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HOW THE CHINA DEVELOPMENT BANK IS REWRITING THE RULES OF FINANCE:
DEBT, OIL AND INFLUENCE

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P R O C E E D I N G S

MS. DOWNS: I am Rebecca Downs and I am a fellow in the John L. Thornton China Center here at Brookings. Today we're going to discuss a terrific new book about one of the most fascinating institutions in China. The institution is China Development Bank and the book is China's Superbank by Henry Sanderson and Mike Forsythe.

Henry and Mike are both reporters with Bloomberg News in Beijing where they've done some terrific reporting on the business interests of China's elite and both of them were part of the team that wrote a prize-winning series of articles on this topic.

In China's Superbank, Henry and Mike use their investigative journalism skills to lift the veil on China Development Bank. Despite the prominent role that the bank has played in financing China's economic boom and the international expansion of its companies, the bank is often absent from or relegated to a minor role in accounts of China, Inc. But fortunately for those of us who are interested in the inner workings of Chinese state capitalism, Henry and Mike have written a highly readable book that charts China Development Bank's rise at home and abroad.

Copies of the book are available for purchase in the back of the room. Please feel free to get up and buy one during the event. After the event, they'll be available for sale in our bookstore.

I'm now going to yield the floor to the authors. They're each going to speak for about 20 minutes and then we'll have plenty of time for Q&A. However, I would like to note that we do need to end a little bit before four o'clock because there is another group that has this room booked for an event. Thank you.

MR. FORSYTHE: Thank you very much. I'm Mike Forsythe and this is

Henry Sanderson here. Thank you very much, Erica. It was really a lot of Erica's work that inspired us to write this book. She's heavily footnoted. She appears in many, many footnotes and references in our book, especially when we talk about the oil for loans program. And so I think Erica early on realized the importance of China Development Bank to China's entire state capitalist model.

And what we did is we also looked at the bank's role internally in China in driving the local government financing vehicle system in China that is responsible in many ways for some of the robust economic growth that we've seen in China and also its work in other aspects internationally -- funding some of the, you know, companies like Quaway, ZTE and the solar and wind companies. So it's in every -- it's finger is in every pie of China's state capitalist model and our thesis in the book is that this bank -- China Development Bank -- is the most powerful bank in the world. And this is a very educated group here. You're probably scoffing at me right now thinking how can that be. You may think, well, we know Goldman Sachs is really the most powerful bank in the world, isn't it? After all, the political connections of Goldman Sachs, we all know in Washington are -- they run true and deep. It seems like every former Treasury Secretary becomes somebody at Goldman or vice versa. Well, we submit that when it comes to political connections, it's really hard to beat China Development Bank.

Until this week, the bank was led by a person whose political connections I think many people at Goldman would be quite jealous of -- Chen Yuan. We're from Beijing, so it's Chen you are, and that's how he likes to refer to himself among his friends. So, Chen Yuan is a princeling among princelings in China. He's the son of Chen Yun and Chen Yun is one of the architects of China's economy during the Mao era and then during the Deng Xiaoping era in the 1980's, arguably the second-most powerful person and one of the chief architects of the economic reform era early on -- a very

powerful man and Chen Yuan is the son. And as we discovered reporting the book, I would say a very filial son as we might -- we can actually maybe discuss in Q&A.

These are political connections that are just really sterling. So we'll check off Goldman Sachs there.

The World Bank. Obviously a policy bank, you know, bar none except for China Development Bank which has a loan book far larger than the World Banks now. And it's a global bank. China Development Bank is all over the world. In Venezuela. In Africa. In Central Asia, Russia and often the size of its projects are much, much larger than the World Bank's. So we'll cross off the World Bank maybe. This is our thesis.

Let's expand the definition of banks. Let's look at central banks. How about the Fed? Surely the Fed, led by Ben Bernanke, the savior of the world after the global financial crisis, right? I mean, after all it was his philosophy, his deep understanding the Great Depression that led to these insightful policies that helped the world recover from the global economic crisis.

Well, as many of you know, China did -- China's economic growth did also slow a little bit. It did slow down. It did decelerate. There were some concerns. But it bounced back quite quickly, quite tremendously afterwards.

We submit that one of the reasons -- and we're not alone in this -- is because of the system of local finance in China. Governor Ed Rendell of Pennsylvania is often fond of saying that there's a lot of shovel-ready projects out there in Pennsylvania and that's how we're going to stimulate the economy. Well, China had \$25 trillion or renminbi worth of shovel-ready projects and many of those shovels actually hit the ground.

This system as we discovered in research was actually invented in 1998 by China Development Bank and spread because of China Development Bank across

the country. And often it was the bank that was creating these local government financing vehicles in places from Yunan to Chung Ching to Tianjin. There's obviously a lot of problems with that system. We'll talk about that as well.

So for all these reasons, we consider, you know, and it is our thesis that - - forget about the other banks. This bank is probably the world's most powerful, most influential bank and Henry is going start getting into some of the details.

MR. SANDERSON: Thank you, Mike. So during this research, obviously we found out policy banks are nothing new. Development banks are nothing new either. But the sheer scale of CDB -- the fact that it's 100 percent state owned and that it's got its fingers in almost every single pie in China -- including private equity, leasing, securities, underwriting -- makes it quite a different animal. And this is just to show you some of the figures.

Mike talked about local governments, what we call LGFEs, these financing vehicles. CDB is, you know, one of the -- is the biggest lender to these guys. Twenty-six percent of all LGFE loans. And we looked at solar, wind and telecom, you know, really some of China's best companies -- Quaway, ZTE. CDB has also lent billions of dollars. And Venezuela -- we devoted a whole chapter to that because the scale is just off the charts. You know they've lent over \$40 billion to Venezuela -- a country with a huge history of default. And the China-Africa Development Fund, which is pretty much the only Chinese private equity fund investing in Africa and despite their attempts to get foreign investors, actually CDB most of the money comes from China Development Bank.

So for all these reasons, we thought this bank was a lens to look at China's state capitalism -- the model -- especially in the light of the financial crisis, what kind of model this is and what we can learn from it.

This is one thing I learned pretty quickly. Local governments in China --

interesting topics. I went three times to this town Loudi in Hunan. We found this stadium just going through bond prospectuses. We went through almost every local government bond that was issued in China and just in minutiae these prospectuses we found one local government was trying to get money for a stadium. This is it. It was a colossal project -- gymnasium, swimming center. And this land that the stadium is on was rural land and then became urban land and a group of farmers were kicked off the land -- moved into shanty towns to make way for this stadium. And this system that CDB invented -- a sort of virtuous circle. Once the stadium is built, the property people told me that all the new apartments around the stadium have gone up in price. Therefore the land has gone up in price. They paid the people who got kicked off the land relatively little -- certainly not market prices.

So this is how -- this is one guy interviewed a few times. He, you know, his whole family history is farmers and for the first time he's now joining the urban economy. He is living in a shanty town and building his own house.

So this is really the whole system of how local governments raise money through selling land and, you know, urbanization, which I would just Chen Yuan, when he came to the bank, urbanization was his fundamental sort of view of how China's economy was going to develop and he has really been pushing it a lot.

So I just -- we -- as I said, we went through lots of prospectuses and, you know, going to these towns is great for anecdotes, but we also came up with a lot of data about local lending as well.

MR. FORSYTHE: We'll just breeze through this really quickly. We won't spend too long. I just wanted to give you kind of an idea. There is a lot of misconceptions about China. People say, well, China's just not a transparent place. It's really hard to get any data there. True. China is also a very transparent place and in

some cases you can get an incredible amount of data if you know where to look. That's also true.

