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HE WEI

Bridge builders of one belt one road 'Why, what and How' of the AIIB and SRF

Abstract

The history of AIIB and SRF is shorter than most of institutes, however so far the two institutes have earned their reputation through business development, and enhanced the confidence of world to B&R initiative. The key hypothesis of this paper is that the two institutes are not some kinds of economic weapons invented to destroy existing world order but new organizations to improve cooperation of countries.

The AIIB and SRF are welcomed widely especially by the members in core region of B&R initiative for several reasons. First, they play indispensable role as the public financing institutes, separately being classed as MDB (multilateral development bank) and SWF (sovereign wealth funds), both are important for Sustainable development investments. Second, they may help to transfer experiences of China and other fast growing countries to undeveloped countries. The third and may be the most important point is, the two institutes may help more cooperation to be realized following B & R initiative.

The missions and functions of the two institutes are fostering sustainable development, promoting regional cooperation, and decreasing the barrier of infrastructure financing. By provide debt financing and capital financing respectively, the two institutes may satisfy different customers with demands of the infrastructure financing in the region.

With the transparency process/governance, the two institutes will act not only new pools of development financing in belt

and road region, but also a promoter and organizer of development financing industry, which may bring more opportunities to the countries in the region, and improve both intergovernmental and non-GOV cooperation to boost infrastructure financing.

The scale of the business of the two institutes has been increased apparently since founded, mainly attributed to regenerative feedback effect caused by multi-win strategy, and the unique position pegged with one belt one road initiative.

One interesting thing for IR scholars is , the two new institutes, as long as China the initiator of B & R initiative, have been doubted by some countries while embraced by some others, for being labeled as challengers of the existing world order. This may remind scholars the metaphor of the trap of Thucydides: the trap did exist for those who thought the threat was there and tried to prevent it happened.

Keywords: B&R initiative, development finance, AIIB , SRF

The emerging of the two new financial institutes, Asia Infrastructure Investment Bank (AIIB) and Silk Road Funds (SRF), was considered as a remarkable event in recent IR study. Both institutes had been founded as supplement measure to underpin One Belt One Road initiative (B&R initiative), which was considered as an action of China to challenge existing order of international finance. Three questions were raised to analyze effects of the two institutes to existing international finance pattern:

- What are the functions of the two institutes?
- Why these two institutes were founded?
- How to implement the functions as designed?

What: The Purposes and functions of the two institutes

According to AIIB's Articles of Agreement, AIIB will focus on investment in infrastructure sector to support sustainable economic development, with clear defined purpose and functions as follows¹:

The purpose of the Bank shall be to: (i) foster sustainable economic development, create wealth and improve infrastructure connectivity in Asia by investing in infrastructure and other productive sectors; and (ii) promote regional cooperation and partnership in addressing development challenges by working in close collaboration with other multilateral and bilateral development institutions.

¹ Articles of Agreement, Asian Infrastructure Investment Bank, https://www.aiib.org/en/about-aiib/basic-documents/_download/articles-of-agreement/basic_document_english-bank_articles_of-agreement.pdf

The Bank shall have the following functions:

- (i) to promote investment in the region of public and private capital for development purposes, in particular for development of infrastructure and other productive sectors;
- (ii) to utilize the resources at its disposal for financing such development in the region, including those projects and programs which will contribute most effectively to the harmonious economic growth of the region as a whole and having special regard to the needs of less developed members in the region;
- (iii) to encourage private investment in projects, enterprises and activities contributing to economic development in the region, in particular in infrastructure and other productive sectors, and to supplement private investment when private capital is not available on reasonable terms and conditions; and (iv) to undertake such other activities and provide such other services as may further these functions.

The purpose of SRF shows a different level of the aim which emphasizes more on cooperation and connectivity, and the centre of the business vision is to support B&R initiative²:

Following a philosophy of openness, inclusiveness and mutual benefit, the Fund mainly provides investment and financing support for trade and economic cooperation and connectivity under the framework of the Silk Road Economic Belt and the 21st-Century Maritime Silk Road Initiative. In collaboration with domestic and international enterprises and financial institutions, the Fund is designed to promote common development and prosperity of China and other countries and regions involved in the Belt and Road Initiative.

