



**Keynote Speech**  
**BRIICS Economies: Prospects and Challenges for Globalisation**

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## BRIICS Economies: Prospects and Challenges for Globalisation

### Introduction

Director Stefan Tangermann, Deputy Secretary General Pier Carlo Padoan, Dr. Isher Ahluwalia, distinguished speakers, fellow participants, ladies and gentlemen: Good morning.

It is a great honor to be invited to deliver a keynote speech at the 2008 OECD Global Forum on Trade: "Globalisation and Emerging Economies."

This forum will focus on BRIICS, namely, Brazil, Russia, India, Indonesia, China, and South Africa in the context of trade policy and globalisation. These countries are today's high-growth emerging economies that account for 46 percent of the world's population, 13 percent of global GDP, 11 percent of global trade and global inward foreign direct investment (FDI), and 33 percent of the world's foreign exchange reserves (see Table below).

**Economic Indicators of OECD, BRIICS and East Asian Economies**

Economy	GDP		Population		Trade (Exp+Imp)		FDI Inflows		Foreign Exch. Reserves	
	\$Bill	(%)	Mill	(%)	\$Bill	(%)	\$Bill	(%)	\$Bill	(%)
<b>OECD</b>	36,812	(76)	1,175	(18)	17,512	(68)	959	(71)	1,875	(37)
<b>USA</b>	13,164	(27)	299	(5)	3,323	(13)	181	(13)	55	(1)
<b>EU</b>	14,260	(29)	452	(7)	9,855	(38)	602	(45)	364	(7)
<b>Japan</b>	4,368	(9)	128	(2)	1,242	(5)	-7	(-1)	880	(17)
<b>BRIICS</b>	6,231	(13)	3,024	(46)	2,885	(11)	151	(11)	1,684	(33)
<b>Brazil</b>	1,067	(2)	189	(3)	235	(1)	19	(1)	85	(2)
<b>China</b>	2,645	(5)	1,312	(20)	1,549	(6)	78	(6)	1,068	(21)
<b>India</b>	912	(2)	1,110	(17)	351	(1)	17	(1)	171	(3)
<b>Indonesia</b>	365	(1)	223	(3)	181	(1)	6	(0)	41	(1)
<b>Russia</b>	987	(2)	143	(2)	433	(2)	31	(2)	296	(6)
<b>South Africa</b>	255	(1)	47	(1)	135	(1)	-0	(-0)	23	(0)
<b>Others</b>	5,420	(11)	2,339	(36)	5,489	(21)	243	(18)	1,479	(29)
<b>East Asia</b>	9,511	(20)	2,074	(32)	6,038	(23)	176	(13)	2,948	(59)
<b>NIEs</b>	1,575	(3)	83	(1)	2,313	(9)	78	(6)	774	(15)
<b>ASEAN</b>	1,055	(2)	556	(9)	6,038	(23)	50	(4)	361	(7)
<b>World</b>	48,462	(100)	6,538	(100)	25,885	(100)	1,352	(100)	5,038	(100)

Note: (a) Trade data are for 2005; GDP, population, and FDI Inflows data are for 2006; and foreign exchange reserve data are for 2007.

(b) FDI inflow data are net inflow data.

(c) East Asia includes: Japan, China, NIEs (Hong Kong; Korea; Singapore; and Taipei, China), and ASEAN countries (Brunei, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam).

Source: World Bank, *World Development Indicators 2008*.

Three BRIICS economies come from Asia. In Asia, dramatic economic growth was recorded in Japan in the 1960s, which then spread to the Asian newly industrialized economies (NIEs) of Hong Kong; Korea; Singapore; and Taipei, China in the 1970s to 1980s. This was followed by successful middle-income ASEAN countries—Malaysia, Thailand, and Indonesia—in the 1980s to 1990s. Subsequently, China, India and Viet

Nam witnessed rapid economic growth in the 1990s and the 2000s. Nine out of the twelve economies that sustained high growth rates of 7 percent or more for 25 years globally are in Asia.<sup>1</sup> This record growth has been achieved by market-oriented economic reforms, and has brought substantial benefits to the people of Asia in the form of a higher standard of living and a substantial decline in poverty incidence.

