Notes on the 50th Annual Meeting of the Asian Development Bank, Yokohama, Japan

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The ADB commemorates its establishment 50 years ago and reflects on the lessons learned from the Asian crisis 20 years ago. The ADB cooperates with but distinguishes itself from the AIIB and focuses on quality projects and poverty reduction. Will Europe look on as China leads the rest of Asia in setting new standards for global infrastructure and trade pacts?

The "who's who" of Asian financial policymakers and bankers blended all too nicely with the throngs of local 'Golden Week' holiday revelers shuffling around Yokohama Bay. Panelists at the 50th Annual Meeting of the Asian Development Bank showed little desire to disturb the cosy conference theme of "Building Together the Prosperity of Asia." However, this was keeping with good manners in Japan, and apart from debating the challenges ahead, the ADB's golden jubilee meeting had plenty of history to look back on.

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A partner to Asia's remarkable transformation

The ADB was established in 1966 with the mission to "foster economic growth and regional cooperation in Asia." Half a century later, the rise of Asia has been quite spectacular, and "the ADB has been a reliable partner in this remarkable transformation" according to its President Takehiko Nakao. The Bank forecasts that GDP in Asia excluding Japan will increase 5.7 percent this year and next. Developing Asia would then contribute 60 percent to global economic growth. As to regional cooperation, there is only so much that even a multilateral development bank can do if the heads of government cannot drop their guard. "As South Korean president, you're almost predestined to talk tough about Japan. That is how you appeal to South Koreans and maintain popularity", the Japan Times quoted a Korean journalist on the latest presidential election.[2]

And the world's most effective regional development bank

During its fifty years of operation, the ADB successfully transformed from a pure lender and 'family doctor' for developing member countries into an institution that provides finance and policy advice as well as technical expertise to public and private actors alike. The Bank built a solid funding base, well supported by its main sponsor Japan (with 15.6 percent the dominant shareholder), and then cleverly secured repeated capital contributions from the other 66 shareholding countries (Asian as well as non-regional) and then leveraged this by borrowing from the international financial markets at the best possible conditions (on the back of a solid triple-A credit rating). Furthermore, the ADB runs a lean and cost-efficient organisation. In comparison to its peers, the Australian Lowy Institute[3] judged the ADB as the world's most efficient regional Multilateral Development Bank.

The Asian Financial Crisis revisited

The ADB's 50th anniversary coincides with a less joyous anniversary. Twenty years ago, almost on the day that Hong Kong was returned to the People's Republic of China, the Asian Financial Crisis struck. Despite having passable fundamentals in terms of economic growth, external trade, budget deficits and sovereign debt, Thailand was driven to the brink of collapse when liquidity was withdrawn, shortly followed by Korea and Indonesia. Financial markets turned to panic when the plunge in Asian currencies against the US Dollar led to an unbearable currency mismatch between the dollar-denominated borrowings of the region's banks and corporates and their local currency assets. The contagion was propelled by the analysis that structural flaws were similar in countries across the region. Weaknesses included inflexible exchange rates, weak banking regulation and supervision, cronyism and poor governance in general. Deep down, the crisis fuelled doubts about whether the so-called 'Tiger Economies' that produced the 'Asian Miracle' on an export- and foreign investment-led economic model were on the right track.

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[2] http://www.japantimes.co.jp/news/2017/05/05/national/politics-diplomacy/anti-japanese-rhetoric-south-korean-presidential-campaign-wont-survive-geopolitical-reality-experts-say/#.WRwF0FKB2u4

[3] https://www.lowyinstitute.org/sites/default/files/documents/Strengthening%20the%20ADB%20in%2021st%20century%20Asia_Web_0.pdf

The Yokohama meeting's main panel discussion was aptly titled, "Twenty Years After the Asian Financial Crisis: Achievements and Ways Forward." At the event, Indonesia's finance minister, Ms. Sri Mulyani Indrawati, recalled some of the chilling facts that knocked her country out: the Rupiah fell 80 percent, inflation shot up to 80 percent, banks lost half their deposits, and GDP contracted by 13.7 percent. This proved to be a useful reminder for an audience with a new generation of bankers to the region. One wonders whether they, or Indonesia's youthful population for that matter, also mind the hardship that the crisis brought to the lives of ordinary Indonesian citizens. Under pressure from the creditors, President Suharto at one point ordered an overnight increase in the prices of fuel, gasoline and electricity by, 25 percent, 71 percent and 20 percent respectively. The ensuing social unrest led to violence in Jakarta and ultimately to the end of President Suharto's 32 years in power. Regime change also happened in Thailand and Korea.

