CDB: Born Bankrupt, Born Shaper

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The Future of National Development Banks
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CDB and China’s transition economy

**China, A transition economy In 1990s**

- **suffered**
- **vicious circle**
- **CDB Born bankrupt**

  - With bad debts, with internal and external crisis
  - With a disordered internal governance
  - Without independence

**China, A transition economy In 2000s**

- **facilitate**
- **virtuous cycle**
- **Benefit from CDB**
  - Born shaper

  - With large healthy assets
  - With a improved governance
  - With independence

Sources: the author.
1 Born in a transition economy
2 Born bankrupt in 1990s
3 An amazing turnaround
4 CDB as a shaper to itself
5 CDB as a shaper to financial system
6 Concluding remarks

Appendix: as a counter-cyclical lender
1 Born in a transition economy
1 Born in a transition economy

Transition in fiscal system

**Figure 1** Central government revenue was crowded out by local government in late 1980s and the beginning of 1990s.

Transition in fiscal system

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1 Born in a transition economy

Transition in fiscal system

Figure 1 Central government revenue was crowded out by local government in late 1980s and the beginning of 1990s.

2.2 Local government: with poor capacity to finance infrastructures

New budget law in 1994

Figure 1: Central government revenue was crowded out by local government in late 1980s and the beginning of 1990s.

Figure 3: The mismatch between Local Government Revenue and Expenditure.
(In percent of general government revenue and expenditure, %)
Transition in banking system
——policy bank business was separated from commercial banks in 1994

Six investment corporations:
Agriculture, forest, energy, transportation, raw material, mechanical and electronic textile

Policy banks: ICBC, ABC, BOC, CCB
Commercial banks: ADBC
CDB
1 Born in a transition economy

Transition in fiscal system

More centralized?

I. A shaper to itself: reforms

II. A shaper to fiscal system: rebalancing

III. A shaper to financial market: benchmarks

Transition in banking system
1 Born in a transition economy

Transition in fiscal system

More centralized?

4. A shaper to itself reforms

5.1 A shaper to fiscal system rebalancing

5.2 A shaper to financial market benchmarks

Transition in banking system
2 Born bankrupt in 1990s

2.1 CDB: a born bankrupt bank

- **Policy banks**
  - ICBC
  - ABC
  - BOC
  - CCB

- **Commercial banks**

- **Six investment corporations:**
  - Agriculture, forest, energy, transportation, raw material, mechanical and electronic textile

1. **CDB**
   - 1 total NPL ratio, 42.65%, in 1997
   - 2 NPL ratio in coal industry, 75%, 1998

- "sits on a mountain of bad debt"
2. Born bankrupt in 1990s

2.2 Local government: with poor capacity to finance infrastructures

Two problems:
1. Project based financing
2. In 1995, the Law of Guarantee was published.

New budget law in 1994

Figure 1: Central government revenue was crowded out by local government in late 1980s and the beginning of 1990s.

New budget law in 1994

Figure 3: The mismatch between Local Government Revenue and Expenditure
(In percent of general government revenue and expenditure, %)
### 2 Born bankrupt in 1990s

#### 2.3 Central government: excessive intervention to CDB

<table>
<thead>
<tr>
<th>CDB’s balance sheet</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>assets</strong></td>
</tr>
<tr>
<td>* CDB’s projects were defined by the SPC (State Planning Commission), which is the predecessor to NDRC</td>
</tr>
<tr>
<td><strong>liabilities</strong></td>
</tr>
<tr>
<td>* Bonds PBoC forced CDB’s bonds onto other commercial banks via administrative command</td>
</tr>
</tbody>
</table>
2 Born bankrupt in 1990s

The whole picture

Central Government
- Assign the key projects

CDB
- A machine of allocating funds with NPL ratio of 42.7%

Local Government
- Poor infrastructures
- Crisis in 1998 Export ↓

Commercial Banks
- High NPLs ratio: 20%

SOEs and Large Es:
- overcapacity

SMEs:
- vulnerable

Budget law: ban on deficit

Crisis in 1998 Capital outflow

Commercial banks retreated from villages and towns

Sources: the author.
3 An amazing turnaround
3 An amazing turnaround

NPL ratio: %

Sources: CDB.
3 An amazing turnaround

Total assets: $ bn

Sources: CDB.
3 An amazing turnaround

Sources: CDB.
3 An amazing turnaround

Sources: CDB.
3 An amazing turnaround

Figure  CDB’s Financing to People’s Livelihood by 2015 (RMB bn)
4 CDB as a shaper to itself
4. A shaper to itself reforms

5.1 A shaper to fiscal system rebalancing

5.2 A shaper to financial market key player in benchmarks

More centralized?

Transition in fiscal system

Transition in banking system
4.1 A shaper to itself
The disposal of NPLs.
Build up the national network of branches.
Reform the loans approval process.

