Role of RCI in Addressing Developing Asia's Long-term Challenges

Yasuyuki Sawada
Chief Economist and Director General
Economic Research and Regional Cooperation Department
Asian Development Bank

International Conference on Regional Integration and Economic Resilience
13 June 2017 | Korea University, Seoul, Republic of Korea

Outline

- Development Progress in Asia
- Long-Term Development Challenges
- Role of Regional Cooperation and Integration in Addressing the Challenges
  - Trade and Investment Integration

Development Progress and Challenges in Asia

ADB

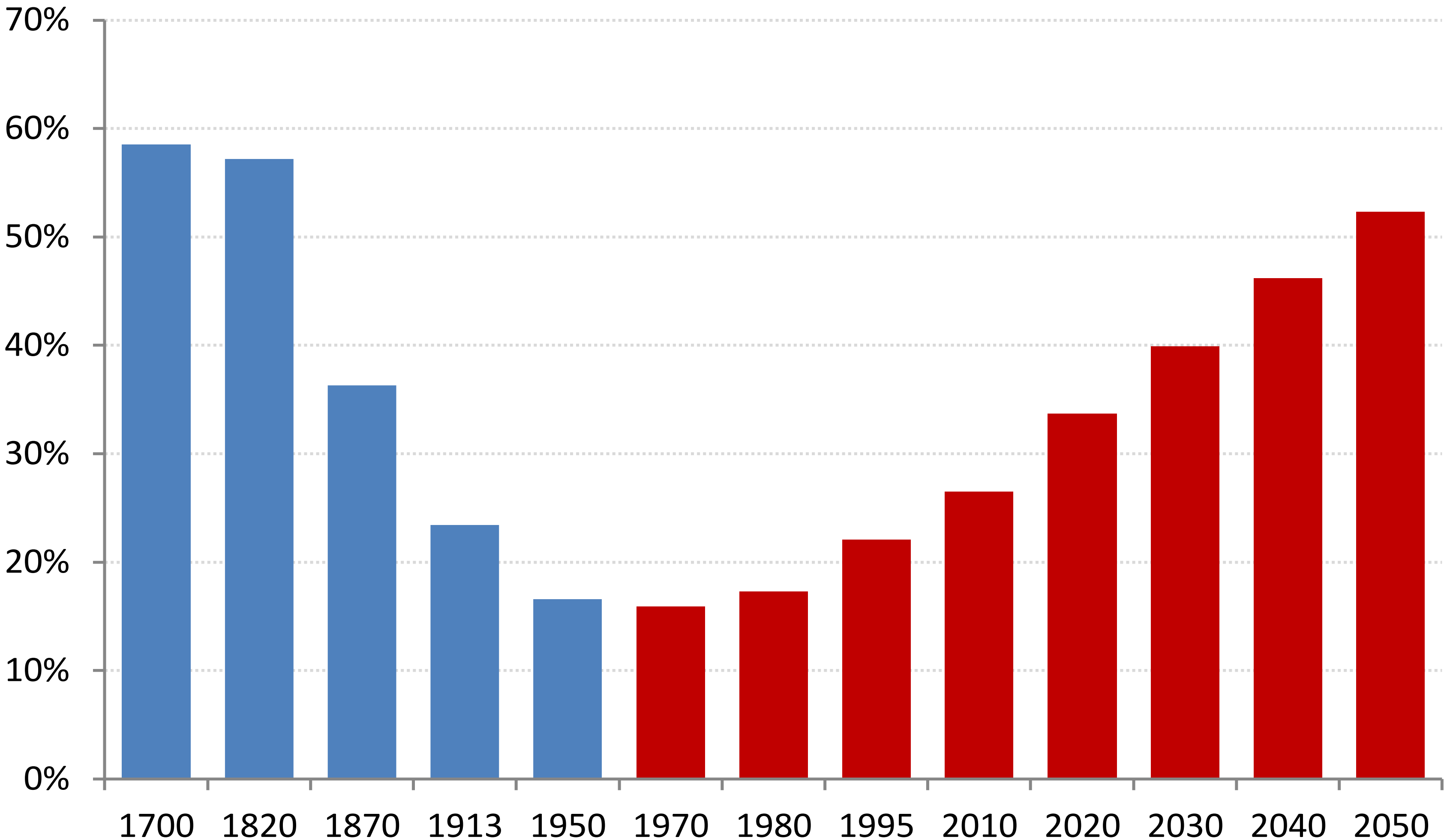
Development progress in Asia

	Poverty Poverty headcount (% of population)	Health Life expectancy (years, median)	Education Survival rate (%, median)	Water Improved water source (% of population with access)	Electricity Access to electricity (% of population)
Initial	66% (1980s)	56 | 51 (1960)	76% (1980s)	70% (1990)	72% (1990)
Latest	11% (2010–2014)	73 | 68 (2014)	89% (2010–2014)	93% (2015)	88% (2012)

GNI = gross national income.
Notes: Poverty headcount is based on $1.90 per day (2011 purchasing power parity) poverty line.
Survival rate is for the last grade of primary education, both sexes. GNI is based on Atlas method, current $.
Source: ADB calculations using data from World Development Indicators, World Bank.

ADB

Asian share of world GDP



Source: Asia 2050: Realizing the Asian Century

ADB

Challenges for a more prosperous and inclusive future

- Maturing global value chains and slowing global trade
- Closing the infrastructure gap
- Investing in human capital
- Scaling up innovation and technological upgrading
- Addressing rising income inequality
- Managing population aging
- Moving towards low carbon growth

ADB

Role of RCI in Addressing the Challenges

Progress of Regional Integration in Asia

(intraregional shares as % of total)

	Trade	FDI	Equity	Debt	Migration	Remittances
2001	53%	47%	12%	8%	42%	33%
Latest	57% (2016)	53% (2015)	20% (2016)	18% (2016)	37% (2015)	28% (2015)

FDI = based on inward foreign direct investment (flows data); Equity = based on equity asset holdings (stock data); Debt = based on debt asset holdings (stock data).

