The Role of the Asian Capital Market and Measures for Cooperation Following the Establishment of the AIIB

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Asian Infrastructure Investment Bank (AIIB, 亚洲基础设施投资银行)

- President Xi Jinping and Prime Minister Li Keqiang mentioned the need to establish the AIIB at the APEC meeting (Indonesia) and the China-ASEAN Summit (Brunei) in Oct. 2013
- 21 countries including India, Pakistan, and Singapore signed an MOU to establish the AIIB on Oct. 24, 2014, in Beijing

Characteristic: International organization between regional governments (区域性政府间国际组织)
Major form: Credit loan (信贷)
Date of establishment: Oct. 24, 2014
Legal capital: $100 billion
Headquarters: Financial district of Xicheng Qu (中国北京西城区金融街, 全国政协礼堂(2015.3))
Founding countries: 57country (2015.4.15)
Secretary general: Jin Liqun(金立群)
Major institution: Liaison office (多边临时秘书处)
Leading countries: China led the establishment of the AIIB which focuses on infrastructure investment in Asia
Objective: Promote exchange and development of global trade
Membership: Open and multilateral cooperative platform for all countries and development organizations
**Economic Background in China**

- The Chinese government made a strategic transition to boost demand in the domestic market and export excess produce to new overseas markets in order to usher in the 'new normal' economy.
- China tried to adjust its stakes in the WB and ADB to overhaul the global financial order dominated by the US and Japan. However, faced with limits, China decided to initiate the establishment of the NDB and the AIIB.
- Despite active overseas investment, tourism deficit, and recent capital outflows, China has $3.9tn of foreign reserves. China can reduce foreign reserves through contribution in the AIIB and NDB, and lower risks from managing foreign reserves assets that are mainly in USD. It will be an opportunity to diversify investment and restructure the global financial order.
- China will increase the proportion of trade settlements in Yuan, pushing for the internationalization of its currency on the back of offshore financial centers and special economic zones, while maintaining mainland regulations.
  - Internationalization of the Yuan will be expedited if settlement of Yuan-based bonds and loans take place through the AIIB.
  - The UK joined the AIIB early in order to gain a first mover advantage over the Euro/Yuan market along with its position in the Euro/Dollar market.

**Regional Background in Asia**

- Asia is home to more than 60% of the global population, takes up 1/3 of the global economy, and boasts the highest growth rate and growth potential.
- According to ADB forecasts, a minimum of $8tn is needed for infrastructure investment in Asia between 2010~2020, an annual average of $800bn.
  - Among $8tn, 68% is for new infrastructure, and 32% is for enhancing existing infrastructure. India alone needs $1tn in development capital.
  - Existing international organizations can't provide $8tn. Due to the absence of an effective cooperative body, abundant capital liquidity in Asian countries is not being converted into infrastructure investment.
- China is one of the top 3 countries in terms of foreign investment, which posted $87.8bn in 2012, a 17.6% increase YoY. Basic infrastructure and manufacturing industries have developed a stable value chain over the last 30 years and have prospects for overseas market expansion.
Relationship Between the ADB and International Organizations

ADB’s annual funding to support infrastructure development in Asia is $12bn (2010~13 average), focusing on energy ($5.4bn), transportation & ICT ($5.3bn) sectors.

- The proportion of infrastructure among all projects of the ADB maintained 60% for the last 4 years

**ADB’s Infrastructure Support**

Source: Sovereign and Nonsovereign Approvals (including Cofinancing)
Relationship Between the ADB and International Organizations

- Infrastructure development capital: ODA 59% ($140bn), OOF 41% ($96bn)
  - Concentrated on transportation/storage ($110bn) and energy ($73bn) sectors
- Bilateral-multilateral support for Asian infrastructure development expanded from $20bn in 2004 to $33.6bn in 2013
  - A total of $236bn was provided as bilateral-multilateral funding (OECD) for Asian infrastructure development in 2004~13
- Proportion of Asia among infrastructure support for developing nations fell from 65% → 48% - China is providing support to Southeastern Asia, Africa, and SCO nations with loans of $20bn, $30bn, and $5bn, respectively.

