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RESEARCH ARTICLE

Development Finance: A Financing Platform Between the Government and the Market

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Abstract
The core of development finance with Chinese characteristics is that it is a “bridge” between the government and the market. Development finance addresses the phenomenon of “market failure” due to information asymmetry and alleviates the problem of “government failure” due to the inefficiency of fiscal subsidies and other funds through government intervention in financial markets. Meanwhile, it integrates the advantages of commercial finance and traditional policy-based finance. It is a form of finance that was introduced in response to institutional backwardness and market failure and in order to safeguard national financial security and enhance economic competitiveness. The core mechanism of development finance is to build a government credit system through cooperation between policy banks and governments and by relying on government-organized credit enhancement, and to form a financing mechanism consisting of “project selection by the government, development finance incubation, and the realization of market outlets”. Development finance combines project construction with market building, makes initiative on the part of the government the focus of the market-oriented operation of development banks, utilizes national credit, and regulates market failure and promotes balanced economic development through reasonable arrangements for credit volumes and structures.

Keywords: Development finance • Commercial finance • Policy-based financing • Government-organized credit enhancement • Bank-government cooperation

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How to restore economic growth has become a common challenge facing countries around the world, and financial measures that can bring capital investment have become an important means for countries to develop their economies. However, in reality, the uneven distribution of financial investment often results in unbalanced development in the world, that is, the "financial paradox of poor countries". As a purely market-based means, commercial finance, limited by the requirements of risk control, often only provides financial support for projects that can provide valuable collateral, while the underdeveloped areas of developing countries and the least developed countries that are in urgent need of financial assistance often find it difficult to obtain financial support. Classical economics holds that the market is an effective means of resource allocation in a perfectly competitive environment, but facts have proved that market information asymmetry will cause "market failure". In order to alleviate this problem, often the government will intervene, but rent-seeking and other issues seriously hinder the efficiency of resource allocation by the government, resulting in the problem of "government failure". Development finance addresses the phenomenon of "market failure" due to information asymmetry and alleviates the problem of "government failure" due to the inefficiency of fiscal subsidies and other funds through government intervention in financial markets. Meanwhile, it integrates the advantages of commercial finance and traditional policy-based finance. It is a form of finance that was introduced in response to institutional backwardness and market failure and in order to safeguard national financial security and enhance economic competitiveness.

International experience shows that for developing countries, development finance plays a special role in making up for institutional backwardness and market failure. In developing countries, governments are faced with very prominent structural guidance tasks and distinct structural optimization objectives, and in particular they need substantial, sustained and strong credit support for the basic and strategic industries of their national economies through development finance. Development finance, as a part of policy-based finance, originated in Europe in the 19th century. In the 1960s and 1970s, development financial institutions were successively established around the world. Compared with commercial financial institutions that have strict requirements for risk, collateral, etc., development financial institutions are mainly funded by governments and provide loans to industries that are poor or cannot be served by commercial banks. In the 1990s, development finance developed into an important mode of financial investment (Leping et al., 2012). The Development Bank of Japan, the KfW and Korea Development Bank are three representative development financial institutions established after World War II. They focused their investment on infrastructure construction such as electricity, coal and steel, and were committed to post-war economic recovery. At that time, however, it was difficult for development financial institutions to maintain the effective operation of government funds through market-based means, and their operation mechanism was questioned by the public.

As the largest developing country in the world, China has been committed to providing financial solutions for developing countries and the least developed countries through development financial services. China Development Bank (CDB) has achieved significant results in the adjustment of the country's industrial structure and the transformation of its economic development mode through development financial services. After the tax-sharing reform in 1994, CDB was officially established. In 1998, it pioneered a means of financing based on state- and government-organized credit enhancement in the light of China's national conditions, giving full play to the different competitive advantages of the government and the market in the process of investment and financing. It is bank-government cooperation. On the one hand, it solves financing problems through market-based means and alleviates the pressure with traditional policy-based financing which is provided mainly by the government through fiscal subsidies; on the one hand, it reduces investment risk and guarantees investment efficiency and return on investment through state- and government-organized credit enhancement. Chen Yuan, former chairman of CDB, pointed out that "development finance is to use the superior resources and high energy of government organizations to advance market and institutional building through market-based financing, promote constructive interactions between the government and the market, and turn a sound market mechanism into an internal driving force for economic development (Yuan, 2012).

So, how does development finance as an extension of policy-based finance utilize the advantages of the government and the market to realize financing? What are the differences between development finance and traditional policy-based finance and commercial finance? As a practitioner of development finance in China, how does CDB solve its own risk problems while achieving policy objectives in the specific financing process? As more and more development financial institutions "go out", does this risk reduction approach also apply to overseas projects? This paper examines the differences between development finance and commercial finance on the basis of summarizing the large amount of first-hand information obtained through a combination of the literature method and the interview method, and on this basis, analyzes the Chinese mode of development finance by taking the two typical cases of CDB's "Wuhu Model" and Malaysia "Kibing Model" as examples. Meanwhile, it provokes discussions on risks associated with the "going out" of development finance.

The Characteristics of Development Finance with Chinese Characteristics

Development finance is a bridge between the government and the market. It guides investment in areas with high technical and market risks, advocates investment in emerging industries or national strategic areas with unclear prospects and great uncertainties, supplements financing for projects with long payback periods and low yields, provides loans to growing infant industries at preferential interest rates, guides the flow and scale of funds in commercial finance through indirect financing activities or guarantees, and provides medium- to long-term and even ultra-long-term loans to relevant projects in light of the fact that commercial finance mainly provides medium- and short-term loans (Yuan, 2004). It can be seen that, as an extension of policy-based finance, development finance mainly relies on state- and government-organized credit enhancement organizations like policy-based finance. It is different from commercial finance in terms of business objectives, areas of investment, investment periods, funding sources, and credit support, but it is not exactly the same as traditional policy-based finance (as shown in Table 1).

