

Samia Zaman**ASIAN INFRASTRUCTURE INVESTMENT BANK (AIIB): EVOLUTION, MOTIVATIONS AND GEOSTRATEGIC IMPLICATIONS****Abstract**

China-led Asian Infrastructure Investment Bank (AIIB) was launched in 2016. Prior to that, the leadership and authority of the Multilateral Development Banks (MDB) were mainly controlled by the United States (US), Western Europe and Japan. Now the world has been experiencing the emergence of a new player in this domain, China. The China-led AIIB has sparked a major debate over China's motivations behind establishing the Bank and the geostrategic implications of the Bank for both regional and extra-regional actors. Therefore, the paper endeavours to understand why China has created the AIIB. It also explores the geostrategic implications of the Bank for the region and beyond. Finally, the paper addresses certain challenges which the Bank needs to address to be a full-fledged MDB.

Keywords: Multilateral Development Bank, Financial Governance, Infrastructure, Connectivity, Environmental Safeguard

1. Introduction

The creation of Asian Infrastructure Investment Bank (AIIB), led by an Asian country targeting to fill up the infrastructure funding gaps of Asia, has brought a major shift in the political economy of the multilateral financial institutions of the world. Besides, AIIB's establishment has created a profound impact on contemporary international relations. Till date, the existing multilateral financial institutions are mainly led and dominated by the United States (US), Western Europe and Japan. Now, the world is experiencing that an Asian country, without the politico-economic support of any western country, has led a multilateral financial institution to provide assistance to other countries in the region and beyond. This is a clear indication that the roles of Asian countries, predominantly China, are shifting to a more prominent position in the world economic order. Chinese President Xi Jinping has spoken about building "a community of common destiny" throughout the world for several years.¹

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¹ Martin A. Weiss, "Asian Infrastructure Investment Bank (AIIB)", *Congressional Research Service*, 03 February 2017.

The AIIB can be seen as a primary manifestation of his overarching foreign policy goals to deepen political, economic and security ties within the neighbourhood and beyond. The launching of the AIIB has created a lot of hype in the field of international relations in terms of motivations behind its creation and its overall implications.

Against this backdrop, the paper aims to understand China's motivations behind establishing the AIIB. It also aims to explore the Bank's geostrategic implications for the region and beyond. Finally, the paper maps out some challenges that the Bank is facing to become a full-fledged Multilateral Development Bank (MDB). Given that, the feature that distinguishes the paper from the existing literature is that it takes into account all possible motivating reasons of China for establishing the AIIB. It is worth mentioning that most of the existing literature which the paper has termed as conventional wisdom is based on a set of interpretations. There are several interpretations for China's motivations for establishing a new MDB. First, China has created the Bank to challenge the Bretton Woods Institutions given the context of the US' reluctance to restructure these institutions; second, China has created the Bank to increase its geopolitical and economic interests by cementing its trade relations with the regional countries of Asia and beyond; finally, China has established the Bank to reduce massive infrastructure financing gaps in Asia. After examining all the interpretations, it gives and validates an alternative explanation to the existing literature on China's motivations behind establishing the AIIB. Drawing on different documents, the paper has been organized as follows. After the Introduction, section two describes the institutional development of the AIIB. Section three examines the structure, governance and membership of the Bank and explains why China has created it. Section four explores the geostrategic implications of the AIIB. Section five addresses challenges facing by the Bank. After addressing the challenges, the paper concludes by summarizing the findings of the paper.

2. Institutional Development

Chinese President Xi Jinping announced the setting up of the AIIB in October 2013 in Bali, Indonesia. The Bank was launched in a ceremony at the Great Hall of the People in Beijing in October 2014.² A Memorandum of Understanding (MoU) on establishing the AIIB was signed by 22 Asian countries in October 2014.³ The ceremony was attended by the then Chinese finance minister Lou Jiwei and delegates from 21 countries including India, Thailand and Malaysia.⁴ After signing the MoU,

² "Three Major Nations Absent as China Launches World Bank Rival in Asia", *Reuters*, 05 November 2014, available at <https://www.reuters.com/article/us-china-aiib/three-major-nations-absent-as-china-launches-world-bank-rival-in-asia-idUSKCN0ID08U20141105>, accessed on 13 March 2018.

³ Asian Infrastructure Investment Bank (AIIB), "50 Countries Sign the Articles of Agreement for the Asian Infrastructure Investment Bank", 29 June 2015, available at https://www.aiib.org/en/news-events/news/2015/20150629_001.html, accessed on 23 February 2018.

⁴ "Three Major Nations Absent as China Launches World Bank Rival in Asia", *op. cit.*

the Prospective Founding Members (PFMs) discussed the Bank's Charter through the mechanism of Chief Negotiators' Meetings. The first Chief Negotiators' Meeting was held in Kunming, China.⁵ The second, third and fourth meetings were held in Mumbai (India),⁶ Almaty (Kazakhstan)⁷ and Beijing (China) respectively.⁸ Finally, the final text of the Articles of Agreement was adopted on 22 May 2015 in the 5th Chief Negotiators' Meeting in Singapore.⁹ On 29 June 2015, representatives from 50 of PFMs out of 57 signed the Bank's Articles of Agreement at the Great Hall of the People in Beijing, China.¹⁰ PFMs include Australia, Austria, Azerbaijan, Bangladesh, Brazil, Brunei Darussalam, Cambodia, China, Egypt, Finland, France, Georgia, Germany, Iceland, India, Indonesia, Iran, Israel, Italy, Jordan, Kazakhstan, Republic of Korea, Kyrgyz Republic, Lao PDR, Luxembourg, Maldives, Malta, Mongolia, Myanmar, Nepal, Netherlands, New Zealand, Norway, Oman, Pakistan, Portugal, Qatar, Russia, Saudi Arabia, Singapore, Spain, Sri Lanka, Sweden, Switzerland, Tajikistan, Turkey, the United Arab Emirates (UAE), the United Kingdom (UK), Uzbekistan and Vietnam. The agreement entered into force on 25 December 2015. It was ratified by 17 member states which represented 50.1 per cent of the Bank's total capital stock.¹¹ The member states which ratified the Articles of Agreement are Australia, Austria, Brunei, China, Georgia, Germany, Jordan, Luxembourg, Mongolia, Myanmar, the Netherlands, New Zealand, Norway, Pakistan, Singapore, South Korea and the United Kingdom.¹² Article 59 of the Articles of Agreement "required deposit of such instruments by at least 10 Signatories with at least 50 per cent of the shares allocated." Thus, the AIIB entered into force. The next step for the AIIB to become a full-fledged MDB was the inaugural meeting of the Board of Governors which, in accordance with Article 60, can announce the commencements of the Bank.¹³ Headquartered in Beijing, it started functioning in January 2016.¹⁴

