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China’s International Development Finance: Past, Present and Future

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Abstract: China has emerged as perhaps the most globally significant development finance provider, going far beyond concessional foreign aid. With China’s initiatives to create and foster new multilateral finance institutions, and to work in terms of large economic landscapes in Africa, Eurasia and Latin America, it becomes important to understand how China’s own experience with rapid industrialization/urbanization processes and regional development is influencing its visions and financial instruments for development across the world. Our paper examines how China’s domestic development experiences have informed its approach to development finance abroad and explores what kinds of challenges and opportunities China will bring as it is moving to the centre stage of international development finance. We argue that a better understanding of China’s development finance abroad involves going beyond looking at linkages to commodity supply chains to focusing on China’s current large ambitions to move up the value chain through technology and innovation and to leverage its own necessary green growth revolution into a global role in a global green growth revolution, with its own advanced expertise and enterprises working at the frontier of development.

To harness China’s growing financial power as a force for good, the world needs to take advantage of China’s proactive move to utilize tri-angular cooperation and multilateral development institutions.

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I. Introduction

In this paper we attempt to chart China’s development finance across its distinct categories, how these various modalities began and how they have evolved over time. We then ask how China’s global development role might evolve in the coming decades as China moves to fulfill its objective of becoming a moderately prosperous nation of 1.5bn people by mid-century through wide-ranging interrelated reforms; at one level managing the macroeconomic challenges of rebalancing its real economy towards more consumption and less investment, at another level simultaneously shifting employment into higher productivity activities and new kinds of value creation with Chinese entrepreneurial firms working on a global scale, while at a third level, carrying through its reform agenda for the financial system, state enterprises and social protection.

It is now widely understood that China’s development finance ranges well beyond its official aid programme as described in its two recent White Papers on Foreign Aid, which cover its grant aid, interest-free loans and concessional loans channeled through the Exim Bank with interest rate subsidies funded from the national budget (State Council, 2011, 2014) This Chinese foreign aid involves fiscal transfers allocated in its annual budget and corresponds more or less with the DAC definition of ODA. Much greater in scale and impact is the lending to developing countries from two key state-owned institutions, the China ExIm Bank and the China Development Bank, funded from bond issues, supporting large resource backed loans and associated project financing and also helping to finance China’s ‘going out’ policy by assisting Chinese companies to develop off-shore business and foreign subsidiaries, and capture market share in strategic global industries.

This paper is organized as follows. We begin in Section 1 below by looking at China’s traditional foreign aid programme, where it now stands after more than 60 years and how its current challenges and reform needs are articulated by Chinese policy experts. We bring these issues back into our final section discussion on the future for Chinese development finance. In Section 2 we move to a brief overview of China’s experience in financing its own development process since the decisive ‘opening-up’ reforms of the late 1970s. On this basis, in Section 3 we trace how the financial engineering devised to promote the rapid urbanization and industrialization process in China, based on explicit and implicit state guarantees, has been applied to China’s ‘going out’ strategy of developing a significant Chinese business capacity in strategic world markets and in developing countries. In section 4, we bring these various strands together to consider how they may play out in the context of China’s evolving situation as it (i) implements its reform programme giving a decisive role to market forces and entrepreneurship; (ii) continues to grow in global macroeconomic weight; and (iii) follows through with its new regional initiatives to work on transformational development programmes on a continental scale, using new China-based multilateral institutions and trilateral cooperation alongside its key policy banks.

Before launching into this storyline, there are three overarching points that are best made upfront, on which we have written elsewhere and are fundamental to understanding Chinese development

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3 China does not participate in the DAC reporting systems and the calculation of the grant element of its subsidized loans is not applicable in its relatively closed financial system. And under the revised definition of ODA agreed at the end of 2014 (DAC, 2014), such calculations would require country allocation data from the Chinese authorities.
finance and related global economic governance issues (Xu and Carey, 2014, 2015a, 2015b). While they will emerge below in various ways, we note them here as essential background, so that the arguments of this paper can be set out more readily.

First, China’s development cooperation model remains based on the non-interference and mutual benefit principles established in the 1950s and 1960s, and is regarded by the Chinese authorities as part of the South South cooperation framework initiated at Bandung in 1955. Aid, trade and investment are seen as interconnected in a mutual benefit framework. Meanwhile, the concept of Official Development Assistance (ODA) formulated by the OECD Development Assistance Committee in 1974 and reinforced in 2014 (DAC, 2014) has at its heart a one-way transfer of wealth from rich countries to poor countries, with any commercial or financial benefits rigorously excluded by accounting rules and policy regimes. At the same time, national interests and foreign policy objectives are part of the scenery of all development cooperation and changing contexts are bringing significant departures from established principles.

