

FROM CONTAINMENT TO RECOVERY



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From Containment to Recovery

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List of Abbreviations

AMC	Advanced Market Commitment
DSA	Debt sustainability analysis
DSSI	Debt Service Suspension Initiative
EAP	East Asia and the Pacific
ECQ	Enhanced Community Quarantine
EIU	Economist Intelligence Unit
EMDE	Emerging Markets and Developing Countries
FDI	Foreign Direct Investment
GDP	Gross domestic product
GEP	Global Economic Prospects
GVC	Global Value Chain
IDS	International Debt Statistics
IMF	International Monetary Fund
LAYS	Learning-Adjusted Years of Schooling
LPM	Local projection method

MFN	Most Favored Nation
NBFI	Nonbank Financial Institutions
NPL	Nonperforming loans
OECD	Organisation for Economic Co-operation and Development
PBOC	People's Bank of China
PPEs	Personal protective equipment
PPG	Public and Publicly Guaranteed
PPP	Purchasing power parity
R&D	Research and Development
STRI	Services Trade Restrictions Index
SME	Small and medium enterprise
TFP	Total factor productivity
U.S.	United States
WHO	World Health Organization

Regions, World Bank Classification and Country Groups

EAP	East Asia and Pacific
ECA	Eastern Europe and Central Asia

LAC	Latin America and the Caribbean
MNA	Middle East and North Africa
SAR	South Asia
SSA	Sub-Saharan Africa

Country Abbreviations

AUS	Australia
BRA	Brazil
BRN	Brunei Darussalam
CAN	Canada
CHN	China
FJI	Fiji
FSM	Federated States of Micronesia
IDN	Indonesia
IND	India
JPN	Japan
KHM	Cambodia
KIR	Kiribati
KOR	Republic of Korea

LAO	Lao People's Democratic Republic
MEX	Mexico
MNG	Mongolia
MMR	Myanmar
MYS	Malaysia
NRU	Nauru
PHL	Philippines
PLW	Palau
PNG	Papua New Guinea
RMI	Republic of the Marshall Islands
RUS	Russia
SGP	Singapore
SLB	Solomon Islands
THA	Thailand
TLS	Timor-Leste

List of Abbreviations continued

TON	Tonga
TUR	Turkey
TUV	Tuvalu
UK	United Kingdom

USA	United States
VNM	Vietnam
VUT	Vanuatu
WSM	Samoa

<i>Currency Units</i>	
A\$	Australian dollar
\$NZ	New Zealand dollar
B	Thai baht
CR	Cambodian riel
D	Vietnamese dong
F\$	Fiji dollar
K	Myanmar kyat
K	Papua New Guinea kina

Kip	Lao kip
P	Philippine peso
RM	Malaysian ringgit
RMB	Chinese renminbi
Rp	Indonesian rupiah
SI\$	Solomon Islands dollar
Tog	Mongolian tugrik
US\$	Timor-Leste (U.S. dollar)
US\$	United States dollar

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Throughout the report, geographic groupings are defined as follows:

Developing East Asia and Pacific comprises Cambodia, China, Indonesia, Lao People's Democratic Republic (PDR), Malaysia, Mongolia, Myanmar, Papua New Guinea, the Philippines, Thailand, Timor-Leste, Vietnam, and the Pacific Island Countries.

The Pacific Island Countries comprise Fiji, Kiribati, the Marshall Islands, the Federated States of Micronesia, Nauru, Palau, Samoa, the Solomon Islands, Tonga, Tuvalu, and Vanuatu.

The **ASEAN** member countries comprise Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.

The **ASEAN-5** comprise Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.

The analysis in this report is based on the latest country-level data available as of September 17, 2020.

Overview

Successful containment: The pandemic has so far been contained in parts of the EAP region, but not in Indonesia and the Philippines, and is still a threat to other countries, most recently Myanmar. The countries that contained the disease used a *combination* of stringent mobility restrictions, extensive testing-based strategies, and information programs to encourage precautionary behavior.

Economic distress: The pandemic and efforts to contain its spread led to a significant curtailment of economic activity. These domestic difficulties were compounded by the pandemic-induced global recession which hit EAP economies that rely on trade and tourism hard. Country outcomes were generally related to how efficiently the disease was contained and how exposed countries were to external shocks. Output contracted by 1.8 percent in China in the first half of 2020 and by 4.0 percent on average in the rest of the region. The COVID-19 shock is expected to increase the number of people living in poverty in the region by 38 million in 2020—including 33 million who would have otherwise escaped poverty, and another 5 million who would be pushed back into poverty—using a poverty line of US\$5.50/day (2011 PPP).

Relief: In response, EAP governments have committed nearly 5 percent of GDP on average to support public health systems, help households to smooth consumption, and help firms to avoid bankruptcy. But since these countries previously spent less than 1 percent of their GDP on average on social assistance, scaling up and implementation have proved difficult. In several countries, assistance has so far reached less than 25 percent of households whose incomes fell and only 10–20 percent of eligible firms. Reaching workers and firms in the informal sector has been most difficult. Continuing support in a protracted crisis would strain the narrow revenue base of most EAP countries.

Mixed prospects for recovery: Successful containment of the disease in some countries is leading to a revival of domestic economic activity. But the EAP region's economy is heavily dependent on the rest of the world, and global demand remains subdued. Trade will see a revival as global economic activity gradually resumes, but tourism is unlikely to recover soon. Though short-term capital has returned to the region, global uncertainty still inhibits domestic and foreign investment. The capacity of financially strained governments to stimulate the economies is also limited. The region is forecast to grow by only 0.9 percent in 2020. Whereas China is forecast to grow by 2.0 percent—because it has kept new infections at a low rate since early March, prioritized the revival of production, and increased public investment—the rest of the EAP region is projected to contract by 3.5 percent on average in 2020. Prospects for the region are brighter in 2021, with growth expected to be 7.9 percent in China and 5.1 percent in the rest of the EAP region, based on the assumption of continued recovery in the region and normalization of activity in major economies, linked to the possible arrival of a vaccine. However, for all economies in the region, output is projected to remain well below pre-pandemic projections for the next two years. The outlook is particularly dire for some highly exposed Pacific Island countries where output is projected to remain about 10 percent below precrisis levels by late-2021.

Adverse impact on inclusive growth: COVID-19 will have a lasting impact on inclusive longer-term growth by hurting investment, human capital, and productivity. Public and private indebtedness, along with worsening bank balance sheets and increased uncertainty, are likely to inhibit public and private investment, as well as pose a risk to economic stability. Sickness, food insecurity, job losses, and school closures could lead to the erosion of human capital and earning losses that last a lifetime. Firm closures and disruption in firm-worker relationships could hurt productivity through a loss of valuable intangible assets. The disruption of trade and global value chains could hurt productivity by leading to a less efficient allocation of resources across sectors and firms, and by dampening the diffusion of technology. Left unremedied, these consequences of the pandemic could reduce regional growth over the next decade by 1 percentage point per year.

The poor will be disproportionately disempowered because of their lower level of access to hospitals, schools, jobs, and finance. The adverse effects on growth and distribution may be partially offset by the COVID-19-induced acceleration in digital technologies, which could boost productivity and improve access to services for the poor.

An integrated view of policy: Policy choices to contain disease surges and provide relief today would ideally be informed by how they will affect recovery and growth tomorrow. And policy choices in one area, say health, will have an impact on goals in other areas, like the economy. Governments face difficult trade-offs. Significant expenditure on relief or a consumption-supporting stimulus may leave an indebted government less equipped to invest in infrastructure, and hence growth. And how governments distribute the burden of public debt across individuals and over time—through indirect taxes, income and profit taxes, inflation, or financial repression—will matter for both growth and distribution. The crisis has shown that taking a dynamic view could help EAP governments make choices today that soften trade-offs tomorrow in seven key areas:

- ***Building capacity for smart containment***—including to test, trace, and isolate—would help contain disease surges with more targeted and less economically disruptive measures. For example, preliminary analysis suggests that open public testing, including of asymptomatic people, could reduce the number of infections by 10 percent in a month. At the same time, cooperating internationally to incentivize the development of a vaccine and preparing to distribute it efficiently and fairly would contribute to social stability and facilitate economic recovery.
- ***Initiating fiscal reforms*** could allow greater spending on relief without sacrificing public investment. The budget constraint is difficult because revenue mobilization is exceptionally low in the EAP countries other than China—only 18 percent of GDP on average, compared to 25 percent in other developing economies and 36 percent in advanced economies. And the greater reliance on indirect taxes, which represent more than 50 percent of government revenue in several countries, has amplified the revenue loss in a crisis in which consumption has contracted sharply. Large fiscal deficits in EAP are projected to increase government debt on average by 7 percentage points of GDP in 2020. High and growing private debt constitutes an additional indirect risk for government finances. Widening the tax base with more progressive taxation of income and profits and less wasteful spending on regressive energy subsidies, in some cases over 2 percent of GDP, could make recovery more inclusive and sustainable.
- EAP governments will need to ***maintain hard-won reputations for financial prudence*** in the face of increasing financing needs. Even though EAP governments are largely financing deficits through domestic borrowing, some are also inducing central banks to buy sovereign bonds. Pursued beyond a point, such actions could undermine central bank independence and inflation control which have been crucial for macroeconomic stability in the region. Overreliance on the banking system as a conduit for extending support could also pose risks. The available data suggest that EAP banks are relatively well-capitalized, but nonperforming loans have increased despite relaxed prudential measures and permissive accounting rules. While these policies may be necessary today, credible commitments to transparency and to early restoration of financial discipline could help mitigate the risk of financial instability.
- Social protection has a triple role: mitigate the immediate impact of the crisis; help workers reintegrate as countries recover; and prevent long-term harm to human capital. ***Widening social protection*** to cover all existing and the new poor, combined with investment in the infrastructure of delivery, would ensure that help reaches people when they need it. Malaysia, with a universal national ID system, wide mobile phone coverage, and high financial inclusion, accomplished a large-scale cash transfer with a 99 percent implementation rate

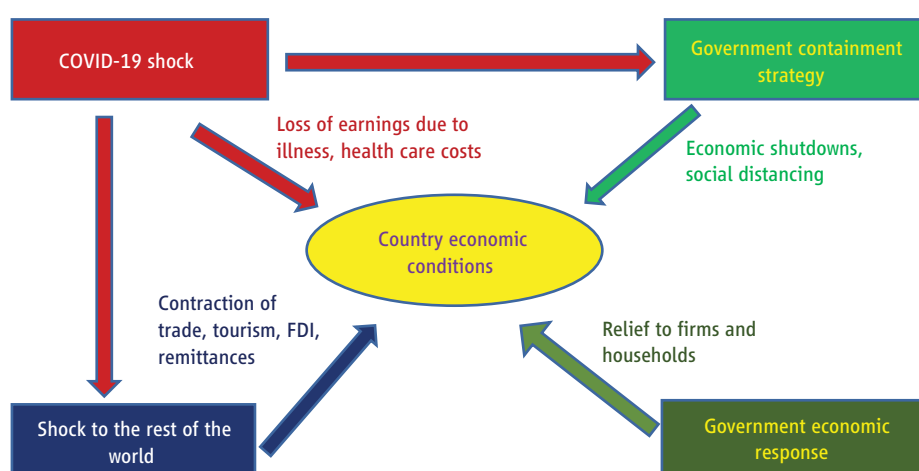
that reached more than 10 million beneficiaries, or one-third of the total population. In contrast, many Pacific Island countries have underdeveloped social protection systems and need to institute flexible coverage that can adapt and be scaled up in response to large shocks.

- ***Devising strategies for smart schooling*** to protect students, staff, teachers, and their families—sanitary protocols, social distance practices, student re-enrollment—could prevent long-term losses of human capital, especially among the poor. School closures due to COVID-19 could result in a loss of 0.7 learning-adjusted years of schooling in EAP countries. As a result, the average student in the region could face a reduction of 4 percent in expected earnings every year of their working lives.
- ***Support for firms*** is needed to prevent bankruptcies and unemployment without unduly inhibiting the efficient reallocation of workers and resources to firms and sectors. Most EAP governments have extended support to firms but access was uneven, with only 10–20 percent of firms in some surveyed countries receiving assistance. Support must be based as far as possible on transparent and objective criteria related to not just past performance or current pain, but the potential to thrive in the future. And to avoid assistance being prolonged unduly, governments can commit to phasing it out by linking it to observable macroeconomic indicators of recovery. Many micro and informal firms operate outside of financial and tax systems, are hard to reach, and are best supported through social protection interventions.
- The crisis is accelerating four existing trends in trade: early recovery in the EAP region is reinforcing *regionalization*; aversion to overdependence in supply chains is encouraging the *relocation* of global value chains (GVCs) from China; digitization is boosting *servicification*; and a craving for self-reliance is increasing *protection* in some areas, even as countries liberalize in others. EAP countries need to ***deepen trade reform***, especially of still-protected services sectors—finance, transport, communications—to enhance firm productivity; avert pressures to protect other sectors; and equip people to take advantage of the digital opportunities whose emergence the pandemic is accelerating. China alone could add 0.5 percent to its own and regional GDP by extending the preferences in its bilateral agreement with the United States to all countries, while embarking on a program of deeper domestic reform and market opening.

From Containment to Recovery

The COVID-19 pandemic has inflicted multiple shocks on the EAP region: the disease, domestic economic shutdowns, and reverberations from the rest of the world (Figure 1). Today, the domestic picture is positive with qualifications. The pandemic has so far been contained in part of the region, but not in Indonesia and the Philippines, and still threatens other countries, most recently Myanmar (Figure 2). The shutdowns have been mostly phased out and replaced by more targeted measures. However, the international picture is cloudy, albeit with a slim silver lining. The region is exceptionally exposed to a world in difficulty, where tourists fear travel and investors balk at uncertainty. After a precipitous fall, trade is beginning to recover, and after a dramatic exit, short-term capital has quietly returned to the region. Governments are seeking to mitigate the economic pain but at the cost of growing fiscal strain.

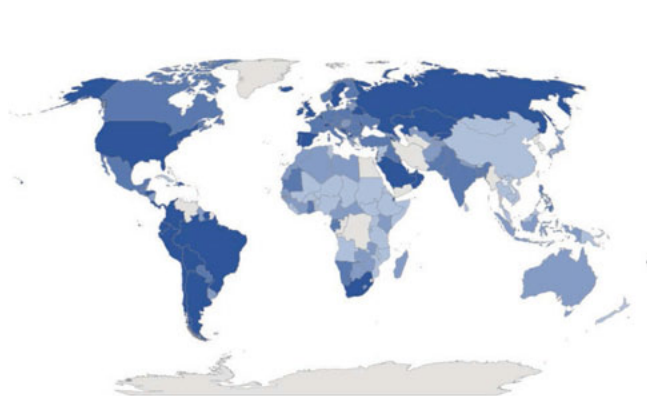
Figure 1. COVID-19 has hit countries with direct and indirect shocks which governments are trying to mitigate



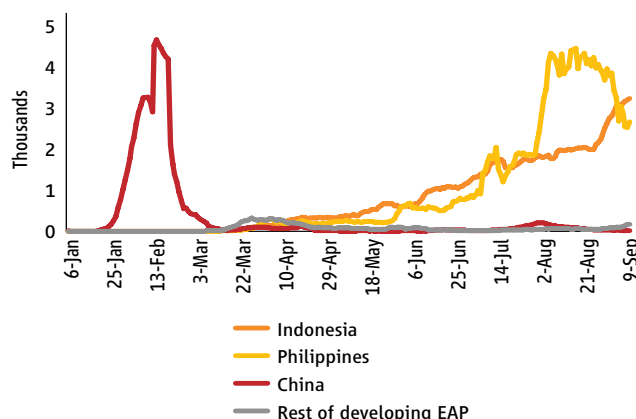
Source: World Bank Staff elaboration.

Figure 2. EAP countries have so far suffered less from COVID-19, and the disease has been largely contained, except in Indonesia and the Philippines

a. Total confirmed cases
(per million)



b. New confirmed cases
(7-day moving average)



Sources: Oxford University, Our World in Data, <https://ourworldindata.org/coronavirus>; World Bank staff elaboration.
Note: Last data point September 10.

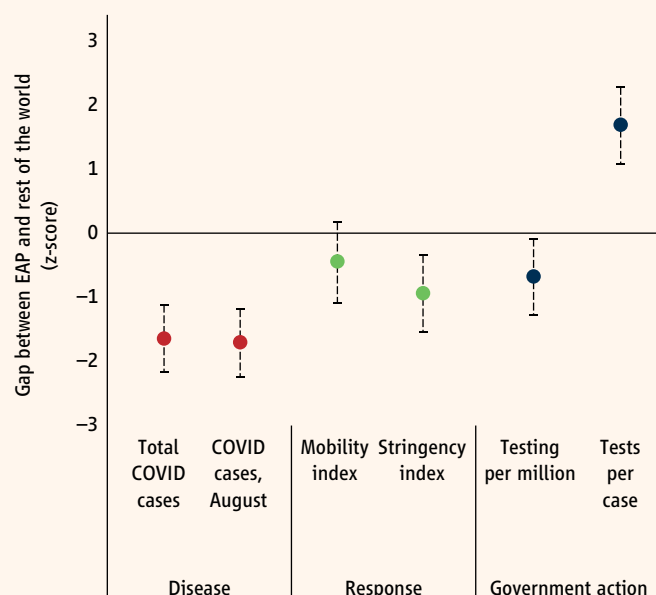
Containing COVID-19

Many EAP countries have been relatively successful in containing the spread of the virus. However, the number of new cases is still high in Indonesia and the Philippines, and beginning to increase in Myanmar (see also Annex A1 for a comparison of the COVID experience of EAP countries). Other countries in the region have also experienced sporadic spikes in the number of new cases in certain localities. Our understanding of what has worked in the battle against COVID-19 is still evolving. Box 1 presents some suggestive empirical evidence that lockdowns, smart containment based on extensive testing, and economic measures such as sick pay have helped contain the disease, Annex A2, which compares the strategies of Indonesia, the Philippines, and Vietnam reveals the importance of early and decisive action as well as of clear and consistent communication.

Box 1. The correlates of successful containment

The measures taken to contain COVID-19 across the world range from lockdowns and curtailing travel; to testing tracing, isolating, or quarantining; and providing economic support, such as sick pay to encourage sick people to stay at home. EAP economies have, on average, employed more stringent mobility restrictions and more tests per case (an indicator of contact tracing) than the rest of the world (Figure B1.1).

Figure B1.1. Comparing containment measures between EAP and rest of the world



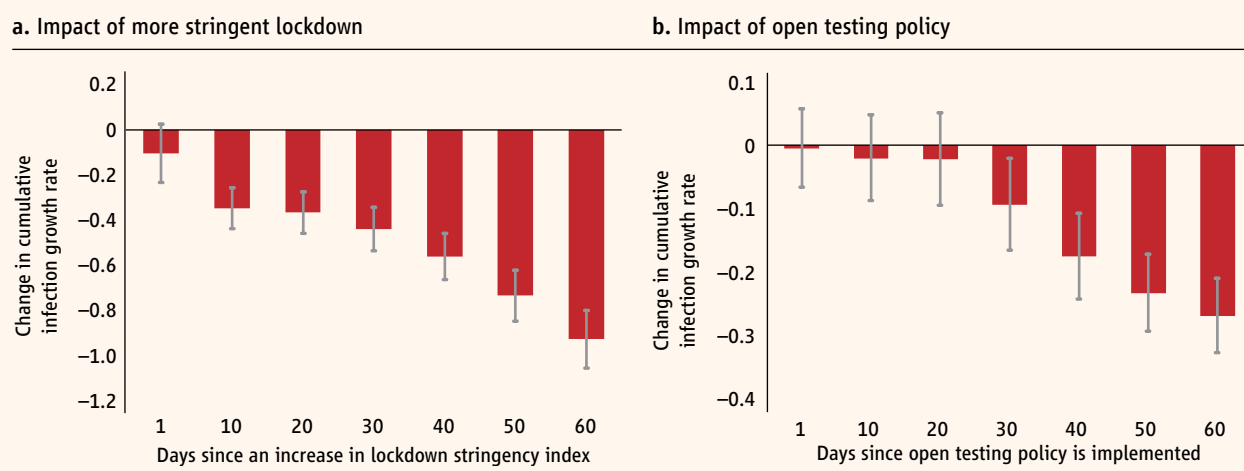
Sources: EAPCE staff, based on data from google; Oxford Covid-19 Government Response Tracker 2020.

Note: The figure depicts the difference in means between the EAP region countries and the rest of the world using standardized z-score variables that allow comparisons in terms of standard deviations. Dashed lines denote 95 percent confidence intervals.

These measures are associated with a slower spread of COVID-19 infections (Figure B1.2). However, there is significant heterogeneity in the time frame over which different policies are effective. A more stringent lockdown policy is almost instantaneously effective in reducing cumulative growth of infected cases. In contrast, the effectiveness of a “smart-containment” policy such as open testing is observed with a lag. Economic support

(continued)

(Box 1. continued)

Figure B1.2. The impact of lockdowns, testing, and economic support over time on the spread of COVID-19

Source: EAPCE staff research, based on data Oxford Covid-19 Government Response Tracker 2020.

Note: Bar heights represent the estimated effects of government introducing an open testing policy on cumulative infection growth rate. A negative value is interpreted as a reduction in the cumulative growth rate of COVID-19-reported cases as a result of the policy introduction. The lockdown stringency index is a rescaled (0–100) average of sub-indicators, with adjustments for whether restrictions are targeted or general: closing of schools, workplaces, and public transport, as well as restrictions on public events, gathering sizes, and domestic and international travel. Testing policy is a binary indicator which equals 1 if testing is open and available to all and 0 otherwise. Whiskers represent 95 percent confidence intervals of the estimates. Each regression includes time and country fixed effects. The dependent variables are standardized as units of deviation from the global mean.

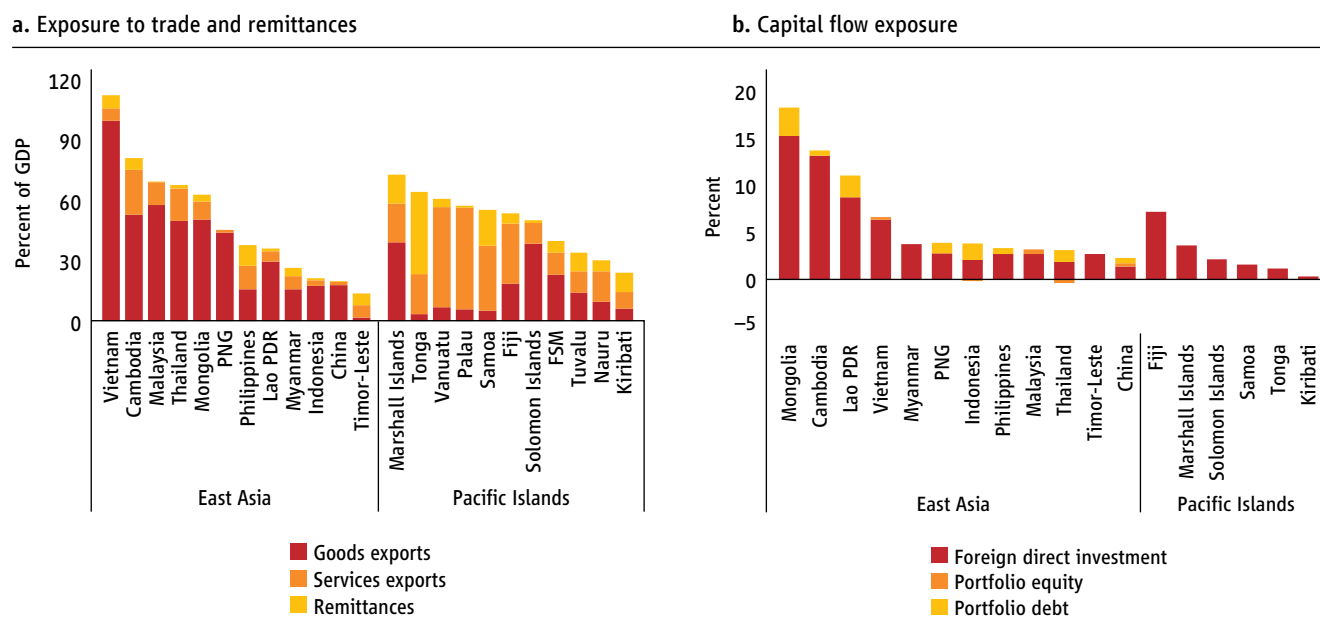
policies, such as income support for lost pay, which encourages sick people to stay at home, are also associated with reduction in infection growth, demonstrating the benefits of an integrated policy approach to containment.

It is relevant that countries like China, Malaysia, and Vietnam, imposed lockdowns relatively early (though in some cases even earlier action would have been desirable) and then transitioned to a testing-based strategy, accompanied by public information campaigns to encourage precautionary behavior. Less successful countries were not able to implement early comprehensive shutdowns (Demirguc-Kunt et al. 2020), build the requisite testing capacity, and induce the necessary behavioral change.

Exposure to a World Economy in Trouble

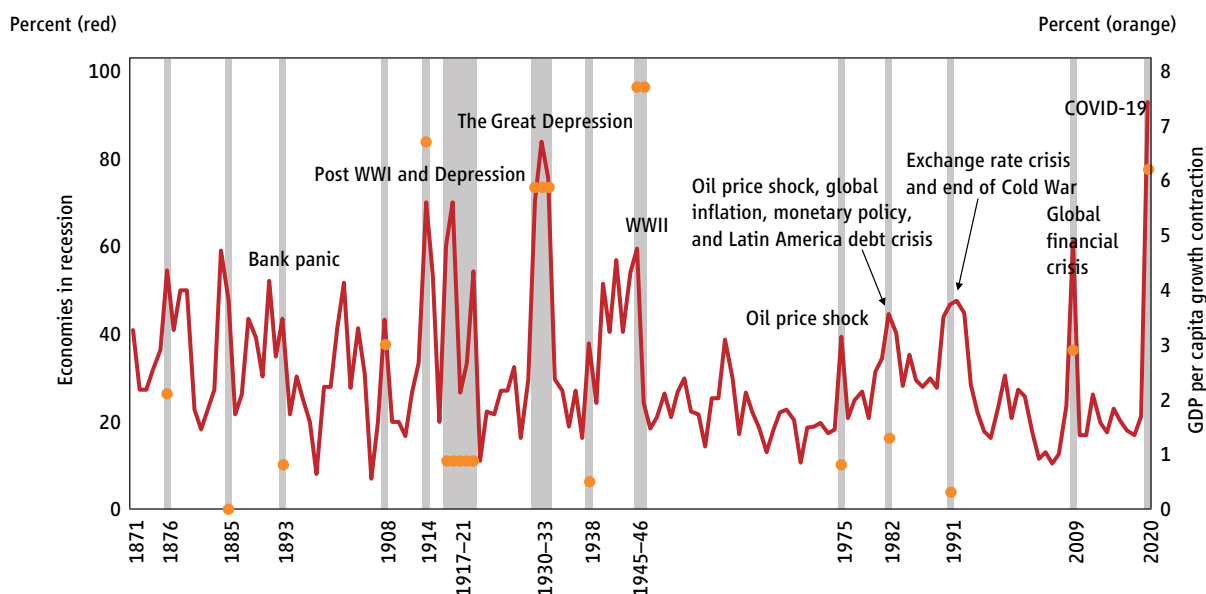
The EAP countries are exposed to the world economy through flows of goods, services, labor, and capital (Figure 3). Vietnam stands out in terms of its share of exports in GDP, though the share is only half as large when expressed in value added terms to adjust for the importance of imported inputs. China's dependence on exports has halved since 2006 to only about 18 percent of GDP, comparable with the relatively low exposure of Indonesia. The latter economies may be less affected by sluggish global demand in the wake of the COVID-19 pandemic, compared to Cambodia, Malaysia, Mongolia, and Thailand which are more reliant on exports. The Philippines, Thailand, and most Pacific Island economies depend more on services exports and are more exposed to travel disruptions.

