

Research on the Establishment of Northeast Asia Bank

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The “Joint Declaration on the Promotion of Tripartite Cooperation among the People's Republic of China, Japan and the Republic of Korea” which was issued by the leaders of China, Korea and Japan in 2003 set out that governments are a major force in promoting multilateral cooperation. Meanwhile it welcomes the participation of industry, business and academic communities as well as civil organizations. It is in this spirit and by the support of Tianjin municipal government that we carry out researches into issues related to the Northeast Asia Bank (hereinafter referred to as ‘the Bank’). We sincerely hope to widely exchange our views over these issues among all experts and to make joint efforts for our common great expectations.

1. The Analysis of Conditions of Establishing the Northeast Asia Bank

We believe the possibilities of establishing the Bank mainly lie in the following aspects: the enormous financing and investment demand in Northeast Asia, the consensus acceptance of banking functions by every country in the region, the prospect for the economic integration in Northeast Asia, and the foreign exchange reserve of the Northeast Asian countries.

(i) The Enormous Financing and Investment Demand for the Infrastructure Construction in Northeast Asia

The infrastructure construction projects in the region consist of energy exploitation, transport network, environmental protection and cross-country economic cooperation.

Energy exploitation will become a key issue of Northeast Asia economic cooperation. According to the forecast by International Energy Association (IEA), the growth of energy demand in Northeast Asia will be 8 to 10 percent per annum in the first 30 years of the 21st century.

Consequently, enormous funds will be needed in further energy cooperation and exploitation in Northeast Asia: USD100 billion on the project of natural gas; USD20 billion on the project of oil; USD8.4 billion on the project of water-supply and electricity. It is estimated USD150 billion are needed to renovate and reconstruct the energy infrastructure in the Far East in the following 30 years.

Future transport network in Northeast Asia mainly include: railway network, cross-sea network, airport and sea port logistic network

The land transport routes which will be built include: Tumen River transport corridor, Korean peninsula transport corridor etc. Russian and Korean experts estimate USD2.5- 5 billion will be needed to renovate railway system in the Korean peninsula. Meanwhile, billions of dollars are also needed to restore the road and railway network in Tumen region

The Northeast Asia plans to build three sea tunnels in the future: the Korea-Japan sea tunnel, the Bohai Sea Straight sea tunnel and the Russia-Japan sea tunnel. They will be significant parts of the paths connecting cities surrounded by Huanghai Sea and Bohai Sea, and important parts of Siberia continental bridge. The Korean experts expect it will take 30 years and USD60 billion to build the Korea-Japan tunnel. The Bohai Sea Straight tunnel needs an investment of USD 14 to 20 billion, while the amount for Russia-Japan tunnel is between USD15 and 50 billion.

The constructions of cross-country economic cooperation zone mainly consist of Tumen River region and border economic cooperation zone. The infrastructure construction in Tumen River region needs an investment of USD100 billion, i.e. USD1 to2 billion per annum. However, the total FDI amount is only USD1.8 billion, which is far short of the UNDP's original plan to raise USD30billion in 20years. The financing needs of Sino-Russian, Sino-Korean, Sino-Mongolian and Sino-Russian-Korean cross-border economic cooperation zones are also gigantic. For example, only the Huichun-Hashang-Luoxian cross-border economic cooperation zone is expected to need USD10billion.

(ii) **The Relevant Interest and Consensus among Countries**

As a product of cooperation among governments, the establishment of the Bank not only needs the support of northeast Asian countries but of other countries as well. Because of the large scale of financing needs and import of advanced technology, we need the participation from other more countries, regions and international organizations. The support from all parties is a primary

driving force in establishing the Bank.

1) Countries in Northeast Asia

Japan will be an important investor in the process of developing Northeast Asia. Meanwhile, it is also the beneficiary of energy exploitation. Therefore, it needs a multilateral platform to shoulder the regional exploitation obligations and to realize its own interests. The Bank offers Japan such an opportunity.

The establishment of the Bank will be a great impetus to the Korean national policy of “A peaceful and prosperous Northeast Asian Era”. In 2003, President Policy Plan Committee---the Korean President’s think tank, listed establishing the Bank as one of the ten new conceptions of Northeast Asian Era. It has become a major policy of the Korean government to promote the establishment of the Bank.

