Special
Article 2

# The OECD, Japan & Asia

By Yumiko Murakami

*Author*
*Yumiko Murakami*

**1964 was an epochal year in various ways for Japan. Perhaps the most significant event for the Japanese was the Tokyo Olympics, which was an important milestone in symbolizing Japan's reconstruction from the devastating war and emergence as a developed economy. The other notable event was Japan's accession to the Organization for Economic Co-operation and Development (OECD) as the first Asian nation to join this global organization. For the following 32 years, until South Korea joined the OECD in 1996, Japan was the sole representative from the Asian region at this prominent international institution. Today, 50 years after Japan's accession, Japan and South Korea are the only member states of the OECD from Asia. There has been, however, a strong sense of recognition within the OECD that other countries in Asia, being some of the most important players in the global economy, are extremely valuable partners and should be critical stakeholders in tackling many, if not all, of the most pressing policy issues facing international society.**

## Asia as Key Region for Global Economy in the Next 50 Years

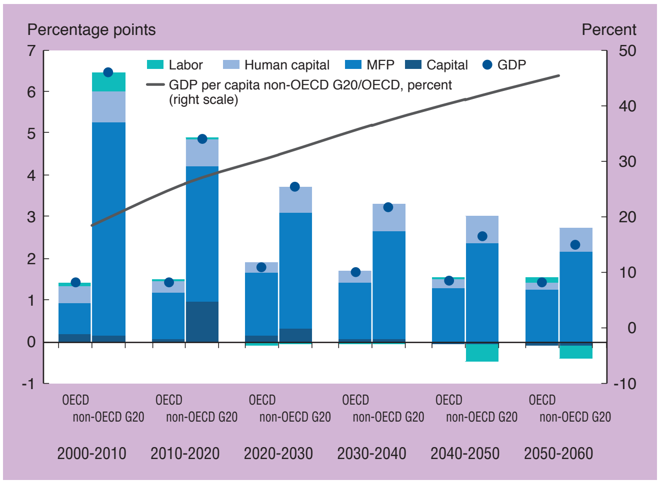
The OECD has recently launched a study to forecast policy challenges for the next 50 years. In this study, it predicts the coming 50 years will likely see a major shift of economic balance towards emerging economies, particularly those in Asia, with the share in world GDP of non-OECD countries rising well beyond that of the current OECD area by 2060. Economic growth will continue to lift masses of people out of poverty, integrating them into the world economy. As the main driver of economic growth, global trade integration will likely deepen over the coming 50 years, as transport costs continue to fall and trade barriers are lowered in line with already agreed upon trade agreements. The pace of integration is likely to slow, however, unless further agreements to lower trade barriers, transaction costs and regulatory obstacles are reached. The evolution of trade will also depend on the way in which firms define reductions in trade and transaction costs, and new technologies that may shorten physical value chains.

While world exports in relation to GDP tripled between 1950 and 1998, the increase between 2010 and 2060 could be around 60% on a global basis. As economic gravity shifts towards Asia, trade will follow the same path. OECD countries' share of world trade is estimated to fall from 50% in 2012 to 25% in 2060. For example, euro-zone exports to Asia and emerging economies may be equivalent to 15% of GDP and similar in size and trade

CHART 1

### Developments in OECD and non-OECD G20-countries, 1990-2060

**Contribution to growth in GDP per capita, 2000-2060 (annual average)**




*Note: The non-OECD G20 countries are Argentina, Brazil, China, India, Indonesia, Russia, Saudi Arabia & South Africa.*

