

Preparing for the next Asia

Stephen Roach explains how the next two decades will bring dramatic changes to the region.

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Asia has proven comparatively resilient against the current downturn, but hurdles still lie ahead. In order to maintain robust growth rates in the face of weak US demand, the region's dynamic economies must stoke domestic consumption and embrace environmentally sustainable development policies. So says Stephen Roach, chairman of Morgan Stanley Asia and author of *The Next Asia: Opportunities and Challenges for a New Globalization*. In this video interview, Roach discusses prospects for increased integration and cooperation between the region's economies, explores the pitfalls and potential for countries like India and Japan, and considers whether the "Asian Century" has finally arrived. Clay Chandler, Asia editor with McKinsey's publishing group, spoke to Roach in Hong Kong in August 2009.

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Clay Chandler: We're joined today by Steve Roach, the chairman of Morgan Stanley Asia. Steve, thank you for being with us. You've been watching and writing about the dynamism in this region for many decades now. In your new book, *The Next Asia*, you write about how the region in the next 20 years will be much different than in the past 20 years. What's driving that change?

Stephen Roach: Well, Clay, I think the Asia of the past 30 years has done an extraordinary job—especially China, but, increasingly, the rest of the region—in lifting standards of living well beyond anything we've seen in the annals of economic development. But the drivers have been primarily export led. And there's been a lot of investment in the export platform that has been required to get that export machine to the state that it's at.

But this model is close to having outlived its usefulness. The next Asia will be more consumer led, will have a growth dynamic that places greater emphasis on the quality of the growth experience, especially in terms of environmental protection and pollution control.

Clay Chandler: If I'm the chief executive of a Fortune 500 company and I'm thinking about my global strategy, how do I need to be thinking differently about Asia than I might have been before the crisis?

Stephen Roach: I think global multinationals have, up until now, primarily viewed developing Asia—and China in particular—as an offshore-production platform. The offshore-efficiency solution is still an attractive option. But what really could be powerful would be a growing opportunity to tap the region's 3.5 billion consumers. This has been the dream all along of the Asian potential. But the consumer dynamic has largely been missing in action. And now, as it comes online, this is an extraordinary bonanza for global multinationals as well.

Clay Chandler: In *The Next Asia*, you strike a very optimistic tone. You note that Asia has always embraced change and that that's really been the secret of Asia's dynamism in years past. But the same thing was said in the wake of the Asian financial crisis in 1997. And yet by and large, most Asian economies went right back to the model that worked so well for them before the Asian financial crisis, a model that was heavily focused on exports and government-led investments. What's different about the economic scene today?

Stephen Roach: The external demands that underpin the export model are now in trouble. So even if Asia is the best and most efficient producer that anyone has ever seen, the external demand is not going to be there the way it was. So if Asia wants to keep growing, if Asia wants to keep developing, if it wants to keep raising the standard of living for its three-and-a-half-billion consumers, it's got to depend more on its own internal demand. So it really boils down to the fact that Asia's options have been narrowed in terms of economic development as never before. And it has no choice but to become more internally, rather than externally, dependent.

Clay Chandler: Let's talk for a moment, if we could, about India, the other big, growing economy in the region.

Stephen Roach: I think the micro has always been very positive in India: a large population of world-class competitive companies; a well-educated, English-speaking, IT-competent workforce; pretty good market

institutions; relatively stable financial institutions; rule of law; democracy. The micro has never been the problem.

What's really been the problem for India has mainly been the macro—inadequate savings; relatively limited foreign direct investment, especially when compared with China; and, of course, the horrible infrastructure. The macro has actually gotten better. In the last three to four years, India's savings rates have moved from the low 20s nationwide to the mid-to-high 30s, which is still short of China but a huge improvement for India.

Foreign direct investments accelerated dramatically—again, not up to Chinese standards, but a huge acceleration vis-à-vis where India has been historically.

And the third leg of the stool is politics. The mid-May election, by sweeping the Communist Party out of this new coalition, gives the reformers an opportunity to finally deliver on the promises they made five-and-a-half years ago, when they first took power. I think that India actually could be the real sleeper in Asia over the next few years. Just at a time when everybody is all lathered up and excited over a China-centric region.

Clay Chandler: You can't really talk about Asia's future without also considering the trajectory of its largest economy. That, of course, is Japan. The story there has been almost unrelentingly gloomy for years. But now we've got a new government.

Stephen Roach: Well, you know, Japan is an example of what happens when you take a very prosperous economy and allow it to experience the post-bubble aftershocks of a massive asset-led implosion.

But here Japan sits, 20 years into the post-bubble era, and it's not clear that it has really awoken from its long slumber, as you aptly put it. This is an economy that remains very much export dependent. Its two largest export markets, the US and China, are not providing much sustenance. The Japanese consumer is very constrained by demography, by unfunded pension liabilities. It still has a very high predisposition toward saving. There has been some capital-spending impetus in recent years but, again, it has largely been driven by a new export linkage into China, and that's on hold right now. And then finally, Japan has a horrific leadership problem. So the combination of structural problems, this long post-bubble hangover, leadership issues—it's hard to be too constructive on the Japanese economy going forward, I'm afraid.

Clay Chandler: How about prospects for greater integration and cooperation in Asia as a whole? In your book, you talk about the emergence of what you call a pan-Asian economic framework. What will that framework look like?

Stephen Roach: Well, I think the building blocks of that framework are starting to fall into place. There's been increased integration in a China-centric supply chain, with most of the large economies in the region—from Japan, to Korea, to Taiwan—now more dependent on exports to China than any of their other major trading partners, including Europe or the United States. So the logistics of an increasingly China-centric supply chain are starting to fall into place.

But here again, I would say that the real challenge for a pan-regional economic integration would be to shift the structure increasingly away from one that's externally led to one that's internally led. When the Asian consumer

starts to rise and is sourced increasingly by the Asian producer, that'll be the real, powerful synergy that I think can take this region to the next place.

Clay Chandler: Is it fair, do you think, to say that the Asian Century has finally arrived?

Stephen Roach: The central premise of my book, *The Next Asia*, is that it's a little early to crack out the champagne and declare the onset of the Asian Century. It's the stuff of great headlines and possibly documentary films, but the next Asia—an Asia which is more balanced, one that brings the Asian consumer into the equation—that's what the Asian Century needs. The Asian Century, in my view, is not a sustainable image if it's an Asia of producers or exporters selling things to others. The Asian Century is one where Asia produces to its home markets, rather than just to markets around the world. And until we see that, I think, again, that champagne is going to have to stay on ice for awhile.



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