As of now, the AIIB is an Asia-based financial institution. According to the official website of the Bank, it is aimed at building sustainable infrastructure and connecting people, services and market in Asia and beyond.¹⁵ The purpose of the AIIB is 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

⁵ Rahul Mishra, "Asian Infrastructure Investment Bank: An Assessment", *India Quarterly*, Vol. 72, No. 1, 2016.

⁶ Ibid.

⁷ Ibid.

⁸ Ibid.

⁹ "Three Major Nations Absent as China Launches World Bank Rival in Asia", op. cit.

¹⁰ "50 Countries Sign the Articles of Agreement for the Asian Infrastructure Investment Bank", op. cit.

¹¹ Ankit Panda, "China-led Asian Infrastructure Investment Bank Enters Into Force: What Next?", *The Diplomat*, 30 December 2015.

¹² Ibid.

¹³ Ibid.

¹⁴ Asian Infrastructure Investment Bank, available at <https://www.aiib.org/en/about-aiib/index.html>, accessed on 01 May 2018.

¹⁵ Ibid.

by working in close collaboration with other multilateral and bilateral development institutions”¹⁶ which are listed in Article 1 of the Articles of Agreement.

To achieve its purpose, the AIIB stated that it intends to promote investment in the region for development purposes and to finance the development of infrastructure and other productive sectors which includes energy and power, environmental protection, rural infrastructure and agriculture development, transportation and telecommunications, water supply and sanitation, urban development and logistics. It wants to invest and encourage private investment in such projects that will contribute to spur economic development in the region.¹⁷

The AIIB has started initially with an authorized capital stock of US\$ 100 billion. Since its Asian character is predominant from the membership status, the majority of its shareholders are the regional countries. The official website of the AIIB categorized between regional members and non-regional members. Regional countries include Afghanistan, Australia, Azerbaijan, Bahrain, Bangladesh, Brunei Darussalam, Cambodia, China, Cyprus, Fiji, Georgia, Hong Kong, China, India, Indonesia, Iran, Israel, Jordan, Kazakhstan, Korea, Kyrgyz Republic, Lao PDR, Malaysia, Maldives, Mongolia, Myanmar, Nepal, New Zealand, Oman, Pakistan, Philippines, Qatar, Russia, Samoa, Saudi Arabia, Singapore, Sri Lanka, Tajikistan, Thailand, Timor-Leste, Uzbekistan, UAE, Vanuatu and Vietnam. They are representing 75 per cent shares.¹⁸ The total authorized capital stock of US\$ 100 billion is divided into 1 million shares. Each share is holding a value of US\$ 100,000.¹⁹ Additionally, under special terms and conditions at times, the authorized capital stock can be increased by a supermajority vote by the Board of Governors which is selected by the member states.²⁰ Each member state is entitled to appoint a Board of Governors and one alternative governor to represent the country in the AIIB Board of Governors.²¹ The AIIB Board of Governors is vested with all the powers. It has an effective say in selecting any AIIB president. The Bank has a Board of Governors, a Board of Directors, a President, one or more Vice-Presidents and other officers and staffs as required.²² Currently, Jin Lique is serving as the President of the AIIB.

Regarding membership, Article 3 of the Articles of Agreement conveys that membership is open to the members of the International Bank for Reconstruction and Development (IBRD) or the Asian Development Bank (ADB).²³ Presently, it has 86

¹⁶ Articles of Agreement, Asian Infrastructure Investment Bank, available at https://www.aiib.org/en/news-events/news/2015/_download/20150629094900288.pdf, accessed on 20 February 2018.

¹⁷ Ibid.

¹⁸ “50 Countries Sign the Articles of Agreement for the Asian Infrastructure Investment Bank”, op. cit.

¹⁹ Rahul Mishra, op. cit.

²⁰ Ibid.

²¹ Ibid.

²² Articles of Agreement, op. cit.

²³ Ibid.

members from around the world.²⁴ It has been able to include almost all the major countries of the world except the US and Japan. Both the regional and extra-regional countries have shown huge interest in the Bank due to its declaratory posture of using the resources and facilities of the Bank for improving infrastructure connectivity in Asia and beyond by promoting both public and private investment in infrastructure development and other productive sectors.

In brief, the Bank wants to play a driving role in the growing demand for infrastructure funding in the region and beyond through increasing investment which would accelerate overall development process.

3. China's Motivations for Establishing the AIIB

Why China established the AIIB? There are different interpretations roaming around the establishment of the Bank. China argues that Asia is in dire need of funding for infrastructure development. According to ADB's report in 2010, Asia can match the living standards of Europe by 2050, if it can facilitate its infrastructure development.²⁵ Investment in infrastructure can spur the economic growth in the region. Asia as a region has been experiencing a vibrant economic momentum over the last few decades. The report reveals that Asia needs an investment in the infrastructure about US\$ 8 trillion over 2010-2020 to maintain the growth. In this context of a huge infrastructure gap, existing institutions cannot fill it. The ADB has a capital stock of around US\$ 160 billion and the World Bank has its capital base of US\$ 223 billion.²⁶ Thus, the AIIB could play a driving role in reducing this massive infrastructure gap. The infrastructure development will also accelerate regional cooperation efforts in Asia. But this interpretation has its own limitations. Although the AIIB can always increase its stock, it has started its journey only with the capital of US\$ 50 billion which is not adequate given the context of huge infrastructure funding gap in the region. It is certain that the AIIB can contribute to the growing needs of infrastructure financing in the region, but it is not something which motivated China solely to establish a new financial institution.