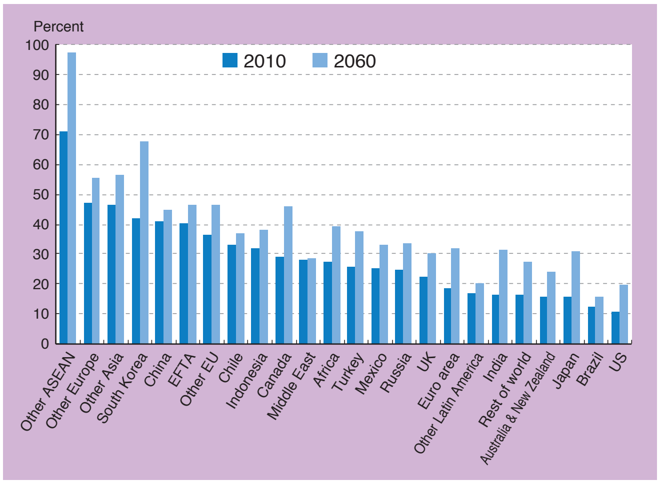
*Source: OECD Economic Outlook 95 long-term database, OECD computations*

*This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.*

CHART 2

### Exports as a share of GDP will increase in all regions

**Exports as percent of GDP**




*Source: ECO/CPE/WP1(2013)13*

*This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.*

within the euro-zone by 2060. Increased cross-country interdependence will help absorb the burdens of global shocks, but it will also make the global economy more vulnerable to imbalances and a number of domestic policy instruments less potent.

Another critical policy challenge over the next 50 years is the continued struggle in environmental protection. Growth could be handicapped further by rising economic damage stemming from environmental degradation and climate change, especially in Asia. By 2060, environmental damage in Southeast Asia may lower GDP by more than 5% compared to the central scenario.

## Beyond the Middle-Income Trap in Emerging Asia

Looking a little earlier than 2060, the OECD addresses mid-term structural policy challenges Asian countries face in our Economic Outlook for Southeast Asia, China and India 2014. One of the most critical challenges in the region is the smooth transitioning of middle-income countries to high-income countries in emerging Asia. Many Asian countries have made remarkable progress over the past four decades with rising income levels, reduced poverty and developing state-of-the-art manufacturing. Some emerging Asian countries – China, India, Indonesia, Malaysia, the Philippines, Thailand and Vietnam – are poised to join Japan, South Korea and Singapore in the ranks of advanced high-income countries within the next few decades, as long as they can sustain their accelerated growth rates comparable to those they have enjoyed until now.

However, graduation to the high-income category is not automatic and there are some cases where countries get "stuck" in the middle-income range for an extended period of time. In fact, many other countries have grown rapidly in their initial stages of development only to falter at a later stage and fail to progress much further. The inability to grow beyond the so-called "middle-income trap" underscores the fact that the challenges of sustaining development become more difficult and complex as development evolves. To sustain development beyond the middle-income trap, countries need to shift away from growth that is driven by factor accumulation. They should rather embrace extensive growth based on productivity increases driven by improvements in the quality of human innovation and other capital.

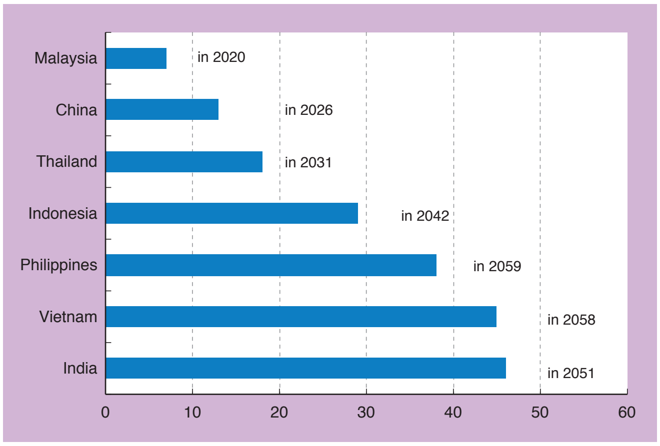
Such a shift entails substantial changes in economic structures towards higher productivity and technologically sensitive sectors. Government policies will be crucial in determining the success of the middle-income ASEAN countries, China and India, in orientating their economic and industrial structures towards sustained productivity-led growth. Historical experience – e.g. the success stories of Japan, South Korea and Singapore – underscores the importance of focusing policies on building and strengthening institutions which supply the key ingredients needed for industrial transformation and shaping business incentives. It naturally follows they must be able to respond to ever-changing market conditions and opportunities.

