

Why Do Asia and Europe Need More Connectivity?

SOME IDEAS FROM THE EUROPEAN AND ASEAN EXPERIENCE

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Asia and Europe require greater physical connectivity and the models for such connectivity are embedded in both Europe and Asia. The Association of Southeast Asian Nations (ASEAN) and the European Union bring regional experience to the issue of creating a framework for connectivity between Asia and Europe. ASEAN has championed a model plan for connectivity. There is a growing need for greater convergence in connectivity within Asia, particularly in ASEAN. Other regional connectivity platforms are emerging, bringing the focus on converging various connectivity channels between Asia and Europe.

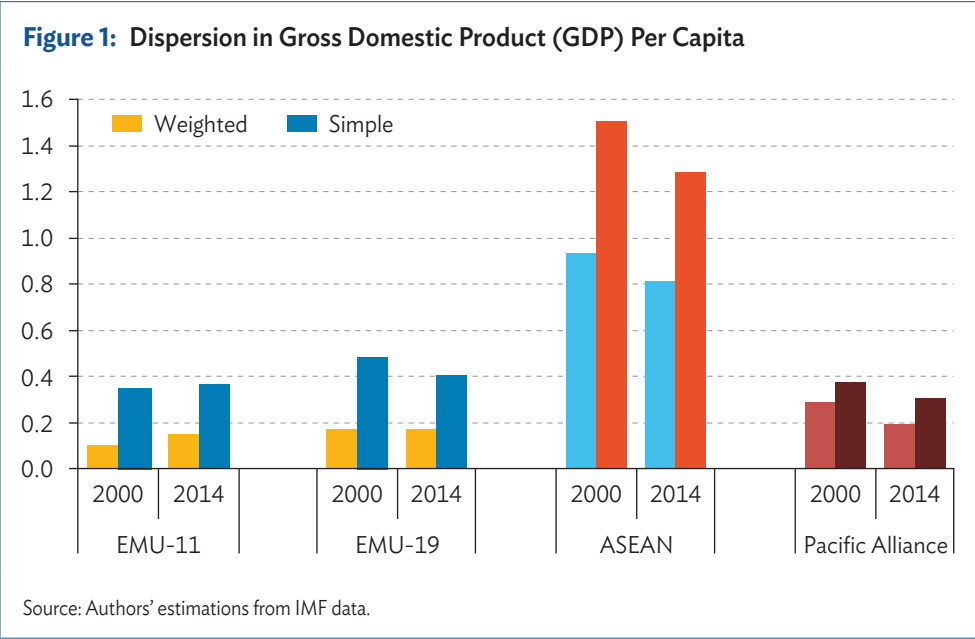
The ASEAN experience in connectivity

One could easily draw similarities between ASEAN (Association of Southeast Asian Nations) and the European Union in terms of economic integration. Despite a significant difference, which is the single currency, the four pillars of the ASEAN economic bloc—creating a single market and production base, maintaining competitiveness, creating equitable economic development, and integrating into the global economy—are also the goals the European Union wants to achieve.

ASEAN is strategically located at the Strait of Malacca, a key shipping lane in the world, and has evolved as one of the fastest-growing consumer markets and manufacturing hubs, serving as tailwind of economic development. However, things may not all come together so easily and ASEAN faces headwind internally from income divergence due to poor infrastructure quality, and externally from the competition caused by development of other trade routes, such as the Eurasia links and Gwadar port in Pakistan, which could bypass the ASEAN landscape. Therefore, it is important for ASEAN to unlock its growth potential by improving connectivity to keep itself in the global value chain.

