

Economic Growth in Asia: Performance and Prospects

Montek Ahluwalia

Former Deputy Chairman of the Planning Commission of India



Asia deserves a special place in any narrative of global development for several reasons. It accounts for more than half of the global population; it once enjoyed a dominant position in the global economy until it was eroded by the industrial revolution in the West 250 years ago; it is the only region where some countries have, in modern times, made the transition from pre-industrial to mature industrialized economies, beginning with Japan and followed by Korea, Taiwan, Hong Kong and Singapore; and finally, it is where a wide range of emerging markets and developing economies (EMDEs) have been experiencing accelerated growth, with good prospects for the process to continue over the next two decades.

This paper focuses on the performance and future potential of Asian EMDEs, defined as in the IMF's World Economic Outlook (WEO) database.¹ The group is very diverse, including many small countries, but the aggregate performance of the group is obviously dominated by China, India, and the "ASEAN 5" which together account for 95 percent

of the GDP. The paper presents a brief summary of past trends and explores prospects for the future. It also comments on the domestic challenges these countries face in realizing their full potential and the implications of their growth prospects for global governance.

Past Trends

Table 1 shows the evolution of shares in global GDP (measured in PPP terms) of major country groupings between 1980 and 2013, with projections up to 2019 based on the IMF WEO forecast. It is clear that the EMDEs as a group grew faster than industrialized countries, increasing their share in global GDP from 30 percent in 1990 to 50.4 percent in 2013. The IMF projects this to increase further to 54.6 percent in 2019.

This is a major structural change in the global economy and is widely recognized as such. However, what is less recognized is the extent to which this is largely an Asian EMDEs story. The share of

TABLE 1. PERCENTAGE SHARES IN WORLD GDP (PPP)

	1980	1990	2000	2013	2019
Advanced Economies	69	69.3	63.0	49.6	45.5
EMDEs	31.0	30.7	37.0	50.4	54.5
Asian EMDEs	7.5	10.8	14.5	25.9	30.5
of which:					
China	2.2	3.8	7.0	15.4	15.3
Others	5.3	7.0	7.5	10.5	15.2
Latin America	11.4	9.5	8.8	8.6	8.4
Middle East and NA	5.4	4.9	4.9	5.0	5.2
Sub-Saharan Africa	2.7	2.4	2.0	2.6	2.9

world GDP originating in the EMDEs is estimated to increase by 23.8 percentage points between 1990 and 2019. As much as 19.7 percentage points, or 83 percent, is due to the Asian EMDEs. China, which has grown at 10 percent per year for three decades, is obviously the star performer in this transformation, accounting for half the increase in the EMDEs total share. However, as Table 1 clearly shows, the share of other Asian EMDEs has also increased significantly.

In contrast, the share of Latin American and Caribbean EMDEs has fallen steadily during this period, reflecting the fact that this region experienced lower growth than the world average. It grew faster than the industrialized countries but more slowly than other EMDEs. Sub-Saharan Africa experienced a decline in share up to 2000, with a reversal thereafter, but even so its share in 2013 was slightly lower than in 1980. The faster growth of African GDP in recent years is a welcome development but considering the high rate of population growth of the region, it cannot be said to signal a strong process of convergence in terms of per capita GDP.

These changes in GDP shares are mirrored by changes in the structure of trade, especially after 1990. As shown in Table 2, the share of all developing countries in world exports declined marginally from 31.7 percent in 1980 to 30 percent in 1990, but then increased to 45 percent in 2012. A similar

pattern is evident in import shares. The increases in trade shares of developing countries are less marked than in the case of GDP because of the use of purchasing power in measuring GDP, whereas trade flows are measured using market exchange rates.

As in the case of GDP, Asian developing countries contributed disproportionately to the structural change. Of the increase in share of trade achieved by developing countries between 1990 and 2012, Asian developing countries accounted for 88 percent in the case of exports and 87 percent in the case of imports. Once again, China played a lead role but, as shown in Table 2, Asian developing countries excluding China were impressively dynamic, much more so than developing countries in Latin America.

