The International Operations and Future Governance of China Development Bank

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I. China Development Bank's expansion of its international operations in 2009

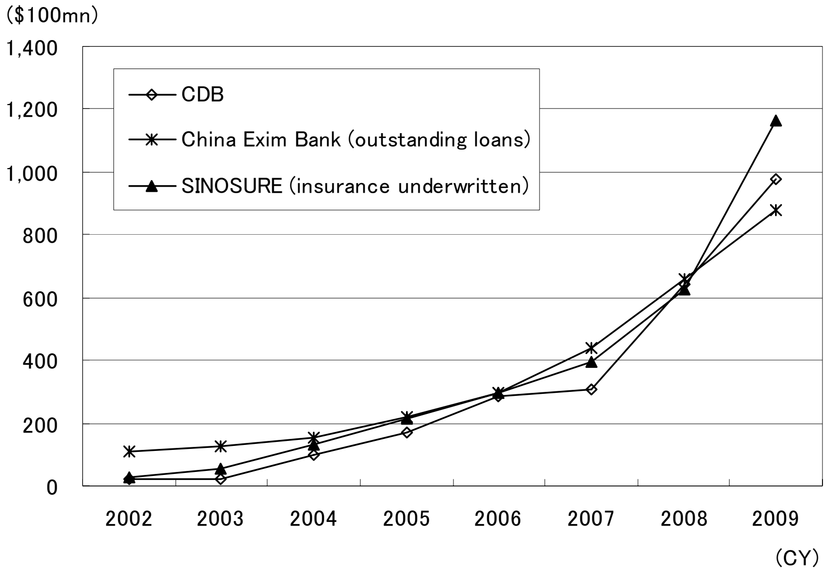
China Development Bank (CDB), which is one of China's policy banks, has been steadily expanding its international operations[1] in recent years. However, in 2009 this rate of expansion increased more than in any other year thus far. As of end-2009, CDB had $97.9 billion in foreign currency loans, which are mainly used to facilitate Chinese companies' international operations and exports of plant and equipment, outstanding, more than either China Export-Import Bank, a government agency that specializes in lending to overseas borrowers, or China Export & Credit Insurance Corporation (SINOSURE), a government agency that insures outward trade and investment (Figure 1).

One of the distinctive features of CDB's international operations is its loans for developing overseas resources on condition that these resources are exported to China. In 2009 it made loans for oil totaling $47 billion to Russia ($25 billion), Brazil ($10 billion), Venezuela ($8 billion) and Turkmenistan ($4 billion).

Another is its efforts to step up its operations in Africa. In November 2009, CDB opened a representative office in Cairo. In the same year it also made available a $1 billion line of credit to foster African SMEs. Furthermore, the China-Africa Development Fund (CADFund) established by CDB opened a representative office in Johannesburg in March 2009 and a similar office in Addis Ababa in March 2010. As of end-May 2010 the Fund, which has a target size of $5 billion to be reached in phases, with first-phase funding of $1 billion provided by CDB, had financed a total of 30 projects in the amount of $800 million since its inception in June 2007 and acted as a catalyst for more than $3 billion of investment in Africa by Chinese companies.

[1] See Sekine, Eiichi, "Chuumoku o Atsumeru Chuugoku Kaigin no Kokusaigyoumu" (China Development Bank's International Operations in the Limelight), Kikan Chuugoku Shihon Shijou Kenkyuu, 2007 Autumn edition, Tokyo Club Foundation for Global Studies (in Japanese).

Figure 1: Scale of operations of China's government-backed financial institutions



Notes: 1. For CDB we have included only outstanding foreign currency loans attributable to its international operations.
2. Data for China Exim Bank are total RMB loans outstanding at the end of each fiscal year and converted to US dollars at the rate obtaining at the end of each calendar year.

Source: Nomura Institute of Capital Markets Research, based on data from CDB, China Exim Bank, and SINOSURE

Yet another of CDB's distinctive features is its efforts to step up its operations in Asia. In July 2009, CDB upgraded its Hong Kong representative office, opened in 1999, to a branch, which was awarded a full banking license. CDB first issued RMB bonds in Hong Kong in 2007 and has been instrumental in developing an offshore RMB market there.

As of end-2009, CDB's international operations covered 78 countries and territories, and are generally regarded as a joint effort by both the public and private sector. However, the exact relationship between the Chinese government, CDB and Chinese companies in this effort is not clear. Neither is how the Chinese government organizes its part of the effort. In the next section we therefore consider the reasons for CDB's establishment and its relationship with the Chinese government. We also examine the Chinese government's internal process for deciding matters related to CDB's international operations. We then consider some of the quantitative and qualitative aspects of CDB's operations and the challenges it faces. We also briefly examine its privatization in 2008. Finally, we consider some of CDB's newer international operations and the direction it is likely to take as well as its relationship with Japan.

II. CDB's establishment, management and its relationship with the Chinese government

1. CDB's establishment and role

1) Establishment process and three principles of management

In the early 1990s China reformed its fiscal and financial systems, with the banks becoming either policy banks or commercial banks. This was because allowing the four major state-run banks that were established in the 1980s to continue to operate as policy banks was one of the factors that led to rampant inflation from 1992 onwards. As a result of these reforms, the existing state-run banks became state-owned commercial banks while public sector lending became the preserve of three newly created policy banks: CDB, China Exim Bank, and Agricultural Development Bank of China.

With regard to CDB, on 17 March 1994 China's State Council issued a directive on establishing the bank together with draft proposals for its establishment and management as well as articles of incorporation. These directives provided that the bank would be a policy bank under the direct control of the State Council with the same status as a government department and that its governor and deputy governors would be appointed by the State Council.

