Highlights of the 2006 Emerging Markets Forum Global Meeting

Jakarta, Indonesia
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SUMMARY OF KEYNOTE ADDRESSES

Former Philippine President Fidel V. Ramos, EMF Co-Chair welcomed the participants to the 2006 EMF Global Meeting. He then gave an overview of the Emerging Markets Forum (EMF). He underscored the Forum's distinctiveness as it focuses exclusively on EMCs. Moreover, President Ramos pointed out that the EMF is unique as it aims to forge globalization-related consensus among its members and put forward a feasible agenda, while being devoid of any ideological bias. Furthermore, he expressed that EMCs have yet to reach their full potential as movers in the international arena. With two-thirds of the world's population residing in developing countries, he said that the EMCs must utilize their strengths to convince the rest of the global community of what needs to be done. However, he asserted, that this can only be done if EMCs agree to forge a common social, political, and economic agenda.

President Ramos then called on the participants to reiterate their commitment to globalization. He recognized that such a task is difficult to achieve. As such, he said, one should focus on a doable and relevant agenda.

In conclusion, the President urged the participants to be caring, sharing, and daring. By caring and sharing, he said that the one should be helpful, generous, and forgiving towards others. By daring, President Ramos explained that the EMF should take cooperative action to overcome challenges, reform to transform, and help others achieve a better quality of life.

Indonesia's Coordinating Minister for Economic Affairs, Dr. Boediono welcomed the Forum participants to Jakarta on behalf of the Government of Indonesia. His keynote address provided the overall context for the Forum deliberations by reiterating Indonesia's commitment to globalization. He focused on key lessons for growth based on the actual Indonesian experience. Dr. Boediono highlighted six vital measures.

First is maintaining macroeconomic stability, particularly low inflation and stable exchange rate. He asserted that such stability is necessary for sustainable growth as inflation hurts the poor the most. Without it, poverty alleviation goals shall be difficult to achieve. Dr. Boediono related that in the 1950s and 60s when, due to political reasons, macroeconomic stability was ignored, Indonesia's economy regressed. In the late 60s however, stabilization policies were put in place. This provided a the groundwor k required for growth at over 7% per annum and poverty reduction form 60% in early 1970s to 18% in the mid -90s.

Second is sustaining a healthy financial sector for efficient resource allocation and sustained growth. In the 1980s, Indonesia liberalized it s financial sector as a way to salvage its oil -dependent economy from the oil price crash. According to Dr. Boediono, the economy responded well to the changes until the 1997 financial crisis, which caused a sharp increase in public debt (from 30% of GDP i n 1997 to 100% in 1999). He asserted that this was mainly linked to an unhealthy banking sector. As such, Indonesia now promotes sound banking supervision.

Third is advancing the development of human capital for greater productivity and competitiveness. Until the early 90's, Indonesia was classified as a country which was able to combine rapid growth and improvement in human capital development. According to Dr. Boediono, however, this took a downturn resulting in a less competitive labor force. As suc h, he says, the country is now again focusing on raising the level of human capacity of its citizens.

Fourth is institutionalizing good governance by ensuring transparency and accountability in both the public and private sector. Based on the Indonesian experience, Dr. Boediono noted that the absence of good governance magnifies the impact of an economic crisis.

Fifth is building capacity to adapt to change . Dr. Boediono observed that the market-based economy adopted by Indonesia in the 1960s proved to significantly contribute to growth.

Sixth is promoting liberalization in trade and investment. Dr. Boediono mentioned that opening up trade and investment bolstered Indonesia's capital, access to technology, and markets.

In closing, Dr. Boediono stress ed that in achieving the above mentioned measures, conscious effort must be exerted to ensure that short -term adjustment and dislocation are kept at a minimum. In order to realize the growth strategy and minimize the pains associated with it, a consensus building approach must be utilized, coupled with political will to stay the course.

To provide an intercontinental perspective on globalization, **Former Tanzania President Benjamin William Mkapa, Investment Climate Facility Co-Chair** provided a brief history of trade between Africa and Asia. He stated that physical evidence proves that as early as the eighth century, Indonesia had already been trading with East Africa. Many other historical accounts show that intercontinental trade between Asia and Africa began long before trade with Europe. As such, President Mkapa noted that it is a misconception to say that Asia discovered the beneficial trade relations with Africa only recently.

President Mkapa recognized the similar challenges in governance and human resource capacity faced by both continents brought about by parallel economic and political experiences of Asia and Africa. Due to the shared ordeals, he believed Asia compared to other regions, was more attuned and sympathetic to Africa's current state of affairs.

President Mkapa presented a snapshot of the rising trend in trade between Asia and Africa brought about by the increased demand for energy and raw materials; and the preferential market access mechanisms in place. He emphasized that more than th e abundance of natural resources Africa is undergoing a surge in other sectors such as manufacturing, telecommunications, infrastructure, finance, tourism and agriculture.

