

# **REGIONAL EFFORTS TO CREATE AN ATTRACTIVE INVESTMENT CLIMATE**

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<sup>1</sup> The views expressed are the authors' and do not necessarily reflect the views and policies of ADB, its Board of Directors, or the governments ADB members represent..

## **REGIONAL EFFORTS TO CREATE AN ATTRACTIVE INVESTMENT CLIMATE**

### **A. Improving Asia's Investment Climate: The Role of Regional Cooperation**

Over the last three decades, countries in Asia have made huge strides in improving their investment climates through the implementation of pro-market and outward-oriented domestic policies. While such domestic policies will continue to play a pivotal role in shaping Asia's investment climate, there is a strong case to be made for strengthening regional efforts in this area: As Asia's economies become more entwined, regional initiatives will become increasingly indispensable to address investment constraints and impediments that are inherently regional in scope.

Among other things, regional efforts can:

**Add value to national policy making and reinforce domestic liberalization efforts.**

Initiatives such as regional investment agreements could strengthen domestic liberalization gains (for example, by ensuring rights to invest) and provide legal security for cross-border investment. Indirectly, their provisions often also protect investment from non-signatories, and thus stimulate inflows from a wide range of potential partners. Their key features are legal and policy frameworks that make it easier, cheaper, and safer to invest. They have previously been used to develop industrial clusters and special economic zones, but, given Asia's rapid development, they could now be applied more widely. In its November 2002 report to the ASEAN+3 Summit, the East Asia Study Group recommended that East Asia explore expanding the ASEAN Investment Area into an East Asia investment area. Because many of the region's economies are now both important investors as well as host countries, such an agreement could stimulate FDI inflows as well as ensure the safety and productivity of investment outflows.

**Provide the necessary cross-border infrastructure—transport, communication, and energy links among Asian economies—that is critical to attracting investments.** Measures to improve domestic investment climates will have limited success in the absence of cross-border infrastructure that adequately connects national markets. Cost estimates of Asia's needs for new infrastructure by 2015 top \$4.7 trillion, much of it to facilitate cross-border connectivity. According to an internal ADB estimate, developing the region's infrastructure will require \$4.7 trillion in investment during

2006–2015—\$3.1 trillion for new capacity and \$1.6 trillion for replacing existing infrastructure. Investment in power and roads would account for about two thirds of total needs. Improved regional connectivity will provide the greatest benefit to small, landlocked developing countries, which are constrained by their market size and geographical location.

**Manage the spillover effects of economic activity and policy among connected economies**, which inevitably grow with deeper economic integration, and which invariably compromise domestic investment climates. The ongoing global financial crisis and the 1997/98 Asian financial crisis are stark reminders of how economic mismanagement in one country can lead to falling trade and investments in others. But routine macroeconomic changes—such as interest rate or currency movements—can also have significant impacts on domestic investment climates. This calls for monitoring regional macroeconomic activity as well as for policy dialogue.

**Liberalize investment beyond levels achievable through global negotiations.** This can be accomplished by establishing regional rules and institutions that enable countries to further integrate markets and by helping to harmonize standards, regulations, and processes so that businesses can operate more effectively in different economies.

Apart from addressing regional constraints and impediments to investment, regional efforts will be critical to **deal with the phenomenon of increasingly complex, overlapping and costly standards and regulations**. One strategy that could be adopted is to work toward converging regional standards regulatory frameworks. Such frameworks can reduce the transaction costs resulting from overlapping and contradictory regulations.

**Regional efforts will also be critical in mitigating the possible negative impacts of unilateral domestic policies.** Fierce competition for foreign investments can lead to a “race to the bottom” in terms of regulations and standards. Pursuing harmonization at the regional level would prevent such a race to the bottom, and perhaps occasion a “race to the top.”

## **B. ADB's Mandate and Role in Catalyzing Investments and Improving the Region's Investment Climate**

Over the years, ADB has provided substantial assistance to its developing member countries (DMCs) to catalyze investments, primarily through direct financing, credit enhancements, and risk mitigation instruments, through its Private Sector Operations. While ADB's participation is usually limited, it leverages a large amount of funds from commercial sources to finance private sector projects. ADB is viewed as a neutral long-term investor committed to the highest standards of corporate conduct; its presence is seen as a source of comfort by other lenders and investors. ADB's role in sovereign risk mitigation is now much more critical as the crisis-affected DMCs try to regain the confidence of foreign investors and lenders.

Aside from contributing finance that is not available on reasonable terms elsewhere and catalyzing funding from other financiers, ADB's involvement can, more importantly, exert influence on regulatory reform advocacy and dialogue. Having worked with governments of the region over the past four decades, ADB has earned a reputation as an honest broker and partner in development. This allows it to facilitate constructive dialogue with host governments, especially in matters pertaining to regulatory frameworks and change.

ADB's initiatives under the PSO are complemented by regional efforts pursued under its Regional Cooperation and Integration Strategy. Adopted in July 2006, the strategy involves four interrelated pillars:

1. Cross-border infrastructure and related software;
2. Trade and investment cooperation and integration;
3. Monetary and financial cooperation and integration; and
4. Cooperation in regional public goods.

