

Asia Roundtable 2005**Singapore****Asia: Tilting the global balance**

The world's economic centre of gravity is shifting towards Asia. This transition is both a source of opportunity and risk for investors and business. The rapid growth in China and India is redefining trade patterns, altering the regional geopolitical order and forcing business and government to adopt new strategies.

Over 250 business and political leaders gathered in Singapore at the World Economic Forum's Asia Roundtable 2005 to examine the strategic implications of key regional concerns such as the growing scarcity of highly skilled workers, the societal impact of growing income disparities in China and India, the global contest for greater raw materials and the political fall-out from China's growing trade surplus with the West. Participants also highlighted emerging issues such as the region's failure to heal its deep historical wounds and the importance of addressing the continent's demographic and environmental challenges. Among the insights that emerged:



*Jiang Jianqing
Chairman and President,
Industrial and Commercial Bank
of China, People's Republic of
China*

Economy and trade

- The growth of China and India is fuelling a rapid increase in intra-Asian trade that is offsetting the region's exposure to economic cycles in the United States.
- Asia's increasing trade integration is a double-edged sword for companies. While free trade agreements provide new growth opportunities abroad, business leaders will also find that their home markets will be open to foreign competition as a result of new trade concessions.
- China's success at attracting foreign investment has, despite perceptions in the region, benefited Asia. Statistics indicate that increased investment in China is producing a corresponding, albeit smaller, rise in investment throughout the rest of Asia.
- Asia needs to develop more diverse means of financing, namely bond issues. The traditional reliance on bank lending and equity placements limits the ability of companies to raise capital. Debt which is evaluated by international rating agencies will help encourage better cash management and improve corporate governance.
- China's growing trade surpluses may trigger protectionist reactions in the West, as public concerns grow over the potential loss of jobs and market share. The private sector should encourage Western governments to focus on how their economies can benefit from Asia's rise, not obstruct it.

Geopolitics and society

- The potential for social unrest in Asia ranked as the number-one concern among participants. China's rapid growth has led to growing economic disparities between the interior and coastal areas. China is not alone with regard to the challenge of ensuring job growth in rural areas. India and other developing Asian nations all face the challenge of providing more equitable growth and preventing social discord.

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- Demographic changes pose one of the biggest long-term threats to Asian growth and stability, with China and Japan faced with rapidly ageing populations and India and Indonesia with growing numbers of young workers looking for gainful employment.
- The region's demand for more natural resources and new energy supplies risks fuelling inflation and constraining growth worldwide. To address this global problem, Asian nations need to develop a cooperative regional framework for securing energy supplies and developing alternative sources of energy.
- The pollution in India and China from inefficient energy practices and limited environmental control poses regional environmental and health risks. Asian governments need to adopt more efficient energy policies and encourage environmentally sound industrial processes. More government funding of research into new and cleaner technologies is also needed.
- Shifts in economic power have also drawn greater international attention to heated public protests linked to the region's history, particularly among China, Japan and Korea. It can no longer be assumed that growing economic ties will mitigate the risk that disputes rooted in history will not result in future conflict.
- Most participants rate the risk of armed conflict in Asia over the next five years as very low, despite the turmoil in the Middle East and North Korea's nuclear ambitions. The situation in the North could, however, give rise to increased militarization throughout North-East Asia, including the possibility of South Korea and Japan developing deterrent nuclear capabilities.

Corporate growth and governance

- Finding and keeping skilled labour is the top growth challenge confronting business leaders in Asia. There is intense competition for good employees throughout the region. Creating a strong brand or public image that employees are proud of can help offset offers of higher salaries from competitors.
- China's success is driving Asian companies and economies to find new ways to compete. This will ultimately make the entire region more competitive, but Asian companies need to increase spending on research and development.
- The creation of global supply chains has already established some Asian cities, such as Hong Kong and Singapore, as hubs for manufacturing and trade. New, competing regional hubs are also emerging, such as Incheon, Shanghai and Shenzhen. Making such hubs a success will require governments to entice companies with the right blend of infrastructure and incentives.
- Many Asian companies are still predominantly closely held, either by families or governments with Japan being a notable exception. Such companies need to adopt more rigorous corporate governance standards if they are looking to expand globally. However, many may opt to stick close to home, where standards of disclosure are lower and markets more familiar. Asia's rapid economic growth serves as a disincentive to reform for those that feel reform is not needed while revenues and profits are growing.

