



# Major Change in Scope and Amount

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Project Number: 37909  
March 2009

## Trade Finance Facilitation Program

In accordance with ADB's public communications policy (PCP, 2005), this abbreviated version of the RRP excludes confidential information and ADB's assessment of project or transaction risk as well as other information referred to in paragraph 126 of the PCP.

Asian Development Bank

## ABBREVIATIONS

ADB	–	Asian Development Bank
CDTA	–	capacity development technical assistance
CG	–	credit guarantee
COBP	–	country operations business plan
CPS	–	country partnership strategy
CSP	–	country strategy paper
DMC	–	developing member country
EBRD	–	European Bank for Reconstruction and Development
IFC	–	International Finance Corporation
IMF	–	International Monetary Fund
L/C	–	letter of credit
LDC	–	less-developed country
PCG	–	partial credit guarantee
PSCM	–	Private Sector Capital Markets Division
PSOD	–	Private Sector Operations Department
RCF	–	revolving credit facility
RCSP	–	regional cooperation strategy and programs
RMU	–	Risk Management Unit
RPA	–	risk participation agreement
SMEs	–	small and medium-sized enterprises
TA	–	technical assistance
TFFP	–	Trade Finance Facilitation Program

## NOTE

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

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## PROGRAM SUMMARY

### Obligors Under Guarantees and Loans

Regional, range of banks

### Classification

Targeting classification: General intervention

Sectors: Finance, industry and trade

Subsector: Trade

Themes: Sustainable economic growth; private sector development, regional cooperation, and capacity development

Subthemes: sustainable economic growth; promoting economic efficiency and enabling private sector

### Environmental and Social Assessment

Environment: Category C

Indigenous peoples and resettlement: Category C

### Project Description

Provision of finance and guarantees through and in conjunction with international banks and developing member country (DMC) banks in support of DMC trade transactions.

A major change in scope and amount for the Trade Finance Facilitation Program is proposed to: (i) extend the term of operation of the Program to December 2013, (ii) increase the overall exposure limit for the Program from \$150 million to \$1 billion, and (iii) increase the maximum tenor of loans and guarantees under the Program from 2 to 3 years.

### Rationale

The Trade Finance Facilitation Program addresses a number of developmental themes central to the priorities of the Asian Development Bank (ADB). The Program promotes the following:

**Support Growth of Trade.** The importance of trade as a tool to help developing countries boost economic growth and generate the resources necessary to reduce poverty cannot be overemphasized. Trade enhances a country's access to goods, services, technologies, and knowledge. It stimulates the entrepreneurial activities of the private sector. It creates jobs and attracts private capital. It fosters vital "learning" processes. It increases foreign exchange earnings. Most importantly, it generates the resources for sustainable development and poverty reduction.

The regional capacity development technical assistance (R-CDTA) that is being proposed in a separate but related document—regional technical assistance for trade finance capacity development—will strengthen the likelihood that the Program's objectives will be achieved. The R-CDTA will increase the ability of DMCs and DMC banks to attract trade finance lines, including from international banks and the Program. The R-CDTA will undertake financial analysis and due diligence in the field on

DMC banks. Such analysis will (i) determine if individual DMC banks have gaps in their financial and technical capacity that would inhibit the provision of trade finance credit lines; and (ii) if there are gaps, identify those gaps. Identified gaps and prescriptions to fill them will be conveyed directly to DMC banks and through seminars conducted in DMCs that involve the broader banking community, government officials, and bank regulators. Annual reviews will provide for an ongoing dialogue with DMC banks and will enable the R-CDTA to monitor gains and work toward capacity development with the same DMC banks on a medium- and longer-term basis.

**Meet Market Demand.** The demand for ADB's trade finance products has risen. The Program has grown as a result of (i) an increase in the number of DMC banks in the Program, (ii) the introduction of a third product under the Program (the risk participation agreement), and (iii) market demand. From 2007 to 2008, exposure under the Program increased by more than 500%.

**Respond to Current Global Financial Crisis.** The global financial crisis has significantly reduced the availability of finance that companies depend on for trade. This lack of trade finance is exacerbating a dire global economic situation. Access to trade finance in times of crisis is crucial to cushion the impact of the global downturn on international trade. As such, the Program is increasingly needed to help fill gaps left by a weak international financial sector in financing trade.

**Support Banking Sector.** The Program supports the banking sector in ADB's DMCs in a number of ways. First, it provides resources for DMC banks to support DMC exporters and importers, which provides DMC banks with a relatively low-risk source of revenue generation. Second, the Program facilitates partnerships between international banks and DMC banks, which underpins the flow of capital from developed countries to developing countries and strengthens DMC banks.

**Support Small and Medium-Sized Enterprises.** The Program supports many small and medium-sized enterprises (SMEs) by providing guarantees and loans through DMC banks. SME development is important to an economy and tends to generate high levels of employment. With access to trade finance, SMEs can expand or sustain their imports and exports, thereby maintaining or increasing employment in DMCs.

**Enable Partnerships.** The Program enables partnerships between international banks and DMC banks that result in greater access to finance for DMC banks—and, by extension, more financial support to importing and exporting companies in DMCs. These relationships result in expanded trade finance lines, and mechanisms for facilitating knowledge and technology transfer to

DMC banks. Because ADB resources are often leverage by private sector resources, \$1 in exposure under the Program often equates to as much as \$2 in increased credit/risk exposure to support trade in the least-developed DMCs. As such, the Program catalyzes private sector capital in support of trade with DMCs.

**Countercyclical Instrument.** The Program is designed to support countries in times of crisis by providing countercyclical support. During political or economic crises, one of the first things affected is the provision of trade finance lines by international banks and insurers. As a result of this reduction or cancellation of credit lines to DMCs and DMC banks, companies in these countries may not be able to import vital foods, medicines, and inputs for export production. Losing trade finance lines results in a loss of import and export contracts, which shrinks employment, gross domestic product, government revenue, and foreign exchange earnings. Although the Program alone cannot prevent the worst effects of a crisis, it can lessen some of them.

**Regional Cooperation and Integration.** The Program supports intraregional and bilateral trade between DMCs. Access to trade finance is a vital component for developing regional cooperation and integration. As noted in the long-term strategic framework 2008–2020 (Strategy 2020), regional cooperation and integration can improve a DMC's ability to expand joint investment and trade with its neighbors, strengthen transport and information connections, and improve information and communications technology.

**Value Added.** Sources for trade finance are evaporating rapidly as a result of tightened liquidity and heightened risk perceptions. The expansion of the Program is important to joining other efforts to support international trade at this challenging time.

<b>Impact and Outcome</b>	The impact of the expansion of the Program will be growth in international and intraregional trade in and among DMCs. The anticipated outcome will be an increase in imports and exports by companies in DMCs.
<b>Period of Utilization</b>	Through 2013
<b>Estimated Project Completion Date</b>	2013
<b>Implementation Arrangements</b>	The Program includes 50 DMC banks, which require monitoring and annual reviews. In addition, at least 75 more DMC banks will be added to the Program. All transactions are conducted subject to DMC bank limits endorsed by ADB's Risk Management Unit (RMU). Funding and guarantee limits are implemented through financial analysis, due diligence, and credit applications submitted to ADB for approval.

**Project Beneficiaries**

Project beneficiaries include SMEs and other companies engaged in importing and exporting, employees and employment seekers who are required as labor in these companies, DMC banks, and DMCs. In addition, DMCs benefit because the Program provides a precise instrument for ADB intervention into those countries that are affected by crisis.

**Risks and Mitigating Measures**

(The information in this section is withheld based on exception 9 in paragraph 126 of the PCP.)

## I. THE PROPOSAL

1. I submit for your approval the following major change in scope and amount for the Trade Finance Facilitation Program, including (i) an extension of the term of operation of the Program to December 2013, (ii) an increase in the overall exposure limit<sup>1</sup> for the Program from \$150 million to \$1 billion,<sup>2</sup> and (iii) an increase in the maximum tenor of loans and guarantees under the Program from 2 to 3 years.<sup>3</sup>

2. The Board of Directors approved the Program in October 2003 for an overall exposure limit of \$150 million. The original 5-year term of operation of the Program expired in December 2008. The scope of the Program has been amended in recent years and undergone a number of changes approved by Management and the Board, including an extension of the Program to December 2009. This major change in scope and amount provides a comprehensive description of the Program as it would be amended. Once approved, it will supersede the terms of the Program as described in the initial report and recommendation of the President approved by the Board and related changes in scope.

## II. RATIONALE: BACKGROUND, CHALLENGES, AND OPPORTUNITIES

3. **Overview.** Trade has long been recognized as an important tool for generating economic growth in developing countries, and integrating these countries into the global market. Its importance in creating the resources necessary to reduce poverty cannot be overemphasized. Trade enhances a country's access to goods, services, technologies, and knowledge. It stimulates the entrepreneurial activities of the private sector. It creates jobs and attracts private capital. It fosters vital "learning" processes. It increases foreign exchange earnings. Most importantly, it generates the resources for sustainable development and poverty reduction.

4. Asia's economic success over the past 50 years has been linked to outward-oriented development policies, investment in infrastructure, and trade-support institutions. Access to ample supplies of trade finance<sup>4</sup> has underpinned much of the trade-oriented economic growth. Nonetheless, much of the success in the region has been confined to a handful of newly industrializing economies alongside a number of less-developed countries (LDCs). Future trade-led growth needs to focus on the LDCs to ensure that economic prosperity is more widespread. Trade finance is a crucial ingredient to this effort.

5. Access to trade finance is crucial for developing countries. The absence of such funds has impeded their ability to fully participate in international trade. In the past, few banks in developing countries have had access and the capacity to obtain trade finance. Many international banks have been risk averse to working with banks in developing countries, even though the risk profile for trade finance is low. This is still largely the case in many countries.

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<sup>1</sup> Program limit and exposure limit are used interchangeably.

<sup>2</sup> Of the \$1 billion, \$500 million will be available for 2009 and the entire amount will be available thereafter. In the event more than \$500 million can be used in 2009, ADB management may take the decision to increase amounts available to the TFFP in 2009, provided it remains within the over-all amount, approval for which is sought in this request for major change, of \$1 billion.

<sup>3</sup> Tenors may be for up to 3 years on an unsecured basis.

<sup>4</sup> Trade finance is the provision of risk mitigation through financial institutions and funding in support of trade.



6. The Aid for Trade initiative of the World Trade Organization, which is an integral part of any Doha trade agreement, emphasizes trade finance. Heads of state and ministers underscored this point at the Manila regional Aid for Trade Review meeting at Asian Development Bank (ADB) headquarters in November 2007.

7. ADB established the Program to address the lack of access to trade finance by developing member countries (DMCs). The Program entailed the provision of short-term guarantees and hard currency loans, which helped DMC banks offer importers and exporters reliable access to domestic trade finance. In addition, it enabled DMC banks to access trade finance from international banks. It also was designed to provide liquidity and stability to the trade finance system during periods of political and/or financial crisis. The Program reduced the risk for importers and exporters by encouraging the use of trade finance instruments.