The rise of BRIICS has important implications for the global economy. Global trade liberalization, global payments imbalances, rising demand for energy, oil and food, the environment and climate change are some of notable examples. These problems can no longer be addressed by G8 or OECD countries alone, without involving major emerging economies, particularly those of Asia. Considering that three BRIICS economies—namely, China, India and Indonesia—are in Asia and that Asia has become an increasingly important player in the global economy, today I will put some emphasis on the experiences and challenges of emerging Asian economies. I will argue that collaboration between OECD and BRIICS economies is essential to resolving many key global issues. I will focus on the impact of the ongoing global shocks—the credit crisis and rising oil and food prices—on emerging Asia, the issue of widening income inequality and social divide in Asia, and the implication of Asia's regional trade arrangements for the global trading system. Let me first briefly mention about the importance of trade and FDI for emerging Asia's remarkable economic success.

### **Emerging Asian Economies**

The major drivers of Asia's economic growth have been outward-oriented policies and supporting economic reforms, which helped expand trade and FDI and form regional production networks and supply chains linked to global markets. While the NIEs continue to provide spark to Asia's growth, today, emerging Asia has three growth centers, namely, ASEAN (where Indonesia is one of the 10 members), China and India. The rise of China has had profound impacts on the ASEAN countries, India and other economies by encouraging them to pursue further economic reforms, which together has brought about intensive competition for export markets, energy and resources. At the same time, they have created huge domestic markets for goods and services to other countries.

A special characteristic of East Asian growth is the formation of regional production networks and supply chains.<sup>2</sup> They were formed as a result of the strategies of multinational corporations (MNCs) to locate some sub-processes of production in different economies in the region—according to their comparative advantage—which are then connected through trade in parts, components and semi-finished products so that final products are assembled for exports in a most cost-effective way. While this international division of labor has been premised on the presence of American and European markets for finished products, the region's relative dependence on these outside markets has been declining and is expected to further decline as demand for final products within East Asia continues to grow.

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<sup>1</sup> These twelve economies are: Bangladesh; Botswana; China; Hong Kong; Indonesia; Japan; Korea; Malaysia; Malta; Oman; Singapore; Taipei, China; and Thailand. Commission on Growth and Development, 2008, *The Growth Report: Strategies for Sustained Growth and Inclusive Development*, May, Washington, DC.

<sup>2</sup> East Asia includes Japan, China, the Asian NIEs (Hong Kong; Korea, Singapore; and Taipei, China), and ASEAN countries (Brunei, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Thailand, and Viet Nam, in addition to Singapore)

MNCs from major OECD economies—such as Japan, the United States and the European Union—initially provided FDI in the Asian NIEs and then in middle-income ASEAN countries (Indonesia, Malaysia, the Philippines, and Thailand), China and Viet Nam. Recently, many emerging East Asian economies have also become FDI investors in low-income ASEAN countries and China, thereby further expanding trade and FDI linkages across East Asia. China has become an active player in the region's production networks and supply chains in recent years. While building a complementary relationship within East Asia, China is at the same time competing against several ASEAN countries in the global markets. India is about to join East Asia's production networks and supply chains.

In South Asia, a similar pattern is emerging, albeit not on the same scale as that in East Asia. The degree of intra-South Asian trade is still limited and the subregion remains a minor player in production networks and supply chains. However its small economies—such as Nepal, Bhutan and Sri Lanka—have increased trade dependence with India. At the same time India's investments are spilling over into its neighboring countries in various industries including chemical, air conditioning, plastics, among others.

Just as China's Lenovo connected to international marketing chains through its acquisition of IBM's personal computer business, Indian firms have been expanding their interconnectivity to OECD production and sales networks in automotive, steel, and other industries. In this way, India's outward FDI increasingly facilitates the attainment of economies of scale, access to markets, suppliers and ideas, and further integration into the global economy. At the same time, rapidly growing inward FDI has been contributing to vital industrial restructuring and rationalization and competitiveness. Due to the two-way flows of inward and outward FDI for India, the dynamic development of its manufacturing sector is beginning to catch up with its already world-class service sector exporters.

Now let me begin with the impact of global shocks—the credit crisis and rising oil and food prices—on Asia and policy challenges for the region.

### **Global Shocks—Credit Crisis, and Oil and Food Prices**

The US subprime crisis that originated in the US housing sector has been affecting the US and European financial systems and their real economic activities since August 2007. Partly reflecting the renewed weakness of the US dollar and a flight to safety amid ongoing financial turmoil, oil prices have broken new records at \$140 per barrel, and prices of major non-oil commodities—food in particular—have also surged to record high levels.

