Asian Infrastructure Investment Bank

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Introduction

The Asian Infrastructure Investment Bank (AIIB) is a Multilateral Development Bank (MDB), established by China and 56 other member states in 2016, with initial pledged capital of US$100 billion, to address the infrastructure deficit in Asia, the world's fastest-growing region. By bolstering finance for development, the bank promises improved economic security for its member states, most of which have unmet demand for energy and other infrastructure. The new institution represents, however, a challenge to the international system. Along with a series of other new institutions and platforms for engaging with the developing world, the AIIB marks China's return to great power status, contributing to global economic governance alongside the United States (US).

In 1944, at Bretton Woods, the US established the International Monetary Fund (IMF) and the World Bank Group as part of a network of multilateral institutions centred around the United Nations (UN) system, described here collectively as the liberal international order. From the end of the Cold War until the second decade of the twenty first century, the US leadership of that international order went largely unchallenged.

The rapid growth of Asia has created significant unmet demand for infrastructure finance, however, and the Bretton Woods MDBs and Japan's subsequent establishment of the Asian Development Bank (ADB) have been unable to meet this demand. Whether the establishment of the AIIB is complementary to the liberal international order and the economic security it seeks to provide, or constitutes a threat, is a matter of debate in international relations. At around the same time as the establishment of the AIIB, the US was abandoning four decades of constructive engagement with China and embracing a new doctrine of strategic competition.

The AIIB has therefore come to represent in the eyes of realists (those focusing on the balance of power) a threat to the US-led order. Meanwhile, the confidence of liberal internationalists that China will rise within the liberal international order has yet to be tested. To be sure, the AIIB does pose a number of normative challenges to how the US had designed and reformed the liberal international order. As will be discussed below, the AIIB diverges in some important respects from the US-led Bretton Woods institutions. In other important respects, however, the AIIB is learning from and adopting best practices by co-funding projects with other MDBs, governments and private sector partners, spreading risks and leveraging its funds to maximise infrastructure investment. It therefore appears likely to deliver on its promise to improve the economic security of its member states, even as China's role in the liberal international order continues to be a work in progress.

The geopolitical background

The evolution of the multilateral system to accommodate new economic powers and the priorities of the developing world has been a long time coming. The IMF and the World Bank were established towards the end of World War Two as part of an allied plan for a liberal post-war order with multilateral mechanisms for international economic cooperation. In the immediate post-war decades, financing for infrastructure development was a priority, first in the reconstruction of Europe and later in developing countries (Humphrey, 2015). Soon after the post-war establishment of the Bretton Woods institutions, however, the world order was frozen by the Cold War into two rival camps, a US-led grouping and a Soviet-led grouping (with scarce space for non-aligned states).

Despite the process of decolonisation, which brought a large number of new nations into the UN system, and the rapid development and growing importance of key Asian and other economies, the multilateral institutions did not adapt to the changing balance and the non-borrower countries continued to determine the allocation of financing for development. Just as the UN Security Council remained controlled by the same Permanent Five since its establishment, the World Bank and the IMF remained controlled by the US (and its European allies). In the later Cold War era, the Group of 77 (G77) developing nations agitated for a New International Economic Order and the response from the US, convinced of its economic model for development, was to advocate for a more muscular neo-liberal, market-led economic agenda as integral to the liberal international order (Gilman, 2017). From the 1990s, the IMF and the World Bank sharply reduced their funding for infrastructure investment to focus instead on poverty alleviation programs and neo-liberal policy prescriptions, applying stringent conditions on finance, including market-oriented economic policy reform and structural economic change, as well as political reforms including the observation of human rights (Larionova & Shelepov, 2016; Stephen & Skidmore, 2019).

Financial liberalization, including capital account liberalization, promoted by the Bretton Woods institutions based on the new neo-liberal orthodoxy, generated a significant backlash in the developing world following the Asian Financial Crisis of 1997 and demonstrably failed to deliver the economic success that economists had predicted (Liao, 2015; Chan & Lee, 2017). Further, the conditions imposed by the IMF and the World Bank are widely perceived to have failed in their objectives to drive economic and political reforms (Limpach & Machaelowa, 2010). While the ADB remained focused on infrastructure financing, the MDBs as a whole were failing to address the demand, in particular in rapidly-growing Asia, for critical infrastructure (ADB, 2017) and demonstrated an aversion to investing in high-risk environments (Humphrey, 2015).

