NATIONAL DEVELOPMENT BANKS IN A COMPARATIVE PERSPECTIVE

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Abstract

A feature characteristic of countries that were late industrializers was their reliance on financial institutions geared to the task of financing capital-intensive investments with direct and indirect support from the State. While in Germany the universal banks served this purpose in the 19th century, developing late industrializers after the Second World War established specialized development banking institutions to play this role, as well as reach credit to sections that were otherwise excluded from the banking network. Despite differences in the evolution of the development banking infrastructure across these countries, there are striking similarities in terms of what they were mandated to do and how they were financed. However, with the turn to financial liberalization, the transformation of development banking across countries has been very different, with seemingly significant consequences.

Introduction

A feature of most countries in the less developed regions in the period after the Second World War was the emergence and consolidation of a set of specialized institutions referred to as development finance institutions (DFIs) or development banks (DBs). The principal factor motivating the creation of these institutions was the need to channel large sums of capital for investment in capital-intensive enterprises in industry and the infrastructural sector.

I. Capital requirements

As Gerschenkron (1962) emphasized, a feature of late industrialization that is (by definition) characteristic of developing countries was the quantum jump in investment needed for industrial take-off. Not only was each industry more capital-intensive than it was in earlier times, but increased interdependence meant that countries had to make simultaneous investments in a larger number of industries. In addition, investment in infrastructural projects characterized by economy-wide externalities (such as power, communications, roads and ports) was crucial to supporting such industrial growth.

The large capital required for such a combination of lumpy investments is unlikely to have been accumulated by many potential private investors in backward economies. Even to the extent that such accumulation had occurred, many of those wealth-holders would be wary of investing large volumes of their own capital in one or a few such projects, with long gestation lags and high risks. These investments had to be either made by the State or supported with external finance on reasonable terms provided to willing private investors.

However, the problem is that in developing economies the financial sector is not sufficiently developed and diversified to undertake such activity. The financial sector tends to be bank dominated. While there are active markets for government bonds, markets for corporate bonds are most often absent. On the other hand, the typical commercial bank is most unsuited to financing such projects. They attract deposits from small savers who have a strong preference for liquidity and short lock-in periods and would like to abjure any income or capital risk. Drawing on capital of this kind, banks would be reticent to expose themselves in any substantial measure to loans that are relatively illiquid and of long maturity, as required by infrastructural projects, for example. An absence of adequate sources of long-term finance is typical of backwardness. Therefore, finding the capital to finance the industrial take-off represents a major challenge.

II. A lesson from history

What is noteworthy is that some of the first-tier late industrializers such as France, Germany and Japan managed to overcome this problem. Alexander Gerschenkron (1962) underlined the important role played by special and unusual kinds of credit institutions in late industrializers in Europe such as France and Germany in the late-nineteenth century. Examples of such institutions were the Crédit Mobilier established by the Pereire brothers in France and the "universal banks" in Germany. They were unique in the sense that they were "financial organizations designed to build thousands of miles of railroads, drill mines, erect factories, pierce canals, construct ports and modernize cities" (Gerschenkron, 1962: 12). Gerschenkron believed that they served as institutional substitutes for crucial "prerequisites" for the industrial take-off, such as the prior accumulation of capital or the availability of adequate entrepreneurial skills and technological expertise. As Gerschenkron (1962: 13) argued: "The difference between banks of the crédit mobilier type and commercial banks in the advanced industrial country of the time (England) was absolute. Between the English bank essentially designed to serve as a source of short-term capital and a bank designed to finance the long-run investment needs of the economy there was a complete gulf."

