China goes global with development banks

At issue

BY ROHINI KAMAL AND KEVIN P. GALLAGHER

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This briefing examines the trajectory of China's evolving leadership in international development finance. It looks at the impact of China's massive increase in development finance for developing countries, arguing that it provides a useful alternative to Western-dominated institutions. It notes that it is too soon to tell if Chinese finance will support socially and environmentally sustainable projects and that concerns remain about transparency, accountability and the environmental and social safeguards used by Chinese institutions.

In just over a decade, China has become a global leader in development finance. China has established a number of bilateral and multilateral funds across the world, in addition to two policy banks, the China Development Bank (CDB) and the Export Import Bank of China (C-EXIM). China has also led efforts to establish new multilateral development banks (MDBs), the New Development Bank (NDB) and the Asian Infrastructure Investment Bank (AIIB), that promise to provide significant financing capabilities into the regime as well.

These banks and funds have the potential to provide an enormous increase in the availability of development finance for a world economy in desperate need of public finance for long-run economic development that is environmentally sustainable and socially inclusive. What is more, they have the potential to provide an alternative to the Western-dominated system that has struggled to fill the glaring gaps in development finance, particularly in infrastructure, and to maintain legitimacy among many borrowing countries and segments of civil society.

The globalisation of China's policy banks

Two of China's policy banks, the CDB and the C-EXIM, already hold more assets than the combined sum of the assets of the Western-backed MDBs. Table 1 shows that the C-EXIM and the CDB have over \$1.8 trillion in assets, whereas the Western-backed banks hold just over \$700 billion. That said, the CDBs' international holdings are just 30 per cent of total assets, putting the two banks' international assets at around \$0.5 trillion. These banks provide concessional and non-concessional (in the case of the C-EXIM) finance in virtually every corner of the world.

Founded in 1994, the CDB is perhaps the largest development institution in the world and fueled the Chinese growth miracle on the mainland. As part of China's broader 'go out' strategy, the CDB has been making loans to foreign governments since the early 2000s. In some countries in Latin America and Africa the CDB is often the largest single source of development bank finance. The CDB raises capital by issuing bonds with

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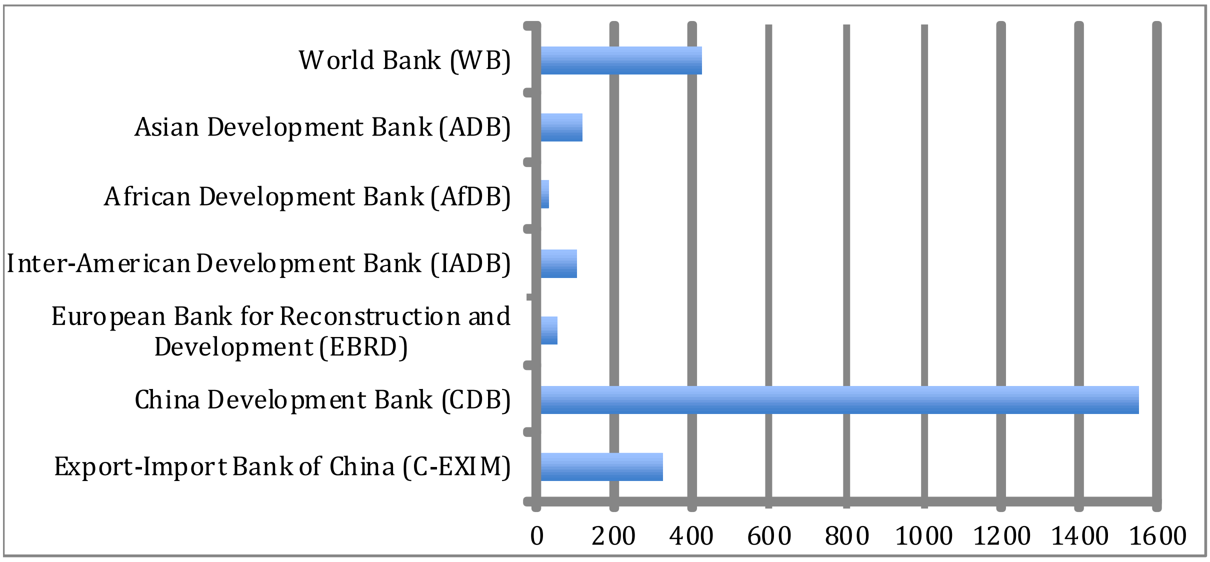
Table 1: China-backed and Western-backed development banks (total assets $ Billion)