2) CDB's initial role

When it was established, CDB's role as a stable long-term source of funds was to raise and attract capital for key national construction projects. CDB's role was seen as not just covering any investment shortfalls in such projects but also as monitoring their scale and funding as well as ensuring that investors took such investments seriously, that a proper risk management system was in place, that investment efficiency was improved, and that the economy grew steadily and at a high rate but on a sound basis.

3) CDB's relationship with the Chinese government at the time of its establishment

According to the aforementioned directives of 1994, the relationship between CDB and the Chinese government is as follows.

First, China's central bank, the People's Bank of China, is responsible for supervising CDB's financial operations. CDB has to submit its financial statements to the Ministry of Finance, which is responsible for monitoring and supervising it.

Second, the State Council is responsible for deciding how much CDB can lend each year and how it can raise the necessary capital.

Third, eligible projects have to be approved by the State Planning Commission (now the State Development and Reform Commission), the State Economic and Trade Commission[2] (as it was then), and the Ministry of Finance. Interest rates and interest rate subsidies have to be approved by the People's Bank of China, the State Planning Commission, the State Economic and Trade Commission, and the Ministry of Finance. The Ministry of Finance is responsible for the budget for interest rate subsidies, which it monitors and disburses.

Fourth, annual (domestic) issuance of bank debentures by CDB has to be approved by the People's Bank of China and the State Planning Commission.

The aforementioned directives envisage that CDB will have the same status as other government departments in terms of organizational and personnel structure and will be run according to the three principles of (1) financial independence, (2) managerial autonomy, and (3) symmetry of powers and responsibilities. In practice, however, CDB is subject to the control and supervision of a number of government departments, including the State Planning Commission, which is responsible for planning key national construction projects, the State Economic and Trade Commission, which is responsible for industrial policy, the People's Bank of China, which is responsible for monetary policy, and the Ministry of Finance, which is responsible for managing the public purse, including interest rate subsidies.

2. Status of CDB's international operations

1) Views at the time of CDB's establishment

When CDB was established, its articles of incorporation envisaged that its international operations would consist of (1) acting as the point of contact for soft loans from international financial organizations and overseas governments (to be relent by CDB to domestic companies), (2) issuing bonds overseas with the approval of the Chinese government, and (3) borrowing at commercial rates from overseas as part of the Chinese government's plans to encourage inward investment. In other words, foreign capital was to be used purely to assist key national construction projects in China itself. Also, all CDB's foreign capital was raised by its International Finance Department.

2) Reasons why CDB began to assist Chinese companies' overseas expansion

CDB began to list the companies whose overseas expansion it assisted in its annual report for 2004. The report emphasizes (1) that many Chinese companies are eager to develop overseas markets and the opportunities they present, (2) that these projects

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[2] China's State Economic and Trade Commission was demerged in 2003, with its responsibility for industrial policy and SME policy going to the State Development and Reform Commission, responsibility for trade going to the Ministry of Commerce, and responsibility for controlling and supervising state-owned enterprises being transferred to the newly established State-owned Assets Supervision and Administration Commission (of the State Council) (SASAC).

tend to be risky and capital-intensive and therefore unattractive to commercial banks, and (3) that CDB has a role to play with its massive capital resources and credit risk management know-how, and states that CDB's senior management made the strategic decision to help Chinese companies expand overseas.

3. Establishing a scheme for lending especially to Chinese companies expanding overseas

1) CDB establishes a scheme to help Chinese companies expand overseas

A year later, in 2005, the Chinese government revealed how it expected CDB to help Chinese companies expand overseas. On 25 September of that year, the State Development and Reform Commission and CDB issued a joint *Notice of National Development and Reform Commission and China Development Bank about the Relevant Issues on Providing More Financing Support to Key Overseas-invested Projects*. What this meant was that, in line with the policy of the 16th National Congress adopted in November 2002 to help Chinese companies expand overseas, a scheme was established to lend funds to Chinese companies to enable them to invest overseas and CDB was required to allocate a certain proportion of its equity investments and loans to this purpose[3].

2) Eligible projects

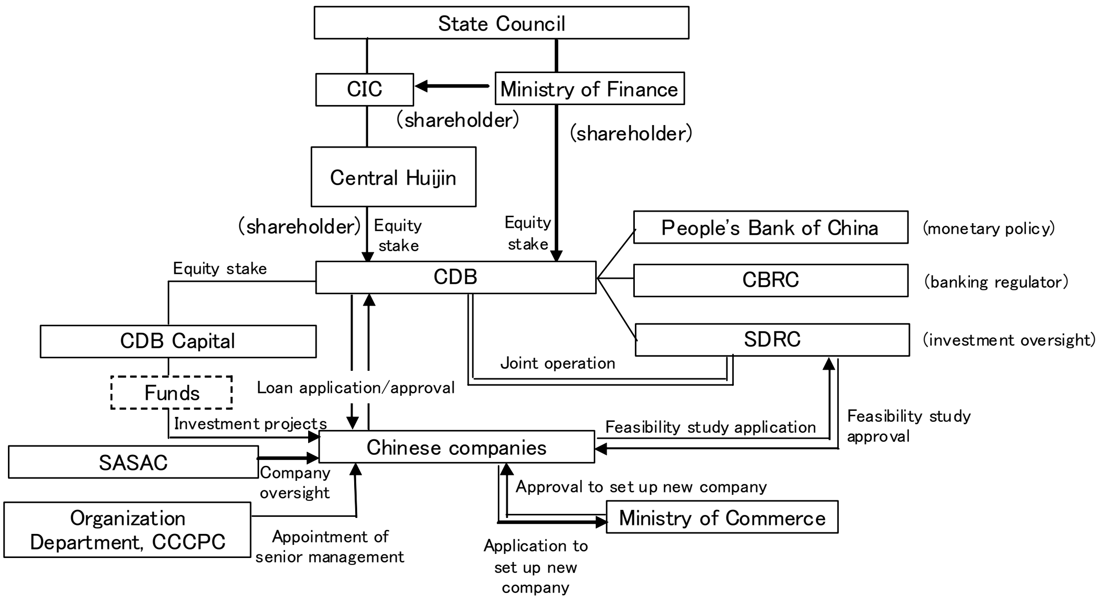
Four types of project were deemed eligible for these loans: (1) projects to develop natural resources in relatively short supply in China; (2) overseas production and basic infrastructure projects aimed at fostering the export of Chinese technology, goods and equipment or Chinese manpower; (3) overseas R&D center projects using advanced overseas technology, management skills and skilled manpower; and (4) mergers with and acquisitions of overseas companies in order to make Chinese companies more competitive and better able to capture a share of overseas markets.