Notes:

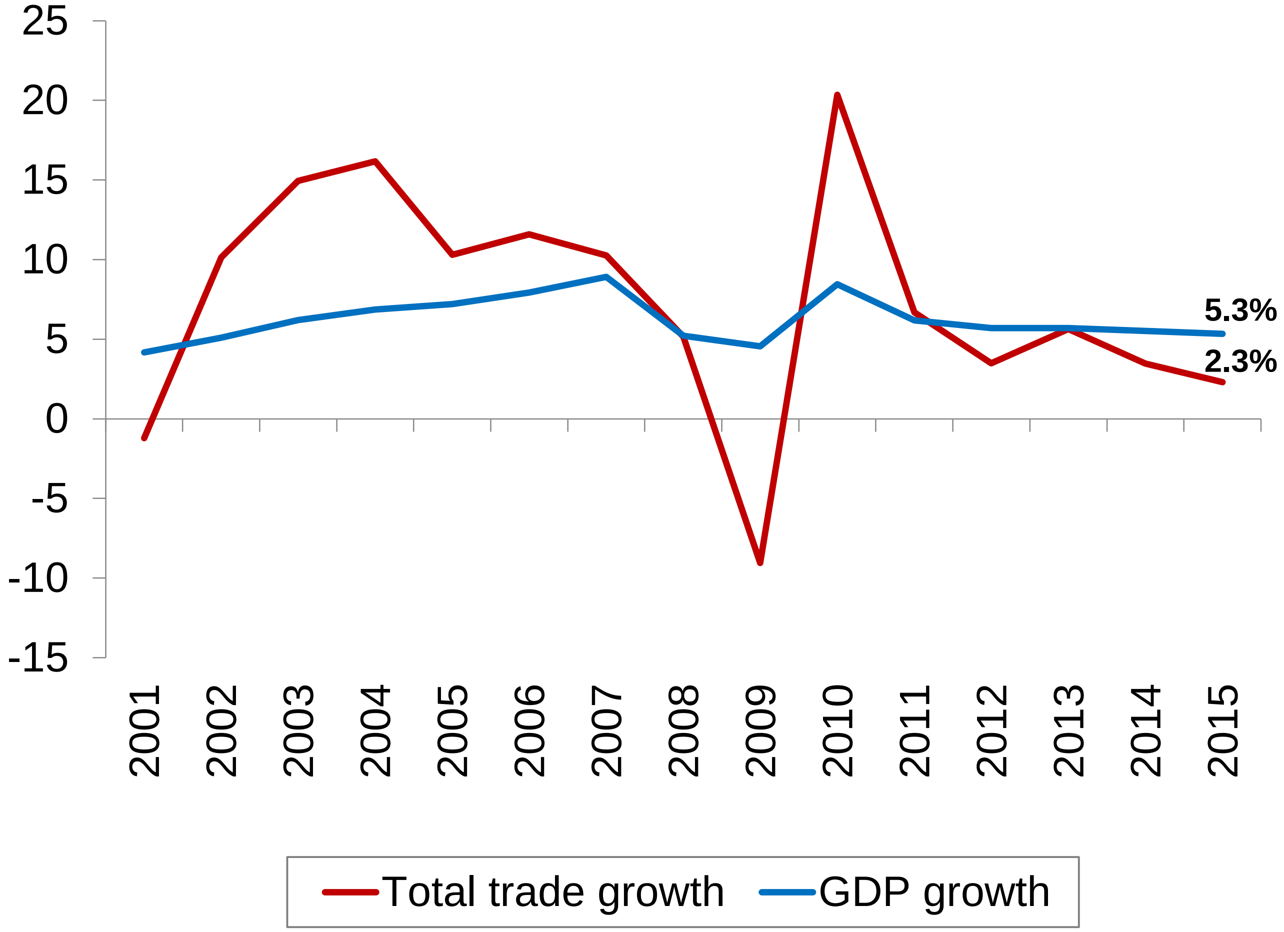
1. Trade, equity and debt data as of January to June 2016 (H1 2016).
2. Migration data in 2001 and 2015; available every 5 years.
3. Remittance data only available starting in 2010.

Source: ADB calculations using data from Association of Southeast Asian Nations (ASEAN) Secretariat, International Monetary Fund, Organisation for Economic Co-operation and Development, United Nations, World Bank, and national sources.

Trade and Investment Integration

ADB

Trade growth slowing down in Asia



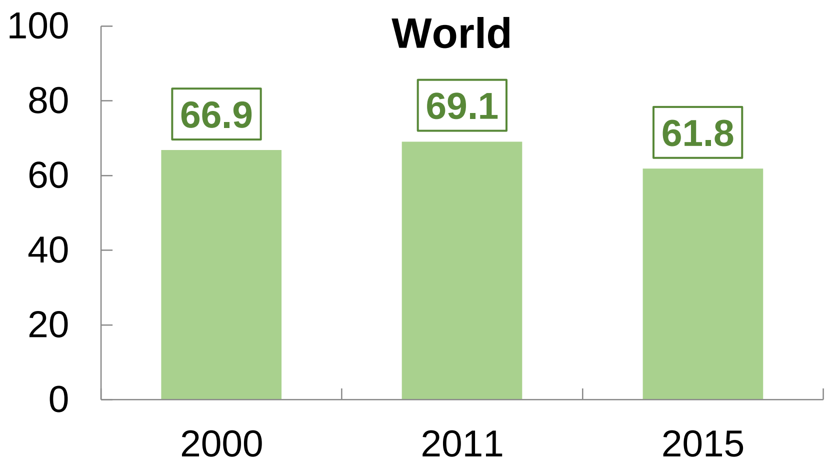
Possible causes:

