



Asia's Growth and the Rise of China

Nakao Takehiko, Former President of the Asian Development Bank and Chairman of the Institute at Mizuho Research Institute Ltd.

Nakao Takehiko, whose approximately seven-year tenure as the President of the Asian Development Bank (ADB) ended in January 2020, described his days at the bank in his recently published book, *Ajia keizai wa do kawattaka* (How has the Asian economy changed?). *Chuokoron's* editorial department asked him about the future of the Asian economy and a rising China. The interview was held in July 2020.

What will a post-COVID-19 Asia be like?

— The COVID-19 pandemic continues. What impact will it have on the Asian economy? With the severity of the pandemic remaining low in Asia, people say that, from a global perspective, its economic recovery will be quick.

Nakao Takehiko: I'm not a medical expert, so I do not know how the COVID-19 pandemic can be brought to an end. The development of the COVID-19 pandemic, and how soon vaccines and treatments can be developed and made available, will impact the economy. It is already clear that the damage will be significant. Economic estimates are being released by a number of institutions. Economic growth in Asia, which has been around six percent so far, is likely to decline to zero in 2020.

Asia, a global production base, has been playing a pivotal role in supply chains. After the pandemic, will people, products and money ever start to move again between countries as they did before? One point worth looking at is what will happen to supply chains. Another is what impact will there be in conjunction with security issues.

As most typically reflected by the US–China conflict, security risks are increasing in Asia. One of the important reasons is that China insists more clearly on what the country believes is beneficial to it. Issues that the country has with other countries, such as territorial disputes, technology transfers and the protection of intellectual property are becoming more serious. Because of these issues and partly due to wage increases in China, there may be increasing adoption by countries of the “China plus one” strategy; i.e., securing additional production outside of China. This idea has been around for some time but it can gain more force. So there can be an increasing shift of production facilities from China back to corporations' home countries or to other Asian countries. On the other hand, some people believe that it is not possible to decouple from China so easily, and that this decoupling most advocated by those who take a hardline attitude towards China in the United States will have a serious impact. Indeed, we have been so heavily dependent on China for the working of global supply chains.



Nakao Takehiko, former president of the Asian Development Bank

Future of a Rising China

— China established the Asian Infrastructure Investment Bank (AIIB) in 2015. What was ADB's view of the AIIB?

Nakao: China has maintained a good relationship with the ADB since it became a member of the bank in 1986 after the 1978 reform and opening-up. The country succeeded in achieving significant growth supported by loans provided by the World Bank and the ADB. China has listened to our advice humbly and has acted cooperatively. China benefits from finance through loans from the ADB and the World Bank. In addition, in my view, China believes it is more important to acquire the expertise of these organizations on a range of matters, including technical expertise and ways to address social and environmental issues.

As President of the ADB I exchanged opinions with high-ranking Chinese officials including Vice Premier Liu He, Yi Gang, the Governor of the People's Bank of China and past finance ministers. They repeatedly expressed China's significant appreciation of ADB's support and said that they would share expertise while continuing to borrow. They also said that China would cooperate actively with developing countries in the Asian region. As an international organization, there is no option for the ADB but to work cooperatively with the AIIB. If the ADB did not cooperate with the AIIB, it would damage its credibility. There are countries including South Korea, Canada and Australia, and European countries that are members of both banks.

Having said that, Japan's joining the AIIB is another issue. If Japan and the United States, as nations, decide not to join the AIIB as they did, it is even more important for the ADB to cooperatively share its knowledge of international standards with the AIIB.

— China's GDP was US\$13.6 trillion in 2018, significantly exceeding Japan's US\$4.9 trillion and getting closer to the United States' US\$20.6 trillion. With this, why is the ADB continuing to provide loans to China?