3) Process from loan application to decision on terms of loan

The loan application process is as follows (Figure 2). First, CDB and the State Development and Reform Commission draw up a joint annual plan to help Chinese companies raise capital for key overseas projects. Second, CDB uses this plan to consider loan applications from Chinese companies and issues a certificate for those it approves. Third, companies submit an application to the State Development and Reform Commission or their provincial Development and Reform Commission, to which they append the loan approval certificate from CDB. Fourth, the State Development and Reform Commission or the provincial Development and Reform

[3] Prior to these directives, on 27 October 2004, the State Development and Reform Commission (SDRC) and China Exim Bank issued a directive on supporting Chinese companies seeking to expand overseas.

Figure 2: Organizations involved in lending to Chinese companies expanding overseas



Notes: 1. CDB was privatized on 11 December 2008.
2. "Chinese companies" refers to enterprises controlled by the central government.
3. "Organization Department, CCCPC" is the Organization Department of the Communist Party of China Central Committee.

Source: Nomura Institute of Capital Markets Research, from various sources

Commission considers the merits of each project and sends an approval form or registration form to CDB, which makes a final decision on the terms of the loan.

The State Development and Reform Commission therefore has the authority to monitor overseas projects carried out by Chinese companies and to control the financing of key projects both at home and abroad through its involvement in CDB's loan application process. However, CDB screens applications at the initial stage before the State Development and Reform Commission becomes involved. In this connection it is perhaps worth mentioning that the Commission lists the projects it has approved on its website[4].

4) CDB's relationship with other government departments

In its international operations CDB has connections with other government departments besides the State Development and Reform Commission.

First, all of CDB's operations, including its international operations, are controlled and supervised by the People's Bank of China, which is responsible for monetary policy, and the China Banking Regulatory Commission (CBRC), which is responsible for regulating the banks. Also, since CDB was privatized in December 2008 (see

[4] See http://wzs.ndrc.gov.cn/jwtz/default.htm.

below), the Ministry of Finance and Central Huijin Investment (a subsidiary of China's sovereign wealth fund, CIC) have a say in CDB's key decisions by virtue of being shareholders.

Second, Chinese companies seeking to expand overseas need to obtain the approval of the Ministry of Commerce to establish an overseas subsidiary. Where the company concerned is a state-owned enterprise, it is the State-owned Assets Supervision and Administration Commission (of the State Council) (SASAC) that is responsible for monitoring its operations and the Organization Department of the Communist Party of China Central Committee that is responsible for appointing senior managers.

Third, on 9 December 2005 the Ministry of Finance and the Ministry of Commerce issued *Measures for the Administration of Special Funds for Foreign Economic and Technical Cooperation* and set up a special fund to provide subsidies and interest rate subsidies for Chinese companies engaged in economic and technical cooperation (including overseas investment). This was not targeted solely at CDB's lending operations. The areas eligible are reviewed each year.

5) CDB's other operations

The above notice not only permits CDB to lend to Chinese companies expanding overseas but also to engage in other, related activities.

The first (in addition to taking equity stakes in key overseas projects) is to offer large long-term loans. The second is to cooperate with international financial institutions and global companies to originate international syndicated loans and overseas loans as a way of raising capital jointly and providing financial assistance. The third is to provide sector analyses and risk analyses of basic infrastructure and basic/key industries. The fourth is to provide letters of credit for projects and financial services related to overseas payments. The fifth is to offer derivatives to enable companies to manage exchange and interest rate risks.

In other words, these measures gave CDB a seal of approval not only to lend money from the Chinese government to Chinese companies expanding overseas but also to engage in related activities.

III. Quantitative and qualitative aspects of CDB's operations

1. CDB's lending operations

1) Lending operations versus investment banking operations

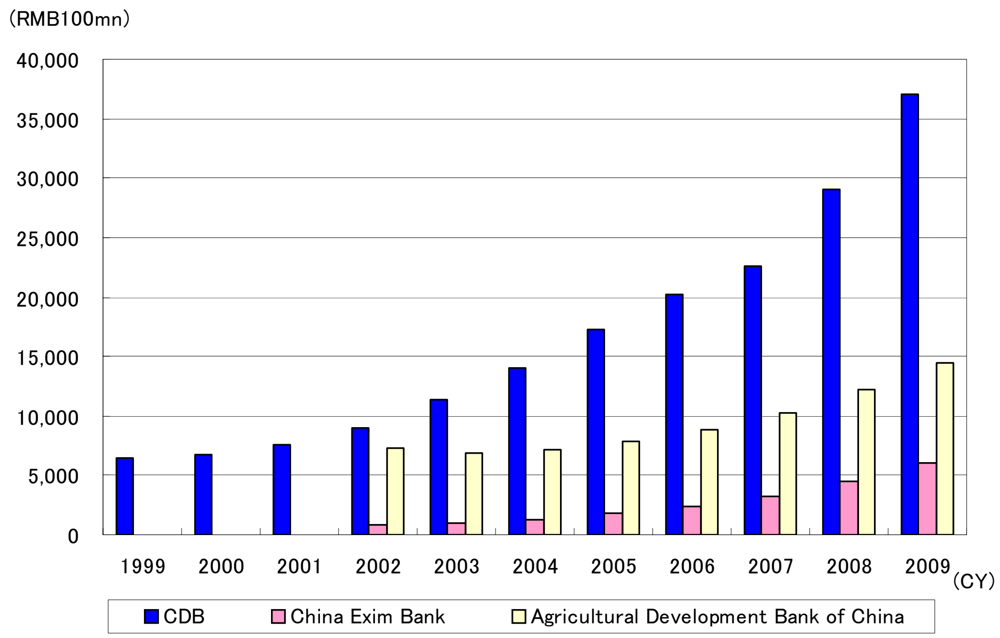
As a result of the above changes, CDB's operations now consist of its (1) (domestic and overseas) lending operations and its (2) investment banking operations (bond underwriting, mergers and acquisitions, fund participation, equity investment and asset securitization). Its lending operations consist of (1) soft loans (long-term preferential loans backed by the borrower's registered capital) and (2) hard loans (funded by bonds issued either in China or overseas).

