

# The SCO Financial Mechanisms: Risk Analysis and Development Prospects

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**Abstract**—The Shanghai Cooperation Organization is one of the leading security organizations in the world; still, the current changes in the global integrational processes dictate the necessity of introduction of the financial components in every integration initiative. Hence, the analysis of the prospects of the SCO financial mechanisms contributes greatly to the development of its potential to fulfil its tasks. For now, the only financial organization under SCO is the Interbank Consortium, but the SCO Bank is actively discussed. The article concentrates on the research of the hypothetical demand for the SCO Bank in Asia and its possible role in the development of the Asian countries with respect to the SCO mission of securing peace and security in the region.

**Keywords**—SCO; Interbank Consortium; SCO Bank; development; demand; financial resources

## I. INTRODUCTION

The Shanghai Cooperation Organization (SCO) is the most powerful institution in the sphere of security and peace after NATO in the world. Its activities are primarily aimed at providing solutions for the regional security problems, such as terrorism, drug trafficking and war risks. Due to the fact that SCO functions in Central Asia, the issues of the regional development and counteracting poverty are the new key problems for SCO to solve in the nearest years [1]. This statement arises to the hypothesis that poverty provides more opportunities for illegal activities and pulling people into criminal organizations [2].

In the modern world the only way to overcome poverty on the regional level, such as Central Asia, is the common cooperation on the financial issues and providing aid and support to the poorest regional countries. The practice of providing credits and donations used by the IDA seems to be not that effective, so FDI in the socially important spheres is the only other way to force the development of the local economy. In this regard, the creation of a new sphere of cooperation in SCO – financial cooperation – will contribute to the fulfillment of the goals of the organization, namely securing a peaceful and sustainably developing region.

The aims of this article are to reveal the potential of the currently existing financial mechanisms affiliated with SCO and to estimate the potential of the creation of the long-discussed SCO Bank project. Hence, the authors have to outline the key factors why such kind of a financial institution is needed in Asia, a region, hosting the Eurasian Development Bank, the Asian Development Bank, the Asian Infrastructure Investment Bank, the New Development Bank of BRICS and the World Bank Group organizations.

## II. METHODOLOGY

The article is based on the theoretical estimation of the SCO financial mechanisms economic potential, so in order to prove the findings of the article the authors followed the methodology of analyzing the development banks supply and demand of financial resources in Asia. This estimation resulted in the creation of the most suitable development bank matrix for the Asian countries based on the algorithm of answers to the general questions.

This algorithm was formed by the statistical study of the projects financed by the Asian development banks and by the World Bank in Asia [3–7]. Frequency statistics method was used – the authors have compared the quantity of the development banks projects, filtering them through three levels of indicators: the level of development, the characteristic of the government system of the country (democratic, non-democratic) and the participation of the country in the integration project affiliated with the development bank.

After the analysis, the authors have concentrated on the LDCs, as they produce the main threats in the region [8, 9] and proved that they are not sufficiently covered by the development banks' projects, so this niche can be taken by the SCO Bank. Based on this statement, the authors revealed the main characteristics of the proposed SCO Bank and its projects.

## III. THE INTERBANK CONSORTIUM AND ITS ROLE IN THE FINANCIAL COOPERATION IN SCO

The Interbank Consortium today is a nominal union of the leading banks of the SCO countries, which provide financial resources for the aims of economic development [10]. The general idea of the institution is to stimulate the financial activity of the banking sectors of the SCO members and to encourage the national banks of the named countries to invest in the SCO member countries. This organization does not have any significant meaning for the regional development today, as it fulfills its functions just nominally [11]. The key issue with the further development of the institution is the lack of financial activities regulation in SCO. Despite the large numbers reported by the SCO IBC – \$98 billion in 2017 of allocated financial resources in the SCO countries, the main share of these resources originates from the China Development Bank.

