



## Board Information Paper

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August 2008

### Asian Infrastructure Financing Initiative

## ABBREVIATIONS

ADB	–	Asian Development Bank
AIFI	–	Asian Infrastructure Financing Initiative
DMC	–	developing member country
IDB	–	Islamic Development Bank
OCO	–	Office of Cofinancing Operations
PSOD	–	Private Sector Operations Department

## NOTE

In this report, "\$" refers to US dollars.

The purpose of the Asian Infrastructure Financing Initiative (AIFI) is to explore various options for the Asian Development Bank to mobilize additional financial resources for infrastructure development.

An interdepartmental group, working under the overall guidance of the **Managing Director General Rajat Nag** has structured the AIFI. The group's work and the preparation of this Board Information Paper were coordinated by Ramesh Subramaniam, Director, Governance, Finance and Trade Division of Central and West Asia Department.

## **I. INTRODUCTION AND BACKGROUND**

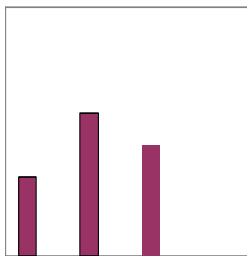
### **1. What is the Asian Infrastructure Financing Initiative?**

1. The Asian Infrastructure Financing Initiative (AIFI) is an operational cofinancing platform to pool financial resources from development partners within Asia and the Pacific region to support infrastructure development in a coordinated manner, together with the Asian Development Bank's (ADB) own investments in infrastructure. The massive infrastructure development needs in the region exceed the resources of any single institution, including those of ADB, and the AIFI will improve regional financial intermediation for infrastructure financing. This paper sets out the AIFI's rationale and structure and explains how it will operate.

### **2. Why is the Asian Infrastructure Financing Initiative needed?**

2. Infrastructure is widely recognized as essential to rapid economic growth and poverty reduction in Asia and the Pacific region. Inadequacy of basic infrastructure<sup>1</sup> presents one of the biggest challenges to the region's sustained economic growth. At the same time, Asia faces a development paradox: while the region is home to huge savings, the infrastructure financing gap is estimated to be in the range of \$370 billion to \$470 billion per year over 2006–2015.<sup>2</sup>

3. Infrastructure development is of high-priority<sup>3</sup> for most ADB developing member countries (DMCs), and as such, it fits well with the mandate of ADB's overarching goal of poverty reduction. Infrastructure development is also one of the five core areas under its recently approved Long-Term Strategic Framework (Strategy 2020).<sup>4</sup> While still a fraction of the region's investment needs, ADB's support for infrastructure development has more than tripled from \$2.2 billion in 2001 to \$6.9 billion in 2007. The share of infrastructure in total lending has gone up from 42% in 2001 to 60% in 2007 (Figures 1 and 2).



4. Moving forward, however, ADB's ability to sustain this trend will depend on the availability of resources. In addition to making efforts to expand its resource base, ADB has also the potential to use its position as a regional development institution to provide a cofinancing platform that will combine and channel resources from various financing partners in a coordinated way. By taking a more structured and programmatic approach, the AIFI has significant advantages over project-by-project cofinancing. It would enable ADB and its financing partners to adopt a syndication approach to mobilizing resources for infrastructure development, resulting in efficiency gains and greater predictability for the beneficiaries. This is particularly critical at a time when the overall macroeconomic environment is increasingly vulnerable, and ADB's own resources are constrained.

5. Strategy 2020 details why infrastructure development is critical, but a few points are worth noting here. While infrastructure needs are large, translating them into viable, bankable projects has consistently been a problem in most DMCs. In addition to fiscal and financial impediments, other constraints include:

- lack of delivery capability, relating to policy, regulation, design, construction and operation; and
- operational and financial risks, other special risks (including country and political risks), lack of sector maturity, and lack of conformity to international principles and practices on safeguards.

6. ADB is a regional development institution with sound knowledge of the countries, sectors, and markets in the region, and significant experience in infrastructure lending and project and corporate financing. It can therefore play a major role in addressing both sets of constraints. Its status as an AAA-rated multilateral institution with a strong and established presence in the region, ensuring strict adherence to social and environmental safeguards, enables it to play a catalytic role. The proposed AIFI will enable ADB to work with its financing partners from the region to address the fiscal and financing constraints to infrastructure development.

## II. THE ASIAN INFRASTRUCTURE FINANCING INITIATIVE PROPOSAL

7. **Purpose, Impact, and Outcomes.** The purpose of the proposed AIFI is to mobilize additional financial resources for infrastructure development. The overall impact will be accelerated economic growth and lower poverty incidence in the region. The outcomes will include: greater support for infrastructure development; increased ADB presence in strategic sectors, which will in turn increase the development impact of ADB's overall assistance; greater collaboration with other development partners; and better use of ADB's own resources by leveraging additional support. In addition, there will be efficiency gains in processing better harmonization amongst development partners (including on safeguards), and greater predictability as more cofinancing can be mobilized in a shorter period of time. As projects funded by the AIFI gain momentum and the inherent risks in project financing in the region are addressed, the facility may also encourage investors from outside the region to contribute.

