic competition. The benefits of outward expansion therefore have to be communicated more effectively. This could take the form of case studies on firms in various countries and sectors that have successfully entered international markets.

Local firms often lack access to information on market characteristics and potential customers. Moreover many small firms have limited ability to use existing data to develop business strategies. To address this problem the Vietnam Chamber of Commerce has developed the SME Market Exchange (SMARTEX) platform to disseminate the latest information on market demand and supply conditions. The platform also provides assistance to SMEs through a self-learning toolkit on accessing trade finance and an export readiness assessment. The Chambers of Commerce in the CLM countries particularly should develop similar platforms to assist their SMEs.

Firms in the region have limited interaction and linkages with other enterprises which restricts the development of enterprise clusters. These clusters are important in attracting international firms who generally prefer to deal with a group rather than individual small firms. Clusters can also increase productivity by providing access to specialised services such as support for meeting international standards, diffusion of learning and best practices on strategies to enter foreign markets and encourage differentiation and specialisation. Greater co-operation among local firms and between local and international firms is therefore required to enter into and upgrade within regional production networks and global value chains.

Annex 5.A1: Net exported and imported products by country in 2014

Rank: 1-6, from biggest to smallest

	Brunei Darussalam	% of export	Cambodia	% of export	Indonesia	% of export	Lao PDR	% of export	Malaysia	% of export
Net export 1	Mineral fuels, oils, distillation products, etc.	89.6	Articles of apparel, accessories, knit or crochet	49.6	Animal, vegetable fats and oils, cleavage products, etc.	11.9	Wood and articles of wood, wood charcoal	29.3	Mineral fuels, oils, distillation products, etc.	22.1
2	Organic chemicals	4.6	Articles of apparel, accessories, not knit or crochet	20.2	Mineral fuels, oils, distillation products, etc.	29.2	Copper and articles thereof	15.7	Animal, vegetable fats and oils, cleavage products, etc.	6.8
3	Musical instruments, parts and accessories	0.0	Footwear, gaiters and the like, parts thereof	9.5	Rubber and articles thereof	4.0	Ores, slag and ash	13.5	Electrical, electronic equipment	28.1
4	Pulp of wood, fibrous cellulosic material, waste etc.	0.0	Cereals	2.4	Pearls, precious stones, metals, coins, etc.	2.6	Articles of apparel, accessories, not knit or crochet	4.4	Wood and articles of wood, wood charcoal	1.9
5	Raw hides and skins (other than fur) and leather	0.0	Wood and articles of wood, wood charcoal	1.5	Footwear, gaiters and the like, parts thereof	2.3	Articles of apparel, accessories, knit or crochet	2.6	Rubber and articles thereof	3.0
6	Arms and ammunition, parts and accessories thereof	0.0	Edible vegetables and certain roots and tubers	0.8	Wood and articles of wood, wood charcoal	2.3	Coffee, tea, mate and spices	1.8	Furniture, lighting, signs, prefabricated buildings	1.2
Net import 6	Miscellaneous chemical products	0.0	Pearls, precious stones, metals, coins, etc.	0.1	Cereals	0.0	Meat and edible meat offal	0.0	Nickel and articles thereof	0.3
5	Articles of iron or steel	0.4	Cotton	0.0	Organic chemicals	1.8	Articles of iron or steel	0.2	Cereals	0.0
4	Electrical, electronic equipment	0.6	Vehicles other than railway, tramway	3.4	Plastics and articles thereof	1.5	Mineral fuels, oils, distillation products, etc.	14.9	Pearls, precious stones, metals, coins, etc.	1.2
3	Ships, boats and other floating structures	0.0	Machinery, nuclear reactors, boilers, etc.	0.2	Iron and steel	0.7	Machinery, nuclear reactors, boilers, etc.	0.1	Aircraft, spacecraft, and parts thereof	0.4
2	Vehicles other than railway, tramway	0.3	Mineral fuels, oils, distillation products, etc.	0.0	Electrical, electronic equipment	5.5	Vehicles other than railway, tramway	0.0	Vehicles other than railway, tramway	0.8
1	Machinery, nuclear reactors, boilers, etc.	1.2	Knitted or crocheted fabric	0.0	Machinery, nuclear reactors, boilers, etc.	3.4	Electrical, electronic equipment	4.3	Iron and steel	0.5

Annex 5.A1: Net exported and imported products by country in 2014 (*cont.*)

Rank: 1-6, from biggest to smallest

	Myanmar	% of export	Philippines	% of export	Singapore	% of export	Thailand	% of export	Viet Nam	% of export
Net export 1	Pearls, precious stones, metals, coins, etc.	52.0	Electrical, electronic equipment	37.4	Electrical, electronic equipment	30.5	Vehicles other than railway, tramway	11.4	Footwear, gaiters and the like, parts thereof	8.5
2	Mineral fuels, oils, distillation products, etc.	21.1	Wood and articles of wood, wood charcoal	5.0	Commodities not elsewhere specified	7.9	Rubber and articles thereof	6.3	Electrical, electronic equipment	28.7
3	Wood and articles of wood, wood charcoal	6.2	Ores, slag and ash	4.6	Organic chemicals	4.5	Machinery, nuclear reactors, boilers, etc.	17.0	Articles of apparel, accessories, not knit or crochet	7.2
4	Articles of apparel, accessories, not knit or crochet	5.4	Machinery, nuclear reactors, boilers, etc.	14.4	Plastics and articles thereof	4.0	Meat, fish and seafood food preparations	2.9	Articles of apparel, accessories, knit or crochet	5.9
5	Edible vegetables and certain roots and tubers	4.4	Optical, photo, technical, medical apparatus, etc.	3.7	Machinery, nuclear reactors, boilers, etc.	13.2	Plastics and articles thereof	5.9	Furniture, lighting, signs, prefabricated buildings	4.1
6	Ores, slag and ash	2.4	Edible fruit, nuts, peel of citrus fruit, melons	2.7	Optical, photo, technical, medical apparatus etc.	3.9	Cereals	2.5	Coffee, tea, mate and spices	2.8
Net import 6	Articles of iron or steel	0.0	Iron and steel	0.2	Salt, sulphur, earth, stone, plaster, lime and cement	0.0	Miscellaneous chemical products	0.4	Vehicles other than railway, tramway	1.1
5	Plastics and articles thereof	0.0	Cereals	0.0	Articles of iron or steel	0.8	Aircraft, spacecraft, and parts thereof	0.4	Meat and edible meat offal	0.0
4	Iron and steel	1.2	Plastics and articles thereof	1.0	Vehicles other than railway, tramway	1.0	Articles of iron or steel	1.8	Knitted or crocheted fabric	0.1
3	Vehicles other than railway, tramway	0.0	Vehicles other than railway, tramway	2.7	Iron and steel	0.6	Electrical, electronic equipment	13.5	Plastics and articles thereof	1.5
2	Electrical, electronic equipment	0.2	Aircraft, spacecraft, and parts thereof	0.4	Pearls, precious stones, metals, coins, etc.	2.0	Iron and steel	0.6	Machinery, nuclear reactors, boilers, etc.	8.2
1	Machinery, nuclear reactors, boilers, etc.	0.1	Mineral fuels, oils, distillation products, etc.	3.0	Mineral fuels, oils, distillation products, etc.	16.8	Mineral fuels, oils, distillation products, etc.	5.3	Iron and steel	1.0

Annex 5.A1: Net exported and imported products by country in 2014 (*cont.*)

Rank: 1-6, from biggest to smallest

	China	% of export	Hong Kong, China	% of export	India	% of export
Net export 1	Machinery, nuclear reactors, boilers, etc.	17.1	Articles of apparel, accessories, knit or crochet	2.0	Cereals	3.2
2	Electrical, electronic equipment	24.4	Machinery, nuclear reactors, boilers, etc.	13.2	Pharmaceutical products	3.7
3	Furniture, lighting, signs, prefabricated buildings	4.0	Articles of apparel, accessories, not knit or crochet	1.7	Vehicles other than railway, tramway	4.6
4	Articles of apparel, accessories, knit or crochet	3.9	Toys, games, sports requisites	1.5	Articles of apparel, accessories, not knit or crochet	2.9
5	Articles of apparel, accessories, not knit or crochet	3.5	Printed books, newspapers, pictures etc.	0.4	Cotton	2.8
6	Footwear, gaiters and the like, parts thereof	2.4	Special woven or tufted fabric, lace, tapestry etc.	0.2	Articles of apparel, accessories, knit or crochet	2.4
Net import 6	Optical, photo, technical, medical apparatus, etc.	3.2	Fish, crustaceans, molluscs, aquatic invertebrates	0.2	Commodities not elsewhere specified	0.3
5	Copper and articles thereof	0.3	Vehicles other than railway, tramway	0.3	Animal, vegetable fats and oils, cleavage products, etc.	0.3
4	Oil seed, oleagic fruits, grain, seed, fruit, etc.	0.1	Meat and edible meat offal	0.4	Machinery, nuclear reactors, boilers, etc.	4.3
3	Commodities not elsewhere specified	0.1	Mineral fuels, oils, distillation products, etc.	0.2	Pearls, precious stones, metals, coins, etc.	12.8
2	Ores, slag and ash	0.0	Pearls, precious stones, metals, coins, etc.	15.7	Electrical, electronic equipment	2.8
1	Mineral fuels, oils, distillation products, etc.	1.5	Electrical, electronic equipment	45.8	Mineral fuels, oils, distillation products, etc.	19.6

Note: the % of export refers to the share of product category in the total exports of corresponding countries in 2014; Product categories are ranked according to their size of net export or net import accordingly on a scale of 1 to 6 where 1 denotes the biggest net export/import and 6 denotes the smallest net export/import.
Source: Compiled by the authors based on the ITC (2015) Trade Map, www.trademap.org/.

Notes

1. The three components of FDI, as defined by UNCTAD (2007), comprise greenfield investment, mergers and acquisitions and intercompany loans. FDI flows tend to fluctuate widely, in particular for smaller countries. This is because the two dominant components of FDI, greenfield investment and M&A, vary significantly as those investments are linked to individual corporate strategies and actions, which are made based on the optimism of prospective investors in a dynamic business environment (Porter, 1985).
2. However, aggregate greenfield investment from OECD countries to ASEAN sharply increased from 2013 to 2014, by 41.9%. More long-term monitoring is required in this matter, as business investments fluctuate widely year by year at the national level.
3. No M&A deals were recorded by Lao PDR or Myanmar during the 2004-13 period.
4. The Forbes Global 2000 is an annual ranking of the 2 000 largest public companies in the world. Launched in 2003, it is based on four criteria: sales, profit, assets, and market value (Forbes, 2015).

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Chapter 6

Structural policy country notes

Structural reforms will be needed to improve the prospects for longer-term inclusive and sustainable growth in Emerging Asia. These structural policy country notes discuss important policy priorities related to the medium-term development plans in the ASEAN member countries, China and India. Priorities vary considerably across this diverse group of countries; although many countries focus on education and infrastructure, other policy areas to be addressed include rural development, social programmes, promoting FDI and taxation. The notes also highlight relevant experiences in OECD countries, providing useful insights and suggestions of best practices that may be valuable examples for policy makers in Emerging Asia.

ASEAN-5

Indonesia

A. Medium-term economic outlook (forecast, 2016-20 average)

GDP growth (percentage change):	5.5
Current account balance (% of GDP):	-1.5
Fiscal balance (% of GDP) (central government):	-2.3

B. Medium-term plan

Period: 2015-19

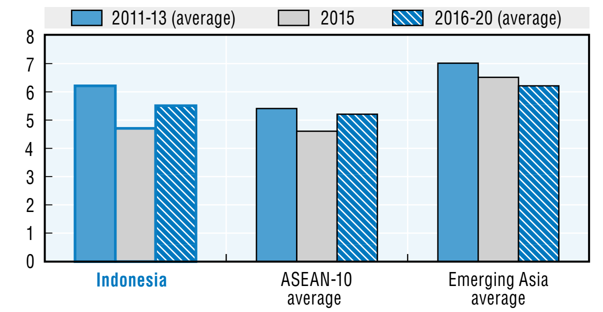
Theme: Realising an Indonesia as a sovereign nation, self-reliant and strong personality that is based on mutual co-operation.

C. Basic data (in 2014)

Total population:	252.2 million*
Population of DKI Jakarta:	10.08 million*
Nominal GDP (US dollar):	888.65 billion
GDP per capita at PPP:	10 651.34 (current International Dollar) **
Exchange rate in the first half of 2015 (period average):	12 966.22 (IDR/USD)

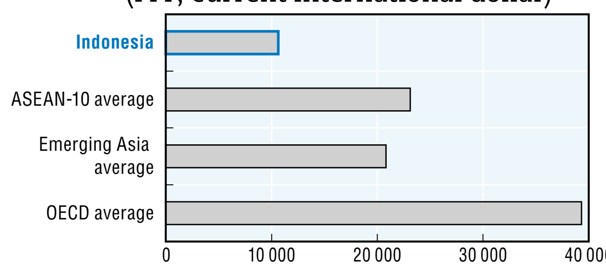
Note: * Total population data for 2014 are estimates.
** IMF estimate.
Sources: OECD Development Centre, MPF-2016, national sources, CEIC and IMF.

GDP growth rates (percentage change)



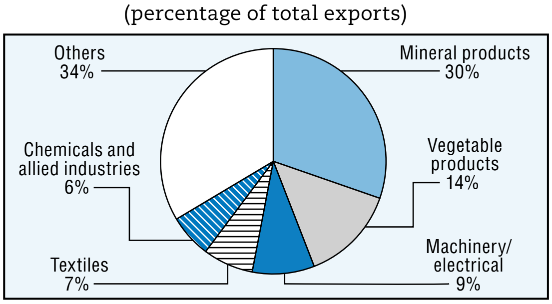
Source: OECD Development Centre, MPF-2016.

GDP per capita, 2014 (PPP, current international dollar)



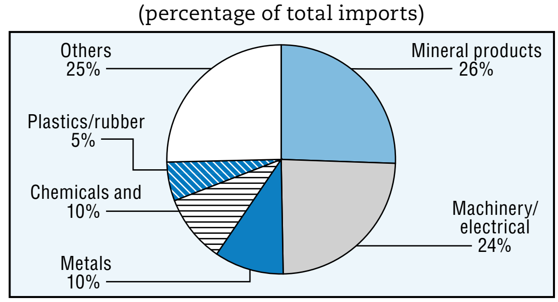
Source: IMF.

Composition of exports, 2014
(percentage of total exports)



Source: Trademap.

Composition of imports, 2014
(percentage of total imports)



Source: Trademap.

Indonesia has recorded impressive economic growth since the global financial crisis of 2008-09, although the rate of growth has slowed in recent years. In the second quarter of 2015, economic growth declined to 4.7%, the lowest level in the last five years. In addition, since 2011, the country's Gini index of income inequality has risen to the highest level in 50 years (OECD, 2015a). At the same time, the trade deficit has increased, especially in food and live animals, affecting food security. Given these problems, the Indonesian government has placed a priority on promoting economic growth and easing income inequality. Over the medium term, challenges faced by the country include improving maritime connectivity, reforming social security, reducing the trade deficit and enhancing food security.

Indonesia: Medium-term policy challenges and responses

- Improve infrastructure for maritime connectivity
- Reform the national social security system
- Improve food security

POLICY FOCUS

Improve infrastructure for maritime connectivity

Indonesia's new administration brings with it a new set of aspirations, one of which concerns maritime development. The initiative, which President Joko Widodo calls Pendulum Nusantara, or global maritime axis, postulates the full realisation of Indonesia's maritime power by utilising the potential offered by the country's position as an archipelago. The nation's strategic maritime positioning offers not just potential benefits, but also vulnerabilities including seaborne smuggling, illegal fishing and sea piracy. The new administration has started to acknowledge these problems and has embarked on several bold measures to tackle them. It is also trying to seize the potential offered by geography in order to ease the movement of goods along Indonesia's waterways. In this regard, the administration is giving much attention to infrastructure development of the maritime sector, especially in relation to connectivity.

Enhancing port capacity and connections with centres of growth

In order to boost maritime development, the government intends to initiate several maritime infrastructure projects, including inter-island sea toll roads; deep-sea ports; new waterways, ports, and terminals; and improvements to existing ports.

Another maritime project is the Tarahan Coal Port in South Sumatra. Opened in June 2015, the port can handle ships with a maximum capacity of 210 000 deadweight tonnage (DWT). With the new port, the authority hopes that it can attract bigger vessels and improve the efficiency of coal transport. The project marks a step forward in the government's keen efforts to promote investment in the port sector through public-private partnerships. The development of new ports and the improvement of existing ports are mandated under the National Ports Master Plan. One aim is to have 39 main ports in 2015, or 6 more than the country had in 2011 (Indonesia Ministry of Transport, 2013).

Improving port capacity, however, does not seem sufficient to boost the nation's productivity and trade. A matter yet to be solved is how to connect the existing ports and hubs to logistics networks and industrial zones. One example concerns the construction of Kalibaru Port, which is expected to be completed this year. Also known as the New Priok Port, the Kalibaru Port serves as an extension to the Tanjung Priok Port, but with a bigger capacity. The issue that sometimes escapes attention is that the new port is situated in North Jakarta, seven kilometres away from Tanjung Priok, meaning that it will keep using the same congested roads for transporting cargo out of the port.

In a broader perspective, the problem reflects Indonesia's unequal infrastructure development, with major ports concentrated in the western part of the archipelago. Approximately 94% of international container volume (exports and imports) and 85% of domestic container volume are handled through just five ports: Tanjung Priok, Tanjung Perak, Belawan, Tanjung Emas, and Panjang (OECD, 2012), all of which are located in Java and Sumatra. Not only are these ports already being used to full capacity – Tanjung Priok, Tanjung Perak, Belawan and Tanjung Emas are using 90% of their effective capacity (OECD, 2012) – but the connections to nearby industrial zones are also heavily congested.

Developing connectivity with international lines and the eastern regions

The five major ports dominate container throughput in Indonesia. In terms of international cargo (exports and imports), most containers are handled in Tanjung Priok and Tanjung Perak (Table 6.1.1).

Table 6.1.1. **Container volumes through Indonesia's top 10 ports in 2009**

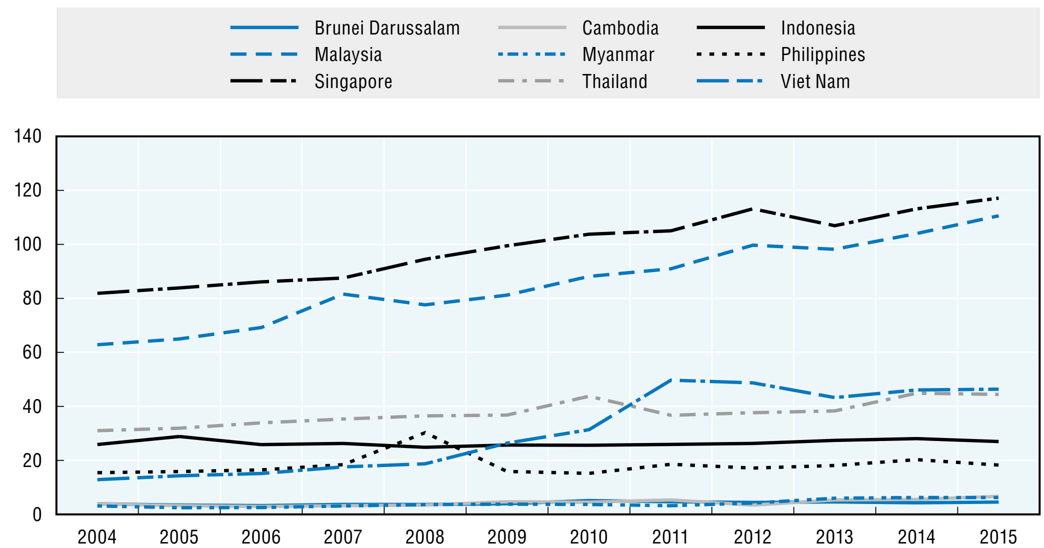
Thousand twenty-foot equivalent units (TEU)

	International			Domestic			
	Imports	Exports	Sub-total	Imports	Exports	Sub-total	Total
Tanjung Priok	1 605	1 485	3 090	328	505	833	3 923
Tanjung Perak	630	576	1 206	256	282	538	1 744
Belawan	302	309	611	180	98	278	889
Tanjung Emas	291	253	544	17	15	32	576
Panjang	137	139	276	14	11	25	301
Makassar	2		2	144	104	248	250
Banjarmasin			0	61	57	118	118
Pontianak			0	70	29	99	99
Samarinda	0		0	50	45	95	95
Pekanbaru	11	32	43	16	13	29	72

Source: OECD (2012), "Regulatory and competition issues in ports, rail and shipping", http://dx.doi.org/10.1787/9789264173637-9-en.

A significant volume of cargo recorded as domestic more likely concerns international shipments carried on domestic vessels to an international gateway (OECD, 2012). This implies that direct exposure to international routes and vessels is still limited, as vessels need to ship through foreign ports to perform exports. These limits on international connectivity are reflected in Indonesia's score in the Liner Shipping Connectivity Index (LSCI), which indicates how well connected a country's ports are to global shipping networks. Indonesia's level of connectivity has stayed mostly the same across the years (Figure 6.1.1).

Figure 6.1.1. **Liner Shipping Connectivity Index (LSCI) of Southeast Asian countries, 2004-15**



Note: No data for Lao PDR.
Source: UNCTAD (2015) *UNCTADstat*, http://unctadstat.unctad.org/.
StatLink http://dx.doi.org/10.1787/888933310177

The concentration of domestic and international shipments in the western regions and industrial zones means that the demands of maritime transport are not equally shared. Ships returning from other regions in Indonesia are mainly empty of cargo. In the eastern parts of the country, where other supporting infrastructure is also inadequate, conditions are even worse. As no means of transport exists for carrying a container, the cargo has to be broken down and carried in smaller trucks. Coupled with the fact that the eastern regions are composed of smaller islands, this makes shipments to the eastern parts of Indonesia costly and inefficient.

As part of a long-term plan to solve the problem of unequal maritime development across the country, the government has drafted a blueprint for a National Logistics System (*Sistem Logistik Nasional*/SISLOGNAS). One immediate aim is to establish Kuala Tanjung Port as the main international hub in the west and Bitung Port as the main international hub in the east. The blueprint also aims to establish short intra-island sea shipping routes (KP3EI, 2012).

Tackling administrative obstacles

The institutional and regulatory landscape is another aspect of infrastructure development that requires attention. In general, relatively complex regulatory requirements for imports have led to long dwell times. The dwell time in Tanjung Priok Port reached 6.09 days in May 2015, according to recent data (Tanjung Priok Customs Office, 2015). Lack of willingness to co-ordinate among the institutions that deal with paperwork apparently contributes significantly to the problem. Computerised and online administration of documents, long in the planning stages, is still not effective across all ports. One effort to ease the regulatory situation is through improvement of the Indonesia National Single Window, which is part of the larger ASEAN Single Window.

POLICY FOCUS

Reform the national social security system

Two laws represent milestones in the government's effort to provide Indonesian society with comprehensive social protection: Law No. 40/2004 on the National Social Security System and Law No. 24/2011 on the Social Security Agency (BPJS). The agencies charged with implementing the new social security system are BPJS Health (BPJS Kesehatan), which officially began work on 1 January 2014, and BPJS Employment (BPJS Ketenagakerjaan), which began operating on 1 July 2015. BPJS Health aims to make health insurance coverage universal, while BPJS Employment aims to provide protection for workers throughout their working lives until retirement (OECD, 2015a).

Achieving universal health coverage

The government of Indonesia is seeking to achieve universal health coverage (UHC) by 2019, as specified in a presidential decree, and sees the expansion of social health insurance as an important mechanism for improving health financing. A new law on social security mandates all residents to join BPJS Health as the single carrier of health insurance.

The main challenge facing national health coverage is to deal with the informal sector. Based on a 2014 study on national health insurance by the Indonesian research institute LPEM, there is a problem with supply-side availability and insurance literacy for most Indonesians, especially those working in the informal sector. These obstacles lower the probability that they will register and pay into the scheme.

Table 6.1.2. **Membership of BPJS Health as of January 2015**

	Membership	Number
A	**Non-contributory member**	
	1 Ex-Jamkesmas	86 400 000
	2 Ex-Jamkesda	8 976 308
	Sub total	95 376 308
B	**Contributory member**	
	1 Formal workers	
	a. Public officials	11 577 254
	b. Military	
	c. Policeman	2 625 518
	d. State-owned enterprise employers	128 297
	e. Local state-owned enterprise employers	270 415
	f. Private employers	3 242 236
	g. Private employers (Ex-Jamsostek)	7 756 720
	2 Informal workers	9 877 935
	3 Non-labour forces	
	a. Pensioners (Ex-public officials)	4 409 808
	b. Veteran	429 782
	c. Independence pioneer	2 723
	d. Pensioners (Ex-private employers)	42 062
	e. Others	926
	Sub total	40 363 676
	Total	135 739 984

Source: BPJS Health.
Note: Jamkesmas, Jamkesda and Jamsostek are previous public insurance schemes.

The latest figures released by BPJS Health show that around 53% of the population has been registered in its programme. Most (72.6%) are non-contributory members financed by the national government (*ex-Jamkesmas*) or local government (*ex-Jamkesda*). As noted above, the main challenge facing the national health insurance initiative is how to deal with the informal sector. Beyond the problem of expanding membership, the government faces a serious financial problem, according to a 2015 joint study by LPEM and FEB UI, the University of Indonesia's faculty of business and economics. The claim ratio of self-enrolled members is more than 645%. This high claim ratio is due to the unsustainability of payments by self-enrolled members, who might typically register with BPJS only once they fall ill and might stop paying premiums when they do not use the health services. Another problem is insurance literacy. Most self-enrolled members lack knowledge about the services provided by BPJS Health. In addition, most of these members register directly with a BPJS office, which is very costly for households in remote areas or with limited access to the offices.

Therefore, it is important for the government to promote insurance literacy by publicising the health insurance programme. In addition, the government could promote online registration, online payment and co-operation with local government authorities for registration and premium collection.

Promoting social security for workers

Social security for Indonesia's workers, managed by BPJS Employment, includes accident benefits, death benefits, old-age benefits and pensions. Workers in the formal sector are the main priority for BPJS Employment at the moment. The programme is mandatory for companies, which face sanctions if they do not register their employees into the social security agency.

Based on the projections of BPJS Employment, workers in the formal sector numbered around 48.21 million in 2014 and will number 50.93 million in 2015, 53.72 million in 2016, 56.58 million in 2017, 59.50 million in 2018 and 62.47 million in 2019. On this basis, BPJS Health estimates that around 23.69 million formal workers (conservative assumption) would have registered in the social security net by the end of 2014, and that this number will increase to 29.85 million in 2015, 36.20 million in 2016, 42.73 million in 2017, 49.46 million in 2018 and 56.43 million in 2019. The expansion of membership is targeted to reach at least 1.3 million new informal-sector participants in 2015, 1.9 million in 2016, 2.5 million in 2017, 3 million in 2018 and at least 3.5 million in 2019.

Table 6.1.3. **BPJS Employment membership targets**

(million people)

Year	Projected number of formal-sector workers	Membership target for formal-sector workers	Membership target for informal-sector workers
2014	48.21	23.69	n.a.
2015	50.93	29.85	1.3
2016	53.72	36.20	1.9
2017	56.58	42.73	2.5
2018	59.50	49.46	3.0
2019	62.47	56.43	3.5

Source: Bappenas.

The challenge for low and middle-income countries is to modify the way social security programmes are financed. Many of these countries are extremely dependent on out-of-pocket expenditures for financing social security. In Indonesia, BPJS Health faced a deficit of around IDR 3.4 trillion (Indonesian rupiahs) by November 2014, and the programme's need for government support will rise to around IDR 6.03 trillion by the end of December 2015.

A projection by LPEM FEB UI (2014) shows that this need will increase to around IDR 21.01 trillion by the end of 2020. The deficit of BPJS Health, mostly caused by the claim ratio of self-enrolled members, is expected to rise to more than 1 000%. Without significant reforms, BPJS Health will burden the government its efforts to reduce the deficit.

Another projection by LPEM FEB UI (2015) concerns the evolution of Indonesia's population from 2015 to 2100. It suggests that, starting from 2035, Indonesia will have an abundant number of working population and a low ratio of dependent population, a stage called demographic bonus. However, starting in 2050, the percentage of older people in Indonesia will outweigh the share of younger people. Beginning in 2075, according to the projection, the country will be experiencing negative population growth, with more deaths than births. The population structure of the country's formal workers is similar to the overall population structure.

Although Indonesia has been on the track toward achieving universal health coverage in 2019, the country currently seems far from meeting its UHC goals. In order to extend coverage to more people, Indonesia should campaign massively to increase insurance literacy through collaboration between BPJS Health and Otoritas Jasa Keuangan, the Indonesian financial services authority. Another option for supporting UHC would be to cut or reallocate fuel subsidies. Unlike the UHC programme, other social security programmes (worker accident benefits, death benefits, old-age benefits and pensions) face no financial issues. This is not just due to the demography dividend, but also because the migration of workers from the informal to the formal sector is increasing. Indonesia should prepare to deepen its financial sector so that it can accommodate the abundant accumulated reserve funds from this programme.

POLICY FOCUS

Improve food security

Given the high level of food imports, food security has improved significantly in Indonesia since the early 2000s. In 2012, agriculture accounted for around 14% of the country's gross domestic product and 35% of employment (OECD, 2015b). The prevalence of undernourishment of the population declined to 8.7% of the population in 2012-14, half the level of only a decade ago, according to estimates by the Food and Agriculture Organization. Further reductions should remain a policy priority.

The government enacted Law No. 18/2012 governing food security in an attempt to improve its approach. The law defines food security as the condition in which individuals in all households have sufficient food at all times, in both quantity and quality, to enable them to live healthy, active, productive and sustainable lives, and in which the food is safe, diverse, nutritious, equitably distributed and affordable, and does not conflict with religion, beliefs or culture. The law aims to strengthen the principles of food sovereignty and food self-reliance in ensuring food security by giving priority to domestic production of staples. Self-sufficiency targets exist for five key staples: rice, maize, soybeans, sugar and beef. The new Indonesian government has revised the timeframe for achieving self-sufficiency to 2017 for rice, maize and soybeans, and to 2019 for beef and sugar.

A national plan gives priority to improving food security

The National Medium-Term Development Plan 2015-2019 lists five strategies relating to food sovereignty: *i)* increase food availability by enhancing domestic production of key crops including rice, maize, soybean, meat, sugar, chilli and onion; *ii)* improve the quality of food distribution and the accessibility of food; *iii)* improve the overall quality and nutritional value of the Indonesian diet; *iv)* protect food security through preparedness for natural disasters, mitigating the impact of climate change, and preventing pest infections and the spread of diseases in animals; *v)* improve the livelihoods and welfare of famers, fishermen and other food producers.

In order to attain these targets, the new government intends to develop and improve the irrigation system and reduce land conversion by 600 000 hectares. In addition, the government intends to rehabilitate 1.75 million hectares of deteriorating irrigation infrastructure and establish 132 000 hectares of swamp irrigation networks in order to balance economic, environmental and sustainability concerns.

The government of Indonesia, in collaboration with the World Food Programme, publishes a Food Security and Vulnerability Atlas (FSVA), the latest edition of which was released in 2015. The FSVA analyses nine indicators of chronic food and nutrition insecurity: i) vulnerability to food; ii) nutrition insecurity; iii) food availability; iv) access to food; v) food utilisation; vi) nutrition; vii) health outcomes; viii) climatic factors; and ix) environmental factors affecting food security. The latest analysis indicates that food and nutrition security in Indonesia improved between 2009 and 2015. Indicators showed that 67% of districts had better food availability, 96% had less poverty, 95% had more access to electricity, 61% had better road access, 44% had improved access to clean water, 94% had improved access to health facilities, 91% had greater literacy among women and 96% had longer life expectancy.

Although the improvements are encouraging, more will need to be done to improve access to food, including through continued investments in infrastructure; accelerate efforts to prevent and reduce malnutrition; and address the increasing vulnerability to climate-related hazards.

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Key government ministries in Indonesia

President	Joko Widodo
Co-ordinating Minister for human development and culture	Puan Maharani
Co-ordinating Minister for maritime affairs	Rizal Ramli
Co-ordinating Minister for political, legal and security affairs	Luhut Panjaitan
Co-ordinating Minister for economic affairs	Darmin Nasution
Administrative and bureaucratic reform	Yuddy Chrisnandi
Agrarian affairs and spatial planning (National Land Agency)	Ferry Mursyidan Baldan
Agriculture	Amran Sulaiman
Communication and informatics	Rudiantara
Cooperatives and SMEs	Anak Puspayoga
Tourism	Arief Yahya
Defence	Ryamizard Ryacudu
Education	Anies Baswedan
Energy and mineral resources	Sudirman Said
Environment and forestry	Siti Nurbaya Bakar
Female empowerment and child protection	Yohana Susana Yembise
Finance	Bambang Brodjonegoro
Foreign affairs	Retno Marsudi
Health	Nila Moeloek
Home affairs	Tjahjo Kumolo
Industry	Saleh Husin
Law and human rights	Yasonna Laoly
Manpower	Hanif Dhakiri
Marine affairs and fisheries	Susi Pudjiastuti
National development planning	Sofyan Djalil
Public works and public housing	Basuki Hadimuljono
Religious affairs	Lukman Hakim Saifuddin
Research, technology and higher education	Muhammad Nasir
Social affairs	Khofifah Indar Parawansa
State-owned enterprises	Rini Soemarno
State secretariat	Pratikno
Trade	Thomas Lembong
Transport	Ignatius Jonan
Village, disadvantaged regions and transmigration	Marwan Jafar
Youth and sports affairs	Imam Nahrawi
Central Bank Governor	Agus Martowardojo

Note: Valid as of 31 October 2015.

Malaysia

A. Medium-term economic outlook (forecast, 2016-20 average)

GDP growth (percentage change):	5.0
Current account balance (% of GDP):	3.4
Fiscal balance (% of GDP) (central government):	-3.3

B. Medium-term plan

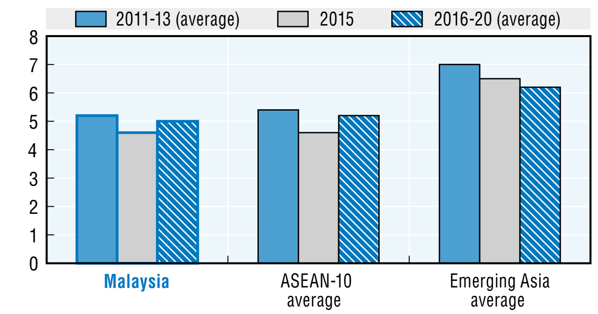
Period:	2011-15
Theme:	Charting development towards a high-income nation.

C. Basic data (in 2014)

Total population:	29.9 million (in 2013)*
Population of Kuala Lumpur	1.72 million (in 2013)*
Nominal GDP (US dollar):	338.11 billion
GDP per capita at PPP:	25 145.35 (current International Dollar) **
Exchange rate in the first half of 2015 (period average):	3.64 (MYR/USD)

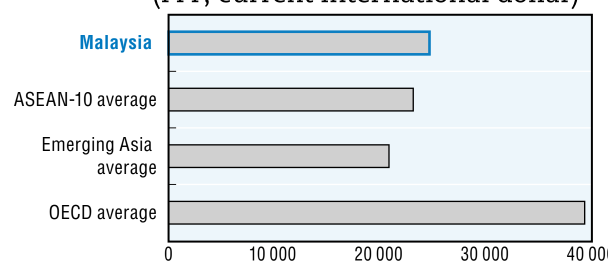
Note: * Population data for 2013 are estimates.
** IMF estimate.
Sources: OECD Development Centre, MPF-2016, national sources, CEIC and IMF.

GDP growth rates (percentage change)



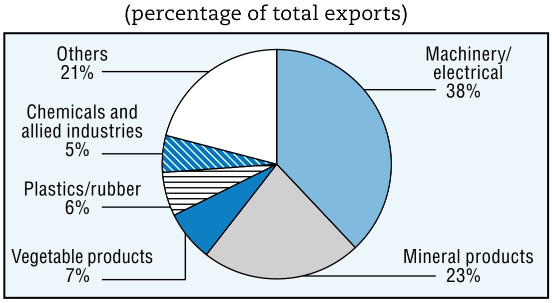
Source: OECD Development Centre, MPF-2016.

GDP per capita, 2014
(PPP, current international dollar)



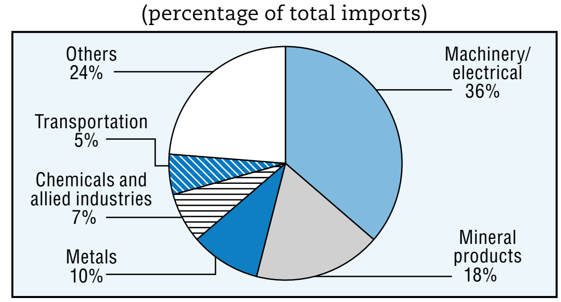
Source: IMF.

Composition of exports, 2014
(percentage of total exports)



Source: Trademap.

Composition of imports, 2014
(percentage of total imports)



Source: Trademap.

Malaysia, which has the third-highest level of gross domestic product (GDP) per capita among ASEAN member countries, continues to have good growth prospects and aims to become a high-income country by 2020. The government has initiated several efforts to achieve this target; however, some structural issues remain to be addressed. Chief among them are *i)* increasing productivity by enhancing the capacity of small and medium-sized enterprises (SMEs), which strongly contribute to employment; *ii)* improving the quality of education both to improve the overall quality of human capital and to provide the highly skilled labour required by value-added industries (both of which also contribute to greater productivity); and *iii)* promoting sustainable developments, or green growth, especially in urban areas.

Malaysia: Medium-term policy challenges and responses

- Raising SME productivity
- Upgrading education to meet industry needs
- Promoting urban green growth

POLICY FOCUS

Raising SME productivity

Enhancing government programmes

Increasing productivity is key to achieving the goal of becoming a high-income nation by 2020. The Government of Malaysia has implemented numerous measures and programmes to enhance productivity through the Malaysia Productivity Corporation (MPC). Of particular focus are SMEs, which play an important role in the Malaysian economy. In 2004, the National SME Development Council (NSDC) was established as the highest body which formulates long-term strategies and policy direction for SME development and ensures more co-ordinated efforts and effective implementation of overall SME development programmes in the country. For more than a decade, the government has driven SME development in the country through the NSDC. The SME Corporation Malaysia (SME Corp) was established in 2009 as a central co-ordinating agency for SME development (Box 6.2.1).

Over the years, SME development in Malaysia has come a long way to become more holistic, not only looking at financing but other relevant issues. The holistic approach to SME development has brought positive results on SME performance and its contribution to the country's economy. Based on the new SME definition, introduced in 1 January 2014, SMEs constituted 98.5% of total business establishments and contributed to 35.9% of the GDP – increased from 29.6% in 2005, 65% of employment and 18% of total exports (SME Corp, 2015). Nevertheless, the contribution of Malaysian SMEs to the country's economy remains relatively small compared with that in advanced economies. The government, therefore, launched the *SME Masterplan 2012-2020* in 2012, aiming to have SME development in line with the country's target to become a high income country by 2020.

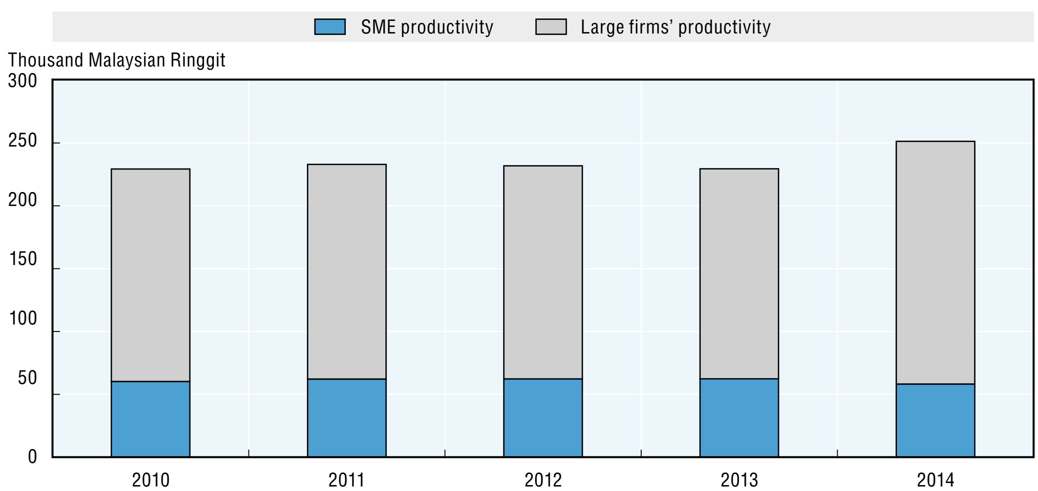
The Government of Malaysia has set the SME contribution targets of 41% of GDP, 65% of employment and 23% of exports by 2020. To achieve the targets, the Malaysian government, through the SME Masterplan, introduced a new SME development framework based on innovation-led and productivity-driven growth. Particular focuses are given to addressing major challenges in several areas including innovation and technology adoption, human capital development, access to financing, market access, legal and regulatory framework as well as infrastructure. Thirty-two initiatives have been included in the Masterplan, including six High Impact Programmes (HIPs).

By 2014, five of the Masterplan's HIPs had been implemented: *i)* integrates business registration and licensing to provide a single window for business registration; *ii)* provides a technology commercialisation platform; *iii)* the GoEx programme supports new exporter SMEs; *iv)* a catalyst programme includes capacity-building to assist SMEs to become world-class players; and *v)* inclusive innovation to empower the bottom

40% through innovation. However, achieving these targets will also require addressing several remaining challenges. SME growth needs to be encouraged further. One of the ways is by focusing on productivity and innovation-led growth. Malaysian SMEs have lower labour productivity compared to both large firms in the country and SMEs in other countries (Figure 6.2.1).

The SME Masterplan will continue to be the overarching policy for SME development under the 11th Malaysia Plan of 2016-2020, addressing persistent challenges, including productivity enhancement. In addition, in order to boost productivity, the Government of Malaysia provides incentives for SMEs to grow their businesses through the Services Sector Blueprint, as the services sector constitutes 90% of total SMEs. Examples include: i) the Services Sector Guarantee Scheme, which facilitates particularly services-sector SMEs to access financing from financial institutions; ii) the Services Export Fund, which encourages Malaysian Service Providers, including SMEs, to export and expand their business overseas; iii) the Business Accelerator Programme, which gives business and technical assistance and advice to SMEs to strengthen and enhance their businesses and improve their capacity, and facilitates their access to financing; and iv) the Soft Loan Scheme for Automation and Modernisation of SMEs.

Figure 6.2.1. **Productivity of SMEs and large firms in Malaysia 2010-14**



Source: Department of Statistics, Malaysia and SME Corp (2015), www.smecorp.gov.my/.
StatLink http://dx.doi.org/10.1787/888933310181

Improving SME training

Notwithstanding such efforts and initiatives, a lack of skills and knowledge remains a major impediment to growth for SMEs. In general, Malaysian SMEs find it expensive to hire professional, highly competent labours (Sin, 2010). Development of human capital is crucial to enhanced productivity and higher-level value-added activity.

To address this issue, the Government of Malaysia through various ministries and agencies related to SME development, including SME Corporation Malaysia, has provided and implemented various support programmes for the human capital development of SMEs. In 2014, a total of 35 programmes for human capital development amounting to MYR 73.9 million were implemented which had benefited more than 65 120 recipients. These include programmes by SME Corp. Malaysia such as: i) training and skills upgrading programmes, including technical and managerial skills, through a number of skills development centres; ii) a SME @ University programme, which provides learning opportunities for chief executive officers of SMEs, particularly in manufacturing, manufacturing-related services, agro-based industries, services, primary agriculture and information and communications technology (ICT) sectors; iii) a SME university internship programme, which links SMEs to universities to improve synergy between industry and tertiary education, particularly in business operation and management, production, financial management, marketing and application of ICT; and iv) a SME mentoring programme, which promotes the potentials of SMEs in the Halal food and beverages industry. These programmes could enhance the skills of the labour force. Improving technical and management skills is crucial for human resource development, while basic ICT skills are needed to encourage better and more widespread use of ICT and technology.

While hiring competent labour is expensive, utilisation of existing training programmes should be further maximised. Despite the numerous programmes provided by the government, SMEs are reluctant to send their employees. As mentioned in the *SME Masterplan 2012-2020*, they see training as a cost rather than an investment. The other issue is the difficulty in keeping highly competent employees once recruited and trained due to the perceived low remuneration and unattractive compensation packages offered. It is important to increase awareness by SMEs, especially top management, of the necessity and benefits of training programmes for their businesses.

Improving ICT literacy of SMEs

Human capital development is not the only factor affecting the productivity of SMEs. Improving capacity by investing in innovation and new technology is also crucial (OECD, 2015). Poor technology and low access to innovation is, in fact, another major challenge hampering the enhanced efficiency and productivity of SMEs. Better use of technology could improve productivity and create better quality products. One study found that Malaysian SMEs perceive limited access to research and development (R&D) infrastructure and better technology, especially ICT, to be major barriers (Saleh, Caputi and Harvie, 2008). According to the 2011 SME census, only 27% of SMEs used ICT in their business operation (SME Corp, 2011).

The government has provided supports for SMEs to enhance technology use and encourage innovation through various programmes implemented by the SME Corp. The 1-InnoCert certification programme, for example, is aimed at promoting and developing innovative companies by encouraging innovations, R&D and high tech. In 2010-12, 115 companies were certified, which fell to 86 in 2012-14. The country also recently created Unit Inovasi Khas, a Special Innovation Unit under the Prime Minister's Office with an objective to oversee an integrated innovation strategy and policy, as well as promote innovation in Malaysia, including assisting SMEs in innovating and introducing new technologies. To encourage businesses, especially micro enterprises, to adopt ICT, SME Corp. introduced the Enabling e-Payment for SMEs and Micro Enterprises, a project under the Digital Malaysia initiative aimed to increase the adoption of e-payment among SMEs. Due to the cost constraint and intricate process of e-payment, SMEs and micro enterprises are facing difficulties in acquiring e-payment capability. With this initiative, SMEs and micro enterprises are being enabled to accept e-payment via means of simplifying the acquisition process and lowering its cost. The project will also accelerate the adoption of e-Payment with the distribution of affordable Point-of-Sale (POS) terminals.

More targeted policies and programmes to improve ICT readiness and technology adoption are crucial to enhancing the productivity of SMEs. The ICT literacy of SMEs needs to improve in all categories of human resources. ICT literacy for SMEs' owners and top management is crucial to facilitate the adoption and integration of appropriate technology into the business. Employees need to be able to understand and operate new technology, while consumers need to be able to use the services provided by a company on the Internet, for instance. While providing workshops, training and courses could improve ICT literacy, course content needs to be tailored to participant type. Employee training, for instance, should focus on the technical skills required to operate ICT, while management training should focus more on the strategy for implementation. More intensive assistance, such as mentoring or consultancy programmes, could also guide SMEs in their choice of ICT, including what kind of technology they need and how to implement it.