2) Size of CDB's loans

According to CDB's annual reports, which are available on the Internet for as far back as 1999, its outstanding loans have increased from RMB648.4 billion at end-1999 to RMB3,708.4 billion at end-2009, an increase of 470% (Figure 3). The amount and rate of increase of its loans are clearly much greater than those of China's two other policy banks.

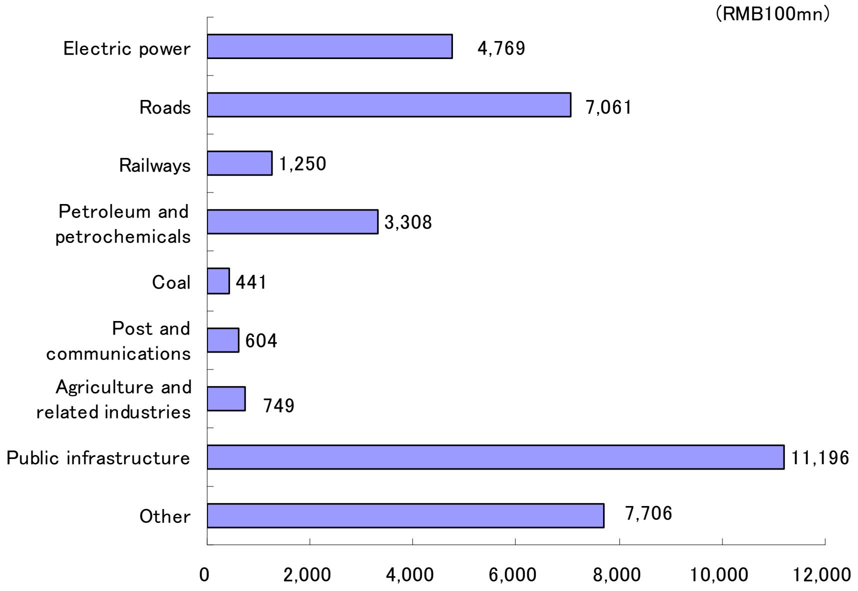
CDB can finance state policy-based projects that fall into the following three categories: basic infrastructure, basic industries, and pillar (i.e., core) industries. As of end-2009, its outstanding loans (in descending order of amount) were to the following categories: basic public infrastructure (RMB1,119.6 billion, 30.2% of total), roads

Figure 3: CDB's loans outstanding



Source: Nomura Institute of Capital Markets Research, from annual reports of banks concerned

Figure 4: CDB's loan categories (as of end-2009)



Source: Nomura Institute of Capital Markets Research, from CDB, *Annual Report for 2009*

(RMB706.1 billion, 19.0%), and electric power RMB476.9 billion, 12.9%} (Figure 4). Although it is not clear what the category "Other" refers to, it may include overseas loans (e.g., for developing natural resources). Since 2004, CDB has listed its main international operations in its annual reports (Figure 5).

3) Increase in number of young staff and in number of those with higher degrees

As we have seen, CDB's domestic and overseas loan portfolios have both been expanding rapidly. In order to keep pace, CDB has been increasing the number of its staff. This has increased from 3,056 (as of end-2003) to 6,221 (as of end-2008). The increase in the number of young staff has been particularly marked. As of end-2008 3,694 (or 59%) of its staff were aged 35 or less (Figure 6).

The number of staff with higher degrees has also been increasing. The increase in the number with MAs has been particularly marked, with 2,584 (or 42% of CDB's staff) now having that qualification (Figure 7).

We think both these factors have probably contributed to the expansion of CDB's operations. CDB's staff totaled 6,711 as of end-2009, and it has been reported that CDB plans to review its staff training program for 2010–2015 and invest more resources in this area[5].

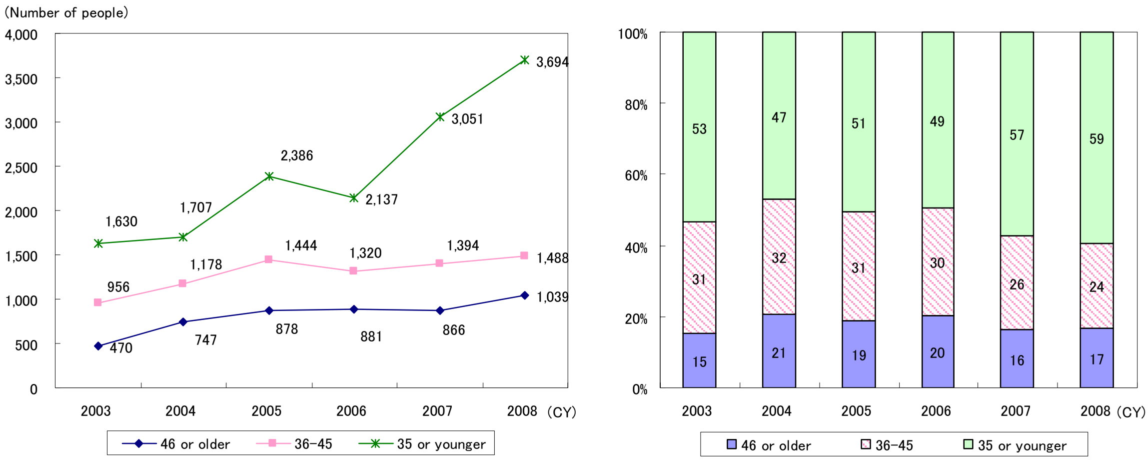
5 China Securities Journal, 2 June 2010.

