



# **ECONOMIC OUTLOOK FOR SOUTHEAST ASIA, CHINA AND INDIA 2015:**

## ***STRENGTHENING INSTITUTIONAL CAPACITY***

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**OECD Development Centre**

**March 2015, Korea**





## 1<sup>st</sup> session

# Macroeconomic perspectives and key structural policy challenges

# Growth remains robust in the medium term, in general



**Real GDP growth of Southeast Asia, China and India** (Annual percentage change)

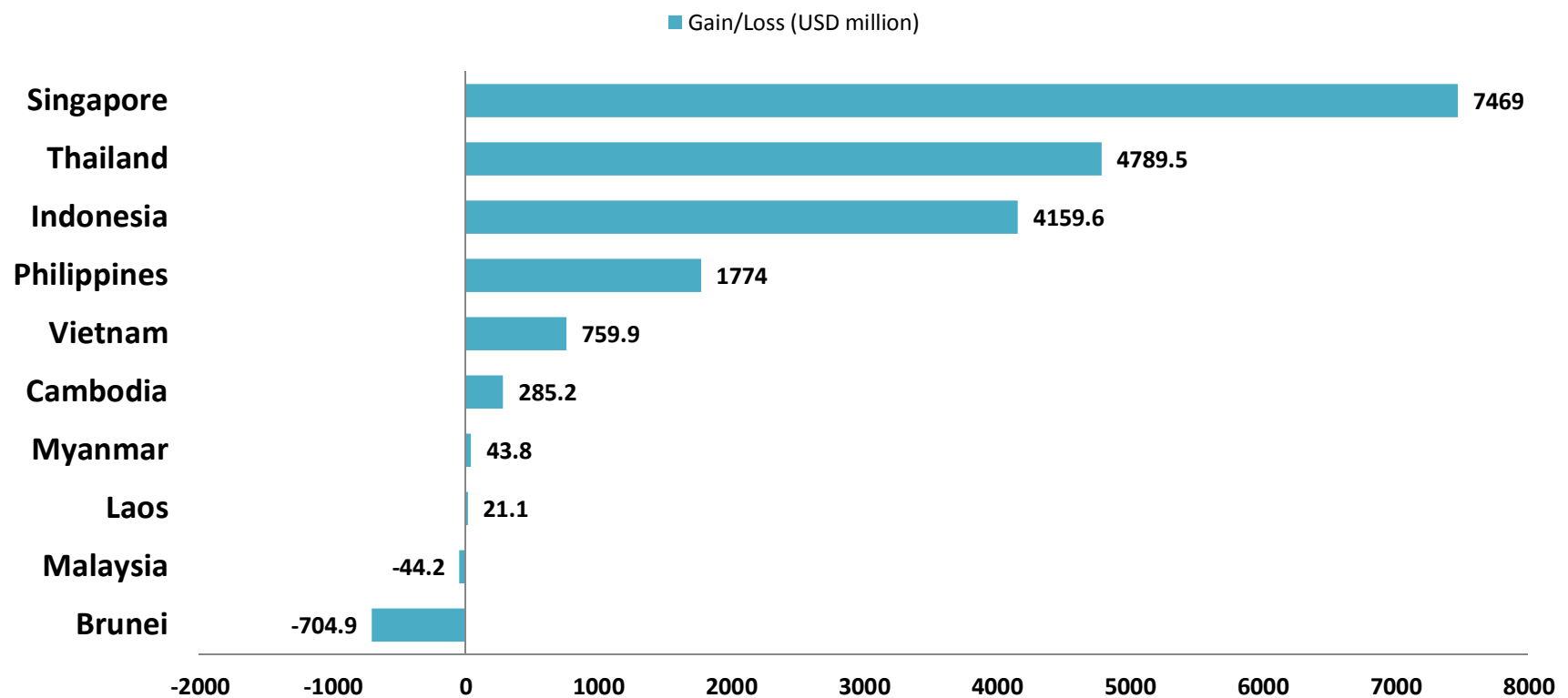
Country	2013	2019	2003-07	2011-13	2015-19
<b>ASEAN 10 countries</b>					
<b>ASEAN-5 countries</b>					
Indonesia	5.8	6.3	5.5	6.2	6.0
Malaysia	4.7	5.6	6.0	5.2	5.6
The Philippines	7.2	6.3	5.7	5.9	6.2
Thailand	2.9	4.6	5.6	3.2	4.1
Viet Nam	5.4	5.8	7.2	5.6	5.7
Brunei Darussalam	-1.8	1.9	1.7	0.9	1.6
Cambodia	7.5	7.3	10.6	7.3	7.1
Lao PDR	8.0	7.7	7.1	8.1	7.6
Myanmar	7.5	7.8	-	6.9	7.8
Singapore	3.9	3.6	7.9	4.1	3.5
<b>Two large economies in the region</b>					
China	7.7	6.6	11.7	8.2	6.8
India	5.0	6.8	8.8	5.5	6.7
<b>Average of ASEAN 10 countries</b>	5.2	5.8	5.9	5.4	5.6
<b>Average of Emerging Asia</b>	6.5	6.5	9.5	7.0	6.5

Notes: The cut-off date of data is 6 October, 2014. Emerging Asia denotes ASEAN-10 countries plus China and India. ASEAN-5 includes Indonesia, Malaysia, Thailand, the Philippines and Viet Nam. Data for Myanmar in 2013 is from ADB.

Source: OECD Development Centre, MPF-2015 (Medium-term projection framework). For more information on MPF, please see [www.oecd.org/dev/asiapacific/mpf](http://www.oecd.org/dev/asiapacific/mpf).

# The impact of the oil price drop varies, with Singapore, Indonesia and Thailand benefiting the most

Figure. International Income Transfers for ASEAN Countries due to the Oil Price Drop

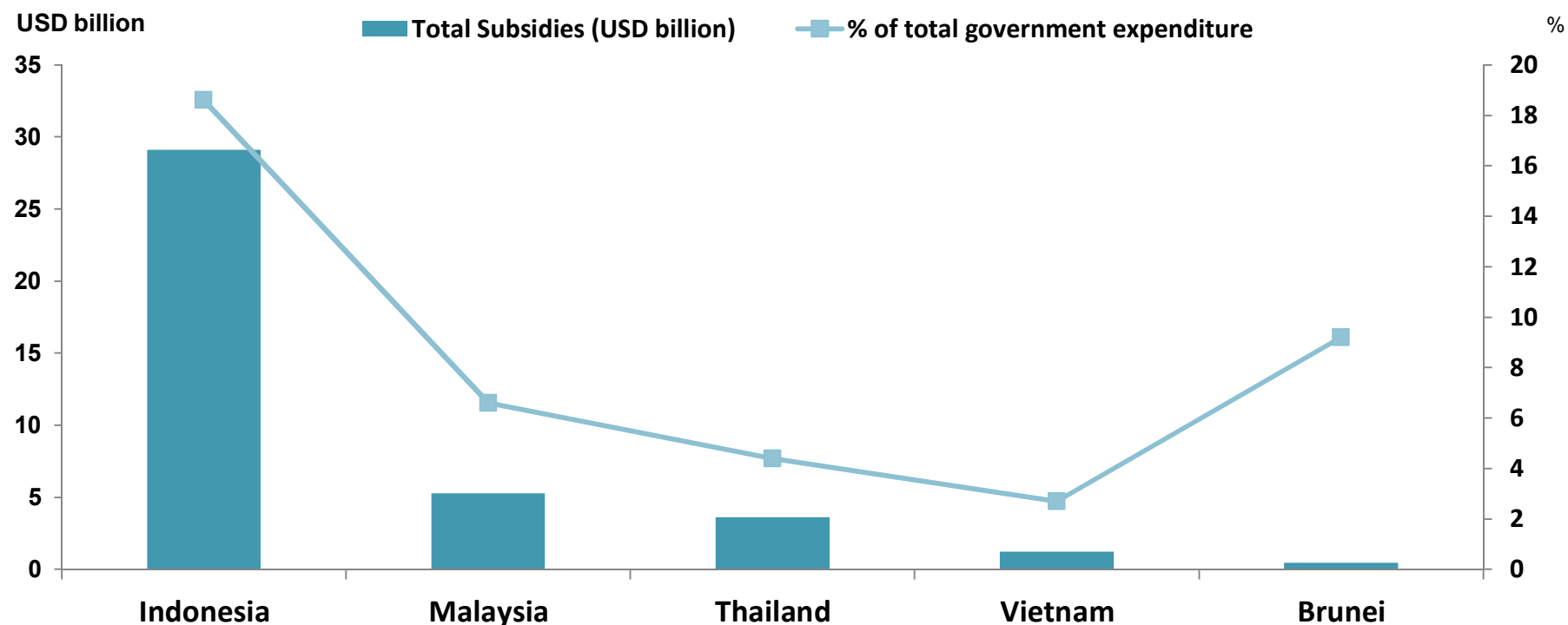


Source: U.S. Energy Information Administration

# Domestic reforms and the global oil price drop



**Fossil Fuel Subsidies in Selected ASEAN Countries, 2013**

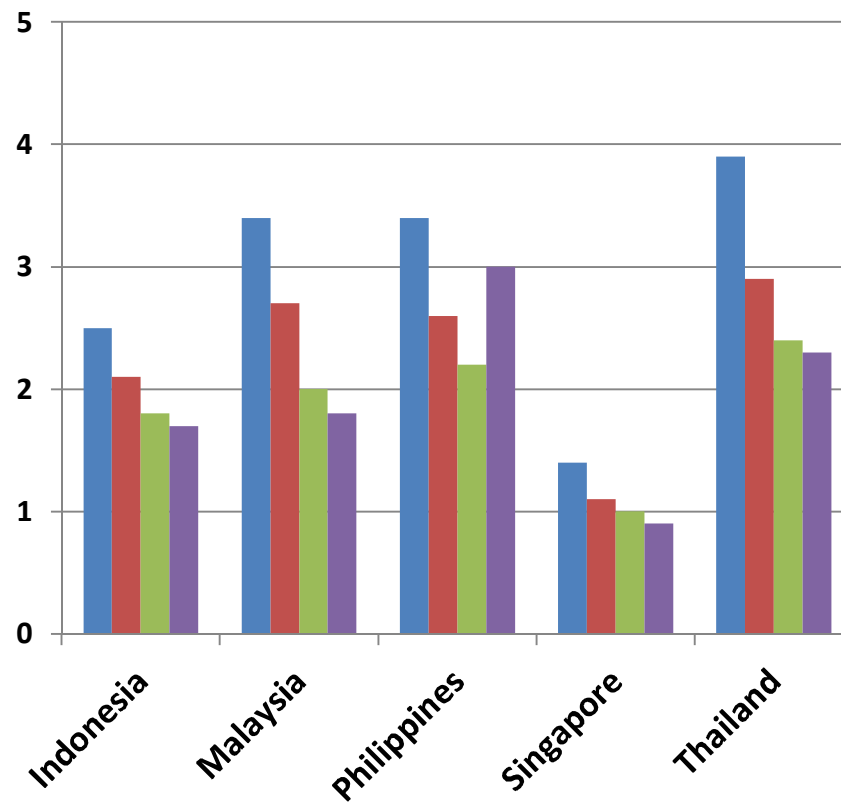


# Non-performing loans are decreasing though credit growth slowed



Non-performing loans  
(percentage of total loans outstanding)

