SOUTHEAST ASIA RISING FROM THE PANDEMIC

MARCH 2022

ASIAN DEVELOPMENT BANK

SOUTHEAST ASIA
RISING FROM THE PANDEMIC

MARCH 2022

ASIAN DEVELOPMENT BANK

6 ADB Avenue, Mandaluyong City, 1550 Metro Manila, Philippines
Tel +63 2 8632 4444; Fax +63 2 8636 2444
www.adb.org

ISBN 978-92-9269-405-0 (print); 978-92-9269-406-7 (electronic); 978-92-9269-407-4 (ebook)
Publication Stock No. TCS220093-2
DOI: http://dx.doi.org/10.22617/TCS220093-2

Notes:
In this publication, “$” refers to United States dollars, “₱” refers to Philippine pesos, “RP” refers to Indonesian rupiah, and “B” refers to Thai baht.

ADB recognizes “China” as the People’s Republic of China, “Korea” as the Republic of Korea, “Laos” as the Lao People’s Democratic Republic, and “Vietnam” as Viet Nam.

On the cover: A collage of photos from around Southeast Asia showing how people are coping and living with the COVID-19 pandemic.

Cover design by Mike Cortes.

Contents

Tables, Figures, and Boxes

Tables

Figures

Boxes

Foreword

Two years after the coronavirus disease (COVID-19) pandemic started in January 2020, Southeast Asia is beginning to recover. Following a 4% decline in output in 2020, growth in the region is now expected to increase by about 3% in 2021. This performance is much lower than our earlier forecast of 4.4% in April 2021, because of tighter restrictions across the region to fight surging infections caused by the Delta variant. For 2022, growth is expected to pick up to 5.1% as 400 million or 59.0% of the population in the region become fully vaccinated, enabling many economies to reopen. However, the spread of the new Omicron variant will likely reduce the growth forecast for the year, as it continues to cause widespread illness and partial lockdowns in the region.

Despite a more favorable prognosis for 2022 compared to the previous year, the economic situation in the region remains fragile, and many households continue to experience huge income losses. Some traditional engines of growth such as hospitality, tourism, transport, and personal services are still not expected to recover anytime soon. The region's output level in 2022 is expected to remain at least 10% below the no-COVID-19 baseline despite improving recovery prospects. More importantly, the number of people in extreme poverty (those who live on less than $1.90 per day) is estimated to have risen by 5.4 million in Southeast Asia in 2020 due to the severe decline in economic activity. For 2021, 4.7 million people are estimated to have fallen below the extreme poverty threshold compared to the poverty estimate without COVID-19 in 2020.

Several global headwinds are also making economic policy making more difficult. First, widespread employment losses, destruction of human capital, and weak investment prospects could trigger economic scarring. Second, the expected tightening of global interest rates, led by the United States federal funds rate, could further weaken the outlook for global economic recovery. Third, the impact of climate change continues unabated, causing more frequent and costly extreme weather and natural hazards, such as the eruption of an underwater volcano that created a tsunami that affected Tonga, Hawaii, and Japan. The outbreak of conflicts poses additional risks.

Looking ahead, one can still be optimistic about the prospects for Southeast Asia. Today, we are seeing more intensified efforts across the region to build back better and greener. As we continue to struggle to make sense of what our world will look like when this pandemic is over, one thing is certain: a return to "business as usual" is no longer an option. The only way forward is to build stronger and more resilient communities and nations. This can be accomplished by improving social assistance programs, increasing support to micro and small enterprises, and expanding competitiveness and human capital. As we rebuild from the devastation brought by the pandemic, we need to promote a recovery that will not only support growth and job creation but also protect the environment. This task is particularly important as we are about to assess our performance with respect to the Paris Climate Accords.

This report examines some of the critical themes associated with economic recovery. It aims to distill regional- and country-level knowledge and experience to help policy makers design better policies. It is my hope that this report will help policy makers understand the challenges of developing effective policies and strategies to ensure that the path to economic recovery is more inclusive and sustainable across the region.

Ramesh Subramaniam
Director General
Southeast Asia Department
Asian Development Bank

Acknowledgments

This report was written by the country economists of the Asian Development Bank (ADB) at its headquarters and resident missions in Southeast Asia. The authors are grateful for the guidance provided by ADB's country directors for Cambodia, Indonesia, the Lao People's Democratic Republic, the Philippines, Thailand, Timor-Leste, and Viet Nam.

James Villafuerte, senior economist, and Dulce Zara, senior regional cooperation officer, of the Regional Cooperation and Operations Coordination Division (SERC) of ADB's Southeast Asia Department (SERD) led the preparation of this report under the supervision of Alfredo Perdiguero, director of SERC. ADB consultants Damaris Yarcia and Mae Hyacinth Kiocho provided technical support, while Maria Theresa Bugayong and Ross Kline Empleo extended administrative assistance.

The authors are thankful for inputs from Nguyen Ba Hung, senior regional cooperation specialist at ADB's Sustainable Development and Climate Change Department, and from SERD's Yurendra Basnett, senior public management specialist; Benita Ainabe, senior financial sector specialist (capital markets); Stephen Schuster, principal financial sector specialist; Kelly Hattel, senior financial sector specialist; Hiroaki Yamaguchi, director; and Steven Schipani, principal tourism industry specialist.

Vanessa Van Zandweghe edited the manuscript. Mike Cortes typeset and produced the layout as well as created the cover design. Lawrence Casiraya proofread the report. The Knowledge Support Division of ADB's Department of Communications facilitated the publishing of this report.

Abbreviations

ADB	Asian Development Bank
ADO	Asian Development Outlook
ASEAN	Association of Southeast Asian Nations
BOL	Bank of the Lao PDR
BOT	Bank of Thailand
CGE	computable general equilibrium
COVID-19	coronavirus disease
EME	emerging markets economy
EU	European Union
FDI	foreign direct investment
GDP	gross domestic product
GTF	garments, travel goods, and footwear (Cambodia)
HEF	Health Equity Fund (Cambodia)
ICT	information and communication technology
ILO	International Labour Organization
IMF	International Monetary Fund
Lao PDR	Lao People's Democratic Republic
LFPR	labor force participation rate
MFI	microfinance institution
MICE	meetings, incentives, conferences, and exhibitions
MSMEs	micro, small, and medium-sized enterprises
NERS	National Employment Recovery Strategy (Philippines)
NSEDP	National Socioeconomic Development Plan (Lao PDR)
NSSF	National Social Security Fund (Cambodia)
PESOs	public employment service office (Philippines)
P2P	peer-to-peer
PFM	public financial management
pp	percentage points
PSF	Philippine Skills Framework
SIB	sector industry board (Philippines)
TESDA	Technical Education and Skills Development Authority (Philippines)
UNDP	United Nations Development Programme
US	United States

Executive Summary

Southeast Asia suffered a deep contraction in 2020 as lockdowns and border closures to control the spread of the coronavirus disease (COVID-19) halted economic activities and production in the region, with some economies more badly affected than others. But 2 years after the pandemic started, Southeast Asia is slowly beginning to recover. The extent of the recovery, however, remains uneven, and sensitive to the volatile path of the pandemic. This report presents recovery scenarios and long-term challenges for the region and provides a closer look into selected drivers of economic growth for Cambodia, Indonesia, the Lao People's Democratic Republic (Lao PDR), Malaysia, the Philippines, Thailand, Timor-Leste, and Viet Nam. These growth drivers include strengthening existing drivers or promoting new ones, particularly ones that can diversify sources of growth for natural-resource dependent countries. The policy recommendations in this report support governments' post-COVID-19 recovery plans to ensure a resilient and inclusive growth for all.

Chapter 1 provides an overview of the important factors and developments affecting the region's economic recovery, including (i) an expansion in agriculture for small economies; (ii) a rebound in tourism, especially domestic tourism; (iii) resilience of merchandise exports; (iv) increasingly concentrated value chains; (v) reliance on commodity exports; (vi) robust remittance inflows; (vii) digital readiness; (viii) a large informal sector, which has magnified the pandemic's disproportionate impact on the poor; and (ix) the size of governments' fiscal and monetary policy response. Using a computable general equilibrium model, the analysis presents two growth scenarios in Southeast Asia in 2022: (i) the spread of the Omicron variant, which disrupts economic activities in the region for about two quarters in 2022; and (ii) increased health expenditures in the region, which would bring the region's health-care system closer to the universal health standards. The chapter then outlines key priority reforms that can contribute to a more robust and resilient economic, social, and environmental systems in the region. These reforms aim to (i) promote health and well-being; (ii) accelerate market reopening, create jobs, and support small enterprises; (iii) build competitiveness and human capital; and (iv) encourage governments to lead the effort in taking care of our planet.

The COVID-19 pandemic has the potential to cause economic scarring, or long-term damage to an economy. It has reversed many of the hard-won economic and development gains in Southeast Asia. The Asian Development Bank estimates that the number of people who are extremely impoverished (those who live on less than $1.90 per day) rose by 5.4 million in Southeast Asia in 2020 due to the steep decline in economic activity. In 2021, 4.7 million people also fell below the extreme poverty threshold compared to the 2020 poverty estimate without COVID-19. The pandemic has also resulted in severe labor market disruptions. The International Labour Organization estimates that there were 10.6 million fewer employed workers in the region in 2020 compared to a no-pandemic scenario. Employment losses were particularly hard on women, youth, and workers in micro, small, and medium-sized enterprises. The employment gap is projected to remain at 9.3 million and 4.1 million jobs in 2021 and 2022, respectively. Thus, the pandemic's impact on poverty and unemployment will likely persist as inactive workers become de-skilled and poor people's access to opportunities further deteriorates. When this happens, the deterioration in inequality could transfer across generations.

Chapters 2 and 3 discuss potential scarring of the pandemic in Indonesia and the Philippines. In Indonesia, early data indicate that economic scarring is mild. Containment of COVID-19 infections and steadily progressing vaccinations have contributed to Indonesia's relatively good economic performance. Timely and substantial fiscal support helped limit the downturn, while monetary and financial policy also supported economic activity. Despite significant improvements in the past year, the recession has led to some damage to Indonesia's economy, such as a reduction in investments and an increase in the number of poor people and unemployed workers. However, long-term damage is unlikely due to a modest increase in the unemployment rate and improvement in labor productivity, mostly through improvements within each sector. There is a good chance that part of the increases in productivity can be sustained. To supplement reforms that aim to raise investment and productivity, the report recommends continued macroeconomic support as well as structural reforms to boost private investment, skills training, and public infrastructure investment. Policy makers can also promote technology adoption and expand access to digital services.

In the Philippines, the COVID-19 pandemic triggered a massive disruption of the labor market, which could leave an enduring impact. Although the unemployment rate has eased since the onset of the pandemic, it remains higher than in 2019 and many workers are working fewer hours. Chapter 3 discusses the factors that could create this long-lasting effect on the labor market. The pandemic has triggered a large reallocation of jobs across sectors. The hardest-hit sectors are those dependent on personal contact, such as accommodation, food services, transportation, and recreational services. This change in employment composition may persist. Companies have also been rapidly adopting digital technologies in their business models, further increasing demand for higher skills. These developments are likely to increase the mismatch between new skills demanded by employers and those skills possessed by displaced workers. The longer displaced workers and new labor market entrants remain unemployed, the more likely they will become less employable because of lost skills. Strengthening labor market programs will be critical to help workers transition to new jobs.

In Southeast Asia, the economic recovery that started to take shape in 2021 has been led by the agriculture sector, which has benefited from workers who lost their jobs in tourism; the construction sector, which is beginning to work on a huge backlog of infrastructure projects; the manufacturing sector, which is responding to strong external demand; and the boom in the digital sector. This changing economic structure will determine the pace of economic recovery. It remains to be seen how exactly this will play out, whether these structural movements will be temporary or whether economic policies and regulations will be adjusted to nurture leading sectors that could drive the recovery. These shifts within and across sectors are discussed in **Chapter 4,** which examines the new drivers of growth in Cambodia, and in **Chapters 5 and 6,** which focus on strengthening the tourism sectors in the Lao PDR and Thailand, respectively.

In Cambodia, the traditional sectors that have driven growth—tourism and hospitality, construction and real estate, and garments—have been badly hit by the pandemic. However, a large increase in agricultural exports such as bananas and other fruits and rapid growth in non-garment manufacturing exports such as electrical parts, bicycles and vehicle spare parts in the past 2 years offer bright spots to propel growth in Cambodia. Opportunities to expand the agriculture sector stem from a growing domestic market, improving market access from new free trade agreements with the People's Republic of China and the Republic of Korea, and upgrading value addition of existing products. Meanwhile, regional integration and foreign direct investment in non-garment manufacturing exports such as electronics, pharmaceuticals, solar technology, and vehicle parts offer great opportunities to expand the non-garment manufacturing sector. Sustaining these trends will help the government achieve its vision of a more resilient and diversified economy.

Prior to the pandemic, the Lao PDR was making steady progress in diversifying its services sector by attracting large numbers of tourists for business and leisure, as well as increasing technology utilization across its population. The COVID-19 pandemic has severely affected the Lao PDR's economy, with economic growth and prospects, particularly in tourism, stymied by the closure of international borders and policies to suppress the spread of the virus. Meanwhile, the digital economy flourished in 2020 and 2021. Firms adopted digital tools to sustain operations, and the government introduced digital learning platforms for students. Despite reforms, competitiveness remains an issue, particularly for the post-pandemic recovery of private sector services including tourism. Chapter 5 outlines policy recommendations in the short and medium term to improve the business environment and labor market governance to expand the country's formal economy, with the help of digitalization and technology adoption tools available to policy makers.

Chapter 6 offers a path to sustainable recovery for the tourism sector in Thailand. The tourism sector has been a key driver of Thailand's economic growth for many years, but it has been affected severely by the pandemic as the Thai government imposed travel restrictions on foreign tourists. Nonetheless, the government plans to use the pandemic as a catalyst to overhaul the sector. It plans to shift away from mass tourism toward attracting "quality" tourists, particularly those with more spending power. Digitalization is expected to become essential to the tourism sector's revival as it can facilitate the inclusion of travel documents such as vaccination certificates and test results, as well as provide more contactless operations. Thailand has also undergone a transition in health and safety, digital platforms, and infrastructure and connectivity—key areas that will determine tourism competitiveness going forward.

Increasing dependence on telecommunications for business and leisure will put countries with weak digital infrastructure at a major disadvantage. Since the pandemic started, the region added around 60 million new internet users. The size of the digital economy is expected to more than double to $350 billion by 2025 with continued adoption, deeper usage, and a new way of life supporting this expansion of digital technologies. However, to make meaningful progress in digital financial services, simplicity and ease of regulations, efficient transport and logistics infrastructure, and digital skills and literacy are critical. Viet Nam offers many lessons from its digital transformation in the last 5 years, including encouraging the discovery and export of high-technology products, expanding customer base in e-commerce, increasing digital option and online platforms, broadening financial access, and significantly improving cybersecurity. **Chapter 7** investigates the prospects for Viet Nam's digital economy in the next decade, presents scenarios on how digital transformation could contribute to economic growth, and provides measures to boost its chances of achieving the best-case scenario.

The pandemic revealed areas of vulnerabilities and highlighted some of the strengths of the countries in the region and the different ways governments have handled each area of public policy. For example, though Southeast Asia's total fiscal response as a share of gross domestic product (GDP) in 2020 (25%) was comparable to the global level (13%), fiscal spending was much higher for Singapore, Indonesia, Malaysia, and the Philippines, ranging from 15% to 41% of their respective 2020 GDP, while the fiscal response of the rest of the countries in the region averaged below 10% of 2020 GDP. In 2021, the total fiscal response in Southeast Asia, about 4% of GDP, was relatively small compared to the previous year.

Timor-Leste was swift to react to the pandemic. **Chapter 8** demonstrates how public financial management-related interventions enabled the government to carry out a series of measures such as cash transfers and food and in-kind distribution to vulnerable households, water and electricity fee waivers, tax-payment deferrals, and salary subsidies to the private sector. A special COVID-19 fund was created which was drawn almost entirely from emergency withdrawals from the Petroleum Fund—the country's sovereign wealth fund. However, oil revenues from taxes and royalties which support the Petroleum Fund have been falling in recent years, with the current oil fields expected to be depleted by 2023. The fiscal situation has become more precarious because of large withdrawals to support the emergency response to the pandemic. The analysis in Chapter 8 identifies some policy reforms to help Timor-Leste improve the efficiency and quality of public expenditure as petroleum resources decline and petroleum revenues dwindle. These reforms include (i) addressing basic public financial management gaps first before moving on to more complex types of reforms, (ii) sequencing and prioritizing reforms, (iii) improving domestic resource mobilization, (iv) enhancing public expenditure management, (v) adopting a forward-looking approach, and (vi) improving donor support.

Finally, countries in Southeast Asia need to fortify their health-care systems, instill pandemic preparedness, and establish health crisis management protocols to combat future outbreaks of diseases. As highlighted in **Chapter 9,** Malaysia is one example of a country in the region that has seen success in managing the COVID-19 pandemic, particularly in keeping COVID-19-related deaths relatively low and rolling out its vaccination program. This success is a result of (i) a strong health-care and hospital system, (ii) good coordination among government agencies and between the public and private sectors, (iii) immediate procurement of vaccines, and (iv) more uniform distribution of resources across states to fight the pandemic. Malaysia plans to continue prioritizing health care to restore the nation's well-being, reduce poverty, and achieve equitable growth.

Investments in health can also enhance the region's growth prospects. The economic growth simulations in Chapter 1 show that a reduction in the economic burden of diseases resulting from an increase in health-care spending can raise GDP growth in Southeast Asia by 1.5 percentage points in 2022 compared to the baseline. In general, the gains in GDP growth stem from a higher labor force participation rate as well as increased labor productivity due to healthier workers in the region.

Southeast Asia:
Establishing Economic Recovery Pathways

1

More than 2 years after the pandemic started, Southeast Asia is slowly beginning to recover with mobility indicators and manufacturing activities rebounding everywhere. The extent of the recovery, however, remains uneven, and sensitive to the volatile path of the pandemic. Output levels in 2022 will likely remain well below the no-COVID baseline level, and the spread of the Omicron variant could further reduce growth forecasts for 2022. However, policies such as investments in health that would bring the region's health-care system closer to the universal health standards can have a significant impact on disease burden and output growth in 2022. While the pandemic has exposed many of the region's economic and social vulnerabilities, it has also intensified earnest efforts to build back better, which governments can do by improving social assistance programs, supporting small enterprises, building competitiveness, and choosing a greener path to economic recovery.

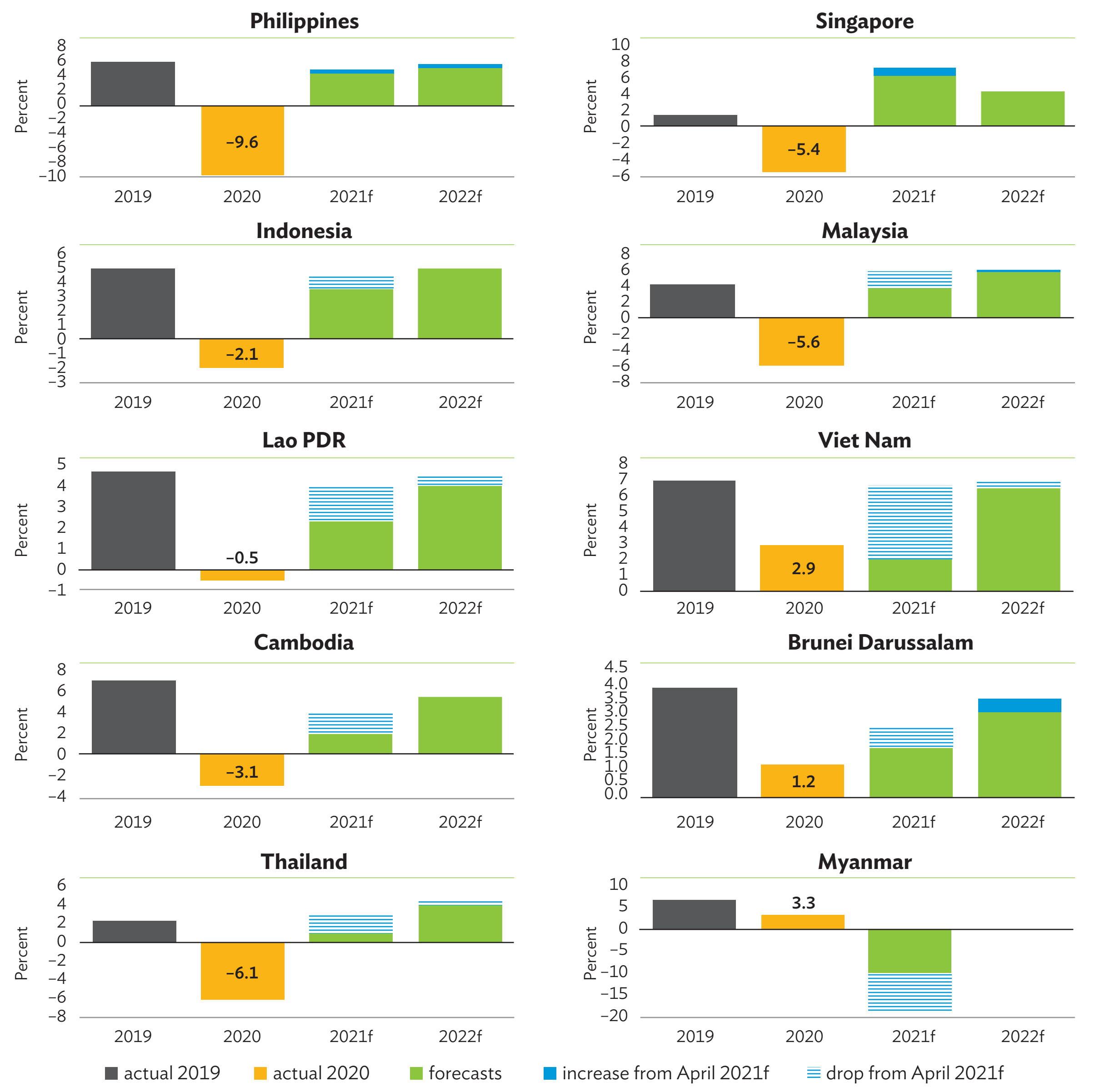
Note: This chapter was written by James Villafuerte of the Regional Cooperation and Operations Coordination Division (SERC) and Damaris Yarcia, SERC consultant.

I Introduction

At the onset of the pandemic, governments in the region had to resort to lockdowns and border closures to control the spread of COVID-19. These measures—necessary but severe—effectively disrupted economic activities and output growth in the region. After growing by 4.4% in 2019, Southeast Asia's output contracted by about 4% in 2020. The decline in output varied across economies in Southeast Asia, with some more severely affected than others. In the Philippines, Thailand, and Malaysia, for example, output in 2020 fell by 9.6%, 6.1%, and 5.6%, respectively (Figure 1.1).

In 2021, as the COVID-19 Delta variant spread across the region, more restrictions on mobility and economic activities were imposed

Figure 1.1: The Pandemic's Impact on Output Growth



f = forecast, Lao PDR = Lao People's Democratic Republic.
Sources: Asian Development Outlook September 2021 Update and Asian Development Outlook December 2021 Supplement.

during the second and third quarters of the year. As a result, the outlook for Southeast Asia in 2021 was downgraded from 4.4% in April to about 3% in December. Forecast revisions within the region vary. Economic projections for Malaysia and Viet Nam, for example, were downgraded after output contracted in the third quarter of 2021, which resulted in a negative outlook for the rest of the year. On the other hand, the performance and forecasts for the Philippines, Singapore, and Indonesia were upgraded. For 2022, projected economic growth for the region remains at 5.1%.

The widespread and rapid administration of vaccines has helped curb the rise in daily new cases and deaths from COVID-19 in some countries in the region, which has allowed governments to slowly lift lockdowns, permit freer movement among the population, and resume business operations. The external environment for Southeast Asia has also improved. Output of major advanced economies, which include the United States (US), Japan, and the euro area, rebounded strongly from contracting by 4.5% in 2020 to expanding by a projected 5.2% in 2021. In Asia, output growth of the two largest economies—the People's Republic of China (PRC) and India—remains solid and is expected to grow by 8% and 9.7%, respectively, in 2021.

As Southeast Asia begins to slowly recover, manufacturing activities in economies with data continue to expand. Mobility indicators in retail and recreational areas in the region also improved 161% in February compared to the trough in 2020. However, two diverging growth scenarios are emerging: a more buoyant growth expected for Singapore, the Philippines, Malaysia, and Indonesia; and less rosy growth expectations for Thailand, Viet Nam, Brunei Darussalam, Cambodia, and the Lao People's Democratic Republic (Lao PDR). The impact of the Delta variant has been more severe in the latter group of countries. These countries are more dependent on tourism, their vaccination progress has been relatively slow, or their manufacturing sector has been hit harder by the spread of COVID-19.

There are several downside risks to economic recovery in Southeast Asia. The first is new COVID-19 variants and their potential effects on local, regional, and global economies. The second is increasing trade costs and continuing disruptions in global supply chains which can spark inflationary pressure as it undermines global confidence, trade, and recovery. The third is the possibility of a weaker external environment arising from premature tapering of quantitative easing and tightening of global interest rates. Southeast Asia is also quite vulnerable to natural hazards and disasters, which due to climate change seem to have become more frequent and costly in terms of damage and reconstruction.

II Drivers of Economic Recovery

Southeast Asia comprises diverse economies with distinct characteristics and features that determine how they were affected by the pandemic. For example, the biggest impact of COVID-19 in the region was on services and tourism, with secondary effects on manufacturing and construction. Among those in the labor force, workers in low-skill office or in-person marketing or sales jobs were most affected as jobs shifted to a digital interface or e-commerce, a trend that is expected to stay. For business establishments, micro and small enterprises that cater to personal services and have little capability to go online were also severely impacted. Among the population, those who proved most defenseless were the poor who are mostly uninsured, work in the informal sector, and do not have savings to draw from during an emergency.

In the same vein, the path to economic recovery will also depend on each country's health and economic response to the pandemic, including its fiscal position; the resilience and skills of the labor force; the capacity of businesses to adopt to changing production processes, trade, and mode of supplying goods and services; and other aspects of the economy that are important for coping with the pandemic. The following is a discussion of some themes that are driving the growth recoveries in various economies in the region.

Changing Economic Structure

The economic structure of Southeast Asia has indeed been affected by the pandemic in two partly opposing directions. On one side, the hardest-hit sectors in 2020 in terms of sector growth, employment, and productivity were mostly in services, particularly accommodations, transport and storage, wholesale and retail, and education (Figure 1.2). Other sectors that were affected in 2020 were construction, mining and quarrying, and manufacturing.

But on the other side, the economic recovery that started to take shape in 2021 has been led by the agriculture sector, which has benefited from workers who lost their jobs in tourism; the construction sector, which is beginning to work on a huge backlog of infrastructure projects; the manufacturing sector, which is responding to strong external demand from industrial economies; and the information and communication technology sector, which benefits from the boom in the digital sector. This changing economic structure will determine the pace of economic recovery. It remains to be seen how exactly this will play out; whether these structural movements will be temporary or whether economic policies and regulations will be adjusted to nurture leading sectors that could drive the growth recovery.

Figure 1.2: Impact and Recovery across Sectors (%)

		2020								Q2 2021		Q3 2021				
Sector	**Industry**	**LAO**	**VIE**	**BRU**	**INO**	**SIN**	**MAL**	**THA**	**PHI**	**BRU**	**MAL**	**VIE**	**INO**	**SIN**	**THA**	**PHI**
	GDP	3.3	2.9	1.1	-2.1	-5.4	-5.6	-6.2	-9.6	-1.5	7.1	1.4	3.2	7.6	1.4	4.9
Agriculture	Agriculture	1.1	2.7	14.4	1.8	-10.0	-2.2	-3.6	-0.2	57.1	-0.7	2.7	1.6	24.9	2.3	-1.0
Industry	Manufacturing	12.8	5.8	23.9	-2.9	7.3	-2.6	-5.7	-9.8	-4.9	15.8	6.1	2.9	11.9	5.0	9.1
	Utilities	20.1	4.1	-2.2	-1.8	-2.2	-1.3	-7.2	-0.4	3.2	3.6	5.1	4.8	3.9	-3.0	4.5
	Construction	14.5	6.8	3.2	-3.3	-35.9	-19.4	2.3	-25.7	-11.0	8.3	-0.6	2.4	26.7	3.7	6.1
	Mining and Quarrying	-16.7	-5.6	-4.9	-2.0		-10.6	-6.9	-18.9	-3.7	3.5	-7.2	3.6		-3.2	0.5
Services	Info/Comm	8.6	7.4	15.9	10.6	2.1	6.0	4.6	5.0	3.4	6.1	5.2	7.0	9.1	5.8	9.3
	Health/Social work	4.6	10.6	2.8	11.6			0.5	-3.8	8.6		21.2	9.8		3.6	14.8
	Finance/Insurance	1.2	6.9	-2.8	3.2	5.0	2.7	2.7	5.5	-3.6	16.9	8.4	3.0	8.0	3.1	5.3
	Public admin.	5.7	6.3	-3.9	0.0		4.5	1.7	4.6	-1.0	5.5	3.0	-1.1		0.9	5.8
	Education	2.2	6.1	-10.5	2.6			2.0	-10.8	-0.4		4.2	-0.1		0.8	8.6
	Wholesale/Retail	1.3	5.5	2.8	-3.7	-3.7	-6.1	-3.7	-6.0	10.6	9.9	-3.1	4.3	5.0	1.7	3.0
	Prof/Bus. Services	4.2	2.6	5.0	-5.4	-12.1		-10.7	-10.0	9.2		-1.5	0.7	-0.8	-3.6	5.9
	Real Est/ Ownership of. Dwellings	2.4	0.3	2.5	2.3	-5.6	-15.2	1.4	-17.0	1.9	-10.5	-0.8	2.4	4.6	1.9	2.0
	Other Services	3.9	-0.9	-2.0	-4.1	-8.9	-10.5	-7.4	-41.1	6.7	-3.3	-6.1	1.7	6.6	2.5	-7.9
	Transport/Storage	-2.9	-1.9	-21.6	-15.0	-25.4	-21.9	-21.0	-30.9	-17.3	3.4	-7.8	1.6	1.4	-4.9	1.7
	Accommodation	-55.0	-14.7	-6.6	-10.2	-26.6	-26.5	-36.6	-45.4	16.7	-15.3	-23.2	3.5	5.5	-17.2	2.2

BRU = Brunei Darussalam, GDP = gross domestic product, INO = Indonesia, LAO = Lao People's Democratic Republic, MAL = Malaysia, PHI = Philippines, SIN = Singapore, THA = Thailand, VIE = Viet Nam.
Note: Numbers in cells are output growth rates. Colors in cells range from green (least-affected sectors) to orange (hardest-hit sectors).
Sources: Various annual and quarterly national accounts, 2020 to latest quarter.

Dependence on Tourism

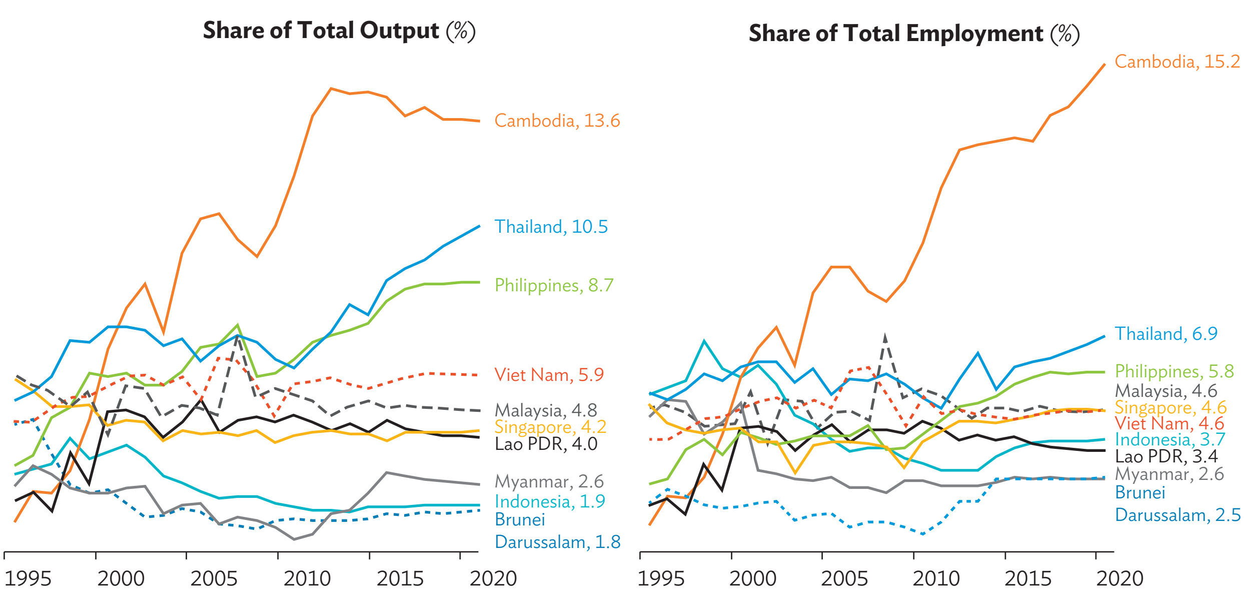
Tourism plays a big role in the region in terms of output growth and employment generation. Because tourism is a key sector that has been disrupted by COVID-19, recovery from the pandemic will also hinge on the degree of recovery of this sector. At present, tourism-related goods and services including transport, accommodation, recreation, and other personal services will likely remain weak while travel remains curtailed and social distancing is enforced. Overall international tourist arrivals increased by 58% in July to September 2021 compared to the same period in 2020, but remained 64% below 2019 levels. The improvement came mainly from a rebound in domestic tourism and summer tourists from the northern hemisphere. But in Asia and the Pacific, arrivals were still 95% below 2019 levels in the third quarter of 2021, as many destinations remained closed to non-essential travel (United Nations World Tourism Organization). This will continue to dampen growth prospects in Southeast Asian economies heavily dependent on international tourism such as Cambodia and Thailand.

In 2020, foreign spending on travel and tourism in Southeast Asia reached $173.3 billion. During the same period, the sector comprised 13.6% of total output and 15.2% of total employment in Cambodia, and 10.5% of total output and 6.9% of total employment in Thailand (Figure 1.3). While the sector is expected to open in the fourth quarter of this year, the expectation is that long-haul travel will not support the recovery of tourism until 2024, and the sector will primarily rely on domestic tourism, which generates a smaller revenue base.

Resilience of Merchandise Exports

The third key factor shaping Southeast Asia's crisis has been the role of international trade, given the region's dependence on exports. Merchandise exports have held up and proved resilient amid the pandemic. This has been particularly true for Malaysia, Singapore, Thailand, and Viet Nam, which benefited from increased demand for

Figure 1.3: Tourism Output and Employment



GDP = gross domestic product, Lao PDR = Lao People's Democratic Republic.
Source: World Bank TCdata360 database (accessed 1 December 2021).

personal protective equipment, electronics, and other products to facilitate working from home. While export and import growth in Southeast Asia dropped sharply in the second quarter of 2020, the region's export growth turned positive by November 2020 as did its import growth by January 2021. In 2021, year-on-year export growth averaged 33% in the first 10 months of the year, while import growth averaged 37% during the same period.

Participation in Global and Regional Supply Chains

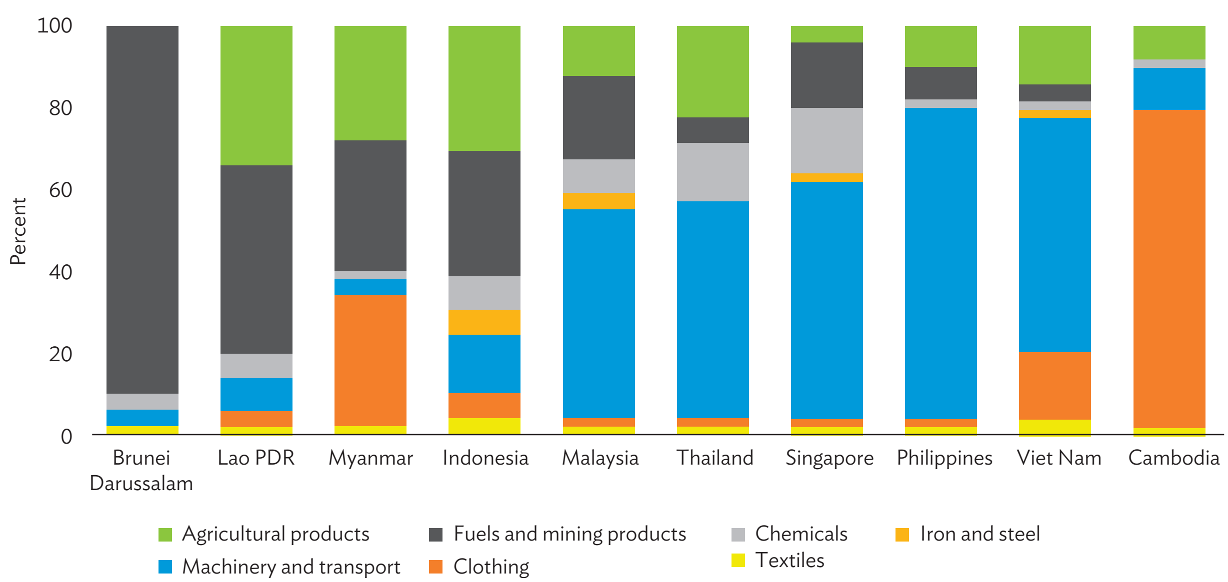
Pandemic-induced state policies such as prolonged restrictions on cross-border trade can alter the dynamics of global and regional supply chains such as shifts in the location of production, subdued production sharing, leaner supply chains, and greater automation in manufacturing. These changes have become more evident in Southeast Asia where value chains have increasingly become more concentrated. There are several reasons for this trend: (i) companies can get closer to large consumer markets, (ii) greater automation and digital technologies are replacing low labor costs in Southeast Asia, and (iii) greater access to new technologies have enhanced the adoptive capacity of many Southeast Asian economies.

It is notable that the pandemic has put pressure on re-shoring the production process away from highly concentrated areas of production and assembly, such as the PRC. This has improved opportunities for countries such as Malaysia, Thailand, and Viet Nam as alternative offshore locations. For Southeast Asia as a whole, this could mean building a regional value chain that is more integrated than it was before the pandemic.

Importance of Commodity Exports

Even before the pandemic, some countries in Southeast Asia have a high dependence on commodity exports such as Brunei Darussalam (92%), the Lao PDR (47%), and Indonesia (31%) (Figure 1.4). One benefit of large commodity exports is the sizeable amount of public funds it generates which are then transferred to households through wage subsidies, reduced

Figure 1.4: Merchandise Exports by Product, 2019



Lao PDR = Lao People's Democratic Republic.
Source: World Trade Organization International Trade Statistics (accessed 20 November 2021).

taxes, and better social infrastructure, as exemplified by Brunei Darussalam. However, a drawback of resource dependence is the exposure to commodity price-related risks, and exports of oil and natural gas as well as their prices tend to be pro-cyclical or move in the same direction as global economic activity. In times of reduced economic activity, demand for these commodity exports falls. Reducing risks would entail diversifying into other commodities and raising the sophistication of the country's export basket by moving into higher-value items, particularly those with a high employment multiplier. But with the pandemic, efforts to diversify economies in the region have become more difficult.

Dependence on Remittance Inflows

Several countries in the region are also very dependent on migration, both as origin countries such as the Philippines and Indonesia, and as destination countries such as Singapore. International migrants who are a major source of remittances support not just their home country's reserves but also a majority of its household population. Any disruptions in international labor demand would, therefore, have direct and immediate effect on the population of migrant-sending countries. For migrant-receiving countries, migrants are an indispensable source of needed human resources. But a huge population of migrants also poses a problem of resource allocation during a health crisis.

In Southeast Asia, four economies are in the top 10 remittance-receiving countries in Asia (Appendix, Table A1.1). In 2021, remittances to the Philippines reached 9.4% of gross domestic product (GDP), and almost 5% of GDP in Viet Nam and Cambodia. Remittances proved relatively immune to the pandemic in the Philippines and Viet Nam—they barely fell in 2020 and already registered positive growth by 2021. The relatively high-skilled and stably employed migrants from these countries cushioned the impact of foreign workers repatriated during the pandemic. In the case of the Philippines, for example, of the 2.2 million overseas Filipino workers, around 20% are managers, professionals, and technical and associate professionals who contribute about 30% of total remittances (Philippine Statistics Authority. 2019 Survey on Overseas Filipinos). In Indonesia, a large share of its migrant workers in developed countries are domestic workers (69%), factory workers (12%), or construction workers (5%).

Migration destinations also vary across countries in the region, which can determine the pace of recovery for each of these countries. For Viet Nam and the Philippines, the bulk of their migrants, 52% and 34%, respectively, are in the US. On the other hand, migrants from the Lao PDR, Cambodia, and Malaysia largely settle within the region, which is recovering less strongly. By sector, telecommunications-based service exports will be more in demand than traditional overseas employment, which would involve actual cross-border movement of persons. In terms of skill type, there will be reduced demand for unskilled work and more stringent requirements for skilled work (Lundt et al. 2021). These trends underscore how the destination country and sector employment of migrants can determine how migrants are likely to fare in times of global recovery.

Preparedness for Digital Economy

There is a digital divide across economies in Southeast Asia in terms of availability, access, cost, quality or speed, reliability, and know-how. Increasing dependence on telecommunications for e-commerce, work, groceries and food deliveries, schooling, and marketing will put countries with weak digital infrastructure at a major disadvantage. In 2021, 75% of the population in the six major economies in the region had access to the internet. Since the pandemic started, the region added around 60 million new internet users, and gross market value of the digital economy in the region reached $170 billion. The size of the digital economy is expected to more than double to $350 billion by 2025 and to $1 trillion by 2030 with continued adoption, deeper usage, and a new way of life emerging from this expansion of digital technologies. However, to support this digital transformation, the region needs to invest in safe and secure digital financial services; adopt simple, transparent, and smarter regulations on privacy and data security; invest in efficient transport and logistics infrastructure; and upgrade digital skills and literacy of people, businesses, and governments.

In particular, transport and logistics are critical for the digital economy, as the sector serves as the digital economy's backend or downstream industry. Regional disparity in transport and logistics infrastructure can further widen the digital divide across countries (Appendix, Figure A1.1).

Large Informal Sector

A big informal sector, to which many micro, small, and medium-sized enterprises (MSMEs) belong, together with low levels of social protection, magnified the disproportionate impact of the pandemic on the vulnerable (Table 1.1). Not all poor are covered by social protection benefits. Public spending on health is below the global average for most countries. Low levels of universal health coverage result in higher out-of-pocket spending on health, leaving households quite vulnerable to falling into poverty due to health shocks. In most countries in the region, the share of health expenditure to GDP is less than half of the global average, and the private sector bears 50%–80% of health spending. There is a huge disparity in per capita spending on health across the region, and the out-of-pocket share of household expenditure on health has gone up for some countries. The deterioration in health care along with poor nutrition and a high level of household debt can further contribute to the loss of human capital, lower potential, and widen income inequality in the region.

Size of Fiscal and Monetary Policy Response

The pandemic revealed areas of vulnerabilities and highlighted some of the strengths of countries in the region and the varying ways governments have handled each area of public policy.