"The first and most major development is the emergence of China and India. This preoccupies every businessman and political leader in the world."

**Lee Hsien-Loong, Prime Minister
and Minister for Finance of
Singapore**

Assessing the impact of China's currency revaluation

Big picture

- The question of whether China should or will revalue its currency has been thrust into the spotlight by China's trade surplus with the US. However, many economists agree that letting the yuan rise against the dollar will have little effect in reducing the US current account deficit.
- China looks set to adopt a more flexible exchange rate regime, in part to stem rapid inflows of foreign investment and to protect against a correspondingly rapid outflow. Just when and exactly how flexible the new regime will be remains unknown.
- Any revaluation of the yuan must be evaluated in the context of China's larger efforts to reform and strengthen its financial system. Most companies have yet to understand the wider impact a revaluation would have in China and throughout Asia.

Context

Few experts expect China to allow its currency to trade freely, or 'free float', anytime soon. But it is likely to adopt a more flexible currency regime to advance macroeconomic goals and reduce the extent to which regulators have to control the money supply to ward off inflation.

China's leaders will move towards a more flexible exchange regime after considering three main areas of concern:

- i. Macroeconomic impact – trade, investment, inflation, employment
- ii. Microeconomic impact – implications for financial sector reforms and stability
- iii. Regional impact – how a revaluation would affect the rest of Asia

Financial sector reform is a critical precursor to exchange rate reform: financial institutions need to be able to weather less predictable exchange rate fluctuations. The massive recapitalization of Chinese state-owned banks in preparation for their privatization is part of this effort.

Strategic insights

- Rather than analysing when and how a revaluation might occur, businesses should instead focus on the larger implications for business and trade. For example, exporters may face immediate margin pressure, while consumer goods industries may benefit.
- Chinese corporations, especially those moving to do business overseas, need to adopt robust risk management systems to offset exchange rate risks.
- A revaluation would likely cause other Asian currencies to appreciate as well. With enhanced purchasing power and consumption, intra-Asia trade and investment would accelerate and enhance the region's economic integration. Revaluation may gradually reduce Asia's linkages with the US economy.
- Progress in financial reforms will serve as an indicator of an imminent revaluation. One key barometer will be whether state-owned banks manage to implement sound credit policies following their recapitalization.

Accommodating the new giants in the global economy

Big picture

- The growth of China and India is fuelling a rapid increase in intra-Asian trade that is offsetting the region's exposure to economic cycles in the United States.
- Supported by a pool of hard-working and increasingly well-educated workers, China has become an engine of growth for Asia and the global economy. The World Bank forecasts that China's economy will grow 8.3% this year, pushing East Asia's growth to 6%.
- Despite concerns that China was diverting foreign investment from the rest of Asia, recent figures show that shifting production across the region produces salutary effects. The Asian Development Bank Institute estimates that a 10% increase in foreign direct investment in China corresponds with a 5-6% rise in investment to the rest of the region.
- High savings rates ensure that Asia has sufficient capital to finance its own expansion. China alone has US\$ 659.1 billion in foreign currency reserves.
- Demographics pose long-term challenges to Asia's growth. Some economies, like China, Japan and Singapore, have ageing populations. Others such as India, Indonesia and Vietnam are struggling to find jobs for their rising numbers of young people.

Context

The United States may be the world's sole superpower, but China has emerged as a competing economic power. As the balance of trade tilts towards Beijing, countries throughout the world must reassess their role in the global economy.