The development of middle-income ASEAN countries and China has been characterized by a high reliance on exports of manufactured goods to advanced economies whose production is distributed across regionally-based global value chains ("Factory Asia"). The participation of most middle-income emerging Asian economies in the global value chain is still largely limited to assembly and other less sophisticated, lower-productivity stages. A number of external forces, along with structural changes in the region, are likely to change the future role and character of Factory Asia. Although Factory Asia is likely to remain of major importance in world manufacturing and a major contributor to regional GDP and economic growth, it will probably evolve toward greater emphasis on supplying regional markets.

To fully realize the benefits of these changes, countries in this region all need over time to foster the progressive transformation of their manufacturing industries towards more sophisticated and demanding

CHART 3

### "Best scenario" simulation of estimated time required to become high-income country for middle-income countries in emerging Asia (years)




*Note: Based on World Bank criteria for classifying economies, high income countries are defined as having gross national income per capita above $12,000 in 2013. Growth prospects, consumer price index and exchange rates in this simulation are in line with MPF-2014. Population projections are based on UN data.*

*Source: OECD Development Centre*

*This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.*

activities with higher productivity and greater dependence on technology. At the same time, further economic development of emerging Asia is likely to depend increasingly on the services sector. Services already account for 37% and 45% of GDP in the middle-income ASEAN countries and China, and between 30-60% of total employment. However, services sector development lags behind that of advanced economies and its share of GDP has fallen or remained largely unchanged in most of these ASEAN countries since the mid-1990s. Further development of the services sector, especially in modern services, will be critical to the success of efforts by middle-income ASEAN countries to become advanced economies. Regulatory barriers that limit entry, stifle competition and discourage investment have been major obstacles to the development of the services sector in most Asian countries. Policy improvement to address these issues is critical in these countries. It is equally important for policy makers to take action in these emerging economies and resolve mismatches between the skills required by industry and those provided by schools, universities and technical/vocational educational facilities.

## OECD Southeast Asia Regional Program

The relevance of Asia in the context of a global economy has been obvious to all of us, especially over the last decade. This trend is likely to continue, which was predicted within our 50-year policy challenge study. The OECD defined Southeast Asia as a region of priority and launched a comprehensive Southeast Asia Regional Program in 2014, in order to enhance and broaden the OECD's engagement within the region. The program's structure is designed to encourage a systematic exchange of experiences in order to develop common solutions to regional and global challenges. It is comprised of thematic Regional Policy Networks, which will build on the work program of substantive OECD and Southeast Asian bodies and dialogue processes. Initial areas of focus for the networks are tax, investment, education and skills, small and medium-sized enterprises, regulatory reform and public-private partnerships (PPPs). Below are highlights of the OECD's activities in each of the six areas.

### Tax Policies & Administration

In an increasingly interconnected world, national tax laws have not kept pace with globally minded corporations, the concept of "fluid" capital and the digital economy. This has left gaps which are being exploited by companies attempting to avoid taxation in their home countries by locating their activities abroad in law to no-tax jurisdictions. This undermines the fairness and integrity of tax systems. The OECD plays a lead role in the development of international tax standards and guidelines. In response to the G20 leaders' call to address base erosion and profit shifting (BEPS), the OECD is currently working on adapting the current international tax system to meet the challenges of globalization and develop approaches to counter BEPS issues.

