CHINA IN THE INTERNATIONAL FINANCIAL SYSTEM
A STUDY OF THE NDB AND THE AIIB
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ABOUT THE GLOBAL ECONOMY PROGRAM

Addressing limitations in the ways nations tackle shared economic challenges, the Global Economy Program at CIGI strives to inform and guide policy debates through world-leading research and sustained stakeholder engagement.

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Through its research, collaboration and publications, the Global Economy Program informs decision makers, fosters dialogue and debate on policy-relevant ideas and strengthens multilateral responses to the most pressing international governance issues.

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EXECUTIVE SUMMARY

From China’s perspective, its participation in the New Development Bank (NDB) and establishment of the Asian Infrastructure Investment Bank (AIIB) will contribute not only to global development financing, but also to improving the international financial system. The two multilateral development banks (MDBs), the AIIB, in particular, demonstrate China’s disappointment at the slow pace of reform in global financial governance, and its determination to promote so-called “incremental reform” in the global financial system. The Chinese government asserts that the AIIB and the NDB are aiming to supplement the existing financial system through the creation of an MDB that upholds high standards and by bringing competitive pressure on the current system. It also reflects China’s efforts to combine its domestic strategy for cutting and absorbing overcapacity with meeting the huge demand on infrastructure investment in Asia and Europe.

Accordingly, China promotes and leads a new type of governance and policy-making model at the AIIB and the NDB. The decision making will primarily rely on forging and reaching a consensus, complemented by the majority voting rules and the power of veto as the last resort. China has the power of veto at the AIIB, but promised it will never abuse the veto and prefers to build consensus through fully consulting and communicating with other members in the policy-making process. China and other members of the BRICS (Brazil, Russia, India, China and South Africa) even forged an equal voting power structure in the decision-making process at the NDB.

The future of the AIIB and the NDB depends largely on whether China can operate them as high-standard MDBs in terms of governance structure, finance, debt sustainability, and environmental and social policy. It will also depend on whether China can maintain a delicate balance between pursuing its national interests and promoting real high-standard MDBs. Specifically, it must determine how to convince the world that the AIIB is not a tool exclusively serving China’s grand strategy, the One Belt, One Road Initiative, and that China’s development under the initiative will benefit all countries in the region of Asia and Europe.

INTRODUCTION

China’s great contribution to the globally coordinated efforts to fight the 2008 global financial crisis (GFC) gave it an enhanced status in the international financial system. This is underscored by its recent membership in three of the most important and exclusive international financial standard-setting bodies — the Financial Stability Board, the Basel Committee on Bank Supervision and the Bank for International Settlements’ Committee on the Global Financial System. Additionally, the 2010 reform package to which the Group of Twenty (G20) leaders committed
increased China’s and other emerging economies’ voting shares in the World Bank and International Monetary Fund (IMF). Put briefly, China obtained recognition and approval as a systemically important and responsible global financial power.

Despite its newfound international recognition as somewhat of a world power, China still identifies itself as a developing country and prioritizes its relations with other developing nations and emerging powers, in particular within international financial institutions. Emerging economies are seeking an improved global economic governance regime that reflects the new realities of their collective rising. In fact, on the sideline of the G20 finance ministers’ and central bank governors’ meeting in Brazil in November 2008, the BRIC (Brazil, Russia, India and China) finance ministers held a meeting and called for reforming the existing international financial system to reflect changes in the global economy and the roles played by the emerging economies. They criticized the weaknesses of the financial regulation led by developed countries that was exposed in the GFC, and the meeting of the BRIC finance ministers sounded a clarion call for reforming the financial system.¹ The IMF and World Bank voting share reform package agreed to at the Seoul G20 Summit symbolized important progress in this direction.

Despite the initial progress, however, the IMF governance reform package, which would bring a greater voice to emerging economies, was delayed. This prompted China and other emerging powers to begin considering the possibility of building a new form of financial arrangement, in which the developing countries can make decisions on their own. Still, in the aftermath of the GFC, the five BRICS nations² finally signed the agreement for establishing the NDB and Contingent Reserve Arrangement (CRA) at the sixth BRICS summit held in Fortaleza, Brazil, in July 2014.

The BRICS countries all agreed that the NDB and the CRA should supplement — not substitute for — the existing efforts of multilateral and regional financial institutions for global growth and development, trying to improve the current financial system in three aspects: under-representation of emerging economies; weaknesses in financial regulations, such as the negative spillover effects brought about by the US dollar-dominated monetary system; and the shortage of development financing.

The BRICS nations collectively faced unprecedented challenges five years after the GFC, and the creation of the NDB and the CRA is a substantial response to their three

² With the inclusion of South Africa in 2011, the grouping of BRIC was renamed BRICS.
of serving its own national interests and benefiting other countries while contributing to the international financial system? What are the governance structures of the NDB and the AIIB? How are their voting shares allocated? Will and how may this allocation evolve in the future? How do the NDB and the AIIB deal with the various risks in investment activities? How will the efficiency of the two banks be improved and how will they acquire a higher credit rating in international financial markets?

