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Reigniting Productivity: A New Growth Model for the Asia-Pacific

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EXECUTIVE SUMMARY

The Asia-Pacific region is reaching the limits of the scale-based and China-driven growth model, as manufacturing specialisation and global value-chain integration now deliver diminishing returns.

Data regressions (and testing over 120 socio-economic variables) show productivity drivers have inverted: **Exports correlate negatively with productivity, while imports – especially services – provide the strongest productivity gains**, showing that openness to innovation and services remains the key lever for economic growth.

Moreover, **connectivity dividends are exhausted. Productivity does not depend on more internet users, but on the uptake of business technology**, such as cloud, AI, and enterprise software. Also, inward FDI (i.e., investments by foreign multinationals) expands the local availability of support services essential for organisational efficiency that also becomes available to domestic SMEs. However, these productivity contributions remain uneven due to regulatory fragmentation and country-specific compliance costs.

Taken together, many businesses in the region, and **SMEs in particular, face technological and organisational capability constraints** rather than just infrastructure gaps (i.e., access to roads, ports, or broadband).

The **Asia-Pacific region needs a capability-driven growth model**, enabled by investment diversification, services integration, and

reducing the fixed costs of technology adoption that hinder SME growth. These remedies are distinct from those prescribed for Europe in the Draghi report, which emphasise scale, reindustrialisation, and state investments.

Recommended actions are:

- Re-anchor openness by **liberalising and deregulating business and digital services**, advancing mutual recognition via plurilateral services and investment arrangements.
- Mobilise **capital for technology adoption through FDIs**, easing borrowing mandates for IT and software, and treating digital capability as a factor of production.
- Reduce regulatory uncertainty by maintaining stable legal regimes, enabling modular **voluntary (“opt-in”) frameworks for data and cloud services firms**, e.g., regionally recognised certification schemes for personal data, trusted cloud, and AI developer designations, with deeper convergence across APEC, CPTPP, and ASEAN.
- Unlock SME scaling by **reforming corporate taxation** that encourages formalisation of the grey economy, simplifying cross-border rules, and ensuring access to computational infrastructure such as cloud and AI tools.
- In the long term, exploit demographic asymmetries in the region via skills-based migration, **higher-age worker retention, and expanding female labour-force participation**.

1. INTRODUCTION: A NEW GROWTH MODEL FOR THE ASIA-PACIFIC

In 2026, the Asia-Pacific countries will remain the world's central engine of trade and growth. According to the World Bank statistics, the region still accounts for around 60 per cent (or US\$65 trillion) of global GDP and nearly half (or US\$ 17 trillion) of world trade, but arguably also a majority of the macropolitical tensions and risks, which, in turn, have become vulnerabilities for the entire global economy.¹

Over the past two decades, **regional growth was structurally anchored in China's reintegration** into the global economy.² This process accounted for a large share of output, manufacturing trade, and incremental productivity gains, especially in East Asia. This is a productivity growth model built on scale, massive labour reallocation into manufacturing, deeper integration into global value chains, and Chinese internal demand. This model mobilised FDI into China but delivered lower costs and greater technology diffusion through cheaper equipment and devices.

However, that era is ending. In the past economic cycle, all countries in the region except two (i.e., Thailand and the Philippines) have experienced declines in total factor productivity (TFP) relative to the US.³ In the short term, strategic uncertainty stemming from competitive rivalry and weaponisation of trade and industrial policy, which, in turn, has led to supply-chain rewiring that takes its toll on productivity.