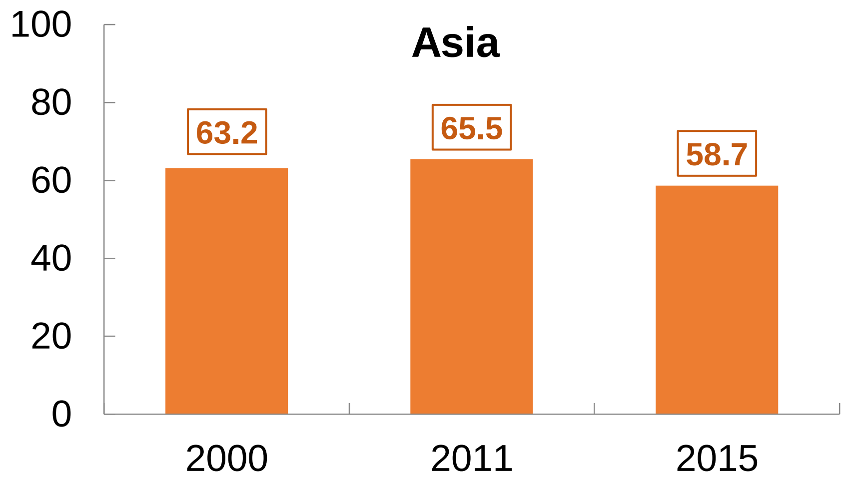
- Weak global recovery
- PRC's growth moderation and structural transformation
- Slower growth of GVC trade
- Increasing use of nontariff measures

* Trade growth is in volume terms

Slower expansion of global value chains

GVC Participation Rate (%)



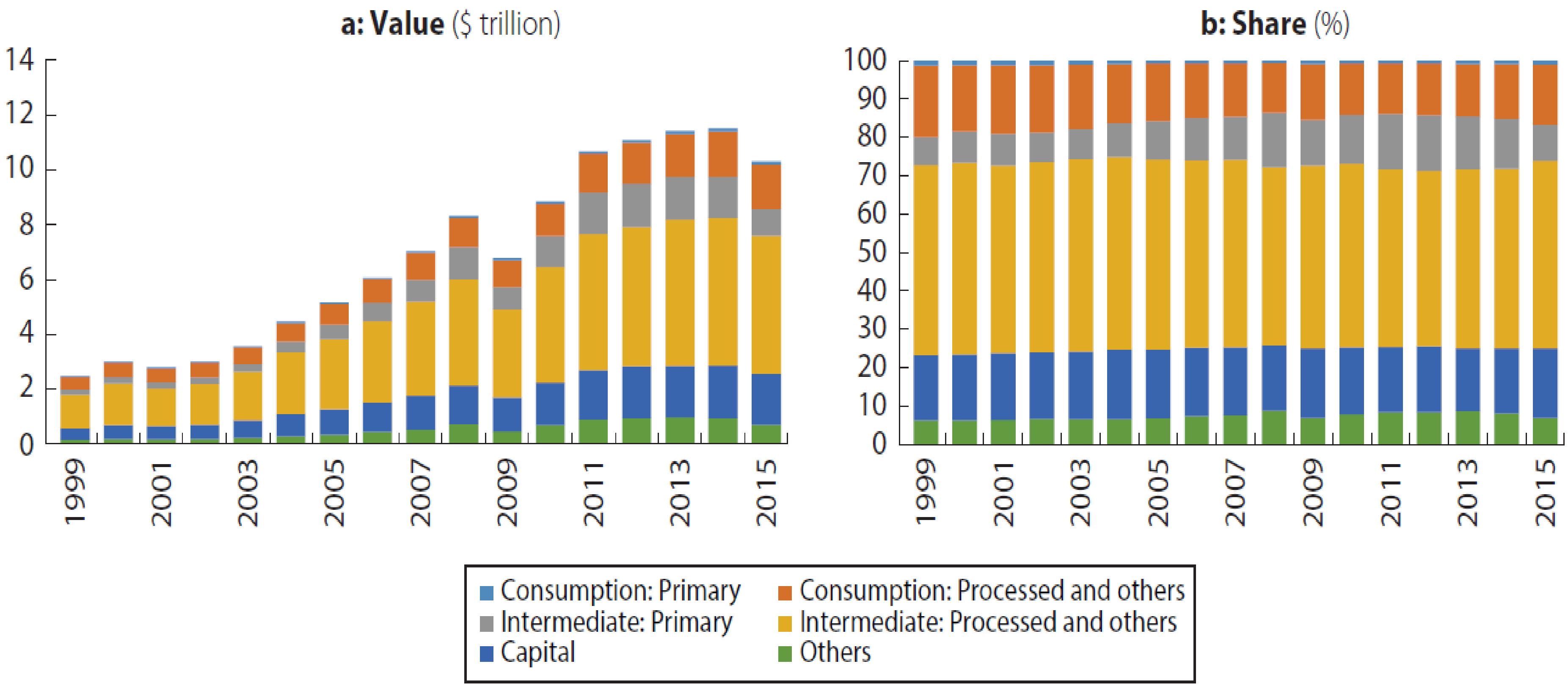


- GVC participation rate increased from 2000 to 2011, but declined from 2011 to 2015 to an even lower level than in 2000
- Asia is no exception

Note: GVC participation rate is calculated by (value added exports using domestically or foreign produced intermediates, excluding double counted terms) / gross exports. Value added decomposition of gross exports data are based on ADB's Multi-Regional Input-Output Table.

