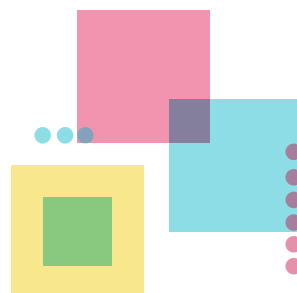


## Executive Summary



Asia is in the middle of a historic transformation. If it continues to follow its recent trajectory, by 2050 its per capita income could rise sixfold in purchasing power parity (PPP) terms to reach Europe's levels today. It would make some 3 billion additional Asians affluent by current standards. By nearly doubling its share of global gross domestic product (GDP) to 52 percent by 2050, Asia would regain the dominant economic position it held some 300 years ago, before the industrial revolution.

But Asia's rise is by no means preordained. Although this outcome is promising, premised on its major economies sustaining their present growth momentum, it does not mean that the path ahead is easy or requires just doing more of the same. Indeed, success will require a different pattern of growth and resolution of a broad array of politically difficult issues over a long period.

This outcome is fraught with multiple risks and challenges, particularly:

- Increasing inequality within countries, which could undermine social cohesion and stability.
- The "Middle Income Trap" for a host of domestic economic, social, and political reasons.
- Intense competition for finite natural resources, as newly affluent Asians aspire to higher standards of living.
- Rising income disparities across countries, which could destabilize the region.
- Global warming and climate change, which could threaten agricultural production, coastal populations, and numerous major urban areas.
- Poor governance and weak institutional capacity, faced by almost all countries.

These challenges are not mutually exclusive. They can affect one another and exacerbate existing tensions and conflicts, or even create new pressures that could threaten Asia's growth, stability, and security.

This book postulates two scenarios of Asia's future growth trajectory: the Asian Century and the Middle Income Trap. These scenarios are not the only ones—they are only two possibilities of how Asia's future may unfold. They have a dual objective: to draw attention to the longer-term implications of the broad trends and to ask "what-if" questions.

## Makings of the Asian Century

The Asian Century scenario extends Asia's past success into the future, putting it on the cusp of a historic transformation. In this scenario, Asia's GDP (at market exchange rates) increases from \$17 trillion in 2010 to \$174 trillion in 2050, or half of global GDP, similar to its share of the global population. With a per capita GDP of \$40,800 (PPP), Asia in 2050 would have incomes similar to Europe's today. It would have no poor countries (those with average per capita GDP of less than \$1,000), compared with eight today. All this assumes that Asian economies can maintain their momentum for another 40 years and adapt to the shifting global economic and technological environment by continually recreating their comparative advantages.

### Actions at three levels

In its march toward the Asian Century, the region must tackle daunting policy, institutional, and governance challenges. Given widely varying country conditions, the precise actions and their timing must vary. Still, it is possible to draw the contours of the major changes necessary for the region along three dimensions: national strategic and policy action; collective regional action to bridge the national and global agendas; and Asia's interactions with the global community. The ability of countries to realize the promise of the Asian Century will be determined by their success in these three areas.

### National action agenda

Seven overarching intergenerational issues and strategic challenges require national action throughout the region.

**Growth and inclusion.** Growth and inclusion need not be mutually exclusive; indeed they can be mutually reinforcing. To sustain growth over the long-term, almost all Asian countries must give much higher priority to inclusion and reducing inequalities—rich/poor, rural/urban, literate/illiterate, and along gender and ethnic lines. Inclusive growth must not only address poverty, but also deal with aspects of equity, equality of access and opportunity, generation of employment and provision of protection to vulnerable in the various facets of daily living.

**Entrepreneurship, innovation, and technological development.** The continuing rapid growth of Asian economies over the next 40 years will require a harnessing of the full potential of technology, innovation and, critically, entrepreneurship. More Asian countries need to emulate Japan, Republic of Korea, and Singapore, and come closer to (preferably achieve) global best practice. The fast-growing converging economies, particularly PRC and India, must move from catching up to frontier entrepreneurship and innovation to create breakthroughs in science and technology. A particularly fruitful area will be inclusive innovation to meet the needs of those at the bottom of the pyramid. A core requirement is a high-quality education system at all levels that promotes creativity.

**Massive urbanization.** By 2050, Asia will be transformed, as its urban population will nearly double from 1.6 billion to 3 billion. Asia's cities, which already account for more than 80 percent of economic output, will be the centers of higher education, innovation, and technological development. The quality and efficiency of urban areas would determine Asia's long-term competitiveness and its social and political stability. Asia must take advantage of being early on its urbanization growth curve to promote compact, energy-efficient, and safe cities.

