Progress of Regional Integration and Connectivity

Purpose: Information
Submitted by: Asian Development Bank
Progress of Regional Integration and Connectivity

Session 1: Global economic and financial outlook, growing inequality, and regional connectivity/integration

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Asian Development Bank
Outline for the Presentation

- ADB Economic Outlook for Developing Asia
- Progress of Financial Integration  
  *(Pillar 1 of Cebu Action Plan)*
- Infrastructure and Financing Need  
  *(Pillar 4 of Cebu Action Plan)*

Note: Pillars 1 and 4 of the Cebu Action Plan are linked to regional integration, compared to Pillars 2 and 3 (Financial Transparency and Reform, and Financial Resilience) which are more domestically orientated.
### Regional GDP Growth (y-o-y, %)

<table>
<thead>
<tr>
<th></th>
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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Developing Asia</td>
<td>7.6</td>
<td>7.3</td>
<td>6.2</td>
<td>6.5</td>
<td>6.1</td>
<td></td>
<td>6.2</td>
<td></td>
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<tr>
<td>ASEAN</td>
<td>5.2</td>
<td>4.7</td>
<td>5.7</td>
<td>5.0</td>
<td>4.4</td>
<td></td>
<td>5.2</td>
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<td>4.4</td>
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<td>5.2</td>
<td>4.6</td>
<td></td>
<td>5.4</td>
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</tr>
<tr>
<td>Indonesia</td>
<td>5.7</td>
<td>6.2</td>
<td>6.0</td>
<td>5.6</td>
<td>5.0</td>
<td>(actual)</td>
<td>5.6</td>
<td></td>
</tr>
<tr>
<td>Other ASEAN</td>
<td>5.8</td>
<td>5.8</td>
<td>5.1</td>
<td>5.0</td>
<td>5.7</td>
<td></td>
<td>5.6</td>
<td></td>
</tr>
<tr>
<td>Newly Industrialized Economies</td>
<td>4.0</td>
<td>4.1</td>
<td>2.3</td>
<td>3.0</td>
<td>3.1</td>
<td></td>
<td>3.7</td>
<td></td>
</tr>
<tr>
<td>Republic of Korea</td>
<td>3.7</td>
<td>3.7</td>
<td>2.3</td>
<td>3.0</td>
<td>3.3</td>
<td>(actual)</td>
<td>3.8</td>
<td></td>
</tr>
<tr>
<td>People's Republic of China</td>
<td>10.0</td>
<td>9.3</td>
<td>7.7</td>
<td>7.7</td>
<td>7.4</td>
<td>(actual)</td>
<td>7.2</td>
<td></td>
</tr>
<tr>
<td>Japan</td>
<td>0.6</td>
<td>-0.5</td>
<td>1.8</td>
<td>1.6</td>
<td>0.0</td>
<td>(actual)</td>
<td>1.5</td>
<td></td>
</tr>
</tbody>
</table>

1 Revisions in India's historical GDP series are not comparable with earlier ADB forecasts.

Notes: Sub-regional averages are weighted by gross national income (Atlas method, current $) from *World Development Indicators*, World Bank. Developing Asia refers to the 45 members of the Asian Development Bank. ADB estimates and forecasts from *Asian Development Outlook Supplement December 2014*. Source: ADB staff estimates.
Progress of financial integration

Potential Benefits

• Efficient, productive use of capital
• Financial deepening
• More investments, higher growth
• Consumption smoothing; risk-sharing

Potential Costs

• Crisis contagion
• Debt vulnerability
• Capital misallocation; asset bubbles

Sources: ADB (2012); Agenor (2003); Azis (2011); IMF (2011); Stiglitz (2010).
Patterns of Capital Flows: (a) FDI more stable; (b) FDI dominates Developing APEC; non-FDI dominates high-income APEC

Note: Financial inflows refer to net incurrence of liabilities per asset type. Source: ADB staff estimates.
### FDI Inflows to APEC (% of total; $ billion)

<table>
<thead>
<tr>
<th>Region</th>
<th>2007</th>
<th>2012</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>APEC High Income</td>
<td>194.3</td>
<td>51.2</td>
<td>354.8</td>
<td>291.5</td>
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<td>567.9</td>
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<tr>
<td>APEC Developing Americas</td>
<td>0.2</td>
<td>21.4</td>
<td>25.5</td>
<td></td>
<td></td>
<td>45.1</td>
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<tr>
<td>APEC Developing Asia</td>
<td>2.4</td>
<td>121.2</td>
<td>56.5</td>
<td></td>
<td></td>
<td>163.0</td>
</tr>
</tbody>
</table>

Latest = 2012.
Source: ADB staff estimate
Financial (non-FDI) capital into APEC economies

