

Economic Outlook and Future Challenges in Developing Asia*

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Developing Asia has rebounded strongly from the global crisis. With its robust growth, developing Asia has provided another “engine of growth” to the world economy when the traditional markets faltered. I think it is extremely important that we start from this perspective of—what I call—developing Asia’s new vantage point.

The economic rise of developing Asia, particularly after the recent global financial crisis, clearly provides a dynamic vantage point for the region. With its “V-shaped” recovery firmly in place, developing Asia has led the world out of recession. Yes, the region’s remarkable resilience is partly due to its limited exposure to toxic assets that sparked the global financial crisis. However, in large part, it also reflects the successful reforms and restructuring undertaken in the aftermath of our own crisis of 1997-98. The Asian financial crisis sowed the seeds for cooperation and integration. The more recent crisis has strengthened Asia’s commitment to bring regional integration to the next level. Stronger regional cooperation made the region’s successful response to the crisis possible. And now—following a year in which Korea successfully hosted the G20 Summit—we join the forces of the global community to work towards strong, sustainable, and balanced global growth.

Across the region’s widely diverse economies, authorities have moved on from recovery to the longer term goal of sustained growth. Asia must broaden and deepen its development strategies to reach more people—to help reduce the poverty that remains our region’s most

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daunting challenge. Ultimately, it is our collective responsibility to build a new foundation for sustainable development and economic growth that can be shared globally.

With this goal in mind, I will address four questions: first, what is the economic prospect for developing Asia; second, what are the medium to long term challenges; third, what is ADB doing to help address those challenges; and finally, what role can the region play as Asia increasingly takes a front row seat in managing global economic reform?

Developing Asian economies have grown impressively over a period of nearly 30 years. The region's real GDP in purchasing power parity (PPP) terms climbed from about \$3.3 trillion in 1980 to an estimated \$24.5 trillion in 2009. That is an increase of 7.5 times, compared with just three times for the world economy during the same period. Real per capita GDP in the region more than quadrupled during the same period, while average global income less than doubled. Such robust, prolonged growth has placed the region squarely on the global economic map, as one of three centers of gravity in the world economy—along with the European Union and the United States.

Developing Asia's remarkable performance reflects its robust economic fundamentals. These include high savings and investment rates, openness to foreign trade and technology, investment in education and human capital, flexible labor markets, and sound fiscal and monetary policies. The past crisis provided an impetus for the necessary—and sometimes painful—financial, monetary, and fiscal reforms. These in turn created the foundation for monetary and fiscal buffers, allowing for ample stimulus to blunt the worst effects of the recent global economic downturn.

All the more remarkable is that the region's sharp turnaround happened against a backdrop of continued fragility and weakness in advanced economies, traditionally the region's major export markets. It appears a decade can make quite a difference. In the late 1990's Asia looked to advanced economies for solving the region's problem; today the world turns to Asia for the helping hand.

I am very optimistic about developing Asia's short term growth prospects. The region's surprisingly robust and speedy recovery from the global crisis was marked by an estimated growth of 8.6% in 2010. With recovery in advanced economies still fragile, last year's export rebound will likely moderate in 2011. ADB currently forecasts 2011 GDP growth to moderate somewhat, but remain vibrant at above 7%. Estimated 2010 growth of People's Republic of China (PRC) is above 10%, with growth this year forecast at a more sustainable 9%. India's GDP expanded an estimated 8.5% last year and should grow a bit faster this year as private demand continues to grow. Although developing Asia's robust growth is set against a backdrop of manageable inflation—about 4% for both 2010 and 2011—inflationary pressures must be monitored closely, particularly in countries where there are signs of overheating, and in light of rising world commodity prices.

The projected moderation in economic growth this year may be seen as “normalization”—it basically represents a return to more sustainable growth rates as the post-crisis recovery takes firm hold. As I mentioned at the outset, the big question for the region is whether this post-crisis recovery can be turned into longer-term sustained high growth. And how can Asia successfully sustain growth beyond the recovery, while continuing to deal with large collective challenges?

Let me address three critical issues that will determine developing Asia's future success—first, rebalancing sources of growth (which should help the orderly resolution of global imbalances as well); second, restructuring growth strategies to ensure they are more inclusive; and third, doing all this without harming our greatest asset, the earth—environmentally sustainable growth.

First, Asia's export-led growth model has generated substantial benefits and will continue to do so. However, the crisis highlighted the risk of unbalanced growth. As I mentioned, economic recovery in advanced economies remains fragile. To turn this post-crisis recovery into a sustained and balanced growth, there should be collective efforts from both developed and developing parts of the world to bring an orderly workout of global

imbalances. Developing Asia needs to strengthen its domestic and regional demand while advanced economies put their private and public sector balance sheets in order. As we will likely see a long period of sluggish demand growth in advanced economies, increased consumption and investment in developing Asia is critical to sustaining global growth. For many developing Asian economies, the important challenge is how to rebalance sources of economic growth by generating more domestic demand without undermining the benefits of trade. With emerging market economies growing rapidly, more demand should come from their own domestic private consumption. It means the diversification of export destinations intra-regionally and in other emerging markets—such as Latin America or Africa—should be accelerated. Developing Asia’s trade profile should be also broadened to include trade of more final goods within the region.