The paper tries to answer these questions. It first focuses on an analysis of China’s motives and intentions in establishing the NDB and the AIIB, and the further promotion of financial cooperation in multilateral regimes. The second and third parts of the paper examine, respectively, the governance structures and allocations of voting shares in the AIIB and the NDB, and how the structures might evolve in the future. The fourth part of the paper concentrates on factors that could determine the future of the AIIB. It makes an assessment on how China can deliver its goal of establishing high-standard MDBs, and on its efforts to balance its national interests and its contribution to the international financial system. The fifth part analyzes governance, political and environmental challenges the AIIB could face. The last part concludes the paper.

CHINA’S MOTIVES AND INTEN TIONS IN THE NDB AND THE AIIB

China and the NDB

In the aftermath of the 2008 GFC, the appeal for strengthening financial cooperation among developing countries emerged, in particular among BRICS nations. As early as November 2008, Indian Prime Minister Manmohan Singh called for additional investment on infrastructure development by the World Bank and the regional development banks (Singh 2008; Chin 2014). In April 2010, a memorandum of understanding (MOU) laying the foundation for a BRIC Inter-Bank Cooperation Mechanism was signed when the first meeting of development banks among BRIC countries was hosted by Brazil. Since then, the governors of the development banks in the five nations (with the inclusion of South Africa in 2011) have met in parallel with the BRICS summits in what has been called the BRICS Financial Forum. At the G20 summit in Seoul in November 2010, Prime Minister Singh raised the idea of recycling surplus savings into investment in developing countries to address infrastructure investment (Business Standard 2010; Suryanarayana 2013). The signing of the BRICS Framework Agreement on Financial Cooperation in April 2011 at the Sanya BRICS summit was a further important step in this direction (Zheng and He 2011).

The idea of a specific South-South development bank was first advocated by economists Romani Stern and Joseph Stiglitz in 2011 to take advantage of the huge amount of foreign reserves needed to meet the demand for investment in developing countries (Stern and Stiglitz 2011). The suggestion was appreciated by India’s foreign minister, Somanahalli Mallaiah Krishna, who mentioned the paper by the two economists in early 2012 when asked in an interview if the BRICS would set up a South-South bank (Suryanarayana 2013). Inspired by the idea, India formally raised the proposal to set up a new development bank to mobilize resources for infrastructure and sustainable development projects in the BRICS and other developing countries at the fourth BRICS summit, held in New Delhi in March 2012 (BRICS Information Centre 2012). Finance ministers from the five nations were directed to study the feasibility and viability of such an initiative, and a joint working group was established to follow up and report back at the next summit.

At the fifth BRICS summit, in Durban, South Africa, in March 2013, the BRICS countries agreed to establish a new development bank with a focus on financing infrastructure (BRICS Information Centre 2013). The proposal for creating a CRA among BRICS countries was also raised and received support from the five countries. Their finance ministers and central bank governors were asked to continue working toward its establishment.

Before 2013, India took the lead in promoting financial cooperation among BRICS countries. China became more active in participating in preparation for the BRICS bank and CRA following the 2013 BRICS summit (Ding 2014), reflecting China’s more positive attitude toward cooperating with its developing-country peers after President Xi came to power at the end of 2012. China fully participated in the finance ministers’ meetings to forge the consensus and pushed for the establishment of the BRICS bank and the CRA at the Durban summit. The agreement on establishing the NDB and the CRA was finally signed at the sixth BRICS summit, held in Fortaleza, Brazil in July 2014.

Since the GFC, developing countries have been worried about the risk brought by the US dollar-dominated international financial system, in particular the quantitative easing (QE) policies. The near-zero interest rates on US dollars that accompanied the introduction of QE caused large-scale capital inflows into BRICS countries and further led to the appreciation of their currencies, bringing more pressure on inflation and huge shrinkage of their dollar-dominated foreign reserves. The end of QE negatively impacted BRICS countries and led to intensified financial vulnerability and economic fluctuations in the form of massive capital outflow, depleting foreign reserves and currency depreciations.

Indeed, China and other emerging powers have criticized the World Bank and the IMF for their inefficient and over-supervised processes of granting loans. The current
gap between the demands for infrastructure investment and available investment from existing international financing organizations in developing countries creates an opportunity for emerging economies to establish a new type of bank with a directed focus in this area.

China shares with other BRICS countries a dissatisfaction toward the Bretton Woods system with regard to financial regulation, the negative spillover effects of QE policy, under-representation of developing countries and failure to meet the global demand for development financing. Improving the current international financial system with a focus on these three aspects thus constitutes the main motive for China’s participation in the creation of the NDB and the CRA.

The CRA is designed to provide liquidity through currency swaps to BRICS members should they face international balance-of-payments difficulties in the short term. That is, the CRA is expected to play a role similar to the IMF, for example, as a pre-emptive measure for coping with the negative impact possibly brought about by what China believes is “irresponsible” policy from developed countries, such as QE. It will try to address the inefficiency and unduly harsh terms of the IMF in its tediously long aid process that failed to fulfill the IMF’s role for bailout. The IMF’s slow response in the 1997-1998 Asian financial crises and in the initial stage of the 2008 GFC was widely criticized in China and some other emerging economies, and these events are regarded as two typical examples of the IMF’s failure as lender of last resort. The CRA also aims to provide the aid without having any political strings attached, including undue demands for economic reform or tighter fiscal discipline, and will only consider the financial conditions in the borrowing nations when it comes to providing aid. It will also encourage BRICS countries to use their own currencies to settle trade and investment, both among themselves and with other developing nations. With respect to the concerns of under-representation of developing countries in the governance of the current international financial system, the NDB and the CRA are not fully capable of addressing the multitude of changes required.