The global economy has sunk into a major recession. The COVID-19 pandemic crisis shares some similarities with other crises, such as those stemming from natural hazards, wars, macroeconomic mismanagement, and international financial meltdowns (Loayza et al. 2020; World Bank 2020a). However, this pandemic crisis arguably combines the worst features of all these crises: a simultaneous supply and demand shock; domestic, regional, and global in scope (Figure 4);

Figure 3. EAP countries have strong links to the rest of the world through flows of goods, services, labor, and capital

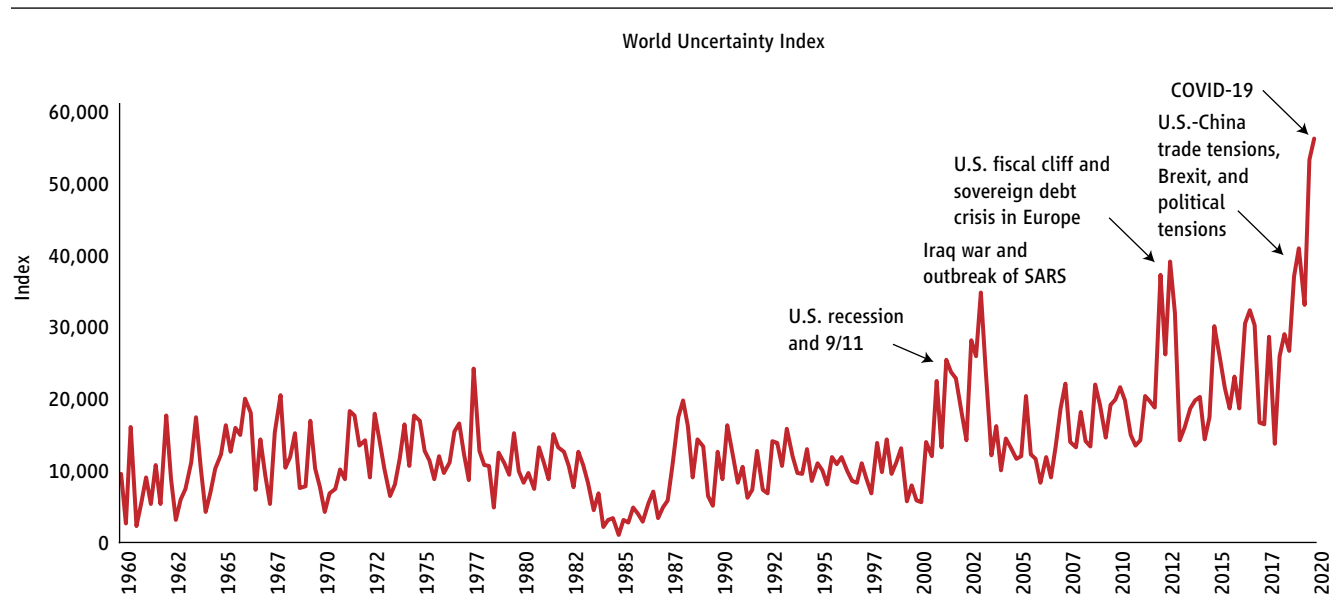
Source: World Bank.

Note: Unweighted average over 2017–19 period or three latest years available.

Figure 4. Much of the world has sunk into an unprecedented recession*(proportion of economies in recession and the contraction in GDP per capita growth)*

Sources: Authors' figure adapted from World Bank 2020a. Data from Inklaar et al. 2018; Kose et al. 2019, 2020.

Note: 2020 uses forecast data. Shaded areas refer to global recessions. Sample includes 183 economies though the sample size varies significantly by year. For crises that last for more than a year, the annualized average of the cumulative contraction of GDP per capita growth during the crisis is used.

Figure 5. COVID-19 has created exceptional uncertainty

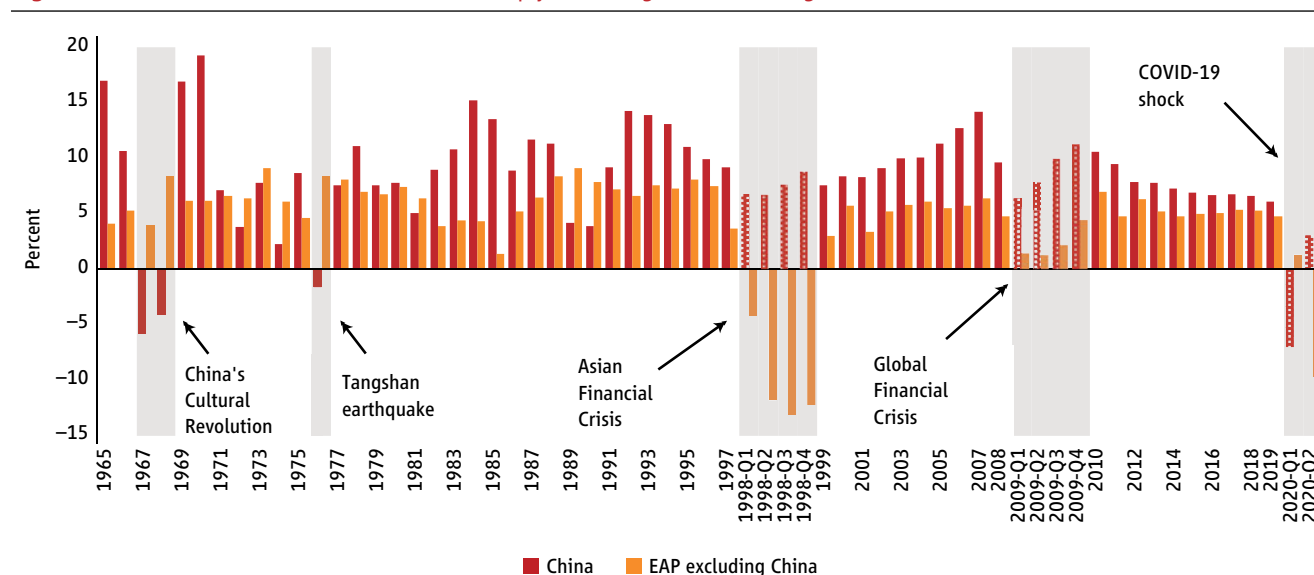
Source: Figure reproduced from Ahir et al. 2018.

Note: The index is constructed by text-mining country reports published by the Economist Intelligence Unit (EIU) for words such as “uncertainty” and its variants. It is then normalized according to the total number of words in each report.

a projected long duration; and a high degree of uncertainty (Figure 5). It has been described as “the most adverse peacetime shock in over a century” (World Bank 2020a) and is bringing about the largest contraction in global GDP per capita since World War II—a 5.6 percent decline in the first half of this year.

The Economic Impact

As a consequence of the domestic and foreign supply and demand shocks, economic activity in the region has declined in the first half of 2020 more sharply than in decades (Figure 6). Regional output contracted by

Figure 6. Domestic and external shocks have sharply reduced growth in the region

Source: World Bank Economic Monitoring.

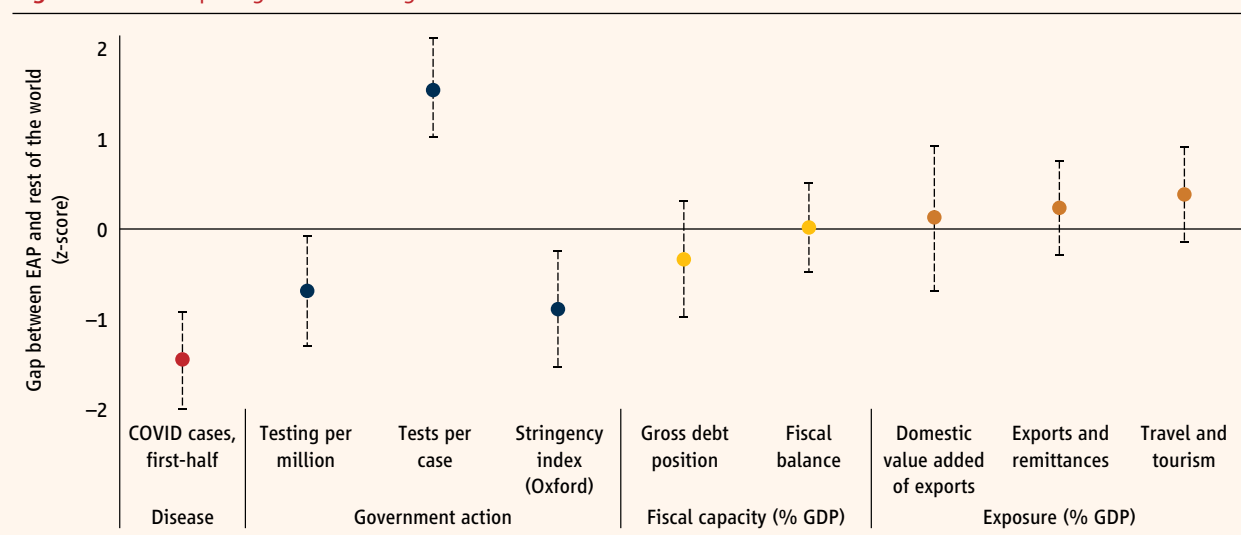
Note: Year on year growth.

2.2 percent (y/y) in the first half of 2020, reflecting the impact of pandemic-related lockdowns and a deep contraction in exports. The impact on regional economies was uneven, with output in China contracting by 1.8 percent and shrinking by 4.0 percent on average in the rest of the region.

Box 2. The correlates of the impact on economic growth

We would expect four country-specific factors to impact growth in the first half of 2020: the spread of COVID-19, the measures taken to contain its spread, the exposure to the global recession, and the capacity of governments to provide fiscal support. Measures that have helped contain the disease in the EAP economies, such as lockdowns and testing and tracing, can have different effects on economic activity (Figure B2.1). Lockdown measures would negatively affect economic growth, and more extensive testing and tracing (smarter containment) could allow more economic activity. In addition, countries reliant on trade, tourism, and travel are likely to experience larger contractions given the global recession. Large fiscal imbalances and high debt levels could limit fiscal space for support. EAP economies appear to have larger services sectors, and to be more dependent on external demand compared to the rest of the world (World Bank 2020b).

Figure B2.1. Comparing correlates of growth between EAP and rest of the world



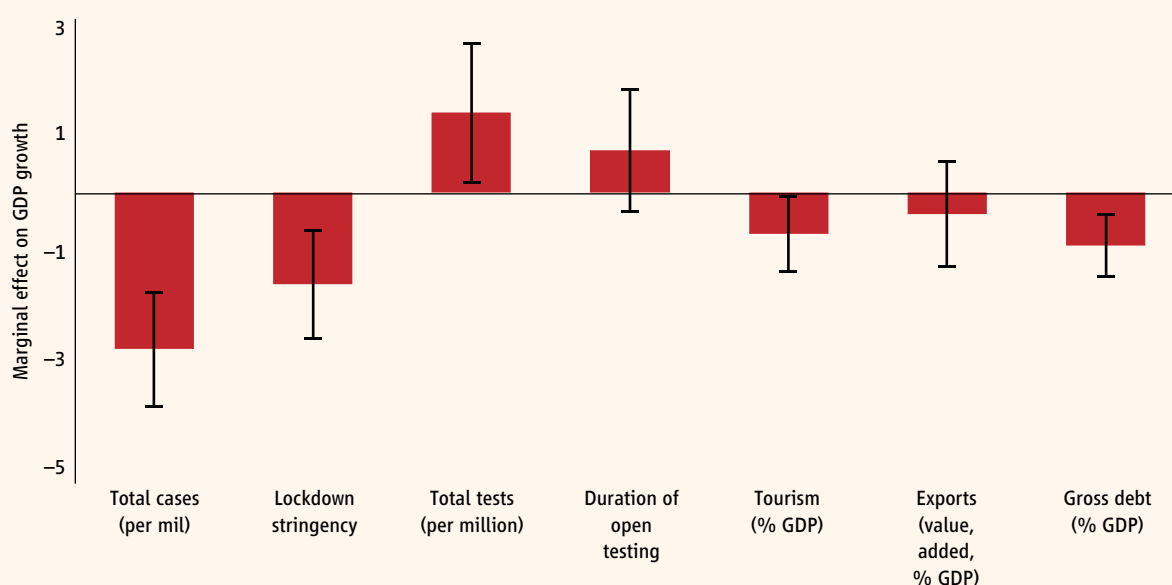
Source: EAPCE staff research, based on data from World Development Indicators; Oxford Covid-19 Government Response Tracker 2020.

Note: The figure depicts the difference in means between the EAP region countries and the rest of the world using standardized z-score variables that allow comparisons in terms of standard deviations. Dashed lines denote 95 percent confidence intervals.

Countries that had more cases of the disease, imposed more stringent lockdowns, depended more on earnings from tourism, and had more indebted governments, experienced a greater decline in GDP growth during the first half of 2020 (Figure B2.2). Testing is positively and significantly correlated with growth outcomes, even after controlling for the level of infection and the stringency of lockdowns policy. More testing may have infused greater confidence in people to step out and engage in economic activity.

(continued)

(Box 2. continued)

Figure B2.2. The impact of the disease, containment strategies, external exposure, and fiscal capacity on economic growth

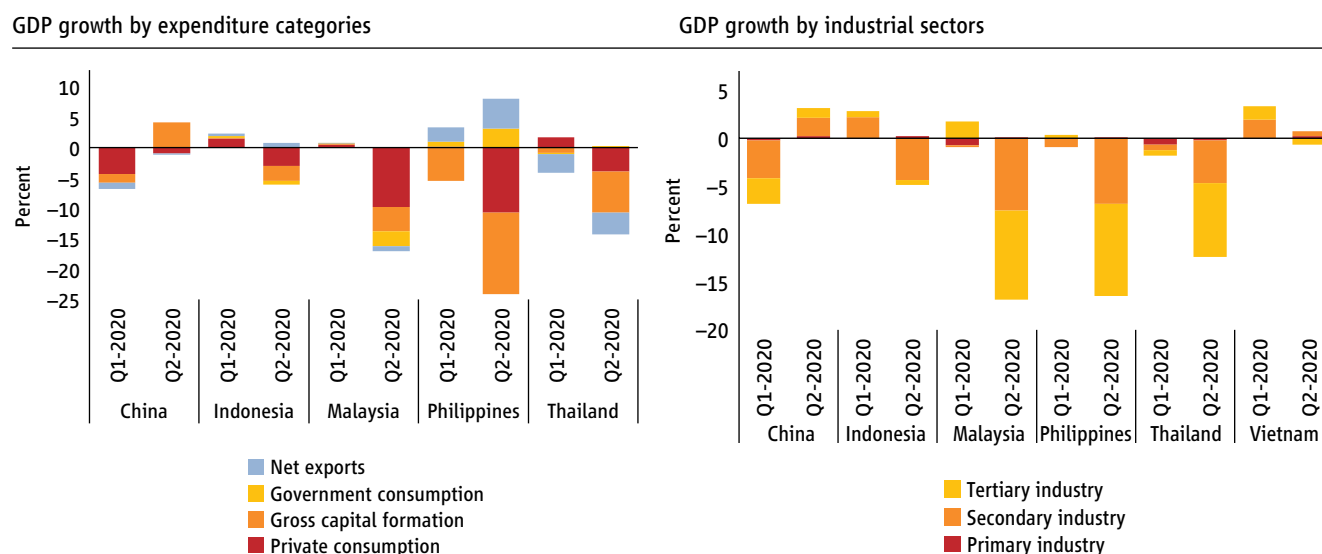
Sources: EAPCE staff research, based on data from World Development Indicators; Oxford Covid-19 Government Response Tracker 2020.

Note: The sample includes 49 countries that have published GDP growth data for Q1 and Q2 2020. The dependent variable is GDP growth in the first half of 2020 relative to the same period in 2019. All explanatory indicators are standardized and expressed in units of standard deviation from global median. Total cases per million and total tests per million are included in log values. Bar heights represent the sizes of the estimated coefficients. Whiskers represent 90 percent confidence intervals.

Regional growth was pulled down by shrinking private consumption and investment, and by contracting manufacturing and services. Private consumption was hit by declining incomes, mobility restrictions, and an increase in precautionary savings. Private investment was dampened by the contraction in domestic and external demands, as well as the increase in uncertainty. Social distancing created a sectoral pattern of contraction not seen in past crises. The sharpest output declines are in services rather than manufacturing, while agriculture remains relatively resilient (Figure 7). In China, where growth bottomed out in 2020-Q2, the recovery was uneven, driven by public investment and net exports, while private investment and consumption remained sluggish. These developments reflected a fiscal policy response predicated on public investment and on a mitigating impact on firms, with relatively limited direct support to household incomes (Box 3).

In most countries, workers in services and manufacturing sectors were hit hardest. Due to lockdowns and shrinking demand, job losses were more prevalent among those working in accommodation and food services, transportation, construction, and manufacturing (Figure 8). Informality rates tend to be higher and the ability to work from home tends to be lower in these activities. In countries like Cambodia, some of the workers who lost jobs in services and manufacturing sought refuge in the less affected agricultural sector.

Figure 7. GDP growth was pulled down by shrinking private consumption and investment, and by contracting manufacturing and services



Sources: Haver Analytics; World Bank.

Note: For China, consumption includes private and government consumption.

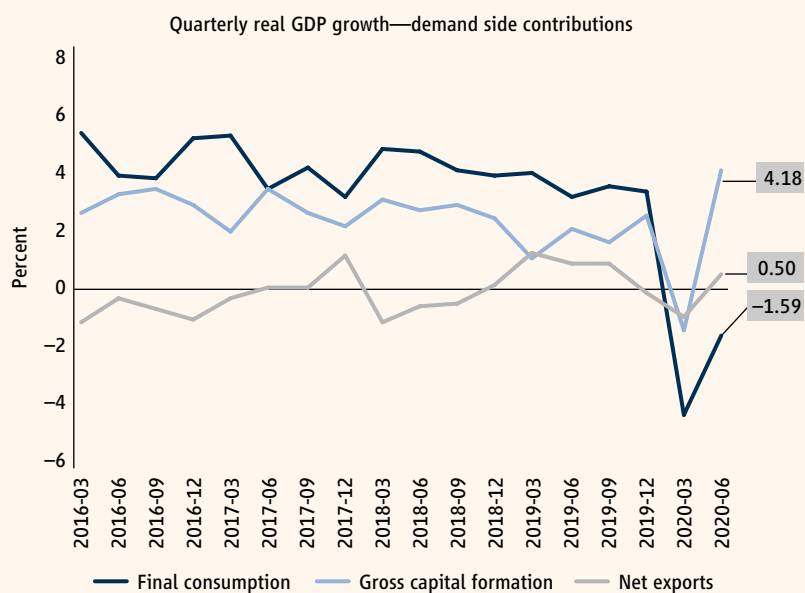
Box 3. COVID-19 and rebalancing China's economy

China's recovery has been fast, but the pattern reveals underlying fragility and emerging imbalances. With containment measures largely removed, the supply side has rebounded quickly. On the demand side, the recovery was driven by public investment and net exports. Meanwhile, private consumption and private investment have trailed, reflecting still dampened investor and consumer confidence (Figure B3.1). Subdued domestic demand, low commodity prices, and limited outbound tourism have led imports to contract even as exports surged. The current account balance to nominal GDP ratio surged to 3.4 percent in 2020Q2, the highest level since 2012.

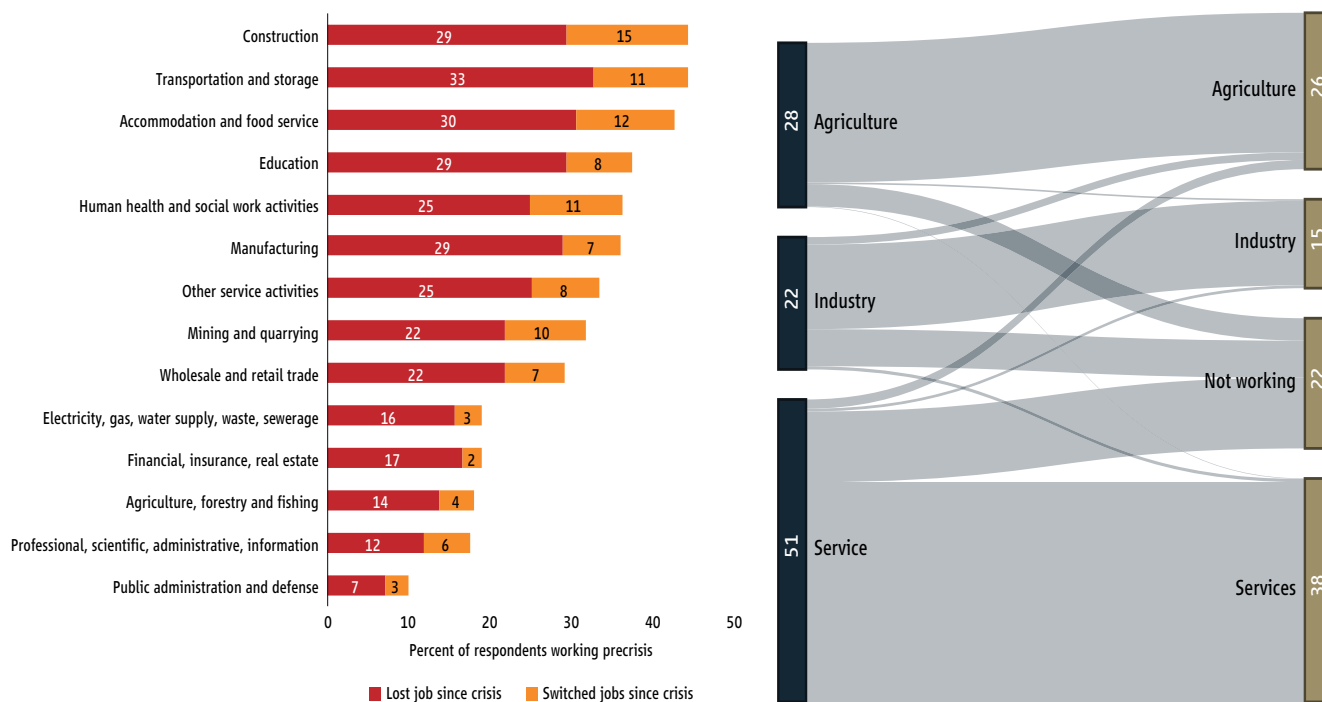
This recovery path partly reflects a fiscal policy response focused on mitigating impacts on firms and boosting public investment. In contrast, support to households and consumption has been relatively limited, despite some measures to scale up social assistance, unemployment benefits, and social pensions. While supporting a short-term rebound, an imbalanced recovery path poses risks to China's long-standing objective of rebalancing the economy from investment and export driven growth toward a more consumption driven growth. Such rebalancing would make China's recovery more sustainable, reduce external imbalances, and hence contribute to lowering international tensions.

(continued)

(Box 3. continued)

Figure B3.1. Reversed rebalancing

Source: Haver Analytics.
Note: Yly growth.

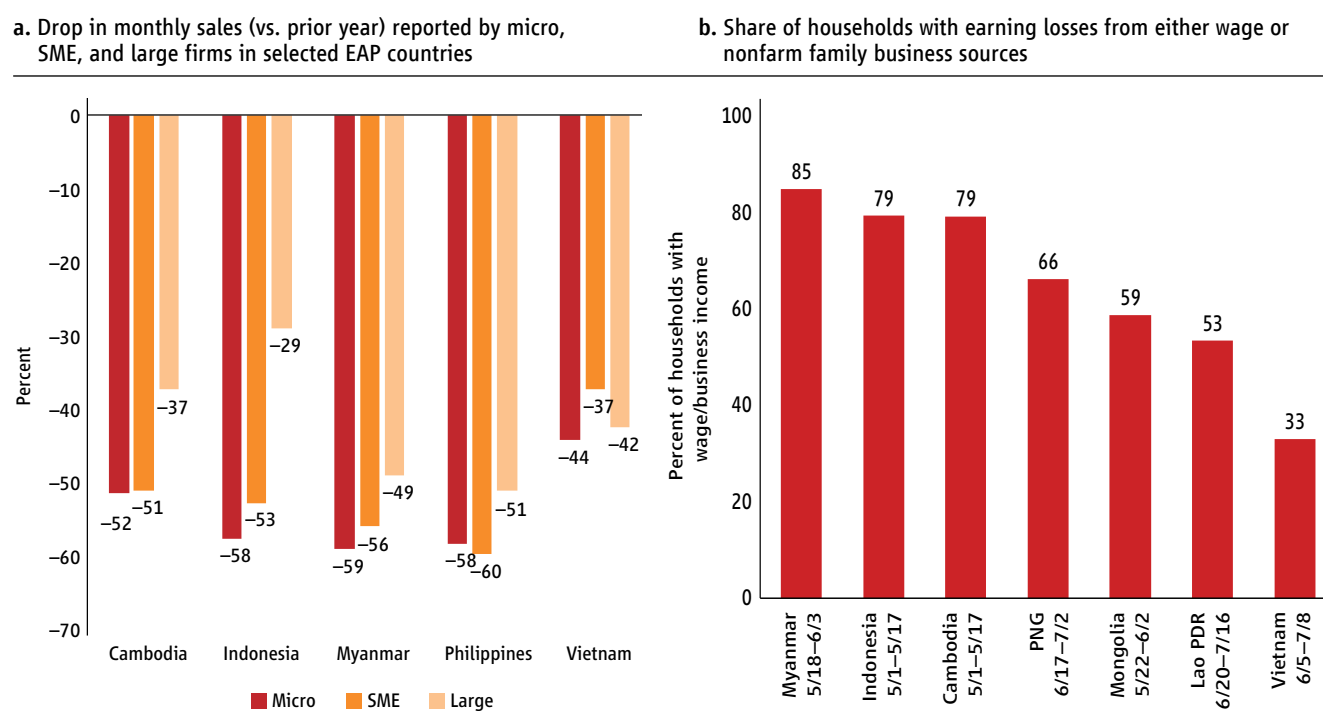
Figure 8. The contraction led to a loss of jobs in services and manufacturing*Changes in employment status from before to after the COVID-19 crisis, by precrisis subsector*

Source: EAP High frequency phone surveys, first round.