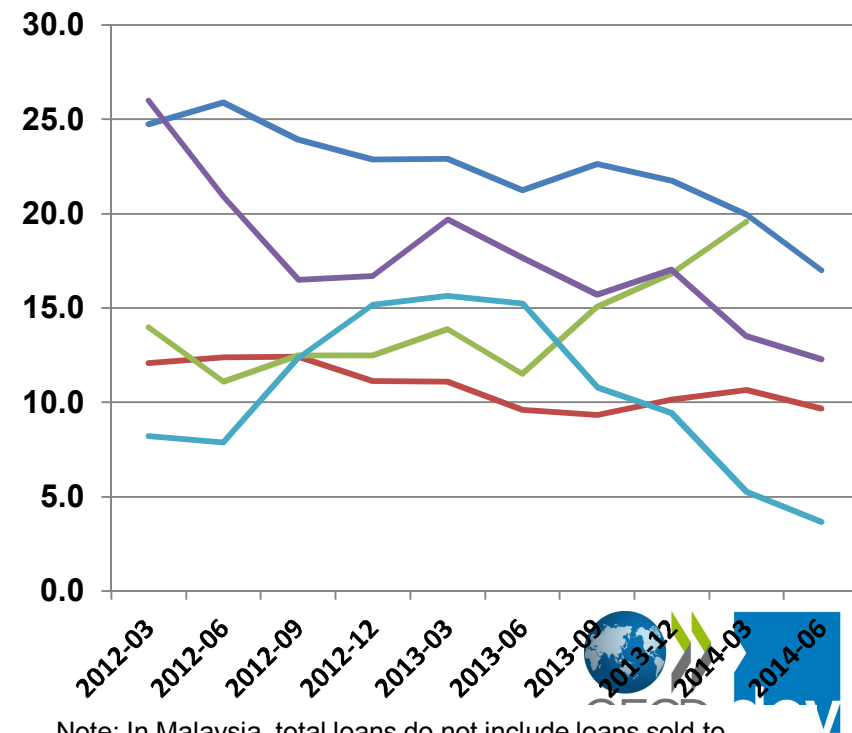
■ 2010 ■ 2011 ■ 2012 ■ 2013



Source: World Bank, World Development Indicators

Bank loan growth in Southeast Asia  
(Percentage changes, yoy)

— Indonesia — Malaysia — Philippines  
— Singapore — Thailand



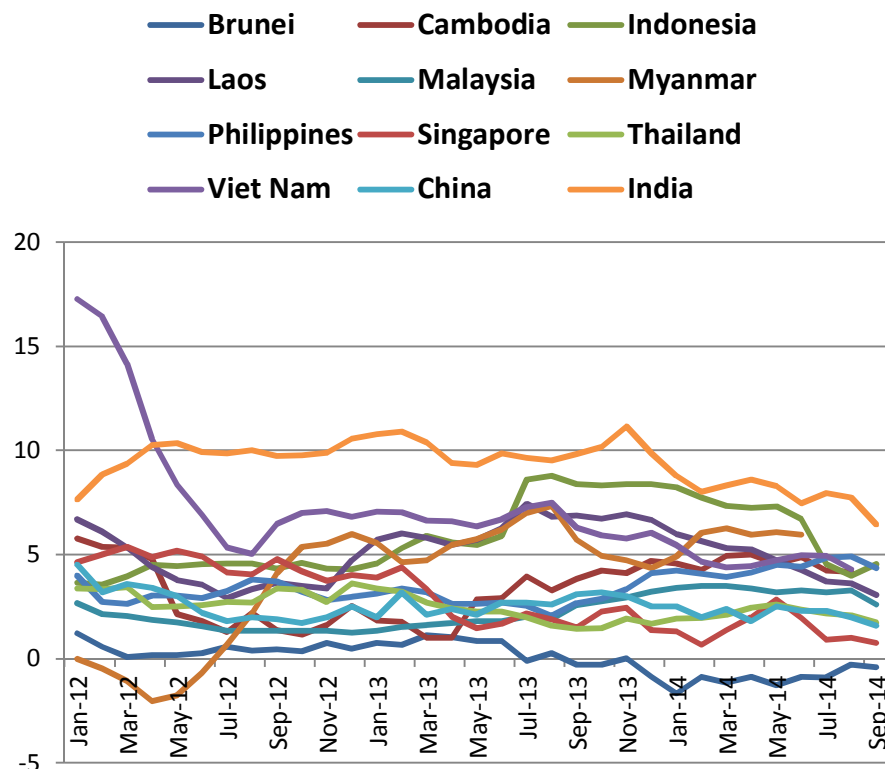
Note: In Malaysia, total loans do not include loans sold to Danaharta, the National Asset Management Company.  
Source: CEIC.

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# Inflationary pressure needs to be carefully managed

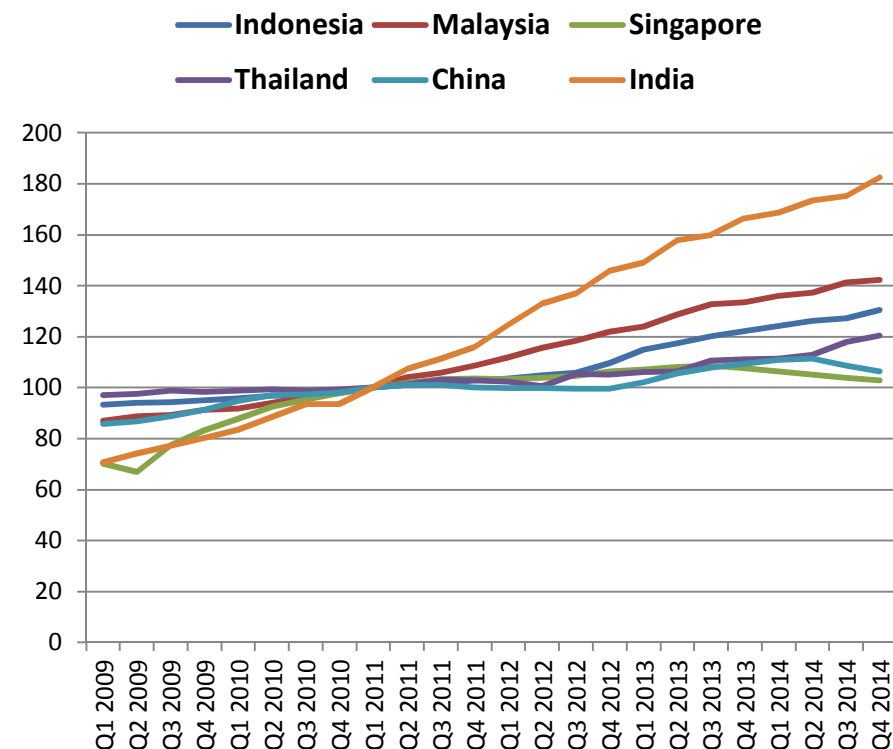


## Consumer price inflation (headline)



Notes: For Cambodia data refer to inflation as registered in Phnom Penh.  
Sources: CEIC and Datastream.

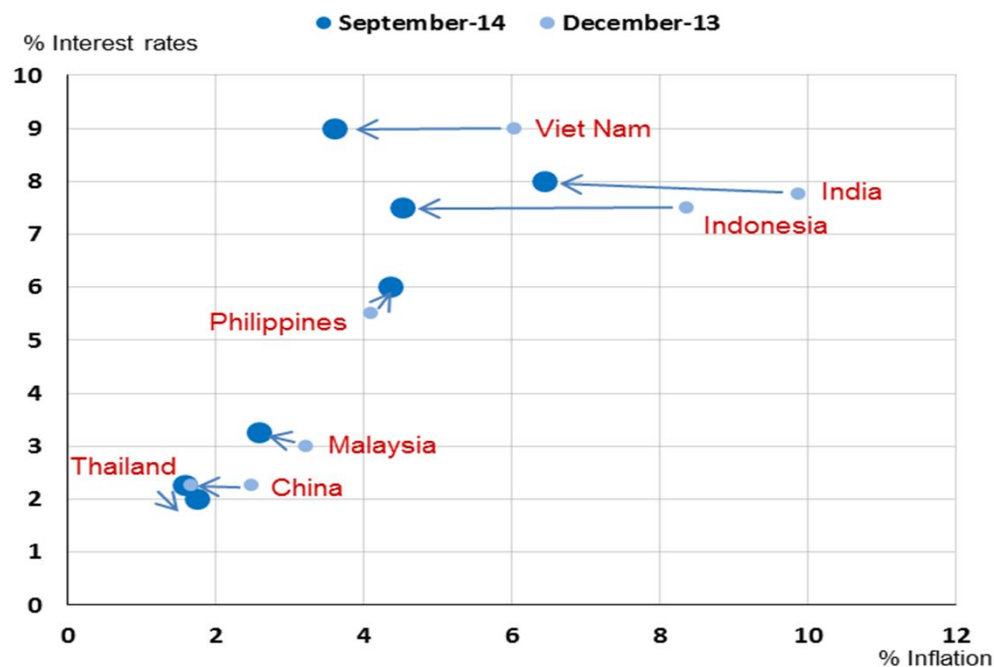
## Housing price indices in Emerging Asia (Index, Jan 2011=100)



Source: Datastream

# Overall, policy interest rates has been fairly stable, though some country cut the rates recently

## Evolution of inflation and policy interest rates



Notes: The figure above illustrates inflation on the horizontal axis and policy interest rates on the vertical axis. For each country, the figure plots inflation and interest rates in December 2013 and August 2011 as well as September 2011 and May 2012. As a consequence, a movement to the right in the figure means rising inflationary pressures, while a movement upwards corresponds to tightening monetary policy in the same period.

Indonesia: Policy Rate: Month End: 1 Month Bank Indonesia Certificates Auction

Malaysia: Policy Rate: Month End: Overnight Policy Rate

Philippines: Policy Rate: Month End: Repurchase Rate

Thailand: Policy Rate: Month End

Viet Nam: Policy Rate: Month End: Prime Lending Rate

China: Policy Rate: Month End: Rediscount Rate

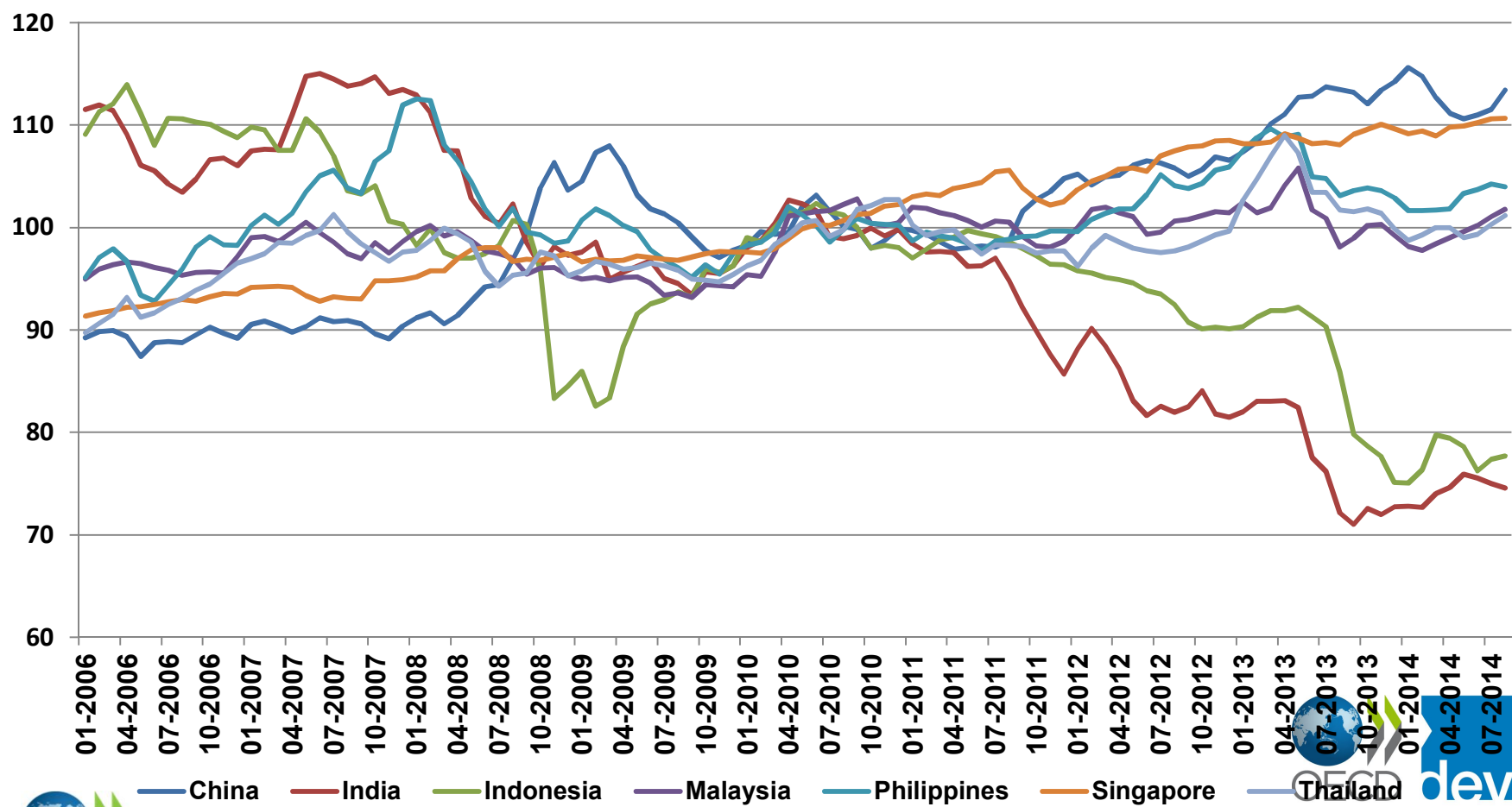
India: Policy Rate: Month End: Repo Rate