The BRICS and other developing countries are experiencing a significant gap in infrastructure investment demand and supply, which has become a major constraint on these countries’ resources exploration and economic growth. While private finance for infrastructure has fallen sharply since the GFC (Chin 2014), fiscal difficulties facing some of the BRICS countries widened the infrastructure investment gap and further hindered their economic growth. The aid from the World Bank and the IMF not only failed to meet the demand for infrastructure investment in BRICS countries, but also came with stricter additional conditions, such as requirements for market-oriented reform on public utilities. The NDB holds the hope for supplementing the lack of infrastructure development financing within BRICS countries and other developing countries.

There are other considerations related to China’s national interests that can, perhaps, provide more insight into the underlying motives behind China’s participation in the two financial arrangements. First, the NDB and the CRA — products of highly institutionalized financial cooperation — are two of a few multilateral coordination arrangements that China values and pays much attention to. The establishment of the NDB and the CRA laid a foundation for further institutionalization of the BRICS, and will help bolster China’s bilateral relations with the other four members. It is a substantial achievement of South-South cooperation, and it conforms to an important philosophy and priority in China’s foreign policy: China always positions itself as a developing country and it continues to adhere to the principle of developing countries being equal partners in cooperation.

Second, participation in the NDB and the CRA provides China with proper multilateral platforms from which to participate in global affairs. China’s role helps the country continue toward its goal of improving the existing international financial system while softening the impact caused by its appeal for reform. With its unique economic model and massive economy, China’s demand for modifying the current financial system unavoidably invited suspicion from the Western powers who dominate the system. Participation in the NDB and the CRA helps reduce some of the attention China attracts as the world’s second-largest economy and biggest trade power, and helps strengthen China’s identity as a developing country (Wang Da 2015).

Third, China’s participation will give more legitimacy to its existing outward investment arrangements, which are funded by the China Development Bank (CDB), the China Exim Bank, also known as the Export-Import Bank of China (CEB), and other financial institutions — a strategy China has been carrying out for over a decade. The CDB and the CEB played key roles in development financing in many developing countries in which China invested — Africa and Latin America, in particular. Indeed, the CEB provided more financing to Sub-Saharan Africa, the world’s poorest region, than the World Bank between 2001 and 2010 (Cohen 2011), and the CDB and the CEB combined lent more money to developing countries than the World

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3 Called the “Beijing Consensus,” this refers to an economic and political development model that is being pursued and implemented in China. In general, it combines state capitalism economically and an authoritative regime politically, with less emphasis on the value of democracy, individual freedoms and human rights, and more emphasis on efficiency, speed and collective interest in its governance of economic and social development.
Bank in 2009 and 2010. The large-scale investment, mainly focusing on infrastructure, has attracted criticism from Western countries concerned with neglect of human rights and environmental protection. More involvement in investment under multilateral frameworks such as the NDB will, to a greater degree, legitimize China’s investment in infrastructure in developing countries. Once Chinese-dominated funds become institutionalized under the NDB, it will help prove that China’s investment is not exclusively serving the Communist Party of China’s grand strategy, and help counter the opposite opinion held by some skeptical Western scholars.

To realize its multilateral and bilateral goals, China demonstrated a careful attitude and made cautious moves while balancing different interests in the process of establishing the NDB and the CRA. China’s economy is larger than those of the other four BRICS countries combined (Abdenur 2014), and China has enjoyed the most stable economic growth and healthiest macroeconomic environment as well. This is evident when looking at indicators such as the current account, employment and inflation, all of which suggests that China, as a primary driver of the bank, arguably should be playing a leading role in the NDB and the CRA. However, this is not the case, since the NDB is an arrangement whereby all members share an equal role in decision making. In fact, this is reported as one reason why the NDB’s creation was delayed for two years: the intense negotiation process in which China conceded to an equal role in decision making (Goh 2015). China did not insist on receiving a relatively larger share and the accompanying increased control of the bank, but instead relinquished a total subscribed capital of US$50 billion to be divided equally among its five founders.

The creation of the NDB is the result of balancing interests among BRICS countries based on the notion of equality. Each member equally put the same share into the start-up capital of US$50 billion, with the goal of reaching US$100 billion in the future in mind. India retains the presidency over operations for the first six years, followed by five-year terms for Brazil and then Russia. The bank’s headquarters are in Shanghai, China, and there is a regional headquarters in Johannesburg, South Africa. Russia and Brazil hold the position of chair of the board of governors and the board of directors, respectively. Each member plays its own, equal role in the NDB’s operations. From China’s perspective, it is necessary to make such a concession, as the most important thing is the actual establishment of the NDB and the CRA. It represents the achievement of institutional financial cooperation within BRICS countries, and the formation of an outstanding representation of developing countries in the international financial system.