**Portfolio Inflows to APEC** (% of total; $ billion)

<table>
<thead>
<tr>
<th></th>
<th>-40%</th>
<th>-20%</th>
<th>0%</th>
<th>20%</th>
<th>40%</th>
<th>60%</th>
<th>80%</th>
<th>100%</th>
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</thead>
<tbody>
<tr>
<td><strong>APEC High Income</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>531.9</td>
<td>21.3</td>
<td>1,016.2</td>
<td>1,569.4</td>
<td></td>
<td></td>
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<tr>
<td>latest</td>
<td>357.7</td>
<td>22.0</td>
<td>237.6</td>
<td>617.3</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>APEC Developing Americas</strong></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>0.4</td>
<td>4.9</td>
<td>3.6</td>
<td>8.9</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>latest</td>
<td>(4.3)</td>
<td>0.4</td>
<td>10.2</td>
<td>6.3</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>APEC Developing Asia</strong></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2007</td>
<td>0.4</td>
<td>170.3</td>
<td>68.3</td>
<td>239.0</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>latest</td>
<td>0.36</td>
<td>85.7</td>
<td>12.5</td>
<td>98.6</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

latest = 2013
Source: ADB staff estimates.
Note: Negative sign could mean a decline in price or volume.
# Financial Vulnerability Indicators—APEC Developing Economies

<table>
<thead>
<tr>
<th>Economy</th>
<th>M2/GDP</th>
<th>Short-term External Debt/Reserves</th>
<th>Non-FDI/Total Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>APEC Developing Americas</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Chile</td>
<td>0.82</td>
<td>0.05</td>
<td>0.50</td>
</tr>
<tr>
<td>Mexico</td>
<td>0.33</td>
<td>0.07</td>
<td>0.61</td>
</tr>
<tr>
<td>Peru</td>
<td>0.43</td>
<td>0.07</td>
<td>0.10</td>
</tr>
<tr>
<td>APEC Developing Asia</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brunei Darussalam</td>
<td>0.70</td>
<td>0.17</td>
<td>—</td>
</tr>
<tr>
<td>People's Republic of China</td>
<td>1.95</td>
<td>0.43</td>
<td>0.18</td>
</tr>
<tr>
<td>Indonesia</td>
<td>0.41</td>
<td>0.03</td>
<td>0.45</td>
</tr>
<tr>
<td>Malaysia</td>
<td>1.44</td>
<td>0.24</td>
<td>0.77</td>
</tr>
<tr>
<td>Papua New Guinea</td>
<td>0.53</td>
<td>0.08</td>
<td>—</td>
</tr>
<tr>
<td>Philippines</td>
<td>0.70</td>
<td>0.10</td>
<td>0.15</td>
</tr>
<tr>
<td>Thailand</td>
<td>1.35</td>
<td>0.25</td>
<td>0.38</td>
</tr>
<tr>
<td>Viet Nam</td>
<td>1.17</td>
<td>0.23</td>
<td>0.41</td>
</tr>
</tbody>
</table>

Latest refers to 2013 data.

For Non-FDI/Total Liabilities, change is computed against 2008 values, except for Indonesia (2010).

Source: ADB staff estimates.
- Asymmetric monetary policy adjustments in the US, Japan, and the Euro zone

- What policy choices (by developing countries) can confer monetary policy autonomy?
How do we tell?

\[
\text{Change in Monetary Policy} = \text{As Required Purely by Changes in Domestic Conditions} + \text{As a Byproduct of Spillover from Foreign Monetary Shocks}
\]

- How big is the second part?
  - Flexible nominal exchange rate regime;
  - Capital controls

- ADB research by X. Han and S.J. Wei
Results from the data

- In spite of the textbook theory, a flexible nominal exchange rate does not confer monetary policy autonomy.
  - Reason: hard to tolerate either depreciation or appreciation

- In comparison, capital controls do seem to provide some insulation from foreign monetary shocks.
Capital controls vs exchange rate regime

**APEC High Income**

- Australia
- Canada
- Japan
- New Zealand
- Russian Federation
- United States

**APEC Developing Asia**

- Hong Kong, China
- Indonesia
- Malaysia
- Papua New Guinea
- PRC
- Republic of Korea
- Singapore
- Thailand
- the Philippines
- Viet Nam

Note: PRC = People’s Republic of China

Sources: The Chinn-Ito website; IMF.

1Capital Controls Index = 1 - the Chinn-Ito index normalized to range between zero and one; Exchange Rate Regime category based on IMF classification
Inclusive finance can help reduce inequality

- Rising inequality has emerged as an important policy question
- **ADB research:** Financial development does not automatically lead to economic inclusion.
  - Some evidence of a non-linear relationship between financial development and inequality.
- **Policymakers must pay attention to financial inclusion:**
  - Expanding household access to financial products
  - Strengthening SMEs access to finance
There is room to improve financial inclusion in Developing APEC

Selected Financial Inclusion Indicators (2011)

Note: SMEs are defined as enterprises with 5-99 employees.
Source: G20 Financial Inclusion Indicators.
Infrastructure development—benefits likely to outweigh costs

**Potential Benefits**

- Lower transport and logistics cost
- Increased trade and investment
- More integrated markets
- Improved productivity and growth
- Lower poverty and inequality

**Potential Costs**

- Negative spillovers, e.g. diseases, human trafficking, security threats
- Displacement/resettlement costs
- Environmental degradation

Sources: ADB 2012; Fujimura (2004); Bourguignon and Pleskovic (2007)
Large physical infrastructure gap between developing and high-income APEC economies

Electricity consumption—APEC (kWh per capita)

Access to clean water —APEC (% of population)

Note: Population used as weights for regional averages. For electric power consumption, data excludes Papua New Guinea. For access to clean water, data excludes Brunei Darussalam and Hong Kong, China.