Second, officially supported market based loans from DAC countries are excluded from ODA and regulated by OECD export credit rules and IMF/World Bank debt sustainability assessment processes. Meanwhile China has established a wide range of such financing, funded from Chinese bond markets with implicit and explicit Chinese government guarantees, with state-owned institutions playing a ‘public entrepreneurship’ role, supplying vision, action and innovation at a scale and speed that has outstripped OECD and Bretton Woods development institutions.

Third, while OECD statistical systems, rules and policy review mechanisms processes require and facilitate transparency in development finance flows at least among finance-providers, China’s aid and broader development finance is relatively less transparent, despite the aggregate information provided in the first two White Papers on China’s Foreign Aid published in 2011 and 2014.

In the articles cited above, we have suggested that existing global governance systems will need to adjust to the new realities of more ambitious and entrepreneurial development finance with China at the forefront. At the same time, China now has very strong reasons to become more transparent as it seeks to engage others in its wide-ranging initiatives and as it becomes heavily dependent on the existence of effective states and markets for the success of burgeoning global investments by innovative Chinese firms in advanced sectors backed by market-based official finance from policy banks with sovereign status.
II. China as a provider of foreign aid

In this section, we first present a brief history of China’s foreign aid, and then examine its new regional initiatives. Finally, we explore the future directions and reform issues of China’s foreign aid programme.

History

The history of Chinese aid goes back to the 1950s and 1960s. Mao Zedong’s Five Principles of 1953, the Bandung conference of 1955, and Zhou Enlai’s Eight Principles of China’s Foreign Aid laid out in Accra in 1964, together encompass the key ideas of equality and mutual benefit, knowledge sharing, non-interference, helping to generate self-reliance and independent development pathways, the own-responsibility of developing countries for their development and South South solidarity. Aid relationships were a part of China’s own search to establish its identity and position in the international community, particularly the competition with Taiwan for China’s seat in the UN, eventually assumed in 1971. Hence aid policy was decided and conducted at the highest political level, domestically and bilaterally, a continuing feature of Chinese aid policy. A large scale aid programme emerged, reaching 6-7 per cent of national budget expenditure in 1973. Support for liberation movements was a leading theme, a high point being the construction of the Tanzania-Zambia railway completed in 1976, a year that was also a key turning point in China’s political history.

From 1976 on, a strong effort to ensure effectiveness and financial discipline in aid projects was applied and the aid budget fell to less than 1 per cent of national fiscal expenditures by 1979. In the 1980s, as the economic reform process got underway, China itself became a significant recipient of aid from DAC countries, articulating its ‘dual role’ as a provider and a recipient and absorbing the lesson that foreign aid could play a catalytic role in economic transformation.

Foreign aid became a toolkit for broader economic cooperation in the 1990s as the reform process towards a socialist market economy was confirmed. In 1995 a Conference on Reforming Foreign Assistance produced a policy decision to establish joint ventures between enterprises from both China and its recipient countries to invest in projects of high return. The Exlm Bank, created in 1994 as a ‘policy bank’, (along with the China Development Bank and the Agricultural Development Bank of China), saw the introduction of concessional loans, with interest subsidies funded from the general budget, to leverage commercially oriented flows. A Foreign Aid Fund for Joint Ventures and Cooperative Projects was established. Provincial governments were enlisted on a pragmatic basis to implement projects, drawing on their own development experiences in China. Main fields of activity were agriculture, education and training, health and infrastructure.
New Regional Initiatives

In 2000, the Forum for China-Africa Cooperation (FOCAC) was founded, where aid, trade, financial credits and private equity have been drawn together. FOCAC is a triennial process at Heads of State level, bolstered by systematic annual visits to African countries by top Chinese leadership. In this framework China-Africa trade soared with China’s growth trajectory generating a global commodities boom and China’s globalisation policies gaining African markets. Chinese foreign investment in Africa began to increase dynamically. And a China Africa Development Fund (CADF), was established, as a subsidiary of the China Development Bank, to inject equity capital into Chinese ventures in Africa. The most recent FOCAC outcome documents and action plans have extended the agenda to embrace support for regional integration and regional infrastructure, industrialization and peace-building, including assistance for an African Standby Force.