President Mkapa, however, acknowledged that much still needs to be done in order to build Africa's domestic capacity. This includes further improvement in its business environment; and development and sustaining sound macroeconomic fundamentals.

In closing, President Mkapa called on the participants to foster closer economic relations in the areas of trade and finance between Africa and Asia.

Indonesian President Susilo Bambang Yudhoyono welcomed the participants at the Presidential Palace and commended the organizers for a successful and productive event. Moreover, he encouraged the organizers to consider holding the subsequent events in Indonesia, with the assurance of his full support. He was looking forward to this meeting since it gave him an opportunity to seek advice from the participants based on their rich international experience on some important issues faced by the Indonesian economy.

As an edifying contribution to the Meeting, Pres. Yudhoyono shared the challenges he faces, steps he has taken, and the goals he aims to achieve as a political leader of an EMC. He began by stating his objectives as President of Indonesia: advancement of democracy and reforms; acceleration of Indonesia's transformation; and rebuilding of an economy after a crisis. Moreover, Pres. Yudhoyono stressed that he plans to accomplish such through a triple track approach of pro-growth, pro-jobs, and pro-poor. In so doing, he seeks to achieve higher sustainable growth through exports and investment; create greater employment; and promote rural agricultural economic activity to alleviate poverty. Admittedly, he said, the greatest overarching challenge is the fight against corruption, which, if unsuccessful, shall undermine efforts to achieve the 3-point agenda. As such, Indonesia is vigilant in combating corruption, which he believes requires a top down strategy, sustained commitment, and structural as well as cultural approach.

President Yudhoyono informed the attendees that positive strides towards achieving the goals have been made. He noted that a recent World Bank study states that bribes to Indonesian government officials has dropped form 10.8% in 2001 to 6.4% in 2005. The President also stated that despite being hit by several natural disasters last year, the increase in the price of oil, the bird flu pandemic and the hike in U.S. Federal reserves, Indonesia grew by 5.6%. Moreover, he reported that the debt to GDP ratio has significantly dropped from over 88% in 2000 to 48% as of last year.

The President stressed that although Indonesia is moving forward, much still needs to be done. The ultimate goal is to achieve enhanced quality of growth through a better targeted comprehensive economic reform program. To date, Indonesia is focusing on the creation of special economic zones, development of bio-energy, and the promotion of international cooperation to achieve common prosperity.

In conclusion, President Yudhoyono acknowledged the importance of the EMF's efforts to provide a venue for EMCs to define their agenda and learn from one another. He encouraged the EMF organizers to continue such effort.

The President's opening remarks were followed by an interactive discussion between the President and the participants. He exchanged views on a variety of economic and social issues including: global economic prospects and global imbalances; how to raise income levels of the rural population; importance of and ways to accelerate infrastructure development; public private partnerships; need for Indonesia to give greater priority to education and human capital development; and political economy of reforms in a democratic country.

SUMMARY OF THEMATIC DISCUSSIONS

I. Global Imbalances and Capital Flows to Emerging Market Countries

Chair: Michel Camdessus
Author: Jack Boorman
Discussants: Ann Krueger, Toyoo Gyohten and Pedro Malan

Salient points of the paper and issues raised by the discussants:

- Global imbalances seem to have multiple causes: structural or monetary policy; changes in demographics; increase in growth under a regime of low interest and inflation rates; and geopolitical motivations. Identifying the precise causes and when and how their unwinding may hit the world economy is the real problem.
- Current account imbalance is not necessarily wrong. What is essential is to how the deficits are spent and how surpluses are saved/invested. Changes in relative growth rates should be the focus.
- Low interest rates and substantial liquidity prevalent in industrial countries; and the accelerated asset accumulation of oil exporting countries have led to the rise in capital inflows to EMCs.
- Debt flows have been accelerating in EMCs in accord with the rapid rise of oil prices and increasing surpluses of oil exporting countries.
- Characteristics of oil exporting countries include, among others: an average fiscal surplus of 12% of GDP; surplus recycling through international banks; low domestic spending; an intent to invest in real assets, but a sense of "nationalism" either by the oil exporting country or the country where the former whishes to invest sometimes impedes this intention; and finally very low import content from US. One of the main questions is: will such observation change U.S. behavior in terms of politics and business?
- Changing patterns of FDI reflects an increase in South-South relations in a scramble for natural resources.
- FDI flows to EMCs have increased to more than 10 times from US$20B in 1990 to approximately US$237B in 2005.
- Expansion of FDI and equity flows to EMCs may be explained by the following factors: increase in commodity prices; strong corporate profits of MNEs in EMCs and consequent reinvestment of a large percentage of these profits in the host countries; increase in U.S. household consumption and thus a surge in demand for consumer

imports; development of an Asian production chain; sound macroeconomic policies; and improved investment climate.
  - These abovementioned factors are complemented by: financial innovations; development of local financial markets; increased privatization and mergers; and a surge in demand for natural resources.
- There is still a concentration of flows to the top 10 FDI recipients. East Asia and the Pacific remain the largest regional FDI destination, while Central Asia has seen a surge of about US$75B in 2005 from about US$30B in 2000.
- There is a need to agree on the basic causes of the current global imbalances in order to reach an agreement on the remedial actions needed on part of the major actors, instead of the current tendency to blame the problem on other parties.
- Given the risks of a hard landing, the multilateral surveillance process of the IMF should be strengthened.