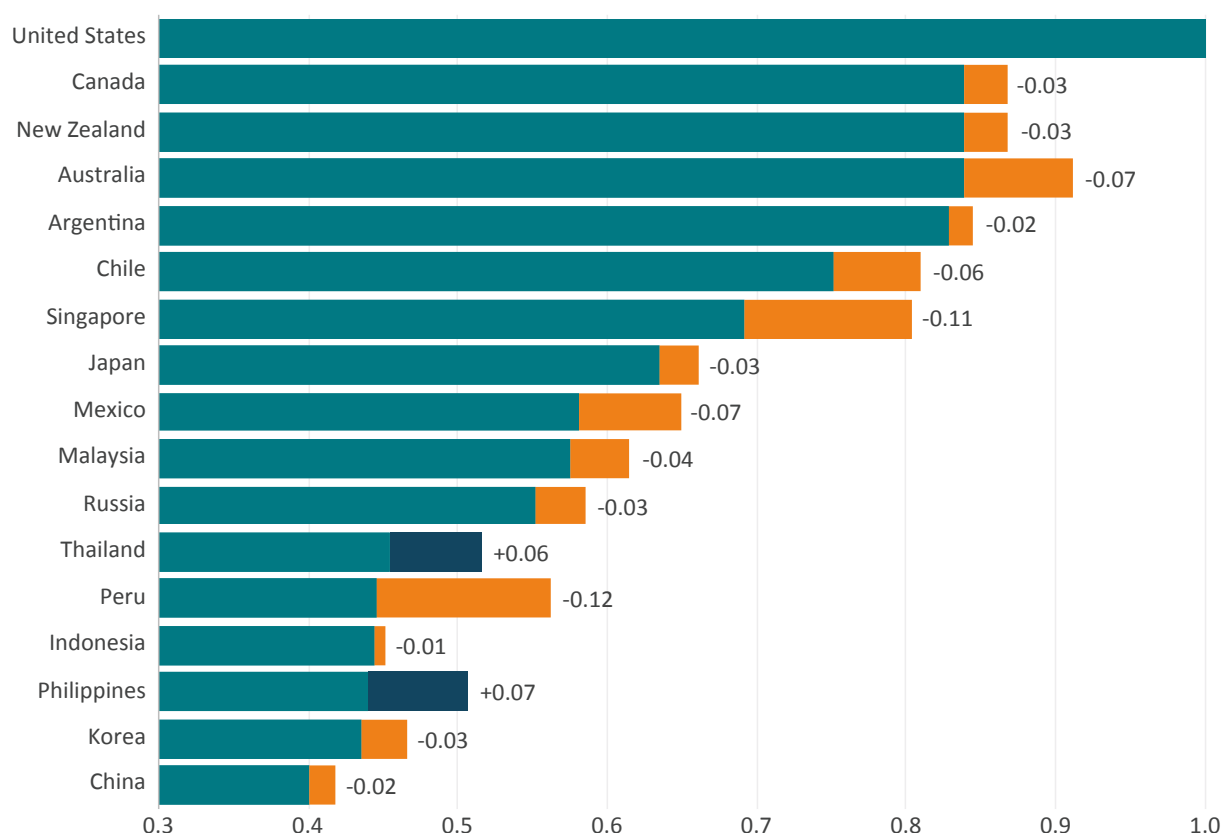
In the medium to long term, productivity growth is also constrained by numerous factors, including capital misallocation, subsidy-driven overcapacities that crowd out FDI, ageing societies in North Asia, weaker cumulative scale advantages due to China's slowdown, and diminishing returns from export-manufacturing specialisation.⁴

¹ World Bank. (2024). World development indicators. World Bank Group.

² Naughton, B. (2021). The rise of China's industrial policy, 1978–2020. AEI Press.

³ Organisation for Economic Co-operation and Development. (2023). OECD economic outlook 2023.

⁴ Asian Development Bank. (2020). Asian development outlook 2020: What drives innovation in Asia? Manila: Asian Development Bank; Naughton, B. (2021). The rise of China's industrial policy, 1978–2020. AEI Press.

FIGURE 1: TOTAL FACTOR PRODUCTIVITY LOST (RELATIVE TO THE US = 1.00) SINCE 2015

Source: Authors' own analysis

Given both structural headwinds and new economic frictions, productivity growth in the region is inevitably slowing down. However, the current productivity frontier depends on a different set of structural determinants than before, and we see the contours of a new Asia-Pacific growth model emerging.

2. CENTRALITY OF PRODUCTIVITY

Productivity may be central to economic growth and competitiveness, yet it remains an elusive concept in public debate. Simply put, economies can boost their growth by becoming more productive through better use of technology, greater organisational efficiency, and a shift towards higher-value sectors. Enhancing productivity is central to both emerging economies in a middle-income trap and industrialised economies that can no longer grow their economies through expanding the population.

The Asia-Pacific is hardly alone in embracing the productivity race – and probably not the worst placed. Notably, Europe's competitiveness crisis provides a benchmark for the Asia-Pacific as well, although the European economy is positioned differently, with problems stemming from different ills. The oft-cited Draghi Report by the European Commission identifies many of the trends observed in other regions: a long-run productivity slowdown,

widening gaps between frontier and laggard firms, chronic underinvestment, and markets that fail to deliver competition and innovation.⁵

However, here is where the similarities end, as the causes and triggers of the productivity slowdown differ widely across regions. Europe's productivity problem is rooted in energy insecurity, overregulation, and declining industrial dynamism due to insufficient risk capital. And the EU responded by massively borrowing and channelling it into a regional industrial policy. Understandably, the Asian economies will respond more heterogeneously, given the much broader diversity than in Europe.

But the challenges in the Asia-Pacific are systemically more complex. Unlike in Europe, most of the problems in the Asia-Pacific region cannot be solved by throwing money at them. Several East Asian economies have already developed national productivity strategies.⁶ A commonality among these reports is how the export-driven or China-led growth may have reached its limits, and more dynamism is needed.

TABLE 1: NOTABLE COMPETITIVENESS STRATEGY WHITE PAPERS ACROSS ASIA-PACIFIC

Economy	Strategy	Core Focus
Korea	New Growth 4.0 Strategy (launched 2023) ⁷	Fostering technological innovation and addressing "killer regulations" that hamper R&D to secure future productivity.
Australia	Revitalising National Competition Policy (agreed November 2024) ⁸	A 10-year, whole-of-economy structural reform plan to improve labour mobility. Extending Unfair Trading Practices (UTP) protections to boost market dynamism.
Singapore	Economic Strategy Review (ESR) (Launched August 2025) ⁹	Ongoing review on competitiveness, leveraging technology and AI to drive broad-based economic growth and improving the startup ecosystem.
China	14 th Five-Year Plan (2021-2025) ¹⁰	High-quality development to ensure labour productivity grows faster than GDP; plans for increased R&D spending and reinforcing the foundational role of competition to develop a high-standard market system.
Japan	Integrated Innovation Strategy (Ongoing through 2025 targets) ¹¹	The central policy focused on integrating Innovation in science and technology, social systems, and human resources. Leveraging AI and next-generation infrastructure to enhance productivity and address an ageing society.