Note: Mongolia does not report on job switches. Sample includes Cambodia, Indonesia, Lao PDR, Mongolia, Myanmar, Papua New Guinea, and Vietnam. Population numbers are in millions of individuals.

The employment and earning impacts of the pandemic have been large and widespread. Firm sales in EAP countries are on average 38 to 58 percent *lower* in April or May 2020, compared to the same month in the previous year (Figure 9). The losses are widespread, even for countries such as Vietnam that have successfully contained the pandemic. Larger firms seem to be recovering faster than SMEs—with SMEs both more vulnerable to the crisis and less able to adapt by going digital. The monthly sales of SMEs have fallen by 7 to 23 percentage points *more* than larger firms in EAP countries. Both wage employees and those working in family businesses, many of which are in the services sector, have experienced significant income declines.

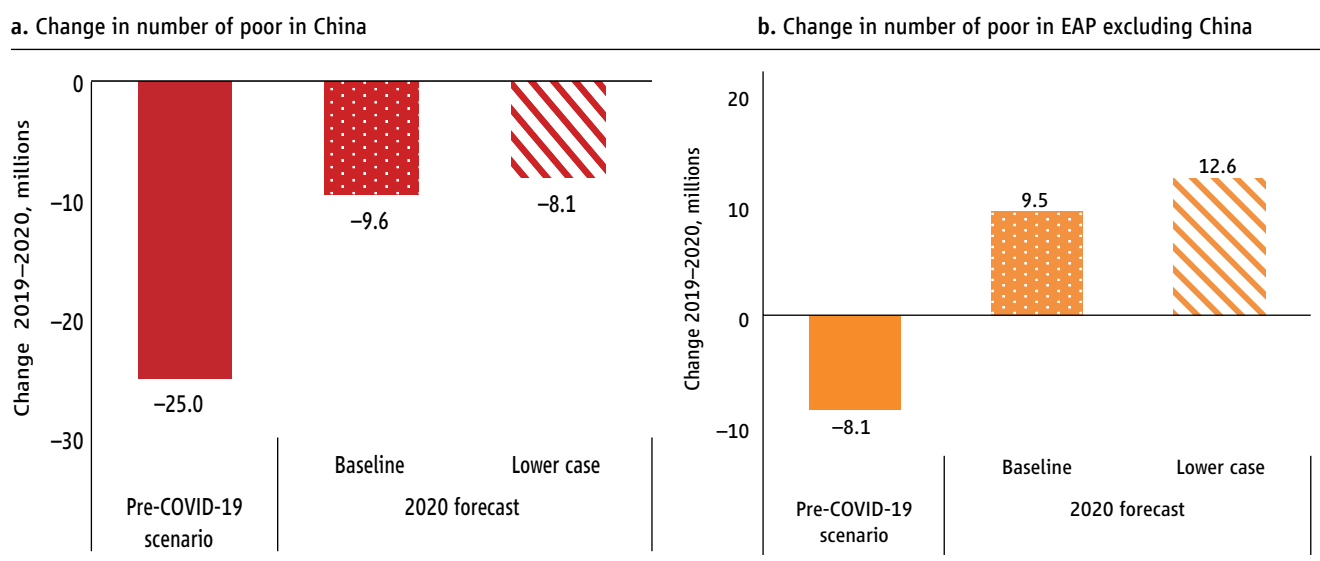
Figure 9. Firm sales and household earnings mirror the macroeconomic contraction



Sources: Business Pulse Surveys; EAP high frequency phone surveys, first round.

Note: A. The survey was conducted in May for Myanmar; June for Cambodia, Indonesia, and Vietnam; and July for the Philippines. Monthly sales refers to firm sales in the last completed month (in the case of Myanmar) or the last 30 days (other countries) prior to the survey, relative to the same period in 2019. Micro is defined as firms having less than 5 employees, SME as having 5–99 employees, large as having 100+ employees. In the case of the Philippines, the change is between July and April, when the Enhanced Community Quarantine (ECQ) was adopted. B. Survey dates are indicated underneath the country names. In Mongolia and Cambodia, wage losses are reported for the whole household, not only heads of households.

Poverty in developing East Asia and Pacific could increase for the first time in 20 years. The COVID-19 pandemic is expected to reverse the sustained trend of poverty reduction in the region. Prior to the onset of COVID-19, 33 million people were projected to escape poverty in 2020 based on the upper-middle-income class poverty line (US\$5.50/day, 2011 PPP). Instead, based on the latest GDP forecasts and past growth to poverty elasticities, poverty is likely to be 1.6–1.8 percentage points higher than previously projected. This translates into between 33 to 38 million *more* poor people than in the pre-COVID-19 scenario. While poverty in China is projected to decline, poverty in the rest of the region is projected to increase (Figure 10).

Figure 10. Up to 38 million more people are being pushed into poverty as a result of the pandemic

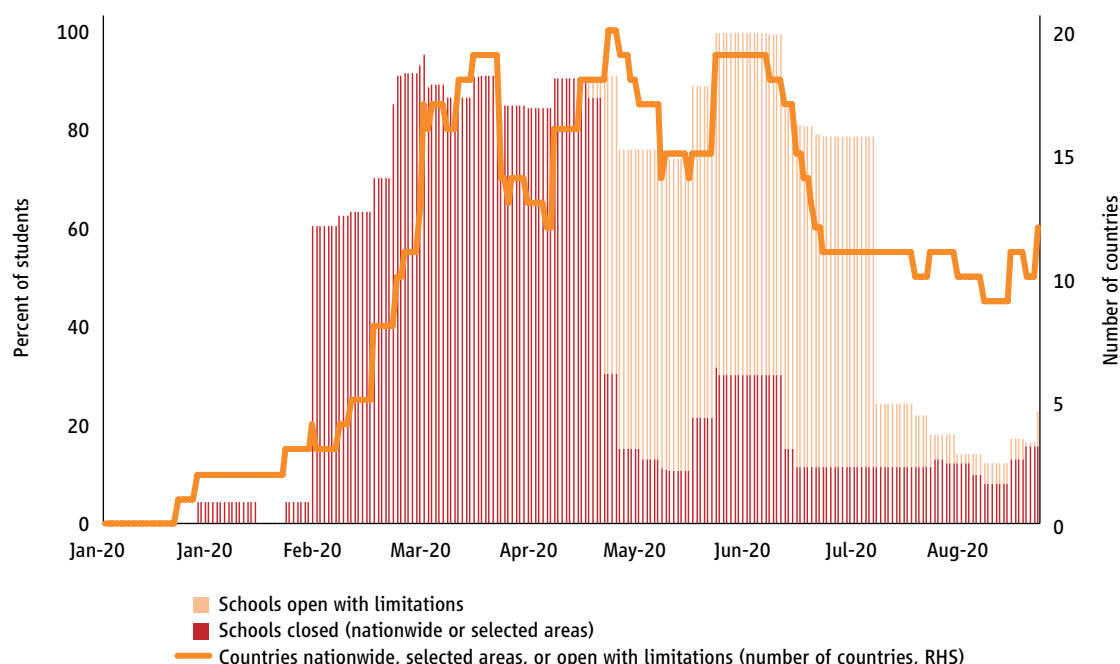
Source: World Bank staff estimates.

Note: Poverty estimates are based on growth forecasts, population projections, and historical growth elasticities of poverty. US\$5.50/day (2011 PPP) indicates the poverty line for upper-middle-income countries. The baseline and lower-case forecasts are as of September 17, 2020.

At the peak of the crisis, up to 20 of the school systems in EAP were affected by closures. Schools closed in China, Mongolia, and Vietnam in January; several other countries followed in mid-to-late March. The data indicate that every student in the region was out of school at one time or another since January 2020, and many for significant durations (Figure 11). Between January 1 and August 31 of this year, schools in the region were closed for an average of 2.7 months or 46 percent of the total time they would have otherwise been in session.

Figure 11. Students in East Asia and the Pacific have lost significant school time due to COVID-19

Number of countries with schools closed or open with limitations due to COVID-19 and the percentage of the region's students affected



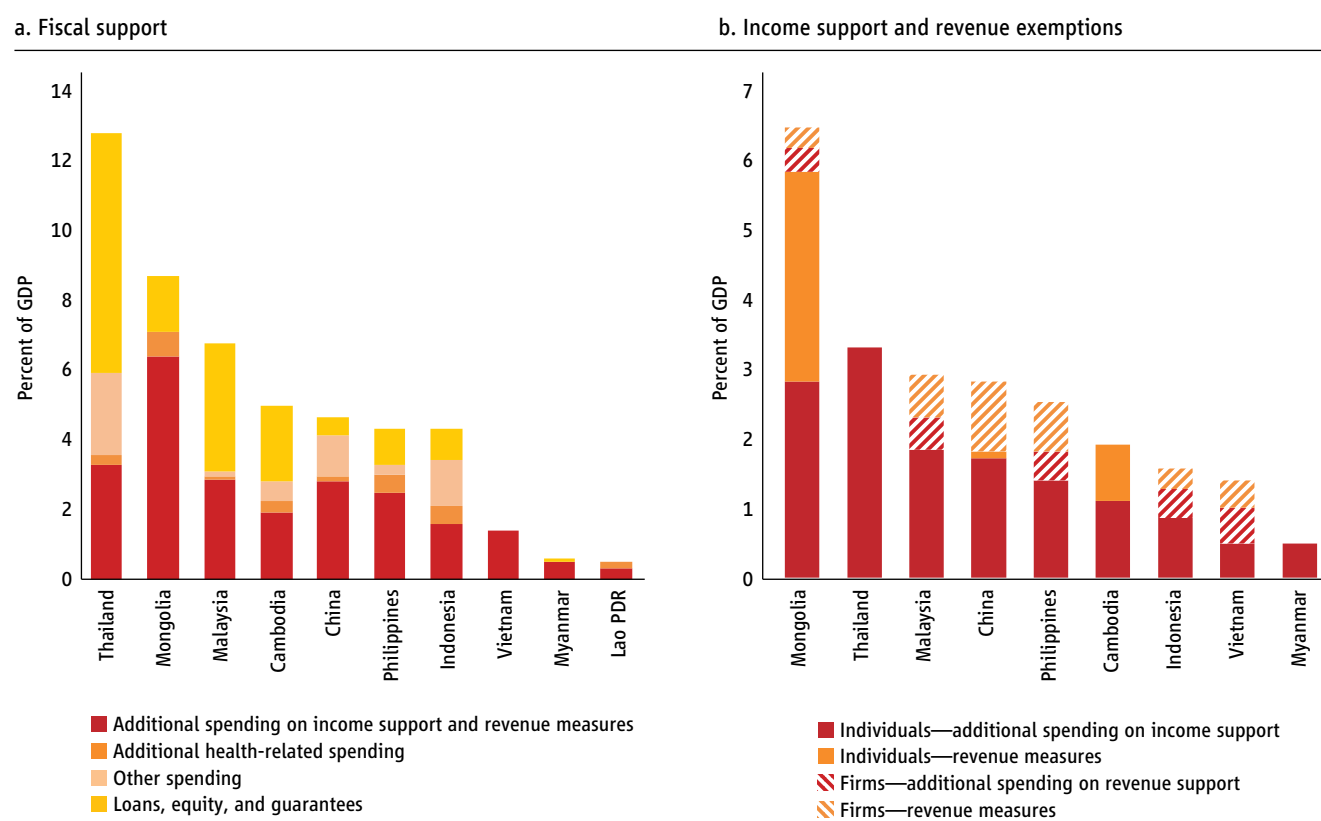
Source: Cloutier et al. (2020), based on Education COVID monitoring database and inputs from country task teams.

Notes: "Schools closed nationwide" means that all schools in the country are closed; "Schools closed in selected areas" means that schools are open in some geographical areas and closed in others; "Open with limitations" means that schools in the country are open but serving only certain grades or serving students on a rotating schedule.

The Government Response

Government stepped in to help households smooth consumption and firms avoid bankruptcies. The average size of fiscal measures announced to date in developing EAP, estimated at around 5 percent of GDP, was comparable to the other developing regions but varied considerably in size and breadth across the developing EAP countries (Figure 12). Nearly two-thirds of these income and revenue measures were directed at individuals to cushion the fall in household incomes. Such measures were broadbased, utilizing social insurance to protect formal sector workers and social assistance to support the poor and vulnerable, as well as labor market interventions. Additional allocations in response to COVID-19 have been higher than the amounts spent on social assistance programs prior to the crisis in most countries. One consequence of this large and rapid response has been that many governments in the region have found it hard to scale up their narrow social protection programs to reach the new COVID-19 poor in the middle class and the informal sector, groups that fall outside the scope of countries' traditional social safety nets (Mason et al. 2020).

Figure 12. To stem the economic pain, governments provided fiscal support to firms and households

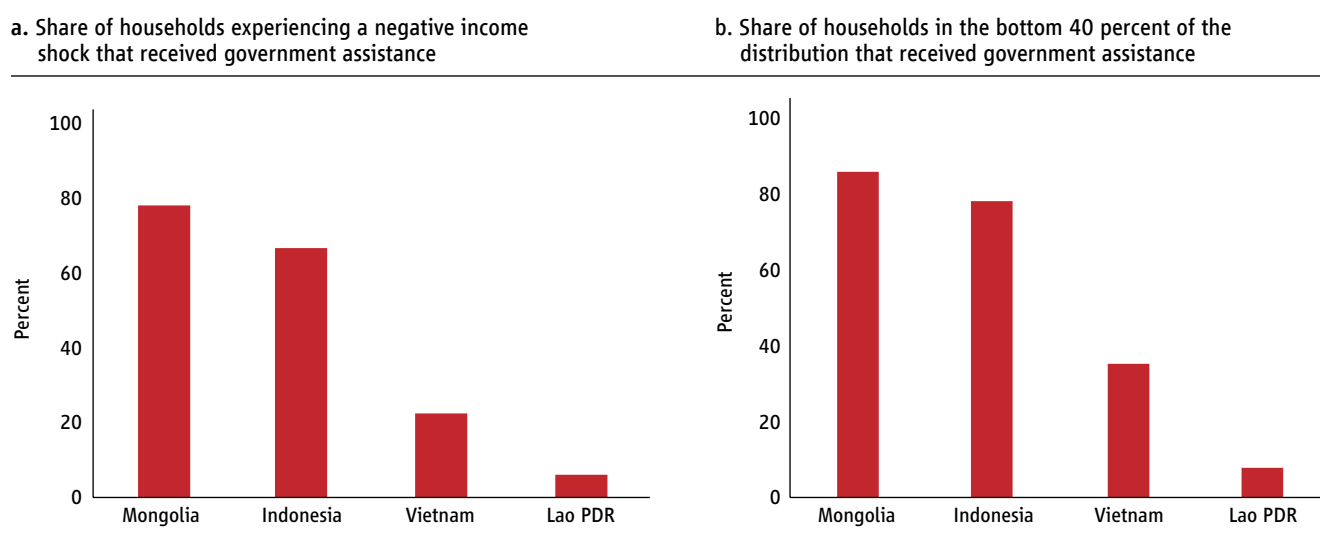


Sources: International Monetary Fund June 2020 World Economic Outlook Update; World Bank staff estimates.

Note: Data are as of September 12, 2020. Data refer to general government, except for Indonesia, Malaysia, and the Philippines, which refer to central government only. Income and revenue support measures include direct transfer payments; reduction or deferral of payment commitments; foregone revenue from tax cuts, credits, and exemptions; and other financial assistance to individuals and firms.

The speed and scope of social protection responses have varied considerably across countries. Several countries in the region, including China, Malaysia, and Thailand, appear to have been able to mobilize their responses quickly. Other countries (e.g., Myanmar, Vietnam) announced ambitious plans early but appear to have been slower in implementing them. And still others—with few existing programs and less developed social protection systems—have mounted little or no COVID-specific response (e.g., Lao PDR). High-frequency data collected by the World Bank between May and early July 2020 highlight cross-country variation in government support to vulnerable groups since the start of the crisis (Figure 13). Beyond cross-country differences, the data also indicate that, at the time of the surveys, programs had reached a higher share of those in the bottom 40 percent of the population—the traditional targets of social assistance—than those whose incomes fell as a result of the pandemic.

Figure 13. Coverage of programs providing support to households during the pandemic has varied across countries

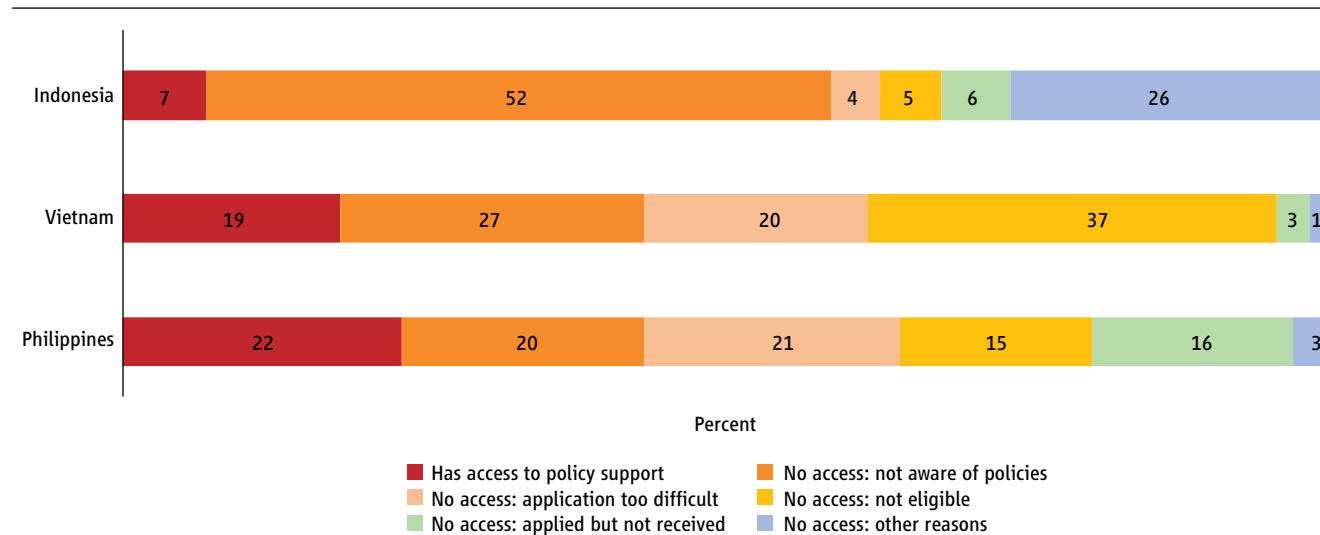


Source: EAP high frequency household phone survey, first round.

Note: Share of households receiving government assistance at the time of the first-round survey. Assistance programs include existing and new programs that were in place at the time of the survey flagged as part of the emergency response to the pandemic. Dates for the first round of data collection for each of the four countries in the figures are as follows: Indonesia (May 1–17, 2020), Lao PDR (June 20–July 17, 2020), Mongolia (May 22–June 2, 2020), and Vietnam (June 5–July 8, 2020).

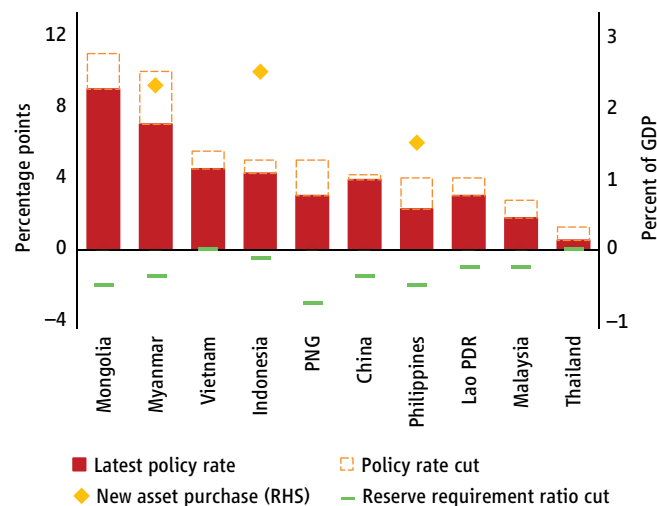
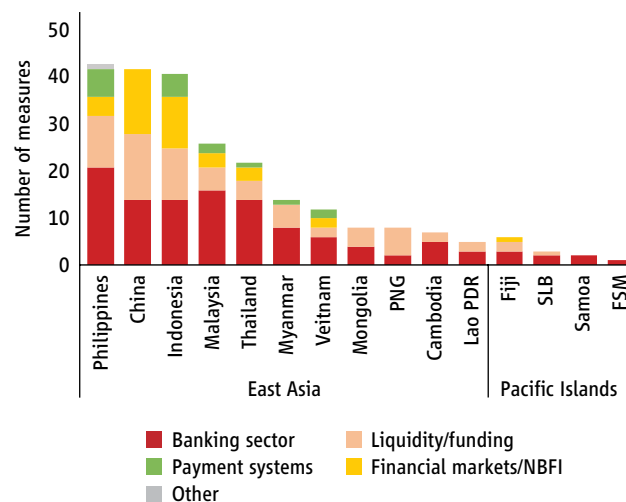
Support has also not reached many firms. Business Pulse Survey data show that only a small share of firms received direct government support. The share varies substantially by country, ranging from less than 10 percent in the case of Indonesia to around 20 percent in the Philippines and Vietnam (Figure 14). In particular, formal financial institutions may not reach many small and medium enterprises (SMEs), and most informal and micro firms, since they are not part of the tax or financial system. Lack of awareness is also a major barrier to firms taking up available COVID support (Apedo-Amah et al. 2020). In Indonesia, the majority of firms were unaware of public support.

Governments have eased monetary policy and increased support to the financial sector (Figure 15). In China, the People's Bank of China (PBOC) has announced more than 2.2 percent of GDP to support the financial sector and firms. In other EAP economies, central banks have cut policy rates and lowered reserve requirements. Some central banks, such as in Indonesia, have directly purchased government bonds, raising market fears of erosion of hard-won central bank independence. Financial sector support has covered both banks and nonbank financial intermediaries.

Figure 14. A fraction of firms received policy support

Sources: Business Pulse Surveys.

Note: The survey was conducted in June for Indonesia and Vietnam, and July for the Philippines.

Figure 15. Governments have also loosened monetary policy and increased support for the financial sector**a. Monetary policy support measures****b. Financial sector support measures**

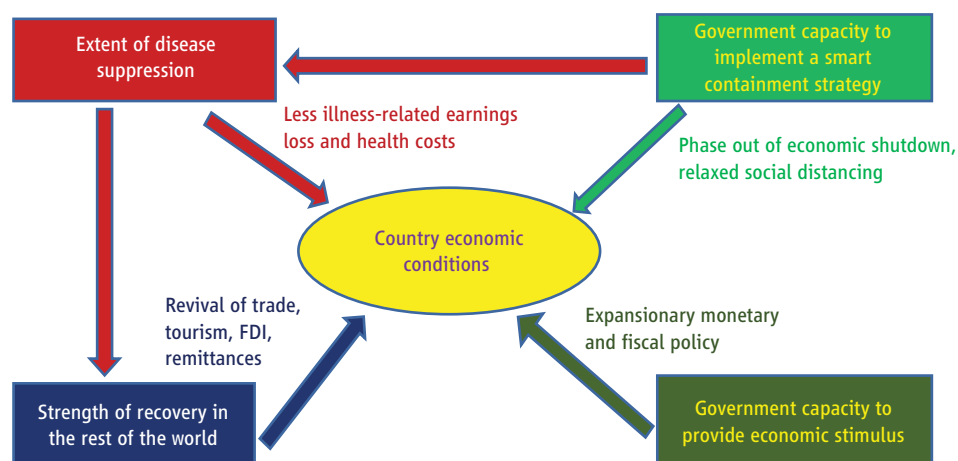
Sources: Haver Analytics; International Monetary Fund Policy Tracker; World Bank staff elaboration.

Note: A. Red bars denote cumulative policy rate cuts since the outbreak. Green lines denote cumulative cuts in reserve requirement ratio. Orange diamonds denote recently announced asset purchases by central banks in the primary market, expressed relative to respective 2019 nominal GDPs. RHS refers to right-hand side. B. PNG refers to Papua New Guinea, SLB refers to Solomon Islands, and FSM to Federated States of Micronesia. NBFI refers to nonbank financial institutions.

Prospects for Recovery

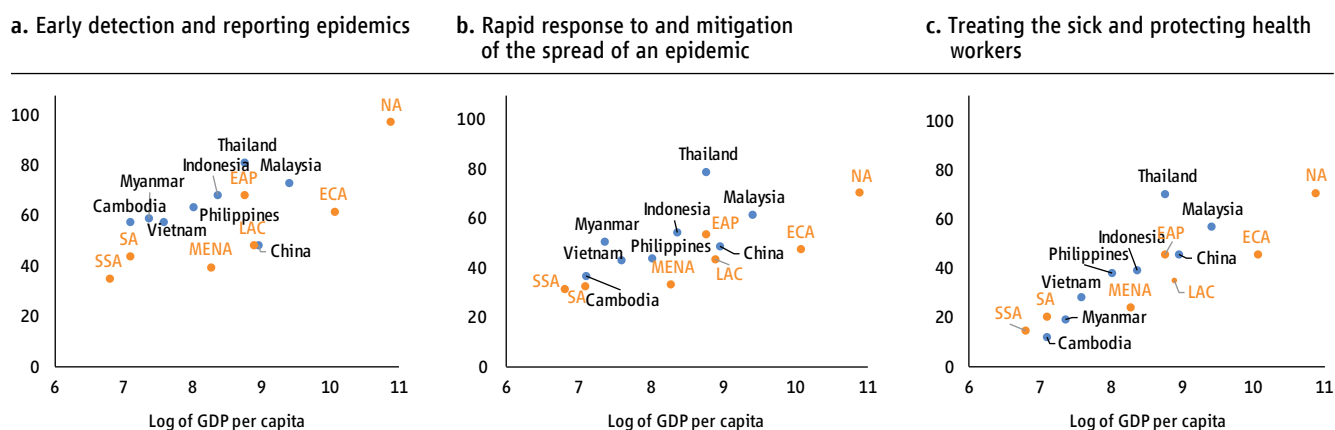
Recovery from the present crisis depends on both domestic and external conditions. A key step toward recovery is resolving the problem that created the crisis. In the present context, sustained revival of domestic economic activity requires the successful containment of the infections or at least their suppression to a rate that allows transition to less disruptive “smart containment” strategies. But for countries in the region, the strength of recovery in the rest of the world also matters, as does the capacity of the government to stimulate economic activity without creating financial stability risks (Figure 16).