Box 6.2.1. **SME Corporation Malaysia (SME Corp.)**

SME Corporation Malaysia (SME Corp. Malaysia), an agency under the Ministry of International Trade and Industry (MITI), is the Central Coordinating Agency (CCA) of SME and principal organisation for the development of progressive SMEs to enhance wealth creation and social well-being of the nation. Previously known as the Small and Medium Industries Development Corporation (SMIDEC), SME Corp. Malaysia's transformation materialised in 2009 when the National SME Development Council (NSDC), the highest policy-making body to chart the policy direction for SME development in the country, decided to appoint a single dedicated agency to formulate broad SME policies across all sectors and co-ordinate SME programmes by relevant ministries and agencies. SME Corp. Malaysia is also the secretariat for the Council, which is chaired by the Prime Minister with members from 16 ministries and key agencies. Apart from the establishment of SME Corp. Malaysia, other key milestones of the Council include:

- Adoption of a standard definition for SMEs in 2005. Effective 1 January 2014, a revised definition was adopted;
- Release of the SME Masterplan (2012-2020) to chart the policy direction of SMEs in order for Malaysia to achieve high income nation status by 2020;
- Establishment of a special SME unit in each of the ministries and agencies involved in SME development; and
- Strengthening of the financial and institutional framework as well as development of comprehensive database.

In addition to being the central point of reference for information and advisory services for all SMEs in Malaysia, SME Corp. Malaysia also promotes development of SMEs through the provision of business support programmes which focus on:

- Innovation and Technology Adoption:
  - Business Accelerator Programme (BAP);
  - Enrichment & Enhancement (E^2);
  - Green LED Programme; and
  - Enabling e-payment for MSMEs.

Box 6.2.1. **SME Corporation Malaysia (SME Corp.)** (*cont.*)

- Human Capital Development:
  - Skills Upgrading Programme;
  - SME @ University;
  - SME-University Internship Programme; and
  - SME Mentoring Programme.
- Access to Financing:
  - Shari'ah-compliant SME Financing Scheme;
  - Soft loan for SMEs; and
  - SME Emergency Fund.
- Market Access:
  - National Mark of Malaysian Brand; and
  - Branding and Packaging Mobile Gallery.
- Ratings and Accreditation:
  - SME Competitiveness Rating for Enhancement (SCORE) and Micro Enterprise Competitiveness Rating for Enhancement (M-CORE);
  - Enterprise 50; and
  - Innovation Certification for Enterprise Rating and Transformation (1-InnoCERT).

Source: SME Corp (2015), SME Corp official website, SME Corporation Malaysia, Kuala Lumpur, www.smecorp.gov.my/.

POLICY FOCUS

Upgrading education to meet industry needs

Higher skilled labour is also needed for high value-added and high-tech industries, which are particularly crucial to achieving the country's ambitious goal of becoming a high-income nation by 2020. Currently, 62% of Malaysian businesses are challenged to find highly skilled labour, according to the *Grant Thornton International Business Report*.

To upgrade education to meet industry needs, the Malaysian government has put some efforts on improvement of technical and vocational education and training (TVET), ensuring its effectiveness and efficiency. The Malaysian government projected that 60% of the 1.5 million jobs that will be created will require TVET related skills. The country will need to increase TVET annual intake from 164 000 in 2013 to 225 000 in 2020 to be able to meet this demand. Efforts have been taken to enhance TVET in secondary schools by rebranding its vocational schools into vocational colleges (VC). This includes the introduction of a new curriculum known as the Vocational College Standard Curriculum which is in compliance with the requirements of the National Occupational Skills Standard (NOSS) and the Malaysian Qualifications Agency (MQA) to ensure that skills acquired by VC graduates are recognised by industries and allow graduates to pursue their education both locally and abroad.

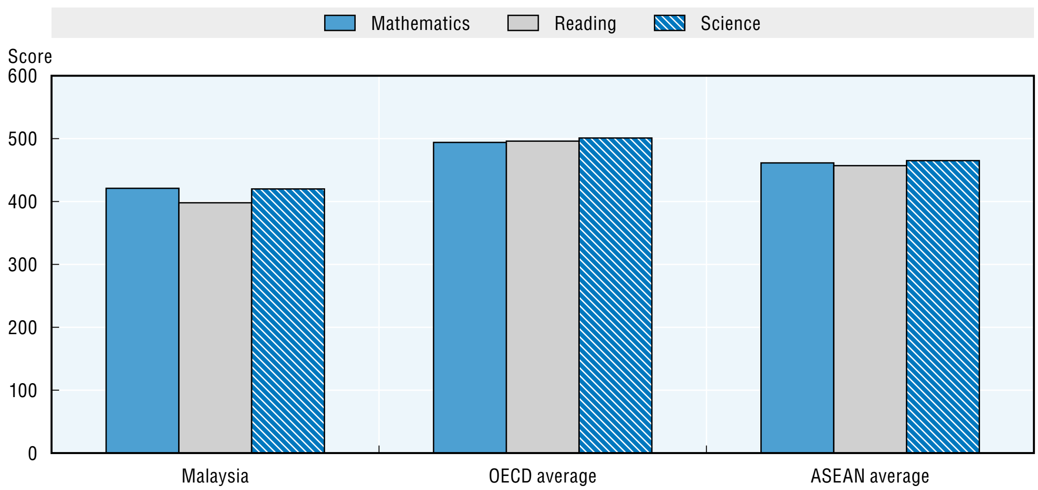
The 11th Malaysia Plan underlined the importance of ensuring that supply matches demand, and there are robust quality control mechanisms which ensure that all public and private institutions meet quality standards. Industry and TVET providers collaborate across the entire value chain from student recruitment through to curriculum design, delivery and job placement, and students are well informed on the opportunities that TVET can offer, view TVET as an attractive pathway and have access to a variety of innovative, industry-led programmes that better prepare them for the workplace. These initiatives require a harmonisation and streamlining of the current TVET system to reduce fragmentation across the various public and private TVET providers. Further efforts will be made to encourage industry-led interventions and programmes to ensure that supply meets the requirements, standards and skills of the industries.

Many aspects of Malaysia's education sector have shown improvement. In the 1950s, about 60% of the population aged 15 and above did not have access to formal education. Thanks to the government's commitment to improve the sector, access to primary education is now almost universal, with 98% enrolment rate in 2014. Initiatives to improve basic literacy, including Bahasa Melayu, English and numeracy, in the first three years of primary schooling, have been conducted through the Literacy and Numeracy Screening (LINUS) programme. Opportunities for students to pursue post-secondary and tertiary education have also increased.

The Malaysian government, taking into account the needs of the nation through an inclusive and participatory approach across all sectors, developed a comprehensive blueprint for the Malaysian education system, building on the foundations of policies developed during the early years of the nation's formation. The *Malaysia Education Blueprint 2013-2025* is built on five system aspirations – access, quality, equity, unity and efficiency, supported by 11 shifts that will provide a common platform for improvement in the common areas of concern agreed upon by stakeholders and the general public. It highlights some ambitious targets, including 100% enrolment of all children between pre-school and upper secondary by 2020; improved scores on international assessments, such as OECD's Programme for International Student Assessment (PISA); and a decrease in achievement gaps between urban and rural areas, among different socio-economic backgrounds and between genders.

While it is clear that Malaysia has shown significant improvement in providing access to education, the country needs to address the challenging goals of ensuring not only access but also equal and quality education. The government has introduced some measures, including initiatives on curriculum enhancement to promote Higher Order Thinking Skills (HOTs), the revamp of the national examinations and school-based assessments, and the strengthening of Science, Technology, Engineering and Mathematics (STEM) education. In addition, teachers in the low-performing schools are given support to ensure the written curriculum is accurately translated into classroom teaching through better teaching resources and an expanded School Improvement Specialist Coach (SISC+) and School Improvement Partner (SIP+) roles. Further strengthening the efforts is, however, necessary to accelerate quality improvements. PISA scores in mathematics, reading and science show Malaysia is still lagging compared to OECD member countries and ASEAN average (Figure 6.2.2).

Figure 6.2.2. **PISA scores in OECD member countries and Southeast Asian countries, 2012**



Note: ASEAN average includes Indonesia, Malaysia, Singapore, Thailand and Viet Nam.
Source: OECD (2012a), *OECD PISA 2012 Results: What Students Know and Can Do*, www.oecd.org/pisa/keyfindings/pisa-2012-results.htm.
StatLink http://dx.doi.org/10.1787/888933310193

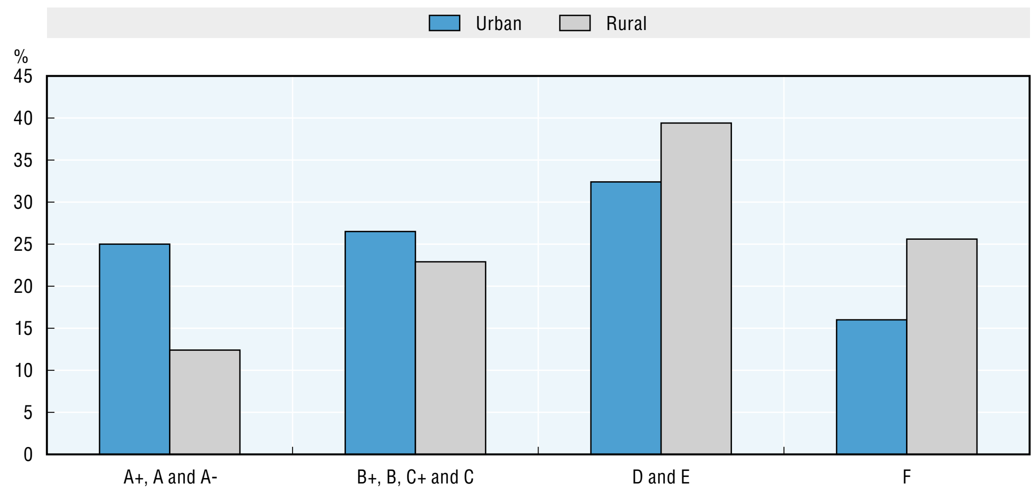
Improving equal access to quality education

Beyond measures to continue improving the quality of education, Malaysia needs to focus more attention on ensuring equal access to it. Access to secondary and tertiary education has shown some general improvements, in the last five years, despite the small increase in the percentage – upper secondary enrolment increased from 83.6% in 2013 to 86.4% in 2014. Equal access to quality education needs to be improved. Teacher quality also needs to be enhanced to support delivery of a higher quality of education.

National examination results show significant variations in performance and achievement among and within states (UNESCO, 2015). Although the urban-rural academic achievement gap narrowed from 2012 to 2014 by 11% in UPSR and 10% in the SPM examination, gaps in rural versus urban access to quality education remain a concern, as does access among students from different socio-economic backgrounds. Dropout rates also tend to be higher among children from less privileged backgrounds. Using education achievement, a 2015 study of education inequality in Sabah from 2009 to 2013 found that education inequality in rural areas is greater than in urban areas (Tan, Ho and Pang, 2015). The study also found that, despite a reduction in the level of inequality in urban and rural areas, the gap between the two demographics is increasing, due to the low improvement rate in rural schools. The 2013 Malaysian Certificate of Education (SPM) examination results from the Sabah State Education Department revealed the difference between urban and rural in percentage of A to F grades earned. Urban areas had a comparatively higher percentage of population earning A, B and C grades, while rural areas had a comparatively higher percentage earning D, E and F grades (Figure 6.2.3), although the gap has decreased from 2012 to 2014, in particular for UPSR examinations.

The majority of students leaving the education system before completing secondary education are from low-income households based on a household survey. In addition to the financial issues, lack of interest in school was mentioned as one of the reasons for their dropping out (Patel, 2014).

Figure 6.2.3. **Percentage of Malaysian population that has taken SPM examinations across grade levels, 2013**



Source: Tan, Ho and Pang (2015), "Education inequality: Become better or worse?", https://mpra.ub.uni-muenchen.de/61627/1/MPRA_paper_61627.pdf.

StatLink http://dx.doi.org/10.1787/888933310207

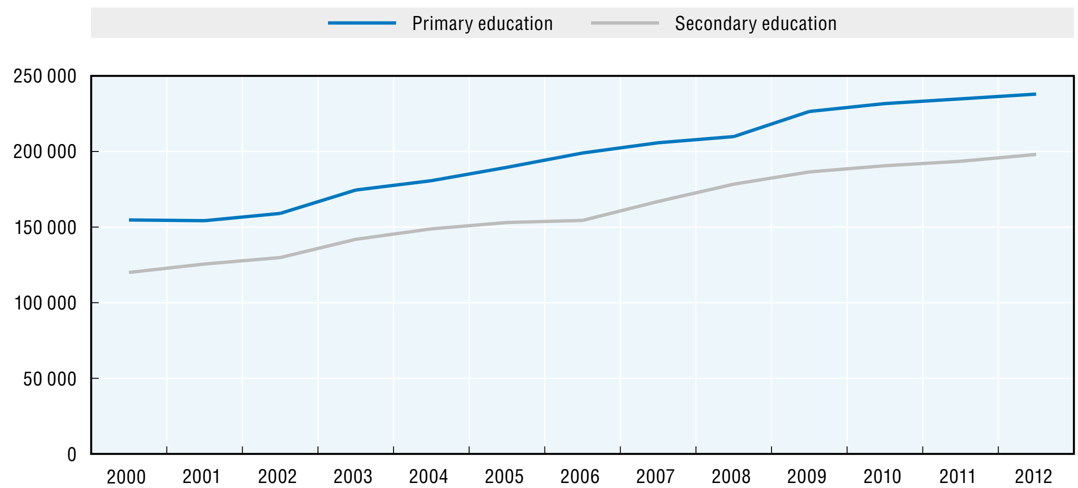
The Government of Malaysia has taken measures to narrow the education gaps between rural and urban populations and to increase access for marginalised groups, including poor and indigenous demographics. The government has invested in infrastructure, such as schools, in rural areas to improve access. While the number of primary schools is greater in rural areas than in urban (5 652 and 2 106 respectively, in 2014), the rural figure was up from 5 635 in 2012. Secondary schools also increased in number, from 1 158 in 2012 to 1 1956 in 2014 (MOE, 2014).

The Government of Malaysia has implemented programmes, such as the District Transformation Programme, *Orang Asli* Education Transformation Plan and Inclusive Education Programme, which also includes equal access to quality education that goes beyond gender, physical ability and social background. As reported in the Ministry of Education Malaysia Annual Report 2014, enrolment of *Orang Asli* students in primary education was 27 978 and at secondary level was 13 229, a 6% increase from 2012. Rural literacy rates have also improved. For instance, Sarawak, with one of the lowest rates, saw literacy increase from 72.1% in 2000 to 82.1% in 2010 (UNESCO, 2015). While it is crucial to further strengthen such programmes to increase access for the poor and marginalised, increasing access must be accompanied by monitoring achievement and drop-out rates, as well as quality assurance of rural schools. A comprehensive study on dropouts is also needed in order to identify the real issues and formulate and develop the right policy and initiatives to address the challenges.

Enhancing the quality of teachers

The number of teachers has increased over the years in Malaysia (Figure 6.2.4) and student-to-teacher ratio has decreased. The country has, therefore, a sufficient quantity of teachers. In fact, the high number of teachers has made education the country's largest sector in terms of total public service workforce (Jamil, 2014).

Figure 6.2.4. **Number of teachers in primary and secondary education in Malaysia, 2000-12**



Source: World Bank (2015), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

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Significant concerns remain, however, about the quality of teachers. Teacher quality is one of the most significant determinants of student outcomes and the quality of education. The OECD Teaching and Learning International Survey (TALIS) 2009 reported that 46% of principals who participated in the study thought that teaching staff at the primary level lacked qualification (i.e. pre-service teacher training). Greater efforts to enhance and ensure teacher quality are needed, over and above financial inducement to excellence. As it is, Malaysian teachers are relatively well paid. The ratio of teacher pay relative to GDP per capita is estimated at 3.9, while figures for OECD member countries range between 1.5 and 2.0 (UNESCO, 2013). To improve the recruitment process of teachers, the Institute of Teacher Education Malaysia (IPGM) has made some improvements to the selection procedure for candidates applying for the Bachelor in Education programme. Besides meeting the basic academic requirements such as excellent SPM results with at least 5 As, credits in Bahasa Melayu and history, pass in English test and excellent results in specific subjects, depending on the course chosen, since 2014 candidates must also undergo a special test known as *Ujian Kelayakan Calon Guru (UKCG)* that includes psychometric, attitude, and physical fitness tests. Those who pass this test will go to the interview session, the final stage of the selection process.

Policies and measures to enhance the quantity and quality of education have been introduced by the Malaysian government, including the initiative to raise the entry bar for teachers from 2013 to be among the top 30% of graduates. This is to ensure that only the best candidates will be recruited as teachers. The ministry will rigorously enforce entry standards to ensure that 100% of every teacher training intake meets the minimum academic requirement for the teacher training programmes in public and private higher education institutions. Additionally, the ministry will ensure that the quality of the curriculum and lecturers is upgraded to deliver the kind of teachers desired. The ministry will also introduce more stringent graduation requirements so that only the best trainees can graduate and be guaranteed placements in Malaysian schools. Notwithstanding, motivating high-performing teachers remains a challenge (Jamil, 2014). The attractiveness of the teaching profession needs boosting further. Good salary and working conditions are already attractive factors. Others, such as recruitment approaches, professional status, social recognition and public image, also affect the perceived attractiveness of a teaching career (IBF International Consulting, 2013).

The Malaysian government has implemented some efforts to address these issues and to improve the attractiveness of the teaching profession, which has led to an increase in applications received for the IPGM B.Ed. programme from 53 337 in 2014 to 69 530 applications in 2015. These efforts have also led to the teaching profession being highly valued in society, as perceived by teachers. The OECD TALIS 2013 reported that 83.8% of teachers believe that the teaching profession is valued in society. The report also mentioned that 97% of Malaysian teachers are satisfied with their job.

In Singapore teaching is a highly attractive profession. Besides offering good pay, professional development and training packages, and career opportunities with a highly selective recruitment process, the Singapore government also provides high-quality teacher training programmes for which tuition is covered by the Ministry of Education (MOE) and candidates receive a monthly stipend. Upon completion, teachers are obliged to teach for several years. The MOE also provides teaching scholarships for top students at both domestic and international universities, contingent upon a multi-year commitment to teaching. Teaching is equally attractive and popular in Korea, where a teaching career is accorded high prestige and social status due to the highly selective entrance, difficulty of obtaining a teaching certificate, high salary and job stability (MOE, 2013). In several European countries, teaching also remains an attractive and even prestigious profession, given its high degree of autonomy, good salary, selectivity and high public appreciation (IBF International Consulting, 2013). In Finland, for example, teaching is a prestigious career, highly respected and highly qualified, since the selection process is tough.

POLICY FOCUS

Promoting urban green growth

In Emerging Asia, cities experience rapid urbanisation as large numbers migrate from rural to urban areas. The resulting increase in urban population is projected to continue for the next 35 years (Figure 6.2.5a). Rising urbanisation will lead to increasing demand for basic amenities and services as well as other economic supports required in the urban areas. In most cases, urbanisation is led by manufacturing and industrialisation, which expose these cities to environmental issues, such as increasing greenhouse gas emissions. In cities facing rapid urban growth, encouraging green growth should have high priority (Matsumoto and Daudey, 2014). Environmental problems will increase as urbanisation trends increase. Issues, such as increasing air, water and land pollution, will need to be addressed. Moreover, cities in most countries in the region are highly exposed to climate change and natural disasters, which increase the environmental risks even more. In recognition of the importance of these environmental concerns, steps are being taken to promote green growth in Malaysia (Box 6.2.2.).

Box 6.2.2. **Advancing green growth**

Malaysia is rich in natural resources among Southeast Asian countries and its exports of natural resource products such as oil, gas and forest products accounted for roughly 16% of GDP in 2014. However, as one of the more developed nations in the region, Malaysia's rapid industrialisation and urbanisation in the past decades have greatly changed its natural environment, especially in eastern Malaysia, with its intensive logging operations. Between 2000 and 2013, Malaysia had a total forest loss of 47 278 km2 or approximately 14.4% of its total land area, ranking 9th globally in absolute loss and highest in the world in total loss compared to total land area (Hansen et al., 2013).

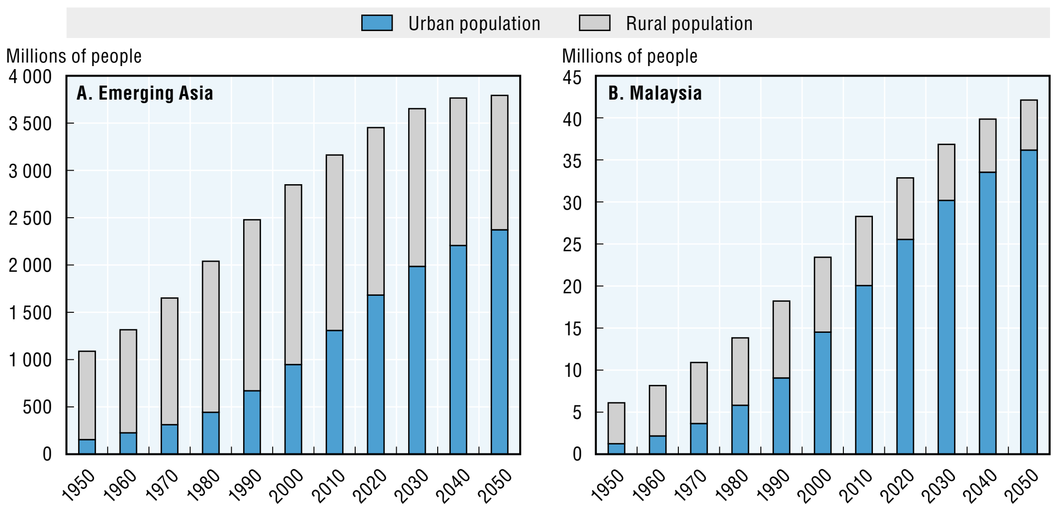
The declining forest cover in Malaysia is primarily due to urbanisation, agricultural fires, forest conversion for palm oil plantations and other forms of agriculture, and commercial logging (OECD, 2012b). In addition, more frequent environmental disasters, rising CO_2 emissions and excessive energy consumption have become major concerns and prompted the government to shift from the conventional "grow first, clean up later" strategy to more sustainable green growth. In the Tenth Malaysia Plan announced in June 2010, environmental sustainability is recognised as an important part of Malaysia's socio-economic development plan.

In the past five years, Malaysia has made progress in advancing green growth by 1) reducing the greenhouse gas emissions intensity of its GDP by more than 33% compared to 2005 levels; 2) expanding installed capacity of renewable energy from 53 MW in 2009 to 243 MW in 2014 3) implementing 194 flood mitigation projects; and 4) placing 23 264 hectares of forested areas under national protection as Permanent Reserved Forest.

To further strengthen the sustainability of its economic development, the government has set two primary green growth targets under the 11th Malaysia Plan 2016-2020: 1) to reduce greenhouse gases emission intensity of GDP by up to 40% compared to 2005 levels by 2020; and 2) to place at least 17% of terrestrial and inland water areas, as well as 10% of coastal and marine areas, under national protection (EPU, 2015). In the 11th Malaysia Plan 2016-2020, green growth has, in fact, become one of the most important issues. The focus areas are strengthening resilience against climate change and natural disasters, strengthening the enabling environment for green growth, adopting the sustainable consumption and production concept, and conserving natural resources for present and future generations. In the 11th Malaysia Plan, strategies to transform the construction sector include a strategy to foster sustainable practices in the construction industry. Under this strategy, efforts are geared towards: *i)* inculcating sustainable practices in the construction value chain, *ii)* reducing irresponsible waste generation by mandating contractors to comply with waste management requirements, and *iii)* encouraging industry players to observe the "health, safety and environment" good practices to increase construction sites safety, reduce accidents and ensure sustainability.

Urban pollution is an increasingly important issue to address in Emerging Asia and Malaysia, with its rapid urbanisation and industrialisation, is no exception (Figure 6.2.5b). Urban green growth policies are, therefore, needed, not only to address urban pollution and environmental issues, but also to support and contribute to achieving national environmental targets.

Figure 6.2.5. **Mid-year estimates of urban and rural populations in Emerging Asia and Malaysia, 1950-2050**



Source: Calculated based on data from UN DESA (2014), *World Urbanisation Prospects: 2014 Revision*, http://esa.un.org/unpd/wup/FinalReport/WUP2014-Report.pdf.

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Building sustainable cities: Iskandar Malaysia Smart City Project

In 2006, the Government of Malaysia launched Iskandar Malaysia in the southern part of Peninsular Malaysia to promote socio-economic development in a holistic and structured manner. The Iskandar Regional Development Authority (IRDA) was also established, serving as the Regulatory Body to plan, promote and facilitate towards realising the vision of developing Iskandar Malaysia into a strong and sustainable metropolis of international standing. As one of the economic regions and corridors in Malaysia, Iskandar Malaysia brings in more investments in selected areas and provides socio-economic development to the people in an already established urban conurbation. The Iskandar Malaysia development plan is divided into three phases: 1) plan and build the foundation (2007-10); 2) strengthen and generate growth (2011-15); and 3) sustain and innovate (2016-25). It will soon begin the third and last phase, towards 2025.

The Government of Malaysia, through IRDA, has been implementing measures in several policy areas, including the environment (with the objective of being a low-carbon society), promoting green economic growth and sustainability. The Comprehensive Development Plan II or CDP 2006-2025 was prepared to guide the development pathways of Iskandar Malaysia and this has been translated into 24 blueprints prepared by IRDA. The blueprints were prepared according to subject matters, such as spatial and environmental planning which includes detailed actions, programmes and implementation plans to be carried out until 2025.

The Low Carbon Society (LCS) Blueprint for Iskandar Malaysia 2025 was also launched in 2012 at the 18th Conference of Parties of the UNFCCC Climate Change Conference held in Doha. The LCS Blueprint for Iskandar Malaysia outlined the LCS implementation actions based on three themes (Table 6.2.1) to guide the development of Iskandar Malaysia in becoming a strong, sustainable metropolis of international standing by 2025. The implementation of LCS Blueprint has begun with key initiatives including improvement of public transport systems through a mobility management system, development of Green Economic Guidelines (GEG) for the nine promoted economic clusters, promoting low carbon lifestyle, such as the Eco-Life challenge for schools, and the launch of the country's first Low Carbon Village in Felda Taib Andak. Under the Green Environment theme, initiatives include a walkable, safe and liveable city designed with CCTV; community police posts; cycling paths and walkways; sustainable waste management.

Table 6.2.1. **Low Carbon Society implementation actions**

	Action Names	Themes
1	Integrated Green Transportation	GREEN ECONOMY
2	Green Industry	
3	Low Carbon Urban Governance	
4	Green Buildings & Construction	
5	Green Energy System & renewable Energy	
6	Low Carbon Lifestyle	GREEN COMMUNITY
7	Community Engagement & Consensus Building	
8	Walkable, Safe, Liveable City Design	GREEN ENVIRONEMENT
9	Smart Growth	
10	Green and Blue Infrastructure & Rural Resources	
11	Sustainable Waste Management	
12	Clean Air Environment	

Source: IRDA (2014), *Iskandar Malaysia Bizwatch*, No. 228, www.iskandarmalaysia.com.my/sites/default/files/IM%20BizWatch%20Feb%202014.pdf.

The Iskandar Malaysia Smart City is an added value enabler which aims to improve quality of life and provide ease of doing business in Iskandar Malaysia. A total of 35 programmes have been identified with 75 projects listed of which, as of August 2015, 37.3% projects have been completed, 32% are ongoing and 30.7% have yet to start. The Smart City Iskandar Malaysia was endorsed by the Prime Minister of Malaysia on 1 November 2012 during the 2nd Inter-session of the Global Science and Innovation Advisory Council (GSIAC) meeting in Kuala Lumpur.

Challenges remain, however. While the project includes a green agenda, its development agenda also includes attracting large investment in many areas, for instance manufacturing, logistics, tourism and properties. The rapid growth of some sectors in Iskandar Malaysia that are known sources of air pollutants, such as electrical and electronics and the oleo chemical and petrochemical sectors, has caused concern (Sembiring and Jackson Ewing, 2014). Activities in the property sector also increase as the city grows. A reliable and transparent assessment and monitoring system is needed to ensure that the rapid development agenda does not conflict with or undermine the green agenda.

The strategic location of Iskandar Malaysia that borders Singapore and at the crossroads of the East-West trade routes is an advantage in attracting investment and workforce. However, infrastructure development, particularly of the public transport system, should be improved to facilitate cross-border movement of people and avoid issues like traffic congestion at the border. Policies to increase the efficiency of the transport system could also enhance the city's attractiveness to firms and human capital, as mentioned in the OECD Green Cities Programme (Box 6.2.3).

Box 6.2.3. **OECD Green Cities Programme**

In 2010, the OECD launched the Green Cities Programme to foster economic growth and development through urban activities that reduce environmental impact. The programme aimed to assess the impact of urban sustainability and green growth policies on urban and national performance through case studies of cities in OECD member countries and others.

Case studies conducted in Paris, Chicago, Stockholm and Kitakyushu identified green urban policies that can contribute to growth in various areas of priority:

- Job creation is supported by energy-efficiency retrofits. In Chicago, single-family residential retrofits involve the installation of insulation and window replacement – relatively low-skilled or semi-skilled labour. Higher skills are needed for retrofits of more elaborate residential and commercial structures, which represent a much smaller share of retrofits.
- City appeal to firms and skilled human capital is supported by increasing the efficiency of transport to improve environmental performance and workers' access to firms.
- Increasing local production of green goods and services is supported by identifying the potential for green specialisation and fostering green technology R&D and innovation.
- Increasing the value of urban land is supported by urban redevelopment, including infill development and eco-districts.

There are challenges to green growth in cities, governance and funding being major examples. Crucial areas implicated are co-ordination across sectors, policy coherence across levels of government, inter-municipal co-operation, improving local capacity, enforcement and incentives to ensure compliance, and monitoring tools. Property taxes, development fees and private financing are possible sources of funding for urban green projects.

In 2012, the OECD launched Urban Green Growth in Dynamic Asia to extend the policy assessment to fast-growing Asian cities, accounting for the specific social, economic and environmental conditions of those cities. Key policy strategies for green growth in Emerging Asia included: *i)* promoting urban resilience; *ii)* addressing poverty and social equality; *iii)* pursuing long-term economic development goals while achieving short-term benefits; *iv)* adopting pro-active green infrastructure strategies in step with rapid development; and *v)* aligning environmental actions with economic growth.

Sources: OECD (2013), *Green Growth in Cities*, http://dx.doi.org/10.1787/9789264195325-en; Matsumoto and Daudey (2014), "Urban Green Growth in Dynamic Asia: A Conceptual Framework", *OECD Regional Development Working Papers*, No. 2014/12, http://dx.doi.org/10.1787/5js7svlw8m0x-en.

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Key government ministries in Malaysia

Prime Minister	Nazib Razak
Deputy Prime Minister	Ahmad Hamidi
Agriculture and agro-based industries	Ahmad Shabery Cheek
Communication and multimedia	Mohd Salleh Keruak
Defence	Hishammuddin Hussein
Domestic trade, co-operation and consumer affairs	Hamzah Zainuddin
Economic planning unit	Rahamat Yusoff
Education	Mahdzir Khalid
Energy, green technology and water	Maximus Ongkili
Federal territories	Tengku Adnan Tengku Mansor
Finance	Nazib Razak
Finance II	Ahmad Husni Hanadzlah
Foreign affairs	Anifah Zahid Aman
Health	S Subramaniam
Higher education	Idris Jusoh
Home affairs	Ahmad Hamidi
Human resources	Richard Riot Jaem
International trade and industry I	Mustapa Mohamed
International trade and industry II	Ong Ka Chuan
Natural resources and environment	Wan Junaidi Tuanku Jaafar
Plantation industries and commodities	Douglas Embas
Public works	Fadillah Yusof
Rural and regional development	Ismail Sabri Yaakob
Science, technology and innovation	Wilfred Madius Tangau
Tourism and culture	Mohamed Nazri Abdul Aziz
Transport	Liow Tiong Lai
Urban well-being, housing and local government	Abdul Rahman
Women, family and community development	Rohani Karim
Youth and sports	Khairy Jamaluddin
Central Bank Governor	Zeti Aziz

Note: Valid as of 31 October 2015.

Philippines

A. Medium-term economic outlook (forecast, 2016-20 average)

GDP growth (percentage change):	5.7
Current account balance (% of GDP):	3.2
Fiscal balance (% of GDP) (central government):	-2.0

B. Medium-term plan

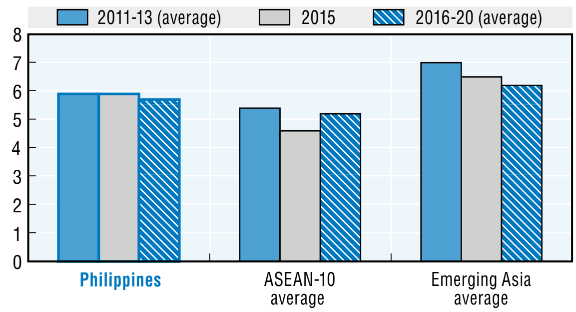
Period: 2011-16
Theme: In pursuit of inclusive growth.

C. Basic data (in 2014)

Total population:	92.3 million*
Population of Metro Manila (NCR):	11.86 million (in 2010)*
Nominal GDP (US dollar):	284.62 billion
GDP per capita at PPP:	6 973.67 (current International Dollar)**
Exchange rate in the first half of 2015 (period average):	44.55 (PHP/USD)

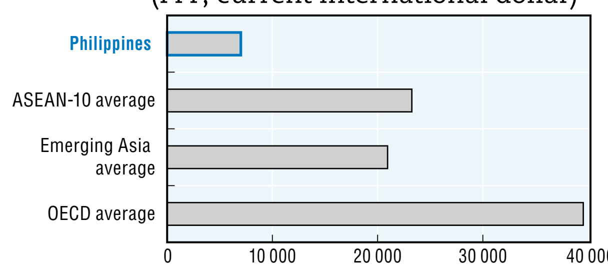
Note: * Population data for 2014 are from Philippines 2010 Census.
** IMF estimate.
Sources: OECD Development Centre, MPF-2016, national sources, CEIC and IMF.

GDP growth rates (percentage change)



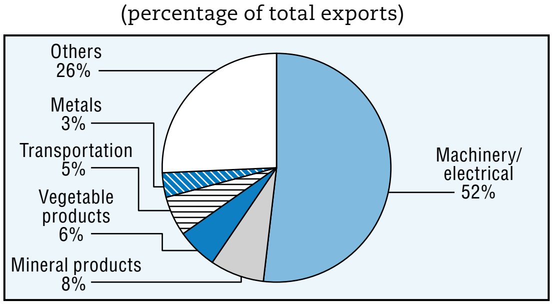
Source: OECD Development Centre, MPF-2016.

GDP per capita, 2014
(PPP, current international dollar)



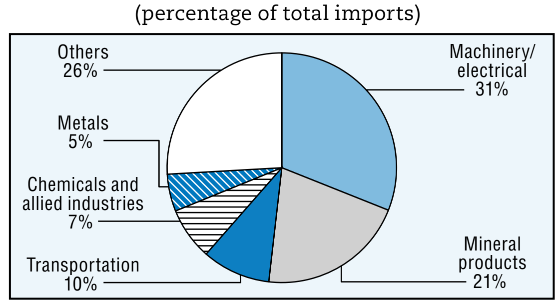
Source: IMF.

Composition of exports, 2014
(percentage of total exports)



Source: Trademap.

Composition of imports, 2014
(percentage of total imports)



Source: Trademap.

Thanks to macroeconomic and political stability, along with domestic demand strongly supported by remittance inflows, growth in the Philippines has led that of the large Association of Southeast Asian Nations-5 (ASEAN-5, comprising Indonesia, Malaysia, the Philippines, Thailand and Viet Nam) economies and is expected to remain stable over the medium term. Despite this favourable outlook, continued growth will require deeper reforms. This need is acknowledged in the Philippine Development Plan 2011-2016, which aims to foster inclusive and sustainable growth through the achievement of targets for macroeconomic stability, competitiveness, social development and environmental protection. Domestic job creation will need to improve to complement the income inflows for the Philippines' overseas workers, necessitating broad reforms. A lack of quality infrastructure and shortcomings in the transportation sector are also challenges to be addressed in supporting growth. Being particularly exposed to natural disasters, stable growth and development in the Philippines depends on the improvement of systems for natural disaster management.

The Philippines: Medium-term policy challenges and responses

- Encourage faster job creation
- Strengthen infrastructure and the transport sector
- Improve disaster risk management

POLICY FOCUS

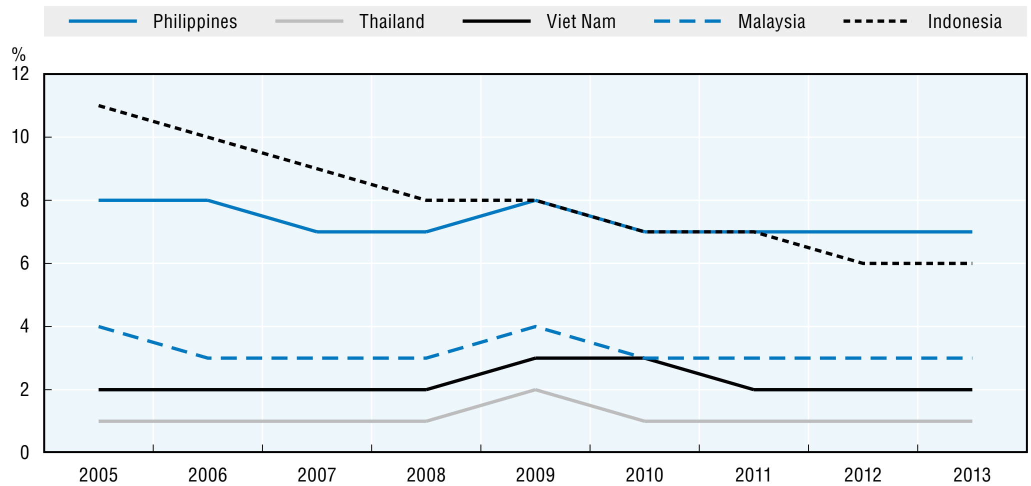
Encourage faster job creation

Faster job creation is needed in the Philippines

Despite strong growth rates, the Philippines continues to struggle with creating jobs for its growing working-age population. Although remittances from Filipinos working abroad have proven to be effective and resilient in supporting development, continued and inclusive growth requires that the jobs challenge be addressed. While remittances help to raise incomes and reduce poverty, they may also contribute to inequality, as higher-income households may be more likely to receive remittances and to receive higher amounts from better-educated overseas workers (Pernia, 2008). At the same time, the underdevelopment of domestic manufacturing and services that has accompanied this growth model prevents the economy from developing and adopting the technologies that would be needed to allow the Philippines eventually to become a high-income country. There is, therefore, a need to encourage investment in job-creating sectors and to develop the skills of workers that match those demanded by firms.

The Philippines faces greater labour market challenges than its peers. With a decline in Indonesian unemployment in recent years, the Philippines' rate of unemployment, which remains fairly stubborn at around or above 7%, is higher than in the rest of the ASEAN-5 countries (Figure 6.3.1). While most spells of unemployment appear to be brief and are becoming more so – approximately 60% of the unemployed in 2013 were out of work for less than six weeks, up from approximately 52% in 2009 – these results are also based on unemployment figures, which exclude the discouraged workers who have left the labour force after failing to find work. Labour force participation rates in the Philippines are also lower than in many neighbouring countries, which may also be a result of remittance flows providing an alternative source of income. While employment grew by an average 2.4% between 1987 and 2013, the population grew at a higher rate, keeping fairly constant the share of the working age population – around 40% of those aged 15 or older – either unemployed or out of the workforce (Figure 6.3.2).

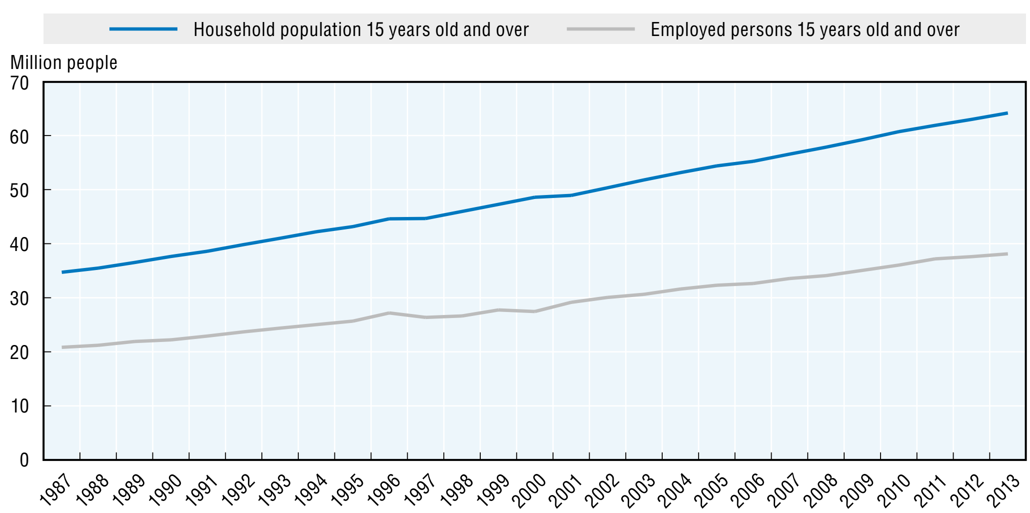
Figure 6.3.1. **Philippines' unemployment rate, 2009-13**



Source: World Bank (2015), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933310237

Figure 6.3.2. **Population and employment in the Philippines, 1987-2013**



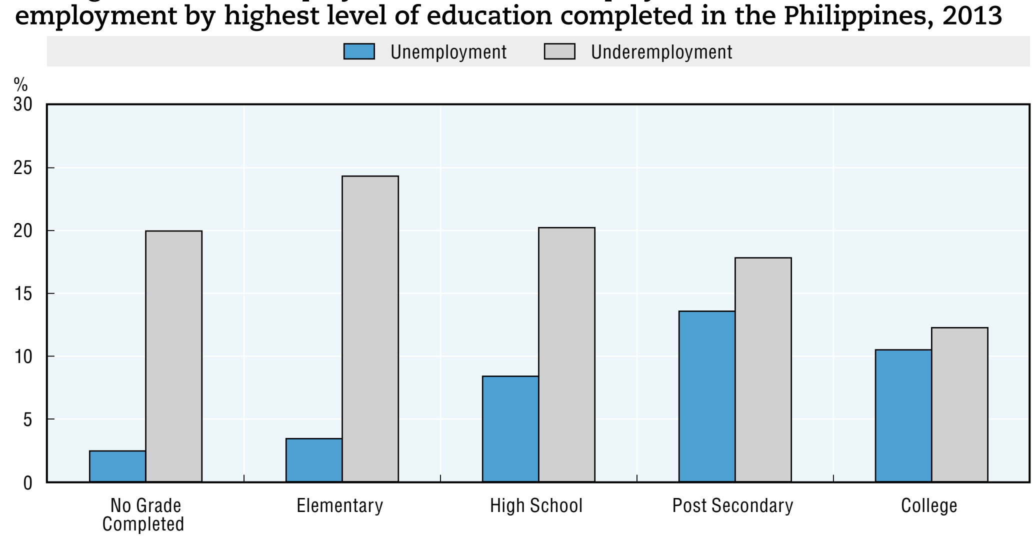
Source: Philippine Statistics Authority (2014), *Yearbook of Labour Statistics*, www.bles.dole.gov.ph.

StatLink http://dx.doi.org/10.1787/888933310249

The Philippines' poor record of job creation may actually be worse than suggested by unemployment and labour force participation figures, as underemployment is often common among the employed, and regional differences in labour markets are considerable. Visible underemployment – the share of total workers who work less than 40 hours per week but would prefer to work more – made up 11.3% of total employment in 2013. Underemployment is most common among those working in family-owned farms or businesses, the self-employed and those employed by private households. Although these workers are employed, presumably they have not been able to find positions where they can work as much as they would like and earn a higher income.

Low rates of job creation impede inclusive growth in the Philippines. Solutions to the lack of jobs and high rates of underemployment are needed to sustain growth, particularly as the country's rapid population growth continues over the coming decades. Unemployment in the Philippines is often more prevalent among the young and well-educated. In 2013, unemployment was highest among 20-24 year-olds at 17%, after which it declined in prevalence in successive age groups. By level of educational attainment, Filipinos with some or completed post-secondary or college education were also the most likely to have difficulty finding work, with 12% of post-secondary graduates and 9% of college graduates unemployed (Figure 6.3.3). While the highly educated may have more trouble in finding work, they tend to find better work when they are employed. Underemployment rates are among their lowest for post-secondary and college graduates, at 15% and 9% of total employment, respectively. Indeed, underemployment tends to be below average among positions that require significant education and training, such as professionals and managers. These outcomes suggest that there may be a lack of demand for educated workers or that there are problems in the education system in providing students with the skills most valued by employers. In addition, many of those unable to find formal employment end up relying on informal sources of income. This is particularly important in creating better employment opportunities for the unemployed and those working informally or in the farming and fishing sectors, where poverty rates tend to be above average.

Figure 6.3.3. **Unemployment and underemployment as shares of total employment by highest level of education completed in the Philippines, 2013**

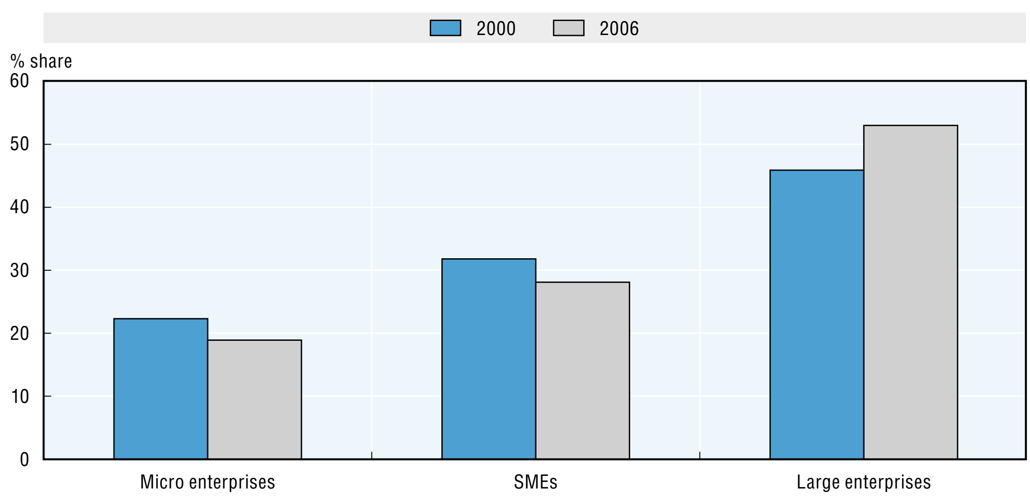


Source: Philippine Statistics Authority (2014), *Yearbook of Labour Statistics*, available at www.bles.dole.gov.ph.
StatLink http://dx.doi.org/10.1787/888933310256

Small and medium-sized enterprise (SME) growth should be a central focus of job-creation efforts

Policies that boost job creation must critically focus on enhancing the growth of SMEs in the Philippines. SMEs accounted for the bulk of manufacturing enterprises (99% share in 2011), as well as a sizeable share of manufacturing employment. However, the performance of SMEs in the last decade has not been vigorous enough to boost the Philippines' manufacturing industry. In particular, the employment share of micro enterprises and SMEs in the manufacturing sector has declined since 2000, from 54.1% to 47.2% in 2011 (Figure 6.3.4). In addition, the labour productivity levels of the manufacturing sector have also declined, particularly with more visible decline in the SMEs (Figure 6.3.5). This weak performance can be attributed particularly to poor access to finance, technology and skills, as well as information gaps and difficulties in product quality and marketing (Aldaba, 2013). According to the World Bank's 2009 Enterprise Survey of the Philippines, access to finance was identified as a major constraint by 15.3% of firms with 5 to 19 workers and 13.4% of firms with 20 to 99 workers, but only 5.9% of firms with 100 or more workers. This challenge remains in spite of government efforts to encourage lending, such as through the Magna Carta for Micro, Small and Medium Enterprises.