And its lessons learned

The magnitude of the Asian Financial Crisis (AFC) overwhelmed the resources of the respective countries affected and of the ADB. In order to halt the currency slides and to stabilise the economies, rescue packages for the three aforementioned countries were made under the leadership of the IMF, while other Asian countries (notably Malaysia) took 'macro prudential measures' (actually, capital controls). Irrespective of the needs and the urgency, the intervention of the IMF was deeply resented by the Asian people. It was perceived as harsh and condescending and, in retrospect, also misguided as it forced austerity on imploding economies, a mistake duly acknowledged by the IMF. It was also criticised for using too much rescue money to bail out the broken banking systems, largely for the repayment of foreign banks.[4]

The Asian Financial Crisis was a traumatic experience for the policy makers. As the Australian economist and former board member of the ADB Peter McCawley writes in his commemorative book[5] on the history of the ADB: "the AFC was seen as a new type of crisis because it originated from the volatility of capital accounts" and "the crisis demonstrated to Asian policy makers that they should not rely solely on IMF support but also strengthen their own policies and institutions." The ADB set out to do so and was instrumental in the shaping of several measures. The two most notable initiatives are the swap arrangement scheme signed among Asia's central banks at the Annual Meeting in 2000, therefore referred to as the 'Chiang Mai Initiative' (CMI), and the 'Asia Bond Market Initiative' (ABMI) that aims at the development of Asian currency-denominated bond markets. The CMI provides Asian central banks with a short-term liquidity help source when a crisis situation reoccurs. The arrangement has since been upgraded to a multilateral scheme (CMIM) involving ASEAN+3 (Japan, China, Korea), increased in size, and institutionalised with an implementation and surveillance unit. That task is entrusted to a Singapore based independent organisation named 'ASEAN+3 Macroeconomic Research Office' (AMRO). At the Yokohama meeting, the new regional entity presented

[4] As much as it may seem unfair that IMF money was used to let creditor banks escape the Asian Financial Crisis largely unscathed, it was vital that foreign banks kept their credit lines open for import letters-of-credit opened by Asian banks.
[5] Peter McCawley, 'Banking on the Future of Asia and the Pacific - 50 years of the Asian Development Bank', published 2017 by the ADB

its first annual regional economic outlook report, adding a new valuable research source on the Asian economy.[6]

But we are doing better now and know it better too

Some view Asia's new and untested financial safety net as a lesser necessity. The region has more diversified sources of growth, invariably strives for ample current account surpluses and high foreign exchange (FX) reserves and showed good resilience during the 2008 Global Financial Crisis. Panelists agreed with Chinese economist Yu Yongding that FX reserves (even China's) are never enough and the focus should be on domestic policies. Ms. Akhtar Aziz Zeti, the former Governor of the Central Bank of Malaysia, asked that countries would get easier access to the safety net. Currently only 30 percent of the CMIM back-up facility is unconditionally available. A higher drawdown requires involvement from the IMF. Dr. Aziz wants that ceiling raised and diplomatically added that "the IMF should leverage on the regional expertise, we know the region better, and need urgent response" (Mind, in 1998 Malaysia declined IMF help and decided on stinging capital controls instead).

Economic integration or interdependence through trade and physical connectivity?

The other side of Asian policy makers' focus on domestic policies is a less ambitious approach towards regional integration. Brexit and other European woes vindicate the 'institutional light' model favoured by ASEAN, or so its leaders believe. "Asia does not want economic and financial convergence, a common currency is not a goal," said Dr. Aziz, who sees the central banking community as the drivers of regional integration. "We have an integrated crisis management framework. The central banking community is on the phone all the time, and governors can be together in 45 minutes when anything happens." In the material world Asia concentrates on trade and physical connectivity, interdependence really rather than integration.

