Economic Prospects in China and ASEAN4
—China’s growth continues to slow, Philippines and Indonesia hold steady

Asian Economic Forecasting Team of JCER*

Points

➢ With labor, capital investment, and productivity growth decelerating, the growth rate in China will decline to a level below 3% in 2030. Income per capita will barely miss the level for a high-income country in 2030. There are huge issues around reducing excess capacity and excess debt.

➢ The growth rate in Malaysia will decline due to a slowdown in the labor force, with average growth of around 3.5% for the period 2026-30. Although the country will enter the ranks of high-income nations in the late 2020s, reforms such as upgrading the industrial structure are vital for further growth.

➢ In the context of a rapidly aging society and a low birthrate, the average Thai growth rate for the period 2026-30 will be the lowest among the ASEAN4 at 2.6%. Income per capita is under pressure from both the Philippines and Indonesia. Labor costs are rising and manufacturing industry competitiveness is declining, but tourism and other service exports are expanding.

➢ With an average growth rate at 5.3% for the period 2026-30, the Philippines will have the highest growth among the ASEAN4. The expanding labor force and capital stock are contributors. Business Process Outsourcing (BPO) will heighten its presence as the engine driving the economy.

➢ Due to labor force and capital stock growth, Indonesia is expected to see average growth rates of around 5% during the 2020s. Whether or not the country can revitalize its declining manufacturing industry is an important point. If the reforms are delayed, there is potential for the growth rate to take a downward turn.

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1. China

- China’s growth rate below 3% by 2030 as growth in the labor force, capital stock, and productivity slows
- Labor productivity slowing to “Asian speeds” as efforts to adjust overinvestment and excess debt continue
- By 2030, income per capita will still be a little below levels in high-income countries

The outlook for the Chinese economy is that the growth rate will drop below 3% in 2030 as growth in the labor force, investment, and productivity alike slows down through 2030 (Fig. 1-1, Fig. 1-2). Led by investment, China has achieved annual growth rates of around 10% since 2000, but adjusting the resulting excess capacity and debt will lead to a pronounced deceleration of investment in particular (Fig. 1-3).

The outlook for the Chinese economy is that the growth rate will drop below 3% in 2030 as growth in the labor force, investment, and productivity alike slows down through 2030 (Fig. 1-1, Fig. 1-2). Led by investment, China has achieved annual growth rates of around 10% since 2000, but adjusting the resulting excess capacity and debt will lead to a pronounced deceleration of investment in particular (Fig. 1-3).
The GNI per capita is expected to fall slightly below the threshold of high-income countries by 2030. In terms of nominal GDP, China overtook Japan in 2009 to rank second in the world and is expected to step up its presence by overtaking the euro zone in 2020, but the gap with the United States, the world’s largest economy, will remain at nearly 30% even in 2030 (Fig. 1-4).

Falling birthrate and aging population

Partly due to the impact of the one-child policy of the past, the Chinese population is aging rapidly while the birth rate is decreasing. The outlook is for the population to decline as of the mid-2020s, and the labor force is also expected to start to decrease around 2018 (Fig. 1-5). The one-child policy has been relaxed in recent years and as of 2016 couples are allowed to have a second child. However, it has been pointed out that the decline in the birth rate is not only a function of policy, there are also major socio-economic factors at work\(^1\), so the expectation is that the policy changes will have limited effect on boosting the number of births.

The labor force participation rate for the elderly is moderate, but the assumption is that it will rise (Fig. 1-6). At present, the retirement age is low compared to advanced countries: sixty for men, fifty-five for women in white-collar positions, and fifty for other women. A gradual rise in the retirement age is under consideration and an announcement of proposed revisions is expected in 2017. In the Green Book of Population and Labor published in December 2015, the Institute of Population and Labor Economics at the Chinese Academy of Social Sciences outlined plans to raise the retirement age to sixty-five for both women and men by 2045 (Fig. 1-7).

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\(^1\) For example, Cai, Yong (2010) “China’s below-replacement fertility: government policy or socioeconomic development?” *Population and Development Review*, 36 (3), pp. 419-440
Despite ongoing policy changes designed to curb the decline in labor force population, it is not possible to offset the aging factor. From an annual increase of 0.4% in the early 2010s, the labor force is expected to decrease by 0.3% in the late 2020s and to slow by approximately 0.7 percentage points over a period of fifteen years.

Until around 2010, the demographic bonus supported growth amid a decline in the ratio of the dependent population of children (under 15) and the elderly (over 65) to the working-age population (aged 15 to 64), but from now on the ratio of the dependent population is expected to increase taking the country into a period of demographic onus (Fig. 1-8). At the same time as the labor force supply comes under pressure, the social security burden will also grow heavier.

Excess capacity and excess debt weighing on growth

After the global financial crisis in 2008, the Chinese government introduced a four trillion yuan stimulus package to accelerate investment in infrastructure and real estate. Although this measure supported the economic climate in China and around the world, corporations are now dealing with excess production capacity and debt as a result of continuing investments without some level of regard for profitability over several years. The capacity ratio in the manufacturing industry has declined by more than ten percentage points over the past five years (Fig. 1-9). By the end of 2015, corporate debt had ballooned to approximately 170% of GDP (Fig. 1-10). This level surpasses the peak in Japan (approximately 150% of GDP at the end of 1994) after the collapse of the bubble economy.

The government has announced measures to cut production capacity including numerical targets for the coal and steel industries where the excesses are particularly large. In the first half of 2016,
it was announced that efforts to reduce excess production capacity were well underway, but there are also signs that rationalization is not straightforward such as the sudden recovery in production output in the steel industry when market conditions improved in the spring of 2016. The outlook is for a prolonged adjustment phase and for investment growth to remain at an average of 2% through to 2030.

Gradual rebalancing of the economy

The thirteenth five-year plan adopted by the National People’s Congress in March 2016 cites five principles for development including innovation, coordination (harmonious interregional development), green development (protecting the environment), openness, and inclusive development (sharing outcomes). This suggests that the focus has shifted from the pace of growth to the content of growth such as adding value and income distribution.

