Abstract

Developing East Asia and Pacific is growing faster than the rest of the world but slower than before the pandemic. While recovering global trade and easing financial conditions are expected to support economies in the region, increasing debt, protectionism and policy uncertainty could dampen growth.

Regional growth is projected to ease to 4.5 percent in 2024 from 5.1 percent last year. Growth in developing East Asia and Pacific excluding China is projected to pick up to 4.6 percent this year from 4.4 percent in 2023. Growth in China is projected to moderate to 4.5 percent this year from 5.2 percent in 2023, because of near term problems, such as high debt and a weak property sector, as well as longer-term challenges, such as aging and trade frictions. Growth among Pacific Island countries is forecast to decline to 3.6 percent in 2024 from 5.6 percent last year, as the post-pandemic rebound dissipates.

EAP’s current macroeconomic challenges risk obscuring the microeconomic foundations of longer-term growth. Over the last decade, growth has been driven primarily by investment rather than by increased productivity of firms. Now private investment is weak and productivity declining – further inhibiting the incentive to invest. Firms are the protagonists of productivity growth. Some of the less productive firms in EAP countries are beginning to catch up with the more productive ones. But the most productive firms in the region are not taking full advantage of new technologies and not seeing the productivity growth of the leading global firms. For example, in digital manufacturing sectors, such as electronics, between 2005 and 2015 the productivity of the top 5 percent of firms globally increased two-and-a-half times faster than the top firms in Indonesia, Malaysia, the Philippines and Viet Nam.

Both incentives and capacity are a problem. Incentives for firms to compete and innovate have been diluted by explicit protection in services and implicit protection in goods. The capacity to manage and innovate has been undermined by the inadequacy of skills. Using industrial policies to improve incentives and capacity will be hard because both fiscal resources and institutional capability are limited. Instead, bold policy action to unleash competition, improve infrastructure and reform education could revitalize the region’s economy.
Overview

Growth

Most economies in developing East Asia and Pacific (EAP), other than several Pacific Island Countries, are growing faster than the rest of the world (figure O1A; table O1), but slower than before the pandemic.

- Growth in China is projected to slow to 4.5 percent in 2024, from 5.2 percent in 2023, as the bounce back from the re-opening of the economy fades and proximate problems, such as elevated debt and weakness in the property sector, as well as longer-term structural factors, such as aging and trade frictions, weigh on growth.

- The rest of the EAP region, which had suffered in 2023 from slow trade growth and tight financial conditions, is expected to grow by 4.6 percent in 2024. The likely rebound in global goods trade and the gradual easing of global financial conditions are expected to offset the impact of China slowing down.

- The Pacific Island countries are expected to see slower growth at 3.6 percent in 2024, as the post-COVID-19 rebound dissipates and the region moves towards its estimated long-term trend growth of 2.6 percent. While output per capita has surpassed pre-pandemic levels in most of the larger EAP economies, Myanmar, Papua New Guinea, Timor-Leste and several Pacific Island Countries are still struggling to get back to pre-pandemic levels (figure O1B).

Figure O1. The EAP region is growing faster than the rest of the world but slower than before the pandemic in most major economies; output per capita is still below pre-pandemic levels in most Pacific Island countries and declined further in some.

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Source: World Economic Outlook database; United Nations; World Bank staff estimates.
Determinants

Economic performance in the region is being shaped by external and domestic developments (figure O2). The key external factors are recovering trade but an increase in trade protection combined with industrial policies, and still tight financial conditions. Among the domestic factors, the most important are amplified public and private debt; the constrained policy stance, especially fiscal and monetary; and increased political and policy uncertainty.

External factors

First, global trade is recovering even though global GDP growth is slowing down. Trade in goods and services grew only by 0.2 percent in 2023 but is projected to grow by 2.3 percent in 2024 – even though GDP growth will slow down from 2.6 percent in 2023 to 2.4 percent in 2024 (figure O3). The projected recovery in trade is attributable to improved real incomes, as wage growth outpaces inflation, and demand shifts back towards more tradable goods from less tradable services. Second, even though inflation has been declining in major economies, core inflation in the US and EU remains elevated and labor markets remain tight, suggesting interest rates will remain higher than pre-pandemic levels in the foreseeable future. Third, almost 3,000 new trade-distorting measures were imposed in 2023, three times as large as those in 2019.