The rise of China to a leading role in global economic governance became evident by the second decade of the twenty-first century, following decades of its "reform and opening up" begun in late 1978. Following elements of the earlier East Asian development models but at a larger scale and with greater role for its Party State, China embraced private sector development, foreign direct investment, integration into global supply chains and investment in large-scale infrastructure. In important respects, this marketization process involved being co-opted into – and cooperating with – the liberal international order. This was confirmed with China's role in Asia Pacific Economic Cooperation (APEC) and in particular by its entry to the World Trade Organisation (WTO) in 2001 and its subsequent membership of the G20 and the Regional Comprehensive Economic Partnership with fourteen major Asia Pacific economies. In each of these platforms, China's political uniqueness is accepted but it is required to adhere to regional and global trade rules. Over the last decades, China has gradually liberalized the internationally exposed sectors of the economy, while retaining state control of strategic sectors. By 2010, it had overtaken Japan to become the second largest economy in the world, by 2013 China became the world's leading trading nation (Woetzel, et.al., 2019) and by 2019 two thirds of the world traded more goods with China than with the US (Leng & Rajah, 2019). Its rapid growth has transformed China from a uniformly poor society four decades ago to a leading global economy with a middle class numbering in the hundreds of millions, although its per capita GDP remains well behind that of the advanced economies.

The dominant international narrative of China's "peaceful rise" rested upon common assumptions (notably in the US) that China would follow a predictable course of integration and interdependence with the forces of globalization. Indeed, there were widely distributed relative gains from China's increasingly important role in global value chains, with international firms benefiting from low cost manufacturing and consumers around the world benefiting from low cost products. The dominant liberal internationalist discourse was based on a normative confidence that China would not only engage economically with the liberal international order but that it would politically liberalise, following the experience of other East Asian economies such as Korea and Taiwan (Overholt, 1993). However, China has not politically liberalised, doubling down during the leadership of Xi Jinping on reforming but strengthening its Marxist-Leninist Party State with Chinese Characteristics, promising a combination of continued economic growth and social order. Indeed, while a significant number of emerging economies across Asia have achieved impressive economic development in recent decades, based on pragmatic policy making, the region remains wracked by serious security dilemmas, including longstanding strategic rivalries, and a resurgent China is feared by many of its neighbours (Mattalib, 2010). The greatest fear of the implications of China's rise, however, has emerged in the world's leading economy.

Despite mutual dependence through investment and trade, US engagement with China was unbalanced due to credit-fuelled consumption in the US and the resulting severe savings deficit, which resulted in soaring Chinese foreign exchange reserves. This provided China with significant capacity to redeploy US currency to financing for development across the world, even while China itself remained theoretically a developing nation itself. Further, Xi's newly assertive leadership began to signal China's wish for a greater role in the world order as institution-builder, rule-maker and norm-setter. Liberal internationalists expected either that China would seek leadership but not contest the key principles underpinning the liberal international order from which it has demonstrably benefited (Ikenberry, 2011) or that China could at least be encouraged to be a responsible stakeholder through a combination of US coercive power and reassurance of respect (Christensen, 2015). The rapidly diminishing US confidence in these narratives in recent years will be discussed below, but first it is important to place the growing Chinese assertiveness into context, as it included far more than just the AIIB.

By the second decade of the twenty first century, not only had China emerged as a major economic power with considerable financial resources, but its rise coincided with a collapse in US and Western economic and political confidence and declining support for free trade and investment (arguably one of the building blocks of the liberal international order), following the financial crises of 2007-8, crowning two decades of sharpening inequality stemming from a declining share of national productivity distributed to labour (Manyika, et.al., 2019).