Another interpretation is that China is creating its own institution to challenge the Bretton Woods Institutions in the face of the US' reluctance to restructure these institutions. The US is not interested to cede its power and authority in the International Monetary Fund (IMF) and the World Bank. The voting structure in these institutions is not fairly distributed and commensurate with the present distribution

²⁴ Ibid.

²⁵ "The Asian Infrastructure Investment Bank (AIIB) and the Implications to Thailand", Research Department, Krungsri, September 2015, available at <https://www.krungsri.com/bank/getmedia/aad28c04-274f-4e92-929d-19530b3d847e/Research-econ-14092015.aspx>, accessed on 10 January 2018.

²⁶ "Why China is Creating a New "World Bank" for Asia", *The Economist*, 11 November 2014.

of power. In other words, China wants to usurp US leadership in the economic arena.²⁷ Some skeptics argue that China-led AIIB will not be able to stand as a multilateral development institution; rather, it will be used as a soft tool to realize China's own strategic interest in the region. There are two aspects of China's emerging role in global economic governance.²⁸ First, Chinese policymakers want China to play a bigger role in the emerging regime of global economic governance.²⁹ Second, China has been relentlessly called on by various state actors to increase its weight in these economic institutions compatible with its rising profile.³⁰ But this interpretation also has limitations. Although the China-led AIIB will yield China's growing soft power in global economic governance without fail, the current financial resources of the Bank will fall short to fulfill its overarching aims of financing development needs of the region of Asia and beyond.

There are other arguments as well. China created the AIIB to increase its geopolitical and commercial interests by intensifying its economic linkage and trade relations in Southeast Asia, South Asia and Central Asia.³¹ Thus, China wants to utilize the mechanism of the AIIB to leverage its high currency reserves since it has the largest foreign exchange reserve in the world.³² The AIIB can promote internationalization of Renminbi (RMB). China has taken a number of steps to promote greater use of RMB. It has issued sovereign bonds denominated in RMB to offshore investors in Hong Kong worth RMB 6 billion in 2009.³³ It was a significant development in the process of internationalization of RMB. The World Bank, the ADB and the International Finance Corporation (IFC) also issued RMB-dominated bonds in 2011 in Hong Kong.³⁴ Similarly, it is expected that the AIIB will also follow the footsteps of these MDBs. AIIB's loan in infrastructure projects and other productive sectors would be mainly RMB dominated loans which will "lead to RMB offshore market" and internationalization of RMB.³⁵ It would also promote China's infrastructure export activities. China's investments in infrastructure are mainly positioned in Asia and Africa. Besides, other parts of the world such as America and the Arctic region are also expected to experience China's investments.³⁶ Figure 1 shows China's infrastructure-related exports in the AIIB countries from 2007 to 2014. The trend suggests that China's infrastructure-related exports to the AIIB member countries are going to expand voluminosly under a

²⁷ Mike Callaghan and Paul Hubbard, "The Asian Infrastructure Investment Bank: Multilateralism on the Silk Road", *China Economic Journal*, Vol. 9, No. 2, 2016, p. 116.

²⁸ Ibid.

²⁹ Ibid.

³⁰ Ibid.

³¹ "The Asian Infrastructure Investment Bank (AIIB) and the Implications to Thailand", op. cit.

³² Ibid.

³³ Robert Cookson, "China in Offshore renminbi bond issue", *Financial Times*, 08 September 2009.

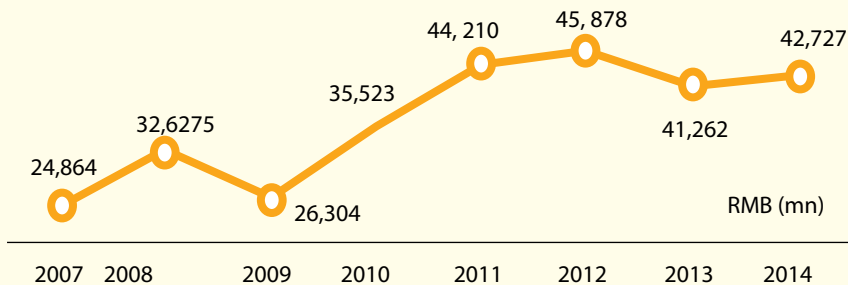
³⁴ "The Asian Infrastructure Investment Bank (AIIB) and the Implications to Thailand", op. cit.

³⁵ Ibid.

³⁶ Penelope Marbler and Lea Shan, "Chinese Investments in Infrastructure Worldwide", *Asia Programme*, IRIS, 2017, available at <http://www.iris-france.org/wp-content/uploads/2017/06/Asia-Focus-36.pdf>, accessed on 20 March 2018.

formal mechanism of the AIIB. Thus, the AIIB will boost the demand for RMB in the international market. But the study has found limitations regarding this interpretation. The paper argues that whereas the internationalization of RMB will definitely take place through using different channels of the AIIB, it is obvious that China has not established a new financial institution merely to promote internationalization of its currency as it has been seeking internationalization of RMB for over the last-half decade through taking different policies.³⁷

Figure 1: China's Infrastructure-related Exports to AIIB Countries



Note: Data based on value of China's exports of railways, cars, airplanes, ships and other transport equipment to 32 countries included in China's custom statistics.

Source: "The Asian Infrastructure Investment Bank (AIIB) and the Implications to Thailand", op. cit.

Amidst all these interpretations, the paper presents an alternative explanation which argues that the AIIB would be instrumental in implementing Chinese President Xi Jinping's signature project, the Belt and Road Initiative (BRI). The Silk Road Economic Belt (SREB) was announced in September 2013 in Kazakhstan. The 21st century Maritime Silk Road was proposed later in Indonesia subsequently with the AIIB. This alternative explanation is based on a three-pronged analysis.