This historical evidence is intriguing, since – as argued above – commercial banks typically do not engage in such lending activity, given the maturity and liquidity mismatches involved. In a set of lectures on continental banking delivered in Cambridge, Piero Sraffa (De Cecco, 2005) attempted to explain what made this possible. According to him, what was experimented with on the continent by the Crédit Mobilier and the German universal banks (Kreditbanken) was a form of "active banking" involving close interaction of banks and industry with an element of domination of the latter by the former owing to "the superior information banks could gather on industry, being at the crucial node of the economic system" (De Cecco, 2005: 352).[1]

A liquidity mismatch only arises if an institution exposed to capital-intensive projects is unable to access cash to meet demands from some of its depositors. Therefore, the issue is not that banks would not be able to call in their long-term credits, but rather that the assets they hold in the form of the securities associated with those credits may not be easily sold and converted to cash to meet demands to pay back deposits. This problem can be resolved if – as happened in Germany – the central bank (Reichsbank) stands by willing to exploit the elasticity of its right of note issue to provide lines of credit to banks engaged in long-term lending to industry when the latter are unable to obtain liquidity from elsewhere. In France, however, the Banque de France not only refused to support the Crédit Mobilier with liquidity as and when required, but also prevented it from issuing long-term bonds. Faced with this problem, Sraffa reportedly argued that while the Crédit Mobilier began with a wise policy of matching maturities of assets and liabilities, it later made the mistake of turning towards financing long-term investment with short-term deposits, which ultimately led to its failure.

Learning from the experience of the Crédit Mobilier, the German State – through the backing of the Reichsbank – successfully used the universal banks to finance German industrialization. De Cecco (2005: 355) summarizes Sraffa's perception of the

system as follows: "German *Grossbanken*, which were heavily involved in maturity transformation, were likely to find themselves periodically stuck in illiquidity situations, and required reliable access to last-resort lending by the Reichsbank. In fact, the whole concept of last-resort lending, which had been developed in the English context, had to be adapted, indeed drastically transformed, to be used in the German one." According to De Cecco (2005: 354) in Sraffa's perception, "the German experience represented a clear case of planned institution building", to realize the task at hand. The universal banks were private, limited liability, joint stock banks, although they were also instruments of the State, acting on its behalf in return for large-scale liquidity support.

III. Development banking

DBs as institutions were clearly inspired by that experience and the subsequent direction that it took in the form of the main-bank system in Japan, which financed export-led industrial expansion with support from and direction by the Bank of Japan and the Japanese Government. Nonetheless, there were two important differences: first, rather than combining the activities of pre-existing commercial banks with the industrial financing function, most developing countries chose to establish stand-alone DFIs expressly geared to realizing specified financing objectives; and second, these institutions were not autonomous creations of the private sector, which subsequently came under government influence, but rather were established by the State and were in many cases State-owned institutions.

DBs are generally mandated to provide credit at terms that render industrial and infrastructure investment viable. They provide working capital and finance long-term investment, including in the form of equity. To safeguard their investments, they closely monitor the activities of the firms they lend to, often nominating directors on the boards of companies. This allows for corrective action as soon as any deficiencies are detected. DBs are also involved in early stage decisions such as choice of technology, scale and location, requiring the acquisition of technical, financial and managerial expertise. They also sometimes provide merchant banking services, taking firms to market, underwriting equity issues and supporting firms with their own reputation.

IV. Policy banks

Since DBs serve to finance activities that may not otherwise be supported by the financial sector, they are sometimes given specific mandates to deliver credit to specified sectors such as marginal farmers and the small-scale sector. Providing credit in small volumes to dispersed and often remotely located borrowers substantially increases transaction costs. If these transaction costs are to be reflected in interest rates charged on loans, the rates could be so high that the loans concerned cannot be used for productive purposes. Accordingly, a subsidy or subvention of some kind would be needed to keep interest rates reasonable. Only specially created banks are likely to undertake such policy lending. Most countries have found that it is best to create separate DBs to provide long-term capital at near-commercial rates and "policy banks" to provide credit to special areas such as agriculture or the small-scale sector, where interest rates have to be subsidized and grace periods have to be longer.

