APRIL 2026

East Asia & Pacific Economic Update

Industrial Policy in the Digital Age

OVERVIEW



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The Office of the Chief Economist of the East Asia & Pacific Region

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Executive Summary

Growth in developing East Asia and Pacific (EAP) remains above the global average but is likely to slow down from 5.0 percent in 2025 to 4.2 percent in 2026 and 4.4 percent in 2027. Underlying the regional trend is China's continued deceleration and the negative growth effect on the rest of the region of higher energy prices. In China, growth is projected to decline from 5.0 percent in 2025 to 4.2 percent in 2026 and to 4.3 percent in 2027, as domestic demand remains subdued, the difficulties in the property sector persist, and external demand weakens. Growth in the rest of the region is projected to slow from 4.9 percent in 2025 to 4.1 percent in 2026 as the region copes with the oil price shock, and to rebound to 5.0 percent in 2027 as geopolitical tensions ease and uncertainty diminishes. Pacific Island Countries are expected to grow at about 2.8 percent in 2026 and 3.0 percent in 2027, with the increase in oil prices imposing a cost in the near term.

Private consumption continues to support growth across the region, but consumer confidence remains weak. Exports of artificial intelligence (AI)-related electronics were a bright spot in 2025, with shipments surging across Malaysia, the Philippines, Thailand, and Viet Nam, but exports of other products grew more slowly. Private investment as a share of GDP remains below pre-pandemic levels across most of the region, amid elevated policy uncertainty and recent shocks.

Three external factors are shaping the regional outlook.

- First, the *conflict in the Middle East* has triggered sharp energy price increases—natural gas indices are up 90 percent, and oil is up 30 percent in the immediate aftermath—which directly hurt net energy importers such as Thailand and Pacific Island Countries, where oil imports represent 5 to 13 percent of GDP. A 30 percent (US$20) increase in crude oil prices would raise inflation by 0.62 and 0.67 percentage points in the Philippines and Thailand after 6 months. Economic activity is also likely to suffer from tighter financing conditions and reduced remittances from Gulf-based workers. Hitherto resilient global growth may also suffer, especially if the conflict continues or escalates, leading to indirect effects on the region—a 1 percentage point reduction in G-7 growth can reduce developing EAP output by around 0.6 percentage points.
- Second, *tariffs on exports* to the United States remain above 2024 levels despite the recent US Supreme Court ruling, which reduced tariffs but also led to a narrowing of the tariff advantage of EAP countries relative to China. At the same time, US trade policies are contributing to elevated economic policy uncertainty, which inhibits investment and induces a shift toward short-term and informal employment.
- Third, the *AI boom* is spurring investment globally and reshaping technology supply chains. Malaysia and Viet Nam are emerging as major exporters of AI-related products, with these exports accounting for one-third of their GDP in 2025. Data center investment is also accelerating across the EAP region. In the near term, AI could lead to higher productivity growth, but diffusion in EAP remains limited because of gaps in connectivity, skills, and startup ecosystems. Only 13 percent to 17 percent of multinational subsidiaries in China and Thailand currently use AI, compared to 37 percent in the United States.

Sustaining longer-term growth in EAP will depend on reversing a structural productivity slowdown. In the past two decades, growth has been driven by capital accumulation even as improvements in productivity have declined; workers are leaving low-productivity agriculture, not for high-productivity manufacturing but for low-productivity services; and frontier firms in the region are falling further behind the global frontier in productivity

and innovation—particularly in digital-intensive sectors.

Industrial policy is increasingly viewed by policy makers as a tool to counter these adverse effects. We take a broad view of industrial policy as remedying *inadequacies in foundational public goods,* like infrastructure, human capital, and institutions; *addressing policy failures,* such as regulatory barriers to entry and competition, that constrain the reallocation of resources toward more productive activities and dampen incentives for firms, thus slowing growth and the creation of better jobs; and *addressing market failures,* such as asymmetric information that limits access to credit, inadequate coordination between linked sectors, or limited investment by firms in R&D and training (since the benefits may accrue to other firms), all of which inhibit desirable economic activity in specific sectors. This special focus delves briefly into the first two pillars and then explores in some depth the third pillar drawing on original research.

Basic human capital, infrastructure, and institutions. The structural transformation and economic dynamism in China, Malaysia, Thailand and, more recently, Viet Nam are largely attributable to the state's role in ensuring adequate foundational public goods. But progress has been uneven and gaps limit further progress. For example, Indonesia, the Philippines and even Malaysia still have many children who lack basic literacy and numeracy, while Viet Nam's remarkable school education coexists with weak tertiary education. Rapid progress on basic infrastructure in China, Malaysia, and Thailand contrasts with big gaps in Indonesia and the Philippines, despite significant improvements. Institutions of macroeconomic management are generally robust; sectoral ministries and regulators less so. Though priorities differ, returns on further investment in these fundamental public goods far exceed costs in most countries.

Policy distortions in services, non-tariff barriers. Pervasive restrictions on trade and investment in many EAP countries limit growth potential. For example, Indonesia's marginalization from global value chains in manufacturing can in part be attributed to the non-tariff barriers that make it hard for exporters to import. The benefits of even partial liberalization are evident in China, Viet Nam, and, more recently, the Philippines. In Viet Nam, the liberalization of telecommunications, finance, and other services on the altar of WTO accession produced significant productivity gains not just in these sectors but also in the manufacturing sectors that use these services. Advancing services reform may well be the most effective and efficient industrial policy.

Targeted interventions can complement—but not substitute for—the enabling framework created by addressing the first two pillars described above. Targeted support, in the form of subsidies, tax exemptions, trade measures, etc., is rising globally and in the EAP region. Export promotion and direct transfers to firms are positively correlated with productivity in the G-20 economies, but not in other emerging economies, suggesting that stronger institutions are a precondition for successful intervention. Furthermore, in both types of countries, subsidized loans can affect input choices—leading firms to substitute machines for workers.

Targeted policy needs to be not just effective but also efficient. Recent research shows an interesting contrast between the Republic of Korea's promotion of heavy manufacturing industries in the 1970s, which has been found to be both effective and efficient, and the more recent case of China's interventions in the shipbuilding sector, which have been found to be highly effective, but mostly inefficient (i.e., costs of providing support exceeded their benefits).

The AI value chain illustrates how the three pillars of industrial policy can work in tandem. While several countries are introducing financial and energy incentives to attract data centers, infrastructure quality and administrative efficiency can remain binding constraints. Much can be learned from the Republic of Korea's remarkable progress in semiconductors. In the first stage, the state attracted foreign capital and technology by offering a workforce with sound basic education and reasonable infrastructure, as well as legal certainty and tax exemptions. In the second stage,

greater engagement by domestic firms was facilitated by offering cheap finance. And in the third stage, domestic innovation was encouraged by the state through support for R&D and coordination between dominant firms.

While domestic firms in Malaysia and Thailand have succeeded in participating in global value chains in semiconductors, the sector remains dominated by foreign firms in Viet Nam. Very few Southeast Asian firms have succeeded in emulating Korean firms in innovative activity. In this respect, the innovative activity of China's firms stands out. Here, state support has helped. For example, public procurement contracts with access to government data led to Chinese AI firms developing new commercial software.

The overarching policy message is ideally to prioritize foundations and address policy failures before considering targeted interventions. In fact, the effectiveness of the third pillar is likely to depend on the implementation of the first two. The success of new export promotion policies in Korea, for instance, hinged crucially on prior policy reform and the quality of public institutions as reflected in the technical and managerial capacity of bureaucrats. Since economywide improvements in the first two pillars may be hard to accomplish in the near term, countries have initially created special economic zones (SEZs). These zones are demarcated areas within a country that typically offer investors better infrastructure, a streamlined regulatory and administrative regime, and a favorable fiscal regime. Where successful, as in the East coast of China, SEZs have become growth poles whose scope and development impact gradually expanded.

Targeted support can facilitate investment but creates fiscal and rent-seeking risks. It must therefore include sunset clauses, transparent reporting, and strict performance benchmarks. Policy makers should prioritize instruments that closely target market failures, ensuring support that fosters competition and local spillovers rather than serving to entrench incumbents.



OVERVIEW

Industrial Policy in the Digital Age

Overview

I. Recent developments and outlook

Projected growth

Growth in developing East Asia and Pacific (EAP) remains above the global average but is likely to slow down from 5.0 percent in 2025 to 4.2 percent in 2026 and to 4.4 percent in 2027. Underlying the regional trend is China's continued deceleration and the negative growth effect of higher energy prices on the rest of the region, which relies significantly on oil imports from the Middle East. In China, growth is projected to decline from 5.0 percent to 4.2 percent in 2026 and to 4.3 percent in 2027 as domestic demand remains subdued, the difficulties in the property sector persist, and external demand weakens. The rest of the region is likely to see growth slowing from 4.9 percent to 4.1 percent in 2026 before rebounding to 5.0 percent in 2027 as geopolitical tensions ease, uncertainty diminishes and external demand recovers. Pacific Island Countries are expected to grow at about 2.8 percent in 2026 and 3.0 percent in 2027, with the increase in oil prices imposing a cost in the near term (figure O.1; table O.2).

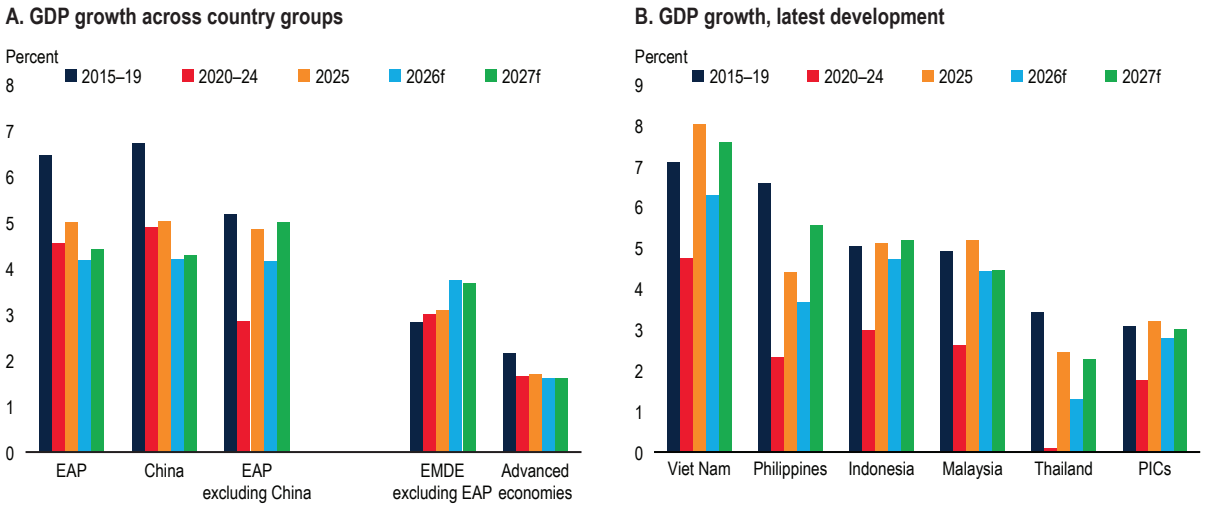
Consumption, investment, and exports

Private consumption has supported growth in all major economies in 2025, although its contribution has remained below prepandemic levels in China, Malaysia, and the Philippines (figure O.2). Manufacturing exports have boosted growth across the region, driven by strong demand for AI-related electronics, front-loading ahead of tariff increases, and value-chain reallocations in favor of the region. Meanwhile, the contribution of services exports has narrowed in most economies, with Malaysia a notable exception. Public investment has supported growth in China and Indonesia, while private investment has been a significant driver in Malaysia, buoyed by new investments in data centers.

Consumption

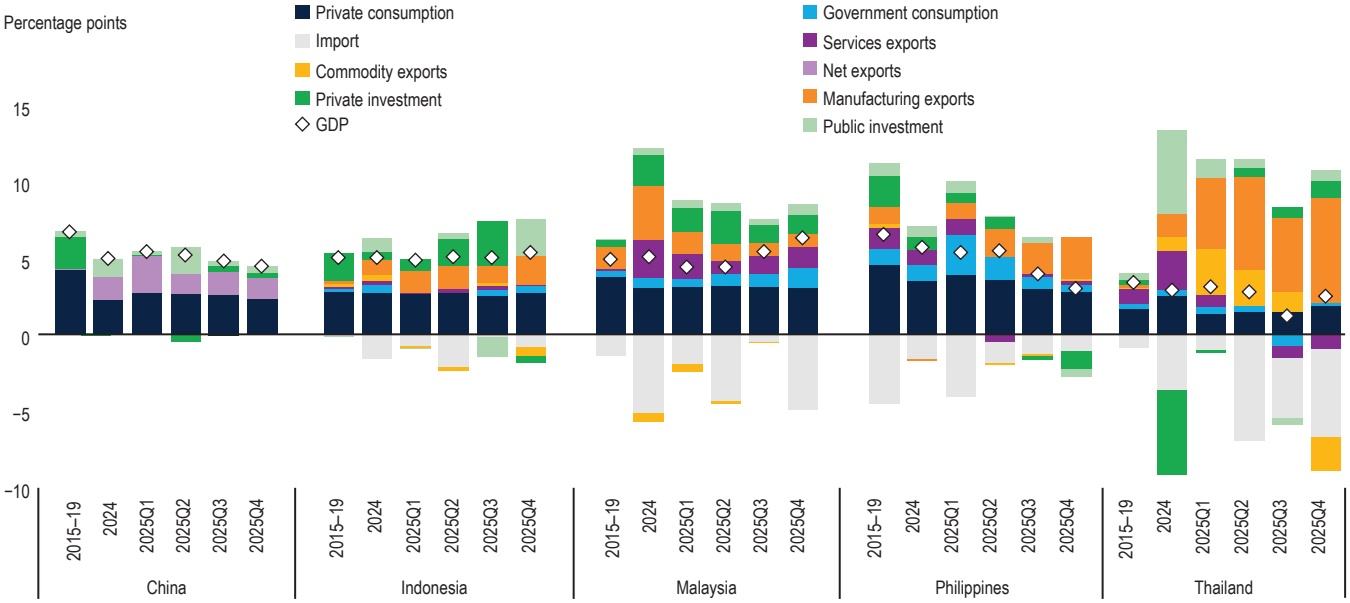
Private consumption continues to serve as a primary growth engine for most economies in the region, yet underlying dynamics reveal fragility. Consumer confidence indexes across the region are at only about 80 percent of their prepandemic baselines. In China, consumer spending has remained cautious

FIGURE O.1 Overall growth in EAP is forecast to decline in 2026 but recover in 2027 in the region outside China.



