

### BOX 2.1.1 Potential growth in East Asia and Pacific

*The East Asia and Pacific region's potential growth rate has fallen in recent years to well below the high rates prior to the global financial crisis and its longer-term average. Notwithstanding this decline, the 7 percent pace remains twice as high as the emerging market and developing economy (EMDE) average. Growth rates in China and in the rest of the region are gradually converging. The slowdown of regional potential growth reflects a moderation of potential growth in China. In the rest of the region, potential growth has been strengthening compared to its longer-term average, mainly reflecting a robust capital accumulation. Policies to boost total factor productivity across the region could partly offset the diminishing returns from capital and the effects of demographic trends in several major economies that dampen labor supply and slow productivity growth.*

#### Introduction

Since the Asian financial crisis 20 years ago, growth in the East Asia and Pacific (EAP) region has been twice as high as the EMDE median (Figure 2.1.1.1). However, the region's growth rate has slowed sharply, especially since the global financial crisis, reflecting both cyclical downturns and a weakening of the region's underlying rate of potential growth (Chapter 3).

Notably, China's potential growth rate fell sharply from around 10 percent during 2003-07 to around 7-8 percent during 2013-17, about 1.3 percentage points below its longer-term (1998-2017) average. Following initial effort to sustain actual growth above potential growth, government-initiated policies that gradually brought actual growth in line with the lower potential growth rate and shifted the impetus of growth from investment to consumption. This prevented the opening of large output gaps. However, and sizable financial vulnerabilities, accumulated during the earlier period of rapid, credit-fueled expansion, have yet to be addressed (World Bank 2016a, 2016d).

Elsewhere in the EAP region, potential growth strengthened somewhat in 2013-17, although with wide divergences among countries. The region excluding China is now experiencing a cyclical upturn of growth toward its trend level, led by the commodity exporters (e.g., Indonesia, Malaysia, Mongolia) that were hit by sharply lower world prices, and Thailand, which faced domestic challenges.

Against this backdrop, this box examines deeper the following questions:

- How has potential growth evolved in the region and what were its main drivers?
- What are the prospects for potential growth?
- What are the policy options to lift potential growth?

Note: This box was prepared by Ekaterine Vashakmadze. Anh Mai Bui and Jinxin Wu provided research assistance.

This box suggests that China's potential growth is expected to be limited by the effects of demographic trends that dampen labor supply and by diminishing returns from capital, while the rest of the region continues to face the challenge of boosting its relatively subdued total factor productivity growth. The EAP region is expected to experience a broad-based slowdown in potential growth to a (still-robust) rate of around 6 percent during the next decade (2018-27). This box concludes that policy efforts could help moderate the slowdown, support poverty reduction, and even help several middle-income regional economies to attain high-income status. As factor accumulation is expected to slow, accelerating productivity growth is the main path for many regional economies to achieve convergence with upper income economies.

#### Evolution of potential growth<sup>1</sup>

At around 7.2 percent in 2013-17, potential growth in the EAP region was about twice as high as the average for other EMDEs, but still well below the rates achieved over the past two decades (Figure 2.1.1.2). This weakening reflected a slowdown of potential growth for China from around 10 percent prior to the global financial crisis to around 7-8 percent.

