

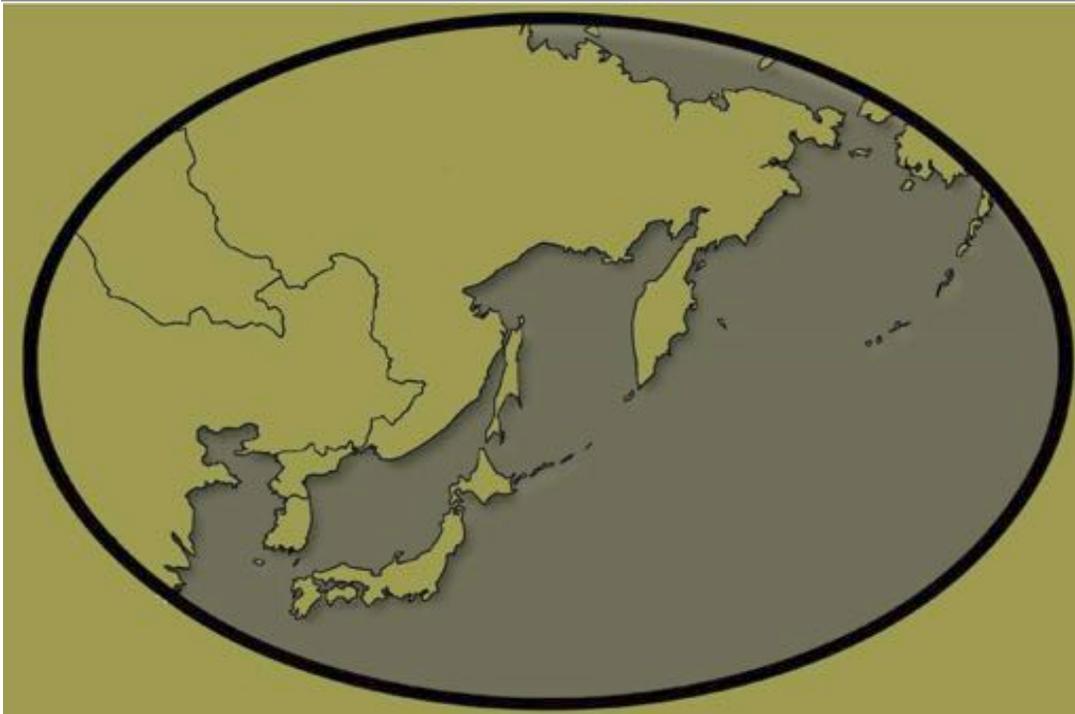


Northeast Asia Economic Forum

# Financing Regional Economic Integration and Functional Cooperation for Northeast Asia:

*A Multilateral Financial Institution for Northeast Asia*

Edited by:  
Lee-Jay Cho & Chang Jae Lee



**Korea Institute for International Economic Policy**

***Financing Regional Economic Integration and  
Functional Cooperation for Northeast Asia***

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**Lee-Jay Cho and Chang Jae Lee**

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## **Preface** (by KIEP President)

The Northeast Asian region, despite the recent changes in political leadership in the major countries of China, Japan Korea and Russia as major players, is still one of the most dynamic economic centers of the world. With its own capital resources and advancing technology along with enormous resources in Russia and Mongolia, and productive linkages to the Pacific and North America, the region continues to play a pivotal role in the global economy. This is a remarkable development in that for centuries until the later part of the twentieth century, this region suffered from the political environment of military conflicts, tension, and territorial rivalries among the major powers of China, Japan, Russia, and the United States.

Even with the phenomenal economic growth in the region in recent decades, regional security and stability has been fragile, mainly attributable to the geopolitical conditions resulting from the Cold War era. In the twenty-first century, for the countries in Northeast Asia to further their development aimed at creating a region in which peaceful coexistence and common prosperity prevail, functional economic cooperation is essential to harness the individual economies together. This is a challenge for the Northeast Asian countries, and initiating specific functional cooperation is one concrete and constructive approach toward meeting this challenge.

Northeast Asia is one region of the world where a formal regional institutional mechanism comparable to the European Union or ASEAN has yet to be developed. Yet, it is crucial for the Northeast Asian countries to continue to promote region-wide cooperative projects. The Korea Institute for International Economic Policy (KIEP) and the Northeast Asia Economic Forum (NEAEF) have been cooperating on the effort toward achieving closer economic and financial cooperation in the region, and this volume presents the results of the project implemented in 2012 to develop a regional institutional arrangement for financing cross border infrastructure developments and thereby regional economic integration.

The northeastern part of China, North Korea, Mongolia, and the Russian Far East together constitute an area that is well-endowed with natural, energy and human resources. This sub-region has the potential of becoming a tremendous source of natural resources for the entire region, and what is needed is to realize that potential through cross border infrastructure developments. Energy security and efficiency, coupled with protection for the environment, and the promotion of green growth, for example, is an important area of cooperation, as the three major countries of China, Japan and Korea are heavily dependent on energy imports and are highly vulnerable to energy crises. Financing requirements for the necessary cross-border infrastructure are likely to be large, and a regional financial institution is a key to meeting that financing need.

This volume, fourth in the series of proceedings volumes titled, *Financing Regional Economic Integration and Functional Cooperation for Northeast Asia: A Multilateral Financial Institution for Northeast Asia*, comprises papers, research reports, and summaries of a main conference and several specialized meetings, as well as affiliated activities, that took place under this project. The results of this project represent activities contributing to the regional economic integration and have been carried out in a spirit of cooperation.

KIEP extends its gratitude to Dr. Lee-Jay Cho, Chairman of the Northeast Asia Economic Forum, for his leadership in implementing the project and to the authors of the papers, conference participants and discussants who contributed to this volume.

Drs. Lee-Jay Cho and Chang Jae Lee would like to extend their appreciation to Dr. Byungwon Bahk, Mr. Zou Ping and Dr. Liu Ming for their effort in planning and coordinating the research and meetings as well as the substance of the research undertaken. Thanks are also due to the staff of NEAEF for their assistance in the course of successful implementation of this project, and to Dr. Kennon Breazeale for his editorial review of this volume.

Chae Wook

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## Introduction and Overview

*Lee-Jay Cho*

The Northeast Asia Economic Forum (NEAEF) is a regional nongovernmental organization created in 1991 to sponsor and facilitate research, networking, and dialogue relevant to the economic and social development of Northeast Asia. The Forum is also committed to promoting understanding and relations among the peoples of Northeast Asia, North America and Europe.

In collaboration with the Korea Institute for International Economic Policy (KIEP) for the year 2012, the NEAEF continued its focus on research, a conference and meetings aimed at establishing the Northeast Asian Bank for Cooperation and Development (NEABCD) on the basis of regional financial cooperation that would promote functional economic cooperation in terms of cross-border resources, energy supplies, infrastructure construction for logistics, capital mobilization, and institutional development. The 2012 cooperative project with KIEP resulted in the publication of this volume of conference proceedings, *Financing Regional Economic Integration and Functional Cooperation for Northeast Asia: A Multilateral Financial Institution for Northeast Asia*. This report volume contains the research outputs, the outlines and summaries of the meetings and will provide valuable materials with new perspectives and ideas for future discussions on institutional developments aimed at economic integration and financial cooperation in Northeast Asia.

NEAEF, as planned for the year 2012, implemented conference and meeting activities in which experts presented their perspectives, views, ideas, concrete proposals and strategies relevant to the issues of a regional financial institution for financial cooperation.

1. Teleconference on Issues of Multilateral Development Banks and the Northeast Asian Bank for Cooperation and Development (NEABCD) at the University of Hawaii, 26 April 2012.

The participants representing China, Korea, Japan and USA, including Chang Jae Lee, Stanley Katz and others, discussed the development bank proposed by the BRICs (Brazil, Russia, India, and China) in the context of multilateral financial institutions. This proposal for what they term the “South-South Bank” reflects the recognition they want for their increasing economic weight in the changing global economy, with the BRICs bank as an alternative to the World Bank as a source of borrowing.

What needs to be done is to find out what preparatory work they have done and who has been involved in the work. It would appear that the only country that could contribute a substantial amount of capital is China, plus perhaps India. Most of the member countries would be borrowers, and thus raising capital will be a major impediment. Capital markets probably will not be very receptive to bonds issued by a bank consisting of BRICs members, South Africa and other developing countries. For most of these countries, any bank would need a “soft window” for its borrowers, and funding such a window would be very problematic in this case.

It was pointed out that new developments were expected from the IMF in October 2012, and some countries are looking for a new approach. The initiative for the BRICs bank came

from India. The BRICs countries have very different economic systems, and it would be difficult for Russia to support the bank, although a little easier for South Africa. No background work has been carried out in China to support the proposal announced at the Delhi meeting. The five countries agreed that each country will study the proposal for a year before engaging in further discussion. The participants exchange views on the changing goals, missions and performance of the World Bank and Asian Development Bank in comparison with other regional and sub-regional banks as well as the OECD.

The plan for this year's activities for the NEAEF/KIEP project was reviewed and discussed.

## 2. Workshop on Regional Financial Cooperation: Planning and Strategy for a Northeast Asian Bank for Cooperation and Development at the Korea Bank Association on June 4–5, Seoul, Korea

Country perspectives of recent developments in multilateral development banks with reference to the BRICs proposal for a Development Bank were presented by the participants from China, Japan and Korea. This was followed by an in-depth discussion of the situation between NEABCD and the BRICs Proposal in the context of Europe and India, and how the NEABCD can fill in the gaps in the dynamic changes that are taking place. The participants recognized the changing roles and mission of the World Bank and Asian Development Bank and also reviewed other regional banks in terms of their mission and performance. For example, in the last quarter century, the number of developing countries has been reduced by half. The time for assistance from the World Bank has dwindled to the extent of reference to “the World Bank is a dying institution.”

With respect to the BRICs proposal in contrast to the NEABCD, the former is recent, whereas the NEABCD has been under discussion for a long time. The BRICs development bank is not a regional bank and it does not compete with the NEABCD.

The ADB and NEABCD should develop in a parallel and complimentary way. These two banks will share the same participants and deserve our support for both banks. It requires a keen focus on the missions and goals of developing stronger infrastructure in the region, especially with respect to the overlap between the two banks, ADB and NEABCD.

The participants endorsed the outstanding features of the proposed Bank and its unique perspective. The first is that this Bank will be more focused on the cross-border infrastructure projects. Second, the bank will play a catalytic role and provide the private funding by means of the credit capability of the bank. Third, the Bank will also work on human resource development and training and education of the host countries to pave the way for better coordination between the donor's community and the recipients in the host country. Fourth, the Bank may underscore the role of the sub-sovereign financial institution, with provincial and municipal governments thereby playing key roles in the infrastructure construction. Fifth, for the purpose of the economic integration of the region in terms of a prosperous economic zone, and particularly from the Japanese perspective, it will contribute to the overlapping development of Japan. In other words, the Bank—by developing the links in infrastructures, such as the proposal for recycling project in logistics and transportation and others that would connect the areas across national borders in the region—will strengthen the physical link and connectivity of Japan, the Korean peninsula and China, extending also to some parts of Russia and Mongolia. Other relevant features were also discussed.

The proposal for the NEABCD enjoys a much better economic environment than that of the US or the EU, which are facing economic difficulties. There is no major locomotive to pull the world economy to recovery, and Northeast Asia can ignite the global recovery, suggesting more support for the NEABCD.

The discussion on future strategy led to the suggestion at this stage for starting from South Korea and China to initiate a dialogue and then expanding it to the three countries of CJK, or these two bilateral meetings simultaneously, such that South Korea with Japan and South Korea with China, and then integrate them together for the proposal to the top leaders of CJK. The ROK was suggested to take a mediating role of initiating communications among the three countries of China, Japan and Korea.

3. The Northeast Asia Economic Forum (NEAEF), in partnership with the Research Center for Financial Cooperation in Northeast Asia and the Asia-Pacific Institute of China, convened the 21<sup>st</sup> annual NEAEF Meeting in Chengmai, Hainan, China, on 7 September 2012.

Representatives from the People's Republic of China, Japan, Republic of Korea, Mongolia, the Russian Federation, the United States and the European Union met to take steps toward greater cooperation and integration among Northeast Asian nations. The specific sessions focused on Financing Infrastructure Development in Northeast Asia, discussion of a Proposal for the Northeast Asian Bank for Cooperation and Development, and on Energy, Environment and Cross-border Infrastructure.

The first session on Financing Infrastructure Development in Northeast Asia featured high-level presentations starting with Maeda Tadashi of the Japan Bank for International Cooperation (JBIC) on the country's perspectives of the Northeast Asian Bank for Cooperation and Development (NEABCD) as well as discussion of past and future efforts of financial cooperation. Commentary focused on functional cooperation and development. Commentary also focused on the need to have mutual trust and to overcome political and cultural barriers in order to move ahead in the future.

The second session was a discussion of a proposal for the NEABCD. Forum participants reviewed and summarized the progress of promoting the establishment of the NEABCD in recent years, and highly appreciated the important contribution made over the years by the Northeast Asia Economic Forum. Participants considered that, despite the impact of the global financial crisis and the European debt crisis, the need to pay close attention to the establishment of the NEABCD remains unchanged. The NEABCD and the Asian Development Bank have different characteristics and missions. Therefore, the NEABCD will help promote economic prosperity and sustainable development in Northeast Asia. There were also recommendations that China take strong leadership and create a short-term roadmap to promote the establishment of the NEABCD.

First, the Northeast Asian Financial Cooperation Research Center should incorporate the recommendations of today's meeting, and make a new research report as soon as possible. At an appropriate time, the Northeast Asia Economic Forum will hand over the report to the central governments of China, Japan and Korea for consideration.

Second, it is suggested that the Chinese, Japanese and Korean members of the Research Center for Financial Cooperation in Northeast Asian should work actively to persuade their respective countries' central governments to support the establishment of the NEABCD.

Third, the central government of China, Korea or Japan should be the first to propose the establishment of the NEABCD, and make it become a major topic of the China, Japan and Korea Summit in 2013.

The NEAEF will pursue a semiofficial trilateral mechanism for the three countries for consultation on the government sides.

Substantive ideas, perspectives, and proposals are discussed in the papers.

Prior to formally establishing the NEABCD, it is proposed during transition that an alternative measure in response to the increasing demand of development projects in this region should be considered. That is the creation of a financing facility formed by China, Japan and Korea, so-called “CJK Bank.”

This Bank, to which the development banks of the three countries would contribute, has a few merits and differences compared with the proposed NEABCD. The Bank can be formed in a simple way since three banks will be involved as shareholders by themselves. The procedure for an entity will be much less complicated than in the case of the NEABCD.

The Bank would finance large-scale projects with a small amount of paid-in capital on a project basis. It could attract large amounts of capital from private investment or borrowings through participating in profitable projects such as cross-border projects of China, Japan and Korea.

Japan would become one of the beneficiaries of the financing. Since Japan has always played a role as a capital-provider, Japan’s being a financial beneficiary could be a new paradigm in multilateral finance institution as pointed out earlier. The Bank could utilize the experience, network and manpower that are necessary for long-term development finance from China Development Bank (CDB), Japan Bank for International Cooperation (JBIC) and Korea Export-Import Bank (KEXIM), which would be the shareholders of the Bank. They have close relationships with a lot of developers in their countries and could encourage them to participate in Northeast Asian infrastructure projects of the PPP type.

The experience and know-how of financing cooperation would be accumulated through the Bank, which could provide a foothold to the establishment of the NEABCD.

One interesting perspective on the proposed NEABCD is stated below.

In response to the argument that NEABCD would create a redundancy with regard to the ADB and the World Bank, there are cases where regionally focused development institutions have complemented, not cannibalized, the existing MDB framework, as with the EBRD in Eastern Europe, CABI in Central America, and Islamic Development Bank in the Middle East, among others. In a similar fashion, the NEABCD can be more effective while moving in tandem with the ADB and the World Bank in addressing region-specific issues.

Regarding the concern that a significant deficiency in appropriate legal, regulatory, and governance frameworks in the region inhibits investment, the NEABCD can actually function as a safeguard for the otherwise risky cross-border investments while facilitating the development of such institutional structures. Furthermore, the NEABCD, in addition to its main function of development capital provider, can specialize in knowledge-building in institutional structures associated with such investments, while also serving its main function as a capital provider.

As to the argument that there are only a few beneficiaries from the establishment of the NEABCD, one needs to underscore the fact that increasing the level of infrastructure development connecting North Korea and Mongolia makes not only economic sense but also political sense, as it can significantly contribute to the regional economic development and stability of the region and the world.

Another perspective is the rise of China in terms of dramatic economic development, especially in the finance sector illustrating the scale of financial resources. These resources that China has achieved can be tapped for a major investment in the newly proposed NEABCD.

The situation in Northeast Asia is changing in connection with the effort for establishing the Bank, and therefore a new idea based on a discussion with UNDP and Greater Tumen Initiative (GTI Secretariat) for the interim period is proposed.

That is, perhaps, a development bank's or EXIM bank's consortium, either bilateral or multilateral banks cooperation may be a more practical, feasible and effective initial step toward financing for sustainable development and investment projects and these cross border projects can include: trade and investments, public and private infrastructure construction, energy and resources.

A review of cross-border infrastructure projects of the past, present and future was done for the purpose of preparing for the content of the proposed Bank as a major step aimed at the next year's proposal to the CJK Government leadership.

#### Conclusion: Progress and Future

The 2012 project, through research and meeting activities, firstly, resulted in clarifying the important regional and international developments and thus more concrete steps toward the financial institutional development for regional economic integration in Northeast Asia. Secondly, the project contributed substantially to the justification of the mission and structural architecture that was needed to actualize a proposed multilateral regional financial institution.

The meeting activities of the NEAEF continued to add to the substantial documentation and fundamental conceptual work contributed by financial experts and practitioners. Several of the presentations provided details on some new dimensions for developing the NEABCD concept along with the advantages of establishing an NEABCD in developing infrastructure for the Northeast Asian region. It was again recognized and reemphasized that a mechanism for informal dialogue involving government officials should be initiated and arranged to expedite preparations for discussion at the top level of the governments concerned. This mechanism will also enable the parties to exchange information and ideas to formulate a common framework and effort toward the establishment of the NEABCD.

We believe that the contents and discussions included in this volume represent this year's meaningful achievements, which will contribute significantly to future discussion and preparation for consideration by the leaders of the governments concerned in Northeast Asia.

More broadly, we believe this project has continued to provide important contributions through timely and necessary research and conference activities aimed at regional economic cooperation and integration in Northeast Asia as well as the wider Asia-Pacific region.

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## **Part I**

# **Financing Economic Integration and a Regional Multilateral Bank: Keynote Papers on the Proposed Northeast Asia Bank for Cooperation and Development (NEABCD)**

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## Advancing of the Establishment of the NEABCD

*Bahk Byungwon*

Since the outbreak of the global financial crisis in the US in 2007 and the subsequent European sovereign debt crisis in recent years, the world economy has been in a great turmoil. Once the leaders of the world economy, the western countries are suffering heavily from the crises. The US economy is still struggling with the lingering impact of the financial crisis, and the ongoing euro-zone crisis, being exacerbated by the Mediterranean countries, remains unresolved.

According to the IMF forecast released in July 2012, the growth of the global economy is estimated to stagnate at 3.5% in 2012. The US economy is anticipated to show a paltry 1.4% and a negative growth is expected for the euro-zone economies. In addition, the future outlook is not so bright for the western countries. For the United States, the possibility of reduction of the budget deficit by simultaneous tax increases and spending cuts, the so-called ‘fiscal cliff’, could lower the economic growth rate and even lead to a prolonged recession. In Europe, despite the efforts by the troika and EU nations, the debt crises in Greece, Spain, and Italy created great risks and uncertainty. Nothing has been resolved yet, and credit rating agencies report a negative forecast and possible further rating cuts for these countries. This will potentially further aggravate the global economic situation.

Turning to our three Northeast Asian countries, China is still expected to grow at a rate of about 8% this year. The Korean and Japanese economies will grow at 3.5% and 2.4%, respectively. These estimates are actually very fragile, since the growth rates forecast has been repeatedly reduced through the year, and we have four more months ahead. The three countries have long been dependent upon exports for their growth, and their exports were made possible by the excess consumption by the US and the European countries, financed by debts.

Excess supply from the Asian countries has been absorbed through excess consumption by debt financing of the US and the EU countries. This scheme is no longer possible, and the Asian countries now have no choice other than to focus their policy efforts upon increasing domestic demand of their own countries. The three key countries in Northeast Asia, namely China, Japan, and Korea, jointly account for about 20% of world GDP, and are now expected *not only* to stand on their own by depending less upon exports to the US and the EU and increasing domestic consumption, *but also* to play the role of the locomotive for the recovery of the global economy. The three Northeast Asian countries have enough potential to meet, and possibly exceed, these expectations.

In comparison with the advanced western countries, the Northeast Asian countries still have the potential for resilient economic growth through boosting investments and increasing domestic demand. The Chinese economy, as a major contributor to world economic growth, has enjoyed uninterrupted growth for the past three decades recording an average 10% annual growth. Meanwhile, China surpassed Japan in terms of GDP in 2010 to become the world’s second largest economy. Many international organizations predict that China may grow larger than the US in 2020.

The strength of Northeast Asia’s economy is also evident at the corporate level. Among companies in the 2012 Fortune’s Global 500 companies listing, 154 are in Northeast Asia. By

adding 12 more companies to the list this year, China is ranked at second place with 73 companies, overtaking Japan for the first time. The US is still ranked first with 132 companies. Japan came in third with 68 companies.

In terms of foreign exchange reserves, China has the largest FX reserve in the world, reaching USD 3.3 trillion, followed by Japan with about USD 1.3 trillion. Russia is ranked third with about USD 0.5 trillion. Korea is ranked seventh with USD 0.3 trillion.

I have shown just a few facets of the potential of these three countries. Now it's time to look into the reasons why we cannot currently fully exploit this potential, and what we must do.

First of all, all three countries have been too dependent upon manufacturing industries for export, and hence do not have strong services industries, which are more important to increase domestic demand. China is expecting an unsatisfactory growth rate of below 8% for 2012, and for the 12<sup>th</sup> 5-year development plan period, China seems to be willing to accept an average growth rate of 7%. This is quite disappointing compared with the 10% average for the past three decades. Korea and Japan also cannot and do not expect quick recovery to former growth rates.

Even though China is still recording an 8% increase of exports this year until July, Korea's export increase rate dropped down to -0.8%. Japan already experienced a decrease of exports last year, marking minus 2.7% in 2011. This gloomy situation is expected to last long since we cannot expect recoveries of the US and EU economies in the near future, and major emerging economies such as Brazil and India are also having difficulties. We now have very strong reasons to find new sources of economic growth within the three countries.

In this vein, increasing the share of intra-regional trade among China, Japan, and Korea is desirable, because this means less dependence on outside markets. The share has jumped from 12% in 1990 to 23% in 2010, and including Hong Kong and Taiwan, the share of intra-regional trade was 37%.

At the same time, many people wonder why we could not make any progress in the direction of institutional economic integration. There was a surge of bilateral and multilateral free trade agreements in East Asia as well as in the world. The three countries also completed a significant number of free trade agreements (FTAs) with other countries. Korea began this movement with successful FTAs with the US and the EU. However, among the three countries, we do not have any bilateral or trilateral FTA.

Based upon the growing need for institutional economic cooperation, however, in December 2008, the first trilateral summit meeting, a new dialogue mechanism among the three countries separately from the ASEAN+3 framework, was held in Fukuoka. And this year, in the fifth Trilateral Summit Meeting, leaders of our three countries finally agreed to launch the CJK FTA negotiation within this year. In addition, China and Korea began negotiations for a bilateral FTA.

As for now, the Korea-China FTA negotiation is moving ahead and gives us some hope of conclusion in the foreseeable future. Even before the territorial disputes broke out again very recently between Korea and Japan and between China and Japan, negotiations for the Korea-Japan FTA didn't show smooth progress, and the negotiation for the trilateral FTA has not yet opened.

I don't know why these chronic territorial disputes, which have been well managed to remain submerged for a long time under the tacit understanding that we have no way out, have again arisen. Our understanding is that the claiming countries are forced by domestic political reasons to repeat their claims against the countries in effective control, but no more. Now that domestic political needs are more than satisfied, I hope that political leaders of the three

countries will return calmly and try to pacify excited national sentiments and divert attention of the people to the urgent necessity of strengthening economic cooperation among the three countries at this critical point of global economic difficulties. Arousing national sentiments of the general public, which is out of control, is never of help in solving these problems.

With regard to the Korea-China FTA, I advise Korean and Chinese colleagues to exert their influence to urge the negotiators on both sides to do their best to develop an FTA of the highest level. I do not think an FTA focusing on the increase of exports will be of great help for weathering through the present global economic difficulties. Now the focus of economic cooperation should be shifted to the increase of investment, not only between Korea and China but among all three countries. We should be very cautious that cross- and co-investments among us should *not* result in increase of production capacity of goods already in excess supply but *should* be funneled into the area where we can stimulate domestic demand and increase the supply of natural resources and foodstuffs, which are in short supply.

This is the reason why I believe that our long cherished dream, the establishment of a new regional international development bank to cover the three countries and beyond, should not be delayed any longer. We have been calling this bank the Northeast Asian Bank for Cooperation and Development. A lot of natural resources and agricultural production potential awaits exploitation here in Mongolia, Siberia, and former Manchuria. Investments in the development of these resources and in social overhead capital (SOC) to make the output by these development projects accessible to the world market will contribute to the global stabilization of resources prices, will increase the demand in this area, and will ultimately contribute to the recovery of the world economy. Do you imagine any other project that can better contribute to the world economy in a shorter period of time?

What is lacking in this area are SOCs to tap these vast possibilities, and in this area, most of the proposed SOC investments are inevitably cross-border and inter-regional. This is the reason why a new international development bank such as the NEABCD is indispensable. We need it not because we do not have money to invest. All the three countries have abundant financial resources to invest. China is investing astronomical amounts of money throughout the world. What we additionally need is an international scheme to secure economic cooperation and political and diplomatic guarantees at the same time. Do you have any better tool to propose for this goal other than the NEABCD?

We have been talking about the necessity of the Bank for the past twenty years. If it were not for the persistence of Dr. Lee-Jay Cho, this would be impossible. There is more than enough justification for the Bank, and the global economic situation has only strengthened the justification of its establishment. What we need now, it seems to me, is the political will of the three countries. Political leaders of the three countries have to draw the attention of the people to practical ways of reviving their economies, including increasing domestic demand, instead of futile attempts to divert attention of the people away from the discontent caused by economic difficulties and toward diplomatic issues. Now it's time for one of the three countries to take the initiative in establishing the Bank. Who is going to take the initiative?

Thank you for your attention.

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## **Toward the Northeast Asian Bank for Cooperation and Development**

*Jin Liqun and Zhang Zhixiang*

I am very pleased and honored to be at today's conference. According to the original plan, Mr. Jin Liqun, former Vice Minister of Finance of China and former Vice President of the Asian Development Bank, was to be at today's conference and make this speech. Since he is still on a mission abroad, I am presenting on his behalf.

My presentation covers five aspects. Let us begin with the brief history of our efforts toward building the Northeast Asian Bank for Cooperation and Development. It is well recognized and accepted that financial cooperation in Northeast Asia is very important, and the need for a new financial institution to help meet the requirement in financing Northeast Asia's future infrastructure development is increasingly acknowledged and supported within the region. People have already conducted a lot of research on the necessity and feasibility of establishing the new financial institution, namely the Northeast Asian Bank for Cooperation and Development. We shall not go over to the details of what we have done together. Instead, however, we shall briefly discuss the rationale of why we need such a bank despite already having the Asian Development Bank, based on our working experience in the ADB, IMF and the World Bank. Let us also touch upon possible future work plans.

The region has both demand for and supply of funding resources for regional development through economic cooperation under a favorable political environment. It has been more than 20 years since the proposal for the bank was initiated. In the 1990s, many experts, including Dr. Stanley Katz and Dr. Lee-Jay Cho, conducted valuable research and received kind and positive responses. Then beginning with the 9<sup>th</sup> Northeast Asia Economic Forum conference hosted by Tianjin, with strong support and great assistance from Tianjin, the Ad Hoc Committee members under the Forum worked together and prepared many necessary documents of high quality. In the meantime, China's economic rise has provided great impetus for the proposed bank. Nevertheless, there are still some issues that need to be clarified and some obstacles to be overcome. There is a consensus that the new proposed bank will strongly help regional peace and development.

At the time when we analyze the objective necessity for a cooperative and development bank in the region, we also need to understand and solve the difficulties involved.

Firstly, people usually wish to know if the Asian Development Bank is sufficient for the region's economic development and if a new bank is necessary. Secondly, Northeast Asia's political situation is complicated, and therefore wisdom and courage are needed to solve the issues left behind by history. More so, the recent frictions require immediate attention from the leadership of China, Korea and Japan. Thirdly, the bank proposal has been discussed for many years and now, it is high time for the central governments to take over the mission and initiate the essential and practical step for pushing forward the establishment of the proposed bank.