Sources: CEIC, Datastream and national sources



# In most cases, currency pressures have been neutral and/or upward

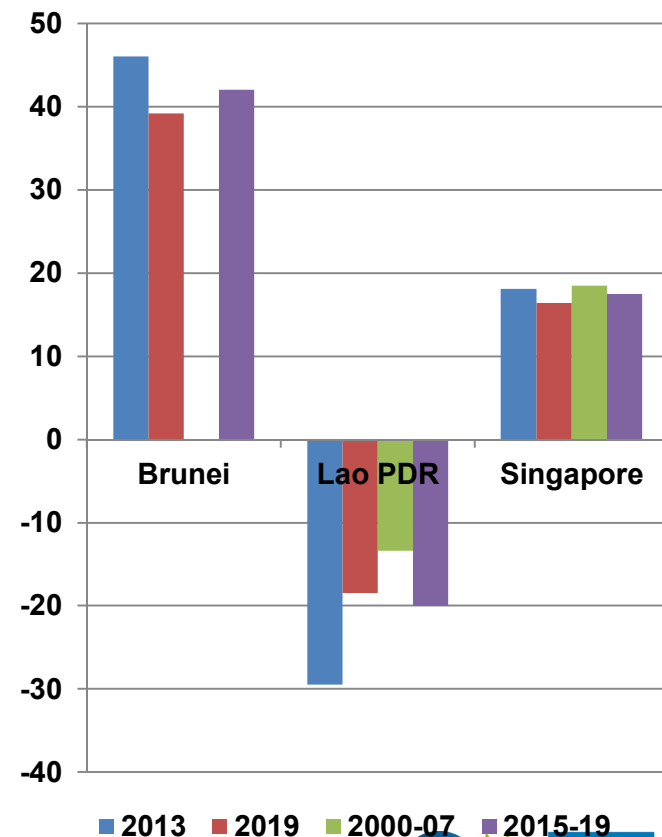
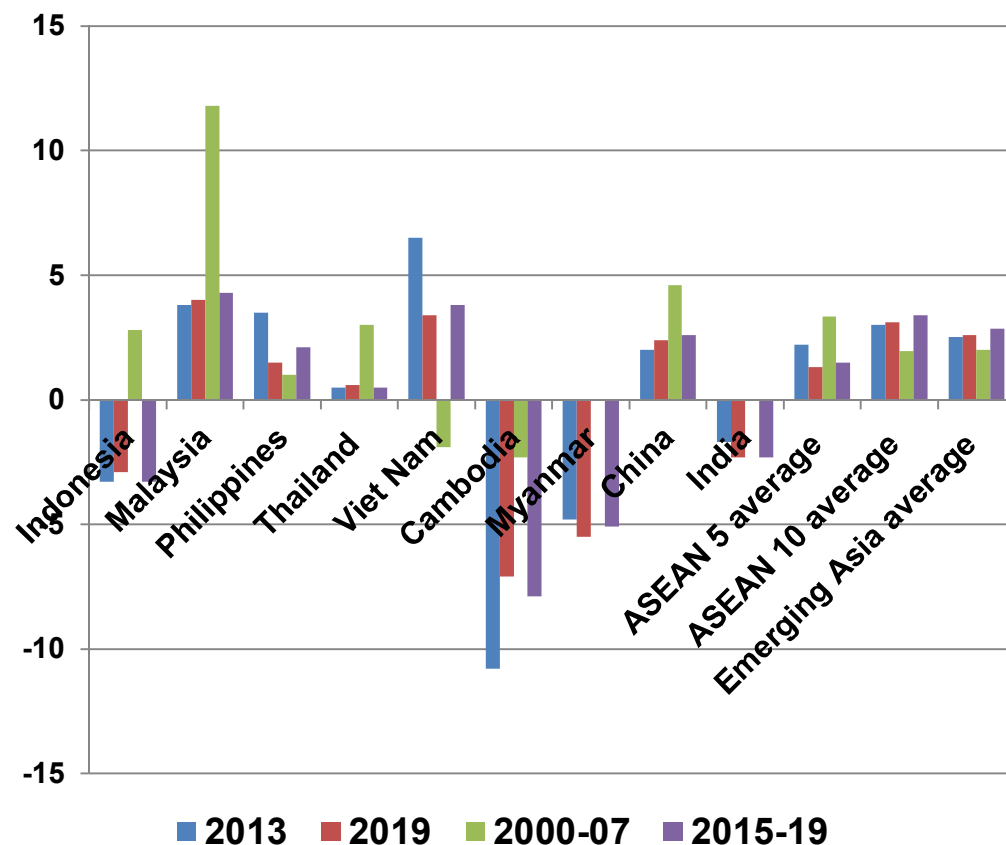
Nominal exchange rates, USD per national currency, 2010 average = 100



Source: International Financial Statistics.

# The region as a whole will record a CA surplus but positions will vary by countries

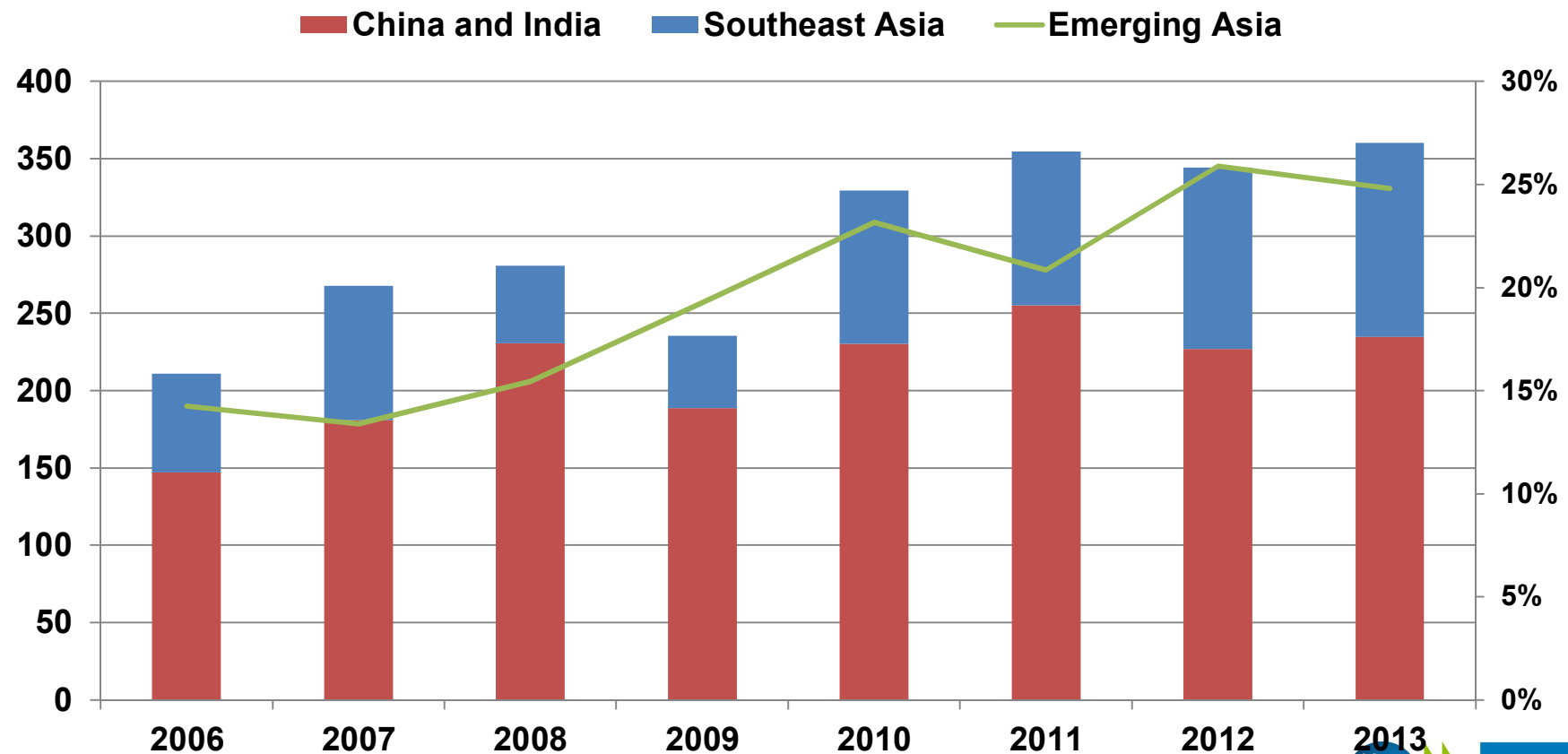
Current account balances of Southeast Asia, China and India (percent of GDP)



# Some signs of FDI slowing...

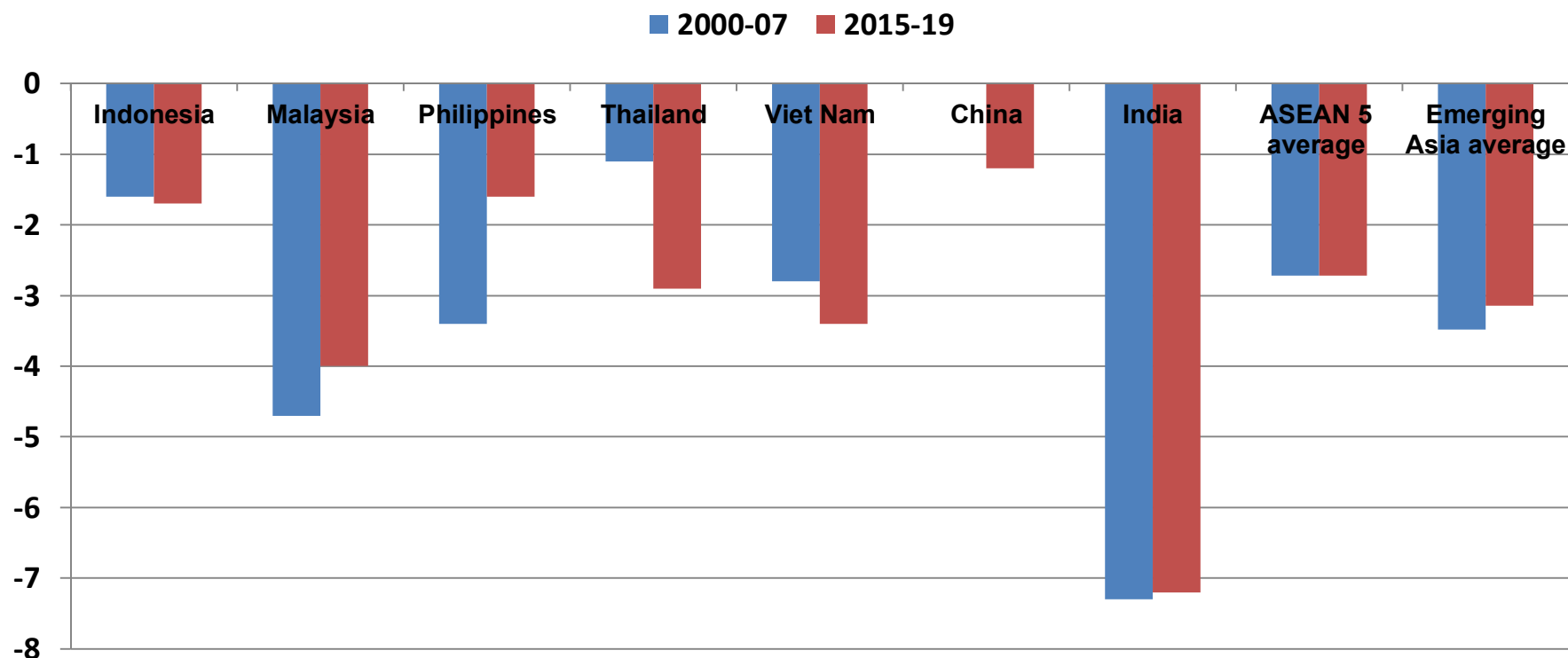


## FDI inflows in Emerging Asia (US billion)



# Fiscal reforms need to be strengthened

## Public finances of Southeast Asia, China and India Fiscal balances (central government) (percent of GDP)



Notes: The cut-off date of data is 6 October, 2014. Emerging Asia denotes ASEAN-10 countries plus China and India. ASEAN-5 includes Indonesia, Malaysia, Thailand, the Philippines and Viet Nam.