This agenda was amplified by Prime Minister Li Keqiang in a speech to the African Union in May 2014, linking the Chinese Dream with the African Dream (the AU Africa 2063 agenda), via major investments in connectivity, embracing high speed rail, regional aviation, and ICT infrastructure and systems, urbanization, industrialization and peace and stability, thus bringing together the “modernization of two continents” (Li, 2014). It was backed up the following month at the African Development Bank Annual Conference with an ‘Africa Growing Together’ Fund of $2bn co-financing money over 10 years, financed by the People’s Bank of China and open to procurement and participation of all AfDB members. At the same time the $20bn credit line extended in FOCAC V, which ends in 2015, was increased to $30bn and the China Africa Development Fund (providing private equity capital) from $3bn to $5bn. FOCAC VI is scheduled for December 2015 in South Africa.

Subsequently China has launched two further wide ranging geographical initiatives, with the Community of Latin American and Carribean States (CELAC) for Latin America (Xinhuanet 2015a) and the Silk Road Initiatives (Xinhuanet 2015b). These geographical initiatives are not concessional aid programmes but broader multidimensional economic cooperation programmes with non-concessional loans and equity investments from the policy banks aiming to crowd in other actors and investment.

Future Directions and Reform Issues

The broad history sketched above has been described as a move through three major phases (Huang and Wei, 2015): (i) the political orientation of the period from 1950-1976; (ii) an economic development orientation from 1978-2015; and (iii) now a strategic orientation underpinning China’s position in a global economy with a new economic geography, as captured in the initiatives noted above linked to its interests and capacities as a major creditor country, transforming its excess foreign reserves into real investments with returns stretching into the long term future.
China is thus moving, very suddenly, from its traditional largely passive role in international development governance to a new role as a proactive institutional and conceptual innovator based around a large view of geography and development. Hitherto, the prevailing critiques of Chinese aid by Chinese academics (IDS 2014, 2015a; CIDRN 2015) have been that:

- a more conceptualized model of China’s aid strategies and objectives is needed to supplement the heavily practical orientation of Chinese aid (Xue, 2014)
- this requires strengthening analytical and research capacities in universities and think tanks and the availability of more data;
- policy and administrative structures need to be more concerted;
- a systematic evaluation function should be introduced;
- A significantly larger professional staff is needed to coordinate and implement China’s development programmes.
- civil society, the private sector and the Chinese public should now be brought into what is a very closed and even secretive system of policy making (despite the White Papers introduced following China’s participation in the Accra High Level Forum on Aid Effectiveness in 2008 and the ongoing activities of the China-DAC Study Group 4).
- Efforts to involve local stakeholders are judged to be inadequate and more training for Chinese actors in the appreciation of local contexts should be a priority (needs also evident in the Chinese enterprise sector).
- China should now take an active part in the new global development partnership agenda, based on its own experience and principles, driven by the real demands of the developing world and thus help to reshape the global development governance structure (Li and Wang).

With China’s active support for the upcoming Sustainable Development Goals (SDGs) and new Climate Change Framework, and with its Presidency of the G20 in 2016, the articulation of a current Chinese perspective on development strategies will no longer be a missing element in global governance discussions. As a sign of a new China-based development discourse, the Development Research Centre (DRC) of the State Council is launching an International Knowledge Centre on Global Development and a Silk Roads Think Tank Network and is building up its own new International Development Department on a significant scale.

Until this point, it can be said that China has generated two parallel systems for providing development cooperation, with the development finance generated by the ExIm Bank and the China Development Bank (CDB) a high multiple of the financial support associated with the traditional Chinese aid programme. Now, with the new regional programmes and China’s ambition to transform its excess foreign reserves into real investments with returns stretching into the long term future, a

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4 The China-DAC Study Group was inaugurated in 2009, with the International Poverty Reduction Centre in China and the DAC Secretariat as co-Chairs (OECD).
new regulation on foreign aid introduced in November 2014 requests the Ministry of Commerce to collaborate with other agencies to formulate long-term policy planning and country strategy papers. From this perspective, strengthened links at the strategic and operational levels between China’s aid programme, its officially supported market-based finance and its regional initiatives are in the offing (Ministry of Commerce, 2014).

The current structure of aid policy making lies under the State Council, chaired by the Prime Minister. What might be considered as China’s traditional aid programme is coordinated by the Ministry of Commerce Department of Aid to Foreign Countries, supported by the Ministry of Foreign Affairs and the Ministry of Finance and involving some 27 other Government departments. The Ministry of Foreign Affairs coordinates the FOCAC through a similar structure and the Ministry of Finance coordinates China’s participation in multilateral development banks.

