

Scaling up Finance for the SDGs: Experiments in South- South Development Banks

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Overall Narrative on Development Finance

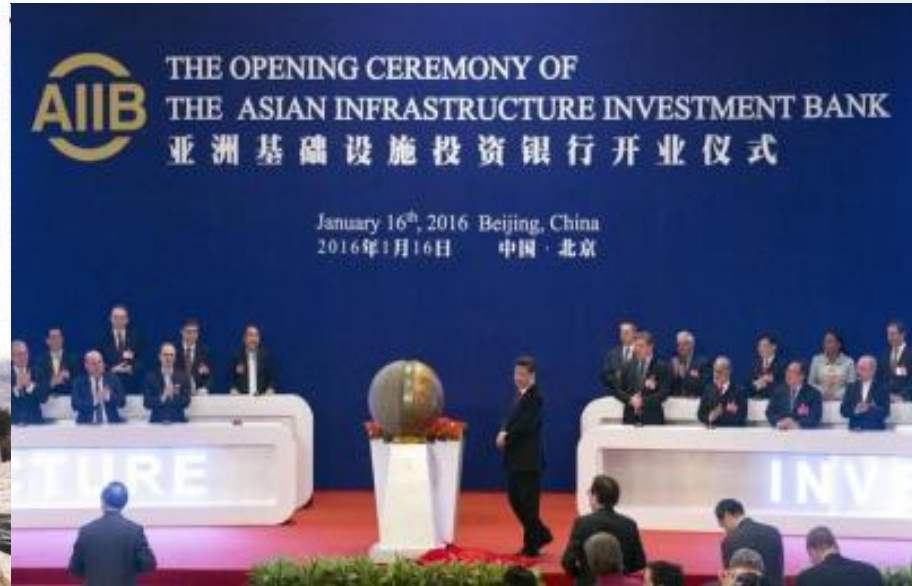
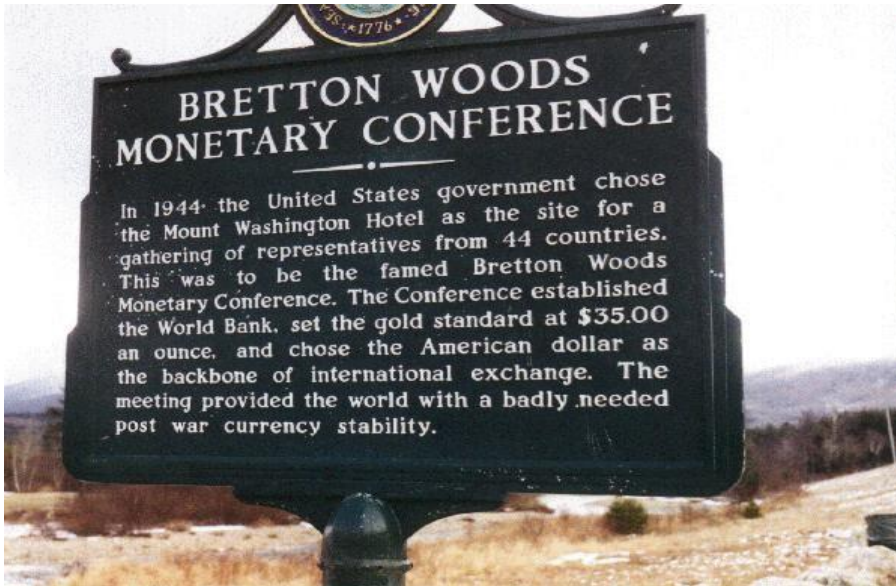
- *Little additional aid promised for SDGs*
- *MDBs: important tools for leveraging private capital for development, but lending capacity limited*
- *Established MDBs finding new ways to expand lending and leverage more*
- *Comparing New MDBs*
- *NDBs and MDBs: loan-to-equity ratios*
- *AllB: Experimenting with new institutional arrangements for scaling up*
- *China's investment funds: supporting the role of AllB*
- *Balance of power changing: advanced countries have to do more to remain relevant*

