AN INVESTIGATION INTO THE FINANCIAL ROBUSTNESS OF ASIA

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ABSTRACT

Recent developments in the fields of global financial architecture and economic growth have made peculiar impact on Asian markets faced with ever increased opportunities as well as challenges to ensure growth for themselves and contribute to the development of the other economies. These challenges include, but are not limited to, the slower economic growth witnessed in recent times due to the continued economic crisis in developed economies, increasing doubts of global investors, burgeoning middle income class and declining exports consequent to the less enthusiastic external markets. This paper analyses the financial development and economic growth in Asia over past fifteen years. Some of the main findings highlight increasing income inequality and gaps in financial inclusion across various economies of the continent. The research also shows that the progressing transition in the region's growth prototype from being predominantly investment oriented to one developing an increased reliance on investment as well as productivity growth also emphasises the earnestness for financial development. The research concludes that in order to be benefitted from a robust financial architecture, governments of various countries of the region should pay heed to integrate their respective financial systems with all inclusive structural and policy reforms.

Keywords: *Macroeconomics, Development Economics, International Economics, Financial Economics, Asian Growth, Asian financial Development,*

INTRODUCTION

Despite being the fastest-growing economic region of the world for last some decades, developing Asia is lumbered with a rather weak financial architecture. Development of the financial system continues to be one of the most significant development targets among the economies of developing Asia.

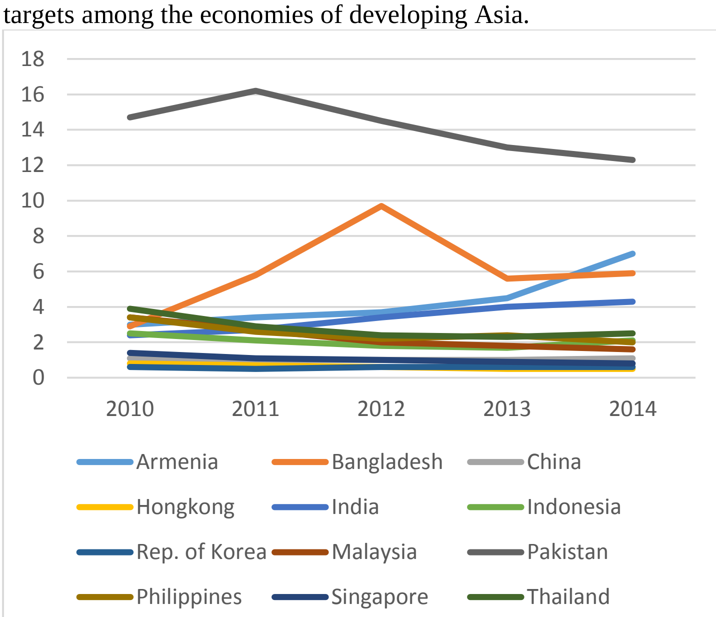

Figure 1: Bank Non-performing Loans to Total Gross Loans (%)
Source: Developed by Author on the basis of World Bank Data

Late 90s were preceded by huge foreign currency inflows in the prime Asian economies but the not so farsighted financial institutions of the region channelled the funds into unproductive investments which enfeebled the investment efficiency and pushed the region into Asian financial crisis. To rebuild the economic robustness, widespread restructuring reforms were initiated across Asia. Ironically, the region was affected adversely once again due to the global financial crisis during 2008–09, but learnt that even financially developed economies are vulnerable to risks consequent to abstruse products, uncontrolled lending, and poor regulation. Asia learnt its lessons well, and embarked upon building sound and efficient banking system supported with strong capital markets. The reforms varied from country to country according to their level of development but as of now, only Hong Kong, China and Singapore seem to have been successful, while the lower-income Asian economies continue to have lack of adequate finance.

Asia has two of the world's fastest growing economies, of India and China and at first glance it may get construed that the paradox of having fast economic growth despite weak financial system in developing Asia shows that a financial robustness and efficiency are not for a country's economic growth and development. But this being far from the fact, only highlights the point that the region would have grown much faster with a well-developed financial system.

