Session 3
Development Financing and Banking in Northeast Asia

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"REGIONAL COOPERATION AND THE NORTHEAST ASIA DEVELOPMENT BANK"

There are many possibilities for regional economic cooperation in the Northeast Asian region—that is, Northeast China, Mongolia, the Russian Far East, and North Korea, which constitute Developing Northeast Asia (DNEA), as well as South Korea, Japan, and in this paper's context Taiwan. The UNDP Tumen River Area Development Programme (TRADP) has been the most seriously discussed since the early 1990s as a possible international cooperative endeavor. Another emerging cooperative project is the establishment of a Northeast Asia Development Bank (NEADB), which was initially proposed by Dr. Duck Woo Nam, former prime minister and finance minister of the Republic of Korea, at the Tianjin Conference on Regional Economic Cooperation in Northeast Asia in 1991. This paper focuses on the financial aspects of Northeast Asia regional cooperation with a particular emphasis on the NEADB.

Complementarity

Northeast Asia contains highly diverse economies, with Japan's GDP being 1,500 times as large as that of Mongolia in 1990. Populations, densities, resource endowments, technological and managerial gaps, and export-import ratios vary widely. These differences, however, complement each other and translate into different advantages and different needs, as shown in Figure 1. Land-poor South Korea and Japan need to promote land-saving industrialization and manufacturing exports so they can import land-based products such as fuel, minerals, timber, and agricultural products. While South Korea and Japan in particular can offer foreign direct investment, ODA, advanced technology, management know-how, and large markets, they lack natural resources and labor. The Russian Far East is endowed with abundant untapped natural resources such as petroleum, coal, metals, forests, and fisheries, yet it is critically short of capital, technology, and human resources. Northeast China and Mongolia are endowed with a vast land mass suitable for agricultural and industrial development. The development advantage of Northeast China is its huge, largely unskilled labor force. North Korea is also rich in natural resources, but it has been suffering from a dearth of capital, energy, modern technology, and industrial and marketing know-how.

Financial Gap

No sophisticated analysis is needed to explain that even if economic, institutional, banking, and financial policy reforms take place so that the economic system in DNEA both encourage savings and efficiently channel them into production loans and investments, DNEA would still have a huge excess demand for funds at rates competitive in world financial markets. This is almost axiomatic for countries at the

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This is a summary report of *A Northeast Asian Development Bank? An Introductory Analysis*, coauthored by Burnham O. Campbell, Sueo Sekiguchi, and Hiroshi Kakazu, East-West Center, August 1994. The project was initiated and headed by Professor Campbell, who could not see the final draft due to his sudden death.

low end of the capital/labor ratio range. The existing resource/current account gap, which does not account for rationed-out demand, requires DNEA to borrow net from the rest of the world.

There is no financial mechanism to meet the borrowing needs of domestic business in DNEA. A large portion of funding requirements for projects such as infrastructure (communications, transportation, energy, natural resource development), industrial, human resources and research development, and working capital must come from outside the DNEA region.

Estimating capital requirements for the DNEA region is not an easy task. Some estimations have been made based on the savings/investment gaps and financing needs for particular infrastructure. According to the UNDP estimate, the TRAD infrastructure projects alone would cost $30 billion over twenty years. Using estimated capital/labor ratios with inevitable rough assumptions, we have estimated DNEA's capital requirements from 1995 to 2005. The estimates are divided into two sources of capital growth: capital widening and capital deepening. The results are presented in Table 1. To move the region's labor force up to the capital/labor ratio achieved in South Korea in 1983 by 2005 would require additional capital of $465 billion, or about $47 billion annually. Assuming a 3 percent regional real annual GDP growth rate from 1990 to 1995, a 5 percent growth rate from 1996 to 2005, and gross savings at 25 percent of regional GDP, the region's net savings are assumed to be $25 billion per annum for Scenario 1 and $19 billion for Scenario 2. This implies that there will be a regional shortfall of roughly $22 billion per annum for Scenario 1 and $28 billion for Scenario 2 to be met with foreign funds including transfers from the rest of China and Russia. Although this figure might differ considerably with different assumptions, any plausible set will yield the same result: to achieve any reasonable target, large quantities of foreign funds will be needed.

