

At Asian Development Bank, U.S.-Japan rift is evident

by Susan Maitra and Ramtanu Maitra

More than a thousand Asian bankers and financial experts descended on New Delhi May 2-4 to attend the 23rd annual meeting of the Asian Development Bank's (ADB) Board of Governors. As it turned out, the temperature inside and outside the meeting venue was unusually high. Although the annual gala event was not destined to bear any fruit as such—it is strictly a talk shop affair—the way things did not happen revealed a growing rift among the advanced sector donor countries—and more precisely a kind of undeclared war between Japan and the United States—over international economic policy, and the direction of the ADB in particular.

Japan, by far the largest donor to the ADB, made the rift apparent without making it appear confrontational. Japanese Finance Minister Ryutaro Hashimoto, who declined to attend the important Interim Committee meeting of the IMF in Washington recently, made it a point to be in New Delhi to assure the ADB member countries that, as he said in his address to the Board of Governors, "Japan is determined to continue to provide support for the developing member countries, including support for the bank itself, in the 1990s." The message was unmistakable: Should the U.S. and other donors choose to strangle the ADB, Japan will still be there. Japan's presence was felt all through the proceedings—starting with the highly visible visit to India by Japanese Prime Minister Toshiki Kaifu which overlapped the opening of the meeting and set the tone.

Among the developing nations' representatives, the worry was over the shrinkage of development resources in the context of a bleak outlook for world economic revival. As India's Alternate Governor, Finance Secretary Bimal Jalan, outlined the predicament in prepared remarks to the meeting, real output and volume of trade in both developed and developing countries dropped again during 1989. Developing nations face a particularly adverse external situation because of a slower growth of world trade, rising interest rates in international markets, weakening of primary commodity prices, and slow progress in debt negotiations, he said. At the same time, in real terms, net financial flows to developing countries have declined at an annual rate of more than 9% during the 1980s, to a level half that at the beginning of the decade!

Of immediate concern is the prospect that financial aid otherwise available for developing countries will be re-routed as investors scramble to cash in on the realignments in East-

ern Europe. This fear was fully expressed in the Pakistani Alternate Governor K.M. Chima's remarks. "There is some genuine apprehension that political changes in Eastern Europe may induce Western nations and Japan to divert a larger share of their resources to Eastern Europe and thus affect the tempo of developing regions," Chima stated. "It would be a sad development if it happens," he added.

Though ADB literature tried to allay these fears, ADB President Tarumizu warned in a seminar following the meeting of a reduced capital flow from the West except to those Asian markets which are well developed already.

Blackmail over replenishing funds

Central among the talking points at the meeting was replenishment of the resources of the Asian Development Fund (ADF), the bank's soft loan facility, and the related issue of applications from Asia's giants, India and China, for access to the soft loan window for the first time. Prior to the meeting ADB officials set a target of \$10.4 billion for ADF replenishment, called ADF-6, stating that that amount would meet the regions' soft loan needs for the three-year period beginning in 1991. ADF-5, due to run its course by the end of this year, had only \$3.6 billion.

As anticipated, the U.S. took a hard line on ADF-6. In prepared remarks to the meeting and a press conference later, U.S. Governor George Folsom—as a deputy assistant secretary of the treasury, he is considered an insultingly low-level appointment to the ADB board—rejected outright the \$10.4 billion figure for ADF-6 and insisted there was no reason to begin negotiating the replenishment since ADF-5 would last through 1991.

No one was particularly surprised at this, though participants noted that a small rise in ADF-6 would automatically rule out consideration of the Indian and Chinese applications. The presumption that the U.S. Congress's hostility to resumed lending to China would cast a shadow on the size of ADF-6, or that Folsom was simply covering up for the U.S.'s own budgetary problems, was widespread.

In fact, however, the U.S. strategy to stall the ADF-6 negotiations is a quite deliberate piece of blackmail, as Folsom made clear when he demanded wide-ranging changes in the organization and operation of the ADB as a prelude to getting down to details on ADF-6. What the U.S. is demanding is a wholesale acceptance of the "conditionalities" policy

Will the ADB measure up?