As the OECD/G20 BEPS Project should have a global impact, the OECD is working directly with countries in the Southeast Asia region to ensure that revised international tax rules reflect their needs. Improving tax transparency and compliance is particularly important for Asia in light of the rapidly increasing integration of Southeast Asia countries into the global economy, as well as further regional integration within ASEAN itself. The OECD organizes approximately 20 tax seminars and policy dialogue events per year for Southeast Asian countries. The events bring together tax officials, from the region as well as other OECD countries, to share experiences and expertise on technical issues, policy and administrative issues. Examples would be tax treaties, transfer pricing, exchange of information, tax administration and other important tax matters. Indonesia, Malaysia, the Philippines and Singapore play a key role as members of the Global Forum on Transparency and Exchange of Information on Tax Purposes. The forum, gathering about 120 OECD and non-OECD jurisdictions, monitors the implementation of internationally agreed upon tax transparency standards through country peer reviews.

### Investment Policy & Promotion

International investment has been a driver of Southeast Asia's economic dynamism and integration into the global economy. Some countries in the region were among the first to welcome foreign direct investment (FDI) as part of a strategy of export-led development. The OECD is deepening its cooperation with Southeast Asia on investment through Investment Policy Reviews conducted in collaboration with the ASEAN Secretariat and through regular regional investment policy dialogue sessions to train government officials using the Policy Framework for Investment. The regional component of the OECD's investment cooperation with ASEAN effectively links a national investment policy framework to regional investment policy development and harmonization. This has given individual ASEAN member states a platform to showcase their reforms and to learn from peers, while at the same time strengthening regional integration initiatives and national reforms.

One of the most critical elements for a sound investment environment is fair competition. Regulatory barriers to competition can potentially hamper investment and economic growth. The OECD has developed a Competition Assessment Toolkit that provides a highly functional methodology to review laws and regulations which could restrain competition. Indonesia, for example, was one of the first ASEAN members to introduce competition law more than a decade ago. Competition policy has played a substantial role in underpinning Indonesia's economic development and investment since 1999.

Another important study conducted by the OECD is the global value chain (GVC) of trade where different stages of production processes are located across different countries. The ASEAN framework, and its core goal of establishing the ASEAN Economic Community by 2015, has promoted trade and investment liberalization which in turn has facilitated GVCs throughout Southeast Asia. To assist countries in reaping the full benefits of GVCs, the OECD is currently undertaking work along an array of different dimensions to address the new challenges GVCs create for policy makers in Southeast Asia.

The OECD has also recently compiled a regulatory database of services regulations – Services Trade Restrictiveness Index – encompassing 17 service sectors and sub-sectors in 40 countries. The project developed a toolkit that contains two distinct but complementary instruments, which allows countries to consider specific regulatory provisions that may be restrictive and may reduce sector efficiency in their economy, and also to compare and contrast their own situation in a given sector to more efficient jurisdictions. It provides the core information for countries to pursue desirable policy reforms, whether on a unilateral, plurilateral or multilateral basis. Currently, Indonesia is included in the study and some other countries in ASEAN are likely to be included in the near future. A critical issue for many countries today is the importance of reducing trade costs through trade facilitating measures. Following the conclusion of the WTO Trade Facilitation Agreement in December 2013 in Bali, the OECD re-estimated the potential trade cost reductions from the full implementation of this agreement to be as high as 15% for many developing countries.

### Education & Skill Development

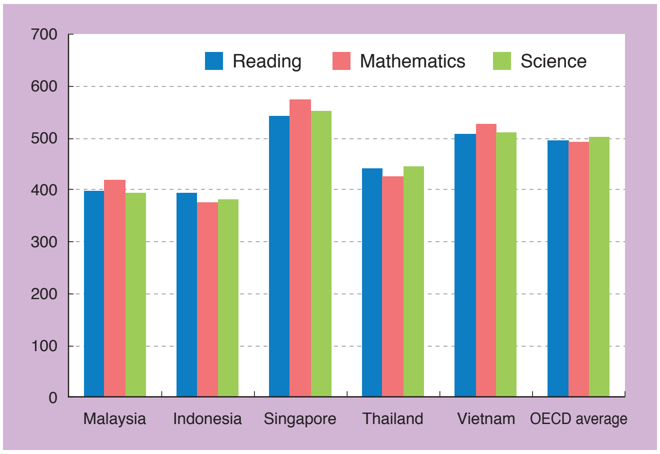
The OECD helps policy makers foster human and social capital skills. The OECD also leverages education and training systems for dynamic/sustainable economies. Through comparative data and policy analysis we strive to promote efficient and effective systems in the hope of improving learning outcomes. Southeast Asian countries have made significant investments in education and have facilitated access to learning opportunities for their young people, beginning in early childhood to tertiary education (in most countries in the region, primary and lower-secondary attainment is relatively high).