Source: World Bank.
Note: e = estimate; EAP = East Asia and Pacific; EMDE = emerging market and developing economies; f = forecast; PICS = Pacific Island Countries.

FIGURE O.2 Consumption supported growth but was lower than the prepandemic levels; manufacturing exports were strong across the region, while private investment surged in Malaysia and Thailand.

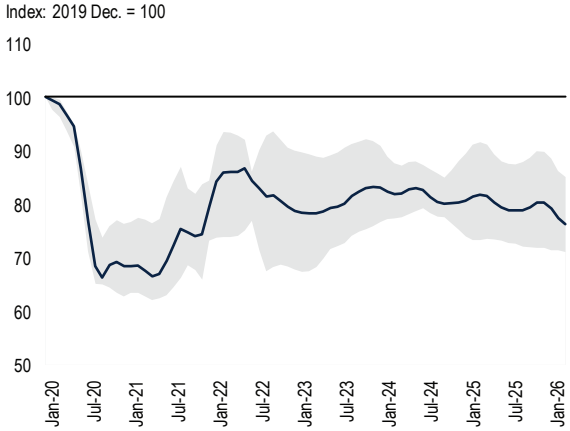


Sources: Haver Analytics; World Bank.

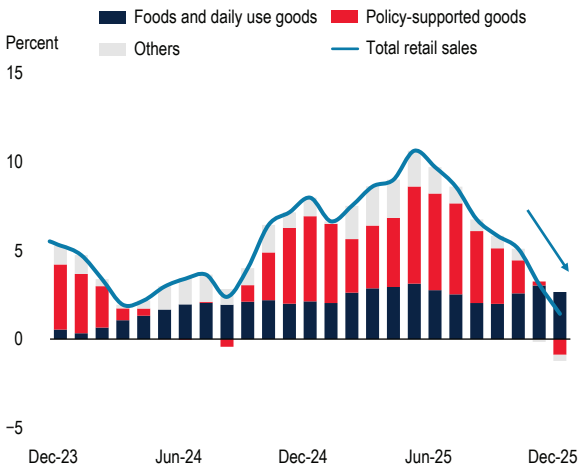
Note: The dark blue bar for China denotes total final consumption and includes household and government consumption. Share of private and public investment is estimated for China, Indonesia, and the Philippines. Share of commodity and manufacturing exports are estimated from balance of payments statistics. Q = quarter.

FIGURE O.3 Consumer confidence remains weak across the region; in China, the impact of consumption subsidies is fading.

A. Consumer confidence



B. China real retail sales, percent, y/y, 3mma



Source: Haver Analytics.

Note: 3mma = 3-month moving average; y/y = year-over-year.

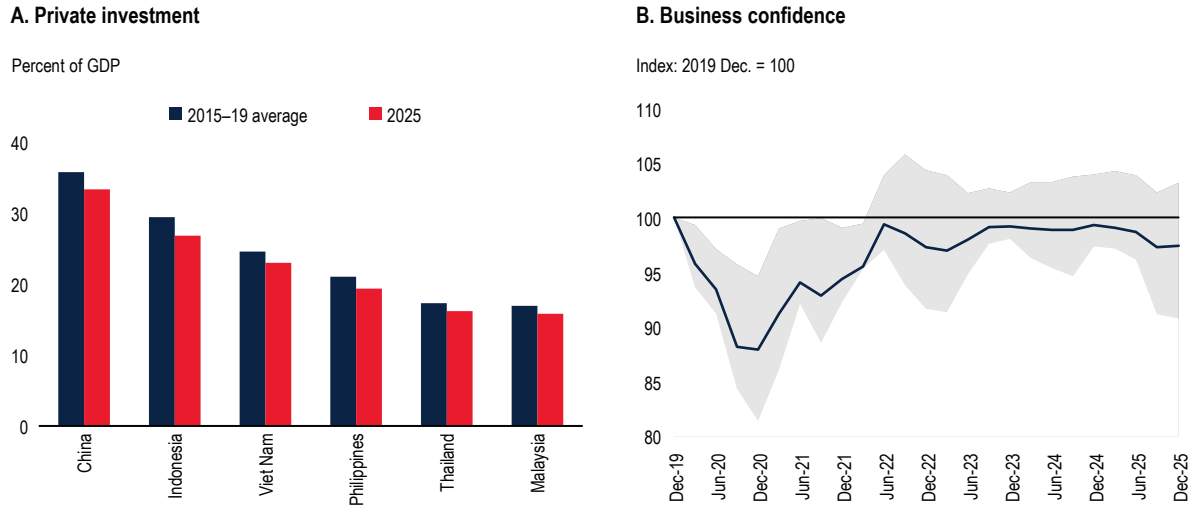
A. The blue line shows the median of China, Indonesia, the Philippines, and Thailand. Gray area shows 25th to 75th percentile range. Retail sales of Thailand is calculated by the average of durable goods and nondurable goods.

amid a soft labor market and a weak housing market (figure O.3). Accommodative policies lifted final consumption growth to 4.6 percent year over year in 2025 from 3.9 percent in 2024, although the boost from consumer subsidies began to fade in the second half of 2025.

Investment

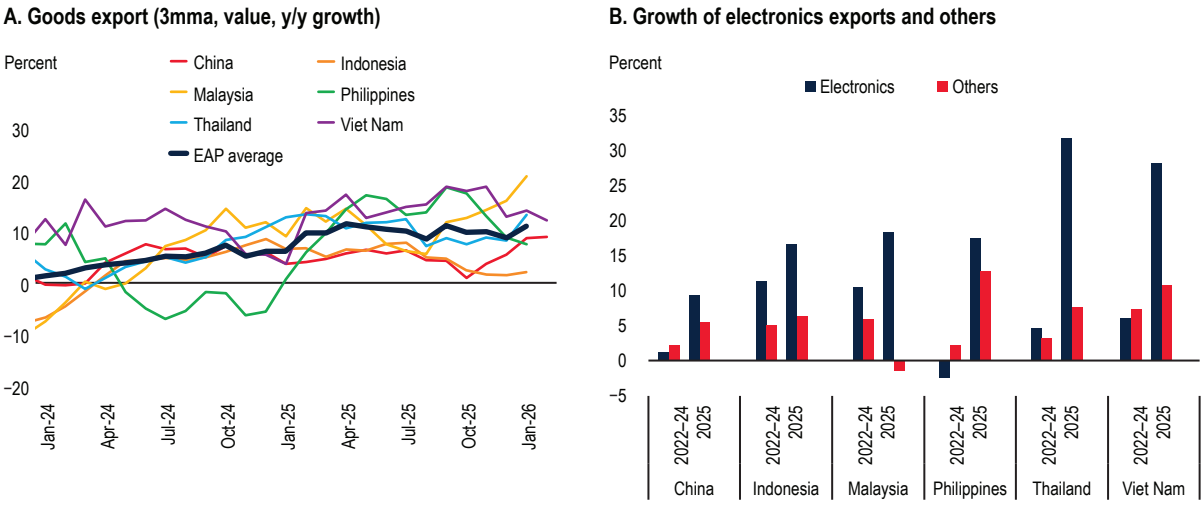
Strong manufacturing performance in selected sectors notwithstanding, private investment as a share of GDP remains below prepandemic levels across developing EAP (figure O.4). Similarly, regional

FIGURE O.4 Private investment as a share of GDP is below prepandemic levels across the region, as is business confidence.



Sources: Haver Analytics; World Bank.
Note: B. Blue line shows the median of China, Indonesia, Malaysia, the Philippines, and Thailand. Gray area shows 25th–75th percentile range. 3-month moving average.

FIGURE O.5 Goods exports accelerated in 2025, primarily driven by the electronics sector.



Source: Haver Analytics.
Note: 3mma = 3-month moving average; EAP = East Asia and Pacific; y/y = year-over-year.

business confidence remains below prepandemic baselines, partly because of elevated economic policy uncertainty, both domestically and globally. During periods of heightened uncertainty firms adopt a "wait-and-see" attitude, delaying or scaling back capital expenditures (World Bank 2025a).

Exports

In 2025, goods exports across East Asia showed generally positive trends, but the growth has moderated in the recent months, especially in Indonesia (figure O.5). The 2025 rally was supported by a global cyclical upswing in technology demand. Electronics export growth outpaced nonelectronics categories; for example, electronics shipments surged by roughly 32 percent in Thailand, 28 percent in Viet Nam, and 17 percent in the Philippines, compared to 8 percent, 11 percent, and 13 percent in nonelectronic exports, respectively. Furthermore, Malaysia's 18 percent jump in electronics effectively offset nonelectronic contractions.

Factors affecting growth

Economic performance across EAP countries is shaped by both external and domestic factors. External factors include: *geopolitical tensions,* more recently the conflict in the Middle East; *trade restrictions,* particularly the escalation of tariffs and nontariff barriers, as well as the associated global economic policy uncertainty; the ongoing *AI boom,* which is immediately reshaping global technology supply chains and creating new opportunities for electronics and semiconductor exporters, and could in the near term lead to higher productivity growth as well as labor market disruptions. Domestic factors include the macroeconomic policy response to these shocks and structural reforms that support growth (figure O.6).

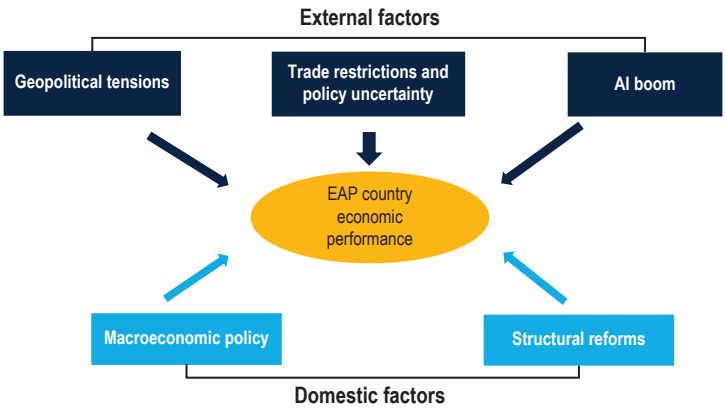
External factors

Geopolitical tensions

The conflict in the Middle East since February 28 has triggered a significant global energy price shock. Natural gas benchmark indices surged 90 percent, and crude oil prices rose over 30 percent in the immediate aftermath, and oil futures shifted upward, reflecting supply reductions (figure O.7). The region is also a major supplier of fertilizers, aluminum, and petrochemicals, with Qatar and Saudi Arabia together accounting for over 10 percent of global nitrogen fertilizer exports.

The conflict can affect EAP economies through multiple channels (figure O.8). First, higher energy, fertilizer, and food prices raise production costs across the region. Second, supply chain disruptions—through production interruptions, maritime chokepoint pressures, and elevated transport costs—disrupt production.[1] Third, tighter financing conditions may emerge as investor flight to safety raises borrowing costs. Fourth, slower global growth, due to heightened uncertainty and weaker consumer and investor sentiment, could reduce external demand for the region's exports. Finally, reduced remittances from Gulf-based workers and higher food and energy costs would compress real incomes, weighing disproportionately on poor households and widening inequality.

FIGURE O.6 External factors affecting economic performance in EAP countries.



Source: World Bank.
Note: AI = artificial intelligence; EAP = East Asia and Pacific.

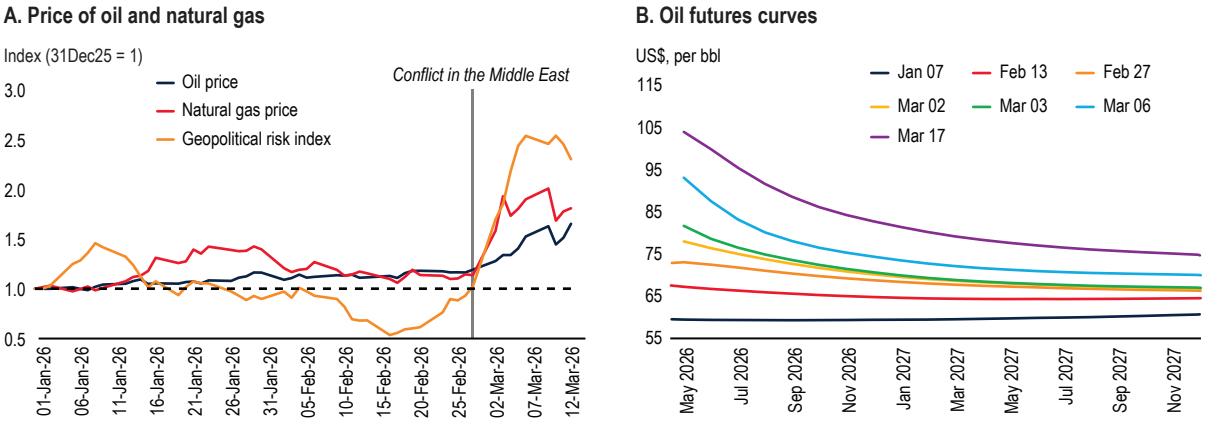
The impact on EAP countries will depend on their exposure to the oil shock, the extent of their vulnerability, and the policy space to respond (figure O.9; table O.1).

Exposure: EAP economies are directly exposed through their dependence on energy imports. Pacific Island nations and major importers like the Lao People's Democratic Republic, Mongolia, and Thailand—where oil imports represent 5 to 13 percent of GDP—face the greatest burden, as higher energy prices compress household purchasing power and raise industrial input costs. In contrast, Malaysia and Papua New Guinea, as net exporters of oil and gas, stand to benefit from improved terms of trade.

Vulnerability: Vulnerability of economies to external shocks arises from inadequate energy buffers, high external financing needs, and fragile price stability. Most developing EAP economies fall short of the IEA's 90-day strategic petroleum reserve benchmark; Cambodia, Indonesia, and Viet Nam hold only 1 to 2 months of coverage, whereas China and Thailand align more closely to the standard. Mongolia and Timor-Leste are more vulnerable macroeconomically, with external financing needs around 40 percent of GDP. External financing needs are also high in Malaysia, driven by private short-term debt, such as trade credits and banking sector flows. Furthermore, elevated baseline inflation constrains the monetary policy space to

[1]One-fifth of global oil and liquefied natural gas (LNG) transits the Strait of Hormuz without viable alternative routes.