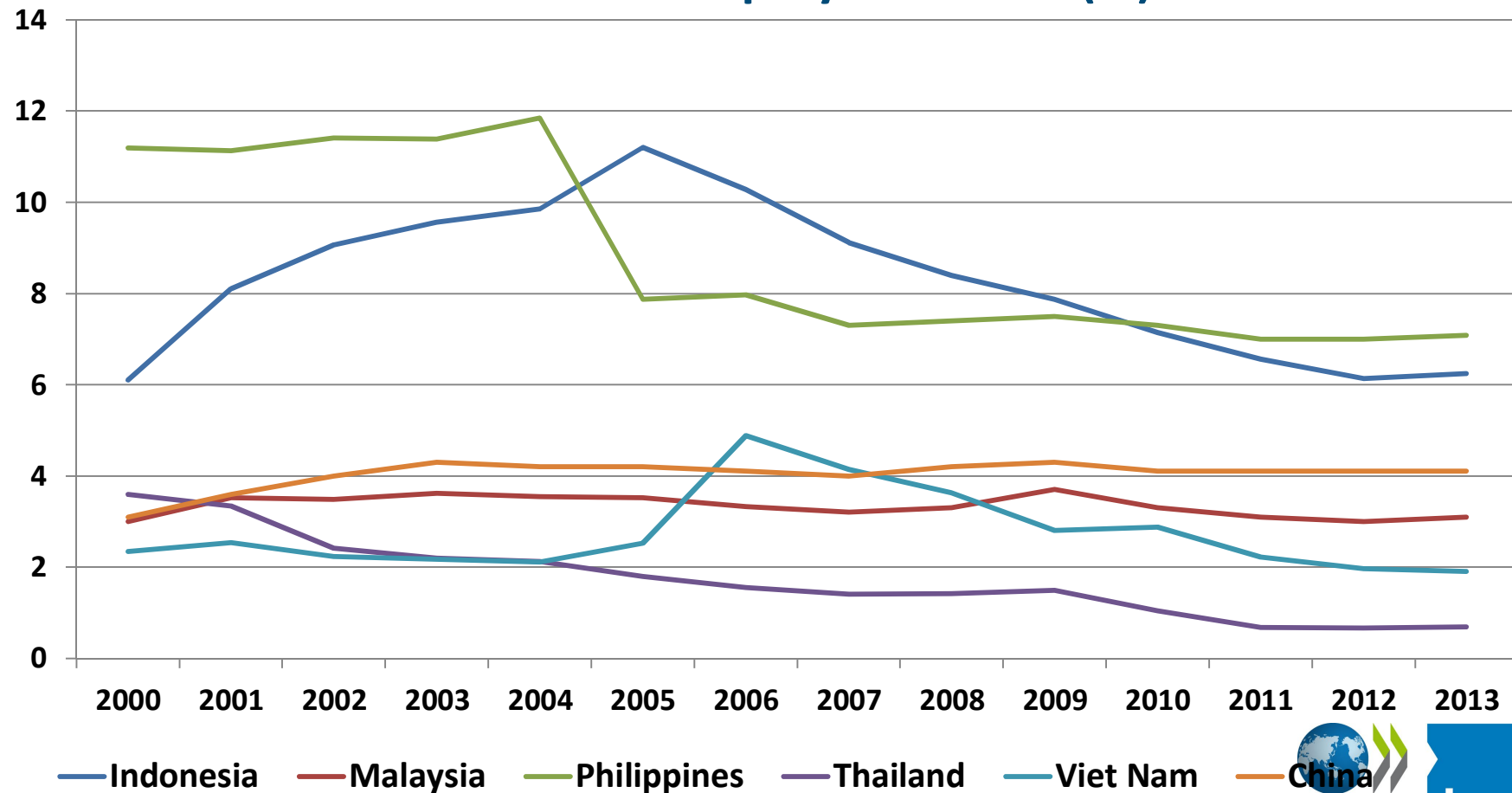
Source: OECD Development Centre, MPF-2015 (Medium-term projection framework). For more information on MPF, please see

[www.oecd.org/dev/asiapacific/mpf](http://www.oecd.org/dev/asiapacific/mpf).

# (Official) Unemployment rates remain low



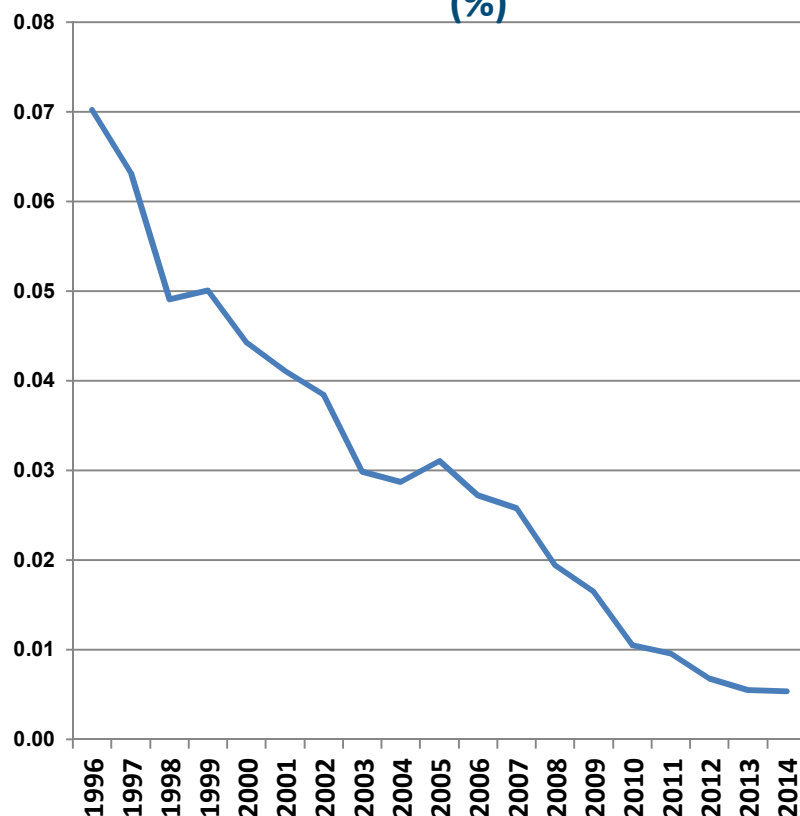
Unemployment rate (%)



# Further acceleration of regional integration towards AEC will be necessary



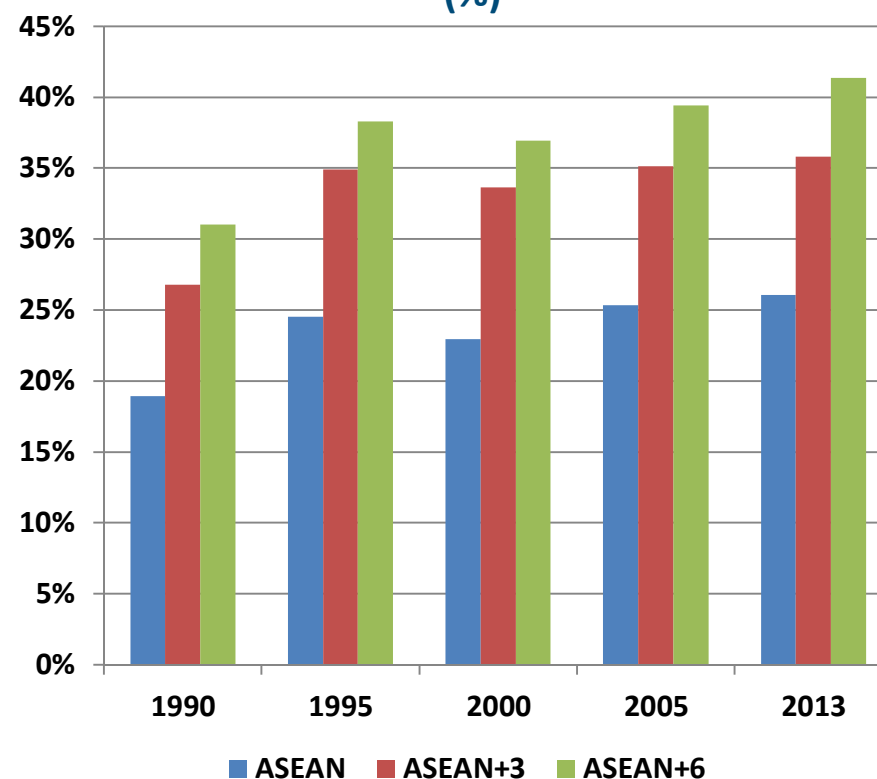
Average of CEPT rates for ASEAN (%)



Source: ASEAN Secretariat



Share of intra-regional trade as percentage of total trade (%)



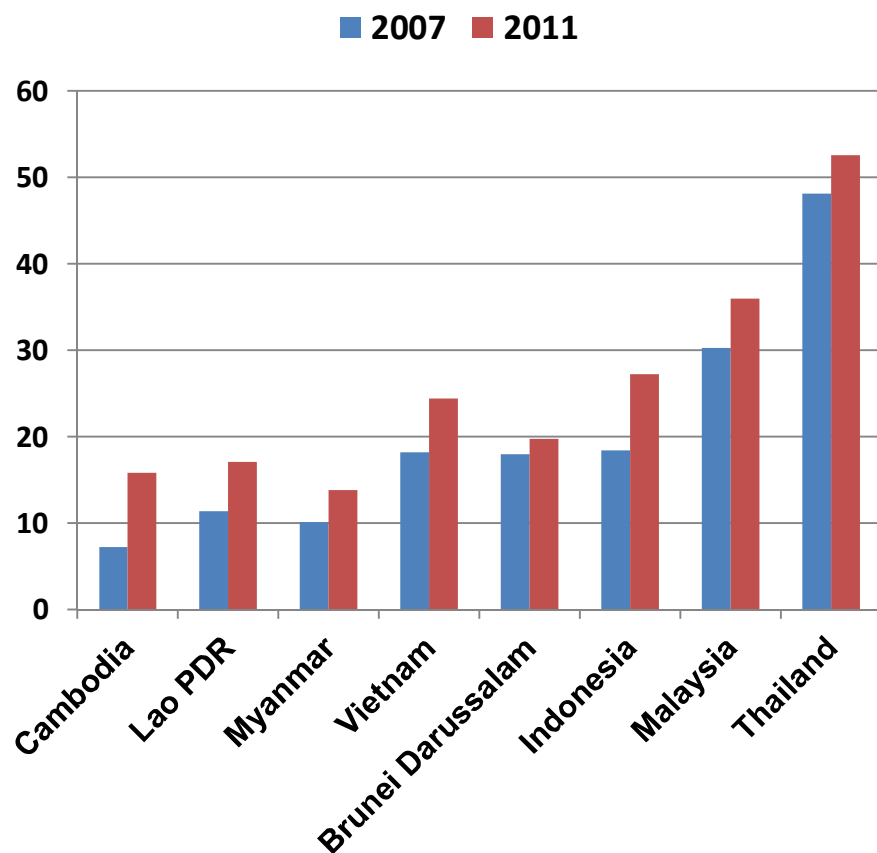
Source: author's calculation. IMF, Direction of Trade Statistics