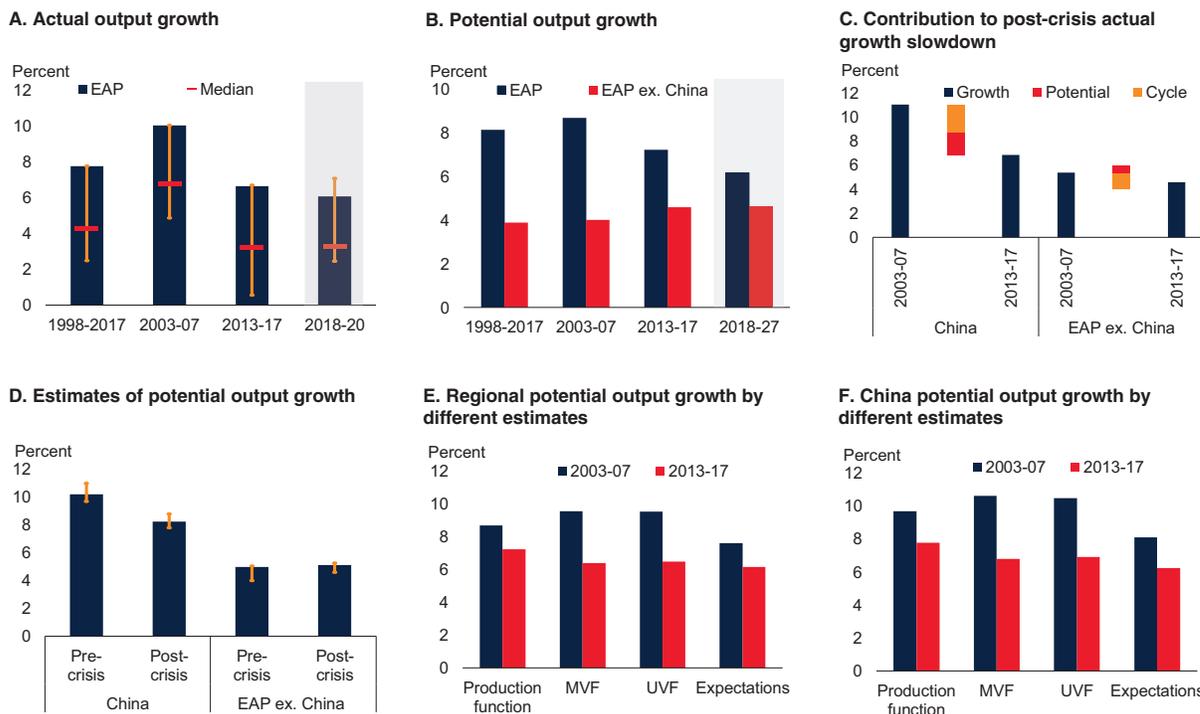
In contrast, potential growth elsewhere in the EAP region reached about 5 percent in 2013-17, about 0.7 percentage point above the longer-term (1998-2017) average rate, although rates varied considerably from country to country.

<sup>1</sup>The remainder of this box refers to potential growth measures derived using the production function approach, as described in Chapter 3. Although estimates of potential growth can vary depending on the underlying methodology, other studies find results similar to those described here. For instance, Anand et al. (2014) report that China's trend growth appears to have peaked around 2006-07 at 11 percent and then slowly declined to below 8 percent by 2013. By contrast, trend growth for the ASEAN countries (e.g., Indonesia, Malaysia, the Philippines, Thailand, and Vietnam) has been stable or marginally stronger. The ADB (2016) estimates potential growth at around 9 percent for China, and 3-5 percent for the ASEAN economies (e.g., Philippines, Indonesia, Malaysia, and Thailand). Bai and Zhang (2017), Nabar and N'Diaye (2013), Maliszewski and Zhang (2015), OECD (2012a), and Perkins and Rawski (2008) have also confirmed the slowdown of potential growth in China.

**BOX 2.1.1 Potential growth in East Asia and Pacific (continued)**

**FIGURE 2.1.1.1 Regional actual and potential growth rates**

Since the Asian financial crisis 20 years ago, growth in the EAP region has been twice as high as the EMDE median. Slowing regional GDP growth in recent years reflects both cyclical and longer-run structural factors. Growth rates in China and in the rest of the region are gradually converging.



Sources: World Bank, World Development Indicators, Penn World Tables, International Monetary Fund.  
 Note: EAP = East Asia and Pacific. EAP ex. China includes Indonesia, Mongolia, Philippines, and Thailand.  
 A. Blue bars show period averages of annual GDP-weighted averages of EAP countries. Red markers show median GDP-weighted averages of the six EMDE regions. Vertical lines denote range of regional GDP-weighted averages.  
 B. C. D. Potential growth estimates based on production function approach.  
 C. Blue bars denote average actual growth over five-year period. Red bars denote contribution of potential growth to change in actual growth between the two five-year periods; orange bars denote contribution of cyclical growth.  
 D. Pre-crisis denotes 2003-07 for World Bank (2018), 2000-07 for ADB (2016), 2003-07 for Anand et al. (2014), and 2006-07 for Barnett et al. (2015). Post-crisis denotes 2013-17 for World Bank (2018), 2008-14 for ADB (2016), 2011-13 for Anand et al. (2014), and 2013 for Barnett et al. (2015). Vertical lines denote range of potential growth estimates in the four above sources. EAP ex. China in the World Bank sample includes Indonesia, Mongolia, Philippines, and Thailand. EAP ex. China in Anand et al. (2014) and the ADB (2016) papers include Indonesia, Malaysia, Philippines, and Thailand.  
 E. F. MVF stands for multivariate filter-based potential growth estimates; UVF stands for univariate filter-based potential growth estimates (specifically, the Hodrick-Prescott filter); Expectations stands for potential growth proxied by five-year-ahead *World Economic Outlook* growth forecasts.