As far as the business objectives are concerned, policy-based finance does not pursue achievements in the operation process, requires a very low return on investment, and hardly considers the issue of profitability, while commercial finance aims at maximizing profits, and gaining profits is its main goal. In contrast, development finance only seeks to "break even or make small profits". Unlike traditional policy-based finance, which does not consider profit at all, or commercial finance, which is profit-oriented, development finance pays more attention to the efficiency of the use of funds than profit. In terms of credit support, unlike commercial finance, which relies on a collateral-based credit guarantee system, development finance, like traditional policy-based finance, mainly relies on credit guarantees provided by the government. But different from the traditional policy-based finance, development finance acquires credit enhancements from government organizations through "bank-government cooperation". In the process of government-organized credit enhancement, the government goes from being passive to being active, and the relationship between the bank and the government changes from separation to cooperation. The core of government-organized credit enhancement is to establish a risk control mechanism and credit system through "bank-government cooperation", so that the party whose credit is enhanced can effectively prevent risks and reduce losses. As far as areas of investment are concerned, in order to maximize profits, commercial finance often chooses areas with relatively mature market development for investment, while policy-based finance invests in government-designated investment categories, and development finance, under the guidance of government policy, develops independently in a market-oriented way, and mainly invests in infrastructure construction and other areas where the level of market development is low, the initial investment is large, earnings start low and end high, and risks are difficult to control. As far as investment periods are concerned, limited by liquidity restrictions, commercial finance mainly offers short-term loans to avoid triggering a liquidity crisis. Development finance retains the investment period characteristics of traditional policy-based finance, and is characterized by the raising and lending of long-term funds. In terms of funding sources, commercial finance derives funding mainly from the savings funds of commercial banks, policy-based finance derives funding mainly from government subsidies, and development finance, backed by government credit, continuously uses and expands the function and role of government credit in market and institutional building through state- and government-organized credit enhancement and bank-government cooperation, so as to ensure the diversity of funding sources. Development finance is a form of financing based on government credit but not yet differentiated by the market ("Research on the Practice of Developmental Finance with Chinese Characteristics" Research Group, 2017; Yuan, 2012).

Table 1
Characteristics of Development Finance

	Policy-based finance	**Development finance**	**Commercial finance**
Business objective	No profit target	To break even or make small profits	To maximize profits
Credit support	Government credit	Government-organized credit enhancement under bank-government cooperation	Collateral
Areas of investment	Designated by the government	Selected by the market under the guidance of the government	Selected by the market independently
Investment period	Long term and medium- to long-term	Long term and medium- to long-term	Short-term
Funding source	Government finances	Diversified funding sources	Banks' savings funds

Development Finance Takes a Policy-Oriented Instead of Risk-Oriented Approach to the Selection of Investment Targets

Development finance is based on the business objective of "breaking even or making small profits" and the support of government credit. Therefore, when it comes to the selection of areas of investment, development finance, rather than taking a risk-oriented approach, as is the case with commercial finance, is guided by the government. Development finance emphasizes market performance, not for furthering the interests of individuals or institutions, but for focusing financial resources on new bottleneck areas to achieve economic and social development goals. The profitability of development finance is conducive to maintaining the market image of government credit, further consolidating and enhancing national credit, and better serving the government's policy intentions.

As mentioned above, the business objective of commercial finance is to maximize profits on the basis of a balance between returns and risks, and minimizing investment risks is an important basis for the selection of investment targets. Based on a collateral-backed credit support system, commercial finance tends to select large enterprises with better profit prospects, less risk and more transparent information or mature market areas as investment targets. Commercial finance is generally reluctant to get involved in rural and backward areas where the market economy is less developed, small and medium-sized enterprises with serious information asymmetry, poor financial conditions, uncertain profit prospects and high risks, and high and new technology industries, as well as large infrastructure that requires large initial investments and have long payback periods.

Since development finance is an extension of policy-based finance, “being policy-based” is its essential attribute. Unlike commercial finance, which allocates micro-financial resources based solely on the profit motive, in terms of resource allocation, development finance provides funds for project areas that need to be given priority for state support and have the public nature of social capital, such as large-scale basic industries, mainly based on the macro objectives of resource allocation and from the perspective of policy-based investment and financing and the formation of social capital, so as to solve the “market failure” problem of commercial finance in the field of investment. However, development finance is different from traditional policy-based finance, which does not care about investment returns. With “breaking even and making small profits” as its business objective, development finance pays more attention to the efficiency of the use of funds, guides private economic activities through the supply of funds, promotes the formation of social capital, and gives full play to the resource allocation function of social capital, so as to solve the low efficiency problem of the “visible hand” in the investment process.

As a bridge between the government and the market, development finance is a powerful strategic tool to implement national macro strategic intentions, gain national strategic significance and promote national economic and social development. Development finance does not go directly into the highly mature commercial sector, but rather starts from immature markets. It builds markets where there are no markets, makes full use of and improves markets where there are, uses financing as a lever to guide private capital into areas given priority for state support, and effectively fills financial market gaps in weak links and backward areas.

Development Finance Resolves the Risks of Large Long-Term Loans

Development finance usually focuses investment on infrastructure construction which requires large amounts of long-term funds. How to deal with concentration risk has become the paramount issue for development finance. By building the new type of cooperative relationship of “bank-government cooperation” and by means of government-organized credit enhancement, developmental finance effectively resolves the risks of large long-term loans.