² Article of association, Silk Road Funds, <http://www.silkroadfund.com.cn/enweb/23786/23796/index.html>

The difference of the wording in the purpose between the two institutes reflects their distinctive positions. As a multilateral institution, AIIB should stand for the common benefits for all member states. Though the operation of AIIB strongly underpin the B&R initiative, the wording of its purpose may not have too much Chinese background and should express its independent status without too much influence by China. However, SRF has no reason to disguise the status of state owned sovereign funds and represents benefit for China.

Public financial institutes of B&R regions

Three key words selected from the above cited purposes of the two institutes might illustrate the thresholds of the pipeline projects of the two institutes, which are sustainable development, connectivity and collaboration common development. Thus both of AIIB and SRF should be classified as public financial institutes operating in B&R regions and playing important role in long term development financing to support projects such as strategic resource exploring and infrastructure building.

Infrastructure projects normally require longer payback term and lower cost of the funds, thus it's hard for commercial financial institutes to take the cases.

SRF has more flexibility for its operation module as an equity fund instead of a bank. Besides working on project level, SRF may also initiate new bilateral funds with other parties, most of which are sovereign funds. These sub-funds may work on certain area such as energy exploring and transportation.

Sustainability inherent in Connectivity

Sustainability of development financing means that the financed project would yield positive output. Sustainable development criteria should be defined in national financing strategies, which means policies and incentives should incorporate it into financing strategies and implementation approaches to support development in economic, social and environmental dimensions.³

In economic aspect, the development financing facility is not a charity or unilateral aid and the financed project should be kept running in healthy manner as proposed in feasibility study so that the facility can be paid back in time with agreed interest. Thus the financing capital would be kept cycling safely in different projects, instead of being eroded in loss-maker projects without positive output.

In social aspect, a financed project should promote the welfare and productivity of the sociality, while the building and operating of the project show no negative effect to environment and other social wealth. This should be appraised by laws and regulations as well as culture elements.

For an infrastructure project which may not be invested for profitability of itself but for the sustainable benefit rooted in the enhancement of productivity and economic output of the region promoted by the project, the repayment resource of the funding should be laid on public expenditure allocated by sovereign treasury. The sustainability of the project should be double confirmed by both the financial institute and the government of host country. On-going monitoring and appraising

³ Report of the Intergovernmental Committee of Experts on Sustainable Development Financing (PP. 13-14), United Nations New York, 2014, United Nations publication

should also be implemented during the lifecycle of the project to ensure the key performance index to reflect the sustainability may reach or even overwhelm the target aim of the project.

To enhance connectivity means to improve efficiency of transferring of materials, goods, population, information and funds. It is one of most important standards to underpin the Sustainability of projects to be selected by the two institutes. With function of decreasing costs of elements transferring while increase the efficiency of the resources exploring, production, and trade, the infrastructure projects may improve connectivity by their nature.

Collaboration instead of the unilateral aid

Collaboration is another key caliber of the projects to be financed. Both international development financial institutes and project host governments are key players in development financing. Government is responsible for the development of its own county, setting up strategy as well as policies to reach the targets of development, search and use financing resources to implement the development plan.

Collaboration means benefits had been identified and acknowledged by two parties participated in the cooperation, which implied the cooperation is not a zero-sum game. In practice during 2013-2015, there were 192 B&R initiative related loans/commitments signed/committed by the Chinese Government institution, representing around \$135 billion aggregate amounts. Ministries of Finance from the recipient countries had validated most of cases.⁴

⁴ Chinese Policy Bank Loans and the Rapid Build out of the 21st Century Maritime Routes (2013-2015), Grisons Peak Special Feature, March, 2016, available http://www.chinainvestmentresearch.org/wp-content/uploads/2016/03/Article_Chinese-Policy-Bank-Loans_2013-2015.pdf.

Some opponents argued that it's doubtful that the two new institutes could reach the international high standards of transparency and efficiency as most infrastructure projects would be highly relied on government authorities with varied level of governance. This has certain extent of conflict with free market principle uphold by developed countries. However, from the view of supporters, since the environment of the business in most of B&R regions were less developed, collaboration between the two institutes and other institutes could help to introduce matured standards had been drawn from advanced practices into those less developed regions, which was also one of key contributions of development financing to the society.