FIGURE O.7 Prices of commodities such as oil and natural gas have increased considerably since the escalation of conflict in the Middle East; oil futures are higher.



Sources: Bloomberg; World Bank.
Notes:
A. Daily Brent prices, and ICE Dutch TTF gas price. Last observation is March 12, 2026.
B. Futures curve for May 2026 contract onwards. Last observation is March 17, 2026.

FIGURE O.8 Conflict in the Middle East can affect EAP economies through multiple channels.

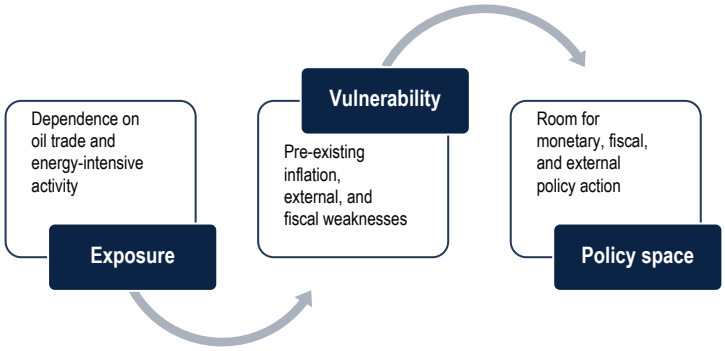
Higher costs of production	Supply chain disruptions	Tighter financing conditions	Slower global growth	Lower remittances, increased inequality
- Energy - Fertilizer - Food	- Production disruptions - Maritime chokepoints - Higher transport costs	- Flight to safety - Higher borrowing costs	- Higher uncertainty - Weaker business sentiment - Lower investment	- Remittances from Gulf - Share of poor household budget on oil and food

Source: World Bank.

respond to new shocks in Myanmar (~20 percent), Lao PDR, and Mongolia (>6 percent), contrasting sharply with the flexibility afforded by subdued or negative inflation in China and Thailand.

Policy space: The impact of the energy price shock will vary across EAP economies depending also on their capacity to respond. Among the most vulnerable are Pacific Island nations—including Fiji, the Federated States of Micronesia, Tonga, and Vanuatu—alongside continental importers like Thailand and Mongolia, which face significant trade balance pressures, limited fiscal buffers and, in the case of the Pacific Islands, low debt-carrying capacity. Lao PDR, China (at the local level), and Thailand are particularly constrained, with high government debt and limited fiscal space. By contrast, economies with stronger buffers—including Cambodia, Viet Nam, and Indonesia—have greater capacity to absorb the shock through strategic reserves, domestic refining capacity, or

FIGURE O.9 Exposure, vulnerability, and policy space determine the impact of geopolitical tensions on EAP economies.



Source: World Bank.

commodity export revenues that provide a natural hedge. On monetary policy, central banks with well-anchored inflation expectations can afford to accommodate energy supply shocks—but a severe or sustained price increase that threatens to dislodge expectations may warrant a shift toward a less

TABLE O.1 EAP countries differ in exposure, vulnerability, and policy space

	Exposure	Vulnerability			Policy space	
	Oil and gas net imports (% of GDP, 2024)	External financing needs (% of GDP, 2025)	Inflation rate (Feb. 2026 or latest)	Reserves (months of imports, 2025)	General government gross debt (% of GDP, 2025)	Fiscal balance (% of GDP, 2025)
Lao PDR	8	19	6	2.6	81	1.9
Mongolia	8	38	6	4.3	41	1.5
Thailand	7	12	–1	8.6	66	–2.7
Cambodia	6	15	1	6.9	27	0.6
Philippines	3	11	2	6.9	63	–5.6
Myanmar	3	1	20	5.7	63	–4.9
China	2	4	1	12.6	71	–7.2
Viet Nam	2	9	3	2.6	36	–3.5
Indonesia	1	9	5	6.2	41	–2.9
Malaysia	–1	42	2	5.2	65	–3.8
Micronesia, Fed. Sts.	18	0	3	3.0	9	6.5
Tuvalu	17	15	15	12.1	3	0.6
Marshall Islands	15	–11	5	2.2	15	1.7
Kiribati	15	19	7	5.4	8	–14.0
Palau	12	20	3	5.5	50	1.5
Fiji	12	10	–1	5.6	79	–4.0
Vanuatu	11	12	2	9.4	49	–5.0
Solomon Islands	9	–5	–1	12.0	30	–3.6
Tonga	9	9	3	10.5	32	5.6
Samoa	6	–6	–1	8.8	21	4.2
Nauru	4	–3	6	3.3	40	3.6
Timor-Leste	2	48	1	8.0	15	–49.0
Papua New Guinea	–16	–12	4	3.7	49	–2.6

Sources: BACI; Haver Analytics; IMF; World Bank.

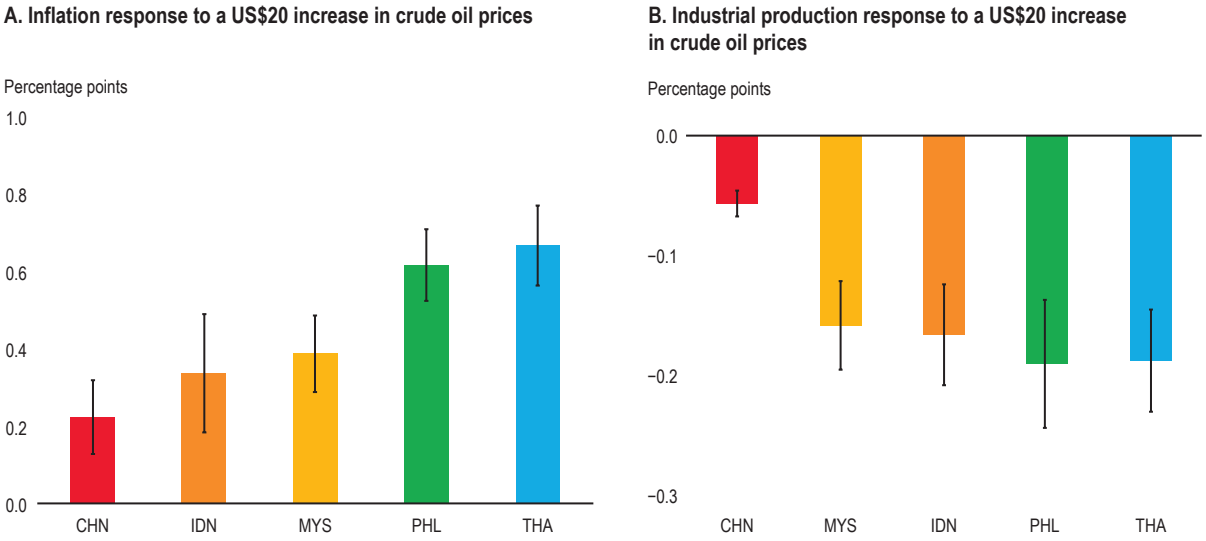
Note: Color scale represents country quantiles relative to the group of EMDEs. Color coding of the general government debt for PICs is based on the risk of external debt distress in the latest debt sustainability analysis. EMDE = emerging market and developing economies.

accommodative stance, particularly in economies where inflation is already elevated.

Assessing policy space in Pacific Island Countries requires looking beyond conventional debt-to-GDP ratios, as even countries with relatively low gross debt levels face high risk of debt distress—including Kiribati, Tonga, and Tuvalu. This reflects the Island economies' structurally limited debt-carrying capacity, itself a product of narrow export bases, high import dependence, and vulnerability to external shocks. Limited access to commercial borrowing and underdeveloped social transfer systems further constrain the ability of Pacific governments to cushion households from shocks such as rising energy prices, making their effective policy space considerably more restricted than headline debt figures suggest.

Higher oil prices transmit to inflation through two channels: directly, via fuel and energy costs, and

FIGURE O.10 Oil price increases lead to higher inflation and lower economic activity.



Source: World Bank.

Note: Bars show annualized percentage point increase in inflation after 6 months for a US$20 increase in crude oil prices, based on current oil futures for 2026. Bayesian hierarchical panel VAR estimated monthly over 2000–25 with 8 lags. Shaded bands denote 68 percent posterior intervals.

indirectly, as higher input costs for transportation, manufacturing, and agriculture ripple through supply chains, compressing household purchasing power and firm margins. A US$20 increase in crude oil prices would raise inflation by 0.67 and 0.62 percentage points in Thailand and the Philippines after 6 months—among the more exposed economies given their reliance on imported oil (figure O.10). Malaysia and Indonesia show more moderate responses, cushioned by subsidies and administered pricing, while China is least affected at 0.22 percentage points, reflecting ample oil reserves. The drag on industrial production follows the same pattern, with Thailand and the Philippines most affected and China the most resilient.

The welfare impact of imported inflation is notably regressive; household expenditure data from the Philippines, for instance, demonstrate that lower-income quintiles allocate a disproportionately larger share of their total consumption to fuel and related transport costs, rendering them highly vulnerable to energy price shocks. Across the region, a sustained 50 percent increase in fuel prices could lead to a 3–4 percent loss in income for households in the region through both direct and indirect effects. In addition, an escalation of the conflict is likely to increase food insecurity (World Food Programme 2026).

In addition to these direct effects, the conflict in the Middle East could have an indirect impact on the region through its effect on global economic activity. A sustained 10 percent increase in oil prices is associated with a reduction in annual global growth of roughly 0.1 percentage point (Lebrand et al. 2024). A prolonged and more intense conflict could significantly reduce global growth. As the scale of disruptions increases, additional channels may emerge. For instance, a prolonged shutdown of Middle East shipping routes could disrupt production in energy-intensive industries, reducing output and triggering broader supply chain disruptions. Some pessimistic scenarios also involve a substantial tightening of global financial conditions, due to higher inflation and mounting risk aversion, generating stronger headwinds to growth.

So far, global growth has been resilient and global financial markets relatively stable. But slower growth in the rest of the world, more likely if the conflict is prolonged, would exert a significant negative impact on developing EAP. A 1 percentage point decrease in G-7 growth is estimated to lower output growth in developing EAP by about 0.6 percentage points within the following year (figure O.11). In addition, China's growth is projected to decline. A 1 percentage point decline in

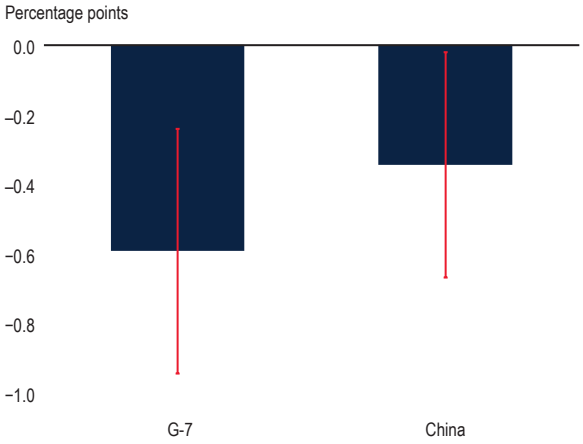
China's growth is estimated to reduce growth in the rest of developing EAP by 0.3 percentage points, underscoring China's significant influence on economic activity across the region.

Trade restrictions and economic policy uncertainty

Tariffs on exports to the United States remain above 2024 levels despite the US Supreme Court ruling on the tariffs imposed under the International Emergency Economic Powers Act (IEEPA) (figure O.12A). The so-called "reciprocal" tariffs were quickly replaced with a global 10% tariff imposed under Section 122. This tariff is a provisional measure lasting until July 2026. Importantly, also the US tariffs on imports from China are now overall lower, which implies that the tariff differential between US tariffs applied to China and those applied to EAP economies has narrowed for most countries compared to end-2025 levels, although it remains above year-ago levels (figure O.12B).

FIGURE O.11 Slower growth in the rest of the world will negatively affect growth in developing East Asia.

Estimates of impacts of a 1 percentage point G-7 and China growth shocks to EAP



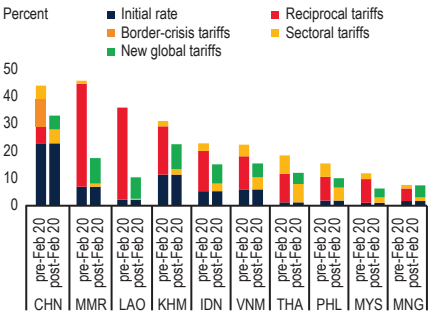
Source: World Bank.
Note: EAP = East Asia and Pacific.
B. Figure shows the impact of one percentage point increase in G-7 and China growth. Effects estimated using a structural Bayesian VAR model that includes the following variables: US monetary policy reaction shock, US real GDP growth, China real GDP growth, commodity weighted prices for recipient country, recipient country real GDP growth, and recipient country exchange rate to the US dollar. EAP countries included in the estimation are Indonesia, Malaysia, the Philippines, and Thailand. The models are estimated from 2000Q1 to 2022Q4, except in Malaysia which starts in 2005Q1.

Micro simulations show the expected negative effects of tariffs on real income for several EAP countries under three different scenarios: (1) the US protection level as of February 7, that is, before the pronouncement of the US Supreme Court; (2) the US protection level without the International Emergency Economic Powers Act (IEEPA) tariffs but before the imposition of the global 10 percent tariff; and (3) the current scenario. Not surprisingly, the countries most exposed to the potential negative effects of the US tariffs are Cambodia, Thailand, and Viet Nam.

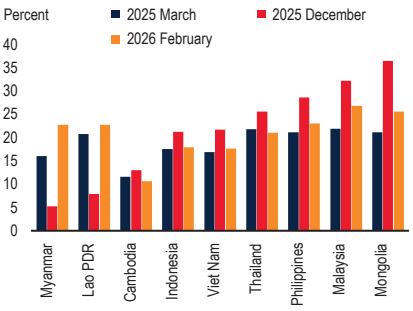
Economic policy uncertainty—particularly regarding trade policy—remains elevated, which can negatively affect the region's economic activity. Uncertainty weighs on investment and employment across EAP, as firms adopt a "wait-and-see" approach, delaying capital expenditures and prioritizing

FIGURE O.12 US tariffs have increased for all EAP countries, but the differential vis-à-vis China is now lower than at the end of 2025.