It is most important and inevitable to address issues of the different roles and functions undertaken by the ADB and the new proposed bank. Earlier research and analysis focused on the missions and operations that make them different, each from the other. We all believe that the two banks are mutually complementary, instead of repetitive.

Indeed, this is not a new issue. I still remember that back in the 1960s, when Japan was proactive in pushing forward the proposal to establish the ADB, some countries, including the United States, were reluctant to recognize the need for it, as the World Bank would be sufficient for Asian countries and a new regional bank would be redundant. Japan was very persistent, playing an important role in rallying support for establishing the bank. Facts of over four decades have fully proved the ADB has contributed a great deal to the rise of Asia.

It is not surprising to see that the existing institutions may not be in favor of a new institution, as it may negatively affect them. However, it is right to point it out that the new institution will not be a rival but instead, a good collaborator. Sub-regional banks and regional banks have different missions and functions, and both are necessary for healthy economic development in the region. The Andean Development Corporation, Nordic Investment Bank and West African Development Bank have provided us with excellent examples.

We are convinced that the proposed bank will play a good and supplementary role for the regional economic development for the following reasons.

First, generally speaking there are two approaches in infrastructure development. One is bottom up infrastructure development that aims to eliminate poverty in a given geographic area, while the other one is the building of core infrastructure that aims to support national economic development.

The main difference between the two approaches is that the first takes poverty reduction as the first priority, while the second addresses economic development in terms of higher gross value-added. All current multilateral financial institutions, such as the World Bank, the UNDP and ADB, that have in-depth involvement in regional and sub-regional projects, adopt the first approach. But the Northeast Asian region, according to its economic development needs and effects, requires the approach beyond the bottom-up to pursue large-scale economic development. With this mission, the proposed new bank would better help and serve all the countries in the region.

I also wish to draw your attention to the various functions of the proposed bank, which are different from ADB. Firstly, the cross-border infrastructure projects in Northeast Asia cannot get enough financial support from the ADB, as the major countries are not eligible for the funding set aside for poverty reduction. The new bank, however, can certainly provide the services for this purpose.

Secondly, the bank will be in a better position to mobilize private resources, as the projects financed through this mechanism could generate higher gross added value, with better returns.

Thirdly, the bank could also provide training programs for the countries in the region, so that the region can benefit from bringing out an advanced team who understand well both the mechanism of the market economy and their own local conditions.

Fourthly, the bank could help promote mutual understanding among people involved in the operations, thus creating a win-win situation. Fifthly, the new bank will particularly focus on the energy related projects and projects of green growth, including reduction of carbon emissions, clean energy and improvement of energy efficiency, which could contribute a great deal to what ADB aims to achieve. And last, but not least, the new bank can also provide a soft window in the new fields, including local government development in capacity building, culture related projects and new technologies, etc.

We envision that the new bank may engage in other functions which are deemed necessary and possible when the situation requires it.

Once the new bank is established, we can well assume that China, Korea and Japan all can benefit from it. As an emerging country, China wishes to contribute more for the region and the world. The new bank would provide China with such an international stage. Korea could use this bank to increase its international influence, while Japan could benefit from the projects sponsored by the new bank, as the ADB mainly supports its less developed members. The new bank could potentially support upgrading and high value-added projects.

I am sure that we all agree that it is high time to make a decision of substantial importance with the new bank. We would like to thank the Northeast Asia Economic Forum and Dr. Cho for their effective and persevering efforts. We are also very grateful for the great help from local governments, particularly the Tianjin Municipal government. They never hesitate, never give up and always remain optimistic. We know for sure that without their hard work, we would not be able to obtain what we have achieved.

However, there is an absolute need to see a new stage where discussions and policy suggestions will move from the level of NGOs and local governments to a higher level of decision making authority by the central governments. Ministry-level discussion and dialogues are surely necessary as the next step of movement. It is also suggested that representatives from either China or Korea or both make a timely proposal officially to that effect. We look forward to the smooth establishment of the bank and early start of necessary official procedures.

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## **Part II**

# **Financing Economic Integration and a Regional Multilateral Bank: Research Papers on the NEABCD**

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# Creation of a Joint-venture Bank by China, Japan and Korea

*Jai Min Lee*

## 1. Introduction

Northeast Asia has great potential for development. For instance, many research institutions have estimated the cost of development projects in this region from US\$16 billion to US\$140 billion in a year, implying that the demand for development projects would be huge within the region.

As major development sectors, we have often mentioned energy development in Far Eastern Russia, infrastructure development in Northeastern China, and natural resource development in Mongolia. However, more than these ongoing projects in less developed region, we should realize there are a number of cross-border projects in developed regions such as China, Japan and Korea.

Unlike other economic blocs such as the EU and NAFTA, the Northeast Asian countries have not actively cooperated with each other due to historical issues or big differences of economic level and system. In other words, this would suggest that this region has a greater potential to develop than any other region in the world.

In order to materialize such development potentials, financing is the indispensable element. Furthermore, there is a large financing demand in order to fulfill the development projects.

We have discussed for a long time how to raise the funds necessary for the development of Northeast Asia. However, fundraising has not yet improved in this region. This is one of reasons why development projects in Northeast Asia have not been actively promoted. In this regard, the purpose of this paper is to propose an idea for increasing the financial liquidity of this region.

## 2. Financial sources for development projects and the NEABCD

There are two kinds of financial sources for development projects: the private sector and public finance institutions. The best way to raise a large amount of money is to mobilize funds from the private sector. Private-sector lenders, however, are not willing to inject their funds into large-scale projects without a guarantee of repayment.

These lenders are very cautious about participating in developing countries' projects since those projects are riskier. In particular, there are a lot of potential social and institutional issues in Northeast Asia. When not addressed properly, these issues tend to become an impediment for private-sector participation in projects. Unless these critical issues are resolved or at least managed by the controlled circumstances, it would be difficult to raise private capital.

Considering the political and institutional aspects, the public financing sources will have to play a key role so as to attract private funding in this region. Public finance sources used by developing countries are from bilateral official development assistance (ODA), official export credit agencies (ECAs), and assistance from multinational development banks (MDBs).

These public finance sources have their own nature and merits. Specifically, MDBs are the most reliable sources, since ECAs and aid providers are bilateral agencies, so that they must consider their own national interest as a priority.

The Asian Development Bank (ADB) has provided financial support for a large number of Asian development projects. Since they had to focus on supporting Southeast Asian countries, however, the Northeast Asian region was considered to be less attractive.

Therefore, we have been discussing the issue of establishing a new MDB, the “Northeast Asian Bank for Cooperation and Development” (NEABCD), which is designed to provide financial support for Northeast Asian projects.

In particular, the Northeast Asia Economic Forum (NEAEF) has dealt with the issue on the establishment of NEABCD for more than 20 years. Thanks to its constant efforts, the government authorities of China, Japan and Korea have begun to take an interest in the NEABCD. This is a very encouraging sign, and we hope that the Bank’s establishment will be discussed on a governmental basis as soon as possible.

Table 1. Chronology of discussions on the proposed Northeast Asian Bank for Cooperation and Development

Year	Place	Event
1991	Tianjin, China	Ma Hong and Li Boxi, of the China State Council Development Center earlier proposed the establishment of the Northeast Asian Development Bank (NEADB) and Duck Woo Nam (former prime minister of South Korea) also proposed in a presentation at the First Northeast Asia Economic Forum (NEAEF).
1993	Yongpyong, S. Korea	Campbell and Kakazu presented their feasibility study report at the fourth NEAEF. The report contained necessity of the NEADB, estimated capital demand in the region, capital investment from possible member countries, organization and operation of the Bank.
1997	Ulanbaatar, Mongolia	S. Stanley Katz (former Vice President, ADB) presented a paper “Capital demand for infrastructure development in Northeast Asia – Necessity of the NEADB” at the seventh NEAEF. His paper was referred later as the “Katz proposal”.
1999	Tianjin, China	Tianjin City Government proposed that the headquarters of the NEADB be located in Tianjin.
2002	Osaka, Japan	The Tokyo Foundation supported a research for the establishment of the NEADB. The result was reported at the development finance session of the NEAEF.
2011	Hawaii	The role of the NEABCD was emphasized to promote cross border cooperation and energy infrastructure in the region. The countries in Northeast Asia were encouraged to work with their government institutions to expedite the process toward achieving consensus for policy action establishing the NEABCD at the 20 <sup>th</sup> NEAEF.

Because of many political issues and procedural problems, however, we still have a long way to go before creating the NEABCD into a multilateral development institution like the Asian Development Bank.

Considering its demand for development projects in the Northeast Asian region, we should not just wait for the launch of the NEABCD. Action must be taken as a first step toward the Bank. That is why we propose the establishment of a joint-venture bank by the development banks of China, Japan and Korea in this paper.

**3. Creation of a joint-venture bank by China, Japan and Korea**

Cooperation and agreement among China, Japan and Korea are very important in having a new MDB in Northeast Asia, since they will be major contributors.

Since inter-government agreement will be difficult and takes a long time to reach, we should consider discussing the financial cooperation among the development banks of the three countries.

They could work with each other to meet the demand for development projects in Northeast Asia. For efficient cooperation, however, they need to create a joint-venture financial organization, which can temporarily be called the “CJK Bank”. Having such a Bank could facilitate the establishment of the NEABCD, by supporting development projects in Northeast Asia as a first stage toward the NEABCD.

i. Formation of the Bank:

As a first step, development banks in China, Japan and Korea should agree to form a joint-venture bank to provide a financial support for development projects in Northeast Asia.

Currently, promising participants would be the China Development Bank (CDB) in China, the Japan Bank for International Cooperation (JBIC) in Japan and the Korea Exim bank (KEXIM) in Korea. They are all governmental banks able to provide long-term loans to oversee development projects.

These banks can contribute the same amount of capital as equity and establish an independent entity for the operation of the Bank. Considering their capital size and finance volume, it would not be difficult to form the entity with equity over US\$1 billion.

Table 2. Profiles of CDB, JBIC and KEXIM

(US\$ billion)

	CDB (2011. 12)	JBIC (2011. 3)	KEXIM (2011. 12)
Capital	70.4	15.5	6.8
Finance Outstanding	874.7	130.9	76.8
Loans	874.4	101.6	40.0
Guarantees	—	29.3	36.8

Sources: Annual Reports of the three banks.

The joint-venture bank would be managed by an independent CEO under a board of directors formed by the three mother banks. The staff would consist of experts in long-term development finance from existing MDBs, ECAs and international commercial banks.

ii. Sectors to be supported by the Bank:

The objective of the Bank is to promote economic development in the Northeast Asian region by expanding the financial liquidity for development projects in Northeast Asia through investment, direct loans and guarantees. Sectors to be supported by the Bank should be cross-border projects of China, Japan and Korea and also development projects that involve companies from the three countries.

There are high demands for cross-border development projects surrounding the three countries. A cross-border economic cooperation program began in the early 1990s in the Tumen River area. Further, three regional cooperation programs, including the Yellow Sea Rim, East Sea (Japan Sea Rim) and Korea-Japan Strait, have been suggested. However, none of these projects has been realized due to the lack of financing.

If financial support is provided in this region, many promising cross-border projects can materialize. For example, submarine tunnel construction between China and Korea and between Japan and Korea will be a promising project. In particular, there have been substantial studies, discussion and other work about building a submarine tunnel between Japan and Korea. One of them is the Busan-Fukuoka JEA Agreement made in 2008. We can also consider the construction of a submarine tunnel between China and Korea in the Yellow Sea.

Developing a regional logistics system would give much benefit to the trade expansion among the three countries. The logistics system would need the construction of innovative terminals, logistics parks, and ICT systems.

In addition, gas pipeline construction passing through the three countries from Russia and offshore energy development projects will contribute to three nations' energy sector.

For sustainable growth in the future, the three nations should collaborate on green growth sectors, including energy efficiency, emissions-reduction, low carbon and environmental protection projects.

The construction of these cross-border projects will facilitate trade and investment among the three countries as well as personnel exchanges. It is certain that these projects will help to strengthen the three countries' economic and political cooperation.

Meanwhile, the Bank has the potential to encourage the three nations' private investors to participate in NEA's public sectors by supporting public-private partnership (PPP) projects in Northeast Asia. A PPP is a public project that is funded and operated through a partnership between the public sector and private firms.

An example of a typical PPP would be a toll road that is financed and constructed by a private developer. A government grants a right to own and operate the project to private developers for a fixed period. Then the project ownership transfers to the government at no cost after the concession term.

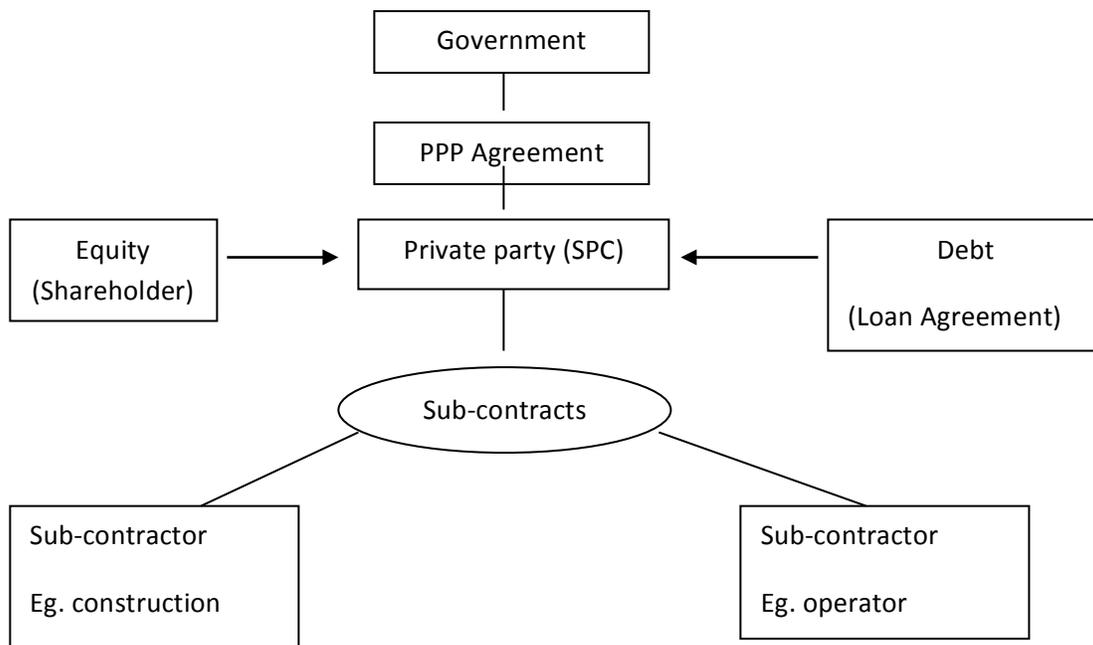
Recently, the fund flow into the developing countries has been led by the private sector. Private capital participation in the development projects of the public sector, which used to be propelled by public funds in the past, has been on a dramatic increase.

Multilateral development banks, export credit agencies and commercial banks participate in PPP projects. Further, project finance (P/F) techniques are being employed to mobilize the funds for those projects.

ADB has increased its role in participating in PPP projects. It has already provided loans and guarantees amounting to USD 23,609 million for 175 projects between 1998 and 2008. It operates a separate department to deal with PPP projects.

JBIC and KEXIM also started providing more loans and guarantees to PPP projects. Specifically, KEXIM supports PPP projects through the linkage of ODA loans and export credits.

Figure 1. Structure of PPP



PPP could be a crucial factor for the construction of infrastructure and energy development in the Northeast Asian region.

Northeast Asia has a great demand for infrastructure development in the public sector. In particular, many of the cross-border infrastructure projects are necessary on a large scale.

Nevertheless, the reason why PPP projects have not been actively promoted is the lack of financial support. Although ADB provides a large amount of funding to PPP projects, the portion allocated to Northeast Asia is very small. Therefore, if the CJK Bank comes into operation, it would help to increase PPP projects in the Northeast Asian region.

### iii. Financing scheme of the Bank:

The financial source of the Bank consists of equities and borrowings. The equities will be raised from contributions by the three development banks, and the Bank could raise large sums of money by issuing global bonds under the guarantee of the three mother banks. Through the guarantee of high credit rating banks, it would be able to secure capital abroad with low interest rates and long maturities.

By using the high quality of the collateral (the credit-standing of the subscribing institutions), the Bank can yield a large multiplier in terms of the amount of cash paid by shareholders. In this sense, it differs distinctly from some infrastructure funds, which have no leverage effect.

When the Bank provides direct lending to the project, it will utilize the co-financing with MDBs, other ECAs and commercial banks as well as the three mother banks.

If the project turns out to be profitable, it could attract a large sum of money from both private and public sources by utilizing the project financing scheme. Since the Bank provides the financial support on a project basis, it could deal with large scale projects.

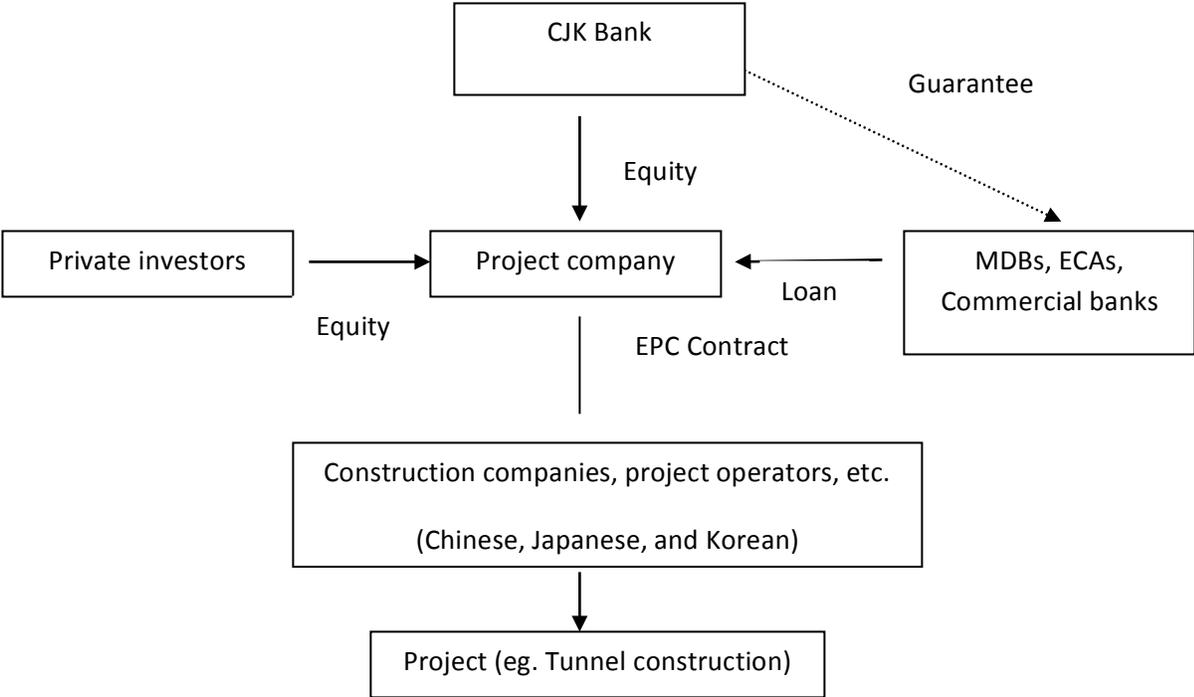
The main financing scheme of the Bank will be equity investment and guarantee. Since the initial amount of the Bank is not large enough, direct lending will need to be provided for the limited level at the initial stage.

If the Bank participates in the project as equity investors, it could maximize the policy leverage. Then, private investors can be more confident in their investment in the projects.

Guarantee business will be the central activity for the facility. It can take on political risk and some credit risks from the commercial banks that provide loans to the projects. Through the guarantee function, the Bank can induce a large sum of private capital into relatively high risk projects.

The Bank invests in the project company for the operation of the project, and the project company will be a borrower of the project. In this structure, if the project falls in default, the Bank's loss will be limited to the amount that is invested or guaranteed for that project.

Figure 2. Financing scheme of the CJK Bank



iv. Comparison with the existing MDBs

The proposed NEABCD is a kind of multilateral development bank, as is the ADB. MDBs provide financial support for development projects in developing countries in more concessional terms and conditions.

However, this Bank will participate in projects that are promoted in developed regions such as Japan, China, and Korea, as well as in developing regions such as Far eastern Russia, Mongolia and North Korea. Hence, Japan, Korea and developed Chinese region will be beneficiaries of the financing, since projects related to three countries will be supported by the Bank.

It is worthwhile to note that Japan, which has been participating in all the MDBs only as a contributor, will be a beneficiary of the financing from this Bank.

For the initial period, the Bank will provide financing on commercial terms. Then it will accumulate profits and utilize them for the capital base of NEADB in the future.

CDB, JBIC and KEXIM, which will be shareholders of the Bank, have broad experience on long-term development financing and include many financing experts and funding capabilities. The Bank can utilize such experience and financing experts immediately when it is set up.

Another merit of the Bank is that it can potentially reduce political obstacles due to operating on a project basis. If the experience and know-how of financing cooperation are accumulated through the facility, it could gain a foothold for the establishment of NEABCD.

#### v. Obstacles to creating the Bank

Since CDB, JBIC and KEXIM are government banks, they need to have agreement from their governments for the creation of the Bank. The procedure will be somewhat complicated. However, the process can be quite simple and less difficult compared with that of establishing the NEABCD.

There is evidence that three banks have contributed capital to form an international financing facility. The ASEAN-plus-3 countries (ASEAN + China, Japan and Korea) launched the Credit Guarantee Investment Facility (CGIF) last year.

The purpose of the CGIF is to activate the bond market in the ASEAN-plus-3 countries. It provides guarantees to corporations in member countries when they issue corporate bonds. Due to the guarantee of the CGIF, which will have a credit rating of triple A, the companies can save the issuing cost and extend its maturity.

The CGIF will be able to promote the economic development of member countries through the activation of the Asian bond market.

The initial capital was 700 million dollars. For the establishment of CGIF, China Exim and JBIC each contributed 200 million dollars and KEXIM contributed 100 million dollars. The rest of the 200 million dollars were allocated from 10 ASEAN member countries (70 million) and ADB (130 million).

The three banks of China, Japan and Korea are members of the board of directors, and they are cooperating with each other to operate the CGIF.

The CGIF is a new multilateral development entity established in order to achieve specific purposes and to cover specific areas, even though the ADB could fulfill such activities.

In this sense, the CJK Bank could have a similar rationale and process for the establishment with CGIF.

In addition, three governmental banks have an experience in having operated a cooperation council. In 2005, China Exim bank, JBIC and KEXIM formed a Northeast Asian Export Credit Agency and a policy meeting was held by their presidents.

At that time, they focused on information sharing and personal exchange rather than discussing financial cooperation. Since then, JBIC and KEXIM have been holding annual meetings thus far.

Such experience could facilitate a creation and operation of the Bank more efficiently.

It is important to note that one of three banks must assume the leadership and begin to discuss this matter as soon as possible.

#### **4. Conclusion**

Demand for the development financing in the Northeast Asian region is still strong because of the need for cross-border projects, joint energy development and infrastructure construction.

The necessity of a Northeast Asian Bank for Cooperation and Development to financially support the Northeast Asian region has been discussed for more than 20 years in the Northeast Asia Economic Forum.

Thanks to the constant efforts of the NEAEF, the issue of the NEABCD has been transferred to the government of China, Japan and Korea, who have begun to realize its necessity.

However, it is expected it will take a long time to set up the Bank, due to many procedural matters, including political consensus. Hence, as a first step for the establishment, we need to consider an alternative measure in response to the increasing demand of development projects in this region. That is the creation of a financing facility formed by China, Japan and Korea: the so-called “CJK Bank.”

The Bank, which would be contributed to by the development banks of the three countries, has a few merits and differences compared with the proposed NEABCD.

First of all, the Bank can be formed in a simple way since three banks will be involved as shareholders by themselves. The procedure of being an entity will be much less complicated than in case of the NEABCD.

Second, the Bank would finance large-scale projects with a small amount of paid-in capital on a project basis. It could attract large amounts of capital from private investment or borrowings through participating in profitable projects such as cross-border projects of China, Japan and Korea.

Third, Japan would become one of beneficiaries of the financing. Some cross-border projects, which will be promoted as main target of the Bank, will be built for Japan. For instance, the Busan-Fukuoka submarine tunnel project is on the financing list. Since Japan has always played a role as a capital-provider, her being a financial beneficiary could be a new paradigm in multilateral finance institution.

Fourth, the Bank could utilize experience, network and manpower that are necessary for long-term development finance from CDB, JBIC and KEXIM, which would be shareholders of the Bank. They have close relationships with a lot of developers in their countries and could encourage them to participate in the Northeast Asian infrastructure projects of the PPP type.

Fifth, the Bank could contribute to strengthening economic cooperation among China, Japan and Korea. Through this Bank, the three countries could increase trade and personal exchange within the region.

In short, the experience and know-how of financing cooperation would be accumulated through the Bank, which could provide a foothold for the establishment of the NEABCD.

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# Re-thinking of the Northeast Asian Bank for Cooperation and Development (NEADB) as an Effective Regional Development Framework

*Jae Hyung Hong*

## 1. Background

Northeast Asia, which includes China, Japan, South Korea, North Korea as well as Mongolia and parts of Russia, covers 22 percent of the Earth's surface and 28 percent of the world's population, and has quickly grown into one of the largest economic spheres in the world, along with the EU and NAFTA (North American Free Trade Area). Northeast Asia can observe its increasing weight in the global economy, as China, the world's largest producer, as well as the largest market, continues its growth, albeit possibly not at the rate of 10 percent per annum of the past 30 years.

Northeast Asia, however, comprises a heterogeneous group of countries characterized by wide gaps in infrastructure attainment: developed countries such as Japan and South Korea and less developed sub-regions and countries such as the northern provinces of China, Siberia, Mongolia and North Korea. Lack of sufficient regional transport, telecommunication, and energy infrastructure hinders the economic cooperation and integration of this otherwise high-potential region.

Infrastructure investment in the region can promote connectivity among the regional countries and, in turn, regional integration by bridging the development gap. Demand impulses generated from financing of infrastructure development in poorer yet resource-rich countries in the region will add to the dynamism of the region. By generating additional demand impulses within the region, such a mechanism might also assist in adjustment with the global imbalances by reducing Northeast Asia's external dependence on the US and Eurozone.

There are several benefits on a sectoral level. While manufacturing supply chains are being formed around China, Japan, South Korea, or the ASEAN region, additional infrastructure investment can expand the existing supply networks to greater Northeast Asia. Advanced technology and know-how from Japan and South Korea can complement the labor and natural resources of Northeast China, Russia, Mongolia, and North Korea. Also, the high level of energy dependency on the Middle East can be reduced by increasing investment to develop abundant energy sources in the region. Currently, the crude oil and natural reserves in the Sakhalin region are estimated to be 2 billion BTU and 3 trillion m<sup>3</sup>. For reference, the daily consumption of crude oil is 1.63 million barrels, increasing 3.9% annually and accounting for 19% of the total global consumption, and for half of the global demand increase, according to the Korea Petroleum Corporation.

From a political economy perspective, greater infrastructure investment in transport, telecommunication, energy, and so on would catalyze economic development, and in turn, reforms and opening of the less developed sub-regions, such as North Korea, and contribute to peace and stability of the entire region. North Korea is currently intensifying its efforts with

China as a way out of its economic troubles while holding onto its nuclear arms program. Yet China's investments are focused on North Korean natural resources and infrastructure near its border with North Korea, which is not encouraging genuine reform or the opening of the North Korean economy. There is indeed a crucial security need to promote such a goal by expanding infrastructure attainment of this strategically important area of North Korea, Mongolia, Northeast China, and Russian Siberia.

## 2. Rationale for the Northeast Asian Bank for Cooperation and Development (NEABCD)

One of the most crucial issues surrounding the economic cooperation and regional integration of Northeast Asia is in securing financial resources to carry out large scale investment projects in the region. The gaps existing between the Northeast Asian countries in terms of level of infrastructure attainment need to be addressed as a part of the program of regional economic cooperation and integration for promoting balanced regional development. Otherwise, the programs of regional cooperation could work to further widen the development gaps.<sup>1</sup> In particular, enabling infrastructure needs to be created in the lagging regions and countries so that they can enjoy the opportunities created by regional trade liberalization and integration. For any development program, whether complementing the region's rich natural resources with the world-class technology, capital and know-how of the region's developed countries, the resource requirement is substantial.