Future Prospects

It is tempting to speculate on what the global economy would look like if the trends observed thus far were to continue over the next decade or two. Such long-term forecasts have well-known limitations but, as Daron Acemoglu (2012) has put it, “...prediction about the future is often a vehicle for clarifying the challenges ahead and because it partly extrapolates from experience it also gives us an opportunity to take stock of the trends that have shaped our age.” It is in this spirit that we present a

TABLE 2. CHANGING STRUCTURE OF WORLD TRADE: PERCENTAGE SHARES

	EXPORTS			IMPORTS		
	1980	1990	2012	1980	1990	2012
Developed Countries	66.2	72.5	50.8	72.2	74.0	55.1
Transition Economies	4.2	3.4	4.6	4.0	3.9	3.4
Developing Countries	29.7	24.1	44.6	23.8	22.1	41.4
of which:						
(i) Asia	18.2	16.9	35.0	13.1	15.9	31.9
(ii) Latin America.	5.4	4.2	6.1	5.9	3.5	6.1
(iii) China	0.9	1.8	11.1	1.0	1.5	9.8
(iv) Developing Asia without China	17.3	14.9	23.9	12.1	14.5	22.1

Source: UNCTAD handbook of Trade Statistics.

forecast up to 2030, using the IMF WEO forecast up to 2019, and making further projections for the period 2020 to 2030 by modifying past trends in light of likely developments.

The modifications to past trends that are built into our forecast for the period 2020 to 2030 (see Table 3) are summarized below.

- (i) For advanced economies the IMF has projected growth of 2.3 percent per year for the period 2014 to 2019, which is much faster than the average of 0.7 percent achieved in 2008 to 2013. This optimism is perhaps justified as a phase of recovery from the prolonged low growth after the crisis. However, these economies face a number of structural constraints which are likely to keep growth low. These include the aging of their populations, the much higher expected costs of social security with not enough evidence of a willingness to face this problem, unresolved policy stresses in the eurozone arising from the adoption of a common currency without a common fiscal policy, and some slowing down in productivity growth. Keeping these factors in mind, we have projected growth in industrialized countries at 1.7 percent per year in the period 2020 to 2030. The U.S., of course, is likely to grow significantly faster, with the eurozone and Japan growing more slowly.
- (ii) The IMF projects Asian EMDEs to grow at 6.6 percent per year in the period 2014 to 2019. This is significantly lower than the growth experienced by this group in earlier periods. As shown in Table 3, Asian EMDEs grew at 7.4 percent in the 1990s, 8.5 percent in the period 2000 to 2007 and 7.6 percent in the period 2008 to 2013. Some moderation in growth rates of Asian EMDEs from the earlier high growth rates recorded by this group seem justifiable in view of the fact that China will slow down from the very high growth rates it was able to achieve earlier partly because China is entering a phase of declining labor force and partly also because the earlier export-based growth strategy implemented is no longer feasible. The IMF projects that China will grow at 6.9 percent in the period 2014 to 2019. We project a further slowing down to an average growth rate of around 6 percent in the period 2020 to 2030. However, China's slowdown is expected to be offset by faster growth in other Asian EMDEs.
- (iii) The IMF projects India to grow at an average rate of 6.4 percent in the period 2014 to 2019, reversing the slowdown experienced in recent years. We project an acceleration to 7 percent in the period 2020 to 2030. This may seem optimistic, but it must be kept in mind that India grew at an average rate of about 8 percent for several years up to 2010, after which growth dipped sharply. While the global slowdown explains part of the dip in India's growth after 2011, most of it was due to a number of domestic constraints which can be overcome through corrective policies. It may be noted that the projection of 7 percent growth is actually lower than current official targets.
- (iv) We project the group of other EMDEs (in Latin America, the Middle East and North Africa, sub-Saharan Africa and Europe) to grow at 4 percent per year over the period 2020 to 2030. This is significantly higher than their estimated recent performance (see Table 3) though lower than in the pre-crisis boom period. The critical assumption underlying our optimism is that these countries have built up institutional capacity for growth and this would help improve growth even if the traditional engine of the industrialized countries slows down.
- (v) The IMF projects all EMDEs to grow at 5.3 percent per year in the period 2014 to 2019. Our assumptions about Asian EMDEs and other EMDEs summarized above yield a growth rate of about 5.5 percent for all