And so one of the places we looked is in bond prospectuses. This is just an example. This is the most indebted local government financing vehicle in China. It's in Tianjin. It's in the Tianjin-Binhigh area is where it does most of its work. If you saw 60 Minutes a few weeks ago, I think Lesley Stahl went there with N. Stevenson Young and they went to the same place we went.

This is a -- this is just an idea of all the debt that has been racked up and you see that the top column is China Development Bank. It's the biggest lender -- line of credit it's given is 74 billion renminbi, so over \$10 billion to this one local government financing vehicle. And keep in mind, there's well over six thousand of these entities in China. This is the largest.

You don't get this kind of data unless they sell a bond. When a local government financing vehicle sells a bond, the magic of disclosure happens. Maybe not the best disclosure, maybe not the most accurate information, but at least it's information. And all the other banks -- almost all of them. It's the A-list of Chinese banks and some B- and C-listers down there. And some trust companies as well are lenders to the local government financing vehicle.

We kind of liken it to the pied piper. If you go through enough of these yourselves -- and we don't have research assistants. We do this all ourselves. When you -- but you have to do that or else you don't see the patterns, right? You have to do it. You can't -- you can't, you know -- you can't let somebody else do it for you. You see throughout these prospectuses the fact that China Development Bank -- they all think China Development Bank, and in many cases it's CDB itself that went in -- and that's the case in Tianjin -- to set up this whole system of local finance. They are the ones who

created it.

And when they come in it's like the pied piper. They lead everybody else in as well and this is the result -- \$317 billion of lines of credit. This is what's left. So this is -- they've spent most of it. They've got some of it left. This is a little backward looking. It's in 2011. We only get new information when they sell a new bond. But, anyway, I've probably talked a little bit too much about that.

This is what they're building with it. If you -- again, if you saw Lesley Stahl -- I think it was Lesley Stahl -- then you'll see. She went there as well. We went there two years ago. This is Eastern Tianjin. This used to be the city of Tongul. And if you're into Chinese history, the Ching Forts, the Dagu Forts are over here. This is Tongul. This is where the troops came up -- the British and French troops in 1860 on their way to Beijing to destroy the summer palace.

And this is Manhattan as you can easily see. East River. Hoboken is over there. Hoboken is SOE-ville basically now. All these buildings over in Hoboken are built by one SOE after another. They all appeared to be empty when I was there and certainly when 60 Minutes was there years later. And I asked a woman who was showing us around there, well, are there any private companies doing anything here? She pointed to a hotel.

What does CDB have to do with this? Again, they created this entire structure that created this ability to finance something like this.

Well, this is a financial center, right? This is a -- in fact, Rockefeller Foundation, Lincoln Center, they're all cooperating to make this into a Manhattan. One would think that you're going to get some big financial anchor tenants in here to buttress this. You know, maybe a Goldman Sachs or at least an ICBC -- one of those big Chinese commercial banks. Let me roll off this name for you. You'll be impressed. Anchor tenant

Tianjin Rural Commercial Bank -- a household name. We all grew up with it, right?

So, anyway, you know, one of the problems of being a journalist in China is obviously we're wrong a lot. We have written stories about how we see all these empty buildings. We say this is a disaster. This is going to collapse and then the buildings fill up with tenants. This is a humbling thing about China.

I've written that story about Beijing office space. I was wrong. People in 1996 wrote that about Pudong in Shanghai. It's going to be a disaster. It's not going to work. They were wrong. People like me are writing about -- we're writing about the railway. Saying they're spending all this money. They're not going to possibly be able to make this a success. We went on the train to Shanghai the other day. It was packed with people. It was magnificent. I was on the Amtrak yesterday coming from New York and I was quite embarrassed frankly to be an American.

So -- so maybe it will work out. Rockefeller Center.

I'll hand it over to you now, Henry. You want to keep talking. We're going to kind of shift away from the domestic part and go to more of the international part, which I think a lot of people are interested in.

MR. SANDERSON: So just as part of this book, we spent a long time sort of researching Chen Yuan, the person -- a lot of stuff that he wrote before he took over the bank and then the early days of the bank. And one of the things that he wanted when he first joined the bank was two things really. One was he would serve the government -- the strategic aims of the government. And number two was they wouldn't make a loss. They wouldn't, you know, have huge amount of losses. So they'd make a profit and also serve the government. And when China -- you know, after China joined the WTO, facing a lot of competition. And anyway, after that, they wanted their companies to go overseas to become global companies. And this go global policy was

something that China Development Bank was one of the first banks to really back this policy. And it's now the Chinese bank with the largest amount of foreign loans -- overseas loans. Some 250 billion foreign currency loans.

So we looked at Africa and Venezuela, but they also -- we didn't get time to look too much. Central Asia, Eastern Europe -- they just did a deal for a power station in Bosnia. They really are lending almost everywhere you can think of. And the Africa chapter -- I went to Ethiopia and we interviewed the head of the China-Africa Development Fund in Beijing. And this fund is very interesting in that it's, you know, nationally a private equity fund. And when we went to interview the head of the fund we brought with us a top Bloomberg editor. One of his first questions was: are you making any money? And the guy said, no, we're not actually. And the Bloomberg editor said well, what's the proposition for investors? You know, what's the -- what's the attraction? And the head of the fund said oh, well, it's a long term -- we think much more long term than you guys. And actually he admitted they found it much more difficult in Africa than they first thought.

So Ethiopia was interesting to see -- see these difficulties first hand actually that I could see. And the theory behind this, which is a theory that Justin Lin, who is at the World Bank now back in Badar. I actually saw him at the Boao Forum and he said the same thing. He said African countries have a unique chance to develop manufacturing as labor costs rise in China. Some of these companies can shift to Africa where there's great raw materials. And Evron in Ethiopia told me how great the leather is. So this is the idea behind this and the CADF -- the China Africa Fund -- has invested in a leather factory there and also is currently investing in a shoe factory.

So this is one of the factories I went to in the Eastern Industry Zone. I'm sure (inaudible). You can see it's a very Chinese style factory. These banners you'll see

most places in China. Every morning they gather outside to sing Chinese songs. And one end of the factory were boxes of these shoes destined for Europe and the U.S. And the motivation -- the morale there seemed high and the idea behind this seems very good. Until I actually -- just talking to more people -- there was so many problems that they talked about. If you think about Ethiopia as land locked, the road -- Djibouti I think is the nearest port and not very good infrastructure to get stuff out of the country.

And interestingly another project -- a glass factory that the fund had invested in was actually -- wasn't working when I was there. It stopped production because they found exporting glass in Africa wasn't as easy as they thought.

This is the raw leather factory on the outskirts of Addis Ababa. And one thing -- one thing the Chinese complained to me a lot about was some of the government policies weren't perhaps as attractive as they would be in China where local governments move heaven and earth to attract foreign investment. They complained there were limits on Chinese staff -- the number of Chinese managers they could bring in. Also limits -- difficulties importing raw materials they needed. And also quite strict labor laws they talked about. They couldn't work the staff as hard as they wanted to.

And another example we looked at was Ghana just mainly because we found during this book there was very little transparency from the bank about its international loans and Ghana was one case where there's a lot of transparency because -- well, it's a democracy and the vice president -- prime minister who is now prime minister -- came out to Beijing and gave a press conference after having lunch with Chen Yuan and was willing to answer lots of things about this big loan the bank has agreed to extend to Ghana -- \$3 billion, which is the largest loan in the country's history. And it's really caused a lot of debate in Ghana because, as you can see from this graph, you know, Ghana got into quite a bit of debt before and went through a series of debt

forgiveness and debt restructurings before China came along. And at the same time oil was discovered off shore.