Looking at a breakdown of the demand-side, the Chinese government has since the early 2000s signaled a shift from the export and investment-led economy of the past to a domestic demand-led economy. In the early 2010s, the ratio of investment to GDP rose, partly due the impact of the economic stimulus measures following the global financial crisis in 2008, but now a rebalancing from investment to consumption is underway (Fig. 1-11). While investment decelerates, consumers aspire to high quality and consumption is increasingly weighted toward services in step with the rise in household incomes.

By industry, the weight of the tertiary industry is increasing, accounting for more than 50% of GDP in 2015 (Fig. 1-12). With demand shifting from investment to consumption, it is expected that in addition to the wholesale and retail industries, the relative importance of the service industries including medical care and welfare, cultural pursuits and entertainment will rise further
in the future.

There has also been a rise in awareness of environmental pollution including air pollution due to PM2.5 fine particulate matter. As mentioned above, one of the five principles of the thirteenth five-year plan is green development, which incorporates targets for improving air and water quality. Similar to Japan since the 1970s, corporations are expected to spend more on measures to protect the environment.

Figure 1-11: Consumption and investment as share of GDP

Figure 1-12: Share of GDP by industry

Progress of structural reforms key to productivity

Amid an inevitable slowdown in labor and capital input, the key to future growth is to what extent it is possible to maintain a rise in productivity.

Aiming to add value to its industry, the Chinese government has announced one policy after another including the Made in China 2025 initiative, which aims to upgrade the manufacturing industry to a “manufacturing powerhouse,” and the Internet Plus initiative, which promotes the integration of IT (information technology) in existing industry. There are in actual fact many IT-related companies posting rapid growth.

But there is a lack of clarity around the timetable for upgrading industry under the current system. The 2015 guidelines for deepening reform at state-owned enterprises present policies for optimizing state-owned enterprise and accepting private-sector capital depending on the public interest. However, up to this point in time, the trend for increasing the presence of state-owned enterprises is more conspicuous. The government aims to integrate and consolidate over one hundred state-owned enterprises affiliated with the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) into approximately forty companies by 2020. Large-scale mergers of state-owned corporations in transport infrastructure, resources,
maritime transportation, and other areas have already been announced.

There are concerns around the maintenance of the market monopoly of the state-owned enterprises. Compared to private enterprise, state-owned enterprises tend to earn lower returns (Fig. 1-13) and the proportion running deficits is also high. The fear is that the benefits of productivity improvement through market competition will not be sufficiently utilized.

The reform of the household registration system that restricts mobility is another factor that influences productivity. Workers who come from rural areas to work in the cities cannot access social security unless they have an urban residence permit (hukou), but the major cities, in particular, still impose restrictions on moving the household registry. In 2014, 55% of the population was permanently resident in cities, but the proportion of the population with urban household registrations remains only around 37% (Fig. 1-14). The expectation is that the regulations will be relaxed from the perspectives of justice and efficiency, but if so, one of the issues will be sources of funding for social security.

Based on this situation, the rate of growth for total factor productivity (TFP) will gradually slow to less than 2% under the baseline scenario.
Pessimistic Scenario: Growth slows to the lower 2% level – Productivity slows to the same pace as Japan after the oil crisis

The baseline scenario outlined above assumes that productivity gains will gradually decline, but if in addition to the reforms of the state-owned enterprises, the reforms of the social security system including moving the household registry, and deregulation of private and foreign capital stagnates, or corporate investment slumps by a credit crunch due to a worsening bad debt problem, another likely scenario is that productivity will slow even further. In a pessimistic scenario where TFP growth declines by another 0.5%, the rate of economic growth will slow to the 2% level by 2030 (Figs. 1-15, 1-16).

If we look at the relationship between past GNI per capita and growth rates for labor productivity (TFP x capital equipment ratio) in seven high-income or upper middle-income economies in Asia (Japan, Korea, Taiwan, Hong Kong, Singapore, Malaysia, Thailand), except China, in 2015, growth is on average high despite some scatter in labor productivity gains at the low-income stage, but as incomes rise there is a tendency for productivity gains to slow (Fig. 1-17). Growth rates for labor productivity in the Asian economies presented in the diagram are high compared to the world average, but even so the impressive growth recorded in China in the 1990s and 2000s stands out in comparison. However, the outlook for the future is for productivity to slow down due to the structural adjustments described above. In the baseline scenario, labor productivity growth in China will slow to a pattern that conforms to past trends in the seven Asian economies. In the pessimistic scenario, it is expected that income levels in China in the late 2020s will be at the same level as Japan in the early 1980s and that labor productivity growth will decline to the same level (under 3%) as Japan at the time. In addition, labor productivity growth in Japan has slowed to around 1% since the collapse of the bubble economy in the early 1990s.

**Fig. 1-15: Pessimistic scenario**

<table>
<thead>
<tr>
<th>CY (5-year average)</th>
<th>06-10</th>
<th>11-15</th>
<th>16-20</th>
<th>21-25</th>
<th>26-30</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP (%)</td>
<td>11.3</td>
<td>7.8</td>
<td>4.9</td>
<td>3.0</td>
<td>2.5</td>
</tr>
<tr>
<td>GNI per capita (USD1,000/capita)</td>
<td>3.3</td>
<td>6.9</td>
<td>8.6</td>
<td>10.4</td>
<td>12.9</td>
</tr>
<tr>
<td>Labor force (%)</td>
<td>0.4</td>
<td>0.4</td>
<td>0.0</td>
<td>-0.2</td>
<td>-0.3</td>
</tr>
<tr>
<td>Consumer price index (%)</td>
<td>2.9</td>
<td>2.9</td>
<td>2.0</td>
<td>1.6</td>
<td>1.8</td>
</tr>
<tr>
<td>Current account balance (% of GDP)</td>
<td>7.2</td>
<td>2.3</td>
<td>2.9</td>
<td>3.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Exchange rate to the dollar yuan/USD</td>
<td>7.23</td>
<td>6.27</td>
<td>6.98</td>
<td>7.11</td>
<td>6.90</td>
</tr>
</tbody>
</table>

Source: Haver Analytics

**Fig. 1-16: Contributions to potential growth**

Source: JCER estimate
Figure 1-17: Income per capita and labor productivity rate of increase

Notes: Plots the average for every five years between 1950 and 2015 for eight upper middle-income and high-income economies in Asia as of 2015. GDP is obtained by converting the dollar volume based on 2011 PPP to 2015 prices.
Source: The Conference Board, Total Economy Database
2. Malaysia

- Real GDP growth rate to average 3.5% between 2026 and 2030
- Expected to join the ranks of high-income countries in 2025
- Educational system reforms, industrial development based on private-sector initiatives key to sustained growth

Growth in working-age population down to 1% between 2026 and 2030

The deceleration of the Malaysian economy is likely to strengthen through 2030. Real GDP growth rate will average 3.5% between 2026 and 2030, which is a decline compared to the 5.3% result for the period 2011 to 2015 (Fig. 2-1). In the same period, both private consumption contributions and gross capital formation are down at 1.9% (3.5% in 2011-15) and 0.8% (1.8% in 2011-15) respectively (-0.9% in 2011-15) (Fig. 2-3).