What is surprising is the degree to which governments have relied on the development banking instrument. A 1998 study by Nicholas Bruck identified over 550 DBs worldwide, of which around 520 were national DBs (NDBs) and 32 international, regional and sub-regional DBs. These were located in 185 countries, with developing countries in particular hosting an average of three or more DBs. Latin America and the Caribbean had the largest number of NDBs (152), followed by Africa (147), Asia and the Pacific (121), Europe (49) and West Asia (47).

As expected, these banks varied significantly in terms of their size and scope of operations. A sample of 90 DFIs studied by de Luna-Martinez and

Vicente (2012) in 2009 found that although almost half of them (49 per cent) were established during the import-substitution years between 1946 and 1989, nearly two-fifths (39 per cent) came into existence during the globalization years between 1990 and 2011. One implication is that irrespective of policy orientation, the failure of private financial markets to deliver adequate long-term finance forces governments to rely on development banking institutions. The de Luna-Martinez and Vicente study defined a DFI as being an institution with "at least 30 per cent State-owned equity" and "an explicit legal mandate to reach socioeconomic goals in a region, sector or particular market segment". It emerges that 74 per cent of these institutions were entirely government owned and controlled and a further 21 per cent had less than 50 per cent of private equity ownership.

Reflecting the fact these were specially established stand-alone institutions – unlike the universal banks of Germany – the DFIs largely depended on non-depository sources of finance. More than half of them (53 per cent) had specific policy mandates, having been "established to support the agriculture sector (13% of all DBs), SMEs [small and medium enterprises] through their lending, guarantee or advisory services (12%), export and import activities (9%), housing (6%), infrastructure projects (4%), local governments (3%), and other sectors (6%)." (de Luna-Martinez and Vicente, 2012: 12). This requirement meant that they could not finance their activities solely with finance from the market. Nearly 90 per cent of the DFIs surveyed borrowed resources from other financial institutions or issued debt instruments in domestic markets and 64 per cent had the benefit of government guarantees for debt issued by them. However, 40 per cent of them received budgetary transfers from the government. This backing allowed around half of these DBs to offer credit at subsidized interest rates, and two-thirds of those institutions reported financing those subsidies with the transfers that they received from the government.[2]

Of course, the evolution of development banking and DFI behaviour varied across nations. In what follows, we consider a few experiences with the evolution and operation of DFIs to identify common elements as well as differences in a policy phenomenon captured in a common phrase yet varying in content across countries.

V. The BNDES in Brazil

A classic case of a country that has relied on one large development banking institution is Brazil, which established the Brazilian Development Bank, also known as National Bank for Economic and Social Development (BNDES – the acronym for its Portuguese name) in 1952. At the end of 2011, the bank's assets amounted to 15 per cent of Brazil's GDP, of which 10 percentage points were accounted for by loans and another 3 comprised investments in corporate equity and debt securities. The first phase of the BNDES's activities stretched to the mid-1960s, during which period (besides investments in developing a new capital at Brasilia) the focus of its activity was the financing of public sector projects in infrastructural sectors like transport and power. During these years, between 80 and 90 per cent of its financing was directed at the public sector (Armijo, 2013: 3).

A transition occurred in the mid-1960s involving three major changes. First, there was a significant step up in BNDES financing. In 1965, BNDES's outlays rose from 3 per cent of capital formation to 6.6 per cent and continued at that enhanced level. Second, more of the institution's financing now went to the private sector, with the public sector's share falling to 44 per cent during 1967–1971 and between 20 and 30 per cent subsequently. This shift in favour of the private sector was accompanied by a change in the sectoral composition of BNDES funding, which was now also directed to sectors such as nonferrous metals, chemicals, petrochemicals, paper, machinery and other industries. Since the 1970s, the bank has also supported Brazilian firms to target foreign markets or go global, by financing the modernization of potential export sectors such as textiles, footwear and apparel and funding efforts by firms such as meat major JBS Friboi to acquire rivals abroad and enhance its presence in international markets. Finally, after the financial crisis of 2008 and the recession that followed, the BNDES was used by the Brazilian Government as the medium for its stimulus aimed at reversing the downturn. As compared with annual loan disbursements of

just R$23.4 billion in 2000, the figure stood at to R$168.4 billion in 2010. Subsequently, disbursements came down to R$139.7 billion in 2011 and R$156 billion in 2012 (Armijo, 2013). This was an unusual role for a DFI. At its peak in 2010, annual BNDES lending amounted to around 70 per cent of long-term credit in the country.