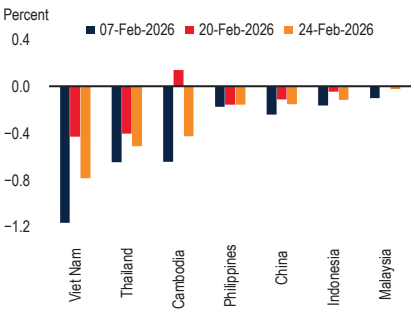
A. Effective tariff rate and its increments



B. Tariff differential between US tariffs applied to China compared to other EAP countries

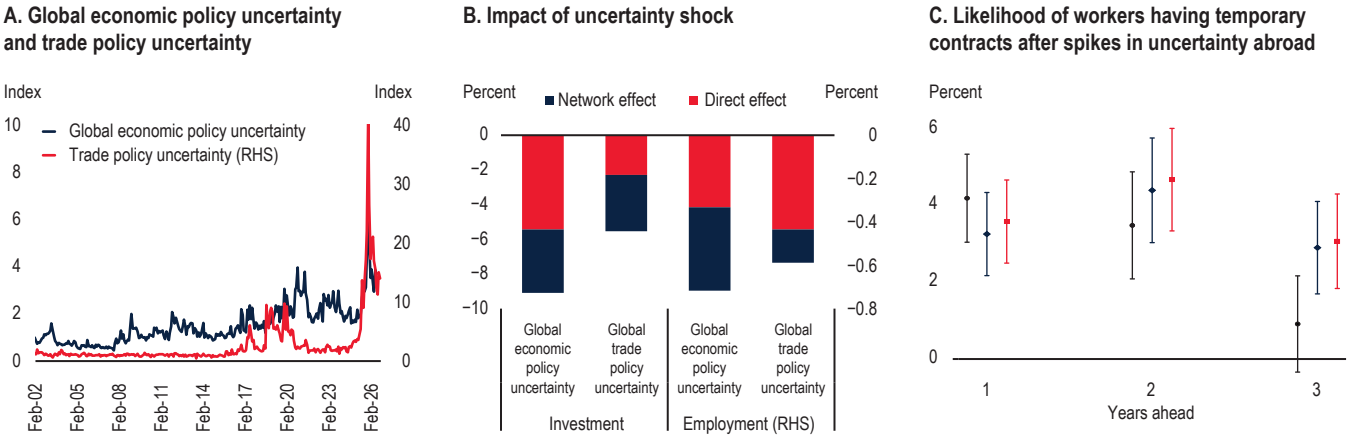


C. Impact on Real Income, different US tariffs regimes



Source: World Bank.
Note: EAP = East Asia and Pacific; Feb = February.

FIGURE O.13 Global economic policy uncertainty, especially around trade, remains elevated, and could hurt investment, employment, and quality of jobs.



Sources: Caldara et al. 2020; Ha et al. 2026; authors' estimates using Viet Nam's LFS 2011–23.

Note: OLS = ordinary least squares; RHS = right-hand side.

A. Trade policy uncertainty index tracks frequency of uncertainty-related articles in major English-language newspapers, normalized so that 1 equals the 2000–15 average.

B. Firm quarterly panel OLS regression. Sample covers listed firms in Indonesia, Malaysia, the Philippines, Thailand, and Viet Nam, 2000–24.

C. Sector-level local projection estimates of labor market outcomes on external trade-weighted uncertainty. Dots show responses to a one-sector-standard-deviation increase in uncertainty abroad; bars are 95 percent confidence intervals clustered at the sector level. Blue lines control for trade-weighted external growth; red lines additionally control for sector trade volumes. X axis shows numbers of years ahead.

liquidity; evidence from firms in the region shows that a one-standard-deviation increase in external policy uncertainty significantly reduces investment growth and slows hiring, with effects transmitted through production networks (figure O.13). Further, evidence from Viet Nam shows that spikes in global uncertainty negatively affect the quality of jobs in the region, raising the likelihood of workers being in temporary contracts and depressing wages.

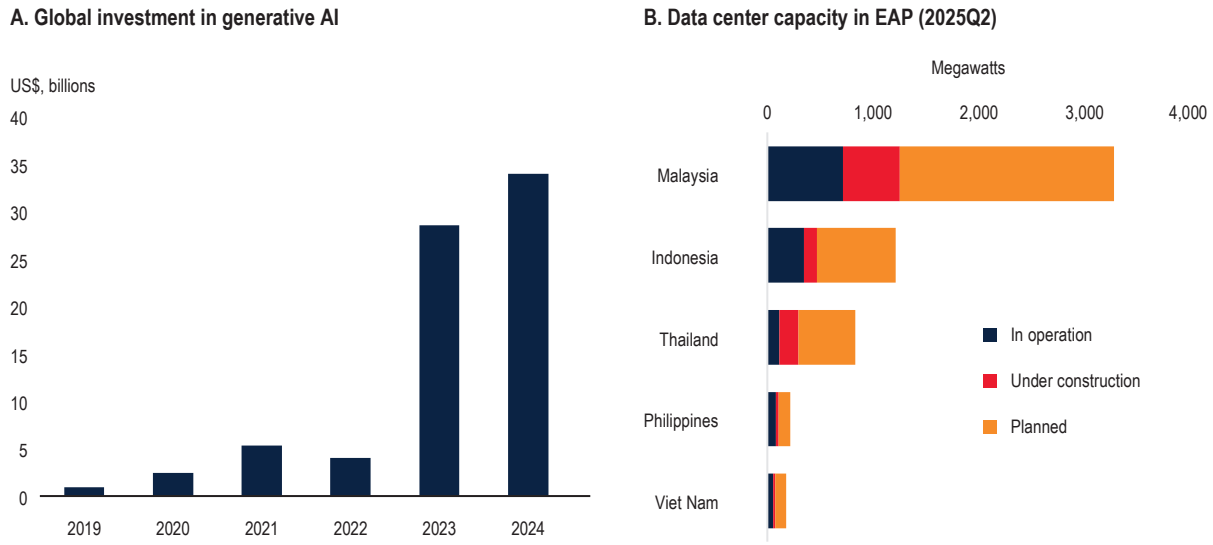
AI boom

The rise of AI holds potential to drive growth across EAP, but realization depends on whether AI delivers broad-based productivity gains globally, and how effectively EAP economies absorb these gains given varying infrastructure, human capital, and institutional capacity. Global private investment in generative AI has surged from near zero in 2019 to US$34 billion in 2024, translating into rapid data center buildout across EAP (figure O.14). Malaysia leads with roughly 700 megawatts (MW) operational and a pipeline exceeding 3,000 MW; Indonesia and Thailand are also seeing significant investment.

AI-related exports have expanded rapidly across several EAP economies in recent years (figure O.15). Intermediate goods—particularly semiconductors—remain the backbone of AI-related trade across the region, although equipment exports such as data center hardware have grown meaningfully. Viet Nam and Malaysia stand out, with AI export shares rising from around 20 and 28 percent of GDP in 2023 to approximately 32 and 34 percent by 2025, respectively—among the highest shares globally. Thailand also shows a meaningful increase in AI exports over the period, rising from around 12 to 16 percent of GDP. By contrast, Indonesia's AI export share remains negligible, and the Philippines shows a modest decline. These shares dwarf those of major advanced economies, where AI export shares range from around 2 percent of GDP for the United States and the EU to 4 percent for Japan.

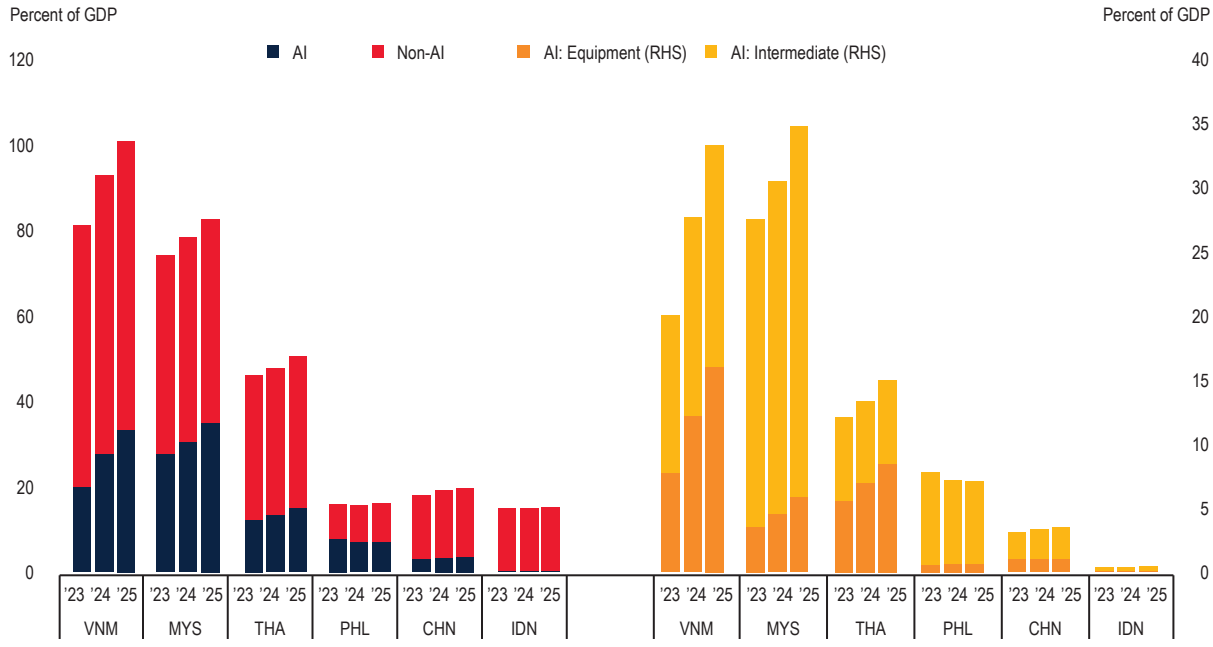
Early evidence suggests that AI is diffusing slowly across EAP, although assessing the true pace of adoption is complicated by the absence of a universal or consistent measure of AI use (figure O.16). What evidence does exist points to a region that remains in the early stages of AI diffusion: Only about 13–17 percent of multinational enterprise subsidiaries in China and Thailand use AI, compared to 37 percent in the United States, and AI adoption is heavily concentrated among multinationals,

FIGURE O.14 Generative AI investment is surging globally, driving investments in data center capacity across EAP.



Source: Quid 2025; Cushman and Wakefield 2025.
Note: AI = artificial intelligence; EAP = East Asia and Pacific.

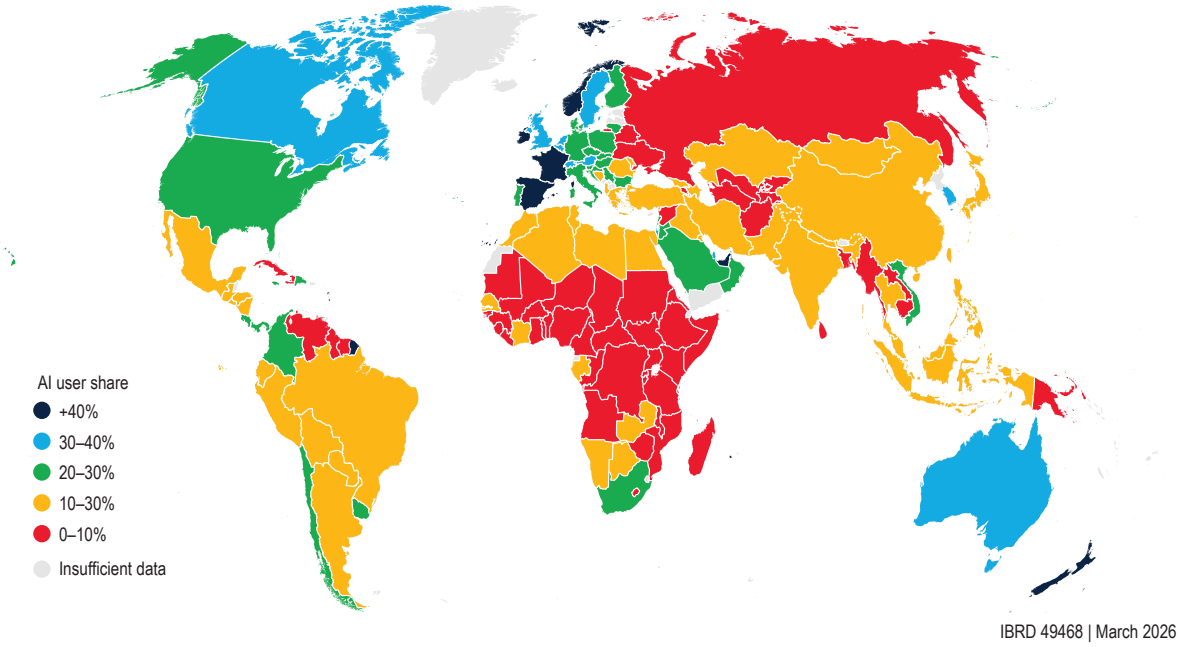
FIGURE O.15 Exports of AI-related goods, including equipment and data center hardware, are rising across EAP.



Source: World Bank calculations based on World Trade Report 2025.
Note: AI-related exports follow the WTO (2025) classification of AI-enabling products covering raw materials, processed chemicals, intermediate inputs, and equipment. The left-hand scale shows total AI and non-AI exports as a percent of GDP. The right-hand scale shows the two largest AI components separately: intermediate inputs (e.g., processors, integrated circuits, semiconductor wafers) and equipment (e.g., semiconductor manufacturing machinery). See WTO (2025), Annex A, for the full product list. AI = artificial intelligence; RHS = right-hand side.

with domestic firms lagging well behind. Moreover, the share of EAP jobs involving tasks that are complementary to AI—and thus positioned to benefit from it—is only about 10 percent, compared to 30 percent in advanced economies, reflecting the region's higher concentration of employment in agriculture and routine manual occupations. Taken together, these patterns suggest that while AI

FIGURE O.16 Early evidence suggests AI is diffusing slowly in much of EAP.



Source: Microsoft.
Note: AI = artificial intelligence; EAP = East Asia and Pacific.

investment is flowing into the region, its diffusion into the broader economy remains nascent.