The Strategy of Exploiting Far East and Siberia, which was constituted by Russia in 2003, clearly set the Far East and Siberia as key to its future national economic development. The Bank to be established will provide Russia with large scale of low-cost fund and technical support. In addition, the involvement in establishing the Bank will offer Russia an important channel through which to participate in Northeast Asian affairs.

The infrastructure construction projects in North Korea and Mongolia have a high demand for fund support. At present, both countries are making efforts to introduce foreign technology and attract fund to restore domestic economy. The Bank will therefore provide fund support to the two countries for their economic construction, which will be helpful to improve the living conditions of the people in both countries.

2) Countries and Organizations outside the Region

For U.S and EU, the promising future of Northeast Asia will bring them a lot of profiting opportunities. Joining the Bank, first, they may enjoy relevant privileges as member countries and participate in the Bank’s decision-making to express the interest requirement for their own countries; second, enterprises of member countries may be preferred in bidding infrastructure construction projects and being selected for making investment.

The goal of the World Bank, UNDP, Asia Development Bank and other international organizations is to raise fund for global or local development. However, it is difficult to meet the needs of every country at the same time. The Bank will provide such organizations a long-term

channel for investment in Northeast Asia, e.g. set up special fund managed by the Bank. This may help enhance their influence in the region and set up a good example for other sub-region development.

(iii) The Prospect of Northeast Asia Economic Integration

The issue of promoting northeast Asian economic integration has drawn intense attention and active support from related countries. In Oct. 2003, the Chinese, Japanese and Korean top leaders released the *Joint Declaration on the Promotion of Tripartite Cooperation among the People's Republic of China, Japan and the Republic of Korea* during the ASEAN+3 Summit in Indonesia. The *Joint Declaration* points out that the three countries will strengthen comprehensive and future-oriented cooperation in various fields, including trade, investment, and finance on the basis of equality, mutual trust, mutual respect, mutual benefit, and all-win situation. In Nov.2004, during ASEN+3 Summit in Laos, the leaders of China, Japan and Korea passed the *Strategy of Cooperative Actions among China, Japan and Korea* and the *Report of Cooperation Progress among China, Japan and Korean* and further made it fixed the policy of promoting the economic integration of three countries under the framework of the *Declaration*.

The *Joint Declaration*, particularly points out the necessity of enhancing the cooperation in finance: In order to promote the regional economic stability, the three countries should continue with more dialogues regarding economic policies and deepen the regional economic cooperation process in future including exploring the possibility of establishing the regional financing and stabilizing mechanism, and developing the regional bond market. The three countries will strengthen the cooperation and coordination in international financial organizations. The *Report of Cooperation Progress among China, Japan and Korea* also points out the direct investment by the three countries will be helpful in realizing their all-win expectations and achieving the economic integration in Northeast Asia. In addition, the *Report* put forward that further efforts should be taken in encouraging the direct investment according to actual needs, and in dealing with especially the specific problems confronted with by investors such as investment obstacles.

To summarize, the major countries in Northeast Asia hold positive attitude toward Northeast Asia economic integration, and pave ways for comprehensive economic and financial cooperation. Meanwhile, they have laid a sound political foundation for the establishment of the Bank

(iv) The Foreign Exchange Reserve in Northeast Asia

All parties of the Bank shall become shareholders only with the foreign exchange reserves provided with by their governments. Therefore the foreign exchange reserves of each country in Northeast Asia are a direct influencing factor determining the successful establishment of the Bank. The total foreign exchange reserves of all six countries in Northeast Asia reached USD2400billion by the end of July, 2006, during which China has exceeded Japan and become the country with highest foreign exchange reserve in the world since March 2006. At the end of July 2006, China's foreign exchange reserve reached USD941.1 billion. Japan is the second with USD871.9 billion. And the number of Russia and Korea are 265.6billion and 225.7 billion respectively.

The high reserve level and multi-currency structure will raise the Bank's credit rating, increase the international investors' confidence, and thus facilitate the financing capability of the Bank in international financial market so as to lower its financing cost and increase financing efficiency during future operation.