China and the AIIB

Paralleling the establishment of the NDB and the CRA was the launch of China’s own national grand strategy in 2013 under President Xi’s new leadership: the One Belt, One Road Initiative. During the same period, the proposal of the AIIB was expected to play a crucial role in financially connecting China and its neighbouring Asian countries along the “belt” and “road.” Judging by the dates that the AIIB and the One Belt, One Road Initiative were proposed, the two appear to be raised in coordination. President Xi raised the “Silk Road Economic Belt” in September 2013, when he visited Kazakhstan, and the “21st Century Maritime Silk Road” in October 2013 when attending the Asia-Pacific Economic Cooperation (APEC) meeting in Indonesia. The AIIB proposal was put forward by President Xi in October 2013 at the same APEC meeting. Infrastructure investment and related financing platforms are the keys to strengthening the connectivity among Asian countries — the core idea of the One Belt, One Road Initiative.

The AIIB first aims to fill the great gap in infrastructure investment in Asia. The Asian Development Bank (ADB) estimated that US$8 trillion of investment in infrastructure such as roads, rails, ports and power plants is needed between 2010 and 2020 (ADB and Asian Development Bank Institute 2009). The World Bank and the ADB can currently only meet about one-eighth of these investments (Huang and Chen 2015). China, based on its own experience, agrees with the economic development theories that infrastructure construction will lay a solid foundation for the economic rise (Wang Da 2015), and therefore advocates the prioritizing and construction of roads, rails, ports, power plants and base transceiver stations, instead of focusing on social sectors such as health, education and other human development — the latter being areas the World Bank’s aid is currently focused on.

China’s AIIB initiatives also focus on furthering its domestic economic reform and opening-up policy and incorporating its development strategy with regional and global growth. The AIIB will play a key role in shifting China’s growth strategy in light of the now apparently unsustainable investment-led growth path that China had relied on for three decades. Indeed, China’s current overcapacity problems are a result of this previous growth path, and these problems need to be addressed through a growth strategy conversion and industrial structure upgrade. Today, China is expanding its outward investment under the “new normal” economy as part of the country’s growth strategy shift. Using the Chinese official line to describe it,

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4 The CDB and the CEB signed loans of at least US$110 billion in 2009 and 2010, while the World Bank made loan commitments of US$100.3 billion from mid-2008 to mid-2010. See Dyer, Anderlini and Sender (2011).

5 For example, see Whyte (2015) and Smith (2015).

6 China’s GDP constitutes 55.95 percent of total BRICS GDP (Pan, Li and Feng 2015).
China is pursuing a brand new opening-up policy toward developing countries and emerging economies, in which China encourages its companies to invest (Wang Youling 2015). The new opening-up policy is different from the old one started in the early 1980s directed toward Western developed countries, which had an emphasis on attracting foreign direct investment from these developed countries and exporting to them. The whole growth model transition will be advanced through the One Belt, One Road initiative and it seems that the AIIB will provide the crucial financial fulcrum for it.

The AIIB serves as China’s newest attempt to improve the existing international financial system. As President Xi (2016) said in his address at the AIIB inauguration ceremony, “the founding and opening of the AIIB means a great deal to the reform of the global economic governance system...and will help make the global economic governance system more just, equitable and effective.” China and other emerging economies have repeatedly called for broader representation and increased voices for themselves in the IMF, but by the autumn of 2013 — when the AIIB was proposed — still had not achieved any substantial progress. It is reasonable to conclude that the fruitless reform efforts from inside the system pushed China to change course and look elsewhere to improve the system, specifically, by exerting pressure from outside of the system. Chinese scholars generally called it an “incremental reform” (Deng 2015; Zhang 2016; Jin and Sun 2015; Wang Da 2015), which aimed to establish a new multilateral financial institution that follows the same standards as the existing one. In that case, the AIIB could be a supplement to and even a competitor within the current international financial system and could push for reform through the competition.

The establishment of the AIIB indicates another consideration in China’s efforts to improve the international financial system: better management of its huge supply of dollar-denominated foreign reserves. The creation of the AIIB will encourage China to pivot its large number of foreign reserves to investments overseas through multilateral financial institutions, and therefore to alleviate some of China’s reliance on the US dollar. For years, investing in US Treasury bonds has been China’s only option for its foreign reserve (Zuo and An 2015; Wang Da 2015). China’s moves in this regard include promoting renminbi (RMB) internationalization through currency swap agreements and establishing offshore RMB markets, as well as the creation of the NDB and the CRA. The AIIB, similar to the NDB, will facilitate China using its enormous US dollar reserves to invest in infrastructure in developing countries under the frameworks of MDBs.

The creation of the AIIB demonstrates China’s resolution and move away from its previous practice of engaging the world. China is taking a leading role for the first time and forging a new reality in the global financial system. The great pressure brought by the US pivot to Asia strategy — in particular its economic component, the Trans-Pacific Partnership negotiation that excluded China — pushed China into seeking a grand strategy to cope with it. The One Belt, One Road Initiative, with the financial and institutional support of the Silk Road Fund and China’s state financial institutions such as the CDB, the CEB and probably the AIIB, will serve to expand China’s strategic space and find new opportunities for economic expansion in the broader Asia-Europe area. China, therefore, endorses more multilateral efforts in this regard and shows more confidence in participating in, and even leading, an international organization. It is following the trend of more aggressively participating in international affairs since Xi came to power in 2012, which embodies the last component of Deng Xiaoping’s “taoguangyanghui, yousuozaowen” (“keep a low profile but achieve something and make a difference”) guideline for China’s foreign policy.