Addis Ababa Action Plan

On bridging the infrastructure gap:

- Main outcome was to establish “global infrastructure forum”, to meet periodically to improve alignment and coordination among established and new infrastructure initiatives
- For example, the World Bank’s **Global Infrastructure Facility (GIF)** has total funding size of \$84.4 million
- But, China is the largest contributor with \$20m
- Other main contributors are: Australia (\$18.6m), Canada (\$15.8m), World Bank (\$15m), and Japan (\$15m)

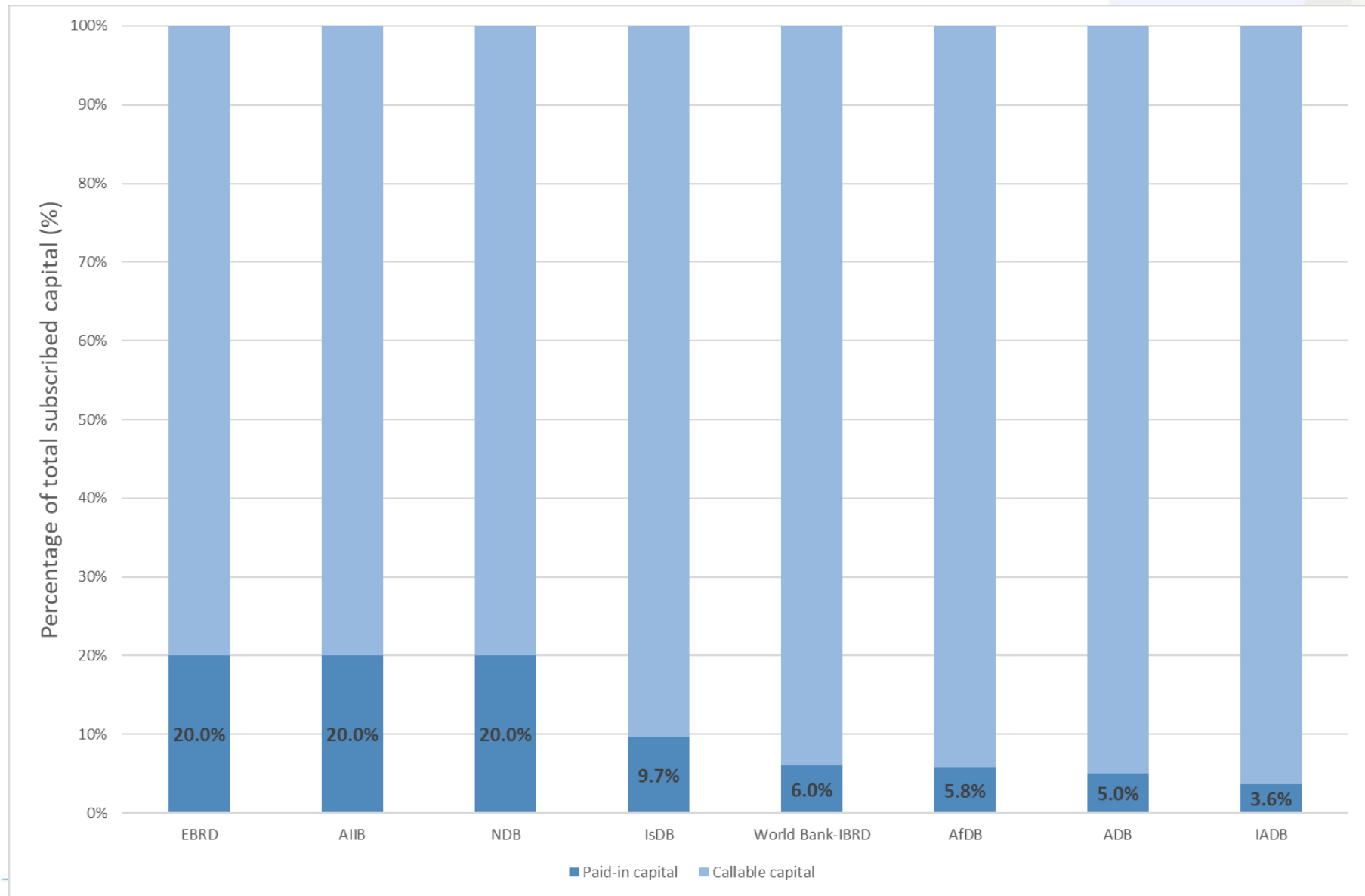
Over 70 years since Bretton Woods: New Players in Development Banking