In terms of ‘aid volume’, the traditional programme as recorded in the Chinese budget numbers amounts to some $3bn. This includes grants, interest free loans, and the ExIM Bank loans with interest rate subsidies. The programme has been growing fast, and capacity limits in terms of both modalities and staff are clear to those working inside the system. External attempts to estimate China’s total development finance produce numbers which are several times larger than this number or even many times larger. These numbers are highly contested among experts (Brautigam 2009; Kitano and Harada 2014; Parks 2015). Chinese concessional aid data are available only at very aggregate level and Chinese export credits and CDB lending transactions are treated as privileged commercial information on a par with OECD data where country to country level aggregates are regarded as confidential. China is not a participant in the Helsinki export credit disciplines under which certain transactions data is shared (Xu and Carey, 2015b). Estimates of Chinese development finance writ large are attempted by independent institutions (AidData, InterAmerican Dialogue)

How might the Chinese coordination structures be reformed to underpin and follow through on these ambitious initiatives? Three options have been identified by Chinese scholars for reforming the traditional foreign aid programme (Huang and Wei, 2015):

First, bringing the planning and coordination function inside the Ministry of Foreign Affairs;

Second, establishing a new comprehensive aid agency outside of the existing departmental structures, and

Third, set up a new central foreign aid leader group under the State Council.

Given the long tradition of top leadership involvement in aid policies in China, this latter option may have particular advantages in terms of the new MoFCm regulation potentially promoting strategic coordination with the new geographical and institutional initiatives, which have been generated outside of the traditional aid programme. The strengthening of the professional human resources, aid modalities and programme design and evaluation processes would be a necessary complement to any of these options.
Against this background we now turn to what we see as the central global interest in China’s development finance – its role as an innovator in leveraging sovereign guarantees to massively scale up support for infrastructure, renewable energy and mobile technology, key components of the UN 2030 Agenda for Global Action to be adopted by Heads of State at the upcoming UN Summit under the heading of Transforming our World. We argue that China, acting as a global public entrepreneur supplying vision, action and innovation and engaging via both its state-owned and private companies, will make a central contribution to the scaling up of sustainable development and employment generation needed for economic transformation.

III. China’s Domestic Development Finance

In this section, we first examine the history of China’s domestic development finance since it adopted the opening-up and reform policy in the late 1970s, and then take a close look at the role of CDB in scaling up long-term finance.

History

China’s economic takeoff began in the rural sector, when a bottom up reform of land tenure arrangements originating in a single small village spread across China, incentivising a large increase in agricultural output and in the words of the current Prime Minister, Li Keqiang, ‘solving the centuries old problem of hunger in China within two years.’ (Li Keqiang, 2015). Public investment in rural infrastructure and schemes to promote rural enterprises created rural employment and lifted incomes. On farm investment was essentially provided by household labour. Food supply and prices for urban consumers provided the basis for an urbanization process to begin, with the rural sector effectively subsidizing the urban sector (Lin, 2011, Demystifying the Chinese Economy).

With low savings and no adequate financial institutions, the modernization and expansion of Chinese industries and infrastructure in the first decade of the reform process (in the 1980s) was financed notably by a series of key ODA Loans from Japan, amounting to some $9bn between 1979 and 1995 (Bräutigam2009). These were resource-backed loans, with repayments made from oil exports to Japan. Here China learned the model that it has later applied in its loans to developing countries. (Brautigam2009; Kitano and Harada, 2014). Other bilateral finance helped as the modernization process got underway. And the World Bank provided not only finance but crucial advice and training in infrastructure project selection, design and management; procurement via competitive bidding processes; and how to raise financing in international bond markets and apply associated debt management techniques. The World Bank also provided advice and training in investment banking. Thus, China’s recognized capacity to learn from its donors and other providers of development finance across a wide range of sectors, applied equally to the development finance sector itself. While China used ODA and other official finance extremely effectively via robust internal management systems and a dedication to learning from its partners, ODA was a relatively small fraction of China’s total external finance through the reform period (Zhou, 2015).
In the early 1990s, domestic savings and state-owned banking institutions began to come into place. But the investment financing demands of an urbanisation/industrialization/globalization growth dynamic were outstripping supply, and this capital shortage was compounded by a major tax reform that sharply reduced the share of tax revenues raised at the local level, while local governments were prohibited from raising funds on capital markets themselves or borrowing from banks. It was at this point that the China Development Bank (CDB) was created as one of a suite of three state-owned ‘policy banks’ directed at helping China to accelerate its growth process, alongside the China Exlm Bank and the China Agricultural Bank.

