

# China's Development Finance: Ambition, Impact and Transparency

In a context of lagging reform in the Bretton Woods institutions, China has brought the debate on its role as a rising power in global economic governance onto the front pages, notably with the divided response of 'the West' to membership in the Asian Infrastructure Investment Bank (AIIB), which is to be headquartered in Beijing. This Policy Briefing argues that China's rise as a development financier has reached the point where it now has basic interests and responsibilities in the systemic functioning of global development financing. Yet there is still a long way to go before Chinese policymakers see transparency of China's development finance outflows and impacts as an area for win-win advances.

China's development cooperation goes back to the 1955 Bandung Conference and earlier. The Bandung principles of mutual benefit, mutual learning and non-interference, were subsequently reflected in the eight principles of Chinese aid formulated in 1964 by former premier Zhou Enlai. This tradition remains an important part of China's present day pragmatism in development cooperation. Over the past decade China has also grown to become the world's major exporter of capital with an explicit 'going out' policy, providing signals and guidance to public and private Chinese enterprises and lenders active in both developed and developing markets. Its stake has risen decisively in the sustainability of the resource supply chains that it has built and in the sustained political and economic development of its partner countries.

As a large exporter of capital, China has developed channels for providing finance on an active basis, including the diversification into real assets of accumulated foreign reserves, which are already several times larger than any safety net that China requires to keep its political and economic independence. Hence the emergence of Chinese financial centres and institutions with an international vocation. Beyond its fast-growing foreign aid programme,

which will make it a top donor country in the foreseeable future, China has the sovereign-guaranteed Export-Import (Exim) Bank and the China Development Bank (CDB) as very major sources of development finance. The CDB also helps to fund Chinese foreign direct investment (FDI) in developing countries.

Another channel for China's capital exports is multilateral development finance. Here, China has previously kept a low profile, but its recent and dramatic set of initiatives to establish China-based institutions has now captured world attention. As a former aid recipient itself, China used multilateral and bilateral aid strategically and well. However, it has been critical of donor-driven policy prescriptions and aid conditionalities. To increase its say in the governance of the World Bank, China decided in 2007 to become a new donor to the International Development Association, the World Bank's aid arm. But gaining influence in US-dominated institutions has been slow, so China decided to set up new development finance institutions in which its priorities and policy approaches would have more impact. The world is now waiting to see how these new institutions, as well as China's existing development finance institutions, its foreign aid programme

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and its enterprises, reflect a larger Chinese project for global development and how it will contribute to a global order of responsible lending and borrowing.

Against this background, this briefing examines three questions regarding China's supply of finance to developing countries.

## Ambition

On the basis of the achievements and challenges of the past three-and-a-half decades, China's leaders have launched a major programme of domestic political, social, economic and ecological reform – in the words of Premier Li Keqiang during his Special Address at the World Economic Forum (WEF) Annual Meeting of the New Champions 2014, a 'self-targeted revolution' releasing the powers of mass entrepreneurship and innovation, with a view to becoming a moderately prosperous middle-income country by 2020, a stated aim of the Chinese Communist Party. At the same time, this reform programme is seen as the way forward to achieving the 'Chinese Dream' of becoming a great nation in a cooperative global system underpinned by what has been presented as a new model of major country relations with the US to ensure that its emergence as a rising power will be peaceful. Although China, as a member of the BRICS (Brazil, Russia, India, China and South Africa), has an expressed objective of progressing to a world order that reflects the emerging new balance of economic power, Mr Li affirmed at the WEF in 2015 that 'the world order established after World War II must be maintained, not overturned'.

Within this vision, China is indeed bringing bold new horizons and new ideas into the global development scene:

- **A new take on global economic geography** – a vision of a new Silk Road reaching across Central Asia and the Middle East to Europe, or across the Indian Ocean to connect the Chinese Dream with the African Union's 'Vision 2063', which envisages an 'integrated, prosperous and peaceful Africa, driven by its own citizens and representing a dynamic force in the global arena'.
- **A new vision of how China will move its economy up the value chain**, creating more opportunities for the world, including in low-income countries with rising labour supply where Chinese firms can apply their management and marketing expertise in labour-intensive industries.