Rebalancing the sources of growth within Asia can help resolve global imbalances as well. At this time, surpluses are concentrated in just a few nations, particularly some rapidly growing economies in Asia; with the deficit primarily in just one country—the United States. Americans need to reduce their debt. Asia needs to invest its surplus to better finance its growing development requirements. Developing Asia has proven its capacity to produce; now, it must show that it can also consume and invest wisely.

Achieving this rebalancing will require demand-side policies that encourage household expenditure and increase private sector investment. It also requires supply-side policies that promote small and medium-sized enterprises and service industries catering to domestic demand. This will involve galvanizing the region’s excess savings to help finance development—particularly in the larger, complex infrastructure projects needed to keep the engine of rapid growth well lubricated. ADB estimates that \$8 trillion is needed through 2020 just to keep infrastructure in line with growth projections. All of this requires more effective and efficient resource allocation, another part of the rebalancing process.

Second, Asia must ensure that its evolving growth paradigm benefits as many people as possible. Whether promoting intra-regional trade, investing in domestic or cross-border

infrastructure, or stimulating growth in services and small and medium enterprises—all strong drivers of domestic consumption—the outcome must be inclusive.

What do we actually mean by “inclusive”? Despite our achievements, we must not forget the “two faces” of Asia. Poverty continues to be the paramount challenge facing the region. According to an ADB study, 14 out of 20 developing Asian economies saw their Gini coefficients—a measure of inequality—increase in recent years as economic growth accelerated.

Developing Asia may be home to 60% of the world’s population, but it is home to two thirds of its poor. Put in perspective, that means 1.8 billion people in our region today live on less than \$2 per day. There is also non-income poverty. For example, while income poverty has fallen considerably, hunger has fallen only marginally. In South Asia, a staggering 45% percent of children under the age of five are underweight. By comparison, the sub-Saharan Africa level is 27%.¹

What does this all tell us? While high economic growth is desirable—and while developing Asia has succeeded in reducing income poverty significantly—we must redouble our efforts to guarantee that people have equal access to opportunities and basic social services. These require greater investment in education and health, particularly for the poor. Expanding social protection to the informal sector and rural households is another policy option that nurtures inclusive growth. For many countries, developing rural infrastructure to connect the poor to markets and enable them to participate in the growth process is essential.

Third, along with human capital, our environment begs for help. We are living in a world of scarce and finite resources. How do we ensure that we leave a sustainable environment and development legacy to future generations? Climate change and climatic volatility are facts. We saw it rear up in many ways these past 12 months. Events range from the devastating floods in Pakistan, to the flood-drought equation in Australia, and the recent winter storms

¹ ADB/UNDP/ESCAP report on MDGs.

across Europe and America. Rising sea levels and higher temperatures all have dramatic effects, forcing large numbers of mostly poor to migrate.

The economic and social implications of climate change are very serious. A recent ADB study focusing on Southeast Asia estimates that, if nothing is done, the total cost of climate change for Indonesia, the Philippines, Thailand, and Viet Nam could reach as high as 6.7% of their combined GDP each year by 2100. Sustainability cannot be achieved unless the world moves onto a low-carbon, climate-resilient development path that embraces both mitigation and adaptation. Environmentally sustainable growth must be considered a national, regional, and global public good.

ADB is committed to reducing poverty in the region; indeed it is our overarching goal. When we consider loans and grants, technical assistance or policy advice, we assess the impact on the poor. Our three strategic agendas as outlined in our *Strategy 2020*—ADB’s strategic framework for the next decade—are inclusive growth, environmentally sustainable growth, and regional integration. Whether providing assistance for building roads or improving a city’s water supply, we ask how many of the beneficiaries are poor and how will it improve their lives.

We know that economic growth is a necessary (although not sufficient) condition to achieve sustained poverty reduction and is thus a critical component in closing the development gap. After 44 years of operation, we also know it depends on the development of a country’s private sector. Thus, we are increasingly focusing on public-private partnerships. Under *Strategy 2020*, we are scaling up support to private sector operations and development to reach half of our annual operations by 2020.

ADB’s assistance for transport, energy, water and other infrastructure, and basic public services such as health care and education help to widen the circle of opportunity so that all members of society can participate in and benefit from economic growth. This supports “inclusive growth.”

Our support for environmentally friendly technologies, such as clean and renewable energy sources and energy efficiency improvement measures, helps developing Asia address environmental sustainability, including climate change. We also work to adopt environmental safeguards and strengthen institutions for their effective enforcement.

Market failures induce public authorities to intervene in supervision, regulation, and better governance. This happened in developing Asia following the regional 1997/98 crisis—and I believe it is happening on a global scale, given the market failures that brought on the global crisis. ADB is extremely active in helping build stronger links among member countries in trade and finance, and cooperation in economic surveillance.