A significant proportion of trade-distorting measures took the form of industrial policy. First, the most active users of industrial policy are the G-20 countries, such as the US, China, India and most of the countries in the EU (figure O4). Second, the number of industrial policy measures implemented also correlates positively with the level of development, except in the case of Brazil, China, India, and Russia. Third, the EAP countries (other than China and Indonesia) were less prone to implementing industrial policies compared to other countries of similar size and level of development. Finally, the EAP countries are potentially exposed to the trade-distortive effects of such policies because the US, China, the Republic of Korea, and Japan are important destination markets, and because the firms receiving subsidies are potential competitors of EAP firms.

Figure O2. A combination of external and domestic factors is influencing economic growth in the EAP region

Source: World Bank staff illustration.
Figure O3. Three linked international developments will shape economic performance in the EAP countries: recovering global trade, increasing trade-distorting measures, and tight financial conditions

A. Global GDP and trade growth

B. New trade-distorting measures

C. Interest rates

Note: B. figure shows the number of new harmful measures implemented by all WTO members, adjusted for reporting lag.

Figure O4. The rich and large countries, i.e. the G20, are the prime practitioners of industrial policy

Domestic factors

Debt

Both private and public debt have increased significantly as a share of GDP in most of the region’s economies (figure O5A). Corporate debt has increased in China and Viet Nam by more than 40 percentage points of GDP since 2010, and now exceeds the level in advanced economies. A 10 percentage points increase in private debt to GDP is associated with a 1.1 percentage point decline in investment growth. And household debt is now much higher in China, Malaysia and Thailand compared to levels in other emerging markets. Furthermore, public debt as a share of GDP is likely to increase due to higher primary deficits, higher interest rates and lower growth (figure O5B). Highly indebted countries such as Lao PDR have experienced a large increase in interest payments in 2023. High debt is associated across countries and over time with lower growth and higher interest rates (EAP Update April 2021).

Macroeconomic policy

Macroeconomic policy has retreated in most economies from the expansionary stance in the 2020–2022 period. Major economies in the region are projected to have a positive or neutral fiscal structural balance in the 2023–24 period compared to previous years (figure O6A). At the same time, policy interest rates have been raised in the EAP region to address the threat of inflation but remain lower than in other emerging market and developing economies (figure O6B) - because the region has generally been less affected by inflationary pressures and central banks have also utilized other monetary policy measures, such as adjusting reserve requirements. However, inflation has remained stubbornly high across the Pacific Island
**Figure O5.** Private and public debt is higher than before the pandemic; public debt as a share of GDP is likely to increase due to higher primary deficits, higher interest rates and lower growth

A. Private and public debt

![Chart showing private and public debt as a share of GDP from 2015 to 2023.]

- **Private Debt**
  - 2015–2019: 70%
  - 2023: 80%
- **Public Debt**
  - 2015–2019: 30%
  - 2023: 40%

B. Contribution to debt-to-GDP

![Chart showing contribution of primary deficit and growth relative to interest rate.]

- **EAP excluding China**
  - 2000–07: 1%
  - 2010–19: 2%
  - 2023–25: 3%
- **China**
  - 2000–07: 3%
  - 2010–19: 4%
  - 2023–25: 5%

Source: Institute of International Finance; World Economic Outlook, IMF, World Bank staff estimates.

Note: A. Bars show median debt/GDP for EAP economies; private debt refers to nonfinancial corporate debt. B. Dotted area shows projections. See notes in Figure 31 for methodology.

**Figure O6.** Fiscal policy has become less expansionary in most countries, while monetary policy has tightened in the region, except in China and Viet Nam

A. Change in structural balance

![Chart showing change in structural balance from 2020 to 2024.]

- **Thailand**: -2%
- **Malaysia**: -1%
- **Philippines**: 0%
- **Indonesia**: 1%
- **China**: 2%

B. Policy rate

![Chart showing policy rate from January 2020 to January 2024.]

- **China**: 3.5%
- **Indonesia**: 3.75%
- **Malaysia**: 1.75%
- **Philippines**: 3.25%
- **Thailand**: 1.5%
- **Viet Nam**: 3%

Source: International Monetary Fund, Haver Analytics.
Countries, as well as in Mongolia, Lao PDR and Myanmar, reflecting the raising prices of some commodities like rice, high dependence on imports, and/or rapid depreciation of currencies. China and Viet Nam are the two countries where rates have recently been reduced due to weak domestic demand and distressed corporate sectors.

Political and policy uncertainty

Economic policy uncertainty index in the region has increased in recent years (figure O7). Political developments within countries as well as rising geopolitical tensions are fueling uncertainty. The resulting lack of predictability or clarity about government policies, market conditions, or geopolitical events, has a negative impact on investment growth, as investors hesitate to invest in new projects or expand their existing businesses.