⁵ European Commission. (2024). Report of the High-Level Group on EU Competitiveness (Draghi Report).

⁶ Government of the Republic of Korea. (2023). New Growth 4.0 Strategy. Seoul: Ministry of Economy and Finance; Government of Australia. (2024). Revitalising National Competition Policy: Federal-State Reform Agreement. Canberra: Australian Government; Government of Singapore. (2025). Economic Strategy Review (ESR). Singapore: Ministry of Trade and Industry; State Council of the People's Republic of China. (2021). 14th Five-Year Plan for National Economic and Social Development (2021–2025). Beijing: State Council; Cabinet Office, Government of Japan. (2020–2025). Integrated Innovation Strategy. Tokyo: Government of Japan.

⁷ Government of the Republic of Korea. (2023). New Growth 4.0 Strategy. Seoul: Ministry of Economy and Finance.

⁸ Government of Australia. (2024). Revitalising National Competition Policy: Federal-State Reform Agreement. Canberra: Australian Government.

⁹ Government of Singapore. (2025). Economic Strategy Review (ESR). Singapore: Ministry of Trade and Industry.

¹⁰ State Council of the People's Republic of China. (2021). 14th Five-Year Plan for National Economic and Social Development (2021–2025). Beijing: State Council.

¹¹ Cabinet Office, Government of Japan. (2020–2025). Integrated Innovation Strategy. Tokyo: Government of Japan.

Amid strategic rivalry and the breakdown of the rule-based economic order, **how does the region reignite its productivity growth?** To answer this question, this report examines productivity gaps across the area in the following section. Then it examines recent data to discuss an alternative growth model for the new regional reality.

3. PRODUCTIVITY GAPS IN THE ASIA-PACIFIC

By and large, the productivity decline in the Asia-Pacific has been consistent with global trends, not least because of the region's large share of the global economy.¹² In the most advanced Asia-Pacific economies (Japan, Korea, Australia, and Canada), productivity is falling behind that of the US.¹³ Convergence between industrialised and emerging economies has also stalled, as ASEAN's productivity growth decelerates, while Latin America remains trapped in its long-run stagnation.

3.1 How Multinationals and SMEs Cope with Competitive Rivalry

While there is a global problem of resource misallocation, insufficient competitive pressure, and slower diffusion of frontier technologies (e.g., digital services), this manifests in the Asia-Pacific as a growing performance gap between multinational and domestic firms. This gap is also expanding due to new compliance costs from localisation mandates, data regulations, and divergent technical standards, which large frontier firms can more easily absorb.¹⁴ In addition, **export controls and import screening regimes have effectively established a dual supply chain management structure** between China and the West.¹⁵

The regulatory environment and compliance burden are especially taxing on SMEs, which are unable to absorb or pass on these costs as large enterprises can. Even among multinationals, their current restructuring and diversification of their supply chains to Vietnam, India, and other countries (so-called China "plus-one" strategies) as supply-chain fragmentation leads to temporarily lower productivity.¹⁶

Moreover, many large enterprises and multinationals are beneficiaries of domestic industrial subsidies that promote localisation of strategic sectors at home.¹⁷ Nonetheless, such policies generate cost-push inflation by increasing demand for scarce factors such as skilled labour, critical raw materials (CRMs), specialised machinery, and energy, and ultimately raising prices

¹² Organisation for Economic Co-operation and Development. (2023). OECD economic outlook 2023.

¹³ Organisation for Economic Co-operation and Development. (2023). OECD economic outlook 2023.

¹⁴ APEC Policy Support Unit. (2022). APEC regional trends analysis: Fragmentation and the new trade environment. Singapore: APEC Secretariat.

¹⁵ APEC Policy Support Unit. (2022). APEC regional trends analysis: Fragmentation and the new trade environment; Antràs, P. (2020). De-globalisation? Global value chains in the post-COVID-19 age (NBER Working Paper No. 28115).

¹⁶ Antràs, P. (2020). De-globalisation? Global value chains in the post-COVID-19 age (NBER Working Paper No. 28115).

¹⁷ International Monetary Fund. (2023). World economic outlook: Navigating fragmentation.; Evenett, S., & Fritz, J. (2023). Global trade alert: 30th report – The subsidy surge continues. University of St. Gallen; Organisation for Economic Co-operation and Development. (2023). OECD economic outlook 2023.

across the economy.¹⁸ When all large economies pursue a subsidy race, they create supply bottlenecks and induce projects that would not be commercially viable under market costs, leading to inefficient capacity expansions or even overcapacities.¹⁹

This combination of factor scarcity and misallocation elevates cost structures rather than compressing them, turning industrial policy into a channel of inflationary pressure rather than productivity growth.