Table 1. < Development Financing for Infrastructure Requirement until 2020<sup>2</sup> >

(in USD 100 millions)

	Ports, Railroads, Roads	Electricity	Energy, Pipeline	Water	Total	Development Financing
China (northern provinces)	416	168	107	28	719	43
Russia (Siberia)	285	17	443	14	759	380
North Korea	258	57	37	28	380	380
Mongolia	33	13	37	14	97	97

<sup>1</sup> P. De and B. Ghosh, "Investigating the linkage between Infrastructure and Regional Development: Era of Planning to Globalization," *Journal of Asian Economics*, Vol.15, No.1

<sup>2</sup> Jung Keun Oh, "Proposal for Northeast Asia Development Bank as Necessary for Peace on the Korean Peninsula," 2011

Total	992	255	624	84	1,955	900
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Note: infrastructure investment in North Korea and Mongolia is assumed to be financed entirely by development finance

Infrastructure investment along borders or periphery areas of the less developed countries in the region is often disadvantaged when competing for government funding, as these areas are sparsely populated and thus lower on the policy agendas of respective governments. China, for example, has been unable to push through with its northeastern regional development initiative, as several other development projects have been simultaneously underway.

Domestic and international financing is necessary for the above-mentioned investment, but the current development support mechanism involving the existing Multilateral Development Banks (MDBs) is limited in capacity to focus specifically on this area due to competition from existing project portfolios or bankable projects in other regions, as well as lack of consensus among their member countries on their regional strategies.

For reference, the International Bank for Reconstruction and Development (IBRD), first established to help post-World-War-II economic reconstruction, provides loans, grants, technical assistance, etc. for the development of infrastructure and reduction of poverty in developing countries. The Inter-American Development Bank (IDB), African Development Bank (AfDB), Asian Development Bank (ADB), and European Bank for Reconstruction and Development (EBRD) were formed to support regional development agendas.

The European Investment Bank (EIB) and North American Development Bank (NADB) were also formed with a regional focus, but their membership is open only to countries in the respective regions. The other MDBs having started with a closed membership structure are now open to non-regional countries, whose equity ownership is in most cases limited to below 40 percent. The EBRD calls for a special attention, as it was established to support the Eastern European countries transition, the case of which could be a good benchmark for the NEABCD.

The level of authorized capital in these MDBs has increased in the range of 2 to 120 times, while the ratio of paid-in to subscribed capital decreased to a 4 to 26-percent level. Especially, the fact that the accumulated loans of the MDBs vis-à-vis their paid-in-capitals are 9 to 33 times greater shows that these institutions are successfully accessing international capital markets for capital raising, a merit unique to MDBs compared with private sector commercial banks or special development funds, as MDBs enjoy high creditworthiness due to the capital subscription with a substantial portion of callable capital base.

In comparison with other regions, Northeast Asia has not been subject to much support from the MDBs. For example, the amount of loans made to the northern provinces of China and Mongolia in 2011 by ADB and IBRD, was a mere 0.9 percent of the total loans from the two institutions.

Table 2. < Amount of ADB and IBRD Loans to the Region, 2011<sup>3</sup> >

(in USD million)

	Loans made to	Loans made to	Total Amount	Regional Loans/
		China (northern	of Annual	Total Amount

<sup>3</sup> ADB Annual Report 2011 and websites, [www.aidflows.org](http://www.aidflows.org) and [www.worldbank.org](http://www.worldbank.org)

	Mongolia	provinces)	Loans	of Annual Loans
ADB*	96	240	21,718	1.5 %
World Bank (IBRD)	66	200	43,006	0.6 %
Total	162	440	64,724	0.9 %

\* Regional make-up of ADB's loans, including Asia Development Fund and co-financing: Southeast Asia 30.3%, South Asia 29.7%, Central/West Asia 28.4%, Northeast Asia 7.8%, Asia-Pacific 2.2%

### 3. Various Models of the NEABCD

The idea of establishing the NEABCD originated in 1990, when Ma Hong, Li Boxi and Nam Duck Woo independently proposed it. It has been under discussion through the Northeast Asia Economic Forum, an annual forum dealing with pertinent economic issues of the region. Most notable in the discussion on the issue are Stanley Katz and the Tokyo Foundation.

Most models included South Korea, China, Japan, Mongolia, Russia, North Korea, and Taiwan (if China does not object to it) from the region, and the US, Australia, New Zealand, and EU from outside the region. For the capitalization level, the Nam model suggested 0.5 percent of the regional country GDPs at the time of incorporation to be set aside for the authorized capital of the Bank, as it was for the ADB case. That meant USD 40 billion of the authorized (or subscribed) capital as well as the paid-in-capital at 25 percent or 50 percent of the authorized (or subscribed) capital, to be paid in yearly installments for 5 years. The subscription could be split 60 to 40 percent between regional and non-regional members, yet the US share would be equal to that of the largest shareholder, highlighting the importance of its role in the regional development.

The Katz model (2002) was similar to the Nam model except in the membership composition and the capital allocation scheme. The Katz model proposed the membership of Japan, South Korea, North Korea, the northern provinces of China, Mongolia, Russian Siberia, Southeast Asia and Oceania countries as well as the US, Canada, the UK, and EU. USD 40 billion was proposed for the authorized capital, 25 percent of which was to be paid in 3-5 yearly installments. The allocation between the regional and non-regional members would be 40 to 60 percent.

The Tokyo Foundation model (2003) suggested for the regional membership South Korea, Japan, China (Northern provinces), Russia (Siberia), and North Korea, and for the non-regional membership, the US, Canada, EU, ADB, and so on. They suggested USD 6 billion of the authorized capital, 50 percent of which was to be paid up. The capital allocation was 56 to 44 percent between the regional and non-regional members.

Table 3. < Comparison of Proposals >

	Nam ('90)	Tokyo Found. ('03)	Katz ('02)

<input type="checkbox"/> Membership			
○ Regional	South Korea, China, Japan, Mongolia, Russia, North Korea, (Taiwan)	South Korea, China, Japan, Mongolia, Russia, North Korea	South Korea, (China), Japan, Mongolia, Russia, North Korea
○ Peripheral		Southeast Asia, Oceania countries	Asia Pacific countries
○ Non-regional	US, Australia, New Zealand, EU	US, Canada, EU, ADB, sovereign wealth funds	US, Canada, Australia, UK, New Zealand, EU
<input type="checkbox"/> Authorized Capitalization	0.5% of member GDP (USD 40 billion )	USD 6 billion	USD 25-50 billion
<input type="checkbox"/> Capital Subscription	USD 40 billion	USD 6 billion	USD 25-50 billion
○ Paid-In Capital	USD 20 billion	USD 3 billion	25% of subscription
(Regional)	(USD 12 billion)	(USD 1.68 billion)	
(Non-regional)	(USD 8 billion)	(USD 1.32 billion)	
○ Callable	USD 20 billion	USD 3 billion	75% of subscription
<input type="checkbox"/> Paid-In Capital/ Authorized (%)	50% (capital paid in 5 installments)	50% (recapitalization if necessary)	Over 25% (capital paid in 3-5 installments)
<input type="checkbox"/> Capital Allocation			
○ Regional	60%	56%	40%
(S. Korea)	(USD 3-4 billion)	(USD 0.36 billion)	(USD 0.5 billion)
(China)	(USD 3-4 billion)	(USD 0.48 billion)	(USD 1.0 billion)
(Japan)	(USD 4-6 billion)	(USD 0.54 billion)	(USD 1.5 billion)
(Others)	(Not specified)	(USD 0.30 billion)	(USD 1.0 billion)
○ Periphery		14%	20%
○ Non-regional	40%	24%+ 6% (ADB, Sovereign Funds)	40%

(US)	(Same as the largest shareholder)	(10%, USD 0.3 billion)	(Not specified)
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In most cases, the non-regional membership of NEADB includes the US, EU, Oceania and Asia-Pacific countries, and the regional membership South Korea, Japan, North Korea, China, Russia. South Korea, Japan and China would likely be donors, while North Korea, parts of China (northeastern provinces), Russia, and Mongolia would likely be recipients. Also, the US and EU are included mostly for the purpose of enhancing the NEABCD's creditworthiness in international capital market.

#### 4. Issues Associated with the NEABCD

The regional countries differ greatly in their views on the region for historical, political and economic reasons, and as a result, have been unable to share a grand design for the regional development agenda. The issues associated with the NEABCD can be summed up as follows:

1) *Funding requirements for the kind of magnitude of infrastructure investment to bridge the widening development gap in Northeast Asia are too large, widespread, and diverse and will require multiple sources of funding.* Inefficient and segmented financial markets in Asia prevent effective intermediation between Asia's large savings and investment needs. In the absence of effective financial markets with significant penetration throughout the region, Asian financial markets are mostly outwardly oriented. Massive savings from net export surpluses flow out of Asia through a few Asian financial centers. This process is inefficient in addressing Asia's investment needs and creates a range of serious problems.

2) *Political and governance risk due to the lack of institutional transparency and corruption in the less developed countries inhibits investment, albeit through an intermediary like the NEABCD.* A significant deficiency in appropriate legal, regulatory, and governance frameworks that encourage cross-border investment and mitigate political, legal, and regulatory risks causes much investment concern. For example, North Korea, most likely to be the biggest beneficiary of an established NEABCD, is still at the center of the regional tensions for its nuclear weapons program, Japanese abductees from the past, hostility toward South Korea, and so on.

Other impediments to the development of viable infrastructure projects in the region include difficulties in design cost estimation, and technical preparation of bankable cross-border, or regional infrastructure projects. Difficulties also arise in gaining full understanding of all potential risks involved (such as political, socio-economic, operational, and financial), and the pricing of those risks.

Also, traditional infrastructure financing in the region, government financing through debt or bonds has limitations. Most Asian debt is financed through bank loans, but these loans are limited in tenor and expose projects to refinancing risks. The past reliance on government funding of infrastructure has stunted the growth of private bond markets and financing, and it is only now that demand for private participation exists.

My response to these issues is as follows:

First, regarding the argument that the NEABCD creates redundancy in light of the ADB and the World Bank, there are cases where regionally focused development institutions have complemented, not cannibalized, the existing MDB framework, as with the EBRD in Eastern Europe, CABI in Central America, and Islamic Development Bank in the Middle East, among others. In a similar fashion, the NEABCD can be more effective while moving in tandem with the ADB and the World Bank in addressing region-specific issues.

Secondly, regarding the concern that a significant deficiency in appropriate legal, regulatory, and governance frameworks in the region inhibits investment, the NEABCD can actually function as a safeguard for the otherwise risky cross-border investments while facilitating the development of such institutional structures.

Furthermore, the NEABCD, in addition to its main function of development capital provider, can specialize in knowledge building in institutional structures associated with such investments while serving its main function as a capital provider.

Lastly, regarding the argument that there are only few beneficiaries from the establishment of the NEABCD, namely North Korea and Mongolia, I would like to emphasize the fact that increasing the level of infrastructure attainment in North Korea and Mongolia makes not only economic sense but also political sense, as it can significantly contribute to the stability of the region and the world.

Also, the mandate can at any time be modified to include other developing countries in and outside the region with the consent of the member countries.

For example, the northern provinces of China and Russian Siberia can be included in the scheme, as the NEABCD expands.

## **5. Prospects for the NEABCD**

The financing of cross-border infrastructure inherently demands a regional perspective in light of the current systematic setbacks. If one takes the example of the transition of Eastern Europe, the European efforts show that even in a region with ample capital market funding, special efforts are needed to directly provide lending for infrastructure or to provide a range of enhancements to investors to prompt their investment.

Extending that model to Northeast Asia suggests that both an efficient regional integrated market and continuing official assistance are needed to support infrastructure development. Until well-capitalized institutional arrangements are firmly established, continued sources of concessional funding will be needed to cover the costs of incentives and guarantees. Also, a regionally focused development institution can serve as a source of technical expertise and assistance in building local capital markets. By acting jointly as money banks, knowledge banks, capacity builders, and honest brokers, MDBs can continue supporting the region's infrastructure development. Utilizing their superb credit ratings and ability to raise funding in international capital markets at and lending funds with low spreads, MDBs should be active in providing loans and guarantees and catalyzing private sector financing.

The argument for a new MDB such as the NEABCD, however, faces several potential challenges. Furthermore, the overall cost of borrowing could be better compared with established institutions due to the additional operational cost of the bank and the bank's initially smaller scale of operation and initial lack of the AAA ratings necessary for the bank to mobilize funds at lower costs in the international capital markets.

I expect China will increase investment in North Korean natural resources and infrastructure near its border with North Korea, as a short term “carrot,” but also for the long-term objective of developing its northern provinces while increasing its influence over North Korea.

In South Korea, one will have to wait and see the result of this year’s election, but its policy toward North Korea is expected to be more conciliatory than before.

The new leadership in Pyongyang, although we will have to wait and see, would try to open its economy on a limited fashion as a way out of its economic trouble, as there seem to be some positive signs recently according to media.

Nonetheless, having achieved the most dynamic economic growth in the world for the past half a century while still containing some of the most backward sub-regions in the world, Northeast Asia needs to strive for further inclusion and integration for the benefit of peaceful and prosperous coexistence. Also, the tension on the Korean Peninsula should be addressed first and foremost, as it is not an exaggeration to say that the peace and prosperity of Northeast Asia cannot be attained without the peace and prosperity of the Korean Peninsula.

The South Korean government has made several initiatives, but considering that it would be difficult for the new leadership in Pyongyang to change its posture all of a sudden to be friendlier, a rather sterile framework such as the NEABCD can be effective in bringing about necessary changes. A multilateral framework such as that of the NEABCD can contribute significantly to economic turnaround and peace settlement, ultimately reducing the cost of reunification in the long run.

There is, therefore, potential for the NEABCD discussion to move forward, because the NEABCD can provide a neutral and safe setting to deal with thorny issues, while the countries can maintain the status quo with respect to their interests, conditional on that the key countries are keen on settling the current deadlock involving the regional security; that North Korea continues its efforts on economic reforms; and that the current tensions, as between the two Koreas and between Japan and Korea, lessens.

All key countries pertinent to the regional discussion would see their political leadership change this year, and as such, uncertainty can work to the advantage of the discussions of easing tensions and of establishing a regional institution such as the NEABCD.

All concerned parties should understand and share the importance of such a grand design in forming a Northeast Asian community, and its benefits to their national interests in the long run.

In conclusion, there is definitely a case for the NEABCD for the regional issues, but given the significant political and economic reasons, it would be preferable to approach the establishment of the NEABCD in a careful fashion and with respect to all possible ramifications, as the current situation of the region calls for a delicate mix of economic and political remedies.

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# **Cross-border projects in the Northeast Asia: Experience, Prospects and Perspective from the Proposed New Financial Institution for Northeast Asia**

*Liu Ming*

## **1. Introduction**

Economic globalization and regional economic integration are two collateral trends for world economic development at present. It has become an important approach for economic development in various countries to strengthen regional cooperation under the background of economic globalization. Regional cooperation usually includes cooperation on three levels: regional, sub-regional and cross-border. The lower the level, the easier the cooperation is, because it is much more difficult for multilateral negotiation than bilateral. Hence, it is well recognized that cross-border cooperation is very important for regional cooperation.

Cross-border cooperation refers to the regional cooperation conducted by neighboring countries in their border areas. Cross-border cooperation, as the lowest level of the regional cooperation, is the basic support of sub-regional cooperation and regional cooperation, while regional cooperation consists of sub-regional cooperation and cross-border cooperation. Although cross-border cooperation has never been a national priority, its importance is well recognized by the developed world. For example, it is a European common objective and a political priority of the European Union. The EU already has an elementary interest in successful cross-border cooperation.

Usually the cross-border cooperation has the following obvious advantages: first, it could promote economic and social development in regions on both sides of common borders; second, it helps to address common challenges, in fields such as energy, infrastructure, environment, public health and the prevention of and fight against organized crime; third, it ensures efficient and secure borders; and fourth, it promotes local cross-border “people-to-people” actions.

Although the cross-border cooperation is highly valued and plays a very important role in Europe, North America and some newly industrialized regions such as Latin America and Southeast Asia, it is yet to be considered well developed in the region of Northeast Asia due to various reasons, including politics, history and economic obstacles. Hence, in this paper we will discuss the importance and the future of cross-border cooperation in Northeast Asia and the blueprint for such cooperation in the region.

The paper is organized as follows. In section 2 we discuss the theoretical analysis of cross-border cooperation. Section 3 provides a summary of current cross-border projects in the region and the potential projects. Then we discuss how to improve the cross-border projects in Northeast Asia and the rationale of the proposed Northeast Asian Bank for Cooperation and Development in section 4.

## **2. The basic theory of cross-border cooperation**

Generally, a border has two major functions. One is the blocking effect, which provides a barrier and an instrument to be applied for controlling illegal immigration, human trafficking,

drugs and weapons and for collecting duties on legal goods. This is the rationale for the infrastructure at a border, which consists of border crossing points and land border installations.

The other is the intermediate effect, which means that the cross border area could provide a physical place for the economic, social and cultural communication. Borders also constitute an opportunity. A border is more than an obstacle to contacts; a border creates “friction” which can offer business possibilities. Differing conditions across the border can therefore also be utilized to benefit regional development. Utilization of a border as a gateway – legally or illegally – means that the border is a resource for those operating across it. It generates benefits that would not be available without the border.

Relatively, the blocking effect and the intermediate effect show different patterns in different regions after World War II. The Cold War and the Arab-Israel War are typical situations where a blocking effect dominated other border functions. However, for most of developed countries, particularly for the European Union, the intermediate effect dominated the border functions. More and more people realize that cross border cooperation could improve the welfare of both countries. First, bilateral trade is definitely more important and easier for neighboring countries than for countries separated by long distances. NAFTA and ASEAN, are two good examples, which promote bilateral and multilateral trade within each region and help dramatically improve quality of life. Furthermore, cross-border cooperation can also reduce transportation and transaction costs through cross border infrastructure upgrading while making trade easier. It can offset the negative effects that the border barrier could bring to the related countries. Second, neighboring countries usually speak different languages, have different histories and cultures, hence, the cooperation could help the countries to understand one another and reduce misunderstandings. From the economic point of view, the border area is the best place for countries with varying backgrounds to share information and increase market efficiency.

Although the importance of cross-border cooperation is well recognized, it is difficult for many countries to conduct such cooperation due to lack of financial support and because the cross-border projects are usually considered bilateral issues and do not receive priority in financial support by the current multinational financial institutions.

This is particularly true for Asian countries. According to Hideaki Tanaka (2004), there are two approaches to infrastructure development. One is bottom-up infrastructure development that aims to eliminate poverty in a given geographic area; and the other is the building of core infrastructure that aims to support national economic development. The main difference between the two approaches is that the first takes poverty reduction as the priority, while the second addresses economic development in terms of higher gross value-added. As Song (2005) argued, the second approach can reduce poverty indirectly through large-scale economic development, taking advantage of available resources to accelerate the speed of capital accumulation.

All multilateral financial institutions, including the ADB, World Bank, and UNDP, which have deep involvement in regional and sub-regional cooperation projects, adopt the first approach in dealing with infrastructure development. Poverty reduction is their top priority. Therefore, regional and sub-regional cooperation initiatives, in general, and infrastructure investment, in particular, in Asia all belong to the bottom-up approach. The fact is that in Asia most of the poor live in remote and isolated areas, especially in border regions. Those areas urgently need to set up linkages with the outside world through infrastructure including highways, railways, and telecommunications in order to take advantage of their rich resources or cheap labor. As a result, cross-border cooperation among relative industrialized countries, usually obtains little support from the ADB and the World Bank, although the costs of such

programs are relative low, the profits of such program are much higher, and risks are low. For example, Korea-Japan cross border cooperation is unable to receive any type of support from the multinational development banks, despite the potential that the projects may be very profitable and the fact that these are both developed countries.

People may argue that such developed countries should not receive support from the ADB and the World Bank because they have enough funds of their own. Such arguments are also applied to some emerging nations such as China, due to its large foreign reserves and sufficient funds. It turned out that cooperative projects between China and ASEAN countries are able to receive financial support, but similar cooperation between China and Korea or Japan could never obtain it from the ADB. However, such arguments neglect a significant fact: such projects may also need international capital mobilized by the multilateral development financial institutions. The international capital may also need to be invested in such projects for their potential profits. Moreover, considering the issues related to history, political conflicts, cultural similarities and differences and even the economic competitiveness of Northeast Asia, bilateral or trilateral cooperation may be very difficult. Therefore, a multilateral development financial institution may help to realize some projects that may not exist without such an intermediating institution. A multilateral development financial institution, or the proposed Northeast Asia Bank for Cooperation and Development (NEABCD), can help the related countries to eliminate the hatred and mistrust, improve the trust between each other and obtain the dual win situation. In other words, such a new financial institution provides not only a traditional function of mobilizing capital but also a new financial cooperative mechanism.

### **3. Cross-border Projects in Northeast Asia: A Brief Review**

Cross-border projects increased quickly within the Northeast region even without financial support from the ADB and the World Bank. It reflects the rising of the economies of the Northeast Asia countries and also indicates the great potential for further cross-border cooperation. The projects focus mainly on energy, transportation and minerals, which shows that the Northeast Asian countries are complimentary with different endowments.

However, it should be noted that many such projects undergo very long and tough negotiations before they are truly implemented. For example, the Eastern Siberia – Pacific Ocean oil pipeline project was finally in formal operation from October 2012 (although in testing operation since 2010), but the original project of this pipeline was proposed by the Russian oil company Yukos in 2001 as an independent oil pipeline. The project proposed to build a pipeline from Angarsk, where Yukos operated a refinery, to Daqing in northern China. At the same time, Transneft proposed an alternative project to pipe oil from Taishet in Irkutsk Oblast to the Far East port of Kozmino near Nakhodka.

In May 2003, the Russian government decided to combine these projects and that Transneft would be in charge of the pipeline, while Yukos would supply the oil. On 29 May 2003, Russia and China signed an agreement on construction of the pipeline. On 31 December 2004, the Russian government approved the construction of the pipeline from Taishet in East Siberia to Pervoznaya in the Pacific region. The negotiation continued for several years and the related countries could not reach an agreement. It was the global financial crisis that finally helped Russia and China to reach an agreement.

The project benefits both China and Russia. According to the published document, Russia would supply China with 15 million tons of oil (300,000 barrels per day) each year for 20 years

in exchange for a loan worth US\$25 billion to Russian companies Transneft and Rosneft for pipeline and oil fields development. If the NEABCD were in operation, it would not be necessary to take such a long time, since the sub-regional bank would be designed to help neighboring countries in eliminating misunderstandings and increasing trust.

We also collected information from other projects. Cross-border energy projects include the China-Russia Transit Electricity Project, China-Russia Natural Gas on the Eastern and Western Side, China-DPRK Longdeng Coal Mineral Project, China-Mongolia Tamucha Oil Field Project, Russia-Japan Sakhalin No.1 and No. 2 Oil and Nature Gas Field Project, Russia-Japan LNG Export Project, Russia-China & Russia-Korea Gas Support from Kovykta Gas Field Project, Russia, Korean and DPRK Gas Pipeline Project, etc. All these projects have similar properties: first, they could be categorized into cross-border projects; second, the projects usually involve competition among China, Korea and Japan; China and Japan in particular are big rivals and these behaviors decrease the welfare for all sides; third, the projects need a huge amount of investment and although all the related countries are considered “rich” countries in the world, it is not enough to support such projects; and fourth, the projects are far from enough. There were tremendous potential projects under planning, which were delayed or canceled due to lack of funding or to political conflicts.

Similarly, in the field of infrastructure and transportation, there are many cross-border projects as well. For example, both China and Japan participated in the upgrading project of Port Zarubino of Russia. Other projects include the Qianjin Town to Fuyuan Railway between China and Russia, Dongning-Ussuriysk Railway between China and Russia, Mongolia Railway Network with the help of Russia, Rajin Port of the DPRK with the support of Russia, etc. These projects have very strong geopolitical backgrounds and are somewhat exclusive. Therefore the expanding cross-border projects are necessary for further development. Again, the investment is still not enough, despite the countries in the region not being traditional poor countries.

In the mineral field, the cross-border projects include Hamgyeongbuk-do Iron Mineral Project between China and the DPRK, Tumurtin Ovoo Zinc Mineral Project between China and Mongolia, Sukhbaatar Iron Project between China and Mongolia, the uranium project between Korea and Russia and a series of projects between Japan and Mongolia. Many concerns over the environmental effects of the mineral projects lead to restricted bilateral cooperation. A sub-regional financial institute can definitely help to solve this awkward situation.

There are many other fields deserving of investments, which are potentially profitable. Tour cooperation, environment protection cooperation, technology cooperation and education cooperation are all attractive. The examples include Xinkai Lake Ecosystem Cooperation between China and Russia, Songhua River Ecosystem Cooperation between China and Russia, Cross-Border Tour project among China, the DPRK and Russia, etc. Based on such cooperation, the FTAs in the region, such as the Busan-Fukuoka Free Trade Zone, Tumen River Project, Rason Special Economic Zone between China and the DPRK, etc are also promoted.

Other than the projects mentioned above, there is great potential for future cross-border cooperation. Japan is very active in energy projects and even more aggressive after the nuclear power station leaking accident. Russia and Japan are planning to cooperate by developing the Kovykta gas field and Tsayanj oil and gas field in Eastern Siberia. Japan is also involved in the oil refining project in Primorskiy Krai of Russia. The proposed project also includes coal field infrastructure between Russia and Japan and between Russia and Korea. Cooperation between Japan and Russia on building high-speed railway in the Far East of Russia is also under evaluation. It is estimated that more than five trillion roubles are needed for upgrading and

developing the Russian railway system alone. Such development is very critical for connecting the transportation among major ports in the Siberian area and the Far East part of Russia. A Sakhalin-Japan-Korea natural gas pipeline plan is also under discussion, which would need even more investment. The Mongolian Tavan Tolgoi Coal Field development is also in negotiation among the countries in the region. Tavan Tolgoi Coal Field is the largest untouched coal field in the world and has high quality coal and the estimated value is more than 300 billion USD.

Although the cross-border projects are important and the bilateral negotiation is relatively easier, many potential projects cannot be implemented due to various reasons. The competition among China, Japan and Korea is the major cause, and lack of funding is also a serious problem. The history and political issues (particularly for the projects related to the DPRK) are also obstacles for further cooperation. The Tumen River Program is restricted for those reasons, and it has been hard to make further progress since 2000. The China-Japan-Korea FTA negotiation is definitely a great step toward regional integration, but it also requires much more effort than any project before. Therefore, a financial development institution in the region is necessary to solving all problems since it provides a new mechanism for regional cooperation.

#### **4. The Role of the Proposed Northeast Asian Bank for Cooperation and Development**

Previous research has proven the necessity and feasibility of the NEABCD. From the cross-border point of view, the NEABCD has more functions.

First, generally speaking, it is well recognized that institutional arrangements, either formal or informal, are crucial to the success of cross-border infrastructure projects. However, the specifics of institutional requirements will differ according to project type. The level of institutional arrangements required will also vary and can extend from the project level to the national or even higher level arrangements. Only the proposed development bank is able to satisfy the various requirements on every level. The proposed NEABCD is able to provide the required legal framework, promote coordination among agencies, and ensure the responsibility and accountability of each party involved in the entire process.

Second, one of the major challenges of cross-border infrastructure projects is that each participating country may have different standards, guidelines, and procedures for technical matters. Since such differences can vary in both content and implementation, the extent to which they impede the development of cross-border projects differs depending on the project type. For example, technical specifications specific to a cross-border railway project will involve rail and bridge design and signage standards only at the construction stage, whereas technical standards are essential throughout both the construction and operation of a cross-border power project, if it is to maintain its operational integrity. Therefore the involved countries need to agree to detailed technical specifications and develop harmonized standards for design, construction, operation, maintenance, health, safety and environment, and measurement in order to mitigate potential risks and environmental impacts. The regional development bank is far better in helping such harmonization than any other mechanism and makes the project much more efficient than the bilateral negotiation project by project and item by item.

Third, another advantage of the regional cooperative development bank is to help coordinate the regulatory issues across countries including pricing, tariffs, transit and user fees, access and use, transmission regulation, metering, load specifications, insurance standards, health and safety, security of supply, and emergency supply arrangements, etc.

Fourth, although cross border cooperation has many functions and is very important, the experience and lessons from other areas suggest that a financial institution could make it more efficient. As EU's experience demonstrates, *times required to fully establish effective cross-border cooperation programs* are fairly long. Eastern Europe external borders were introduced more than a decade ago and its functions are still not fully operating yet. In the Mediterranean, partner countries are only now beginning to participate in interregional activities through the first Neighbourhood Programmes, with limited experiences achieved to date. As for Northeast Asia, the C-J-K FTA was proposed over ten years ago and only recently have the three countries begun negotiation. The proposed NEABCD will simplify the procedure and speed up negotiations.

Moreover, although the cross-border cooperation is more interesting for the local and regional authorities in the border regions, smooth cooperation at the regional and local level also requires political and administrative support at the national level, and the lack of such support has on occasions been an obstacle. The proposed NEABCD also provides a new mechanism to connect the local and central governments.

It has been 20 years since the NEABCD was first proposed. The landscape in Northeast Asia has changed a lot in during this time, and it is now the most prosperous region in the world. It is unusual for such an important region to be without its own development financial institution. The ADB and the World Bank are definitely not sufficient. Although the cross-border program is also considered their major business, the ADB and the World Bank have not and will not in the future support the cross-border projects in the region of Northeast Asia, because the region as a whole is not considered a poor area. The limited funds are required to be used for what is considered a poorer place. The proposed NEABCD, in this sense, could fulfill the tasks and benefit not only Mongolia (a relative poor county in the region), but also China and Russia (new emerging markets) and developed countries such as Japan and Korea.