The impact of external and domestic factors

A growth shock originating in the region’s largest trading partners, China and the US, would impact EAP economies through bilateral trade and financial flows, including foreign direct investment (FDI) (World Bank 2023a). An unexpected 1 percentage point decline in US (China’s) GDP growth rate would decrease growth rate in the other developing EAP countries, on average, by an estimated 0.5 (0.3) percentage points (figure O8A). Unanticipated shocks to US monetary policy also affect growth; a 25 basis points increase lowers growth by an estimated 0.5 percentage points.

Figure O7. Economic policy uncertainty has increased in the US and China

World and economic policy uncertainty

Source: World Uncertainty Index; Economic Policy Uncertainty Index.
Note: “China” shows Economic Policy Uncertainty index based on South China Morning Post and mainland China newspapers. “Other EAP” shows median of Indonesia, Malaysia, Thailand, Philippines and Viet Nam using World Uncertainty Index’s 4-quarter moving average. “Global” shows global Economy Policy Uncertainty index. 3-quarter moving average.

Figure O8. Growth in the region is influenced by development in the region’s largest trading partners

A. Impact of 1 pp decrease in China and US GDP growth, and 25 bps increase in US 2-year yield

Source: World Bank staff’s estimations.
Notes: The results are based on a panel Vector autoregressions for Indonesia, Malaysia, Philippines and Thailand. A. Bars show impact of the following shocks: one percentage point decrease in China and US growth, and 25 bps increase in US 2-year interest rate yield. Effects estimated using a structural Bayesian VAR model. B. Bars show dynamic responses of EAP productions to a one-standard-deviation increase in macroeconomic uncertainty in the US and China. See Box A1 for further details.
Apart from changes in the level of macroeconomic variables in the US and China, an increase in macroeconomic uncertainty also has an impact on EAP countries, by inhibiting investment and consumption. A one standard deviation increase in macro uncertainty in the US and China is associated with, respectively, a 0.5 and 0.3 percentage point decline in industrial output growth and a 3 percent drop in asset prices in EAP within one year (figure O8B).

**Consumption**

Even though retail sales of most countries surpassed their pre-pandemic levels, the growth trend of retail sales is lower than the pre-pandemic rate in most EAP economies (Figure O9). Proximate factors such as an increase in household debt (e.g., in Malaysia, Thailand), depreciated property values (e.g., in China), and increased political uncertainty have weighed on consumer confidence and hence spending.

**Figure O9. Trends in private consumption are flatter than in the pre-pandemic period**

A. Real retail sales, EAP excl. China

B. Real retail sales, China

Source: Haver Analytics.

Note: Figure shows seasonally adjusted real retail sales indexed to January-2015. When volume-based retail sales data were not available, value-based retail sales were adjusted by the consumer price index. China’s retail sales include limited services sectors. Straight line shows pre-COVID trend and dashed line shows the trend since January 2021. A. Unweighted average of Indonesia, Malaysia, Philippines (manufacturing sales), Thailand, and Viet Nam.

**Investment**

Private investment as a share of GDP has been lower than pre-pandemic levels in developing EAP in recent years (figure O10), due to higher debt, interest rates and policy uncertainty. Public investment generally supported economic activity during the pandemic and exceeded the pre-pandemic levels in terms of GDP share in Indonesia, Philippines, Thailand, and Viet Nam.

**Exports**

After falling by more than 20 percent from their peak in the second quarter of 2022 in Indonesia and Malaysia, and by more than 10 percent in China and Viet Nam, goods exports across EAP countries have begun to recover with the world economy during the second half of 2023 (figure O11A). As of Q4-2023, goods export growth had returned to or been approaching positive territory in China, Thailand, and Viet Nam. The revival of tourism has helped services exports in Malaysia and Fiji, but on average total tourist arrivals (and tourism receipts) seem to have plateaued below the pre-pandemic level, in part because Chinese tourists have not returned in pre-pandemic numbers (figure O11B).
Figure O10. Private investment as a share of GDP is lower than before the pandemic and so, in some countries, is public investment

A. Private investment

B. Public investment

Source: World Bank staff estimates.