Better a diluted trade pact than none?

Economic growth in the region and the rise of China at the tail-end of regional supply chains has helped intra-regional trade grow to 57 percent of total trade in 2015, not much under the 63 percent for the EU.[7] More demand from Asian consumers and new trade agreements are likely to raise the intra-regional share higher soon. Asia is determined not to let the backlash in the US and in Europe against trade treaties thwart its plans for trade pacts. Having overcome the initial disappointment, Japan is reconsidering the possibility of keeping the Trans Pacific Partnership (TPP) alive without the participation of the US. More likely is that the Regional Comprehensive Economic Partnership (RCEP), a regional alternative that includes China and India, gains the upper hand. Not only is the combined trade volume of the sixteen RCEP countries twice the size of the TPP down to eleven members, the RCEP is also lighter in contents, less intrusive and therefore easier to adopt. The crucial difference and downside however is that the RCEP would exclude rules on the important areas of labour and environmental standards and leave sensitive issues such as state-owned enterprises, government procurement

[6] http://www.amro-asia.org/asean3-regional-economic-outlook-areo-2017/

[7] see https://aric.adb.org/beta

and e-commerce with loose enforcement. Asia's big trade pact may therefore end up having minor substance, but the political and strategic attraction would make it a major trophy for President Xi Jinping who told the world at Davos that China would take over the lead in promoting free trade. A successful conclusion of RCEP would also be a welcome landmark achievement for ASEAN, which like the ADB celebrates its 50th anniversary this year.[8] New-generation trade agreements are meant to set a standard of excellence for international trade treaties in the 21st century as TPP and TTIP (the 'Transatlantic Trade and Investment Partnership' between the UE and US) were crafted to be. The window of opportunity seen by former US President Obama for the West to set the rules while it still can seems to have been closed rather carelessly. Will the hoped-for EU-Japan Trade and Strategic Partnerships prove pessimists wrong? Or shall Europe and Japan look on as China leads Asia and the rest of us towards lower quality rules for world trade?

The ADB doubles its estimate of Asia's infrastructure investment needs

Better physical connectivity is the other focus for regional integration. Investment in transport comes second only to electricity power generation in the infrastructure needs for the region. Because of higher growth in Asia and after adjustments for the goals of the Paris Agreement on Climate Change, the ADB has more than doubled its 2009 estimates for infrastructure needs in developing Asia until 2030 to a whopping USD 26 trillion, i.e. about a third of the world's current GDP. If the region is to maintain its growth momentum, eradicate poverty and respond to climate change, by 2030 USD 14.7 trillion would need to be invested in power plants, USD 8.4 trillion in transport, USD 2.3 trillion in telecom and USD 800 billion in water and sanitation. On an annual basis the requirement is USD 1.7 trillion against a current investment of only USD 881 billion. That leaves a huge gap of five percent to GDP (excluding China where the gap is only 1.2 percent), over half of which would need to be financed by the private sector. Specifically, private enterprises would have to increase their investments in Asian infrastructure from about USD 63 billion today to USD 250 billion per year over the period from 2016 to 2020.

Raising a multi-trillion dollar question about financing

Asia's huge needs for infrastructure financing compete with similar plans worldwide. Think of China's Belt and Road Initiative, Europe's Juncker Plan, and the 1 trillion dollar wish-list made in the US. How to generate the financing is a multi-trillion dollar question. At first glance, Asia starts with an advantage. The ADB calculated that fiscal reforms across Asia could generate additional revenues equivalent to two percent of GDP (thus bridging 40 percent of the estimated financing gap). As to the Belt and Road Initiative, China is prepared to stump up massive funding via its two state development banks, the Silk Road Fund, its state owned commercial banks and via the Asia Infrastructure Investment Bank (AIIB), the newly created multilateral investment bank that is now in its first full year of operation. In contrast, Europe and the US have scant opportunity on the public front to create more fiscal space for its infrastructure plans, with some voices even calling for central banks to finance them outright instead. A closer look from a private sector viewpoint shows Asia in a disadvantageous position. There is higher risk