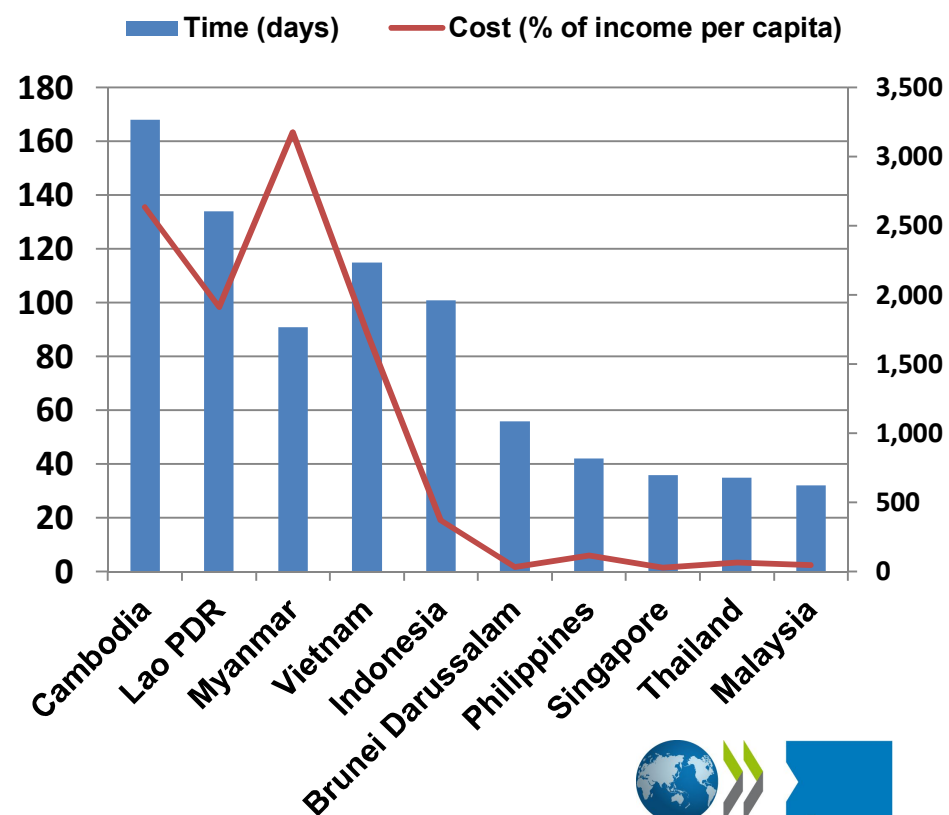
# Disparities within the region should narrow



School enrolment, tertiary (% gross)



Access to electricity (2012)



Source: World Bank's World Development Indicators (WDI)

OECD



Source: World Bank's Doing Business database

# Risks: Emerging Asia may have to contend with external risks



- Normalisation of US monetary policy
- Slowdown in Chinese economy
- Implementation of structural policies related to *Abenomics* in Japan



# Domestic risk: Managing political transformations



- **Leadership change (Indonesia, India)**
- **Political uncertainty (Thailand and Viet Nam)**

**Table: Thailand's Roadmap to Democracy (3 stages)**

Stage	Time	Focus Issue
<b>1<sup>st</sup> Stage</b>	From August 2014 (2-3 months)	Facilitation of reconciliation and peace through dialogues between all political sides, overseen by reconciliation centres set up by the NCPO. A temporary Constitution is created in July to legitimize the May coup and allow the establishment of an interim government.
<b>2<sup>nd</sup> Stage</b>	September-October 2014	The 250-member National Reform Council, which will be tasked with recommending reforms as well as approving the new charter that will take effect from July 2015, is formed
<b>3<sup>rd</sup> Stage</b>	October 2015 (Expected)	General election will take place under a democratic system

# Thematic focus: Strengthening institutional capacity

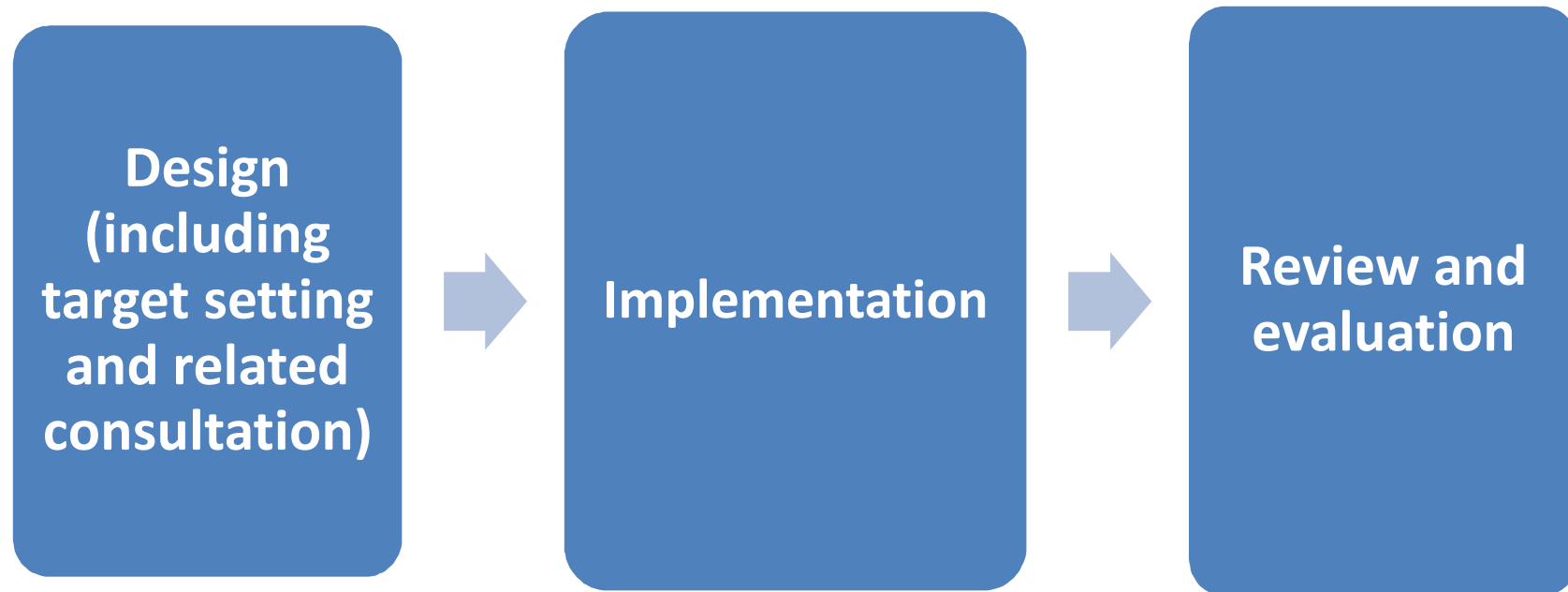


## Three key questions:

- **Institutions for effective policy implementation: what are the barriers to achieving medium-term plan target?**
- **Public sector reforms: What factors have shaped their effectiveness?**
- **Institutions and informality**

# The national economic planning process comprises design, implementation and evaluation

**The planning process comprises design,  
implementation and evaluation**



# Summary: Policy challenges of implementing the national plans



## Policy challenges in implementing national plans in Emerging Asia

Country	Policy focus
<b>ASEAN countries</b>	
<b>Indonesia</b>	The largest gaps are found in the health area. Improving access to and quality of health services, especially for mothers and children, is crucial. The coverage of the newly-implemented health insurance scheme needs to be expanded.
	Further efforts are needed to improve the education system, particularly access to secondary and tertiary education for students from low-income households.
	Increasing inequality is not being adequately addressed by the national plan.
<b>Malaysia</b>	Further improvements in productivity are needed to support sustainable economic growth and transform Malaysia into a high-income and developed nation.
	Further development of ICT, which will be particularly important in supporting growth, is needed.
	Fiscal stability should also be enhanced and dependence on oil should be reduced. The successful introduction of GST is important to improve tax performance.
<b>Myanmar</b>	Reliable indicators, measurable goals and measurements of government performance are necessary for effective planning and monitoring, in particular in the areas of regulatory reforms and public finance.
	Policy planning and budgeting including appropriate financial supports in agriculture and education should be developed.
	Co-operation with the private sector in the context of PPP and setting up new businesses and civil society is an important part for Myanmar's ongoing transition.
<b>Philippines</b>	To sustain economic growth, the Philippines need to step up its competitiveness in the global rank through quality employment and increasing value added from innovation.
	A responsive, development –oriented and inclusive financial system must be pursued to serve as a platform for efficient management and mobilisation of resources.
	Social development must be further improved to ensure equal opportunities for Filipinos to be employed with a decent job, acquire assets, and raise their living standards.

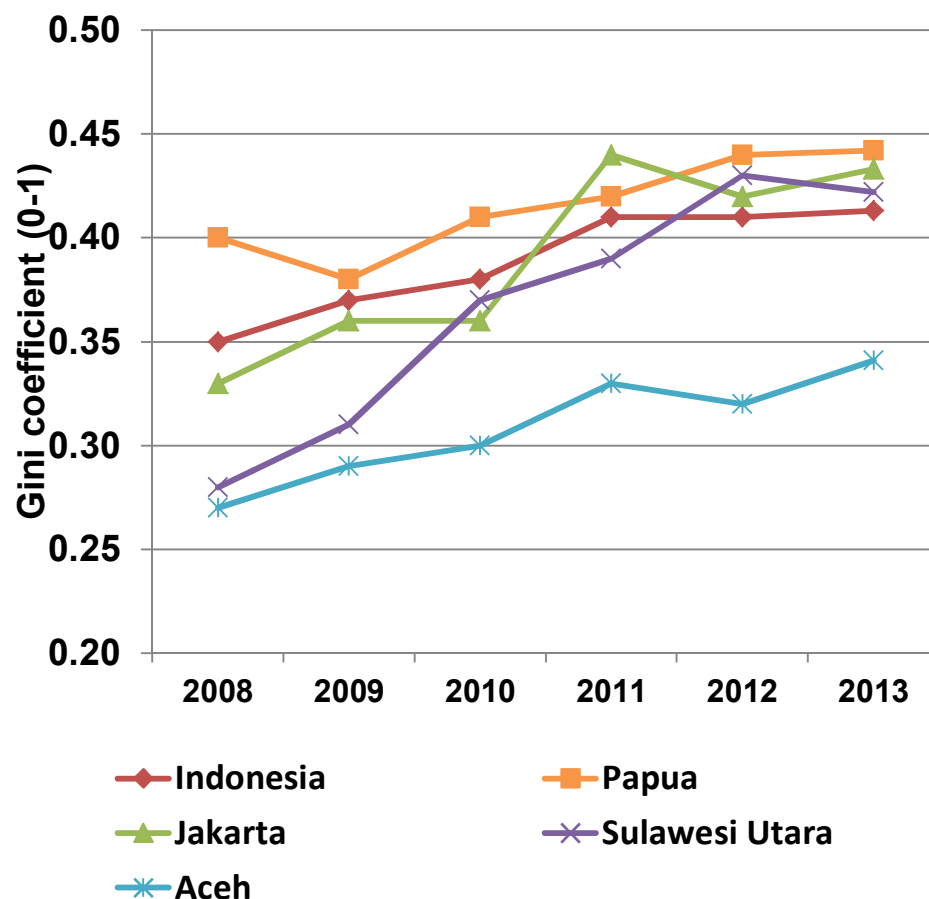


Country	Policy focus
<b>ASEAN countries</b>	
<b>Thailand</b>	To ensure sustainable economic growth as well as to enhance Thailand's competitiveness, accelerated progress will be needed to meet several targets, together with enhancing productivity.
	In particular, further efforts in environmental management are needed to support green growth.
	Improving good governance, particularly anti-corruption and transparency, needs more effort to reduce obstacles to growth.
<b>Vietnam</b>	Maintaining stability in key economic and social indicators is a priority for implementing socio-economic strategies for the country.
	Addressing implementation gaps in developing high-tech industries and skills-training of workers is essential to achieving not only the medium-term plan, but also the 2020 vision of a modern, industrialised Viet Nam.
<b>Two large economies in Emerging Asia</b>	
<b>China</b>	Environmental degradation remains a major issue despite the country's efforts in reducing pollution. Further efforts are needed to increase clean energy consumption.
	Rural and agriculture development could help promoting urban-rural social equality.
	Services have the potential to help drive future growth, but their development requires continued economic reforms and improvements in education.
<b>India</b>	Manufacturing has been slowing down in the last few years, and it even shows negative growth in 2013-14.
	Access to secondary education needs to improve to achieve the goal of universal secondary education by 2017.
	The public sector health system needs to be strengthened. Access to both curative and preventive health care facilities needs to improve.
	Accelerating development of infrastructure is crucial, especially in rural areas.

# Policy challenges in Indonesia



Inequality in Indonesia and selected provinces, 2008-13



Source: Statistics Indonesia, Badan Pusat Statistik (BPS).