So we really think this loan poses a lot of interesting questions about what China can do different from the past. Oil, obviously, in Africa hasn't been that successful in Nigeria and Angola. So their debt levels have gone back up. And amazingly six -- the contract for this loan stipulates 60 percent has to go to Chinese companies which is incredible amount of money. And this is all sorts of projects -- including projects like a gas project by Sinopec so they can sell the gas from the oil fields. And in this way, the way the Chinese see it is that these projects will help the country pay back its loan.

And Venezuela is also similar oil for loan structure.

MR. FORSYTHE: Yeah. We looked at Venezuela in particular just because of the sheer size of the lending that's gone on there. And Erica has done, you know, did all the pioneering research on this and is far more knowledgeable than us, so I'll be very careful what I say.

So you'll both -- you recognize the person on the left -- the late president of the country, Hugo Chavez, and then the man on the right is Chen Yuan, who is in the process of leaving CDB. As far as we know, his replacement has been named. I think the Bank of Communications Chairman is on his way there -- Hu Huaihang. So there is a lot of transition there. A very close relationship -- over four years, 40 billion in loans made by CDB to Venezuela. Most of that's in dollars, but about 70 billion renminbi, I think, in renminbi loans. So a little over \$10 billion of that in renminbi loans.

This is for the oil for loans program, which again I think in Q&A maybe Erica can talk a little bit more about. But the idea being is there is a way to secure oil deliveries to China and this goes around the world. It's in Russia. It's in countries in

Africa. In Central Asia as well and involves gas.

Now one thing I have to say is this was a very difficult book to report and Erica had the same, I think, comparing some of the similar problems -- actually talking to people at CDB. We have one advantage in that we're reporters. We often go to events in Beijing and if there was a CDB person there, we would just kind of try to get them as they were leaving or maybe, you know, coming back from the restroom or something. And we did get a few people this way.

Chen Yuan never did -- we never did an interview with him. Some of the higher officials in the bank -- Gao Tien -- never got a chance to. They were often very nice and polite to us, but declined to talk to us.

This guy was different. He talked to us. I captured him one year going out from a restroom at the National People's Congress and then the next year trying to do it again, he finally relented and gave an interview. His name is Liu Kegu. He's retired now, but he was a vice governor of the bank and he was really the point man for CDB in Latin America. Hugo Chavez -- the late Hugo Chavez called him his brother. So he would bring, you know, groups of officials -- Chinese officials, CDB officials -- over to Venezuela to meet with all the ministers there. An amazing guy.

Now one of the things we really wanted to focus on in the book is the political risk involved. He didn't want to talk about politics with us, although he had a lot of nice things to say about Chavez. And we kept asking what about the political risk to these loans in Venezuela? Now, I mean, we know that they're being paid back through oil shipments. We know that. But, you know, what if there's a political instability in the country? You know, what's going to happen? Well, this is his philosophy. Oil is very simple to drill. You drill a hole. You put in a pipe and it comes out and then you ship it. So Venezuela's debt serviceability is very strong.

You laugh. So far it's working. So far, so good. But, as we all know, there's been a lot of political turmoil and instability in Venezuela as of late. The country has two centuries of defaulting and disappointing and heartbreaks for international investors. So the question is -- and the currency was devalued in February. It certainly is no darling of rating agencies. So, you know, the question for the bank is is it exposing itself to risk and is it appropriately shielding itself from the risk in Venezuela?

One thing we did look at that I think has been done by other scholars, you know, I think Kevin Gallagher as well, but I think we actually -- we kind of advanced it a little bit -- is taking a look at the whole system of lending to Venezuela. So, look beyond the oil for loans and what kinds of contracts are Chinese companies winning in Venezuela? So there is a very common expression in China, you know, that you hear ad nauseum. This is a win-win situation (inaudible). But, in this case it's true. China wins twice. So China gets oil -- or at least Chinese state oil companies take delivery of oil -- and then the Chinese SOEs for the most part, which are major CDB clients, get contracts. And so I tallied up -- we tallied up \$11.6 billion in contracts that Chinese firms won. And there are some stipulations as well on, you know, mandatory or, you know, compelling the Venezuelans to buy Chinese products or get Chinese services -- you know, get contracts for Chinese companies.

So that's just what we counted up. There's probably a lot more out there. But the fact is that you can find this material. It is -- you know, Chinese state-owned enterprises are corporatized. That means that they issue annual reports. These are actual public documents. You can find them. If they sell a bond, there's even more disclosure. So just an example -- Socidic, you know, the granddaddy of all SOEs, is in Venezuela -- is doing quite a few projects there. One of the projects they're doing and you can just get the information in Chinese -- they're building 20,000 housing units and

it's won the praise of Hugo Chavez as well.

So, you know, we just -- you keep looking through these documents and you can actually start piecing together the amount of Chinese contracts. It's really just a key word search on these documents.

And so it wouldn't be a PowerPoint presentation without one of these fancy graphics here. All it just illustrates is the fact that Chinese SOEs are getting contracts and China is getting oil. And one of the things we discovered -- and this is something Erica was really investigating in her piece that she wrote for Brookings is, you know, is the -- is the oil really getting to China? And we were really lucky -- before publication last year, when Chen Yuen discovered we were really going to write this book and really going to publish it, he did send a couple of emissaries to us. And in the course of a conversation, which was a fascinating one, they did admit that, yes, indeed, a lot of the oil actually never makes it to China. Because like really? Are you really going to send it all across the Pacific Ocean? I mean that's really expensive. You burn half the oil getting there. So it's also very heavy oil. Most refineries to take care of this -- to refine this kind of oil are in the United States. And so why ship it all the way over to China. There's a huge disparity in Venezuelan export figures to China and Chinese import figures of Venezuelan oil. They said, quite frankly, yes, it's being sold elsewhere. It's not going to China. So that was I thought something we could contribute to the general scholarship. It's all a system -- if you want to talk a little bit about that.

MR. SANDERSON: Sure. We wanted one company to sort of sum up what this bank is about and how it's different from western banks. And this company, Chery Auto, sort of did that for us. In a sense, this company exhibits all the sort of support the CDB can give a Chinese company. Of course, their products have actually got to be good, but look at this company. It's a product of a local government ownership

in China. An LGFE owns stakes in this company. It's also first received loans and lines of credit from CDB -- not a small amount either. And then it's moved into Africa with the help of China-Africa Development Fund. And also it's moved into Venezuela. Chavez actually was pretty keen on Chery -- had his own nicknames for these cars. So you can see that this one company has expanded in areas where the bank can help.

And we also looked at Quaway and ZTE. This is one quote that stuck out at us from the USXM bank, which, of course, is a complete minnow compared to CDB. He said the one thing that kept him up at night was China Development Bank. Why did he say this? Well, if you look at the figures -- lines of credit and loans to ZTE and Quaway have been pretty huge. And this graph actually comes from a book written for CDB about case studies by the bank. And Chen Yuan met the head of Quaway. I think it was 2004, 2005. They signed the first line of credit. And then after that you could see their overseas sales just shot up pretty dramatically. So I think you can make the case that this line of credit had a pretty big impact on this company's success.

We worked with some of our overseas bureaus to interview some of these companies in the developing world. And, you know, they told that these lines of credit did make a big difference and they were just too attractive to resist.

Chen Yuan also interestingly hasn't been shy about saying that this bank is the cause or one of the reasons for these company's success. This is an essay he wrote in China Reform Magazine.

Yeah, just to say, this bank, he says, is a principle source of finance for overseas investments. So this really builds the case that we're trying to make that this bank is the power behind China's overseas investment.

