



ASIAN DEVELOPMENT BANK'S SUBMISSION TO THE AUSTRALIAN GOVERNMENT FOREIGN POLICY WHITE PAPER

I. Introduction

Australia and the Asian Development Bank (ADB) share a common focus on the stability and prosperity of the Asia and Pacific region. Australia was a founding member of the ADB upon its establishment in 1966, and has remained an influential voice within the Bank since that time. We enjoy a long and successful history of working together to build a brighter future for the region, and its people. In that spirit, the ADB is pleased to provide this submission to the Australian Government Foreign Policy White Paper.

ADB is the only multilateral development bank focused solely on the Asia and Pacific region, with operations spanning from Central and West Asia through to Australia's immediate vicinity in Southeast Asia and the Pacific Islands. ADB is a multilateral development bank in the truest sense of the words. Multilateralism, a development focus, and its role as a bank are the defining features of the ADB. The Bank was conceived as a financial institution that would be Asian in character and foster economic growth and cooperation in one of the poorest regions in the world. ADB assists its members, and partners, by providing loans, technical assistance, grants, and equity investments to promote social and economic development. ADB is composed of 67 member countries, 48 of which are from the Asia and Pacific region.

In 2016, ADB celebrated its 50th anniversary since its establishment. Over the past 50 years, ADB has mobilized more than \$250 billion to finance a range of investments including in infrastructure, health, education, agriculture, capacity building, research, and knowledge sharing. This support has helped to expand opportunities and build prosperity across Asia and the Pacific, contributing significantly to the region's historic global rise. ADB's annual investments in Asia and the Pacific hit a new record high of \$17.5 billion in 2016, and the Bank mobilized a further \$13.0 billion in cofinancing from partners. ADB also processed 26 nonsovereign operations in 2016, amounting to \$2.5 billion in value.

The Asia and Pacific region is changing fast, and ADB is changing with it. The region's future is bright but there remains significant unfinished business and new and emerging challenges. Financing development remains a central challenge, particularly in less developed countries, but the region's needs go well beyond this immediate challenge. While ADB is scaling up its financing, ADB is also leveraging its financial resources to address emerging opportunities and challenges facing the region such as responding to climate change and rapid urbanization, promoting structural reform and regional cooperation, and helping to introduce new and appropriate technologies.

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Australia's role as a shareholder, financier, and partner of the ADB has been highly valuable, both for ADB itself and for developing member countries. Australia has an influential voice within ADB and has helped steer the Bank in important ways, including promoting a strong focus on the needs of small and fragile states, notably in the Pacific. Australia has also been a staunch supporter of private sector development as well as mainstreaming gender considerations into project design and implementation. ADB looks forward to Australia continuing to play an influential role in both the Bank and the region. As an advanced economy in the region, Australia has much to offer in terms of its ideas, knowledge and expertise, and a global reach that can help foster greater cooperation and connectivity between the Asia and Pacific region and the rest of the world.

II. A fast-changing landscape in Asia and the Pacific

The Asia and Pacific region has made tremendous development progress over the last few decades. Strong economic growth has been underpinned by good government policies and investments in infrastructure and human capital. This, in turn, has contributed to a significant reduction in poverty across the region. ADB expects this positive economic trajectory to continue. However, this broad outlook masks both ongoing and growing challenges, and continued progress cannot be taken for granted.

Asia has undergone a dramatic transformation over the past several decades

When ADB was established in the mid-1960s Asia was a very different place to what it is today. Poverty was widespread and the region was experiencing a tumultuous period with many countries having only recently gained independence from colonial rule following the end of World War II. Despite these initial challenges, Asia went on to experience remarkable economic progress that vastly surpassed most expectations. Initially this was led by Japan, followed by the Newly Industrialized Economies (NIEs) in East Asia. Other countries in the region soon followed, including Malaysia, Thailand, and Indonesia. Market-oriented reforms in the region's two giants, the People's Republic of China (PRC) and India, then sparked rapid economic growth on an unprecedented scale that has since transformed the world economy.

Asia's rise presents the world with enormous opportunities for greater prosperity

Asia will continue to make an ever greater contribution to global economic dynamism. Despite moderating growth in some countries, Asia's overall growth performance remains robust. Annual economic growth remains around 6% a year and Asia currently accounts for about two thirds of global economic growth. If the region continues its recent growth path, it will account for more than half of global GDP by 2050.