Why: Reasons to establish the new institutes

One popular view supported by many scholars and evidenced by initial official announcements was that the two institutes were founded by China to facilitate B&R initiative. The inter-dependent relations between the emerging of the two institutes and the initiative of B&R could be deduced by the correlations between the goal of B&R initiative and purpose of the institutes, and also were implied by the subsequences of the time of the initiative of B&R and the two institutes.⁵

The initiative of B&R has been considered as a long-term activity since 2013, when Mr. Xi Jinping, the president of China, first raised it.⁶ The B&R regions has approximately 60%

⁵ M. A. Weiss , Asian Infrastructure Investment Bank (AIIB) , Congressional Research Service (R44754). 3 Feb, 2017. Available at : <https://fas.org/srgp/crs/row/R44754.pdf>

⁶ Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road, National Development and

of population of the world, thus from a view of realism, a new Marshall plan is a meaningful metaphor which refers to not only the economic effect caused by the initiative, but also the power transformation from the States to P.R.C.

Through research on Chinese foreign trade and investment in recent years, the scholar deduced four main goals of Chinese government B&R initiative⁷:

- Decrease the economy's dependence on domestic infrastructure investment and keep the contributions of economic output from related industries by transfer the investment to B&R countries.
- Improve popularization of Chinese Currency of RMB in international market with stable position comparable with other dominated currencies.
- Secure energy supply with more stable supplier countries and transportation routes, which is most essential to manufacture industry of China.
- Decrease transaction cost and improves economies on B&R countries, to increase the demands to Chinese products and services.

Financing had been considered as one of most important tools to catalyze enormous deals by bridge the gap between the requirements and productions for a long time, as showed by the enforcement of Marshall Plan.

The truth of the matter is that Europe's requirements for the next three to four years of foreign food and other essential products - principally from America - are so

Reform Commission of the People's Republic of China, http://en.ndrc.gov.cn/newsrelease/201503/t20150330_669367.html. [accessed: 28.03.2015]

⁷ S. Djankov, *China's Belt and Road Initiative Motives, Scope, and Challenges*, Vol.1, pp. 6-10.

much greater than her present ability to pay that she must have substantial additional help or face economic, social and political deterioration of a very grave character. (From the speech given by General George C. Marshall, Secretary of State, at Harvard University on June 5, 1947)⁸

Insufficiency of development financing

One reason officially upheld by China for the foundation of the two institutes is the absolute insufficiency of the supplement of development financing in B&R regions.

We may have a quick overview on the situation of the market. There are a lot of international development banks (ADB, AFDB, CAF, EBRD, IADB) act as main development financial institutes especially for projects with low profit but high benefit to society, i.e sustainable development project.

Even sustainable projects are not necessarily have poor return rate of investment and may not only relied on public financing (for instance in China many of High-way projects are financed by PPP model or BOT model, most of which commercial financing with normal conditions), however, for those less developed regions, economic ecosystems may be very weak and direct economic outputs of infrastructure projects may be not enough to support high cost of commercial financing, thus infrastructure of these region were hard to be improved without development financing support.

The gap between the demands and supply of development financing in B&R region is huge. Per the estimation of ADB, a massive infrastructure funding gap of some \$8 trillion will

⁸ *The Marshall Plan Speech*, <http://marshallfoundation.org/marshall/the-marshall-plan/marshall-plan-speech/>

exist only between 2010 and 2020.⁹ Existing institutions cannot fill it: ADB has a capital base (money both paid-in and pledged by member nations) of just over \$160 billion and World Bank has \$223 billion. AIIB will start with \$50 billion in capital — hardly enough for what is needed but still a helpful boost.

The deep embedded reason for the insufficient supply of developing financing relies on the inconsistency or unbalance of the supply for goods and services provided by developed country and the demands of the undeveloped countries. Generally speaking, if one economic entity may provide goods and services matched with another economic entity that have ability to pay for it, financing may help to promote the trade between the two entities. Similar cooperation between financing sector and production as well as service sectors may also exist if one entity can gain from the output of investment in another entity.

However, from the breakdown of trade and investment in typical undeveloped counties, the partials from highly developed countries are far lower than those from undeveloped countries. In another word, the contribution of business with undeveloped countries did not weighed much in economics of developed countries. Thus there is no reason for financing sector or the government of the developed countries to put much emphasis on development financing.