2. The Framework Design of Northeast Asia Bank

There are mainly three key points in the framework design of the Bank: 1) The theoretical orientation of the Bank, including the nature of the Bank and its relationship with other multi-lateral financial institutions; 2) The capital arrangement, i.e. the total capital, subscription method and equity ratio; 3) Resource and operation of the fund.

(i) The Theoretical Orientation of the Northeast Asia Bank

1) The nature of the Bank

If to take into account the actual financing needs in Northeast Asia and the experience from other multilateral international financial institutions, a policy-oriented bank is the best suitable choice. The Bank should be a sub-regional policy-oriented bank as well as a financial institution executing the long-term financing and investing plans for each government in the region whose capital is to be provided with by the government or the governmental financial institutions of each country in the region as its initiators and shareholders.

There are two following reasons:

First, as being a policy-oriented bank, it aims mostly to provide fund support to the infrastructure construction projects in the region. The fund required for by these projects is usually of huge amount and long term. Consequently, it is the policy-oriented bank that is able to meet the requirements of providing low-cost financing.

Second, although as being a policy-oriented bank, yet it does not mean the Bank will operate entirely without considering the market. The Bank will allocate its fund mainly according to the market parameters. It will have the same means of financing and investment as modern commercial bank does. Besides, the Bank will enjoy the advantages such as having high credit rating, making large scale of financing and investment, and offering lower lending rate.

2) Relations between the Bank and other multilateral financial institutions

The relations between the Bank and other multilateral financial institutions will be complementary, cooperative and coexisting, but not substitutive. There are three reasons:

First, the Bank will make up the investment shortage in Northeast Asia by other multilateral financial institutions. The existing multilateral financial institutions can not meet the financing demands for basic facilities construction in Northeast Asia. For instance, the Asia Development Bank, as a multilateral financial institution in Asia, puts its investment mainly in Southeast Asia and South Asia. There is only 4% of its total investment which is put in Northeast Asia. As the largest development bank in the world, the funds of the World Bank are mostly invested in Latin America and Africa. Therefore, the Bank will have a wider space for its business development.

Second, from the analysis of existing cases, the regional and sub-regional multilateral financial institutions are able to coexist with each other. In Europe, there is the European Bank for Reconstruction and Development and European Investment Bank .Besides, the Nordic countries set up Nordic Investment Bank for the development of their local economies. In America there is Inter-American Development Bank and North American Development Bank which complements each other.

(ii) Capital and Equity Structure of the Bank

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 Bank 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 Bank 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 Bank's total capital amount to the GDP amount of all countries in Northeast Asia as 0.5%. Therefore, the Bank's total capital amount will be USD40billion.

2) Subscription Approach

The equity of the Bank 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 Bank starts to operate; while the uncalled capital is a back-up fund which will not be paid unless the Bank 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

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 Bank'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%.

The detailed subscription approach is as followed:

- (a) Provided that the Bank's total capital is USD40billion, which will be raised by 4million shares, each worth USD10, 000.
- (b) The Bank's paid-up capital ratio required is 10%, i.e. the total paid-up capital will be USD4billion.
- (c) The paid-up capital shall be paid within a number of years. Half of the total amount shall be paid with freely convertible currency (e.g. US dollar), the rest may be paid in each country's domestic currency.

3) Design of equity structure

(a) Principles of equity ratio

Two principles are critical to the design of the equity ratio: first, equality and mutual benefit; second, the ratio shall indicate the economic development and the potential development of the member countries.

(b) The equity ratio of countries in/outside Northeast Asia

To design such a ratio, we must first consider the need to attract fund and import technology from developed countries, so that certain amount of shares should be distributed to those countries outside; second, we must put the interest of local countries first, therefore, they should be given the lion's share. With regard to the practice of other multilateral financial institutions, and the Bank's principle being to better serve the member countries in Northeast Asia, the equity ratio to member countries in Northeast Asia shall not be less than 60%, and the rest 40% shall be subscribed by multilateral financial institutions or countries outside the region.

4) The design of equity ratio of member countries in Northeast Asia.

