

The Asian Century has arrived

The future of Asia is no longer just a story about China. In the decades ahead, Asian economies will go from participating in global trade and innovation flows to determining their shape and direction.



Oliver Tonby: You are listening to *The Future of Asia* podcast, by McKinsey & Company. I am Oliver Tonby, your host and chairman of McKinsey Asia. In this series, we feature leaders from across the region to discuss the forces, the opportunities, and the challenges that are shaping the future of Asia. Asia is in need of a new narrative. We need to stop talking about Asia as rising. We need to start asking ourselves how Asia is going to lead. Asian GDP is now going to be 50 percent of the global GDP by 2040.

Right now, 44 percent of international students are Asian, 119 of the world's 235 unicorns [as of April 2019, there were 331 unicorns in the world] are Asian, and 50 percent of growth in consumer consumption—consumer demand—over the next decade is going to come in Asia. This is not a China-only story. It is about India, the world's third-largest economy already by PPP [purchasing-power parity] standards. ASEAN [Association of Southeast Asian Nations] is soon to be the world's fourth-largest economy. Japan's hopeful resurgence. To make a long story short, it's not about if and when Asia will rise, but how Asia is going to lead.

Today, I am joined by two global thought leaders on Asia: Parag Khanna, managing partner of FutureMap and author of the recent book *The Future Is Asian*, and James Crabtree, senior fellow at the Centre on Asia and Globalisation and author of the 2018 bestseller *The Billionaire Raj*. Let's warm up with a little bit of a personal side, Parag and James. Tell me something interesting about yourselves. Parag, tell me about your most exciting recent trip.

Parag Khanna: I love to kick off that way. I think that talking about travel is revealing about the future of Asia in many ways because I went back into the Caucasus, one of my favorite little corners of the world, that is geographically in Asia. But when I say the Caucasus, no one thinks of Asia. Traveling through Georgia and Azerbaijan one sees the ways in which they're looking at growing trade with Asia. There are tourists from Asia; I saw Indians, Chinese, and so forth there. It's very much a Silk Road story—the new Silk Road extends that far and beyond. The Caucasus is a gorgeous place.

Oliver Tonby: I recall in the past you've also been telling other stories about a trip with a jeep?

Parag Khanna: Well, there have been many of those. I'll give two. One is just driving across China. It took a few months going through Tibet and Xinjiang, which people don't realize are China's two largest provinces but with the smallest populations. It was the summer of 2006, before there were roads and airports and so on. It literally did take more than two months to cover the distance over the Tibetan plateau.

Then from London to Mongolia—that was another Silk Road kind of trip in a jeep. Most of which was across Russia and, again, that speaks to the way China, in particular, sees Russia's role in Asia, because Russia is so compliant with Belt and Road [Initiative] kinds of priorities. They've been refurbishing railways across Russia, and highways as well. Russia increasingly sees itself as Asian. In all of my books—actually, the last couple of decades—I've always placed Russia very strongly in Asia, and that's more true now than ever.

Oliver Tonby: Fascinating. You've seen all this change firsthand over the last 25 years and more. We're going to come back to some of those topics that you already started talking about there. James, what's your most memorable episode or experience over the last many years in Asia?

James Crabtree: I live in Singapore now, but I lived in India for five years. The most fun that I had was a trip skiing in Kashmir. We were recording this at a moment in which Kashmir was very much in the news. The skiing in Kashmir is as good as anywhere you'll find in the world, but also it's the only place where you'll share chairlifts with Indian soldiers with Kalashnikovs, who were going up to areas close to the line of control.

The most interesting trip I've taken recently has been to Myanmar. I wanted to know it a lot better, and last month I spent a bit of time there trying to learn more about the extraordinary Chinese influence that's spreading out from China's western provinces in large infrastructure projects and in

other ways as China attempts to finally find a way to create its own California, West Coast maritime access, which, partially, Chinese strategists want to do by developing links through Myanmar into Western China. That was fascinating culturally, but also geopolitically.

Oliver Tonby: Fantastic. I am joined by two people who have known Asia for many, many, many years but also know what's happening on the ground, and you've seen it live. Now, let's start with what is the narrative about Asia. What should the narrative about Asia be? Because I think that is changing and it deserves to change. Parag?