8. **Proposal.** The AIFI will have two parts. The first will be a coordinated cofinancing framework, which will help ADB adopt a syndication approach, by mobilizing a larger pool of committed cofinancing resources and by drawing from that pool for specific projects depending on project and country requirements. The second part will be the establishment by ADB of one or more funds. Through the funds, ADB will cofinance sovereign and nonsovereign projects. In addition, contributing institutions may also invest in equity funds together with ADB.

9. The cofinancing framework is aimed at Governments, and institutions such as national development banks and export–import banks, with the objective of mobilizing committed cofinancing over a 3–5 year period. While there would be terms and conditions attached to cofinancing, ADB will generally lead the due diligence and appraisal of the projects. Processing and financing of individual project transactions may be on a joint or parallel basis.

10. The funds are aimed at investors interested in portfolio investment (such as pension funds, sovereign wealth funds, or governments). The mix of the funds' investments—such as sovereign or nonsovereign loans, or nonsovereign equity—will reflect the participating investors' risk–return appetite, as well as the nature of ADB's project pipelines. The investors and ADB will agree whether to focus on a selected number of DMCs or to ensure broad diversification in all DMCs, or to concentrate on particular types of projects. Investments in the funds may be managed by ADB as a trustee or by third parties.

### III. Regional Participation in the Asian Infrastructure Financing Initiative

11. **Potential Partners.** ADB has had discussions on the AIFI with authorities and institutions in the People's Republic of China, India, Republic of Korea, Malaysia, and Singapore, as well as with the Islamic Development Bank (IDB). There has been considerable interest from potential contributors and investors as well as from users of the AIFI. As of end-July 2008, the Republic of Korea had pledged \$3.50 billion and the Islamic Development Bank \$1.15 billion, for a total of \$4.65 billion. Contributions to the trust fund are yet to be confirmed.

**Table 1: Participation in the Asian Infrastructure Financing Initiative**  
(\$ million, as of 31 July 2008)

AIFI Components	Total Pledged Amount	Details
<b>1. Cofinancing Framework</b>	<b>4,500.0</b>	
<b>1a. Sovereign</b>	<b>1,500.0</b>	
Government of the Republic of Korea		500.0
Islamic Development Bank		1,000.0
<b>1b. Nonsovereign</b>	<b>3,000.0</b>	
Korea Export–Import Bank		2,500.0
Korea Development Bank		500.0
<b>2. Funds</b>	<b>150.0</b>	
<b>Entrusted to ADB</b>	<b>0.0</b>	
<b>Managed by Third Parties</b>	<b>150.0</b>	
IDB through the Islamic Asia Infrastructure Fund		150.0
<b>Total (1+2)</b>	<b>4,650.0</b>	

12. **Republic of Korea:** The Economic Development Cooperation Fund (EDCF) of the Government of the Republic of Korea has contributed through cofinancing several ADB projects in the past. Building on that relationship and in line with its own expanding development priorities in the region, the Government of the Republic of Korea has committed \$500 million in new cofinancing through its Economic Development Cooperation Fund window for ADB-financed sovereign infrastructure projects as part of the AIFI. In parallel, two key institutions in the Republic of Korea have committed large cofinancing support for nonsovereign projects. The Korea Export-Import Bank will mobilize \$2.5 billion for cofinancing nonsovereign projects under the AIFI, and the Korea Development Bank will provide \$500 million for cofinancing nonsovereign projects supported by ADB.

13. **Islamic Development Bank:** IDB has a mandate to promote economic development and social progress in its member countries individually and jointly in accordance with the principles of *sharia*.<sup>5</sup> Infrastructure development is an important element in IDB's strategy. IDB and ADB have 12 common DMCs<sup>6</sup> and this common membership provides both institutions with a unique opportunity to work together. Given the large infrastructure needs and limited resources, a harmonized approach in the common DMCs will greatly enhance the effectiveness and impact of both institutions. Table 2 presents ADB's projected public sector lending (within its current resource envelope) for infrastructure development in the common DMCs. In addition, there are significant nonsovereign opportunities as well in those countries. ADB and IDB will systematically explore cofinancing arrangements for each potential infrastructure intervention.

