Event Report

2014 ADB Annual Meeting

Notes on the 47th Annual Meeting of the Asian Development Bank, Astana, Kazakhstan

2-5 May 2014

Erik Famaey [1]

Connectivity was the main theme of discussion at this year's Annual Meeting of the Asia Development Bank held in Astana, Kazakhstan, from 2 to 5 May 2014. Participants told about the far-flung stopovers they had to make when flying in, and panelists talked about how Kazakhstan and the other Central Asian countries could benefit from a revived Silk Road linking Asia to Europe. Physical and financial challenges aside, Central Asia faces up to geo-political wrangling as both Russia and China push for strategic alliances. Russia has deep cultural ties and wants to re-engage the region following the collapse of the Soviet Union. China has security concerns at its western border and wants the region's oil and gas. Energy sales to China are already the region's largest export. However, Central Asia may yet find that financing and re-building new silk-road corridors do not help if politics, customs unions, red tape and corruption halt the traffic.

Whether for social welfare or for infrastructure, the massive need for development finance in Asia makes the ADB as necessary as ever, notwithstanding the graduation of many regional economies to "middle-income" status. The ambition displayed by the ADB is undoubtedly also spurred by China's plan to set up an "Asian Infrastructure Investment Bank".

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Physical and financial challenges aside, Central Asia faces up to geo-political wrangling as both Russia and China push for strategic alliances.[2] Russia has deep cultural ties and wants to re-engage the region following the collapse of the Soviet Union. China has security concerns at its western border and wants the region's oil and gas. Energy sales to China are already the region's largest export. Leaving no doubt, the state controlled Astana Times, a bi-weekly publication - and the single English language newspaper available at the conference, reported on the Kazakh intention to "further deepen the ties with Russia across the spectrum of inter-state relations" beyond the existing Customs Union which also includes Belarus. Having abolished custom controls at the common borders, the next step is the establishment of a Eurasian Economic Union (EEU).

The EEU treaty would come into force on January 1, 2015 and is to be extended towards other countries with Armenia and Kyrgyzstan as likely early joiners. The Union should further boost Kazakh business with Russia but it also increases Kazakhstan's exposure to the volatility of the Russian economy and its currency in particular. That is a particularly risky situation seeing the fall-out of the crisis in Ukraine on the Russian economy. There was also a cost upfront: the 19 percent devaluation of the Kazakh currency in February is seen as partly induced by the need to align the currencies in preparation of the union. For non-member countries such as China and the EU, tightening of the union's external borders (with Russia having imposed 82 percent of its customs tariffs unchanged) makes trading with the newly formed economic bloc on a non-preferential basis more difficult.

China, meanwhile, is investing billions of dollars in Central Asia's energy mining and in the related pipeline infrastructure eastwards. Yet China is also making huge investments in railway linkages throughout Central Asia. Last year it inaugurated regular rail services between Chongqing and Germany, a link that takes 16 days, some 20 days saving compared to seaborne transport.

For Russia, China, and Europe alike, the strategic geographic location of Central Asia can significantly strengthen the logistics of the global supply chain. Whether the Central Asian countries will benefit merely through transit fees or can integrate into global value chains, depends on more than roads, railways and pipelines. The ADB Research Institute sees poor soft infrastructure, such as slow customs clearance, and "a stubborn lack of regional cooperation in Central Asia", as the main factors that impede progress in trade facilitation.[3]

One important element in the soft infrastructure is the availability of trade finance. A banker panelist observed that the increasing regulatory pressure on international banks to hold higher capital buffers and apply ever more costly compliance procedures (Know-Your-Customer and Anti-Money-Laundering procedures), rendered trade finance services for SMEs in less developed countries uneconomical. As a result, banks are generally

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[2] Yu Xichao. (2014). China's Rise in Central Asia, Implications for EU interests. *EIAS EU-Asia at a Glance*, March 2014. Retrieved from http://eias.org/publication/eu-asia-glance/chinas-rise-central-asia-implications-eu-interests

[3] Asian Development Bank Institute (2014). *Connecting Central Asia with Economic Centers*. Tokyo : ADB

unwilling to grow this business and look for ways to keep it going. To shift the risk through "supply-chain finance", or to bundle a portfolio of transactions and sell it off to investors, are relatively sophisticated alternatives that are not yet readily deployable across Asia. The ADB offers a more traditional guarantee scheme that provides insurance on trade finance risk in Asia. It has also started offering supply-chain finance through cooperation with private banks.

ADB president Mr Takehiko Nakao echoed the concern: "What Asian financial institutions need is not just regulation but the promotion of financial activities that foster growth in developing Asia". The comment underlines that under president Nakao, now one year in function, the ADB keeps its focus on poverty eradication. Two-thirds of the world's poor live in Asia. The spectacular economic growth remained unequally shared.

How to realize inclusive growth by leveraging fiscal policy was one of the few questions at the conference where the European experience was looked at, albeit with contradicting messages: inequality in Europe is relatively low thanks to social welfare spending, but the expense is difficult to maintain. Furthermore, fiscal spending in Europe since the great financial crisis has failed because it did not deliver growth. Asia has big catch-up potential on the funding side and needs on the spending side, observed president Nakao: the ratio of tax revenue to GDP is 18 percent compared to 32 percent in the OECD and 22 percent in Latin America. Spending on education is just 3 percent to GDP in Asia against 5 percent in advanced economies and Latin America, on health care it is 8 percent in developed countries, 4 percent in Latin America and 2 percent in Asia.