First, in different key economic meetings in China presided by Xi Jinping, the President said that the primary task of the AIIB is to provide capital for schemes related to BRI.³⁸ Thus, the speeches of Xi Jinping show that the establishment of the AIIB has been driven by the funding needs for projects related to BRI.

Second, when the world was hit by the global financial crisis and recession in the North Atlantic, China's export-led growth faced some limitations.³⁹ A working

³⁷ Craig Chan and Wee Choon Teo, "RMB Internationalization: Prospects and Challenges", *BRINK ASIA*, 12 June 2018, available at <https://www.brinknews.com/asia/rmb-internationalization-prospects-and-challenges/>, accessed on 01 July 2018.

³⁸ "Xi Stresses Implementing Central Economic Policies", *Xinhua*, 10 February 2015, available at http://www.xinhuanet.com/english/china/2015-02/10/c_127481077.htm, accessed on 01 March 2018.

³⁹ Mike Callaghan and Paul Hubbard, op. cit.

paper was published by the ADB Institute in 2009, which was translated into Chinese and published by the Chinese Academy of Social Sciences.⁴⁰ The paper argued that a modern Silk Road is imperative to tap the potentials of Asia.⁴¹ The crux of the paper is an integrated Asia needs to restore Asian Silk Route. Once upon a time Asia was the most important trade and economic center of the world, the Silk Road served as the cross border network of trade routes across the continent of Asia.⁴² It was an extensive interconnected artery. But in recent times, the transport cost and lack of connectivity is seriously hindering the process of intra-regional trade. Although the economies of Asia have been emerging vibrantly and have become important components of international trade network, the economic potential of Asia remains largely untapped due to lack of connectivity. Thus, Asia needs to strengthen its physical connectivity base to revive its position as an international trade hub. In this process, restoring the ancient Asian Silk Road could be instrumental. It is very much possible that this literature has had a profound impact on Chinese policymakers. Upon considering this, China-led AIIB can be used to revive the ancient Silk Road, which is now termed as SREB, through financing infrastructure development.

Finally, some other prominent Chinese scholars have pointed out some key hindrances for the BRI initiatives. The most important impediment is the absence of a platform through which the member countries can be financially supported to be integrated with BRI project.⁴³

Thus, the AIIB has been established as an instrument of influence in the context of implementing the BRI. China's BRI project, which was initially known as One Belt One Road (OBOR) Initiative, offers a proposed infrastructure network which connects more than "60 countries across the land terrain of the ancient Silk Road land route (Silk Road Economic Belt) from China to the Mediterranean, plus an ocean route (Silk Road Economic Belt) connecting Europe with the Middle East, Africa and Southeast Asia".⁴⁴ There are perceptions that the AIIB is working as the financing wing of the BRI. China has set up a number of institutions and initiatives to make the BRI a reality. The AIIB is one of them. If the BRI is a complete plan for connectivity and investment, the AIIB is a vehicle through which China's investment capacity would be diverted out.⁴⁵ The BRI is China's grand strategy which is financially backed by the AIIB and two other development funds: the Silk Road Infrastructure Fund and the New Development Bank (NDB) established by the BRICS (Brazil, Russia, India, China and South Africa)

⁴⁰ Ibid.

⁴¹ ADB Institute, "Restoring the Asian Silk Route: Toward an Integrated Asia", *ADB Working Paper Series*, 2009, available at <https://www.adb.org/sites/default/files/publication/155995/adbi-wp140.pdf>, accessed on 30 December 2017.

⁴² Ibid.

⁴³ Mike Callaghan and Paul Hubbard, op. cit.

⁴⁴ "Perspectives on the Emerging Role of the Asian Infrastructure Investment Bank", *International Affairs*, Vol. 93, No. 5, 2017, p. 1066.

⁴⁵ Ibid.

in 2014. The Silk Road Infrastructure Fund is funded by Chinese foreign exchange reserves. It can act like a sovereign wealth funding mechanism. The AIIB will facilitate the implementation of the BRI by expanding China's economic influence. The BRI is much more interregional and pan-continental than regional. The pan-continental nature suggests China's expanding influence on other countries. The programme got a massive boost when China unveiled a separate Silk Road Fund of US\$ 40 billion in November 2014. Thus, these initiatives will definitely enhance China's influence and stakes in the region.⁴⁶ In brief, the AIIB, amongst other funding mechanisms, is created to implement the BRI successfully.

4. Geostrategic Implications

The China-led AIIB is expected to yield significant geostrategic implications for the region and beyond. The AIIB's formation is going to have a significant impact on both China as well as the regional order. China's growing footprint in international political economy will be tangible with the gradual maturity of the Bank. Its geopolitical importance also lies in the fact that both regional countries and extra regional countries will be impacted. Following are the geopolitical implications that the Bank is likely to make with its course of action.

4.1 *Expanding China's Regional and Global Influence*

Although the AIIB is an economic endeavour, it is not just about economics. The AIIB will yield significant strategic and political authority for China over the region and beyond. The way the US achieved strategic and political preeminence through its status, position and authority in the Bretton Woods Institutions, China will also be benefitted through its pivotal role in the AIIB, as economic might begets political power. The AIIB will help China to project its influence while attempting to facilitate connectivity between Asia and Europe. With better connectivity and regional integration of Asia, Africa and Europe, China can take advantage of its burgeoning economic needs and growth. Economic influence through the mechanism of the AIIB would translate into strengthened Chinese soft power in regional power dynamics and beyond. The AIIB represents "a new tool of statecraft to build and exert influence and authority".⁴⁷ This will also enhance the leadership status of China in international politics. A more prominent Chinese voice will be heard in the global institutional order. According to G. John Ikenberry and Darren J. Lim, "the AIIB can increase China's influence and authority in two distinct ways. Firstly, China has established an alternative to Bretton Woods system in terms of multilateral development lending. If

⁴⁶ Yong Deng, "China: The Post- Responsible Power", *The Washington Quarterly*, Vol. 37, No. 4, 2015, pp. 117-132.

