

Case for Financing Cross-border Infrastructure in Mongolia and Russian Far East

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Summary

There is a large amount of financing demand for the infrastructure construction in Mongolia and the Russian Far East, particularly for the cross-border projects for natural resources, technology spillovers and trade and logistics. It is very difficult for any single country to undertake the huge amount of investment as well as risk alone while a regional development financial institution would meet the requirements and provide financing for such projects continuously. Furthermore, the current multilateral financial institutions could not meet financing need of infrastructure construction. One approach to finance cross-border infrastructure is to establish a new region-based development bank. The establishment of the Northeast Asia Bank for Cooperation and Development (NEABCD) effectively supplement deficient investment of other multilateral financial institutions. In addition, the NEABCD can also form a complementary cooperation relationship between other international financial institutions.

Issues in Financing Cross-Border Infrastructure Projects

Geography of Mongolia and the Russian Far East indicates the significance of cross-border infrastructure. Natural resources in landlocked Mongolia, as well as inland area in the Russian Far East, could not be promptly transported and exported without good cross-border (or international) railways and highways.

Based on current data of Mongolia and the Russian Far East, there exists a huge capital demand on the infrastructure construction for projects of energy cooperation, natural reserves exploitation, low carbon economy development, energy conservation and environmental protection, logistic and transportation and technology trade. For instance, it is estimated that in next thirty years, the upgrading and renovation of current energy infrastructure in the Russian Far East at least need 150 billion dollar investment. In addition, the major natural gas projects require 100 billion dollars investment, the major oil projects require 20 billion dollars investment, and the hydroelectric system construction requires 8.4 billion dollars investment.

The major cross-border projects feature a large amount of capital and a long investment payoff period. The financing of major cross-border projects is far beyond the capacity of mobilizing the deposit and foreign exchange of one single nation or one certain region. To achieve a high level of infrastructure investments will require substantial transfers of external financial resources to the region. The questions to be addressed, therefore, are how and where financing in the amounts projected as necessary to meet infrastructure investments can be secured. A study sponsored by the Northeast Asia Economic Forum concludes that financing for infrastructure in Mongolia and the Russian Far East would have to come from three main sources: (1) private sector credits and investments, (2)

bilateral official assistance and (3) the existing multilateral development banks (the Asian Development Bank and World Bank). These three sources, however, cannot successfully provide the funds for cross-border infrastructure projects.

First, cross-border infrastructure projects are too risky for the private sector credits and investments. In the long-term strategic perspective, projects have a great profit potential, but low profitability in the short term. Currently, most of the successfully operated large-scale cross border projects are supported by the loans and guarantees of major policy international or regional financial institutions that do not aim for short-term profits. The sole private capitals normally do not have the capacity or will to invest in the major cross border projects independently.

Second, bilateral official assistance is easily affected by domestic and international politics. Japanese financial assistance to Mongolia is politically acceptable, while it is sometimes argued whether Mongolia has strong financial capacity to repay possible loans from Japan. Financial assistance from Japan to Russia with the intention to construct cross-border infrastructure would be politically unacceptable unless territorial issues over the Kurile Islands proceed toward a solution. An issue of financial assistance coordination exists even when all the concerned countries could overcome domestic political issues. They will have to cooperate and decide who pays how much for what activities. Aid coordination is important but difficult task when interests of many countries are different.

Third, it is difficult for the Asian Development Bank (ADB) and the World Bank to provide large amount of funds to cross-border infrastructure projects. These multinational development banks have their comparative advantages in financing and managing these large-scale projects. However, actors who can receive their financial credits and investments are sovereign governments and entities with the government guarantees. Sub-sovereign actors cannot borrow directly from the ADB and the World Bank. Therefore, funds will have to go to Moscow at first before they are delivered to the Russian Far East. A coordination problem would emerge in financing cross-border infrastructure projects at a sovereign level. Concerned governments will have to agree on terms of assistance to a particular cross-border project.

A Solution: the Northeast Asian Bank for Cooperation and Development

The most effective solution to meet this shortfall would be the creation of a new sub-regional development financing institution: the Northeast Asia Bank for Cooperation and Development (NEABCD). The purpose of the NEABCD would be to supplement the capital transfer activities of the ADB, the World Bank, and private and official sources, thereby ensuring a more adequate flow of capital to Mongolia and the Russian Far East for infrastructure development projects.

Since long-term capital available in international capital markets is potentially available to

finance the region's projected net capital investment needs, the issue is how to tap these capital resources; that is, how to mobilize and transfer (intermediate) funds from international capital markets to the region. After evaluating the alternatives, it has been concluded that a new financial mechanism must be established that is capable of intermediating long-term capital from international capital markets to Northeast Asia for infrastructure investments. This capital intermediation requirement provides the rationale and the justification for establishing the NEABCD.

