Guidance document

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NOVEMBER 2019 | No. 2

# Towards a Sustainable Belt and Road Initiative?

## Paving the Way for a Common Sustainable Development Finance Framework

Policy Paper

AFD éditions
AGENCE FRANÇAISE DE DÉVELOPPEMENT

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**Keywords:** Foreign Aid, Development finance, Sustainable Development Goals, Belt and Road Initiative, China.

**Abstract:** The study of China's international financial flows shows that it has become a major player in international financing. With the Belt and Road Initiative, China has promoted a narrative of development based primarily on economic growth, interconnectedness through transport infrastructure, and commercial trade. At the Second Belt and Road Forum in April 2019, the Chinese authorities declared their wish to focus on issues related to financial and environmental sustainability, planning a move towards a "higher quality" Belt and Road Initiative. This discourse provides an opportunity for increased dialogue and greater cooperation with other actors involved in development finance, although this presupposes a convergence in the financial, social, and environmental practices of Chinese and non-Chinese financial actors. This article makes a number of recommendations for creating these new convergences, and offers some approaches to a common framework for sustainable finance and development.

**Please cite this paper as:** BERTUZZI, M., T. MELONIO, A. PORNET and L. TREMEL (2019), "Towards a Sustainable Belt and Road Initiative? Paving the Way for a Common Sustainable Development Finance Framework", Policy Paper AFD, n° 2, November. https://www.afd.fr/fr/nouvelles-routes-soie-durables

**Acknowledgments:** The authors would like to thank all those who made constructive contributions to this Policy Paper, and particularly (i) for the collection and handling of data in Chinese: Louise Marchand; (ii) for their helpful rereading and remarks: Cyrille Bellier, Vincent Caupin, Sophie Chauvin, David Chetboun, Hubert de Milly, Hélène Djoufelkit, Hélène Ehrhart, Christoph Haushofer, Manuel Lafont Rapnouil, Gurvan Le Bras, Florent Mc Isaac, Régis Marodon, Olivier Najar, Mary-Françoise Renard, Luis Reyes, and Cécile Valadier. In writing this paper, we also benefited from discussions with members* and speakers** at the Conseil Scientifique (Scientific Council) of the Agence Française de Développement (French Development Agency) (AFD) on September 5–6, 2019: *Francis Akindès, Elisabeth Claverie de Saint-Martin, Gaël Giraud, Maria Eugenia Ibarraran, Hervé Le Treut, Jean-Paul Moatti, Charbel Nahas, Kako Nubukpo, Jean-Michel Severino, Thomas Sterner, and Lun Zhang; **Chris Alden, Jean-Pierre Cabestan, Alice Ekman, Rémi Genevey, Manuel Lafont Rapnouil, Jean-Paul Maréchal, Mary-Françoise Renard, Michele Ruta, Sébastien Treyer, and Jiajun Xu.

**Methodological limits:** This Policy Paper offers a synthesis of key facts based on recent literature and available data. Figures are drawn from the databases of research institutions and think tanks, annual reports by major Chinese actors, and press releases and other media sources. Our research has been limited to scientific literature in French and English, as well as a number of Chinese sources.

# Highlights

- In just a few decades, China has become a major player in infrastructure-based development finance. The Belt and Road Initiative (BRI) was launched by President Xi Jinping in 2013 as a successor to Deng Xiaoping's "low-profile" doctrine. The BRI reflects a paradigm shift in Chinese foreign policy, and demonstrates China's increasing assertiveness on the international stage.
- The BRI broadly reflects a Chinese model of development finance, aiming to position itself "beyond aid." It combines the fundamentals of a Chinese approach to "foreign aid" policy —the principle of non-interference, which has been in place since 1964, and an emphasis on "win-win" partnerships and South-South cooperation—with resolutely economic and commercial objectives. It includes both foreign aid instruments (grants, interest-free loans, and concessional/preferential loans) and investment instruments (loans on market terms, investing through the acquisition of stakes in businesses). In doing so, it raises questions for the international community about the future of its own accounting framework for development finance.

- According to our estimates, between 2013 and 2017, 450–480 billion dollars (USD) were invested by the main Chinese financial actors as part of the BRI. According to estimates by Kitano (2019), over the same period, about 28 billion USD was spent on finance resembling official development assistance.
- Institutionally, China's cooperation policy is fragmented. Remarks by the Chinese authorities show that they want to improve management of the policy, and introduce greater consistency. This is reflected in the creation in 2018 of a new agency, the China International Development Cooperation Agency (CIDCA).
- The "adaptive" approach of the Chinese authorities is also shown by their increasing recognition of the debt risks caused by BRI financing, and by a range of green BRI initiatives. In an otherwise uncertain international macroeconomic context, we may be witnessing the first signs of a stabilization, or even a decline, in Chinese overseas finance.
- The shift towards a more sustainable BRI, which involves a number of significant changes, could pave the way for enhanced dialogue and cooperation between Chinese financial actors and their counterparts. This would demand a common framework for sustainable development finance, especially with regard to environmental and social impacts.

# Recommendations

By setting the BRI within the wider framework of the 2030 Agenda and its seventeen Sustainable Development Goals (SDGs), China is presented with new opportunities for its cooperation policy. By contrast, a failure to consider environmental and social issues when selecting BRI projects damages efforts to achieve the SDGs. The seventeenth SDG encourages partnerships in order to achieve the SDGs. In this spirit, the following recommendations propose some ways China and others involved in sustainable development finance might converge.

- **Financial sustainability**
  - If all Chinese financial bodies were required to rigorously apply the new debt sustainability framework published by the Chinese Ministry of Finance, it would greatly reduce borrowing states' risk of debt distress, as well as financial actors' risk of exposure. Setting up joint "debt alert" thresholds between national, regional, and bilateral development banks and members of the International Development Finance Club (IDFC) on the one hand, and the major multilateral banks on the other, would also represent an important step towards more sustainable, better coordinated financing. In addition, China is currently only an observer to the Paris Club. Joining it would send a powerful message that it is willing to coordinate with other creditor nations, and would also have the advantage of limiting the country's risk of exposure.
- **Environmental and social impacts**
  - The "Greening the BRI" initiatives launched at the Second Belt and Road Forum (BRF), which was held in Beijing on April 25–27, 2019, describe a number of ways sustainable development could be integrated into each of the pillars of the BRI. A commitment by China and its partner countries to these initiatives, through monitoring and implementation, is key in reducing the environmental impacts of BRI projects.

- Setting targets for an ambitious number of projects with positive effects on climate change offers a way of making BRI funding more sustainable. Such targets would apply to financial institutions, and primarily to Chinese policy banks and commercial banks. The use of concessional financing, in addition to non-concessional financing, could expand the range of projects financed through the BRI. While less profitable in terms of investment, the leverage effects of such finance in fighting climate change and protecting biodiversity offer a way of guaranteeing the sustainability of global sustainable development trajectories.
- Effectively aligning the BRI with the SDGs would require putting several measures in place: establishing stronger environmental and social standards for training and monitoring in BRI-funded projects; assessing more regularly and systematically the economic, social, and environmental impact of projects; aligning projects with states' long-term sustainable development trajectories, in line with their nationally determined contributions (NDCs) to the Paris Agreement; and increasing transparency for BRI funding. The co-financing of projects by actors involved in development finance (both bilateral and multilateral) would facilitate the convergence of social and environmental standards, and so ensure the greatest possible impact for such projects in terms of sustainable development. Finally, the interactions and possible contradictions between the Sustainable Development Goals (SDGs) could be considered, with the aim of encouraging convergence between those involved in development finance.

# Introduction

In less than fifty years, China has become the second largest economy in the world. According to the World Bank (WB) figures, its annual gross domestic product (GDP) per capita has increased almost forty-fold in the last fifty years, from 197 constant USD in 1969 to nearly 7,754 USD in 2018. This growth has been accompanied by an increasing international presence. While China is still treated as a developing country by the World Trade Organization (WTO) and in the country's own official discourse, it has become a prominent lender by exploiting its financial advantages, which derive from its trade surplus in particular. China's financial institutions now play a growing role in international finance. In terms of their respective balance sheets, China Development Bank (CDB) has become the world's leading development bank, and China Exim Bank (Chexim) has become the largest export bank (in 2017, CDB's total assets were 2,361 billion USD, and Chexim's were 539 billion USD).

Launched in 2013 by Chinese President Xi Jinping, the Belt and Road Initiative (BRI) forms part of a long history in which the People's Republic of China has gone through various phases of political and economic extroversion. The initiative is distinguished more by its scale and deliberate visibility than by any change in diplomatic approach. According to official sources, the BRI is now active in 138 countries.[1] In 2017, the Chinese government planned to inject 113 billion USD into the initiative—about eight times the amount it spent on foreign direct investment (FDI) in the same year (Zhou et al., 2018). The BRI focuses on creating a global strategic infrastructure network between China and its partners, but it covers many other sectors, including health, education, the digital sphere, culture, and aerospace.

1 As of October 25, 2019, official Chinese statistics on the BRI website put the number of countries having signed agreements at 138. See https://eng.yidaiyilu.gov.cn/info/iList.jsp?site_id=CMSydylyw&cat_id=10076&cur_page=5.

This new phase of Chinese overseas engagement has provoked both enthusiasm and concern. It challenges traditional development aid practices, and does not conform to longstanding distinctions between development aid, export promotion, and development finance. Looking beyond the political narrative, how are we to measure and define Chinese overseas finance, and the way in which it has changed? Do such investments offer a new model of development finance? Looking beyond public statements discourse, what are the conditions under which this investment can contribute to the Sustainable Development Goals (SDGs), and ensure compliance with the provisions of the Paris Agreement? Is a "high-quality BRI" really possible?

This Policy Paper answers these questions by examining the development of Chinese financial flows and the growing role played by China in international finance (section 1); by asking whether categories of development aid can be used to define Chinese finance (section 2); and by studying the financial, environmental, and social sustainability impacts of Chinese finance, in view of the need to keep the international financial system stable, to fight against climate change, and to preserve biodiversity (section 3).

Our remarks pave the way for **a discussion on how to define a common framework for financing sustainable development, one that goes beyond aid—particularly since Chinese overseas finance has stabilized since 2018, having apparently reached a "plateau" as part of a general policy of increased risk control.**

# 1.
# The Development of Chinese Overseas Finance: From the "Go Out" Policy to the BRI

China's economic and commercial rise has accelerated over the last thirty years and, since the 2000s, has been accompanied by growing financial power. Like its lending to governments and businesses, China's foreign direct investment (FDI) is expanding rapidly. These capital flows are directed towards both developed and developing countries.

### 1.1 – China's Assertiveness in Overseas Finance

While China's dominant position in world trade is well known, its growing role in international finance is poorly documented in official sources[2]. Estimates often cover different regions or actors, making it difficult to accurately examine Chinese financial flows overseas. However, the available data already demonstrates a number of major trends.

#### • China as a Longstanding International Lender

Present financial flows may show a recent upsurge dating back to the 2000s, but China is by no means a newcomer to international finance. It has always been an internationally active lender and donor (see Figure 1). During the 1950s and 1960s, China made large loans and grants to several of its allies. After a period of relative stagnation in the 1980s and 1990s, international loans as a proportion of GDP increased again in the early 2000s. This coincided with China's increasing share of global GDP and the recent surplus in its trade balance[3]. **While the volume of lending has remained relatively controlled relative to GDP, China has recently surpassed the World Bank and the International Monetary Fund (IMF) as the leading creditor for developing and emerging countries (Horn and al., 2019).**

#### • Financial Flows Shaped by Successive Waves of Reforms

As the Chinese economy has internationalized, first through industrial exports and then through FDI, the country has gone from being a goods manufacturer to a provider of finance.