Parag Khanna: Well, I think you've said it explicitly in your introduction. It is not just China. China is a pillar of Asia, but among the elements of a new narrative that I would pursue, or certainly highlight, is that Asia's going through what I call the fourth wave of growth. Japan was the first leader, if you will, of the postwar Asian growth miracle. The "Tiger" economies [Hong Kong, Singapore, South Korea, and Taiwan] came next, then China, and now you have the fourth wave, which is Pakistan and India—South Asia through Bangladesh, as well as the Southeast Asian countries. South and Southeast Asia, comprising this fourth wave of Asian growth, is a pillar of the new Asian narrative. It's not just China.

The second, though, is of course that Asia is Asianizing. There is an integration process. Again, as the McKinsey research points out, intra-Asian growth exceeds Asian trade with the rest of the world. This internal process has been very successful in promoting Asian economic resilience and will continue to more things as the regional comprehensive economic partnership unfolds.

The third is somewhat softer. Part of these two previous points, but it really needs to be highlighted by itself, is that Asia is an additive story. It's not just about the geopolitical rivalries between these civilizations and powers that have historical tensions over territory. It's also very much about the sort of additive complementarities that each gives to the others

through their role in finance and technology, trade, and other areas.

This mutually reinforcing story is also very important. Rather than being something that is just happening on the margins of a much deeper set of geopolitical tensions that will inevitably spill over and become World War III, rather, it is, in fact, 365 days a year of incremental progress between Asian countries that is the deeper story and that's preventing the notion of inevitable conflict between Asian powers from actually taking place. Among the many arguments James is going to give—much more and better ones—I think that if we could think of ten parts of the new Asian narrative, that's three or four to start.

Oliver Tonby: James, you agree?

James Crabtree: I do. I mean the globalization that we have come to be familiar with over the last 20 or 30 years is one in which bits of Asia were connected with the three poles of the rich world: North America, Europe, and, to some extent, Eastern Asia: Japan and Korea. The story we became familiar with was Asian exporters connecting with those parts of the rich world. What we're now going to see is a different and more complicated story in which Asia begins to connect much more with itself. The growth that is going to flow from that is going to be much greater than what we've seen already.

If you chart the Asian century from 1980, which was when China first opened up, we've had 40 years, and in the next 40 years we'll see Asia become much more central to the global economy. It's already larger than the rest of the world economy combined, but you're also going to see much greater interconnection, as Parag says, between parts of Asia. It still takes 30 or 40 hours to get from Kuala Lumpur, in Malaysia, to Bangkok by train. The idea that Asian connectedness is at the level that it needs to be is clearly incorrect, and there's still going to be a huge amount of infrastructure investment, digital connectivity, and movement of people that is going to increase.

It's going to increase more quickly than it has over the preceding period, and that's particularly true in the poorer parts of the continent, like the lower-middle-income countries—Myanmar, where I just visited; India, where I used to live; and Southeast Asia, as Parag says. These, in a sense, are going to become the locus of growth for Asia in the way that East Asia did over the last period.

Oliver Tonby: I think the numbers would bear out what you're saying, which is that Asia is becoming more interconnected. Just look at the share of interregional trade, which has already passed 60 percent of all the trade in Asia. We're seeing that in the numbers. You also started picking up on some infrastructure topics. Parag, you've spent a lot of time observing, thinking, about the Belt and Road Initiative. Say a few words about that.

Parag Khanna: Sure. I think the process of the infrastructural harmonization, coordination—just cross-border development of trade routes and linkages—has actually been happening since pretty much the day the Soviet Union collapsed, which is now almost 30 years ago. The world started paying close attention to it, really, four or five years ago, with the announcement of this Belt and Road Initiative. It's one of the phrases.

Oliver Tonby: When they put a name to it, yeah.

Parag Khanna: When China put a name to it. But it's been happening, financed by Japan, financed by Korea, partially by China with various pipeline projects, tactical sorts of things. It's been happening again in an evolutionary way, with many participants, for a couple of decades.

Belt and Road as a term has concentrated the mind. First of all, China has obviously amplified what has been going on, taking it to a whole new level. It's partly, to a large degree, what Chinese financial institutions, development banks, and the MBBs [McKinsey, Boston Consulting Group, and Bain] have been doing from a unilateral standpoint in terms of the financial firepower and lending and so forth.