8. **Global Financial Crisis.** This proposal is submitted for Board consideration in the midst of a global financial crisis, which has led to economic recession in many developed countries.<sup>5</sup> The International Monetary Fund (IMF) projects global growth of only 0.5% in 2009, virtually all of it coming from developing countries.<sup>6</sup> Yet, the Institute for International Finance forecasts capital flows in 2009 to these countries will be less than half the amount in 2008, and only one fifth of 2007 levels. If the world is to emerge from the current economic malaise, it will require a focus on international trade,<sup>7</sup> which can help fuel virtually the only growth in evidence, which is in developing countries. To capitalize on this growth, financial resources in the form of trade finance are needed.

9. Despite the precipitous decline in international trade, demand for trade finance is increasing. While many international trade transactions would normally occur on open account terms (meaning no trade finance guarantees on importer-payment risk), exporters are increasingly requiring trade finance because of heightened concerns about payment risk. As such, heightened demand was noted at the Program and roundtable discussions held in January and February 2009, which included 13 banks.

10. The decrease in supply of trade finance is severe. Three primary factors are contributing to a shortage of supply:

- (i) International banks have less credit available. They are focused on dedicating more capital to bolstering their capital adequacy and less to extending credit in general, including for trade finance.
- (ii) The global economic decline has created new concerns among financial institutions and investors about risk in developing countries. Slowing exports from DMCs and the possibility of declining remittances are of particular concern as it appears that the global economic decline will be protracted rather than short-lived. As such, financial institutions have reduced DMC country exposure limits.

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<sup>5</sup> According to the IMF *World Economic Outlook Update* of 28 January 2009, "...output in the advanced economies is now expected to contract by 2 percent in 2009. This would be the first annual contraction during the postwar period, with a cumulative output loss (relative to potential) comparable to the 1974–75 and 1980–82 periods".

<sup>6</sup> According to the IMF, 28 January 2009, "Growth in emerging and developing economies is expected to slow sharply from 6¼ percent in 2008 to 3¼ percent in 2009, under the drag of falling export demand and financing..."

<sup>7</sup> The World Bank predicts that international trade will contract in 2009 for the first time since 1982, when economies in Europe and North America were in recession.

Lower DMC country limits among international banks is contributing to the shortage of trade finance available in the market.

- (iii) In the midst of financial institution failures and downgrades in developed countries, primarily in Western countries, banks have reduced their lines to insurance and other financial entities that normally leverage country and DMC bank limits for trade finance. Because of concerns over these counterparty risks, less trade finance is available.

11. Maintaining trade flows is vital during this period. Access to trade finance in times of crisis is crucial to cushioning the shock of the global downturn in international trade. The impact of the decline in trade finance is magnified in developing countries. The World Trade Organization has observed that the tightening or absence of trade finance in developing countries can prolong their recovery during an economic crisis.<sup>8</sup> In a deep economic downturn, DMC banks are unable to provide trade finance because their trade finance lines from international banks have been reduced or cut, thus leaving productive domestic sectors without working capital. Most importantly, the lower-income segments of the population in developing countries that are employed by small and medium-sized enterprises (SMEs), or depend upon exporting and/or importing businesses, are likely to suffer first and most from loss of employment.

12. The Program can help by providing support to international trade. It is ideally suited to address important aspects of this crisis. The Program benefits DMCs by providing the resources (through DMC banks) needed to support international trade, including for vital goods such as food, fuel, medicines, and inputs for export production. The Program also supports companies in developed countries that seek to export goods and services to developing countries, the primary area of growth in the global economy today. This proposal is, in part, ADB's response to this serious problem.

### III. THE PROGRAM

#### A. The Current Program

13. **Overview.** The Program started operations in 2004 and consists of three products:<sup>9</sup> (i) a credit guarantee (CG) facility, under which ADB issues guarantees to participating international and regional banks (confirming banks) to guarantee payment obligations issued by approved DMC/local banks (issuing banks) in selected DMCs;<sup>10</sup> (ii) a revolving credit facility (RCF), under which ADB provides trade-related loans to DMC banks in support of DMC companies' export and import activities; and (iii) risk participation agreement (RPA), under which ADB shares risk with international banks to support and expand trade in challenging and frontier markets. The

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<sup>8</sup> Auboin, Marc. 2007. *Boosting Trade Finance in Developing Countries: What Link with the WTO?* World Trade Organization Economics Research and Statistics Division

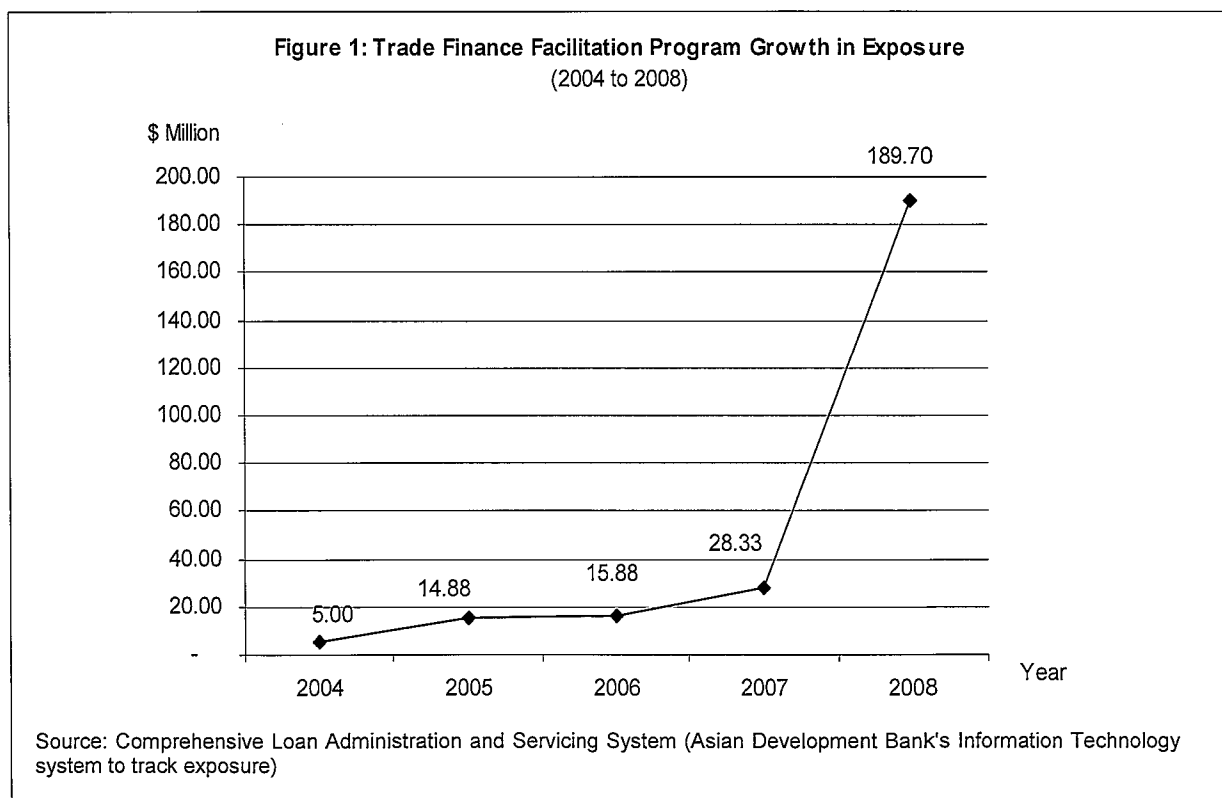
<sup>9</sup> The Program is encouraged to develop new products according to market demand, provided those products comply with the parameters (exposure and tenor limits) established herein. This includes the possibility of assuming risk on different types of financial institutions in addition to banks. This includes schemes to share risk with other multilateral development banks, government, private entities and bi-lateral organizations.

<sup>10</sup> Guarantees are issued subject to ADB-endorsed guarantee limits provided for DMC banks.

CG and RPA are (unfunded) products,<sup>11</sup> while the RCF is funded. Detailed descriptions of these three products of the Program are in Appendixes 1–3.<sup>12</sup>

14. Under the TFFP (CG and RPA products), ADB assumes DMC country and DMC bank risk in support of trade transactions. The Program often attracts private sector resources from developed countries to support trade with DMCs, mostly the least-developed DMCs, multiplying capacity to support trade. At the same time, it often leverages ADB's resources, enabling ADB to get the greatest development impact per dollar invested.

15. The Program is demand driven and results-oriented. It has grown dramatically in the past 12 months (Figure 1). Strong levels of programmatic growth have been due to a variety of factors, including an increase in the number of participating banks in the Program, the introduction of the RPA,<sup>13</sup> and an overall increase in market demand for trade finance. For 2008, the Program had an aggregate exposure of almost \$190 million. This amount was not in breach of the Program exposure limit of \$150 million, because tenors for most transactions were less than 6 months, allowing Program limits to be recycled/revolving in support of new transactions. The net exposure of ADB never exceeded \$150 million.

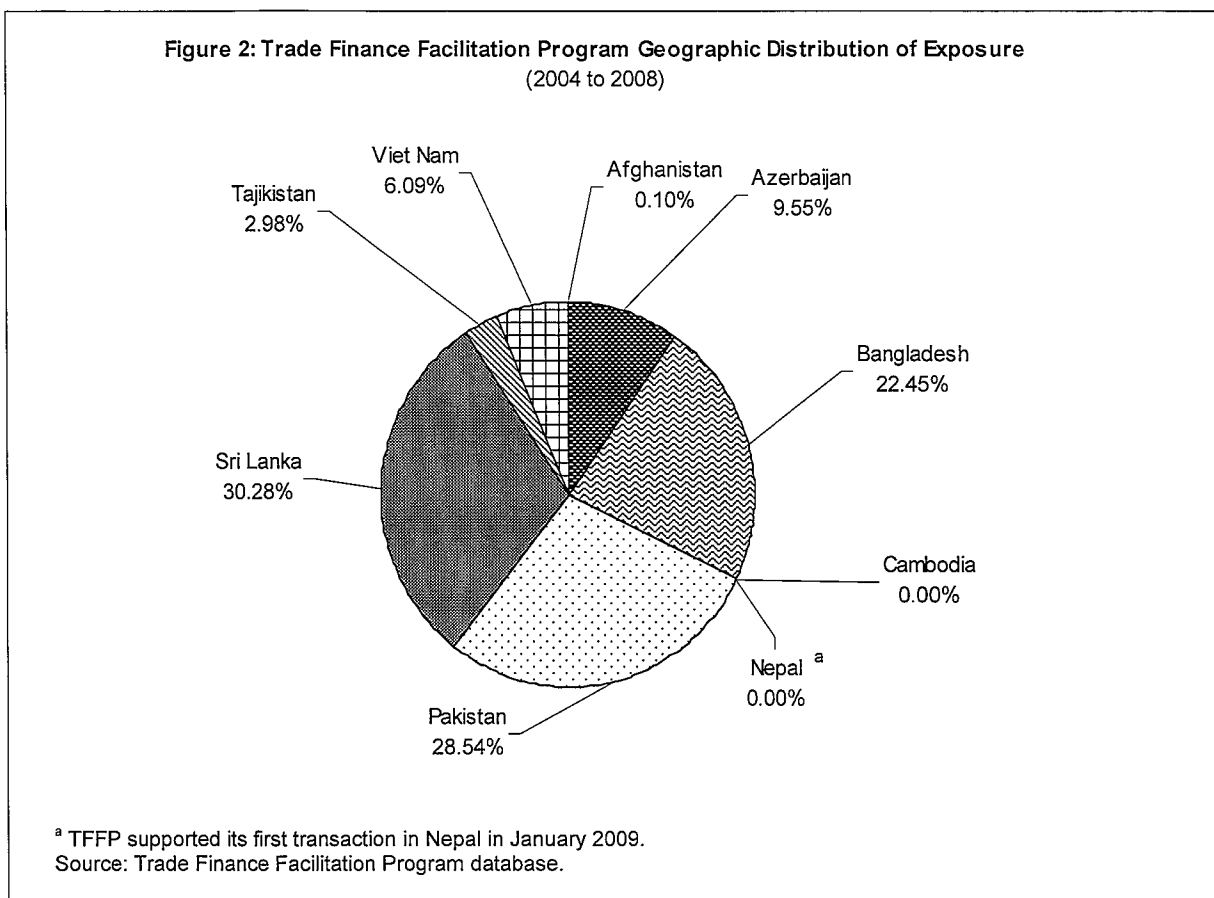


<sup>11</sup> The RPA is treated as a Guarantee for the purposes of this document, however unlike a guarantee it does not provide for subrogation rights.