## **5. Appendix: Illustrative Projects**

### **Project 1: Eastern Siberia – Pacific Ocean oil pipeline**

The original project of this pipeline was proposed by the Russian oil company Yukos in 2001 as an independent oil pipeline. The project proposed to build a pipeline from Angarsk, where Yukos operated a refinery, to Daqing in northern China. At the same time, Transneft proposed an alternative project to pipe oil from Taishet in Irkutsk Oblast to the Far East port of Kozmino near Nakhodka. In May 2003, the Russian government decided to combine these projects and that Transneft would be in charge of the pipeline, while Yukos would supply the oil. On 29 May 2003, Russia and China signed an agreement on construction of the pipeline. On 31 December 2004, the Russian government approved the construction of the pipeline from Taishet in East Siberia to Pervoznaya in the Pacific region.

Construction of the pipeline started in April 2006. On 4 October 2008, the section between Taishet and Talakan was launched in a reverse to pump oil from Surgutneftegas-owned Alinsky deposit. The first stage of the pipeline was completely laid in May 2009 and the whole first stage was reversed in December 2009. The terminal at Kozmino was inaugurated by Russian Prime Minister Vladimir Putin on 28 December 2009.

In February 2009, Russia and China signed a deal according to which the spur pipeline to China would be built and Russia would supply China with 15 million tonnes of oil (300,000

barrels per day) each year for 20 years in exchange for a loan worth US\$25 billion to Russian companies Transneft and Rosneft for pipeline and oil fields development.

Construction of the spur to China started in the Russian territory on 27 April 2008 and in Chinese territory on 18 May 2009. On January 1, 2011, Russia said it had begun scheduled oil shipments to China, with the plan to increase the rate up to 300 thousand barrels per day ( $\sim 1.5 \times 10^7$  t/a) in 2011.

## **Project 2: Russia-Japan LNG Export Project**

Russia and Japan are putting energy cooperation ahead of a longstanding territorial dispute as they move ahead with a long-awaited liquefied natural gas project in this far eastern seaport. Russian President Vladimir Putin and Japanese Prime Minister Yoshihiko Noda oversaw the signing of a memorandum for the \$13 billion project with Japan's Agency for Natural Resources and Energy on Saturday, on the sidelines of a Pacific Rim summit, Russian oil and gas giant Gazprom said.

The project "will have a great meaning for developing the eastern part of the Unified Gas Supply System of Russia as well as raising Russian gas supplies to Asia-Pacific markets including Japan," Alexei Miller, Gazprom's chairman, said in a statement.

"I would like to emphasize that the Japanese market has an advantageous size and is considered a top priority in the Far East," Miller said.

Japan used 83 million tons of LNG in 2011, accounting for 14 percent of its total energy use. Almost all the natural gas Japan uses is in the form of LNG.

Gazprom is the world's largest producer of gas, but its pipeline gas business has been hard hit by sliding demand for gas while competing liquefied natural gas carried by ship has flooded European markets. Gazprom relies on pipelines and long-term pricing agreements.

Miller forecast that Gazprom's exports of natural gas to the Asia-Pacific would soon exceed the volume sold to Europe.

"Taking into account the dynamics of the growth of gas demand in the Asia-Pacific region, now the decisions will be considerably accelerated," Miller said.

Japan and Russia appear to be making at least some headway on their tussle over islands north of Japan claimed by both sides. Deputy Ministers are to meet later this fall to discuss the issue with the aim of eventually signing a peace treaty, officials said Saturday on the sidelines of the Asia-Pacific Economic Cooperation forum, which is holding its annual summit in Vladivostok.

The two sides agreed to ban crab poaching in the Sea of Okhotsk and signed an agreement on building a timber processing factory in Siberia. Meanwhile, Noda and Putin agreed to arrange a visit by the Japanese leader to Russia by December, said a senior Japanese official who briefed journalists about the talks.

The two sides want to resolve their differences in a "quiet and constructive atmosphere," the official cited Noda as saying.

Gazprom and its partners have conducted a feasibility study on transmission and marketing of natural gas and chemical products in the Asia-Pacific region.

Japan Far East Gas Co., the consortium participating in the government-backed project, includes Itochu Corp., Japan Petroleum Exploration Co., Marubeni Corp., Inpex Corp. and Itochu Oil Exploration Co.

Gazprom plans to extend a natural gas pipeline from Sakhalin to Vladivostok to a seaside terminal where the gas would be processed for shipment to Japan and other markets. The new

project, if completed, would have a capacity of 10 million tons annually, doubling Gazprom's capacity from its sole other plant, on Sakhalin.

As with other energy deals, the success of the project will depend on the two sides reaching an agreement on pricing. Discord over pricing has held up projects with the Chinese, delaying earlier pipeline deals.

### **Project 3: Russia-China-Korea gas project in the pipeline**

China and South Korea are moving closer to pipelining natural gas from Russia's Eastern Siberia to their shores, under a US\$20 billion project set to bind the three nations for decades.

A joint feasibility study is expected to be completed in the next few weeks, which will then be submitted to the respective governments for final approval, said officials from BP in an interview. BP is the major shareholder in Russia Petroleum, the project's gas supplier.

The project aims to build a cross-border pipeline to carry 20 billion cubic meters of natural gas from the Kovykta field in Russia's Irkutsk Province to China's Northeastern provinces, and then onto Beijing and the nearby Bohai Rim via domestic branches.

An additional 10 billion cubic meters of gas will be delivered to South Korea through an undersea pipeline in the port city of Dalian on the Bohai Rim.

Dr. Neil Beveridge, commercial manager of Gas, Power and Upstream Department of BP China, said the construction of the pipeline could start in early 2005, if the governments give the project the green light this year.

If all goes according to plan, the delivery of gas to China and South Korea is expected to be under way by 2008.

"Senior government officials have expressed their willingness to proceed with the long-discussed project as soon as possible following successful completion of the feasibility study," said Beveridge.

Analysts say the gas project is set to further deepen the co-operation between China and Russia in the energy sector, a move which will help revitalize the Russian economy and alleviate energy shortages in China.

Late last month, the two countries clinched a US\$150 billion deal to ship 700 million tons of Russian crude from Eastern Siberia via a pipeline to China over the next 25 years. The oil pipeline route parallels the proposed route of the gas trunk.

Beveridge said major partners of the project, including Russia Petroleum, China National Petroleum Corp (CNPC), China's largest oil company, and South Korea's Kogas, have agreed on the pipeline route and the timing for first gas supplies.

Negotiations are still under way on the price range for gas sales to China and South Korea, he said.

The proposed route circumvents Mongolia, which is believed to be preferred by China. Though a pipeline going through Mongolia to Northeast China could shorten the transport distance, China believes it is more secure by avoiding passing through a fourth country. Such a route could also facilitate construction as it follows the same route as the Sino-Russia oil pipeline.

Daniel Teo, vice-president of Strategy and Co-operate Affairs of BP China, said that BP would not rule out the possibility of agreeing to allow CNPC to take stakes in the Kovykta gas field.

As for the gas price, BP insisted that it would be competitive compared with alternative forms of energy, including imported liquefied natural gas (LNG).

It is also likely to be cheaper than the average price of 1.35 Yuan (16 US cents) per cubic meter for gas delivered by China's soon-to-be completed West-East Gas Pipeline. That pipeline, currently under construction by CNPC's listed firm PetroChina and foreign consortium, will deliver gas from the country's far western frontier to Shanghai in the east by the end of this year.

#### **Project 4: Russia and Japan Sakhalin-2 Project**

The Sakhalin-2 LNG plant is the first of its kind in Russia. It is located in Prigorodnoye in Aniva Bay, 13 kilometers (8.1 mi) east of Korsakov. Construction of the LNG plant was carried out by OAO Nipigaspererabothka (Nipigas) and the KhimEnergo consortium, together with two Japanese companies Chiyoda Corporation and Toyo Engineering Corporation. The plant has been designed to prevent major loss of containment in the event of an earthquake and to ensure the structural integrity of critical elements such as emergency shutdown valves and the control room of the plant.

The LNG plant includes:

- Two 100,000 cubic meters (3,500,000 cu ft.) LNG storage tanks
- An LNG jetty
- Two LNG processing trains, each with capacity of 4.8 million tons of LNG per year
- Two refrigerant storage spheres, 1,600 cubic meters (57,000 cu ft.) each (gross capacity) for propane and ethane storage
- A diesel fuel system
- A heat transfer fluid system for the supply of heat to various process consumers
- Five gas turbine driven generators with a total capacity of around 129 MW electrical power
- Utility systems including instrument air and nitrogen plants and diesel fuel systems
- A waste water treatment plant to treat both sewage water and coil-containing water.[citation needed]

The LNG plant production capacity is 9.6 million tons of LNG per year. The consortium is examining the possibility of adding another train. A special gas liquefaction process was developed by Shell for use in cold climates such as Sakhalin, based on the use of a double mixed refrigerant.

The LNG plant has two LNG double-walled, storage tanks with a capacity of 100,000 cubic meters (3,500,000 cu ft.) each. LNG is exported via an 805 meters (2,641 ft.) jetty in Aniva Bay. The jetty is fitted with four arms – two loading arms, one dual purpose arm and one vapour return arm. The upper deck is designed for a road bed and electric cables. The lower deck is used for the LNG pipeline, communication lines and a footpath. LNG is pumped from the storage tanks into the parallel loading lines which are brought to the LNG jetty. At the jetty head, the pipelines are connected with the jetty's four loading arms. The water depth at the tail of the jetty is 14 meters (46 ft.). The jetty will service LNG tankers which have capacities of between 18,000 and 145,000 cubic meters (640,000 and 5,100,000 cu ft.). Loading operations are estimated to take from six to 16 hours, depending on vessel capacity. The jetty will be able to handle loading of around 160 LNG carriers per year.

#### **Project 5: Tumurtiin Ovoo Zinc Mineral Project China and Mongolia-TSAIRT MINERAL Co., Ltd.**

Tsairt Mineral Co. Ltd. is a joint venture co-invested by NFC (51% of equity) and Metalimpex Company (49% of equity) in the Republic of Mongolia, registered in Barun Urt, Sukhbaatar Aymag with initial registered capital of 100,000 USD.

The company processes an open-pit zinc mine named as Tumurttin-Ovoo zinc mine and a concentrator with the capacity of 300 kt/a ore treatment, which were constructed by NFC as general contractor from May 2004 to August 2005. By the end of July 2009, the company had produced a total of 2,220,200 tons of zinc concentrate.

Tsairt Mineral is a model taxpayer, provides more than 450 job opportunities to local Mongolians, and actively takes part in programs for public welfare such as sponsoring 20 needy local university students every year, donations and construction of local infrastructure, promoting local social and economic development significantly. The construction and operation of Tumurttin-Ovoo zinc mine has been appraised as model project of Sino-Mongolian cooperation by Chinese and Mongolian central governments.

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# **Financing Cross-Border Infrastructure of coastal cities of Japan and Korea: Pan East Sea Economic and Logistics Cooperation as the Third Step for Northeast Asian Era**

*Jung Duk Lim and Yul Seong Kim*

## **1. Introduction**

Major economic regions in the world experience new environmental change as globalization proceeds. As market systems prevail, the unit of competition moves to mega city regions (MCR) or wide economic area (regions). Two major economic regions in Northeast Asia are the Pan Yellow Sea Economic Region (PYSER) including the Bohai area of China and the West Coast area of Korea and Pan East Sea Economic Region (PESER) covering Northeast Three Provinces in China, Far East Russia, West Coastal area in Japan and East Sea side in North and South Korea.

In PYSER, economic linkages are active by the economically developed cities in the region. Air flights, car ferry routes, feeder routes are established between cities of Shanghai, Tianjin and Qingdao in China and of Seoul, Incheon and Gyeonggi Province in Korea. Instead, economic linkages in PESER are inactivated by political and economic instability in North Korea, which includes insufficient number of mega cities and lack of transportation and logistical infrastructure.

However PESER contains economic complement in terms of labor forces and market in the Northeast provinces of China, land and resources of Far East Russia, labor forces of North Korea, capital and technology of west coastal area of Japan and market and industrial technology of South Korea. Moreover, the possibility of exchange and cooperation in PESER increases by many important activities as follows: Chang-Ji-Tu development plan of China, 2012 APEC meeting in Vladivostok, West coast development plan and designation of Japan Sea hub port of Hakada, Kitakyushu, Shimonoseki, Fushikito-yama and Niigata in Japan and negotiation of FTA between Korea and China.

These activities will enhance the development cooperation and the potential of cities in the Pan East Sea rim. The other possibility exists such as the development of border areas of North Korea and China, Chinese linkage to East Sea and installation of transportation facilities of energy resources in Far East Russia overcoming present barriers and impediments. Therefore the expansion of logistic networks, extension of energy networks and investment for resource development are required from the national perspective and tourism and exchange of human beings, logistics and networks of goods and business cooperation are required from a regional standpoint.

From the standpoint of Busan she needs to make use of the potential of PESER and try to strengthen the role of forming the PESER and its consequent cooperation. This paper tries to identify the systems and items of cooperation in PSEER and the role of Busan as a hub city in the region.

This study covers the following spatial, time and contents classification at large. The area to be covered includes PESER rims and hinterland for the close linkages of the areas. The time to be defined is 2010 by the reason of availability of statistical data. The contents to be covered include the current situation of PESER, environmental change, outlook of cooperation and trade, the positioning of Busan in the era of PESER as a regional hub.



<Figure 1> Coverage of Pan East Sea

## 2. Review on Economic Cooperation in NEA

### 1) Pan Yellow Sea Economic Cooperation

The PYSER covers Shandong, Hebei, Liaoning, Beijing, Tianjin, Korea and Japan in general (Kim 2000). The position of the region in the world is not very peculiar but recognized as a manufacturing hub. Shipbuilding, steel manufacturing and automobile production are major industries in the region. The potential of the region will be enhanced by networking of technology and logistics within the region. (Kim, 2000).

Comparing PYSER and PESER, the former has greater potential to establish an integrated economic area. While PESER has no mega cities within its coverage PYSER contains several mega city regions, each having distinguished industrial capabilities. In PYSER industries of electronics, automobiles and machineries, there is a great potential in becoming a global leader. If a more efficient network of technology, production and logistics could be implemented the above vision could be realized. Three constituents of PYSER possess complementary characteristics: Kyushu with abundant capital and high technology, Korea with moderate capital and technology and the Bohai area with cheap labor and strong industrial capability. The population of 300 million in the region forms a large market of SMEs by itself.

The trade volume, investment, logistics, and visitors are currently increasing in the region. Trade volume of inter-industries as well as intra-industries has been increasing and this implies

the structural change toward more horizontal direction. So far the direction of FDI has flow from both Korea and Japan to China but more bilateral investment is expected within ten years considering continuing economic growth of China. Moreover intercity networking in PYSER will be increased by the nature of the region.

## 2) Pan East Sea Economic Cooperation

PESER covers three Northeast provinces of China, Far East Russia, border areas of North Korea, South Korea and West coast of Japan (Kim, 2005). There have been many regional cooperation proposals to realize mutual benefits as the conflicts within the region decreased. The proposals include economic cooperation, security cooperation, community cooperation and environment cooperation, etc.

A scheme for PESER cooperation was first proposed by the area in the west coast of Japan such as Niigata and Toyama. The proposal aimed at enhancing the potential and capability of the region along the East Sea (Japan Sea) rim. The original purpose emphasized not the national cooperation but the cooperation of peripheral areas far from the national core in order to overcome the lagged ness by trade and cooperation.



Source: Kim, Jin-Gee (2012), *Pan East Sea Economic Zone*

<Figure 2> Rise of Pan East Sea

## 3. Pan East Sea Economic Cooperation as a New Engine for NEAEC

### 1) Major Economic Development Plans

The major economic development plans includes Northeast China, Russia Far East and Northeast border area of North Korea. The area of Japan is not included because of lack of large development plans.

(1) Northeast area of China

The Northeast China development aims not only at a regional development and its physical infrastructure provision, but at national development strategy for 21<sup>st</sup> century targeting development and equilibrium. This scheme seems to be related to the energy security and securing of its transportation corridor which is a hot issue recently. We discuss the rehabilitation project of East Frontier Railroad (see Fig. 3), integration of land-sea-railroad area project and Chang-Ji-Tu development plan which have strategic implications for North Korea and the Korean Peninsula.

First, the reconstruction of Hada (Harbin-Dalian) line which is a trunk line in Northeast China and reconstruction of railroad passing eastern part of Northeast China. The East Frontier Railroad will cross from southern part of Liaodong peninsula to frontiers of China- North Korea, China-Russia so as to facilitate trade and economic cooperation between Northeast China, Russia, North and South Korea, Mongol and Japan. Since this railroad passes by the border area of North Korea, it will stimulate the opening of North Korea and also increase the dependence of the North Korean economy to China. (Won, 2005).



Source: Won, Dong-Wook (2005). Northeast China's regional development and rail transport strategy

<Figure 3> Railroad Network in Northeast China and East Frontier Railroad Plan

The integration project of land-port-railroad is planning to link Jilin, Liaoning, Heilongjiang and North Korea. China sought to strengthen trade, cooperation in technology and resource with neighboring countries of North Korea, Russia, South Korea and Japan and this project supports the plan by the infrastructure. More specifically China engaged in Tumen river development plan enthusiastically and thus explored the channel (linkage) to the East Sea and tried to make the region into a free trade zone so as to develop it into a new core of economic development in Northeast Asia. This means the frontier cooperation project between North Korea and China is closely linked to Northeast promotion strategy of China in lieu of the integration project explained above. (Won and Noh, 2009).

The Chang-Ji-Tu development plans the economic integration of Changchun and Jilin who are the two major cities in Jilin province forming an industrial cluster and at the same time make Yanji-Longjing-Tumen as a frontier base for development and make Hunchun and Rajin as a window for outside regions.

The Chinese government established eight major projects for this plan. They are construction of Tumen river free trade zone, international inland port construction (Hunchun-Hassan, Hunchun- Rajin), Changchun Scientific Incubating Area, establishment of international industrial cooperation area, construction of modern logistics corridor, establishment of service headquarter, construction of eco-tourism area and construction of modern agriculture model area, etc.. The investment will amount to 280 billion Yuan up to 2020. (Bae, 2010).

## (2) Russia Far East

Russia has an ambition to make Siberia as a part of Asia Pacific which emerged as a new hub of global economy. The process for this trial will guarantee the geo-economic interest for Russia. The representative development plans for Russia Far East are Russia Far East Strategy 2013 and 2025 and the main content lies in priority in infrastructure development and investment in coastal area. (Правительство Российской Федерации, 2007). The plan includes expansion and modernization of existing transportation system and regional energy industry and new projects. Eighty percent of total budget goes to these projects. The largest part of the program was related to Primorsky area for the preparation of 2012 APEC summit meeting.

## (3) Northeastern Border Area of North Korea

North Korea established her first special economic zone at Rajin-Sunbong area in early 1990s in vain and tried again to establish Shinuiju free trade zone in 2000s for globalization. The outcome has been unsatisfactory so far but we need to analyze the performance of two special zones.

The Rajin-Sunbong zone seemed to attract FDI from China, Russia and Japan. This special zone aimed at making the zone as an international tourism, international logistics and manufacturing export. North Korea made a special law for the project. This project was implemented with the cooperation of UNDP. In June 21, 2011, both North Korea and China held the launching ceremony for Rasun Economic and Trade Area. The joint development of Rasun special zone declared development of resource industry, equipment industry, high tech industry, light industry, service industry and high efficiency agriculture. The area to be developed is

479km<sup>2</sup> and the total investment to be made is 3.5 billion dollars in five years and 2 billion dollars goes to the infrastructure by the Chinese side (Kim et. al, 2011).

## 2) Transportation and Logistics

### (1) Northeast China

The most promising and influential area for trade and cooperation in PESER will be three Northeast China provinces in the future. Among three provinces Jilin and Heilongjiang will be more involved because of link to the East Sea. A part of trade goods is expected to be transported through Rajin port when infrastructure is completed.

Currently traded goods between Busan and Northeast China mostly go to Dalian in Liaoning Province. However the capacity of Dalian port is saturated and the ships have to wait for days for loading and unloading. The Chng-Ji-Tu plan is reported to have the relation on this problem in order to make Rajin a new window.

<Table 1> Trade Volume between Busan and Ports in Northeast China

		2008		2009		2010	
		TEU	ton	TEU	ton	TEU	ton
export	Dalian	140,334	858,088	101,760	829,259	127,537	972,452
	Dandong	14	1,266	92	864	12	115
	Inkou	5,586	2,512	2,407	3,641	3,384	7,438
	Jinjou	187	4,757	251	6,416	140	3,728
	total	146,121	866,623	104,510	840,180	131,073	983,733
import	Dalian	245,577	2,973,028	217,568	2,648,946	256,793	3,308,224
	Dandong	205	88,478	16	28,531	8	31,423
	Inkou	5,954	109,808	2,323	46,928	3,558	68,901
	Jinjou	248	3,386	134	4,697	-	8,269
	total	251,984	3,174,700	220,041	2,729,102	260,359	3,416,817
total	Dalian	385,911	3,831,116	319,328	3,478,205	384,330	4,280,676
	Dandong	219	89,744	108	29,395	20	31,538

	Inkou	11,540	112,320	4,730	50,569	6,942	76,339
	Kinjou	435	8,143	385	11,113	140	11,997
	total	398,105	4,041,323	324,551	3,569,282	391,432	4,400,550

Source: Korea Customs Service•Korea Customs and Trade Development Institute (2011), “Statistical Yearbook of Import and Export Logistics”

By the same token air cargo trade volume between Incheon and Gimhae in Korea and major airports in NEC is shown in Table 2. In 2010 air cargo volume between Korea and China was 485 thousand tons, in which the share of the three provinces in NEC is less than one percent. The reason is due to the difference in industrial structure and traded items such as machineries and electronics parts. That is, the three NEC provinces have less technology intensive industries. In addition, the region lacks links with major hub airports in NEC. However the region possesses abundant natural resources and raw materials and thus the demand for maritime transportation is higher than air transportation which implies a need for infrastructure on maritime logistics.

<Table 2>Air Cargo between Korean Airports and NEC Airports

(unit: ton)

		2008		2009		2010	
		Incheon	Gimhae	Incheon	Gimhae	Incheon	Gimhae
export	Shenyang	1,047	-	818	-	839	-
	Dalian	851	4	703	6	778	-
	Harbin	108	-	75	-	48	-
	Changchun	150	-	54	-	97	-
	total	2,156	4	1,650	6	1,762	0
import	Shenyang	865	13	723	11	805	14
	Dalian	833	-	579	-	658	-
	Harbin	61	-	44	-	19	-
	Changchun	103	-	95	-	194	-
	total	1,862	13	1,441	11	1,676	14

	Shenyang	1,912	13	1,541	11	1,644	14
	Dalian	1,684	4	1,282	6	1,436	-
total	Harbin	169	-	119	-	67	-
	Changchun	253	-	149	-	291	-
	total	4,018	17	3,091	17	3,438	14

(2) Far East Russia (FER)

FER is not as influential as NEC three provinces in NEA economic cooperation scheme but it is estimated to be as important as a channel of energy resources connecting to the East Sea. Recently many firms of Korean and non-Korean invest actively in energy resources in Primorsky and Kamchaka peninsula and this proves the importance of the region and raises the possibility of cooperation.

Presently all the maritime trade is handled by ports in FER. And the trade with Busan of the FER ports exceeds 50 percent currently. According to the Containerization International Yearbook, 2012, Bostonic is the largest port in FER and it handles 245 thousand TEUs a year while the total trade volume of Vladivostok is 338 TEUs. Busan is the largest counterpart of these ports such that 80 percent of cargo of Bostonic head for Busan and 60 percent of Vladivostok too. The port facilities of two ports are old and thus the growth of trade volume with Busan is not high but the possibility of future is very high. In 2010, trade between Busan and ports in FER amounted to 447 thousand TEUs of container cargos and 3,954 thousand tons of general cargo.

<Table 3> Trade volume between Busan and Ports in FER

		2008		2009		2010	
		TEU	ton	TEU	ton	TEU	ton
export	Bostonic	123,548	1,122,894	60,796	629,167	117,603	1,182,240
	Vladivostok	81,811	1,063,964	66,457	864,379	102,522	1,357,297
	Korsakof	6,072	59,682	3,936	37,785	5,272	60,109
	Nahodka	18,720	101,922	2,066	32,022	1,019	9,702
	others	31,445	282,936	17,595	227,008	34,466	288,342
	total	261,596	2,631,398	150,850	1,790,361	260,882	2,897,690

import	Bostonic	75,712	244,054	47,605	362,012	73,713	431,337
	Vladibostok	80,814	214,754	58,342	239,626	96,379	192,615
	Korsakof	8,661	27,940	5,607	12,223	5,359	5,982
	Nahodka	20,886	350,053	1,875	59,447	399	32,393
	others	14,500	457,592	11,776	367,460	10,483	394,556
	total	200,573	1,294,393	125,205	1,040,768	186,333	1,056,883
총계	Bostonic	199,260	1,366,948	108,401	991,179	191,316	1,613,577
	Vladibostok	162,625	1,278,718	124,799	1,104,005	198,901	1,549,912
	Korsakof	14,733	87,622	9,543	50,008	10,631	66,091
	Nahodka	39,606	451,975	3,941	91,469	1,418	42,095
	others	45,945	740,528	29,371	594,468	44,949	682,898
	total	462,169	3,925,791	276,055	2,831,129	447,215	3,954,573

By the same way air cargos between Incheon and Gimhae in Korea and major air ports in FER are shown in Table 4. In the case of Busan and Vladivostok the number of flight recorded 104 meaning one round trip a week. Currently the number increased to two times a week. The volume of air cargo between Korea and Russia was 23 thousand tons in 2010 of which the share of FER was less than 1.7 %. The reason is exactly the same as in the case of NEC provinces explained before. However the FER region has the potential of energy development and the trade volume with Busan is absolutely large and thus the establishment of maritime route instead of air is suggested to be amplified.

<Table 4> Trade Volume between Korean Air Ports and Major Air Ports in FER

(unit: ton)

		2008		2009		2010	
		Incheon	Gimhae	Incheon	Gimhae	Incheon	Gimhae
export	Khabarovsk	407	-	735	-	137	-

Vladivostok	162	17	102	82	141	11
YUZHNO-SAHALINSK	85	-	61	-	94	-
계	654	17	898	82	372	11

### (3) Border Area in NK (North Korea)

Sea cargo transaction in PES between South and North Korea was stopped 5.24 declaration caused by NK's sinking attack of the Chonam navy ship of South Korea. The declaration includes stop of trade and economic cooperation between South and North, The South and North Korean governments signed an agreement to open sea routes between Busan, Pohang, Ulsan, Sokcho, Incheon, Gunsan, Yeosu in South Korea and Rajin, Cheongjin, Heungnam, Wonsan, Gosung, Haeju in North Korea.

Among the NK ports hub ports (Rajin, Cheongjin, Heungnam, Wonsan and Gosung are clustered in PES area and thus the declaration reduced the sea cargo volumes resulting in the malfunction of these ports. Moreover the blockade of Jeju Strait brought in economic loss of 50 million dollars and confusion in logistics system to North Korea. The follow-up agreement signed in 2005 added the guarantee oh the passage of NK vessels through Jeju Strait. The main content is that the passing NK vessel is allowed to have one mile width of right and left side. When using Jeju Strait NK vessel could save 230 miles of distance and 20 hours of time when sailing between east and west ports.

The sinking accident caused the overall loss of economic benefit of NK. And also the Chinese cargos heading for SK through Rajin were stopped by the 5. 24 measures. The success of Chang-Ji-Tu development plan partially depends on the linkage to Busan port through Rajin. Therefore the Chinese government continually requests the resume of transfer of Chinese cargo in Busan.

### West Coastal Area of Japan (WCAJ)

The share of trade between WCAJ and Northeast Asia is higher than that of Japan. Among the ports in WCAJ Niigata and Toyama having both port and airport, show the share of over 50 percent in which the trade with Busan occupies absolute weight. On the other hand Hokkaido and Toyama have relatively higher share in trade with Russia because they import fuels and raw materials, the reason why ports in WCAJ have higher shade with NEA compared with eastern part of Japan is that this area has relatively smaller size of ports and airports.

In 2010, trade volume between Korea and Japan increased to 2,520 thousand TEUs of container cargo and 54.56 million tons of general cargo. The trade volume between Busan and ports in WCAJ is relatively smaller compared with ports in Eastern Coast and Kyushu area. In 2010 the total cargo ports in WCAJ 240 thousand TEUs of container cargo and 2,040 thousand tons of general cargo which is about 10 percent of Japan. Among the ports Akita, Niigata, Toyama, Kanazawa have relatively higher trade shares, more than half of cargos in WCAJ ports is with Busan and the dependence ratio is likely to rise in the future. Because the cost of land

transportation in the case of using Eastern Coast is more expensive by 40 percent than the case of using Busan. WCAJ is also a promising area for cooperation with Busan in the future for the above reason.