Main discussion points:

- There is empirical evidence that illustrates low spending of oil exporting countries and their preference for security markets over banking, since the former is transparent, albeit volatile.
- Agreed that there is a changing pattern in FDIs of oil exporting countries. Their investment pattern clearly shows that they are veering away from Europe and the U.S. South-South FDI is on the rise.
- By not investing in developing countries within its region, oil exporting countries risk greater political instability.

Forum recommendations:

- Further diagnose and desegregate causes of global imbalance in order to prescribe an effective approach to the problem.
- Multilateral surveillance should be implemented as a confidence building measure. However, it is a difficult process. Advocacy for the acceptance of such tool is required.
- Strengthen EMC's domestic capital markets in order to compete for surpluses of oil exporting countries. Moreover, EMCs should prioritize governance and institutional building.
- The G7 must be more open to greater investment especially from EMCs and must not try to politicize matters; and take an active role in assisting poorer countries.

II. Private Capital Flows: Emerging Market Countries: Major Drivers, Recent Developments, and Key Issues

Chair: *Bimal Jalan*
Author: *V. Sundararajan and Harinder Kohli*
Discussants: Varun Bery, Gyorgy Szapary, and Paul Hugentobler

Salient points of the paper and issues raised by the discussants:

- Since 1999, observed developments in private capital inflows are as follows:
    - Massive volume growth since 2002, with substantial concentration of flows both among regions and within regions; and the dampening of volatility due to the imposition of reforms in local financial markets.
    - Considerable shift in regional and country composition of private capital flows. Top 10 recipients of private capital flows have shifted significantly between 1994-1995 and 2004-2005. Thailand, Indonesia, Argentina and Hungary have dropped out of the list, while Taiwan, Turkey, Russia and India have made the present decade's list;
    - FDIs almost doubled during 2003-2005 with Asia and Europe absorbing most of the inflow growth. Portfolio capital flows in 2005 was over US$178B, with Asia as the largest contributor.
    - There has been an increasing trend in favor of South-South and South-North flows; and
    - Remarkable growth of portfolio capital relative to other forms of inflows. Compared to bank lending which showed a sharp decline in net outflows from US$32B in 2004 to US$2B in 2005, private capital inflows rose to US$495B in the same year, from US$423B in the previous year.
- Two major factors influencing size and direction of capital inflows:
    - Relative investment returns and risk-return mix. This includes prospects for growth, expected change in exchange rates, relative yields on various instruments, corporate profitability, and macroeconomic policy framework. In addition, structural factors affecting "investability" in EMC assets, and special factors such as privatization and mergers also impinge on size and direction of capital inflows.
    - Risk-adjusted returns. These include, among others, global demand, terms of trade, access to external financing, sovereign ratings, financial soundness of banks and non-banks, and capacity to respond to various shocks.
- There has been a significant shift in regional and country preference to private capital flows. Evidence indicates the growing

importance of portfolio capital relative to other types of private capital flows by EMCs.
- Sectoral intervention is generally unacceptable except for security reasons.
- In many instances, EMCs are small relative to multinational corporations. Therefore, the latter has greater impact on the former.
- EMC's middle class savers prefer bank deposits over the stock market to ensure protection of their capital stock.
- Transparency and accountability are vital in the management and administration of government, regulatory, and financial institutions.
- Good governance is a key element to attract investors. Serious efforts to combat corruption in EMCs must be put in place.
- Efficient management capacity is required to build a sound and stable investment environment.
- Equities investors look for an exit strategy before investing in a country. A very small percentage of equities market players enter EMCs due to the unpredictability of business processes and economic environment. When equities investors do, they tend to have local teams manage international investments.

Main discussion points:
- Investment funds are not a problem. It is the dearth of management capacity and good governance in most EMCs that poses a challenge in attracting investors. This is primarily a result of the lack of competition within the EMCs.
- Management of expectations requires credibility.
- Although capital inflows may provide stop gap measures, they may also cause an increase in inflation in the long-run. Domestic savings must remain robust and be the main source of investment.
- Preference for FDIs is being looked at as a more transparent option over other instruments since institutional investors have management teams looking after it. As such, there is a certain confidence in exercising due diligence.

Forum recommendations:
- Develop national and regional capital markets to mop up surpluses of oil exporting countries.
- Complement short-term capital inflow liberalization by outflow liberalization.
- Sustain macroeconomic stability; improve management capacity of both private and public sector; and institutionalize and implement good governance measures to increase transparency, accountability, efficiency, and predictability; and as well as combat corruption.