<sup>12</sup> Going forward, the Program will continue to provide guarantees and loans in United States Dollars, European Union Euros and Japanese Yen.

<sup>13</sup> Refer to Appendix 7 for the procedure on RPA product.

16. **Geographic Distribution.** As the private sector seeks risk mitigation, mostly for the least-developed countries, the Program gravitates to the DMCs most in need. The Program currently operates in the following countries:<sup>14</sup> Afghanistan, Azerbaijan, Bangladesh, Cambodia, Nepal, Pakistan, Sri Lanka, Tajikistan,<sup>15</sup> and Viet Nam.<sup>16</sup> Figure 2 provides information on the geographic distribution and exposure of the Program.



17. **Program Results.** The Program has supported 1,195 international trade transactions valued at more than \$578 million. The Program involves 72 international banks and 50 DMC banks, 39 of which were added since December 2007. The number of DMC banks will increase to about 100 by the end of 2009.<sup>17</sup> Detailed program results are in Table 1.

<sup>14</sup> For an explanation of how the Program determines in which countries it targets in order of priority, refer to para. 25.

<sup>15</sup> The Program is currently unable to do business through the one participating Tajik bank because of a breach in financial covenants.

<sup>16</sup> Cambodia registers no exposure in Figure 2 because DMC bank lines in this country have recently been approved. While lines in Nepal have also recently been established, the Program has supported a transaction (medical equipment imported from Japan) in that market, but the dollar value was small and therefore does not register in Figure 2. Exposure by geography is closely correlated to the number of DMC banks participating in the Program by country. Exposure under the Program portfolio will broaden as it expands to more banks within the below-mentioned countries and as it expands to new countries.

<sup>17</sup> Capacity building technical assistance (CDTA) is also proposed in parallel with this report. The CDTA will be used to hire consultants who will work in DMCs with DMC banks to assess and increase their capacity to participate in the Program.

**Table 1: Key Program Results****A. Development Results**

1. Supported 675 intra-regional trade transactions
2. Supported 532 DMC-to-DMC trade transactions
3. Supported over 158 SME trade transactions
4. 1,195 trade transactions supported representing a total value of over \$578 million

**B. Program Results**

1. Implemented in 9 countries
2. Increased volume by 570% in 2008 over 2007; increased volume by 78% in 2007 compared with 2006
3. The Program operated on a profitable basis
4. No losses and no problem loans in the history of TFFP

DMC = developing member country, SME = small and medium-sized enterprises, TFFP = Trade Finance Facilitation Program.

Source: Capital Markets and Financial Sectors Division-Trade Finance Facilitation Program.

18. **Lessons Learned.** ADB has learned a number of lessons during the 4 years of the Program's operations. These lessons have been incorporated into the operational strategy for the Program. The primary lessons learned are the following:

- (i) A market-based strategy is important for the success of the Program, both with respect to DMCs and DMC banks to target for expansion. The RPA under the Program has helped to facilitate close coordination with market players, facilitating a market-based strategy of targeting DMCs and DMC banks. This has resulted in higher utilization of lines under the Program.
- (ii) For the Program to fulfill its mandate to react quickly to crises in DMCs, it needs to have the immediate flexibility to provide 100% cover on all its lines per DMC bank that have been approved by ADB's Risk Management Unit (RMU).

**B. Program Extension and Increase of Exposure**

19. The maximum overall exposure at any one time that the current Program can assume is set at \$150 million.<sup>18</sup> Current levels of delegated credit lines combined with market analysis conducted by the Program provide overwhelming evidence that demand exceeds the current exposure limits. Therefore, the Program's relevance to the market is clear, as well as the imperative to extend the Program and increase its overall exposure limit.<sup>19</sup>

<sup>18</sup> The exposure limit is the amount of exposure that can be assumed by ADB under the Program at any one time. Tenors for individual transactions are frequently as short as 30, 60, and 90 days. As such, transaction volumes are high and are constantly revolving. This volume and turnover make administration particularly challenging. The high turnover also means that exposure levels fluctuate significantly from week to week and month to month.

<sup>19</sup> The exposure limit is net of those amounts of risk distributed, offloaded, and/or syndicated to non-DMC counterparty risks.

20. **Growing Demand.** As of December 2008, Program volume was 570% higher than in 2007. The Program increased by 78% in transaction volumes in 2007 compared with 2006. As shown in Table 2, a survey of demand from nine banks to share risk in DMCs under the Program surpasses \$3 billion.

21. (The information in this paragraph is withheld based on exception 9 in paragraph 126 of the PCP.)

22. The proposed Program limit increase to \$1 billion may not meet demand, especially since this exposure limit would apply in aggregate to all DMCs and all obligor (DMC bank) risks assumed under the Program. In this context, the proposed \$1 billion—spread unevenly among all DMCs and DMC banks—is not a large amount. It is anticipated that the Program may require further increases before 2013. The Program limit is currently available to nine DMCs. The Program expects to expand in about six DMCs by the end of 2009, and double its network of issuing banks to 100 by then. DMC banks have expressed a strong interest in higher Program limits because they are the recipients (and beneficiaries, along with their importing and exporting clients) of the higher exposure.

23. **Market Trends and the Impact on Program Limits.** In the current credit crunch and risk environment, many (if not most) international banks have reduced their exposures, including trade finance facilities. This has had an impact on DMC banks and their importing and exporting clients, which are finding funding more scarce and expensive. Non-funded trade finance products, (such as guarantees on letters of credit) have also become more scarce and expensive, as some international banks are taking a more cautious approach to country and bank risk.

24. Three market trends in particular are affecting the trade finance market and demand for the Program:

- (i) **Tightened liquidity.** International banks are dedicating more capital to bolstering their capital adequacy and less to extending credit, including for trade transactions. This leaves less capacity to support trade in DMCs. As such, the Program is in strong demand to fill the gap in available trade finance.
- (ii) **Risk aversion to developing member countries.** The global economic slowdown has created new concerns among international financial institutions and investors about DMC risk. As such, less capital has been allocated to DMCs to support a wide array of economic activity, including trade. An increase in the Program limit would (albeit in a very small way) fill some of the gap left by the private sector and provide additional support to DMC importing and exporting companies.
- (iii) **Concern about counterparty risk.** In the midst of financial institution failures in developed countries, ADB—as a AAA-rated entity—is an attractive counterparty risk to international banks looking to mitigate commercial (DMC bank) risk and country and/or political risk through the Program's guarantee products.

25. **Expansion Strategy.** Since the first quarter of 2007, the Program's expansion strategy has been market driven, and it will continue to be. To determine where market demand is highest for Program support, ADB asked bank partners where need is greatest for risk

mitigation. The Program chooses in which countries to expand (in order of priority), as well as the banks that ADB considers for inclusion, based on the list of countries and DMC banks provided by the market. The next countries targeted for implementation are Indonesia, the Philippines, Mongolia, Azerbaijan, Uzbekistan, Afghanistan, Kazakhstan, and Turkmenistan.

26. An element of the Program's expansion strategy involves addressing capacity constraints among DMCs and DMC banks. Under a joint Technical Assistance Special Fund–Japan Special Fund regional capacity development technical assistance (R-CDTA), which is also proposed for Board approval, the Program's expansion is complemented with capacity development in DMCs. This R-CDTA is proposed for Board consideration in a separate document.

### **C. Operational and Guiding Principles**

27. (The information in this section is withheld based on exception 9 in paragraph 126 of the PCP.)

### **D. Monitoring and Oversight<sup>20</sup>**

28. The Program has embedded in its procedures, checks and balances, monitoring, and oversight that involve multiple departments of ADB.

- (i) Before the Program can enter into a transaction, ADB must endorse DMC bank limits for amount and tenor. (A detailed process of establishing DMC bank limits is in Appendix 4)
- (ii) The Program team ensures that the authorizations and limits are sufficient to conduct a transaction, and then generates the transaction.<sup>21</sup>
- (iii) All transactions and exposure are entered into the ADB's information technology system such that ADB can monitor to determine that no Program transaction has been conducted without sufficient Program and ADB-endorsed DMC bank (obligor) limits.

## **IV. PROGRAM BENEFITS, IMPACTS, ASSUMPTIONS, AND RISKS**

### **A. Justification**

#### **1. Development Outcome**

29. The importance of trade as a tool to help developing countries boost economic growth and generate the resources necessary to reduce poverty cannot be overemphasized. Trade enhances a country's access to goods, services, technologies, and knowledge. It stimulates the entrepreneurial activities of the private sector. It creates jobs and attracts private capital. It

<sup>20</sup> Section III D of this report is subject to change in the event of need and as deemed appropriate by ADB Management.

<sup>21</sup> This will not be the case for Program products (such as the RPA) that do not involve approvals for individual transactions, but are reported monthly (or otherwise) on a portfolio basis. The reports are submitted and checked by the Program team and verified by the Controller's Department. All transactions, including those that are reported on a portfolio basis can be conducted only within Program limits and ADB-endorsed DMC bank (obligor) limits.

fosters vital "learning" processes. It increases foreign exchange earnings. Most importantly, it generates the resources for sustainable development and poverty reduction.

30. For low-income countries in particular, developing links to international markets for exports, imports, and capital plays an important role in economic expansion. Trade also provides access to modern technology, expertise, and ideas, and is a strong source of competitive pressure for improving efficiency and productivity. The development patterns of many countries, including Japan and the Republic of Korea, demonstrate how trade is a powerful development mechanism, as does the recent growth of the PRC and India. Trade expansion depends on reliable financing, both long-term for capital goods and short-term for commodities and consumer goods.