But it isn't that all roads lead to China, right? Many countries are getting involved in what I call this

infrastructure arms race. You have the Europeans, you have the Americans. Japan and India are redoubling. Lots of countries are saying, "We want to be part of this infrastructure story." What you'll have is many Silk Roads leading in many directions, not just east–west to China but north–south, as well, in between various pairs of countries. I think we already have strong evidence that this is not only a China-centric story. We can look again at these bilateral pairings of countries and see growth in their trade even if it doesn't involve China.

Some in China would like to call them movement, rather than merely a purely Beijing-centric one to many kinds of exercise. There is firm evidence that it is in fact a many-to-many phenomenon, and that's where I've always viewed it going because that's actually in the genuine spirit of what the Silk Roads were—not really dominated by anyone but rather with China now, at this point, just adding more force to it.

Again, there is a lot more that can be said about it, but generally speaking, it's getting us to appreciate the multiplier effect that infrastructure has on domestic growth, GDP growth, organizational consumption but, of course, also on cross-border trade, which is very important for Asians in order to genuinely exploit the complementarities that they have with each other.

Oliver Tonby: There are many different angles we could pick up on here. Let me start with one. We hear a lot about different associations; trade agreements; TPP, the Trans-Pacific Partnership; RCEP [The Regional Comprehensive Economic Partnership]; the Asian Infrastructure Investment Bank; and so on. Are they important, are they real, or are they going to happen? What role do they play, James?

James Crabtree: I think you've seen different things in different parts of the world. We live in a moment in which it appears that the global state system is falling apart, but here in Asia there's some evidence to go in the other direction. You have the signing of the Trans-Pacific Partnership, now renamed without the United States [as the Comprehensive and Progressive Agreement for Trans-Pacific

Partnership]. You potentially have the signature of RCEP, an Asian-led trade agreement. You have the European Union signing trade deals with Japan, Singapore, Korea, potentially with others, potentially with ASEAN as a whole, if they get their act together.

As for the global trade system that we have come to know as the engine of globalization, I think it would be fair to say the future is going to be more problematic. This is still a complicated picture in which there are some parts of the world, particularly here, where policy elites are trying to push forward with trade and integration, and integration remains one of Asia's big challenges. It isn't just that it takes ages to get from Kuala Lumpur to Thailand; it is the large parts of Asia's potentially productive economy, particularly in South Asia, that barely trade with each other at all. This mission of integration is one that is a big part of Asia's future success.

Oliver Tonby: You mentioned ASEAN, and we can debate whether it's a glass half full or half empty. ASEAN as such has been a big driver for good, many would say, in terms of making trade easier. It's hindered some of the tensions that we otherwise have seen historically. On the other hand, other people are quite impatient and saying, "Now listen, progress could be much faster." What's your view, James and then Parag?

James Crabtree: I think there was a time in which a few were European, as both of us are, and Europeans liked to think that the rest of the world was going to become Europeanized. They looked at ASEAN and thought, well, maybe over time ASEAN as a grouping of southeast Asian nations would go down the EU route. I think that's almost impossible to imagine.

I think ASEAN firstly had real complications about its membership. You have one of the richest countries in the world, with Singapore at the top, and then you have some of the poorest countries in the world, with Laos and Myanmar at the bottom. You also have a very complicated security relationship with China. I think ASEAN will gradually continue to integrate, but you're not going to see anything close to a European-style supernational project. In a sense, that's one of

the big tensions for Asia and ASEAN, which is that, economically, as has been true over the last 40 years, all of the signs point toward greater integration and greater growth.

You do have a big complication on the security front, where Asia's security architecture has always been more complicated than in other parts of the world. In particular, the relationship between China and other parts of Asia, and the way China's rising influence is reacted to by other Asian countries—particularly the smaller, more vulnerable ASEAN countries—will have a big say in how successful Asia is in developing its economic potential. In the end, if you don't have a security architecture that allows you to trade freely—as we're seeing, at the moment, countries like Japan and Korea are fighting with one another over trade—that can be a severe damper on their own growth.

You have a tension between the economic potential and the complications of the security situation, and ASEAN is right in the middle of that. In a way, you could say that where Western Europe was the front line of geopolitical competition in the second half of the 20th century, ASEAN is going to be where this is played out between China, India, and the United States in the 21st century.