III. Bilateral and Regional Trade vs. Global Agreements: Drivers, Trends, and Key Issues

Chair: *Mari Pangtesu*
Paper: *Luis Miguel Castilla*
Discussants: Hidehiro Konno and Rajat Nag

Salient points of the paper and issues raised by the discussants :

- In general, trade liberalization and improved competition policy have sustained growth and improved standards of living. The challenge lies in the identification of different compatible trade options;
- Latin America's average growth rate is relatively lower in the 1990s in comparison to the 1960s and 1970s, and relative to the growth rate achieved in East Asia for the mentioned decades. This may be attributed to the following factors:
    - Low investment in physical capital. Latin America invested 20% of GDP in such assets over the past 2 decades, while South East Asia has put in 30% of GDP in the same period. This may be due to low savings rate in Latin America, which has dropped from over 22% of GDP in the 1980's to about 18% in the period of 1998-2001. In contrast, domestic savings in Southeast Asia was at 35% of GDP during the 1990s;
    - Low productivity and value added. Southeast Asia has experienced a surge in manufactured exports, manufactured goods being the fastest-growing export, while Latin America continues to rely on its natural resources, and thus has limited value added in its exports;
    - High concentration of exports. Latin America has less diversified exports than East Asia; and
    - High trade and non-trade barriers. Although East Asia applied higher tariff levels (16% average) than Latin America (11% average) in the period of 1996-1999, the former implemented trade efficiency and facilitation measures; and improved infrastructure leading to lower trade costs.
- If the WTO stalemate continues, regional and bilateral trade agreements will not be viewed as complementary to the multilateral system, but as alternatives.

Main discussion points:

- Unilateral, bilateral, regional, and multilateral agreements complement one another. However, multilateral agreements remain the most ideal, especially for developing countries, where they enjoy a one is to one vote and have greater protection under WTO's dispute resolution mechanisms.

- Developed countries have a greater opportunity to secure the conditions they desire through FTAs, specifically bilateral agreements with developing countries. FTAs are perceived by some as building blocks to multilateralism.
- FTAs have its share of advantages and disadvantages. Advantages include: pressure to implement structural reforms; an opportunity for wider markets; and increased capital inflows. Disadvantages include: complexity of managing several FTAs; and the cost of negotiations.
- Most emerging market countries have very limited capacity in their trade ministries. They are unable to work on more than one or two negotiations at a time.
- Drivers of FTAs include, among others: market economy principle; bandwagon effect; impact of US and EU trade policies; emergence of China; and the role and relationship of FDIs and FTAs.
- Asia has successfully integrated economically, however, national liberalization and openness still requires immense work.

Forum recommendations:

- Aim to secure multilateral agreements without disregarding other FTAs. Multilateral institutions should work closely to achieve such agreements, while business groups in EMCs should actively express support for the aforementioned agreements.
- Do not underestimate bilateral agreements as a tool utilized by developed countries to further their protectionist and discriminatory policies.
- To fully exploit the advantages of multilateral agreements and FTAs, EMCs should: enhance the technical capacity of the public and private sector; eliminate trade and non-trade barriers; ensure a stable macroeconomic environment; build necessary infrastructure, linkages, and networks; and allay inequity.

IV. FDI Flows Out of EMCs and Emergence of EMC-based Global FDI Players

Chair:	*Shengman Zhang*
Papers:	*Outward Foreign Direct Investment from Emerging Economies: New Players in the World Economy by* Heinz Hauser *Outward Foreign Direct Investment from India by* Rakesh Jha, and

The International Capital Flows' New Directions by Marcilio Marques Moreira

Discussants: Cyrus Adralan and Makoto Utsumi

Salient points of the papers and issues raised by the discussants:

Heinz Hauser

- Major reasons for the robust outward FDIs from EMCs, specifically South-South flows are as follows: opening of developing economies with regard to trade and foreign investment regulation; sustained growth and maturing of domestic markets which provide a strong foundation for international expansion; FDI follows regional patterns due to factors as trade, proximity, shared culture and language, among others.
- Comparative advantages of investing in developing countries by EMC MNEs over competitors from industrial countries include familiarity with the technology, business practices, and the like.
- Immense opportunities for outsourcing labor intensive parts of the supply chain, hence FDIs; and rise in regional trade agreements.
- Key motivations for EMC's firms to go overseas although returns in their home market are high include: energy and raw materials security; market defense; market expansion; and multiplying firm specific advantages.
- Chief points EMCs should consider about FDI are: sensitivity of FDI to the quality of economic and political institutions of the country; stronger competition for FDI by EMCs will increase the influence of business on politics; trade and investment have a strong regional bias; FDI in the form of corporate takeovers by MNEs from EMCs in developed countries is usually met by a protectionist attitude; and growing number of new MNEs raise the competition for human capital.