For example, though Southeast Asia's total fiscal response in 2020 (25% of GDP) was comparable to the global level (13%) (Rajah

Table 1.1: Southeast Asia's Micro, Small, and Medium-Sized Enterprises

Country	Latest available year	Enterprises (number)	Percent of enterprises	Employees (person)	Percent of employment	Contribution to GDP (%)
Brunei Darussalam	2019	5,990	97.3	64,517	55.6	27.0
Cambodia	2014	512,870	99.8	1,345,100	71.8	–
Indonesia	2019	65,465,497	99.99	119,562,843	96.9	60.5
Lao PDR	2020	133,721	99.8	472,529	82.4	–
Malaysia	2020	1,151,339	97.2	7,253	48.0	38.2
Myanmar	2019	75,116	89.9	–	–	–
Philippines	2020	957,620	99.5	5,380,815	62.7	–
Singapore	2020	279,700	99.5	2,360,000	70.4	42.8
Thailand	2020	3,134,442	99.5	12,714,916	71.7	34.2
Viet Nam	2019	651,138	97.4	5,681,518	37.5	–

GDP = gross domestic product, Lao PDR = Lao People's Democratic Republic.
Notes: Employment figures for Lao PDR are for 2018. Figures for Singapore only cover Small and Medium-Sized Enterprises and its contribution to GDP refers to SME contribution to total enterprises nominal value added
Sources: Asian Development Bank (ADB). 2020 ADB Asia Small and Medium-Sized Enterprise Monitor Volume 1: Country and Regional Reviews. https://data.adb.org/dataset/2020-adb-asia-sme-monitor-vol1-country-regional-reviews (accessed December 2021) , except for the Philippines: official sources..

2021), fiscal spending as a share of GDP was much higher for Singapore, Indonesia, Malaysia, and the Philippines, ranging from 15%–41% of their respective 2020 GDP, while the fiscal response of the rest of the countries in the region averaged below 10% of 2020 GDP. In 2021, the total fiscal response in Southeast Asia, about 4% of GDP, was relatively small compared to the previous year. Malaysia and Thailand maintained their considerable spending levels in 2020, while for Singapore, Indonesia, and Viet Nam, spending decreased significantly in 2021. Still, the fiscal response in Southeast Asia played a major role in limiting the impact of the pandemic.

Central banks in Southeast Asia were able to implement crucial and timely decisions to stabilize financial markets. Central banks, particularly in Indonesia, helped stabilize the local bond markets in the face of a threat of capital flight early in the pandemic by purchasing quantities of domestic government bonds in the secondary market. This also allowed the governments to finance the budget deficits brought by the pandemic (Singh and Jena 2021). The rise in global liquidity from central banks of developed economies also helped calm financial markets. Since the start of the pandemic, several policy rate cuts were carried out by central banks in Southeast Asia. The cumulative rate cuts ranged from 0.79 to 2.70 percentage points starting March 2020.

III Development Impacts and Long-Term Challenges

The COVID-19 pandemic has reversed many of the hard-won economic and development gains in Southeast Asia. For example, ADB estimates that the number of people who are extremely impoverished (those who live on less than $1.90 per day) rose by 5.4 million in Southeast Asia in 2020 due to the severe decline in economic activity. For 2021, another 4.7 million people fell below the extreme poverty threshold compared to the 2020 no-COVID-19 poverty baseline.

The pandemic has also resulted in severe labor market disruptions. The International Labour Organization (ILO) estimates that in 2020, employment in the region was 10.6 million less than the no-pandemic scenario. Employment losses were particularly hard on women, youth, and MSME workers. Furthermore, ILO does not expect the labor market to immediately recover even when the economic recovery process begins as some workers will have likely de-skilled quickly and thus find it difficult to get a job. The employment gap is projected to remain at 9.3 million and 4.1 million jobs in 2021 and 2022, respectively (ILO 2021). Thus, the pandemic's impact on poverty and unemployment will likely persist as inactive workers become de-skilled and poor people's access to opportunities further deteriorates. When this happens, the deterioration in inequality will transfer across generations.

Inequality and income gaps have also increased throughout the region. Income gaps widen as more skilled workers continue to work through online platforms whereas unskilled workers who lost their jobs from earlier lockdowns remain unemployed. Inequality has also increased considerably as individuals and households varied in terms of their capability to cope with the pandemic. Generally, the impact of mobility restrictions fell heavily on the informal economy and retail sector in urban areas where women and young workers who are unskilled are disproportionately represented.

Inequality is a bane to growth. Many economies in the region have seen rising inequality in tandem with economic recovery. This erodes the backbone of society in several ways. It reduces the incentives for those who work in sectors that fall behind. It also hampers investment in education for those who have lost significant income. Rising inequality also undermines social cohesion.

Despite the solid economic recovery in the region, the output levels of economies in Asia will likely remain well below the no-COVID-19 baseline.[1] This could stem from several factors, including the destruction of human capital and slowing productivity. First, given the significant deaths and disabilities resulting from COVID-19, massive job displacements, and impact on skills and future earnings losses due to school closures, the impact on human capital in Southeast Asia will be substantial. For example, an ADB study estimates the losses to skills and productivity due to school closures to be higher than 5% of the region's GDP. Second, the lack of social protection can also severely hamper countries' efforts to prepare for and proactively respond to disasters such as pandemics. These weaknesses undermine levels of preparedness, exacerbate the economic and social impacts of a disaster, and restrict the opportunities to build back better and enhance resilience to future hazard events.

A comparison of the 2021 actual GDP outcome and 2022 Asian Development Outlook (ADO) forecasts with trend output levels in Asia show that despite the solid economic recovery in the region, the actual GDP outcome for 2021 and forecasted output levels in 2022 will remain well below the no-COVID trend output (Table 1.2). For Southeast Asia as a group, the average expected output level in the region in 2021 and 2022 is at least 10% below its no-COVID output level. The Philippines, Cambodia, Malaysia, the Lao PDR, and Thailand have the highest output gap relative to their trend output levels. For the Philippines and Cambodia, this stems from the relatively strong trend growth in the 10 years to 2019.

With the continuing spread of the Omicron variant, there is a pressing concern that the expected economic recovery in 2022 could be stalled by the emergence of a new wave of COVID infections. How the ongoing economic recovery could be affected by further COVID-19 mutations is presented in Table 1.3. The table presents the results of a computable general equilibrium (CGE) simulation exercise based on a recursive-dynamic GDyn model

Table 1.2: GDP Comparison of Growth Forecasts with 10-Year Trend Growth

Country	Trend Growth (%)	ADO Forecast (%)		Deviation from Trend (%)	
	2009-2019	2021	2022	2021	2022
ASEAN	5.3	3.2	5.1	-10.6	-10.3
ASEAN-5	5.1	4.0	5.0	-10.5	-10.7
Indonesia	5.4	3.7	5.0	-8.6	-9.0
Malaysia	5.3	3.1	5.9	-12.3	-11.8
Philippines	6.4	5.6	6.0	-15.7	-16.0
Singapore	4.9	7.6	4.1	-7.5	-8.3
Thailand	3.6	1.6	4.0	-11.2	-10.8
BCLV	6.3	-2.0	6.2	-11.4	-7.2
Brunei Darussalam	0.5	1.8	3.5	2.1	5.1
Cambodia	7.0	1.9	5.5	-13.8	-15.0
Lao PDR	7.3	2.3	4.0	-11.6	-14.3
Viet Nam	6.3	2.6	6.5	-6.6	-6.4

ADO = Asian Development Outlook; ASEAN = Association of Southeast Asian Nations; BCLV = Brunei Darussalam, Cambodia, Lao PDR, Viet Nam; GDP = gross domestic product; Lao PDR = Lao People's Democratic Republic.
Sources: ADO December 2021 Supplement; BCML (Brunei Darussalam, Cambodia, Myanmar, and Lao PDR) forecasts from ADO September 2021 Update.

[1] The baseline output without COVID-19 is estimated by applying the average yearly growth from 2009 to 2019 to the pre-pandemic output level.

developed by Ianchovichina and Walmsley (2012).[2] The baseline scenario for this simulation replicates the forecasts from the December 2021 ADO supplement. The pessimistic scenario assumes that higher COVID-19 infections in 2022 could affect about two quarters of economic activities in the region, mainly through its impact on demand and the supply of workers who will either get sick or be required to isolate as they are exposed directly to the disease.

The CGE simulation shows that if the Omicron variant spreads and triggers supply and demand shocks affecting about two quarters of economic activities in 2022, then economic growth in Southeast Asia could be 0.8 percentage points lower than projected in the ADO. All economies in the region would post a weaker growth in 2022, with Viet Nam (–1.9 percentage points), Thailand (–1.1 percentage points), Malaysia (–0.8 percentage point), and the Lao PDR (–0.8 percentage point) most heavily affected. Compared to the downgrade in economic forecast for 2021 due to the emergence of the Delta variant, the likely magnitude of the downgrade for 2022 because of the Omicron variant is much more muted. This reflects the higher level of vaccination in the region, the enhanced capacity of these economies to operate even with partial mobility restrictions, and the less severe hospitalization associated with this particular variant.

Table 1.3 presents another scenario on the impact of policies to increase health expenditures in the region, to address not just rising cases of COVID-19 but also other communicable and noncommunicable diseases. Presently, the health-care system in the region has a low medical surge capacity which could contribute to relatively high case fatality rates. This is apparent in the region's low number of hospital beds and physicians per population (Appendix, Table A1.2) and other health-care indicators. Many countries in the region fall below the world average in terms of availability of health facilities and health-care professionals. With the ongoing crisis, there has been a shortage in health personnel such as nurses and doctors; health

Table 1.3: Economic Growth under a Pessimistic Scenario of High COVID-19 Cases in 2022 and a Policy of Higher Health Spending

	Baseline Scenario		Pessimistic Scenario		Policy Scenario	
	GDP Growth (%)		Deviation from Baseline (percentage point)		Deviation from Baseline (percentage points)	
Developing Economies	**2021**	**2022**	**2021**	**2022**	**2021**	**2022**
Southeast Asia	**3.0**	**5.1**	**0.0**	**-0.8**	**0.0**	**1.5**
Brunei Darussalam	1.8	3.5	0.0	-0.4	0.0	1.1
Cambodia	1.9	5.5	0.0	-0.4	0.0	1.1
Indonesia	3.5	5.0	0.0	-0.5	0.0	1.4
Lao PDR	2.3	4.0	0.0	-0.8	0.0	1.6
Malaysia	3.8	5.9	0.0	-0.8	0.0	1.3
Philippines	5.1	6.0	0.0	-0.4	0.0	1.1
Singapore	6.9	4.1	0.0	-0.2	0.0	1.7
Thailand	1.0	4.0	0.0	-1.1	0.0	2.4
Viet Nam	2.0	6.5	0.0	-1.9	0.0	1.0

COVID - 19 = coronavirus disease, GDP = gross domestic product, Lao PDR = Lao People's Democratic Republic.
Source: ADB.

[2] The GDyn Model is the dynamic extension of the standard Global Trade Analysis Project (GTAP) model, which is a multi-region, multisector computable general equilibrium (CGE) model. This dynamic CGE model combines aspects of financial assets and associated income flows, capital accumulation, and investment theory. The CGE simulation also uses the GTAP 10A database with a reference year of 2014 (Carrico, Corong, and van der Mensbrugghe 2020), which the analysis also updated to 2020 using World Bank macro data sets and the ADB Multi-Region Input–Output database and ADO forecasts.

facilities such as hospitals, hospital beds, and isolation facilities; and medical supplies such as ventilators and medicines. These measures correlate with survival rates of COVID-19 patients.

In this scenario, the analysis mimics the impact of increased health spending by assuming that health-care systems develop in such a way that the economic burden of the diseases falls based on current best-available research advances and practices. Starting from the burden estimated by the Institute for Health Metrics and Evaluation at the University of Washington Seattle, the analysis embarks on the realistic burden-reduction assumptions laid out in a McKinsey study (2020). One deviation that the analysis takes from the McKinsey study is the assumption that improvements in health-care systems continue until 2030, while the McKinsey study goes on until 2040. In other words, the assumption here is relatively more conservative compared to the McKinsey study which has a decade of additional health-care improvements. The analysis also assumes that the investments required to make these improvements happen immediately, are endogenous, and hence they are determined within the model and approximately worth 4.8% of GDP globally.

Based on this simulation, reduced disease burden could enhance the growth prospect in Southeast Asia by about 1.5 percentage points in 2022 compared to the baseline. In general, the increased GDP growth stems from higher health spending, higher labor force participation rate, as well as increased labor productivity from better health of workers in the region. Thailand, Singapore, and the Lao PDR are the top three countries that will benefit the most from this reduction in disease burden, with all economies in the region posting at least 1% higher growth.

Reinvigorating Growth and Building Resilience

The pandemic has exposed many of the vulnerabilities of the region's economic and social systems—a weak health system, limited safety nets for social protection, flaws in the region's trade and supply chains, discontinuity in the business environment, and gaps in the region's decarbonization commitments, among others.

Association of Southeast Asian Nations (ASEAN) governments have implemented a wide range and various concoction of measures in response to COVID-19, from health system and social welfare measures, subsidies to firms, tax deferrals to monetary policy. All the economies responded in terms of monetary and health system measures. Income support measures were carried out by all except for the Lao PDR and Brunei Darussalam (Table 1.4). Tax policy changes were made in the entire region, except for Singapore. Further, in terms of credit guarantees from governments to private stakeholders, the response remained limited to Malaysia. In general, the central banks across the entire ASEAN region have responded with monetary policy measures by slashing interest rates to record low levels.

Going forward, policy makers in the region should also focus on strengthening macroeconomic fundamentals and correct existing economic and financial imbalances. Maintaining sufficient international reserves and policy space could help cushion possible shocks in the future. As policy normalization could trigger capital flow reversals and currency depreciation, adopting macro-prudential regulations, adjusting domestic interest rates, harmonizing rules and regulations across economies to attract more intraregional flows, and strengthening the domestic investor base could be helpful.

Table 1.4: Fiscal and Monetary Policy in ASEAN Economies in Response to COVID-19

Country	Fiscal Stimulus Package								Monetary and Financial Sector Policy	
	Overall fiscal measures	Health system measures	Income support measures for individuals and households, excluding tax and contribution charges	Tax and contribution policy changes	Public sector subsidies to firms	Deferral of taxes and social security contributions and bringing-forward expenditure within current fiscal year	Public sector loans or capital injections to firms	Loan guarantees by the state, benefitting private borrowers	Monetary policy	Prudential regulation
Brunei Darussalam	✓	✓		✓	✓	✓	✓		✓	✓
Cambodia	✓	✓	✓	✓	✓		✓		✓	✓
Indonesia	✓	✓	✓	✓		✓			✓	
Lao PDR	✓	✓		✓		✓	✓		✓	✓
Malaysia	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Myanmar	✓	✓	✓			✓	✓		✓	✓
Philippines	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Singapore	✓	✓	✓		✓	✓	✓		✓	
Thailand	✓	✓	✓	✓	✓	✓	✓		✓	✓
Viet Nam	✓	✓	✓	✓	✓	✓	✓		✓	✓

ASEAN = Association of Southeast Asian Nations, Lao PDR = Lao People's Democratic Republic.
Sources: Charan Singh and Pabitra Kumar Jena. 2021. Central Banks' Responses to COVID-19 in ASEAN Economies. ERIA Discussion Paper Series No. 398;

There is also an urgent need to further strengthen regional economic surveillance and policy dialogue among policy makers in the region to better manage new risks arising in the horizon. Streamlining regulations and policies to augment market liquidity and promote greater financial resilience and stability is also needed.

Economies in the region should also exercise greater fiscal prudence to contain budget deficits and public debt. Two years after the pandemic, fiscal balances and public and private sector debt in all economies in the region have deteriorated compared with pre-pandemic levels. And some economies in the region could face debt-servicing problems should US interest rates rise or their currencies depreciate as the global economy normalizes.

However, it is expected that some priority spending—such as investment in the health-care system, stronger social protection measures, and support to the MSME sector—will continue to be critical during the economic recovery phase. Therefore, strengthening domestic resource mobilization either through stronger tax administration, introduction of new taxes, and review of tax expenditures is important. Better targeting, stronger partnership with the private sector, and the use of insurance markets could also be helpful to provide for some of these public services.

Policy makers could also pursue broader and deeper structural reforms to raise productivity in the region. Presently, a reform momentum is emerging in the region to build back better and greener. In much of Southeast Asia, there is a genuine desire to improve national health systems, to streamline domestic regulations and spur competitiveness, to invest in smart and clean infrastructure to boost growth, and to adopt technology and innovation to nurture a green economy. With these goals in mind, the following key priority reforms can contribute to a more robust and resilient economic and social system in the region:

(i) **Promote the health and well-being of people in the region.** Sound health and social protection and assistance policies are needed to build trust and safeguard people's well-being. On the health side, countries need to fortify the health-care system, instill pandemic preparedness, and establish health crisis management protocols. Countries also need to upscale core health capabilities; improve health surveillance; and ensure continued availability of adequate medical supplies, medicines, and vaccines. On social protection, it is important that targeted social assistance programs—geared to the youth, informal sector workers, returning migrant workers, and poor households—are continued. Focus on female-headed households who have been severely affected by the crisis should also be prioritized. Support and retooling of displaced workers (informal and unskilled), especially in sectors that are still held down by the pandemic, is also critical. Adopting a digital, integrated, and flexible social protection system linked to social registries using big data is also essential.

(ii) **Accelerate market reopening, create jobs, and support MSMEs.** This requires rolling out a strong national vaccination program, promoting the use of digital technology, adopting strict health and safety protocols at the workplace, offering incentives to firms to save existing jobs and create new jobs, and investing in logistics and infrastructure to ensure the smooth flow of goods and services. Authorities in the region should continue to provide well-targeted incentives, tax relief, subsidies, credit support, and training programs to affected MSMEs, especially those that are not able to smoothly transition to digital platforms. With the increasing role of digital technology, there is a need to improve internet speed and access and invest in digital literacy and skills across the region to ensure that no community, worker, or student is left out.

(iii) **Build competitiveness and human capital.** On competitiveness, facilitate setting up, running, and exiting a business; reduce red tape; improve logistics; and ease barriers to transport and trade that can improve business efficiency and productivity. Technology adoption and incubation can also help support, upscale, and modernize MSMEs and other enterprises. On human capital, more investment is needed to create a future workforce that is adequately qualified to support a modern economy. This involves quite substantial improvements in the education system as well as technical and vocational training that cater to the needs of businesses engaged in sectors of the future. Governments should also support expanded access to remote learning and create better linkages between education and job market needs.

(iv) **Governments in the region need to lead efforts to take care of our planet.** Policies should be redesigned to support the switch to cleaner fuels and protect our waterways and oceans. Public and private collaboration should focus on the need to reduce, recycle, and reuse materials to minimize our environmental impact. Tax policies and regulations should penalize carbon to curb business and activities related to carbon-intensive industries. Recovery plans should also promote green infrastructure investments as this is not only good for the environment but also good for growth and jobs. Moreover, it is critical that communities support a more sustainable and healthier lifestyle that builds human welfare, prevents the spread of diseases, and reduces vulnerability to natural hazards.

References

ADB. 2021. *Asian Development Outlook (ADO) December 2021 Supplement: Recovery Continues.* Manila.

_______. 2021. *Asian Development Outlook (ADO) September 2021 Update: Transforming Agriculture in Asia.* Manila.

International Labour Organization (ILO). 2021. *COVID-19 and the ASEAN Labor Market: Impact and Policy Response.* ILO Policy Brief. August.

Lund, Susan, Anu Madgavkar, James Manyika, Sven Smit, Kweilin Ellingrud, Mary Meaney, and Olivia Robinson. 2021. *The Post-pandemic Economy: The Future of Work after COVID-19.* McKinsey Global Institute.

Rajah, Roland. 2021. *Southeast Asia's Post-pandemic Recovery Outlook.* Brookings Southeast Asia Insights.

Singh, Charan and Pabitra Kumar Jena. 2021. Central Bank's Responses to COVID-19 in ASEAN Economies. *ERIA Discussion Paper Series* No. 398

Appendix

Table A1.1: Remittance Inflows

Global Rank	Asia Rank	Country	Remittance Inflows ($ million) 2018	2019	2020	2021	Share in 2021 (%) Total	GDP	Growth Rate (%) 2018–2019	2019–2020	2020–2021
4	3	Philippines	33,809	35,167	34,913	36,240	4.8	9.4	4.0	-0.7	3.8
10	6	Viet Nam	16,000	17,000	17,200	18,060	2.4	4.9	6.3	1.2	5.0
19	7	Indonesia	11,215	11,666	9,651	9,168	1.2	0.8	4.0	-17.3	-5.0
25	10	Thailand	7,466	8,162	8,257	7,664	1.0	1.4	9.3	1.2	-7.2
58	15	Myanmar	2,673	2,553	2,250	2,235	0.3	3.3	-4.5	-11.9	-0.6
69	17	Malaysia	1,686	1,597	1,432	1,538	0.2	0.4	-5.2	-10.4	7.4
80	20	Cambodia	1,431	1,525	1,272	1,175	0.2	4.5	6.5	-16.6	-7.7
134	27	Lao PDR	240	297	232	213	0.0	1.1	23.6	-21.7	-8.1

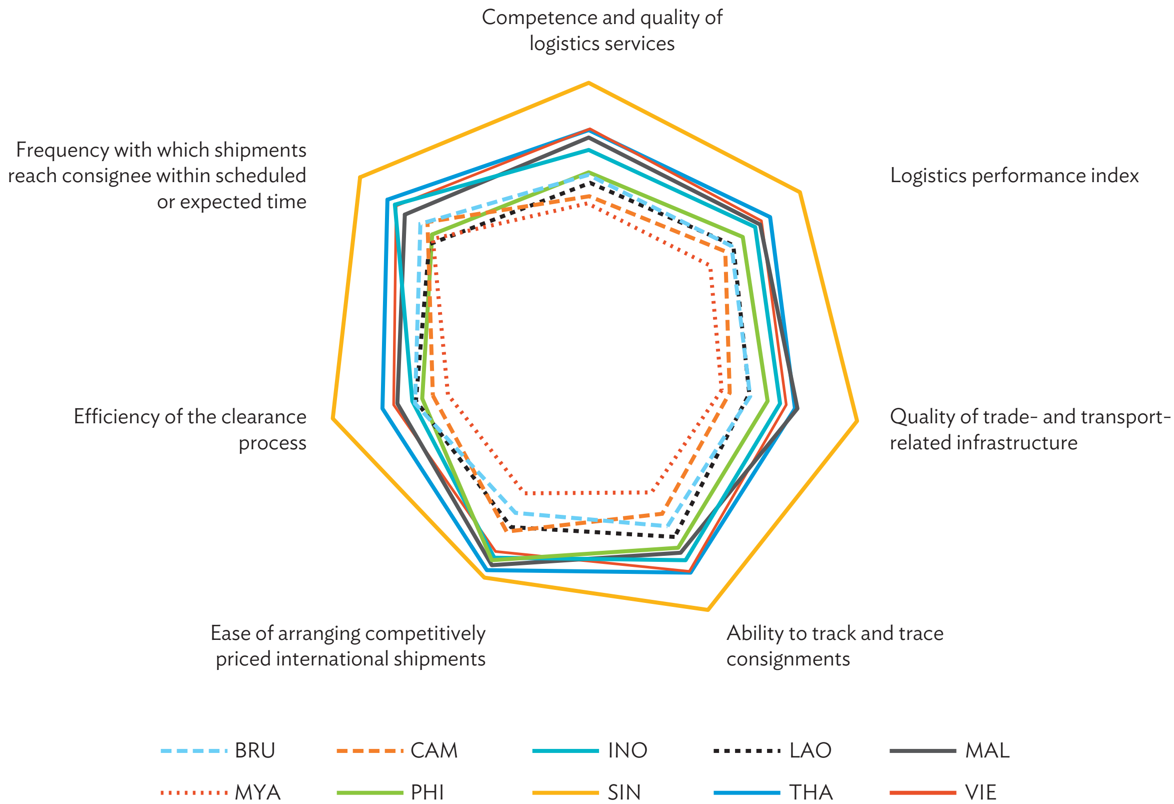
GDP = gross domestic product, Lao PDR = Lao People's Democratic Republic.
Source: World Bank Migration and Remittance database, accessed 22 November 2021.

Table A1.2: Key Indicators of the Health-Care System
(Per 1,000 persons)

Country	Hospital Beds		Physicians	
Cambodia	0.90	(2016)	0.19	(2014)
Philippines	0.99	(2014)	0.60	(2017)
Myanmar	1.04	(2017)	0.74	(2019)
Indonesia	1.04	(2017)	0.47	(2019)
Lao PDR	1.50	(2012)	0.37	(2017)
Malaysia	1.88	(2017)	1.54	(2015)
Thailand	2.10	(2010)	0.92	(2019)
Singapore	2.49	(2017)	2.29	(2016)
Viet Nam	2.60	(2014)	0.83	(2016)
Brunei Darussalam	2.85	(2017)	1.61	(2017)
World	**2.89**	**(2017)**	**1.76**	**(2017)**

Lao PDR = Lao People's Democratic Republic.
Source: World Bank Health Nutrition and Population Statistics (accessed 16 February 2022).

Figure A1.1: Regional Disparity in Transport and Logistics Infrastructure, 2018

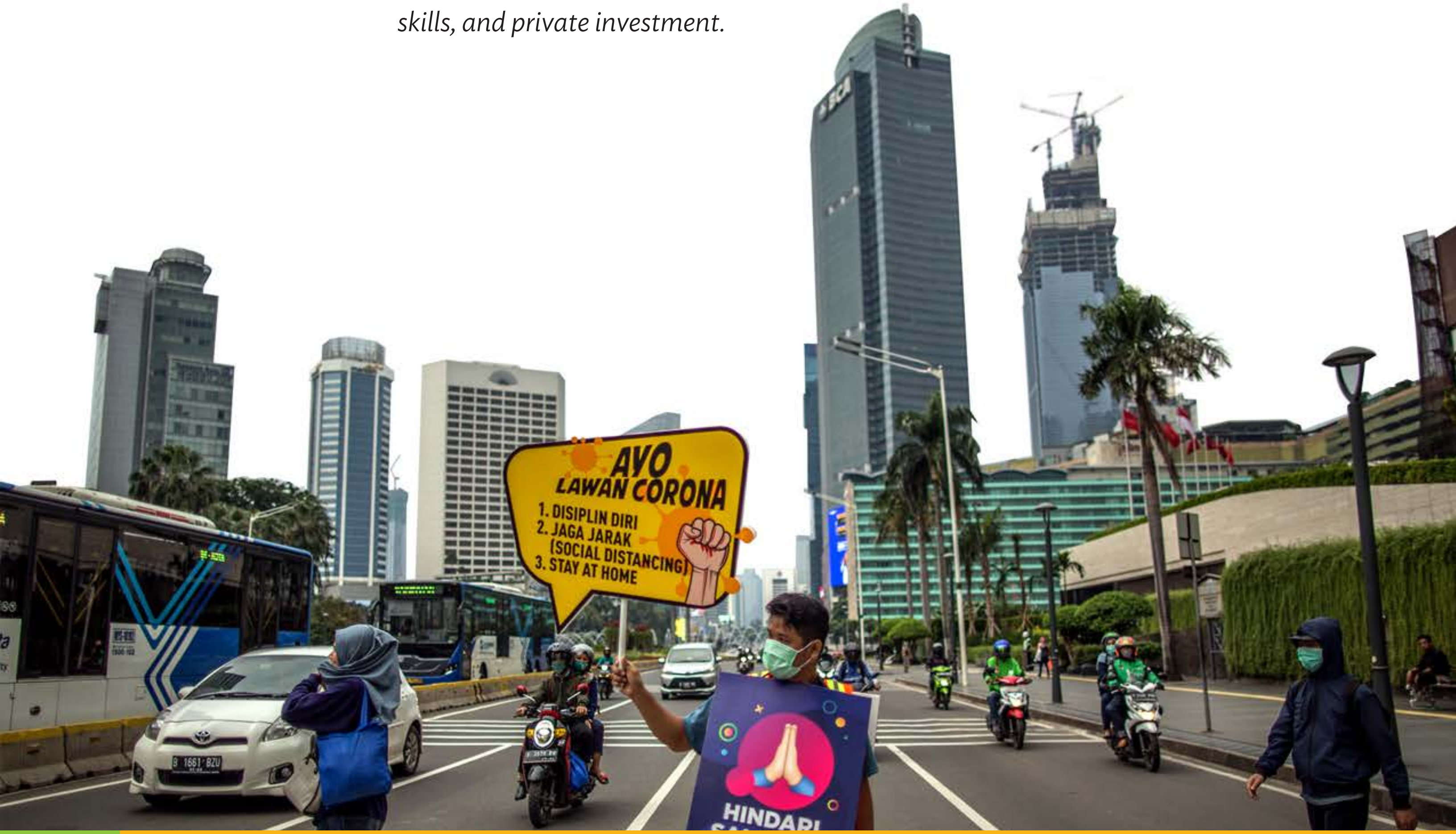


BRU = Brunei Darussalam, CAM = Cambodia, INO = Indonesia, LAO = Lao People's Democratic Republic, MAL = Malaysia, MYA = Myanmar, PHI = Philippines, SIN = Singapore, THA = Thailand, VIE = Viet Nam.
Source: Logistics Performance Index Database (accessed 9 February 2022).

2

Indonesia:
Boosting Post-Pandemic Productivity Prospects

The COVID-19 pandemic has the potential to cause economic scarring, or long-term damage to an economy. Such effects are difficult to predict, but early data indicate that scarring is unlikely to be substantial in Indonesia. The economy experienced a mild contraction and recovery has been swift. Labor productivity increased, and there is a good chance that part of the increases can be sustained. Finally, Indonesia is adopting reforms to raise investment and productivity. Nevertheless, significant uncertainty remains, and downside risks have increased in 2022. To sustain the recovery, continued flexibility in macroeconomic policy will be essential, including, if needed, stimulus measures and social safety nets. To further avert the prospect of scarring and promote long-term growth, structural reforms are critical to increase public infrastructure, job creation, learning and skills, and private investment.



Volunteers carry banners on how to fight the COVID-19 outbreak in Jakarta, Indonesia (Photo by Afriadi Hikmal/ADB).

Note: This chapter was written by Priasto Aji and Henry Ma of ADB's Indonesia Resident Mission in Jakarta.

I The Economy during the Pandemic

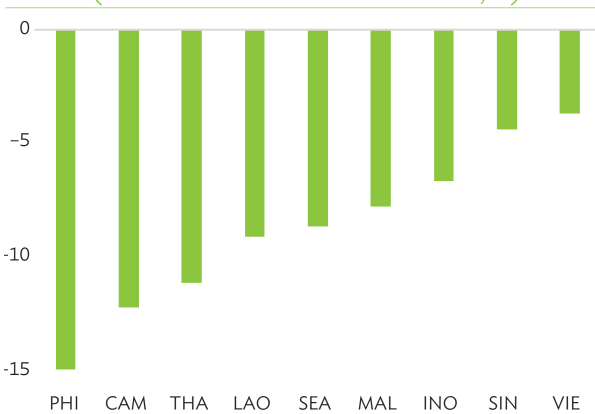
The Indonesian economy contracted in 2020, but the recession was moderate compared to the downturn in 1998 and to other Southeast Asian economies during the pandemic. GDP fell by 2.1% in 2020, but based on the quarterly growth of seasonally adjusted GDP, activity started to pick up again in the third quarter of that year.

By 2022, Indonesia's economy will have regained more ground compared to its peers. Growth is estimated to have been 3.5% in 2021 and projected to be about 5% in 2022, but with downside risks. This improved economic performance has been due to (i) a gradual recovery of pent-up demand for goods and services as mobility restrictions were relaxed and vaccinations progressed, (ii) a large and timely macroeconomic policy response, and (iii) a supportive external environment. Comparing the difference between projected output through 2022 with the pre-pandemic trend output, the gap for Indonesia is projected to be relatively small compared to most economies in Southeast Asia (Figure 2.1).

Containment of COVID-19 infections and steadily progressing vaccinations have contributed to Indonesia's relatively good economic performance. Between March 2020 and July 2021, only one surge occurred, with daily infections peaking at about 12,000 in February 2021. A worse outbreak occurred from July to August 2021, with daily infections rising to about 50,000 (Figure 2.2), but it was swiftly contained through mobility restrictions and a stepped-up vaccination campaign. By end-2021, infections were below 200 and about 57% of the targeted population, or 114 million people, had been fully vaccinated. However, there is still significant uncertainty regarding the course of the pandemic, especially with the rise of the Omicron variant in early 2022.

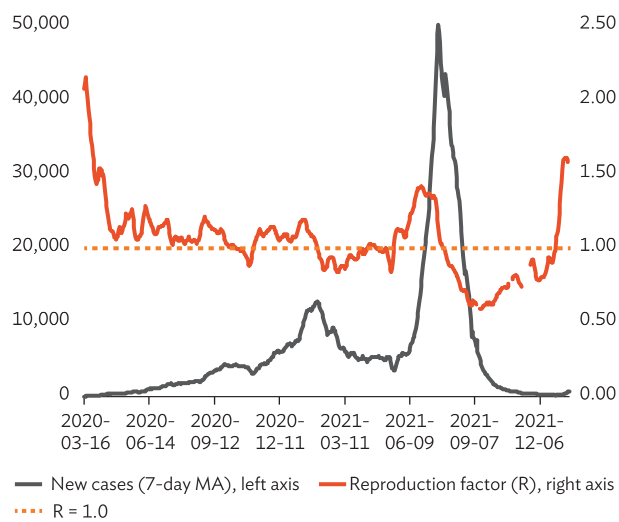
Timely and substantial fiscal support helped limit the downturn. The government responded with a bold package to prop up the economy. The 3% deficit ceiling was suspended, and emergency spending was enacted, amounting to a net 3.8% of GDP in 2020 and another 4% in 2021. The fiscal deficit was raised from 2.2% of GDP in 2019 to 6.2% of GDP in 2020, and was budgeted to be 5.8% of GDP in 2021. Preliminary estimates point to a deficit of 4.65% of GDP in

Figure 2.1: Gap between Forecasted GDP and Estimated GDP, 2022
(Based on the Pre-Pandemic Trend, %)



CAM = Cambodia, GDP = gross domestic product, INO = Indonesia, LAO = Lao People's Democratic Republic, MAL = Malaysia, PHI = Philippines, SEA = Southeast Asia, SIN = Singapore, THA = Thailand, VIE = Viet Nam.
Note: Output gap is calculated as the difference between Asian Development Outlook 2021 projections and pre-pandemic growth trend calculated as average GDP growth from 2016–2019.
Source: ADB staff estimates.

Figure 2.2: COVID-19 New Cases and Reproduction Factor



Source: Our World in Data.

2021. As a result, the public debt rose from 31% of GDP in 2019 to about 41% of GDP in 2021, albeit still well below the debt ceiling of 60%.

Monetary and financial policy have also supported economic activity. Since February 2020, the central bank cut its policy rate six times and by 125 basis points to 3.5%, its lowest level since 2006. It also purchased government bonds on the primary market to help finance the deficit and committed to being a buyer of last resort, and it intervened to smooth the volatility of the rupiah and preserve liquidity in the local currency money market. The financial regulator allowed banks to relax loan ratings, a policy extended through March 2023, to give corporate debtors breathing space and allow banks time to tap additional capital, sell assets, or reduce costs.

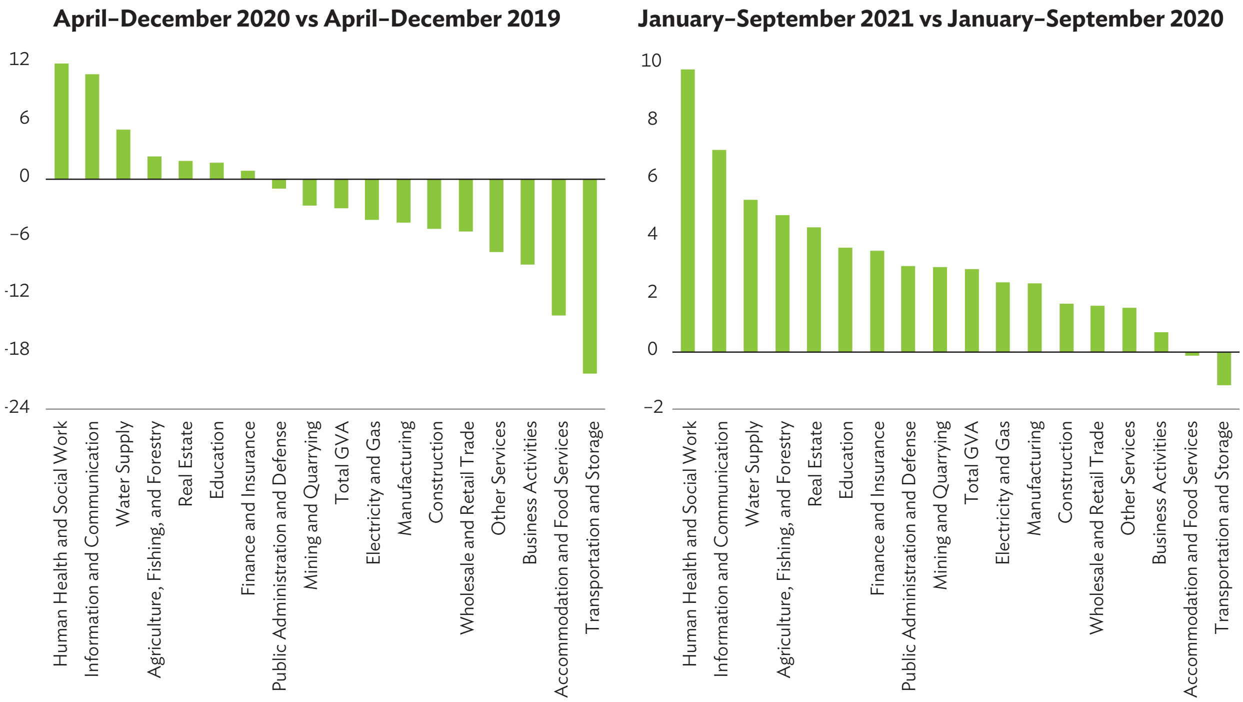
Strong export performance contributed to the recovery. In 2020, the contribution of net exports was positive and significant, but largely because imports fell faster than exports. In US dollar terms, merchandise exports fell by 3% in 2020, while merchandise imports fell by 18%. By contrast, in 2021, imports grew as demand recovered and exports grew even faster, resulting in a record trade surplus. Prices were buoyant for commodities such as crude palm oil and coal.

Despite significant improvements in the past year, the recession has led to some damage to the economy. Gross fixed capital formation shrank by 5% in 2020 and grew by only 4% during 2021. Unemployment rose from 5.01% in February 2019 to 7.07% in August 2020—its highest rate in 9 years—and to 6.25% in February 2021 and 6.49% in August 2021. The poverty rate, which had not risen since 2015, rose from 9.2% in 2019 to 10.2% in 2020, equivalent to about 28 million people below the official poverty line, before falling back to 9.7% in September 2021. The Gini coefficient of inequality rose from 0.380 in 2019 to 0.385 in 2020, and fell to 0.381 in September 2021. The World Bank reclassified Indonesia as a lower middle-income economy in July 2021, after being classified as upper middle-income in 2020.

From the onset of the pandemic, sectors that relied more heavily on in-person contact suffered more. During the last three quarters of 2020, year-on-year output contracted most in many service industries, including transport, hotels and restaurants, business activities, and wholesale and retail trade (Figure 2.3). Gross value added in health and human services rose by about 12% due to strong demand for medical services. Not surprisingly, information and communication, which was best-placed to adopt to remote working, also did well, with the sector's output growing by 11%. Output in agriculture rose due to good weather in the second half of 2020 as well as the influx of workers from other sectors because agriculture serves as a safety net for informal workers. Utilities—water, electricity, and gas—also did well because this sector is relatively capital-intensive.

In 2021, sectors that could cope best with remote working continued to grow. Hence, information and communication and utilities sectors had among the highest growth rates. Continuing strong demand for medical services also supported growth in the health sector.

Figure 2.3: Growth of Sector Gross Value Added



GVA = gross value added.
Source: ADB staff estimates based on national income accounts, Central Bureau of Statistics.

II Did the Recession Cause Scarring?

Studies of health crises have found that the recessions they induce can have long-lasting costs. Martin Fuentes and Moder (2021) find that the initial impact of pandemics dissipates after 2 years. However, Ma, Rogers, and Zhou (2020) conclude that although rapid recovery is possible, output could still be below its pre-shock level 5 years later. Another study by Cuesta Aguirre and Hannan (2021) notes that there could be fewer adverse effects if there are large responses in public spending. In this regard, Indonesia's fiscal response was timely and substantial.

Hence, there is some reason to be concerned that Indonesia's economy could suffer from scarring. Conceptually, the pandemic could lead to medium- and long-term scarring in the following ways:

(i) Deaths reduce labor supply.

(ii) Impaired mental health could lower labor productivity.

(iii) Individuals can lose skills, contacts, and motivation, thus prolonging unemployment or underemployment.

(iv) Learning losses lead to lower productivity and earnings.

(v) Reduced investment lowers the capital stock (tangible and intangible) and could decrease productivity and innovation. Lingering uncertainty and debt overhang resulting from the recession could reduce future investment.

(vi) Closures of firms disrupt firm–worker and firm–firm relationships, which are intangible assets.

(vii) Surviving firms could enjoy market power, reducing dynamism. New firms may find it harder to start up or survive, further reducing dynamism.

(viii) Conversely, if governments prop up troubled firms, their delayed exit could hamper creative destruction, or reallocation of firms and sectors.

(ix) Disruption of global trade could cut countries off from trade's productivity benefits.

(x) Disruption of urbanization could reduce the innovation generated in cities.

The pandemic's disruptions, however, could also have positive effects:

(i) Work from home reduces the need for commuting and physical infrastructure such as offices.

(ii) Companies adopt new ways of working (such as food delivery, digital banking, and online streaming). As these new ways spread and even more are discovered, productivity could further rise.

(iii) If the downturn is brief and/or troubled firms use forbearance to restructure, then the breathing space provided by governments can help foster reallocation.

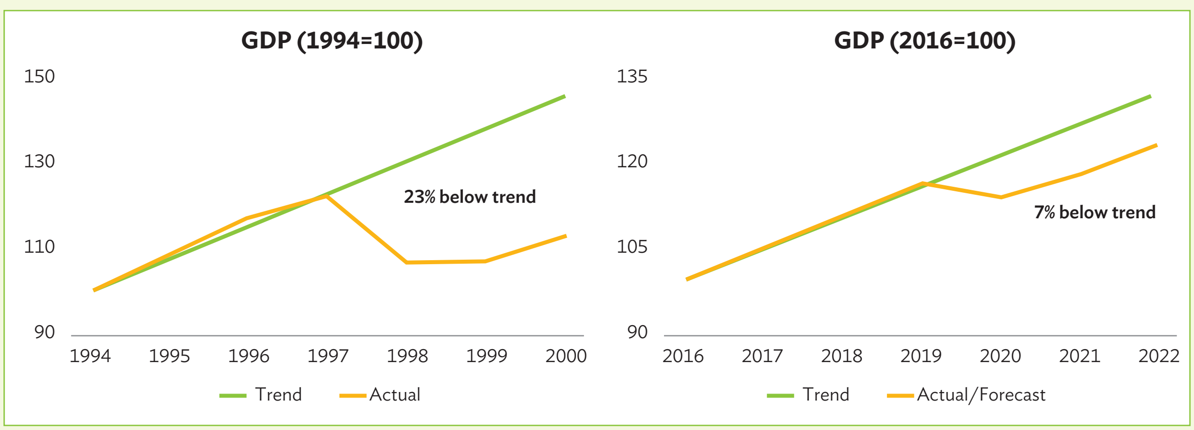
(iv) If the downturn hastens the entry and exit of firms, then this can boost productivity and growth.

Although it is too soon to be definitive, there are reasons to expect that significant scarring would be unlikely for Indonesia (Box 2.1). Some studies (Claessens, Kose, and Terrones 2009) have concluded that recessions resulting from financial crises (such as Indonesia's in 1998) are worse than those resulting from, say, fiscal policy, monetary tightening, or oil price shocks. The following are other reasons why scarring is unlikely:

(i) The likelihood of scarring depends on the degree and duration of the downturn. Because Indonesia's recession has been moderate and brief, the negative impact on productivity, investment, and innovation will hopefully be limited. This crucially depends, however, on the pickup in economic activity being sustained in 2022.

