



# The future of Asia

Asian flows and networks are defining  
the next phase of globalization

**Discussion paper**

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MGI is led by four McKinsey & Company senior partners: Jacques Bughin and Jonathan Woetzel, as well as James Manyika and Sven Smit, who also serve as co-chairs of MGI. Michael Chui, Susan Lund, Anu Madgavkar, Jan Mischke, Sree Ramaswamy, and Jaana Remes are MGI partners, and Mekala Krishnan and Jeongmin Seong are MGI senior fellows.

Project teams are led by the MGI partners and a group of senior fellows and include consultants from McKinsey offices around the world. These teams draw on McKinsey’s global network of partners and industry and management experts. The MGI Council, which includes leaders from McKinsey offices around the world and the firm’s sector practices, includes Michael Birshan, Andrés Cadena, Sandrine Devillard, André Dua, Kweilin Ellingrud, Tarek Elmasry, Katy George, Rajat Gupta, Eric Hazan, Acha Leke, Scott Nyquist, Gary Pinkus, Sven Smit, Oliver Tonby, and Eckart Windhagen. In addition, leading economists, including Nobel laureates, advise MGI research.

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# Preface

The Asian Century has begun. Already the world's largest regional economy, Asia is set to continue to grow in scale and influence. This region is at the forefront of shifting patterns of globalization, and is indeed shifting faster than the rest of the world, suggesting that it is Asia more than any other region of the world that will shape the next phase of globalization.

In this paper, we build on the January 2019 McKinsey Global Institute (MGI) report *Globalization in transition: The future of trade and value chains* by examining Asia's rise on eight dimensions incorporating 16 types of flow, looking at the increasing integration of the economies of the region, and highlighting the development of three powerful new Asian networks: industrialization, innovation, and culture and mobility, and the rising cities that are pivotal components of those networks. This paper is one of a series on the future of Asia, prepared in collaboration with the Asia offices of McKinsey & Company, which will all be available at <https://www.mckinsey.com/featured-insights/future-of-asia>.

The research was led by Oliver Tonby, McKinsey senior partner in Singapore, and chairman, McKinsey Asia; Jonathan Woetzel, McKinsey senior partner and a director of MGI in Shanghai; Wonsik Choi, McKinsey senior partner, and managing partner, Korea; Karel Eloot, McKinsey senior partner in Shanghai; Rajat Dhawan, McKinsey senior partner in Gurgaon; and Jeongmin Seong, MGI senior fellow in Shanghai. Patti Wang, a consultant in Shanghai, led the project team that comprised Takakazu Doi, Gahwan Kim, Lily Ma, Erik Rong, and Raye Qin. We are grateful to a number of MGI colleagues who were closely involved in the project, namely Jacques Bughin, Michael Chui, Shishir Gupta, Mekala Krishnan, Susan Lund, Anu Madgavkar, and James Manyika. We thank key members of MGI's operations team including Janet Bush, MGI senior editor, who helped write and edited this report; Julie Philpot, editorial production manager; Laura Brown, Marisa Carder, and Patrick White, MGI design specialists; Lauren Meling, MGI digital editor; Cathy Gui, head of MGI external relations in Asia; and Tim Beacom, MGI knowledge specialist. We are also indebted to Kathryn Hanes, Samantha Hayden, and Kate Hegarty of Asia's external communications team, and Meng Liu and Ziad Haider, McKinsey risk specialists in China and Asia, respectively.

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This report contributes to MGI's mission to help business and policy leaders understand the forces transforming the global economy, identify strategic locations, and prepare for the next wave of growth. As with all MGI research, this work is independent and has not been commissioned or sponsored in any way by any business, government, or other institution. While we are grateful for all the input we have received, the report and views expressed here are ours alone. We welcome your comments on this research at [MGI@mckinsey.com](mailto:MGI@mckinsey.com).

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# The future of Asia: Asian flows and networks are defining the next phase of globalization

Asia is the world's largest regional economy, and its power is expected to grow as its constituent economies integrate more deeply with one another in trade, innovation, and culture and people flows. Asia will fuel and shape the next phase of globalization in what can justifiably be called the Asian Century.

- Asia is increasingly becoming the world's center. Between 2000 and 2017, its share of global real GDP in purchasing-power-parity terms rose from 32 to 42 percent; its share of global consumption from 23 to 28 percent; and its share of the world's middle classes from 23 to 40 percent. By 2040, those three measures of scale are expected to increase further to 52, 39, and 54 percent, respectively. Although Asia faces challenges such as growing risks in financial systems, inequality, and pressure on the environment, Asia's medium- to long-term growth outlook appears robust.
- Global flows are shifting toward Asia on seven of eight dimensions—trade, capital, people, knowledge, transport, culture, resources, and the environment. The only flow that has declined is waste (environment). From 2007 to 2017, Asia's share of global goods trade rose from 27 to 33 percent, of global capital flows from 13 to 23 percent, of worldwide patents from 52 to 65 percent (although its share of IP charges has remained constant at around 25 percent), and of global container-shipping traffic from 59 to 62 percent.
- Asia is becoming more Asian as intraregional flows expand—moving within the region are 60 percent of goods traded by Asian economies, 59 percent of foreign direct investment, 74 percent of Asian air travelers, and 71 percent of Asian investment in startups.
- Asia is diverse but complementary. Based on scale, economic development, interaction within Asia, and connectedness with the world, we distinguished four Asias among many: (1) Advanced Asia provides significant capital and technology to its neighbors; (2) China, large and distinct enough to stand on its own, acts as a regional anchor and a connectivity and innovation platform; (3) Emerging Asia provides labor and long-term market growth potential, and is culturally diverse; and (4) Frontier Asia and India accesses a broad base of trade partners and investors, and provides growth opportunities. The complementary nature of these groups can make Asia more prosperous and resilient.
- The integration and intraregional flows across different Asias are creating powerful networks, with new urban hubs and spokes emerging rapidly. We highlight three major networks. First, an “industrialization” network is developing with rising consumption, maturing domestic value chains, and uncertainties in global trade leading to the formation of Asia-for-Asia supply chains. Second, Asian networks of capital, ideas, and technologies are forming powerful “innovation” hubs, enabling the leapfrogging of Asian countries through a multilocal innovation network. Third, “culture and mobility” networks are developing as Asian scale and people flows can create the next global entertainment blockbuster and stimulate large value creation opportunities in adjacent areas such as tourism. These Asian networks can turn “unknown” cities into new hubs that companies can consider as destinations for future investment.
- Although Asia still faces risks and challenges, decision makers need to be prepared to win in the Asian Century. They need to be relevant to Asia by joining Asian flows and networks and offer what Asia needs; protect from and prepare for risks by responding to environmental challenges, filling skills gaps, and enhancing institutional capabilities; rethink the Asian operating model to unlock opportunities from complementary characteristics of the multiple Asias; and forge a stronger framework for intraregional collaboration, including, for instance, an effective mechanism for resolving disputes and facilitating more flows beyond trade.

# Asian flows and networks: Redefining globalization

Asia is becoming bigger and more integrated



## Asia is diverse, but also complementary



- Advanced Asia
- China
- Emerging Asia
- Frontier Asia and India

Category	Metric	Advanced Asia	China	Emerging Asia	Frontier Asia and India
Innovation	Patents, 2017 Thousand	569	1,395	33	50
		●	●	●	●
Market	GDP growth, 2017-40 CAGR, %	1.1	4.4	4.7	5.7
		●	●	●	●
Labor	Growth in working-age population, 2017-40 Million	-20	-132	80	332
		●	●	●	●
Capital	Net FDI outflow, 2013-17 \$ million	378	73	-153	-218
		●	●	●	●
Culture diversity	Number of different official languages	7	2	13	14
		●	●	●	●

## Asia's integration is producing three powerful regional networks



**Industrialization**  
Asia-for-Asia supply chains are emerging due to rising consumption and maturing domestic value chains



**Innovation**  
Asian capital, ideas, and technologies are enabling leapfrogging to multi-local innovation across the region



**Culture and mobility**  
Asia is a growing hub for people flows and a rising cultural force

# 1. Asia—the world’s largest regional economy—matters

The Asian Century has begun. Asia is the world’s growth powerhouse and its largest regional economy (see Box 1, “Defining Asia”). The region has reached a tipping point at which its scale is of global significance; most types of global cross-border flows today are shifting toward Asia and flows within Asia are rising. As Asia’s diverse economies integrate with each other, dynamic networks of industry, innovation, and people are now beginning to have significant weight, propelling broad-based growth across the region. Asia is at the vanguard of a new phase of globalization. Globally, we have seen cross-border goods trade become less intensive, less based on arbitraging labor costs in different countries, more knowledge-intensive, and more regionally concentrated; cross-border services trade is increasing. In all respects, these shifts are happening faster in Asia. In short, Asia matters.

This paper is the first of a series focused on the future of Asia. Here we go beyond macroeconomic indicators and explore Asia’s rise on eight dimensions incorporating 16 types of flow, discuss the fact that the region’s constituent economies are diverse, but in many ways complement one another and are integrating with one another rapidly, and look at the new intraregional networks that are binding the region’s economies closer together.

Asia’s rise is impressive, and its medium- to long-term growth outlook appears robust, offering exciting prospects for businesses around the world. There will be risks and challenges both business and political, including the risk of escalating trade tensions.<sup>1</sup> A recent McKinsey report has pointed to the storm that appears to be brewing in Asia’s financial system due to thinning margins and rising costs associated with increased risk, nonperforming loans, and macroeconomic uncertainties.<sup>2</sup> Geopolitical relationships, trade disputes, climate change, and inequality could lead to significant disruption of global flows and social stability, posing risks to Asia’s economy. These potential risks make it even more important to understand the nature and dynamics of Asia’s rise on different dimensions, how the region is interacting among its own economies and those in the rest of the world, and

Box 1.

## **Defining Asia**

In this paper, we follow the groupings used by the United Nations, which counts 83 regions as part of the Asia and Oceania region, with some exceptions. We omit Iran and countries in the UN’s Western Asia grouping that includes Saudi Arabia and the rest of the Middle East. This is because these two groups of economies are dissimilar to those of the rest of Asia and do not have strong economic ties with those economies. While we include Oceania in our analysis, available data are limited for many countries. In this report, we will refer to these economies in our scope as “Asia” instead of “Asia and Oceania” (see the technical appendix for more detail). We use “China” to refer to mainland China, Hong Kong, Macao, and Taiwan. We note that the groupings and maps displayed are for reference only.

<sup>1</sup> *China and the world: Inside the dynamics of a changing relationship*, McKinsey Global Institute, July 2019.

<sup>2</sup> “Bracing for consolidation: The quest for scale,” *Asia-Pacific Banking Review 2019*, McKinsey & Company, July 2019.

what potential additional opportunities could be on the table. This paper ends by looking at how governments within and beyond Asia might interact with one another to make the most of new opportunities and mitigate any tensions (trade among them), and the strategies that companies might usefully employ to navigate Asia's rising networks and maximize returns.

### **Asia's rise has been impressive and has much further to run**

Global discourse has recently been dominated by short-term concerns arising from trade tensions and the deceleration in China's GDP growth rate, but Asia's long-term prospects are robust and its increasing scale could strengthen the region's role in the world even further in the years ahead. Scholar Parag Khanna asserts that the "Asian Century" has begun and that the region's rise is not cyclical but structural.<sup>3</sup> Even at a somewhat cooler growth rate, China is still adding the size of the Australian economy every year. India and the economies of the Association of Southeast Asian Nations (ASEAN)—both \$2 trillion to \$3 trillion economies—are growing faster than the global average. Asia is strengthening as an economy as the drivers of growth broaden beyond trade, ensuring long-term sustainability that will reinforce the region's global influence.

Asia's rise to global significance is apparent in all major macroeconomic indicators, notably in GDP, consumption, and urbanization (Exhibit 1). In 2000, Asia accounted for 32 percent of global GDP in terms of purchasing power parity. This share increased to 42 percent in 2017 and is on course for a share of nearly 52 percent by 2040. In contrast, Europe's share declined from 26 to 22 percent, and North America from 25 to 18 percent from 2000 to 2017. In real GDP terms, Asia's share was 34 percent in 2017, and that is expected to reach 46 percent by 2040.

The same pattern of increasing size and global presence is happening in consumption. In 2000, Asia accounted for 23 percent of the global total, rising to 28 percent in 2017. By 2040, Asia could account for 39 percent of global consumption. Asia's share of the global middle classes rose from 23 percent in 2000 to 40 percent in 2017 and is expected to reach 54 percent by 2040.<sup>4</sup> Asia's urban population—an important metric because people living in cities produce the lion's share of the world's wealth and GDP growth—had reached 2.0 billion in 2017, up from 1.2 billion in 2000, and it is expected to hit 2.8 billion by 2040, about half of the global urban population.<sup>5</sup> People of working age drive economic growth around the world, and Asia's working-age population is rising strongly—from 2.4 billion in 2000 to 3.1 billion in 2017. By 2040, that number is projected to increase to 3.4 billion. Asia's macroeconomic growth is apparent in the development of powerful and dynamic cities (see Box 2, "Global urban hubs are underpinning the growth of Asia").

As Asia's economies have gathered strength, some social indicators have also improved markedly. Growth has taken an estimated 646 million people out of poverty since the turn of the century. The mortality rate has fallen since then from 6.9 to 6.3 per 1,000 population, and, as such, is now comparable with or even superior to rates in North America (defined as Canada, Mexico, and the United States) and Europe. Education has come on by leaps and bounds. Average life expectancy at birth increased from 68 years in 1997 to 73 years in 2017. The literacy rate rose from 77 percent in 2007 to 84 percent in 2017, thus catching up rapidly with rates in North America and Europe.<sup>6</sup>

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<sup>3</sup> Parag Khanna, *The Future is Asian: Commerce, Conflict, and Culture in the 21st Century*, Simon & Schuster/Hachette, 2019.

<sup>4</sup> Defined as households with income between \$20,000 and \$70,000 at constant 2015 prices.

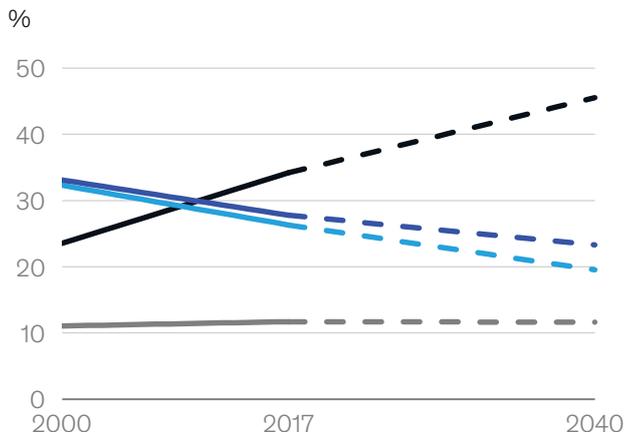
<sup>5</sup> For a general discussion of the importance of cities to the global economy, see, for instance, *Urban world: The global consumers to watch*, McKinsey Global Institute, April 2016.

<sup>6</sup> World Bank.

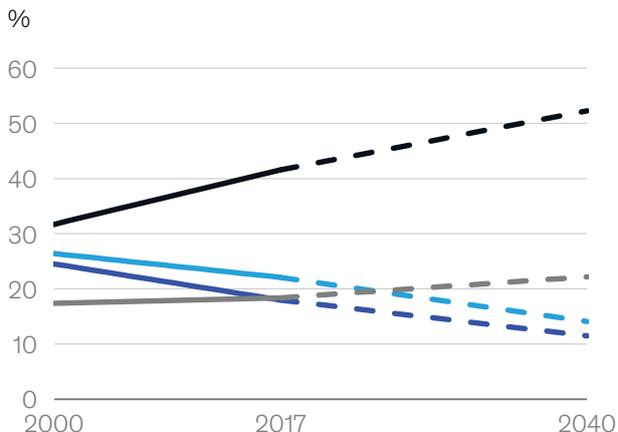
# Key macroeconomic indicators demonstrate Asia's upward trajectory.

Regional share of key indicators

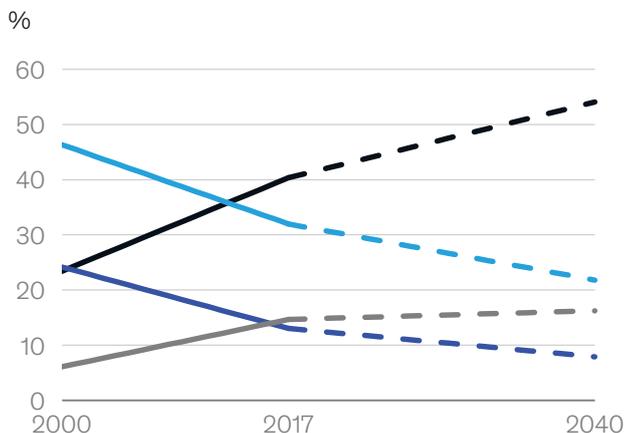
**Global real GDP<sup>1</sup>**



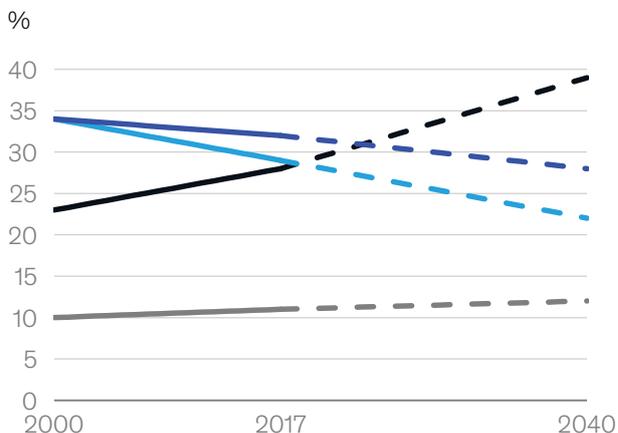
**Global GDP (purchasing power parity)**



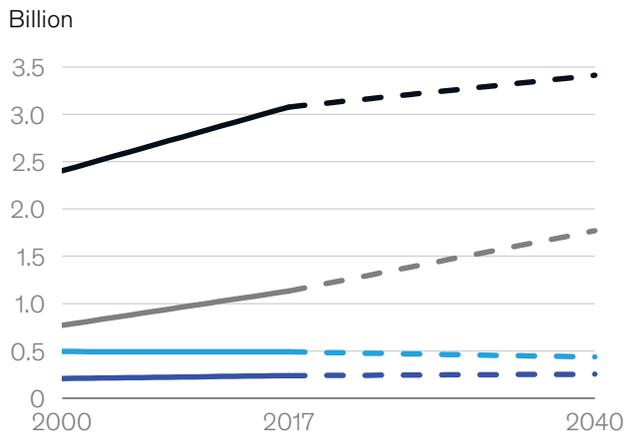
**Middle-class consumers<sup>2</sup>**



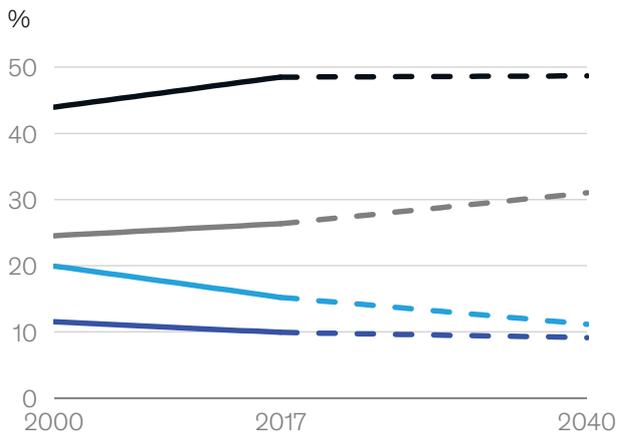
**Consumption**



**Working-age population**



**Urban population**



— Asia — Europe — North America — Rest of world — Actual — Forecast

1. Real GDP in 2017 US dollars.

2. Defined as households with income between \$20,000 and \$70,000 (constant 2015 prices).

Note: Figures are from the McKinsey Global Growth Model's baseline simulations and projections by external institutions, subject to modifications based on changes in economic conditions.

Source: World Bank; World Health Organization; McKinsey Global Growth Model; McKinsey Global Institute analysis

Box 2.

### Global urban hubs are underpinning the growth of Asia

In our analysis, we identified the 20 largest, fastest-growing, and most connected cities at the heart of Asia's development that are already global hubs. Of these, seven are in China, two in Japan, two in India, two in Australia, and one each in Bangladesh, Indonesia, Malaysia, Pakistan, Singapore, South Korea, and Thailand. In general, they are national or provincial capitals with strong abilities to mobilize economic and political resources. They are large and tend to have long histories, which means that they have discernible brands. They are growing quickly, driving growth in both population and GDP. They are highly connected both through travelers and capital, creating world-class cities for global citizens (Exhibit 2).

Exhibit 2

### MGI mapped the 20 biggest, fastest-growing, and most connected urban hubs in Asia.



Note: Metrics used include GDP nominal and growth rate, population nominal and growth rate, consumption, volume of airline passengers, total greenfield investments, and number of foreign citizens.

Source: IHS; Oxford Economics; McKinsey Global Growth Model; Euromonitor; FDI Atlas; McKinsey Global Institute analysis

Beyond macroeconomic indicators, we explored Asia's rise on eight dimensions incorporating 16 types of flow (see the technical appendix for more detail).<sup>7</sup> We found that on seven of the eight dimensions, there have been shifts toward Asia over the past decade (Exhibit 3). The exception is waste flows, which have fallen and which we look at in our section on the environment. MGI research has highlighted the importance of connectivity. Global flows support growth by raising productivity and creating more efficient markets with global scale. Accelerating catch-up growth is a major opportunity for developing economies. MGI estimates that global flows boosted global GDP by at least 10 percent in a ten-year period.<sup>8</sup>

To give just a few examples, Asia's share of global goods trade has risen from 25 percent in 2000–02 to 33 percent in 2015–17. Asia now accounts for 23 percent of capital flows, compared with 13 percent ten years ago. The region is responsible for 48 percent of international students, up from 43 percent a decade ago. Asia today accounts for 16 percent of global cross-border flows of data, up from 10 percent. Its share of corporate revenue in the global media and hospitality industries has also been increasing, from 17 percent a decade ago to 22 percent today. The region's share of patents filed worldwide in 2017 was 65 percent, up from 52 percent ten years earlier, while the region's share of IP charges has been consistent at around 25 percent over the past decade. Over the same period, Asia's share of global energy demand has risen from 36 to 43 percent, and its share of global energy flows from 21 to 29 percent. Even in the case of flows in which Asia already has a significant share, that share is continuing to grow. For example, Asia's share of global container-shipping traffic has risen from 59 to 62 percent. In this section, we look at each of the dimensions in turn.

Not only is Asia rising in terms of scale, but it is also integrating rapidly, arguably setting the pace for a new stage of globalization: regionalization. Globally, after years of decline, the intraregional share of global goods trade is now rising. That share has increased by 2.7 percentage points since 2013, and the trend is most marked in Asia and EU-28 economies and most apparent in global innovation value chains where there is a need to integrate many suppliers closely in just-in-time sequencing. On all eight dimensions studied, Asia's integration is increasing and there is an observable shift toward regionalization. For instance, 60 percent of goods traded by Asian economies are within the region (the highest intraregional share of any region apart from Europe), 71 percent of Asian investment in startups and 59 percent of foreign direct investment (FDI) is intraregional, and 74 percent of Asian air travelers travel within the region.

When we combine scale and intraregional integration, we find four key types of flow (Exhibit 4). The top right quadrant of the exhibit shows flows where Asia has a high share of the global total and where intraregional flows are also significant. In the bottom right are flows where Asia's global share is high but regionalization is low—here Asia makes a significant contribution to global flows but still depends on the rest of the world to drive those flows. In the top left quadrant are flows where the intraregional element is high but global share is low. Finally, at the bottom left is the one dimension—culture—where Asia has a low share and the intraregional element is somewhat limited. To summarize:

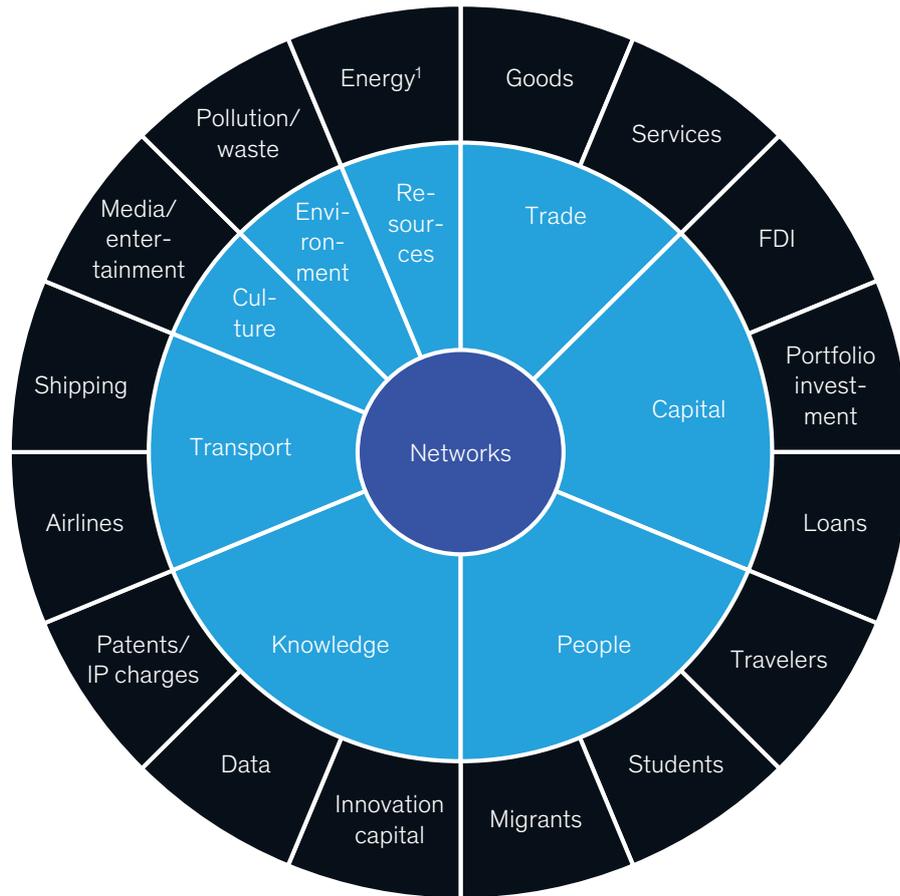
- **Asia-led.** Asia accounts for a large share of global flows, and the intraregional share of its flows is high, including in goods trade, shipping, travel (both number of travelers and airline revenue), and investment in startups, for example. Decision makers can benefit by ensuring that their economies are part of Asian flows.

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<sup>7</sup> Recent MGI research on China looked at eight dimensions of global scale and integration. These are broadly the same as the eight dimensions in this paper with one exception. In this paper, transportation is one of the dimensions instead of firms in the China report. MGI will publish separately on the changing role of Asian firms in 2020. For the research on China, see *China and the world: Inside the dynamics of a changing relationship*, McKinsey Global Institute, July 2019. We included a few data points that measure stocks against bilateral flows (for instance, patents) as these stocks are important contributors to the formation of networks.

<sup>8</sup> *Digital globalization: The new era of global flows*, McKinsey Global Institute, March 2016.

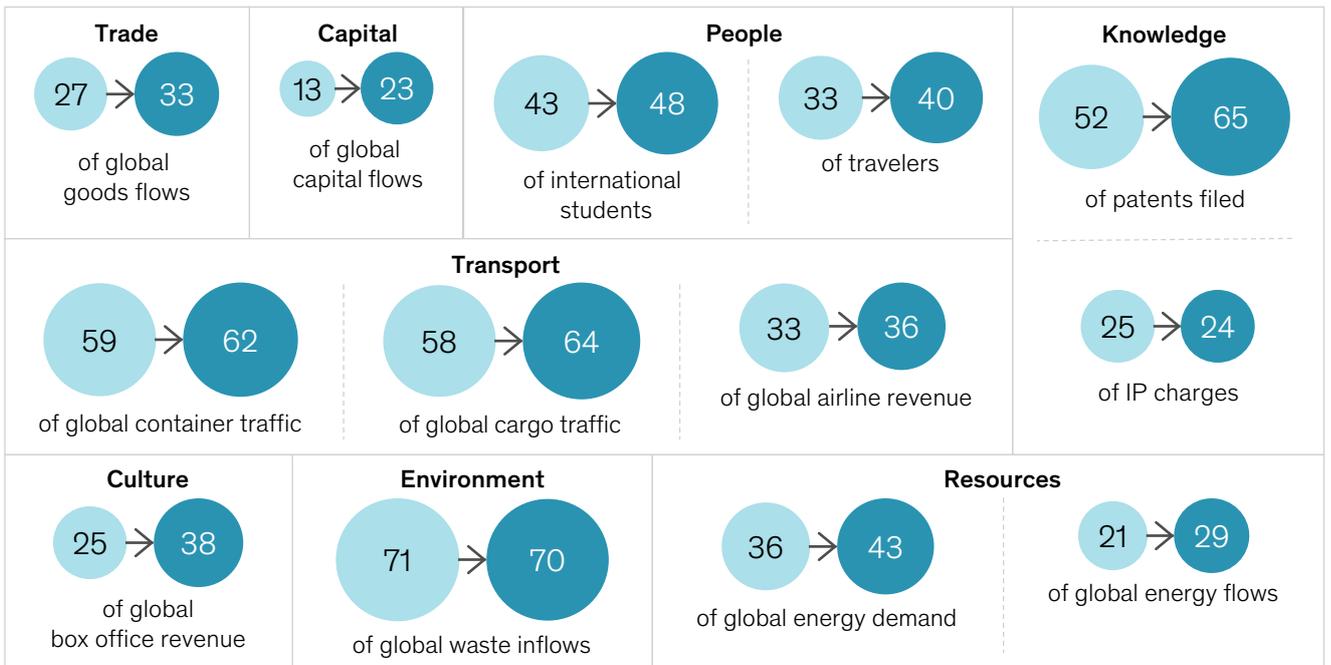
Asia has gained scale on seven of eight types of flows over the past decade.



Share of Asia in global flow, 2005–07 vs 2015–17<sup>2</sup>

● 2005–07 ● 2015–17

%



1. Includes both conventional and renewable energy sources.

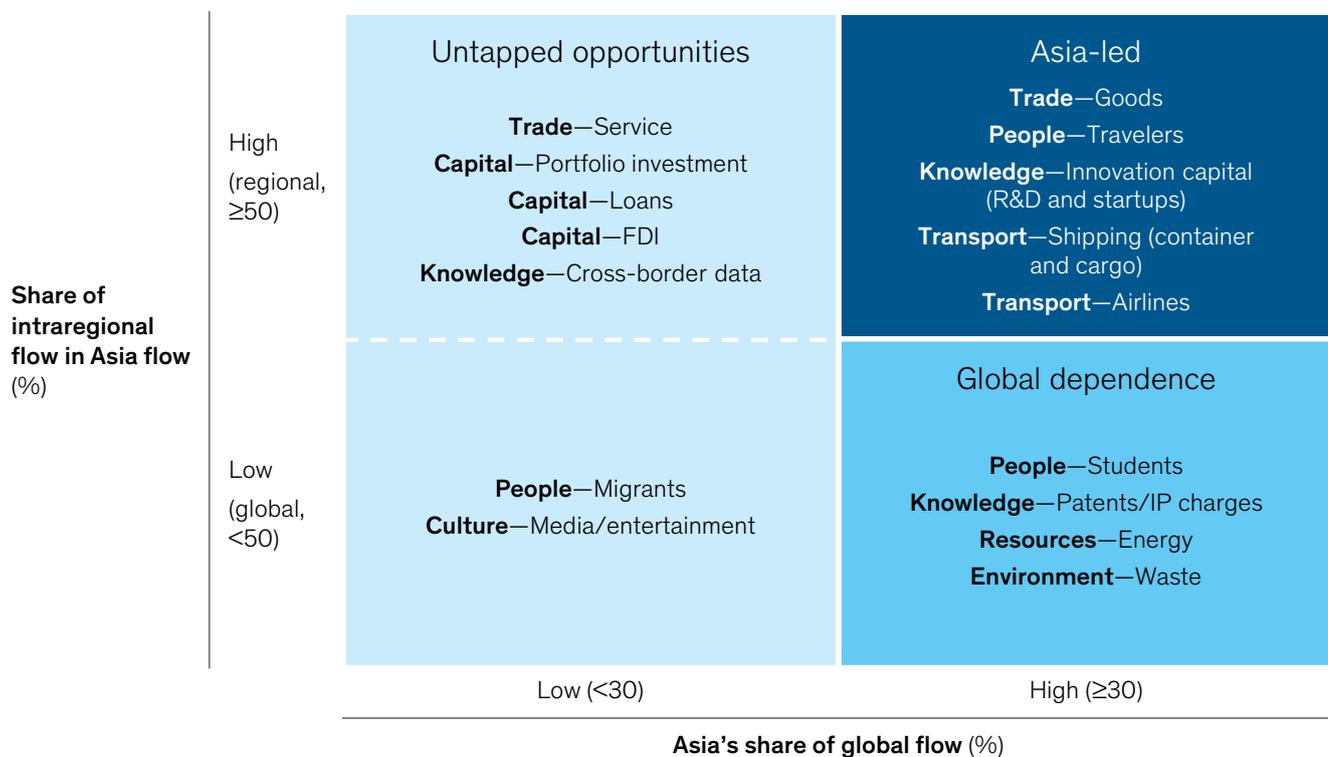
2. In some cases, used alternative periods because of data availability or volatility.