China's rapid growth has strained supplies of key resources, including copper, iron ore, oil and natural gas. This has resulted in an increasingly tense competition to secure resource supplies and is altering the relationship between exporters and importers, such as Australia and China, and impacting bilateral relations between rival buyers, such as China and Japan.

While the shortage of resources has raised the risk that a single disaster could disrupt supplies, one of the greatest risks to Asia and the world is that the Chinese economy may slow significantly. So far, efforts by the Chinese authorities to cool the economy have been only partially successful, with concerns persisting over a potential property market bubble and too much bank lending.

While its population is ageing, China faces an immediate problem of finding jobs for those still of working age. Poor labourers from western China still flood into the eastern seaboard. Yet, companies suffer from a shortage of skilled labour that is pushing up wages, dampening innovation and threatening growth. This migrant labour and rural discontent presents a growing challenge as does rising unemployment as state-owned enterprises are restructured.

"In the next 20-30 years, China and India will emerge as strategic powers and Asia's challenge is to deal with this in a stable and peaceful way."

Lim Hng Kiang, Minister for Trade and Industry of Singapore

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China's rapid rise is also creating discomfort among distant trading partners. The wave of Chinese textile exports following the end to import quotas has already sparked a move by the EU to impose protectionist tariffs on Chinese imports. In the West and in Asia, China's success in low-cost manufacturing is forcing companies and governments to accelerate changes to lower costs, to gain economies of scale and to move higher up the value chain. Doing so will create job losses, require worker retraining and challenge the adequacy of existing social safety nets.

ASEAN response to the rise of India and China is to reduce trade barriers within the group with the view of eventually creating a European-style economic community. Its ten members have also joined a global rush to cement bilateral and regional free trade agreements.

China's ascendance has thrown into starker relief Japan's struggle to rekindle growth, once Asia's biggest source of investment and financing, whose economy has slowed and whose labour force is shrinking.



*John Chen
Chairman, Chief
Executive Officer and
President, Sybase,
USA*

Strategic insights

- Innovation entails risk. Asia's high savings rates provide ample capital, but more diverse and sophisticated capital markets, including bonds, are needed to ensure that those savings can be invested in a way that rewards risk taking.
- Asian companies need to invest more in research and development to devise products that can open new markets and compete on quality, rather than on cost alone.
- Asia's growing middle class presents great market opportunities, but so does its even larger lower class. Companies should develop products that tap the bottom segments of the market pyramid, following the path the cellular phone industry is already taking.
- Asia's increasing trade integration poses opportunities and risks for companies. Governments may compromise the interests of state-owned enterprises to win greater access to foreign markets.
- Chinese companies need to improve efficiency and reduce waste and pollution. Pollution is costing China billions of dollars in health costs every year and is a threat to the global environment.
- Companies in the West should stress to their political leaders the importance of continued engagement with Asia in order to avert a protectionist backlash.

Satisfying the growing hunger for natural resources

Big Picture

- Asia's rapid growth has stretched global commodity supplies to the breaking point, pushing prices, especially oil, to record highs.
- Asia produces 10% of the world's crude oil but consumes 24% of it, making it increasingly reliant on oil from the Middle East.
- Inefficient energy use poses one of the greatest risks to growth in India and China. Oil imports cost India the equivalent of 3% of its gross domestic product. And China requires nearly 12 times as much energy as Japan for every US\$ 1 of economic output.

Context

Rapidly rising demand for key materials such as copper, nickel, iron ore, oil and natural gas has caught the world's suppliers off guard, creating capacity constraints, shortages and bottlenecks. The commodities industry, moribund for over a decade, has become a seller's market, reversing the balance of power between importers and exporters.

On one hand, China's race for resources helps recycle its export-driven earnings into the global economy. For example, more than half of all Chinese foreign investment goes into mining, much of it in capital-hungry regions like Latin America. On the other hand, the commodities rush has exacerbated regional tensions. Japan and China are competing over natural gas from Siberia, oil drilling sites in the East China Sea and iron ore contracts from Australia.