When compared with DBs in other contexts, the sources of finance for the BNDES have been unusual. Besides bond issues, resources from multilateral organizations, transfers from the treasury and deposits from the Government of funds from privatization, the institution benefited from resources garnered through a special cess. In the early-1970s, the Brazilian Government instituted the Social Integration Programme (PIS) and the Public Employment Savings Programme (PASEP), which were to be financed with payroll taxes imposed on company profits. Under President Ernesto Geisel (1974–1979), the administration of these funds was transferred to BNDES. Subsequently, under the 1988 Constitution, changes were made in the management of PIS-PASEP, which led to the creation of a Workers Assistance Fund, whereby 40 per cent of accruals had to be mandatorily routed to BNDES for investments in employment-generating projects. In addition, the Government has used various measures such as special taxes and cesses, levies on insurance and investment companies and the reallocation of pension fund capital to direct resources to the industrial financing activities of the BNDES (Baer and Villela, 1980). In 2007, 10 per cent of BNDES funds came from the Government's investment in its equity, and 75 per cent from obligatory investments of FAT (Workers' Support Fund) resources and special programmes such as the Accelerated Growth Programme (PAC - the acronym for its Portuguese name) and the Sustainable Investment Programme.

A consequence of this is that through BNDES, the Brazilian Federal Government has been an important source of long-term credit to the country's corporate sector. Implicit in that process has been the delivery of a subsidy to the private sector through BNDES. The rate of interest at which the Government borrows from the market, which is the benchmark SELIC (*Sistema Especial de Liquidação e Custódia* or Special System for Settlement and Custody) rate set by the central bank, is higher than the TJLP (*Taxa de Juros de Longo Prazo* or Long-Term Interest Rate), the rate at which it lends to the BNDES. This amounts to subsidized lending to the BNDES at the cost of the taxpayer. To the extent that BNDES offers credit to its borrowers at a rate lower than the SELIC, there is also a transfer to the latter. Indeed, the BNDES lends at rates close to the TJLP. According to Lazzarini et al. (2011), if the BNDES had obtained funds at the SELIC rate, then its net interest margin would have been negative in many years. BNDES is clearly being used by the Federal Government as a means to make implicit transfers to a select set of firms that it supports.

This holds considerable relevance because there is evidence of concentration in BNDES lending. In 2012, close to two-fifths of BNDES outstanding loans were with the five top borrowers. It also holds large chunks of equity in private firms such as Fibria (30.4 per cent), Klabin (20.3 per cent), JBS Friboi (17.3 per cent), Marfrig (13.9 per cent) and America Latina Logistica (12.2 per cent). During the 2008–2010 period when BNDES lending accelerated, $16 billion was advanced to the food industry and $30 billion to Petrobas. Together, this amounted to 50 per cent of BNDES lending to the manufacturing sector. To the extent that this reflects the Government's new growth priorities, BNDES as a DFI is clearly an instrument of State capitalist development in Brazil.

VI. The Indian experience

The other country that conducted a remarkable experiment with development banking was India. A distinguishing feature of the experience was the creation of a large number of DFIs, including numerous industrial financing institutions, a number of policy banks and a set of special purpose vehicles to finance investments in sectors like power and shipping. This deviation from the Brazilian path – where the industrial financing function was largely concentrated in the BNDES - was the result of a number of factors. First, a decision to segment financing for large and small industry so that the latter is not deprived of finance. Second, the creation of special institutions to channel funds received from foreign donors. Finally, the creation of policy banks aimed at providing finance to targeted groups, sectors and industries.