Rakesh Jha

- Drivers of India's outward FDI include: increased competitiveness of Indian MNEs due to improved corporate governance, profitability, and financial strength; strategic considerations of Indian firms which include access to technology, distribution networks, skills, markets, brand names, and natural resources; and liberalization of the Indian economy and greater openness of markets.
- Sectors leading the outward FDI in the period of 2001-2006 were manufacturing followed by non-financial services, specifically software development and IT service providers.
- In fiscal year 2005-2006, there was a marked increase in outbound mergers and acquisitions. In 2005-2006, the largest outbound acquisition by volume was in Europe accounting for more than 50%,

while South America received the highest investment in value terms accounting for 39% due largely to high value oil and gas deals.

- Destination of outward FDIs are Russia, accounting for about 15% of total cumulative outflows in 2003-2006, followed by Sudan and the US accounting for approximately 14% and 12%, respectively. Investments in Russia and Sudan were largely in the acquisition of natural resources. Investments in the US were motivated by strategic concerns, and access to markets and technology.
- Improvements in India's policy and regulatory framework which provided a good environment for increasing investments abroad were driven by the following factors: recognition that individual companies which had the ability to invest abroad were constrained by domestic regulatory framework; and companies required a portfolio of locational assets to remain competitive.

Marcilio Marques Moreira

- Breakdown of the core-periphery paradigm was brought about by: greater integration and interdependence of industrial economies and EMCs; and substantial current account surpluses generated by EMCs through savings generated or profits acquired by commodity exporting countries.
- FDIs have gained greater significance than trade. FDI stocks have grown from over 15% in 1980-1984 to almost 22% in 2000-2004. FDI in EMCs has expanded from 12% of total assets to more than 26% over the same period. FDI from EMC to EMC has increased from US$14B in 1995 to US$45B in 2003.
- Factors that spawned the upsurge in outward FDIs to EMCs include: legal and regulatory liberalization; improved macroeconomic environment; and competitiveness demand on the corporate level.

Main discussion points:

- Growth of FDI outflows is likely to be sustained due to the following reasons: sound macroeconomic policies; domestic growth due to low inflation and increased consumption; and competition.
- South-South and South-North FDIs are on the rise. South-South FDIs are generally led by a jostle for raw materials. This may lead to an uneven global playing field.
- Ideally, FDI is beneficial since: it provides the best avenue for the transfer of technology and management skills; offers opportunities to a wider market; and encourages the standardization of best business practices.
- However, since markets are imperfect, EMC's FDI to other countries may be due to the "push" factor, wherein the home country may not be conducive to support investments. This may be brought

about by high labor cost, faulty regulatory framework, and corruption, among others.

- Some of the constraints that hamper the achievement of even greater EMC FDI outflows to other EMCs: lack of knowledge and information; dubious corporate structures; insufficient currencies to acquire; protectionism in the guise of nationalism, and reluctant creditors.

Forum recommendations:

- Conduct a review on whether a company's ratings should be based on its operating and governance capacity rather than on the sovereign rating of the country where it has its headquarters.
- Study the global reallocation of resources. Determine the drivers of FDIs. Examine the constraints hampering further growth of FDIs.
- Recognize that corruption is a serious development issue. However, one must dissect the concrete and abstract notions of corruption in order to paint a realistic and fair picture of a country.

V. Development of National and Regional Financial Markets

Chair: *Roberto De Ocampo*
Papers: *Financial Markets in Latin America by Claudio Loser*
Building National and Regional Financial Markets: The East Asian Experience by Andrew Sheng, and
Asian Financial Markets and Asian Bond Markets Initiative by Eisuke Sakakibara
Discussant: *Raghuram Rajan*

Salient points of the papers and issues raised by discussants:
Claudio Loser

- Chief characteristics of Latin American financial systems are as follows:
    - Largely bank dominated. Deposit to GDP ratios are less than 50%, with 90% being the average in East Asian EMCs. Lending is directed to consumer credit, rather than investment. As such, investments are financed from retained earnings or non-bank and foreign sources;
    - Banks maintain increased concentration of assets as a result of the 1990s bank restructuring. More than 66% of bank assets are in the 10 largest institutions, which hold about 70% of deposits and provide 75% of credit. This suggests a lack of competition as financing from security markets which is supposed to contend with banks, are negligible since access to this option is limited only to top corporate borrowers;

- Asset and equity returns are below the industrial countries; and
- Possess a considerable and growing share of dollar denominated bank deposits and credits. However, in the recent years, fixed income investors have moved away from public sector external debt to local instruments due to the narrowing of the spread.