I'll just talk briefly about Solo. As interestingly, you know, also financial crisis -- both simultaneously, China and the U.S. wanted a renewable energy industry

and one of the jobs that would come from that industry. And in 2010, CDB lent almost every single company in China renewable energy -- wind and solar. And we're lucky to have this Bloomberg New Energy Finance that tracks these figures and they get a total of 68.8 billion lines of credit since 2010. You know, if you compare the Solyndra guarantee in the U.S. was just a couple of million dollars. So it's really on a different scale.

This one graph we use just to sum up how China's financial system works. This is -- this really says a lot about how little sense of risk there is in China's financial system. You can see that this top graph is a bond of a German solar company - Solar World. So you can see late 2011, people started getting worried about this industry. People started dumping their bond. The yield went right up to over 40 percent. At the same time, you can see these Chinese companies who sold bonds in China. The yield barely budges at all. So that means these Chinese companies effectively could borrow again at this rate. They also are getting this money, you know, from the bond market. So this sums up how little sense of risk there is in China's system. It's a closed system. The bond market in China doesn't suffer from crises of confidence that the other markets have. It doesn't have hedge funds dumping debt the whole time.

Again, Mike was saying how much detail you can find in these prospectuses. We found a lot. You can find loans for Yingli, 1.34 billion. It's all there. It's all disclosed. It's not a secret.

Do you want to say more about it?

MR. FORSYTHE: Yeah. I mean I would say in this one, you know, if you're looking at Yingli -- so Yingli Solar is one of the largest solar companies in China. It's listed on the New York Stock Exchange. Its stock price has been hammered in the last couple of years -- just like the international ones. And yet it can still borrow at that low rate and its bond prices aren't fluctuating.

This is actually not the listed ARM, but this is the group. This is the Chinese company that owns the listed company in New York. And so you can just see how the lending is documented year after year. This is U.S. dollars in units of hundreds of millions of dollars.

So there's just a lot of information out there that, you know, some people may not think is available. It is. It's just -- you just have to look through all these documents.

Another bond prospectus -- and again there's China Development Bank right there. You know, one thing you may be thinking is we're talking about lines of credit, lines of credit, lines of credit. Well, are they all used up? You know, you can have a line of credit, but if you don't use it is it really lending? In this case, this is CDB; you say there's nothing left. It's been all used. You know, most of the other banks that are on here, there's still some of some that hasn't been used up. But this eight year loan and the maturity on the CDB loan is much longer than -- or the lending on the CDB money -- the bank lending is much longer.

So this is information about bank lending that's in a bond prospectus. So it's not just bond information you find in there. It's actually the lending information. And sometimes these prospectuses are incredibly detailed and list, you know, for very specific loans on very specific dates the exact maturities, the interest rate. So you can get a lot of information about bank lending that the -- China's biggest banks are making -- not just CDB -- to these -- to Chinese companies and to local government financing vehicles whatever in these prospectuses. So I think it's a lot of interesting information.

I think we'll sum things up here. Do you want to wrap it up?

MR. SANDERSON: Sure. You know, a lot of people asked us in our talks in China how Chinese people got value for their money and this is kind of critical

question. We didn't talk too much about how CDB gets its money, but it sells -- you know, almost every week, it's selling maybe 20 trillion of yarn in bonds, or billions of yarn in bonds, which commercial banks buy. Commercial banks own 80 percent of these bonds and essentially this money comes from Chinese depositors in the end of the day. So you've really got to ask: what's CDB done for this money that it's getting it relatively cheap costs.

We, you know, we came to the conclusion that, you know, the LGFE model has helped promote GDP in China. It's also created a lot of useful infrastructure. Oil for loans has helped secure oil for China. And CDB has also promoted these great companies -- Quaway and ZTE.

On the minus side, interestingly a lot of risk factors we pointed out have actually come to the fore since we published this book -- such as Venezuela. The solar companies -- LDK just defaulted the other day. It's a Chinese solar company. And Suntec also defaulted. So you -- for the renewable energy, you've got to ask maybe the model is too good, too successful for its own good.

And also trade partners. You know, if there's backlash to a lot of this lending, is that actually really a good model if it creates tension with trade partners? That's something also to look into.

And local government debt. I'm amazed. We still go to conferences in China. Still such a hot topic -- local government debt. It hasn't gone away. People are still really worried about what's going to happen with this debt. I was at the Boao Forum and our previous finance minister said, oh, yeah, I estimate local government debt is now 20 trillion nuan and his official estimate is 10.7 trillion nuan.

So, you know, the one thing is they don't know how much is out there and they seem to be thinking, you know, an extra trillion here and there is no big deal.

That is a huge problem for this bank being the biggest lender to local governments. So all these risk factors make this book a very hot topic.

Thanks very much.

MS. DOWNS: Well, thank you, Henry and Mike, for a great presentation.

Before I open up the floor to questions, I have one I'd like to ask myself and this is going to require peering into your crystal balls.

As you mention in your book, you can't really understand China Development Bank without understanding Chen Yuan because his fingerprints are all over the institution and he really singlehandedly made the bank what it is today. As you mentioned in the beginning of your talk, he's stepping down reportedly to spearhead China's efforts to work on the BRICS Development Bank. And so my question is what impact is Chen Yuan's departure from CDB likely to have on the bank and its operations?

MR. SANDERSON: Yeah, I'll just say, yeah, in the book, we did find that this institution is a real child of Chen Yuan. At the beginning, when he took over, had 40 percent nonperforming loans. His -- I think his political clout allowed the bank to reduce those nonperforming loans and become a more professional institution. But because he's been there so long, I feel like the challenge for this bank is to have a sustainable culture, you know, integrity beyond him. And talking to a lot of international lawyers that we did in Beijing that deal with the bank the whole time, they always complained about oh, we had to wait for Chen Yuan to sign off on a document. So it's still pretty hierarchical under him. And I think the challenge is Hu Huaibang, right? He doesn't have the political connections that Chen Yuan has. But does the bank have a self-sustaining culture of professionalism to continue? I think that's the big question.

MR. FORSYTHE: And maybe Mr. Hu does and we just don't know. But he certainly doesn't have the pedigree of Chen Yuan. That we know for sure. And I think

one way you can look -- one place to look, you know, and metrically you can look at whether that political influence survives or whether the impact of his departure is -- so CDB -- it exists because -- it doesn't have depositors. You can't put your money really in the CDB bank -- unless you're an oil company. But if you're -- a depositor doesn't put money in the CDB. They buy bonds. As Henry said, they're bond financed. And so those bonds are -- they have a zero risk weighting. In other words, banks don't have to set aside capital when they buy these bonds. They're basically sovereign debt. It's -- and there has been a push for years to change that. And every year it seems CDB gets a waiver. It's extended another year, another year because the bank technically is a commercial bank. I think more in name only, you know, commercial bank. It's a policy bank. But one of the hallmarks of it being a commercial bank is to lose that risk -- there is zero risk weighting. If it does that, that means CDB is going to have to pay more to borrow money. And that means whatever profit margin it has is going to be squeezed even further and since it's such a small profit margin, it's conceivable that that's going to become a loss now and it will be a money losing bank.

So that's something to look for. If it's able to extend that, ad infinitum, you know, on and on and on -- well, maybe -- maybe Chen's departure, you know, isn't as big of an impact as one would think. But it certainly -- you know, he is the bank.

MS. DOWNS: Thank you. I'm now going to open up the floor. And if you could identify yourself by name and institution before answering your question, that would be great. I'll start up here with Deborah.

