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CAN THE ASIAN TIGERS CHANGE THEIR STRIPES TO SURVIVE THE NEW ENVIRONMENT?

by Jean-Pierre A. Verbiest, Assistant Chief Economist
Asian Development Bank

Excellencies, Ladies and Gentlemen,

Good Evening

Many years ago in 1979-1980 when I was with the National Bank of Belgium, I was a member of this prestigious institute and I have a fond remembrance of many really interesting debates. Since 1980, I have lived in Southeast Asia, and I never thought that one day I would have the honor to address a meeting of the Institute. It is indeed a great honor to be with you tonight and share with you some insights on the economic perspectives of the most dynamic region in the world, developing Asia.

My presentation tonight deals with the Asian tigers and their adjustment to a new environment. Will the Asian tigers become extinct? Are new cubs growing up? Is the Asian tiger story one of the past?

My main message is that the Asian tiger story we know is only the beginning of a story. The Asian tigers will not change their stripes, and their stripes will become even bolder.

First, as demonstrated since the Asian financial crisis, the old tigers (Korea, Hong Kong, Taipei,China and Singapore) and the newer tigers in Southeast Asia have been fighting their way back up, and shown remarkable resilience. Scars remain but are healing. Some cubs in Southeast Asia are growing such as Viet Nam. But more importantly, new and very large tigers are growing up. PRC (China) has now joined the group, and India is increasingly on its way to join, and will do so in the decade to come.

Second, behind this optimistic outlook, there are new major dynamics at work, namely rapid growth in intraregional trade, a progressive coming of age of the Asian consumer, and stronger regional cooperation and integration. Recently, the discussions on greater integration between the ASEAN on the one hand, and China and India on the other, held in conjunction with the October Bali ASEAN Summit are an indication of things to come.

Third, the continuation of important economic policy reforms to support domestic and foreign investment, innovation and productivity growth are a prerequisite for the continued success and sustained high growth in all the tigers.

Together, the new and old tigers will make the twenty-first century Asia's century.

A little more than six years ago, it was not far fetched to predict that the then coming 21st century would be "the Asian century". East and Southeast Asia's economies were flush with foreign investment and high growth rates. South Asia's liberalization initiated in the early 1990s was beginning to pay dividends.

But that prediction rang hollow during the East Asian financial crisis of 1997-1998. The crisis heralded the collapse of the East Asian regional development model based on export growth and increasing openness to capital flows. In addition to large declines in per capita income, huge amounts of nonperforming loans (NPLs) suddenly became evident, representing a large contingent fiscal liability for many tiger countries. By the end of December 1998, about 50% of banks' loan portfolios in Indonesia, and 45% in Thailand contained NPLs.

The region was effectively written off economically by the end of 1998, with the exception of China. Yet, only two years later, East and Southeast Asia had regained their position as the fastest growing economic regions in the world, with gross domestic product expanding by 8.1% and 6.2%, respectively in 2000. Strong export growth averaging more than 20% was the driving force of the brisk recovery.

But, there were more shocks to come for the region in 2001, with the bursting of the high-tech bubble and a recession in major industrial countries, exacerbated by the terrorist strikes in the United States. As a result, except for China, gross domestic product (GDP) growth in most East and Southeast Asian countries was less than one third that of 2000, mainly because of a huge fall in external demand. In contrast, South Asia raised its growth rate to 5.0%

In 2002 and 2003, the East and Southeast Asian subregions steadily started to pick up speed again, now spurred by strong growth in intraregional trade and strengthening domestic demand. This took place despite a sluggish recovery in industrial countries and a continued depressed high-tech sector.

The resilience of the East and Southeast Asian economies has been particularly remarkable during the first half of this year, when they were rocked by multiple shocks, including high and volatile oil prices, jitters of terrorism and the Iraq War, and, of course, the SARS epidemic. ADB estimated that the SARS epidemic cost East and Southeast Asia about $18 billion in terms of GDP and $60 billion in terms of business lost (2% of aggregate GDP).