⁴⁷ G. John Ikenberry and Darren J. Lim, "China's Emerging Institutional Statecraft", Brookings Institute, 2017, available at <https://www.brookings.edu/wp-content/uploads/2017/04/chinas-emerging-institutional-statecraft.pdf>, accessed on 15 March 2018.

the AIIB can be properly functional and provide equivalent service, many developing countries will depend on it. As there are complaints about the Bretton Woods system about being inefficient and bureaucratic, the prospective reduced participation of these states in Bretton Woods system will give China greater authority and power in the international order. China can also threaten to withdraw its membership from existing institutional arrangements. Second, the AIIB will allow China to consolidate its engagements with the member countries. The growth of economic relations between the loan recipient countries and the AIIB will translate into strengthened political ties with China.⁴⁸ Thus, China can foster bilateral relations by leveraging its institutional authority.

Besides, utilizing institutions to provide foreign investment will lead to close bilateral relations of China with the rest of the world. Thus, these engagements will erode anti-China sentiment to the regional and extra-regional actors. In brief, the AIIB, being an MDB, has a broad base of membership. The eagerness with which the member states from Asia and Europe joined the Bank is itself a source of confidence for China. It gives both credibility and legitimacy to China that such a large number of countries have confidence in its leadership. This elevated China's status in global political arena to a great extent. Despite vehement opposition from both the US and Japan, some critically important actors in the global political economic arena have joined the Bank which is a major source of viability for China-led AIIB. Thus, the AIIB is an enabler for China which is translating its increasing capabilities into greater Chinese political clout.

Finally, the history of other existing dominant institutions such as the World Bank and the ADB suggests that position and authority in multilateral institutions worked as a source of political influence. Japan's dominance in the ADB worked in favour of Japan while garnering support for temporary membership in the United Nations Security Council (UNSC). Thus, it can be expected that the China-led bank will work as an additional source for softening China's image in its neighbouring countries and worldwide. The countries in Asia may hesitate to accept financing from China for infrastructure and other development projects, but they will be comfortable if the financing comes from a multilateral institution. Thus, China can pursue its BRI initiative backed by the AIIB by yielding considerable politico-strategic clout in the region and beyond.

4.2 *Norm Setting*

Since the end of the World War-II, global financial and trade arrangements were largely shaped by the US. With the US at the centre, the pillars of global financial architecture, commonly known as the Bretton Woods Institutions, reflected

⁴⁸ Ibid.

the US interests. In the regional context of Asia, Japan has been the prominent actor in terms of dominating financial arrangements. Japan has dominated the ADB. Presently, China has come up with an idea to cut down the dominance of them in the region. It intends to change the regional economic setup. It aims to establish a new financial framework dominated by China itself. China also wants its economic prowess and decisions reflected in the newly emerging financial architecture. For many, the AIIB presents as “vanguard for an alternative economic world order”.⁴⁹ It is because China is frustrated over the slow progress in reforming process of the MDB governance. The present distribution of voting power in the World Bank, IMF and the ADB does not reflect the growing economic weight of China. China, being the World’s second largest economy, holds a minor role in the leading MDBs. The US is the largest contributor in both the World Bank and the IMF. Voting power is based on the individual country’s funding contributions. Currently, the US holds a 17.48 per cent voting share in the World Bank and 16.21 per cent voting share in the IMF.⁵⁰ Along with this, Japan holds a voting share of 12.80 per cent in the ADB where as China holds 5.477 per cent.⁵¹ Thus, Japan’s voting power is more than double from China. Besides, the US holds a voting share of 12.752 per cent in the ADB.⁵² These realities added frustration to Chinese policymakers. In this backdrop, China continued to push for reforms that can address the changing scenario of global economy and the US Congress continued to block such reforms.

China can now use the AIIB to promote its own policy goals. It has its own industrial goals which are designed by the State-Party. Its industrial goal aims to strengthen China’s State-Owned Enterprises (SOEs)⁵³ which plays an important role in Chinese economy. They also dominate China’s strategic sectors and industrial pillars.⁵⁴ China wants its SOEs to compete with the most powerful multinational companies. Since the AIIB is established to offer loans to countries to develop infrastructure projects such as building of roads, dams, power plants, rail transports and air transports, these SOEs of China can undertake these projects under the AIIB framework.⁵⁵ Thus, China will provide loans to countries which are in need of infrastructural development. A significant amount of these loans will be used again to pay to China’s SOEs which are experiencing excess capacity to some extent from building infrastructure projects in China.⁵⁶

⁴⁹ G. John Ikenberry and Darren J. Lim, op. cit.

⁵⁰ Daniel C. K. Chow, “Why China Established the Asia Infrastructure Investment Bank”, *Vanderbilt Journal of Transnational Law*, Vol. 49, available at https://www.vanderbilt.edu/jotl/wp-content/uploads/sites/78/7.-Chow_Paginated.pdf, accessed on 30 February 2018.

⁵¹ Ibid.

⁵² Ibid.

⁵³ Ibid.

⁵⁴ Kjeld Erik Brødsgaard, “Can China keep controlling its SOEs?”, *The Diplomat*, 05 March 2018.

⁵⁵ Daniel C. K. Chow, op. cit.

⁵⁶ Ibid.

Besides, at present, most of the international transactions are conducted in US dollars. It yields soft powers for the US. The US dollar holds considerable confidence. Besides, the US can freeze any transactions in US dollars by blocking the transfer of dollars by its banks. In this context, China intends to make the Asian region less dollar dependent. For this purpose, China-led AIIB can sanction loan in RMB. Currently, China wants to promote RMB and consequently, the IMF declared RMB as one of its official currencies.⁵⁷ If China becomes capable to conduct the transaction in RMB, it can easily deal directly with the countries which have been facing the US sanctions against them. It is because China will not need dollars to do transactions with these countries. In addition to that, China will also be able to control transactions in RMB by using Chinese banks. Conducting transaction in RMB would be an issue of prestige for China. The AIIB has the potential to make RMB a powerful currency.

