



# The Asian Development Bank

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## Summary

The Asian Development Bank (AsDB) is a multilateral development finance institution based in Manila, Philippines. The United States is a founding member of the AsDB and Congress periodically authorizes and appropriates funds for both the AsDB and Asian Development Fund (AsDF), the AsDB's concessional lending facility, through the annual State, Foreign Operations and Related Agencies appropriations bill. P.L. 110-161, *the Consolidated Appropriations Act, 2008*, provided \$75.153 million toward President Bush's 2008 budget request of \$115.3 million. This report will be updated as events warrant.

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## **Introduction**

The Asian Development Bank (AsDB, the Bank), founded in 1966 with headquarters in Manila, Philippines, is a multilateral development finance institution whose primary goals are reducing poverty and enhancing economic growth in Asia and the Pacific region. It seeks to accomplish these goals by extending project loans and grants, making equity investments, and providing technical assistance to its developing member countries (DMCs). Of the AsDB's 67 members, 48 are located in Asia. Of its regional members, 44 are classified as DMCs and are eligible to receive assistance.

The AsDB is owned by its member countries through the purchase of shares. The United States and Japan are the two largest shareholders of the Bank; each has a 15.57% share in the institution and 12.76% of the vote. The Bank's Articles of Agreement mandate that regional members maintain a majority of the Bank's total votes, a minimum of 60%. Currently, regional members have 65.04% of the vote. Share ownership (financial support) accounts for 80% of a country's voting power at the AsDB. The remaining 20% of votes is distributed equally among all members.

The president of the AsDB is Haruhiko Kuroda, a former advisor to Japanese Prime Minister Junichiro Koizumi on international monetary issues, who assumed the presidency in February 2005 following the resignation of Tadao Chino. On October 3, 2006, he was re-elected as President and began serving a five-year term on November 24, 2006. The Bank's Articles stipulate that the President shall be a national of a regional member country. By tradition, the AsDB president is Japanese.

Like other Multilateral Development Banks (MDBs), the AsDB's governing structure consists of a Board of Governors and a Board of Directors. The Board of Governors is the AsDB's highest policy-making body and is composed of one representative from each member country who casts the votes accorded that country. U.S. Secretary of the Treasury Henry Paulson serves as the U.S. representative on the Board of Governors, which meets at the Bank's annual meeting. The Board of Governors is responsible for the most important issues including selecting new members and determining the AsDB president. Day-to-day management of the Bank is delegated to the Board of Directors, which is in continuous session throughout the year. The Board of Directors consists of 12 members; eight are elected by countries in the Asia-Pacific region. Three countries have individual representation on the Board of Directors: the United States, Japan, and China. The remaining member countries are divided into voting groups that elect a representative to the Board. The President manages the staff of the Bank and serves as the chairperson of the Board of Directors.

## **Resources and Operations**

Like other MDBs, the AsDB relies on two types of resources: paid-in capital and callable capital. Paid-in capital represents funds held by the Bank and transferred to it by member countries who buy shares in the Bank (for votes). Callable capital represents promises of funds available to the AsDB by its member countries. Callable capital cannot be used to make loans. It can only be used to meet the AsDB's obligations to its bondholders if the AsDB ever lacks sufficient funds (on account of defaults, for example) to repay them the money it borrowed to fund its ordinary capital

operations. No call has ever been made on the AsDB's callable resources. The Bank has sufficient resources that lessen this likelihood. In FY2000, the United States, under the AsDB's latest multi-year general capital increase (GCI-IV), completed its commitment with a payment of \$13.7 million. Total U.S. contributions under GCI-IV were \$66.6 million of paid-in capital and \$3.264 billion of callable capital. For FY2008, the Bush Administration is not requesting any funding for the general resources of the AsDB.

The AsDB provides assistance for numerous projects ranging from economic infrastructure to social programs. The types of projects that the AsDB funds have changed over time. In its early years, from 1966 to 1971, 77% of funds were lent for economic infrastructure programs while only 0.5 % went for social programs. Since then, the share going to economic infrastructure has declined slightly, while funding for social programs has grown. However, transportation and other large infrastructure projects continue to account for the bulk of AsDB loans—almost 50%. In 2005, the AsDB provided \$7.4 billion of assistance to its member countries across all operations.<sup>1</sup> This included \$5.80 billion lent to public and private sector operations and \$1.15 billion in grant-based financing. The size of the AsDB's lending portfolio has increased slightly in recent years, but remains below peak lending, during the East Asian financial crisis in 1997, when its total operations increased to \$9.5 billion, mostly attributable to a \$4 billion financial sector program loan to South Korea.