Looking at a breakdown of the potential growth rate, labor force contributions, in particular, are decreasing (Fig. 2-2). The growth in labor force is expected to decline from 4.2% in 2011-2015 to 1% in 2026-2030 (Fig. 2-4). Since no major growth in capital stock is expected as oil-related investment falters due to the drop in resource prices, total factor productivity (TFP) will be key, but the contribution is likely to decline...
with the rise in income levels. The Malaysian government has set a goal of joining the ranks of high-income countries by 2020, but according to our forecasts, this is likely to be delayed until 2025\(^2\).

The environment will be severe in the near future. According to our forecasts, GDP growth rate is expected to slow from 5% in 2015 to approximately 4% in 2016. The sluggish growth in consumption and exports will have an effect. At 89%, the high level of household debt-to-GDP ratio (2015) will hobble consumption. Compared to the other key ASEAN countries, Malaysia is highly dependent on China for its exports, so the slowdown in the Chinese economy is another negative factor. In the period January to June 2016, year-on-year net profit at the state-owned PETRONAS petroleum company fell by 84% due to the impact of the low price of crude oil. A reduction in government tax revenue looks unavoidable due to the dependency on tax yields and dividends from PETRONAS and other resource companies for the majority of annual income.

The Malaysian government has long flagged improved productivity as an important issue and has also indicated that the country wants to escape the “middle-income trap.” The Eleventh Malaysia Plan (Fig. 2-5), the five-year plan covering the period 2016-20 that was announced in May 2015, emphasizes entry into the ranks of high-income countries and promotes structural reform including (1) an inclusive society, (2) improved wellbeing, (3) human capital development, (4) environmental measures, (5) strengthening infrastructure, and so on, by investing 20% of the 2015 nominal GDP, or 260 billion ringgit, during the period. If the oil prices recover, growth rates are likely to improve temporarily, but this is not to say that growth will strengthen in the medium to long term.

Figure 2-4: Population prospects
Figure 2-5: The Eleventh Malaysia Plan
numerical targets (2016-20)

<table>
<thead>
<tr>
<th>Target Description</th>
<th>Year 2016-20 Goals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real economic growth rate:</td>
<td>Average 5-6%</td>
</tr>
<tr>
<td>Real private consumption:</td>
<td>Annual average 6.4%</td>
</tr>
<tr>
<td>Public investment (nominal):</td>
<td>Expand by average of 131 billion ringgit annually</td>
</tr>
<tr>
<td>Private investment (nominal):</td>
<td>Expand by average of 291 billion ringgit annually</td>
</tr>
<tr>
<td>Annual revenue:</td>
<td>Expand by annual rate of 7.9%, reduce dependency on petroleum-related income</td>
</tr>
<tr>
<td>Fiscal deficit:</td>
<td>Reduce from 3.2% of GDP to 0.6%</td>
</tr>
<tr>
<td>Government debt:</td>
<td>Reduce from 53.3% of GDP to 43.5%</td>
</tr>
<tr>
<td>Inflation rate:</td>
<td>Low and stable. Annual average of 2.5-3%</td>
</tr>
<tr>
<td>Unemployment rate:</td>
<td>2.8%</td>
</tr>
<tr>
<td>GNI per capita:</td>
<td>54,100 ringgit</td>
</tr>
<tr>
<td>Increase average monthly household income:</td>
<td>From 6141 ringgit (2014) to 15,400 ringgit</td>
</tr>
</tbody>
</table>

Note: Prepared from press materials, 1 ringgit=approx. 25 yen (September 16, 2016)

\(^2\) Depreciation of the ringgit has had an impact since the end of 2014.
Halting the decline in export competitiveness

One of the structural issues of the Malaysian economy is the decline in the competitiveness of exports. According to the present forecast, it is assumed that the extent of the contribution of exports of goods and services to the growth rate will decline from 3.2% in the period 2016-20 to 2.4% in the period 2026-30. The context is sluggish growth in appliances and electronics.

Malaysia developed as an export hub for appliances and electronics in the 1980s based on Prime Minister Mohamad Mahathir’s Look East Policy of learning from economic growth in Japan and Korea. But, the cost advantages have been eroded with the intensifying price war around semiconductors, which account for the largest share of exports, and the rise in wage levels at home where the monthly salary per person in the manufacturing industry for the period April-June 2016 was 3058 ringgit, an increase of a little over one third compared to five years ago (2291 ringgit)\(^3\). China, which is one of the main shipping destinations, has expanded their own production capacity, which has also had an impact.

In fact, since peaking in 2006, semiconductor export value has made little progress and the ratio of manufactured goods as a share of the export of goods has declined from a peak of 80% in 2000 to 67% in 2015 (World Bank survey). The appliances and electronics sector, including semiconductors, accounted for 12% of manufacturing industry investment in 2015, a drop of approximately 7% points compared to two years previously (Fig. 2-6).

The petroleum refinery and products sector has increasingly made its presence felt as a force for driving investment. Over the past several years, the industry has accounted for a rising share of investment in the manufacturing industry, outperforming the appliances and electronics sector for the second year running in 2015 with a ratio of 36.1%. However, the oil-related industries tend to be influenced by fluctuations in the price of resources. It is essential for Malaysia to continue to withdraw from the resource-based industries and to develop new industries that are internationally competitive.