Source: IMF; UNCTAD; WTO; OECD; McKinsey FDI Atlas Database; McKinsey Global Institute analysis

- **Global dependence.** Although Asia accounts for a large share of global flows, the majority of its flows are still global, indicating a significant degree of mutual dependence between the region and the rest of the world. Asia is an importer of education (students), knowledge (patents and intellectual property [IP] charges), resources (energy), and environment externalities (waste). The world can continue to sharpen its value proposition to offer relevant value to Asia and prepare for the potential reversal of such flows.
- **Untapped opportunities.** Asia's flows are still relatively small, implying significant headroom for these flows to grow. Decision makers can invest in that future growth by betting on underdeveloped service trade and capital markets as well as capitalizing on its distinctive culture.

Exhibit 4

**Asia's share in global flows has become significant, and its economies are increasingly integrating.**



Source: McKinsey Global Institute analysis

**Trade: Asia's global share is rising with stronger intraregional ties**

Recent MGI research highlighted five structural changes in globalization and trade over the past decade. In this paper, we show that the shift is even more obvious in Asia (see Box 3, "Five key forces affecting global trade").<sup>9</sup>

Asia's share of global goods traded increased from 25 percent in 2000–02 to 27 percent in 2005–07 and to 33 percent in 2015–17 (Exhibit 5). The share of exports of goods rose from 27 to 35 percent, and in the case of goods imports from 23 to 31 percent between 2000–02 and 2015–17. China, Japan, and South Korea are the major source countries

<sup>9</sup> Globalization in transition: The future of trade and value chains, McKinsey Global Institute, January 2019.

for exports, accounting for 68 percent of total exports in Asia in 2015–17. The same three countries account for 64 percent of imports.

Asia's services trade increased from 21 to 25 percent of the global total between 2000–02 and 2014–16, lower than goods trade, indicating more growth potential. Services exports rose from 22 to 25 percent, and services imports rose rapidly from 19 to 26 percent in the same period, and a large share of them—35 percent—in 2016 were imports of tourism. As incomes have risen, Asian consumers have started spending more on traveling.

Trade ties among Asian countries are strengthening. Worldwide, the share of trade in both goods and services that takes place within regions as opposed to between them is growing, and Asia is at the forefront of this trend. Sixty percent of goods trade (an increase from 56 percent in 2007) and 60 percent of services trade (from 46 percent in 2007) took place within Asia in 2017.

The only region that has a higher share of intraregional trade than Asia is Europe at 71 percent. The share of intraregional trade in goods is much lower in other regions: 45 percent within the North American Free Trade Area, 22 percent in Latin America, and 21 percent in the Middle East and Africa.

The rise of Asia's intraregional share of trade is even more marked when we look at a longer timeframe. Between 2000 and 2017, intraregional trade in Asia expanded by 4.0 times, much faster than the pace of global trade growth, which grew by 2.8 times. This rising share of intraregional trade has created new and large trade corridors in the region. Of these, 25 fast-growing Asian corridors accounted for 71 percent of Asian intraregional trade and 42 percent of total Asia trade; these top 25 corridors grew at nearly double the rate of other corridors (Exhibit 6). In 2000, only three corridors within Asia had trade volume of more than \$50 billion; by 2017, there were 15. The strongest trade corridors are forming around China and India. Of the 25 fastest-growing corridors from 2000 to 2017, only eight did not involve these two economies.

The trend of stronger regionalization partly reflects the fact that domestic consumption is increasingly driving growth in Asian economies, and therefore that more goods and services are being consumed within economies. Asia's share of global consumption increased from 23 percent in 2000 to 28 percent in 2017. In China, for instance, in 11 of the 16 quarters since 2015, domestic consumption has contributed more than 60 percent of total GDP growth.<sup>10</sup> As more goods and services are consumed at home, less are exported. China's gross exports as a share of gross output declined from 17.2 percent to 10.0 percent from 2007 to 2017.

Another factor behind the increasing regionalization of Asia (and other regions) is a movement toward building domestic supply chains. Asia's emerging economies are developing new industrial capabilities and are starting to move into making more sophisticated products; as such, they are becoming less reliant on foreign imports of intermediate inputs and final goods. In China, imported intermediate inputs as a share of gross output peaked at 7.6 percent in 2004, declining to 3.6 percent by 2017. In India, these inputs peaked at 9.6 percent in 2011, before dropping to 6.2 percent in 2017.

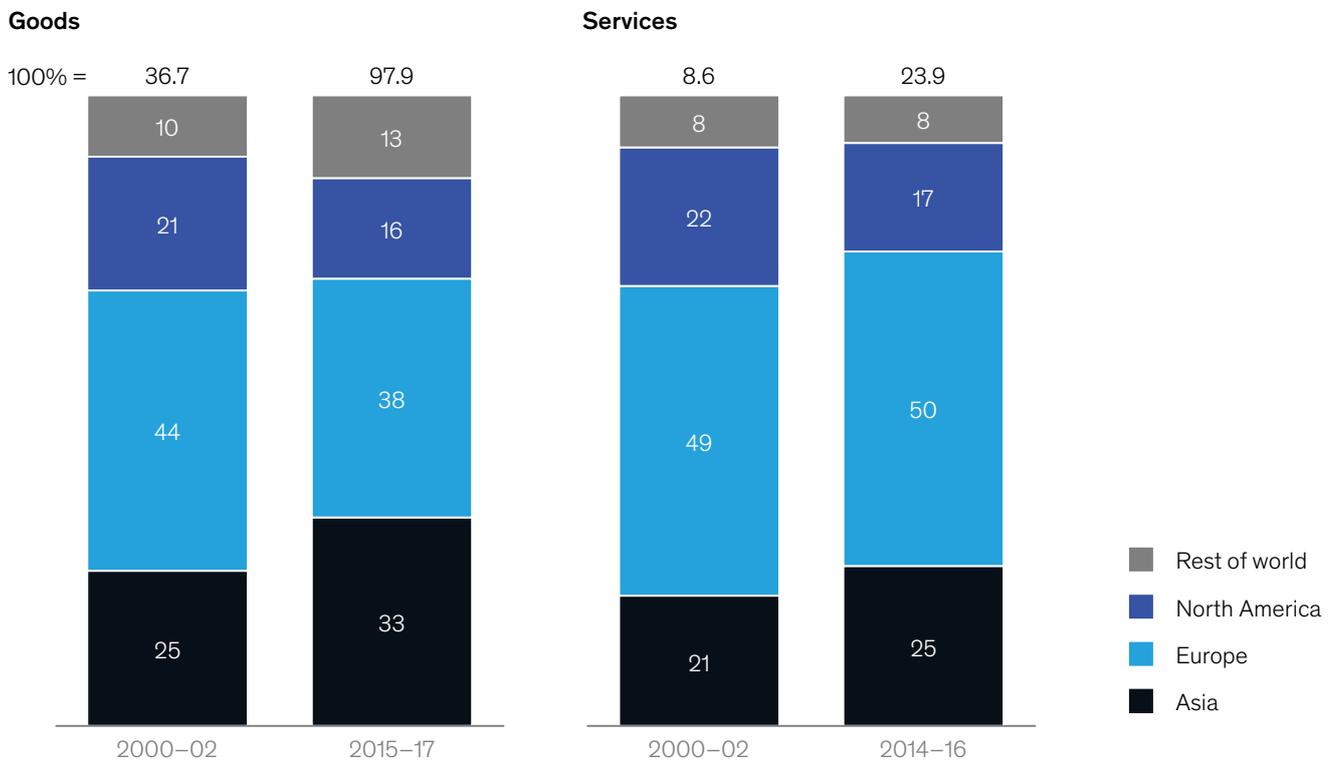
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<sup>10</sup> *China and the world: Inside the dynamics of a changing relationship*, McKinsey Global Institute, July 2019.

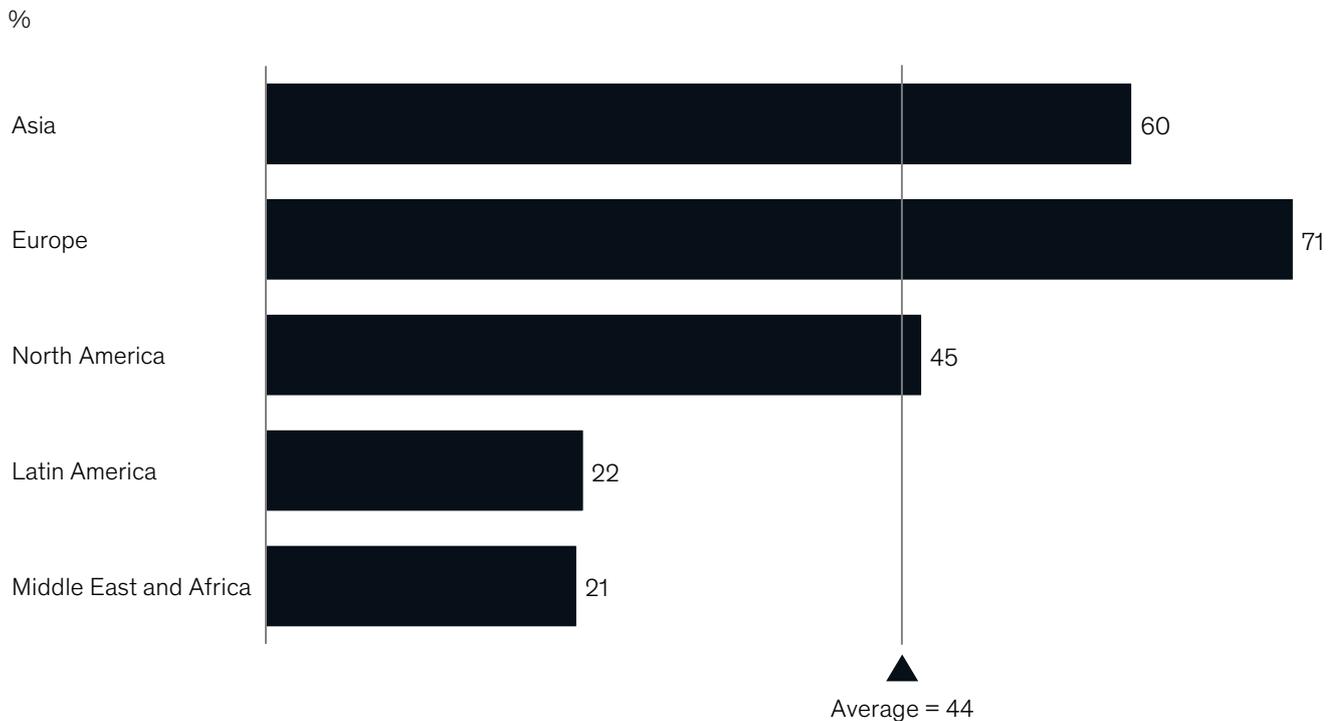
## Asia's share of global trade is rising.

### Trade volume (imports and exports)

%; \$ trillion



### Intraregional share of goods trade flows, 2017



Note: Figures may not sum to 100% because of rounding.  
 Source: IMF; UNCTAD; WTO; OECD; McKinsey Global Institute analysis

## China is the anchor driving the development of intraregional trade in Asia.

Trade volume

\$ billion

<10

10–25

26–50

51–100

101–250

251–500

>500

2000

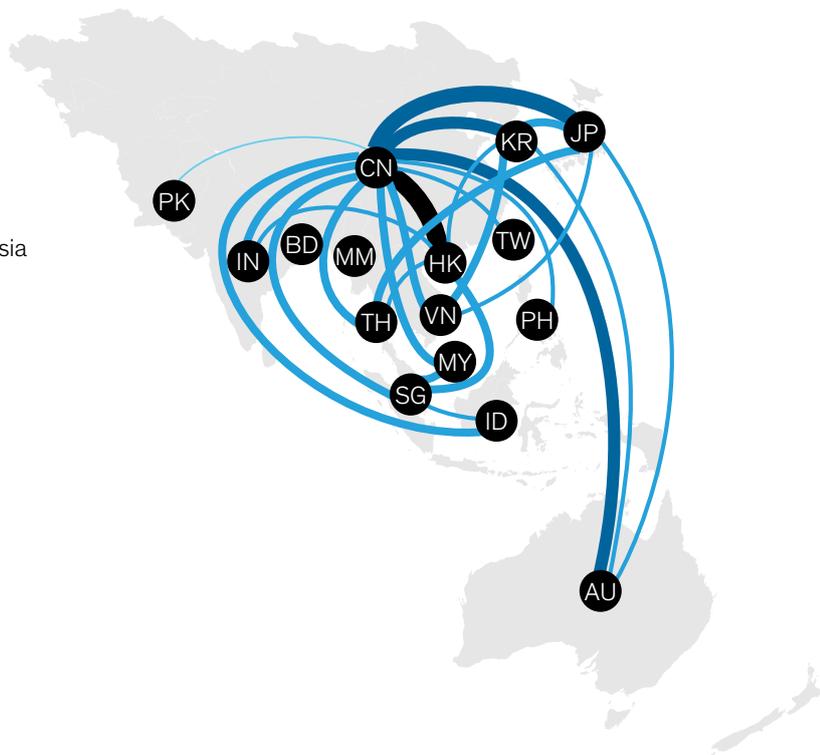


2017

2.8x  
global trade

4.0x  
intraregional trade in Asia

5.2x  
top 25 Asia corridors



Note: These are major trade corridors between economies in Asia, and are not representative of national territories.  
Source: IMF; UNCTAD; WTO; OECD; McKinsey Global Institute analysis

Box 3.

### Five key forces affecting global trade

Globalization reached a turning point in the 2000s in five key respects, according to 2019 MGI research that analyzed 23 value chains in 43 countries to explore how trade, production, and participation in the global economy changed between 1995 and 2017.<sup>1</sup> The shifts identified are happening faster in Asia, suggesting that this is the region that, more than any other, is shaping the next phase of globalization. The research highlighted five major changes:

- 1. Goods-producing value chains have become less trade-intensive.** Output and trade continue to grow in absolute terms, but a smaller share of the goods is now traded across borders. Between 2007 and 2017, exports declined from 28.1 to 22.5 percent of gross output in goods-producing value chains. The intensity of global goods trade fell between 2007 and 2017, from 28.1 to 22.5 percent. Asia's trade intensity dropped from 20 to 14 percent, driving the global reduction in intensity. During the same period, North America's trade intensity rose slightly from 19 to 20 percent. In Europe, there was a more significant increase in intensity from 42 to 49 percent.
- 2. Cross-border services are growing more than 60 percent faster than trade in goods.** Such cross-border flows generate much more economic value than is reflected in traditional trade statistics. If three unmeasured aspects were included (the value added services contribute to exported goods, the intangibles companies sent to foreign affiliates, and free digital services made available to global users), the share of cross-border services is more than half. Growth in services trade is fastest in Asia with a compound annual rate of 6.4 percent, compared with a global figure of 3.9 percent; Asia's rapid growth in services trade reflects a surge in tourism (see our later discussion on people flows for more detail).
- 3. Less than 20 percent of goods trade is based on labor-cost arbitrage, and in many value chains, that share has been declining over the past decade.** Global trade in labor-intensive goods based on such arbitrage declined from 55 percent of total global trade in 2005 to 43 percent in 2017. For sure, this type of manufacturing is still an important part of the economic development of many economies in Asia. Cambodia and Vietnam, for instance, have become key centers for labor-intensive manufacturing as labor costs in China have risen. Their outflows of labor-intensive manufactured goods have grown at compound annual rates over the past ten years of 12 and 19 percent, respectively. Vietnam, which has less than one-third the labor costs of China, has, for instance, become a globally important exporter of electronics. The wage gap between economies is falling even more rapidly in Asia than in other regions. For instance, the wage gap between China and Japan dropped from a multiple of 46 in 1996 to a multiple of only four in 2016.
- 4. Global value chains are becoming more knowledge-intensive and reliant on high-skill labor.** Investment in intangible assets such as R&D, brands, and IP has more than doubled as a share of revenue, from 5.5 to 13.1 percent, since 2000. Again, Asia is in the vanguard of this trend. Between 2006 and 2016, investment in knowledge-intensive assets grew at a compound annual rate of 6.4 percent. In some sectors, Asia is the leading global investor in intangibles; in electronics, for instance, Asia accounts for 61 percent of global investment. In 2017, Asia's cross-border data flows were 97 times their value a decade earlier—in comparison, the global figure was 63 times higher.
- 5. Goods-producing value chains are becoming more regionally concentrated.** Particularly in sectors such as automotive, and computers and electronics—and especially in Asia and Europe—companies are increasingly establishing production in proximity to demand.

<sup>1</sup> For further discussion, see *Globalization in transition: The future of trade and value chains*, McKinsey Global Institute, January 2019; and *China's role in the next phase of globalization*, McKinsey Global Institute, April 2017.

## Capital: Asia is increasingly funding its own growth

Global capital flows, including FDI, portfolio investment, and loans, have been volatile over the past decade. There was a significant decline after the 2008 financial crisis and a slow subsequent recovery. Overall, Asia's share of global capital flows increased from 13 to 23 percent between 2003–07 and 2013–17.<sup>11</sup> That growth was largely driven by FDI that accounted for 39 percent of Asia's capital flows in 2013–17 and 56 percent of growth in those flows from 2003–07 to 2013–17.

Asia's share of global FDI flows increased from 12 percent in 2003–07 to 26 percent in 2013–17. The region mainly gained share from Europe, where the share of global FDI flows fell from 66 percent in 2003–07 to 47 percent in 2013–17 (Exhibit 7).

Asia is increasingly funding itself with its own capital. The key driver of Asia's growth in capital flows is a significant increase in outflows—especially outflows within the region. Asia's FDI outflows in 2013–17 were valued at 3.1 times a decade previously; over the same period, global FDI outflows rose 2.1 times. Asia's FDI inflows grew 2.4 times, compared with 1.3 times globally. In 2013–17, intraregional FDI was 59 percent, up from 45 percent in 2003–07. These increases reflect the fact that Asia is increasingly funding its own economic growth as it builds regional supply chains and expands capacity to satisfy its own growing consumption.

However, as previous MGI research has noted, at the same time investment in Asia increased, so, too, did debt. China alone accounts for more than one-third of growth in global debt since the crisis. Its total debt has increased by more than five times over the past decade to reach \$29.6 trillion by mid-2017, or 246 percent of its GDP. China's debt share of GDP is now similar to that of advanced economies.<sup>12</sup> China now has one of the highest ratios of corporate debt relative to GDP in the world, and a large amount of this borrowing is from companies with a low interest coverage ratio and is therefore at higher risk of default.<sup>13</sup> One recent study highlighted concern that some of China's lending to developing countries may be “hidden”—neither the World Bank nor the International Monetary Fund (IMF) has data on this.<sup>14</sup>

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<sup>11</sup> We excluded loans because data were highly volatile reflecting a period of deleveraging after the financial crisis. Asia's share increased from 11 to 28 percent over the same period if loans are included.

<sup>12</sup> *A decade after the global financial crisis: What has (and hasn't) changed?*, McKinsey Global Institute, September 2018.

<sup>13</sup> *Rising corporate debt: Peril or promise?*, McKinsey Global Institute, June 2018.

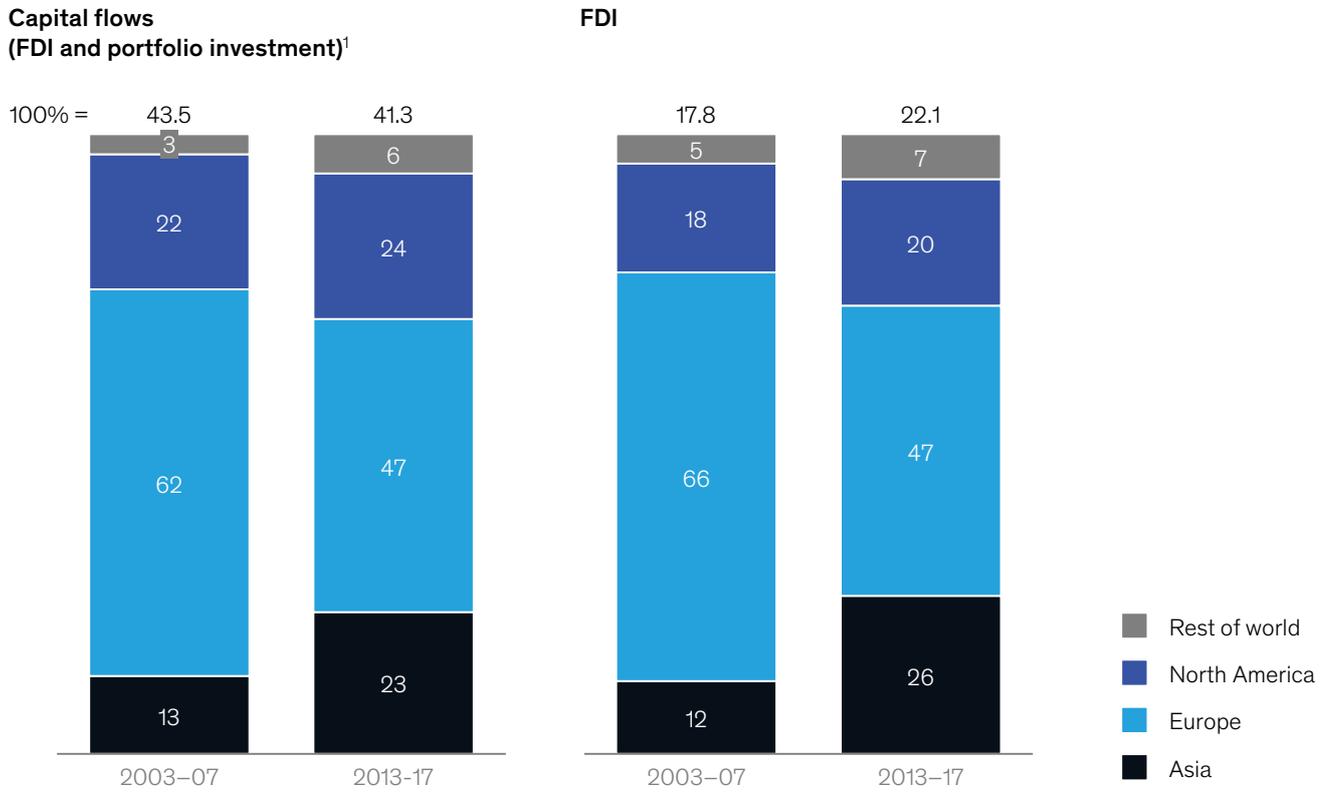
<sup>14</sup> “A new study tracks the surge in Chinese loans to poor countries,” *Economist*, July 13, 2019.

## Asia is increasing its share of global capital flows.

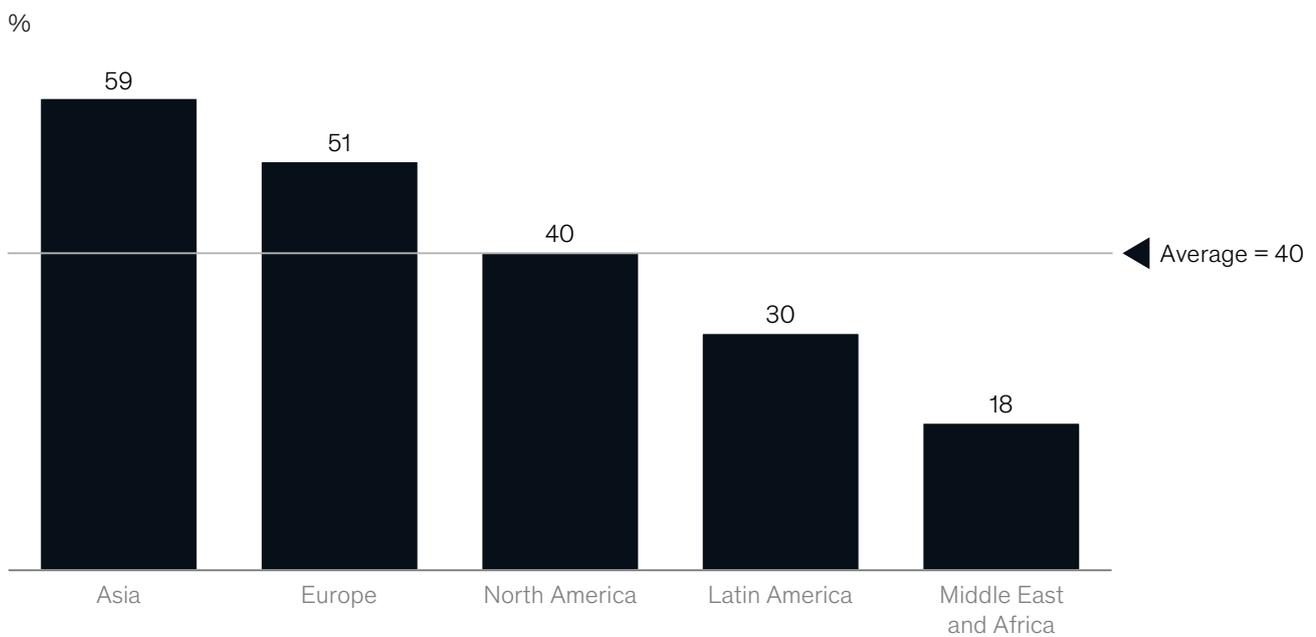
### Capital volume (inflows and outflows)

%; \$ trillion

#### Capital flows (FDI and portfolio investment)<sup>1</sup>



#### Intraregional share of FDI by region, 2013-17



1. Excludes loans because of high volatility in data due to deleveraging after the financial crisis. Asia's share increased from 11 to 28% in the same period if loans are included.

Note: Figures may not sum to 100% because of rounding.

Source: IMF; McKinsey FDI Atlas Database; McKinsey Global Institute analysis

## People: Asians are increasingly on the move

We analyzed three types of people flows: travelers, migrants, and students. Asia's share of travelers and students has been increasing while its share in migrants has held steady over the past decade. Asia's share of air travelers increased from 33 to 40 percent between 2009–11 and 2016–18. The share of international students from Asia engaged in tertiary education both within the region and beyond has grown from 43 to 48 percent from 2007 to 2016. This was largely driven by an increase in Chinese students going to study outside their home country, accounting for 46 percent of growth in this period. India, Malaysia, and South Korea have also witnessed more students going abroad for tertiary education, representing an additional 16 percent of growth in Asia's outflows of international students. In the meantime, Asia has increased in importance as a destination for international students, accounting for a 20 percent share, up from 17 percent previously. Australia, Japan, Malaysia, and South Korea were the most popular destinations. Asia's share of migrant flows remained steady at around 26 to 27 percent between 2005 and 2017; a slight decline in Asia's share as a destination from 19 to 17 percent was balanced by a rise in its share as an origin from 32 to 33 percent (Exhibit 8).

Previous MGI research found that around 80 percent of all migrants come from developing regions. China and India are among the leading countries of origin with ten million and 16 million, respectively. Other large sources of migrants in Asia are Bangladesh and Pakistan, each with six million, and the Philippines and Afghanistan, each with five million. Three Asian countries were found to be top of the list for receipts of remittances from migrants—in 2014, \$70 billion was remitted to India, \$62 billion to China, and \$28 billion to the Philippines.<sup>15</sup>

The majority of people flows are within Asia. Most Asians are traveling within their home region. In 2016–18, 74 percent of cross-border trips (both by destination and origin) taken by air were within Asia—49 percent in the case of migrants and 34 percent in the case of students over the same period. On travelers, Asia's intraregional share is more than ten percentage points higher than those of other regions (except Europe); in contrast, the intraregional shares of student and migrant flows are similar to other regions. This points to the fact that Asians travel frequently within their home region for business or leisure, but are still looking for work and education opportunities farther afield.

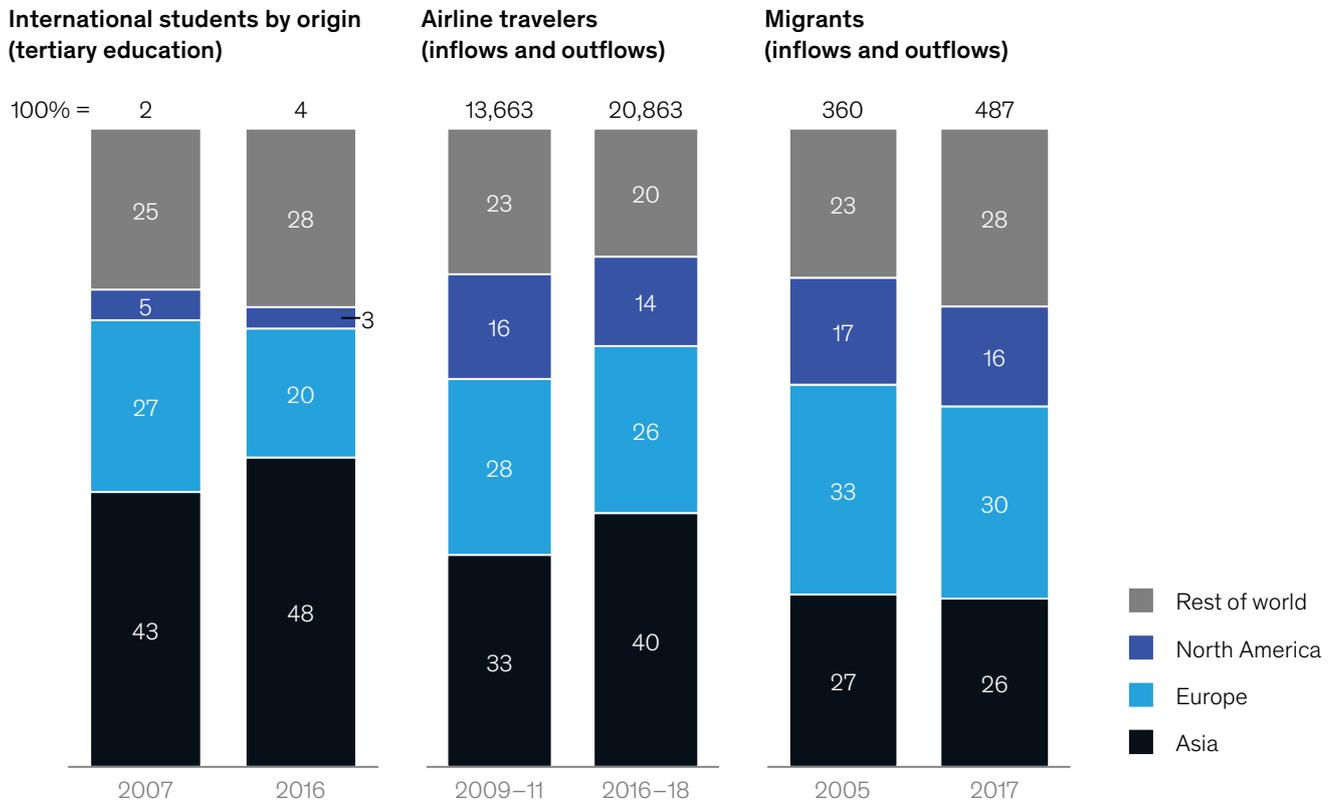
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<sup>15</sup> *People on the move: Global migration's impact and opportunity*, McKinsey Global Institute, December 2016.

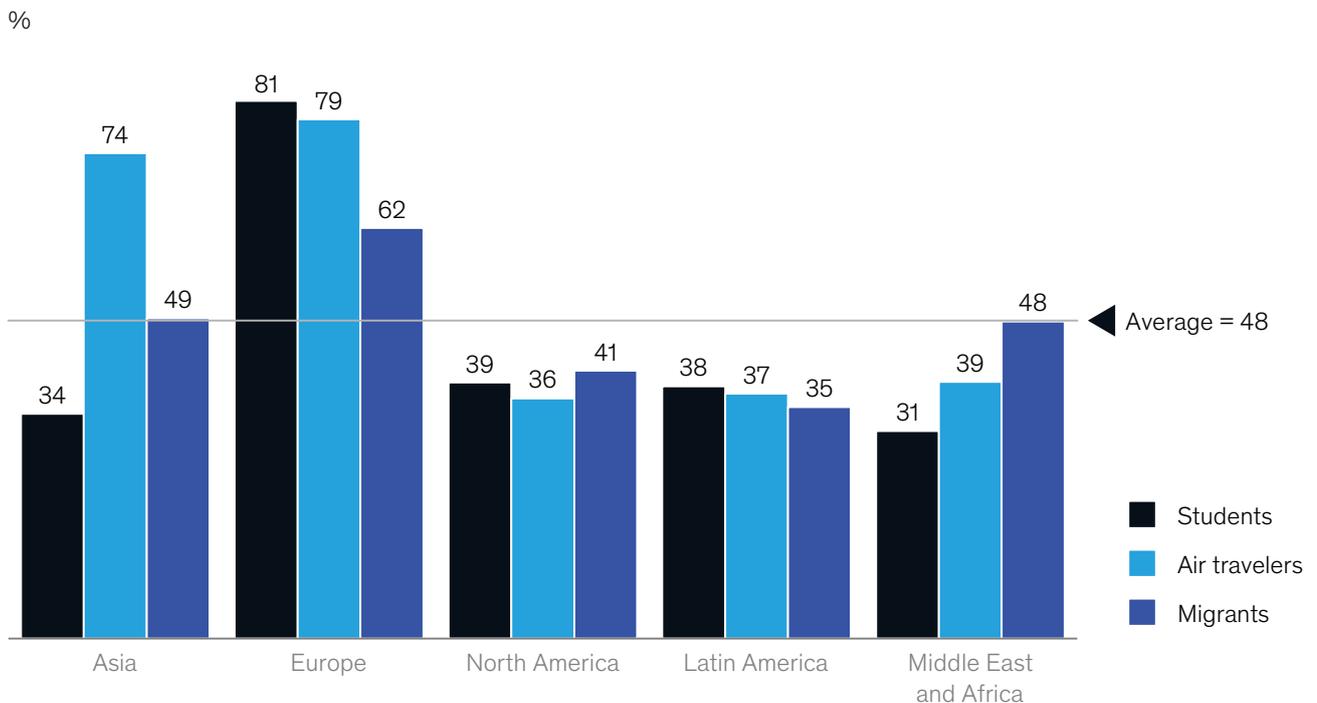
### On three types of people flows, Asians are increasingly on the move.