Oliver Tonby: Let's continue on ASEAN for a couple of minutes. Parag, I think ASEAN is one of the new and exciting parts of the new narrative in Asia. Just a couple of words about that.

Parag Khanna: Sure. The thing is about the teleology of integration, this notion that ASEAN should have evolved in the direction of the European Union. The fact being, of course, that this is a diverse region of the world, with a high degree of inequality. Both are points that James made: you were never really going to have ASEAN look like the European Union in a supernational kind of way. The homogeneity and the common geopolitical view, if you will, don't exist in this part of the world.

But that doesn't mean that you're not going to have the essential building—ASEAN-ization, if you will. Much more important than how robust or supernational the institution is, is to what extent

the economies are getting complementary, building relations and ties with each other in a way that maintains the momentum for that process. That we clearly see happening.

I just want to emphasize a point that James made about the inequality. We talk about a broader Asia of three billion middle-class consumers. That still means that there are about two billion poor people in Asia. A lot of them are either in South Asia or Southeast Asia. We have a long way to go to pull them upward. We have a long way to go in terms of the regulatory harmonization that we want to see happen, between ASEAN countries, that will help to drive the intraregional growth forward. James also mentioned that South Asian countries barely trade with each other.

The rate of intra-ASEAN trade as a share of total trade is low. This is, again, measuring it against Europe, which is disingenuous and irrelevant at some level, right? Because when you have very large countries, and many of them have complementary economies, you're not going to have a high-volume trade. They have to be rich, services-based economies to expect to see a large volume of trade between them. I think that ASEAN will get to where it's going, which is not where Europe is going, but certainly a much better place in terms of the complementary movement of goods and services than what we have right now, and that's, again, a positive story that doesn't get enough attention.

James Crabtree: Right. I mean there's one other interesting point, another challenge for Asia, which is particularly true for the lower-middle-income countries, not so much the ones who've already made it—the Asian Tigers—but those who are trying to make it. You have the global background of trade conflicts, but as McKinsey research has pointed out, at other points the success of Asia has come from building an exporting economy based on cheap labor.

That's going to become more difficult to repeat in the future because the global value chains that come through and out of Asia increasingly are service driven, digital. The places that prosper by connecting

to those value chains are more highly skilled, more urban. The image of Asia's future prosperity is less likely to be factories making garments or wooden furniture. That makes it more difficult for countries like India and Myanmar to prosper.

In addition to the tension between security and economic growth, you have the changing nature of globalization, which is driven by a whole range of factors, including automation—what people call the fourth industrial revolution. That makes it more difficult for the rising Asian powers to mimic the growth model that propelled the early pioneers of Asia.

Parag Khanna: James, I'll just add a statistical data point that's very useful in this regard. The good news is that even the Vietnams and Philippineses and Indonesias—the countries that we think of as being dependent on this manufacturing, export-led growth model of the previous Tiger generation—already are economies where 50 percent or more of GDP is services driven.

They have a fairly—what you might call a modern—economic structure or composition, despite their low income level. They are getting most of the marginal new jobs being created in manufacturing in the world, which is good for them. But they depend on it much less than their own economies did a generation ago or the Tiger economies did a generation ago. In other words, this is a sweet spot where Vietnam, the Philippines, and other like countries get to have their cake and eat it too. They get the jobs—certainly less than before, because of automation—but they're getting plenty of new manufacturing work. But they are already services-driven economies, right? They are digitizing, financializing, urbanizing, and so forth.

That doesn't lead to an exact prediction about whether or not they will overcome the so-called middle-income trap. But let's remember that this itself is an outdated concept when you think about the falling cost of goods and services.

Oliver Tonby: Yeah, and, again, the numbers absolutely bear out what you were saying—just going back to this point that you were making,

James. Today it's less than 20 percent. Eighteen percent of trade today is based on this low-labor-cost arbitrage, right? Which is significantly down over the last decade.

We look what is happening now. China is increasingly producing for China. India is producing increasingly for India. In China, we've seen that the percentage of goods manufactured that are exported has gone from just about 16 percent to 8.3 percent in a decade. By the way, that is while manufacturing overall has tripled, so it's not that they're doing less—they're actually doing a lot more, but the percentage exported is much less. China is producing for China and so forth, and that's true for all the countries.

Overall, we'll focus on the longer term, but we know there is a lot of tension, there's a lot of conflicting interests in the short term: trade wars and what have you. Are these important in the grand scheme of things?