Owning to the necessity of unifying “safety, liquidity and profitability” in the course of operation and considering the need to match the maturities of assets and liabilities, development finance is generally unwilling and unable to provide large amounts of long-term and sustained credit support for infrastructure, basic industries and other quasi-public goods areas with economies of scale and positive externalities. The construction and development of these areas play a decisive role in the balanced development and rapid growth of the economy in the early stages of economic development. If we rely solely on commercial finance, a large number of investment projects and construction areas that have a role in the formation of social capital will be subject to severe financing constraints in the process of economic development and take-off. This is also one of the problems faced by developing countries in the process of financial deepening.

In addition, judging by the role of commercial finance in balanced economic growth, the main business of commercial finance includes industrial and commercial lending, consumer lending, agricultural lending, real estate mortgage lending, interbank lending and other forms of lending. These areas of investment are consumption areas with relatively high short-term profits. They are all at the end of the industrial chain, and their influence on related industries is very limited in scope and strength. Because commercial finance cannot make full use of the linkage between industries, the accumulation effect of capital cannot be brought into full play, the multiplier effect is limited and the influence is weak. In addition, the spillover effect of commercial finance is limited. Although commercial finance has a responsibility and obligation to assist the government in achieving certain social objectives, this responsibility and obligation cannot replace the core objective of commercial finance - profit maximization, so its social function is very limited.

Therefore, medium- to long-term investments in development finance effectively solve the deficiencies of short-term investments in commercial finance. But how does development finance resolve economic cycle risks? The government credit and market financing mechanism established by development finance through "bank-government cooperation" provides an institutional guarantee for solving this problem. First, institutional risks in the investment and financing process are remedied by relying on state- and government-organized credit enhancement and with the help of government commitments, government credit and government coordination. Second, a variety of means such as government coordination, development finance, capital markets and national macro-control are integrated to deal with the economic cycle risks brought by large medium- to long-term loans. Finally, national credit is securitized. Development financial bonds are guaranteed by national credit. Their safety is second only to government bonds—hence the term "silver-edged bonds". Their ability to cover risks is better than that of the retail savings of commercial banks (Yuan, 2004).

As an extension of policy-based finance, development finance aims at serving national strategies, uses medium- to long-term financing as a lever, relies on national credit, raises large amounts of funds through the issuance of financial bonds, supports the key areas and weak links of national economic and social development in a market-oriented way, and gives full play to the role of medium- to long-term financing as a pioneer and dominant force in China's economic construction.

The Credit Support System of Development Finance Helps Ease the Pressure on Fiscal Expenditure

Government-organized credit enhancement is the core of credit support for development finance. This kind of special cooperation between banks and governments effectively makes up for the deficiencies of the collateral system, and gives full play to the organizational and political advantages of governments. Credit endorsement by the government helps development finance diversify financing sources, and effectively eases the pressure on government spending caused by traditional policy-based finance relying solely on fiscal subsidies.

In the early stages of economic construction in developing countries, a large amount of investment is needed for infrastructure construction, and basic industries are important but weak industries. Affected by risks, basic industries hardly have access to commercial financing, and need direct fiscal subsidies and policy-based financial support from the government. For most countries, in the recovery and early stages of economic development, due to the weak foundations of economic development and take-off, and an underdeveloped financial system, it is difficult to raise funds needed for investment in basic and important industries in economic development through financial markets, and the government's fiscal spending is the primary funding source. The government gives huge, sustained and strong direct credit support to the basic and strategic industries of the national economy through policy-based finance. But large-scale and sustained fiscal spending has the potential to increase the burden on the government and plunge it into a fiscal crisis. In this context, establishing development financial institutions and raising the huge amount of funds needed for economic development through the issuance of policy-based bonds is conducive to easing the pressure on fiscal expenditure and reducing the fiscal expenditure burden.

Development finance helps promote private investment through a government-backed credit support system, greatly easing spending pressures on local finances. The primary source of fiscal investment is the central government. Limited by its status and responsibilities, the central government is subject to many inconveniences and is likely to have coordination problems when cooperating with other economic entities. Meanwhile, the government's management style is not suitable for the market. Development financial institutions are standardized financial entities and are on an equal footing with other market entities, so they have a flexible choice of projects, conduct management in a standardized way, and can engage in market-oriented operations, including cooperation with private investors and equity participation.

Development finance attracts private capital mainly through market behavior, and makes private capital feel profitable. As long as it operates successfully, development finance can work very well in attracting and leading the way for private capital, and really play a role in promoting balanced economic growth. Development financial institutions attract private investment mainly through direct financing and indirect financing. Indirect financing is to indirectly attract private investment through information production activities, that is, development financial institutions take the lead in making investments, private commercial financial institutions follow suit, and then development financial institutions change the direction of investment and start another cycle. Meanwhile, development financial institutions make use of the advantages of policy-based finance in information production to select excellent enterprises and improve the reputation of enterprises in financing markets. In this way, a mechanism whereby policy-based finance leads and guides the investment orientation of commercial finance is formed. As financing offered by policy-based financial institutions is accompanied by the production and transmission of information, it reduces the agency cost of external financing for enterprises, improves the market value of enterprises, and induces private banks to offer financing to enterprises.