**AllB Investment Direction and Position**

**Direction**
- Financing for basic infrastructure investment in the Asia-Pacific region
  - Loans, equity investment, collateral, etc.
- Investment area – Various industries including transportation, energy, telecommunication, agriculture, and urban construction

✓ First confirmed project: Funding to construct the Silk Road – Railway connecting Beijing and Baghdad, capital of Iraq

*<Infrastructure Investment Demand Forecast in the Asia-Pacific Region (2010~20)>

<table>
<thead>
<tr>
<th>Sector</th>
<th>Region</th>
<th>Unit: USD 1tn</th>
</tr>
</thead>
<tbody>
<tr>
<td>에너지</td>
<td>동아시아/태평양</td>
<td>4.67</td>
</tr>
<tr>
<td>운송</td>
<td>남아시아</td>
<td>2.87</td>
</tr>
<tr>
<td>통신</td>
<td>중앙아시아</td>
<td>0.46</td>
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<tr>
<td>물/위생</td>
<td></td>
<td>0.38</td>
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<tr>
<td></td>
<td>농업</td>
<td>1.06</td>
</tr>
<tr>
<td></td>
<td>통신</td>
<td>2.47</td>
</tr>
<tr>
<td></td>
<td>운송</td>
<td>4.09</td>
</tr>
</tbody>
</table>
One Belt, One Road (Framework)

✓ One Belt (帶, Silk Road Economic Belt) project is divided into 3 Belts
  China  Central Asia  Russia  Europe
  China  Central Asia  West Asia / Persian Gulf  Mediterranean
  China  Southeast Asia  South Asia

✓ One Road (路, 21st Century Maritime Silk Road) project is divided into 2 Roads
  China  South China Sea  South Pacific
  China  South China Sea  Indian Ocean  Europe
### One Belt, One Road Project utilizing the AIIB

- The Chinese government has held substantial discussions with neighboring countries to push for the One Belt One Road Initiative for the past year, and is implementing a series of policies to obtain early achievements

  - Promote the establishment of the AIIB ($100bn)
  - Currently proposing the development of the Silk Road Fund and China-Eurasia Economic Cooperation Fund
  - Plans to revitalize the cooperative platform to further push for the projects

### Relationship Between the AIIB and the Chinese Silk Road Fund

- **The Silk Road Fund is registered as a limited liability company, aiming for a capital of $40bn. Currently, it has received investment of $10bn***.
  
  * Foreign currency reserves $6.5bn, China Investment Corporation $1.5bn, Export-Import Bank $1.5bn, China Development Bank $500mn.

- Its objective of investing into the One Belt, One Road Initiative and national infrastructure directly corresponds to the goal of the AIIB, and there was an announcement that the Fund will play a complementary role.

- The Silk Road Fund is expected to focus more on infrastructure projects within the Chinese border, and overseas projects that are vital for China but difficult for the member countries to come to an agreement on.

- Although it may not be explicit, Chinese contributions to the AIIB are likely to evolve into a master-feeder fund relationship with the Silk Road Fund.
Cooperation Mechanism

- China plans to establish a bilateral and multilateral cooperative mechanism to use it as a platform for the successful operation of the One Belt, One Road Initiative.

  - **Cooperative partners**
    - SCO (Shanghai Cooperation Organization), APEC, ASEM, ASEAN + China, etc.
    - Boao Forum, China-ASEAN Expo, China Eurasia Expo, Euro-Asia Economic Forum, China-Arab State Forum, etc.