Integration needs real convergence,
but reality remains very far

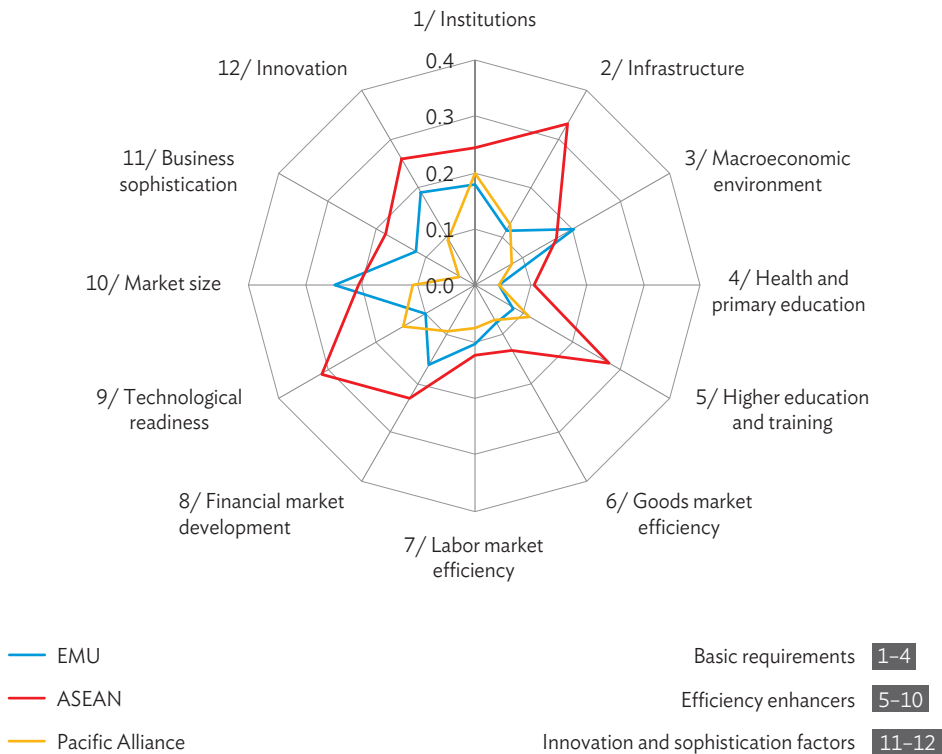
Convergence is about raising income and productivity. Despite sharing the same promising growth potential, ASEAN countries are at different stages of development, which also results in divergence in income. We measure in real terms the dispersion of gross domestic product (GDP) per capita adjusted by its mean—i.e. the coefficient of variation. Although there are positive developments in terms of real convergence, dispersion in GDP per capita in ASEAN remains very high and levels are significantly above EMU-11¹ (Figure 1). The stage of development of some of its members is on the antipodes: Singapore and Brunei Darussalam average more than 70,000 PPP (purchasing power parity)-adjusted US dollar per capita, whereas Cambodia, Lao PDR, Myanmar, and Viet Nam do not even reach US\$6,000.



Infrastructure is the key behind high divergence

ASEAN has enjoyed sound economic growth in the last decade; yet, why is the divergence higher than the EMU? Among all factors, infrastructure is the key reason. The World Economic Forum releases every year the Global Competitiveness Index composed of basic requirements, efficiency enhancers, and innovation and sophistication factors.

¹ To enhance economic integration, eleven European countries formed the Economic and Monetary Union (EMU) and adopted euro as the single currency in 1999.

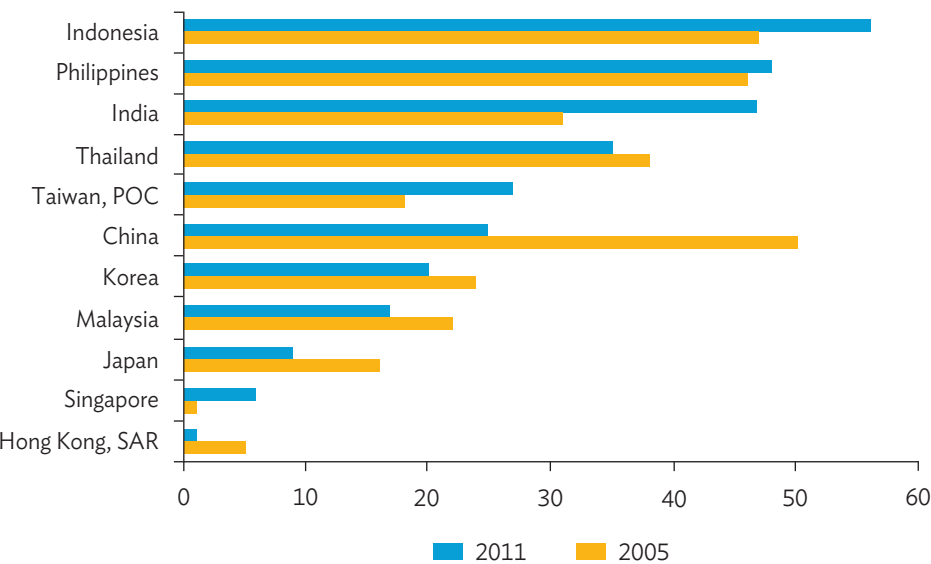
Figure 2: Basic Requirements for Global Competitiveness Index