Domestic policy

Macroeconomic policy

The oil price shock confronts the regional policy makers with the challenge of dealing with the twin threats of inflation and growth deceleration. The challenge is most evident in the case of monetary policy. The supply-side energy price shock may merit "looking through" rather than "overreacting" unless it leads to expectations of higher inflation and therefore to higher nominal wages and prices of other inputs.[2] In the latter case, if the authorities seek to contain inflation by increasing interest rates, there would be an adverse impact on already-slowing growth. In economies such as Lao PDR, Mongolia and, especially, Myanmar and Tuvalu, where inflation is already relatively high and expectations are less strongly anchored, a prolonged commodity price shock may necessitate a less accommodative stance. Even where inflation is relatively low, as in Indonesia and the Philippines, close monitoring remains warranted, as a sustained shock could dislodge inflation expectations.

On the fiscal side, if the government seeks to protect households (or firms) from the price shock by providing energy subsidies, the resulting higher deficits could also lead to increased borrowing and debt, which could result in higher interest rates that inhibit investment and growth. These risks are particularly acute in economies with already-elevated debt levels and limited fiscal space. Lao PDR faces debt sustainability concerns, while several Pacific Island Countries are constrained by small revenue bases and dependence on external financing, leaving little room to absorb additional spending pressures without risking unsustainable fiscal positions. Given the difficult trade-off, better-targeted support—for both the poor and the vulnerable in the middle class—can help those most in need at a more reasonable fiscal cost.

Structural reforms

Even in a difficult external environment, EAP countries can forge a dynamic path. But supporting near term growth through fiscal measures may deliver less

[2]https://www.ft.com/content/e70ea434-f585-4271-bb75-7265b3f02a37?syn-25a6b1a6=1.

durable development benefits than deeper domestic reforms.

Growth in some EAP countries is relatively high, but measures to sustain growth today may not be conducive to growth tomorrow. In China and Indonesia, for example, current growth (of about 5 percent per annum) exceeds estimates of potential growth largely thanks to government support. In both countries, reforms, such as addressing nontariff barriers, especially in services, as well as deregulation and business licensing simplification (in the case of Indonesia), could enhance potential growth and productive job creation.

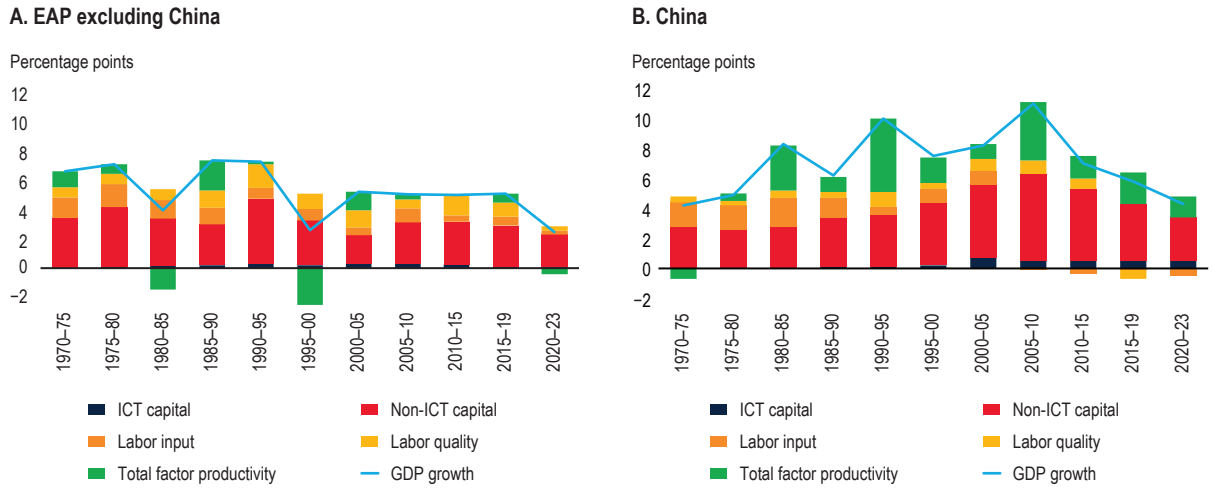
In other countries, recent structural reforms are likely to improve economic efficiency and support growth. For instance, the Philippines has opened key sectors to greater competition—including logistics, telecoms and renewable energy—and is seeking to build the capabilities of the labor force through the newly enacted Enterprise-Based Education and Training (EBET) framework. Viet Nam, too, has launched a wave of institutional reforms aimed at creating a more efficient state. In late 2024, the government began significant bureaucratic restructuring, reducing ministries and agencies, consolidating local governments (reducing provinces from 63 to 34 and removing district-level governments); streamlining public employees (reducing staff by 20 percent or at least 100,000 employees over 5 years); and reforms such as the new Land Law, State Budget Law, and streamlined business services to improve the investment climate. In both countries, improved economic performance will depend on the implementation of the reforms.

A longer view

A longer-run perspective reveals structural growth challenges across the region. In EAP excluding China, capital accumulation has driven growth for decades, but TFP contributions have declined sharply—from 1.3 percentage points in 2000–05 to near zero in 2010–15—and the contribution of labor has diminished as populations age (figure O.17). China has relied more on TFP and ICT-related investment, though both have slowed, and a shrinking labor force now subtracts from output growth. As returns to capital accumulation diminish, sustaining growth will increasingly depend on productivity gains that have so far remained elusive.

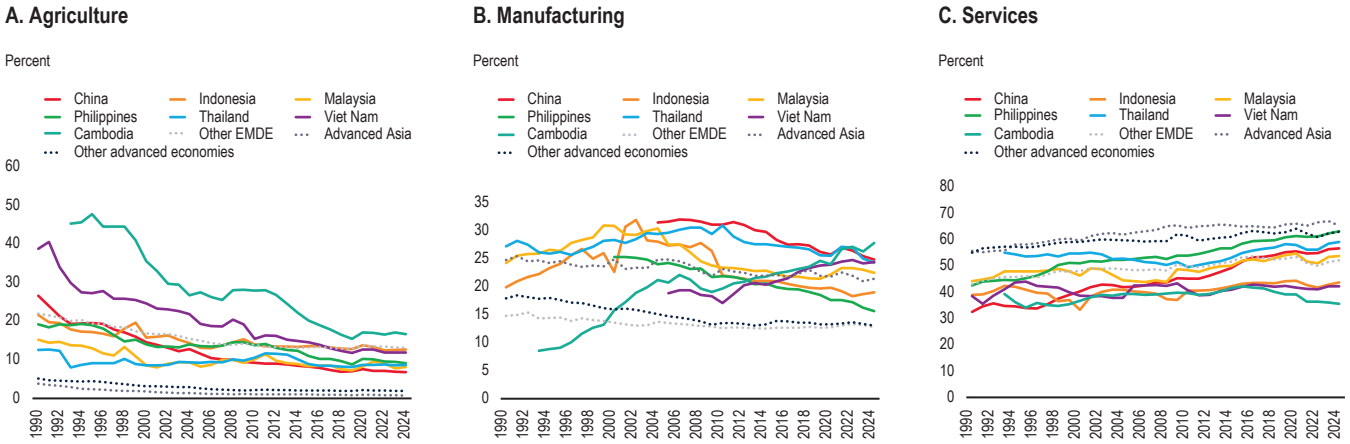
Two structural factors help explain the productivity slowdown. First, the pattern of sectoral change has shifted: manufacturing's share of GDP—a high-productivity sector—rose across the region through the early 2000s but has declined since, limiting the scope for productivity gains through

FIGURE O.17 A longer view: Capital accumulation, not productivity improvements, has driven recent growth in the region outside China.



Source: APO.
Note: Regional aggregates use APO GDP-weighted averages. EAP = East Asia and Pacific; ICT = information and communication technology.

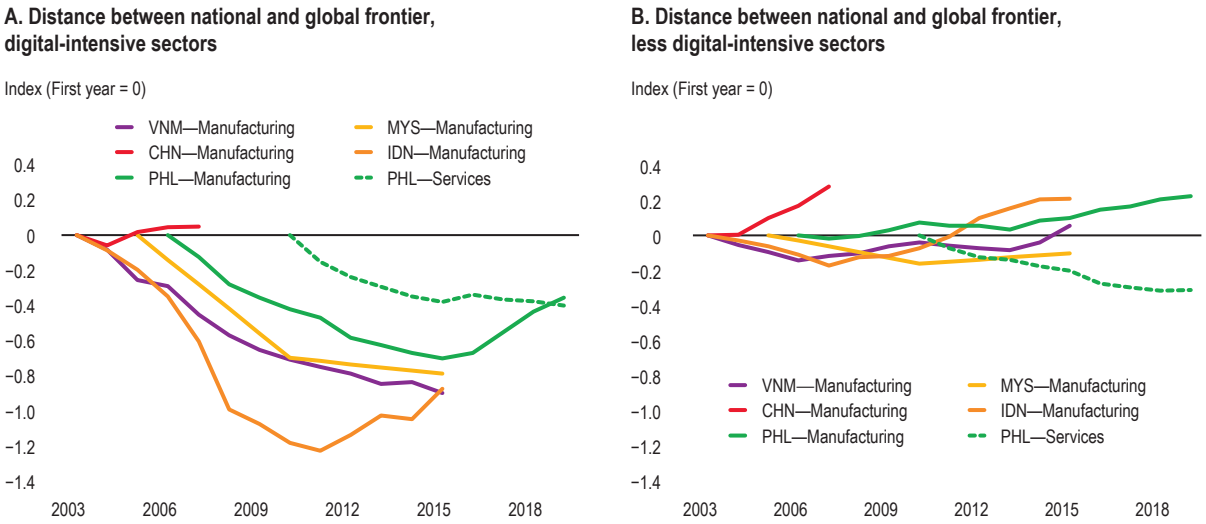
FIGURE O.18 In recent years, the share of manufacturing in GDP declined in EAP economies (other than Cambodia and Viet Nam), and the share of services in GDP increased.



Source: WDI.

Note: Advanced Asia includes Japan, the Republic of Korea, and Singapore. Country groups exclude those with less than 1 million population. EAP = East Asia and Pacific; EMDE = emerging market and developing economies.

FIGURE O.19 Firms at the national frontier in EAP countries are falling behind the global frontier, especially in digital-intensive sectors.



Sources: World Bank calculations using Statistical Office micro-data and Criscuolo 2023 for global frontier.

Note: National frontier is defined as the 90th percentile firm productivity for each country and industry. Digital intensity of sectors is defined according to Eurostat. EAP = East Asia and Pacific.

labor reallocation (figure O.18). Second, frontier firms in EAP are falling further behind the global technological frontier, particularly in digital-intensive sectors (figure O.19). In digital manufacturing, global frontier productivity rose by 76 percent between 2005 and 2015, while national frontier firms in Indonesia, Malaysia, the Philippines, and Viet Nam achieved average gains of only 31 percent—underscoring a widening gap in the region's capacity to absorb and deploy frontier technologies. Over the longer run, sustaining growth will depend on reversing a structural productivity slowdown.

II. Industrial policy in the digital age

EAP countries face a triple challenge. Their exportled, labor-intensive development model is increasingly threatened by rising protectionism in advanced economies and by automation. Moreover,

as highlighted in the first part of the report, the contribution of total factor productivity to growth has markedly declined across most EAP countries in recent decades, with the productivity of leading firms lagging global leaders, especially in the most technologically advanced sectors. In this context, industrial policy is increasingly viewed by policy makers as a tool to counter the adverse effects of foreign protection, to revive productivity and generate more and better jobs.

We propose an approach to industrial policy based on three pillars:

1. *Foundational public goods:* Remedying inadequate provision by the market of public goods needed for all economic activity, notably foundational infrastructure and basic human capital–as well as institutions, including those that ensure macroeconomic stability.

2. *Addressing policy failures:* Reforming existing policies that impede desirable economic activity, such as barriers to competition in transport, communication, and financial services, and barriers to international trade.

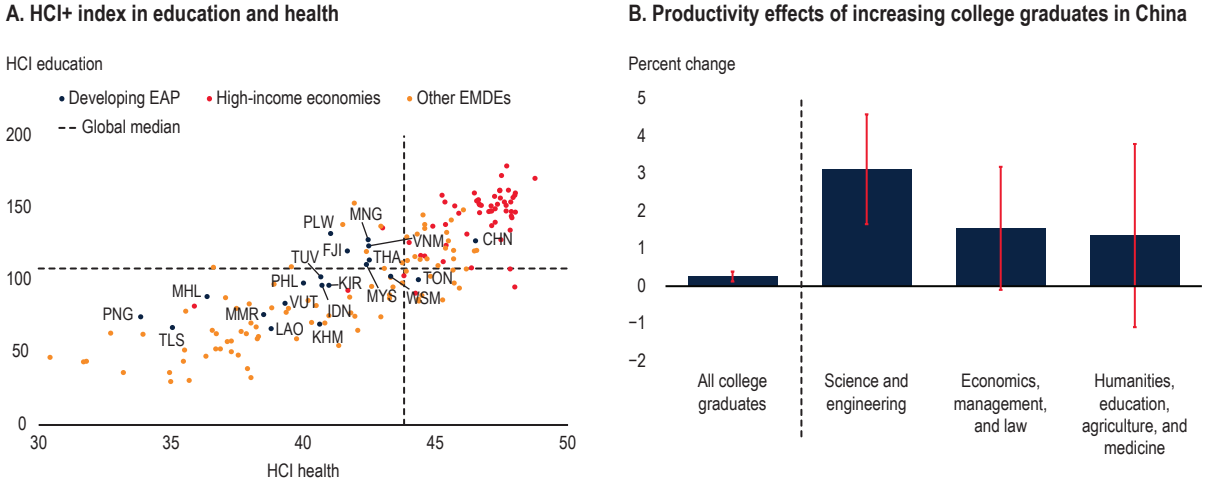
3. *Addressing market failures:* Targeted interventions to address market failures that inhibit desirable economic activity in specific sectors.

In this special focus, we first briefly delve into the first two pillars and then devote the core of the material to the third pillar drawing on original research. Across pillars, we spotlight an area currently of interest to policy makers in the region: the AI value chain.