Comparing New MDBs

	 New Development Bank	 ASIAN INFRASTRUCTURE INVESTMENT BANK
Official Launch	July 2015	January 2016
Headquarters	Shanghai	Beijing
Largest Shareholder	Equal among BRICS	China (32%)
Credit Rating	AAA (domestic, China)	AAA (international)
Total Lending (\$billions)	3.4	4.2
Total Number of Projects	13	24
Member Countries	5	84
Countries Invested	5	12
Target Sectors (% , value)	Renewable energy and environmental (74%)	Infrastructure (100%) <i>of which: energy (45%)</i>
Staff (# people)	130 (end-2017)	100 (end-2016)
Authorized capital (\$bn)	100	100
Subscribed capital (\$bn)	50	100
Callable capital (\$bn)	40	80
Paid-in capital (\$bn)	10	20

Conservative Capital Structure



Loan-to-Equity 'Gearing' Ratios

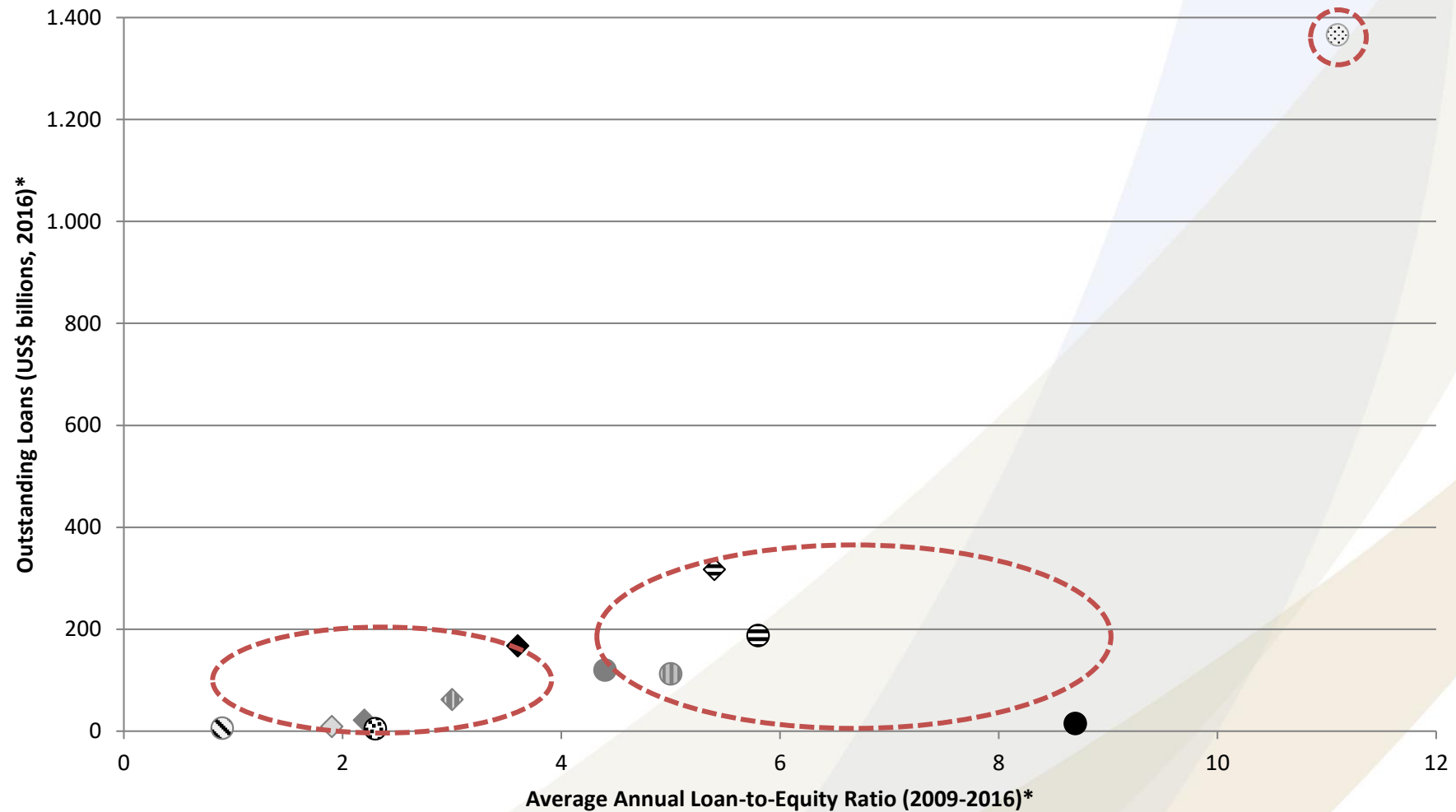
- **Loan-to-Equity Gearing ratio:** the extent of loan operations for a given amount of shareholder capital
- **Funding model:** to maintain triple-A bond rating, existing MDBs adopt a conservative approach to lending operations
- Reassure rating agencies and investors that bank financial resources are sufficient to cover potential loan losses
- World Bank gearing ratio recently raised to **5**
- **At issue:** how much capital is necessary to preserve a triple-A rating? MDBs have no regulator
= overly cautious financial policies