Figure 16. Recovery depends on suppression of the disease, global economic conditions, and state support



Developing the capacity to contain outbreaks is vital for recovery. For most countries in the EAP region that have largely contained the disease, the key public health policy issue is to strengthen their ability to respond to future outbreaks through more targeted and less disruptive interventions. In this respect, Cambodia, Myanmar, and the PICs, rank low on the capacity scale, based on the Global Health Security Index. Even though Indonesia and the Philippines are ranked in the middle of the capacity scale, they still need to find a way of managing COVID-19 (Figure 17).

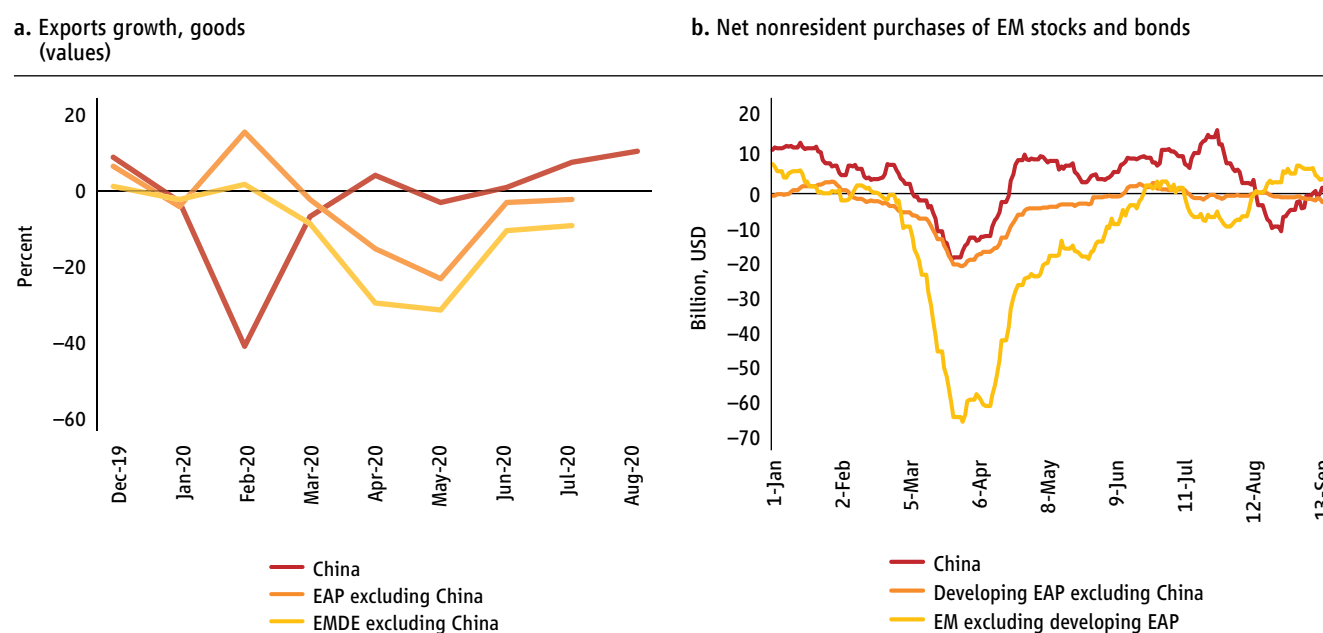
Figure 17. The capacity to detect and respond to epidemics is uneven across countries



Sources: Global Health Security Index 2019, Nuclear Threat Initiative, Johns Hopkins Center for Health Security, The Economist Intelligence Unit. EAP: East Asia and Pacific; ECA: Eastern and Central Europe; LAC: Latin America and the Caribbean; MENA: Middle East and Northern Africa; NA: North America; SA: South Asia; SSA: Sub-Saharan Africa.
Note: The index is scaled from 0 to 100 corresponding to the least to the best performance.

But domestic containment is not sufficient for a full-fledged recovery because the regions' economies are integrated into the global economy. Trade is beginning to recover as economic activity gradually resumes in other parts of the world, but tourism will remain subdued (Figure 18). Global uncertainty still inhibits domestic and foreign investment, but industry indicators show signs of recovery, and short-term capital is no longer flowing out (Figure 19).

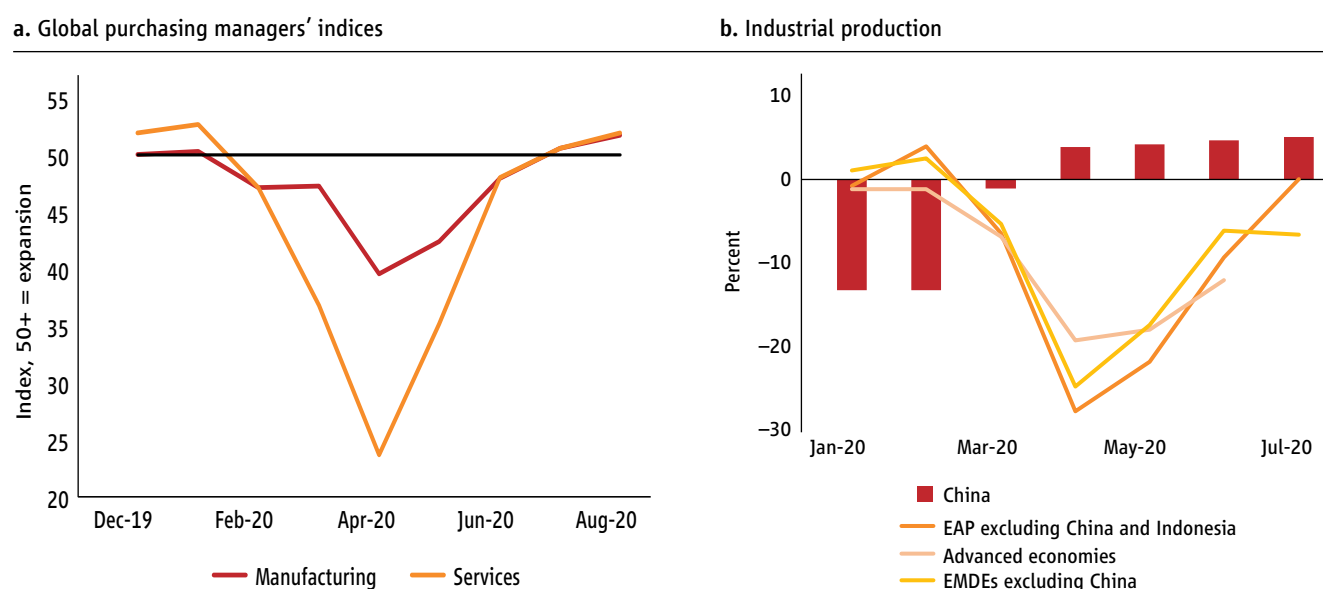
Figure 18. Trade is recovering, and capital flows are stabilizing



Sources: Institute of International Finance; Haver Analytics; World Bank.

Note: A. Year-on-year growth, 2020. Developing East Asia includes Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.

Figure 19. Global economic activity is beginning to recover



Source: Haver Analytics.

Note: A. Year-on-year growth. Developing East Asia includes Indonesia, Malaysia, the Philippines, Thailand, and Vietnam.

The COVID-19 shock is expected to have an uneven impact across the region.

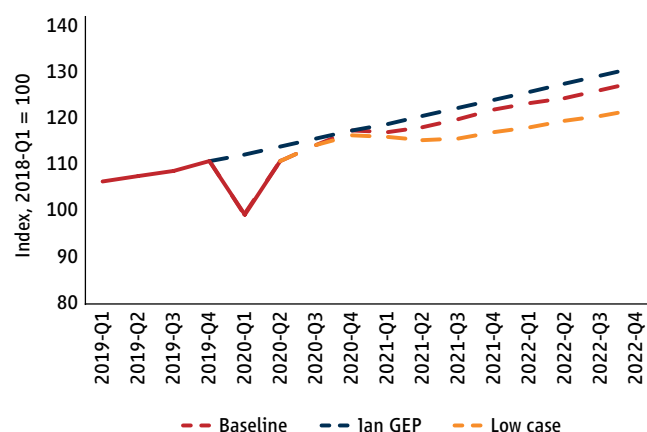
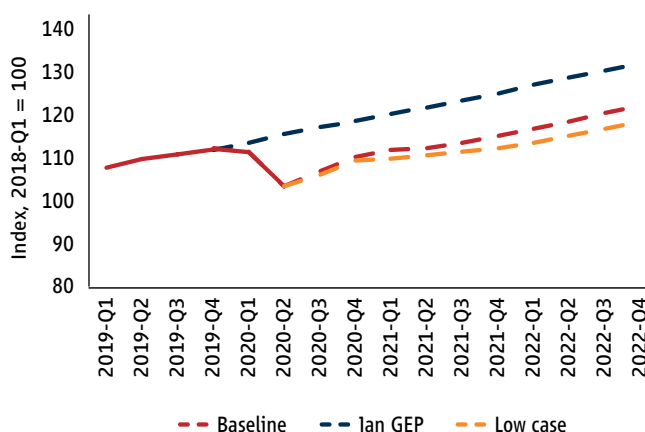
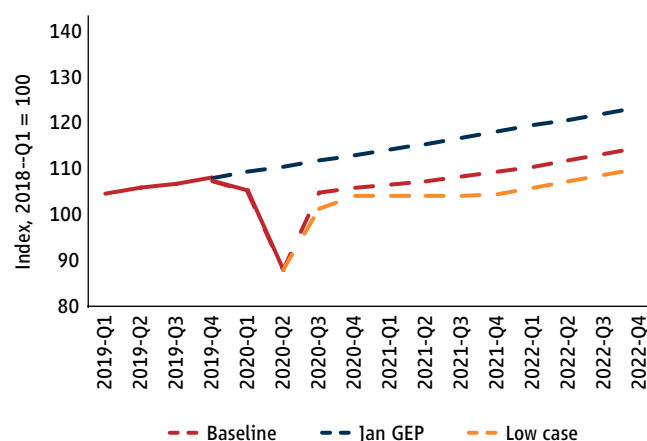
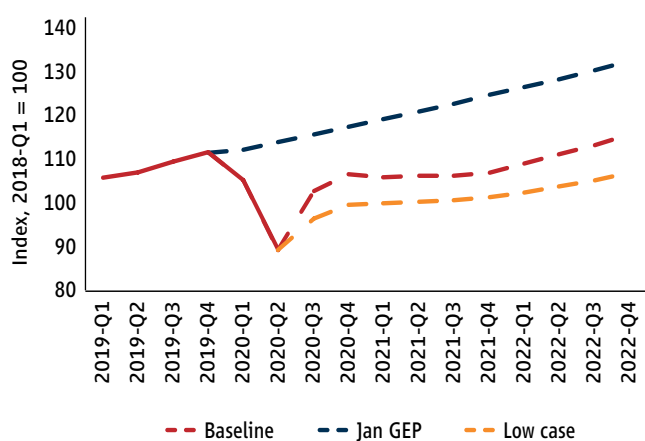
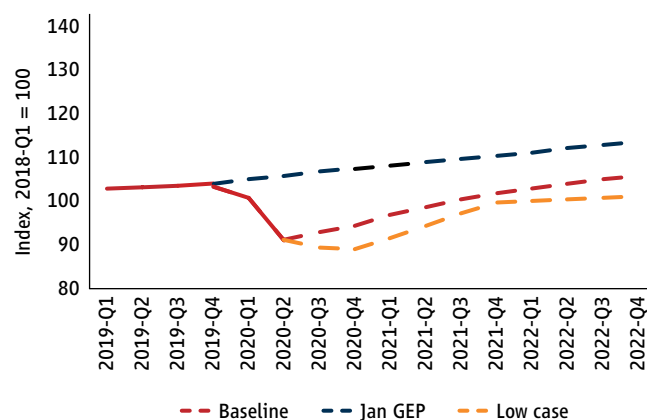
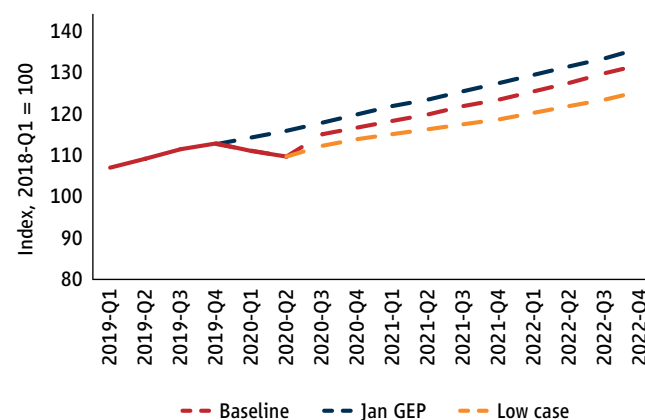
China and Vietnam are already recovering (Figure 20). China was hit first by the disease but has been able to control the pandemic and deal with subsequent outbreaks through targeted action (Loayza et al. 2020). China's dependence on external markets has diminished: the share of trade in GDP has declined from a peak of 64 percent in 2006 to 36 percent in 2019. Nevertheless, its recovery has in part been driven by a strong rebound in exports, which is leading to an increased current account surplus, and may lead to a renewal of trade tensions. Vietnam too was able to control the pandemic at relatively low human and economic costs. Despite its high exposure to trade and deep engagement in global value chains, it is already beginning to see an economic revival.

Recovery in other countries that have contained the disease is dependent on external conditions. On the health front, Malaysia and Thailand's robust health systems seem equipped to deal with future outbreaks, but Thailand is more vulnerable because it has an older population and denser living conditions. Externally, Malaysia and Thailand are especially suffering from the drop in exports and tourists, and remain vulnerable to abrupt changes in external financing conditions. In addition, political uncertainty remains elevated in Malaysia and Thailand. Their recovery is therefore likely to be slower than that of China and Vietnam.

Cambodia, Lao PDR, and Mongolia have suffered less from the disease, and their lockdowns have been relatively mild but are also vulnerable to the global recession. They have young populations, but the risk of infection is present because of poor living conditions and overcrowded dwellings. Dealing with outbreaks in some of these countries could be a challenge because of weaknesses in their health systems. Their main vulnerability, however, resides on the external front. All depend on tourism, trade, and external financing to varying degrees. They all have large current account deficits and sizeable external debt obligations. For all these countries, domestic economic activity is likely to revive, but the strength and sustainability of recovery will ultimately depend on external conditions. Myanmar has recently seen a surge in new cases, which make a fast recovery uncertain.

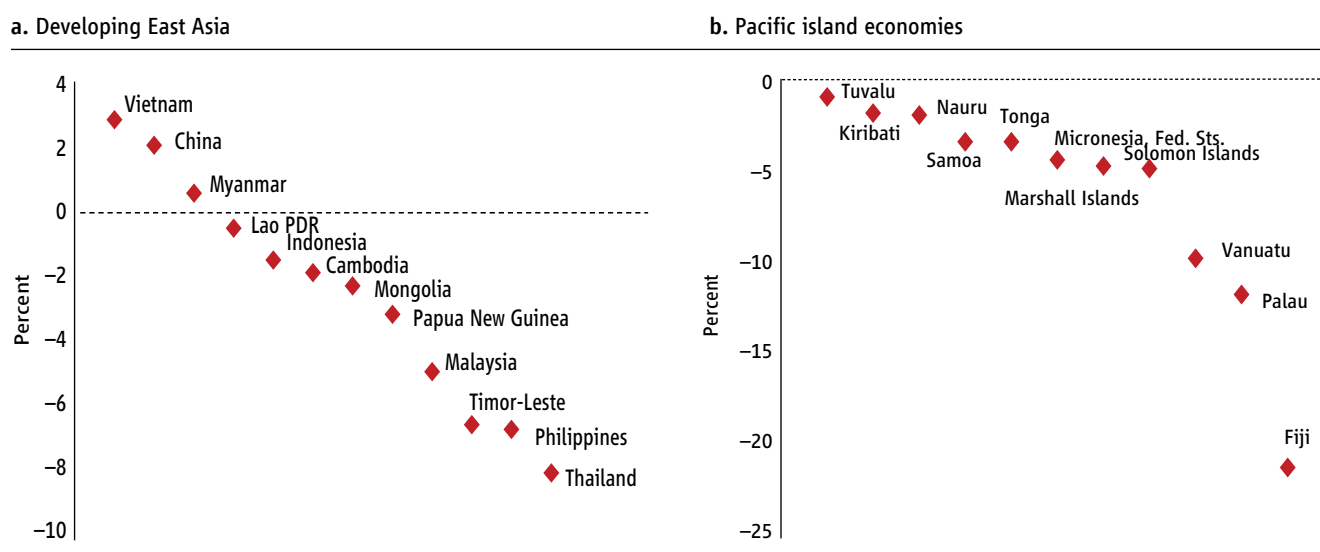
Indonesia and the Philippines face uncertain prospects. The region's two most populous countries after China have not so far succeeded in controlling the pandemic. Indonesia has not imposed strict lockdowns and seems to be relying on softer measures, while the Philippines has gone on a cycle of repeated strict lockdowns and reopenings. Both countries have the advantage of young populations but suffer from large informal sectors and poor living conditions for a large fraction of their population. Indonesia is much less exposed than the Philippines to the rest of the world through trade, tourism, and remittances. Indonesia's output is therefore projected to be less affected than that of the Philippines, but the outlook is uncertain. Indonesia, because of domestic conditions, and the Philippines, because of both domestic and external conditions, face the prospect of an uneven and volatile economic recovery.

The Pacific Island countries have been largely spared by the pandemic but are highly vulnerable to the global crisis (Figure 21). They are heavily reliant on tourism, fishing revenues, and international aid. Their capacity to deal with pandemics is low, and therefore the trade-off between opening to the rest of the world and saving people is sharp. Some Pacific Island economies may experience more than 10 percent drop in their GDP level in 2020. They are likely to start on the path of sustained recovery only when global conditions return to normal (Annex Table A2.2).

Figure 20. Output is unlikely to catch up to the precrisis trend**a. China****b. Indonesia****c. Malaysia****d. Philippines****e. Thailand****f. Vietnam**

Source: World Bank staff estimates.

Note: Red and orange lines show quarterly projections of GDP growth. GEP refers to Global Economic Prospects. Baseline refers to a scenario of severe growth slowdown followed by a strong recovery. Lower case refers to a scenario of a deeper contraction followed by a sluggish recovery.

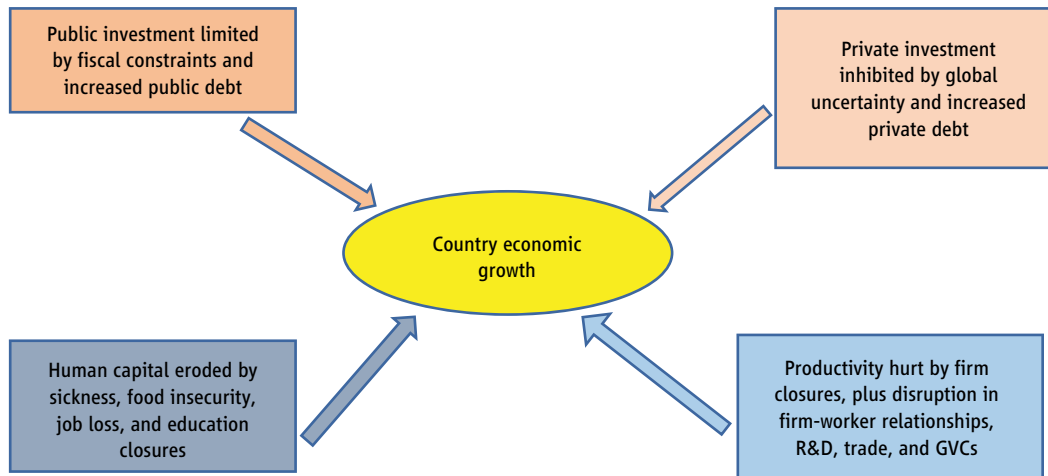
Figure 21. About four-fifths of the regional economies, including all Pacific Island economies, are expected to contract in 2020

Source: World Bank staff estimates.

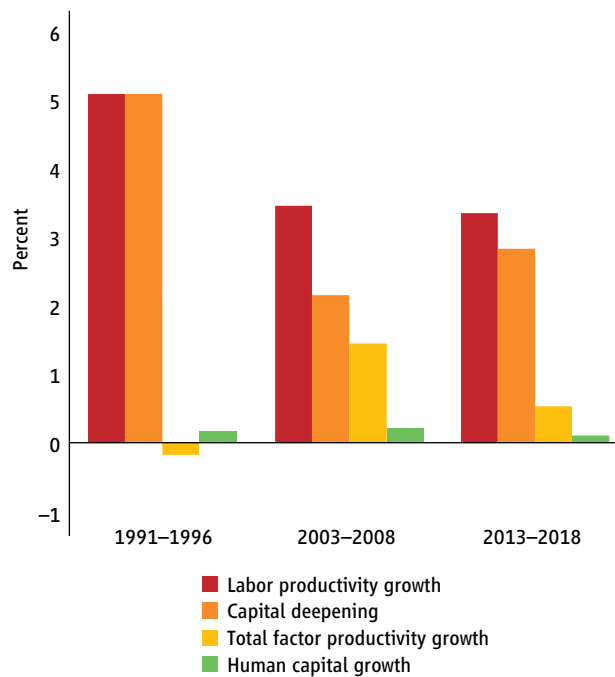
Note: Myanmar growth rate refers to fiscal year from October to September.

Implications for Inclusive Growth

COVID-19 will have a significant adverse impact on inclusive longer-term growth (Figure 22). The scars left by the COVID-19 crisis will hurt investment, human capital, and productivity growth (Figure 23). Public and private indebtedness, along with worsening bank balance sheets and increased uncertainty, are likely to inhibit public and private investment. These factors also pose a risk to economic stability. Sickness, food insecurity, job losses, and school closures could lead to health and learning losses that could last a lifetime. The poor will be disproportionately disempowered because of worse access to hospitals, schools, jobs, and finance. Bankruptcy of firms and disruption in firm-worker and firm-firm relationships could hurt productivity by leading to a loss of valuable intangible assets. The disruption of trade and global value chains (GVCs) could deprive countries of their productivity-enhancing benefits through the improvement of resource allocation across firms and sectors, and the diffusion of technology. But these adverse effects on growth and distribution may be partially offset by the COVID-19-induced acceleration in the diffusion of technologies, which have the potential to boost productivity and improve access to services for the poor. For these benefits to arise, these technologies must be broadly available.

Figure 22. The COVID-19 shock will hurt growth by inhibiting investment, eroding human capital, and dampening productivity

Source: World Bank staff illustration.

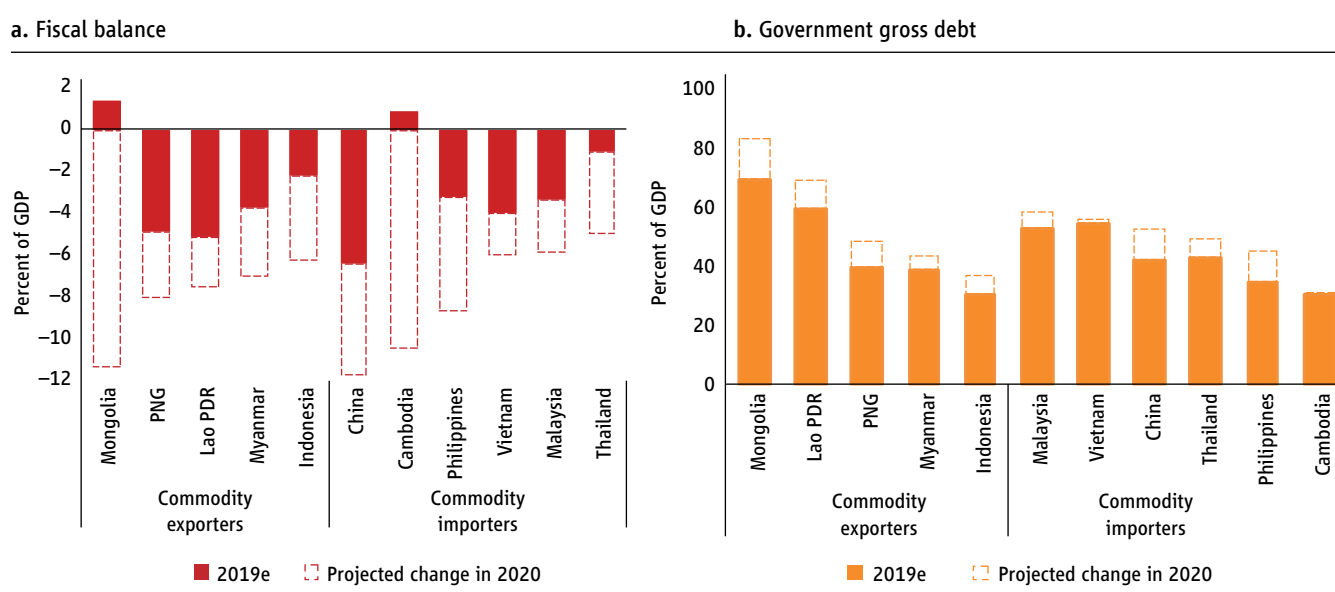
Figure 23. The EAP region was witnessing a productivity slowdown before COVID-19

Sources: Islamaj and Saavedra-Caballero 2020; Asian Productivity Organization; Penn World Table; World Bank Staff elaboration.
Note: Excludes China.