Some things have started to germinate. For example, ICT-BPO services are expanding in Malaysia. The ICT-BPO industry develops software for financial and communication industries and offers value-added services via call centers. Successfully developing this industry would boost the potential growth rate for Malaysia, raising the possibility for the growth rate to be adjusted upwards.

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\(^3\) Based on Haver Analytics
Improving education standards

Since Malaysia aims to enter the ranks of high-income countries, improving the level of human resources is essential. Although the enrollment rate in higher education (tertiary education, universities, vocational colleges etc.) is 38.5% (2013) and rising, the rate is below Thailand (51.4%) and both Indonesia and the Philippines are gaining on Malaysia (Fig. 2-7).

Higher education as a percentage of the overall education budget is high at 34%, but this is not linked to higher enrolment rates. In addition to enhancing export competitiveness and upgrading the industry structure, reforming the education system to augment the supply of skilled workers is essential.

The outcome of the Bumiputera policy

Malaysia has continued the Bumiputera policy of preferential treatment for the majority Malay since the 1970s. Under the policy, preferential treatment is implemented based on a system of ethnic quotas in various fields including shares, employment, education, business licenses, land, and financing. The policy has brought political and social stability by giving preference to the Malays, who are economically disadvantaged compared to the minority Chinese and other ethnic populations but it has also had adverse effects. For example, a World Bank study in 2011 sounded the alarm bells saying that ethnic Chinese are continuing to leave Malaysia because they resent the limitations placed on opportunities for education and employment in the country. This brain drain phenomenon is a cause of the skilled worker shortage.

The Bumiputera policy is also involved in the problems around the government-linked companies (GLC) that control the Malaysian economy. The GLCs have a very strong presence in many sectors in Malaysia including resources, communication, transport, and banking. The GLCs are, of course, Malay-owned corporations, so the scale of government patronage has been increased under the Bumiputera policy. Many GLCs are strongly motivated to develop overseas business and to act as a driving force for developing an international outlook for the economy but, on the other hand, they obstruct healthy competition and distort the economy due to their unparalleled influence within the country. The government needs to stimulate competition through privatization and to revitalize private investment.

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However, amid a conspicuous exodus of ethnic Chinese from the ruling party, the ruling coalition party led by Prime Minister Najib Razak is increasing its reliance on the ethnic Malay whose numbers are on the rise (Fig. 2-8). Since the Bumiputera policy is a national policy enshrined in the Malaysian constitution, any revision would be a major exercise. Given these issues, the kind of reform of the social and economic systems that would make major contributions to sustained productivity growth can hardly be expected to take hold in Malaysia.

High hurdles on the path to Asian NIEs levels

GNI per capita has already exceeded 10,000 US dollars in Malaysia. As mentioned at the outset, Malaysia is likely to be the first among the five countries discussed in this report to become a high-income country. Malaysia is one of the participating nations in the Trans-Pacific Strategic Economic Partnership Agreement (TPP), but this forecast has not taken the effect of this agreement into account. The future of the TPP is shrouded in uncertainty, but if the agreement takes effect, trade and investment can be expected to expand, and it is possible that growth rates for Malaysia will exceed the forecasts.

However, the Malaysian government aims to raise the country’s economic level to the same level as Korea, Taiwan, and other newly industrialized economies (NIEs) in Asia. Seeing that GNI per capita in Korea is 2.6 times higher than Malaysia (2015), a great deal of effort will doubtless be required to reach this level.

Where the political climate in the near term is concerned, the suspicions swirling around Prime Minister Najib’s involvement with the 1MDB state development fund have not yet developed into a question of the Prime Minister’s liability. Rather, the Prime Minister appears to be consolidating his authority by expelling opposing forces from the ruling party. In fact, the opposition parties in Malaysia have been weakened, and it is widely thought that the ruling coalition under Najib’s leadership is likely to once again win the next general election to be held by 2018, and that he will remain in office. However, if it becomes clear that Najib has been involved in wrongdoing, the political situation will instantly become fluid with the potential to have adverse effects on foreign investment in Malaysia.
3. Thailand

- Real GDP growth rate for 2026-30 forecast to average 2.6%
- Total population to take downward turn from 2023, labor force also to decline ahead of 2030
- Export of goods is sluggish, but there is hope for service exports focused on tourism

The population will peak in 2023

The real GDP growth rate in Thailand will decline from an average of 3.0% in the period 2016-20, to 2.6% in the 2020s (Fig. 3-1). Gross national income (GNI) per capita in 2030 is forecast to be 13,500 US dollars, a 2.3-fold increase from 2015. But Thailand will not reach the threshold of a high-income country (approx. 16,800 US dollars in 2030); rather, it will remain a upper-middle income country in 2030. Thailand will maintain a higher standard than Indonesia and the Philippines, but will come under pressure from both countries where high growth will continue.

Demographics is a negative factor (Fig. 3-3). The population of Thailand (65.12 million in 2014) will peak at 66.03 million in 2023 before entering a slow decline. The labor force peaked in 2012 at 39.41 million. In 2014, 15% of the population was aged 60 or over, but that proportion is forecast to nearly double to 27% by 2030 as society continues to age. The unemployment rate in Thailand has long hovered around 1%, but since an increase in the labor force cannot be expected, the rate is likely to decline to the 0.5% level in the future.

The unemployment rate in Thailand is extremely low compared to neighboring countries. The reason is said to be that the agricultural sector in Thailand has a high labor absorption capacity, and that unemployed workers in urban areas return to the rural areas to find employment in agriculture. Accounting for 40% of all employment, the agricultural sector is certainly large (Fig. 3-4). However, the agricultural sector in Indonesia also has similar levels of employment, yet the
unemployment rate in Indonesia is higher than in Thailand, so the high labor absorption capacity of the agricultural sector alone is not a credible explanation for the low unemployment figures\(^5\). In Thailand, agriculture accounts for no more than 9% of nominal GDP and the wages are low at approximately 40% of the average wage in 2015. It is assumed that the problem is a structural one, where agricultural laborers are satisfied with relatively low wages and do not shift to sectors with higher wages.

Compared to neighboring countries, the rapid advance in the aging population and low birth rate in Thailand suggests that the employment situation with its extremely low availability of workers is set to continue. Labor input is expected to make a negative contribution to potential GDP growth in the years leading up to 2030 (Fig. 3-2). Full employment will be maintained, but Thailand is likely to need policies to enhance productivity in the agricultural sector in order to shift surplus workers to the non-agricultural sectors, and to accept migrants from neighboring countries.