Parag Khanna: Well, I think that we have to put the trade war in context. It's woken a lot of people up to things that were already happening, but if we were to have this conversation ten years from now, it would be disingenuous to attribute things that have been happening since before the trade war to the trade war. We have an opportunity now to make sure that people understand the correct sequencing of what's been going on.

For example, Japan has been diverting foreign investment from China into Southeast Asia for ten years, well before the trade war. It's been doing so because of the labor-cost arbitrage—because Chinese wages are rising—and because of geopolitical tensions with China. You remember the rare-earth mineral dispute, for example. Western countries and firms, multinationals, started to see what Japan was doing and to also wake up to the ASEAN opportunity before the trade war.

If we look back ten years from now and we say, wow, ASEAN really benefited, it must be because of the trade war, let's be clear that it's not just because of the trade war. The trade war was an accelerant to something that was underway. What

was also underway way before the trade war was, again, the fundamental data that you pointed out at the top, which is that intra-Asian trade has exceeded trade outside the region. This integration process was going on before the Western financial crisis, before the trade war. We should not be looking back and falsely attributing Asia's own progress and integration to either of those phenomena. We should view it as something much more organic, if you will.

To the final point, does the trade war, in the end, really matter? Clearly, it's accelerating things that were already underway, which is not only Asia's own integration, but then your Asian integration, as well, because Europe's trade with Asia exceeds its trade with United States by a very wide margin. Europe already has been looking to Asia as a way to hedge against, sort of, political volatility and the economic kind of plateau of the United States for a very long time, before the trade war, before the Trump administration. We should think about these things. As you write, let's take a step back, think about the long term, and the more you look at it, the less today's focus on the trade war genuinely matters.

James Crabtree: I think it's immensely significant for two reasons. The first of which is we have had, for the last 30 or 40 years, an unusual interregnum in history: what people call the rules-based order that was an attempt to separate economic and security policy, which was reasonably successful under the United States umbrella. If countries had economic arguments with one another, they did that in the economic domain. They did it through WTO [World Trade Organization], they did it by rules associated with either global or regional trade agreements, and it's very clear that what is happening is that it's breaking down.

It's partially breaking down because of the United States, but also because of others. Look at what's happening between Japan and Korea at the moment. This intermingling of security and economic policy, which is the normal order of things and has been true for most of human existence, is returning. That simply makes it more difficult to do business, introduces all sorts of

levels of uncertainty on lots of different levels. I think that the return of a certain kind of history is significant, and it's also significant for what we were talking about before: that in the end, the type of globalization we're moving toward is different from the one that we've been used to: it's more Chinese, more digital, less to do with labor-intensive manufacturing.

Nonetheless, if you're India or Myanmar, you still want to build a labor-intensive manufacturing economy. You have a lot of people who need jobs. You want a slice of that Chinese factory economy. You want to be making smartphones. You want to be making solar panels, in part because of the magic of manufacturing. It's the best way that we know to take the hundreds of millions of people who still work on farms and move them into cities and into productive labor.

Parag is right that a lot of these economies have service sectors, but these are service sectors working in a Vodafone shop. It's not working in a software developer. Manufacturing remains the most successful engine of globalization and economic development for the poorest countries. If that becomes more difficult, as it will, and if trade is costlier, it will have a dampening effect on Asia's ability to prosper, particularly among these poorer countries.

Parag Khanna: I'll add one point, one word of hope. Given this situation where Myanmar and Indonesia are going to struggle to generate a large industrial base as a real engine or motor of growth, this will, hopefully, get them to focus on greater efficiencies in the endowments that they do have, which is natural resources and so forth.

Because if you think about the mismanagement, the waves, the corruption, the low productivity in those sectors, they do need to get right what God has given them, right? I'm saying this very pointedly at a country like Myanmar, where six or seven years ago I remember doing a panel with a minister and he said, "Remember, six or seven years ago Myanmar was even less developed than it is today." He said, "We are going to be a

'smart nation.'" I was, like, hold on, can you please get your timber, jade, gas, and other things right first because, just to add to what James was saying, when you think about the engines of growth historically, yes, for Asian countries what you said is absolutely true: manufacturing.

If we're talking about Persian Gulf countries, that's not true. They got their energy sectors right. Let's have every country do best with what they have, and that's what comparative advantage is all about.