**The China Development Bank and the financial engineering of superfast growth**

After a shaky start in which the CDB accumulated nonperforming loans equivalent to 40 per cent of its loan portfolio, a new President of the CDB, Chen Yuan, introduced a strong loan approval process and bad debts were transferred off its balance sheet. At the same time, in the context of the purchase and transfer to China of a closed down UK automobile plant, the CDB developed in association with the city of Wuhu, a financing model based on the creation of what was to be the first Local Government Financing Vehicle (LGFV). These structures allowed local governments to raise money off their budgets and balance sheets, effectively getting around the financial constraints imposed by the fiscal reforms of 1994. Essentially, the LGFVs raised revenue from land sales of requisitioned farm land and its absorption into the urbanization process. This revenue was dedicated first to repaying loans from financial institutions used to finance urbanization.

In a somewhat parallel fashion to the land reform of 1978, originating as an initiative of one village then replicated across China, the LGFVs were an innovative response to a specific local opportunity that quickly became a standard part of the urban/industrial development process across China. CDB assistance and loans mobilized a further tier of lending from China’s state-owned commercial banks. The CDB raised its own funding from bond issues purchased by these commercial banks, whose funding came from their deposit base. CDB bond issues were and continue to be state guaranteed, a move to reclassify the CDB from ‘policy bank’ to ‘commercial bank’ under the previous government having never been confirmed. Indeed, recently in March 2015, the State Council re-emphasized that CDB should continue to rely on sovereign creditworthiness and deploy market mechanisms in an effort to achieve its public mandates such as stabilizing economic growth, adjusting economic structures, and further scaling up support for priority sectors and underprivileged regions.

It is not within the scope of this paper to review the costs and benefits of this whole phase of China’s financial and economic history and the legacy issues associated with it, including the investment boom associated with China’s response to the 2008 financial crisis and local government debt burdens. Suffice it to say that the CDB has been at the origin and at the core of the financial engineering underlying China’s modern urban infrastructure and special economic zones, the completion of major projects such as the Three Gorges Dam and the Pudong district of Shanghai, the involvement of the west of China in the development process, linking up China’s cities and regions with advanced transport infrastructure and investing in some of China’s most entrepreneurial private companies. It has also moved into financing environmental protection and clean up programmes. Suffice it to say also that mistakes and risks as well as success provide important lessons for China and for other countries, including the importance of the integrity of institutions,
the social and environmental dimensions of development, responsibilities and revenues at different levels of government, the efficiency of public investment, all of which are the subject of intensive study and debate in China itself.

For our purposes here, the key point is that the CDB has through this history, become a development financing institution of global importance with financial and professional skills, experience and connections that are huge assets. Its recent moves into private equity financing, with international partners, and its involvement with highly entrepreneurial Chinese firms with global reach and ambitions, underline its capacity to act at the frontiers of development, with a long-term perspective, a creative learning by doing approach and innovative financial engineering (Sanderson and Forsythe, 2013).

IV. China as a provider of market-based official development finance

After examining ideas and practices of China’s development finance, we move to explore the role of China as a significant provider of market-based official development finance abroad. We first illustrate how Chinese policy banks have sparked a renewed interest in market-based official finance among advanced economies, and then take a step further to explore opportunities and challenges of market-based official development finance as a fast growing sector of development finance.

The Chinese Policy Banks spark a reawakening interest in market-based official finance

Both the CDB and the China ExIm Bank constitute development institutions that rank in scale and capacities with the multilateral development banks; indeed their lending flow to developing countries exceeds that of the World Bank. Like the multilateral development banks, they are providing an intermediation function between financial markets and developing countries that is based on sovereign guarantees. Both are funded by renminbi bond issues, purchased by Chinese banks and with the same credit rating as Chinese government bonds. The CDB has launched successful international bond issues as well. Such market-based development finance is official in the sense that it relies on sovereign creditworthiness to raise funds rather than direct fiscal transfers.

The role of market-based official development finance is in the process of being rediscovered, not least because of the scale of the financing needs foreseen moving from billions to trillions in the words of a recent report relating the collective thinking in the established MDBs and the IMF (World Bank/IMF, 2015;; IDS, 2015b). In the Addis Ababa Action Agenda (4A) the MDBs are encouraged to carry further their collective thinking about their own role, scale and functioning. On the bilateral front, the actions of a number of DAC country agencies to borrow on financial markets to finance loans that have then been reported as ODA, without any fiscal transfer involved, has provoked a significant tightening up of the ODA definition of concessional lending, but alongside that, a proposal to create a new measure - Total Official Support for Sustainable Development (TOSSD)- to capture market-based official support for development finance from all sources.
The case of the CDB and the China ExIm Bank has undoubtedly helped to stimulate this reawakening and the initiatives of some DAC countries to expand or create such development financing entities are likewise inspired at least indirectly by the Chinese example (Canada has moved to create a development financing entity, although it has to be noted at the same time the US ExIm Bank has descended into legislative limbo). The 4A endorses the expansion of development banks as an instrument for intermediation between financial markets and scaled up development programmes (IDS, 2015b).