Asian economies are fast-becoming more important and sophisticated economic partners with the rest of the world. They maintain a strong outwards orientation, are deeply integrated into, and actively moving up, global value chains. Asian economies are also pursuing greater integration amongst themselves and with outside partners, such as through the Regional Comprehensive Economic Partnership negotiations, of which Australia is a part. Education and skill levels are rising fast across the region and remain a focus for continued investment. Many

Asian economies are also investing more in research and development and placing priority on developing new industries and technologies.

With significant domestic savings, outward Asian investment is rising and helping to connect Asian economies to each other, and with more advanced markets. This carries significant benefits by reducing the cost of capital, funding productive investment, strengthening trade and production networks and enabling technology and knowledge transfer. At the same time, domestic demand is growing fast and Asia's expanding middle class presents a rapidly growing consumer market for the world.

Yet Asia's future positive outlook is premised on sustained efforts to address remaining and emerging challenges

Asia's past development experience shows the critical need for countries to have sound macroeconomic management, sustained investment in infrastructure, health and education, and the continued promotion of open trade and investment regimes. In addition, Asia's experience also highlights that governments must provide sound leadership; good governance helps promote growth, social inclusiveness, and economic outcomes. Underpinning these factors is the need to maintain security and political stability, both across the region and within countries.

There remains significant *divergence* within the region and within countries. Fragile and conflict affected states (e.g. Afghanistan and Myanmar), many of the Pacific Islands and, to a lesser extent, Central and West Asia, are not on the same trajectory as the rest of Asia and risk being left behind. Millions of people also remain in entrenched poverty across Asia. While the region has made tremendous progress in reducing income poverty, 43% of the world's poor (people living on less than \$1.90 a day, the threshold for extreme poverty) still live in Asia and the Pacific. Many of the remaining poor are not well-connected to the growth process that has lifted millions of others out of poverty. Where poverty reduction is occurring, inequality is often rising (e.g. in PRC and Indonesia). This divergence—growth for some and stagnation for others—could present risks to continued stability and greater prosperity in the region, and elsewhere. For this reason, key international agreements such as the Sustainable Development Goals and COP21 place inclusiveness and resilience at the heart of the development agenda.

Climate change presents a growing threat to prosperity and stability in the region. As its economic heft increases, Asia's contribution to global climate change mitigation efforts will be increasingly essential. Huge investments in renewable energy, energy efficiency, sustainable transport and smart-cities are needed. Countries must also invest in adaption through resilient infrastructure, smart agriculture, and better disaster preparedness. This is particularly important for Pacific Island countries which are highly vulnerable to the effects of climate change, being heavily exposed to rising sea levels and higher frequency and more severe extreme weather events.

Infrastructure needs in Asia and the Pacific remain substantial. The region faces a massive infrastructure financing gap, which ADB estimates to be around \$8 trillion. Infrastructure development efforts must also effectively meet the challenges of climate change mitigation and adaptation and rapid urbanization. Incorporating advanced technology is essential to addressing

these issues. Despite ongoing capital market development, channeling regional and global savings, as well as private investments, into financing Asian infrastructure has proven challenging.

Asia's changing demography is presenting new challenges. Some Asian countries will continue to have a growing labor force for some time and the challenge for these countries will be to create good employment opportunities. In other countries, birth rates are below replacement levels; slower labor force growth in these countries will weigh on growth. In most countries, people are living longer and this will pose challenges to pensions, health systems, and fiscal sustainability. On the other hand, this trend could lead to higher consumption rates and new market opportunities.

The ongoing digital revolution offers both challenges and opportunities. Many observers are concerned that greater use of artificial intelligence and robots could eliminate wide swathes of jobs. Technological changes could also have important implications for Asia's industrial growth model and trading relationships. However, new technologies can also support the emergence of employment opportunities in new fields. New technologies can also help people in lagging regions to transcend long-standing barriers to development by, for example, helping them to access basic social services, mobile banking and smart agriculture solutions.

Asia needs sustained efforts to ensure the stability of its financial markets. Capital markets in Asia are fast becoming more interconnected with global financial markets. Growing systemic connectivity also brings greater potential for market volatility, both from the rest of the world to Asia, and in the reverse direction. Many financial markets in Asia are still relatively shallow and less well-regulated compared to those in more mature markets, making them vulnerable to potential volatility. Although significant progress has been made, the lessons from the 1997 East Asia financial crisis remain squarely in the minds of Asian policymakers. As the financial sector in Asia seeks to extend beyond its traditional customer base, it will by definition take on new risks, making it essential to continually strengthen and harmonize policy and regulatory frameworks across the region.