In summary, development finance is a mode of finance between policy-based finance and commercial finance. Its core is to form a financing mechanism consisting of "project selection by the government, development finance incubation, and the realization of market outlets" through cooperation between policy banks and the government, government-organized credit enhancement, and the creation of a government credit system. On the one hand, development financial institutions actively implement the government's development strategy, and local governments determine investment projects according to the needs of national industrial policies and regional strategic planning (project selection by the government).On the other hand, development financial institutions resolve risks in the course of their own operations with the help of government-organized credit enhancement, and promote project construction and financing system construction with financing under government coordination (development finance incubation). Finally, the realization of market outlets is to design different repayment mechanisms for different loan forms, purposes and uses, including normal loan repayment, repurchases by parent companies, the issuance of shares in capital markets, and other market-based means, so as to achieve the business objective of "breaking even or making small profits" (Yuan, 2010).

Next, based on the two cases of the Anhui "Wuhu Model" and the Malaysia "Kibing Model", this paper will expound the specific operation mechanism of development finance and clarify how development financial institutions resolve risks in the financing process.

“Wuhu Model”: Use Government-Organized Credit Enhancement to Resolve Urbanization Financing Risks

With the rapid development of China’s economy, China is facing a series of problems brought about by urbanization. Compared with the West, China’s urbanization involves a large population and is unprecedentedly complex. Among the many questions we face, the central question of “where the money comes from” is not to be avoided. In traditional urbanization, informal institutional arrangements such as local land finance and the development mode of “only wanting land and not wanting people” have given rise to many problems such as local debt risks and social contradictions. In the process of new-type urbanization, it is necessary to build strong and efficient medium- to long-term financing systems and financing markets. However, urban construction projects have the attributes of public goods in that they are generally anticipatory, geared to the needs of society and oriented towards public interest, and they are characterized by large investments, long construction cycles, high sunk costs, inelasticity of demand, etc., which is clearly misaligned with commercial finance’s pursuit of short-term profits. Such misalignment has created a gap in urban construction financing in China.

There are two relatively mature financing models for urban infrastructure construction in the world. One is the municipal bond model of the United States, under which municipal bonds are issued by local governments and guaranteed by credit guarantee companies to attract the participation of individual investors in urban infrastructure construction; the other is the Japanese model dominated by investment with central or local tax revenues, under which the central finance assigns a development blueprint to each region through direct intervention or fiscal subsidies. However, the smooth implementation of the municipal bond model requires effective institutional support to ensure an intergenerational balance between financing and repayment, and the central finance model needs to be supported by strong fiscal revenues (Yuan, 2010). But for most local governments in China, institutional building is inadequate, and large-scale issuance of municipal bonds can easily cause local government debt imbalances. In addition, most local governments are not supported by strong fiscal revenues, and long-term large government subsidies will further exacerbate local fiscal deficits. The “Wuhu Model” of development finance pioneered by CDB in cooperation with the local government of Wuhu, Anhui Province effectively solves the funding source issue for urbanization construction through “bank-government cooperation” and government-organized credit enhancement.

Wuhu is a famous city in southern Anhui Province with a long history of more than 2,000 years and a profound business tradition. In the late 1990s, Wuhu was in the take-off period of a new round of economic and social development, and efforts were urgently needed to advance urban infrastructure construction, but due to the fact that the economic benefits of urban construction projects were insignificant and the government's financial resources were insufficient, a shortage of funds had become a bottleneck restricting infrastructure construction in Wuhu. The "Wuhu Model" is an epitome of development finance boosting urbanization in China. The biggest feature of the "Wuhu Model" of development finance pioneered by CDB in cooperation with the local government of Wuhu is the creation of a new type of bank-government cooperation. By using government-organized credit enhancement to turn local urban construction investment companies into financing platforms, and with the help of "loan bundling", it combines the advantages of CDB in financing with the advantages of local governments in organization and coordination to solve the urban construction financing problem that has plagued local governments for a long time.

Local Government-Organized Credit Enhancement Resolves the Risks of Large Long-Term Loans

The new bank-government relationship constructed by the "Wuhu Model" solves the difficulties that local governments have in securing funds in the process of urbanization. As mentioned earlier, commercial finance is sensitive to risks and often requires collateral. Urban construction requires a large number of infrastructure construction projects. These projects take place over a long period of time and generate little profit, so they can hardly meet commercial finance's demand for short-term profits. The new bank-government cooperative relationship under the "Wuhu Model" initiated cooperation between policy banks and local governments, solved the project credit issue through the endorsement of projects by local governments, and gives full play to the advantages of policy banks in financing and the advantages of local governments in organization and coordination.

After the 1980s, driven by the reform of the national investment and financing system, local governments joined a push to set up urban construction investment companies, providing a platform for government-organized credit enhancement under the "Wuhu Model". On August 10, 1998, CDB and the Anhui provincial government signed an investment and financing service cooperation agreement in Beijing, under which the parties would jointly built a credit support system and agreed on the source and method of repayment. CDB and the Wuhu municipal government set up an infrastructure construction financing committee to jointly discuss overall development plans and implementation plans, and assess overall debt-paying ability. The Wuhu municipal government established Wuhu Urban Construction Investment Company as the main lender in the urban construction process of Wuhu. The local government borrowed from CDB through the financing platform, integrating the local government's credit reference and financing activities. The credit structure follows the World Bank model. Guarantees or undertakings are provided by local finances. In the same year, CDB signed a 10-year loan agreement worth 1.08 billion yuan with Wuhu Urban

Construction Investment Company. The money was mainly used for six infrastructure construction projects in Wuhu City, including road construction, urban water supply system improvement, landfill site construction, etc. Regarding the loan guarantee and source of repayment, a model whereby repayment funds were arranged within and outside the budget of Wuhu city and repayment was fully guaranteed by Wuhu city's finance was adopted.The core of the "Wuhu Model" is to strengthen the role of local governments in the financing process and establish a risk control mechanism and credit system through government-organized credit enhancement, thereby alleviating the economic risk of large long-term loans provided by development finance for urban construction.