Figure O11. Goods exports are beginning to recover but slowly; tourist arrivals have plateaued below pre-pandemic levels in several economies

A. Goods exports (year-on-year growth)

B. Tourist arrivals compared to pre-pandemic

Source: Haver Analytics.
Note: A. three-month moving average. B. figure shows monthly tourist arrivals indexed to the same month in 2019.
China

After a strong post-COVID rebound in early 2023, growth momentum in China has slowed. Deflationary pressures, falling capacity utilization, and a sluggish labor market suggest that aggregate demand is falling short of aggregate supply. Investment in infrastructure and real estate — major drivers of rapid growth in recent decades — has slowed significantly, as the property market is undergoing a protracted but necessary correction while high debt levels and diminishing returns to investment constrain further infrastructure expansion. China is aiming to transition to a more balanced growth path but the quest to ignite alternative demand drivers is proving difficult.

A central challenge is the high rate of savings and hence the relatively low domestic consumption (figure O12A). To sustain aggregate demand, China needs high rates of investment, high levels of export, or high levels of government spending. Over the past decade China did succeed in reducing its dependence on exports and switching from external to domestic sources of demand. But the result was a domestic imbalance, with a heavy reliance on investment in infrastructure and real estate. Now China is attempting a rebalancing within investment, favoring advanced manufacturing (figure O12B). The risk is a new imbalance could emerge between manufacturing capacity and demand, both domestic and international.

To support aggregate demand, the government has announced moderate macroeconomic stimulus. The government’s cautious macroeconomic policy approach suggests that it is seeking to strike a balance between providing near-term stimulus and achieving the longer-term goal of stable and sustainable growth. Addressing structural imbalances in aggregate demand will require more than conventional fiscal stimulus. Instead, reforms that reduce precautionary savings, such as strengthening social protection and pension, more progressive taxation, and reallocation of public spending from infrastructure to human capital, would stimulate consumption and lead to more balanced growth. At the same time, a transparent and predictable policy environment and equal treatment of enterprises regardless of ownership would support investor confidence and encourage private investment while allowing market forces to play a greater role in the allocation of capital, mitigating risks of over-capacity.

**Figure O12.** The consumption share of GDP remains relatively low in China; investment is growing faster in manufacturing but is slowing down in infrastructure and real estate

<table>
<thead>
<tr>
<th>A. Household consumption</th>
<th>B. Investment growth by sector</th>
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<td>Percent of GDP</td>
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<td>Infrastructure</td>
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Source: WDI, Haver Analytics.

Note: A. countries with more than 1.5 million population are shown. B. figure shows average year-on-year growth.
While growth in per capita incomes in the EAP region has surpassed that in most other emerging market and developing economies in the last two decades, it was driven primarily by investing in capital rather than improvements in total productivity growth (figure O13). Growth in labor productivity can arise from greater capital (capital deepening), improvements in human capital (through education and skills) and higher total factor productivity or TFP (the part of production that is attributable to innovation because it cannot be explained by increases in quantities of labor or physical and human capital). In the long-run, productivity (TFP) – the efficiency with which inputs are transformed into outputs - is the key driver of growth. Understanding the sources of declining productivity growth in EAP economies would help design policies that support long-term growth.

Table 1. GDP growth forecast

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Source: World Bank; World Bank estimates and projections.
Note: Percent growth of GDP at market prices. Values for 2023 for the small island economies refer to GDP growth estimates. Values for Timor-Leste represent non-oil GDP. For the following countries, values correspond to the fiscal year: Federal states of Micronesia, Palau, and Republic of the Marshall Islands (October 1–September 30); Nauru, Samoa, and Tonga (July 1–June 30). Myanmar growth rates refer to the fiscal year from October to September.
The special focus of this Update examines the challenge of productivity growth through novel firm level analysis; the factors behind its slowdown; and what policies would reignite TFP, a vital driver of economic growth.

What has happened to firm-level productivity?

Aggregate productivity growth is a dynamic process involving: (i) productivity growth within existing firms; (ii) the reallocation of market share to more productive firms; and (iii) firm entry and exit (figure O14). Correctly diagnosing the sources of the productivity slowdown matters for prescribing the right policies.

In many East Asian economies, productivity growth is mostly due to improvements in productivity within existing firms (figure O15). In this respect, firms in the region resemble those in other countries, including the US but also Latin America and in Eastern Europe. Since most productivity growth has been due to within firm productivity growth, the slowdown in aggregate productivity is likely to reflect a slowdown in within-firm growth. Why the productivity slowdown has come at a time of rapid technological progress is a puzzle.
What has happened to productivity within frontier and laggard firms?