A distinguishing feature of the CDB and ExIm Bank’s operations in developing countries is the level of ambition and scale and the associated search for transformative impact. They involve large packages of financing in often politically risky situations, such as the $2bn ExIm multi-sector package for Angola in 2004 leading on to further large involvement in Angola’s development process; the $6bn CDB package for the DRC in 2010 (reduced from an initial $9bn after IMF intervention, cutting out some of the territorial development dimensions); a $10bn CDB country loan to Brazil (the subject of a Harvard Business School case study); a cumulative $40bn of lending to Venezuela; a series of major infrastructure development loans to Ecuador; the financing of industrial development zones in Africa, with associated urban development lending as in Ethiopia; the credit lines made available under the FOCAC action plans; and most recently a $45bn financing package for Pakistan.

These packages are in almost all cases contractually linked to repayment from resource revenue streams generated by projects within the packages, but the activities include support for broader development investments and associate other Chinese financial institutions and investors, contractors and provincial level actors. The financial transactions involved in project financing pass through Chinese channels, and for the most part procurement is tied to Chinese procurement though this can be relaxed. As mentioned earlier, many of the techniques and packages and association of national actors are learned from the Japanese resource backed loans to China in the 1980s.

**The Chinese policy banks as ‘public entrepreneurs’**

Yet the CDB and ExIm are by no means dedicated development financing institutions. Much of their international business is with developed countries, including Australia and Russia. Financing for the UK nuclear energy industry is under discussion. And they provide major credit lines to Chinese enterprises, not just state-owned but also private companies such as Huawei, Alibaba and solar and wind-power companies. For these private companies, the loan terms for ExIm and CDB credit lines are not concessional, but they provide the confidence to work with long-term horizons and to scale up. They also crowd in financing from other financial institutions, both Chinese and international. (Sanderson and Forsythe, 2013).

It is in this sense that we see the Chinese policy banks as a central part of the ‘public entrepreneurship’ that has enabled China to overcome the first mover problem long identified by development economists, whereby the development process must be co-created by the public sector and the private sector in close interaction (Klein et al, 2010, Xu and Carey, 2015b). The state capitalism mode so often used to describe China’s development model misses how the public and private sectors have interacted in China’s development process at a decentralized level. The policy
banks have assisted the emergence of a creative, entrepreneurial private sector that has driven Chinese growth and employment and is currently beginning to impact on advanced industries globally with new business models with fast reaction times (Tse, 2015). China does not have a planned economy but an innovative networked economy with decentralized decision-making in a context of centralized policy vision and authority that is moving a complex country along a comprehensive, ambitious reform path in an established trial and error tradition.

How then is the Chinese development banking function to be regarded and assessed in terms of its roles and impacts, and the extent to which it repairs market failures or creates distortions in resource allocation and institutional incentives? And what is the contribution to international development finance in terms of ideas?

A first point here is that these two ‘policy banks’ are intensely focused on financing the real economy and its transformation via creative, adventurous financial intermediation. A common critique of the global financial industry and indeed of the OECD corporate sector is that it is engaged in socially unproductive financial and fiscal engineering and the accumulation of profits that are returned to shareholders rather than invested in the future (Kay, 2012, Haldane, 2015). While entrepreneurship is still alive, problems of short-termism and low returns on pension fund assets are major policy preoccupations at the level of the G20. In the field of development financing a current conundrum is how to mobilize large pools of long-term savings into long-term investments in infrastructure (a conundrum applying in OECD countries themselves), lifting economic performance and hence income streams from investments in developing country real and financial assets stretching over the longer term. Sovereign guarantees of one kind or another are now widely accepted as a necessary part of the solution to this market failure. The Chinese policy banks are using their sovereign status to solve exactly that conundrum and take the view that investment on a large scale is needed to produce the economic transformations required for developing countries to raise their growth rates and to generate the capacity to service their loans.