Few policy-makers believe that Asia's economy can sustain its present rate of growth with commodity prices so high. One problem is that the biggest emerging consumers of resources, China and India, are also among the most wasteful resource users.

In addition to raising the cost of economic development, such inefficient use of resources is producing dangerous levels of pollution, damaging the global environment and imposing billions of dollars in health costs.

However, the rising price for oil is making alternative energy sources, from solar power to hydrogen fuel, relatively more economical to develop.

Strategic insights

- Asian nations, particularly big energy consumers such as Japan, South Korea and China need to cooperate on energy security and stimulate the development of new energy sources.
- Asian governments, particularly China's, need to develop comprehensive national energy policies that give companies incentives for upgrading to more energy-efficient technologies.
- Asian governments should finance research into alternative energy production such as converting coal to gas and extracting seabed methane, which will drive down the cost of commercializing these technologies.



"Asia's voracious demand for resources is a major risk."

*Mohamed A. Alabbar
Chairman,
Emaar Properties,
United Arab Emirates*

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Financing Asia's future growth

Big picture

- Developing countries in East Asia will spend more than US\$1 trillion over the next five years on infrastructure, the Asian Development Bank estimates. China is expected to require 80% of this.
- Outside Japan, Asia's bond markets have tripled in size since 1997, to US\$ 1.3 trillion. But these markets remain relatively undeveloped and trading costs are still high.
- The corporate bond sector varies in size from country to country, from less than 2% of GDP in Indonesia, to more than 54% in South Korea.
- Private equity and venture capital funds are a small but growing source of financing in Asia. In 2003, Asian companies raised US\$ 17 billion through 245 equity-linked issues and executed 22 deals totalling US\$ 900 million, up from four deals worth US\$ 37 million in 2002.

Context

East Asian corporations still rely heavily on short-term bank loans and stock markets to finance their operations. Family-owned enterprises, however, are often reluctant to be tied to banks or abide by more rigorous disclosure requirements.

Several markets, including Singapore, Malaysia and South Korea, have improved the availability of higher-yield government bonds with longer maturities. With such instruments available as benchmarks, investors and issuers are better able to match loans with the life of the projects they finance.

Despite these advances, low turnover still keeps many investors away from Asian markets. Tax issues, currency exchange controls and a tendency among local investors to hold bonds to maturity inhibit more liquid trading.

As Asian economies grow, private equity and venture capital will become more important sources of capital. China already has 40 companies listed on a secondary stock exchange for small and medium size enterprises and is planning the development of a Chinese NASDAQ.

Strategic insights

- Governments should offer tax incentives that encourage companies to better align their capital structures with value-enhancing activities.
- Despite a traditional aversion to debt among Asian companies, servicing debt payments can make family and state-owned enterprises more disciplined about the way they use funds. Bonds can force family-owned businesses to adopt more rigorous corporate governance procedures.
- As Asian firms become more sophisticated, demand for more complex financial instruments will increase, attracting more international institutional investors and improving risk management.
- Governments should nurture investment conditions by developing science parks, innovation centres and secondary bourses. They can then attract the foreign investment needed to create jobs and wealth through venture capital and private equity investments.

Transforming the region's closely-held companies

Big picture

- Many of Asia's companies are still controlled by a founding family or government body. For example, of the companies listed on the Hong Kong Stock Exchange, 90% have one shareholder owning more than 20% of their stock.
- According to recent research, 41% of Asian businesspeople believe children should be introduced to the family business at an early age. Yet, opinions vary widely within the region. In Japan, only 13% of those surveyed held this view, as compared to 50% of Malaysians and 63% of Indonesians.
- Growing sales and profits are encouraging Asia's most successful companies to go global. In business cultures that operate under rules-based systems of corporate governance, closely-held Asian companies are often viewed as nepotistic and opaque violators of intellectual property rights (IPR).
- It is estimated that 90% of companies in China use pirated software. Combating piracy and nurturing respect for intellectual property rights remains a key challenge not only for Western companies, but also for Asian governments and firms.