Box 2.1: A Tale of Two Downturns

Output gaps are one (crude) way of evaluating potential scarring. By this measure, Indonesia's recession has been exceptionally mild. Indonesia's output 2 years after the Asian financial crisis in 1997–1998 was 23% below the pre-crisis trend. In contrast, based on the pre-pandemic trend growth of 5%, gross domestic product (GDP) by 2022 would only be about 7% below potential.



GDP = gross domestic product.
Note: Pre-crisis growth trend is calculated as average GDP growth rate for 1993–1996 for the Asian financial crisis and 2016–2019 for the pre-pandemic growth.
Source: ADB staff estimates.

(ii) The swift containment of infections and the ongoing normalization of activities, including schooling, will help reduce labor and learning losses. The impact on mental health, however, will take time to show.

(iii) Scarring depends on how quickly individuals and firms adjust. Available data through August 2021 show that labor productivity has risen significantly. If sustained, these gains would support, or even raise, trend growth post-pandemic.

(iv) Structural reforms are being adopted or planned, which would promote investment, improve the business environment, foster job creation, promote innovation, and attract foreign investment and technology. These reforms address long-standing growth challenges.

(v) People have not relocated out of cities, which, as noted above, are seen as centers for inducing innovation.

(vi) Any disruption to trade seems to have been temporary, and Indonesia experienced strong growth of exports and imports in 2021.

Some studies point toward potentially significant scarring; these studies are based on the concept that prolonged unemployment could lead to workers losing their skills, job contacts, and motivation, while learning loss from school disruptions could affect children's lifetime incomes.

A study by Molato-Gayares (2021) notes that 2% of Indonesia's schoolchildren dropped out of school in 2020 due to lack of money, and that 20% of these dropouts did not wish to continue schooling. For those who did continue schooling, children likely lost academic learning due to school closures and ineffective remote learning. Using three scenarios—optimistic, intermediate, and pessimistic—Molato-Gayares (2021) estimates that compared to a non-pandemic scenario, learning-adjusted years of schooling in Indonesia declined by 13%–18%. Because every year of lost schooling reduces a student's expected annual earnings by 10.4% (or about Rp3.7 million), she estimates that these students' lost earnings over 45 years of their working life could amount to 13%–18% of GDP in 2020 (Table 2.1).

Table 2.1: Estimates of Learning Losses in Indonesia

	Optimistic	Intermediate	Pessimistic
Loss in earnings per student per year (constant 2020 $)	226	257	302
Loss in lifetime earnings (constant 2020 $ billion)	140	160	188
% of 2020 GDP	13	15	18

GDP = gross domestic product.
Note: For instruction days closed between 16 February 2020 and 30 September 2021.
Source: Asian Development Bank estimates.

Molato-Gayares (2021) also recommends measures to mitigate learning losses from school disruptions. Authorities must ensure that classes are safe to attend by promoting vaccinations and school safety protocols. Schools must be able to rapidly assess students' current learning to guide remedial measures, and they must better integrate remote learning modes in the school system. Finally, schools must be better prepared for future closures to minimize disruption.

Preliminary information is also available on labor market losses during the pandemic. Pritadrajati, Kusuma, and Saxena (2021) use the Indonesia Family Life Survey to measure the consequences not only of unemployment but also informal self-employment. They posit that the longer workers take to get back to regular employment, the more they miss out on job-specific training and the more their general work skills depreciate. When the economy slows, workers typically resort to informal employment in agriculture, whose contribution to GDP rose from 12.7% in 2019 to 13.7% in 2020, although this share has since fallen. During the same period, the share of informal workers rose from 55.9% to 60.5% and is about 59.6% in 2021. Pritadrajati, Kusuma, and Saxena (2021) also show that the wage penalty incurred due to unemployment and a transition to informal self-employment can vary across demographics:

(i) The scarring effect of unemployment is statistically significant only for older workers aged 45–60, who suffer a wage penalty of 13.4%. By contrast, the scarring effect of informal self-employment is statistically significant only for workers aged 25–34, who suffer a wage penalty of 2.4%.

(ii) Workers with senior secondary education experience the largest scarring effect on wages, a penalty of 5.34%. Similarly, workers with senior secondary education suffer most from informal employment, with a wage penalty of 6%.

(iii) Females suffer a wage penalty of 4% due to unemployment, while males experience a 2.5% penalty. By contrast, males suffer a higher wage penalty than females from informal employment at 3.6%, compared to a 2.9% penalty for females.

Labor market losses can be mitigated by the Pre-Employment Card program, which helps displaced workers reintegrate. The program enables recipients, 11.4 million to date, to obtain incentives and training to improve their skills. Graduates of the program can also receive training for starting businesses.

Labor market and learning losses have also been mitigated by the prompt provision of social safety nets. These programs reduced income shocks and averted distress sales of productive assets, high indebtedness, and stunting due to reduced nutrition. The research institution Social Monitoring and Early Response Unit has studied the impact of social assistance through the National Economic Recovery program and finds the following (Suryahadi et al. 2021):

(i) Without assistance, the median expenditure of all households would have dropped by 6.2% in 2020. Because of the programs, the median expenditure dropped by only 3.1%. The mitigating effect was most evident for the bottom 40% of households.

(ii) The poverty rate would have risen from 9.2% in 2019 to 14.2% in 2020. The actual poverty rate was 10.2%, indicating that the programs averted a 4-percentage point increase.

(iii) The Gini coefficient would have risen from 0.380 in 2019 to 0.402 in 2020. Instead, the actual Gini was 0.385, indicating that the programs averted an increase of 0.017.

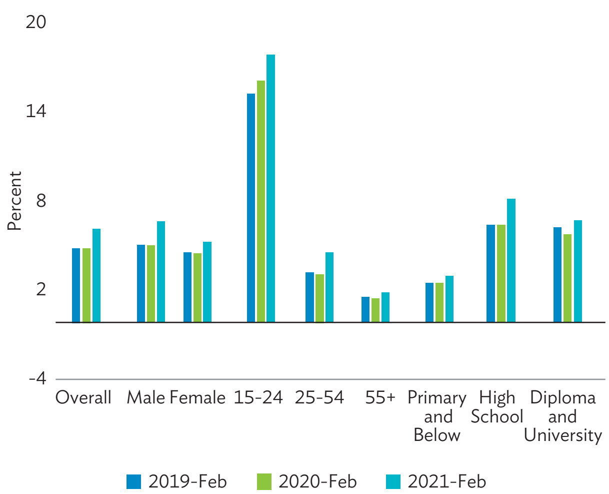
While Molato-Gayares (2021) and Pritadrajati, Kusuma, and Saxena (2021) point toward scarring, other data suggest that significant scarring is unlikely:

First, the increase in the unemployment rate and the fall in the labor force participation rate (LFPR) and employment rate have been modest. The overall unemployment rate, which was 5.0%–5.5% pre-pandemic, peaked at 7.07% in August 2020 and was 6.49% in August 2021. The largest increases in unemployment since 2019 have been experienced by males aged 20–24 and those with only some high school education (Figure 2.4).[1] Individuals dropping out of the labor force mitigated the rise in unemployment. The LFPR dipped from 69.3% in February 2019 to 68.1% in February 2021, but it rose slightly between August 2019 and August 2021 (Figure 2.5). Hence, a better indicator may be the employment rate, or the percentage of those 15 and older who are working. The employment rate slid from 65.9% in February 2019 to 63% in August 2020 and 63.8% in February 2021. Nevertheless, the negative effects can be seen as quite modest.

[1] Due to strong seasonality, for each key labor market indicator, two figures are presented to facilitate comparison: first, data for the February labor force surveys in the years considered; and second, for the August surveys.

Second, there has been a slight shift in the workforce toward more educated workers. To the extent that higher human capital promotes growth, this is a positive development. During February 2019 to February 2021, the share of employment of those with primary education or less fell by 3.1%, while the share of those with secondary education increased by 2.8%, and those with diplomas or university education increased by 0.4%. During August 2019 and August 2021, the share of those with primary education or less fell by 2%, those with secondary education increased by 1.6%, and those with diplomas or university education fell by 0.4% (Figure 2.5). On the other hand, a larger share of employment by older workers, which is associated with reduced innovation, could hurt future growth. The share of prime-age workers (aged 20–54) fell by 0.5%, while the share of those above 55 rose by 1.4%.

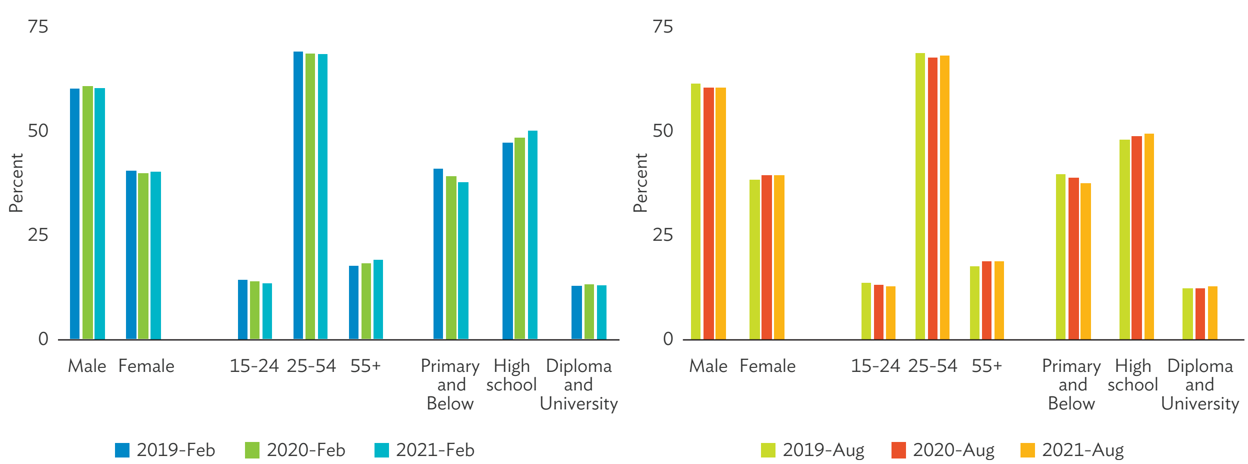
Figure 2.4: Unemployment Rate



Source: ADB staff estimates, based on Sukernas data.

Third, female labor force participation has fallen only slightly, from 55.5% in February 2019 to 54.6% in February 2020 and further to 54% in February 2021; comparing the August surveys, however, the indicator rose from 51.9% in August 2019 to 53.1% in August 2020 and 53.3% in August 2021 (Figure 2.6). However, Indonesia's female LFPR has been exceptionally low at 55% in 2009–2019, which suggests that there is a large pool of unused labor resources. During recessions, female workers are more likely to experience scarring due to inhospitable labor market conditions even during normal times and gender-biased roles in the household.

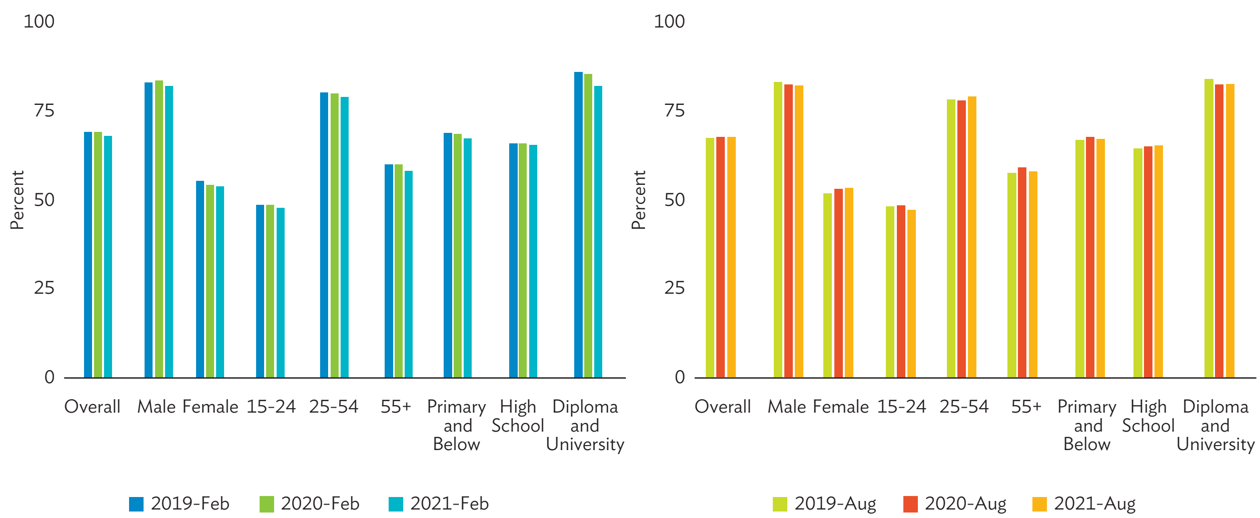
Figure 2.5: Employment Shares



Source: ADB staff estimates, based on Sukernas data.

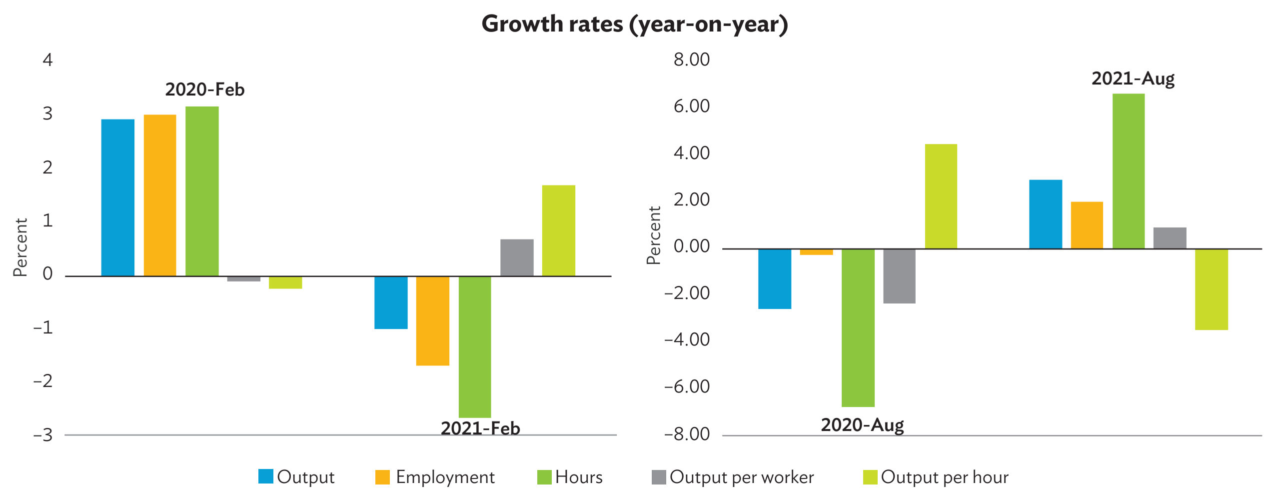
Fourth, as noted earlier, labor productivity has increased significantly. In a conventional recession, labor productivity typically drops. The recession during the pandemic, however, has led to higher labor productivity in many economies (IMF 2021). Similarly, in Indonesia, labor productivity, measured as output per hour worked, rose in the third quarter (Q3) of 2020 by 4.49% (compared to Q3 2019), and continued to rise in Q1 2021 by 1.71% (Figure 2.7). This development indicates that although the Indonesian labor market is characterized by significant rigidities, it can adjust relatively nimbly to economic conditions. Although output per hour worked subsequently fell by 3.44% in Q3 2021, on net, the gain during Q3 2019 to Q3 2020 was not fully offset and productivity in Q3 2021 was still higher than its pre-pandemic level.

Figure 2.6: Labor Force Participation Rate



Source: ADB staff estimates, based on Sukernas data.

Figure 2.7: Labor Productivity and Its Components



Source: ADB staff estimates, based on national income accounts and Sukernas data.

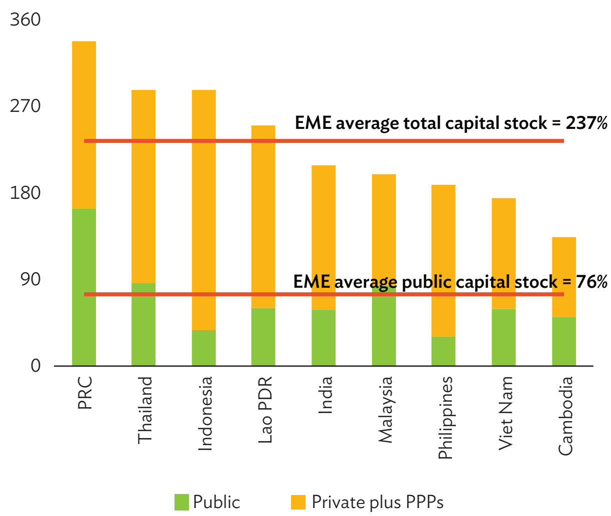
Overall labor productivity has increased mostly through improvements within each sector, and not through a reallocation of labor across sectors. As productivity-enhancing practices are developed, any increase in productivity would first be evident in only some firms and sectors. Over time, the more productive firms and sectors should increase their shares at the expense of others. In Indonesia, the overall increases in labor productivity in Q3 2020, Q1 2021, and Q3 2021 can be decomposed into two parts: (i) within each sector, that is, how productivity changed while holding its share constant; and (ii) between sectors, that is, how each sector's share changed while holding its productivity constant. Labor survey data show that the "within" component accounted for an average of 91% of the increase in productivity, while the "between" component accounted for about 9%.

III Prospects for Productivity Growth and Recommendations

The most far-reaching of recent reforms is the Omnibus Job Creation Law, which was passed in 2020. The Omnibus Job Creation Law can boost investment and productivity. The law aims to strengthen the economy by making it easier to do business, increasing competitiveness, and fostering job creation. A risk-based approach will be adopted for issuing business licenses. Almost all sectors will be open for investment, both local and foreign, and investment restrictions will be simplified. Both tax and nontax incentives will be provided, such as supporting infrastructure and visa assistance for foreign managers and skilled workers. Labor regulations will be simplified by changing the minimum wage formula, making working periods flexible, relaxing outsourcing restrictions, removing limits on the duration of fixed-term contracts, and reducing the maximum level of required severance pay. The reforms, while necessary, will not be sufficient. Implementation will be key, as will reforms in other areas.[2]

Tax reform measures can also help achieve the positive scenario outlined above. Indonesia's total capital stock compares favorably to its peers. However, its public capital stock is relatively low (Figure 2.8). Because public capital as "social overhead" can give positive externalities to private ventures, Indonesia needs to increase public investment. Financing for these needed investments can come from the tax measures passed in September 2021, which are projected to increase tax revenues by about 1% of GDP through 2024.

Figure 2.8: Capital Stock, 2017
(% of GDP)



EME = emerging markets economy, GDP = gross domestic product, Lao PDR = Lao People's Democratic Republic, PPP = public-private partnership, PRC = People's Republic of China.
Source: ADB staff estimates based on International Monetary Fund Investment and Capital Stock Dataset, 2019.

Digitization is growing fast in Indonesia and promises to help sustain productivity increases. As noted above, output in information and communication continued to post healthy growth during the pandemic. With the youth making

[2] In December 2021, the Constitutional Court ruled that the passage of the law was procedurally flawed and would need to be remedied. The provisions, however, were not declared unconstitutional and can still be implemented once the corrective measures are enacted.

up more than half of Indonesia's citizens, and with more than 170 million active social media users, Indonesia is on the brink of becoming the biggest digital economy in Southeast Asia. According to the e-Conomy SEA 2021 report, Indonesia's internet economy—measured in gross merchandise value—grew by 49% to $70 billion in 2021, faster than the 18% growth in 2020. All sectors—e-commerce, transport and food, online travel, and online media—are projected to post double-digit growth. The overall digital economy is projected to be worth $146 billion by 2025. There has also been a large shift toward digital finance. For instance, McKinsey's Indonesia Banking Survey found that about 78% of Indonesian customers now use digital banking actively, and only 55% visit a branch at least once a month, compared to 57% and 81%, respectively, in 2017. According to Bank Indonesia, e-money transactions, which are mostly used by lower-income individuals, almost quadrupled between January 2019 and August 2021, while digital banking transactions grew by more than 60% in the same period.

Several measures would help fully harness the potential of digitization. While internet service is affordable and currently about 75% of the population has access, bandwidth per user and connection speeds are low. Moreover, Innovate Indonesia, a study conducted by ADB and the Ministry of Finance, finds that technology adoption is still low in industries due primarily to financial constraints, lack of skilled workers, technical uncertainties, and digital infrastructure gaps. The study highlights that if Indonesia were to optimize its adoption of new technologies, it could increase GDP per capita to $14,747 by 2045, which would make Indonesia a high-income economy. The report recommends a suite of policies:

(i) Address infrastructure gaps and ensure that regulatory frameworks are updated appropriately in response to changes brought by new technologies.

(ii) Increase awareness of the value of new technologies to businesses, for instance, by creating sector and cross-sector technology forums in cooperation with universities, research centers, and technology vendors.

(iii) Facilitate technology transfer and technical support for firms, for instance, by developing a stratified approach combining a variety of support measures to address the diverse needs of firms at varying stages of technological sophistication.

(iv) Take advantage of technologies that are becoming cheaper and more widely available, for instance, by developing a catalogue of affordable plug-and-play technological solutions that are easy to use.

(v) Ensure a critical mass of workers trained in new technologies, for instance, by upgrading existing training centers to expand offerings in new technologies and establishing training programs in technological entrepreneurship.

If these key measures are implemented, then there is reason to be sanguine about the post-pandemic outlook for Indonesia.[3] Although the adverse impacts of the pandemic have somewhat been contained, new variants could arise, and therefore the projections have wide margins of error. To ensure a normalization of activity and complete recovery, vaccination of the target population must be administered with deliberate speed. To make up for learning losses, remedial measures for schoolchildren should be adopted. To promote investment and productivity, it will be critical to improve the business environment, facilitate investment, upgrade skills, and generate revenues to increase physical infrastructure and human capital.

[3] A joint conference of the Economic and Financial Committee of the European Commission on the European Union and the euro area also concluded that "the Covid-19 shocks is likely to be more temporary in nature and that strong policy support has limited the kind of scarring effects that persisted long after the Global Crisis" (McMorrow et al. 2021).

References

Claessens, Stijn, Ayhan Kose, and Marco Terrones. 2009. What Happens During Recessions, Crunches, and Busts? Economic Policy, 60: 653-700

Cuesta Aguirre, Juan Pablo and Swarnali Ahmed Hannan. 2021. Recovering from Pandemics: Policies and Structural Features Matter. *VoxEU.* 12 August.

International Monetary Fund. 2021. *Boosting Productivity in the Aftermath of Covid-19*. Washington, DC.

Ma, Chang, John H. Rogers, and Sili Zhou. 2020. *Global Economic and Financial Effects of 21st Century Pandemics and Epidemics*. Unpublished.

Martin Fuentes, Natalia and Isabella Moder. 2021. The Scarring Effects of Covid-19 on the Global Economy. *VoxEU.* 5 February.

McMorrow, Kieran, Francois Blondeau, Francesca D'Auria, Bjorn Dohring, Atanas Hristov, Christoph Maier, and Anna Thum-Thysen. 2021. Output Gaps, Potential Output and the Covid-19 Crisis: Policymaking Under Uncertainty. *VoxEU.* 10 December.

Molato-Gayares, Rhea. 2021. *Learning and Earning Losses from COVID-19 School Closures in Developing Asia*. *Asian Development Outlook*. ADB.

Pritadrajati, Dyah, A. C. Kusuma, and S. C. Saxena. 2021. Scarred for Life: Lasting Consequences of Unemployment and Informal Self-Employment— An Empirical Evidence from Indonesia. *Economic Analysis and Policy* 70: 206–19.

Suryahadi, Asep, Ridho Al Izzati, and Athia Yumna. 2021. The Impact of Covid-19 and Social Protection Programs on Poverty in Indonesia. *Bulletin of Indonesian Economic Studies* 57 (3): 267–96.

Philippines:
Mitigating Risks of Long-Term Labor Market Scarring

3

The COVID-19 pandemic triggered a massive disruption of the labor market in the Philippines. Although the unemployment rate has eased since the onset of the pandemic, it remains higher than in 2019 and many workers are working fewer hours. There has been an observed shift from formal or wage and salary employment to informal employment. Young and prime-age workers have been disproportionately affected. Several sectors experienced job losses, though industries with higher-skilled jobs such as information and communication technology and professional and business services have not been hit as hard. Some employment-intensive sectors like tourism will take a while to recover. This divergence will increase skills mismatches as workers do not transition easily between sectors given differences in required skills. Companies have also been rapidly adopting digital technologies in their business models, further raising demand for higher value-added skills. These developments are likely to increase the mismatch between new skills demanded by employers and those possessed by displaced workers. The longer displaced workers and new labor market entrants remain unemployed, the more likely they will become less employable because of lost skills. Reforms are ongoing to strengthen labor market programs and support workers and enterprises as they recover and transition. Transformative investment climate reforms bode well for investment and employment.

Job fairs shifted to digital platforms during the pandemic (Photo by DOLE Davao Region).

Note: This chapter was written by Cristina Lozano and Teresa Mendoza of ADB's Philippines Country Office in Manila.

I Macroeconomic Performance

GDP fell by 9.6% in 2020 under the impact of the COVID-19 pandemic, the first recession since the 1997-1998 Asian financial crisis. Pandemic containment measures severely limited the movement of people and commerce. Steep declines in consumption and investment were only partly offset by higher government spending particularly on social assistance and health services. As mobility restrictions were relaxed and COVID-19 vaccination rollout advanced, the economy rebounded in 2021 to expand by 5.6% year on year.

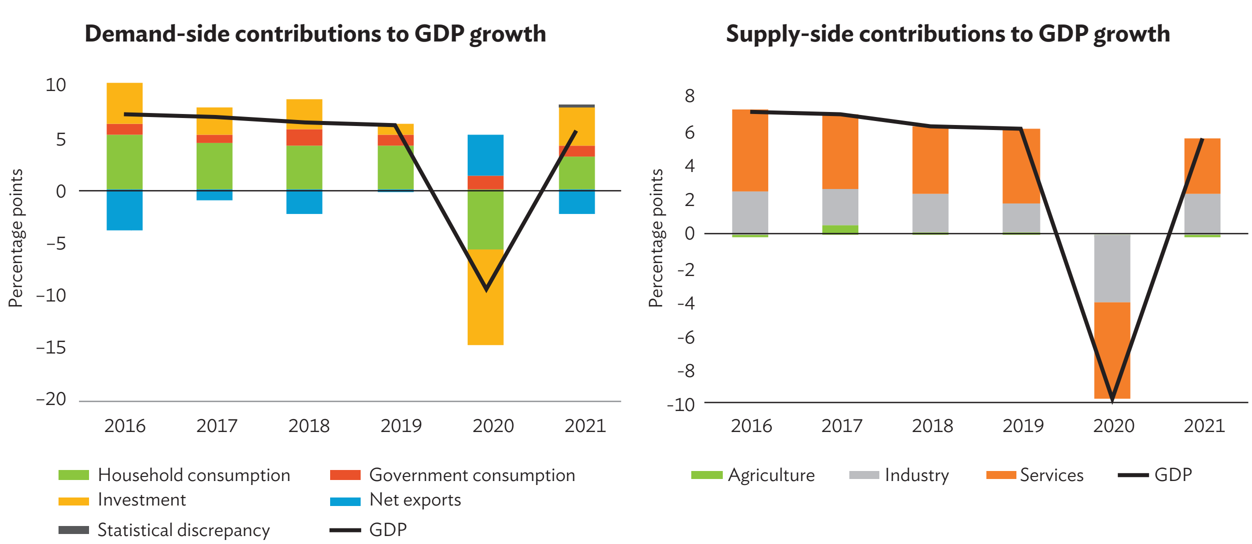
Investment and household consumption were the major growth drivers. Investment rose by 19% on a rebound on outlays for machinery and transport equipment. Private construction recovered while public construction growth accelerated in line with the country's "Build Build Build" infrastructure program. Household consumption, about three-fourths of GDP, picked up strongly with a 7.3% year-on-year growth in the second half to 4.2% for the full year. Consumer and business confidence improved on the acceleration of the country's vaccination program and further reopening of the economy. Exports rose but were outpaced by imports, with capital goods a key contributor.

On the supply side, all sectors of the economy contributed to growth in 2021 except agriculture which marginally contracted, weighed by lower pork production. Services sector was the lead contributor to growth expanding by 5.3%, with trade, finance, information and communication, and business services as key drivers. Industry grew by 8.2%, largely driven by manufacturing and construction (Figure 3.1).

Economic growth is expected to accelerate in 2022 on recovering domestic demand. Fiscal and monetary policies continue to be supportive. Budget expenditure in 2022 is 11.5% higher than in 2021 with significant increases in spending for infrastructure and social services.

The government aims to raise infrastructure spending to 5.8% of GDP in 2022 from an estimate of 5.1% of GDP in 2021. The monetary authorities in February 2022 maintained the policy interest rate at a record low.

Figure 3.1: Demand- and Supply-Side Contributions to GDP Growth



GDP = gross domestic product.
Source: Philippine Statistics Authority.

Vaccines have been rolled out to an increasingly larger share of the population, which has allowed the economy to further reopen and restore consumer and business confidence. In February 2022, mobility restrictions were further relaxed in Metro Manila and some provinces amid declining COVID-19 cases, and the country has started to allow fully vaccinated international travelers to enter the country, boosting tourism prospects.

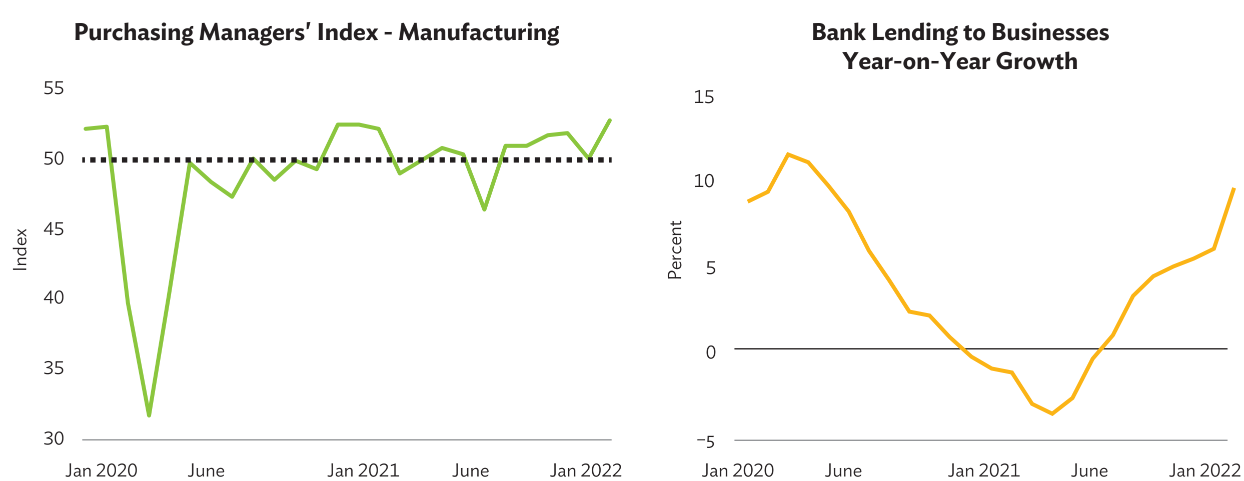
Private investment indicators are favorable with double-digit growth in imports of capital goods, a pickup in the Purchasing Managers' Index (PMI), and lending to businesses. The manufacturing PMI rose to 52.8 in February 2022, while lending growth accelerated to 9.6% year on year in January 2022 (Figure 3.2). Foreign direct investment (FDI) net inflows rebounded by 54.2% year on year in 2021, channeled mostly into manufacturing sector and utilities.

Reforms are supporting economic recovery. A National Employment Recovery Strategy (NERS), institutionalized in June 2021, creates a policy environment that fosters quality employment. It aims to improve access to employment, livelihood, and training opportunities, and provides support to businesses to generate employment. The corporate income tax rate has been cut and restrictions on foreign participation in some investment areas have been relaxed. The rollout of the Philippine Identification System or Philsys registration for a national ID has been accelerated to improve targeting and delivery of public services and simplify public and private transactions. Also ongoing are programs supporting financial inclusion and expanded delivery of financial services through digital channels, including linkages to the PhilSys for accelerated financial inclusion and innovation.

II Scarring in the Labor Market

The Philippines was experiencing its longest ever economic and job expansion prior to the COVID-19 pandemic. The economy posted over 6% average annual growth between 2010 and 2019. The unemployment rate declined to 5.1% in 2019, the lowest in over a decade. Wage and salary employment (a measure of modern employment) rose at an average of 4.6% annually from 2015 to 2019.

Figure 3.2: Business Indicators



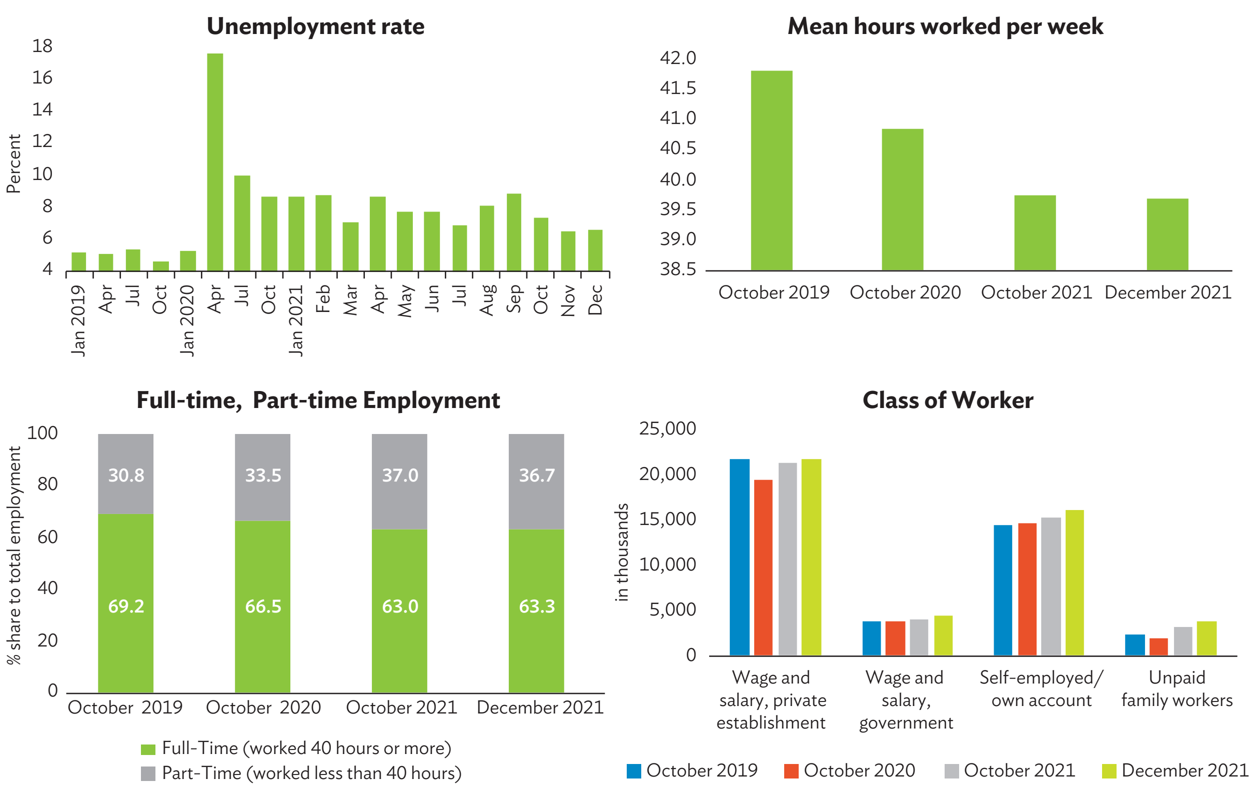
Note: Above 50 indicates expansion, below 50 indicates contraction.
Source: Bangko Sentral ng Pilipinas.

The COVID-19 pandemic reversed some of these gains. At the onset of the pandemic, the unemployment rate peaked to 17.6% in April 2020 during the country's most severe lockdown to contain the spread of the virus (Figure 3.3). Unemployment rate has eased since then to average 10.3% for the full year 2020, though this is more than double the 5.1% rate in 2019. Like unemployment, the poverty rate rose under the impact of the pandemic. The poverty incidence declined from 23.5% of the population in 2015 to 16.7% in 2018. However, the pandemic has reversed recent gains in poverty alleviation and the poverty incidence increased to 23.7% in the first semester of 2021, equivalent to 26.1 million poor Filipinos and an increase of 3.9 million from the same period in 2018. Many poor households and low-skilled workers reliant on incomes generated from the informal sector are especially hard-hit.

Nearly 2 years into the crisis and while the economy is recovering, the unemployment rate remains above the pre-pandemic level though easing from 7.4% in October 2021 to 6.6% in December 2021. The labor force participation rate (LFPR) in April 2020 was estimated at 55.7%, the lowest in over a decade. Since then, it has recovered to 65.1 % in December 2021, though recovery in jobs has lagged and there was a rise in part-time and informal employment.

Among the employed, there was an increase in the share of part-time employment to 37% in October 2021. The mean hours worked per week was 39.7 in October 2021, 5% lower than the pre-pandemic level in October 2019.[1] Between the two periods, the number of part-time workers rose by 21.8% to 16 million in October 2021, while full-time employment fell by 7.8% to

Figure 3.3: Labor Market Indicators



Source: Philippine Statistics Authority.

[1] Mean hours worked per week remained at 39.7 in December 2021.

27.3 million. The underemployment rate rose from 12.8% in October 2019 to 16.1% in October 2021. It eased to 14.7% in December 2021, though still equivalent to 6.8 million employed people looking for additional work.

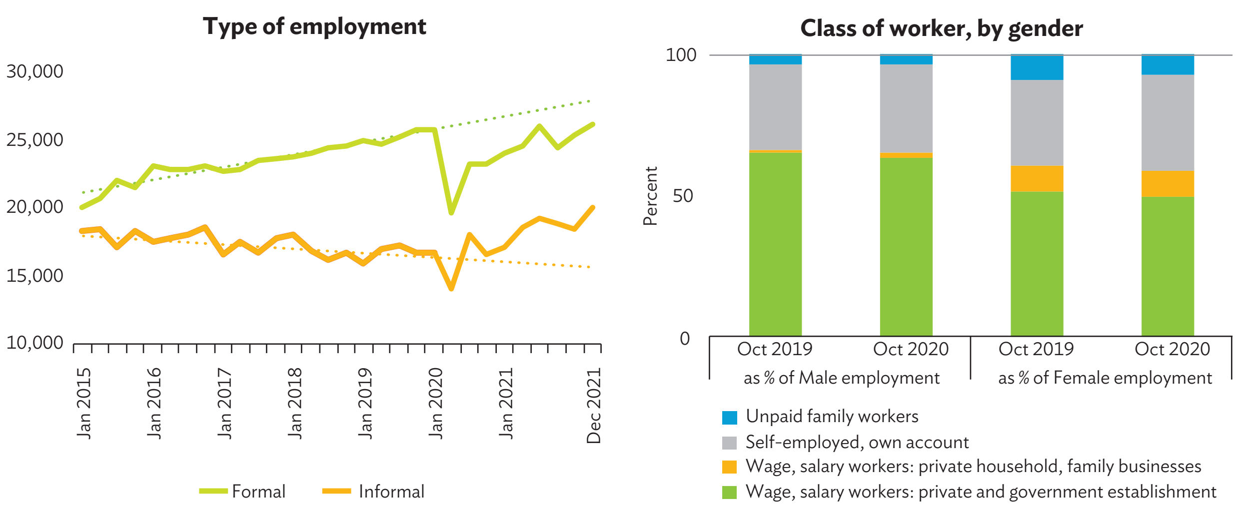
Rising Informal Employment

There has been a shift from wage and salary or formal employment to informal, largely self-employed, during the pandemic (Figure 3.4). Wage and salary jobs in private establishments declined by about 600,000 between October 2019 and October 2021, while own-account workers who are largely self-employed rose by nearly 700,000. Informal workers tend to be paid less, enjoy little labor protection, and are likely to be exposed to occupational hazards. They are overrepresented among the poor who have limited job security and little, if any, social protection. Even prior to the pandemic, 18% of self-employed and unpaid family workers were reported to be poor in 2018.

Disproportionate Impact on Young and Prime-Age Workers

COVID-19-induced disruptions in education and training, employment, and earnings increased job-search constraints have adversely impacted young people. The youth unemployment rate rose to 19.4% in October 2020 before easing to 15.1% in October 2021, still higher than 12.8% in October 2019. Although young workers represented only 15% of the workforce in October 2021, they accounted for about a third of the unemployed. The youth's mean hours of work per week declined to 36.5 in October 2021, 8.8% lower than the pre-pandemic level (Figure 3.5) and lower than the national average.[2] The youth were among the first and most affected by the COVID-19 pandemic as they tend to work in heavily affected sectors such as wholesale and retail trade, accommodations, and food services, especially young women. The youth are also often the first to be laid off during an economic crisis due to limited experience compared to adult workers.

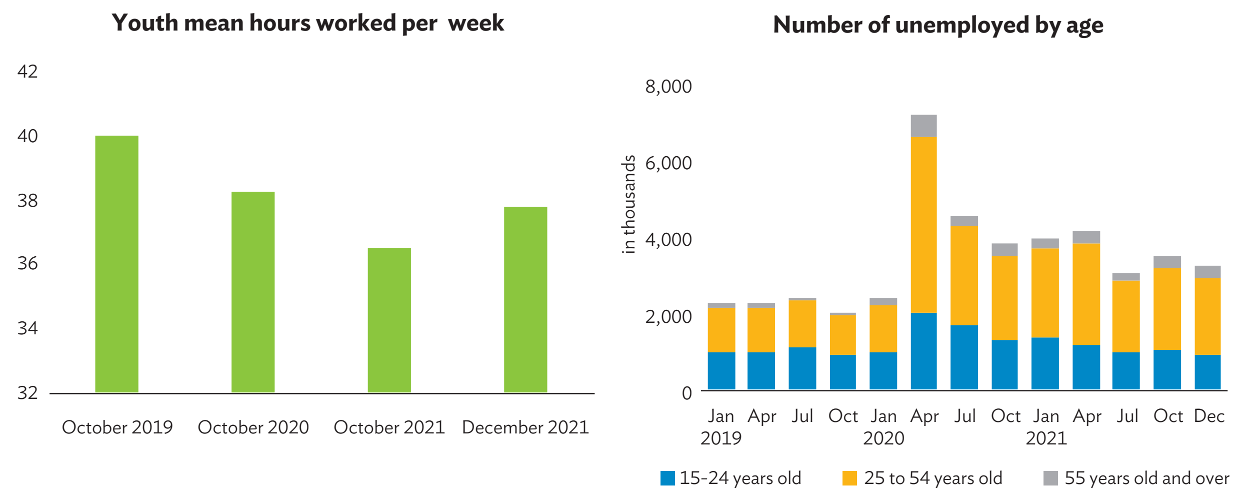
Figure 3.4: Formal and Informal Employment



Source: Philippine Statistics Authority.

[2] In December 2021, youth mean hours of work was 37.8, and youth unemployment rate at 12.8%.

Figure 3.5: Labor Market Activity by Age Group



Source: Philippine Statistics Authority.

Prime-age workers (aged 25 to 54 years) representing 70% of the labor force also suffered significant job losses. This age group reported 2.1 million jobless workers in October 2021, more than double the pre-pandemic level in 2019. They faced the biggest deficit in employment relative to the pre-crisis situation.