Although a full-blown financial and economic crisis in the US is highly unlikely, the US economy is slowing down fast and may even be contracting. With housing prices continuing to decline, the weakening US economy can affect the growth prospects of the Asian economy. However, there are several positive factors that provide Asia with some cushion: its financial institutions' limited direct exposure to subprime-related products; the availability of huge savings; increasing diversification of export markets into resource-rich countries in the Middle East, Latin America and even Africa; and expanding regional demand for final goods and services. Despite the possible negative

impacts through financial and real (i.e., trade) channels, I am optimistic that Asia will continue to achieve robust—though somewhat lower—economic growth. Economic growth rates of China, India and ASEAN were 11.9 percent, 8.7 percent, and 6.5 percent, respectively in 2007, and are expected to go down to 10.0 percent, 8.0 percent, and 5.7 percent, respectively, in 2008 according to ADB.<sup>3</sup> Though growth will likely slow down, its level will still be quite robust.

A real challenge for Asia is a continued rise in oil, food and other commodity prices and their inflationary impacts. With precarious supply conditions and inventory rundowns in the global markets, both crude oil and food prices may continue to rise, or at least stay high. There is no denying that speculative activities in oil, food and other commodity markets have played some important role in pushing up prices, but a large part of the price increases reflects fundamental, structural factors in the global economy of: (i) the creation of global liquidity since the bursting of the IT bubble in 2001 and the steep decline of the US dollar against all major currencies; (ii) persistent and rising demand for oil, food and other commodities by the rapidly growing, large emerging economies, like China and India; and (iii) inadequate supply of crude oil, food grain and other commodities.

In countries where the international prices of oil and food are passed on to the domestic prices, we already witness social anxieties and tensions across Asia. Food comprises a large share of the poor's total consumption expenditures (often more than 60%) in emerging and developing Asia. Food and energy combined comprise an even larger share (over 75%) of total expenditures. As a result, millions of people in Asia—perhaps as many as 1.2 billion—have become vulnerable to soaring food and oil prices. In addition, as food carries a considerable weight in the basket for the consumer price index (CPI) in emerging and developing Asia, food price increases directly raise general CPI inflation.<sup>4</sup> Inflation has already reached alarming levels in Viet Nam (27%), India (11%), Indonesia (11%), the Philippines (10%), Thailand (9%), China (8%), and many other economies. In countries where governments maintain food and oil subsidies, widening gaps between international and domestic prices have expanded the fiscal cost of subsidy to an unsustainable level.

Asian policymakers should respond to the soaring oil and food prices by adopting several measures. First, they need to pass on, in principle, the structural—if not the whole—part of high international prices to the domestic markets so as to induce market-based demand and supply responses, thereby encouraging efficient use of oil and energy and greater production of food. This requires substantial reduction, or even elimination, of fuel and food subsidies and price controls where they exist. To compensate this, governments should institute a cash subsidy program to directly help low-income people and sectors which are severely hit by price rises.

Second, to the extent that increases in global oil and food prices are driven by structural factors, the authorities should pursue tight monetary policy to control inflation. Prevention of a vicious circle of rising inflationary expectations, wage increases and

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<sup>3</sup> ADB, 2008, *Asian Development Outlook 2008*, Manila.

<sup>4</sup> Food price weights in CPI are high in Asia: 57.0% in India, 46.6% in the Philippines, 42.3% in Indonesia, 33.2% in China, 32.7% in Thailand, 30.0% in Malaysia; 26.9% in Hong Kong, and 25% in Taipei, China. Asian Development Bank, 2008, *Food Prices and Inflation in Developing Asia: Is Poverty Reduction Coming to an End?*, Economics and Research Department (April), Manila.

price hikes is critical because once a wage-price spiral is embedded in the economy it is hard and very costly to restore price stability. Tight monetary policy should be accompanied by currency appreciation in economies where foreign exchange reserves continue to rise.

Third, governments should adopt a set of structural policies to assist the market-driven responses to the higher prices to work better—such as promoting energy-saving initiatives, developing alternative sources of energy, and increasing investment to improve agricultural infrastructure, technology and productivity. Authorities in emerging Asia—like ASEAN, China and India—can use their public resources for implementing such structural policies.