## Policy challenges of implementing the national plan in Indonesia

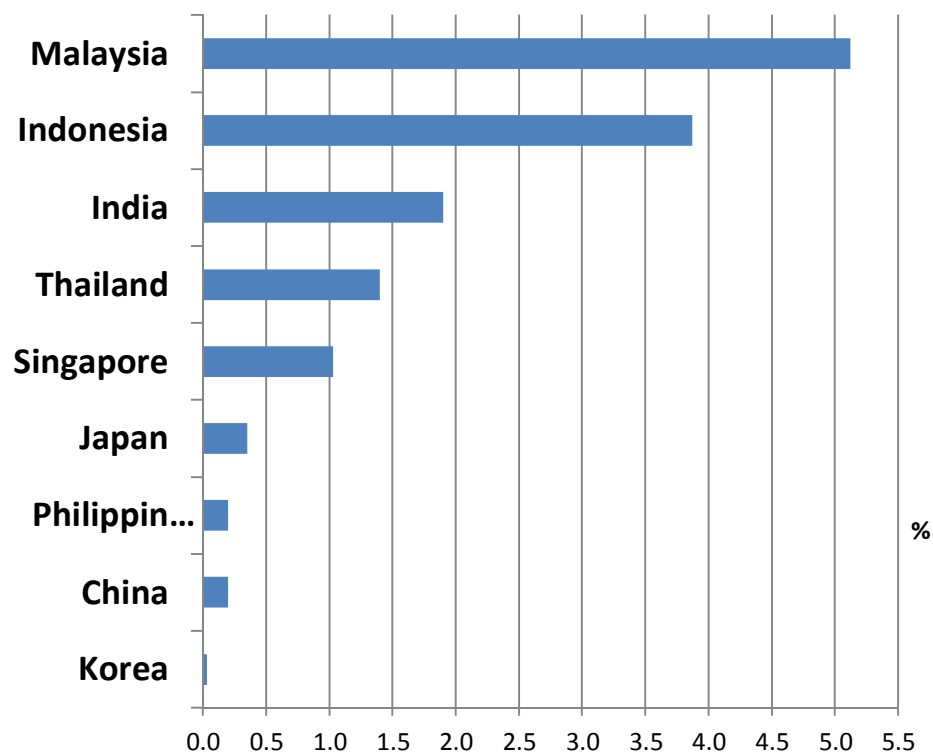
- Improve access to and the quality of health services – especially for mothers and children – as large gaps between targets and achievements are to be found in healthcare. Expand the coverage of the newly implemented health insurance scheme.
- Further improve the education system, particularly in access to secondary and tertiary education for students from low-income households.
- Address rising inequality adequately.



# Policy challenges in Malaysia



**Subsidies for petroleum products, 2011  
(percentage of GDP)**



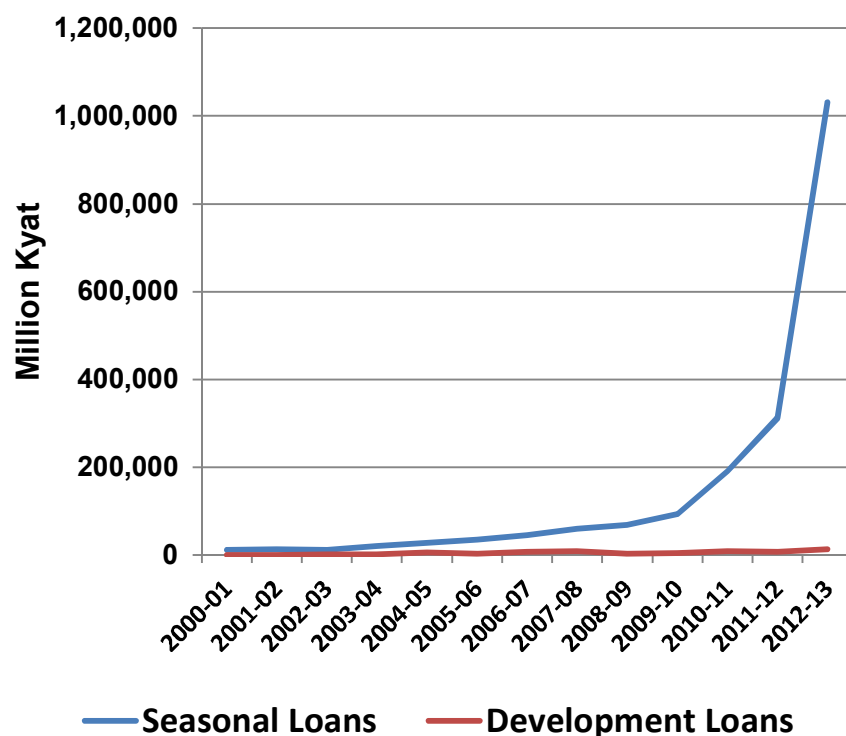
## Policy challenges of implementing the national plan in Malaysia

- Improve productivity to support sustainable economic growth and transform Malaysia into a high-income developed nation.
- Further develop ICT, which is particularly important in supporting growth.
- Enhance fiscal stability and reduce dependence on oil. The successful introduction of a goods and service tax (GST) is key to improving tax performance.

# Policy challenges in Myanmar



Myanmar Agriculture Development Bank's loans to farmers,  
2000-01 to 2012-13



## Policy challenges of implementing the national plan in Myanmar

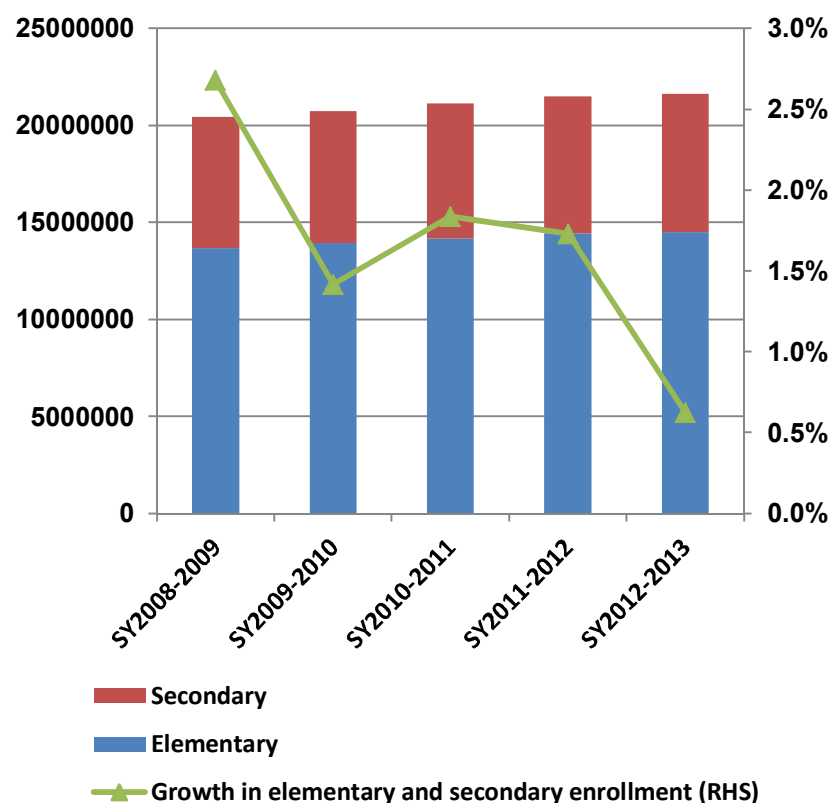
- Introduce reliable indicators, measurable goals, and measurements of government performance to make planning and monitoring effective, particularly in regulatory reform and public finance.
- Develop policy planning and budgeting, which includes appropriate financial supports in agriculture and education.
- Ensure co-operation with the private sector through PPPs, enable business start-ups, and foster civil society because all are important to Myanmar's on-going transition.



# Policy challenges in the Philippines



## Elementary and secondary enrolment rates, 2008-9 to 2012-13



Source: National Statistics Office, Department of Education, Philippines

## Policy challenges of implementing the national plan in Philippines

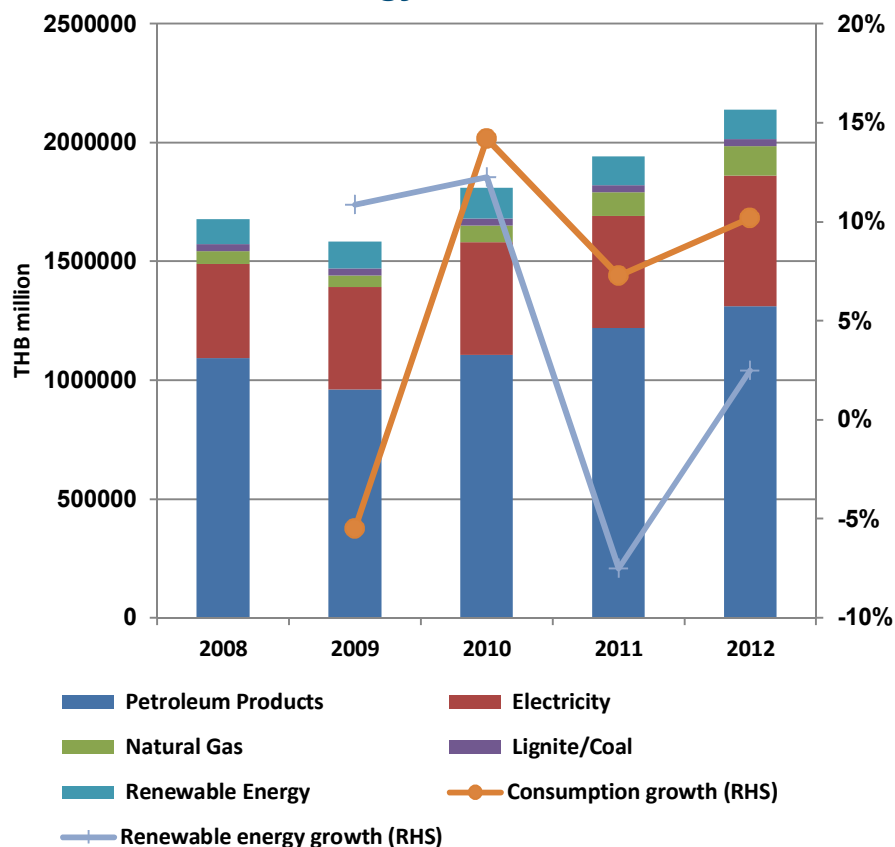
- Sustain economic growth by stepping up the country's global competitiveness through quality employment and increase value added from innovation.
- Strive to put in place a responsive, development-oriented, and inclusive financial system to serve as a platform for efficient management and the mobilisation of resources.
- Further improve social development to ensure all Filipinos benefit from equal opportunity when it comes to having a decent job, acquiring assets and enjoying higher living standards.



# Policy challenges in Thailand



Final energy consumption expenditure by energy source



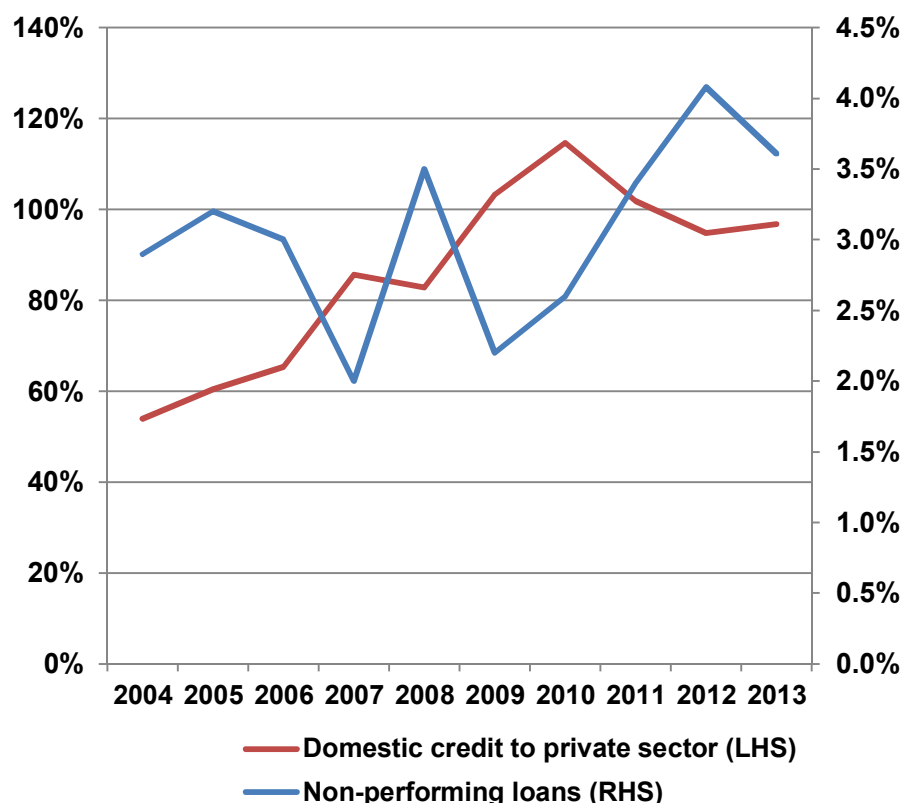
## Policy challenges of implementing the national plan in Thailand

- Ensure sustainable economic growth and improve competitiveness through accelerated progress towards certain targets and enhanced productivity.
- Support green growth through further efforts to improve environmental management.
- Improve governance – particularly with regard to corruption and transparency – so as to reduce obstacles to growth.