Women were adversely affected as well. Women represented 38.7% of the workforce in Q4 2019, but accounted for nearly 45% of job losses in Q2 2020 during the height of the lockdown. The female unemployment rate more than tripled to 15.6% in April 2020 from 4.6 % in October 2019. It has eased to 7.7% in October 2021, compared to 7.2% unemployment rate for men.[3] Women are largely employed in the services sector such as retail sales and hospitality, which were highly affected by the pandemic.

Furthermore, even before the pandemic, women account for a lower share in formal employment. In October 2019, 51.8% of female employment was categorized as wage and salary workers in private and government establishments, declining to 49.7% in October 2020. The corresponding share for male employment was higher at 65.2% in October 2019 and 63.6% in October 2021. In contrast, women had a higher share in informal employment including unpaid family work and self-employment.

Transmission Channels of the Pandemic on Employment

The following factors could create long-lasting effects on the labor market:

First, the pandemic has triggered a large reallocation of jobs across sectors. While job losses have occurred across most sectors, the hardest-hit sectors are those dependent on personal contact, such as accommodation, food services, transportation, and recreational services. In contrast, the sectors that recovered quickly and presented positive job growth are those that tend to absorb lower shares of labor such as information and communication technology (ICT) and several higher-skilled services sectors.

This divergence will increase skills mismatches as workers do not transition easily between sectors given differences in required skills and experiences.

[3] In December 2021, female unemployment rate was 7.0%, male unemployment rate was at 6.3%.

Second, companies are modifying their business models to rely more on technology. Digital transformation, automation, and remote working are transforming jobs, facilities, processes, and skills needs, increasing demand for higher value-added services. These developments are reshaping the labor market and increasing demand for new skills.

Finally, there will be a higher number of job seekers, including people who lost their jobs, school dropouts, and new labor market entrants. The longer laid-off workers and new labor market entrants remain unemployed, the more likely they will become less employable because of lost skills.

III Government's COVID-19 Response: Programs and Reforms

The government implemented a range of fiscal support measures which provided rapid health responses and emergency subsidies to poor and low-income families and displaced workers to mitigate the pandemic's worst effects. These include unemployment benefits, cash transfers, livelihood assistance, wage subsidies, and other support to businesses, especially for micro, small, and medium-sized enterprises (MSMEs). The Bayanihan to Heal as One Act (Bayanihan 1) and the Bayanihan to Recover as One Act (Bayanihan 2) were both approved in 2020, laying out the COVID-19 response programs and funding. As of 30 September 2021, the national government released ₱690.3 billion (about $13 billion) to various agencies for their programs.

The government rolled out a large-scale social amelioration program which extended cash grants for a limited period to approximately 18 million poor and low-income families, including those under the existing Pantawid Pamilyang Pilipino Program. Since the onset of the pandemic, over 4 million displaced workers in the informal and formal sectors, as well as displaced overseas Filipino workers, also received cash assistance. The government also provided temporary wage employment to workers in the informal sector. MSMEs were given wage subsidies along with loan assistance and credit guarantees.

Supporting Employment Recovery

From rapid relief, the focus has shifted to structural reforms to support workers and businesses as they recover and transition to the post-pandemic landscape. The NERS is a product of a tripartite social dialogue among government, businesses, and workers, laying out a blueprint for addressing the pandemic's negative long-lasting effects on the labor market. The strategy harmonizes the programs of various government agencies, including social protection, training, upskilling, and support to businesses. The following are among the key initiatives to operationalize the NERS which cover active labor market programs and transformative investment climate reforms:

Philippine Skills Framework (PSF). To help address skills mismatch, the government launched the Philippine Skills Framework (PSF) in June 2021, an interagency initiative led by the Department of Trade and Industry and the Technical Education and Skills Development Authority (TESDA). Based on Singapore's SkillsFuture model, the PSF serves as a platform for relevant industry information, sector-specific skills requirements for jobs and career pathways to guide job seekers, educational institutions to design market-updated curricula, and companies to develop progressive human resource development plans. The first PSF for supply chain and logistics was approved in June 2021. The PSF will also be implemented in the following sectors: construction; information technology and business process management; tourism; health and wellness; food (agriculture, fishery); manufacturing; and creative design industries.

Industry boards. TESDA approved the framework for establishing multistakeholder industry boards to enhance linkages between the public and private sectors. The industry boards will forecast industry skills requirements and provide labor market information and inputs to the design of skills development schemes, and technical and vocational education and training policy. It will be initially established in sectors of agri-fishery, construction, information and communication technology, health, and logistics. Among the industry boards established are located in Cebu and Davao. TESDA also approved in 2021 the implementation of a 1-year pilot for industry assessment and certification system, which creates a new pathway for industry-led skills certification.

Expanded employment facilitation programs. The government is adopting measures to broaden access and quality of employment facilitation services. More public employment service offices (PESOs) have been institutionalized nationwide, and *barangay*-based PESOs are being integrated into the network to support employment facilitation at the municipality or *barangay* level. Training regulations and competency standards have been developed for PESO staff for core public employment service functions such as labor market information, placement and referral, livelihood and self-employment, career guidance, and employment coaching.

JobStart program enhancements.[4] To ensure continuity amid the pandemic, key aspects of the JobStart program were digitized, including the enlistment and processing of applications. A Youth Employment Exchange online tool was created to link employers with JobStart trainees for virtual engagement and technical training. The online tool facilitates JobStart implementation in a real-time, easy, and secure manner. In addition, the Life Skills Training program was enhanced to become an online course, with JobStart modules expanded to include mental health, digital literacy, health and safety awareness, and women empowerment. A 5-year JobStart national rollout strategy is planned to be launched in 2022.

Investment climate reforms. The government approved amendments to the following laws to ease restrictions on foreign participation in key investment areas: (i) the Public Service Act to allow full foreign ownership in public services including telecommunications, air carriers, domestic shipping, railways and subways; (ii) the Foreign Investments Act, and (iii) the Retail Trade Liberalization Act, which eased the equity and capitalization requirements for investors in the retail trade sector. The Corporate Recovery and Tax Incentives for Enterprises Act reduced the corporate income tax rate for MSMEs from 30% to 20%, and to 25% for all other businesses, and enhances fiscal incentives to investors to make them time-bound and performance-based.

The government, through the Anti-Red Tape Authority, also reduced business regulatory compliance costs by launching the Central Business Portal, an online one-stop shop for business-related information and transactions such as securing business permits, licenses, and clearances.

IV Recommendations

As the Philippines recovers from the pandemic, it will be important to implement effective policy measures to support workers' labor market transitions as well as strengthen the resilience of MSMEs and support their future growth.

Measures to Support Training and Redeployment

Enabling companies to maintain and increase access to skills as well as develop further skills is an important aspect of the policy response

[4] The JobStart program enhances employability of the youth by reducing their job search period and increasing their employability through training (life skills and technical skills required by industries), paid internship, and full-cycle employment facilitation services.

to the crisis. Investing in upskilling and reskilling is vital to support the reallocation of workers at risk of displacement and respond to changes in the demand for skills brought by automation, digitalization, and structural changes.

Workplace skills development. Countries that have successfully upgraded workers' skills have done so through industry- and employer-led skills training schemes. Successful models like SkillNet Ireland include the provision of annual grants to networks of enterprises to fund their short-term training of workers. In this model, employers from a sector or locality formalize a network of at least 30 enterprises. The network is responsible for designing and implementing the training program, recruiting training providers, and accessing certification for its workers. Conditions can be added such as setting quotas for job seekers and at-risk groups including young workers. This approach is a cost-effective model to upskill and reskill workers and nurture a culture of workplace training and coordination across enterprises in an industry or locality.

Apprenticeship programs. Apprenticeship reforms with more involvement of the private sector are also critical to address skills shortages. Drawing on international best practices, reforms should include (i) setting up an apprenticeship council to oversee policy; (ii) industry-led development of apprenticeship programs; (iii) progressive salary scales; (iv) extending apprenticeships to 2–4 years; and (v) extending apprenticeship programs to modern services such as legal, finance, and communication occupations. Reforms should also include monitoring the compliance of enterprises with industry apprenticeship programs.

Innovative solutions to broaden reach of trainings to the disadvantaged. The pandemic has exacerbated inequalities in access to digital technologies, amplifying gaps in access to trainings and employment programs. Online learning or training platforms risk leaving the disadvantaged population, particularly those from low-income households, without access to digital technologies. Targeted, flexible, and responsive trainings will be important. In the Netherlands, in-person vocational education and training in small groups cater to those who do not have sufficient access to digital resources. Innovative solutions involving public–private partnerships can improve access and develop capacity in digital and distance learning and training. Appropriate measures need to be in place to ensure quality of training.

Measures to Support Digitalization

Many countries have intensified small and medium-sized enterprise (SME) digitalization support as a result of the pandemic. Emerging technologies offer a range of applications to improve SME performance and overcome size-related limitations. Firms have moved operations online and implemented smart working solutions to remain in business during lockdowns and overcome disruptions in supply chains, with online platforms playing an instrumental role in connecting users to new markets, suppliers, or resources.

Government-funded technology extension programs. These programs provide advice or expertise to enterprises to improve technology use and innovation, by expanding the absorption and adaptation of existing technologies. The services are provided by networks of specialists that conduct technology and problem-solving diagnosis, and plan for improvement and implementation assistance. The support can be provided to individual enterprises or simultaneously to groups of enterprises with common needs. Spain launched an SME program in the context of COVID-19 to support these enterprises and the self-employed to rethink their business models and strengthen managerial and digital skills with tools such as assessment of digital maturity level, advisory services, and training. Germany also supports SMEs in the digitalization of business processes and digital market development. SMEs benefit from the expertise of consultancy firms that have been authorized for such programs and support businesses individually throughout the whole process.

Strengthening management skills in SMEs. The financial and technical support are supplemented in many cases with training and guidance on the skill set and organizational changes required to support technological change. Digital diagnostic tools combined with trainings, workshops, and more intensive approaches like management coaching help identify management deficiencies.

Measures to Address Long-Standing Gaps in Social Protection

Unemployment Insurance (UI) schemes are implemented to protect employed individuals against the risk of job loss. The Philippines' UI benefit offers limited coverage. It is critically important that the Social Security System has a well-funded UI scheme to provide workers with income stability during major economic shocks and disruptions to the labor market. Empirical research shows that unemployment insurance simultaneously enhances productivity and stabilizes consumption, acting as an automatic stabilizer that cushions the impacts of economic crises and helps to prepare for the next growth period.

Integrating active labor market policies in the design of UI schemes is important so the income support is conditional on participation in labor market programs, therefore enhancing employability and linking the UI to future labor market re-insertion. Malaysia's UI uses a national pooled insurance fund in which both employers and employees make monthly contributions. The government provides funding if there is a financing gap, and workers qualify only if involuntarily unemployed. Another good example is a program in Chile, where employers and employees make monthly contributions to an account in the name of the employee. This is complemented by the Solidarity Unemployment Fund, which employees can access only after depleting their individual savings accounts. As a fully funded system, the Chilean scheme does not create contingent fiscal liabilities.

References

ADB. 2021. *Asian Development Outlook (ADO) April 2021.* Manila.

Department of Budget and Management (DBM). 2021a. Technical Notes on the 2022 Proposed National Budget. https://www.dbm.gov.ph/index.php/budget-documents/2022/technical-notes-on-the-2022-proposed-national-budget.

______. 2021b. Status of COVID-19 Releases. https://www.dbm.gov.ph/index.php/programs-projects/status-of-covid-19-releases.

Philippine Statistics Authority. First Semester 2021 Poverty Statistics. https://psa.gov.ph/content/proportion-poor-filipinos-registered-237-percent-first-semester-2021.

Technical Education Skills Development Authority (TESDA). 2021a. Circular on Implementing Guidelines for Pilot Implementation on the Establishment of Industry Boards.

______. 2021b. Guidelines on the Adoption of the Industry-based Assessment and Certification System.

Cambodia:
Identifying Drivers for a Stronger Recovery

4

Cambodia's performance in vaccinating its population has been outstanding—far exceeding the performance of countries with similar populations and income levels—and has enabled the Government of Cambodia to ease restrictions and reopen its borders. It is doing so from a position of strength, having managed the pandemic well and recording relatively few fatalities. Despite this strong performance, the pandemic has had a severe impact on Cambodia's economy. The tourism and hospitality sector has been decimated, the construction and real estate sector has slowed markedly, and the garment sector has weathered large shocks. Fortunately, there have also been some bright spots, including rapid growth in non-garment manufacturing exports and a large increase in agricultural exports. Sustaining these trends will help the government achieve its vision of a more resilient and diversified economy.

Coffee shop in Phnom Penh practicing standard safety measures required by the Ministry of Health (Photo by Sokunthea Chor).

Note: This chapter was written by Poullang Doung and David Freedman of ADB's Cambodia Resident Mission in Phnom Penh.

I Impact of the COVID-19 Pandemic

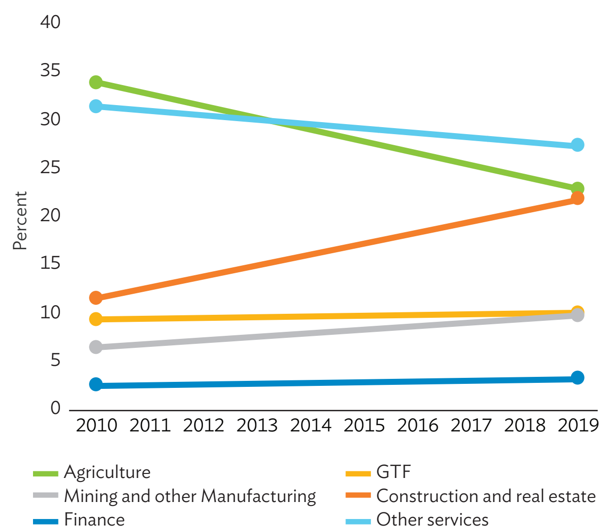
Pre-pandemic Macroeconomic Trends

Cambodia's economy grew rapidly in the years leading up to the pandemic. In 2010–2019, the economy expanded by an average of 7% per annum, making it one of the fastest-growing economies in the world. This rapid growth was underpinned by macroeconomic stability; openness to trade and foreign direct investment (FDI); and an ongoing process of structural transformation led by export-oriented labor-intensive manufacturing of products such as garments, travel goods, and footwear (GTF). Despite its rapid growth, Cambodia is classified as a low-income country, and its average per capita income has remained far below its immediate neighbors and most other members of the Association of Southeast Asian Nations (ASEAN).

Diversification of the rural economy through growth of off-farm businesses has been identified as a key driver of poverty reduction in Cambodia (World Bank 2017). According to the revised poverty survey questionnaire and method, the poverty rate in Cambodia was 33.4% in 2009 and 26.3% in 2014. The poverty rate has gone down to 17.8% in 2019–2020. Over the 10-year period, the poverty rate in Cambodia has been reduced by about 16.1% or 1.6% per year, which is higher than the government's goal of 1% per year. However, many nonpoor households remain highly vulnerable to income shocks, with incomes close to the poverty line and rising levels of household debt.

The profile and composition of Cambodia's economic growth shifted significantly in the decade leading up to the pandemic. The agriculture sector recorded minimal growth in total output, but labor productivity increased as workers moved into other sectors. Growth of value added in the GTF sector slowed, while the contribution from mining and other manufacturing increased from a low base. However, the most significant change was the very rapid growth of construction and real estate services, which contributed 26.5% of total real output growth during 2010–2019 and contributed 22.5% of total nominal GDP in 2019. (Figure 4.1)

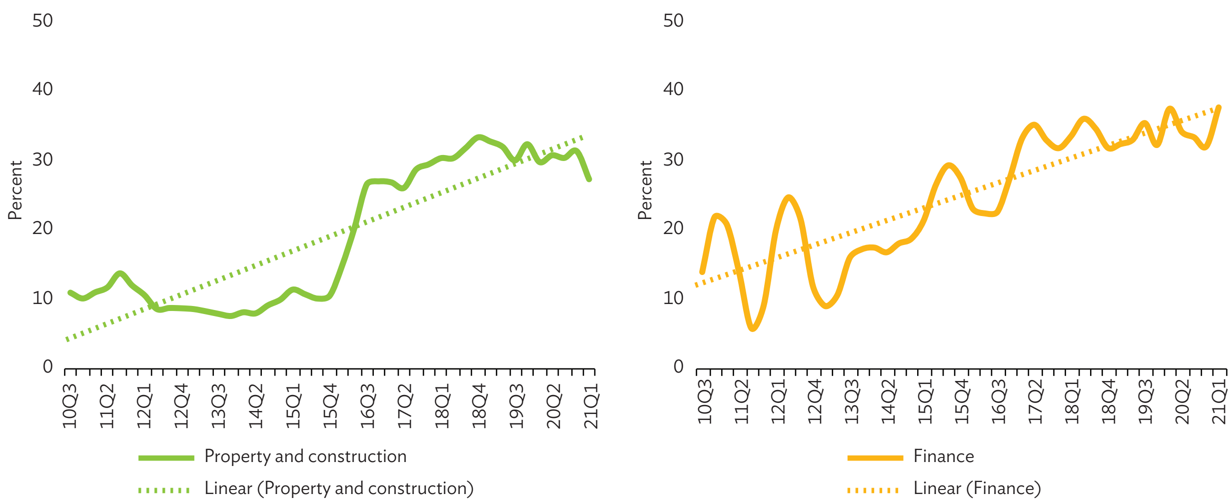
Figure 4.1: Growth in Gross Value Added by Sector



GTF = garments, travel goods, and footwear.
Source: Asian Development Outlook Database.

The boom in construction was partially driven by domestic demand, which was stimulated by the expansion of urban centers. However, foreign demand for investment properties in Cambodia was also a key feature of the pre-pandemic property boom. The years leading up to the pandemic saw a surge in FDI for property developments, with the share of FDI going into construction rising from 3.8% in 2010 to 6.8% in 2019. Much of this increase was due to rising investments from the People's Republic of China (PRC), which accounted for 47.6% of total FDI in 2019. There was also a notable increase in foreign investment in financial services, with the share of FDI going to this sector rising from 19% in 2010 to 33.4% in 2019 (Figure 4.2).

Figure 4.2: Share of FDI in Construction and Finance to Total FDI



FDI = foreign direct investment.
Source: Asian Development Outlook Database.

Openness to foreign investment in the financial sector and high rates of dollarization have been cited as key factors that contributed to the rapid growth of private sector credit in the years preceding the pandemic. During 2015–2019 the number of licensed banks and microfinance institutions (MFIs) increased from 105 to 145, and private sector credit growth averaged 24.4%, reaching 166.8% of GDP at the end of 2019. Cross-country comparisons show that the level of private sector credit is high considering Cambodia's overall level of development and maturity of the sector.

Policy Responses

Cambodia recorded its first case of COVID-19 on 27 January 2020 but managed to avoid widespread local transmission of the novel coronavirus. This all changed when a large cluster of cases was discovered in Phnom Penh on 20 February 2021. Despite efforts to curb the transmission of the virus, it quickly spread to the rest of the country, leading to a surge in cases and deaths that forced the government to adopt strict health controls and new measures, including school closures, forced closure of specific categories of businesses such as restaurants, curfews, travel bans, a lockdown in Phnom Penh, and temporary closure of land borders. Cambodia faced further pressure as the local incidence of the more contagious Delta variant of the coronavirus began to increase in August 2021.

Health measures. Cambodia moved quickly to procure COVID-19 vaccines in 2021 and has implemented a highly effective vaccine campaign. As vaccine availability improved, the government pivoted from prioritizing specific demographic groups for vaccination to an area-based vaccine strategy in which all residents within a given area were called for vaccination at the same time. This allowed the government to accelerate the vaccine rollout and optimize the use of health system capacity. The government has also been proactive in expanding vaccination to younger groups and initiating the use of booster shots to ensure high levels of immunity. The impact of this proactive approach can be seen in the rapid rollout of vaccines and an exceptionally high vaccination rate in 2021. During the fourth quarter (Q4) of 2021, the government began a staged reopening of the economy with phased reopening of schools and reductions in quarantine requirements.

Fiscal policy measures. The government also moved swiftly to provide targeted tax relief to firms in the sectors that were most directly impacted by the pandemic. The first package of policy measures was introduced in February 2020, and the initial package of tax relief was expanded and extended through a further six rounds of measures during 2020. Key measures included partial wage subsidies of $40 per month for workers in the GTF and tourism sectors who had been temporarily laid off or furloughed, a suspension of social security contributions for firms in the tourism and GTF sectors, and a temporary suspension of value-added tax payments for qualifying firms in the tourism and hospitality sector. The government also waived license fees for firms in the tourism and aviation sectors.

In addition to providing tax relief, the government sought to use its own budget and balance sheet to stimulate bank lending to small and medium-sized enterprises (SMEs) by state-owned and private banks. One of these measures included establishing the state-owned SME Bank of Cambodia with $100 million in capital, of which $50 million was allocated to the first SME Co-financing Scheme (SCFS I) formed with participating financial institutions (PFIs) which include commercial banks and MFIs.[1] The SME Bank launched its second SME Co-financing Scheme (SCFS II) in August 2021 with an initial reserved fund of $100 million followed by an additional provision of $40 million, 50% of which will come from the SME Bank. The rest will be covered by PFIs, which include commercial banks, specialized banks, and MFIs.[2] SCFS II will assist SMEs that have been negatively impacted by COVID-19 to restart their businesses. SMEs in industry, services, and trade can apply for loans at the PFIs for capital expenditure-investment (limited to a maximum of $500,000) and working capital (limited to a maximum of $300,000) for a tenure of up to 7 years.

Social protection measures. Social assistance has been at the forefront of the government's response to COVID-19. Monthly cash transfers to poor and vulnerable households in the national ID-Poor database have been the main mechanism for providing social assistance. A smaller second group receiving assistance are laid-off workers in the garment and tourism sectors who receive wage subsidies with employer cost-sharing.

Approximately 700,000 families or 2.8 million people are currently registered in the ID-Poor database. The cash transfers began in June 2020 and a total of $306 million was disbursed that year using the Wing mobile transfer platform.[3] Payment amounts were adjusted to reflect the severity of the households' poverty, and size and composition. The government initially budgeted $200 million for cash transfers in 2021 and was expected to phase the transfers out by midyear, but it subsequently extended the program to the end of 2021 and increased the budget to $335 million. The program is set to continue in 2022 with an indicative budget of $200 million.

Economic and Social Impacts

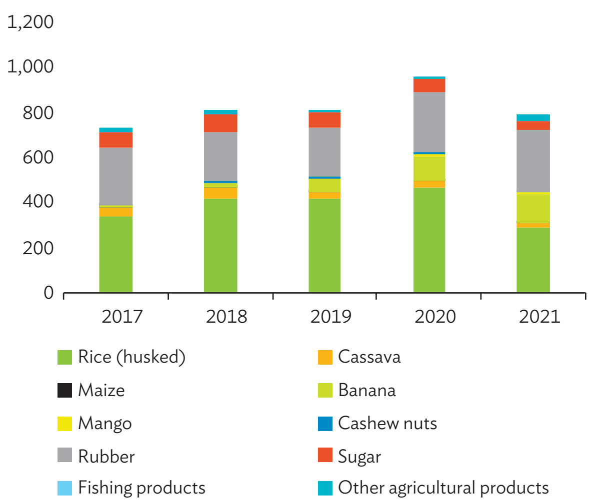
Real economy. Real GDP is estimated to have contracted by 3.1% in 2020 and is projected to grow by 1.9% in 2021. While total agricultural production grew modestly during 2020–2021, exports of agricultural products increased by 25.1% in 2020 and by 32.7% year on year in the first nine months of 2021. This increase may partly reflect better recording of cross-border trade, but it also reflects substantial growth in new exports such as fresh bananas and other fruits (Figure 4.3).

1 The SCFS I was launched in April 2020 and fully subscribed in October 2020, 4 months ahead of schedule.

2 The PFIs include but are not limited to ACLEDA Bank, ABA Bank, Cambodia Post Bank, Prince Bank, Hong Leong Bank, Chip Mong Bank, Canadia Bank, Union Commercial Bank, SBI Ly Hour Bank, PRASAC Microfinance Institution, Maybank (Cambodia), Hattha Bank, Sathapana Bank, Asia-Pacific Development Bank, Phnom Penh Commercial Bank, RHB Bank (Cambodia), Foreign Trade Bank of Cambodia, CAMMA Microfinance, CIMB Bank, AMRET Microfinance, Daun Penh Specialized Bank, Vattanac Bank, Phillip Bank, Branch of Industrial Bank of Korea, DGB Bank, and AMK Microfinance.

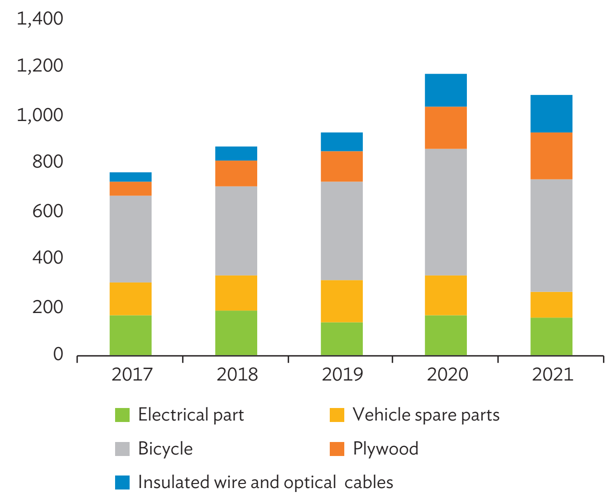
3 Wing Bank website: https://www.wingmoney.com/en/.

Figure 4.3: Growth in Nontraditional Agricultural Exports



Source: Asian Development Outlook Database.

Figure 4.4: Growth in Non-GTF Manufacturing Exports



GTF = garments, travel goods, and footwear.
Source: Asian Development Outlook Database.

Industrial output contracted by 1.4% in 2020 on the back of contractions in construction activity and a 9.9% decline in GTF exports. Demand for GTF exports began to pick up in the second half (H2) of 2020, but production was hit by factory closures during H1 2021 as the local outbreak of COVID-19 escalated. There are clear signs of an ongoing adjustment in export patterns following the partial withdrawal of European Union (EU) trade preferences taking effect as of 12 August 2020, with exports to the EU in the first 9 months of 2021 down by 1.2% year on year, while exports to the United States (US) were up by 41.4% during the same period. Non-GTF manufacturing exports grew strongly in 2020, rising 21.9% year on year on the back of increasing production capacity and strong global demand for merchandise exports (Figure 4.4). This growth has continued into 2021, with exports up 31.1% year on year during January to September.

The services sector is expected to contract in both 2020 and 2021. Reductions in service sector output in 2020 were largely driven by the large drop in international visitors and the slowdown in real estate activities. In 2021, the impact of restrictions on international visitors has been compounded by the local outbreak of COVID-19, which has further dampened demand for in-person services including hotels, restaurants, and accommodations.

Monetary and financial sector. Consumer price inflation picked up slightly in 2020, averaging 2.9% compared to 1.9% in 2019. Inflation was initially forecast at 3.1% in 2021 and 3% in 2022, but a slower than expected recovery in domestic demand saw the forecast trimmed to 2.9% in 2021 and 2.7% in 2022. While the overall price level has been stable, flooding in Q4 2020 caused a spike in food prices in some areas and there has been a broad-based increase in the price of basic foods. Based on data collected by the World Food Programme, the price of a basket of basic foods has increased significantly during 2021 and was up by 4.9% year on year in August. The decline in GDP during 2020 and modest recovery in 2021 suggests that output is now well below its long-run potential. However, higher commodity prices and a spike in inflation in advanced economies could contribute to domestic inflationary pressures.

The package of policy measures introduced by the National Bank of Cambodia has helped maintain liquidity and stimulate continued growth of private sector credit. Total private sector credit increased by 22.2% in 2020 and by a further 9.5% in H1 2021, resulting in a total increase of 32.2% between January 2020 and June 2021. Growth in lending to businesses in construction and real estate; wholesale and retail trade; and transport, storage, and communications was particularly pronounced. Growth in lending to firms has been highest in sectors that have been most directly affected by the pandemic. This trend may partly reflect banks' and MFIs' utilization of the National Bank of Cambodia's loan restructuring program to revise the repayment schedules for existing loans to businesses that have been heavily impacted by the pandemic.

Social impacts. A survey program carried out by ADB, United Nations Children's Fund (UNICEF), and World Food Programme shows that the pandemic has caused widespread reductions in household income. The trend through 2020 and into 2021 is broadly consistent with the progression of the pandemic and severity of non-pharmaceutical interventions. Household incomes initially fell sharply as economic activity slowed in 2020 and appeared to be recovering before the large local outbreak of COVID-19 began in 2021. Following this outbreak, the proportion of households reporting income losses and the extent of these income losses both increased significantly. Job losses contributed to the declines in household income, with 22% of households reporting a job loss in the July 2021 survey wave and improving to 16% in October. However, reductions in wage income appear to have been a more significant factor and have certainly been more widespread, with 61% and improving to 52% in October of households reporting some reduction in wage income in July.

National surveys also reveal significant intra-household inequalities with respect to food. In July 2021, 84% of surveyed households had an overall pattern of food consumption that exceeded the minimum recommended level of dietary diversity. However, within these same households, only 56% of women had a diet that met minimum standards for dietary diversity. The quality of children's diets is also a persistent concern, with only 35% of children under the age of 5 consuming a minimum acceptable diet in July 2021.

The prolonged closure of schools to prevent transmission of COVID-19 led to widespread loss of learning opportunities and is likely to have a lasting impact on human capital formation. The cumulative duration of school closures in Cambodia was longer than most countries in Asia and the Pacific and was high by global standards. The government made efforts to support remote learning by providing online classes and broadcasting educational materials through the television network.

The pandemic disrupted existing patterns of labor migration due to the reduction in employment opportunities in Thailand—the main destination for low- and semi-skilled Cambodian migrant workers—and increased restrictions on cross-border movements. Before the pandemic, it was estimated that approximately 1 million Cambodians were working overseas, with the majority working in Thailand. In the early stages of the pandemic, sudden layoffs triggered a large flow of returning migrants from Thailand, with an estimated 112,000 migrants returning to Cambodia by August 2020 (IOM 2020).

II Planning for an Inclusive Recovery

Key Challenges and Opportunities

Health sector. Although mass vaccination has reduced the risk that COVID-19 poses to public health, a safe reopening of the economy and relaxation of preventative health measures will require a careful approach and continued vigilance. Cambodia will need to continue to strengthen its capacity for surveillance, diagnosis, and treatment of COVID-19 and other communicable diseases that could form the basis of future pandemics. This will require continued investments in health system strengthening, including mobilization of additional funding, investments in health infrastructure, and human resource development programs for health professionals.

A new Health Sector Strategic Plan is being prepared for 2021–2030, which will build on Cambodia's earlier successes in reducing infant and maternal mortality and tackling communicable diseases such as HIV, malaria, and tuberculosis. The new strategic plan will be a comprehensive plan and is expected to include high-level targets to expand access to universal health coverage, improve the efficiency of services, and strengthen health system management. The expansion of health financing schemes such as the Health Equity Fund (HEF), which finances treatment of poor households at public health facilities, and the National Social Security Fund (NSSF), which provides health insurance to civil servants and private sector employees, have helped improve access to health services and ensure equity. In 2021, 46.5% of the population was covered by the HEF or NSSF. Expanding the share of the population who are covered by the HEF, NSSF, or equivalent schemes will be crucial for achieving high levels of access to universal health coverage.

Several issues will need to be addressed to expand the coverage of health insurance schemes. Many of these issues relate to recognizing the key role that private health facilities play within Cambodia's health system. In 2019, private health providers accounted for 91.5% of all health facilities and 47.9% of health sector workers, and are estimated to handle 69% of all out-patient cases per year, receiving 71% of all out-of-pocket spending. It will be important to establish clear minimum care standards that can be applied consistently across all providers. This would facilitate enrollment of private health facilities under the HEF and NSSF, thus enabling greater use of the schemes, and would help ensure the overall efficiency of the health system.

(i) **Macroeconomic management.** Public debt is expected to increase during 2020–2025, with the latest government projections showing total publicly guaranteed external debt reaching 39% of GDP in 2025. This projection does not consider the possible realization of contingent public liabilities which have not been systematically documented or disclosed to the public but are understood to be significant. Plans for domestic sovereign bond issuance during 2022 will help to diversify financing sources for public expenditures and support broader policy objectives such as capital market development and increased use of local currency. The planned issuance will also create a need to enhance government capacity for debt management.

(ii) **Financial sector.** The key issues in this sector are the phasing out of regulatory forbearance and the need for policy interventions to strengthen sector stability and prudential regulation, and to rebalance the sector while maintaining access to finance. The loan restructuring program and other policy adjustments to ensure liquidity were appropriate policies given the high levels of uncertainty at the start of the pandemic and the significant impact on the real economy. The rapid growth in total lending since the start of the pandemic and continued low levels of nonperforming loans are testament to the success of these measures. However, they cannot remain in place indefinitely and will need to be phased out as the economy recovers.

The size of Cambodia's financial sector relative to the real economy, the rapid growth in lending in recent years, and the high level of dollarization all give some cause for caution. Key areas for concern include (i) the large amount of loan restructuring that has been undertaken by some banks and MFIs; (ii) the potential increase in "evergreening" of loans, masking an underlying deterioration in the quality of bank and MFI assets; (iii) the high degree of sector concentration of lending by some banks, including high levels of exposure to construction and real estate; and (iv) cross-shareholding and related party dealings between local banks and other businesses, including property developers.

(iii) **Productive sectors.** The rapid growth in exports of agricultural products and non-GTF manufactures has shown that Cambodia can diversify away from its traditional focus on production and exports of GTF. Meanwhile, high vaccination rates have positioned the country for reopening to tourism in Q4 2021. Regional and global tourism is expected to recover steadily from 2022 onward, and there is potential for Cambodia to capture a larger share of international visitor arrivals within the ASEAN region. There are thus clear opportunities within agriculture, manufacturing, and tourism. These opportunities and priority actions to realize them are summarized in Table 4.1.

Table 4.1: Opportunities and Priorities

Sector	Opportunities	Priorities
Agriculture	1. **Growing domestic market** • Increasing demand for protein and other high-quality local products 2. **Improving market access** • New free trade agreements (FTAs) with the People's Republic of China (PRC) and the Republic of Korea that include preferential access for agri-exports 3. **Upgrading and value addition** • Ongoing shift to production of higher-value crops and/or commodities • Increased local processing and production differentiation	1. **Enhance supply chain efficiency** • Improve information flows across existing value chains • Strengthen trade facilitation to enable continued export growth • Upgrade supporting infrastructure and institutions related to research, development, and assurance of product quality and safety 2. **Increase industry value addition** • Expand range of locally produced products by encouraging inbound investment and domestic innovation • Expand sales channels by leveraging e-commerce • Promote domestic investment and foreign direct investment (FDI) by strengthening investment facilitation 3. **Improve productivity** • Stimulate the supply and adoption of advanced processing equipment • Work with key players across the value chain to leverage digital technologies 4. **Build industry resilience** • Streamline regulations and reduce the cost and complexity of maintaining legal compliance • Promote partnerships across the value chain • Pursue food circularity policies to increase overall sustainability

continued on next page

Table 4.1 continued

<table>
<tr><th>Sector</th><th>Opportunities</th><th>Priorities</th></tr>
<tr><td>Non-GTF (garments, travel goods, and footwear) manufacturing</td><td>1. Regional integration
• Increased linkages with PRC-centered production networks following the Cambodia-PRC FTA.
• Potential to become preferred destination for PRC-based manufacturers seeking to establish offshore production due to rising domestic costs and/or reduced access to export markets.
• Increased integration with regional production networks through promotion of Cambodia as a platform for Thailand+1 and Viet Nam+1 production strategies
2. FDI-driven diversification
• Established foothold in sectors with clear potential for further growth:
☐ Electronics
☐ Pharmaceuticals
☐ Solar technology
☐ Vehicle parts</td><td>1. Upgrade special economic zones (SEZs)
• Improve regulation and facilitation of SEZs to achieve improvements in overall efficiency and competitiveness
• Improve infrastructure and certification of SEZs to meet the needs of high-quality investors, e.g., on energy efficiency and environmental sustainability
• Coordinate various stakeholders to improve the operational performance of SEZs and address key constraints to expansion of high-productivity firms
• Design and implement well-articulated sector policies to support clustering and ongoing industrial upgrading and transformation
2. Develop human capital
• Design and implement industry skills transformation maps through close public–private collaboration
• Develop incentives to support increased localization of research and development
3. Trade and investment agreements
• Further expand bilateral investment treaties and implement existing treaty commitments relating to trade and investment</td></tr>
<tr><td>Tourism</td><td>1. New infrastructure
• Improved transport connectivity:
☐ New airports in Phnom Penh, Siem Reap, and Sihanoukville
☐ New road links
• Increased investment in the coastal region
2. Global recovery and new trends
• Wellness-based tourism
• Environment-focused tourism
3. Upgrading and diversification
• Untapped natural and cultural resources
• Prior trend of short stay, low-spend with few repeat visitors</td><td>1. Visitor safety
• Implement a well-designed tourism safety campaign and prevent reputational and brand damage
2. Destination development
• Angkor heritage development
• Pedestrian zoning and visitor infrastructure
• Cambodia Pass and Visit Cambodia 2022–2023
3. Governance
• Sector coordination
• Digital literacy and skills</td></tr>
</table>

Source: ADB.

While the opportunities are clear, it is also important to highlight potential threats. While Cambodia's access to export markets is improving due to signing new free trade agreements (FTAs) with the PRC and the Republic of Korea, the country remains vulnerable to the withdrawal of EU or US trade preferences. Further reduction in access to the EU market or full or partial loss of preferential access to the US market would have significant impacts on the GTF sector and other merchandise exports. The advisory notice that was published by the US State Department on 10 November 2021 suggests that this is a real risk, and uncertainty about future market access may undermine Cambodia's attractiveness as an FDI destination. Cambodia may also be impacted by the ongoing adjustment in the real estate market in the PRC, including reduced demand for overseas property among PRC retail investors and tighter financing conditions for PRC-based property developers. This may exacerbate the slowdown in Cambodia's construction and real estate markets that began in 2020, with potential for ongoing projects to be suspended due to weak demand and funding constraints.

(iv) **Human capital.** Skills shortages and a lack of well-qualified workers could be a key barrier to capturing the opportunities described above. In the near term, there is a challenge of achieving a return to full employment and facilitating the redeployment of workers from lower-productivity sectors into higher-productivity activities that are expanding. The skills development fund that was established by the government with ADB support can play a key role in facilitating this shift by supporting worker reskilling and upskilling programs. These programs should be developed as part of a broader approach to industry skills development, and, wherever possible, the programs should be designed and implemented through public–private collaborations.

Mitigating the impact of COVID-19 on the education of the current school-age population and sustaining the pace of improvements in both the quality and coverage of primary and secondary education will be crucial for longer-term competitiveness. There is a clear risk that the loss of learning that has already occurred will be compounded by increased dropout of school-age children due to economic pressures and the failure to offer suitable reintegration programs to make up for lost learning time. Mitigating these risks should be a key priority and will require close monitoring of children's return to school and timely interventions to address rising dropout rates.

(v) **Social inclusion.** With support from its development partners, the government was able to leverage the existing ID-Poor database of poor and vulnerable households to deliver unconditional cash transfers to groups that had already been identified as poor or vulnerable before the pandemic. It also moved quickly to roll out ID-Poor on Demand as a more flexible and responsive process for enrolling newly poor households into the ID-Poor database. Although the ID-Poor on Demand framework provides greater flexibility and efficiency, it does so at the cost of community-level participation in poverty identification that was a key feature of the earlier enrollment processes.

Another key issue relates to the tapering or phasing out of emergency social assistance payments to poor households. Considering the scale of the pandemic's impact on poor households, there is likely to be continued need for financial support. However, it may be difficult to secure political support for continued extensions of the current unconditional cash transfer program. Transitioning to an updated program that incorporates simple conditions related to nutrition, health, and education may be a viable solution and could provide a platform for broader public communication on issues related to human capital formation such as nutrition, school attendance, and vaccination.

It is also important to strengthen the integration of informal sector workers into the overall framework for social protection. Further development of the NSSF through promotion of voluntary self-enrollment is one clear pathway for achieving this. Previous assessments have provided detailed actionable recommendations on the pathways for expanding the scope and coverage of the NSSF to include informal workers. These recommendations should now be reviewed and incorporated into the updated plans for strengthening social protection following the mid-term review of the National Social Protection Policy Framework 2016–2025.

Government Recovery Plan

In December 2021, the government launched "Strategic Framework and Programs for Economic Recovery in the Context of Living with the COVID-19 in a New Normal 2021-2023" which covers three pillars (or 3Rs): recovery, reform, and resilience.

Recovery will aim to revive key sectors that were the pillars of the economy before the COVID-19 crisis. It will focus on rapidly generating more jobs in these sectors and ensuring the security, managing the impact, and maintaining the stability and revitalization of potential businesses.

Reform will focus on continuing to introduce key structural reform measures, including measures to improve the investment climate and trade facilitation, improve the effectiveness of logistics systems, and maximize the benefits from existing FTAs. The goal of these measures is to build a solid foundation for growth, diversification, and competitiveness.

Resilience will concentrate on strengthening preparedness and responsiveness to ensure the sustainability and inclusiveness of socio-economic development and help the country prepare for similar diseases or crises that may erupt in the future. It will also aim to develop human resources and promote productivity, develop SMEs, harness the digital sector, strengthen resilience to climate change, promote a green economy, and develop health and social protection systems.

The government is also planning to extend some of the key COVID-19 response programs such as the cash transfer program into 2022.

III Policy Recommendations

Despite the success of government policies to manage the pandemic, the country's GDP is now expected to be permanently lower than it would have been if the pandemic had not occurred. Furthermore, the impacts of the pandemic on both households and firms remain severe. Outstanding progress with vaccination means that Cambodia is well-positioned for recovery in 2022. However, downside risks remain, and the recovery cannot be taken for granted. The government's Strategic Framework and Programs for Economic Recovery in the Context of Living with the COVID-19 in a New Normal 2021–2023 builds on existing and ongoing reform programs. The proposed actions under this recovery plan are sensible, and implementation of the plan will help to ensure recovery. The following recommendations aim to support the recovery process by mitigating key risks and accelerating the overall recovery process:

(i) **Ensure a safe and well-managed reopening.** Cambodia's high vaccination rates have put it in a very favorable position to ease restrictions on domestic activities and reopen to international visitors. However, the experience of other countries that are proceeding with reopening suggests that health risks remain. The government should therefore be proactive in monitoring the incidence of COVID-19 within the population as well as the prevalence of different COVID-19 variants to enable timely adjustments in policies if needed.

   (a) Establish a national program to track the incidence of COVID-19 in different regions and among different occupational groups.

   (b) Maintain proactive communication with the public on risks related to COVID-19, current policies and non-pharmaceutical interventions, and recommended or required actions in the event of exposure to infection.

   (c) Establish and enforce clear guidance for safe management of activities and business operations with a higher risk of infection.

(ii) **Accelerate upgrading of health services.** The pandemic has highlighted the importance of continuing to strengthen health system capacity and accelerating progress toward complete universal health-care coverage. Emerging from the pandemic, the government should take the opportunity to adopt more ambitious goals under the forthcoming Health Sector Strategic Plan 2021–2030:

(a) Strengthen the integration of private health service providers into national health systems.

- Establish and enforce clear standards for quality care across different service providers.
- Develop frameworks for re-imbursement of selected fees through public health insurance schemes.
- Strengthen the frameworks for safe sharing of health data and patient information between service providers.

(b) Expand the share of the population covered by health insurance schemes and the extent of the coverage provided by these schemes.

