**Regional Symposium: Policies and Environment Conducive to Investment**

**The Australian APEC Study Centre/Melbourne APEC Finance Centre**

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**Opening Address: Gary Judd QC, Chairman, ASB Bank Ltd, CBA Group; ABAC member New Zealand and Co-Chair of the Advisory Group on APEC Financial System Capacity Building.**

In Bogor, Indonesia in 1994 the APEC Leaders agreed to adopt the long-term goal of free and open trade and investment in the Asia-Pacific. They declared that the goal would be pursued by further reducing barriers to trade and investment and by promoting the free flow of goods, services and capital among the APEC economies.

In the investment context, the Leaders fleshed out that declaration by outlining non-binding investment principles. The principles are standards against which the conduct of economies and investment participants may be measured. Principles of this sort may need to evolve to cater for changing circumstances. 16 years after the declaration of the investment principles when the 16 years old Bogor Goals were themselves being reviewed, ABAC decided to also look at the investment principles through a 2010 lens. The result was revised principles which ABAC has recommended to APEC Leaders.

The investment principles, both original and revised, have as their underlying objective the promotion of the free flow of capital between the economies of the region.

Like the 1994 principles, and the Leaders' declarations upon which they were based, the revised principles[[1]](#footnote-1) recognise the importance of investment to economic development, the stimulation of growth, the creation of jobs and the flow of technology in the Asia-Pacific region and reflect that most APEC economies are both sources and recipients of foreign investment.

The objective of this symposium is to build policy and implementation capacities to minimise investor risk in an uncertain global economic climate and to encourage and facilitate investment flows in the Asia-Pacific region.

As the principles emphasise the importance of promoting domestic environments that are conducive to attracting foreign investment, they are directly relevant to this symposium's objective. Policies and their implementation may be judged successful or not according to the extent they align with the principles so long as the principles themselves are the right principles and are sufficiently comprehensive.

What do the principles cover? This is a broad summary. They promote transparency in legislation and implementation of legislation. They promote non-discrimination regardless of the source of the investment including that foreign investors are treated no less favourably than domestic investors. They ban investment incentives which distort fair competition. They ban performance requirements that distort or limit expansion of trade and investment. They ban expropriation of foreign investments or measures having similar effect. They require member economies to ensure free and prompt transfer of funds related to foreign investment. They record acceptance by member economies that disputes will be settled promptly by recognised dispute resolution mechanisms and that access to such mechanisms will be facilitated. They require member economies to promote the temporary entry of key personnel for activities connected with foreign investment. They say member economies must endeavour to avoid double taxation related to foreign investment. They say that regulatory and institutional barriers to the outflow of investment must be minimised.

The principles also record that acceptance of foreign investment is facilitated when foreign investors abide by the host economy's laws, regulations, administrative guidelines and policies, just as domestic investors should.

The principles are directed towards domestic reform to facilitate and encourage investment flows. It is helpful to consider what an economies' financial sector would look like if it were adapted to support those principles.

Mark Johnson, an Australian ABAC member who is Chairman of ABAC's Advisory Group on APEC Financial System Capacity Building chaired the Australian Financial Centre Forum. It produced a report containing a vision.

The Forum's vision is to have –

A financial sector which is open, competitive and underpinned by strong, stable and sound institutions. It exhibits the lowest possible barriers to entry consistent with the maintenance of financial stability and integrity, so as to encourage new entrants and foster price competition and innovation. It is a sector with a reputation for transparency, integrity and efficiency. It is a sector where the critical mass of skills, experience and reputation encourages both domestic and overseas participants to do business. It thus exhibits a high-volume of cross-border transactions in a wide variety of financial products, services and currencies.

Were each of the economies within the APEC region to adopt policies and build capacities consistent with the Forum's vision, they would have no difficulty complying with the APEC Investment Principles. Moreover, those policies and capacities would tend to generate deep and liquid capital markets. The absence of such markets is an impediment to the facilitation and encouragement of investment flows. Investment flows are impeded both because without such markets access to capital is made more difficult and also because without them it is more difficult to lay off risk.

A key risk is currency risk. Domestic policies of the sort encapsulated by the Forum's vision and envisaged by the APEC Investment Principles may result in the eventual generation of deep and liquid capital markets which have the ability to facilitate risk mitigation but they cannot remove the underlying risk itself which arises from economies having separate currencies which may strengthen or weaken in response to various causes.

The introduction to the symposium's program referred to the recent report by the OECD and UNCTAD to the G 20. The complete passage from which the extract has been taken is this

Today's report [a report dated 4 November 2010] comes at a time when foreign direct investment ... flows to G 20 countries declined sharply

by 36 % in the second quarter of 2010 (or by 14% when compared to the second quarter in 2009), and when new risk factors, such as competitive devaluations, are emerging. As a result, G20 and global FDI flows for 2010 as a whole could remain stagnant, rendering a new global FDI boom a distant prospect. This is a matter of serious concern, since public investment is running out of steam, while private investment in the form of FDI does not appear to be ready to step up to the plate to sustain global economic growth.

Currency instability is an impediment to cross-border investments. It has been specifically identified as a major risk to be addressed in the context of public-private partnerships. It also creates major risks not just for cross-border investments but in relation to investment generally. Decisions, e.g. to expand a factory or invest in developing an export market become that much harder when there is much uncertainty about what will happen with the exchange rate in the medium term. Unlike the trader, for whom short-term volatility is the major problem because it inhibits making quick and accurate trade decisions, the investor can probably live with short-term volatility but instability over the longer term is a different matter.