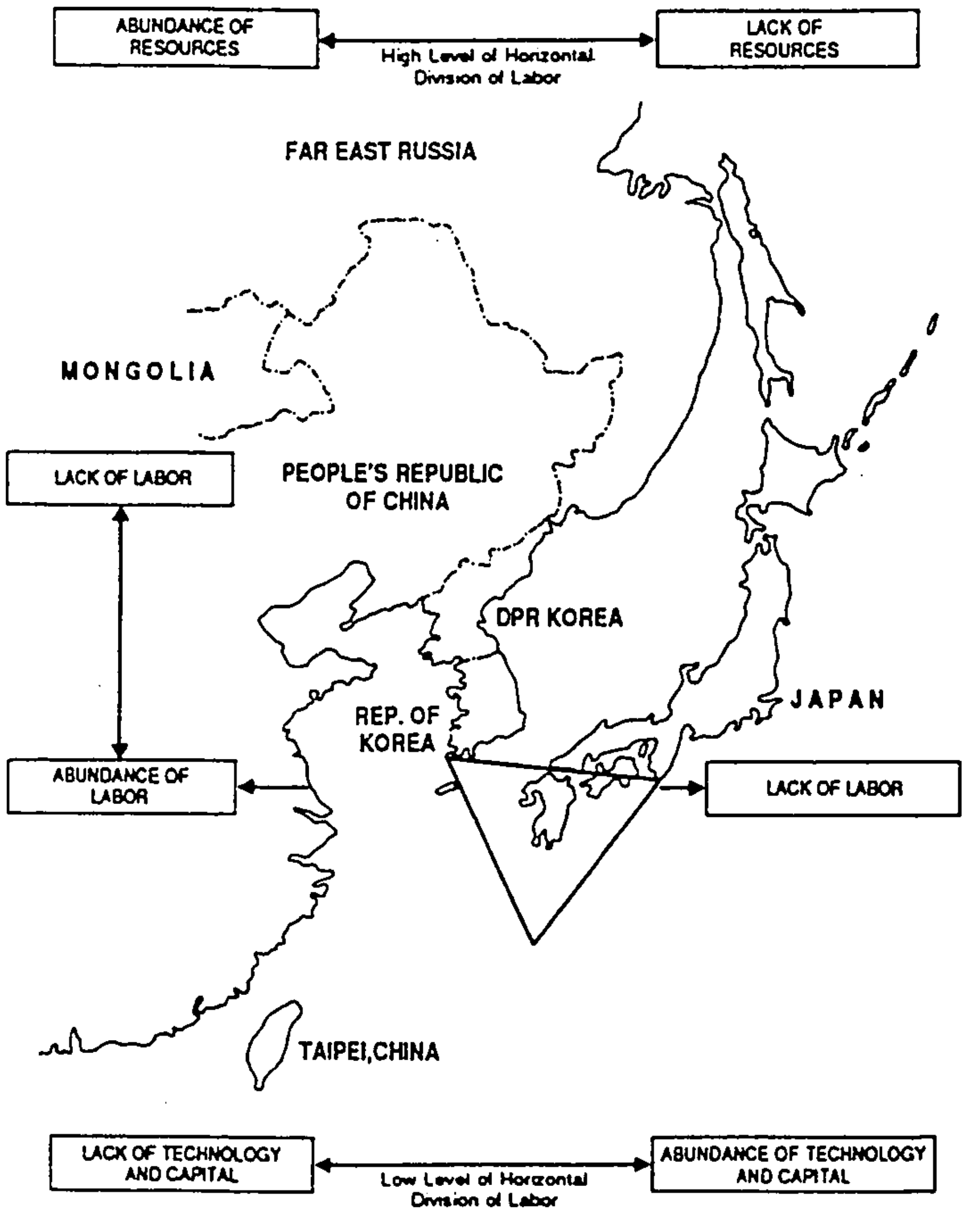
Why the NEADB?

1. Private sector funding sources such as debt security and equity issues in world financial markets and FDI are not enough to meet the required resource needs of the region, mainly because of high risk and low returns compared to other regions and the sheer lack of financial information about the opportunities in DNEA. According to our rough estimates, the investment return ratio of TRAD is estimated to be 12 percent, almost at the breakeven point, and much less profitable than the estimated 28 percent return for the southern China region. The private sector is also not willing to finance infrastructure projects that require large funds and long gestation period. It is also questionable whether or not any BOT scheme can be effectively applied in the region.

2. In view of the geopolitical-economic conditions of DNEA, the amount of foreign official sources such as grants and loans will be limited. ODA can work only where the long-run opportunity costs of such funds are clearly understood and the government has a clear long-run goal and is administratively efficient. Foreign aid would not likely be used efficiently at present in DNEA.

3. The existing multilateral banks such as the World Bank, ADB, and EBRD do not cover North Korea, which is a key player in regional economic cooperation and political stability. The multilateral banks also lack focus, resources, and a commitment to address the needs of the region in an strong and consecutive manner.

Figure 1
ECONOMIC COMPLEMENTARITY AMONG
THE NORTHEAST ASIAN ECONOMIES



Source: Myo Thant, Min Tang and H. Kakazu, ed., Growth Triangles in Asia: A New Approach to Regional Economic Cooperation, Oxford University Press, 1994

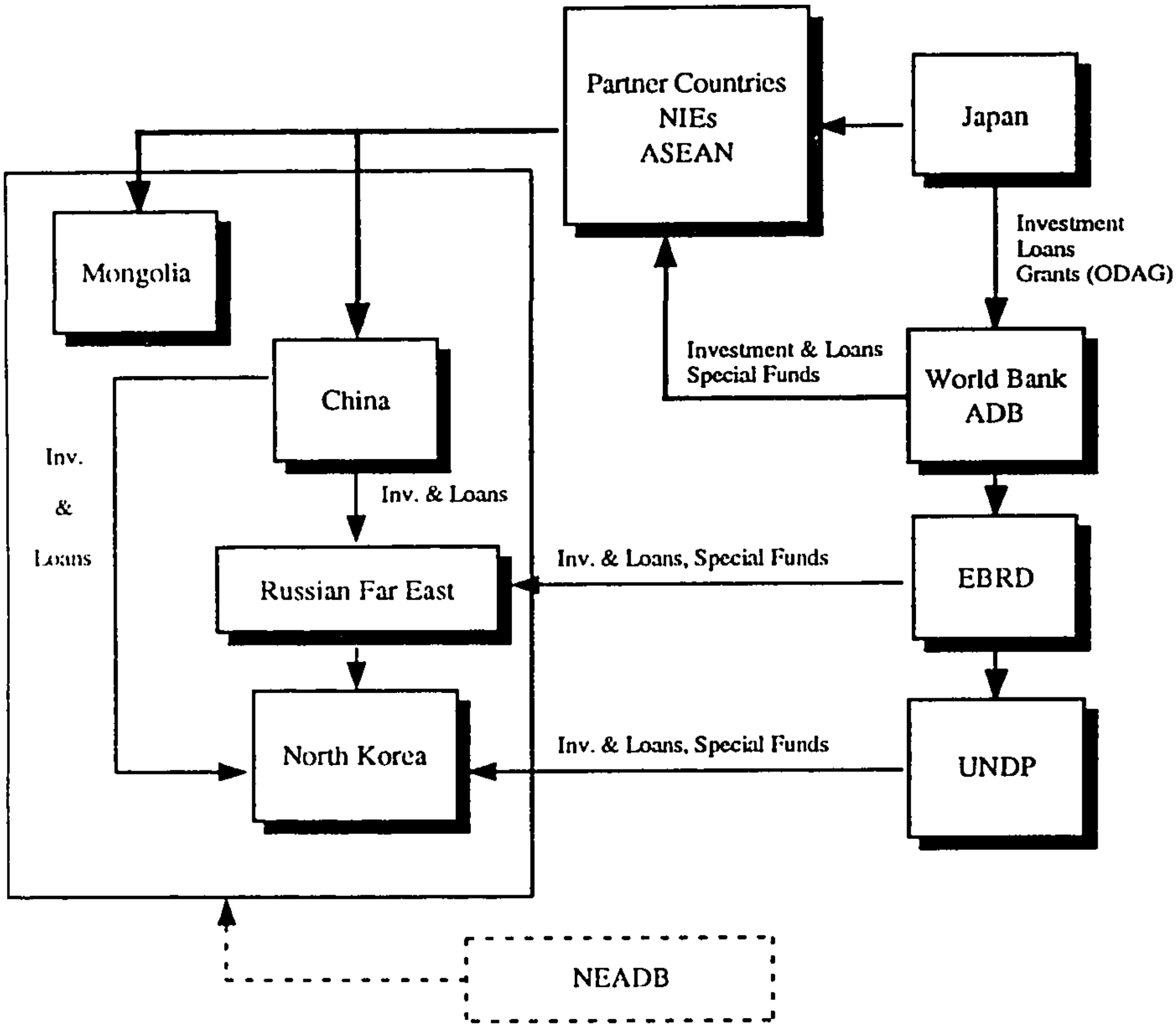
TABLE 1. Forecast Savings and Capital Deficits: DNEA, 1996–2005 ($ billion)