# Policy challenges in Viet Nam



Domestic credit to the private sector and non-performing loans, 2004-13



Note: Domestic credit figures represent annual averages, while NPL ratios represent monthly averages from December in the respective year.  
Sources: World Bank (2014), World Development Indicators, World Bank, Washington, DC; State Bank of Vietnam (2014), Statistics on the Performance of Credit Institutions, State Bank of Vietnam, Hanoi, [www.sbv.gov.vn](http://www.sbv.gov.vn).

## Policy challenges of implementing the national plan in Viet Nam

- **Maintain stability in key economic and social policy areas as a priority for implementing socio-economic strategies for the country.**
- **Address implementation gaps in developing high-tech industries and skills training in order not only to meet the medium-term plan's goals, but to make the 2020 vision of a modern, industrialised Viet Nam a reality.**

# Policy challenges in CLM



- **Dependency on external demand**
- **Specialization of labour intensive activities (diversification)**
- **Current account deficits**
- **Inflationary pressure**

# Public sector reforms have had a major impact on Emerging Asia



Numerous public sector reform (PSR) efforts have been made across a range of policy areas in Emerging Asia in recent decades, offering lessons on what makes for successful reforms

- **Public financial management**
  - Public expenditure management
  - Tax administration
- **Administrative reforms**
  - Organisational, including decentralisation
  - Civil service
  - Anti-corruption



## 2<sup>st</sup> session

# Strengthening Institutional Capacity

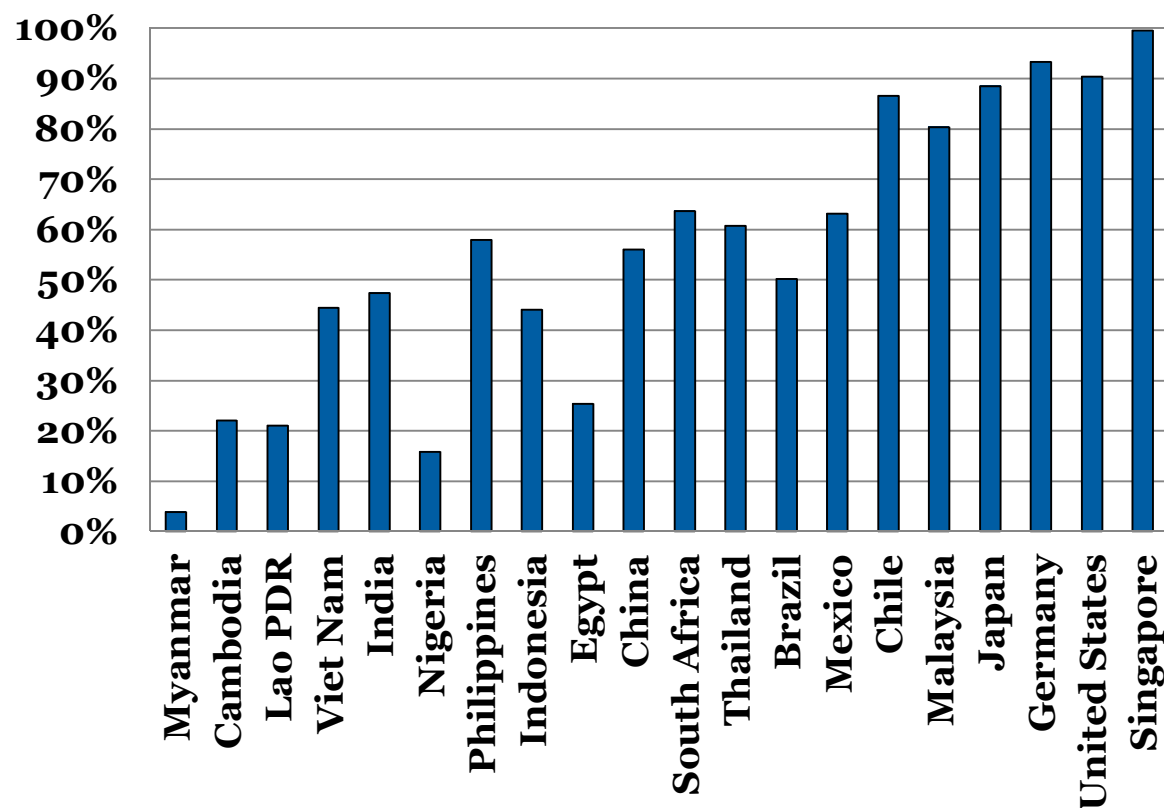
# Reform is still needed in Emerging Asia and other developing countries



- Indicators of institutional capacity are imperfect, but suggest the need for improvements in overall governance, budgeting, anti-corruption and other areas
- Government performance – by most measures – is roughly correlated with *per capita* income levels



Government Effectiveness Index percentile rankings, 2012



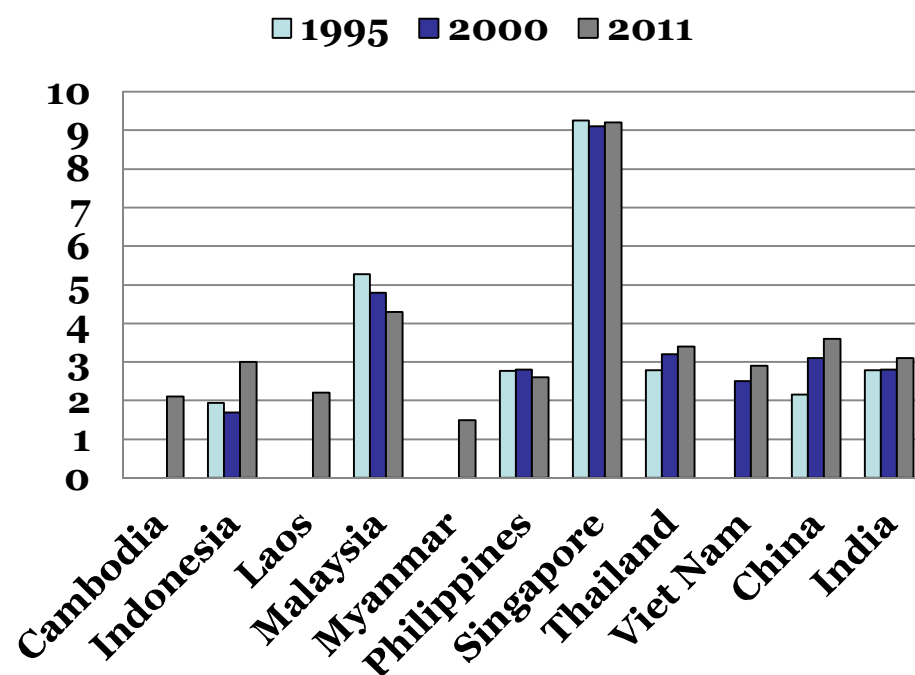
Notes: Figure shows percentile rank among all countries (ranging from 0 [lowest] to 100 [highest] ranks). Countries are arranged from lowest to highest *per capita* income at purchasing power parities. It reflects perceptions of the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies.

Source: World Bank (2014a), *World Governance Indicators* (database), World Bank, Washington, DC.

# Corruption is stubbornly high and extensive in most cases



Transparency International Index of Perceived Corruption, 1995-2011



**Note:** The Corruption Perception Index ranks countries and territories based on how corrupt their public sector is perceived to be. A country/territory's score indicates the perceived level of public sector corruption on a scale of 0 to 10, where 0 denotes "highly corrupt" and 10 "very clean". A country's rank indicates its position relative to the other countries and territories in the index.

**Source:** Transparency International, Corruption Perception Index 1995, 2000, 2011.

Percentage of survey respondents who think of national institutions as "corrupt" or "extremely corrupt", 2013

Percentage of those surveyed believing sector is corrupt or highly corrupt	Political Parties	Parliament /Legislature	Judiciary	Police	Public officials/ Civil servants
Cambodia	28	16	60	37	30
India	86	65	45	75	65
Indonesia	86	89	86	91	79
Malaysia	69	44	35	76	46
Philippines	58	52	56	69	64
Thailand	68	45	18	71	58
Viet Nam	27	28	53	72	55

**Source:** Transparency International (2013), Global Corruption Barometer 2013, Transparency International, Berlin, <http://www.transparency.org/research/gcb/overview>.



# Public sector reforms have a range of potential benefits



Economic benefits	Broader social / political benefits
<ul style="list-style-type: none"><li>• Encourage FDI</li><li>• Enhance fiscal stability</li><li>• Facilitate private sector development</li><li>• Improve efficiency of public service delivery</li><li>• Improve aggregate productivity</li><li>• Promote more rapid growth</li></ul>	<ul style="list-style-type: none"><li>• Improve government credibility</li><li>• Increase transparency and accountability</li><li>• Reduce poverty</li><li>• Encourage more inclusive development</li></ul>

Sources: OECD Development Centre's compilation.

# Financial reform efforts show the importance of commitment and pacing



- Tax administration reforms in Emerging Asia have tried to improve tax yields, lower the costs of compliance for firms and individuals, and improve fairness and transparency
  - Reform measures include the additional use of ICT in the administration or the streamlining of tax procedures (as in China's reforms to reduce compliance burdens on firms)
  - Indonesia's reforms in the wake of the 1997 Asian Financial Crisis included establishing large taxpayer and other specialised units, as well as improving training and incentives for staff
- Public expenditure management reforms can be very broad, involving most actors in the government, and can bring about extensive changes to the public sector
  - PEM reform measures include basing budgets on performance criteria and controlling expenditure disbursements through a single treasury account to improve government effectiveness and transparency/accountability
  - The success of PEM reforms is highly dependent on existing government capacities – advanced features like performance evaluations and other explicit mechanisms to tie pay to performance are missing or at an early stage of development except in Malaysia

# Administrative reforms have often proven challenging



- Civil service reforms need high-level political commitment where they challenge entrenched interests in the bureaucracy
  - Reforms to civil service recruitment and remuneration often face opposition and have had mixed results
  - New approaches to recruitment in China in the 1990s raised skill levels through competitive recruitment and other innovations, but compensation is still mostly linked to rank rather than responsibility there and elsewhere in the region
- Anti-corruption measures need to address multiple issues that contribute to the problem, including historical practices, opaque rules and compensation systems
  - Even well-designed organisations to fight corruption may be insufficient by themselves – Indonesia's Corruption Eradication Commission (KPK), for example, had some success in prosecuting corruption before a strong backlash from judicial and police officials
- Decentralisation is complex and has been particularly challenging to implement
  - Fairly systematic plans were used in Thailand, the Philippines and Viet Nam, but reforms in pursuit of economic goals (China) or as a rapid response to a crisis (Indonesia) were less successful

