Economic Outlook for Southeast Asia, China and India 2014
BEYOND THE MIDDLE-INCOME TRAP
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BEYOND THE MIDDLE-INCOME TRAP
Foreword

The Economic Outlook for Southeast Asia, China and India is an annual publication on Asia's regional economic growth, development and regional integration process. 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 Outlook evolved from the Southeast Asian Economic Outlook.

The 2014 edition is designed to inform the debate on the challenges of the middle-income trap and key policies for avoiding it, while seeking to promote further economic and social integration across the region.

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. This project also benefited from the generous support of other Emerging Asian countries.

This Outlook is the result of policy dialogue and consultation at regional level, mainly in Singapore in July 2013, and country-based consultations in Asia in June-July 2013. It should be noted that the country-specific “Structural Policy Country Notes” in the Outlook were prepared after taking into consideration important determinants of economic growth and development mentioned in each country's medium-term economic development plans.

Like other regional economic outlooks produced by the OECD Development Centre, the report was prepared in collaboration with a regional partner, in this case 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

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The team was led by Kensuke Tanaka, Head of the Asia Desk and overall guidance was provided by Mario Pezzini, Director of the OECD Development Centre. This edition was drafted by a core team composed of Kensuke Tanaka, Gabor Fulop, Charles Pigott, Koon Hui Tee, Pitchaya Sirivunnabood, Anna Mae Tuazon and Rony Soerakoesoemah. Gabor Fulop managed statistical work related to the report. Nguyen Tu Anh, Stephanie Mak and Pang Eng Fong provided useful inputs in preparing the publication. Administrative support provided by Elisabeth Turner was highly appreciated. Selcuk Ozsahin, participant of the OECD Corporate Traineeship Programme, provided statistical assistance. Charles Pigott and Ken Kincaid provided extensive editorial advice and Quah Boon Haut provided useful comments on the draft.

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Elizabeth Nash, Delphine Grandrieux, Louise Schets, Vanda Legrandgerard and Studio Pykha turned the manuscript into the publication. Aida Buendia designed the cover page of the publication. Bochra Kriout, Naoko Kawaguchi and Yumiko Murakami, media and press relations, provided excellent support.

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Introduction

Emerging Asian economies continued to face headwinds during 2013 from sluggish growth in the global economy and turbulence in financial markets arising from the uncertainties surrounding the future monetary policies in major OECD countries. In the near term, economic growth is expected to improve gradually as domestic demand will continue to provide growth support, alongside gradual recovery in external demand. However, downside risks to growth and financial stability remain as there are signs that the surge in capital inflows into the region driven by international investors’ search for higher yields is beginning to reverse in response to an expected onset of the tapering of quantitative easing in the United States possibly in the latter part of 2013.

Economic growth prospects over the medium term nevertheless remain favourable. Real GDP growth in Emerging Asia should recover gradually from the slowdown in 2013 to achieve robust growth over 2014-18. In some cases, notably that of China, growth will be slower than during the years prior to the global financial crisis. On balance, growth in the medium term will be driven more by domestic demand, particularly private consumption. Exports growth is projected to be slower than in the past and the regional current account surplus should narrow appreciably in relation to GDP. Inflation rates are projected to remain low, or to fall in those cases where they are presently high, and fiscal deficits should decline, leading to stable or falling debt to GDP ratios.

The management of risks arising from fluctuating capital inflows will be a key challenge in the medium term. The scope for using capital controls to deal with surge in capital inflow – whose effectiveness is in any case limited in magnitude and duration – will become even more limited as Emerging Asian countries further liberalise their capital accounts. In the near and medium term, macro-prudential measures will be key instruments for containing the financial risks from large movements in capital flows.

More importantly, over the longer term, structural reforms will be the key to improve the benefits of capital flows and minimising their associated risks. Structural policy changes will be needed to sustain robust real economic growth. The various projects for economic integration in the Emerging Asian region promise to considerably reinforce and boost the efforts of individual countries to achieve their development goals. These regional integration efforts have reached a critical stage and their expected progress over the next several years is a positive factor in the favourable medium-term outlook for Emerging Asia.

Overview and main findings: The economic outlook for 2014-18

Real GDP growth in emerging Asian economies (Southeast Asia as well as China and India) should improve gradually and remain robust over the 2014-18 period, according to the results of the OECD Development Centre’s Medium Term Projection Framework for this Outlook (MPF-2014, see www.oecd.org/dev/asiapacific/mpf and Box 1.2 for more details). Growth in the Southeast Asian region is projected to average a robust rate of 5.4% per annum between 2014-18, comparable to the pre-global financial crisis period during 2000-07 (Table 1.1).
1. MEDIUM-TERM ECONOMIC OUTLOOK FOR EMERGING ASIA: PROSPECTS AND ASSESSMENTS

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

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<td><strong>2 large economies in Emerging Asia</strong></td>
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<td>China</td>
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Notes: The cut-off date for data is 6 September 2013. Emerging Asia includes ASEAN 10 countries plus China and India. *) Excludes Myanmar; **) Excludes Brunei Darussalam and Myanmar.

Source: OECD Development Centre, MPF-2014. For more detailed information of MPF, see www.oecd.org/dev/asiapacific/mpf. Emerging Asia includes ASEAN-10 countries, China and India.

Within the Southeast Asian economies, the growth projection for individual countries reflects their different stages of development and medium-term growth drivers. Indonesia is projected to be the fastest growing economy in the ASEAN-6 countries, followed by the Philippines, with average annual growth rates of 6.0% and 5.8% respectively over 2014-18. Notably, the projected medium-term growth rates in these two countries are considerably stronger than their average growth prior to the global financial crisis. The strong medium-term outlook for Indonesia and the Philippines will be underpinned by robust growth in domestic demand, as well as strong infrastructure spending and implementation of structural economic reforms.

Real GDP in Malaysia and Thailand is projected to grow by 5.1% and 4.9% per annum respectively over the period 2014-18, led by stronger growth in domestic demand especially in infrastructure investment and private consumption. While the projected growth rates for Malaysia and Thailand compare favourably to the growth for other developing countries at a similar stage of economic development, stronger productivity growth is needed for Malaysia and Thailand to sustain long-term growth beyond the “middle-income trap”. For Singapore, the economy is projected to grow by 3.3% over the period 2014-18, reflecting its more advanced stage of economic development and the economy’s shift towards more sustainable and inclusive growth, led by productivity growth and innovation.
The CLMV countries (i.e. Cambodia, Lao PDR, Myanmar and Viet Nam) are projected to grow at a robust pace over the medium term, led by Laos at 7.7% per annum. Real GDP growth in Cambodia and Myanmar is projected to average close to 7% growth per annum during 2014-18, underscoring its significant improvement in investment appeal as the country opens up to foreign investment. For Viet Nam, while real GDP growth is projected to remain healthy at 5.4% over the medium term, growth will be slower than prior to the global financial crisis owing to slower external demand from advanced economies. Weak macroeconomic management policies could pose downside risks to growth.

As a whole, Emerging Asian countries are expected to grow by a healthy rate of 6.9% by 2018, somewhat slower than the 8.6% registered before the global financial crisis (Figure 1.1). This slower growth largely reflects the moderated pace of expansion in the two large Emerging Asian economies of China and India. Notably for China, real GDP growth is expected to moderate to 7.5% by 2018 (compared to 10.5% during 2000-07) as the country rebalances its growth model towards consumption-driven growth. Implementation of structural reforms will be a crucial factor to steer the Chinese economy towards sustainable development and to allow it to move into a higher income bracket. Similarly, India’s growth is projected to moderate to 6.1% by 2018, compared to 7.1% during 2000-07.

Figure 1.1. GDP growth in Southeast Asia, China and India: Comparison between 2012 and 2018
Annual percentage change

Note: 2012 data for Myanmar are not included.
Source: OECD Development Centre, MPF-2014. The cut-off date for data is 6 September 2013.
StatLink™ http://dx.doi.org/10.1787/888932937168
The other main results of the MPF-2014, which are discussed in detail in the remainder of this chapter, are as follows.

- While real GDP growth in Emerging Asia will moderate gradually, it remains robust over the 2014-18 period.
- Domestic demand, particularly private consumption and investment, will be the main driver of growth in most cases. Most ASEAN-6 countries remain in current account surplus, while CLMV countries will remain in deficit in the medium term.
- Fiscal deficits will narrow in most countries, leading to stable or lower public debt to GDP ratios.
- Countries will face key macroeconomic policy challenges over the medium term from fluctuations in capital flows.

Recent macroeconomic developments and near-term prospects

Amidst external headwinds, growth momentum in Emerging Asian economies eased in the first half of 2013. In the near term, while domestic demand will continue to provide growth support, alongside gradual recovery in external demand, Emerging Asia will face a challenging macro environment. These include downside risks to growth and financial stability arising from a prospective reversal of capital inflows. Nevertheless, the underlying resilience in macroeconomic fundamentals remains intact, but policy makers in Emerging Asia will need to stay focused on implementing structural reforms to ensure sustainable economic growth over the medium term while dealing with near-term challenges.

Weakness in external demand continued to weigh on economic growth in Emerging Asia

The global economy continued to experience tepid growth in the first half of 2013. In the advanced economies, US GDP growth was moderate, while economic activity remains weak in the euro area. Persistent external headwinds have weighed on growth in emerging Asia. In China, real GDP growth slowed to 7.5% on a year-on-year basis in the second quarter of 2013, down from 7.7% in the first quarter and 7.9% in the fourth quarter of 2012. While the pace of China's economic growth has slowed, the risk of a hard landing remains low given the stable growth in domestic demand. India's economy has slowed even more, as growth eased to 4.4% year-on-year in the second quarter of 2013, its slowest pace in four years, partly owing to weak external demand that slowed export growth.

The slowdown in China coupled with tepid growth in the advanced economies have weakened the growth momentum of Southeast Asian economies, given that they are becoming more dependent on China as a key trading partner. In particular, Thailand, Southeast Asia's second-biggest economy, entered a technical recession for the first time since the global financial crisis, as real GDP contracted by 0.3% on a seasonally adjusted basis in the second quarter of 2013, following a revised 1.7% decline in the first quarter. Indonesia's real GDP growth slowed to 5.8% on a year-on-year basis in the second quarter of 2013, the first time that growth has dropped below 6.0% since the third quarter of 2010. In Malaysia and Viet Nam, while real GDP improved slightly in the second quarter of 2013, underlying growth momentum was subdued. On the other hand, Singapore's GDP grew at an accelerated pace of 3.8% year-on-year in the second quarter of 2013, up from 0.2% in the previous quarter, on the back of improvements in trade-related sectors as well as resilience in domestic-oriented sectors. The Philippines economy was the strongest performer, growing by 7.5% in the second quarter and matching the pace of growth recorded in China, largely thanks to its strong domestic demand.
Nevertheless, external demand should pick up as the global economy improves gradually in the near term. The latest OECD Development Centre’s Asian Business Cycle Indicators (ABCIs) suggest that although growth outlook is mixed across Emerging Asia, there are signs of growth stabilisation for China and a more positive outlook for the Philippines and Singapore (OECD, 2013a). However, the growth prospects for India are still weak (Figure 1.2).