Source: Authors' elaboration from WEF Global Competitiveness Report data.

According to the assessment, ASEAN shows a large degree of dispersion, significantly above readings for the EMU. This diagnostic is particularly true for infrastructure (Figure 2).

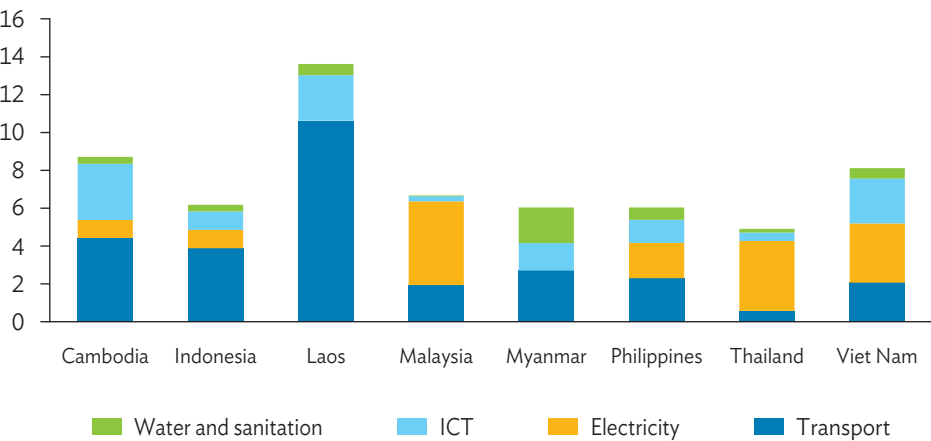
The quality of infrastructure is generally low in ASEAN, except Singapore, and has fallen relative to global peers, especially when comparing to the huge improvement in China (Figure 3). The need for infrastructure investment of ASEAN countries range from 5 percent to 13 percent of their GDP, and transportation is the sector that most needs such investment. Lao PDR, a landlocked country, needs 11 percent of its GDP for transport investment, whereas Indonesia needs 4 percent of GDP and is likely to be the largest spender due to its economic size (Figure 4). The latest estimate by the United Nations Conference on Trade and Development (UNCTAD) has confirmed the needs of investment in transport infrastructure in ASEAN. An annual investment of US\$110 billion is needed in ASEAN in 2015–2025, and half of the amount is dedicated to transportation (Figure 5).

Figure 3: Basic Infrastructure Ranking



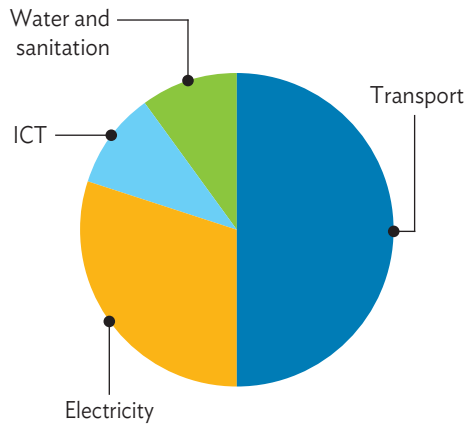
Note: A lower ranking indicates a better score out of 51 countries in 2005 and 59 countries in 2011.
Source: IMD, *World Competitiveness Online*.