<Table 5>Trade Volume between Busan and Ports in WCAJ

		2008		2009		2010	
		TEU	ton	TEU	ton	TEU	ton
export	Sakaiminato	5,768	47,184	5,440	44,798	8,662	63,833
	Tsuruga	3,710	30,208	4,901	32,983	9,492	60,513
	Kanazawa	12,639	100,878	8,862	75,245	13,750	108,460
	Toyama	20,125	107,718	16,641	93,176	21,930	125,515
	Naoetsu	8,103	95,844	6,749	73,401	9,480	105,629
	Niigata	35,641	310,766	31,215	256,194	38,451	313,479
	Akita	21,459	212,038	18,555	178,286	23,527	232,884
	Sakata	4,224	41,798	3,617	34,776	4,207	46,543
	Hamada	1,935	23,784	1,196	14,942	1,594	19,621
	Maizuru	380	2,820	1,008	8,192	1,437	14,835
	total	113,984	973,038	98,184	811,993	132,530	1,091,312
import	Sakaiminato	6,571	59,850	6,115	58,655	9,657	98,023
	Tsuruga	3,838	18,822	5,499	12,985	9,111	59,236
	Kanazawa	11,301	78,823	8,683	67,787	13,595	88,505
	Toyama	21,319	112,981	19,334	125,062	23,211	149,391
	Naoetsu	8,952	45,262	8,475	56,403	9,916	64,420
	Niigata	36,210	168,985	8,475	213,320	9,916	307,014

	Akita	22,304	126,957	20,298	106,452	24,776	141,884
	Sakata	3,890	29,768	2,991	20,410	3,107	18,015
	Hamada	1,987	10,499	1,239	6,904	1,573	9,565
	Maizuru	319	2,195	898	10,206	1,419	15,364
	total	116,691	654,142	82,007	678,184	106,281	951,417
total	Sakaiminato	12,339	107,034	11,555	103,453	18,319	161,856
	Tsuruga	7,548	49,030	10,400	45,968	18,603	119,749
	Kanazawa	23,940	179,701	17,545	143,032	27,345	196,965
	Toyama	41,444	220,699	35,975	218,238	45,141	274,906
	Naoetsu	17,055	141,106	15,224	129,804	19,396	170,049
	Niigata	71,851	479,751	39,690	469,514	48,367	620,493
	Akita	43,763	338,995	38,853	284,738	48,303	374,768
	Sakata	8,114	71,566	6,608	55,186	7,314	64,558
	Hamada	3,922	34,283	2,435	21,846	3,167	29,186
	Maizuru	699	5,015	1,906	18,398	2,856	30,199
	total	230,675	1,627,180	180,191	1,490,177	238,811	2,042,729

Likewise, airports in WCAJ are relatively smaller sized and have no real connection with major airports in NEA. Airports in FER, NEC, WCAJ have no regular flight connection with Busan. With Incheon airport a smaller share of transaction is reported. The reason cited above also supports the amplification of sea logistics network rather than air in this region.

<Table 6>Trade volume between Korea and major air ports in WCAJ

		(unit: ton)		
		2008	2009	2010
export	Akita	19	2	5

	Niigata	120	46	41
	Toyama	113	35	34
	Komatsu	15	8	16
	total	267	91	96
import	Akita	0	0	0
	Niigata	23	13	7
	Toyama	7	4	1
	Komatsu	17	1	1
	total	47	18	9
total	Akita	19	2	5
	Niigata	143	59	48
	Toyama	120	39	35
	Komatsu	32	9	17
	total	314	109	105

### 3) Perspective for Cooperation in PESER

In order to determine the outlook of trade and cooperation in PESER an estimate of regional potential is required. A potential could be estimated by geo-economic aspect and transportation, logistics linkage aspect, economic complementarity aspect and political and social stability aspect.

However this work requires consistent statistical data, same evaluation standard. It is almost impossible. This study outlook with limited material such as general situation, infrastructure, economy size, trade volume with Busan and various development plans and perspective, political and social stability as qualitative data.

China has consistently pursued various kinds of development plans in NEC and PESER such as ‘Northeast Promotion Strategy’ from 2003, reconstruction of East Frontier Railroad, integration of ‘land –port-zone(custom) project, aiming at launching to the river mouth of Tumen river leading to East Sea. Especially the Chang-Ji-Tu development plan made the road connection between Hunchun and Rajin possible in 2009 and also China helps the reconstruction of Rajin port. Between China and Russia a railroad connection between Hunchun and Maharino

and surface connection between Hunchun and Zarubino and also reconstruction of Zarubino port. Besides these development plans abundant energy resources and underground resources may lead to forming a NEA logistics and energy market in NEC and FER and cooperation for development (Kim et. al, 2005). Competition and cooperation in this region will become stronger. Especially since the Rajin-Sunbong development project is conducted by a Chinese initiative, cooperation with Busan in any format is anticipated in the future. Since a new government begins in February 2013 in Korea, a visible change may occur in this region.

#### **4. Role of Busan as a Regional Hub**

##### 1) Networking

The largest part of global competitiveness of Busan comes from various forms of sea logistics network connecting major ports in PESER. The Busan port has absolute competitiveness in the region in such a way that Japan has more lines through Busan than her own direct connection, and all the ports in FER have more than 60 percent of share with Busan in total traded volume. Therefore provisions of more advanced transportation channel and logistics service connecting Asia continent and Pacific will be available by establishment of various logistics routs. Busan needs to seek supporting measures to provide infrastructure, law, system, etc. For this, establishment of logistics lines of air, Ro-Ro line and car ferry. In addition, review on custom management and institutional support is required to establish a non-stop logistics system.

The recent hot issue of the Chang-Ji-Tu development project and Rajin-Sunbong development plan is an important opportunity for Busan to display a positive attitude towards the projects, which is desirable. Raw materials in NEC three provinces used to be exported through Dalian after in-land transportation causing high logistics cost. If Rajin port is used, 30 percent of logistics cost is expected to be reduced. Therefore shipping liners in Busan are suggested to reopen the Busan-Rajin line and induce cargos from North china by providing supporting facilities. The competitiveness in PESER could be enhanced by these initiatives.

##### 2) Infrastructure

Recently spatial coverage of one day global logistics expanded rapidly by modernization of maritime transportation equipment (techno super liner, wig vessel, for example) speed technology (under-sea tunnel, speed vessel, for example) and advance in communication technology. The recent average speed of car ferry and Ro-Ro boat is 20 knots (37 Km per hour) but the speed of newly constructed boat amounts to 40 knots (74 km). The speed of techno-super liner built in Japan boasts of 50 knots per hour. A wig vessel can cruise at the speed of 100 km an hour. The global one day limit of sea transportation which covers 99 percent of global trade volume is estimated to expand from 600 km to 1000 km. If so, the limit of one day transportation in PESER will be extended to Kyushu, Kanazawa and Tsuruga in Japan, Rajin-Sunbong of NK, Hunchun of NEC, Vladivostok and Bostonic in FER. Therefore the logistics infrastructure such as multi-purpose piers, Ro-Ro piers and car ferry piers are necessary and that requires a huge investment.

The idea of a tunnel between Fukuoka and Busan is a natural growth of the proposed cross border economic sub-region connecting the both side of the channel and need to be pursued for further physical integration in Northeast Asia. *The implications of enormous capital requirements strengthen the arguments for the proposed Northeast Bank for Cooperation and Development (NEABCD).*

The cross investment between countries of Korea, China, Russia and Japan and major cities in PESER can reduce the risk of foreign investment and induce synergy effect by concentration of logistics path of firms and regions and mutually beneficial. In addition, that investment makes efficient use of domestic and foreign resources, market available, secure stable demand for domestic ports possible and provides a foothold for outreach to China, Russia and NK.

As a first step, examination of an off-shore free trade zone is suggested. A designation of Special Zone (Korea-China-Japan-Russia Zone) in major ports in PESER could be considered. In the special zone customs are exempted, free trade is allowed and the function of Global SCM will be supported. Before that, an establishment of common logistics center is suggested in a port in each country for the purpose of strengthening of networking.

### 3) Transportation

Busan is the largest port city in PESER and needs to strengthen its hub function in the region by securing transportation means and transport network. And anticipating the turning point of South-North relation, connection of East Sea line and operation is prepared, and furthermore the role of land bridge against the connection of TKR and TSR is to be examined for the future. The suggestion is:

1) To heighten the function of port and reopen the line to Rajin. Presently 45 percent of total cargo of Busan is transshipment cargos heading for PYSER. In the near future the volume of NEC cargos through Rajin port is anticipated. The networking with Rajin is important in this context. Next steps include constructing cooperation networks with major ports and cities to establish integrated port systems. China also considers Shanghai centered logistics system along with transportation of resources to the southwest through Rajin, Busan needs to consider the impact of the other plan too;

2) To strengthen the function of hub airport. In the short run, the increase of flight is necessary to connect with PESER regional hubs such as Niigata, Komatsu and Vladivostok. Activation of the sea ferry is necessary. In the medium and long run the transfer of Gimhae to Gaduk is necessary. Since there is no hub airport in eastern coast area the new port should function as a hub to PYSER and PESER too;

3) Anticipating the role of terminal of TKR and TSR and piped natural gas (PNG), Busan needs to review its urban infrastructure. The logistics base and railroad terminal in West Busan is required and the central government needs to designate Busan as the terminal of PNG, and thus extend the line to the western coast of Japan.

## 5. Conclusion

PESER emerges as a new promising region by Chang-Ji-Tu development plan and its advancement to East Sea through Rajin, the rising of west coast of Japan after Fukushima accident and the necessity of securing energy source from Russia, development of FER and

energy resources in Russia and the possibility of opening of North Pole route. Busan needs to prepare actions against these changes and become a hub city as transportation, logistics, culture, information and cooperation and trade.

Currently PESER has a great potential but a substantial problem as well. The problems are the region being politically unstable and economically under developed, and less mega city regions to play the role of a hub. The demand for transportation is insufficient for cargo ships and air flight for regular operation, etc. And also information on region is insufficient and inaccurate. Based on these problems some suggestions are made to play the role of regional hub: 1) To strengthen the network between Busan and cities in PESER. In the part of logistics, construction of special zone in hub cities, formation of logistics specialist network is necessary. A launch of PESER Cities Forum is suggested. 2) To raise the capability of information dispersion of Busan, a study on regional information such as resources, industries, firms and development plans, etc. and an establishment of PESER information center is suggested. 3) A leading role of Busan within the region is suggested to initiate regional cooperation.

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# **China's Development in the Financial Sector in the Context of the proposed NEABCD\***

*Tu Hong and Zhang Jiangping*

During the last half century, the Northeast Asian region experienced prosperous economic changes for member countries such as Japan and more recently South Korea, while China waited patiently in the wings.

Following the unprecedentedly rapid demographic and industrial transitions resulting in miraculous developments in the newly industrialized economies of South Korea, Taiwan, Hong Kong and Singapore, frequently referred to as the “four small tigers”, the dramatic rise of China in economic development within the span of one generation is a historical phenomenon. This growth pattern for the aforementioned countries was spurred by trade and reinforced by the favorable stage of demographic transition thereby benefitting substantially from the “demographic dividend”.

This chapter consists of two parts, the first one on the development of the financial sector in China and the second one on the status and pending issues of the proposed regional financial institution, Northeast Asian Bank for Cooperation and Development (NEABCD).

## **1. China's Development in the Financial Sector**

### **i. International trade and foreign reserves**

Despite predictions of China's rise in economic power, the accelerated rate at which it has continued to grow is astounding. China's financial sector achieved increases that predictions were never prepared for.

International Trade has been one of the two engines (with investment being the other engine) driving the high economic growth in China, paving the way for growth in an extraordinarily short amount of time and fostering this 21<sup>st</sup> century global power. (See Fig. 1)

Fig. 1

International trade volume of China during 2001-2011(Billion US Dollars)

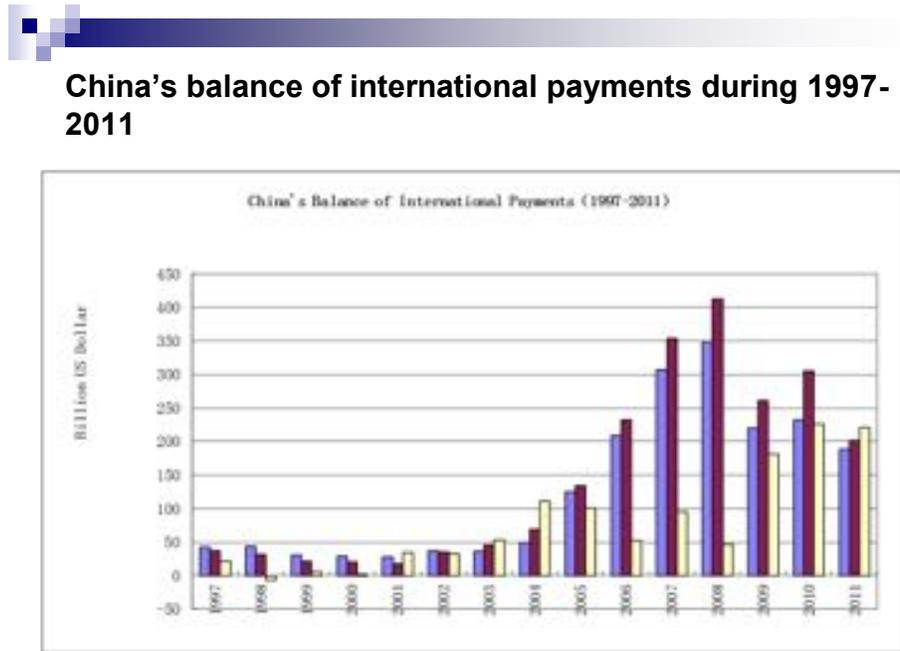
Year	Export and Import		Export		Import	
	Volume	Growth rate (%)	Volume	Growth rate (%)	Volume	Growth rate (%)
2001	5096.51	7.5	2660.98	6.8	2435.53	8.2
2002	6207.66	21.8	3255.96	22.4	2951.70	21.2
2003	8509.88	37.1	4382.28	34.6	4127.60	39.8
2004	11545.54	35.7	5933.26	35.4	5612.29	36.0
2005	14219.06	23.2	7619.53	28.4	6599.53	17.6
2006	17604.39	23.8	9689.78	27.2	7914.61	19.9
2007	21765.72	23.6	12204.56	26.0	9561.16	20.8
2008	25632.60	17.8	14306.93	17.3	11325.67	18.5
2009	22075.35	-13.9	12016.12	-16.0	10059.23	-11.2
2010	29727.6	34.7	15779.3	31.3	13948.3	38.7
2011	36420.6	22.5	18986.0	20.3	17434.6	24.9

Long seen as a strong manufacturing region known for an abundance of low-wage labor, China leveraged this competitive advantage in a massive scale and is the largest exporting country in the world. The share of China's exports in the world more than doubled in one decade with 4.3 percent in 2001 and 10.4 percent in 2011.

With an annual average growth rate of international trade over 30 percent, which is far higher than the world average, China's record is impressive. The country's volume of international trade ranks second globally. China is also second in the world in its share of imports which increased dramatically from 3.8 percent to 9.1 percent. Breaking the top ten in service trade in the year 2000 was momentous, but even more triumphant is its rise to fourth place in only a decade.

Fig. 2 also shows the balance of international payments for China which attest to the unprecedented increases in the wealth resulting from the success story of international trade.

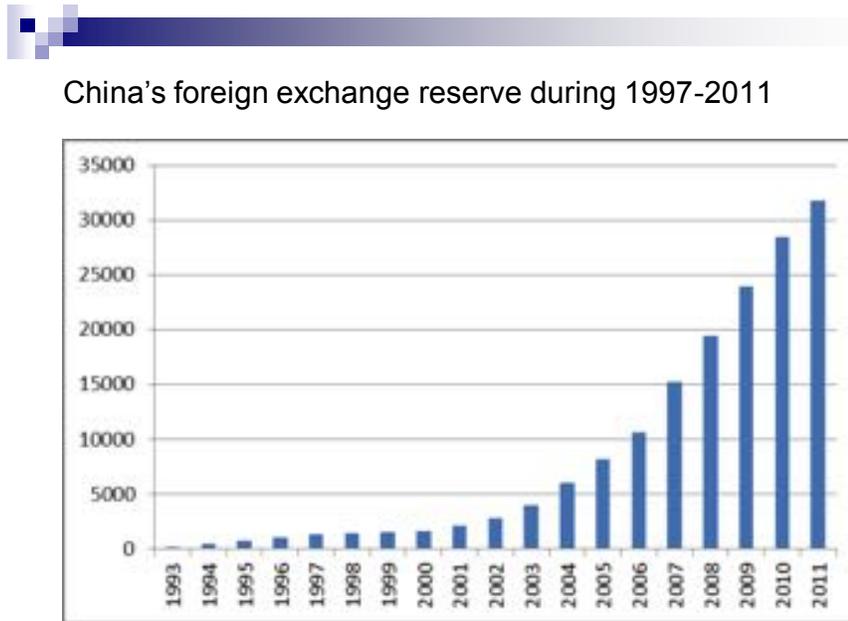
Fig. 2



**ii. Unprecedented accumulation of foreign reserves**

The story told by China's foreign exchange reserves could mimic a fairy tale. The year 2006 was pivotal in that China surpassed both 1 trillion USD and Japan's reserves (See Fig. 3).

Fig. 3



Even more monumental, in approximately two years, China doubled its foreign exchange reserves in 2008 and then in 2011, surpassed 3 trillion USD of reserves. As of September 2012, with approximately 3.285 trillion USD in foreign exchange reserves, China has nearly two trillion USD more in reserves than the closest ranking country below it, Japan. (The USA ranks 17<sup>th</sup> with 151.87 billion USD in reserves.)

China's currency, the Renminbi's (RMB) appreciation has been contributing statistically to the Gross Domestic Product (GDP) increases. The value of the Chinese Yuan has increased considerably during the recent decade and about 2 percent in the last two years.

The influx of large volumes of foreign investments has been a crucial factor in the rapid growth of the Chinese economy, and as shown in Fig 4. The Foreign Direct Investment (FDI) has increased significantly for China over the last decade, and FDI in the manufacturing sector has been one of the principal components of rapid Chinese economic growth.

Fig. 4



## China's FDI inflows

Year	No. of new established foreign invested enterprises	Growth rate	Amount of foreign capital actually used (billion US \$)	Growth rate
2003	41081	20.22%	53.5	1.44%
2004	43664	6.29%	60.6	13.32%
2005*	39679	1.17%	53.1	-1.9%
2006	41485	-5.76%	69.5	-4.06%
2007	37888	-8.69%	82.7	13.8%
2008	27514	-27.35%	92.4	23.58%
2009	23435	-14.83%	90.0	-2.56
2010	27406	16.94%	105.7	17.44%
2011	27712	1.12	116.0	9.72

The year 2003 saw a spike in growth of 20.22 percent in the number of newly established foreign invested enterprises. In 2012, China became the largest recipient of foreign direct investment reaching 59.1 billion USD in the first six months of the year.

As a consequence of the ballooning size of its foreign exchange reserve, China itself is spending large sums of money outward of its domestic sphere. Its non-financial outward direct investment significantly increased from 2.7 billion USD in 2002 to 60.1 billion in USD in 2011 which in only nine years is a growth rate of about 2126%. China's strength is not only domestic, but its international power is accelerating. (See Fig. 5).

Fig. 5



**China's non-financial outward direct investment(billion US dollar)**

Year	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Flows	2.7	2.9	5.5	12.3	17.6	25.6	41.8	43.3	59.0	60.1
Growth rate%	-	5.6	93.0	104.7	43.5	45.5	58.6	3.6	36.3	1.8

**2. China's Challenges and Risks: Near-Term Issues**

China does have its share of issues that it must continue to overcome. They are the near-term macroeconomic management challenges to pay attention to the real estate market, local government debts, and financial reform and deepening.

**i. Real estate**

As a result of liberalizing the property rights and as an important component of the dramatic economic growth, investment in real estate in the residential property market has gradually increased as well as its contributing to the substantial portion of its Gross National Product (GNP). Fig. 6 shows the dynamics of the residential property market in terms of investment, price, sales, and real estate loans.

Real estate investment in China accounts for a quarter of total fixed asset investments. China's residential property market, however, is declining. The domestic impacts of the decline in China's real estate investment are the decrease of activity in other linked sectors, which both cut imports and weakens exports. Global spillovers affect capital goods manufacturers that have sizeable direct exposure to China, especially in Korea and Japan and those that are highly integrated with the rest of the G20.

Fig. 6

## China's residential property market

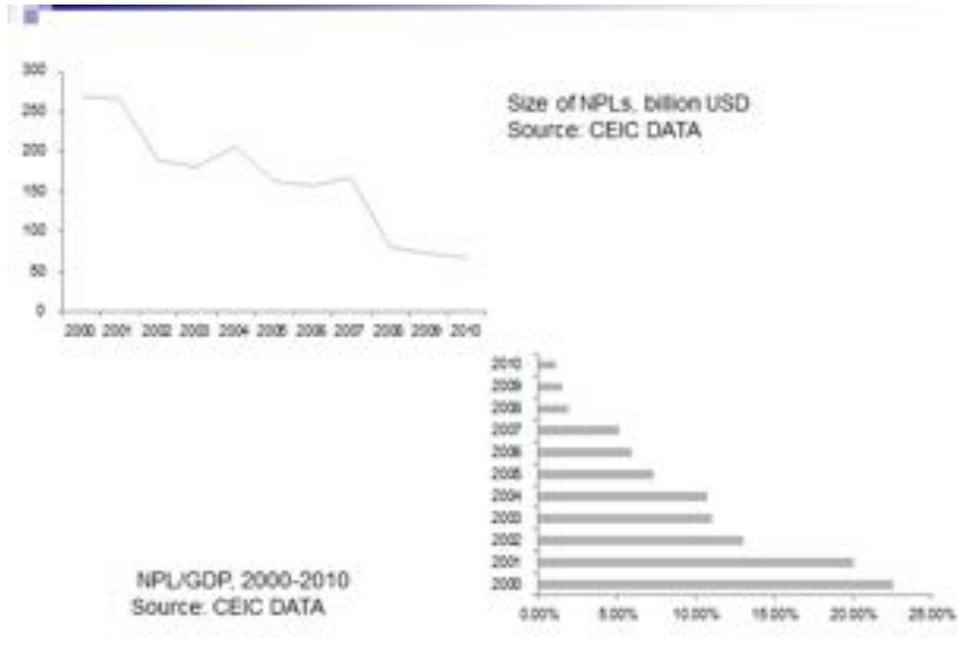


The rapidly increasing investments in the real estate market has contributed to something close to a bubble and rendered risk for more inflation. This is another major challenge that the Chinese government faces in dealing with its increasing wealth. For example, China has not yet instituted the residential real estate tax.

### ii. Non-performing loans

The situation on the non-performing loans (NPL) has been improving, and China has proven many naysayers wrong. Speculators echoed concerns of China's economic downfall through its large non-performing loans, for example. Significant declines in non-performing loans suggest that China is able to handle and overcome these problems. (Fig. 7)

Fig. 7



### iii. Local Government debts

Much of China's recent growth after the 2008 global financial crisis has been through investment in infrastructure construction and a good majority of the increasing debts by the local governments are related to infrastructure construction. China has another difficult issue of on the one hand, restraining investment in local infrastructure construction thereby reducing its economic growth (See Figs. 8, 9).

Fig. 8

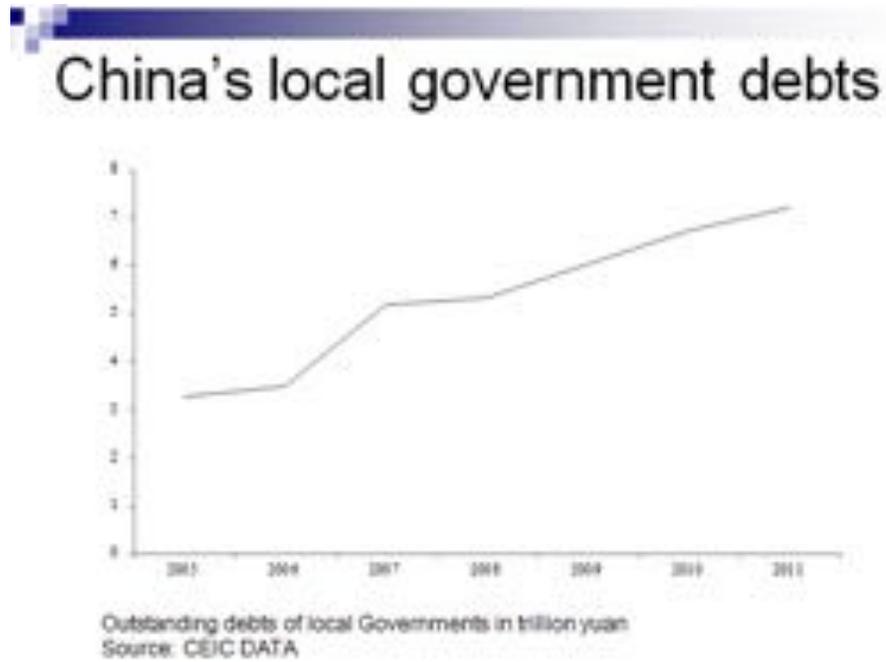
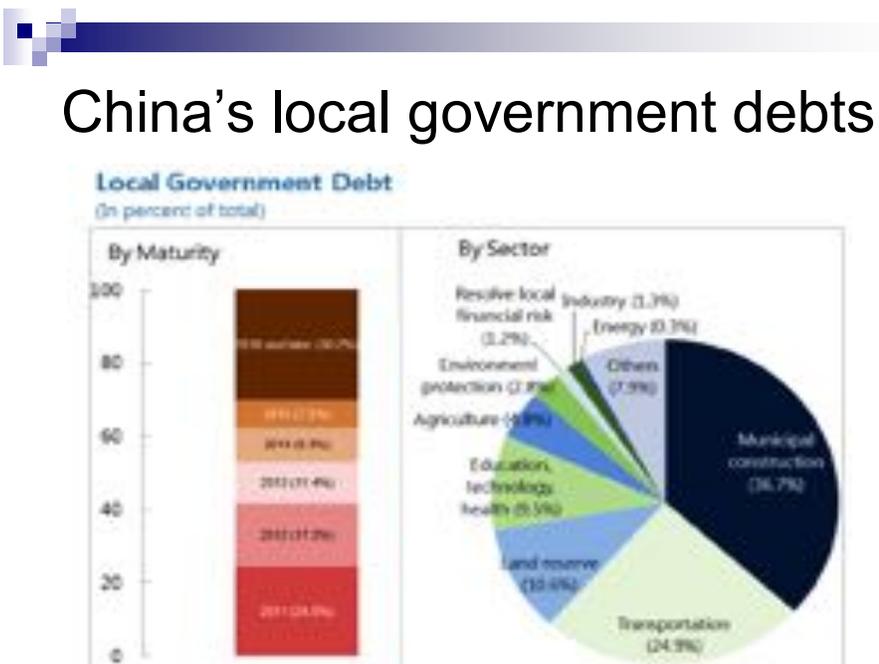


Fig. 9



#### iv. China's Financial System and its Reforms

China's financial system consists of 1) Banking and intermediation, which includes policy banks, commercial banks, and non-bank financial institutions; 2), capital markets, which include the stock market, bond market, and others; and 3) the non-standard financial sector.

The current structure of China's banking system is structured into 1) commercial banks, which are state owned, partially state owned, and private owned and foreign banks; 2) non-bank financial institutions include rural credit cooperatives, urban credit cooperatives, postal savings, trust invest companies, and financial companies; and 3) policy banks, which are composed of Export-Import (Exim) bank, China Development Bank (CDB, which has been reformed and turned into a commercial bank in 2008) and Agricultural Development of China (ADC).

Both the stock market, followed by the bond market has been gradually developing in China. The recent indicators show an evolving structure of the capital market as shown in the figures (10, 11) below. The initial opening of the finance industry in the first decade of this century was also followed by a significant increase in the number of the foreign bank branches.