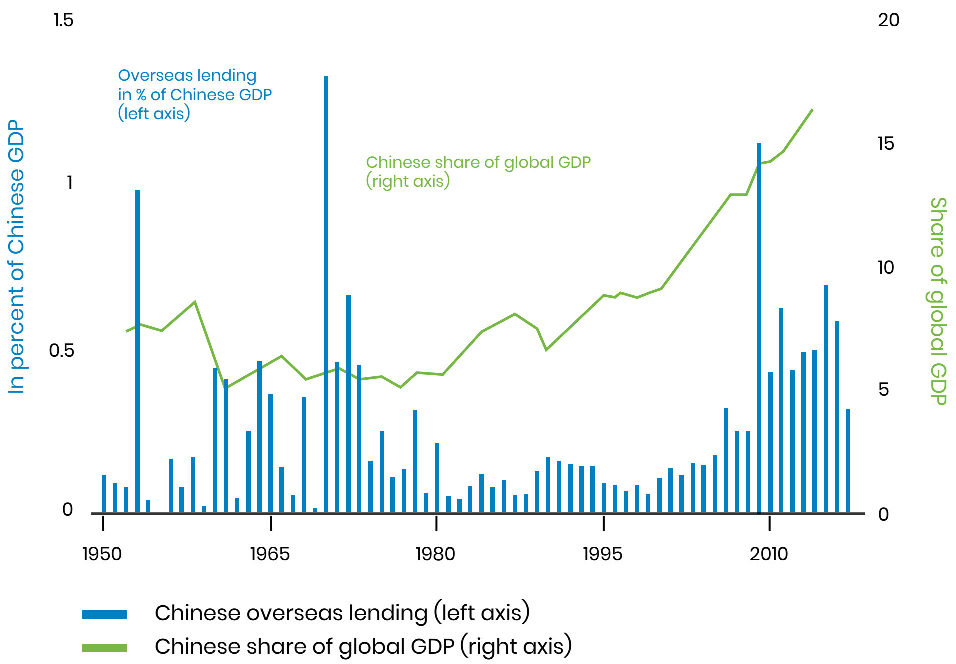
In the late 1970s, the creation of special economic zones (SEZs) by Deng Xiaoping attracted FDI (Zeng, 2015; Crane and Albrecht, 2017). In the early 2000s, Jiang Zemin's "Go Out" policy—which encouraged Chinese companies to invest abroad—made China a major player in FDI. These policies were, and remain, driven by the desire to conquer international markets, to transfer industrial capacities from the provinces of eastern China toward the west, and to clear the accumulated over-capacity in steel, cement, and heavy equipment.

After the opening of the Chinese market and the creation of SEZs, the increase in Chinese finance, domestically at first and then overseas, followed the approach taken by the major development policies established from the 1990s onwards (Sanjuan, 2007, 2016). The first of these, from 1990, focused on the area around the Yangtze River, from the Pudong SEZ to Shanghai. The second, known as the "Go West" policy, began in 2000. Its aim was to develop western China, particularly by creating transport and communication networks—a preliminary to the BRI. Beginning in 2007, a third policy focused on high-speed train lines. A fourth, introduced in 2009, was directed at ten major urban areas. The most recent such policy remains the BRI, which became part of the Communist Party of China's constitution in 2017, and today stands as a continuation of these earlier economic policies.

2 China does not produce a report compiling all the data on its foreign loans. There is also no comprehensive, disaggregated and destination-specific global inventory and flow of Chinese debt. According to Horn et al. (2019) many of these financial flows are not reported to the IMF, the Bank for International Settlements (BIS) or the World Bank. A partial alternative source is based on the annual reports of Chinese financial institutions.

3 China's current account surplus has gone from 10% of GDP in 2007 to 0.4% in 2018, a shift that is related to a fall in the commercial surplus and the deterioration of the balance of services, which has fallen into deficit.

Figure 1 - China as longstanding international lender (1949-2017)




Note: The figure shows Chinese overseas lending from Horn et al. (2019) database, scaled by Chinese GDP (blue bars, left-hand axis) and the Chinese share of global GDP on purchasing power parity basis (green line, right-hand axis). GDP data are taken from the Penn World Table.

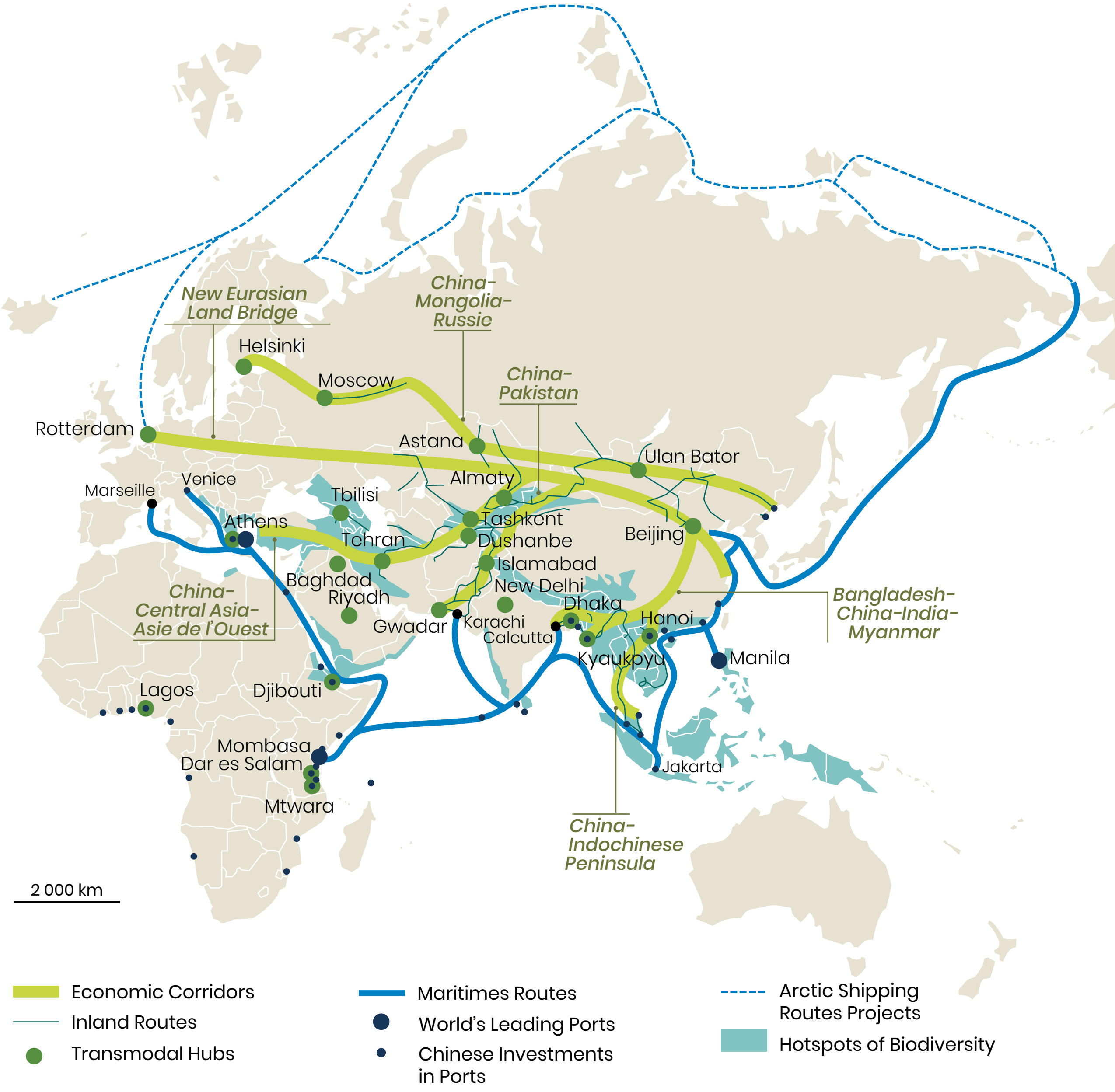
Source: Horn et al. (2019).

### 1.2 – The Changing Shape of the BRI

Launched in 2013 by President Xi Jinping, the BRI is now a major component of China's political, economic, and commercial growth.

According to some authors, the motivations behind the initiative oscillate between efforts to restore economic and political equilibria. Wang (2016) argues that, while the "Go Out" policy reflected China's foreign policy activism, the BRI is instead explained by "the growing problems with the old growth model, the changing relationship between the government and state-owned enterprises and banks, and the public dissatisfaction with the government's management of its foreign reserves." For other authors (Dollar, 2015; Fuchs and Rudyak, 2017), rather than being explained as a response to internal economic constraints, the BRI is driven by recurrent Chinese dissatisfaction with the way in which partially US-controlled multilateral institutions operate, and by China's growing influence on global governance standards.

Map 1 - The BRI: Land corridors, maritime routes—and polar corridors on the horizon?




Sources: Authors, based on multiple sources: BRI China Trade Research, HKTDC, The Artic Institute, Mercator Institute for China Studies, Renmin University of China, World Bank. ©AFD

## • A Broadening Frontier

The goal of the BRI was initially to build and invest in connectivity (port, road, rail, energy, industrial, and digital) infrastructure in Eurasia, Africa, the Middle East, and Latin America. It now also includes cooperation sectors in health, education, training, and higher education.[4] Through this initiative, China has sought to increase its projection capacity, initially in economic terms—an effort that has accompanied improvements in quality made to achieve the ambitious goals of Made in China 2025,[5] and to promote a world order "with Chinese characteristics" (Dumond et al., 2018).

The geographic and sectoral frontiers of the initiative have continued to expand. While the BRI has no definitive borders, most of its projects are concentrated around six land-based corridors (the Belt) and a network of ports (the Road), linking the Chinese coast to Europe by way of the Indian Ocean, the African coastline, and the Mediterranean (see Map 1). To date, the official website lists 138 countries that have signed Memorandums of Understanding (MoUs)

There is currently no public list of projects that are part of the BRI. Public statements and unofficial databases nonetheless provide an idea of the diversity of projects undertaken[6]. Dumond et al. (2018) mention some examples: railroads to improve freight transport (the Duisburg-Chongqing line), port infrastructure (the port of Piraeus in Greece), dry ports and inter-modal terminals (Khorgos in Kazakhstan), special economic zones (the China-Belarus Industrial Park in Minsk), pipelines (Myanmar-China), digital infrastructure (fiber optics in Pakistan), a language exchange and visa program (United Arab Emirates), and tourism infrastructure (Cambodia).

## • Increasing Finance Volumes through a Range of Channels

**While it remains controversial whether the BRI has a knock-on effect on finance volumes, it is indisputable that Chinese financial flows overseas, and the range of funding channels available (see Box 1), have increased continually since the 2000s—at least, until the "plateau" in 2018.**

4 The BRI is based on five pillars: 1) policy coordination; 2) facilities connectivity; 3) unimpeded trade; 4) financial integration; and 5) people-to-people exchanges.

5 According to Dumond et al. (2018), the goal of Made in China 2025, which was presented in 2015, is to make China into a major industrial power through the acquisition of expertise in fundamental technologies in ten sectors: information technology, robotics, aeronautics, naval and maritime equipment, railroads, automobiles, electricity, agricultural equipment, new materials, and medicine. In each of these sectors, the plan sets precise goals regarding market share for Chinese intellectual property both domestically and abroad.

6 For example, the "China Global Investment Tracker" database compiled by the American Enterprise Institute and the Heritage Foundation.

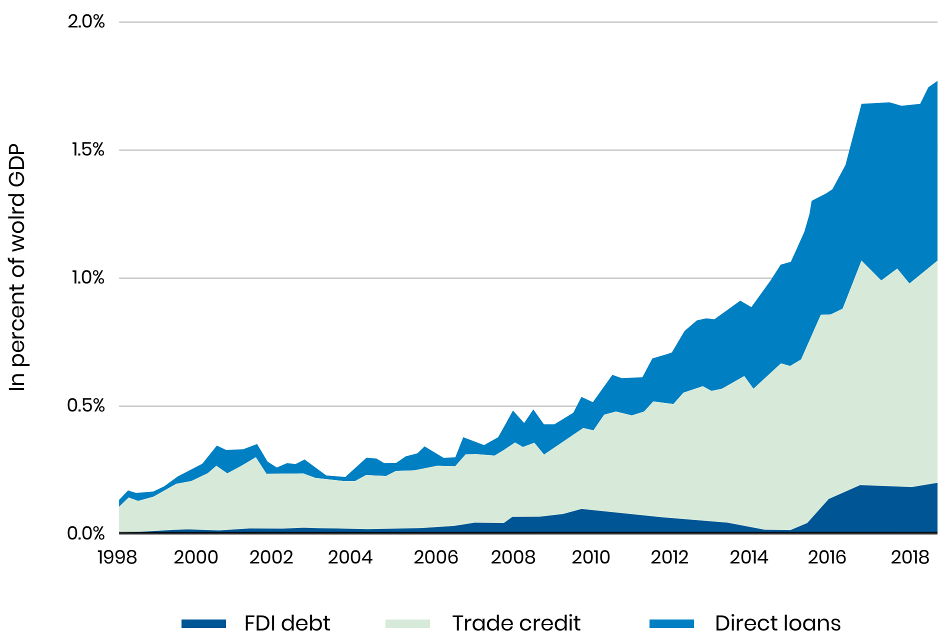
# Box 1. The main financial channels by which China interacts with emerging and developing countries

**As emphasized by Kratz et al. (forthcoming), China's main financial channels for interacting with emerging and developing countries are varied. These channels range from "aid-like" instruments, such as grants, zero-interest loans and concessional or preferential loans, to commercial instruments (market-based/non concessional loans and equity investments) and currency exchange in the form of swap lines.**

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Type | Aid-Like Channels | | | Commercial Channels | | | Other |
| Channel | Grants | Zero Interest Loans | Concessional & Preferential Lending | Commercial Lending | Foreign Direct Investment | Portfolio Investment | Currency Swaps |
| Flow | Grant | Debt | | | Equity | | Currency |

Source: Kratz et al. (forthcoming).