⁹ B. N. Bhattacharyay, *Financing Asia's Infrastructure: Modes of Development and Integration of Asian Financial Markets*, "ADBI Working Paper Series", No. 229, <https://www.adb.org/sites/default/files/publication/156084/adbi-wp229.pdf>

Easier to start new than Change old ones

Someone may argue that since China is a member of most development financial institutes, it may initiate proposals to increase the supply of development financing instead of to introduce new institutes into the system.¹⁰ However, as mentioned, the reason of inadequacy of the public funding supply is that the existing development financial system relied too much on the developed counties.

Thus another motivation of China to found the new institutes is that, same as B&R initiative is to change the weight of the region in global economy, the two institutes are to change the under-represented position of China in MDB financing world.

Compared with the States and other developed counties, China enjoy larger volume of benefits from trade and investments in developing countries, and also rely more on the supply of energy as well as other bulk stocks yield from developing countries. However, China was a minor participator in MDBs in terms of voting share. In the beginning of 2014, China had only 3.8% voting shares in World Bank with 16.1% of share of global GDP while the shares of the States were 16.8% and 19.2% for GDP.¹¹ Chinese Voting share in ADB was also minority while Japan, U.S.A and other developed counties dominated majority of voting shares. Thus not too much influence might China hope to have in these MDBs, and it was

¹⁰ J. Jin, *The True Aim of China in Setting up the AIIB Challenging the International Financial System or Securing Multilateral Credibility?*, July / August 2015, Japan SPOTLIGHT

¹¹ R. Harding, J. Leahy, L. Hornby, *Emerging economies: Taking a stand*, *The Financial Times*, July 16, 2014, <https://www.ft.com/content/875d6570-0cc6-11e4-bf1e-00144feabdc0>

not realistic to promote the change of increasing underwritten facilities for Asia infrastructure investments to fit the initiative of B&R, while funds for development financing had been undersupplied globally for many years.

Thus for China it was an easier way to set up new institutes with more influence power, compared with long and complicated process to search change in old systems, which is hard to achieve not only for technical reasons but also for game equilibriums between member countries.

While member countries with leading power including U.S.A and Japan treated releasing of voting power in MDBs as a threaten to their leading position, it's hard to find Pareto Improvement to reach new equilibriums satisfying main stakeholders with hegemony guaranteed by veto rights in hand.

Holding 26.06% voting power, China possesses the veto power over important decisions at AIIB.

The disparity of voting power among the members shows some kind of certainty of the power distribution in AIIB.

How: The hard way to be founded and even prosperous

It's obviously that a new institute like AIIB may challenge the existing system and weaken the power of key players. The States hold opposite opinion of AIIB just as the way they treat other BRICS banks- they might oppose AIIB more than BRICS banks¹². Till the end of July 2017, the United States and Japan still kept distance from AIIB, while other 76 countries had joined the bank as members.

¹² Ch. Dixon, *The New BRICS Bank: Challenging the International Financial Order?*, "Policy Paper", No. 28, March 2015, The Global Policy Institute.

The attitude of the United States to the initiative of AIIB did affect many countries, which had been illustrated by the history of recruit members. The first announcement of the initiative of AIIB was made on 2nd, Oct. 2013. After 1 year, when the first memorandum was signed to prepare the founding of AIIB, only 21 of 65 countries in the B&R region participated¹³, most of which are less developed countries.

AIIB With only developing countries who have high demands of development financing as members and China as the funding source, AIIB would have only limited influence to the existing system.

AIIB AIIB The existing system of development financing would not be significantly challenged, and the supply of development financing would also not to be much changed. If this happened, B&R initiative would be undermined by lacking of financing support and participation of B&R countries, which would imply the failure of the initiative.

Advocating from UK and other developed countries

However, on 12th, March, 2015, the United Kingdom announced to join AIIB, which was criticized by the United States. The decision of the United Kingdom may be driven by two key opinions, which were also held by other members of AIIB. One is that B&R initiative would boost the economic development of the given region, while the other one is that China would put its strength to enable the initiative to be reality. The United Kingdom is much closer to the region of B&R and the financial sector is one of pillars to the economics

¹³ 21 Asian countries sign MOU to set up AIIB, "Xinhua", October 24, 2014, http://www.china.org.cn/world/2014-10/24/content_33864818.htm.

of the UK. Embracement the change caused by AIIB may bring more benefits than refusing it.