The AIIB has provided China with an opportunity to project itself as a norm setting international actor in the global politics. The existing dominant financial institutions such as the World Bank and the IMF are primarily dominated by the US, which promotes US policies in the loan recipient countries. These policies embodied in a set of political and economic conditions are known as the Washington Consensus.⁵⁸ These policies include fiscal discipline with a focus on limits on government spending, redirection of public expenditures toward education, health and infrastructure, tax reform with a focus on broadening the tax base, market dominated interest rates, competitive exchange rate, trade liberalization, openness to foreign direct investment, privatization of state owned enterprises, deregulation, legal security for property rights and reduced roles for the state. These conditions aim to flourish the western concept of capitalism and economic liberalism in the loan recipient countries. The loan recipient countries have to comply with decisions imposed by the World Bank and the IMF. Besides, these institutions also impose conditions of environmental protection, sustainability and workers' right to loan to the potential loan seeking countries.⁵⁹ Overall, the US has been using the mechanisms of the World Bank and the IMF to further its policy goals in different countries of the world irrespective of the individualistic character of the individual states. Thus, the US has been dominating the international trade and financial regime. Ian Bremmer, President of the Eurasian Group once noted that "for decades (the US has) used its authority in the World Bank and IMF.....to guide developing countries onward western values".⁶⁰ Joseph Stiglitz, a Nobel laureate and Chief Economist of the World Bank from 1997-2000, also spoke against the conditions imposed on the individual countries by the World Bank and the IMF. He spoke against the simplicity of both Washington Consensus and IMF's "one - size - fits - all".⁶¹ He argued that these conditions which are referred to as

⁵⁷ Ibid.

⁵⁸ Daniel C. K. Chow, op. cit.

⁵⁹ Ibid.

⁶⁰ Ibid.

⁶¹ "The bumpy ride of Joe Stiglitz", *The Economist*, 16 December 1999.

“conditionality” are too rigidly applied to countries regardless of their individualistic characteristics. He also argued that “traditional conditionality has failed by and large.”⁶²

By contrast, China does not support imposing conditions to grant loans to the loan recipient countries which will appear very appealing to many countries. The formation of the AIIB will directly or indirectly challenge the western-style trade and financial regime. It is perceived that China will set a new set of rules for international trade and financial activities. China believes that each country has its own right to decide its course of action in its domestic affairs. These sovereign states should not be subjected to a set of political and economic conditions imposed by any international institution. This Chinese stance goes in direct opposition to the US stance to use conditions to realize their policy goals across the world. Some scholars are thinking of a new competing ideological agreement named as “Beijing Consensus”.⁶³ In contrast to the doctrine of conditionality, China is expected to follow a doctrine of non-interference.⁶⁴ China is not concerned with the political characteristics of an individual country with which it engages in economic affairs. For China, the economic system, environmental protection regime, sustainability and workers’ right of an individual country are important but China will not dictate their course of action to grant them loans. It respects individual countries’ decision to govern their own administration. This signals a clear shift from the previous trade and financial regime.

4.3 *Declining US influence in Asia-Pacific Region*

The AIIB is comprised of almost all major economies of the world except the US and Japan. It is interesting to map out that the AIIB has been able to attract many countries in the region and beyond. Several important and close partners of the US have joined the Bank. Although the apprehension about a China-led bank was lurking around, the countries decided to join the Bank due to commercial reasons. Despite the US opposition, the member countries preferred the burgeoning bank to get more financial support. Besides, many countries take bilateral loans from China. In this regard, it is more convenient for countries to take loans from a MDB rather than an individual country. Initially, Australia and South Korea which are deemed as major US partners in the Asia-Pacific region, took a decision not to join the Bank.⁶⁵ Similarly, Indonesia also stepped back from joining the Bank. Later, all three of them became members of the Bank. The consideration of financial benefits came prior to politico-strategic consideration. In fact, Australia was the first country which signed the Articles of Agreement. Similarly, Indonesia

⁶² Ibid.

⁶³ Daniel C. K. Chow, op. cit.

⁶⁴ Ibid.

⁶⁵ Ricardo Bustillo and Maiza Andoni, “China, the EU and multilateralism: the Asian Infrastructure Investment Bank”, *SciELO*, 16 July 2018, available at http://www.scielo.br/scielo.php?script=sci_arttext&pid=S0034-73292018000100207, accessed on 30 July 2018.

wanted China to establish AIIB's headquarter in its capital, Jakarta.⁶⁶ Even the US plea was ignored by many Western European allies. Even the UK which is the US' closest ally refused to the US plea to shun the AIIB. G-7 members also discussed the issue of the AIIB. The first country of G-7 to join the Bank was the UK.⁶⁷ And it acted without waiting for its other G-7 partners like France, Germany or Italy. Later, France, Germany and Italy processed their applications to join the Bank. Some other smaller European countries rushed to join the AIIB prior to 31 March 2014, so that they can become founding members. In fact, Canada was the only country which did not join the Bank. Besides, the first western country which applied to join the Bank was New Zealand. It expressed its interest to join the Bank in 2014. In return, President Xi Jinping praised New Zealand's "independent voice". In brief, although the US official position was that joining the AIIB is up to the individual states to decide, the US tried informally to keep the G-7 unified to take a uniform stance regarding joining the AIIB. The US's inability to enforce a uniform decision among G-7 members and its failure to dissuade its key allies from joining was viewed as a serious setback to the US diplomacy. There are many criticisms regarding the US approach towards the AIIB. Joseph Nye noted that the "US deciding people should not join" the Bank is a "sign of stupidity".⁶⁸

5. The Way Ahead

The AIIB is a newly emerged MDB in the landscape of contemporary international financial governance. It has been operating its activities of providing loans or investing in infrastructures for almost two years. It is playing important roles in contributing to the member countries' infrastructural development ranging from development of motorway to development of gas storage facility. Thus, it provided loans of about US\$ 1.3 billion in its first year and US\$ 3.30 billion in its second year.⁶⁹ However, there are still skepticisms in the field of contemporary international finance governance that whether the AIIB would able to stand as a viable new MDB. From the perspective of viability, the paper has mapped out several challenges which are crucial to address.