[8] For further reading, see http://asia.nikkei.com/Features/Mirage-of-Free-Trade/The-long-frustrating-quest-for-free-trade-in-Asia

associated with developing countries where political, social, currency, legal and other concerns compound on the basic construction, implementation and operational risks of infrastructure projects. Furthermore, Asian finance is very much bank sourced, not well suited for the big tickets and long durations that are required to finance infrastructure projects. The ADB has put in place new policies and programmes geared towards risk mitigation, turning itself into a provider of finance plus knowledge. Its bond market initiative is part of policies that will develop Asia's capital markets, so they can retain and put to use more of the region's savings in Asia.

Is the ADB's quest for quality projects clashing with the mood of the times?

The ADB's strategy to become more of an 'enabler of bankable projects' is a challenge in itself but even more so when the environment increasingly presses for quick deliverables. Just like the US under President Trump balks at long and intricate talks for trade agreements, the Chinese approach to infrastructure projects tends to put speed and cost before other considerations. Under the Belt and Road Initiative, China exports its infrastructure-led development model to the rest of the world despite having burdened its banks with large non-performing loans. The overseas bilateral lending from China is already more than the combined loan books of the world's multilateral development banks and is growing fast. China's offshore investment drive comes with zeal and a set of provisions that recipient countries find difficult to resist. By contrast, the ADB's emphasis is on 'quality projects' – a characteristic relentlessly pushed by Japan – with high safeguards for social and environmental protection. Concerns that Chinese influence over the AIIB might relax such conditions have kept Japan and the US from joining the AIIB as shareholders. Most European countries brushed aside reservations and quickly followed the UK in signing up as AIIB co-founding members. Will Europe look on as China sets new, possibly looser benchmarks for safeguards at multilateral development banks? The concerns seem overdone. At the Belt and Road Summit held in Beijing the weekend after the ADB conference, the European representatives collectively withheld from signing the Summit Declaration, finding it too light on matters regarding transparency of public procurement policy as well as environmental and social standards. Meanwhile, the ADB and the AIIB have already co-financed a few projects, and in Yokohama the presidents of both institutions reiterated their willingness for further cooperation.

It takes a Multilateral Development Bank to take on multiple challenges

The spiraling need for quality infrastructure in Asia is bound to remain a focus area for the ADB even 50 years after its establishment. But the region's economic development has led stakeholders to pull attention to other areas. Becoming the world's most successful manufacturing base is leading to growing inequality. Furthermore, with the exception of Korea and Taiwan, Asia's emerging industrial economies have difficulty escaping the so-called 'middle income trap' whereby a country's workforce has become too expensive to remain competitive but not yet high-tech enough to beat the leading bracket. Considering as well the impact of ageing, now starting to bite China too, Asia now joins the advanced economies in worrying about the stagnation of productivity. Meanwhile, some of the bank's shareholders think that China should slowly 'graduate' from the ADB's development finance.

Japan's Crown Prince's valuable message to the ADB, will Europe also have one?

All the aforementioned issues were the subject of discussions at the Yokohama meeting and shape the future direction of the Bank under its 'Strategy 2030'. But in his speech during the Opening Session, Japan's Crown Prince Naruhito, reminded that "there are still over 300 million people living in poverty in this region, and poverty reduction through sustainable and inclusive growth remains an important agenda." His Imperial Highness touched an issue at the heart of the debate about the future of development finance in Asia. Whereas the AIIB's president Jin Liqun says that "in the articles (of incorporation) of the AIIB, there is nothing about the overarching objectives of poverty reduction,"[9] the ADB's President Nakao continues to cite poverty first when talking about the priorities ahead. As member of both development banks, European countries together hold over 20 percent of voting rights in both the ADB and the AIIB. Their shareholding translates into real voting power only if they speak with one voice. For European countries, engaging effectively with Asia's two Multilateral Development Banks, should be a collective responsibility, and must be seen as an opportunity first and foremost.

[9] in the Financial Times, Special Report, on Asian Infrastructure & Trade, FT, May 4 2017

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