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"Loan Bundling" Broadens Financing Channels and Eases the Pressure on Fiscal Expenditure

As mentioned earlier, because urban infrastructure construction incurs high sunk costs and is slow to produce results, it is difficult to obtain financing from the market, and local fiscal subsidies are often relied upon, putting a lot of pressure on local fiscal expenditure.

What makes the development finance model implemented by CDB in Wuhu unique is that traditional financial support is no longer relied upon as a funding source, and a wide range of financing options are available through "loan bundling". Under the "Wuhu Model", urban construction projects that commercial finance is not willing to invest in are bundled through "loan bundling", the financing platform designated by the municipal government acts as the legal person who manages all borrowings and repayments, and the "debt service reserve" created out of budgetary revenues serves as the source of repayment. This model is called "loan bundling". Multiple urban construction projects are "bundled", so that high-quality projects can "remedy" low-quality projects, shortages can be supplemented by surpluses, and losses can be made up by profits, turning the bundle as a whole into a high-quality project. In addition, local government finances provide guarantees and undertakings to provide government endorsements for financing projects.

While organizing credit enhancement, local governments actively introduce a series of preferential policies to attract investment. "Bundled" projects are endorsed by government credit, effectively dispelling private investors' risk concerns. In addition, the "debt service reserve" created out of budgetary revenues also provides evidence of repayment ability for the urban construction investment and financing platform, namely the legal person who manages all borrowings.

The "Land + Finance" Guarantee Model Strengthens the Credit Support System

In 2002, the "Wuhu Model" launched the "Land + Finance" model, under which the government authorizes the borrower to pledge land transfer proceeds as the main repayment guarantee, and with the approval of the Wuhu Municipal People's Congress, repayment will be made with municipal fiscal subsidies if the borrower fails to repay the loan principal plus interest in time. CDB and the Wuhu municipal government jointly decided to establish the Wuhu Municipal Land Reserve Center to centrally manage and operate the land reserves, development and auctions of Wuhu city (Research Institute of China Development Bank, 2011). The government authorizes the urban construction investment company (the borrower) to pledge land transfer proceeds as the main repayment guarantee, and with the approval of the Wuhu Municipal People's Congress, repayment will be made with municipal government subsidies if the borrower fails to repay the loan principal plus interest in time.

On the basis of the original policy banks plus local governments, this innovation gives full play to the huge value of land, improves the credit structure, and eases financing difficulties in the urbanization process. This model organically combines the source of infrastructure loan repayment with income from land appreciation, and organically integrates the infrastructure financing mechanism with the concept of "managing the city". Through a series of institutional designs such as standardizing the land transfer system and setting up a financing platform, it pledges the right to derive income from land, covers the cost of urban infrastructure construction with income from land appreciation, and cultivates market-oriented operation entities, not only creating a virtuous circle for the government's infrastructure funds, but also reducing financial risks and driving the development of related industries.

It can be seen that under the "Wuhu Model" of development finance, CDB reduces the economic risk of providing medium- to long-term loans through local government-organized credit enhancement and the "land + finance" pledge model. In addition, with the help of "loan bundling", high-quality projects and low-quality projects are combined, which coupled with government credit endorsement makes it possible to obtain funds from a wide range of sources in the market, realizing a virtuous cycle of capital flow. Under the "Wuhu Model", an urban infrastructure investment and financing mechanism that operates in a virtuous cycle has been created, a market-oriented investment and financing platform carrier has been cultivated, financing channels for urban infrastructure construction have been opened up, and commercial banks and other social funds are actively involved, laying a solid foundation for continuously, rapidly and efficiently advancing urban infrastructure construction in Wuhu city.

"Kibing Model": Development Finance Solves Issues Concerning the Financing of International Production Capacity Cooperation

With the continuous advancement of the Belt and Road Initiative, the Chinese government encourages enterprises that possess advantages to "go out" in a variety of ways to optimize the distribution of manufacturing locations. The "Kibing Model" whereby CDB helped Kibing Group invest and build a plant in Malaysia by means of development finance is a typical case of development finance supporting the "going out" of domestic private enterprises' advantageous production capacity and serving China's Belt and Road Initiative, and sheds light on issues concerning the financing of international production capacity cooperation.

Kibing Group is a large enterprise group in China that mainly produces high-end glass products such as high-quality float glass, energy-saving glass, solar glass and ultra-thin glass, with production bases in Hunan, Fujian, Guangdong and Zhejiang provinces. In 2014, in response to China's Belt and Road initiative and the call for the "going out" of advantageous production capacity, Zhangzhou Kibing Glass Co., Ltd. established a wholly-owned subsidiary Kibing Group (Malaysia) Co., Ltd. (hereinafter referred to as "Kibing Malaysia Company"), and invested 1.18 billion yuan to build the group's first overseas glass production base in Seremban, Negeri Sembilan, Malaysia. As the local political and commercial environment in Malaysia is quite different from that in China, Chinese enterprises often encounter issues such as credit structure, overseas taxes, administrative inefficiency and controls over the outflow of foreign exchange funds in the process of investment and plant construction. Under the "Kibing Model", CDB helped the private enterprise solve the relevant problems encountered in the process of investment and plant construction in a foreign country by means of development finance.