3.2 Demographics

The East Asian demographic profile is fractured, with ageing societies in North Asia, notably Japan, Korea, China, and Taiwan, that are reducing labour supply and raising dependency ratios.²⁰ Japan's median age is now 49, and Korea will be the fastest ageing society in the world by 2030. As a consequence of the past one-child policy, China's working-age population has already peaked, and dependency ratios have risen sharply.

Ageing is not necessarily an inherent drag on productivity or growth, provided that the society can extend the period during which citizens are economically active. The challenge is not ageing itself but incentivising older workers to remain in the labour force, stay healthy, skilled and productive through adaptable work arrangements supported by technology.²¹

This dilemma mirrors part of the European debate, where a region-wide demographic decline leads to slow growth.²² However, the Asia-Pacific challenge concerns the asymmetry between ageing high-income economies and younger middle-income economies that cannot leverage demographics to drive productivity convergence.

The young societies in Southeast Asia and Latin America have young, expanding workforces with scope for reallocation from processing industries to higher-productivity sectors. Yet, they cannot fully convert it into productivity gains due to structural barriers to participation. For instance, **female labour-force participation was a tenet of Abenomics structural reforms in Japan**, but remains constrained in Indonesia, Malaysia, Mexico, and Peru. The most potentially productive workers are misallocated into the much less productive informal economy, and as a result, emerging economies underutilise their demographic dividends, and labour reallocation into higher-productivity sectors proceeds more slowly than for those who industrialised in the last century.²³

¹⁸ International Monetary Fund. (2023). World economic outlook: Navigating fragmentation; Evenett, S., & Fritz, J. (2023). Global trade alert: 30th report – The subsidy surge continues.

¹⁹ Organisation for Economic Co-operation and Development. (2023). OECD economic outlook 2023.

²⁰ Asian Development Bank. (2020). Asian development outlook 2020: What drives innovation in Asia? Manila: Asian Development Bank.

²¹ Cabinet Office, Government of Japan. (2023). Annual report on the ageing society 2023. Tokyo: Government of Japan.

²² European Commission. (2023). 2023 ageing report.

²³ International Labour Organization. (2022). World employment and social outlook 2022.

The proven policy response – i.e., migration from young societies to ageing ones – seems obvious. Despite being the historical adjustment mechanism in North America, East Asia, and Oceania, migration is politically constrained, reducing the capacity to offset ageing through inflows of skilled labour.

3.3 Structural Weakness in Capital Formation

For the past two decades, foreign direct investment (FDI) into China has dominated global capital flows, spilling over into the creation of the East Asian production network. **At its peak, China absorbed nearly a quarter of global FDI flows, exceeding the shares of all other APEC members combined.**²⁴

This “all eggs in one Chinese basket” approach was foundational to Asia’s productivity shock and high returns. However, the reliance on a single investment destination has created unhedgeable risks as the Chinese economy slows and vulnerabilities to diplomatic coercion. Due to this overfocus on China, other countries have also struggled to accumulate comparable capital stocks, particularly in advanced manufacturing, digital infrastructure, and innovation-intensive sectors.

Although the Asia-Pacific region is highly liquid (not least thanks to its many sovereign wealth funds, pension funds and institutional investors), its allocation to productivity-enhancing sectors remains limited by regulatory constraints, conservative mandates, or domestic financial systems that are too underdeveloped to mobilise long-horizon, risk-bearing capital.²⁵ Where Europe’s Draghi report emphasises missing risk capital and internal regulatory fragmentation, the Asia-Pacific faces an added layer of concentration that suppresses long-horizon investment: Years of China-centric allocation patterns have suppressed the emergence of deeper, more productive capital markets elsewhere in the Asia-Pacific, making the regional ecosystem under-diversified and underdeveloped.

3.4 Exhausted Connectivity Dividends

The Asia-Pacific region has made significant investments in 4G and 5G infrastructure, with impressive rollout, while the pandemic also accelerated the transition to service economies. Nevertheless, the businesses in the region have failed to capitalise on and achieve similar growth of actual use cases of that infrastructure, e.g., cloud computing, the internet of things, enterprise resource planning (ERP) systems, cross-border data analytics, and AI-enabled business processes. In short, the region excelled in building connectivity, but still suffers from a digital capability gap compared to the US.²⁶

²⁴ United Nations Conference on Trade and Development. (2023). World investment report 2023: Investing in sustainable energy for all.; APEC Policy Support Unit. (2022). APEC regional trends analysis: Fragmentation and the new trade environment. Singapore: APEC Secretariat.

²⁵ Asian Development Bank. (2021). Asian development outlook 2021: Financing a green and inclusive recovery. Manila: Asian Development Bank.

²⁶ Asian Development Bank. (2021). Asian development outlook 2021: Financing a green and inclusive recovery; Organisation for Economic Co-operation and Development. (2023). OECD economic outlook 2023.

The capability gap has a visible impact on competitiveness. Mobile internet was a major driver of productivity growth in the past, but **investments in connectivity infrastructure alone no longer deliver meaningful gains. Instead, the productivity gains require deeper integration of business applications into organisational practices** and predictable regulatory regimes within a country as well as across borders.