- Underlying weaknesses of the Latin American financial systems: low savings rate; unstable macroeconomic environment; microeconomic and institutional structural challenges; and high volatile capital inflows.
- Problems faced by the Latin American banking system led to a series of financial crises. The experience highlighted the need for reforms in the sector. The changes were targeted towards resolving weak banks and strengthening regulation and supervision.
- Financial integration has been strongly linked to FDI and trade. Advances in formal regional financial cooperation in Latin America have been limited. However, efforts to integrate stock markets and create sub-regional development banks in Central America are in the offing.
- Future financial integration may be enhanced through adopting international best practices regarding accounting standards, disclosure, information sharing, and tax regimes. However, macroeconomic instability and problems with key national institutions may hinder such integration. Establishment of clear property rights and assurance of legal stability are required to attract international players into Latin America.

Andrew Sheng

- Key characteristics of Asian economies are as follows: fastest growing region in the world; third area of trade integration next to the EU and NAFTA; rising intra-regional trade from about 35% to 55% of total world trade in the period covering 1990-2005, second to EU's 66% and forerunner to NAFTA's 45%; smallest GDP level in 2004 of US$8.9T, compared to NAFTA's US$13.4T and EU's US$12.7T; bank-dominated financial sector; high level of net foreign assets resulting from its export orientation leading to a net asset position of US$2.7T or 30% of GDP in 2004, in contrast to EU's net liability position of US$1.2T or about 9% of GDP and NAFTA's much larger net liability position of US$3.1T or approximately 23% of GDP; lowest gross asset position of US$8.6T, whereas EU and NAFTA's positions are at US$31.2T and US$11T, respectively; capital and debt markets are shallow and lack integration; and balance of payments surplus in the region is seen as the counterpoint to growing global imbalance.

- Characteristics of the Asian financial markets, similar to that of Latin America: loss of domestic and global share to Europe and the US; the US Dollar is the key trading and financial currency; and possess microeconomic and institutional problems.
- Reasons for the slow-paced development of financial markets in Asia, Latin America and EMCs are brought about by the emphasis on: flow analysis rather than on balance sheet weaknesses; and theoretical search for the correct policies rather than devoting resources on the institutional context of policies.
- Institutional change is more difficult to achieve due to numerous vested interests, conflicting views, and huge efforts of coordination. It is also burdened by the lack of bureaucratic capacity to implement policies and introduce institutional reform.
- It is imperative to focus on the importance of effectively managing social change in the public bureaucracy, specifically towards government-market relationships. The public bureaucracy must change its structure to fit its strategy. Moreover, it must have the capacity to educate, regulate, lead and motivate change.

Eisuke Sakakibara

- EMCs have encountered difficulties in managing financial market reforms due to the combination of premature capital liberalization and insufficient financial supervision with the lack of strong financial markets.
- International bond markets have been dominated by the Dollar and the Euro, amounting to about 90% of the total bond market issues in 2005Q1. A large number of bond issuers are in Asia, but they do not invest in the Asian markets due to the following factors: inadequate clearing system; insufficient development of repo markets; and presence of direct regulations hampering transactions.
- In order to raise liquidity in the region, there is a need to nurture an Asian market and establish the necessary infrastructure. Moreover, market players should be encouraged to employ practices conducive to raising transactions in the region.
- Asian Bond Market Initiative (ABMI) was launched at the ASEAN+ Finance Ministers' meeting in May 2005 to respond to this call.
- Investing a portion of foreign reserves in sovereign/corporate bonds should also be explored. This shall strengthen financial safety nets of the region and contribute to economic and financial stability necessary for the development of a bond market.
- Short-term regional financial arrangements may also be implemented to ease fluctuations in capital flow; and boost confidence in Asian financial markets. This shall complement existing international and regional financing arrangements.

Main discussion points:

- There is a surplus of available funds in Asia. Moreover, there are sufficient market players.
- It has been proven that countries with better governance have larger bond markets.
- Structure follows strategy. Therefore, good macroeconomic policies that assure predictability stem from good governance.
- Commonality of values and purpose promote growth with equity.
- Think globally, and act regionally, but remember that fundamental battles are fought on the domestic (national) front. Hence, there is a need to work at all three levels; global, regional and local, with action at the national level as the necessary building block.
- It is discomforting to note that regional investments are undertaken without effective mechanisms for proper surveillance.

Forum recommendations:

- Find ways to pool available resources for investment at the regional level.
- Build institutional infrastructure (where markets are considered institutions) to encourage market participants to adopt practices conducive to dramatically increase transactions within the region.
- Resolve national issues before attempting to go regional.
- Implement effective international surveillance monitoring.
- Make studies on change management readily available to EMCs.