Development Finance Resolves Credit Risk in Financing through the Dual Means of the Government and the Market

Chinese enterprises generally set up local project companies to operate their overseas investment projects. As local financial institutions are not familiar with foreign enterprises, it is difficult for project companies to get credit support from local financial institutions. For risk assessment reasons, domestic banks generally do not accept land, real estate, equity, equipment and other assets formed by overseas investment as collateral for loans. Due to the relatively high risk of overseas investment projects and the weak strength of private enterprises, it is difficult for overseas investment projects to obtain bank credit support. Kibing Group was a private enterprise controlled by natural persons, and the project was a purely market-oriented project. There were great challenges in building a reasonable credit structure. Using only the project assets as collateral was far from meeting the credit structure requirements. In addition, the project required substantial financing and had a long payback period, and ordinary commercial banks could not provide products that met such financing needs.

The key to solving this problem lied in market building and credit structure construction. In terms of market building, CDB hired industry experts to give expert opinions, and visited the Malaysian Investment Development Authority (MIDA), the Plate Glass Industry Association, and upstream and downstream importers and exporters to understand the local market along multiple dimensions, and conducted due diligence on the Malaysian plate glass market in collaboration with CDB's review department for the industry. In addition, we also examined the operations and financial position of Kibing Group, visited the headquarters of Kibing Group in Dongshan, Zhangzhou, and studied the upstream and downstream markets of the group. In terms of credit structure, CDB experts and Kibing Group made an inventory of resources that could be used as collateral, including guarantees provided by the parent company of the group, mining rights, land, plants, machinery and equipment, joint and several liability guarantees provided by the actual controller, and project assets. In the end, the two parties negotiated and designed a reasonable collateral scheme to meet the credit structure requirements and reduce CDB's credit structure risk.

Development Finance Gives Full Play to National Policy Support to Solve the Overseas Tax Problem

Malaysia implements a withholding tax system for overseas financial institutions, with the withholding tax rate ranging from 10% to 15%. Non-resident companies are subject to withholding tax on interest and royalties from Malaysia. China and Malaysia signed the Agreement between the Government of the People's Republic of China and the Government of Malaysia for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with respect to Taxes on Income (hereinafter referred to as the "Agreement") in 1985, stipulating that the interest obtained by the government of one contracting state (including institutions wholly owned by the government) from the other contracting state shall be exempted from taxation in the other contracting state. However, under the then tax regulations of Malaysia, development banks were not included in the tax exemption list, and loan interest was subject to 10% withholding tax, which increased the financing cost and burden of borrowers.

In order to solve this problem, CDB, with strong support from the finance and accounting bureau and the international cooperation bureau of the head office, took the initiative to coordinate with the State Administration of Taxation and Fujian Provincial Tax Service, and helped negotiate with the Malaysian government to include CDB in the double taxation avoidance list between China and Malaysia, so as to exempt CDB from interest withholding tax in Malaysia. In November 2016, in the presence of Premier Li Keqiang and Prime Minister of Malaysia, the State Administration of

Taxation and the Ministry of Finance of Malaysia signed the Exchange of Notes Concerning the Tax Convention between China and Malaysia on behalf of the two governments, and incorporated it into the joint communiqué between China and Malaysia, establishing the tax-exempt status of "7 + 7" state-owned institutions of China and Malaysia, including CDB. The agreement directly exempted CDB loans for Kibing Group's project from the 10% withholding tax in Malaysia.

"Syndicated Loans" Provide Medium- and Long- Term Loans for the Going out of Private Enterprises

In the process of cooperation between CDB and Kibing Group, due to the low administrative efficiency of Malaysian government agencies, the issuance of a land certificate for land purchase to the borrower was delayed, making it impossible to meet the conditions for signing a medium- to long-term contract. This made Kibing Group unable to sign a medium- to long-term contract, but project construction was in urgent need of large-scale funding support.

Through syndicated loans, export credit, project financing and other means, CDB secured funding from special funds such as the China-Africa Development Fund, the Special Loan for the Development of African SMEs, and the special arrangement for export financing and insurance for complete sets of large equipment, so as to increase financing support for international production capacity cooperation. Meanwhile, CDB actively innovated credit products to meet the financing needs of enterprises in international production capacity cooperation, promoted the innovation of mortgage (pledge) financing products, explored the use of equity, overseas assets, etc. as collateral for financing, and provided credit support for project financing through performance guarantees, financing guarantees and other external guarantees.

China—under pressure to control its foreign exchange funds—imposed strict controls on the outflow of foreign exchange funds in 2016. For the private companies like Kibing Group that needed to invest and build factories overseas, their projects were then at a critical stage of construction, but their own funds and CDB loans had difficulty exiting China, leaving them struggling to pay for project construction. This directly affected normal project construction. Taking full account of the borrower's demand for funds, under the "Kibing Model", CDB provided loans in dual currencies, namely RMB and USD, to facilitate the use of funds by enterprises.

The Malaysia "Kibing Model" is an important innovation developed by CDB in response to the country's Belt and Road initiative with the help of development finance. It solves Chinese private enterprises' financing difficulties in the "going out" process through syndicated loans, export credit, project financing and other means. It can be seen that state- or government-organized credit enhancement is an important tool for risk aversion for development finance with Chinese characteristics. Then is this approach applicable to all overseas projects funded by development finance? What are the risks? In the next part, on the basis of summarizing the characteristics of development finance with Chinese characteristics, this paper will discuss the potential risks that development finance may encounter in the process of "going out".