In designing such a ratio, the World Bank and other institutions use weighting average by taking into account of the three main economy indicators: GDP, Forex Reserve, and foreign trade volume. In selecting the economic indicators as reference for designing the Bank's equity ratio, on one hand we should consider the factors of GDP, foreign exchange reserves and foreign

trade volume; on the other hand we should focus more on their respective growth rate which can show each country's investment capability, economy actuality, and its development potential and interest claim. All these are essential considerations in designing the Bank's equity ratio to each member country in Northeast Asia.

In order to accelerate the establishment of the Bank, the assigned governmental representatives of each country in Northeast Asia are highly suggested to hold negotiations on the related issues as early as possible. Considering the urgency of the Bank's establishment, we can take flexible ways for negotiation. For instance, the governmental policy-oriented financial institutions of each country can hold negotiations directly with the large enterprises hold by their governments to quicken the steps for the Bank's establishment. The governmental policy-oriented financial institutions in Northeast Asia include: China Development Bank, China Import and Export Bank, South Korea Development Bank, South Korea Export and Import Bank, Russia Development Bank, Development Bank of Japan, etc.

(iii) The operation of the Bank

1) Capital sources

At the early phase after the Bank's establishment, because of the relatively fewer shareholders and small capital, the main source of fund is the submission from share holder countries, including direct fiscal investment, investment from policy-oriented financial institutions and large enterprises hold by government. When condition meets, long term funds and other funds with long term character of member countries can be absorbed directly.

With the increase of the Bank's shareholders in number and the enlargement of its capital, apart from submission from shareholders, other ways such as bond launching, funding and direct loaning can be considered.

2) Capital operation

At the start period of the Bank's establishment, due to its small capital, the main field of capital use is operated by "agent" model, i.e. the project to be invested in Northeast Asia from other multilateral financial institutions are consigned to the Bank. The funds can be received and paid, managed, and used by the Bank according to the intuition's instruction or special purposes. The agent businesses include information technology services, loan transferable services and

project consigned agent business, etc.

With the increasing channels of the Bank's capital sources, other ways of funds operation can be expanded, such as loans, stock investment, joint financing, fund investment, technology aid and Grant Aid.

3. The analysis for the headquarter location of the Bank

(i) The analysis of selecting headquarters location by multilateral banks

From the headquarters location selecting experiences of multilateral financial institutions, the headquarters site conditions of the Bank should include: unparalleled geographical location, convenient transportation and communication, tremendous economic development potential, favorable policy and stable financial environment.

(ii) The conditions in China meet the requirements of the headquarters location

China has made tremendous achievements since its economic reform and opening to the outside world. The market economy system is being established and its open economy rapidly develops. China has been preliminarily chosen as the world manufacturing base in the global work allocation system. What's more, China's FDI has continuously reached a high level around the world over the past few years. Placing the headquarters of the Bank in China will make full use of the foreign capital flowing into China, thus guaranteeing the Bank's capital sources for its operation after the establishment. Besides, as the biggest developing country in the world, China needs an enormous amount of fund for its basic facilities construction and therefore provides a huge market for the use of the Bank's capital.

In the aspect of finance system reform, after entry into WTO, China has gradually fulfilled its finance opening policy and has made progress in its capital market reform and opening, banking and interest marketing reform, finance regulation system improvement, foreign exchange system and capital account reform, and financial market innovation, which will undoubtedly create a favorable economic and financial environment.

In the aspect of foreign policies and relations, China keeps a good relation with every country in Northeast Asia. The Sino-Russian relationship has been going up greatly in recent years. It constantly keeps the traditional ties of friendship with Mongolia and north Korea. Besides,

China has frequent and close contacts with Japan and South Korea in trade and economy. Therefore, it will be widely supported that China being selected as the headquarters location for the Bank.

(iii) Suggestions for the location of the headquarter of the Bank

It has been commonly agreed and widely accepted by the experts and scholars of every country in Northeast Asia that Tianjin is recommended to be selected as the headquarters location of the Bank. The recommendation has been already included in *Tianjin Declaration* and *Changchun Declaration* during the Northeast Asia Economic Forum. Therefore, it is suitable to select Tianjin.