Figure 4: Projected Infrastructure Investment in ASEAN (2010–2020, % GDP)



Sources: ADB, Natixis.

Figure 5: Projected Infrastructure Investment in ASEAN (2015–2025, US\$ billion)



Sources: UNCTAD, Natixis.

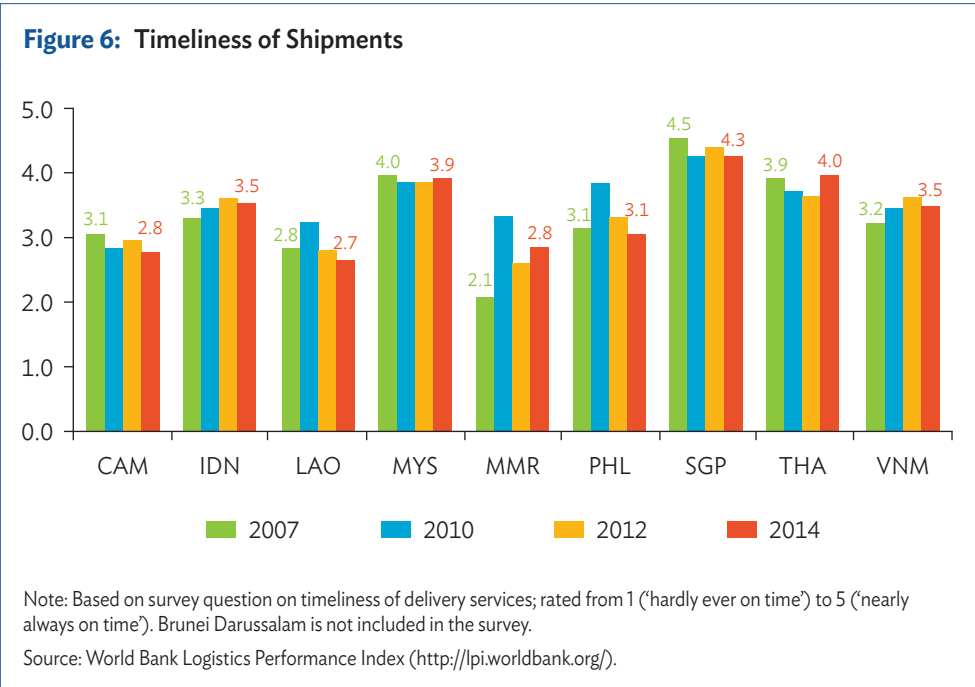
What has been done for connectivity? Europe and Emerging Asia

In 2014, the European Commission launched its ‘investment plan for Europe’, the Juncker Plan, announcing the mobilisation of an additional €315 billion in public and private investments over three years (2015–2017). The key of the Juncker Plan is that the newly created fund—namely, the European Fund for Strategic Investments—will provide credit protection and mobilise capital for additional risk financing; in other words, fostering private investment.

Europe has been proactive in developing infrastructure and improving connectivity. The Juncker Plan has attracted China’s interest and the European Bank for Reconstruction and Development (EBRD) has approved China’s membership. Although we do not have all official statistics reporting the railway time from China to Europe, *China Daily* has reported that it takes 16 days to transport from Chongqing, the inland China city, to Duisburg in Germany whereas 36 days are needed for the sea route from Shanghai through ASEAN and Middle East. The Eurasia Railway under the Belt and Road Initiative will likely shorten the time cost between Europe and Asia.