The industrial finance infrastructure comprised the Industrial Finance Corporation of India (IFCI), established in 1948, the State Financial Institutions set up under an Act which came into effect in August 1952, the Industrial Credit and Investment Corporation of India (ICICI), the first DFI in the private sector, established in January 1955 with a long-term foreign exchange loan from the World Bank, the Refinance Corporation for Industry (1958) established to channel counterpart funds of the United States Agricultural Trade Development and Assistance Act of 1954 (Public Law 480) earmarked for lending to the private sector, and the Industrial Development Bank of India (IDBI) established in 1964 as an apex DB. Thus, by the end of the 1980s, the industrial development banking infrastructure in India comprised three all-India DBs (IFCI, ICICI and IDBI) and 18 State Financial Corporations (SFC). In 1990, the Government established the Small Industries Development Bank of India (SIDBI) as an all-India financial institution for the financing of micro, small and medium enterprises.

Despite this elaborate infrastructure, disbursements by all financial institutions (including "investment institutions" such as the Life Insurance Corporation, Unit Trust of India and General Insurance Corporation) amounted to just 2.2 per cent of gross capital formation by the financial year 1970/71. With a view to supporting various term-financing institutions, the Reserve Bank of India (RBI) set up the National Industrial Credit (Long-Term Operations) Fund from 1964/65. The post-1972 period witnessed a phenomenal rise in financial assistance provided by these institutions (including investment institutions), and the assistance disbursed by them rose to 10.3 per cent of gross capital formation in 1990/91 and 15.2 per cent in 1993/94. Given the nature of and the role envisaged for the DFIs, the Government and the RBI had an important role in providing them resources. In addition, public banks and the Life Insurance Corporation and General Insurance Corporation also played a role (Kumar, 2013).

However, with the balance of payments crisis of 1991 triggering a major financial liberalization effort, a decline in development banking followed. Domestic and foreign private institutions that were now given greater scope objected to the provision of concessional finance to the DFIs as a source of unfair competition, which kept them out of areas that they were now looking to enter. The resulting pressure to create a "level playing field", to which the Government succumbed as reflected in the Narasimham Committee reports of the 1990s (especially Narasimham, 1998), triggered a process through which the leading DFIs were transformed into commercial banks, starting with the ICICI in 2002 and the IDBI in 2004. By 2011/12, assistance disbursed by the DFIs amounted to just 3.2 per cent of gross capital formation (Kumar, 2013).[3] By 2012, there were only two all-India development banking institutions: the National Bank for Agricultural and Rural Development (established in 1982) and the Small Industries Development Bank of India. Only these two policy banks have expanded their operations substantially in recent years.

VII. Comparing two experiences

An interesting feature of the experiences of Brazil and India discussed above is the trajectory that development banking took in the years after these two countries opted for internal and external liberalization during the period of globalization. In Brazil, reform notwithstanding, the BNDES has grown in strength, as noted above, which has served Brazil well. The bank's role significantly increased when private activity slackened in the aftermath of the financial crisis. This countercyclical role helped Brazil to face the crisis much better than many other developing countries. The BNDES had stepped in to keep business credit going when private sector loans dried up in 2008 (Bevins, 2010).

On the other hand, liberalization led to a decline in development banking and the demise of the major DFIs in India. In 1993, the IFCI Act was amended to convert the IFCI – established as a statutory corporation – into a public limited company. The stated intention was to do away with the institution's dependence on funding from the central bank and the Government, requiring it to access capital from the open market. Since this would involve borrowing at market rates, the role played by the IFCI has been substantially transformed. In the case of the ICICI, which was allowed to set up a banking subsidiary in 1994, the parent ICICI was integrated with ICICI Bank (its recently established subsidiary) through a

reverse merger in 2002, to create what was essentially a pure commercial bank. Similar moves were undertaken to transform the IDBI. In 2003, the IDBI Act was repealed and a company in the name of IDBI Ltd was established, which in turn set up IDBI Bank as a subsidiary. Subsequently, IDBI was merged with IDBI Bank, marking the end of industrial development banking in India.