As the premier development financing institution in Asia, where nearly half the world's population is concentrated, a large portion in abject poverty, the Asian Development Bank faces a great challenge. Whether the bank will move effectively to become a significant catalyst to economic transformation in Asia in the coming period remains to be seen, but there is no doubt that the benefits for Asia and the world economy could be significant.

The ADB opened its doors for business in Manila in December 1966 and now has a membership of 49. Thirty-four of the members are from the Asia-Pacific region, and the rest are the industrial capital-exporting nations of the North. The bank's president is deputed from the Japanese Finance Ministry, a privilege Japan has earned as the largest donor.

The bank's principal functions are to make loans and equity investments to promote economic and social advancement of its developing member countries, to provide technical assistance, to promote the investment of public and private capital for development purposes (e.g., help set up national development banks), and assist in members' planning and coordination of development policy.

After 23 years, however, the bank remains small in terms of its operations, and is often accused of being too conservative. With a total of \$29 billion outstanding in loans to 942 projects, it is about one-tenth the size of the World Bank operationally, but its earnings are about one-third of the World Bank's. The ADB's limited borrowing from international capital markets—a mere \$645 million

last year—is complemented by a rate of return on investment of 9.39%. Last year's profit was \$435 million. Despite the carefully maintained Triple-A rating, ADB is now running up against a number of problems. Most basic, perhaps, is the fact that though overall demand for money is increasing,

member countries have "graduated" out of the bank's program—South Korea being the latest—and others like Thailand have put a cap on foreign borrowing. The narrowing borrower base is increasingly concentrated among the most needy and problematic nations, such as China and the countries of South Asia.

ADB's task is complicated by its inability to take decisions free of the donor countries' political whims. The current U.S. campaign to impose the "conditionalities" policy in the context of a vastly expanded "macro-economic program lending" effort on the ADB is typical of the problem. Though the ADB claims officially that internal instability is not conducive to lending to Vietnam, Cambodia, or Afghanistan, it is an open secret that it is the donors' political strongarming that has kept these nations off the borrowers' list.

Past bank president Fukioka's decision to establish the Asian Finance and Investment Corp. last year is another example. AFIC, with \$35 million investment, was designed to meet the demand for credit and assistance from the developing countries' private sectors. Though 30% owned by ADB, AFIC is independent. It was opposed by some donors on the grounds that it was merely a vehicle to recycle Japanese surpluses into the region's private sector and capture business for Japanese firms. Others argue it is an end-run around the U.S. demand to incorporate private sector operations into the conditionalities policy.

of tying assistance to changes in domestic policy by the ADB.

The most important problem, Folsom railed, is the "distorted economic policies" that prevail in the developing member countries of the ADB, and that undermine the beneficial effects of the projects ADB undertakes. To make the ADB input effective, Folsom insisted, ADB must impose "medium-term macro-economic programs" in the developing member countries that will lead to the promotion of market economies. "The bank should address with borrowing countries, as part of its dialogue efforts, needed reforms in their industrial and financial sectors which will set the stage for private sector growth," Folsom said.

Collision course over conditionalities

It is apparent that the U.S. and the ADB are on a collision course over the issue of imposing "conditionalities" in the

form of macro-economic program loan requirements. The ADB is primarily a project and sectoral lending institution, which has concentrated investments in infrastructural development—more than a third of ADB loans are in agriculture and agro-industry, nearly 20% are in energy, just over 15% in transport and communications, 10% in development banks and 7% in water supply and sanitation. Since 1987, the ADB approved a total of \$1 billion in 12 program loans to different members, a small fraction of total lending during the same period.

In developing nations these activities invariably involve the public sector; moreover, ADB officials point out, the ADB charter does not have any provision for imposing policy conditions on loans.

Not surprisingly, ADB's skepticism of conditionalities policy is shared by Japanese officials. One has only to talk

briefly with Japanese businessmen in India to appreciate their sensitivity to the many counterproductive features of everyday economic practice, but they are equally aware that these things are not changed abstractly or by fiat. As Finance Minister Hashimoto said, the need is "to promote policy dialogue and to enhance country-specific development strategies so that the bank's lending and investment activities can truly be in line with the member countries' development requirements."