Following his elevation to the leadership of the Chinese Party State in 2012, Xi set about announcing a series of initiatives to build upon China's bilateral financing support to developing countries, to construct new regional and global platforms for economic cooperation. The most ambitious of these was the Belt and Road Initiative (BRI), an umbrella term for a suite of Chinese infrastructure-funding initiatives, utilising Chinese capital and expertise for investment in infrastructure connectivity, policy coordination, trade, financial integration and people-to-people links (State Council of the People's Republic of China, 2015; National Development and Reform Commission, 2015). It includes projects that will bring new funding, new technology, management capabilities, employment and, most importantly, new infrastructure such as transport, power, communications and water to support trade, development and economic integration across Central Asia, South Asia, South-East Asia and beyond to Central, Eastern and Southern Europe and South America as well as to the South Pacific and the Arctic. More than one hundred and twenty-five nations have signed BRI cooperation agreements with China (Raiser & Ruta, 2019). In its massive scale, the BRI is likely to drive substantial trade and investment development, with the World Bank estimating that trade in the BRI economic corridors is currently 30 per cent below potential, and that foreign direct investment may be as much as 70 per cent below potential, with BRI investments likely to raise global income with significant net benefits for BRI countries, particularly in East Asia (Maliszewska & van der Mensbrugghe, 2019).

The AIIB was announced as part of a suite of financing vehicles to support the BRI, including another MDB, the New Development Bank (founded in partnership with the BRICS countries, i.e., Brazil, Russia, India and South Africa), a Silk Road Fund, and various regional infrastructure financing platforms. The Chinese initiatives were described in terms of building "new Silk Roads" reminiscent of the trading routes that linked China to the civilizations across Eurasia in the centuries before the rise of Western Europe and its colonisation of the world. To realists and a renewed chorus of geopolitical commentators in the West (as well as to some enthusiastic commentators in China), it began to look like China wanted to challenge the world order. Whether the new Chinese initiatives were a threat to the liberal international order or would complement and strengthen processes of international economic cooperation became a matter of vigorous debate (and, in relation to the AIIB, this will be further discussed below).

The shift in the Western narrative is well described by Mearsheimer's influential "offensive realism", in which great powers seek to maximise power and a rising power will seek to become a regional hegemon, while its competitor will seek to prevent the rising power from reaching regional hegemony (Mearsheimer, 2014). The assumption rapidly took hold in the West that China was indeed seeking hegemony, seemingly reinforced by militarization of the disputed islands in the strategically important South China Sea and the rapid modernisation of China's maritime military and cyber-security capabilities. Following the election of US President Donald Trump, the US switched its strategy from constructive engagement with China to a doctrine of "strategic competition" (US Government, 2017; Department of Defense, 2018) and launched a trade war and a campaign against the BRI, labelling it a "debt trap". The US, Mearsheimer had predicted, would respond to China's rise just as it responded towards the Soviet Union as a peer competitor, by combining with allies to prevent China from gaining power. Indeed, Mearsheimer expected that countries in Asia would need to "choose sides" and that most would rationally seek to preserve their relationship with their powerful protector in the face of a more and more powerful China.

On the basis of Mearsheimer's analysis, the US expected that its allies would support it in boycotting the AIIB. To the US, the AIIB constituted one element of China's threat to the liberal international order and the Obama administration (which "pivoted" to Asia to reassure its allies of its continued role in the Pacific) actively lobbied allies to oppose the new institution. Only Japan followed the US. In joining the AIIB, other US allies demonstrated that they rejected the realist analysis and were prepared to welcome the AIIB as complementary to the liberal international order. This suggests the binary US-led narrative that frames Chinese institution-building as a risk to the liberal international order does not adequately explain the context in which the AIIB was founded or the way it is operating.

Indeed, the AIIB can alternatively be seen as one of a number of innovations in the international system of the early twenty-first century to accommodate a wider range of powers and address regional and global problems, including the founding of the G20 and East Asia Summit and the Paris Agreement on Climate Change. The failed US campaign against the AIIB arguably weakened its standing in the region and strengthened the role and standing of China (Aberg, 2016). The AIIB will evolve to provide China with a greater role in regional and global rule-making, particularly when linked with the much larger BRI. How China will play such a role over time remains an open question but some of the normative challenges are apparent in the design of the AIIB.

The AIIB's normative challenges

As the first MDB to be established by a developing country with some important new characteristics, the AIIB does indeed represent a set of normative challenges to the liberal international order led by the US. First, its creation by rising China reflects a demand for multi-polarity in the leadership of global economic governance. Second, its structure reflects a more equitable representation of the developing world. Third, its focus is on developing world priorities. Fourth, and finally, it imposes no conditions based on internal political concerns. Together, these are priorities that China is likely to promote more broadly across the multilateral system over time. These will thus impact on the external perception of China's leadership and its norm-setting power in global governance (Peng & Tok, 2016).