4.2 Be independent of central government intervention
in selecting projects through
(1) A strong president
(2) Build an approval system
(3) planning runs first

2.1 CDB: a born bankrupt bank
- Policy banks: ICBC, ABC, BOC, CCB
- Commercial banks
- Six investment corporations: Agriculture, forest, energy, transportation, raw material, mechanical and electronic industry
- 1 total NPL ratio, 42.65%, in 1997
- 2 NPL ratio in coal industry, 75%, 1998
- 1 with bad debt
- 2 without any subsidiaries

4.2 Be independent of central government intervention
in bond market

CDB’s balance sheet

**ads**

* CDB’s projects were defined by the SPC (State Planning Commission), which is the predecessor to NDRC

*bad debt
Stock and flow

* Bonds
PBoC forced CDB’s bonds onto other commercial banks via administrative command
5 CDB as a shaper to financial system
5.1 CDB as a shaper to fiscal system: LGFV
5 CDB as a shaper to financial system

- **CDB**
  - Only for assigned key projects by central government

- **Local Government**
  - No deficit
  - Limited investment

- **Infrastructure projects**

Sources: the author.
5 CDB as a shaper to financial system

CDB

Local Government

LGFV

A legal person with corporate governance structure

Sources: the author.
5 CDB as a shaper to financial system

- Local Government
  - Authorization & promise
  - Serves for the local government
- CDB
  - Repayment package
  - Financing package
- LGFV
  - A legal person with corporate governance structure
- Infrastructure projects 1
  - with high revenues
- Infrastructure projects 2
  - with revenues
- Infrastructure projects 3
  - without revenues

Sources: the author.
5 CDB as a shaper to financial system

- 2008 Sub-prime crisis

** Sources: the author.
5 CDB as a shaper to financial system

Local Government

- Authorization & promise
- Serves for the local government

Infrastructure projects 1
- with high revenues

Infrastructure projects 2
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Infrastructure projects 3
- without revenues

CDB

- Financing package
- Repayment package

LGFV

- A legal person with corporate governance structure

Sources: the author.

Commercial banks

Shadow banks

Information for supervision

concept of credit
5 CDB as a shaper to financial system

Local Government

Central Government

Infrastructure projects 1
with high revenues

Infrastructure projects 2
with revenues

Infrastructure projects 3
without revenues

CDB

LGFV

A legal person
with corporate
governance structure

Repayment package

Financing package

Concept of credit

Information for supervision

Sources: the author.

Commercial banks

Shadow banks

Central Government
5 CDB as a shaper to financial system

Central Government

New budget law in 2015

Infrastructure projects 1
- with high revenues

Infrastructure projects 2
- with revenues

Infrastructure projects 3
- without revenues

LGFV

A legal person with corporate governance structure

Serves for the local government

Authorization & promise

Revenues

Investment

Concept of credit

Information for supervision

CDB

Commercial banks

Shadow banks

PPP mode

PPP mode

Central Government

Sources: the author.
5.2 CDB as a key player in monetary policy framework
Monetary policy 1: contributions to construct primary interest rate in two ways

- Banks (70%)
- Mutual Funds (16%)
- Others (14%)

Monetary policy 2: as a tool of liquidity release as a guide to long term interest rate

- PBoC

Loans

Capital injection

Outstanding Loan Balance in 2015 Breakdown by Industry

- Transportation, 26%
- Public infrastructure, 13%
- Urban renewal, 15%
- Energy, 15%
- Others, 22%

Fiscal policy 1: Loans for infrastructure investment

Fiscal policy 2: Capital injections to a company/project

PSL: Pledged Supplementary Lending

Sources: Goldman Sachs global research (2016), CDB’s annual report, and the author.
5 A shaper in monetary policy framework

Monetary policy 1: contributions to construct primary interest rate in two ways

- Banks (70%)
- Mutual Funds (16%)
- Others (14%)

Monetary policy 2: as a tool of liquidity release as a guide to long term interest rate

- PBoC
- PSL

Loans

Capital injection

Outstanding Loan Balance in 2015
Breakdown by Industry

- Transportation, 26%
- Energy, 15%
- Urban renewal, 15%
- Others, 22%
- Strategic emerging industries, 9%
- Public infrastructure, 13%

Fiscal policy 1:
Loans for infrastructure investment

Fiscal policy 2:
Capital injections to a company/project

CDB development fund

¥ 580bn in 2015

Sources: Goldman Sachs global research (2016), CDB’s annual report, and the author.
• Monetary policy 1:
  contributions to construct primary interest rate in two ways

- An application of Shibor: floating rate bonds based on Shibor, 74% of them are issued by CDB.
- CDB's interest rate itself as a kind of benchmark in the market

Sources: CDB's annual report, 2015.
Monetary policy 2.1

**PSL as a tool of liquidity release**

Sources: WIND and author's calculation.
• Monetary policy 2.2

PSL interest rate as a guide to long term interest rate

Sources: WIND.
6 Concluding remarks

CDB’s revival resulted from

• the reconstruction of internal governance
• its function to develop a sound credit system and to shape the financial market
• the correction to the excessive 1994-fiscal-reform. Especially the rebalancing the fiscal capacity between the local and central government
• CDB works as a connection between the central government and local government

? The independence of a national development bank?
Thank you!

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Born bankrupt, born shaper
a story applies not only to CDB.

More shapers lead to more changes.
Figure CDB’s counter-cyclical: net increase of loans

Why LGBs are forbidden since 1994?

Local government
- Issue too much bond
- With zero interest rate
- Force the staff to buy

Public financial system
in chaos

Producer
- Neglect promises and commitment
- Producer prefer to export
Local government
- Local protectionism of the gov.

Private financial system
in disorder
Private financial system in disorder

Public financial system in chaos

CDB

Alibaba

Local government
- Issue too much bond
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