Figure 2 - China's Overseas Lending Boom



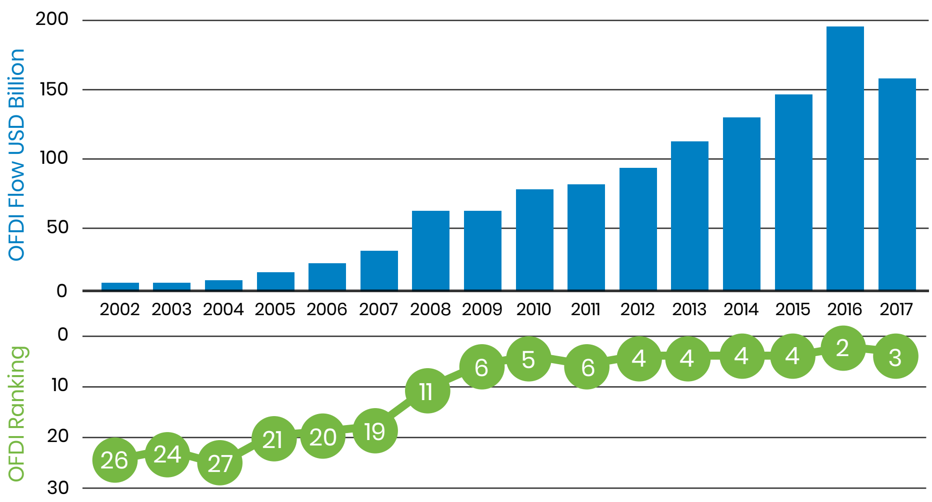

Note: This figure shows a subset of outstanding Chinese overseas bet claims as reported in China's Balance of Payments (BoP) Statistics, scaled by global GDP. Trade credit includes short- and long-term trade credits and advances. FDI debt claims arise in case of inter-company lending across borders. Portfolio debt is excluded. Data: PBOC and IMF.

Source: Horn et al. (2019).

As emphasized by Horn et al. (2019), outstanding debt to China held by other countries (loans and commercial credit) in 1998 was low, but rose by 2018 to more than 1,600 billion USD, or nearly 2% of global GDP (cf. figure 2).

As loans, Chinese FDI has steadily increased. In 2016, China became the second largest country in terms of outward FDI after the United States (see Figure 3). Such investment is primarily directed at developed countries, particularly Europe and the United States (Horn et al., 2019).

Figure 3 - China's OFDI Flow in USD Billion and Global Ranking, 2002-2017



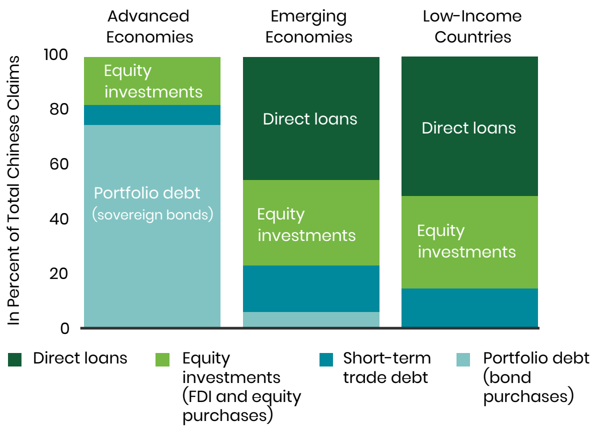

Note: Data from MOFCOM and UNCTAD (2018).

Source: Zhou et al. (2018).

The type of financing used by China varies according to the wealth of the recipient country (see Figure 4) (Horn et al., 2019). Sovereign bond issues by high-income countries are regularly underwritten by the People's Bank of China (PBOC). By contrast, low- and middle-income countries typically receive direct loans from Chinese public banks, often at market rates and backed by public guarantees. In rarer cases, these loans may take as collateral (or be guaranteed by) resources[7] —oil, raw materials, and territorial concessions, which may include management, extraction, and development rights. Chinese equity investments are apparently distributed across all types of countries.

7 This guarantee policy—which in China's case is also called the Angola model—is a well-tested approach. The use of "debt for nature swaps" is not restricted to China. Other actors, including environmental organizations, the US, and multilateral funds, have all established "resource-backed loans" since the 1980s. According to the World Bank, other banks—like Korea Exim Bank in the Democratic Republic of Congo—have also followed China in adopting the practice (Horn et al., 2019).

Figure 4 - China's tailored approach of exporting capital: Country groups




Notes: This figure shows the composition of Chinese foreign claims into different asset classes and instruments by recipient country group. Data on Chinese claims is based on numerous different data sources, country classification into income groups follows the IMF World Economic Outlook database.
Note that subscriptions to sovereign bonds consist mainly of investment of foreign exchange reserves of China.

Source: Horn et al. (2019).

China's ability to mobilize increasing financial resources makes it a leading player in development finance. Indeed, according to AidData[8], Chinese public funding allocated overseas in 2014 surpassed equivalent US funding. However, treating such funding as a contribution to development remains controversial, especially among the lenders who make up the Development Assistance Committee (DAC) of the Organization for Economic Co-operation and Development (OECD).

8 https://www.aiddata.org/china-official-finance

# 2.
# Chinese Cooperation Policy: Aid, Business Internationalization Support, and Development Finance

The rapid development of Chinese cooperation policy, the fragmentation of the actors involved, and the lack of data harmonization all make analyzing Chinese cooperation policy a particularly difficult task. Few articles in the literature deal with the way this policy is implemented. This section examines two systems in order to gain an understanding of the nature of Chinese development finance: Chinese foreign aid and the BRI.

### 2.1 – The Characteristics of Chinese Foreign Aid

Chinese foreign aid is not a new phenomenon. China began providing foreign aid to other developing countries in 1950, when it provided aid to North Korea and Vietnam. It has published two white papers, in 2011 and 2014, to explain its foreign aid system. In September 2019, a white paper titled China and the World in the New Era presented China's vision of international relations and its own cooperation policy. Interestingly, the word "development" appears more than two hundred times in the document.

**In its first white paper on foreign aid, published in 2011, China was already seeking "a model [of foreign aid] with its own characteristics," attempting to define this separately from the approach of those traditionally involved in official development assistance.**

- **Projects Financed Primarily by Concessional Loans**

In 2017, according to data released by the Ministry of Commerce (MOFCOM),[9] China had carried out 309 foreign aid projects, including nearly sixty major infrastructure projects. These include, for instance, the construction of a cross-border fiber optic cable between China and Pakistan, the China-Maldives Friendship Bridge, a stadium in Cambodia, and the Africa Centres for Disease Control and Prevention (Kitano, 2018).

1. According to the 2014 white paper on foreign aid, Chinese foreign aid comes in three forms:

2. grants, which finance technical assistance projects, humanitarian aid, the supply of goods and materials, training, volunteers, and medical teams;

3. interest-free loans, which finance public infrastructure projects to improve living conditions;

4. concessional loans, primarily for medium- and large-scale infrastructure projects.

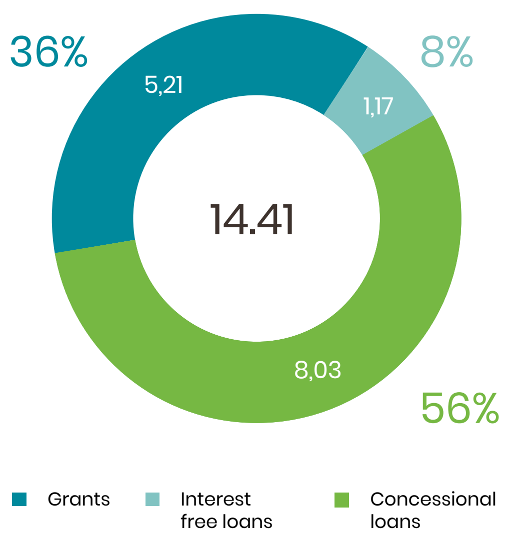
Unlike grants and interest-free loans, which are funded from the Chinese state budget and managed by the MOFCOM, concessional loans are managed by Chexim.[10]

9 Ministry of Commerce, "Year-end Overview XI for Commerce Work in 2017: Actively Carry out Foreign Assistance to Boost the Building of a Community of Shared Future for Mankind," January 15, 2018, http://english.mofcom.gov.cn/article/zt_overview2017/news/201803/20180302718767.shtml.

10 Although subsidies on these loans are still funded from the state budget, and are decided by the MOFCOM.

Most of this finance is in the form of concessional loans. According to official Chinese figures, between 2010 and 2012, out of 14.41 billion USD in foreign aid, 8.03 billion USD (55.7%) was allocated in the form of concessional loans, while 5.21 billion USD (36.2%) was allocated as grants, and 1.17 billion USD (8.1%) as interest-free loans (see Figure 5).

Figure 5 - Allocation of Chinese foreign aid between 2010 and 2012 (in billions of USD) according to official sources




Source: Authors, based on data from China's 2014 White Paper on Foreign Aid. ©AFD

Chinese aid is primarily bilateral. Using data from Kitano (2019), we can estimate China's multilateral aid at around 25% of the total annual aid over the period 2015–18.[11]

## • A Foreign Aid Policy Directed by the Chinese State

As with all Chinese policy, foreign aid policy is set by the Central Committee of the Communist Party (Zhang and Smith, 2017). The institutional structure of foreign aid is complex, and fragmented between a large number of actors.

- The **State Council** oversees the entire scheme. Its role is to supervise and approve the budget. The State Council's Development Research Center also has a think tank, the Center for International Knowledge on Development (CIKD), whose job is to consider its development doctrine relative to the Sustainable Development Goals.
- The **China International Development Cooperation Agency** (CIDCA) was created in 2018, and is composed primarily of Ministry of Commerce (MOFCOM) staff, supported by the Ministry of Foreign Affairs (MOFA). Its mandate is to coordinate aid allocation and to develop projects for implementation by the MOFCOM (see below). However, a recent article by the Brookings Institute (Sun, 2019) shows that the CIDCA's budget is equivalent to 1% of MOFCOM's overseas economic cooperation budget in 2019. The CIDCA is currently responsible for evaluating foreign aid projects.
- Despite the creation of the CIDCA in 2018, the **Ministry of Commerce** (MOFCOM) remains the central institution for foreign aid in terms of budget.[12] Its importance diverges sharply from practice in other countries that provide development assistance, where the ministry of foreign affairs is responsible for aid.[13] The creation of the CIDCA has not yet changed this state of affairs: the MOFCOM retains the ability to initiate bilateral foreign aid projects (allocating grants and interest-free loans and subsidizing concessional loans).

11 The estimates by Kitano (2018, 2019) account for financing allocated by the Chinese state to international organizations that are eligible for ODA according to the DAC (OECD).

12 In terms of administrative regulation, the way aid is managed at this stage remains unclear. There are regulatory requirements (banfa 办法) that govern the internal processes of the CIDCA (which established such requirements in 2018) and the MOFCOM (which did so in 2014). Note that the CIDCA's banfa 办法 very closely reproduce those of MOFCOM (see Marina Rudyak's work on this topic). By contrast, CIDCA has been mandated to create a law on foreign aid (falü 法律) that, once drafted, will apply to all ministries, including the MOFCOM.

13 The connection between Chinese aid and the MOFCOM is unique (Voituriez et al., 2017). In other DAC countries, it is the ministry of foreign affairs (MOFA) that oversees strategic aid programs, sometimes alongside the ministry of finance (MOF).

- The **Ministry of Foreign Affairs** (MOFA) plays an advisory role in foreign aid. It helps to define strategy and coordinate China's foreign policy under the aegis of the central government.
- The **Ministry of Finance** (MOF) prepares the budget, authorizes grants to multilateral organizations, manages debt cancellation and restructuring, and approves annual aid plans.
- The **People's Bank of China** (PBOC) oversees the Silk Road Fund (SRF) alongside the State Administration of Foreign Exchange (SAFE), and manages relations with the International Monetary Fund (IMF) and multilateral development banks – the African Development Bank (AfDB) and the European Bank for Reconstruction and Development (EBRD) in particular.
- **China Exim Bank** (Chexim) provides concessional loans from the Chinese government and preferential buyer loans. The latter play a key role in promoting an export-oriented economy.
- **Between 12 and 20 other ministries and agencies** (e.g., the Agency for International Economic Cooperation) play a role in foreign cooperation policy. On the ground, the economic and commercial advisers of the Chinese Embassy oversee and coordinate aid.
- In addition, tens of thousands of Chinese firms (both public and private), hospitals, educational institutions, non-governmental organizations (NGOs), and other organizations are involved in implementing projects in the field.

The diagram on page 16 illustrates the complexity of this system and the range of actors involved in China's broader development finance ecosystem.

### • Financing Taking a Diplomatic Stance

China's current foreign aid doctrine is based on the eight key principles of Chinese aid set out in 1964 by Prime Minister Zhou Enlai during a visit to Ghana (see Box 2).