Context

Owner-dominated companies often suffer from weak corporate governance and inefficient decision-making procedures, which limit their global expansion.



Michael Hawker
Chief Executive Officer and
Managing Director,
Insurance Australia Group
(IAG), Australia

In Asia, these issues are further complicated by pervasive, non-contractual, kinship-based business models in which trust and relationships are valued over formal contracts. Some established family-owned companies in Asia have managed to cultivate a trusted brand over several generations. Others are concerned only with gaining market share even at the expense of violating intellectual property rights (IPR).

Consequently, some experts predict that technology transfer from the West – so beneficial to Asia – may slow or stop unless adequate IPR protection is assured. The tacit support of IPR violations may stifle home-grown innovation and erode Asia's future competitiveness. Asian firms intent on seeking foreign overseas markets or listings have to consider how to tackle this problem.

Asia is far from culturally homogenous and differences in corporate governance exist across the region. In China, corporate founders typically strive to learn the rules of Western corporate governance but still fall short of market expectations. Introducing independent directors will be essential for some Asian companies to operate globally, but reform will only take root if boards are held accountable.

The concept of corporate social responsibility is also relatively new to Asian countries, with the exception of Japan. While some firms are making the transition from family-run businesses to professionally-managed, publicly-traded companies, others are still run for the benefit of the extended family members. The transition period may last several generations.

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Specific conditions may help accelerate corporate transitions. In post-war Japan, for example, high estate taxes interrupted corporate lineages. Many of Japan's largest publicly-owned multinationals resulted from this tax change and have since developed progressive attitudes toward corporate governance, intellectual property rights and social responsibility. Some experts believe China may develop along similar lines, given the strength of the state and its expressed concerns over these issues.

Asian companies operating in Western markets will have to consider how they deal with increased exposure to market competition and demands for more robust corporate governance. For example, Western customers may require proof of factory conditions or boardroom effectiveness. But these demands, and the additional administrative costs and legal risks they entail, may make Asian firms hesitate over international expansion, and excessive requirements for corporate governance may inhibit global growth.

"Unless there is improvement in global governance structures, many economies will revert to protectionism to try to slow down the rate of change."

Michael Hawker, Chief Executive Officer and Managing Director, Insurance Australia Group (IAG), Australia

Strategic insights

- More Asian firms may attempt to finance growth and create innovation within the region to avoid adopting Western standards of governance. Business models that circumnavigate intellectual property rights (IPR) are also likely to emerge in the wake of greater international enforcement of IPR.
- First-generation, founder controlled enterprises should consider exploiting opportunities at home and within Asia before heading West. Such companies should first gain experience operating in more familiar cultures and create efficiencies arising from geographical proximity, as well as learning from entering nearby markets. The privatization of state-owned enterprises and regional market growth provides ample opportunities close to home.
- Asian family-owned firms need to encourage diversity in employment practices. Thinking globally and acting locally means fully exploiting the knowledge and culture accumulated within a company's domestic operations.
- Though not yet common to the region, hostile takeovers will become more frequent as shareholders demand better performance, greater transparency and more disclosure.



Lee Hsien-Loong, Prime Minister and Minister for Finance of Singapore, greets participants at the World Economic Forum's Asia Roundtable 2005

Recruiting and retaining a skilled workforce in Asia

Big picture

- With a combined population of nearly 2.4 billion, China and India are commonly viewed as vast pools of inexpensive labour. Yet, rapidly rising labour costs and the difficulty of attracting and retaining qualified employees have forced many companies to reassess their human resources strategies and broader business goals.
- Shortages are particularly acute in Asia for experienced managers and leaders, skilled professionals, vocational workers and creative talent. These shortages have led to substantial wage inflation and increasing employee turnover.
- Poor harmonization of public sector education and training with company needs requires many firms to provide further training to give new employees the necessary job skills.
- Company training can create its own set of problems in a tight labour market as well-trained employees are more likely to be poached by competitors.