31. The developmental impact of ADB's Program is strong. The Program addresses the following areas and themes:

- (i) **Support banking sector.** The Program supports the banking sector in ADB's DMCs in a number of ways. First, it channels resources to DMC banks to provide trade finance services to DMC exporting and importing companies. These trade finance services provide DMC banks with a relatively low-risk source of revenue generation. Second, the Program facilitates partnerships between international banks and DMC banks, which underpins the flow of capital from developed countries to developing countries and strengthens DMC banks. Third, the Program strengthens DMC banks' knowledge about financial reporting standards, transparency, and governance through ADB's due diligence process on each DMC bank it considers for inclusion in the Program.
- (ii) **Support small and medium-sized enterprises.**<sup>22</sup> The Program supports many SMEs by providing guarantees and loans through DMC banks. SME development is important to an economy and tends to generate high levels of employment. With access to trade finance, SMEs can expand or sustain their imports and exports, thereby increasing employment in DMCs.
- (iii) **Enable partnerships.** The Program enables partnerships between international banks and DMC banks that result in greater access to finance for DMC banks, and by extension more financial support to importing and exporting companies in DMCs. Through the Program's CG facility, and more recently through the RPA product, the Program provides a means for establishing strong working relationships between international banks and DMC banks. These relationships result in expanded trade finance lines and a mechanism for facilitating knowledge and technology transfer to DMC banks.<sup>23</sup> Because private sector resources are leveraged through ADB's Program, \$1 in Program exposure often equates to as much as \$2 in increased credit/risk exposure to the least-developed DMCs. As such, the Program catalyzes private sector capital in support of trade with DMCs.

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<sup>22</sup> Table 1 shows the statistics on the number of SMEs supported by the Program to date

<sup>23</sup> In addition to enabling partnerships, the Program supports and encourages private-private partnerships between international and DMC banks. These partnerships result not only in credit lines to DMCs, but often in knowledge and/or technology transfer, especially in areas such as anti-money-laundering measures, as well as treasury and risk management. Especially in the least-developed financial markets, international banks provide training in risk management and treasury products to (i) improve their risk on DMC banks, and (ii) facilitate sales of treasury and risk management products.



- (iv) **Countercyclical instrument.** The Program is designed to support countries in times of crisis by providing countercyclical support. During political or economic crises, one of the first things affected is the provision of trade finance lines by international banks and insurers. As a result of this reduction or cancellation of credit lines to DMCs and DMC banks, companies in these countries may not be able to import vital foods, medicines, and inputs for export production. Losing trade finance lines results in a loss of import and export contracts, which shrinks employment, gross domestic product, government revenue, and foreign exchange earnings. Although the Program alone cannot prevent the worst effects of a crisis, it can lessen some of them. By providing guarantees (through CG and RPA products) to international banks covering DMC and DMC bank risk, the Program helps maintain trade finance lines to DMC countries in challenging times. The Program also provides liquidity (through the RCF product) to DMC banks, which is used to support DMC exporters with pre-export finance.

Related to the first countercyclical development-impact component is the manner in which ADB can respond to economic crisis. Massive sovereign loans are a relatively blunt instrument, which nevertheless may have a place in a range of intervention options. The Program provides a precise instrument or mechanism through which efficient and effective support can be channeled directly to the private finance sector and the trade sector of a crisis-stricken DMC.<sup>24</sup>

- (v) **Regional cooperation and integration.**<sup>25</sup> The Program supports intraregional and bilateral trade between DMCs. Access to trade finance is a vital component for developing regional cooperation and integration. As noted in the long-term strategic framework 2008–2020 (Strategy 2020), regional cooperation and integration can improve a DMC's ability to expand joint investment and trade with its neighbors, strengthen transport and information connections, and improve information and communications technology.
- (vi) **Respond to current global financial crisis.** The global financial crisis has significantly reduced the availability of finance that companies depend on for trade. This lack of trade finance is exacerbating a dire global economic environment. Access to trade finance in times of crisis is crucial to ensuring that international trade can help absorb the shock of the global economic slump. As such, the Program is increasingly needed to help fill gaps left by a weak international finance sector in financing trade.

## 2. Program Objectives

32. ADB's objectives for the Program are to increase the availability of trade finance to DMCs and DMC banks throughout Asia and the Pacific. The Program will provide funding in

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<sup>24</sup> While not part of ADB's mandate, another benefit to the Program in countercyclical circumstances is that it provides guarantees supporting exports from MCs to DMCs, which is important in the context of recessions occurring in MCs and economic growth (albeit at diminished rates) in DMCs. This underscores the notion of mutual gains in international trade, where trade fuels economic growth in both the exporter's and importer's country.

<sup>25</sup> Table 1 provides statistics on the number of intraregional and DMC–DMC transactions supported by the Program to date.

conjunction with DMC banks, and guarantees in conjunction with international and DMC banks, in support of DMC trade transactions.

33. The R-CDTA that is proposed under a separate but related document will improve the ability of DMCs and DMC banks to attract trade finance lines, including from international banks and the Program. The R-CDTA will undertake financial analysis and due diligence in the field on DMC banks. Such analysis will (i) determine if individual DMC banks have gaps in their financial and technical capacity that would inhibit the provision of trade finance credit lines; and (ii) if there are gaps, identify those gaps. Identified gaps and prescriptions to fill those gaps will be conveyed directly to DMC banks and through seminars involving the broader banking community in targeted DMCs, as well as government officials and bank regulators. Annual reviews will provide for an ongoing dialogue with DMC banks, and will enable the R-CDTA to monitor gains and work toward capacity development with the same DMC banks on a medium- and longer-term basis.

### **3. Value Added**

34. Sources of trade finance are evaporating rapidly as a result of tightened liquidity and heightened risk perceptions. The expansion of ADB's Program is important to joining other efforts to support international trade at this challenging time.

### **4. Design and Monitoring Framework**

35. ADB has prepared a design and monitoring framework and will measure the expected development impact of the Program in accordance with ADB's *Management and Development Results Policy*.<sup>26</sup> The design and monitoring framework is in Appendix 8.

### **5. Goods and Services**

36. The international and regional flow of services is an increasingly important component of international trade. Although many DMC economies lack the breadth and depth of services of major developed countries, the Program should be responsive to this growing trend in DMCs. Because of the importance of the flow of services across borders, services are not excluded from the Program.<sup>27</sup>

37. An underlying goal of the Program is to bolster trade with ADB's DMCs. In keeping with this objective, approval from the Board is requested to allow the Program to support transactions in which the import or export of goods and services involve all countries, including non-ADB member countries, so long as the goods flow to or from a DMC that is not an embargoed country.

### **6. Fit to Sector and Country Strategy and Program**

38. The Program addresses a number of developmental themes central to ADB's priorities: fostering intraregional trade; focusing on low-income countries; supporting SMEs; and helping to mitigate the impact of the global financial crisis on low-income countries. The Program fosters

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<sup>26</sup> ADB. 2007. *Management and Development Results Policy*. Manila.

<sup>27</sup> As with the trade finance programs of EBRD and IFC, the TFFP supports trade in services including in the form of bid, performance and advance payment guarantees.

partnerships between ADB, international banks, and DMC banks, which supports two of the five drivers of change cited in Strategy 2020: (i) private sector development and private sector operations, and (ii) partnerships. In addition, the Program bolsters ADB's plan to (i) have 80% of its operations in its new core operational areas by 2012; and (ii) scale up private sector development and private sector operations in all operational areas, reaching 50% of annual operations by 2020. The Program also focuses on two of the five core ADB specializations supporting Strategy 2020: (i) regional cooperation and integration, and (ii) finance sector development. Furthermore, it supports two pillars of the regional cooperation and integration strategy (July 2006): (i) trade and investment cooperation and integration (pillar 2); and (ii) monetary, financial cooperation and integration (pillar 3).

## **B. Social and Environmental Safeguard Policies**

39. The Program has been assigned a category C environmental classification and a category C with respect to ADB's *Policy on Indigenous Peoples* (1998) and *Involuntary Resettlement Policy* (1995). The Program's agreements include a list of excluded activities in line with ADB requirement for private sector operations.

## **C. Anticorruption Policy, and Combating Money Laundering and the Financing of Terrorism**

40. Consistent with its commitment to good governance, accountability, and transparency and further to ADB's *Anticorruption Policy* (1998, as amended to date) and *Combating Money Laundering and the Financing of Terrorism Policy* (2003), ADB will require banks participating in the Program to maintain and comply with internal procedures and controls following international best practice standards for the purpose of preventing corruption or money laundering activities or the financing of terrorism; and covenant with ADB to refrain from engaging in such activities.

## **D. Main Risks and Mitigation Measures**

(The information in this section is withheld based on exception 9 in paragraph 126 of the PCP.)

## **V. EXPOSURE LIMITS**

41. Exposure limits are closely monitored to ensure that any exposure by ADB under the Program is within approved aggregate sector, country, group, and single project limits for nonsovereign operations.

## **VI. RECOMMENDATION**

42. I am satisfied that the proposed major change in scope and amount would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the revised Trade Finance Facilitation Program as described in this paper, including the following key changes.

- (i) an increase of the overall exposure limit for the Trade Finance Facilitation Program to \$1,000,000,000;<sup>28</sup>

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<sup>28</sup> Of the \$1 billion, \$500 million will be available for 2009 and the entire amount will be available thereafter.

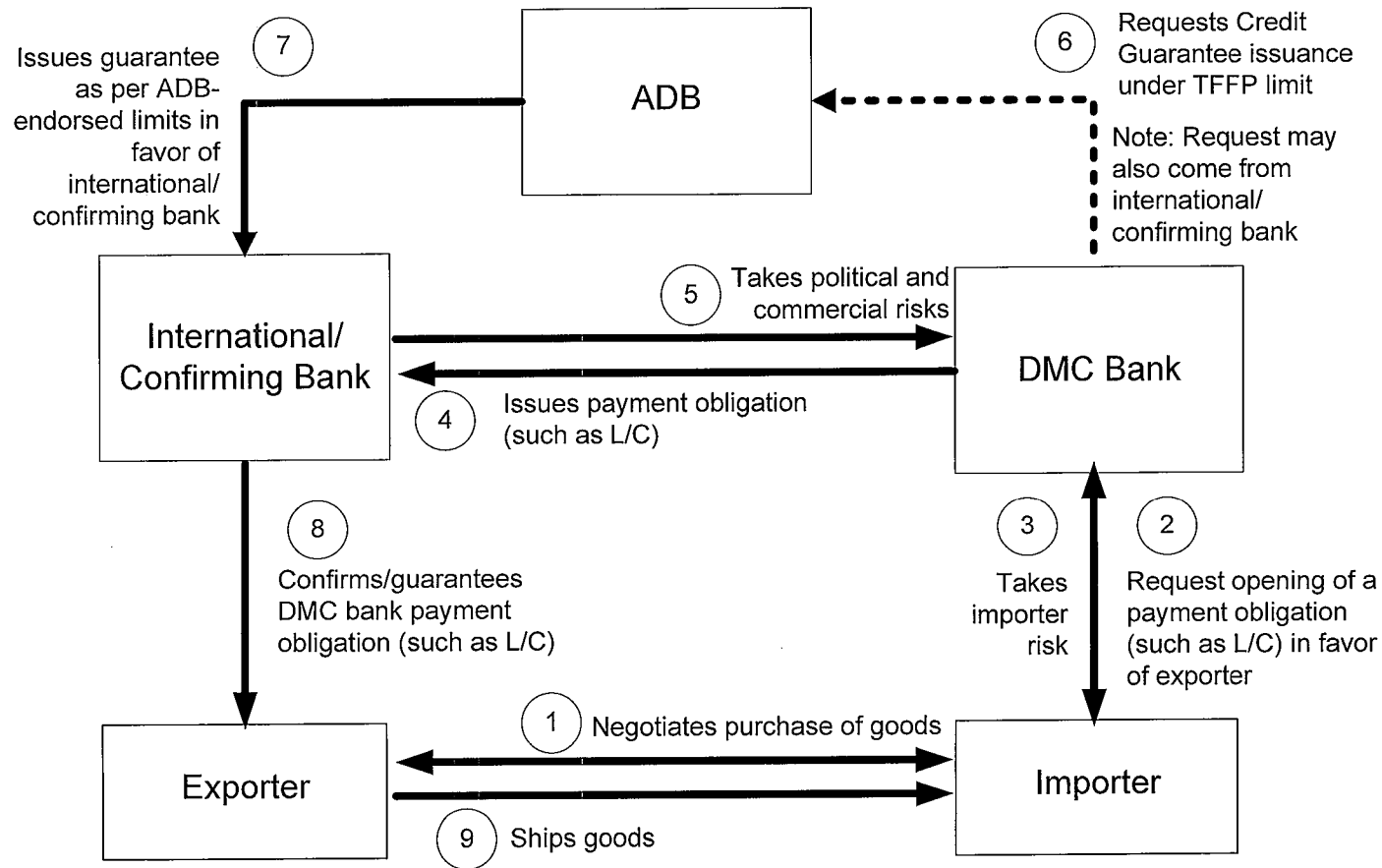
- (ii) an extension of the term of operation of the Trade Finance Facilitation Program to December 2013; and
- (iii) an increase in the maximum tenor of funds loaned or guaranteed under the Trade Finance Facilitation Program from 2 to 3 years.