## Box 2. Zhou Enlai's eight principles, as set out in the 2011 white paper on foreign aid

**"1. The Chinese government always bases itself on the principle of equality and mutual benefit in providing aid to other countries. It never regards such aid as a kind of unilateral alms but as something mutual.**
**2. In providing aid to other countries, the Chinese government strictly respects the sovereignty of recipient countries, and never attaches any conditions or asks for any privileges.**
**3. China provides economic aid in the form of interest-free or low-interest loans, and extends the time limit for the repayment when necessary so as to lighten the burden on recipient countries as far as possible.**
**4. In providing aid to other countries, the purpose of the Chinese government is not to make recipient countries dependent on China but to help them embark step by step on the road of self-reliance and independent economic development.**
**5. The Chinese government does its best to help recipient countries complete projects which require less investment but yield quicker results, so that the latter may increase their income and accumulate capital.**
**6. The Chinese government provides the best-quality equipment and materials manufactured by China at international market prices. If the equipment and materials provided by the Chinese government are not up to the agreed specifications and quality, the Chinese government undertakes to replace them or refund the payment.**
**7. In giving any particular technical assistance, the Chinese government will see to it that the personnel of the recipient country fully master the technology.**
**8. The experts dispatched by China to help in construction in recipient countries will have the same standard of living as the experts of the recipient country. The Chinese experts are not allowed to make any special demands or enjoy any special amenities."**

Source: http://www.china.org.cn/government/whitepaper/2011-04/21/content_22411843.htm

The Chinese development narrative emphasizes the importance of respecting "national independence" (the principle of non-interference) and countries' "right to independently select their own path and model of development." The basic principles China still defends remain **"mutual respect, equality, keeping promise [sic.], mutual benefits, and win-win [partnerships]"** (State Council Information Office, 2014), and it abstains for any interference in other nations' internal affairs. China identifies itself as "a developing country," one other such countries can use as an inspiration for their own development. According to its 2011 white paper, Chinese foreign aid "falls into the category of South-South cooperation," and is a form of "mutual help between developing countries" (State Council Information Office, 2011).

For Fuchs and Rudyak (2017) and Dollar (2018), foreign aid is a way for China to ensure that its partners support its project of reforming the established international economic order.[14] This matches the analysis of the Institute for Sustainable Development and International Relations (IDDRI), which interprets the Chinese narrative as **"aid to serve a project for emancipation,"** and would be "justified by the means, rather than the ends" (Voituriez et al., 2017).

### • An Approach outside the ODA Framework

China has been a "key partner" of the OECD since 2007[15] and since 2015 has been a member of the Development Centre[16]. It also participates in meetings of the DAC, a body that comprises the main official development assistance (ODA) donors. However, China does not use the ODA accounting framework. Quantitative estimates of Chinese aid-equivalent financing differ depending on the accounting method used.

According to OECD estimates, China's concessional financing for development was 4.8 billion USD in 2017, up from 3.6 billion USD in 2016 (OECD, 2019). However, the OECD considers Chinese concessional loans to be "associated finance," and argues that they should not be considered aid, since they are not subject to competitive bidding during the procurement process (Kitano, 2018).

Meanwhile, Kitano estimates China's net foreign aid at 6.4 billion USD in 2018, up slightly from 2017 (6.1 billion USD) and 2016 (5.8 billion USD). His calculations include foreign aid as defined by the Chinese government[17]—which includes concessional financing—and contributions to multilateral organizations (Kitano, 2019).

Finally, AidData estimates that, in 2014, China allocated 6.9 billion USD to ODA[18]—an amount that should be compared to the figure of 4.9 billion USD for foreign aid that Kitano (2019) gives.
More generally, such differences in estimates show the still-current debates about the shape of public development aid. By trying to distinguish its own approach from the traditional development aid mode promoted and standardized within the OECD, China is re-examining the scope of development financing.

According to AidData's alternative accounting method,19 the total amount of Chinese public financing between 2000 and 2014 was 354.3 billion USD, very close to the 394.6 billion USD spent by the US (Figure 6), although its characteristics are quite different.

14 Their argument about strategies for internationalizing the Renminbi is supported by the white paper China and the World in the New Era (State Council Information Office, 2019): "The internationalization of the Renminbi has broadened monetary settlement options for global trade and promoted diversity in the international monetary system. It aims to supplement and improve rather than change the current system."

15 China became an OECD key partner in 2007, alongside four other developing countries: South Africa, Brazil, India, and Indonesia.

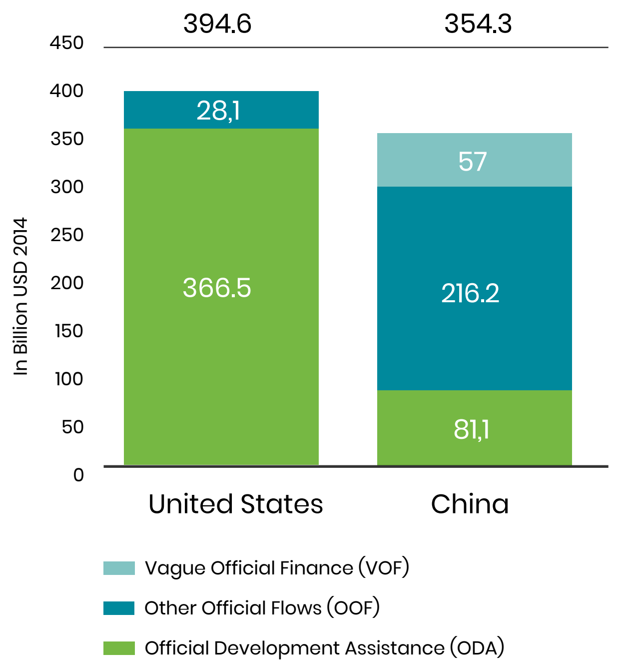
16 The Development Centre is a forum for development policy dialogue that brings together OECD countries and developing countries

17 To produce his estimates, Kitano (2019) used six spending categories: "(1) grants and interest-free loans by the Ministry of Commerce (MOFCOM), (2) grants managed by other ministries responsible for foreign aid, (3) scholarships provided by the Ministry of Education (MOE) to students from other developing countries, (4) interest subsidies on concessional loans, which are deducted from the total amount of aid, (5) concessional loans managed by the Export-Import Bank of China (China Exim Bank) as bilateral foreign aid, and (6) subscriptions and contributions to ODA-eligible international organizations as multilateral foreign aid." For his estimates for 2017–18, Kitano also includes CIDCA overheads in his calculations.

18 See https://www.aiddata.org/china-official-finance.

19 Ibid.

Figure 6 - The composition of international public finance in the US and China (2000-2014)




Source: AidData, https://www.aiddata.org/china-official-finance.

### 2.2 – The BRI: A new Era for China's Cooperation Policy?

After a "political" phase of supporting its allies (1950–76), and an "economic development" phase (1978–2013), China's cooperation policy entered a third phase in 2013 with the launch of the BRI: a "strategic" approach (Huang and Wei, 2015; Xu and Carey, 2015) focused on strengthening China's position in a global economy with a new economic geography.

**The BRI confirms China's stance on its cooperation policy: its investment strategy combines the fundamentals of foreign aid policy (South-South cooperation, the principle of non-interference, and win-win partnerships) with resolutely economic and commercial ambitions.**

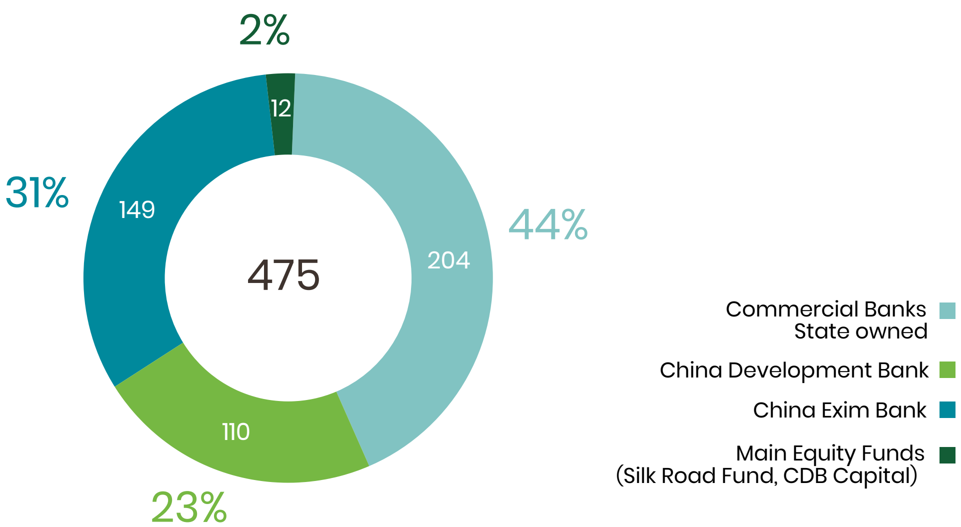
Chinese finance is driven by a variety of players, including policy banks and (public) commercial banks, equity funds, auxiliary institutions represented by import-export credit insurance firms, and newly established multilateral institutions like AIIB and NDB. The National Development and Reform Commission (NDRC) has played a major role in promoting the BRI (Kitano, 2018). The creation of CIDCA demonstrates the Chinese government's desire to improve the coordination of its funding system.

Diagram 1 presents a simplified view of the Chinese development finance ecosystem.

According to our estimates, based on public data reported by a selection of Chinese actors, the amount of financing for the BRI, between 2013 (launch of the initiative) and 2017, can be estimated at 475 billion USD, with a margin of error that can raise the estimate between USD 450 and USD 480 billion (see Figure 7).[20]

20 The AFD estimate of 475 billion USD over the period 2013-2017 could be considered as a financing ceiling. In 2017, the Financial Times put the figure at 232 billion USD (estimated at the end of 2016), and in 2019 the World Bank put the figure at 598 billion USD (for seventy countries along BRI corridors, excluding China) for completed, current, and planned projects.

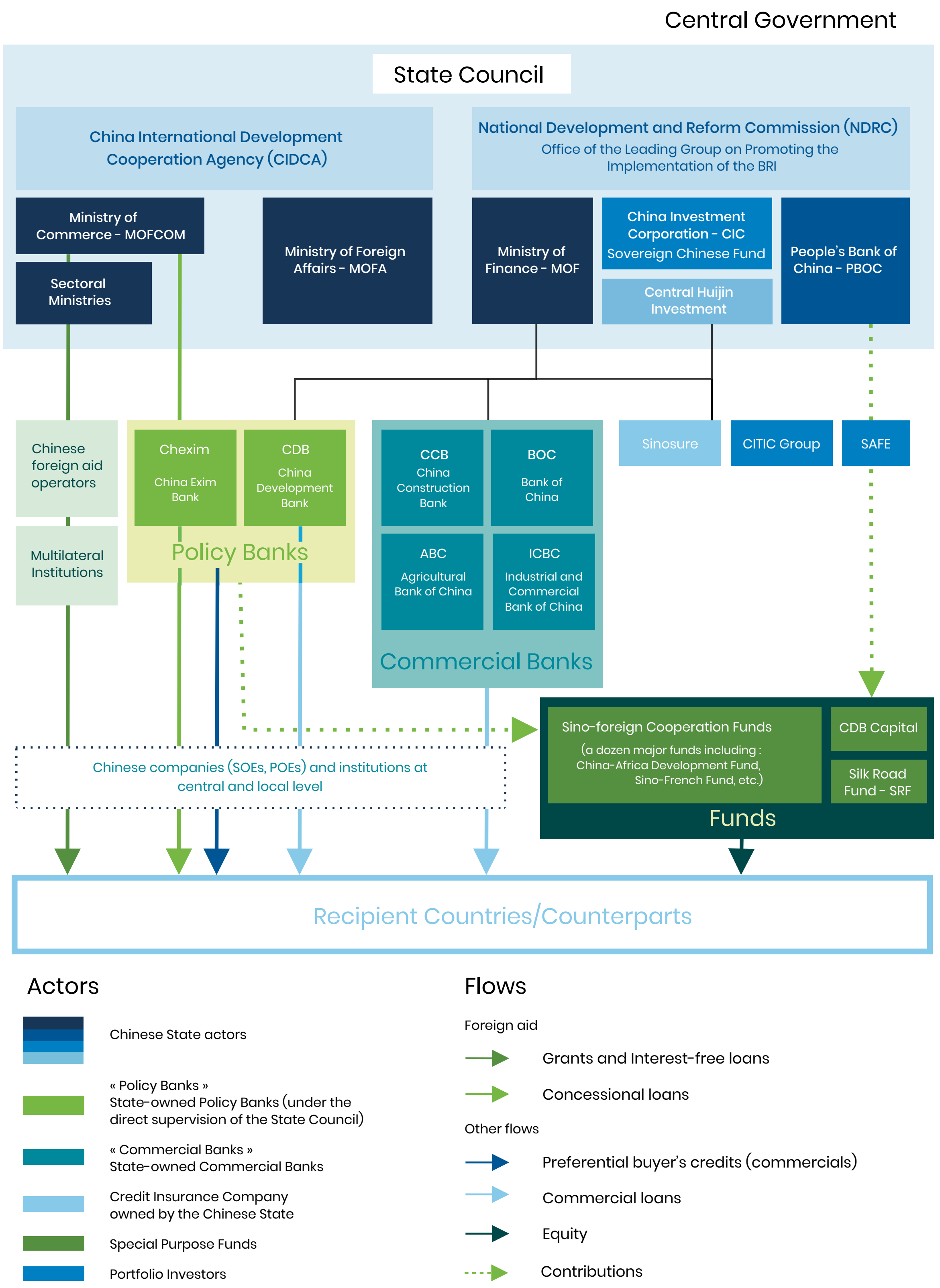
Figure 7 - Estimated BRI financing by main Chinese actors (cumulative amounts, 2013-17)




Notes:
These estimates take into account investments in BRI projects (within and outside China) as reported by the institutions concerned, with the exception of CDB Capital (a subsidiary of CDB). In the absence of detailed data, the amount given for CDB Capital is an estimate of reported investment outside China between 2013 and 2017.
The four commercial banks (the "Big 4") are the Agricultural Bank of China (ABC), the Bank of China (BOC), the China Construction Bank (CCB), and the Industrial and Commercial Bank of China (ICBC).