Source: ADB staff estimates.
Soft infrastructure—room for improvement for developing APEC

Logistics Performance Index—a worldwide survey of operators on the ground (global freight forwarders and express carriers), providing feedback on the logistics “friendliness” of the countries in which they operate and those with which they trade. The index ranges from 1 to 5, with a higher score representing better performance. Source: ADB staff estimates.
Developing Asia’s infrastructure needs—particularly electricity—are large

Infrastructure Needs in Developing Asia (2008 $, billion, 2010-2020)

$750 bn per year * for 2010-2020

*The yearly expenditure was obtained by dividing $8.2 trillion infrastructure needs by 11 years. Of the $8.2 trillion, $320 billion are regional projects.

Source: ADB and ADBI (2009).

Economic Research and Regional Cooperation Department
Infrastructure investments face many challenges

<table>
<thead>
<tr>
<th>Challenge</th>
<th>Public</th>
<th>Private</th>
</tr>
</thead>
<tbody>
<tr>
<td>Large-scale investment, huge sunk costs, long pay-back periods</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Conflicting objectives (national vs. local, economic vs. political, short-term vs. long-term)</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Weak governance (coordination failure, corruption)</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Insufficient capacity to originate, implement, or manage infrastructure projects</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Fraught with risks in developing countries</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Political risks, e.g. sovereign default/expropriation</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Regulatory risks, e.g. inconsistent/discriminatory regulation</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Social and environmental issues, e.g. resettlement</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

More challenges in the case of cross-border infrastructure: varying political, regulatory, and administrative regimes; uneven distribution of benefits; and higher investment costs

Sources: Brooks and Go (2011); De, Samudram, and Moholkar (2010); UNTT Working Group on Sustainable Development Financing (2013)
Adverse regulatory changes and breach of contract are of most concern to investors.

### Types of Political Risk of Most Concern to Investors in Developing Economies

(% of total respondents, next 12 months)

<table>
<thead>
<tr>
<th>Risk Type</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adverse regulatory changes</td>
<td>56</td>
</tr>
<tr>
<td>Breach of contract</td>
<td>45</td>
</tr>
<tr>
<td>Foreign exchange restrictions</td>
<td>37</td>
</tr>
<tr>
<td>Civil disturbance</td>
<td>30</td>
</tr>
<tr>
<td>Non-honoring of financial obligations</td>
<td>27</td>
</tr>
<tr>
<td>Expropriation</td>
<td>19</td>
</tr>
<tr>
<td>Terrorism</td>
<td>11</td>
</tr>
<tr>
<td>War</td>
<td>6</td>
</tr>
</tbody>
</table>

ADB’s 3-pronged solution to connectivity

- **Regional infrastructure connectivity support**
  - During the last 2 decades, the ADB mobilized more than $35 billion for regional connectivity in the Asia-Pacific region.

- **Trade facilitation support at national level and at border**
  - During the last 5 years, Asia has actively implemented customs modernization and trade facilitation reforms.
  - As a result, for example, Asia has improved its accession level to the International Convention on Simplification and Harmonization of Customs Procedures (Kyoto Convention) by 14-% point reaching 40% of the 45 ADB DMCs.

- **Trade finance program**
  - ADB TFP supported $16.1 billion for over 7,181 transactions, mobilized $9.8 billion co-financing, 4,591 SMEs, and serving 18 DMCs in Asia
Subregional infrastructure projects

- **CAREC**: $24.6bn, 158 projects (2001-2014)
- **GMS**: $17.1bn, 70 projects (1992-2014)
- **SASEC**: $6.5bn, 34 projects (2001-2014)
- **BIMP-EAGA**: $0.1bn, 1 project (2006-2010)
- **IMT-GT**: $5.2bn, 11 projects (2013-2016)
- **ASEAN**: Association of Southeast Asian Nations
- **BIMP-EAGA**: Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area
- **BIMSTEC**: Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation
- **CAREC**: Central Asia Regional Economic Cooperation
- **GMS**: Greater Mekong Subregion
- **IMT-GT**: Indonesia-Malaysia-Thailand Growth Triangle
- **PDMD**: Pacific Developing Member Countries
- **SAARC**: South Asian Association for Regional Cooperation

Source: ADB regional departments.
Key Messages

- Economic outlook for APEC relatively optimistic

- Financial integration:
  - Developing APEC relies more on FDI; advance APEC on non-FDI
  - Signs of potential financial vulnerability in APEC require vigilance
  - Capital controls can confer monetary policy autonomy
  - Inclusive finance can help reduce inequality

- Infrastructure Investments
  - Hard/soft infrastructure needs in Developing APEC are big
    - Especially investments in power generation
  - Multiple challenges constrain private sector infrastructure investment
    - Political and regulatory risks are of most concern to investors
Thank You!

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