Following the same logic that governs China’s participation in the NDB and the CRA, China’s AIIB-related initiatives serve the purpose of alleviating the suspicion held by Western countries of China’s outward investment in the world, and assimilating itself into the international financial system under a transparent, open multilateral framework. One difference is that as the founder and biggest shareholder of the AIIB, China subjects itself to much more scrutiny from Western countries than it does with its role at the NDB. The United States and Japan worry that China will implement the so-called “Chinese rules” at the AIIB, and follow its past investment model of focusing on large-scale and sometimes unnecessary infrastructure projects such as stadiums, and loans to unstable governments, while forcibly uprooting villagers with little compensation and ignoring high standards long promoted by its Western counterparts (such as environmental protection, human rights and anti-corruption measures) (Perlez 2015).

In many respects, the forging of this transparent multilateral bank founded on high standards may even be a reflection of a new level of sincerity from China. China’s extensive efforts to finally persuade major Western powers such as the United Kingdom, France, Germany and Australia to join the AIIB signalled a certain humbleness. The AIIB hired experienced financial veterans from developed countries as senior staff, and China also took advice on loaning decisions from other member countries such as the

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7 The US “pivot” to Asia or rebalancing strategy refers to the Obama administration reorienting significant elements of its foreign policy toward the Asia-Pacific region. The strategy became known to the world after US Secretary of State Hillary Clinton raised it and explained it in detail in an article titled “America’s Pacific Century” in *Foreign Policy* in November 2011.
United Kingdom and Australia (ibid.). While the United States did not join as a founding member, this was not due to lack of effort from China: the AIIB’s president, Jin Liqun, actively attempted to have the United States join at the ground floor while preparing the establishment of the bank. Moreover, after the visit to Washington in September 2015 by President Xi, the United States seemed to have softened in its opposition to the AIIB. China even acknowledged the likely possibility that its voting share — 26.06 percent, which gives it the veto on substantial matters at the bank — would be diluted as more countries join in the future. This suggests that the voting shares of China and other founding members of the AIIB are flexible and helps eliminate any notion that China intends to dominate operations.

In summary, the major motives behind China’s creation of the AIIB are its efforts to use the bank to improve the international financial system and to meet the huge demand for infrastructure investment in Asia, while coordinating China’s grand strategy to better connect itself with countries in Asia and Europe. It is also a reflection of China’s shift in how it engages with the world. Diplomatically, China is changing its previous more bilateral approach in favour of newer multilateral institutions. Economically, it opens a door for Chinese companies exporting overcapacity, and allows China to channel its substantial foreign reserves toward infrastructure construction outside of China’s borders under a multilateral framework. Whether China can convince the suspicious Western countries, the United States, in particular, that it is able to establish and operate a high-standard MDB depends on the bank’s performance under China’s leadership over the coming years. At present, the spotlight is on the bank’s first batch of loans, which were scheduled to be issued in the early months of 2016.

GOVERNANCE STRUCTURE AND DECISION MAKING IN THE NDB

The Agreement on the New Development Bank reached at the sixth BRICS summit stipulates that the initial subscribed capital of the bank “shall be of US$50 billion, equally shared among founding members” and “the voting power of each member shall equal its subscribed shares in the capital stock of the Bank.” The equal share and weight of each member country in decision making underscores the most outstanding feature of the governance structure of the NDB.

The governance structure includes a board of governors, a board of directors, a president and vice presidents as decided by the board of governors, and other officers and staff. All the powers of the bank are vested in the board of governors, which consists of one governor and one alternate appointed by each member. An alternate may only vote if the principal is absent. The board of governors holds the power for strategic matters, including admittance of members and allocation of initial shares, suspension of membership, changes in the capital stock, amending the agreement, establishing the board of governors, ceasing the presidency, termination of operations, distribution of assets and so on. Decisions concerning such strategic matters require a special majority vote within the board of governors.

The board of directors, on the other hand, is responsible for the conduct of general operations, and exercises all the powers delegated to it by the board of governors, which mainly include decisions concerning business strategies, country strategies, loans, guarantees, equity investments, borrowing by the bank, setting of basic operational procedures and charges, furnishing of technical assistance and other operations of the bank. Each of the founding members appoints one director and one alternate. Decisions made by the board of directors require a qualified majority, unless the board of governors decides otherwise. The board of governors meets quarterly as a non-resident body.

The president conducts, under the direction of the board of directors, the ordinary business of the bank, and heads the credit and investment committee responsible for decisions on loans, guarantees, equity investments and technical assistance up to a limit specified by the board of directors. Serving for a five-year, non-renewable term, the president and vice president are supposed to act as professional managers beyond the influence of political affairs.

The governance structure and decision-making process demonstrate the equal decision-making power shared by each member of the BRICS countries in the NDB. The members — including China — view this governance structure as an innovative arrangement in multilateral financial governing, as it differs from those of the IMF and World Bank (Pan, Li and Feng 2015). Members at the NDB champion equal power, rights and opportunities (Zhu 2015) and leaders of the BRICS countries praise the advantages of the equal power decision-making system in the international financial institution. The biggest challenge, however, still lies ahead, and concerns guaranteeing the efficiency of decisions at the NDB, given

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8 Examples include Stephen F. Lintner from the United States, a former senior adviser from the World Bank, and Natalie Lichtenstein, a newly retired assistant general counsel to the World Bank.