The institution has nearly no impact on securing the sustainable economic development of the region and provides

little or no assistance to the promotion of trade and economic cooperation within the framework of SCO. Still, the prospects of the development of this cooperation direction are significant. Firstly, the SCO IBC builds a basis of the cooperation between the leading commercial banks in the region, forming strong ties and developing mechanisms of cutting financial interactions costs between the banks. Secondly, despite its low impact on the economic development of the region, the institution helps its member banks to get access to the financial resources of the other members, which is extremely relevant in the situation of sanctions, imposed by the EU and the USA against Russia, especially against the Russian banking sector, and during the trade war between the USA and China, when financial instruments of pressure will be undoubtedly used. In addition, the newly signed agreement on the trade in national currencies between Russia and China contributes greatly to the effectiveness of the SCO IBC – the main national banks will benefit from the formed financial infrastructure between the members of the institution [12].

Despite the positive effects described above, the institution remains a corporate non-transparent financial corporation, the activity of which does not significantly contribute to the development of the SCO financial mechanisms.

IV. THE SCO BANK PROSPECTS AND PROBLEMS

Asia is one of the most rapidly developing continents of the world, so it is obvious that, to support such a development tempo, Asian countries are in need of financial resources. The development banks provide one of the ways to solve this problem, as their activity is aimed at the support of the economic development of their members. There are 5 major development banks in Asia – ADB, NDB, AIIB, EDB and the World Bank group, which take actions for stimulating the development of countries all over the world. One of the main points of this paper is that the development banks appear along with the demand for them in the region, while the regional leader offers the supply of the financial resources for the less developed countries, in this way the development banks are the means of capital transfer between the more and less developed economies. Let us figure out the demand for each development bank in the region and figure out the economic spheres, where the SCO Bank could function [13].

Asian Development Bank – the demand for this bank was formed in the middle of the XX century by the fast-developing economies of Asia (the Asian tigers), Japan was the leader among them. The bank supported the economies of these countries and promoted democratic values to deter the influence of the USSR in Asia. Today the main demand for the bank resources is formed by the countries that are a part of a China-deterioration coalition, so the bank is demanded by the market economy of the fast-developing economies of the region in order to support high-tech projects and provide financial consultation services.

New Development Bank of BRICS was created in the framework of the development of BRICS financial cooperation, so the main demand for it was in the BRICS countries, which offered their investment projects to the investors from other BRICS countries. In such way, NDB focuses on the projects in Russia, India and China (within the

Asian region) with the highest rate of return and economic impact.

Asian Infrastructure Investment Bank is a recently created but serious instrument of the financial cooperation in Asia. The demand for this institute arose from the insufficiency of financial support to the least developed countries in Asia, participating in BRI for the development of their infrastructure and energy sector. The supply of the financial resources comes from China.

Eurasian Development Bank was formed in the framework of EAEU, and it functions in the countries of the Union. The demand for its resources comprises mainly the government-corporate sector of the EAEU countries, and its resources are used in the development of the national companies and local infrastructure and energy, mainly invoked by the business needs. The key supplier of the financial resources in this organization is Russia.

Still the demand for the financial resources in Asia is much more significant than the described banks can satisfy [14]. The analysis of the demand and supply of the development banks in Asia allows to form a matrix of supply-demand possibilities for the Asian countries through the algorithm in Fig. 1.

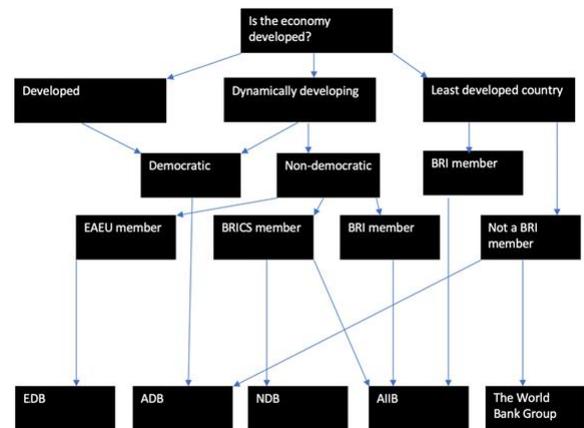


Fig. 1. The matrix of the most suitable development bank for Asian countries, according to the banks' specialization (developed by the authors).