	Est. DNEA GDP[a]	Gross Invest Rate 25%[b]	Net Invest Rate 20%[c]	Net Invest Rate 15%[c]	Avg. Ann. Cap. Req. for Widening	Left for Deepening Scenario 1	Left for Deepining Scenario 2	Avg. Ann. Total Cap. Req.	Resulting Deficit Scenario 1	Resulting Deficit Scenario 2
1996	99	25	20	15	8	12	7	47	27	32
1997	104	26	21	16	8	13	8	47	26	31
1998	109	27	22	16	8	14	8	47	25	31
1999	114	29	23	17	8	15	9	47	24	30
2000	120	30	24	18	8	16	10	47	23	29
2001	126	31	25	19	8	17	11	47	22	28
2002	132	33	26	20	8	18	12	47	21	27
2003	139	35	28	21	8	20	13	47	19	26
2004	146	36	29	22	8	21	14	47	18	25
2005	153	38	31	23	8	23	15	47	16	24
Total	—	—	249	187	80	169	107	465	221	283
Avg. Ann.	—	—	24.9	18.7	8	16.9	10.7	47	22.1	28.3

[a] Assumes 5% real annual growth rate for 1996–2005.
[b] Gross Investment equals Gross National Savings; based on NEC's 1990 rate, this is assumed to be 25%.
[c] Net Investment, or investment after depreciation allowances (and any government consumption deficit), is assumed to be 20% in Scenario 1 and 15% in Scenario 2.

FIGURE 2

A CONCEPT OF LINKED DEVELOPMENT FINANCING IN THE NORTHEAST ASIAN ECONOMIC ZONE



4. The NEADB could overcome or at least ameliorate many of DNEA's financial problems by reducing and diversifying political-financial risk, channeling funds more efficiently, and providing information and necessary human resources.

5. The NEADB would also be important as an international financial intermediary in linking financial flows among the regional member countries, as sketched in Figure 2. The concept could be most effectively applied in Northeast Asia because (1) the region contains diversified political-economic areas, and (2) the operational areas of the NEADB, North Korea in particular, are isolated from international financial markets. This linked cooperative scheme would also be useful not only in breaking the political deadlock among the countries of Northeast Asia but in enhancing confidence building between South Korea and Japan.

Strategies

1. In view of the long-standing political conflicts and economic inefficiency in DNEA, the initiative in establishing the NEADB should be taken by a summit that includes the Northeast Asian countries and the United States, as was the case when the EBRD was established by the EC summit after the collapse of the USSR in 1989. The UNDP or a possible host country could initiate the summit.

2. Another realistic possibility is to start the NEADB with a Northeast Asia special development fund at the ADB, which already covers several countries of the region. A special fund for the Russian Far East could also be set up at the EBRD. Both funds could then be combined into one to establish a new NEADB. In any case, we should note here that adjustment and coordination with the ADB and EBRD will be a needed first step toward realizing the idea of the NEADB.

3. It is important to show that many development projects including infrastructure and natural resources in DNEA can be profitable in the long run, once the massive infusion of capital required for the projects is initiated by the NEADB.

4. An international study group should be set up to draft a feasibility plan to establish the NEADB. The ADB would be the best model for designing the NEADB.

Nanbara Akira
Deputy Governor
Export-Import Bank of Japan

I recently attended a symposium held by the Export-Import Bank of Japan. It covered a wider theme than this forum: economic development in the Asia-Pacific region, not only in Northeast Asia. The symposium, "Economic Development in Asia-Pacific toward Global Partnership in the 21st Century: New Trends of Interest and Financial Cooperation," highlighted the growing and new trends of foreign private direct investment in the region. Many countries have opened the door to private sector foreign direct investment, and more companies are doing so; thus, the competition over FDI is intensifying. On the part of the recipient countries, they have to be attractive. They can't waste any more time. The consensus among the conference participants was that FDI will be the principle vehicle for increasing the flow of goods and services in the Asia-Pacific region; that is, FDI will bring about capital, trade, technology, skill, and entrepreneurship (including both tangibles and intangibles). At the same time, FDI will bring about assets to investors also; that is, FDI will be a plus-sum game, and it is a positive, horizontal division of labor. This will offer advantages to both recipients and investors. Not only larger companies but smaller and medium-size companies are participating in FDI; not only Japanese but other countries' multinational and transnational companies are developing themselves through FDI activities.

The borderless society is now materializing, at least in the private sector. For private sector companies, large oceans (to date, the Pacific and the Indian Oceans) are now small ponds. What we are talking about now is whether the Sea of Japan will be another pond or not.