Context

The search for qualified talent is one of the most pressing challenges for business leaders in Asia. Companies throughout the region, particularly in India and China, are experiencing a tremendous shortage of qualified staff and key skills. Talented senior managers are in short supply. Many employees require additional training, as their formal education rarely meets business demands. In turn, this increases their employability elsewhere, making them more difficult, and more expensive, to retain.

In south-eastern China, minimum wage levels now approach those in Thailand and exceed those in Vietnam, Cambodia and Bangladesh. Yet, there is a persistent shortage of nearly two million workers, forcing many companies to move inland or out of China altogether. These changes are taking place amid falling birth rates among the wealthy industrialized countries and the decline of China's working age population caused by the introduction of the one-child policy in 1979.

As a result, many companies are revising their growth strategies and calculating the total cost of employment, including social charges. In capital-intensive operations, labour is only a small part of total costs. Some large Japanese corporations have opted to build new manufacturing plants in Japan rather than expand facilities in China, in large part because of high turnover rates, shortages of qualified staff and concerns about intellectual property violations.

Branding and corporate culture play a critical role in retaining employees. Employee retention programmes are most successful when a company's brand clearly reflects positive values and staff are selected not only for their skills, but also for how well they fit in with those values. The right culture is particularly attractive to young people, helping companies to avoid competing for talent purely on the basis of salary.

"Everyone says we grow too fast. No! We are too slow. We need development, and faster, because we are a huge country."

Chen Feng, Chairman, China Hainan Airlines Co. Ltd, People's Republic of China

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Corporate social responsibility programmes are another way to reinforce company values and give employees a sense of pride in their company. Organizations should highlight the importance of the individual within the organization and foster shared values and objectives. Continuous training also provides employees with attractive career development options.

Integrating employees into a company's culture is particularly challenging for multinationals in Asia, as each country has a distinct culture. As a result, foreign firms that do not adopt effective selection processes and training programmes are likely to suffer even higher employee turnover. Rapid sales growth and high employee turnover further exacerbate the difficulties in transferring corporate culture to Asian offices.

In addition to introducing their own retention programmes, many companies are asking governments to improve the employability of graduates. Some companies are going even further, initiating relationships with schools and faculty members to improve their understanding of business needs and treat students as potential employees.



*Kim Hyun Chong
Minister of Trade of the
Republic of Korea*

Strategic insights

- The most important aspect of employee retention lies in the initial recruitment process. Organizations need to learn how to hire people who are supportive of the business model and values of the company.
- Companies should invest in continual retraining to improve employees' skills and create non-financial incentives for staff to remain with the firm for longer periods. Multinationals should send people overseas to help reinforce corporate culture and identity.
- Senior executives need to understand the total cost of employment and be prepared to move to where the required talent is abundant.
- Direct communication with universities and technical institutes can help encourage schools and governments to adapt their curricula to prepare students for employment. Exchanges with universities and faculty members can be helpful.

Finding the right regional hub

Big picture

- The rise of China as an exporting nation and the globalization of production have helped Hong Kong and Singapore to emerge as Asia's leading hubs for trade and commerce. Combined with rising intra-Asian trade, their success has focused attention on the role of hubs in ensuring economic competitiveness.
- Historically, business hubs emerged because of geographic location or access to natural resources, but technology and globalization have redefined the concept. Today's successful hubs are distinguished by clusters of capabilities that are highly valued by businesses in the region.

Context

Asia's large, fragmented population and reliance on external trade make the emergence of hubs both natural and necessary. Excluding Japan, Asia's share of world exports rose from 23% in 1985 to 38% in 2002, with more than half of that trade taking place within Asia. Trade has also grown thanks to the globalization of production: almost half of Hong Kong's exports are intermediate goods.