Intermediate goods trade also slowed

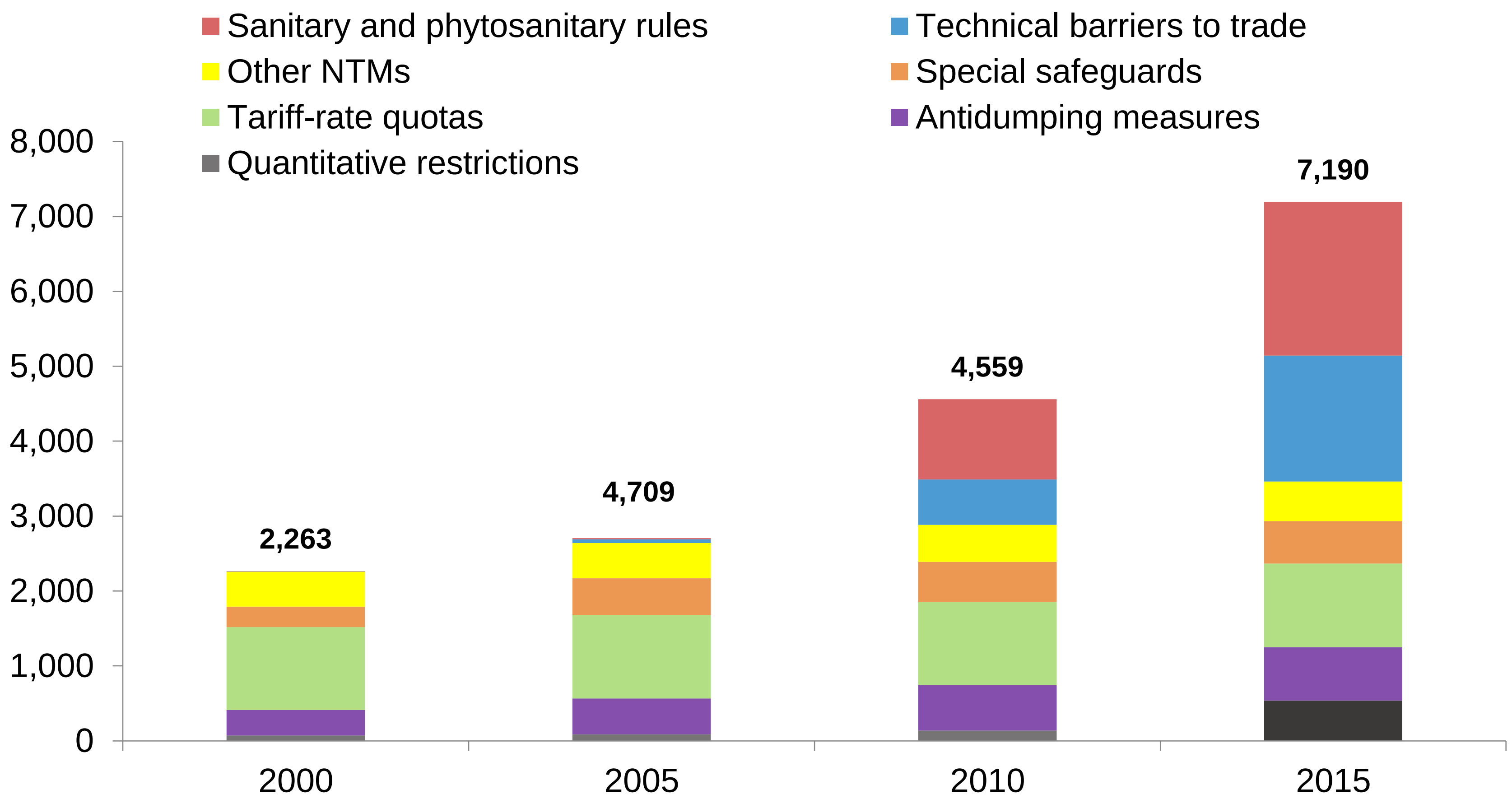
Total Trade by Commodity Groups—Asia



Note: Based on Broad Economic Categories.
Source: ADB calculations using data from United Nations. Commodity Trade Database. https://comtrade.un.org (accessed October 2016).