Figure 3-3: Total population, old-age population, working-age population

![Figure 3-3](image)

Figure 3-4: Employment in the agricultural sector and the unemployment rate

![Figure 3-4](image)

**Weight of growing household debt**

Although the growth rate of private consumption will gradually decline, it will stay at the 3% level until 2030. The population will decrease, but growth in employment income per capita will be maintained at a little less than 6% to reach 265,000 baht in 2030, or 2.4 times the 2014 figure. The increase in consumer purchasing power will accelerate the trend toward a consumption-led economy. Meanwhile, the expected increase in the ratio of household debt to nominal GDP from 72% in 2015 to 100% in 2030 will weigh on consumption growth.

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\(^5\) Kumagai, Shotaro (2012) “Naze Tai no shitsugyōritsu ha hikui noka? – Teishitsugyōritsu no haikei to bukka he no eikyō” (Why is the unemployment rate in Thailand low: Background to low unemployment rate and impact on the cost of living), The Economic and Social Research Institute, Cabinet Office
No major growth in private investment can be expected due to sluggish growth in the domestic market and a decline in international competitiveness. Growth is expected to fluctuate at the 2-3% level. Increased income for workers is a positive, but it is a negative factor for overseas manufacturing industry in search of a cheap labor force. If integration with markets in the neighboring countries goes ahead by means of the ASEAN Economic Community (AEC), there will be no need to place production hubs in Thailand where the cost of labor is high. As a result of sluggish domestic and international demand, there is currently excess automobile manufacturing capacity with corporations refraining from major investment in the near future. It will likely take some time before direct overseas investment recovers (Fig. 3-5). Consumption as a share of GDP will rise somewhat from 67% in 2015 to 69% in 2030. Investment will stay at 24-25% (Fig. 3-6).

The current forecast is premised on assumptions about external conditions such as (1) economic growth in China will slow to 2.8% by 2030, (2) crude oil prices will recover to USD100 through 2030, and (3) interest rates in the United States will rise to 2.75% by 2030. Under these conditions, the consumer price index in Thailand will rise in line with the increase in crude oil prices from the 1-2% level in the late 2010s until the early 2020s before stabilizing around 2% (Fig. 3-7). Interest rate variations are also expected to move in tandem with inflation trends. Expectations for infrastructure improvement and other public investment is rising, but with an accelerating deterioration in the fiscal balance, outstanding public debt is also expected to increase, raising issues about sustainability. Social welfare spending will also increase by 2030 in line with the aging society. Both government investment and government spending will remain at the 1% level.

Figure 3-5: Gross fixed capital formation
Figure 3-6: Real GDP composition ratio

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6 The Bank of Thailand inflation target is currently 2.5% plus/minus 1.5%.
Service exports are compensating for the slowdown in manufactured goods exports

Thailand is an export-dependent economy. Exports grew by an annual average of 5.5% in the period 2001-15, but will slow to 2.3% in the period 2016-30. Exports accounted for 75% of GDP in 2015, but the share will decline to 70% by 2030. Since domestic demand is not expanding much, imports are also sluggish, resulting in net exports maintaining a plus. The export-oriented economic structure is not undergoing much change. With the deepening of the AEC, it is thought that exports to neighboring countries will continue to expand with the focus on automobiles and automotive products. Since the electronics industry, which includes hard disk drives (HDD) and white goods, is confronted with a shift to new electronic devices and other structural changes in the industry, its position as an export industry is likely to decline. Direct investment by foreign enterprise is flowing into Vietnam and the Philippines where labor is plentiful. The rise in labor costs is probably linked to the declining influence of Thailand as a hub for export manufacturing7.

The competitiveness of the manufacturing industry is likely to decline, but the tourism and services industries are compensating for the decline. The proportion of the services export industry as a percentage of goods and services exports will rise from 23% in 2015 to 38% in 2030 (Fig. 3-8). The outlook is for industry to become increasingly service-oriented with the focus on the tourism industry. In 2015, Thailand received thirty million overseas visitors, but the number of tourists is expected to top ninety million by 20308.

Toward infrastructure upgrades and the digital economy in the 12th development plan

The Thai government is currently controlled by the military. In a national referendum on a proposal to reform the constitution held in August 2016, 61% of voters chose in favor of the draft

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7 Bank of Thailand, Monetary Policy Report, June 2015
8 Incidentally, Japan aims to triple the number of overseas visitors from 19.74 million in 2015 to sixty million by 2030.
Economic Prospects in China and ASEAN4: 2016-2030
September 2016

There are prospects for a general election to be held by late 2017 to pave the way for a return to civil government. However, in the five years since implementation, the military government can appoint almost all 250 members of the upper house and the upper house can also participate in the choice of prime minister. There will be no return to the democracy prior to the coup d’état even after the election, and it is likely that the administration will be heavily tinged by military control.

The provisional military government will be in place until late 2017, but it is preparing economic policies to raise Thailand’s international competitiveness in the long term. The National Economic and Social Development Board (NESDB) is formulating the 12th National Economic and Social Development Plan, the five-year plan covering the period 2017 to 2021. According to press reports, the goals are to achieve 5% annual economic growth and to increase GNI per capita from the present 6000 dollars to 8200 dollars. However, as mentioned at the outset, we forecast that reaching these goals will be difficult.

The 12th development plan is set to hammer out ten strategies including developing human resources, eliminating the income divide, developing hi-tech and technical innovation, upgrading the transport and logistics infrastructure, promoting urban expansion and special economic zones, and cooperating with neighboring countries to improve connectivity. The policies include plans to upgrade the rail and road networks by investing approximately 1.8 trillion baht in upgrades to the infrastructure by 2020. In terms of industrial policy, there are plans to cultivate new industry such as robots, aircraft and transportation, biotech, medicine, and the digital industries on the basis of the existing automobile and agricultural industries, in addition to the cluster policy outlined in September 2015, which aims to concentrate specific industries in specific regions. Concerning the digital industries, it was decided to set up a Ministry of Digital Economy and Society by reorganizing the Ministry of Information and Communication Technology.