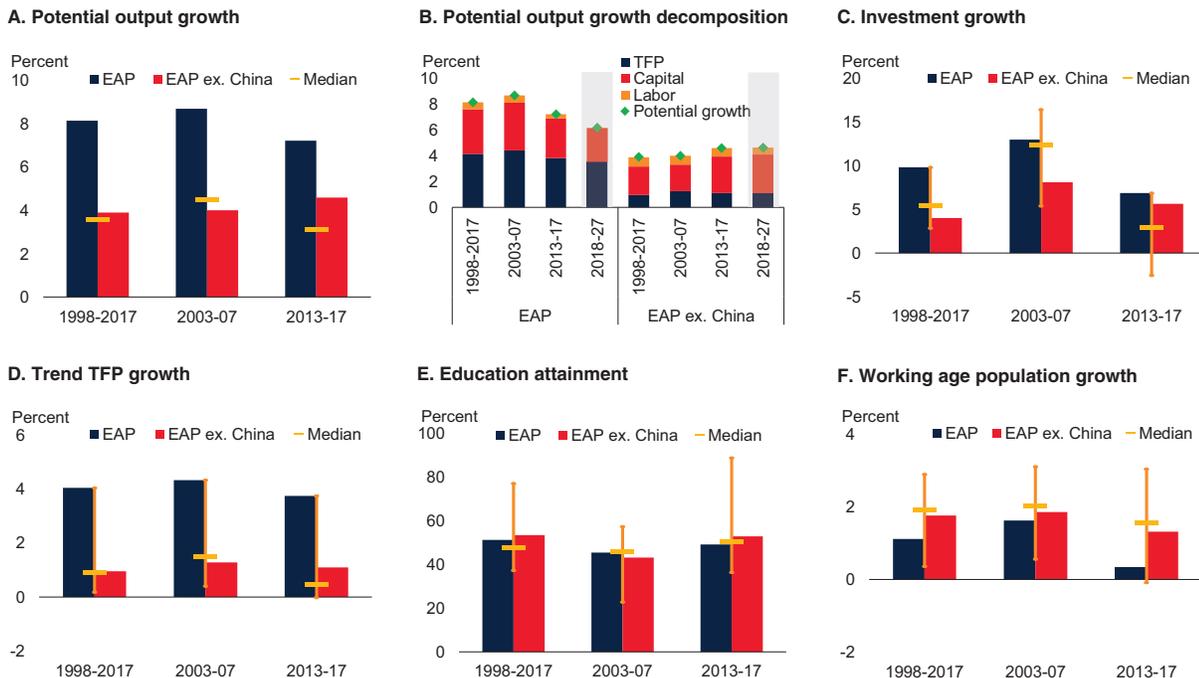
- Potential growth accelerated in Malaysia to around 5 percent in 2013-17 (just above its longer-term average), thanks to a series of comprehensive structural reforms that offset the impact of a declining workforce on labor supply (ADB 2016; BNM 2012 and 2015; IMF 2016a; Lian and Shahrir 2014; Munoz et al. 2016).
- In contrast, potential growth in Thailand weakened to around 3.5 percent on average in 2013-17, close to the long-term average, following a short-lived acceleration to around 4 percent in 2003-07. Potential growth in Thailand, which is the lowest in South East Asia, was held back by unfavorable demographics and

domestic policy uncertainty that discouraged investment, all of which weighed on TFP growth (ADB 2016; IMF 2016b).

- Potential growth in Indonesia, the country most severely affected by the Asian financial crisis, strengthened to above 5 percent in 2013-17, thanks to favorable demographics, robust investment growth and reforms (Tabor 2015; IMF 2017c; OECD 2016a; World Bank 2015b).
- Potential growth also accelerated in the Philippines to around 5-6 percent in 2013-17—more than 1 percentage point above the longer-term average rate.

**BOX 2.1.1 Potential growth in East Asia and Pacific (continued)****FIGURE 2.1.1.2 Drivers of potential growth**

Slowing regional potential growth, increasingly determined by China's performance, was broad based and reflected weakness in all of its main drivers. Excluding China, rising capital accumulation offset weakening productivity growth in the region.