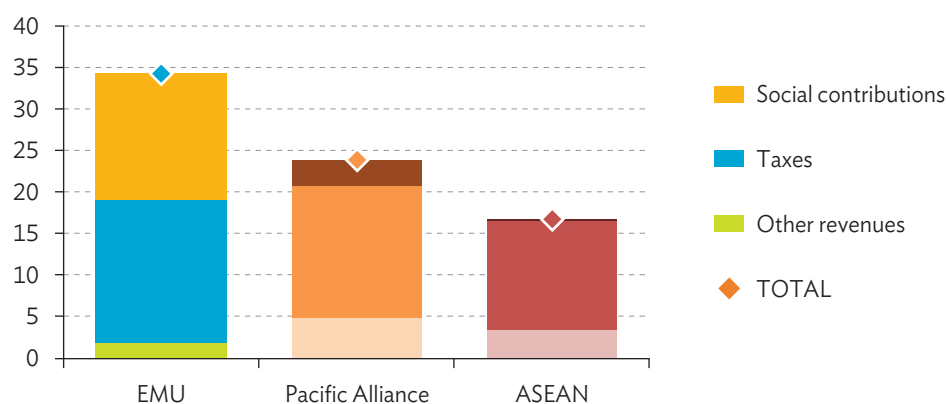
ASEAN has also launched its Master Plan on Connectivity. Internally, after the progress in eliminating tariffs within ASEAN, intra-ASEAN trade and foreign direct investment have increased at a faster pace. The quality of infrastructure has now become the key to lower trade costs for economic integration and trade facilitation. Projects on railway have speeded up in Indonesia, Lao PDR, and Thailand.

Timeliness of shipments (Figure 6) is a good proxy to measure the progress of ASEAN connectivity; an improvement in average delivery timeliness between 2007 and 2014 is observed in Indonesia, Myanmar, Thailand, and Viet Nam, but the level is still far from more developed logistics hub such as Singapore.



How to do it?

If further investment on infrastructure is essential, how does ASEAN fund the needs? We argue that the fiscal room of ASEAN countries is rather limited and therefore public–private partnership is essential to its success (Figure 7). Private participation has generally increased in more developed countries but the ratio remains low in less developed ones (Table 1). Asia clearly needs to expand the participation of private investors in its infrastructure projects. Multilateral organisations can help but they will not be able to fill the gap.

Figure 7: Comparison of Fiscal Revenues

Source: Authors' elaboration from BIS and World Bank data.

Table 1: Gross Fixed Capital Formation

	2000–2004		2005–2009		2010–2014	
	Value	Private (%)	Value	Private (%)	Value	Private (%)
Indonesia	131,560	87	180,598	89	251,255	91
Singapore	15,866	76	44,193	84	72,452	82
Malaysia	28,757	44	38,475	54	61,610	59
Viet Nam	20,220	71	32,108	71	33,519	67
Thailand	29,936	69	25,825	74	33,366	78
Philippines	3,892	87	19,795	87	30,492	86
Myanmar	3,892	57	5,480	57	10,014	55
Cambodia	758	64	1,217	67	1,820	56

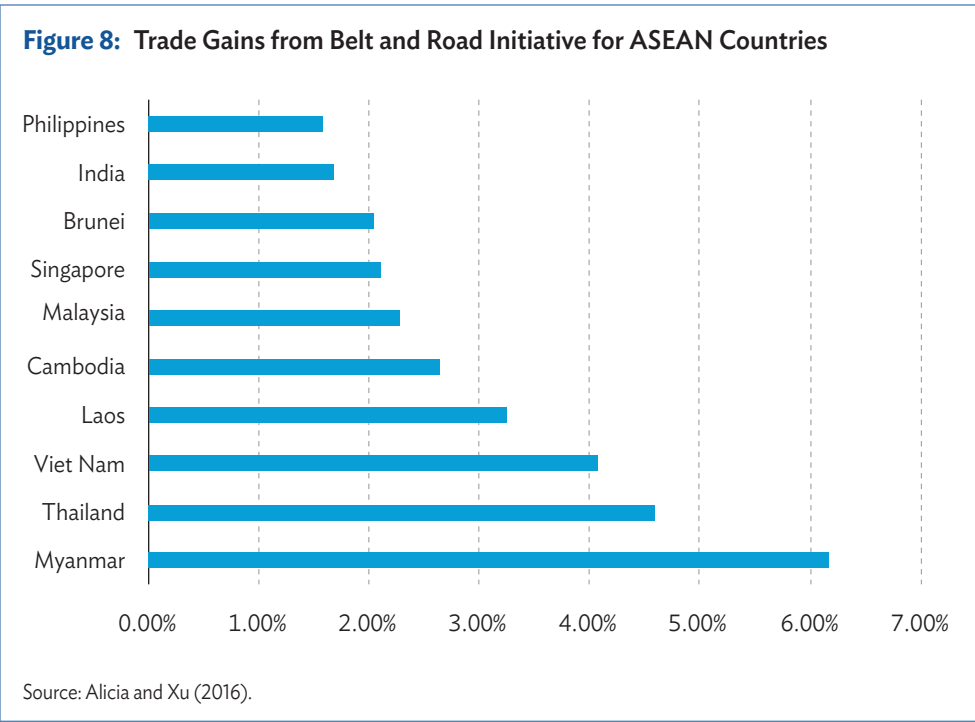
Source: Asian Investment Report, Natixis.