Loan-to-Equity Ratios, Selected MDBs

	2009	2010	2011	2012	2013	2014	2015	2016	Annual average
AfDB	1.6	1.7	1.9	2.0	2.0	2.1	2.0	n/a	1.9
ADB	2.6	2.7	2.8	3.0	2.9	3.1	3.3	3.6	3.0
CAF	n/a	n/a	2.3	2.4	2.3	2.2	2.1	2.1	2.2
EIB	5.3	5.7	5.7	5.4	5.2	5.6	5.2	5.4	5.4
World Bank (IBRD)	2.9	3.3	3.4	3.6	3.6	3.8	3.9	4.3	3.6

Source: Authors' elaboration based on balance sheets' information from MDB annual reports.

Loan Levels and Gearing Ratios: Selected MDBs and NDBs



◆ AfDB ◆ ADB ◆ CAF ◆ EIB ◆ WB (IBRD) ⊕ DBSA ⊙ IDC ⊖ BNDES ● India EXIM ⊖ JBIC ● KDB ⊕ CDB

Features of CDB's High Gearing Ratio

- Mid-1990s, CDB was bankrupt and was bailed-out in late-1990s. Today, it is world's largest national development bank (by assets), and China's largest bank for foreign investment and financing
- CDB benefits from high-grade country credit rating, and implicit guarantee from government
- CDB issues long-term bonds purchased by state-owned banks that consider them as assets with 'risk-free' returns on depositors' funds
- Chinese policy-makers often invoke the term **“exploration”** 探索 to explain their experience in domestic development finance

AIIB's Jin Liqun: “We must have creative spirit, and **neither clone the World Bank nor copy the ADB.**”

But can bank experimentation occur at the multilateral-level?

AIIB Special Fund Mechanism

AIIB's articles of agreement permit, by super majority vote, a max. gearing ratio of **2.5** of the bank's "unimpaired subscribed capital, reserves and retained earnings included in its **ordinary resources**"

- Article 10 mentions that Bank operations consist of two types:
 - 1) Ordinary operations financed from **ordinary resources**;
 - 2) Special operations financed from **special funds resources**
- These two types of operations may separately finance elements of the **same** project or program
- Remainder of Article 10 establishes clear partition between ordinary resources and special funds resources

Tapping Domestic and International Capital Markets?