It is critical to manage the emerging risks of globalization. Globalization brings new challenges such as rising protectionist sentiment and pushback against migration. Since 2012, global trade growth is just keeping up with economic growth. Previously, it was growing twice as fast. Trade has been a key driver of Asia's growth model, particularly for several of the smaller and highly open Asian economies. A sustained slowdown in global trade would have negative implications for Asia's growth trajectory.

III. How ADB is responding to a fast-changing region

The Asia and Pacific region is changing fast, and ADB is changing with it. As economies have become more developed and face new challenges, the demands of developing countries have become more complex. Member countries still show strong demand for ADB financing to help fund their development, but they are also interested in ADB helping them to leverage new sources of finance and deliver innovative knowledge-based solutions. ADB is currently developing a new corporate strategy, Strategy 2030, which will guide how ADB evolves in a

fast-changing region. Nonetheless, ADB is already actively helping to address some of the most pressing issues confronting the region, many of which are of critical interest to Australia.

ADB is scaling up its operations to help deliver on new global development agendas

In 2015, the ADB Board of Governors and donors to the Asian Development Fund (ADF), ADB's concessional financing arm, unanimously consented to the merger of ADF lending operations with ADB ordinary capital resources. This innovation allows ADB to leverage its concessional lending in a manner unique among multilateral development banks. The merger will allow ADB to increase assistance to developing member countries by up to 50%. Assistance to low income countries will increase disproportionately, rising by 70% compared to the previous ADF replenishment period.

With this path-breaking reform, ADB's financing capacity (annual approvals of new loans and grants) will increase to more than \$20 billion by 2020. ADB hopes to match this by leveraging 1:1 cofinancing, which would take total financing to more than \$40 billion per year. In addition, ADB will expand its private sector operations and support for public-private partnerships, catalyzing greater private resources for development. Such enhanced financing will be essential to delivering on the SDGs, which represent a broad and ambitious development agenda, and require huge resources, capacities, and political will to achieve.

Recent years have also seen the emergence of new financing institutions that can provide added support to infrastructure investment in the region—the Asian Infrastructure Investment Bank (AIIB), of which Australia is a member, has started its operations and the New Development Bank has approved its first loans. The entry of these new institutions provides opportunities for collaboration and encourages ADB to be stronger, better and faster. In May 2016 ADB and AIIB signed a memorandum of understanding to underpin our cooperation and ADB has now approved cofinancing with AIIB for projects in Pakistan and Bangladesh. Further cofinancing opportunities are being pursued

Addressing the challenges of the next decade

Focusing on the specific challenges confronting the region's development outlook, the ADB is playing a critical role in a number of ways which we expect to continue and deepen as we move forward.

- **Closing remaining development gaps.** ADB will continue its work to eliminate extreme poverty in the region and help to catalyze growth in countries that are struggling to keep up with the rest of the region, including small and fragile states. ADB's enhanced lending capacity will provide a significant increase in the financial resources available to these countries. This is particularly true in the Pacific Islands where ADB financing remains of macroeconomic significance.
- **Seizing the opportunities of advanced technologies.** ADB is increasing its focus on helping developing member countries take advantage of new technologies. Improving technology offers profound opportunities to improve the quality of infrastructure in the region and respond to the challenges posed by climate change and rapid urbanization. New

technologies also offer important opportunities to transcend longstanding barriers to development to help people in remote and lagging regions to access basic services.

- **Mobilizing private capital for development.** ADB is working to strengthen policy frameworks and government capacity for public-private partnerships (PPPs) in Asia. This includes helping countries to develop PPP laws and dedicated PPP centers within governments. In 2014 ADB established an Office of Public-Private Partnerships to provide transaction advisory services and in 2016 launched the Asia-Pacific Project Preparation Facility (AP3F) with the support of Australia, Japan and Canada, to provide early stage support to develop bankable projects for private financing.
- **Tackling the challenges of climate change.** ADB is doubling annual climate financing from \$3 billion to \$6 billion by 2020. Of the \$6 billion, \$4 billion will be dedicated to climate change mitigation, by scaling up support for renewable energy, energy efficiency, sustainable transport, and building smart cities. The remaining \$2 billion will be committed to climate change adaptation. For ADB, taking the opportunity to build sustainable cities of the future, sustainable infrastructure continues to be the mainstay of ADB's operations, especially in lagging areas, encompassing investments in clean energy, sustainable transport, water and urban development. ADB is an 'accredited entity' with the Green Climate Fund (GCF), of which Australia is currently the co-chair of the board, and expects to play an important role in helping the GCF deliver on its considerable ambitions through cofinanced climate change mitigation and adaptation projects. ADB has successfully assisted Pacific developing member countries to secure about \$50 million in GCF grants to finance transformative investments in climate resilient infrastructure and renewable energy.
- **Promoting structural reform.** ADB continues to play an important role in helping governments in the region devise and implement reforms to support sustainable and inclusive development. This is achieved through policy-based loans, technical assistance, and knowledge work. ADB is continuing to sharpen its role as a knowledge broker in the region as policy reform remains vital to helping Asian economies transition from middle to high income status.
- **Supporting international cooperation.** Promoting regional cooperation remains a core part of the ADB Charter. ADB is scaling up its efforts in this area through increased support for cross-border projects, particularly in infrastructure, regulatory harmonization, and addressing regional public goods such as trans-border environment and health issues. ADB can also continue to play a pivotal role in supporting continued regional integration, through its role as an "honest broker".