1) The Prospect and Economic Development Potentials of Binhai New Area

The economic zones surrounded by Bohai Sea are located in the center of Northeast Asia which will have tremendous development potential in China in coming years. At present, the Bohai rim development has been upgraded to the level of country's strategy, and it will be the third economic growth engine in the new century following the successful development of the Zhujiang River Delta and the Yangtze River Delta.

Tianjin's Binhai New Area is in the heartland of Bohai rim. Premier Wen Jiabao has fully affirmed the rapid growth of Binhai New Area. He points out that the development of Binhai New Area is not only important to the long term development of Tianjin, but also plays an important role in vitalizing the regional economy of Bohai rim areas.

2) The Basic Facilities Conditions in Binhai New Area

In *The 11th Five-year Plan Outline of Tianjin Binhai New Area*, it is planned that the functions in six major areas will be improved and advanced to a new level in Tianjin Binhai New Area: advanced manufacturing base, international trade and marine & air transportation services, modern logistics, technology and management innovation base, leisure & tourism spot, and model area for reforms and innovations. Lately, the State Development Planning Commission has given a written reply regarding the plan of port construction and inter-city transportation around Bohai Bay, and has officially approved to build Beijing-Tianjin city railway and another high way between them. The expansion of Tianjin seaport and airport is also on the construction plan. All these have provided favorable basic facilities conditions for the planning and building of Binhai New Area.

Overall, Tianjian Binhai new area, as the future conglomeration for multinational corporations, international capital, technology and information among China even the northeast area, will fully sustain the operation of Northeast Asian Bank, and is feasible for the headquarter location.

2) Tianjin's Transport and Trade Position in Northeast Asia

Tianjin, a linkage of the Pacific Ocean and Euro-Asia Bridge, with the largest port in northern China, is an important transport and trade hub in Northeast Asia. Tianjin keeps a close and frequent economic and cooperative contact with countries in Northeast Asia. It has become a major investment destination for Japan and Korea. The trade volumes of the two countries with Tianjin make up one third of Tianjin's import-export volume with the other countries in Asia.

3) The Sound Financial Infrastructure in Tianjin

Tianjin was the first batch of cities to open up financial industry when China joined the WTO. Ever since the year 2000, many Chinese and joint-venture financial institutions including Bohai Bank, Sino-German Bausparkass, Bohai Securities, Hengan Life Insurance, Sun-Life Everbright Life Insurance, Bohai Property Insurance, etc. have chosen Tianjin to locate their headquarters. In addition, the internationally-renowned financial institutions such as Citi bank, HSBC, Standard Charters, Bank of Tokyo-Mitsubishi, Korea Foreign Exchange Bank, etc. have all set up offices in Tianjin. Recently, the Chinese government has approved Tianjin Binhai New Area to be the testing place for the comprehensive supplementary reform in financial industry, encouraging the financial reform and innovation carried out in Binhai New Area. The significant reforms, in the aspects of financial enterprises, financial business, financial market and finance opening-up etc., shall be first carried out and tested in principle in Tianjin Binhai New Area. This approval will provide the Bank a sound financial policy environment and a wider space for its business development and financial innovation in future.

4) Beijing-Tianjin Metropolitan Region

Beijing-Tianjin is expected to be the third largest metropolitan region in Northeast Asia after Tokyo-Yokohama and Seoul- Incheon, which means that locating the Bank's headquarters in the region, as it were, is the same as it is located in the Beijing-Tianjin Metropolitan Region. Therefore, the Bank will be effectively assisted in its decision-making and services by Beijing's

advantages as being the center in China for finance, information and scientific research.

In summing up the above-mentioned, Tianjin Binhai New Area will be the most attractive place to transnational enterprises, international capital, and advanced technology, and a center of various information in China as well as in Northeast Asia . The Tianjin Municipal government will also do its utmost to assist in various ways the establishment of the Bank. Besides, the natural environment in Binhai New Area is appropriate for the Bank's headquarters location. Located on the coast of the Bohai Sea, the Area is neatly covered in green, has nice air and is considered the best living place.