While growth in domestic demand has moderated, it remains a key pillar of growth

Despite some moderation in its growth, domestic demand has remained resilient and a key pillar of growth in most Emerging Asian economies. In Indonesia and Malaysia, private consumption growth moderated slightly to 5.1% and 7.2% respectively in the second quarter of 2013, while Thailand’s private consumption eased sharply to 2.4%, down from 4.4% in the first quarter. In contrast, private consumption growth accelerated in the Philippines in the second quarter of 2013 partly owing to buoyant foreign remittance inflows. Overall, private consumption continued to be a key pillar of growth, accounting for more than half of the overall real GDP growth in half of 2013 in India, Malaysia and Viet Nam and more than a third of the growth for the China, Indonesia, Philippines, Singapore and Thailand (Figure 1.3).
Growth in retail sales is holding up across most countries in Emerging Asia, as consumer confidence remains broadly stable. Supported by rising disposable income, retail sales of consumer goods in China and Philippines remained buoyant. By contrast, retail sales in Thailand declined in the second quarter of 2013 and are expected to remain soft in the near term as consumer confidence has weakened amidst economic concerns. The consumer confidence index showed some stabilisation in July (Figure 1.4).

Note: * Data for China and Viet Nam refer to 2012. ** Data for China refer to 2012, ADB estimates.
Source: CEIC.
StatLink: [http://dx.doi.org/10.1787/888932937206](http://dx.doi.org/10.1787/888932937206)
Figure 1.4. Private consumption indicators


StatLink http://dx.doi.org/10.1787/888932937225
Financial market volatility and capital outflows have increased downside risks in the near term.

The key near-term downside risk facing Emerging Asia is volatility in the financial markets. The rise in global bond yields since May 2013, triggered by the prospects of a tapering of quantitative easing (QE) in the US, resulted in significant regional financial market turbulence during the June-August period, along with higher financing costs, capital outflows and sharp currency depreciations. Emerging Asian economies with large current account deficits and comparative vulnerability to capital outflows, such as India and Indonesia, bore the brunt of the financial turmoil (Figure 1.5). Moreover, fears of contagion risks rose with the sell-off in equities and spikes in sovereign bond spreads and credit default swap rates during the period May-August across Emerging Asia (Figure 1.6 and 1.7).

Figure 1.5. Current account balances and changes in nominal exchange rates

Source: OECD Development Centre calculation based on national sources.
StatLink http://dx.doi.org/10.1787/888932937244

Figure 1.6. Stock indices in Emerging Asia

Index, January 2011=100

Source: CEIC.
StatLink http://dx.doi.org/10.1787/888932937263
Emerging Asia should weather the turbulence, as underlying macroeconomic fundamentals remain intact

The financial turbulence buffeting Emerging Asia has heightened fears of contagion risks with concerns of impending economic crisis in the region, drawing parallels to past crises episodes such as the Asian Financial Crisis (AFC) of 1997-98 and India’s balance of payment crisis in 1991. Indeed, there are some signs of macroeconomic weaknesses, particularly in India and Indonesia, where persistent current account deficits warrant concerns. Nevertheless, the overall macroeconomic fundamentals in Emerging Asia are broadly favourable and should enable the region to weather the turbulence.

International reserves across Emerging Asia economies have generally increased since 2000, which will help to provide a buffer against external shocks¹ (Figure 1.8). More importantly, unlike the fixed exchange rate regimes and currency overvaluation which led to the AFC, the greater flexibility of exchange rates currently has reduced the risk of substantial currency misalignment and the need for central banks in Emerging Asia to use reserves to defend their currencies.³
Figure 1.8. International reserves position

Note: UNCTAD estimate for LAO PDR 2012.
Source: International Financial Statistics (IFS).
StatLink  | http://dx.doi.org/10.1787/888932937301
Growth stabilisation in China and recovery in advanced economies will help to bolster regional current account balances

To some extent, the prolonged weakness in external demand has weighed on the current account balance positions in Emerging Asia. In particular, given the increasing importance of China as a key trading partner, the slowdown in the Chinese economy has weighed on the export performance of Emerging Asian economies.

However, incoming indicators suggest signs of growth stabilisation in the near term and have allayed concerns of an imminent hard-landing in China. Industrial production picked up to 10.4% year-on-year in August 2013, the fastest pace of growth in 17 months. Industry profits rebounded in July 2013 as net income rose 12% on a year-on-year basis after gaining 6.3% in the previous month, exports grew by 5.1% on a year-on-year basis in July 2013, while imports gained 10.9%, after contracting by 3.1% and 0.7%, respectively, in June. The official Purchasing Managers’ Index (PMI) figure, published by China’s National Bureau of Statistics, rose to 51.0 in August 2013 from 50.3 in July, the highest level since April 2012. This coincided with continued improvement in China’s manufacturing PMI. Recent fine-tuning of government policy has begun to feed into improvement in domestic demand conditions and economic activities are likely to pick up in the near term. However the degree to which growth is becoming more balanced is not yet clear and the government is likely to focus on structural reforms to rebalance the economy (Box 1.1).

Box 1.1. Structural slowdown in China

China has been experiencing a growth slowdown, which saw its GDP growth moderating from 10.6% in 2010 to 7.8% last year and 7.6% in the first half of 2013. For the whole of 2013, the government’s official growth target at 7.5% would represent the slowest pace of growth since 1990. While growth appears to have stabilised, the government is unlikely to use massive fiscal stimulus policies in the short term.

Indeed, China will not make any major changes in its short-term macroeconomic policies and will make greater efforts to press ahead with structural reforms and rebalance its economy, driven by consumption and more inclusive growth. At the conclusion of a meeting of the State Council (China’s cabinet) in July 2013, Premier Li Keqiang announced three measures to support growth: i) a waiver of value-added and business taxes for select small and medium-sized enterprises (SMEs) (those with monthly sales below RMB 20 thousand (Chinese renminbi), or about USD 3.3 thousand) effective from 1 August; ii) support for exports through simplification of customs procedures, cuts in export taxes and fees, and maintenance of exchange rate stability; and iii) promotion of public-private partnerships to invest in railway and city subway systems. Separately, the State Agency for Foreign Exchange (SAFE) announced a simplification of administrative procedures for settlement of trade in services.

These measures are the latest sign of the government’s shift toward growth-supportive measures to achieve the 7.5% growth target for this year. Notably, the measures aim to improve efficiency, while avoiding large-scale stimulus spending given the limited scope for such measures and the continued focus on curtailing domestic financial excesses. Indeed, one of the policy priorities stated in the 12th Five Year Plan is to improve the provision of basic public services and deepening fiscal reform through improvements to transfer payments, budget management and tax systems. As will be discussed in Chapter 2 Structural Policy Country Notes, while China has made progress in these areas, it can do more to streamline administrative efficiency and accelerate budgetary reform.
In addition, the incipient economic recovery in the advanced economies will also provide support to exports from Emerging Asian economies. The US economy expanded at a 2.5% annualised rate in the second quarter of 2013, up from 1.1% in the preceding quarter. The euro area exited its worst recession on record, with euro area GDP growing by 0.3% in the second quarter of 2013. In Japan, the economy expanded for the third consecutive quarter, with GDP growing at an annualised rate of 2.6% in the second quarter of 2012. Moreover, Japan's consumer price index increased at the fastest pace since 2008 in July 2013, adding to signs that “Abenomics” is making progress in pulling the economy out of 15 years of deflation. Indeed, the OECD Composite Leading Indicators (CLI) point to economic growth outlook firming in the US and to growth above trend in Japan. In the euro area as a whole, the CLI continues to indicate a gain in growth momentum.4

Capital outflows and currency depreciation pose macroeconomic management dilemmas

Inflationary pressures are generally modest across most countries in Emerging Asia. In Singapore, the year-on-year growth in the overall consumer price index (CPI) has been below 2% since April 2013, while CPI inflation for China, Malaysia, Thailand and Philippines is hovering around 2%. By contrast, the headline CPI inflation in India and Indonesia surged to 9.6% and 8.6% respectively in July 2013, following measures to reduce fuel subsidies in a bid to narrow their current account deficits (Figure 1.9). However, core CPI inflation in India and Indonesia is lower, at 7.7% and 4.4% respectively.

While monetary policy ideally should remain accommodative given the modest inflationary pressures in most countries and the moderation of economic growth, capital outflows and currency depreciation will constrain policy options. Indeed, rapid currency depreciation can be destabilising to the economy and create inflation pressures. In addition, global oil prices will remain volatile should there be renewed tension in the Middle East. These external events have added to uncertainty about inflation and pose policy dilemmas in the region in the near term.

Against this backdrop, policy responses differ across countries in Emerging Asia. India and Indonesia, which are running large current account deficits and experiencing the greatest currency depreciation pressures, have tightened their monetary policies. The Reserve Bank of India (RBI) introduced measures in July to tighten liquidity in an effort to stem the rupee's decline.5 Bank Indonesia raised its benchmark interest rate by half a percentage point to 7% in an unscheduled move on 29 August. It also raised the deposit facility rate by half a point to 5.25%. By contrast, other countries in the region have largely maintained their monetary policy stance (Figure 1.10).
### Figure 1.9. Consumer price inflation

**Year-on-year percentage change**

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<td>Cambodia</td>
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<tr>
<td>Malaysia</td>
<td>Medium grey</td>
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<tr>
<td>Myanmar</td>
<td>Dotted</td>
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<tr>
<td>Philippines</td>
<td>Dark blue</td>
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<tr>
<td>Singapore</td>
<td>Gray</td>
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<tr>
<td>Thailand</td>
<td>Gray dashed</td>
</tr>
<tr>
<td>Viet Nam</td>
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<tr>
<td>China</td>
<td>Black</td>
</tr>
<tr>
<td>India</td>
<td>Black dashed</td>
</tr>
</tbody>
</table>

**Notes:**
- For Brunei core inflation refers to weighted average of Non-Food and Non-Housing, -Water, -Electricity, -Gas & -Other Fuels and Non-Transport consumer prices.
- For Cambodia core inflation refers to weighted average of Non-Food and Non-Housing & -Utilities and Non-Transportation consumer prices.
- For Malaysia core inflation refers to weighted average of Non-Food and Non-Housing, -Water, -Electricity, -Gas & -Other Fuels consumer prices.
- For Myanmar core inflation refers to simple average of Non-Food and Non-Fuel & -Light consumer prices.
- For Singapore the core inflation measure of the Monetary Authority of Singapore (MAS) monitors excludes the components of “Accommodation” and “Private Road Transport”.
- For Viet Nam core inflation refers to weighted average of Non-Foods & -Foodstuffs and Non-Transportation consumer prices.
- For India core inflation refers to weighted average of Non-Food, -Beverages & -Tobacco and Non-Fuel & -Light 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 consumer prices.