Nakao: It is a question that people often ask, given that China seems to have met the criteria for ending borrowings. The criteria for sunseting regular ADB assistance comprise (i) gross national income (GNI) per capita exceeding the threshold of US\$6,975 (as of 2018), (ii) the availability of commercial capital flows on reasonable terms, and (iii) the strength of key economic and social institutions. These are the same criteria as those used by the World Bank. If these conditions are met entirely, the ADB would discuss processes for ending assistance. China's GNI at US\$9,470 is well exceeding the threshold, and it has good access to financing from the market. However, the ADB observes that China's institutional strength, the third factor, has not reached the expected level, which is why the ADB has continued to provide loans. This is the same policy as that of the World Bank regarding lending to China.

There are several additional reasons for the ADB's continued lending to China. First, the areas for which the ADB provides loans to China are focused on environmental problems and climate change issues, which are expected to produce positive external effects. Second, ADB lending to China is decreasing in amounts more recently. Third, interest rates charged to China come with spread on top of the ADB's financing interest in the market, hence accruing revenue which can be used to cover the ADB's administrative cost, build up capital and support poorer countries. Fourth, the bank is a financial institution and issues AAA-rated ADB bonds. Its rating may be affected if it loses China, a large borrowing nation with high credibility. In other words, the bank would need more capital to maintain its rating

without lending to China. Finally, I believe that it is desirable for the Asian region and international society to keep a cooperative and constructive relationship with China through the ADB's loans to it, which require collaboration between the ADB and the Chinese authorities in preparing and implementing projects.

— China has the economic capability to raise funds itself and its technical capabilities are improving. Are we correct in understanding that the reason why China continues to borrow money from the ADB despite this is that it wishes to acquire the bank's expertise and maintain a relationship with international society?

Nakao: That's right. Although China has funds and technologies, it does not have sufficient knowledge regarding environmental problems, the relocation of residents affected by infrastructure projects, and other social policy areas. Hiring outside consultants may be an option. But China appreciates the significance of the knowledge the ADB has accumulated over more than half a century in the areas of infrastructure development and social policies. China wants to acquire ADB's expertise and share the experience of other loan recipient countries.

China may also intend to showcase itself as an important member of international society. The China Development Forum, which is held every spring, is a spectacular annual event. The country invites dozens of dignitaries, including the leaders of international organizations such as the International Monetary Fund (IMF), World Bank, ADB and Organization for Economic Cooperation and Development (OECD), the CEOs of major companies from around the world and Nobel Prize winning economists for the occasion. Through initiatives like this and the AIIB, which is an international organization established by China on its own, China seeks to put itself in the spotlight as an important member in international society. These initiatives may also reflect its strong desire to demonstrate its power and stature in international society.

Will the AIIB will become a threat?

— Is the AIIB a threat to the ADB?

Nakao: The ADB does not consider the AIIB to be a threat because there is a great difference between the two banks in the size of loans, the size of their staffs, and their accumulated knowledge. There is a large scope for cooperation.

— Voting rights within the ADB are determined based on ratios of capital contributions of member countries, similar to other organizations such as the World Bank. Are we correct in assuming that the United States, which with a 15.6% shareholding keeps the position of largest shareholder together with Japan, is against continued lending to China?

Nakao: Generally speaking, institutions, including international agencies, that spend US taxpayers' money are bound by conditions imposed by the US Congress. As such, the United States often automatically abstains from voting or casts no votes even for decisions made within international organizations, including the ADB, if it pertains to certain projects for a specific country. Since it took power, the Trump administration's position toward China has become increasingly severe.

— You said earlier that the ADB should be involved with the AIIB, but Japan’s membership at the AIIB is another issue. What is your opinion of the possibility of Japan becoming a member of the AIIB?

Nakao: I understand that the AIIB was established to facilitate infrastructure investment in Asia. In addition, my thinking was that if the AIIB’s operation is conducted based on socially- and environmentally-conscious standards and fair tender processes, the ADB would be able to work cooperatively with the AIIB.