IV. Australia and the ADB

Australia plays a prominent role at ADB, from supporting sound governance and management, to financing Bank operations, and coordinating development activities on the ground. Australia was a founding member of ADB, is the Bank's fifth-largest shareholder and the third largest contributor to the ADF. And as one of the ADB's regional developed member countries, Australia holds a unique place in ADB that is both focused on Asia yet global and multilateral in

reach. The partnership between ADB and Australia has evolved to embrace a full range of dimensions, including strategic dialogue, coordination in country and sector programs, cofinancing or working together on projects, and knowledge sharing.

Australia is a valued partner and leading voice in the ADB

Australia is one of the most advanced economies in the Asia and Pacific region. Australia is a highly respected and influential voice within the ADB and plays a key role in the governance and management of the bank. The Australian Treasurer sits on the ADB Board of Governors. Australia has a permanent seat on the ADB Board of Directors which oversees both ADB strategic directions and operations, including the approval of loan, grant, and investment decisions.

Australia has been a pivotal voice within ADB. Recently, Australia provided active support for the merger of the Bank's ordinary capital and concessional resources which is allowing ADB to greatly expand its financing capacity and, importantly, helped ensure that this innovation disproportionately benefits low income countries, such as Afghanistan and those in the Pacific. More generally, Australia has played a critical role in the Bank to promote its strong focus on small and fragile states as well as its work on gender issues and private sector development.

Australia's engagement within the ADB is highly valued not only for its considerable financial contribution but also for the wealth of knowledge and expertise that it brings. Australia is a leader in the Pacific region in delivering development programs in small and fragile states and has a wide network of embassies and consulates with skilled professional staff and local networks. Countries in Asia and the Pacific look to Australia for its wealth of technical expertise, particularly in the areas of water, dryland farming, mining, food security, and public sector governance. Such knowledge sharing also comes through the presence of Australian staff at ADB, which account for 6% of all international staff working at the Bank, and the participation of companies and consultants from Australia in ADB projects and activities, who have been awarded a cumulative total of \$1.82 billion in procurement contracts on ADB-financed projects.

Australia is an important financier of the bank

Since joining in 1966, Australia has contributed \$8.52 billion in capital subscriptions. Australia is the third largest ADF donor, having contributed a cumulative total of \$2.5 billion, representing 7.61% of total ADF contributions since ADF's inception. For the ADF XII replenishment, which will be used to finance ADF grant operations in 2017-2020, Australia pledged to contribute A\$500 million, representing 11% of total ADF XII funds. In addition to such core funding, Australia also contributes to specific ADB projects as a cofinancier. Australia has provided a cumulative total of \$811 million in cofinancing for ADB projects.

Australia and the ADB have an excellent partnership to build upon

At the operational level, ADB works very closely with the Australian Government, particularly through the Department of Foreign Affairs and Trade (DFAT). The box below presents some recent highlights of this cooperation. ADB maintains a Pacific Coordination and Liaison Office in Sydney and DFAT and ADB conduct annual high level consultations between senior officials

from each agency. We also coordinate very closely on the ground in developing member countries in delivering ADB operations and DFAT development assistance. ADB benefits from DFAT's extensive presence in the Asia and Pacific region and is increasing its own field presence, particularly in the Pacific. In 2016 ADB and DFAT signed a new Partnership Framework formalizing these arrangements and other measures to enhance our cooperation.

