

Reading Comprehension

Task : *What reforms should be implemented in the context of existing challenges to sustain Asia's leadership in global growth?*

Sustaining Asia's Momentum: Time for reform

Asia has led global growth for the past several decades, with an average rate of close to 6 percent since 1990. If the current trend continues, Asia's economy will be larger than that of the United States and the European Union combined in less than two decades.

While Asia's future appears bright, its success is not guaranteed. It depends crucially on choosing the right policy mix to contain risks and secure growth. In the near term, the region faces some emerging vulnerabilities and may continue to be hit by volatility in global markets.

Resilience and growth

The year 2013 witnessed several waves of global financial volatility, leading to a pullback in capital flows from emerging markets, including in Asia. But Asia has remained broadly resilient to global risk. Swift actions taken to address vulnerabilities are starting to bear fruit, and the growth momentum is set to continue.

Asia is projected to grow at 5.5 percent in 2014 and 5.6 percent in 2015, retaining its global growth leadership. Exports will pick up as the recovery continues in advanced economies, while domestic demand across the region will be supported by healthy labor markets and strong credit growth.

With continued tightening of global liquidity as tapering of the U.S. fiscal stimulus proceeds, Asia will face somewhat higher interest rates and surges of capital flow and asset price volatility, but overall financial conditions should remain broadly supportive.

There are, as always, risks to this prognosis. Further tightening of global financial conditions remains a threat. And the impact of higher global interest rates could be strengthened by rising household and corporate debt in some parts of the region.

If these risks took place, they would likely moderate, rather than halt, momentum in the region. But deeper structural challenges could create more difficult obstacles for countries across the region as they pursue sustained growth. Asia faces some particular challenges.

Improving institutions and governance: In much of Asia, institutions and governance have not caught up to those of advanced economies as quickly as other aspects of economic development. Strengthening the rule of law will enhance resource allocation and productivity. Relaxing tight product market regulations—high barriers to entry, in particular—could boost innovation and efficiency. In a number of cases, this will require tackling the dominance of state-owned enterprises—as planned for instance in China and Vietnam. Easing tight job protections for regular workers while putting together an unemployment safety net, for instance in India and Indonesia, could help stimulate job creation in the formal labor market.

Coping with an aging Asia: A demographic transition in East Asia contributed substantially to the region's economic miracle in the second half of the 20th century. But having benefited from favorable demographics earlier, many Asian economies will see a substantial rise in the dependency ratio over the next few decades, which will tend to reduce growth and raise governments' spending burdens.

India, in contrast, will enjoy a demographic dividend—its dependency ratio is projected to fall by 8 percentage points by 2030—as it will in the Philippines and lower-income Asian economies. These countries will face a different challenge: finding good jobs for the rapidly growing pool of workers and ensuring that the dividend does not instead become a burden.

Prudent policies can help decrease the adverse effects of demographic trends. Asian policymakers should both adapt and fight back. They can adapt by building age-proof pension systems to ensure that retirees are protected by an adequate social safety net and to encourage labor force participation by seniors. They can fight back with productivity-enhancing reforms.

Curbing rising inequality: Finally, rising inequality is both an important social and economic issue. In fact, high levels of inequality can limit overall growth. Inequality in Asia is still generally below what it is in Latin America and sub-Saharan Africa, but incomes in Asia are diverging faster than in these other regions. While these other regions saw a reduction in inequality, in Asia the disparity has widened over the past two decades.

The right policies can help curb rising inequality without threatening Asia's growth model—as was the case in Asia during the three decades leading up to the 1990s. Policies to ensure more equal access to public services—notably education and healthcare, enhance public infrastructure, and broaden access to finance can raise growth and improve equity.

Promoting financial development: With its impressive number of assets—sound macroeconomic policies, high saving, rising education, still unused labor resources, and fast technological progress—Asia has the right ingredients for sustaining growth.

But to combine these ingredients effectively, there is an urgent need to promote capital market development and reduce the heavy reliance on bank-based financial intermediation. Important steps include diversifying the domestic investor base in the region through the expansion of pension and insurance funds, enhancing financial literacy, and improving disclosure and accounting standards within the region.

With successful implementation of these steps, Asia's financial sectors will be ready to meet the demands of the real economy.

An Asian century?

Some say that the 21st century will be an Asian century. And there are good reasons to think this. But simply extrapolating from the strong economic performance of recent decades can be misleading. To achieve their full potential, Asian countries will need to clear a number of major obstacles.