**Sources:** CEIC and Datastream.

StatLink: [http://dx.doi.org/10.1787/888932937320](http://dx.doi.org/10.1787/888932937320)
Macroeconomic management should focus on boosting medium-term growth prospects

Policy makers will face further policy conflicts in the event of a prolongation of capital outflows and/or currency depreciation pressures. Significant tightening of macroeconomic policies to stem currency depreciation will dampen economic growth. For Indonesia, although the moderation in GDP growth this year has been comparatively milder and private consumption remains robust, a sharp increase in interest rates could aggravate the weakness in investment, which has slowed for four consecutive quarters since the third quarter of 2012. India faces an even greater dilemma, as the authorities cannot afford to tighten macroeconomic policy significantly further given the already brittle economy.

Use of capital controls, such as those deployed by India in July 2013 to restrict the amount of investment which its citizens and companies can invest overseas, also poses risks. Imposition of such capital controls can damage the confidence of foreign investors and discourage foreign direct investment, which would be detrimental to medium-term growth prospects.

Hence, management of capital flows will continue to be one of the key medium-term policy challenges facing Emerging Asia. Indeed, as discussed later in this Chapter, it will be imperative for policy makers to step up efforts to implement structural reforms and to liberalise regulatory regimes to boost their medium-and long-term growth potential.
Medium-term growth prospects: greater reliance on domestic demand for growth

The results of the MPF-2014 indicate that while growth will continue to be robust over the medium term, it will be driven more by domestic demand and less by (net) exports than was the case prior to the global financial crisis. The shift in the composition of growth will be accompanied by lower current account surpluses in relation to GDP of the Southeast Asia region, while China’s surplus will remain noticeably lower relative to GDP than in the years prior to the global financial crisis. Inflation is projected to remain moderate in most cases, or fall back to moderate levels in the Lao PDR, Viet Nam and India. Government budget deficits are likely to be moderate on average in relation to GDP, and declining in some cases, leading to stable or falling public debt ratios to GDP (Box 1.2).

Box 1.2. Key assumptions of the medium-term outlook until 2018

- Output gaps – the gap between actual and potential GDP – will converge to zero by 2018.
- Exchange rates of most Emerging Asian economies will gradually appreciate (against the USD) through 2018.
- Inflation-targeting countries will continue to pursue price stability and adjust monetary policies to support their target.
- Regional economic integration initiatives and projects remain on track.
- The various five-year plans of Emerging Asian countries will largely be implemented, where feasible, subject to budgetary and other policy considerations (see Chapter 2 Structural Country Notes for reference).
- The cut-off date of data for MPF-2014 is 6 September 2013. For more detailed information on MPF, see www.oecd.org/dev/asiapacific/mpf.

Private consumption will provide a key support for domestic demand

Growth of private consumption will continue to be robust and a key contributor to overall GDP growth over the medium term across most countries in Emerging Asia. China is projected to post the fastest growth in private consumption, at 8.9% annually over the period 2014-18, as the economy continues to rebalance its growth model towards consumption-driven growth. This growth is substantially faster than 6.7% per annum registered prior to the global financial crisis during 2000-07. Private consumption growth in India is also projected to be strong, averaging 6.3% during 2014-18, the same pace of growth as recorded prior to the global financial crisis (Figure 1.11).
Within the Southeast Asian economies, private consumption growth is projected to remain buoyant at 5.1% per annum during 2014-18. Malaysia and the Philippines are projected to post the fastest rate of private consumption growth at 6.7% and 6.0% respectively, followed by Viet Nam at 5.8%. Elsewhere, private consumption growth will also remain robust in Indonesia and Thailand at 5.0% and 4.6% respectively during 2014-18. In particular, private consumption in Indonesia and the Philippines will grow at a faster clip compared to before the global financial crisis.

Labour markets in Emerging Asia are expected to remain relatively tight and this will help to continue to support growth in wages and private consumption. Macroeconomic policies have also helped to support private consumption growth by providing price stability over the medium term. Moreover, reinforcing structural factors are becoming important drivers of private consumption growth. Indeed, as noted in the 2013 edition of the Outlook (OECD, 2013b), the rise of the middle class, especially in China and India but also broadly across Southeast Asian countries, will help to boost spending on household durables and automobiles as well as education and health services.

More importantly, government policies will play an increasingly critical role in driving sustainable growth in private consumption over the medium term. The rise of the middle class will be intertwined with the continued shift of the industry structure in Emerging Asia towards services sectors. Recognising this, policy makers across Emerging Asia have taken steps to liberalise the services sectors, but there is still scope for further regulatory reforms.
Fiscal reforms to enhance transfer payments, budget management, and tax systems can also help to support consumption. As noted in the Structural Policy Country Note in Chapter 2, the Chinese government has planned several fiscal reforms in the areas of tax, budget and transfer payments as a key priority area under the 12th Five Year Plan. Such fiscal reforms will help to make government more efficient in providing adequate public services. Government redirection of resources to social welfare programmes can increase late household consumption by reducing discretionary level of precautionary savings (HSBC, 2013). Similarly, across Southeast Asian countries, increasing government spending on health and social safety-net programmes will continue to encourage consumption spending by freeing up household resources and by reducing their need for precautionary saving (OECD, 2011).

Government policies to narrow income gaps and promote more inclusive growth can also help to support sustainable growth in private consumption. For example, in India consumption growth in rural areas has grown at a faster pace than in urban areas. Rural consumption has been underpinned by strong increases in rural incomes owing to rising non-farm employment opportunities and the government’s focus on employment generation schemes such as the Mahatma Gandhi National Rural Employment Scheme. Cash payments and/or subsidies to poorer households have also been increased in the Philippines and Malaysia, while Singapore has increased its “in-work” income supplement for low wage workers as well as support for those who are unable to work. Private consumption in Malaysia and Thailand will also be supported by increases in wages of public workers and in statutory minimum wage rates for the private sector.

**Investment growth will remain robust**

Investment is projected to remain robust in Emerging Asia over the period 2014-18 at 6.6% per annum. In the Southeast Asian region, investment growth is projected to be healthy in the next five years at 6.3% per annum, with Indonesia and Philippines growing at faster pace compared to the pre-global financial crisis (Figure 1.12). However investment growth in China is projected to moderate during 2014-18, as structural policies and other factors favouring greater dependence on consumption take hold. Investment growth in India is also projected to be slower over 2014-18 than during 2000-07, partly reflecting government budgetary constraints and uncertainties over prospects for further reforms.
Government infrastructure spending continues to contribute considerably to overall investment growth across the Southeast Asia countries. In Indonesia, infrastructure remains a top priority under the Master Plan for Acceleration and Expansion of Indonesia’s Economic Development (MP3EI), which calls for investment in infrastructure projects in six economic corridors. In Malaysia, the government’s Economic Transformation Programme (ETP) to develop higher value-added industries and infrastructure will continue to support infrastructure spending. Under the Philippine Development Plan, the government plan to increase infrastructure spending to around 5% of GDP by 2016, as it allocates more funds to build roads, railways, airports and bridges to support its goal of inclusive and sustainable growth. Thailand is also aggressively pursuing infrastructure improvements, and has recently rolled out ambitious development plans to invest THB 5.5 trillion (Thai baht) (USD 179 billion) – 20% of Thailand’s GDP – on new roads, rail networks and other projects over the next seven years (Credit Suisse, 2013).

More importantly, private investment will be the key to sustained growth in overall investment. Private-public partnership (PPP) programmes will play an increasingly critical role in infrastructure projects across the Emerging Asian economies. In Indonesia, 32 out of 79 infrastructure projects in the MP3EI are listed as PPP and this form of infrastructure programme will be increasingly prominent along the Economic Corridors of the MP3EI (Strategic Asia, 2012). Similarly, the Malaysian government has introduced several strategies to accelerate investment including enhancing private-public sector collaboration to increase the inflow of investments over the medium term. In the Philippines, the government has prioritised PPP projects, including the construction of medical, power, education and transport infrastructure, to complement the current construction projects in road and schools and provide support for growth in private investment (Standard Chartered, 2013).
The Emerging Asian region’s resilient macroeconomic fundamentals are an important competitive advantage in attracting Foreign Direct Investment (FDI). Over the medium term, this competitive advantage will help to sustain strong FDI inflows into the region and to support growth in domestic investment. FDI inflows into Emerging Asia as a share of global FDI inflows have increased steadily in the past five years, from 13.3% in 2007 to 25.0% in 2012 (Figure 1.13). China and Singapore were the second and eighth largest FDI recipients globally in 2012, while India and Indonesia were also among the top 20. Driven by continued intra-regional restructuring in manufacturing, lower-income countries such as Cambodia, Myanmar, the Philippines and Viet Nam were attractive FDI locations for labour-intensive manufacturing (UNCTAD, 2013).

![Figure 1.13. FDI inflows in Emerging Asia](image)

**Notes:** China includes Mainland, Chinese Taipei, Macao and Hong Kong. Southeast Asia does not include Timor-Leste.


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**Current account surpluses will narrow while net capital inflows remain strong**

The current account surpluses in most of the Emerging Asian economies are projected to remain broadly stable or to decline over the next five years as domestic demand becomes the key driver of overall growth. The current account surplus in China is projected to nearly halve from 2.3% of GDP in 2012 to 1.2% of GDP by 2018, as the country rebalance its growth towards consumption-led growth. India’s current account deficit is projected to decline moderately from 5.0% of GDP in 2012 to 3.4% of GDP in 2018 (Figure 1.14).

In Southeast Asia, the overall current account surplus is projected to lower from 5.5% of GDP in 2012 to 4.4% of GDP by 2018. This largely reflects the projected lower current account surplus for Brunei Darussalam, Malaysia, Singapore and the Philippines. For Indonesia, the current account deficit is projected to remain stable at 2.8% of GDP in 2018. The CLMV countries, particularly Cambodia, Lao PDR and Myanmar are projected to continue to run current account deficits through 2018, although they should narrow.
Macroeconomic policies will support robust growth

The favourable economic growth outlook assumes that macroeconomic policies will continue to be effective. In particular, the projection framework assumes that monetary policies will continue to help to sustain price stability consistent with central bank targets in across most Southeast Asian economies as well as China, and to progressively reduce inflation rates in India, Indonesia and Viet Nam, where they have been comparatively high.