Overseas Political Risks of Chinese-style Development Finance

The above two cases confirm the basic logic behind the operation of development finance, that is, development financial institutions ensure that their business objective of "breaking even or making small profits" is met through state- or local government-organized credit enhancement. It should be noted, however, that one of the core premises of this operational logic is that the state or government responsible for organizing credit enhancement first needs to be a development-oriented state or government, which means that the political system can get enough space to take the initiative. Under the "Wuhu Model" mentioned above, CDB offered, in cooperation with the local government of Wuhu, guarantees for medium- to long-term loans needed for urban construction by means of local government-organized credit enhancement. In the event of a default, repayment will be made through the "debt service reserve" created by the local finance. Local development and promotion of officials follow the local championship system all year round. Defaults on policy-based loans will greatly affect the political achievements of local officials, and thus affect their promotion. Moreover, most local governments have soft budget constraints in their fiscal expenditures. Even if the relevant local fiscal expenditure is inadequate to cover the cost of the project, funds will be raised through central government subsidies or transfer payments to ensure the smooth operation of the project. Therefore, local governments are very willing to provide guarantees for urban infrastructure construction and other projects funded by development finance.

It can be seen that a government that is willing to "guarantee" is a prerequisite for the realization of a virtuous circle for the operational logic of development finance. However, when Chinese-style development finance undertakes overseas projects, directly copying the domestic operating mechanism may create exposure to default risk due to differences in national governance logic. China's development finance practice at Sri Lanka's Hambantota Port encountered this kind of problem, and even led to allegations that China was setting up a "debt trap".

So, why did the Export-Import Bank of China (EIBC) think this project was a project that could be supported by development finance? In fact, at the beginning of the Hambantota Port project, the Sri Lankan government first sought financing from Japan and India, but both countries refused to invest due to risks associated with short-term investments. Thereupon, the Sri Lankan government turned to China for investment.

After a comprehensive evaluation of the project, EIBC concluded that it met the investment requirements of development finance.

First, the Hambantota Port project was a medium- to long-term national strategic project implemented by the Sri Lankan government, and met development finance's requirements for medium- to long-term investments. Sri Lanka's economy had suffered a severe setback after more than two decades of civil war since 1983. In order to revive the economy, after coming to power in 2005, Rajapaksa's government unveiled Sri Lanka's medium- to long-term development plan, Sri Lanka, the Emerging Wonder of Asia: Mahinda Chintana, Vision for the Future, which aimed to develop Sri Lanka into Asia's knowledge, aviation, investment, business and energy center. The Hambantota Port project was a key project under the "Two Wings and One Belt" strategy in "Mahinda's Vision". The "two wings" refer to Colombo and Hambantota, and the "one belt" refers to the economic belt between Colombo and Hambantota. The strategy aimed to build Hambantota into an industrial base in Sri Lanka linked with Colombo, and the Hambantota Port project came into being at the historic moment.

Second, after a comprehensive evaluation, EIBC thought that the project had great development potential. Located just 10 nautical miles from the Indian Ocean's busiest international shipping lane, which is regularly used by a large number of vessels, Hambantota Port serves as an important transshipment hub and refueling base for vessels. In fact, in 2003 and 2006, the SNC-Lavalin Group, a Canadian company and Ramboll, a Danish engineering consulting firm, respectively evaluated the Hambantota Port project, and both believed that the port's prospects for development were optimistic.

Finally, the government of Sri Lanka was willing to borrow under a sovereign guarantee. To borrow under a sovereign guarantee means that a country borrows money with its own sovereign credit as the guarantee, which is consistent with the operational logic of development finance in China. It was with the help of national sovereign credit that EIBC organized credit enhancement for this round of development financing.

For this reason, EIBC decided to provide financing for the Hambantota Port project through development finance. However, in the first phase of investment in 2008, EIBC, acting out of prudence, only provided commercial loans totaling $306 million to cover 85% of the cost of the Hambantota Port project. This was because Sri Lanka was in the midst of a fierce civil war, the domestic situation was not clear, "Mahinda's Vision" had just been proposed, its development prospects were still uncertain, and whether it could be successfully implemented had yet to be verified (Kee, 2018). But the development potential of Hambantota Port as a logistics and transportation hub did exist, and Hambantota was the hometown of President Rajapaksa. As the new president, he was very much hoping to boost the economy through infrastructure investment in Hambantota, which to some extent provided a guarantee for the development of

Hambantota Port. At the end of Sri Lanka's civil war in 2009, Rajapaksa's government launched "Mahinda's Vision 2.0". The updated version of the development plan was more practical and concrete. By this time the development prospects of the Hambantota Port project were clearer. Consequently, in the second phase of the project, EIBC raised the investment to $900 million.

However, due to the different nature of the political system, the development finance logic, which can realize a virtuous circle in China, may encounter potential political risks abroad due to regime change. After losing his reelection bid in the 2015 presidential election in Sri Lanka, President Rajapaksa was accused by his successor President Sirisena of stimulating the economy by borrowing heavily, putting huge pressure on public finances. The new government thought that the Hambantota Port project needed to be reviewed, so the project was suspended. In addition, due to poor management and a lack of industrial and commercial operations, Sri Lanka Ports Authority was unable to attract passing ships to the port. As a result, Hambantota Port had been operating at a loss for years. But Sirisena's government did not deny that the construction of infrastructure such as the Hambantota Port project would promote Sri Lanka's economic development. In 2016, the Sri Lankan government decided to restart the operation and development of Hambantota Port through market-oriented reforms, and offered to rent out the operating rights of the Hambantota Port project in a single package through bidding in the hope of reversing the loss-making situation. In the bidding process, the Sri Lankan government once again gave priority to Japanese and Indian companies, but received a refusal again, and then turned to Chinese enterprises. In the end, China Merchants Port Holdings Company Limited (CMPort), a subsidiary of China Merchants Group, won the bid and formed a joint venture with the Sri Lankan government to operate Hambantota Port. According to the agreement, CMPort would acquire an 85% stake in Hambantota International Ports Group (HIPG) and a 49.3% stake in Hambantota International Port Services (HIPS), representing about 70% of the total equity; CMPort owned the operating and management rights of the above two companies, as well as the lease and development rights of approximately 11.5 square kilometers of land in the port area; the concession period was 99 years. CMPort invested a total of $1.12 billion in Sri Lanka, of which $974 million were used to acquire the 85% stake in HIPG and the remaining $146 million were deposited into a bank account in the name of CMPort in Sri Lanka to be used for the expansion of Hambantota Port and shipping-related business. Within 10 years from the effective date of the concession agreement, Sri Lanka Ports Authority has the right to repurchase 20% of HIPG's shares on terms acceptable to all parties. 70 years after the entry into force of the agreement, Sri Lanka Ports Authority may acquire all the shares of HIPG held by CMPort at a reasonable price determined by the valuer appointed by both parties. At the end of the 80th year of the agreement, Sri Lanka Ports Authority can acquire the shares held by CMPort in HIPG at a price of $1 per share, allowing CMPort to retain 40% of the shares in HIPS. When the agreement expires at the end of the 99th year, CMPort will transfer all its shares in HIPG and HIPS to the Sri Lankan government and Sri Lanka Ports Authority at a nominal price of $1 per share.