The absence of these specialized institutions is bound to limit access to long-term capital for the manufacturing sector. One result is that the Government has had to use the publicly-owned commercial banks as a means of financing infrastructural investment. The share of infrastructure in lending to industry by scheduled commercial banks in India has risen from less than 5 per cent in 1998 to 32 per cent in 2012, when aggregate credit provided by scheduled commercial banks rose from 21 to 56 per cent of GDP, with the share of advances to industry falling from around 50 to 40 per cent. Absolute lending to industry and thus infrastructure was extremely high. Given the reliance of banks on shorter maturity deposits that are extremely liquid, this exposure to infrastructure implied large maturity and liquidity mismatches. Unsurprisingly, defaults have been on the rise and non-performing assets have shot up, leading to balance sheet fragility.

As the Brazilian trajectory shows, this was not the inevitable direction that policy and outcomes had to take, even under liberalization.

VIII. The Republic of Korea: The State and development finance

Brazil and India are similar in the sense that they both pursued industrialization strategies in which the principal source of demand was the domestic market. This raises the question of whether developing market economies that pursue export-oriented or export-led industrialization strategies also rely on development banking. A useful case to consider here is the Republic of Korea. Among the factors responsible for the Republic of Korea's success – with its mercantilist, outward-oriented industrialization strategy of growth based upon rapid acquisition of larger shares in segments of the world market for manufactures – was the role of the State in guiding industry to the segments of the global market that were dynamic. For this to work, the State must through its financial policies ensure an adequate flow of credit at favourable interest rates to firms investing in these sectors, so that they can not only make investments in frontline technologies and internationally competitive scales of production, but also have the means to sustain themselves during the long period when they acquire and expand market share. These financial policies would include interest rate differentials and favoured financing of private investment. Indeed, development banking was an important component of this process.

As Cole and Park (1983) note, at the end of the Second World War when the South part of Korea was first occupied by the United States and then just after the Government of Korea was elected, "[the Republic of] Korea had the shell of a modern financial system" (Cole and Park, 1983: 48). In the words of Bloomfield and Jensen (as quoted by Cole and Park), who were sent in 1950 from the United States Federal Reserve to help Korean officials reform the Korean financial system: "All the existing banking institutions are engaged predominantly in a regular commercial banking business consisting essentially of accepting demand deposits and of making short-term loans and advances to primary producers, to businessmen and to Government Agencies." (Cole and Park, 1983: 49) Thus, in the case of the Republic of Korea, there was also a major gap to be filled with respect to long-term financing.

Therefore, the Government decided to set up the Korea Development Bank (KDB) in 1954, with the primary objective of granting medium- and long-term loans to industry. Wholly owned by the Government and built on the assets and facilities of the Industrial Bank, the KDB came to account for over 40 per cent of total bank lending by the end of 1955. At one point, it accounted for 70 per cent of the equipment loans and 10 per cent of working capital loans made by all financial institutions (Sakong and Koh, 2010). These loans were not based upon deposits — about a third of the loans were supported by aid counterpart funds and two-thirds with financing from the Bank of Korea and the Government. In the 1950s, 50 per cent of the funds came from the Government fiscal loans programme and another 30 per cent raised by

issuing bonds. Development banking had become an important instrument of policy.