*Koh Boon-Hwee
Chairman,
Singapore Airlines Limited,
Singapore*

The ports of Shanghai and Shenzhen – currently ranked third and fifth, respectively, in terms of worldwide freight tonnage – are growing fast. But many acknowledge that Hong Kong and Singapore retain a lead because they are a source of finance, skilled workers and business support services, rather than mere port and freight handling services.

South Korea has committed billions into making Incheon North-East Asia's hub for information technology. While North-East Asia accounts for 20% of global GDP and over US\$ 2 trillion in trade, many experts question whether it needs its own hub.

Advances in technology continue to reduce the cost and volume of shipping. Asia's leaders will be challenged by this reconfiguration of business and trade flows. Even Hong Kong and Singapore face rising unemployment and slowing productivity gains.

Strategic insights

- It remains to be seen whether Asia's hubs will complement each other, or compete. Clustering capabilities and skills in a business hub helps build competitive advantage.
- Governments and companies need to think creatively to take advantage of technology and enable hubs to flourish. Dubai's success in casting itself as the Gulf's business hub, for example, may serve as a case study in how to influence growth trends rather than merely to react to them.
- Creating a hub requires active cooperation between business and government. Governments can help create the right infrastructure, institutions and regulatory environments to attract businesses. Companies, in turn, create the products, services and innovations that give a hub the critical mass it requires to compete.

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Managing the rise of China and India

Big picture

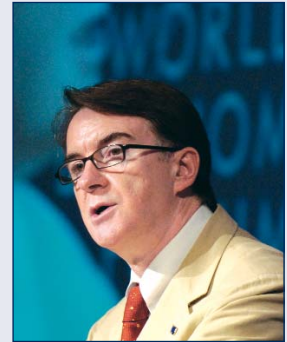
- The pace of Asia's economic integration will increase as nations undertake the economic reforms necessary to maintain or increase their regional competitiveness.
- The US-Japan military alliance, Asia's most powerful, is adjusting to new regional realities. The growing geopolitical influence of China and India will alter the region's future balance of power

Context

Trade within Asia is growing at nearly three times the global rate, with China emerging as the biggest trading partner for most Asian countries. China's peaceful development strategy aims to draw its neighbours into its economic and geopolitical sphere of influence through strategic partnerships.

Asian countries have watched China's rise with a mixture of fear and admiration, recognizing that Beijing presents them with both opportunities and challenges as it gains greater confidence in international affairs. ASEAN has responded by engaging the US, the EU, Japan, India and Australia, in deeper political and economic dialogues from which it hopes to produce free trade agreements and promote regional security.

ASEAN members are also implementing reforms once considered too difficult to achieve in order to maintain their competitiveness and differentiate themselves from the competition. Malaysia, for example, has replaced Malay with English as the language of instruction for math and science. And Singapore is placing more emphasis on innovation and research.



*Peter Mandelson
Commissioner,
Trade, European
Commission, Brussels,
Belgium*

Strategic insights

- Economic competition and cooperation between India, China and ASEAN and other Asian countries will make the region a stronger player in the global economy. There is the risk of protectionist backlash within the developed world as jobs there may be lost and necessary structural reforms may prove politically difficult.
- Few meaningful lessons have yet been drawn about how and what China and India can learn from each other. Their economic potential and performance cannot be assessed without considering their unique history, politics, culture and institutions. Yet, as different as they are, China and India share the problem of ensuring that the majority of their people, particularly in rural areas, benefit from rapid economic expansion.
- Fluid alliances in Asia are creating a new geopolitical balance. China, India, the US and Japan will align where their interests converge even as they try to project their own influence. Despite their rivalry, each power recognizes the importance of maintaining regional stability and will likely seek to maintain status quo and avoid major conflicts.