Sources: Haver Analytics, World Bank staff estimates, Penn World Tables, World Development Indicators, United Nations Educational, Scientific, and Cultural Organization (UNESCO) Institute of Statistics.

Note: EAP = East Asia and Pacific.

A. C. -F. Yellow markers show median of the six EMDE regions.

B. Potential growth estimates based on production function approach (Chapter 3).

C. -F. Vertical bars denote range of averages for all EMDE regions.

E. The percentage of population ages 25 and over that attained or completed lower secondary education. EAP ex. China includes Indonesia, Malaysia, Mongolia, Philippines, and Thailand.

More than a decade of policies aimed at shifting growth from consumption to investment resulted in a strong capital accumulation, supported by favorable demographics.

- Potential growth in Cambodia, Lao PDR, and Vietnam, three economies closely linked to China, remained high in 2013-17 (around 6 percent in Vietnam and around 7 percent in Cambodia and Lao PDR). But these rates are below longer-term averages and reflect the limitations of growth driven by foreign inflows (Cambodia), natural resources (Lao PDR), and public spending (Vietnam) (Breu et al. 2012; World Bank and Ministry of Planning and Investment of Vietnam 2016).
- Potential growth slowed in Myanmar, Papua New Guinea, Timor-Leste, and Mongolia, owing to their

dependence on commodity exports, the collapse in global commodity prices, and weakness in major commodity-importing economies such as China.

- Potential growth in Pacific Islands was weak and volatile throughout the entire period reflecting country-specific factors, but may have improved recently amid a global growth recovery (World Bank 2017g).

### Drivers of potential growth

The recent slowdown in regional potential growth, which has been mostly attributable to China, reflected weakness in all its fundamental drivers (Figure 2.1.1.2).

- Contribution from regional working-age population growth to regional potential growth fell from about

### BOX 2.1.1 Potential growth in East Asia and Pacific (continued)

0.6 percentage points in 2003-2007 to around 0.3 percentage point in 2013-17. This reflects a sharp slowdown of growth of China's working-age population since the late 2000s. Notwithstanding these regional demographic trends, many countries, including Malaysia, the Philippines, and Cambodia, continue to enjoy rising working-age populations.

- Regional potential growth that had resulted from rapid capital accumulation also moderated as the effects of the recent investment surge, especially in China faded. Although investment growth has eased from stimulus-driven peaks in 2010-12 that produced overcapacity in some economies, high investment ratios across the region (e.g., about 43 percent of GDP in China in 2013-17 on average) continued to support potential growth.
- Regional TFP growth also slowed, as the productivity boost following China's World Trade Organization (WTO) accession in 2001 dissipated, the allocation of capital become less efficient during a prolonged investment boom, and as economies increasingly shifted their production from the manufacturing section with stronger TFP growth to the services sector with lower TFP growth (Nabar and N'Diaye 2013; Maliszewski and Zhang 2015).

There have been important cross-country differences in the recent trends in potential growth within the EAP region.

- China's slowdown was broad-based. As its population ages, the contribution from working-age population growth has fallen from about 0.6 percentage points in 2003-07 to -0.1 in 2013-17. Despite a policy-guided decline in investment, capital accumulation slowed, but remained strong, accounting for about 40 percent of potential growth. TFP growth declined, in part reflecting declining productivity of investment, misallocation of resources, and narrowing room for catchup productivity growth. But its contribution to potential growth remained higher than the EMDE average (Chapter 3; Nabar and N'Diaye 2013; Anand et al. 2014).
- In the rest of the region, potential growth continued to rely heavily on factor accumulation, while TFP growth remained subdued. Notably, diminishing labor supply growth was more than offset by a higher contribution from capital accumulation (Anand et al. 2014). Although productivity growth remained subdued, it inched up in 2013-17, led by Indonesia, the Philippines, and Vietnam. In contrast to the rest

of the group, Thailand experienced a broad-based decline in potential growth. This follows several years of weak confidence, investment, and FDI inflows, against the backdrop of sharp decline in labor supply growth.

#### *Labor supply*

During the past five decades and until the late 2000s, regional growth has been supported by a rapidly growing working-age population (IMF 2017d; World Bank 2013a, 2015c). Many regional economies reaped a "demographic dividend" as the number of workers grew faster than the number of dependents. However, overall, these demographic trends have since turned less favorable and are expected to deteriorate over the next decade.