TABLE 3. GROWTH RATE PROJECTIONS FOR DIFFERENT REGIONS

	Average Annual Growth of GDP For Different Periods				
	1990 to 1999	2000 to 2007	2008 to 2013	2014 to 2019	2020 to 2030
World	3.1	4.2	2.9	3.9	4.0
Advanced Economies	2.8	2.6	0.7	2.3	1.7
All EMDEs	3.7	6.6	5.4	5.3	5.5
Asian EMDEs	7.4	8.5	7.6	6.6	6.6
Other EMDEs	1.7	5.1	2.8	3.7	4.0

Note: Growth rates for the first four rows and the first four columns are from the IMF WEO database. The growth rates in the last column are author's projections. Growth rates for other EMDEs in the fifth row have been calculated as the implicit residual growth rate for this category given the growth rates for all EMDEs and for Asian EMDEs as reported in WEO, using the shares of Asian and other EMDEs in each year as the basis for deriving the residual.

EMDEs in the period 2020 to 2030. This is significantly lower than the growth achieved by this group in the pre-crisis period and a little lower than the growth rate achieved over the longer period 2000 to 2013 but is broadly in line with the assumption that a slowdown in China will be offset by an acceleration elsewhere.

It must be emphasized that the growth projections listed above are not derived from a quantitative model of the global economy and its constituent parts. They are at best a set of quantitative projections going 10 years beyond the IMF's WEO projections. However, they do allow us to examine what the world might be like if these projections, or something like them, are realized. In the rest of this section, we present the main conclusions that can be drawn from Table 3.

Perhaps the most robust conclusion is that the share of advanced economies in global GDP, which has been falling since 1990, will fall further from just under 50 percent in 2013 to 35 percent in 2030, and the share of EMDEs will probably rise to about 65 percent. This follows from the simple fact that EMDEs are likely to grow much faster than industrialized countries because of (a) the large "catching up" possibilities which exist and (b) the improved ability of the EMDEs to exploit this capability whereas the advanced economies are likely to slow down for the reasons discussed above. This is not very different from conclusions reached

by others engaging in long term forecasting based on past performance e.g. OECD (2012) and ADB (2011). Pritchett and Summers (2014) have raised the interesting issue that the principle of reversion to the mean provides a firmer basis for projection, which of course implies that countries that have done well in the past are much more likely to slow down. We reject this approach because it does not allow for structural changes underway which can lead to the differential performances over an extended period.

Since the Asian EMDEs are projected to grow faster than any other group, their share in global GDP is likely to rise to around 40 percent by 2030. With this development the share of Asia, including the industrialized Asian countries Japan, Korea, Taiwan, Singapore, Australia and New Zealand, will have expanded impressively from around 18 percent in 1990 to an estimated 43 percent in 2030.² This certainly vindicates the view that the 21st century will be Asia's century. However, this Asian resurgence also involves a substantial shift in the distribution of Asian GDP and trade towards the Asian EMDEs. Japan has experienced slow growth for two decades and its share has been falling steadily and will continue to do so. The other industrialized countries of the region—Korea, Australia, New Zealand, Singapore and Taiwan—are expected to have a higher growth rate than Japan, but they are all expected to grow more slowly than the Asian EMDEs. The share of Asian EMDEs in Asia's GDP is therefore set to increase substantially

from about 75 percent in 2013 to an estimated 88 percent of Asian GDP by 2030.