Oliver Tonby: We're going to come back to some of the things you said, especially on technology. Coming back to the trade tensions and trade war that we have today, what I hear is, of course, that it matters to the CEO who needs to make short-term decisions around how much to invest, where to invest, and how to plan for a growth. That is a difficult decision and is now even more difficult.

In the long run, what this also does is accelerate some of these trends and shifts that we see across Asia—shifts in supply chains, where everything is going to be produced and so forth. Perhaps, worryingly, it starts to undermine the way economics, trade, et cetera have been happening. You talked about a rules-based order, James. It starts undermining some of the confidence, some of the trust and relationships. Those are the long-term implications of the short-term tensions that we see. Hopefully, short-term tensions.

James Crabtree: I think you see different trends pulling in different directions. If you think about value chains, then the global value chains that multinationals have created have lengthened substantially over the last generation. They have become longer and more complicated. They have become more diverse. They're in different parts of the world. You think of the classic examples—the iPhone, the Airbus, what have you.

Now geopolitical tensions are going to, I think, almost undoubtedly force companies to shorten those value chains. They're going to localize them. They're going to regionalize them. They're going to

make them less complicated. That would be one direction. Technology pulls you in other directions as technology becomes more diffuse, as more of the value in products is contained not in the physical goods but in the services, IP [intellectual property], and digital infrastructure wrapped around them. Then that will take you in a different direction.

The interplay of these factors—the way that geopolitics and trade tensions and the rising cost of trade will change incentives for companies—might take you back from the vision that we had before the financial crisis: the age of hyperglobalization. Then you have a new world opening up that will create a different set of incentives. That may also privilege different countries. For instance, we've got very used to the winners of stages of globalization being the manufacturing exporters. Most recently, Vietnam has been the one that's been able to manage that. It may well be, if they get their act together, that the next stage could be India and the Philippines, countries that have large English-language-speaking populations and that have a tech base that is deeper than in other countries. This change in globalization will create winners and losers, just as the last one did.

Parag Khanna: The better part of globalization has also long been regionalization. We shouldn't pretend that the two are necessarily antithetical. If you look at the Asianization process, and you think about the trade agreements within the Asian region—more than 20 bilateral or interregional negotiations underway—they borrow a lot from the global playbook of the WTO, right?

It's not that the global trading system is dead. It's about the rules more than it is about one specific institution. You don't have the League of Nations anymore, but one generation of institutions passes on certain codes and laws and norms that evolve and are adopted and integrated in different ways. It's true that the WTO is on the ropes in many ways, but it has been since way before the trade war because we weren't able to make progress among

countries and on basic issues like agriculture or very advanced issues on IP protection.

Yet you're forming these major Asian trade agreements, which are contributing in many ways to globalization because as Asia integrates further, it becomes a very attractive market and it brings in, still, a lot of foreign capital and firms, right? They are borrowing from the key architecture templates and rules from the global level. Even if the global trading system "falls apart," the DNA of the WTO and its rules are embedded in these new regional entities and institutions.

I take an evolutionary view in which so-called fragmented isn't necessarily totally fragmented—it's a phase. McKinsey has tried to do a lot to quantify the value of global services trade, as hard as it is, and never really properly covered that well. We have a parallel set of agreements, in global trade negotiations, around technology and services, in which there are coalitions of dozens of countries that are significantly liberalizing trade in those areas that haven't been fully addressed by the WTO. Let's not hold up the WTO as the one and only institution that embodies the notion of trade. Trade continues, complementarities continue, comparative advantage continues and flourishes around the world in many ways.

Oliver Tonby: Let's shift topic from where we were. You've mentioned the word "technology" and different types a few times. Let's zoom in on technology for a second. Some actually would say that an ongoing so-called trade war isn't about trade; it's actually about technology IP and so forth. Certainly, if you look at technology in Asia over the past decade, there have been huge leaps forward, right? I mentioned earlier 119 unicorns out of 230 globally are here in Asia. We see the amount of venture investment.

China is already the second largest, behind only the US, globally. We see that, actually, the majority of the venture investments in Asia are done by Asians, Asian institutions. There's just an incredible growth, and it's not only China. India has more unicorns than Germany, and they're spending

more venture financing than Germany. But how do you think about technology and its role and its standing in Asia?