Recent firm-level evidence from China confirms that the productivity frontier in China has shifted from connectivity and physical capital toward intangible digital assets and organisational integration.²⁷ Firms with higher shares of digital intangible assets and explicit digital transformation strategies exhibit stronger financial performance, underscoring that productivity gains now depend on capability formation rather than infrastructure availability.

3.5 Compound Regulatory Costs

The technology diffusion gap is a central constraint for SMEs, which account for the bulk of the regional economy. Regulatory compliance costs reduce incentives to invest – and such costs are non-transferable and market-specific sunk costs: Entering another market requires duplicating the same ERPs or data platforms to meet divergent rules on data management and liability requirements.

Regulatory fragmentation disincentivises regional expansion, as each additional market imposes incremental fixed costs and legal risks that are difficult to offset by proportional revenue gains for SMEs and service companies. Empirical studies have also shown that policy uncertainty delays frontier-technology deployment.²⁸

Several economies (e.g., Australia, Singapore, Japan, Korea, Indonesia) have updated their content-liability rules, in seeking to address a harsher political climate of hate speech and disinformation. However, these frameworks often expand platform and services liability in ways that increase legal uncertainty, raise moderation and monitoring costs, and lead to over-removal of lawful content by private companies, thereby creating both legal and political tensions. Furthermore, many have also introduced ex-ante digital market regulations that draw heavily on (but are not necessarily interoperable with) EU AI rules by incorporating its systemic-risk or sovereignty approaches that add further layers of divergence.

²⁷ Tian, X., & Ma, Y. (2025). Digital asset intensity and strategic disclosure effects on firm performance: Evidence from China. *International Review of Economics & Finance*.

²⁸ Handley, K., & Limão, N. (2017). Policy uncertainty, trade and welfare: Theory and evidence for China and the U.S. *American Economic Review*, 107(9), 2731–2783.

TABLE 2: RECENT DATA SOVEREIGNTY, DIGITAL MARKET AND AI REGULATIONS

Economy	Sovereignty policies	Impact
China	Network Data Security Regulations (NDSR) (September 2024) ²⁹	Clarifies cybersecurity thresholds that require localisation and transfer decisions on important information.
Vietnam	Personal Data Protection Decree No. 13/2023/ND-CP (PDPD) (April 2023) ³⁰ and Decree No. 163/2024/ND-CP (Guiding the Telecommunications Law) (December 2024) ³¹	PDPD imposes strict requirements on cross-border data transfers and mandates data localisation. Telecommunications Law contains obligations for offshore service providers to comply with government requests to block illegal content and suspend services.
Australia	Privacy Act 1988 Amendments (First Tranche) (December 2024) ³²	Introduces automated decision transparency requirements and significantly increases penalties for privacy breaches.
Thailand	Personal Data Protection Act (PDPA) Secondary Laws (Ongoing 2023–2025) ³³	Finalises rules on mechanisms for international data transfers (e.g., Binding Corporate Rules) for full PDPA enforcement.

Economy	Digital market restrictions	Impact
Japan	Act on Promotion of Competition for Specified Smartphone Software (June 2024); ³⁴ Act on Improving Transparency and Fairness in Trading Digital Platforms (2021) ³⁵	Ex-ante regulation mandating third-party app stores and payment systems, and disclosure of business terms.
Korea	Telecommunications Business Act (TBA) Amendments (2021); ³⁶ Electronic Commerce Act Amendments (February 2025); ³⁷ and further pending amendments	Mandating third-party payment options, prohibiting dark patterns in subscription services (e.g., hidden renewals, drip pricing) and requiring proactive consent for paid services.
Canada	Competition Act Amendments (June 2025) ³⁸	Expands the rights of private parties to seek remedies, including the ability to claim disgorgement.
Australia	Revisions of Competition and Consumer Act 2010 (CCA) (proposals pending) ³⁹	Ex-ante conduct codes for designated foreign platforms

²⁹ Cyberspace Administration of China. (2024). Network Data Security Regulations (NDSR).

³⁰ Government of Vietnam. (2023). Decree No. 13/2023/ND-CP on Personal Data Protection (PDPD).

³¹ Government of Vietnam. (2024). Decree No. 163/2024/ND-CP guiding the Telecommunications Law.

³² Government of Australia. (2024). Privacy Act 1988 amendments.

³³ Government of Thailand. (2023–2025). Personal Data Protection Act (PDPA) secondary legislation.

³⁴ Government of Japan. (2024). Act on Promotion of Competition for Specified Smartphone Software.

³⁵ Government of Japan. (2021). Act on Improving Transparency and Fairness in Trading Digital Platforms.

³⁶ Government of the Republic of Korea. (2021). Telecommunications Business Act amendments.

³⁷ Government of the Republic of Korea. (2025). Electronic Commerce Act amendments.

³⁸ Government of Canada. (2025). Competition Act amendments.

³⁹ Government of Australia. (n.d.). Proposed revisions to the Competition and Consumer Act 2010 (CCA).