- **A new readiness to work with others** on these large agendas of global and local connectivity and development, as witnessed in the broad membership of the AIIB and the US\$2bn Growing Together Fund established at the African Development Bank.
- **New ideas of how mass entrepreneurship and innovation can be a way forward** for development in China, and perhaps in other parts of the world. Mr Li has drawn these ideas from the work of US Nobel Prize winner, Edmund Phelps, embodied in a newly released, innovation-driven development strategy and the 'Made in China 2025' strategy. The vision here is that providing a nation of 1.5 billion people with the intellectual and economic space for dynamic market-driven innovation will change China and the world at the same time.

China's political reform programme and its economic, social and environmental dimensions are currently the subject of intense debate inside and outside China. What cannot be doubted is that the Chinese Dream has profound implications globally in terms of its impact on development trajectories.

## Impact

China's development impact so far is difficult to judge, with little hard data available. This is particularly the case for the bulk of the development finance provided by China, which is supplied at (Chinese) market terms by the Exim Bank and the CDB. Nevertheless, this finance clearly did much to underwrite the investment boom in resource-related ventures and infrastructure, integral to the commodities boom created by prolonged fast growth in China. These institutions also financed a wider range of transport, energy and telecommunications infrastructure in developing countries. The 'Africa rising' story has much to do with this supply of Chinese development finance, even if its magnitude has been overestimated.

It is clear that China has ideas that go beyond the prevailing wisdom on aid programming among the countries of the Organisation for Economic Co-operation and Development (OECD), though not so far from the ideas of Japan and Korea, with whom it shares the experience of being a 'developmental state' with a 'learning by doing' development model. Chinese development finance has been a major impulse behind the 'identity crisis' among members of the OECD-Development Assistance Committee (DAC), propelling a tightening of concessionality rules for official development assistance flows

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alongside an initiative to create a broad category of 'total official support for sustainable development'. This broader category would bring recognition and transparency to flows from all providers of development finance, China prospectively included.

The relocation of labour-intensive Chinese industries to developing regions with large increases in labour supply would be financed essentially through Chinese FDI. In 2014, outflows of FDI from China exceeded inflows for the first time. Mr Li has announced an expectation for Chinese FDI stocks in Africa to rise from a current \$25bn to \$100bn by 2020. In the context of the Forum for China-Africa Cooperation (FOCAC), China is providing \$30bn of credit lines through the CDB, China Exim Bank and other commercial banks in the current three-year period (2013–15). When the next FOCAC meeting is held in South Africa in November 2015, this could rise to \$50bn according to some reports. Yet how much of this financing actually gets drawn down is less clear.

The use of rising capital inflows to Africa requires active investment strategies and capacities on the part of African governments and their integration into forward-financing scenarios extending into the long term. The new World Bank-International Monetary Fund (IMF) debt sustainability framework looks at aggregate borrowing plans of developing countries on a 20-year time horizon. The Chinese position has been to ensure that the transformative impacts of large-scale infrastructure financing are factored into the assessment of debt sustainability. Both the former President of the China Exim Bank Li Ruogu and Jin Liqun, a potential president of the AIIB, have made the case that large-scale infrastructure transforms economic capacities in a way not captured by current debt sustainability calculations.

The principle of 'non-interference' is another area of difference where impact issues are in question. There are signs that this principle is being applied now with less tolerance for corruption and mismanagement of resources, and with more engagement of Chinese economic expertise. Large loans to Brazil and Venezuela were subject to extensive study by teams from the CDB, but are now embroiled in complex local political economy problems. And financial support to Zimbabwe is on hold, pending a programme of technical assistance from China's National Development Reform Commission to develop financial management systems to stop

'leakages' of public money, and to provide management expertise for the reform of Zimbabwe's state-owned enterprises.