Looking at aggregate forecasts of economic performance in East and Southeast Asia, growth should accelerate from 5.9% and 3.9%, respectively in 2003 to 6.5% and 5% in 2004 and 2005 – a remarkable achievement compared to other regions in the world. For South Asia, GDP growth is also forecast to rise to 6.0-6.5% for 2004-2005.

These figures, while reflecting the overall economic strength of the region, hide significant differences in performance and stages of development. Among the old tigers, Hong Kong and Taipei,China have experienced slow growth since 2001 as their production base relocated rapidly to China and their real estate markets collapsed. As a result, domestic demand in both economies has been very weak and unemployment historically high. In Hong Kong, unemployment stands currently at about 8%. Similarly Singapore's economy has been in recession or close to it since 2001 as its electronics exports suffered from the bursting of the high tech bubble. Its economy is also going through a significant restructuring to decrease its reliance on electronics exports.

In Southeast Asia, among the larger economies, Viet Nam remains very much an economy in transition and a growing cub. It has persistently pursued market opening and liberalization reforms over the past decade, and as a result, it has been growing at a remarkable average rate of 7% since 1993. Macroeconomic stability, expansionary policies and a well performing external sector have underpinned strong growth in Thailand. In contrast, Indonesia and the Philippines, and to a lesser extent Malaysia, are struggling with low investment levels, both domestic and foreign. Political uncertainties combined with weaknesses in their investment environment and incomplete reforms, particularly financial sector reforms, are keeping growth in these economies well below potential. The smaller economies of Southeast Asia, Cambodia, Lao PDR and Myanmar, are still in an early development stage.

In all countries of East and Southeast Asia, economic reforms to tackle structural constraints and accelerate economic growth are ongoing, albeit at different paces. Medium-term and long-term economic projections indicate that growth in most countries is unlikely to return to the high averages of the 1980-1996 period. However, a return to more sustainable but robust growth is generally projected.

Suddenly, the "Asian century" aspiration once again has some credibility. But compared to before the Asian financial crisis, there are now different dynamics at work that have created a new economic environment, equipping the region to better withstand major shocks.

The Emergence of a Dynamic Trading Region

A very distinctive and notable feature of economic developments in the region has been the emergence of China as a major growth engine for intraregional trade. While China remains a relatively poor country, its remarkable growth over the past 2 decades, when its per capita income more than tripled from about $300 in 1980 to just over a $1000 today, has resulted in a substantial increase in trade between most Asian economies, in particular the old tigers, and China.

But what has been particularly remarkable is the huge acceleration of export growth of nearly all East, Southeast and South Asian countries to China over the past 2 years, starting towards the end of 2001 and continuing through 2003. This appears to be only the start of a fundamental change in Asia's development and is entirely driven by the business community. While it is a very positive development, it carries also with it new responsibilities and risks for the countries of the region, and on which I will elaborate later in my address.

For economies in East Asia, China has become the largest export market while for those in Southeast Asia, China has become an important export destination. Typically, for all these regional economies, the share of total exports going to China has doubled since the start of 2000. China has already overtaken the US as the main export market for Korea (about 20% of Korea's exports). Despite the SARS epidemic, Korean exports to China soared at 48.7% year on year during the first 9 months of 2003. For Taipei,China, the growth was 111.9%. For the ASEAN-5 countries, the share of China's export market rose from 3% at the beginning of 2000 to over 7.8% in September 2003. Again, year on year exports of ASEAN-5 to China surged by 46.1% in the first 9 months of 2003. Importantly, contrary to earlier fears, East and Southeast Asian tigers have developed a trade surplus with China. China itself has become part of the tiger group, given its high growth, its export achievements and large import absorption. Recently for instance, it was estimated that China's demand for raw materials imports are actually driving up global raw material prices, from agricultural products to minerals and metals.

Another important feature is that similar trends are observed in South Asia, which traditionally traded relatively little with China. Remarkably, India's exports to China rose at about 120% year on year since the middle of 2002 while China's exports to India increased by 15% during the same period. This is an important new development involving the two largest developing economies in Asia. With India's increasing openness, participation in regional trade and intention to compete economically with China, the making of yet a new tiger is, I firmly believe, not far away.