Now, what I would like to emphasize here is that private sector FDI in the Asia-Pacific region has not been promoted by the central governments and the multilateral financial institutions. FDI has not been necessarily facilitated by central governments and multilateral financial institutions alone. Instead, through private sector entrepreneurship, at least at the beginning, that was done on a bilateral basis. Of course, I do not deny the roles played by multilateral financial institutions and central governments, but their roles are confined to that of a catalyst for private sector development—and this includes the Export-Import Bank of Japan, where I work.

The role of the recipient country government is to create an environment that is attractive to FDI. Measures for creating such an environment include tax incentives and customs tariffs, but the basics are these: (1) there should be minimal red tape on the part of the governments; (2) education should be improved to produce more hard-working people; and (3) there should be improved infrastructure, including roads, ports, power, and water.

To date, central governments—not only the recipients but investor central governments and international multilateral financial institutions—have been playing important roles in development of infrastructure. But recently we have been witnessing BOT (build, operate, transfer) and BOO (build, own, operate) schemes in which private sector money has been spent more and more. Major players include Hopewell, which is famous.

I have talked about the globalization or global partnership in the Asia-Pacific region. I wonder if we can see these same kind of movements specifically in East Asia;

it seems not yet. That is why we are holding this kind of forum, and I applaud the effort.

In the morning session we discussed Tumen River development and also the establishment of a Northeast Asian Development Bank. I applaud these efforts, the ideas, but if we are suggesting formation of a bloc in Northeast Asia then I would have to reserve my views. In my view formation of a bloc would be basically defensive. It is inward looking. In the postwar era, Japan and East Asia's development has been supported by forward-looking, non-defensive actions. APEC is not a bloc; it is an open forum to regions as well.

To reiterate, the role of the government is to create the right climate. What produces income is production activity by private sector companies, and what produces increases in production is increases in productivity. Productivity is increased by private sector entrepreneurship and by the perspiration of industrious and hard-working people. Rome is not built in a day.

Last, just very briefly, I would like to touch upon the roles played by the Export-Import Bank of Japan. The Bank has a history of forty years, and at present it is engaged not only in export financing but import financing, investment financing, and untied credit. Unfortunately, with regard to North Korea because of political problems and with Mongolia, the Bank does not have a track record. With regard to Russia, because of the policies of the G-7, we are not providing untied loans, but we have records with regard to investment financing. We have track records for telecommunications and hotel projects that involve joint ventures by KDD. Yesterday, the submarine cable was completed between Pusan and Khabarovsk, and we conducted $200 million of export credit for trans-Siberian telecommunications.

We are not an assistance organization. We charge reasonable interest. These are not assistances; our borrowers are our customers. Because we charge reasonable interest, we have to make sure that interests are paid. We have to have repayment of the principle, so I would emphasize at last that it is kind of us if we lend and kind of us if we don't lend.

Jan P. M. van Heeswijk
Assistant Chief
Strategy and Policy Office
Asian Development Bank

"Development Financing and Banking"

The Asian Development Bank appreciates this opportunity to speak briefly on the important issue of financing economic development in Northeast Asia. As the only multilateral financial institution based exclusively in, and serving, the Asia-Pacific region, the ADB has a keen interest in seeing its developing member countries achieve shared prosperity from a broadened and cooperative pattern of economic growth in Northeast Asia.

The ADB has considerable experience in supporting regional economic cooperation among countries in Asia. Most recently, this support has concentrated on cooperation among economies of the Greater Mekong subregion, and in planning and establishing "growth triangles" that link specific investment and trade zones in neighboring countries of Southeast Asia. In both cases, ADB financing is intended to facilitate the relaxation of demand- and supply-side constraints on individual countries by expanding access to key inputs—including capital, physical, and human resources—and by enlarging the effective market for each country for undertaking its trade and investment.

The Greater Mekong subregion provides an excellent example of the roles the ADB may play to achieve development involving participation among countries. Through a program of regional technical assistance, the Bank conducted substantive research and detailed consultation to identify the scope, opportunities, benefits, costs, and mechanisms associated with enhancing economic cooperation among the countries concerned. The identification of viable projects of mutual interest to participating countries has been a key activity. The emphasis of ADB's involvement is now shifting from project identification to project preparation and implementation.

Based on this experience as well as its other efforts in promoting regional economic cooperation, the ADB considers that *the central challenge in achieving sustained economic cooperation is mobilizing the resources required for priority projects and initiatives.* Although there is much more to economic cooperation among developing member countries of Asia than infrastructure, and more to their development than money, infrastructure-related development is generally a priority, a necessary condition for the sustainablility of expanded cooperation over time. There must therefore be a corresponding emphasis on resource mobilization for the financing of infrastructure-related development in the developing economies of Northeast Asia, posing a central challenge to the relevant public as well as private sector institutions in this subregion.

The financing needs for infrastructure in the lower-income economies of the subregion will be in the billions of dollars over the coming years. Only a small part of this is likely to be met through official concessional sources, that is, from governments and multilateral banks and other agencies. Institutionally, a part of the needed funds may be provided by the banking system, but there will still be a significant shortfall. Furthermore, the public sector external debt of some of the associated economies is relatively high, constraining their ability to borrow additional external resources. In the transitional economies involved in Northeast Asia's development, the banking and financial systems are also in a process of transition.

Private sector participation through both direct and portfolio investment is likely to be essential for the successful development of Northeast Asia, particularly when cooperation—not to mention domestic economic reform in the developing economies—will be market-driven. This means that alternatives to lending to or through the public sector will be extremely important. Alternative financing refers to various types of private, nonrecourse and limited recourse, external financing and includes foreign direct investment, equity portfolio investment, and private nonguaranteed debt.