### **Rising Inequality and Social Divide**

Largely as a result of sustained economic growth, much progress has been achieved in reducing poverty and improving social conditions in Asia. However, the rapid growth has also caused rising economic inequality—particularly income inequality—within a country. To reduce inequality, benefits of growth should be shared by low-income groups. While it is not clear that rapid globalisation and liberalisation in emerging Asian economies—such as ASEAN, China and India—are the main forces responsible for rising inequality, these economies need to adjust their domestic policies to support a more inclusive growth. The key is to create economic opportunities for the poor and ensure broad access to such opportunities.

Economic growth driven by labor intensive industries can create opportunities for many. Workers with sufficient human capital can more easily take advantage of new employment opportunities. This requires investment in education and health and establishment of institutions to help the poor have access to opportunities like microfinance. Governments can also introduce social safety nets to protect those most exposed to market and other risks.

Another effective approach is to focus on infrastructure development, which is a powerful means of achieving inclusive growth. It can create opportunities and help expand access to opportunities. For example, provision of clean water improves health, rural development enhances farmers' productivity, and electricity is a vital source of economic activity. Transport systems can expand access by connecting farmers with markets and workers with job sites. More fundamentally, infrastructure improves overall productivity and competitiveness of a country, a prerequisite for economic growth. Sustaining the rapid growth of China, India and ASEAN will require infrastructure, particularly for transport and energy. ADB's most recent estimate for infrastructure needs for Asia is \$470 billion per year over the next 10 years.<sup>5</sup>

The public sector alone will not be able to meet Asia's huge infrastructure needs and therefore, will require substantial private capital to close the financing gap and acquire new technology and management skills. Public-private partnerships as well as FDI in the infrastructure industry are critical. Let me inform you that the Asian Development Bank Institute (ADBI) is spearheading ADB's flagship study to address many of the challenges confronting Asia's infrastructure shortfall. For effective social protection and

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<sup>5</sup> ADB, 2007, *Assessing Infrastructure Requirements for Developing Asia: 2006-2015*, unpublished report, Manila.

infrastructure development, strong governance and institutional capacities are indispensable.

### **Regional Trade Arrangements**

In the Doha Development Round of WTO negotiations, views are divided not only among developed countries—particularly between the US and the EU—on agricultural liberalisation, but also between OECD and BRIICS countries on the treatment of manufacturing trade, agriculture and services. China, India and Brazil have been negotiating intensively to reach the outcome that serves the intended development objective of the round. Their active participation has demonstrated an increased maturity in the negotiation process, and a challenge for OECD economies is to ensure a win-win result, not a one-sided outcome.

At the same time, many Asian economies have been connecting with each other, with OECD economies, and with the rest of the world through expanding networks of trade agreements. Asia is indeed witnessing an increasing trend in bilateral and plurilateral free trade agreements (FTAs). Although FTAs have the potential costs of non-member discrimination and trade diversion, they also provide the benefits of creating trade and FDI among members, which can further stimulate trade with non-members. Benefits to smaller, poorer economies are particularly substantial once they are linked with large, growing neighbors—like China and India.

Many Asian FTAs go beyond the liberalisation of goods trade, including various WTO-plus elements that are not necessarily negotiated under WTO, such as trade facilitation, investment, competition policy and procurement, and other types of cooperation such as SME promotion, IT development, and the environment. They are also outward-looking as many Asian authorities have formed, or are negotiating, FTAs with non-Asian partners.

In East Asia, cooperation for regional economic integration is in progress. ASEAN is the integration hub and has formed, or begun to form, a series of ASEAN+1 FTAs (with China, Korea, Japan, India, Australia, New Zealand, and the EU among others) while striving to establish the ASEAN Economic Community by 2015. But the proliferation of so many FTAs, and the creation of a “noodle bowl” of multiple, overlapping rules of origin, standards and procedures, is making it cumbersome and costly for firms—particularly SMEs—to enjoy trade preferences. East Asian economies can benefit more by consolidating the noodle bowl into a single, region-wide FTA, such as an ASEAN+3 FTA (including Japan, China and Korea) or an ASEAN+6 FTA (further including India, Australia and New Zealand). Once a single FTA is formed, it will be much easier to connect East Asia with North America and Europe through cross-regional agreements. This type of regional and cross-regional cooperation is likely to be an effective way to navigate the dynamics of today’s accelerating regionalism towards globalisation. In this sense, deeper regional cooperation and integration in East Asia can be a building block for the WTO process.