Considering this as a good opportunity to investigate the existing and potential characteristics of Asian financial sector, this paper is organized as follows. Section II provides a brief review of financial development and economic growth in developing Asia. Section III addresses the issues of financial exclusion and income inequality as they exist in developing Asia. Section IV discusses the issues needed for prevention of financial instability. Section V presents the conclusion on the basis of the findings and discussions made.

FINANCIAL DEVELOPMENT AND ECONOMIC GROWTH IN ASIA

In comparison to other developing economies, developing Asia had a habit of high savings and high investments. Demographics make a big reason for it as the region has witnessed rapid growth in the working-age population and resulting low dependency among people, which grew the savings. But at the same time, population was also ageing which would result in economic slow-down later on.

Asia experienced slow growth partly as an effect of the global crisis also, because of which the developed economies of the world were badly hit. Since most of these developed economies such as the USA and European Union constituted the most important buyers for developing Asia's exports, the failure of these economies to recover adequately casted an adverse effect for developing Asia's export-led growth.

Adding to the challenges thrown by environment created by declining balance of trade, the region faced a plethora of internal structural growth hindrances. The economic slowdown can also be attributed to developing Asia's success in the past. As economies grow prosperous, the economic growth becomes slow after a certain threshold. For example, the People's Republic of China is experiencing the slowdown due to the restructuring of excess rural labor getting exhausted but the promising sign is a government-induced transition to more sustainable growth rate.

Having said that, investment still remains a significant cause of growth in key Asian economies for example India, Indonesia, and the Philippines, where the financial architecture can enhance the investment environment. In fact the scope of improvement in investment lies also in the high-investment economies such as China, where a part of the geographical territory is still underdeveloped.

Economic growth in developing Asia can be ensured by increasing the productivity levels of various factors of production. Technological progress and knowledge development are the other two important factors that can contribute to improve the factor productivity as well as efficiency. To witness technology and knowledge led growth, Asian economies will have to research and development and the promising part is that Asia houses countries such as China, and Korea which are reputed worldwide for their global contribution in the field. The lower-income economies will have to rely on knowledge and technology import and modifying them to suit indigenous environment and needs.

