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**Economic Cooperation
and Connectivity in the
Asia-Pacific Region**

Haruhiko Kuroda



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**Economic Cooperation and Connectivity
in the Asia-Pacific Region**

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Abstract

The views expressed in this Working Paper are those of the author(s) and should not necessarily be considered as reflecting the views or carrying the endorsement of the United Nations. Working Papers describe research in progress by the author(s) and are published to elicit comments and to further debate. This publication has been issued without formal editing.

The region needs to invest in an efficient system of regional infrastructure for a seamless Asia to emerge. This will provide the foundation for Asian common markets and facilitate the creation of an eventual pan-Asian community. None of this will be easy, but it will have to be done by building institutions, harmonizing policies and regulations, developing and aligning standards, and, most crucially, attracting the required capital to the right kinds of regional projects. In these uncertain times, Asia must forge ahead with the challenging and immensely rewarding task of integrating this vast and diverse region to benefit all its citizens and the world at large. This will help boost further growth and prosperity in the region, spread the benefits of growth more widely and evenly and will enhance the region's competitiveness. It will help reduce poverty and promote greater environmental sustainability. The support and strong partnership of ADB, UNESCAP and other development partners will ensure that the vision of a truly pan-Asian economic community materializes.

* This paper is an edited version of the text of the Distinguished Persons Lecture delivered by Mr Haruhiko Kuroda, President of Asian Development Bank at ESCAP in Bangkok on 11 November 2010.

CONTENTS

1. INTRODUCTION	1
2. CURRENT ECONOMIC GROWTH AND CHALLENGES IN ASIA.....	1
3. INFRASTRUCTURE DEVELOPMENT IN DEVELOPING ASIA.....	2
3.1 Connectivity and Poverty Reduction.....	2
3.2 Region's Infrastructure Stock and Investment.....	2
3.3 The Asian Highway and Trans-Asian Railway.....	3
4. SUPPORTING CONNECTIVITY.....	3
4.1 Support for Subregional Programs.....	3
4.2 Policies and Regulations to Complement Connectivity.....	4
4.3 Knowledge Sharing and Partnerships.....	4
4.4 Efforts to Catalyze Private Participation.....	5
4.5 Mobilizing Additional Finance.....	5
4.6 Sustainable Infrastructure Development for the Region.....	6
5. CONCLUSION.....	6

1. INTRODUCTION

The subject of regional cooperation and connectivity could not be more relevant in the context of Asia today. In Ha Noi recently on the occasion of 17th ASEAN Summit, where the leaders adopted the Master Plan on ASEAN Connectivity. The Master Plan identified key strategies and actions to enhance the region's connectivity in three dimensions: physical, institutional, and "people-to-people". ADB and UNESCAP both supported preparation of the Master Plan.

At ADB, support for regional cooperation and integration best manifests itself through four pillars—infrastructure, trade and investment, money and finance, and regional public goods. There are, therefore, several facets of regional cooperation and connectivity and they cut across several infrastructure sectors including energy, water, and telecommunications. The focus is on improving connectivity through regional infrastructure development. Improving connectivity is essential for the region's prosperity, continued growth and, most importantly, poverty reduction.

ADB's vision of a "seamless Asia", where countries are already better integrated with a sound stock of infrastructure, represents a key development goal for the region. But this is not without challenges, which range from massive investment requirements to complex policy coordination issues. In today's world it is also important to ensure that regional integration leads to green and inclusive growth and that its benefits are reaped equitably. Given the enormity of the challenges, no single agency or government can take them on alone. ADB sees the need for a renewed set of partnerships – not only with traditional partners like UNESCAP- but also with a large number and variety of other stakeholders, including particularly the private sector.

2. CURRENT ECONOMIC GROWTH AND CHALLENGES IN ASIA

In ADB's most recent *Asian Development Outlook Update*, it has been forecast that developing Asia's gross domestic product would grow at 8.2 per cent in 2010, significantly above last year's 5.4 per cent. The region's recovery is well on track. For 2011, with stimulus gradually withdrawn, growth will cool somewhat, but remain robust at 7.3 per cent. In particular, the region's largest economy – the People's Republic of China – is expanding at an annual rate of nearly 10 per cent. India is projected to grow steadily above 8 per cent this year.