**Number of people**

%; million



**Intraregional share of people flows by region, latest available year**



Note: Figures may not sum to 100% because of rounding.  
 Source: IATA; UN Migrant Stock; UNESCO education data; McKinsey Global Institute analysis

## **Knowledge: Asia is a globally important producer of knowledge**

Around the world, value chains are becoming more knowledge-intensive. As a share of revenue, global intangible assets such as R&D, brands, software, and IP increased from 5.4 percent in 2000 to 13.1 percent in 2016. Asia is very much at the forefront of this trend as it builds significant scale in key areas (Exhibit 9). Across the region, investment in knowledge-intensive assets grew at a compound annual rate of 6.4 percent between 2006 and 2016. In some key sectors, Asia is leading the world on investment in intangible assets. In electronics, for instance, Asia accounts for 61 percent of global investment.

In 2015–17, 65 percent of the world's patents were generated in Asia, up from 52 percent in 2005–07. Although we note that the quantity of patents may not reflect the quality of knowledge, it still is an indication of vibrant innovation-related activities in the region. Asia is a heavy spender on R&D, accounting for 41 percent of global R&D spending in PPP terms in 2015–17, up from 31 percent in 2005–07. Asia has been investing heavily in startups that are overwhelmingly technology-based, fueling the knowledge economy. In 2015–17, Asia accounted for 41 percent of global invested capital in startups, up from 10 percent in 2005–07. The amount of capital invested in startups is growing faster in Asia than in the rest of the world. Such investment grew at a compound annual rate of 76 percent in China between 2013 and 2018, at 43 percent in the rest of Asia, but only 27 percent in Europe and 19 percent in North America. Although Asia's share of cross-border data flows is relatively small at about 16 percent in 2017, it has been growing rapidly. In that year, these flows were 97 times their value only ten years earlier; in comparison, over this period, global cross-border data flows were 63 times higher.

Asia's knowledge-investment flows are highly intraregional, while knowledge-charge flows remain global. In 2018, for instance, 71 percent of startup investment was intraregional, reflecting the fact that Asian corporations are investing in the development of technology beyond their domestic economies. About 78 percent of Asia's IP-charge imports in 2017 came from outside Asia; 54 percent came from North America. In summary, Asian economies are still relatively dependent on other regions for knowledge, but are funding one another's knowledge development.

## Asia is increasingly a major producer of knowledge.

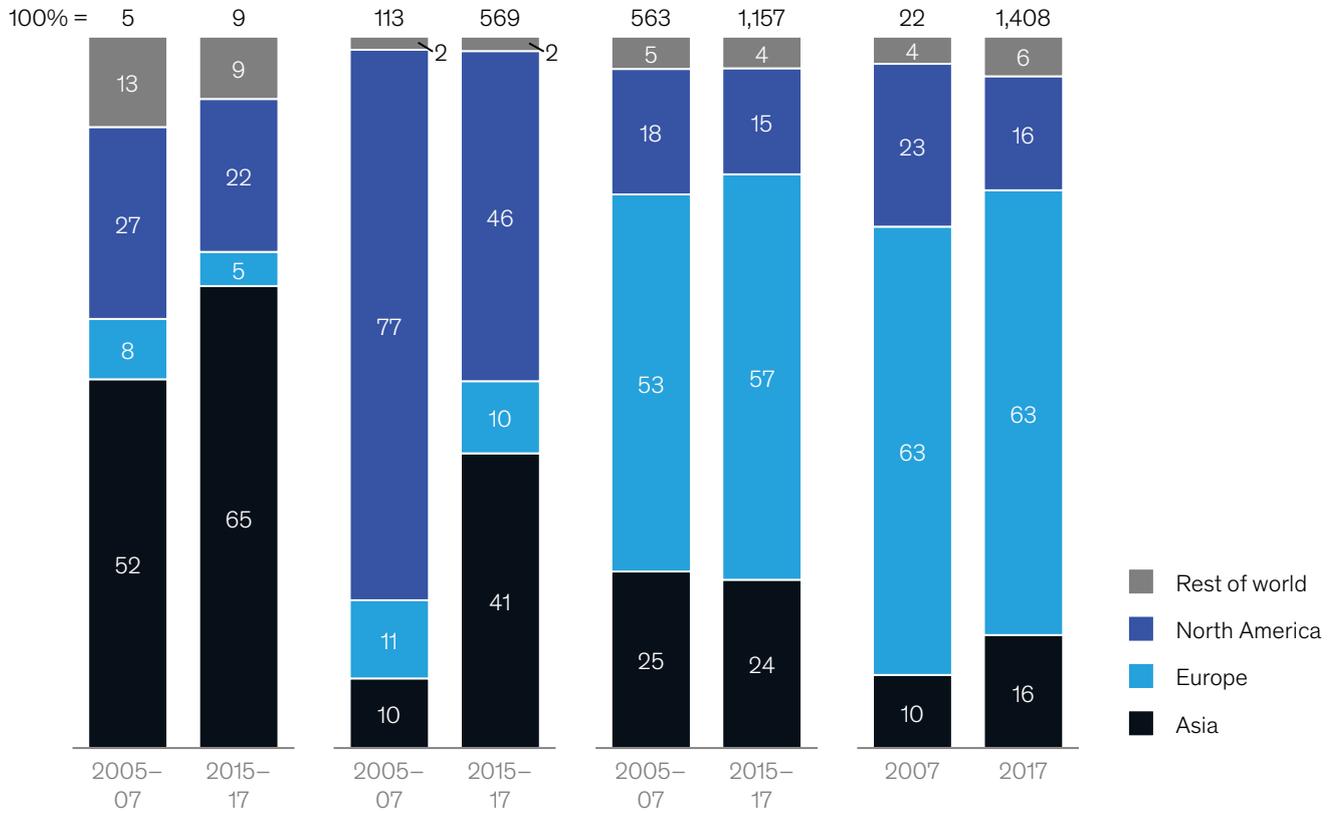
### Knowledge metrics

**Patents**  
%; million

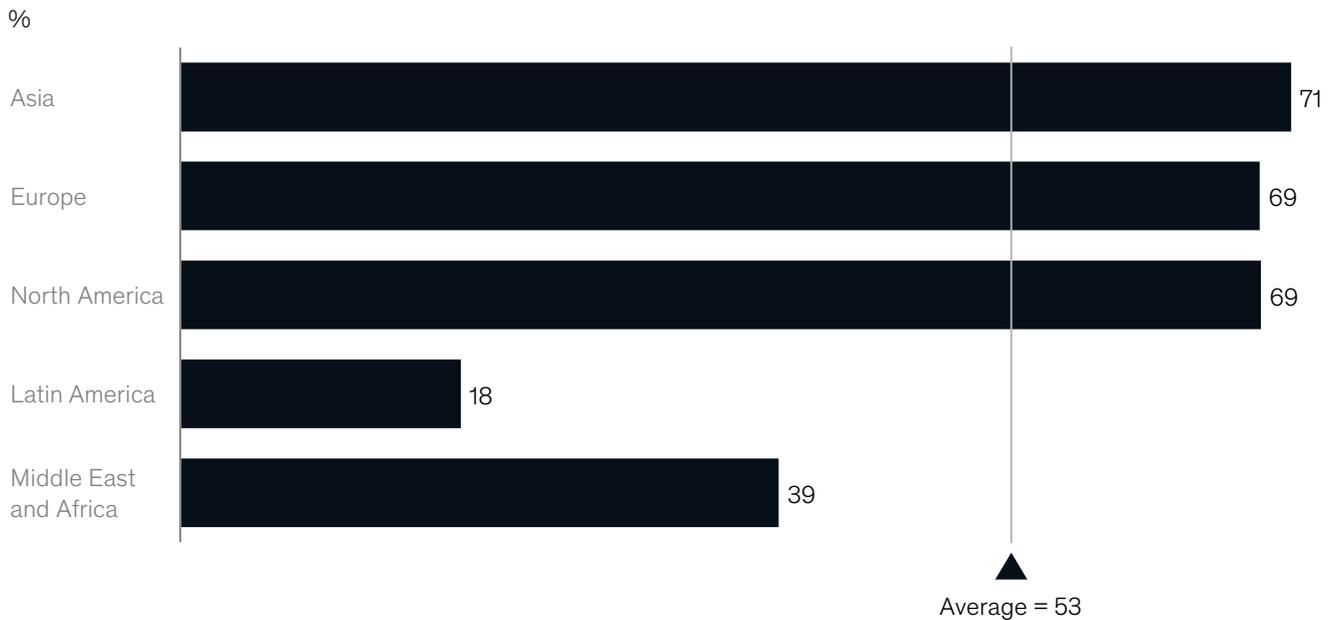
**Investment in startups**  
%; \$ billion

**IP charges**  
%; \$ billion

**Cross-border data**  
%; thousand Gbps



### Intraregional share of startup investment, 2018



Note: Figures may not sum to 100% because of rounding.

Source: WIPO; Prequin; World Bank; TeleGeography; McKinsey Global Institute analysis

## **Transport: Asia is the world's largest hub for goods and people flows**

Asia is a globally important hub for the transportation of goods—its share of goods transported is double its own trade volume—and is becoming a mega-exchange for travelers (Exhibit 10).

The region is a global interchange for cargo and container shipping with 64 percent and 62 percent of the global total, respectively, in 2016. In comparison, Europe accounted for 16 percent of both cargo and container shipping. Asia has accounted for 120 percent of the increase in global cargo traffic since 2008 and 75 percent of the rise in container-shipment traffic over the same period. Shipping traffic is becoming increasingly concentrated around the South China Sea, described by one commentator as “the throat of the Western Pacific and Indian oceans—the mass of connective economic tissue where global sea routes coalesce.” The South China Sea carries an estimated one-third of global shipping.<sup>16</sup> The United Nations Conference on Trade and Development (UNCTAD) estimated that \$3.37 trillion of trade passed through the South China Sea in 2016.<sup>17</sup>

Asia is rapidly becoming a major hub for international travelers, too. Its share of airline travel revenue rose from 33 percent in 2009–11 to 36 percent in 2016–18. In the latter period, the European share was 23 percent, and North America's 28 percent according to IATA data.

A large share of transportation flows is intraregional. The intraregional share of air travel revenue, for instance, was about 55 percent in 2018, almost 20 percentage points higher than the average of all regions.

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<sup>16</sup> Robert D. Kaplan, “Why the South China Sea is so crucial,” *Business Insider Australia*, February 20, 2015.

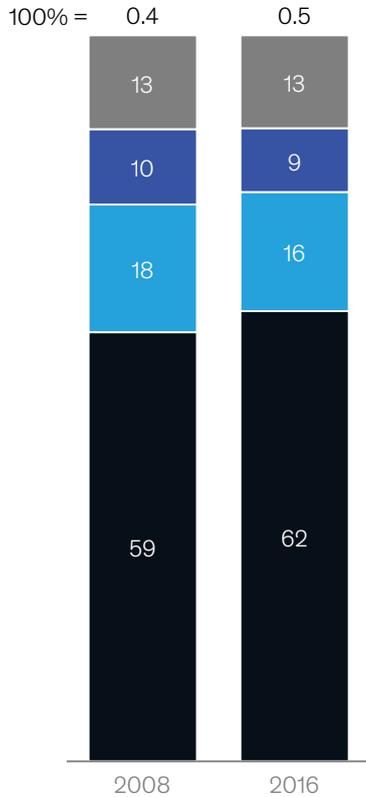
<sup>17</sup> *How much trade transits the South China Sea?*, China Power, <https://chinapower.csis.org/much-trade-transits-south-china-sea/#easy-footnote-bottom-1-3073>.

## Asia is becoming a more prominent global hub for the transport of goods and people flows.

### Goods

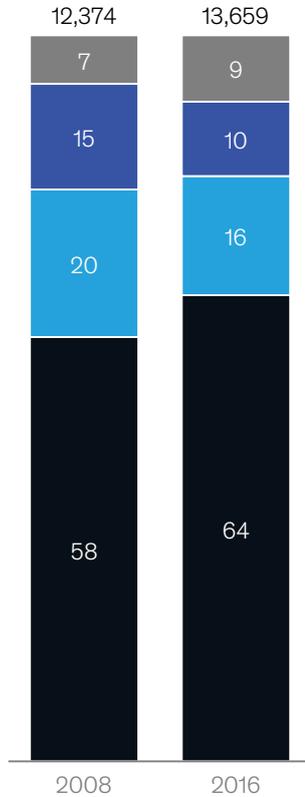
#### Container traffic

%; million TEU<sup>1</sup>



#### Cargo traffic

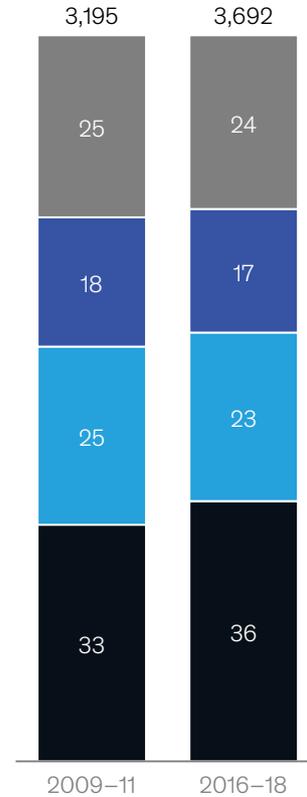
%; million tons



### People

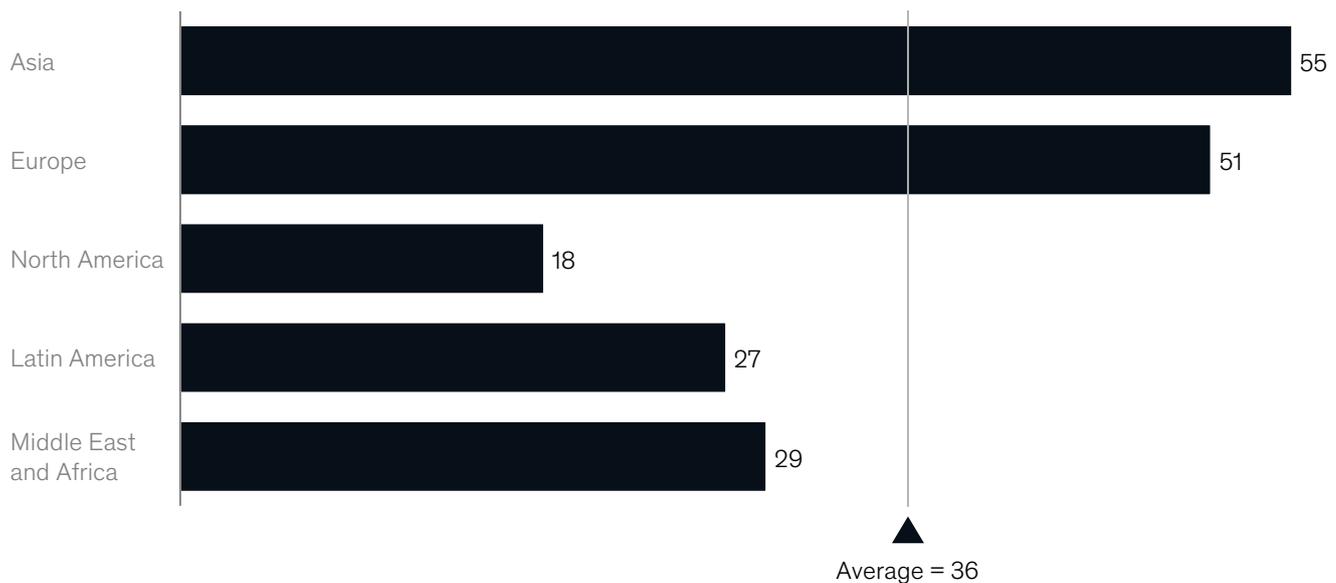
#### Air travel revenue

%; \$ billion



### Intraregional share of air travel revenue, 2018

%



1. Twenty-foot equivalent units.

Note: Figures may not sum to 100% because of rounding.

Source: IATA; UN; UNESCO; McKinsey Global Institute analysis

## Culture: Asian entertainment and culture is going global

Asian cultural industries are gaining global scale and significance, with some countries becoming major exporters, earning exports while projecting their image to the rest of the world and opening up opportunities in sectors from retail to tourism. The United States has undoubted strength in movie production, accounting for all top ten grossing movies in 2018.<sup>18</sup> However, Asia is increasingly important as a market, accounting for 38 percent of worldwide box office sales from 25 percent a decade ago. Asia's scale offers attractive business opportunities for global players. *Avengers: Endgame*, the blockbuster of 2019, earned most from Asian countries. In India, this was one of the highest openings of the year. In China, the film set an opening-day record with an estimated \$107.2 million in ticket sales.<sup>19</sup> Some Asian economies are creating blockbusters. BTS, a South Korean pop group, has been No. 1 on iTunes in more than 65 countries and has almost 12 million subscribers on YouTube.<sup>20</sup>

Asia's cultural flows including the "publishing, printing, and reproduction of recorded media" and "personal, cultural, and recreational services" of MGI's Global Flows Database are increasing despite such global flows being generally static. Asia's share of global entertainment flows increased from 15 percent in 2005–07 to 19 percent in 2015–17. Its share of global revenue from entertainment and hospitality companies increased from 17 percent in 2005–07 to 22 percent in 2015–17 (Exhibit 11). Asia's share of global tourism has increased from 20 percent in 2007 to 33 percent in 2016.

Intraregional cultural flows are increasing. For example, 53 percent of online viewers surveyed in Singapore watch South Korean dramas on a regular basis, according to PCCW Media.<sup>21</sup> More than 2.5 billion view Japan's ninja series *Naruto* on Youku, a Chinese video streaming platform.<sup>22</sup> The Indian film *Dangal* grossed around \$170 million in China. Yoga that originates in India, including events, studios, and products, has become a \$6 billion market in the region.<sup>23</sup>

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<sup>18</sup> "Top 2018 movies at the worldwide box office," The Numbers, <https://www.the-numbers.com/box-office-records/worldwide/all-movies/cumulative/released-in-2018>. Two of the world's top ten grossing movies (*Bohemian Rhapsody* and *Fantastic Beasts: The Crimes of Grindelwald*) were produced in the United Kingdom and the United States.

<sup>19</sup> "Avengers Endgame an inch away from becoming the highest-grossing movie worldwide," *Business Today*, June 12, 2019; and Lisa Richwine and Pei Li, "Disney's 'Avengers: Endgame' smashes China opening day record," Reuters, April 24, 2019.

<sup>20</sup> "BTS: Who are they and how did they become so successful?," BBC, October 11, 2018.

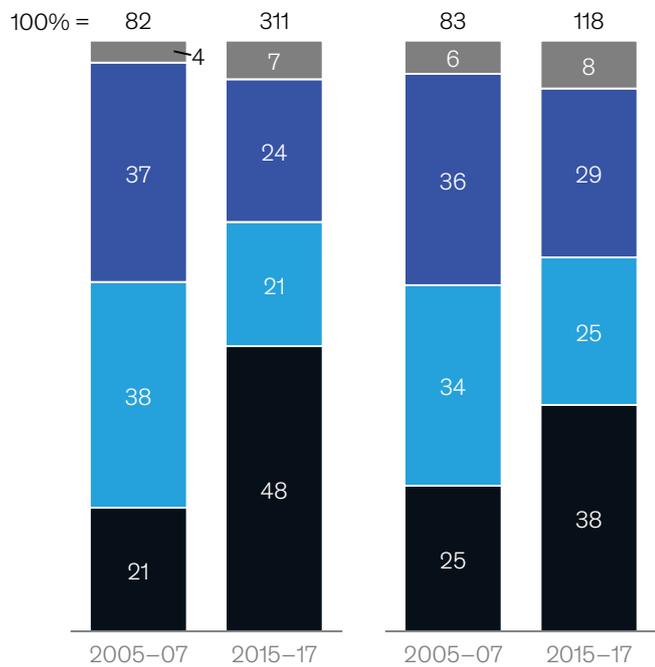
<sup>21</sup> See, for instance, Vivienne Tay, "Descendants of the Sun shines bright for brands," *Marketing Interactive*, April 21, 2016.

<sup>22</sup> Emily Cashen, "Anime enjoys explosive popularity in China," *Business Destinations*, August 22, 2017.

<sup>23</sup> Sonalie Figueiras, "Five growing health and wellness market trends in Asia," *naturalproductsglobal.com*, June 27, 2017.

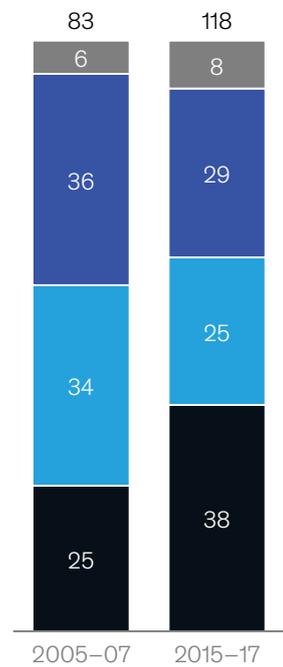
### Asia has the scale and influence to create global blockbusters.

**Global games market size**  
%; \$ billion

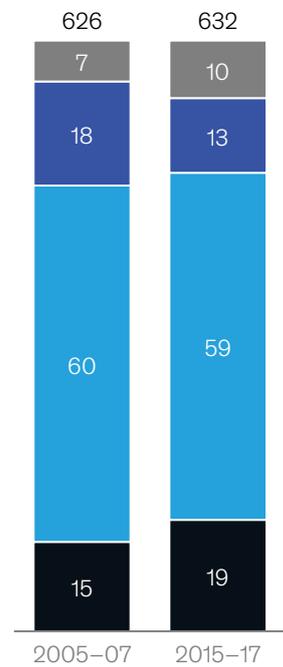


■ Asia                      ■ North America  
■ Europe, Middle East, and North Africa    ■ Rest of world

**Global box office revenue**  
%; \$ billion

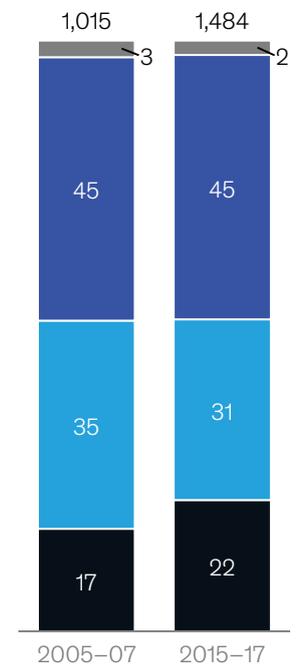


**Entertainment content (imports and exports)<sup>1</sup>**  
%; \$ billion

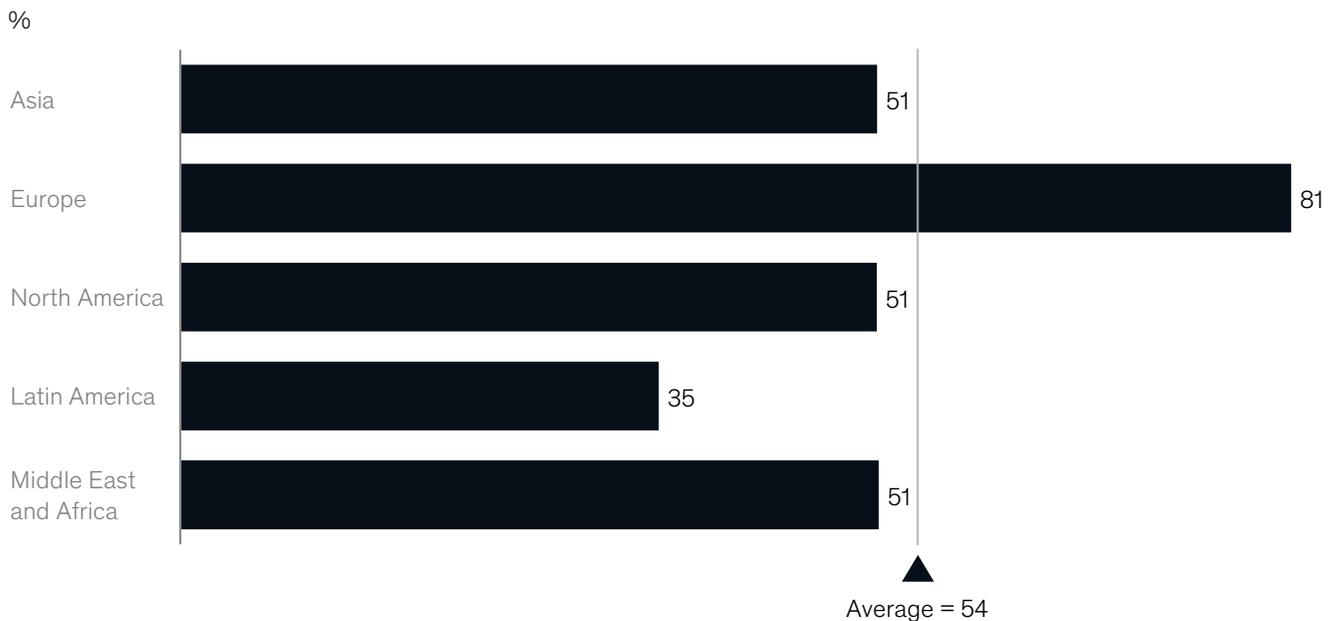


■ Asia                      ■ North America  
■ Europe                      ■ Rest of world

**Revenue from entertainment and hospitality companies<sup>2</sup>**  
%; \$ billion



### Intraregional share of publishing and personal, cultural, and recreational services flows, 2017



1. Includes publishing and personal, cultural, and recreational services.

2. Includes 1,109 companies in media, hotels, restaurants, and leisure sector in McKinsey Corporate Performance Analytics Database.

Note: Figures may not sum to 100% because of rounding.

Source: IMF; UNCTAD; WTO; OECD; McKinsey Corporate Performance Analytics Database; IHS; McKinsey Global Institute analysis

## **Resources: Asia is becoming a global player in energy consumption, production, and investment**

Asia accounts for a very large and increasing share of global energy demand—43 percent in 2017, compared with 29 percent in 2000. In 2030, the region is projected to generate 46 percent of global energy demand. Asia accounted for 29 percent of global energy flows in 2015–17, an increase from 21 percent in 2000–02. In the meantime, Asia's energy intensity remains high, with major economies like China, South Korea, and Vietnam consuming over 1.2 times the world average. Asia's share of energy demand is expected to rise even further as the region's population continues to grow, in contrast to many other countries around the world whose population growth is slowing and populations are even contracting (Exhibit 12).

The region is investing heavily in renewables technology as Asian countries seek to meet burgeoning energy demand more efficiently and with less deleterious impact on the environment. Measured by concentration of fine particulate matter PM2.5, 12 of the 20 most polluted countries in the world are in Asia, according to data from IQAir. The region accounts for more than half of global carbon emissions, with China representing 28 percent. Asia's share of global investment in renewables increased from 24 in 2005–07 to 57 percent in 2016–18, mainly driven by increased investment in China, which accounts for 64 percent of the increase in Asia.

Although the intraregional share of energy flows is low at 45 percent, intraregional collaboration is rising. Among Northeast Asian countries, the Asia Super Grid initiative aims to build a massive connected electricity grid that will enable the exchange of power from renewable resources like solar, wind, and hydro across the continent. The initiative has been backed by China, Japan, Mongolia, Russia, and South Korea.<sup>24</sup> In October 2018, the International Renewable Energy Agency signed an agreement with ASEAN to forge a new partnership on deploying renewable energy; ASEAN is targeting 23 percent of primary energy to come from renewables by 2025.<sup>25</sup> Asia is expected to account for around 51 percent of global investment in renewable energy between 2018 and 2040.<sup>26</sup> As Asia further develops its renewable energy capacity, the region may move toward a higher regional share of sourcing energy.

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<sup>24</sup> "About 'Asia Super Grid (ASG)," Renewable Energy Institute, <https://www.renewable-ei.org/en/asg/about/>.

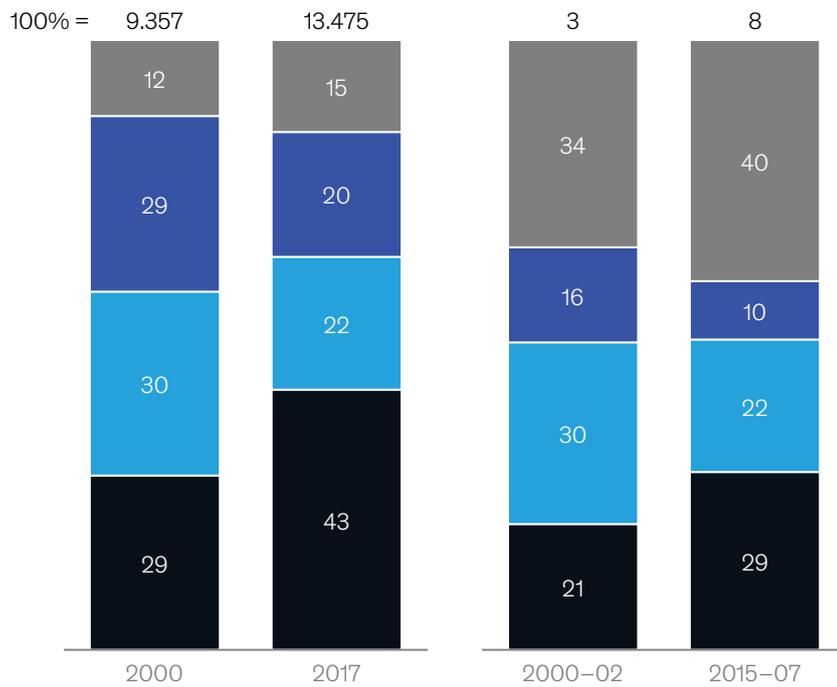
<sup>25</sup> "IRENA signs partnership with Southeast Asian countries as region looks to scale-up renewables," press release, International Renewable Energy Agency, October 30, 2018.

<sup>26</sup> *World energy outlook 2018*, International Energy Agency, <https://www.iea.org/weo/weo2018/secure/>.