ADB

Nontariff measures imposed against developing Asia increasing

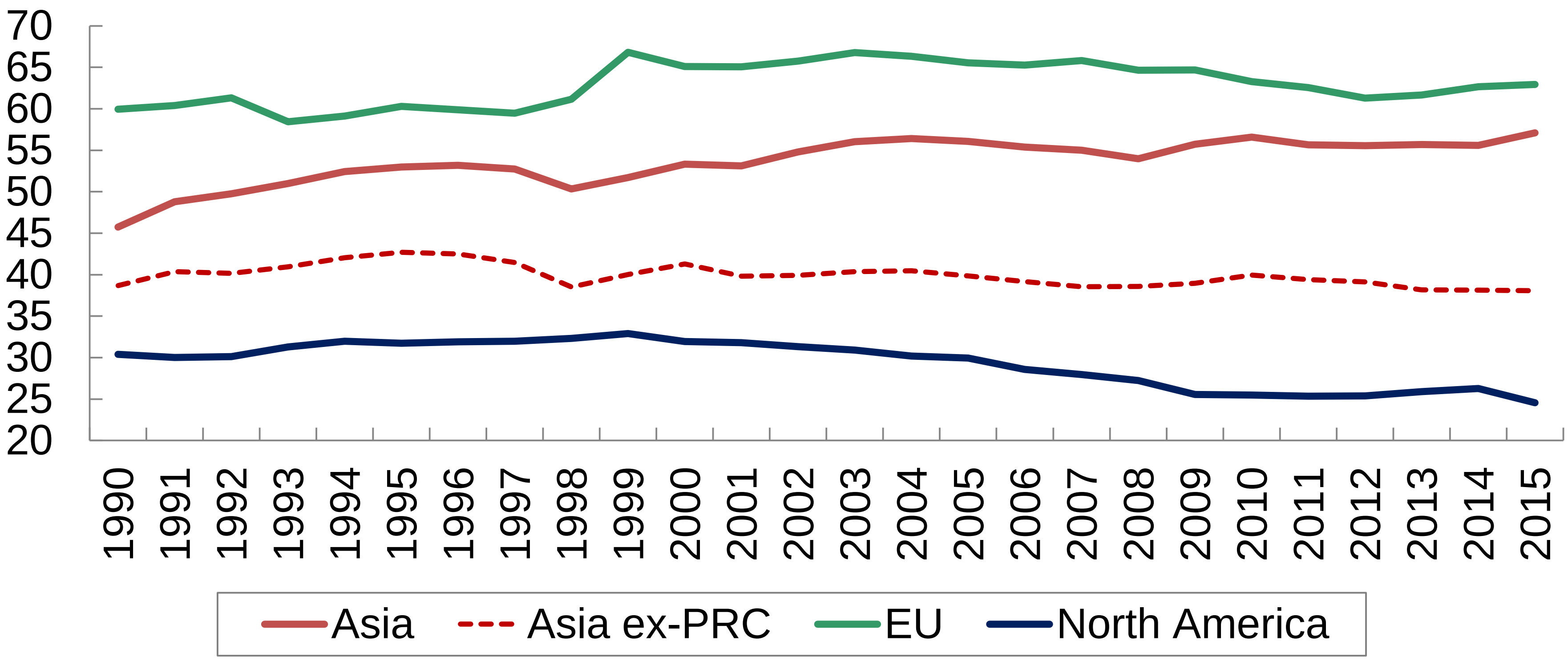


Note: A stock approach is used wherein measures in force at the selected date are recorded. Measures in force are discounted from measures initiated, and measures withdrawn are discounted from measures in force. Nontariff measures include antidumping actions, countervailing duties, quantitative restrictions, safeguards, sanitary and phytosanitary rules both regular and emergency, special safeguards, regular technical barriers to trade, tariff-rate quotas, and export subsidies.

Source: World Trade Organization. Integrated Trade Intelligence Portal. www.wto.org (accessed 31 August 2016).

Despite slowdown in overall trade, intra-Asia trade share increased

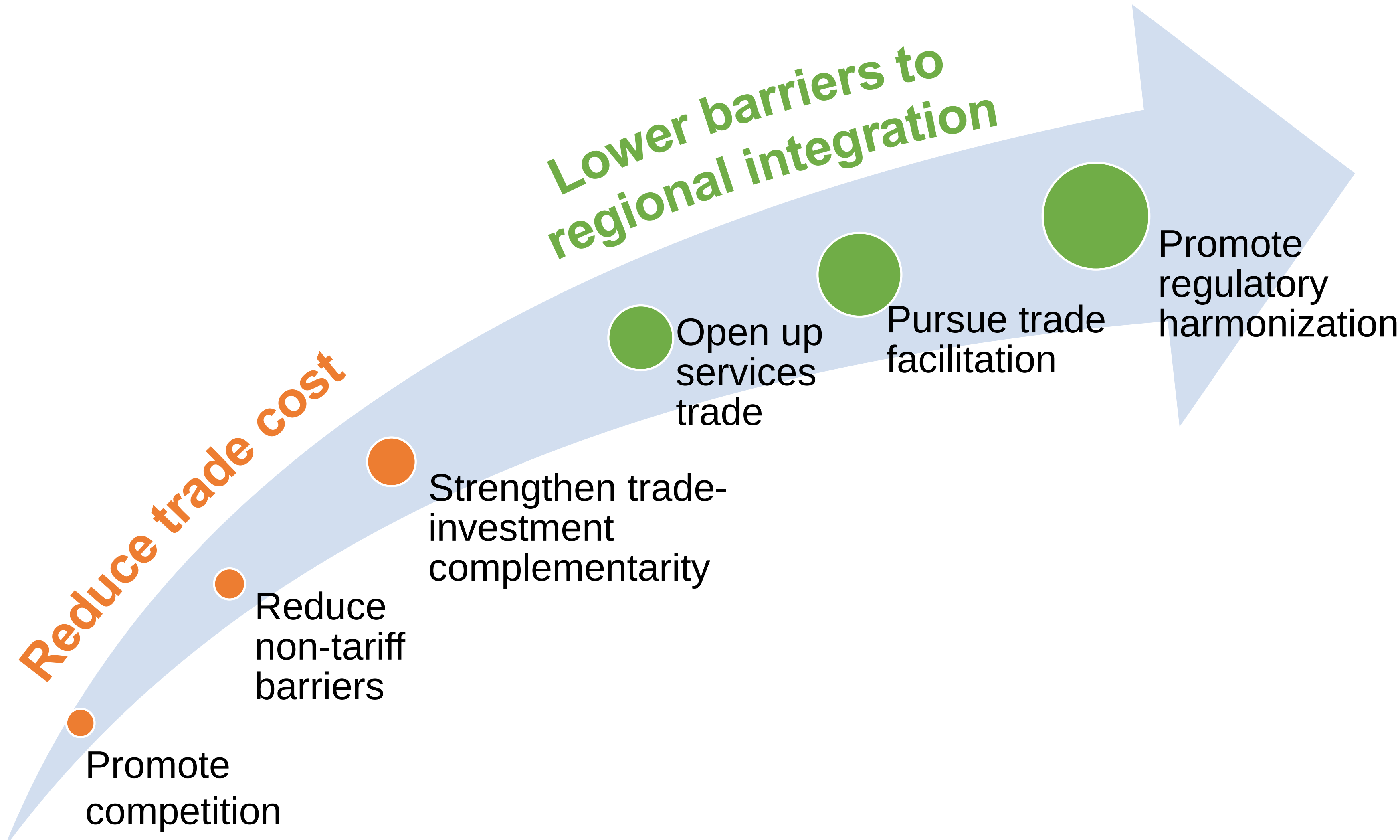
Intraregional Trade Shares—Asia, EU, North America (%)



Note: European Union (EU) refers to the aggregate of the 28 EU members . North America covers Canada, Mexico, and the United States.
Source: ADB calculations using data from the CEIC database; and *Direction of Trade Statistics*, International Monetary Fund.