A second question is related to the efficiency and viability of the Chinese policy banks. A first take here is that the world has a fundamental conundrum that in the OECD world real investment is seen as very risky and outsourced to emerging countries, where state interventions and misaligned incentives have pushed up investment to the point of overinvestment and reduced its productivity with resulting negative value creation (OECD 2015b). In China, the resolution of this conundrum is a switch from investment to consumption of around 10 per cent of GDP, with a concomitant rise in the efficiency of investment. This is not a contested question. The Chinese reform programme is geared to such a switch, to making the role of market forces the decisive element in resource allocation, and to making integrity of systems and people a central objective, with deep functional and legitimacy dimensions and with the political and management complexities of this policy shift being acknowledged on all sides.

But a third question is whether China is taking on too much risk in its lending to developing countries with problematic political contexts and complex projects. Is China’s sovereign guarantee being stretched too far? At what point does China in fact depart from its non-interference principle and become engaged in policy dialogue that parallels or contradicts the Bretton Woods institutions, notably in countries such as Zimbabwe or Venezuela?
And finally, does China’s development strategy via the use of policy banks and explicit and implicit guarantees amount to a manipulation of market incentives that damages global welfare or promotes the prospects for sustainable development across the world? We now turn to these questions.

V. An Entrepreneurial China: Impacts of China’s International Development Finance in the Future

Looking ahead, an entrepreneurial China, already a reality, will be a global development force. In its economic transformation it has acquired management and entrepreneurial resources via inward foreign investment and huge financial capacities. It has a widening range of innovative enterprises that will drive up productivity and value addition, in combination with a new innovation based development strategy announced earlier this year with the objective of spreading entrepreneurship throughout the economy (State Council, 2015, Li Keqiang, 2014). Its leading entrepreneurs support the comprehensive reform programme introduced by the Chinese Communist Party in 2013, which involves complex implementation issues with global impacts (Tse, 2015). While there are different possible scenarios for China’s pathway ahead in terms of its capital flows and reserve accumulation, capital exports via rising foreign direct investment and its large regional initiatives seem certain to be a continuing vector.

The most fundamental issue is indeed how China’s economic evolution impacts on global development prospects and global welfare. Here we focus on three medium term issues with structural development impacts. The impacts would come at three levels: macroeconomic; technologies, business models and structural transformation; and global development partnerships.

At the macroeconomic level, China’s continuing growth at some ‘new normal’ will influence growth prospects worldwide via commodity prices, global demand and global confidence. Furthermore, whether or not the rebalancing of investment and consumption in China still leaves China with a net current account surplus, the impulses towards diversification of its foreign reserves and towards becoming a reserve currency will generate significant capital exports. These capital exports will be facilitated by the institutional and technical capacities that China has developed in the years of its infrastructure investment boom, as embodied in large engineering firms such a Power China and the railway and road construction industries, but also the new generation of entrepreneurial private companies.

At the level of structural transformation, rising income levels mean rising labour costs and hence a move of labour intensive industries to low income countries associated with rising Chinese foreign direct investment in those countries. Justin Lin estimates that some 85 million low wage jobs will leave China for other developing countries in the next 10 years accompanied by a large flow of Chinese investment and sees this process as an engine for structural transformation in Africa. (Lin and Wang, 2014; Poon, 2014).
As China moves up the value chain and confronts its domestic challenges and opportunities, it will absorb and generate technologies and business models that will change development prospects. As is happening globally, entrepreneurial companies, including companies from China, will be in the forefront of transformational development advances (Fry, 2015). Three critical areas are already apparent here.

First, Chinese companies are driving down the costs of renewable energy, particularly solar technologies, to the point where low carbon development strategies become feasible for developing countries. Solar energy costs have fallen rapidly thanks to Chinese investments. (IEA, 2014) (A significant 45 per cent share of China’s incremental energy production over the medium term is forecast to be supplied from renewable sources, with solar energy as a strategic part of the energy system). Off grid solar energy systems already transform the lives of poor people in developing countries. Solar powered street lighting in Mogadishu made in China and financed by the UK and Norway has made life secure after dark and can do so in towns and villages everywhere. Affordable electric vehicles and urban mass transport (including battery powered buses now in production) are a policy priority. The IEA expects that China will account for 46 per cent of global nuclear power expansion in the medium term. Hence China’s strong incentives to deal with its own air pollution and create a green economy at scale promise to generate large positive spillovers for the world as a whole in terms of the costs and supply of low carbon energy technologies.

Second, the Chinese contribution to making affordable mobile technology hardware and infrastructure available in developing countries is having a major impact on lives and livelihoods across the developing world. Chinese mobile and internet companies are now moving into the forefront of these sectors, including the development of internet based financial services, and the supply of low cost smart phones, reshaping current business models in the global smart phone industry and now in the mobile content industry as well. Its contribution to the vibrant mobile industry in Africa, where local firms are in the vanguard of leapfrogging applications of mobile technology, is particularly significant.