Increasing public and private sector indebtedness

Deteriorating fiscal positions, low revenue mobilization, and a shrinking tax base will reduce governments' ability to provide relief and invest in public infrastructure if the shock lingers. Large fiscal deficits in EAP are projected to increase government debt on average by 7 percentage points of GDP in 2020 (Figure 24). In some countries, like China, the fiscal burden of addressing the impact of COVID-19 also falls on subnational governments. The region is characterized by several structural weaknesses, including weak revenue generating capacity. Revenue mobilization is comparatively low in the developing EAP region relative to other EMDEs and high-income economies. Many commodity exporting EAP countries with relatively high shares of volatile resource revenues have also seen their government revenues decline sharply over the past decade following the commodity price plunge in 2012. Meanwhile, most commodity importing EAP countries have continued to rely heavily on indirect taxes, including value added and trade taxes, which are expected to shrink as the COVID-19 pandemic and the necessary public measures to contain its spread have resulted in substantial reductions in private consumption and trade.

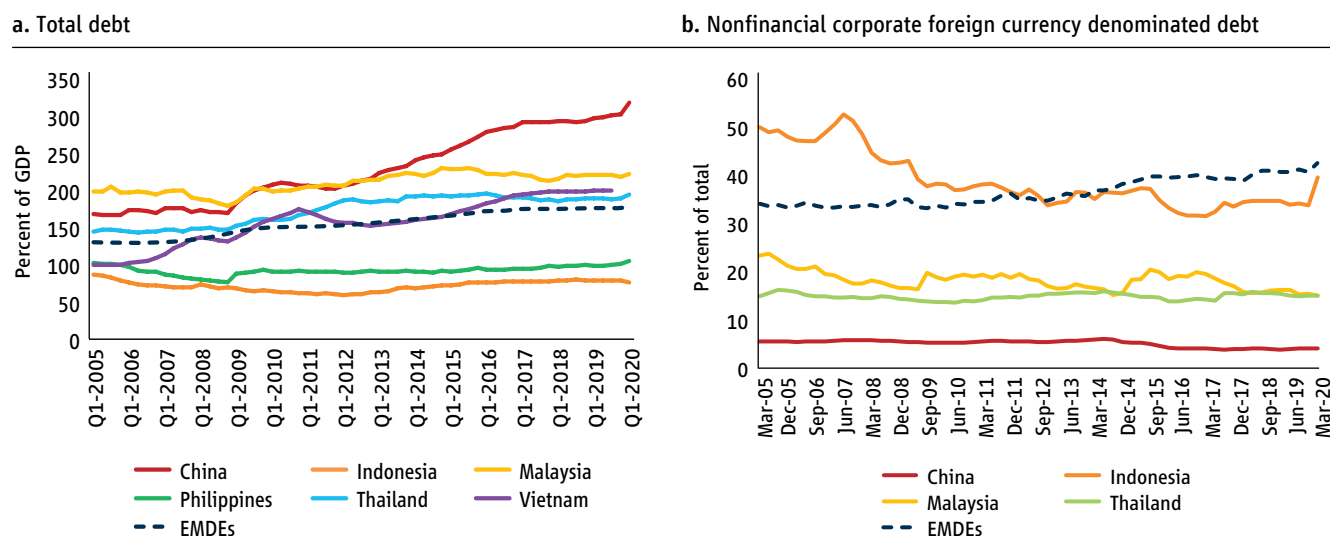
Figure 24. Fiscal positions are expected to deteriorate and add to government debt



Source: World Bank staff estimates.

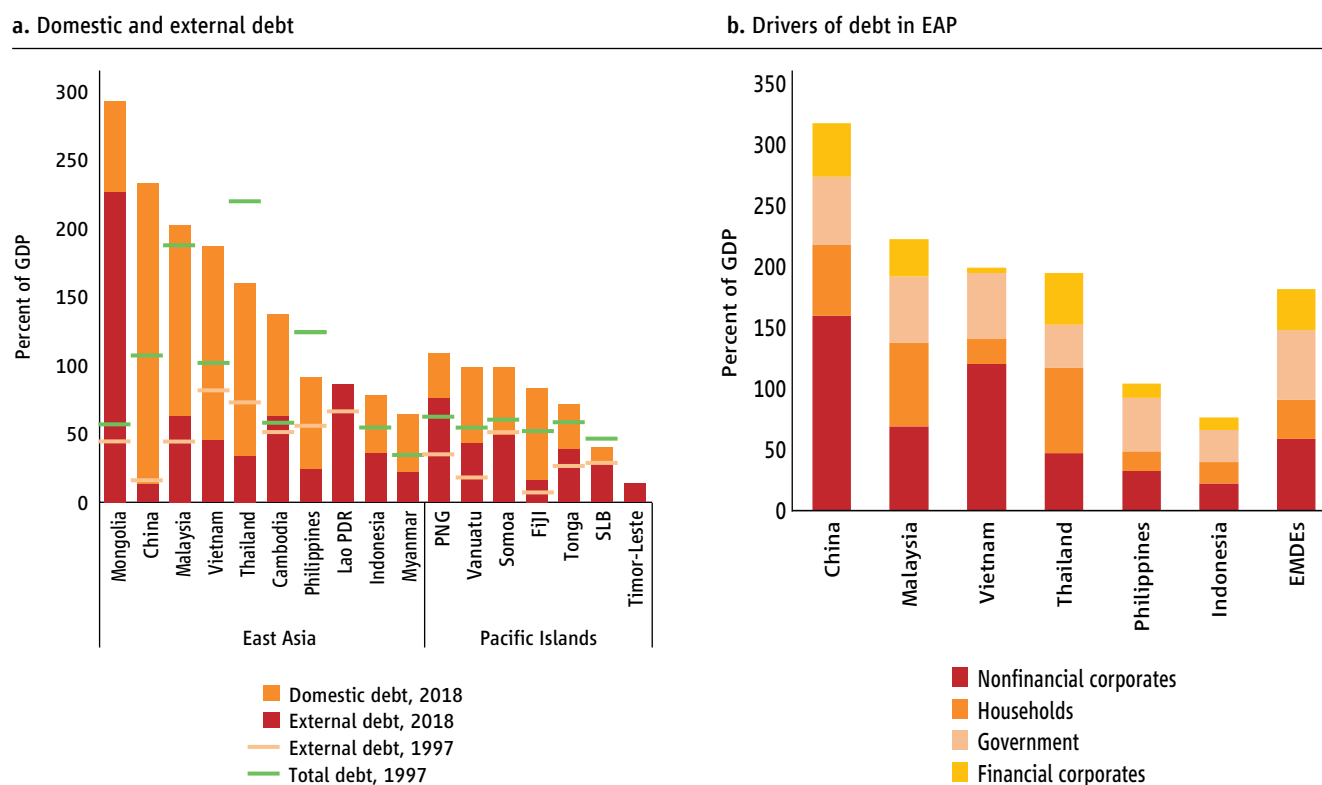
Note: Estimates refer to general government, except for Indonesia and Malaysia, which refer to central government only.

In some countries, financial instability is likely to be amplified because of the rapid growth in private sector debt (Figure 25). Private debt has been increasing in many economies in the region. Dependence on domestic debt held by foreign investors, substantial debt denominated in foreign currencies, and the need to refinance debt in a short time represent significant sources of vulnerability in several countries across the region. Developing EAP economies are vulnerable in different ways, for example, through elevated domestic debt (China, Vietnam, Malaysia), private sector debt (China, Malaysia, Thailand), external debt (Lao PDR, Mongolia, Malaysia, Papua New Guinea, Cambodia); or heavy reliance on short-term debt (Malaysia; Thailand) (Figure 26; Table 1).

Figure 25. Private debt in EAP has been gradually increasing, driven by households and nonfinancial corporates

Source: Institute of International Finance.

Note: Data shown is for Q1 2020, with the exception of Vietnam; that data availability ends in Q3 2019.

Figure 26. Existing levels of debt are high in some countries but most of the debt is domestic and private

Sources: Institute of International Finance; World Bank.

Note: Data shown is for Q1 2020, with the exception of Vietnam; that data availability ends in Q3 2019.

Table 1. The region's economies have been fiscally prudent, but existing vulnerabilities coupled with the size of the shock are a cause for concern

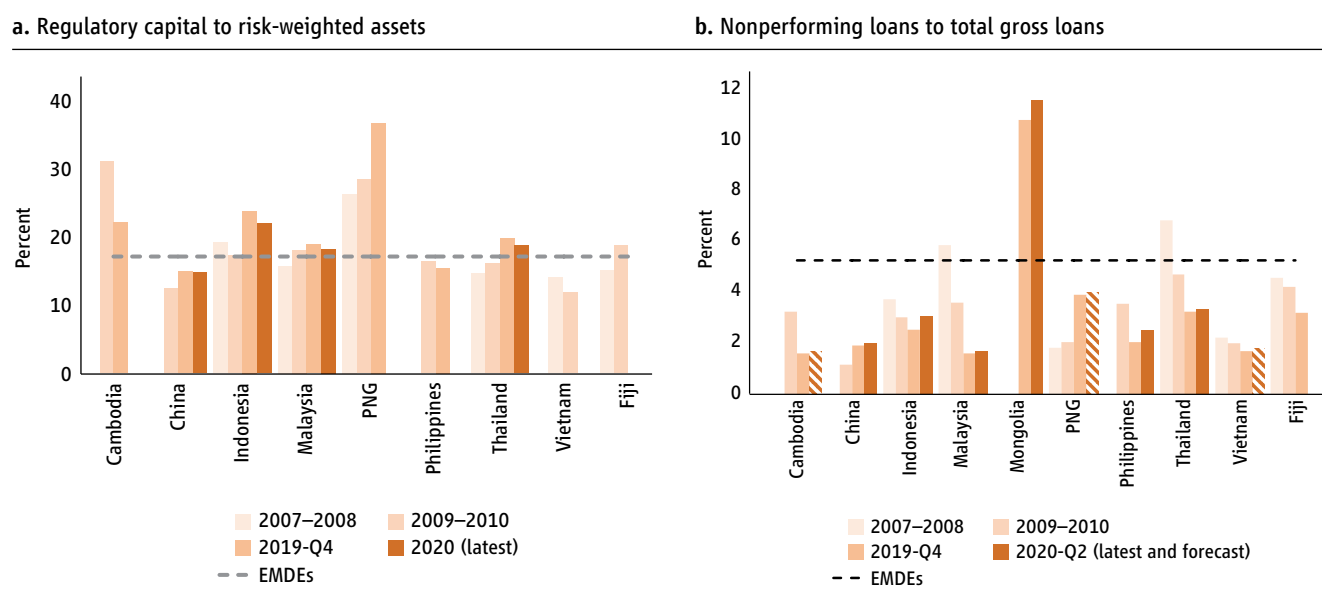
	<i>Government gross debt % of GDP</i>	<i>Fiscal balance % of GDP</i>	<i>Government revenue % of GDP</i>	<i>Domestic credit to private sector % of GDP</i>	<i>External debt % of GDP</i>	<i>Gross external financing needs % of reserves</i>
	<i>2020f</i>	<i>2020f</i>	<i>2020f</i>	<i>2019</i>	<i>2019</i>	<i>2020f</i>
China	53	−11.8	25	205	14	26
Indonesia	37	−6.3	10	41	36	46
Malaysia	58	−5.9	16	136	60	84
Philippines	45	−8.7	14	48	23	20
Thailand	49	−5.0	19	116	33	20
Vietnam	56	−6.0	23	110	36	23
Cambodia	30	−10.5	17	97	55	30
Lao PDR	69	−7.6	11	—	86	259
Mongolia	83	−11.4	26	50	226	144
Myanmar	44	−7.1	17	26	22	67
Papua New Guinea	48	−8.1	15	14	70	—
Timor-Leste	17	−30.4	39	16	10	50

Sources: International Monetary Fund; World Bank; World Bank staff estimates.

Note: Cell colors are assigned according to the following criteria: Orange: the country is at the bottom 10th percentile level among EMDEs; Light orange: between the 10th and 25th percentile range; Yellow: between the 25th and 50th percentile range; Light green: between the 50th and 75th percentile range; Green: above the 90th percentile level. Gross external financing needs = current account deficit plus short-term external debt. Short-term debt includes all debt having an original maturity of one year or less and interest in arrears on long-term debt. Total reserves includes gold. External debt data refers to 2018 for Lao PDR, Myanmar, Timor-Leste and Vietnam. The interquartile range for gross external financing needs (% of reserves) in EMDEs refers to 2018.

Impact on bank balance sheets

Economic hardship may further worsen banks' balance sheets. Available data for 2020 suggest that nonperforming loans (NPLs) and other measures of financial sector strength have deteriorated only slightly in recent months (Figure 27). However, these data may understate the actual level because COVID-19-related regulatory relaxation and forbearance may have led to a more lenient classification of poorly performing loans. High levels of NPLs are problematic because they impair bank balance sheets, depress credit growth, and delay economic recovery (Aiyar et al. 2015; Kalemli-Ozcan et al. 2015).

Figure 27. Financial institutions in EAP are relatively well capitalized but nonperforming loans are increasing

Source: International Monetary Fund Financial Soundness Indicators.

Note: Latest available data. Patterned areas show estimates for NPLs based on equations developed by Jakubik and Reininger (2013) using a dynamic panel approach which incorporates macroeconomic fundamentals as determinants of NPLs.

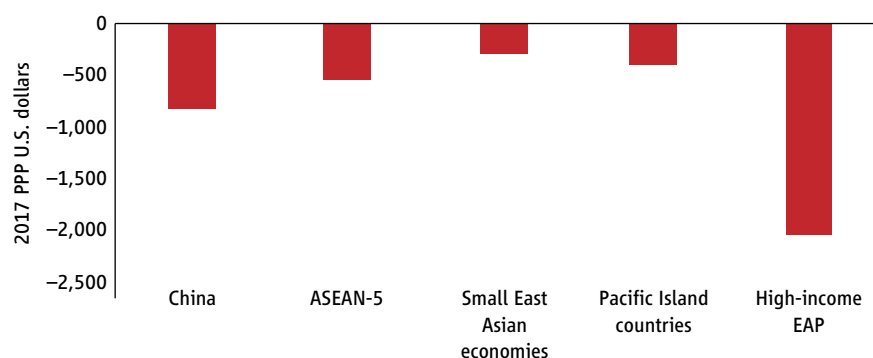
Long-term effects on human capital

If schools are closed for an additional four months, beyond the closures experienced from January to August 2020, COVID-19 could result in a loss of 0.7 learning-adjusted years of schooling. In China and the ASEAN-5, for example, learning-adjusted years of schooling are expected to drop by 0.8 points, whereas in the small East Asian economies, learning-adjusted years of schooling is expected to decline by 0.7 points (Figure 28). Because school closures have been less common in the Pacific Island countries, the expected decline in learning-adjusted years of schooling is somewhat less, estimated at 0.4 points.

Figure 28. School closures are expected to have lasting impacts on students' learning in the region

Source: Cloutier et al. (2020).

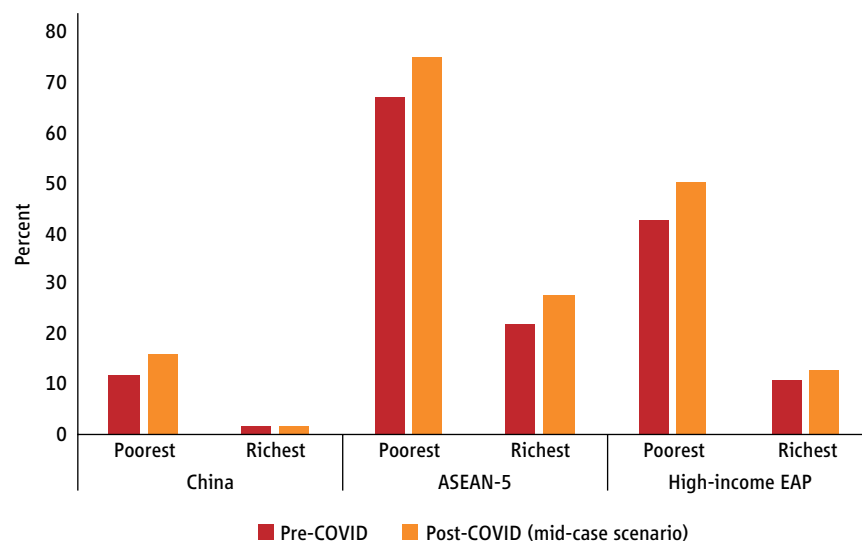
Note: Results expressed in Learning-Adjusted Years of Schooling (LAYS). Simulation results based on latest available LAYS data for EAP countries (unweighted averages).

Figure 29. Lost learning-adjusted years of schooling have real costs in terms of peoples' earnings*Effects of lower learning-adjusted years of schools on individuals' yearly earnings, by subregion*

Source: Cloutier et al. (2020).
 Note: Simulation results (unweighted average).

Fewer learning-adjusted years of schooling translate into substantial losses in individuals' earnings over their working lives. The average student in the region, from the cohort in school today, could face a reduction of US\$865 (in 2017 PPP dollars) in yearly earnings in the mid-case scenario compared to those in which there was no pandemic. This is equivalent to a reduction, on average, of 4 percent in expected earnings every year (Figure 29).

The adverse effects of the COVID-19 crisis on learning and human capital are expected to be greater among the poor than the nonpoor. Poor households have less access to mobile technologies that could enable distance learning during periods of school closures. A simulation analysis suggests that learning outcomes among the poor will be more adversely affected by school closures than those of the nonpoor (Figure 30).

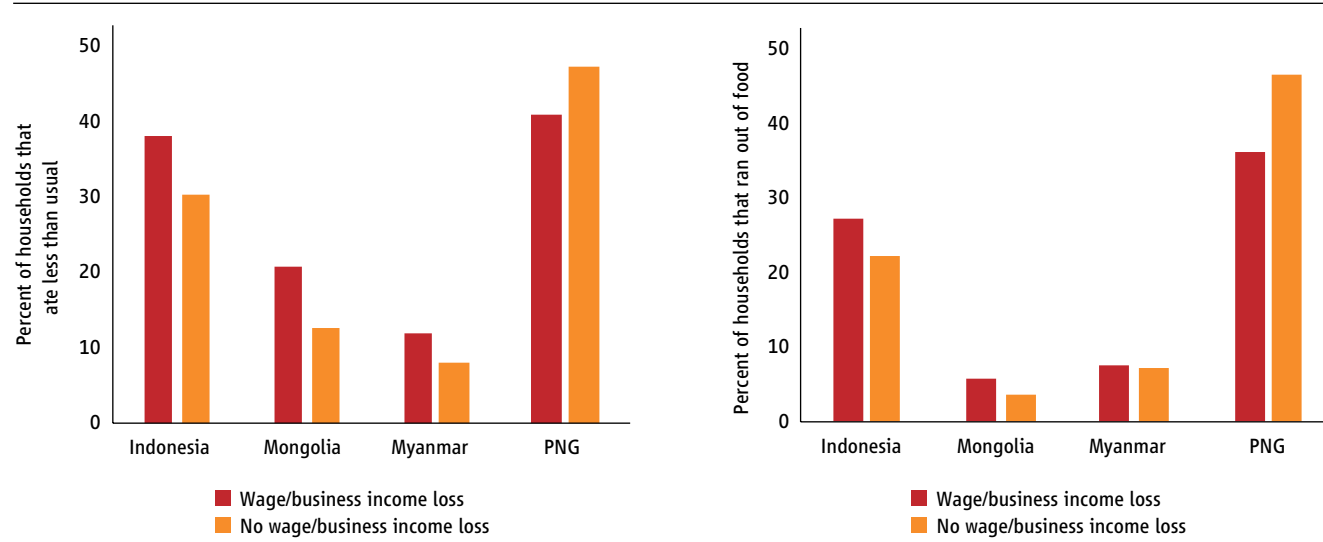
Figure 30. The effects of the COVID-19 shock on learning are likely to be larger among the poor than among the wealthy*The share of students achieving below minimum proficiency on PISA/PISA-D tests (measured by PISA scores below 2)*

Source: Cloutier et al. (2020).
 Note: Share of students below minimum proficiency levels, as measured by a PISA score of less than 2. Simulation results based on the latest available PISA and PISA-D scores for 15 countries (unweighted average).

The economic shock to households may have other durable consequences on human capital accumulation. Countries are reporting significant disruptions in immunization. One-third of primary health care networks reported temporary shutdowns of immunization services in Indonesia, measles coverage in Lao PDR dropped from 83 to 40 percent from end of 2019 to end of May of 2020, and the number of vaccinations in PNG dropped by 34 percent. These countries also experienced a substantial decline in antenatal care coverage.

In addition, increasing food insecurity in some countries in the region could translate into a higher incidence of malnutrition and stunting. More than a third of households in Indonesia indicate that they ate less than usual because of lack of money or other resources, and a fourth said that they ran out of food, but these rates are higher among households that experienced income losses (Figure 31). Similarly, high numbers are observed in PNG, a country that was also badly hit by the crisis. While food production has not been seriously affected, and households are for the most part able to purchase basic staples and proteins if needed, food insecurity seems to be driven by income losses associated with the crisis. In Indonesia, a follow-up survey in June 2020 suggested that the proportion of households facing food shortages had declined between early May and end-May/early June 2020, although still over one-fourth of households reported facing at least some food shortages.

Figure 31. Food insecurity may be driven by income losses



Sources: EAP high frequency household phone surveys, first round.

Notes: For panel A, in Indonesia and Mongolia the question referred to "eating less than you thought you should (because of lack of money or resources)" while in Myanmar and PNG it referred to "eating less than usual."

Implications for productivity

The crisis is likely to hurt productivity growth. The crisis will generate negative effects by driving firms out of business, losing valuable intangible assets, and diminishing productivity-enhancing investments within firms. But the crisis is also accelerating the diffusion of digital technologies and that may alleviate these adverse effects.

First, evidence from past crises suggests that not just weak but strong firms are likely to exit (Hallward-Driemeier and Rijkers 2013). More productive firms may be better able to weather the ongoing crisis through a broader customer base, better access to finance, or adapting new business models, but that may not be adequate in the face of persistently low demand. The exit of good firms will mean the loss of intangible assets—firm-worker and supply chain relationships or management practices—that matter for productivity and are difficult to rebuild. Unemployment

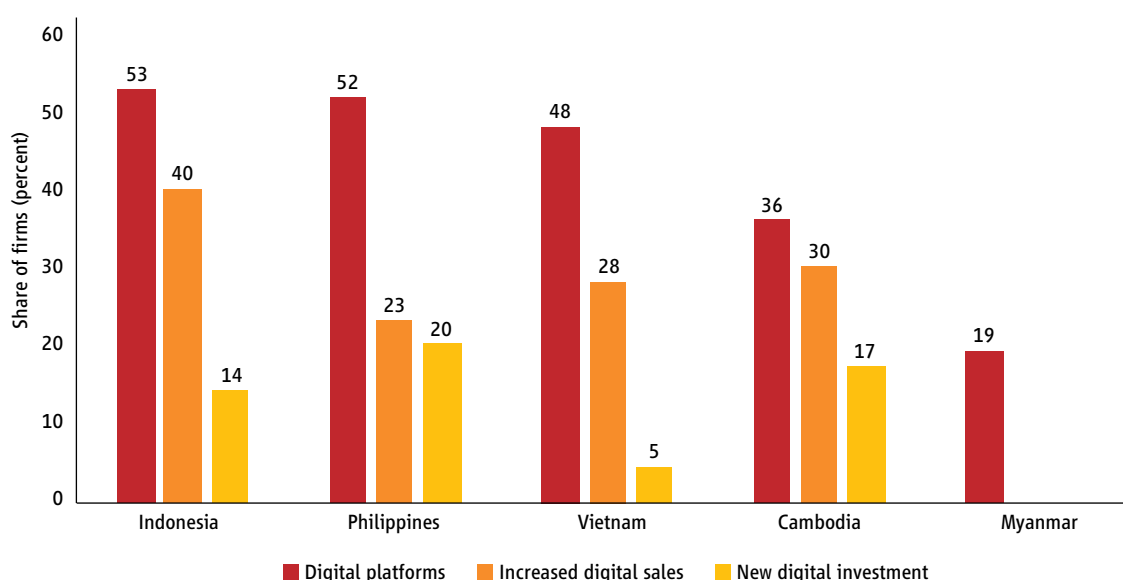
could deprive the firm (if it survives) of hard-to-replace skills and reduce the worker's future earnings if they are unable to employ these firm-specific skills elsewhere.

Second, fewer firms are likely to enter, and start-ups typically find it hard to survive. That will scar longer-term productivity growth because start-ups help diffuse new technologies and business models. In Myanmar, new business registrations dropped 70 percent in April compared to March, and also in relatively resilient Vietnam there was a 5 percent drop in new business registrations in the first seven months of 2020, compared to the same period in 2019.

Third, surviving firms may face prolonged uncertainty and be saddled with debt—reducing their future productivity-enhancing investments. During past crises, firms were less likely to undertake disruptive, radical innovation and disproportionately cut back on intangible investments, such as research and development (R&D) product innovation and worker training. The pandemic has led to enormous increases in firm uncertainty, dwarfing those recorded during the financial crisis, and left firms with increased debts and stranded assets, such as unused office and factory capacity. Firms have responded by significantly cutting expenditures on innovation, training, and general management improvements, which is likely to considerably curb future productivity growth.

One bright spot is that COVID has accelerated investment in digital technologies which may translate into faster but unequal productivity growth (Figure 32). Both firms and households are investing in computers, software, and skills to cope with social distancing constraints. These changes are likely to durably modify the nature of work and relationships between firms. The result may be increased productivity due to lower commuting, transaction, and search costs, but diminished face-to-face interaction may also inhibit innovation and diffusion of ideas. The crisis may also be catalyzing the use of digital financial services to keep financial systems functioning and keep people safe. Across 74 countries, daily downloads of fintech apps have increased 24 percent since their COVID lockdown, with a marked 65 percent increase in Asia. However, diffusion of new digital technologies requires governments to create a regulatory and incentive framework which encourages the creation of the broadband infrastructure, competitive pricing of services, and complementary intangible investments in training and reorganization by firms. Large and productive firms in locations with high-quality digital infrastructure are better placed to make such investments—which can widen disparities between the best firms and the rest.

Figure 32. Firms are increasing their use of digital platforms and investing in digital solutions



Source: Business Pulse Surveys.