Source: Gallagher, Kevin P., Gregory Chinn, and Rohini Kamal (2016 forthcoming), *The globalization of Chinese development finance*, Boston University, Global Economic Governance Initiative

terms of up to 30 years to institutional investors in both renminbi and other currencies. It is the second-largest bond issuer in China, after the Ministry of Finance, and its bonds enjoy a credit rating equivalent to government bonds. The Chinese state has full ownership of the Bank and implicitly guarantees its debt, enabling the CDB to provide lower interest rates and longer-term loans than other Chinese banks. The CDB is also China's largest foreign currency lender, drawing directly on China's vast foreign currency reserves.

Along with the CDB, C-EXIM plays an important role in supporting the state's foreign trade and economic development in the global arena. C-EXIM provides financing for trade in high–technology products and equipment; offshore construction contracts, overseas investment projects; and provides international guarantees. Furthermore, C-EXIM is mandated to promote China's long-term access to strategically important natural resources through various instruments, such as export credits, direct lending and credit guarantees.

China-backed global development funds

China has also pioneered a host of bilateral and regional development funds. These funds add upwards of $100 billion in development finance provided by the Chinese in recent years. Table 2 exhibits the major funds that we were able to confirm.

A major portion of these Chinese investments is in Asia, with the largest being the $40 billion Silk Road Fund established in 2014 with investment from state institutions including the C-EXIM and CDB. The fund is open to investors from other countries as well and has provisions to expand maritime connectivity between China and the rest of Asia (Central, South and Southeast Asia, and the Middle East), and beyond Asia to include North and Northeast Africa and Europe. Over the last decade China has further created a massive platform of public and private investments in Africa and in the Latin America and the Caribbean (LAC) region. The largest investments in both regions are in infrastructure. The largest initiative to date in the LAC region is the $20 billion CELAC-China Investment Fund announced early last year.

In the larger arena China seeks to strengthen South-South relations and contribute to global development. To this end, China announced the creation of the $3.1

billion South-South Climate Cooperation Fund in a China-US joint presidential statement on climate change in September 2015, to be used to finance initiatives in developing countries worldwide to combat climate change. China also pledged $2 billion for the creation of a South-South Cooperation Fund aimed at assisting developing countries in implementing their post-2015 development agenda, as announced last year at the UN Sustainable Development Summit at the UN headquarters in New York. Plans to create an Academy of South-South Cooperation and Development were also announced, with the aim to facilitate studies and exchanges by developing countries on theories and practices of development suited to their respective national conditions.

New multilaterals

With much fanfare, China helped spawn two global development banks, the NDB and the AIIB. The NDB was launched in July 2015 by Brazil, Russia, India, China and South Africa - collectively known as the BRICS countries. The NDB will provide financing to developing countries to help finance development projects, at least initially in infrastructure and with a focus on renewable energy. Each BRICS member is expected to put an equal share into establishing the startup capital of $50 billion with a goal of reaching $100 billion. Under the current set-up membership may not just be limited to BRICS nations. Future members could include countries in other emerging markets blocs. Each member country will send its finance minister or central bank chair to the NDB's representative board. The Bank is set up in a way that no country will have veto power over voting decisions, in pointed contrast to the veto power the US enjoys over World Bank (and IMF) decision-making. The NDB is expected to issue its first loans in 2016 for renewable energy projects in Bangladesh.