Figure 5: CDB projects (2004–09)

Year	Country/region	Project	Details
2004	–		CDB supported Chinese companies seeking to expand overseas, approving loans worth $780 million in 2004. These companies included China National Petroleum Company (CNPC), China Petroleum & Chemical Corporation (Sinopec), China Minmetals Corporation (CMC), CITIC Group, China Metallurgical Group Corporation (MCC), and China Construction Group.
2005	–		CDB actively supported investment in and the development of overseas oil and mineral resources by Chinese companies, including CNPC, Sinopec, Sinochem, MCC, and CMC. It also proposed that five banks from the five member nations of the Shanghai Cooperation Organization (SCO) (namely, CDB itself, the Kazakhstan Development Bank, Russia's Vnesheconombank, the Tajikistan State Savings Bank, and the National Bank for Foreign Economic Activity of Uzbekistan) cooperate in order to promote economic and investment cooperation among members. As a result of its efforts, the five banks came together to form an association. On 26 October 2005, at the fourth session of the SCO, held in Moscow, the five banks signed a memorandum of understanding to form the SCO Interbank Association, chaired by CDB Chairman Chen Yuan.
2006	Kazakhstan	CITIC's purchase of Nations Energy's stake in Kazakh oil and natural gas resources	CITIC's purchase of Nations Energy's stake in Kazakh oil and natural gas resources was a major development in China's outward investment policy. CDB provided invaluable support for the acquisition by authorizing a loan of $1.8–2.57 billion, $1.71 billion of which had already been disbursed by December 2006. The success of the project helped to widen the area of cooperation between China and Kazakhstan as well as helping to diversify the range of energy projects in which Chinese companies could cooperate with their Kazakh counterparts. It also strengthened economic ties between the two countries.
	Chile	Joint development of copper resources by CMC and Chile's CODELCO	CDB supports joint development of copper resources by CMC and Chile's CODELCO. CMC is due to take delivery of 836,250 tonnes of copper from Chile over the next 15 years. The cooperation between the two nations in the development of Chile's copper resources is an event of historical importance. Investment in the project will total $2.0 billion. CDB acted as arranger, lead manager, agent and financing agent, draw up the financing plan and lent the project $330 million.
	France	Sinochem's acquisition of foreign technological know-how	Sinochem, one of China's leading chemical companies, acquired a 100% stake in the French company Adisseo in what was the first successful example of M&A in the Chinese chemical industry. CDB lent Sinochem €340 million of the €400 million acquisition costs and guaranteed that the project would be completed by 17 January 2006. It enabled Sinochem to achieve its aim of acquiring production technology and raising the standard of China's chemical industry so that it would be able to increase its share of the international market. The project's success helped China's methionine industry to develop rapidly and should eventually help to solve China's "three rural issues."
2007	Australia	CDB helps CITIC Pacific to acquire magnetite mining rights in Western Australia	This was the first overseas project in which a Chinese company acquired all the mining rights. This enabled China to strengthen its position in the iron ore market and also served as an example to other Chinese companies of how they could acquire a foreign company. CDB authorized more than $3.0 billion in loans for the first and second phases of the project, in which CITIC Pacific will build the infrastructure for a 2.0 billion tonne magnetite iron ore mine, from which it will then extract the ore.
	United Kingdom	Stake in Barclays Bank	CDB's £1.45 billion stake in Barclays Bank was an important step in CDB's privatization. Barclays allowed CDB to benefit from its management expertise, technology, and training. For its part, CDB helped Barclays to diversify and to implement its strategy of becoming a leading global bank. The two banks cooperated in the fields of asset management, commodity trading, client sharing, and African operations.
2008	Brazil	Second phase of Candiota coal-fired power plant in Brazil	The Candiota coal-fired power plant was the first project resulting from the framework for cooperation between the two countries. The plant will generate 350MW of electricity, and CDB has committed itself to lend $430 million.
	Central Asia	Central Asia natural gas pipeline	The Central Asia natural gas pipeline is an important means of transporting Chinese imports of natural gas. 1,800km long, the pipeline will have a capacity of 30 billion cubic meters of natural gas a year. Loans for the project will total $11.0 billion, $8.1 billion of which will be from CDB.
2009	–		Main projects: expansion of telecom network involving Chinese companies Huawei and ZTE and Indian company Reliance Industries ($750 million loan); Sino-Russian oil cooperation ($25 billion loan); Sino-Brazilian oil cooperation ($10 billion loan); coal-fired power plant in Indonesia ($1.05 billion loan); renminbi loan to Kyrgyzstan (RMB13 million); cotton cultivation and processing in Malawi ($34.72 million investment via CADFund).

