

Research on the Establishment of The Northeast Asia Bank

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

1. The Analysis on Conditions of Establishing NEAB

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

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

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

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

Consequently, enormous funds will be needed in further energy cooperation and exploitation in Northeast Asia: USD100 billion on the project of natural gas; USD20 billion on the project of oil; USD8.4 billion on the project of water-supply and electricity. It is estimated USD150 billion

are needed to renovate and reconstruct the energy infrastructure in the Far East in the following 30 years.

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

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

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

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

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

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

1) Countries in Northeast Asia

Japan will be an important investor in the process of developing Northeast Asia. Meanwhile,

it is also the beneficiary of energy exploitation. Therefore, it needs a multilateral platform to shoulder the regional exploitation obligations and to realize its own interests. NEAB offers Japan such an opportunity.

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

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

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

2) Countries and Organizations outside the Region

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

The goal of the World Bank, UNDP, Asian Development Bank and other international organizations is to raise fund for global or local development. However, it is difficult to meet the needs of every country at the same time. NEAB will provide such organizations a long-term channel for investment in Northeast Asia, e.g. set up special fund managed by NEAB. This may help enhance their influence in the region and set up a good example for other sub-region development.

(iii) The Prospect of Northeast Asia Economic Integration

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

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

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

(iv) The Foreign Exchange Reserve in Northeast Asia

All parties of NEAB shall become shareholders only with the foreign exchange reserves provided with by their governments. Therefore the foreign exchange reserves of each country in Northeast Asia are a direct influencing factor determining the successful establishment of NEAB. The total foreign exchange reserves of all six countries in Northeast Asia reached USD2, 500 billion by the end of December, 2006, during which China exceeded Japan in the reserve amount in March, 2006 and becomes the No.1 country for its foreign exchange reserve. By the end of December, 2006, the total foreign exchange reserve in China reached USD1068.49 1billion, Japan reached to USD881 billion, Korea reached to USD238.882 billion, Russia reached to USD295.568

billion.

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

2. The Framework Design of NEAB

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

(i) The Theoretical Orientation of NEAB

1) The nature of NEAB

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

There are two following reasons:

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

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

2) Relations between NEAB and other multilateral financial institutions

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

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

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

(ii) Capital and Equity Ratio of NEAB

1) The total capital amount

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

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

0.5%. Therefore, NEAB's total capital amount will be USD40billion.

2) Subscription Approach

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

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

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

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

The detailed subscription approach is as followed:

- (a) Provided that NEAB's total capital is USD40billion, which will be raised by 4million shares will be subscribed, each worth USD10, 000.
- (b) NEAB's paid-up capital ratio required is 10%, i.e. the total paid-up capital will be USD4billion.
- (c) The paid-up capital shall be paid within a number of years. Half of the total

amount shall be paid with freely convertible currency (e.g. US dollar), the rest may be paid in domestic currency.

3) Design of equity ratio

(a) Principles of equity ratio

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

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

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

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

In designing such a ratio, the World Bank and other institutions use weighted average by taking into account of the three main economy indicators: GDP, Forex Reserve, and foreign trade volume. In selecting the economic indicators as reference for designing NEAB's equity ratio, on one hand we should consider the factors of GDP, foreign exchange reserves and foreign trade volume; on the other hand we should focus more on their respective growth rate which can show each country's investment capability, economy actuality, and its development potential and interest claim. All these are essential considerations in designing NEAB's equity ratio to each member country in Northeast Asia.

In designing such a ratio, we will take into account of the three main economy indicators: GDP, Forex Reserve, and foreign trade volume, and their respective growth rate. The method we use for calculation of such is **comprehensive weighted average**. The following table shows the equity ratio of each member country based on the statistics between 2000 and 2005. The final equity ratio percentage will be worked out and fixed through discussions mutual negotiations

Equity Ratio of Six Member Countries in NEAB

China	Japan	Korea	Russia	DPRK	Mongolia
30%	30%	14%	16%	4%	6%

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

(ii) Capital operation

1) Capital sources

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

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

2) Capital operation

At the start period of NEAB’s establishment, due to its small capital, the main field of capital use is operated by “agent” model, i.e. the project funds which are to be invested in Northeast Asia from other multilateral financial institutions are consigned to NEAB. The funds can be received and paid, managed, and used by the Bank according to the intuition’s instruction or special

purposes. The agent businesses include information technology services, loan transferable services and project consigned agent business, etc.

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

3. The analysis and suggestions for headquarters location of NEAB

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

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

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

China has made tremendous achievements since its economic reform and opening to the outside world. The market economy system is being established and its open economy rapidly develops. China has been preliminarily chosen as the world manufacturing base in the global work allocation system. What's more, China's FDI has continuously reached a high level around the world over the past few years. In the aspect of finance system reform, after entry into WTO, China has gradually fulfilled its finance opening policy and has made progress in its capital market reform and opening, banking and interest marketing reform, finance regulation system improvement, foreign exchange system and capital account reform, and financial market innovation, which will undoubtedly create a favorable economic and financial environment.

4. Appeals and Suggestions

As the scholar from China, I am very much honored to attend this splendid conference. I would like to use this valuable opportunity in the last part of my speech to appeal for and make some suggestions on the following:

- (i) To work out a Letter of Appeal which will be based on the common agreements reached so far by the Northeast Asian Economic Symposium during the 4th

special committee meeting, and present it to the governments of northeast Asian countries. In this letter, we will appeal for the support from all governments in preparing as much and as early as possible for the final establishment of NEAB, because it is a matter of interest to every country. NEAB will further deepen the regional financial cooperation; become a platform of internationally sub-regional development bank; and push forward the common development of every country in the region.

(ii) To suggest that the Northeast Asian Economic Symposium put forward an operation approach for pushing forward the regional cooperation, that is, a cooperative model which will be reflected as “ to be supported by non-government organizations; participated in by both government and non-government organizations; start off from the business already available and seek for new gradually; mutual beneficial and co-development”. We believe that the support from non-government organizations, especially the intellectual support from the research organizations is very important.

In order to make the research work on the possibility of establishing NEAB, and the preparation for establishing it be conducted in a sustainable way, I suggest that, on the basis of the regular meeting held by NEAB’s special committee, to set up NEAB’s Research Organization led by the Symposium. The authoritative people from China, Japan, and Korea will be tentatively invited as consultants to give guidance to the research and preparation work for the establishment of the bank, and provide with decision-making suggestions for the participation of the governments in the region.

Thank you very much for your time.