The establishment of a new multilateral organisation led by and headquartered in China provides China with an enhanced role in global economic governance, with new rule-making and norm-setting power that is likely to generate strengthened influence in the developing world. It provides legitimacy to China's major role in financing for development in the face of US (and Japanese) resistance to giving China such legitimacy. A greater role for China based on its economic weight goes directly to the matters of geopolitics discussed above. For some time in the early twenty-first century, liberal internationalists talked about a "G2" which would see greater global economic coordination between the US and China. The recent switch in US geopolitical strategy to embrace the realist fear of rising China and to designate it as a strategic competitor is a critical piece in the puzzle of whether China can play a greater role in economic governance without conflict with the US. China's claimed role is to reform and democratise, rather than to overthrow, the international system.

The structure of the AIIB itself importantly diverges from the norm established in the Bretton Woods institutions that entrenched US leadership and the structural dominance of the developed world in decision making. The creation of the new MDB reflected the resistance over many years to voting share reform in the existing institutions. Not only does the US by convention provide the President of the World Bank (by convention, the IMF is led by a European), but it retains veto-wielding stakes in each. Voting rights of major developing countries, although slightly adjusted in recent years, have not grown to match their relative weight in the global economy. In the IMF, the US has a weighted voting power of 16.52%, with the world's third largest economy, Japan, at 6.15%. China, although a larger economy than Japan, has 6.09% since recent reforms. In 2016, the IMF included the renminbi in its basket of currencies that comprise the Special Drawing Rights, boosting the long-term internationalization of the Chinese currency. In the World Bank Group, the US retains voting rights of 15.98%, with Japan at 6.89% and China at only 4.45%. The Asian Development Bank established by Japan (the US prevented its establishment of an Asian Monetary Fund) provides equal voting rights of 15.6% to Japan and the US, but only 6.4% to China. The imbalance is clear, but significant reform has long been blocked by the US Congress, with only a small-scale adjustment of voting shares approved by Congress in late 2015, arguably in response to the establishment of the AIIB itself (Peng & Tok, 2016).

The AIIB uses a similar formula to the other MDBs in determining voting rights based on a combination of basic votes, share votes and Founding Member Votes. Where it diverges, however, is that from its establishment, developing countries have a structural majority and nine of the twelve directorships are reserved for Asian members. China holds 26.59% voting power providing it with a veto over key strategic decisions (a super-majority of 75% of the votes is required to amend the founding treaty), although its share will decrease as new members join. Indeed, China offered to reduce its voting share to below the veto threshold if the US and Japan agreed to join as co-founding members, as part of its bid to attract broad international involvement (Hu, 2015). The Chinese veto does not extend to operational matters such as project approvals. Other major shareholders include Australia, India (second largest shareholder at 7.64%), Indonesia, Korea, Russia, and non-regional members such as France, Germany and the United Kingdom.

The normative challenge set by the AIIB would, if extended to other organisations in the multilateral system, see a shift of power to the developing world commensurate with its economic weight. It may be difficult in the long term for the US to justify its resistance to this trend.

The AIIB normatively endorses China's model of infrastructure-driven development, which itself builds upon the successful East Asian model of development. By successfully leveraging more finance for infrastructure and implementing projects well, the AIIB may reinforce the emerging consensus in Asia (and more broadly across the developing world) that there is an alternative development path to the "Washington Consensus". As noted above, the disillusionment with the IMF and the World Bank's preferred neo-liberal economic solutions had already become apparent well before the AIIB was established. Some have referred to the alternative Chinese model as a "Beijing Consensus" (Yagci, 2016), characterised by a focus on industrialization and a central role for state investment in infrastructure to build capabilities to attract investment and build export industries. Prior to the establishment of the AIIB, or even the announcement of the BRI, China had already begun to embark on an ambitious program of extending development finance for developing country partners to build infrastructure. Its domestic policy banks, the Export Import Bank of China (Exim Bank) and China Development Bank (CDB) remain the largest funders of what are now labelled "Belt and Road" projects, lending Chinese foreign currency reserves to developing countries. Indeed, the CDB is now the world's largest source of development finance. The new initiatives such as the AIIB and the NDB represent the internationalization of this effort and further spreading of risk, as Chinese capital alone cannot fund the infrastructure needs of the developing world.