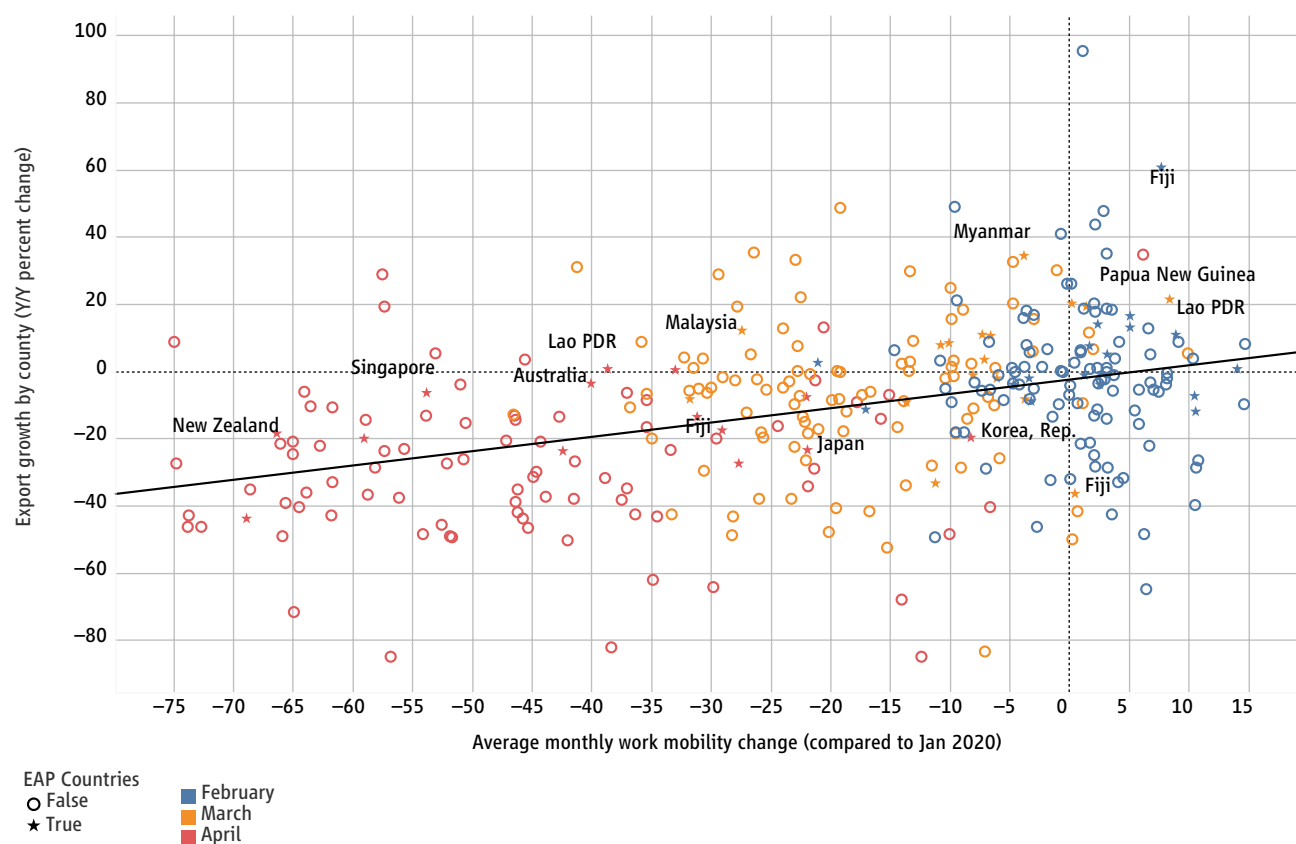
Note: Data on increased digital sales and new digital investment are not available for Myanmar. The survey was conducted in May for Myanmar; June for Cambodia, Indonesia, and Vietnam; and July for the Philippines.

Trade: Resilience, regionalization, relocation, and servicification

Trade has been a powerful engine of EAP growth, by encouraging the movement of resources to more productive sectors and firms and encouraging the international diffusion of technologies and knowledge. Since the 1990s, the growth of global value chains has brought further benefits to the world and the region through hyper-specialization in parts and tasks, and the sharing of knowledge between firms in long-term relationships. Therefore, the impact of COVID-19 on trade and GVCs is critical to the region's growth prospects.

Global trade shrank because of the stringent policy response but is beginning to recover. The trade decline was caused by the disruption of production in source countries and the contraction of consumption in destination countries. Recent research finds that a 1 percent decline in worker mobility led to a 0.5 percent decline in export growth, and a 1 percent decline in retail mobility led to a 0.25 percent decline in import growth. These negative trade effects intensified over the early months of 2020 with the increase in the number of cases and the stringency of lockdown policies (Figure 33). Since China first, and then many other countries in the region suppressed outbreaks faster than other parts of the world, domestic shutdowns were phased out, and production and consumption also recovered faster than in other parts of the world. That meant exports of EAP countries also showed greater resilience.

Figure 33. Export growth across countries was hurt by their restrictions on work mobility

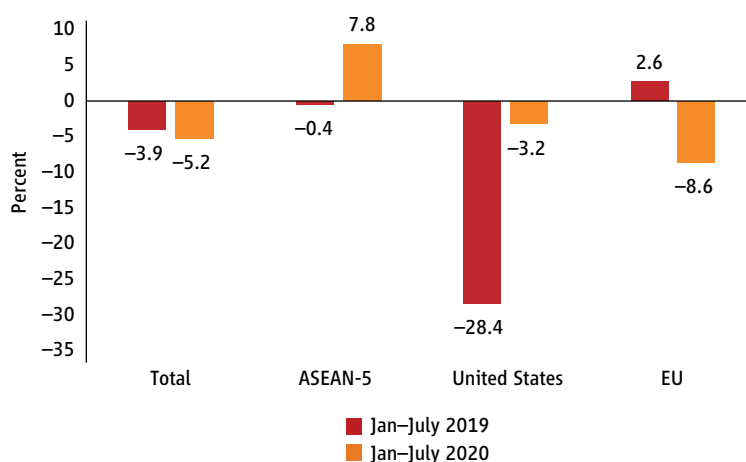


Source: Espitia et al. (2020).

Participation in global value chains may have enhanced this resilience in unexpected ways. The disruption of production in source countries adversely affected exports of products that rely on imported inputs from those countries. But the negative impact of a disruption in production in exporting countries themselves was mitigated by greater backward participation in global value chains, i.e., a higher share of imported value added in exports. Thus, the diversification benefits of GVC participation reduced vulnerability to domestic shocks, especially because the intensity of the COVID-19 shock varied over time across countries.

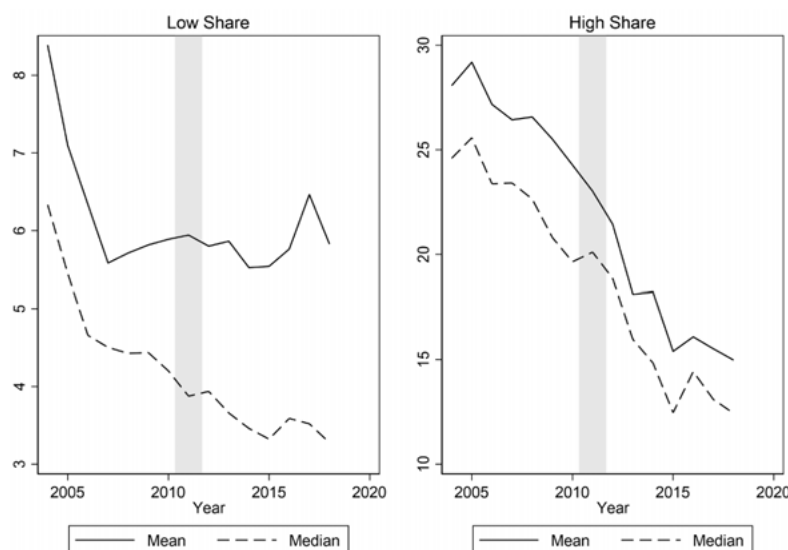
Regionalization: The COVID-19 shock is deepening integration within EAP. Faster recovery in the region meant that intra-regional trade suffered less than trade in and with other parts of the world. The ambitious targets specified in the China-U.S. Trade Agreement had the potential to divert China's imports away from EAP and toward the United States, but the opposite has occurred. In sum, the recent evidence suggests that COVID-19 has further boosted the trend toward the regionalization of EAP trade evident in the last two decades (Figure 34). Foreign direct investment (FDI) may follow the same pattern. The region now receives more FDI from countries in the region, especially high income, than from countries outside of the region.

Figure 34. China's import growth from the United States has declined but from EAP has picked up this year relative to last year



Source: China's customs administration.
Note: EU represents 27 European Union countries.

Relocation: COVID-19 may not lead to retreat from GVCs but could lead to a shift away from China of some manufacturing activity. Real wages are increasing in China due to demographic change and growth, and that was already leading to a shift of some manufacturing activity to other countries. An analysis of past shocks suggests that importers do not bring production home but reduce excessive dependence on any single foreign source. Thus the 2011 earthquake in Japan did not lead to reshoring, nearshoring, or diversification, but imports shifted away from Japan, who had a high share in imports, and toward developing countries that had a revealed comparative advantage in the input (Figure 35). These results cannot be mechanically applied to COVID-19, but the observed pattern of switching may provide clues about the future. Import dependence on China was high before the coming of COVID-19, as was its export similarity with other developing countries.

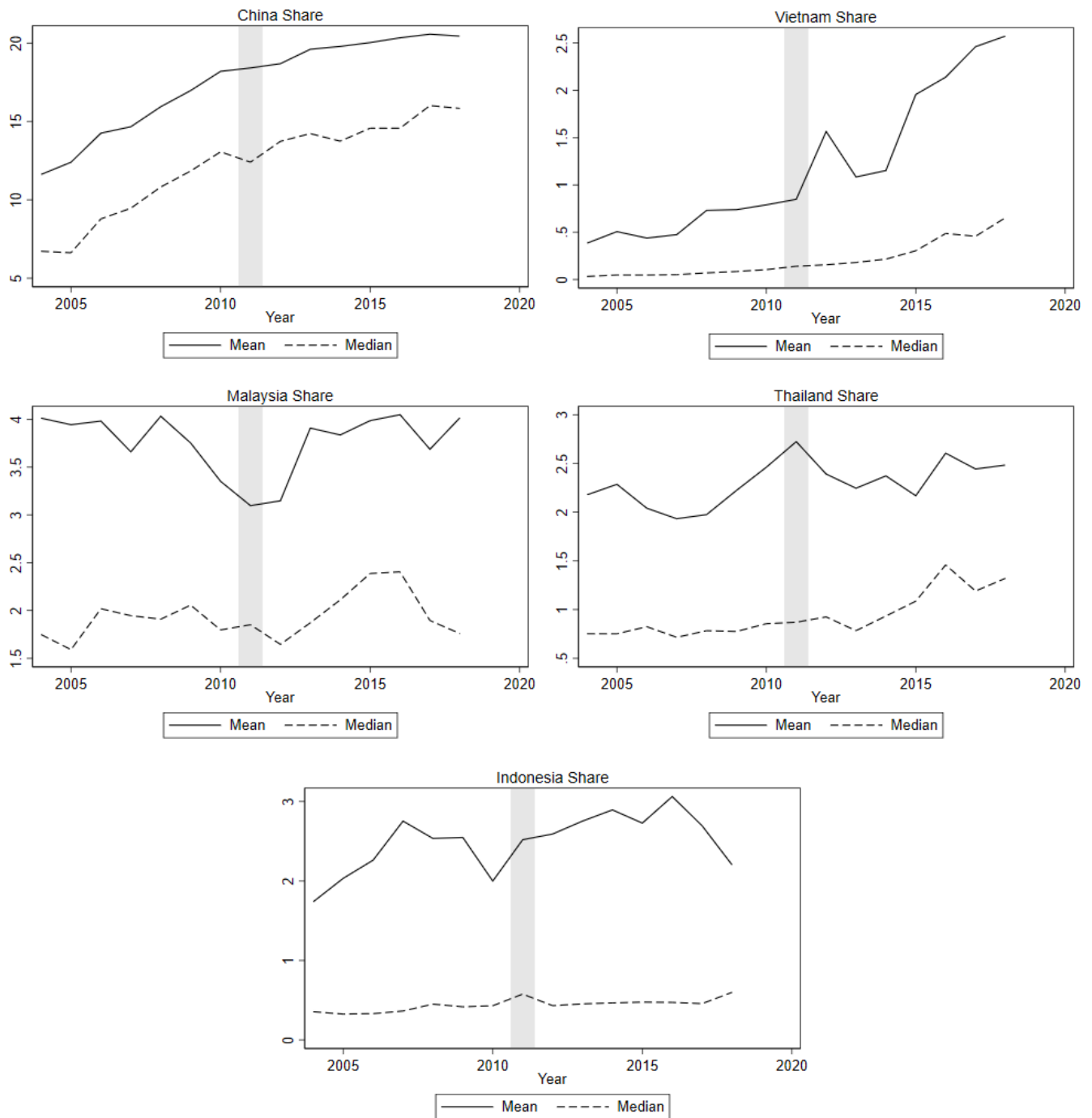
Figure 35. Post-tsunami changes in import patterns suggest relocation where there was high dependence, not reshoring

Source: Freund et al. (2020).

Note: The figures plot Japan's mean and median market share of auto components in country products in which Japan had an average market share lower than 15 percent (left panel "Low Share") and greater than 15 percent (right panel "High Share") calculated over the 2004–2010 period.

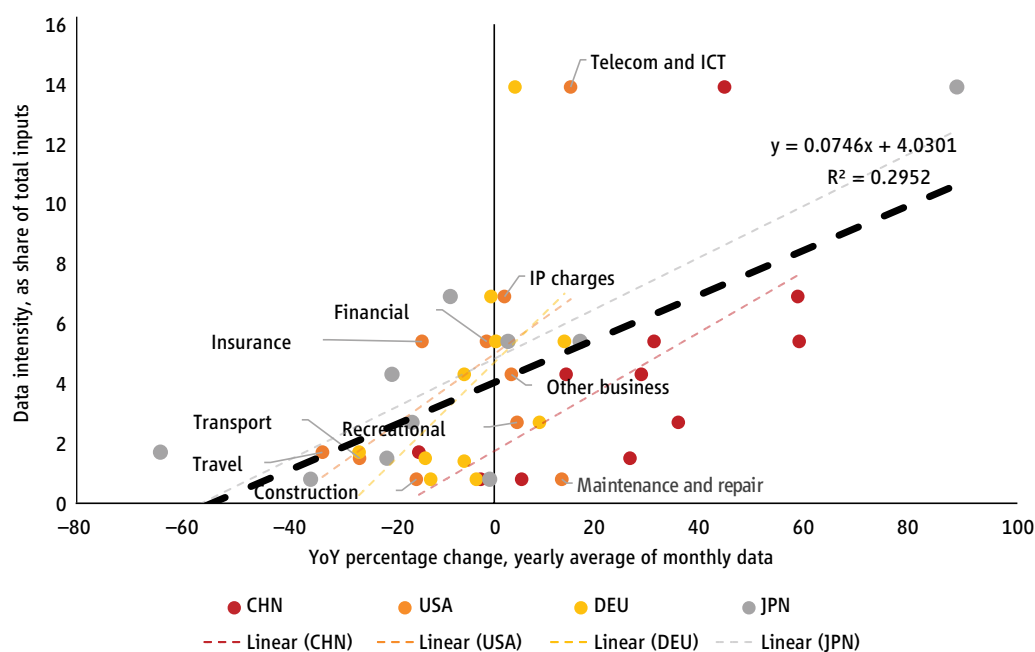
The pattern of where production went after the Japan shock may indicate where production may shift from China. For example, in electronic products, shifts away from Japan in products where it had a high share, were toward China (a continued trend), Vietnam (an acceleration), and Malaysia (a reversal of a prior decline), but not significantly toward Indonesia or Thailand (Figure 36).

COVID-19 is likely to shift the pattern of services globalization from trade in face-to-face services, like tourism and international transport, to trade in digitally delivered services, like telecommunications, business, and software (Figure 37). The information and communication technology revolution has already led to a rapid growth in business services exports from countries like the Philippines. Since COVID-19 is making face-to-face transactions difficult, firms and people are investing heavily in digital equipment and literacy. The result will be a levelling of domestic and international trade costs in a range of services, from education to health. Since digital investments are "sunk costs"—i.e., computers bought, and skills learnt are here to stay—the impact will be more durable than the pandemic. The result will be new opportunities for developing countries, like Malaysia and Thailand, which have successfully participated in manufacturing value chains, to now advance into services exports. In addition, since knowledge-intensive services like education are becoming easier to trade than ever before, servicification reduces the costs of acquiring skills that can boost productivity.

Figure 36. Post-tsunami changes suggest GVC relocation is sensitive to EAP country conditions

Source: Freund et al. (2020).

Note: The figures plot each country's mean and median market share in country products, in which Japan had an average market share greater than 15 percent calculated over the 2004–2010 period.

Figure 37. The structure of services trade is changing: shrinking face-to-face and growing digitally delivered services

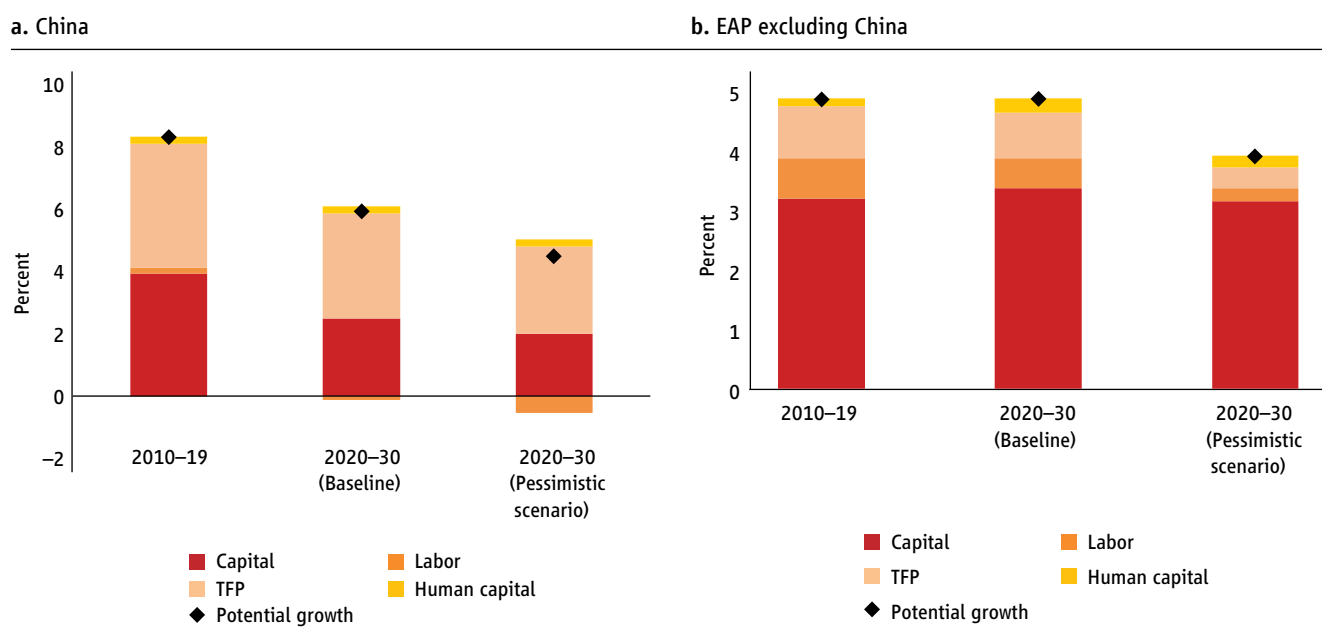
Source: Mattoo and Taglioni (2020).

Implications for potential growth

Potential growth—the growth rate of the level of output an economy would sustain at full capacity utilization and full employment—was decelerating in the region before the COVID-19 crisis. Worsening demographic trends, reflecting a declining trend in the share of the working-age population in China, Thailand, and Vietnam, are dampening labor supply in many countries (World Bank 2018). A slowing pace of capital accumulation reflects rebalancing and policy efforts to rein in credit growth in China, and lower investment rates in other countries due to heightened policy uncertainty. Slowing human capital accumulation in lower-income economies (Cambodia, Lao PDR), and slowing factor reallocation (China, Malaysia, Thailand, Vietnam) have contributed to lower total factor productivity growth.

COVID-19 will dampen potential growth. Assuming that each underlying component of potential growth (investment, human capital, and labor force participation rate) follows the historical trend, EAP potential growth is expected to decline in the next decade by almost 2 percentage points, from 7.6 percent in the last decade (2010–19) to 5.7 percent on average (over 2020–2030) regardless of the effects of COVID-19 (Figure 38). Under a pessimistic scenario, which reflects the negative impact of COVID-19 on investment, productivity, and labor participation, the potential growth is expected to decline more sharply to 4.4 percent on average over the next decade (2020–30).

Policy reform can mitigate the adverse effect of COVID on potential growth. Efforts to promote higher investment, better education, and health, and to close the gap between male and female labor force participation would help. Investment growth would not only boost potential growth by adding to the capital stock, but also via improved total factor productivity (TFP). Improvements in education (in terms of secondary and tertiary enrollment and competition rates) and health outcomes (in terms of life expectancy) can improve potential growth via their effect on labor supply

Figure 38. COVID-19 will dampen potential growth

Sources: Penn World Tables; World Bank staff estimations.

Note: GDP-weighted averages of production function-based potential growth. TFP is total factor productivity growth.

and TFP growth. Raising the labor supply can also be achieved through reforms aimed at increasing female labor force participation rates. Some of these policy issues are discussed in the next section.

An Integrated View of Policy

Crises by their very nature create political pressure to take a “here-and-now” view of policy. While such focus is desirable, policy choices to contain the disease and provide relief today would ideally be informed by how they will affect recovery and growth tomorrow. For example, the experience so far shows that saving lives cannot be treated as a separate goal from saving livelihoods. How lives are saved (e.g., through stringent shutdowns or through investing in the capacity to test, trace, and isolate) will determine how much need there is to provide relief from economic distress. And how relief is provided can affect prospects for recovery and growth.

An integrated and inter-temporal view of goals and policies could at least increase awareness of opportunity costs and may even lead to socially desirable choices. In some cases, measures to provide relief, support recovery, and sustain longer-term growth are mutually supportive. For example, ensuring the survival of firms that are likely to thrive post-COVID-19, if it were possible to identify these firms, would provide relief to workers, facilitate a quick recovery, and boost growth. In other cases, governments must make policy choices in the face of difficult trade-offs, which are most evident when considering government spending but could arise with policy choices. For example, in deciding on whether schools should be open, countries would consider both the benefits in terms of containment and the costs in terms of lost learning. In protecting jobs and firms, they would consider the benefits of preserving employer-employee matches and expertise versus the costs of inhibiting reallocation of workers and production across

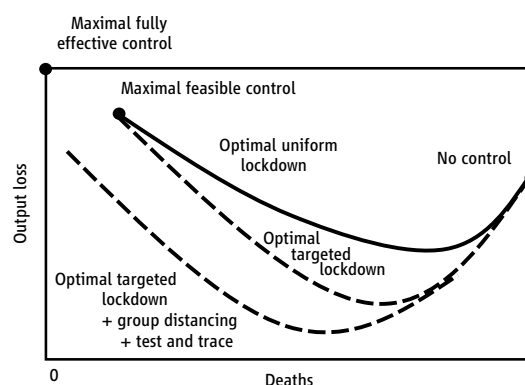
firms and sectors. Taking these trade-offs into account may lead to better, more nuanced policies: countries may decide that nurseries and elementary schools should stay open because the benefits of learning outweigh the risks of infection; and countries may provide support to firms but credibly commit to phasing it out based on objective macroeconomic indicators of recovery.

A dynamic view could also help governments make choices today that soften trade-offs tomorrow. That is important because some policies take time to implement or to have an effect. Thus, building the capacity to test, trace, and isolate today could help contain future surges of the disease tomorrow, with more targeted and less disruptive shutdowns. Similarly, implementing tax reforms today that help mobilize resources tomorrow could allow greater spending on social protection without sacrificing public investment in infrastructure.

Containment policy

Countries still face a trade-off between containment and recovery, which can be alleviated by developing the capacity for smart containment. The disease still rages in some countries like Indonesia and the Philippines, and even those that have suppressed its spread like China and Vietnam still face a threat of resurgence in infections. Indonesia and the Philippines must decide now on how far to relax containment measures to revive economic activity, and China and Vietnam will have to decide how far to reimpose such measures to preserve activity. Ideally, the period of stringent containment or dormancy would be used to create the capacity to limit the spread of disease without recourse to excessively disruptive measures, as seems to have been accomplished in countries like China and Vietnam. Where such capacity has not yet been created, continued strengthening of the capacity to test, trace, and quarantine; target lockdowns; and modify behavior will help soften the trade-off between lives and livelihoods (Figure 39) (Acemoglu et al. 2020; Loayza 2020). However, countries with poor health systems, such as the PICs, might choose to minimize health costs, e.g., by shutting off international travel, as even a single case could easily lead to overloaded hospitals and a high death rate. In any case, regional and wider international cooperation can help ease the trade-off for all countries between opening borders and preventing disease spillovers. Looking ahead, countries must invest early in building capacity to distribute a COVID-19 vaccine efficiently and fairly, in order to ensure social stability and facilitate economic recovery (Box 4).

Figure 39. Strengthening capacity for smart containment can soften the trade-off between saving lives and preserving livelihoods



Source: Acemoglu et al. 2020.

Box 4. Accelerating and anticipating the development of the COVID-19 vaccine

What is the status of vaccine development and production capacity?

There are over 250 vaccine candidates being pursued, and 37 are in human trials. At least US\$6.7 billion has been invested in vaccine research and development. Results from early phases of the clinical trials are promising, and at least nine candidates have progressed to Phase III trials of safety and efficacy. Results from some front-running candidate vaccines are expected in October 2020, after which regulators will review the results and decide whether to approve them. In EAP, Indonesia is hosting trials of Sinovac's vaccine, and the Philippines will begin trials in October 2020 of a vaccine developed in Russia.

Global production capacity is optimistically estimated at one billion doses by the end of 2020, rising to an estimated eight billion by the end of 2021. Deals between countries, vaccine developers, and manufacturers have already been arranged to produce vaccines for specific countries. In EAP, AstraZeneca has negotiated production agreements with Chinese and Japanese companies to produce hundreds of millions of doses of its vaccine for use in those two countries.

How will the vaccine be financed?

Some countries, many of them high-income, have signed agreements with manufacturers of front-runner candidates. To promote equitable access, the COVAX Facility is an agreement with countries to pool global demand and resources for eventual COVID-19 vaccines. The COVAX Advanced Market Commitment (AMC) is a financial instrument that mobilizes official development assistance to subsidize the purchase of COVID-19 vaccines for low- and lower-middle-income countries and other IDA-eligible economies. The COVAX AMC will procure vaccines for eligible countries through the COVAX Facility, both of which will be administered by the secretariat of Gavi. All countries are eligible to join the COVAX Facility, while the COVAX AMC is only open to 92 eligible countries (based on GNI or size or fragility of state); 18 EAP countries are eligible. Of the 80 countries that have expressed interest in self-financing participation in the COVAX Facility, Singapore, Republic of Korea, and Palau are those from EAP that have agreed to be publicly named.