- Evaluate the uptake and utilization of the Health Equity Fund (HEF) and identify actions to increase utilization.
- Review options for providing a self-enrollment insurance scheme to households who are losing access to the HEF due to increased income.
- Review options for expanding the coverage of the NSSF to include more informal sector workers by introducing simple and user-friendly self-pay and self-enrollment options for informal sector workers.
- Review options for integration of the HEF and NSSF into a single health insurance scheme with equal access to insurance coverage but different underlying funding models for different groups.

(c) Position the health sector to fully leverage digital technologies in line with the Digital Society and Economy Framework 2021–2035.

- Develop a framework and action plan for digitization of health services and patient data with a clear time frame for complete phaseout of non-digital records.
- Leverage digital technology for enhanced prevention, management, and treatment of noncommunicable diseases through personalized health services.

(iii) **Strengthen social protection to ensure inclusive recovery.** Social protection programs helped to prevent extreme deprivation during the most acute phase of the pandemic and will be crucial for ensuring inclusive recovery. It will be important to avoid a premature withdrawal of support to poor households and to design a smooth transition from emergency assistance to longer-term programs that are efficient and effective:

(a) Provide a clear commitment to extend the current program of unconditional cash transfers into 2022 and design a successor program to ensure a smooth transition.

(b) Complete the planned evaluation of ID-Poor and use the evaluation findings to inform a workplan for further development and strengthening of the ID-Poor program and systems.

(c) Review options for a successor to the unconditional cash transfer program, including a conditional cash transfer and graduation package for households transitioning out of poverty.

(d) Review the debt levels of poor households and assess options for an expanded program of debt restructuring or debt cancellation for the poorest households.

(e) Establish unemployment insurance and social safety net mechanisms for informal sector workers.

(iv) **Implement structural reforms to improve competitiveness.** There are clear opportunities for Cambodia to develop new goods and services exports that can sustain productivity improvement and growth, thus driving continued improvements in living standards. To achieve these opportunities, the government could develop a clearly prioritized set of reforms that can be implemented as part of the COVID-19 recovery plan:

(a) Use the revision of the investment law as catalyst for a broader effort to strengthen investment promotion and facilitation.

(b) Work with special economic zone operators and key tenants to identify opportunities to streamline regulatory processes and upgrade supporting infrastructure.

(c) Develop a more comprehensive and coherent vision to leverage environmental sustainability as a source of future competitive advantage.

(d) Work with industry stakeholders to design and implement industry transformation maps for key sectors encompassing skills development and upgrading of technology, production processes, and product quality.

(v) **Adopt preventative measures to maintain macro-stability**. The large buildup of private debt has led to increased vulnerabilities. Achieving a well-managed tapering and phaseout of the loan restructuring program and other regulatory forbearance will be crucial in 2022. The government should therefore be proactive in the coordination between the stakeholders involved in macroeconomic manage-ment and financial sector regulation:

(a) Convene the National Financial Stability Committee and establish permanent working groups to address key dimensions of financial stability.

(b) Prepare contingency plans for addressing a sudden rise in nonperforming loans and a workplan for strengthening loan resolution mechanisms.

(c) Accelerate the development of local capital markets as an alternative to bank financing.

(d) Use the update of the national Financial Sector Development Strategy as an opportunity to define an updated pathway for financial sector development with slower credit growth and improved financial inclusion.

References

International Organization for Migration (IOM). 2020. COVID-19 Response. *Situation Report* 11. 6 August. Phnom Penh.

World Bank. 2017. *Cambodia Systematic Country Diagnostic: Sustaining Strong Growth for the Benefit of All.* Washington, DC.

Lao People's Democratic Republic:
Building Tourism Competitiveness

5

The Lao People's Democratic Republic (Lao PDR) was making steady progress toward the diversification of its services sector by improving the business environment and growing tourism, while increasing the use of technology to enable these diversification efforts. However, the pandemic changed the course of the economy. The tourism sector suffered, but digital services thrived. Despite the uptick in technology adoption among the population, the majority of enterprises remain in the analog space and are yet to modernize. The comparatively low uptake of new technologies by enterprises can in part be attributed to competitiveness deficits linked to the country's cumbersome business environment. Businesses in the Lao PDR, particularly those in tourism, remain disadvantaged by excessive licensing requirements and widespread informal practices. This regulatory setting has implications on enterprises' use of finance and technology, both of which are needed for improving service quality and market access to unlock firm growth. As a result, enterprise resilience to shocks remains weak, with an incomplete reform agenda affecting the productive potential and risk exposure of the private sector. A transformative reform agenda to address the country's deficits in tourism competitiveness is needed, including greater focus on business development across supply chains, investments, and the regulatory environment.

Taken from the first Laos-Thai Friendship Bridge in Vientiane capital (Photo by ADB Multimedia Library).

Note: This chapter was written by Emma Allen, Mai Lin Villaruel, Soulinthone Leuangkhamsing, and Steven Schipani of ADB's Lao PDR Resident Mission in Vientiane.

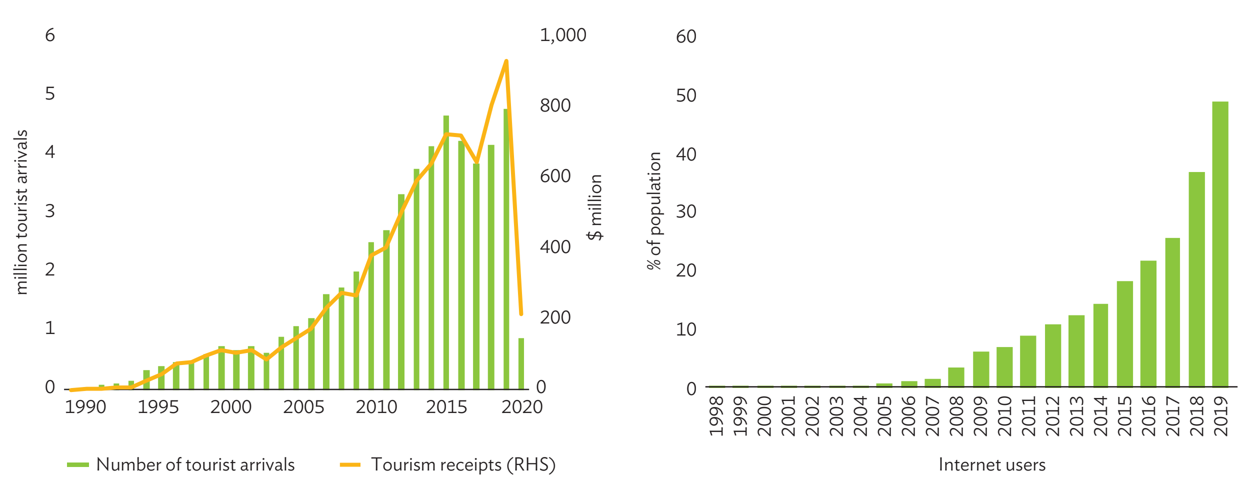
I Economic Performance: Impact of COVID-19 on Tourism and Technology

Prior to the pandemic, the Lao PDR was making steady progress in the diversification of its services sector through attracting large numbers of tourists for business and leisure, as well as through increasing technology utilization across its population. Since the country opened its doors for international tourism, tourist arrivals have increased rapidly from only 14,400 in 1990 to almost 5 million in 2019, contributing $935 million in receipts to the economy. As the economy expanded, internet users in the Lao PDR have also gradually risen from almost nil in 2000 to about half of the population in 2019 (Figure 5.1).

In 2019, tourism in the Lao PDR contributed approximately 10% of GDP and accounted for about 350,000 jobs (World Travel and Tourism Council 2021a).[1] It was the country's third-largest source of foreign exchange earnings behind mineral and electricity exports. Tourist arrivals reached 4.8 million, with the largest share of arrivals coming from neighboring countries, particularly nationals from Thailand (45%), the PRC (21%), and Viet Nam (19%). Domestic trips were estimated at 2.3 million in 2019. The government's tourism promotion budget was equivalent to 0.7% of total government expenditures, administered by the Ministry of Information, Culture and Tourism. Tourism in the Lao PDR is largely associated with locally owned micro and small enterprises, rather than internationally branded hotels and resorts. However, technology utilization and adoption in these enterprises has been limited, hindering the speed of service quality upgrading and the overall competitiveness of the Lao PDR's tourism sector.

Though the majority of tourism enterprises are yet to integrate themselves with the digital economy, their activities are linked to many segments of the economy, including hotels

Figure 5.1: Key Indicators of Tourism and the Digital Economy



Source: Tourism Development Department, Ministry of Information, Culture and Tourism.

Sources: World Development Indicator, World Bank, Government of the Lao PDR, and Lao PDR Voluntary National Review on Implementation of the 2030 Agenda for Sustainable Development (accessed 10 November 2020).

[1] Tourism as a share of GDP is defined as value added generated by industries that deal directly with tourists, including hotels, travel agents, airlines, and other passenger transport services, as well as the activities of restaurants and leisure industries that deal directly with tourists. See World Travel and Tourism Council (2021a) for details.

and restaurants, retail trade, transportation services, and recreational services. The Lao PDR's leisure tourism market is largely associated with the country's three World Heritage Sites (the town of Luang Prabang, Vat Phou and associated ancient settlements within the Champasak Cultural Landscape, and megalithic jar sites in Xiangkhouang—Plain of Jars), as well as natural tourism sites such as Namkat Yorla Pa in Oudomxai Province. Lao Khaen music is also recognized as a World Intangible Cultural Heritage. Meanwhile, to promote tourism-related business and investment, the government commenced a reform program in 2018 to improve the business environment. Thus far, four major regulatory reforms have been passed that seek to streamline business procedures for a more speedy, transparent, and effective business climate.[2]

Digitalization is at the core of the Lao PDR's socioeconomic development plans for supporting innovation and increasing efficiency to facilitate economic growth across sectors, including tourism. Access to telecommunication services, especially mobile phone services, has expanded over the past years. In 2019, 95% of geographic areas in the Lao PDR had mobile network coverage, but only 27% of households had internet access (Government of the Lao PDR 2021). The ratio of the number of people with a fixed internet broadband connection per 100 persons increased from 0.216 in 2016 to 1.064 in 2019. However, internet has been predominantly used for social activities, such as reading news, entertainment, and connecting with friends and family. Using the internet and information and communication technology (ICT) for productive purposes by firms is still limited. As of March 2020, only 6.6% of enterprises reported that they apply such technologies.

In addition, despite improvements in digital connectivity, the Lao PDR lags behind its regional peers in terms of access to quality and affordable internet services. According to the World Economic Forum's 2019 Travel & Tourism Competitiveness Report, the Lao PDR has the lowest ICT readiness score among Southeast Asian countries, and its score at 3.49 is far below the regional average of 4.80 for Asia and the Pacific (World Economic Forum 2019a). Despite enactment of several laws to promote digital adoption and establishment of an e-government portal to modernize and digitalize public administration, ICT sector development still faces numerous challenges.

The COVID-19 pandemic has severely affected the Lao PDR's economy, with economic growth and prospects, particularly in tourism, stymied by the closure of international borders and policies to suppress the spread of the virus. In 2020, restrictions on inbound visitors averted a large-scale domestic public health crisis but stifled domestic and external demand. Economic growth in the Lao PDR contracted for the first time since the 1997–1998 Asian financial crisis, with real GDP growth sliding from 4.7% in 2019 to a 0.5% contraction in 2020. The unemployment rate reached 23.4% in 2020, up from 16% in 2018. International visitor arrivals plunged by 81.5%. As tourism ground to a halt, hotels and restaurant services shrank by 15%. As a result, earnings from restaurants, accommodation, tourist attractions, and tour agencies declined by more than half, with businesses struggling with cash flow and financial institutions reluctant to extend credit to these enterprises (ADB 2021). In response, the Bank of the Lao PDR (BOL) announced two policy measures in March and May to mitigate the pandemic's impact. The first measure was on credit, including a reduction in reserves requirement and the policy rate, permitting banks to defer loan services payments and restructure loans, and encouraging financial institutions

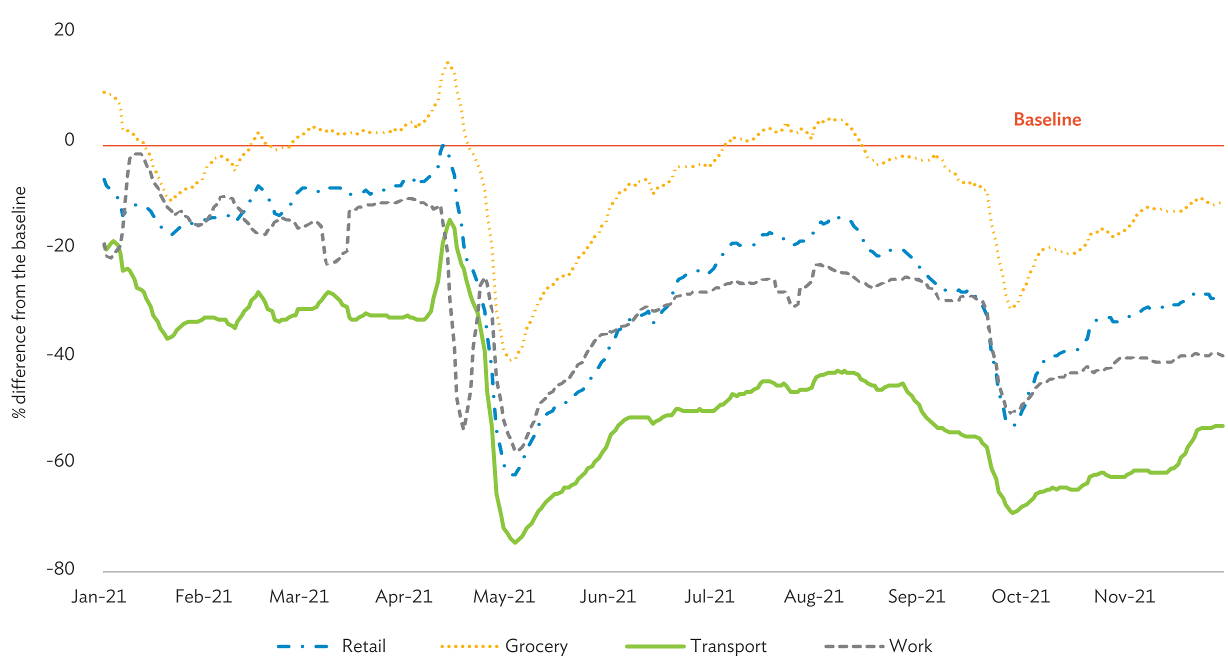
[2] The four major regulatory reforms are Prime Ministerial Order (PMO) No.02/PM: Improvement of Regulations and Coordination Mechanism on Doing Business in Lao PDR; Prime Minister's Decree No. 3/2019: The Endorsement of [Business Activities under] the Controlled Business List and the Concession List of Lao PDR; PMO No.12/PM: Facilitation of Import and Export, Temporary Import, Transit and Movement of Goods in Lao PDR; and PMO No.03/PM Improvement of Services Related to the Issuance of Investment and Business Licenses.

to reduce interest rates and provide new loans to their clients. The second measure was on providing credit lines through commercial banks for businesses affected by COVID-19.

In 2021, an unexpected second wave of COVID-19 infections delayed economic recovery in the Lao PDR and kept borders shut to international tourists, with consumption hit hard by the containment measures implemented beginning in April 2021. Policies to stop the spread of COVID-19 curbed output in manufacturing and hurt growth in retail trade, transport, and tourism services. Curtailed economic activity increased joblessness, particularly among women, and reduced incomes, with households whose members have low skills and education suffering most. Data from Google Mobility highlights the drop in retail trade and restaurant visits as people stayed home (Figure 5.2). Visits to retail stores and recreation venues, groceries and pharmacies, and workplaces dropped by 51%, 29%, and 54%, respectively, compared to the same period in 2020. In response, the BOL continued to implement policy measures easing access to credit. The BOL also provided an additional kip credit line for businesses through subsidized credit via commercial banks. It also injected financing into a fund operated by the Ministry of Industry and Commerce for Small and Medium Enterprises. Tourism enterprises received almost 20% of these funds.

However, the pandemic spurred technology adoption. Firms began venturing into adopting digital models to sustain operations. The number of local restaurants and small shops using online platforms such as Go Teddy and Food Panda increased as people resorted to food delivery services due to regulations that restricted mobility. For example, these two platforms saw the number of online orders grow from between 100 to 200 orders per day before the pandemic to around 1,200 to 2,000 orders per day after April 2020 (UNDP 2020).

Figure 5.2: Community Mobility Trends, 2021



Note: The data are measured as % change compared to the baseline—the median value from the 5-week period 3 January to 6 February 2020. Data are converted into a rolling 7-day average.
Source: Google LLC. Google COVID-19 Community Mobility Reports. https://www.google.com/covid19/mobility/ (accessed 10 November 2021).

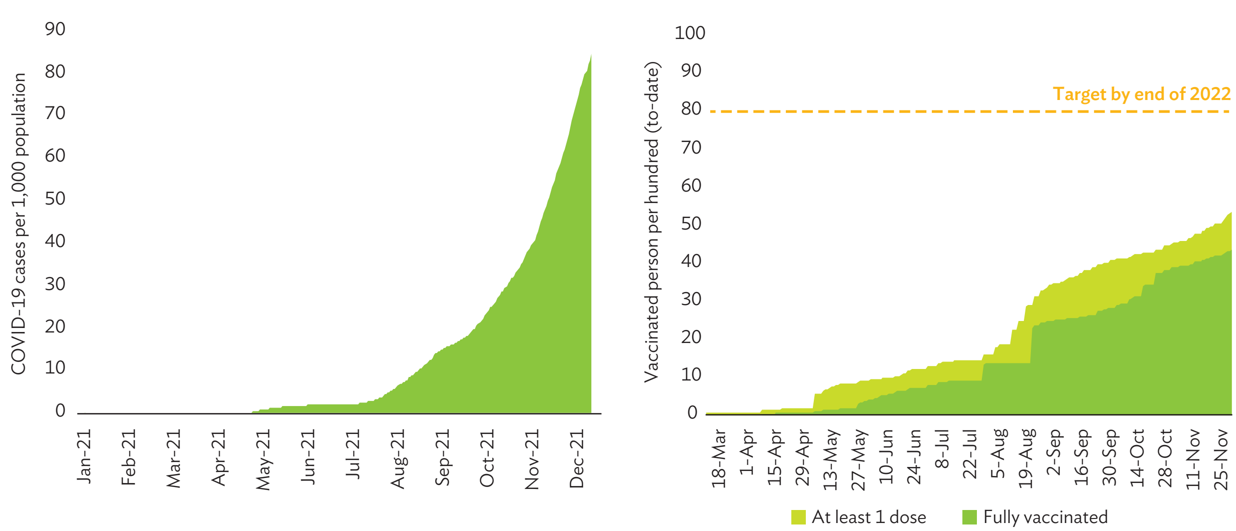
The digital economy continued to flourish in 2021. Internet users in the Lao PDR increased by 15% between 2020 and 2021.[3]

II Economic Prospects: Tourism and Technology

The Lao PDR's economic growth is unlikely to recover to pre-COVID-19 levels in the near term, with projections for real GDP growth not expected to exceed 4.5% in 2022 and 2023. Recovery of international tourism is linked to the reopening policies of countries across the world and the ability of national public health systems to effectively administer COVID-19 prevention and treatment programs, including vaccination programs. As technology use rapidly accelerated during the pandemic all over the world, the recovery of tourism, including its enterprises, is likely to be driven by the sector's online presence and technology adoption in the everyday business transactions of tourism-related companies.

The government is planning for economic recovery and reopening the country to tourism despite rising new cases of COVID-19. The Prime Minister issued an order on 10 November 2021 to relevant authorities to focus on: (i) vaccinating 50% of the population by the end of 2021 and 80% by the end of 2022; (ii) increasing the provision of quality vaccines, medical equipment, medicines, and quarantine or treatment facilities (hospitals, hotels, and guest houses); and (iii) raising awareness of the general public on COVID-19 prevention and control, especially as people transition to learning to live safely with COVID-19. As targeted, the vaccination rate rose steadily and reached 50% by the end of 2021, but this remains below the levels needed to achieve herd immunity. At the same time, officially recorded COVID-19 cases have continued to rise, with a shift from cases linked to returning migrant workers to broader community transmissions (Figure 5.3).

Figure 5.3: COVID-19 Key Indicators, 2021



Source: Ministry of Health (https://www.covid19.gov.la/index.php).

[3] The report is from social media management platform Hootsuite: https://datareportal.com/reports/digital-2021-laos (accessed 8 November 2021).

Leisure tourism recovery prospects will be bolstered by the completion of large transport infrastructure projects, including the Lao PDR–PRC railway and the Vientiane–Vang Vieng expressway. The government is also seeking to accelerate rural development by strengthening local tourism supply chains, including those linked to agricultural production, homestay programs, nature conservation, organic farming, and handicraft industries. The government is targeting 15 million international tourist arrivals during 2021–2025, which is expected to generate $3.8 billion in revenue. But this still equates to only $250 per tourist, which is low by regional standards. To support businesses associated with tourism and trade, the government is focusing on strengthening the implementation of reforms announced in 2018 to improve the business environment. These include moving enterprise registration online and consolidating licensing requirements through single-window services. To support a robust recovery of tourism industries, and to realize targets in development plans and policy measures, it is critical to strengthen efforts to move tourism enterprises into the digital space.

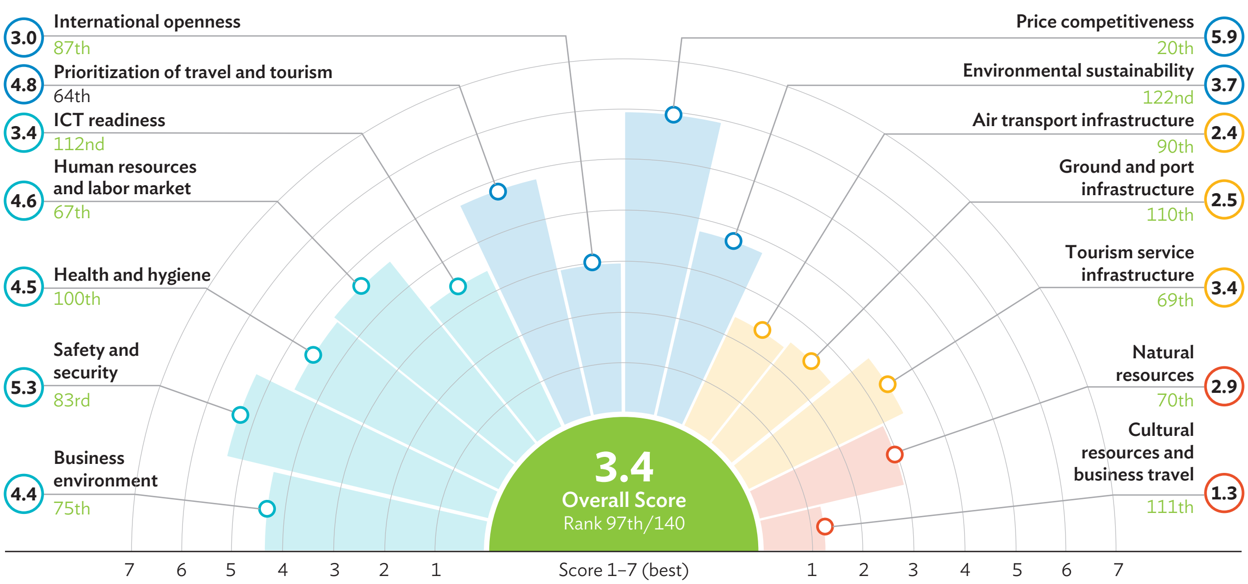
In addition, the government is planning major investments in ICT infrastructure and digital services. In the medium term, the government seeks to extend the use of high-speed internet via fiber optic transmission network to all 148 districts nationwide to become an internet gateway between the PRC and ASEAN. By the end of 2025, it aims to further expand 3G coverage to reach 100% of the population, 4G to 90% of the population, and 5G in Vientiane Capital and major cities in 17 provinces. It also plans to increase computer literacy to 70% of the population and registered high-speed landline and wireless internet users to 70% of the population. With these investments, the number of internet users is expected to continue to increase, and internet services will improve. There have also been rapid developments in financial technology, such as mobile payment and electronic banking. Thus, opportunities for tourism firms that are technology enabled will continue to grow as digital proficiency accelerates and online services become the status quo.

Some risks to the recovery of the tourism industry include inadequate health system capacity and vaccine procurement programs and lack of a system that can link digital proof of vaccine to travel passports, which is increasingly required for international trade and tourism. Continuation of lockdowns is also likely to cause disruptions to tourism, particularly business travel. Mobility restrictions, as well as factory closures in manufacturing and padlocked construction sites, have broad implications for the destination of investments. In addition, low technology readiness and limited utilization of ICT tools in enterprises may also slow the recovery.

III Challenges and Opportunities

Tourism competitiveness. The Lao PDR ranked 97th out of 140 economies in the 2019 World Economic Forum Travel and Tourism Competitiveness Index (World Economic Forum 2019b), behind most of its peers in the Greater Mekong Subregion (Figure 5.4). It fared well in terms of price competitiveness, due to the country's relatively low cost of living, and in terms of its less restrictive visa requirements and low crime rate. In terms of environment and culture, the Lao PDR offers beautiful, pristine natural resources with its people still practicing their rich traditional culture. There are 23 national protected areas that cover nearly 14% of the country, which are recognized as among the best-designed national protected area systems in the world (ICEM 2003). The country's major tourist destinations are Luang Prabang, Luang Namtha, Savannakhet, and the capital city Vientiane. These destinations offer a range of tourist attractions including World Heritage sites, large tracts of tropical monsoon forests, diverse wildlife populations, and unique ethnic cultures. Improvements are

Figure 5.4: Travel and Tourism Competitiveness Index, 2019



ICT = information and communication technology.
Source: World Economic Forum. 2019. Travel and Tourism Competitiveness Index, 2019 edition. Davos.

Table 5.1: Provincial Trade Facilitation Index, 2017 and 2019

Index	2019	2017	Change
Overall	**55.4**	**48.8**	**6.6**
Starting a business	67.0	59.0	8.0
Transparency and access to information	26.9	40.8	–13.9
Regulatory burden	74.7	59.0	15.7
Informal charges	50.1	46.1	4.0
Consistency in implementation	53.9	37.7	16.2
Business friendliness	59.6	60.2	–0.6

Note: 100 is best and 0 is worst.
Source: ADB staff calculations for 2019 Provincial Facilitation for Investment and Trade Report.

needed for sustainable management of these destinations, particularly investments in water and sanitation infrastructure.

Business environment. The World Economic Forum Travel and Tourism Competitiveness Index also assesses the quality of the business environment and the report has historically raised concerns regarding the time for starting a business in the Lao PDR. Recognizing this issue, the government issued a range of policies to improve the business environment. For example, in 2018, Prime Minister Order No. 02 (PMO 02/2018) was adopted, which included a major reform to issue tax identification numbers and business registration certificates at the same time. Results of enterprise surveys on provincial trade facilitation show that, between 2017 and 2019, firms reported that the overall business environment had improved (Table 5.1). The decrease in regulatory burden was a big factor, particularly in terms of the time and costs involved with complying with business licensing requirements.

However, the same surveys also found that there was lack of meaningful progress on

(i) transparency and access to information, (ii) business friendliness, and (iii) informal charges. Moreover, companies in the Lao PDR remain disadvantaged by excessive licensing requirements and informal practices. More than two-thirds of enterprises in the country reported that they had to pay informal charges to obtain operating licenses to register their business. Complicated document procedures prompted many entrepreneurs to resort to paying informal charges to save time and costs. Compared to other businesses, tourism-related enterprises reported slightly more favorable conditions associated with reduced regulatory burden from fewer licensing requirements (Table 5.2). This is because small enterprises involved in tourism or retail trade are not required to apply for an additional sector business-operation license after receiving their business registration certificate. However, tourism enterprises reported greater challenges in accessing information and, as a result, reported more substantial issues with informal charges.

Enterprise structure. The quality of the regulatory environment has important implications for the structure and growth of enterprises, which is essential for upgrading and diversification needed for structural transformation, as well as the creation of quality jobs and middle-class expansion. The 2020 Economic Census conducted by the National Bureau of Statistics reports that the Lao PDR has many micro and small enterprises, but not many medium-sized or large enterprises. Microenterprises account for 94.2% of all enterprises, followed by small enterprises at 4.9%, and medium-sized and large enterprises at 0.7% and 0.2%, respectively. In terms of employment, most of the labor force are employed in microenterprises, with enterprises that have five or fewer employees accounting for 90.6% of all firms, while enterprises with more than 50 employees account for only 0.4% of firms. Regulatory compliance is low while informality is high. Of the enterprises surveyed, 69.6% reported that they do not have a registration for their business, 87.1% reported that they do not have a tax identification number, and 98.1% do not participate in social security. Most enterprises do not practice accounting, nor do they use ICT tools in their business. Less than 10% of enterprises reported having a loan in the last 3 years.

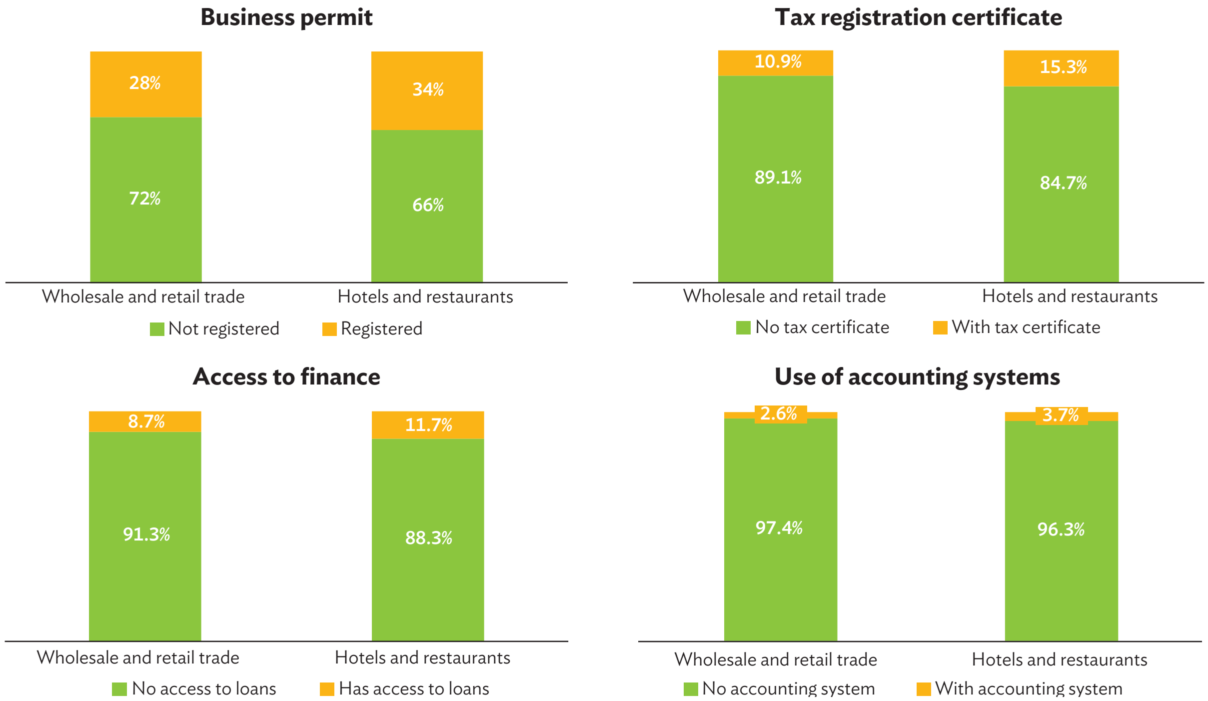
Tourism enterprise regulatory compliance and use of growth enablers. The main segments of the economy that involve tourism—retail trade enterprises, hotels, and restaurants—also feature low levels of regulatory compliance and limited use of growth enablers, such as practicing accounting, access to finance, and adoption of ICT tools and systems. As a result, productivity in tourism is likely to remain constrained and highly vulnerable to risks. According to the 2020 Economic Census, less than one-third of tourism enterprises have an enterprise registration certificate, indicating that regulatory compliance is low and that many enterprises operate informally (Figure 5.5). Only 10.9% of trade enterprises and 15.3% of hotels and restaurants have a tax identification number. Moreover, only 8.7% of trade enterprises and

Table 5.2: Provincial Trade Facilitation Index for Trade and Services, 2019

Index	Trade and Services	All Sectors
Overall	**55.9**	**55.4**
Starting a business	68.1	67.0
Transparency and access to information	25.1	26.9
Regulatory burden	78.7	74.7
Informal charges	51.2	50.1
Consistency in implementation	53.5	53.9
Business friendliness	59.0	59.6

Note: 100 is best and 0 is worst.
Source: ADB staff calculations for 2019 Provincial Facilitation for Investment and Trade Report.

Figure 5.5: Selected Indicators for Trade, Hotels, and Restaurants, 2020
(% of enterprises)



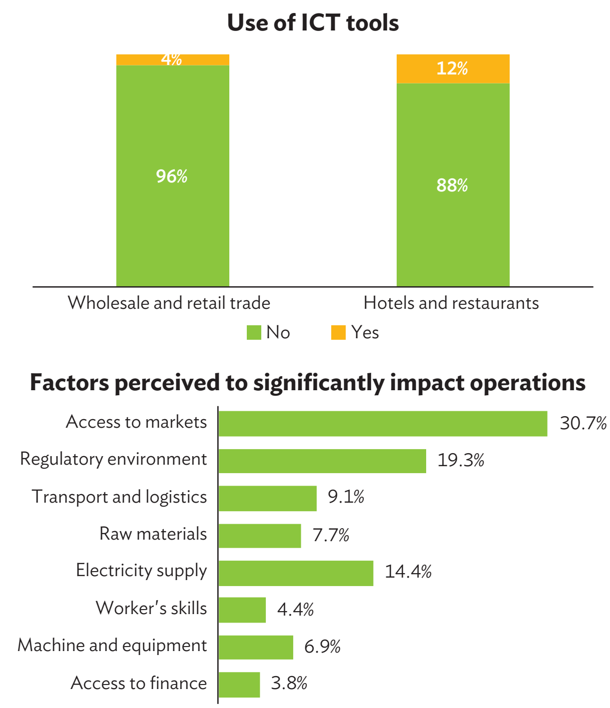
Source: ADB staff calculations based on a 60% sample of the Lao PDR's Economic Census 2020.

11.7% of hotels and restaurants reported having a loan in the last 3 years. Bookkeeping practices were used by only 2.6% and 3.7% of trade enterprises and hotels and restaurants, respectively. Hotels and restaurants performed better than trade enterprises on most of these measures, but their performance is still below what is observed in other countries in Southeast Asia. Upgrading the service quality of hotels, restaurants, and trade enterprises to high-quality and modern standards, as targeted by the government in its 9th National Socioeconomic Development Plan (NSEDP), will involve improving performance on these metrics.

Technology adoption. Digitalization offers more opportunities for tourism enterprises to expand their market and improve competitiveness and productivity. An ADB survey found that enterprises with web presence were associated with higher levels of hotel occupancy, which translates into more stable revenues and income growth (ADB 2021). However, in 2020, only 6.6% of the enterprises surveyed reported using ICT tools in their businesses. About 12% of hotels and restaurants reported using them, compared to only 4.4% for trade enterprises (Figure 5.6). Of the enterprises that used ICT tools, less than half reported applying them to support sales and services. This represents a missed opportunity. ICT tools can help these enterprises enter new markets, which they report is the most significant issue impacting them. Another challenge for tourism in the Lao PDR is that it tends to capture tourists with a "low spend." The country is often considered an add-on destination, as most tourists stay for short periods, and lower-quality services reduce tourist spending. The 9th NSEDP seeks to facilitate the use of technology to help tourism enterprises find new markets, expand the use of online booking services, and implement tourism marketing strategies targeting appropriate market segments and price points.

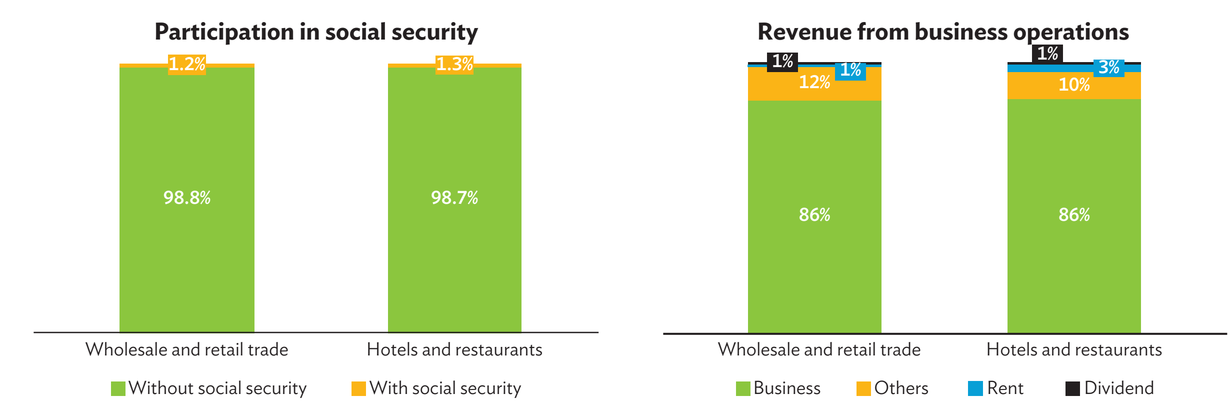
Resilience to shocks. While the tourism sector has rapidly adapted to shifting travel trends arising from the pandemic, its overall resilience to economic shocks remains weak due to limited use of social security and insurance systems. In total, only 1.9% of enterprises surveyed in the 2020 Economic Census reported that they participated in social security, insurance, and medical insurance programs. Participation of enterprises involved in tourism was lower at 1.2% for trade enterprises and 1.3% for those in hotels and restaurants (Figure 5.7). The low participation rate of tourism enterprises in social security schemes may be attributed to the challenging

Figure 5.6: Selected ICT Indicators for Trade, Hotels, and Restaurants, 2020
(% of enterprises)



ICT = information and communication technology.
Source: ADB staff calculations based on a 70% sample of the Lao PDR's Economic Census 2020.

Figure 5.7: Selected Social Protection Indicators for Trade, Hotels, and Restaurants, 2020
(% of enterprises)



Source: ADB staff calculations based on a 70% sample of the Lao PDR's Economic Census 2020.

work environment in the sector, i.e., high informal work arrangements due to seasonality and other demand fluctuations. Lack of participation in such schemes implies greater exposure for both workers and enterprise owners to risks associated with income loss and poverty. Mechanisms that offset these risks are critical for a sustainable and resilient tourism recovery.

In addition, only 4% of enterprises reported general insurance expenditures, with trade enterprises and hotels reporting slightly lower levels at 2.7% and 2.9%, respectively. This highlights low utilization of risk mitigation instruments by the private sector. Revenue sources of enterprises also lack diversification, with firms' income primarily derived from business activities rather than rent or dividend payments from investments (Figure 5.7). Hotels and restaurants were more likely to report income from rent, but the incidence is still low considering the nature of activities in this sector. This indicates higher vulnerability to both demand and supply shocks.

Low levels of financial inclusion, lack of income diversification, and low participation in social security and insurance schemes heighten enterprises' exposure to risks, and tourism enterprises tend to be more exposed than the average enterprise. Although the regulatory environment for businesses includes provisions for issuance of social security registration certificates, participation is low.[4] In addition, registration also does not automatically trigger payments from the enterprises into these schemes. Lack of consolidation and system integration leaves a gap in the policy framework, weakening the private sector's resilience to income shocks. It also has implications for the ability of firms to attract and retain talent. Although regulatory compliance remains low, enterprises contribute to government revenues through licensing and taxation payments. There is space to explore mechanisms to incentivize compliance by strengthening programs and products that reduce the risk of firms and improve social protection for workers.

Amid these challenges, the country is also undergoing several transitions related to macroeconomic stability, the health system, education, unemployment, and investments in roads and railway, which impact the broader development context (Box 5.1).

Box 5.1: Macroeconomic Transitions

Sustainability of medium-term macroeconomic policy framework. The medium-term macroeconomic policy framework of the Lao People's Democratic Republic (Lao PDR) is facing extreme pressure from high public and publicly guaranteed debt, which was reported at 72% of gross domestic product in 2020, and exchange rate risks. Improvements in macroeconomic management are needed to address these risks and prevent further pressure on employment, wages, prices, social spending, infrastructure maintenance, and the welfare of the poor. In this regard, the national agenda for resolving economic and financial difficulties facing the country for 2021–2023 was approved at an extraordinary session of the National Assembly in August 2021. It focuses on five areas: increasing public revenue, sustainable debt management, monetary stability, improved business environment, and effective governance. Interventions in these areas will pave the way for enhancing the quality of public expenditures and improving policy delivery mechanisms.

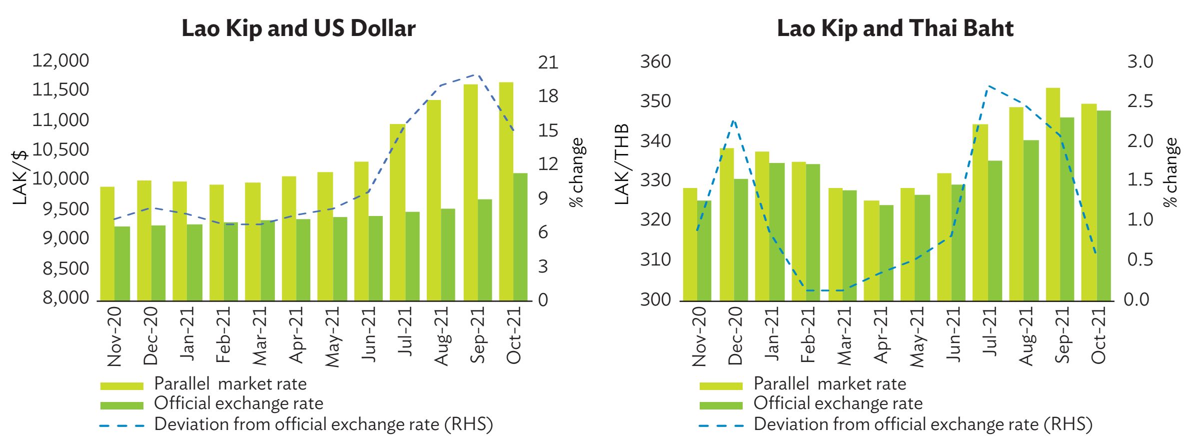
Currency depreciation. In 2021, the kip depreciated against the United States (US) dollar by 11.1%, with the spread between official and parallel rates for the kip and US dollar exceeding 20% during July, reflecting a domestic shortage of currency following large external public debt payments. The kip also depreciated against the Thai baht by 5.6% in the official market. The weakening of the local currency may contribute to the attractiveness of the Lao PDR as a destination for leisure tourism based on price competitiveness. However, investors may face heightened local currency risks, particularly given recent revisions to the Law on Foreign Exchange Management that require all domestic transactions to be conducted in kip.

continued on next page

[4] Per Instruction No.1206/MoLAS dated 23 April 2019, social security registration certifications are to be released within 2 working days of application.

Box 5.1 continued

Foreign Currency Trends, 2020–2021



LAK = Lao kip, THB = Thai baht.
Source: Bank of the Lao PDR.

Exhausted health system. Coronavirus disease (COVID-19) cases have been increasing exponentially and the health system is under tremendous strain. There is a need to address response gaps through investments in epidemiology and laboratory capacity; improvements in the quality of health-care services—quarantine facilities, hospitals, and local services; and improvements in access to health equipment and treatment. In addition, substantial efforts are required on broader public health issues, such as community immunization programs, inclusive of vaccine certifications and sustainable vaccine financing, and safely reopening borders with other countries.