Fig. 10

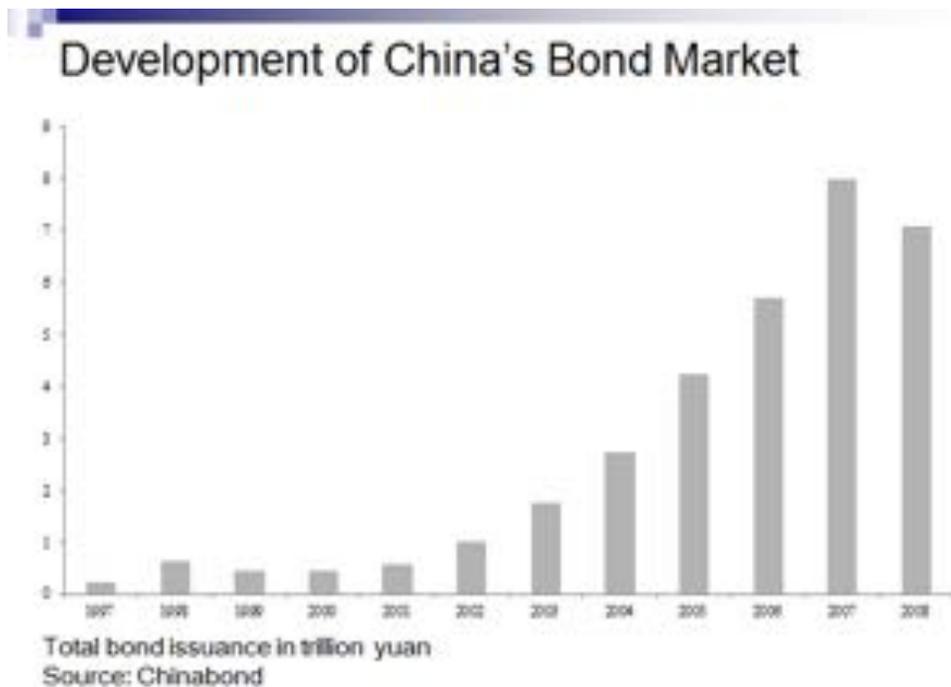
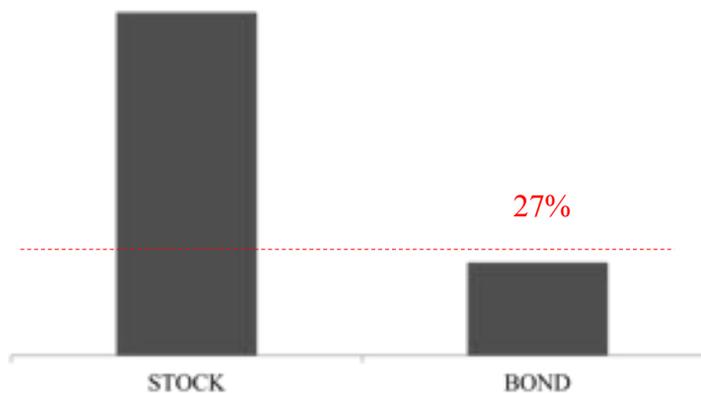


Fig. 11



Relative size of China's bond and stock market in 2007



Source: CSRC

Assets of the banking industry account for predominant shares of 95 percent of financial assets. The majority of banks are State-owned or partially State-owned. The imbalance between loans to the state sector and hybrid sector is sizeable. The majority of loans are given to State-Owned Enterprises (SOEs). The size of the loans made to Township Village Enterprises or TVEs, privately and collectively-owned firms and joint ventures, which all belong to the hybrid sector, is much smaller. There is also a great amount of NPLs within state-owned banks, in particular, among the “Big Four” (Industrial and Commercial Bank of China, Bank of China, China Construction Bank and Agricultural Bank of China)

In China there has been a considerable lag in the development of a financial system that would correspond with the size of its economy, and the government will continue its effort in deepening the reforms to reduce the systemic imbalances and achieve a harmonious and healthy financial sector of the Chinese economy.

### **3. Long-Term Challenges and Risks in Demographics and Energy**

China is experiencing a rapid demographic change. In China, there was and is for now an abundant supply of low-cost rural labor, but there have also been wage inflation and labor shortages in recent years. Transforming from the abundant supplier of low-cost rural labor to having increases in wage inflation and labor shortage is an important factor for China in its path moving forward. China will continue to benefit from an excess supply of labor through 2020. Excess labor is estimated in the range of 150 million at the present time, and projected to fall to around 30 million in 2020. China is poised to cross the Lewisian Turning Point (LTP) somewhere between 2020 and 2025.

In addition to the projected decline in the labor force post-2015, according to the World Bank's China 2030 Report, the old-age dependency ratio is expected to increase at an almost unprecedented rate over the coming decades, from about 13½ percent in 2010 to around 20 percent in 2020 and around 28 percent in 2030. The rural old-age dependency ratio will rise to over 34 by 2030.

The consequences will be transformation of the current growth model, and the fiscal burden of supporting a growing old-age population. One long-term growth pattern transformational considerations include increasing dependence on domestic consumption, innovation and technological advancements.

Another important challenge is the energy efficiency of China, which is only one eighth that of Japan and one quarter that of the USA. China stands as the second largest consumer of energy in the world, and therefore must worry about resource consumption and protection of the environment. Long-term, there will be a transformation of growth patterns. Examples include more dependency on domestic consumption, more dependency on innovation and technologic improvement, and more efficient use of energy and resources.

#### **4. Changing Dynamics in Asia-Pacific Region and Prospects for establishing the Northeast Asian Bank for Cooperation and Development (NEABCD)**

##### **i. Recent change in dynamics**

The economic strategy for the US is to move westward to Asia and the general trend appears to reflect it.

First, the Trans-Pacific Partnership (TPP) is one indication of this trend. Secondly, in East Asia, the CJK FTA among China, Japan, and Korea is another important thrust and expanding this into ASEAN + 3 and further vision of expanding into the larger framework of ASEAN + 6 including New Zealand, Australia, and India forming a regional comprehensive economic partnership (RCEP). This would converge with the East Asia FTA (EAFTA).

The Russian strategy is aimed at eastward expansion of economic cooperation, namely, Russia, Kazakhstan, Belorussia, Russia- New Zealand, and Russia-Vietnam FTA.

##### **ii. Greater dependency in intraregional trade and investment and emerging horizons for FTAs**

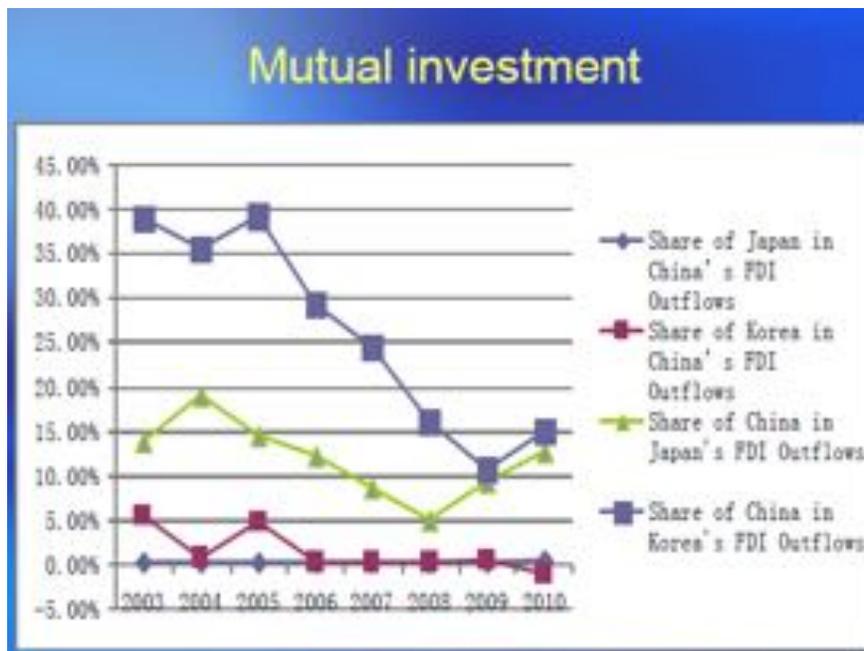
Japan's and Korea's dependency rate on exports from China have increased significantly from 2001 to present. In about ten years, Japan's dependency has increased from an estimated 7 percent to almost 20 percent, while South Korea's dependency has grown from about 12 percent to around 25 percent. China's dependency on exports from these two countries has declined, from a slight 1 percent from 2001 to 2010 with Korean exports to an almost 10 percent decline from around 17 percent to about 7 percent with Japanese exports (see Fig. 12).

Fig. 12



The figure shows that the mutual investments among the three major countries in Northeast Asia have intertwined. With the changing economic dynamics in Northeast Asia, it's inevitable that the interlocking of investments will be strengthened not only in terms of face value, but in an intensity involving technology and capital (See Fig. 13).

Fig. 13



The three countries summit agreed on the FTA for China, Japan and Korea recently and despite some difficulties, it is proceeding. There have been no disputes on ASEAN + 3 and ASEAN + 6, namely the Regional Collaborative Economic Partnership (RCEP). There also have been movements in bilateral and trilateral approaches for FTA. There have been discussions as to which approach would be more efficient.

These FTAs are all aimed at producing in a cooperative manner, products with increasing demands and the FTAs would serve as a good foundation for a multilateral development bank to function positively and in some ways proposal for NEABCD if realized would contribute to expediting the process of FTA discussions.

Despite the progress in the region, there are still many trade barriers. The agricultural issues between Japan and Korea and manufacturing for China require some consideration. Between the three prominent countries, namely China, Korea and Japan, there are still feelings of mistrust and thinking reminiscent of the Cold war.

Recently the territorial disputes have become more alarming these are contributing to the deterioration of the diplomatic atmosphere. Frequent military drills continue to ignite ill feelings. The change in political leaders may contribute to the uncertainty and security concerns, but will also provide hope of a better future. Despite the affinity of grouping and geographic proximity shared by the countries in this region, each country is unique in various ways including its history, culture, people and government. These factors can contribute to and impact the progress of both an FTA and the proposed multilateral development bank for Northeast Asia.

Sub-regional economic cooperation can be achieved in Northeast Asia most likely through implementing Local Development Mechanisms (LDMs). This can be accomplished through cross-border infrastructure development, such as cross-border industrial parks, jointly by China and Russia, China and Mongolia and China and North Korea; Recycling Industries Pilot bases in China, Japan, and Korea; and CJK Economic Cooperation Experimental zones by linking the cities on the coastal areas such as Busan, Fukuoka, and Qingdao and cross sea transportation linkages between China and Republic of Korea. Multi-parks pattern in one zone, Shangdong Province; Core-parks pattern as a tariff free port in Qingdao or Yantai.

There have been discussions in China among the People's Bank of China, Ministry of Foreign Affairs, Ministry of Finance, and China Bank Regulatory Commission (CBRC) on the NEABCD as a sub-regional multilateral bank. The paid up capital for this proposed institution is to be provided by the China Development Bank (CDB), China Export-Import Bank, and some commercial banks, may not be sufficient.

The relationship between the new bank and the Asian Development Bank is basically influenced by Japan and the US. The official views of Japan and Korea regarding the multilateral development banks are still uncertain. It seems that Japan has concerns and is hesitant on the NEABCD. For the NEABCD to be successful, Japan must be on board. South Korea seems open to the idea and perhaps the first step will be taken by China and Korea. The Tianjin Municipality in China has been supportive of the NEABCD and will positively promote it.

### **iii. Interim suggestions and recommendations**

As a first practical step, a proposal for an association of development banks and Exim banks may be more plausible and feasible for financing major trade and investment projects, as well as cross-border infrastructure construction. Cross-border projects can be implemented in

trade and investment, public infrastructure and private business, both hard and soft projects as espoused by the Greater Tumen Initiative (GTI), including energy and resources.

Due to the barriers and difficulties, a possible, practical approach to the long-awaited NEABCD and a first infant step could be to begin with a Northeast Asian Banks Association. There are mixed thoughts on this, but it may be the platform needed to eventually reach the goal of establishing the bank. This first step involving either bilateral or trilateral cooperation from the export and import banks and development banks should be considered.

The beginning of this process could be a spring board to the establishment of the NEABCD, which may take a few years.

The bank association approach would have the bank's cost share by generating paid-in capital from the cooperating banks. The Secretariat for the association may be patterned after the GTI (Greater Tumen Initiative) Secretariat. This approach would also require preparation of charter and regulations and rules for collaborative activities.

This approach is an idea that may not be realized because Japan is not a member of the GTI and the largest financial development institution of Japan, the Japan Bank for International Cooperation (JBIC), is indispensable in cross-border infrastructure construction in this region. There have also been interesting developments in establishing regional multilateral financial institutions, such as the Shanghai Cooperation Organization Banks Consortium, established in 2005; it is different from a single development bank. It provides consortium loans and priorities include manufacturing, infrastructure (transportation and energy), agriculture, and environment. In 2010, the Shanghai Cooperation Organization Development Bank was proposed by Prime Minister Wen.

Another most recent example of initiative in developing a multilateral financial institution for development is the initiative for the BRICS bank by India. The BRICS countries have very different economic systems, and it would be difficult for Russia to support the bank, although a little easier for South Africa. No background work has been carried out in China to support the proposal announced at the Delhi meeting. The five countries agreed that each country will study the proposal for a year before engaging in further discussion.

We do not foresee any impact from the BRIC proposal on the regional bank proposal for Northeast Asia. In contrast to the Central Asian case, where it would have been difficult to set up a bank, because the per-capita incomes in borrowing countries are so low, the Forum's long-term study has shown that the NEABCD is feasible.

The NEABCD would have one group of borrowers, whereas the BRICS bank would have another group, without much overlap. It would be difficult for any country to mobilize so much capital all at one time for even one new bank, much less two banks. In terms of timing and given the background work already accomplished, the NEABCD proposal has greater advantage. For China, there would be no problem in raising the initial capital, even for two banks. The more important issue is demonstrating common interests among the countries as a means of promoting the NEABCD. China's Ministry of Foreign Affairs and Ministry of Finance are important in relation to the NEABCD. The two ministries have not yet received any indication from Japan about the plan, and it would be very helpful if the Japanese government could give them some positive sign.

With the numerous years of discussion on the NEABCD, it has been difficult to transform it into action. There are many required steps to establishing the NEABCD and all will need to be implemented thoroughly. A new study, or 'grand design' providing a strategic view for the medium to long term is necessary. There must be planning action points for the short term.

Having support from both the central and local government is imperative. The plan will also require a larger view of cooperation as stated in the Greater Tumen area Initiative (GTI) framework and platform.

## **5. Conclusion**

The tides have shifted from the years of Japan's global dominance to China's prosperous reign. Despite its issues, China is more than well equipped to become a prominent member in the proposed NEABCD. Japan was urged for years to pursue and lead the efforts in this Bank and given the opportunity to be at the fore front. Now with the changes taking place, it may need this type of cooperation more than ever to sustain its own economy. If Japan cooperates with China, South Korea and other countries within the region, this could lead to a successful partnership and has the potential to benefit all parties. China is more than able to afford and fund the NEABCD and prominently stand out as both a major contributor as well as a beneficiary.

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# Proposal for a Northeast Asian Bank for Cooperation and Development (NEABCD)

*Lee-Jay Cho*

## 1. Background

The idea of establishing a Northeast Asian Development Bank (NEADB) was first proposed more than two decades ago. The 1993 meeting of the Northeast Asia Economic Forum recommended that governments in the region carefully study its feasibility. The Forum selected Dr. S. Stanley Katz, former vice president of the Asian Development Bank (ADB), to oversee this study.

As envisioned by the government experts, the Bank would serve as a regional financial and development organization to attract capital for regional development projects, further the economic cooperation and regional integration of Northeast Asian nations, and promote social and economic development within Northeast Asia, in a fiscally, socially and environmentally sound and responsible manner.

The proposal to establish the Bank is the result of a multi-year review and effort—a major recommendation by the Northeast Asia Economic Forum (NEAEF). The NEAEF is a regional nongovernmental organization created in 1991 to sponsor and facilitate research, networking, and dialogue relevant to the economic cooperation and development of Northeast Asia.

The NEAEF has distilled a consensus and agreement about the basic concept of establishing the Bank in a collaborative effort of eminent experts of the nations of Northeast Asia, particularly the People’s Republic of China, Japan, the Republic of Korea, and the United States as well. The NEAEF has held six meetings of the Ad-Hoc Committee for Establishing the Northeast Asian Bank for Cooperation and Development (NEABCD) – the first one in 1999. The NEAEF has also established the NEABCD Advisory and Steering Committee, chaired by Dr. Stanley Katz, (former Vice-President of the Asian Development Bank). The Advisory and Steering Committee is composed of prominent members with extensive financial experience in Northeast Asia. Many of the members have experience working with international financial institutions and national development banks currently and in the past\*. The Committee is a part of the Research Center for Financial Cooperation in Northeast Asia, also established under the leadership of the NEAEF.

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\* For example, Mr. Watanabe Hiroshi as President and CEO, Japan Bank for International Cooperation (JBIC) and Former Vice-Minister of Finance for International Affairs, spoke at the Session on Financial Cooperation of the 17<sup>th</sup> Northeast Asia Economic Forum in Tianjin in October, 2008.

“With much effort, this financial institution needs to promote arrangement and implementation of important projects, for example, such as cross-border projects involving China and the Korean Peninsula, as well as domestic projects. One country alone cannot promote and achieve such cross-border projects”. He outlined Japan’s proposal for development with quality in terms of:

*PACE for Asian Future*

P: Public Mass-Transportation for Good Urban Living

A: Agricultural Renovation for Easing Tight Market

C: Clean Coal Power Generation for Cleaner Environment

E: Educational Investment for Income Redistribution

## **2. Northeast Asia: Regional Characteristics and Factor Endowments**

Northeast Asia includes China (including in particular the northeastern part), Mongolia, the Korean peninsula, the Russian Far East, and Japan. During the past century, the political environment of Northeast Asia has been dominated by tension, military conflict, and territorial rivalries among its major powers.

This region covers a vast land area with tremendous differences in factor endowments. The Russian land mass is endowed with rich minerals, natural gas, timber, and marine resources. Mongolia too, with only 2.5 million inhabitants, is a vast area with enormous natural and mineral resources. The Chinese provinces in the northeast have abundant human and agricultural resources. North Korea has potentially high quality labor and geographically strategic coastlines and connections. South Korea enjoys a central location and has capital and industrial and construction technologies. Japan is a world economic power and has massive reserves of capital, advanced technology, and managerial know-how. Northeast Asia has been characterized as a Natural Economic Territory (NAT). As such if these factor endowments can be harnessed through economic and physical integration, this region has an enormous potential of becoming a dynamic economic community. But with the exception of Japan and South Korea, the potential is not realized due to the lack of technology and the poor quality of and inadequate infrastructures in transportation, modern ports, communications, fiscal services, reliable energy supplies, and stable institutions, etc.

## **3. Developing Regional Cross-border Infrastructures**

### **i) Regional Transportation and Logistics System**

Transportation infrastructure is an important key to the integration of Northeast Asia. For example, air traffic tends to grow as fast as or even faster than economic growth, and the rate of container traffic growth is generally outstripping the rate of trade growth. In the twenty-first century, transportation capacity is expected to fall short of demand in the countries of the region. Along with these new requirements, the physical condition of existing transport infrastructure in the region must be considered, much of which is more than several decades old.

The Korean peninsula, for example, could serve as a hub of transportation, telecommunications, energy exchanges (including natural gas), and related services for that area, if integrated systems could evolve.

Consequently, very sizable investments are required to replace a substantial part of the existing infrastructure. The ability to finance this development to continue the region's present and increase the future pace of economic growth is crucial.

### **ii) Natural Gas as a New Energy Source**

Future dynamic economic growth in Northeast Asia depends on the availability of sufficient energy sources, and to meet this demand, for example, the use of natural gas must be

expanded. The proposal for an international pipeline system for Northeast Asia has been drawing increasing attention. This cross-border project would be a means of developing a multinational, cooperative, corporate institution that would bind the region in a common interest. Most importantly, it would contribute to energy security and peace.

Building the necessary infrastructure for the transportation of natural gas, however, will require enormous long-term capital investments. But because of the abundant reserves of gas in the region, and the strong projected future demand for it, generating the necessary financial resources in Northeast Asia and elsewhere in the world is feasible.

Japan must secure adequate supplies of energy for continued economic growth and stability during the coming century, and China's demand for oil and gas has been rapidly growing and will continue over the long term. If the project for a pipeline system for Northeast Asia were realized, designed, planned, and carried out multinationally, stretching from the Russian Far East, Mongolia, China, the Korean peninsula, and linked to Japan; with Japan taking the initiative with its capital and technology, it would be an important step toward the dynamic and peaceful economic development of Northeast Asia in the twenty-first century.

### **iii) Developing Telecommunications Infrastructures**

Revolutionary change is taking place in information technology, and recent technological innovations are changing how business, government, and other sectors of economic life and social life operate. Economic globalization has been hastened by electronic communication, much of it through North America and Europe, and it is exerting major influence in Northeast Asia. The dramatic increase in the use of the Internet and a concomitant expansion of networks in Japan, Korea, and China underscore the telecommunications dimension of potential economic growth. Intraregional communication infrastructures, however, are inadequate, and more information highways need to be built and related facilities expanded. The increasing demand for submarine cables, landline fiber optic cables, digital telephone exchanges, mobile telephones, and relay stations must be met.

The expansion of Internet communications will also require extensive Internet and computer network development, satellite launches, MSS (Mobile Satellite System) installations, software development, and personnel training. All this will call for enormous capital that must be mobilized to realize the region's potential for growth. The challenge of national, legal, and institutional barriers must be met for effective telecommunications through promoting deregulation, privatization, and structural reform.

## **4. The Rationale for a Northeast Asian Bank for Cooperation and Development (NEABCD)**

Over and above the construction and improvements of cross-border infrastructures in transportation, energy and environment, and communications sectors in the region are crucial for future dynamic economic development, and this will depend on the region's ability to mobilize capital resources including private investment. The private investments will increase rapidly when investors perceive that their investments will be supported by adequate highway, railway, and air transportation systems; ports and harbors; modern telecommunications; reliable energy supplies; and sound environmental programs. Upgrading Northeast Asia's infrastructure and the importation of engineering and construction services, materials, and plant and equipment – much of it from outside the region – will bring the region's infrastructure up to standards and permit it

to compete successfully with other areas, for limited private-sector resources will involve investments in infrastructure far beyond the region's own capacity.

An earlier study by the Northeast Asia Economic Forum estimated that the cost of upgrading and expanding infrastructure would amount to \$7.5 billion a year for the next 15 to 20 years. These figures need to be updated and will likely be much higher. The questions to be addressed, therefore, are *how* and *where* this financing can be secured. A study sponsored by the Northeast Asia Economic Forum concludes that financing for the Northeast Asian infrastructure must come from three main sources: (1) private sector credits and investments; (2) bilateral official assistance; and (3) existing multilateral development banks (the ADB and the World Bank). Recent studies have revealed, however, that the total amount of financing that can reasonably be expected from existing multilateral financial institutions, governments, and the private sector will fall far short of meeting the region's projected needs for financing infrastructure.

To reflect the enhanced role of the Bank in expanding and improving cooperation within the Northeast Asian region in infrastructure development and financing, it was decided at a recent meeting of the Advisory and Steering Committee to expand the name of the Bank from the Northeast Asian Development Bank (NEADB) to the Northeast Asian Bank for Cooperation and Development NEABCD.

A new regionally oriented development bank, such as the NEABCD, would provide an important part of the additional financing that could be effectively employed in expanding and improving Northeast Asia's infrastructure base. Its purpose 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 Northeast Asia for infrastructure.

In a recent briefing memo circulated amongst Committee members, the following justification was offered:

“The second important justification for The Bank is the consensus among experts that the existing multilateral development banks (MDB's), which consist of the World Bank and Asian Development Bank (ADB) have not met and cannot meet Northeast Asia's financing needs for regional development and cross-border infrastructure projects. This is primarily due to the fact that the multilateral financial institutions have shifted away from their traditional main focus on infrastructure development, especially large-scale infrastructure projects. The World Bank, as the world's biggest development bank, has shifted toward the principal goal of poverty reduction and thus mainly invests in the poor areas of Latin America and Africa. In a similar vein, the involvement of ADB in specific and concrete development projects in Northeast Asia is extremely limited, since the ADB focuses more on Southeast Asia, Southwest Asia, and Central Asia. The Northeast Asian region accounts for only 4 percent of the Asian Development Bank's total investment. It is not anticipated that any of the MDB's will change their programs to respond to the needs of Northeast Asia or provide financing at adequate levels to promote regional development. At the same time, The Bank shall not be a clone of the existing regional development banks, since they have shifted away from functions that The Bank intends to pursue for the region. The Bank will, of course, form a complementary cooperative relationship between

other international financial institutions in order to maximize the overall benefits they could provide.”

The proposed NEABCD would supplement, but not supplant, the financing provided by the existing multilateral financial institutions (the World Bank and the ADB). The NEABCD financing would primarily be directed to infrastructure projects that would benefit the countries and the region as a whole. The Bank would also provide technical assistance in the identification, design, evaluation, and implementation of these projects.

## **5. Capital Requirement: Who Pays?**

The prospective regional shareholders of the proposed bank would be China (including Hong Kong and Macau), Japan, South Korea, Mongolia, and Russia. Participation by Taiwan is also highly desirable because of its economic strength and extensive capital resources. The United States would be expected to be a major participant among the non-regional members, along with the European Union, Australia, and New Zealand.

The proposed capital structure for the NEABCD suggested an initial capitalization of \$40 billion, evidenced by capital shares, of which 50 percent would be subscribed and paid in for shares over five years, and 50 percent would be subscribed (but not paid in) in the form of callable capital shares (that is, a form of "safety-net" commitment that would require no disbursements by shareholders). It is assumed that the regional countries' share of the Bank's capital would be \$24 billion, representing 60 percent of the NEABCD's total capital. The 40 percent balance (\$16 billion) would be available for subscription by non-regional nations.

Referring to the Asian Development Bank's model, the subscribed capital constitutes the largest part of the ADB's financial resources: 93 percent of it is callable capital, and the remaining 7 percent being paid-in capital. In other words, 93 percent of the ADB's capital does not represent cash payment; it represents a form of payment guarantee by the member governments. The 7 percent, or \$3.3 billion, represents the actual cost of creating and running the ADB incurred by all member countries.\*\* On the basis of this \$3.3 billion, the bank would thus be able to mobilize as much as \$87 billion (net of the Special Fund), leveraging the confidence of lenders in the guarantees of sovereign states in the form of subscribed callable capital shares. The guarantee of the Bank's liquidity and assets by sovereign governments is the basic difference between commercial banks and an official multilateral development bank.

Apart from financial activities, the NEABCD would be entrusted to carry out diverse auxiliary functions, including research on the sub-regions' economies, studies on policy issues, collecting and disseminating information, and educating and training public officials in the region. These kinds of auxiliary functions are especially important as the former socialist countries of China, Russia, Mongolia, and North Korea are in need of technical assistance to make the transition to market economies.

The China-Japan-Korea Free Trade Agreement (CJK FTA) is an important step toward a regional economic partnership in Northeast Asia, given geographic proximity of the three countries and their common goal of pursuing economic integration in the Asia-Pacific region. Building on the history of bilateral commercial partnership and the recent wave of bilateral free trade agreement negotiations, the respective heads of state in China, Korea and Japan launched a Trilateral Joint Study Committee to investigate the prospect of the CJK-FTA.

The new Bank would provide a means of regional economic cooperation, gaining prominence within and outside the region. In this context, the Japanese idea of creating an Asian

Monetary Fund would carry weight when use of the yen as an international reserve currency increases through the operations of the NEABCD.

The economic development and increase in economic interaction among the region's member countries could translate into greater political stability within Northeast Asia. And membership in the NEABCD would impose the responsibility to participate and work cooperatively within the Bank's institutional system and structures, which would bring a much needed learning process to the Northeast Asian countries.

## **6. Some Economic and Political Implications: Economic partnership and regional security**

The creation of the NEABCD would provide China and Japan with a means to make part of their trade surplus with countries outside the region available for the economic development of the region. Japan has a long-standing political and moral obligation to these countries with which it shares a history of conflict and war. Its contribution to regional economic development will enhance its regional and global leadership role.

China's rising economic status provides more opportunities for the NEABCD. With its dramatically increasing foreign reserves surpassing that of Japan by almost twofold, China is playing a very important role in the world economy and in the Northeast Asian region. China is also willing to make any necessary contribution to the regional economic development and the integration of the regional economy. China, a giant country although challenged by many economic and social problems, also has much to gain from the NEABCD through its access to financial resources and technical assistance. China would very likely be a major borrower from the proposed bank. The NEABCD, though, would be able to help promote mutual understanding and cooperation between China and the rest of the member nations and help to maintain peace and security in the region and elsewhere in the world.

Capital participation of the United States in the NEABCD is required for the obvious reason that the world's richest nation is needed to continue playing the role of a counterbalancing power, thereby helping to maintain peace and security in the region and in the world. The geopolitical situation has changed following the disintegration of the Soviet Union. Nevertheless, the security role of the United States in the region is in no way diminished, although it operates in a different context. In particular, U.S. foreign policy toward North Korea is that of engagement, implying that the United States and other OECD countries are expected to extend economic aid, provided that North Korea gives up its destructive military capabilities. The economic assistance is aimed at inducing Pyongyang to gradually open its doors to the outside world and to become a member of the regional and global community through economic and political reforms. The proposed NEABCD fits this purpose perfectly. The U.S. would be able to pursue its foreign policy at much less economic cost than it would without a development bank in the region.