Source: Authors, using data from 2017 annual reports, press releases, and media sources. ©AFD

Diagram 1. A simplified diagram of the main Chinese development funding actors




Note: Horn et al. (2019) identify three funds that carry out China's foreign exchange portfolio investments: the State Administration of Foreign Exchange (SAFE), the agency attached to the PBOC that manages foreign exchange reserves; the China International Trust and Investment Corporation Group (CITIC Group), a Chinese investment fund; and the China Investment Corporation (CIC), a Chinese sovereign fund created to diversify China's foreign exchange reserves. CIC holds a majority stake in Sinosure and the four commercial banks through its subsidiary, Central Huijin Investment.

Source: Authors, based on Horn et al. (2019) and Kitano (2018). ©AFD

### • The Prominent Role of Policy Banks and Commercial Banks in Chinese Overseas

According to our analysis of public data, in the period 2013–17, 97% of Chinese international lending operations relating to the BRI (cumulative figures) were financed by the **two policy banks**[21] that operate overseas (CDB[22] and Chexim), and by **the four major Chinese commercial banks:** Industrial and Commercial Bank of China (ICBC), Bank of China (BoC), China Construction Bank (CCB), and Agricultural Bank of China (ABC).

**Out of the 475 billion USD allocated under the BRI** between 2013 and 2017, **149 billion USD (31%) was provided by China Exim Bank, and 110 billion USD (23%) by CDB. Meanwhile, 204 billion USD (43%) came from China's state-owned commercial banks.** In addition, **an analysis of data published by these same institutions on their overseas financing** (total overseas loans, not restricted to the BRI) **suggests that these figures began to plateau in 2018.** According to a recent analysis (Gavekal Dragonomics, 2019), the value of new BRI-related projects in 61 countries has fallen by 13% in 2018, to 126 billion USD, prefiguring a similar change in 2019.

## Box 3. The role of policy banks in Chinese overseas financing

**Policy banks are financial institutions whose assets are wholly owned by the Chinese central government.[23] Unlike commercial banks, these "policy-loan" banks do not collect deposits from individuals and do not have to meet profitability targets.[24] The functions of Chexim are similar to those of an overseas export credit agency, because of its active involvement in supporting Chinese businesses, as well as financing overseas trade and investment. In terms of overseas finance, CDB mainly intervenes through non-concessional loans. Chexim is the only Chinese bank authorized to make concessional loans abroad, and only when the aid is tied. Such loans are granted in sectors including energy, transport, telecommunications, industry, mining, health, and housing.**

21 Three policy banks exist, but only two of them (CDB and Chexim) operate on an international level as part of the BRI. We do not include the third policy bank, the Agricultural Development Bank of China (ADBC) in our scope, as it has yet to carry out any overseas financing. ADBC focuses on funding BRI projects within Chinese provinces (cf. Annual Report 2017 in English, pp. 22, 29, and 30 - http://www.adbc.com.cn/en/n1064/n1071/index.html).

22 CDB is the largest Chinese investment and overseas finance bank. As well as offering traditional credit, the two banks (CDB and Chexim) have established China-overseas cooperation funds. At the end of 2018, CDB declared that it had 312.4 billion USD in loans outstanding for international operations, making it the largest Chinese issuer of foreign-currency loans.

23 The liberalization of the financial sector began with the Commercial Bank Law of 1995, bringing an end to private-sector monopolies (recall that, in 1993, the four commercial banks controlled 80.4% of Chinese market share in terms of assets). With the support of the World Bank, the 1995 law transferred certain public service activities, which had been carried out until that point by private banks, to three new specialized banks, which were called "policy banks." These were created by the Policy Banks Law of 1994: China Development Bank (which funds infrastructure and essential equipment projects), China Exim Bank (for overseas trade), and the Agricultural Development Bank of China (for infrastructure). Unlike commercial banks, these "policy" lending banks do not take on individual deposits and have no profit goals. The state also explicitly guarantees the whole of their balance sheet. In the case of CDB, in particular, this allowed them to play a major role in creating a national bond issues market.

24 According to Gaëlle Brillant, this separation of activities exists only in theory, as "policy" loan banks finance themselves through loans from the central bank, deposits from state institutions, and state-guaranteed deposits that are held by the four commercial banks.

According to a report by the City of London Corporation and PBOC (2018), the four Chinese state-owned commercial banks, account for a significant portion of BRI finance. With their overseas branches and diversified financing services system, China's commercial banks offer a full range of credit products (loans, domestic and foreign bonds, and general cross-border financial services). The policy banks act using a range of widened instruments: preferential and long-term loans (such as concessional loans), preferential export credits, special purpose loans, and strategic equity investments through multilateral or bilateral funds.

Moreover, according to Ekman et al. (2018), international banks (like Standard Chartered, United Bank for Africa, and Barclays Africa) have signed MoUs with CDB. In addition, through their overseas subsidiaries, international banks (Citigroup, HSBC, Standard Chartered) also help to implement the BRI through financial services potentially provided to BRI projects.

- **The Underestimated Role of Trade Credit Insurance Firms**

A less well-known but equally important player is Sinosure (China Export and Credit Insurance Corporation, a credit insurance and finance guarantee company. Its purpose is to allow the state to act as a shareholder in the three major Chinese public banks. Sinosure is jointly run by the National Development and Reform Commission (NDRC), the MOF, the MOFCOM, and the PBOC. In 2012, Sinosure was granted the status of a ministerial-level financial institution. An article in the Belt and Road Portal describes the different stages involved in its work: seeking financing opportunities abroad, with a focus on high-quality projects; assessing foreign investment opportunities through country risk analysis and research into the firms or industrial/commercial sectors under consideration; making an investment plan; and implementing the project, with continuous risk management, analysis, and negotiation with counterparts until the end of the project.[25] Sinosure reimburses the lender in the event of default, expropriation, exchange restrictions, political unrest, or breach of contract, insuring Chinese companies for up to 95% of their investments. Its involvement at every stage of a project, and its potential "veto" over some of them, mean that Sinosure plays a role in coordinating and steering a large number of development projects, both in terms of where firms originate (the "Chinese element") and in terms of financial sustainability.

25 See http://www.chinagoabroad.com/zh/contributor/china-export-credit-insurance-corporation (article in Mandarin).

• **Sino-Foreign Cooperation Funds: New Protagonists**

In addition to offering traditional credit activities, policy banks participate in Chinese overseas investment funds, which finance joint investments between China and other countries or regions. For example, CDB Capital (a subsidiary of CDB) and foreign investors have jointly created funds like the United Arab Emirates-China Joint Investment Cooperation Fund, the China-Portuguese Speaking Countries Cooperation and Development Fund, and the Sino French (Midcap) Fund. These funds invest directly in companies or projects in the form of equities, quasi-equity, convertible bonds, and hybrid instruments. An analysis of the major funds suggests an overall annual equity investment of 3–4 billion USD (see Table 1). The sources of financing for these funds are primarily foreign exchange reserves and, secondarily, CDB and Chexim. CDB Capital and the SRF act as "central" funds for the BRI, and provide finance for other funds that are ultimately responsible for direct investment. But the "waterfall" structure used by Chinese investment funds has not enabled very high investment rates, since the amounts actually invested in recent years remain far from those initially envisaged.

For example, the SRF, which was created in 2014 as a joint project between the Chinese state, Chexim, and CDB, had initial holdings of 40 billion USD. By June 2017, the SRF had invested in sixteen BRI projects, a total of 6 billion USD (City of London Corporation-PBOC Report, 2018).

Table 1 - Major public investment funds involved in the Belt and Road Initiative

| NAME OF FUND | CREATION DATE | SHAREHOLDERS | GLOBAL BUDGET (MILLIONS OF USD) | INITIAL BUDGET (MILLIONS OF USD) | ESTIMATED ANNUAL INVESTMENT (MILLIONS OF USD) |
|---|---|---|---|---|---|
| **CDB Capital** (Invests both in China and abroad) | 2009 | CDB | 8,000 (the total assets of CDB Capital are four times higher) | - | 1,200 (+800 in other funds) [a] |
| **Silk Road Fund** (SRF) | 2014 | Chinese state 80% (SAFE, 65%, CIC, 15%), China Exim Bank 15%, CDB 5% | 40,000 + 100,000 (RMB) | 10,000 | 1,000 [b] |
| **United Arab Emirates-China Joint Investment Cooperation Fund** | 2015 | CDB Capital, Chinese state (via SAFE), Mubadala 50% (UAE) | 10,000 | 4,000 | 300-400 [c] |
| **China-Africa Development Fund** (CADFund) | 2006 | CDB Capital | 10,000 | 5,000 | 380-400 [d] |
| **China-Africa Fund for Industrial Cooperation** (CAFIC) | 2015 | Chinese state 80% (via SAFE), China Exim Bank 20% | 10,000 | - | 400-500 [e] |
| **China-Central and Eastern Europe Investment Cooperation Fund** | 2012 | China Exim Bank, Silk Road Fund, Hungarian Exim Bank | 1,800 | 435 | 80-100 [f] |
| **China-EU Co-Investment Fund** (CECIF) | 2018 | Silk Road Fund 50%, BEI 50% | 500 | 500 | NC |

| NAME OF FUND | CREATION DATE | SHAREHOLDERS | GLOBAL BUDGET (MILLIONS OF USD) | INITIAL BUDGET (MILLIONS OF USD) | ESTIMATED ANNUAL INVESTMENT (MILLIONS OF USD) |
|---|---|---|---|---|---|
| **Sino-French Funds** (SME 1, Midcaps, Innovation, SME 2, Midcaps 2) | 2012-2014-2015-2016-2018 | CDB Capital (50%), BPI (50%) Management: Cathay Open funds | 230 (EUR) +600 +287 +200 +1,200 | 230 (EUR) +600 +250 +150 +600 | 200-250 |
| **China-Portuguese Speaking Countries Cooperation and Development Fund** | 2013 | CDB Capital (60%), Macau Industrial and Commercial Development Fund (40%) | 1,000 | 125 | 30-40 [g] |
| **China-Latin America and Caribbean Industrial Cooperation Investment Fund** (CLACICIF) [h] | 2015 | Chinese state 85% (via SAFE), CDB Capital 15% | 30,000 | 10,000 | NC |
| **China-Latin America and Caribbean Cooperation Fund** | 2013 | PBOC; from 2015, China Exim Bank Management: IDB | 5,000 (2,000 PBOC, 3,000 China Exim Bank) | 2,000 | 280 [i] |

Notes:

a Since its creation, CDB Capital has invested 170 billion RMB (24 billion USD) outside China. Around 20% of its investments were carried out on behalf of third parties. http://www.cdb.com.cn/English/ywgl/zhjryw/gkjryxzrgs/
70 billion RMB have been invested in the bilateral or multilateral funds cited in this table. https://www.cdb-capital.com/GKJR/funden/list

b In 2018, the fund announced an investment level of 70% (7 billion USD), compared to 6 billion one year earlier.
http://www.silkroadfund.com.cn/enweb/23809/23812/36341/index.html
http://www.silkroadfund.com.cn/enweb/23809/23812/35485/index.html

c The fund, managed by Mubadala, has invested almost 1 billion USD in the two and a half years it has existed.
https://www.thenational.ae/business/economy/uae-china-investment-fund-commits-1bn-for-potential-investments-1.729591

d In September 2018, the CAD Fund announced that it had invested 4.6 billion USD since its creation—a little less than 400 million each year.
http://www.xinhuanet.com/english/2018-09/01/c_137437000.htm

e 1.4 billion invested in October 2018. http://global.chinadaily.com.cn/a/201810/03/WS5bb4da22a310eff303280a03.html

f The first phase of the fund seems to have been invested in 2017–18.
http://china-ceefund.com/Template/news.aspx?page=ContentPage&nodeid=12&contentid=165

g The first phase of investment ended in 2017. http://www.cdb.com.cn/English/xwzx_715/khdt/201701/t20170117_4035.html

h It appears that the fund is being restructured, which may distance it from its initial mandate of equity investment. https://www.inframation-group.com/top-china-outbound-investment-funds-management-overhaul

i 1.42 billion USD had been invested by the end of 2018. http://www.xinhuanet.com/english/2019-04/25/c_138007944.htm

Source: Authors, based on public data sources noted above. ©AFD

### • The Asian Infrastructure Investment Bank (AIIB): A Bridge between Development Aid and Investment Strategies

Relations between the BRI and the Asian Infrastructure Investment Bank (AIIB) remain complex. The bank was created on China's initiative in 2015, and had 100 member states by 2019. While the link between the BRI and the AIIB has not been formalized, connections exist regarding certain issues, particularly in terms of infrastructure finance. A number of important dates testify to this proximity. While the beginnings of the project date to 2009, the AIIB was announced by President Xi in 2013, the same year that the BRI was created. Its shareholders included numerous foreign states[26], placing a distance between the BRI and this new multilateral Asian bank. With the motto "lean, clean, and green," the AIIB welcomed teams from the European Bank for Reconstruction and Development (EBRD), the European Investment

26 China remains the majority stakeholder and holds a blocking minority.

Bank (EIB), the Asian Development Bank (ADB), and the World Bank (WB). Like the WB and the EBRD, for instance, the AIIB signed a partnership MoU with the BRI. Nonetheless, China retains its hold over governance of the AIIB. It is by far the majority shareholder, and has a de facto veto over a number of decisions. Its headquarters are in Beijing, and its Chinese president has a very large delegation.