On the fiscal front, according to officially announced budget plans, some countries in the region will continue to reduce their fiscal deficits, although at a somewhat more moderate pace than recently (Figure 1.15). Singapore is the only country projected to continue to run a fiscal surplus. Malaysia, which suffered a downgrade in its international credit rating in 2013 owing to a surge in its budget deficit, is projected to reduce the deficit to 4.5% of GDP during 2014-18, compared to about 4.7% during 2000-07.8 However, the fiscal deficit in India is projected to remain considerable at 8.0% of GDP.

Notes: ASEAN-6 average includes Brunei, Indonesia, Malaysia, the Philippines, Singapore, Thailand. CLMV average includes Cambodia, Lao PDR, Myanmar, Viet Nam. Emerging Asia average includes all ASEAN countries and China and India. Owing to data availability country averages for 2000-07 do not include Brunei and Myanmar.

Source: OECD Development Centre, MPF-2014.

StatLink http://dx.doi.org/10.1787/888932937415
A. Fiscal balance *

Budget consolidation in most of the Emerging Asian countries is thus projected to be gradual and relatively limited. Consolidation via containing increases in budget expenditure remains a challenge for the region given their ambitious infrastructure development plans. Greater PPP financing of infrastructure spending will help to alleviate the burden on government financing. Hence, as will be discussed later in this chapter, it is imperative for governments to focus on implementing structural policies to enhance FDI and to reap the benefits of capital inflows.

The medium-term economic outlook is subject to both upside and downside risks

The medium-term economic projection for Emerging Asia is subject to developments on both external and domestic fronts.

- More prolonged economic weakness in the euro area and the United States would moderate the projected robust real growth in Emerging Asia to some extent.
- Renewed inflationary pressures from food, oil and other commodity prices could re-emerge as a result of the severe droughts in major farming regions and geopolitical tensions surrounding Middle East oil producers. Rising commodity prices could add to inflationary pressures in Emerging Asia and constrain the space for monetary easing to cushion weakness in external demand. Surges in commodity prices could also complicate budget consolidation efforts in those countries where commodity subsidies are now comparatively large.
• Severe financial volatility could arise if there is a disorderly exit from QE in the advanced economies. This could raise macroeconomic risks and aggravate volatility in capital flows and currency depreciation pressures and pose challenging policy dilemmas.

• On the domestic front, slower or ineffective implementation of economic reforms and projects would moderate the projected strong medium-term growth. For example, widespread delays in infrastructure projects, particularly in Indonesia, the Philippines and India, would lead to lower than projected growth, while a slower pace in economic reforms will limit investment growth and productivity gains. On the other hand, should the implementation of such reforms and projects surprise on the upside, the benefits to productivity and growth would be greater than now projected.

Key policy challenges to sustaining healthy growth in the medium term

The success of Emerging Asian countries in realising their favourable medium-term growth and development prospects will hinge on the management of several key challenges. To harness their growth potential, it is critical for policy makers to implement structural policies, liberalise regulatory regimes, particularly in the services sectors, and foster greater economic co-operation and integration.

• Managing the spillover effects of capital flows will continue to be an important policy challenge. Governments should focus on implementing structural policies to reap the benefits of capital inflows and greater regional co-ordination to deal with capital flows.

• Governments in ASEAN need to step up efforts to ensure that economic integration remains on track.

The spillover impacts of quantitative easing on capital flows will need to be managed

Capital mobility is a key component of international finance. Capital flows allow for savings to be channelled from surplus countries to deficit countries, thus supporting long-term economic growth through better allocation of saving and investment. However, if not managed properly, large international capital flows can make the receiving countries vulnerable to various types of financial risks and pose several important policy challenges.

Since the aftermath of the global financial crisis, the advanced economies have pursued large scale expansionary policies to help stabilise financial markets and promote growth. In particular, the United States Federal Reserve has launched three rounds of unprecedented large-scale quantitative easing policies resulting in a huge expansion of its balance sheet.

Some have argued that these large scale quantitative easing policies were primarily responsible for large flows of capital to the Emerging Asian economies that followed. These inflows have led to problematic spillover effects on export competitiveness on these countries and posed financial risks. However, in the early part of the third quarter of 2013, the landscape has changed swiftly. Capital outflows have increased across emerging Asian economies amidst signs of slower growth in the region and rising expectations over the impending exit from quantitative easing in the United States.
Against this backdrop, management of international capital flows while ensuring sustainable economic growth will continue to be a key medium-term macroeconomic policy challenge facing Emerging Asian economies. Sharp reversals or “sudden stops” in capital inflows also present danger to the macroeconomy. These risks have sparked renewed policy interest and debate on the use of capital controls.

The ebb and flows of capital movements will pose important policy challenges over the medium term

Capital inflows into the Emerging Asian economies can be viewed as driven by factors which are internal to the economies receiving the flows (“pull” factors) and external to those economies (“push” factors) (Figure 1.16). Pull factors are the conditions which help determine the attractiveness to international investors of directing capital inflows towards Emerging Asia. These include domestic monetary and financial conditions, steps towards financial liberalisation and political stability.

However, the recent drivers of capital inflows have mostly been characterised by push factors. Monetary policy since the global financial crisis has remained unusually expansionary in the advanced economies and interest rates are at historically low levels. Furthermore, central banks in the advanced economies have flooded markets with liquidity. These conditions have pushed investors to seek more profitable investment opportunities in emerging markets, particularly in periods when investors overall tolerance for risk is relatively high. Overall, differentials in real growth and interest rates between emerging and advanced economies along with the global risk appetite of investors have been statistically and economically important determinants of net private capital inflows into emerging economies, including Emerging Asian economies (Ahmed and Zlate, 2013).
Large capital inflows can have several problematic spillover effects on the receiving countries. First, they tend to exert upward pressure on real exchange rates which, if it persists, can undermine export competitiveness. Second, as highlighted in the 2013 edition of the Outlook, capital inflow surges ("capital bonanzas") can be an important driver of domestic credit booms (OECD, 2013b). The evidence discussed there indicates that surges in cross-border lending by foreigners tend to increase the probability of an onset of a credit boom. Countries which have less developed financial markets as well as limited competition in the domestic banking sector tend to be most prone to credit booms from capital inflow surges.

Third, persistent capital inflows can trigger and prolong asset price bubbles and amplify financial risks. Recent housing price increases in emerging Asian economies are partly attributable to the large capital inflows that have accompanied the prolonged quantitative easing policies in advanced economies. In addition, the danger of a sudden stop of capital inflows and a retrenchment of investors threatens not only growth prospects, but could lead to banking sector distress (Gerlach and Tillmann, 2011).

In essence, the ebb and flows of capital movements posed important policy challenges over the medium term. Conventional macroeconomic tools seem to offer limited effectiveness in managing large capital inflows. In particular, it is becoming increasingly difficult to prevent movement in capital flows from fluctuation in the exchange rate while maintaining domestic monetary policy control, as capital accounts have become more liberalised (Box 1.3). Allowing the exchange rate to fluctuate is often the best way to cope with large capital flows (this is the usual response of most developed countries), but Emerging Asian economies are typically reluctant to allow a significant real appreciation of their currencies for fear of adverse consequences on their export competitiveness; conversely sharp currency depreciation can destabilise financial markets and add to inflationary pressure. In view of this limited policy space, some Emerging Asian economies have introduced macroprudential and other regulatory measures to influence capital inflows and foreign exchange positions in the post-global financial crisis era.

Macrounprudential measures can be useful but the scope for capital controls is declining

Policy responses to capital flows undertaken by Emerging Asian economies largely aim to safeguard macroeconomic and financial stability by managing large capital inflows and pre-empting the build-up of financial vulnerabilities in specific sectors. These involve the use of: i) macroeconomic measures (such as greater exchange rate flexibility); and ii) other macroprudential and capital flow management measures (CFMs). The CFMs can be system-wide (such as limits on foreign currency lending and net open currency positions) or sector-specific measures (such as caps on Loan-to-Value (LTV) ratios and Debt-to-Income (DTI) ratio).
Box 1.3. **Capital account openness across Emerging Asian economies**

Capital account openness varies across emerging Asian economies. This variation is illustrated by the *de jure* index of financial openness constructed by Chinn and Ito (2008) based on the International Monetary Fund (IMF)'s *Annual Report on Exchange Arrangements and Exchange Restrictions*, where a higher index value indicates greater openness (see figure below). Except for Singapore, most Emerging Asian economies maintain various controls on cross-border capital flows, though many are substantially open with respect to foreign direct investment inflows and to portfolio inflows through purchases by non-residents of domestic securities.

![Degree of capital account openness](image)

**Degree of capital account openness**

*De jure* index of financial openness

Source: Chinn-Ito Index based on the IMF’s Annual Report on Exchange Arrangements and Exchange Restrictions, where a higher index value indicates greater openness.

[StatLink](http://dx.doi.org/10.1787/888932937472)

Other, *de facto*, measures of capital account openness are broadly consistent with the *de jure* indices. Lane and Milesi-Ferretti (2006) developed a volume-based measure of international financial integration, defined as the ratio of the stock of assets and liabilities to GDP. Kawai and Lamberte (2012) updated data for 2005 and 2009 by using the IMF’s *International Financial Statistics* stock data, where available, or capital flow data, where stock data are not available. For Asia, the ratio generally rose for all economies from 1990 to 2009.

The use of macroprudential and other regulatory measures to manage the effects of capital flows is fairly recent, although most of the specific instruments have long been used to address other domestic financial risk factors. As discussed further in Chapter 3, Emerging Asian countries have greatly strengthened their frameworks for macroprudential oversight since 1997. Three main categories of instruments are usually distinguished based on the source of the risks they are intended to address, namely credit, liquidity and capital-related measures. The distinctions may be somewhat more ambiguous in practice (see for example IMF, 2012a).
Thus far, Emerging Asian economies have largely pursued macroeconomic measures (such as greater exchange rate flexibility) and macroprudential measures and other CFM measures to deal with the effects of capital inflows. Against the backdrop of rising housing prices and the associated prudential concerns, credit-related measures (LTV and DTI caps), property-related taxes and capital-related measures have been commonly used across emerging Asian economies (Table 1.2). While administrative measures such as the imposition of minimum holding periods have been adopted (for example in Indonesia), these economies have not deployed market-based measures such as a Tobin tax.

Table 1.2. Macroprudential and other CFM measures undertaken by selected Emerging Asian economies

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In assessing the prospective usefulness of regulatory measures aim at limiting capital inflows or what the IMF (2011) calls capital flow management measures, it is important to bear in mind the following considerations for Emerging Asian economies (see Kawai and Lamberte, 2012).

