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IN FOCUS

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Asian Infrastructure Investment Bank

Overview

On October 24, 2014, China launched a new development bank, the Asian Infrastructure Investment Bank (AIIB), posing a challenge to U.S. policymakers. Chinese President Xi Jinping has said that the bank would "promote interconnectivity and economic integration in the region." and "cooperate with existing multilateral development banks," including the World Bank and the Asian Development Bank (ADB).

The ADB estimates Asia's total infrastructure investment needs at $8 trillion between now and 2020. This sum is substantially greater than any individual country or existing multilateral development bank (MDB) can provide. Collectively, existing MDBs currently provide around $130 billion of annual infrastructure financing. Addressing Asia's large infrastructure gap will likely require mobilizing public and private sources of financing, as well as new sources of long-term development finance.

However, the creation of the AIIB, the proposed Bank raises many issues including: the Bank's governance and operational practices, the U.S. role and possible participation, and the relationship between the AIIB and the existing MDBs, among others. Some observers have raised concerns about the transparency and governance of China-funded development projects and see the AIIB proposal potentially undermining decades of efforts by the United States and others to improve governance and environmental and social standards. An additional possible U.S. concern is the emergence of Chinese-led regional economic institutions, such as the AIIB, in which the United States may have little influence.

Membership and Organization

As of April 8, 2015, the AIIB has 35 founding members including India, the Philippines, Singapore, New Zealand, and Saudi Arabia. Several European countries including France, Germany, Italy, Luxembourg and the United Kingdom have also joined the AIIB, reportedly over U.S. objections. An additional 23 countries, including Australia and South Korea have applied to join the AIIB. Japan has not yet decided whether it will seek to join the Bank.

According to Chinese officials, the AIIB's Articles of Agreement are to be finalized by June 2015; and lending is slated to begin by the end of 2015. The AIIB's initial total capital reportedly will be $100 billion, with 20% paid-in and 80% callable capital. China is expected to initially contribute $50 billion, half of the initial subscribed capital. This would give China a 50% share of total voting power in the institution. India would be the second largest shareholder. The headquarters of the bank will be in Beijing. Its head will be Jin Liqun, a former Chinese Vice Minister of Finance, sovereign wealth fund chairman, and ADB Vice-President.

The AIIB has caused some friction between the United States, which views it warily, and key allies and partners, which have chosen to join or expressed an interest in joining. Critics have suggested that the United States has wasted political capital in its efforts to persuade allies and partners not to join what is arguably a relatively small institution. U.S. officials, however, argue that countries have the greatest leverage to improve governance when they are on the outside, negotiating to join the AIIB and lend their prestige to the institution. "I hope before the final commitments are made anyone who lends their name to this organization will make sure that the governance is appropriate," noted U.S. Treasury Secretary Jack Lew in March 2015.

> The United States stands ready to welcome new institutions into the international development architecture, provided that they share the international community's strong commitment to complementing the existing institutions and maintaining time-tested, and ever-improving, principles and standards. *Nathan Sheets, Under Secretary for International Affairs, Department of the Treasury, January 7, 2015.*

Issues for Congress

The AIIB raises several political and economic issues for U.S. policymakers as they examine the AIIB proposal and consider potential U.S. involvement with the Bank.

China's Economic Diplomacy

The AIIB is one of several mechanisms to support a more assertive Chinese international economic policy. China sees the AIIB and other financing mechanisms, including a $40 billion Silk Road Fund, the $100 billion New Development Bank (formerly known as the BRICS Development Bank), and the Shanghai Cooperation Organization Development Bank, as a means to finance what it calls a "Silk Road Economic Belt" and a "21st Century Maritime Silk Road." The "Silk Road Economic Belt" would be a network of highways, railways and other critical infrastructure linking China to Central and South Asia, the Middle East and Europe. The Silk Road Maritime Route entails building or expanding ports throughout Asia, the Middle East, Africa and Europe.