Generally, FDI has played the central role in the mobilization of private financing for development in the developing economies of Asia. Much of this went into support of the manufacturing sector. While this source of financing is gaining importance for infrastructure-related needs, the potential of other forms of private financing should be considered. These would include equity portfolio investment, private nonguaranteed debt, and corporate bonds. The use of these alternative forms of private finance will demand significant participation from the region's capital and bond markets for mobilizing resources *and* channeling them to the appropriate investment activities. However, these markets are not well developed in some of the economies of Northeast Asia and may require technical assistance from multilateral agencies such as the ADB to assist in their establishment or to expand their capabilities. While much of the long-term debt will likely be sourced in overseas markets, regional markets should be encouraged to play a broadened and more active role.

A major issue associated with encouraging private investment in developing countries—particularly those economies in transition from being centrally planned to becoming market-oriented—is the issue of risk. This becomes even more important in cases where the nature of the project involves multicountry, transborder investment and trade. How investment risk is actually allocated and managed will determine the ability to attract private investment and the cost of capital. It is here that a multilateral financial institution such as the ADB can play an important role. Allow me to elaborate a bit further.

Development of Northeast Asia will be achieved in large part through cooperation among the relevant countries. Each country will have different perceptions, expectations, and constraints in relation to investment issues, strategies, programs, and projects. In this context, an "outside" institution that is credible to all participants can make an important contribution, acting as an "honest broker" both in the consultative process and in the identification and preparation of jointly acceptable investment programs and projects. However, this role does not preclude or diminish the very important role of bank assistance to other national development efforts in the associated developing member countries involving sectoral policy reforms, institutional capacity building, and project-level finance at the national or subnational level.

The ADB desires to use its institutional capabilities to act as a catalyst for cooperation in financing subregional development. In this regard, the Bank attempts to underwrite some of the managerial and technical risk and uncertainty associated with cooperation and thereby provides an incentive—to the participating countries, to other international, regional, and bilateral agencies, and to the private sector—to consider, support, and join cooperation initiatives. By bringing to bear its knowledge of the economies of the subregion, its developmental and financial experience and capabilities inclusive of support for subregional cooperation, and its associated credibility in its relations with Asian governments, multilateral and bilateral agencies, and the private sector, the Bank can lower perceptions of risk and uncertainty that may otherwise be associated with certain investment activities. As a result, the scope for "bankable" subregional investments will increase.

In practice, the ADB's subregional financing activities have been undertaken primarily through technical assistance operations on a grant basis. This modality remains appropriate for support to activities that increase awareness and understanding of the potential for investment, and for identifying potential projects that have subregional implications. Such financing remains appropriate as well for supporting regional efforts in research and technical cooperation networks, information systems, and training.

ADB financing for relatively large projects is done through lending operations, inclusive of cofinancing with either official or private sector cofinanciers. Bank support for subregional investments could be pursued through lending to national projects whose economic viability is dependent, in part, on parallel investments in one or more neighboring countries, or through lending to regional projects. In the case of regional projects, their feasibility in terms of financing would be enhanced if the content of the project allowed for allocation of costs to individual countries; this, in turn, would allow for the normal Bank procedure of having a separate loan with each country, in line with each country's eligibility for concessional or ordinary capital resources, and with regard to their status as a developing member country of the ADB. In cases where the investment is associated with costs not readily divisible among borrowers, reaching agreement on cost allocation among countries will be essential for the purpose of financing, with the Bank playing an important role as a provider of information, and, if requested, as a facilitator of negotiations among the concerned parties.

In the case of Northeast Asia, some of the countries concerned are not presently members of the ADB. It is important to point out that Bank policy prohibits its funds from being used to support activities in nonmember countries. In this context, there need to be mechanisms or procedures to ensure that assistance from the Bank does indeed go toward supporting related projects deemed to be of high priority by the concerned ADB member countries.

There is potentially a wide scope for ADB assistance to development in Bank member countries of the Northeast Asia region. The specific issues to be put forward for consideration of Bank support are, however, dependent on the development priorities of the developing member countries, and on their requests for assistance. With this in mind, opportunities for Bank support for development of this region could, for example, include complementary investments in national transportation and national telecommunication infrastructure; common hydropower potential and petroleum resources as well as intercountry transmission of energy supplies; common resource exploitation and management; cooperation in intraregional trade and investment; and cooperation in human resource development and in research and technology exchange and information systems.

In closing, I wish to make clear that the proper course for the ADB would be to complement, and where appropriate collaborate in, the efforts of other agencies—both public and private—in the development of the Northeast Asia region. Financial relationships need not always dominate these collaborative efforts. It is equally important that the ADB develop a sufficient understanding and appreciation of the mandates, capabilities, and experience of the various parties interested or engaged in the region's development. Such understanding and appreciation by the Bank would be a major factor in determining the nature of its assistance, as well as the roles it could play with respect to cooperative investments and related activities.

Yoshida Wataru

Senior Banker
Russian Team
European Bank for Reconstruction and Development

I am in charge of the Russian Team at the EBRD, and today I would like to introduce to you the EBRD's activities in Russia, as well as the situation in the Far East.

The EBRD was established to assist Central and Eastern Europe, including the former Soviet Union, in its transition from a centrally planned to a market-led economy. The EBRD actively encourages the growth of the private sector in Russian business and industry, and it is formally required to have 60 percent of its operations in the private sector. Its operations are closely coordinated with other multilateral institutions such as the World Bank, the International Finance Corporation, and bilateral donors. At the same time, it plays a catalytic role in attracting additional private and public resources. Overall, then, the EBRD does not intend to act alone but in coordination with other multilateral institutions.

The Bank began its operations in the Russian Federation in September 1991. I would like to explain to you briefly the financing of the EBRD. The finances and the human resources at the EBRD are quite limited, and therefore the Bank's strategy concentrates on key areas where it can have the greatest impact using its limited resources. For direct funding, the Bank will seek to provide the form of financing that best matches the project, including long-term lending and equity participation, in both rubles and other hard currencies. Characteristics of typical projects include the following: the total cost of the project is usually more than US$50 million; the Russian partner participates more often in kind than in cash, including plant machinery and equipment; and the EBRD can fund up to 35 percent of the total project cost.