First, ASEAN member states are committed to creating an ASEAN Economic Community (AEC) by 2015, which is defined to be a region characterised by free movement of goods, services, and investment and freer movement of capital. It is difficult for any of these countries to reverse the process of capital account liberalisation by introducing new barriers to capital mobility except during an emergency on a temporary basis. Indeed, the low degree of capital account openness in some ASEAN countries implies that they may have to undertake substantial capital account liberalisation relatively quickly and must do in a manner consistent with the ultimate requirements of AEC.
Second, Singapore, as a major international financial centre, cannot afford to take measures to restrict the freedom of international investors to move funds across borders. Given the depth of its financial market and the robust regulatory regime in place, the use of CFMs is probably not necessary except during a crisis. The other Emerging Asian economies have maintained some restrictions on capital inflows, with tighter controls on outflows. Even Indonesia, arguably the most financially open economy in the rest of the region, is known to subject banking flows to tight control.

Third, China and India still maintain extensive restrictions on capital inflows (as well as on capital outflows). For these countries, use of capital controls only represents a reversal of the gradual capital account liberalisation process. For the CLMV countries, Viet Nam, to some extent, still maintains restrictions on capital flows; Cambodia and the Lao PDR have virtually no domestic financial markets, while Myanmar’s capital account is closed.

These considerations suggest that: i) use of outright capital controls (or what the IMF (2011) calls residency-based CFMs) is feasible for only for a handful of emerging Asian economies (e.g. Indonesia, Malaysia, the Philippines and Thailand); ii) purchases by non-residents of domestic securities are the main (or the only) target of any potential CFMs; and iii) the use of outright capital controls (that explicitly discriminate against foreign investors) is increasingly ruled out as a feasible policy option, especially if it is pursued by individual countries. This last point is highlighted by the types of measures that have been introduced by some of these countries recently to limit capital inflows or inflow volatility. Except for the Indian measure, the other measures (introduced by Indonesia and Thailand) are carefully designed not to discriminate against foreign investors. The pressing question for Emerging Asia’s policy makers is not when or in what sequence to employ CFMs. It is rather what non-residency-based CFMs are effective in mitigating the risk of capital inflows (if not directly reducing the purchases by non-residents of domestic securities) as they preserve their commitment to an open capital account regime (Kawai and Lamberte, 2012).

Moreover, the empirical literature generally tends to find that capital controls have only weak effects on capital flows (BIS, 2012). Evidence is mixed as to whether capital controls can appreciably limit the overall size of capital flows. For example, Forbes and Warnock (2011) examined a large cross-country panel of data and found no evidence that the stringency of capital controls has any influence on the size of flows during extreme episodes – either episodes of capital surges (when foreigners bring large amounts of money into a country) or episodes of stops (when they take large amounts of money out). On the other hand, a recent study by Ahmed and Zlate (2013) found that the new capital control measures introduced since 2009 have exerted a significant dampening effect on inflows for emerging market economies. Specifically, the number of capital control measures in place has a negative and statistically significant effect on both total flows and portfolio inflows.

There is some evidence that controls can change the composition of flows. De Gregorio, Edwards and Valdes (2000) find that Chilean controls changed the composition of flows toward longer maturities. This finding is confirmed in the recent study by IMF researchers Ostry et al. (2011) The meta-study of Magud, Reinhart and Rogoff (2011) finds this to be a robust outcome over many empirical studies. Ostry et al. (2011) also find that the currency composition of flows can be effectively altered by policies that discourage borrowing in foreign currencies. Evidence is mixed on the question of
whether capital controls actually allow countries to control real exchange rates and have more independent monetary policy, though the meta-study of Magud et al. tends to favour this conclusion.

Regional co-operation will help in managing capital flows

There is a geographical component to the pattern and size of large net capital inflows, which Schadler (2010) calls the “neighbourhood” effect. Conversely, when sudden outflows cause a currency crisis, contagion often has a regional focus, as was the case during the Asian financial crisis in 1997-98 and in Europe at the height of the 2008 global financial crisis. These patterns must be related to the interconnectedness among the neighbouring economies of a region (Park and Takagi, 2012). This tendency suggests that collective action at the regional level will be important for Emerging Asian economies to manage the spillover effects of quantitative easing in the advanced economies.

There are two areas of co-operation amongst Emerging Asian economies for managing capital flows. First, these countries can co-ordinate the introduction of prudential and other regulatory measures, given the recognition that individual countries are finding it increasingly difficult to do so alone (Kawai and Lamberte, 2012). In this aspect, collective action can be helpful in two ways. First, if these measures are either introduced as part of regional efforts or sanctioned by a regional decision, there could be less negative reaction from international investors. Second, these measures, if effective in one country, would divert more capital inflows to its regional neighbours. Without a regional framework, use of prudential and other regulatory measures to limit capital inflows could turn into a tool of beggar-thy-neighbour policies. Indeed, the IMF (2012b) found that controls on capital inflows can have significant direct portfolio effects not only on the country instituting the controls but also externality effects on other countries.

Second, there is also greater scope to tap the Chiang Mai Initiative Multilateralization (CMIM) for monitoring capital flow movements and improving crisis prevention and management capacity in the region. In early May 2013, the meeting of the Finance Ministers and Central Bank Governors of ASEAN+3 reached a consensus to transform the ASEAN+3 Macroeconomic Research Office (AMRO) – an independent regional surveillance unit supporting the CMIM – into an international organisation. Moreover, it was agreed in May 2013 to amend the CMIM Agreement to reflect the following measures: doubling the size of the CMIM from USD 120 billion to USD 240 billion; introducing a crisis prevention facility (the Precautionary Line); and minimising the IMF-linked portion from 80% to 70% (and further to 60% in 2014). These regional co-operation efforts could help to prevent the occurrence of financial crises and foster the capacity to manage crises effectively if they occur (Bank of Japan, 2013).

More importantly, structural policy reforms will be critical to reap the benefits of capital flows

Structural policy reforms can maximise the long-term gains from international capital movements in support of stronger, more balanced and sustainable growth. Structural policy, including financial and product market regulation, have a large impact on net foreign capital positions. An OECD (2012) analysis of a large sample of mature and emerging-market economies shows that countries with more open financial markets, better institutional quality and more competitive product and labour markets appear to be more able to attract and absorb foreign and domestic capital flows.
In addition, structural policy can help to minimise the short-term risks associated with capital flows. While improved structural policy settings are likely to increase the overall scale of capital flows, this may heighten short-term risks. On the other hand, better structural policies (more competition-friendly product market regulation, more adaptable labour markets, higher institutional quality and greater capital account openness) are associated with a composition of capital inflows – principally more FDI and less debt – which is more stable and less prone to risk. The net effect of capital flows on short-term risks will depend not only on the particular form of structural reforms enacted, but also on how they are reinforced by progress in financial reforms to strengthen the prudential and macroprudential framework in both emerging and advanced economies (OECD, 2011).

**Efforts to pursue ASEAN economic integration should be stepped up**

The ASEAN region has vast strengths to play an increasingly important role on the global economic stage. With a population of over 600 million, it is the third largest market in the world, larger than the European Union. With a combined GDP of over USD 2.2 trillion, its ten member states make up the fifth largest economy in the world.

As integration with the world economy intensifies, the ASEAN region finds itself facing important opportunities and challenges including the need to better integrate the newer members into the regional and global economy. Hence, to harness its medium-term economic growth potential, ASEAN needs to capitalise on its strengths while overcoming a number of distinct challenges to attain the medium-term goal of a common market within the ASEAN community by 2015 (Box 1.4).

**Box 1.4. Recent progress in implementing the Roadmap for the ASEAN Community**

The Roadmap for the ASEAN Community (2009-2015) was developed to put the objective of regional integration at the centre of ASEAN’s co-operation and to provide a framework for more coherent implementation of the regional integration programmes. The various actions under the Roadmap are intended to ensure that the benefits of integration are spread across all ten countries.

Recent progress in implementing the ASEAN Community Roadmap includes the following:

- **Trade and Investment**: Implementation of the ASEAN free trade agreements (FTA) with other countries (dubbed as “ASEAN plus one” agreements) and the other mandates that arise from the various consultations with major trading partners; launch of formal negotiations for the regional comprehensive economic partnership (RCEP) agreement between ASEAN and its six FTA partners: Australia, China, India, Japan, Korea and New Zealand, which aims to consolidate the plus one agreements; the coming into force of the ASEAN Comprehensive Investment Agreement in 2012 which covers investment liberalisation, promotion, facilitation and protection; and trade facilitation and enhancement initiatives in the region through the ASEAN Single Window.
While development gaps have narrowed, they remain significant in some areas

One of the key medium-term policy challenges lies in narrowing the social and economic development gaps among the ASEAN members. Indeed, the journey to build an ASEAN Community by 2015 requires member countries, including the newer members, to not only stay on the same track but to keep pace.

To monitor the progress of efforts to narrow the disparities in socio-economic development, the Narrowing Development Gap Indicators (NDGIs), first released by the OECD Development Centre and the ASEAN Secretariat in 2013, provide important comparative information on various socio-economic development indicators among ASEAN countries.

The NDGIs measure the gap between the averages of two country-groups in ASEAN: Cambodia, Lao PDR, Myanmar and Viet Nam (CLMV) and the more highly developed and prosperous ASEAN-6 countries (Brunei Darussalam, Indonesia, Malaysia, the Philippines, Singapore and Thailand). Each gap indicator and its sub-indicators is measured on a scale with 11 steps, where 0 denotes no gap and 10 is the widest gap. The 2013 Outlook reported that for the period 2005 to 2011, of the six policy area indicators, development gaps were widest in the areas of Poverty and Human Resource Development.
The Outlook 2014 paints a broadly similar picture. The NDGIs and their sub-indicators for 2012 show that the gap between CLMV and ASEAN-6, remained widest for Poverty and human Resource Development Gap at 4.2 and 3.8 respectively, although these two indicators have improved slightly compared to 2011. The Infrastructure Gap was 3.3, followed by the Information Communication Technology (ICT) and Trade and Investment Gaps both at 3.1, while the Tourism Gap was the smallest at 1.6 (Figure 1.17).

Figure 1.17. Narrowing Development Gap Indicators (NDGIs): Disparities between CLMV and ASEAN-6, 2012

Note: Each sub-index of the NDGI, whose value ranges from 0 to 10 base points – where 0 denotes no gap and 10 the widest gap – is built from multiple variables within six key policy areas shown above. For more detailed information, see www.oecd.org/dev/asiapacific.

Source: ASEAN Secretariat and OECD Development Centre. http://dx.doi.org/10.1787/888932957491

Implementation of the IAI Work Plan will be key to narrowing development gaps

The implementation of the Initiative for ASEAN Integration (IAI) Work Plan will be the main driver for efforts to narrow the development gaps in ASEAN and to support the three ASEAN Community Blueprints (Political-Security Community, Economic Community and Socio-Cultural Community).