Our projections for different groups of countries add up to produce a global GDP growth of about 4 percent per year in the period 2020 to 2030. This is a little higher than the IMF forecast of 3.9 percent for 2014 to 2019, but it is not unreasonable if one allows for the impact of improved performance in the EMDEs. Given their increasing share in global GDP a modest improvement in EMDE performance could offset slower growth in the advanced economies. It is relevant to ask whether there are aggregate supply constraints that might force the world economy to slow down. Availability of energy is clearly one potential problem, and although falling energy prices from July to October 2014 make this look less of a problem than it did only a few months ago, there is no justification for complacency over a longer period. However, it can be argued that technological change related to the exploitation of renewable energy along with advances in energy efficiency could help overcome this constraint. We return to this issue later in the paper.

A key assumption underlying our projections in Table 3 is that the Asian EMDEs will continue to grow faster than other EMDEs despite the fact that China is expected to slow down. The past performance of this group certainly justifies this assumption, but while past performance is relevant, a credible case for continued faster growth has to be based on some structural strengths in these economies that distinguish them from others in terms of growth potential. The most important structural strength of Asian EMDEs is their

demonstrated ability to sustain much higher rates of investment than the other regions (see Table 4). High rates of investment produce a faster growth of capital stock, which leads to higher growth. This is the unconventional investment—growth linkage. Equally important is the impact on growth of total factor productivity because new technology is typically embedded in new machinery, and the rate of induction of new machinery is a function of the rate of investment. Moreover, general productivity growth is also often dependent on improved infrastructure, which also typically requires large investments.³

Underlying the high rates of investment in Asian EMDEs is another structural factor, namely the high rates of domestic savings. Table 4 shows that while savings rates have been rising in all regions, they have been consistently higher for Asian EMDEs and this differential is projected to continue. The IMF projects a savings rate of 43.1 percent for Asian EMDEs in 2019, but only 19 percent for the other two regions respectively. Low rates of savings would not matter from the growth perspective if it were possible to achieve high rates of investment despite lower savings by attracting large net foreign inflows. However, there are limits to the extent to which investment rates can be raised much above domestic savings rates for an extended period of time and experience suggests that excessive reliance on foreign inflows can generate vulnerability in the face of volatility. What this means is that a sustainable high investment strategy requires high rates of domestic savings and the Asian EMDEs have a big advantage in this respect.

TABLE 4. INVESTMENT AND SAVINGS RATES IN EMDES BY REGIONS (PERCENT OF GDP)

	1980		1990		2000		2013		2019	
	INV	SAV	INV	SAV	INV	SAV	INV	SAV	INV	SAV
All EMDEs	26.0	25.4	25.7	23.0	23.7	25.2	32.2	32.9	33.1	33.2
Asian EMDEs	28.8	24.8	32.7	30.0	29.6	31.5	42.7	43.8	41.6	43.1
Lat. America & Caribbean	24.3	21.6	18.2	18.8	21.1	18.5	21.3	18.5	21.9	19.1
Middle East and N. Africa	26.3	36.2	26.4	22.0	20.3	30.8	25.4	35.7	27.3	30.3
Sub-Saharan Africa	21.0	18.4	16.1	15.9	17.2	17.9	23.0	19.5	22.6	19.0

Asian EMDEs also benefit from several other structural features favoring growth. The major countries have (a) a dynamic private sector, with a growing capability to build global linkages, (b) a relatively young and in many countries still growing labor force which is increasingly becoming better skilled, and (c) a relatively well-functioning and well-regulated financial sector, dominated by banks but with growing capital markets in many countries, and an expanding role for other financial intermediaries. The state of infrastructure in many of these countries remains deficient but this is an area which is at the top of the policy agenda in most countries. Most of these countries have directed large investments toward modernizing their energy and transport-related infrastructure. Telecommunications and IT infrastructure have expanded impressively. Internet connectivity has lagged behind, but is now set to expand in most countries.

Since many of these favorable features also exist in other EMDEs, especially in Latin America, it is relevant to ask why they have not helped to push growth to higher levels. A plausible explanation is that the positive impact of these factors is enhanced in an environment where investment rates are high. It has become conventional in policy analysis to emphasize the role of economic reforms in increasing total factor productivity growth (TFPG), and therefore growth, and this relationship is indeed important. However, the potential gain from reforms is much greater in an environment where investment is also high. While reforms can themselves often stimulate investment, the relationship is not as automatic as is sometimes presented.