Developing Asia's remarkable performance has not only pulled the region out of recession, but also helped steer the world economy toward recovery. For 2010, developing Asia's contribution to world growth is expected to be about 46 per cent. Several risks remain, including weak performance in developed countries and volatile capital inflows to emerging economies, but there is reason for optimism.

In the longer term, of course, several other challenges remain. Asia needs to continue efforts to rebalance sources of growth more toward domestic and regional demand. This is essential if developing Asia's rapid growth is to be sustained. It will require policies to boost consumption and a better investment climate. Regional cooperation and integration will play an important role in rebalancing growth. But the remaining barriers to intra-regional trade would also need to be removed if Asia is to become the ultimate consumer of a major part of

its final products. In addition, markets will need to expand to include the increasingly affluent consumers within the region.

3. INFRASTRUCTURE DEVELOPMENT IN DEVELOPING ASIA

Rebalancing growth will largely depend on the region's ability to develop greater economic connectivity. Good quality and reliable infrastructure would be needed for connecting the region. Unless infrastructure can be improved and expanded, and its management made efficient, it will become a bottleneck to growth, a threat to competitiveness and an obstacle to poverty reduction. Enhancing physical connectivity and establishing international trade supply chains will further boost the trade in intermediate and final goods, help companies to grow and create more jobs. The need to reduce transport and logistics costs by connecting production clusters across economies and markets will be a major challenge in the coming decades.

3.1 Connectivity and Poverty Reduction

Studies by ADB have shown that connectivity brings important benefits. Cross-border infrastructure projects have helped raise household incomes through improved access to markets and increased the access of the poor to economic opportunities and basic social services. It has enhanced trade and investment by reducing the cost of doing business and encouraged private sector development by creating business opportunities. By way of illustration, a recent study has shown that the completion of the East-West Economic Corridor in Savannakhet province of the Lao PDR was associated with a 35 per cent decline in the incidence of income poverty in six years.

Macro-level studies confirm that the long-term impacts of regional connectivity are several times greater than those in the short-run. In the short-run, the benefits of regional connectivity emanate from reductions in transport cost and time and increases in trade volumes. However, in the long-run, regional connectivity helps to unlock the tremendous potential of the region by removing constraints and bottlenecks to growth. Investors respond to the changed structure of incentives with new capital investments and workers respond by moving to regions with greater returns to their labor. In other words, regional connectivity allows changes in factors of production, which help accelerate growth and reduce poverty.

3.2 Region's Infrastructure Stock and Investment

Specifically with respect to the region's infrastructure stock, Asia lags in both quantity and quality when compared with advanced economies. Moreover, the level of infrastructure development also varies widely across the region. These gaps have to be quickly closed if the development disparities – both within and across the countries – are to be reduced.

To do this will require substantial resources. As was noted in a recent publication, *Infrastructure for a Seamless Asia*, the region needs an investment of about \$8 trillion during this decade to support infrastructure development. This is well above the current investment levels and can be met only by resorting to innovative methods of resource mobilization.

3.3 *The Asian Highway and Trans-Asian Railway*

The ADB has noted the specific examples of the Asian Highway and the Trans-Asian Railway. Together, they represent about 250,000 kilometers of road and rail networks connecting capital cities, major industrial zones and other important commercial areas. ADB has already made a significant contribution to the physical development of these important networks. It has helped finance about 18,000 kilometers of the Asian Highway, accounting for 13 per cent of its total length. But, a great deal of work remains to be done to optimize these networks and ensure that they operate at levels that maximize the returns on the extensive investments made.

A joint ADB/UNESCAP study¹ is underway to identify high-priority projects that will link Asia's production networks and supply chains with regional markets. The combined efforts of ADB and UNESCAP should yield useful ideas and options for expanding the scale and pace of regional infrastructure development.

But the Asian Highway and Trans-Asian Railway are only two important parts of an overall network of logistics infrastructure that includes rail, road, inland water transport, coastal shipping and expanded container port operations. It is no surprise that the six largest ports by container traffic worldwide are in Asia—Hong Kong, China; Singapore; Shanghai; Shenzhen; Busan; and Kaoshiung. It is important that there is integrated thinking across individual sectors in developing our regional infrastructure – this would bring significant benefits by way of optimized investments and performance in the region.