The largest AsDB borrower in 2005 was China at \$1.5 billion. Other top borrowers were Indonesia (\$1.14 billion), Pakistan (\$776 million), and Vietnam (\$578 million). As reflected in its borrower mix, a string of natural disasters has driven the bulk of AsDB lending over the past few years. In response to the December 26, 2004 tsunami off the coast of Aceh, Indonesia, the AsDB launched the largest grants program in its history. As of December 15, 2006, AsDB's total approved assistance and co-financed funds for tsunami-affected countries stood at US \$891.24 million. Of this, \$724.34 million, or 81%, is grant funding. To help Pakistan rebuild following the October 2005 earthquake that killed over 70,000 people, the AsDB pledged over \$1 billion for reconstruction efforts. The AsDB has also played a central role in combating Avian Flu in the region.

## **China and the Future of AsDB Operations**

China has a unique relationship with the AsDB. With annual real GDP growth between 1979 and 2005 averaging 9.7%, China has emerged as a major economic leader in the region. China is the second largest regional shareholder (behind Japan) with 6.43% of total shares and 5.44% of the vote. Despite its rapidly growing economic resources, and expanding investments throughout Asia and Africa, China remains, paradoxically some argue, one of the AsDB's most important borrower countries. Cumulatively, China is the AsDB's second largest debtor. Since joining the AsDB in 1986, China has received \$16.4 billion in total assistance. Some critics argue that the AsDB, as well as the other development banks, should not lend to middle-income countries such as China that are able to raise capital on the private markets, or that have well-developed foreign investment programs of their own. Ceasing such lending, however, would deprive the MDBs of a major source of income, and force them to fundamentally change their focus and overall business strategy. A policy shift away from lending to middle-income countries and focusing exclusively on the needs of the poorest countries would also likely entail significantly increased levels of

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<sup>1</sup> The following data are from the 2006 Asian Development Bank Annual Report, April 2006.

MDB funding from donor nations to support MDB lending to their poorest member countries. Higher levels of MDB funding may be difficult given increased aid budgets constraints in the United States and other MDB donor nations.

The growing role of China as a source of development capital in Asia highlights an additional concern for many that AsDB assistance is not competitive with that offered by bilateral creditors and the private sector. Developing countries like Pakistan and Indonesia, once unable to access the global financial markets, can now access private capital relatively easily. China, and other emerging creditors, are increasingly providing development assistance without the environmental and anti-corruption standards that are a requirement for borrowing from the AsDB or other MDBs. In Asia, China is providing loans to several poorer countries including Cambodia, Laos, and Myanmar. The likely reasons for this boost in China's lending to its poorer neighbors are future gains from additional infrastructure in the region and the increased trade that it will be able to support. Reportedly, Cambodia's Prime Minister boasts that China's spring 2005 offer of \$600 million of loans to pay for two bridges near the capital, Phnom Penh, a hydropower plant, and a fiber-optic cable to create telecommunications links between Cambodia, Vietnam, and Thailand had "no strings attached."<sup>2</sup>

Furthermore, an August 2006 assessment of the Bank's market-rate lending, which drives a majority of the institution's operational finances, determined that the AsDB may "no longer be meeting the needs of its [market-rate lending] clients effectively."<sup>3</sup> AsDB clients raised several concerns including high costs for AsDB borrowing compared to other MDBs and the private sector; intrusive non-financial costs driven by shifting AsDB strategies and policies; limited variety of AsDB services; and, perhaps most distressing, concern regarding the potential "erosion of country and sector knowledge" at the AsDB.<sup>4</sup> These concerns, combined with increased competition for developing country debt, either from regional power-houses like China, or from private investors on the world's capital markets, have had a negative effect on the institution's finances. The AsDB's income from its market-rate lending and other AsDB investments decreased by 38% between 2001 and 2004. The Bank hopes to reinvigorate its lending to middle-income countries through several measures designed to decrease costs and ease constraints on borrowing. This may raise concerns among some Members of Congress that loosening constraints on borrowing may conflict with two MDB reform areas that have been of special interest to the Administration and Congress: increasing project oversight and greater reliance on performance-based lending.