The Work Plan is currently in phase two (IAI Work Plan II) which covers the period 2009-15. The Work Plans have mainly focused on soft infrastructure. However given the current state of development in the CLMV, emphasis is now being placed on infrastructure facilities (e.g. airports, seaports, roads, bridges, and other facilities). Particularly in the Master Plan for ASEAN Connectivity, support for developing and improving physical connectivity has become an important priority area that can potentially accelerate economic integration. Prioritising infrastructure development will benefit the region in the medium to long term.

Along with four general enabling actions, the IAI Work Plan II is composed of 182 prescribed actions that will support CLMV countries to better participate in the integration process. Out of the 182 actions, 19 are studies, 78 are policy and implementation support, and 85 are training programmes, apprenticeships and other capacity building activities.
The following discussion highlights the components of the NDGIs where gaps are largest and provides a concise description of ASEAN’s prescribed initiatives to support the CLMV, mainly through the IAI Work Plan II.

The three largest gaps between CLMV and ASEAN-6 under the Poverty Gap sub-indices can be found in the mortality rate for children under the age of five years, the percentage of the population with access to improved drinking-water source and the poverty headcount ratio (Figure 1.18).

**Figure 1.18. Poverty Gap Sub-Indices between CLMV and ASEAN-6, 2012**

![Poverty Gap Sub-Indices between CLMV and ASEAN-6, 2012](source)

<table>
<thead>
<tr>
<th>Poverty Gap Sub-Index</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improved water source</td>
<td></td>
</tr>
<tr>
<td>Mortality rate (under the age of 5)</td>
<td></td>
</tr>
<tr>
<td>Poverty headcount ratio</td>
<td></td>
</tr>
<tr>
<td>Mean shortfall from the poverty line</td>
<td></td>
</tr>
<tr>
<td>Prevalence of undernourishment</td>
<td></td>
</tr>
<tr>
<td>Life expectancy at birth</td>
<td></td>
</tr>
<tr>
<td>Improved sanitation facilities</td>
<td></td>
</tr>
<tr>
<td>Poverty Gap Sub-Index</td>
<td></td>
</tr>
</tbody>
</table>

Source: OECD Development Centre calculations based on World Bank’s World Development Indicators (WDI).

[StatLink](http://dx.doi.org/10.1787/888932937510)

Table 1.3. **IAI Work Plan II Action to Narrow the Poverty Gap Sub-Indices**

<table>
<thead>
<tr>
<th>Key programme</th>
<th>IAI Work Plan II Action</th>
</tr>
</thead>
</table>
| Poverty alleviation                   | Implement projects related to poverty alleviation in CLMV with due attention to female households in rural areas.  
Conduct workshops for CLMV to review and assess the impact of numerous internationally funded poverty-reduction programmes and to adopt best practices.  
Conduct workshops on economic development at grassroots level and in rural areas. |
| Access to health care and promotion of healthy lifestyle | Enhance quality of herbal medicine and prevent illegal importation.  
Develop and implement action plan under the new ASEAN-WHO Memorandum of Understanding (2009-2013) to include capacity building activities on Healthy Lifestyles for CLMV. |
| Improving capability to control communicable diseases | Integrate responses to HIV epidemic under the Third ASEAN Work Programme on HIV and AIDS, 2006-2013.  
Employ existing mechanisms to control other Emerging Infectious Diseases (EID) including TB and malaria.  
Integrate HIV and AIDS impact assessment into the feasibility study phase for development projects with due attention to gender-responsive aspects. |
| Ensuring a drug-free ASEAN             | Provide support through exchange of experiences, best practices and technical assistance to develop patterns for drug-replacement crops/alternative crops as substitute in the areas previously used for illicit drug crops.  
Enhance capabilities and provide technical assistance for the treatment and rehabilitation of addicted persons including synthetic drugs users.  
Provide advisory assistance to create linkages between government, non-governmental organisations and civil society to establish comprehensive system which can provide treatment, rehabilitation and aftercare services.  
Develop national public awareness strategy and implementation plan against the threat of illicit drugs. |

Source: ASEAN Secretariat.
The IAI Work Plan Actions related to these sub-indices address the areas of poverty alleviation, access to health care and promotion of healthy lifestyles, improving capabilities to control communicable diseases, and ensuring a drug-free ASEAN (Table 1.3).

The three largest gaps between CLMV and ASEAN-6 under the Human Resource Development Gap sub-index are in the labour participation rate, the competitiveness of higher education institutions based on global rankings of universities, and the number of unpaid family and own-account workers (Figure 1.19).

Figure 1.19. Human Resource Development Gap Sub-Index between ASEAN-6 and CLMV, 2012

Note: An asterisk (*) indicates a larger value for CLMV countries ASEAN-6 and thus denotes a change in the direction of the gap between the two country groups.

Source: OECD Development Centre calculations based on World Bank’s World Development Indicators (WDI), World Bank’s Doing Business database, national sources, ADB Key Indicators 2011, ILO Key Indicators of the Labour Market (KLIM), UNESCO UIS database and QS University Ranking.

http://dx.doi.org/10.1787/888932937529

The IAI Work Plan Actions related to this sub-index mainly focus on advancing and prioritising education, investing in human resource development and promoting decent work (Table 1.4 and Box 1.5).

Table 1.4. IAI Work Plan II Action to Narrow the Human Resource Development Gap Sub-Index

<table>
<thead>
<tr>
<th>Key programme</th>
<th>IAI Work Plan II Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advancing and prioritising education</td>
<td>Conduct a programme for training in the management of higher education for CLMV countries.</td>
</tr>
<tr>
<td>Investing in HRD</td>
<td>Conduct a seminar on strategic planning for skills development.</td>
</tr>
<tr>
<td></td>
<td>Study the possibility of establishing vocational/university exchange programmes or temporary training programmes for certain skills sets that are needed for CLMV.</td>
</tr>
<tr>
<td>Promotion of decent work</td>
<td>Implement a programme to promote safety in the workplace in CLMV countries.</td>
</tr>
<tr>
<td></td>
<td>Provide advisory assistance to CLMV in the development of the informal sector, including policy measures and training programmes.</td>
</tr>
</tbody>
</table>

Source: ASEAN Secretariat.
Box 1.5. Education plays a significant role in narrowing the development gap in ASEAN

The role of education in narrowing the development gap in ASEAN is particularly evident in the IAI Work Plan where capacity building and human resource development are key elements to ASEAN integration efforts.

Of the 182 actions in the IAI Work Plan, 47% come in the form of capacity-building activities such as training courses, workshops, attachment programmes, language training, academic scholarships and the like. These capacity-building efforts under the IAI span across all three pillars of the ASEAN Community and general enabling actions such as English proficiency training and trainers’ training on project management.

The Work Plan also prescribes actions on training managers and administrators of higher education institutions; establishing vocational or university-based exchange programmes, and training programmes for specific skills sets needed by CLMV; and providing support in the implementation of ASEAN’s Mutual Recognition Agreements.

Projects have been implemented to support these prescribed actions. A flagship project is the Attachment Officers’ Programmes for CLMV diplomats and officials that are being supported by Japan and Brunei Darussalam. Through Japan’s assistance 11 batches of CLMV officials have been attached at the ASEAN Secretariat for between six months and one year to help them learn more about the work of ASEAN and to help them bring back home the skills and lessons they have learned from the programme. Most graduates of the Programme return to their home countries or get posted abroad taking on more senior roles in their respective ministries. Two batches are currently posted at the Secretariat.

Other on-going and up-coming IAI projects include support from various ASEAN Dialogue Partners on establishing or refining policies for National Qualifications Framework to harmonise recognition of qualifications across ASEAN countries, giving particular attention to supporting CLMV countries. The US, through the Lower Mekong Initiative, will pursue a comprehensive programme supportive of education and IAI, covering programmes such as increasing technical English skills, policy formulation and information sharing on accreditation and equivalencies benchmarks, exploring emerging technologies such as massive open online courses, Internet-based distance learning, and implementing programmes geared towards youth, young professionals and women.

The three largest gaps between CLMV and ASEAN-6 under the Infrastructure Gap sub-index can be found in the number of days to get an electricity connection, the percentage of paved roads, and access to electricity (Figure 1.20).
Figure 1.20. Infrastructure Gap Sub-Index between CLMV and ASEAN-6, 2012

Note: An asterisk (*) indicates a larger value for CLMV countries ASEAN-6 and thus denotes a change in the direction of the gap between the two country groups.

Source: OECD Development Centre calculations based on UNESCAP Asia-Pacific database, World Bank’s World Development Indicators (WDI), World Bank’s Doing Business database and UN Energy Statistics database.

http://dx.doi.org/10.1787/888932937548

The IAI Work Plan Actions related to this sub-index focus more on providing technical assistance for planning and operating road, multimodal transport, railway and maritime projects, as well as training programmes on the use of energy sources, power distribution and regulation, and energy conservation (Table 1.5 and Box 1.6).

Box 1.6. Implementation of the IAI Work Plan will require more targeted resources

Capacity-building is important for the CLMV countries’ ability to implement regional integration projects but having adequate resources to carry the projects out is also essential. Easing the resource constraint particularly of capacity building reflects the commitment of ASEAN to ensure that the community is not two-tiered.

ASEAN has a number of Co-operation Programmes to support and carry out regional activities in the various sectors. To address the more complex regional undertakings, the ASEAN Infrastructure Fund (AIF) has been set up as a limited company incorporated in Malaysia. The Asian Development Bank provides the administrative services to the AIF and co-finances the loans to infrastructure projects that are expected to contribute to the ASEAN Master Plan on Connectivity.
Similarly, China has set up a USD 15 billion credit facility and a USD 10 billion China-ASEAN Investment Cooperation Fund with a focus on infrastructure and connectivity. China’s support of the Master Plan on ASEAN Connectivity also paves the way for a more active role and enhanced co-operation with ASEAN in infrastructure development, transport, energy and resources, ICT, and trade and investment facilitation.

An equally important external source of funds is the private sector. Meeting financing requirements for accelerating infrastructure development will require greater co-ordination between the public and private sectors. The use of Public-Private Partnership (PPP) in infrastructure development will have to be enhanced. The ASEAN Economic Community Symposium and ASEAN Connectivity Symposium are examples of regional events designed to involve private sector actors in the economic integration and connectivity process through identification of infrastructure investment projects.

