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Development finance with Chinese characteristics?

China wants to improve current financial institutions, not supplant them

Illustration: Jayachandran/Mint

After a late flurry of additions to the founding membership of the Asian Infrastructure Investment Bank (AIIB), attention now turns to setting the China-led AIIB's rules and regulations. But important questions remain—most important, whether AIIB is a potential rival or a welcome complement to existing multilateral financial institutions such as the World Bank.

Since China and 20 mostly Asian countries signed AIIB's initial memorandum of understanding last October, 36 other countries—including Australia, Brazil, Egypt, Finland, France, Germany, Indonesia, Iran, Israel, Italy, Norway, Russia, Saudi Arabia, South Africa, South Korea, Sweden, Switzerland, Turkey, and the UK—have joined as founding members.

According to China's finance ministry, AIIB's founding members are to complete negotiations on the articles of agreement before July, with operations to begin by the end of the year. China will serve as the standing chairman of the negotiators' meetings, which will be co-chaired by the member country hosting the talks. The fourth chief negotiators' meeting was completed in Beijing in April, and the fifth took place in Singapore this week. The Chinese economist **Jin Liqun** has been selected to lead AIIB's multilateral interim secretariat, charged with overseeing the bank's establishment.

While gross domestic product (GDP) will be the basic criterion for share allocation among the founding members, the finance ministry suggested in October that China does not necessarily need the 50% stake that its GDP would imply. Moreover, although AIIB will be based in Beijing, the ministry has said that regional offices and senior management appointments will be subject to further consultation and negotiation.

Like the $50 billion New Development Bank announced by the Brics countries (Brazil, Russia, India, China, and South Africa) last summer, AIIB has faced considerable scrutiny, with some Western leaders questioning its governance, transparency, and motives. Indeed, many in the West have portrayed their establishment as part of an effort to displace existing multilateral lenders.

But the new development banks seem less interested in supplanting current institutions than in improving upon them—an objective shared by those institutions themselves. As deputy finance minister **Shi Yaobin** pointed out recently, by recognizing the need to reform their governance, existing multilateral lenders have shown that there are, in fact, no "best practices"—only "better practices". There is no reason improvements cannot originate elsewhere.

In fact, given its experimental approach to development, China is well-suited—and, as some top officials have hinted, more than willing—to contribute to this process. If China can help find a way to balance the need for high standards and safeguards in project lending with the imperative of rapid loan dispersion, global economic governance would benefit significantly.

In pioneering a more pragmatic approach to development finance, China's institutional model could be the $40 billion Silk Road Fund (SRF) that President **Xi Jinping** announced last November. SRF and AIIB will serve as the key financial instruments of China's One Belt, One Road strategy, centred on the creation of two modern-day Silk Roads—the (overland) Silk Road Economic Belt and the 21st Century Maritime Silk Road—stretching across Asia towards Europe. The initiative will aim to promote economic cooperation and integration in the Asia-Pacific region, mainly by providing financing for infrastructure such as roads, railways, airports, seaports, and power plants.

Yet SRF has received scant attention from Western media. This is unfortunate, because what little is known about it suggests that it could play an important role in transforming development finance.

According to Chinese media, SRF will be capitalized by four state agencies. The state administration of foreign exchange will hold a 65% stake; the China Investment Corporation (CIC, the country's sovereign-wealth fund) and the China Export-Import Bank (China Exim) will each have a 15% stake; and the China Development Bank (CDB) will hold the remaining 5%. The Fund was officially registered in December 2014, and held its first board of directors meeting the following month.

In a sense, SRF can be considered China's latest sovereign-wealth-fund initiative, and some media have even referred to it as the "second CIC". But, whereas CIC is under the managerial control of the finance ministry, SRF's operations appear to reflect the influence of the People's Bank of China (PBoC).

In a recent interview, PBoC's governor, **Zhou Xiaochuan**, suggested that SRF would concentrate more on "cooperation projects", particularly

direct equity investment, before hinting at the Fund's "just right" financing features. For example, Zhou indicated that SRF will adopt at least a 15-year time horizon for investments, rather than the 7-10-year horizon adopted by many private equity firms, to account for the slower return on infrastructure investment in developing countries.

Moreover, SRF could act as a catalyst for other state financial institutions to contribute to a selected project's equity and debt financing. The Fund and other private and public investors—would first make joint equity investments in the project. China Exim and CDB could subsequently disburse loans for debt financing, with CIC providing further equity financing. When AIIB is up and running, it, too, could support this process, by arranging debt financing alongside SRF's initial equity investment.

Of course, there is still much to digest in these new financing initiatives. But one can see the emerging contours of a South-South development-finance landscape—one with the potential to transform multilateral lending more broadly. **©2015/PROJECT SYNDICATE**

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