The final important normative challenge of the AIIB is its commitment not to attach political conditions to its lending. This is a significant break from the practices of the Bretton Woods institutions. The IMF and World Bank have explicitly linked financing to encouraging practices considered important to good governance, including accountability, rule of law, human rights, decentralized political authority, political pluralism and participation. China has consistently opposed the imposition of such conditions, and, in this, it is supported by others in the developing world. For China, "non-interference" in the internal affairs of other countries is a key plank of its contemporary foreign policy orthodoxy and a key driving principle in its participation in the multilateral system. China often abstains or opposes moves in the UN that it perceives are interfering in the internal affairs of member states. China is particularly sensitive about international interference within its sovereign territory, considered to be a result of its "century of humiliation" at the hands of imperial powers. Such sensitivity to foreign interference is not unusual for any nation but China is unique as a rising power in its claim that it will not interfere in other nations' internal affairs. The claim is widely distrusted in the international community. Article 31 of the AIIB's *Articles of Agreement* states, nonetheless, that the Bank "shall not interfere in the political affairs of any member" and further that its decisions will not be influenced by "political character" of any members.

China may still be a "partial power" (Shambaugh, 2013), a long way from matching the hard and soft power of the US, but the creation of the AIIB, as part of a suite of other initiatives for financing development, indicates that China is beginning to exercise influence in shaping new norms in the international system. While some commentators perceive a geopolitical project, to build a "parallel order" and sphere of influence to ultimately challenge the prevailing international rules (Hodzi & Chen, 2017), a closer examination of the operations of the AIIB allows a preliminary assessment of how China will wield its growing influence.

The AIIB's operations

The AIIB was launched in 2014 and commenced operations in January 2016 with an initial pledged capital of US$100 billion (about two thirds the size of the ADB). The Bank reached a milestone of one hundred approved memberships by mid-2019, at which time it had provided US$8.5 billion in finance to 45 projects in 18 countries and received the highest credit ratings from the world's three leading rating agencies, Standard & Poor's, Moody's and Fitch Group (Chen & Chen, 2019). The leading destination for AIIB investment has been India, with funding for thirteen projects worth a total of US$2.9 billion at November 2019 (AIIB, 2019). Despite fears when it was launched that the AIIB would prioritize Chinese firms and would operate at lower standards than other MDBs (Hameiri & Jones, 2018), the bank has implemented best practice operations.

The AIIB has pursued a "lean, clean and green" philosophy, seeking to demonstrate that it can overcome the widely observed constraints on the traditional MDBs by operating with a smaller team without a resident board as well as with less cumbersome and costly processes for borrowers, yet still meet high standards (Humphrey, 2015). In time, it may provide healthy competition to the Bretton Woods institutions, although in its early years it also seeks to learn from them and, as an ongoing priority, to work with the established MDBs collaboratively.

Jin Liqun, a former Vice President of the ADB and Chinese Vice Minister of Finance, was appointed to lead the establishment of the AIIB as inaugural President and Chair of the Board of Directors. The Board of Directors is non-resident, designed to provide separation between strategic policy and budget and management supervision determined by member states, on the one hand, and day-to-day operations determined by professional management on the other hand. This arguably provides higher efficiency than in the case of the Bretton Woods institutions, with their resident boards of directors overseeing operations (Stephen & Skidmore, 2019) driven by non-borrower priorities (Humphrey, 2015). Expert and experienced staff have been recruited from other MDBs to assist the AIIB to learn, build its capabilities and implement best practices. A high proportion of staff is internationally educated (Oswald, 2017; Shelepov, 2018). While the operating structure mirrors those of the Bretton Woods institutions, it is slimmer, allowing fast and efficient decision-making. Throughout its operations, its commitment to best practices, including in project appraisal, zero tolerance for corruption, open public procurement and transparent tendering, is modelled on the established MDBs. In so doing, the AIIB has internalised a set of operating norms from other multilateral institutions. China's failure to adopt more transparent processes in its bilateral aid and infrastructure-lending has been a matter of some criticism and it is as yet unclear if the AIIB will be a source of learning for the Chinese domestic policy banks over time (Chan & Lee, 2017; Stephen & Skidmore, 2019).