I made that decision as the President of the ADB. The national decision was made from a different viewpoint. With this in mind, I will look back at what I have heard from many people in Japan.

The main reasons cited by those who were in favor of Japan joining the AIIB were: “A good relationship should be maintained with China,” “Ensure that Japanese companies are not placed in a disadvantageous position regarding procurement and construction of projects supported by the AIIB,” “Participating as an AIIB insider is an effective method of ensuring the AIIB’s compliance with international standards,” and “Asian countries are encouraging Japan to join the AIIB.”

On the other hand, the major arguments of people opposing joining the AIIB were, “If Japan joins the AIIB, it will be asked to make a significant capital contribution using taxpayers’ money as an advanced country in the Asian region,” “While the relationship with China is important, cooperation can also be achieved through the ADB and the Japan International Cooperation Agency (JICA),” “Winning tenders for materials and construction for the projects of developing countries is difficult for Japanese companies anyway because of their over-performance and high costs,” and “Commenting as an outsider can be more effective than as an insider because an overwhelmingly large share of the AIIB’s voting power is held by China.” I myself was inclined to support the latter arguments compared to the former.

— By launching the AIIB, China is trying to increase its presence in international society. However, the country poses serious problems, such as its disregard for intellectual property rights, the forcing of technology transfers and the human rights issues surrounding Hong Kong and the Uighurs. What are your thoughts about this?

Nakao: Although China has been attempting to raise its status in international society, it has paid inadequate attention to the negative eye that international society has turned toward China more recently due to a variety of problems, and China has always focused on providing explanations domestically. There is no disputing that China is a great power with a long and respectable history. Its economic strength in terms of GDP is about three times that of Japan now, and coupled with its technical strength the country has established itself as a significant presence in international society. For example, China has already acquired voting shares of and positions within the IMF and the World Bank, things that Japan achieved after a great deal of effort over many years. On the other hand, China wants to assert that it is still a developing country and believes that there are many things that it should be permitted to do as a developing country. I have the impression that this is what is causing the difference between its views and international society’s regarding the behavior of China, a double standard from the perspective of those outside China.

It seems that China still feels deep humiliation because of its experience being invaded or affected by Western powers since the Opium Wars. Likewise, before World War II, Japan became increasingly frustrated and resentful due to the unequal treatment it received from the Western world. Consequently,

it pursued an expansionist policy, causing significant damage to its people and neighboring countries. I hope that China will not move in that direction. If it seeks stable growth and the improvement of its people's lives, it will naturally become a country that earns more respect from the world. I have shared these views with high-ranking Chinese officials.

China had been taking the low-profile policy promoted by Deng Xiaoping, which entailed cooperating with the international society instead of asserting itself. However, since Xi Jinping came to power, I am afraid to say that China looks to have become more self-assertive. For example, the country has made the nine-dash line for its claims of the South China Sea. Southeast Asian countries have rebuked China for this claim. There is also an intensifying border confrontation with India. Xi's hardline stance toward Hong Kong and the Uighurs invites international criticism. From China's perspective, these may be its unarguable core interests, but from the perspective of other countries or international society, they are intent on changing the status quo and are not acceptable.

— Sri Lanka constructed its third international seaport, the Hambantota Port, using loans from the Export-Import Bank of China (China Eximbank). But it had to hand over the port's operation rights for 99 years to Chinese companies because it was unable to repay the debt. The *New York Times* pointed out that this was a Chinese debt trap. Is it possible that the AIIB will similarly become an organization facilitating the Belt and Road Initiative (BRI)?

Nakao: The *New York Times* reported about that debt trap in June 2018, when the US- China conflict was coming to the surface. China had been providing loans to developing countries through China Eximbank or China Development Bank (CDB) with tied aid conditions to ensure that the loans were linked to its exports. The AIIB's loans are not tied to anything, following international procurement standards, so I expect that there is no chance of the AIIB becoming a BRI institution. On the other hand, China's own BRI-oriented loans have problems from the perspective of economic rationality or debt sustainability.