However, major challenges remain in both quality and equality. While students in Singapore lead the world in problem solving and Vietnam's 15 year-old students perform at levels above the OECD average, students in Indonesia, Malaysia and Thailand do not attain minimum skill levels. The disparity among countries may hinder regional economic integration. While in some countries a very high proportion of students continue to study beyond compulsory education, less than a third of students who enter primary schools go on to secondary level in Cambodia, for example. Qualified teachers are the key to success and the shortage of teachers in secondary schools is severe in some parts of the region, especially in remote areas. More than 85% of teachers in Malaysia have bachelor or postgraduate diplomas in education, but in Laos many teachers have low levels of formal schooling. Some 37% of them have had the same level of schooling as the students they teach. In many instances, they have actually had less schooling.

The capacity of educational systems to respond to the economy's current and future skills needs is crucial. There should be a good match between the skills required by industry and those provided by schools, colleges, and universities. In Southeast Asia, training systems are often outdated and the region is facing a growing demand for higher skills in global value chains, in particular the middle-income ASEAN countries. The current and planned work of the OECD in Southeast Asia has three pillars: promoting participation in international education surveys, country education policy reviews, and regional policy peer-learning. Through the Program for International Student Assessment, the OECD has been evaluating the knowledge and skills of the world's 15-year-olds since 2000. The Teaching and Learning International Survey studies teaching and teachers' capacities to provide quality education, while the Survey of Adult Skills measures the key cognitive and workplace skills needed for individuals to participate in society and to be active in the labor market. By participating in these surveys, countries in Southeast Asia can obtain important perspectives on the issues and challenges facing their education policies.

CHART 4

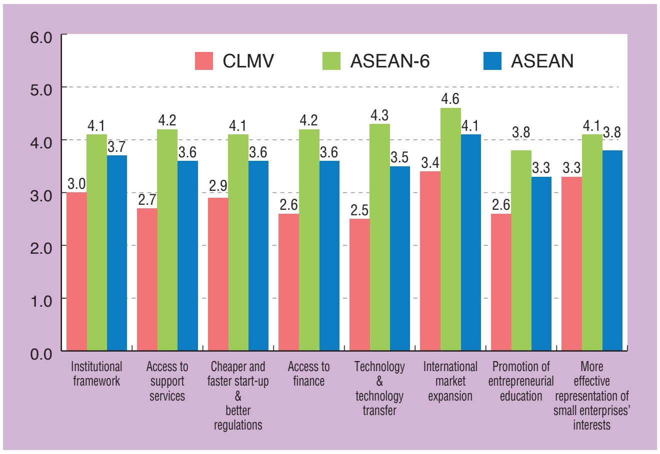
## OECD PISA score in Southeast Asia & OECD countries, 2012 (score)




*Source: OECD, PISA 2012 database*

CHART 5

## ASEAN SME Policy Index – by group of countries & policy dimension




*Source: Economic Research Institute for ASEAN and East Asia (ERIA), 2014, ASEAN SME Policy Index 2014: Towards Competitive and Innovative ASEAN SMEs*

### Small & Medium-Sized Enterprises (SMEs)

Access to finance for micro and small companies in particular remains difficult. Moving beyond microfinance to longer-term financial products and services remains a major challenge and is critical to achieving greater growth. The OECD has recently developed a partnership with the Asia Development Bank in SME finance. In 2013, a joint project on "Enhancing financial accessibility for SMEs; Lessons from Asian and OECD Area's Crises" was launched. It analyses policies and experiences to improve bank lending efficiency and to broaden the range of financing instruments available for SMEs and entrepreneurs.