ADB President Kimimasa Taramizu, formerly a senior adviser to Japan's Finance Ministry, was considerably more blunt in an interview with the Indian daily *The Economic Times*, when he complained that some donor countries insisted on taking "a totally macro-economic approach." They are, perhaps, not satisfied, Taramizu said. "That is wrong, you know," he continued. "The macro-economic approach is not always appropriate. Japan, for instance, is still on the way to 100% liberalization. So the success of Japan cannot be explained by a totally macro-economic approach. Perhaps you are thinking of the U.S. Perhaps they are sticking to the macro approach. I think the development thrust of the developing member countries has to have another approach."

Speaking for India, Bimal Jalan told the meeting that while the bank should encourage more rapid disbursement program lending, "we are concerned about the attachment of onerous conditionalities accompanying this form of assistance." Conditionalities "seriously erode the benefit of the assistance," Jalan said. "Usually, the imposition of these conditionalities vitiates the principles of equity and frustrates the very objective of growth with social justice."

While Japan and the U.S. openly differed on the ADF-6 and conditionalities, they apparently agreed that the time was not right to restart lending to China, which was cut off following the massacre in Tiananmen Square last June. A 16-man delegation from the P.R.C, headed by ADB Governor and head of the People's Bank of China Li Guixian, was complemented by a 40-strong unofficial business delegation.

While George Folsom did not mention China, Hashimoto devoted a paragraph to the subject. "Japan, as a country that is situated in Asia and has a long history of mutual relations with the P.R.C., very much hopes that efforts on both sides will repair China's relations with the other countries and the multilateral institutions as soon as possible," the Japanese finance minister stated. Japan-watchers pointed not to the content, but to the mere presence of that paragraph as significant.

ADB officials say the bank is eager to resume lending to China on economic grounds. But ADB Vice President Stanley Katz told reporters the bank couldn't make an independent judgment on the issue, apart that is, from the Group of Seven donor countries' decision to restrict lending to China to "basic human needs," but will be watching the World Bank on the issue. For their part, World Bank officials at the meeting confirmed that they would seek approval on May 29 for

Asia experiencing declining growth

During 1989, developing Asia remained the most dynamic and rapidly growing region in the world, according to ADB's *Asian Development Outlook* for 1990. Though average growth rates, at 5.4%, declined sharply from 1988's 9.3%, they are far better than the world average of 3.2% and less than 2% for other developing countries.

Within Asia, there is a significant gap between the growth rates of the Asian "tigers"—South Korea, Taiwan, Singapore, and Hong Kong—which dropped only this year from over 10% to 6.2%, and the 2-3% growth rates of Indochina and the South Asia nations of Bangladesh, Sri Lanka, and Nepal. In between, the Southeast Asian nations kept to a steady 6-8% growth rate, and India and Pakistan grew at rates of 4.5% and 5.6% respectively. India was down by about half from 1988 due to slowed agricultural output and a shortage of foreign exchange which pinched capital goods imports.

Indian Finance Minister Bimal Jalan attributed the ability of the developing countries of Asia to fare better than Africa and South America to their efforts to solve the food problem, diversified economic and technological bases, and stability in macro-economic policies (i.e., not a lot of outside interference). But, Jalan cautioned, the region continues to face serious problems, including widespread poverty and inadequate financial resources for programs such as basic infrastructure.

a resumption of normal lending to China.

With the politicization of the ADB at an advanced stage, it is to be seen whether the Soviet Union, now a favorite among the donor nations, will be allowed membership anytime soon. "If not the whole Soviet Union, then perhaps some of the Asian republics could apply for the ADB membership," said Viacheslav Zakharov, deputy chairman of the Soviet State Bank, who led a four-man delegation as observers. Zakharov's argument is that if Estonia and Lithuania can have missions at the independent United Nations, why can't the Asian republics have membership in the ADB independent of the Soviet Union?