## **7. Conclusion**

The North East Asian Bank for Cooperation and Development has been proposed to help fill the region's long term infrastructure financing needs and thereby to accelerate the region's economic development and integration. As proposed, it would become an important institutional vehicle for mobilizing funds in international capital markets for the region's infrastructure needs.

These funds would be raised by bond issues and transferred through the Bank's lending operations to finance imports of equipment and services for infrastructure investments in Northeast Asia. Such transfers and investments, along with associated technical advice and assistance, are essential for developing the region's resources, attracting private enterprise, banking, and investments, and creating a long-term Northeast Asian market for goods and services.

Besides serving these functions, the NEABCD would ensure that the projects it helped to finance are in priority sectors of the region as a whole. It would also ensure that the projects are free of inappropriate payments and that they could meet internationally accepted standards of technical, economic and financial feasibility. Moreover, the Bank would provide a means for spreading a significant part of the financing of developing Northeast Asia to the international capital markets. From a broader fiscal policy perspective, the Bank could help to avoid the mismatching of funds and investments that has proved injurious to Asian nations in recent years.

Along with the capital flow, more effective transfers of industrial technology, managerial skills, and know-how can be promoted through the proposed regional bank. By having the member countries of this region, including ultimately North Korea, join this financial institution, cooperative efforts toward economic development in a regional framework would be better facilitated than through bilateral intergovernmental agreements.

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\*\*Let us hypothetically suggest that a regional member country were to subscribe to 5 percent of the new Bank's proposed shares (12.5 percent of the regional total); its total financial commitment would be \$2 billion. Half of that, or \$1 billion, would be paid to the Bank in exchange for shares. The payments would be made in five annual installments of \$200 million each. The balance of the country's commitment would be "callable" and would remain uncalled except in the unlikely event of a major financial failure (All existing multilateral development banks have similar callable shares; and none has ever called, or expects to call, any of these shares). Under these assumptions, the annual governmental budgetary cost for a purchase of 5 percent of the NEABCD's shares would be \$200 million for five years. Thus, depending on the countries' subscriptions to the Bank's capital shares, for example, Japan's estimated cost for 5 percent of the Bank's capital spread over five years would amount to \$1 billion, and if China purchases the same amount of shares equal to Japan, the cost would be the same, \$1 billion

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## Appendix

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# **Appendix A: Teleconference on Issues of Multilateral Development Banks and Northeast Asia Bank for Cooperation and Development (NEABCD)**

26 April 2012, 14:00

Teleconference facility at Saunders Hall

College of Social Science, University of Hawaii at Manoa

Organized by the

Northeast Asia Economic Forum

## **Questions and issues circulated in advance for the Teleconference on the Multilateral Development Banks and the Northeast Asian Bank for Cooperation and Development (NEABCD)**

1. Recent developments in multilateral development banks with special reference to the BRICS proposal for a new development bank
2. Changing goals and missions of the World Bank and Asian Development Bank
3. Review of other regional banks in terms of their missions and performance
4. Research agenda for this year's NEAEF/KIEP project on the NEABCD
5. Other matters

## **List of Participants**

**Lee-Jay Cho**, Chairman, Northeast Asia Economic Forum (NEAEF)

**Richard Dubanoski**, Former Dean of the College of Social Sciences, University of Hawaii at Manoa

**Stanley Katz**, Former Executive Vice President, Asian Development Bank (ADB)

**Chang-Jae Lee**, Senior Fellow of the Korea Institute for International Economic Policy (KIEP) and Former Chair, East Asia FTA Joint Expert Group

**Chung Lee**, Former Associate Dean of the College of Social Sciences and Professor Emeritus of Economics, University of Hawaii at Manoa

**Ghon Rhee**, Professor of Finance, Shidler College of Business, University of Hawaii at Manoa

**Li Kotetsu**, Professor of Economics, School of Future Learning, Hokuriku University, Japan

**Zhang Jianping**, Director, Department of International Regional Cooperation, Institute for International Economic Research, National Development and Reform Commission of China (NDRC)

**Kennon Breazeale**, Rapporteur, Secretary of the NEAEF

**Stanley Katz**, (Sarasota, Florida), **Zhang Jianping** (Beijing) and **Li Kotetsu** (Hokuriku) participated through the Skype teleconferencing facility provided by the University of Hawaii in Saunders Hall.

## Summary of Discussion

Lee-Jay Cho opened the meeting by inviting participants to present their views about recent developments in the multilateral development banks, the recent proposal by the BRICS for a new bank, and what the Northeast Asia Economic Forum needs to do this year with respect to the proposed Northeast Asian Bank for Cooperation and Development (NEABCD).

Stanley Katz outlined the BRICS proposal as he understood it from the press release issued at the recent meeting in Delhi of the BRIC group of countries (Brazil, Russia, India, and China) and South Africa. Their proposal for what they term “South-South Bank” reflects the recognition they want for their increasing economic weight in the changing global economy, with the BRIC bank as an alternative to the World Bank as a source of borrowing. We need to find out what preparatory work they have done and who has been involved in the work. Although details are lacking, it would appear that the only country that could contribute a substantial amount of capital is China, or perhaps India. Most of the member countries would be borrowers, and thus raising capital will be a major impediment. Capital markets will probably not be very receptive to bonds issued by a bank consisting of BRIC members, South Africa and other developing countries. For most of these countries, any bank would need a “soft window” for its borrowers, and funding such a window would be very problematic in this case.

Zhang Jianping pointed out that new developments are expected from the IMF in October 2012 and some countries are looking for a new approach. The initiative for the BRICS bank came from India. The BRICS countries have very different economic systems, and it would be difficult for Russia to support the bank, although a little easier for South Africa. No background work has been carried out in China to support the proposal announced at the Delhi meeting. The

five countries agreed that each country will study the proposal for a year before engaging in further discussion.

Li Kotetsu reported that the bank proposal has appeared in international news reports in Japan. Japanese officials have made no comment about it, however, and no discussion about it has appeared thus far in the Japanese media.

Lee-Jay Cho asked whether the extensive Forum network can interact with the Chinese researchers to provide some dialogue about the issue. Zhang Jianping said he will try to find out who is or will be involved in the study in China.

Lee-Jay Cho pointed out the recent division among countries in the choice of the new President of the World Bank. This reflects the feeling among some countries that the World Bank is no longer carrying out its original mission, and the resultant dissatisfaction with current leadership. He invited comments on these issues in relation to the proposal for the BRICS bank. Stanley Katz reiterated the need of the lesser development countries for a “soft window.” The World Bank does not have the resources for a “soft window” and is thus not attractive to these countries. Many countries have already “graduated” from World Bank assistance, including Japan long ago and countries such as Malaysia and Thailand more recently. These countries would be regarded as the most creditworthy ones. The less-developed countries today, however, do not have the necessary institutional framework to use capital effectively, hence the change in World Bank emphasis in their case, in order to promote the development of these institutions (such as banking systems, health care, and so on). The World Bank has realized that capital itself is only one part of the need. Lending over the decades for poverty reduction has not proved to be cost effective. These countries do not have planning commissions, the intellectual capital, and so on that would enable them to use capital effectively. Lending from the World Bank and the Asian Development Bank (ADB) has changed over the decades, and it is doubtful whether they will revert to the old way of lending. From the viewpoint of the less-developed countries, if there is no way for them to get long-term funding through the “soft window”, then the purpose of the bank is lost to them. In the case of Europe, there is a conflict between those who support austerity (such as Germany) and those who see pumping more money into the economy as the solution, and this is a distinctly different case from the less-developed countries.

Ghon Rhee added that the policymakers at the World Bank and the IMF may not know, at this juncture, what to do about their future direction. With regard to the proposed BRICS bank, he emphasized that the Forum needs to obtain more information about the proposal so that the Forum can determine what can be done vis-à-vis the Forum’s network and building on the past work of the Forum for the NEABCD.

Zhang Jianping pointed out that not only has the World Bank’s lending changed, but also the requirements imposed on borrowers are very complicated and problematic for them, and this does not have a positive effect on lending to less-developed countries. He did not think the United States, European Union, or Japan will react to the BRICS proposal.

Lee-Jay Cho pointed out that existing development bank rules are very old. ADB for example was founded in 1966. He invited participants to comment on whether the rules of these banks could be changed and whether some countries, such as China, might gain a more leading role to reflect its changed economic position in the region and the global economy.

Stanley Katz observed that the imbalance of shares in the ADB could be corrected, but that this issue would have to be raised by the Board of Directors of ADB. With regard to the NEABCD, a new regional bank seems feasible and would meet the region’s needs. He observed, however, that the European Bank for Reconstruction and Development (EBRD) has a special

role vis-à-vis the countries formerly under the influence of the Soviet Union, but that the EBRD cannot engage in certain types of lending (for example, to public-sector enterprises), and thus is not a good model for the NEABCD.

Chung Lee raised the issue of an appropriate model to meet the needs of the Northeast Asian countries. In this regard, they might look to the OECD rather than the existing development banks. The OECD coordinates policy for the members, and coordination is needed for region-wide development. In this regard, he asked which countries in Northeast Asia, except Mongolia and North Korea, could be termed “developing” economies in need of the bank’s capital?

Stanley Katz replied that he had worked for the OECD and was not impressed by its performance in terms of coordination. Moreover, the countries that would benefit from the BRICS proposal are very diverse, have little in common, and are geographically dispersed. These differences would make it very difficult to establish such a bank for them. By contrast, the rationale of the NEABCD is cross-border infrastructure projects that are feasible within a regional context.

Zhang Jianping observed that Russia’s biggest concern now is Europe. He pointed out that a proposal had once been made for a Central Asian Development Bank, but that Russia did not take much interest. He did not think Russia will be very positive about the NEABCD but might take a positive stance on the BRICS bank proposal.

Lee-Jay Cho replied that the Forum researchers accepted from the very beginning that the NEABCD, which would focus on the Russian Far East, would have relatively limited appeal to Russian policymakers in Moscow and St. Petersburg.

Chang-Jae Lee discussed the work of the East Asia FTA Joint Expert Group and its relevance to the proposed NEABCD. The bank proposal is not on the FTA agenda for 2012, but an appropriate time to get in on the agenda might be at the 2013 meeting in South Korea.

Zhang Jianping noted that, from the Chinese viewpoint, the year 2012 would also be appropriate, since it marks the 40th anniversary of the establishment of diplomatic relations between China and Japan and the 20th anniversary in the case of South Korea.

Lee-Jay Cho invited the views of participants as to whether the BRICS bank proposal is a plus or a minus for the NEABCD proposal.

Zhang Jianping thought that the answer should be “neutral.” He did not foresee any impact from the BRICS proposal on the regional bank proposal for Northeast Asia. In contrast to the Central Asian case, where it would have been difficult to set up a bank, because the per-capita incomes in borrowing countries are so low, the Forum’s long-term study has shown that the NEABCD is feasible.

Stanley Katz said that it is difficult to foresee the implications of the BRICS proposal. He pointed out that the NEABCD would have one group of borrowers, whereas the BRICS bank would have another group, without much overlap. He reiterated that it would be difficult for any country to mobilize so much capital all at one time for even one new bank, much less two banks. In terms of timing and given the background work already accomplished, he felt that it would be best for the NEABCD proposal to proceed.

Zhang Jianping replied that, for China, there would be no problem in raising the initial capital, even for two banks. The more important issue is demonstrating common interests among the countries as a means of promoting the NEABCD. He also pointed out the importance of China’s Ministry of Foreign Affairs and Ministry of Finance in relation to the NEABCD. The

two ministries have not yet received any indication from Japan about the plan, and it would be very helpful if the Japanese government could give them some positive sign.

Lee-Jay Cho thanked the participants for their contributions and provided a brief summary of points, with particular emphasis on identifying and contacting the people who are working on the BRICS proposal, working on a plan for the Japanese to communicate with the two Chinese ministries, and updating the existing Forum data on the NEABCD in preparation for the next year.

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## **Appendix B: Seoul Meeting on the NEABCD at the Korea Federation of Banks**

Regional Financial Cooperation: Planning and  
Strategy for a Development Bank in Northeast Asia

Organized by

Northeast Asia Economic Forum

**In Cooperation with**

**Korea Institute for International Economic Policy (KIEP)**

**Hosted by**

**Korea Federation of Banks**

**On June 4 -5, Seoul, Korea**

**Venue: Korea Federation of Banks conference room**

**Summary**

**Morning Session: Recent developments in multilateral development banks with reference to BRICS proposal for a Development Bank and the Proposed NEABCD**

Country perspectives of recent developments in multilateral development banks with reference to the BRICs proposal for a Development Bank were presented by the participants

from China, Japan and Korea. This was followed by in-depth discussion of the situation of in Northeast Asia and the BRICS proposal in the context of Europe and India, and how the NEABCD can fill in the gaps in the dynamic changes that are taking place.

The participants recognized changing roles and mission of the World Bank and Asian Development Bank and also reviewed other regional banks in terms of their mission and performance. For example, in the last quarter century, a number of developing countries have been reduced by half. The time for assistance from World Bank has dwindled to the extent of reference to “the World Bank is a dying institution.”

The current World Bank's mission does not help to solve the unbalanced economies of the world. In the past the World Bank has spent more than 60 percent largely on infrastructure, health issues, education, and poverty reduction. By 2011, however, proportion on social sector rose more than 50 percent, leaving only 30 percent for infrastructure construction. There are donor countries, especially in the EU, which prefer the social sector.

The BRICS proposal doesn't have a focus and doesn't have a mandate.

This BRICS proposal faces a lot of questions and difficult challenges.

In this connection, the NEABCD has been researched and discussed for a number of years and in the view of the Chinese on this BRICS issue, China Development Bank is involved in the BRICS proposal. During the summit India proposed, China and Russia accepted, and this proposal needs to be discussed in terms of its mission and goal, organization structure, capitalization and location, which have not been clarified.

With respect to the BRICS proposal in contrast to the NEABCD, the former is recent, whereas the NEABCD has been in discussion for a long time. The BRIC development bank is not a regional bank and it doesn't compete with NEABCD.

The NEABCD has reached a certain consensus and then therefore they could learn from the experience from the research and discussion that has been done concerning the NEABCD. China and its part in 2009 to explore the establishment of central Asian development have not been realized. There needs to be more study and research done with the Central Asian development bank.

As to the required capital resources, China has sufficient foreign reserve at USD 3.3 trillion to meet the requirement.

Considering the new reality and the crisis in Euro zone, making the proposed role of the NEABDC clear to the existing banks such as the World Bank, ADB and EBRD, in terms of filling in the gap and complementarily will be pivotal.

The establishment of the NEABCD should be predominantly for investment for infrastructure development. The ADB and the NEABCD should develop in a parallel and complementary way and therefore, the relationship should be cooperative to avoid overlap. These two banks will share the same participants and deserve our support both banks. It requires a keen focus on the mission and goals of developing stronger infrastructure in the region, especially with respect to the overlap between the two banks, the ADB and the NEADB.

In this way, the creation of this Bank can be complementary to the existing banks. We can design the Bank to avoid unnecessary overlap with the functions of the existing banks.

The participants discussed and endorsed the outstanding features of the proposed bank and its unique perspective. The first is that this Bank will be more focused on cross-border infrastructure projects. Second, the Bank will play a catalytic role and provide private funding by means of the credit capability of the Bank. Third, the Bank will also work on human resource

development and training and education of the host countries to pave the way for a better coordination between the donor's community and the recipients in the host country.

Fourth, the Bank may underscore the role of the sub-sovereign financial institution, thereby provincial and municipal governments playing key roles in the infrastructure construction.

The fifth is that, as a community of neighboring nations, China, Japan and Korea need to cooperate in promoting green growth, climate change and sustainable development by means of cutting edge technology, policy dialogue and technical assistance, and invite the other regional players for the green growth.

### **Afternoon Session: Physical Integration through Cross border Infra-structure and Perspective from Japan**

Japan is at a turning point in its economic outlook and challenges after the great natural disaster in Tohoku area and is reexamining its status as donor as well as future recipient by participant in cross-border projects.

For the purpose of the economic integration of the region in terms of a prosperous economic zone, and particularly from the Japanese perspective, the proposed Bank can contribute to the overlapping development of Japan. In other words, by investing in the linkages of infrastructures, such as the proposal for recycling project in logistics and transportation and others that would connect the areas across national borders in the region, the Bank will strengthen the physical link and connectivity of Japan, the Korean peninsula and China extending to some parts of Russia and Mongolia. The connectivity also includes massive infrastructures, which are for energy and natural resources such as gas and oil pipeline, and also transmission and distribution of powers network.

Russia is in accession process to Sakhalin II. The Putin administration is going to undertake the legal framework for accelerating the commitment to accession to Sakhalin II. It'll enhance trade because in Far East Russia, the trade is very small. They're expanding the capabilities of the liquefied natural gas in Vladivostok by means of the refurbishing of the gas pipeline from Sakhalin to the eastern side of Siberia. Northeast Asia needs more maritime logistics connectivity. South Korea will have the larger role in maritime logistics

New investments in infrastructure in Japan, in response to natural disaster, for example, is estimated to cost 2-3 trillion dollars over the next 20 years and this would be a change from budget cut to increased spending in developing critically important infrastructure. The Japanese taxpayers will not tolerate another investment and donation to a new multilateral regional bank.

Japan invested heavily in the EBRD and the ADB without any direct benefits for Japan. The implication is that Japan needs to have an effective way to be able to spend. It has to be done with respect to the regional context. Redefining the mission of the Bank will help to move forward in a practical manner. It depends on the agenda and can be accomplished.

For Japan the NEABCD can be a Bank of the future by involving the local provincial governments in the cross-border projects such as construction of the Hakata- Busan tunnel, Nigata's Japan Sea Rim Cooperation Rim projects, construction of the gas pipeline from Sakhalin to Tokyo, promoting or enlarging the maritime logistics and refurbishing the port cities in Japan. Japan must involve local provincial governments as in the case of China in that certain provinces such as northeast three provinces lagging in economic development are eligible to

receive the fund. This means changing the current mindset regarding division between a donor versus recipient community.

Large scale transnational infrastructure developments through the Bank will give Japanese companies opportunities for business investments .

This Bank cannot cover the total cost of this gigantic cross border infrastructure projects, yet, it will cover a small but critical component. It can play the major role in mobilize the fund, and take on the neutral and catalytic role. By burden the sharing, the spending in the creation of the Bank will be less costly than the direct engagement in the infrastructure projects.

The proposal is not just one notion only such as Mr. Hatoyama's "East Asia Co-Prosperty" but is the tangible and practical one which will pave the way to the creation of the Northeast Asian Bank for Cooperation and Development. This is a possible bright side at the same time, for economic growth, for one cannot come between stringent fiscal discipline, and growth in GDP.

This is an opportune and critical time to pursue whatever is possible with sovereign funds based on trade surplus reserves. Direct loans and development assistance alone are not enough for the creation as a regional bank as a facilitator. By mobilizing more funding from private sector and external resources, even from outside the region, this Bank can play the role of the catalyst and should be designed as a more suitable catalyst for that purpose. The three countries of China, Japan and Korea would not agree on the rationale of establishing a traditional development bank. A clear differentiation from the traditional bank is required. Multilateral banks can have public and private sectors together.

The physical integration of the region will pave the way for the development and prosperous future for promoting economic growth. For this reason, the three leaders of the nation states need to agree broadly of economic and physical integration of the region of Northeast Asia.

The proposal for the NEABCD is in a much better economic environment than the US or EU, which are facing economic difficulties. There is no major locomotive to pull the world economy to recovery, and Northeast Asia can ignite the global recovery suggesting more support for the NEABCD.

The physical integration of the Northeast Asia region through the cross border infrastructure will pave the way for the development and prosperous future through economic growth. Not just only the process, step to be taken to deliver the proposal to the government leaders by encouraging them to draw the bigger picture with the Bank as only one of the instruments.

The discussion on future strategy led to the suggestion at this stage for starting from South Korea and China to initiate a dialogue and then expand it to the three countries of CJK, or these two bilateral meetings simultaneously, such that South Korea with Japan and South Korea with China, and then integrate them together for the proposal to the top leaders of CJK. ROK was suggested to take a mediating role of initiating communications among the three countries of China, Japan and Korea.

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## **Agenda**

# **Round Table Workshop on Regional Financial Cooperation: Planning and Strategy for a Development Bank in Northeast Asia**

**Organized by**

**Northeast Asia Economic Forum**

**In Cooperation with**

**Korea Institute for International Economic Policy (KIEP)**

**Hosted by**

**Korea Federation of Banks.**

**On June 4 -5, Seoul, Korea**

**Venue: Korea Federation of Banks conference room**

**June 4**

**15:00 Preparatory Individual Consultations**

**18:00 Opening Reception and Dinner hosted by Former Speaker**

**Park Kwan Yong and Chairman Lee-Jay Cho**

**June 5**

**9:00 – 12:00 Morning Session: Opening and Review of Recent Developments**

**Lee Jay Cho, Session Chair**

**Summary of the Honolulu Teleconference on April 26 with Stanley Katz and others.**

**Country Perspectives of Recent Developments in Multilateral Development Banks with Reference to BRICS proposal for Development Bank: China, Japan and Korea**

**10:30- 10:45 Coffee Break**

**10:45- 12:00**

**Changing Role and Mission of the World Bank and Asia Development Bank and Review of Other Regional Banks in terms of their mission and performance**

**Discussants: Uhm Rak Yong, Lim Jung Duk, Lee Jaemin, Chang Jae Lee**

**Zou Ping, Maeda Takashi, Hong Jae Hyung and others**

**12:00 -13:30                    Lunch to be arranged**

**13:45- 15:45 Afternoon Session: Planning and Strategy**

**Byungwon Bahk, Session Chair**

**China: Zou Ping, Wang Xuzhu**

**Japan: Maeda Takashi**

**Korea, Lee-Jay Cho *et al***

**15:45-16:00 Coffee Break**

**16:00- 17:00 Open Discussions and Conclusion**

**18:00 Dinner hosted by Chairman Bahk Byungwon of Korea Federation of Banks**

#### **List of Participants\***

Park Kwan Yong, former Speaker of the National Assembly, ROK

Hong Jae Hyung, former Vice Speaker of the National Assembly, ROK

Che Wook, President of KIEP

Lee Chang Jae, Senior Fellow of KIEP and former Chair, East Asia FTA Joint Expert Group

Kim Jungsoo, Advisor, KIEP

Uhm Rak Yong, Non-Executive Independent Director, SK Telecom and former President, Korea Development Bank

Lim Jung Duk, Professor Emeritus, Busan National University and Chairman, Institute for City and Economy, Korea

Kim Jung Gook, Chairman, CEO, Korea Technology Guarantee Fund

Lee Jae Min, Professor, Korea Maritime University. former Vice President, Korea Exim Bank

Kim Jun Kyung, former Vice President, KDI and Professor, KDI School

Pae Wonkee, Professor, CPA, School of Business, Hongik University

Nakayama Taro, former Foreign Minister of Japan

Maeda Tadashi, Head, Corporate Planning, Japan Bank for International Cooperation and Special Advisor to the Cabinet, Japan

Wang Xuzhu, former Vice Mayor of Tianjin Municipal Government

Zou Ping, President, China API and former Director General, State Council China Development Center (CDC)

Zhang Jianbao, Director, Finance Division, Tianjin Municipal Government

Lee-Jay Cho, Chairman, NEAEF

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## **Appendix C: 2012 Northeast Asia Economic Forum Annual Conference**

The twenty-first Northeast Asia Economic Forum on Functional Cooperation and Financing Economic Integration was held in Chengmai, Hainan, China, September 6-7, 2012

Organized by the Northeast Asia Economic Forum and the Research Center for Financial Cooperation in Northeast Asia; Cooperating Institutions: Korea Institute for International Economic Policy, Korea Telecom, Korea International Trade Association, Korea Asia Pacific Institute, College of Social Sciences, University of Hawaii at Mānoa, China Association for Social & Economic System Analysis Research, Tianjin Municipal Government, Nankai University,

### **The Hainan Declaration**

**7 September 2012**

The Northeast Asia Economic Forum (NEAEF), in partnership with the Research Center for Financial Cooperation in Northeast Asia and the Asia Pacific Institute of China, convened the 21<sup>st</sup> annual NEAEF meeting in Chengmai, Hainan, China, on 7 September 2012. Representatives from the People's Republic of China, Japan, Republic of Korea, Mongolia, the Russian Federation, the United States and the European Union met to take steps toward greater cooperation and integration among Northeast Asian nations. Hainan—the beautiful island of longevity in China, and a province whose rapid growth is being driven by a desire to modernize and promote tourism—served as an exceptional setting for discussing existing and new opportunities for Northeast Asia.

This year's annual conference added to twenty years of significant accomplishment in the NEAEF, through the annual meeting process, and continued its vision for a peaceful and prosperous Northeast Asia through regional economic cooperation and development. Much of the discussion in the Forum looked to the future and emphasized the need for Japan, Korea, and China to find the political will to work together on establishing the Northeast Asian Bank for Cooperation and Development (NEABCD).

The annual conference provided marked progress toward a common goal of regional integration through productive discussion of vital themes within the Forum's sessions. The specific sessions focused on Financing Infrastructure Development in Northeast Asia, discussion of a Proposal for the Northeast Asian Bank for Cooperation and Development, and Energy, Environment and Cross-border Infrastructure.

An energetic opening ceremony included the welcoming remarks of Jiang Zhenhua, the former Vice Chairman of the Standing Committee of the People's Congress, PRC, which underscored the importance of cooperation in Northeast Asia and the need for such cooperation to extend beyond mere economic relations. In his statement the Vice Chairman supported the work of the Northeast Asia Economic Forum in promoting Northeast Asian cooperation,

especially the work of pursuing a Northeast Asian Development Bank. Remarks were also delivered by representatives of Japan (Kaifu Toshiki, the former Prime Minister of Japan, delivered by Ozaki Michio of JOICFP) and the USA (George Ariyoshi, Honorary Conference Chairman and former Governor of Hawaii). Additionally, there were keynote speeches from Bahk Byungwon, Chairman of the Korea Association of Banks and former Senior Advisor to the President of Korea, and Jin Liqun, Chairman of the Supervisory Board, China Investment Corporation and former Vice Minister of Finance, jointly with Zhang Zhixiang, former Director General, Asian Development Bank and former Executive Director of the International Monetary Fund.

The first session on Financing Infrastructure Development in Northeast Asia featured high-level presentations starting with Maeda Tadashi of JBIC on the countries' perspectives of the Northeast Asian Bank for Cooperation and Development (NEABCD) as well as discussion of past and future efforts of financial cooperation. Commentary focused on functional cooperation and development. Commentary also focused on the need to have mutual trust and to overcome political and cultural barriers in order to move ahead in the future.

The second session was a discussion of a proposal for the NEABCD. Forum participants reviewed and summarized the progress of promoting the establishment of the NEABCD in recent years, and highly appreciated the important contribution made over the years by the Northeast Asia Economic Forum. Participants considered that, despite the impact of the world financial crisis and the European debt crisis, the need to pay close attention to the establishment of the NEABCD remains unchanged. The NEABCD and the Asian Development Bank have different characteristics and missions. Therefore, the NEABCD will help promote economic prosperity and sustainable development in Northeast Asia. There were also recommendations that China take strong leadership and create a short-term roadmap to promote the establishment of the NEABCD:

First, the Northeast Asia Financial Cooperation Research Center should incorporate the recommendations of today's meeting, and make a new research report as soon as possible. At an appropriate time, the Northeast Asia Economic Forum will hand over the report to the central governments of China, Japan and Korea for consideration. Second, it is suggested that the Chinese, Japanese and Korean members of the Northeast Asia Financial Cooperation Research Center should work actively to persuade their countries' central governments to support the establishment of the NEABCD. Third, the central government of China, or of Korea or of Japan should be the first to propose the establishment of the NEABCD, and make it become a major topic of the China, Japan and Korea Summit in 2013.

The third and final session on Energy, Environment and Cross-border Infrastructure featured information about "smart" technology, the importance of reducing carbon dioxide emissions, and the benefits of renewable energies and green growth strategies.

A major theme that the participants discussed throughout the conference is the important shift of discussing details, especially in the area of financing, as a method to move from generalizations about Northeast Asian cooperation to implementable functional cooperation.

Forum participants expressed appreciation for the support provided by the Freeman Foundation and other cooperating institutions for the Young Leaders Program, now in its seventh year, which features Fellows from the People's Republic of China, Japan, Republic of Korea, Mongolia, the Russian Federation, and the United States. The Fellows' attendance contributed to the Forum's goal of ensuring a long-term future of cooperation and integration in Northeast Asia.

The NEAEF expressed its gratitude to the Research Center for Financial Cooperation in Northeast Asia and the Asia Pacific Institute of China for hosting and providing generous support for the Forum's annual conference in Hainan. The NEAEF also expressed its gratitude to the Korea Institute for International Economic Policy; The Freeman Foundation, the College of Social Sciences, University of Hawaii at Manoa; China Association for Social and Economic System Analysis Research; Tianjin Municipal Government; Korea Telecom; Korea International Trade Association; Korea Asia Pacific Institute; Hitachi; Japan Electric Power Information Center; Nankai University and other cooperating institutions for their assistance with the Forum conference and the Young Leaders Program in Hainan.