Many accounts of the AIIB debate have argued that Congress's decision not to ratify the 2010 reforms of the

International Monetary Fund's quota system, which would have modestly increased China's stake in the IMF, seems to have convinced China to create new financial institutions.

Figure 1. China's Silk Road Economic Belt and Maritime Silk Road Initiatives

Source: Xinhuanet.com and Barclays Research.

Chinese officials see economic development in the region as helping to guard against regional instability (e.g., in Afghanistan, Pakistan, and Central Asia) and deepening regional political linkages to Beijing. Regional Chinese infrastructure financing may also serve to channel China's overcapacity in its construction sector. Over the past decade, China has devoted around half of its GDP to domestic investment. If the slowdown in the Chinese economy continues, regional infrastructure financing would be a way to redirect China's excess capacity in sectors such as rail and highways or port construction.

China's funding of new development banks also raises questions about China's relationship with the MDBs, where it remains a large borrower. Critics question why China still feels it needs to work with the World Bank to hone its project management skills, and yet thinks it has sufficient management expertise to run a new development bank.

Transparency and Governance Concerns

Several operational aspects of the proposed AIIB raise concerns for U.S. and other officials. China's holding of more than 50% of the voting power would make the AIIB the only MDB in which one country has a majority of the total voting power. Second, the AIIB, as currently envisioned, would have a non-resident Board of Directors, which would not be involved in approving AIIB investment decisions; investment decisions would be made by AIIB staff. At existing MDBs, a member-driven Board of Directors meets regularly to make lending decisions and approve specific projects.

It also appears that the AIIB may not fully endorse other MDBs' emphasis on open, transparent, and accountable practices, including procurement procedures, as well as safeguards for labor, environmental, and other social concerns. The U.S. government considers these rules and safeguards central to the effectiveness of development assistance, and has used its leadership in the MDBs to advocate for their use.

For example, the World Bank and other MDBs have operational guidelines on dealing with involuntary resettlement. If MDB development projects require the forced relocation of a population, there are operational procedures to ensure compensation and resettlement planning. By contrast, China has supported large scale infrastructure projects throughout Asia with less regard to social or environmental standards, or the underlying institutions in the recipient country. Some observers have raised concerns that countries will resist the safeguards and conditions attached to World Bank or ADB loans and turn to the AIIB instead. Chinese officials have given assurances that the AIIB would adapt the MDBs' best practices. The continued participation of European countries, as well as cooperation with the IMF and other MDBs, will likely require that China fulfill these assurances.

Competitive pressure from the AIIB and other sources of financing may lead the MDBs to reconsider World Bank international best practices in procurement policies and other safeguards and either relax their safeguards or transfer the responsibility for compliance to the borrower country. The World Bank is currently reviewing its safeguard policies and its policy on the use of so-called "Country Systems," which might allow countries to apply their own social and environmental safeguard systems in some circumstances. Absent best practices on procurement and other safeguards, there may be greater potential for corruption in MDB-funded projects, especially in countries with weak domestic institutions.

Commercial Implications for U.S. Firms

Many European governments appear to be joining the AIIB to assure access for their firms in bidding for contracts on potential infrastructure projects. While China has issued assurances that there will be open and transparent procurement, it remains uncertain whether firms from non-AIIB member countries will be able to bid. China's existing loan and project management practices continue to cause issue. The impact AIIB lending may have on setting technological standards in the region is another concern. For example, if China uses the AIIB to install Huawei network and telecommunications equipment throughout the Asia-pacific region, U.S. technology firms might be effectively kept out of the Asia-Pacific market.

Global Financing for Infrastructure Investment

MDB support for infrastructure financing has waned in recent years. China's AIIB plans may encourage MDBs and financial institutions to examine ways of increasing infrastructure financing in Asia. Three Japanese banks and five banks from France, Britain, and Australia have also agreed to partner with the ADB to facilitate infrastructure investment by providing advice to borrowing countries on matters like raising funds and project management.

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