MR. BRAUTIGAM: Hi. I'm Deborah Brautigam from Johns Hopkins University SAIS, our neighbor here at Brookings. Great book, you guys. I recommend it highly to everybody. You did a wonderful job.

A few quick points. It really seems as though the CDB is -- one of its

roles as an export credit agency, and as an export credit agency -- export credit agencies always finance their own companies to do things and their own companies to provide services. So why should this be very controversial if, you know, 60, 70 percent -- that's actually quite good, you know, if you get to use 40 or 30 percent of the loan for something else.

Second point -- you mention that you have some tension I think in your model, which is that these loans or these lines of credit are a way to secure oil deliveries to China. That's one thing you said. And then you also pointed out later on that the oil doesn't necessarily go to China. So I'm seeing in Africa that these loans are secured by cocoa beans, sesame seeds and it's not, you know, a desperate search for these things. So is it more the security or is more the -- I mean is it more the security for the loan or is it more the resource security that's operating here?

Quick point on loans versus lines of credit. We're seeing lots of lines of credit, I would say. To call them loans, most of the ones I'm seeing, they have to actually become a loan in order to become a debt. And so when they're just out there as a framework agreement, it's not really a loan. It's a potential loan. So there's a difference there between what the debt situation is for these countries.

And then finally, is CDB the most powerful bank? What is power? And what about influence? And I would say the World Bank still has a lot of influence and they can leverage a lot of other money through their ideas. I don't see CDB coming out there with ideas. We saw one example in Venezuela of some policy advice coming in. But other than that, where are the ideas? Where is the influence coming? Or is it just raw money?

MR. FORSYTHE: I mean I think certainly raw money -- just to answer the last question -- is one of the hallmarks of CDB. You know, the scale that it can bring

to all sorts of projects from, you know, Venezuela to Russia to wherever is something that you don't see replicated in any other countries. And certainly, you know, from the interviews we did, it does look like, you know -- and I think we were careful -- we need to differentiate between lines of credit and lending and I think we tried to do that there. And, in fact, those documents do that as well.

It's interesting to note though that ZTE has -- looks like they've already gone through their initial \$15 billion line of credit. Now they've got another \$20 billion line of credit. And so it looks like they are being used up and it's certainly in local government areas. And in the one case, the CDB one was the one they used up. So those loans, they are making those loans.

I know there's a lot of questions there, Deborah, but --

MR. SANDERSON: I'll just say about ideas and influence. You know, looking at the BRICS Bank, I think, Chen Yuan was really pushing for that pretty strongly. And I think if you want to talk about international influence, maybe that's one way that they've tried to promote their model right through the BRICS Bank. And if these reports are true that he's going to head the BRICS Bank, then I think you could see his influence behind it pretty strongly.

On other ways, I mean, just doing this book, you know, Brazilian Development Bank was very interested in it. I think they have had impact on other development banks in the sense that they've looked at this model quite closely. So that also, I think, had an impact.

On the export credit agency -- again I agree with Mike. It's more to do with the size. Size and also total state ownership in a one party system with Leninist, you know, structure. And Chen Yuan's pedigree is --

MR. FORSYTHE: Right.

MR. SANDERSON: You know I'm not sure how many export credit agencies operate on that political model.

MR. FORSYTHE: And it would be very interesting to actually look at -- we did look at statistics for Ecuador, Brazil. You saw the same pattern. There was a discrepancy with the Ecuadorian oil export figures and the Chinese import figures from Ecuador. You know, we didn't find any documentation that said that they were -- that oil was actually being sold elsewhere, but it is also geographically far away from China. It would be very interesting to look like in Africa for some of the other commodities to see if that pattern also holds.

Again you have to put a lot of faith in statistics and, you know, and obviously in China, there's lies, there's damn lies, there's statistics, then there's Chinese statistics. So, you know, I don't know, you know, how reliable they are, but there certainly is a discrepancy.

MR. SANDERSON: I would -- just to follow -- on the loan. Was it for oil or was that just collateral? I think since Chavez has died -- a lot of Chinese scholars who study this, they keep saying as long as they export oil, there's no problem. So I do think collateral is a big part of it, especially if the oil is not going to China. But then it's more -- the agreement is more just a right to access the supply, not necessarily the right to immediately buy it at a certain price.

MR. FORSYTHE: And I know, Erica -- if that's -- what did you find though also in your research about that?

MS. DOWNS. I guess I would say that it's not just about oil. I mean I think you can't completely dismiss that in terms of the motivations. But I guess when it comes to Venezuela, my view is actually -- is that the biggest winners are the Chinese construction companies that are getting business there. And in terms of the gap --

PDVSA, the Venezuelan oil company, which is the one that's delivering the oil to China Oil, in their -- in some of their annual financial publications, they do -- they do have tables that show one sort of how much oil they've been delivering to China Oil on an annual basis to secure these loans. And they also have another table that shows how much they export to China. And there is a bit of a gap. So not everything is going to China, as Mike said. And China Oil, the company that takes, delivers actually, you know, a trader of oil in the Americas. So I wouldn't be surprised -- I'm not surprised to see that there is that gap because some of that probably is being sold locally.

The gentlemen here in the tan jacket.

MR. WOOD. I'm Barry Wood. I write for Moneyweb in Johannesburg and RTHK in Hong Kong. I was in Durbin for the BRICS Summit, where President "G" was very much the star and his visits to Tanzania and Congo, as well as South Africa. What do you think China has in mind for the BRICS Bank? They can't simply foist a Chinese model on Brazilians and Russians and Indians, I wouldn't think. And do you think some of the tensions about working out the ownership structure is the reason that the formulation of the BRICS Bank has been delayed?

MR. FORSYTHE: All yours.

MR. SANDERSON: Tricky question. I do agree. It seems in my mind that these countries don't have actually a lot in common beyond high growth that's actually slowing now. So I don't -- I think there will be a lot of disagreement in how to arrange a BRICS Bank. And given that CDB is not that transparent -- it hasn't been that transparent -- is that the kind of model that they want. That's a big question.

I think we still have to see the details, but I again was disappointed there was so little details out of the BRICS Summit. That must mean they are having some problems I think.

MR. FORSYTHE: But having Chen Yuan, you know, if he really does have a role and if does take the chairmanship, is a signal that, you know, if you've got that kind of commitment from China, you know, maybe China -- you know, we don't know for sure -- but maybe China will be committed to this bank and want to make it a success. And obviously China can bring a lot of money to the table. So, you know, when I saw that Chen Yuan looked like he might be heading it -- and again we haven't confirmed that independently. I think we've confirmed with CDB that indeed he's leaving and the new guy is coming in. But the BRICS part is -- I haven't. I haven't been looking in the last day or so though. I don't know what's going on. But, you know, given his influence, I think it's something, you know, notable that, you know, maybe they're taking this seriously. Again, that's just my opinion. I don't know. I don't have any fact to really back that up though.

MR. WOOD: It had been said, for example, that the headquarters would be in Shanghai. But that, too, now seems to be open to discussion.

MR. SANDERSON: Yeah, and I would just say just a week before the BRICS Summit, foreign ministry had a press briefing I went to and they gave very little details about the bank. Almost nothing. So --

MR. FORSYTHE: Not that we get any details from foreign ministry, but you know.

MS. DOWNS. Nick.

SPEAKER: I'm Nick (inaudible). I was with Chen Yuan on Wednesday last week and he told me he'd be stepping down soon. So I don't think there's any doubt about that at all. Though I don't think there's been any official announcement.