## Asia accounts for an increasing share of global energy demand and is investing heavily in renewables.

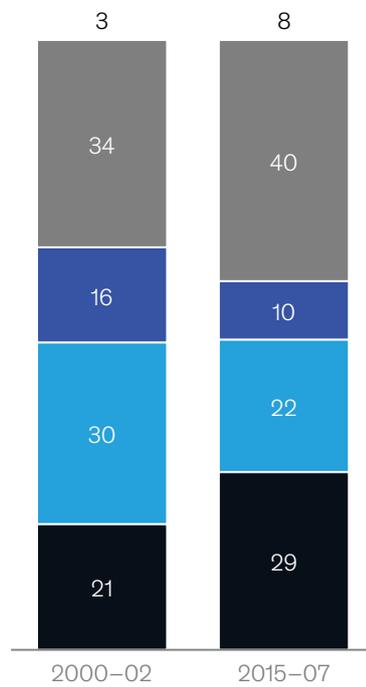
### Historical primary energy demand

%; million tons oil equivalent



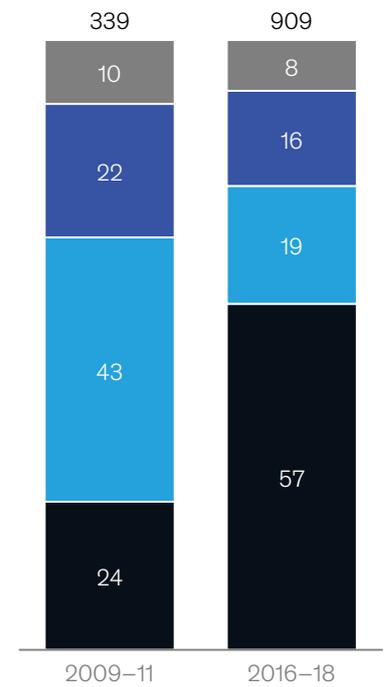
### Energy flows<sup>1</sup>

%; \$ billion



### Investment in renewables

%; \$ billion

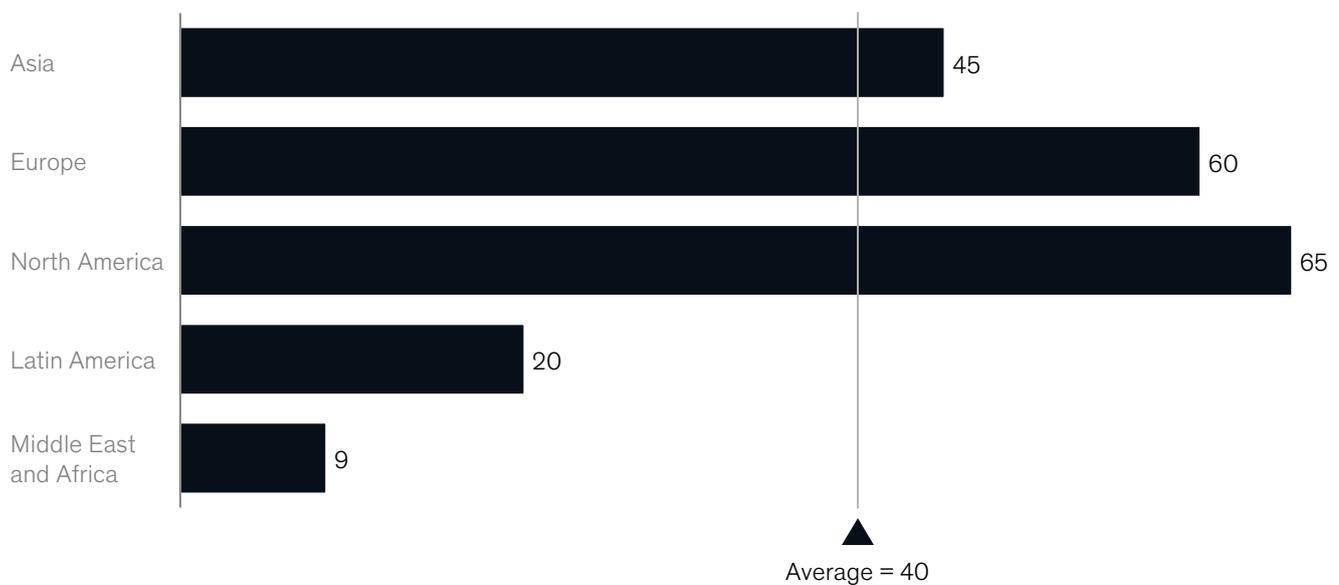


Asia  
 North America  
 Europe and Central Asia  
 Rest of world

Asia  
 North America  
 Europe  
 Rest of world

### Intraregional share of energy flows, 2017

%



1. Includes goods flows in mining and oil and gas sectors.

Note: Figures may not sum to 100% because of rounding.

Source: BP Statistical Review of World Energy, 2019; IMF; UNCTAD; WTO; OECD; World Energy Outlook, OECD/IEA, 2017; McKinsey Global Institute analysis

## **Environment: Asia is paying increasing attention to its own waste, reducing global imports**

Asia accounts for around 39 percent of global waste generated and is a major importer of waste from other countries. In 2017, Asia accounted for 70 percent of global inflows of waste, similar to 71 percent in 2007. Waste imports have largely occurred globally rather than intraregionally, with over 66 percent of global exports of waste to Asia coming from North America and the European Union (EU).<sup>27</sup> In 2017, China accounted for 76 percent of Asia's waste imports. On paper waste, China took in 60 percent of the total waste produced by the United States and more than 70 percent of European waste.<sup>28</sup> In 2016, waste from the United States made up 10 percent of China's total waste imports.<sup>29</sup>

As Asians become richer and consume more, they could generate an increasing amount of waste, and this may prove to be a catalyst for a new approach to environmental regulation and supervision (Exhibit 13).

Asia is taking steps to reduce inflows of global waste—to better cope with the waste generated in its own region—and focus more on sustainability. A shift is now observable in several countries. China, for instance, unveiled a “national sword” policy at the start of 2018 that banned the import of most plastics and other materials for recycling processors that have handled nearly half of the world's recyclable waste over the past 25 years. Before the ban, 95 percent of the plastics collected for recycling in the EU and 70 percent in the United States were sold and shipped to China.<sup>30</sup>

Since China's ban, Malaysia, Thailand, and Vietnam have taken over as chief waste importers, but these roles may shift in the next several years. In 2018, waste imports to Malaysia increased from 20,000 tonnes in 2016 to 110,000. Thailand and Vietnam imported a combined 140,000 tonnes of waste in 2018.<sup>31</sup> The latter subsequently placed restrictions on the amount of toxic waste being shipped into the country. The rapid overwhelming of landfills and the negative impact on the health of the local population—such as widespread cases of lung cancer and asthma—encouraged Southeast Asian countries to follow suit in tightening regulations, with Thailand intending to ban waste imports by 2021 and Vietnam considering similarly definitive action.<sup>32</sup> Such regulations could result in a significant decrease of waste being shipped to Asia.

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<sup>27</sup> Statista.

<sup>28</sup> *After China's import ban, where to with the world's waste?* DW, <https://www.dw.com/en/after-chinas-import-ban-where-to-with-the-worlds-waste/a-48213871>.

<sup>29</sup> Christopher Joyce, “Where will your plastic trash go now that China doesn't want it?,” NPR, March 13, 2019.

<sup>30</sup> Cheryl Katz, “Piling up: How China's ban on importing waste has stalled global recycling,” *Yale Environment* 360, March 7, 2019.

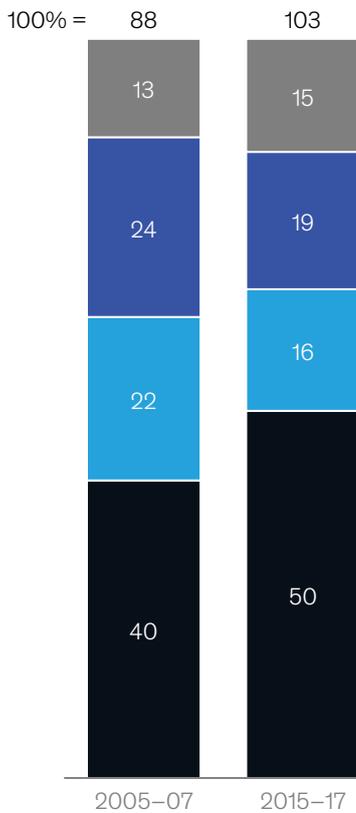
<sup>31</sup> Tang Damin, *Developing countries turn away from plastic waste imports*, China Dialogue, June 12, 2019.

<sup>32</sup> “South-East Asian countries are banning imports of waste for recycling,” *Economist*, June 15, 2019.

## Asia is paying increased attention to its own waste and reducing global imports.

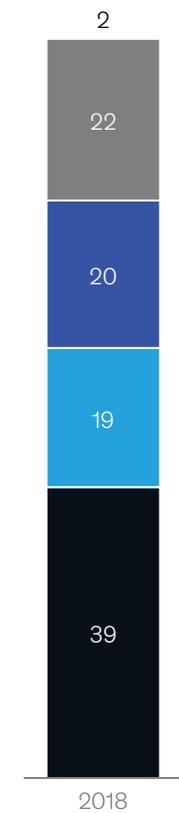
### Carbon emissions

%; MtCO<sub>2</sub>



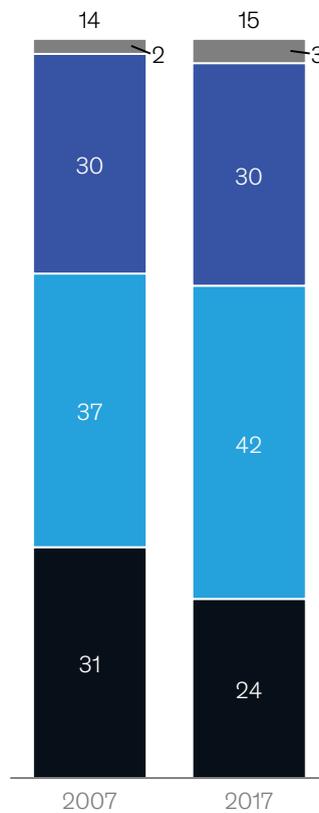
### Global waste generated<sup>1</sup>

%; billion tonnes



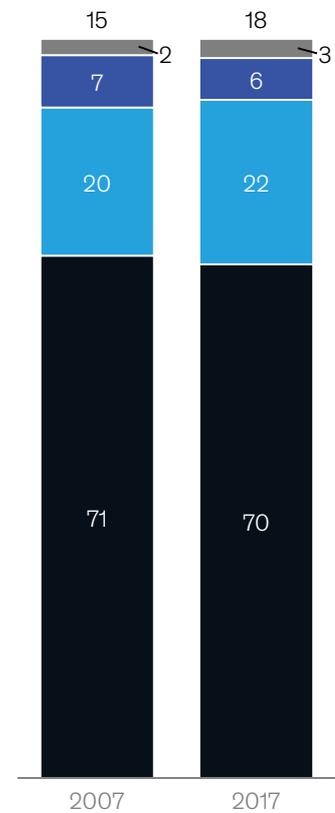
### Global exports of waste<sup>2</sup>

%; \$ billion



### Global imports of waste

%; \$ billion

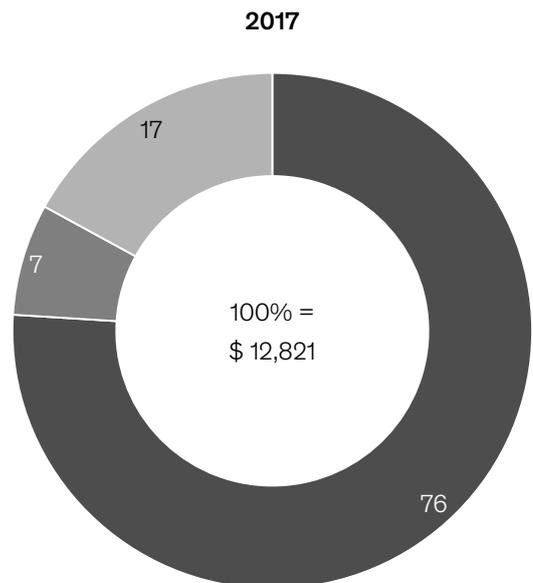
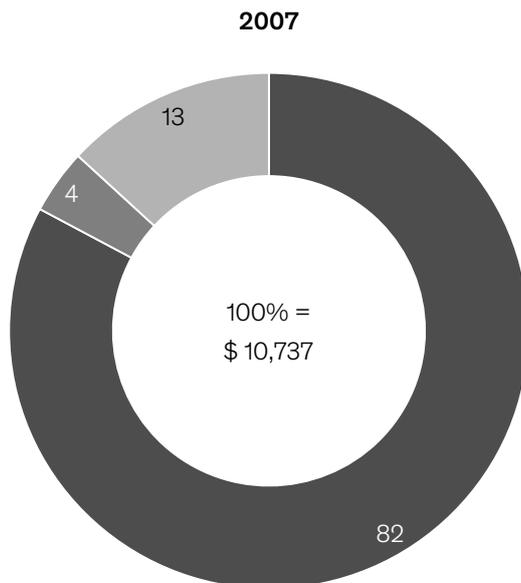


■ Asia ■ Europe ■ North America ■ Rest of world

### Asian imports of waste

%; \$ million

■ China  
■ India  
■ Rest of Asia



1. Covers 217 countries based on 2018 data collection from "What a waste" World Bank project.

2. UN Comtrade reports waste imports and exports separately as stock data instead of bilateral data. There is a discrepancy in total imports and total exports.

Source: World Bank; UNESCO; *World Energy Outlook*, OECD/IEA, 2017; McKinsey Global Institute analysis

# 2. Asia is diverse, but also complementary

Asia is already big and still rising in scale, but what is Asia? This is a highly diverse region, home to about four billion people who speak about 2,300 languages.<sup>33</sup> Its nations have widely varying forms of government, economic systems, indicators of human development, demographics, and per capita income—ranging from \$863 in Nepal to \$57,713 in Singapore. Simply put, there is no one Asia, but many.

However diverse the region, the different characteristics of its economies complement one another. This complementarity is fueling the integration of Asia and the development of powerful networks.

## Economic characteristics define at least four Asias

When discussing the region, observers typically segment its constituent countries by geography, grouping China, Japan, and South Korea as Northeast Asia, the ten ASEAN member states plus Timor-Leste as Southeast Asia, nine countries including Bangladesh, India, Pakistan, and Sri Lanka as South Asia, and five countries as Central Asia. We took a different view using nine indicators on four dimensions, and identified at least four Asias with different characteristics in the way they interact with one another and the rest of the world. The four dimensions are:

- **Scale.** Scale matters for the role countries play on the global stage, and Asian economies differ significantly in this regard. We used overall GDP as well as population to gauge the scale of economies in the region.
- **Economic development.** The degree of economic development can indicate what each economy can contribute to the global economy, such as capital and technology, and its growth potential through industrialization and urbanization. We used per capita GDP, the urbanization rate, and the R&D investment share of GDP.
- **Interaction with Asia.** The model of integration is important because this can indicate who a country's major economic partners are and significant interdependencies. We used the intraregional shares of goods exported, capital inflows and outflows, and people inflows and outflows, and then calculated a weighted average of these shares.

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<sup>33</sup> Major languages spoken in Asia, World Atlas, <https://www.worldatlas.com/articles/major-languages-spoken-in-asia.html>.

**There is no single Asia but four or more, each with distinct characteristics in the way they interact with one another ...**

Grouping	Economies	Total scale		Average economic development		
		Real GDP, 2017 <sup>1</sup> \$ trillion	Population, 2017 Million	Per capita GDP, 2017 <sup>1,2</sup> \$ thousand	Urbanization, 2017 <sup>2</sup> %	R&D spending as share of GDP, 2017 <sup>2</sup> %
Advanced Asia	Australia, Japan, New Zealand, Singapore, South Korea	8.2	213	38.6	89	3.1
China	Hong Kong, Macao, Mainland China, Taiwan	13.0	1,442	9.0	57	2.0
Emerging Asia	Bhutan, Brunei, Cambodia, Indonesia, Laos, Malaysia, Mongolia, Myanmar, Nepal, Philippines, Thailand, Vietnam	2.5	675	3.6	47	0.4
Frontier Asia and India	Afghanistan, Bangladesh, Fiji, India, Kazakhstan, Kyrgyzstan, Maldives, Pakistan, Sri Lanka, Tajikistan, Turkmenistan, Uzbekistan	3.5	1,825	1.9	34	0.5

1. Real GDP and per capita GDP are at 2017 constant prices and exchange rates.  
 2. Per capita GDP and R&D spending as a share of GDP are weighted by GDP; urbanization is weighted by population.  
 Source: IHS; Oxford Economics; IMF; UNCTAD; WTO; OECD; McKinsey Global Institute analysis

— **Connectedness with the world.** Countries have different degrees of openness toward the world. MGI research found that cross-border flows are adding \$450 billion to global GDP each year and that the most connected countries drive 40 percent more benefit than the least connected.<sup>34</sup> We used the MGI Connectedness Index to measure the degree of connectedness of each economy.<sup>35</sup>

This approach revealed four distinct blocs in Asia, each of which has different characteristics in the way they interact with one another and the rest of the world (Exhibits 14 and 15).<sup>36</sup>

<sup>34</sup> *Global flows in a digital age: How trade, finance, people, and data connect the global economy*, McKinsey Global Institute, April 2014; and *Digital globalization: The new era of global flows*, McKinsey Global Institute, March 2016.  
<sup>35</sup> For more detail on the index, see *Digital globalization: The new era of global flows*, McKinsey Global Institute, March 2016.  
<sup>36</sup> We excluded North Korea in Northeast Asia, Timor-Leste in Southeast Asia, and 27 countries in Oceania because of a lack of data.

... and with the world.

□ Key differentiator

Interaction with Asia: average intraregional share



Average connectedness with the world

Grouping	Economies	Interaction with Asia: average intraregional share				Average connectedness with the world
		Goods exports, 2017	Capital (imports + exports), 2013–17	People travel (imports + exports), 2018	Average	MGI Connectedness Index global rank, 2017
Advanced Asia	Australia, Japan, New Zealand, Singapore, South Korea	67	63	80	70	22
China	Hong Kong, Macao, Mainland China, Taiwan	74	70	78	76	9
Emerging Asia	Bhutan, Brunei, Cambodia, Indonesia, Laos, Malaysia, Mongolia, Myanmar, Nepal, Philippines, Thailand, Vietnam	72	80	85	79	69
Frontier Asia and India	Afghanistan, Bangladesh, Fiji, India, Kazakhstan, Kyrgyzstan, Maldives, Pakistan, Sri Lanka, Tajikistan, Turkmenistan, Uzbekistan	31	34	33	31	86

Source: IHS; Oxford Economics; IMF; UNCTAD; WTO; OECD; McKinsey Global Institute analysis

The four Asias we highlight are (1) Advanced Asia, comprising countries that are significant providers of capital and technology to the rest of the region; (2) China, which is large enough and sufficiently distinct from others in the region to stand in its own category, and which acts as an anchor economy and as a connectivity and innovation platform for neighboring countries; (3) Emerging Asia, with high shares of regional flows, is a major source of labor and is culturally diverse (all ASEAN countries except for Singapore belong in this group); and (4) Frontier Asia and India, economies that historically have had low levels of regional integration and as a result had a more diverse global base of trading partners and investors; these economies are still urbanizing rapidly (most, but not all, South Asian countries belong to this group). We acknowledge that the economies of the latter two groups do not follow the definition of “emerging” or “frontier” economies usually used by financial markets and investors, but we named them this way for illustrative purposes as most of the economies in each group fall in the category.

The economy of each of these Asias is expected to be comparable in size to individual continents by 2040. China may almost be comparable to the size of North America by then. Advanced Asia and Frontier Asia and India may each be bigger than the Middle East and Africa combined. Emerging Asia may be comparable with Latin America (Exhibit 16).

Each of the four Asias is likely to be comparable with the size of individual continents.



GDP \$ trillion	Advanced Asia	China	Emerging Asia	Frontier Asia and India
Asia, 2017	8	13	3	4
Asia, 2040	11	36	7	13
Other comparable economies, 2040	Middle East and Africa 9	North America 34	Latin America 8	Middle East and Africa 9
	Advanced Asia may be bigger than Middle East and Africa	China may be as big as North America	Emerging Asia may be comparable to Latin America	Frontier Asia and India may be bigger than Middle East and Africa

Note: Figures are from the McKinsey Global Growth Model's baseline simulations and projections by external institutions, subject to modifications based on changes in economic conditions.

Source: McKinsey Global Growth Model; IHS, McKinsey Global Institute analysis

## The four Asias can complement one another

The four Asias are at different stages of economic development and comparative advantage. Advanced Asia and China have developed large innovation capacity and rank high on the Global Innovation Index.<sup>37</sup> In these respects, the other two Asias lag behind. However, the working-age populations of Advanced Asia and China are declining, while the economies of Emerging Asia and Frontier Asia and India combined are projected to add 412 million people to their labor pools between 2017 and 2040. On the demand side, while GDP growth in Advanced Asia is expected to slow to a compound annual rate of 1.1 percent between 2017 and 2040, China, Emerging Asia, and Frontier Asia and India are expected to continue to provide an expanding market, with GDP growing at a compound rate of more than 4 percent over this period. If we look at cultural diversity, Emerging Asia and Frontier Asia and India contribute a significant cultural heritage, with more than ten official languages in each region, for instance. The various groups of Asian economies play complementary roles, and as such work together to make the region more resilient to short-term global volatility. (Exhibit 17).

### Advanced Asia is a major provider of capital and technology

Advanced Asia comprises Australia, Japan, New Zealand, Singapore, and South Korea. These economies have all achieved high levels of per capita GDP of between \$30,000 and \$60,000, and are very urbanized, with an urbanization rate of between 82 and 100 percent. They also tend to be highly connected, tending to rank in the top 20 of the MGI Connectedness Index. They play three key roles for the rest of Asia:

- **Technology provider.** They tend to invest heavily on R&D, spending between 2 and 4 percent of GDP. They also have strong technological and innovation foundations. For example, they rank high on the 2019 edition of the Global Innovation Index.<sup>38</sup> In the 2019 index, Singapore ranked eighth, South Korea 11th, Japan 15th, Australia 22nd, and New Zealand 25th.
- **Capital provider.** These countries also provide significant capital to other economies in the region and beyond. Their outbound FDI was \$1 trillion in 2013–17, accounting for 54 percent of total regional FDI outflows. For example, South Korea is a top investor in Vietnam, accounting for 33 percent of overall FDI inflows. Japan provides 35 percent of FDI inflows to Myanmar and 17 percent of such inflows to the Philippines.
- **Market.** The combined GDP of these countries is \$8.2 trillion in 2017, or 10 percent of global GDP. Per capita incomes are relatively high and steadily rising, and therefore so is consumption in these economies, including on premium goods. This offers a large and growing opportunity for other economies in the region. For example, in 2018 Japan spent \$12 billion on prestige cosmetics and fragrances, a number estimated to grow to more than \$15 billion by 2023, according to McKinsey's statistics.

### China is Asia's anchor economy, providing a connectivity and innovation platform

China has substantial scale in terms of GDP and population and is a global and regional power. It became the world's largest economy in terms of purchasing power parity in 2014. In 2018, China accounted for about 16 percent of world GDP. In nominal terms, China's GDP was 66 percent that of the United States in 2018, making it the second-largest economy in the world.<sup>39</sup> As China's economy grows in scale, it is increasingly playing a connecting role, linking trade, capital, people, and other flows. On the MGI Connectedness Index, which ranks participation by flows of goods, services, finance, people, and data, China was the ninth most connected country in the world in 2017.<sup>40</sup> It plays four important roles in Asia:

<sup>37</sup> Soumitra Dutta, Bruno Lanvin, and Sacha Wunsch-Vincent, eds., *Global Innovation Index 2019: Creating healthy lives—The future of medical innovation*, 12th edition, 2019.

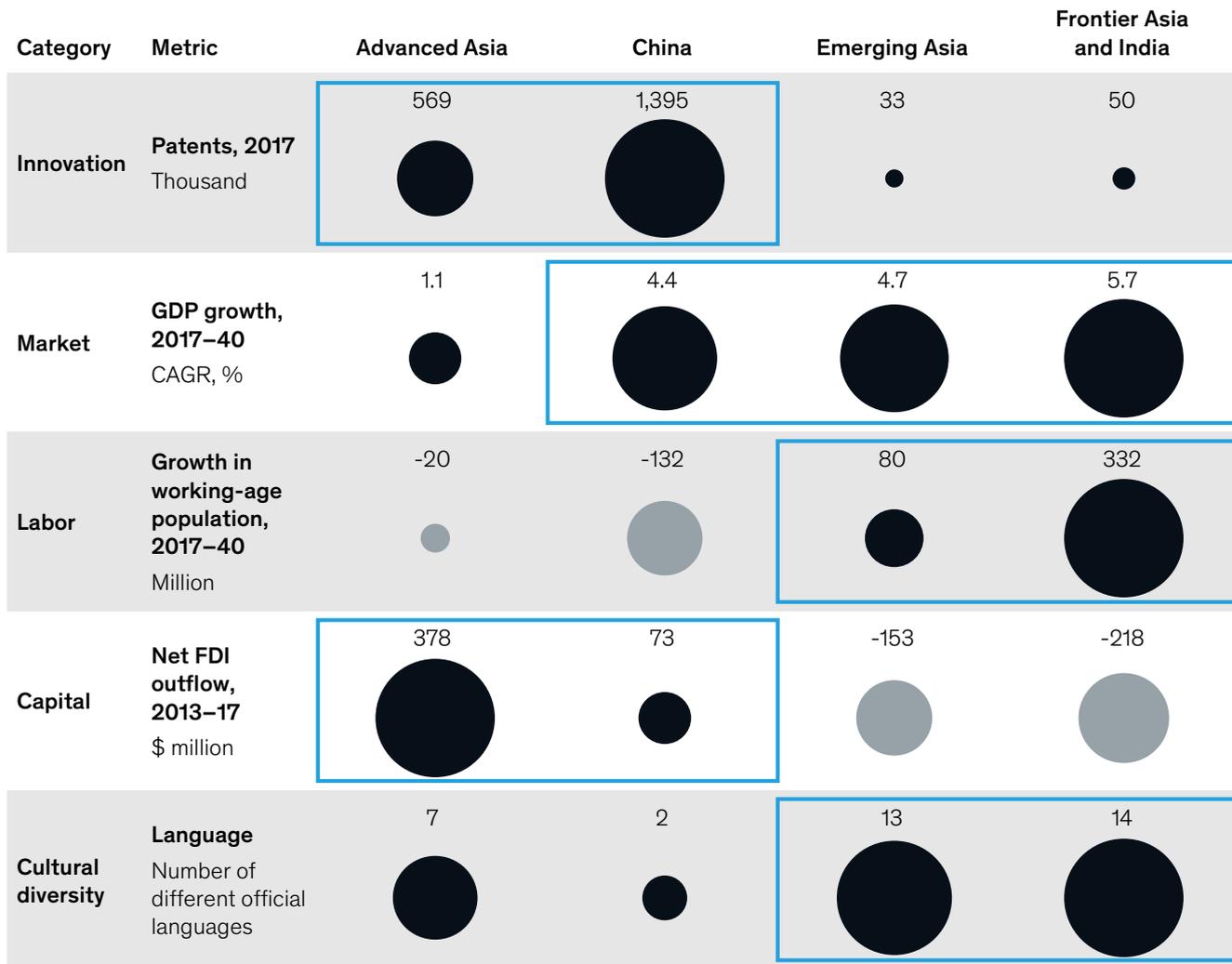
<sup>38</sup> *Ibid.*

<sup>39</sup> *China and the world: Inside the dynamics of a changing relationship*, McKinsey Global Institute, July 2019.

<sup>40</sup> *Digital globalization: The new era of global flows*, McKinsey Global Institute, March 2016.

Each Asia plays different roles with its distinct characteristics.

□ Concentration



Note: Figures are from the McKinsey Global Growth Model's baseline simulations and projections by external institutions, subject to modifications based on changes in economic conditions.

Source: WIPO; McKinsey Global Growth Model; IHS; United Nations; IMF; CEIC; Nations Online; McKinsey Global Institute analysis

- **Global trade platform.** Asian economies are tightly linked with China through regional supply chains, and their exposure to China has been growing, particularly as a destination for their exports. China is now the largest trading partner for Malaysia, the Philippines, and Singapore, for instance. Asia has accounted for about 60 percent of China's total imports over the past decade. As China phases out labor-intensive manufacturing in favor of R&D- and capital-intensive manufacturing, there is room for other countries to step up and play this role.
- **Market.** China's incremental consumption growth in the period to 2030 is likely to be comparable to that of Western Europe and the United States combined and nearly double that of ASEAN economies combined. According to consensus forecasts, growth in Chinese consumption during this period could be around \$6 trillion. China can become an import destination for both developing and advanced economies. It is already becoming an anchor economy for neighboring countries.
- **Investor.** China has been increasing its FDI in neighboring countries. In 2013–17, it accounted for 35 percent of total Asian outbound FDI. Between 2013 and 2017, for

instance, Chinese outbound FDI was equivalent to 6 percent of domestic investment in Malaysia and 5 percent in Singapore. The Belt and Road Initiative (BRI) may further strengthen capital connectivity.

- **Innovator.** China has developed significant innovation capacity.<sup>41</sup> It accounted for 44 percent of global patent applications in 2017, is home to about 28 percent of global unicorns (77 percent of Asian unicorns), and produces 57 percent of global STEM graduates (70 percent of the Asian total). China has developed a globally competitive digital economy, and many of its business models are sources of inspiration for startups in developing economies.<sup>42</sup>

### **Emerging Asia offers labor, growth opportunities, and cultural diversity**

This group has 12 countries: Bhutan, Brunei, Cambodia, Indonesia, Laos, Malaysia, Mongolia, Myanmar, Nepal, the Philippines, Thailand, and Vietnam. This group is relatively diverse but tends to be characterized by small economies that are highly connected to one another. It consists of all the Southeast Asian economies except Singapore, which we categorize as being in Advanced Asia. The average share of intraregional flows in these economies is 79 percent, the highest of the four Asias. Around 72 percent of trade, 80 percent of capital flows, and 85 percent of people flows in this group are intraregional. These economies are the source of three elements of the broader Asian economy:

- **Labor.** These economies provide Asia with a substantial pool of labor. Their combined working-age population is projected to increase by 18 percent by 2040. In many cases, wages are less than 50 percent those in mainland China, which means that these economies potentially are alternative locations for companies that opt to adjust their operational footprint.
- **Growth.** These countries offer Asia new sources of growth. Many of these economies grew at a rate of more than 6 percent between 2013 and 2017 and are expected to continue to exceed global average GDP growth of 2.7 percent between 2017 and 2040—posting 4 to 5 percent growth a year according to a McKinsey simulation.<sup>43</sup>
- **Cultural diversity.** This group is arguably the most culturally diverse in Asia. A combined population of 641 million speaks nearly 600 languages. This diversity has attracted many visitors. In 2017, about 125 million people visited ASEAN's ten member countries, up 40 percent from five years earlier. Indonesia's Bali island alone welcomes more than one million tourists a month.<sup>44</sup> This diversity creates rich opportunities but also complexity. Businesses and policy makers need to understand cultural differences in order to tap into business opportunities, and manage that complexity.

### **Frontier Asia and India is less integrated with Asia, has young populations, and is urbanizing rapidly**

This group has 12 countries: Afghanistan, Bangladesh, Fiji, India, Kazakhstan, Kyrgyzstan, Maldives, Pakistan, Sri Lanka, Tajikistan, Turkmenistan, and Uzbekistan. This Asia has a rather different profile than the three others. Look, for instance, at the share of intraregional goods trade, and capital and people flows. The rest of Asia is tightly interconnected, with an intraregional share of these flows of more than 50 percent. In comparison, Frontier Asia and India is much more international, courtesy of long-established ties—some established in the European colonial era—with Western Europe, as well as with the United States. It is notable that the average intraregional share of goods, capital, and people is only 31 percent, the

<sup>41</sup> *The China effect on global innovation*, McKinsey Global Institute, October 2015.

<sup>42</sup> *Digital China: Powering the economy to global competitiveness*, McKinsey Global Institute, December 2017.

<sup>43</sup> Using the McKinsey Global Growth Model (GGM). The GGM uses a general equilibrium calculation to generate forecasts of scenarios drawing on a combination of more than 100 macroeconomic indicators. GGM uses time-series trends to build forward-looking scenarios of the global economy on the basis of long-term trends, including changes in population structure, productivity growth, and trade.

<sup>44</sup> "Tourism in Indonesia: Rising foreign visitor arrivals in February 2018," Indonesia Investments, April 4, 2018.

lowest in Asia. For many years, these economies tended to look to the West. In 2017, Europe, the Middle East and Africa, and North America accounted for 45 percent of these economies' imports and 66 percent of exports, 56 percent of their FDI inflows, and 53 percent of their FDI outflows. These economies offer three key ingredients to the broader Asian economy:

- **Services.** These economies are major producers of services and notably of business services. Frontier Asia and India accounts for 7 percent of Asia's goods exports but 19 percent of its service exports. In the case of India, 53 percent of GDP comes from services. Although facing intense competition, India's share in the \$186 billion global business-process-outsourcing industry is large at 36 percent.<sup>45</sup>
- **Young labor force.** In 2015, the median age in India was only 27 and is still expected to be only 38 in 2050, consistently younger than China's median age by around ten years. The average urbanization rate of these economies is only 34 percent, compared with 89 percent in Advanced Asia, 57 percent in China, and 47 percent in Emerging Asia. There is therefore huge potential for growth to continue to be fueled by a young workforce and for urbanization to continue to generate GDP and productivity growth.
- **New markets.** Average GDP growth for this part of Asia was 6.8 percent from 2013 to 2017, the highest of the four Asias. GDP in India and Bangladesh grew at rates of 7.3 percent and 6.8 percent between 2013 and 2017, respectively, and is expected to continue to post compound growth of more than 5 percent between 2017 and 2040, according to McKinsey's GGM simulation. Incremental consumption may reach 2.4 trillion by 2030.

Our discussion of "four Asias," of course, does not provide a mechanistic description and analysis of this diverse region. Rather, it is a way of thinking about Asia that challenges assumptions of homogeneity and demonstrates the widely differing characteristics of its economies. We note, too, that limitations on the availability of data for all countries in the region informed our decision to focus on four groups of economies. The reality is more complex. For instance, previous McKinsey research has suggested that urban China alone can be divided into 20 to 25 clusters of cities, which may help determine how new corridors may develop.<sup>46</sup> An interesting example is the new electronics corridor that is developing between South Korea and Vietnam, which we discuss in the next section.

The complementary characteristics of the four Asias and increasing flows between countries in the regions create new networks. As Asia becomes more interconnected, interesting networks will continue to emerge. We believe three particular "networks" are helping to reinforce those flows and connections—industrialization, innovation, and cultural and mobility—that we discuss in the next three sections of this paper.