Disruptions in education. As cases continued to rise, schools and educational institutions in the country remained closed. This has affected more than 1.7 million students enrolled in the pre-primary, primary, secondary, tertiary, technical-vocational schools, and other educational institutions for the school years 2020 and 2021. The government, with the support of development partners, has published educational programs in print, TV, radio, and online platforms to support continuity of learning. However, online connectivity remains an issue for remote areas, along with affordability of information technology equipment and internet data packages. Prolonged school closures put students' learning and well-being at risk.

Higher joblessness. Unemployment and labor underutilization is expected to persist in the short to medium term. Businesses have been restricted in their operations for more than 3 of 12 months in 2020 and all of 2021. In May 2021, 5.5% of businesses closed permanently, while 33% were temporarily closed (World Bank 2021). Among businesses in operation, 65% reported a fall in revenue from pre-lockdown levels. An ADB survey found that 50% of tourism enterprises were temporarily closed in May 2020 (ADB 2020). International travel restrictions have forced many hospitality enterprises to close their businesses without knowing when they could reopen. Thousands of workers who worked directly and indirectly in the tourism sector have been furloughed or are unemployed.

Improved connectivity. The Lao PDR is a landlocked country with a significant economic disadvantage compared to other countries in the region. However, the government is determined to connect the Lao PDR to its neighboring countries through infrastructure investments. The East–West Corridor highway links Vientiane, the capital, with the large port of Da Nang in central Viet Nam. The North–South Corridor highway connects the Lao PDR with Cambodia and Thailand to the south and southwest, and to the People's Republic of China (PRC) in the north. One of the biggest investments the government has ever made is the express train linking the Lao PDR to the PRC, which opened on 3 December 2021. This will provide the Lao PDR with a link by land to global and regional supply chains, which could make the country more attractive to investors, create new jobs, and accelerate economic growth. These assets represent a huge opportunity to capture value by businesses and the government.

Source: Asian Development Bank.

IV Conclusions and Policy Options

Tourism businesses that focus on domestic tourists may have benefited from border closures during the pandemic since goods and services from neighboring countries were limited, but once borders reopen domestic enterprises will have to compete with businesses abroad to sustain their income. Moreover, in the absence of reforms that (i) improve regulatory compliance by consolidating requirements; (ii) optimize use of accounting, ICT tools, and finance to support firm growth; and (iii) enable agile policy responses from government, inequality of outcomes and opportunities are likely to persist.

Moving online offers opportunities and solutions to overcome constraints faced by the tourism industry in their post-pandemic recovery. In the short, medium, and long term, it will be important to continue to improve the business environment and labor market governance to expand the formal economy. Policies to encourage financial inclusion and social protection are also needed. However, strategies to strengthen technology adoption and digitalization should be considered in each step of the recovery planning and policy development process. Several specific short- and medium-term policy recommendations are worth considering:

Short-Term Recommendations

(i) **Health security.** Develop appropriate health services and public health policies to achieve health security for reopening the economy and protecting the country from future disease outbreaks.

(ii) **Business development.** Raise awareness on the benefits of practicing accounting, using ICT, and accessing finance to enable firm growth; and promote the use of digital platforms for tourism sales and marketing, e-commerce, and payments. The 9th NSEDP has assigned the Ministry of Information, Culture and Tourism to develop digital advertising campaigns and promote technology adoption in tourism. The government's recent partnership with Facebook (Build Your Business with Facebook) is a good example of how to use an online campaign to empower local enterprises and promote business development. Government and firms should also use social media platforms that are popular in the PRC to maximize opportunities, particularly those linked to the new Lao PDR–PRC railway.

(iii) **Regulatory compliance.** Grow government revenues through improvements in the business environment. As mentioned, regulatory compliance remains low among tourism enterprises, which limits their contribution to government revenues. However, these enterprises still contribute to revenues through licensing and taxation payments. Mechanisms to incentivize regulatory compliance should look at how to strengthen programs and products that reduce the risk of firms and improve the welfare of workers. These include (a) one-stop services that automate and digitize business registrations and tax collection and (b) improving delivery of public services that are valued by enterprises. Such services include tourism destination marketing, sanitation and environmental protection, and tourism vocational training, among others.

Medium-Term Recommendations

(i) **Tourism supply chains.** Understand how tourism can become a driver of recovery and inclusive growth, particularly through diversification and upgrading via new technologies. There is a need to integrate ICT in tourism supply chains and for tourism to increase its interlinkages with other sectors in the economy, such as agriculture. The 9th NSEDP seeks to promote ecotourism and agriculture linkages by improving the quality of the tourism service network in the production and use of environment-friendly and locally produced products to reduce waste, protect natural resources, and provide a unique local experience to visitors.

(ii) **Tourism investment promotion**. Mobilize public and private investment by supporting investment project design, expanding public–private partnerships, and developing mechanisms for funding destination investment and management.

(iii) **Quality tourism jobs.** Strengthen business management and digital literacy through skills investment, portability of certifications, and protections for a regionally competitive workforce. Interventions are particularly needed to increase participation in social security and insurance schemes to reduce enterprises' exposure to risks. This can be advanced through regulatory consolidation and system integration. Such reforms should be well planned to ensure the realization of broad sweeping benefits for health security, talent retention, and government revenue collections.

References

ADB. 2020. The Impact of COVID-19 on Tourism Enterprises in the Lao People's Democratic Republic: An Initial Assessment. *ADB Briefs.* https://www.adb.org/sites/default/files/publication/613466/adb-brief-141-impact-covid-19-tourism-lao-pdr.pdf.

_______. 2021. *Developing Agriculture and Tourism for Inclusive Growth in the Lao People's Democratic Republic.* https://www.adb.org/publications/agriculture-tourism-inclusive-growth-lao-pdr.

_______. 2022. Provincial Facilitation for Investment and Trade Index: Measuring Economic Governance for Business Development.

Government of the Lao PDR. 2021. *Lao PDR Voluntary National Review on Implementation of the 2030 Agenda for Sustainable Development.* https://laopdr.un.org/en/13108-voluntary-national-review-implementation-2030-agenda-sustainable-development.

International Centre for Environment Management (ICEM). 2003. *Lao People's Democratic Republic National Report on Protected Areas and Development: Review of Protected Areas and Development in the Four Countries of the Lower Mekong River Region.* https://icem.com.au/documents/biodiversity/pad/lao_pdr_nr.pdf.

United Nations Development Programme (UNDP). 2020. How COVID-19 Could Accelerate Digitalization in Laos. https://www.la.undp.org/content/lao_pdr/en/home/blog/2020/how-covid19-could-accelerate-digitalization-in-laos.html.

World Economic Forum. 2019a. *The Travel & Tourism Competitiveness Report 2019.* https://www.weforum.org/reports/the-travel-tourism-competitiveness-report-2019.

_______. 2019b. Lao PDR: Travel & Tourism Competitiveness Index 2019 edition. https://reports.weforum.org/travel-and-tourism-competitiveness-report-2019/country-profiles/#economy=LAO.

World Travel and Tourism Council. 2021a. *LAOS 2021 Annual Research: Key Highlights.*

_______. 2021b. Travel & Tourism Economic Impact 2021: Global Economic Impact & Trends.

World Bank. 2021. Monitoring the Impact of COVID-19 in Lao PDR. https://www.worldbank.org/en/country/lao/brief/monitoring-the-impact-of-covid-19-in-lao-pdr

6

Thailand:
Recharging the Future of Tourism

While merchandise exports and investments in export-oriented sectors have bounced back to pre-pandemic levels in Thailand, the services sector—particularly tourism, which before the pandemic contributed to about a fifth of the country's GDP and total employment—is likely to recover more slowly. Nonetheless, the government sees the pandemic as an opportunity to overhaul the tourism sector, to move the industry away from mass tourism to high-value and low-density tourism, which would better align its development policies with its climate objectives and strengthen economic resilience. The government is also working hard to promote domestic tourism, especially as international travel is likely to take some time to recover. Investments in infrastructure to upgrade transportation links within the country is another area of transition, as is the use of digital platforms as an essential tool to revive the tourism sector.

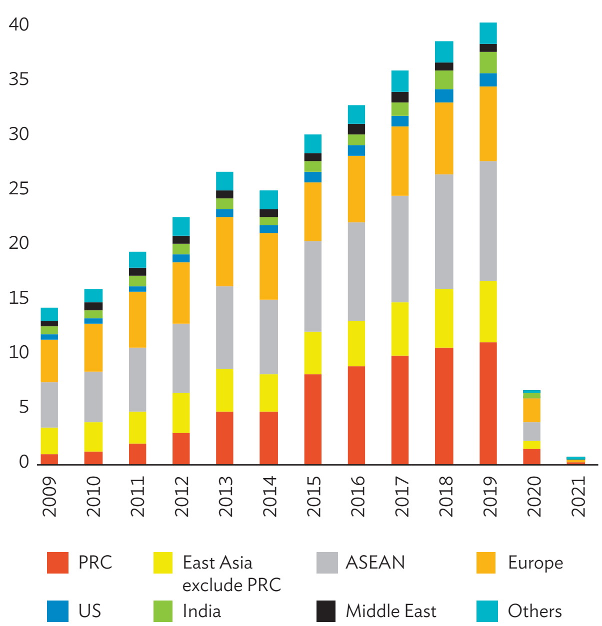
While Thailand aims to move forward to high-value and sustainable tourism, digital technology and investment in public infrastructure are essential to revive the tourism sector (Photo by ADB Multimedia Library).

Note: This chapter was written by Chitchanok Annonjarn of ADB's Thailand Resident Mission in Bangkok.

I COVID-19's Impact on the Economy and Tourism Industry

The tourism sector has been a key driver of Thailand's economic growth for many years. In 2019, revenue from international tourists accounted for 11% of GDP. However, the pandemic halted international travel and caused a significant contraction in economic activities. The tourism sector was affected most as the government imposed travel restrictions on foreign tourists. The number of foreign tourists in Thailand plunged from 39.9 million in 2019 to 6.7 million in 2020 and 0.4 million in 2021 (Figure 6.1), causing foreign tourist receipts to drop by around 90% and forcing businesses to shut down and lay off workers, particularly low-skilled, informal, and migrant workers.

Figure 6.1: Number of Foreign Tourist Arrivals
(million)



ASEAN = Association of Southeast Asian Nations, PRC = People's Republic of China, US = United States.
Source: Ministry of Tourism and Sports.

Thailand's GDP in 2020 contracted by 6.1%, its worst performance since the 1997 Asian financial crisis. Despite starting from a low base, the economy in the first half of 2021 expanded by only 2% due to a significant resurgence in COVID-19 infections. The number of foreign tourist arrivals has also been disappointing, even though Thailand has been open to foreign tourists with special tourist visas since October 2020, and the government launched two tourism recovery pilot programs in July 2021—the Phuket Sandbox and Samui Plus—that allowed foreigners who are fully vaccinated to enter Thailand without a requirement to quarantine.

With the national vaccination program picking up pace into the second half of 2021, Thailand was gearing up for the reopening of Bangkok and other major cities in October 2021. However, the plan was postponed until November 2021 as vaccination rates fell short of targets.

II Economic Prospects and Recovery Pathways

Thailand has had success in containing the spread of COVID-19 during 2020 and the first quarter of 2021. However, the situation deteriorated from April to August 2021. New daily COVID-19 cases soared and were driven by the more highly transmissible Delta variant that resulted in a higher death toll. The onset of a severe wave of COVID-19 infections prompted the government to impose stricter lockdown measures in Bangkok and high-risk provinces in July that were then extended in August, thus worsening the country's near-term economic outlook. Furthermore, the vaccination program progressed slowly because of inadequate supplies. As of August 2021, only 10% of the population was fully vaccinated.

In September 2021, new daily COVID-19 cases in Thailand started to decline. The number of people who were fully vaccinated rose to 45% of population at the end of October as the government tried to increase the rate of vaccinations from an average of 250,000 doses administered a day in July to more than 750,000 doses a day on average in October. With these positive developments, the government decided to ease restrictions on the retail sector in the beginning of September and further eased some restrictions in high-risk provinces, allowing more types of businesses such as recreational and personal care establishments including gyms, cinemas, and massage parlors to open, and reducing the time required to quarantine for interprovincial travel nationwide beginning October.

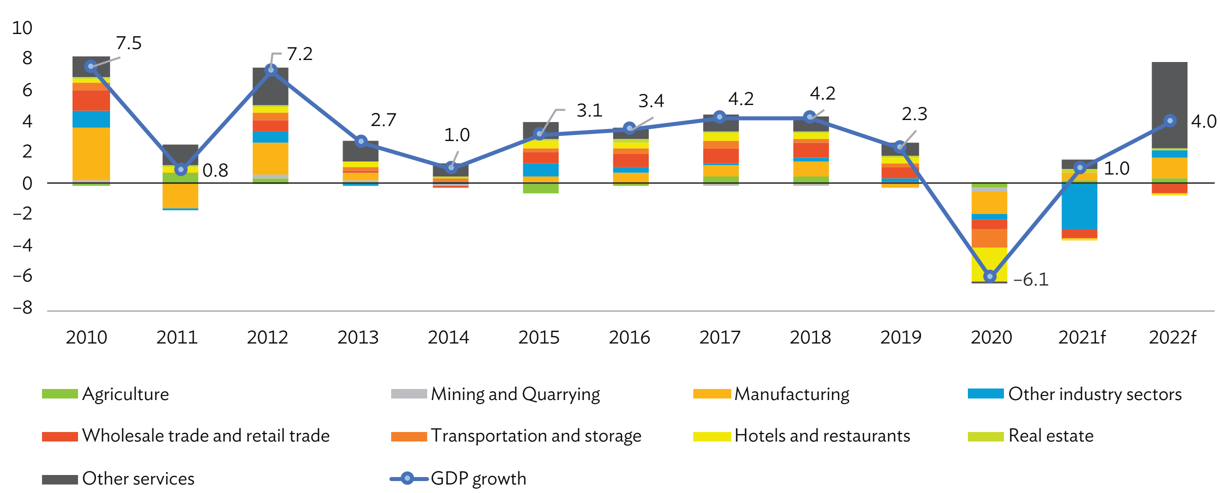
While relaxing restrictions may have helped boost economic activities in the last quarter of 2021, the overall impact of the surge in infections is expected to be a significant drag on GDP growth in 2021. The economy is projected to continue to face a number of economic challenges despite a strong rebound of merchandise exports in 2021. GDP growth in 2021 is projected to be 1%, down from an earlier estimate of 3%. The growth forecast for 2022 has been lowered to 4% from an earlier forecast of 4.5% (ADB 2021).

Thailand is expected to follow a K-shaped economic recovery that reflects a divergence in performance across sectors (Figure 6.2). The outbreak in Thailand has been worse and longer than expected, and the services sector, particularly tourism, is likely to recover more slowly than other sectors and is expected to be a drag on economic recovery. In contrast, merchandise exports and investments in export-oriented sectors have bounced back to pre-pandemic levels, and the outlook over the next few years is strong.

Employment in tourism-related sectors has gained importance over the past decade (Figure 6.3). Slow tourism recovery, however, could keep unemployment elevated as businesses operating in provinces under a lockdown and nighttime curfew reduce their workforce and hire fewer workers. Unemployment increased from 1.04% in 2019 to 1.89% in the second quarter of 2021, and the number of unemployed for more than 12 months increased by 20% from the previous quarter. Furthermore, the unemployed

Figure 6.2: Contribution to GDP Growth

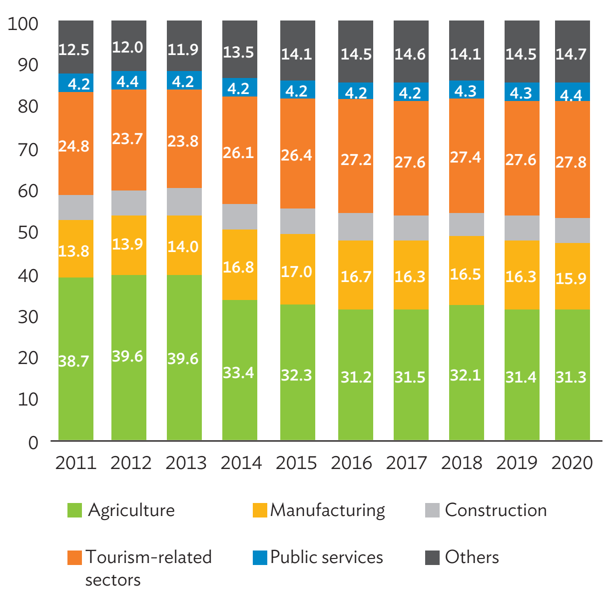
(%)



f = forecast, GDP = gross domestic product.
Sources: Office of the National Economic and Social Development Council and ADB estimates.

tended to remain unemployed for a longer period, according to a report by the Office of the National Economic and Social Development Council (NESDC 2021). Physical jobs in the tourism sector are likely to suffer a prolonged slump, which is expected to persist in 2022. In the past, going back to one's hometown in a rural area after having lost a job in Bangkok or other major tourist destinations was a viable alternative. Those who had lost their jobs could easily enter the agriculture sector or become self-employed. However, the impact of COVID-19 on tourism-related sectors this time has been massive, and rural areas' capacity to absorb workers has been greatly diminished. Moreover, it is difficult to create more jobs amid the pandemic because of weak demand. If this situation persists, it could considerably deteriorate household incomes and private consumption over the next few years.

Figure 6.3: Share of Employment by Sector
(% of total employment)

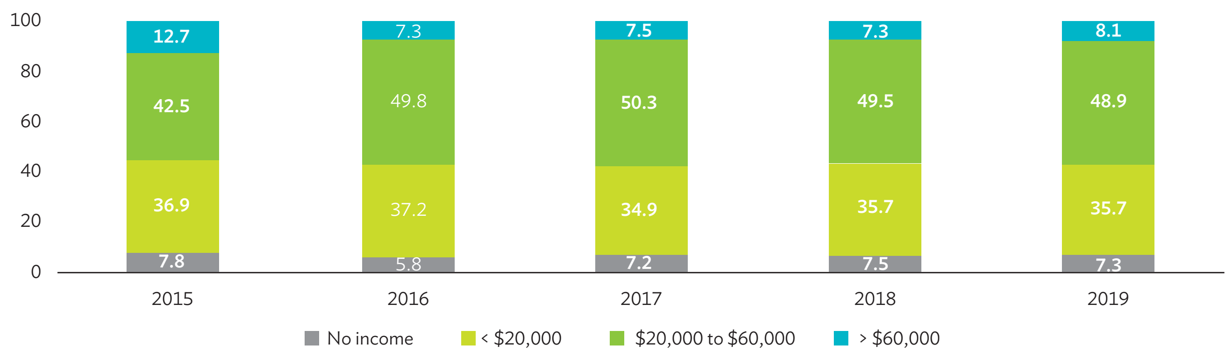


Note: Tourism-related sectors include wholesale and retail trade, transport and storage, and accommodation and food service activities.
Source: National Statistical Office.

There are certainly greater risks to the overall economic outlook than there were in early 2021. The possibility of further severe COVID-19 outbreaks in the country and more contagious variants pose significant downside risks. Delays in the vaccine rollout could also adversely affect domestic mobility, consumption, and tourism. Although the number of international tourist arrivals is expected to go up to 20 million in 2022, this is still far below pre-pandemic levels (Figure 6.1). Tourism and related service sectors could recover more quickly if vaccination in both Thailand and other countries were sufficient to ensure confidence in international travel and health safety. Nonetheless, the Tourism Authority of Thailand (TAT) predicts that it could take 5 years before tourism is fully revived in Thailand (TAT Intelligence Center 2021). This would inevitably force workers in tourism-related sectors to seek job opportunities in other sectors, or businesses to change their business model to survive this period. The TAT also recognizes a careful strategy is required to reopen tourism successfully. The key to succeed is to build *confidence* in the tourism sector. If the sector can make tourists feel safe, then both Thai and non-Thai tourists would return.

The government plans to use the pandemic as a catalyst to overhaul the tourism sector. As high-income tourists—those who earn more than $60,000 per year—tend to account for only a small portion of international travelers to Thailand (Figure 6.4), the government plans to attract tourists with more spending power and move away from mass tourism. The government's tourism revival strategy is to target big spenders who seek privacy and social distancing, both during the pandemic and also after it passes. The government is also attempting to promote more specific tourism segments such as medical, wellness, sports, and food tourism; and ultra-luxury travel. Quality travel would help address several

Figure 6.4: Share of International Tourists by Annual Income
(% of total)



Note: The group with no income includes students and elderly persons.
Source: Ministry of Tourism and Sports.

issues that already existed before the pandemic, such as overcrowding at beaches and other environmental impacts. During the pandemic, many of Thailand's outstanding national parks have witnessed a dramatic recovery in wildlife and quality of environment (TAT 2020). Thus, the country intends to ensure that these areas remain pristine when tourists return, to preserve it for future generations. In June 2020, the TAT signed a memorandum of understanding with the United Nations Development Programme (UNDP) to develop a long-term sustainable tourism strategy. This move will prepare the sector to align with the United Nations Sustainable Development Goals (SDGs) and enhance the overall quality of tourism products and services nationwide (TAT 2020).

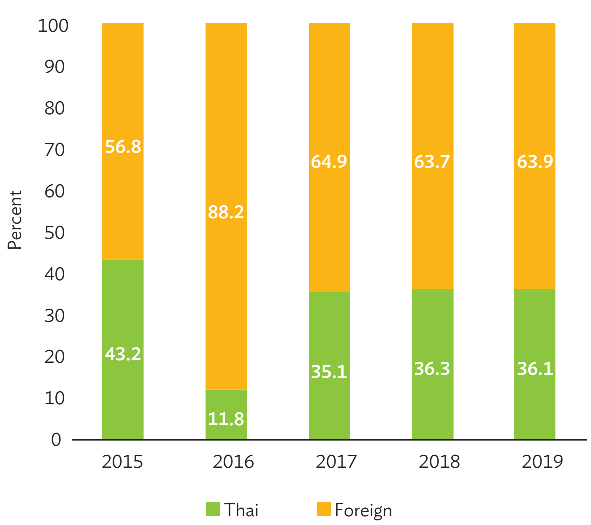
On the demand side, COVID-19 has caused a significant change in travel preferences worldwide. Health-related factors have become a strong consideration in travelers' choice of destinations. According to a study by Bank of Thailand and credit card company VISA, travelers tend to make trips closer to home, prefer niche travel in small groups, and avoid crowded tourist spots (Bank of Thailand and VISA 2021). Some of them are willing to pay more for greater safety and quality. Digitalization is expected to become vital as it could facilitate the inclusion of travel documents such as vaccination certificates and test results, as well as provide more contactless operations.

III The Tourism Sector's Competitive Landscape Prior to COVID-19

Over the past decade, the tourism sector has grown in importance in Thailand. The number of annual foreign tourist arrivals rose rapidly from 14.1 million in 2009 to 39.9 million in 2019 (Figure 6.1) (Ministry of Tourism and Sports 2019). The direct and indirect contribution of travel and tourism to Thailand's GDP in 2019 was about 20%, and the sector employed about 8 million workers or about 21% of total employment (World Travel and Tourism Council 2020). According to The Travel & Tourism Competitiveness Report 2019 (World Economic Forum 2019), Thailand ranked 31st out of 140 countries globally in overall travel and tourism competitiveness, improving from 34th in 2017. Thailand stood out through a combination of rich natural and cultural resources as well as strong price competitiveness. The country also improved its performance in areas such as air transport infrastructure, ICT readiness, travel and tourism prioritization, and international openness. However, Thailand dropped from 122nd to 130th in environmental sustainability, prompting authorities to act to prevent a wider fallout. In addition to environmental concerns, the tourism industry faced four structural issues prior to the pandemic:

(i) **Sector imbalance.** From 2016 to 2019, foreign tourists on average accounted for a larger share of total tourism receipts than domestic tourists (Figure 6.5). To address this imbalance, the government offered several incentives to boost domestic tourism, including personal income tax deductions for hotel expenses and discounts for Thais who travel during weekdays. The government's efforts were quite successful as the share of domestic tourism receipts increased from 12% in 2016 to 36% in 2019. However, the sector imbalance remained, partly because most domestic trips were short—about 2 to 3 days, usually on weekends—while foreign tourists visited Thailand for about 10 days on average.

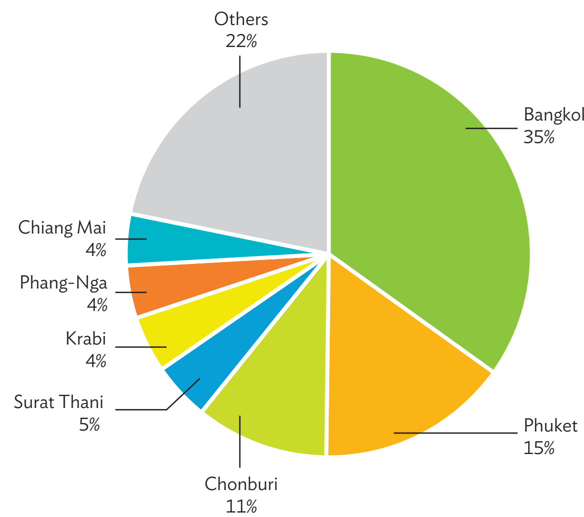
Figure 6.5: Tourism Sector Receipts
(% of total)



Source: Ministry of Tourism and Sports.

(ii) **Location concentration**. International tourism was highly concentrated in a few provinces with iconic attractions. In 2019, Bangkok received the largest share of foreign tourists, followed by Phuket, Chonburi, Surat Thani, Krabi, Phang-Nga, and Chiang Mai (Figure 6.6). Meanwhile, 70 other provinces in the country had less than 1% of total foreign tourists or fewer than 0.5 million foreign tourists. Popular destinations were islands and beaches, while cultural and historical attractions received much less attention.

Figure 6.6: Share of International Tourists by Destination in Thailand



Source: Ministry of Tourism and Sports.

(iii) **Quantity over quality**. Though the number of tourists and travel receipts increased, spending per trip declined since 2018, partly because the share of foreign tourists from low- and middle-income groups—who tend to spend less than tourists in higher-income groups—increased. In addition, the large numbers of tourists that flocked to a limited number of locations caused the amount of litter as well as noise and air pollution in those areas to increase, affecting local people, ocean life, and wildlife.

(iv) **Limitations of transportation infra-structure.** Thailand experienced a surge in visitors a few years before COVID-19 hit the country, and its airports had trouble handling such large numbers of tourists.

In 2019, over 60 million people passed through Suvarnabhumi Airport which has an annual capacity of 45 million, and over 40 million passengers passed through Don Mueang Airport which has a capacity of 30 million. Infrastructure connectivity between primary and secondary cities was another issue. Domestic flights serving smaller airports originate mainly from Bangkok and do not connect directly to other small airports. Some attractions, especially in secondary cities, do not have airports within 1–2 hours' drive (Ministry of Tourism and Sports 2017).

IV Efforts to Build Back the Tourism Industry

The government's tourism revival strategy is to target high-income tourists seeking privacy and social distancing, even after the pandemic passes. Specifically, the TAT has introduced a new tourism concept called "SEXY," where each letter stands for one of four areas that the tourism sector will focus on: S for safety and hygiene; E for environmental sustainability; X for extra experience, which are new products or new features of well-known destinations; and Y for yield, a high-value form of tourism that targets individuals with high spending potential (TAT 2021).

In addition, Thailand introduced a "sandbox" program for Phuket and Samui islands in July 2021, which allowed vaccinated foreign tourists from low- and medium-risk countries to visit these islands without a 14-day quarantine. The rest of the country would open several months later; in October 2021, the government announced that Thailand would be open to fully vaccinated foreign tourists traveling by air initially from 63 low-risk countries, including the United Kingdom, Singapore, Germany, the People's Republic of China (PRC), and the United States. The new rules, which started on 1 November 2021 and do not require travelers to quarantine (Appendix, Figure A6.1), are expected to draw foreign tourists to Thailand during the year-end holidays (high season). More COVID-19 restrictions were relaxed beginning 16 October 2021. The nighttime curfew was shortened from 6 hours to 4 hours. Travel between Bangkok and other high-risk provinces were able to resume normal operations, but social distancing measures must be applied. Businesses were encouraged to prepare for the reopening.

Interprovincial travel between high-risk provinces and other areas resumed in September 2021. To encourage domestic travel in the short term, the cabinet approved an extension of Phase 3 of the "We Travel Together" campaign, implementing it until February 2022. Under this campaign, the government will subsidize 40% of a traveler's hotel expenses, or up to B3,000 per room per night. Those who qualify will also receive food coupons of up to B600 per day. The government will also refund 40% of the price of an air ticket, or up to B2,000 or B3,000 under conditions set by each province. The cabinet also approved the "Tour Travel Thai" campaign in which the government contributes 40% of a tour package price, or up to B5,000 per person.

The Centre for Economic Situation Administration, which handles the country's economic and social rehabilitation from the pandemic, approved the establishment of a "Tourism Transformation Fund," which will subsidize projects that focus on high-value and sustainable tourism. Proceeds from the B500 tourism fee per person to be collected by the Ministry of Tourism and Sports starting in 2022 will go into the fund. Of the B500 fee, B200 will be earmarked for projects initiated by the private sector, community enterprises, or social enterprises that can help the tourism sector restructure away from mass tourism and toward a high-value or bio-, circular, and green economic model as well as environmentally concerned tourism. The fund aims to collect B5 billion in 2022 assuming 10 million foreign tourist arrivals.

V Opportunities and Challenges Ahead

Thailand has undergone a transition in three prominent areas that will determine tourism competitiveness going forward. The first area of transition is in **health and safety.** The TAT's Amazing Thailand Safety and Health Administration Certification Program was launched in 2020 to identify businesses—which include hotels, attractions, eateries, transport companies, and tour operators—that have passed official inspection for implementing all appropriate COVID-19 hygiene and quality-control methods. The certification will ensure that high-quality service standards that help prevent the spread of COVID-19 are met, which is expected to improve confidence among tourists. The second area of transition is in **digital platforms,** which includes digital payments via quick response (QR) codes such as PromptPay (an interbank mobile payment system which is now linked with DuitNow in Malaysia and PayNow in Singapore), other applications such as WeChat which provides contactless payment services, and several applications that can track and trace COVID-19 cases to help contain the spread of the virus. Improvements in **infrastructure and connectivity** is the third area of transition. Projects underway include a high-speed railway that will connect three of Thailand's major airports—Don Mueang, Suvarnabhumi, and Rayong U-Tapao; another high-speed railway that will connect five Thai provinces in the Eastern Economic Corridor investment zone; and an 873-kilometer-long high-speed railway that will connect Thailand and the PRC.

The pandemic could be an opportunity for Thailand to transform the entire tourism sector more sustainably, from mass tourism to high-end and low-density tourism, which would better align its development policies with its climate objectives and strengthen economic recovery and resilience. Before COVID-19 disrupted international travel, some of the country's popular beaches, islands, and other natural attractions were struggling to cope with large numbers of foreign tourists. As a result, the Thai authorities decided to temporarily close the national parks during the pandemic to allow the natural habitat to recover from the damage caused by mass tourism. The pandemic also gives authorities an opportunity to revise the natural conservation plan. Starting 2022, authorities plan to close the parks for several months each year to improve conservation of these areas.

It is also a good time to give domestic tourism a big push. The government has worked hard to promote and incentivize domestic travel for several years, especially as international travel to Thailand may not bounce back as fast as the government hopes. According to the Second National Tourism Plan (2017–2021), a Thai tourist makes 1.57 trips per year on average, which is significantly lower than Thailand's regional peers, such as the PRC (2.45 trips per year), Japan (2.33), Malaysia (2.22), and the Republic of Korea (2.02). The distribution of Thai domestic tourists is more spread out across different regions in the country compared to that of foreign tourists, partly because of family visits and because information on domestic tourist attractions is usually available in the Thai language. Various financial incentives and discounts offered by the government can help boost domestic tourism.

The tourism industry is also moving toward the use of digital platforms, and several policy responses have accelerated this transition. For example, the government developed the Thailand Pass, which is a web-based system that collects travel and health information from individuals who want to visit Thailand. Upon approval, travelers will receive a QR code which will allow them to enter the country. Travelers may also be required to scan a QR code at the entrance of a hotel, restaurant, or shopping center which provide these QR codes. If travelers are in close contact with any confirmed COVID-19 cases, they can be notified and offered recommendations such as to quarantine. This could help enhance health and hygiene standards in Thailand. Moreover, since digitalization is changing the way people live, work, and travel, it could open opportunities for businesses in the tourism industry to access new markets. Tourism businesses are using new technologies such as data analytics and revenue management software to enhance productivity and efficiency, as well as increase their capacity to develop new business models.

Finally, a new type of tourism called “workation” has emerged during the pandemic which allows workers to go on a trip while continuing to work online. Technology allows organizations to run online meetings with ease and provides the relevant online tools to maintain efficiency. With many employees around the world now working from home, workation is on the rise. This is an opportunity for businesses to provide travelers the option of staying in Thailand for a longer period, offering valuable amenities such as workspaces and high-speed internet connection to customers.

The country’s tourism strategy should seek a reputation for quality, value, and variety, to attract visitors and generate repeat visits. A focus on “yield” is an important aspect to maintain and enhance the country’s tourism competitiveness. Yield can be defined as sales revenues received per tourist in different market segments, or a financial rate of return for operators. Alternatively, yield can also include environmental and social value. An increased capacity for tourism stakeholders to develop policies to enhance destination competitiveness in the long term is the main element to take into consideration. Enhanced destination competitiveness can also be an outcome of planning initiatives, new product development, and marketing promotion strategies at both the macro level by authorities and the micro level by individual operators (Dwyer et al. 2006).

However, several challenges remain. If the number of new cases of COVID-19 reaches an unmanageable level, then it will be very difficult to boost domestic tourism and fully reopen the country to foreign tourists. The COVID-19 vaccine is also a critical factor determining the reopening of the country. Though it is not clear that the vaccine can stop the spread of the virus, it is effective in terms of limiting severe cases and prevent deaths. In addition, high private sector debt and limited access to financing for micro, small, and medium-sized enterprises (MSMEs) are important obstacles for businesses to increase investments in technologies or offer large discounts and promotional activities to attract visitors. This lack of financing could prevent a more inclusive recovery for MSMEs within the industry as tourists return to the country.

VI Policy Recommendations

A return to the pre-pandemic level of international tourist arrivals and spending is likely to take more than 2 years given that virus resurgence and travel trends are unpredictable. In the near term, flattening the curve of infection rates, and removing restrictions that prevent foreign tourists from coming to Thailand necessary to shore up economic activities and keep businesses in tourism-related sectors running. At the same time, public health management, hospitality, and medical services should be ready to ensure a safe and comfortable visit to the country. In the longer term, tourism sector reforms should take a stronger stance on sustainable tourism through policies that instill a sense of environmental consciousness and discourage tourists from overcrowding attractions and damaging the natural environment.

Short-term recommendations

(a) **Ensure a safe return of tourism.** Thailand should pay special attention to health and hygiene protocols, as tourists will now have high expectations from hospitality service providers. Wellness and medical tourism could be prioritized at the initial stage.

(b) **Support businesses to help them stay afloat.** Although authorities have continued to help businesses in the tourism industry that are struggling with liquidity due to delays in fully reopening the country to foreign visitors, authorities can also help these businesses seek new sources of financing, for example, by helping entrepreneurs explore crowdfunding or developing mechanisms to increase access to finance.

(c) **Bolster domestic and short-haul travel within the region.** Domestic and regional tourism are relatively easy to promote, and they can generate higher revenue than tourism from outside the country and region. Although spending per trip for domestic and regional trips tends to be lower, the volume can be larger. Marketing and promotion, financial incentives, and product development should be offered continuously to local travelers. Furthermore, because domestic travelers have better knowledge of the local sociocultural environment, they will tend to look for a variety of destinations and activities. Thus, products and services should be varied to meet their demand.

(d) **Promote intra-region tourism.** Increasing demand for travel closer to home can make intra-region tourism an important way to revive the industry. According to analytics company GlobalData, the growth of low-cost carriers and an open-skies agreement have made intra-ASEAN travel already more accessible. Tourists from Southeast Asian countries can easily travel within the region due to proximity, simple visa processes, and similar cultures. Furthermore, the ASEAN Travel Corridor Arrangement (ASEAN 2021) could facilitate essential business travel among ASEAN countries under strict public health protocols. Although travel corridor arrangement is intended for business travelers, this could be a good start for ASEAN to reap the full potential of intra-region tourism.

Medium- and long-term recommendations

(a) **Support green and digital transitions.** It is important to build greener tourism infrastructure across the value chain. This includes accommodations, event venues, transportation, and tourism activities. A community-based conservation initiative should be promoted to help preserve natural resources and the environment. Increasing digital connectivity and virtual promotional campaigns will help stimulate demand and gain access to a wider market.

(b) **Incorporate tourism in Thailand's national spatial development strategy.** With workation on the rise, there is an opportunity for Thailand to develop secondary destinations that may be overlooked by tourists. This would be a way to decentralize and decongest Bangkok and its surrounding areas.

(c) **Diversify tourism offerings around the country.** To counter overcrowding and promote secondary cities, authorities could look into upgrading transport links around the country, which would distribute the economic benefits of tourism across different regions of the country. Authorities should also have a concrete plan to shift the country's reputation away from being a budget destination toward a preferred destination for an affluent market. To accomplish this shift, Thailand will need to upgrade its products and services to serve high-income tourists' demand.

(d) **Encourage year-round tourism.** Thailand is a great year-round destination. More support for business tourism or MICE (meetings, incentives, conferences, and exhibitions) tourism could smooth travel seasonal patterns, because tourism businesses can generate year-round revenue from MICE tourists even during the low season. MICE tourists usually consider the convenience of acquiring a visa and entry, as well as the strength of venues. This would require incentives to attract more foreign direct investment to Thailand. Meanwhile, Thai businesses could also reach out to partners in other countries to seek further opportunities for MICE tourism.

References

ADB. 2021. *Asian Development Outlook (ADO) 2021 Update: Transforming Agriculture in Asia.* Manila.

Association of Southeast Asian Nations (ASEAN). 2021. ASEAN Declaration on an ASEAN Travel Corridor Arrangement Framework. https://asean.org/wp-content/uploads/2020/11/5-ASEAN-Declaration-on-an-ASEAN-Travel-Corridor-Arrangement_FINAL.pdf.

Bank of Thailand (BOT) and VISA. 2021. *Revitalising Thailand's Tourism Sector.* https://www.bot.or.th/Thai/MonetaryPolicy/EconomicConditions/AAA/250624_WhitepaperVISA.pdf.

Dwyer, Larry, Peter Forsyth, Liz Fredline, and Leo Jago. 2006. *Concepts of tourism yield and their measurement*. https://www.researchgate.net/publication/228803669_Concepts_of_tourism_yield_and_their_measurement.

Ministry of Tourism and Sports. 2017. *The Second National Tourism Development Plan.* https://secretary.mots.go.th/ewtadmin/ewt/policy/download/article/article_20171130140746.pdf.

_______. 2019. Tourism Statistics.

Office of the National Economic and Social Development Council (NESDC). 2021. Thailand Social's Outlook of Q2/2021. NESDC News.

Tourism Authority of Thailand (TAT). 2020. TAT–UNDP Team Up to Strengthen Sustainable Tourism in Thailand. Press release. 5 June. https://www.tatnews.org/2020/06/tat-undp-team-up-to-strengthen-sustai.

_______. 2021. TAT "SEXY" Concept Promotes Safe and Sustainable Travel in Thailand´s New Normal. Press release. 30 January. https://www.tatnews.org/2021/01/tat-sexy-concept-promotes-safe-and-sustainable-travel-in-thailands-new-normal/.

TAT Intelligence Center.2021. Tourism Situation Report. https://intelligencecenter.tat.or.th/

World Economic Forum. 2019. *The Travel & Tourism Competitiveness Report 2019.* https://www3.weforum.org/docs/WEF_TTCR_2019.pdf.

World Travel and Tourism Council. 2020. *Thailand 2020 Annual Research: Key Highlights* (accessed 7 October 2021).

Appendix

Figure A6.1: Quarantine-Free Entry Requirements from 1 November 2021

Source: Tourism Authority of Thailand (2021). https://www.tatnews.org/2021/10/quarantine-free-thailand-reopening-for-vaccinated-tourists-from-1-november-2021/.

Viet Nam:
Leveraging Digital Transformation to Power Post-Pandemic Economic Recovery

7

Viet Nam's economy has been hit hard by a fourth wave of COVID-19 infections, resulting in a sharp contraction in consumption, investments, and industrial production and an even greater impact on businesses and people's lives. As a result, Viet Nam's GDP expanded by only 2.6% in 2021. Nonetheless, the economy is expected to converge to its pre-pandemic growth rate of 6.5%–7.0% in 2022 and beyond, thanks to fast vaccination progress, sustained global economic recovery, and certain key drivers of economic growth which include the economy's digital transformation.

The country has already found initial success in developing a digital economy in the last 5 years, including improvements in its legal framework, digital infrastructure, information and communication technology (ICT) sector, digital platforms, and cybersecurity. It has also made significant advances in digital finance, catalyzed by increased use of digital payments during the pandemic, a young and technology-savvy population, and a boom in smartphone penetration. All three financial subsectors—banking, securities, and insurance—have successfully adopted new digital technologies in the last 5 years. With a strong commitment from the government and policy incentives and regulations in place for start-ups and emerging financial services, including a "sandbox regime" to test new products, Viet Nam's digital finance sector is expected to record unprecedented growth in 2021–2025 and beyond as it promotes non-cash payments, financial inclusion, and green finance.

ICT application at TH farm in Nghe An province (Photo by Tran Viet Tuan/ADB).

Note: This chapter was written by Nguyen Luu Thuc Phuong of ADB's Viet Nam Resident Mission (VRM) in Ha Noi and Luc Can, a VRM consultant.

I The Economy during the Pandemic

Despite the pandemic's complicated and unpredictable development, Viet Nam's GDP growth in 2020 was among the highest in the world at 2.9% year on year. In 2021, amid being severely affected by a fourth wave of COVID-19 infections, Viet Nam's economy still showed some positive signs: (i) vaccine administration accelerated, (ii) many policies and support packages were promulgated, (iii) industrial production recovered, (iv) trade growth continued its momentum, (v) inflation was at its lowest level in 6 years, (vi) foreign direct investment recovered, (vii) the exchange rate was stable, (viii) lending rates declined to support businesses, and (ix) the country's digital transformation made substantial progress.

Nevertheless, the economy still faces various challenges, including (i) a pandemic that remains complicated worldwide and nationwide; (ii) retail revenues that continue to decline, showing a weak and slowly recovering demand; (iii) unsustainable state budget revenues amid increased expenditure, resulting in a higher fiscal deficit; (iv) slow public investment disbursement; (v) several obstacles for businesses; and (vi) delayed economic restructuring and an increase in nonperforming loans.

Both the World Bank and ADB forecast that Viet Nam's economy will recover in the near-term. For 2022 and beyond, Viet Nam's economy is expected to grow by 6.5%–7.0%. This rebound will be supported by a more sustainable global economic recovery, a high vaccination rate in the country, and domestic drivers such as the economy's digital transformation.

In 2021, inflation for full year averaged at 1.8%, the lowest in 6 years, mainly due to weak demand. With a stronger economic recovery and domestic demand expected for 2022, inflation for 2022 is projected to be 3.8%.

A number of factors are expected to contribute to strong economic growth in Viet Nam: (i) the government's consistency and determination in improving institutions (including the digital institutional landscape), (ii) deeper international integration as shown by the country's participation in 16 bilateral and multilateral free trade agreements, (iii) a dynamic and engaged private sector, and (iv) the rise of the young and tech-savvy middle class which brings many opportunities for domestic consumer and labor markets in taking advantage of the country's digital transformation.