The proposed NEABCD would supplement, but would not supplant, the contributions of the existing multilateral financial institutions (the Asian Development Bank and the World Bank) to advancing the region's economic development. NEABCD financing would be primarily directed to infrastructure projects that would benefit the countries and the region as a whole. The NEABCD would also provide technical assistance in the identification, design, evaluation and implementation of such projects. In addition, the NEABCD would provide technical advice on the preparation and implementation of policies, legal framework, institutions, etc. needed to support and facilitate the region's development. Detailed information on the proposed NEABCD will be written in the Appendix.

Appendix

1. The Feasibility for Establishing the NEABCD

1.1.1. The Basic Credentials are Matured

Currently, the Northeast Asia region is the third largest regional economy in the world and is preceded only by United States of America and European Union. It is also the region with the largest development potential and fastest economic growth among the world. The total foreign exchange reserves rank first in the world. China, Korea and Japan are all major capital-exporting countries. We have the ability of absorbing as well as allocating the financial resource and we have the ability of management.

The Northeast Asia region has formed a network production sharing structure. Resources, capital, technology, production, management, marketing and service are formed robustly. The high dependence between each NEA country has set up a good economic foundation for the mechanism of sharing the mutual benefit and risk and provide the energy for the further regional development.

During the process of overcoming the global financial crisis, Northeast Asia countries have realized that the regional cooperation can never be overestimated. The establishment of the NEABCD is a very objective choice for the economic cooperation and financial cooperation.

1.1.2. The History of the Research and Institutional Supports of the NEABCD

The idea of the NEABCD was proposed in 1991, when NEAEF had its first annual conference in Changchun and Tianjin, China. It was proposed as Northeast Asia Development Bank (NEADB).

NEAEF promoted the initial research on the establishment of the NEABCD in the following years. In 1997, in the 7th annual conference of NEAEF held in Ulaanbaatar, Mongolia, the proposed bank became a major topic and Dr. Stanley Katz's leading research on this topic draw increasing attentions.

In 1999, the 9th annual conference in Tianjin made the topic more attractive and thereafter, the bank topic was discussed thoroughly in almost every annual conference. Tianjin made commitments on the NEABCD¹ and Tianjin became one of the most active cooperative partners for establishing the NEABCD. From then on, Tianjin played a very important role in promoting to establish the NEABCD.

¹ Please refer to the attachment

6th Ad-Hoc Committee Meetings were held for establishing the NEABCD in Tianjin, Los Angeles and Honolulu, respectively. On the 4th Ad-Hoc Committee, the so-called NEADB were changed to the NEABCD to avoid the misunderstanding between the ADB and the NEADB.

Under the leadership of the NEAEF and with the strong support from Tianjin Municipal Government, in 2009 the Research Center for Financial Cooperation in Northeast Asia was established at Nankai University, Tianjin, China. Its charters indicate that the purpose and mission of the Research Center is to establish the NEABCD. It is fulfilling its mission now.

1.2. The Consensus on the Establishment of the NEABCD

It has been more than 15 years since research began on the establishing the NEABCD under the leadership of the NEAEF. Many conference materials document the each step of progress of the research efforts. Various research organizations from China, Korea, Japan, Mongolia, Russia and the United States have continuously supported and actively participated the research and discussion about promoting the establishment of the NEABCD, Consensus is reached from non-government level that it is necessary and feasible to establish the NEABCD and the time appears ripe to move the Bank proposal forward on a fast-track basis. On that basis, the Bank can be established considerably sooner than had been anticipated earlier.

The China Development Bank, the China Export-Import Bank, the Korean Export and Import Bank, the Japan Bank for International Cooperation are governmental affiliations and can get involved in the research on establishment of the bank.

The idea of the establishment of the NEABCD has already obtained the supports and endorsements form some governments and international organizations. Chinese central government has clearly states that will fully support the research on the establishment of the NEABCD. Many governmental officials in their private individual capacity and researchers from all the countries in the region expressed their supports and the UNDP and Parliament of European Union also sent their representatives to attend the discussions and give full concerns.

China's rising provides more opportunities for the NEABCD. As discussed in a series of meetings in Honolulu and Tianjin, China has been playing very important role in the world economy and in the Northeast Asia region. China is also willing to make any necessary contribution to the regional economic development and the integration of regional economy. Tianjin, as the financial and economic center of Northern China, provided, is providing and will provide very strong support for the establishment of the NEABCD.

Various Memorandums from recent meetings emphasized the importance of cross-border projects and sustainable development, which is a very important complimentary for the work of the ADB and World Bank.