- AllB's institutional design appears to maintain a *de jure* loan-to-equity ratio aimed at safeguarding access to international capital markets
- Also creating a conduit that – in indirectly tapping China's domestic capital markets – allows for *de facto* infrastructure financing to be scaled-up above the statutory limit
- (AllB plans its first international bond issuance in the second quarter of this year)
- China has also established a growing number of purpose-built national, regional and bilateral investment funds to provide **equity financing**

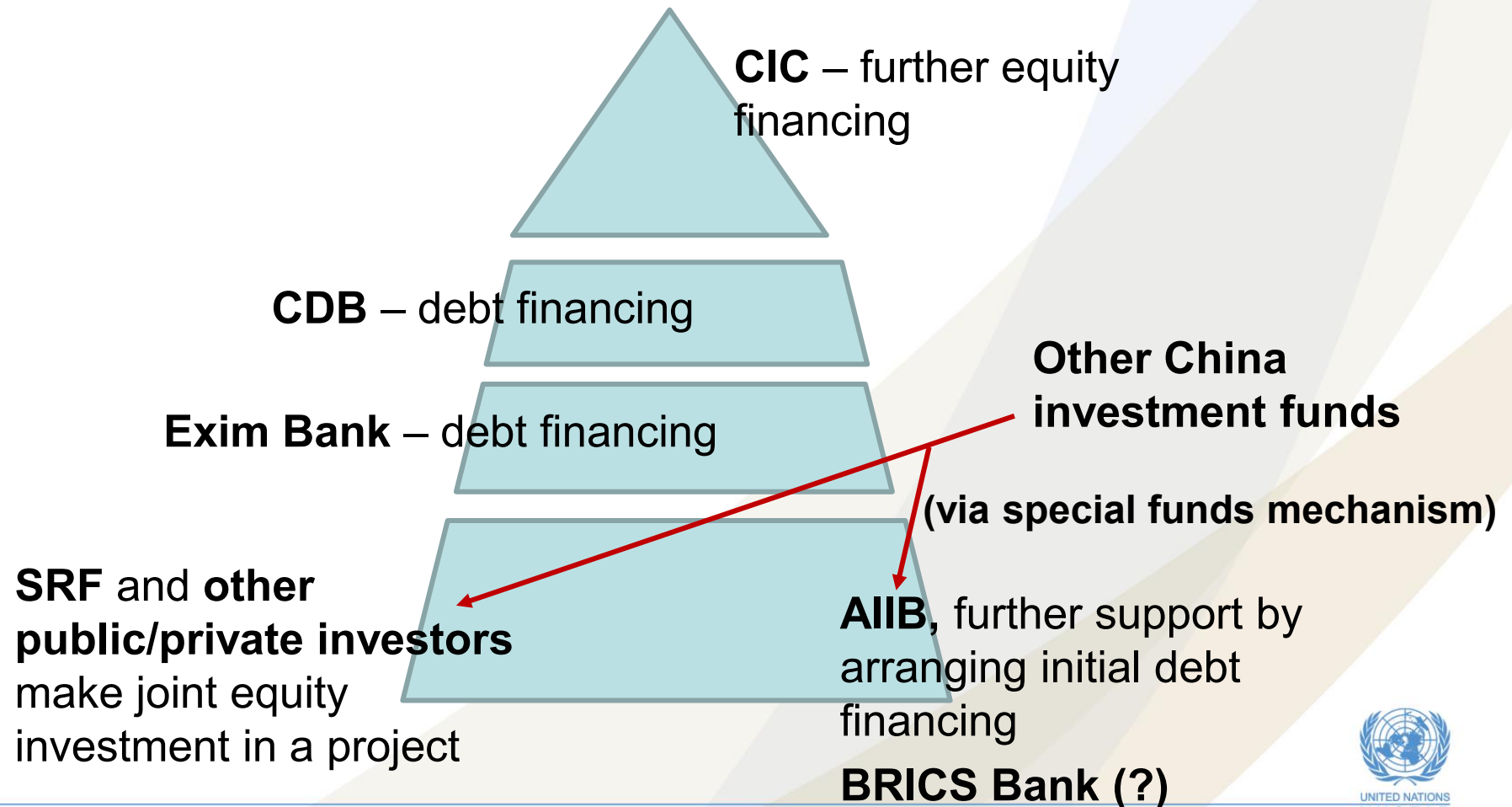
Selected China National, Bilateral, and Regional Investment Funds