First, there are still suspicion and apprehensions regarding the motivation and objectives of the AIIB. There are perceptions that the Bank would be used for furthering Chinese commercial and political interest. The paper argues that, with 85 member countries, it would be very difficult for China to finance the projects only favourable for its own political and economic needs. Besides, China should make sure that the AIIB is

⁶⁶ "Indonesia says Jakarta will compete with Beijing to host AIIB", *China Daily*, 23 March 2015, available at http://www.chinadaily.com.cn/business/2015-03/23/content_19883346.htm, accessed on 30 July 2018.

⁶⁷ Ana Swanson, "Is the UK 'Accommodating' China by Joining its New Investment Bank", *Forbes*, 15 March 2015, available at <https://www.forbes.com/sites/anaswanson/2015/03/15/is-the-uk-accommodating-china-by-joining-the-asian-infrastructure-investment-bank/#61abba5e4dfd>, accessed on 23 June 2018.

⁶⁸ Rahul Mishra, op. cit.

⁶⁹ Salvatore Babones, "China's AIIB Expected to Lend \$10-15B a Year, But Has Only Managed \$4.4B in 2 Years", *Forbes*, 16 January 2018, available at <https://www.forbes.com/sites/salvatorebabones/2018/01/16/chinas-aiib-expected-to-lend-10-15b-a-year-but-has-only-managed-4-4b-in-2-years/#31933f0b37f1>, accessed on 30 January 2018.

led by China, not dominated by it. All the members will be treated equally based on the principles of the Bank agreed in the Articles of the Agreement. China's share in the Bank has raised another concern. China is the largest shareholder of the Bank. Many countries are worried of China's 30.34 per cent shares in the Bank with a voting share of 26.06 per cent.⁷⁰ However, China can assure the members and potential members that the present distribution of share and voting can change with the expansion of the membership of the Bank. Besides, the US and Japan have not joined the Bank. They remain un-committal, although their official positions have improved from the past regarding the AIIB. For China, the AIIB is a new forum to advance its relations with these countries. China should work harder to appease these concerns and skepticism; it is because participation of these countries could enable the Bank earning higher credit rating.⁷¹ Memberships of these countries would also serve as a source of legitimacy for the Bank.⁷²

Second, the nature of the Bank is ambiguous. The Bank needs to take a clear stance on its very identity. Whether it would be a development aid agency or an MDB? Although the Bank started with the objective of filling the financing gaps in the infrastructure market of Asia, China also focused on the idea that the Bank should act like an MDB which needs to be paid back of its loans. The infrastructure projects in the region have a long tradition of funding cycles. It takes a lot of time for the completion process of the projects. There is also a potential for waste and mismanagements. In this backdrop, question rises that how China is going to balance these two traits of the Bank of becoming MDB with the motivation to fill the infrastructure financing needs of the region. What seems more realistic is that the Bank will end up limiting its scope in providing financing for infrastructure projects in the region. The Bank needs to be cautious and selective in project selection and financing process.

Third, the AIIB must adhere to the policies of environmental and social safeguard propagated by the existing MDBs. There are concerns that the Bank will "lend to dictators, despoil the environment and trample human rights".⁷³ President Xi Jinping announced earlier that the Bank will follow the "good practices" of existing institutions out there.⁷⁴ The AIIB has included in its founding principles that its foundation is built on "the lessons of experience of...existing Multilateral Development Banks. In addition to that, the Bank's mode of operation is "lean, clean and green".⁷⁵ Although setting policy theoretically is different from getting things in practice. In 2015, the World Bank admitted that it had

⁷⁰ Enda Curran, "The AIIB: China's World Bank", *Bloomberg*, 06 August 2018, available at <https://www.bloomberg.com/quicktake/chinas-world-bank>, accessed on 25 August 2018.

⁷¹ Zhiquan Zhu, "China's AIIB and OBOR: ambitions and challenges", *The Diplomat*, 09 October 2015, available at <https://thediplomat.com/2015/10/chinas-aiib-and-obor-ambitions-and-challenges/>, accessed on 30 October 2017.

⁷² Ibid.

⁷³ Mike Callaghan and Paul Hubbard, op. cit.

⁷⁴ Don Rodney Ong Junio, "Asian Infrastructure Investment Bank: An Idea Whose Time Has Come?", *The Diplomat*, 04 December 2014.

⁷⁵ Asian Infrastructure Investment Bank, op. cit.

failed miserably to uphold its policies to protect the poor in the process of building dams and roads. Many people were swept aside which was a direct implication of building these projects. In this context, the AIIB will be scrutinized more closely in the aftermath of its lending in projects whether there are any negative environmental or social implications.

Fourth, security of the investments is another big challenge for the AIIB. Many countries which are suffering from lack of infrastructure or weak infrastructure are also facing violent conflicts. Violent conflicts such as insurgency, terrorism, violent extremism would hinder the implementation process of any development project. For instance, the Kashgar-Gwadar corridor which links Western China and Pakistan through roads and pipelines is such a route which has many conflict-prone areas. Besides, China has announced to build 81,000 kilometres of high-speed railway which will involve more than 65 countries.⁷⁶ Many of these countries embody conflict-ridden and vulnerable territory. Khyber Pakhtunkhwa region of Pakistan, Western Thailand and Afghanistan are such conflict-ridden parts of the project. Thus, the security aspect of such gigantic projects is a great concern.

Fifth, the AIIB wants to maintain high standards and regulations for its governance. It wants to deliver funding more efficiently than the existing MDB like the World Bank and the ADB. The AIIB has realized that maintaining high standards in the governance process of the Bank will protect it against a bad lending decision. High standards and regulations are also prerequisites for good credit rating which in turn also determines its legitimacy and international fundraising. The AIIB has been given AAA rating, the highest possible rating in Asia by Moody's Investors Service due to "the strength of AIIB's governance frameworks, including its policies on risk management, capital adequacy and liquidity".⁷⁷ The Chinese leadership and the AIIB authority are willing to maintain standard regulations for governance purpose, but there are alleged disagreements domestically. Sometimes, certain domestic interest lobby wants to view the AIIB as a tool to extend Chinese interests around the world. Therefore, the AIIB needs to take these issues under consideration to become a viable financial institution.