9 See http://nddbrics.org/agreement.html.

10 Article 6 of the agreement stipulates that a special majority shall be understood as an affirmative vote of four of the founding members concurrent with an affirmative vote of two-thirds of the total voting power of the members.

11 Article 6 of the agreement stipulates that a qualified majority shall be understood as an affirmative vote of two-thirds of the total voting power of the members.
that a qualified or special majority is needed in the board of
governors and board of directors on important issues.
The likelihood of reaching an impasse along the way to a
final decision is greater under such a model.

China’s acceptance of the equal power governance and
decision-making model of the NDB indicates a degree of
self-imposed restriction of its power, as well as its political
willingness to push South-South economic cooperation
(Pang 2014). Indeed, concerns and suspicion of other
BRICS countries over China’s possible dominance did
motivate the final agreement on the equal power decision.
Brazilian President Dilma Rousseff had even made it
clear that while Brazil does not like a US-led order, it is
not willing to see China as the new leader either (ibid.).
China’s self-discipline of its power, in the eyes of other
members of the bank, is a reluctant compromise. China,
however, is still satisfied with the establishment of, and
its role in, the NDB and the CRA. At least officially, the
NDB’s equal power governance model incarnates one of
the principles of China’s foreign policy: the equality of all
states in international affairs. In this way, China believes it
can win support and trust from the BRICS countries.

That said, China’s influence in NDB operations is still
strong. It successfully made Shanghai the headquarters of
the NDB, and Zhu Xian, a Chinese official, was appointed
as one of the four vice presidents and functions as the
chief operating officer. These arrangements, along with
the relative size of China’s economy and stability of
its currency, technically guarantee China’s continued
influence at the bank.

Financing Mechanism in the NDB and China’s
Influence

Designing and building a well-functioning financing
mechanism is the key for any development bank. The
NDB will have to seek financing from international
markets in the form of bonds and bills, or financing via
financial derivative markets, including exchange — trade
derivatives markets and over-the-counter derivatives
markets. Only through standard international financing
can the NDB perform like a “normal” MDB and improve
its credit rating in the future.

However, financing from international capital markets
will be a difficult task for the NDB. On the one hand, since
the 2008 GFC, financing for infrastructure has dropped
and almost all forms of financing channels, including
private banks, traditional debt, sovereign wealth funds
and pension funds, and even bilateral official development
assistance and the MDBs, are reluctant to enter into the
infrastructure sector (Chin 2014). The NDB, as a new
development bank that focuses mainly on infrastructure
investment, will surely encounter many difficulties in this
regard. On the other hand, as a newly established bank that
focuses on infrastructure and sustainable development,
the NDB has no credit at its outset, which will make it
heavily reliant on government financing in the first years
of operation. China’s AA- credit rating is the highest of
the BRICS countries (other members’ credit ratings are
between BBB- and BBB+). This bolsters China’s already
key role in maintaining the NDB’s credit rating in the early
years of operation.

The NDB will probably need to seek financing in domestic
markets within BRICS countries. In view of the facts above,
the NDB will issue bonds denominated in local currency
within the five countries, and thus five capital pools within
the bank would be created. The fact that Chinese markets
may be the main sources for the NDB financing suggests
that the initial bonds will be issued in RMB (Zhou 2015a;
2015b). Leslie Maasdorp, one of the vice presidents and
the chief financial officer of the NDB, declared that the
BRICS bank will issue its first RMB bond of 4.85 billion
yuan at the end of May 2016.12 This is in accordance with
the bank’s principle of using local currencies, as well as
NDB President K. V. Kamath’s comments at the opening
ceremony of the NDB in July 2015 (ibid.).

Another way to improve the NDB’s financing mechanism
is to cooperate with other multilateral financial institutions,
such as the AIIB, and seek joint financing. As banks focusing
on infrastructure and with headquarters located in China,
it is natural that the NDB and the AIIB cooperate in certain
ways. In fact, NDB President Kamath and AIIB President
Jin have already discussed potential cooperation and co-
financing (on some projects) between the two, especially
for substantial projects (You and Yao 2015). For instance,
the AIIB can provide loans to certain large projects while
the NDB seeks other ways of offering capital.

Under current circumstances, the NDB’s financing
channels will mainly rely on China’s huge domestic
financial market and issuing of RMB bonds. Its credit
rating will depend on China’s current mediocre — yet
highest among the BRICS — sovereign credit rating, AA-.
This will definitely enhance China’s influence at the bank.

China and the CRA

China will be able to play quite a different role at the CRA
due to the differences in goals, size, governing structure
and decision-making process between the CRA and
the NDB. First, unlike the NDB, the BRICS CRA is set
up to provide mutual liquidity support, and to further
strengthen financial stability, when any member faces
short-term balance-of-payments pressures. Second, the
CRA’s voting power is mainly distributed among five
countries based on the size of each member’s commitment,
in addition to a base voting power (five percent of total)
distributed to each. China’s commitment of US$41 billion

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was the largest of the five members and is associated with 39.5 percent of the voting power — the biggest among the five. Brazil, Russia and India each has 18.1 percent of voting power and South Africa has 5.75 percent (Yan 2014).