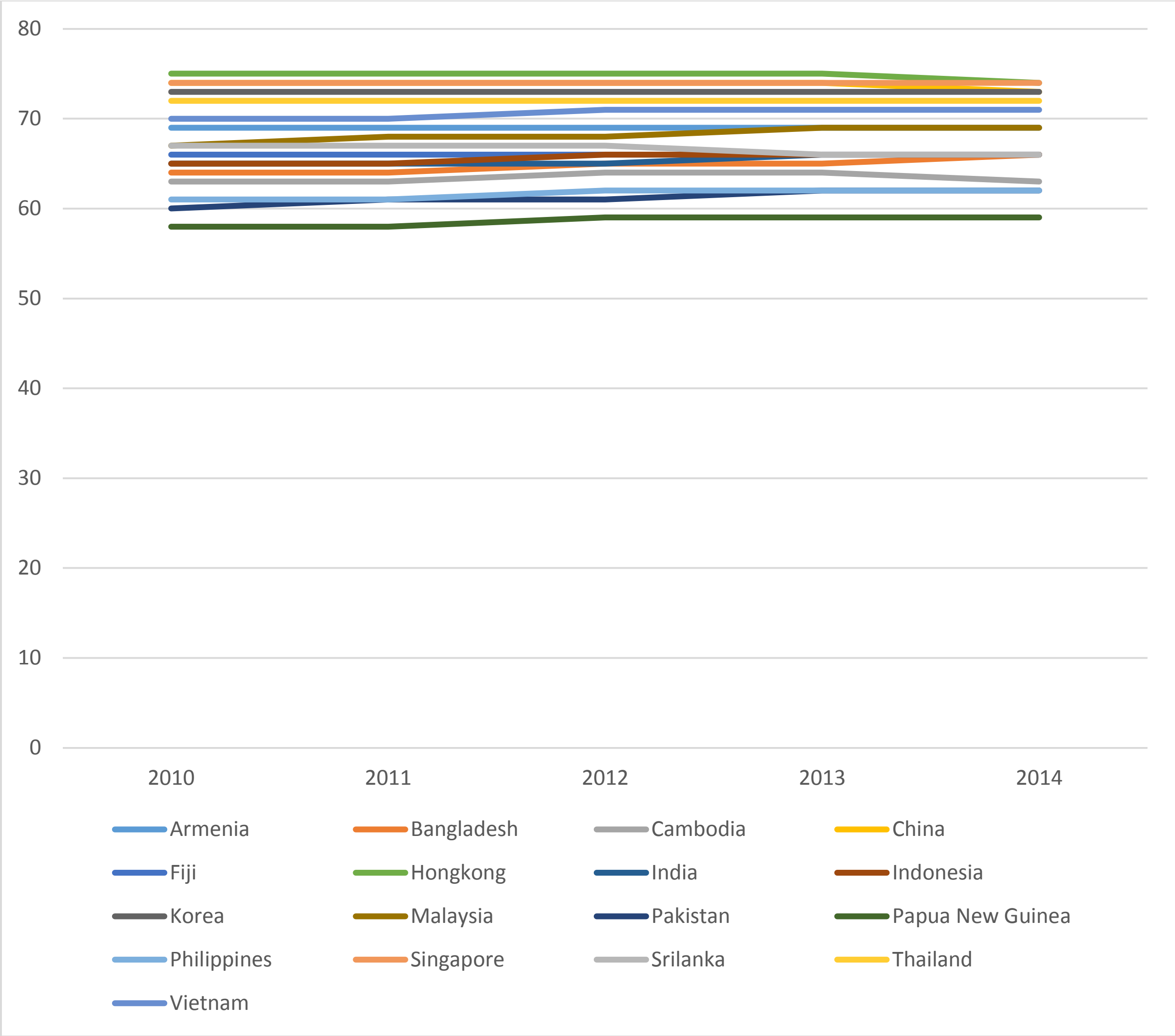

Figure 2: Population aged 15-64 (% of total)
Source: World Bank Data 2015

ADDRESSING FINANCIAL EXCLUSION AND INCOME INEQUALITY

Asia, as a region together, witnessed very fast economic growth as a result of steep rises in personal incomes and consequent living standards. Such rapid growth metamorphosed the region from a typically low-income under-growing to one of the three strongest centers of the global economy. Most of the countries have considerably reduced the number of people living under poverty lines. The relatively poor also have a better access to technological advancements as comparison to their past. But this has also resulted in ever increased levels of consumerism and capitalism. As a result the economic inequality is rising as also the disparity in income distribution. One evident instrument for dealing with this mounting inequality is fiscal policy. The government can help promote equity through progressive taxation as well as increased public spending.

In many Asian economies, only a low percentage of low-income group people have financial inclusion. Financial exclusion does not only sweep across the household sector of developing Asia, but also extends to the business sector. Small and medium-sized enterprises get restricted in terms of growth and expansion many a time due to lack of adequate finance.