My question is more on the financing. You mentioned that this bank is funded entirely by issuing bonds to other financial institutions rather than taking deposits from either corporate or -- corporate customers or households. Can you say something

about -- you know, since you've examined all these bond prospectuses -- what can you -- how would characterize the yields that they have to pay to get other financial institutions to hold their bonds and how is this reflected in their lending costs? Like for example, if you take the vendor lending that Quaway has available for its end users or the purchasers of its telecom switching equipment or whatever it is they're selling, is it -- what can you -- how would you characterize it or what can you tell us about it?

MR. SANDERSON: So I'll just say looking at CDB's own bonds, they're always or most often a little more high yield than Treasury's, but lower yield than, you know, private companies obviously and the smaller banks in China. But interestingly they're not -- they're not so close to Treasury's that it's the same as a government borrowing. So there is some difference and it does actually fluctuate because CDB bonds are the best traded bonds in China. So there is actually a lot of liquidity, so people trade them a lot. So there is actually more fluctuation than in these LGFE bonds or private companies.

I think it is reflected in the lending -- well, domestically CDB -- if you look at these prospectuses, they often lend at similar rates to commercial banks. Maybe the PBOC rate plus a small margin. But I think the thing is maturity of the loans are much longer and the amount of the loans is much larger. And then overseas, you know, there have been reports that CDB can use the foreign exchange reserves to lend in dollars. If that's the case, then they have a huge advantage in terms of getting dollars to lend overseas. So I think overseas their loans are based on (inaudible). I don't think the rate is ridiculously cheap -- not that we found. But it's much longer maturity and just the sheer amount of money, I think, is different.

MR. FORSYTHE: And so, you know, some of the -- so they're paying, you know, a little bit more than what a Treasury bond would be yielding in China. Some

of the bond prospectuses you dig up, you know, again they have details on CDB bank lending. And so you see for a typical one, you know, like Ningbo. They're the construction company. The local government financing people in Ningbo would borrow around seven percent. Sometimes you see eight percent. So there is a spread there. I mean certainly they are, you know -- they aren't giving in many cases, you know, a completely bargain basement rate, you know, to these -- their local government clients. That's still a pretty good rate, you know, for these banks considering how difficult it is if you're a private company to borrow any money. And so but we can actually, you know, dig up some more, you know, specific, you know, examples around the country, Nick, if you'd like just to see what kind of -- what kind of rate CDB's making on its loans to these (inaudible).

SPEAKER: But it makes a currency loss every year because its overseas loans -- converts renminbi to lend in dollars. So it does make a loss on that.

MR. FORSYTHE: Although it does have some overseas bonds, too. It does borrow.

MS. DOWNS: Okay. In the back.

SPEAKER: Thank you. My name is (inaudible 52:17) from George Washington University. You mentioned Eastern Europe and actually like that China Development Bank lent to Eastern Europe and Bosnia. So I am interested to your thoughts and is it going to have some kind of implications or some kind of influence on the European Union and what's your thought about that? Thank you.

MR. FORSYTHE: We didn't focus a lot on Europe. Really actually we focused mostly on the developing countries. You know, I know there's been difficulties with some Chinese lending -- like for that highway project in Poland, you know. And there is a conflict in many cases in projects around the world on the Chinese standards

and best practices and sometimes best practices in EU nations. So there's a pretty steep learning curve there.

MR. SANDERSON: Yeah, I would say for the Eastern -- Bosnia case, you know, I was talking to a lawyer who worked on that case and one problem they're finding in Europe is that the Chinese company doing the construction is often to the European client unproven and untested and often they don't want to take the risk of that company doing the project. And CDB also doesn't necessarily want to take the risk. So while the finance might be there, the Chinese companies often have problems convincing the client they can do the job.

But it is having an impact on the EU. You know, the British are really trying to get Chinese investment right now and CDB is one of the top places to go lobby. And, you know, Guangdong Nuclear might do a deal in the UK. I'm sure CDB will be involved. But again convincing the UK public that Guangdong Nuclear is going to be a safe -- safe investment is not easy.

MS. DOWNS. Up here.

SPEAKER: Thank you very much. I'm (inaudible) with Chinese Embassy. And I have two comments and one question.

The first is that from economic prospective, we might need to tell the difference between the policy bank and the commercial bank. CDB is a policy bank based on commercial operation. And so I think the CDB needs to implement some common objective. And actually I think the policy bank is common (inaudible) word. Even here, U.S. has an import-export bank and even President Obama said yes to set (inaudible) national infrastructure bank. So I think that if we take into the policy bank -- take policy bank sector factor into account, maybe it's understandable to -- maybe it's more easy to understand than operation of CDB.

Secondly is about China's investment in Africa. I think China's investment in Africa is to pursue (inaudible). China's president just visited Africa. In Tanzania, he paid tribute to cemetery where 69 Chinese engineers, workers were buried there. They sacrificed their life in building Tanzania-Zambia Railway in 1970s, which was winner of the most prominent China's aid project in Africa. So China's investment -- China has long-lasting friendship with Africa countries. Most Africa countries welcome China's investment. Just as picture in your slides that China help African countries to build their own manufacturing system, to invest a lot in infrastructure, to help them to training local staff. And according to our study, among all the -- China's concession loans to Africa, most of them go to infrastructure projects. Only about less than 10 percent go to any other sector.

My question is that just -- the CDB shoulder some responsibility to implement so-called policy project. My question is that -- have you ever evaluated the cost of such policy projects for the bank? If taking to these factors, maybe the CDB is not so powerful.

MR. FORSYTHE: You mean the cost. How do you mean that?

SPEAKER: Cost of policy bank. Cost of implement government ranked projects -- at the local level, infrastructure, urbanization.

MR. FORSYTHE: Right. I mean all we can really look at is their lending that they do. You know, the annual reports of CDB consistently do show a small profit for the bank. That's their annual report. You know, clearly these are massive projects. And I would say that we completely agree with you that, yes, it's a policy bank, but it tries to act at least on commercial principles, which is what, you know -- that's -- maybe that's, you know, something that I think Chen Yuan has contributed to the, you know, the thinking on policy bank around the world, you know, is his attitude toward risk

management and projects. And he did say no to the NDRC, you know, when he took over the bank after 1998. He did -- he did nix some projects. He did say no. And so he was able to improve the performance of the bank. But it is still a policy bank. It's still there to carry out the policies of the government -- even though it's also a commercial bank, although in name maybe more than in reality.

So, but on the cost --

MR. SANDERSON: Yeah, we'll just say there probably are some costs, but the bank is trying to make it up. It's expanding into private equity. It has, you know, a very expensive office in Hong Kong -- CDB Capital. It's the biggest bond underwriter in China through CDB Securities. It's moved into all these different area where it can actually make money and you've got to question what it's doing in private equity, for instance. What's it doing in Hong Kong? You know the head of the Hong Kong branch got removed recently because of a certain (inaudible) deal. You know, there's a big risk of policy drift for this bank is moving into so many areas. And I think one of those reasons is to make money, right? So that it can bear the burden of some of these other policy projects.

MS. DOWNS. Here.

MR. PARK: Thanks. I'm Don Park, George Washington University. So my question is how far is it really true that they're operating according to commercial principles? I mean this is something -- right, you say a lot, but then when I look at the details of what you say, that doesn't really add up. For example, first of all their source of funds is not the market rate for capital, right? They're getting them, you know, at very, very low cost. And yet even then they're barely making a profit. They're going around the world making loans where no other commercial bank, you know, that's responsible to its shareholders and its domestic regulators will dare to tread. So either they have

discovered, you know, a different way of assessing commercial risk that no one else in the world has discovered, or they're not operating according to commercial principles. I mean I guess that's -- I think it's got to be one of the other doesn't it?