II Viet Nam's Digital Economy

Digital Transformation in 2016–2021

Viet Nam's National Strategy for Digital Transformation to 2025 and 2030 (Decision 749/QD-TTg 2020) prioritizes digital transformation as one of the main goals of Viet Nam's 2021–2030 National Development Strategy. Eight priority sectors were identified for digital transformation, which include finance, health, and education. While the lack of standard definitions and reliable statistics have made assessing the components and dimensions of Viet Nam's digital economy challenging, similar to most developing economies at an early stage of digitalization, Viet Nam has clearly been making significant progress in the past 5 years.

Some measures already show the outcome of the country's efforts to advance digitalization. According to the *e-Conomy SEA 2020* report by Google, Temasek, and Bain & Company (2020), and using a narrow definition of the digital economy that includes the ICT sector, ICT-producing sectors, and digital and platform-enabled products and services, the value of Viet Nam's digital economy is estimated at $21 billion, equivalent to 6.1% of Viet Nam's GDP in 2021, with a compound annual growth rate of 29% in 2016–2021, the fastest in ASEAN. Viet

Nam also ranks high in digitalization in four of the most popular global indexes: (i) *Fletcher School's Digital Intelligence Index* which classifies Viet Nam as a "breakout" economy with rapidly evolving digital advancements, along with Thailand, Indonesia, and Cambodia; (ii) *Cisco Global Digital Readiness Index* which placed Viet Nam in the "accelerate (high)" stage (middle stage of digital readiness), together with the People's Republic of China, India, Thailand, and Malaysia, and higher than the Philippines, Indonesia, Cambodia, and the Lao People's Democratic Republic; (iii) *Global Connectivity Index* where Viet Nam is in the "adopters" group, ranked 55th out of 79 countries globally and 5th in ASEAN, preceded by Singapore (2), Malaysia (34), Thailand (46), and Cambodia (54), but higher than Indonesia (58) and the Philippines (59); and (iv) *Digital Adoption Index* and the World Bank's *Connect, Harness, Innovate, and Protect* framework, which placed Viet Nam in the same group as Thailand and Indonesia and noted the country's good performance in connectivity and progress in the use of new digital tools.

(i) ***Legal framework.*** The Vietnamese government, industries, and local authorities have made several breakthroughs in developing a favorable legal framework for digital transformation. A number of policies and regulations, outlined in Table 7.1, provide a roadmap and targets on the development of a digital economy along with other economic and social goals. These policies aim to encourage start-ups, promote technology adoption in emerging sectors, measure the scope and components of the country's digital economy, and provide more protection for online consumers.

Table 7.1: Institutional Development of Viet Nam's Digital Economy, 2016–2021

Notable Incentive Policies and Regulations	Main Contents	Highlighted Targets
Resolution 52-NQ/TW (2019) Decision 749/QD-TTg (2020) Decision 2889/QD-TTg (2020)	Guide for proactive participation in the Fourth Industrial Revolution; roadmap and targets for national digital transformation by 2025–2030	To increase digital economy's contribution to gross domestic product to 25% by 2025 and 30% by 2030 To be a pioneer in testing new technologies and digital models
Decision 188/QD-TTg (2021) amending and supplementing Decision 844/QD-TTg (2016)	Initiatives for the start-up ecosystem in Viet Nam by 2025–2030	To cooperate with five most prestigious global start-up ecosystems To rank in top 15 start-up ecosystems in Asia and the Pacific
Decision 1726/QĐ-BTTTT (2020) Draft revised Law on Statistics (2021)	Issuance of Digital Transformation Index and filling the data gaps in digitalization	To better capture the scope and components of the digital economy
The Law on Supporting SMEs (2017) Decree 38/2018/ND-CP and Decree 31/2021/ND-CP Decree 13/2019/ND-CP and Decree 94/2020/ND-CP	Creating a favorable environment for small and medium-sized enterprises (SMEs), start ups, and investors (cutting administrative procedures, tax exemptions, land lease cost reduction, etc.)	To attract foreign direct investment and venture capital investment to develop SMEs and start-ups To realize specific targets of Decision 749/QD-TTg on Viet Nam's digital transformation
Decision 999/2019/QD-TTg Draft decree on sandbox regime for new business models	Promoting the sharing economy and technology adoption	To remove regulatory hurdles in emerging sectors including fintech and peer-to-peer lending To create a national data platform which can be shared among related parties
Coming revised Decree 52/2013/ND-CP	Providing a more comprehensive legal framework for e-commerce and more protection for shoppers	To enhance consumer trust Increase online shopping penetration rate to at least 55% by 2025

Source: ADB.

(ii) ***Digital infrastructure development***. The government has proven to be an effective builder of modern digital infrastructure. In its own operations, a rapidly developing e-government has significantly reduced the number of administrative procedures and increased the number of digital public services tenfold between February 2020 and April 2021. The government has also sought to promote SMEs and startups, for example, by simplifying administrative procedures and working on regional, national, and subnational initiatives such as ASEAN Startup, Viet Nam Innovation Partnership, Viet Nam National Innovation Centre, National Startup Support Centre of Viet Nam, Saigon Innovation Hub, and Speed-UP to connect Viet Nam's start-up ecosystem within the country and with the rest of the world. The country has relatively good internet connectivity. Compared to other ASEAN economies, Viet Nam is leading the way in launching "Fifth Generation (5G) technology". It also boasts the lowest internet access cost, third-largest number of internet users, second-highest mobile penetration, and second-fastest average mobile connectivity speed in the region. According to a study by Hootsuite and We Are Social (2021), Viet Nam's internet, social media, and mobile connection penetration rates are 70.3%, 73.7%, and 160.0%, respectively, which are higher than the global average.

(iii) ***Digital workforce and skills.*** According to the World Bank, Viet Nam's human capital index in 2020 is in the high human development category, ranking 48th out of 157 countries and second in ASEAN (behind Singapore). The share of trained workers in the country increased from 51.6% in 2015 to about 64.5% in 2020. With more than 50,000 information technology (IT) enterprises, 955,000 IT employees, and 80,000 IT graduates per year, Viet Nam has increasingly gained traction in technology investments and start-ups, moving the country from an IT outsourcing destination to one that can domestically produce technology products under its "Make in Vietnam" initiative. However, Viet Nam's workforce still lacks the necessary skills to fully harness the digital economy. Viet Nam needs to develop a high-quality talent pool and upgrade its workers' digital and soft skills to fully take advantage of digitalization opportunities.

In addition to the above efforts and outcomes, Viet Nam's impressive digital transformation in the past 5 years can be seen in the following developments:

(i) ***Strong growth momentum in the ICT sector.*** One of the leading industries in Viet Nam, the ICT sector (core digital economy) grew at a compound annual growth rate of 26.1% in 2016–2021. Notwithstanding the pandemic's impact on businesses and households, ICT revenue is forecasted to grow at 15%–16% in 2021, 2.5 times higher than GDP. The country's "Make in Vietnam" initiative is expected to encourage the discovery and export of high-technology products.

(ii) ***Expanding customer base in e-commerce.*** E-commerce market size was estimated at $13 billion or 3.4% of GDP in 2021, growing at a compound annual growth rate of 37.5%. Among ASEAN countries, Viet Nam had the highest online shopping penetration rate at 70.8% in the third quarter of 2021. Online shopping value per customer was $240 in the same period, 1.5 times higher than in 2015. Up to 60% of Vietnamese enterprises have developed international and domestic online business-to-customer and business-to-business platforms. Viet Nam's e-commerce revenue is estimated to retain its growth rate of 30% in 2021 and beyond thanks to a significant number of new digital consumers (8 million or 14% new digital consumers since the pandemic started, which is close to the ASEAN average of 16% and of which 55% comes from nonmetro areas). Of these new consumers, 99% intend to continue shopping online post-pandemic.

(iii) ***Increasing digital adoption and online platforms.*** According to the World Bank, the share of firms using digital platforms, e-commerce websites, online social media, and mobile specialized apps increased sharply to 73% in January 2021 from 48% in June 2020, and the number of firms investing in digital solutions more than quadrupled from 5% to 21% during the same period. Signs of growing digitalization can be seen in all sectors of the economy, from leading sectors such as ICT, e-commerce, and fintech to emerging technology sectors such as health and education. Viet Nam has two of ASEAN's 12 unicorn start-ups (companies valued at $1 billion or more)—VNG and VNPay—tech companies with diverse platform-enabled services and products such as online games, e-commerce, digital financial services, fintech, and other new technologies. Homegrown digital platform-based marketplaces such as Sendo and Tiki compete with regional players like Lazada and Shopee. Viet Nam's online media revenue in 2020 was $1.3 billion, double of what it was in 2016.

(iv) ***A booming fintech sector.*** Fintech refers to innovations in financial services driven by digital technologies, and the number of fintech start-ups in Viet Nam has quadrupled from 39 in 2015 to 154 in 2020, particularly in payments, peer-to-peer lending, blockchain, point-of-sales, and wealth management. The size of Viet Nam's fintech market was estimated at $8 billion in 2020, double of that in 2017. Financial institutions have accelerated their digitalization efforts by collaborating with fintech companies to modernize business activities, promote competitiveness, and contribute to Viet Nam's financial inclusion objectives (see Box 7.1 for a case study on Viet Nam's digital finance sector).

(v) ***Significant improvements in cyber-security.*** Viet Nam moved up 50 places in the International Telecommunication Union's 2020 Global Cybersecurity Index compared to its position in 2017, to reach 25th place out of 194 countries and fourth in ASEAN. This improved ranking places Viet Nam in the group of countries considered to have a high commitment to global and regional network safety and security. Viet Nam was also ranked second lowest in mobile malware threats in ASEAN, as mentioned in the same report.

Box 7.1: A Case Study on Viet Nam's Digital Finance Sector

The financial sector—which includes banking, securities, and insurance—contributes significantly to Viet Nam's economy, but it still has a number of shortcomings. First, many individuals do not have access to financial services. Viet Nam has about four bank branches per 100,000 adults (World Bank 2020), fewer than other countries in ASEAN such as Indonesia (15.2), Thailand (11.2), and Malaysia (9). While 70% of Vietnamese adults have a bank account, only half of them have access to credit services (State Bank of Vietnam [SBV] 2021). Second, financial institutions in Viet Nam still rely on physical documents in their operations. Physical documents are not only costly to store but paper-based operations create long processing times. Digital finance, currently a bright spot in Viet Nam's digital transformation, can be part of the solution.

Recent developments in the digital transformation of financial services

Legal landscape. Apart from identifying finance as a priority sector in the country's National Strategy for Digital Transformation (Decision 749/QĐ-TTg), other incentives to support digital finance have been put in place. These include providing credit information services (Decree No. 58/2021/ND-CP); allowing banks to use e-KYC (electronic know your client) for opening a current account (Circular 16/2020/TT-NHNN); and implementing a pilot program for mobile money service (Decision No.316/QD-TTg) and regulatory sandbox for fintech companies.

Infrastructure and environment. According to the SBV at the end of June 2021, 95% of commercial banks in Viet Nam have been building a digital transformation strategy, such as setting up a pure digital bank or digitalizing their business operations. Insurance and securities companies have also prioritized IT investments. The Ho Chi Minh City Stock Exchange's new securities trading system, which was built in cooperation with FPT, one of the Viet Nam's largest information and communication technology corporations, will improve transparency and investors' confidence. Cooperation between banks and fintech companies is a way for incumbent financial institutions to rapidly digitize, raise competitiveness, and meet the customers' demand for digital-first products and services. According to a PricewaterhouseCoopers 2019 survey, 72% of Viet Nam's fintech companies actively collaborated with banks and payment intermediaries to create new business models and provide a wide range of digital financial services such as mobile money, peer-to-peer (P2P) lending, e-KYC, blockchain, and digital payments.

Human resources and digital skills. To meet the demand for workers who are skilled in both technology and finance, the government has been putting more resources into education and training and creating more opportunities for financial institutions to attract talent and improve the quality of the workforce. Financial institutions also need to train their existing employees' soft skills such as critical thinking and problem-solving, communication, teamwork, creativity, and management, which are important for success in a rapidly changing digital economy.

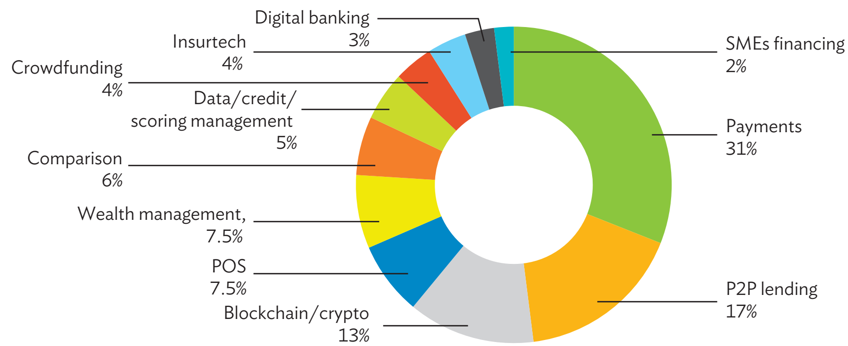
Digital financial products and services. More and more cashless products have been developed to allow for mobile, internet, and QR code payments. This includes mobile banking apps which can also be used for payments. In the future, banks will be able to personalize their services thanks to the development of artificial intelligence, data analytics, machine learning, Internet of Things, augmented reality/virtual reality, and blockchain. In the insurance sector, companies have introduced digitally enabled products for claims submissions, claims settlements, and insurance payments. For securities, online services have become more popular, from setting up an account, borrowing (margin loans), to consulting and advisory services. As of 2020, there were 123 fintech start-ups in Viet Nam compared to 430 in Singapore, 233 in Malaysia, and 322 in Indonesia. Fintechs in Viet Nam are concentrated in payments, P2P lending, and blockchain.

Financial inclusion through digital financial platforms. In recent years, the financial services industry has started several new initiatives that can help improve financial accessibility, particularly in rural and remote areas. These initiatives include ways to expand digital payments and new channels to deliver financial services. Currently, there are about 80 banks and private service providers that offer intermediary digital payment services through bank accounts, including electronic payment services, cash collection, e-money, and e-wallet. The government's mobile money pilot scheme should help consolidate this trend by targeting the country's unbanked customers. Thanks to rapidly expanding digital financial services, unbanked consumers' broad range of needs have gradually been addressed. P2P lending platforms, for example, can provide credit services, mobile banking apps, mobile money, and digital wallets without the presence of financial institutions.

continued on next page

Box 7.1 continued

Fintech in Viet Nam, 2020



P2P = peer-to-peer, POS = point of sale, SMEs = small and medium-sized enterprises.
Sources: fintechnews.sg, UOB, PwC 2021.

Digital finance outlook

Despite high rates of smartphone and internet use and significant progress in developing new digital products, the country still has some way to go in serving the country's large unbanked population. Low-quality connectivity and ICT infrastructure in rural and remote areas have also kept the benefits of digital financial services from reaching more people. But these challenges also present many opportunities, and Viet Nam's digital finance sector is expected to grow rapidly in the next decade as these challenges are addressed.

Various performance targets have been set for the banking sector, including 50% of digitally enabled banking operations by 2025 and 70% by 2030, 70% of banking transactions through digital channels by 2025 and 80% by 2030, and a 300% increase in mobile payments by 2025 (according to Backbase's latest forecast). For the insurance sector, companies are expected to use digital channels and participate in digital banking ecosystems with large banks. IT infrastructure projects, most notably the national insurance database, are being completed, which will facilitate ecosystem initiatives. For the securities sector, new generations of investors (Gen Y and Gen Z) will experience modern securities transaction systems that are expected to increase the current exchanges' capacity by 3.5 to 5.5 times. Finally, blockchain is seen as one of the key platforms for digital finance.

Prospects for the Digital Economy in the Next 10 Years

Strategies and roadmap. Keys targets for Viet Nam's digital economy through 2025 and 2030 as outlined in the National Strategy for Digital Transformation include (i) expanding 5G coverage nationwide; (ii) increasing the digital economy's contribution to GDP to 20% by 2025 and 30% by 2030; (iii) reaching the top 30 countries in the Global Innovation Index, ICT Development Index, Global Competitiveness Index, and Global Cybersecurity Index, and the top 50 countries in the E-Government Development Index; and (iv) increasing labor productivity by 8% per annum.

Opportunities. Viet Nam offers many opportunities to further develop its digital economy, including (i) government support and a clear strategy and determination to pursue digital transformation; (ii) availability of resources such as affordable high-speed internet and a young, tech-savvy population; (iii) cross cutting digital policies and regulations such as a regulatory sandbox regime and more effective support programs for start-ups; (iv) various priorities for the digitalization of the ICT sector, e-commerce, digital financial services, and digital payments; and (v) prospective financial customers due to a large unbanked population.

Challenges. Despite impressive results, various obstacles associated with digitalization remain such as: (i) low level of digital transformation awareness and low digitization readiness compared to other ASEAN members, (ii) incomplete and inconsistent legal framework, (iii) inadequate digital infrastructure, (iv) insufficient digital skills (from basic computer use to advanced skills), (v) underdeveloped innovation ecosystems, and (vi) complicated cybersecurity and privacy risks.

Role of various key stakeholders. The government has a crucial and direct role to set the overall policy and regulatory framework for regulating and facilitating digital transformation. In addition, the relevant ministries, agencies, and localities must work together to improve the legal framework for digitalization, create a favorable environment for innovation, provide financial support for digital upskilling and nurturing start-ups, and capitalize on international cooperation in digitalization. The Vietnam National Innovation Center serves as a key engine for catalyzing innovation and supporting the start-up ecosystem and digital economy. Other key players are firms and financial institutions which apply and commercialize the new technologies.

Digital transformation's contribution to GDP. Table 7.2 presents three different scenarios on how the digital economy can contribute to GDP growth in the next decade.

In the first scenario, the analysis assumes that the ICT sector's spillover effect to other economic sectors is minimal, and digitally applied economic activities, products, and services increase slowly. This slow digital transformation generates the digital economy's lowest contribution to GDP growth at 0.38–0.4 percentage points (pp) by 2025 and 0.53–0.60 pp by 2030. A more robust digital growth in the second scenario assumes a strong ICT sector that will significantly speed up Viet Nam's digital transformation of all economic and social activities; 4G and 5G coverage nationwide; and smart-banking account penetration of 50%–55%. In this scenario, the analysis estimates a higher contribution to GDP growth of 1.15–1.35 pp by 2030.

The third scenario assumes the most advanced level of technology diffusion, adoption, and adaptation; 5G coverage nationwide; and a smart-banking account penetration rate of over 80%. This advanced digital economy is estimated to contribute 1.65–1.85 pp to GDP growth by 2030. In addition, under this scenario, the analysis expects that the ratio of research and development investments to GDP will reach the ASEAN average of 1.8%–2.0% by 2025–2030; labor productivity will grow by 8.5%–10.0% per annum; the number of digital technology enterprises will reach 100,000 by 2030; and e-payment and e-commerce will increase by a compound annual growth rate of 35%–40% in 2021–2030. A close collaboration

Table 7.2: Digital Transformation Scenarios, 2025–2030

	Contribution of digital economy to GDP growth by 2025 (pp)	Contribution of digital economy to GDP growth by 2030 (pp)	Contribution of TFP to GDP (%)	Annual labor productivity growth rate, 2021–2030 (%)	ICOR
Scenario 1 (Slow digital transformation)	0.38–0.40	0.53–0.60	44–45	5.8–6.0	6.1–6.2
Scenario 2 (Robust digital transformation)	0.63–0.85	1.15–1.35	45–48	6.5–7.5	5.2–5.4
Scenario 3 (Advanced digital economy)	1.20–1.35	1.65–1.85	52–55	8.5–10	4.0–4.5

GDP = gross domestic product, ICOR = incremental capital–output ratio, pp = percentage points, TFP = total factor productivity.
Source: ADB forecasts (October 2021).

with all stakeholders will help Viet Nam realize these outcomes. Resources from the private sector (high-tech start-ups, investment funds, and venture capital firms); securities markets; foreign direct investment; and funding from international donors such as ADB and other development partners, are also important.

III Recommendations for Further Digital Transformation

To help Viet Nam achieve the goals presented in the National Strategy for Digital Transformation and narrow the gap with other ASEAN digital economies, Viet Nam needs to:

(i) **Establish a national committee for digital transformation to better coordinate various stakeholders.** The committee should be chaired by Viet Nam's Prime Minister and represented by leaders from the Ministry of Information and Communication, Ministry of Finance, Ministry of Planning and Investment, State Bank of Vietnam, Ministry of Industry and Trade, Office of the Government/Digital Services, and possibly some local leaders.

(ii) **Build a complete regulatory framework for a digital economy that includes a sandbox regime for fintech, P2P lending, and new digital business models**. This would involve revising Decree 52/2013/ND-CP for e-commerce and revising the Law on Statistics to better capture the scope and components of a digital economy.

(iii) **Create a more favorable environment for innovative activities.** This would include expanding the role of the National Innovation Center in supporting innovation, start-up ecosystems, and the digital economy; providing more information for start-ups, SMEs, and venture capital funds; and facilitating the integration of start-ups into the supply chain (i.e., linking with large and medium-sized corporations and technology transfers)

(iv) **Upgrade digital infrastructure.** This can be accomplished by improving the quality and speed of IT and internet connectivity, especially in rural and remote areas; expanding 5G mobile networks; and creating a data platform which can be shared among related parties and enterprises.

(v) **Improve digital skills and build a highly qualified labor force.** More resources are needed for education and training (i.e., technical and vocational education and training, on-the-job IT training, and English and soft skills training courses) and expanding the talent pool (i.e., IT scholarship programs and attracting digital talents around the world). The country also needs to actively participate in both international and regional cooperation and initiatives to build a highly qualified labor force.

(vi) **Promote data privacy and cybersecurity.** The Decree on Personal Data Protection should be issued soon. Moreover, the government should consider establishing a cybersecurity standard and cyber-insurance market for both the public and private sectors. It should also cooperate with ASEAN to build a data management framework to improve privacy protection and facilitate digital cross-border data flows and data localization.

(vii) **Boost digital finance.** This can be accomplished by creating a more favorable legal environment for digital finance transformation, building a comprehensive and extensive financial education strategy until 2030, providing education on digital financial skills and knowledge for individuals and businesses, and promoting digital payments to reduce cash payments and improve financial inclusion, especially of the unbanked.

(viii) **Leverage public—private partnerships in digital transformation.** Conducting a successful and sustainable large-scale digital transformation requires a partnership between public and private organizations, not only in terms of investment financing, but also collaborating to adopt new technologies and services. This partnership will require a number of measures to determine the areas of responsibility of the state and of private organizations in implementing digital state programs, as well as establishing the ultimate beneficiary of digital management models. As such, an enabling legal framework on public—private partnership and a clear roadmap for implementing the country's national digital transformation strategy would be of utmost importance.

References

AlphaBeta. 2021. *Unlock Viet Nam's Digital Potential: Harnessing the Economic Opportunities of the Digital Transformation with Google's Contribution.*

Australia Aid, Csiro, and Data 61. 2019. *Viet Nam's Future Digital Economy towards 2030 & 2045.*

Backbase. 2021. *Fintech and Digital Banking 2025 Asia Pacific—Second Edition.* Singapore.

Cisco Systems, Inc. 2019. *Cisco Global Digital Readiness Index 2019.*

DoVenture. 2021. *Viet Nam Innovation & Tech Investment Report 2020.* https://doventures.vc/en/insights/news/Viet Nam-innovation-and-tech-investment-report-2020-out-now.

Fintechnews. 2020. *Viet Nam Fintech Report.* https://fintechnews.sg/45354/Viet Nam/2020-fintech-Viet Nam-report-and-startup-map/.

Findexable. 2021. Global Fintech Rankings Report: Bridging the Gap. https://findexable.com/2021-fintech-rankings/.

Google, Temasek, and Bain & Company. 2020. *e-Conomy SEA 2020.* https://www.bain.com/insights/e-conomy-sea-2020/.

_______. 2021. *e-Conomy SEA 2021.* https://www.bain.com/insights/e-conomy-sea-2021/.

Hootsuite and We Are Social. 2021. *Digital 2021: Viet Nam*. https://datareportal.com/reports/digital-2021-Viet Nam. 11 February.

Huawei. 2020. Global Connectivity Index (GCI) Report and Methodology: Vietnam Country Profile. https://www.huawei.com/minisite/gci/en/country-profile-vn.html.

International Telecommunication Union.2020. Global Cybersecurity Index 2020: Measuring commitment to cybersecurity. https://www.itu.int/epublications/publication/D-STR-GCI.01-2021-HTM-E/

Merchant Machine. 2021. The Countries Most Reliant on Cash. https://merchantmachine.co.uk/most-reliant-on-cash/.

McKinsey & Company. 2021. *Emerging Markets Leap Forward in Digital Banking Innovation and Adoption.* https://www.mckinsey.com/industries/financial-services/our-insights/emerging-markets-leap-forward-in-digital-banking-innovation-and-adoption.

PricewaterhouseCoopers (PwC). 2019. *Global Fintech Survey.* https://www.pwc.com/sk/en/current-press-releases/pwc-global-fintech-report-2019.html.

State Bank of Vietnam (SBV). 2019. *Viet Nam Fintech Ecosystem Report.*

_______. 2021. *SBV Annual Report 2020.*

The Fletcher School at Tufts University. 2020. *Digital in the Time of Covid–Trust in the Digital Economy and Its Evolution Across 90 Economies as the Planet Paused for a Pandemic.*

United Overseas Bank (UOB), PricewaterhouseCoopers (PwC), and Singapore Fintech Association (SFA). 2021. *Fintech in ASEAN 2021: Digital Takes Flight.* https://www.uobgroup.com/techecosystem/news-insights-fintech-in-asean-2021.html.

World Bank. 2016. *Digital Adoption Index (DAI): Measuring the Global Spread of Digital Technologies.*

_______. 2021. *Digital Viet Nam: The Path to Tomorrow,* Taking Stock. August 2021.

World Bank International Development Association (IDA). 2020. https://data.worldbank.org/indicator/.

Timor-Leste:
Addressing Public Financial Management Challenges for Pandemic Recovery

8

Government spending financed through the Petroleum Fund—the country's sovereign wealth fund—has been the main driver of economic growth in Timor-Leste. Since the country's independence in 2000, rapid growth during 2007–2013 was driven by high levels of government capital investments. However, output growth was negative for 3 of the past 5 years due to a phase of political flux. Delays in budget approvals constrained public spending causing the GDP to contract. The emergence of the COVID-19 pandemic in 2020 and the ensuing lockdown, along with the global economic slowdown, further exacerbated the economic situation, and growth was −8.6% in 2020 and an estimated 1.8% in 2021. The Petroleum Fund provided a fiscal buffer which allowed the government to respond to the short-term socioeconomic impact of the pandemic without significantly reducing expenditure or increasing the debt ratio. However, the effects of the pandemic on the country's fiscal situation will be felt in the medium to long term. Reforms in public financial management (PFM) are critical for the sustainability of the Petroleum Fund and the country's future.

Food distribution program. ADB 's $1 million grant approved in June 2020, to support the Government of Timor-Leste's COVID-19 response, included food assistance to vulnerable households. This helped launch the Government's Cesta Basica or basic food basket program.

Note: This chapter was written by Kavita Iyengar of ADB's Timor-Leste Resident Mission in Dili and Claire Potdevin, Consultant.

I Economic Background

Timor-Leste is an oil and gas producer. Oil revenues from royalties and taxes are placed in the Petroleum Fund. In the past decade, the economy has been dominated by offshore petroleum production and government spending, which have allowed it to make significant strides in the development of critical road and electricity infrastructure and basic services. GDP growth peaked at 11.3% in 2008.[1] It was in this optimistic scenario that Timor-Leste's Strategic Development Plan 2011–2030 was developed in 2010 with the goal of achieving upper middle-income status by 2030. However, growth declined over the next decade, averaging 4.9% per year in 2010–2016. Delays in budget approvals contributed to the economy contracting by 4.1% in 2017 and 1.1% in 2018 and growing by a mere 1.8% in 2019.

The global pandemic compounded these problems, bringing GDP down to −8.6% in 2020. Although the government responded swiftly to the health crisis, an economy that was already weighed down by the rejection of the 2020 state budget also had to contend with lockdowns and international border closures that caused business activities to cease, which impacted both the formal and informal private sector and led to a drastic fall in household incomes, particularly for the most vulnerable. In 2021, a rise in cases that led to strict lockdowns and sanitary fences around most municipalities, as well as the devastating impact of cyclone Seroja, put additional pressure on the country. Growth was modest at an estimated 1.8% in 2021 despite the government's recovery measures.

Timor-Leste has seen limited progress in the development of a sustainable and productive non-oil economy, and a large share of formal business activities such as transport and construction originate from public spending, which contributed one-third of GDP in 2020.[2] That same year, oil exports represented 93.6% of total goods exports.[3] Non-oil exports of goods and services represented only 1.2% of oil GDP. The only sector that has seen significant progress over the past decade is public administration, while other sectors such as services and agriculture as share of non-oil GDP have remained stagnant, despite additional workers entering those sectors (Table 8.1). Factor productivity is lower than in other countries in Southeast Asia, especially agricultural productivity, reflecting the challenge that Timor-Leste faces in modernizing agriculture and developing new industries such as manufacturing and tourism. The share of goods and services exports in GDP excluding oil and

Table 8.1: Contribution to GDP and Share of Employment by Sector

	Value added to GDP (%)		**Share of Employment** (%)	
	2010	**2020**	**2010**	**2016** (latest)
Agriculture	14.1	18.4	51.2	31.6
Industry	5.0	12.6	8.9	17.5
Services	38.1	65.8	39.5	50.2
Of which: Public administration, defense, education, human health, and social work activities	10.8	29.6	9.8	18.2
Not specified		–	–	0.7

GDP = gross domestic product.
Note: Value added to non-oil GDP excludes extraction of crude petroleum and natural gas.
Source: Department General of Statistics (National Accounts) and ILO (Timor-Leste Labour Force Survey 2010 – 2013 – 2016).

[1] GDP refers to the domestic economy excluding production activity in areas of joint sovereignty, such as the Joint Petroleum Development Area.
[2] Department of Statistics. 2021. *Timor-Leste National Account 2000–2020*. Dili.
[3] Department of Statistics. 2021. *External Trade Statistics 2020*. Dili.

gas exports is among the lowest in the world.[4] Formal employment rates are low at 31% of the working-age population. Youth unemployment is high and the proportion of those not in education nor in employment or training is 21%, much higher than the regional average. This highlights the lack of opportunities for young people entering the labor market. Thus, the overall challenge is how to diversify the economy to create more employment.

II Fiscal Policy and Public Financial Management in Timor-Leste

Timor-Leste has a unique fiscal system because of the Petroleum Fund, which is managed by the Central Bank of Timor-Leste and mostly invested in high-quality international bonds and equities. The estimated sustainable income (ESI), computed as 3% of estimated petroleum wealth, is the annual estimate of the maximum withdrawal that can be sustained without depleting the fund. The Petroleum Fund provides a large fiscal space and has financed ambitious capital investments in 2015–2019, with fund withdrawals financing about 73% of the state budgets. However, in the same period, cumulative withdrawals from the fund exceeded the ESI by 103%. Such large levels of public spending, which require large withdrawals from the fund, pose high risks to the fund's sustainability.

Though investment revenues have been high in recent years, oil tax revenues and royalties have been falling, with the current oil fields expected to be depleted by 2023. COVID-19 has impacted the development of the Greater Sunrise Joint Venture—a new oil reserve—with major oil companies announcing large cuts in their capital investment in 2020. The performance of the Petroleum Fund's investment portfolio in 2020–2021 has allowed it to reach an all-time high of $19.7 billion in August 2021, but it is also financing the second-highest state budget of Timor-Leste's history at $1.9 billion (pre-supplementary budget) for 2021 to finance the pandemic recovery. The fiscal situation has become more precarious because of large withdrawals from the Petroleum Fund to support the emergency response to the pandemic.

Fiscal Impact of the Country's Response to the COVID-19 Crisis

Timor-Leste was swift to react to the pandemic. A state of emergency was declared in late March 2020, less than a week after the first case was detected in the country, and an Integrated Crisis Management Center was established to lead the COVID-19 health response. With support from development partners, the government established isolation and quarantine facilities along with a local surveillance system. In-country testing facilities were established by June 2020 (Fiertz 2021). The government also carried out a series of measures such as cash transfers and food and in-kind distribution to vulnerable households, water and electricity fee waivers, tax payment deferrals, and salary subsidies to the private sector.

To fund these efforts, the government led several PFM-related interventions. A special extra-budgetary COVID-19 fund, presided over by a ministerial committee and supported by a technical secretariat, was established by decree-law.[5] The special fund offered a way of pooling different sources of funds—public and aid flows—and enabled acceleration of the fund's disbursement by relaxing rules applicable to the central budget, which was valuable for the emergency response. Timor-Leste's COVID-19 fund provided an example of good PFM practice, although countries are often warned against creating special extra-budgetary funds which follow less rigorous rules than the central budget in terms of planning and budgeting, reporting, and auditing. The COVID-19 fund was almost entirely funded through emergency withdrawals

[4] World Bank Data. https://data.worldbank.org/indicator/NE.EXP.GNFS.ZS (accessed 2 September 2021).
[5] Other countries with COVID-19-related extra-budgetary funds include Nepal, Malaysia, and Sri Lanka.

from the Petroleum Fund, approved by the Parliament. Timor-Leste also adjusted its integrated financial management information system to enable integrated reporting for expenditures related to COVID-19 (ADB 2021). No expense was operated until procurement plans were approved by the Ministry of Finance and detailed budget executions were published regularly on the ministry's website.

The use of supplementary reserves, contingency funds, or reappropriations from other budget categories would have preserved the Petroleum Fund's reserves, but these measures were not available without the 2020 state budget. Development partners did not finance the COVID-19 fund but used their own disbursement channels. This highlights both the difficulty faced by development partners to align with the principles of the Paris Declaration and Timor-Leste to present a PFM system that is considered efficient and transparent enough to allow emergency disbursements. On the other hand, for the supplementary budget adopted in 2021, the government chose to use the unspent balance from 2020 and to reappropriate funds from the capital expenditure category to increase allocations to the contingency funds. When applying cuts to capital expenditures, experts recommend not to reallocate funds from ongoing projects or maintenance funds, to limit the risk of sunk costs and a long-term impact on the sustainability of public infrastructure (IMF 2020). The government reappropriated spending from capital-intensive projects that have not yet started, and which will be postponed to the recovery phase.

III Challenges to Public Financial Management

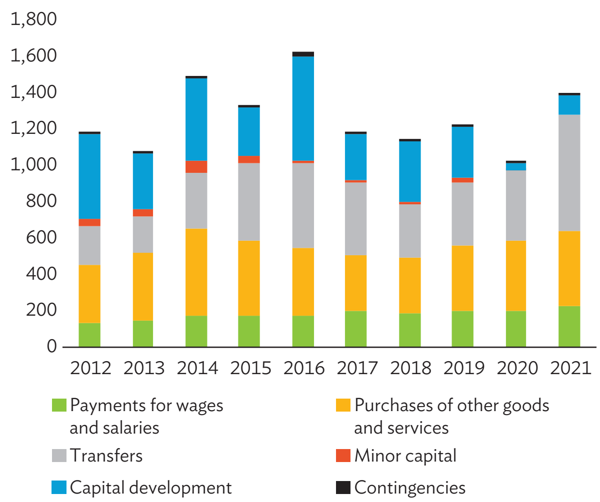
Timor-Leste falls in the category of small island developing states and fragile and conflict-affected situations, and it experiences the typical challenges of such countries which includes geographic isolation, a small population, a narrow economic market, governance issues, and the need for capacity building in the public sector. These specificities call for context-sensitive interventions and "best practices" that may apply to the country's situation. As a resource-rich country, the case of Timor-Leste is also unique because of its currently available large fiscal reserve, which in the short term provided a buffer and protected it from the type of budget pressure that most developing countries faced during the COVID-19 pandemic. While Timor-Leste could resort to emergency withdrawals from the Petroleum Fund, its reliance on the fund highlights the urgency of reforms as well as Timor-Leste's current challenges with public financial management:

Sustainability of Public Expenditure

Public expenditure levels in Timor-Leste are among the highest in the world, averaging 86% of GDP during 2008–2020 (Figure 8.1). The government has used the Petroleum Fund to engage in a series of large capital investments and establish substantial social transfers programs since 2008. During unexpected emergencies, as in 2020–2021, the government provided wide-ranging health and socioeconomic policy responses to vulnerable households financed through emergency withdrawals from the Petroleum Fund. Despite designs to ensure the durability of the fund, such as the establishment of a fiscal rule defining annually the amount that can be sustainably withdrawn from the fund, the government's annual "extraordinary" withdrawals have become normalized. Bringing public spending back to sustainable levels is urgently needed and can be managed by slowing down large capital investments.

In addition, there needs to be focus on improving the quality of expenditures. Line ministries struggle with low execution rates caused by budgeting and planning issues and bottlenecks during budget execution. The quality of service delivery is generally considered low, including in health, water and sanitation, and education (World Bank 2015a) (Box 8.1).

Figure 8.1: Budget Expenditure by Item
($ million)



Source: Budget Transparency Portal.

Efforts to improve budget prioritization and increase budgeting efficiency to improve service delivery include creating autonomous agencies and introducing a program structure. However, implementation of these efforts is still at an early stage and has not had a meaningful impact on the quality of service delivery (World Bank 2020). On the capital side, studies have raised concerns regarding the efficiency and effectiveness of public spending (World Bank 2015b). Crucial investments are needed in human capital sectors, including education, health, and water and sanitation, as well as infrastructure maintenance.

Box 8.1: Public Financial Management and Basic Service Delivery in Education and Health in Timor-Leste

A well-performing public financial management (PFM) system is seen as a necessary but insufficient condition for quality service delivery in education and health, such as ensuring timely payment of salaries to teachers and nurses, regular and predictable maintenance funding for schools and hospitals, and good quality audit functions to ensure transparent use of social protection funds. Political and capacity factors also influence outcomes, and this requires identifying country-specific challenges (Rao 2013).

Social services in Timor-Leste face challenges for effective targeting and delivery. In spite of clear progress on several social indicators such as life expectancy and years of schooling, the quality of basic services in Timor-Leste remains inadequate. Budget allocations to social sectors as a share of gross domestic product are relatively high at approximately 30% toward social solidarity, education, and health (World Bank 2020). However, there was limited progress in early-grade reading assessment between 2009 and 2017 (World Bank 2019) and in access and quality of basic health services.

Timor-Leste has made noteworthy progress in some PFM issues related to health and education, but gaps need to be addressed. The education and health ministers have established management information systems which track valuable data to inform budget prioritization, though these systems are currently underused. The development of a costed plan for the education sector is likely to improve strategic spending and predictability. Linking the personal information management system and the government's financial management system is likely to have improved payroll payments. However, persistent gaps in PFM systems in both ministries are likely to adversely impact service delivery (World Bank 2021). These include delays in procurement, especially for capital expenditure, which slow down delivery of services. Recent decentralization of some health and education service responsibilities to municipalities is adding a new level of complexity. Execution rates are lower at the municipal level than at the national level, highlighting capacity gaps and potential delays in the allocation and disbursement of funds.

Sector diagnostic analyses are needed to prepare clear action plans. Government has conducted very limited assessments of sector efficiency and effectiveness (World Bank 2020). Identifying bottlenecks is essential to improve spending efficiency. For example, the average rate of budget execution for the Ministry of Health in 2016–2020 was 94%. Unreliable funding flows to health centers and inefficiencies in the procurement of drugs often occur in low- and middle-income countries (International Monetary Fund 2021). Budget execution bottlenecks need to be identified at the ministry levels to improve costings of programs through a series of sector studies, and to provide a new base for a better-informed annual budget process, which will facilitate the transition toward quality multiyear budgeting.

Mobilizing of Domestic Revenues

The presence of oil revenues provides Timor-Leste with a large fiscal reserve, but reforms for a sustainable fiscal framework need to be initiated. Increasing the share of domestic revenues has become increasingly urgent. Low domestic revenues are linked to a limited tax base due to a large proportion of the population living close to or under the poverty line, and an underdeveloped private sector. In the medium term, acceleration of economic activity provides the opportunity to increase revenues. However, in the short term, increasing the rate of tax collection and formalizing the limited—but growing—private sector, which still largely operates informally, can potentially increase revenues. Significant progress was made in the last 2 years particularly with upgrading both the customs and tax revenue systems, which will improve the collection of payments and tracking of arrears and facilitate payments through the internet and ATM. However, much remains to be done to improve the efficiency of revenue collection, starting with a review of the legal system and improving revenue administrations' tax enforcement capacity, which is currently constrained by limited human resources (World Bank 2020).

Enhancing Public Financial Management Framework

Over the past 2 decades, Timor-Leste has managed to establish basic systems for PFM, procurement, and anticorruption. The country's PFM system is increasingly being strengthened. Milestones achieved in the last decade include creating a Treasury Single Account, decentralizing budget and procurement functions to all line ministries and municipalities, and increasing the role of the external audit body. More recently, an ambitious budget reform has been initiated which introduced the basis for program budgeting and more rigorous annual planning activities. The financial management and information system was rolled out to all line ministries and municipalities, and the procurement and planning modules have been expanded. A new PFM law adopted in July 2021 by the Parliament introduced a new framework for medium-term planning and budgeting, including a new "Law of Major Planning Options," to be approved by Parliament at the beginning of each year, which would provide multiyear financial programming through binding budget ceilings for the fiscal year and indicative projections for the following 4 years. The law is expected to reinforce the strategic planning phase, strengthen accountability arrangements, and ensure coherence with the entire budget management cycle.[6]

However, major gaps in basic PFM functions remain. The 2020 Public Expenditure and Financial Accountability assessment highlighted significant weaknesses in the areas of assets and liabilities management, internal audit, and the implementation of policy-based fiscal strategy and budgeting. Revenue forecasts lack accuracy and budget execution rates are low particularly for capital expenditure, reflecting limited capacity for accurate budgeting and public investment management (World Bank 2020). Given that improving revenue mobilization and increasing efficiency of public sector spending are two of the most urgent issues for Timor-Leste in the coming years, addressing these limitations will be key to building a more sustainable fiscal model.

Other Challenges Highlighted by the Pandemic

The pandemic exposed several weaknesses in Timor-Leste's PFM system. While the COVID-19 fund was an example of transparent financial management, there were delays in setting it up and disbursing the funds. A key element of successful crisis management is the provision of timely assistance to frontline health services and social sectors using budgetary frameworks that are already in place. The creation of the COVID-19 fund was announced in March 2020

6 As of August 2021, different amendments to the Budget Framework Law were still under deliberation in Parliament.

but became effective by law in mid-April and started disbursing in May. Such delays could be avoided if the government used existing budget systems. The absence of strong internal controls and audit mechanisms risk limiting the extent of financial inclusion in emergency response activities by the government. The pandemic also highlighted the lack of updated data on poverty and vulnerable populations, causing difficulties in implementing cash transfers. An efficient PFM system should enable good service delivery and requires information and communication technology (ICT) systems and data such as on national IDs to allow proper tracking of individuals, activities, and results.

IV Going Forward: Addressing the Challenges

Establishing a sound PFM framework is a necessary condition for Timor-Leste to achieve its objective of economic diversification and sustainable growth. As petroleum resources decline and petroleum revenues dwindle, the efficiency and quality of public expenditure needs to be addressed. To make informed decisions, the government needs relevant financial information regarding risks, debts, and deficits along with a system to manage, monitor, and report expenditure and revenue in an efficient and transparent manner. This alone can bring about macroeconomic stability (Welham, Krause, and Hedger 2013).

Strengthening PFM will also accelerate efforts to recover from the current crisis and help respond to future shocks. Dealing with any crisis necessitates improvements in accurate budgeting, efficient tracking, timely management of budget execution, and strengthening audit to prevent mismanagement of funds. Further, to achieve the objectives of the government's economic recovery plan, the country needs to address several issues such as the capacity of public servants; ICT development; weaknesses in the procurement system; regulatory gaps; and reducing bottlenecks in service delivery, especially in education and health.