The contribution from labor supply growth declined to just 0.3 percentage point in 2013-17 from around 0.6 percentage point during the 2003-07 period. This was especially stark in China, where the contribution declined from 0.6 percentage point pre-crisis to -0.1 post-crisis, and in Thailand where labor supply growth has also stalled due to rapid aging.

Despite this overall regional trend, many regional economies are still enjoying the demographic dividend from rapid labor supply growth (e.g., Cambodia, Indonesia, Malaysia, Myanmar, Lao PDR, and Papua New Guinea, and the Philippines; World Bank 2015c). While this supports potential growth, rapidly growing populations in lower-income countries pose other challenges, including providing adequate public service delivery.

Several factors besides demographic trends have affected labor supply within the EAP region. For example, labor force participation rates (and productivity) have been boosted by increases in secondary school completion rates of 10 percentage points between 2013-17 and 2003-07, tertiary enrollment rates by 14 percent, and life expectancy by 2 years. The effect was particularly pronounced in China and Malaysia, which have made large strides in improving life expectancy and education over the past two decades. In contrast, the region has not seen a major improvement in its female labor force participation rate between 2013-17 and 2003-07, with some exceptions (e.g., Malaysia).

#### *Capital accumulation*

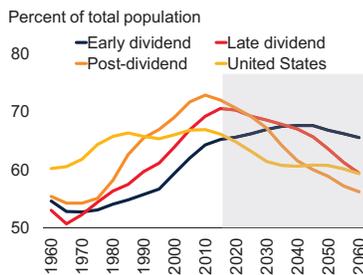
Although rates of capital accumulation eased in most EAP economies during 2013-17 compared with pre-crisis rates, their contribution to potential growth remained robust.

**BOX 2.1.1 Potential growth in East Asia and Pacific (continued)**

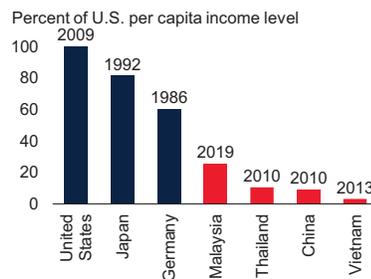
**FIGURE 2.1.1.3 Income convergence**

Over five decades and until the late 2000s, regional growth was supported by a rapidly growing working-age population. However, demographic trends are now less favorable and are expected to deteriorate over the next decade. Malaysia and China could reach high-income status within a decade, even at expected slower potential growth rates. A combination of policies to improve investment, education and health outcomes and labor market reforms could stem the expected decline in global potential growth over 2018-27.

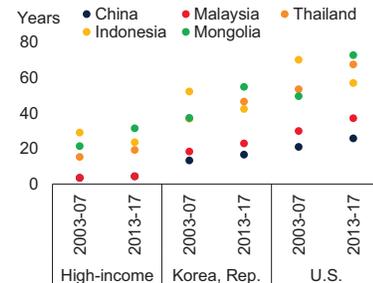
**A. Share of working-age population**



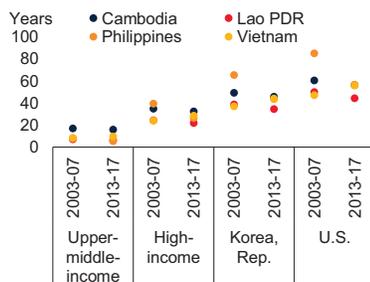
**B. Relative per capita income at peak working-age population share**



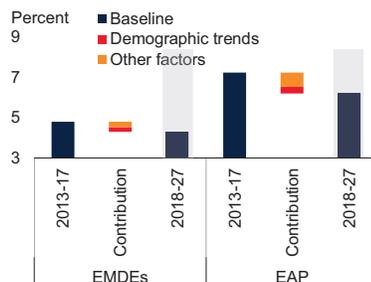
**C. Years for per capita income to converge to higher income levels**



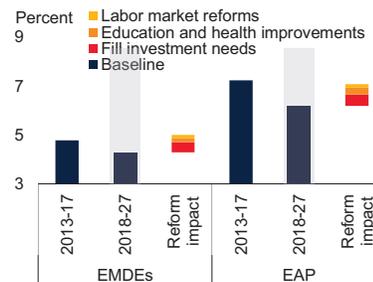
**D. Years for per capita income to converge to upper-middle-income levels**



**E. Baseline potential output growth**



**F. Potential output growth under reform scenarios**



Sources: United Nations World Population Prospects: 2017 Revision (medium-fertility scenario); World Bank staff estimates; International Monetary Fund, World Economic Outlook.