As for the situation in Russia, we have financed $1.3 billion in 39 projects. We have lent 370 million ECU, and the total value is $92.2 million, a part of which has already been disbursed.

We have had a major resident office in Moscow and on October 1 we also opened an additional office in Vladivostok. Vladivostok happens to be one of the key locations for EBRD, and therefore we decided to establish an office there.

With regard to the Russian Far East, I will share with you three points. First, we are establishing what we call regional venture funds (RVFs) in selected regions of Russia. Each RVF will have capital of US$30 million to invest as new equity capital in medium-size privatized and other private enterprises to finance projects expected to earn a commercial return. The Bank's capital will be complemented in each RVF by $20 million, financed from a donor government, which will be used to meet the operating costs of the RVF and provide consulting service support to enterprises in which the RVF invests. Each RVF will be a closed-end fund with a ten-year life. We have a grant from the Foreign Ministry of Japan.

As for the policies of each RVF, the minimum investment is $300,000 and the maximum is $3 million. The capital provided must be used to finance the new project, including associated working capital. The principle criterion will be whether the expected return on investment is commensurate with the risks. Eligible projects are expected to involve the rationalization, modernization, and expansion of productive capacity. For venture funds in the Far East, we have Daiwa Securities and Itochu Corporation as fund managers. We hope to further activate the RVFs in the future.

The second pillar of our activity in the Russian Far East is the Financial Institutions Development Project (FIDP), which aims to strengthen and develop a core group of between thirty and forty Russian commercial banks that are expected to assume prominent roles within the developing Russian commercial banking sector. In the absence of fully effective capital markets, the commercial banks are likely to play a key role in the transformation and restructuring of the Russian economy.

The program has been undertaken in cooperation with the Russian government and the World Bank. In support of the project, the EBRD has extended a US$100 million loan to the Russian Federation. The proceeds of the EBRD loan are lent to the banks through a project implementation unit established within the Ministry of Finance. The project has three main purposes: to strengthen bank operations by preparing and implementing strategies and business plans for each of the banks; to modernize the banks' information technology and automation programs; and to develop measures aimed at enhancing the financial soundness of the banks. Technical assistance will be provided mainly through contractual arrangements with leading foreign banks.

In addition to the FIDP, a jointly financed EBRD–World Bank credit line for $300 million is in place to provide loan financing to large and medium-size private sector companies via the core group of banks. We have selected three banks for the Russian Far East, and the programs have already been initiated.

Our third pillar in the Far East concerns financing not limited to joint ventures. As of last year, two shipping companies were borrowers of our finances, and we hope to step up such forms of finance in the future.

This covers my explanation of EBRD's activities in the Russian Far East. Now let me share with you the future strategy and policies vis-à-vis the Russian Federation. We have four pillars. Our first pillar is to promote the development of enterprises. Our second pillar is to support the financial sector. The third pillar is to develop energy resources. And the fourth pillar is to support critical infrastructure.

With regard to financial support for enterprises, we are thinking in terms of assisting restructuring. As for medium and small enterprises, we hope to participate in operations. As for major Russian enterprises, not even joint ventures, if it contributes to the restructuring of such companies, we would like to take a look at possibilities of finances in a positive light.

In terms of support of the financial sector, the EBRD will give direct bank-to-bank operations to Russian banks. The FIDP project banks will be the first priority for us to give support. In order to promote trade, the EBRD will reguarantee the guarantees by the commercial banks of Russia. To foster the capital market in Russia, we would like to provide any possible support.

For the development of energy resources, as we have done in the past, we would like to focus on oil and gas sector development. Energy conservation will be another important point, and rating the level of safety for nuclear power reactors would be yet another priority.

Concerning infrastructure development, we want to provide assistance to the construction of the railway sector, airport development, and port projects pursued by the private sector. Roads and highways we expect to be shared with the World Bank. As for toll motorways, we hope to finance this as a BOT. In the telecommunications sector, we hope to get involved in those generating convertible currency revenues.

These are the EBRD operational objectives for the Russian Federation for 1994 and 1995. In collaboration with other multilateral financial institutions, we would like to set examples of support in the Russian Federation.

Park Sung Sang
President
Korea Asia-Pacific Institute

I would like to make two proposals to this Fifth Meeting of the Northeast Asia Economic Forum in Niigata.

The first one is a Tumen River Development International Commercial Bank. Although there may be consensus among all of us to establish and promote a Northeast Asia Development Bank, this may take too much time to realize because of the need not only to deal with the governments of Northeast Asian countries but also to acquire the agreements of governments of developed countries outside the region. Without the participation of the governments of developed countries, the Northeast Asia Development Bank cannot be inaugurated.

Should we wait until the Northeast Asia Development Bank becomes operational? A Tumen River Development International Commercial Bank could substitute for a while for the NEADB, to some extent, until the latter materialized. In my view, banking services are a prerequisite for business people from outside the Tumen River Economic Zone. Thus, an international commercial bank should be regarded as an indispensable portion of the infrastructure of Tumen River area development.

My second recommendation is for the establishment of an official institutional authority—that is, a Tumen River Development Authority—in each bordering country, not just in one country. The reason for this recommendation stems from the delay in reaching a formal agreement on the Tumen River Development Corporation, in that the idea might conflict with territorial sovereignty. Thus, I would like to recommend that each country set up a Tumen River Development Authority, that is, a Tumen River Development Authority of DPRK, a Tumen River Development Authority of China, and a Tumen River Development Authority of Russia.

These three separate Tumen River Development Agents or Authorities can manage their own domestic programs in the Tumen River Free Economic Zone as did the Tennessee Valley Authority of the United States. These three independent authorities can cooperate whenever they need to solve common problems of the Tumen River Are Development Programme. The creation of these three independent authorities might help to solve the problem of territorial sovereignty of the riparian countries of the Tumen River Area Free Economic Zone.