Table 2: Chinese development funds in world economy ($ billion)

Region	$ billion
Asia	
Silk Road Fund	40
The Green Silk Road Fund	4.8
China-ASEAN Fund	1
Eurasia	
China-Central and Eastern Europe Investment Fund	4
Russia-China Investment Fund	2
Latin America and Caribbean	
CELAC-China Investment Fund	20
China-LAC Industrial Cooperation Fund	10
China-LAC Investment Fund	5
China-Mexico Investment Fund	2.4
Africa	
China-Africa Development Fund	2
Africa Growing Together Fund	2
China-Africa Industrial Capacity Cooperation Fund Company Limited (CAICCF)	-
Global South	
South-South Climate Fund	3.2
South-South Cooperation Fund	2
Total	**98.4**

Source: Gallagher, Kevin P., Gregory Chinn, and Rohini Kamal (2016 forthcoming), *The globalization of Chinese development finance*, Boston University, Global Economic Governance Initiative

The AIIB was created to support infrastructure construction in the Asia-Pacific region. It was proposed by China in 2013 and formally started operations in December 2015 after the Articles of Agreement (AoA) entered into force with ratification from 17 member states holding 50.1 per cent of the shares. This is in accordance with the AoA, which requires ratification from 10 member states holding a total number of 50 per cent of the initial subscriptions of the authorised capital stock. By end of February this year, all 57 of the AIIB's Prospective Founding Members (PFMs) had ratified the AoA. The Memorandum of Understanding (MoU) specifies that the authorised capital of the AIIB is $100 billion and the initial subscribed capital is expected to be around $50 billion. The AIIB's investment capacity could reach $250 billion by the end of 2020 in accordance with provisions made in its AoA. The AIIB is likely to co-finance projects with the World Bank and Asian Development Bank (ADB), particularly in the first years of its operations.

The PFMs include most developed nations, with notable exceptions being US, Canada and Japan. China currently holds the largest share of voting rights of the AIIB, just above the one-quarter threshold needed to block any decisions requiring a supermajority vote (a super majority is defined by the articles to be three-fourths of the voting power and two-thirds of the members). This gives China the power to potentially block decisions involving structure, membership, capital increases, and other significant issues laid out in the articles that require a super majority of votes, but not decisions related to day-to-day operations.

In terms of operational details, the AIIB is expected to be overseen by an unpaid, nonresident board of directors. This set-up aims to accelerate the speed of the loans approval process. The AIIB will open bidding for projects to all, unlike the ADB, which restricts contracts to member countries. The procurement policy will be "more streamlined" in terms of its operational details relative to the other development banks. The Environmental and Social Framework (ESF) was approved in February 2016, with the possibility for updates after the first three years of operation if needed.

Civil society raised concerns regarding the public consultation process of the AIIB's ESF and its content

There were concerns raised by civil society regarding not only the public consultation process of the ESF, but also its contents, in particular the reliance on corporate and country systems; lack of detail on the AIIB's oversight mechanism; the omission of coal from its exclusion list; its adoption of the phased approach, which allows plans for impacts on indigenous groups to be made after project approval; and the lack of requirement of mandatory environmental or social impact assessments for projects in Category B, defined as having limited environmental and social impacts.

Opportunity and challenge

There is no doubt that China has massively increased the scale of development finance to developing nations across the world. It also appears that China-backed development banks represent a different emphasis for development policy than the Western-backed system, with a focus on infrastructure and structural transformation. However, the record thus far of the CDB and C-EXIM has raised questions whether Chinese banks are properly incorporating social and environmental risk into these activities, and the extent to which the project cycle is governed in a transparent and accountable manner. There is also concern regarding the implication of the more streamlined social and environment safeguard provisions in China-led development initiatives on the ongoing safeguards review at the World Bank .

It is too early to tell whether the new multilateral funds and new multilateral development banks will steer such finance toward infrastructure that is more environmentally sustainable and socially inclusive. China has made green finance a major focus of its G20 presidency, co-chairing a Green Finance Study Group that will look to "green" global finance. A developing country-led effort to green global development finance in a manner that is inclusive, accountable would be a welcome addition to the global development-banking regime. Such an outcome is not inevitable, however, and should be the goal of policy-makers and civil society alike.

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The globalization of Chinese development finance, Gallagher, Kevin P., Gregory Chinn, and Rohini Kamal (2016 forthcoming), Boston University, Global Economic Governance Initiative

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