Questions remain about the costs of the vaccines and their delivery, how countries utilizing COVAX AMC may cofinance the vaccine, how development partners will choose to support COVAX AMC, and how federal and local financing and systems may interact in implementation.

How should vaccine delivery be managed?

Despite decades of implementation, there are many weaknesses even in current routine immunization programs; in EAP, Papua New Guinea's recent polio outbreak and Samoa's measles surge are clear evidence. While the COVID-19 vaccine will need to be administered primarily among adults, most immunization systems worldwide are designed for children, which suggests that new strategies may need to be developed.

Vaccine delivery mechanisms for COVID-19 will also depend significantly on the characteristics of the approved vaccine. Different leading candidates have different cold chain maintenance requirements and different numbers

(continued)

(Box 4. continued)

of required doses. These factors will influence the immunization infrastructure that needs to be developed and the requirements for vaccine recipient monitoring.

Countries must ensure effective vaccine communication campaigns; end-to-end supply chain and logistics management systems for effective vaccine storage, handling, and stock management; cold chain control; service and coverage tracking systems; and well trained, protected, motivated, and supervised health care workers to administer the vaccine. Raising the visibility of early adopters of the vaccine and other mechanisms of social influence may help mitigate legitimate vaccine apprehension among the general public.

EAP countries with relatively low routine vaccination coverage, including Samoa; Micronesia, Fed. Sts.; the Marshall Islands; and particularly Papua New Guinea (all with DTP3 coverage <80 percent) may benefit from concerted efforts now to identify existing bottlenecks. Addressing known weaknesses in the immediate term can facilitate rapid dissemination of the vaccine once it is available.

How should vaccine administration be prioritized?

Since vaccine administration may need to be allocated strategically until a sufficient supply is available, the World Health Organization (WHO) recommends that health care workers (including health facility support staff) be prioritized first, followed by the elderly and those with pre-existing conditions, and then followed by essential workers. Countries may also need to consider trade-offs between minimizing deaths or years of life lost, preventing mortality as opposed to infections; and whether to prioritize certain subpopulations, such as young people who are more likely to spread the disease asymptomatically, vulnerable and/or low income individuals who cannot socially isolate or take other precautions, or members of the population whose return to work would hasten economic recovery.

Fiscal policy

Revenue constraints create sharp trade-offs between government spending on relief, recovery, and growth.

Governments today must consider three needs. Fiscal relief is required and has already been provided by the EAP governments in the current recession to prevent business closures, widespread unemployment, and a collapse in household incomes. Further fiscal stimulus could facilitate recovery by helping to overcome the coordination problems which can trap economies in underemployment equilibria—when social distancing no longer dampens the propensity to consume, and hence fiscal multipliers. Fiscal resources for investment in the hard and soft infrastructure, from broadband to health and educational capacity, could support stable, inclusive growth. As noted above, some types of spending—such as support that helps high potential firms to survive—can fulfil all three needs. In other cases, there is an opportunity cost: significant expenditure on relief today or a consumption-supporting stimulus tomorrow will leave an indebted government less equipped to invest in infrastructure and hence growth (Box 5).

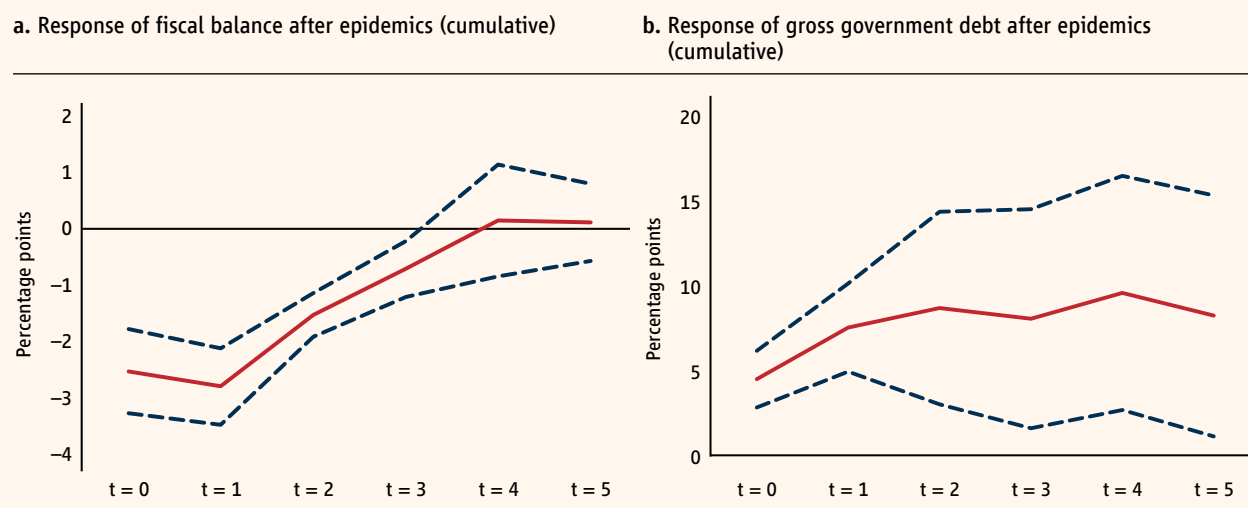
The intertemporal budget constraints are difficult because EAP economies have narrow revenue bases and financing conditions are not easy. Revenue mobilization is exceptionally low in the EAP region (Figure 40). Furthermore, the greater reliance on indirect taxes has amplified the revenue loss in a crisis where consumption has

Box 5. Fiscal positions and economic growth after pandemics

Fiscal positions in affected countries deteriorate during pandemics. As epidemics usually cause an economic downturn, government expenditure increases and revenue decreases. The deterioration in the affected country's fiscal position and the accumulation of debt may hinder its economic recovery. To help draw inferences on the possible effects of COVID-19 on fiscal positions and output, we examine how past epidemics (SARS, MERS, Ebola, H1N1, and Zika) have affected fiscal positions and GDP growth. The reach of the COVID-19 pandemic is of course much larger than that of these other pandemics, but past experience can help us identify the channels and significance of effects. The local projection method (LPM) is used to provide a reduced-form estimate of the response of output to adverse events over various horizons and to identify key transmission channels (Jorda 2005; Jorda et al. 2013).

First, fiscal positions in affected countries deteriorate because of pandemics (Figure B5.1). This effect is persistent. The fiscal balance-to-GDP ratio decreases by 2.5 percentage points in the aftermath of epidemics and remains at a lower level for the next three years. Gross government debt increases and remains above its pre-epidemic level for the five years following an episode.

Figure B5.1. Fiscal positions deteriorate in the aftermath of epidemics



Source: World Bank staff estimations.

Note: Lines show the estimated impacts of the past epidemics on fiscal deficit and gross debt positions relative to non-affected economies. The five epidemics considered are SARS (2002–03), H1N1 (2009), MERS (2012), Ebola (2014–15), and Zika (2015–16). The regressions control for country fixed effects, trade to GDP ratio, log of population size, log of real GDP per capita, and a decade dummy. In addition, regressions control for business cycle dynamics and financial crisis by including U.S. recession and banking crisis dummies. The dashed line represents 90 percent confidence intervals.

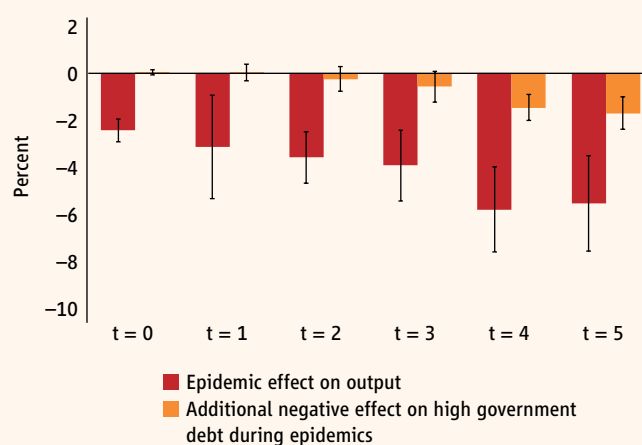
The affected country's real GDP remains below its pre-epidemic level relative to non-affected countries for more than five years. This suggests a long-run negative effect of epidemics on the affected country's economy (Figure B5.2). Recent epidemics since 2000 have indeed had a significant and durable negative effect on GDP growth in the countries affected (Ma et al. 2020). Following Romer and Romer (2019), the regression is modified to disentangle the impact of the pre-epidemic fiscal position on economic recovery after an epidemic. The results suggest that countries with higher gross government debt suffer more losses in output during epidemics, likely

(continued)

(Box 5. continued)

reflecting a lower ability of governments to support the economy. While output is estimated to be on average 7 percent lower after five years relative to a non-affected economy, higher debt can explain between 1 and 2 percentage points of the total loss in output.

Figure B5.2. Worsening fiscal positions contribute to output losses in the aftermath of epidemics

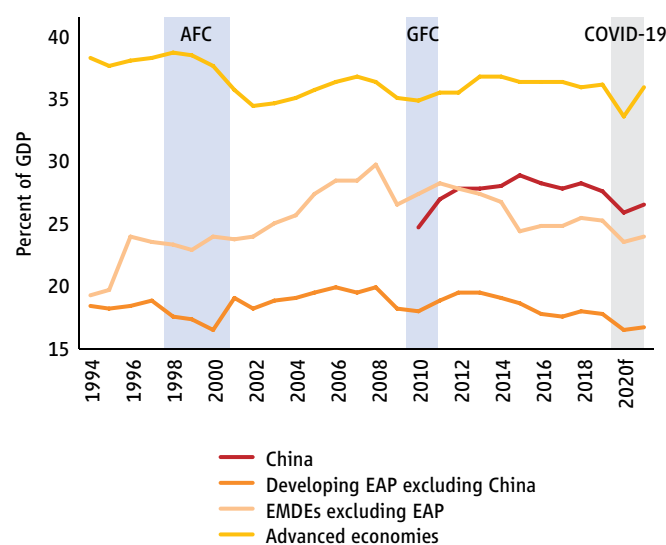


Source: World Bank staff estimations.

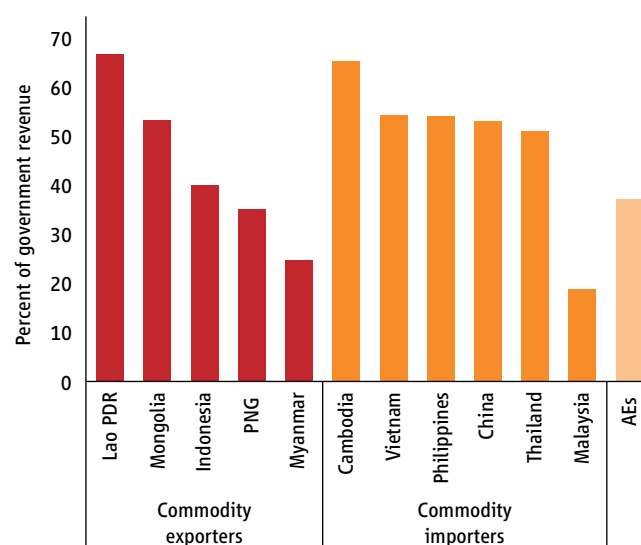
Note: Red bars show the estimated impacts of the past epidemics on output levels relative to non-affected economies over various horizons. Orange bars measure the additional response of output level that affected a 0.1 standard deviation increase in pre-epidemic government debt to GDP ratio. The five epidemics considered are SARS (2002–03), H1N1 (2009), MERS (2012), Ebola (2014–15), and Zika (2015–16). The regressions control for country fixed effect, trade to GDP ratio, log of population size, log of real GDP per capita, lagged government debt to GDP ratio, and a decade dummy. In addition, regressions include control for business cycle dynamics and financial crises by including U.S. recession and banking crises dummies at the current period.

Figure 40. Revenue mobilization is comparatively low in developing EAP region

a. General government revenue



b. Indirect taxes as a share of total government revenue, 2018



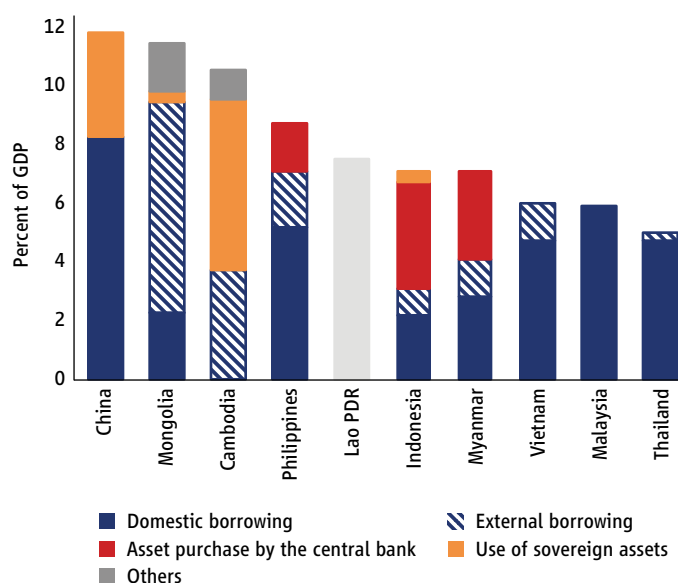
Sources: International Monetary Fund Fiscal Monitor and Government Finance Statistics; International Center for Tax and Development and United Nations University World Institute for Development Economics Research (ICTD/UNU-WIDER) Government Revenue Dataset; World Bank staff calculations.

Note: A. Averages are computed with current U.S. dollar GDP weight. B. Total revenue excludes social contributions and grants revenue. 2018 or latest available year.

contracted sharply. Governments therefore confront hard choices on the financing side. Even though the levels of indebtedness are not high in most countries, they are growing, and excessive borrowing could lead to an unsustainable fiscal situation, resulting in debt crises. Inducing central banks to buy sovereign bonds beyond a point could undermine central bank independence and inflation control, which have been crucial for macroeconomic stability in the region. And overreliance on the banking system, as a conduit for support by relaxing prudential measures and allowing permissive accounting, could threaten financial stability in countries where bank balance sheets are already weakening (Figure 41).

Figure 41. Most countries financed their fiscal deficit through increased domestic borrowing

Financing of fiscal deficit



Sources: International Monetary Fund; Official national country statistics; World Bank; World Bank staff calculations.

Note: Information is not available for Lao PDR. The Philippines' government borrowing is expected to exceed its estimated deficit in 2020.

The EAP economies have traditionally had small governments and raised limited revenues. Most EAP countries, except China, Mongolia, and Vietnam, have defied the conventional logic that open economies need to have larger governments whose spending plays a risk-reducing role in economies exposed to significant volatility (Rodrik 1998). That commitment to limited government has been consistent with the objective of creating a business-friendly low-tax environment where dynamic firms helped deliver not just *growth*, but also ensure it was *inclusive* by shifting the distribution of incomes to the right. Those actions are also consistent with the goal of *stability*, because firm performance was seen as critical to recovery from recessions which would help the region “grow out of debt.” Even in this crisis, as discussed above, government measures have complemented support for households with support for firms.

But COVID-19 may reinforce the argument for revisiting the low-tax model. In the early phases of their development, the low-tax environment yielded high investment and growth rates, which compensated for limited state capacity to stabilize or redistribute. As the EAP economies incomes converge toward those of richer countries and returns to investment decline, the incremental growth benefits of low taxation may also decline relative to the costs of volatility and worsening distribution. Particularly, given the enormity of the COVID-19 shock and its capacity to inflict durable and debilitating scars, the scale of government action needed to meet both growth and distributional goals needs to be supported by a stronger revenue base.

Reform can soften the fiscal trade-offs and lead to better social outcomes. The increased need for government spending and the increasing debt could hurt the goals of longer-term stable and inclusive growth. For example, how

governments distribute the burden of the economic losses incurred during the crisis will matter. Reducing the burden of public debt through inflationary measures or indirect taxation could be regressive. Dealing with debt through financial repression could inhibit growth. Governments may need to consider deeper reforms where the revenue base is widened and includes a greater role for direct income and corporate taxes to supplement the reliance on indirect taxes. Currently, the region's systems of taxes and transfers do not worsen inequality, but they have had relatively little effect on mitigating it. This contrasts to the effects of taxes and transfers in some advanced economies, which tend to be strongly equality enhancing. In parallel, there is of course need for expenditure reform, including of subsidies that are not socially desirable, such as those that are regressive and keep the price of carbon-based energy artificially low (Box 6). The speed of such reform may be influenced by the current global environment, where the costs of borrowing are likely to be durably low, both because of loose monetary policy and diminished global growth.

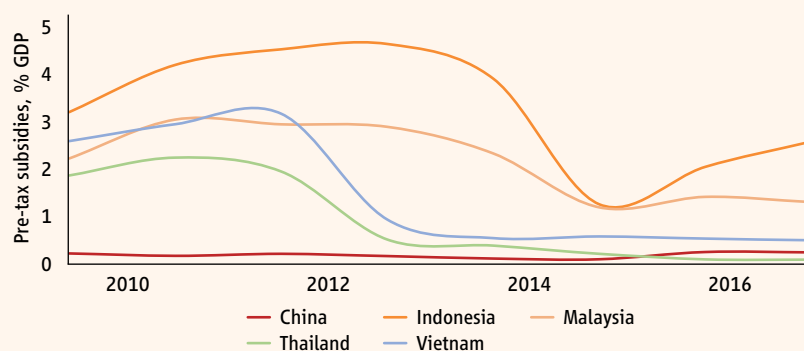
Box 6. Carbon pricing: Sustainable finance for sustainable development?

The pandemic has triggered an unprecedented increase in public spending. Governments are struggling to fund extensive recovery packages without cutting other expenditures or reducing public investment. Energy pricing reforms could alleviate this fiscal pressure while addressing the threat of global warming.

Carbon tax revenues could be substantial for EAP economies, even from a modest tax that would keep fuel prices below the 2019 pre-pandemic levels. Despite recovering recently, global oil prices remain about one-third below their pre-COVID levels. Coal prices are now above the levels immediately prior to the crisis, but below the average prices over the last three years. Against this backdrop, introducing, for example, a US\$50 carbon tax in the Philippines would raise longer-term gasoline prices by 14 percent, roughly equivalent to the differential between current and pre-COVID prices, while generating more than 1 percent of GDP in additional revenue.

Fiscal space can also be created by curbing fuel subsidies. These still have a significant footprint in government budgets, accounting for as much as 0.25 percent GDP in China, 0.50 percent in Vietnam, 1.31 percent in Malaysia, and 2.58 percent in Indonesia (Coady et al. 2019). In recent years, progress toward limiting fuel subsidies has halted in Vietnam and has actually been reversed in Indonesia (Figure B6.1). The dramatic fall in energy prices due to the global economic slowdown reduces the rationale for such subsidies and presents the opportunity for substantial fiscal savings.

Figure B6.1. Fossil fuel subsidies account for substantial share of GDP



Source: International Monetary Fund data from <https://www.imf.org/en/Topics/climate-change/energy-subsidies>

(continued)

(Box 6. continued)

Carbon prices can contribute to an inclusive and sustainable recovery. Pigato (2018) shows that carbon taxes tend to be progressive in developing countries and less distortionary than taxes on labor or income. Shifting taxation from labor to carbon would reduce the opportunity cost of formality and improve the efficiency of the tax system, thus stimulating the economy. Sustaining carbon prices would disincentivize reliance on coal and oil, and promote a recovery that favors the use of cleaner sources of energy.

Policy makers can build on the experience of several countries, including China, Korea, Rep., Japan, and Singapore, where carbon pricing initiatives are already underway. Recycling some carbon-tax revenue could also help overcome political opposition to the introduction of such a scheme (Klenert et al. 2018).

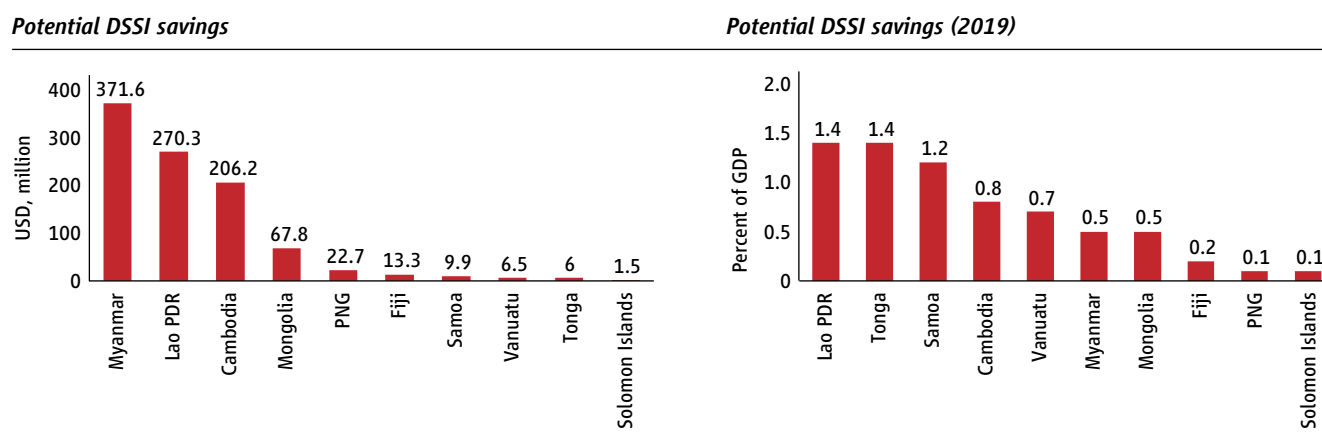
As countries work to enhance domestic resource mobilization, international support can help. The expenditure needs and contracting revenues due to the pandemic are creating fiscal difficulties for some EAP countries. Countries with large fiscal deficits or large debt burdens are particularly vulnerable. New bouts of debt distress and/or financial instability are possible and will become more likely in the absence of stepped-up external support (Table 2). The G20 Debt Service Suspension Initiative (DSSI) for poor countries announced in April could defer up to US\$12 billion in debt service due in 2020, and can help several EAP economies alleviate debt, including Lao PDR, Cambodia, and many Pacific Island economies (Figure 42). There is a case for extending the DSSI into 2021, including all Public and Publicly Guaranteed (PPG) bilateral debt should be covered. Private sector creditors need to participate; a voluntary approach has not produced results. Debt sustainability analysis (DSAs) will be undertaken jointly by WB/IMF to look at longer-term sustainability concerns. Greater debt transparency is critical to help countries make more informed borrowing and investment decisions and to attract foreign direct investment.

Table 2. Debt distress remains high for several Pacific Island economies

	<i>Risk of external debt distress</i>	<i>Risk of overall debt distress</i>	<i>Date of DSA Publication</i>
Cambodia	Low	Low	19-Dec
Kiribati	High	High	19-Jan
Lao PDR	High	High	19-Aug
Marshall Islands	High	—	18-Sep
Micronesia, Fed. Sts.	High	High	19-Sep
Myanmar	Low	Low	20-Mar
PNG	High	High	20-Jun
Samoa	High	High	20-Apr
Solomon Islands	Moderate	Moderate	20-Jun
Timor-Leste	Low	Low	19-May
Tonga	High	—	18-Jan
Tuvalu	High	—	18-Jul
Vanuatu	Moderate	Moderate	19-Jun

Source: World Bank.

Note: DSA refers to Debt Sustainability Analysis. Risk assessment is based on Low Income Debt Sustainability Framework (LIC DSF) and reflects published DSA ratings as of end-June 2020.

Figure 42. The Debt Service Suspension Initiative can have significant benefits for some EAP countries

Source: World Bank COVID-19 Debt Service Suspension Initiative: <https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative>

Note: DSSI refers to Debt Service Suspension Initiative. Estimated debt service payments owed. World Bank International Debt Statistics (IDS) data based on monthly projections for May–December 2020, based on end-2018 public and publicly guaranteed debt outstanding and disbursed.

Support for firms

Trade-offs also arise in implementing support for firms during the COVID-19 crisis. Crises are bad selectors with both good and bad firms driven out. Therefore, policy support is crucial, but difficult to design. Government support faces one key tradeoff: *immediate indiscriminate versus slower, targeted implementation*. Firms highly reliant on cash flows may not survive a shock of the magnitude and depth generated by the pandemic for long. Prompt government action is needed to avoid igniting downward spirals. But prompt action is likely to be indiscriminate, at least initially, since designing new, targeted policies takes time. The downside is that broad support may keep zombie and unproductive firms afloat, along with productive firms with intangible assets that are important for the recovery. When more capital is sunk in zombie firms, the resources available for productive firms to scale up are more limited.

Nevertheless, policy should strive for a more efficient allocation of financial support even in the short term. Support is rarely indiscriminate. Even when it is in principle available for all firms, only some firms may be adequately informed, identified, or politically connected to take advantage of it. Therefore, the challenge is to define objective and transparent criteria, to both avoid supporting unproductive firms and to mitigate concerns about picking winners. Ideally, such criteria would be based not just on past performance or current pain but on a firm possessing intangible assets that will be valuable in a post-COVID-19 world. Micro and informal firms which operate outside of financial and tax systems will have few such assets and are in any case hard to reach. Therefore, they are better supported through social protection interventions. In some cases, past performance, as revealed by previous years' profits, tax revenues or trade flows, or present performance, as reflected in stock prices, may provide clues on firm potential. For example, controlling for market risk, there is as much as a 25 percent gap in cumulative return between more and less resilient firms in U.S. asset markets. Support may be directly tailored to encourage investment in intangibles and promote long-term productivity growth, for example by incentivizing R&D or skills training. In any case, governments must credibly commit to terminating assistance when it is no longer needed to avoid the risk of capture by politically connected firms. For example, in Brazil, credit market interventions in response to the financial crisis continued to expand even after the economy recovered. One option is to legally link the continuation of support to certain objective macroeconomic indicators of recovery.