Furthermore, the CRA has a dual governance structure consisting of the Council of CRA Governors and the standing committee. The governing council is responsible for high-level and strategic decisions such as reviewing and modifying the size of the committed resources, approving changes in the size of individual commitments, approving the entry of new countries as parties to the CRA, and reviewing and modifying the CRA’s instruments.13 The governing council makes decisions by consensus. The standing committee makes decisions by consensus. The standing committee is responsible for the executive level and operational decisions of the CRA, including approving requests for support through the liquidity or precautionary instruments, approving requests for renewals of support through the liquidity or precautionary instruments, and approving operational procedures for the liquidity and precautionary instruments. As a matter of principle, the standing committee makes decisions by consensus, but decisions on the first two types of approvals are taken by simple majority of weighted voting of providing parties.14

The governance structure and decision-making mechanism demonstrate the balance of power at the CRA, and indicate the achieved compromise and balance of interests among the five countries. Decisions are usually taken by consensus at the governing council and standing committee. A simple majority of weighted voting on the two crucial issues — approving requests for support through the liquidity and requests for renewals of support through the liquidity — guarantees the decision-making efficiency to some degree. As for China, although it committed the largest share of resources to the CRA, it does not have power of veto and has to share equal power with the other four members on most of the issues, including South Africa, who only contributed US$5 billion. On the two key issues of approving requests for support through the liquidity and requests for renewals of support through the liquidity, China does have more power than the other four members, but is still without the power of veto. China and any other member of the CRA together can make a decision on the two key issues. However, any other three countries (when they are providing parties) together can surpass China and make their decision on the two key issues, despite China’s largest voting power.

Apparently, the total committed resources of the CRA, US$100 billion, are not enough to solve practical problems when short-term balance-of-payments crises hit members of the CRA. That said, the CRA assistance will reflect a crucial consideration: a united approach to resolving financial crises that is different from that of the IMF and current international financial institutions. Specifically, the CRA is not going to impose any additional or political conditions on the recipient countries, which constitutes a challenge to the IMF and other international financial institutions. The CRA will play the role of lender of last resort among BRICS countries when liquidity crises affect a member.

In addition, as a foreign reserve pool, the CRA will play its role and prevent members of the BRICS from debt default, in particular should these countries face panics caused by large-scale currency devaluation and capital outflow. China’s huge amount of foreign reserves dwarf the total size of the CRA resources and, as a result, China may not require assistance from the CRA. Other members of the BRICS also own large amounts of foreign reserves, and, in 2013, most of them actually felt that the CRA would not be necessary (Tang 2015). During 2014-2015, the BRICS countries generally suffered large-scale capital flight and the Brazilian real, Russian ruble and Chinese yuan experienced sharp declines in their values, prompted by the expected QE policy exit and the interest rate rise by the Federal Reserve. China, Brazil and Russia, in particular, suffered a great deal of foreign reserve losses due to large-scale intervention in the currency market. Under the new circumstances, BRICS countries’ tone of speech on the CRA gradually changed and the CRA, which embodies concerted efforts among BRICS countries to provide mutual assistance, achieved its momentum (ibid.). With its huge foreign reserves and the biggest committed share, China has the greatest influence at the CRA, although it does not possess the power of veto.

Through the establishment of the NDB and the CRA, China acquired appropriate multilateral institutions through which to expand its influence in the international financial system. As the de facto most influential player at the NDB and the CRA, China can use its substantial amount of foreign reserves to influence international financial regimes. As founding instruments, the NDB and the CRA will play a supplementary role in the existing financial system, which the IMF and the World Bank dominate. These arrangements also serve China’s other domestic and foreign policy goals as well as the BRICS’ and the world’s interests. First, they unite the BRICS countries and increase their influence in world matters, and will promote infrastructure and sustainable development in BRICS countries and assist or prevent short-term balance-of-payments crises. Second, the arrangements help China to diversify its foreign reserves, thus managing risk (since at present they are all invested in US Treasury bonds), while at the same time appealing to China’s “going out” strategy by giving more legitimacy to China’s overseas investments and shielding against a certain degree of criticism. Third,
it could help promote the internationalization of China’s RMB. Through RMB financing, such as issuing RMB-denominated bonds within the NDB and the AIIB, the RMB could gradually gain recognition among international investors.

**GOVERNANCE STRUCTURE AND DECISION MAKING AT THE AIIB**

The AIIB’s governance structure consists of the board of governors, the board of directors and an executive level that includes a president and one or more vice presidents, among other officers and staff. All the powers of the bank are vested in the board of governors. Major policies and decisions, such as increasing or decreasing the authorized capital stock of the bank, amending the AIIB agreement, electing the president, determining the reserves, and the allocation and distribution of net profits, all require a supermajority vote. Admitting new members and determining the conditions of their admission, however, only requires a special majority vote. The board of directors is composed of 12 members and is responsible for the direction of the general operations of the bank and for exercising all the powers delegated to it by the board of governors, including establishing the policies of the bank and making decisions on major operational and financial policies and on the delegation of authority to the president under bank policies, which requires a majority representing not less than three-fourths of the total power of the membership.