Figure 6.3.4. **Share of manufacturing employment by size of enterprise in the Philippines**

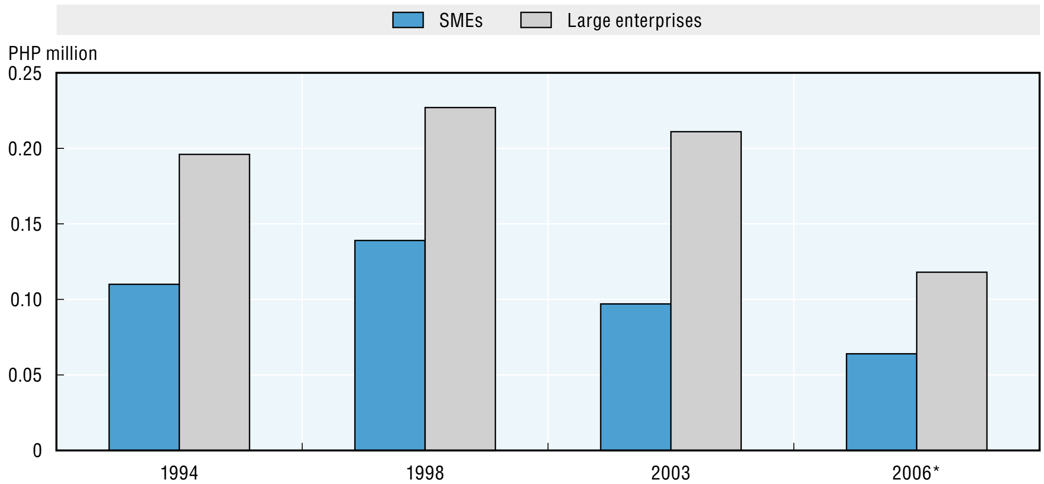


Note: Micro enterprises are defined as those with assets worth PHP 3 million or less; Small enterprises are defined as those with assets worth PHP 3-15 million; Medium enterprises are defined as those with assets worth PHP 15-100 million; Large enterprises are defined as those with assets worth PHP 100 million or more.

Source: Aldaba (2013), "ASEAN Economic Community 2015 SME Development: Narrowing Development Gap Measure", *PIDS Discussion Paper*, http://dirp3.pids.gov.ph/ris/dps/pidsdps1305.pdf.

StatLink http://dx.doi.org/10.1787/888933310264

Figure 6.3.5. **Manufacturing labour productivity by size of enterprise in the Philippines, at 1985 prices**



Notes: *Values in 2006 are not comparable with previous years, as the 2006 Annual Survey of Establishments covers only the formal sector of the economy; Small enterprises are defined as those with assets worth PHP 3-15 million; Medium enterprises are defined as those with assets worth PHP 15-100 million; Large enterprises are defined as those with assets worth PHP 100 million or more.

Source: Aldaba (2013), "ASEAN Economic Community 2015 SME Development: Narrowing Development Gap Measure", *PIDS Discussion Paper*, http://dirp3.pids.gov.ph/ris/dps/pidsdps1305.pdf.

StatLink http://dx.doi.org/10.1787/888933310276

SMEs provide an important source of domestic employment creation and resilience against more volatile external economic fluctuations, and serve as a mechanism for local capacity building. While multi-national enterprises and domestic large enterprises have been playing an important role in accelerating the industrialisation process, SMEs provide the crucial industrial linkages to set off a chain reaction of broad-based and sustainable development. In addition, SMEs play key roles as subcontractors and suppliers of intermediate inputs to multi-national enterprises and domestic large enterprises. Without them, industrial growth in developing countries would not be able to realise sustainable increase in domestic value added, employment, productivity and industrial linkages (Lim, 2008). To its credit, the government has consciously engaged and co-ordinated with stakeholders and agencies in the public and private sectors to harness the science and technology to enhance linkages between SMEs and large enterprises, improve competitiveness and productivity.

Food processing could be an important source of job creation

It is crucial to invest in the manufacturing and services sectors that will improve employment opportunities for both low- and high-skilled workers in the Philippines, reversing the decline of labour-intensive manufacturing industries, such as garments and footwear, that has occurred since the late 1990s. The Philippines' food-processing industry is the most dominant manufacturing sector in the country. It accounts for 40% of total manufacturing output and forms a key sector of the economy with healthy growth rates. The sector comprises fruits and vegetables; meat and poultry; flour and bakery; dairy products; fish and marine foods; beverages; confectioneries; food condiments and seasonings; food supplements; bottled water; snack foods; and fats and oils. This sector is heavily reliant on both domestically produced and imported agri-food products. Recent economic liberalisation by the Philippines government has resulted in a relatively open trading system with some of the lowest applied tariffs in the region, allowing the sector to benefit from access to lower-cost imported inputs (DPI Agribusiness Group, 2009).

To develop the food-processing manufacturing industry and improve market access, policies should focus on enhancing the standards and regulatory rules for these industries (Usui, 2012). In addition, Dueñas-Caparas (2006) found that skilled manpower, as measured by the share of skilled workers to total workers, has a significant and positive effect on the industries' export decisions, as more highly skilled labour is associated with greater productivity. It is important, therefore, that policies target human capital development, particularly skilled manpower.

POLICY FOCUS

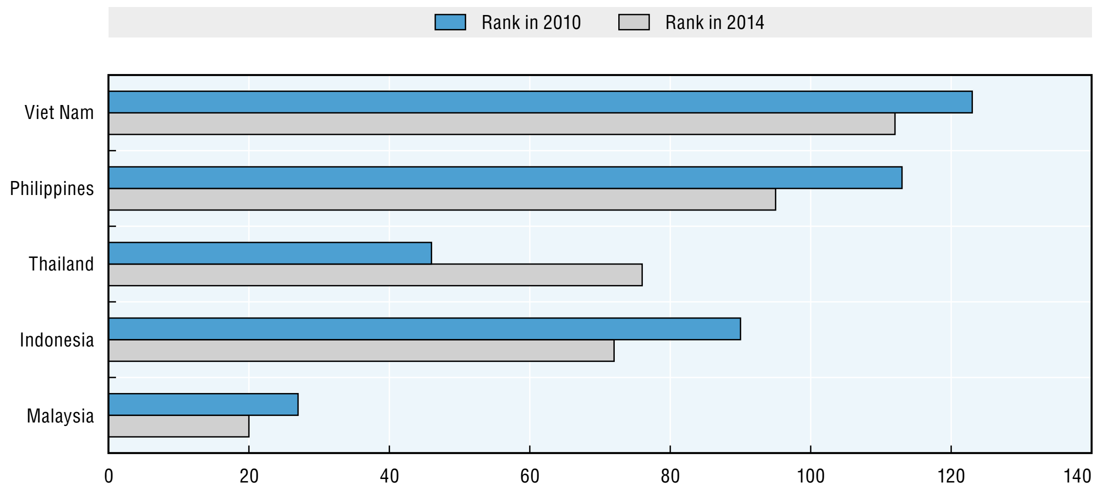
Strengthen infrastructure and the transport sector

Infrastructure has improved with strong government support

Inadequate infrastructure in the Philippines has long been a concern. The infrastructure development of a country is vital to its economic growth and social development, and is fundamental to the investment climate, facilitating delivery of goods and services, improving quality of life and boosting tourism. Lack of infrastructure not only tempers investment and production through higher input transport and services supply costs, but impairs competition, as smaller companies are more susceptible to infrastructure weakness (OECD, 2010).

The Government of the Philippines is working to improve the country's infrastructure. According to the World Economic Forum (WEF), in 2010, the quality of the Philippines' infrastructure ranked at the lower end among the ASEAN-5 (Figure 6.3.6), especially as regards transport. While infrastructure expenditure was only about 1.7% of gross domestic product (GDP) in 2010, the government plans to expand it to 4% in 2015 and 5% by 2016. Infrastructure spending reached 3.4% in 2014, exceeding the target of 3%. To meet the 2015 target, the government increased the budget for infrastructure-related departments earlier this year, boosting the allocation to the Department of Public Works and Highways (DPWH) by 37.9%, the Department of Transportation and Communication (DOTC) by 21.9% and the Department of Agriculture by 11.5%. The government has acknowledged an annual infrastructure investment of 5-7% of GDP is needed for sustainable economic growth. Infrastructure development has improved over the past five years, but the Philippines needs to maintain persistent efforts in order to catch up with its ASEAN-5 peers.

Figure 6.3.6. **Infrastructure quality ranking of ASEAN-5 countries**



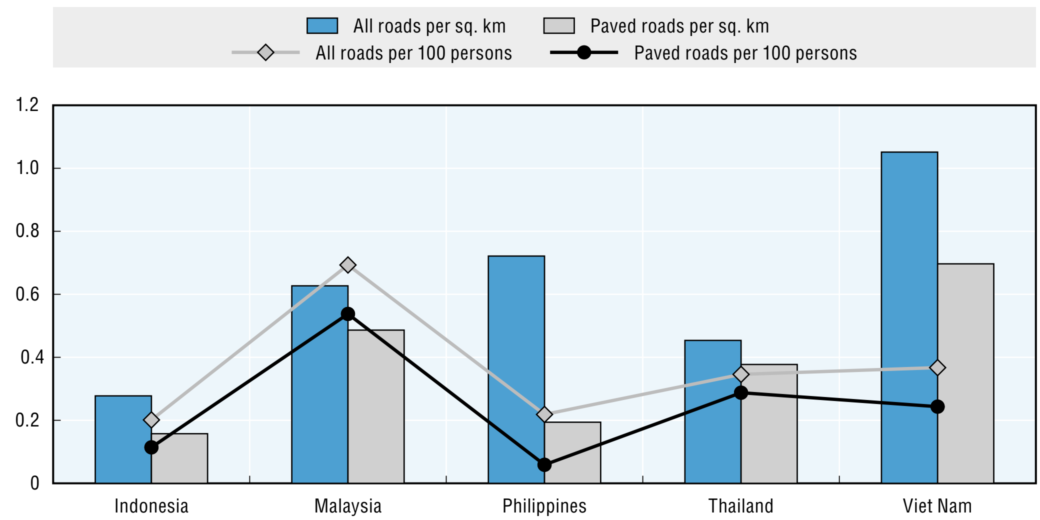
Source: WEF (2014), *The Global Competitiveness Report 2014-2015*, www.weforum.org/reports/global-competitiveness-report-2014-2015.

StatLink http://dx.doi.org/10.1787/888933310289

National roads are well-maintained, while local roads remain in dismal condition

Underdeveloped transportation infrastructure can be a serious constraint on business operations. Transportation infrastructure development has improved the Philippines' ranking from 106 in 2010 to 74 in 2014, surpassing Viet Nam yet still lagging behind other ASEAN-5 countries (WEF, 2014). Recent land transportation infrastructure data indicate that the road network in the Philippines requires further attention and investment. Although the Philippines has a relatively high number of roads after adjusting for land size (0.72 km per km^2), the number of paved roads is relatively low compared to other ASEAN-5 countries (0.19 km per km^2) (Figure 6.3.7). Adjusted for population, there is 0.22 km of road per 100 people in the Philippines, of which only 0.06 km is paved, the lowest percentage among the ASEAN-5.

Figure 6.3.7. **Road network coverage in ASEAN-5 countries, 2012/13**

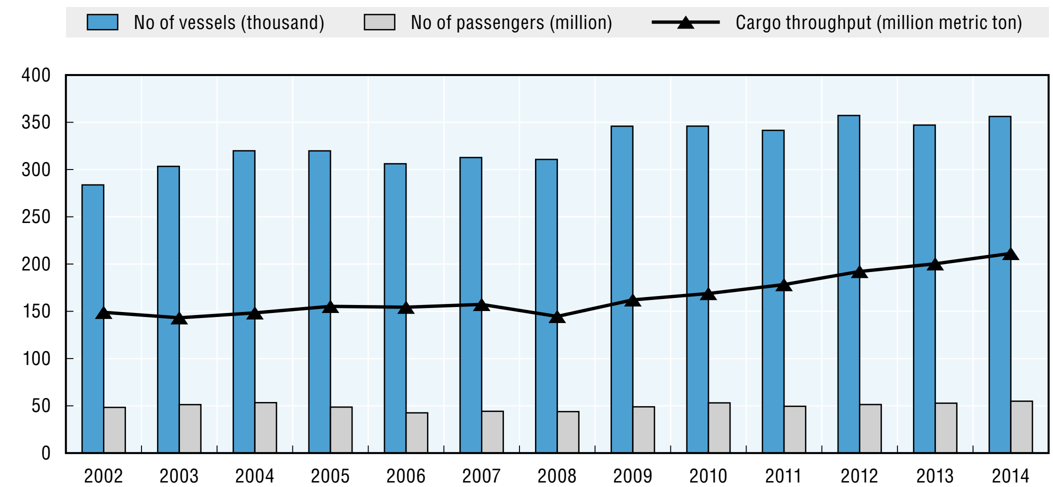


Note: Philippines and Viet Nam data are for 2012; others are for 2013.
Sources: AJTP (2013), ASEAN-Japan Transport Statistics Book, DPWH (2012), *2012 Strategic Infrastructure Policies and Programs*; World Bank (2015), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.
StatLink http://dx.doi.org/10.1787/888933310292

Maritime transport lags behind other ASEAN countries, although some progress has been made

For a country with over 1 800 km of coastline and a population scattered on 7 107 islands, maritime transport could play an important role in facilitating the development of the Philippines. The number of ports is very large but difficult to measure due to the variety of port types. It is believed there are over 2 500 private and public ports among the islands. However, the standard of most of these ports is low, despite enhanced infrastructure investment in recent years. The Philippines' maritime infrastructure ranks at 101 in the WEF Global Competitiveness Index, behind its ASEAN neighbours, including Viet Nam (88), Indonesia (77) and Thailand (54). The poor state of maritime transportation in the Philippines is also reflected in it accounting for a minor percentage of passenger travels in the country. Growth of cargo transport, which reached 211 million metric tonnes (Mt) in 2014, is the strongest after 2008, but passenger transport has changed little in the past decade, totalling 54.9 million passengers in 2014 (Figure 6.3.8). The Philippine Development Plan 2011-2016 identified the development of a Strong Republic Nautical Highway (SRNH) and Roll-on/roll-off (RORO) terminals system as a major area in transport development, with the aim of connecting all main ports in the country.

Figure 6.3.8. **Maritime transportation in the Philippines by user group**



Source: CEIC

StatLink http://dx.doi.org/10.1787/888933310306

Considerable investment has gone into port development in the past few years. Between 2010 and 2012, 128 new domestic ports and 16 international ports were erected. By the end of 2009, 22 ports in the SRNH network had been constructed or upgraded for RORO operation by the end of 2009. By the end of 2012, there were 41 shipping firms with 129 vessels serving 18 of the 32 routes in the SRNH – a rapid increase from 25 companies with 42 RORO vessels in 2009. In 2013, the government invested a total of PHP 3.27 billion for 122 port construction projects across three regions: Luzon, Visayas and Mindanao. Among these, 26 were completed by the end of 2013, 30 were under construction, 6 were suspended and a majority of 60 projects were still under procurement. Several big Capital Expenditure Program infrastructure projects were completed in 2013 as well, including the Puerto Princesa Port Expansion Project, the Coron Port Expansion Project and the Port of Legazpi R.C. Wharf Construction. While no rigorous or extensive impact assessment has been carried out, early studies show a 12-hour reduction in travel time between Minadao and Luzon and transport cost reductions of 37-43% for passengers and 24-34% for cargo through infrastructure improvement. In addition to new constructions, the Philippines Ports Authority is investing considerable funds on infrastructure maintenance. In 2013, its allocation for repair and maintenance allocation accounted for approximately a quarter of total operating expenses at PHP 1.7 billion.

In October 2013, the RORO route from Mindanao to Indonesia was inaugurated, making it the first intra-ASEAN RORO route. Compared to previous shipping methods, the new system cut transport costs by 10% and lowered transportation time from 2-3 days to 1.5 days. The next route connecting Batangas with Humen, China and Danang, Viet Nam will launch in 2015. Compared to other ASEAN countries, the Philippines is on track to meet the challenges of the trans-ASEAN maritime transport network outlined in the Master plan on ASEAN Connectivity of 2011.

The legal and institutional framework for public-private partnerships needs to be strengthened further

Properly employed, PPPs can offer additional resources for infrastructure development and maintenance, as well as potentially raising efficiency and introducing better technologies and management skills. In the Philippines, PPP development has seen gradual improvement since the Build-Operate-and-Transfer (BOT) Center was transformed into the Public-Private Partnership Center in 2010, extending the focus to other variants such as joint ventures, concession and management contracts, in addition to BOT contracts.

Although progress in using PPPs for various projects, especially infrastructure investment projects, has been promising, a number of issues remain. According to the PPP Center, 10 out of 55 total PPP projects have been awarded, 15 are still in the bidding process and more than half have not finished their feasibility studies (Table 6.3.1). The slow progress may be due to time-consuming BOT laws regarding project assessment. It may take the government years to give the green light, and private investors have complained about bureaucratic complexity. In response, the government has been pushing for amendments to the old BOT Law to institutionalise reforms already made and strengthen the legal framework. Proposed amendments include institutionalising the Project Development and Monitoring Facility, PPP Governing Board and the PPP Center in order to facilitate implementation of PPP projects; prohibiting issuance of Temporary Restraining Orders and preliminary injunction by the lower courts; and extending the challenge period for unsolicited projects.

Table 6.3.1. **Awarded PPP projects and associated costs in the Philippines**

Project	Cost (USD millions)
Daang Hari-South Luzon Expressway Link Road Project	44.44
PPP for School Infrastructure Project Phase I	363.25
Ninoy Aquino International Airport Expressway (Phase II) Project	350.65
PPP for School Infrastructure Project Phase II	85.34
Modernisation of the Philippine Orthopedic Center	192.13
Automatic Fare Collection System	38.03
Mactan-Cebu International Airport Passenger Terminal Building	387.35
Light Rapid Transit Line 1 Cavite Extension and O&M	1 434.89
Southwest Integrated Transport System Project	55.27
Cavite-Laguna Expressway	1227.28

Source: Public-Private Partnership Center of the Philippines (n.d.), http://ppp.gov.ph/?page_id=26075.

Risk-sharing is the fundamental advantage of PPP schemes. Whether or not a sufficient amount of risk is transferred to the private investors determines the project's value for money, as risk-sharing incentivises private companies to finish the project on time and within budget and to improve efficiency (OECD, 2008). However, currently in the Philippines, PPP project risk is usually borne by the public sectors due to government concessions to the private sectors during procurement. This often results from the profitless feature of many PPP infrastructure projects which compels the government to offer incentives for private participation. Some economists argue that PPP should be one but not the only option for infrastructure investment; other options, such as official development assistance, foreign loans and self-financing (made possible by revenue increases in recent years) should factor in as well. The rapid growth of national revenues in recent years also allows the government to undertake smaller-scale infrastructure projects through self-financing alone. In general, only projects that have appropriate levels of profitability and self-sustainability would then be pursued via PPP.

A regulatory framework is a critical factor in PPPs, as its effectiveness dictates the implementation success of other components. Without an effective regulatory environment, projects may be beleaguered by red tape, corruption, circumvention of laws and weak enforcement. The Philippines has improved its regulatory framework by enhancing existing laws and introducing new complementary regulations (Table 6.3.2). The recently proposed PPP Act was introduced in 2013 and has so far secured approvals from both the Economic Development Cluster and the PPP Governing Board. According to officials from the PPP Center, the act is likely to be passed by Congress in 2015 and become an important complement to existing BOT laws and regulations. However, implementation may be complicated. The current dispute mechanism in the Philippines contains loopholes that can lead to expensive and prolonged judicial process. Upon project completion, the government needs to assume oversight and ensure the quality of services contracted to private partners with mechanisms like contractual pricing, whereby a private operator's revenues are regulated in accordance with its performance.

Table 6.3.2. **Timeline of infrastructure-related legislative and regulatory changes in the Philippines**

Title	Date	Changes
RA 6957 (amended by RA 7718)	9 July 1990	Establishment of BOT and other PPP schemes
RA 9184	2003	Government Procurement Reform Act brought in to address corruption and delays in public procurements
RA 9285	2 April 2004	Institutionalisation of an alternative dispute resolution (ADR) system and establishment of the office for ADR. Its Implementing Rules and Regulations (IRR) went into effect on 31 December 2009.
	2006	Revisions to the IRR of the BOT Law on bid invitation advertisements, government contribution to projects and allowing project proponents to enter a management contract with another entity for the day-to-day operation of the project
EO 8	9 September 2010	Reorganisation and rename of the BOT Center to the PPP Center of the Philippines, and transfer of its attachment from DOTC to NEDA
RA 8975	6 December 2010	Nullification of all courts other than the Supreme Court for cases restraining a national government project in order to avoid delay
EO78 (amended by EO 136)	4 July 2012	Requirement of ADR mechanisms in all PPP contracts
RA 7718	28 May 2012	Major revisions to the IRR of the BOT Law to clarify compensation mechanism and unsolicited bids, among other elements
EO 136	28 May 2013	Revisions to EO 8 regarding reorganising and renaming the BOT Center to PPP Center
PPP Act	TBD (2015)	Potential revisions to RA 7718, including 1) expanding the coverage of PPP to include other public-private co-operation schemes such as joint venture; 2) providing more options for implementing agencies to deal with unsolicited proposals and extend their Swiss challenge period; 3) facilitating expansion/extension of current infrastructure facility; 4) promoting more transparency and efficiency in PPP procurement and contract award; 5) strengthening legal and regulatory support and preventing court injunctions and temporary restraining orders on awarded PPP projects; 6) providing tax exemption to PPP projects of national significance; 7) institutionalising the Contingent Liability Fund, the PDMF, the PPP Governing Board and the PPP Center; and 8) making ADR mandatory for all PPP contracts.

Source: OECD Development Centre based on national sources.

A specialised government unit dedicated to the creation, management and assessment of PPP projects is essential in supporting efficient PPP schemes. As the central co-ordinating and monitoring agency tasked with facilitating the implementation of all PPP projects, the PPP Center of the Philippines offers advisory services; technical assistance; training to national implementing agencies; recommendations on policy reforms to improve PPP-related legal and regulatory frameworks; management of a revolving fund to facilitate project preparations; and implementation monitoring of priority PPP projects. Although the centre is successful in fulfilling its obligations, its role as the *national* agency for PPP programmes restricts its vision mostly to large national infrastructure projects. The country began to encourage PPP schemes at the local level with the first PPP project rolled out by a local government unit in March 2015. PPP units of lower administrative divisions should be established to facilitate smaller, region-specific PPP projects. A clear differentiation of the roles and regulatory powers between a national PPP centre and regional PPP units will need to be defined to ensure efficiency.

POLICY FOCUS

Improve disaster risk management

The Philippines is one of the countries most prone to natural disasters in the world. It is exposed to multiple natural hazards from typhoons, earthquakes, volcanic eruptions and especially flooding. Disasters present a broad range of impacts, with potentially long-lasting, multi-generational effects. In addition to direct damage to lives, buildings, equipment and infrastructure, such disasters may have major indirect consequences, such as interruption of business, loss of employment and output, decrease in tax revenues, impaired institutional capacities and a rise in poverty rates. These impacts generate potentially catastrophic losses, particularly in the context of a developing country like the Philippines. Existing uncontrolled urbanisation, fragile infrastructure and high poverty rates exacerbate its vulnerabilities, while its underdeveloped risk-management infrastructure does nothing to alleviate or mitigate related costs.

In response to the increasingly devastating effects of disasters, the government strengthened the risk-management framework long before the advent of Typhoon Yolanda.[1] Along with the increase in number and impact of disasters (possibly associated with climate change and human factors, such as urbanisation), related reforms were implemented in the 2000s. In 2005, the Philippines adopted the *Hyogo Framework for Action 2005-2015*, which served as a guideline to reducing disaster risk and vulnerability to natural hazards. In 2009, the Senate of the Philippines ratified the *ASEAN Agreement on Disaster Management and Emergency Response* (AADMER),[2] which binds ASEAN member states to promoting regional co-operation, collaborating in reducing disaster losses and intensifying joint emergency response. In addition, the Philippine Disaster Risk Reduction and Management Act of 2010 acknowledges the need to adopt a comprehensive disaster risk-management approach, and the National Disaster Risk Reduction and Management Plan 2011-2028 was established in 2010.

Despite these measures, there is still ample room to strengthen the disaster risk-management framework in the Philippines. Common among recent reforms has been a focus on risk-mitigation strategies and risk-financing capacity. Development of a comprehensive disaster risk-financing and insurance strategy to strengthen the country's fiscal resilience is part of this holistic approach. Following Typhoon Yolanda and its large associated costs, even greater attention has been focused on these areas with two issues identified as key: 1) finance and risk sharing; and 2) institutions and governance in line with the *Methodological Framework of Disaster Risk Assessment and Risk Financing: A G20 and OECD Methodological Report* and the OECD report *Disaster Risk Financing in APEC Economies: Practices and Challenges*.

More recently, after Typhoon Yolanda, the Reconstruction Assistance on Yolanda (RAY) was adopted as the Philippine government's strategic plan to guide the recovery and reconstruction of the economy and lives and livelihoods in affected areas. The objective of the plan is to restore the economic and social conditions of these areas to their pre-typhoon levels at minimum and to a higher level of disaster resilience. NEDA released the RAY *Build Back Better* document in December 2013, right after Yolanda. It provided a preliminary assessment of damage and loss, economic and social impact, and recovery and reconstruction plans. A second RAY document, *Implementation for Results*, was released in 2014, providing a framework to ensure that the objectives of the Yolanda rehabilitation programme are closely aligned with the Philippine Development Plan 2011-2016.

Early warning tools in the Philippines are being improved

Early warning is a critical element of disaster preparedness that can save lives and limit the impact of natural disasters. Effective early warning systems include four interdependent aspects: 1) risk knowledge developed through systematic data collection on potential events and exposures; 2) monitoring and warning systems to identify and assess specific risks; 3) communication and dissemination systems to spread risk information and early warnings to affected populations; and 4) response capabilities developed at the national and local level.

The Philippine Atmospheric, Geophysical and Astronomical Services Administration and the Philippine Institute of Volcanology and Seismology are the central government institutions tasked with detection and warning alerts. They work in close co-operation with Project Nationwide Operational Assessment of Hazards (NOAH), a programme launched by the Department of Science and Technology in 2012 to forecast natural hazards and incite disaster preparedness. It works with warning agencies to provide a six-hour lead-time warning to vulnerable communities against impending floods.

At the same time, new technologies are being incorporated into early warning systems alongside traditional methods of communication. Information and communication technology tools and improved tools for analysis have helped to improve the early warning system in the Philippines. For example, the National Telecommunications Commission is implementing the Integrated Services Digital Broadcast-Terrestrial (ISDB-T) standard adopted by 16 other countries as of October 2014. An important feature of the ISDB-T system is the Emergency Warning Broadcast System. This enables a remote emergency warning signal to turn on receivers, such as mobile phones and televisions, that are in standby mode automatically, proceeding to automatic activation and reception of warning broadcasts of occurring natural hazards.

High-tech solutions are also being used to improve longer-term disaster planning. The Disaster Risk and Exposure Assessment for Mitigation programme of the Department of Science and Technology, in partnership with the University of the Philippines, is applying remote sensing Light Detection and Ranging technology to produce detailed, high-resolution three-dimensional flood hazard maps. These maps will help to create improved flood forecasting models, which will be incorporated into Project NOAH. Similarly, the Coastal Hazards and Storm Surge Assessment and Mitigation, another component of Project NOAH, is generating wave surge, wave refraction and coastal circulation models to understand and recommend solutions for coastal erosion. This will be used to predict storm surge impacts and provide a high resolution simulation of where and how a storm surge will affect local communities.

Box 6.3.1. **Catastrophe bonds**

Risks associated with natural disasters can be managed through the use of catastrophe-linked securities, such as catastrophe bonds. These have recently gained popularity among investors, particularly long-term funds, with more than half of the capital in catastrophe-linked assets coming from pension funds, endowments and sovereign wealth funds. These often offer a high yield, with a typical return in the range of 5-15% above the London Interbank Offered Rate (Risk Management Solutions, 2012).

The Government of the Philippines entered into a special contingent credit arrangement with the World Bank, the Disaster Risk Management Development Policy Loan with a Catastrophe Deferred Drawdown Option (CAT-DDO), in September 2011. This financial tool, aimed at covering disaster costs in excess of funds allocated under the Philippine Disaster Risk Reduction and Management Act of 2010, is a contingent credit line providing immediate liquidity up to the amount of USD 500 million or 0.25% of GDP (whichever is less) in the aftermath of a natural disaster. This arrangement was soon used after Tropical Storm Sendong (Washi), which hit the country on 29 December 2011. The Philippines was able to access the full amount of the CAT-DDO, USD 500 million, immediately to reduce the fiscal burden associated with the disaster.

Notes

1. For instance, in 1941, the Civilian Emergency Administration was established and tasked to formulate and execute policies and plans for the protection and welfare of the civilian population under extraordinary and emergency conditions. In 1954, the National Civil Defense Administration (NCDA) and the national and local civil defence councils were established. In 1970, a Disaster and Calamities Plan was prepared. Then in 1972, the Office of Civil Defense was established to co-ordinate national level activities and functions of the national government, private institutions and civic organisations. In 1978, a Presidential Decree was issued to strengthen the Philippines disaster control capability and to establish a national programme for community disaster preparedness.
2. The AADMER contains provisions on disaster risk identification; monitoring and early warning; prevention and mitigation; preparedness and response; rehabilitation; technical co-operation and research; mechanisms for co-ordination; and simplified customs and immigration.

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Key government ministries in the Philippines

President	Benigno Aquino III
Vice-president	Jejomar Binay
Agrarian reform	Virgilio De Los Reyes
Agriculture	Proceso Alcala
Budget and management	Florencio Abad
Defence	Voltaire Gazmin
Education	Armin Luistro
Energy	Carlos Petilla
Environment and natural resources	Ramon Paje
Executive secretary	Paquito Ochoa, Jr.
Finance	Cesar Purisima
Foreign affairs	Albert del Rosario
Health	Janette Loreta-Garin
Interior and local government	Mel Senen Sarmiento
Justice	Alfredo Caguioa
Labour and employment	Rosalinda Baldoz
National economic and development authority	Arsenio Balisacan
Public works and highways	Rogelio Singson
Science and technology	Mario Montejo
Social welfare and development	Corazon Juliano-Soliman
Tourism	Ramon Jimenez, Jr.
Trade and industry	Gregory Domingo
Transportation and communications	Joseph Emilio Abaya
Central Bank Governor	Amando M. Tetangco

Note: Valid as of 31 October 2015.

Thailand

A. Medium-term economic outlook (forecast, 2016-20 average)

GDP growth (percentage change):	3.6
Current account balance (% of GDP):	2.1
Fiscal balance (% of GDP) (central government):	-2.8

B. Medium-term plan

Period: 2012-16

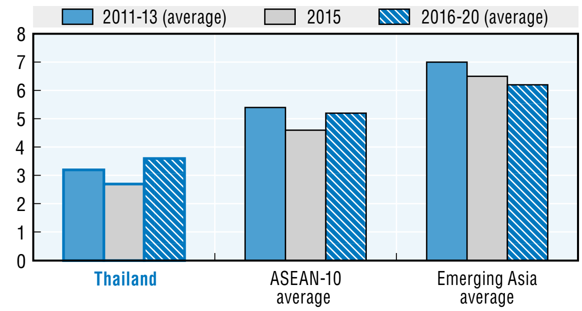
Theme: A happy society with equity, fairness and resilience under the philosophy of a sufficiency economy

C. Basic data (in 2014)

Total population:	65.1 million*
Population of Bangkok:	10.63 million*
Nominal GDP (US dollar):	404.82 billion
GDP per capita at PPP:	15 578.56 (current International Dollar) **
Exchange rate in the first half of 2015 (period average):	32.94 (THB/USD)

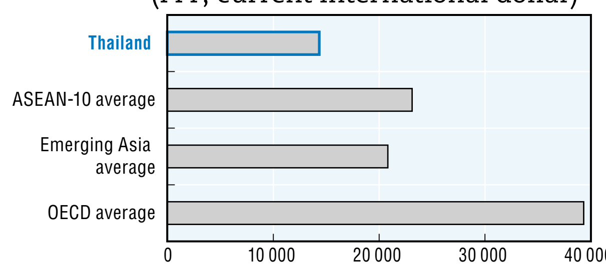
Note: * Population data for 2014 are estimates.
**IMF estimate.
Sources: OECD Development Centre, MPF-2016, national sources, CEIC and IMF.

GDP growth rates (percentage change)



Source: OECD Development Centre, MPF-2016.

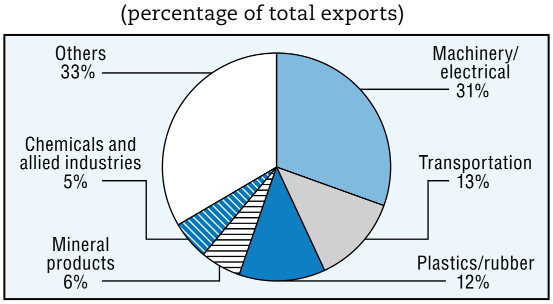
GDP per capita, 2014 (PPP, current international dollar)



Source: IMF.

Composition of exports, 2014

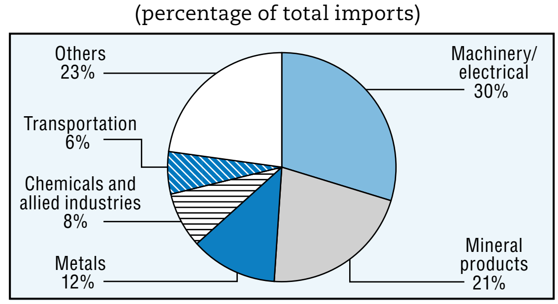
(percentage of total exports)



Source: Trademap.

Composition of imports, 2014

(percentage of total imports)



Source: Trademap.

Strengthening economic and social development has been the focus of development plans in Thailand. The country enjoyed relatively high growth rates before the global financial crisis, with average gross domestic product (GDP) growth of 5.6% from 2003 to 2007. However, growth began to slip in late 2013 and has not yet made a significant recovery. Over the past two years, a period of political instability has been accompanied by an economic slowdown. Additional macroeconomic measures to strengthen the momentum of growth need to be carefully managed in order to be effective. The tourism sector, which has remained relatively resilient, could underpin the recovery of growth.

Thailand: Medium-term policy challenges and responses

- Use macroeconomic policies to revive growth
- Strengthen sustainable tourism

POLICY FOCUS

Use macroeconomic policies to revive growth

Annual GDP growth in Thailand was only 0.9% in 2014, although it picked up in the first two quarters of 2015, to 3.0% in Q1 and 2.8% in Q2. The slowdown was felt across the economy, with a few exceptions in the services and utilities sectors; for example, growth reached 6.6% in financial intermediation and 3.8% in education in 2014. Households remained cautious about spending, and private consumption growth contracted by 1.5% in Q2 amid uncertain economic prospects. At the same time, a decline in investment had a large negative impact on GDP growth in 2014. Exports of goods and services did not grow in 2014, while imports of goods and services declined by 5.4%. Meanwhile, political uncertainties could affect growth. Under a plan for the re-establishment of democratic rule, adopted in May 2014, elections were to be in October 2015 following a period of dialogue and reconciliation and the adoption of a new constitution. But that date has been pushed back due to delays in approving the new constitution (Box 6.4.1).

Box 6.4.1. **Constitutional reform and the return to democracy**

Following the establishment of the ruling National Council for Peace and Order (NCPO) on 22 May 2014, Thailand's military-led administration outlined a three-part plan to lead to the re-establishment of democratic rule. The plan called for a period of reconciliation and dialogue among political factions; the establishment of a legislative council, the National Reconciliation Commission (NRC); and a democratic election under a new constitution. This process was originally intended to take a little more than one year to complete, with elections to be held in October 2015, but delays in adopting the constitution have altered the time frame (Table 6.4.1).

Table 6.4.1. **Time frame for moving to new elections**

Time	Progress / plan
From August 2014 (2-3 months)	Facilitation of reconciliation and peace through dialogue among all political factions, overseen by reconciliation centres established by the NCPO. A temporary constitution was created in July 2014 to legitimise the May military takeover and allow the establishment of an interim government.
November 2014	NRC holds first session. 250 members selected by military administration are tasked with developing reforms and designing and approving a new draft constitution.
September 2015	NRC votes down the draft constitution prepared by the Constitution Drafting Committee.
October 2015	New constitution drafting panel to be established
August – September 2016	Possible date of public referendum on revised draft constitution
First half of 2017	Earliest possible date of elections

Source: National sources.

Box 6.4.1. **Constitutional reform and the return to democracy** (*cont.*)

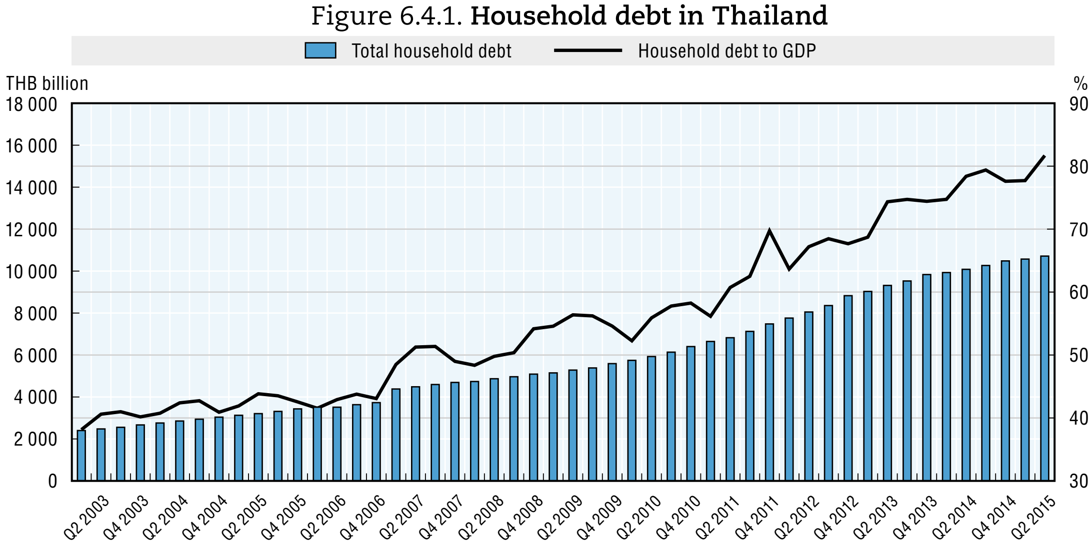
An interim constitution came into force on 22 July 2014 and the NRC, a 250-member body appointed by the military administration, was formed in November 2014 under this interim document. However, finalisation of the new constitution and progress on the roadmap to democracy have been delayed. The NRC's Constitution Drafting Committee (CDC) produced a draft charter including changes to the electoral system and composition of the Senate, which would be mostly appointed, among other aspects of government. While the administration originally stated that the draft constitution would not be put to a nationwide vote, it was announced in May 2015 that a referendum would in fact be held on the new constitution following its approval by the NRC, which received the draft in August. But the NRC voted against the draft constitution by 135 to 105, with 7 abstentions. As had been planned beforehand, the NRC was disbanded after this vote. A new 21-member panel was to be selected by the military administration in October charged with rewriting the draft constitution. Following initial approval, this revised draft would be put to a public referendum in August or September 2016. If approved in the referendum, elections could be held in the first half of 2017 at the earliest.

Rising household debt is a cause for concern

Private consumption is an important driver of the Thai economy. In order to boost private consumption, the Thai government approved a THB 136 billion (Thai Baht) stimulus package on 31 August 2015. This consumption-oriented stimulus package includes THB 60 billion in soft loans to low-income earners via village funds, with two years' interest waived; THB 36 billion for local governments of sub-districts, or *tambon*; and THB 40 billion to support small government projects.

These efforts may be impeded, however, by the problem of Thailand's rising household debt. Over the past decade, household debt has been rising quickly, from around 40% of GDP in 2003 to 80% currently (Figure 6.4.1). This level is one of the highest among Southeast Asian countries, following Malaysia.

Figure 6.4.1. **Household debt in Thailand**



Source: CEIC.

StatLink http://dx.doi.org/10.1787/888933310314

While gross debt accumulation has slowed since 2013, reflecting consumer concern over spending amid worsening economic prospects, the ratio of debt to GDP has maintained its upward trend, indicating a slowdown in household income. The heavy debt burden lowers the incentive for households to consume and hampers the effectiveness of a stimulus policy that aims to offer low-interest loans, as people are reluctant to take on more debts. Government policies to strengthen social safety nets and other social assistance programmes could be effective in strengthening consumption in the long term.

Careful management of macroeconomic policies can help revive growth

An improvement in exports could play an important role in reviving growth. Although Thailand's trade balance rose from USD 6.7 billion in 2013 to USD 24.6 billion in 2014, and its current account balance improved from -1.0% of GDP to 3.6% of GDP over the same period, this was the result of a large drop in imports rather than an increase in exports. In 2015, growth in exports of goods and services, at only 1.0% in both Q1 and Q2, has been slower than growth in the economy as a whole. In addition to domestic factors and slow investment growth in particular, Thai exporters are constrained by the recent slow growth of major trading partners, especially China, Thailand's largest export market.

In order to stimulate economic growth, the Bank of Thailand cut policy interest rates twice between March and April, from 2% to 1.5%. Economic recovery nonetheless remained sluggish, mainly because the impact on the real economy was limited. Relatively high exchange-rate volatility might be affecting the weak impact on the real economy.

A second recent stimulus package, announced by the Thai government on 9 September 2015, is therefore a step in the right direction. This THB 206 billion package represents about 1.6% of Thai GDP in 2014. It will include a number of measures to support small and medium-sized enterprises (SMEs), providing soft loans, loan guarantees and corporate tax cuts. For example, the corporate tax rate for SMEs with net profit of more than THB 300 000 will go down from the current rate of 15-20% to 10% for 2015-16. Newly registered start-up companies in targeted industries such as food processing and high tech will enjoy a five-year tax holiday. The government will also subsidise loans to SMEs and keep interest rates low in order to encourage investment by small businesses. This new stimulus package has been welcomed by the private sector and is likely to boost business sentiment in Thailand: the Thai benchmark stock index hit a three-week high immediately after the announcement.

POLICY FOCUS

Strengthen sustainable tourism

The tourism sector has remained relatively resilient despite the instability in Thailand, although there might be some negative near-term impact due to the bombing in Bangkok in August. Tourism is one of the most important sectors in Thailand's economy: travel and tourism directly accounted for 8.6% of GDP in 2014 and directly contributed 5.8% to total employment (World Travel and Tourism Council, 2015). The total contribution of the sector, including direct, indirect and induced impacts, was 19.3% of the country's

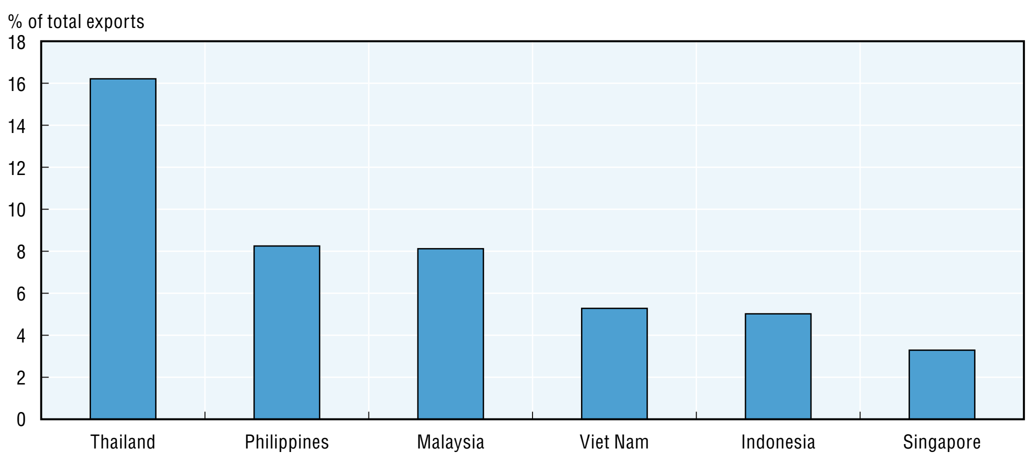
GDP in 2014.[1] Compared to other countries in the region, Thailand's economy is relatively more dependent on tourism. The share of tourism revenues in Thailand's total exports of goods and services is higher than in any of its neighbouring countries (Figure 6.4.2).

The Thai tourism sector faces challenges

Thailand's tourism sector tends to bounce back despite negative shocks and is known for its resilience (Credit Suisse, 2014). However, more attention to the sector is needed, as tourism continues to face significant challenges due to recent domestic and international developments. Visitor arrivals dropped in 2014 following the political unrest (Figure 6.4.3), and there is new pressure due to the recent bombing. Promptly building back confidence in the country's stability is crucial, while at the same time steps should be taken to ensure safety and security in order to build confidence among tourists.

The Thai government has recognised the importance of the tourism sector in the economy. The 11th national economic and social development plan (2012-16) included tourism development as part of an effort to restructure the country's service sector. The plan envisages rehabilitating and increasing the quality of tourist attractions to improve market demand. The government set targets of THB 1.4 trillion (approximately USD 38.6 billion) in tourist receipts and 28.8 million international visitors for 2015.