4. SUPPORTING CONNECTIVITY

ADB seeks to try and demonstrate the advantages of an integrated approach to the development of subregional connectivity. It supports subregional programs through carefully designed project structures, underpinned by sound analyses and knowledge work, and accompanied by some innovative financing. The reality is that unless clean and sustainable infrastructure is targeted within a green growth framework and the required finances catalyzed, especially from private sources, there would be a loss of momentum that the countries have generated for regional cooperation.

4.1 *Support for Subregional Programs*

The momentum consists of the several subregional cooperation programs that have been developed since the early 1990s and which have been supported by ADB and a number of development partners including, of course, UNESCAP. These include the Greater Mekong Subregion (or GMS) Economic Cooperation program; the Central Asia Regional Economic Cooperation program (or CAREC); the Brunei Darussalam, Indonesia, Malaysia, Philippines East ASEAN Growth Area program (or BIMP-EAGA); the Indonesia-Malaysia-Thailand Growth Triangle (or IMT-GT), and the South Asia Subregional Economic Cooperation program (or SASEC). Several of these have made significant progress and remain an important avenue for fostering region-wide connectivity.

¹ Under TA-7557: Promoting regional Infrastructure Development, approved in July 2010.

Efforts such as these at the subregional level clearly benefit overall regional integration as well. For example, the region has seen a dramatic increase in free trade agreements, or FTAs. There were two formal FTAs in 1990. Now, 20 years later, there are more than 230. Although some worry about the “noodle bowl effect of FTAs”, in the face of the stalled Doha Round, it shows that the region is continuing to move toward greater interconnectivity. The total share of intra-regional trade has risen from about 46 per cent in 1990 to over 56 per cent in 2009. Intra-regional foreign direct investment during the same period has jumped from around 10 per cent to more than 60 per cent. To maintain this momentum, Asia must ensure that its infrastructure stock grows rapidly and efficiently so that the region enhances its competitiveness.

4.2 Policies and Regulations to Complement Connectivity

An expanded infrastructure stock by itself will be insufficient to develop and enhance Asia’s competitive edge. Asia must also invest in smart policies and regulations to foster effective cross-border movements of goods, services, and people. Harmonizing and simplifying customs procedures, information sharing, customs modernization, establishing transparent transit rules and improving logistics in general are critical to infrastructure expansion. In this regard, the announcement at the APEC Finance Ministers’ meeting last week that the Government of Japan would provide up to \$25 million through ADB for trade facilitation in Asia, is a welcome development. All these initiatives must be done within an enabling policy, legal and regulatory environment. It is important to remember that while governments may be at the center of many of these arrangements, eventually it is public-private partnerships (or PPPs) that will be required to bring the value addition to regional infrastructure development.

4.3 Knowledge Sharing and Partnerships

The need for improved knowledge sharing and partnership for improving connectivity cannot be emphasized enough. The region has a broad spectrum of regional cooperation and integration experiences. Some countries and sub-regions have impressive records in improving connectivity. These experiences and approaches need to be distilled and shared widely within the region. Lessons from outside the region, including those from developed countries, will also be useful for the countries of the region.

It needs to be stressed that nothing that is done to make investments, whether public or private, into regional infrastructure development, can be effective unless underpinned by a sound knowledge base. Regionalism, its context, the socio-economic and cultural settings and the imperatives of coming together for a better common future, are all subjects that require exploring to understand the dynamics of design. ADB has given attention to developing knowledge products to help policy-makers seize the opportunities for improving regional connectivity. More can be done in partnership with development partners and regional think-tanks and organizations like UNESCAP.

The ADB has recently established partnerships with the Korea Transport Institute, the Inter-American Development Bank, the Clean Air Initiative for Asian Cities Center and the Global Road Safety Partnership. It is also leading the Partnership on Sustainable Low Carbon Transport, the largest multi-stakeholder initiative on sustainable low-carbon transport.

4.4 Efforts to Catalyze Private Participation

Asia has recently replaced Latin America as the leading recipient of private infrastructure investment in the developing world. Private investment in infrastructure grew from around \$75 billion in the late 1990s to almost \$100 billion in 2008. This is a significant increase. Although it will obviously not meet the \$8 trillion investment requirement, the region has a clear potential to attract additional investment.