MR. SANDERSON: I think it's a different way of risk and interestingly ICBC did go into Venezuela after CDB had sort of laid the path. They also did a deal in Venezuela. So I get the sense they have a different ways of measuring risk.

MR. PARK: But is that an accurate way, you know?

MR. SANDERSON: I don't know. But they told us -- say, oh, yeah, we don't use western credit rating agencies. You know they have their own way of --

MR. PARK: (Inaudible) which you guys pointed out in your article, rates the bonds of Loudi, I believe, higher than -- as better risks than United States Treasury's, right?

MR. FORSYTHE: Oh, yes. In fact, the worst bond in China -- the filthiest, ugliest local commercial -- local government financing vehicle bond in China is not in Loudi, but is in Heilongjiang province. It's in this county -- Euchin County. And that bond is rated above U.S. Treasury's by Dagong. And, so, you know, and as we pointed out in the graph, the risk pricing doesn't seem to be reflective of the actual risks like in the market, you know.

So, Yingli's stock, you know, which is traded in New York, like all the other solar stocks, just took a beating, you know, because it's, you know, it started to go into a loss. It was losing money. There was overcapacity thanks to them in the industry. And so when -- when the company is exposed to global markets, you see, you know, it behaves in the same way. It's, you know, the stock price goes down. But, internally, in China, nothing happens, you know. You don't even see an uptake in the yields of this bond. That's clearly, you know -- I'll say it here. That's a misallocation of capital. That's

just not -- that's not risk pricing. You're not pricing the risk. Unless, you know, there's no risk of default at all because the government is always going to bail it out and then -- but that leads, you know, as Nick would always say, you know, to maybe a misallocation of capital.

My favorite example, again, is in Ningbuo. So the Ningbuo local construction vehicle borrows at seven percent a year. Down the road in Wenjo, there's a private drug company, a pharmaceutical company. They want to expand, increase consumption in GDP, which is consistent with the five-year plan. They can also borrow at seven percent. Seven percent a month. So, you know, their debt is not guaranteed. They, you know -- the Ningbuo, you know, there hasn't been a default, as far as we know on a local government financing vehicle yet. There has been some problems like in Yunan, but they seem to somehow get fixed. So if it's risk free -- if they're not going to default, this is what you get.

MR. SANDERSON: Just one last point on do they run on commercial principles? You know I asked Shargai Head of Bank of China should they commercialize? And he said, yes, they should. And I think if commercial banks are sort of slightly annoyed by CDB status, then I think that means they think CDB is making too much money or getting too good of a deal. So that's also quite interesting.

MS. DOWNS. Up here.

SPEAKER: Hi. Thank you very much for the talks. It's been extremely interesting. My question was again -- surprise, surprise -- on the topic of bonds. Amazingly enough. This is a somewhat pedantic question but I'm going to ask it anyway. So it's interesting that the way CDB finances itself is issuing domestic renminbi bonds, right?

SPEAKER: Yes.

SPEAKER: I'm assuming to access a pool, you know, of domestic savings and then it turns around and makes dollar loans, I would assume, to, you know, to countries and companies such as in Venezuela, right? How does it deal with that mismatch? Because we're talking about huge amounts, right? So it's raising a bunch of, you know, renminbi -- it's raising money in renminbi and then turning around and making loans in dollars. Where does it get the dollars to do that? Does it go to the government?

MR. SANDERSON: So most of its lending is domestic, right? Renminbi.

SPEAKER: Ok. Most of --

MR. FORSYTHE: Most of it. About 75 -- more than 75 percent.

MR. SANDERSON: So maybe one one-fourth is overseas. So they're not making a loss on every loan. But, yeah, they do make a currency loss for dollar loans. But, I think, as I said, if those reports in Xieshin that they do use the current -- foreign exchange reserves. See if they can use those, then obviously that's hugely advantageous. They also do sell some bonds overseas -- raise --

SPEAKER: My question was just the source of it. Like what's the source of those dollars? Does it -- does it get it from the government? Because it's obviously got to, you know, got to make a dollar loan.

MR. SANDERSON: Yeah. We don't know.

SPEAKER: Okay. There's no (inaudible).

MR. FORSYTHE: Some of it converted from renminbi in which they make a loss. Some of it from overseas bonds, and maybe some from foreign exchange reserves in dollars.

MS. DOWNS. Back here. The woman in the white jacket.

SPEAKER: Hi. My name is (inaudible). I'm from the World Resources Institute, China Office. And thank you for the presentation.

You pointed out that CDB played a very important role in China's urbanization process in the past. As you correctly pointed out, that the Chinese local government in the past decades, many relied on selling lands to raise revenue. That's a fact. Actually 83 percent of China's local government's revenue coming from selling loans -- selling lands. And, of course, the remaining part -- many is channeled by CDB. So my question is this China's very unique local government -- very unique financing model is really decided by their limited financing mechanisms they have because the Chinese local governments are not allowed to issue local bonds -- government bonds. Not like in the U.S. Cities can raise their own bonds. In Chinese government, local governments are not allowed to. So the government's local (inaudible) have raised lots of issues with the central government and NIBC is currently -- NDIC is kind of piloting in five provinces. Allowed them to issue limited local government bonds. So moving forward, do you think that will impact China local government's financing model and impact CDB's impact -- the roles in China's urbanization or just local infrastructure?

MR. SANDERSON: You can do property tax. I'll do bonds. So just on the bonds. Yeah, they did do this trial where a few cities could issue bonds directly. But it was a complete disaster because the rate they sold the bonds at were below Treasury's. So that shoe -- no one was looking at them at the risk of their own local government. So that didn't work and I think that's why -- so far I don't think they've expanded that trial hugely. And I think if they can do that, then I think, you know, CDB's role will get less if these local governments can raise money on their own, which is I think what they want. But in order for that to happen, you need a proper market. You need people to look at the local government itself, not just think oh, they're going to be bailed out by central government. So you need to have some sense of risk and pricing.

MR. FORSYTHE: I think what you really need to look at is a property

tax. And it's something we've been looking very closely as a way to wean the local governments away from their dependence on land sales. There's obviously been pilot projects as well with property tax in Chong Ching and Shanghai, but they've been pilot projects for a couple of years now and it hasn't expanded. There's a lot of talk about it. There's talk now and there's, in fact, there's state council, you know, mandates on starting to set up the national registry for homes. And so this is a very big pool of money that could be used as a revenue stream to go away from the dependence on land sales.

It will be very interesting to see if that actually comes to pass and how it comes to pass, because it will say so much about how this new government in China may be able to overcome some of the vested interests we always hear about, you know. There certainly are, you know, as China becomes a more complex country, you know, and with a lot more money at stake, there's a lot more interests at stake that may be opposing a policy, just like in, you know -- like in any country. And so in China, you would -- one would think a real estate developer, property developer or maybe an official with a lot of houses would not be too keen to have a national property registry and a property tax because that would be, you know, wouldn't be good for them. And so if the central government can overcome that -- if the central government can overcome maybe opposition from local governments who like this system, or then, you know, it will say a lot, I think, about -- about the strength and the commitment of the government to reforming their financial system. And maybe Nick knows a little bit more about what's going on.

People I've talked to say that it's definitely, you know, there's definitely things, you know, happening on that -- on the property tax implementation national wide. And why not? In 2010, I think, HSBC estimated that residential property in China was worth -- I think it was 109 trillion renminbi. So 18, 19 trillion U.S. dollars more. That's

certainly got to be more than that now. So there's a huge base of value that you can tax that, you know, would bring in a big revenue stream for the government.