Economy	AI governance rules	Impact
China	Interim Measures for the Management of Generative AI Services (July 2023) ⁴⁰	Strict content security and data-source consent requirements for training AI models impose a high compliance burden.
Japan	Act on Promotion of Competition for Specified Smartphone Software (June 2024) ⁴¹	Includes obligations to allow third-party AI search engines.
Singapore	Advisory Guidelines on the Use of Personal Data in AI Recommendation and Decision Systems (March 2024) ⁴²	Transparency and explanations for automated decisions using personal data, guiding ethical AI use.
Korea	AI Basic Act (2025) ⁴³	Requiring human monitoring, transparency and explainability requirements for "high-impact" AI systems.

In such an increasingly fragmented regulatory environment, rational businesses under-invest in scalable cloud, AI, enterprise resource planning (ERP) systems, and other business software – especially if the banking system prohibits borrowing and amortising the fixed costs required to integrate and digitise business processes.

4. NEW PRODUCTIVITY LEVERS SINCE 2015

The previous sections have shown that the historical China-centric model has reached diminishing returns, and the region's productivity slowdown reflects both short and long-term factors, such as the security environment, demographics, suppressed investments, and regulatory complexity.

To move from diagnosis to prescription, we now turn to a more granular, data-driven assessment of which levers have mattered most in the region's current technological and geopolitical cycle. The objective of this section is not to retell the past, but to quantify productivity drivers in the world as it now exists. While the full technical notes are in the annex, regressions allow us to isolate constraints and drivers across the region as a whole, despite vastly different income levels, industrial structures, and institutional capacities.

To that end, we have conducted a series of Feasible Generalised Least Squares regressions on panel data from APEC Statistics, World Bank Enterprise Surveys, and the Penn World Tables since 2015.⁴⁴ The choice of period is deliberate. The region has entered a new political climate characterised by the escalation of competitive rivalry and controls, resulting in bifurcated regulatory spheres.⁴⁵ The period also marks a new technological stage, with half of the population in the region using mobile phones, and the marginal effect of further mobile internet penetration

⁴⁰ Cyberspace Administration of China. (2023). Interim Measures for the Management of Generative AI Services.

⁴¹ Government of Japan. (2024). Act on Promotion of Competition for Specified Smartphone Software.

⁴² Personal Data Protection Commission Singapore. (2024). Advisory guidelines on the use of personal data in AI recommendation and decision systems.

⁴³ Government of the Republic of Korea. (2025). AI Basic Act.

⁴⁴ Asia-Pacific Economic Cooperation. (2022). APEC in charts 2022; World Bank. (n.d.). World Bank enterprise surveys; Penn World Tables. (n.d.). Version 10.x.

⁴⁵ APEC Policy Support Unit. (2022). APEC regional trends analysis: Fragmentation and the new trade environment; International Monetary Fund. (2023). World economic outlook: Navigating fragmentation.

began to diminish. Finally, the breakpoint gives equal weight to pre- and post-pandemic periods. In the course of this exercise, we have tested over 120 socio-economic variables and their impact on productivity.

In the first set of regressions, we examine the relationship between total factor productivity (TFP) and a set of variables capturing structural constraints at the national level. The second regression exercise focuses on SMEs, given their importance to the region, accounting for half of its GDP. SME productivity is also shaped less by capacity for capital accumulation and more by access to digital tools, organisational capabilities, and financial mechanisms.

4.1 What Drives Total Factor Productivity?

The regression results confirm the structural break: the drivers of productivity in the 2000s no longer determine performance in the 2020s.⁴⁶ Most notably:

- An **increase in imports, especially services, shows a strongly positive relationship**: a 10 percentage-point increase in foreign services imports is associated with a 9-point improvement (on a scale between 0 and 100) in TFP. The results indicate that openness remains the region's most durable productivity lever. This is consistent with the argument that capability formation increasingly depends on access to foreign business services, data tools, cloud infrastructure, enterprise systems, and specialised intermediate inputs. The results demonstrate how service imports play the role that capital goods once played: they embed tacit know-how, organisational practices, and technological capabilities that diffuse across domestic firms.⁴⁷
- An increase in **exports exhibits a strong negative association with productivity (TFP)**: a 10 percentage-point increase in exports is associated with an 8-point decline in TFP (0-100). The results suggest that the traditional export-led model is no longer a meaningful engine of productivity.⁴⁸ Inflationary environment and high trading costs have eroded the scale economies that once underpinned manufacturing productivity, while localisation and "plus-one" restructuring, where ICT industries have diversified to additional countries besides China, may have also reduced the efficiency of exports. The net effect is that export intensity now correlates with lower productivity growth.
- **Technological adoption (network readiness index) is highly significant** ($p > 0.001$) and yields higher productivity gains than internet usage: a 10-point increase in technological adoption yields a 2.3-point increase in TFP, compared to 1.9 points for an equivalent increase of internet users among the population.
- Inbound FDI is positive but statistically insignificant ($p > 0.135$), implying that **capital inflows alone may not increase national productivity** unless they are paired with the absorption of new technology, where organisations deploy technologies into business practices.

⁴⁶ Asia-Pacific Economic Cooperation. (2022). APEC in charts 2022; World Bank. (n.d.). World Bank Enterprise Surveys. World Bank Group; Penn World Tables. (n.d.). Version 10.x. Groningen Growth and Development Centre.

⁴⁷ Antràs, P. (2020). De-globalisation? Global value chains in the post-COVID-19 age.