Third, the KDB's charter was revised to allow it to borrow funds from abroad and guarantee foreign borrowing by Korean enterprises. In fact, an interesting feature of industrial finance in the Republic of Korea was the guarantee system, largely created to privilege borrowing abroad over attracting foreign investment, to keep Japanese capital at bay. Firms wishing to borrow from abroad obtained approval from the Economic Planning Board, which was ratified by the National Assembly. Once that was achieved, the Bank of Korea (BOK) (or later the Korea Exchange Bank) issued a guarantee to the foreign lender and the KDB issued one to the Bank of Korea. Therefore, while the borrower was committed to repaying the loan and carrying the exchange risk, that commitment was underwritten by the KDB and BOK, which by guaranteeing against default were ensuring access to foreign borrowing. Between 1960 and 1978, foreign loan guarantees by the KDB rose from 0.2 billion won to 3,898.3 billion won.

Besides the KDB, the other DFIs established in the Republic of Korea included the National Investment Fund, the Korea Development Finance Corporation and the Export-Import Bank of Korea. The Korea Development Finance Corporation, established in 1967 with support from the World Bank, was mandated "to assist in the development and creation of private enterprises by providing medium and long-term financing and equity participation, as well as technical and managerial consulting services" (quoted in Cole and Park, 1983: 73). It took on the underwriting of equity shares and debentures as a major activity.

With the launch of the Heavy and Chemical Industries strategy, the National Investment Fund (NIF) was set up in 1974 to direct savings to these industries. The NIF mobilized its resources through the sale of bonds, obtaining loans from the deposit money banks and other savings and investment institutions and transfers from the Government's budget. The role of the State was visible in the fact that the deposit money banks were required to provide the NIF with 15 per cent of their incremental deposits and non-life insurance companies as much as 50 per cent of their insurance premiums and other receipts (Cole and Park, 1983: 77). While the Ministry of Finance was responsible for administering the NIF, its management was entrusted to the BOK. The NIFs lending often included an implicit subsidy reflected in lending rates lower than deposit or borrowing rates, although these were covered with funds from the Government.

Clearly then, the Republic of Korea was also a late industrializer in which development finance (supported by the State through the budget and the central bank) played an extremely important role and contributed in no small measure to the success of its late industrialization. However, the DB's role here included support for borrowing from abroad to acquire foreign technology, which was subsequently leveraged to launch a successful export-oriented strategy.

IX. China: A different trajectory

Among the DBs that are spoken of today, one that receives special attention due to its large size and asset base as well as its growing global presence is the China Development Bank (CDB). Development banking came late to China, and was the product of two trends. The first was China's economic reform that created an environment in which firms and agents large and small had to find resources for investment from sources other than the central Government or the local one. The second was the decision of the party and Government in the Deng Xiao Ping era in the early-1990s to accelerate investment and growth in China.

In the years prior to 1993, it was difficult to separate development banking from "normal" or commercial banking in China. Long-term investments were financed either directly from the State budget or through directing credit to the enterprise sector. In fact, until the 1980s, the only bank of relevance was the People's Bank of China, which subsumed all kinds of financial activities through its head office, branches across the country and subsidiary units such as the Bank of China. In this environment, financial policy in China involved the direct allocation of resources from the Government's budget or the use of directed credit in the form of

mandatory credit quotas for the State-owned banks that mobilized public savings (Xu, 1998).

This system was put to the test when China's Government decided to accelerate growth within the framework of an increasingly liberalized economy in the early-1990s. With the mandate to raise investment and a promise of rewards if they did, provincial leaders went on a spending spree. They were helped by the fact that provincial governments substantially influenced appointments to and the operations of regional bank branches, including branches of the central bank. The result was a borrowing and spending spree, not only to finance infrastructure but also large "prestige projects", which were not revenue earning. The inflationary spiral that followed and the evidence that provincial governments were finding it difficult to service the debts they had accumulated to finance these projects led the central Government to ban borrowing by provincial governments in 1994 (Xu, 1998).

Measures were undertaken to recapitalize the commercial banks and remove non-performing assets from their accounts. Furthermore, asset liability and risk management procedures were introduced and the State-owned commercial banks were required to reduce bad loans over time. They were also issued guidelines to lend against collateral, take account of borrower creditworthiness when lending and limit their exposure to any single borrower to 10 per cent of their capital (Xu, 1998).