	Name	Established	Scale (\$bn)	Chinese Investors	Other Investors
1	China-Africa Development Fund	2007	10	China Development Bank (CDB)	-
2	China-ASEAN Investment Cooperation Fund	2013	10	China Export-Import Bank (EXIM)	-
3	China-Central and Eastern Europe Investment Cooperation Fund	2013	1	China Exim	Hungarian Export-Import Bank
4	Silk Road Fund (SRF)	2014	40	SAFE, CIC, EXIM, CDB	-
	China-Kazakhstan Production Capacity Investment Fund	2015	[2]	SRF	-
5	China-LAC Cooperation Fund (Private Equity Fund)	2015	3	EXIM	-
6	China-LAC Industrial Cooperation Investment Fund (CLAIFUND)	2015	10	SAFE, CDB	-
	China-Brazil Production Capacity Cooperation Fund	2017	[20]	CLAIFUND and other Chinese institutions (\$15bn)	BNDES, Caixa Economica Federal (\$5bn)
7	China-Africa Production Capacity Cooperation Fund	2016	10	SAFE, EXIM	-
8	China-Russia Regional Development Investment Fund	2017	15.4	National Development and Reform Commission (NDRC)	-
TOTAL			99.4		

Scaling-Up Development Finance?

- Signals that Chinese policy-makers seek to experiment with **long-term non-concessional** development finance
- **PBoC Zhou Xiaochuan**: positioned the role of development finance as in between that of concessional and commercial finance, but “**slightly tilted**” toward the latter
- Not inconceivable that these various vehicles could selectively finance AIIB infrastructure projects through the special funds mechanism
- Especially as the Bank garners further expertise managing projects in different regional contexts

Conceptual Infrastructure Project Financing Structure: Zhou Xiaochuan, PBoC



Some Policy Considerations I

- Measures to boost lending capacity by MDBs is welcome, but still limited given SDG financing needs
- Much attention on AIIB/NDB but focus often overlooks China's underlying institutional architecture and experience
- Context of **Belt & Road Plan**: AIIB and B&R are not the same but significant overlap
- Could this emerging architecture represent China's answer to "blended finance" trends in ODA?
- China's willingness to invest and clear injection of new ideas presents a new dynamic in international development: **what response from international community?**

Some Policy Considerations II

At signing ceremony for the New Development Bank HQ, then-Finance Minister Lou Jiwei outlined **5 types of “innovations”** needed for multilateral development banking for the 21st century:

i. innovative development thinking, that supports countries in pursuit of their own development models and greater South-South experience sharing;

ii. innovative business models, that provide developing countries with custom-tailored support in finance, technology and knowledge;

 *iii. innovative organizational structures*, that are fit-for-purpose, allowing flexible and efficient operational procedures;

 *iv. innovative financing tools*, that expand financing channels;

v. innovative development practices, that treat development as a dynamic process

Some Policy Considerations III

Policy Experimentation via Belt & Road Initiative?

- Unlike WTO and TPP, B&R does not set agreed rules and protocols
- Rather, it focuses on infrastructure development to enhance connectivity and boost trade and investment
- B&R involves coordinated diplomatic effort; at B&R Summit in May no multilateral organization was established, but it was an opportunity to explore joint issues and align interests among participants
- **Limitations of WTO = opportunity for B&R**
- WTO is well-suited for relationships between developed countries, but limited for relationships between developing countries
- B&R provides more flexible path between China and partner countries, anchored in joint investment and infrastructure projects

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