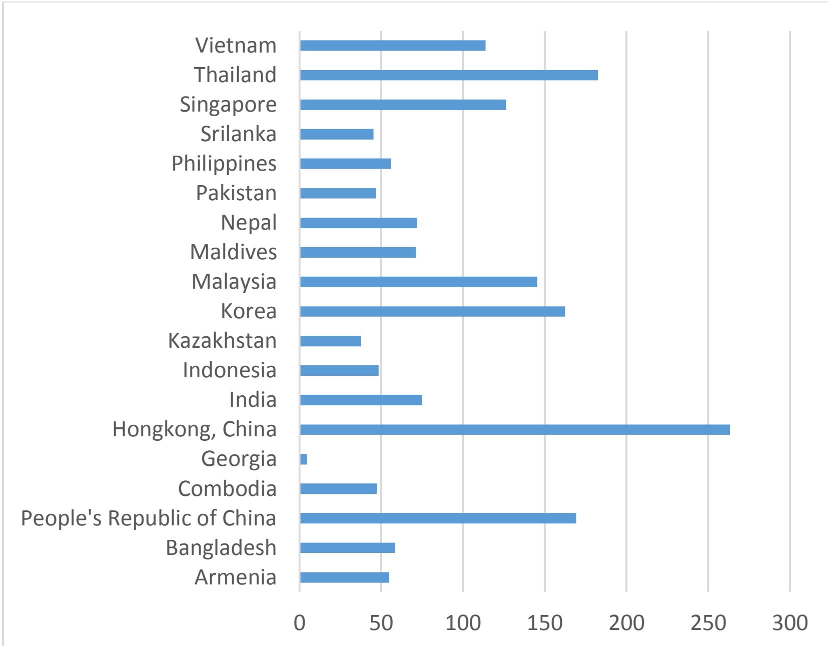

Figure 3: Domestic credit provided by financial sector (% of GDP) for year 2014
Source: Developed by author on the basis of World Bank data.

A particularly malevolent kind of financial exclusion pervades in Asian economies, especially due to favouritism shown state-owned enterprises by state-owned financial institutions. This results in lack of adequate finance for private sector and most badly affected are the new companies as well as the small and medium enterprises. This also partially explains the reasons for low economic growth in such economies because the private sector is usually the more efficient, innovative and productivity growth. Financial exclusion limits such innovative enterprises and slows down the economic growth.

PREVENTING FINANCIAL INSTABILITY

In May 2013, US Federal Reserve Chairman Ben Bernanke signalled to narrowing quantitative easing. This was when the Asian economies got a hint of their financial volatility due to the dependence of the financial architecture of the region on the monetary policy initiatives of developed economies of rest of the world.

Financial development and innovation have the potential to increase risk of bringing financial instability in absence of an efficient regulatory system. Financial development enhances economic growth by increasing investment, mobilising capital, enhancing innovation, and raising productivity. But the Asian financial crisis showed that it can also contribute to financial instability. The crisis brought with it, abrupt and huge reversal of foreign capital inflow which had an upsetting influence on aggregate demand and growth in developing Asia. Almost all rapidly growing economies crashed due to shocked financial markets. This further witnessed steep depreciation in the value of national currencies, smashed investor and consumer confidence, reduced productivity, steeply declined output and increasing unemployment. Needless to say, the region experienced heightened social problems.

Though it may seem that such financial instability was a result of extreme financial development but in reality, this happened because the financial systems in the Asian economies were not resilient enough to withstand the internal as well as external shocks.

This gave the experience and the knowledge to the Asian economies that irrespective of the ownership of financial institutions being government or private, there should be extensive state guidance, and innovation oriented pragmatic regulatory policies. In certain instances, innovative measures such as macro prudential policies may aid a rigorous regulatory framework.

Preferably, financial development ought to go on in a manner which diminishes the risk of financial stability while capitalizes on the paybacks for economic growth.

CONCLUSION

Financial development in Asian economies is a topic of prime concern to them. The region is characterised by a dynamic real economy and comparatively weak financial sector. The region's growth has decelerated since the global crisis, triggered by a harsh external environment and internal structural challenges.

The slowdown magnifies the cost of financial underdevelopment, particularly in terms of unmet growth. Additionally, emphasising the earnestness of financial development is the growing change in the region's growth archetype from investment based to investment and productivity based. The significance of innovation and knowledge in the economic growth of the region makes it essential for its financial system to channel more, better and cheaper finances to new enterprises.

Financial development in Asia needs building rigorous and efficient banking system, equity markets, and bond markets that transform savings into productive investments while alleviating their vulnerability to shocks. In the past the superseding importance of growth lay in growing as fast as possible. This priority seemed appropriate in wake of the region's very low income level and high poverty. Nevertheless, developing Asia has eventually evolved into more of middle-income region, and most economies are now becoming aware of the fact that sustained quality of growth is as important as the expanse of growth. A prime constituent of high quality growth is a higher inclusive growth. Financial inclusion enables inclusive growth, by expanding the spread of financial services to broader bands of population and economy, especially poorer households, start-up firms and small enterprises.

A rigorous and efficient financial system has huge profits for economic growth and development. Such profits become even greater if financial development is accompanied with all inclusive structural and policy reforms. Concisely, financial development and inclusion are most effective in a regulatory environment which is conducive to growth and development.

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