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<sup>45</sup> Sanjeev K. Ahuja, "BPO industry challenged: Outsourcing giant India losing to China, small countries," *Hindustan Times*, March 8, 2017.

<sup>46</sup> Yuval Atsmon, Ari Kertesz, and Ireena Vittal, "Is your emerging-market strategy local enough?" *McKinsey Quarterly*, April 2011.

# 3. Industrialization: Asia-for-Asia supply- chain networks are emerging

Rising consumption, maturing domestic value chains, and uncertainties about global trade are driving the formation of Asia-for-Asia supply chains. An industrialization network is developing from Advanced Asia and China to Emerging Asia and Frontier Asia and India. China was once the world's factory, but as its costs have risen and as the emphasis of its economy has shifted from labor-intensive manufacturing to knowledge-intensive manufacturing and services, other Asian economies are now taking over that role.

We analyzed Asia's industrialization network by looking at a combination of flows of goods, FDI, shipping, and energy. Most of Asia is still industrializing, but countries are at very different stages of this process (Exhibit 18). The contribution of manufacturing to both GDP and employment tends to show up as an inverted U-shaped curve. Although countries of Advanced Asia have passed the peak, many countries haven't reached that point yet and have huge potential to continue to industrialize. Manufacturing sector employment tends to peak at around 30 percent of total employment, usually after economies reach per capita GDP of between \$10,000 and \$20,000. Many Asian countries are at 15 to 20 percent in terms of employment in manufacturing, suggesting huge potential for further growth. We note the trend of "premature deindustrialization"—when the output of the manufacturing sector peaks at an even lower level of economic development. Technology and automation can be the reason behind the shift. Previous MGI research found that about half of the activities that people do in the global economy have the potential to be automated by adapting current technology.<sup>47</sup> The automation potential of countries varies a great deal. Our midpoint adoption rate scenario suggests that in Asia, for instance, 26 percent of current work activities could be displaced by automation in Japan by 2030 but only 6 percent in India. In economies where wages are lower, there is less incentive to automate as a way of cutting the wage bill, and therefore adoption rates can be slower.<sup>48</sup> This also suggests that there remains significant scope for Emerging Asia and Frontier Asia and India to continue to industrialize. Rising demand in the region can be an important factor facilitating further development of manufacturing sectors.<sup>49</sup>

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<sup>47</sup> *A future that works: Automation, employment, and productivity*, McKinsey Global Institute, December 2017.

<sup>48</sup> *Jobs lost, jobs gained: Workforce transitions in a time of automation*, McKinsey Global Institute, December 2017.

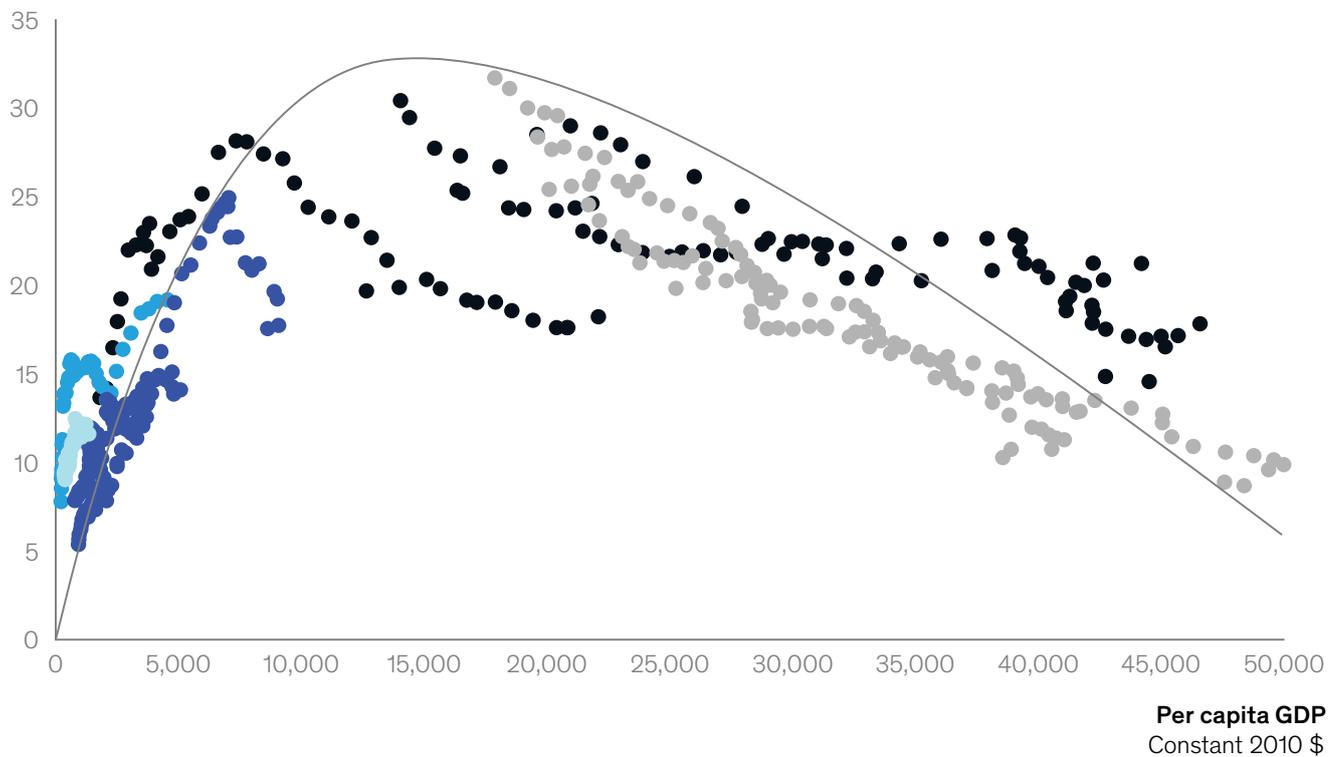
<sup>49</sup> *Outperformers: High-growth emerging economies and the companies that propel them*, McKinsey Global Institute, September 2018.

## Asian economies have room to industrialize further.

Manufacturing employment tends to follow inverted U-shape as an economy prospers

### Economic development as shown through manufacturing employment

% of total employment



Source: World Bank Database; GGDC database; McKinsey Global Institute analysis

In Asia's deepening industrialization network, we discern three major developments. First, China is reducing labor-intensive manufacturing and others are taking up the slack, notably economies in Emerging Asia. Second, China and Advanced Asia are investing heavily in Emerging Asia, empowering growth of these economies. Third, Frontier Asia and India economies have a largely underdeveloped industrial base in comparison with other Asian economies, suggesting large untapped potential. We highlight the electronics sector as an example of the changing dynamics of industrialization across the four Asias.

## **China is phasing out labor-intensive manufacturing, and Emerging Asia and Frontier Asia and India are picking up share**

China is still a very considerable manufacturer, but the economy is shifting from labor-intensive manufacturing to R&D- and capital-intensive manufacturing. This is creating opportunities for other Asian economies (Exhibit 19). From 2007 to 2017, China's manufacturing share of GDP increased slightly, from 30 to 34 percent. At the same time, manufacturing became a more prominent activity in other Asian economies. The manufacturing share of GDP in Vietnam increased from 16 in 2007 to 22 percent in 2017. Some Frontier Asia and India countries are also industrializing. Bangladesh's manufacturing share of GDP rose from 16 to 22 percent between 2007 and 2017. Moreover, recent trade tensions between the United States and China have pushed more manufacturers, including Chinese companies, to move out of China. According to one estimate, 33 listed companies in China have informed China's two stock exchanges of their plans to set up or expand production abroad.<sup>50</sup>

Reflecting these shifts, between 2014 and 2017 China's share of emerging economies' labor-intensive manufactured exports declined from 55 to 52 percent. During the same period, Vietnam's share increased by 2.2 percentage points and Cambodia's by 0.4 percentage point.

Vietnam is becoming a prominent beneficiary of China's move away from labor-intensive manufacturing.<sup>51</sup> Nike has manufactured more of its product lines in Vietnam than in China since 2009, and Adidas made the same switch in 2012. Both shoe manufacturers shifted their production to Vietnam when wages in China rose to about \$400 a month.<sup>52</sup>

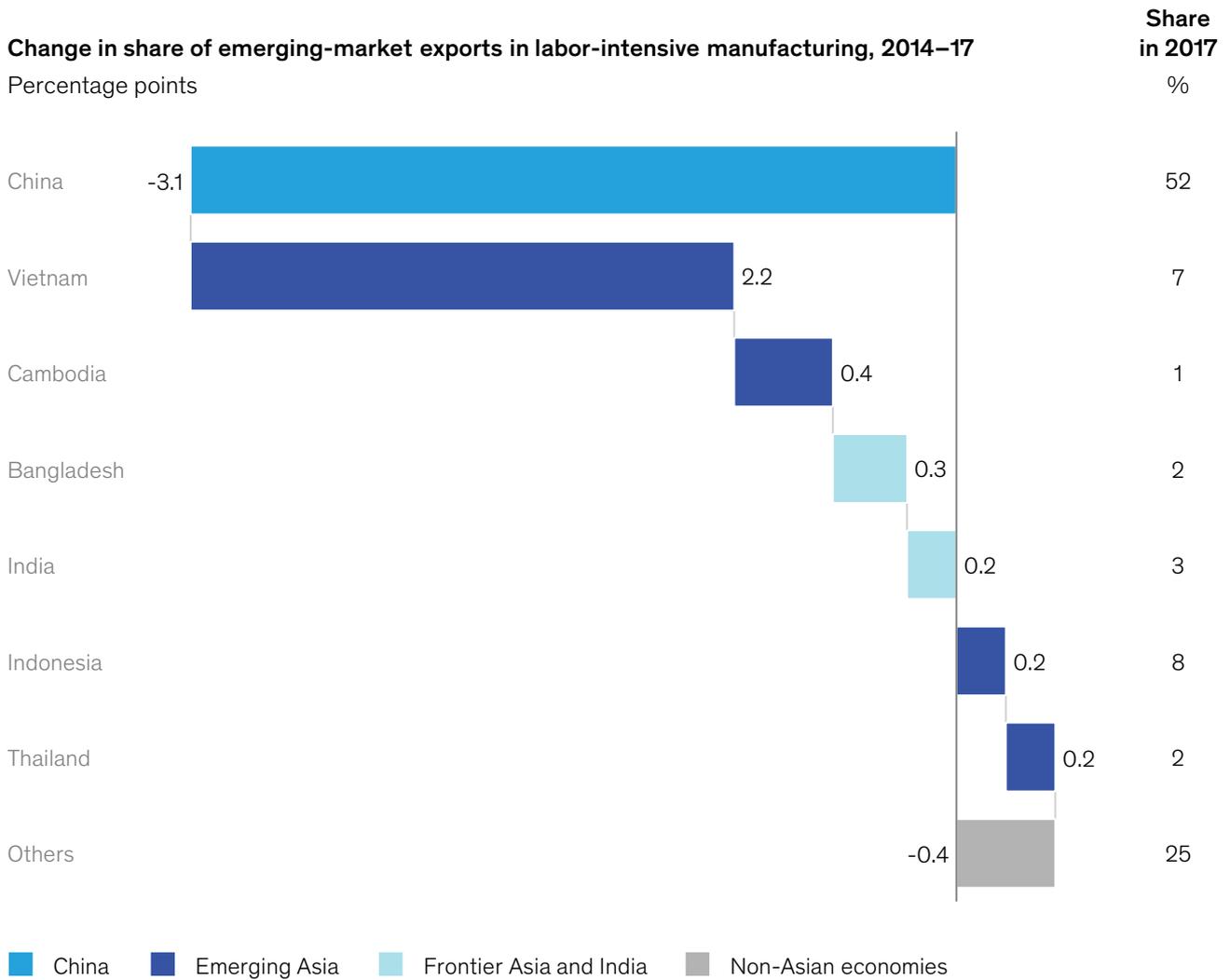
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<sup>50</sup> CK Tan, "Goodbye China: Chinese manufacturers follow multinationals out the door," *Nikkei Asian Review*, August 21, 2019.

<sup>51</sup> Vietnam is one of 11 economies that MGI has identified as being an "outperformer." These economies achieved real average annual per capita GDP growth between 1995 and 2016 of at least 5 percent. See *Outperformers: High-growth emerging economies and the companies that propel them*, McKinsey Global Institute, September 2018.

<sup>52</sup> Kyssha Mah, "Supply chain shifts from China to Vietnam," *Vietnam Briefing*, January 9, 2019, <https://www.vietnam-briefing.com/news/supply-chain-shifts-china-vietnam.html/>.

**As China shifts away from labor-intensive manufacturing, Emerging and Frontier Asia are picking up a share of this activity.**



Source: IMF; WTO; McKinsey Global Institute analysis

## **Advanced Asia and China are investing heavily in Emerging Asia, facilitating growth in these economies**

China and the economies of Advanced Asia are considerable enablers of economic development in Emerging Asia economies through trade and investment. Consider that these two Asias account for 43 percent of Emerging Asia's exports (Exhibit 20). China and Advanced Asia also account for 47 percent of Emerging Asia's FDI inflows and outflows (see Box 4, "How South Korea is facilitating the development of Vietnam's electronics sector").

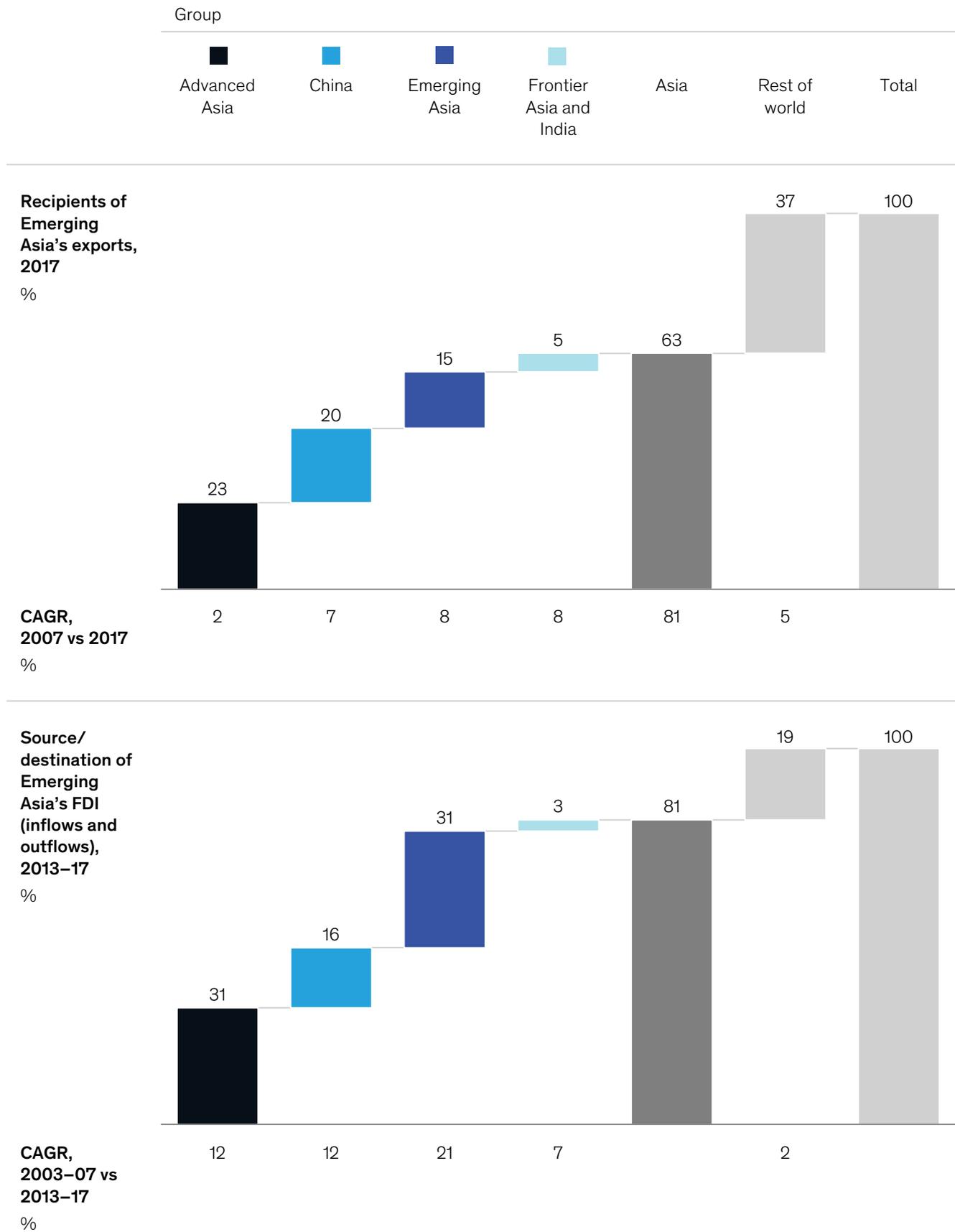
We are seeing a trend of companies that have been operating in China and Advanced Asia moving production to Emerging Asia in search of lower costs as demand slows. One example is LG Electronics, which announced in April 2019 that it aimed to boost the annual production capacity of its smartphone plant in Vietnam by 83 percent to 11 million handsets in the second half of the year.<sup>53</sup>

However, despite major influence from Advanced Asia and China, Emerging Asia's economic ties are still stronger within the group. For instance, other economies in Emerging Asia still accounted for 15 percent of the subregion's exports in 2017. Thirty-one percent of Emerging Asia's capital flows between 2013 and 2017 remained within the subregion, up from 26 percent in 2008–12.

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<sup>53</sup> Ju-min Park, "LG Elec to shut S. Korea phone plant, move production to Vietnam," Reuters, April 25, 2019.

**Other Asian regions are playing a key role as importers and investors in Emerging Asia's industrialization.**



Source: IMF; UNCTAD; WTO; OECD; McKinsey Global Institute analysis

Box 4.

### **How South Korea is facilitating the development of Vietnam's electronics sector**

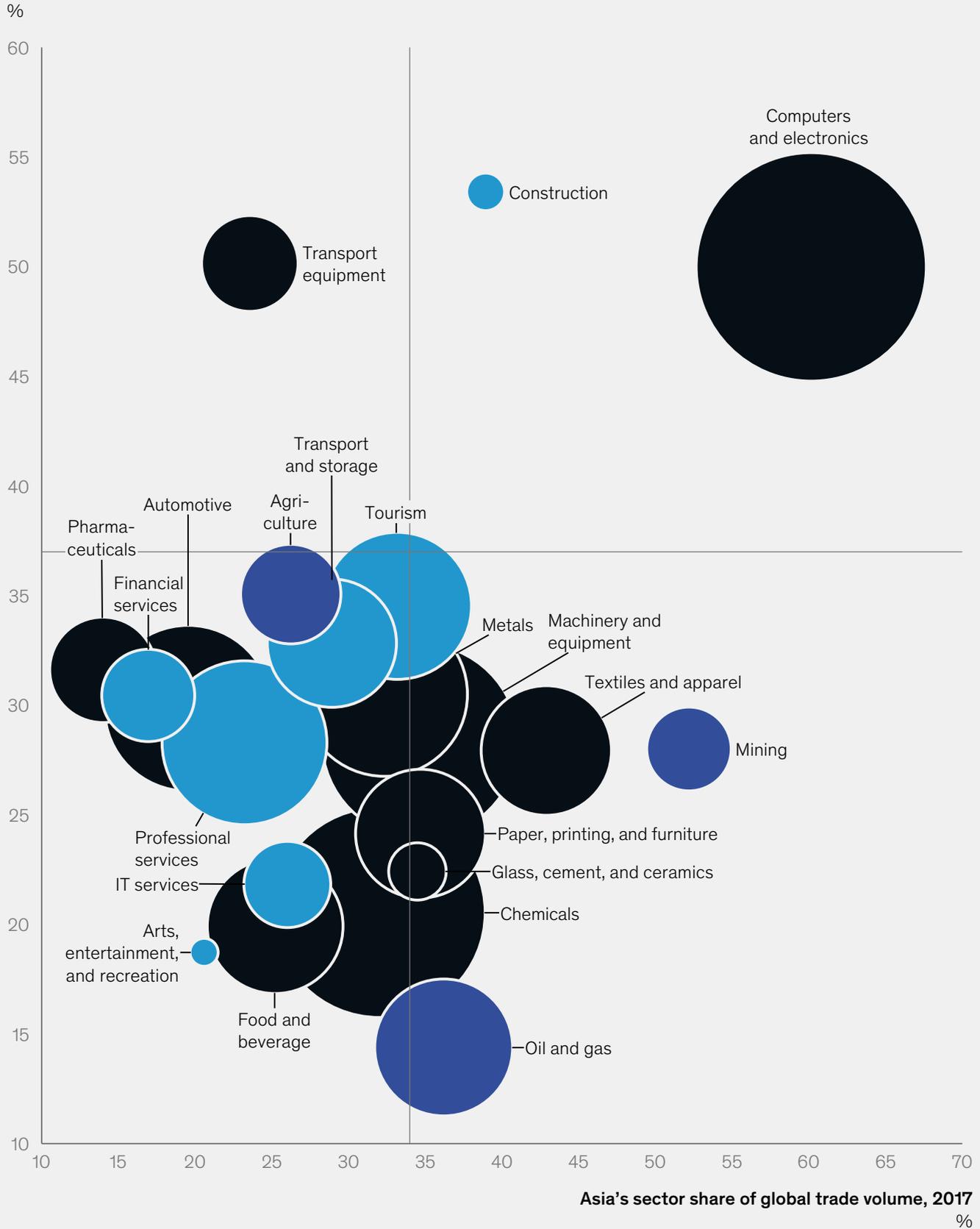
The electronics sector is one of the most heavily invested and traded sectors in Asia (Exhibit 21). Electronics exports from Vietnam are growing rapidly—18 times between 2008 and 2018. Global electronics companies have invested more than \$15 billion since 2010 to set up production facilities and build partnerships with local parts manufacturers, according to the Vietnam Electronic Industries Association. As MGI research has previously found, the most productive electronics companies are subsidiaries of or joint ventures with these multinationals.<sup>1</sup> A specific driver of Vietnam's rise in electronics is its dynamic partnership with South Korea—79 percent of Vietnam's computer and electronics FDI inflows come from South Korea, helping it become a hub for electronics manufacturing (Exhibit 22).

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<sup>1</sup> Hong Anh, "Localisation: Game-changer for Vietnamese manufacturing industry," *Vietnam Investment Review*, June 30, 2017. Also see *Outperformers: High-growth emerging economies and the companies that propel them*, McKinsey Global Institute, September 2018.

**Electronics is one of the most heavily invested sectors in Asia.**

**Asia's sector share of global inbound FDI investment, 2013–17**

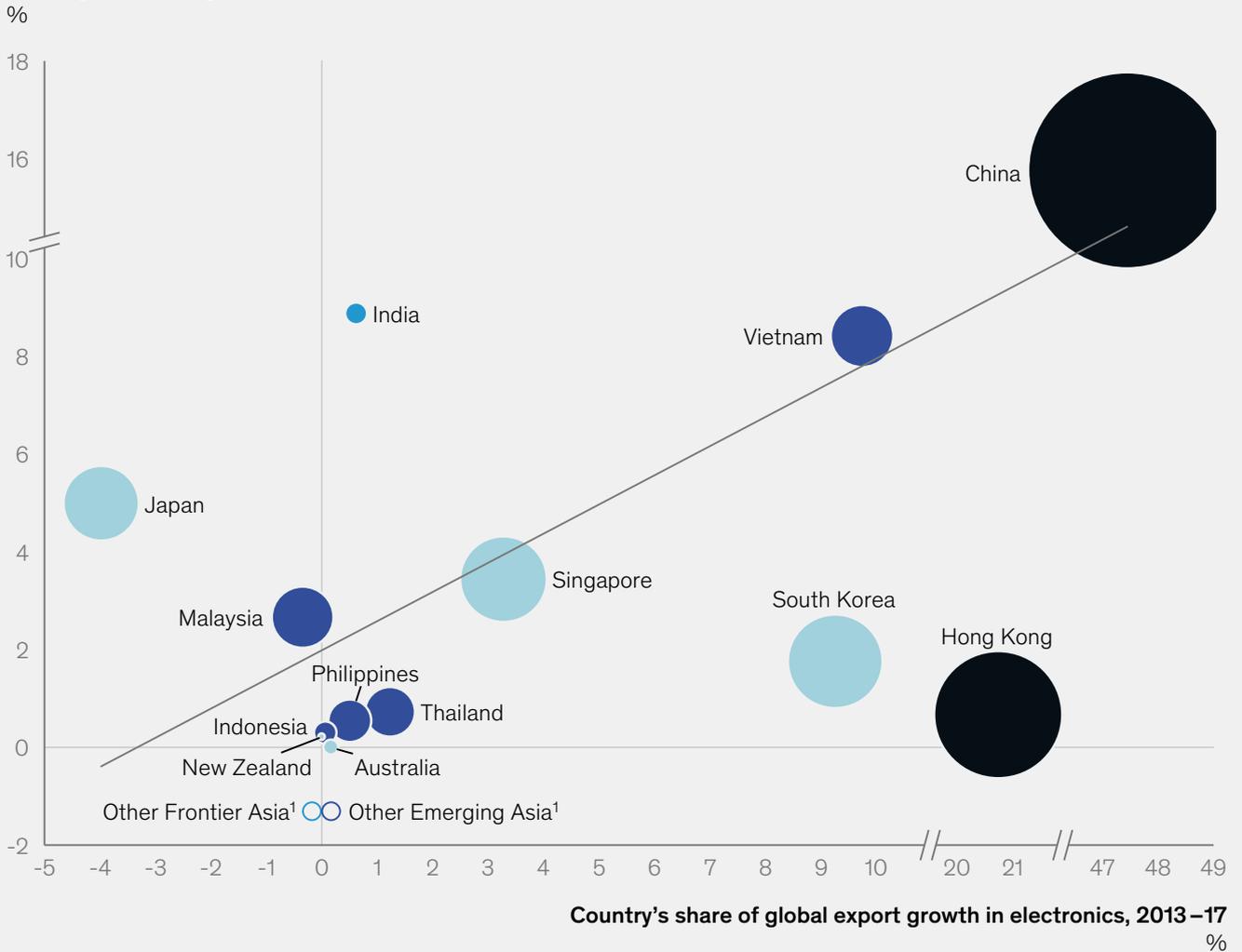


● Manufactured goods ● Services ● Primary resources

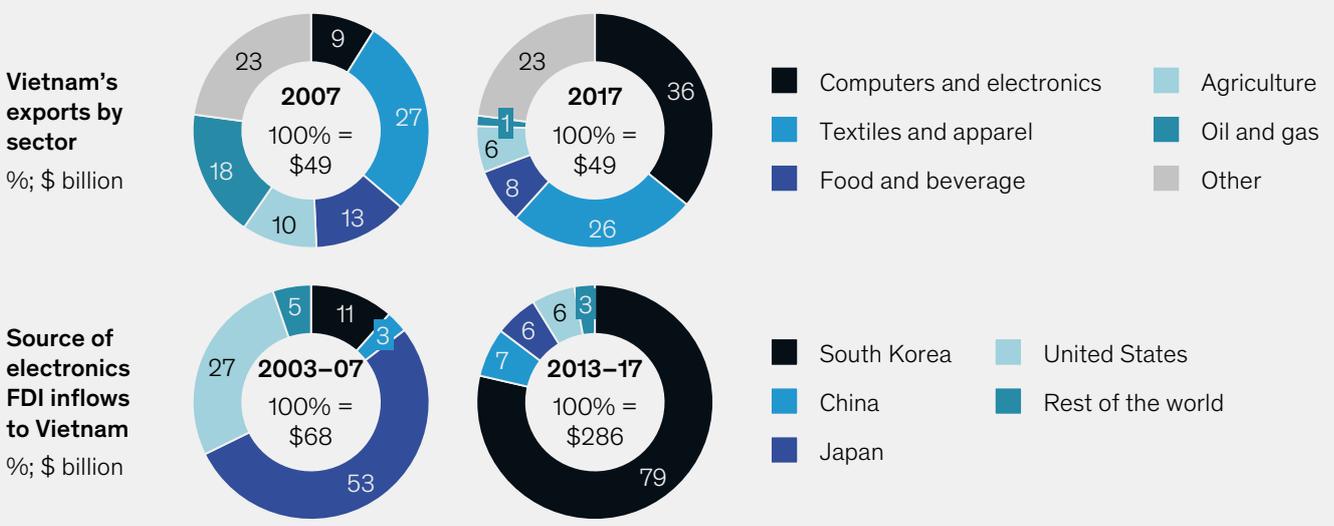
Source: McKinsey FDI Atlas Database; IMF; UNCTAD; WTO; OECD; McKinsey Global Institute analysis

**Vietnam has experienced significant growth in its electronics sector.**

**Country's share of global FDI inflows in electronics, 2013-17**



● China ● Frontier Asia and India ● Emerging Asia ● Advanced Asia



1. Certain data points are too small to be shown. Other Frontier Asia includes Bangladesh, Pakistan, and Sri Lanka. Other Emerging Asia includes Cambodia, Laos, and Myanmar.  
 Source: McKinsey FDI Atlas Database; IMF; UNCTAD; WTO; OECD; McKinsey Global Institute analysis

## Frontier Asia and India has large potential to grow its industrial base

Frontier Asia has been finding it difficult to develop its domestic manufacturing sector. Countries in this cluster have faced a number of notable challenges. First, there has been a persistent gap in the capacity and quality of its infrastructure compared with other regions. For example, India's coastline is 7,500 kilometers long and has 12 major ports transporting 382 million 20-foot equivalent units (TEUs). In comparison, China's coastline is 14,500 kilometers long and has 30 major ports transporting 4.1 billion TEUs.<sup>54</sup> As a result, companies have been hobbled by high logistics costs. Bangladesh's logistics costs are between 16 and 20 percent of its GDP.<sup>55</sup> India's logistics costs are 14 percent of GDP, compared with 10 percent in South Korea and 8 percent in developed economies.<sup>56</sup> A second challenge is institutional. A combination of heavy and time-consuming bureaucracy and corruption has made decision making slow; companies struggle to acquire land and develop new manufacturing capacity in a timely manner. According to the World Bank's Government Effectiveness Index, all countries in the Frontier Asia and India group rank in the bottom half of 200 countries; Afghanistan ranks lowest at 186, with Turkmenistan at 180, Tajikistan 178, Uzbekistan 167, Bangladesh 158, Pakistan 156, Kazakhstan 122, India 107, and Sri Lanka 106.<sup>57</sup> However, we do note that some countries have been making notable progress. India's rank overall on Worldwide Governance Indicators jumped from 114th to 107th between 2007 and 2018. In addition, according to the World Bank's 2019 ease of doing business ranking, India increased its ranking by 23 spots from a year ago. A third issue is a significant skills gap. The average time spent in education in Bangladesh is 5.8 years, in Pakistan 5.6 years, and in India at 5.1 years.<sup>58</sup>

However, this group of economies has huge potential. These countries have large and young populations. Rapid urbanization will constantly supply low-cost labor. In addition, significant capital and investment are flowing into the region, and cities are starting to pop up as rising industrialization hubs.

The region has significant scope to integrate further with other Asian economies. Exports from Bangladesh, Pakistan, and Sri Lanka to the rest of Asia are now growing at a faster compound annual rate than to other regions. For instance, Pakistan's exports to Asia are growing at a compound annual rate of 9 percent, compared with only 4 percent in the case of Europe. Exports to North America from Pakistan have been dropping by 1 percent a year.

## New cities across Asia are developing as dynamic industrialization hubs

The rising cities that we have identified that form a dynamic part of Asia's industrialization network have some common characteristics. They tend to have received strategic and investment support from their respective governments (national and provincial) that has enabled their development. Often that support has been in the form of government designating the city and its surrounding areas as a special economic zone (SEZ) explicitly designed to attract business investment. In most cases, too, governments have backed up these efforts by paying considerable attention to, and investing in, supporting road, rail, and port infrastructure. These cities have all attracted large businesses both domestic and multinational (Exhibit 23). Here we briefly describe four rising cities in Asia's industrialization network.

- **Jamnagar, India.** The city's overall industrialization index grew at a compound rate of 42 percent from 2007 to 2017.<sup>59</sup> Its greenfield investment in manufacturing grew from less than \$20 million in 2007 to \$8 billion in 2017. The economy of this metropolis on India's west coast—known as India's "oil city"—is driven by heavy industries such as oil,

<sup>54</sup> AAPA database, American Association of Port Authorities, 2017.

<sup>55</sup> Suman Saha, "Logistics: The next frontier," *Daily Star*, July 17, 2013.

<sup>56</sup> "India aiming to reduce logistics cost to less than 10% of GDP by 2022," *Business Standard*, August 24, 2018.

<sup>57</sup> The Worldwide Governance Indicators project, <http://info.worldbank.org/governance/wgi/index.aspx#home>.

<sup>58</sup> Rashmi Pratap, "Average Indian spends only 5 years at school: World Bank," *Hindu BusinessLine*, June 3, 2013.

