

Foreword

Since the 2007–09 global financial crisis, Asian economies have been giving more emphasis to domestic and regional demand to secure sustainable and inclusive growth. Closer regional integration is a means to foster Asian demand and growth. Regional integration confers benefits, including expanding the size of markets, thereby realizing scale economies and enhancing the scope for specialization, lowering trading costs, lowering funding costs and facilitating capital investment in the region. It can also promote more inclusive growth by bringing isolated regions and marginalized people closer to markets.

Connecting Asia: Infrastructure for Integrating South and Southeast Asia highlights the potential contribution to growth that greater connectivity between these two regions can make. Trade and investment between them, while making progress, has been limited, hindered by bottlenecks and gaps in trade infrastructure, trade barriers and a low level of regional cooperation. In particular, South Asia lags in terms of its participation in supply chain networks. Given the proven capacity of supply chain networks to contribute to economic development in Southeast Asia and East Asia, this represents a substantial underexploited opportunity.

Several new developments suggest that the time is ripe for research on cross-regional integration. The recent political and economic reforms in Myanmar – the key land bridge between the two regions – make possible closer economic ties and connectivity that were not feasible earlier. The election of a new pro-business Indian government provides renewed impetus for deepening domestic economic reforms, furthering the country's Look East Policy and enhancing cross-border infrastructure investments.

Connectivity, including both physical connectivity and the associated soft infrastructure, can foster closer economic ties between South Asia and Southeast Asia. Physical connectivity here relates to transport infrastructure (road, rail and ports) and energy infrastructure, while associated soft infrastructure includes the critical areas of financing of infrastructure, trade facilitation, trade and investment reforms, and institutions for coordination.

Increased investment in cross-border infrastructure is the first key to improve connectivity between neighbouring countries, and thereby

promote trade and investment growth. Good quality infrastructure boosts productivity, reduces trade costs and promotes investment from both home and abroad. It also provides people with access to basic services, such as health care and education, and to jobs and other economic opportunities. On the other hand, poor infrastructure can prevent economies from unleashing their potential. Project evaluation is useful to share lessons and best practices in infrastructure investments. Use of public–private partnerships can inject private sector discipline into project selection and implementation, but they are not a panacea, and close attention to the allocation of costs, risks and benefits is needed to avoid failure.

Improvements in trade and transport facilitation can also substantially lower trading costs and thereby stimulate trade. Key elements include, for those countries that have not already done so, signing of the Revised Kyoto Convention and adoption of Single Window systems, as well as adoption of cross-border transit agreements.

Furthermore, open trade and investment regimes are another key driver of growth as they allow economies to exploit their comparative advantages, gain access to the global market, tap foreign capital and benefit from technology transfer. Non-tariff barriers – such as excessive red tape, cumbersome licensing requirements or misuse of sanitary or phytosanitary rules on food – need to be reduced, as non-tariff barriers are increasingly replacing tariffs as protective measures.

Market-driven exchange rates can also support competitiveness and growth of trade, subject to the constraint that capital flow volatility is not too great. They also can encourage more open capital markets, together with development of financial markets at a pace consistent with financial stability that can facilitate the freer flow of foreign direct investment and portfolio investment to attractive investment projects.

Financing remains a fundamental challenge. Greater financial integration can enhance the potential for Asia's high savings to be invested more efficiently in the region. Given the constraints on traditional sources of infrastructure financing – public funds and banks – it is necessary to develop alternative sources of financing, both from international investment funds and from the private sector. Public–private partnerships have significant potential to improve access to infrastructure finance in Asia.

Small and medium-sized enterprises (SMEs) need greater access to finance to be able to participate in cross-border trade. This requires financial development, including expansion of financing capacity for start-up companies. Since new companies are typically small, improving financial access for SMEs should be a key aspect of such a strategy. This calls for related activities that include development of venture capital, crowd-funding vehicles, such as hometown investment trust funds, and

credit market databases, such as Japan's Credit Risk Database of SMEs. Financing for SMEs and start-up companies through bank loans can be difficult owing to the uncertainty of their business.

Regional integration also requires greater provision of regional public goods, which involves increased coordination among institutions, both at the national and regional levels. Asia has already had some notably successful projects of regional integration, such as the Greater Mekong Subregion program and the South Asia Subregional Economic Cooperation program. The challenge now is to extend this progress to cross-regional integration as well.

This volume contains the background papers prepared for a major study *Connecting South Asia and Southeast Asia* conducted jointly by the Asian Development Bank (ADB) and the Asian Development Bank Institute (ADBI). The study was managed by Michael Plummer (Professor, Johns Hopkins University and Director of SAIS Europe), Peter Morgan (Senior Consultant for Research, ADBI) and Ganeshan Wignaraja (Advisor, Economic Research and Regional Cooperation Department, ADB), who wrote the overview and edited this volume. Menaka Arudchelvan, Jenny Balboa and Yan Zhang provided efficient research assistance. The ADBI's publications unit headed by Robert Davis and supported by Kae Sugawara coordinated the publication process. Ainslie Smith edited the chapters. Grant Stillman and Tsuyoshi Hyokai of the ADBI oversaw the book's contract administration and financing, with the support of Tokiko Yamanaka and Keiko Aoki.

It is my hope that this book will contribute to the ongoing dialogue about how to strengthen the links between South Asia and Southeast Asia to provide a more secure basis for inclusive and sustainable growth in the region.

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