The AIIB seems to serve as a bridge between the BRI and other development donors. Following a proposal by Denmark and the United Kingdom, the DAC decided in 2017 to include the AIIB as an eligible ODA institution[27] (Kitano, 2018). However, the AIIB has contributed to the ambiguity about the concept of ODA: there is nothing to prevent it from funding projects in countries not on the DAC list—as in Oman, for example, where it finances two projects. In addition, the AIIB also funds projects in OECD countries. Finally, the word "Asian" in its name does not imply that its work is focused on a particular region, since it can potentially become involved anywhere in the world.

Financial collaboration between BRI countries and China has gradually increased. Chinese banks are actively growing abroad, and have established branches in many countries. According to Dumond et al. (2018), a source at Moody's stated in September 2017 that bilateral currency swap lines (swap agreements between central banks) had been established between China and 36 states (including 24 BRI partners). In addition, China also encourages Panda Bonds (RMB bonds issued in China by foreign issuers), which are sometimes BRI stamped. These practices have a dual purpose, of promoting the BRI and internationalizing the RMB, while indirectly serving diplomatic ends.

***

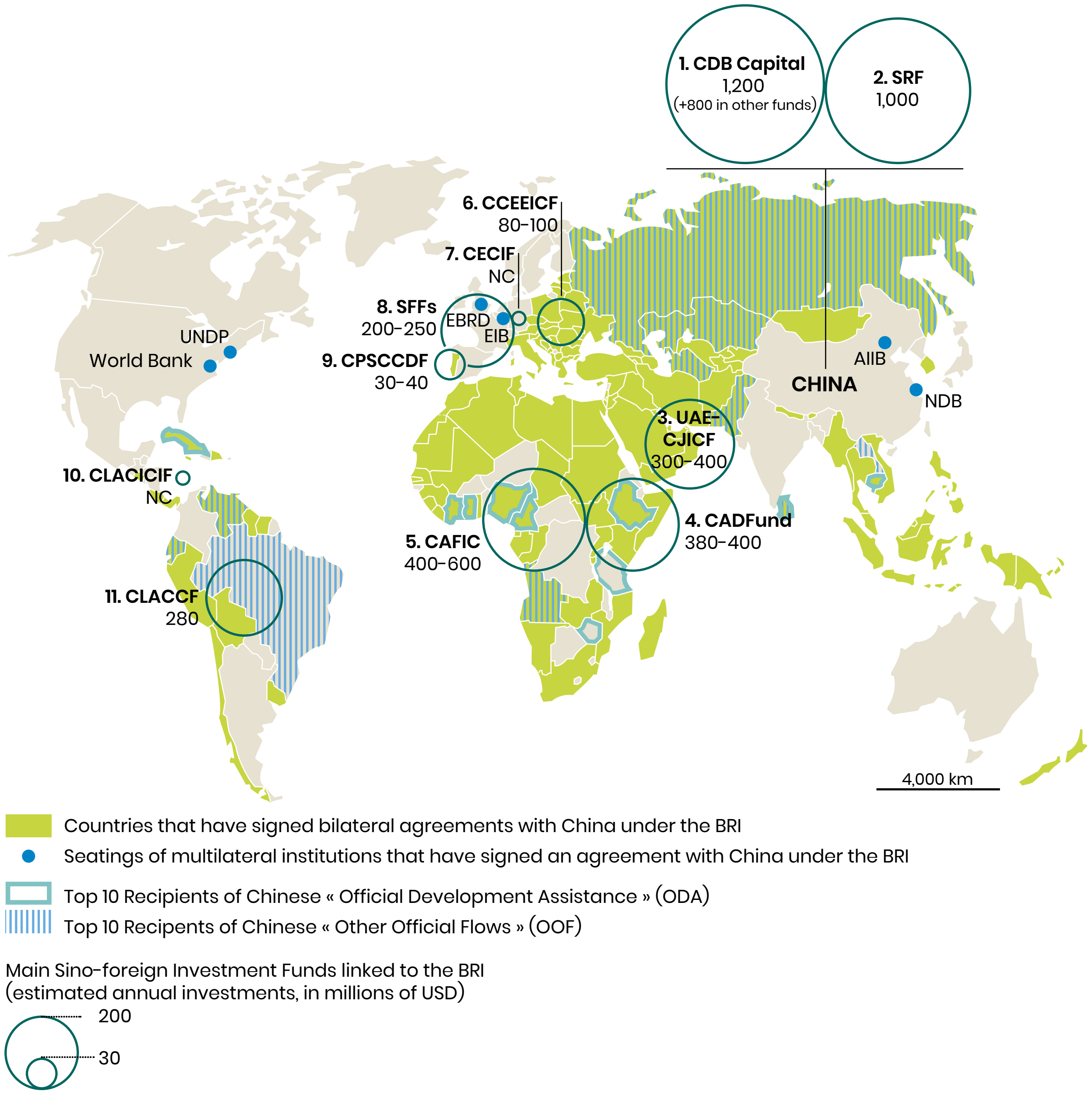
The BRI reinforces the idea of a Chinese approach to development, one that goes beyond the OECD's development accounting models. Furthermore, because the BRI is not just open to developing countries, the initiative broadens the scope of China's cooperation policy. The participation of Italy—the first G7 country to take part in the initiative in March 2019—demonstrates this desire to go beyond the North-South divide.

At the Second Belt and Road Forum (BRF), held in April 2019, Xi Jinping emphasized that "we must always take a development-oriented approach and see that the vision of sustainable development underpins project selection, implementation and management"[28]. At the same time, actors traditionally involved in development are raising questions about the future of the ODA's theoretical framework and, more broadly, are thinking about how to redirect financial flows towards the SDGs. These developments could provide an opportunity to define a new common international reference framework for development finance and beyond.

27 Organisation for Economic Co-operation and Development, Annex 2: List of ODA-eligible International Organisations, July 2017. https://www.oecd.org/dac/stats/annex2.htm.

28 See http://www.chinadaily.com.cn/a/201904/26/WS5d9c5a05a310cf3e3556f38b.html.

Map 2 - The Geography of Chinese Development Funding




1. **CDB Capital**
2. **Silk Road Fund (SRF)**
3. **United Arab Emirates-China Joint Investment Cooperation Fund (UAE-CJICF)**
4. **China-Africa Development Fund (CADFund)**
5. **China-Africa Fund for Industrial Cooperation (CAFIC)**
6. **China-Central and Eastern Europe Investment Cooperation Fund (CCEEICF)**
7. **China-European Union Co-Investment Fund (CECIF)**
8. **Sino-French Funds (SFFs)**
9. **China-Portuguese Speaking Countries Cooperation and Development Fund (CPSCCDF)**
10. **China-Latin America and Caribbean Industrial Cooperation Investment Fund (CLACICIF)**
11. **China-Latin America and Caribbean Cooperation Fund (CLACCF)**

Sources: Authors, based on public data collected online (see the reconstruction in Table 1), AidData database https://www.aiddata.org/china-official-finance, and official Chinese data from the BRI website https://eng.yidaiyilu.gov.cn/info/iList.jsp?site_id=CMSydylyw&cat_id=10076&cur_page=5 ©AFD

# 3.
# A New “High Quality” BRI: Financing Sustainable Development?

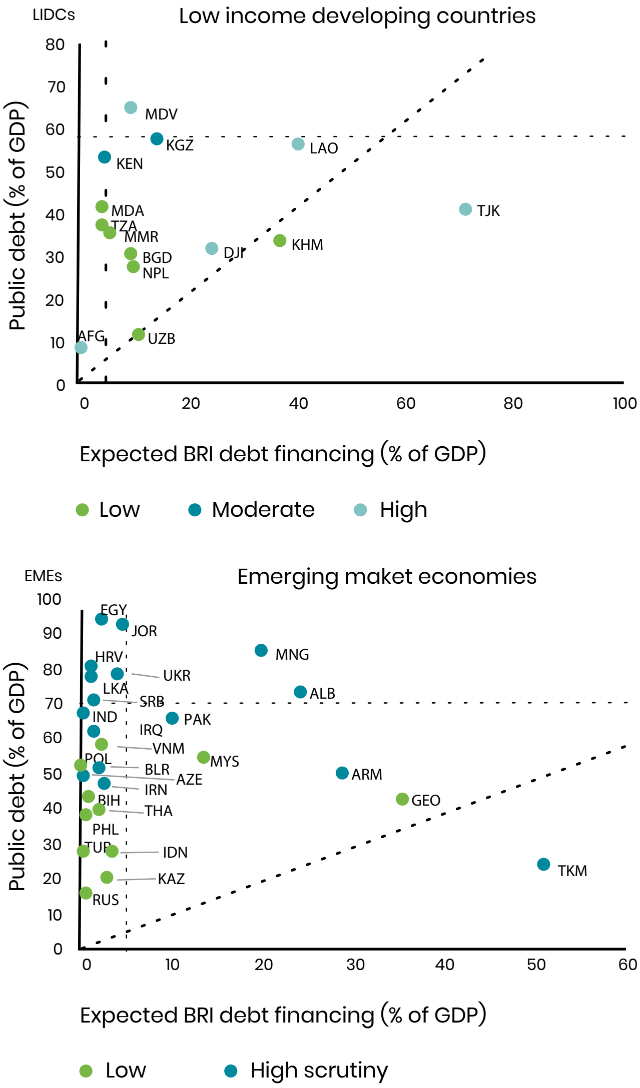
Since its formulation in 2013, Xi Jinping's BRI narrative has gained an international audience: almost every actor involved in international relations—governments, firms, intellectuals, civil society—has reacted to the proposal, whether positively or negatively. Xi Jinping and the Chinese authorities seem to have adopted an "adaptive" strategy, allowing or even instructing those involved to make practical adjustments as they implement the initiative, in order to respond to criticisms by participating states. Two aspects of the BRI have been particularly criticized: the economic viability of the projects, given the dangers that partner states run of becoming over-indebted; and the consideration of environmental requirements in projects given the challenges posed by climate change.

### 3.1 – Making the BRI Financially Sustainable

#### • The Increasing Danger of Over-Indebtedness

Since the launch of the BRI, a number of authors have pointed out—with varying degrees of alarm—that public debt growth is rising too rapidly in the developing countries involved, increasing the fragility of their macroeconomic balances. For example, the two graphs below, produced by the World Bank (2019), indicate those countries (out of a sample of 71[29]) that are likely to see a significant rise in their debt. Between twenty and twenty-five—a third of the sample—may see their risk of over-indebtedness increase, and move into a different risk category.

Figure 8 - Public debt and expected BRI debt financing (% of GDP)




Note: WEO, WIND database, LIC DSF DSAs, and MAC DSAs. Note: The authors assume that (i) only BRI investments identified from 2016 to 2018 as a under construction and planned would result in additional debt financing, and (ii) debt financing would amount to 40 percent of the cost of investment in the power, electricity, and mining sectors, and 80 percent of the cost of investment in transport and other sectors.