Bank officials say the proposal cannot be considered serious, because "it would complicate matters for the bank." But in the meantime, the high-level Soviet delegation took advantage of the opportunity to participate in informal dis-

cussions on the new European Bank for Reconstruction and Development.

Environmentalism rears its head

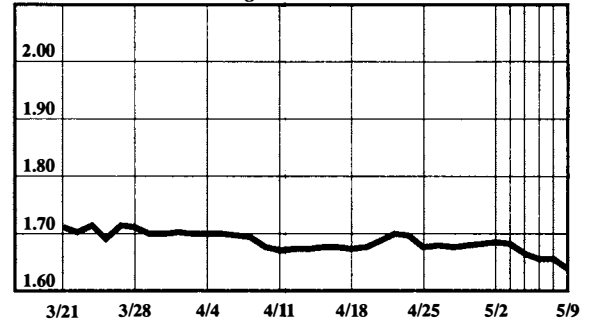
Environment was inevitably another talking point around the meeting. ADB has promised to take environmental considerations into account more systematically, and a number of non-government organizations were present to underline the point. Chip Fay, a rabid environmentalist from the Philippines, demanded that the ADB conduct a complete review and redesign of an ongoing project in the Philippines before committing the second tranche of funding due in July. ADB Governor for France, Denis Samuel-Lajeunesse, who proposed an SDR 1 billion program to explore and implement remedies for the global environment under the World Bank and U.N., said France was prepared to commit 10-15% of the money. U.K. Governor Lynda Chalker, championing environmental causes, warned against "talking about money rather than developing a means of delivering the technology," while the U.S. called for the environmental division to be upgraded.

Interestingly, in a preemptive move, Indonesia is actively discussing its commitment to protecting the tropical rain forests. The Indonesians are leery of being tossed into the same handbasket as Brazil and other countries which have borne the brunt of environmentalist criticism in recent years, and are anxious to stop passage of a bill in the U.S. Congress detrimental to the tropical hardwood industry. Their counter-offensive received considerable publicity around the ADB meeting.

Currency Rates

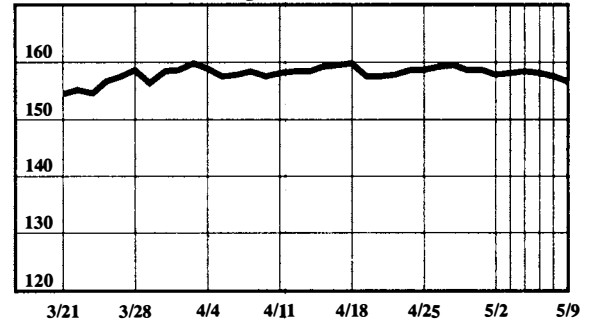
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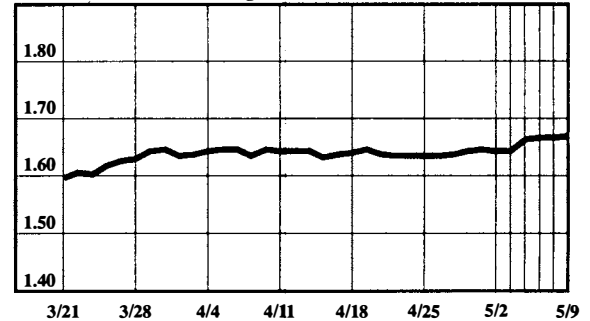
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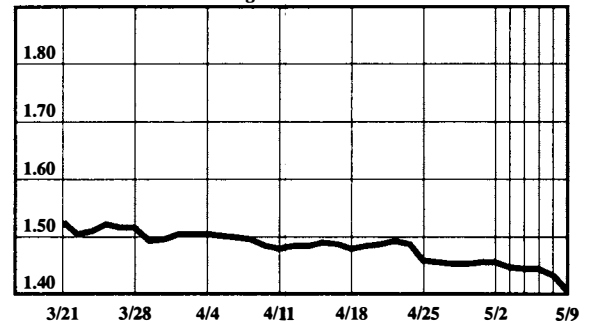
The British pound in dollars

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing



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