<sup>59</sup> The industrialization index includes the following metrics: manufacturing greenfield investment, infrastructure greenfield investment, investment and net exports, and working-age population by 2025.

petrochemicals, cement, and fertilizers.<sup>60</sup> Reliance Industries, India's largest private company, has established the world's largest oil refinery and petrochemicals plant in Jamnagar and is planning to expand capacity. The city's key industries benefit from extensive infrastructure, including widely available factory accommodation provided by Gujarat Industrial Development; bus facilities carrying workers between home and factory; truck carrier facilities; a major airport; 82 miles of railway track with 38 large stations and six small and medium-size stops; and eight ports including Jamnagar Port, which is the only all-weather deep-sea port in India with the potential to operate 365 days a year.<sup>61</sup>

- **Phnom Penh, Cambodia.** The city's overall industrialization index is growing at a compound annual rate of 24 percent from 2007 to 2017. Phnom Penh has posted rapid compound annual growth in FDI of 16 percent for manufacturing and 49 percent for infrastructure. It also has a robust working-age population, expected to grow from 1.2 million in 2015 to 1.5 million in 2025. The city set up an SEZ in 2016 that was listed on Cambodia's securities market.<sup>62</sup> The SEZ is expected to achieve a 50 percent boost in non-land revenue by 2023 by shifting toward more service-based activities and by setting up a new SEZ in Poipet.<sup>63</sup> More than half of the companies operating in the SEZ are from China, Japan, the Philippines, Thailand, and Vietnam.<sup>64</sup> They benefit not only from the SEZ but also from extensive transportation infrastructure.
- **Hai Phong, Vietnam.** The city's overall industrialization index is growing at a compound annual rate of 23 percent from 2007 to 2017. Hai Phong has posted rapid growth in FDI of 18 percent in the case of manufacturing and 44 percent for infrastructure. It has a large working-age population of one million. The city's investment and net exports grew at a compound annual rate of 15 percent between 2007 and 2017. One of Vietnam's major manufacturing and logistics hubs with proximity to major export markets, the city is the location of offices of many international companies. Hai Phong is one of Vietnam's five centrally governed cities and has received sustained official strategic and investment support, including investment in infrastructure. The city has 13 industrial parks and intends to build five or six more.<sup>65</sup> In 2017, its economy grew by 14 percent, the fastest rate since 1994 and twice the national average. The government sees the city as pivotal to the economy's continued modernization and industrialization.<sup>66</sup> It aims for Hai Phong to account for 6.4 percent of Vietnam's GDP by 2025.
- **Bekasi, Indonesia.** The city's industrialization index is growing at a compound annual rate of 15 percent from 2007 to 2017. Bekasi has been experiencing rapid growth in FDI of 29 percent in the case of manufacturing. The city also has a large working-age population, projected to reach 4.4 million by 2025. Its investment and net exports grew at a compound annual rate of 12 percent between 2007 and 2017. It is a city with increasing economic importance, stemming from its status as a center for Indonesia's automotive and motorcycle industry and its proximity to Jakarta, the capital and the country's largest market for cars. Popularly known as the Detroit of Indonesia, the city has received considerable investment from global automakers and components manufacturers. Bekasi is home to a number of industrial estates. Industry benefits from access to the port of Tanjung Priok in North Jakarta, which is Indonesia's busiest and most advanced seaport handling more than half of the country's trans-shipment cargo traffic.<sup>67</sup>

<sup>60</sup> Kishor Thesia, *District industrial potential survey report of Jamnagar District 2015–16*, MSME Development Institute, Government of India, [http://dcmsme.gov.in/dips/DIPS percent20of percent20Jamnagar percent20District.2015-16..pdf](http://dcmsme.gov.in/dips/DIPS%20of%20percent20Jamnagar%20District.2015-16..pdf); and "Jamnagar: The oil city of India," Gujarat: The State of Lions, [http://tourismgujaratinfo.blogspot.com/2012/09/jamnagar-oil-city-of-india\\_21.html](http://tourismgujaratinfo.blogspot.com/2012/09/jamnagar-oil-city-of-india_21.html).

<sup>61</sup> P. Manoj, "Reliance to boost capacity of SEZ refinery in Jamnagar by 5.8 mt," *Hindu BusinessLine*, December 12, 2018.

<sup>62</sup> Kun Kourchettana, "Phnom Penh SEZ gets \$10M in investment," *Phnom Penh Post*, October 22, 2018.

<sup>63</sup> Sok Chan, "Phnom Penh SEZ to raise non-land revenue by 50%," *Khmer Times*, May 10, 2019.

<sup>64</sup> Andreas Kohl, "Phnom Penh SEZ: Japan's Special Economic Zone in Cambodia," Adrianople Group, May 7, 2019.

<sup>65</sup> "Hai Phong to build 5-6 industrial parks," Dantri International, February 15, 2019.

<sup>66</sup> "Hai Phong hoped to complete industrialisation modernisation by 2025," *Voice of Vietnam*, January 28, 2019.

<sup>67</sup> "Automotive manufacturing industry Indonesia," Indonesia Investments, <https://www.indonesia-investments.com/business/industries-sectors/automotive-industry/item6047>; and "Bekasi and Karawang industry is the most favorite industrial estate in Indonesia," Karawang New Industry City, <https://www.knic.co.id/bekasi-and-karawang-industry-is-the-most-favorite-industrial-estate-in-indonesia>.

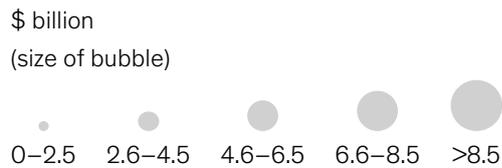
**MGI mapped the 50 fastest-rising cities on Asia's industrialization network.**



**Metrics analyzed**

- Manufacturing greenfield investment (depicted)
- Infrastructure greenfield investment
- Investment and net export
- Working-age population

**Manufacturing greenfield investment, 2017**



**Overall index CAGR**



Source: UN; The Economist Intelligence Unit; FDI Atlas; IHS; McKinsey Global Institute analysis

# 4. Innovation: Asia is leapfrogging through multilocal networks

While Asia's industrialization network is globally integrated with trillions of tons of goods moving across borders every year, its innovation network is much more localized. Whether innovation is in the form of a new business model, IP, or groundbreaking research, innovation does not flow as easily as goods. This reflects the fact that innovation happens when and where there is a concentration of talent, capital, and infrastructure in one location. So in Asia we are seeing an innovation network powered with local talent but funded with regional capital that has led to the formation of "multilocal networks"—in other words, the solutions offered in each local market are tailored to local consumers and regulation and usually managed by local entrepreneurs.

## **Multilocal innovations are occurring in all four Asias**

The combination of local innovation and intraregional funding and knowledge is making Asia a global innovation powerhouse. Each of the four Asias we have highlighted has established innovation capabilities in a different way.

Advanced Asia and China have built strong innovation foundations and are providing capital and knowledge to power innovation in other Asian economies. The engine of innovation in Advanced Asia is a base of large incumbent companies and institutions that are driving technological advances. China's primary engines are its digital champions, unicorns, and well-funded startups. Developing startup ecosystems in Emerging Asia and Frontier Asia and India are spearheading rapid change. Asia also has huge resources for innovation. For example, by 2030, China and India could account for more than 60 percent of science, technology, engineering, and math (STEM) graduates in major economies, compared with only 8 percent in Europe and 4 percent in the United States.<sup>68</sup> Although there may be quality gaps, the large talent pool can facilitate a significant amount of local innovation. At the same time, Emerging Asia and Frontier Asia offer huge opportunities to deploy proven business models, capital, and innovative ideas. These economies have inefficiencies in consumer-facing sectors and industry that offer an opportunity to leapfrog in terms of innovation, and the pace of growth of startups and funding is much faster in these regions than it is in Advanced Asia. Dynamics across all four Asias can make the region a global innovation powerhouse (Exhibit 24).

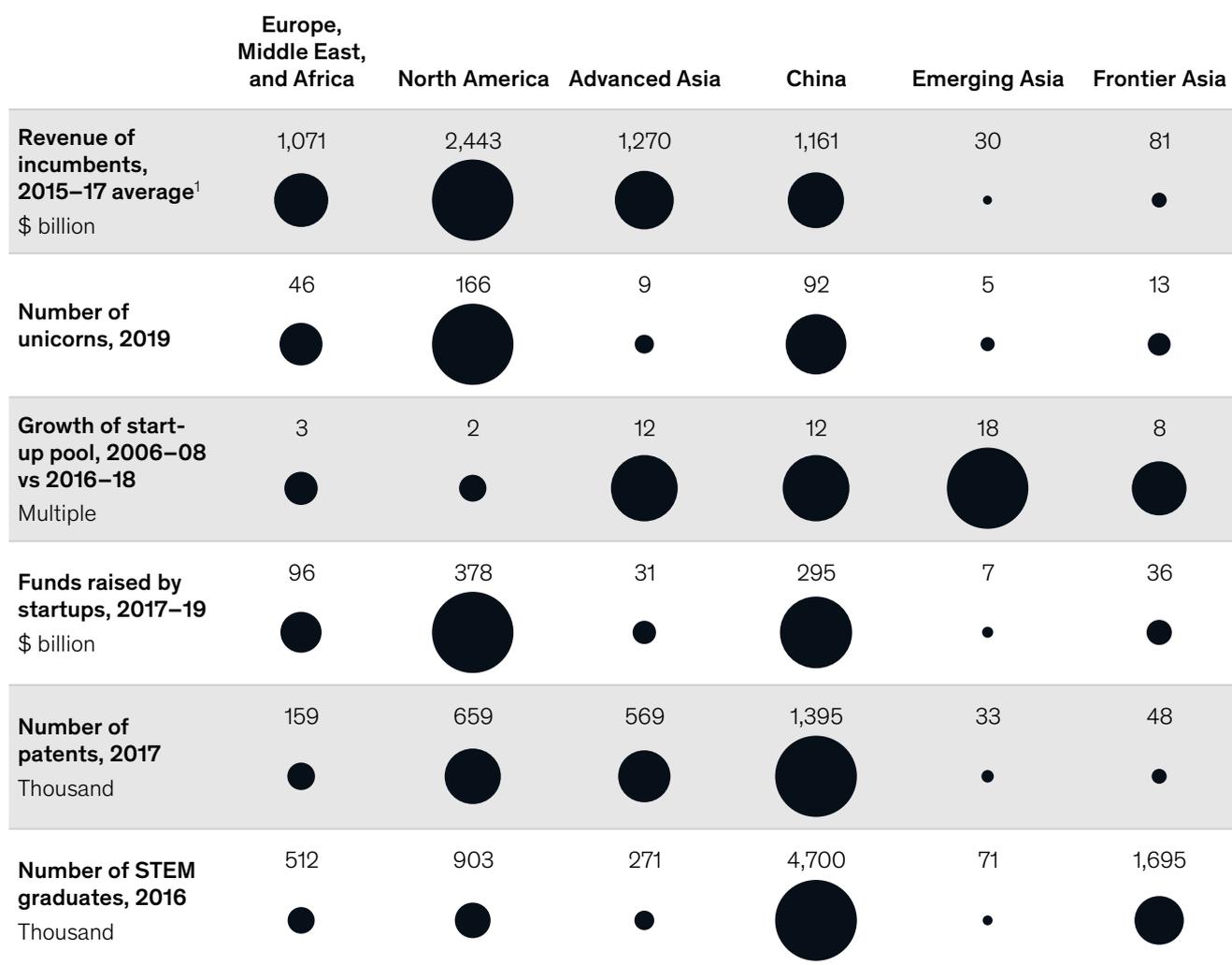
Advanced Asia and China have prioritized technology and have invested—and will continue to invest—a substantial amount in R&D and innovation. In 2017 South Korea invested around \$65 billion, or 4.2 percent of GDP; Japan \$153 billion, or 3.1 percent of GDP; Singapore \$7 billion, or 2.2 percent; and China \$255 billion, or 2.1 percent, according to UNESCO data.<sup>69</sup>

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<sup>68</sup> *How is the global talent pool changing (2013, 2030)?*, Education indicators in focus, OECD, April 2015.

<sup>69</sup> "Science, technology and innovation," UNESCO, [http://data.uis.unesco.org/Index.aspx?DataSetCode=SCN\\_DS&lang=en#](http://data.uis.unesco.org/Index.aspx?DataSetCode=SCN_DS&lang=en#).

## Advanced Asia and China have strong innovation foundations and considerable momentum.



1. Major subcategories include internet software and services, hardware, software, semiconductors, and other major innovation/technology-focused firms.

Source: WIPO; McKinsey Global Growth Model; IHS; United Nations; FDI Atlas; Nations Online; McKinsey Global Institute analysis

As a result, they have built significant IP. China accounts for 40 percent of global patent applications. South Korea has launched its “fourth industrial revolution,” not only focusing on information and communications technologies, in which it is already a leading player, but also expanding into other areas such as smart factories and farms, future vehicles, and the data economy.<sup>70</sup> Japan is a leading player in robotics, artificial intelligence (AI), and healthcare.<sup>71</sup> Singapore’s RIE2020 plan enshrines ambitions to establish the city-state as a leader in the services and digital economies, urban solutions, sustainability, and smart manufacturing. China has become a global force in the internet, AI, and the digital economy. It is making headway in emerging technologies such as 5G and quantum computing.<sup>72</sup> Advanced Asia has also grown a large pool of technology companies. Among the world’s 3,000 largest

<sup>70</sup> “Innovative environment,” Invest Korea, <http://www.investkorea.org/en/innovation/infra.do>.

<sup>71</sup> “Innovation Japan,” Government of Japan, <https://www.japan.go.jp/technology/innovation/>.

<sup>72</sup> MGI has published extensively on innovation in China. See *China and the world: Inside the dynamics of a changing relationship*, McKinsey Global Institute, July 2019; *Notes from the AI frontier: Modeling the impact of AI on the world economy*, McKinsey Global Institute, September 2018; *Digital China: Powering the economy to global competitiveness*, McKinsey Global Institute, December 2017; *Artificial intelligence: Implications for China*, McKinsey Global Institute, April 2017; and *The China effect on global innovation*, McKinsey Global Institute, October 2015.

companies, 50 percent are in Asia. China has 746 companies, Japan 290, and South Korea 232. In share of unicorns, Asia accounts for 36 percent of the total.<sup>73</sup>

Asia's pattern of innovation tends to differ from that of the West in being largely multilocal. However, the business models and ideas pursued may be inspired by what is happening in other countries and be funded by multinationals.

Consider ride hailing as an example of these differences. Asia has a more diverse set of local ride-hailing options that have sprouted up over the past five years or so. In the Chinese market, Didi Chuxing ride-hailing service has rapidly built a 90 percent market share.<sup>74</sup> Grab is a top operator in eight countries in Southeast Asia, namely Cambodia, Indonesia, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam.<sup>75</sup> Ola Cabs is the favorite ride-hailing company in India, while unicorn Go-Jek is the most popular in Indonesia.

E-commerce in Asia is rich with local solutions. In Southeast Asia, for instance, Lazada has developed a 46 percent market share, followed by Shopee and 11Street with 23 and 13 percent, respectively.<sup>76</sup> In India Flipkart is the leading player, while in South Korea Coupang has the highest market share and Rakuten has the highest share in Japan. In China, Alibaba, JD.com, and most recently Pinduoduo are fueling consumers' online purchases. Asian capital is a significant source of funding for these firms. For example, Bukalapak, Indonesia's fourth-largest unicorn, is backed by the Seoul-based Mirae Asset-Naver Asia Growth Fund. Tokopedia, also based in Indonesia, raised funding from Alibaba and SoftBank while India's Paytm Mall is backed by Alibaba.

To support the booming e-commerce industry, Asia has an established system of local mobile-payment services, which are now used to handle 53 percent of consumer purchases in the region.<sup>77</sup> Asian countries tend to have two or three major local providers. In China, Alipay and Tenpay account for more than 90 percent of total third-party transactions. Tenpay has 700 million users in China and 900 million globally. In India, Paytm, ItzCash, Hike, and MobiKwik have 55 million to 120 million users on their platforms.<sup>78</sup> In South Korea, Kakao Pay, Samsung Pay, and Zero Pay are bringing a variety of payment solutions to citizens. According to the Bank of Korea, in 2017 the total volume of payments facilitated by simplified mobile-pay services reached a record 67.2 billion won, up 158 percent from 2016.<sup>79</sup> A variety of local solutions have emerged for a range of reasons, including the existence of local internet giants that use payments as an extension of their ecosystems, for instance to pay for utilities and insurance, alliances with local financial institutions, and local regulations.

### **Intraregional flows of capital are forming innovation networks across the four Asias**

Capital flows are often a leading indicator of where innovation is taking root, and these flows are changing dynamically. Startup funding in Asia has grown rapidly. Asia's share increased from 16 percent in 2013 to 47 percent in 2018. China and Japan tend to raise funds domestically, while less advanced economies in Emerging Asia are experiencing strong capital inflows from other economies within Asia, especially from the economies of Advanced Asia and China (Exhibit 25). About 70 percent of venture capital funding in Asia is intraregional. Among many examples of intraregional capital flows, Japan's SoftBank has led several large funding rounds for Indian unicorns. Paytm and Oyo both raised significant

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<sup>73</sup> CB Insights data as of August 2019, <https://www.cbinsights.com/research-unicorn-companies>.

<sup>74</sup> Echo Huang, "China's ride-hailing giant Didi is welcoming its competitors to its app," Quartz, July 16, 2019.

<sup>75</sup> "A Southeast Asian journey," Grab, <https://www.grab.com/sg/brand-story/>.

<sup>76</sup> Pooja Singh, "Lazada leads the e-commerce battle in Southeast Asia," *Entrepreneur Asia Pacific*, January 25, 2019.

<sup>77</sup> "Asia Pacific leads the world in mobile payments in latest study by Kantar TNS," Kantar, <http://www.tnsglobal.com/asia-pacific/intelligence-applied/asia-pacific-leads-world-mobile-payments-latest-study-kantar-tns>.

<sup>78</sup> Trefis Team, "Is Paytm worth \$20 billion?," *Forbes*, December 3, 2018; and Tarush Bhalla, "In the race to be India's next unicorn, MobiKwik claims steady growth and online push," *Your Story*, May 13, 2017.

<sup>79</sup> Sohn Ji-young, "Going walletless: Korea's mobile payment market diversifies as competition grows," *Korea Herald*, January 27, 2019.

funding from Softbank.<sup>80</sup> China's tech companies are also active investors in Emerging Asian and Indian tech startups. For example, in 2017 Tencent led an investment in Indonesia's Uber rival Go-Jek. Recent investment in Singaporean ride-sharing service Grab totaled \$9.1 billion, with Asian firms accounting for 60 percent of the total.<sup>81</sup> Investments have included \$1.46 billion from SoftBank and \$1 billion from Toyota.<sup>82</sup> Alibaba has invested \$4 billion in Lazada, the largest e-commerce platform in Southeast Asia.

As companies in Advanced Asia open manufacturing companies in Emerging Asia, local labor and firms can benefit from technology spillovers from these foreign companies. Similarly, as Advanced Asia and China fund startup and innovation activities in Emerging Asia and Frontier Asia and India, these foreign companies will not only help emerging economies participate in the global value chain, but also help facilitate the sharing of new ideas and foster the next wave of technology breakthroughs.<sup>83</sup>

Exhibit 25

### Advanced Asia and China are leading investors in startups in Emerging Asia.

		Domestic investment ratio %	Intraregional investment %	Extraregional investment %
<b>Advanced Asia</b>	Japan	84	5	11
	South Korea	30	23	47
	Australia	49	10	41
	Singapore	26	66	8
<b>China</b>	China	57	19	24
<b>Emerging Asia</b>	Indonesia	2	75	23
	Thailand	17	65	18
	Vietnam	7	83	10
<b>Frontier Asia</b>	India	26	30	44

Source: Preqin Database; McKinsey Global Institute analysis

<sup>80</sup> Priyamvada Mathur, "Inside Softbank's high-profile investments in Indian startups," PitchBook, May 15, 2019.

<sup>81</sup> Crunchbase.

<sup>82</sup> Jon Russell, "Grab confirms \$1.46B investment from SoftBank's Vision Fund," TechCrunch, March 5, 2019; and Jon Russell, "Grab picks up \$2 billion more to fuel growth in post-Uber Southeast Asia," TechCrunch, August 1, 2018.

<sup>83</sup> John Van Reenen and Linda Yueh, *Why has China grown so fast? The role of international technology transfer*, Department of Economics University of Oxford working paper, January 2012.

## Innovation hubs are emerging in all four Asias

Asian cities are competing with one another to become innovation hubs—the region's equivalent of Silicon Valley, but with an Asian twist.<sup>84</sup> Each city has different approaches and offerings based on differing competitive advantage. Beijing and Shenzhen in China are well-established as innovation centers, and here we focus on some lesser known examples of urban centers. We highlight four rising cities on the innovation network (Exhibit 26).

- **Wuhan, China.** The city's innovation index is rising at a compound rate of 13 percent over the ten years from 2007 to 2017.<sup>85</sup> Wuhan, the most populous city in central China, is positioning itself as one of the most progressive business cities in Asia with a combination of traditional industries such as automobile manufacturing and pharmaceuticals, and new high-tech industries such as opto-electronic technology, biology engineering, new materials development and production, and environmental protection technology.<sup>86</sup> The number of patents that companies in Wuhan have produced increased at a compound annual rate of 32 percent between 2007 and 2017. The city is home to the streaming unicorn Douyu. In 2018, the Ministry of Education and the Hubei provincial government signed an agreement to build a group of world-class universities.<sup>87</sup> Today, Wuhan has three national development zones, four scientific and technological development parks, more than 350 research institutes, 1,656 high-tech enterprises, and numerous enterprise incubators and investments from 230 Fortune Global 500 firms.
- **Jakarta, Indonesia.** The city's innovation index has been rising at a compound annual rate of 12 percent from 2007 to 2017. In 2018, as much as 90 percent of 235 fintech companies were based in Jakarta, and some leading Indonesian unicorns including Bukalapak, Go-Jek, Tokopedia, and Traveloka are headquartered in Indonesia's capital.<sup>88</sup> The city also houses prominent startup accelerators. This innovation cluster is aided by the fact that Jakarta-based universities, including the Bandung Institute of Technology, Binus University, and the University of Indonesia, produce thousands of graduates a year. Major multinational companies, the country's largest banks, local companies, and international technology companies make the city their central base. Furthermore, Jakarta's greenfield FDI in knowledge-intensive sectors has increased at a compound annual rate of 20 percent over the past ten years to \$1.1 billion, and is on a par with investment by China's Shenzhen. In 2019, the government renewed its 1,000 Startups initiative (launched in 2016) that aims to coordinate efforts among public and private players to boost entrepreneurship across the country.<sup>89</sup>
- **Yangon, Myanmar.** This city's score on the innovation index has been rising at a compound annual rate of 11 percent from 2007 to 2017. The established commercial center of the country, Yangon is on its way to becoming a tech hub. In 2014, Phandeeyar, a community tech hub, was set up to jump-start a new ecosystem of startups.<sup>90</sup> In just ten years, greenfield FDI in knowledge-intensive sectors in the city soared from a negligible amount to \$2.6 billion in 2017. UNCTAD and the United Nations Development Programme organized an entrepreneurship training course in conjunction with international telecommunications company Ooredoo in December 2018 and awarded financial support for the best three business plans that resulted.<sup>91</sup> Samsung's Tech Institute has supported more than 800 students through its Android training programs in conjunction with the government and universities. A number of accelerators and incubators have

<sup>84</sup> "Southeast Asian tech hubs race to become the next Silicon Valley," *Nikkei Asian Review*, October 24, 2018.

<sup>85</sup> Metrics used to calculate the innovation of each city include number of patents filed, knowledge-intensive sector's greenfield investment, number of top 500 universities, number of unicorns (as of April 2019), revenue of technology firms, and the high-speed internet penetration rate.

<sup>86</sup> Hepeng Jia, "Science cities: Discovery central," *Nature Index*, December 5, 2018; and

<sup>87</sup> "MOE and Hubei Provincial Government sign 'Double First-Class' agreement," Ministry of Education, China, May 29, 2018.

<sup>88</sup> Adrian Li and Faiz Rahman, "Commentary: Jakarta, the next tech hub we can't ignore," *Jakarta Globe*, November 22, 2016.

<sup>89</sup> Khamila Mulia, "Indonesian government renews its '1000 Startups' initiative," *KrAsia*, May 22, 2019.

<sup>90</sup> "Phandeeyar: Building Myanmar's innovation ecosystem," *Luminate*, October 12, 2018.

<sup>91</sup> "Young Yangon entrepreneurs get business skills boost in Myanmar," UNCTAD, December 20, 2018.

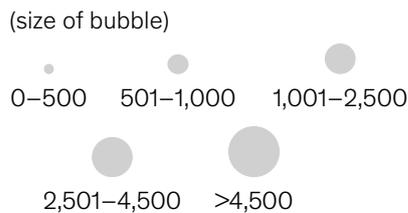
**MGI mapped the 50 fastest-rising cities on Asia's innovation network.**



**Metrics analyzed**

- Number of patents filed (depicted)
- Knowledge-intensive sector's greenfield investment
- Number of top 500 universities
- Number of unicorns (as of April 2019)
- Revenue of technology firms
- High-speed internet penetration rate

**Number of patents filed, 2017**



**Overall index CAGR**



Source: UN; The Economist Intelligence Unit; FDI Atlas; IHS; McKinsey Global Institute analysis

headquartered in the city.<sup>92</sup> In 2018, the Yangon regional government did a deal with a Swiss startup incubator to launch the Yangon Innovation Center.<sup>93</sup>

- **Hyderabad, India.** The city's innovation index has been rising at a compound annual rate of 7 percent between 2007 and 2017. While Bangalore, accounting for 40 percent of India's IT industry, is known as India's Silicon Valley, Hyderabad is now also quickly catching up and has become India's second Silicon Valley. In 2017 it generated more than 1,400 patents, and \$1.7 billion of FDI flowed into the city's knowledge-intensive sectors. Hyderabad has a booming software industry supported by the government in terms of allocating land for IT parks and transportation infrastructure. The city has been chosen to be the host of a new silicon development facility called Fab City. It also hosted 3,000 of India's 20,000 startups and has capacity for more.<sup>94</sup> In 2017, Invesco opened its first innovation hub in Hyderabad.<sup>95</sup> Facebook is launching three more innovation hubs in India and has already set up one in Hyderabad in partnership with T-Hub.<sup>96</sup>

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<sup>92</sup> "Myanmar: A burgeoning start-up ecosystem," GSMA, January 23, 2019.

<sup>93</sup> Thiha Ko, "Yangon to build innovation centre with Seedstars," *Myanmar Times*, October 2, 2018.

<sup>94</sup> Rama Iyer, "Hyderabad—The future startup capital of India," CFO Insights, [https://www.yesbank.in/pdf/special\\_feature\\_hyderabad.pdf](https://www.yesbank.in/pdf/special_feature_hyderabad.pdf).

<sup>95</sup> Varsha Bansal, "Invesco opens first innovation hub in Hyderabad, invites local startups," *Economic Times*, May 10, 2017.

<sup>96</sup> "Facebook to launch 3 more innovation hubs in India by 2019," *Hindu BusinessLine*, October 9, 2018.

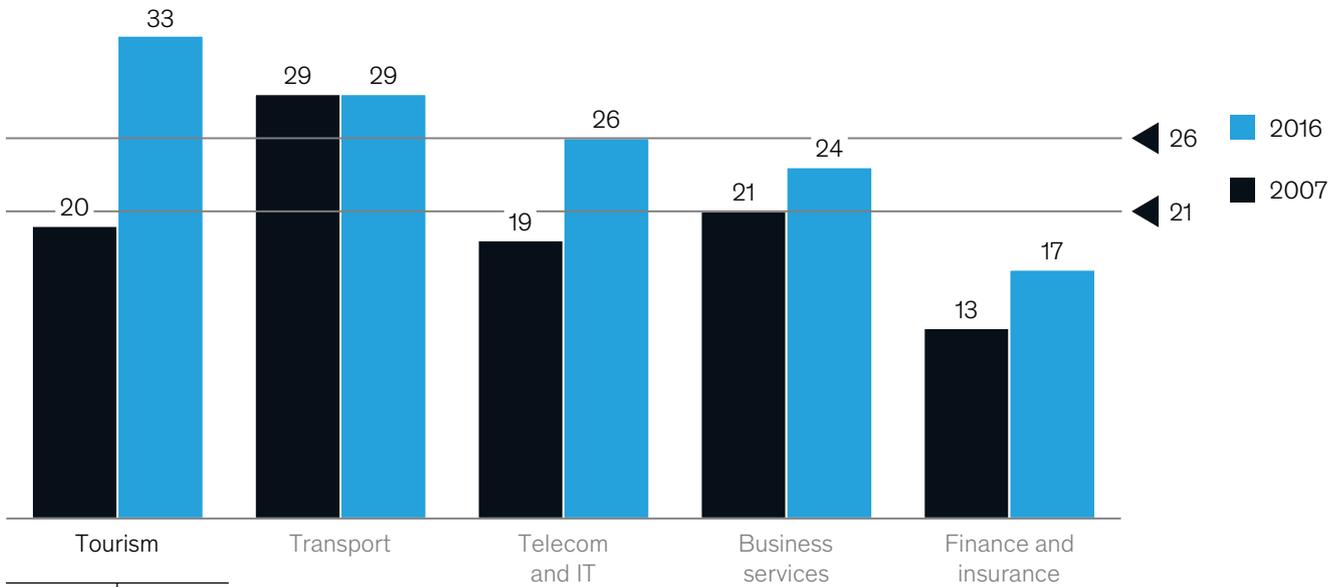
# 5. Culture and mobility: Asia is a growing hub for people flows and a rising cultural force

Asia is a major hub for people flows, and its importance is rising. Consumption of services, especially tourism, is booming (Exhibit 27). At the same time, in contrast to the past when the region was largely a recipient of Western culture with Asian citizens enthusiastic consumers of Hollywood movies and British pop music, for instance, today cultural flows go in both directions. Asia has sufficient scale, cultural content, and diversity to create its own blockbusters. In addition to viewing and learning about other cultures through digital media, Asians are translating their on-screen curiosity into real-life exploration as the region becomes an increasingly important hub for flows of people, including tourists, and for global transportation networks. In this section, we explore three emerging networks: tourism, air traffic, and cultural content.

**Asia's trade in services is growing exceptionally fast, with tourism being the strongest driving force.**

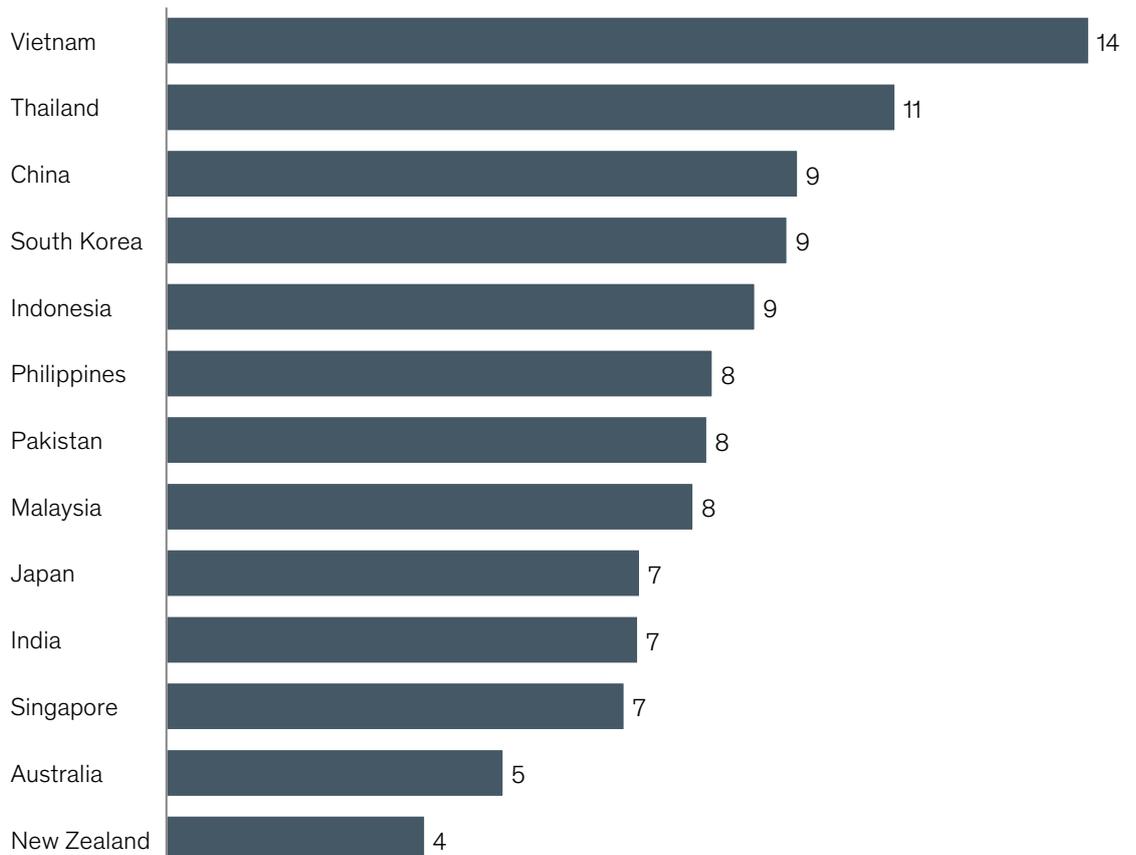
**Asia's share in global services trade**

%



**Travelers to/from Asia's top travel hubs**

CAGR, % of change in volume of travelers, 2009–18



Source: IATA; IMF; UNCTAD; WTO; OECD; McKinsey Global Institute analysis

## Travel network: Asia is redefining global travel standards as both a large outbound market and a growing destination

People from Asia are traveling more, creating potential for the development of global and regional travel hubs. Four of the ten most visited cities in the world are in the region. Over the past decade, travel in Asia has grown at incredible speed. In 2009, Bangkok was the 21st most visited city in the world; by 2017 it was ninth, attracting more than 98 million travelers that year.