- **Chinese municipal governments and Chinese-speaking nations promoting the One Belt, One Road Initiative**

  - **One Belt (一帯) project**
    - Xinjiang Autonomous Region: Center for trade, transportation, culture, science, and education of the Silk Road Economic Belt
    - Aiming to become a trade and logistics hub by establishing a pilot trade zone
      - Center for industry and cultural exchange among Central, South, and East Asian countries
    - Heilongjiang province: Build an Eurasia high-speed rail by cooperating with Russia

  - **One Road (一带一路) project**
    - Guangxi Zhuang Autonomous Region: Gateway for the Silk Road Economic Belt and 21st Century Maritime Silk Road, based on geopolitical proximity with ASEAN countries
    - Yunnan province: Aiming to become a regional hub for international transportation on the back of geopolitical traits

- **Other Chinese-speaking countries**
  - Hong Kong-Macao: Expected to contribute to the One Belt, One Road Initiative and its successful operation, based on the existing economic cooperative model between free trade zones within China
  - Taiwan: Planning to make proper arrangements for Taiwan to participate in the project
Cooperation Priorities

A. Policy Coordination

- China is planning to create a collaborative channel between governments of relevant countries, exchange policy information, and conduct policy coordination in order to build trust and policy consensus for the One Belt, One Road Initiative.

B. Infrastructure & Facilities Connectivity

- Construct infrastructure with standardized operation
- Build advanced port facilities and strengthen connectivity
- Build energy infrastructure networks
- Build cross-border electricity transmission networks
- Establish the Information Silk Road and strengthen connectivity

C. Free Trade

- Cooperation for free trade and investment without any barriers is one of the major goals of the One Belt, One Road Initiative.
- Planning to hold discussions with relevant countries of the One Belt, One Road Initiative on a single window for regional free trade and investment including FTAs.
Cooperation Priorities

D. Financial Integration

- China will concentrate efforts in creating a sound financial investment environment to provide financing for the One Belt, One Road Initiative

  - Establishment of an Asian credit information system

- Existing bilateral currency swap policies between many countries will be maintained.

- Efforts for the establishment and development of the Asian bond market

  - Encourage relevant countries of the One Belt, One Road Initiative to issue government bonds in the Chinese bond market, and institutional/corporate investors within China to issue RMB bonds or foreign currency denominated bond in overseas markets.

- Focus efforts in establishing and revitalizing regional development banks

  - AIIB, Brics New Development Bank

  - SCO(Shanghai Cooperation Organization) financing center

  - Silk Road Fund

  - China-ASEAN Interbank Association

- Establish a system for the early detection of financial crises in Asia, and an information exchange system between countries
Cooperation Priorities

E. People-to-People Bond

- China is hoping for active people-to-people exchange in culture, academia, business, media, and among the youth and women in order to boost bilateral / multilateral cooperation.

- China will send more students to study abroad and will also offer national scholarships to 10,000 foreign students studying in China.

- Making efforts to facilitate tourism in the Asian region.

  - Joint development of tourist spots
  - Improvement of related systems including visas to promote tourist convenience
  - Expansion of exchange in sports

- Regional efforts to promote health in Asia.

  - Exchange of information on epidemics
  - Development of medical/ health professionals
  - Improvement of comprehensive public health technologies, etc.

- Expansion of cooperation for the development of science technology.

  - Establishment of a comprehensive research center, an international science technology transfer center, maritime technology cooperation center, etc.
Utilization of the AIIIB by Korea

- **Development of Northeast Asia and Unification Financing**
  - As 60% of ADB investment funds are centered in Southeast Asia and South Asia, investment in Northeast Asia is relatively small. In particular, North Korea is excluded from investment due to concerns over investment returns because it is an extremely impoverished country and does not meet the standards for political governance.

- **Coordination with the Eurasian Initiative**
  - President Park announced the Eurasian Initiative in October 2013 and introduced the idea of a Silk Road Express that passes through Busan, Russia, China, Central Asia, and Europe as part of this Initiative.
  - The level of impact on Korea including Busan will depend on negotiation efforts by the Korean government in the One Belt One Road Initiative.
  - In the meantime, efforts to develop Northeast Asia through the Great Tumen Initiative are underway as there is significant demand for infrastructure development in Northeast Asia such as North Korea, the Three Northeastern Provinces of China, Far East Russia, and Mongolia.