All the above suggests that China's transition to the status of the world's largest capital exporter, and its own internal political and economic reforms, are making developmental impact the major criterion in its development policies. There is here a basic point of convergence with 'Western donors'. The BRICS New Development Bank will need to establish a reputation as a 'good bank' in terms of standards and stakeholder engagement if it is to underpin the objective of the BRICS to be a highly regarded part of global governance arrangements in a changing world. And for China, with the New Development Bank hosted in Shanghai, and the AIIB and Silk Road Fund in Beijing, the impact on China's reputation as a centre of global finance and development thinking, along with China's basic interest and role in sustainable development globally, will be powerful forces in the direction of convergence. Yet this does not necessarily mean that China will adopt the same standards or rules as OECD countries. China is dedicated to bringing its own perspectives to improving existing ideas and practices.

### Transparency

In moving from the margins of development finance to being a central actor and provider, China now has basic interests and responsibilities in the systemic functioning of global development financing. This turning point is evidenced by systematic efforts made by the Ministry of Commerce to establish a comprehensive aid database and to develop evaluation tools for project management. Yet despite institutionalised endeavours to improve the internal auditing system of its aid programmes, Chinese policymakers are still ambivalent regarding how far China should go to disclose its development finance outflows and impacts as they ponder appropriate standards for aid data and evaluation methods.

While keeping abreast of OECD-DAC practice, Chinese policymakers tend to believe that China should tailor existing international standards to its own concepts – for example, it should take account of mutual benefits in its data and evaluation standards, which is alien to the DAC's North-South welfare/resource transfer concept. In the foreseeable future, the 'most likely' scenario is that China will neither join the DAC system to publicise its aid data in line with DAC standards, nor actively take a leadership

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role in advancing distinctive standards for South-South development cooperation. In this 'most likely' scenario China will rather continue to strengthen the internal auditing system of its development finance outflows and gradually refine its existing standards for transparency and evaluation. Annual reports would provide a vehicle for publishing this material and shaping domestic public opinion on the growing scale of Chinese foreign aid.

Yet there are powerful forces within and beyond China that may bring rapid acceleration to this scenario. Transparency is now a key principle in China's own domestic reform programme. And China's move to create new international institutions and to work with others on ambitious new development investments carries the implication of transparency,

synergy, and collective impact evaluation at the country and regional levels. Alongside these fundamental factors, independent endeavours to generate data on China's development finance by mining news reports and satellite searches will create pressure to provide disaggregated official numbers. China has recently acceded to the IMF's Special Data Dissemination Standard, which signals a readiness to enhance the availability of timely economic and financial data. And, with the US, it has entered into negotiations towards creating a new multilateral framework for export credit rules of the game. Meanwhile, China's own development research community is making the case for active involvement in international development forums and for increased structure, transparency and evaluation in China's foreign aid.

## Policy implications

In summary, below are core messages policymakers need to know to better engage with China as a rising development financier:

- Reflecting its status as the world's largest exporter of capital – a status likely to persist even with growth at a 'new normal' and higher domestic consumption reducing the current account surplus – China's emergence as the world's largest supplier of finance to developing countries is associated with increased interests and responsibilities in global governance systems. The creation of new multilateral development banks to be located in Beijing and Shanghai brings new horizons and new thinking to an institutional landscape so far largely determined by the Bretton Woods institutions and Western concepts and intellectual centres. At the same time there will be strong 'convergence' factors as the new institutions seek to establish their reputation for promoting effective and sustainable development, while adding a strong 'transformation' and 'speed' thrust into the design and implementation of large infrastructure projects and environmentally sustainable green-growth programmes.
- China's wide-ranging domestic reform programme, and its search to work with others to generate new global development dynamics in a sustained global order, implies greater transparency of data and impact than is currently envisaged in Beijing. China's presidency of the G20 in 2016 may provide a context in which advances in these crucial areas may become politically feasible as they become functionally necessary.



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## Further reading

Li, X. and Carey, R. (2014) *The BRICS and the International Development System: Challenge and Convergence?*, IDS Evidence Report 58, Brighton: IDS

Xu, J. and Carey, R. (2014) 'China's Development Finance: What Issues for Reporting and Monitoring Systems?', *IDS Bulletin* 45.4: 102–13

## Credits

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