Cooperation between ADB and DFAT in the Pacific

The Pacific region has been a top priority of the partnership between ADB and DFAT. It is the top recipient of Australian cofinancing of ADB projects, with cofinancing in the Pacific rising from an initial level of only \$80,000 in 1994 to \$211 million in 2010-2015. Australian grants coupled with ADB's financing have facilitated critical investments in infrastructure and public services aimed at improving livelihoods in the Pacific. For example

- (i) In Kiribati, ADB, Australia, and the World Bank jointly supported the country's largest ever single infrastructure project: rehabilitating 31 km of the main road and 10 km of feeder roads on the atoll of South Tarawa.
- (ii) In Samoa, ADB, Australia, and other partners over many years have financed about 60% of the country's total power generation capacity.
- (iii) In Solomon Islands, the partnership has built improved climate-proofed roads, bringing people closer to markets, schools, and health services. ADB and DFAT are now jointly supporting the upgrading of Solomon Islands' transport sector as a whole.
- (iv) Policy-based financing in Kiribati, Nauru, Samoa, Solomon Islands, Tonga, and Tuvalu have helped spearhead critical economic reforms and been backed by substantial financing to enable the countries' productive investment.
- (v) The ADB and DFAT have worked together to promote private sector development in the region through the provision of policy advisory services to improve the business enabling environment. For example, this work has made it significantly easier to set up new businesses in many parts of the Pacific.
- (vi) With the support of Australia, the establishment of the Pacific Business Investment Facility in September 2014 marked the beginning of a new approach towards helping businesses in the Pacific expand through accessing commercial bank financing.

ADB is a proven partner for Australia

The Australian Government has commissioned a number of its own assessments of the ADB. A 2015 review concluded that ADB is a leading development institution that has outstanding knowledge and technical capacity and is an important source of policy advice for developing countries.¹ The report noted that ADB backs up this technical capacity with financing on a scale that Australia cannot match. A 2012 publicly available assessment of Australia's multilateral partners ranked ADB in the top group of strong performers out the 42 multilateral agencies

¹ Australian Government. 2015. *Banking Our Aid: Australia's Non-Core Funding to the Asian Development Bank and the World Bank*. Department of Foreign Affairs and Trade Office of Development Effectiveness. Canberra

reviewed.² It concluded that the Australian Government can have a high degree of confidence that ADB funding will deliver tangible development benefits in line with Australia's development objectives, and that the investment will represent good value for money.

Reflecting ADB's continual strive for improvement in achieving development results, the Bank is often its own harshest critic. The Independent Evaluation Department (IED) independently and systematically evaluates ADB policies, strategies, operations, and special concerns that relate to organizational and operational effectiveness. In 2007, ADB launched its annual series of Development Effectiveness Reviews which track the region's progress and provide a frank assessment of the Bank's performance. In 2008, ADB became the first multilateral development bank to adopt a corporate results framework that has since been further developed and refined to ensure progress is tracked and that there is clear performance accountability.

V. Working together for a shared vision of Asia and the Pacific

Australia and ADB are well placed to work together to support the ongoing stability and prosperity of Asia and the Pacific. Australia has unique assets, capabilities, and perspectives that can make an important contribution to the region's development, including through working with ADB as a shareholder, financier, and partner.

Australia is well placed to foster greater international cooperation and integration through its simultaneous participation in regional multilateralism—including its membership of the ADB, AIIB and groupings such as the East Asia Summit and RCEP negotiating partners—and its reach and involvement in global multilateral initiatives such as the G20. For instance, as a member of both ADB and AIIB, Australia can make an important contribution to promoting effective cooperation and collaboration between our two institutions.

Australia also has considerable knowledge, expertise and technical capabilities to offer pertaining to many of the critical challenges facing the region, including through development assistance (especially in small and fragile states), the use of advanced technology, public private partnerships, climate change, and critical policy areas such as financial sector regulation, pension and health systems, and sustainable fiscal management. Australia's development assistance budget and network of skilled officials working across the region are key capabilities and mechanisms for transmitting Australian ideas, knowledge and expertise to countries in the region as well as working effectively and influentially with partners such as ADB.

ADB for its part would like to encourage the Australian Government to continue playing an active role within ADB and the region. Australia's role as a shareholder, financier, and partner has been influential in the Bank's success to date and can help to ensure its continued success in helping address the challenges facing the region in the decade ahead. In turn, ADB's role as a multilateral development bank focused solely on the Asia and Pacific region offers Australia a unique partner in promoting its own national interests in fostering greater regional multilateralism and the continued growth and stability of the Asia and Pacific region.

² Australian Government. 2012. *Australian Multilateral Assessment*. Australian Agency for International Development. Canberra