### **Contributing to the World Economy together with OECD Economies**

BRIICS economies have made significant contributions to the world economy as key suppliers and markets for goods and services. Such contributions could be further enhanced if they collaborated more closely with OECD economies. I believe there is

significant scope for collaboration between these two large groups of countries, and I would like to end my talk by summarizing some policy options and directions on global shocks, trade issues, and social dimensions.

First, regarding the issue of global shocks, major OECD economies—particularly the US—need to maintain stable financial markets and currency values, as their financial and currency stability is vital for the health and steady growth of emerging economies. OECD economies should be encouraged to transfer energy-efficient technologies to BRIICS—particularly China and India—as these technologies can contribute to the latter's energy security, environmental improvement, and sustainable growth and development. Similarly, BRIICS economies need to: strengthen their financial systems to make them resilient to global financial turmoil; maintain steady domestic demand to offset the potential negative impact of economic slowdown in key OECD countries; and address the rising oil and food prices by adopting a combination of tight monetary policy, market-based structural policies and social sector protection. Tight monetary policy, often accompanied by currency appreciation, is essential to contain inflationary pressure coming from rising oil and food prices. Structural policies may focus on the reduction of domestic price distortions, and the improvement of energy efficiency and agricultural productivity. Targeted social protection should be designed to directly help low-income people and sectors hit by rising energy and food prices.

Second, on trade issues, OECD and BRIICS economies should come up with an agreement on the WTO Doha Round. Facing economic slowdown, major OECD economies should resist temptations to introduce protectionist measures and should maintain open trading and investment regimes. Given the recent rise in investment activities by several BRIICS economies—such as China, India and Russia—in OECD and developing economies through private FDI and sovereign wealth funds, it is important to encourage healthy competition among OECD and BRIICS economies to produce a win-win situation. For BRIICS and other emerging economies, adoption of an inward-looking policy is no longer a viable option as they need the global markets to sustain economic growth. East Asian economies should work together to make FTAs multilateral-friendly and at the same time create a single, region-wide FTA. These efforts should be complemented by behind-the-border reforms to improve business climates in their own domestic economies.

Given the considerable development gap between emerging and poorer developing economies, there is a need to share experiences and lessons learned from OECD and successful BRIICS economies with the poorer peers. The lagging developing economies are advised to further pursue domestic reforms so that they can benefit from open trade and investment regimes. We know from the East Asian experience that regional trade integration is an important tool for narrowing development gaps for poor economies as they can be brought into the regional and global production networks and supply chains and enjoy access to a larger market.

Finally, on the issue of income inequality and social divide, both OECD and BRIICS economies have common interests to ensure that the fruits of globalisation and economic growth are shared by all in their individual countries. The role of infrastructure development should be emphasized as an instrument to help achieve inclusive growth. On social sector protection, BRIICS can learn lessons from OECD economies. Governance reforms are essential to ensure that infrastructure and social protection policies can be effective in realizing inclusive growth.



## Conclusion

The resolution of proliferating global issues—like global payments imbalances, the global credit crisis, energy and food security, the environment and climate change—requires close collaboration between OECD and BRIICS economies. The G8 or OECD countries can no longer address these issues without involving BRIICS. The international community needs effective global governance mechanisms to reflect the voice and responsibilities of concerned players. One direction could be to expand the current G8 to G11 (by including Brazil, China and India), G13 (by adding Mexico and South Africa), or G14 (by further adding Saudi Arabia). Another, more practical direction would be for the G8 to organize an *ad hoc* meeting with whatever group that is most relevant to the issue at hand—like the Major Economies Meeting on climate change (16 countries including G8 and Australia, Brazil, China, India, Indonesia, Korea, Mexico, and South Africa).

From this perspective, OECD's engagement with BRIICS on key issues is laudable and should be further strengthened. Global financial institutions must also take into account in their governance framework the changing economic realities, by providing a greater voice to BRIICS and other emerging economies. This will help these economies shoulder greater responsibilities in global economic management and also help increase the legitimacy and credibility of the global institutions. I am optimistic that more effective global governance mechanisms will be created through strong support from, and cooperation with OECD economies.