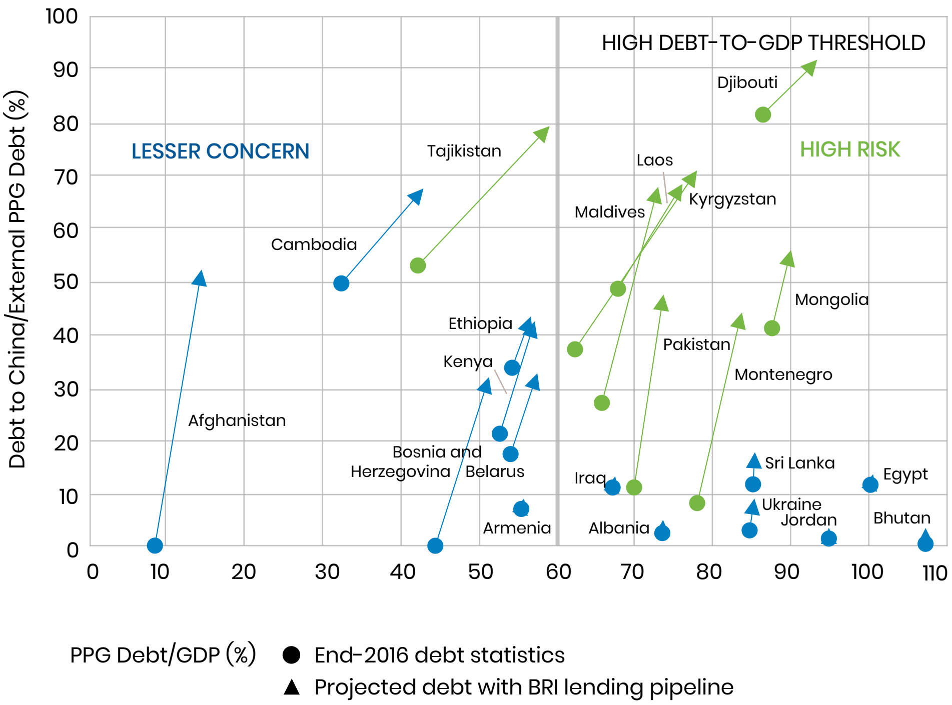
Source: World Bank (2019).

29 The World Bank's analysis focused on a geographical scope and retained a list of 71 countries along the BRI's "connectivity corridors".

The figure above (Figure 8) does not address financial sustainability issues in all 138 states that have signed an agreement or memorandum of understanding (MoU) with China, or countries that have not signed MoUs, but have received financing from Chinese banks or public bodies. Note that obtaining significant funding does not automatically lead to participation in the BRI. In Latin America, for example, three of the top four recipient countries for Chinese direct investment (Brazil, Argentina, and Mexico) have not formally signed agreements with China. As a consequence, it is better to retain a wide scope when measuring the impact of Chinese overseas financing.

Another indicator of the rise in global debt risk is the increased frequency, since 2013, with which debts linked to Chinese loans are renegotiated or rescheduled. A study by the Rhodium group (Kratz et al., 2019) identified thirty such instances since 2013. A second study by the Center for Global Development (Hurley et al., 2018), covering 68 countries, concluded that 23 of these could be at risk of over-indebtedness. In eight cases, this is likely due to projects that have already been started and loans that have already been made. However, this second study, which deals comprehensively with cases of renegotiation prior to 2012 (82 between 2000 and 2012), identifies only two cases of debt renegotiation after 2013, compared to thirty such cases prior to that time.

Figure 9 - Immediate marginal impact of BRI lending pipeline




Note: Lebanon is not shown on the figure because it has a much higher PPG Debt/GDP (143.6%) than the other countries surveyed, and has no identified BRI projects. Calculations by the authors are based on public data on BRI projects.

Source: Hurley et al. (2018).

Although its timeframe and geographical scope is limited, the study by the Center for Global Development (CGDev) reveals two striking facts. First, in many countries, Chinese financing is present in vast quantities. Secondly, in many countries, the danger of over-indebtedness was always present. The issue, it seems, is less one of identifying who is responsible for over-indebtedness—whether the first or the last lender, or the borrower themselves. Rather, it is to find solutions to deal with these situations effectively and fairly.

From this point of view, there have been substantial developments since 2018. On September 3, 2018, during a meeting with the business community that served as a prelude to the summit of the Forum on China-Africa Cooperation (FOCAC), the Chinese president warned against financing "vanity projects."[30] Supporting projects with low economic returns—i.e., less than the cost of Chinese financing—is the main risk for the financial sustainability of borrowing states. While such "white elephant" projects were not mentioned in his speech to African heads of state,[31] the Chinese president's remark seemed to mark an initial turning point.

### • The Debt Sustainability Framework: A Rigorous Tool

This new orientation was formalized on April 25, 2019—the day of the opening of the Second Belt and Road Forum (BRF) in Beijing—with the Chinese Ministry of Finance's publication of a new "Debt Sustainability Framework." A debt sustainability framework aims to prevent state over-indebtedness by identifying critical economic variables that can lead them to default. In terms of its theoretical architecture, China's framework strongly resembles the debt sustainability framework jointly developed for low-income countries by the International Monetary Fund and the World Bank.[32]
The theoretical framework presented by the Chinese government contains a number of innovations that usefully complement the framework established by the Bretton Woods Institutions. In particular:

- the discount rate used to calculate the net present value of the debt can potentially vary (whereas the IMF's debt sustainability framework has a standard rate of 5%);
- the "stress tests" used differ slightly from those in the standard debt sustainability framework, and determine how big a shock would have to be to cause a default, rather than calculating the impact of a standardized shock of 10%;
- and, perhaps most importantly, the Chinese government is willing to measure returns on debt-financed investments in order to determine whether a stabilization of debt relative to GDP can be expected.

The Chinese authorities have signaled that implementing this debt sustainability framework will initially be left to the discretion of the various financial institutions, and is not mandatory. The way in which Chinese financial actors apply this framework will determine its impact to a large degree. If they apply it too loosely, or without sufficient rigor, the ability of governments or other counterparts to repay their loans may be adversely affected.

Recommendation: If all Chinese financial bodies were required to rigorously apply the new debt sustainability framework published by the Chinese Ministry of Finance, it would greatly reduce borrowing states' risk of debt distress, as well as financial actors' risk of exposure. Setting up joint "debt alert" thresholds between national, regional, and bilateral development banks and members of the International Development Finance Club (IDFC) on the one hand, and the major multilateral banks on the other, would also represent an important step towards more sustainable, better coordinated financing.

As Buchheit et al. (2019) have pointed out, there have also been repeated holdout problems during past periods of over-indebtedness. When lenders are not coordinated, each of them may have an interest in the others agreeing to have their debt restructured: partial restructuring may improve the debtor's solvency, and the lender may subsequently find that they recoup more of their money. In this arrangement, there is no one creditor who takes the initiative and debts continue to accumulate at length, leading to a restructuring process that is even more costly and damaging for all the stakeholders, including borrowers. Pitchford and Wright (2010, 2017) have proposed theoretical

30 "Resources for our co-operation are not to be spent on any vanity projects but in places where they count the most." Remarks made to the business community of the Forum on China-Africa Cooperation, reported for instance by the BBC: https://www.bbc.com/news/world-africa-45394668.
31 See http://www.xinhuanet.com/english/2018-09/03/c_129946189.htm.
32 The framework is available at: http://m.mof.gov.cn/czxw/201904/P020190425513990982189.pdf.

models to explain coordination problems between creditors, applying these empirically to the restructuring of Argentine debt. House et al. (2017) have shown that the average duration of the pre-negotiation period for debt restructuring is eight years (compared to three for the negotiation itself), and costs a considerable amount (an average of 18 GDP points).

Recommendation: China is currently only an observer to the Paris Club. Joining it would send a powerful message that it is willing to coordinate with other creditor nations, and would also have the advantage of limiting the country's risk of exposure. Recent membership by developing countries (South Korea, Brazil) shows that the Club is willing to expand, and that it can fully include the new key players in sovereign finance.

### 3.2 – Aligning Finance with the SDGs and the Paris Agreement

In addition to the criterion of financial sustainability, observers are increasingly assessing BRI-related projects in terms of the SDGs. The BRI narrative told by the Chinese authorities increasingly draws a connection between the initiative's goals and the 2030 Agenda for Sustainable Development, adopted by all UN member states in 2015. The Second Belt and Road Forum (April 2019) focused in particular on "greening" the BRI. Recognition of environmental problems is a growing issue for the initiative, and is crucial for achieving the SDGs.

#### • Current Funding for High-Emission Projects

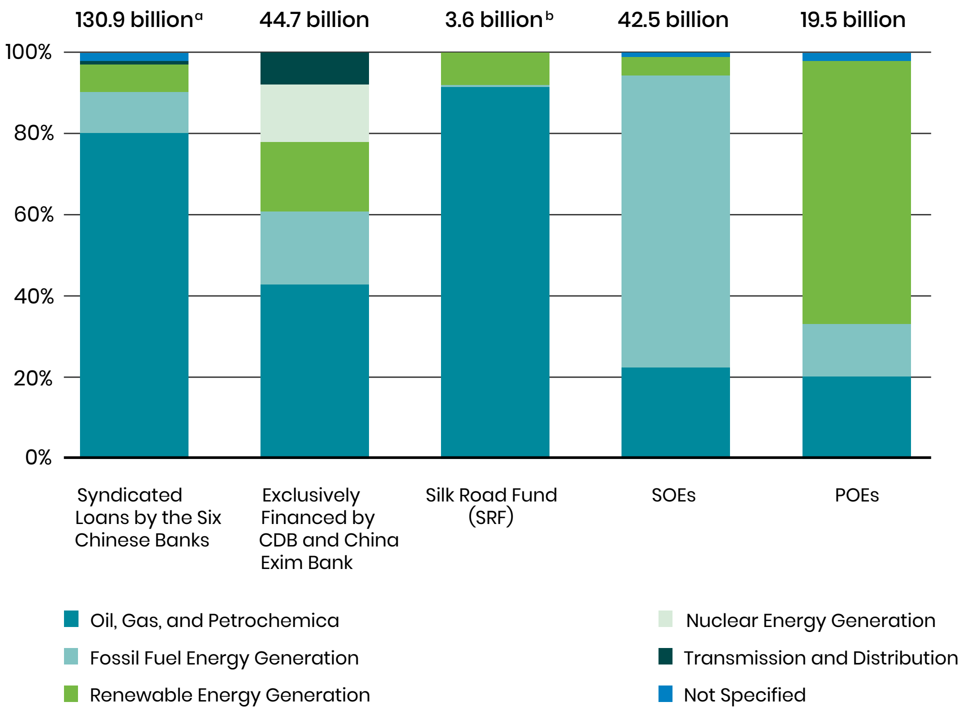
In the final communiqué of the Second Belt and Road Forum, the participants underlined "the importance of promoting green development and addressing the challenges of environmental protection and climate change."[33] At the same time, there are many signs that China is playing an increased role in sustainable development diplomacy: its strong commitment to fighting climate change since it ratified the Paris Agreement;[34] its involvement in implementing the 2030 Agenda for Sustainable Development; and the decision to hold the 15th Conference of the Parties (COP 15), on Biodiversity, in China, which will take place in 2020. However, the infrastructure currently financed under the BRI remains geared towards investments that emit high levels of greenhouse gases.

According to Zhou et al. (2018), most overseas energy and transport contracts won by China involve traditional, CO2-emitting projects: fossil fuels, roads and airport construction, aircraft and automobile manufacturing, and so on. The authors estimate that, between 2014 and 2017, 91% of the investments in which the six major Chinese banks (policy banks and commercial banks) jointly participated in the energy sector focused on fossil fuels. Similarly, 61% of CDB and Chexim loans focused on fossil fuels (Figure 10). During the same period, 93% of the Silk Road Fund's energy investments went towards fossil fuel projects. By contrast, nearly two thirds (64%) of cross-border energy sector investments by Chinese privately-owned enterprises (POEs) were directed towards renewable energy projects.

33 See http://www.chinadaily.com.cn/a/201904/28/WS5cc4fa20a3104842260b8cf7.html.

34 The Paris Agreement, which was drafted following negotiations during COP 21 in December 2015, was ratified by China on September 3, 2016.

Figure 10 - China's Energy-Sector Financial Flows to BRI Countries by Subsector, 2014-2017




Notes:
a Syndicated loans by the six Chinese banks are total loan amounts of projects in which the six Chinese banks participated. The actual contributions by individual banks were not available for many of the transactions. The six Chinese banks are China Development Bank, Export-Import Bank of China, Agricultural Bank of China, Bank of China, China Construction Bank, and Industrial and Commercial Bank of China.
b SRF includes four project investments that disclose investment amounts.

Source: Zhou et al. (2018).

While many international finance institutions have decided to stop funding new coal-fired power plants (notably the World Bank), China remains one of the largest funders of coal-fired power plants in the world. A study (Shearer et al., 2019) published by the Institute for Energy Economics and Financial Analysis (IEEFA) estimates that, for all coal-fired power plants outside China (producing 399 gigawatts in July 2018), the Chinese state and Chinese financial institutions initiated or proposed financing for more than a quarter of them (102 gigawatts, or 26%).