A. Early dividend countries include Cambodia, Lao PDR, Indonesia, and Philippines. Late dividend countries include Malaysia and Vietnam. Post dividend countries include China and Thailand. Post dividend is defined as a total fertility rate 30 years earlier below 2.1, and a shrinking working-age population share over the subsequent 15 years, or a shrinking absolute working-age population. Late dividend is defined as a total fertility rate 30 years earlier above 2.1, and a shrinking working-age population share over the subsequent 15 years. Early dividend is defined as an increasing working-age population share over the subsequent 15 years.

B. Figure shows per capita income in percent of U.S. per capita income in the year when the working age population share peaked (years shown above the bars). Only countries where working-age population shares reach peak before 2020. Red bars are East Asia Pacific countries.

C. D. Number of years to converge to per capita GDP of the specified country or income group in 2017. The years to converge for each country are calculated as the years to close the difference between GDP per capita in 2017, assuming average potential growth in the period specified. Potential growth of China, Indonesia, Mongolia, Philippines, and Thailand is from the production function approach. Potential growth of other countries is from the five-year expectation approach.

E. "Other factors" reflects declining population growth, trend improvements in human capital, and a slowdown in investment growth to output growth.

F. Policy scenarios are described in Annex 3.1.

- In some ASEAN economies, such as Indonesia and the Philippines, supportive monetary policy had spurred investment and, hence, capital accumulation in the wake of the global financial crisis.
  - In Malaysia, capital accumulation has gathered momentum with investments made under the Economic Transformation Program (Munoz et al. 2016).
  - Rapid capital accumulation has also reflected infrastructure upgrades. In the Philippines, improved macroeconomic policy management and the government's public-private partnership initiative, have boosted capital accumulation.
- Investment in developing EAP was largely supported by high domestic saving rates and foreign investment. EAP attracted half of global FDI during 2013-17, and FDI stocks exceeded 50 percent of GDP in all economies. Foreign capital played an important role in transfer of new

### BOX 2.1.1 Potential growth in East Asia and Pacific (continued)

technologies and knowhow, the development of human capital, the integration into global markets, improved competitiveness, and firms' development and reorganization (Moura and Forte 2010; World Bank 2017h). However, in smaller, heavily commodity-dependent economies, including Mongolia and Papua New Guinea, investment has contracted sharply during 2013-17 as FDI for mining-sector projects declined.

#### *TFP growth*

In most EAP countries, potential TFP growth has eased or remained subdued post-crisis. This has been attributed to temporary and persistent factors (Asian Productivity Organization (APO) 2016; Box 3.2; World Bank 2017h).<sup>2</sup> Temporary factors include heightened policy uncertainty (e.g., Myanmar, Thailand) and investment weakness in several commodity-exporting economies severely affected by the plunge in commodity prices (e.g., Mongolia, Papua New Guinea). Persistent factors, which contributed to a moderation of TFP growth, include maturing global value chains (e.g., China, Malaysia), a switch in information and communications technologies to consumer applications from productivity-enhancing hardware and software (e.g., China), and slowing human capital accumulation and weak human capital investment in lower income economies with limited fiscal space (e.g., Cambodia, Lao PDR). Slowing productivity growth has also been attributed to slowing factor reallocation (e.g., China, Malaysia, Thailand). In contrast, TFP growth in several economies (e.g., Indonesia and the Philippines) benefited from sustained high investment rates amid political stability, and the potential for productivity increases from factor reallocation that is at quite early stages.

**Maturing gains from factor reallocation.** The reallocation of labor toward sectors enjoying higher or faster productivity growth—particularly from agriculture to manufacturing, construction, and non-traditional services—has been an important channel underpinning productivity gains in the region and has slowed in some countries (World Bank 2017h). This transformation has stalled in Thailand, weakened significantly in China, and proceeded slowly in Malaysia since the Asian financial crisis. In contrast, TFP has grown in Indonesia, Vietnam, and the Philippines, where labor reallocation continues at a rapid pace. In Vietnam, intersectoral reallocation continues to account for approximately half of labor

productivity growth, with no signs of a slowdown (World Bank 2017h).