James Crabtree: I think you're right. The venture scene here is particularly interesting. It's happened very quickly. India has a bench of technological talent going back to the formation of its IT-outsourcing industry at the turn of the century, let's say when I lived there in 2012, 2013—that was in the aftermath of the Alibaba IPO. You had a lot of money that had previously been in China, or chasing Chinese profits, that went to India.

Only in the last couple of years have you seen the extraordinary flourishing of Southeast Asia—the kind of ASEAN tech scene as well—driven by companies like Grab and Gojek. Increasingly, the VC community has realized that there are 600 million consumers here, and although this is a more complicated market than China or, potentially, India, this is going to be a big source of growth, as well.

I think one note of caution, though. Parag mentioned earlier this idea that people are very keen in Asia to use the phrase “smart nation,” which is a Singaporean phrase. But the word that is often used is “leapfrogging”—that, somehow, because you have lots of mobile phones and you have companies like Grab and Gojek, you are moving very quickly from being, in a sense, an integrated kind of country to a very advanced sort of country and that you can do that across all domains. That doesn't really work.

In the end, the successful Asian countries that developed did the basic things right. If you were in Singapore, you became experts in municipal sewerage, building regulation, and urban planning. You develop high-capacity state organizations where civil servants were well paid, not corrupt. In a sense, the temptation of technology, remarkable though it is, shouldn't take you away from the fact that the basic drivers of good development often have nothing to do with technology at all. They're about high-quality institutions and getting the basics right.

I think there is a huge potential in Asia to use technology to combat a whole range of challenges, from poverty to climate change, which we haven't mentioned but is one of the most significant, but you have to realize that that isn't all that you need in order to develop quickly.

Parag Khanna: I couldn't agree more with what James is saying. Even with Gojek as a superapp in Indonesia, Indonesia is still Indonesia, right? There are things that this superapp can do, and in some ways, they are contributing to the state nest. This is the area where things get interesting. Indonesia is still a weak and limited state.

However, in terms of leapfrogging—because I think that's the term that I agree with James we should be using, in a guarded way—maybe the one thing that Gojek can do, and this is more potential than actual, is to help Indonesia be a better state in the sense that poorer countries can use technology for public-service delivery more efficiently than they would have if they were to go through a conventional development process.

If you think about healthcare services, a country like Indonesia and India, which is very poor per capita, is legislating healthcare and a minimum healthcare standard. They're not middle-income countries. They aren't \$40,000 high-income countries, either, where they can afford to have a European-style welfare state. Then why is it that they have the confidence to say, “You know what? Let's legislate universal healthcare because we're going to find technological solutions to delivering basic medical care at a very low cost.”

They wouldn't be able to do it without some of the new technological inputs. The critical thing, just one of the points, is that we do celebrate the unicorns and the inventiveness to the extent that that's happening in Asia. Fundamentally, the role of technology in promoting Asian growth is not so much how much did you invent but how much did you adapt, how much did you incorporate?

Countries that are not going to be major pioneers of new technologies—like Vietnam and Indonesia—

the question is how much they are absorbing the lowest-cost, best-performing technology platforms that are going to help them develop anyway. That's less sexy than looking at unicorns, but in terms of scaled impact for a large society, that matters a lot.

Oliver Tonby: We haven't heard much about Japan and Korea so far in this conversation. Any thoughts on technology in Japan, in Korea? How is that changing companies and what have you? Any thoughts on that?

Parag Khanna: First of all, it's what's happening indigenously, domestically, in those economies because they are the most mature, sophisticated, technologically penetrated countries in the world in terms of everything from telecommunications standards to the role of technology in healthcare, as well as their R&D and everything from materials to biomedical.

What you see is a highly evolved sort of society in terms of the role of technology in those countries. Then there's also how are they exporting it, and we're seeing a lot more of that as well because they are doing a lot to diversify, again, their supply chains and bringing the manufacturing of certain technologies—such as ships, mobile phones—into secondary markets.

They are spreading technology much more rapidly, and that way it's also happening in the automotive sector as well. They are exporting things like Internet of Things. Japan also has its own AI [artificial intelligence] initiative, so it's, again, not just about Baidu going out and being a kind of Chinese engine of data absorption and services in the region; it's also Japanese companies. Whether it's Internet of Things, sensors, AI—in all of these areas, Japan and Korea are not just innovators for their own economies but they are exporting these as well.