Table 1.5. IAI Work Plan II action to narrow the Infrastructure Development Gap Sub-Index

<table>
<thead>
<tr>
<th>Key programme</th>
<th>IAI Work Plan II Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Infrastructure</td>
<td>Continuation, intensification and expansion of training in multimodal transport.</td>
</tr>
<tr>
<td>Development</td>
<td>Provide training on multimodal transport, logistics and supply chain management.</td>
</tr>
<tr>
<td></td>
<td>Provide technical assistance and training for CLMV in establishing and operating their segments of the Singapore-Kunming Rail Link.</td>
</tr>
<tr>
<td></td>
<td>Conduct a feasibility study on the upgrading of secondary roads in each of the CLMV countries for connecting to the ASEAN Highway Network.</td>
</tr>
<tr>
<td></td>
<td>Undertake activities on the application of ICT to transportation.</td>
</tr>
<tr>
<td></td>
<td>Conduct training projects for container transport, urban transport planning, traffic management and transport engineering.</td>
</tr>
<tr>
<td></td>
<td>Conduct a capacity-building project on traffic safety in inland waterways.</td>
</tr>
<tr>
<td></td>
<td>Consider implementation of Viet Nam’s proposal to convert the Inland Waterways College in Ho Chi Minh City into a regional training centre for inland waterways.</td>
</tr>
<tr>
<td></td>
<td>Provide support to amend the road transport law and road traffic law for CLMV to comply with regional obligations.</td>
</tr>
<tr>
<td></td>
<td>Provide training on railway operation for CLMV.</td>
</tr>
<tr>
<td></td>
<td>Implement projects to build CLMV capacity to participate in ASEAN energy schemes, primarily the ASEAN Power Grid.</td>
</tr>
<tr>
<td></td>
<td>Provide training in high-voltage inter-connection and in power-systems planning.</td>
</tr>
<tr>
<td></td>
<td>Provide training in fuel quality testing, fuel transport safety, power trading and negotiations on transboundary power tariffs.</td>
</tr>
<tr>
<td></td>
<td>Develop a programme on fuel conservation and renewable energy, with a training component.</td>
</tr>
</tbody>
</table>

Source: ASEAN Secretariat.

The three largest gaps between CLMV and ASEAN-6 in the ICT sub-index are in the percentage of people that own computers, the number of Internet users, and the degree to which the regulatory framework is favourable to the sectors (Figure 1.21).
The IAI Work Plan’s prescribed actions on ICT include both the provision of technical assistance for planning and the implementation of national ICT infrastructure that will help connect ASEAN countries to each other and to the rest of the world on the economic front; and the promotion and provision of training programs to maximise and increase the utilisation of ICT throughout the region (Table 1.6).

### Table 1.6. IAI Work Plan II action to narrow the ICT Sub-Index Gap

<table>
<thead>
<tr>
<th>Key programme</th>
<th>IAI Work Plan II Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Infrastructure development</td>
<td>Provide support for formulation of national ICT master plans.</td>
</tr>
<tr>
<td></td>
<td>Provide support for formulation of e-government master plans.</td>
</tr>
<tr>
<td></td>
<td>Provide support for formulation of national action plans for human resource development in ICT.</td>
</tr>
<tr>
<td></td>
<td>Provide support to review telecommunications regulations to support liberalisation (and development) of the telecom sector with an integrated approach on regulation and policy reform (on competition policy, foreign investment, licensing, allocation of resources such as frequencies and access facilities).</td>
</tr>
<tr>
<td></td>
<td>Provide support to complete the GMS Information Superhighway to provide the telecom backbone network and connectivity to all parts of CLMV.</td>
</tr>
<tr>
<td></td>
<td>Conduct a study and implement measures to implement CLMV ICT manufacturing bases/clusters (and to be connected to other IT parks in ASEAN).</td>
</tr>
<tr>
<td></td>
<td>Conduct training programmes on the basis of a coherent programme for the ICT focal points of CLMV.</td>
</tr>
<tr>
<td>Promoting ICT</td>
<td>Provide expertise training in the management of large-scale ICT projects in CLMV countries.</td>
</tr>
<tr>
<td></td>
<td>Provide support in building up and developing a group of CEOs for ICT.</td>
</tr>
<tr>
<td></td>
<td>Provide support for CLMV countries in studying and building of structures and information standards serving e-government.</td>
</tr>
<tr>
<td></td>
<td>Develop a standard ICT infrastructure of CLMV for their people, especially women, youth, elderly and disabled persons, to easily access ICT.</td>
</tr>
<tr>
<td></td>
<td>Provide ICT training for people in each CLMV country including women, youth, elderly and disabled persons.</td>
</tr>
<tr>
<td></td>
<td>Provide support to implement capacity building programmes to increase ICT literacy in ASEAN, including women, children, elderly and disabled people.</td>
</tr>
</tbody>
</table>

Source: ASEAN Secretariat.
The three largest gaps between CLMV and ASEAN-6 under the Tourism Gap sub-index are in the number of international tourist arrivals, the number of hotels, and the amount of the direct contribution of travel and tourism to countries’ GDP (Figure 1.22).

**Figure 1.22. Tourism Gap Sub-Index between CLMV and ASEAN-6, 2012**

CLMV countries have fared well in tourism in the last few years, with most of the countries opening up to the global market. In 2012, CLMV countries registered a 19.7% growth in visitor arrivals and remain committed to achieve the target of 25 million arrivals by 2015. The CLMV countries will co-operate on the development of tourism products and infrastructure, and jointly promote the “Four Countries, One Destination” campaign.

The IAI Work Plan, following the ASEAN Economic Community Blueprint, considers tourism as a key services sector, and suggests capacity-building initiatives for tourism professionals. The signing of the mutual recognition agreement for tourism professionals in ASEAN is a milestone for the sector and is one area where CLMV countries may be able to catch up most easily (Table 1.7).

**Table 1.7. IAI Work Plan II action to narrow the Tourism Gap Sub-Index**

<table>
<thead>
<tr>
<th>Key programme</th>
<th>IAI Work Plan II Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Free flow of services - tourism</td>
<td>Provide technical assistance in formulating services-related policy measures in tourism sector including air transport services, liberalisation of tourism services and the use of tourism professionals. Provide joint training in tourism services sector to strengthen the capacity of government officials and private sectors in charge of services in CLMV countries.</td>
</tr>
</tbody>
</table>

The three largest gaps between CLMV and ASEAN-6 under the Trade and Investment Gap sub-index are in average tariff rates, the ease of exporting measured by the number of days to export, and the intensity of investor protection (transparency and access to and disclosure of information) (Figure 1.23).
Figure 1.23. Trade and Investment Gap Sub-Index between CLMV and ASEAN-6, 2012

Gaps between CLMV and ASEAN-6 countries in trade liberalisation and participation in the global market are evident in ASEAN trade and tariff statistics. More than 80% of the total trade in ASEAN is accounted for by the ASEAN-6 countries. While the average tariff on imports in the ASEAN-6 was 0.05% in 2012, it was 1.69% in the CLMV. To narrow the trade and investment gap, the Work Plan focuses on key areas such as the aspirations for free flow of goods, services, and investment; enhancing external economic relations through free trade agreements, and increasing participation in global supply chains (Table 1.8).
<table>
<thead>
<tr>
<th>Key programme</th>
<th>IAI Work Plan II Action to Narrow the Trade and Investment Gap Sub-Index</th>
</tr>
</thead>
</table>
| Free flow of goods | Conduct a study to analyse the state, in each of the CLMV countries, of each of the relevant priority sectors and how the sector would benefit from or be affected by more rapid regional integration within ASEAN, proposing measures to undertake adjustments to reap the benefits and mitigate the costs. Implement the agreed measures.  
Conduct a study to identify obstacles encountered by CLMV exporters to or through ASEAN-6 countries and vice versa.  
Conduct a review with a view to implement effectively the ASEAN Integration System of Preferences.  
Conduct a study on ways by which the ASEAN-6 can help strengthen the export competitiveness of the CLMV countries.  
Implement the agreed recommendations of the study on managing the revenue losses and adjustment costs arising from CLMV participation in AFTA.  
Assist CLMV in capacity building to ensure the implementation of National Single Window.  
Conduct attachment programmes and other methods of improving the familiarity of the customs and other agencies of the CLMV countries with the CEPT scheme and other integration measures and strengthening their capacity to implement them.  
Conduct programmes to familiarise the private sector in the CLMV countries with ASEAN Trade in Goods Agreement (ATIGA) and other integration measures.  
Continue implementation of the IAI training and institution-building programmes in customs administration and operations.  
Continue implementation of additional programmes on the basis of a coherent capacity building programme adopted by the ASEAN customs authorities, including training in the application of rules of origin, risk assessment and enforcement of agreements related to customs.  
Provide assistance to those CLMV countries that need assistance in drafting or amending customs related legislation.  
Implement programmes on customs-related information on transparency, appeal mechanism and access to information.  
Implement programmes on customs automation. |
| Free flow of services | Conduct a study to analyse the state and impact of free flow of services in each of the CLMV countries in the global and regional contexts, including the five priority sectors for the integration of trade in services. Implement the agreed measures. |
| Free flow of investment | Conduct a research study to identify the difficulties encountered by investors in their operations in CLMV countries.  
Undertake a review of possible strategies to attract investment, improve the investment climate, build capacities and maximise the benefits of FDI for development.  
Conduct capacity building programmes to review, streamline and simplify procedures for investment applications and approvals.  
Provide technical assistance in strengthening databases, such as on rules and regulations and incentives, for investments covering goods and services to facilitate policy formulation, and dissemination of investment information.  
Conduct a study of the human resource requirements of the sectors to which the CLMV countries seek to draw investments, including reforms in the educational system and short-term vocational training.  
Conduct programmes to familiarise the private sector in the CLMV countries with ASEAN Comprehensive Investment Agreement (ACIA) and other integration measures. |
| External economic relations (FTAs) | Conduct training programmes for the CLMV countries in the application of the rules of origin of trade agreements concluded or being negotiated by ASEAN.  
Conduct capacity-building programmes to provide policy advice to CLMV governments in the negotiation of free trade agreements in accordance with their respective needs and interest.  
Provide assistance to the CLMV governments in ensuring that their specific requirements are taken into account in the study on the investment elements of FTAs being negotiated between ASEAN and Dialogue Partners. |
| Enhanced participation in global supply chains | Provide training in the assessment of overseas markets.  
Conduct studies of the major markets for actual or potential CLMV exports.  
Support CLMV countries in conducting studies on impact of integration in agricultural sector. |

Source: ASEAN Secretariat.
The Trans-Pacific Partnership (TPP) is a proposed free trade agreement under negotiation by 12 countries: Australia, Brunei Darussalam, Chile, Canada, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Viet Nam. The TPP is an expansion of the Trans Pacific Strategic Economic Partnership Agreement (P4) that is a Free Trade Agreement (FTA) between Brunei Darussalam, Chile, Singapore and New Zealand signed in 2005. As the P4 evolves into the TPP, new countries have the opportunity to join through a process of consultation, assessment and consensus building among current members.