The CDB was established as part of this process in 1994. Therefore, unlike in India, it was a product of reform rather than a victim of the same. However, three factors gave CDB a privileged position. First, it was established at a time when banks were being restrained from lending to projects that were either capital-intensive in nature, with long gestation lags, or were in the infrastructural area. This gave CDB a niche that it could seek to occupy, during a time when China was pursuing a high-investment growth strategy. Second, this was the phase of rapid urbanization in China, resulting in huge demands for infrastructure. Third, much of the investment in infrastructure was being undertaken by provincial governments that did not have the tax revenues needed to finance those expenditures and could not borrow to finance the same due to the 1994 ban. To circumvent the ban, they established special local government financing vehicles (LGFVs), which became important clients of CDB (Sanderson and Forsythe, 2013).

CDB mobilized resources by issuing bonds that were subscribed to by banks that saw these instruments as being safe despite yielding higher returns. After a lacklustre initial innings, CDB registered a dramatic expansion of its asset base. That process was accelerated in 2008-2009, when CDB became a leading vehicle to finance the Government's gigantic stimulus package adopted in response to the global financial crisis. By 2011, the assets of CDB were estimated at $991 billion, as compared with $545 billion for the World Bank group,[4] $306 billion for BNDES (2010) and $132 billion for the KDB (Sanderson and Forsythe, 2013).

Four areas accounted for CDB's huge asset base. The first was lending that was part of its original mandate, involving replacing the Government and the commercial banks as lender to the State-owned enterprises. The second was lending to the LGFVs to finance the huge infrastructural investments being undertaken by the provincial governments. According to Sanderson and Forsythe (2013), as much as half of CDB's loan book could comprise lending to local governments, and the bank may account for as much as one-third of all LGFV loans, making it a bigger lender than all of the four commercial banks put together. The third, which has been visible since the last decade, is financing China's "going out" policy or spread abroad, partly as a manufacturing investor in low cost locations in Africa and Latin America but more importantly as an acquirer of mineral and oil resources across the globe. Finally, as a major investor in China's wind, solar and telecommunications companies, with Huawei Technologies being the largest beneficiary.

It is to be expected that many of these projects would not be profit-making, stretching from some infrastructural projects to ventures in the solar and wind area. Nonetheless, CDB is considered an extremely well-managed financial institution with the lowest ratio of non-performing loans among China's lenders (Sanderson and Forsythe, 2013). This must be because the central Government and the provincial ones ensure that there are no defaults on payments to the institution. The role of the State is crucial in ensuring the stability of a system where one gigantic DB stands at the centre of an investment-led growth strategy. The transition away from the era of "planning" to one with a socialist market economy may not mean much in terms of explaining how China is financing its high growth trajectory.

X. Conclusion

Thus, over a significantly long period of time, countries embarking on a process of development within the framework of mixed, capitalist economies have sought to use the developing banking function – embedded in available or specially created institutions – to promote their development goals. The role of these institutions in the development trajectories of late industrializing, developing market economies cannot be overemphasized. They have played a role independent of the kind of industrialization strategies pursued and irrespective of the extent of industrial and financial regulation. Therefore, it is surprising that under financial liberalization India has chosen to do away with specialized development banking institutions on the grounds that equity and bond markets would do the job.

Notes

1 Hilferding (1910) argued that the close relationship between banks and industry allowed capital to assume the form of "finance capital", which was the most abstract form of capital.

2 Eighteen per cent of the institutions that received transfers declared that if transfers were withdrawn, they would not be able to operate.

3 Figures computed from information provided in tables 13 and 83 of Reserve Bank of India (2013).

4 Comprising the International Bank for Reconstruction and Development (IBRD), the International Development Association and the International Finance Corporation.

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