Policies to Realize Growth Potential

The projections summarized above provide grounds for optimism, but rapid growth in Asian EMDEs should not be taken as a preordained outcome. They only highlight the potential and there are many examples of countries having grown rapidly for a while and then hitting a new constraint. This is sometimes called the Middle Income trap but what it really means is that to sustain high

growth countries have to be constantly vigilant about creating a policy environment that would enable their growth potential to be realized.

The most obvious of these is the maintenance of macroeconomic stability as a precondition for strong growth. It is actually relevant for all countries and therefore for the Asian EMDEs also. In practice this translates into (a) keeping fiscal deficits under reasonable control to avoid crowding out in the short run and the build up of an excessive burden of government debt in the longer term, (b) ensuring that inflation rates remain moderate, which is a critical requirement for high rates of savings and effective intermediation of savings through the financial system, (c) ensuring that the current account deficit is contained at levels consistent with stable long-term external capital flows, (d) and ensuring that the financial system is well regulated and supervised, minimizing risks of systemic instability. Fortunately, Asian EMDEs have shown high sensitivity to these issues, especially in the aftermath of the Asian crisis, when financial stability and financial sector reform was given much prominence. There is good reason to believe that macro policy will remain broadly supportive in most important countries in the region.

Open trade regimes are also regarded as a critical requirement for achieving rapid growth in today's interconnected world and here too, Asian EMDEs have a good record. Of the major economies, India was traditionally more closed than others, but Indian policies have also changed and India is aggressively pursuing a "Look East Policy," which is reflected in several partnership agreements that incorporate a phased process of tariff reduction leading to free trade for most products over the next few years. Agreements have been signed with Japan, Korea and the ASEAN and also with South Asian countries. Negotiations are underway with the EU. Both the prospective scale of trade flows in Asia and the trends towards greater regional integration can be expected to stimulate growth.

An area where Asian EMDEs have not emerged especially successful so far is financial integration.

Asian EMDEs have not progressed in financial integration as much as they have in trade integration and this is an area where calibrated moves to develop an Asian market could yield significant efficiency gains. Since Asian EMDEs are characterized by high savings rates, it can be argued that the development of an Asian financial market could contribute to economic efficiency. Asian governments, corporate borrowers, pension funds and other long term investors could all benefit from a more active Asian capital market, which would also impart greater liquidity to Asian paper

Energy policy is another area which will pose a major challenge. Asian EMDEs are net energy importers and if growth takes place as projected, their energy demands will also grow. If domestic production of energy cannot increase sufficiently rapidly, import dependence will increase, putting a strain on the balance of payments and raising issues of energy security. Asian EMDEs have to respond by (a) reducing energy demand through massive efforts to increase energy efficiency (b) expanding domestic energy production to reduce excessive import dependence and (c) over the longer term shifting away from fossil fuels and towards greener energy sources. This calls for action across several fronts.

Increasing energy efficiency requires policies which, at the micro level, encourage households and firms to adopt energy efficient technologies combined with action at the “system level” which enables a shift in freight traffic away from roads to railways, shifting from private urban transport to public transport, adopting urban land use planning which minimizes the need to travel long distances and introducing building codes that will reduce the energy required to heat and cool buildings. Increased domestic production of green energy also calls for action at several levels. The cost of solar energy, and to a lesser extent also wind energy, is falling and this will help make these sources more competitive over time. However, increased reliance on these energy sources on any substantial scale presents the problem of dealing with the variability in supply. This calls for supplementary

investment in back-up generation capacity based on gas, introduction of smart grid features to help manage variability in supply, using advanced battery technology for storage of electricity and the like. All these involve costs and the extent to which renewable power becomes genuinely competitive on a full accounting basis will depend on how quickly the costs of all these components (and not just solar generation) can be passed on through higher energy prices.