The P4 resulted in removing most tariffs on goods traded between the four countries. It also included further pledges to open government procurement contracts to businesses operating in any of the four countries as well as to co-operate on issues such as customs procedures, labour practices, intellectual property and competition policies. It is planned to be a broad-based agreement on all sorts of horizontal issues other than trade with the objective of generating growth in the countries involved. The negotiations include such topics as environmental safeguards, small and medium-sized enterprises (SMEs), government procurement and the treatment of state-owned enterprises (SOEs), innovation and competitiveness, intellectual property rights, as well as regulatory coherence and co-operation. Furthermore, in principle under the TPP there will be no exemptions.

However, the TPP negotiations have also raised concerns and criticism because of the TPP’s potential negative impact on certain sectors, products and services in certain member countries and the effect of its expansive scope on intellectual property laws and patent enforcement (for example, on the distribution of generic drugs).

The Regional Comprehensive Economic Partnership (RCEP), which was launched by the leaders of the ASEAN in November 2011, aims to build a FTA between the ten ASEAN nations and the six countries with which ASEAN has existing FTAs – Australia, China, India, Japan, Korea, and New Zealand – and which are also known as the ASEAN Free Trade Partners (AFPs) in relation to the RCEP. The RCEP is expected to lead to greater economic integration within the ASEAN as well as to broaden and deepen the engagements already achieved through the existing ASEAN+1 FTAs.

Similarly to the TPP, the RCEP is expected to be broad in the sense that the negotiations not only cover trade in goods and services but also issues related to investment, economic and technical co-operation, intellectual property, competition, and dispute settlement. Regarding the negotiations on trade in goods and services, however, the possibility of exemptions has not yet been ruled out. The ultimate aim is to progressively eliminate all tariff and non-tariff barriers as well as to eliminate the majority of restrictions and discriminatory measures with respect to trade in services in order to establish a free trade area among the participating countries. Furthermore, the RCEP also has the objective of narrowing development gaps with the less developed ASEAN countries through early elimination of tariffs on specific products and provision of development assistance. The target year to sign the final RCEP agreement is 2015, in line with the proposed date for creation of the ASEAN Economic Community.
In terms of country coverage, there is an overlap between the TPP and the RCEP negotiations as several countries, including Australia, Brunei Darussalam, Malaysia, New Zealand, Singapore and Viet Nam, are taking part in both negotiations. Whereas both the TPP and the RCEP would create an economic zone currently unmatched by size, the two initiatives differ in some attributes. While the trade share of the two agreements to the total world trade would be similar, just below 30%, the TPP would account for a larger share of global GDP of around 38% with a substantially higher average per capita income of above USD 33 000. On the other hand, the RCEP would have a total population more than eight times of that of TPP (see Table below).

### Comparison of the Trans-Pacific Partnership (TPP) and the Regional Comprehensive Economic Partnership (RCEP)

<table>
<thead>
<tr>
<th>Countries involved</th>
<th>Population (million)</th>
<th>GDP per capita (PPP USD)</th>
<th>Total trade (import and export of goods and services)</th>
<th>FDI inflow</th>
<th>FDI outflow</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>TPP</strong></td>
<td>12 (i.e. Australia, Brunei Darussalam, Chile, Canada, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, the United States and Viet Nam)</td>
<td>0.8</td>
<td>28</td>
<td>33 000</td>
<td>26%</td>
</tr>
<tr>
<td><strong>RCEP</strong></td>
<td>16 (i.e. ASEAN countries, Australia, China, India, Japan, Korea and New Zealand)</td>
<td>3.4</td>
<td>21</td>
<td>20 000</td>
<td>27%</td>
</tr>
</tbody>
</table>

Note: Figures refer to 2012 or latest year available. GDP per capita (PPP USD) is calculated as a simple average.

Sources: IMF World Economic Outlook Database, World Bank World Development Indicators, and United Nations Conference on Trade and Development (UNCTAD), (all accessed 29 August 2013).

Both the TPP and the RCEP have similar broad objectives such as increased market access for goods, services, skills and technology, large markets offering economies of scale and scope for specialisation, and insurance against protectionist measures (Wignaraja, 2013).

Recent analyses by Petri, Plummer and Zhai (2012 and 2013) point to considerable potential welfare gains from the two integration projects. They simulate different scenarios using a computable general equilibrium model to see the income gains (including both trade and FDI effects) of the potential trade agreements as compared to a baseline projection. The result of simulations suggest that the agreements would bring economic benefits to the global economy by 2025, although there are considerable differences in income gains both at a country level and among the different scenarios.
Narrowing socio-economic development gaps remains a key medium-term policy challenge

Narrowing socio-economic development gaps continues to be a critical medium-term policy challenge to enhance ASEAN’s growth potential as well as its integration process. However as the above analysis has shown, despite some narrowing of development gaps, the poverty and human resource development gaps remain significant and wide disparities persist in the areas of infrastructure, and trade and investment and ICT.

While the IAI Workplan II is a useful driver for efforts to narrow the development gaps in ASEAN, there should be greater efforts in the push for greater social and economic integration, particularly in infrastructure and trade and investment. For example, the infrastructure development can be sped up with better allocation of resources and consensus in implementation. There could also be greater regional co-operation to attract investment and liberalise trade to harness the growth potential of the ASEAN region.

As disparities in poverty also remain wide, more vigorous policies are needed to speed up poverty alleviation. For human resource development, there should be greater focus to enhance labour productivity and reduce skills mismatches. More importantly, the inequitable access to higher education and its uneven quality are important areas for policy reforms. Chapter 2 discusses in greater detail such policy reforms, particularly as they relate to CLMV countries.

In essence, while closing development gaps will necessarily involve implementation of structural policies which are longer-term in nature, it will require continued efforts and commitment from ASEAN member countries to bridge development gaps. These efforts will provide a solid foundation for the integration process as it strives towards the goals of the ASEAN Community by 2015 and beyond.

Conclusion

Recent economic developments have highlighted both the strengths of the Emerging Asian economies and their vulnerabilities. The countries’ comparative success in sustaining robust growth in the face of major external shocks highlights their strong economic fundamentals and their considerable improvement since the 1997-98 Asian financial crisis. However the slowdown in growth in 2013, although modest, and the strains arising from fluctuating capital flows into the region underscore the continued sensitivity of the region to external real and financial shocks.

The region has demonstrated strengths which indicate favourable prospects for continued robust growth in the medium term but the vulnerabilities underscore that further structural reforms are not only necessary over the long term but in some cases increasingly urgent. Effective management of fluctuations in capital flows, which pose one of the key downside risks in the medium term, will ultimately require better development of capital markets and strengthened capabilities for macroprudential oversight and regulation. Achievement of a more stable and productive composition of capital inflows will depend on structural reforms to broaden the range of investment outlets for foreign as well as domestic residents. Further development of regional co-operation on common financial issues could also help greatly in managing the effects of capital flows and in avoiding conflicts.
Regional efforts to achieve greater integration and freer trade with other countries have become increasingly intense and progressively more ambitious in recent years. In principle, these efforts aim to establish a free flow of goods, services and investments, and freer flow of capital among the ASEAN countries and, to a lesser extent with China and other Asian countries, within the medium term. Even if these agreements are not fully implemented within the official timelines, they are likely to bring significant direct benefits to the participants. The increasing economic integration within the region will also boost structural reforms at the national level by enhancing their potential benefits and improving incentives for national governments to carry out reforms to keep up with their neighbours.
Notes

1. The US Federal Reserve announced on 18 September 2013 that it will continue its current pace of bond-buying programme. In its Federal Open Market Committee (FOMC) statement, the Fed said that while the economy and labour market continue to improve, the central bank decided to await more evidence that progress will be sustained before adjusting the pace of its purchases. The postponement of QE tapering has brought some temporary reprieve for Emerging Asia and helped to ease financial market conditions in India and Indonesia.

2. In September, India and Japan agreed to more than triple their bilateral currency swap arrangement to USD 50 billion, a development that is likely to bring stability in financial markets in the country. This followed from an earlier announcement in late August by Bank Indonesia to extend a bilateral swap deal with the Bank of Japan valued at USD 12 billion that will allow the two to borrow from each other’s foreign-exchange reserves.

3. A recent empirical study by Frankel and Saravelos (2012) found that international reserves and real exchange rate overvaluation stood out as useful leading indicators of the recent global financial crisis. They were also the top two indicators identified in their extensive literature review.


5. Specifically, the total amount of funds that the RBI will lend to banks through its overnight Liquidity Adjustment Facility (LAF) at the repo rate was lowered to around INR 750 billion (Indian rupee). Banks needing funds above what they can access from the LAF have to turn to the Marginal Standing Facility (MSF), for which the RBI has raised the borrowing rate by 200bp to 10.25%. The RBI describes its liquidity tightening measures as temporary, but it will want to see a period of sustained currency stability before it reverses them. Indeed, in September 2013, the RBI Reserve Bank hiked the repo rate by 25 basis points but unwound some of the exceptional measures taken earlier to defend the rupee: i) the marginal standing facility rate, which has become the effective policy rate during periods of acute liquidity shortages, was reduced by 75 basis points from 10.25% to 9.5%; and ii) the cash reserve ratio (CRR) was kept constant at 4% but the daily CRR balance requirement for banks was lowered from 99% to 95%.

6. The six economic corridors and respective key focus areas are: Sumatera (production centre of natural resource and national energy source); Kalimantan (production centre of mining and national energy source); Sulawesi (production centre of agriculture, plantation and fisheries); Jawa (industrial and services); Bali-Nusa Tenggara (tourism and livestock); and KE. Papau – KE.P. Maluku (natural resources).


8. In July 2013, global ratings agency, Fitch, downgraded its credit outlook on Malaysia to negative from stable, saying in a statement that Malaysia’s public finances were its key rating weakness and warned of future negative shocks should no reforms and measures be taken by the federal government to remedy the country’s financial standing. Since then, the government has raised fuel prices for the first time since 2010, to curb subsidies that have stretched government budgets and threatened investor confidence. The fuel price increases will help the government save about MYR 1.1 billion (Malaysian ringgit) in 2013 and MYR 3.3 billion annually in future by reducing state subsidies.

9. It is well known that a fixed exchange rate regime, an open capital account and domestic monetary policy autonomy are conceptually incompatible – that is an “impossible trinity” or “trilemma”. Specifically, a fixed exchange rate regime with an open capital account implies that the central bank cannot independently control domestic interest rates, which will fluctuate with foreign interest rates. The only way to retain complete monetary independence with an open capital account is to allow the exchange rate to vary with fluctuations in capital flows. An empirical study by Aizenman et al. (2008) also suggests that countries do face the binding trilemma.

10. The Chiang Mai Initiatives, later renamed the Chiang Mai Initiative Multilateralization (CMIM), was established in 2000 as a framework for crisis prevention and management among the Association of Southeast Asian Nations Plus Three (ASEAN+3) countries.
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