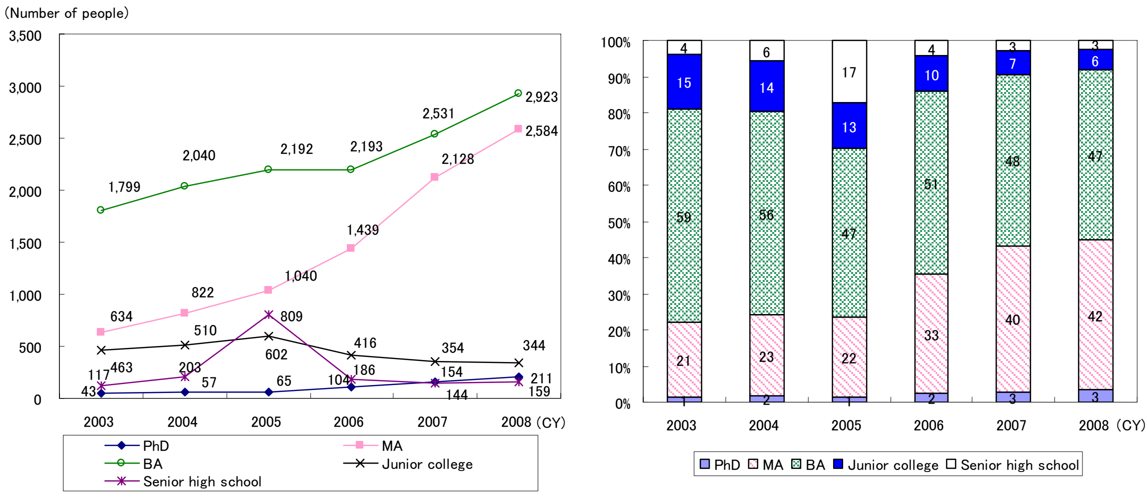
Source: Nomura Institute of Capital Markets Research, from CDB annual reports

Figure 6: Age structure of workforce (number, breakdown)



Source: Nomura Institute of Capital Markets Research, from *China Financial Yearbook* for each year concerned

Figure 7: Educational qualifications of workforce (number, breakdown)



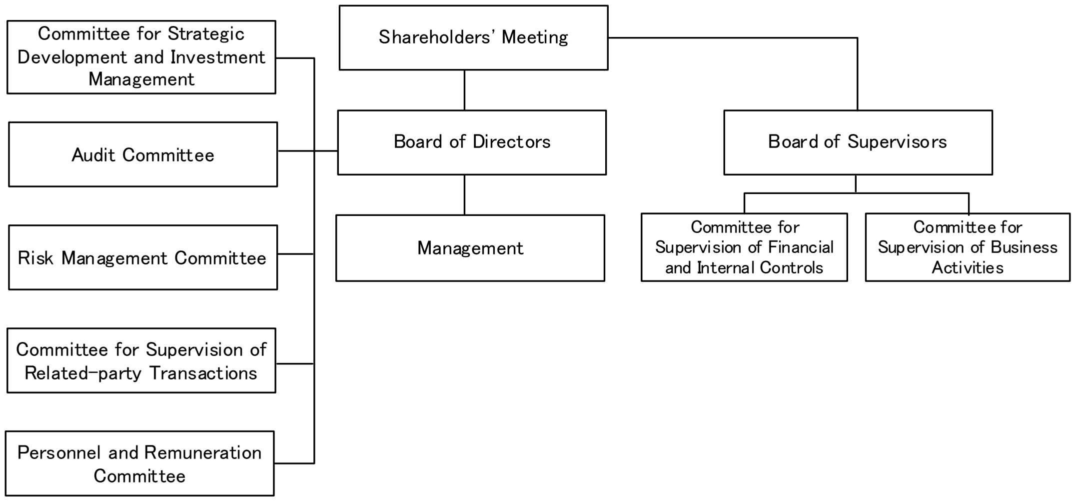
Source: Nomura Institute of Capital Markets Research, from *China Financial Yearbook* for each year concerned

2. Qualitative aspects of CDB's operations

1) Capital increases

In order to maintain financial stability while expanding its operations, CDB has had to increase its capitalization over the past four years while taking on new staff. In particular, its equity capital increased from RMB50 billion as of end-2006 to RMB196.1bn as of end-2007 as a result of a RMB146.1bn injection of public funds. When CDB was privatized on 11 December 2008, it underwent a capital restructuring that increased its equity capital to RMB300.0 billion as a result of a RMB103.9bn injection.

Figure 8: Governance structure of CDB since privatization



Source: Nomura Institute of Capital Markets Research, from CDB data

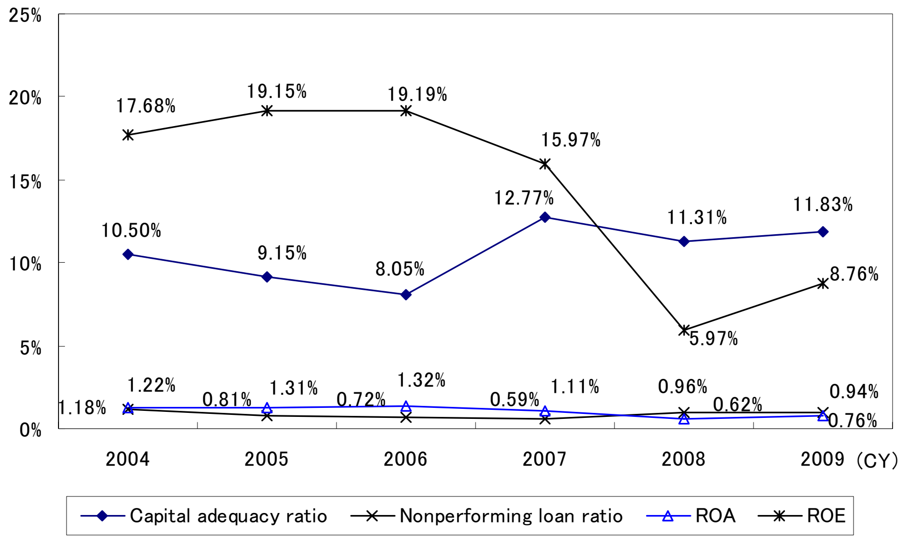
The capital injection at the end of 2007 was actually funded by China's foreign exchange reserves. In December 2003 CDB was given a $20.0 billion capital injection by Central Huijin Investment Ltd ("Central Huijin"), which had been set up as a vehicle for injecting public money into Chinese financial institutions.