Sugano Tetsuo
General Manager
Russia and East Europe
Bank of Tokyo

I have listened with great interest to the statements made by the conference participants. Something that I realized anew, which is my first point, is that for the development of Northeast Asia there are developments of both planes and points, which should concurrently go forward. The development of planes means that parties such as China, Russia, and North Korea should receive assistance from the UNDP and other international agencies, and at the same time create an economic zone that covers many countries.The development of points would be illustrated by renovation of the port of Zarubino, for example, by taking advantage of private sector energy.

One of the main questions here is how to finance. With regard to this question, there have been suggestions to create a Northeast Asia Development Bank or to create a special unit in the Asian Development Bank, but because of various difficulties with the recipients and the fund providers, I think either of these would be a time-consuming process. To move forward from here, I think we have to define clearly the development of Northeast Asia for the time being, and based on the actual situation, the needed money should be provided by and borne by the parties concerned. This is my second point.

Now, how should we understand the development of Northeast Asia for the time being? I emphasize the words "for the time being." I would suggest that we start with the renovation of Zarubino Port. This is my third point. With the renovation of Zarubino, the Russians would benefit from cargo handling, the linkage to railroads in China would be essential, and grains and mineral resources would come from China, which would enhance business activities in this part of the world.

So, for the time being, when we talk about development of Northeast Asia, we might first conduct a detailed economic survey regarding the renovation of Zarubino Port; second, we could convey the results to Russians and secure all-out cooperation from them; and third, we would have to secure funds for the renovation and start the renovation. I recommend that we focus our attention on these three points and create a successful case study.

Among these three steps, for the first one, the detailed economic study on renovation of Zarubino Port, we have to face the issue of money—who should provide the funds? This is a headache, but already the Niigata Prefecture, in conjunction with ERINA, has conducted a first-stage survey, so perhaps the complementary second-stage detailed survey could be conducted with help coming from the private sector. This is the fourth point that I would like to make. If a detailed survey is realized with cooperation from the private sector, we have the basis to go on to the next stages.

My fifth and final point is that, as part of the Japanese contribution to the rest of the world, perhaps we should move from bilateral assistance to multilateral assistance that would be conducive to the development of the whole region, including the Tumen River Basin. Money could be allocated for these purposes. I think this merits our attention.

Haraguchi Hiroshi
Executive Director
Economic Research Institute for Northeast Asia

Listening to the discussions since yesterday, it seems that the provision aspect of the development funds has been mainly discussed. Here I would like to talk about the recipients of the funds, the borrowers.

The provision of funds can mainly be categorized into two types: grants or gifts, and financing. Financing here, as was clearly stated by Mr. Nambara, is based on the premise that it is going to be repaid. In the case of both public funds and private funds, the borrowers should be creditworthy. That's the basis for viable financing. In other words, borrowers have to have the ability to repay. More specifically, the purpose of the funds (the projects themselves) should reasonable, viable, and implementable.

Now, if the project meets these conditions, then next it must be determined whether the borrowers can ensure that the project will be implemented as planned. But the development of the Tumen River area is a multinational project. What sort of entity can be responsible as the borrower? In assessing the risks, we are used to an assessment system of only one country. But this kind of multilateral project requires a different kind of assessment. In such a context, I suggest that, first of all, with regard to the project itself, the parties concerned, multilateral organizations, and the fund providers must come to a consensus.

On this point, yesterday, Dr. Cho talked about a development association. He said that this could play the role of consultant. I can echo his view in this context as well. Based on the consensus on the project itself, there has to be an entity that actually conducts development. Perhaps an international joint development public corporation could be established, and this entity could become a creditworthy borrower. This is a possibility.

Dr. Park mentioned the possibility of establishing a development corporation in Korea, and I think these entities could become backup organizations for this public corporation. Money is very valuable, and it should be used effectively. We have to address this issue.

Nakajima Masashi
Researcher
Economic Research Institute for Northeast Asia

I would like to comment on the issue of public funds. The previous speakers mentioned the role of public funds, for example, as a catalyst for introduction of private funds and as a trigger for attracting private funds. Because of the lack of infrastructure and institutions, this role as a trigger or as a catalyst of public funds is being required.

First of all, public funds can largely be defined into two types. One is bilateral ODA, and the other is multilateral ODA. In the case of bilateral ODA, one of the constraints is that this work on a request basis; all projects must be based on requests from the beneficiary, and the provider will do a screening after being so requested. When we look at the region as a whole, even when there is a great need for development of infrastructure, if that project is low priority in that beneficiary country, then the ODA request will not be made. For example, in the case of ODA from Japan to China, the amount is quite high, but in the past ten years the amount shared by the three northeastern provinces is 1.6 percent. The GDP share of these three provinces is 11 percent, and thus the ODA share to these areas is very low.

Another point is that, in the case of the Japan Sea Rim, cooperation between municipalities is leading, rather than national government-to-government cooperation. Therefore, I think we should rely more on cooperation among municipalities in providing for and identifying the needs for ODA. In addition to government-to-government communication, we need to establish a new pipeline for ODA between municipalities so that we can more effectively identify projects that are urgent.

S. Stanley Katz
Visiting Fellow, East-West Center
and
Former Senior Vice President, Asian Development Bank

Five major points emerged from the session on development financing and banking. Let me try to summarize them:

1. The first point is that anywhere in the world, whether it's in Asia, North America, Europe, or Latin America, wherever nations and regions have been most successful in achieving rapid and self-sustaining economic development, they have been supported by comprehensive and effective financing and banking institutions and systems. There is very little question that the same conditions will apply in the Northeast Asian area. There is little question that the successful development of Northeast Asia will also depend to a very major extent on the establishment and availability of necessary supporting financial banking institutions.

These institutions are needed for a variety of reasons. First, they must mobilize domestic and foreign, and I stress foreign, savings and channel financial resources to the needed capital investment projects in the region. In that way, the banking system provides the foundation and the very basic building blocks of economic development for the region.