James Crabtree: They are on the front line of geopolitical competition, for starters. Both are American allies in an era in which that's more complicated; both countries have a complicated

relationship with China, so that's a problem. It's also problematic from a technological point of view. Just as the Americans and the Germans worry about what happens to their high-quality technology in an area in which China is becoming more prosperous, so Japan and Korea feel much the same threat—companies like Samsung, for instance, which has spent so much money on IP, are being threatened by the rise of China and developing an innovation economy.

These are innovative, technologically advanced societies. They themselves worry that they are not able to mimic what you see in Silicon Valley or in the suburbs of Beijing in terms of technological innovation that's creating companies that are then going on to have a global presence. You have companies, like SoftBank, which are very high profile, but there are fewer—apart from Samsung—fewer tech giants emerging from these countries. I think there are three interesting areas to watch: the geopolitical position, their technological relations with China, and then the extent to which they are able to sustain and develop their position as world-leading innovation economies.

Oliver Tonby: Two questions to each of you as we start to round off. Number one, anything that is important that we haven't covered on Asia overall? What advice would you have for a leader listening to this conversation, in terms of how to think about Asia?

James Crabtree: I think the biggest and most obvious one is climate. This is going to be an extraordinary driver of all sorts of developments around Asia—many of them bad, unfortunately, but some of them good.

We were recording this podcast a few days after the Singaporean prime minister gave his annual address, in which Singapore, being the most technocratic and long-term government in Asia, rolled out the beginnings of a 100-year plan to begin to protect this small island, where the three of us live, from climate change. That is going to involve a huge amount of investment, some of which will have productive consequences. I fear

if you are in India, for instance, or other climate-affected nations, that many of the consequences of this are going to be bad.

I suppose if I were giving advice to a political leader, the advice that I would give is that the only thing that solves all of the challenges that Asia has is high-quality government. There is a problem Asia has that is rooted in its history, including figures like Lee Kuan Yew, where there is a skepticism of the state. A lot of Asian economies still do not want to be seen to be sclerotic, Western European-style bloated governments. In the end, you can't solve problems like climate change, urbanization, or industrial development unless you have high-quality government. That was what Singapore got right. It developed world-class institutions.

If you look around the rest of the continent—particularly places like India, where I used to live—they're very far from world-class institutions. I think that is the big challenge. It's not to do with technology; it's to do with institutional development.

Parag Khanna: I would like to echo that. Maybe we can take those two things that James mentioned and write them, side by side, as the two major issues to be talked about further, which are governance and climate change, and the governance of climate change, which requires foresight and long-term planning, investment, decisiveness. And, of course, many Asian governments lack those characteristics. I think that they are learning fast from each other, and one of those things that we do see here in Singapore is that a lot of governments are sending their ministers and officials to Singapore to learn how to do these basics.

Of course, they do feel the threat. They're not blind. They may not be the least corrupt countries

in the world, but they certainly are noticing the impact of cyclones and tropical storms and rising sea levels and so forth on their economies and realizing that they have to do something. They can lie to their own people, but they can't lie to nature, so to speak. I'm hoping that instead of the kind of breakneck pace of coastal urbanization development, where a lot of the trillions of dollars of infrastructure spending has been going, there are governments that are going to say, wait a minute, what are we going to do about resettling our populations, moving further inland, thinking about water conservation, less soil erosion, subsidence, and all of these things that need to be done in terms of climate adaptation.

Hopefully, that focuses the mind and, in some way, leads to greater accountability, spending, and more foresight about how to productively employ labor while also becoming as future ready as countries can be in what's going to be a volatile climate.

Oliver Tonby: James, Parag, let me thank you so much for joining us this morning. A fascinating conversation. I'm not going to try to summarize, to be honest, because we covered many things. I'll just end by saying that this leaves me being an optimist about Asia long term, but I would say a realistic optimist rather than only an optimist.

Parag Khanna: Thank you for having us.

James Crabtree: Thank you.

Oliver Tonby: You have been listening to *The Future of Asia* podcast. To learn more about McKinsey, our people, and our latest thinking, visit us at [McKinsey.com/futureofasia](https://www.mckinsey.com/futureofasia), or find us on LinkedIn, Twitter, and Facebook.

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