### <Estimate of Infrastructure Demand in Northeast Asia> (Unit: USD 100mn)

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<tbody>
<tr>
<td><strong>Region</strong></td>
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<tr>
<td>Three Northeastern Provinces</td>
<td>2000~15</td>
<td>-</td>
<td>612</td>
<td>636</td>
<td>488</td>
</tr>
<tr>
<td>Far East Russia</td>
<td>2011~20</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Mongolia</td>
<td>2001~10</td>
<td>413</td>
<td>18</td>
<td></td>
<td></td>
</tr>
<tr>
<td>North Korea</td>
<td>2010~25</td>
<td>531</td>
<td>12</td>
<td>53</td>
<td></td>
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<tr>
<td>Cross-Boarder</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td></td>
<td>22</td>
</tr>
<tr>
<td><strong>Total Demand</strong></td>
<td>-</td>
<td>-</td>
<td>1,601</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td><strong>Yearly Demand</strong></td>
<td>75</td>
<td>160</td>
<td>667</td>
<td>629</td>
<td></td>
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</tbody>
</table>
## Cooperation with China

- There is much room for cooperation in various fields as the economies of the countries participating in the One Belt One Road Initiative are largely supplementary to one another.

- There are four preconditions for cooperation:
  - Policy sharing, linking facilities, trade facilitation, platform for loans and transactions, public support

<table>
<thead>
<tr>
<th>Area of Cooperation</th>
<th>Details</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Finance</strong></td>
<td>Establishment of an investment/loan system and credit system; Establishment of a currency swap and settlement system; <strong>Opening and development of an Asian bond market</strong>; Joint efforts in venture investment and formation of private funds, etc.; Cooperation in financial regulation (Risk prevention and the establishment of a risk response system)</td>
</tr>
<tr>
<td><strong>Education and Medicine</strong></td>
<td>Joint establishment of schools; Culture sharing (broadcast, movies, art, books); Cooperation in the medical and healthcare industries</td>
</tr>
<tr>
<td><strong>Tourism</strong></td>
<td>Development of 21st century Silk Road travel packages and expansion of cooperation</td>
</tr>
<tr>
<td><strong>Areas of Mutual Investment</strong></td>
<td>Stronger cooperation in the agriculture-forestry-wood-fishing industries and production/manufacturing of farming tools and agricultural products; maritime industry and environment protection; development of traditional energy resources as well as new or renewable energy such as water power, wind power, solar power, and nuclear energy; expansion of cooperation in the overall value chain</td>
</tr>
<tr>
<td><strong>Collaboration in New Industries</strong></td>
<td>Stronger cooperation in new industries such as IT, bio, new energy, and new materials; Cooperation in investments for start-ups</td>
</tr>
<tr>
<td><strong>Development of a Special Zone for Regional Economic Cooperation</strong></td>
<td>Development of a special zone for international economic cooperation that encompasses the service, trade, and finance sectors (e-logistics, special zone for capital); Stronger cooperation in the green industry, dealing with the ecological environment, biodiversity, and climate change.</td>
</tr>
<tr>
<td><strong>Start-ups and Job Creation</strong></td>
<td>A platform that integrates the vast human capital and entrepreneurial human capital of countries such as Korea and China into the central west, southeast, and central east Asia is needed, which is also an area for more synergetic potential among countries related to the One Belt, One Road Initiative; Development of an R&amp;D center, international technology exchange, joint research on major technology, science and technology professionals exchange, etc.; Cooperation in platforms such as production and marketing; Cooperation in education medicine, elderly health care; Cultural exchange, etc.</td>
</tr>
</tbody>
</table>
Barriers to Entry to the Chinese Financial Market and Direction for Cooperation

- Currently, development entities conform to financing policies set by the WB. However, the AIIB requires a new financing and financial product transaction platform because countries that have the largest infrastructure demand such as China and India do not have open capital markets.
- It is expected that open tenders that take into account factors such as price and quality, and financing from member countries will take preference.

Institutional Barriers and Working-level Uncertainties of Financial Cooperation

- Institutional Barriers in China:
  - Foreign securities companies banned from establishing local corporations
  - Only allowed to enter by establishing main office or through joint ventures. There are limits to business activities.