Third, China’s urbanization process, still ongoing, has generated many achievements and lessons. The learning by doing basis of the economic growth mechanism, intimately associated with the development of cities and constant interaction of people and the economics of agglomeration are abundantly evident in China. So are the human and social costs of rapid urbanization and inefficiencies in urban planning. The need for a new urban development model is acknowledged. (OECD Urban Policy Review of China 2015). Innovative energy efficient building designs and city layouts are being introduced. Meanwhile, China is helping with urban development in Ethiopia, both in Addis Ababa and secondary cities. Again the scope of actual and potential Chinese assistance and investment in the urban sector is an order of magnitude beyond other bilateral or even multilateral assistance providers. In all of the above areas, the Chinese policy banks are providing financial support to the Chinese companies involved in the domestic industries concerned and in the international expansion of those industries.
Finally, at the level of global development partnerships, evidence increasingly shows that China is ready to take a leadership role in the field of international development. The question of China’s approach to global development partnerships has been radically clarified by the announcements of its major regional initiatives - for Africa’s modernization, for the creation of land and maritime linkages across Eurasia and beyond, and for transcontinental linkages in Latin America. In each of these initiatives, China is expressing its desire to engage other partners. At the same time these initiatives reflect a readiness to take on leadership roles in the creation of new economic landscapes that have been beyond the scope of the international development agenda so far.

Just as striking are China’s initiatives to establish an Asian Infrastructure Investment Bank and host the New Development Bank being set up by the BRICS Summit members. A Silk Road Fund has also been established, based in Beijing as a provider of equity finance, and a Shanghai Cooperation Organisation Development Bank is also to be set up (India and Pakistan have just become members of the SCO and hence the SCO Bank will have a larger significance than previously foreseen). Again China is ready to engage with others in these new ventures. The geopolitical impact is evident, particularly in the divided response of G7 countries towards joining the AIIB and the ongoing reluctance in the US Congress to adjust power sharing in the Bretton Woods institutions to open the way for China to be more influential there (Galan and Ma, 2015).

The new reality is that a Chinese sponsored set of multilateral finance institutions will be a part of the scenery of development cooperation in the future (Reisen, 2015). Chinese policymakers increasingly realise that a multilateral approach to development finance can not only mitigate risks in politically risky countries and uncharted frontier markets, but also create scope for positive-sum gains for key stakeholders. And the new multilateral institutions bring scope for innovative financial engineering that can generate funding to match the new scale of ambition in the SDGs (Reisen, 2015; Lim and Mako, 2015).
VI. Conclusion

In this paper we have examined how China’s domestic development experiences have informed its approach to development finance abroad and explored what kinds of challenges and opportunities China will bring as it is moving to the centre stage of international development finance. A key lesson China brings from its domestic experience is the level of ambition – a readiness to think in terms of creating new economic landscapes involving comprehensive financial packages and assembling multiple actors. The idea of transformative investment has been advanced in the global policy discussion by China and absorbed into the G20 and World Bank vocabulary. China’s public entrepreneurship model of development, with policy banks and innovative enterprises playing a key role, is gaining recognition as well as generating global economic governance issues (Xu and Carey, 2015b). At the same time, China is moving forward with the lessons of its experience in terms of the social and human capital dimensions and environmental impacts. The strong domestic priority for creating a green economy is generating global spillovers in terms of green energy technologies. These domestic priorities and capacities as well as reputational factors should work to shape the priorities and standards in its international initiatives.

The shift from a passive role in international development discussions to becoming a leader of large new regional initiatives and new multilateral finance development finance institutions is a radical step forward in China’s articulation of a strategic approach to its position in the global economy in which it may soon become the largest actor. For some, the evidence is that China’s development cooperation model is not on a convergent path with other development cooperation providers (Kondoh, 2014; ODI, 2015). But the new MofCom regulations (MofCom 2014), together with the reform ideas emerging from the Chinese research community, may assist in creating synergies between China’s traditional aid programmes and those of other providers and with the new regional initiatives, in which China is inviting wide participation.

To harness China’s growing financial power as a force for good, the international development community needs to take advantage of China’s proactive move to utilize tri-angular cooperation and multilateral development institutions. As China moves to work with others and as its common interest in effective states and markets becomes more evident and unavoidable, a decision to provide significantly greater transparency in Chinese development finance would need to be made (Xu and Carey, 2015a). The transformation paradigm central to the new UN Sustainable Development Goals provides common ground for the cooperation between China and advanced economies in developing countries.
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