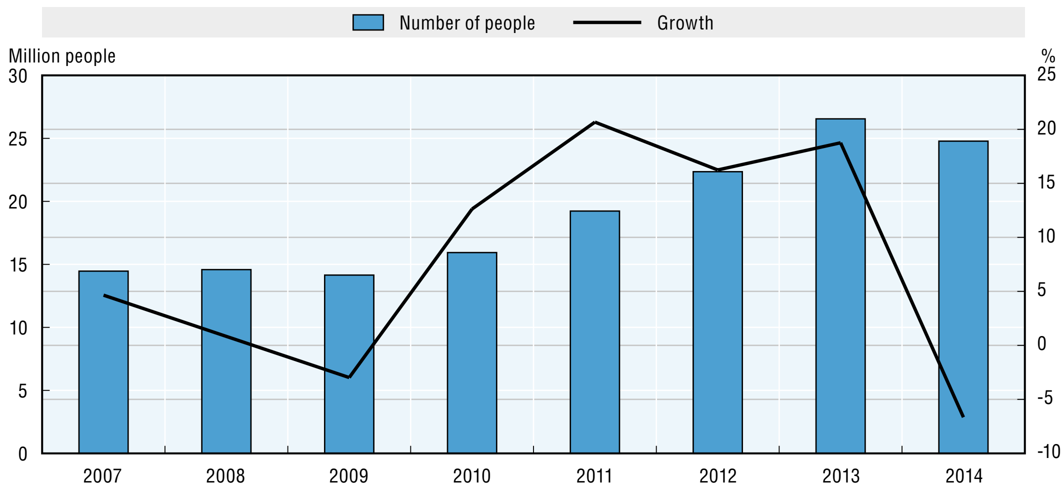
Figure 6.4.2. **International tourism receipts of Thailand 2013**



Source: World Bank (2015) *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.
StatLink http://dx.doi.org/10.1787/888933310327

In its efforts to promote tourism, the Thai government has launched a campaign called "Discover Thainess 2015". Implemented by the Tourism Authority of Thailand (TAT), it aims to attract more tourists and have them stay longer and spend more in the country. Special activities and events are being held throughout the year to promote "Thainess" – Thai characteristics and aspects of culture such as the Thai way of life, food, arts, wellness, festivals, wisdom and fun. The campaign identified 12 provinces as "hidden gems" that are recommended for tourists: Lampang, Phetchabun, Nan, Buri Ram, Loei, Samut Songkhram, Ratchaburi, Trat, Chanthaburi, Trang, Chumphon, and Nakhon Si Thammarat. As of August, the country had received 20.11 million international visitors and THB 952 billion in tourist revenues since January 2015, according to the TAT.

Figure 6.4.3. **Visitor arrivals in Thailand**



Source: CEIC.

StatLink http://dx.doi.org/10.1787/888933310331

Sustainable tourism should be developed further

While increasing the number of tourists is important, it is also crucial to ensure the sustainability of the sector by promoting sustainable tourism and non-traditional tourist activities, such as community-based tourism and ecotourism. Co-operation and co-ordination between the public and private sectors is necessary to ensure that the government's plans are in line with the industry's needs. Association of Southeast Asian Nations (ASEAN) regional integration could also be seen as an opportunity to boost Thailand's tourism sector.

Despite the tourism sector's contribution to the economy through revenues and employment opportunities, concerns have been growing about the potential costs of tourism to the economy. Poorly planned and managed tourism can negatively affect the host country. One such factor is financial leakage, when revenues arising from tourism-related activities do not reach or do not remain in the destination country. A study of tourism leakage in Thailand estimated that 70% of all money spent by tourists ended up leaving Thailand, through foreign-owned tour operators, airlines and hotels, or through imported drinks and food (Boz, 2011). In addition, tourism can put pressure on the environment. Poorly managed mass tourism can be responsible for rising greenhouse gas emissions, problems with water and waste management and degradation of biodiversity, among other issues. In Thailand, this poses the challenge of facilitating economic growth while at the same time protecting the country's natural resources (Nitikasetsoontorn, 2015).

Considering the importance of tourism to the economy, Thailand should pay more attention to the sector's sustainability. This means taking into account tourism's current and future impact on Thailand's environment, infrastructure, culture and local economic development. Community-based tourism enhances the involvement and participation of local people in planning and developing tourism in their areas. The aim is to ensure a positive impact of tourism on the social, economic and environmental condition of their communities. Ecotourism, meanwhile, aims to promote sustainable development by encouraging nature-based tourism. In comparison with mass tourism, community-based tourism and ecotourism are often considered to be alternatives for ensuring sustainability.

The Thai government has acknowledged the importance of sustainable tourism. A body known as the Designated Area for Sustainable Tourism Administration has been established, tasked with: creating a dialogue among all concerned parties, including government agencies, network partners and the private sector; working with local authorities and communities to realise their potential; and promoting best practices in the areas of human capital, financial seeding tools and knowledge in management in order to achieve sustainable tourism development.

Six areas have been designated for sustainable tourism: *i)* the Chang Islands and vicinity, as a “Low Carbon Destination”; *ii)* Pattaya city and vicinity as a “Greenovative Tourism City”; *iii)* the historical parks of Sukhotai-Si Satchanalai-Kamphaengphet as a “World Heritage City”; *iv)* Loei as a “Leisure City”; *v)* Nan Old Town as a “Living Old Town”; and *vi)* Uthong Ancient City as “Origin of Suvarnabhumi”. Destinations in these designated areas are being developed for sustainability in three dimensions: economic sustainability, which supports creative tourism; social sustainability, which supports community-based tourism, and environmental sustainability, which supports low-carbon tourism.

Challenges remain, however. It is not an easy task to develop new destinations and create new tourism activities that are different and non-traditional, while at the same time ensuring the attractiveness of these destinations. People need to be made aware of the benefits and importance of sustainable tourism. Community-based, environment-friendly and low-carbon tourism need further promotion – not only in order to attract tourists, both domestic and international, but also to encourage the participation and involvement of community members. It is also crucial to improve the skills of local people in areas relating to tourism: foreign languages, hospitality and tour guiding, as well as marketing and entrepreneurship. Moreover, infrastructure development is needed to support the main goals of sustainable tourism. The country’s public transport system should be well linked to tour routes in order to provide easy access to tourist destinations.

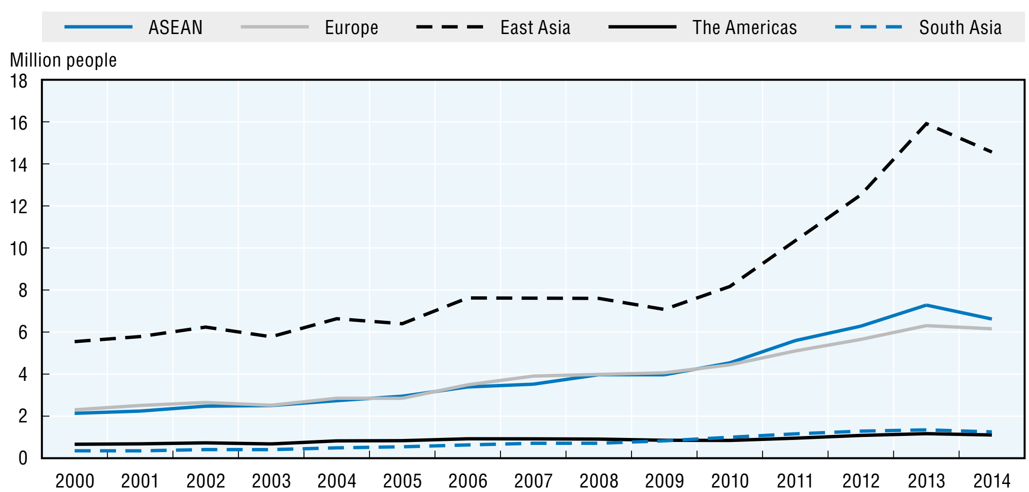
ASEAN regional integration can help boost tourism

The ASEAN region is considered the fastest growing area in terms of international tourist arrivals. The region has attracted a large volume of visitors in recent years and Thailand is one of the largest tourist recipients. The ASEAN countries have implemented various measures to increase regional connectivity, and this should help stimulate tourism. For example, ASEAN has sought to facilitate the movement of tourism professionals by implementing the ASEAN Mutual Recognition Arrangement on Tourism Professionals. Under this arrangement, common standards have been established for 32 job titles under 6 tourism areas: tour operation, travel agencies, front office, housekeeping, food production, and food and beverage service. Other measures include the establishment of the ASEAN Tourism Qualifications Equivalent Matrix as a reference for the industry, and the ASEAN Tourism Professional Registration System.

In addition, Thailand participates in sub-regional initiatives such as the Greater Mekong Sub-region (GMS), which has launched a tourism package to promote tourism connectivity within the Greater Mekong area. Under this umbrella, Thailand has started co-operation in tourism with other GMS countries. For instance, the TAT collaborates with Myanmar in a tour package called “Two Kingdoms One Destination”.

The ASEAN integration measures offer new tourism opportunities to each of the member countries, including Thailand. Tourism-related companies can refer to ASEAN standards to improve their quality and competitiveness. With the free movement of tourism professionals, companies can recruit qualified workers from other ASEAN countries, while domestic tourism workers can move to other ASEAN countries. The benefits of this regional integration come not only in the form of free movement of intra-regional professionals, but also of intra-regional tourists. Thailand still has room for improvement in terms of increasing the number of tourists coming from other ASEAN countries. Far fewer tourists are coming to Thailand from ASEAN than from East Asia, and the number of ASEAN tourists visiting Thailand hardly differs from the number of visitors from geographically distant Europe (Figure 6.4.4). Attracting more ASEAN tourists could therefore help boost the country's tourism sector.

Figure 6.4.4. **Visitor arrivals in Thailand by nationality**



Source: CEIC.

StatLink http://dx.doi.org/10.1787/888933310349

ASEAN integration, despite its benefits, also means that workers in the tourism sector face greater competition. Improving the quality of human capital is therefore an urgent matter for Thailand. Micro, small and medium enterprises involved in tourism will be particularly affected by increased competition. It is necessary to improve small businesses' adaptability to change to enable them to follow new developments in the sector. Steps like the adoption of information and communications technology should be encouraged. Increased tourism could also put further pressure on infrastructure and the environment. Collective and regional measures are needed to address these issues, many of which will have regional consequences. The ASEAN member countries should therefore not work in isolation on promoting sustainable tourism, but should join forces and work together.

Note

1 Total contribution includes direct, indirect and induced impacts on the economy. Indirect contribution includes GDP and jobs supported by travel and tourism spending, government collective spending which helps travel and tourism activity, domestic purchases of goods and services by the sectors dealing directly with tourists, while induced contribution measures GDP and jobs supported by the spending of those who are directly or indirectly employed by the travel and tourism sector.

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Key government ministries in Thailand

Prime Minister	Prayuth Chan-ocha
Agriculture and co-operatives	General Chatchai Sarikulya
Commerce	Apiradi Tantraporn
Culture	Veera Rojpojanarat
Defence	General Prawit Wongsuwon
Education	General Dapong Ratanasuwan
Energy	General Anantaporn Kanchanarat
Finance	Apisak Tantivorawong
Foreign affairs	Don Pramudwinai
Health	Piyasakol Sakolsatayadorn
ICT	Uttama Savanayana
Industry	Atchaka Sibunruang
Interior	General Anupong Paochinda
Justice	General Paiboon Khoomchaya
Labour	General Sirichai Ditthakul
National economic and social development board	Arkhom Termpittayapaisith
Natural resources and environment	General Surasak Kanchanarat
Science and technology	Pichet Durongkaveroj
Social development and human security	General Adul Saengsingkaew
Tourism and sports	Kobkarn Wattanavrangkul
Transport	Arkhorn Termpittyapaisith
Central Bank Governor	Veerathai Santiprabhob

Note: Valid as of 31 October 2015.

Viet Nam

A. Medium-term economic outlook (forecast, 2016-20 average)

GDP growth (percentage change):	6.1
Current account balance (% of GDP):	3.2
Fiscal balance (% of GDP) (central government):	-4.9

B. Medium-term plan

Period: 2011-20

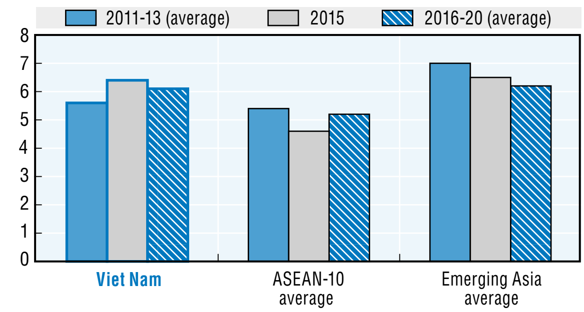
Theme: A modern, industrialised country by 2020.

C. Basic data (in 2014)

Total population:	90.7 million*
Population of Hanoi:	7.09 million*
Nominal GDP (US dollar):	185.90 billion **
GDP per capita at PPP:	5 655.79 (current International Dollar) **
Exchange rate in the first half of 2015 (period average):	21 520.76 (VND/USD)

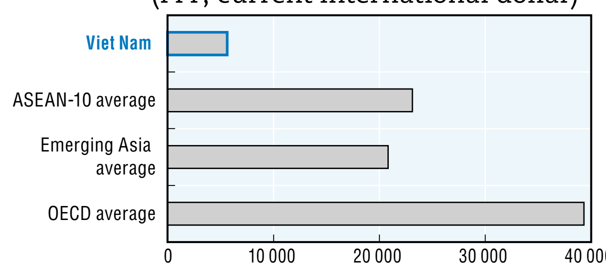
Note: * Population data for 2014 are estimates.
** IMF estimate.
Sources: OECD Development Centre, MPF-2016, national sources, CEIC and IMF.

GDP growth rates (percentage change)



Source: OECD Development Centre, MPF-2016.

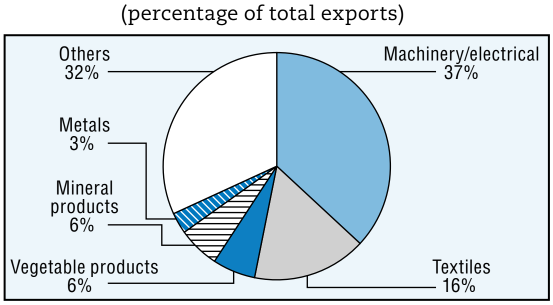
GDP per capita, 2014 (PPP, current international dollar)



Source: IMF.

Composition of exports, 2014

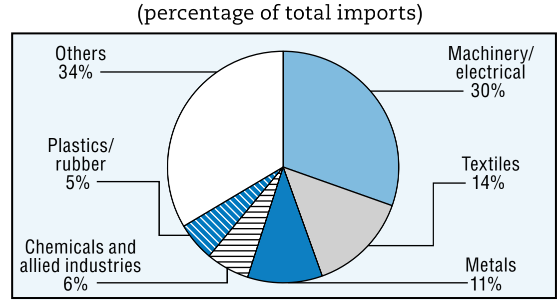
(percentage of total exports)



Source: Trademap.

Composition of imports, 2014

(percentage of total imports)



Source: Trademap.

Growth in Viet Nam has been strong and macroeconomic stability has improved, with inflation falling considerably. International openness has been an important engine of growth, with growing exports. The current five-year Socio-Economic Development Plan (SEDP 2011-2015) aims for sustainable and inclusive growth towards the goal of becoming a "modernity-oriented industrial nation by 2020". To maintain high rates of growth, more work will be needed on promoting development. Of particular importance will be the development of needed infrastructure, the reform of state-owned enterprises (SOEs) to encourage efficiency and fair competition, and encouraging a robust labour market that will create jobs and raise productivity.

Viet Nam: Medium-term policy challenges and responses

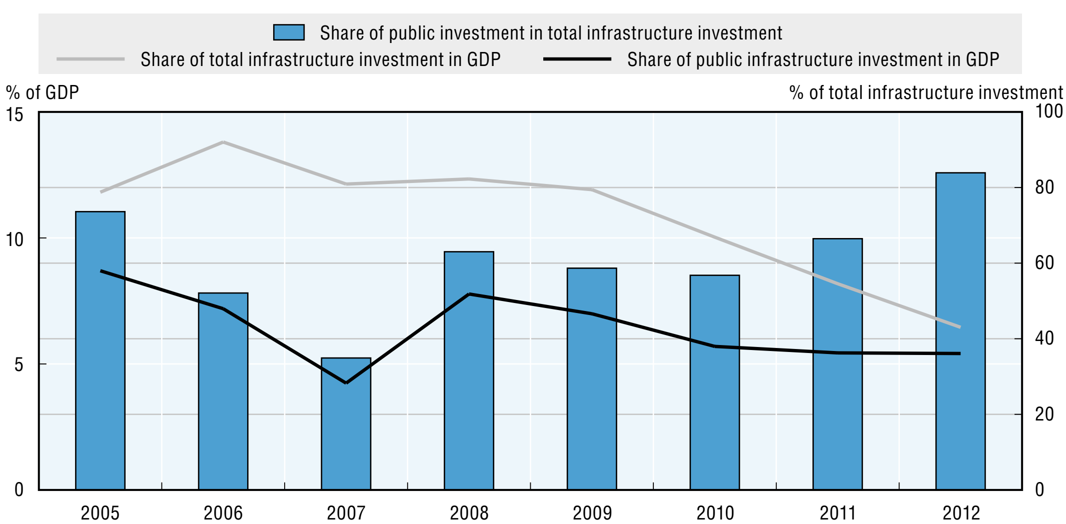
- Improve infrastructure to support growth
- Reform and restructure state-owned enterprises
- Promote job creation and productivity growth

POLICY FOCUS

Improve infrastructure to support growth

Strengthening investment in infrastructure is considered one of the most important measures for promoting Viet Nam's industrialisation and modernisation by 2020. Investment in infrastructure always accounts for a significant share of total investment in Viet Nam; it exceeded 10% of total investment from 2005 to 2011, but dipped to 8.2% in 2012 and 6.5% in 2013. Despite this decline, however, the share is still considerable compared to that of other ASEAN countries, namely Indonesia, Philippines, Cambodia, etc. Though mobilisation of capital for infrastructure investment has become more diversified with the increasing engagement of the private and foreign direct investment (FDI) sectors, public investment still accounts for the biggest share (Figure 6.5.1).

Figure 6.5.1. **Public investment accounts for the biggest share in infrastructure investment in Viet Nam**



Note: Infrastructure investment includes electricity, gas, steam and air conditioning supply; water supply, sewerage, waste management and remediation activities; construction; transport and storage; and information and telecommunication. The share of public investment to total infrastructure investment is indicated in the right axis.

Source: General Statistics Office of Viet Nam, www.gso.gov.vn.

StatLink http://dx.doi.org/10.1787/888933310358

Public investment is less effective than investment from other sources and overall investment. A calculation by Pho Thi Kim Chi (2013) shows that the incremental capital/output ratio (ICOR) of the state sector is always higher than that of other sources, despite recent improvement. For example, the overall ICOR in 2011 is estimated at 5.38, while the figure for the state sector is estimated at 8.54. The seriousness of this inefficiency is also reflected in the lack of responsiveness of gross domestic product (GDP) growth to investment: the GDP growth rate decelerated between 2006 and 2010, even as the investment rate increased steadily during that period.

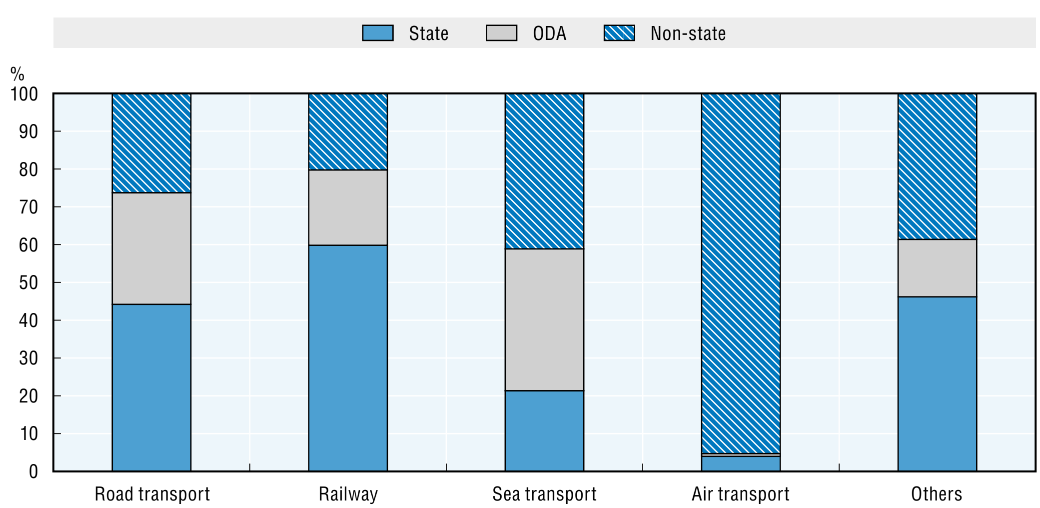
The effectiveness of public investment projects has not yet been assessed. In general, Viet Nam focuses only on raising the absolute level of investment, rather than on the outcome of investments and the cost of public projects. The fragmentation of public infrastructure investment also results in duplication and waste, and is a major underlying cause of investment inefficiency.

Additional investment in infrastructure is needed to achieve growth

For Viet Nam to achieve the GDP target of USD 300 billion by 2020, total capital demand for the period 2016-20 is projected at VND 2 200 trillion to 2 300 trillion (Viet Nam dong), according to a 2013 World Bank estimation, and each year Viet Nam will need to mobilise USD 30 billion for infrastructure projects. Meanwhile, Thanh and Dapice (2009) have projected that there will be a huge annual shortfall of needed infrastructure investment, with potential available annual funding from the public and private sectors at less than USD 16 billion per year.

According to a Ministry of Transport estimation (2014), over the next five-year period (2016-20), mid-term capital demand for transport infrastructure projects (including roads, railways, airways, seaways and other related areas) will exceed VND 1 015 trillion, of which the state will provide 41.6%, while 24.1% will be mobilised from official development assistance (ODA) and 34.3% from other non-state sources (Figure 6.5.2). Road transport projects are estimated to account for the largest share (64.1%), followed by railway projects (11.7%), air transport projects (10.0%), etc. This indicates that public investment will be able to finance less than half of mid-term capital demand for transport infrastructure in the coming period. Meanwhile, the capacity to mobilise capital from other sources is unsecured, and will depend on investment incentives put forward by the government and local authorities, as well as the internal and external economic condition, which is uncertain.

Figure 6.5.2. **Planned capital mobilisation for transport infrastructure in Viet Nam, 2016-20**



Source: Ministry of Transport of Viet Nam (2014), *Draft of medium-term capital demand for the period of 2016-2020*.
StatLink http://dx.doi.org/10.1787/888933310367

Additional sources of funding are needed to finance infrastructure investment

As indicated above, state investment is expected to meet less than half of capital demand in the 2016-20 period. Meanwhile, mobilisation of ODA capital will be more difficult, as Viet Nam has now moved up to the status of a lower middle-income country. With ODA for Viet Nam likely to decrease in the future and be replaced by commercial lending, strengthening capital mobilisation from other sources is critical for the country's socio-economic development in general and for infrastructure development in particular.

Viet Nam recently enacted policies to restructure public investment towards efficiency-based allocation and to strengthen institutional frameworks for monitoring and assessing projects financed by public investment. The legal framework for public investment activities has been institutionalised: the Law on Public Investment, which took effect on 1 January 2015, seeks to improve the effectiveness of public investment management in line with international practices; the Law on Enterprises, which was approved by late 2014 and took effect on 1 July 2015, regulates the management and utilisation of state capital in manufacturing and business activities at enterprises. Viet Nam is also taking legal steps to encourage foreign and private investors to engage in infrastructure investment. The Law on Investment, promulgated in late 2014 to replace the previous 2005 law, aims to create a more favourable environment for business and investment activities by simplifying customs and administrative procedures and improving transparency. The Law on Auction, promulgated in 2013, provides consistent and unified regulations on auctions in order to promote transparency and competition and thus improve the efficiency of public investment. A measure adopted in 2010 (Decision No. 71/2010/QD-TTg) instituted regulations for pilot public-private partnership (PPP) investment projects. These policies could help Viet Nam mitigate its dependence on public investment for infrastructure and improve the investment environment for both public and non-public investments.

Though the government has paid attention to capital mobilisation from the private sector via PPP, BT projects, build-operate-transfer (BOT) projects, etc., such measures are only suitable for large investors, not small investors. An alternative practical measure would be to mobilise capital from domestic and foreign sources via domestic and foreign capital markets. Emphasis should be placed on mobilising unemployed domestic capital from citizens, life insurance and social insurance funds and foreign sources. Public infrastructure projects can be securitised and then sold in stock markets. In India, for example, infrastructure development funds may issue government-guaranteed bonds and sell them at domestic and foreign stock markets. In the case of Korea, each infrastructure project may establish a management fund unit, which will then be listed in the stock market. The state can engage in the fund via capital contribution or by providing guarantee services, buying shares, etc. When the project is completed or is able to mobilise stable capital flows, the state may withdraw its capital in the fund for transfer to other projects. This approach is only effective if the government can reinforce the transparency and accountability of public investment activities through an effective audit mechanism and supervision, inspection and monitoring, especially of citizens and the community.

POLICY FOCUS

Reform and restructure state-owned enterprises

In reforming state-owned enterprises, Viet Nam maintains a gradual approach – it starts by changing the legal framework and then proceeds to *equitisation* of small SOEs, while remaining in control of big SOEs. The SOE reform process consequently takes a long time, with modest results. Private firms face unfair competition from large SOEs, which have preferential access to financial and other resources. The efficiency of these firms and of the business sector more generally could be improved through reforms to create a level playing field, with improved transparency and accountability for SOEs.

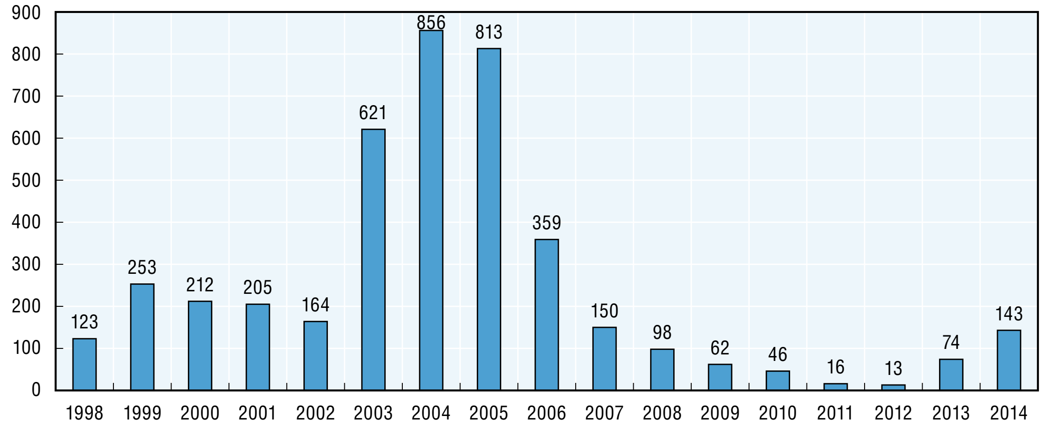
SOE reform has been gradual in Viet Nam

For a long time, Viet Nam's SOEs operated under a particular legal framework for management that gave SOEs a specific legal form and operating mechanism distinct from the rules for private enterprises. In 2005, in preparation for joining the World Trade Organization, the Law on Enterprises was promulgated with the goal of establishing a uniform legal framework ensuring equality among the enterprises of all economic sectors. Then, from 1 July 2010, SOEs were converted into limited liability companies and joint-stock companies. In 2014, Viet Nam continued to amend the Law on Enterprises and the Law on Investment – which are not directly related to SOEs, but mark a step towards creating a level playing field among different types of enterprises and enhancing market competition. The Law on Public Investment, which took effect on 1 January 2015, demonstrates the government's support of SOE restructuring. Currently, there is no *de jure* distinction between SOEs and private enterprises in the business legal system.

The main measure of reform of SOEs in Viet Nam is *equitisation*, or transforming SOEs into joint stock companies, through either the partial or full sale of state capital. This measure was strongly implemented in the 2001-06 period and then slowed to nearly a standstill; the process restarted and accelerated in 2011, although the pace remains quite slow. Viet Nam also applied other measures, such as transferring SOEs to employees, or leasing, contracting or selling them out. These measures have mostly been applied for small-scale and inefficient SOEs. Since 1999, 222 enterprises have been transferred and 158 enterprises sold. Leasing and contracting are unsuccessful measures due to the lack of a legal framework for the transfer of the right of management of SOEs. Consequently, since 2008, the contract and lease measures for SOEs are no longer applied. In addition, Viet Nam has piloted the hiring of a general director/director for some SOEs.

Small-scale local SOEs with prolonged losses have been merged and consolidated to reduce the burden on the economy. To date, Viet Nam has merged and consolidated 877 SOEs and dissolved 313, while 92 SOEs have gone bankrupt. Viet Nam seems to be reluctant to give up a controlling right on large SOEs; some of these enterprises are still under 100% control by the state, while a small number are equitised to a small degree. With these measures, Viet Nam has sharply reduced the number of SOEs and the number of sectors and fields of activity of SOEs, on the one hand, while reinforcing large SOEs by establishing the State Economic Group and National Corporation, on the other hand.

Figure 6.5.3. **Number of organised SOEs in Viet Nam**



Source: Ministry of Planning and Investment, www.mpi.gov.vn/en/Pages/default.aspx.
StatLink http://dx.doi.org/10.1787/888933310373

Only by 2012 did Viet Nam officially set out to improve governance of SOEs in accordance with market principles. On the basis of international practices, Viet Nam has undertaken the following key measures: *i)* imposing the same common business rules for SOEs as for private enterprises; *ii)* defining accountability more clearly for performance, enhancing supervision and clearly stating the operational objectives of SOEs; *iii)* treating equally the small shareholders in enterprises of which the state has a dominant share by improving the enforcement mechanisms of the Law on Enterprise; *iv)* applying standards of information disclosure by public companies in SOEs; *v)* enhancing the capacity and accountability of board members of SOEs.

Further challenges in SOE reform

To some extent, Viet Nam has been successful in privatising small-scale SOEs and equitising and reducing their performance sectors. The remaining SOEs, in which the state holds a large and dominant share, are mainly big enterprises. These SOEs are estimated to account for more than one-third of total assets of Vietnamese enterprises; they hold about 70% of production and business premises and retain dominant positions in many significant markets, such as energy, mining, telecommunications and providing infrastructure services (World Bank, 2015). Compared to private enterprises, SOEs – the only firms able to borrow from the Viet Nam Development Bank – have easy access to finance, loans, state budget capital, land and other resources, which distorts market production factors: the cost of capital for SOEs is lower than the market price and does not fully cover the risks. In terms of business results, SOEs are required to preserve all capital injected by the state, whether they make a profit or not. If SOEs are unable to pay their debts, the government does not let them go bankrupt but tends to bail them out, freeze, restructure or even eliminate their debts, or transfer the debts to other SOEs. When SOEs are unable to pay tax, these enterprises are permitted to be in arrears with their debts or enjoy debt reduction or even debt elimination.

The underlying cause of inequality between SOEs and private enterprises, as mentioned above, stems from the state's practice of positioning SOEs in a way that is not in line with market economics. The state authorities (line ministries and provincial or city people's committees) tend to keep SOEs in a dominant position because of the official and unofficial benefits provided by these enterprises. In return, the SOEs also try to rely on line ministries and people's committees in order to receive the incentives noted above.

This has created three major problems in the functioning of Vietnamese state-owned enterprises in comparison with international practices. First, state ownership functions are not distinct from state management functions or from the market-regulation functions of state administrative agencies. Second, state ownership functions are implemented inconsistently. Third, the people in charge of state ownership functions – the apparatus and staff – are not specialised and professional.

To improve the efficiency of Vietnamese SOEs and make them operate fully in accordance with market mechanisms, it is necessary to reconsider their role and functioning and to reform state management of these enterprises. The agency in charge of the state ownership function in SOEs must be independent from the agency that implements the state management function and the market regulation function. Viet Nam needs to build, launch and implement a consistent policy of state ownership for SOEs with a clearly defined organisational model of the ownership agency. This is the prerequisite for creating a level playing field for all enterprises and for making SOEs compete under the same conditions as the private sector. Viet Nam also needs to continue improving the legal framework for tracking, monitoring and evaluating SOE performance; to enhance the mechanism for information disclosure and accountability of CEOs of these enterprises; and to restructure the council of members in order to increase management accountability and efficiency.

The most important of the measures mentioned above is to separate the functions of state ownership and state management. This will be the fulcrum for promoting reform and improving the efficiency of SOEs, because it will comprehensively affect all other measures.

POLICY FOCUS

Promote job creation and productivity growth

Viet Nam has a relatively young population. More than 75% of the population is working age, with this ratio tending to increase, and three-quarters of the labour force is aged 15-44. The rate of participation in the work force is quite high, at 77.4%, and provides a plentiful labour supply. Over the space of ten years, from 2004 to 2014, the workforce grew by more than 10 million people. This rapid increase induces labour policy to put more emphasis on job creation than job quality.

Table 6.5.1. **Viet Nam's population and labour force, 2004-14**

	2004	2014
Population (thousands)	81 436	90 729
Labour force (thousands)	43 242	53 748
Agriculture (%)	57.89	46.31
Industry and construction (%)	17.35	21.44
Services (%)	24.75	32.20
Skilled labour (%)	9.82	26.41
Unemployment rate (%)	2.14	1.87

Source: General Statistics Office of Viet Nam (2014), Report on Labour Force Survey 2014, Hanoi, https://www.gso.gov.vn/default_en.aspx?tabid=515&idmid=5&ItemID=15115.

Over the last ten years, the unemployment rate is around 2%. The structure of employment has shifted steadily out of agriculture towards the service sector and industry and construction.

However, labour quality remains low. In 2014, unskilled workers made up more than 73% of Viet Nam's labour force, and the proportion of unskilled workers is decreasing slowly. Moreover, there is a big mismatch between the skills in which people are trained and those demanded by employers. In 2012, according to the World Bank, the working attitude of employees in Viet Nam was seriously inadequate (World Bank, 2012). There was a big deficiency in skills for creative thinking, information technology, management and problem solving, and the majority of employers contended that job candidates did not have adequate skills (World Bank, 2013).

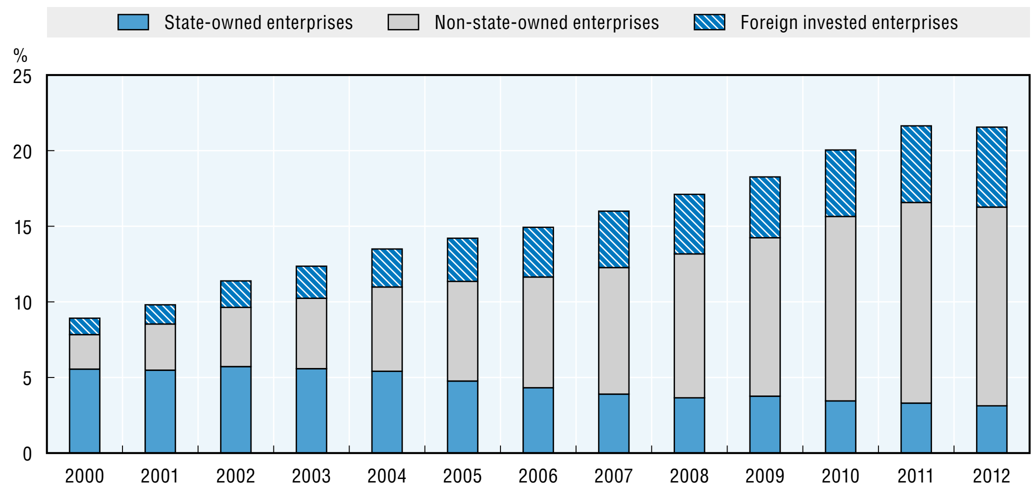
Labour productivity remains relatively low in Viet Nam

Labour productivity in Viet Nam is still quite low in comparison with neighbouring countries. Although Viet Nam's annual growth rate of productivity in 2007-13 was one of the highest of the ASEAN 5 countries (Indonesia, Malaysia, The Philippines, Thailand and Viet Nam), this rate has since slowed. Applying shift-share analysis to productivity growth in Viet Nam, Nguyen (2015) showed that, from 2010 to 2013, the contribution to overall productivity growth increased, in particular, quality of physical and human capital.

Studies about Vietnamese productivity show that the main factors behind its slow growth are: i) low quality of human and physical capital; ii) the small scale of production; and iii) misallocation of resources (Nguyen Tu Anh et al., 2015; Nguyen Dinh Cung and Nguyen Tu Anh, 2015; Nguyen Ba Ngoc and Pham Minh Thu, 2014). It will take time to overcome the first of these factors. Viet Nam already has a long-term strategy to improve the quality of human capital and research and development capacity.

The most important factor behind the low growth of productivity, however, is that most of the Vietnamese workforce is working in the informal sector (Figure 6.5.4). The rapid growth of jobs created by non-state enterprises and FIEs has helped to improve the status of employment in Viet Nam. Still, as of the end of 2012, nearly 80% of the total work force was employed in informal sector. According to the Survey on Labour Force and Employment, 63% of jobs in the economy in 2014 are categorised as vulnerable, and most of them involve workers in the informal sector.

Figure 6.5.4. **Percentage of employees working in the formal sector in Viet Nam**



Source: General Statistics Office of Viet Nam (nd), *Statistical Yearbook of Vietnam* (from 2000 to 2013), https://www.gso.gov.vn/default_en.aspx?tabid=515&idmid=5&ItemID=15197.

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Under the pressure of creating enough jobs for its rapidly increasing labour force, Viet Nam has had to rely on the informal sector, encouraging people to create jobs for themselves. Those doing business in the informal sector are unofficially given favourable conditions. For example, employers in the informal sector can easily avoid value-added taxes, and they are allowed to pay income tax as a lump sum that is much lower than the tax they would have to pay if they were working in the formal sector. They are de facto facing no legal problems if they ignore the responsibility to pay social security and other welfare contributions to which employees are entitled by law.[1]

Businesses in the informal sector, however, are almost unable to access capital in the financial market and are not eligible to access land for production under favourable conditions. Consequently, businesses in the informal sector do little to expand the scale of production or use new technology, and therefore rarely improve productivity. Jobs in the informal sector are low paid, with insecure working conditions and without the protection of social insurance. Viet Nam needs to strike a balance between job creation and job improvement. The country may now begin encouraging businesses in the informal sector to go formal without adding costs to their production by granting them a tax holiday, tax reductions or credit subsidies. The more the workforce is employed in the formal sector, the greater the probability that Viet Nam will succeed in increasing the growth rate of productivity.

Note

1. In 2014 the number of workers participating in the social insurance system accounted for 21.7% of the total workforce, most of them from the formal sector. This is 2.2 times higher than in 2004.

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Key government ministries in Viet Nam

Prime Minister	Nguyen Tan Dung
Agriculture and rural development	Cao Duc Phat
Construction	Trinh Dinh Dung
Culture, sports and tourism	Hoang Tuan Anh
Education and training	Pham Vu Luan
Ethnic minority affairs	Giang Seo Phu
Finance	Dinh Tien Dung
Foreign affairs	Pham Binh Minh
Health	Nguyen Thi Kim Tien
Home affairs	Nguyen Thai Binh
Industry and trade	Vu Huy Hoang
Information and communications	Nguyen Bac Son
Justice	Ha Hung Cuong
Labour, war invalids and social affairs	Pham Thi Hai Chuyen
National defence	Phung Quang Thanh
Natural resources and environment	Nguyen Minh Quang
Planning and investment	Bui Quang Vinh
Public security	Tran Dai Quang
Science and technology	Nguyen Quan
Transport	Dinh La Thang
Central Bank Governor	Nguyen Van Binh

Note: Valid as of 31 October 2015.

BRUNEI DARUSSALAM AND SINGAPORE

BRUNEI DARUSSALAM AND SINGAPORE

Brunei Darussalam

A. Medium-term economic outlook (forecast, 2016-20 average):

GDP growth (percentage change):	1.8
Current account balance (% of GDP):	15.8

B. Medium-term plan

Period: 2012-17

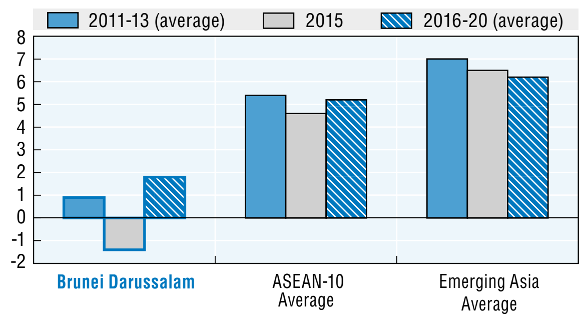
Theme: Knowledge and innovation to enhance productivity and economic growth.

C. Basic data (in 2014)

Total population:	0.4119 million *
Population of Brunei/Muara:	0.2953 million *
Nominal GDP (US dollar):	17.10 billion
GDP per capita at PPP:	79 890.18 (current International Dollar) **
Exchange rate in the first half of 2015 (period average):	1.35 (BND/USD)

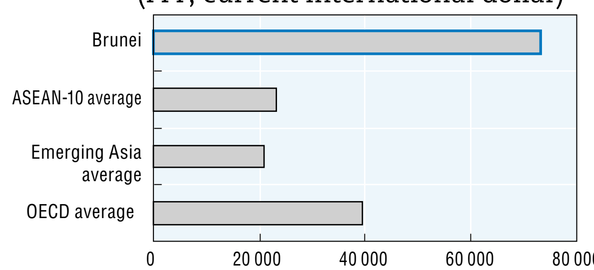
Note: * Population data for 2014 are estimates.
** IMF estimate
Sources: OECD Development Centre, MPF-2016, national sources, CEIC and IMF.

GDP growth rates (percentage change)



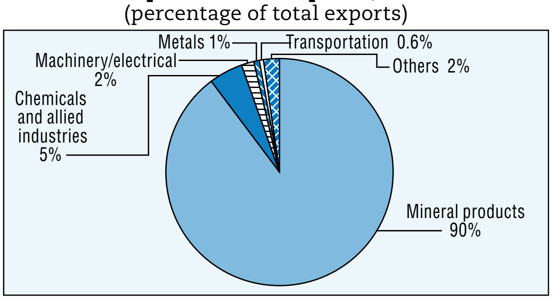
Source: OECD Development Centre, MPF-2016.

GDP per capita, 2014
(PPP, current international dollar)



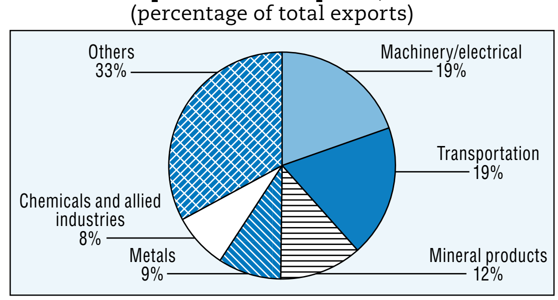
Source: IMF.

Composition of exports, 2014
(percentage of total exports)



Source: Trademap.

Composition of imports, 2014
(percentage of total exports)



Source: Trademap.

The recent global decline in oil prices has had a very negative effect on the economy and fiscal balance of Brunei Darussalam, where oil and gas comprise the largest share of GDP and exports. While these are expected to recover as oil prices increase again, the country has long had one of the lowest gross domestic product (GDP) growth rates in the region. As highlighted by the consequences of the drop in oil prices, achieving sustained and stable growth quickly requires economic diversification. Foreign direct investment (FDI) will be critical in financing the development of new sectors and bringing new technologies to Brunei Darussalam provided the regulatory environment improves and the necessary infrastructure is supported and built. More generally, constraints on the private sector need to be loosened to give new sectors, such as tourism and finance, space to develop. While the position of public finances tends to be strong, it would be useful to diversify revenue bases and rethink patterns of expenditure to promote a more balanced economy.

Brunei Darussalam: Medium-term policy challenges and responses

- Encourage foreign direct investment inflows
- Reform the business sector to promote diversification
- Reform public finance

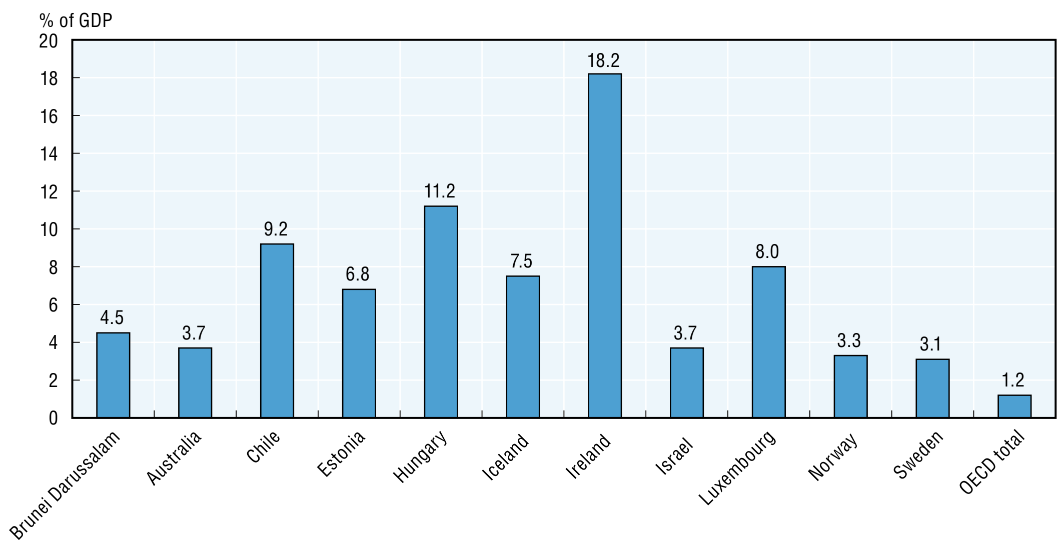
POLICY FOCUS

Encourage foreign direct investment inflows

Although classified as a high-income nation, Brunei Darussalam faces several considerable challenges to its economy. It owes its economic prosperity to natural resource endowments. The oil and gas sector accounts for the majority of the country's GDP, exports and revenues. Like many resource-driven economies, the country is challenged to develop non-energy sectors as the main growth drivers. One of the most important policy prescriptions common to almost all energy-producing countries is to increase the inflow of FDI.

The Brunei Darussalam government identifies FDI as one of the most important growth and employment generators. In 2012, the total FDI inflow amounted to around 4.5% of GDP, higher than the OECD member country average for that year (Figure 6.6.1). However, the energy sector was the strongest contributor. The mining and quarrying sector contributed 65.6% (Figure 6.6.2).

