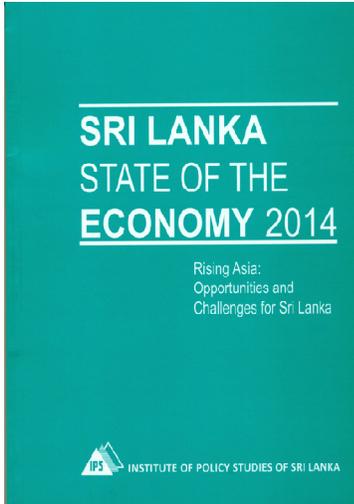


## RISING ASIA: OPPORTUNITIES AND CHALLENGES FOR SRI LANKA



It is now generally accepted that the 21<sup>st</sup> century will see Asia continue to emerge as the power house of the global economy, building on the remarkable socio-economic progress seen in the region over the last 50 years. Asia's rise is exemplified by its increasing contribution to the world economy which has grown from one-fifth to about one-third of world GDP at present, and is expected to increase further to over 50 per cent by 2050<sup>1</sup>. Some have called this possibility the 'Asian Century'.

The region is already the most populous in the world, and in the 21<sup>st</sup> century, it is expected to be home to the largest middle class in the world, providing much of the momentum for the global GDP growth<sup>2</sup>. Asia will not only be the largest consumer of goods, but also the largest producer of goods and services, influencing global trends. These developments are likely to have profound implications for countries right across the world, including Sri Lanka. As the centre of global gravity shifts to Asia, Sri Lanka – strategically located in Asia next to the Indian subcontinent, and in close proximity to Southeast Asia – will have sizable economic opportunities to explore in its own backyard.

### A Rising Asia in the Global Economy

On many dimensions, Asia is booming. Asia's performance has been the best in the 21<sup>st</sup> Century with the incomes of developing Asia at nearly US\$ 5,000 (PPP) in 2010, growing by

9.4 per cent between 2000 and 2010. Investment rates reached a high of 35 per cent of GDP over the last decade, while the exports grew by 11.4 per cent. Net inflows of private capital averaged US\$ 83 billion a year, while external debt fell to 14.5 of GDP. Asia has accumulated huge foreign exchange reserves in excess of US\$ 3.5 trillion.

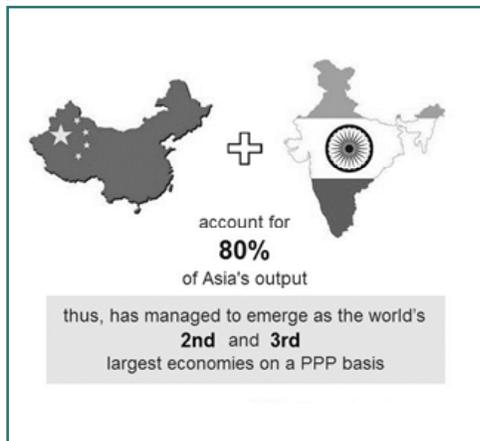
Asia's growth is increasingly being driven by the large economies of China and India which have emerged as the world's second and third largest economies on a purchasing power parity (PPP) basis. Asia's contribution to world output growth will largely be the result of sustained growth by China and India. They are expected to grow rapidly, albeit at a slightly slower pace compared to the past decade.

Consequently, world output which was largely dominated by advanced economies is shifting to emerging and developing Asia, with the Asian region catching up in terms of both PPP and current US dollar terms, and accounting for an increasing share of world output. Asia's share of global output has increased from 7.5% in 1980 to 23% by 2010, and is expected to reach around 30% by 2019. If the region continues to grow on its present trajectory, Asia could account for more than a half of global GDP by 2050<sup>1</sup>.

Per capita GDP in emerging and developing Asia too has recorded high growth rates during the past three decades. It increased from US\$ 411 to US\$ 5,227 over the period 1980-2010<sup>2</sup>. With rising in incomes and

people escaping poverty, Asia's low income earners have been gradually progressing to the middle income class over the past couple of decades. Although the proportion is relatively small compared to other parts of the world, Asia's middle class (defined as those consuming on average between US\$ 2-20 per day), has grown from 21% of the region's population in 1990 to 56% by 2008<sup>3</sup>. Consequently, Asia has emerged as a region with the largest number of a middle class population in 2008 with 1.9 billion of emerging Asia's population in the middle class category. The figure is projected to expand to 59% by 2030. The rising middle class is expected to bring about higher expenditure and consumption patterns.

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Developing Asia's rapid economic growth has also raised the region's importance in world trade, FDI and aid. Asia's share in world trade has been growing vigorously over the years; exports and imports from the region have grown at twice the rate of the rest of the world over the past three decades. Asia's economies are increasingly vital not only to the world but to each other. As Asia's economies have grown larger, they also have become more integrated – through trade, financial flows and direct investment. However, increasing integration in the region is mostly confined to East Asia.