“This government has actively promoted closer political and economic engagement with the Asia-Pacific region and forging links between the UK and Asian economies to give our companies the best opportunity to work and invest in the world’s fastest growing markets is a key part of our long term economic plan. Joining AIIB at the founding stage will create an unrivalled opportunity for the UK and Asia to invest and grow together”.¹⁴

The UK’s decision of participation in AIIB was appraised as a flag followed by other developed states including Germany and France. This may reflect the fact that European countries also regard B&R as a serious initiative, and cooperation with AIIB may bring more opportunities to participate in the developing process of B&R region, which was important for these countries to keep or expand the leading position with existing advantages on production capability, finance operating and hi-tech research.

Multiplayer instead of bi-polar pattern

The participation in AIIB may also show the interests of these member countries to B&R initiative, which make the B&R initiative different from Marshall Plan for it not only has China as a solo dominator in the plan but also lot of roles can play for those countries who wish to have their benefits expanded

¹⁴ *UK announces plans to join Asian Infrastructure Investment Bank*, The Rt Hon George Osborne, HM Treasury, 12 March 2015, <https://www.gov.uk/government/news/uk-announces-plans-to-join-asian-infrastructure-investment-bank>

with B&R initiative.¹⁵ This can easily be understood, for the potential enormous benefits in B&R initiative can be illustrated by abovementioned requirements of infrastructure investments, and the member countries may enjoy more benefits through cooperation in the development financing and projects to be facilitated, for instance, expand markets for domestic suppliers of core parts of equipments and technologies.

For instance, the Greek port project has been initiated for creating a new trade link between Central Europe and Asia via Greece and the Balkans, which affects both intra-EU relations and EU–Asia relations. By stimulating the development of logistics and transportation, the new link would benefit for the stability and economic growth of EU.¹⁶

Though warned by U.S., the ones who expect to benefit from B&R initiative are keen to join AIIB before others do so, and they believe others may hold the same attitude. If the real world may be simplified into the scenario of which all players have same interest and information of each other, per the game theory the results will be very simple, and they will make positive decision to participate the play as soon as possible.

Two key assumptions are implied to apply the game theory on the analyze .One assumption is that the initiative would be a long run game; while the other is all participators may gain from the game. Both of the two assumptions are to reflect the determination of China to promote B&R initiative as a key long term development strategy.

Actually, from the time when B&R initiative was first raised to year 2015, China had proved its firm determination with

¹⁵ G. Grieger, *One Belt, One Road (OBOR): China's regional integration initiative*, July, 2016, European parliament research service

¹⁶ F. van der Putten ,M. Meijnders, *China, Europe and the Maritime Silk Road*, March 2015, Clingendael report, p.5-6.

a lot of infrastructure projects as aforementioned in the B&R region, some of which had already changed original pattern of trade and investments of the region. The increasing members of AIIB illustrates that from views of more and more countries, the two assumptions are seemed to be true, and B&R initiative are more inclined of multiplayer model. The surrounding countries had to take it as a serious decision if they will make choice to join the list of player as soon as better.

SRF as lever Fulcrum of B&R and AIIB

While AIIB is backed by states of members, SRF is owned 100% by Chinese government. SRF was first introduced on 4th, Nov, 2014 by Chinese government. The founding of the institute showed world strong evidence that China did treat B&R as a long term play. SRF was initially funded with 40 Billion dollars, which equaled to 80% of capital of AIIB.

SRF had more flexibility than other multi-institutes for it being agent of solo Shareholder of China government. Thus the founding of SRF can be treated as a lever Fulcrum to change the attitudes of some states to B&R initiatives. With benefits of bilateral deals arranged by SRF, some countries might change their role from spectators to advocates of the B&R and AIIB earlier than other counties, who would be affected by the change of their coalition county later.

Abundant reserves to be explored

Another reason for the broad advocating to AIIB is that there were abundant resources of development financing had been wasted for long time due to inefficiency of existing financial system. Foreign currency reserves which hold by governments

were far more adequate than the safety level they should be preserved, while yield nothing for its unused status of deposits in IMF accounts and other status of reserves.¹⁷

New established development financial institutes such as AIIB may make win-win deals by using these underexplored reserves in long term development financing, which may increase the return rate to countries who contribute their abundant reserves while not cause inflation due to oversupply of currency in the facility aimed country.