Regional economies are of course also important markets for Chinese exports, accounting for about 35% of China's exports in 2002. Exports from China to other Asian economies have also been growing rapidly, at double-digit figures, but at a much slower pace than its imports from the region.

One might wonder if Chinese exports have displaced other Asian exports to third country markets. Trade data show that globally Japan has been the major loser. China has in fact contributed significantly to both trade expansion and creation, and is emerging as a major catalyst for growth in other Asian economies.

These remarkable trends which have emerged over the past 2 decades_and amplified over the past few years_point to major changes which will occur in the region over the medium term as intraregional trade becomes a major force to be reckoned with. As China continues to pursue its WTO entry related reforms, tremendous trade opportunities will open in all areas, particularly in services. China is also fast becoming a major importer of primary commodities from the region, including food products. Long-term growth estimates over the next decade put the size of the Chinese economy at about $2.9 trillion, much larger than Germany today. Recent trade developments, particularly with China, also indicate that India will progressively become a second growth pole for the region. India is looking more closely at the Chinese development model and at stronger competition with China, while trying to benefit from the rapid expansion of the Chinese market. The greater opening of the Indian market would in turn immensely benefit the rest of Asia, particularly the old tigers, as well as provide major markets for Indian exporters. Already, Korea plays an important role in a number of sectors in the Indian economy, such as the automobile industry. Long-term growth estimates indicate that the size of India's economy could reach about $1 trillion a decade from now, about double today's size. In a decade, China and India together would have an economy about the size of that of Japan today, but a fast expanding and dynamic economy.

Over the next decade, China and India will increasingly emerge as major drivers of growth in Asia. For the old tigers, either individually (as perhaps Korea) or as a group (in the case of ASEAN), the emergence of these new giant tigers will offer tremendous opportunities as well as challenges. Intraregional trade is already growing rapidly. As for the challenges, they are in implementing sound policies in support of private sector investment and creativity, and maintain macroeconomic stability. More rapid integration of ASEAN would enable ASEAN as a group and its individual member countries, to enhance competitiveness and become a third growth pole in Asia. ASEAN's current population is 540 million. Its aggregate income could also reach about $1 trillion in a decade.

For Europe, these changes in the Asian region are very important. First, competition from Asia will increase faster than before, making economic reforms in Europe the more urgent. Second, the rise of the Asian tigers is not a zero sum game. Both in terms of trade and investment, Asia will offer a more attractive market, particularly as it integrates economically in the context of ASEAN, ASEAN plus two and ASEAN plus India. Third, in these transformations, Asia can also learn a lot from the European integration experience in the areas of trade integration, monetary integration and in the resolution of regional disparities. There is a great and unique opportunity for Europe to share its experience and integration knowledge with Asia. That chance should not be lost.

The Coming of Age of the Asian Consumer

Let me now turn to a second major change, which has been occurring in Asia. Domestic demand, mainly private consumption demand, has been increasing rapidly over the past few years in most countries of the region, and is likely to emerge over time as another major driver of growth. I see this as partly the outcome of the Asian financial crisis, and partly as a result of the 2001 experience which was a reminder that heavy reliance on exports to industrial countries can lead to large economic fluctuations. Not that one is a substitute for the other_and exports will remain a major source of growth for most Asian economies_but a better balance between domestic demand and exports can attenuate economic fluctuations. Stronger domestic consumer demand has been supported both by policy_fiscal and monetary policy_and financial sector developments.

Over the past 3 years, fiscal and monetary policies have generally been expansionary in most East and Southeast Asian countries as shown by growing budget deficits and significant growth in money supply and lower interest rates.

On the financial side, an interesting observation is the generally fast growth in consumer credit since early 2002, partly through a fast expansion in credit card issuance. In some countries, in particular Korea, and to a lesser extent Thailand, the use of credit cards had become excessive by 2003, leading monetary authorities to tighten regulations. One can say, however, that, over the past two years, Asian financial institutions have started to recognize the importance of the Asian consumer as a major source of business. In fact, in the case of Thailand, wider access to credit by farmers and small businesses is a cornerstone of Prime Minister Thaksin's economic policies.