Broad policy reforms, while they can take time, support the entry and expansion of innovative businesses—the productive firms of tomorrow. Although the support of existing productive firms today is important, the recovery also depends upon new innovative firms, and start-up firms are particularly sensitive to the business environment. *Strengthening venture capital and early-stage finance* market development, through tax policy, public funding or regulatory reform can all help innovative start-ups. *Reducing red tape and streamlining regulatory systems* can facilitate firm entry and reduce the bureaucratic advantages of incumbents. *Improving insolvency resolution* can promote the exit of zombie firms, freeing resources for productive firms to scale up. The introduction of specialized bankruptcy courts in selected Chinese cities has led to faster resolutions of bankruptcy cases, decreased the share of labor in zombie-intensive industries, and increased average product of capital. *Accelerating infrastructure investments*, such as improving access to digital infrastructure, can reduce the barriers to broader adoption of digital business models, such as e-commerce, remote working, and cloud computing. *Liberalizing services and reducing barriers to competition* are largely untapped avenues to promote more efficient resource allocation. Promoting competition in upstream sectors, complemented by prudential and other regulatory reform, can benefit the whole economy. Business environment reforms are often triggered by crises, being hard to implement in normal times, so this represents an opportunity to get the policies right.

Social protection

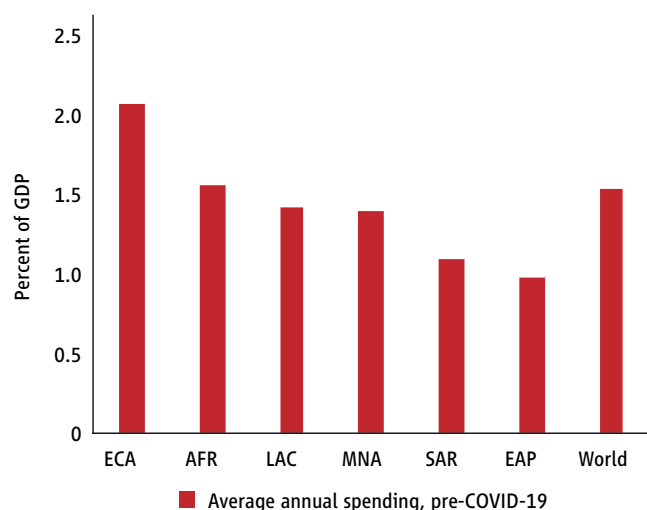
EAP countries have spent relatively little on social protection, but most have stepped up support in response to the pandemic (Figure 43). Countries' responses have been substantial and broadbased, utilizing the following range of social protection instruments: social insurance to protect formal sector workers, social assistance programs—particularly cash and in-kind transfers—to support poor and vulnerable households, and labor market measures to promote employment continuity and strengthen workers' skills. Moreover, governments in the region recognize that social protection has a triple role to play: in mitigating the immediate impacts of the crisis; in supporting workers to reintegrate productively in the economy as countries recover; and in ensuring that short-term impacts of the crisis do not result in long-term harm to human capital, productivity, and economic opportunity.

An important lesson from the crisis to date is that countries with well-functioning social protection programs and good implementation infrastructure, pre-COVID, have been able to scale up more quickly during the pandemic (Figure 44). For example, Malaysia's ability to mount a quick and wide-ranging social protection response reflected the fact that it could leverage existing programs and good implementation infrastructure, including a universal national ID system, broad mobile phone coverage, and high financial inclusion. Similarly, Thailand's ability to identify, screen, and provide support to millions of previously uncovered workers and farmers is also built on a robust national ID system, broad digital-mobile infrastructure, and sound information systems. In contrast, many Pacific Island countries have the least developed social protection systems in the world. Continuing to build staff and administrative capacity to implement expanded programs is critical for effective delivery during the crisis but also represents an investment in countries' abilities to deal with future needs. In this sense, the pandemic represents an important opportunity for countries to undertake measures that will result in long-term strengthening of their social protection systems, including the ability to adapt to future shocks.

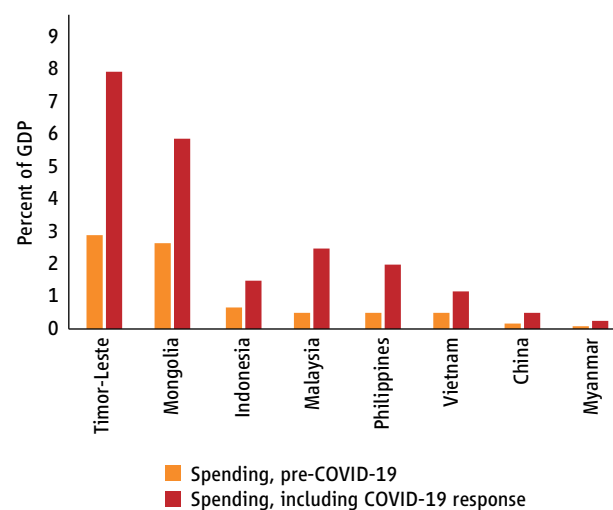
As countries begin to recover, social protection programs can play an important role in supporting workers' integration back into the economy. This economic recovery role will require a different mix of policies and instruments than those used during the crisis phase, however. Labor market initiatives will need to take a more prominent role, providing workers with: *training and skills upgrading* to help them meet changing demands in the labor market;

Figure 43. While most East Asia and Pacific countries have spent relatively little on social protection pre-COVID, the response to the crisis has been substantial in most countries

a. Average public spending on social assistance, by region and worldwide



b. Public spending on social assistance in selected East Asian countries, pre-COVID-19 and including countries' COVID-19 responses

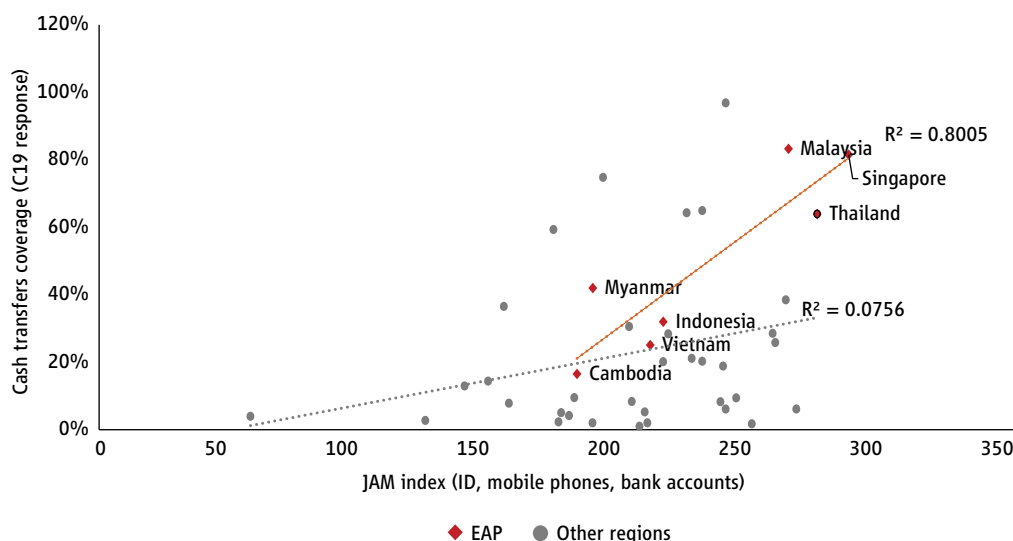


Source: A. World Bank staff calculations based on ASPIRE database data; B. World Bank staff estimates.

Note: Figures capture central government spending on social assistance. In contexts where social assistance spending by local governments is important, as in China, figures may underestimate pre-COVID spending levels as well as the magnitude of the response.

Figure 44. The scale of a country's COVID-19 social protection response is related to a country's existing "delivery capacity"

(actual or planned COVID-19 cash transfer coverage, percent of population)



Source: Mason et al. (2020).

Note: The JAM Index, which combines a measure of the prevalence of citizen identification, mobile phone coverage, and bank accounts. While JAM Indexes also exist for China, Lao PDR, and Mongolia, no national level data are available on cash transfers in China. In Lao PDR, the government did not launch a specific COVID-19 response. In Mongolia, coverage by the Child Money Program was near-universal prior to the pandemic. So, rather than expanding coverage, the Government of Mongolia raised the amount of the associated cash transfer.

employment support services/job placement to help match employers' needs with workers' skills; and *special employment support measures for selected groups*, such as youth and older workers, including through *targeted wage subsidies* that incentivize new hiring and skills development for the post-COVID economy.

Social protection programs can also play a role, as part of a multi-sectoral strategy, in ensuring that the short-term impacts of the crisis do not result in irreversible harm to people's human capital. COVID-19 shocks, including child malnutrition, stunting, and reduced student learning, can have persistent impacts on people's well-being, productivity, and economic opportunity. The poor remain particularly vulnerable to long-term impacts, as they possess fewer assets and have less access to services. Cash transfers, along with waivers on fees for basic services that incentivize service access, including continued education participation, can help. However, such policies need to be predictable in scope and duration because uncertainty can lead to precautionary behavior, such as excessive curtailment of consumption or dropping out of school, which can have a durable adverse impact on human capital.

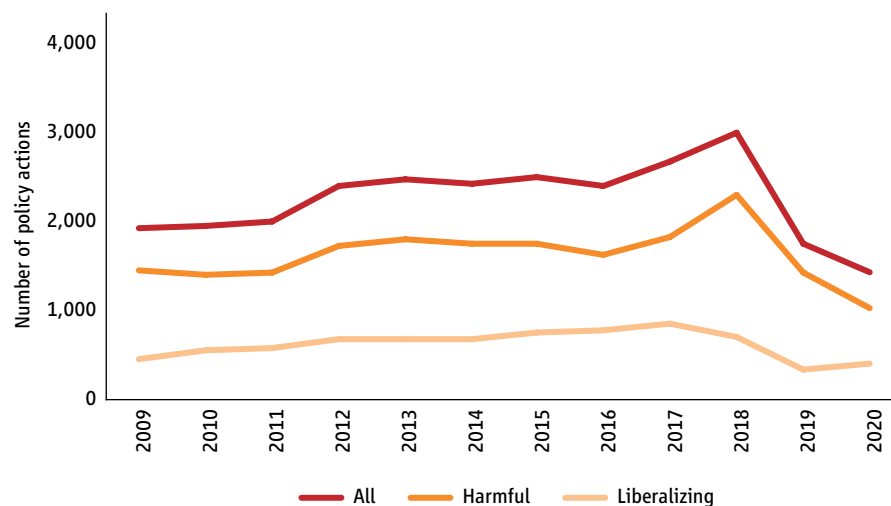
Early investments in strategies to prevent and recoup COVID-19-induced learning losses could avert long-term losses in human capital. In-person education still dominates remote education when it comes to learning. Fortunately, as of early September 2020, only 12 countries still had schools closed or with limitations (down from as many as 20 in April). But the situation remains fluid and countries are occasionally reclosing in response to new outbreaks. Sustained opening requires measures to protect students, staff, teachers, and their families. Such measures include sanitary protocols, social distance practices, and initiatives to support student re-enrollment. Learning losses can also be mitigated through measures to adjust school curricula, as needed, and to develop rapid catch-up periods when schools reopen. In the longer term, countries should seek to develop more resilient and inclusive education systems that can deliver learning in the event of future crises, including through remote learning.

Trade policy

COVID-19 could deepen divisions and worsen protection. The failure to address growing inequality within countries through progressive domestic policies was already leading to a backlash against globalization. In addition, growing tensions between international powers and the erosion of multilateral disciplines were generating uncertainty that hurt all trade and investment. Now COVID-19 is creating a stronger craving for self-sufficiency in an uncertain environment. Since some countries will recover and export before others, and many governments will have subsidized their firms to cope with COVID-19, a sense of unfairness could spawn more trade restrictions. And the pandemic could also deepen great power divisions and renew calls for decoupling. Resisting these trends is important for recovery.

But export restrictions have also been accompanied by significant import liberalization. To cope with scarcity, countries in the region and elsewhere are resorting to export restrictions to meet domestic demand, especially in personal protective equipment (PPEs) and some other goods (Figure 45). Examples include restrictions on face masks by Indonesia, Malaysia, and Thailand; Vietnam's export curbs; and China's minimum purchase price on rice. But the recognition of the value of imports when domestic production was disrupted led to the steepest percentage rise in import liberalizing measures since 2009 (by 39 percent) and the steepest percentage fall in import restricting measures (by 59 percent) in 2020.

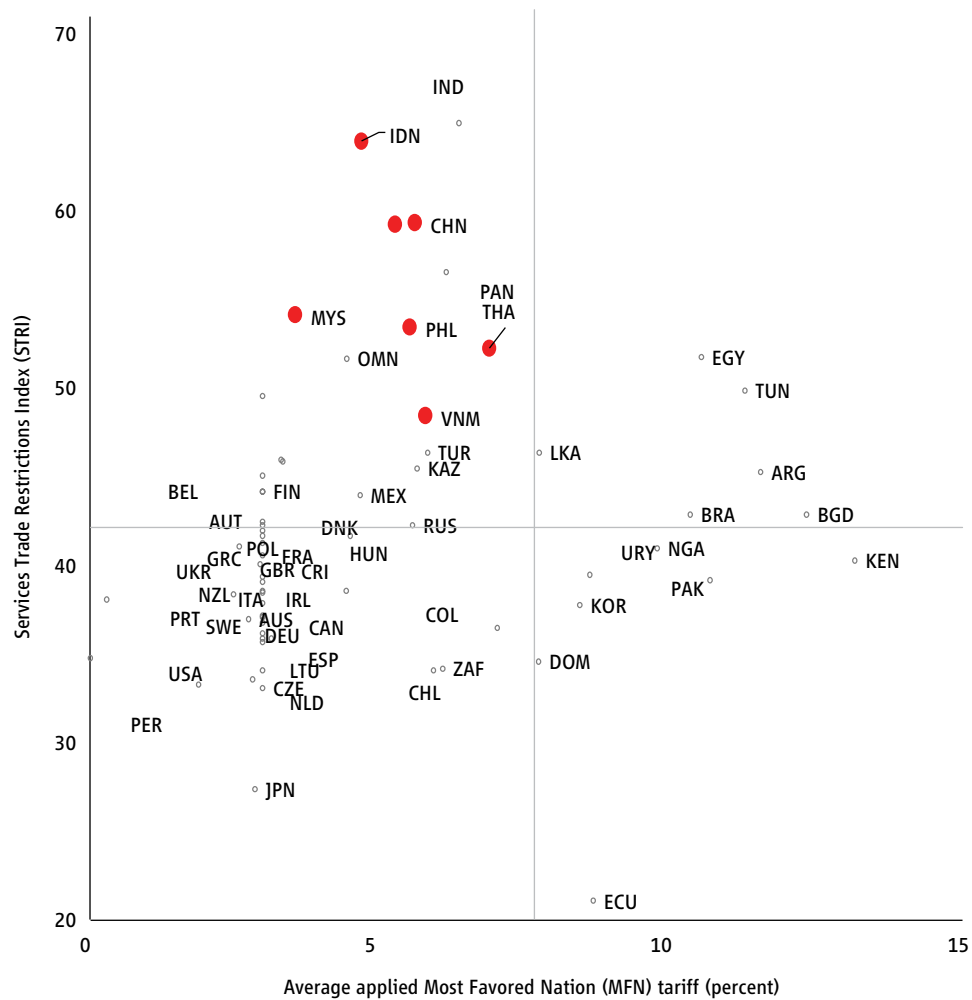
Figure 45. Recourse to trade-restricting measures has declined significantly and to trade liberalizing measures has increased slightly



Source: Global Trade Alert.

If the China-U.S. trade agreement was implemented through reforms and market opening in China that benefitted all trading partners, then it could provide a 0.5 percent income boost to the world economy. The agreement, in its original form, averted a damaging trade war and provided relief from the trade tensions that hurt the EAP region's economic performance in 2019. Now COVID-19 may make it difficult, at least in 2020, to meet the quantitative import expansion commitments made by China because of the contraction in China's demand and the likely contraction in U.S. production. Instead of renegotiating the bilateral commitments, all countries would benefit if China opens its market to all trading partners rather than to the United States alone. China's income, and that of most developing countries in EAP, could be nearly 0.5 percent higher. Moreover, turning the agreement into a model of nondiscriminatory market opening could be a credible down payment toward the revival of a multilateral trading system—which is in the interest of both the region and the rest of the world.

Other countries in the region seeking to take advantage of the relocation of global value chains must also focus on goods and services trade policy reforms. For example, Indonesia is considering phasing out restrictions on foreign investment that had reduced inflows to a relative trickle (2 percent of GDP), and is investing in roads and ports to enhance the competitiveness of non-resource sectors of the economy. However, Indonesia also needs to make it easier for firms to import-to-export by reforming its pre-shipment inspection, technical standards, and port-pricing strategies. Many countries in the region penalize their firms by restricting trade and investment in services, and deprive them of access to efficient transport, finance, communication, and other business services (Figure 46). Liberalizing services policies is also essential to take advantage of the new opportunities in services in the post-COVID-19 world.

Figure 46. EAP countries still maintain relatively restrictive services trade policies

Sources: Constantinescu et al. (2018); Borchert et al. (2020).

Note: The figure presents the import weighted average tariff in 2016 for each country and the World Bank Services Trade Restrictions Index for the same year.

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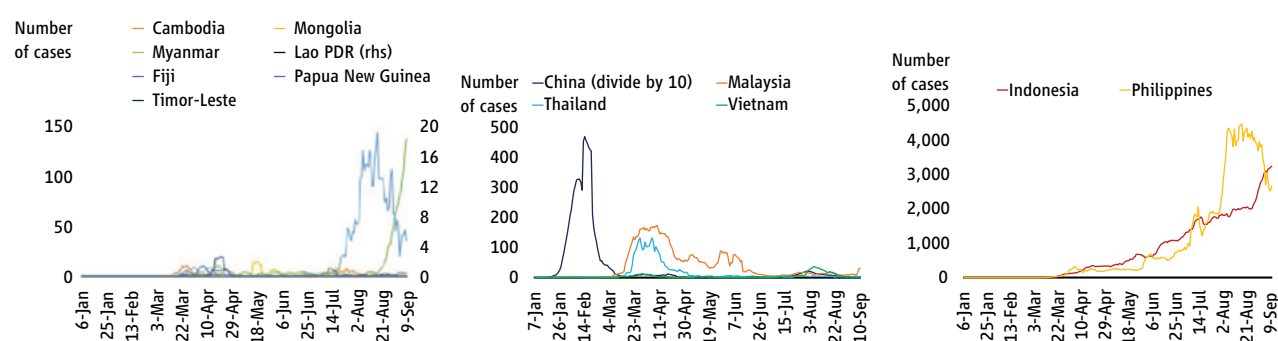
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Annex A1. Figures

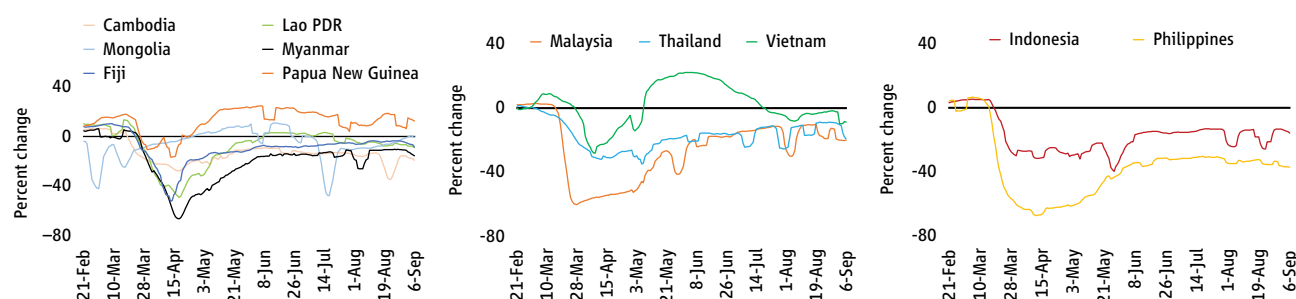
EAP countries can be divided into three broad groups: countries that have seen a relatively low number of cases (Cambodia, Fiji, Lao PDR, Mongolia, Myanmar, Papua New Guinea, and Timor-Leste); countries that saw an initial surge in cases, but were able to contain further spread of the virus (China, Malaysia, Thailand, and Vietnam); and countries that are still struggling to contain the spread of the virus (Indonesia and the Philippines) (Annex Figure A1.1). The depth and duration of mobility restrictions in the three groups of countries appears to roughly reflect the spread of the disease spread. Vietnam appears to have resumed activity soon after successful containment, and mobility in Malaysia and Thailand is now close to where it was in January.

Figure A1.1. Countries that have contained the disease have curtailed mobility less

a. COVID-19 new confirmed cases (7-day moving average) in developing EAP



b. Workplace mobility (percent change from baseline in January 2020, 7-days moving average)



Sources: Johns Hopkins University, Center for Systems Science and Engineering COVID-19 Dashboard; Google Mobility Reports; World Bank staff calculations.

Annex A2. Tables

Table A2.1. Disease progression and policy response in Vietnam, Indonesia, and the Philippines

	<i>Vietnam</i>	<i>Indonesia</i>	<i>Philippines</i>
How early and comprehensive were mobility restrictions?	<p>First confirmed case on February 5.</p> <p>Early restrictions on international arrivals starting on January 30. Closed borders and suspended all international flights March 22 to date.</p> <p>Schools closed while cases in single digits. Strict nationwide lockdown from April 1 to 15. No local transmission until mid-July and domestic economy opened up. Targeted lockdowns introduced in July following new cases in selected areas of the country.</p>	<p>First confirmed case on March 2. Travel restrictions initiated on March 5 for people with travel history to affected regions. No self-isolation requirements until later. Domestic and international ban except for repatriation flights from April 24 to June 1, covering busiest period. Flight ban lifted with safety measures in place.</p> <p>Schools in most affected areas closed at end of March. Partial lockdown introduced mid-late March with authority delegated to subnational governments; relaxed in June; re-imposed on September 14.</p>	<p>First confirmed case on January 25.</p> <p>Gradual expansion of travel restrictions from late January onward. The government also implemented repatriation and 14-day quarantine for returning overseas Filipinos from these areas, as well as cruise ship returnees.</p> <p>Lockdowns March 15–April 30 for Metro Manila expanded to Luzon. Degrees of lockdown continue to exist, varying by local government authorities.</p>
How adequate was testing capacity and how comprehensive was the testing, tracing, and isolation strategy?	<p>Strong testing capacity from early on: 123 laboratories across the country with capacity of 46,000 samples per day.</p> <p>Positive cases diagnosed per test carried out to date: 0.12%.</p> <p>Testing targeted at four tiers of close contacts and people with symptoms. Recently been expanded to hot spot communities and at-risk settings.</p> <p>Local centers for disease control collaborating with hospitals in case detection, isolation, and treatment.</p> <p>Confirmed positive case (Tier 1) must be isolated and treated in health facilities.</p> <p>Home-based isolation of confirmed cases not allowed in Vietnam to prevent transmission to family members and community.</p>	<p>Testing capacity has been scaled up from 3,000 to 30,000 tests per day; 40% of capacity in worst-hit Jakarta.</p> <p>Positive cases diagnosed per test carried out to date: 13.20%.</p> <p>Tracing relies on the government local health offices and primary health care facility network, (Puskesmas) and is hampered by stigma as well as capacity constraints. Surveillance system is not fully interoperable—the information is not yet linked with laboratory or service delivery data; also largely manual.</p> <p>Isolation facilities are established at the national and subnational levels.</p>	<p>Testing capacity scaled up since March through establishment of local laboratories from 200 to 29,000 per day.</p> <p>Positive cases diagnosed per test carried out to date: 8.50%</p> <p>Tracing capacity remains weak despite 50,000+ contact tracers plus tracing apps developed by local software companies.</p> <p>PhilHealth approved community benefit package in April covering all identified services needed to effectively manage cases needing isolation services.</p> <p>Quarantine and isolation capacity gradually expanded.</p>

	<i>Vietnam</i>	<i>Indonesia</i>	<i>Philippines</i>
Was communication clear and consistent throughout?	Clear, strong communication from central government about the dangers of the illness even before the first case was reported. Risk communication strategy took advantage of Vietnam's high use of social media. Overall, public and private telecom companies have collectively sent billions of messages on COVID-19 prevention to mobile phone users so far.	Public communication coordinated by the National Task Force. Focused on behavior change: wearing masks in public, social and physical distancing, handwashing, and workplace prevention. The national and local COVID task forces public communication webpages include 'Hoax Buster' feature to counter misinformation.	Information programs are still limited and need to be expanded. Department of Health (DOH) established a dedicated website to provide latest information and updates. Several Local Government Units (LGUs) provide information by social media. DOH provides daily bulletin on the current nationwide total cases.

Table A2.2. Developing East Asia and Pacific: baseline and lowercase GDP growth projections

	<i>2017</i>	<i>2018</i>	<i>2019^a</i>	<i>Forecast^d</i>			
				<i>Baseline 2020</i>	<i>Low case 2020</i>	<i>Baseline 2021</i>	<i>Low case 2021</i>
Developing EAP^a	6.5	6.3	5.8	0.9	0.3	7.4	4.5
China	6.8	6.6	6.1	2.0	1.6	7.9	4.8
Developing EAP excluding. China^a	5.4	5.2	4.8	-3.5	-4.8	5.1	3.4
Developing ASEAN ^a	5.4	5.3	4.8	-3.5	-4.7	5.1	3.4
Indonesia	5.1	5.2	5.0	-1.6	-2.0	4.4	3.0
Malaysia	5.7	4.7	4.3	-4.9	-6.1	6.3	4.4
Philippines	6.9	6.3	6.0	-6.9	-9.9	5.3	2.9
Thailand	4.0	4.1	2.4	-8.3	-10.4	4.9	3.5
Vietnam	6.8	7.1	7.0	2.8	1.5	6.8	4.5
Cambodia	7.0	7.5	7.1	-2.0	-2.9	4.3	3.0
Lao PDR	6.9	6.3	4.7	-0.6	-2.4	4.9	2.8
Myanmar ^c	5.8	6.4	6.8	0.5	-0.9	5.9	3.0
Mongolia	5.4	7.0	5.0	-2.4	-4.3	5.6	3.6
Fiji	5.4	3.5	-1.3	-21.7	-25.0	6.4	5.1
Papua New Guinea	3.5	-0.8	5.9	-3.3	-4.1	3.2	0.6
Solomon Islands	5.3	3.9	1.2	-4.8	-7.4	3.2	2.8
Timor-Leste ^b	-3.8	-0.8	3.4	-6.8	-9.8	3.1	3.0

Source: World Bank staff estimates.

Note: a. Estimate. b. Nonoil GDP. c. Myanmar growth rates refer to the pre- and post-pandemic period for fiscal year from October to September. d. Baseline refers to a scenario of severe growth slowdown followed by a strong recovery. Lower case refers to a scenario of a deeper contraction followed by a sluggish recovery. Weighted averages are calculated for developing EAP.