**Maturing global supply chains.** Productivity in the region, and especially in China, was boosted by rapid integration into global and regional supply chains in the wake of China's accession to the World Trade Organization. The maturing of these supply chains has meant that this surge in productivity growth has waned (Constantinescu, Mattoo, and Ruta 2017; Kummritz et al. 2017).

**Other factors.** Among the factors contributing to the region's subdued TFP are weak research and development (particularly in Indonesia, the Philippines, Thailand, Vietnam), inadequate infrastructure (particularly in Indonesia and Thailand), low levels of economic complexity (particularly in Indonesia, the Philippines, and Vietnam), and difficulty in doing business and stringent regulations in product markets (particularly in Malaysia and Thailand) (Munoz et al. 2016; World Bank 2017h). Finally, distortions in economic incentives leading to factor misallocation (reflected in sectoral overcapacity, for example) appear to be holding back productivity in China and Vietnam (IMF 2017d).

#### Prospects for potential growth: What could happen?

Potential growth within the EAP region is expected to ease further by about 1 percentage point to around 6 percent during 2018-27, reflecting a slowdown in China.<sup>3</sup>

This potential growth slowdown reflects ongoing demographic trends that are dampening labor supply, slowing productivity growth and putting the region at risks of becoming old before becoming rich (Figure 2.1.1.3; IMF 2017d). The largest declines in the share of the working-age population are expected in China. In contrast, many countries, including Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, and Papua New Guinea, and the Philippines, will see a rise in working-age populations and could enjoy a demographic dividend if they generate sufficient jobs (Bloom, Canning, and Fink 2010; IMF 2017d; World Bank 2015c).

A slowing pace of capital accumulation is projected to reduce EAP potential growth by about 0.4 percentage point. The steepest slowdowns in capital accumulation are

<sup>2</sup>For more detailed discussion please see the "World Bank East Asia Regional Economic Update," April 2017.

<sup>3</sup>The baseline scenario assumes broadly constant policies, long-term investment-to-GDP ratios, and population dynamics as projected in the UN Population Projections (Chapter 3).

### BOX 2.1.1 Potential growth in East Asia and Pacific (continued)

expected in China, where policy efforts to rein in credit growth continue, and the Philippines, where a surge in public investment is expected to fade. In contrast, in Thailand, investment is expected to recover from depressed levels.

Stabilizing global value chains (GVC) and maturing electronics technologies may also dampen productivity growth. In manufacturing, greater vertical specialization has been associated with higher labor productivity (Kumritz et al. 2017). The slower pace of GVC expansion could slow productivity growth by removing incentives to take advantage of a more efficient international division of labor and diffusion of technology.

#### Policy options to lift potential growth

Against this backdrop, the region faces the challenge of completing China's transition to a slower but more sustainable and balanced growth path, and of implementing growth-enhancing reforms to achieve convergence with higher income status. Meeting these priorities will require attending to the following policy priorities:

**Improved resource allocation in China.** Corporate sector reform, more sustainable credit growth, and a stronger intergovernmental fiscal system could help eliminate excess industrial capacity and improve the allocation of resources (IMF 2017d; Jin and Rial 2016; World Bank 2017i). Institutional reforms—such as better corporate governance, enhanced auditing and accounting standards, and a stronger regulatory framework—could promote competition and productivity growth.

**Investment into technological and physical capital.** Several countries in the region continue to have sizable infrastructure investment needs (Vashakmadze et al. 2017). Such investment can be financed by raising additional revenue (e.g., Cambodia, Indonesia, Lao PDR, the Philippines), reducing reliance on resource revenues (e.g., Indonesia, Malaysia, Mongolia, Papua New Guinea), increasing the efficiency of public investment (Indonesia, Lao PDR, Vietnam), rebalancing public expenditures towards public investment and promoting public-private cooperation (World Bank 2011, 2015b). Developing and implementing rigorous and transparent processes for project selection, appraisal, and procurement, could make public investment more efficient and could improve operation and maintenance of assets (IMF 2017d). Enhancing transparency and governance of state-owned

enterprises could ease pressure on fiscal resources (e.g., Thailand, Vietnam; World Bank 2016a).