Lifting trade restrictions and strengthening intra-regional trade will help reduce Asia's overdependence on exports to industrial countries and increase their resilience to regional and global economic shocks. Through existing groups such as ASEAN, ASEAN+3—which includes PRC, Japan, and Korea—or the East Asia Summit process, ADB also works to ease trade, consolidate free trade agreements, and facilitate efficient capital flows and investments by broadening and deepening capital markets.

To conclude, developing Asia faces an opening of a new era. Emerged strongly from the crisis, developing Asia should now work shoulder to shoulder with the world's major powers to tackle the daunting challenges of ensuring the post-crisis world to reclaim the path to strong, sustainable, and balanced growth. Its vast diversity means that challenges vary in intensity across the region. But they should remain centered around rebalancing the sources of growth, making sure that growth benefits all, and passing the livable earth to the next generation without sacrificing growth.

ADB is committed to working with communities, governments, civil society, academia, and other development partners to achieve balanced, inclusive and sustainable growth across the Asia and Pacific region, which will also bring enormous benefits for the world at large. We are grateful for Korea's continuing support of these important goals, and look

forward to further strengthening our partnership. We are passionate about our business and will continue to do our best toward the realization of an Asia and Pacific free of poverty.

Questions & Answers

Q What role does Korea play in the ADB?

A I think Korea, as an original member of ADB, has made a great contribution. Of course, Korea was initially a borrowing member, and ADB extended substantial loans to Korea to invest in infrastructure, education, and other areas. However, Korea quickly graduated from receiving assistance from ADB to becoming one of the major donors. Korea also contributes human resources. Among the more than 2,500 staff, of which 900 are professional staff, there are a significant number of Koreans. There are currently only a few Koreans at senior level positions, but I am quite sure that there will be more Koreans rising to senior positions in the coming years. But, Korea's contribution to ADB is not limited to financial resources or human resources. Intellectual contributions are also important. Korea, as I said in my initial statement, has developed very quickly from developing country status to developed economy status within three decades. This means that Korea's experience could provide very good lessons for developing countries in Asia. Here, I think ADB can learn from Korea's economic development and could disseminate those lessons to other developing countries in Asia. Korea's role in ADB is expanding and will continue to expand.

Q ADB recently issued RMB-denominated bonds. What is ADB's plan on the scale and utilization of RMB bonds in the future? Second, all of us are quite familiar with the Chiang Mai Initiative. What is the role of ADB in this and how can ADB continue to play an active role in these new institutions?

A ADB has actually issued RMB bonds twice. It was first done in China itself, and was done again recently in Hong Kong. The RMB bond issued in Hong Kong was the first RMB bond issued outside of China. In both cases, ADB used the proceeds of the bond issuance for private sector operations in China. As you know, China still maintains comprehensive capital controls. That means RMB bonds cannot easily be converted into other currencies. Even to issue RMB bonds requires special permission. ADB is expanding its private sector operations in China and to do that Chinese currency is required. In the future, when China lifts capital controls, issuing RMB bonds will not be tightly linked with ADB's private sector operations in China. RMB will be convertible, and we can use those currencies in other developing nations. But at this moment that is not the case. Within these existing constraints ADB got very good terms. Actually, the interest rate we pay on RMB bonds are even lower than the Chinese central government pays on its RMB bonds. I think we can continue to issue RMB bonds, and once capital controls are lifted, we can substantially increase RMB bond issuance.

The Chiang Mai Initiative is now expanded and multilateralized. Initially it was a network of bilateral swap arrangements, but now it is a \$120 billion financial safety net. That is a very significant amount, particularly for ASEAN nations. It is almost a kind of Asian monetary fund. China has nearly \$3 trillion in foreign reserves and Japan has \$1 trillion in reserves. This is probably more than enough, but for many ASEAN nations CMI provides a very important safety net for their economies. It will continue to be so. ADB, from the outset, has been involved in establishing the CMI and its expansion, and plans to continue its support and involvement.

Q Does ADB still have plans to expedite the forming of a regional currency for Asia?

A I still believe that in the long run there will be a regional currency in Asia despite the fact that the Eurozone has experienced significant difficulties over the last 12 months. Of course, in order to establish a common currency or a regional currency there has to be a regional common market. The European Union had established an efficient, common, single market before embarking on a single currency. At this stage only ASEAN is aiming at something like a common market. A common market requires not just an FTA or customs union in which internal tariffs would be completely abolished. More than that, a common market requires various domestic regulations be harmonized and only then would a common market emerge. As of now there is no schedule or blueprint to establish a common market for East Asia as a whole. A blueprint only exists for ASEAN. Then, based on the common market, a regional currency could be established. But, establishing a regional currency is a quantum leap because in order to establish a single common currency member currencies have to be abolished and a single central bank has to be established. This is a very big political decision. Unless minimum political consensus exists it is very difficult. If all potential members of a common currency are democracies then it may work. But if there are non-democratic countries it is very difficult for democratic countries to give up their central banks or currencies. So, first there should be a common market and then a single currency. Making the jump from a common market to a common currency was a very large political decision even in Europe. Not all member of the EU use the euro. This shows how difficult it is. Even now, as I said, the last twelve months have shown that it is not so easy to manage the single currency. Although I believe that in the long run there will be a common currency in Asia it will take several decades before it is established.