# Past experience with reform in the region offers useful lessons for the future



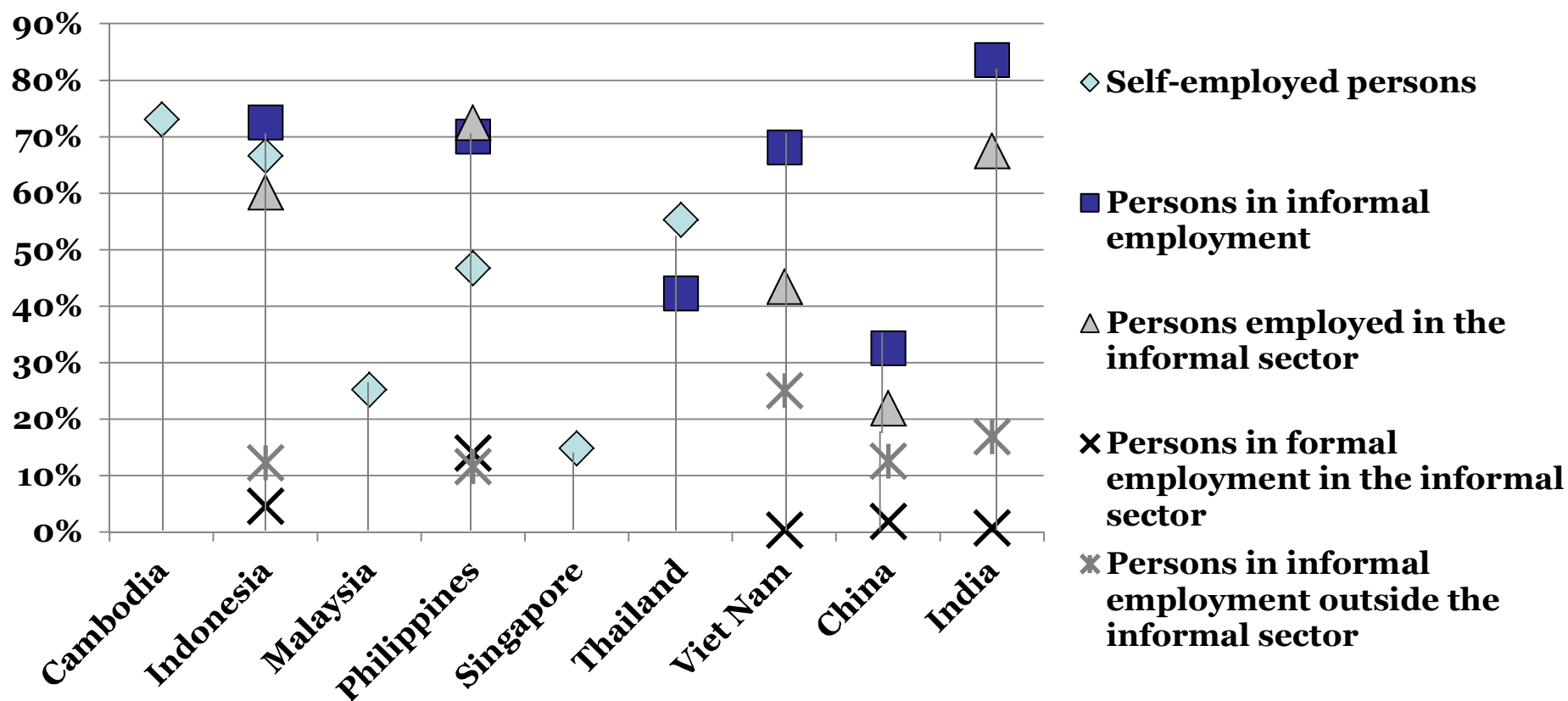
While there are no magic bullets for designing and implementing successful PSRs, experience in Emerging Asia suggests some guidelines

- PSRs need to be adapted to existing institutional capacities
  - Results-oriented budgeting likely to be a poor fit in countries at an early stage of development
- Beginning reforms with measures producing quick results can build support
  - Indonesian tax administration reforms began with efforts to improve tax collection to boost revenues in the near term
- Sustained political support is critical to success
  - Lack of commitment was the biggest obstacle to tax administration reform attempts in the Philippines
- The interests of key stakeholders often needs to be taken into account
  - Conflicting interests can pose barriers to reform, potentially requiring some compromise

# Informal employment has multiple definitions and measures



Informal employment as a share of total non-agricultural employment, by various measures



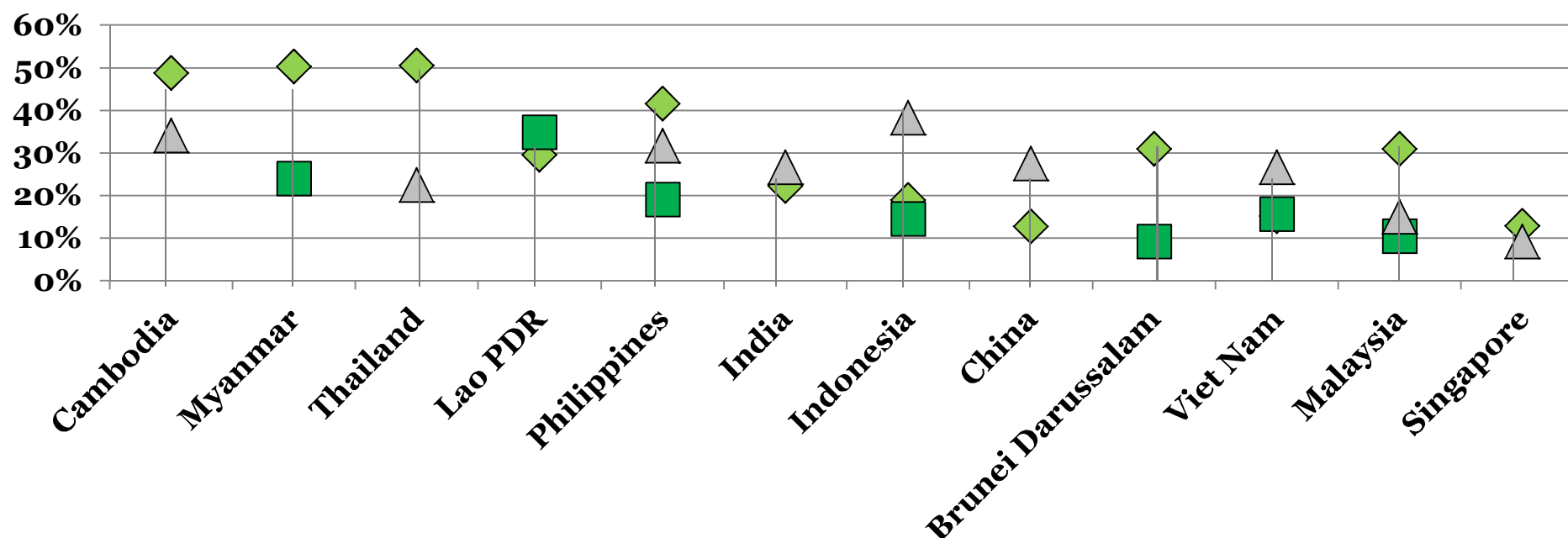
Note: All data from various years in 2008 – 2010.

Source: International Labour Organization (2010), *LABORSTA* (database), ILO, Geneva.

# Despite inconsistencies, differing measures of informal output show similar patterns



Informal output as a share of total output, by various measures



◆ Schneider, Buehn and Montenegro (2010) MIMIC estimates

■ Currency ratio estimates

△ WEF Executive Opinion Survey

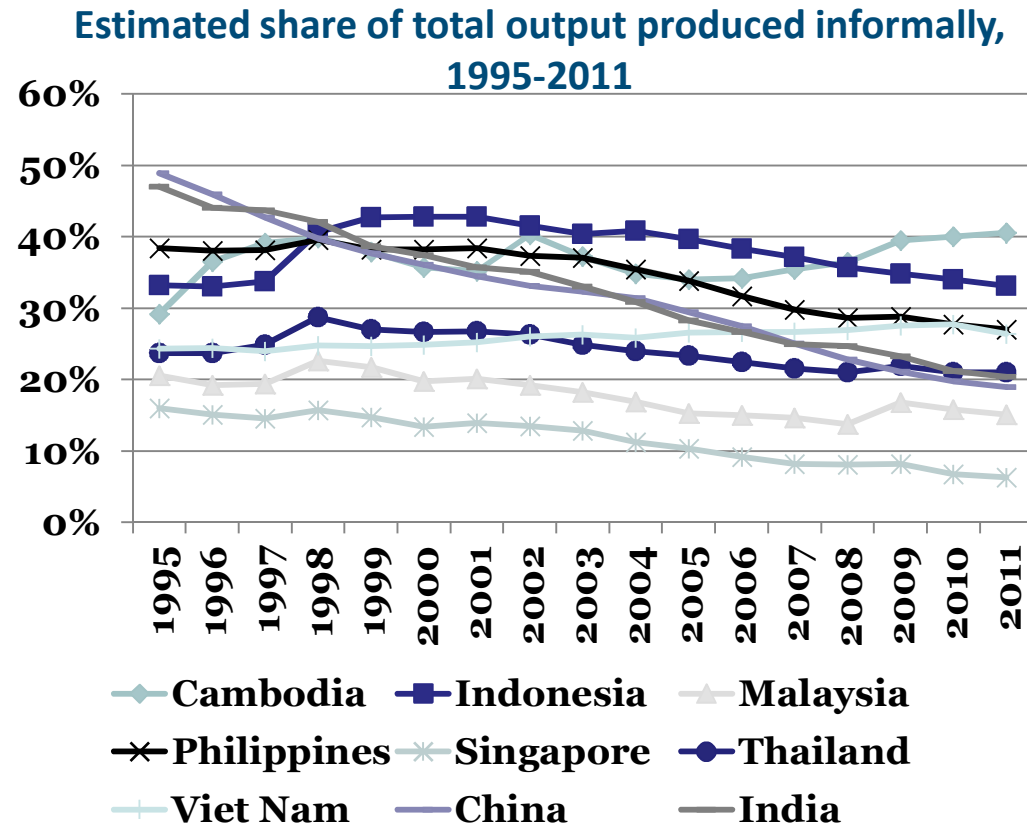
Note: Averages of 2000-2007 values from MIMIC and currency ratio estimations and 2006 survey results.

Sources: Schneider, Buehn and Montenegro (2010); WEF Executive Opinion Survey; OECD Development Centre

# Informality appears to be declining in most countries in Emerging Asia



- Self-employment and estimated non-reported output shares are generally falling across Emerging Asia
- Cyclical factors remain important over the short term – estimated informal output shares increased in many countries in the region following the 1997 Asian Financial Crisis



Note: Informal output shares estimated using WEF Executive Opinion Survey values for 2006, extended with growth rates estimated using the electricity consumption method. Estimates for Brunei Darussalam, Lao PDR and Myanmar are not available.

Sources: World Economic Forum (2006), *The Global Competitiveness Report 2006-2007*, World Economic Forum, New York; OECD Development Centre calculations.

# Tax and regulation, development, culture and other factors encourage informality



- Excessive tax and regulatory burdens may discourage formal production and employment
  - ... but these are not always much more constraining where informality is higher – the OECD's *Indicators of Employment Protection* show that labour market regulation in China, India and Indonesia is not much different from levels in some OECD countries
- Underdevelopment and inequality, particularly during periods of structural transformation can push workers and entrepreneurs into informality
  - Recent rural-urban migrants in Indonesia, for example, are often more likely to work informally and for lower wages than those settled longer
- Social norms can make firms and workers more willing to break rules, potentially creating a viscous cycle of informality
  - Better governance can change norms, however; the AsiaBarometer survey shows higher willingness to pay tax where trust in government is higher



# ... but quality institutions are a fundamental factor



- High-quality institutions and governance are needed for the formal sector to thrive
- At the same time, effective tax and regulatory enforcement discourage informality

Rule of law and share of informal production in total output, 2011



Notes: The PRS Rule of Law Index, which varies from 0 to 1, gives higher scores to countries where the legal system is strong and impartial and the law is popularly observed. Informal output shares estimated using WEF Executive Opinion Survey values for 2006, extended with growth rates estimated using the electricity consumption method.

Sources: Political Risk Services (2014), *International Country Risk Guide* (database), PRS, Syracuse; OECD Development Centre calculations.

# Governments can strengthen institutional capacities to encourage formalisation



Growth alone cannot be relied upon to reduce informality – comprehensive (broad and targeted) policy strategies are needed

- Institutional and judicial reforms can help strengthen the formal sector
  - Contract enforcement, protection of property rights among priority areas
- Encouraging formality through policies supportive of SMEs
  - Assistance with training, access to finance and tailored support services
- Tax, regulatory and administrative reforms can lower the cost of operating and working formally
  - Reformed tax structures and reduced red tape, addressing corruption
- Policies targeting informality should also be considered
  - Concessions and enhanced enforcement where informality is most prevalent

# Main messages



- **Medium-term growth prospects look favourable in Emerging Asia, averaging 6.5% per year over 2015-19, though risks to this outlook remain and continued regional integration is needed.**
- **National development plans in the region tend to identify priorities fairly well, but results in achieving targets are mixed, due to uneven capacities and effort.**
- **Recent public sector reforms in Emerging Asia have been most successful when they are adapted to existing capacities, paced appropriately, have ongoing support and do not seriously threaten the interests of key stakeholders.**
- **Informality poses a barrier to growth that requires comprehensive policy solutions raising the benefits of formality and lowering its costs.**