I know that's a little bit off topic, but it actually is on topic because, you know, CDB may have to change as well. If its model domestically is to encourage, you know, local government financing and urbanization -- if that focus is too much on infrastructure, that may not be in accord with what the government wants to do -- encouraging more consumption. So the bank may have to evolve. The local governments may have to evolve.

MR. SANDERSON: Just add the (inaudible) talks about urbanization, but I think it's going to be a different sort of urbanization. I think he's talking more about building bigger towns, rather than huge cities. So it's just a question of whether CDB's goal of urbanization is the same that what (inaudible) is talking about. You know, whether the bank still has a role. I'm not sure.

MS. DOWNS. Back here.

SPEAKER: William Pettis from the Inter-American Dialogues China Program. So the World Bank has mega and the U.S. is hoping to underwrite certain types of political risk. China has SINOSURE. What role, if any, does SINOSURE have in terms of the China Development Bank's investments?

MR. SANDERSON: You know, that's interesting, we gave a talk in Shanghai, and a lawyer who had done a lot of these CDB deals came up and said SINOSURE was really key to the whole process and we hadn't focused on it enough. And I think they are taking a lot of risk is what she said in these deals. And you've got to question, you know, what's behind them? How much the central government is willing to take those losses? I think they did make losses on Libya maybe -- some other places. But we didn't look at it that much.

MR. FORSYTHE: Yeah. We probably need to look at it a lot more.

Yeah. I think that's a worthwhile project -- to look at SINOSURE more.

MS. DOWNS. Back there.

SPEAKER: I'm Jason Chu from SIES. I'm a business scholar to SIES.

I'm a PH candidate from China. My question is about all this loans -- actually commercial loans to Africa from CDB. And you mentioned a large part of these loans is benefit China's (inaudible) for the infrastructure project in Africa. My question is how do they make this happen? How could they make the -- all the Chinese companies gather projects? As is written in the contracts between the government and the CDB -- or the companies and CDB -- or just because this Chinese infrastructure construction companies are more competitive than others. Thank you.

MR. FORSYTHE: And if you ask CDB, I think they would say -- you know, and the SOEs -- they say, well, you know, we do these projects now better than anybody else. That's certainly what Chen Yuan's emissaries told us, you know. It's like, well, the French don't do this anymore really, you know. We can do it such a much better cost. Maybe the French should be more like IBM and just be the consultants -- help us on environmental, you know, best practices and things and we'll actually do all the work, you know, our SOEs. So, you know, maybe even if they didn't have those stipulations that Chinese companies would still be getting, you know, some of these projects. But certainly it is codified, you know, in regulations agreements. You know, in Venezuela, Ghana, Brazil. You know, it's there.

MR. SANDERSON: I'll just say these are very complicated contracts drawn up by foreign law firms -- White and Case -- these kinds of firms. They do detail a lot of these contracts. But they're interestingly -- one lawyer was telling me that in Venezuela, as soon as you draw down the money, you have to start paying interest on it.

And there was some concern that they couldn't find enough projects to use that money quickly enough. So that's kind of interesting -- whether they're all actually used on the desired projects. But --

MR. FORSYTHE: Erica, I mean you looked at this really carefully, too.

MS. DOWNS. Yeah, I mean, just I guess to jump in here. In the case of Brazil, there was a \$10 billion loan extended to the Brazilian national oil company, Petrobras, back in 2009 and three billion of that was earmarked for buying oil services and equipment from China. My understanding is that that has not been touched. But nonetheless, when I was researching this -- one of my many Google searches turned up a document. I forget who issued it in China, but basically saying -- it was basically a document aimed at oil services companies saying that CDB made this three billion -- this \$10 billion loan to Petrobras. Three million is earmarked for oil service companies. If you want to come bid or if you want to come find out more about, you know, what you might be able to, you know, to do in Brazil, you know. And then they had a date and a location.

And then, as Henry and Mike mentioned, in the case of the \$20 billion dual currency loan to Venezuela. That's codified. You can find it. There's a publication called The Official Gazette and it says that the projects are going to be decided sort of jointly by CDB and Venezuela, sort of on a project-by-project basis and there's a certain amount of the money has to be spent on buying and hiring from China. Although how go from that to sort of specific companies coming in, I'm not exactly sure.

MR. SANDERSON: Yeah, I think that's the crucial point. It's very easy in a contract to specify a project, but actually carrying that out is much more difficult. And I was just looking at news this morning and one of the Venezuelan railway projects is not getting its money paid back or is running into some difficulties. So I think that actually carrying out the project is more difficult than just writing it in the contract.

MS. DOWNS. Up here.

SPEAKER: Thanks. Great presentation. I had a question about the oil for money or the commodities for money deals and how they're structured. Are these left open to the extent that you'll pay us back with resources based on the price at that time of those resources to what, you know, the equivalent of what you borrowed? Or are they pegging a price for that resource? Are they speculating on the resource in some sort of way and might that factor into the question that the gentlemen over there raised, which is is it from that speculation that they derive some greater sense of security on the loans that they're making?

MR. SANDERSON: So I think, yeah, according to the lawyers, it's at market prices, but they use a sort of average market price to forecast what the price would be over the life of the loan. But it's not -- it's not a set price throughout the entire agreement of the loan, right?

MR. FORSYTHE: Right. That's what you found too. I mean --

MS. DOWNS. Yeah. I mean, I think too -- I mean the one difference would be the first two four billion dollar loans from CDB to the China-Venezuela Joint Investment Fund. Those had fixed prices. The first one was X number of barrels at 100 barrels per day and then the other one had a -- I think that had a fluctuating -- there was a price ban. Then I think the subsequent ones have -- are market prices. And Petrobras was very clear that they were, you know, that they were selling at a market price. And I think in Turkmenistan, where it's gas, it's too opaque to know.

MR. SANDERSON: And Ghana -- same thing. I remember the press conference is something he kept stressing was it's not like they're getting our oil for cheap, you know, was something he kept saying.

MS. DOWNS. Okay. One more question. In the back.

SPEAKER: Hi. Chris Falen with Rio Tinto. My question is regard to the China-Africa Development Fund and some of the issues that you mentioned they had run into infrastructurally in Africa. I was curious if you see CDB or the CADF changing their risk premia calculations within the continent of Africa in regards to infrastructure loans and development in any of those contexts?

MR. FORSYTHE: I don't know if it's changed -- I don't recently. I haven't looked at them, you know, recently -- whether it's changing. You would probably know more than us considering you know the cooperation between CADF and Rio Tinto. But, yeah, I don't know.

MR. SANDERSON: Yeah, I don't get any sense it's changing. Although, we haven't heard -- we haven't interviewed them recently. But I know (inaudible) went on his recent trip and there was a whole pledge of money for more deals. So I don't think they're sort of changing their focus -- at least not that I've seen.

Ethiopia -- the glass factory -- it was shut while I was there, but they did say that they were going to restart it and get the project going again. So I don't see any sign of their like changing necessarily.

MR. FORSYTHE: Right. But as far as if there has been a recent change in their way they look at risks and price risks, I -- honestly we just don't know. I don't know. But maybe we can ask -- try to get some information on it. Or you might know, Deborah.

MS. BRAUTIGAM: I just talked them in January. They're going eight projects in South Africa. And they have a big chunk there. So that suggests to me that that's why the 10 percent projects anyway are going into that one country, which is riskier now, but it's still pretty stable. So that's -- and that's more there than any other country in Africa.

MS. DOWNS. Unfortunately, I'm going to have to draw our discussion to a close because this room is booked at four o'clock. Thank you again, Mike and Henry. And thank you everyone for coming.

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