If these plans are quietly advanced under the supervision of the military, the growth rate and national income per capita are likely to rise higher than the forecasts by means of improving productivity and accumulating capital stock.

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9 The Nation (website), “Human resources at the core of 12th national development plan: PM”, 15 September, 2015
10 Nikkei Shimbun (electronic version), dated March 4, 2016
4. The Philippines

- Maintain real GDP growth rate at the 5% level in the 2026-30 period
- BPO revenue becomes driving force as it exceeds overseas remittances
- Improving the investment environment is an issue. For now, attention is on economic reforms by the Duterte regime

**Figure 4-1: Economic prospect**

<table>
<thead>
<tr>
<th>C.Y.</th>
<th>(5-year average)</th>
<th>06-10</th>
<th>11-15</th>
<th>16-20</th>
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<tbody>
<tr>
<td>Real GDP (YoY%)</td>
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<td>5.9</td>
<td>6.2</td>
<td>5.5</td>
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<tr>
<td>Consumer price index (YoY%)</td>
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<td>3.4</td>
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<td>Current account balance (% of GDP)</td>
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<td>-1.7</td>
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<td>Exchange rate to the dollar (PHP/USD)</td>
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<td>47.3</td>
<td>46.0</td>
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</tr>
</tbody>
</table>

Source: Haver Analytics

**Figure 4-2: Contributions to potential growth**

**Figure 4-3: Real GDP growth rate**

Economy led by consumption and investment

Real GDP growth rate for the period 2026-30 in the Philippines is expected to clock 5.3%, down from 5.9% in the period 2011-15, but remaining at the 5% level (Fig. 4-1). This is still the highest growth rate among the ASEAN4. The demographic bonus is set to continue as the labor force increases due to the high birthrate with the population reaching 124 million in 2030 (100 million in 2015) and the labor force increasing to approximately 54 million (42 million in 2015). If the rate of increase of the labor force averages 1.6% annually in the period 2026-30, it will likewise be the highest rate of increase in the ASEAN4.

Consumption and investment are driving growth (Fig. 4-3). Rodrigo Duterte, inaugurated as President of the Philippines at the end of July 2016, has disclosed aims to raise the budget for infrastructure development as a share of GDP from 4.3% in 2015 to 7% by the end of his term in office in 2022. It is likely that government-led infrastructure investment in roads, airports, bridges etc. will expand over the next several years.
Consumption performance will also remain steady due to the population increase and the rise in remittances by Overseas Filipino Workers (OFW). The rate of contribution of private consumption to the GDP growth rate in the period 2016-20 is forecast to exceed 70%. The scenario where consumption and investment are the drivers will continue in 2026-30. The potential growth rate will roughly consistently stay at the 5% level until 2030. Labor force contributions will gradually decline, but capital stock growth will rise.

**BPO and OFW are the two great engines**

BPO (Business Process Outsourcing) and OFW are expected to take on the role of economic engines in the medium to long term. OFW remittances, which account for approximately 10% of GDP, will increase with the rise in OFW numbers and growth in the world economy, pushing up domestic consumption. Meanwhile, BPO is stepping up its sense of presence to outshine OFW. In recent years, OFW remittances have increased by USD 1.5 billion annually, but BPO is continuing to rise at twice the pace, or USD 3.5 billion annually (Fig. 4-4).

BPO is outsourcing some corporate business functions such as HR and accounting, customer service, or other indirect operations to an external party. According to the IT and Business Process Association of the Philippines (IBPAP), total BPO revenue for 2015 rose by 12% year-on-year to USD 21.2 billion. According to IBPAP management, BPO could potentially rise to USD 28.9 billion in 2017 to exceed overseas remittances.

The Philippines is competitive as a destination for BPO because (1) it has the largest population of English speakers in Southeast Asia, (2) labor costs are low, and (3) the government is supportive (corporate tax exemptions for a limited period and other incentives). The classic example is the call center operations with telephone operators on standby. In fact, the Philippines has the world’s largest share of call centers. Many major U.S. companies outsource operations to the Philippines. According to statistics for 2013, the Philippines accounted for 55% of all such outsourcing in terms of order volume.

In recent years, there has also been an increase in IT-related services producing sophisticated software for financial institutions, which are expected to become a new driver for BPO. Japanese corporations are also prominent customers in this field. Six special IT zones have already been introduced in Davao City on Mindanao, which is President Duterte’s birthplace. There is also potential for the BPO business to expand to areas outside Metro Manila.
According to industry officials, salaries for IT-related work, including software production, start from 20,000 pesos (approx. 50,000 yen), which is high compared to the 15,000-20,000 pesos at call centers. According to the Philippine Software Industry Association, there are more and more highly skilled professionals in the IT field and competitiveness is increasing. For the time being, sales are forecast to rise at a rate of 20% annually, and employment to expand. In addition to the IT field, medical records and other hospital systems, animation and game development are also expanding. Originally, animation was mainly done by hand, but with the advance of 3D and other technologies, it has turned into a business with relatively high unit costs.

The issue of reducing disparity

There are major regional disparities in the Philippines, which is a factor that prevents economic standards from rising. According to a government survey, the top 29% of households account for 63% of total household income. The benefits of high growth have not been adequately passed on to the low-income groups. As indicated in Fig. 4-5, there are also great regional disparities with a large gap in poverty rates (annual income of 19,000 pesos or less) between the National Capital Region (3.9%) and the Autonomous Region in Muslim Mindanao (55.8%). GDP per capita in the NCR (including Manila) is conspicuously high at 399,000 pesos, but the figures for Mindanao, where there are large Muslim populations, and Bicol are fairly low at 27,000 and 47,000 pesos respectively. As the first president from Mindanao, Duterte is eager to make Davao City a successful model for regional cities. The plan is to concentrate budget allocation to the regions with the intent to correct regional disparities.

Figure 4-5: GDP per capita and poverty rate disparity by region

Many people in local business communities are also calling for development of the manufacturing industries. In the context of rising domestic demand, Toyota Motor Corp.,

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13 The Family Income and Expenditure Survey (2012), Philippine Statistics Authority
Mitsubishi Motors Corp., and other automotive companies are building factories in the Philippines. However, compared to the other major countries in the ASEAN, the manufacturing industry has a modest presence. As well as absorbing the expanding labor force, stimulating the manufacturing industry is also crucial for enhancing the industrial base and export capacity.