43. I further recommend that the Board approve, as it did in the original Program report and recommendation of the President, by requisite affirmation vote of Directors representing not less than two-thirds of the total voting power of ADB's members, pursuant to Article 14 (ix) of the Articles of Agreement, that obligations issued by DMC banks included in the Program to cover goods and services procured from non-ADB member countries that flow to or from such developing member countries be eligible for support under the Program. If the required affirmative vote of Directors is not obtained and the Board has approved the recommendation in paragraph 70 above, then only obligations that cover goods and services procured from ADB member countries will be eligible for support under the Program.

Haruhiko Kuroda  
President

10 March 2009

## CREDIT GUARANTEE (CG) PRODUCT

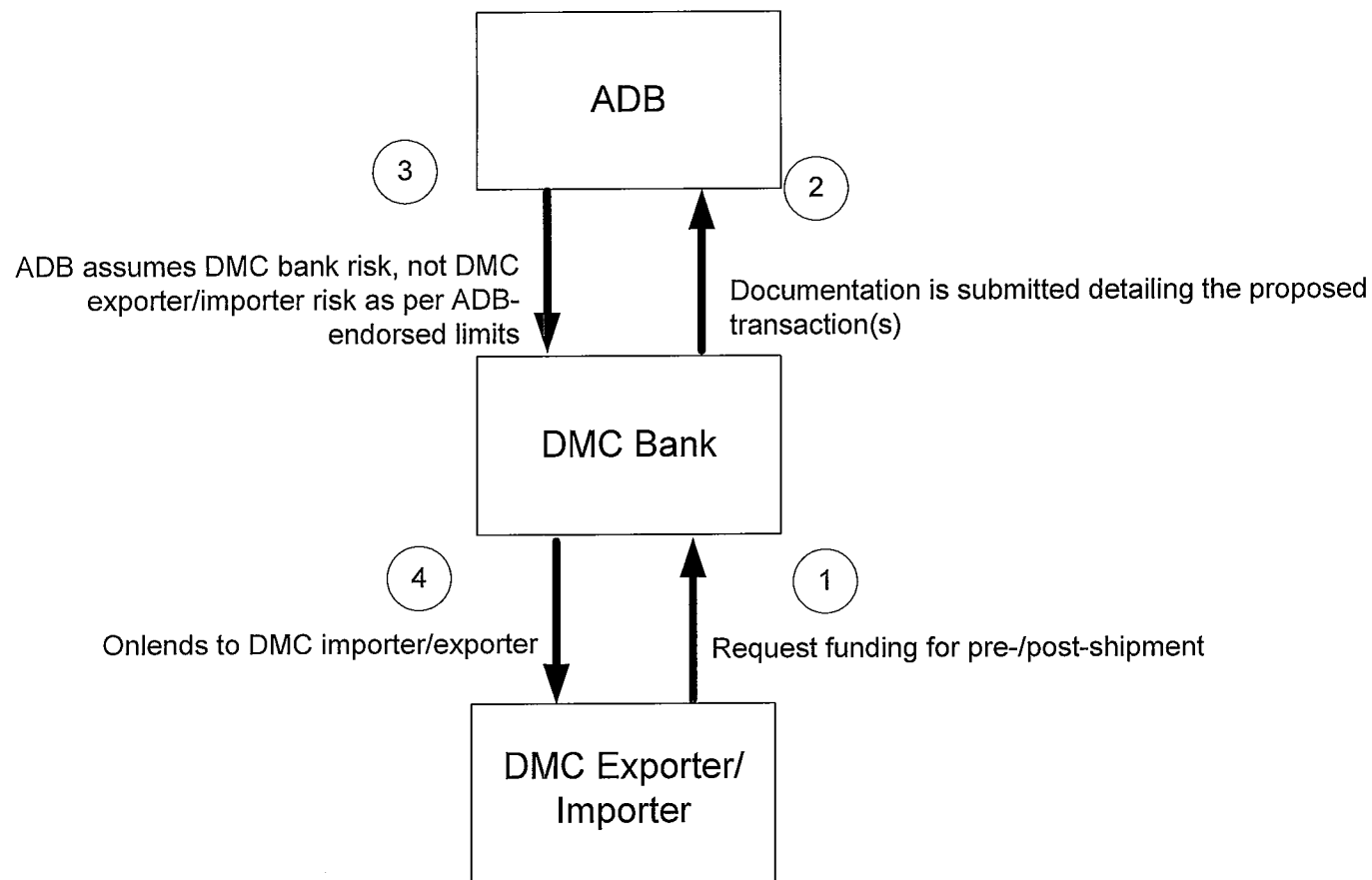


ADB = Asian Development Bank, DMC = developing member country, L/C = letter of credit .

Notes:

1. Prior to any transaction being eligible, the Trade Finance Facilitation Program will have already secured ADB-endorsed DMC bank limits.
  2. Notwithstanding step 1, the entire process can take as little time as a few days.
  3. This diagram is only an example to provide a general idea of the TFFP's CG product. This is in reference to para. 13.
- Source: Capital Markets and Financial Sectors Division-TFFP.

## REVOLVING CREDIT FACILITY PRODUCT

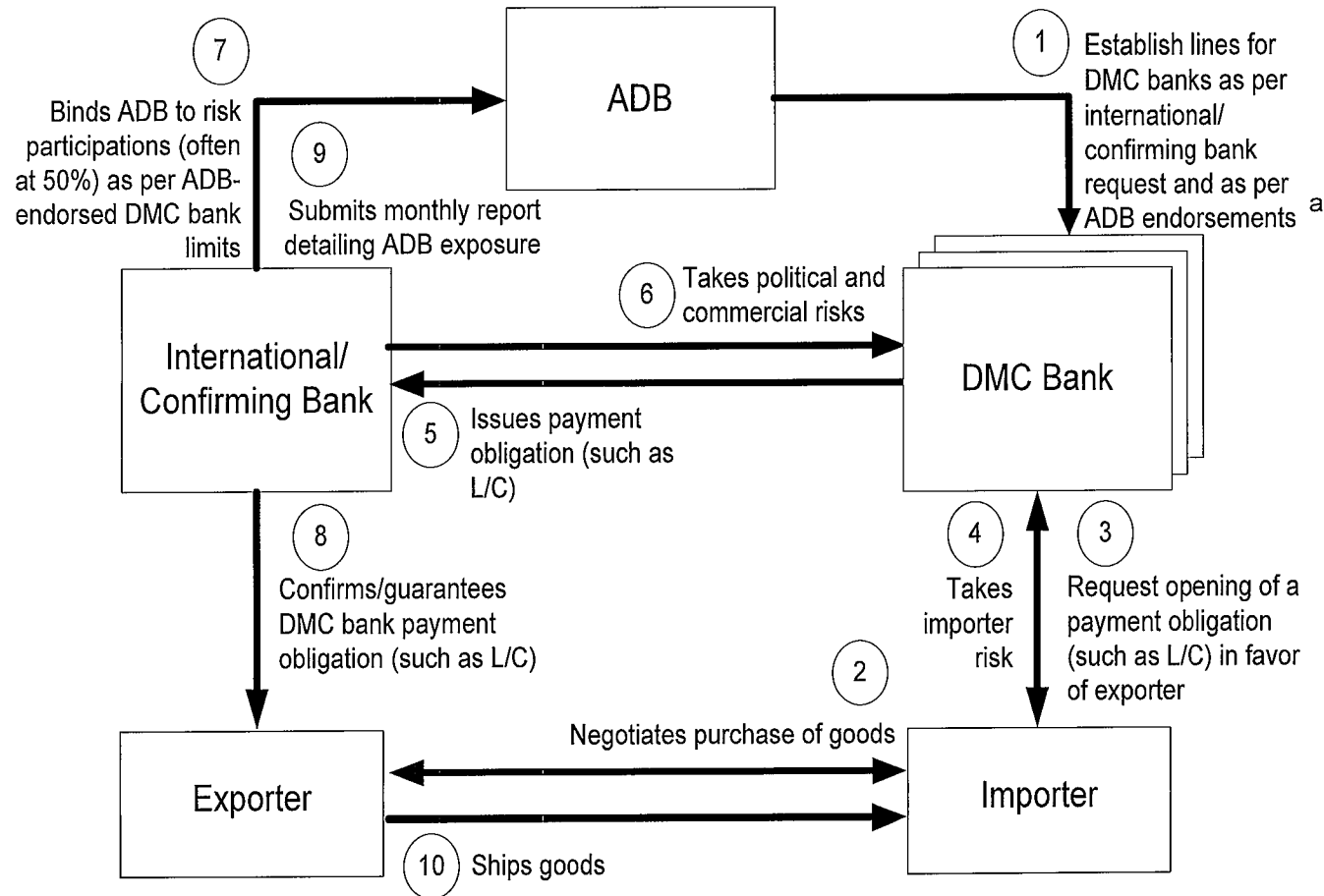


ADB = Asian Development Bank, DMC = developing member country, RCF = revolving credit facility.

Notes:

1. Prior to any transaction being eligible, the Trade Finance Facilitation Program will have already secured ADB-endorsed DMC bank limits.
  2. Most often, the RCF has supported pre-export financing to DMC companies.
  3. This diagram is only an example to provide a general idea of the TFFP's RCF product. This is in reference to para. 13.
- Source: Capital Markets and Financial Sectors Division-TFFP.

## RISK PARTICIPATION AGREEMENT PRODUCT



ADB = Asian Development Bank, DMC = developing member country, L/C = letter of credit.

<sup>a</sup> Assuming ADB endorsement, a portion of DMC bank limit is delegated to International/confirming bank(s) to bind ADB risk participations as per step 7.