Tourism is big business. Asia's tourism boom has been led by China, but there has been significant growth in Emerging Asia and Frontier Asia and India, too. Tourism grew at a compound annual rate of around 5 percent in India between 2015 and 2018.<sup>97</sup> In China, tourism grew at around 13 percent, and in Vietnam, growth was around 27 percent over the same period.<sup>98</sup> Tourism can account for a large share of individual countries' GDP. Consider, for instance, that tourism contributed 9.7 percent directly to Thailand's GDP in 2019.<sup>99</sup> The fastest growth in tourism has been intraregional, growing at 2.7 times over the past decade—faster than the expansion of international tourism. Key intraregional corridors for travelers have developed between China and Thailand, South Korea and Japan, and China and Japan. The number of tourists traveling between these pairs of destinations has grown by 29, 8, and 7 percent, respectively, over the past ten years (Exhibit 28).

Some 74 percent of Asian travel is intraregional. Asian citizens who are new to travel to other countries tend to dip their toes in the water by making trips in their home region before graduating to long haul. This evolution is happening faster in Asia than it has in other regions, and Asian travelers are growing in sophistication if anything faster than expected. We noticed four trends that may today be focused on a particular country or part of Asia, but could equally be applicable to others as their tourism markets grow:

- **China is redefining the world's travel standards.** Chinese tourists are arguably having an even greater impact than Japan's in the 1980s and 1990s. In 2018, around 150 million Chinese tourists made outbound trips, and their number is expected to reach 160 million by 2020.<sup>100</sup> They have an economic effect, of course. China is the world's largest source of outbound tourists in the world, and their spending in destination economies is very significant, including within Asia. For instance, spending by Chinese visitors is equivalent to 7 and 9 percent of private consumption in Singapore and Thailand, respectively.<sup>101</sup> But Chinese tourists are also having an impact on quality as the industry adopts standards that are universally expected in Western markets. For instance, major retailers have staffed sales personnel who speak Mandarin, and major hotels all now offer hot water kettles, flexible and international electrical sockets, and multilanguage signage. This Chinese tourism boom has had an impact on other sectors—and beyond retail. For instance, lots of Asian countries now accept digital payments through companies such as Alipay in order to attract Chinese visitors. In 2018, 50,000 outlets in South Korea offered Alipay as an option.<sup>102</sup> Such trends are not confined to Asia. In 2018, Finland became the first country to offer Chinese tourists a fully cashless experience during their visit by adopting Alipay.<sup>103</sup> The number of overnight stays in Finland by Chinese travelers rose from 98,100 in 2007 to 361,800 in 2017.<sup>104</sup> Today, value-added tax returns for purchases within the EU can be completed with Alipay. This is just one example of increasing numbers of Asian tourists becoming catalysts for Western countries to adopt a cashless approach, creating a path for Asian firms to reach global markets.

<sup>97</sup> *Tourism & hospitality*, India Brand Equity Foundation, April 2019, <https://www.ibef.org/download/tourism-and-hospitality-apr-2019.pdf>.

<sup>98</sup> "Vietnam tourist arrivals," Trading Economics, <https://tradingeconomics.com/vietnam/tourist-arrivals>.

<sup>99</sup> World Travel & Tourism Council, 2019.

<sup>100</sup> "Basic situation of the tourism market in 2018," Ministry of Culture and Tourism, China, [http://zwgk.mct.gov.cn/auto255/201902/t20190212\\_837271.html?keywords=](http://zwgk.mct.gov.cn/auto255/201902/t20190212_837271.html?keywords=); and McKinsey 2017 China Outbound Traveler Survey.

<sup>101</sup> *Chinese tourists: Dispelling the myths*, McKinsey & Company, September 2018.

<sup>102</sup> Park Ga-young, "Korea among top spending destinations for Alipay users," *Korea Herald*, September 3, 2018.

<sup>103</sup> Tom Brennan, *Finland first to offer all-Alipay travel to Chinese tourists*, Alizila, February 2, 2018.

<sup>104</sup> Ren Xiaojin, "Finland records surge in Chinese tourists," *China Daily*, September 10, 2018.

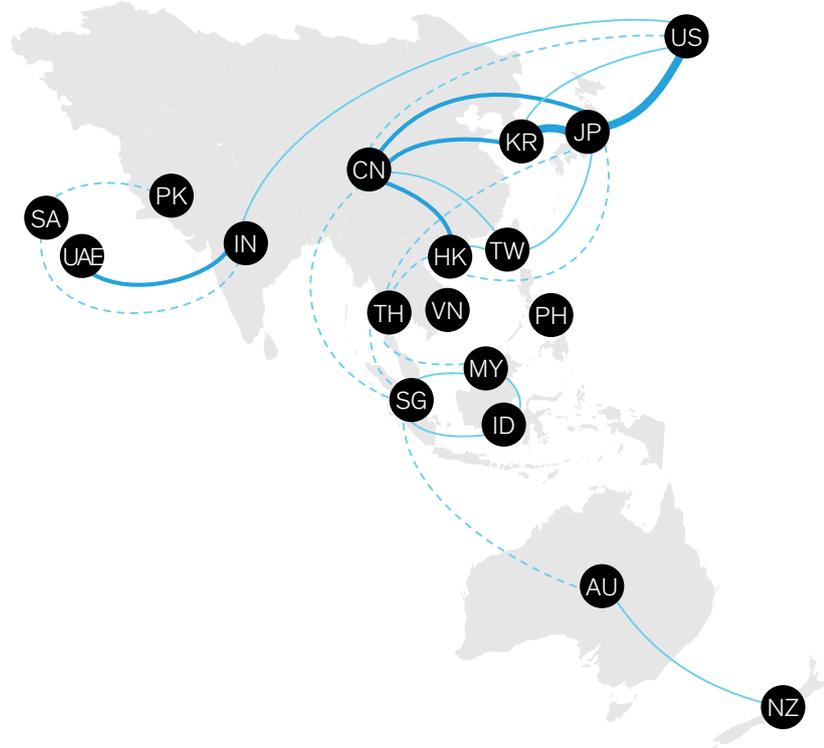
**Intraregional travel is flourishing as new destinations emerge, creating new corridors to spread Asia's culture.**

**Traveler volume**

Million people



2009

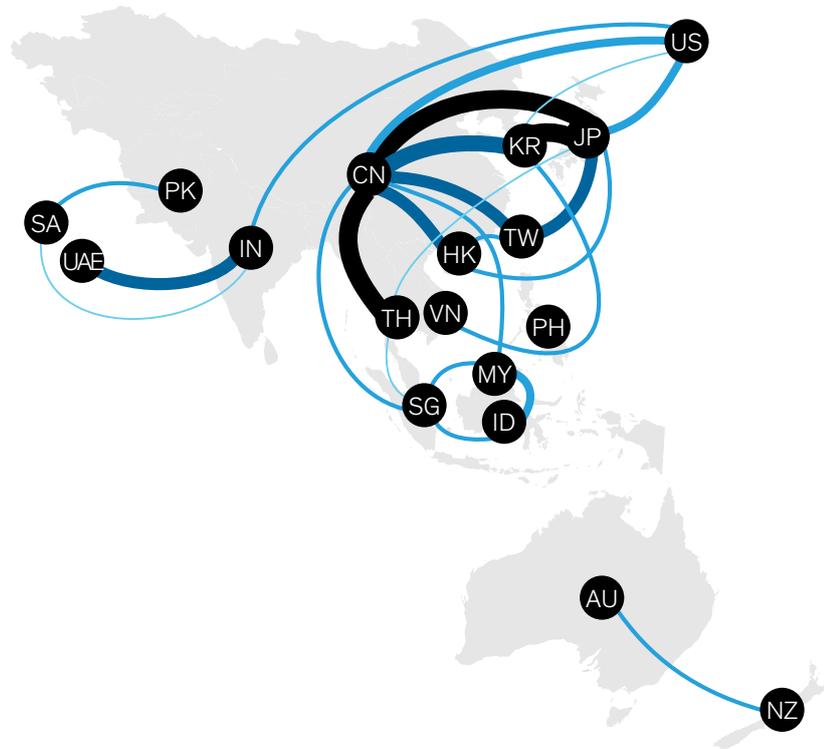


2018

1.8x  
global travelers

2.2x  
top 25 Asia corridors

2.7x  
intraregional travelers  
in Asia



Note: These are major air travel corridors between economies in Asia, and are not representative of national territories.  
Source: IATA; McKinsey Global Institute analysis

- **Emerging Asia and Frontier Asia and India are capturing the value of more visitors, but risk overtourism.** Countries in Emerging Asia have a wealth of natural and cultural gems, from beaches to treks and ancient ruins that appeal to visitors from around the world, and are still relatively affordable. This has made some hot spots into top regional and international tourism destinations. Tourism is increasing its share of GDP not only for Thailand but also for arguably less visited destinations such as Cambodia; tourism's direct contribution to the GDP of the latter increased from 10.4 to 14.4 percent between 2008 to 2018.<sup>105</sup> Similar trends can also be observed in the Philippines where tourism's direct contribution to GDP increased from 5.8 to 12.3 percent over the same period.<sup>106</sup> In comparison, tourism has continuously contributed less than 2 percent to Japan's GDP over the past ten years even though Japan is one of Asia's most popular destinations for tourism. Although tourism makes a very important contribution to these emerging Asian economies, the authorities are keenly aware of the danger of oversaturation. McKinsey research in collaboration with the World Travel & Tourism Council found that overcrowding posed a significant risk to the preservation of cultural and historical sites in cities such as Bangkok, Beijing, Delhi, Manila, and Mumbai. Some key risks highlighted were alienated local residents, overloaded infrastructure, environmental damage, threats to cultural heritage through, for instance, vandalism, and a degraded tourism experience that could put off visitors in the future.<sup>107</sup> Emerging Asia and Frontier Asia and India might consider taking similar steps as countries of Advanced Asia to protect their natural and cultural riches. Japan has recently been promoting a new tourism route—the Dragon Route—as an alternative to the well-established and popular Golden Route that takes in Kyoto and Tokyo, and is very crowded. The Dragon Route takes visitors to lesser known inland sites such as Shirakawa-go, a UNESCO World Heritage Site, and Kanazawa, entry point to Japan's Alps.<sup>108</sup> Not only will this route be less crowded, but its promotion should help boost the economic development of rural towns and cities that have been bypassed by the bulk of tourists.
  
- **Advanced Asia is developing distinctive destinations for niche travelers.** Although tourism may be a relatively small contributor to the GDP of these economies (2 percent in the case of Japan, as noted, and 3 percent for Australia, for instance), the industry still offers an important connection point to the rest of the world. As these economies look for new opportunities from foreign visitors, many of them are offering niche experiences, such as cosmetic tourism in South Korea and tourism associated with education in Australia. Agencies and hospitals arranging visits for cosmetic surgery in South Korea curate the entire experience, from online consultations before the trip to pickup at the airport, translators, and accommodation. Revenue from foreign patients increased more than 15-fold between 2009 and 2016, from around \$45 million to more than \$700 million, and is estimated to have risen to more than \$825 million in 2018.<sup>109</sup> Cosmetic surgery brings the country around 300,000 tourists a year.<sup>110</sup> Australia is a major destination for international students, with half a million coming each year, and this creates tourism as friends and family visit. The Australian government says international students are a strategic priority because, on average, they spend 8.5 times more than other tourists, and one in four education visitors have friends or family visit the country, resulting in almost 300,000 visitors spending \$1.1 billion in Australia in 2018.<sup>111</sup>

<sup>105</sup> World Travel & Tourism Council, 2019.

<sup>106</sup> Ibid.

<sup>107</sup> *Coping with success: Managing overcrowding in tourism destinations*, McKinsey & Company and World Travel & Tourism Council, December 2017.

<sup>108</sup> "Here's 40 of YOUR Japan travel questions answered," Japaniverse, June 24, 2019, <http://www.japaniverse.com/japans-dragon-route/>.

<sup>109</sup> Seo Jin-woo and Minu Kim, "S. Korean medical industry sees surge in number of foreign patients," Pulse, March 19, 2019, <https://pulsenews.co.kr/view.php?year=2019&no=164472>

<sup>110</sup> "South Korea," *International Medical Travel Journal*, <https://www.imtj.com/country/KR/#horizontalTab5>.

<sup>111</sup> "Edu-tourism and the impact of international students," Australian Government, May 10, 2019, <https://www.austrade.gov.au/Australian/Education/News/Austrade-update/edu-tourism-and-the-impact-of-international-students>.

## **Air traffic network: Asia is becoming a global interchange and home to the world's fastest-growing airports**

Asia has accounted for more than 50 percent of total growth in air passengers over the past decade. In 2009, Asia had 150 million outbound international passengers; by 2018 that figure had risen to more than 415 million. As noted, Asia's share of total airline passengers rose to 40 percent in 2018, an increase of eight percentage points since 2009, a larger share than any other region; Europe comes nearest with a 28 percent share, down from 30 percent in the earlier period. Today, Asia is home to 11 of the world's 25 busiest airports.

The average share of transfers at the top airport is 15 percent. On this measure, Atlanta, Georgia, is not only the world's busiest hub in terms of passengers but also for transfers who account for 31 percent of total travelers to the airport. In Asia, the average share of transfer passengers is only 10 percent. Airports with the highest share are Kuala Lumpur and Hong Kong, with 17 and 13 percent, respectively. However, consider that Bangkok airport, gateway to one of the world's hottest tourist destinations, only has 9 percent transfers. There is clearly scope for more growth as international hubs among Asia's airports, including a hub based at the new airport in Beijing (see Box 5, "The opportunities that await Beijing's new Daxing airport," and Exhibit 29).

The advantages of hosting a major airport hub include the ability to launch flights from less common destinations—for instance, Beijing to Boston—and attracting inbound investment and tourism. The airport in Atlanta is the home base for Delta Air Lines, and as the world's busiest hub has not only attracted many tourists but has also acted as a magnet for the location of the headquarters of numerous businesses in Atlanta because travel is so easy to the city.

Box 5.

### The opportunities that await Beijing's new Daxing airport

The Chinese capital's new airport, Daxing, opens up possibilities for reinvigorated growth in the country's major airlines. For 40 years, passenger numbers at the long-established Beijing Capital Airport grew at an average of 12 percent a year, but in the past few years that growth rate has fallen sharply to only around 2 percent because the airport has very little spare capacity. Adding capacity would open the door to renewed growth in passenger numbers—and bring down airfares that have risen because of lack of capacity—and in turn enable airlines to open new routes from Beijing.

There is huge latent demand from Chinese carriers looking to expand their global route networks, in particular to Europe and the United States, as outbound tourism booms and as the BRI opens new opportunities. However, much of the expansion thus far has been new routes from secondary Chinese cities, such as Wuhan to San Francisco, Zhengzhou

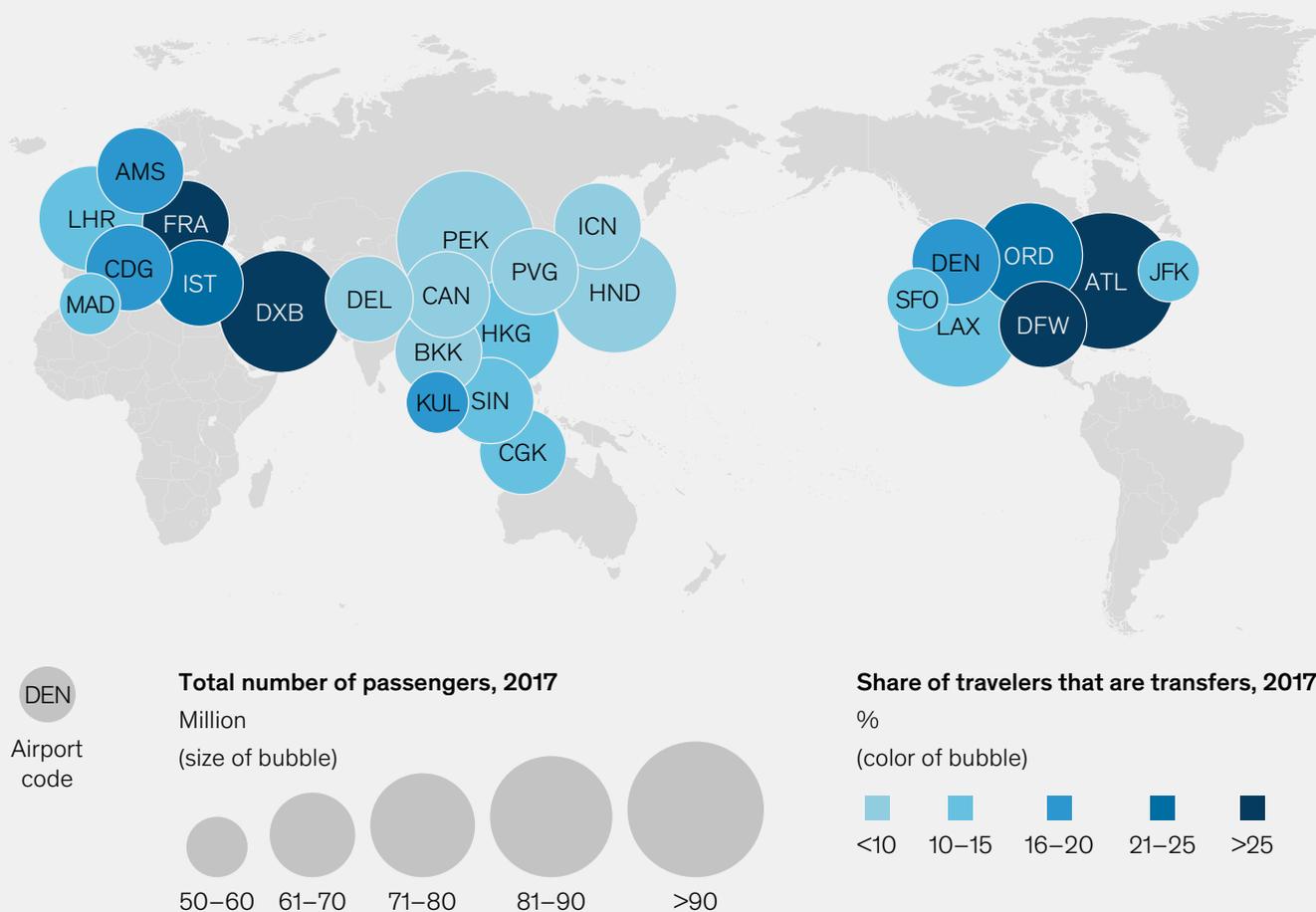
to London, and Shenzhen to Seattle. Airlines have struggled to make such secondary routes profitable, and in many cases they have had to be bolstered by local government subsidies. Two factors have stood in the way: lack of capacity at major hubs like Beijing and a historical policy by the Civil Aviation Administration of having only one carrier per long-haul route.

The opening of Daxing may change the game on both fronts. All three major carriers will have long-haul hubs at Beijing Daxing. However, Beijing has work to do to compete with major hubs outside China. Today, for instance, while other international hubs check baggage all the way through journeys with connecting flights, China's airports usually require baggage to be reclaimed before being transferred to a domestic flight. Connection times are long—120 minutes for Beijing compared with 50 minutes at Hong Kong airport. China's airports and airlines are working to improve all these factors, but it's a long process.

Exhibit 29

### Asia is home to some of the world's busiest and fastest-growing airports, but still has scope to build scale as a regional and global interchange.

World's top 25 busiest airports



Source: AIC; IATA; McKinsey Global Institute analysis

## Cultural content network: Asia has the scale and influence to create the next entertainment blockbuster

In 2007, Asia generated \$6.5 billion in box office revenue, or around 25 percent of the global total. Just ten years later, that number has grown 2.6 times to \$16.7 billion—in the same period, US box office revenue increased only 1.2 times—and now accounts for 41 percent of global revenue. To put absolute numbers on this, Asia's growth in box office equates to more than one billion net new movie ticket sales.

But Asia is not simply a consumer of media. Increasingly, the region is creating content and using digital channels to share its culture both within the region and with the rest of the world. In 2015, the Japan-produced blockbuster *Dragon Ball Z: Resurrection "F"* was the first independent film to become one of the ten highest grossing anime films domestically in Japan as well as establishing a new record for a theatrical release in the United States, where it grossed \$8.4 million in only nine days.

Chinese internet company Baidu's video-streaming affiliate iQiyi.com bought the exclusive rights to stream the South Korean TV series *Descendants of the Sun* in China for \$250,000 per episode, equivalent to about 40 percent of the show's production costs. The program became the first to be released simultaneously in China and South Korea, and was viewed more than one billion times on the platform.<sup>112</sup> Beyond just Asia, Netflix also bought the rights to *Descendants of the Sun* as it entered the South Korea market.

India is an established powerhouse for movie production, and Bollywood continues to go from strength to strength—well beyond its home country. In 2018, it produced the largest number of films in the world at 1,813, almost double the number made by China, the next largest producer.<sup>113</sup> Revenue earned overseas by Indian movies nearly tripled in 2017 to \$367 million.<sup>114</sup> *Dangal* made \$228 million overseas, becoming the highest grossing Bollywood movie outside India.

## The rising cities in Asia's culture and mobility network

For thousands of years, Asian cities have been writing rich stories from the rise and fall of empires that built the magnificent palaces that are now UNESCO-protected sites to the modern romances told by Bollywood. With their rich heritage, Asian cities are increasingly becoming a hub of the interchange of people, culture, and ideas. Some of these cities are well-known tourist destinations such as Bangkok and Seoul, while others are just beginning to find their own unique identities (Exhibit 30). Here we look at four cities:

- **Manila, the Philippines.** The city's culture index rose at a compound annual rate of 9 percent from 2007 to 2017. Dubbed variously the Pearl of the Orient and the Riviera of the Orient, Manila has long been a popular travel destination. In 2017, 1.68 million tourists visited the walled city, and international tourist arrivals rose by 7.7 percent to 7.1 million in 2018 from the previous year. However, the city is working on expanding tourism. Hotel capacity has risen along with an increase in casinos, and regional airports have been expanded and upgraded. The Department of Tourism is considering expanding its "visa on arrival" program to India.<sup>115</sup> The tourism and transportation departments are working on a plan to develop at least 85 airports across the country to promote growth in tourism, and the tourism department now offers express accreditation for tourism companies.

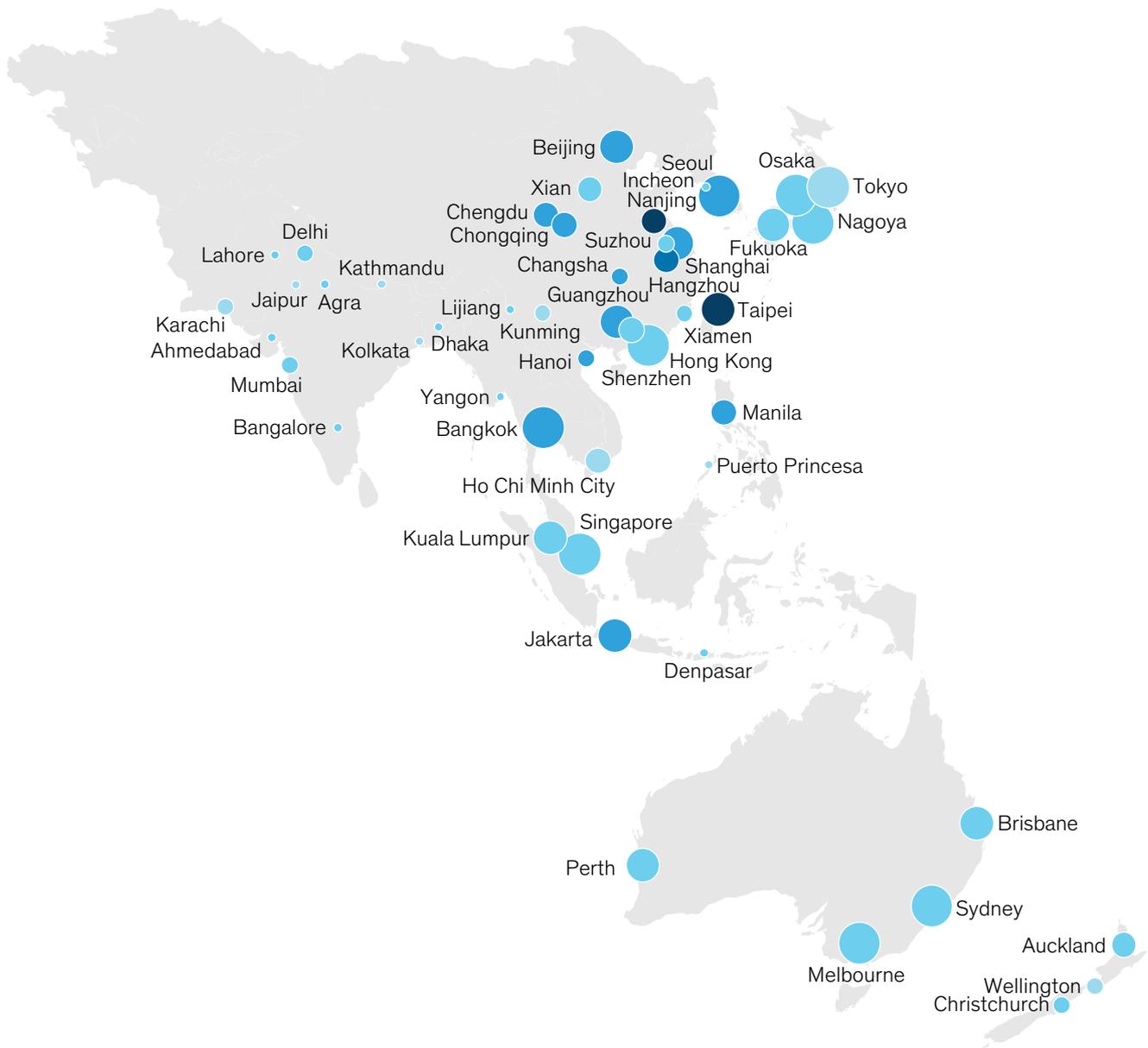
<sup>112</sup> John Kang, "Korean drama 'Descendants of the Sun' breaks records thanks to Chinese investments," *Forbes*, April 5, 2016.

<sup>113</sup> Indian feature films certified during the year 2018, <http://www.filmfed.org/IFF2018.html>.

<sup>114</sup> Parth Vohra, "Indian movies attract millions around the world—and that number looks set to grow," CNBC, August 2, 2018.

<sup>115</sup> Anna Felicia Bajo, "DOT eyes expansion of 'visa upon arrival' policy for Indian tourists," GMA News Online, August 22, 2017.

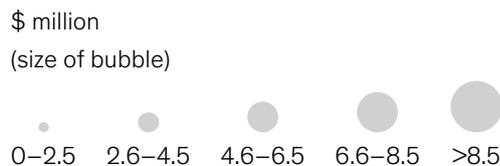
**MGI mapped the 50 fastest-rising cities on Asia's culture and mobility network.**



**Metrics analyzed**

- Cultural consumption (depicted)
- Cultural greenfield investment
- Volume of airport passengers
- Volume of foreign citizens
- Revenue of entertainment and cultural companies
- World Heritage Sites

**Cultural consumption, 2017**



**Overall index CAGR**



Source: UN; The Economist Intelligence Unit; FDI Atlas; IHS; McKinsey Global Institute analysis

- **Bangkok, Thailand.** The city's culture index rose at a compound annual rate of 7 percent between 2007 and 2017. Bangkok has witnessed exponential growth in tourism over the past decade. This city of more than ten million people offers a wide range of activities including sightseeing, shopping, and a vibrant night life. In 2017, international visitors spent \$16.36 billion, up 16 percent from the previous year.<sup>116</sup> Bangkok ranked fifth in the world for such spending in 2017 after Dubai, Makkah, London, and Singapore.<sup>117</sup> The number of international overnight visitors reached 20 million in 2017.<sup>118</sup> Rapid growth in Thailand's medical tourism has been facilitated by the development of more extensive medical infrastructure. Thailand has extended permission-to-stay to citizens of 19 nations believed to provide large inflows of medical tourists with the aim of becoming a major medical hub. Thailand has been a favored destination for international filmmaking since the 1970s. Recently, major productions filmed in the country have included Hollywood's *Hangover 2* and Chinese box-office hits *Detective Chinatown* and *Lost in Thailand*. To further develop itself as a film location, in 2017 Thailand introduced a 15 percent cash-rebate scheme for foreign films produced in the country.<sup>119</sup>
  
- **Hanoi, Vietnam.** The city's culture index rose at a compound annual rate of 5 percent between 2007 and 2017. The number of international arrivals to Vietnam nearly quadrupled from 4.2 million in 2008 to 15.5 million in 2018, and between 2016 and 2018, the number of tourists arriving in Hanoi grew at 10.2 percent a year. The annual growth rate of foreign visitors hit the 22.5 percent mark. In 2018, the city welcomed 26.3 million visitors, including more than six million from overseas. Euromonitor ranked Hanoi fourth among Southeast Asian capital cities for the number of foreign tourists in 2018. Expanding tourism is a major thrust. The city plans the development of 20 to 30 high-quality tourist sites, has approved 75 high-end accommodation projects with nearly 20,000 rooms, and aims to attract investment for new shopping sectors, as well as entertainment and sports venues. Formula One comes to Hanoi in 2020 as well as the Southeast Asian Games, both of which are expected to attract huge tourist numbers.<sup>120</sup>
  
- **Auckland, New Zealand.** The city's culture index rose at a compound annual rate of 2 percent between 2007 and 2017. Although Auckland is not the fastest-growing city for tourism, the city gets 2.6 million international visitors every year—that number is higher than the city's own population of 1.6 million and is expected to rise significantly in 2021 when the city hosts the America's Cup, the APEC leaders' summit, the women's world rugby and cricket cups, and the men's softball world championship. By 2025, the Ministry of Business, Innovation, and Employment expects the city to experience increases of 39 percent in overnight guests, 26 percent in international students, and 58 percent in annual international visitors. By 2022, Auckland Airport plans to invest about \$1.8 billion in aeronautical infrastructure to accommodate 40 million passengers and 260,000 flights by 2040. On the cultural front, the city is collaborating with government agencies and the private sector to ensure that the regional film industry has the capabilities to host domestic and international productions.

<sup>116</sup> Statista, <https://www.statista.com/statistics/310420/international-visitor-spending-in-bangkok/>.

<sup>117</sup> Statista, <https://www.statista.com/statistics/310405/leading-cities-in-international-visitor-spending-worldwide/>.

<sup>118</sup> Statista, <https://www.statista.com/statistics/310374/international-overnight-visitors-to-bangkok/>.

<sup>119</sup> World of Locations, <http://www.worldoflocations.com/asia/>.

<sup>120</sup> "Hanoi works hard to establish itself as tourist hub," Voice of Vietnam, February 7, 2019.

# 6. Thriving in the Asian Century

As Asia grows larger in scale, develops stronger intraregional connections, and forms new networks, business executives and policy makers both within the region and around the world need to assess how to tap into Asian opportunities including those arising from the complementary characteristics in the region's different geographies. As Asia integrates, businesses are already forging dynamic connections between countries, but policy makers can help to maximize the benefits of the synergies by forging stronger institutional partnerships. Asia is not without political tensions between countries, and closer cooperation may be needed to resolve them when they arise. We acknowledge that there are risks ahead that will need to be mitigated, including trade disputes, financial risks, pressure on the environment, growing urban inequality, large skills shortages, and institutional gaps related to policy stability, resource allocation and corruption, for example. In this section, we look at four areas for consideration by decision makers:

## 1. Be relevant to Asia

Firms in Asia and around the world need to consider how to make their business relevant to the world's largest regional economy, but aspirations and strategy need to be nuanced to reflect different Asian flows, some of which are already global in terms of scale and highly intraregional while others remain relatively underdeveloped. Companies that already have a substantial presence in Asia will need to continually revisit and refresh strategy to remain relevant and effective in a highly dynamic environment. Companies that have a minimal presence in Asia might consider increasing their investment in the region in order to ride the wave of increasing flows and economic growth.