Ports, roads, and other physical infrastructure in the Philippines have previously been identified as inadequate. The 2016 edition of the World Bank’s Doing Business Index (189 countries and regions surveyed) also indicates that the Philippines scores badly on systems and rules, ranking 165th in the world for starting a business, 155th for protecting minority investors, and 140th for enforcing contracts. Requirements include improving the investment environment by relaxing regulations and attracting foreign investment.

Positives and negatives of the exodus of human resources

The exodus of human resources in the shape of the OFW has both positive and negative aspects for the Philippine economy. According to a survey by the Commission on Filipinos Overseas (CFO), university students and graduates account for the highest number of registered OFWs at 38,000, or a little over 50%. They account for the vast majority, far more than high school students or graduates (approx. 17,000), or elementary school students or graduates (approx. 11,000). Moreover, the number of registered university students or graduates tends to increase. This suggests that many well-educated people are moving overseas in search of work amid limited attractive workplaces in the country (Fig.4-6). These well-educated workers are important because they make up the core of the OFWs supporting the Philippine economy, but on the other hand, the fact that they do not take jobs at home is one reason for the lack of improvement in the skill set of domestic workers.

Professor Tereso Tullao at De La Salle University, the most prestigious private university in the Philippines, complains about the lack of government investment in education. He goes on to say that there are many universities in the Philippines, but only 20% of the schools have secured the required standards. It is not enough to create enough employment in the country to absorb workers, but it is also important for the Philippine economy to expand the education infrastructure to educate outstanding human resources.
Economic reforms under the Duterte administration

Once ridiculed as an ASEAN failure, the Philippine economy today continues to show the highest growth rate among the principal ASEAN countries and expectations for further growth are rising. As indicated by this forecast, the Philippine economy has high potential to enhance economic levels ahead of 2030.

President Duterte has hit the headlines for the way he handled narcotics crime and corruption during his time as mayor of Davao, but he has rapidly worked out a succession of economic policies. In his inaugural speech in July, he laid out policies intended to reinforce the economic infrastructure including (1) fiscal and monetary policies aimed at high growth, (2) lower income tax rates for individuals and corporations, improving the investment environment, (3) promote investment in the labor-intensive manufacturing, agricultural, and tourism industries to create employment, and (4) upgrade national roads and bridges, and improve the infrastructure in the Mindanao region.

If the series of reform proposals makes steady progress, the foundations for sustained growth will be reinforced. However, it is uncertain whether or not the reforms will remain on track amid deep-seated opposition within the country. In some views, the president simply wants to use the state machine to maintain and reinforce public security. Since Duterte assumed the office of president on a promise to eradicate drug dealers within six months, around one thousand suspected drug dealers have been killed\(^\text{14}\), and Duterte has been criticized by the United Nations for the use of “extrajudicial measures.” Duterte has hit back, warning that he may withdraw from the UN. If friction with the international community grows stronger, foreign investment in the Philippines will slow, potentially putting downward pressure on the GDP growth rate.

\(^{14}\) Reported by the Philippine National Police on September 4, 2016. Applies to a period of roughly two months since Duterte took office as president at the end of June.
5. Indonesia

- Real GDP growth rate expected to remain at the 5% level in the 2020s.
- With the population increasing and incomes rising, consumption will continue to expand, driving growth.
- Stimulating the manufacturing industry is an issue. If reforms stagnate, growth will be hobbled.

Figure 5-1: Economic prospect

<table>
<thead>
<tr>
<th></th>
<th>C.Y. (5-year average)</th>
<th>Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real GDP (YoY%)</td>
<td>5.8 5.5 5.0 4.9 4.9</td>
<td></td>
</tr>
<tr>
<td>GNI per capita (USD1,000/capita)</td>
<td>2.3 3.7 4.2 6.3 10.2</td>
<td></td>
</tr>
<tr>
<td>Labor force (YoY%)</td>
<td>1.8 1.0 1.4 1.2 1.1</td>
<td></td>
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<tr>
<td>Consumer price index (YoY%)</td>
<td>7.8 5.7 4.4 5.0 4.9</td>
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<tr>
<td>Current account balance (% of GDP)</td>
<td>1.5 -2.2 -2.7 -5.8 -7.9</td>
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<tr>
<td>Exchange rate to the dollar (IDR/USD)</td>
<td>9498 10776 13632 14357 14285</td>
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</table>

Source: Haver Analytics

Working-age population will account for 70% of total population in 2030

With real GDP growth rates set to continue at the 5% level as of 2020, Indonesia together with the Philippines will be the drivers of growth in the ASEAN4 (Fig. 5-1). Stable population growth is a positive factor. In 2030, the overall population will increase at a rate of 0.7%, but the labor force will grow by 1.1%, the second highest figures in the ASEAN4 after the Philippines. In 2030, the working-age population (aged 15 to 64) will account for approximately 70% of the total population, making it possible to take advantage of abundant labor (Fig. 5-3). In addition to a rise in capital stock due to increases in infrastructure investment, regulatory reform progress may also lead to a rise in total factor productivity (TFP) (Fig. 5-2). As a result, GNI per capita in Indonesia is forecast to increase from an average of 3700 dollars in 2011-15 to 12,300 dollars in 2030. Even though Indonesia will not reach the ranks of high-income countries, the country is only 1200 dollars behind Thailand, which finds itself in a situation of low growth compared to Indonesia.

Strong private consumption

Two years have passed since President Joko Widodo took office in October 2014. Due to the effect of a series of economic reforms including foreign investment deregulation, and economic
stimulus measures such as cuts to electricity tariffs since September 2015, economic performance in the near term is steady with real GDP growth for the period April to June 2016 at 5.2%. As indicated by the rise in sales of automobile, private consumption, which accounts for 60% of nominal GDP, is strong. Consumer confidence is picking up as incomes rise and prices stabilize, but opening up the e-commerce market and other deregulation has also provided a boost. The inflation rate is down, the rupiah has stabilized as the economy rallies, and there is some leeway for cutting interest rates. Assuming that prices remain stable, the population increase will sustain consumption growth in the medium term. Hinging on the government’s plans for infrastructure development, gross capital formation is also forecast to rise (Fig. 5-4).