The ADB is strengthening its operations to enhance PPPs. It is to focus on raising awareness for PPP among policy-makers, creating an enabling policy environment, project development, and project financing. ADB continues to find ways to better leverage additional resources. For example, ADB's \$1.2 billion in loans to the India Infrastructure Finance Company has helped catalyze \$14.6 billion in private investments to finance 43 PPP projects with a total project cost of \$15.8 billion. It is hoped to identify additional ways that can raise financing for infrastructure in other parts of the region.

Bringing in the private sector in partnership to operate regional infrastructure is a growing phenomenon. A recent example is the 650 kilometer reconstruction of the Trans-Asian Railway stretching from Cambodia's border with Thailand to its border with Viet Nam. The private operation of this railway system through a concession agreement between the Cambodian government and a private operator is an excellent example of partnership that should be seen in greater number. Drawing in private expertise is as important as drawing in private capital in the funding and operation of regional infrastructure.

4.5 Mobilizing Additional Finance

To complement ADB's increased lending and PPP promotion, it is important to continue developing domestic capital markets to utilize the region's vast domestic savings. ADB has supported the Asian Bond Markets Initiative, which has been working to deepen domestic capital markets and promote local currency bond issuance for widening both the issuer and investor base. Credit enhancements, such as the new \$700 million Credit Guarantee and Investment Facility, established by ASEAN+3 with ADB support this year, will also make it easier to promote PPP projects.

There are other initiatives, too, that mobilize financing specifically for infrastructure development. In 2008, ADB established the Asia Infrastructure Financing Initiative—a parallel financing agreement with the Republic of Korea and Islamic Development Bank contributing \$3.5 billion and \$1 billion, respectively. In addition, in response to a request from ASEAN finance ministers, ADB has been working to establish an ASEAN Infrastructure Fund that will significantly contribute toward meeting financing requirements of the Master Plan on ASEAN Connectivity.

In the long run, the region needs to develop deeper and more robust domestic financial markets to help fund bankable infrastructure projects. In South America, for instance, private pension funds have created large financial resources focused on long-term investments. These could also be complemented by regional financial markets. But this will take time. In the short term, infrastructure—and regional infrastructure, in particular—will have to be funded

largely by the public sector, complemented by domestic savings and private sector resources where possible.

4.6 Sustainable Infrastructure Development for the Region

Finally, in promoting regional infrastructure development, it is important to ensure that a green path is followed. This is a critical task for the region. For example, the contribution of Asia's energy sector to global carbon dioxide emissions has more than tripled since 1980, from about 8 per cent to 30 per cent today. If projections hold, Asia's contribution could rise to 43 per cent by 2030, making it the region with the highest emissions.

In response, enhanced efforts are needed to help developing economies move onto low-carbon paths by improving their energy efficiency; expanding the use of renewable energy sources; reducing greenhouse gas emissions and modernizing transport systems, among others. It is also needed to help countries adapt to the unavoidable impacts of climate change, including: "climate-proofing" projects, integration of climate change adaptation considerations and disaster risk management.

Asia is in the midst of a water crisis. The time has come to put the region's collective efforts to find effective ways of sharing its common water resources better – not simply to ensure that the regional infrastructure works better, but also because the region's growing food demands must be met.

5. CONCLUSION

A seamless Asia will emerge but infrastructure connectivity will not happen if the region does not invest in an efficient system of regional infrastructure. This will provide the foundation for Asian common markets and facilitate the creation of an eventual pan-Asian community. None of this will be easy, but it will have to be done by building institutions, harmonizing policies and regulations, developing and aligning standards, and, most crucially, attracting the required capital to the right kinds of regional projects.

No single institution can, or should, address these questions alone. This is why *Infrastructure for a Seamless Asia* proposes to establish a "Pan-Asia Infrastructure Forum" to coordinate and guide the natural evolution of infrastructure connectivity. The Forum would provide an effective platform for optimizing links between energy, water, transport and telecommunications and would work toward harmonizing related policies and regulations. It is a concept worth pursuing.

In these uncertain times, Asia must forge ahead with the challenging and immensely rewarding task of integrating this vast and diverse region to benefit all its citizens and the world at large. This will help boost further growth and prosperity in the region and spread the benefits of growth more widely and evenly. It will enhance the region's competitiveness. It will help reduce poverty and promote greater environmental sustainability. The support and strong partnership of ADB, UNESCAP and other development partners will ensure that the vision of a truly pan-Asian economic community materializes.