Figure 6.6.1. **FDI inflows for Brunei Darussalam and selected OECD countries, 2012**

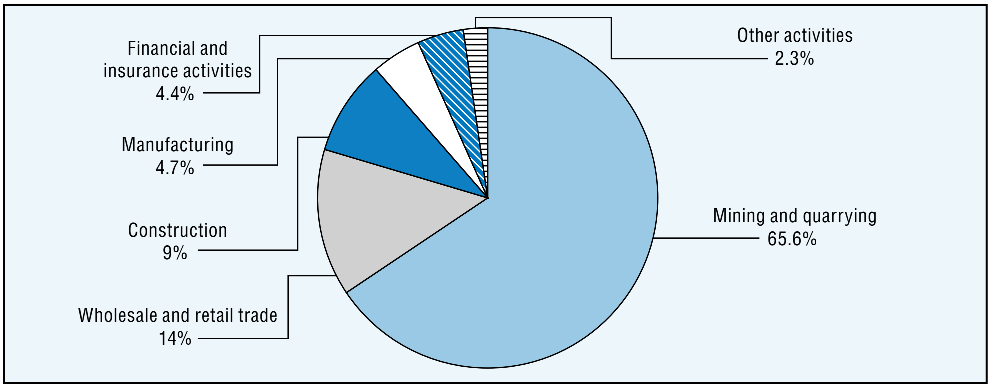


Note: The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: Department of Economic Planning and Development; OECD.

StatLink http://dx.doi.org/10.1787/888933310397

Figure 6.6.2. **Brunei Darussalam FDI inflows by sector, 2012**



Source: Department of Economic Planning and Development.
StatLink http://dx.doi.org/10.1787/888933310409

Brunei Darussalam has accumulated large gross national savings from oil and gas over the years. While FDI is not necessary to capital accumulation, foreign businesses are crucial in other important areas. The country's slow economic growth, driven by capital-intensive oil and gas sector and the government sector, has resulted in high unemployment (9.3% in 2011). Despite contributing approximately two-thirds to total GDP, oil and gas contributes only 3.3% to total employment.

Brunei Darussalam's income per capita is second only to Singapore in Southeast Asia. Underdeveloped domestic sectors may not provide the high-income jobs necessary to sustain the country's high reservation wage. Increased foreign investment would also increase Brunei Darussalam's technological know-how, managerial expertise and access to international markets.

Attractive business environment, support for innovation and adequate infrastructure are important factors in attracting FDI to Brunei Darussalam

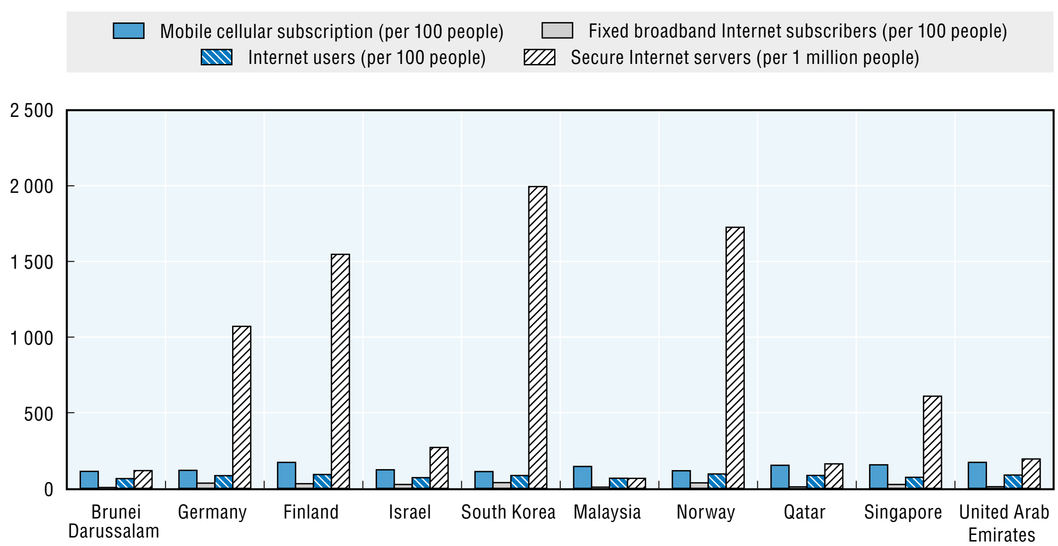
The government has established several authorities and programmes to attract more FDI. Brunei Darussalam has the advantages of a politically stable government, macroeconomic stability, low taxes, low energy costs, low crime and a pristine natural environment. However, several shortcomings contribute to the current low levels of non-energy FDI, including difficulties in starting and running businesses, difficulties in registering property, inadequate physical infrastructure and weak intellectual property protection. The World Bank's *Ease of Doing Business 2015: Comparing Business Regulations for Domestic Firms in 189 Economies* (2015a) ranks Brunei Darussalam at 101 out of 189 countries, 1 being the most conducive to business operations. To improve its rating, Brunei Darussalam would need major improvements in a number of indicators, especially starting a business, registering property, enforcing contracts and protecting minority investors.

The government hopes to raise foreign investor confidence by improving intellectual property rights protection. In 2013, the Brunei Intellectual Property Office (BruIPO) was established. Some encouraging results include the increase in foreign application of patents from 15 in 2013 to 91 in 2014. However, the innovation ecosystem still needs improvement. At around 0.1%, Brunei Darussalam's gross expenditure on research and development (R&D) is very low. Among the initiatives to encourage R&D is the introduction of the Brunei Research Incentive Scheme (BRISc), a cost-sharing grant programme. Under this scheme, foreign companies could obtain up to 70.0% of R&D

funding from the government. Some new establishments have also been set up to provide new businesses and start-ups with incubation facilities. While these are steps in the right direction, it is essential authorities monitor the progress of new companies and ensure they continue to grow.

Foreign business requires good infrastructure in order to thrive. Despite good basic infrastructure, the country needs improvements in several areas, especially information communication technology (ICT), transportation and industrial facilities. In ICT, Brunei Darussalam lags behind many developing and developed economies (Figure 6.6.3). The government has upgraded ICT infrastructure in recent years with fibre-to-the-home (FTTH) broadband services. As of 2015, the Brunei Darussalam International Airport has modern, fully operational ICT. Several industrial parks have also been equipped, for example the Bio Innovation Corridor, established to focus on Halal research and manufacturing.

Figure 6.6.3. **ICT indicators for Brunei Darussalam and selected OECD countries, 2013**



Note: The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: World Bank (2015b), *World Development Indicators* (database), http://data.worldbank.org/data-catalog/world-development-indicators.

StatLink http://dx.doi.org/10.1787/888933310419

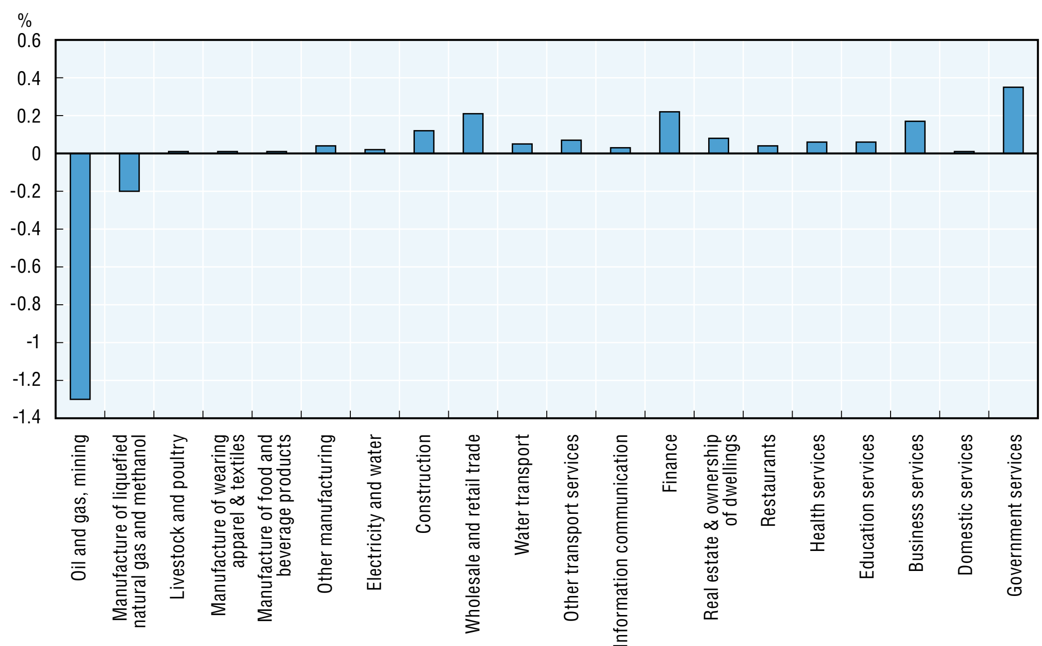
POLICY FOCUS

Reform the business sector to promote diversification

Non-oil and gas private sectors are the long-term answer for a more sustainable economy in Brunei Darussalam. Currently, these sectors, comprising mostly the services sector, only contribute approximately 25% to overall GDP, but they contribute approximately 60% to total employment. The non-energy sectors have also been outperforming the oil and gas sector in terms of growth, especially in the last few years as oil and gas mining experience a downturn (Figure 6.6.4). The better performing non-energy private sectors include finance, trade and business services.

The government still receives approximately 90% of its revenues from the oil and gas sector. Major improvements are needed to shift Brunei Darussalam to a private sector-driven economy. Apart from growth and employment, the expansion of non-energy private sectors would also broaden the government's revenue base. Due to the dominance of oil and gas revenues, as well as the absence of several taxes, including personal income tax, sources of government revenue are limited. Tax revenues collected from non-energy sectors only amounted to approximately 5% of total revenue.

Figure 6.6.4. **Average growth contributions of selected sectors in Brunei Darussalam, 2011-14**



Source: Department of Economic Planning and Development.

StatLink http://dx.doi.org/10.1787/888933310423

Several sectors have been identified in official policy documents, ministerial strategic plans and white papers as having the potential to be the next growth drivers in Brunei Darussalam. The sectors include financial and business services, tourism, Halal products, logistics, ICT and oil and gas downstream. Other sectors, such as education services and creative industries, have also been considered. Identifying the sectors is only the beginning. The main challenge will be to come up with effective execution plans to realise agreed-upon objectives. In addition, some sectors may need a specific focus. Tourism, for example, could prioritise health tourism and MICE (meetings, incentives, conferences and exhibitions) activities. Finance could focus on Islamic *sukuk*, Islamic insurance or wealth management. Once sectors have been determined and prioritised, industrial policies and reforms would have to be implemented to support the promoted sectors. That is, a clear industrial road map has to be drawn and cascaded to the relevant government organisations. Currently, no clear national plan exists or else is well-articulated to respective stakeholders.

The cost and bureaucracy of starting and running a business and access to finance constrain private sector development

The cost and bureaucracy of starting and running a business must be reduced for the private sector to thrive. The World Bank ranks Brunei Darussalam 179 out of

189 countries for ease of starting a business (Table 6.6.1). Currently, it takes an average of 101 days and requires 15 procedures. In the East Asia and Pacific region, it takes approximately one-third the time and fewer than half the procedures, and OECD member countries average 9.2 days and 4.8 procedures. Bureaucratic processes would have to be streamlined significantly to make Brunei Darussalam more business friendly. One major hindrance has been the application and approval process for the Miscellaneous Licence. As of 1 January 2015, this licence was replaced by the Business Licence, which takes fewer days for approval.

Table 6.6.1. **Indicators of ease of starting a business in Brunei Darussalam and selected regions, 2015**

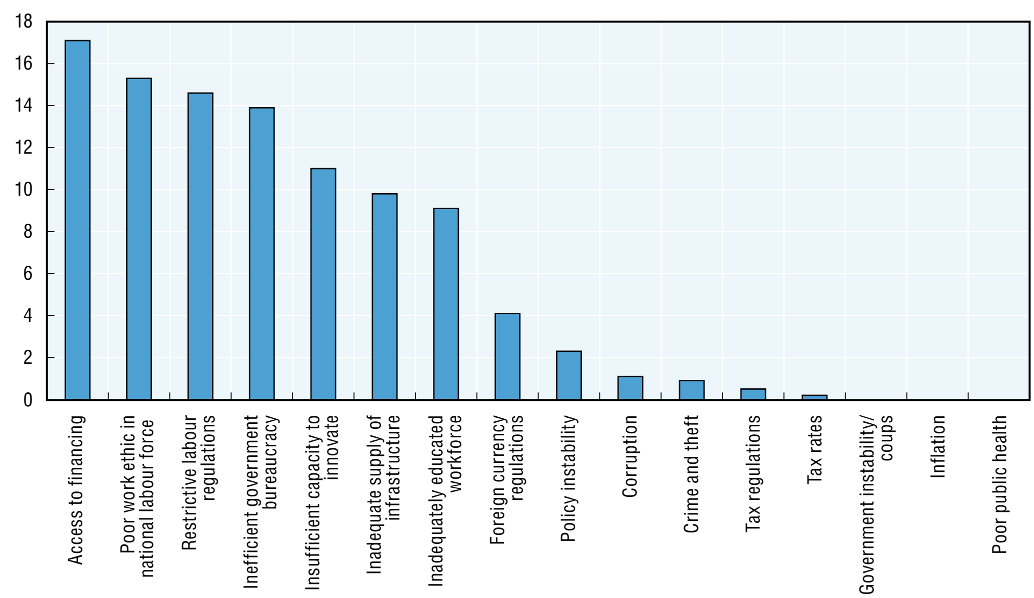
Indicator	Brunei Darussalam	East Asia and Pacific region average	OECD member countries average
Procedures (number)	15.0	7.3	4.8
Time (days)	101.0	34.4	9.2
Cost (% of income per capita)	10.4	27.7	3.4

Source: World Bank (2015a), *Ease of Doing Business 2015: Comparing Business Regulations for Domestic Firms in 189 Economies*, www.doingbusiness.org/~/media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB15-Chapters/DB15-Report-Overview.pdf.

Financing of private sector business needs improvement. According to the World Economic Forum's *Global Competitiveness Report 2013-2014*, access to financing is the greatest impediment to doing business in Brunei Darussalam (Figure 6.6.5). In 2012, the monetary authority launched the Credit Bureau to improve access to credit for businesses, among other goals. More such reforms and programmes are needed.

Figure 6.6.5. **Top impediments to doing business in Brunei Darussalam**

(Percentage of respondents)



Source: WEF (2013), *Global Competitiveness Report 2013-2014*, http://reports.weforum.org/the-global-competitiveness-report-2013-2014/#=2014.

StatLink http://dx.doi.org/10.1787/888933310432

To grow, companies must have strong foundations as well as the right environment. In early 2015, the government introduced the Enterprise 100 Transformation Programme, a structured programme covering aspects of business from corporate governance to capitalisation, to assist select local companies to achieve annual revenues of BND 100 million within the next five to ten years. The 12 participating companies spanned food and beverage manufacturing, logistics, education, oil and gas services, engineering and technology, and aviation.

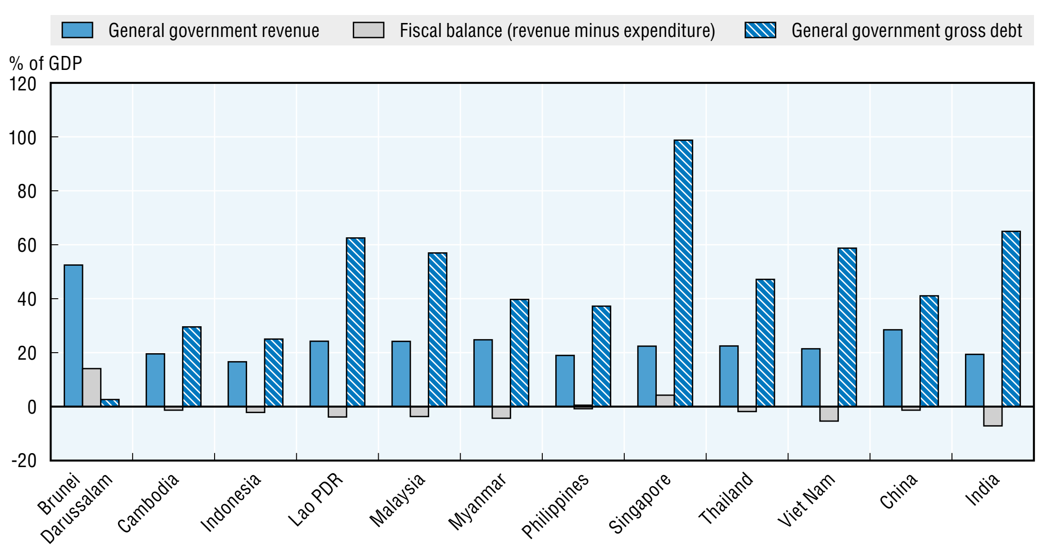
Government-linked companies (GLC) need more attention. As with many developing economies, GLC make a sizeable contribution to the country's economy in both jobs and output. Greater transparency and accountability would ensure GLC are well managed and profitable. GLC boards of directors should also include more members with strong business credentials. The government established the investment holding company Darussalam Assets in 2013 to improve GLC performance. Its immediate tasks include improving corporate governance, introducing better financial reporting standards and developing existing human resources.

POLICY FOCUS

Reform public finance

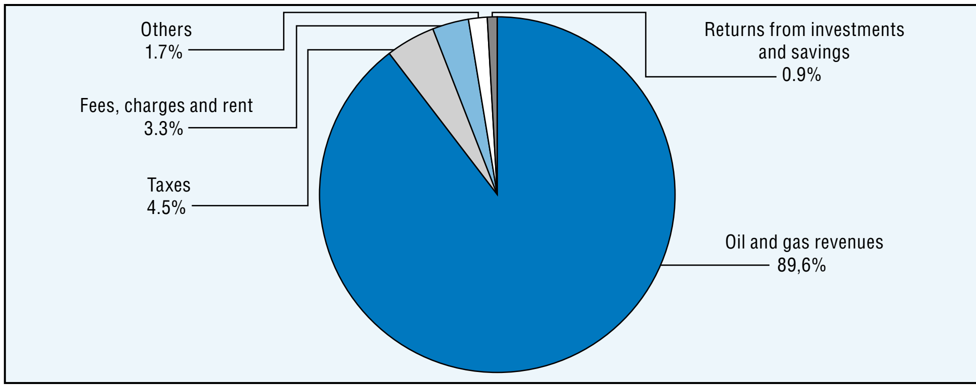
Government services is by far the biggest employer of local Bruneians and the second most prominent sector after oil and gas. Brunei Darussalam's public finance is enviable in many respects. The government has high revenues, large surpluses and low debt relative to GDP (Figure 6.6.6), large gross national savings and large fiscal buffers. A sovereign wealth fund manages the country's foreign assets, and the country established the Sustainability Fund in 2009. Of its three sub-funds, the Fiscal Stabilisation Reserve fund helps cover the financing gap when there is a shortfall in revenue. However, with almost 90% of total revenue coming from the oil and gas sector, further reforms are needed to improve public finance efficiency and maintain fiscal stability (Figure 6.6.7).

Figure 6.6.6. **Public finance indicators in Emerging Asia, 2014**



Source: International Monetary Fund (2015), *World Economic Outlook* (database), www.imf.org/external/pubs/ft/weo/2015/01/weodata/index.aspx.
StatLink http://dx.doi.org/10.1787/888933310446

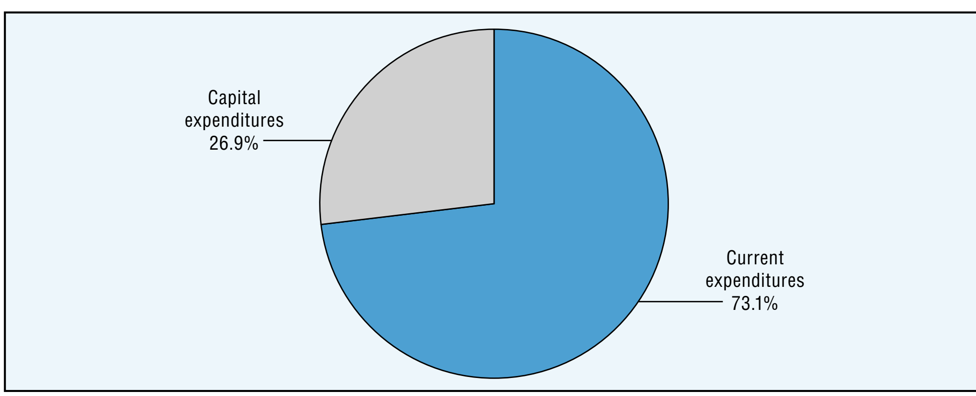
Figure 6.6.7. **Brunei Darussalam government revenue by source, 2010-14**



Source: Ministry of Finance.
StatLink http://dx.doi.org/10.1787/888933310458

Brunei Darussalam should ensure the large annual surpluses are spent or invested optimally. As current expenditures tend to be greater than capital expenditures, the majority of spending is commonly directed towards current expenditures (Figure 6.6.8). Brunei Darussalam dedicates relatively little to education compared to other countries, while military spending is comparatively high at over 3.0% of GDP. A greater allocation to education would increase the country's potential output.

Figure 6.6.8. **Brunei Darussalam government expenditures by type, 2010-14**



Source: Ministry of Finance.
StatLink http://dx.doi.org/10.1787/888933310461

Public-private partnerships may be a useful tool in pursing public projects

Spending efficiency could also be improved through public-private partnerships (PPP). Currently, the majority of infrastructure spending is through the government's capital expenditure using traditional modes of project financing. This is typically less efficient due to government bureaucracy. The PPP approach may ensure government assets are better maintained and provide business opportunities to companies from various sectors, including construction, business services and financial services. Privatisation and PPP are not new agendas, and they have been mentioned in the country's policy documents. Brunei Darussalam's ten-year Outline of Strategies and

Policies for Development (OSPD 2007-17) includes the following privatisation and PPP-related policy objectives:

- "privatizing those services currently provided by the public sector that are best undertaken by the private sector";
- "privatizing, commercializing and outsourcing of government services as a way of expanding opportunities for local SMEs and entrepreneurs";
- "adopting appropriate legal and regulatory frameworks to promote investment in social and industrial infrastructure, including privatization and public-private partnerships (PPP) in line with international best practice"; and
- as PPPs have been identified as a key to public finance agenda, speeding up "PPP implementation in order to reap its full benefits".

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Key government ministries in Brunei Darussalam

Sultan and Prime Minister	Hassanal Bolkiah Mu'izzaddin
Senior Minister and Heir to the throne	Prince Billah Bolkiah
Communications	Abdullah Bakar
Culture, youth and sports	Hazair Abdullah
Defence	Hassanal Bolkiah Mu'izzaddin
Development	Suyoi Osman
Economic planning and development (Jabatab Perkhidmatan Pengurusan)	Prince Billah Bolkiah
Education	Abu Bakar Apong
Energy	Mohammad Yasmin Umar
Finance	Hassanal Bolkiah Mu'izzaddin
Finance (second minister)	Abdul Rahman Ibrahim
Foreign affairs and trade	Hassanal Bolkiah Mu'izzaddin
Foreign affairs and trade (second minister)	Lim Jock Seng
Health	Adanan Mohd Yusof
Home affairs	Badaruddin Othman
Industry and primary resources	Yahya Bakar
Religious affairs	Mohamed Abd Rahman
Chairman of Monetary Authority (AMBD)	Prince Billah Bolkiah

Note: Valid as of 31 October 2015.

Singapore

A. Medium-term economic outlook (forecast, 2016-20 average)

GDP growth (percentage change):	2.6
Current account balance (% of GDP):	16.9

B. Medium-term plan

Period: 2010-20

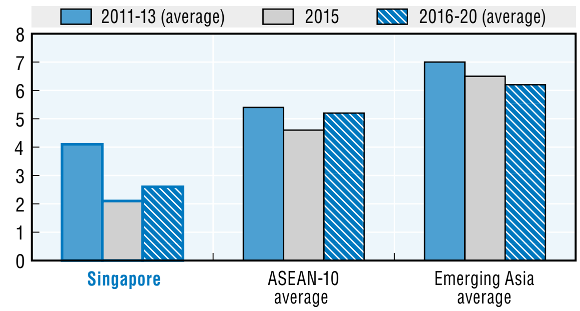
Theme: Highly skilled people, innovative economy, distinctive global city.

C. Basic data (in 2014)

Total population:	5.47 million*
Nominal GDP (US dollar):	307.87 billion
GDP per capita at PPP:	83 065.59 (current International Dollar) **
Exchange rate in the first half of 2015 (period average):	1.35 (SGD/USD)

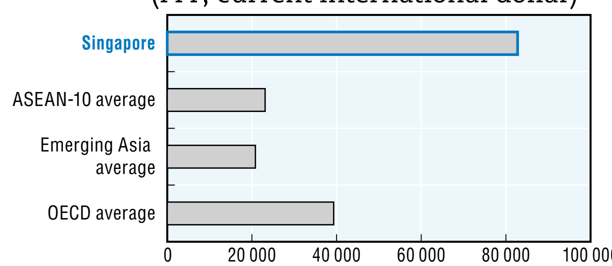
Note: * Total population data for 2014 are estimates.
** IMF estimate.
Sources: OECD Development Centre, MPF-2016, national sources, CEIC and IMF.

GDP growth rates (percentage change)



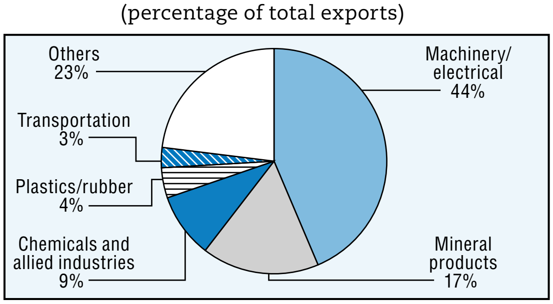
Source: OECD Development Centre, MPF-2016.

GDP per capita, 2014
(PPP, current international dollar)



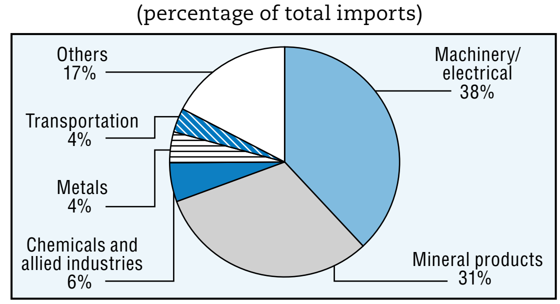
Source: IMF.

Composition of exports, 2014
(percentage of total exports)



Source: Trademap.

Composition of imports, 2014
(percentage of total imports)



Source: Trademap.

As Singapore celebrates 50 years of independence, the country also celebrates 50 years of exceptional progress. In 1965, Singapore's nominal gross domestic product (GDP) per capita was approximately USD 500, on par with Mexico and South Africa. By 2015, Singapore's GDP per capita had caught up with Germany at approximately USD 56 000 (Monetary Authority of Singapore, 2015). However, apart from GDP growth, aspects such as overall quality of life, income inequality and environmental sustainability remain a challenge. Two emergent areas of focus for the medium to long term include increasing ageing supports to promote inclusion and avoid slowdown in labour force growth; and leveraging data to build a smart, energy-efficient city.

Singapore: Medium-term policy challenges and responses

- Strengthen labour market and social policies for ageing population
- Leverage data to build a smart, energy-efficient city

POLICY FOCUS

Strengthen labour market and social policies for ageing population

Today, there are some 440 000 people 65 and over in Singapore, double that of 15 years ago. In 15 years' time, it will double again to 900 000. At the same time, the life expectancy of Singaporeans at 65 years of age has continued to rise. In 2013, it was 18.8 years for men, up from 18.0 years in 2003. Women could expect to live longer past 65: 22.0 years in 2013 (Department of Statistics Singapore, 2014a). That retired elderly have to support themselves without income for around 20 years has significant implications for the future labour force and social programmes.

Raise the employability of older low-income Singaporeans

An ageing population is likely to result in a sharp slowdown in labour force growth, labour shortages, and slower economic growth. To mitigate this, Singapore's government has been encouraging participation of older workers in the labour market. For instance, employers' Central Provident Fund (CPF) contribution for older workers was increased, and the re-employment age has been raised from 62 to 65 to encourage older workers to return to the workforce.

The Retirement Age Act was introduced in 1993, raising the retirement age from 55 years to 60 years. After two years of voluntary adherence, only 10% of the total workforce enjoy the higher retirement age. After the Re-employment and Retirement Age Act came into effect in 2012, 99% of private sector employees who turned 62 in 2013 were re-employed, demonstrating the efficacy and need for legislation.

To support employers and to raise the employability of older low-income Singaporeans, the Special Employment Credit (SEC) was introduced in 2011. Employers who hire Singaporean employees over 50 earning up to SGD 4 000 per month receive a SEC of up to 8% of the employee's monthly wages. In 2014, the SEC was enhanced for one year to help employers cope with cost increases associated with the increase in CPF contribution rates. With this enhancement, employers who hire Singaporeans over 50 will receive a SEC of up to 8.5% of an employee's monthly wages. In 2015, employers who hire Singaporean workers over 65 will receive a SEC of up to 11.5% of an employee's monthly wages. Between January 2011 and June 2012, SGD 268 million has been paid to 91 000 employers for employing 404 000 eligible employees.

On the sociological side, the Tripartite Committee on Employability of Older Workers (TriCom) was set up in 2005 to ameliorate the perception of older workers by employers, employees and the public. In 2013, TriCom mapped out new directions to advance tripartite efforts in supporting the employment, employability and productivity of older workers, including age management and job redesign, re-employment, and public communications to promote positive perceptions of older workers amongst employers, employees and the general public.

Box 6.7.1. **Older worker employment policy in Switzerland**

Within the Organisation for Economic Co-operation and Development (OECD), Switzerland has one of the highest employment rates for older workers. Singapore could draw some lessons from the Swiss experience. In 2012, 70.5% of Swiss aged 55 to 64 were working, well above the OECD average of 54%. Switzerland's exceptionally strong performance is attributable to the high proportion of men and of university graduates in this age group who are working (79.5% and 85%, respectively). Also, Switzerland has OECD member countries' highest share of part-time jobs for workers aged 55 to 64: 16% for men and 59% for women (almost four times higher than for men) in 2012 (OECD, 2014) .

In 2005, the Swiss Federal Department of Home Affairs and the Federal Department of Economic Affairs set up a joint steering group. One of the working groups focused on ways to increase the reintegration of older job-seekers. Switzerland continues to make progress in encouraging the innovative action of Regional Placement Offices (ORPs) in helping older job-seekers go back to work, especially the long-term unemployed. This consists mainly of early, intensive guidance and personal follow-up. Skills assessment and training in job-hunting techniques were the practices most used to find work for the target group of older job-seekers (OECD, 2011a). Those registered with a placement office meet job counsellors regularly to discuss individual action plans, receive information about job vacancies, etc. Some ORPs have also launched high-profile campaigns to raise public awareness about the benefits of older job-seekers' greater experience.

Strengthening social programmes

In terms of social support for the ageing population, the government launched the Pioneer Generation Package to help the elderly with their health-care costs for life. Pioneers (Singapore citizens aged 65 and over in 2014) will receive the following lifetime benefits (Pioneer Generation, 2015):

- Medisave top-up of SGD 200 to SGD 800 annually. In 2015, approximately SGD 202 million in Medisave top-ups will be disbursed. Pioneers born earlier receive more top-ups, as they have typically accumulated fewer savings.
- Additional 50% off subsidised treatments at polyclinics and specialist outpatient clinics
- Subsidies at select general practitioner (GP) and dental clinics
- Subsidies for MediShield Life (MSHL) premiums of 40-60%
- Lesser MSHL premiums than Pioneers paid in previous years, despite the larger benefits that they, like other Singaporeans, will receive under MSHL.

The Pioneer Generation Package is a very timely intervention in view of the increased need for health care for the elderly. For instance, the elderly accounted for 32% of total hospital patients discharged in 2014, up from 23% in 2000. In terms of hospital beds, the elderly made up nearly half of total bed days, up from one-third in 2000 (Table 6.7.1) (Department of Statistics Singapore, 2014b).

Besides helping to finance access to health care, the government is also increasing the number of beds in acute care hospitals by 25% by the end of the decade, doubling the number of community hospital beds, increasing nursing home capacity by approximately 70%, and investing in bringing affordable care into the community so that the elderly can be cared for at home (Ministry of Finance, 2015).

Table 6.7.1. **Elderly hospital patient discharge rate and length of stay in Singapore, 1980-2014**

(% of total)

Year	Hospital patients discharged	Hospital bed days
1980	12.9	20.1
1990	14.4	25.6
2000	23.5	35.1
2010	28.8	43.7
2011	29.6	44.3
2012	30.3	46.5
2013	31.3	47.8
2014	32.1	47.9

Source: Department of Statistics Singapore (2014b), *Key Indicators on the Elderly* (dataset), www.singstat.gov.sg/docs/default-source/default-document-library/statistics/browse_by_theme/population/statistical_tables/elderly.xls.

OECD member countries are experiencing unprecedented demographic change: increased longevity, a growing proportion of elderly and falling birth rates. In Scandinavia, patient hotels offer accommodation for low-dependency patients who do not need full hospital services but may need heightened access to them. The cost of accommodating a person in a patient hotel is considerably lower than in a hospital. Throughout OECD member countries, patient hotels offer intermediate care for those recovering from illness or recuperating after a medical procedure requiring ongoing support but not hospital-level medical care. Denmark's Odense University Hospital's patient hotel has been in operation since opening in the hospital grounds in 1997. The largest patient hotel company in Scandinavia is Norlandia Care, operating in Norway, Sweden and Finland, which caters to non-patients and patients needing minimal nursing care (OECD, 2011b). Similar alternatives to hospitals could also be considered in Singapore as a way of reducing the increased pressures on hospitals of an ageing population

POLICY FOCUS

Leverage data to build a smart, energy-efficient city

In Singapore, power consumption increased by one-third over the past decade and is expected to grow by a further 30% by 2050. As a step toward sustainable living, the first "smart" and eco-friendly housing district in Singapore, Punggol Northshore, was made available for sale in May 2015. Smart technologies will be used for estate planning, and various smart technologies will be test-bedded for lighting and waste management, etc.

This initiative forms part of a key thrust in Singapore's 2015 budget towards major reinvestment in infrastructure. With the medium-term plans, development expenditures have already increased from SGD 12 billion five years ago to approximately SGD 20 billion (4.8% of GDP) in the coming fiscal year. They will grow by 50% to approximately SGD 30 billion (6% of GDP) by the end of this decade (Ministry of Finance, 2015). These investments will be complemented by the new Smart Nation initiative, which seeks to turn the country into the world's first truly smart nation, powered by big data and analytics technologies, and next-generation connected and sensor networks to live sustainably and comfortably (Smart Nation, 2015).

The Housing and Development Board (HDB) is tasked with providing residents with well-designed homes located in green and sustainable towns. A Smart HDB Town Framework has been developed to guide the development of Smart HDB Towns across four key dimensions; Smart Planning, Smart Environment, Smart Estate and Smart Living (Housing & Development Board, 2014).The use of computer simulation and data analytics will enable HDB to improve the way it plans and designs its towns, precincts and buildings, and to derive optimal, sustainable and cost-effective solutions. For example, HDB is assessing the effectiveness of various sustainability initiatives, such as LED lighting, solar energy, skyrise and vertical greenery, rainwater harvesting, recycling and pneumatic waste collection, to determine the best combination to achieve sustainability goals.

HDB is looking to link estates with a network of sensors to create a "smart environment". These sensors will capture real-time information on environmental factors, such as temperature and humidity. Innovative solutions can then be found to create a more pleasant environment for residents. For example, smart fans located in common areas can be triggered when certain thresholds of temperature and humidity are reached. The fan speed can be regulated to improve comfort level while reducing energy consumption. Common area lighting fitted with sensors can help HDB understand human traffic patterns and thereby optimise the energy-efficient provision of lighting. Lighting with little or no human traffic could be reduced to 30%, potentially reducing energy usage by as much as 40%. A smart pneumatic waste conveyance system will be adopted in new HDB developments. By fitting this facility with sensors, waste disposal patterns and volume can be monitored. Based on the data, waste bin design can be improved and frequency of collection can be varied according to volume, again optimising the resources needed for collection.

Ensuring data privacy

The development of automatic data processing enables vast quantities of data to be transmitted within seconds across national frontiers, indeed across continents. While investment in this technology can bring a lot of value to the population, it is now essential that governments, in collaboration with all other stakeholders, take steps to build confidence that individual privacy rights are respected.

Privacy protection laws have been introduced, or will be introduced shortly, in approximately half of all OECD member countries (Austria, Canada, Denmark, France, Germany, Luxembourg, Norway, Sweden and the United States have passed legislation. Belgium, Iceland, the Netherlands, Spain and Switzerland have prepared draft bills) to prevent what are considered violations of fundamental human rights, such as the unlawful storage of personal data, the storage of inaccurate personal data or the abuse or unauthorised disclosure of such data. Individuals and businesses must be protected both from the misuse of the Internet by terrorists, cyber-criminal groups, and from the over-reach of governments and businesses that collect and use private data. Singapore could consider harmonising national privacy legislation with OECD guidelines, not only upholding human rights but preventing interruptions in international flows of data. The guidelines represent a consensus on basic principles which can be built into existing national legislation or serve as a basis for legislation in countries that do not yet have it.

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Key government ministries in Singapore

Prime Minister	Lee Hsien Loong
Deputy Prime Minister	Teo Chee Hean
Coordinating Minister for Economic and Social Policies	Tharman Shanmugaratnam
Coordinating Minister for Infrastructure	Khaw Boon Wan
Communications and information	Yaacob Ibrahim
Culture, community and youth	Grace Fu Hai Yien
Defence	Ng Eng Hen
Education	Heng Swee Keat
Environment and water resources	Masagos Zulkifli
Finance	Heng Swee Keat
Foreign affairs	Vivian Balakrishnan
Health	Gan Kim Yong
Home affairs	K. Shanmugan
Law	K. Shanmugam
Manpower	Lim Swee Say
Muslim affairs	Yaacob Ibrahim
National development	Lawrence Wong
National security	Teo Chee Hean
Social and family development	Tan Chuan Jin
Trade and industry (Trade)	Lim Hng Kiang
Trade and industry (Industry)	S. Iswaran
Transport	Khaw Boon Wan
Chairman of the Monetary Authority	Tharman Shanmugaratnam

Note: Valid as of 31 October 2015.

CLM

Cambodia

A. Medium-term economic outlook (forecast, 2016-20 average)

GDP growth (percentage change)	7.3
Current account balance (% of GDP):	-9.4

B. Medium-term plan

Period: 2014-18

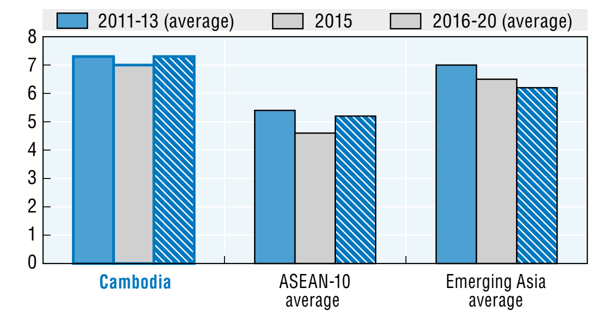
Theme: For growth, employment, equality and efficiency, to reach the status of an upper-middle-income country.

C. Basic data (in 2014)

Total population:	14.7 million (in 2013)*
Population of Phnom Penh:	1.74 million (in 2013)*
Nominal GDP (US dollar):	16.55 billion **
GDP per capita at PPP:	3 275.67 (current International Dollar) **
Exchange rate in the first half of 2015 (period average):	4 056.83 (KHR/USD)

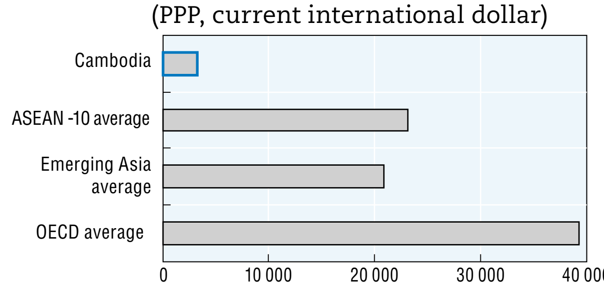
Note: * Population data for 2013 are estimates.
** IMF estimate.
Sources: OECD Development Centre, MPF-2016, national sources, CEIC and IMF.

GDP growth rates (percentage changes)



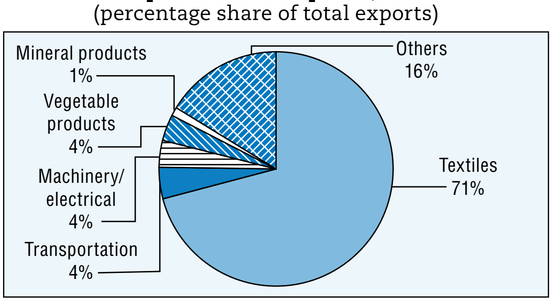
Source: OECD Development Centre, MPF-2016.

GDP per capita, 2014
(PPP, current international dollar)



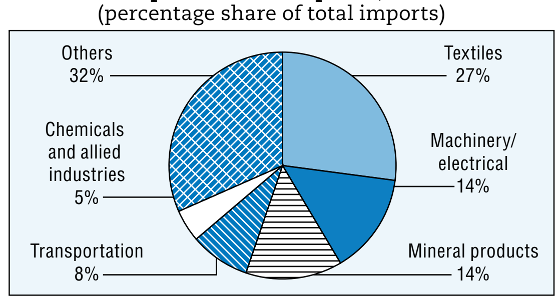
Source: IMF.

Composition of exports, 2014
(percentage share of total exports)



Source: Trademap.

Composition of imports, 2014
(percentage share of total imports)



Source: Trademap.

Despite regional and domestic tensions, Cambodia's economic performance has been relatively robust and supported by expansion in construction activities, as well as a strong real estate sector and resilient exports (garment and tourism). Cambodia's economic growth in 2014 is estimated at around 7.0%, slightly lower than 7.4% in 2013. With this growth, the gross domestic product (GDP) per capita increased to USD 1 123 in 2014. Inflation was at approximately 3.9% year-on-year (yoy) in 2014 – in line with relatively stable projections in commodity and petroleum prices – and is projected to be around 3.5% in 2015.

Cambodia: Medium-term policy challenges and responses

- Improve competitiveness by strengthening TVET
- Address complex challenges in developing tourism

POLICY FOCUS

Improve competitiveness by strengthening TVET

The technical and vocational education and training (TVET) system traditionally plays two roles in Cambodia, with a new role emerging linked to the region's efforts to integrate into regional and global markets. The first role is as an instrument to overcome the social exclusion resulting from high dropout rates among basic education students. TVET is seen as an educational alternative for those who "fail" academically and cannot be accommodated in higher education. The second role is TVET as part of active labour market policies designed to combat youth unemployment and, to a lesser extent, retrain workers affected by economic restructuring. In 2011, only 723 students nationally were enrolled in formal TVET training in public institutions under the Ministry of Labor and Vocational Training (MLVT) and a further 1 640 were enrolled in informal TVET training programmes. Third is TVET as an instrument to develop a knowledge-based economy. This emerging role has been driven by Cambodia's transition to a more open, market-orientated economy and correlates with the need to integrate and successfully compete in world markets.

Transforming TVET from low-quality, second-choice learning into higher quality learning opportunities driven by labour market demand requires an ongoing, systemised and co-ordinated approach. International studies indicate that TVET reform requires a series of changes to be implemented. These are grouped as governance, funding, quality, private sector participation, and access to quality learning programmes.

Governance reforms seek to include key stakeholders in strategic decisions and the management of TVET policies and services. It also requires the development of accountability mechanisms and decentralisation to ensure efficiency, relevance and quality in the delivery of TVET services. A diversification of funding sources is required to meet the challenges of better quality TVET, while new funding allocation mechanisms are needed for TVET institutions to create the incentives for improved relevance and the delivery of quality TVET.

Quality improvements cover a wide range of issues, such as curricula development; teacher and trainer development; better assessment and outcomes measurement; monitoring and evaluation; standards for qualifications; and accreditation mechanisms.

Table 6.8.1. **Enrolment in and graduation from TVET programmes registered under MLVT by training provider type, 2012-13**

	Public institutions		Private institutions		Non-governmental organisation (NGO) institutions	
Accredited programmes, by level	Currently enrolled	Graduates	Currently enrolled	Graduates	Currently enrolled	Graduates
Bachelor & Postgraduate	10 559	2 792	7 003	121	194	20
Diploma (Associate Bachelor)	4 174	2 730	1 250	443	1 232	446
Certificate I, II, III	1 115	1 255	0	0	1 118	964
Informal Training	29 207	76 500	6 338	7 075	1 056	874
Total	45 055	83 277	14 591	7 639	3 600	2 304

Source: MLVT (2015), TVET Strategic Plan 2014-2018, Ministry of Labor and Vocational Training.

Reforming private sector participation in TVET ranges from governance arrangements to the development of public-private partnerships (PPP) for the delivery of TVET services, and the development of in-service training and lifelong learning opportunities (Table 6.8.1).

MLVT's TVET vision for the future conveys the important message that TVET is critical in poverty alleviation through both an increase in skilled employment locally and throughout the Association of Southeast Asian (ASEAN) region and the lifelong employment and productivity of individuals. This vision dictates an accessible, demand-driven TVET system responsive to continuing and emerging labour market demands, resulting in the socio-economic development of individuals, communities and country.

Recent reforms have focused on: 1) providing equitable access to TVET services; 2) improving quality and relevancy of TVET training; and 3) strengthening the management and governance of TVET. From 2009 to 2013, Cambodia started laying the foundations for a quality-driven, responsive TVET system by developing the Cambodian Qualifications Framework (CQF), introducing Competency Based Training, and developing a labour market information and management system. The country now needs to embed and implement these systems and develop the capacity of staff to work within them. Developing and implementing quality frameworks across all areas of the business is a key focus for (GDVT) over the next five years.

The government has already embarked on a range of reform initiatives to improve the provision of education and training. For instance, the five policy priorities outlined in the Government Circular on the Promotion of Quality and Effective Technical and Vocational Education and Training from the Prime Minister in February 2011 provides an important framework for 1) linking training to market demand; 2) ensuring training quality for enhanced productivity; 3) strengthening public-private partnership; 4) ensuring equity in training; and 5) promoting TVET for social-economic development (RGC in UNESCO, 2013).

In the Fifth Legislature, the Royal Government of Cambodia (RGC) will develop and implement a national TVET policy, which will underpin all priorities and actions of the MLVT TVET Strategic Plan 2014-2018. It will place emphasis on ensuring that all Cambodian people have equal opportunity to access TVET services and training, both formal and informal, without discrimination. Equally, the implementation of the MLVT TVET strategic plan is linked to economic development, social inclusion, better quality products and services and improved management and governance.

Complex challenges require new approaches to transforming TVET in Cambodia

A number of challenges continue to impact the development of TVET and present issues directly affecting the overall labour productivity and competitiveness of the country. It is recognised that Cambodia's productivity will increase primarily through investment in value-added industry with more advanced technology. However, the use of such equipment requires higher skill levels, and the challenge to confront this "skill gap" is an ongoing problem. In addition, Cambodia currently lacks a robust TVET system that works closely with the private sector, including export sectors, to ensure skill needs are met. Enrolment statistics indicate that, while growth of TVET is slow, Cambodia's higher education institutions have grown quite rapidly over the past decade, leading to a rapid rise in university graduates compared to TVET graduates.