Sixth, the Bank needs to be more independent in the selection and completion of the financing of the projects. In 2016, the Bank committed to finance nine projects worth of US\$ 1.73 billion.⁷⁸ Among them, six were co-financed by the World Bank, the ADB or other financial institutions. In these projects which were co-financed, the AIIB has taken the assistance of these financial institutions in terms of knowledge sharing, project management, technical expertise and so on. Although the AIIB is still in its nascent stage, it should gradually obtain its own capabilities in terms of legal, technical and managerial issues of the projects so that it could operate the projects independently. Mutual cooperation with other MDBs will always provide the AIIB with an opportunity to share

⁷⁶ Zhiqun Zhu, op. cit.

⁷⁷ Fu Jun, "Three major challenges AIIB must overcome", *China Daily*, 07 May 2017.

⁷⁸ Ibid.

experience on the management of the projects, but in the long run, if it could finance the potential projects independently, it will strengthen its portfolio.

Finally, since its inception, the AIIB has financed those projects which belong to hard infrastructure. Its financing covered gas pipeline, two power plants, a port facility, redevelopment of a poor district, a power distribution line, a motorway construction and railway and road improvement in the year 2016. On the other hand, the World Bank-financed projects not only cover hard infrastructure but also soft infrastructure. Hard infrastructure includes roads, electricity transmission/distribution, water supply and urban development, etc., and soft infrastructure includes health policy, urban management, decentralization, assistance to subnational governments, etc. For Asia, development of both hard and soft components of the infrastructural body is critical for comprehensive development. The AIIB, thus, needs to expand its scope of funding in accordance with the development needs of Asia.

6. Conclusion

The AIIB has started functioning with the declaratory objective of promoting investment in the region for development purpose. It began its journey with an authorized capital stock of US\$ 100 billion. The Bank is predominantly Asian in nature since most of its member countries are from Asia. The Asian countries presently represent 75 per cent share of the Bank. Given these characteristics, a major MDB like the AIIB has been established in a generation. There are different arguments roaming around China's motivations behind creating such a major MDB. For China, it has led the Bank to meet the huge infrastructure development needs of Asia which in turn will accelerate the regional cooperation process. Another school of thought views the establishment of the Bank led by China as a means to challenge the Bretton Woods Institutions. It is because the US is reluctant to restructure these institutions with the growing politico-economic profile of China. Some scholars also think that the AIIB will not be able to establish itself as a viable MDB. Rather it will be used as a tool to realize China's regional strategic interest through deepening commercial ties and economic relations with the regional countries. In other words, the AIIB will increase China's political clout in the region and beyond. Besides, there are interpretations that China wants to use the mechanism of the AIIB to leverage its high currency reserve. Through the channels of the AIIB, China wants to promote RMB. Amidst all these arguments, the paper presents an alternative explanation that China-led AIIB will be instrumental in implementing Chinese President Xi Jinping's BRI project. To have the successful implementation of the BRI, China will need the AIIB as one of the BRI's principal funding mechanism. The alternative explanation is based on a three-pronged analysis. First, in different meetings, Chinese President Xi Jinping verbally expressed that the funding needs of different projects related to BRI has driven China to establish the AIIB, which, among other instruments, will contribute to the successful implementation of the BRI. Second, the global financial crisis and its aftermath research works might have a profound impact on China's establishment of the Bank since many research papers

especially the ADB Working Paper suggested that a modern Silk Road should be restored to tap the full potential of Asia in terms of enhancing connectivity. Thus, the AIIB would be instrumental in reviving the Ancient Silk Road. Finally, the absence of a financial platform through which the member countries of the BRI can be fully integrated with the BRI, might have motivated China to establish the Bank.

Therefore, the paper has explored the geostrategic implications of the AIIB for the region and beyond. The paper has found out several key geostrategic implications of the Bank. First, the establishment and well functioning of the Bank will result in expanding China's regional and global sphere of influence. China will yield significant soft power in regional power dynamic and beyond through economic influence using the mechanism of the AIIB. Besides, history shows that leading position and authority in dominant MDB generally works as a source of political influence. Thus, China can strengthen its leadership status in international politics. Second, the formation of the AIIB and its governance maintaining standard ethical, economic and environmental rules and regulations will provide China with an opportunity to project itself as an important stakeholder in the norms setting domain of international political economy. Third, the formation of the AIIB will lead the world to the emergence of a China-led financial architecture. A significant portion of global trade and financial arrangements will largely be shaped by China onwards. Finally, it is interesting that the AIIB has been able to attract a large number of regional and extra-regional countries in the face of US reluctance. Many close and important partners of the US have joined the AIIB because they prefer business first. The influence of the US is thus diminishing in the Asia-Pacific region. The paper has also mapped out the way forward in terms of its further development. It has mapped out several challenges the Bank is facing to become a full-fledged MDB. First, there are apprehensions and suspicions regarding China's motivation for creating the Bank as well as its objectives. China needs to assure the member countries as well as the potential members that it is leading and not dominating the Bank, given the provisions of distribution of share and voting arrangements. Second, the objective of the Bank should be in line with its scope of the investment considering the regional context which is creating an ambiguity on the very identity of the Bank. Third, maintaining high standards of social and environmental safeguards propagated by existing MDBs would be another major challenge for China. Fourth, security of investment remains a big challenge for the Bank considering the ongoing violent conflicts such as insurgency, terrorism and violent extremism in the member countries' political environment. Fifth, maintaining high standards and regulations in the governance process of the Bank will lead to its good credit rating and legitimacy which appears as another source of challenge for the Bank. Sixth, selection and financing of projects independently on the part of the Bank is another important area of expertise which is yet to be obtained. Finally, the AIIB's project financing should not only cover hard infrastructure but also soft infrastructure. Addressing these challenges would help the Bank to become a viable MDB.