With regard to FDI, Asia's role as a source of investment as well as a destination has been strengthening. Both inward and outward flows in advanced economies have slowed during the past three decades, while FDI flows to developing Asia have picked up. In fact, FDI inflows to the Asian region now account for 15% of total global inflows, up from 11% in 1980<sup>1</sup>. Similarly, FDI outflows from Asia have grown but at a faster pace after 2005, and the region has increased its share to almost 10% of outflows in 2012. Aside from trade and FDI, emerging Asian countries have become important sources of aid and development finance as countries in the region compete for natural resources and regional and global influence.

### Major Challenges Confronting Emerging and Developing Asia

As Asia continues to grow and converge with average global living standards, there will be risks and challenges the region will have to overcome to sustain its growth momentum to realize the Asian Century. The notion of the Asian Century assumes that Asian economies can maintain their present growth momentum for another 40 years, whilst adapting to changes in global economic and technological environment, and recreate comparative advantages on a continuous basis. Alternative scenario to the Asian Century is the 'Middle Income Trap' scenario, where countries will fail to make a timely transition from resource-driven growth with low cost labour and capital to productivity-driven growth. Under this scenario, Asia would fall far short of the Asian Century and the costs would be staggering; total GDP in 2050 would reach only US\$ 61 trillion and not US\$ 148 trillion, and GDP per capita (PPP) would be only US\$ 20,300, as opposed to US\$ 38,600<sup>1</sup>.



While Asia's rapid growth in recent decades has lifted hundreds of millions out of extreme poverty, the region still remains home to two-thirds of the world's poor, with more than 800 million Asians still living on less than US\$ 1.25 a day and 1.7 billion surviving on less than US\$ 2 a day<sup>2</sup>. Moreover the gap between Asia's rich and poor has widened alarmingly in the past two decades. In many countries, the richest 1% of households account for close to 10% of total consumption, and the top 5% account for more than 20%. Hence, the opportunities generated by rapid economic growth have not been equally shared by all, and could threaten social cohesion and political stability within countries.

Another most visible side-effect of Asia's rapid growth has been issues related to environmental degradation and urbanisation. Over-exploitation of natural resources, such as water, land, energy, forestry, and fisheries, has resulted in degrading air quality and eco-systems, reducing the supply of clean water, and creating significant health hazards. The detriments of urbanization in the region has included pollution, congestions, waste management, housing issues and over-burdened infrastructure.

### Implications of Emerging Asia for Sri Lanka

With Asia becoming not only the largest consumer, but also the largest producer of goods and services, Sri Lanka should seize new and expanding opportunities that will come with it – opportunities in trading goods and services that would benefit Sri Lankan businesses and consumers alike. Moreover, it will provide an opportunity for Sri Lanka to diversify its dependence away from industrial economies, reducing its susceptibility to developments and imperatives in these markets. Sri Lanka stands to benefit from strengthening trade relations with Asia considering the demand prospects for its major exports to the region, combined with its geographic proximity. The country not only has a potential to expand trade in goods with the rest of the Asian region, but also in services where Sri Lanka has a comparative advantage in producing and exporting travel, transportation, computer and information, communication, and insurance services.

While Sri Lankan businesses should take the lead in reaping the opportunities of emerging Asia, the government should also support such efforts by reducing the cost of doing business at home, removing unnecessary barriers to trade, attracting foreign investment, and better integrating the country with

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regional markets. In this context, it is vital that Sri Lanka deepens and broadens its engagement with Asia in the years to come. Sri Lanka should engage with the region not only economically, but also politically, culturally and socially. Improving people-to-people contacts could unlock large economic gains.

<sup>1</sup> ADB (2011), Asia 2050: Realizing the Asian Century, Asian Development Bank, Manila.

<sup>2</sup> Lee Kuan Yew (2014), "Congratulatory Remarks" at the 20th International Conference on the Future of Asia "Rising Asia - Messages for the Next 20 Years", 22-23 May 2014, Tokyo. Available at: <http://future-of-asia.nikkei.jp/asia2014/eng/message.html>

<sup>3</sup> ADB (2011), "Asia 2050: Realizing the Asian Century", Asian Development Bank, Manila.

<sup>4</sup> IMF, "World Economic Outlook" database available at: <http://www.imf.org/external/pubs/ft/weo/2014/01/weodata/index.aspx>

<sup>5</sup> Chun, N. (2010), "Middle Class Size in the Past, Present, and Future: A Description of Trends in Asia", ADB Economics Working Paper Series No 217, Asian Development Bank, Manila.

<sup>6</sup> UNCTAD (2014, "Global Investment Trends Monitor" No.15, available at [http://unctad.org/en/PublicationsLibrary/webdiaeia2014d1\\_en.pdf](http://unctad.org/en/PublicationsLibrary/webdiaeia2014d1_en.pdf).

<sup>7</sup> ADB (2011), "Asia 2050: Realizing the Asian Century", Asian Development Bank, Manila.

<sup>8</sup> Kuroda, H. (2013), "Asia's Challenges", OECD Forum, available at <http://www.oecd.org/forum/asia-challenges.htm>