The specific case of the Belt and Road Initiative and how it may affect Emerging Asia

Since 2013 China has embarked on the Belt and Road Initiative to boost connectivity with 64 countries by building infrastructure and facilitating trade. Most initiatives are immature compared with the ASEAN Master Plan, but China's switching its diplomatic focus to neighbouring economies is a positive sign.

Given the high cost involved in connectivity associated infrastructure investment, China’s participation will introduce a potential source of funding for infrastructure investment in the ASEAN region. Additionally, China has accumulated rich experience in investing in railway, road, and natural gas establishment that she could share with ASEAN economies. The convergence of the Belt and Road Initiative and the Master Plan on Connectivity would, therefore, inevitably attract more Chinese firms to invest in the area and accelerate the implementation of enhancing connectivity for ASEAN.

Moreover, the Belt and Road Initiative also provides new opportunity for ASEAN to extend its connectivity towards other regions, i.e. Europe. The final objective of China’s ambitious initiative is to build a seamless trade network extending from Asia to Europe. If completed, the trade cost prohibiting exports from ASEAN manufacturers to Europe would be sizeably eliminated. Conservative estimates stemming from an empirical exercise conducted by Garcia-Herrero and Xu (2016) indicate that reduced transportation costs from the Belt and Road Initiative can increase trade for ASEAN countries by at least 2–6 percent (Figure 8). The real benefit from the initiative could be even higher if we were to take into account its interaction with the Master Plan and the associated financial assistance.



General blueprint: Asia–Europe Connectivity

Enhancing physical connectivity of ASEAN countries is part of the expansion of transportation infrastructure in Asia. The United Nations initiated the Asian Highway Network in 1959 and finally reached an endorsement of the Asian Land Transport Infrastructure Development project in 1992. Stepping into the 21st century, ASEAN, China, India, and West Asian countries have successively launched their own connectivity plan to promote trade in the region.

In 2015, China, Russia, and Mongolia agreed in principle to build a ‘Steppe Road’ in Mongolia to revive a premodern transport network that facilitates trade between China and Russia, a sign that the future of the current Asian connectivity will be finally extended to Europe. Along with Europe’s Juncker Plan, the prospect of seamless Asia–Europe connectivity is already on the way.

Against this backdrop, the infrastructure investment of ASEAN is not only advantageous to foster trade and investment within the region but also creates opportunities for ASEAN to take part in external competitions in other Asian regions and the European markets.

Outlook

Internally, better connectivity could lower trade cost and facilitate investment.

Externally, physical connectivity from Asia to Europe will bring new opportunities and external competition to both regions. New infrastructure plans such as the Belt and Road Initiative and institutional structures such as the Asian Infrastructure Investment Bank (AIIB), aimed at improving regional and international connectivity through infrastructure upgrade, will likely bring benefits. All in all, improvement in physical connectivity will inevitably reshape trade and investment patterns between Asian and European economies. Physical connectivity will also bring people across the continents closer. Thus, it is crucial that the Asia–Europe Meeting not only enhances but also facilitates greater physical connectivity through multilateral connectivity plans to explore new opportunities.

REFERENCE

Garcia-Herrero, A. and J.W. Xu (2016), ‘China’s Belt and Road Initiative: Can Europe expect any trade gains?’, unpublished manuscript.