Whether for social welfare or for infrastructure, the massive need for development finance in Asia makes the ADB as necessary as ever, notwithstanding the graduation of many regional economies to "middle-income" status. In 2013, direct financing by the ADB amounted to USD 14.4 billion (with disbursements hovering around 8 billion since 2010). Co-financing partners added 6.6 billion. In 2012 one dollar spent by the ADB was supplemented by six dollars from the private sector. The ratio dropped in 2013 but that volatility is partly explained by the relatively small size of the portfolio. Developing the private sector is a key element in the bank's strategy. In 2013 41 percent of the bank's projects supported private sector development, the goal is to lift the ratio to 50 percent by 2020.

The evolution illustrates the trend towards turning the ADB from strictly a "financier" to an "enabler" of private sector initiatives that lead to inclusive and environmentally sustainable growth. The strategy does not diminish the bank's ambition to strengthen its lending capacity. Following the tripling of its subscribed capital five years ago, another capital increase is being considered. In Astana, the bank also announced an innovative plan to merge the Asian Development Fund (ADF) into the mainstream resources of the bank. Since 1974 the ADF has existed as a pool for soft loans to the poorest countries. The fund was managed separate from the bank's balance sheet where the assets are mainly loans at market rates. Combining the two in a way that allows leveraging an expanded equity base would increase the ADB's lending capacity significantly. It would also ease the financial burden for the ADF donor countries, in particular for Japan, which contributes no less than 46 percent of the USD 33.5 billion fund.

The ambition displayed by the ADB is undoubtedly spurred by China's plan to set up an "Asian Infrastructure Investment Bank". The AIIB would start with a capital of USD 50 billion mainly, but not exclusively, financed by the People's Republic. President Nakao said the ADB is "happy to cooperate" pointing to the estimated need for USD 800 billion - annually over the next ten years - for infrastructure finance in Asia. In truth the ADB heeds the risk of being marginalised. Vice-President Bindu Lohani insisted that cooperation with the China led multilateral institution is conditional to the new bank holding up high standards, as the ADB would "never compromise on safeguards and social standards or governance issues".[4]

China's plan to set up a new development bank does not necessarily compromise its involvement in the ADB. Japan may be the ADB's major contributor and holder of the president's seat since its establishment, a feature that is similar to the practice at the IMF and World Bank, China gets great benefit from its membership, not in the least financially. The PRC is the largest beneficiary of loans from the ADB accounting for a quarter of the ADB's total exposure. The country also has the biggest share in the procurement of goods and services for ADB projects. At the annual meeting China's governor asked for more "voice and representation for emerging economies" but concluded pledging "support for the ADB to play its due role".

If ever the Japan-dominated ADB and the China-dominated AIIB are going to do some arm-twisting, it is unlikely that the financial muscle will make the difference. But were the AIIB to undercut the ADB's high standards on governance, social and environmental safeguards, it could well trump the competition.

Central Asia may yet find that financing and re-building new silk-road corridors do not help if politics, customs unions, red tape, and corruption halt the traffic. Similarly, no amount of multilateral finance will ever be enough to finance Asia's infrastructure needs, let alone realize the goal of inclusive and sustainable economic growth in Asia. Building a level-playing market with legal certainty for the private sector to unleash its resources should be the priority.

The ADB has earned itself a reputation as a "knowledge bank" that provides policy advice and expertise to member countries. It is also stepping up private sector development programmes. Furthermore, the bank works intensively on regional and sub-regional cooperation and integration, development of capital markets, gender equality, and many other issues that together make the institutional framework that is necessary to realize the promise that Asia holds.

Asia's growth is a win-win opportunity for East and West, already made to profit by many European companies through investments and trade. Still, Europe's part of the ADB's procurement and consultancy business is declining steadily.[5] With 17 percent combined, European countries as a bloc have the biggest voting power in the ADB. How to maximize the benefits of European shareholding in the Asian Development Bank and leverage it onto our private sector is a topic that deserves more attention.

[4] See http://www.emergingmarkets.org/Article/3337154/Asia/ADB-warns-China-on-new-infrastructure-bank.html

[5] Okano-Heijmans, M. & Waardenburg, D. (2014). The Asian Development Bank: What's in it for Europe? Economic Diplomacy and Geostrategic Interests in an Asian Context , *Clingendael Report,* February 2014

ADB key numbers (USD billion, at 31 Dec. 2013)

ASIA DEVELOPMENT BANK	
Subscribed capital	**162.8**
Main shareholders: Japan 15.7%, US 15.6%, China PRC 6.5%	
Paid-in capital and reserves	**17.1**
Total outstanding loans, guarantees and investments	**55.8**
Main country exposures: China 25%, India 22%, Philippines 9%	
ASIA DEVELOPMENT FUND	
Total received contributions	**33.6**
Main contributors: Japan 46%, US 12%, Germany 6%	
Total outstanding loans and investments	**35.3**
Main borrowers: Bangladesh 21%, Pakistan 18%, Vietnam 16%	

Source: ADB Annual Report 2013