Developing Asia needs a New Economic Paradigm*

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The euphoria around emerging markets faded a while ago, but somehow the hope persists that economies in Asia can buck the global trend and grow fast enough to create an alternative growth pole. It is true that the global financial crisis and its aftermath proved that Asian "decoupling" is a myth, and the ongoing trade-cum-technology war instigated by the U.S. against China does not generate much optimism about immediate prospects for China as the dominant economy in the region. But it is a season for grasping at straws.

The basic problem is the inadequacy of effective demand in the global economy, reflecting decades of wage suppression that have left wages falling well short of productivity growth. The lack of demand growth in turn has reduced the incentive to invest in productive assets. So, instead of investing more, big capital competes for the rents that can be sucked out from intellectual property rights and various forms of market manipulation.

Developed countries are not providing net demand stimulus to the global economy, as they run current account surpluses or smaller deficits. Europe is increasingly responsible for global current account surpluses, as Germany forces the rest of the eurozone to become mercantilist in its own image. So where will the required new demand come from for global capitalism? Can developing Asia take up the global demand slack?

Unfortunately, that now seems unlikely, unless the economic model that underpins growth strategy in most of the region changes dramatically. The slowing growth in much of the region points to the limits of the existing strategy, and the fragilities that it has generated.

During the global boom, Asian economies focused on exports as the engine of growth, and this worked in their favour as long as the United States drew in more and more net imports (ironically financed by savings from the rest of the world, especially these same Asian countries). China became the hub of a regional production network oriented towards exporting to the Global North, drawing in much of the region (as well as other developing regions) in ever-stronger links that made intermediate trade dominate in intra-Asian trade.

After the global crisis, the strategy changed. As exports markets declined or languished, there was little choice but to look for other, regional or domestic markets. All while China served as the survivor and reviver, through its stimulus policies that also expanded exports from the region. But even so, these other Asian markets expanded on the basis of growing debt rather than rising wage incomes. This was both external and domestic debt – especially directed towards retail credit for housing and real estate, and to the bank credit to the construction industry.

External debt provides an additional source of vulnerability for developing countries. Total cross-border and foreign currency denominated debt of Asian developing economies increased from $375 billion at the end of the first quarter of 2007 to $1.394 trillion by the first quarter of 2019. And much more of it is now in the form of bonds held by private non-bank investors. By the last quarter of 2018, the share of total external debt held as securities by non-banks increased was 58 per cent in Indonesia and 63 per cent in the Philippines. In Thailand it had increased to 22 per cent from 14 per cent six years previously, while for India the increase was from 7 to 21 per cent over the same period. Bond markets are notoriously fickle and can experience large swings on relatively small changes in perception, so developing countries with such exposure can experience problems at much lower levels of debt to GDP ratios.

Indeed, the risks inherent in such reliance have been evident as net cross-border capital flows have become more volatile and turned close to negative for many Asian countries. Net outflows from China were significant between early 2014 and mid 2017, though they have since stabilised. But the rest of the Asian region as a whole also shows decreasing net inflows.

This both reflects and amplifies the problems evident on the trade front. Asian exports had been decelerating well before Mr Trump entered the scene: after the recovery from the global crisis, trade growth declined from 2014 and had only recently recovered. Meanwhile the dependence of the rest of Asia on trade with China remains high, but on less favourable terms. As exports to the North stagnate and decline, China is relying more on developing Asia as a market and China's trade surpluses with the region are increasing.

So China is rebalancing and learning to cope with threats posed by US trade wars – but this need not be good news for the rest of developing Asia. The diversion of trade by US may benefit some countries (like Vietnam and Philippines) now, but the net effects of the trade war are still not clear even for them. Deceleration of export earnings and stagnant global markets make it harder to earn foreign exchange and rely on external demand. Levels of "self-insurance" through large foreign exchange reserves are also coming down. Essentially, even if most of developing Asia were no longer to rely on export-led growth, some rejuvenation of global demand is still absolutely essential for a sustained recovery in the region.

Meanwhile, two features of the previous growth are generating growing problems: the ecological damage and growing inequality of assets and incomes. Carbon emissions are being addressed more actively through an emphasis on renewable energy, especially in China. But the impact of climate change is already evident across the region, and mitigation and adaptation measures are inadequate. Atmospheric pollution is now the worst in India but widespread across Asia; water pollution and scarcity have become so marked that water wars may define the future; declining soil quality and disappearing forests and natural habitats point to the over-exploitation of nature. At the same time, increasing inequalities are not just unjust, but are creating unpleasant societies with growing social tensions, as different forms of violence based on social divisions (gender, ethnic group, caste, etc) emerge or becoming more widespread. These can even spill over into geo-political insecurity and threats of war.

A feasible alternative strategy would have to address these, as well as the fact that structural transformation still inadequate in most countries, other than a few successful outliers in east/southeast Asia. Jobless growth in several countries has been compounded by recent job losses, particularly evident in India, along with persistent and growing informality in labour markets. This generates further negative multiplier effects on economic activity, even as concerns with fiscal discipline prevent countercyclical measures or the required public investments to cope with climate change and environmental concerns.

All this cries out for a 21st century version of a New Deal and a Marshall plan, ideally as part of a co-ordinated Global Green New Deal. The US New Deal, as well as the Marshall Plan, had three crucial aspects: recovery, redistribution and regulation. The plan for recovery relied on massive fiscal stimulus, and was characterised by speed, scale and generosity. Redistribution was achieved through fiscal policies, through employment generation and through regulation of capital, labour and land markets. All of these were crucial in reviving global demand in mid-20th century – but all of these are currently missing from the policy agenda today. China's outward reach in the Belt and Road Initiative is positive but inadequate in these respects.

Developing Asia would be a major beneficiary of a Global Green New Deal: a co-ordinated push with a major role for public investment in "green" infrastructure and activities as well as employment-generating care activities. This will not happen through incentivising private investment through Public-Private Partnerships and "innovative" financing deals, as currently proposed by OECD and G20. Instead, enhanced public spending can be financed by enhanced public revenues through greater tax co-operation especially for taxing MNCs (including digital companies) based on the unitary principle with formula-based distribution, as proposed by ICRICT. There is also a big potential role for central banks and development banks, as UNCTAD is highlighting. Redistribution and regulation have to be essential elements of this alternative but necessary strategy. Even if global agreement is hard to achieve, regional co-operation is essential for this – and may actually be feasible in Asia.

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