CDB's privatization was carried out in line with the decision by the Financial Work Conference convened by the CPC Central Committee and State Council in 2007 to reform the country's three policy banks. The decision to reform the three policy banks is reported to have been the result of (1) a gradual shift of emphasis in the banks' operations from the implementation of government policy to the pursuit of commercial objectives, (2) the need to implement government policy in new areas, and (3) problems concerning the role of the policy banks, governance, risk control, incentive mechanisms, and regulation (People's Bank of China, *China Financial Stability Report 2009*). As a result of being privatized, CDB went from being a financial institution under the direct control of the State Council to being a joint-stock company under the control of its shareholders: namely, the Ministry of Finance (with a 51.3% share) and Central Huijin (with a 48.7% share). At the same time, CDB was reorganized along lines more in keeping with a joint-stock company, with a Board of Supervisors being set up under the General Shareholders' Meeting to supervise the bank's operations, while various independent committees were set up to discuss matters of strategic importance (Figure 8).

2) Need to improve return on assets and return on equity

As a result of recapitalizing, CDB's capital adequacy ratio, which had declined to 8.05% in 2006, rose to 12.77% in 2007 only to decline again in 2008 (by 1.46

Figure 9: CDB: key business indicators



Note: Data are on a consolidated basis.
Source: Nomura Institute of Capital Markets Research, from CDB data

percentage points) to 11.31% (Figure 9). We think this was because CDB expanded its loan portfolio following the Chinese government's announcement in November 2008 of a RMB4 trillion economic stimulus package. In 2009 CDB's capital adequacy ratio improved slightly to 11.83%.

In 2009 CDB's net profit recovered sharply to RMB31.9 billion from RMB20.8 billion in 2008. CDB's return on assets declined to 1.11% in 2007 from 1.32% in 2006 and to 0.62% in 2008. CDB's return on equity declined to 15.97% in 2007 from 19.19% in 2006 and to 5.97% in 2008. Since then, its return on assets has improved to 0.76% in 2009 and its return on equity to 8.76%.

CDB's nonperforming loan ratio rose to 0.96% in 2008 from 0.59% in 2007 but improved slightly to 0.94% in 2009.

3) CDB also needs to make its international operations more profitable

In notes to its 2008 annual report CDB provides a geographical breakdown of its segment data (Figure 10). According to this information, (1) most of CDB's assets are in China's eastern provinces; (2) CDB's operating expenses on its international operations exceed its interest income, leaving it with a pre-tax loss; and, as a result, (3) CDB's (profitable) domestic operations have been subsidizing its (unprofitable) international operations.

As we have seen from the low level of CDB's nonperforming loan ratio, the standard of CDB's due diligence and credit control is also highly rated in China, and it

Figure 10: Extracts from CDB's consolidated income statement (for 2008)

(RMBmn)

	Eastern China	Central China	Western China	Outside mainland China
Interest income	175,000	42,874	45,282	52
Interest expense	−120,861	−29,857	−28,588	–
Net interest income	54,139	13,017	16,694	52
Fee and commission income	2,384	861	1,060	–
Fee and commission expense	−109	−11	−21	–
Net fee and commission income	2,275	850	1,039	–
Other income and expenditure, net	−3,846	19	26	381
Operating expenses	−28,739	−5,241	−15,065	−12,771
Nonoperating income and expenditure, net	5,132	−6	−18	–
Gross profit	28,961	8,639	2,676	−12,338

Source: Nomura Institute of Capital Markets Research, from CDB data

will be interesting to see how CDB goes about improving the quality of its operations, especially the profitability of its international operations.

IV. Outlook for CDB's international operations

1. CDB's involvement in fund management and its establishment of a fund management company

When CDB was established in 1994, there was much interest in what would happen to China's existing national specialized investment corporations. In other words, the question was what would happen to the six investment companies that had been responsible for investing in China's key national projects and key companies. Eventually, the six companies were restructured and amalgamated as the State Development & Investment Corporation (SDIC), which is now under the control of CDB.

A few years later, on 31 August 2009, CDB Capital was established with a registered capital of RMB35.0 billion. Its role was to engage in private equity investment, direct investment, investment consulting, and advising clients on mergers and acquisitions (Figure 2). We think this development was probably the result of CDB's privatization in 2008 and the need to separate its commercial and investment banking functions in order to avoid a conflict of interests. As a result of this hiving off of CDB's fund management activities, CDB's nonfinancial assets were transferred to CDB Capital. The overseas assets consisted of the China-Africa Development Fund (CADFund), the China-Belgium Direct Investment Fund, the China-ASEAN Investment Cooperation Fund, and the China-Italy Mandarin Fund, while the domestic assets consisted of the Bohai Industrial Fund as well as stakes in companies such as Aluminum Corporation of China, Jinchuan Group, Jincheng Anthracite Mining Group, and Tianjin Eco-City.

Furthermore, on 9 March 2010, CDB Caofeidian Investment Company was established to develop Caofeidian in the Binhai New Area now under development on the outskirts of Tianjin. The new company has a registered capital of RMB1 billion, RMB300 million of which is CDB Capital's share.

The use of such funds to assist Chinese companies both at home and abroad, but especially to expand overseas, is a key element of CDB's international operations. Indeed, CDB's overseas funds could even be regarded as its overseas arms.