The pandemic presented the country with an opportunity to test its PFM system in the face of a crisis. There is a need to now focus again on fiscal and public expenditure measures and implementation of structural reforms that had been initiated in past years. The successive lockdowns in 2020 and 2021 made it difficult to hold necessary consultations on the reform process, including parliamentary discussions on draft laws and implementation of training programs to civil servants.

However, the pandemic also highlighted the necessity of PFM reforms and triggered many discussions, especially on the implementation of tax reforms (Gupta and Jalles 2021). In addition, the recovery efforts the government has committed to has opened a window of opportunity for interventions. The short-term interventions have played a role in improving the PFM system, for instance, by identifying financing and budget execution issues that can lead to service delivery bottlenecks in the health sector. Improving the government's emergency response to the crisis is also helping inform future PFM reforms (International Federation of Accountants 2021). The pandemic accelerated the registration of businesses in the formal sector in Timor-Leste, which will help in assessing domestic revenue mobilization. The preparation of longer-term recovery measures is also taking a more strategic approach by identifying where public spending is most needed, as a basis for future budgeting (ADB 2021). Ongoing discussions regarding passing key PFM and tax laws are indicative of the government's intention to include key elements of PFM reform in its recovery efforts.

Regardless of how economic recovery from the pandemic shapes PFM reforms, a number of essential elements are needed to ensure good results:

Address basic PFM gaps first

Understanding the impediments and delays in previous attempts at reforms is an essential first step. PFM literature highlights the importance of establishing solid foundations before moving to more complex types of reforms, in particular by focusing on the establishment of good fiscal control and a certain efficiency in high-level budget allocation, before moving toward operation and services efficiency (Welham and Hadley 2015). Timor-Leste made noteworthy progress in the reinforcement of several basic but essential PFM functions. This includes strengthening core treasury systems with the establishment of a Treasury Single Account, and increasingly effective accounting and reporting through regular financial reports, which offer a fairly accurate and transparent picture of the government's financial position.

However, budget credibility is a central issue that needs strengthening, specifically with respect to revenue forecasts and systemically low budget execution rates. While the initiative of the government to accelerate the development of a multiyear, program-based budgeting system can improve the quality of the budget in the medium term, the government also needs to increase its attention to basic annual forecasting and improve its capacity to produce accurate fiscal targets. The government must first ensure the preparation of budgets with accurate expenditure and revenue estimates, without which establishing a medium-term expenditure framework will yield unrealistic budget estimates.

Sequence and prioritize reforms

A coherent PFM roadmap needs to be developed and implemented in a sequential manner. A large number of ambitious reforms were initiated by the government but were highly fragmented, and efforts by different donor agencies were uncoordinated. There are issues of overlapping mandates, siloed initiatives, and lack of coordination, for instance, with responsibilities related to medium-term planning and budgeting between the Ministry of Finance and the Prime Minister's Office of Planning, Monitoring, and Evaluation, or between the Inspector General of the State and the Internal Audit Office. Clarifying the objectives and the sequencing of reforms with coordinated support from donors is a first step for implementation of PFM reforms. Additionally, adapting the reform plan specifically to Timor-Leste is more likely to give fruitful results rather than applying a model with best international practices when core PFM functions are not fully in place. For example, the rapid implementation of an accrual-accounting reform which was planned in 2017 may have been premature and challenging in the current context, and strengthening the current cash-based system in the short term appears sufficient for the country's needs.

Several development partners are supporting the government in developing a PFM reform sequencing plan based on the conclusions of the 2020 Public Expenditure and Financial Accountability report and the recent progress on the Organisation for Economic Co-operation and Development's Budget Reform roadmap. While the fragilities of the system are known, the challenge is in developing a tangible roadmap. The progression of reforms needs to be ambitious but also realistic, at a pace and scale matching the country's ability to carry out these reforms. A gradual and phased approach with clear short- and medium-term prioritization and an initially defined fixed resource constraint is more likely to provide positive outcomes.

Improve domestic revenue collection

The government has taken needed steps toward improving revenue collection, such as establishing autonomous tax and customs agencies, upgrading the tax management system, and opening an online tax payment platform. More recently, the government announced it would accelerate the adoption of the pending value-added tax law and the Fees and Charges Law. Improving tax compliance requires long-term policies with the government conducting appropriate control and behavioral change among taxpayers (Chooi 2020). However, an impact assessment of PFM reform shows that institutional or legal changes alone usually do not lead to improvement in PFM outcomes (Fritz, Verhoeven, and Avenia 2017). The enforcement of new tax laws will depend entirely on the capacity of the tax and customs authorities to both monitor tax collection and inform taxpayers. Without the establishment of risk management plans or efforts to strengthen the capacity of staff in revenue agencies, there is a high risk that the new laws will not be enforced.

Enhance public expenditure management

Improving budget reliability and efficiency is one of the country's most urgent challenges. The new PFM law adopted in 2021 is a step toward improving budget credibility by introducing stricter expenditure controls. However, rather than only reinforcing controls, identifying the factors to make budget estimates reliable and supporting the Ministry of Finance and line ministries to produce accurate budget estimates are also needed to obtain rapid results. Tangible initiatives would allow rationalization of public sector spending, such as conducting deeper sector-by-sector analyses to better understand and address the challenges.

Identifying and resolving bottlenecks in spending and service delivery is another priority area which was further highlighted by the pandemic. Increasing the budgets toward health and education will only produce results if the allocation is executed and utilized.

Addressing shortcomings in management of public investments is important for improving budget credibility. Capital expenditure historically shows the lowest rates of budget execution, typically overestimating the absorptive capacity of the ministries tasked with the capital projects. The government's capacity for appraisal, selection, costing, and monitoring of public investment projects requires strengthening (World Bank 2016a). Additionally, the current legal framework for procurement lacks clarity and does not meet international standards, although a new procurement omnibus law has been pending. The adoption of this new law would facilitate the development of clear updated guidelines and manuals and would provide the basis for enhancing public investment practices in the Ministry of Public Works and other relevant actors, as well as raising the government's procurement capacity as a whole.

Adopt a forward-looking approach

The pandemic also brought to light issues regarding the use of tools for disaster risk financing and the state budget as a means to respond to emergencies. These aspects need to be integrated into Timor-Leste's PFM system, particularly with the objective of reducing the dependency on the Petroleum Fund in the future. Ensuring government consultation at every step of the technical preparation process, including the final prioritization and sequencing of the plan, is a necessary requirement for implementing successful reforms. Budgeting begins as a political exercise, and it is essential to engage the government in discussions on a design that reflects both national priorities and technical needs. To be successful, the PFM reform plan needs to account for informal behaviors, the climate for reform, local political dynamics, and organizational factors (Pretorius and Pretorius 2008; Diamond 2013). Finally, a key element for successful reforms lies in the efforts of donors to coordinate among themselves.

Improve donor support

Support to PFM in Timor-Leste would benefit from improved coordination among development partners (World Bank 2020). The government's adoption of a unified plan will facilitate cooperation and division of labor. Harmonizing donors' initiatives will greatly enhance the overall impact of different interventions. Research shows that donors providing capacity building is more successful when it comes with substantial pre-design and country-context preparatory work, allowing for flexible outcomes which adapt to the evolution of the country and strong ownership from the recipient country (Welham, Krause, and Hedger 2013). Simply applying "best practice" technocratic solutions is unlikely to bring successful outcomes, and more attention needs to be given to the country's specific context and fragilities, particularly for capacity-building activities (ADB 2016).

In addition to the elements outlined above, looking into the experiences of successful PFM reforms in neighboring countries with similar characteristics can provide lessons for Timor-Leste. For example, there are numerous assessments on the requirements for successful (or failed) implementation of PFM strategies in the Pacific islands (World Bank 2016b).[7] Country ownership and a conducive political environment are two key elements for the success of the reform plan. PFM reforms often call for financial and human resource mobilization and cannot be done without extensive planning and investment by the government. A study has also found that most countries in the region were not ready for more "advanced" PFM functions, such as accrual accounting or fiscal risk analysis, and that for most countries, developing local capacity should take precedence over the establishment of more elaborate PFM tools (Allen et al. 2020).

Reforms should also take into account the limited size of island countries when designing a plan. The creation of additional bodies such as PFM reform units, reform commissions, and special PFM units can further stretch small ministries of finance and line ministries with limited capacities. Additionally, smaller economies have limited staff and high turnover of personnel, which constrains the impact of traditional capacity-building interventions and calls for broader, more long-lasting support for capacity through long-term technical assistance (World Bank 2013).

The COVID-19 pandemic put enormous pressure on governments of all countries to rapidly finance and disburse large support programs to health and various socioeconomic sectors. This has been a reminder of the importance a well-functioning PFM system in times of crisis to manage emergency procurements while ensuring fiscal transparency and traceability. The pandemic highlighted the strengths of Timor-Leste's PFM system, confirming its relative transparency and the comparative rigor of the Treasury Department's accounting system with the publication of budget plans and regular execution reports. The Parliament's oversight of the budgeting process was maintained despite the state of emergency. But it also highlighted the dependency on the Petroleum Fund and brought to the forefront the necessity of PFM reforms to build the bedrock for effective governance and economic growth.

---

[7] Successful reforms are defined as those that respond to real identified dysfunction and provide a specific set of solutions rather than attempt to seek a major policy change. Some reforms were hindered by capacity issues, either because the reform process was too burdensome for the existing staff or because of the lack of available specialized staff. Another identified shortcoming of some reforms was the lack of reflection of the political-economy context, with misalignments or unfounded assumptions regarding motivations and incentives of policy makers and government staff. Tonga and Kiribati are two examples of successful reform processes.

References

ADB. 2016. *Better Performing Institutions in ADB Developing Member Countries: Positioning ADB's Approach to Public Sector Management and Institutional Performance*. Manila.

_______. 2021. *Addressing the COVID-19 Crisis: Lessons from Support for Public Financial Management. Synthesis Note No.6 (COVID Series-2*). Independent Evaluation Department. Manila.

Allen, Richard, Majdeline El Rayess, Laura Doherty, and Priya Goel. 2020. *Review of the Public Financial Management Reform Strategy for Pacific Island Countries, 2010–2020*. Working Paper No. 20/183. Washington, DC: International Monetary Fund.

Chooi, Annette. 2020. Improving Tax Compliance. *The Governance Brief* 39. Manila.

Diamond, Jack. 2013. *Good Practice Note on Sequencing PFM Reforms*. Washington, DC: Public Expenditure and Financial Accountability (PEFA) Secretariat.

Fiertz, Nathalie. 2021. Young and Resilient: Timor-Leste in the Time of COVID-19. Fragile States Index.

Fritz, Verena, Marijn Verhoeven, and Ambra Avenia. 2017. *Political Economy of Public Financial Management Reforms: Experiences and Implications for Dialogue and Operational Engagement*. Washington, DC: World Bank.

Gupta, Sanjeev and Joao Tovar Jalles. 2021. *Can COVID-19 Induce Governments to Implement Tax Reforms in Developing Countries?* Washington, DC: Center for Global Development Working Paper.

International Labour Organization (ILO). 2019. *Timor-Leste Labour Force Survey 2010–2013–2016 Main Trends Based on Harmonization*. Dili.

International Monetary Fund (IMF). 2020. *COVID-19 Funds in Response to the Pandemic–- Special Series on COVID-19*. Washington, DC.

International Federation of Accountants. 2021. *From Crisis to Recovery: Public Sector Priorities to Support Covid-19 Recovery.* New York.

Pretorius, Carole and Nico Pretorius. 2008. *Review of Public Financial Management Reform Literature*. London: Department for International Development.

Rao, Sumedh. 2013. *Measuring the Impact of PFM Reforms on Service Delivery*. Birmingham: Governance and Social Development Resource Centre.

Welham, Bryn and Sierd Hadley. 2015. *Basic Enough Budgets: What Should You Do When You Can't Do Everything?* London: ODI.

Welham, Bryn, Philipp Krause, and Edward Hedger. 2013. *Linking PFM Dimensions to Development Priorities*. London: ODI.

World Bank. 2013. *Pacific Islands: PFM Design under Capacity Constraints*. Washington, DC.

_______. 2015a. *Service Delivery Assessment: Water Supply and Sanitation in Timor-Leste Turning Finance into Services for the Future*. Washington, DC.

_______. 2015b. *Timor-Leste – Public Expenditure Review: Infrastructure*. Washington, DC.

_______. 2016a. *Public Investment Management Assessment*. Washington, DC.

_______. 2016b. *Strengthening Public Financial Management Reform in Pacific Island Countries*. Washington, DC.

_______. 2020. *Timor-Leste Public Expenditure and Financial Accountability Assessment 2018*. Washington, DC.

9 Malaysia: Strengthening the Health System for Economic Recovery

Despite a high number of COVID-19 cases, Malaysia's management of the pandemic has been successful in producing a relatively low fatality rate and one of the highest vaccination rates in the region. A strong primary health-care and hospital system, uniform distribution of resources across states, and effective coordination among various stakeholders have helped mitigate the pandemic's impact. These factors are the result of the country's long-standing commitment and effort toward affordable and quality health care. As Malaysia recovers from the pandemic, it plans to continue prioritizing health care as one way to restore the nation's well-being, reduce poverty, and achieve equitable growth.

On 28 January 2022, Malaysia received the first batch of Pfizer-BioNTech vaccines for children ages 5-12 years old (photo by Ministry of Health Malaysia).

Note: This chapter was written by James Villafuerte and Maria Theresa Bugayong of ADB's Regional Cooperation and Operations Coordination Division (SERC) in Manila; and Mae Hyacinth Kiocho, a SERC consultant.

I The Economy during the Pandemic

Swings between tightening and relaxing restrictions as COVID-19 cases waxed and waned resulted in marked volatility in GDP performance in 2021. Lockdowns crimped businesses and depressed economic activities in the third quarter. GDP grew by 3% for the first 9 months of 2021, an improvement from the 6.4% contraction in the same period last year. A rapid vaccination program enabled 75% of the total population to be fully vaccinated by 1 November 2021, paving the way for the gradual lifting of restrictions and increased operations across economic sectors. In October, the government eased restrictions in the Klang Valley (composed of Selangor, Kuala Lumpur, and Putrajaya), a positive development as it is estimated to contribute around 40% to Malaysia's GDP. With more firms adapting to the new operating environment, and with continued government support, the economy is expected to resume its growth momentum in the last quarter of 2021.

Stimulus and relief measures, along with government subsidies, helped cushion the drop in incomes and consumption spending. Private consumption was particularly strong in the first half of 2021, but slowed beginning in the third quarter to yield a 1.2% increase in the first nine months. The reimposition of containment measures to curb the resurgence of COVID-19 cases in August dampened consumer spending. A decline in retail trade has been noted starting in June. Motor vehicle sales for the first 9 months declined by 13.9% relative to last year. However, as one of Southeast Asia's most digitally advanced countries, growth in online purchases in Malaysia remained strong.

Investment performed strongly after being weighed down by supply disruptions following mobility restrictions. Fixed investment declined slightly by 0.1% in the first three quarters of 2021 after contracting by 15.3% in the same period last year. Increased capital spending in telecommunications and manufacturing industries' exports of electrical and electronic products supported private fixed investment. Public fixed investment, which had been on a downtrend since 2018, contracted by 15.4% in the first three quarters relative to the same period last year.

The external sector benefited from strengthening foreign demand buoyed by electronic and electrical products. Exports and imports valued in Malaysian ringgit increased at an estimated 25% and 21%, respectively, in the first 9 months of the year. On 25 October, Malaysia's Prime Minister launched the National Trade Blueprint to boost goods exports in 2021–2025 to support the 12th Malaysia Plan. Efforts are being made to expedite the Regional Comprehensive Economic Partnership ratification process by amending certain laws to comply with Malaysia's obligations and commitments under the agreement.

Agriculture production contracted by 0.7% in the first half of 2021 and a further 1.9% in the third quarter. Layoffs and the inability of some workers to return for the harvest period led to a shortage of workers, which hit the plantation subsector particularly hard.

In contrast, industry output strengthened during the first three quarters of 2021 over the same period last year. Manufacturing was strong in the first half, with growth strongest in electrical and electronic products. This rebound was abruptly cut short due to uncertainties caused by the reimposition of mobility restrictions. Business conditions indices have fallen from their June levels, with firms reporting difficulties in securing components. Shortages of intermediate inputs have also impinged production, including the production of motor vehicles. Consumption-related manufactures such as food, beverages, and tobacco registered gains, though still slower than their pre-pandemic pace. Mining output expanded from higher commodity prices, although the sector's contribution to the economy remains below 10% of GDP. Construction declined by 2.6% in the first three quarters mainly in fixed investments.

Stringent measures to contain COVID-19 have severely hurt the services sector. Growth in services, which was 1.4% in the first three quarters of 2021 over the same period last year, remains weak. However, financial, insurance, information, and communication services performed well. Growth in tourism remained subdued during the first three quarters of the year but is expected to accelerate. Interstate travel and tourism activities have been allowed to resume after the vaccination rate for adults reached 90%.

Consumer prices grew by 2.2% year on year in September, with year-to-date inflation at 2.3%. Inflation remained muted despite soaring shipping container rates and energy prices as economies recover from the pandemic. The rise in coal and gas prices due to supply chain disruptions and the recovery in global demand is prompting industries to turn to oil. Brent crude oil is now trading at a 3-day average of $97.95 per barrel. Higher energy prices are adding to inflationary pressures, but thanks to government subsidies of electricity tariffs and fuel, price increases have mostly emanated from transport and food.

Monetary and fiscal policy provided strong support in 2021, which mainly targeted small and medium-sized enterprises (SMEs) to protect employment and enhance social protection. The banking sector provided affordable financing schemes and better access to credit or grants. Financial assistance was provided to those most impacted, especially households with incomes in the bottom 40% (B40 group). A Financial Management and Resilience Programme (URUS) will soon be set up for the B50 group. Some improvement has been noted in the labor market—the unemployment rate dropped to 4.6% in August from 4.9% in January.

The pace of economic activity is expected to quicken slightly in the last quarter of 2021, aided by the gradual implementation of spending plans outlined in the 12th Malaysia Plan. Private consumption will remain the primary driver of Malaysia's economic growth. The outlook, however, continues to be highly contingent on global recovery and commodity price developments, and policy measures. Higher energy prices are adding to inflationary pressures, but inflation is expected to remain relatively subdued in 2022.

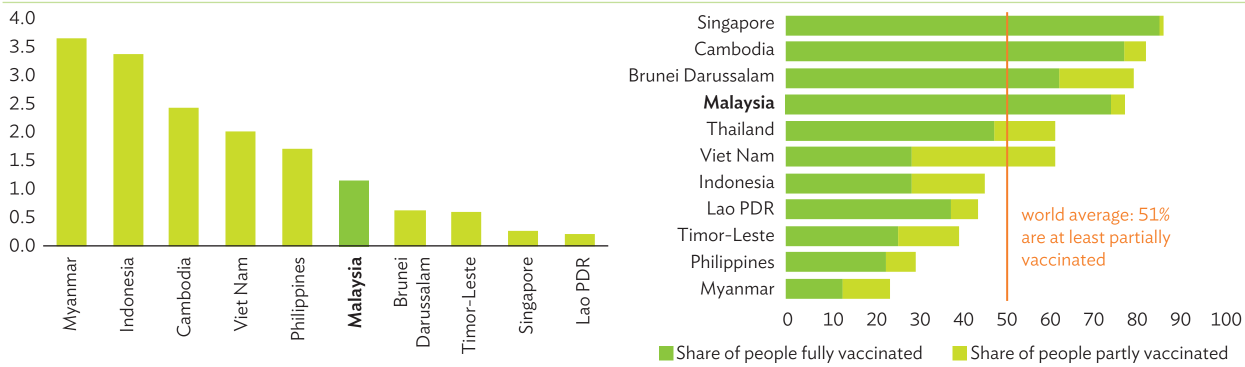
II Malaysia's Management of the COVID-19 Pandemic

Malaysia experienced a resurgence of COVID-19 cases in 2021, averaging 20,419 new cases per day in August. At the end of August, it had the highest number of new cases per million, both globally and within ASEAN. Even with the surge in cases, however, Malaysia succeeded in keeping COVID-19-related deaths relatively low. The country's COVID-19 case fatality ratio—calculated as the proportion of deaths to the total number of confirmed cases—was around 1% (Figure 9.1). Malaysia's vaccination rollout was also successful. More than 50% of its population was vaccinated by September 2021, and its vaccine coverage is among the highest in ASEAN, ranking fourth after Brunei Darussalam, Singapore, and Cambodia in the share of the population fully vaccinated against COVID-19.

Malaysia's commendable performance in managing and mitigating the pandemic has been credited to several factors:

Strong health-care and hospital system. Although Malaysia is behind some of its peers in ASEAN in terms of the ratio of medical infrastructure and personnel to the population (e.g., hospital beds per 1,000, physicians per 1,000, and nurses and midwives per 1,000) (Figure 9.2), the country is among the best in the subregion based on health-related indicators such as life expectancy, the Human Development Index, and the Sustainable Development Goals Index (Figure 9.3).

Figure 9.1: Case Fatality Ratio and Share of People Vaccinated as of November 2021
(%)



Lao PDR = Lao People's Democratic Republic.
Note: The case fatality ratio is calculated as the proportion of deaths to the total number of confirmed cases.
Source: Our World in Data.

Figure 9.2: Health System Infrastructure and Personnel

Country	Hospital Beds per 1,000 People	Physicians per 1,000 People	Nurses and Midwives per 1,000 People	UHC Coverage
Brunei Darussalam	2.85	1.61	5.90	77
Cambodia	0.90	0.19	1.01	61
Indonesia	1.04	0.47	3.81	59
Lao PDR	1.50	0.37	0.72	50
Malaysia	**1.88**	**1.54**	**3.487**	**76**
Myanmar	1.04	0.74	1.08	61
Philippines	0.99	0.60	5.44	55
Singapore	2.49	2.29	6.24	86
Thailand	2.10	0.92	3.15	83
Timor-Leste	5.90	0.77	1.76	53
Viet Nam	2.60	0.83	1.45	70
World	2.89	1.76	3.96	67

Lao PDR = Lao People's Democratic Republic, UHC = universal health coverage.
Source: World Development Indicators, World Bank

Figure 9.3: Selected Health Indicators

Country	Life Expectancy	Human Development Index	Sustainable Development Goals Index
Brunei Darussalam	75.86	0.84	68.27
Cambodia	69.82	0.59	64.54
Indonesia	71.72	0.72	66.34
Lao PDR	67.92	0.61	63.01
Malaysia	**76.16**	**0.81**	**70.88**
Myanmar	67.13	0.58	64.95
Philippines	71.23	0.72	64.51
Singapore	83.62	0.94	69.89
Thailand	77.15	0.78	74.19
Timor-Leste	69.50	0.61	...
Viet Nam	75.40	0.70	72.85

... = not available, Lao PDR = Lao People's Democratic Republic.
Note: Higher scores on the Human Development Index and Sustainable Development Goals Index indicate higher human development of a country and best outcome in achieving targets.
Source: Human Development Data Center, Sustainable Development Report.

Several studies and reviews on Malaysia's health-care system highlight its strengths. Results of the Quality and Costs of Primary Care study conducted in 2015 reveal that Malaysia's public primary-care clinics provide comprehensive care and good accessibility: more than two-thirds of the patients surveyed reported that home-to-clinic travel time was less than 20 minutes (Sivasampu, Noh, and Chin 2015). A review by Jaafar et al. 2013 highlights the country's comprehensive public primary health care, which includes primary-care activities serving remote areas.

A study by Lim et al. (2021) also finds Malaysia's primary health-care delivery to be comparable to those of some high-income and upper middle-income countries.[1] The comparative study ranked primary health-care delivery in terms of accessibility, comprehensiveness, continuity, and coordination. Malaysia garnered an above-average score in accessibility and continuity and outperformed other upper middle-income countries in all aspects except for accessibility.

Good coordination among government agencies, and between the public and private sectors. The government has been responsive to the challenges posed by the pandemic. In January 2020, with cases increasing in neighboring countries and Malaysia reporting its first COVID-19 case, the Ministry of Health (MOH) swiftly prepared and released a comprehensive plan covering different components of preparedness, such as heightened screening and coordination of agencies at entry points; enhanced sampling and assignment of treating and sampling centers to hospitals and laboratories, respectively; increased public health surveillance; and stockpiling and procurement of required personal protective equipment and medicines. The government implemented the Movement Control Order in March 2020 to reduce spread and transmission as the number of cases continued to rise. With the surge in cases putting a strain on public hospitals, the government quickly converted various multipurpose halls into COVID-19 Quarantine and Low-Risk Treatment Centres to expand treatment capacity and reduce the burden on hospitals.

The government engaged the private sector in managing the pandemic on different fronts. Anticipating overloaded capacity in public hospitals due to the increase in cases, the MOH involved private hospitals in treating COVID-19 patients, which increased resources such as hospital beds and ventilators. The MOH collaborated with private medical associations to disseminate accurate information to keep communities well-informed. The government also established private hospitals and clinics as vaccination centers under the National Immunisation Programme.

Immediate procurement of vaccines. In November 2020, Malaysia started negotiating with vaccine manufacturers to procure vaccines for its constituents. By February 2021, the government announced that it had secured enough vaccines for the entire population and started its nationwide COVID-19 immunization program later in the month. The country was one of four countries in ASEAN that started vaccinating in the first 2 months of 2021.

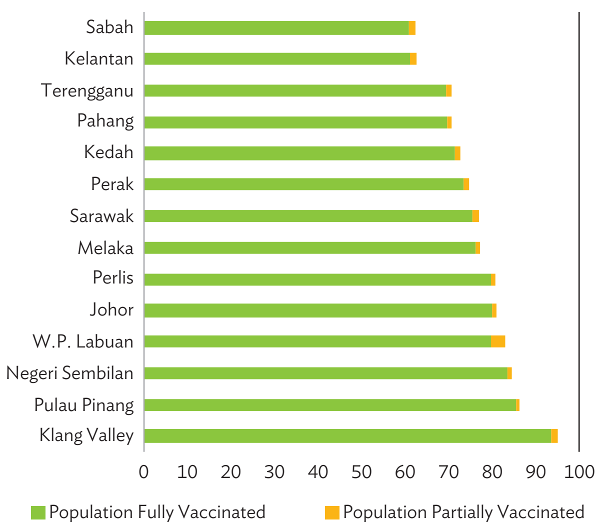
In addition to sourcing vaccines from bilateral agreements with vaccine manufacturers and other countries, Malaysia participated in the COVID-19 Vaccine Global Access (COVAX) facility which guaranteed vaccine supply for 10% of the country's population.[2] This lessened the country's reliance on bilateral agreements to procure the vaccines.

[1] The study covered countries that participated in the Quality and Costs of Primary Care study, an international study which assesses the primary-care system in 34 countries based on quality, equity, and cost. In Lim et al. (2021), the high-income countries included in the study were England, the Netherlands, and Spain, while the upper middle-income countries were Malaysia, North Macedonia, Romania, and Turkey.

[2] The COVAX facility is a global initiative by the Gavi, the Vaccine Alliance, the Coalition for Epidemic Preparedness Innovation, and the World Health Organization to ensure equitable access globally of diagnostics, treatments, and vaccines.

Uniform distribution of resources to fight the pandemic. The unified approach adopted by the government and the even distribution of resources have been credited for the minimal gap in performance across states (Md Hamzah et al. 2021). The MOH was able to mobilize resources across states, transferring health-care workers from states with low cases to states tagged as red zone districts (i.e., with 40 active cases or greater). Looking at the vaccination figures across the states, no state lagged behind—all states have vaccinated at least 60% of their population (Figure 9.4).

Figure 9.4: Vaccination Progress by State
(% of population)



Source: COVIDNOW. https://covidnow.moh.gov.my/ (accessed 18 October 2021).

Medium-Term Policy Priorities for the Health Sector

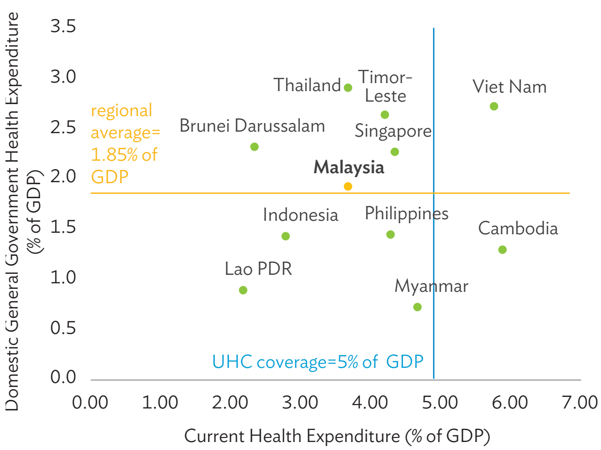
Malaysia has long recognized access to affordable and quality health as one of the foundations for achieving equitable growth and poverty reduction. The importance accorded to health has clearly stood the country in good stead during the COVID-19 pandemic. However, the pandemic has also highlighted a number of long-standing challenges facing Malaysia's health-care system. As Malaysia transitions to the new normal, it must contend with the following priorities:

Prepare for future outbreaks while combating the rise in communicable and noncommunicable diseases. Since the beginning of the century alone, there have been several global health emergencies, including severe acute respiratory syndrome or SARS in the early 2000s, the 2009 H1N1 influenza pandemic, the outbreak of Middle East respiratory syndrome or MERS in 2012, and COVID-19 in 2020. Researchers caution that the spread of infectious diseases will become even more prevalent, fueled partly by increased habitat loss, urbanization, and globalization. Moving forward, Malaysia's health-care system will need to be strengthened to ensure resilience to future shocks and vulnerabilities. At the same time, COVID-19 has caused resources to be diverted away from other pressing health priorities, such as combating other communicable and noncommunicable diseases. Restoring a better balance between these competing needs will have to be prioritized.

Improve coverage, level, and quality of public health services and programs. Publicly provided health care dominates the health sector in Malaysia, with the public sector accounting for roughly 53% of total expenditure on health in 2019 (MOH 2021). An estimated 70% of the population rely on the public health-care sector (Anand 2021). Yet, some estimates note that the public health-care sector accounts for just 45% of all registered doctors, and between 25% and 30% of specialists (Quek 2014). Apart from this unevenness in the allocation of resources across different levels of health care, the 12th Malaysia Plan also notes remaining gaps in health-care access and infrastructure, particularly in remote areas.

Ensure sustainable health-care financing. Financing additional improvements to increase the coverage, level, and quality of public health systems and programs will require substantial resources. Malaysia's public health-care sector is already heavily subsidized and is essentially free for all citizens. Despite this, Malaysia's overall health spending has only averaged about 4% of GDP since 2010, still shy of the universal health coverage benchmark of 5% of GDP (MOH 2021) (Figure 9.5). Given the pandemic's devastating impact on government coffers, improving the efficiency and equity of public spending on health is needed more than ever. This will include action on several fronts, including enhancing cost-effectiveness, improving targeting of public financing toward the poor and vulnerable, reducing fragmentation and duplication, and cutting other forms of waste.

Figure 9.5: Health-Care Spending



GDP = gross domestic product,Lao PDR = Lao People's Democratic Republic, UHC = universal health coverage.
Source: World Health Organization Global Health Expenditure database (accessed on 10 November 2021).

The 12th Malaysia Plan recognizes these challenges and proposes several policy measures to address them in the medium term. Some of the more notable policy measures included under the 12th Malaysia Plan are the following:

(i) **Adoption of a blueprint for Malaysia health-care system reform.** The blueprint will include reforms to strengthen both public and private health care, improve regulation of private health care, and strengthen health-care financing. It will also introduce new policies to address specific and/or emerging health needs, such as mental health and food safety.

(ii) **Measures to increase preparedness for future health crises and combat communicable and noncommunicable diseases.** Preparedness will be improved through measures such as providing health-care services with better facilities, pharmaceutical services, health personnel, and medical equipment; ensuring compliance with the standard requirements set by the World Health Organization for safety measures at clinical laboratories; and strengthening the multi-hazard public emergency response teams through health personnel and medical equipment support, among others. Meanwhile, communicable and noncommunicable diseases will be addressed through a combination of early prevention and intervention programs, such as raising awareness about these diseases, promoting health literacy, and early screening and diagnosis in the case of noncommunicable diseases.

(iii) **Measures to improve health-care capacity and equitable access to quality care.** The 12th Malaysia Plan calls for the formulation of a master plan to address remaining shortfalls and imbalances in the distribution of health-care facilities and human resources. In addition, it calls for an expansion of the cluster hospital concept to increase accessibility to specialists' services; enhancement of the curriculum of the National Postgraduate Training Programme to raise the quality and quantity of medical specialists; increase in investments to build and maintain health infrastructure; expansion of mobile health services to reach clients in remote areas; and increase in utilization of emerging technologies to provide better access to health-care services.

(iv) **Reforms in health-care financing.** To achieve sustainable health-care financing without sacrificing affordable and equitable access to health, the 12th Malaysia Plan proposes to raise public health-care charges for higher-income patients; streamline subsidies for health-care services based on a means test; introduce a national health endowment fund financed through *waqf*, a charitable donation under Islamic Law; encourage citizens to purchase more health insurance; expand the existing social protection scheme under the Social Security Organisation to cover workers in the informal sector; expand the PeKa B40 program to cover the cost of treatment and services at private health-care facilities; maximize opportunities for greater private sector participation in financing and procurement; and incorporate a more detailed analysis of public health expenditure in the National Health Accounts report.

(v) **Measures to leverage digital technologies.** The 12th Malaysia Plan recognizes the role that digital technologies can play in raising efficiency and improving quality, while maintaining cost-effectiveness. Priority measures include the Electronic Medical Record initiative, which will create a lifetime health record and facilitate the flow of information among health-care facilities; a virtual platform that will be integrated with the Malaysian Health Data Warehouse to facilitate data sharing across government agencies; a new center for digital health research and innovation at the National Institutes of Health to fast-track the development of innovative digital health-care products and services; and a new center for external quality assurance providers that will be part of the existing National Public Health Laboratory.

(vi) **Measures to improve health literacy and awareness.** Key initiatives include the development of a national health literacy policy and a health literacy surveillance system to support the policy's implementation. Programs for health care will also be intensified using various platforms at all levels.

The 12th Malaysia Plan contains a fair assessment of emerging priorities and identifies a comprehensive set of policy measures to address them. However, a number of additional issues and policy options may warrant consideration.

First, COVID-19 has highlighted the importance of early and swift action to reduce the spread of diseases. Early prevention, detection, and control are key to minimizing the health, social, and economic impacts of future outbreaks, and should form a central component of future preparedness plans as well as the envisioned national health literacy policy and health literacy surveillance system. For other communicable and noncommunicable diseases, striking the right balance between preventative care and treatment must be an immediate goal. The pandemic has inadvertently led to the neglect of preventative care and treatment of non-COVID-19 illnesses. With both patients and doctors deferring screening and treatment of non-COVID-19 illnesses during the pandemic, more resources may be needed for the treatment of such illnesses in the immediate future (CodeBlue 2021 and Yii 2021).

Second, the proposed master plan on health-care facilities and human resources must address the need to increase doctors and specialists in the public health care system. Government tried to address this gap in 2016 by introducing a contract system, and contract doctors are now estimated to account for about 41% of the workforce in the public sector (Su-Lyn 2021). However, contract doctors have raised numerous grievances surrounding remuneration, benefits, job security, and opportunities to pursue specialization, with perceptions of unfair treatment ultimately leading to a strike by contract doctors in July 2021 (CodeBlue 2021, Yii 2021, and Jamaluddin et al. 2021).

Third, there are a number of additional measures that could be considered to increase health care financing and make it more impactful and sustainable:

(i) Allocate emergency or countercyclical financing response to COVID-19 toward strengthening health systems for routine health services, especially primary health care, and bolstering core public health functions. Ensuring that health takes up a sizeable chunk of fiscal stimulus will be critical not only to address the current crisis, but also prepare for future ones.

(ii) Earmark taxes or additional revenues for health programs. The 12th Malaysia Plan already recommends expanding the scope of the sugar tax as a measure to help combat noncommunicable diseases. Earmarking the revenues from this tax would achieve two objectives at the same time generating health resources and promoting the adoption of healthy behaviors. In Europe, the United Kingdom recently introduced a health and social care tax which will come into force in 2023. The 12th Malaysia Plan has similarly raised the possibility of introducing a dedicated tax to finance poverty alleviation programs; a portion of this tax could also be ring-fenced to fund health services and programs aimed at the poor. In the Philippines, revenues from the use of a gambling tax or auctioning of impounded smuggled items have helped bolster financing for basic social services. The People's Republic of China (PRC) also implements welfare lotteries whose revenues have been earmarked for health care.

(iii) Revisit option of introducing a unified social health insurance (SHI)-based system. The practice of cherry-picking good risks through private health insurance leads to a fragmented health insurance system. Therefore, nationalized risk pooling could be more helpful. Past attempts to introduce a unified SHI-based system in Malaysia have floundered, and research suggests that this has mainly been due to lack of public support. Malaysians have grown accustomed to the current health-care system, which is fairly progressive and provides almost universal access to affordable, publicly provided health care. As such, it is important not just to design a system in a way that maintains progressivity, but also ensure that this progressivity is widely and effectively communicated to the public (Croke et al. 2019).

Finally, the timeliness and predictability of funds are vital for effective emergency response and early recovery. Some estimates suggest that a dollar received immediately after a disaster is worth up to $5 delivered later in a typical aid cycle (CAREC 2020). The typical approach to financing public health emergencies continues to rely primarily on budget support and/or reallocation and external borrowing. However, this approach tends to be highly unpredictable, with major repercussions on long-term growth and stability.

Like many countries in Asia and the Pacific, Malaysia continues to lack capacity for disaster risk financing, which includes financing for public health emergencies. Innovative approaches, such as disaster insurance and contingency funds, will have to be assessed along with the more traditional options with the aim of identifying the optimal mix for the country.

Providing disaster insurance as part of an integrated approach to risk financing would support the rapid provision of liquidity during a public health emergency. Risk layering—which involves adopting a set of complementary risk financing instruments to respond to different severities of disaster events—could also be beneficial.

References

Anand, Ram. 2021. Malaysia Committed to Reforming Healthcare System Post-pandemic. *The Straits Times.* 13 October. https://www.straitstimes.com/asia/se-asia/malaysia-committed-to-reforming-healthcare-system-post-pandemic.

Central Asia Regional Economic Cooperation (CAREC). 2020. Inception Meeting–Technical Assistance Developing a Disaster Risk Transfer Facility in the Central Asia Regional Economic Cooperation Region. 8 September. https://www.carecprogram.org/uploads/2020-disaster-risk-inception-pres1.pdf.

CodeBlue. 2021. 12th Malaysia Plan: The Government Needs to Review Its Strategies on Health—The Galen Centre. 27 September. https://codeblue.galencentre.org/2021/09/27/12th-malaysia-plan-the-government-needs-to-review-its-strategies-on-health-the-galen-centre/.

Croke, Kevin, Mariana Binti Mohd Yusoff, Zalilah Abdullah, Ainul Nadziha Mohd Hanafiah, Khairiah Mokhtaruddin, Emira Soleha Ramli, Nor Filzatun Borhan, Yadira Almodovar-Diaz, Rifat Atun, and Amrit Kaur Virk. 2019. The Political Economy of Health Financing Reform in Malaysia. *Health Policy and Planning* 34 (10): 732–39. doi: 10.1093/heapol/czz089.

Jaafar, Safurah, Kamaliah Mohd Noh, Khairiyah Abdul Muttalib, Nour Hanah Othman, and Judith Healy. 2013. Malaysia Health System Review. *Health Systems in Transition* 3 (1). New Delhi: World Health Organization, Regional Office for the Western Pacific.

Jamaluddin, Jazlan, Nurul Nadia Baharum, Siti Nuradliah Jamil, and Mohd Azzahi Mohamed Kamel. 2021. Doctors Strike during COVID-19 Pandemic in Malaysia: Between Right and Wrong. *Voices in Bioethics* 7. doi: 10.52214/vib.v7i.8586.

Lim, Ming Tsuey, Su Miin Ong, Seng Fah Tong, Peter Groenewegen, and Sheamini Sivasampu. 2021. Comparison between Primary Care Service Delivery in Malaysia and other Participating Countries of the QUALICOPC Project: A Cross-Sectional Study. *BMJ Open* 11 (5). doi: 10.1136/bmjopen-2020-047126.

Md Hamzah, Nurhafiza, Ming-Miin Yu, and Kok Fong See. 2021. Assessing the Efficiency of Malaysia Health System in COVID-19 Prevention and Treatment Response. *Health Care Management Science* 24 (2): 273–85. doi: 10.1007/s10729-020-09539-9.

Ministry of Health (MOH). 2021. *Malaysia National Health Accounts Health Expenditure Report 1997–2019.* https://www.moh.gov.my/moh/resources/Penerbitan/Penerbitan%20Utama/MNHA/MNHA_HealtExpenditure_Report_1997-2019_02092021.pdf.

Quek, David. 2014. The Malaysian Health Care System: A Review. https://www.researchgate.net/publication/237409933.

Radu, Alexandra. 2021. Malaysia Aims to Speed Up COVID-19 Vaccination Campaign. *The Diplomat*. 8 June. https://thediplomat.com/2021/06/malaysia-aims-to-speed-up-covid-19-vaccination-campaign/

Shah, Ain Umaira Md, Syafiqah Nur Azrie Safri, Rathedevi Thevadas, Nor Kamariah Noordin, Azmawani Abd Rahman, Zamberi Sekawi, Aini Ideris, and Mohamed Thariq Hameed Sultan. COVID-19 outbreak in Malaysia: Actions taken by the Malaysian government. *International Journal of Infectious Diseases* 97 (2020): 108-116.

Sivasampu, S., K. Mohamad Noh, and M. C. Chin. 2015. Quality and Costs of Primary Care (QUALICOPC) Malaysia: Phase 1–Public Clinic. Kuala Lumpur: Ministry of Health Malaysia and Harvard T.H. Chan School of Public Health, Harvard University.

Su-Lyn, Boo. 2021. 12th Malaysia Plan Treats Covid-19 Like a Bad Dream. 28 September. https://codeblue.galencentre.org/2021/09/28/12th-malaysia-plan-treats-covid-19-like-a-bad-dream/.

Tan, Ching Siang, Saim Lokman, Yao Rao, Szu Hua Kok, and Long Chiau Ming. Public and Private Sectors Collective Response to Combat COVID-19 in Malaysia. *Journal of Pharmaceutical Policy and Practice* 14, no. 1 (2021). doi:10.1186/s40545-021-00322-x.

Yii, Kelvin. 2021. Khairy Must Reset Healthcare System, Covid-19 Strategy. *Malaysiakini*. 28 August. https://www.malaysiakini.com/columns/589000.

Southeast Asia Rising from the Pandemic

This publication offers a comprehensive regional-level analysis of Southeast Asia's fragile recovery from the coronavirus disease (COVID-19) that damaged some core economic drivers and sank millions into poverty. It gives a rundown of how eight Southeast Asian countries have dealt with the pandemic and are now beginning to recover. It looks at how countries have reshaped their economies to cope with the crisis and considers the impact of job losses as COVID-19 sent development gains into reverse. Against a backdrop of global economic headwinds and looming climate change, it offers a range of recommendations for how policy makers can best weave lessons from the pandemic into their drive for a resilient and inclusive recovery.

About the Asian Development Bank

ADB is committed to achieving a prosperous, inclusive, resilient, and sustainable Asia and the Pacific, while sustaining its efforts to eradicate extreme poverty. Established in 1966, it is owned by 68 members —49 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

ADB

ASIAN DEVELOPMENT BANK
6 ADB Avenue, Mandaluyong City
1550 Metro Manila, Philippines
www.adb.org