## **Keynote Speech**

**Bahk Byungwon** presented his thoughts in his keynote speech. Since the outbreak of the global financial crisis in the US in 2007 and the subsequent European sovereign debt crisis in recent years, the world economy has been in a great turmoil. Once the leaders of the world economy, the western countries are suffering heavily from the crises.

China, Korea, and Japan have long depended on exports from the US and European Union for growth, but this is no longer possible. They will need to focus their policy efforts on increasing domestic demand within their own countries. Accounting for roughly 20% of the world's GDP, the three countries are expected pave the way for global economy recovery. Compared to the advanced economies of the western countries, they still have the potential for resilient economic growth. These are compelling reasons to find new sources of economic growth within the three countries.

Increasing the share of intra-regional trade between China, Japan, and Korea is desirable, because there will be less dependence upon outside markets. Currently, there are no established bilateral or trilateral FTAs.

The growing need for institutional economic cooperation, created the first trilateral summit meeting, which took place in Fukuoka on December 2008. In the fifth Trilateral Summit Meeting of 2012, leaders of the three countries agreed to launch the CJK FTA negotiation within this year. China and Korea began negotiations for a bilateral FTA, but negotiations between China and Japan and Korea and Japan have not shown much promise.

The establishment of a new regional international development bank, the Northeast Asian Bank for Cooperation and Development, should not be delayed any longer. Many natural resources and agricultural production are available in Mongolia, Siberia, and former Manchuria. Investments in development of these resources and in social overhead capital (SOCs) to make the output by these development projects accessible to the world market will contribute to the global stabilization of resources prices, the increase of demand of this area, and ultimately to the recovery of the world economy. Is there any other project that can better contribute to the world economy in a shorter period of time?

What is missing in this region are SOCs to tap these vast possibilities. This is the reason why a new international development bank such as the NEABCD is indispensable. We need it not because of a lack of money to invest, but in order to secure economic cooperation and political and diplomatic guarantees. Is there a better tool to meet this goal other than the NEABCD?

There have been discussions on the necessity of this Bank for the past twenty years. It would not be possible without the persistence of Dr. Lee-Jay Cho. The global economic situation has strengthened the justification for the establishment of the Bank.

The political will of the three countries is now more important than ever. Political leaders will need to direct attention to increasing domestic demand. It is time for one of the three countries to take the initiative in establishing the Bank.

**Zhang Zhixiang**'s keynote presentation was titled "Toward the Northeast Asian Bank for Cooperation and Development." **Jin Liqun** is abroad on a mission and was unable to attend the conference to deliver this speech.

It is well recognized and accepted that financial cooperation in Northeast Asia is very important and the region supports the need for a new financial institution to help meet the requirement in financing future infrastructure development. A large amount of research on the necessity and feasibility of establishing the new financial institution, namely the Northeast Asian Bank for Cooperation and Development, has been conducted.

There is a consensus that the new proposed development bank will strongly help support regional peace, development, and economic cooperation by providing funds to meet supply and demand.

Challenges include the political situation in Northeast Asia, implementing obstacles, and opponents arguing that the Asian Development Bank (ADB) is already sufficient for sub-regional development.

Because the NEABCD has a different mission and functions from the ADB, it will complement and foster collaboration with the ADB instead of the fear that it will simply be another repetitive form of the ADB. The proposed bank will play a pivotal role in regional economic development for the following reasons.

The two approaches in infrastructure development are: 1) a bottom up infrastructure development approach that aims to eliminate poverty in a given geographic area and 2) an approach that aims to support national economic development. The main difference between the two approaches is that the first makes poverty reduction its first priority, while the second addresses economic development in terms of higher gross value-added.

All current multilateral financial institutions, such as the World Bank, the UNDP and the ADB that have in depth involvement in regional and sub-regional projects, adopt the first approach. But the Northeast Asian region, according to its economic development needs and effects, require the approach beyond the bottom-up and pursue large-scale economic development. With this mission, the proposed new bank would better serve the countries in the region.

The differentiating functions of the NEABCD will include financial support of cross-border infrastructure projects, providing better positioning in mobilizing private resources, training and improving the quality of human resources for countries within the region, promoting mutual understanding and cooperation amongst Northeast Asian countries, providing the ability to focus on green growth and energy related projects, and fostering an exchange of advanced technologies and ideas.

Existing institutions may not be in favor of a new emerging institution, because they feel they might be adversely affected. However, the new institution will not be a rival but a good collaborator. Sub-regional banks and regional banks have different missions and functions and both are necessary for healthy economic development in the region. The Andean Development Corporation, Nordic Investment Bank and West African Development Bank have provided us with excellent examples.

Once the new bank is established, China, Korea and Japan will most likely benefit from it. As an emerging country, China hopes to contribute more to the region and the world and the new bank would provide China with such an international stage. Korea could use this bank to increase its international influence, while Japan could benefit from the projects sponsored by the new bank, since the ADB mainly supports less developed members.

Now is the time to make critical decisions with the new bank in mind. There is a need to develop a new stage where discussions and policy suggestion at the level of NGOs and local governments should be replaced by a higher level of decision making by the central governments. Ministry-level discussion and dialogues are necessary in the next step. Officials from China and Korea should help pave the way by starting early and ensuring procedures are in place.

## **Session 1: Financing Infrastructure Development in Northeast Asia**

**Tadashi Maeda** presented “Perspectives on the NEABCD: Northeast Asian Bank for Cooperation and Development.” Both trade volume and gross domestic product (GDP) have been growing in Northeast Asia. Trade volume has grown tremendously from a little under \$200 billion USD in 2001 to over \$800 billion USD in 2011, which about four times in ten years. It is imperative to establish the infrastructure required to facilitate regional economic integration. A financial cooperation scheme, namely the NEABCD, to support such an effort is a necessary requirement. An abundance of energy and mineral resources and large scale economies from the surrounding region, which account for one-fourth of the World’s GDP needs to be effectively utilized. Economic integration could help further develop inter-regional trade and shared energy and logistical infrastructure.

Areas to be potentially addressed by regional cooperation include energy, recycling ports, Pan Yellow-Sea economic, and New Eurasia land bridge.

Mr. Maeda presented perspectives on NEABCD from existing examples including regional cross-border projects, involvement of municipal governments, catalytic role to mobilizing private funds, donor countries prospering from projects, prioritizing environmentally focused projects, and a huge potential for energy related infrastructure.

**Jae Hyung Hong** gave a presentation on the Northeast Asian Bank for Cooperation and Development. He prefaced his presentation by highlighting the widening development gap and tension between the countries in the Northeast Asian region, as well as the resilience and strong economic performance Asia has shown in the wake of the global economic crises. Northeast Asia, one of the largest and most populated areas in the world, comprises a diverse group of countries, characterized by wide gaps in economic development.

Challenges that result from a lack of sufficient regional transportation, telecommunication, and energy infrastructure hinder economic cooperation and integration of this otherwise high-potential region.

Infrastructure investment can promote connectivity among the regional countries, and regional integration can be achieved by bridging the development gap. Also, infrastructure investments for developing abundant energy sources in the region have the potential to reduce high levels of external energy dependency.

Lastly, greater infrastructure investments would catalyze economic development, and in turn, reform an opening of the less developed sub-regions like North Korea, and contribute to peace and stability of the entire region.

## **Commentators:**

**Chang Jae Lee** commented that there is a need to develop a report on the cross border infrastructure projects that have been successfully proposed, initiated and being implemented, projects that are pending, projects that have failed, and projects being planned for the future. The discussion of these categories of projects will be helpful in the design for the Development Bank that would outline the content and function of the bank oriented towards the future.

**Ma Junlu** presented “Northeast Asian Bank for Cooperation and Development: A New Mechanism for International Cooperation.” The countries of Northeast Asia need to financially cooperate in the form of a sub-regional development bank. Successful past examples include the Shanghai Cooperation Organization Development Bank, BRICS Development Bank, The China-ASEAN Inter-Bank Association, and the China-ASEAN Investment Cooperation Fund.

Large potential gains will emerge with cooperation including Free Trade Agreement (FTA) negotiations between China, Japan, and Korea; oil pipeline infrastructure collaboration among Northeast Asian countries; and cross-border projects involving bilateral or multilateral efforts. The dynamic of cooperation will improve through minimizing unexpected risks, increasing the Northeast Asian regional influence throughout the world, strengthening trusts among Northeast Asian countries, serving as a supplement to the Asian Development Bank and World Bank systems, and providing a successful example for other proposed institutions.

If a research center for Financial Cooperation in Northeast Asia is developed, it will allow research to be conducted on the Northeast Asian Bank for Cooperation and Development (NEABCD), provide background for government officials, and provide basic training programs for future NEABCD.

**Li Kotetsu (Gang-Zhe)** presented “The Great Changing Environment of Northeast Asia Economic Cooperation Environment and New Strategy for Financial Cooperation.” The environment for economic cooperation in the Northeast Asian region has changed dramatically over the last twenty years. The past ten years have seen a significant rise in economic power in this region. The Chinese economy, which overtook Japan as the second in the world, is the driving force behind this rise.

Other geopolitical changes in Northeast Asia international relations include the start of the three countries summit (Japan, China, and Korea) in 2008 and the Shanghai Cooperation Organization, which greatly strengthened the collaborative relationship between China and Russia. Other changes include China’s strategy change in the Tumen River Region development and changes in private capital flow (FDI) in the Northeast Asian region.

A two-step strategy will be necessary to promote Northeast Asian economic cooperation. It will begin with strengthening the cooperation framework among Japan, China and Korea through development of mutual trust and as a second step, including North Korea, Mongolia, and Russia as cooperating partners.

In order to promote the NEABCD, Japan, China and South Korea must establish a Northeast Asian Economic Cooperation Foundation (NEAECF) through the CJK summit. Countries including Russia, Mongolia, North Korea, and Hong Kong should be invited to participate in the foundation. Using the NEAECF as a base, the NEABCD can then be established.

Because of its political and economic power, China will need to take leadership in promoting the NEABCD in order for it to succeed. In addition, the NEABCD will need the support of South Korea and Japan.

**Nakano Tamotsu** complimented the NEAEF for initiating the proposal for NEABCD and past efforts – it is like creating a sound UN for the region for peace and economic development.

## **Session 2: Panel Discussion on Proposal for the Northeast Asian Bank for Cooperation and Development: Plans for Future**

**Zhang Xiaoyan** presented his thoughts. He believes that in the future, communication with special departments by informing them of new ideas and concepts, will direct government attention to promoting civil society research.

What should we do in the next step? We have to have a plan. Promote this thing, make research on NEA BCD. We should make roadmap. 3 years ago we made a roadmap. Very good ideas were there. Leaders from state council and department to the establishment of bank, central bank, ministry of commerce and from China leaders had positive attitude on this issue. First suggestion is to make short-term roadmap set up the bank. And then action plan. Procedures, specific steps, goal in short-time is that we can try our best bilateral trilateral agreements in 3 countries. CJK summit our topic should be proposed, then have feedback.

Methods: Role of NGOs, experts, scholars are high. Also the Northeast Asia research center and NEAEF. Research center should provide research results. From this meeting now on, after the meeting, all the people should start work. Report should be systematic, problem oriented, prioritized.

Secondly, it should be proposed to new governments. I think we should work to bottom to up, up to bottom. NEAEF can be the initiator. This Forum has a way of building networks.

Third, Our Tianjin municipal government will always support, never give up in terms of establishing a bank, and will give full support in research center in Tianjin. The Tianjin municipal government will communicate with central government, report to them, and gather support for establishing the Bank.

In conclusion, considering all the factors, a champion to initiate this will need to be determined.

**Zhang Zhixiang** commented that so much has been achieved in 20 years. He agrees there should be a mechanism to ensure better results. It should concentrate on action items to move forward this concept in to a new stage. A report detailing the steps is crucial.

**Zhang Jianping** presented “NEA Macro-View and Strategic Approach on NEABCD.” In the past ten years, both Japan and Korea’s dependency on exporting to China has increased gradually and largely so if compared to the declining percentages being imported from China. Although some progress and discussion has ensued, there are still many barriers to a Free Trade Agreement (FTA) and Northeast Asian Bank for Cooperation and Development (NEABCD) including security concerns, changing political leaders, frequent military drills, a worsening diplomatic atmosphere, increasing territorial disputes, and differences between countries.

Coupled with these barriers is the hesitancy from Japan and unclear official attitudes from both Japan and Korea.

One practical approach to the NEABCD discusses a Northeast Asian Banks Association as the first step, which is a more practical feasible and effective channel for sustainable development and financing major trade and investment projects. This could be a crucial stepping stone leading to the desired goal of a NEABCD.

The Shanghai Cooperation Organization Banks Consortium is a successful example. Established in 2005, its priorities include manufacturing, infrastructure, agriculture, and the environment.

In order to achieve a similar outcome and gain cooperation toward the NEABCD, support from central and local governments, cooperation with GTI framework and platforms, planning action in the short term and a new study on the strategic view for mid to long-term are required.

**Maeda Tadashi** commented that leadership and focus are pertinent. He hopes to see more cooperation from Korea and Japan. He feels that China is always the one with the initiative pertaining to this situation.

**Hong Jae Hyung** expressed three points. He noted that changes in the near future hinge on political circumstances. There are elections taking place in the US, China, and Japan this year that need to be closely followed. Political leaders are busy dealing with elections and both the European and world economic crisis thus having no time for long-term projects. They continue to aim for peace and prosperity with this NEABCD.

History reveals that central governments need to support and show a strong initiative for this project. Suggested parties to do so include the central bank of China, the ADB, and the Japanese government.

Both multilateral and bilateral approaches are necessary. A multilateral approach will support borrowing funds from Europe, American, and Japanese bankers, investors, and financial monetary markets, to name a few.

**Zou Ping** believes that progress can be made. He believes the Chinese government is cautious in terms of the Eurozone and financial crises. There needs to be more discussion, which generates research reports to be submitted for new government representatives, which will increase their confidence in what is being proposed.

### **Session 3: Energy, Environment and Cross-border Infrastructure**

NEAEF's third session had four presentations about energy, environment, and cross-border infrastructure, chaired by **Steve Cowper**, the former governor of Alaska.

Before session three presentations, **Steve Cowper** noted that there have been quite a number of changes over the last few years that have had an effect on Northeast Asia's energy supply and demand.

Today, the US is increasingly reliant on its own oil resources. Reliance on other countries for oil is significantly reduced due to new and advanced oil recovery techniques. The US is now completely self-reliant on natural gas and will become a net exporter as soon as delivery systems are built and operated. We may see a quick transition to natural gas for electricity production and generation. A lot of progress is being achieved in non-emissive ways of generating electricity.

**Masahiko Yamaguchi** presented “Hitachi’s Smart City Business,” a model, in which the use of energy in urban areas is optimized and managed by IT control centers.

Hitachi has been working on developments ranging from social infrastructure such as energy, transportation, and water, to life infrastructure such as finance, medical, and education. The company believes that establishing new services through enhancement of each systems and building linkage among them will become of particular importance in realizing a Smart City.

Mr. Yamaguchi explained Hitachi’s basic model of the City Management System, which included three aspects, “supply”, “demand”, and “storage.” Power sources, vehicles, and water treatment make up the “supply,” while people, goods, and facilities encompass the “demand” and lastly the “storage” includes batteries, stations, and reservoirs. Management control, smoothing and stabilization will balance the supply and demand.

All three aspects will be harmonized through IT bringing about total optimization where people will not have to wait long for trains and where water usage will be controlled as to preserve water resources efficiently.

The technologies applied in Smart cities include the smart grid, home energy management systems, community energy management systems, smart mobility including EV utilities and traffic hub solutions.

In a Smart Grid, data will be collected from each base such as power plants and transmission systems. They will run simulations and produce countermeasure to estimate stability under a variety of possible scenarios. A generator control will be implemented in case of grid fault.

A home energy management system will provide a comfortable and ecological lifestyle by using data and linking electrical appliances, home energy fixtures, new energy equipment, and portable terminals within the network. Energy management will be carried out on a community level.

The Community Energy Management System is composed of Distribution Energy Management System and Demand Side Management, along with the existing distribution system. The Distribution Energy Management System controls power voltage and the Demand Side Management controls the needs of the demand side facilities to equalize the power load. It is estimated that various types of Electric Vehicles such as small size carts, cars, buses will be used in the next generation environmentally friendly cities. Since it will take some time to charge electricity into EVs, in order to utilize EVs as major urban transportation, they should be efficiently charged between operations. The infrastructure system will be a key player here. An ecofriendly and stable power supply and demand can be realized in cities by leveraging natural energy and EVs.

Hitachi’s on-going Smart City projects worldwide include advanced smart grid in Hawaii, smart community in Spain, Tianjin Eco-city, Dalian Eco-city, and Rental EVs in Okinawa.

In conclusion, Hitachi is promoting a city where people come together and enjoy a comfortable lifestyle. Hitachi will continue providing various services through cutting-edge technology and knowhow.

**Yoshiki Iinuma** presented “Economics of Renewable Energy in Japan,” an overview of the economics of the various renewable energy sources in Japan, focusing on technical feasibility, capacity factor, and liberalized energy costs.

In 2009, renewable energy sources made up 13 percent of the world's total primary energy supply and of that 76 percent were from bio fuels and waste. The other renewable energy sources include hydropower, wind, solar/tide, and geothermal.

Renewable energy makes up 12 percent of China's energy, 3 percent of energy in Japan, Mongolia and Russia, 1 percent of Korea's energy, and 5 percent of energy in the United States. Perceived renewable benefits include a pollution-free environment, energy security, price stability, and job creation. Some examples of using renewable energy throughout the world include the Walney 1 Offshore Wind Farm in the UK and the use of Photovoltaic (PV) panels at the Tokyo Institute of Technology.

The attributes of renewable energies in Japan were described. PV has an unstable output and it requires back-up power. However, it may contribute to meet peak demand and the system costs have been gradually decreasing. Wind power is also an unstable output, which requires back-up power and produces excess power at night. Hydropower is a stable power source with a high capacity factor. Only small and medium hydro potential remains in Japan. The liberalized cost estimates of renewable energies, in order of increasing costs per kilowatt hour are geothermal, wind (2010), wind (2030), residential PV (2030), offshore wind and residential PV (2010).

Geothermal energy is also a stable power, but development risk is very high. Biomass, another stable power, has a thermal efficiency lower than fossil-fuels. Both geothermal and nuclear energies are sensitive to the capacity factor and when the capacity factor increases, so do costs.

Public policies on renewable energy in Japan include Renewable Portfolio Standard (RPS), Feed-in Tariff (FIT), Feed-in Premium (FIP), Production Tax Credit, and Investment Credit.

In conclusion, the century of oil and gas is over. It is now time to concentrate on the energy mix.

**Zhang Jianping** called for multilateral cooperation in energy issues in this presentation. Particularly, he proposed the creation of technology transfer centers, so that countries in Northeast Asia can mutually benefit and develop and implement new green technologies to extract energy resources.

The energy cooperation in the region is growing as demonstrated in examples of the electric hydropower in Russia being transferred to Northern China and multilateral gas transmission projects. China is currently negotiating natural gas prices with Russia, but it's difficult for China to accept gas from Russia because of high prices. The negotiations on natural gas projects are in trouble.

Discussion between Mongolia and China and Mongolia and Japan are crucial. What about investors? Coal exploration? It may be an option to promote more energy cooperation in Mongolia using traditional energy resources.

It is possible to promote renewable energy in this region. For example, shale gas in the United States has already become a commercial realization. This is an energy revolution allowing the US to effectively reduce its international reliance on oil. In the past, the US needed to import natural gas, but now the US will become a net exporter instead. It's very difficult, however, to export and to make it a commercial realization. This is a good lesson for China. China needs to improve its technology and build its human resources in this field as well as its technological level to consume shale gas. The NEAEF can foster multilateral energy cooperation among Russia, Japan and China.

China is proud of its current wind power capacity and production. It has the greatest wind power capacity in the world. The motto of the next 5 year plan in China is focused on saving energy and reducing pollution emission.

Currently, China hasn't achieved the key marks for pollution emission reduction and energy saving. In the next few years it will be more difficult to achieve initial levels. Sustainable development and green development in China needs to be communicated. A technology exchange information center needs to be established, and advanced countries need to participate in order to support developing countries.

**Jeong Shik Shin** presented “Green Growth: Korea’s Vision and Strategy.” He advocated for a green growth paradigm shift and described how Korea is leading the world with its Green Growth Strategy in order to achieve a low carbon society, energy security, new engine for growth, and improve the quality of life.

Climate change and the economic crisis are two global challenges that were highlighted and can be addressed by the proposed Low Carbon Green Growth Paradigm. This virtuous model relies on high energy efficiency, low fossil fuel dependency, and green growth in order to break the vicious cycle of poverty, global warming, dependence on fossil fuels and unsustainable economic growth.

The positive results are long-term, but opponents cite short-term burden and costs as reasons to not proceed. In order to effectively move forward, a government-backed policy is necessary to support these efforts and to both minimize short-term burden and maximize long-term gains.

Green Growth is necessary to move in the right direction since change is eminent. Green growth is declared Korea’s new development vision. This began with the vision of President Lee Myung-bak in August 2008. The last 60 years were “brown” growth and the next 60 years will need to focus on green growth. Green growth brings prosperity and elements include improvement in the quality of life, green energy paradigm, and contributions to the global community.

Milestones in green growth for Korea include the 2009 launching of the Presidential committee on Green Growth and announcement of the National Green Growth Strategy and Five-Year Plan for Green Growth (2009-2013) in 2009.

There are many plans underway to continue investment in green growth. The Green New Deal is expected to create 0.96 million jobs, the Four Main Rivers Restoration project has the potential to secure water, prevent floods, create water-friendly public spaces, and promote river-side community development, and the Smart grid test bed on Jeju island is expected to create a nation-wide smart grid by 2030.

The business community has joined in the efforts with proposed investments by Samsung Electronics, LG, and POSCO. From 2008-2010, the business sector has seen a 48 percent increase in green investments, with the highest priority focusing on PV.

Korea’s aspiration is to be a leader in the international effort in creating a global green growth initiative, which includes knowledge sharing, technology-sharing, and policy leadership. Challenges include garnering continued support from both the public and business community. Future tasks include shifting to a green economy and society structure, strengthening foundations for green industry development, and enhancing international green growth leadership.

**Mitsuo Uchida** commented on the section by highlighting the increasing global

energy and environmental risks. The world energy demand will continue to increase due to the large and growing populations of emerging countries. China is the largest consumer of energy consumption, electricity generation and CO<sub>2</sub> emissions, while India ranks fourth in energy consumption and third in CO<sub>2</sub> emissions. We may witness oil shocks in the near future as our fossil fuel dependency on Asia rises.

The triple challenges of the 21<sup>st</sup> century energy policy are making substantial reductions in greenhouse gas emissions, while ensuring a secure supply of energy, all at reasonable costs to the economy in order to promote competitiveness in the globalizing world. The road to reducing CO<sub>2</sub> emissions consists of lowering the dependency on fossil fuels, increasing use of natural gas and nuclear energy, boosting energy efficiency, and reduction in economic growth.

Electricity's importance in solving the challenges include potential advances in power generation technology and advances in efficient electro-technologies such as heat pumps and the potential of electricity in transportation, which will both help reduce CO<sub>2</sub> emissions and bolster energy supply security.

Renewable energy is continually innovated and more technical progress is necessary to provide more stable forms of alternative energy. Solar and wind power are unstable and should be separate from existing grids.

Nuclear power generation is an essential part of the portfolio for carbon-free generation. While 13.5 percent of the world's electricity is produced by nuclear power stations, the Japanese government is looking to decrease its nuclear energy use following the recent Fukushima earthquake.

Will nuclear energy be replaced by NES? Currently, the elimination of nuclear power plants cannot be achieved soon. In the short run, there is no choice but to switch to thermal power using natural gas, and the amount of natural gas produced has sharply increased with the established technology of extracting gas from shale in the US.

There are huge natural gas fields near the Northeast Asian region. Fuel-cell cogeneration systems using natural gas installed in commercial complexes, homes and other facilities, could improve energy efficiency dramatically while CO<sub>2</sub> emissions drop. Clean natural gas is a desired choice for back-up generation systems in solar and wind power.

Development in international energy trade has begun in the European Union and between the US and Canada. A Northeast Asian energy community can be initiated if there is an integration of infrastructure in energy, transport, and communication between the Northeast Asian countries. This will also require encouragement of entrepreneurship and investments leading to economic prosperity in the region. Barriers will include difficulty in funding the infrastructure investment and the diversity of the region where the member economies are at different levels of development.

Despite the difficulties, the Northeast Asian region should make the development of infrastructure linkage one of its primary goals.

# AGENDA

Venue: West Coast Resort Hotel, Yingbin peninsula,  
Chengmai, Hainan, China

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Thursday, September 6, 2012

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All day check-in

**18:30 Reception Dinner**

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Friday, September 7, 2012

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**8:30-9:00 Opening Ceremony**

Chair: **LEE-JAY CHO**, Chairman, Northeast Asia Economic Forum

**Welcoming Remarks:**

**JIANG ZHENGHUA**, former Vice President of the People's Congress, China

**Remarks by Country Representative:**

**KAIFU TOSHIKI**, former Prime Minister of Japan

**HONG JAE HYUNG**, former Vice Speaker of the Korean National Assembly and Deputy Prime Minister for Economic Planning, Korea

**GEORGE ARIYOSHI**, Honorary Conference Chairman and former Governor of Hawaii

**9:00-9:30 Keynote Speech**

**BAHK BYUNGWON**, Chairman of Korea Association of Banks and former Senior Advisor to President of Korea

**JIN LIQUN**, Chairman of Supervisory Board, China Investment Corporation and former Vice Minister of Finance and **ZHANG ZHIXIANG**, former Director General, Asian Development Bank and former Executive Director of the International Monetary Fund.

**9:30-9:45 Coffee Break**

**9:45-12:00 Session 1 Financing Infrastructure Development in Northeast Asia**

Co-chairs: **LEE-JAY CHO**, Chairman NEAEF and **WANG SHUZU**, former Vice Mayor of Tianjin City; former Vice-chairman of the Standing Committee of the People's Congress of Tianjin City; Executive Vice Chairman, Board of Directors, Research Center for Financial Cooperation in Northeast Asia

**TADASHI MAEDA**, Head, Corporate Planning Department, Japan Bank for International Cooperation and Special Advisor to the Cabinet, Japan

**JAE HYUNG HONG**, former Speaker of the Korean National Assembly

**ZOU LIXING**, Senior Researcher and Vice-President, Institute of Research at China Development Bank

**ALEXANDER GORYUNOV**, Deputy Director, Economic Research Institute, Far East Branch, Russia Academy of Science, Russia

**Commentators:**

**CHANG JAE LEE**, Senior Fellow, KIEP,

**MA JUNLU**, Professor, Nankai University,

**LI KOTETSU**, Professor of Economics, School of Future Learning

**NAKANO TAMOTSU**, Chairman of Nakano Associates, Japan

**GLYN FORD**, Former Chair, Asia Committee, EU Parliament

**12:00 -13:15 Lunch**

**13:15-14:30 Session 2: Panel Discussion on the Proposal for the Northeast Asian Bank for Cooperation and Development: Plans for Future**

**WANG JIANYE**, Chief Economist, Export-Import Bank of China

**ZHANG XIAOYAN**, Deputy Director, Tianjin Development and Reform Committee and Director, Research Center for Financial Cooperation in Northeast Asia

**TADASHI MAEDA**, Head, Corporate Planning Department, Japan Bank for International Cooperation and Special Advisor to the Cabinet, Japan

**BAHK BYUNGWON**, Chairman of Korea Association of Banks and Former Senior Advisor to President of Korea

**ZHANG JIANPING**, Senior Economist, Director, Department of International Regional Cooperation, Institute for International Economic Research, National Development and Reform Commission (NDRC)

**14:30-14:45 Coffee Break**

**14:45-16:30 Session 3: Energy, Environment and Cross-border Infrastructure**

Chair: **Steve Cowper**, Former Governor of Alaska

**Masahiko Yamaguchi**, the general manager in charge of external relations for Hitachi

**YOSHIKI IINUMA**, Director of Research Department, Japan Electric Power Information Center, Inc. (JEPIC)

**ZHANG JIANPING**, Senior Economist, Director, Department of International Regional Cooperation, Institute for International Economic Research, National Development and Reform Commission (NDRC)

**JEONG SHIK SHIN**, Member of the Presidential Committee for Green Growth Korea and former President, Korea Energy Economics Institute(KEEI)

**Commentators: MITSUO UCHIDA**, Professor, Chukyo University and Former Director, Central Research Institute of Electric Power Industry, Japan

**16:30-17:15 Closing Session**

Chair: **LEE-JAY CHO**

Summaries by Session Chairs

Hainan Statement

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**Saturday, September 8, 2012**

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Check out of hotel and departure from Hainan