- Efforts to expand the scope of joint ventures for individual projects
  - Create a market for regional financing between Korea and China (ex: debt capital market between regions)
  - Ventures in the credit rating sector
  - Promote synergy between ventures of Korean and Chinese firms with the private fund mechanism
Regional Cooperation in the Asian Capital Market

- There is a possibility that various tools will be used to raise the level of leverage against capital, such as bond issuance, underwriting of subordinate bonds, loan securitization, etc.

- It is expected that international IBs located in the UK, Singapore, and Hong Kong, in particular Australian IBs that enjoy global competitiveness (Macquarie) will display intense competition and activity.

- It is expected that each project will take the form of a corporation in order to promote public private partnership (PPP) - Social overhead capital investment company

### Capital Sources

1. Huge foreign reserves
2. AIIIB establishment
3. Silk Road Fund (Jan.6, 2015)
4. International funds and international organizations
5. Private capital

### Capital Pool

1. Securitization of One Belt One Road cross-border infrastructure securities
2. Establishment of an Exchange for One Belt One Road cross-border infrastructure securities ("一带一路上路基础设施证券交易所")
3. PPP loans such as issuance of bonds and funds, etc.
4. Expansion of offshore RMB bonds

### Areas of Investment Cooperation

1. Investment in basic facilities
2. Energy and development
3. Industry investment (Establishment of joint fund)
4. Financial collaboration (trade loans, cross-border insurance service, cross-border settlement, loans, and guarantees of the RMB, foreign currency hedge products)
Active Establishment of the RMB Hub by AllB Member Countries

- Expected increase in demand for RMB bonds
  - Most international organizations utilize USD-based finance and loans/guarantees-based finance.
  - RMB-based finance may take up the leading role if China takes the initiative and countries that aspire to be offshore RMB hubs, such as the UK and Singapore, provide support.
  - In particular, project financing and an increase of local government bond issuance is expected.
Establishment of a Korea–China Global RMB Bond Hub Platform

Chart 3  Bond Market (% of GDP, (horizontal axis) and Per capita GDP (USD, vertical axis)

(Source) Asian Bonds Online, IMF

East Asia

ASEAN 6 countries
Establishment of a Korea–China Global RMB Bond Hub Platform

WHY Korea?
- Korea – Open market vs. China – Closed market
- Tax benefits
- Low transaction costs, excellent infrastructure
- Low interest rates
Complete Overseas Securities Investment and Fund Management Support System

✓ Overseas securities investment support for Korean investors (KSD)
  - Overseas securities investment support for 37 overseas markets through 4 foreign depository institutions (reserves: $ 18.8bn)
  ※ Foreign depository institutions: 1. Euroclear, 2. Clearstream, 3. Citibank, 4. HSBC

< Current Status of Destinations that Receive Investment Support >
  - Asia(11)
  - Americas(5)
  - Europe(17)
  - Africa(2)
  - ICSD(2)

✓ Fund management support for the Korean capital market (KSD)
  - Comprehensive services for the entire fund asset management process, from subscription to redemption through FundNet

< Current Status of FundNet >
  - No. of Funds: 12,261
  - Net Fund Assets: ₩ 428tn (₩ 2.4tn)
Support for Korean Investors in Investments to China

✓ **RMB financing support in the Korean capital market**
  - Issuance and distribution of RMB bonds and CDs
    (Bonds - 3 issues, ￥580mn; CD – 8 issues, ￥1.5bn for the first time)
  - Repo transaction support for RMB procurement
    (￥89mn)

✓ **Chinese securities investment support through RQFII**
  - Korea designated as an offshore RMB hub
    (July 2014, RQFII limit ￥80bn)
  - Support for RQFII application by Korean investors, opening accounts, deposit and settlement

✓ **Chinese securities investment support through Shanghai-Hong Kong Stock Connect**
  - The Shanghai-HK Stock Connect opened in November 2014
  - Support for investment in mainland Chinese securities through the HK CSD provided to Korean investors

✓ **Efforts toward an Asian bond market settlement system with the CCDC**
  - Working with China and the CCDC (China Central Depository & Clearing Co.) to establish a CSD Linkage Model

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Source: KSD
創新自我，追求無我