However, since it was a Chinese company that won the bid, some media alleged that Chinese-style development finance was a “debt trap.” So what does the actual process look like?

First, the Hambantota Port project is not a debt trap laid by China. The project was initiated based on the political will of the former president of Sri Lanka, rather than proposed by China. The reason why the Sri Lankan government borrowed from China was that it failed to obtain financing from Japan and India. After the financial crisis, compared with other countries that were caught up in the vortex of the economic crisis, China became the country most likely to invest abroad thanks to its steady economic growth. EIBC’s willingness to provide loans for the Hambantota Port project in Sri Lanka is not based on the so-called strategic goal of dominating, or China’s intention to use it as China’s military base as claimed by some media, but on the recognition of the viability of the development of the shipping logistics market in the Indian Ocean, where Hambantota Port is located. Moreover, the leased port is jointly operated by a joint venture composed of CMPort and the Sri Lankan government. The Sri Lankan government holds 30% of the shares, and the port is not used for military purposes (Jianming, 2020; Kee, 2018).

Second, the Sri Lankan government voluntarily decided to transfer the port’s operating rights in order to implement market-oriented reforms, CMPort acquired operating rights not through a debt/equity swap. Since its launch, the Hambantota Port project had been operating at a loss for years due to poor management. Sirisena’s new government hoped to improve the situation by resorting to the market-oriented means of renting out the port’s operating rights, and form a joint venture with the winning company to jointly operate the port. After winning the bid, CMPort paid $1.12 billion for a 70% stake in the joint venture. Part of the money was used to make up for the port’s operating losses, and the other part was used to repay other debts. The loans offered to the Hambantota Port were not converted into equity under the lease. The development finance loans provided by EIBC have been transferred to the Ministry of Finance of Sri Lanka and still need to be repaid in full (Hameiri, 2020; Jianming, 2020).

Finally, it was not the debt pressure from China that plunged the Sri Lankan government into a sovereign debt crisis. In fact, it was excessive borrowing from capital markets dominated by the West (Hameiri, 2020). Since the outbreak of the civil war, Sri Lanka’s economic development has been severely hampered, and non-productive inputs such as arms procurement have risen sharply. As a result, over the years, Sri Lanka has been running a massive fiscal deficit and relying on debt for development. In the past, Sri

Lanka's main creditors were Japan, Europe and the United States, as well as international multilateral financial institutions such as the IMF. It was not until the end of the civil war that China became a major creditor of Sri Lanka, but china's debt share was very small compared with other creditors. As of 2016, Chinese loans accounted for only 9% of Sri Lanka's government debt, and more than two-thirds of them were medium- to long-term loans at preferential rates, not enough to create the so-called debt crisis. After its sovereign credit rating was downgraded, Sri Lanka could no longer get concessional loans from other countries, and had to borrow high-interest short-term commercial loans from banks such as those in the United Kingdom and the United States. This was what really caused Sri Lanka's debt crisis (Yinghui et al., 2019).

A large number of facts have proved that the Hambantota Port project in Sri Lanka is not "Chinese debt trap". When receiving credentials presented by new ambassadors from South Korea, Germany, the Holy See and Switzerland, Sri Lanka's current president Gotabaya specifically pointed out that the Hambantota Port project was a project with great development potential and not a "debt trap" ("President defends…" 2020). Professor Shahar Hameiri at Australia's Lowy Institute has also confirmed in his research that there is no such thing. First, the Hambantota Port project is not a debt trap set by China. The project was initiated based on the political will of the former president of Sri Lanka, rather than proposed by China. The reason why the Sri Lankan government borrowed from China was that it failed to obtain financing from Japan and India. After the financial crisis, compared with other countries that were caught up in the vortex of the economic crisis, China became the country most likely to invest abroad thanks to its steady economic growth (Srinivasan, 2020). EIBC's willingness to provide loans for the Hambantota Port project in Sri Lanka is not based on the so-called strategic goal of dominating, or China's intention to use it as China's military base as claimed by some media, but on the recognition of the viability of the development of the shipping logistics market in the Indian Ocean, where Hambantota Port is located. Sri Lanka's sovereign debt crisis was not caused by Chinese investment (Hameiri, 2020).

However, the problems encountered in the Hambantota Port development financing project and the ensuing response from international media also provide a lesson for the "going out" of China's development finance. How to avoid political risks under a completely different political system in the process of "going out" of development finance remains an outstanding issue that needs to be tackled urgently in the development of China's development finance.

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