VI. The New Global Energy Scene: Implications for EMCs as Consumers and Producers

Chair: *L. Enrique Garcia*
Paper: *Armando Ribeiro*
Discussants: Francois Bourguignon, Bindu Lohani, and Xavier Nogales

Salient points of the paper and issues raised by discussants:

- The world's total consumption of primary energy increased at an average rate of 1.5% from 1990 to 2003. In 2003, the most important source of primary energy was petroleum followed by coal and natural gas coming in at 2nd and 3rd, respectively.
- Electricity consumption from 1990-2003 increased by 40%, having a 30% increase in OECD Countries and 56% in non-OECD countries.
- It is projected that world demand for energy will rise by 2%/annum in the period of 2003-2030.
- It is anticipated oil will continue to be the most dominant source of energy growing from 80M barrels/day of consumption to 118M in

2030. High dependency on oil is attributed to the transport sector requirement.

- Natural gas will be the second most important source of natural energy.
- Despite concerns for the environment, demand for coal is likely to reach 27% in 2030 from 24% in 2003. Largest increase in coal consumption is expected to come from China and India.
- Electricity consumption is estimated to at a rate of 2.7%/annum from 2003 to 2030.
- Energy conservation without hampering econo mic growth is necessary. This may be done by improving energy efficiency and thereby reducing energy import bills; improving energy security; and reducing environmental degradation.
- It is projected that about US$9T is required for investments in energy until 2030 for non-OECD countries.
- Energy consumption constitutes 80% of global green house gases emissions, with carbon dioxide as the most vital component. In 2003, carbon dioxide emissions were estimated at 25B metric tons, 52% coming from OECD countrie s. However, it is estimated that by 2030, non-OECD countries may represent 60% of total world emissions amounting to 43B metric tons.
- Although the current oil price level in real terms is at the same level as it was in the 1980's, the global economy is mo re resilient to oil price shocks due to rapid growth in the economy, whereby the price of oil is compensated by high commodity prices. Another distinction is the fact that supply side in the 1980's was low due to cuts in supply, while today, there is an in crease in supply, but a more rapid increase in demand for oil.
- Given the ever growing demand for energy, the issues confronting non-oil exporting economies are as follows: cost financing for energy requirements; price of oil which is expected to stabilize at US$50-60/barrel; security of supply not only in terms of demand volume, but also in terms of reliability and quality; fiscal cost; and environmental impact.
- ADB's perspective: energy efficiency and environmental protection should be aggressively pursu ed by Asian EMCs. ADB has a facility to subsidize such efforts.
- Problem of national energy security and supply is a priority. However, countries which depend on energy -exporting countries should also be assured by them of continued supply. Joint ventures and diversification of sources should be explored.

Main discussion points:

- To date, 1.4 billion people do not have access to electricity. It is expected that once interconnected, their economic benefit shall escalate by 2.26 times.
- Private sector, together with non-government organizations should engage proactively in the promotion of good governance; and as well as in the support of growth that is both equitable and sustainable.
- ADB specifically recommends that China reduce its energy use for the same GDP level. This shall help promote economic stability of EMCs and global environmental sustainability.
- Rising oil prices negatively affects most less developed counties no matter if this is brought about by a supply shortage or a surge in demand for oil.
- Capacity for energy infrastructure lending on the part of the banks is significantly less than total needs. As such, there are insufficient funds to invest in energy infrastructure.
- High energy prices should be a natural deterrent for consuming enormous amounts of energy. As such, the direction of energy prices should be the same direction taken by energy conservation.
- A key part of the solution to this serious global problem is energy conservation.

Forum recommendations:

- Promote energy efficiency especially in the transport system and buildings.
- Invest in clean energy research and production to bring down the cost of utilization of non-traditional energy sources.
- Diversify investments and explore pension plans for financing.
- Recommend price incentives for energy conservation and innovation.
- With support form multilaterals, conduct an international energy summit to seek agreements on energy and its relation to environmental and economic policies.

VII. Private Finance for Infrastructure and Logistics Development; Experiences and Prospects in Asia and Latin America

Chair: *Pedro Malan*
Papers: *Haruhito Kuroda*
Harpaul Alberto Kohli
Discussants: Margarito Teves, Rajiv Lall, and L. Enrique Garcia

Salient points of the paper and issues raised by the discussants :

- Strong export growth and high foreign direct investments have been two important drivers of growth in the Asian region. Asia has reported an average growth of 17%/annum for regional exports. This is due to trade liberalization, tariff reduction, and the significant lowering of non-tariff barriers. The marked rise in Asian exports has been coupled with a surge of FDIs into the region.
- There is increasing concern that the continuing rise in logistics cost due to inadequate transport and communications infrastructure, uncompetitive transport and logistics sectors, and high fuel cost shall affect the overall export performance of Asia. Contrary to the trend of declining logistics cost as a percentage of GDP in Europe and North America, they have been on the rise in Asia. T his may be attributed to the following: fast pace of urbanization (It is predicted that Asian cities need to make space for 500M new entrants in the next 20 years); and infrastructure demand is estimated to grow rapidly in the coming decades due to primari ly to Asia's growth.
- Asia's infrastructure investment needs are projected at US$3 trillion for the next 10 years. Current investment rates are half of this need.
- Major challenges to mobilize finances required to meet Asia's demand for infrastructure includ e: lack of clear plans which provide good quality information illustrating the capacity to deliver credible results; inadequate human and institutional capacities; dearth of fiscal space; and absence of a mechanism to mobilize part of the savings of ADB me mber countries (reported at US$1.5 trillion in 2004) through capital market reforms for infrastructure projects.
- Strengthening regional and domestic bond markets is an initial step to capital mobilization. The Asian Bond Markets Initiative (ABMI) is one such option.
- In order to implement Asia's infrastructure agenda, capital market reforms should be undertaken together with the following: improve policy environment and governance; build human capacities; engage in participative processes; and strengthen accountability.
- In countries like India, the basic constraint to higher investment is not lack of funding but rather poor governance (lack of clear rules of game, cumbersome government decision making, slow reforms)
- In Latin America there are many examples of successful public private partnerships and of regional projects that are facilitating regional trade and investments. CAF is acting as a catalyst in the development and financing of such projects.