From the analysis of existing cases, the regional and sub-regional multilateral financial institutions are able to coexist with each other: the European Bank for Reconstruction and Development and European Investment Bank in Europe; the Nordic Investment Bank for the development of the Nordic countries; and the Inter-American Development Bank for Latin American and Caribbean countries.

2. Purpose, Character, and Principle of Northeast Asia Bank for Cooperation and Development

2.1 The Purpose – To Promote the Sustainable Development of Northeast Asia Region

The NEABCD will put priority on large scale cross border infrastructure construction, energy and natural resources development, energy-saving and emission-reduction, low carbon economy, environmental protection and promotion of intraregional trade and investment and meet the continuously capital demand of middle income country or country which gradually stepping into the middle income level.

2.2 The Character – Sub-regional Multilateral Policy Bank

The NEABCD will accept capital contribution of Northeast Asian nations' policy banks with governmental background and allocate the investment capital through policy-oriented operation.

2.3 Capital Scale – Proposed 40 Billion Dollars for Initial Capital

2.3.1 The total capital amount

The current practice of the multilateral financial institutions is to take the total GDP amount of the area as the chief reference to fix the total capital amount, i.e. to fix the ratio of the bank's capital amount to the total GDP amount of all countries in the area. In our case the capital amount of the NEABCD will be mainly determined by taking reference to the GDP amount of all countries in Northeast Asia, while the investment demand in the region and the orientation of the NEABCD will also be considered.

With regard to the following such as the total GDP amount in Northeast Asia, the current practice of the capital amount determined by the membership countries of multilateral financial institutions, the tremendous investment requirement in Northeast Asia, and the Bank's main objective of supplying fund to the basic facilities construction in the region, we consider to set the ratio of the NEABCD's total capital amount to the GDP amount of

all countries in Northeast Asia as 0.5%. Therefore, the NEABCD's total capital amount will be USD 40 billion.

2.3.2 Subscription Approach

The equity of the NEABCD is composed of paid-up capital and uncalled capital. The paid-up capital, which is the actual capital every member country contributes, is the original capital when the NEABCD starts to operate; while the uncalled capital is a back-up fund which will not be paid unless the NEABCD meets with some emergencies or operation crises.

In order to design the paid-up capital ratio, we must not only draw the experience from other multi-lateral institutions but also take the financing needs and the economic strength in Northeast Asia into account. The following table shows the paid-up and uncalled capital ratio of the major multilateral institutions.

Table 1. The paid-up and uncalled capital ratio of the major multilateral institutions

Bank	Paid-up Ratio	Uncalled Ratio
World Bank	20%	80%
Asia Development Bank	7%	93%
European Development Bank	30%	70%
American Development Bank	4.3%	95.7%
Nordic Investment Bank	10.1%	89.9%

The NEABCD's main objective is to supply fund for basic facilities construction in Northeast Asia. These projects generally need huge amount of fund and take many years, thus the paid-up capital by the membership country should be as much as required. In addition, with regard to the economic strength of every member country, the paid-up capital ratio will be set as 10%.

With the economic development and increasing financial demand, the NEABCD could gradually increase the capital and stock.

2.4 The Principle of Share Allocation – Considering All Aspects of Northeast Asia.

The Northeast Asian countries are the major shareholders with a controlling stake. The non-regional countries and international financial institutions can also take part in the NEABCD. The share allocation of every Northeast Asian country could refer to every

nation's GDP, foreign exchange reserves, foreign trade volume and their relevant growth rates, using the synthetically weighting method.

2.5 Selection of Headquarter – Consider the Efforts and Credentials from the Candidates

Selection for the Headquarter of the NEABCD should reflect the efforts and credentials from the candidates that could be from any country in the region. The headquarters of the NEABCD should be located in the Northeast Asian region and must meet the following requirements: capabilities for both domestic and external financing expansion, effective channels of international transportation and communication, low cost operational environment, and ability to provide high quality offices, living accommodations, educational facilities and feasible logistic services. According to the convention of multilateral financial institutions, the headquarters should have strong policy support from both central and local governments of whereabouts.

In China, Tianjin is proposed to be the headquarter place for its previous efforts and economic development and potentials. Tianjin municipal government is committed to provide an office building for the NEABCD. Tianjin is also committed to providing convenient working and living conditions such as health care and education facilities for children for the NEABCD staff and officers. Prefecture of Niigata in Japan officially shows interest to invite headquarter of the NEABCD to City of Niigata.

2.6 Selection of Chairman of the Board and President of the NEABCD

After the site selection of bank headquarter, considering the benefits of the headquarter-located country and the other countries, shareholders will select the Chairman of the board. The president of the bank will be recruited through a world wide open selection, and adopt the fixed-tenure appointment system