**Table 2: Projected ADB Public Sector Project Pipeline in Infrastructure Sectors in Common Developing Member Countries of ADB and IDB, 2008–2010**  
(\$ million)

Sector	2008	2009	2010	Total
Energy	657.0	870.0	810.0	<b>2,337.0</b>
Roads	465.0	835.0	920.0	<b>2,220.0</b>
Other Transport	-	150.0	-	<b>150.0</b>
Water and Other Urban Infrastructure	418.0	715.0	435.0	<b>1,568.0</b>
<b>Total</b>	<b>1,540.0</b>	<b>2,570.0</b>	<b>2,165.0</b>	<b>6,275.0</b>

14. **Structuring Projects.** A key task for ADB and IDB will be to design financing structures that comply with Islamic financing principles for the potential transactions that can be financed out of the IDB portion of the AIFI.

15. **Islamic Asia Infrastructure Fund.** IDB and ADB are in the process of developing a private equity fund, established in Labuan, Malaysia, that will make equity investments in infrastructure projects in common DMCs. It is proposed that IDB will invest \$150 million in the proposed Islamic Asia Infrastructure Fund and ADB will invest \$100 million. The fund is proposed to be managed by a joint venture between Commerce International Merchant Bank (CIMB) and Standard Bank. It is anticipated that the fund manager will raise additional resources from other investors once operations begin. The proposed investment will be submitted for consideration by ADB's and IDB's Boards in the last quarter of 2008.

16. **Approach Adopted by ADB in Inviting Participation.** Work on the AIFI has been undertaken at various levels. First, a range of internal and external issues were discussed by the AIFI working group members with regard to ADB's role in infrastructure financing development. These included demand for infrastructure, resource mobilization and cofinancing, business processes, knowledge management, and ADB's skills and human resources. Second, staff held consultations in selected countries on the AIFI proposal. Third, several ADB teams visited the countries or institutions concerned, and ADB hosted visits by officials from the PRC and the IDB. Fourth, based on these consultations, ADB signed memoranda of understanding with the IDB in November 2007, and with the Republic of Korea in June 2008, agreeing to collaborate on establishing the AIFI and on the indicative contributions (as outlined in Table 1).

<sup>5</sup> The main principles include, among others, prohibition on taking or receiving interest (but this does not preclude a return on investments); sharing of risks between the provider and recipient of capital in return for a share in profit; prohibition of speculation; ensuring that no party to a financial transaction is exploited; and ensuring that investments are directed towards creating or increasing productive capacity.

<sup>6</sup> Afghanistan, Azerbaijan, Bangladesh, Indonesia, Kazakhstan, Kyrgyz Republic, Maldives, Pakistan, Tajikistan, Turkmenistan, and Uzbekistan.

#### IV. Operational Considerations

17. **Encouraging Cofinancing in General.** Management has emphasized the need for staff of the regional departments and the Private Sector Operations Department (PSOD) to pay greater attention to cofinancing. Performance in mobilizing resources will be recognized as part of the personnel performance evaluation exercise.

18. **Identification of Business Opportunities.** As the AIFI adopts a programmatic approach, ADB will work with the contributing partners to identify countries, sectors, and priority projects for financing under AIFI. Dedicated retreats and meetings have been planned, where teams from ADB and the cofinanciers will exchange information on project pipelines and agree on concrete steps.

19. **ADB's Role in Projects Financed by AIFI.** Once projects are identified, ADB will take the lead in the preparation, processing, implementation, and evaluation of projects, including components that are funded through AIFI contributions. Joint missions with the cofinancing partners will be fielded for all project stages, wherever possible.

20. **Human Resources.** The AIFI will need appropriate staff commitment, backed by adequate institutional incentives for cofinancing. Combining the resources of other development partners does not mean that staff requirements in project processing will be reduced, as structuring cofinanced projects and working with other partners will consume significant time and require considerable efforts. Staff requirements will be reflected through the ongoing Work Program and Budget Framework exercise.

21. **Mode of Cofinancing.** Efforts will be made to structure as many of the projects as possible on joint cofinancing basis, though parallel cofinancing may need to be pursued in some cases.

22. **Financing Terms.** ADB's financing terms will apply to all trust fund projects and the ADB-financed portion of projects under the cofinancing framework. The terms of the concerned contributing partner shall apply to its portion of the cofinancing.<sup>7</sup>

23. **Compliance with ADB Safeguard Requirements.** All projects financed under the AIFI will comply with ADB's applicable social and environmental safeguard requirements.

24. **Implementation Arrangements.** All operational work will come under the responsibility of the regional departments and PSOD, with OCO supporting coordination with the cofinanciers.

#### V. Next Steps

25. Regional departments, PSOD and OCO are now focusing efforts on making the pledged support effective as quickly as possible. Projects that could potentially benefit from AIFI financing are being identified, and joint project missions are being fielded to several countries. OCO will prepare framework agreements or letters to facilitate financing partnerships under the AIFI as required. ADB is also continuing its dialogue with other regional members and their institutions to mobilize participation in the AIFI. OCO will report on the progress of related cofinancing arrangements through its regular annual reports.

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<sup>7</sup> For sovereign cofinancing, terms are normally expected to be comparable with or better than ADB terms.