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**
- **AIIB: Experimenting with new institutional arrangements for scaling up**
- **China’s investment funds: supporting the role of AIIB**
- **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

In 1944, the United States government chose the Mount Washington Hotel as the site for a gathering of representatives from 44 countries. This was to be the famed Bretton Woods Monetary Conference. The Conference established the World Bank, set the gold standard at $35.00 an ounce, and chose the American dollar as the backbone of international exchange. The meeting provided the world with a badly needed post war currency stability.
## Comparing New MDBs

<table>
<thead>
<tr>
<th></th>
<th>NDB</th>
<th>AIIB</th>
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<tbody>
<tr>
<td><strong>Official Launch</strong></td>
<td>July 2015</td>
<td>January 2016</td>
</tr>
<tr>
<td><strong>Headquarters</strong></td>
<td>Shanghai</td>
<td>Beijing</td>
</tr>
<tr>
<td><strong>Largest Shareholder</strong></td>
<td>Equal among BRICS</td>
<td>China (32%)</td>
</tr>
<tr>
<td><strong>Credit Rating</strong></td>
<td>AAA (domestic, China)</td>
<td>AAA (international)</td>
</tr>
<tr>
<td><strong>Total Lending ($billions)</strong></td>
<td>3.4</td>
<td>4.2</td>
</tr>
<tr>
<td><strong>Total Number of Projects</strong></td>
<td>13</td>
<td>24</td>
</tr>
<tr>
<td><strong>Member Countries</strong></td>
<td>5</td>
<td>84</td>
</tr>
<tr>
<td><strong>Countries Invested</strong></td>
<td>5</td>
<td>12</td>
</tr>
<tr>
<td><strong>Target Sectors (%), value</strong></td>
<td>Renewable energy and environmental (74%)</td>
<td>Infrastructure (100%) of which: energy (45%)</td>
</tr>
<tr>
<td><strong>Staff (# people)</strong></td>
<td>130 (end-2017)</td>
<td>100 (end-2016)</td>
</tr>
<tr>
<td><strong>Authorized capital ($bn)</strong></td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td><strong>Subscribed capital ($bn)</strong></td>
<td>50</td>
<td>100</td>
</tr>
<tr>
<td><strong>Callable capital ($bn)</strong></td>
<td>40</td>
<td>80</td>
</tr>
<tr>
<td><strong>Paid-in capital ($bn)</strong></td>
<td>10</td>
<td>20</td>
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</table>
Conservative Capital Structure

Percentage of total subscribed capital (%)

- EBRD: 20.0%
- ADB: 20.0%
- NDB: 20.0%
- IsDB: 9.7%
- World Bank-IBRD: 6.0%
- AfDB: 5.8%
- ADB: 5.0%
- IADB: 3.6%

Paid-in capital  Callable capital
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

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</thead>
<tbody>
<tr>
<td>AfDB</td>
<td>1.6</td>
<td>1.7</td>
<td>1.9</td>
<td>2.0</td>
<td>2.0</td>
<td>2.1</td>
<td>2.0</td>
<td>n/a</td>
<td>1.9</td>
</tr>
<tr>
<td>ADB</td>
<td>2.6</td>
<td>2.7</td>
<td>2.8</td>
<td>3.0</td>
<td>2.9</td>
<td>3.1</td>
<td>3.3</td>
<td>3.6</td>
<td>3.0</td>
</tr>
<tr>
<td>CAF</td>
<td>n/a</td>
<td>n/a</td>
<td>2.3</td>
<td>2.4</td>
<td>2.3</td>
<td>2.2</td>
<td>2.1</td>
<td>2.1</td>
<td>2.2</td>
</tr>
<tr>
<td>EIB</td>
<td>5.3</td>
<td>5.7</td>
<td>5.7</td>
<td>5.4</td>
<td>5.2</td>
<td>5.6</td>
<td>5.2</td>
<td>5.4</td>
<td>5.4</td>
</tr>
<tr>
<td>World Bank (IBRD)</td>
<td>2.9</td>
<td>3.3</td>
<td>3.4</td>
<td>3.6</td>
<td>3.6</td>
<td>3.8</td>
<td>3.9</td>
<td>4.3</td>
<td>3.6</td>
</tr>
</tbody>
</table>

*Source: Authors’ elaboration based on balance sheets’ information from MDB annual reports.*
Loan Levels and Gearing Ratios: Selected MDBs and NDBs
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

AllIB’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?

- AllIB’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.

- (AllIB 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

<table>
<thead>
<tr>
<th>Name</th>
<th>Established</th>
<th>Scale ($bn)</th>
<th>Chinese Investors</th>
<th>Other Investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>China-Africa Development Fund</td>
<td>2007</td>
<td>10</td>
<td>China Development Bank (CDB)</td>
<td>-</td>
</tr>
<tr>
<td>China-ASEAN Investment Cooperation Fund</td>
<td>2013</td>
<td>10</td>
<td>China Export-Import Bank (EXIM)</td>
<td>-</td>
</tr>
<tr>
<td>China-Central and Eastern Europe Investment Cooperation Fund</td>
<td>2013</td>
<td>1</td>
<td>China Exim</td>
<td>Hungarian Export-Import Bank</td>
</tr>
<tr>
<td>Silk Road Fund (SRF)</td>
<td>2014</td>
<td>40</td>
<td>SAFE, CIC, EXIM, CDB</td>
<td>-</td>
</tr>
<tr>
<td>China-Kazakhstan Production Capacity Investment Fund</td>
<td>2015</td>
<td>[2]</td>
<td>SRF</td>
<td>-</td>
</tr>
<tr>
<td>China-LAC Cooperation Fund (Private Equity Fund)</td>
<td>2015</td>
<td>3</td>
<td>EXIM</td>
<td>-</td>
</tr>
<tr>
<td>China-LAC Industrial Cooperation Investment Fund (CLAIFUND)</td>
<td>2015</td>
<td>10</td>
<td>SAFE, CDB</td>
<td>-</td>
</tr>
<tr>
<td>China-Africa Production Capacity Cooperation Fund</td>
<td>2016</td>
<td>10</td>
<td>SAFE, EXIM</td>
<td>-</td>
</tr>
<tr>
<td>China-Russia Regional Development Investment Fund</td>
<td>2017</td>
<td>15.4</td>
<td>National Development and Reform Commission (NDRC)</td>
<td>-</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td></td>
<td><strong>99.4</strong></td>
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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

- **CIC** – further equity financing
- **CDB** – debt financing
- **Exim Bank** – debt financing

**SRF** and other public/private investors make joint equity investment in a project

**AIIB**, further support by arranging initial debt financing

**BRICS Bank** (?) and other China investment funds (via special funds mechanism)
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.