In the 1990s, new technologies were being adopted earlier by EAP frontier firms, defined as the most productive ones in a country, but diffusing more slowly to other firms than had been the case in the past (Cirera et al., 2021; Innovation Imperative Report). This pattern was consistent with the experience of advanced economies.

However, the productivity growth of the national frontier firms in EAP economies has been falling further behind the global frontier in digital-intensive sectors in recent years, such as electronics (figure O16). The slowdown in growth of the national frontier is starker in digital-intensive sectors – the same sectors where the best firms in rich countries are pulling away. For example, in digital manufacturing sectors, between 2005 and 2015 the productivity of the global frontier increased by 76 percent, whereas the national frontier firms in Indonesia, Malaysia, the Philippines and Viet Nam increased their productivity by only 31 percent on average. For less digital-intensive sectors, the gap between the national frontier firms and the global ones is less stark. The relative stagnation of the national frontier is also observed in developing countries beyond EAP, though to a lesser extent. Since new technologies typically arrive first at the frontier, and then spillover to other firms, revitalizing the national frontier firms matters for the future growth of all firms.

Advanced digital technologies, such as data analytics, are diffusing slowly to the national leaders in EAP. Unsurprisingly, firms in developing East Asia are less sophisticated than those in the advanced countries. However, whereas the average firm in EAP is somewhat behind the average firm in advanced economies, the most sophisticated firms in EAP are far behind the most sophisticated firms globally (Cirera et al., forthcoming). The relative lack of sophistication of the national frontier is also true beyond East Asia, although to a somewhat lesser degree.
Why are the leaders not leading?

EAP’s relative inertia in productivity growth may be because frontier firms do not have adequate incentives and because all firms lack the relevant capabilities. The most productive firms in East Asia and Pacific are more likely to identify barriers to trade, paucity of skills and weakness in the transport and telecommunications infrastructure, as key constraints (figure O17).

Firms require the right incentives

Low levels of competition could explain the relatively low productivity growth of frontier firms in EAP. Higher competition (or the threat of competition), which can come from openness to trade and investment, increases the incentives for frontier firms to innovate and grow (Aghion et al., 2009, 2021). While manufacturing tariffs are relatively low in EAP countries, tariffs in agriculture and non-tariff measures in manufacturing still limit competition. Furthermore, product market regulations in China and Indonesia are 50 percent more restrictive than in the US (OECD). Some EAP markets, for example in Viet Nam, are dominated by State Owned Enterprises (SOEs) that can also influence competitive conditions.
EAP, the number of startups has fallen dramatically over the past decades, especially in digital-intensive sectors, and the region is increasingly full of aging incumbents.

Frontier firms in EAP that are more exposed to competition show faster productivity growth (figure O18). Foreign owned frontier firms showed 5 per cent faster annual productivity growth than other frontier firms, whereas state-owned firms have 3 per cent slower productivity growth. Moreover, competition from foreign firms or state-owned firms within a sector can have important indirect spillovers on the growth of domestically or privately owned frontier firms.

**Figure O18.** Higher SOE presence in EAP is associated with lower and higher foreign firm presence with higher productivity growth of frontier firms

<table>
<thead>
<tr>
<th>A. Direct effect</th>
<th>B. Indirect effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>SOE</td>
<td>Foreign</td>
</tr>
<tr>
<td>5</td>
<td>3</td>
</tr>
<tr>
<td>4</td>
<td>2</td>
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<tr>
<td>3</td>
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<td>2</td>
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<td>1</td>
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<td>-1</td>
<td>-3</td>
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<tr>
<td>-2</td>
<td>-4</td>
</tr>
</tbody>
</table>

Source: Authors’ calculations using Statistical Office micro-data for China, Indonesia and the Philippines.
Notes: Direct effect of foreign ownership reflects the difference in annual TFP growth between foreign-owned and domestic-owned frontier firms. Frontier firms reflect the most productive 10% of firms within a country and industry. Indirect effect represents the differential annual TFP growth for domestic-owned frontier firms in industries with 10% higher foreign ownership (measured as the share of industry sales due to foreign owned firms). State ownership (SOE) is defined similarly.

**Firms require the right capabilities**

Productivity growth and adoption of sophisticated technologies require advanced skills and high-quality digital infrastructure. While access to mobile broadband is widespread in EAP, high-speed fiber is unevenly available across and within countries. Some technologies (such as e-commerce) need only basic mobile broadband. In contrast, modern data technologies (such as data analytics or cloud computing) require high-speed fiber broadband to send and receive data to and from customers/suppliers/within firms, and the right combination of digital and management skills to embed data-driven decision making within businesses.

