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Bank of Japan

## **Realizing the Asian Century**

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the International Conference on The Future of Asia*

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## **1. Introduction**

Good morning. I am honored to be here today at the International Conference on the Future of Asia.

In the 45 years of my career, I have moved from the Ministry of Finance to Hitotsubashi University, the Asian Development Bank, and now to the Bank of Japan. But wherever I have worked, my focus has been on Asia, and I have always cherished my ties with my Asian colleagues. From this standpoint, I will first briefly touch upon economic developments in Asia, then move to the thrust of my speech today, which is the challenges to realizing the Asian Century and how these may be addressed, and close with how Japan can contribute to these efforts.

## **2. Economic Developments in Asia: Factors driving growth**

While developed economies have experienced prolonged economic downturns since the Lehman Shock and the ensuing global financial crisis, Asia has maintained a higher growth rate than any other region in the world, albeit with some slowdown. In particular, the growth of ASEAN economies has been outstanding, with a boost in economic growth in 2012.

I would like to point out three structural changes supporting the strength of the Asian economies. The first change is that the supply chain in Asia has been enhanced. An intra-regional supply chain network, covering not just finished goods but also other areas of the supply chain ladder such as raw materials and intermediate goods, has been established by the relocation of firms, thereby underpinning the global competitiveness of the region.

This integrated supply chain network would not have been possible without the second change I wish to point out, that is, trade liberalization, with the increase in FTA agreements between economies both inside and outside the region. This trade liberalization is most pronounced in the Korean and ASEAN economies. Intra-regional and cross-regional trade in ASEAN economies is growing much faster than the global average.

The third change is closely linked to the other two changes: the autonomous expansion of domestic demand with the increase in income reflecting increased production activities in the region. The expansion of domestic demand can be seen as a result of the Asian economies' rebalancing of their economic growth toward a more domestic-driven model from that based on foreign demand. In particular, the economic rebalancing in China to achieve "quality economic growth" deserves attention, as it is vital for China to maintain sustainable growth, and will have significant implications for all of Asia.

It should be noted that these three changes are not mutually exclusive, but rather intertwined. The shift from "Factory Asia" (as a manufacturing base) to "Consumer Asia" (as a consumption center) is expected to change the nature of the supply chain, stimulate new demand in Asia, and foster new industries.

### **3. Realizing the Asian Century: How to avoid the Middle Income Trap**

Looking ahead 30 to 40 years, we may well expect Asian economies to be even more prosperous. The Asian Development Bank, where I was President until this spring, published a report titled Asia 2050: Realizing the Asian Century in 2011. The report forecasts that Asia's GDP would comprise half of global GDP by 2050, which is about double the current share, on the condition that Asian economies maintain their momentum.

However, the rise of Asia is by no means preordained. The path will not be easy and requires more than just doing more of the same. The report warns of another future if the region cannot tackle its daunting policy, institutional, and governance challenges in a timely manner. In this pessimistic scenario, the region could fall into a Middle Income Trap and become stuck with low growth rates.

The concept of the Middle Income Trap originally pertained to resource-rich countries in Latin America and Africa that became middle-income economies by extracting and exporting their resources, but did not climb higher to become developed economies. Asian economies have risen from being low-income to

middle-income, not just by depending on natural resources, but by utilizing their human resources in the form of abundant labor to manufacture and export goods. But the question is whether high and sustainable economic growth can be maintained after passing the Lewisian Turning Point, where surplus labor from the agricultural sector is absorbed into the industrial sector and upward pressure is exerted on industrial sector wages. There are only four Asian economies, other than Japan, that have joined the league of developed countries with per capita Gross National Income of more than 10,000 USD since World War II: South Korea, Taiwan, Hong Kong, and Singapore, often dubbed the Four Asian Tigers. This shows how much more difficult it is for a middle-income economy to become a developed economy than for a low-income economy to become a middle-income economy.

The key lies in whether a middle-income economy has the ability to grasp its growth potential, and whether there are autonomous mechanisms in place to fully exploit its growth potential. I mentioned in the first part of my speech that the growth potential in Asia is high. With that in mind, in order to avoid the Middle Income Trap and realize high growth, Asian economies require not only robust macroeconomic policies, but also strenuous efforts to implement the necessary structural reforms in order to improve production inputs, such as labor, capital and technology, and to push their growth potential to new frontiers. The concrete measures will vary for each economy as they face a unique set of challenges, and each economy will have to make its own decisions. Nevertheless, there may also be common challenges such as liberalizing regulations so as to create an environment conducive to innovation, and strengthening economic governance in order to enhance transparency and social fairness. To add to this, improving education levels is crucial to making the best of human resources. I strongly believe Asia can overcome these challenges.

#### **4. Enhancing Regional Cooperation in Asia**

In discussing the Asian Century, the question naturally arises as to how its realization would contribute to the stability of the region and the global economy. There are many issues that Asian economies should tackle together as one.

Among constructive efforts, I would like to stress, as the governor of a central bank, the importance of regional financial cooperation.

The stronger network among Asian economies and closer ties with the global economy in terms of trade and investment obviously has its merits, but it also increases the risk of contagion to stress events in other regions, such as financial crises. It is also important to avoid becoming the source of stress that might endanger the stability of the global economy and financial markets.

In order to enhance resilience against shocks, as well as making the financial system more robust, it is important to build a regional financial intermediary system that is not solely dependent on foreign capital. In addition, enhancing the safety net as a backstop against a global financial crisis is also essential.

Asian central banks and financial authorities are actively engaged in sharing insights by exchanging information and opinions, as part of their efforts to increase the effectiveness of financial supervision. We are also committed to promoting the local currency-denominated bond markets so that the abundant savings of Asian economies can be utilized effectively within the region. One positive step towards enhancing the region's safety net is the current efforts to strengthen the Chiang Mai Initiative. If Asia succeeds in strengthening its own financial system, it can play an even more important role globally in designing new international financial architecture and discussing governance systems.

## **5. Conclusion: How can Japan contribute?**

To conclude, I would like to address the question, what can Japan do to contribute to the realization of the Asian Century? The answer to this question is not singular. As I mentioned earlier, Japan can contribute through trade, investment, and financial cooperation. Japan can also assert its identity as a member of the Asian region, to participate in the stronger regional ties and cooperation, through which Japan can achieve higher growth. This would be mutually beneficial for both Japan and other Asian economies.

In its early-April Monetary Policy Meeting, the Bank of Japan introduced a new

policy framework, Quantitative and Qualitative Easing (QQE), with the aim of achieving the price stability target of 2 percent in terms of the year-on-year rate of change in the consumer price index (CPI) at the earliest possible time, with a time horizon of about two years. The Bank believes this will lead Japan's economy to overcome the deflation that has lasted for nearly 15 years, and reinvigorate the economy, adding substance to Japan's efforts to contribute to the realization of the Asian Century.