Focus on Right things

To achieve aforementioned purposes, the two institutes must define critical criteria for projects to be engaged. As showed on the website of AIIB:

AIIB's project process is guided by its strategic goals and thematic priorities: sustainable infrastructure, cross country connectivity and private capital mobilization.

Three principles claimed by Jin Li Qun, the President of AIIB, further illustrated the key standards of qualified candidate projects¹⁸:

- (1) The project must be possible in enforcement and operation with positive expected economic value.
- (2) The project must be environment friendly.
- (3) The project must be supported by the government of host country.

¹⁷ World Economic Situation and Prospects 2015, United Nations, p. 64. http://www.un.org/en/development/desa/policy/wesp/wesp_archive/2015wesp_full_en.pdf

¹⁸ Z. Qianxian, *Jinliqun: three principles shall be hold on to finance OBOR countries*, 15 May 2015, "Xinhua Telecom"

In practice, the development financing institutes draw great attention on the compliance aspect of the project selection and approval process. The executive committee of the institutes would scrutinize and verify if the projects comply with the internal policies before the final approval granted.

Similar principles and implementation processes are also implanted in the operation of SRF, with more flexibility and openness in terms of operating model and project host countries.

Existing experience and resources

As above discussed, the development financial institutes has different characters and process from commercial financial institutes. Thus the experience or know-how is the most important element for AIIB and SRF, especially on how to implement proper process to communicate with shareholders, develop strategy as well as finance projects, and cooperate with other institutes.

Though the two institutions have only operated for a short while, China's development financing keep prosperous in both domestic and international market for a long time. With productivity increase and technology progress, development financing has been boomed to support trade and investment between China and other countries for almost twenty years, and with no doubt B&R region has been the most attractive hotspot in recent years. For instance, China Exim bank recently disclosed that its credit portfolio in B&R region had reached 1200 cases with almost 100 billion dollars loan balance.¹⁹

¹⁹ H. Xiaolian, *Construct the safeguard system of financing for B&R*, May 2017, No. 9, China financing.

The existing base of development financing may help the two institutes in start-up stage to recruit qualified management team and staff to initiate the business in proper way. The two institutes have also recruited staff openly worldwide, which may help to absorb experiences of good practices on how to deal development financing business with diversified backgrounds.

However, knowing how to learn is more important than knowing what's in hand so far. The development space is much larger than any time before for AIIB and SRF. For the infrastructure projects to be financed, the technology level, culture background and most important, the expectation and tradition of development financing by government in host countries are totally different.

As start-up institutes, there're long ways to go for both AIIF and SRF. It may be a bit earlier to judge if the two institutes are on the right way to achieve their goals, however, with the broadly participation of sovereign institutes, the achievements of the two institutes should be self-evidenced by their contributions to B&R regions in the future.

Summary: A new pattern of development finance in B&R regions

During aforementioned discussing, it's clear that there are apparent differences between the two new established financing institutes and existing development financing institutes in terms of missions, functions as well as operation models.

Since the missions of the institutes are inherent within the B&R initiative, the core functions of the two institutes are to facilitate collaboration of states of B&R regions in infrastructure developing, which would introduce a sustainable development model to improve connectivity and efficiency

of the regions. This may be a new pattern of development finance for the B&R regions in future.

As we know rivers are common nature barriers to block trade and economic development in the past and even now in some areas of the world, for the cost of a bridge could be too high to be afforded by people who lived in two banks of the river for decades or even centuries. Thus why the Mehmed Paša Sokolović Bridge in small town of Višegrad, Bosnia and Herzegovina, was appreciated as an incredible masterpiece which changed fates of lot of people in hundreds of years, as the episodes of 'The bridge on Drina river' showed to us, which was written by Yugoslav writer Ivo Andrić.

While nature barriers still exist in lot of place, there are nowadays some other artificial barriers to block international connectivity, which are harder to remove than ever due to lack of collaboration, experience, and financing support. The more bridges were built to span these barriers, the better of the world would be. Thus Bridge Builder may be a proper personified role expected by B&R states for the two institutes.

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