Adapting to Asia's emerging identity

Big picture

- Anti-Japanese demonstrations in China and South Korea have highlighted how disputes over historical issues can threaten growing economic ties. Simmering disagreements rooted in history, culture and identity can lead to an unhealthy nationalism within the region.
- Governments would like to resolve such issues peacefully, but lack consensus on the best way to do so. Growing trade flows and business ties do not make it less likely that such disputes will result in wider tensions.
- Asia's population will shift dramatically across the region over the next 20 to 25 years and its impact is unclear. While Japan's workforce shrinks, India's will grow by up to 40%, creating economic and social challenges for both governments and businesses.
- China's increasing profile in Asia's economy has made the issue of Chinese social stability a matter of concern for companies all over Asia.

Context

Disputes about Japan's record during World War II have long been the source of regional tensions, the most recent flare-up occurring over Chinese and Korean objections to the latest description of events in some Japanese school textbooks. Despite numerous official apologies and over US\$ 25 billion in aid provided by Japan to China alone, the issue of historical interpretation remains a thorny one.



"We need now more aggressive, more proactive reform rather than reactive reform."

Heizo Takenaka
Minister of State for
Economic and Fiscal Policy
and for Privatization of the
Postal Services

China's economic rise has given it a greater voice in the region, changing the way Asians view their collective past. Japan and China have a strong interest in maintaining close economic ties and cordial relations: Japan is China's top trading partner and China is Japan's second-largest one, with US\$ 160 billion in annual bilateral trade. Japanese companies increasingly rely on China for production and sales and Japanese brands and businesses could suffer if cultural relations were to sour further. A recent survey of Chinese university graduates indicates that Japanese companies are losing popularity as employers.

The growing income gap between China's bustling coast and the underdeveloped western and central regions presents a huge challenge. Beijing and Shanghai have some of the world's most expensive office rentals. Yet, the average rural citizen – more than 70% of the population still lives in the countryside – is earning much less than the current Chinese per capita GDP of US\$ 1,100 a year.

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The closure of state-owned industries presents an additional problem given the lack of an adequate social safety net. Official figures for urban unemployment hover between 4 and 5%, but some experts say the real figures could be significantly higher. Still, 15 million new workers migrate from the countryside to urban areas in search of work every year.

Programmes to step up rural and inland development, bolster the social safety net and end corruption in local government may eventually alleviate the tensions but social unrest could pose a threat to stable economic growth.

China is far from the only country concerned with the impact of social issues on future growth. In Indonesia, poverty, corruption, terrorism and religious differences threaten economic life and discourage foreign investment. India's rigid caste system and religious and linguistic diversity also present potential problems, though the country's traditions of democracy and non-violence mitigate those risks.

Even as they struggle with the burdens of the past and present, Asian countries must also plan for future dramatic demographic shifts. China's relatively young population has supported rapid growth in labour-intensive industries and spurred consumer spending. By 2050, however, the proportion of elderly in the population will rise to 24% from 7.1% in 2001, placing a heavy burden on China's nascent social security system. Sustaining Japan's workforce would require a pace of immigration that would challenge the country's traditional society and identity. Conversely, India's working age population will become the largest in the world. More than one-third of the country's population is currently under the age of 15.

*"We need to be
Japanese and also realize that
we are members of Asia."*

**Yoshito Sengoku, Member of
the House of Representatives
of Japan**

Strategic insights

- Historical and cultural disputes in Asia will continue to create new risks to business and trade. Although most of the attention has lately been focused on Japan, Korea and China, companies need to consider similar issues throughout the region.
- Business leaders need to better understand the social and cultural climate in which they operate. This will help prevent cultural misunderstandings and enable them to mitigate the impact of any flare-ups.
- Greater political will is needed to ensure that history and culture do not obstruct regional integration and trade. Asian leaders need to break decisively with the conflicts of the past.
- Leaders should make plans to cope with the potential social and financial problems related to the tremendous population changes taking place across the region.

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