Access to skills and modern data infrastructure is uneven in the EAP. In 14 of the region’s 22 middle-income countries, more than half of 10-year-olds are unable to read and understand an age-appropriate text. Even basic digital skills are not widely available in EAP, with less than a quarter of workers in Cambodia, Mongolia, Philippines, Thailand, and Viet Nam able to use the “copy and paste” function in a document. Over 50 percent of innovating firms in Indonesia, Malaysia, Myanmar, the Philippines, Thailand, and Viet Nam cite a lack of managerial and leadership skills as a challenge when hiring new workers (World Bank 2022, Innovation Imperative in East Asia). The average firms in both developed and developing EAP are on average less well managed than the US (see Figure O19). However, the best managed firms in developing EAP are behind the best managed in advanced EAP and far behind the best managed in the US.
How can policy help boost productivity growth?

While it may be presumed that capacity issues are purely an issue for laggard firms, our evidence in the previous section showed that frontier firms also do not have sufficient capacity in some respects, such as management skills. We highlight complementary reforms to boost competition, digital infrastructure and skills as policy priorities for reigniting frontier firm productivity.

Reform of goods and services markets can spur competition and accelerate productivity growth. While EAP goods markets are relatively open, liberalization of remaining tariffs and the relatively opaque non-tariff measures (NTMs) could increase exposure to competition at home and equip firms to compete abroad. For example, a recent survey reveals that 55 percent of exporters in the EAP region see NTMs as a burden limiting their ability to expand into new markets (ITS, 2023). Elimination of restrictions on entry and operation in services too could have a pro-competitive impact (World Bank 2023). For example, services reforms in Viet Nam are associated with a more than 3 percent increase in labor productivity of firms in these same sectors as well as downstream manufacturing (figure O20).

Competition-enhancing policies have larger impacts when combined with infrastructure-improving policies and investment. Initial evidence from the rollout of the Philippines’ fiber backbone to 12 provinces suggests that this leads to increased use.

Figure O19. The best managed firms in developing EAP have skills far below the best in advanced economies

Figure O20. Opening services to competition can increase productivity of services sectors and downstream manufacturing sectors

A. Productivity effects of service reform on services firms (own-effect)

B. Productivity effects of services reform on manufacturing firms (downstream effect)

Note: OLS regression results. The dependent variable is the change in log value-added per worker between 2016 and 2008. The main explanatory variable is the change in STRI values in Trade, Transport, Finance, Professionals, and Telecommunication sectors between 2016 and 2008 in Panel A, and the change in the "downstream" STRI for manufacturing sectors in Panel B. The downstream STRI is a sector-specific measure for each 2-digit manufacturing sector, calculated by the average STRI of the above five services sectors weighted by the corresponding purchasing value from each manufacturing sectors. The regression sample in panel A consists of all enterprises operating in Trade, Transport, Finance, Professionals, and Telecommunication sectors, and all manufacturing enterprises in Panel B, in 2008 and 2016. All regressions control for firms' baseline revenue and employment. Standard errors clustered at the industry level.
of e-commerce, but mainly for firms with higher quality connections and for firms in more competitive sectors. Openness to foreign competition and access to fiber broadband for firms in the country both individually increase technology adoption, but their combined impact is more than double.

Improving human capital is imperative and has at least three dimensions. First is fixing the foundation of basic skills on which more advanced skills can be built (World Bank 2023). Teacher knowledge of content and teaching methods have been identified as key problems. Investing in teacher training is estimated to produce benefits in terms of discounted life-time earnings that are ten times larger than the costs.

Second, individuals must be equipped with the skills to work with new technologies as well as the ability to innovate. That requires an emphasis on investments in tertiary education to develop workers’ advanced cognitive, technical, and socio-emotional skills. To remedy these gaps, students need to be exposed early to a range of tasks, from the factory floor to R&D departments. Links need to be strengthened between research institutions and firms, including through incentives for research institution-industry collaboration.

Third, is enhancing the abilities of managers already in the work force. Differences in management quality are an important contributor to productivity differences across countries. Recent research suggests that management quality can be improved. For example, firms provided with management consulting in Colombia improved their management practices and increased employment (Iacovone et al., 2022). Both intensive and expensive one-on-one consulting and consulting in small groups of firms led to improvements in management practices of a similar magnitude (8–10 percentage points) and in firm sales, profits and labor productivity. Such targeted support can be especially effective when combined with fostering competition, which motivates managers skill upgrading (McKenzie, 2023).