Pillar 1: Foundational public goods

The new World Bank Human Capital Index shows how EAP's relative edge in human capital lies in education, while the region trails on health. Mongolia and Viet Nam's relative overperformance on education contrasts with their underperformance on health. Malaysia and Thailand show similar imbalances. Most other EAP countries underperform on both dimensions (figure O.20A). China's HCI stands out with both education and health outcomes that approach high-income benchmarks. Notwithstanding the relative edge in education, absolute endowments remain weak in many countries. For example, Viet Nam's stellar performance in school education contrasts with the relative weakness of its tertiary education. This weakness matters, since, for instance, in China the massive expansion of tertiary education since the early 2000s boosted the productivity, exports, and innovation of firms engaged in skill-intensive manufacturing (figure O.20B).

FIGURE O.20 Most developing EAP countries have significant deficits in human capital; China shows how the expansion of tertiary education can boost productivity.



Sources: A: World Bank Human Capital Index 2026. B: Che and Zhang 2017.
Note: HCI = Human Capital Index; EAP = East Asia and Pacific; EMDE = emerging market and developing economies.

Pillar 2: Addressing policy failures

While the EAP countries have been open to trade and investment in goods, services–ranging from transport and telecommunications to finance and the professions–are relatively restricted in most EAP countries (figure O.21A). A range of rules condition or restrict the entry and operations of foreign firms, as well as their ability to deliver services across borders. Amid the digital revolution, countries also restrict cross-border data movement and require data to be stored or processed domestically. The gains from services liberalization are large. For example, even the partial liberalization in Viet Nam over 2008–16 generated a sizeable increase in productivity not only in the services sectors, but also in the manufacturing sectors using services as intermediate inputs (figure O.21B).

Pillar 3: Addressing market failures

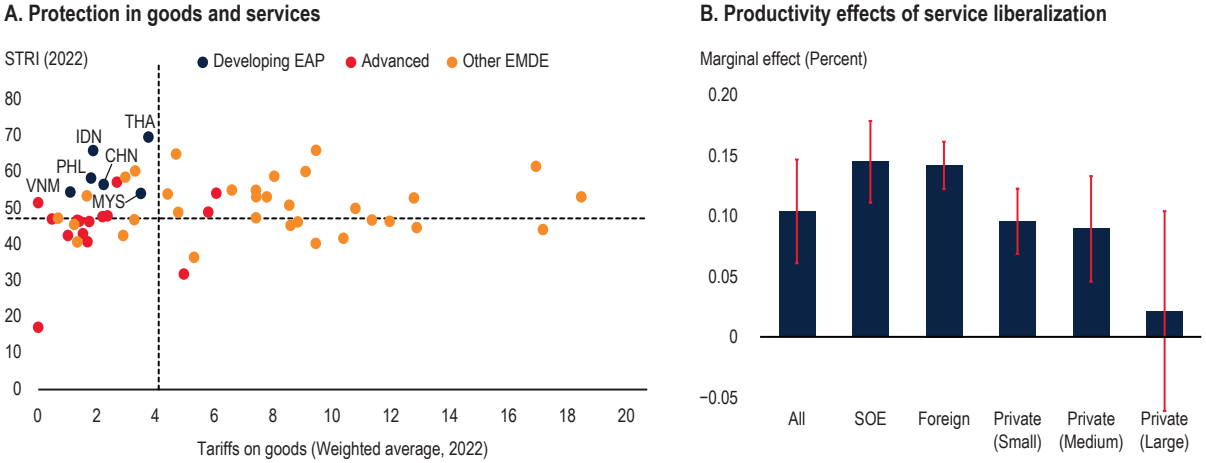
Moving to targeted support, the report shows that these measures are on the rise both globally (figure O.22A) and in most EAP countries, though the bulk of activity is concentrated in the G-20 countries. Countries choose different instruments, and different levels of targeting. In China, the Philippines, and Thailand, subsidies (including tax breaks) are the most prevalent form of IP measure utilized. Export incentives are prevalent in Japan and the Republic of Korea, while Indonesia utilizes relatively more export measures (such as export restrictions).

The report provides evidence on the impact of these policies drawing from three different sources: (1) a new cross-country analysis, (2) a new firm-level analysis from China, and (3) drawing lessons from existing studies on specific sectors and countries.

Analysis conducted by merging firm-level data with sectoral-level IP information reveals that the effects of IP measures on firm performance are heterogeneous. Instruments targeting export performance and production capacity are correlated with increase in revenues and productivity in G-20 countries but not in other developing economies (figure O.23A). These findings suggest that a certain level of institutional development may be a precondition for effective deployment of industrial policy. Moreover, some IP measures might introduce distortions in input choices: subsidized loans correlate with an increase in capital intensity but decrease in employment, both in G-20 (figure O.23B) and developing economies.

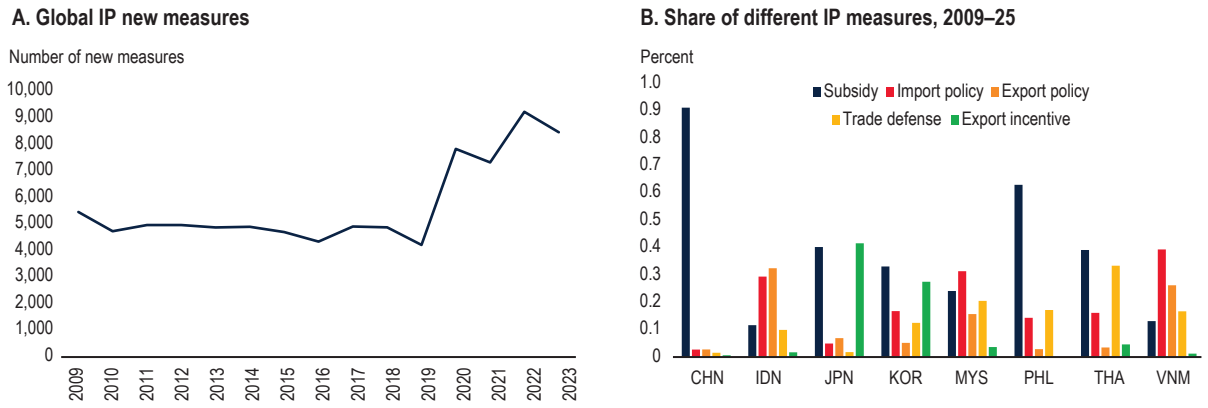
Preliminary firm-level evidence from China suggests that industrial policy support is substantial (2.2 percent to 2.4 percent of total value-added in the sample). Foreign firms tend to receive larger

FIGURE O.21 In EAP, services remain relatively protected; Viet Nam shows how liberalizing services can increase productivity.



Sources: A: WITS and WB-WTO STRI database. B: World Bank 2024a.
Note: EAP = East Asia and Pacific; EMDE = emerging market and developing economies; SOE = state-owned enterprise.
A. Scatterplot of the service trade restriction index (average of the STRI scores for Finance, Communication, and Transport sectors) against weighted average of tariff on goods.
A. and B. Dotted vertical and horizontal lines represent global medians.

FIGURE O.22 The number of new trade and industrial policy measures has increased significantly after 2020, with differences between countries in types of measures chosen.

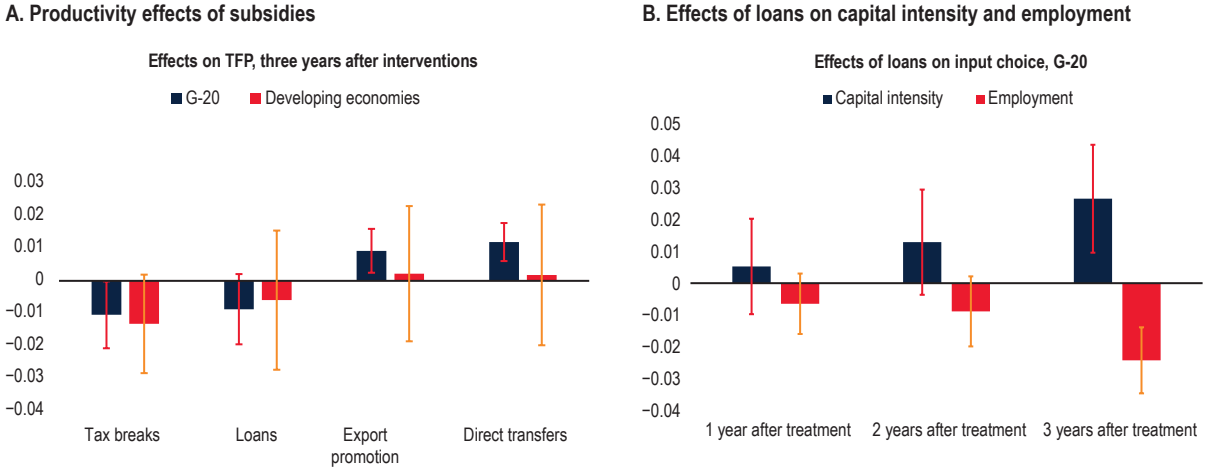


Sources: A: GTA Database (global sample). B: NIPO. As explained in the report these databases, while widely used, are subject to some methodological caveats.

Note: IP = industrial policy.

B. The most prevalent instruments by category. Subsidies include financial grants, production subsidies, state loans, loans guarantee interest rate subsidies and tax exemptions. Import policy includes tariffs, quotas, import ban, import licensing requirements. Export policies include export bans, export licensing requirements and export taxes. Export incentives include trade finance, financial assistance in foreign markets, tax-based export incentives.

FIGURE O.23 Export promotion and direct transfers have positive productivity effects in the G-20 economies, but not in other emerging economies; subsidized loans can affect factor markets—leading firms to choose machines over workers.

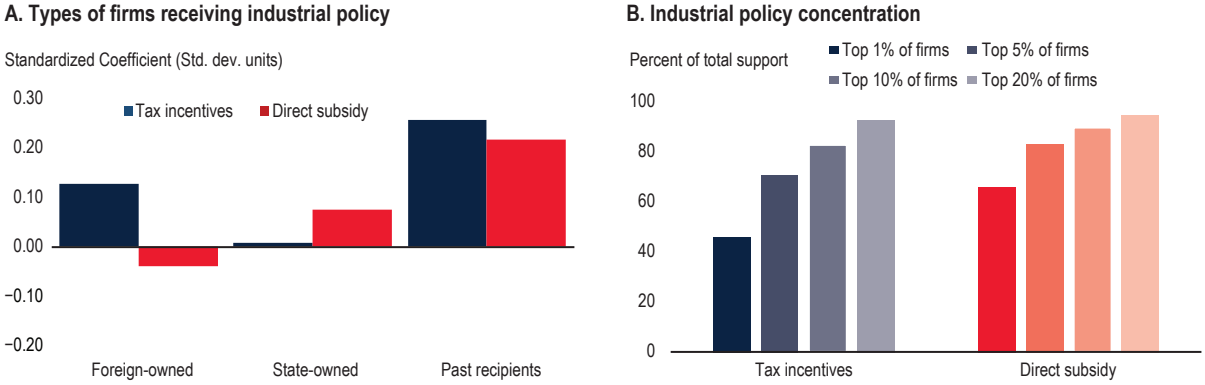


Sources: GTA; ORBIS.

Note: The econometric specification used in the analysis is an augmented three-way fixed effects difference-in-differences model. The time-varying dependent variables, at the firm level, are alternatively: TFP (estimated with the Wooldridge (2009)'s method), logs of capital intensity (capital-to-employees ratio), logs of employment (number of employees). Subsidies are measured with dummy variables at the country-sector-year level, with sectors defined at a 3-digit level. The model controls for country-sector, sector-time and country-time fixed effects and for firm-level fixed effects. Standard errors are robust to heteroskedasticity and clustered at the firm level. The period of analysis is 2012 to 2019. TFP = total factor productivity.

tax incentives (than domestic firms), whereas state-owned enterprises (SOEs) receive more direct subsidies (figure O.24A). Past recipients are much more likely to continue to receive subsidies or tax incentives in the future, suggesting persistence of policy support and limited use of sunset clauses. Subsidies also appear to be concentrated in relatively few firms (figure O.24B), which could dampen aggregate productivity by entrenching incumbents and slowing reallocation toward more productive firms. Conversely, support distributed across a broader range of firms has been shown to foster competition and innovation in China (Aghion et al. 2015).

FIGURE O.24 Direct subsidies are concentrated in relatively few firms that tend to be state owned; tax incentives are less concentrated and directed more to foreign firms.



Source: World Bank calculations based on Chinese State Taxation Administration data.

Note: Std. dev. = standard deviation.

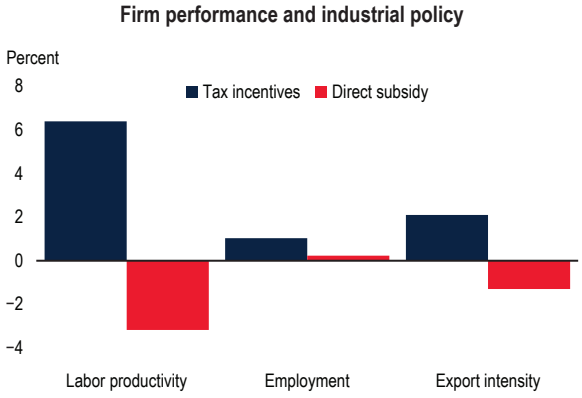
A. Reflects pooled cross-section regressions of outcomes: tax incentives (as a share of their statutory tax bill) or direct subsidies (as a share of sales), including zeroes for non-recipients. All firm characteristics are included in a single regression, which also controls for labor productivity, employment, a negative profit dummy, and year and 2-digit sector fixed effects. Depicts fully standardized regression coefficients to enable comparability across different units of the variables above, i.e., they show the change in tax incentives or direct subsidies, in standard deviation units (std. dev. units), associated with a 1 standard deviation increase in firm characteristics (foreign ownership, labor productivity, etc.). For comparability all variables are standardized, including dummy variables. The negative bars reflect that increases in the firm characteristic (e.g., higher labor productivity) is associated with lower direct subsidies.

B. Bars reflect the share of total tax incentives / direct subsidies accounted for by the top 1, 5, 10, or 20 percent of firms.

The choice of industrial policy instrument may influence Chinese firm performance (figure O.25). Tax incentives are associated with increases in labor productivity and exports, whereas direct subsidies are correlated with declines in both. These estimates are correlations and may partly reflect differing trends between the low-performing firms that tend to receive subsidies and the high performers that receive tax incentives. Nevertheless, the results align with findings for listed firms, where subsidies often support inefficient firms preserving jobs rather than funding productive R&D or growth (Branstetter et al. 2023).