Cooperation with other multilateral and bilateral development institutions is cited as core to the AIIB's purpose in Article 1 of the Bank's *Articles of Agreement*. In its operations to date, the AIIB has sought to maximise its impact, leverage its contributions and to spread risks and harness other benefits from co-financing projects with other MDBs. Approximately three quarters of projects approved to date have been co-financed with other institutions (Shelepov, 2018) and these have been widely observed to be constructive partnerships (Gåsemyr, 2019). The AIIB has cooperation and co-financing agreements with the World Bank, ADB, NDB, European Bank for Reconstruction and Development (EBRD), European Investment Bank (EIB), Inter-American Development Bank (IDB) and the Eurasian Development Bank (EaDB). Co-financing with MDBs has three main operational effects in addition to increasing the pool of funds available for infrastructure projects. First, co-financing shares and mitigates risks. Second, it ensures that the AIIB aligns with and therefore reinforces the best practice standards and operations of other MDBs, as it is bound by co-financing agreements to follow standards in areas from procurement to environmental sustainability. Third, by leveraging resources, developing common approaches and spreading risks across multiple institutions, the AIIB facilitates coordination, cooperation and the strengthening of the multilateral system, ensuring that it is positioned over time as a non-controversial contributor to the network of MDBs.

Further, the AIIB seeks to become a leader in catalysing private capital investment in infrastructure by working on developing emerging market infrastructure as an asset class. The objective is to develop a pipeline of private sector projects for which the bank will provide leveraging finance, in partnership with other MDBs, commercial banks and institutional investors. Becoming a leader in this field will require maintenance of the highest reputation for the AIIB, its staff, operations and outcomes.

Finally, the bank's commitment to sustainability throughout its lending portfolio is an important operational principle that will strengthen its reputation and which aligns the work of the AIIB with the priorities of the multilateral system as articulated in the UN 2030 Sustainable Development Goals. Sustainable infrastructure is one of the bank's three thematic priorities and it is funding a number of projects in the fields of renewable energy, energy efficiency, rehabilitation and upgrading of existing plants, and transmission and distribution networks, to support member states achieving their commitments under the Paris Climate Agreement and national development plans. The AIIB has adopted a Social and Environmental Framework to ensure environmental and social sustainability of its infrastructure projects. It is also developing a Water Strategy, to guide the investment sector in addressing water security challenges, to which the AIIB has contributed US$1.4 billion (International Institute for Sustainable Development, 2019). China is seeking to position itself as a champion of renewable energy with massive investments in new technologies and infrastructure within China. Notably, and by contrast, China continues through its bilateral programs of infrastructure financing to finance the building of coal-fired power stations across the developing world, attracting much criticism.

Conclusion

The AIIB represents a new public good created by China that is both complementary to the liberal international order, in augmenting the deficient financing of infrastructure by the existing institutions, as well as creating norm-challenging competition to the existing institutions. It reinforces China's new role as a member of the leading group of nations in the international system and its capacity to be a norm entrepreneur, strengthening the case for more equitable representation of developing nations and shifting emphasis in international development away from the Washington Consensus to a new, perhaps more practical, focus on infrastructure development. Its co-funding with other MDBs of important infrastructure projects bolsters economic security for its members and for the region. Indeed, in the post-Cold War world, economic security has been more often provided through international cooperation than geopolitical confrontation (Cable, 1995).

The AIIB has implemented best practice governance and operations and, on its own, the bank poses no apparent threat to the liberal international order. Of course, it must be placed within a broader context of the geopolitical contest underway between the US and China and China's ambitious programs – on a much larger scale than the AIIB – of funding infrastructure development through its Belt and Road Initiative and other regional and bilateral arrangements. Some nations that remain nervous of China's broader ambitions have nevertheless welcomed the AIIB as a new source of multilateral infrastructure funding. China's BRI and other initiatives reinforce the trend to multipolarity and a diversity of political, social and economic systems within multilateralism. If the AIIB can be a source of learning to implement best practices across those broader programs, it will be very helpful indeed.

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