Cambodia reportedly also lacks a transparent labour market information system to help educators and labour market entrants understand where the demand is, what the skill requirements are, and how to assist employers in identifying where potential new workers can be found. Furthermore, TVET is typically unresponsive to labour market demands. There continues to be a lack of infrastructure, tools, technical documents and regulations related to labour statistics and labour market information. This, together with the low capacity levels of TVET management staff, teachers and support staff, hinders the success of TVET. Due to the lack of stakeholder engagement and other quality issues, the supply of TVET graduates does not adequately meet the demands of industry. This mismatch between supply and demand has an impact on the overall productivity and economic development of Cambodia.

In Cambodia, the emphasis continues to be on higher education (university qualifications), perpetuating the low enrolment and high dropout rates for TVET. Possible causes include weak linkages between the labour market and TVET training programmes. In addition, schools do not adequately prepare students for TVET options, nor is there sufficient focus on promoting a positive image of TVET. The negative perception arises from TVET being positioned as second-chance or second-rate education. In Cambodia, as in many other countries, young people seen as academic underachievers are shunted into TVET programmes and institutions, reinforcing negative perceptions and its low valuation.

Inadequate government funding reduces the capacity of TVET to deliver accessible and high-quality products and services to students. TVET system development has been slower in Cambodia than in some ASEAN neighbours due to inadequate capacity levels and governance skills in management, and a general lack of enforcement of approved policies and a regulatory TVET framework. This problem is compounded by the lack of information-sharing among ministries, while inadequate management levels and co-ordination capacity stifles growth and innovation.

Cambodia's development model has important consequences for its education and training system. A large portion of the Cambodian economy comprises informal work and rural economic activities. However, the country is benefiting from a wave of foreign direct investment (FDI), mainly through industries characterised by labour-intensive, low-skill and low-pay work (for example, the garment industry). There are critical policy challenges for TVET, both in responding to immediate needs for skills in new industries and in developing the national capacity to migrate to higher skill industries.

Initiatives to improve the quality and relevance of TVET include strengthening and reforming the CQF; introducing competency and skill recognition testing centres; implementing a comprehensive quality assurance framework across all aspects of TVET; improving TVET curricula and the capacity of teachers and non-teaching staff; strengthening partnerships between the state and the private sector; and ensuring training is linked with industry needs and worker productivity. Expanded services and priority for women, vulnerable groups and those from remote areas will help to improve accessibility. Administrative and governance reforms have also been designed to improve the management of the sector.

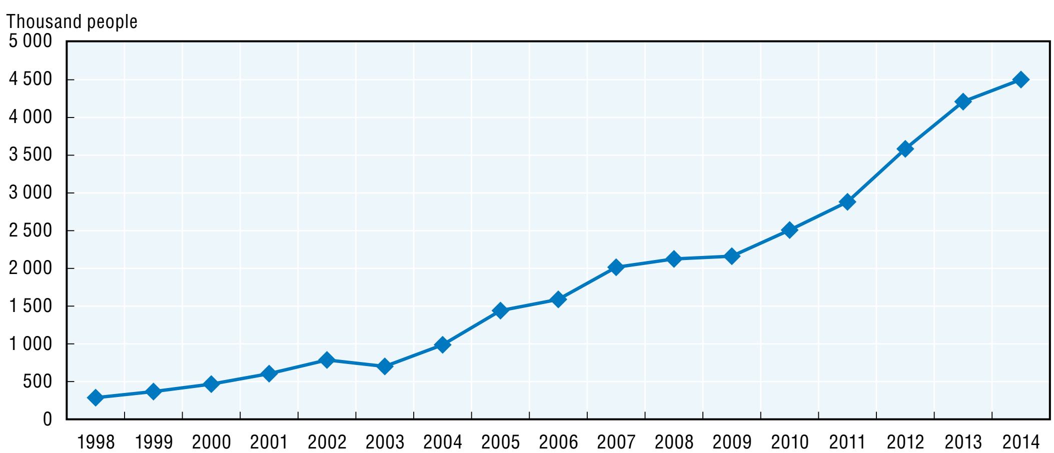
Finally, in a country where large numbers of new entrants to the labour force find jobs as informal workers, attention needs to be paid to promoting quality learning opportunities to develop their competencies and skills. A suitable framework will have a large impact on skills and productivity for informal workers.

POLICY FOCUS

Address complex challenges in developing tourism

Cambodia is rich in both cultural and ecotourism destinations; however, its infrastructure, management skill level and workforce are still limited, in both quantity and quality, and limit potential to capitalise on this endowment. Tourist flows to Cambodia increased in a linear fashion during the period 1994-2010 (Figure 6.8.1). The number of tourist arrivals was 350 000 in 1994 and grew at an average rate of 26.5% from 1998 to 2004. It slowed down to an average rate of 19.6% during 2005-08. Growth was the lowest in the last decade in 2009 at 1.7%, reflecting the impact of the global economic crisis in 2008-09, but it reached 16.0% in 2010. The impact of the crisis was purely short term.

Figure 6.8.1. **Tourist arrivals in Cambodia, 1998-2014**



Source: CEIC

StatLink http://dx.doi.org/10.1787/888933310472

The contribution of the tourism sector to economic development has been significant. It could reach 15.0% of GDP in 2010 (MoT, 2010). The direct value added captured by the hotel and restaurant sub-sector has increased over time and accounted for approximately 4.5% of GDP (NA, 2010). The sector employed around 6 500 people in 1998, which increased to approximately 10 000 in 2001 (NIS, 2008) and to approximately 60 000 in 2008 (Census, 2008). According to Cambodia – Nation-wide Establishment Listing 2009, there are 2 014 hotels that employed around 20 000 workers countrywide (NIS, 2009). "Food services" stands at approximately 27 000 establishments with 93 000 employees. The direct role and indirect effects of the food service industry is significant for tourism development.

Cambodia's chief tourist attractions are its culture, ecological assets and history. Currently, most tourists to Cambodia are from neighbouring and regional countries. It is less well known or popular as a tourist destination for international travellers. Cambodia's main tourism asset is the Angkor Wat temple, around which the tourist industry has developed. It is the central reason most tourists visit Cambodia. There are several more temples distributed across the country, but they are rarely visited. More options for entertainment and other leisure activities would encourage tourists to stay longer and spend more, supporting more income-generating activities and livelihoods than the present Angkor Wat-centric approach. For example, tropical beaches and river resorts as have been successfully developed in Thailand could be additional attractions.

Cambodia has the potential to develop a vibrant, multidimensional tourism industry. Cambodia is the heart of the Khmer culture that flourished in Southeast Asia for many centuries. An inventory in 2001 listed 209 tourist sites, including 81 cultural sites, 98 ecotourism sites, 26 parks/beaches, 1 recreation site and 3 tourist villages (Padeco, 2001). In 2010, the Ministry of Tourism (MoT) listed 291 tourist sites in its website, including Khmer Rouge historical sites. Recreation sites show the fastest growth, especially the development of 34 islands in the Gulf of Thailand.

In 2008, 85.1% of visitors to Cambodia were classified as tourists. In 2010, 75.6% were tourists, 16.75% were business and official travellers, and 2.90% were visitors of friends and relatives. In the last decade, approximately 80.0% of tourist arrivals were classified as leisure travellers, suggesting that Cambodia is mainly a destination for leisure tourism. For around 90.0% of visitors, the visit was their first to Cambodia. Since the bulk of visitors were also leisure travellers, they were not likely to repeat their visits. Non-leisure-related opportunities would more likely attract subsequent visits.

In 2010, on average, tourists stayed six days and spent USD 100 per day. Group travellers spent roughly USD 1 100 per person per visit, while single individuals spent half that amount. More than 60% of tourists were single individuals. The distribution of sex and age of tourists is well balanced: 30% of travellers are under 30 years of age, 50% are between 30 and 50, and approximately 20% are over 50. Over 60% are male. Cambodia is, therefore, a destination of choice for the average tourist and the potential for tourism demand is large.

During 2006-07, investment in the fixed assets of tourism sector rose steadily. Investments in the construction of Japanese-style hotels, resort centres and restaurants have shown strong growth. In 2008, such investment dropped by 55%, due to the turmoil in the international capital market. The conflict on the Cambodia-Thai border and the economic meltdown in 2009 continued to depress tourism investment. In 2008, Cambodia had 1 323 lodging establishments, more than double from 2000. Of these, 398 were hotels and 925 were guesthouses. In 2010, the number of hotels increased to 440 and guesthouses to 1 087. The total number of rooms available reached 40 000, while the current average number of tourist arrivals, both national and international, is estimated at approximately 3 000 per day.

A range of policy responses are needed to address complex challenges in the tourism sector

Lack of infrastructure makes it difficult for Cambodia to attract tourists. Cambodia did well during 2009-10 to improve road connections as part of the economic recovery programme, allowing both domestic and international tourists to travel practically the entire country under reasonably safe conditions. National roads have improved significantly, but the sub-national roads are not well maintained and impede comfortable travel to remote tourist destinations. Air travel has also expanded rapidly, even though the open skies policy has benefited the foreign airlines more than the domestic. Railways and waterways remain undeveloped. Waterway transportation has considerable potential for ecotourism development. Once efforts underway to build the necessary transport infrastructure are completed, tourism development in Cambodia will receive a further boost; however, inadequate maintenance of assets and limited access to tourism sites could threaten the future development of the sector. Environmental costs could also render tourism development unsustainable.

Managing tourist sites remains problematic in most cases, since the role of the various stakeholders is not quite clear. There are overlapping responsibilities in managing the sites. For example, temples are under the responsibility of the Ministry of Culture and Fine Arts, while eco sites may be under the Ministry of Environment or the Ministry of Agriculture, Fishery and Forestry. Some sites are managed by the Ministry of Culture and Religious Affairs.

The tourism market is concentrated on mass tourism. Foreign visitors have concentrated on only three main destinations: Siem Reap, Phnom Penh and Sihanoukville Province. The average length of stay (6.5 days) is relatively short compared to the regional average. The challenge is to transform other tourist destinations already well known to domestic visitors, such as Mondulkiri, Rattanakiri, Steung Treng and Kratie, into destinations suitable to receive and host foreign visitors.

Diversifying tourist destinations and making it appealing to a greater diversity of countries of origin should be high on the policy agenda. A public relations campaign promoting Cambodia as a destination of foreign tourists could be strengthened. Promoting domestic tourism would help to reduce the vulnerability of the tourism sector to external shocks.

A regional approach to tourism is an attractive option. ASEAN could project the region as a world-class tourist destination and agree to identify regional tourist "hotspots" which could then be developed as regional projects. Integration of transport arrangements to connect these destinations could be supported through a regional carbon initiative (RCI). Cambodia has already made good progress to facilitate cross-border transportation and in implementing the single visa initiative of ASEAN.

Visa facilitation agreements with regional countries, facilitation of cross-border transport, and the open skies policy, which permits direct flights from some countries to Siem Reap, have been effective in the development of the tourism industry. Nonetheless, a systematic policy and incentive framework is needed to support the domestic tourism industry. Facilitating cross-border transportation of tourists to a greater degree is a high priority.

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Key government ministries in Cambodia

Prime Minister	Hun Sen
Agriculture, forestry and fisheries	Ouk Rabun
Commerce	Sun Chanthol
Cults and religious affairs	Min Khin
Culture and fine arts	Phoeung Sakona
Economy and finance	Aun Porn Moniroth
Education, youth and sport	Hang Chuon Naron
Environment	Say Sam Al
Foreign affairs and international co-operation	Hor Nam Hong
Health	Mam Bunheng
Industry and handicrafts	Cham Prasidh
Information	Khieu Kanharith
Interior	Sar Kheng
Justice	Ang Vong Vattana
Labour and vocational training	Ith Sam Heng
Land management, urbanisation, and construction	Im Chhun Lim
Mines and energy	Suy Sem
National defence	Tea Banh
Planning	Chhay Than
Posts and telecommunications	Prak Sokhonn
Public works and transportation	Tram Iv Toek
Relations with the national assembly, senate, and inspection	Men Sam An
Rural development	Chea Sophara
Social affairs, war veterans, and youth rehabilitation	Vorng Saut
Tourism	Thong Khon
Water resources and meteorology	Lim Kean-Hao
Women's affairs	Ing Kantha Phavi
Central Bank Governor	Chea Chanto

Note: Valid as of 31 October 2015.

Lao PDR

A. Medium-term economic outlook (forecast, 2016-20 average)

GDP growth (percentage change):	7.3
Current account balance (% of GDP):	-17.8

B. Medium-term plan

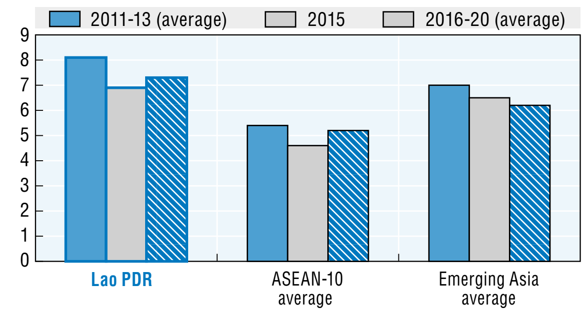
Period:	2011-15
Theme:	Socio-economic development, industrialisation and modernisation towards the year 2020.

C. Basic data (in 2014)

Total population:	6.6 million*
Population of Vientiane:	0.81 million*
Nominal GDP (US dollar):	11.68 billion **
GDP per capita at PPP:	5 005.83 (current International Dollar) **
Exchange rate in the first half of 2015 (period average):	8 102.38 (LAK/USD)

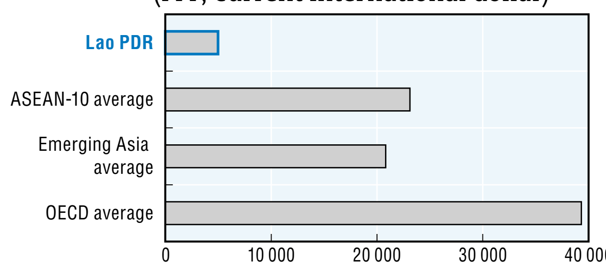
Note: * Population data for 2014 are estimates.
** IMF estimate.
Sources: OECD Development Centre, MPF-2016, national sources and IMF.

GDP growth rates (percentage changes)



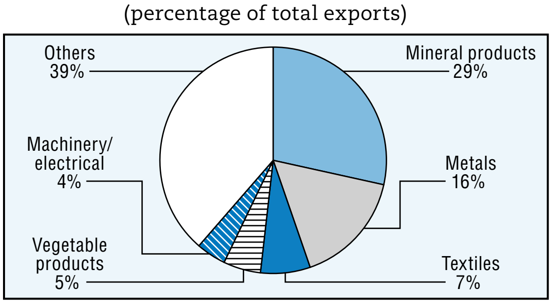
Source: OECD Development Centre, MPF-2016.

GDP per capita, 2014
(PPP, current international dollar)



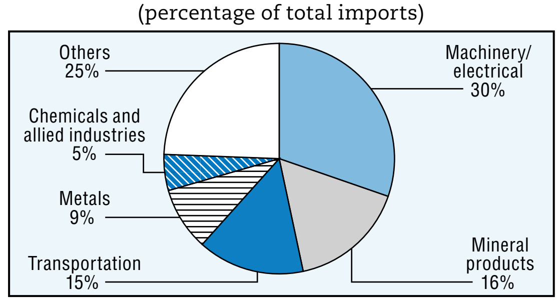
Source: IMF.

Composition of exports, 2014
(percentage of total exports)



Source: Trademap.

Composition of imports, 2014
(percentage of total imports)



Source: Trademap.

The economy of Lao PDR has grown quickly since the country's transition to a market economy, largely as a result of natural resource development. According to the World Bank, Lao PDR became a lower-middle income economy in 2011, and the government is seeking to graduate from Least Developed Country status by 2020. In recognition of the opportunities provided by openness, progress is also being made in regional and international integration. Lao PDR is participating in the development of the Association of Southeast Asian Nations (ASEAN) Economic Community and officially became a member of the World Trade Organization in February 2013.

Despite this progress, risks remain, and reforms will be needed in the future. Balanced growth will be particularly important for ensuring continued development. Properly handled, the boom in natural resources has the potential to be a driver of growth. But steps need to be taken to manage the potentially destabilising macroeconomic effects of resource development and to encourage economic diversification. Small and medium-sized enterprises (SMEs), which are already making a large contribution to the economy of Lao PDR, can be an important part of this diversification, if constraints in financing, training, access to technology and market access can be overcome. Tourism is another sector where further growth can be envisaged over the medium term.

LAO PDR: Medium-term policy challenges and responses

- Manage the natural resource boom
- Foster SME development
- Promote travel and tourism

POLICY FOCUS

Manage the natural resource boom

Resource booms can have both positive and negative impacts on an economy. Empirical studies show that resource-rich countries suffer from slow growth compared with resource-poor countries, mainly due to Dutch disease, but also to conflicts and rent seeking. Lao PDR is a resource-rich economy in terms of mining and hydropower, although there have been very few studies on the matter. In addition, the Lao government has not yet designed relevant policy options for managing the country's resources. In order to promote broad-based growth in Lao PDR and deal with Dutch disease, it is important to consider the following policy options.

Lao PDR is rich in resources for hydropower development and mining

According to the World Energy Council, Lao PDR has the potential to develop 18 gigawatts (GW) of hydropower capacity, the equivalent of around 63 terawatt-hours (TWh) per year, assuming a 40% capacity factor. The country has 14 operational projects and 12 projects under construction. Lao PDR's electricity generation history started in 1971 with the commissioning of the Nam Ngum Dam. The dam had an installed capacity at that time of just 30 MW, but capacity had increased to 150 MW by 1987. As of the early 1990s, only 20% of Nam Ngum's generation was consumed domestically, primarily to supply Vientiane, with the balance exported to Thailand.

Most hydropower projects, particularly the large ones, are independent power producer projects for export, and the majority of export projects are developed in order to supply Thailand. Export projects are backed by a memorandum of understanding between the Lao government and the governments of interested countries – mainly Thailand, with an export target of 7 000 MW by 2050. An agreement with Viet Nam also exists for electricity exports of up to 3 000 MW by 2020, while an agreement with Cambodia provides for only a small capacity (around 15 MW). Revenues to the Lao government come from many different sources, including: land fees; royalties; profit tax; turnover tax; personal income tax; dividend withholding tax; import and export duties; fees (buying and selling of shares, licence fees, technical service fees); and contributions to funds (for environmental protection, community development, human resources, sustainable development and project monitoring). Apart from taxes and royalties, the government also receives dividend payments from hydropower operations in which it holds an equity stake.

Lao PDR is rich in mineral resources. The country has more than 500 mineral deposits (World Bank, 2006). The two biggest mining projects are Phu Bia Mining Limited (90% owned by Pan Aust Limited and 10% by the government) and Lane Xang Minerals Limited (90% owned by MMG Limited and 10% by the government). Each company has sufficient mineral resources for at least ten years of production; has maintained or added to its resource base annually; has a successful track record of discovering new mineral occurrences; and spends USD 25-45 million annually on Lao exploration and evaluation of discoveries. This can be expected to sustain the level of production and revenues from tax royalties. In 2001, 48 companies were investing in the mining sector in Lao PDR. By March 2012, there were 290 projects, of which 107 involved prospection, 125 exploration and 58 mining. From 2005 to 2013, the mining sector contributed more than 2% annually to the country's real growth rate of approximately 7%. On the fiscal side, the combined mining and hydro contribution to total government revenues is estimated to have grown by more than 20% over the same period. Tax revenues from resources (profit tax and royalties from mining, and other resource revenue) have increased as a percentage of gross domestic product (GDP) since around fiscal year (FY) 2005/06 and peaked off at around 3% of GDP in FY2007/2008. Resource tax revenue reached 2.5% of GDP in FY2010/11 partly due to favourable gold and copper prices in international markets.

Natural resource development poses risks to stable and sustained growth

Resource booms provide an important source of financing for low-income, developing countries, but growth narrowly based on the exploitation of natural resources can have a negative impact on development if it fosters political or economic instability. One potential source of instability is Dutch disease, which occurs when capital inflows lead to real exchange-rate appreciation that negatively impacts the production and export of tradeable goods, including in agriculture and industry (Corden and Neary, 1982).

There are signs that Lao PDR may be exposed to the risk of Dutch disease. According to the World Bank (2010), the real effective exchange rate appreciated by 50% between 2001 and 2009. Labour productivity in Lao PDR was stagnant between 2005 and 2006 relative to other countries in the same income group (World Bank, 2010). Due to the resource movement effect and appreciation of the real exchange rate, the growth of non-resource sectors (manufacturing and agriculture) is slow (World Bank, 2014). Real wages are growing despite stagnant labour productivity, and manufacturing exporters tend to be less profitable than non-exporters.

In order to overcome the country's poor level of infrastructure, human resources and productivity, the government of Lao PDR (GoL) has enthusiastically promoted foreign direct investment (FDI). FDI inflows in 2007 were estimated at about USD 950 million, a 60% increase over the previous year. About 90% of these inflows were linked to the resources industry and accounted for most of the increase. Despite the massive impact of foreign capital flows and the general boom in the Lao resource sector, there is no policy option for coping with the negative impact of this sector. Therefore, in order mitigate this negative impact, it is important to identify policy options for dealing with Dutch disease in Lao PDR.

Before turning to policy options, it is important to consider the characteristics of mining and empirical studies from other countries. First, the mining market is volatile. The markets for primary products, including mineral commodities, are known for their instability. Price variations of 30% or more within a year or two are not uncommon. Market instability makes it difficult for developing countries to count on revenues from the mineral sector, and hampers the effective planning needed for economic development. Second, local communities tend to bear most of the environmental and other social costs associated with mining, while the benefits flow largely to the central government and elsewhere. Third, mining is often an enclave activity. Needed supplies are imported, and little value added is created domestically, as ores and concentrates are exported for processing abroad. Fourth, mining requires few workers, and many of those it does employ, particularly the more skilled workers, come from abroad. As a result, the host country gets little from mining besides the monetary benefits flowing from corporate taxation and royalties.

Strategies for mitigating the negative consequences of the resource boom

The main objective here is to identify the policy options for dealing with Dutch disease in Lao PDR. Further to an analysis based on lessons learned from other countries, interviews with key policy makers and a review of the macroeconomic situation in Lao PDR, we propose several strategies to mitigate or avoid Dutch disease in the country.

Economic diversification should be a priority. Most FDI is in the resources sector (mining and hydropower), and this may have a negative impact on non-resource sectors such as manufacturing and agriculture, each of which is labour intensive and crucial to long-term development. Therefore, it is important to promote FDI in non-resource sectors and to support the development of SMEs, which are facing various issues and need more help from the government (Kyophilavong, 2008; GIZ, 2013). It is also important to improve the climate for doing business in non-resource sectors in order to reduce costs and boost competitiveness. In addition, special economic zones (SEZs) may be an important component of attracting investment in non-resource sectors and of supporting their competitiveness.

The management of fiscal and monetary policy could also be improved. It is important to continue concentrating on the current reform in public financial management in order to increase fiscal discipline, including transparency and accountability. A well-functioning financial management mechanism should be established for revenues from natural resources, with appropriate shares for long-term savings and investment. In particular, an appropriate budget deficit should be maintained – no more than 5% of GDP – in order to avoid a debt trap. Good management of money supply is required for economic growth and in order to ensure macroeconomic stability.

Effort should be made to balance the budget. The Lao government has tended to expand expenditure first, and only then find the revenue sources (Saysombath and Kyophilavong, 2013). In addition, Lao PDR faces large budget deficits and high external debts. Given that rising windfall expenditures accelerate real exchange-rate appreciation, which negatively affects production in sectors that are not booming, policy makers need to strive to balance the budget. In other words, the Lao government should narrow expenditure, focus more on education and health care, and promote the production of tradeable goods, without neglecting important investments.

POLICY FOCUS

Foster SME development

Lao PDR has succeeded in maintaining high growth during the past decade, but its engine of growth depends on the resources sector (mining and hydropower). This will hinder long-term development. In order to diversify the economy and investment, development of SMEs is key. SMEs have strong potential in agribusiness, tourism, textiles and handicrafts, among other industries. Their development is one of the country's most important policies (GoL, 2011). The main objective here is to provide policy recommendations to support SME development in Lao PDR.

SMEs play an important role in diversifying the economy and generating employment, income and new technology for long-term development. Therefore, strengthening their development is one of the most important factors for long-term growth. However, SMEs in Lao PDR are at an early stage of development and face various problems, including access to capital, finding skilled technical labour, access to technology and business development service providers, and increased fees and regulations. In order to overcome these problems, the country needs a comprehensive and effective policy to support SME development.

SMEs face internal and external challenges

SMEs in Lao PDR perceive the lack of capital to be their most significant internal constraint (GIZ, 2014). A recent increase in the number of financial institutions in the country has not contributed much to easing access to finance for SMEs. Complex application procedures, high collateral requirements and high lending rates are the main issues (Kyophilavong, 2011). The skills shortage is another major constraint facing SMEs. The government is starting to focus on strategies to redress the twin problems of low skills levels and the insufficient number of skilled workers in the country, which also faces a shortage of unskilled labour. These internal constraints on SMEs are amplified by low levels of technology and high labour costs.

As for external constraints, the majority of SMEs are more concerned about domestic competition than international competition, and high taxes and duties are also problematic. High taxes harm competitiveness and deter FDI, leading to less economic growth (GIZ, 2014, Kyophilavong et al., 2007). Electricity, fuel prices and exchange-rate regulation are important external issues for SMEs. Even as Lao PDR exports electricity to neighbouring countries, domestic demand for electricity has increased significantly, leading to a shortage of electricity and higher prices. And since Lao PDR imports all of its oil, price fluctuations make it difficult for producers to plan inputs and outputs accurately. Foreign exchange-rate regulations have been identified as a more important external problem for large enterprises than for smaller enterprises, since large firms are more involved in international transactions. A small change in foreign exchange rates can have a large effect on turnover and profit. While many of these external factors are difficult to control, SEZs can be useful in providing SMEs with a better operating environment and opportunities to develop productive clusters.

The government has enacted reforms to assist SMEs

The government of Lao PDR has enhanced private-sector development to promote growth (GoL, 2004). In order to promote both SME and private-sector development, the government promulgated Primary Office Decree No.42/PM. The goals of this decree are: *i)* to improve the regulatory environment; *ii)* to enhance the competitiveness of establishments; *iii)* to expand domestic and international market access; *iv)* to improve access to finance; *v)* to encourage the development of business organisation; *vi)* to enhance entrepreneurial attitudes and characteristics within society. Furthermore, the decree established the SME Promotion and Development Office (SMEPDO), which is charged with promoting the establishment of SMEs and their sustainable development.

Several laws and regulations have been issued in support of private-sector development, which the government views as an engine of growth. Legislation includes the Business Law and the Law on Promotion and Management of Foreign Direct

Investment. However, there is still a lack of supporting decrees and the regulatory framework required to implement the new measures.

The institutional framework of SMEs is based on the Seventh Five-Year National Socio-Economic Development Plan (2011-2015) (GoL, 2011), the SME Promotion Law (GoL, 2011), the Decree on Implementation of the SME Law (2012), and the Decree on the Promotion and Development of Small and Medium-Sized Enterprises (GoL, 2004).

The Lao government has ranked SME development as the top priority of its development agenda. Seven strategic tasks have been defined: *i)* improving the regulatory environment and public administration of economic activities; *ii)* improving access to finance; *iii)* training of new entrepreneurs; *iv)* increasing support and business development services; *v)* enhancing business linkages between large enterprises and SMEs; *vi)* promoting increased productivity to upgrade the quality and standards of products and services offered by SMEs; *vii)* enhancing access to markets and enlarging markets for SMEs. But despite this policy orientation, there is a lack of the funding, human resources, knowledge and experience necessary for implementing the government's strategies.

An improved business environment and targeted policies can help spur SME growth

With competitiveness declining in non-resource sectors, promoting macroeconomic stability and improving the business climate for the private sector is crucial. But despite the government's significant efforts in recent years to improve the business climate, Lao PDR still stands toward the bottom in the World Bank's global ranking on the ease of doing business.

It is important to tackle the internal and external constraints faced by SMEs in order for these enterprises to increase their competitiveness and productivity. As noted above, constraints include limited access to finance, low levels of technology, competition, electricity prices and excessively high taxes and duties.

Obtaining a business licence is still a time-consuming process in Lao PDR, despite regulations, and so far there is no one-stop window for business start-ups. The country needs to implement guidelines to support the laws and regulations enacted to date, and possibly to develop new decrees.

Despite the government's efforts to facilitate access to finance, this remains a major problem for SMEs. It is important to inject money into funds for the promotion and development of SMEs in order to meet demand for funding. The application and documentation processes should be simplified, as most owners of SMEs do not have a high level of education. It is also important to conduct more qualified assessments of loan requests that focus on the viability of business ideas rather than on collateral (Kyophilavong, 2011). Finally, information gaps remain. SMEs face the problem of low management skills; they need government support to address this issue. It is important to increase funding for information and support services, and to increase the capacity building of service providers..

The low level of technology is a major obstacle for SMEs. The need for training is quite high, but there is a limited supply on offer from private firms, the government, international organisations and non-governmental organisations. In order to overcome technology limitations, funding for research, innovation and technology development activities should be increased. In addition, the private sector, universities and the government should strengthen their co-operation on innovation and technology development.

Improvement of market access for SMEs is important. Although Lao PDR has a trade portal to support SME exports in the international market, there are still issues of asymmetric information. Indeed, most SMEs seem unaware of the information available on the trade portal. To overcome this problem, it is important for the government to raise awareness about the importance of the trade portal and to provide information on the market for SMEs. The Trade and Private Sector Development Programme is helping to address trade-related concerns among SMEs and other firms by: developing a more conducive trade and investment environment; improving competitiveness for agribusiness, manufacturing and services; and improving the aid-for-trade governance framework for mainstreaming trade and private-sector development. In addition, improvement of information technology skills for SME owners and managers is a top priority in promoting market access for SMEs.

POLICY FOCUS

Promote travel and tourism

The tourism sector holds the potential to promote economic growth and reduce poverty in Lao PDR. But although the sector is growing, it faces serious constraints and seems to be small in comparison with the tourism industry in neighbouring countries. New strategies are needed to improve tourism policy in order to make tourism an engine of economic growth. It is important to attract more tourists from non-neighbouring countries and to increase spending on tourism, improve infrastructure, upgrade skills and human resources, introduce more public-private collaboration and ensure that environmental and cultural protections are in place.

Tourism in Lao PDR is growing and making important contributions to the economy

The government of Lao PDR has adopted a broad approach in promoting a range of types of tourism in the country. The first tourism master plan was to limit the number of international tourists in order to promote package tours for small groups of upper-market tourists (UN, 1996). However, the National Tourism Strategy 2006-2020 took a broader approach, embracing mass-market tourism while focusing on cultural tourism and, in particular, ecotourism in rural and remote areas (LNTA, 2005). Ecotourism takes advantage of the country's natural assets, including the Mekong River and numerous waterfalls, and the government takes a role in guiding the private sector to develop tourism with sustainable and long-term potential. At the same time, the government also continues to focus on community-based tourism as a tool to reduce poverty and promote economic growth (GoL, 2004). This broad approach is consistent with the Greater Mekong Sub region (GMS) tourism sector strategy endorsed by GMS countries in 2006. Through this strategy, member countries aim to promote the GMS as a single destination, ensure that tourism contributes to poverty reduction, minimise the adverse impacts of tourism, empower women and develop tourism products and services that distribute the benefits of tourism more widely.

Tourism has been growing significantly in Lao PDR. The number of tourist arrivals increased steadily from 1994 to 2014, with an average growth rate of 18%, although the number dipped on two occasions in the early 2000s. The main factors behind the decrease – from 737 208 in 2000 to 673 823 in 2001, and from 735 662 in 2002 to 636 361 in 2003 – were the terrorist attacks in the United States on 11 September 2001 and the spread of the SARS epidemic in Asia in the first quarter of 2003. Tourism recovered in 2004 and has continued to grow. In 2014, the number of tourist arrivals reached 4.15 million.

The growing numbers of tourists have generated large amounts of revenue and employment. Indeed, one of the most important contributions of the tourism sector is the generation of foreign income. From 1990 to 2014, annual tourist arrivals increased from 14 400 to 4.15 million (LNTA, 2015). By 2014, tourism revenues had reached USD 641 million, making the sector the second largest source of foreign exchange, after mineral exports. Tourism has also led to the creation of many jobs. The sector provides 17 000 full-time jobs and indirect employment for an additional 167 000 people (LNTA, 2009a). The tourism sector is also helping to drive the reduction in poverty in Lao PDR, partly thanks to the government's strategic promotion of smaller ecotourism and community tourism projects, which can have greater impacts on the poor. These areas of tourism have contributed significantly to poverty reduction (UNESCO, 2008; Schipani, 2011; Harrison and Schipani, 2007).

The expansion of tourism has also fuelled investment, with the addition of new hotels, guesthouses, restaurants and entertainment establishments. The number of hotels increased from 491 in 2013 to 515 in 2014, while guesthouses and resorts increased from 1 868 in 2013 to 1 911 in 2014. The number of restaurants and entertainment establishments also increased significantly.

Broad changes are needed to overcome the challenges facing the tourism sector

Despite the contribution of tourism to the economy and poverty reduction, the tourism sector faces various challenges, including how to attract more tourists from more countries and how to increase tourists' expenditure per day. The 18% average annual tourism growth rate from 1994 to 2014 is relatively low compared with neighbouring countries such as Thailand, Malaysia, Viet Nam and Cambodia. Moreover, the share of tourist arrivals in Lao PDR was about 4% of all tourist arrivals in ASEAN in 2013.

Table 6.9.1. **Intra- and extra-ASEAN tourism in ASEAN countries**

Percentage

Country	Intra-ASEAN	Extra-ASEAN
Brunei Darussalam	54.57	45.43
Cambodia	43.50	56.50
Indonesia	39.95	60.05
Lao PDR	80.47	19.53
Malaysia	74.30	25.70
Myanmar	24.29	75.71
Philippines	9.02	90.98
Singapore	39.28	60.72
Thailand	27.91	72.09
Viet Nam	19.02	80.98
ASEAN	44.11	55.89

Source: ASEAN-Tourism Statistics.

Tourism arrivals in Lao PDR increased to 4.15 million in 2014, but most international tourists – a full 80% – are visiting from ASEAN countries such as Thailand and Viet Nam. Tourism is far less diversified in Lao PDR, in terms of the visitors' countries of origin, than in neighbouring countries such as Thailand and Myanmar (Table 6.9.1). It is important to promote tourism development to attract more tourists from non-neighbouring countries (extra-ASEAN tourists).

Despite the increasing number of tourists, their expenditure per day in Lao PDR is relatively small. Tourists from neighbouring countries generally visit on 1-2 day package tours or quickly transit the country. In 2009, tourists from non-neighbouring countries visited for about 6.5 days on average and spent about USD 60 per day. These tourists are interested in nature- and culture-based activities (LNTA, 2009b).

Tourism cuts across sectors. Therefore, in order to promote tourism, it is important to improve other sectors such as cross-border movement of labour, remittances, financial development, etc. Achieving these goals requires improvements in infrastructure and skills. Poor infrastructure seems to be one of the most important challenges in terms of developing the tourism sector in Lao PDR. The road network that links cities to tourist destinations is relatively poor (JICA, 2012). The problem involves not only hard infrastructure, but also soft and institutional infrastructure, especially cross-border transportation. All of these areas need improvement. It is important to promote cross-border traffic agreements and institutions and to implement the Agreement on the Recognition of Domestic Driving Licenses, endorsed by ASEAN in 1985. In addition, 24-hour cross-border transit is necessary to facilitate tourism, trade and investment. Lao PDR also needs to implement the ASEAN Open Skies Agreement, which came into effect on 1 January 2015, with a view to increasing air connectivity in secondary international airports.

The lack of qualified personnel in Lao PDR is an important problem facing the promotion of tourism. The Lao National Institute of Tourism and Hospitality has been established in order to develop standards and qualifications. However, the curriculum and teaching materials need to be improved. In order to improve human resources development and service quality, it is important to implement fully ASEAN's Mutual Recognition Arrangement on Tourism Professionals. To develop the standards and qualifications for job titles in housekeeping, front office, food production, etc. at the Lao National Institute of Tourism and Hospitality, it is important to implement ASEAN's six tourism standards: *i)* green hotel; *ii)* food and beverage services; *iii)* public restrooms; *iv)* home stay*; v)* ecotourism; and *vi)* tourism heritage.

Public-private collaboration may be useful in developing the tourism sector. It is important to co-operate on a multi-sector basis involving tour companies, hotels, restaurants, airlines, transportation companies, etc. To attract more tourists to Lao PDR, promotion of the ASEAN Tourism Fair and Visit ASEAN Year is also important. Moreover, more efficient and effective use of public and private resources for destination marketing is needed, with a view to attracting higher-spending markets and tourists from a more diverse range of countries.

At the same time, the environment and culture should be protected. Lao PDR has promoted ecotourism and community-based tourism for economic development and poverty reduction. Therefore, in order to promote tourism, it is crucial to protect the country's cultural and environmental resources. Any decline in biodiversity and natural resources will harm the promotion of ecotourism.

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Key government ministries in Lao PDR

Prime Minister	Thongsing Thammavong
Agriculture and forestry	Phet Phomphiphak
Defence	Sengnouane Xayalath
Education and sports	Phankham Viphavanh
Energy and mines	Khammany Inthirath
Finance	Lien Thikeo
Foreign affairs	Thongloun Sisoulith
Home affairs	Khammanh Sounvileuth
Industry and commerce	Khemmani Pholsena
Information, culture and tourism	Bosengkham Vongdara
Justice	Chaleuan Yiapaoheu
Labour and social welfare	Khampheng Saysompheng
Natural resources and environment	Sommad Pholsena
Planning and investment	Somdy Douangdy
Post, telecommunications and communications	Hiem Phommachanh
Public health	Eksavang Vongvichit
Public security	Brig Gen Somkeo Silavong
Public works and transport	Bounchanh Sinthavong
Science and technology	Boviengkham Vongdara
Central Bank Governor	Somphao Phaysith

Note: Valid as of 31 October 2015.

Myanmar[1]

A. Medium-term economic outlook (forecast, 2016-20 average)

GDP growth (percentage change):	8.3
Current account balance (% of GDP):	-6.1

B. Medium-term plan

Period: 2012-15

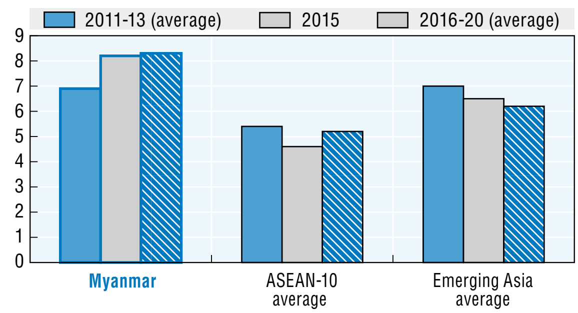
Theme: Development of industry, balanced development, improvements in education, health, living standards and statistical capacities

C. Basic data (in 2014)

Total population:	51.42 million*
Population of Kuala Lumpur	1.16 million*
Nominal GDP (US dollar):	63.14 billion
GDP per capita at PPP:	4 752.40 (current International Dollar)**
Exchange rate in the first half of 2015 (period average):	1029.55 (MMK/USD)

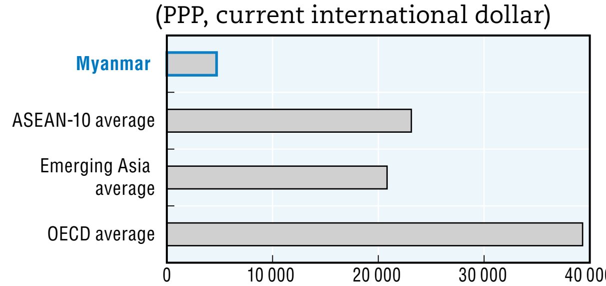
Note: * Population data for 2014 are from Myanmar 2014 Census
** IMF estimate.
Sources: OECD Development Centre, MPF-2016, national sources, CEIC and IMF

GDP growth rates (percentage changes)



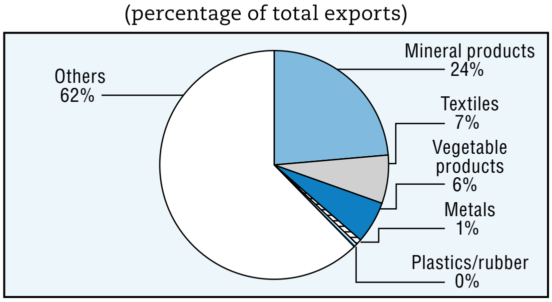
Source: OECD Development Centre, MPF-2016.

GDP per capita, 2014
(PPP, current international dollar)



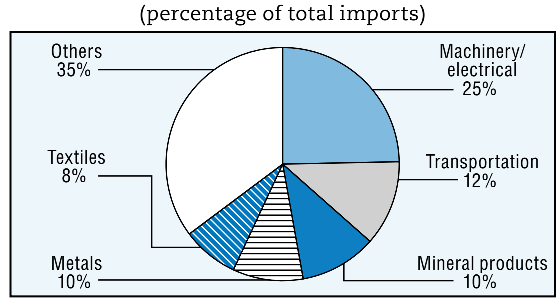
Source: IMF.

Composition of exports, 2014
(percentage of total exports)



Source: Trademap.

Composition of imports, 2014
(percentage of total imports)



Source: Trademap.

Myanmar has undergone significant political and economic change since its transition to civilian government in 2011. Its new international openness and the end of foreign sanctions are creating many opportunities for this fast-growing economy. Plans are being created and implemented to ensure that the country benefits from these changes and its strong resource base, favourable geographic position and ongoing regional integration. Policy priorities for 2012-15 were laid out in the Framework for Economic and Social Reforms, which outlined policy priorities and reforms intended to help support the implementation of the 20-year National Comprehensive Development Plan.

As recognised in these plans, a wide range of reforms are needed for Myanmar to take advantage of current opportunities and to reach its growth targets. Important policy areas include the following: 1) upgrading and modernising agriculture to raise productivity and free labour to work in manufacturing and services; 2) developing human capital to provide the skills needed in these growing sectors; and 3) financing development by efficiently mobilising and allocating external and domestic sources of funds.

Myanmar: Medium-term policy challenges and responses

- Upgrade and modernise agriculture
- Develop human capital
- Finance development

POLICY FOCUS

Upgrade and modernise agriculture

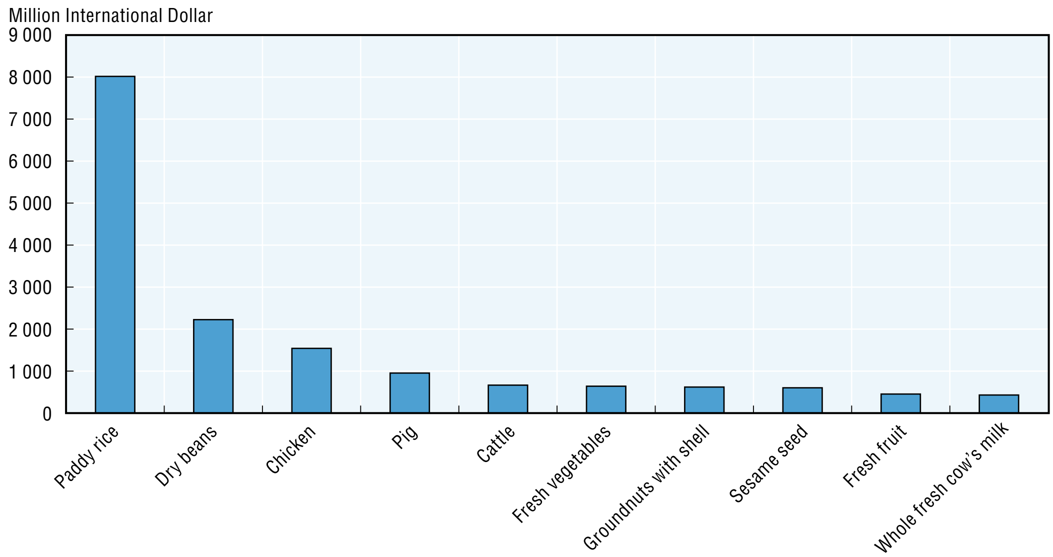
Agriculture plays a major role in the economy of Myanmar, accounting for approximately 60% of employment, 32% of gross domestic product (GDP) and 20% of export earnings. As implied by the large difference in output and employment shares, however, labour productivity and incomes are low in this sector. The upgrading and modernisation of Myanmar's agricultural sector will play a major role in the country's economic development. The marginal product of labour is quite low in agriculture, which employs a large share of the labour force. Improved on-farm productivity, which would free labour to work in other sectors, and the expansion of the wider agri-food sector and manufacturing and services more generally would contribute significantly to income growth. A favourable farming environment and the country's proximity to major markets provide opportunities for the development of export agriculture. However, a broad set of reforms are needed to make farms more efficient and to improve the quality, safety and value-added attributes of agricultural commodities.

Much of agriculture remains subsistence based. Myanmar's farming sector predominantly consists of small farms, with 54% of farms less than 2 hectares in size in 2010, according to the Myanmar Census of Agriculture. Only 4.3% of farms were between 8 and 20 hectares, and 0.3% were larger than 20 hectares. This distribution of land may have negative effects on labour productivity. While smaller farms tend to produce higher yields per hectare, they are associated with less output per worker (FAO, 2014).

Paddy rice is by far the most important crop in Myanmar, with 29 million tonnes produced in 2013, valued at 8 billion international dollars (Figure 6.10.1). Other major commodities include pulses, nuts and seeds, fruits, vegetables and meat. Despite its dominance in domestic production, rice and rice products accounted for only 16% of the value of crop exports in 2010/11 (Figure 6.10.2). Pulses were instead the most valuable, accounting for 65% of the total value. Most of the rice that is sold abroad is sold at the lowest international standard, which depresses prices. Improved quality of pulses and rubber exports may also raise the value of these commodities.