Much of what needs to be done to reduce energy intensity lies in the realm of regulation and public action, such as setting energy efficiency standards, modifying building codes to encourage energy efficient buildings, and reorganizing the transport system to provide viable energy-saving alternatives. Achieving co-ordinated action in these areas, at a scale that can make a difference, poses many challenges if only because some of these areas are in the domain of the national government while others are in the domain of states or provinces, or even particular municipalities. Regulatory and public action needs to be supported by rational energy pricing which also poses a major challenge. In many countries the prices of oil, gas, coal and electricity are set below economic cost with the result that they provide insufficient incentive to consumers to adopt energy efficient options and also provide insufficient incentive to invest.

Ideally, prices of fossil fuels should not only cover their full economic cost, but also bear an implicit carbon tax to reflect the “unpriced burden” they impose on society in terms of carbon emissions. The surplus generated from this additional charge could be used to subsidize renewable energy and invest in system infrastructure to save energy.⁴ The adjustments needed to achieve this theoretical ideal are difficult to make in one “big bang” effort, but they can be phased in over a period of time and suitable provisions could be made to protect the poorest sections of the population. None of this is politically easy, but it is necessary and navigating these difficult waters will be a major test for political leadership in the Asian EMDEs.

The management of scarce water resources is another major challenge facing Asian EMDEs. Many Asian countries are now entering a period when it will not be easy to meet the demand for water generated by a growing population and a rapidly rising GDP. The problem is likely to be aggravated if climate change leads to greater variability in rainfall and more frequent occurrence of extreme events.

Meeting the water requirements of urban and industrial users could lead to serious conflict with rural areas unless agricultural practices change to reduce water intensity. In India, for example, about 80 percent of the fresh water available is used in agriculture. Fortunately, the intensity of water use can be cut in half for many crops just by using existing technology, but it is difficult to encourage farmers to shift to water-saving technology if water for agriculture continues to be underpriced. Part of the problem in India is that the legal framework of water rights is not well suited to deal with an era of water scarcity. There are no well-defined principles for settling disputes between different states on sharing the water of interstate rivers. At the micro level, a farmer has the right to pump out any amount of ground water from a well located on his own land. This has led to excessive extraction, well beyond the rate of recharge in many areas, lowering the water table and damaging the aquifer, leading to increasingly poor water quality. It also causes shallow wells, typically used by poorer members of the community, to dry up. The problem is compounded by the fact that in some parts of the country the electricity supplied to farmers to run their pumps is either free, or massively underpriced.

Cities also need to rethink their policy on water use. Too many cities in Asia allow untreated effluent and sewage to flow back into fresh water sources, polluting them for downstream users. A fundamental principle that must be politically enforced is that urban and industrial users extracting fresh water from rivers, lakes, or ground water sources, must ensure that the water returned to natural water bodies after use is treated to bring it to an

acceptable level. The real cost of water made available to cities and industrial users must therefore include not only the full cost of extracting and delivering the water, but also the cost of treating the return flow. These costs must be borne by the user. Large industrial users can be forced to bear the cost of treatment themselves. For cities, it calls for a major rationalization of water charges. There are legitimate distributional concerns about raising water charges for the poorer sections of the population, but these concerns can be met by having a structure which charges a low rate for use corresponding to the minimum needs of a household, with the loss on this account being compensated by a higher price for others. In practice, the situation in many countries is that water use charges do not cover even the full cost of extraction and delivery, with no accounting whatsoever for the cost of treatment before return.

Rapid growth of the type projected can only be sustained if the labor force has the skill level needed to achieve the levels of productivity which underlie an acceleration in growth. This problem is now clearly recognized in almost all Asian EMDEs and they are all committed to universal secondary education with an expansion in higher education. However, while access to school education has been made near universal, the challenge of improving the quality of education remains. There is also a need to give special emphasis to skill development to ensure that the supply of skilled labor matches the emerging demands in the labor market. Opinions vary on how this is best achieved, and individual countries will of course experiment, but there is general agreement that much greater involvement by employers is necessary in designing courses.