- **Be part of Asian flows and networks that are already large-scale with a major intraregional element.** Asia is a global leader in flows including trade, air travel, innovation capital, and shipping, and therefore companies need to have a strong presence in these flows. Consider increasing air travel to and from Asia, for instance. German airline Lufthansa has seized the opportunity, increasing its flights to Seoul and Singapore from six and five days a week, respectively, to daily. Lufthansa's new flights to Osaka made the airline one of the top five European carriers for Japan.<sup>121</sup> The airline has estimated that adding more routes to China and Southeast Asia could boost passenger numbers by 40 percent. Lufthansa has also recently added a new flight to Bengaluru to cater to growing international traffic to Europe from South India.<sup>122</sup>
- **Offer Asia resources and flows on which it remains dependent.** On flows where Asia has scale but where the region continues to depend on non-Asian economies—IP in the case of knowledge flows, education in people flows, and energy in resources, for instance—there is an opportunity to meet Asian demand until it can meet demand from within the region. Take education, for instance: the United Kingdom has made a concerted effort to attract Chinese students. In the 2016–17 academic year, about 95,000 Chinese students went to study in the United Kingdom, five times more than students from the United States, the next largest source of foreign students. This large number reflected, for

<sup>121</sup> "Lufthansa increases flights to Asia," *TTR Weekly*, April 2, 2019.

<sup>122</sup> "The world's biggest airlines in 2018," *Airport Technology*, June 22, 2018, <https://www.airport-technology.com/features/worlds-biggest-airlines-2018/>; and "Annual results 2018," Lufthansa Group, <https://www.lufthansagroup.com/en/themes/annual-report-2018.html>.

instance, the government's simplification of visa applications and its provision of a post-study work visa at 23 British universities. British schools have also invested in marketing to China and establishing research partnerships with Chinese universities. Some leading British schools have set up campuses in China, and 296 out of 661 international schools in China teach the UK curriculum.<sup>123</sup>

- **Create opportunities for Asia to expand underdeveloped flows.** Relatively untapped opportunities exist in services trade, capital flows, data sharing, and culture. Given Asia's continuing growth, this is an area where local and foreign companies can further develop industries and explore new opportunities. In the entertainment industry, for instance, Netflix is investing heavily in Asian content, creating new demand. After entering the South Korean market in 2016, not only has Netflix boosted subscriptions from less than a million to 2.4 million over the past year, but it also invests in the production of original content from South Korea.<sup>124</sup> In Indonesia, which sold only 16 million cinema tickets in 2015 but 43 million in 2017, streaming companies Hulu, Netflix, and Amazon Prime are looking to make or buy local content.<sup>125</sup>

## 2. Rethink the Asian operating model

Asia is a diverse region with complementary characteristics and thriving in these markets is not always straightforward; many companies have tried and failed to gain a meaningful foothold in the region, and been forced to retreat. To give themselves the best chance of success, firms need to understand the nuances of differences within the region—even down to the level of individual cities—when developing their Asian operating models. Identifying synergies in order to capture economies of scale in this diverse region is arguably pivotal; managing diversity in the very different economies of the region, particularly those in Emerging Asia and Frontier Asia and India is another imperative. Some broad areas for consideration are:

- **Unlock opportunities arising from the complementary characteristics of the four Asias.** The different, but complementary, roles played by different parts of Asia offer openings to explore partnerships and collaborations between them and develop new supply chains. We are seeing major Asian companies forging dynamic links in different parts of the region, with Advanced Asia and China deploying capital and investing in technology solutions in the growing markets of Emerging Asia and Frontier Asia across sectors. For instance, in logistics, China's Alibaba is developing a logistics hub within Malaysia's digital free-trade zone to make cross-regional shipments more affordable for small and medium-size companies; this could be a model that spreads across the region. Similarly, in healthcare, Chinese insurer Ping An has announced a joint venture with Grab to offer users in Southeast Asia a healthcare tool using AI-assisted medical consultations, medicine delivery, and the booking of appointments.<sup>126</sup> In manufacturing, Japanese and South Korean auto companies are highly successful in India. South Korean companies are building market share in Vietnam, especially in electronics and the consumer sector. In finance, Singapore-based DBS Bank plans to enter India's credit card market in 2020 to tap into the considerable growth potential in the latter economy; as of May 2019, data show that India had only 48.9 million credit card users, compared with 825 million using debit cards.<sup>127</sup> WeChat is now offering remittance services to Filipinos living in Hong Kong.<sup>128</sup>

<sup>123</sup> Cecily Liu, "Chinese students flock to UK universities," *China Daily*, September 3, 2018.

<sup>124</sup> Troy Stangarone, "How Netflix is reshaping South Korean entertainment," *Diplomat*, April 29, 2019.

<sup>125</sup> Karlis Salna, "Hollywood finds a new golden age of cinema in Indonesia," *Bloomberg*, March 4, 2019.

<sup>126</sup> Enoch Yiu, "Ping An Insurance aims to take its financial, health-care technologies into new Asian markets," *South China Morning Post*, August 27, 2018.

<sup>127</sup> "DBS Bank to enter India's credit card market next year," *Channel News Asia*, August 20, 2019.

<sup>128</sup> Bien Perez, "WeChat taps Hong Kong's community of 170,000 Filipinos to help them remit funds home," *South China Morning Post*, October 24, 2017.

- **Think cities and city clusters.** As we have noted, a growing number of major cities are central to Asia's rising networks, and companies need to factor urban areas explicitly into their thinking, including cities that may not today be well known especially outside their home countries. Previous MGI research found that about 420 cities in emerging markets could generate 45 percent of global growth—34 percent of that growth coming from cities in Asia—and that companies need to make such cities a core target of strategy.<sup>129</sup> Companies need to be aware of which cities are expanding most on Asia's developing networks, and potentially build strategy around clusters of cities. In India, for instance, McKinsey has identified 14 major urban clusters that between them are home to 17 percent of the country's population and 40 percent of GDP in 2030. There are many examples of companies with an explicit Asian urban strategy, including Starbucks, for instance. The company has established 8,600 outlets across the region that generated 18 percent of total revenue in 2018.<sup>130</sup> This success partly reflects the company's ability to adapt its operating model to distinctive Asian markets. In Hong Kong, for example, outlets were modified to be spaces for work and study as well as socializing, because executives spotted an opportunity arising from Hong Kong's constrained space.<sup>131</sup>

### 3. Protect from and prepare for risks

To make the most of Asia's growing scale and importance in the world economy, there is work to be done to ensure that growth can be sustained and therefore that the region can continue to offer opportunities for businesses within the region and beyond. Risk is rising on a number of dimensions, including tensions around trade, climate change, polluted cities, corruption, and inequality, strengthening the imperative for governments and corporations to act. Areas to consider include the following:

- **Respond to environmental pressures.** The environment is an increasingly pressing issue for economies around the world, and there are tensions between countries as we have seen in the case of waste exports to Asia from other parts of the world and the beginnings of a pushback from Asia as it deals with its homegrown waste challenges. Countries need to better anticipate their needs; Western governments were, to an extent, blindsided by China's ban on imported plastic waste and have yet to build sufficient recycling capacity. But the issues go far beyond waste, of course. The United Nations and others argue that the climate has already changed, that extreme weather events are becoming more frequent, and that there is an urgent imperative to react in a concerted way to stand in the way of further global warming and mitigate the impact of the climate change that has already happened.<sup>132</sup> Asia, as we have noted, is both a major source of carbon emissions and a considerable investor in renewable technologies. Environmental challenges can have a direct impact on economic growth, too. In India, for instance, forthcoming MGI research finds that extreme heat could mean lost daylight working hours by 2030, negatively affecting productivity and GDP growth. In response, the Indian Ministry of Environment, Forest, and Climate Change released an India Cooling Action Plan in March 2019, becoming the first major country in the world to release a national policy document on cooling that includes establishing a national science and technology program to support the development of new cooling solutions. Singapore has announced plans for significant investment in infrastructure to protect the low-lying island nation against rising sea levels.<sup>133</sup> Asian governments and firms need to continue their efforts on environmental conservation. The economies of Emerging Asia may potentially bypass the environmental externalities that China is going through. Non-Asian economies may need to prepare for

<sup>129</sup> *Urban world: Mapping the economic power of cities*, McKinsey Global Institute, March 2011.

<sup>130</sup> Pamela Ambler, "Kevin Johnson accelerates Starbucks expansion across Asia amid intensifying competition," *Forbes*, March 13, 2019; and "Starbucks—Expanding in Asia," EOS Intelligence, March 8, 2017.

<sup>131</sup> Rajiv Nanjapla, "What drove Starbucks's revenue in 2018?," Market Realist, <https://marketrealist.com/2018/12/what-drove-starbucks-revenue-in-2018/>.

<sup>132</sup> *Climate change 2013: The physical science basis*, Fifth Assessment Report on the Intergovernmental Panel on Climate Change, 2013; and *Climate change*, United Nations, <https://www.un.org/en/sections/issues-depth/climate-change/>.

<sup>133</sup> Chang Ai-Lien, "Investing more in infrastructure to protect against climate change," *Straits Times*, February 19, 2019.

a future when Asia no longer accepts the externalities, and instead work with Asia to build a clean, energy-efficient, and sustainable world. New thinking is beginning to emerge. A successful transition to being a smart city can deliver real impact that improves the quality of life of citizens and addresses environmental challenges. MGI research has found that smart solutions could remove up to some 270,000 kilotons of greenhouse gas emissions annually in Southeast Asia, for instance.<sup>134</sup>

- **Fill skills gaps.** For Emerging Asia and Frontier Asia, in particular, there is an imperative to boost their pools of available skills in order to benefit from growing industrialization and innovation and to tackle inequality. Many economies in these parts of Asia are dealing with considerable skills gaps. For instance, according to one estimate, Indonesia anticipates a shortfall of nine million skilled and semi-skilled IT workers in the period to 2030, and the Philippines has sufficient IT graduates to fill only about one-quarter of vacancies. An estimated 90 percent of Malaysian IT graduates need additional training to ensure that they are work-ready, and 90 percent of such graduates in Thailand are failing to pass basic qualifications required by prospective employers.<sup>135</sup> Meeting these skills challenges is clearly vital if these economies are to take advantage of their growing working-age populations to propel growth and avoid potential disruption to social stability caused by inequality. Policy makers can strengthen investment in education, improve education curricula, and engage private-sector players in offering training programs. Advanced Asia and China have relatively high skills overall and can perhaps focus on creating opportunities to attract global talent by offering entrepreneurial opportunities. All parts of Asia can explore joint initiatives, learning from one another's experience and best practices, on, for instance, reskilling midcareer workers or designing processes to enable collaboration between workers and automated systems. MGI has estimated that, by 2030, 75 million to 375 million workers (3 to 14 percent of the global workforce) may need to switch occupational categories due to automation and shifts in the type of labor and skills that employers are looking for.<sup>136</sup> The number of likely transitions required varies depending on the stage of economic development of countries. For instance, up to 27 million—or as much as 46 percent—of current workers in Japan may need to switch occupations. In China, up to 102 million or 13 percent could be in this position; in India, the equivalent number is 38 million or 6 percent. As well as switching occupations and very often learning new skills or raising skills levels, workers who remain in their current occupations will also need to adapt as they increasingly work alongside machines that take over more routine tasks. Broadly, more workers in the automation age will require social and emotional skills, creativity, high-level cognitive capabilities and other skills that are relatively less likely to be automated.
- **Enhance institutional capabilities.** One key enabler of higher productivity, incomes, and demand is effective institutions to, for instance, promote healthy competition, allocate resources based on market principles, and design prudent macroeconomic decisions in exchange rate, monetary, and fiscal policy.<sup>137</sup> Institutional capabilities are also critical enablers of public and private spending on relevant infrastructure and human-capital development. The World Economic Forum has pointed out that poor performance on the institutions pillar of its global competitiveness index (defined as including security, property rights, social capital, checks and balances, transparency and ethics, public-sector performance, and corporate governance) continues to hinder competitiveness in many countries.<sup>138</sup> According to WEF, South Asia (roughly equivalent to our Frontier Asia and India group) scores only 50.1; the only region to score lower with 47.5 was Sub-Saharan Africa. However, some parts of Asia score considerably better than this. East Asia and Pacific (broadly equivalent to our Advanced Asia, China, and Emerging Asia

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<sup>134</sup> *Smart cities in Southeast Asia*, McKinsey Global Institute, July 2018.

<sup>135</sup> Charlotte Trueman, "How businesses in Southeast Asia are closing the tech skills gap," *CIO*, September 7, 2018.

<sup>136</sup> *Jobs lost, jobs gained: Workforce transitions in a time of automation*, McKinsey Global Institute, December 2017.

<sup>137</sup> *Outperformers: High-growth emerging economies and the companies that propel them*, McKinsey Global Institute, September 2018.

<sup>138</sup> *The global competitiveness report 2018*, World Economic Forum, 2018.

groupings) has an average score of 61.6, close to the 64.5 scored by Europe and North America. Continuous improvement in institutional performance is an important enabler of growth.

#### 4. Forge stronger intraregional collaboration

Today, Asian countries are regionally integrated to differing degrees, but the trend toward further integration is clear and ongoing, and the region needs to think more strategically about how to grow and prosper together. Topics to consider include the following:

- **Develop effective dispute resolution systems.** Asia is not without geopolitical tensions, and the region might consider how to work together to resolve disputes that could compromise the mutual social and economic benefits of rising integration between the countries of this diverse region. Territorial disputes, for instance, have created tension among neighboring countries.<sup>139</sup> Competing commercial interests can raise tensions, including trade tensions. Historical context can affect economic relationships. One example is the trade dispute between Japan and South Korea, the former having imposed tighter export restrictions on three chemicals needed for South Korean manufacturing of smartphones, semiconductors, and television displays.<sup>140</sup> ASEAN, Asia's high-profile regional intergovernmental organization representing ten countries in Southeast Asia, includes in its 2007 charter a commitment that member states resolve conflict peacefully, but no mandatory instrument is attached.<sup>141</sup> Although global trading systems can be used to address disputes and conflicts in Asia, there is pressure to reform various areas including dispute settlement mechanisms, the speed of decision making, and the monitoring of compliance. In addition to global systems, stakeholders in Asia can also explore agreements with a group of like-minded countries on a new set of rules to establish common understanding and rules on discussing and resolve key issues. The role of strong institutions to mediate and resolve conflicts is also important.<sup>142</sup> Singapore has set up the Singapore International Commercial Court, which offers the services of judges from different jurisdictions and the ability to use foreign law, evidential rules, and legal representation, for example. More broadly as Asian economies have grown and collaborated more, arbitration services are on the rise.<sup>143</sup> As regional networks are becoming stronger and connections among multiple flows emerge, more creative options can be explored among countries in Asia and the world.
- **Forge stronger relationships beyond trade.** As Asian integrates, there are many ways to facilitate closer links—beyond trade. In investment and financial services, for instance, after three years of planning, the Asia Region Funds Passport launched in February 2019, designed to enable cross-border offerings of managed funds to five Asian countries—Australia, Japan, New Zealand, South Korea, and Thailand—under the auspices of the Asia-Pacific Economic Cooperation. Recent treaties such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and the Regional Comprehensive Economic Partnership (RCEP) have started to include some additional elements. For instance, the CPTPP includes topics such as IP, data flows, the environment, and labor practices. RCEP not only covers goods and services trade but also investment, IP, and dispute resolution.<sup>144</sup> ASEAN Plus 3 explores collaboration opportunities in strategic areas such as the facilitation of tourist visits, cooperation among education institutions, development of an Asian bond market, and cooperation in food safety and

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<sup>139</sup> "Territorial disputes in the South China Sea," Global Conflict Tracker, Council on Foreign Relations, updated August 21, 2019.

<sup>140</sup> Satoshi Sugiyama, "Frustrated with South Korea, Japan greenlights curbs on smartphone and semiconductor supplies," *Japan Times*, July 4, 2019.

<sup>141</sup> Nicole Jenne, "Managing territorial disputes in Southeast Asia: Is there more than the South China Sea?," *Journal of Current Southeast Asian Affairs*, December 1, 2017.

<sup>142</sup> Vivienne Bath, "Dispute resolution along the Belt and Road," *East Asia Forum*, June 7, 2019.

<sup>143</sup> Chiann Bao, "International arbitration in Asia on the rise: Cause & effect," *Arbitration Brief*, 2014, Volume 4, Issue 1, pp. 31–51.

<sup>144</sup> "Explained: Regional Comprehensive Economic Partnership (RCEP)," *South China Morning Post*, February 19, 2019.

climate change, for example.<sup>145</sup> Stakeholders can continue the conversation and unlock additional doors to facilitate greater flows in the region.

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This is Asia's Century. It is vital for businesses looking for growth and new market opportunities to understand the region and its dynamics—its growing flows both global and intraregional and the rise of powerful new networks, studded with cities that may not be on the radar of decision makers today, but have the potential to become vital investment destinations for the near future.

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<sup>145</sup> *Overview of ASEAN Plus Three cooperation*, ASEAN Secretariat Information Paper, June 2017.

# Technical appendix

This appendix is divided into the following sections:

1. Dimensions and flows
2. Diverse Asia
3. Three networks

## 1. Dimensions and flows

MGI's earlier research on globalization largely focused on five types of flows: goods, services, capital, people, and data.<sup>146</sup> In this paper, we expand the scope of this analysis to include eight dimensions and 16 types of flow in order to show diverse flows among Asian economies. The eight dimensions are trade, capital, people, knowledge, transport, culture, resources, and the environment.

There is no one consistent source of data across these flows. To create an integrated view, we used 20 different data sources, conducted an extensive literature review, and interviewed local experts. Our data sources include:

- **Trade:** the McKinsey Global Flows Database.<sup>147</sup>
- **Capital:** regional share of loans, portfolio investment, and FDI from the IMF Balance of Payments; bilateral FDI flows from FDI Atlas; CEIC for China FDI net flows.
- **People:** international students by origin (tertiary education) from UNESCO; airline travelers from IATA PaxIS Plus report; migrants from the United Nations.
- **Knowledge:** patents from World Intellectual Property Organization; investment in startups from Preqin; IP charges from the World Bank; cross-border data from TeleGeography.
- **Transport:** container traffic and cargo traffic from the American Association of Port Authorities; air travel revenue from IATA PaxIS Plus report.
- **Culture:** size of global games market from IHS; global box office revenue from the Motion Picture Association of America; publishing and personal, cultural, and recreational services from the McKinsey Global Flows Database; revenue from entertainment and hospitality companies from the McKinsey Corporate Performance Analytics tool.
- **Resources:** energy demand from the *BP Statistical Review of World Energy 2019*; energy flows from the McKinsey Global Flows Database; investment in renewables from Our World in Data and REN21.
- **Environment:** carbon emission from the Global Carbon Atlas; waste production from the World Bank; and waste flows from UN Comtrade.

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<sup>146</sup> *Digital globalization: The new era of global flows*, McKinsey Global Institute, March 2016.

<sup>147</sup> For detail, see the technical appendix of *Globalization in transition: The future of trade and value chains*, McKinsey Global Institute, January 2019.

## 2. Diverse Asia

In this paper, we segment Asia into “four Asias” based on four dimensions of nine indicators. In our analysis, we start with a list of 82 economies grouped under “Asia and Oceania” by the United Nations. We then omit Iran and 19 economies in the UN’s Western Asia grouping that includes Saudi Arabia and the rest of Middle East. This is because these two groups of economies are dissimilar to those of the rest of Asia and do not have strong economic ties with those economies. When segmenting Asia based on its economies’ distinct characteristics, we further exclude 29 economies because of a lack of data. Those economies are: American Samoa, Christmas Island, Cocos (Keeling) Islands, Cook Islands, French Polynesia, Guam, Heard Island and McDonald Island, Kiribati, Marshall Islands, Micronesia (Federated States of), Nauru, New Caledonia, Niue, Norfolk Island, North Korea, Northern Mariana Islands, Pacific Islands (Trusted Territory), Palau, Papua New Guinea, Pitcairn, Samoa, Solomon Islands, Timor-Leste, Tokelau, Tonga, Tuvalu, United States Minor Outlying Islands, Vanuatu, and Wallis and Futuna Islands. This leaves 33 economies for the final analysis (Exhibits A1 and A2).

We grouped economies under China as one of the four Asias based on its unique large scale. We then grouped five economies with over \$20,000 per capita GDP and over \$100 billion total real GDP as “Advanced Asia.” For the rest of the economies, we separated the economies with high interaction with the rest of Asian economies with the standard that the average intraregional share of goods exports, capital flows, and people flows needs to be above 60 percent, and named these economies “Emerging Asia.” We then named the rest of the economies “Frontier Asia and India.” We acknowledge that these economies do not follow the strict definition of “Emerging” or “Frontier” economies, but we named them this way for illustrative purposes as most of the economies in each group follow the definition.

We then looked for additional indicators to analyze the distinct characteristics of each of the four Asias (Exhibits A3 and A4). The indicators analyzed include number of patents and global innovation index for innovation, working-age population and manufacturing labor cost for population, FDI inflows and outflows for capital, and 2013–17 and projected 2017–40 compound annual GDP growth rates for GDP growth. We also summarized the number of distinct official languages in each of the four Asias to paint a picture of the cultural diversity of each region.

**There is no single Asia but four or more, each with distinct characteristics on how they interact with one another ...**

Grouping	Economies	Scale		Economic development		
		Real GDP, 2017 \$ trillion	Population, 2017 Million	Per capita GDP, 2017 \$ thousand	Urbanization %	R&D spending/ GDP, 2017 %
<b>Advanced Asia</b>	Japan	4.9	127	38.2	92	3.1
	South Korea	1.5	51	30.0	82	4.2
	Australia	1.3	25	53.3	86	1.9
	Singapore	0.3	6	57.7	100	2.2
	New Zealand	0.2	5	42.1	86	1.3
<b>China</b>	Mainland China	12.1	1,410	8.6	58	2.1
	Taiwan	0.6	24	24.4	n/a	n/a
	Hong Kong	0.3	7	46.3	100	n/a
	Macao	n/a	1	n/a	100	n/a
<b>Emerging Asia</b>	Indonesia	1.0	264	3.8	55	0.1
	Thailand	0.5	69	6.6	49	0.8
	Philippines	0.3	105	3.0	47	0.1
	Malaysia	0.3	32	9.9	74	1.3
	Vietnam	0.2	95	2.3	35	0.4
	Myanmar	0.1	53	1.3	30	n/a
	Nepal	<0.1	29	0.9	19	n/a
	Cambodia	<0.1	16	1.4	23	0.1
	Brunei	<0.1	<1	28.3	77	n/a
	Mongolia	<0.1	3	3.7	68	0.2
	Bhutan	<0.1	<1	3.1	n/a	n/a
	Laos	<0.1	7	n/a	34	n/a
<b>Frontier Asia and India</b>	India	2.6	1,341	1.9	34	0.6
	Pakistan	0.3	197	1.5	36	0.2
	Bangladesh	0.2	165	1.5	36	0
	Kazakhstan	0.2	18	8.4	57	0.1
	Sri Lanka	0.1	21	4.2	18	0.1
	Uzbekistan	0.1	32	1.9	51	0.2
	Turkmenistan	<0.1	6	6.6	51	n/a
	Afghanistan	<0.1	35	0.6	n/a	n/a
	Tajikistan	<0.1	9	0.8	27	0.1
	Fiji	<0.1	<1	5.6	56	n/a
	Maldives	<0.1	<1	12.2	41	n/a
	Kyrgyzstan	<0.1	n/a	0	n/a	0.1

Note: We follow the groupings used by the UN and UNCTAD, which count 83 economies as part of the Asia and Oceania region, with some exceptions. We omit Iran and 19 economies in the UN's Western Asia grouping that includes Saudi Arabia and the Middle East. This is because these two groups of economies are dissimilar to those of the rest of Asia and do not have strong economic ties with those economies. For this analysis, we excluded economies (mostly economies in Oceania) with limited data, and conducted grouping for 33 economies.

Source: IHS; Oxford Economics; McKinsey Global Institute analysis

## ... and with the world.

		Interaction with Asia				Connectedness with the world
		Low  High 				Low  High 
		Intraregional share (%)				MGI
Grouping	Economies	Goods exports, 2017	Capital (imports + exports), 2013–17	People travel (imports + exports), 2018	Weighted average of intraregional shares	Connectedness Index global rank, 2017
<b>Advanced Asia</b>	Japan	57	50	79	62	17
	South Korea	63	62	84	70	15
	Australia	72	57	68	66	20
	Singapore	78	64	89	77	2
	New Zealand	65	83	78	75	55
<b>China</b>	Mainland China	46	50	73	56	9
	Taiwan	n/a	75	86	81	n/a
	Hong Kong	76	68	76	73	n/a
	Macao	100	89	n/a	94	n/a
<b>Emerging Asia</b>	Indonesia	69	81	82	77	53
	Thailand	64	88	82	78	24
	Philippines	66	63	71	66	54
	Malaysia	71	76	91	79	22
	Vietnam	46	83	83	71	18
	Myanmar	91	88	94	91	95
	Nepal	65	100	57	74	n/a
	Cambodia	28	90	96	71	75
	Brunei	97	77	95	90	82
	Mongolia	81	27	76	61	90
	Bhutan	99	100	100	100	132
	Laos	91	89	97	92	115
<b>Frontier Asia and India</b>	India	33	43	32	36	33
	Pakistan	29	61	8	33	n/a
	Bangladesh	13	76	40	43	71
	Kazakhstan	24	31	20	25	41
	Sri Lanka	23	70	57	50	97
	Uzbekistan	n/a	74	20	47	n/a
	Turkmenistan	4	0	23	9	n/a
	Afghanistan	89	0	33	41	n/a
	Tajikistan	n/a	27	10	19	125
	Fiji	n/a	19	83	51	128
	Maldives	n/a	0	57	29	105
Kyrgyzstan	n/a	0	13	7	n/a	

Note: We follow the groupings used by the UN and UNCTAD, which count 83 countries and territories as part of the Asia and Oceania region, with some exceptions. We omit Iran and 19 economies in the UN's Western Asia grouping that includes Saudi Arabia and the Middle East. This is because these two groups of economies are dissimilar to those of the rest of Asia and do not have strong economic ties with those economies. For this analysis, we excluded economies (mostly economies in Oceania) with limited data, and conducted grouping for 33 economies.

Source: IHS; Oxford Economics; IMF; UNCTAD; WTO; OECD; McKinsey Global Institute analysis

## Each Asia plays different roles with its distinct characteristics: innovation, population ...

Grouping	Economies	Innovation		Population		Manufacturing labor cost, 2018 \$
		Number of patents, 2017 Thousand	Global innovation index ranking, 2019	Growth in working-age population, 2017-40 Million		
Advanced Asia	Japan	318.5	15	-14.9		26.6
	South Korea	204.8	11	-7.5		26.1
	Australia	28.9	22	2.9		32.2
	Singapore	10.9	8	-0.3		28.6
	New Zealand	6.2	25	0.2		25.0
China	Mainland China	1,381.6	14	-128.3		6.2
	Taiwan	n/a	0	-3.3		10.9
	Hong Kong	13.3	13	-0.7		8.7
	Macao	0.1	n/a	<0.1		n/a
Emerging Asia	Indonesia	9.3	85	33.0		0.8
	Thailand	7.9	43	-7.7		2.9
	Philippines	3.4	54	24.9		2.1
	Malaysia	7.1	35	5.3		2.7
	Vietnam	5.4	42	6.1		2.4
	Myanmar	n/a	n/a	5.9		n/a
	Nepal	<0.1	109	6.0		n/a
	Cambodia	n/a	98	3.6		n/a
	Brunei	0.1	71	<0.1		n/a
	Mongolia	0.2	53	0.5		n/a
	Bhutan	n/a	n/a	0.1		n/a
	Laos	n/a	n/a	1.7		n/a
	Frontier Asia and India	India	46.6	52	210.9	
Pakistan		0.7	105	64.3		0.7
Bangladesh		0.3	116	26.5		n/a
Kazakhstan		1.2	79	2.5		2.0
Sri Lanka		0.5	89	-0.4		1.0
Uzbekistan		0.6	n/a	5.7		n/a
Turkmenistan		n/a	n/a	1.2		n/a
Afghanistan		n/a	n/a	16.8		n/a
Tajikistan		<0.1	100	2.9		n/a
Fiji		n/a	n/a	0.1		n/a
Maldives		n/a	n/a	0.1		n/a
Kyrgyzstan		0.1	90	1.1		n/a

Source: WIPO; Global Innovation Index 2019 Report; UN; The Economist Intelligence Unit; IMFBoP; CEIC; IHS; McKinsey Global Institute analysis

## ... capital, and GDP growth.

Grouping	Economies	Capital		GDP growth	
		FDI outflow, 2013–17 \$ billion	FDI inflow, 2013–17 \$ billion	CAGR (%)	
				2013–17	2017–40
Advanced Asia	Japan	774.5	93.8	1.1	0.5
	South Korea	141.8	55.3	3.0	1.7
	Australia	28.1	246.5	2.5	2.2
	Singapore	180.6	342.5	2.4	2.6
	New Zealand	-1.5	7.3	3.5	2.0
China	Mainland China	731.1	658.0	6.9	4.6
	Taiwan	428.9	417.0	2.4	1.9
	Hong Kong	0.9	9.4	2.8	2.4
	Macao	1.9	3.4	n/a	n/a
Emerging Asia	Indonesia	21.1	94.1	5.0	5.0
	Thailand	54.8	40.7	2.9	3.4
	Philippines	21.8	33.5	6.4	5.2
	Malaysia	55.9	54.8	5.0	4.0
	Vietnam	5.7	56.6	6.4	5.8
	Myanmar	n/a	16.5	6.9	5.8
	Nepal	n/a	0.5	4.4	4.3
	Cambodia	0.4	11.0	7.0	5.8
	Brunei	n/a	0.5	-1.0	2.7
	Mongolia	0.2	-0.2	4.3	4.1
	Bhutan	n/a	n/a	6.3	5.9
	Laos	n/a	5.2	7.4	5.9
Frontier Asia and India	India	37.1	191.2	7.3	6.3
	Pakistan	0.5	10.1	5.2	4.1
	Bangladesh	0.8	12.5	6.8	5.1
	Kazakhstan	12.4	45.2	2.6	2.9
	Sri Lanka	0.5	4.8	4.4	4.0
	Uzbekistan	n/a	n/a	7.2	3.0
	Turkmenistan	n/a	n/a	7.4	3.6
	Afghanistan	n/a	0.4	2.1	4.0
	Tajikistan	0.1	1.2	6.7	3.7
	Fiji	<0.1	1.6	4.2	2.5
	Maldives	n/a	2.0	4.1	3.9
	Kyrgyzstan	n/a	n/a	n/a	n/a

Source: WIPO; *Global Innovation Index 2019*; UN; The Economist Intelligence Unit; IMF BoP; CEIC; IHS; McKinsey Global Institute analysis

### 3. Three networks

We highlight these three networks (of many) because they not only have a significant influence on how Asia's economies are developing but also potentially are influencing patterns of globalization the world over:

- **Scale: industrialization.** Asia is increasing its significant scale on most of the dimensions explored in this paper. On the supply side, its emerging industrialization network is likely to have a global impact. Asia has been a major driver of industrialization for decades. In the 1970s to the 1990s, Japan and South Korea were in the vanguard. In the 1990s to the 2000s, China became the factory to the world. Now, an increasing amount of industrial activity is taking place in Asia beyond China—particularly in Southeast Asia. On the demand side, 39 percent of the world's consumption will be in Asia by 2040. This rising scale is likely to propel the growth of new industrialization anchors and hubs within the region and potentially have the power to reshape global industrial networks.
- **Speed of change: innovation.** The rapidity with which Asia is innovating could also have a major impact on the global stage, underscoring the importance of its emerging innovation network. Japan and South Korea have long established innovation foundations and knowledge bases, and now China and India are moving to the forefront. It is striking that unicorns are forming three to four years faster on average than in the West. More than 29,000 kilometers of high-speed rail is being built within a decade, and thousands of STEM students are graduating each year.
- **Potential to create value: culture and mobility.** We focus on Asia's development network in culture and mobility because we believe there is significant untapped value. Today, Asia punches below its weight on both, but each is growing fast. Moreover, culture and mobility networks have the potential for large multiplier effects on adjacent industries—and on the global economy. For instance, one study on the United States found that the arts contributed \$763.6 billion to the US economy—more than agriculture, transport, or warehousing.<sup>148</sup> Although tourism tends to be relatively small in terms of economies' overall GDP, it can generate large multiplier effects, boosting activity in other sectors. Consider a hotel, for instance. A hotel will directly employ staff but will also create secondary employment on farms supplying food. Tourists who visit a country spend money, and this creates demand for local products.<sup>149</sup> McKinsey has estimated that in 2018 Chinese tourists spent at least \$388 billion renminbi overseas on luxury goods.<sup>150</sup>

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<sup>148</sup> "The arts contribute more than \$760 billion to the U.S. economy," National Endowment for the Arts, March 6, 2018.

<sup>149</sup> "Tourism multiplier effect," Barcelona Field Studies Centre, <https://geographyfieldwork.com/TouristMultiplier.htm>.

<sup>150</sup> *China luxury report 2019: How young Chinese consumers are reshaping global luxury*, McKinsey & Company, April 2019.

# Further reading from MGI

*A decade after the global financial crisis: What has (and hasn't) changed?*, September 2018.

*Artificial intelligence: Implications for China*, April 2017.

*China and the world: Inside the dynamics of a changing relationship*, July 2019.

*China's role in the next phase of globalization*, April 2017.

*Digital China: Powering the economy to global competitiveness*, December 2017.

*Digital globalization: The new era of global flows*, March 2016.

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