ADB

Reinvigorating Regional Trade Growth and Integration

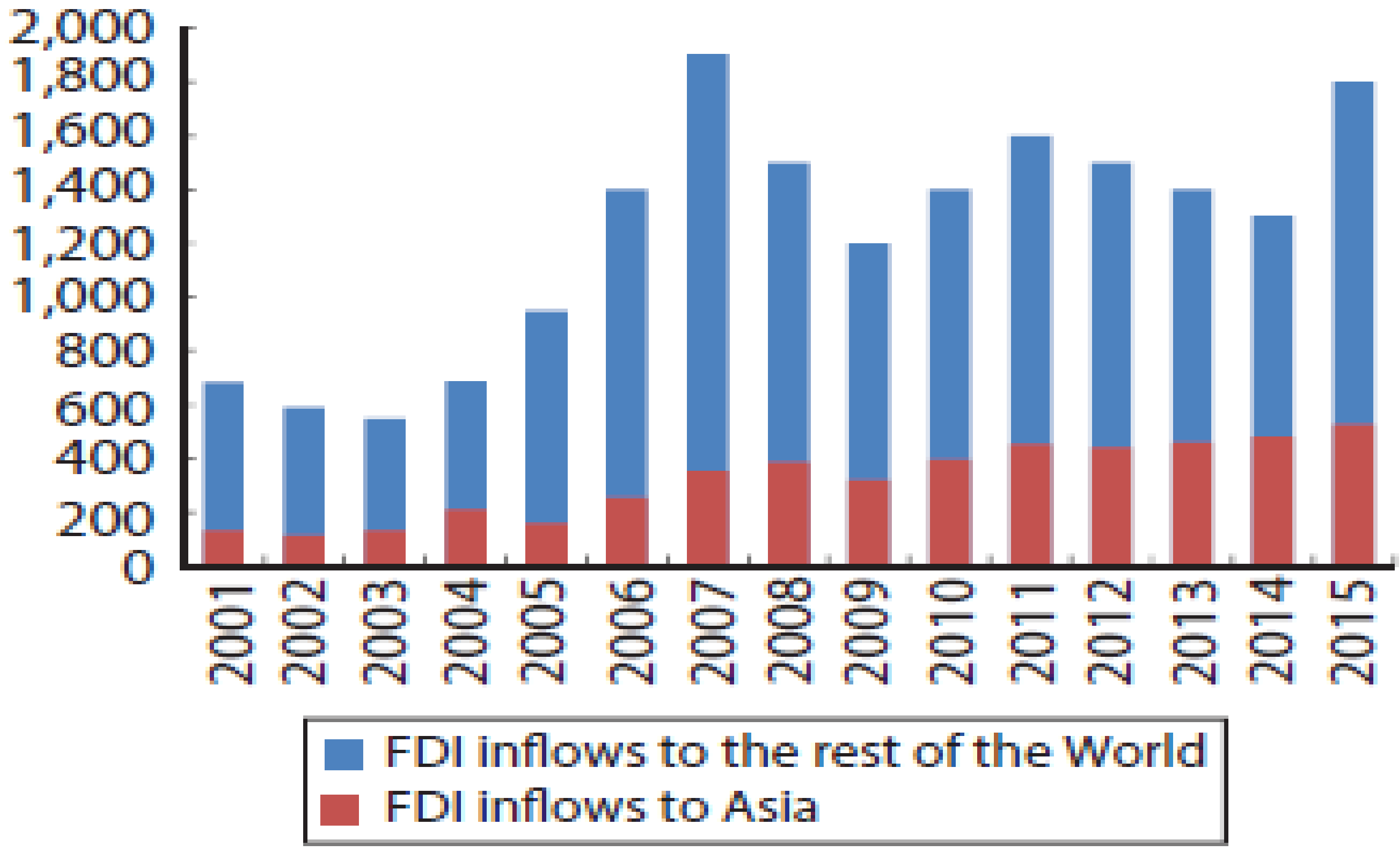


Policy responses to Trade Growth Slowdown

- Continue to deepen global/regional value chains
  - ✓ In economies with low GVC participation, reforms can improve business environment and facilitate GVC participation
- Promote service trade by reducing restrictions in market access and skill gaps, among others
- Continue to liberalize trade and resist protectionism
  - ✓ Reduce residual import tariff
  - ✓ Reduce non-tariff trade barriers and promote greater cooperation in trade facilitation
  - ✓ Conclude mega-regional trade agreements such as RCEP and APEC free trade area.
- Improve regional connectivity to reduce trading cost.