Finally, all Asian EMDEs will face major challenges in managing the pressures of urbanization as the level of urbanization increases. This is especially so in the large and heavily populated economies that will have to deal with a growing number of megapolises. Development of efficient and livable cities is a prerequisite for rapid growth since economies of agglomeration are important drivers of the

growth process. Globalization and the increased presence of multinational investors will place additional demands for developing well-serviced and functionally efficient cities. While there are some exceptional successes, the overall situation regarding the management of urbanization in Asian EMDEs remains seriously deficient with large parts of the population living in slums with inadequate access to basic facilities such as clean drinking water and sanitation. In many countries this will require a degree of devolution and political empowerment much greater than exists at present.

The list of policy challenges enumerated above is not comprehensive. Individual countries will have numerous sector-specific challenges that need to be met. However, the policy challenges set out above are of broader relevance and call for concerted effort out of the ordinary. While there are bound to be slippages on some fronts, it is necessary to achieve a critical degree of momentum in each of these areas to create an environment supportive of rapid growth.

Implications for Global Governance

The prospect of the share of Asian EMDEs in global GDP reaching 40 percent in 2030 raises the issue of the representation of these countries in institutions of global governance. Asian EMDEs are well-represented in institutions such as the G-20, which includes China, India and Indonesia. However, the G-20 is a consultative grouping. The representation of Asian EMDEs in international financial institutions such as the IMF, the World Bank and even the Asian Development Bank is not at all consistent with the share of global GDP they are projected to achieve. The need to increase the shareholding of international financial institutions in favor of developing countries to reflect changing economic power has been on the agenda for some time. It will gain prominence in the next decade especially with regard to the representation of Asian EMDEs as the larger countries in this group—China, India and Indonesia—increase in relative economic size.

Recent experience with such efforts is not encouraging. A relatively modest restructuring in IMF quota shares was agreed in 2010 at the time of the last IMF quota review that would have increased the share of developing countries and other under-represented countries by a few percentage points and reduced the number of European seats on the board by two. The G-20 at the summit level endorsed this initiative and set a deadline for implementation by December 2012. However, it has not been possible to do so because the U.S. administration has not been able to get congressional approval to ratify the increase. Without U.S. ratification it is not possible to reach the 85 percent majority needed to implement the proposal.

The failure to ratify the quota increase means the IMF doesn't have quota-based resources to provide a credible safety net to deal with a major international crisis involving many countries. Such a crisis cannot be ruled out given the potential volatility of capital flows and the inadequacy of the IMF to deal with such a situation damages its credibility as the international lender of last resort. The IMF has recognized the limitations placed upon it by emphasizing the need for building broader safety nets than the IMF can provide and in this context has emphasized the importance of building larger foreign exchange reserves and entering into regional reserve-pooling arrangements such as the Chiang Mai initiative. However, pushing developing countries to build larger reserves, which is contractionary from the point of view of global demand, is hardly the right approach at a time when the global economy suffers from demand deficiency. In effect, a political unwillingness to take modest steps towards reform has produced a situation where the effectiveness of an important international institution is jeopardized.

A similar situation confronts the World Bank. There is universal agreement that expanded investment in infrastructure in emerging and developing economies is not only necessary for the emerging markets to create supply-side conditions favoring higher growth, but would also strengthen the much-needed aggregate demand in the global

economy. However, the bank is simply not in a position to respond with significant financial support for such investment. The net lending of the World Bank is down to a little over \$10 billion per year, which is much smaller than the absorptive capacity of the emerging markets. There is a view that there is enough private capital in the world to fund infrastructure projects in developing countries provided these projects are well-conceived and supported by a sound policy environment, and it is these deficiencies rather than a lack of financing that holds up investment in infrastructure. However, this ignores the fact that the ability to expand multilateral lending, possibly in support of public private partnerships in infrastructure, would lead to reduced risk perception on the part of financiers and would also help to create the policy environment needed. A larger role for Asian EMDEs in the World Bank would help push the institution to be more responsive on this issue.