⁴⁸ Asian Development Bank. (2021). Asian development outlook 2021: Financing a green and inclusive recovery.

- While population growth seems to correlate strongly with productivity, the effects of increased labour force participation (female or general) were not statistically significant. However, the results do not imply that expanding the labour force yields no benefits – only that the positive effects may take longer to materialise.

The empirical results suggest that economies that rely on imported capabilities, rather than attempting to recreate them through industrial policy, move closer to the productivity frontier. Taken together, the results confirm that the Asia-Pacific productivity model has inverted.

4.2 Unleashing SMEs for Regional Growth

The regression results for SMEs underscore the economy-wide results with some important differences.

- Both **imports and exports have no impact on SME labour productivity**, implying that SMEs face a structural disadvantage due to prohibitive regulatory and logistics costs that only larger firms can absorb. This is also evident from the significant results on Ease of Doing Business, which show a widening productivity wedge in which regulatory protection depresses SME competitiveness relative to multinationals rather than raising it.
- Unlike in the general case above, inbound FDI is clearly significant. **SMEs do not generate capabilities endogenously but acquire them by participating in ecosystems.** When foreign businesses enter and invest in a market, they bring managerial practices, business services, supply-chain standards, and technology platforms that domestic SMEs would otherwise not have access to. These spillovers disproportionately benefit SMEs because they lack the internal organisational capital of larger firms. In other words, FDI is a channel for importing capabilities as they operate at the steepest part of the learning curve.
- Consequently, **technological adoption remains relevant among SMEs:** A 10-point increase in technological adoption yields a 1.5-point increase in TFP, compared to 0.5 points for an equivalent increase in internet users. SMEs generally underinvest in systems, tools and platforms – not because they lack awareness, but because high fees, immature banking systems, and regulatory fragmentation create non-transferable sunk costs that result in a structural tax on scaling.⁴⁹
- Corporate income tax becomes an impediment to productivity once startups scale up and reach the maturity phase: **a tax increase on medium-sized businesses has a particularly negative impact**, as it is likely to incentivise consumption that reduces the value-added of the companies that seek to minimise their tax base, which in turn lowers productivity.

SME productivity is therefore a capability and deregulation challenge, rather than an infrastructure bottleneck or a trading problem. Closing the SME productivity gap requires reducing the fixed costs of digitalisation, simplifying cross-border operations, and enabling SMEs to access the

⁴⁹ International Labour Organization. (2022). World employment and social outlook 2022.

computational and organisational tools used by frontier firms, which include the availability of business services (outsourced accounting, logistics, data analytics and marketing), cloud infrastructure, and professional support that diffuses managerial and organisational practices. The most consequential productivity reforms for SMEs are to address regulatory barriers that restrict them, as well as their access to business services that enable productivity growth.

5. CONCLUSIONS: A CAPABILITY-DRIVEN GROWTH MODEL

The Asia-Pacific region is rapidly reaching the end of the productivity dividends of the scale-based, manufacturing, and China-centric model. This is supported by empirical evidence: exports no longer raise productivity, whereas imports of services, capital, and technology do. The channels of productivity have inverted, and economies that draw in business services, global know-how, and organisational technologies are the ones that move forward.

The new Asia-Pacific growth model relies less on scale and more on capability: The region will grow not by expanding industrial capacity (which merely adds to existing overcapacities in the region) but by deepening business infrastructure that allows organisations to expand their capabilities.

In turn, capability is no longer improved through mere upskilling or physical access to infrastructure, such as internet connectivity or transport networks. Instead, capabilities are developed through intangible factors, such as technological adoption (e.g., cloud, AI, and business platforms), organisational efficiency, access to business and ICT services, and continued ecosystem linkages between researchers, clusters, suppliers, and buyers in the region. This is particularly true for SMEs, which will determine whether the Asia-Pacific region returns to a path of productivity growth, provided the region shifts from a manufacturing-export model to a capability model.

This conclusion contrasts with the European prescriptions set out in the Draghi Report. Europe's diagnosis centres on a lack of manufacturing scale, chronic public underinvestment, and internal fragmentation. Asia-Pacific's constraints are different – the region is already liquid, its assets and resources reasonably mobile, and equipped with a competitive environment. The EU prescribes scale, reindustrialisation, and coordinated state investment, but these are ills that brought an end to the productivity growth in the Asia-Pacific. What makes the region competitive today is, instead, a carefully targeted openness, investment diversification, and services integration.

Such remedies can be packaged into a grand bargain among countries that must use services, investments, and interoperable technology rules to diversify away from a narrow export-led model based on a few target markets or commodities. One fitting initiative could be a compact to upgrade services and investment within an existing regional agreement, such as the CPTPP or within ASEAN.

*Recommendations***Re-anchor the region in openness for capability-building trade:**

- Reopen the channels of imported productivity by liberalising business and digital services.
- Create mutual recognition of professional and technical certifications to scale the availability of advanced skills, allowing firms to adopt technologies quickly across borders.
- For example, APEC countries could undertake services and investment liberalisation through open plurilateral arrangements that avoid hub-and-spoke models underpinned by just a single country.