Another important partner for the OECD is the Economic Research Institute for ASEAN and East Asia (ERIA), with whom the OECD has been collaborating on assessing SME policies in the 10 ASEAN member countries. The OECD-ERIA ASEAN SME Policy Index 2014: Towards Competitive and Innovative ASEAN SMEs was launched at the 2014 OECD Southeast Asia Regional Forum in Bali. The report measures convergence towards the policy guidelines of the ASEAN Strategic Plan for SME Development (2010-2015) and illustrates a substantial disparity in SME policy performance between the CLMV nations (Cambodia, Laos, Myanmar and Vietnam) and the ASEAN-6 countries. While Singapore and Malaysia exhibit high standards in SME policy, further efforts are needed in CLMV countries to reduce development gaps. Structural reforms have been identified to enhance productivity, human capital and enterprise performance and will be supported through workshops exchanging "good practices" in SME policy between ASEAN-6 and the OECD.

### Regulatory Reform

The OECD has a long-standing engagement with Southeast Asia on regulatory reform. Highlights of this engagement include the 2005 APEC-OECD Integrated Checklist on Regulatory Reform, the 2011 Review of Administrative Simplification in Vietnam and the 2012 Regulatory Reform Review of Indonesia. In 2013-2014 the OECD has been assisting Malaysia in building institutional capacity on regulatory impact analysis, a new requirement under the "National Policy on the Development and Implementation of Regulations".

In Vietnam, regulatory reforms between 2007 and 2010 resulted in the simplification and standardization of 10,000 administrative procedures at the communal level and 700 at the district level. These and other regulatory reforms were estimated to provide annual compliance cost savings for business and society of US$1.4 billion. In Indonesia, regulatory reforms have included efforts to strengthen coherence between national and subnational regulations, with 37% of 13,200 subnational regulations invalidated from 2010 to 2012. Following the 2012 Regulatory Reform Review of Indonesia, the OECD is supporting the government's efforts to develop guidelines on public consultation within a regular process. Currently, discussions are underway between ASEAN and the OECD to develop Product Market Regulation and Regulatory Management Systems indicators to support reforms in Southeast Asia.

### Connectivity & the Role of Public-Private Partnerships for Infrastructure Development

The OECD Economic Outlook for Southeast Asia, China and India 2014 identified infrastructure investments as a critical component for ASEAN countries to foster economic growth and reduce poverty. According to Asian Development Bank estimates, ASEAN members need to invest $60 billion annually until 2020 to maintain and expand existing infrastructure. To raise the required resources, public funds need to be complemented by privately-financed infrastructure investments including public-private partnerships (PPPs). PPPs are an important tool for decision makers to strengthen economic and social development. By harnessing private-sector experience and allocating risks to those parties, governments can make great strides in ensuring a value-for-money proposition.

The OECD Network of Senior PPP Officials was established to ensure PPPs and capital investment projects deliver value for money and that potential risks are managed properly. The network has developed the OECD Principles for Public Governance of PPPs, which examine institutional capacities and the selection of PPP projects based on "value for money" and uses the ordinary budget process to ensure fiscal sustainability. The OECD has also developed a conceptual framework to help manage fiscal risks through good capital budgeting. This should serve as a backdrop to ensuring value for money within the context of capital procurement, and finally in setting up dedicated PPP units. JS

*Yumiko Murakami has been head of the OECD Tokyo Centre since 2013. She previously held senior positions as managing director at Goldman Sachs and Co. (New York), Goldman Sachs, Japan, and Credit Suisse Group, Tokyo. She has an MA from Stanford University in Russian Studies and International Relations, and an MA from Harvard University in Business Administration.*