Figure 6.10.1. **Gross production value of Myanmar's top ten agricultural commodities, 2013**

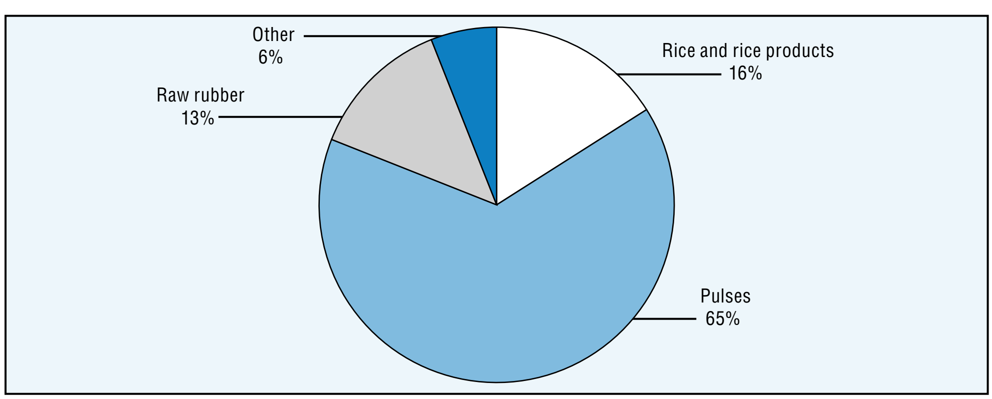
Million international Dollar at constant 2004-06 price



Source: FAO (2015), *FAOSTAT* (database), http://faostat3.fao.org/.

StatLink http://dx.doi.org/10.1787/888933310480

Figure 6.10.2. **Share of Myanmar's agricultural crop exports by type, 2010/11**



Source: CSO (2013), *Myanmar Data on CD-ROM 2011*, Central Statistical Organization, Ministry of Planning and Economic Development.

StatLink http://dx.doi.org/10.1787/888933310499

Financing will be needed for farmers to make the investments that will allow them to take advantage of new opportunities in the future by increasing production and improving efficiency and quality. The Myanmar Agriculture Development Bank (MADB) provides seasonal and some longer-term loans to farmers but faces funding constraints due in part to interest rate limits. While the Global Treasure Bank, formerly the Myanmar Livestock and Fisheries Development Bank, now operates as a commercial bank targeting farmers and rural industry, there are potential synergies in co-operating with the MADB to reach clients throughout the country, particularly in building upon MADB's network of branch offices and local knowledge.

The Farm Land Law of 2012 should help to improve access to finance by formalising land use and tenure rights and allowing farmers to use their Land Use Certificates (LUCs) as collateral in securing financing. This would require commercial banks to be able to operate freely in the agricultural sector and to be willing to accept LUCs as collateral. Farmers should also have access to reliable crop insurance programmes. The Food and Agriculture Organization (FAO) and Government of Myanmar are working together to develop risk management tools. A weather index-based scheme would help to manage risks to sector performance and livelihoods from the floods and droughts with which they are often stricken. Weather index-based schemes are relatively easier to implement because they do not require farm-level data and are not subject to moral hazard, as communities or areas are covered instead.

Along with financing, improved knowledge and skills will be critical in modernising farming. However, the limited resources available for Ministry of Agriculture and Irrigation (MOAI) extension services leave many village managers over-extended and unable to reach many farmers, who, as a result, often rely on agro-input dealers for technical assistance. Additional funding would, therefore, be needed to provide the unbiased assistance associated with better economic and environmental outcomes. Efforts to provide better training for extension workers, as are being made by the Central Agricultural Research and Training Centre, are worthwhile. These may be complemented with measures to reach farmers through alternative means, such as through the Internet, radio and mobile phones, or by encouraging farmer-to-farmer information programmes. Alternative funding options may also include co-payment schemes or public-private partnerships (PPP), where appropriate.

The provision of assistance programmes and policy development is further complicated by the organisation of agriculture-related ministries. While farms are often mixed enterprises, aspects of agricultural policy are divided among the MOAI, the Ministry of Livestock, Fisheries and Rural Development, and the Ministry of Environmental Conservation and Forestry. Greater co-ordination may be necessary to ensure that policies are consistent and efficient.

Expanded agricultural trade will put additional strain on already limited health and safety inspection services. There is only one internationally accredited government laboratory in Nay Pyi Taw that can test pesticide residue levels, forcing some traders to accept delays and increased costs in sending samples abroad for testing. More laboratories certified by the International Organization for Standardization and qualified staff are needed. Again, additional investment in health and safety services may be partly funded through fee-based inspection services for exporters and the use of PPPs for inspection and training on good agricultural practices (GAPs) at the farm level. Additional efforts over the longer term will be needed to meet the standards of higher-income countries and various private standards.

Finally, upgrading and exporting can be facilitated through alternative organisational and marketing strategies for the agricultural sector. Collective marketing organisations, contract farming and agro-food clusters can be used to lower exporting costs and spread modern farming practises. These arrangements are already in use in Myanmar; some 58 rice specialist companies engage in contract farming arrangements whereby they supply farmers with inputs and technical assistance for fixed price deliveries of rice. Myanmar's agro-food producer associations may also have roles to play in providing market information, technical assistance and co-operative marketing. Clusters and value chains may be used to improve quality and branding of products and can be promoted through the development of supportive soft and hard infrastructure and even the offer of temporary fiscal incentives.

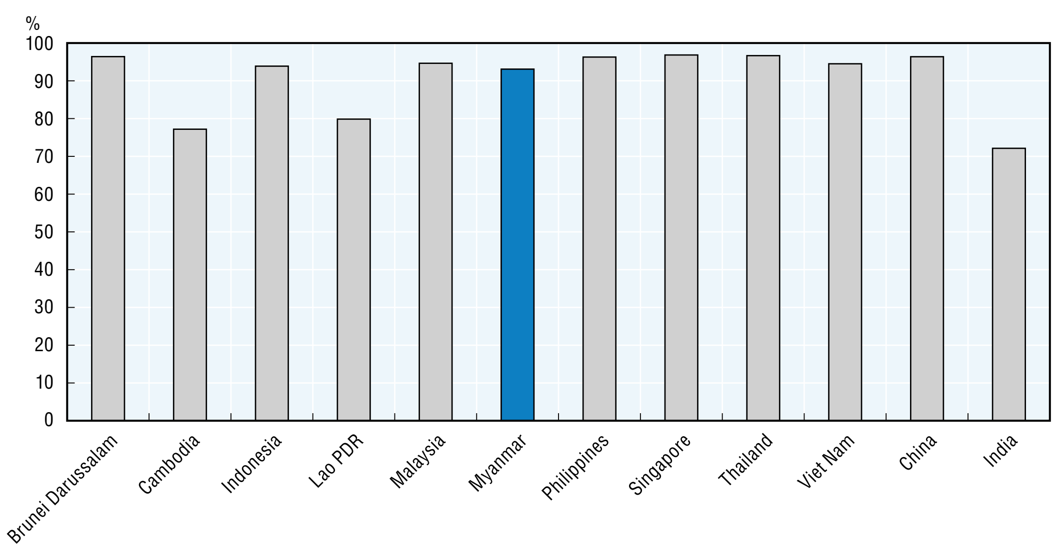
POLICY FOCUS

Develop human capital

Improved access to and quality of education will be critical in supporting structural transformation and the expansion of modern manufacturing and services industries. While basic education in Myanmar is fairly strong, skills gaps continue to be a serious impediment to growth. Reforms are needed to improve higher education, worker readiness and technical skills in particular. The brain drain will also need to be addressed to ensure that Myanmar benefits from its investments in education and training.

Basic levels of education are fairly common in Myanmar, although advanced education and specific skills are rarer. While functional literacy rates are thought to be much lower (UNESCO, 2014), the UNESCO Institute for Statistics estimates Myanmar's adult literacy rate at 93%, not far below that of higher-income countries in Emerging Asia and considerably better than the literacy rates of Lao PDR, Cambodia and India (Figure 6.10.3). Literacy and basic education have long been emphasised in the country; a nation-wide adult literacy programme was introduced in 1973 and several summer literacy programmes were introduced in 1996. Net enrolment rates for 2010/11 were 84.6% for primary education, but fell to 47.2% in lower secondary and 30% in upper secondary. Tertiary education is also not particularly common; in 2011, there were only 1 285.19 tertiary students per 100 000 inhabitants, below the levels seen in many neighbouring countries, including Lao PDR (1 983.59) and Cambodia (1 573.26).

Figure 6.10.3. **Estimated adult literacy rates in Emerging Asia, 2015**



Source: UNESCO (2015), *UNESCO Institute for Statistics Data Centre* (database), www.uis.unesco.org.
StatLink http://dx.doi.org/10.1787/888933310501

Expanded access to education and improved quality are needed across the education system. High drop-out rates are associated with financial burdens, the physical distance children travel to school and the lack of more mother tongue education for children who are not native speakers of the Myanmar language. Teacher quality has a major impact on student achievement, and much more could be done in Myanmar to train strong educators. Current reforms aim to have all teachers complete five years of training to the BA level, although there is no deadline for the achievement of this goal. Reviews of selection criteria for teacher training programmes and of incentives for teachers may also help to attract better-qualified and more motivated teachers.

The capacity to provide technical and vocational education (TVET) is currently limited in Myanmar, although TVET holds considerable potential in helping to prepare workers for positions in the manufacturing and services sectors, which are set to grow quickly in the country. Employers are particularly interested in finding more workers with computer skills and information and communications technology skills. Both curricula and practical experience that are relevant to employers are particularly important in these specialised programmes. TVET systems created to address such shortages will need to be designed through engagement with employers, unions and students and should use teachers who are familiar with the workplace.

Assistance in skills development is gradually evolving. An increasing number of jobseekers have been making use of the 91 labour exchange offices run by the Ministry of Labour, Employment and Social Security (MoLESS). These offices offer help on employment issues in addition to skills development services. MoLESS also runs four skills training centres focused on preparing workers to work abroad under the Employment Permit System. The Employment and Skills Development Law of 2013 established an Employee Skills Development Fund that will finance training programmes with mandatory contributions by employers of 0.5% of employees' wages. The details of this fund remain to be settled; however, along with similar programmes among business associations, there may be more resources available to invest in worker training in the future.

Migration patterns will also affect the composition of skills in the country. While official figures state that 514 000 Myanmar nationals live abroad, estimates including unofficial migration are as high as 5.5 million, which would mean that a greater share of Myanmar's population lives abroad (around 10%) than even in the Philippines (4.4%) (Mon, 2014; OECD, 2012). Most Myanmar migrants surveyed recently in Thailand said that they wanted to return home, preferably to their hometowns or villages, in the future. The creation of jobs where they can put to use the skills they have gained in working abroad will, therefore, help to convince these workers to return.

The policy-making framework regarding education, skills and employment is complex. The National Education Committee co-ordinates education decision making, but another 11 ministries hold responsibility for various aspects of the education system. Similarly, Myanmar currently lacks a national qualification framework to provide transparent and reliable information on skills held by workers, and the development of a framework in line with ASEAN standards is being managed by three ministries. However, efforts are being made to improve planning across the Government, including the Comprehensive Education Sector Review, which was initiated in 2012 and is led by the Ministry of Education to develop a costed strategic plan for the education sector.

POLICY FOCUS

Finance development

Myanmar's growth depends on the effective mobilisation and allocation of financial resources to meet the country's sizeable investment needs. While international sources of funding are expected to grow quickly as the country continues to open, under-utilised domestic sources will likely be more important. However, reforms to the investment environment, financial system, and government revenue collection and expenditure management are needed to secure these sources of financing.

Myanmar has significant funding needs as a result of its under-investment. While investment has accelerated in recent decades, reaching around 9% of GDP in the 1990s and 13% in the 2000s, these rates remain far below those seen in many other Emerging Asia economies. Myanmar's low income level and low rates of investment have, therefore, produced a significant gap in capital stocks. In fact, to sustain convergence with other Asian economies over the next two decades, Myanmar would need an estimated average investment rate of 21% to 30% of GDP through to 2035 – well above current levels (OECD, 2014).

Economic sanctions and political tension affected aid flows to Myanmar in the past, although this is changing as a result of the international community's approach to Myanmar as it reforms. Official development assistance (ODA) commitments increased dramatically from USD 246 million in 2007 to USD 763 million in 2012. While new procedures have been established to manage ODA, these can be cumbersome and time consuming. The administration of ODA may need reform or additional resources in the future, particularly in ensuring that effective monitoring and evaluation take place to avoid rent-seeking and corruption.

Sanctions also limited foreign direct investment (FDI) in the past two decades, although China; Hong Kong, China; Thailand; Korea and others continued to invest in the country. According to the United Nations Conference on Trade and Development, FDI flows increased from USD 191 million in 2002 to USD 2.2 billion in 2012. As it has grown, FDI has diversified, both in terms of partner countries and economic sectors. Notably, China's share of inward FDI flows has shrunk and smaller projects outside of natural resources and power provision projects have become more common. Despite these promising developments and legislative and regulatory reforms, including the passing of the new Foreign Investment Law in 2012, complexities and uncertainties in the approval process for FDI – along with challenges in the business environment more broadly – will need to be addressed to facilitate further such investment throughout the economy in the future.

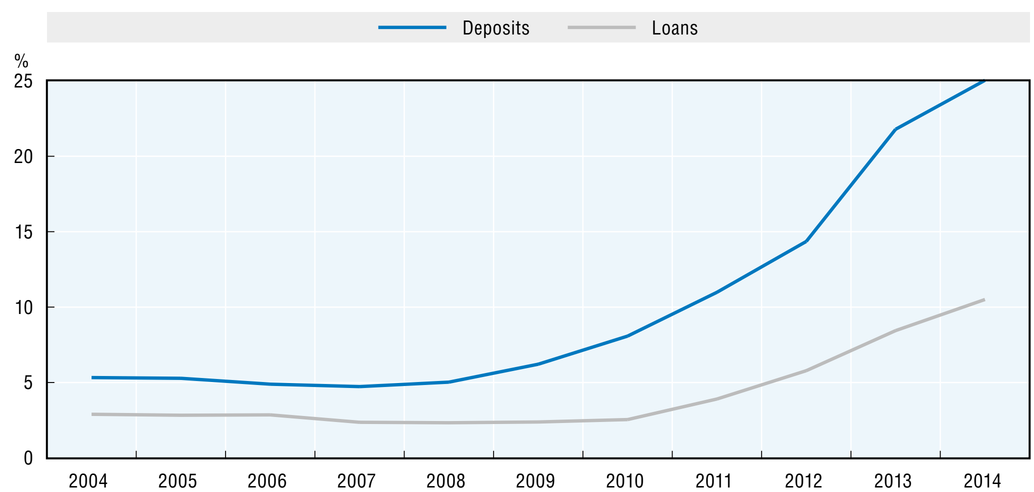
Remittance flows can be another important source of financing for development. While Myanmar has a large number of people working abroad, many are unofficial migrants who may face difficulties in sending money home through official transfer mechanisms.Net inward official flows, which are likely to be significantly smaller than total flows, have nevertheless grown considerably, from USD 111 million in 2005 to USD 556 million in 2012, according to the Word Bank (2011). Working with destination countries to legalise and register migrants could help them to secure better-paying jobs and to make use of official channels for sending remittances, boosting these flows.

Despite the promise of these international sources of financing, government revenues and domestic private savings are more likely to make up the larger share of financing for investment growth in Myanmar. Good progress has been made in these areas as well, although further reforms will be needed to support these sources of funds.

Government revenues are insufficient to meet the country's development needs. Tax revenues are particularly low as a result of the tax structure and challenges in collection. There are 200 000 registered taxpayers in the country, representing just 0.4% of the population (World Bank, 2013). As a result, total government revenue and tax revenue relative to GDP are among the lowest in Emerging Asia. While revenues from the exploitation of natural resources will help to bring in additional funding, further changes are also needed, particularly to tax administration. Collection could be improved and burdens on business reduced through administrative reforms to tax liability assessments and a switch to self-assessment, for example. At the same time, the continued modernisation of planning and budgeting through the adoption of public expenditure management processes will help to ensure that revenues are used responsibly.

The development of the capabilities of Myanmar's financial system, itself still at an early stage of development, will be critical in mobilising financial resources for development. Currently, nearly all assets are held by commercial banks, and formal financial markets are nearly non-existent. As a result, a limited range of financial services are available. While access to financial services is also low, particularly in rural areas, it is improving and commercial banks are seeing rising values of deposits and borrowing (Figure 6.10.4).

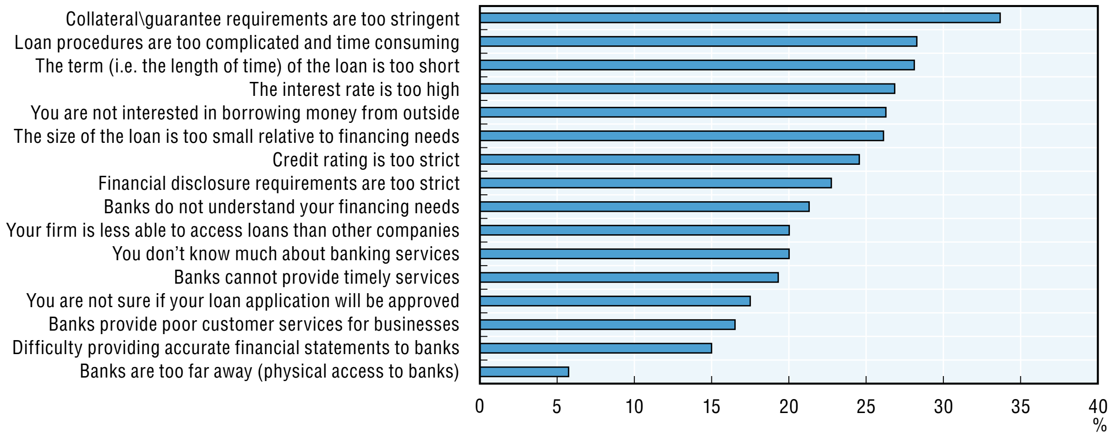
Figure 6.10.4. **Outstanding deposits with and loans from commercial banks as a percentage of Myanmar's GDP**



Source: IMF (2013), *Financial Access Survey* (database), http://fas.imf.org.
StatLink http://dx.doi.org/10.1787/888933310519

Despite improvements, businesses still face financial constraints. According to respondents of the *Myanmar Business Survey 2014*, collateral and guarantee requirements are the most common obstacle for securing financing, faced by 34% of firms (Figure 6.10.5). Complicated procedures and short terms for loans were also among the most common problems. Regulatory restrictions on the banking sector have been relaxed, e.g. those on interest rates, but work needs to be done in important areas, including establishing a credit bureau, which is currently underway. The sector could also benefit from a gradual opening up to foreign banks. Financial market development cannot be neglected, however; the development of strong interbank and bond markets should be prioritised to underpin the financial system.

Figure 6.10.5. **Share of identified obstacles to securing finance for Myanmar firms, 2013**



Source: OECD, UMFCCI and UNESCAP (2014), *Myanmar Business Survey 2014* (database).
StatLink http://dx.doi.org/10.1787/888933310523

Note

1. This Country Note is largely based on OECD (2015), *Multi-dimensional Review of Myanmar: Volume 2. In-depth Analysis and Recommendations, OECD Development Pathways*, OECD Publishing, Paris, available at http://dx.doi.org/10.1787/9789264220577-en (accessed 26 August 2015).

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Key government ministries in Myanmar

President	Thein Sein
Agriculture and irrigation	Myint Hlaing
Border affairs	Lt. Gen. Kyaw Swe
Commerce	Win Myint
Communication and information technology	Zeyar Aung
Construction	Kyaw Lwin
Co-operatives	Kyaw Hsan
Culture	Aye Myint Kyu
Defence	Lt. Gen. Sein Win
Education	Khin San Yi
Electric power	Khin Maung Soe
Energy	Zeyar Aung
Environmental conservation and forestry	Win Tun
Finance and revenue	Win Shein
Foreign affairs	Wunna Maung Lwin
Health	Than Aung
Home affairs	Lt. Gen. Ko Ko
Hotels and tourism	Htay Aung
Immigration and population	Lt. Gen. Ko Ko
Industry	U Maung Myint
Information	Ye Htut
Labour, employment and social security	Aye Myint
Livestock and fisheries	Ohn Myint
Mines	Myint Aung
National planning and economic development	Kan Zaw
Rail transport	Nyan Tun Aung
Religious affairs	Soe Win
Science and technology	Ko Ko Oo
Social welfare, relief and resettlement	Myat Myat Ohn Khin
Sports	Tint Hsan
Transport	Nyan Tun Aung
Central Bank Governor	Kyaw Kyaw Maung

Note: Valid as of 31 October 2015.

CHINA AND INDIA

China[1]

A. Medium-term economic outlook (forecast, 2016-20 average)

GDP growth (percentage change):	6.0
Current account balance (% of GDP):	2.3
Fiscal balance (% of GDP) (central government):	-1.7

B. Medium-term plan

Period: 2011-15

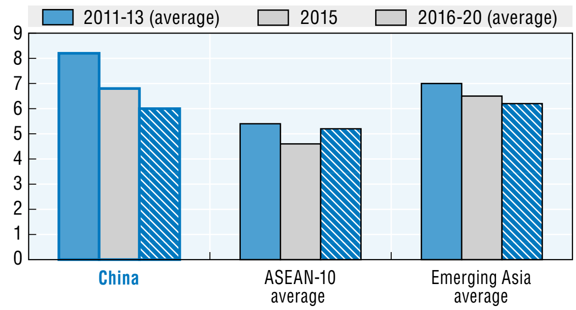
Theme: Rebalancing the economy, ameliorating social inequality, and protecting the environment.

C. Basic data (in 2014)

Total population:	1367.80 million*
Population of Beijing:	21.52 million*
Nominal GDP (US dollar):	10 356.51 billion
GDP per capita at PPP:	13 224.00 (current International Dollar)**
Exchange rate in the first half of 2015	6.22 (RMB/USD)

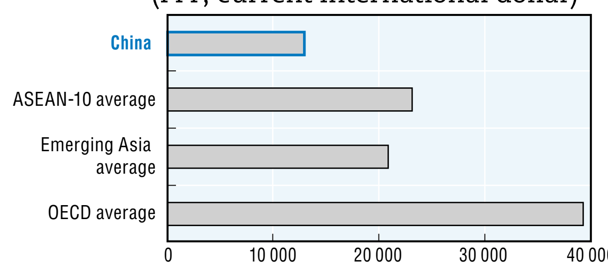
Note: * Population data for 2014 are estimates.
** IMF estimate.
Sources: OECD Development Centre, MPF-2016, national sources, CEIC and IMF.

GDP growth rates (percentage changes)



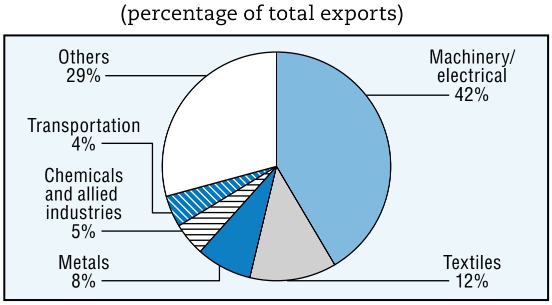
Source: OECD Development Centre, MPF-2016.

GDP per capita, 2014
(PPP, current international dollar)

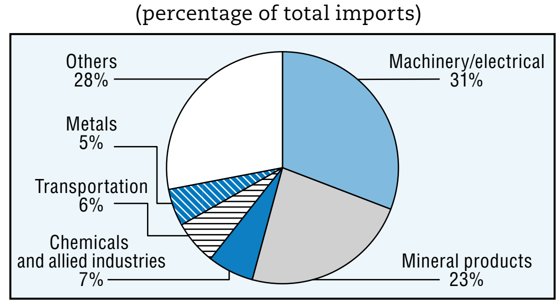


Source: IMF.

Composition of exports, 2014
(percentage of total exports)



Composition of imports, 2014
(percentage of total imports)



China is now entering its "new normal", a less rapid but more stable and sustainable stage of growth. While still impressive, recent rates of growth might be more difficult to sustain in the future. China is facing serious structural challenges to improve the "quality" of growth and to avoid a sharp deceleration. Chief among them are 1) environmental challenges; 2) human capital mismatches; and 3) boosting rural incomes. The long-standing principle of prioritising growth has led to severe environmental degradation caused primarily by the excessive use of coal as a source of energy, along with inefficient, volume-based expansion in many heavy industries. Current growth strategies seek to correct such past excesses. An ageing population implies comparatively fewer people entering the labour force and thus a loss of competitiveness in labour-intensive production. Upgrading human capital to facilitate transition to a higher value-added economy is required. While rapid urbanisation has been a major driver of productivity growth, rural productivity remains low. Among other measures, greater circulation of land and better access to finance are needed to boost rural incomes and unlock this additional source of growth.

China: Medium-term policy challenges and responses

- Strengthen environmental regulations to improve quality of growth
- Upgrade human capital to facilitate transition to a higher value-added economy
- Boost rural development to ensure robust growth of incomes

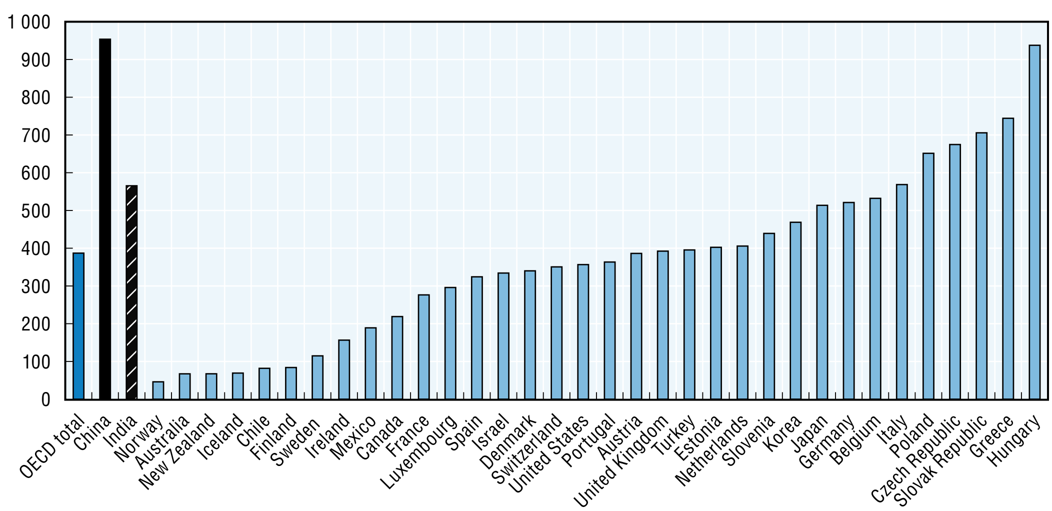
POLICY FOCUS

Strengthen environmental regulations to improve quality of growth

Improving environmental quality is a government priority (OECD, 2015a). Severe air, soil and water pollution adversely affect citizen health, degrading quality of life and hindering productivity. For instance, China has substantially more deaths from ambient air pollution per million capita than OECD member countries (Figure 6.11.1).

Figure 6.11.1. **Deaths from ambient air pollution capita in OECD member countries, China and India, 2010**

Per million capita



Note: The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: OECD (2014a), *The Cost of Air Pollution: Health Impacts of Road Transport*, http://dx.doi.org/10.1787/9789264210448-en.

StatLink http://dx.doi.org/10.1787/888933310534

Widespread pollution is due to uncontrolled industry expansion in previous decades, coal burning in power plants, vehicle emissions, low environmental standards and a lack of enforcement, and a low level of awareness. The sole goal of growth has led to a neglect of both environment and efficiency and to fierce competition and overinvestment in a number of industries.

Along with widespread environmental degradation, volume-based expansion by firms in the past couple of decades resulted in excess capacity in several industries, such as steel, cement, aluminium, flat glass and, downstream, electrical and railway equipment. Rationalisation of existing capacity is warranted, given fierce price competition, environmental damage and inefficiencies in many industries. The National Development and Reform Commission has long called for avoiding "blind" investment and redundant construction in steel mills, copper smelters and electrolytic aluminium. In 2013, the State Council took action more directly, issuing guidelines to close down or merge high-cost production facilities across the country so as to reap economies of scale and restore profitability. Fewer steel mills now operate in Hebei, and several aluminium smelters have been selected for closure in Guangxi and Guizhou. Rationalisation will help check greenhouse gas emissions, which tripled in two decades to reach 28% of global emissions in 2013 (Global Carbon Project, 2014). Smelters are also a significant source of air pollution. Estimates suggest that outdoor air pollution caused 1.3 million premature deaths in 2010, highlighting the pressing need to continue curbing pollution-intensive industry (OECD, 2014a). However, even as sizeable capacity is being phased out in some areas, massive new capacity is being built in others, as with the aluminium smelters in the four coal-rich Western provinces of Gansu, Ningxia, Qinghai and Xinjiang. While the relocation of energy-intensive industries is based on a better exploitation of comparative advantages, and new facilities are typically more modern and cleaner, their proliferation works against efforts to reduce excess capacity.

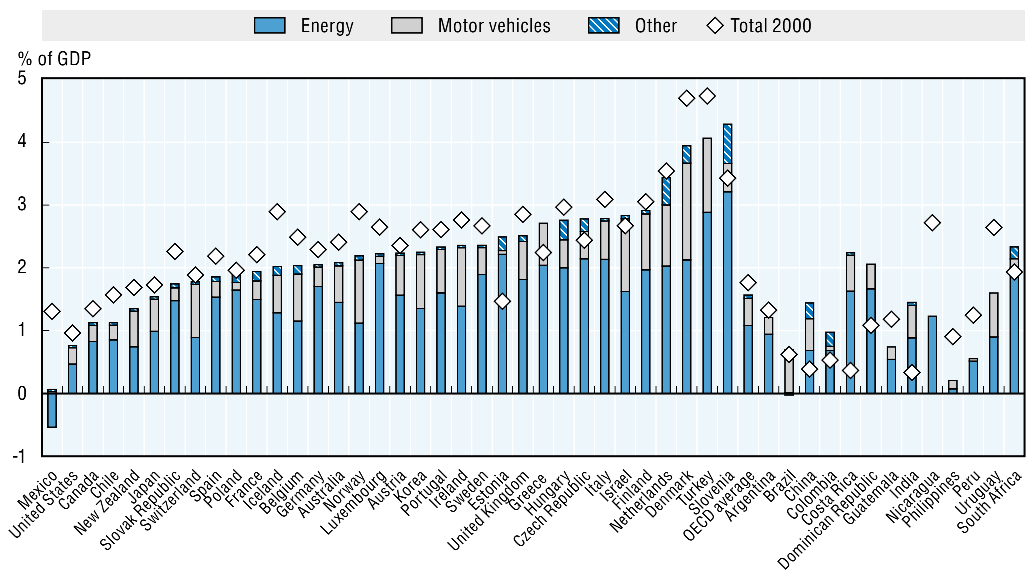
A more level playing field for enterprises would make for a more market-based rationalisation of excess capacity. Stricter enforcement of environmental standards across the board would halt excessive and environmentally destructive competition among private firms. Private firms reportedly pollute more than their state-owned counterparts, in particular in the cement, steel and flat glass industries. This partly reflects greater investment in environmental protection by state-owned firms in recent years (Zhang, 2013). By contrast, private firms economised on such spending to cut costs and remain competitive.

Recently, measures to improve air quality appear to be succeeding. In 2014, most Chinese regions with pollution problems made significant progress in improving air quality (Clean Air Alliance of China, 2015). The average PM2.5 (particulate matter less than 2.5 microns in diameter that can lodge in the lungs) concentration in ten polluted Chinese regions declined by 11.9% in 2014. This decline, however, was a mere 4% in Beijing, the lowest among those regions. Improvement of air quality has continued in 2015. The average drop in PM2.5 in 189 cities was 16% in the first half of the year compared to the same period a year earlier. As China's urban air pollution is primarily the result of heavy industry production, coal burning in power plants and vehicle emissions, and as particulate matter is the product of chemical reactions between other pollutants, it is difficult to ascribe the improved air quality to improvements in any one factor. While it is still the most important source of energy, the reduction in coal burning by 5% in the four major industries of power, steel, chemicals and construction is likely a major factor. Slowing of the economy, excess capacity in many heavily polluting industries and increased attempts to increase the share of non-fossil fuels among the sources of energy all contributed to lower demand for coal. The share of coal is targeted for reduction from the present 66% to below 62% by 2020.

Beijing closed down three of its coal-fired power plants in the past year, with the last one scheduled to close next year. It is gradually switching to natural gas. In addition, the number of vehicles is restricted and licence plates can only be obtained by lottery. Several steel mills in the neighbouring Hebei province have also been shut.

Another significant milestone in improving environmental quality is the release of the draft Environmental Tax Law for public opinion in June 2015. The draft law submitted for review by the State Council in November 2014 imposes levies on air, water, noise and waste polluters. It does not, however, cover CO_2 emissions. Furthermore, urban sewage and refuse treatment plants will be exempt, as will agriculture, except large-scale animal husbandry. Motor vehicles, locomotives, non-road mobile machinery, ships and aircraft will also be exempt, as long as the pollutants are within national standards. Authorities can tax at most three pollutants, except heavy metals, for which the maximum number is five. The tax level will be close to the current pollution charge, thus the impact may not be immediate; however, with strengthening standards, pollution is expected to decrease. On average, environmental taxes are less important as a source of government revenue in China than in OECD member countries (Figure 6.11.2). Moreover, sub-national authorities may adopt more stringent standards according to circumstances. Although this is the first environmental tax law, environmental criteria feature in several tax exemption regulations. For instance, violators of environmental laws and regulations cannot enjoy the 15% reduction in the corporate income tax usually extended to high-tech firms. Similar conditions apply to software and integrated circuit producers hoping to enjoy such tax benefits.

Figure 6.11.2. **Revenues from environment-related taxes in OECD member countries, China and India, 2000 and 2013**



Note: Values for India refer to 2011, values for China and Nicaragua refer to 2012 while others refer to 2013. The statistical data for Israel are supplied by and under the responsibility of the relevant Israeli authorities. The use of such data by the OECD is without prejudice to the status of the Golan Heights, East Jerusalem and Israeli settlements in the West Bank under the terms of international law.

Source: OECD (nd), *OECD/EEA Database on taxes, Charges and Other Instruments used for Environmental Policy*, www2.oecd.org/ecoinst/queries/.

StatLink http://dx.doi.org/10.1787/888933310549

China also revised its environmental laws in April 2014, with unlimited fines for polluters. Polluters will also be liable to be sued by environmental organisations. More specific environment-related regulations were accepted by the 14th meeting of the Comprehensive Deepening of Reforms Group in July 2015, extending the liability of persons in charge of units where the damage happens beyond their term and even beyond their retirement. This determination by the government to make polluters responsible for damages is also reflected in the important change to joint responsibility between the Party and the government for environment-related damages. Until then, Party officials had gone unscathed following severe pollution cases in their areas of jurisdiction.

In August 2015, the 16th session of China's 12th National People's Congress Standing Committee reviewed a report on the results of the inspection relating to the enforcement of the Water Pollution Prevention and Control Law. The inspection was carried out by the top legislature on the enforcement of the law from May to June. The report indicated that drinking water sources in 278, or 84.5%, of the 329 cities inspected met national standards. In rural areas, the share of households with access to safe running water was expected to reach 75% by the end of 2015. State Council members revealed during the review of the report that water pollution concerns will be reflected in a series of policies, including industrial, taxation, financial and investment policies, and that the government will consider incorporating water quality among the indicators used in the appraisal of local government officials.

POLICY FOCUS

Upgrade human capital to facilitate transition to a higher value-added economy

Human capital accumulation has played a large role in China's economic catch-up over the past three decades, notwithstanding the even more rapid build-up of physical capital (China Center for Human Capital and Labor Market Research, 2013). It is becoming even more crucial now to bring about further improvements in living standards in the face of an ageing population and to provide the skills needed to transition from "the world's factory" into a leading innovator. As China transits to a knowledge-based economy with higher value-added industries and a vibrant service sector, new skills need to be provided to meet demand by those industries. Workplace-based vocational training and lifelong learning will be key to that end. Innovation can become an engine of growth, provided more weight is attached to quality and application in university research evaluation, and world-class researchers are attracted and retained by greater research autonomy, merit-based promotion and stronger protection of intellectual property rights.

Providing the skills needed by a knowledge-based economy

Migrant labour shortages in coastal cities in recent years might suggest that China has reached a turning point, where rural labour supply is exhausted. In fact, this shortage is caused by obstacles to internal migration. Limited access to public services and social welfare benefits for rural migrants reduces their number and the length of their stay in cities. Although the Social Insurance Law, effective since mid-2011, requires all employers to pay health, unemployment, work injury and pension insurances for all of their workers, including migrants, this remains an exception rather than standard practice. Therefore, migrants only stay about seven years in cities on average (Meng, 2012). If restrictions on the access to public services and social benefits were relaxed, 62% of migrants indicated that they would stay in the city forever. Given the still large pool of potential migrants, the removal of restrictions would boost labour supply in the medium term.

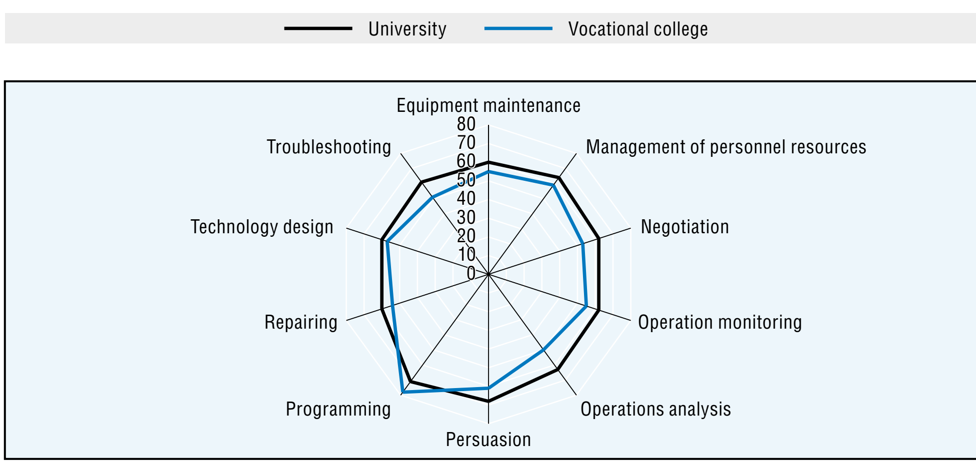
However, as the share of the overall working-age population falls, future growth will increasingly depend on the performance of the education system. The present industry structure, based on abundant low-cost labour, needs to adjust to rising wages as labour becomes scarcer once the remaining surplus labour in rural areas has shifted to more productive jobs in cities. Rising wages will imply a change in the relative prices of capital and labour and substitution from labour to capital. More capital-intensive production, in turn, demands higher skills. Indeed, education, measured by years of schooling, is positively correlated with capital intensity in manufacturing (Qu and Cai, 2011). As most of the workforce in China is composed of junior and senior high-school graduates, there is ample scope for investment in education and training to boost labour productivity. Labour productivity would be 23% higher if junior high-school graduates had senior high-school education and would double if senior high-school graduates had college training. Higher education attainment alone, however, may not be sufficient. To adapt to the changing industry structure, a broad set of skills and wide general knowledge are needed, facilitating the acquisition of new skills.

Jobseekers' skill sets do not sufficiently match market demand

The supply and demand of skills do not match for new graduates. The My China Occupational Skills (MyCOS) graduate survey conducted in 2013 and covering 150 000 recent graduates asked them to rank skill categories by importance for their new jobs (Molnar, Wang and Gao, 2015). Soft skills such as management and communications ranked among the top ones. For university graduates, speaking, negotiation, persuasion and active learning precede practical skills such as programming. Vocational college graduates rank programming first, but the following skills in the ranking are similar to those of university graduates: speaking, negotiation, persuasion, and judgement and decision making. Maths, writing and repairing are considered by both types of graduates among the least important knowledge or skills in the present marketplace. The skills acquired at the time of graduation do not appear to match the skills necessary to perform the job. The difference between the self-reported acquired skills at the time of graduation and the skills needed in their job six months after graduation gives a gauge of the mismatch in the graduate labour market. According to this measure, university graduates experienced the greatest mismatch in programming, followed by persuasion, management of personnel resources, operations analysis, operation monitoring and negotiation (Figure 6.11.3). Vocational college graduates also felt their programming skill deficit is the most acute, followed by persuasion, management of personnel resources, technology design and equipment maintenance.

Figure 6.11.3. **Programming as well as management and other soft skills are falling short in China**

Percentage of university graduates in the top ten skill categories with the greatest gap, 2013



Notes: University and vocational college graduates who had a job six months after graduation were asked whether the 5 skill categories out of 35 that are related to their job are necessary to perform their job (scale 1-7) and whether they had acquired the given skill by the time of graduation (scale 1-7). The difference between the weighted averages of the extent of necessity and the extent of acquired skills at school captures the skills gap. The ranking is based on the results for university graduates. Vocational college graduate skill shortages in the same skill categories are shown for comparison.

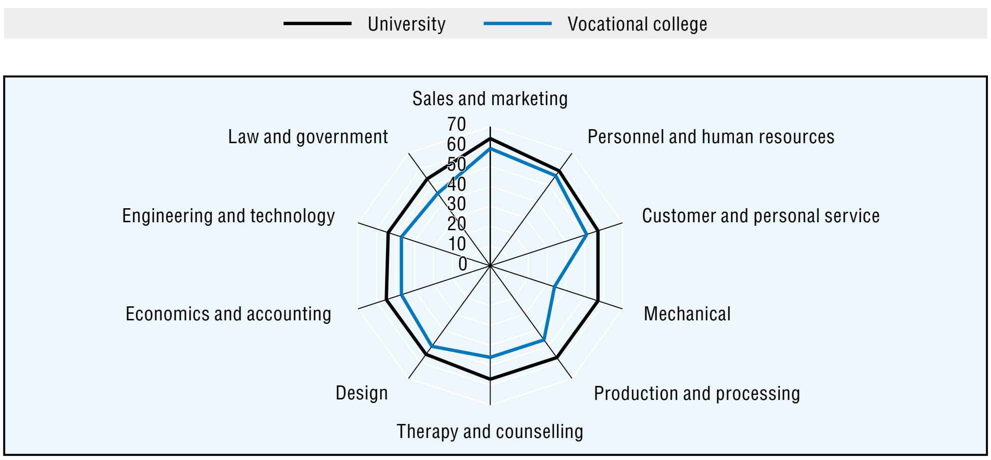
Source: OECD (2015b), *OECD Economic Surveys: China*, http://dx.doi.org/10.1787/eco_surveys-chn-2015-en.

StatLink http://dx.doi.org/10.1787/888933310551

There also appears to be a gap between the knowledge that students acquire at higher education institutions and what is needed in their jobs. College training needs to catch up with the rapid development of services in recent years to provide enough professionals in areas such as sales and marketing, reported to have the greatest shortage: 64% of university and 59% of vocational college graduates judge their knowledge in this area insufficient to perform their job (Figure 6.11.4). Other services for which training is insufficient include personnel and human resources, therapy and counselling, and customer and personal services.

Figure 6.11.4. **Service-related training is not meeting labour market needs in China**

Percentage of graduates reporting shortage of knowledge, top ten areas, 2013



Notes: University and vocational college graduates who had a job six months after graduation were asked whether the 5 knowledge categories out of 28 that are related to their job are necessary to perform their job (scale 1-7) and whether they had acquired the given knowledge by the time of graduation (scale 1-7). The difference between the weighted averages of the extent of necessity and the extent of acquired knowledge at school captures the knowledge gap. The ranking is based on the results for university graduates. Vocational college graduate knowledge shortages in the same knowledge categories are shown for comparison.

Source: OECD (2015b), *OECD Economic Surveys: China*, http://dx.doi.org/10.1787/eco_surveys-chn-2015-en.

StatLink http://dx.doi.org/10.1787/888933310569

Workplace-based vocational education and lifelong learning are key to providing the needed skills

Many jobs require vocational qualifications in China, and this is likely to remain the case, given higher-level qualifications are also in high demand in OECD member countries with more advanced industry structures (OECD, 2014b). In fact, as China's industrial structure adjusts towards that of more advanced countries, with services playing a greater role and with higher value-added manufacturing, demand for vocational skills is likely to increase further. A key to developing relevant skills is work experience, or workplace learning, which should be part of the curriculum, with credit given and quality assured. In countries with successful upper secondary and post-secondary vocational training systems, such as Switzerland or Germany, workplace learning is typically part of the credit-earning curriculum in the form of apprenticeships or substantial internships (OECD 2014b). Workplace training is a precious experience for students as they can acquire the practical skills needed for their profession and thus become more employable by the time they graduate. It also provides an environment where trainees and employers can get to know each other, potentially leading to a job offer following graduation.

The Chinese government has made strengthening workplace training a major target of its vocational education reforms. However, workplace training in China is sporadic. The 1996 Vocational Education Law encourages partnerships with industry to gain practical experience. A 2011 survey of over 100 secondary vocational schools in two provinces showed that, although 91% of schools had some type of industry partnership, most such partnerships took the form of sending graduates to enterprises as full-time employees (80%) and only just over 70% of teachers reported that any of their students ever attended industry internships (Yi et al., 2013). In August 2014, the Ministry of Education issued an Opinion on Piloting a Modern Apprenticeship System, with detailed implementation measures to follow. As workplace training is not systematic at vocational schools, the quality of available assignments is not assured, potentially leading to abuse of student labour. In some cases, interns were assigned tasks usually performed by unskilled workers. Such experience does not improve students' practical skills, nor does it help their future job search. Some soft skills that are perceived to be missing by tertiary graduates, such as sales, marketing and dealing with customers in general, can be learnt more effectively in workplaces than in classrooms. Making workplace training a systemic and mandatory part of the curriculum would have a number of advantages. It would provide a powerful tool by which the mix of provision of skills can be matched to labour market demand (by constraining provision in fields that employers do not support with work placements). It would, therefore, provide strong incentives both for training providers and employers to work in partnership (since government funding would only flow to training where such local partnerships exist in the form of work placements). It would also avoid the risk that internships are only available to students whose parents are well-connected.

Better university-industry collaboration is needed

China generates a large volume of knowledge, being the third largest producer of scientific articles (National Science Foundation, 2014). Most of the world's top 20 patenting universities were in China in 2008, but patents' rate of utilisation is low at 5% compared to, for instance, Japan at 27%, and the bulk of university research lacks relevance for business (Luan, Zhou and Liu, 2010). Producing more patents can boost productivity only if they are used or effectively commercialised. A better research evaluation system at universities that strikes a balance between quantity and quality, including applicability, would encourage more focus on utilisation. The present evaluation system focuses on patenting but pays less attention to utilisation. Since 2002, universities can own intellectual property rights in government-funded projects, which led to the surge in the number of patents, but incentives for commercialisation are lacking. National Technology Transfer Centres (NTTCs) act as intermediaries between university and industry to diffuse inventions. Unlike University Technology Transfer Offices in advanced economies, which transfer technology through licensing, NTTCs in China mainly capitalise inventions through technology development contracts and the creation of university technology-based firms (Miesing, Tang and Li, 2014). More autonomy for NTTC staff to market patented technology could make NTTCs more effective in increasing the utilisation rate of university patents. The East China University of Science and Technology, for instance, built up a patent-transfer and commercialisation system and reached a 53% utilisation rate (Luan, Zhou and Liu, 2010). Zhejiang University established its own Science and Technology Development and Transfer Office in the early 1980s and maintains close contacts with local governments. Its technology co-operation projects reach over 20 cities and counties in the province.