Mobilise capital to promote technology adoption:

- Treat digital capability as a factor of production: fiscally incentivise deployment of ERP systems, cloud migration, integrated data architectures, and AI-enabled business processes.
- Prioritise liberalisation and tax incentives for inward FDI in services and technology, where spillovers to domestic firms and TFP growth are strongest.
- Easing lending mandates for commercial banks when businesses invest in IT, intellectual property licensing, and software, and removing regulations that segment domestic capital markets.

Reduce regulatory uncertainty:

- Stable legal regimes for investments, professional services, and frontier technologies, as regulatory uncertainty disincentivises organisational transformation.
- Modular, voluntary ("opt-in") frameworks for data and cloud services firms, e.g., regionally recognised certification schemes modelled on APEC CBPR for data management, trusted cloud and AI developer designations that reduce national compliance reporting and market-specific sunk costs.
- Enhance APEC, CPTPP, ASEAN and other regulatory convergence initiatives on data, privacy, and digital markets to reduce compliance costs that SMEs cannot amortise.

Unlock SME scaling:

- Reform SME corporate income taxes to favour formalisation and investments rather than hidden private consumption that artificially suppresses productivity. Simplification to encourage technology-based business services and reforming mandates on local data storage or paper verifications that would enable digital-only accounting and other compliance requirements.

- Facilitating SME access to computational infrastructure, AI stacks, cloud storage credits, and AI tooling is now as essential as mobile internet once was. Cloud adoption schemes with subsidies or tax credits for subscriptions, reducing initial fixed costs for digital transformation
- Introduce business ecosystems (cloud-based ERPs, productivity tools, marketing tools) that avoid large upfront investments.

Exploit demographic asymmetries within the region for the long term

- Labour mobilisation by deploying selective, skills-based migration to bridge demographic mismatches where politically viable.
- Support worker retention at higher ages through adaptable work arrangements and productivity-enhancing automation technologies
- Many APEC economies with large unused labour reserves could also expand female labour force participation to support long-term productivity growth.

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6. TECHNICAL ANNEX

6.1 Regression Results: TFP of the Total Economy

Variable	Coefficient	P>z
Population, ages 15-64 of total pop (%)	0.014165	0.016
Population growth rate, annual (%)	0.026064	0.019
Labour force participation rate (%)	-0.00094	0.923
Female labour participation (%)	-0.0105	0.195
Employment, agriculture, of total (%)	-0.00105	0.629
Employment, industry, of total (%)	0.019185	0
Employment, services, of total (%)	0	0
Imports, goods, of GDP (%)	0.570099	0
Imports, services, of GDP (%)	0.913434	0.085
Exports, goods, of GDP (%)	-0.8308	0
Exports, services, of GDP (%)	-0.78148	0.114
MFN applied tariff simple average (%)	-0.0002348	0.883
MFN applied rate, duty-free, share (%)	0.00000727	0.318
Economic freedom of the world index (0-10)	-0.11835	0.882
Ease of doing business index (0-100)	0.002625	0.022
FDI flows, inward, of gross investments (%)	0.000925	0.135
FDI flows, outward, of gross investments (%)	-0.00229	0.006
Small business income tax rate (%)	0.037241	0
Medium business income tax rate (%)	-0.03297	0
Average reported effective income tax (%)	0.002949	0.188
Internet subscriptions, broadband (%)	-0.00647	0.072
Internet users of total population (%)	0.001873	0.001
Network readiness index - technology adoption (0-100)	0.002274	0.001
Year	-0.01319	0.002
Emerging country dummy (yes/no)	-0.45738	0
Constant	27.64605	0.03

6.2 Regression Results: Labor Productivity of Small Businesses

Variable	Coefficient	P>z
Population, ages 15-64 of total pop (%)	0.002909	0.017
Population growth rate, annual (%)	0.007836	0.034
Labour force participation rate (%)	-0.0072	0.013
Female labour participation (%)	0.004565	0.069
Employment, agriculture, of total (%)	-0.00236	0.002
Employment, industry, of total (%)	-4.26E-06	0.996
Employment, services, of total (%)	0	0
Imports, goods, of GDP (%)	0.045568	0.308
Imports, services, of GDP (%)	0.015795	0.899
Exports, goods, of GDP (%)	-0.00901	0.838
Exports, services, of GDP (%)	-0.03207	0.79
MFN applied tariff simple average (%)	0.000649	0.853
MFN applied rate, duty-free, share (%)	-0.00061	0.001
Economic freedom of the world index (0-10)	0.001647	0.824
Ease of doing business index (0-100)	0.000809	0.019
FDI flows, inward, of gross investments (%)	0.000679	0
FDI flows, outward, of gross investments (%)	-0.00106	0
Small business income tax rate (%)	0.004232	0.145
Medium business income tax rate (%)	-0.00643	0
Average reported effective income tax (%)	0.002279	0.001
Internet subscriptions, broadband (%)	-0.00215	0.038
Internet users of total population (%)	0.000485	0.017
Network readiness index - technology adoption (0-100)	0.001542	0
Year	-0.00564	0
Emerging country dummy (yes/no)	-0.04768	0.03
Constant	11.39655	0