Notes:

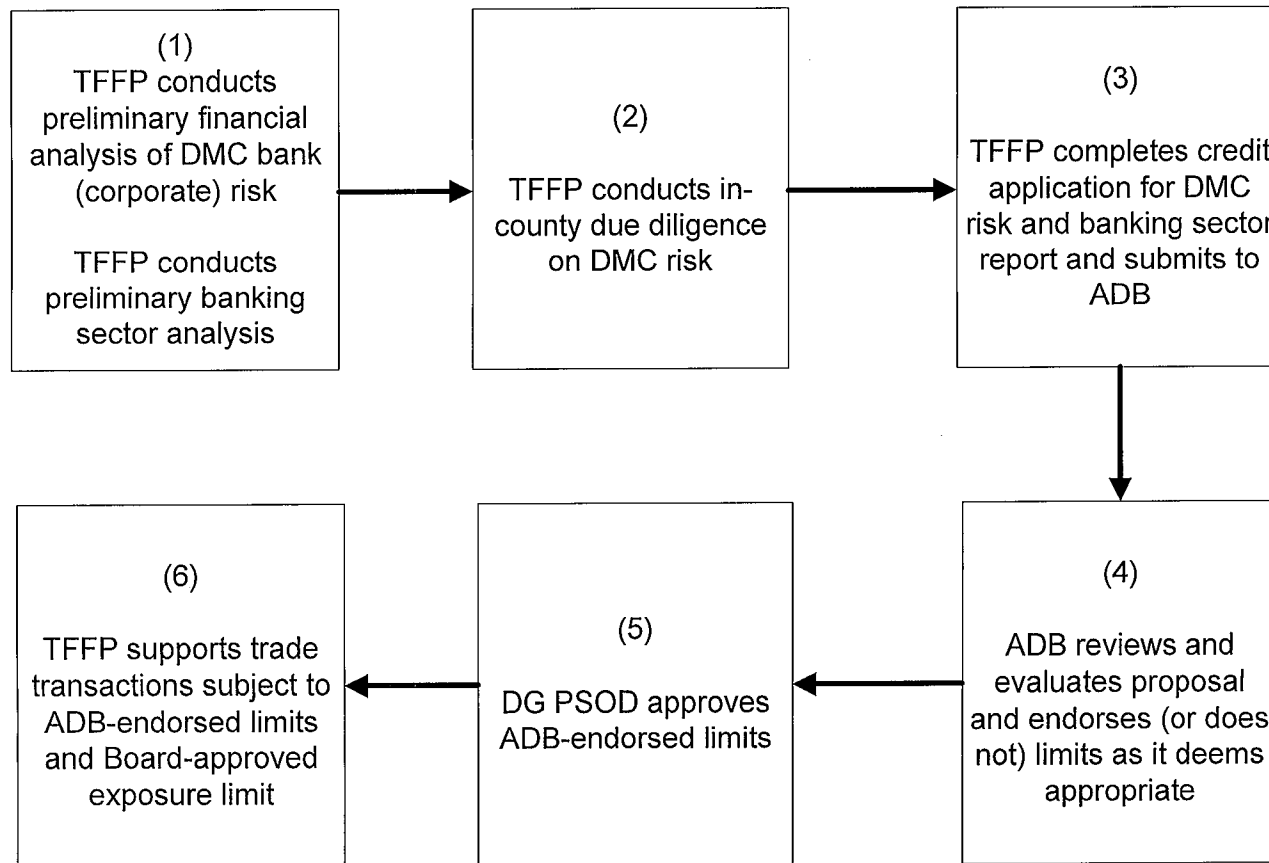
1. Prior to any transaction being eligible, the Trade Finance Facilitation Program (TFFP) will have already secured ADB-endorsed DMC bank limits.

2. This diagram is only an example to provide a general idea of the TFFP's Credit Guarantee product. This is in reference to para. 13

Source: Capital Markets and Financial Sectors Division-TFFP

## PROCESS OF ESTABLISHING DEVELOPING MEMBER COUNTRY BANK LIMITS

(TFFP conducts business subject to ADB-endorsed limits.)



ADB = Asian Development Bank, DG = director general, DMC = developing member country, PSOD = Private Sector Operations Department, TFFP = Trade Finance Facilitation Program.

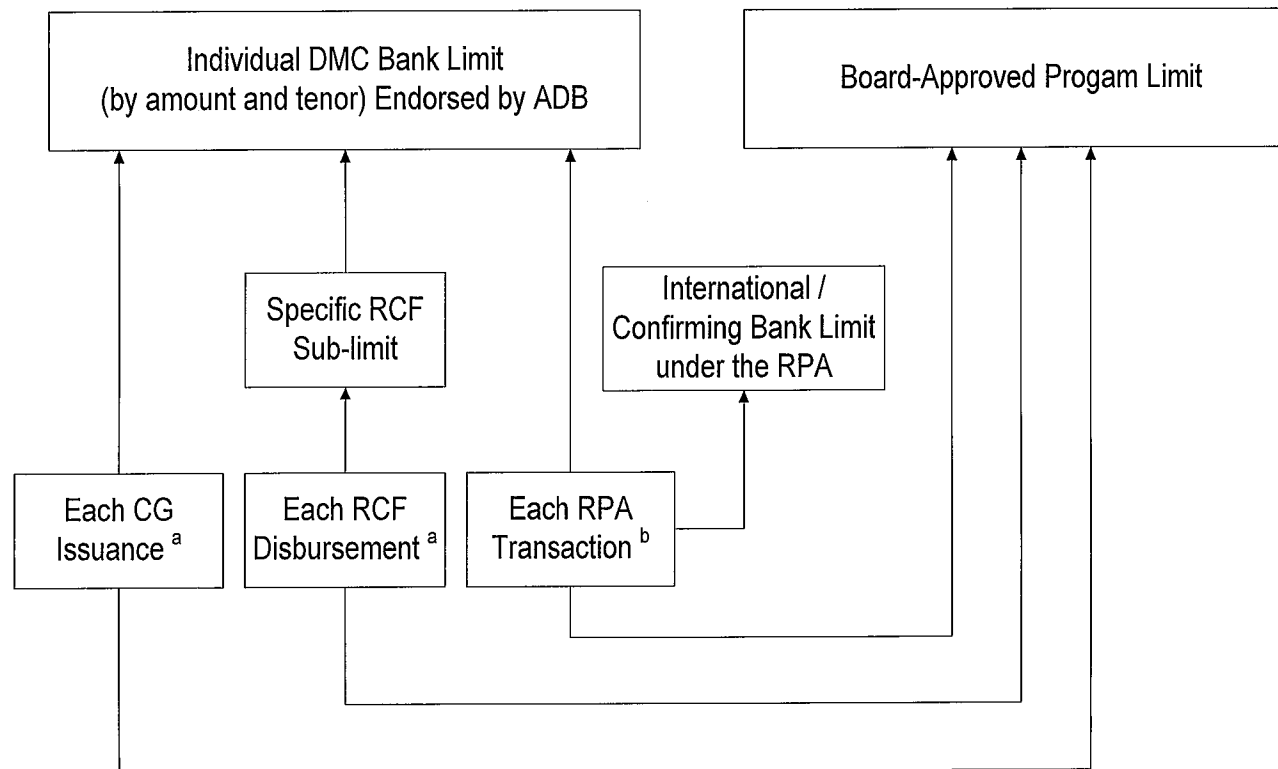
Note: This diagram is only an example to provide a general sense for the process of establishing DMC limits under which TFFP conducts business. This is in reference to para. 54.

Source: Capital Markets and Financial Sectors Division-TFFP.



### TRADE FINANCE FACILITATION PROGRAM TWO-TIERED LIMITS

TFFP conducts business subject to ADB-endorsed limits and the Board-approved exposure limit.  
(maximum exposure at any one time)



ADB = Asian Development Bank, DMC = developing member country, CG = credit guarantee, RCF = revolving credit facility, RPA = risk participation agreement, TFFP = Trade Finance Facilitation Program.

<sup>a</sup> Please refer to Appendix 6 for detailed workflow process.

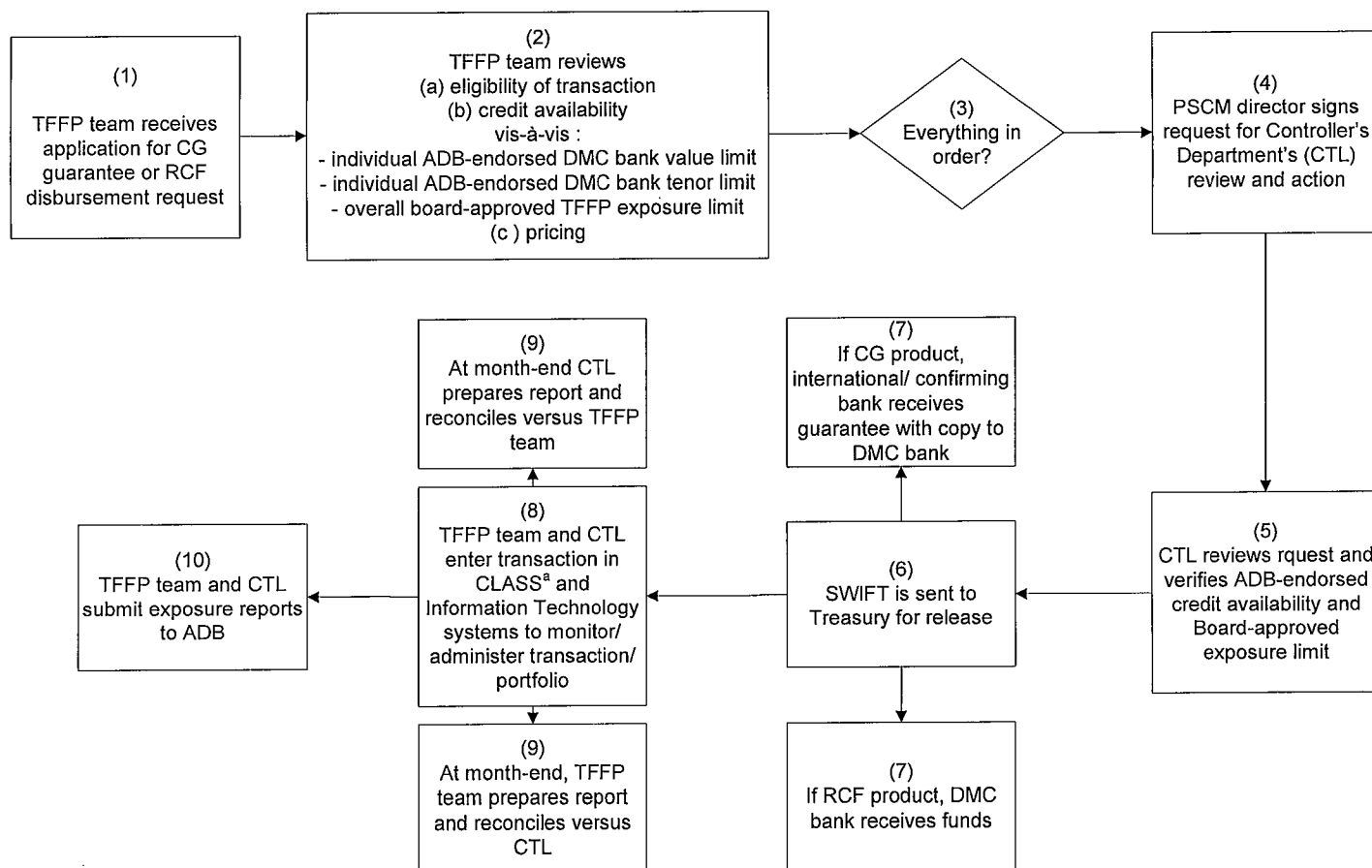
<sup>b</sup> Please refer to Appendix 7 for detailed workflow process.