In the OECD member countries, including Japan, all public loans are controlled by the finance ministry of each country and discussed among the members of the Paris Club, a group of official creditor countries. But China is not a member either of the OECD or the Paris Club. In China, China Eximbank, CDB and other state-owned companies providing public loans are moving in such an unorganized way that even the authorities do not fully understand the money being invested. Against this backdrop, many of the international projects China engages in can become problematic. China intends to exercise its influence on countries through BRI and ensure that Chinese products are purchased. However, whether or not things will go as expected is questionable.

Basically, the goal of the BRI is to reconstruct the land and sea routes of the Silk Road connecting China and Europe in the past. The railroad connecting China to Europe via Central Asia is one of the most important projects of the plan. However, Central Asia is not densely populated, and the land is so vast that it is difficult to operate services in a financially justifiable way. Samarkand, the ancient capital of Uzbekistan had flourished since before the Christian era. In the 15th century it started to decline because the Indian routes had been developed and eventually prospered. Because of the high maintenance costs when compared to sea or air transportation, I don't believe that it is easy to operate competitive land transportation.

— You described exchanges with high-ranking Chinese officials including Vice Premier Liu He in the book, and we were surprised at their enlightened and progressive ways of thinking. We felt there was a gap between their ideas and China's policies.

Nakao: I've known Vice Premier Liu He since 2009. He is an intelligent person who was a graduate student at Harvard. I was impressed when Liu said that it was important to implement Schumpeterian structural reforms rather than the easier path of adopting Keynesian expansionary policies. People who attain high-ranking government positions in such a large country after encountering and going through many challenges are very capable.

While China has achieved remarkable economic growth and technological advances, it still faces poverty in its interior. When I visited Yunnan Province for a poverty reduction project financed by the ADB, I saw a middle-age unmarried man taking care of his elderly mother who was sleeping on a bed that seemed to be made of straw, with light coming only from a naked light bulb. The vice minister of finance, who was accompanying me, was so stunned by the way they lived that he pulled some money out of his pocket and handed it to him. I feel that the high-ranking officials that I have become acquainted with are sincere people.

China is such a large country that correcting income disparities and other regional disparities is not easy. China wishes to impress the world and be a major country, but it still has to address many problems as a developing country. It should focus its efforts on the correction of disparities and the achievement of sustainable development while at the same time leveraging market economy-based systems. In my view, China's recent initiatives to strengthen its state-led and party-led structures in its economic system and its self-assertiveness in the geopolitical arena are not beneficial for China.

Asian growth led by the market and the private sector

— It is likely that Asia will continue to grow economically, supported by the region's large population. Some people have said that the 21st century is the Asian Century. Do you have any insight into its future?

Nakao: When the ADB was founded in 1966, Asia was so poor that the most urgent challenge was ensuring that people had access to food. At that time, Western economists pessimistically believed that Asia was stagnant, except Japan which underwent recovery from the war devastation and was in the process of high-speed growth. However, following remarkable economic progress, in 2018, the average GDP per capita of the Asian developing countries was US\$4,903, fifteen times the US\$330 it had been in 1960. Asian developing countries' share of the global GDP also expanded from four percent in 1960 to 24% in 2018. If growth continues at this pace, it is expected that the share of Asia including Australia, Japan and New Zealand in the global GDP will exceed 50% by 2050. Given that the population of Asia is approximately 55% of the world's population, it is natural that its share of the global GDP would exceed 50%, as long as it attains productivity at average levels.

The ADB published *Asia's Journey to Prosperity – Policy, Market, and Technology over 50 Years* in January 2020 just before my departure. The book was written by many ADB economists with different backgrounds and nationalities. I was deeply involved in the book production as a kind of lead editor. We sought to rewrite *East Asia Miracle: Economic Growth and Public Policy*, a famous book published by the World Bank in 1993, by including the developments in China and Central Asia that had not been

covered in the World Bank book. In addition, the ADB's new publication explores new themes such as the prospects for the service industry, climate change and gender issues.