**Trade integration.** Rising international trade has been an important source of EAP growth. The region opened its economies to trade and foreign direct investment, exploiting competitive advantages in the manufacturing sector. Increased trade openness has brought strong productivity gains, especially after the Asian financial crisis, against the backdrop of solid economic institutions and improved macroeconomic fundamentals (Havrylyshyn 1990; Trejos and Barboza 2015; Eris and Ulasan 2013). However, protracted weakness in advanced economies, signs of weakened commitment to trade liberalization, and an increased risk of protectionism are threatening prospects for a further expansion of trade. Steps that could help counter this risk include:

- Lowering non-tariff barriers would further expand global and regional trade and improve the international allocation of investment, thereby boosting productivity and competitiveness. Barriers to services trade remain elevated for many countries of the region (e.g., Indonesia, Malaysia, the Philippines, Thailand). Restrictions on foreign control and ownership, discretionary licensing, and limits on the operations of foreign companies have significant negative impacts on the delivery of services across borders. In addition, foreign entry restrictions in some EAP countries are prohibitive for many professional services such as legal, accounting, or engineering (World Bank 2016a).
- Regional partnerships and trade agreements, including the ASEAN economic community and the proposed Regional Comprehensive Economic Partnerships, will help stimulate structural reforms and promote stable income growth. These partnerships can also help to boost the region's resilience, as they did during the global financial crisis in 2008-09, facilitate reforms and help to overcome constraints in services, investment, competition, and small and medium enterprise (SME) development (World Bank 2016a, 2016f).

**Investment into human capital.** High-quality education would raise labor-force skills, and promote productivity growth (World Bank 2014a, 2017j). Reforms that reduce barriers to female labor force participation could increase participation rates and productivity (ADB 2015; Kinoshita and Guo 2015).

### BOX 2.1.1 Potential growth in East Asia and Pacific (concluded)

**Investment in technological capital and spurring innovation.** Productivity growth can also be boosted by spurring innovation and technology adaptation (Cirera and Maloney 2017). This could be achieved through higher spending on research and development and attracting foreign direct investment, which can be an important source of technology transfer.

- In China and upper-middle-income economies, the effectiveness of R&D spending could be improved, and measures could be taken to raise productivity in the services sectors, in particular by reducing barriers to competition (World Bank and Development Research Center of the State Council of the People's Republic of China 2012; Munoz et al. 2016; World Bank 2016g).
- Lower-income EAP countries may be able to capitalize on rising FDI inflows by strengthening their capacity to adopt new technology (World Bank 2014b, 2017h). The ASEAN-4 countries (e.g., Indonesia, Malaysia, Thailand, and the Philippines) have begun by strengthening the quality and flexibility of domestic education systems. In some economies, better public infrastructure could foster connectivity and spur innovation.

**Urbanization.** The region has the potential for continued, rapid urban development (World Bank 2015d). Although more than 450 million people moved to cities between 2000 and 2016, the share of people living in urban centers in the EAP region remains at 54 percent in 2016 (around 50 percent excluding China), well below the advanced-

economy average (80.5 percent) in the majority of the region's economies.<sup>4</sup> China's current urbanization rate is 55.6 percent, with only 23.7 percent of China's population in urban agglomerations compared to 45.3 percent in the United States. With still a large share of the EAP workforce engaged in agriculture, there is scope for substantial productivity gains from moving workers to urban centers and employment in manufacturing and services, particularly in Cambodia, Indonesia, the Philippines, Timor-Leste, Thailand, and Vietnam (World Bank 2016a). Measures to foster urbanization include investment in infrastructure and social services, making land more accessible on a fair and transparent basis, encouraging facilities that support recent migrants, and coordinating urban services across municipal boundaries.<sup>5</sup>

**Business climate reforms.** Improvements in the business climate and reductions in the cost of doing business would also help (e.g., Cambodia, Fiji, Lao PDR, Myanmar, Papua New Guinea, Timor-Leste, and the small Pacific Islands; World Bank 2017k, 2017l). Cambodia, Lao PDR, Myanmar, and Papua New Guinea rank low on the 2016 Corruption Perception Index reported by Transparency International and on other governance indicators. Enhanced transparency, strengthened accountability, and greater responsiveness of state institutions to the needs of the private sector would bolster investor confidence and invite productivity-enhancing investment (Kummritz et al. 2017).

<sup>4</sup> Urbanization rates are particularly low at only 13 percent in Papua New Guinea, 21 percent in Cambodia, and around 35 percent in Myanmar and Vietnam.

<sup>5</sup> Felipe, Sotocinal, and Bayudan-Dacuycuy (2015), ADB (2016), Creehan (2015), Bryson and Nelson (2016), World Bank and Development Research Center of the State Council, China (2014).