The developed economy in Asia is Japan, its needs for finance are supported by the national economy, the ADB and the support from the Bretton-Woods system financial institutions (IMF, WB etc.). The dynamically developing economies in Asia are able to acquire finance through numerous institutes, while the LDC have nearly no options – either relatively expensive credits from ADB or the World Bank group, or cheaper financial support from AIIB, but only for infrastructure and energy development.

The needs of the LDC are far wider than the two named spheres. Their economic development depends on the basic industries of their economies, which are not developed. In addition to that, the crime level in these countries also depends on their economic development. Since the BRI and other integration initiatives in Asia cannot avoid interactions with the LDCs, it is reasonable to establish an organization that will achieve the goals of regional security through economic measures, according to the authors' view, the SCO Bank may

become such an organization, as the regional demand for it exists in the sphere of counteracting security threats through fighting poverty.

## V. DISCUSSION

The analysis given above allows to pinpoint several important characteristics of the SCO Bank that are required to satisfy the specific demand for it in the region.

1) The Bank should be aimed at fighting poverty, so it will not get financial resources needed for its sustainable development from the returned credits. This forms the need to support the organization financially, so the dynamically developing economies of Asia should form their budgets with respect to these costs.

2) The Bank should support only the projects of social importance.

3) The Bank activity effectiveness will be assessed by the level of crime, terrorism risks and drug trafficking volumes in the region, so it should work in the sphere of promoting the understanding of common harm done by the named activities to the Asian region in general.

4) The Bank should work in tight cooperation with the SCO security mechanisms, and in case of military conflicts or social unrest stop the financial flows to the countries involved.

5) The Bank should promote trade in national currencies, so its credits are to be issued in national currency of the recipient country, taking all the risks it may cause to the Bank. In order to hedge the financial risks of this model, the SCO Bank should have the reserve instruments, which are to be formed by state guaranties of the member states and a reserve fund created from the revenues the Bank will get from other activities.

6) Due to the fact that the Bank will have little or no profits from its main financial activity, it should provide other financial services, for instance, clearing services on deals in national currencies, informational services, such as statistics collection and analysis and rating evaluation of the countries or companies, etc.

The Bank is to function in a region with high level of criminal activities, including the financial crimes, so the system of the Bank should incorporate the mechanisms of the credit risks estimation from deviant behavior. As a result, it may prove effective to form a financial security authority on the basis of the Bank mechanisms.

Taking all the mentioned points into account, the projects that will be offered for the Bank financing should be assessed by the following criteria:

- What social significance does the project have for the recipient country?
- What contribution to the common security in Asia does the project provide?
- May the project be dictated by the countries with mightier economies, or it is solely the decision of the local government?
- How will the project contribute to the development of basic industries of the recipient economy?

- How will the project affect local small business and does it contribute to its development or to the development of the big companies?

The answers to these questions should comply with the general aim of the SCO Bank – the comprehensive development of the least developed economies, based on the support of rational resource management and the formation of social state cutting down the threats to the Asian region.

## VI. CONCLUSION

The current financial mechanisms of the SCO are weak, moreover, they are insufficiently covered by information, so their further research before the significant changes in information policy of SCO and its affiliated structures seems impossible.

The SCO IBC has a potential of the basis formation for further banking spheres cooperation, but it does not realize it, as there is no clear strategy for its future development and aims of the current activity.

The SCO Bank proves to be an organization with a significant role in the cooperation in Asia and it has its own niche in the system of the Asian development banks, namely the overcoming of poverty and fighting the strategic threats to the region by the means of financial instruments and economy development of the least developed states of Asia.

At the same time, it is notable that the SCO Bank should be a development bank with specific characteristics, allowing it to function in the situation of high risks and low return rate in the region with high levels of crime (including the financial crime), so it should be referred to as the financial security organization in Asia. It will require significant financial resources inflow from the dynamically developing member countries, but it will contribute to the formation of the better future for the Asian region.

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