In addition to the foundation, however, there is a second range of banking and financial institution requirements that are needed to support the day-to-day exchanges of goods and services of imports and exports in the region. This banking service is essentially the liquidity and the lubricant of a market-based economy and is a second range of essentially microeconomic banking requirements.

2. The savings and investment gap that has been projected by macroeconomic models is huge by any definition, and the rate of return on capital, the so-called IRR, will not be as great as it would have to be to attract the kind of private investment to the region required to fill the funding gap.

3. The fact that the investment rate of return is not substantial does not mean that we should not make every effort possible to attract private investment and trade and financing to the region. Obviously, the private sector will be increasingly important in the development of this region. It will be the source of income, of jobs, of commerce, of technology transfers, and so on. But the private sector alone will need some incentives; as Mr. Nanbara pointed out, it will need to have a lot of the red tape cut, and it will need education, but it will also need a great deal of infrastructure.

4. Some of the infrastructure can be built by the private investors on a BOT or a BOO basis. In fact, however, much of the infrastructure does not lend itself to commercial type investment by the private sector, which means that if it is going to be done at all, it will have to be done in the public sector, possibly with sell-offs to the private sector when it is up and running. Infrastructure can be provided in some few cases by the private sector where there is a commercial dimension, for example, in telecommunications or toll roads. But typically infrastructure is very costly and it doesn't pay off in a reasonably market-defined length of time. So much infrastructure is not attractive to the private sector and will necessarily involve the public sector.

5. When one looks around at sources of financing for such capital requirements of the Northeast Asian region, certainly some assistance will come from the ADB and the EBRD. Mr. van Heeswijk indicated that the ADB can be helpful in some respects in helping to fill the huge capital gap, but the ADB itself has limited resources. It

prefers typically to do cofinancing, rather than to finance whole projects by itself. But it also can be helpful in a very important area which I think has been neglected. That is the area of developing and identifying and putting projects that are now simply concepts into concrete form so that they can be brought to financial institutions, in other words, transferring a project from a dream to a bankable proposition. That's something that is very important. The ADB has done this repeatedly in its client countries through the use of grant technical assistance. That, I think, will be a very important element in the future development of the Northeast Asian region.

We cannot, however, expect the ADB to do the full job. As I said, they prefer cofinancing, and not all the countries of the Northeast Asia area are members of the ADB. North Korea, for example, is not. The ADB is now going through a search for more resources itself (its resources are quite limited), and it does have the problem of having to identify a specific country as its borrower, which means that regional organizations or regional-type activities would be difficult for the ADB to fund. It can be done, but it is awkward and difficult; it requires allocation of costs and benefits, and the actual loan to be made to an individual country borrower or guaranteed by that country borrower.

We heard from Mr. Yoshida that the EBRD is very active in developing the commercial banking sector in Russia, which is a vital sector. The banking sector, obviously, is the lifeblood of an economy, but it cannot be developed without assistance, and that is what the EBRD is doing in Russia. Unfortunately, wheras Russia is a member of the EBRD, the rest of the Northeast Asian countries are not, so that EBRD would not be able to play a very substantial role in the development of the Northeast Asian economies. Again, EBRD has limitations in terms of its public-private financing; 60 percent of its financing has to be in the private sector. This might be suitable for countries that have private sectors that can be resurrected, but it is probably not suitable in the countries where the private sector has been very small or nonexistent. So I think we can look to the EBRD for some assistance, but it will probably be marginal for some time to come.

On the basis of these five observations, I draw essentially three or four main conclusions.

The first conclusion is that the private sector and private investment will be central and of great importance for the economic development of the Northeast Asian Region, and it should be actively supported.

The second conclusion involves the commercial banking sector. There is, obviously, a serious need for commercial banking services in the region, and right now the gap in those services is vast. Such services are needed to finance the exchange of goods and services, that is, to finance trade and to provide a "lubricant" for the market system. One proposal for dealing with this gap was advanced by Dr. Park, which is for a Tumen River Development International Commercial Bank. That is an innovative suggestion and certainly deserves to be reviewed and analyzed further.

Third, in light of the huge amounts of financing and technical assistance the region will require, and the limited volume of financing that can be provided by private investors and the existing international financial institutions such as the ADB, EBRD, and World Bank, it is virtually inescapable that the region will need a new specifically focused development bank of its own. Such a development bank will be critical in mobilizing overseas savings for the region, and further work on the development of a Northeast Asia Development Bank should be pursued as expeditiously as possible.

Instead of a new regional development bank, it has been asked, couldn't we simply just get together funds from the World Bank and the Asian Development Bank and the EBRD and form some sort of hybrid fund. Let me tell you, speaking as a veteran of the World Bank, of the Asian Development Bank, and the European Bank, that this is truly not a viable proposition.

First of all, the funds of these existing banks are already highly earmarked; they're bespoken; it is difficult to expect the existing borrowers from these banks to say, yes, we'll let some of our funds go to a new group of countries. Second, financing for development is heavily dependent on borrowing in capital markets in Japan, Europe, and North America, and the borrowing capacity of the existing institutions very often runs to the ceiling in terms of their own capitalization ratios. It also runs to the ceiling in terms of the attractiveness of the financing instruments in the capital markets.

A new instrument is usually attractive to the capital markets because the markets are not already loaded up with debt from that institution. For example, the World Bank's outstanding borrowing runs into the billions and billions of dollars, as does the Asian Bank's. So there is a limit on how much new capital can be drawn into this region from the capital markets. There is, similarly, a limit on increases in equity holdings by the current owners of these banks. The ADB as you know, is in the process of developing another capital contribution program and the outlook is rather uncertain. So the opportunity to bring in new equity capital through the shareholder side is limited for these existing banks.

Finally, there would be tremendous administrative problems. The staffs of these organizations are generally spread pretty thin. To try to amalgamate a whole array of different policies and programs of different organizations and to deal with four or five different banks in terms of different policies, different procedures, different lending terms, different shareholders, different maturities, different interest rates, different repayment periods, and so on would becomes a real nightmare. I think that to pursue this proposal would really be an exercise in frustration and futility.