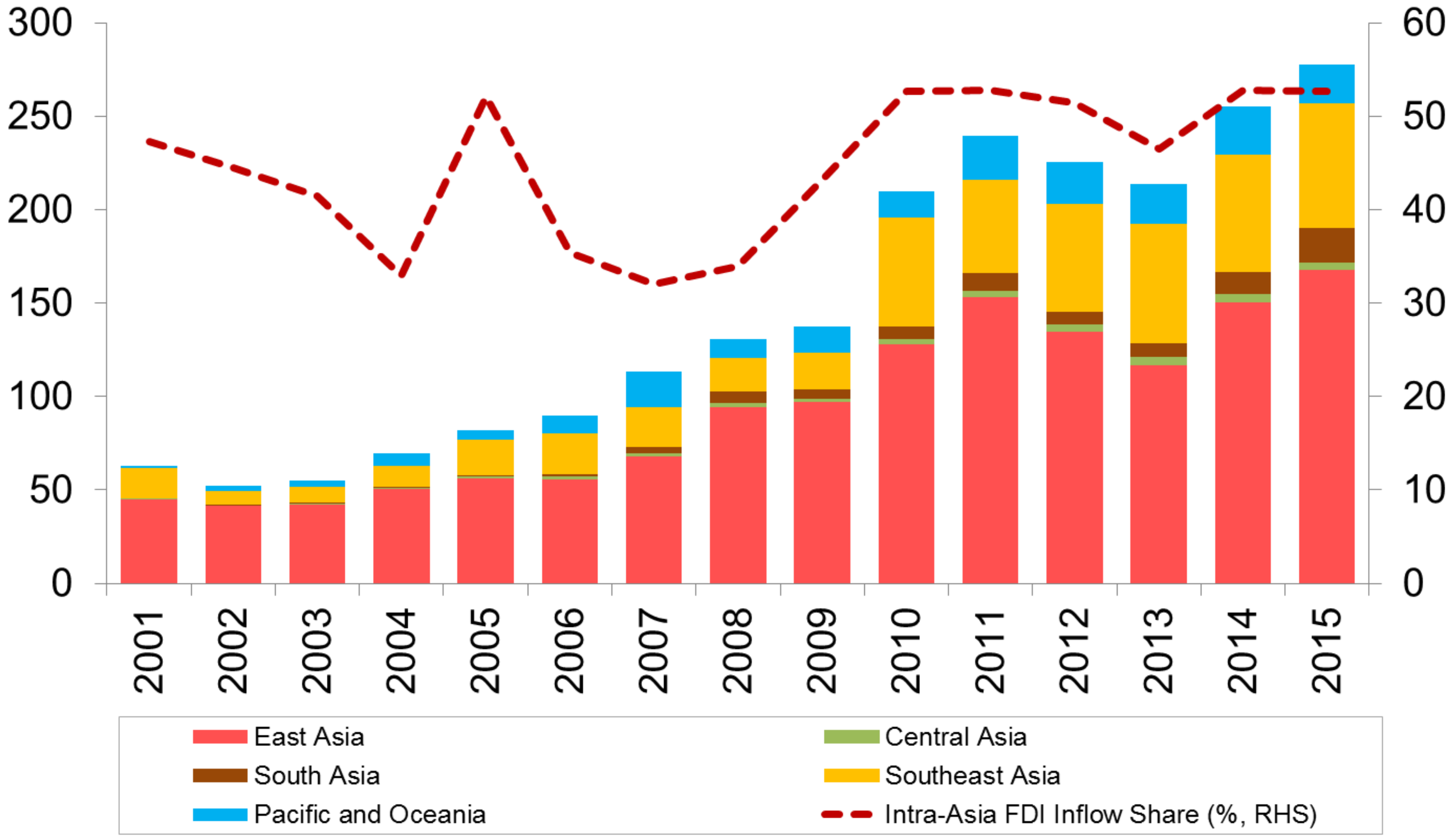
ADB

Total FDI Inflows ($ billion)



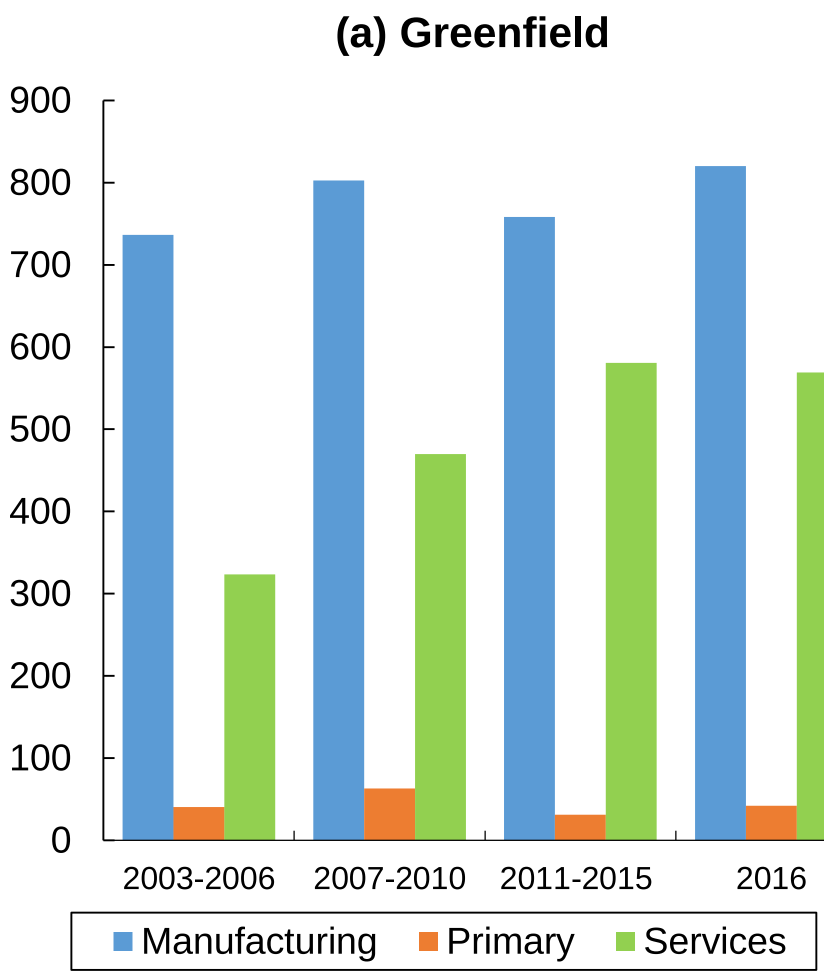
FDI = foreign direct investment.
Source: ADB calculations using data from ASEAN Secretariat, Eurostat, OECD, UNCTAD, and national sources.