A joint report from Tsinghua University, Vivid Economics, and the ClimateWorks Foundation published in September 2019 shows that, if we extend growth trajectories, BRI countries (of which there are 126, according to the criteria of the study) accounted for only 28% of CO2 emissions in 2015, but could account for 66% in 2050 (Tsinghua University et al., 2019). If this growth continues, global $CO_2$ emissions would be double the level necessary to keep the temperature increase at two degrees by the end of the century. Bringing the BRI into alignment with the Paris Agreement remains a major challenge.

### • A Possible Reorientation Towards a Green BRI

In May 2017, the Chinese government published guidance on promoting a "green Belt and Road."[35] It encourages the funding of resource-efficient, environmentally friendly, low-carbon projects. The document aims to promote environmental protection across all of the BRI pillars, from policy coordination to financial integration. This guidance

35 "Guidance on Promoting Green Belt and Road," https://eng.yidaiyilu.gov.cn/zchj/qwfb/12479.htm.

includes a plan, published by the Chinese Ministry of Ecology and Environment, which describes measures including the publication of environmental performance information by companies; support for green financial systems and trade in environmental goods and services; and the promotion of green overseas investment, focused on environmental policies and legislation, personnel exchange, and environmental pilot projects.

Zhou et al. (2018) highlight the need to translate these concepts, which are defined at a very high level, into concrete actions within individual projects. As an echo of these recommendations, the Second Belt and Road provided an opportunity for a number of coalitions aimed at guiding the BRI towards "greener" investments (see Table 2).

Recommendation: The "Greening the BRI" initiatives launched at the Second Belt and Road Forum, which was held in Beijing on April 25–27, 2019, describe a number of ways sustainable development could be integrated into each of the pillars of the BRI. A commitment by China and its partner countries to these initiatives, through monitoring and implementation, is key in reducing the environmental impacts of BRI projects.

Table 2 - The main announcements for "greening" the BRI during the Second Belt and Road Forum

| | | |
|---|---|---|
| **BRI INTERNATIONAL GREEN DEVELOPMENT COALITION** | Coalition to integrate sustainable development within each of the BRI's priorities (policy coordination, facilities connectivity, unimpeded trade, financial integration, and people-to-people exchanges) | Involves 134 partners (25 states, UN agencies, academic institutions, and businesses) |
| **BRI GREEN COOLING INITIATIVE** | Initiative to improve the environmental performance of air conditioners | Launched by the NDRC*, UN agencies, and the Energy Foundation. |
| **BRI GREEN LIGHTING INITIATIVE** | Initiative to deploy "green" lighting systems | Launched by the NDRC* and UN agencies |
| **BRI ENVIRONMENTAL BIG DATA PLATFORM** | Initiative to centralize data on the environmental performance of BRI projects and to encourage the sharing of best practices | No further details available |
| **BRI GREEN INVESTMENT PRINCIPLES** | A set of voluntary principles to promote green investment in BRI countries | Announced in late 2018 by the City of London Corporation's Green Finance Initiative, in partnership with China's Green Finance Committee. Signed by 27 financial institutions, including CDB, China Exim Bank, the Agricultural Development Bank of China, and the Silk Road Fund |

** NDRC: National Development and Reform Commission*

Notes: Websites consulted:
https://www.beltandroad.news/2019/04/28/joint-communique-of-the-leaders/
https://wedocs.unep.org/bitstream/handle/20.500.11822/28901/Belt_and_Road.pdf?sequence=1&isAllowed=y
https://www.unenvironment.org/regions/asia-and-pacific/regional-initiatives/belt-and-road-initiative-international-green
http://www.efchina.org/News-en/EF-China-News-en/news-efchina-20190428-en
https://www.iddri.org/fr/publications-et-evenements/billet-de-blog/les-nouvelles-routes-de-la-soie-peuvent-elles-renforcer
http://gflp.org.cn/index/index/newsdetail/id/42.html

Source: Authors, based on public data sources noted above.

As the joint report by Tsinghua University, Vivid Economics, and the ClimateWorks Foundation (2019) highlights, it is urgent to redirect investment in BRI countries to avoid technological lock-in, which will affect these countries' long-term energy choices. Investment decisions made today will determine the level of carbon emissions to be released into the atmosphere in the coming decades. The stakes are particularly high because the means for transformation in BRI countries are significant: the report estimates that, in the next twenty years, 60% of global infrastructure investment will be made in countries participating in the BRI.

Zhou et al. (2018) argue that China could become a driver of low-carbon development in BRI countries. If CDB set a target of directing 32% of its investments towards projects with positive effects on climate change, as the World Bank does, it would, in a single quarter, spend 35 billion USD on the fight against climate change— equivalent to what multilateral development banks allocate to climate finance in a year. According to a report by the International Development Finance Club (2018), CDB allocated 155 billion USD for green finance in 2017.

Recommendation: Setting targets for an ambitious number of projects with positive effects on climate change offers a way of making BRI funding more sustainable. Such targets would apply to financial institutions, and primarily to Chinese policy banks and commercial banks. The use of concessional financing, in addition to non-concessional financing, could expand the range of projects financed through the BRI. While less profitable in terms of investment, the leverage effects of such finance in fighting climate change and protecting biodiversity offer a way of guaranteeing the sustainability of global sustainable development trajectories.

Simulations by the World Bank (2019) for countries on the BRI transport corridors show that the initiative could bring 32 million people above what it calls the lower middle-income International Poverty Line (a threshold of 3.20 USD per day). The World Bank argues that the success of the initiative will require greater transparency, attention to the problems specific to each country, and stronger multilateral cooperation around the initiative. A joint report by the UNDP and the China Center for International

Economic Exchanges (2017) also emphasized the BRI's transformative potential, while noting that its realization will depend especially on strategically aligning the initiative with countries' individual sustainable development priorities. Focusing the goals of the BRI on poverty reduction, environmental protection, and inclusive social development will be very important for encouraging development among participating countries.

More broadly, the final communiqué of the Second Belt and Road Forum places an emphasis on interaction between the economic, social, and environmental aspects of the SDGs: "We emphasize the importance of economic, social, fiscal, financial and environmental sustainability of projects, while striking a good balance among economic growth, social progress and environmental protection."[36] Debates about this issue, and about potential contradictions between the goals set by the 2030 Agenda, are far from over. They can encourage reflection on the definition of sustainable growth trajectories at the national level, from an economic, social, and environmental point of view.

Recommendation: Effectively aligning the BRI with the SDGs would require putting several measures in place: establishing stronger environmental and social standards for training and monitoring in BRI-funded projects; assessing more regularly and systematically the economic, social, and environmental impact of projects; aligning projects with states' long-term sustainable development trajectories, in line with their nationally determined contributions (NDCs) to the Paris Agreement; and increasing transparency for BRI funding. The co-financing of projects by actors involved in development finance (both bilateral and multilateral) would facilitate the convergence of social and environmental standards, and so ensure the greatest possible impact for such projects in terms of sustainable development. Finally, the interactions and possible contradictions between the Sustainable Development Goals (SDGs) could be considered, with the aim of encouraging convergence between those involved in development finance.

36 See http://www.chinadaily.com.cn/a/201904/28/WS5cc4fa20a3104842260b8cf7_2.html.

# Conclusion

Facing a demand for development finance on a global level, the World Bank has emphasized the need to go "from billions to trillions." It may seem difficult to imagine a substantial, rapid increase in global investment, or leveraging of public resources on private resources on a scale that would mobilize "thousands of billions" in finance. Nonetheless, redirecting huge sums invested on financial markets towards sustainable projects remains the most important issue facing us at present.

Finance institutions are considering new indicators that would allow them to ensure that the financial flows they generate are compatible with the SDGs. There is much debate and research currently being done on new measures and frameworks. Such work will be brought together by the UNDP and the OECD as they establish a "common framework" for finance compatible with the SDGs. The IDFC, of which CDB is a member, has also put the issue on its agenda. Furthermore, DAC member countries, some emerging donors (like Brazil), and some recipient countries have set up a database called the Total Official Support for Sustainable Development (TOSSD)[37] to complement the Creditor Reporting System, from which the ODA aggregate is extracted. If China adopts it, this new foundation—which is open to all forms of international public funding, without any restriction on their "sustainability"—could provide an initial tool for ensuring the transparency of BRI funding.

37 While both the broad outlines and the details of this new measure are still to be determined, Total Official Support for Sustainable Development (TOSSD) is likely to include all concessional and non-concessional flows from donors to developing countries.

China, which promotes a narrative of "common development," has become a major player in development finance over a few short years. Its further goal is apparently to become a key player in discussions about redirecting financial flows towards sustainable development. China can use its project of going "beyond aid" to pursue this ambition. The BRI may provide an opportunity for dialogue between the actors involved in development finance, and for convergence between the economic, social, and environmental norms and standards of project funding—paving the way towards a common framework for sustainable development finance.

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# List of Acronyms and Abbreviations

| | |
|---|---|
| **ABC** | Agricultural Bank of China |
| **ADB** | Asian Development Bank |
| **AFD** | Agence Française de Développement (French Development Agency) |
| **AFDB** | African Development Bank |
| **AIIB** | Asian Infrastructure Investment Bank |
| **BIS** | Bank for International Settlements |
| **BOC** | Bank of China |
| **BRF** | Belt and Road Forum |
| **BRI** | Belt and Road Initiative |
| **CCB** | China Construction Bank |
| **CDB** | China Development Bank |
| **CGDEV** | Center for Global Development |
| **CHEXIM** | China Exim Bank |
| **CIC** | China Investment Corporation |
| **CIDCA** | China International Development Cooperation Agency |
| **CIKD** | Center for International Knowledge on Development |
| **CITIC GROUP** | China International Trust and Investment Corporation Group |
| **COP** | Conference of the Parties |
| **DAC** | Development Assistance Committee |
| **DSAS** | Debt Sustainability Analyses |
| **DSF** | Debt Sustainability Framework |
| **EBRD** | European Bank for Reconstruction and Development |
| **EIB** | European Investment Bank |
| **EMES** | Emerging market economies |
| **EUR** | Euro [Eurozone currency] |
| **FDI** | Foreign direct investment |
| **FOCAC** | Forum on China-Africa Cooperation |
| **G7** | Group of Seven |
| **GDP** | Gross domestic product |
| **ICBC** | Industrial and Commercial Bank of China |
| **IDB** | Inter-American Development Bank |
| **IDDRI** | Institut du Développement Durable et des Relations Internationales [Institute for Sustainable Development and International Relations] |

| | |
|---|---|
| **IDFC** | International Development Finance Club |
| **IEEFA** | Institute for Energy Economics and Financial Analysis |
| **IMF** | International Monetary Fund |
| **LIC** | Low-income country |
| **LIDCS** | Low-income developing countries |
| **MAC** | Market-access country |
| **MOF** | Ministry of Finance of the People's Republic of China |
| **MOFA** | Ministry of Foreign Affairs of the People's Republic of China |
| **MOFCOM** | Ministry of Commerce of the People's Republic of China |
| **MOU** | Memorandum of Understanding |
| **NDB** | New Development Bank |
| **NDC** | Nationally determined contribution |
| **NDRC** | National Development and Reform Commission of the People's Republic of China |
| **NGO** | Non-governmental organization |
| **ODA** | Official Development Assistance |
| **OECD** | Organization for Economic Co-operation and Development |
| **OOF** | Other Official Flows |
| **PBOC** | People's Bank of China |
| **POE** | Privately-owned enterprise |
| **PPG** | Public and publicly guaranteed |
| **RMB** | Renminbi [Chinese currency] |
| **SAFE** | State Administration of Foreign Exchange of the People's Republic of China |
| **SCDRC** | State Council Development and Reform Commission |
| **SDGS** | Sustainable Development Goals |
| **SEZ** | Special economic zone |
| **SOE** | State-owned enterprise |
| **SRF** | Silk Road Fund |
| **TOSSD** | Total Official Support for Sustainable Development |
| **UN** | United Nations |
| **UNCTAD** | United Nations Conference on Trade and Development |
| **UNDP** | United Nations Development Programme |
| **USD** | Dollar [United States currency] |
| **VOF** | Vague Official Finance |
| **WB** | World Bank |
| **WEO** | World Economic Outlook |
| **WTO** | World Trade Organization |

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**What is AFD?**

The Agence Française de Développement (AFD) Group is a public entity which finances, supports and expedites transitions toward a more just and sustainable world. As a French overseas aid platform for sustainable development and investment, we and our partners create shared solutions, with and for the people of the global South.

Active in more than 4,000 projects in the French overseas departments and some 115 countries, our teams strive to promote health, education and gender equality, and are working to protect our common resources — peace, education, health, biodiversity and a stable climate.

It's our way of honoring the commitment France and the French people have made to fulfill the Sustainable Development Goals. Towards a world in common.

Legal deposit: 4th quarter 2019
ISSN : 2680-7416

**Design and production** Luciole
**Graphic design** MeMo, Juliegilles, D. Cazeils