In addition, CDB has set up a number of financial leasing companies, which can also be regarded as overseas arms. To be more precise, CDB restructured Shenzhen Financial Leasing Company (founded in December 1984) in May 2008 and set up CDB Leasing in cooperation with HNA Group and Xi'an Aircraft Industry Group in order to provide financial support for leasing aircraft from overseas.

2. Relationship between CDB's privatization and its international operations

In this section we discuss the relationship between CDB's international operations (see above) and its privatization. CDB's privatization was approved by the State Council in the form of two proposals, neither of which has been published. Also, a general meeting was held on 1 December 2008 in the run-up to privatization to discuss CDB's new articles of incorporation. However, this has not been published, either.

As the aforementioned policies of the People's Bank of China on the reform of the country's policy banks give only a general indication of why CDB was privatized, we have to draw our own conclusions from related information and how CDB's international operations have actually developed. Although the original aim was not to become either just a commercial bank or an investment bank, we imagine that, by engaging in commercial banking, CDB intended to (1) provide a service suited to the different levels of development of the coastal regions and the interior, (2) provide new services such as financial assistance to Chinese companies looking to expand overseas, and (3) determine its own future as a joint stock company, albeit subject to government control and supervision. CDB's then president, Chen Yuan, described CDB's new role as "development financing" and presumably steered CDB's commercial and investment banking operations in that direction. CDB's decision, in 2007, to take a stake in Barclays Bank can also be seen as an attempt to acquire commercial and investment banking know-how [6]. This expansion of CDB's international operations can be seen as part of CDB's efforts to promote development financing, and, ever since it set up a new loan facility in 2005 in coordination with the State Development and Reform Commission, CDB's reputation with Chinese companies has grown along with the size of its international loans.

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[6] CDB has acquired Aviation Securities (established in December 2003) with the approval of the China Banking Regulatory Commission (CBRC) and China Securities Regulatory Commission (CSRC), and intends to relaunch the company as a wholly owned subsidiary, CDB Securities.

At the same time, however, and as a result of the global financial crisis that deepened in 2008, perceptions of CDB's role within China itself have been reported as having changed, with signs that some have begun to call for CDB to return to its traditional role as a policy bank[7]. Moreover, some Chinese researchers have argued that not all the functions of a policy bank can be performed by a purely commercial bank, and some of these views can be seen on CDB's website[8]. CDB's chairman, Chen Yuan, has described CDB's business strategy as a trinity consisting of "two basics and one pillar" (i.e., basic infrastructure, basic industries, and pillar industries), basic finance, and international cooperation. In particular, basic finance consists of lending the funds to build the infrastructure needed in rural villages, small business loans, mortgages for medium- and low-income families, and student loans. The fact that CDB's operations expanded to include public welfare as a result of the global financial crisis has obscured the reasons for and objectives of the privatization that CDB had worked towards since before the financial crisis began.

When Chen Yuan became president of CDB in 1998, he helped to bolster the Chinese economy, which had been hit by the Asian currency crisis in 1997, in coordination with the government's stimulus measures and has again endeavored to make the most of CDB's resources during the recent global financial crisis. He is also a deputy governor of the People's Bank of China and has a wide network of economic and financial specialists both at home and abroad. As he is also the son of the late Chen Yun, one of the founders of the PRC, a former first vice premier and an authority on economic policy, he is also an influential figure in Chinese politics. While we cannot rule out the possibility that the moves to transform CDB into a commercial and investment bank as part of its privatization may yet be modified, a complete reversal of the process is unlikely. Likewise, we cannot see any change in CDB's efforts to expand its international operations. However, it does face some new challenges, including what to make of its traditional role as a policy bank and how to achieve both quantity and quality under its new governance.

3. CDB's international operations and Japan

That leaves the question of the future relationship between CDB's international operations and Japan.

First, we need to understand the direction in which CDB's international operations are taking CDB. CDB therefore needs to publish enough information about its operations, including its international operations, to enable outsiders to do this. In Japan, when a new public-sector financial institution is established, the law governing it and a detailed description of the activities it may engage in and the rules it must follow must be enacted and published. In the case of CDB, new articles of incorporation were enacted after it was privatized (just as they were before). Publishing such information would enable a comparison with similar Japanese

[7] “CDB turns away from the path of reform,” November 1 2009, Financial Times

[8] Guo Tianyong, Director of the Research Center of the Chinese Banking Industry, Central University of Finance and Economics, Beijing

institutions. Moreover, this would enable those familiar with the experience of such institutions in Japan to pass on this knowledge to their Chinese counterparts, depending on their needs.

Second, if Chinese companies expand overseas in concert with Japanese companies, CDB might finance the Chinese companies while Japanese financial institutions might finance the Japanese companies. In a world where companies are active globally, Japanese companies expanding into China may want to sell the products they produce there to a third country, while Chinese and Japanese companies may want to market their products jointly in such a country. It might be worthwhile for Japanese financial institutions to consider developing an investment banking capability that would cater for such needs in concert with CDB.

Third, CDB itself needs assistance with raising capital. In the past, CDB has issued global bonds. However, in future, it might want to raise fresh capital on international financial markets to finance the expansion of its international operations. Furthermore, if foreign investors were given access to China's interbank bond market, they would be able to buy directly any bonds issued by CDB. Also, CDB might have to raise capital not by issuing bonds but by issuing new stock in order to boost its capital adequacy ratio. In such a situation, we can imagine that it might want to offer stock to strategic overseas investors with the potential for synergies in its international operations. Whether or not CDB needed to issue bonds or stock, Japanese financial institutions, which know the situation in neighboring China better than institutions in other countries, are—indeed, have to remain—reliable partners. As we have seen, CDB has scope for cooperating with such institutions in its drive to improve staff training.

CDB's international operations and governance are also important because of the potential for such tie-ups with Japanese institutions. We will continue to monitor developments at CDB carefully.