**Financial transformation.** As its share of global GDP rises to 50 percent or more, Asia should also have about the same share of the world's financial assets, banks, and equity and bond markets, etc. In transforming its financial systems, Asia's leaders must remain mindful of the lessons of the 1997–1998 Asian financial crisis and the Great Recession of 2007–2009. Asia will need to formulate its own approach to finance, avoiding both overreliance on market self-regulation and excessive central government control of bank-dominated systems. It will also need to become more open to institutional innovation, also to support inclusive finance.

**Radical reduction in the intensity of energy and natural resource use.** The anticipated affluence of some 3 billion additional Asians will put tremendous pressure on the earth's finite natural resources. Asia will be the most affected by, and responsible for, excessive reliance on energy imports. Out of self-interest, it will need to take the lead in radical energy efficiency and diversification programs by switching from fossil fuels to renewable energy. Asia's future competitiveness will depend heavily on how efficiently it uses its natural resources and progresses to a low-carbon future.

**Climate change.** Climate change could affect every human being on the planet. With over half the world's population, Asia has more at stake than any other region. Climate change has far-reaching implications for the way Asia needs to move forward: dramatically increasing energy efficiency and reducing reliance on fossil fuels; adopting a new approach to urbanization by building more compact and eco-friendly cities; relying much more on mass transit for urban dwellers and railways for long-distance transport; and changing lifestyles to alleviate pressures on finite natural resources.

**Governance and institutions.** The recent deterioration in the quality and credibility of national political and economic institutions (illustrated by rising corruption) is likely to become a binding constraint to growth in Asia. High-quality institutions will help fast-growing converging economies avoid the Middle Income Trap, and slow- or modest-growth aspiring economies to establish the basic institutions for moving toward sustained economic growth. Throughout Asia, an expanding middle class will exert new demands for greater voice and participation, greater accountability for results, and greater personal space. Although daunting, eradicating corruption is critical for all countries to maintain social and political stability and retain legitimacy. These common challenges all require effective governance, both at central and local levels. Asia must retool its institutions with an emphasis on transparency, accountability, predictability, and enforceability.

These intergenerational issues apply to most Asian economies, but their relative priority will vary over time, depending on the group a country belongs to at a given time.

**High-income developed economies.<sup>1</sup>** This group of seven economies—especially Japan, Republic of Korea, and Singapore—should lead the rest of Asia in two areas: making the scientific and technological breakthroughs that are crucial to Asia; and moving beyond high economic growth toward promoting broader social well-being.

**Fast-growing converging economies.<sup>2</sup>** Avoiding the Middle Income Trap should be the main objective of this group's eleven countries. They should—in addition to further reducing inequalities and consolidating the fundamentals of development—train a world-class, skilled labor force and build credible and predictable institutions that protect property rights (physical and intellectual) and allow fair dispute-resolution. Constantly improving the business climate will be key.

**Slow- or modest-growth aspiring economies.<sup>3</sup>** The highest priority of this group of thirty one countries—which includes low- and lower-middle-income economies—must be to raise economic growth toward that in their more successful Asian neighbors. They should focus on the fundamentals of development: faster and more inclusive growth by reducing inequalities through better education for all; infrastructure development; and major improvements in institutions, the business environment, and openness to external markets.

## Regional cooperation

Regional cooperation (including integration) is critical for Asia's march toward prosperity. It will become much more important for a number of reasons: it will cement the region's hard-won economic gains in the face of vulnerabilities to global shocks; it could be an important bridge between individual Asian countries and the rest of the world; it can help those Asian economies that are rebalancing growth toward “internal” (domestic and regional) demand to fully open their markets to neighbors in the region; with development assistance, it can help reduce cross-country disparities in income and opportunities (which, if left unchecked, could generate instability or conflict); it can be a stepping stone for poorer countries to move up the value chain and maximize their growth potential; in technological development, energy security, and disaster preparedness, it can help respond better to global challenges, and yield significant synergies and positive spillovers; and, through managing the regional commons, it can contribute to Asia's long-term stability and peace.

Given its diversity, Asia will need to develop its own model that builds on its past positive

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1 Brunei Darussalam; Hong Kong, China; Japan; Republic of Korea; Macao, China; Singapore; and Taipei, China.