And it appears to be working. Malaysia and the Philippines have indicated that they might adopt similar policies.

This coming of age of the Asian consumer is a positive trend. In countries such as Korea, Malaysia, China, Indonesia, Philippines, Thailand, and even India, consumer demand has played an increasing role in supporting economic growth since early 2002. The rapid growth in the number of shopping malls in India over the past two years is a sign of the changing times.

Taking a longer term perspective, per capita incomes have been rising substantially in Asia over the past 2 decades, particularly in the new and old tiger countries, and a rather large middle class is emerging. The size of the populations of the new and old Asian tigers is large, but importantly, the composition of the population is generally very young_more than half the Indian population is below 25, 30% of the population of China, Indonesia, Malaysia, Philippines, Viet Nam and India is below 15 years of age. The younger generations have not experienced the hardships (including famine in several countries) that their elders have known. As they enter active life, they might be prepared to save less than previous generations. Also, long-term projections indicate that urbanization will be a major trend across Asia over the next 2 decades. This will further stimulate consumption.

The emergence of the Asian consumer is a phenomenon which thus is only beginning. A huge potential market is in the making. For a long time, this market will of course be much smaller than that of major industrial countries' markets or even that of Japan alone, but it will be progressively a new force driving growth in the countries of the region.

The importance of continuing policy reform

Let me now conclude by saying a few words about the need for continued policy reform in Asia. As I mentioned earlier in my address, for the dynamics above to happen and the tigers to grow up, the importance of continued policy reforms cannot be stressed enough. Broadly speaking, a number of macroeconomic and microeconomic policy issues have to be addressed in all countries of the region to maintain their competitiveness in the new regional and global environment.

A disappointing feature in several developing countries of Asia, with the notable exception of PRC, has been weakness in business investment since the Asian financial crisis. Macroeconomic imbalances, fragility of the banking sector as well as microeconomic constraints impacting negatively on the investment climate need urgent policy responses to arrest and reverse the trend in business investment, and raise long-term growth potential. In the case of PRC, the country also faces huge policy challenges over the medium- and long-term. Most critical is financial sector reform to deal with non-performing loans amounting to over 25% of banks' loan portfolio (over $350 billion). However, such reform is intimately linked to state-owned enterprises (SOE) reform and the maintenance of social stability. Other challenges are the development of small- and medium-scale enterprises and coping with chronic investment overheating. Continued reforms in China are critical to reduce risks for the rest of Asia.

In raising growth potential, three important changes underway in Asia would need to be factored in. First, while the importance of outward-looking market orientation which was so important for the East Asian miracle, has now become received wisdom, there is a subtle shift underway in many developing countries that emphasize the importance of domestic demand, particularly consumption. The coming of age of the Asian consumer will make growth more balanced and will cushion these economies from external shocks.

Second, the rapid growth in intraregional trade led by PRC poses enormous opportunities and challenges to the rest of Asia. There will be both trade and FDI creation and diversion from the rapid ascent of PRC. In strengthening complementarities with PRC and in augmenting capacity to compete with it, economies will need to raise productivity and competitiveness.

Third, the increase in intraregional trade must be accompanied by stronger regional cooperation both within and among subregions in Asia. The dimensions of economic policy in Asia will have to change, and closer cooperation between the governments will have to be institutionalized. The process of economic integration, which has essentially been business driven so far, will increasingly also require that government coordinate their economic policies to avoid the outbreak of new shocks and respond sensibly to them when they emerge by taking a regional perspective. The common responsibility of policy makers in the region will need to also go beyond just national policies and cooperation. There is a collective responsibility for the larger and stronger economies in Asia to assist countries or regions within countries, which fall behind in the regional integration and growth process. As I mentioned earlier, there are many lessons, which could be learned here from the EU experience.

To conclude, the dynamics of the Asian tiger story that I have just described are already well underway. The emergence of a vibrant intraregional trade, the fast coming of age of the Asian consumer and a fast maturing regional cooperation and integration process will lead to profound transformations in Asia over the next decades, but they will also profoundly affect other countries and regions in the world, and notably Europe. We can look forward to the 21st Century as that of Asia.