## **The Asian Development Fund**

The Asian Development Fund (AsDF), the AsDB's concessional facility, was created in 1972 to provide loans to Asia's poorest countries. The AsDF is funded principally through periodic replenishments by donor nations. There have been seven replenishments since the AsDF was created in 1972. The most recent, AsDF-9, covers the years 2005 to 2008. Donors agreed to contribute \$7 billion over the four-year period, an increase from the \$5.7 billion provided during AsDF-8 (2001-2004). Japan maintains its position as the leading AsDF contributor in AsDF-9

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<sup>2</sup> Jane Perlez, "China Competes With West in Aid to its Neighbors," *New York Times*, September 18, 2006.

<sup>3</sup> Asian Development Bank, *Enhancing Asian Development Bank Support to Middle-Income Countries and Borrowers from Ordinary Capital Resources*, August 2006.

<sup>4</sup> *Ibid*, p. 13.

with \$1.18 billion pledged, followed by the United States with \$461 million, Australia with \$218 million, and the United Kingdom with \$202 million. Contributions from the Asia and Pacific region accounted for almost half of the replenishment. Contributions to the AsDF do not count towards voting percentages.

During the replenishment negotiations, the United States focused on several policy issues including the introduction of a grants facility, increased performance assessment of AsDB projects, and the introduction of performance-based allocations. In the agreement, the AsDB noted that grants are to represent 21% of total AsDF funding. Under the new \$7 billion AsDF-9 replenishment, donors pledged new contributions of \$3.2 billion, plus some additional voluntary contributions. The balance is expected to be met by additional contributions and/or internal AsDB resources. Donors also agreed to increase the weight given to good governance and strong policy performance in the system used to allocate AsDF resources to borrower (or grantee) countries; to increase resources for anti-corruption activities; and to establish a results management unit to oversee the implementation of a new results measurement strategy.

In November 2006, AsDF donor nations undertook a mid-term review of AsDF-9. According to the chair's summary, donors were generally happy with AsDF progress so far, but felt that implementation of the AsDB's results measurement initiatives, and overall "framework for managing for results" was too slow. This echoed comments made by U.S. Alternate ED Kenneth Peel at the 2006 annual meetings, "While there has been some progress, overall actual implementation of the AsDF IX commitments remains disappointingly slow. We appreciate the good work being done, such as the results-based country strategies, but want quantitative targets to be incorporated consistently in all projects and we need progress in implementing a new incentive system that rewards staff for development impacts, not increasing lending targets."<sup>5</sup>

## Congressional Action

Authorization for the United States to participate in AsDF-9 was included in the FY2006 Foreign Operations appropriations bill (P.L. 109-102), which also appropriated \$99 million (including a 1% across the board rescission) toward the Administration's FY2006 request of \$115.25 million for the first scheduled payment toward AsDF-9. The Bush Administration did not include an arrears request for FY2007, requesting again its scheduled contribution of \$115.25 million. FY2007 AsDB appropriations (and other Foreign Operations programs) operated under the terms of a continuing appropriations resolution (P.L. 110-5) which provided funding at the FY2006 level or the House-passed FY2007 level, whichever was less. Since the House passed the full presidential request of \$115.25 million on June 9, 2006 (H.Rept. 109-486), FY2007 AsDB funding were set at the FY2006 level of \$99 million. For 2008, the Administration requested \$133.9 million: \$115.25 million for the third scheduled contribution and \$18.6 million to pay a portion of arrears. P.L. 110-161, *the Consolidated Appropriations Act, 2008*, provided \$75.153 million toward this request.

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<sup>5</sup> Statement of Kenneth Peel at the Asian Development Bank Meetings, Hyderabad, India, May 4-6, 2006. AsDB Summary of Proceedings, p. 127.