Main discussion points:

- Currently, only about 50% of Asia's projected demand for infrastructure of US$3T over the next ten years can be financed.

- The participants agreed that major issues that negatively affect infrastructure finance are, among others: lack of adequate information on projects due to deficient project preparation; dearth of good governance policies and mechanisms (including pricing and risk management); weak local capital markets; and conflicts between rural-urban, central-rural-center, and private-public.

Forum recommendations:

- Build on human capacity. An option is to obtain the service provided by ADB's Project Development Facility to assist in capacity building for project proposal design.
- Improve policy environment and governance.
- Explore pension funds as an important source of infrastructure financing.
- Unbundle infrastructure costs and explore the most efficient financing options acceptable to both government and the private sector.
- Take into account ADB's Asian Bond Market Initiatives which aims to strengthen regional and domestic bond markets.
- Prioritize a series of reforms and prepare an action plan focused at delivering results through consensus building involving all stakeholders.

VIII. From Talk to Action

Chair: Moeen Qureshi
Discussants: Gautam Kaji and Harinder Kohli

The time has come to stand back and take stock of where we are now and where we want to go. We all have a clear sense that we live in a world undergoing rapid changes, putting pressure at a global, regional, national, and local level. We need to build institutions to take on the challenge of change. We need greater public-private interaction so the market may function more efficiently. Policy without action has no merit, and action without policy is misguided.

To sum up our discussions led to the following conclusions:

Global Imbalance

- Global imbalance is the image of change taking place in the international market. It is characterized by a shifting pattern in savings, investments, and demographics.
- As the price of oil increases, so does the surplus of oil exporting countries.
- Below are observations made regarding oil exporting countries:

    - Changing investment preference;
    - Saving more, spending less; and
    - Diversifying hard assets.
- A broad consensus has been reached that there is little danger of a financial crisis but there is still a risk of a hard landing. This shall have serious implications on the management of EMCs and the G7.
- EMCs must:
    - Put in place sound macroeconomic policies; and
    - Strong corporate governance structure focusing on greater transparency and accountability.
- G7 must:
    - Be more open to greater investment especially from EMCs and must not try to politicize matters; and
    - Take an active role in assisting poor countries.
- Multilaterals should get involved. If the IMF aims to do so, it must be given tools – multilateral surveillance, for example.

FDI

- There is a sustained growth of FDIs into EMCs. However, investments still tend to be consolidated in a relatively limited set of countries.
- FDI from EMC to EMC usually involves a resource-rich country.
- Portfolio investment is increasingly becoming a vital investment instrument and is helping in the deepening of domestic capital markets.
- There is a need to develop regional capital markets to mop up surpluses of oil exporting countries.

Trade

- A multilateral agreement is clearly the best option, but other FTAs should not be disregarded.
- Broader systemic implications – the Fund and the World Bank should work closely.
- Business groups in EMCs should be more active in expressing their support for multilateral agreements.

Energy

- Energy's impact on growth, development, and the environment is immense. As such, there is an urgent need for an International Energy Forum or framework. Some form of agreement must be reached. In order to arrive at an understanding, support from multilaterals would be appreciated.

Infrastructure

- Infrastructure receives either intense attention (during a flexible fiscal environment) or intense neglect (during a stringent fiscal environment).

- There is a growing recognition that public-private partnerships are vital, but an enabling environment must be put in place to increase transparency and accountability; and ultimately, build institutions.
- Capital markets development is required to finance infrastructure development.

Recommendations for Follow-Up Action on Jakarta Meeting:

- Publish a compendium of all papers presented at the Conference. Make it available to multilaterals, the academe, government and private sector.
- For the next Conference, focus on fewer topics. Subjects suggested are energy, trade (Asia-Africa relations), and infrastructure.
- Involve the media for greater dissemination of studies, recommendations, and future plans.
- Enhance the EMF so that it may provide greater interaction among other cross-continent EMCs whereby solutions put forward by co-EMCs to challenges faced shall be discussed.
- Encourage greater participation of the private sector.