As well as giving rise to the need to try to structure investments in a way which mitigates the risk of investment returns being undermined by currency movements, volatility and instability induce undesirable behaviour. For example, unpredictable capital flows cause some countries to maintain capital controls. Whilst perhaps being intended to deal more particularly with short-term capital flows, such controls are also barriers to investment. Consequentially they are also barriers to regional economic integration which is an APEC objective.

OECD and UNCTAD put forward competitive devaluations as a new risk factor. Competitive devaluations may perhaps be a *new* risk factor but they are simply one example of multiple causes of currency instability.

Capital flows may themselves be the cause of currency volatility and instability in some cases – and part of the cause in others. Interest rates which influence the carry trade, and the carry trade's influence on the market, are important factors. Longer term movements in exchange rates are more likely to be caused by the strength or weakness of particular economies and by monetary measures undertaken to deal with domestic conditions. If monetary conditions are loose there will be a tendency for structural depreciation arising from the increase in the supply of that currency.

There are some who see currency volatility and currency instability as part of a wider problem. For example, the late Tommaso Padoa-Schioppa, President of Notre Europe and a former Minister of Economy and Finance in the Italian government regarded what he called "unsustainable monetary disorder" as lying at the bottom of the global financial crisis. The multilateral trade and payments system needs, he said, to be defended "against the constant and lethal dangers to which unsustainable monetary disorder exposes it".

A 2009 Report of the Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System reached a similar conclusion. The Commission, chaired by Joseph Stiglitz -- 2002 Nobel Prize in Economics winner and member then Chairman of the Clinton Administration Council of Economic Advisers 1993–1997 -- was in no doubt that the international trade and financial system needed to be profoundly reformed to meet the needs and changed conditions of the early 21st century.

The Stiglitz Commission was of the opinion that there needs to be a new global reserve currency, declaring "This is an idea whose time has come".

Economist Barry Eichengreen edited, with Duck-Koo Chung, a collection of essays under the description Fostering Monetary & Financial Cooperation in East Asia. His own essay, Fostering Monetary & Exchange-rate Cooperation in East Asia, discusses the creation of an East Asian "parallel regional currency". He commences by noting that Leaders in East Asia are consistent in calling for cooperation to stabilise exchange rates.

The suggestion I put forward for consideration is the establishment of a parallel currency for the Asia-Pacific. What could be considered is the creation of an APEC reserve currency – for now let's call it the APECCU.

APEC's 21 members include the world's three largest economies, account for approximately 40% of the world's population, approximately 54% of world GDP and about 43% of world trade. APEC is probably better placed than any other institution to advance and achieve a concrete solution. It has the unparalleled experience of successfully advancing free trade and investment for the economies of the region. An APEC initiative might be the catalyst for global reform in the same way as APEC was able to be a catalyst for the successful completion of the Uruguay round. Obvious candidates for early participation would be East Asian economies outside APEC. But APEC has the institutional structure to get it up and running. So, to my mind an APEC reserve currency makes better sense than an East Asian reserve currency.

It could have the following features.

Its value could be fixed in a way similar to the way in which IMF Special Drawing Rights are fixed but would be based on a basket of the 21 APEC currencies. The value of the APECCU would fluctuate according to the fluctuation of the currencies in the basket.

The APECCU would not replace domestic currencies – it would not be a single currency for the region like the euro is for the euro zone economies. Economies would not be prevented from having exchange rate arrangements considered to be necessary or desirable for their own economies' monetary or other economic conditions. Their domestic currencies would adjust against the APECCU according to the arrangements they have in place. Control of their own monetary and other economic conditions would be enhanced because of greater stability of the exchange rate of their currency with the APEC reserve currency.

Volatility can be eliminated only by currency union. As the proposal is not for currency union, there will still be volatility as between an economy's domestic currency and the APECCU. This will arise both because of fluctuations in the value of the domestic currency and also because of fluctuations in the value of the APECCU.

Movements in the exchange rates of the larger economies would have greater influence on the APECCU’s value than movements in the smaller economies, but as one of 21 currencies the impact would be indirect and fluctuations might tend to cancel each other out. Even if that did not occur, there would be diversification unlike the present situation where changes in monetary and other economic conditions in the US have an immediate and direct impact on exchange rates with the US dollar. Whilst volatility of the APEC reserve currency will not be eliminated -- volatility in the movement of its value will be dampened by diversification. Dampened volatility will reduce uncertainty and risk.

Tommaso Padoa-Schioppa died suddenly earlier this year. He loved a quotation from Jean Monnet, as recounted in a eulogy given by Jean-Claude Trichet, President of the European Central Bank. Translated from the French it is: "When one is determined as regards the desired goal, one must act without making multiple hypotheses on the risks of failure. As long as you did not try it, you cannot state that the endeavour is impossible".

Plainly many difficulties would have to be overcome to bring to fruition a proposal for a parallel reserve currency within APEC. It is an ambitious proposal. But as expressed so potently in that quotation, difficulties exist to be overcome and if the goal is desirable we should not be deterred from trying.

The simplified aim of this symposium is to increase private investment flows within the Asia-Pacific region. Investment flows will be increased if uncertainties facing investors are reduced. Uncertainties will be reduced by domestic reforms to bring economies' laws, practices, policies and institutions into line with the APEC non-binding investment principles. Uncertainties would be further reduced if a way could be found to achieve currency stability and, more broadly, to eliminate monetary disorder.

1. <http://www.keidanren.or.jp/abac/report/en/20101014d.pdf> [↑](#footnote-ref-1)