Government R&D support became increasingly targeted towards SOEs, which is correlated with a substantial increase in their patenting after the Global Financial Crisis (figure O.26A). Each SOE applied for nearly twice as many patents as the average private manufacturing firm over the period 2011–13, an increase of 150 percent compared to the pre-financial crisis period. The disparity may reflect other differences between SOEs and private firms, although a significant difference persists even conditional on firm size, age, export status, and sector. However, this growth in SOE patenting coincided with increases in government R&D support that were increasingly targeted toward SOEs. In fact, SOEs are less efficient innovators than their

FIGURE O.25 China's direct subsidies are associated with falling productivity, in contrast to tax incentives, which are more dispersed and correlated with productivity increases.

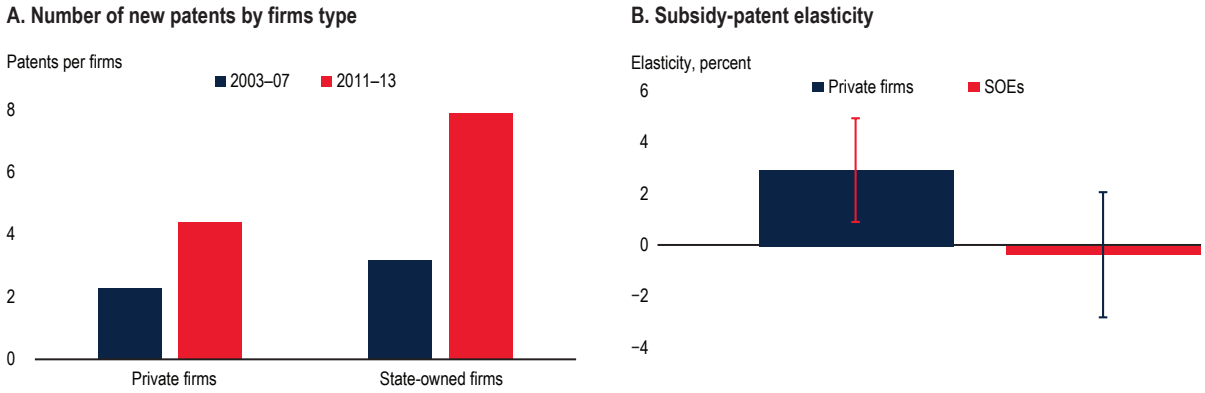


Source: World Bank calculations based on Chinese State Taxation Administration data.

Note: Labor productivity reflects real value added per worker, export intensity denotes exports as a share of sales. Chart depicts the estimated percentage change in firm outcomes for a 10 percentage point increase in tax incentives as a share of the firm's statutory corporate tax bill (in blue) or direct subsidies as a share of firm sales (in red). Estimates obtained via two-way fixed effects regressions including firm and year dummies. All coefficients are statistically significant at the 1 percent level, except for employment for direct subsidies. Similar estimates are found when restricting the data to only firms with positive profits, rather than all firms in the data.

privately owned counterparts, with much smaller increases in patenting for a given increase in subsidy (figure O.26B). Similar evidence from Zhan and Zhu (2020) shows that privatizing Chinese SOEs increased their patenting with no change in their R&D expenditure (i.e., privatization increased their

FIGURE O.26 Chinese SOEs patent more, but they are less efficient innovators, than privately owned firms.



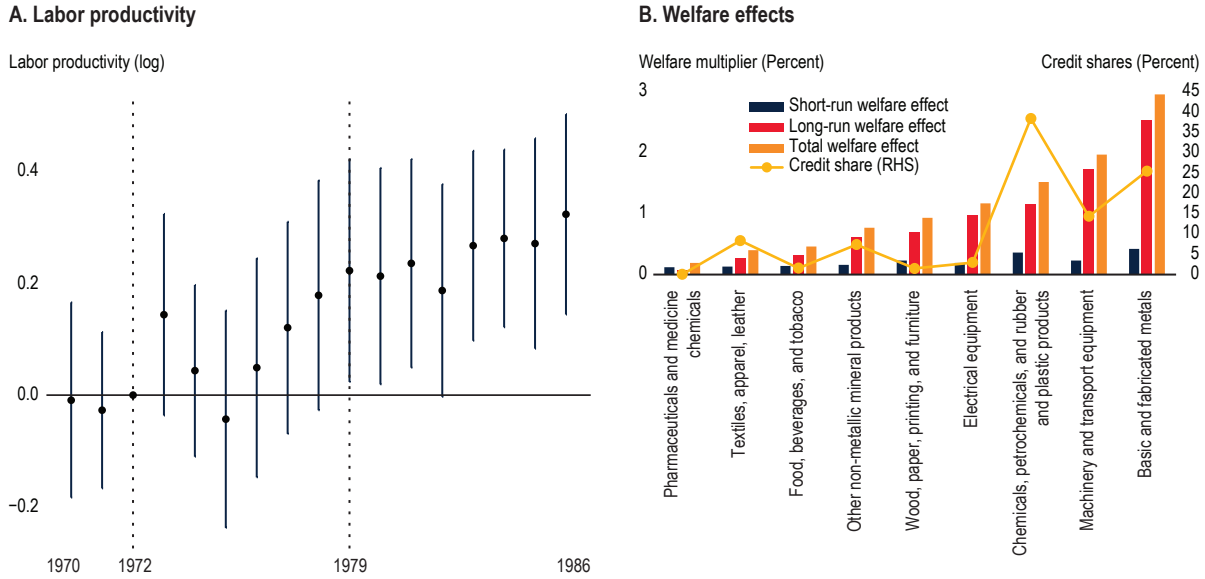
Sources: Betts and Cao 2025 and World Bank calculations based on ASM-PATSTAT data for manufacturing firms.

Note: SOE = state-owned enterprise; R&D = research and development.

A. Average number of utility patent applications per firm, by year and firm ownership type.

B. The bar is the estimated coefficient of each measurement on subsidy, conditional on firm size, firm age, firm's export status, firm fixed effect, industry-year fixed effect, and location fixed effect. Regressions are weighted by the inverse of the number of utility patents filed by the firm in a given year (1/N_it), so that each firm-year contributes equally to the estimates. The whisker is the 95 percent confidence interval.

FIGURE O.27 In the Republic of Korea, the industrial policies in the 1970s increased labor productivity of affected industries as well as welfare.



Sources: A. Lane 2025. B. Choi and Levchenko 2024.

Note: RHS = right-hand side.

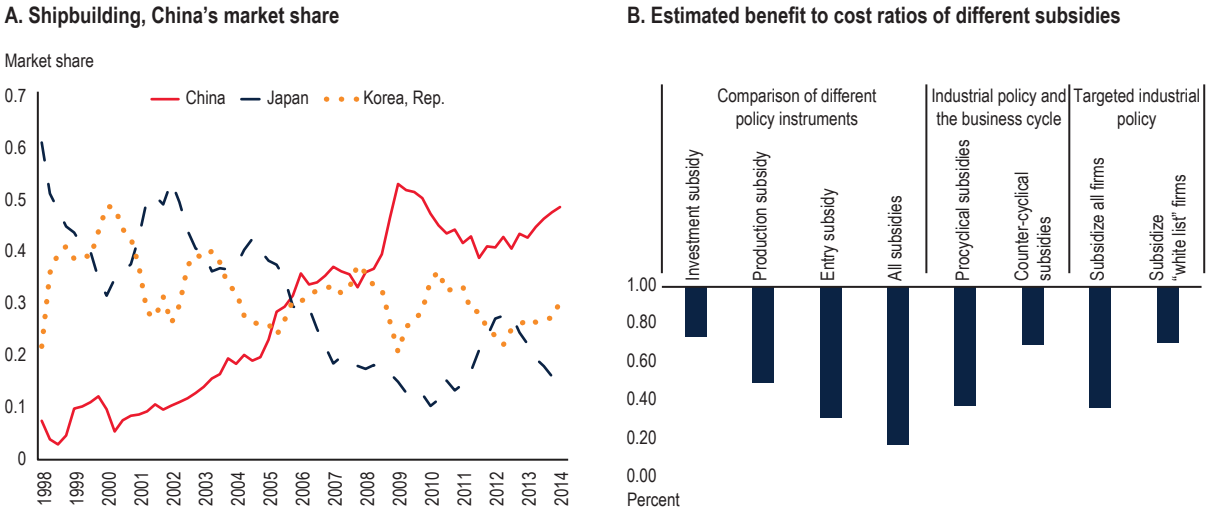
A. Increase in labor productivity in treated industries versus non-treated.

B. Changes in welfare in the short run (blue bars), long run (red bars), and in total (orange bars) from giving each sector a subsidy in the amount of 1 percent of the initial GDP (left-hand side), and the share of the aggregate credit received by each sector (yellow line, right-hand side).

innovation efficiency). The innovation support could have been more effective had it been directed towards these more efficient privately owned firms.

Lastly, the report draws on rigorous academic evidence on specific countries and sectors. The key theme here is the distinction between the *effectiveness* of IP interventions (meaning the ability to increase production or revenues) and their *efficiency,* namely, whether the effects of the interventions justify their costs. Recent research shows an interesting contrast between the case of the Republic of Korea's drive for heavy manufacturing industries in the 1970s, which has been found to be both effective and efficient (figure O.27), and the more recent case of the Chinese interventions in

FIGURE O.28 State interventions in China's shipbuilding industry significantly increased China's global market share, but the costs of the interventions were greater than the benefits.



Sources: A. Barwick et al. 2025. B. Barwick et al. 2024.

Note:

A. Market shares by country are computed from quarterly ship orders.

B. Ratio of estimated delta profits per subsidy unit from table 1 in Barwick et al. 2024. A number below one indicates that the estimated benefits are below the costs of the subsidy (i.e., the subsidy is inefficient).

the shipbuilding sector, which have been found to be highly effective, but mostly inefficient, i.e., with costs exceeding their benefits (figure O.28). While these studies are country-specific, a recent article examines the efficiency of industrial policy across many countries (Barteleme et al. 2025). The main message is quite sobering—even optimally designed industrial policies only increase GDP (equivalent to welfare in their model) about 1 percent on average globally and for China and Viet Nam.

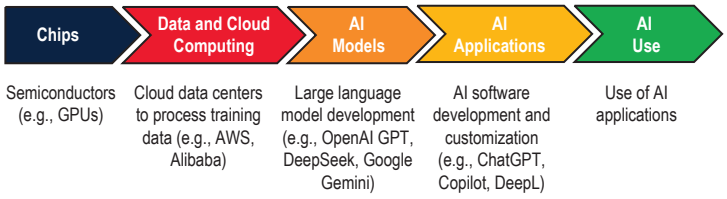
Spotlight: AI value chain

The AI value chain represents an interdependent sequence of activities, beginning with semiconductor production (design, fabrication, assembly-testing-packaging) and data infrastructure required to train foundational models (figure O.29). These inputs enable the development of downstream AI applications—from chatbots to autonomous vehicles—that deliver services to firms and households.

a. Chips

The experience of Korea illustrates the ideal trajectory, moving from assembly to global leadership in fabrication (now 22 percent of global output)

FIGURE O.29 AI value chain



Source: Adapted from Gambacorta and Shreeti 2025.

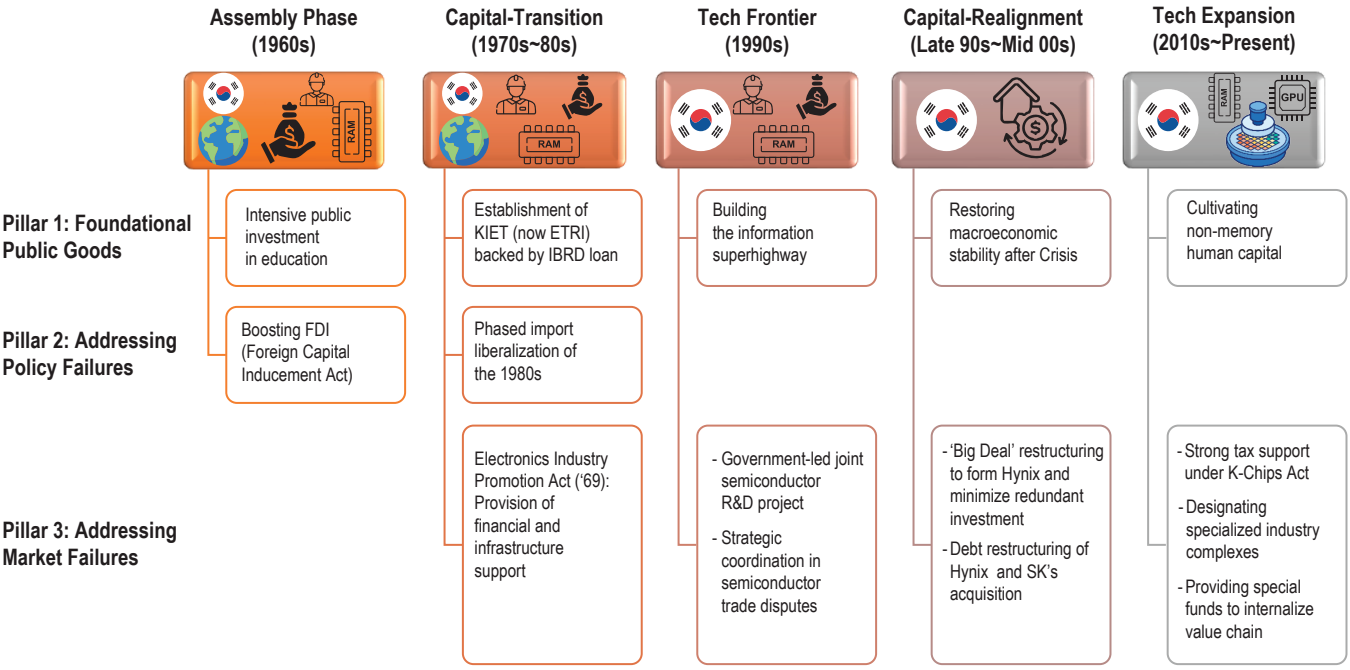
Note: AI = artificial intelligence; GPT = generative pre-trained transformer; GPU = graphics processing unit.

through decades of sustained investment in human capital, targeted incentives, and strategic consolidation (figure O.30). Yet this path is demanding: Korea's success required decades of coordinated policy and significant public risk-taking. Malaysia, the Philippines, and Viet Nam have established strong footholds in assembly and testing (ATP) but face "middle-income" bottlenecks—skill shortages and infrastructure gaps—that prevent them from replicating this ascent into higher-value segments.

b. Cloud data centers

While several countries are introducing financial and energy incentives to attract data centers, infrastructure quality and administrative efficiency can remain binding constraints. Data centers are large, capital-intensive investments for which time to

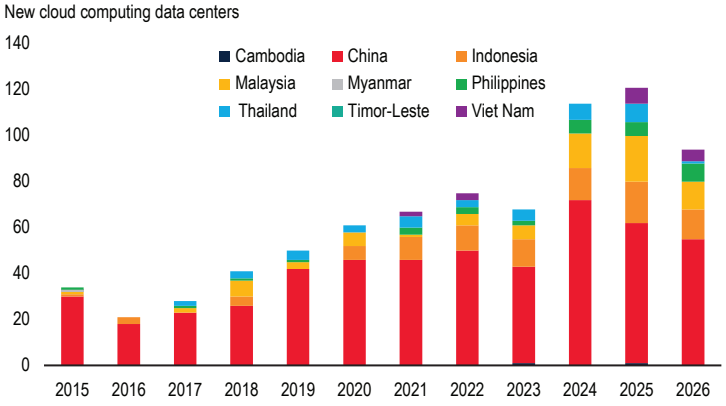
FIGURE O.30 The Republic of Korea's progression to the technology frontier accompanied sustained investment in the three pillars.