Note: This diagram is only an example to provide a general sense for the process of monitoring limits under the TFFP. This is in reference to para. 55.

While CG and RPA are subject to the overall DMC bank limit (amount/tenor) and have no sub-limits, the RCF requires a specific Risk Management Unit-endorsed sub-limit under the overall DMC bank limit. While RCF limits can be applied to CG and RPA transactions without Risk Management Unit approval, the reverse does not apply.

Source: Capital Markets and Financial Sectors Division-TFFP.

## DISBURSEMENT AND ISSUANCE PROCEDURES FOR CREDIT GUARANTEE AND REVOLVING CREDIT FACILITY PRODUCTS



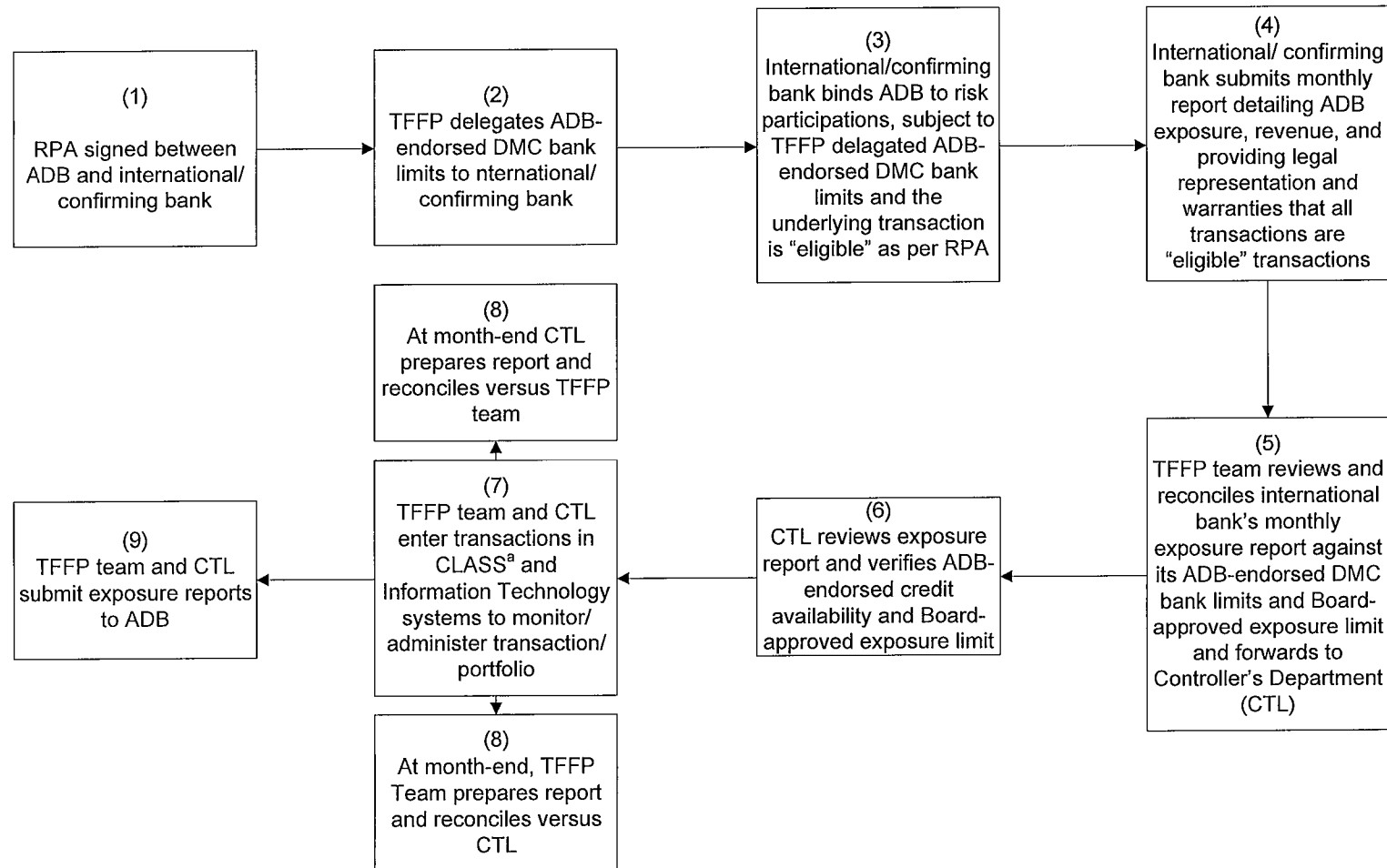
ADB = Asian Development Bank, CG = credit guarantee, DMC = developing member country, RCF = revolving credit facility, SWIFT = Society for Worldwide Interbank Financial Telecommunication, TFFP = Trade Finance Facilitation Program.

<sup>a</sup> CLASS is a ADB-wide system for transaction processing and monitoring.

Note: This diagram is only an example to provide a general idea of TFFP transaction processes. This is in reference to appendix 5.

Source: Capital Markets and Financial Sectors Division-TFFP.

## PROCEDURE FOR RISK PARTICIPATION AGREEMENT PRODUCT



ADB = Asian Development Bank, DMC = developing member country, RPA = risk participation agreement, TFFP = Trade Finance Facilitation Program.

<sup>a</sup> CLASS is a ADB-wide system for transaction processing and monitoring.

Note: This diagram is only an example to provide a general idea of TFFP transaction processes. This is in reference to para. 15.

Source: Capital Markets and Financial Sectors Division-TFFP.

## DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets/Indicators	Data Sources/Reporting Mechanisms	Assumptions and Risks
<b>Impact</b> Higher/stable levels of international/intra-regional trade in/among DMCs	More trade transactions—from the current 1,195 to at least 5,975 by 2013  More intraregional trade transactions—from the current 675 to at least 3,375 by 2013  More bilateral trade transactions between DMCs—from the current 532 to 2,660 by 2013	TFFP statistics demonstrating the (i) number of trade transactions supported, (ii) number of intraregional trade transactions supported, and (iii) number of bilateral trade transactions between DMCs supported	<b>Assumptions</b> Perception of risk in DMCs remains a concern to private sector, increasing the demand for the TFFP  <b>Risks</b> Protectionism rises
<b>Outcome</b> DMC companies increase their importing and exporting activities	The number of trade transactions supported under the TFFP increases—from the current 1,195 to 5,975 by 2013  The number of SMEs supported under the TFFP increases—from the about 158 currently to at least 790 by 2013	TFFP statistics demonstrating the number of transactions supported under the Program  TFFP statistics	<b>Risks</b> Newly imposed export/import restrictions prevent growth in trade
<b>Outputs</b> 1. DMC banks have support to provide financing and guarantees to DMC importing and exporting companies  2. International banks provide trade finance lines to DMC banks to support potential trade volumes	Increase the number of DMC banks participating in TFFP—from the current 50 to at least 125 by 2013  Achieve sustainability through profit and average fees of 2% per year on average tenors of 180 days (or as determined by market pricing)  Increase the number of international banks participating in TFFP from the current 72 to at least 82 by 2013	TFFP statistics  TFFP statistics  TFFP statistics	<b>Risks</b> Political and economic instability cause international banks to withdraw trade lines  ADB's ADB retracts TFFP lines and restricts maximum percentage of risk (up to 100%) TFFP can assume  Insufficient resources allocated to TFFP

Design Summary	Performance Targets/Indicators	Data Sources/Reporting Mechanisms	Assumptions and Risks
<p><b>Activities with Milestones</b></p> <p>1.1. Submit credit applications (for TFFP lines) on DMC banks to ADB for endorsement.</p> <p>1.3. Conduct annual review and submit same to ADB for banks in Bangladesh, Sri Lanka, Nepal, and Cambodia by the end of Q4 2009.</p> <p>1.4. For 2009, conduct financial analysis/due diligence on 50 new DMC banks and submit same to ADB for consideration of TFFP limits.</p> <p>1.5. ADB reviews and conducts analysis on credit applications provided by TFFP and provides endorsements for DMC risk limits. (TFFP undertakes transactions subject to ADB endorsed limits.)</p> <p>1.6. Market the TFFP to companies and SMEs to ensure that they are taking full advantage of the TFFP through partner banks (both DMC banks and international banks); speak at seminars and other appropriate forums that involve target audience.</p> <p>1.7. Redesign TFFP website to enhance knowledge of the TFFP and how to access its products by Q1 2009.</p> <p>1.8. DMC banks conduct financial analysis and due diligence on DMC companies to be comfortable assuming those risks.</p> <p>2.1. Market, originate, negotiate, and sign at least two more TFFP agreements with international banks by the end of 2009. At least one of the new agreements should facilitate TFFP expansion into Central Asia.</p> <p>2.2. Shift part of DMC bank limits from RPA product to CG product, and therefore include all 72 international (confirming) banks in TFFP's expansion. Most if not all TFFP DMC banks will be available for risk sharing to all 72 international (confirming) banks by the end of 2009.</p> <p>2.3. International banks conduct financial analysis and due diligence on DMC banks to establish/maintain their respective DMC bank limits. International banks also conduct country risk assessments to establish DMC country limits.</p> <p>3. Recruit consultants and staff to manage existing TFFP portfolio and expansion prudently.</p>			<p><b>Inputs</b></p> <p><b>ADB</b> \$1 billion (financing and guarantees) revolving maximum exposure at any time</p> <p><b>Private sector</b>, international banks</p> <p>Under 50:50 risk-sharing with the private sector, its input will be one-for-one with ADB. Under other risk-sharing scenarios, private sector input will most likely be 80:20 and otherwise. (As at December 2008, most TFFP guarantee transactions are 50:50 risk-sharing.)</p> <p><b>Risk Participation Agreements</b></p> <p>Entities such as JBIC of Japan (and over time others) will be sharing risk under ADB's TFFP, and as such leveraging TFFP capacity to support trade. Risk participation agreements will most often involve 50:50 risk sharing.</p>

ADB = Asian Development Bank, DMC = developing member countries, JBIC = Japan Bank for International Cooperation, SMEs = small and medium-sized enterprises, TFFP = Trade Finance Facilitation Program

Note: This is in reference to para. 63.

## **Links to Regional and Country Strategy Programs and Country Operations Business Plans<sup>1</sup>**

1. The Trade Finance Facilitation Program addresses a number of developmental themes central to the priorities of the Asian Development Bank (ADB): fostering intraregional trade; focusing on low-income countries; supporting small and medium-sized enterprises (SMEs); and helping to mitigate the impact of the global financial crisis on low-income countries. The Program also supports two of the five drivers of change cited in the long-term strategic framework of the Asian Development Bank 2008–2020 (Strategy 2020): (i) private sector development and private sector operations, and (ii) partnerships. It also focuses on two of the five core ADB specializations supporting Strategy 2020: (i) regional cooperation and integration, and (ii) finance sector development. Furthermore, it supports two pillars of the regional cooperation and integration strategy (July 2006): (i) trade and investment cooperation and integration (pillar 2), and (ii) monetary, financial cooperation and integration (pillar 3).