A number of activities pursued under these four pillars would have an impact on the investment climate of DMCs individually, as well as the region as a whole. Of these activities, four key efforts are worth mentioning here:

1. **Developing Cross-Border Infrastructure and Related Software.** Physical connectivity plays an indispensable role in improving the investment climate. Physical connections—particularly robust transport and communication links—are

essential for the movement of goods, services, capital, people, and information across countries. As such, of ADB's support to RCI has focused on the development of cross-border infrastructure and related software. The bulk of these have gone to ADB's Greater Mekong Subregion or GMS program. The initial focus of the GMS was on connectivity; improving cross-border links in transport, power and telecommunications, in keeping with the economic corridor approach to development adopted by the GMS countries during the 8th GMS Ministerial Meeting held in Manila in 1998. ADB has coordinated approximately \$10 billion of investment in the GMS, largely in these areas. ADB has assisted in mobilizing funds through direct coordination with development partners and the private sector. The Central Asia Regional Cooperation Program, or CAREC, has likewise sought to promote shared infrastructure projects.

In addition to investments in hard infrastructure, ADB has also supported the development of soft infrastructure, through the harmonization of regulations, procedures and standards. The GMS Cross-Border Transport Agreement (CBTA), for instance, is a compact and comprehensive multilateral instrument that covers all the relevant aspects of cross-border transport facilitation in one document. The CAREC program is also working on improving the region's policy environment in priority areas.

2. **Securing regional macroeconomic and financial stability.** Securing regional macroeconomic and financial stability is critical to managing volatility in increasingly integrated markets – volatility which invariably compromise affect domestic investment climates. ADB supports a number of initiatives in this regard, including the ASEAN+3 Economic Review and Policy Dialogue (ERPD); the Chiang Mai Initiative (CMI); and the Asian Bond Markets Initiative. ADB's role in these regional forums and initiatives has been significant. At the request of the countries and regional groupings, ADB supports regional policy dialogue and other initiatives such as ASEAN, ASEAN+3, APEC, and ASEM. ADB also plays a key role in capacity building and institutional strengthening of many of these regional groupings. ADB undertakes policy-relevant analytical work on various issues related to regional monetary and financial cooperation and integration, regional economic surveillance, early warning systems, capital flows and capital market developments, financial sector reforms and restructuring, and regional exchange rate arrangements.

3. **Promoting Convergence in Regulations and Standards.** As the region becomes more integrated, improving the investment climate will increasingly hinge on the convergence of regulations, procedures, and standards toward international best practices. ADB has pursued a number of efforts towards this end, encompassing accounting and auditing standards; timely and accurate disclosure rules; sound environmental, labor, and social standards; provisions for adequate protection of minority shareholder rights; and effective bankruptcy and foreclosure regimes. Apart from a range of regional training activities directed at regulators and legislators, ADB's key activities have involved stand alone programs and projects with regulatory reform objectives, and loans and technical assistance with significant regulatory reform components. Many of these activities have been pursued as part of ADB's Private Sector Development Strategy and Private Sector Operations.
  
4. **Creating, consolidating, and disseminating knowledge and information about the region's investment climate.** As part of its Knowledge Management objectives, ADB produces a range of knowledge products which support economic policy formulation and dialogue on catalyzing investments. Chief among these is the Investment Climate and Productivity Study (ICS), which has been undertaken in collaboration with the World Bank. The ICS examines constraints to firm growth and productivity in selected Asian developing countries to help identify specific policy and institutional reforms to promote investments and improve productivity. The ICS surveys were initially undertaken in the Philippines and Indonesia in 2003, followed by Sri Lanka in early 2004, and Lao PDR in 2005.

### **C. Strategy 2020: Future Priorities in Catalyzing Investments and Improving Asia's Investment Climate**

Under ADB's new long-term strategic framework, Strategy 2020, ADB aims to do more to help DMCs attract direct private sector investments that support inclusive growth and improve the environment. To spur market-led growth, ADB will invest in infrastructure and advise governments on the basics of a business-friendly environment, including reliable rules, regulations and policies that do not disadvantage private sector enterprise. ADB's tools to catalyze change through greater private investments in DMCs will include direct financing, credit enhancements, risk mitigation guarantees, and innovative new financial instruments. These tools will create value by attracting private capital and deploying business management or technical expertise to specific sectors

and transactions.

Apart from highlighting ADB's future priorities for Private Sector Operations, Strategy 2020 also highlights its priorities for RCI, one of five core operational areas under the Strategy.

- Under Strategy 2020, ADB will progressively increase aggregate public and private sector lending for regional and sub-regional projects to at least 30% of ADB operations by 2020.
- RCI projects will increase to 20% of operations in 2009-2011, while TAs for this purpose will increase to 25%.
- RCI projects in 2009-2011 remain biased towards cross-border infrastructure, with transport and energy accounting for 57% and 22% of RCI projects, respectively.
- RCI-related TAs, on the other hand, focus mainly on financial sector development (34% of RCI TAs).

Given this greater focus on RCI, regional efforts are likely to play an even greater role in creating an attractive investment climate in Asia.

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