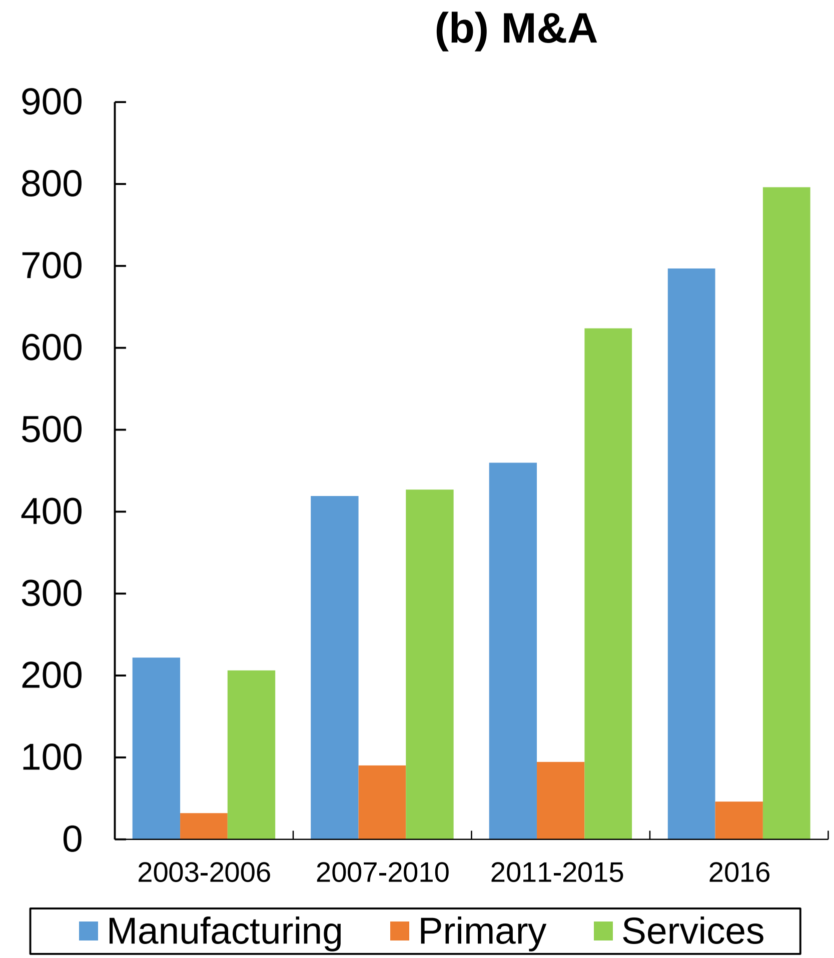
Intra-Asia FDI Inflows ($ billion)



Source: ADB calculations using data from ASEAN Secretariat, Eurostat, OECD, UNCTAD, and national sources.

Intra-Asian FDI by sector, mode of entry
(Number of Projects)





FDI = foreign direct investment, M&A = merger and acquisition.
Source: ADB calculations using M&A data from Zephyr database, and fDi Markets, Financial Times.

Patterns—GVC-FDI: Most common country pairs

Destination	Origin	No. of Affiliates that Import and Export	% of Affiliates that Import and Export
1. PRC	Japan	2,260	81%
2. PRC	Hong Kong, China	1,314	76%
3. PRC	United States	646	74%
4. PRC	Germany	625	76%
5. PRC	Taipei,China	401	79%
6. PRC	Korea	358	86%
7. PRC	Singapore	337	71%
8. Viet Nam	Japan	306	72%
9. Thailand	Japan	258	64%
10. Indonesia	Japan	214	53%
11. Taipei,China	Japan	212	74%
12. PRC	France	177	77%
13. Malaysia	Japan	175	78%
14. Philippines	Japan	171	69%
15. Singapore	Japan	164	54%

Trade-Investment Nexus

- FDI in Developing Asia is closely related to global value chains (GVCs) in the manufacturing sector, with abundant labor, low trade barriers, and downstream specialization helping attract GVC-linked FDI, often geared to re-exporting intermediate and final goods to home/third country.
- 57% of all foreign owned firms in Asia (and 70% in the manufacturing sector) are engaged in GVC-related activities, compared with only 11% of domestically owned firms.
- Asian owned firms are engaged more in GVC related activities (67%) compared to those owned by non-Asian multinationals (45%)
- Japan is the largest source of GVC-linked FDI in Asia followed by Republic of Korea, while PRC is the most popular host.
- Multinationals from India and PRC are also internationalizing rapidly, with 32% and 21% of Indian and PRC owned firms engaged in GVC related activities.

ADB

Downside risks to investment outlook

- Still fragile external environment

- Threat of growing protectionism

  US withdrawal from Trans-Pacific Partnership (TPP); growing non-trade barriers;

- US Fed interest rate hikes and high private sector debt in Asia

  Vulnerability to growth slowdown; capital flow disruptions; and currency depreciation

ADB

How to continue attracting FDI ?

- Institutional qualities–proxied by perception-based measures of regulatory quality, government effectiveness, and rule of law; and ease of doing business matter significantly for attracting FDIs
- Continue to leverage labor abundance to attract export-oriented multinationals, particularly from within the region, by lowering trade barriers and fostering greater input-output links within the domestic economy.
- Regional trade and investment agreements help attract FDI, especially from north to south, by improving business environment, reducing trade costs, and granting non-discrimination (such as national treatment) status.
- Bilateral Investment Treaties (BIT) can facilitate cross-border FDIs. In particular, investor-state dispute mechanism (ISDM) is a critical enabler.

Key Messages

- Regional cooperation and integration (RCI) could help in supporting the region's progress and addressing the challenges it is facing
- Policy priorities:
    - Despite the uncertain global environment, the region can continue to remain a hub for foreign direct investment through credible policy reforms aimed at creating better governance and business environment.
    - Developing Asian economies need to work together to reinvigorate trade growth through cooperation that lowers trade costs and barriers for greater intraregional integration.
    - More intensive intra-Asian trade and investment integration, can guard against more inward-oriented policies in advanced economies, weak external demand and uncertain global economic environment.

ADB