Training and attracting highly skilled human resources would boost innovation

Although China has the world's largest pool of human resources for science and technology, the shares of tertiary graduates in general and of doctoral graduates in science and engineering in particular are still very low. Furthermore, China aspires to train more world-class researchers. The need to attract globally established academics has long been recognised, to wit: the Changjiang Scholars scheme established by the Ministry of Education in 1998 or the Thousand Talents Project launched in 2008. A more recent and comprehensive initiative is the *National Medium-and Long-term Talent Development Plan (2010-2020)* to attract and retain highly skilled individuals in six broad areas (political leaders and officials, business entrepreneurs, technical professionals, highly skilled industry staff, skilled workers in agriculture and rural areas, and skilled social workers). In 2014, approximately one-third of companies encountered a skills shortage, and 6% filled the gap by recruiting foreign talent (Standard Chartered, 2014). Although this share appears to be increasing, the talent gap is still well below the approximately 70% skills shortage reported in Brazil and India (Manpower, 2014). Returnees, overseas workers and students are important human resources to tap for the knowledge economy. Returnees facilitate both direct technology transfer and indirect technology spillovers to other local firms. Given the limited success to date in reversing the brain drain, in particular as regards leading scientists, more efforts are needed in addition to financial incentives, including research autonomy, merit-based promotion and stronger protection of intellectual property rights.

POLICY FOCUS

Boost rural development to ensure robust growth of incomes

Living standards in rural China remain far below those in urban areas, even though, for the first time in many years, rural income per capita exceeded one third of the urban level in 2014. To narrow this gap, reforms should facilitate the reallocation of resources, promote agricultural productivity gains and provide better government services in rural China.

China is still in the relatively early stages of the adjustment process, whereby the share of agriculture in the overall economy diminishes. As part of this process, the government is planning on 100 million new rural migrants moving to cities by 2020 (in addition to settling the 100 million migrant workers already residing in cities). This process is facilitating productivity gains as labour moves from less to more productive use. This "shift effect" of labour for more productive use explained approximately one fifth of the labour productivity gains over the past decade (Molnar and Chalaux, 2015) and, although its contribution is expected to decrease, there is still ample room to realise productivity gains related to such shifts.

Labour productivity in China's agricultural sector remains low compared to more advanced economies. Reforms that improve farmers' access to finance will spur productivity-enhancing farm investment and mechanisation. A recent attempt in this direction is the issue of the Guiding Opinion on Building an Agricultural Credit Guarantee System with Budgetary Support (Document Cainong No. 2015/121) in July 2015. Provinces will assume the leading role, with central government support, in establishing a country-wide guarantee system whereby at least 70% of the guaranteed loans go to crop farmers or professional farmers with sufficient operation scale. The provincial government is supposed to inject capital into the credit guarantee institution at the provincial, city and county levels using the central subsidies for scaling up crop production. Non-budgetary units such as banks and other strategic partners are allowed to own the credit guarantee institution jointly, but their share cannot be higher than 20%.

In addition, measures that encourage the reallocation of resources to the most productive uses will be key to raising productivity in the agricultural sector and other parts of the economy. Rural land in China is owned by village collectives, with rights to farmland distributed to village households with a renewable contract term of 30 years. For the purposes of equality, each household has the rights to a number of plots of varying quality that may be geographically separated. As a consequence, average farm size (where a farm is defined as a continuous tract of agricultural land) in China is very low compared to other countries (Table 6.11.1). This is reinforced by constraints on trading farmland operation rights (as distinct from the contract rights that remain with the original recipient) that make it hard for farmers who wish to pursue other work to transfer operation rights to productive farmers who want to scale up production. Such constraints include poorly defined farmland contract rights and a lack of institutional structures for the trading of operation rights. Additionally, weak rule of law in some areas may result in a lack of enforcement of land rights even if households possess certificates detailing their contract rights to rural land.

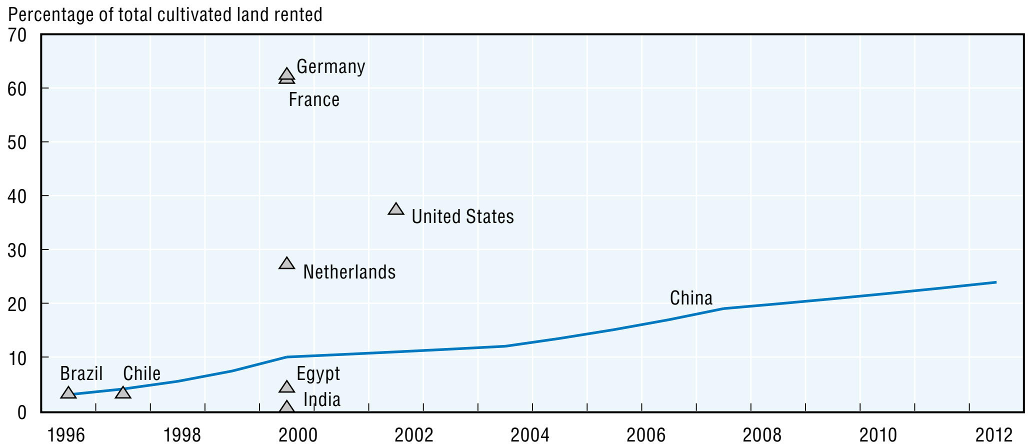
Table 6.11.1. **Average farm size is small in China**

Country	Average farm size (hectares)
China	0.6
Viet Nam	0.7
Indonesia	0.8
Japan	1.2
India	1.3
Thailand	3.2
Turkey	3.2
Colombia	25.0
Venezuela	60.0
Brazil	73.0
Chile	84.0
South Africa	288.0

Notes: Data for comparison countries are from agricultural censuses taken between 1996 and 2005. Data for China are for 2010.
Source: Huang et al. (2012), *2000 FAO World Census of Agriculture*, www.fao.org/docrep/013/i1595e/i1595e00.htm.

With increasing encouragement from the central government and new instruments, the trading of operating rights has steadily risen over the past two decades (Figure 6.11.5). Nevertheless, the frequency of land rental in China remains below that of advanced countries.

Figure 6.11.5. **The proportion of rented farmland in China has increased but remains below advanced countries**



Notes: The share of rented cultivated farmland in China increased from 3% in 1996 to approximately 24% in 2013. Estimates from the World Census of Agriculture highlight that China's share of rented farmland by 2013 remained below that of many developed economies in around 2000, including France (2000), Germany (2000), the United States (2002) and the Netherlands (2000).

Source: Gao et al. (2012), *2000 FAO World Census of Agriculture*, State Council of the People's Republic of China.

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Arable land per capita in China is low relative to other countries, meaning that production methods need to preserve the fertility of land resources in the long run. As well as supporting rural incomes, this is important for China's ability to meet its food security objectives. One farming practice that is threatening the sustainability of rural land is the overuse of chemical fertilisers, with the intensity of nitrogen fertiliser consumption approximately double that of other countries with large agricultural sectors. The government's efforts to encourage the use of new technologies can be expected to reduce overuse, as would reducing subsidies for fertiliser products, improving farmer education and promoting the reallocation of agricultural resources to more highly skilled farmers. Grassland degradation is also an ongoing concern for the long-run fertility of agricultural land. Grassland is vital as the feed base for livestock and plays an important function in capturing greenhouse gas emissions. Further reforms to promote the preservation of grassland include educating farmers about appropriate animal species selection and, possibly, government payments to farmers for restoring grassland areas that are linked to the associated reduction in emissions.

Raising agricultural productivity will help narrow the urban-rural divide. However, income support policies may continue to be needed for agricultural producers, as the effects of productivity-enhancing reforms take time to materialise. Furthermore, such policies are important for groups that struggle to adjust during this period of rapid structural change in the rural economy. China's policy support for agricultural producers has risen significantly in recent years. These policies are meant to support rural incomes and food security and to promote the mechanisation of agricultural production. However, some policies, such as minimum purchase prices for grains, may have adverse impacts on downstream firms. In the future, firm productivity will benefit from reforms that gradually replace minimum purchase prices for key grain crops with direct payments to farmers.

Note

1. This country note is partly based on the 2015 OECD Economic Survey of China.

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Key government ministries in China

President	Xi Jinping
Premier	Li Keqiang
Agriculture	Han Changfu
Civil affairs	Li Liguo
Commerce	Gao Hucheng
Culture	Cai Wu
Education	Yuan Guiren
Environmental protection	Zhou Shengxian
Ethnic affairs commission	Wang Zhengwei
Finance	Lou Jiwei
Foreign affairs	Wang Yi
Housing and urban-rural development	Jiang Weixin
Human resources and social security	Yin Weimin
Industry and information technology	Miao Wei
Justice	Wu Aiying
Land and resources	Jiang Daming
National defence	General Chang Wanquan
National development and reform commission	Xu Shaoshi
Population and family planning commission	Li Bin
Public security	Guo Shengkun
Science and technology	Wan Gang
State security	Geng Huichang
Supervision	Huang Shuxian
Transportation	Yang Chuantang
Water resources	Chen Lei
Central Bank Governor	Zhou Xiaochuan

Note: Valid as of 31 October 2015.

India

A. Medium-term economic outlook (forecast, 2016-20 average)

GDP growth (percentage change):	7.3
Current account balance (% of GDP):	-1.6
Fiscal balance (% of GDP) (central government):	-7.0

B. Medium-term plan

Period: 2012-17

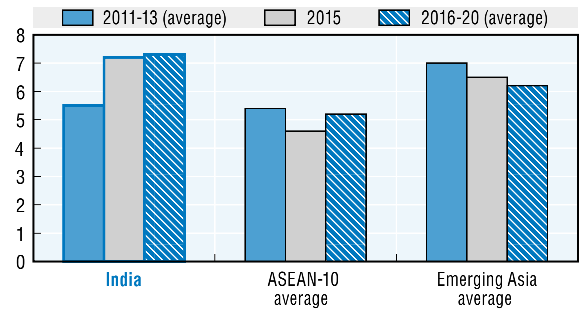
Theme: Faster, more inclusive and sustainable growth

C. Basic data (in 2014)

Total population:	1 251 million*
Population of NCT of Delhi:	17.6 million*
Nominal GDP (US dollar):	2051.23 billion
GDP per capita at PPP:	5 808.43 (current International Dollar)**
Exchange rate in the first half of 2015	62.79 (INR/USD)

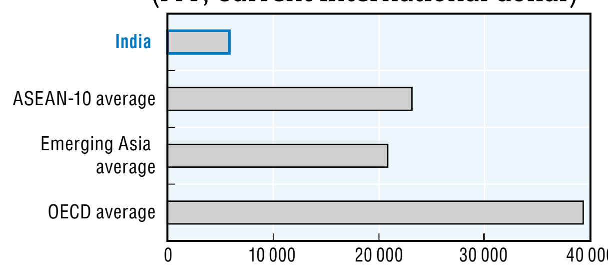
Note: * Population data for 2014 are estimates.
** IMF estimate.
Sources: OECD Development Centre, MPF-2016, national sources, CEIC and IMF.

GDP growth rates (percentage change)



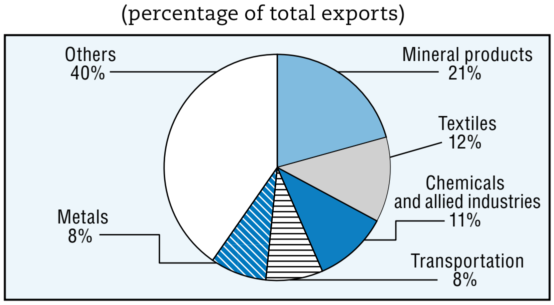
Source: OECD Development Centre, MPF-2016.

GDP per capita, 2014
(PPP, current international dollar)



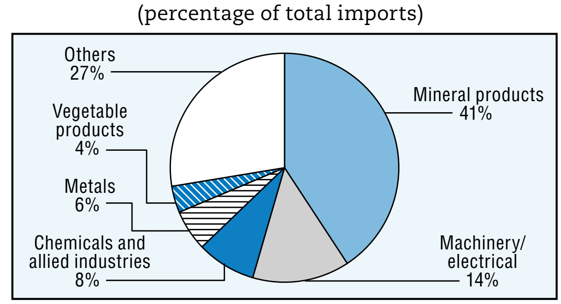
Source: IMF.

Composition of exports, 2014
(percentage of total exports)



Source: Trademap.

Composition of imports, 2014
(percentage of total imports)



Source: Trademap.

India's economy has performed moderately well, and stable growth is expected over the medium term, supported by continuing structural transformation, favourable demographics and promising reforms. Still, serious challenges need to be addressed for growth goals to be realised and to foster broad-based and inclusive development. The Twelfth Five Year Plan (2012-2017) outlines policy reforms intended to raise the country's growth rate to 8% over the plan's period and back to the estimated potential rate of 9% by its end, under the vision of "faster, sustainable, and more inclusive growth". This is to be achieved through the development of infrastructure and of human and institutional capabilities, extending the reach of banking and insurance, investing in science and technology, managing natural resources and the environment responsibly, and engaging with the global economy. The improvement of financial literacy across the country will be an important complement to efforts to improve financial access for inclusive development. Access to and quality of education must also be improved generally for India to reap the potential benefits of its young population.

India: Medium-term policy challenges and responses

- Strengthen financial education initiatives
- Enhance education access and quality

POLICY FOCUS

Strengthen financial education initiatives

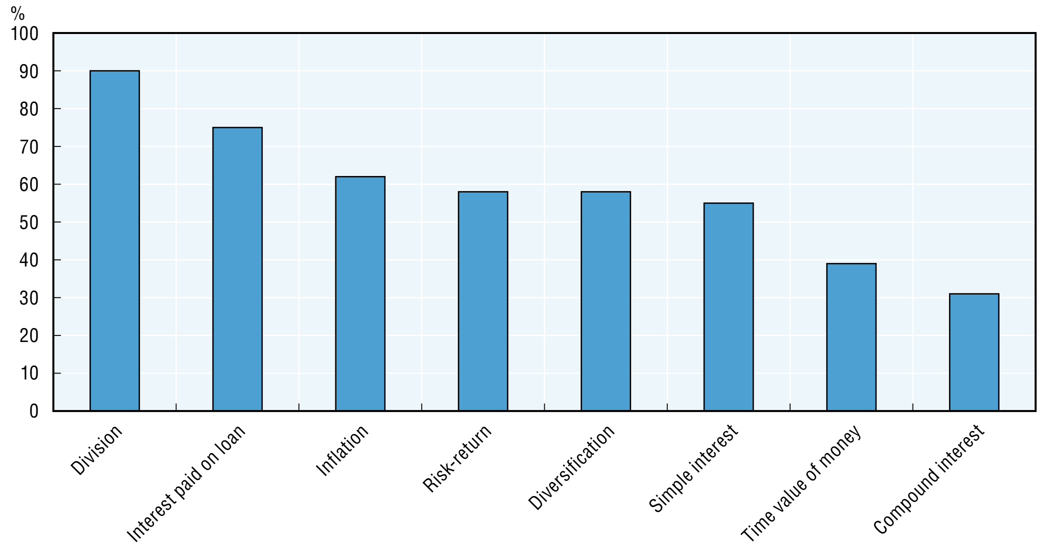
Financial literacy for households and businesses is critical, particularly as financial markets grow more sophisticated and complex and individuals are faced with an increased number of decisions, such as their saving and investing, borrowing, insurance and pension options. Greater widespread financial literacy is particularly important in ensuring that financial markets contribute to real growth in India. Recognising this, steps are being taken to bolster financial literacy, but more will be needed to realise optimal outcomes.

Co-ordinated initiatives are being developed to better understand the need for financial education and to develop and implement solutions in India. The Technical Group on Financial Inclusion and Financial Literacy, created by the Financial Stability and Development Council in 2011, is headed by the Deputy Governor of the Reserve Bank of India and includes representatives from financial sector regulatory authorities to co-ordinate their work on financial education. This group led the preparation of the draft National Strategy for Financial Education in 2012-13, to be implemented by the National Centre for Financial Education (NCFE), established under the National Institute of Securities Market (NISM).

The 2014 Financial Literacy and Inclusion Survey by the NCFE asked respondents about their financial attitudes, behaviours and knowledge. Testing respondents on their financial knowledge in seven categories, it found that they were comfortable with concepts like division and interest on loans, had moderate knowledge of inflation, risk-return, diversification and simple interest, and were least knowledgeable about the time value of money and compound interest (Figure 6.12.1). Urban residents showed higher levels of knowledge than rural residents (differing by 7.4 percentage points on average across the eight categories) and men showed higher levels than women (differing by 7.0 percentage points on average). Knowledge levels in most categories also declined in older age categories.

The survey found high levels of awareness (although not always high levels of use) for some financial products and services, such as savings bank accounts (93%) and life insurance (84%), but relatively low levels of awareness of a number of potentially important products and services, including crop and livestock insurance (27% and 24%, respectively) and pension products, such as the Employees Provident Fund (38%), National Pension Scheme (36%) and Family and/or Employee Pension Schemes (30%).

Figure 6.12.1. **Financial knowledge by category in India, 2014**



Source: NISM (2015), *Financial Literacy and Inclusion in India*.
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National strategies for financial education are important in co-ordinating policy responses to the need for improved understanding of financial products and services. The National Strategy for Financial Education seeks to improve financial literacy for multiple overlapping reasons, including inclusive growth, knowledge and skill in financial management, freedom from exploitation, avoiding indebtedness, entrepreneurship, and managing personal responsibilities for pensions. Stakeholders identified for participation include a range of financial institutions, educational institutions, non-governmental organisations, financial sector regulators, government actors at the central and state levels, and multilateral international organisations. Under the strategy, basic, sector-focused and product education is to be delivered through the school curriculum, social marketing, resource persons, adult education, self-help groups, microfinance institutions, integrated communication channels, dedicated helpline and other channels. The strategy offers an opportunity to co-ordinate various pre-existing efforts in financial education undertaken by the Reserve Bank of India, Securities Exchange Board of India, Insurance Regulatory and Development Authority and various private sector actors. Recently, the OECD developed the *OECD/INFE High-level Principles on National Strategies for Financial Education*, which outline the elements of national strategies concerning financial education, including co-operation among stakeholders (OECD, 2012).

Improving financial literacy is particularly important as the accessibility of financial services is improved across the country. *Pradhan Mantri Jan Dhan Yojana* (the Prime Minister's People Money Scheme), the financial inclusion scheme launched by Prime Minister Narendra Modi in August 2014, exceeded its target of opening 75 million accounts by January 2015, although many of these were reported to be empty. Under this programme, account holders are expected to receive debit cards and accident and life insurance policies. It thus builds upon the expansion of accessibility previously promoted by the Reserve Bank of India, which included measures to expand the presence of banks through the country and the goals of having a bank branch in all villages with a population above 2 000.

Financial education is a critical demand-side complement to these reforms to improve trust in and understanding of the financial sector. Indeed, evidence from India and elsewhere has suggested that a combination of increased access and improved financial literacy and attitudes toward the use of financial services can have important effects on the use of bank accounts and other services (Calderone et al., 2013; Cole, Sampson and Zia, 2009). The low rates of use of newly opened bank accounts, for example, may point to a lack of interest in financial services or low levels of trust in and awareness of the benefits of holding these accounts. Under the *Jan Dhan Yojana*, information has also been delivered through school and public information campaigns.

One of the key challenges of a financial education programme in India would be how to address the urban-rural and gender gaps. The National Strategy for Financial Education's commitment to including both central and state governments should be managed with recognition of the fact that ensuring regional co-ordination will be critical in any effort to strengthen financial education in India. Additional effort to create formal structures to reduce these inequalities will urgently be needed in India (see, for example, Chakrabarty, 2014).

Furthermore, since financial education depends on strong basic education, enhancing access to and quality of education, particularly regarding literacy and numeracy, is critical. As illustrated by the results of the OECD's Programme for International Student Assessment (PISA) 2012, which included questions testing students' knowledge and skills in making financial decisions, there is typically a positive correlation between financial literacy and mathematics and reading skills (OECD, 2014). There is significant room for improving education outcomes in India, where the adult literacy rate (2008-12) is only 62.8%.

POLICY FOCUS

Enhance education access and quality

India's Twelfth Five Year Plan (2012-2017) has focused the development agenda towards achieving inclusive and sustainable growth. Education has been highlighted as a key instrument to develop the human resource capabilities required to reduce poverty, enhance equality and empower citizens to participate in democracy. The country has a young and abundant population, which has great potential to contribute to economic growth if given access to the right education and skills. Reaping the benefits of this demographic dividend requires both wide-scale access to education at all levels, as well as improvements in the quality of education provided (OECD, 2015a).

While access to primary education is near universal, secondary and tertiary education access remains low

India has made dramatic progress in providing access to primary education, mainly through major government initiatives such as the Sarva Shiksha Abhiyan programme for universal elementary education; the Right to Free Education, which makes education a fundamental right; and the Midday Meal scheme, which contributes to student retention. Over 98% of children were found to be enrolled in primary school in 2012 (UNICEF, nd). Even in rural areas, enrolment levels are over 96% for the 6-14 year age group (ASER, 2014). As a result, drop-out rates have fallen and literacy rates have risen to an estimated 90% in 2015 (UIS, 2015). However, this success at the primary level has put pressure on capacity in the secondary and tertiary levels, which still lag behind.

India's economic transformation requires a workforce that is skilled in more than just basic literacy and numeracy. These higher level skills must be developed in high-quality secondary and tertiary institutions. While the country is home to several elite academic institutions, such as Indian Institutes of Technology and Indian Institutes of Management, it still lags behind its regional peers in terms of providing wide-scale access to higher education. High drop-out rates in the secondary and lower-secondary levels appear to be a perennial problem that disrupts the basic education cycle. India's net attendance rate of 94% at the primary level drops dramatically to 64% at the lower-secondary level (UNICEF, 2014). Major reasons for children leaving school include the direct as well as opportunity costs of education; norms relating to child labour; early marriage, particularly for girls; and discrimination in the workplace against certain social and religious groups, which reduces their perceived benefits of education (UNICEF, 2014).

Unequal access to education remains a problem

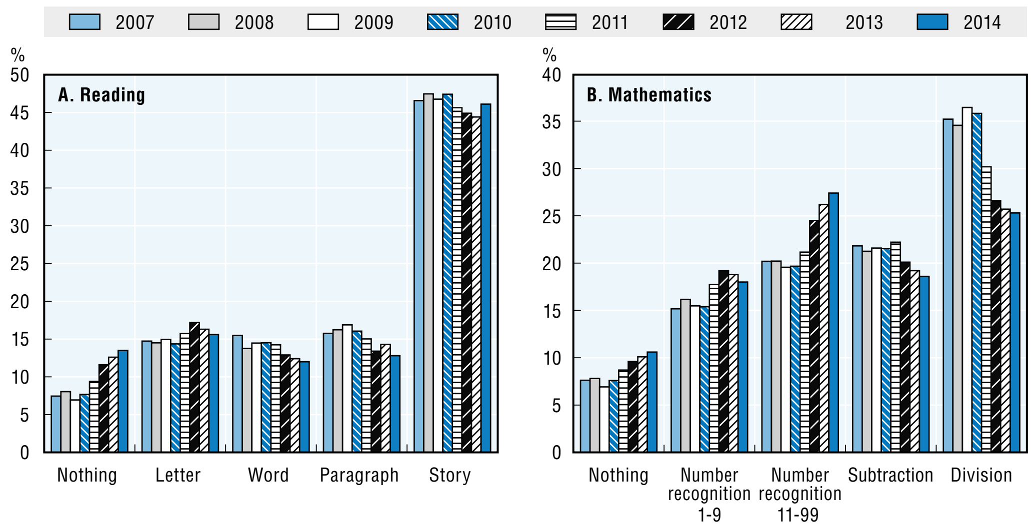
Persistent disparities in access to education remain at all levels between urban and rural areas, genders, communities and socio-economic backgrounds. Girls are less likely to stay in lower secondary school compared to boys at all income levels. The difference between access to education in urban and rural areas appears small when looking at the national average; however, deprivation in urban areas tends to be concentrated in slums, which can be as disadvantaged as rural areas (UNICEF, 2014). Exclusion rates in rural areas would tend to be higher than urban non-slum areas. In urban areas, disadvantages are also concentrated in groups from a low socio-economic background. Some 75% of out-of-school children are from the lowest wealth quintile in urban areas compared to 45% in rural areas. Certain groups, such as Muslims and Scheduled Tribes, have higher rates of exclusion, with 9.1% and 9.3% of lower-secondary-age children excluded from school, respectively (UNICEF, 2014).

Quality of education remains a serious challenge

Comprehensive data on education quality throughout India are not available, although two Indian states, Himachal Pradesh and Tamil Nadu, did conduct a PISA in 2009. The results placed these states at the bottom of the rankings, below the 63 other countries participating and only just ahead of Kyrgyzstan (OECD, 2015b). The situation for the country as a whole may be even worse, as Himachal Pradesh and Tamil Nadu perform relatively better than other states. They ranked 11th and 14th in literacy, respectively.

A major evaluation of education quality in rural India is conducted through the *Annual Status of Education Report 2014 (Rural)*. Over 550 000 children in 16 000 villages across the country are surveyed annually. The results reveal education quality in rural India to be rather dismal. Only a quarter of children in the third year level can read a second-year text fluently (ASER, 2014). This ratio rises to half for children in the fifth year level. Overall reading levels are either declining or remain at a standstill, although, in some cases, there have been small improvements. The proportion of children in the fifth-year level who can read a second-year text has increased slightly, from 46.8% in 2012 to 48.1% in 2014 (ASER, 2014). An assessment of mathematical abilities shows a rather steep decline in the ability to perform higher level calculations, such as division and subtraction, over the last seven years (Figure 6.12.2). In 2014, only a quarter of students are able to solve a division problem and a subtraction problem, while less than 20% are able to solve at most a subtraction problem. The more basic abilities such as recognition of numbers have shown some improvement over the last few years (Figure 6.12.2).

Figure 6.12.2. **Proportion of children with reading and mathematical abilities in India**



Note: See key to comprehension levels in the Appendix.
Source: ASER (2015), (database).
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As enrolment rates have increased dramatically, the government has rushed to find and train the required number of teachers to comply with the maximum student-teacher ratio of 30:1 stipulated in the Right to Education Act for primary schools. To achieve this goal, the government has largely relied on the recruitment of para-teachers on short contracts with lower benefits compared to regular public sector teachers. There is mixed evidence on their performance, as some studies show that para-teachers are more committed and less absent than their regular counterparts (UNICEF, 2014). However, assessments of student learning outcomes discussed previously reveal that even basic reading and numerical abilities are not being achieved (ASER, 2014). One option is for teacher salaries to be tied to training to encourage teachers to acquire new skills and implement them in the classroom. Evaluations of teaching ability based on student learning outcomes could also be used to identify teachers who require additional training.

Inadequate basic facilities in schools can have a detrimental impact on learning outcomes. Problems, such as the lack of access to drinking water and toilet facilities, can make it difficult to retain students, especially girls. In recent years there has been significant progress in both of these areas. The availability of usable toilets in rural schools has increased from 47% in 2010 to 65% in 2014, while the availability of drinking water has increased from 73% in 2010 to 76% in 2014 (ASER, 2014). Higher-level facilities and equipment, such as library books and computers, are now more widely available in rural schools. Computer access increased from 15.8% in 2010 to 19.6% in 2014, while library books were available in 78% of schools in 2014, up from 63% in 2010 (ASER, 2014).

Appendix

Comprehension level key for Figure 6.12.2

Reading	
Story	Can read a long paragraph (Std 2 level text)
Paragraph	Can read a short paragraph (Std 1 level text) but unable to read a longer paragraph
Word	Can read 4 out of 5 words correctly but unable to read a paragraph
Letter	Can only identify 4 out of 5 letters correctly but unable to read words
Nothing	Identifies fewer than 4 out of 5 letters correctly
Mathematics	
Division	Can solve a 3-digit by 1-digit division problem
Subtraction	Can solve two 2-digit by 2-digit subtraction problems with carryover but not division
Number recognition 11-99	Can identify 4 out of 5 numbers between 11 and 99 but unable to carry out a subtraction
Number recognition 1-9	Can identify 4 out of 5 numbers between 1 and 9 but unable to recognise numbers between 11-99
Nothing	Identifies fewer than 4 out of 5 single-digit numbers correctly

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Key government ministries in India

Prime minister	Narendra Modi
Agriculture	Radha Mohan Singh
Chemicals and fertilisers	Ananth Kumar
Civil aviation	Ashok Gajapathi Raju Pusapati
Coal	Piyush Goyal
Commerce and industry	Nirmala Sitharaman
Communications and information technology	Ravi Shankar Prasad
Consumer affairs, food and public distribution	Ramvilas Paswan
Corporate affairs	Arun Jaitley
Culture	Mahesh Sharma
Defence	Manohar Parrikar
Development of north eastern region	Jitendra Singh
Drinking water and sanitation	Chaudhary Singh
Earth sciences	Harsh Vardhan
Environment, forest and climate change	Prakash Javadekar
External affairs	Sushma Swaraj
Finance	Arun Jaitley
Food processing industries	Harsimrat Bedal
Health and family welfare	Jagat Prakash Nadda
Heavy industries and public enterprises	Anant Geete
Home affairs	Rajnath Singh
Housing and urban poverty alleviation	M. Venkaiah Naidu
Human resource development	Smriti Irani
Information and broadcasting	Arun Jaitley
Labour and employment	Narendra Singh Tomar
Law and justice	Sadananda Gowda
Micro, small and medium enterprises	Kalraj Mishra
Mines	Narendra Singh Tomar
Minority affairs	Najma Heptulla
New and renewable energy	Piyush Goyal
Planning	Inderjit Singh Rao
Power	Piyush Goyal
Railways	Suresh Prabhu
Road transport and highways	Nitin Gadkari
Rural development	Chaudhary Birender Singh
Science and technology	Harsh Vardhan
Shipping	Nitin Gadkari
Skill development and entrepreneurship	Rajiv Pratap Rudy
Social justice and empowerment	Thaawar Chand Gehlot
Steel	Narendra Singh Tomar
Textiles	Santosh Kumar Gangwar
Tourism	Mahesh Sharma
Tribal affairs	Jual Oram
Urban development	Venkaiah Naidu
Water resources	Uma Bharati
Women and child development	Maneka Gandhi
Youth affairs and sports	Sarbananda Sonowal
Central Bank Governor	Raghuram Rajan

Note: Valid as of 31 October 2015.

Annex A. Statistical annex

Table A.1. **Real GDP growth of Southeast Asia, China and India**

Annual percentage change

Country	2014	2015	2016	2016-20 (average)	2011-13 (average)	2003-07 (average)
ASEAN-5						
Indonesia	5.0	4.7	5.2	5.5	6.2	5.5
Malaysia	6.0	4.6	4.6	5.0	5.2	6.0
Philippines	6.1	5.9	6.0	5.7	5.9	5.7
Thailand	0.9	2.7	3.1	3.6	3.2	5.6
Viet Nam	6.0	6.4	5.9	6.0	5.6	7.2
Brunei Darussalam and Singapore						
Brunei Darussalam	-2.3	-1.4	0.5	1.8	0.9	1.7
Singapore	2.9	2.1	2.4	2.6	4.1	7.9
CLM countries						
Cambodia	7.0	7.0	7.1	7.3	7.3	10.6
Lao PDR	7.4	6.9	7.0	7.3	8.1	7.1
Myanmar	7.7	8.2	8.2	8.3	6.9	-
China and India						
China	7.3	6.8	6.5	6.0	8.2	11.7
India	7.3	7.2	7.3	7.3	5.5	8.8
Average of ASEAN 10 countries	4.6	4.6	4.9	5.2	5.4	5.9
Average of Emerging Asia	6.7	6.5	6.4	6.2	7.0	9.5

Note: The cut-off date of data is 2 November 2015. The weighted averages are used for ASEAN average and Emerging Asia average. The results of China, India, and Indonesia (for 2015 and 2016 projections are based on the OECD Economic Outlook 98). 2003-07 average does not include Myanmar.
Source: OECD Development Centre, MPF-2016.

Table A.2. **Current account balance of Southeast Asia, China and India**

Percentage of GDP

Country	2014	2015	2016	2016-20 (average)	2000-07 (average)
ASEAN-5					
Indonesia	-3.1	-1.6	-1.7	-1.5	2.8
Malaysia	4.3	2.6	2.8	3.4	11.8
Philippines	4.4	4.5	3.9	3.2	1.0
Thailand	3.3	5.0	3.0	2.1	3.0
Viet Nam	4.9	0.7	1.0	3.2	-1.9
Brunei Darussalam and Singapore					
Brunei Darussalam	20.8	10.0	12.0	15.8	-
Singapore	19.1	19.5	18.9	16.9	18.5
CLM countries					
Cambodia	-11.7	-12.0	-11.6	-9.4	-2.3
Lao PDR	-25.0	-23.1	-21.2	-17.8	-13.4
Myanmar	-7.1	-7.2	-6.9	-6.1	-
China and India					
China	2.1	3.1	2.8	2.3	4.6
India	-1.3	-0.7	-1.0	-1.6	0.0
Average of ASEAN 10 countries	1.6	1.9	1.4	1.4	4.4
Average of ASEAN 5 countries	0.7	1.1	0.7	0.8	3.5
Average of Emerging Asia	1.2	2.0	1.6	1.2	3.4

Note: The cut-off date of data is 2 November 2015. The weighted averages are used for ASEAN average and Emerging Asia average. The results of China, India, and Indonesia (for 2015 and 2016 projections are based on the OECD Economic Outlook 98). 2000-07 average does not include Brunei Darussalam and Myanmar.
Source: OECD Development Centre, MPF-2016.

Table A.3. **Private consumption in Southeast Asia, China and India**

Percentage changes

Country	2014	2016-20 (average)	2000-07 (average)
ASEAN-5			
Indonesia	5.3	5.3	3.7
Malaysia	7.0	6.4	8.0
Philippines	5.4	5.9	4.9
Thailand	0.6	3.2	4.6
Viet Nam	6.1	6.7	7.1
China and India			
China	7.5	6.6	6.7
India	5.5	6.2	6.3
ASEAN-5 average	4.7	5.3	4.9
Emerging Asia average	6.5	6.3	6.2

Note: The cut-off date of data is 2 November 2015. The weighted averages are used for ASEAN average and Emerging Asia average.
Source: OECD Development Centre, MPF-2016.

Table A.4. **Gross fixed capital formation in Southeast Asia, China and India**

Percentage changes

Country	2014	2016-20 (average)	2000-07 (average)
ASEAN-5			
Indonesia	4.1	6.7	8.3
Malaysia	4.8	5.9	6.7
Philippines	6.8	6.8	4.2
Thailand	-2.6	4.3	6.8
Viet Nam	9.3	8.7	12.5
China and India			
China	7.2	6.7	12.2
India	4.1	6.4	11.8
ASEAN-5 average	3.7	6.4	7.6
Emerging Asia average	5.8	6.6	11.0

Note: The cut-off date of data is 2 November 2015. The weighted averages are used for ASEAN average and Emerging Asia average.
Source: OECD Development Centre, MPF-2016.

Table A.5. **Public finances of Southeast Asia, China and India**

Fiscal balances (central government)

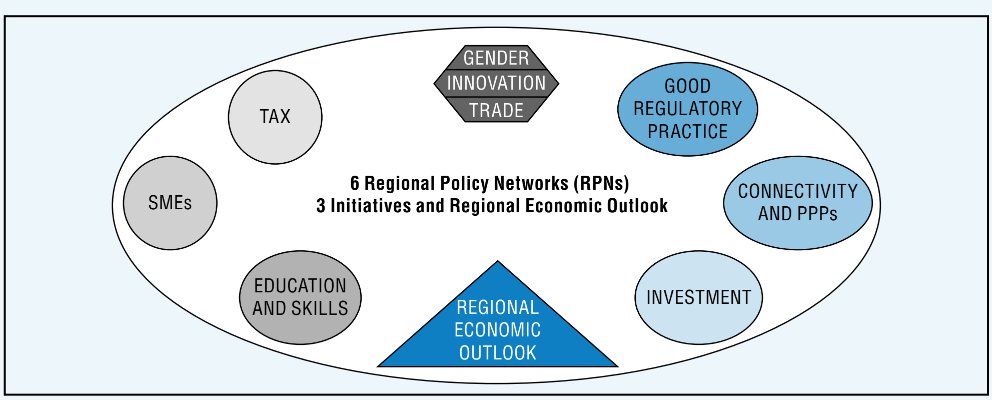
Country	2014	2016-20 (average)	2000-07 (average)
ASEAN-5			
Indonesia	-2.2	-2.3	-1.6
Malaysia	-3.7	-3.3	-4.7
Philippines	-0.6	-2.0	-3.4
Thailand	-2.0	-2.8	-1.1
Viet Nam	-4.4	-4.9	-2.8
China and India			
China	-1.0	-1.7	-
India	-7.1	-7.0	-7.3
ASEAN-5 average	-2.4	-2.7	-2.2
Emerging Asia average	-2.7	-3.2	-4.8

Note: The cut-off date of data is 2 November 2015. The weighted averages are used for ASEAN average and Emerging Asia average. 2000-07 average does not include China.
Source: OECD Development Centre, MPF-2016.

Annex B. Summary of recent developments in policy areas covered by the OECD Southeast Asia Regional Programme

- The **OECD Southeast Asia Regional Programme** (SEARP) was launched at the OECD Council Meeting at Ministerial Level (MCM) in 2014 to foster mutual learning and the exchange of good practices between policy makers in Southeast Asia and OECD countries. This followed an initial MCM decision made in 2007 giving priority to Southeast Asia as a region of strategic interest to the OECD.
- The Programme's structure is designed to encourage a systematic exchange of experience to develop common solutions to regional and national challenges. It is comprised of **six Regional Policy Networks** (RPNs), **three Initiatives** and a **Regional Economic Outlook** that builds on the substantive work programmes of OECD and Southeast Asian bodies. The RPNs are Tax Policy and Administration, Good Regulatory Practice, Investment, Education, SME Policies and Connectivity/PPPs. The three Initiatives focus on Trade, Innovation and Gender. The *Economic Outlook for Southeast Asia, China and India* was included in the Programme at the MCM in 2015 with the role of providing a horizontal view of activities, identifying emerging trends in the region and providing a backbone for the different streams of the Programme.
- This document has been prepared as background information for the Southeast Asia Regional Programme, to provide an update on regional developments in each of the Regional Policy Networks and Initiatives. The full version of this document which includes developments at the country level and key policy challenges along with references to further reading on the topic and summaries of the RPN/Initiative will be available for download at www.oecd.org/dev/economic-outlook-for-southeast-asia-china-and-india-23101113.htm.

OECD Southeast Asia Programme



- With the help of the RPN on **Tax Policy and Administration**, a new global standard for the automatic exchange of financial account information (AEOI) has been finalised and jurisdictions are working towards its implementation. Under this system, bulk taxpayer information such as income from salaries and dividends, purchase or sale of immovable property, etc. will be automatically transmitted from the source country to the residence country. To assist countries in developing the necessary capacity to implement this system, the Global Forum on Transparency and Exchange of Information for Tax Purposes, which has 126 member jurisdictions, has held training events for countries in the region, including in the Philippines and Malaysia in the first half of 2015.
- In terms of **Good Regulatory Practice**, ASEAN Member States have made significant regulatory reforms supporting regional agreements such as the *ASEAN Economic Community Blueprint and Master Plan on ASEAN Connectivity*. ASEAN Framework Agreements have been signed on services, integration of priority sectors, facilitation of goods in transit, intellectual property co-operation and others. The need to develop responsive regulations with stakeholder consultation was recently highlighted in the *Nay Pyi Taw Declaration on the ASEAN Community's Post 2015 Vision*.
- The ASEAN Comprehensive **Investmen**t Agreement (ACIA) came into force in March 2012 to simplify and clarify the investment environment in ASEAN by creating common standards and protection provisions. The agreement goes beyond investment liberalisation to include promotion and facilitation. Investment promotion is co-ordinated by a dedicated Investment Promotion Authority (IPA) which serves as a link between the private sector, government ministries and local government units. The ASEAN region has selectively liberalised its investment regimes through free trade agreements with Australia and New Zealand (AANZFTA), China (China-ASEAN FTA), India (AIFTA), Japan (AJCEP) and Korea (AKFTA) while negotiations are still underway for liberalisation under the Regional Comprehensive Economic Partnership (RCEP).
- ASEAN Plus Three co-operation –between ten ASEAN members, China, Japan and Korea- has extended to **financial integration** through the Chiang Mai Initiative Multilateralisation (CMIM) and Asian Bond Market Initiative (ABMI). The CMIM replaces the previous bilateral swap lines with a multilateral swap arrangement that aims to create a regional safety network against financial crises. The ABMI has created an efficient and liquid local currency bond market to better mobilise savings for investments in Asia. The Credit Guarantee and Investment Facility (CGIF), a component of the ABMI, was created in May 2011 as a regional credit guarantee and investment trust fund in Asia to boost long-term investment in the region. It offers credit guarantees for local currency bonds issued by investment grade companies in ASEAN+3 countries.
- **Education** reform in the ASEAN region has been guided by the *ASEAN Socio-Cultural Community Blueprint* and the *ASEAN 5-Year Work Plan on Education (2011-2015)*. Several major reforms have occurred as a result. The *ASEAN Qualification Reference Framework* was launched in August 2014 to reconcile national differences in the assessment of qualifications and facilitate the free movement of skilled labour. Mutual recognition agreements (MRAs) have been signed for professional services such as engineering and architecture provide recognition for registered ASEAN professionals. The *ASEAN Curriculum Sourcebook* has been developed as a tool to promote an ASEAN identity and inter-cultural understanding. ASEAN Studies courses are also available for graduate students. The ASEAN University Network promotes collaborative research among 26 universities from the 10 ASEAN countries. It also serves as a forum to conduct quality assessments and develop education policy in the region.

- The ASEAN region has focused on **SME** development as part of the AEC agenda to promote equitable economic growth guided by the *ASEAN Strategic Action Plan for SME Development (2010-2015)*. The ASEAN Business Incubator Network (ABINet) has been created to provide business matching and support services. It is currently operational in thirty centres across the region. The ASEAN Online SME Academy is expected to be launched in 2015 to not only provide business information and training resources but also to serve as a platform for networking with regional and global businesses, mentors, financiers, and policy makers. The *SME Guidebook Towards the AEC 2015* has been created to provide information on financing, support services, customs procedures and rules of origin.
- The *Master Plan on ASEAN* ***Connectivity*** (MPAC), launched in 2010, lays out the key strategies to connect the region through physical infrastructure, effective institutions and empowered people. It addresses constraints in physical infrastructure such as poor quality roads and railway and institutional bottlenecks such as differing standards, and connects people by promotion tourism and cultural understanding. The MPAC has revitalised several long-running infrastructure development projects including the ASEAN Highway Network (AHN) and the Singapore Kunming Rail Link (SKRL). Projects related to the AHN such as the Mekong Bridge in Neak Loung and the installation of road and numbering signs along the Transit Transport Routes (TTR) have been completed. Some missing links of the SKRL such as the Poipet-Sisophon and Aranyaprathet-Klongluk have been completed yet many links involving Cambodia, Thailand and Viet Nam remain to be finished. The *ASEAN Principles for* ***Public-Private Partnership*** *Frameworks* was launched in November 2014 to provide ASEAN Member States with guidance on how to create a predictable and efficient PPP environment for infrastructure investment and to address issues related to cross-border regional infrastructure projects. The Principles cover four main areas: policy and organisational framework for private participation; project selection, development and implementation; affordability and budget transparency; and transnational infrastructure connectivity. Within Southeast Asia, many countries are embracing public-private partnerships and seeking to strengthen their institutional, legal, and public financial management systems for PPPs, while taking steps to promote infrastructure as an investment choice for domestic and international investors:
- The establishment of the ASEAN Free **Trade** Area (AFTA) and the ASEAN Trade in Goods Agreement (ATIGA) have led to falling tariff rates throughout the region. The ten ASEAN members are co-operating with their six free-trade agreement partners (Australia, China, India, Japan, the Republic of Korea and New Zealand) in creating a Regional Comprehensive Economic Partnership (RCEP). The agreement aims to eliminate tariff and non-tariff barriers as well as multilateralise the existing bilateral trade agreements. Negotiations are still ongoing with the 10th Round to be held in South Korea in October 2015. The ASEAN Self-Certification System has been introduced, reducing compliance costs associated with rules of origin (ROO) by allowing exporters to make invoice declarations themselves rather than relying on government officials. The liberalisation of services has been facilitated by the signing of the *ASEAN Framework Agreement on Services* (AFAS) in 1995 and mutual recognition agreements (MRAs) in several sectors. MRAs for engineering and architecture are the most advanced with the harmonisation of standards and provision of recognition for registered ASEAN professionals. ASEAN countries have improved their performance across various trade facilitation areas, according to the OECD's *Trade Facilitation Indicators* and the World Bank's Ease of *Doing Business Index* and *Logistics Performance Index*. This has been supported, for instance, by

improvements in availability and user-friendliness of information on procedures and regulations, requirements for fewer documents, improvements in the permit application process, as well as reductions in the physical inspection rates and clearance times.

- **Innovation** policy in the region has been guided by the ASEAN *Plan of Action on Science and Technology* (2007-2011) which has been extended to 2015 and updated with the *Krabi Initiative* adopted by ASEAN Ministers in December 2010. Amongst the various initiatives in a comprehensive eight-track path, the plan sought to enhance external partnerships and R&D human resource capacities. Several external partnerships have been developed to strengthen innovation capabilities in the region. The China-ASEAN Science and Technology Partnership (STEP) programme was launched in 2012 to facilitate collaborative research and technology transfers. The ASEAN-Japan Cooperation Committee on Science and Technology (AJCCST) provides a forum for policy makers to share information on topics such as Japan's recent experience with their Comprehensive Strategy on Science, Technology and Innovation. Similar forums exist between ASEAN and China, the EU, Japan, India, Russia and the Republic of Korea.
- To address **gender** inequalities the Work Plan of the ASEAN Committee on Women (2011-2015) has sought to influence the ASEAN Community Blueprints to ensure that there will be credible gender mainstreaming into government and regional policies, programs and processes. The ASEAN Women's Entrepreneurship Network (AWEN) was launched in 2014 to scale up women's entrepreneurship and foster linkages between female entrepreneurs in the region.

Economic Outlook for Southeast Asia, China and India 2016

ENHANCING REGIONAL TIES

The annual *Economic Outlook for Southeast Asia, China and India* examines Asia's regional economic growth, development and regional integration process. It focuses on the economic conditions of Association of Southeast Asian Nations (ASEAN) member countries: Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Viet Nam. It also addresses relevant economic issues in the People's Republic of China and India to fully reflect economic developments in the region. The 2016 edition of the *Economic Outlook for Southeast Asia, China and India* comprises three main parts, each highlighting a particular dimension of recent economic developments in the region. The first part presents the regional economic monitor, depicting the medium-term economic outlook and macroeconomic challenges in the region. The second part consists of three chapters on "enhancing regional ties", which is the special thematic focus of this edition. The third part includes structural policy country notes.

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