## The AsDB Policy Agenda and Possible U.S. Concerns

In 1999, the AsDB initiated a major policy shift toward fighting poverty in the region. The Bank introduced a 15-year long-term strategic framework aimed at cutting the Asian population living in extreme poverty by 50% by 2015. The Framework defines three core areas of activity to reduce poverty in Asia: sustainable economic growth, inclusive social development, and good governance policies.<sup>6</sup> A poverty reduction unit has been set up and poverty studies have been completed for many developing member countries. As the first stage in its long-term poverty reduction strategy, the AsDB implemented a five-year medium term strategy covering 2001-2005, focusing on increasing sustainable economic growth in the region while also establishing social safety nets to ensure that growth is “broad-based and pro-poor.”<sup>7</sup>

In March 2006, the AsDB completed developing its second medium-term strategy, covering the years 2006-2008. In the strategy, known as MTS II, President Kuroda proposes further expanding the AsDB’s purview to include a wide array of new initiatives to promote greater trade and monetary integration in Asia. Proposed new AsDB efforts include cross-border transport and other physical connectivity activity, increasing regional trade linkages, and encouraging regional exchange rate and monetary policy coordination with the future goal of a single Asian currency.<sup>8</sup> President Kuroda has also renewed efforts toward regional monetary integration. In March 2006, prior to the AsDB’s 2006 annual meeting in Hyderabad, India, he announced his intention of creating an Asian Currency Unit (ACU), overseen by the AsDB. As envisioned, the ACU would be unit of account—comprised of a basket of regional currencies weighted by either exports or GDP shares—to support monetary integration efforts and to be used by financial market participants for regional settlement of payments and invoicing of trade transactions.

Kuroda’s AsDB agenda, while greeted warmly by China, Japan, and other major regional countries, raised concerns among the United States and other non-regional members who worry that the new strategy may divert the AsDB from its focus on poverty reduction and stray into policy issues that have traditionally been the purview of the International Monetary Fund. At the AsDB’s 2006 annual meeting, then U.S. Treasury Under Secretary Timothy Adams raised concerns about AsDB “mission-creep.”<sup>9</sup> Italy’s AsDB Executive Director commented that the “AsDB must remain firmly anchored to its vision of an Asia and Pacific region free from poverty.... All other strategic objectives must be pursued in ways that contribute to this goal.”<sup>10</sup> Although President Kuroda has denied that increased integration efforts will crowd out the AsDB’s poverty work, discord may increase between regional countries, and the non-regional countries, who are the primary contributors to the AsDF.

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<sup>6</sup> Asian Development Bank, *The Long-Term Strategic Framework of the Asian Development Bank*, AsDB Policy Paper, February 2001.

<sup>7</sup> See Asian Development Bank, *Medium-Term Strategy (2001-2005)*, September 2001.

<sup>8</sup> Jeremy Clift, “The Quiet Integrationist,” *Finance and Development*, International Monetary Fund, March 2006. Available at <http://www.imf.org/external/pubs/ft/fandd/2006/03/people.htm>.

<sup>9</sup> Rick Carew, “Asian Development Bank’s Future At Crossroads,” *Dow-Jones Newswires*, May 8, 2006.

<sup>10</sup> Ibid.



Concerns over the AsDB's policy agenda remained at the forefront during the 2007 annual meetings in May 2007. At the meeting, President Kuroda presented Bank Governors with a report on the future role of the Bank prepared by a group of eminent persons chaired by UNCTAD Secretary General Supachai Panithpakdi. The report reaffirmed President Kuroda's goal of reducing the Bank's focus on poverty alleviation in favor of Asian financial integration and the needs of the region's middle-income countries. While Germany was supportive of the strategy and Japan remained relatively neutral, many criticized the Bank for betraying its focus on the poorest and neediest countries, and placing it in a situation where the AsDB would compete with other institutions, such as the International Monetary Fund (IMF) and Asia-Pacific Economic Cooperation (APEC), which are already involved in Asian financial reform. The United States reiterated its concerns, arguing that the Bank not lose focus on serving the needs of the extreme poor.<sup>11</sup>

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<sup>11</sup> Associated Press, "Booming Asia, at crossroads of poverty and prosperity, spurs debate over development," May 7, 2007.