

China: the AIIB to test diplomatic skills

- The AIIB is key to China's "One Belt, One Road" strategy
- China and founding members must cement the bank's objectives, create a credible governance structure and adopt prudent and transparent lending practices
- The most difficult challenge may be balancing China's interests with other founding members'

What is the Asian Infrastructure Investment Bank (AIIB)?

The AIIB is a response to Asia's infrastructure financing gap. The Asian Development Bank estimates that between 2010 and 2020, around \$8 trillion in investment will be needed in the Asia-Pacific region to improve infrastructure [1]. The ADB, however, is able to provide only about \$10 billion annually for this purpose, about 1.25% of the estimated need. Premier Li Keqiang believes that the AIIB and the Asian Development Bank could "work in parallel in promoting Asian development".

President Xi Jinping first spoke publicly about the AIIB in October 2013. It is being created and largely funded by China as a multilateral lender to the region. On 24 October 2014, China signed the memorandum of understanding on establishing the AIIB in Beijing with 20 other countries [2]. The bank aims to raise \$100 billion for future projects, and China has committed \$50 billion, making it the biggest shareholder. More than fifty countries in Asia and Europe, among them long-term allies of the US as well as giants like Russia and India, have signed up to be founding members. Negotiations on how the bank will be run are underway.

What the AIIB can achieve for China

The AIIB is central to China's "One Belt, One Road" strategy. It will fund highways, ports and other infrastructure throughout a "Silk Road Economic Belt" across the Eurasian land mass. Among other things, it would allow China to export its technologies and production more broadly to the region.

The AIIB would also hasten RMB internationalisation. First, to finance infrastructure spending, Beijing is encouraging Chinese banks to extend credit to project participants – most likely in the Chinese currency. Second, "One Belt, One Road" would boost China's overseas direct investment (ODI). Recipient countries would use yuan to purchase capital goods, construction materials and services from the mainland. The circular nature of these flows will further raise yuan settlement for China's exports. Finally, closer trade and business ties with China would increase regional demand for the yuan. If the strategy is successful, the adoption of the yuan as an international currency could be hastened significantly.

The AIIB is central to Beijing's One Belt, One Road strategy

In the shorter-term, infrastructure projects could cushion the economic slow-down brought on by the economic transition, as many of the initial projects would be located in China. Longer-term, railway and road linkages between China's undeveloped western areas and developed eastern regions would increase economic and market integration, improve labor mobility and create business opportunities more broadly.

The next steps

The AIIB has been established in name; the practical aspects must be forged. What lies ahead?

The AIIB has yet to produce a clear mission statement

1. Clarifying objectives

Despite the fanfare surrounding the establishment of the AIIB, a clear mission statement has yet to be produced. In the words of President Xi, the AIIB would boost growth and improve infrastructure across the region to help fulfill an "Asia-Pacific dream". Many find this laudable but vague. Only when the aims are clarified can participating countries decide how much to contribute and what role they might best play.

The first thing that needs to be clarified is purpose. Does the AIIB aim to spur economic growth? Reduce poverty? Something else? The second thing that needs clarification is whether the AIIB will be a for-profit or non-profit bank. Apparently the related Silk Road Fund is not to be an aid agency so presumably neither would the AIIB be [3]. Questions remain – Finance Minister Lou Jiwei has said the AIIB is intended to finance 'quasi-commercial' operations, which plainly leaves room for speculation.

The third area of needed clarification is scope. While infrastructure lending is the main function, the AIIB could engage in other activities, like other multinational institutions. For instance, besides lending, the World Bank engages in FDI promotion, dispute arbitration, education and advisory services. Whether the AIIB intends to do this too needs to be addressed.

2. Creating a credible governance structure

Perhaps the biggest question that needs to be answered is who will decide what the aims are and where the funds will go? China has already offered to forgo veto power and proposes that no single country be allowed to dictate decision-making at the bank. This contrasts sharply the IMF, where the US has effective veto power [4] despite holding less than 20% of voting shares (Table 1).

China has offered to forgo veto power at the AIIB

Table 1: Voting shares at existing multilateral institutions

	IMF	ADB	World Bank
	(% of total)		
China	3.8	5.5	4.4
Japan	6.2	12.8	6.8
USA	16.7	12.8	15.9

Since the AIIB was in large part borne of China's and other emerging economies' frustration with existing western institutions, the new bank is going to have to be more consensus-based and/or 'democratic'. Not surprisingly or unreasonably, one proposal is to make voting rights proportional to GDP. China would have a strong voice initially as potentially the largest shareholder at the bank's inception, but its share would be diluted as new members sign on. Moreover, a simple China majority would likely be precluded at any stage in the progression.

3. Social and environmental differences

A growing challenge for China is how to promote growth while considering the environmental impact. This will surely be even more difficult in an international environment such as the AIIB, where many views (and votes) will have to be taken into account. As a leader of a multilateral institution, China must work alongside AIIB members to follow a set of consistent and transparent guidelines regarding fund objectives and disbursement.

Initially, the AIIB may borrow the environmental and social standards of the World Bank and ADB. Plainly this would be more complicated than if China were considering a domestic project, and would involve experts from different fields beyond banking and finance. The standards that the AIIB would adhere to and any divergences therefrom will need to be clarified / codified by the founding members and clearly communicated to the public.

Uncharted waters

China has leapt to the forefront of international politics with the establishment of the AIIB. Now it must show that it can negotiate with a large number of members in a large number of areas. Goals must be clarified, organizational structure must be clarified, and growth and development objectives must be weighed against environmental / social concerns, all in a multilateral context that potential members expect will be more democratic than the IMF.

Fifty-seven members have signed on to the AIIB. China must now show them why.

Notes:

- [1] "Infrastructure for supporting inclusive growth and poverty reduction in Asia", Asian Development Bank, 2012
- [2] China, India, Thailand, Malaysia, Singapore, the Philippines, Pakistan, Bangladesh, Brunei, Cambodia, Kazakhstan, Kuwait, Laos, Myanmar, Mongolia, Nepal, Oman, Qatar, Sri Lanka, Uzbekistan, and Vietnam
- [3] The US\$40 billion Silk Road Fund is sponsored by official foreign exchange reserves, China Investment Corporation, the Export-Import Bank of China, and the China Development Bank. It aims to provide financing and investment services along the One Belt and One Road (Silk Road Economic Belt and the 21st Century Maritime Silk Road)
- [4] Many decisions at the IMF require an 85% majority vote to pass. Since the US holds 16.74% of total voting rights, it has an effective veto power in these areas.

The trickiest part is aligning the interests of participating countries with China's strategic aims

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