2. The Program is directly linked to a number of the strategies and business opportunities presented in country strategy papers (CSPs), regional cooperation strategy and programs (RCSPs), and country operations business plans (COBPs) for ADB's developing member countries (DMCs). A review of these documents underscores the importance of the provision of trade finance to enable ADB to meet its development objectives. The following is an overview of the links to some of the CSPs, COBPs, and RCSPs.

### **A. Bangladesh**

3. ADB's main objective for Bangladesh, as articulated in the 2006–2010 CSP, is to help the country address critical constraints to broad-based economic growth, social development, and good governance. The strategy, implemented in conjunction with the World Bank, the Department for International Development of the United Kingdom, and the Government of Japan, focuses on (i) improving the investment climate for private sector-led growth and employment, (ii) advancing the social development agenda to empower the poor, (iii) addressing key governance issues on a sector and thematic basis. ADB's private sector activities will complement those of the public sector and catalyze private investment in support of infrastructure projects and the finance sector. Regarding the current business plan, as set forth in the COBP for 2009–2011, ADB will continue to support investment, as well as policy and institutional reforms in the energy, transport, education, and integrated urban infrastructure sectors. ADB will also continue to support SMEs and the finance sector.

4. The Program supports both the CSP with respect to supporting SMEs and strengthening the finance sector, and complements ADB's current business plan for Bangladesh. First, the Program directly supports the goal of improving the investment climate for private-sector led growth and employment. By providing guarantees and funds to banks in Bangladesh, the Program will help domestic banks develop links to global partners, which will facilitate private sector activities that create jobs. Second, the Program will encourage growth of the private sector in Bangladesh through access to funds from banks. Third, the Program will benefit from and complement two public sector initiatives in the COBP: the Development of Transport Corridor for Trade Facilitation Project (to be developed in 2009) and the SME Sector Development Program II. The Development of Transport Corridor for Trade Facilitation Project will strengthen physical infrastructure for trade, while the SME Sector Development Program II

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<sup>1</sup> This is in reference to para. 67.

will develop infrastructure for SMEs, enhance access to finance for SMEs, strengthen capacity of organizations working for SME development, and boost the capacity of the SME workforce. The Program will further help to increase the trade and volume of goods between Bangladesh and other countries in the region by providing funding for SMEs to increase their entrepreneurial activities. The Program will directly support the SME Sector Development Program by further increasing access to finance for SMEs.

## **B. Indonesia**

5. Noting the Government of Indonesia's goals of supporting pro-poor, sustainable economic growth and promoting social development, the current CSP for Indonesia seeks to directly address the constraints to achieving these goals.<sup>2</sup> Past constraints that the CSP highlights included an adverse investment climate, poor physical infrastructure, an underdeveloped finance sector, weak decentralized capacities, poor public sector and natural resource management, and low development spending. Based upon these constraints, ADB is focusing on the following activities: (i) improving infrastructure and related services with more public and private sector investment, (ii) deepening the finance sector, (iii) improving decentralization with greater regional spending, (iv) accelerating the achievement of the Millennium Development Goals, and (v) strengthening environment and natural resources management. One of the priority onlending programs for finance sector development that has been highlighted in support of ADB's goals is trade finance.

6. The Program will support ADB's strategic and business objectives in Indonesia. First, it supports the development of the finance sector by providing banks with trade finance. Second, it helps to address one of the constraints to pro-poor economic growth: job creation. The CSP states that most job creation since 1997 has been in the informal sector and through SMEs, while job creation in trade, manufacturing, and services has stagnated. Moreover, the CSP notes that overcoming these constraints is critical if Indonesia is to respond to labor market mobility and trade liberalization with the Association of Southeast Asian Nations (ASEAN) Free Trade Area. The Program will support growth of trade in the country, which will then spur job creation. Finally, the provision of trade finance helps to increase regional cooperation and integration. The CSP notes that ADB will help to plan development projects that have Indonesian national and regional significance, including trade facilitation.

## **C. Philippines**

7. The country strategy for the Philippines, as embodied in the 2009–2010 COBP, which extends the 2005–2007 CSP, focuses on supporting fiscal consolidation, improving the investment climate in the country, and accelerating the attainment of the Millennium Development Goals.<sup>3</sup> Three of the five core areas of Strategy 2020 are incorporated into the current country strategy: support for the environment, infrastructure, and development of the finance sector. With respect to the private sector, operations will target infrastructure and the finance sector. Infrastructure projects are expected to include power and transmission, renewable energy, water supply, and port operations. Regarding the finance sector, the COBP states that ADB will seek opportunities to (i) provide loans to domestic banks or nonbank

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<sup>2</sup> ADB. 2006. *Country Strategy and Program: Indonesia 2006–2009*. Manila.

<sup>3</sup> The Philippines CSP for 2005–2007 is the current CSP. In 2008, ADB and the Government agreed to extend the CSP through the COBP for 2009–2010.

finance companies to support microfinance and SMEs; (ii) support asset-backed securitizations; and (iii) provide partial credit guarantees to support lending to SMEs.

8. The Program supports the strategic plans and objectives of the COBP and the CSP in numerous ways. First, the CSP notes that ADB's public and private sector operations will reinforce fiscal consolidation by (i) placing less demand on public resources, (ii) reducing pressure on public debt by allowing the Government access to foreign and local funds at competitive spreads and for longer maturities, and (iii) reducing the need for public spending by "crowding in" private participation. By enabling ADB's DMCs—in this case, the Philippines—to access trade finance, public resources will be under less pressure because financing for projects in a number of sectors, particularly in times of economic crisis when sources of funds become constrained, can be supported through nongovernment funding. Finally, enabling banks to have access to trade finance will help to support infrastructure and SME business opportunities, as articulated in the COBP.

#### **D. Sri Lanka**

9. ADB's strategic focus for Sri Lanka is to strengthen the investment climate in the country and achieve socially inclusive development. The country partnership strategy (CPS) for 2009–2011 states that ADB will support governance programs and private sector development through improvements in the investment climate. To strengthen the investment climate, ADB will (i) improve macroeconomic management, (ii) introduce regulatory frameworks for private sector investments relating to public–private partnerships, and (iii) increase the provision of economic infrastructure. ADB and the World Bank conducted a joint investment climate assessment in 2005 that, as noted in the CSP, concluded that the private sector is constrained by weak infrastructure and a lack of access to finance. Thus, ADB's strategy for supporting the expansion of the private sector will be to target higher levels of private investment and upgrade infrastructure, particularly in the transport and power sectors. With respect to socially inclusive development, ADB will expand access to high-quality services in the water, transport, and power sectors, and improve access to education.

10. The CSP notes that there is potential for ADB to expand its presence in Sri Lanka through investments and financing in support of the aforementioned strategy and targets. Future opportunities include power generation and port terminals. The CSP also highlights the current efforts of the Program. The expansion of the Program will allow ADB to support additional financing and guarantees to Sri Lankan banks, which will help to improve the investment climate through access to finance. In addition, by increasing Program activities in Sri Lanka, ADB will help to address the other key bottleneck to private sector growth in Sri Lanka—infrastructure development. Trade finance supports many goods and services that contribute to infrastructure projects. Thus, the expansion of the Program is directly linked to ADB's objective of improving the investment climate by addressing the two primary bottlenecks identified by ADB and private sector participants in Sri Lanka.

#### **E. Central Asia Regional Cooperation Program**

11. The RCSP for 2006–2008 on the Central Asia Regional Cooperation (CAREC) program focuses on trade as one of the three building blocks of its program, as it was originally



envisaged in its efforts to reduce poverty in the region.<sup>4</sup> Given that CAREC is a multi-institutional initiative, participants have undertaken initiatives to efficiently achieve the targets of CAREC. ADB is in charge of trade facilitation and transport issues, while the International Monetary Fund is responsible for trade policy. CAREC's trade facilitation program, led by ADB, has undertaken a number of initiatives to enhance trade in the region, including (i) revision of customs codes; (ii) reengineering of customs business processes and development of customs modernization plans; (iii) customs modernization and infrastructure development; (iv) bilateral customs cooperation; and (v) capacity building activities in 2005 that emphasized customs automation and data exchange, risk management, and post-clearance audits.

12. The Program will complement the efforts by the public sector under the RCSP update. A number of initiatives address the improvement of the environment for trade and trade finance in the region. The Program will also leverage the groundwork that has been completed by the public sector, such as the Integrated Trade Facilitation Support for Central Asia Regional Economic Cooperation,<sup>5</sup> which helped to facilitate better customs cooperation and improved trade logistics. Furthermore, the technical assistance will strengthen the role of the private sector, thereby increasing trade activity in this region, which is the ultimate goal of the RCSP.

## **F. Greater Mekong Subregion**

13. The RCSP for the Greater Mekong Subregion (GMS) for 2007–2009 aims to improve regional cooperation and integration in the GMS to foster greater economic prosperity and reduce poverty. The strategy has four pillars: (i) strengthening connectivity and facilitating cross-border movement and tourism; (ii) integrating national markets to promote economic efficiency and private sector development; (iii) addressing health and other social, economic, and capacity building issues associated with subregional links; and (iv) managing the environment and shared natural resources to help ensure sustainable development and conservation of natural resources.<sup>6</sup> In coordination with the RCSP, the GMS COBP for 2009–2011 focuses on projects that boost physical and power connectivity in the region, and promote health and safeguard the environment. In addition, a trade facilitation and logistics development regional project preparatory technical assistance is planned for 2009.

14. The Program complements the current program set forth in the COBP for 2009–2011, and directly supports the development goals as articulated in the RCSP. The Program will address objectives (i) and (ii) in the RCSP (para. 9). It will help to facilitate cross-border movement and increase the role of the private sector in the region by expanding access to trade finance, which will then encourage local businesses to engage in intraregional trade, as well as international trade. The Program will also benefit from projects that have been or will be undertaken by the public sector in the GMS, such as the CDTA for Technical Assistance for Enhancing Transport and Trade Facilitation in the GMS, which seeks to improve transport and

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<sup>4</sup> ADB. 2005. *Central Asia Regional Cooperation Strategy and Program Update: 2006–2008*. Manila. The CAREC program was established in 1997 and is a joint institutional effort that consists of the European Bank for Reconstruction and Development, the International Monetary Fund, the Islamic Development Bank, the United Nations Development Programme, and the World Bank. Participating countries are Afghanistan, Azerbaijan, People's Republic of China, Kazakhstan, Kyrgyz Republic, Mongolia, Russian Federation, Tajikistan, and Uzbekistan. The initiative focuses on trade, transport, and energy.

<sup>5</sup> ADB. 2007. "Integrated Trade Facilitation Support for Central Asia Regional Economic Cooperation", R242-07. Manila.

<sup>6</sup> ADB. 2006. "The Greater Mekong Subregion – Beyond Borders (2007-2009)". Manila.

trade facilitation through better regulatory procedures relating to trade, transport, and logistics services that are critical for trade.<sup>7</sup>

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<sup>7</sup> ADB. 2006. "Support to Trade Facilitation and Capacity Building in the Greater Mekong Subregion", CDTA 6328. Manila.