Initially, the Joko administration faced a situation where opposition parties controlled the majority of parliament, but the power base has stabilized since the main opposition Golkar party backed the ruling party and coalition government in May 2016. The Joko administration has announced thirteen economic reform packages since September 2015. Specifically, the packages include the simplification of investment procedures, reforms to the wage system, expanding incentives inside the special economic zones, building energy infrastructure, and encouraging business startups. In the July 2016 cabinet reshuffle, the president appointed Dr Sri Mulyani Indrawati, Managing Director at the World Bank, to the post of Finance Minister. Indrawati also served as Finance Minister in the Yudhoyono administration and is known to enjoy the confidence of the markets. Inviting a known reformer to join the Cabinet will allow the administration to implement a series of reform programs while attracting capital from abroad, and to promote a large-scale infrastructure program, including power stations, highways, and ports, with a total project cost of approximately 5,400 trillion rupiah (approx. 54 trillion yen).
Withdrawing from the resource-based industries is key

Developing the manufacturing industry is likely to be one of the challenges for the Indonesian economy. Amid the steep rise in resource prices in the 2000s, growth in Indonesia continued to rely on resources because oil and coal are the country’s main products. As a result, the presence of the manufacturing industry was diminished. The fact is that the manufacturing industry as a share of GDP continued to decline in the 2000s to the point where it’s now at the same level as the Philippines (Fig. 5-5).

If we look at Indonesian exports, the top five products are all related to resources or agriculture including coal, palm oil, or petroleum gas, and together they account for approximately 40% of total export value. Industrial products narrowly make it into sixth place with automobiles. Although not targeted in this forecast, major investment by Samsung in Vietnam, another ASEAN member nation, led to mobile phones emerging as the largest export item, replacing sewn products in 2013. This is how the value of Vietnamese exports rose rapidly to overtake the value of Indonesian exports in 2015.

On top of weakening resource prices, Indonesia has also been a net importer of oil since 2012, revealing the limits on the conventional resource-dependent growth model. In the future, the country will be required to attract substantial foreign investment to the manufacturing sector, create employment to match the increase in the working-age population, and to promote exports. Whether or not Indonesia can leverage the location advantage as a production and export hub to attract foreign capital will be critical in this regard. However, similarly to China, the trend for rising unit labor costs (ULC) has been strengthened in Indonesia, where costs are rising at a quicker pace than Thailand in recent years (Fig. 5-6). Although wages have risen substantially in recent years, they are still at a low level for an ASEAN country, but cost competitiveness is declining because productivity is low.

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15 2014 results based on UN COMTRADE. HS4 digit
Infrastructure development and deregulation are a given to increase productivity, but it is also essential to improve the quality of labor. Indonesia enjoys advantages due to the scale of its population and labor force. However, despite the high diffusion rate of compulsory education, education levels are low. According to the OECD Programme for International Student Assessment (PISA)\textsuperscript{16}, students perform badly across the board in the three areas of mathematics, reading, and science, falling short of other ASEAN countries (Fig. 5-7). Improving the education system is an important challenge for any country, but we can safely say that the necessity to do so is higher in Indonesia. Women’s labor participation rate is approximately 63% of the male rate (2015), putting Indonesia just ahead of India and Malaysia in Asia\textsuperscript{17}. Promoting employment for women by informing women of educational opportunities is also an important measure.

Expand GVC participation

Korea, Taiwan, and other newly industrialized economies (NIEs) in Asia, as well as Malaysia and other principal Asian countries have continued to grow while boosting their participation in the Global Value Chain (GVC). Specifically, they have expanded economic relations with several foreign countries by attracting investment by multinationals in the manufacturing industries and playing a role in the international division of labor. The size of the trade in parts suggests the degree of participation in the GVC. In Indonesia, the ratio of the parts trade as a share of total imports is 13% (2014)\textsuperscript{18}, smaller than Malaysia at 28%, the Philippines at 25%, and Thailand at 18%, suggesting a relative level of neglect where GVC is concerned. Foreign policy is also

\textsuperscript{16} PISA (Programme for International Student Assessment) is an international academic performance test implemented by the OECD. 65 countries are surveyed. 15-year-olds are tested on mathematics, reading, and science once every three years.

\textsuperscript{17} Based on the World Economic Forum gender gap index

\textsuperscript{18} Based on RIETI-TID 2014, METI
important to increase GVC participation.

Specifically, it is a matter of expanding the framework for economic collaboration with other countries. As a member of the ASEAN, Indonesia participates in the ASEAN Economic Community (AEC), which launched at the end of 2015. Unlike Vietnam and Malaysia, however, Indonesia is not participating in the Trans-Pacific Partnership (TPP). Even though the prospects for ratification by the United States are not good and the outlook for the future is stormy, President Joko has said that the flow of economic integration will not stop, indicating a positive stance on TPP participation. With negotiations scheduled for a free trade agreement (FTA) with the European Union, Indonesia should contribute to GVC participation by tackling trade and investment liberalization and developing transparency around rules.

Focus on the President’s leadership qualities

As mentioned at the outset, Indonesia is supported by its population trends and the medium-term outlook for the economy is relatively bright among the ASEAN4. For the time being, this forecast assumes that structural reform initiatives, including deregulation, will gradually have some effect and that we can expect increased productivity. Still, it is difficult to be optimistic about the future. The standard of the business environment in Indonesia is the lowest among the principal ASEAN countries (Fig. 5-8). The country rates low on law enforcement, property registration, and business licensing, and there are many challenges ahead. In Indonesia, the presidential term is five years with a maximum of two terms in office. The next presidential election is in 2019. President Joko will focus on consolidating his power base in the lead-up to the next election, and once he is reelected, he is likely to tackle difficult issues such as promoting regional economic partnerships where opposition is strong. If the reforms stagnate, the possibility of a downturn in the growth rate emerges.

Figure 5-8: Asian countries ranked for ease of doing business

![Figure 5-8: Asian countries ranked for ease of doing business](image)

Note: Rankings among 189 countries and regions.
Source: “Doing Business Index,” World Bank

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