The new ADB book stressed the role of the market and the private sector. The growth of Asia was often attributed by Western scholars to Asia-specific, government-led economic and financial policies. During the 1980s, some scholars, including Chalmers A. Johnson, a professor at University of California, Berkeley, developed the revisionist idea of the Japanese economic system with an emphasis on the roles of bureaucracy played by officials of the Ministry of International Trade and Industry and the Ministry of Finance. Obviously, since the period leading up to World War II the government of Japan had adopted industrial policies aimed at fostering domestic industries. Just after the war, there was a continuation of national mobilization of resources when the country experienced extreme shortages of resources, savings, and foreign currency. Until sometime in the 1960s, the government tried to help industries catch up with other advanced economies. However, similar policies were implemented by other countries globally during the era of industrialization, including the United States and Germany.

Having studied the history of economic development in Asian countries, we found that the successful policies of every country could be explained by standard economic theories, such as open trade and investment systems, investments in infrastructure and education, and stable macroeconomic policies, taking into consideration their respective development stages. So our stance is that, there were no special factors contributing to the growth of Asia, such as an "Asian consensus".

— We understand that you emphasized this in your book.

Nakao: Modernization and industrialization took place in Europe and the United States ahead of other areas, and ideas of economics were also developed in the Western world. There is no denying that Western ideas have led the world so far in modern history. However, today, Asia has many excellent economists and many of them have the ability to communicate in English. They must explain their economies.

I was involved with the Japan-US Structural Impediments Initiative in the late 1980s when I worked for the Ministry of Finance. At that time, I felt very awkward facing one-sided arguments, such as about Japan's engaging in unfair competition through the collaboration of its political, bureaucratic and financial circles or the high land prices that were the result of exclusionary policies. Even now, there is some misunderstanding due to such exaggerated perceptions of the Asian economy as "export oriented." Although Japan needed to promote exports to import natural resources and technologies, it did not drive growth by keeping the current surplus positive. Rather, Japan suffered from a constant current account deficit up until the mid-1960s.

Economists in Asia should analyze the economy and history of their own country, proactively share this with the world and proclaim new ideas. I don't like the "as Western economists say so" attitude. Asia has its own history of economic development and ideas that it should be more proud of. For instance, Japan has a long tradition of merchants and craftsmanship, and accumulation of capital passed down since the Edo era (1603–1867). The rice future market in Osaka, Sumitomo copper mining, Mitsui garment store, and exchangers of gold and silver which later became banks are well-known. In the Meiji era (1868–1912), people's energy, which had been suppressed by the feudal system, broke out and contributed to the creation of modern systems and a modern economy in a short period of time. The same is true in the early part of the 20th century, when Japan's urban private railway networks and city planning

including department stores annexed to railway stations, residential areas and leisure facilities were driven by such entrepreneurs as Kobayashi Ichizo (1873–1957), the founder of the Hankyu Group in Osaka, and Goto Keita (1882–1959), the founder of the Tokyu Group in Tokyo.

— What should Japan do to deal with its sluggish economy?

Nakao: The per capita productivity of working age people in Japan has been growing almost at the same pace as the United States. However, the growth of the GDP has been slow due to the shrinking and aging of the population. It is also true that the balance-sheet adjustments after the bubble burst in the early 1990s have continued to have a negative impact. In addition, Japanese industry has lost its luster as it faces tough competition from the manufacturing industries of China and Korea and, at the same time, the IT industry of the United States.

That said, Japan has an abundance of unique added value and high level technologies that have not fully contributed to realizing economic outcome. In my opinion, the key is to allocate more financial resources to higher education and technology development and make Asia's rising economic power an integral part of Japan's vitality not only through trade and investment relations but also interactions in the areas of education, high level human resources, financing, and technologies.

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