Similar problems affect the Asian Development Bank (ADB) where 27 industrialized country members (including European Union members and the United States) have 67 percent of the voting share. This was broadly consistent with their share in global GDP in 1980 but if their share declines to 35 percent by 2030 as projected earlier in this paper, it is reasonable to ask why there should not be a commensurate change in voting power with a much greater role for the Asian EMDEs. The point is especially relevant for the ADB since Asia has a high rate of savings and a restructured ADB would effectively be relying on the Asian and Middle Eastern savings pool to mobilize resources. The ADB could take the lead in the restructuring of international financial institutions if Japan were willing to take the initiative.

Restructuring existing institutions is always difficult since incumbents are understandably unwilling to allow their dominant position to be eroded. However, inflexibility in responding to changed circumstances only leads to the institutions themselves becoming irrelevant or being bypassed by new institutions. The decision by the BRICS group to establish a new multilateral development bank,

and the decision of the Chinese government to establish a new bank for infrastructure, with the participation of many emerging market countries exemplify this phenomenon. Since the major shareholders were not willing to expand the World Bank's capital and scale of multilateral lending, the BRICS countries resorted to the only alternative available that was to set up a new institution. It is possible to argue that if these countries had the option to contribute their capital subscriptions to an expansion of the capital of the World Bank, with an associated change in voting structure to reflect their contributions, they may well have opted for this alternative rather than setting up an entirely new institution.

To summarize, the prospects for Asian EMDEs are very positive, provided appropriate policy actions are taken to support the high growth of which these countries are capable. Given the record of steady improvement in policies in most Asian EMDEs, it is reasonable to expect that the policy actions needed to achieve this result will be implemented on a reasonable scale. This means Asia's role in the global economy is set to increase substantially, and within Asia the weight of what are today called EMDEs will increase. Accommodating this structural change in the formal institutions of global governance will require the advanced economies of today to make sufficient room for the new actors. While this is not disputed, it is not at all clear that there is a political will to do what is necessary. However, failure to act will only erode the credibility of established international institutions and lead to them being replaced by new institutions. A proliferation of institutions is not at all optimal. What would be best is if existing and established institutions are restructured to reflect changing realities. Unfortunately, there is not enough evidence of the political will that is necessary to achieve this result.

References

- Acemoglu, Daron. 2012. "The World Our Grandchildren will Inherit: The Rights Revolution and Beyond" Palacio-Huerta, I. (ed) *Economic Possibilities For Our Grandchildren*. MIT Press.
- ADB. 2011. "Asia 2050 Realizing the Asian Century."
- OECD. 2012. "Looking to 2060: Long Term Global Growth Prospects."
- Pritchett, Lant and Larry Summers. 2014. "Asiaphoria Meets Regression to the Mean." NBER Working Paper No 20573. <http://www.nber.org/papers/w20573>
- IMF WEO Database. 2014. accessible at www.imf.org

Endnotes

1. The IMF definition excludes a number of emerging market countries of the Middle East that are geographically a part of the Asian continent but are grouped under Middle East and North Africa. Unfortunately Pakistan and Afghanistan, both unambiguously South Asian countries, are also in that group and not included as Asian EMDEs. Data used in this paper are from the

IMFs WEO Database (2014).

2. This is broadly consistent with the estimates of ADB (2011) which projects the share of Asia in global GDP to be 50 percent by 2050. The slowing down in the rate of increase in Asia's GDP will slow down after 2030 as the scope for convergence is progressively exhausted.
3. It may be thought that the high rates of investment for all Asian EMDEs in Table 4 is bloated by the very high investment rates in China, but even if China is excluded, other Asian EMDEs such as India, or the ASEAN 5, have much higher rates than those prevailing in other regions.
4. Logically, such otherwise optimal outcomes are unlikely to be realized by countries acting on their own simply because the benefits of emissions avoided accrue to all countries, whereas the cost is borne by the country imposing the additional tax. It is only as part of a global compact in which all countries act together that we can expect sufficient action and that too depends on a global agreement on burden sharing. The lack of progress in the UNFCCC negotiations on the issue of burden sharing illustrates the practical difficulties that arise.