2 Armenia; Azerbaijan; Cambodia; PRC; Georgia; India; Indonesia; Kazakhstan; Malaysia; Thailand; and Viet Nam.

3 Afghanistan; Bangladesh; Bhutan; Cook Islands; the Democratic People's Republic of Korea; Fiji Islands; Iran; Kiribati; the Kyrgyz Republic; the Lao People's Democratic Republic (Lao PDR); Maldives; Marshall Islands; Federated States of Micronesia; Mongolia; Myanmar; Nauru; Nepal; Pakistan; Palau; Papua New Guinea; the Philippines; Samoa; Solomon Islands; Sri Lanka; Tajikistan; Timor-Leste; Tonga; Turkmenistan; Tuvalu; Uzbekistan; and Vanuatu.

experience: a market-driven and pragmatic approach supported by an evolving institutional framework that facilitates free regional trade and investment flows throughout Asia, as well as some labor mobility. An Asian economic community must be based on two general principles—openness and transparency. Openness will be a continuation of Asia's long-standing policy of open regionalism, a key factor in East Asia's past success.

Crucial for increased regional cooperation is strong political leadership. Building Asia's regionalism will require collective leadership that recognizes a balance of power among participants. Asia's major economic powers, like PRC, India, Indonesia, Japan, and Republic of Korea, will be important in integrating Asia and shaping its role in the global economy.

### **Global agenda**

Asia's growth and larger footprint in the global economy will bring new challenges, responsibilities, and obligations. The region will need to take greater ownership of the global commons. It will need to gradually transform itself from a passive onlooker in the debate on global rule making and a reticent follower of the rules, to an active debater and constructive rule maker. As an emerging global leader, Asia should act as—and be seen as—a responsible global citizen. When formulating its domestic or regional policy agenda, Asia will need to consider the regional and global implications. It will need to delicately manage its rapidly rising role as a major player in global governance non-assertively and constructively.

As Asia becomes the center of the global economy, it will be in its own interest that the rest of world also does well economically and politically. Peace and security throughout the world will be essential for its long-term prosperity. The Asian Century should not be Asia's alone but the century of shared global prosperity.

Asia's efforts to enhance regional cooperation must not be at the cost of its traditional openness to the rest of the world. Asia must adhere, as mentioned, to its long-standing strategy of open regionalism.

### **Asian Century vs. Middle Income Trap**

The agendas in this book—national, regional, and global—are wide-ranging and require far-sighted leadership. The region has to face up to the daunting opportunity that lies before it. How many countries will meet this challenge? The answer is unclear. Given this reality and uncertainties about the various drivers, the book postulates two quantitative scenarios with very different outcomes.

Most of the discussion is based on the optimistic Asian Century scenario. This scenario assumes that the 11 economies with a demonstrated record of sustained convergence to best global practice over the past 30 years or so continue this trend over the next 40 years and that a number of modest-growth aspiring economies will become convergers by 2020. In this scenario,

Asia will take its place among the ranks of the affluent on par with those in Europe today; some 3 billion additional Asians will become affluent by 2050. This is the desired or ideal scenario for Asia as a whole.

The Middle Income Trap scenario assumes that these fast-growing converging economies fall into that trap in the next 5–10 years, without any of the slow- or modest-growth aspiring economies improving their record; in other words, Asia follows the pattern of Latin America over the past 30 years. This is the pessimistic scenario and could be taken as a wake-up call to Asian leaders.

There will be a huge difference in the outcomes of the two scenarios. The economic and social costs of missing the Asian Century are staggering. If today's fast-growing converging economies become mired in the Middle Income Trap, total GDP in 2050 would reach only \$65 trillion, not \$174 trillion (at market exchange rates). GDP per capita would be only \$20,600, not \$40,800 (PPP). Such an outcome would deprive billions of Asians of a lifetime of affluence and well-being.

The possibility of a “perfect storm” cannot be ruled out in thinking about Asia through 2050. A combination of bad macro policies, finance sector exuberance with lax supervision, conflict, climate change, natural disasters, changing demography, and weak governance could jeopardize Asian growth. In this worst case—or doomsday—scenario, Asia could stumble into a financial meltdown, major conflict, or regionwide chaos well before 2050. It is impossible to quantify this scenario, but Asia's leaders must be aware of the potential for such a catastrophe and avoid it at all costs.

### **The intangibles**

Four overriding intangibles will determine Asia's long-term destiny. First is the ability of Asia's leaders to persevere during the inevitable ups and downs and to focus on the long term. The region's ability to maintain the current momentum for another 40 years will require continual adjustments in strategy and policies to respond to changing circumstances and shifting comparative advantages. This will place a tremendous premium on mature, far-sighted, and enlightened leadership. Second is the willingness and ability of Asia to emulate the success of East Asia to adopt a (so far) pragmatic rather than ideological approach to policy formulation and to keep a laser-like focus on results. Third is Asia's success in building much greater mutual trust and confidence among its major economies, which is vital for regional cooperation. And fourth is the commitment and ability of Asian leaders to modernize governance and retool institutions, while enhancing transparency and accountability.