Source: World Bank.

Note: ETRI = Electronics and Telecommunications Research Institute; FDI = foreign direct investment; IBRD = International Bank for Reconstruction and Development; KIET = Korea Institute for Industrial Economics and Trade; R&D = research and development.

FIGURE O.31 Cloud computing data center expansion is concentrated in a few EAP countries.



Source: Straub et al. 2026.

Note: The figure shows the annual sum of data center projects completed or scheduled to be completed in each year. The database was constructed manually by merging multiple sources, primarily TeleGeography, GlobalData, and DataCentersMap.

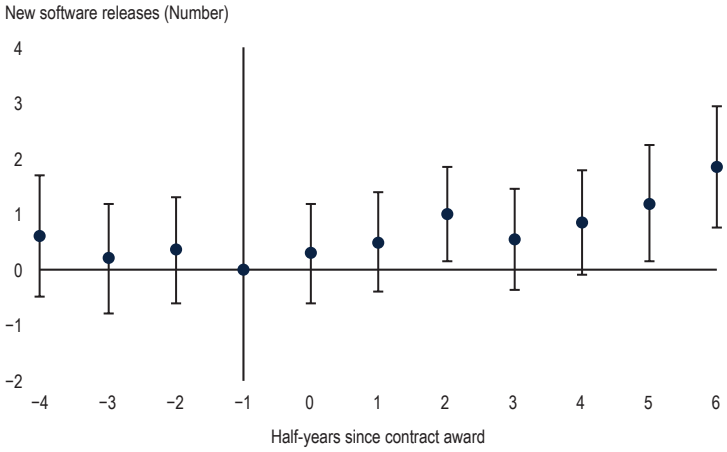
market is a critical determinant of returns. In several EAP countries, projects have been delayed due to both insufficient investment in power and fiber infrastructure, and the challenges of coordinating across multiple government agencies. Malaysia's Green Lane Pathway illustrates what is possible when these coordination failures are addressed: by establishing a One-Stop-Centre and fast-tracking grid connections, Malaysia reduced the time from application to data center operation from 36–48 months to just 12 months. Malaysia has experienced a data center boom in recent years (figure O.31). However, timely access to reliable infrastructure and access to finance remains a constraint for new data centers in several EAP countries.

c. AI applications

Despite the potential gains, policies in EAP countries are mostly focused on earlier stages of the AI value chain rather than AI applications. In previous ICT waves, most productivity gains were based on how technology was used rather than on building the underlying hardware. Since AI is a general-purpose technology, the range of potential applications is huge. Furthermore, the barriers to entry in AI applications (such as data and skills), although high, are much lower than in developing AI models.

Access to government data is a form of industrial policy that can spur development of downstream AI applications. For instance, Chinese AI firms awarded government procurement contracts that included access to large-scale data sets (such as video or image archives) increased their commercial software development by roughly 20 percent in the three years following the contract award (figure O.32). While the majority of EAP countries has policies related to open government data, implementation has typically been limited.

FIGURE O.32 Public procurement contracts with access to government data led to Chinese AI firms developing new commercial software.



Source: Beraja et al. 2023.

Note: Estimates from an event study regression showing the cumulative software releases intended for commercial uses in periods before and after the award of a government procurement contract and resulting from data-rich public security contracts, relative to data-scarce ones. Regressions control for firm and time period fixed effects.

Conclusion

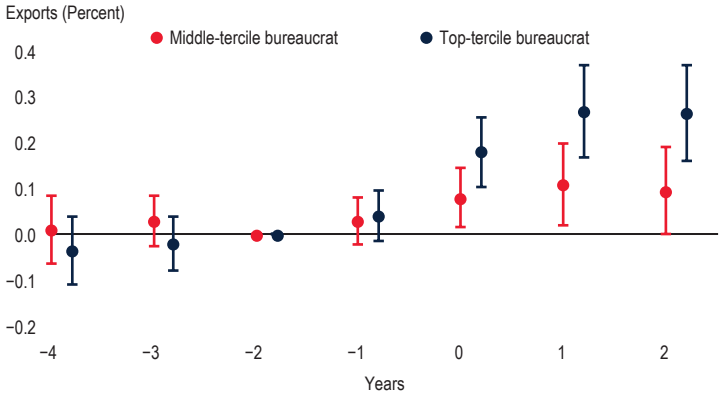
To conclude, we bring together our main findings and cast them in our three-pillars framework.

1. Basic human capital, infrastructure, and institutions. Investment in human capital, infrastructure, and effective institutions generate benefits for all firms and sectors. Viet Nam's transformation from an agrarian, centrally planned economy to Asia's most trade-intensive economy was driven primarily by these economy-wide reforms, not by sector-picking. The same is true for the development trajectories of many EAP countries: from China to the Philippines, from Thailand to Malaysia. The benefits to costs ratio of investments in infrastructure and human capital are found to be high for many EAP countries.

2. Address policy failures by liberating services, eliminating nontariff barriers, and providing the right business environment, including for the digital economy. In many EAP countries, including China, Indonesia, Malaysia, and Thailand, the pervasive use of restrictions in services, the persistence of nontariff barriers, and burdensome licensing limit the scope for development. The benefits of opening up to trade and investment in goods have been amply demonstrated in the region; the benefits of even partial liberalization of services are evident in countries like China and Viet Nam, and more recently in the Philippines, which reformed its restrictive Public Services Act. State-owned firms account for a large share of activity in some EAP countries in key sectors (such as banking), which can limit competition and misallocate resources (World Bank 2023). Spurring productivity growth and avoiding the middle-income trap requires action across these pillars to give firms the right incentives (by strengthening competition) and the capabilities (through better skills and infrastructure) to invest in innovation (De Nicola et al. 2025).

3. Targeted interventions can complement—but not substitute for—the enabling framework created by 1 and 2 above. While it is difficult to establish the efficiency of industrial policy, strengthening the first two foundational pillars is not only efficient, but might also improve the effectiveness of targeted support. For example, aspects of industrial policy in China and Viet Nam, such as tax exemptions for investors, were implemented in a strong institutional and infrastructural context, alongside significant liberalization on the altar of WTO accession. In contrast, industrial policy in Indonesia, in the form of export restrictions, is being implemented when complementary public goods are not well developed and barriers to trade in goods and services persist, which limits access to key complementary inputs. In general, allocating

FIGURE O.33 Export promotion policies are more effective when implemented by more able bureaucrats.



Source: Barteska and Lee 2025.

Note: Figure illustrates event study estimates of log exports before and after the switch to a new bureaucrat in Korea, Rep.'s export promotion offices abroad. The omitted category is a transition in the bottom tercile.

support to firms operating in more competitive sectors has been shown to spur greater increases in productivity (Aghion et al. 2015). In addition, the effectiveness of new export promotion policies in Korea depended crucially on the quality of public institutions as reflected in the ability of the bureaucrats (figure O.33).

Proactive sector-specific industrial policy is more likely to be effective where fundamentals are sound and major policy failures have been addressed. However, achieving such conditions nationwide is unlikely in the near term, so countries can use special economic zones (SEZs) to prioritize reforms. SEZs are demarcated areas within a country which typically offer investors better infrastructure, a streamlined regulatory and administrative regime (including improved customs), and a fiscal regime with reduced corporate income tax, value added tax, and other taxes and labor contributions, sometimes complemented by training or other subsidies (World Bank 2020). Although evidence on their impact is mixed, several EAP countries have clear success stories where SEZs are well-governed, engage the private sector, and form strong linkages with the rest of the domestic economy (World Bank 2024b). Recent SEZs have also moved beyond the traditional focus on manufacturing, as illustrated by the Johor–Singapore SEZ, which combines cross-border trade and migration facilitation, streamlined regulations, digital infrastructure, and fiscal incentives to attract investment in AI and data centers, as well as high-tech manufacturing.

The AI value chain also illustrates how the three pillars of industrial policy should work in tandem. Foundational horizontal policies are critical: without investments in high-speed digital infrastructure, energy, and a skilled workforce, participation will remain limited. Second, removing distortions is essential to reducing the cost of key inputs, such as opening access to public data and cross-border data. Finally, targeted interventions need to be carefully considered and seen as complements rather than substitutes for the first two pillars. While several countries are introducing financial and energy incentives to attract data centers, infrastructure quality, availability of financing sources, and administrative efficiency can remain binding constraints.

The case for industrial policy has always been compelling in principle, whereas the practice of industrial policy has usually been less principled. While this special focus provides a policy framework, practical implementation requires careful instrument design (Fernandes and Reed 2026). Targeting specific sectors or firms can catalyze investment but carry fiscal and rent-seeking risks; they must therefore be transparently implemented, include sunset clauses, and have strict performance benchmarks. Policy makers should prioritize instruments that closely target market failures, ensuring that support fosters competition and local spillovers rather than entrenching incumbents.

TABLE O.2 GDP growth

	2015–19	2020–24	2025	Apr 2026 forecast		Oct 2025 forecast	
				2026	2027	2025	2026
East Asia and Pacific	6.5	4.5	5.0	**4.2**	**4.4**	4.8	4.3
East Asia and Pacific (excluding China)	5.2	2.9	4.9	**4.1**	**5.0**	4.4	4.5
Pacific Island Countries	3.1	1.8	3.2	**2.8**	**3.0**	2.7	2.8
China	6.7	4.9	5.0	**4.2**	**4.3**	4.8	4.2
Indonesia	5.0	3.4	5.1	**4.7**	**5.2**	4.8	4.8
Malaysia	4.9	3.1	5.2	**4.4**	**4.4**	4.1	4.1
Philippines	6.6	3.0	4.4	**3.7**	**5.6**	5.3	5.4
Thailand	3.4	0.7	2.4	**1.3**	**2.3**	2.0	1.8
Viet Nam	7.1	5.2	8.0	**6.3**	**7.6**	6.6	6.1
Cambodia	8.0	3.1	4.8	**3.9**	**4.9**	4.8	4.3
Lao PDR	6.6	2.7	4.5	**3.5**	**3.7**	3.7	3.6
Mongolia	4.6	2.9	6.9	**5.0**	**5.5**	5.9	5.6
Myanmar	6.4	–3.3	–1.3	**2.0**	**4.0**	–1.8	3.0
Papua New Guinea	4.0	1.9	5.6	**3.8**	**3.8**	4.3	3.2
Timor-Leste	5.2	1.0	4.5	**4.1**	**4.0**	4.0	3.4
Palau	1.0	–1.9	6.7	**3.6**	**2.7**	5.7	3.5
Fiji	3.1	3.2	3.2	**2.7**	**3.2**	2.9	3.0
Solomon Islands	3.0	–0.1	3.6	**2.9**	**3.2**	2.5	2.7
Tuvalu	6.7	–1.5	3.0	**2.5**	**2.7**	3.0	2.6
Marshall Islands	4.8	–0.6	2.5	**3.3**	**2.4**	2.5	4.1
Vanuatu	3.5	0.3	1.7	**2.3**	**2.7**	1.7	2.8
Kiribati	5.8	4.2	4.3	**3.1**	**2.4**	3.9	3.2
Tonga	2.3	0.2	2.7	**2.0**	**1.8**	2.7	2.3
Samoa	3.4	2.4	4.2	**4.0**	**3.3**	2.1	2.5
Micronesia, Fed. Sts.	2.0	–0.9	1.1	**0.8**	**1.3**	1.1	1.5
Nauru	1.7	2.6	2.1	**1.9**	**1.9**	2.1	1.9

Source: World Bank.

Note: Percent growth of GDP at market prices. Values for 2025 for the small island economies refer to GDP growth estimates. Values for Timor-Leste represent non-oil GDP. For the following countries, values correspond to the fiscal year: Federal States of Micronesia, Myanmar, Palau, and Republic of the Marshall Islands (October 1–September 30); Nauru, Samoa, and Tonga (July 1–June 30).

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East Asia and the Pacific (EAP) continues to outpace much of the world in economic growth, but momentum is slowing in 2026. Three external factors are shaping the regional outlook. First, the conflict in the Middle East has driven up energy prices, which directly hurts energy importers across the region. Second, tariffs on exports to the US as well as economic policy uncertainty remain elevated, inhibiting investment and inducing a shift towards short-term and informal employment. Third, the AI boom is spurring investment globally and reshaping technology supply chains, though EAP's ability to capture its benefits is constrained by gaps in connectivity and skills. Underlying these developments is a deeper structural challenge: productivity growth is stalling. Structural reforms have lost momentum, new jobs are concentrating in low-productivity services, and leading firms are falling behind the global digital frontier. In this context, industrial policy is increasingly viewed by policymakers as a means to open new development pathways. We suggest a practical, three-principle approach to industrial policy. First, get the fundamentals right. Investments in education, infrastructure, and government effectiveness typically yield the highest returns. Second, do no harm. Pro-competition reforms—especially in services—can be powerful forms of industrial policy. Lastly, scrutinize targeted interventions rigorously.

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