Under the governance structure and decision-making rules, China, with its 26.06 percent of total voting power, owns the de facto power of veto on major policies and decisions that generally require a supermajority. No less than three-fourths of the total voting power of the members are required to pass a decision on major policies and decisions in the board of governors and the board of directors. China’s 26.06 percentage share of voting power is calculated based on the rule of vote in article 28 of the AIIB agreement, which stipulates that the total voting power of each member consists of the sum of its basic votes, share votes and, in the case of a founding member, its founding member votes. The basic votes and founding member votes are fixed and the share vote is distributed based on the size of each member’s GDP. China has the largest GDP of the Asian members in the AIIB, and its capital subscription to the total authorized capital stock of the bank tops all members of the AIIB — US$29.78 billion, accounting for 30.34 percent of the total authorized capital stock of the bank.

China’s current holding of veto power is not so much the result of China seeking it as much as it is a product of China’s calculated voting share. In fact, Shi Yaobin, deputy minister of finance, explained that China’s share and veto at the AIIB in its current form are the natural outcome of calculations based on the bank’s rules and are not because China deliberately sought them. He also made it clear that China’s shares and voting power at the AIIB would be diluted with more new members joining (Ministry of Finance of the People’s Republic of China 2015). That said, even with the power of veto for the time being, it is expected that China will be cautious and not abuse it (Fu 2015; Fu 2016).

In any case, holding the veto at the AIIB is an important issue that tests China’s wisdom and ability to lead a multilateral financial institution. Some members of the AIIB have concerns about China’s power of veto. In the very beginning, China promised that it would not seek the veto — unlike the United States at the IMF and World Bank — and that the bank’s decision making would mainly rely on reaching a consensus (Fu 2016), but, in the end, China received the power of veto. Although Chinese senior officials repeatedly opposed seeking veto power, analysts in China thought it was reasonable (Fu 2015). After all, China is the initiator of the bank and also has the largest economy among the AIIB members, which makes it the biggest shareholder. As such, it arguably should be the most influential member at the bank. This reflects the concern within China over losing control of the bank to Western countries if China does not have the veto.

In the end, China’s “unexpected” acquisition of veto power at the bank did not draw any strong response from other members. China’s reiteration of reaching consensus and cautious use of the veto power seemed to reassure suspicious members. Furthermore, China has shown strong interest in showing the United States and the world that the AIIB will have a transparent and high-standard governing structure. Its success would build up China’s credibility and give it clout in international financial institutions. Therefore, it would be wise for China to adhere to its promise and deliver high standards at the bank while maintaining prudence in using its veto power.

For the Western countries, the voting power they gained seemed acceptable, especially in light of China not maintaining over 50 percent of the vote — as predicted before by the United States (Perlez 2015). Furthermore, if the Western countries — specifically Europe, Australia, New Zealand, Singapore and South Korea — vote in a unified way, they could acquire more than 25 percent of the

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16 According to article 28 of the AIIB agreement, a supermajority vote of the board of governors requires an affirmative vote of two-thirds of the total number of governors, representing not less than three-fourths of the total voting power of the members.

17 According to article 28 of the AIIB agreement, a majority vote of the board of governors requires an affirmative vote of a majority of the total number of governors, representing not less than a majority of the total voting power of the members.
voting power and also acquire a de facto power of veto. In their eyes, China made some substantial concessions concerning the voting rules, further reflecting the intended balance of power within the bank (Thomas 2015).

The AIIB’s board of directors functions on a non-resident basis, which is designed to make its management less checked, and make the decision process smoother and thus more effective. In contrast, the full-time resident directors at the IMF and the World Bank mean decision making is usually slow, due to political jockeying. The board of directors at the World Bank, in past experiences, undermined decision-making effectiveness as different considerations, including political and micro-managing issues, easily led to conflicts in loaning conditions (Sheng and Xiao 2015). AIIB President Jin had criticized the ADB’s resident board of directors, calling it “a disaster” (Perlez 2015). China chose to designate greater power to the management, the president in particular, an elected position over which China has the power of veto. The unpaid, non-resident directors at the AIIB will also save the bank a huge cost. According to David Dollar, a former World Bank official, the resident board costs the World Bank some $70 million annually (Magnier 2015).

Although, at present, the United States is not an AIIB member, China continues to reach out. Xi’s visit to Washington in September 2015 is a reflection of this. During the visit, the two countries reached a somewhat vague compromise over the operations of the AIIB:

Both sides acknowledge that for new and future institutions to be significant contributors to the international financial architecture, these institutions, like the existing international financial institutions, are to be properly structured and operated in line with the principles of professionalism, transparency, efficiency, and effectiveness, and with the existing high environmental and governance standards, recognizing that these standards continuously evolve and improve. (The White House 2015)

In this way, the United States officially acknowledged that the AIIB will be a significant supplement to the existing international financial system. The US statement demonstrates that the two countries have put the dispute over the AIIB behind them. This was a fairly substantial step, especially considering the United States’ previous strong opposition and lobbying to prevent its allies from joining it, as well as the fact that the AIIB posed a big challenge to the US-dominated international financial order. In return, China made even more promises to reassure the United States. It promised to operate the bank following high environmental and governance standards, and to act cooperatively on supporting the current international financial architecture and to “meaningfully increase its role as a donor” in the World Bank and other regional banks, including the ADB, the African Development Bank and the Inter-American Development Bank (IADB) (ibid.) — all of which are potential regional rivals to China’s AIIB. China also promised to meaningfully increase its financial contribution to the International Development Association, the Asian Development Fund and the African Development Fund — all of which are institutions under the framework of existing international financial architecture — to meet the needs of the poorest countries.

Something that might have a crucial impact on China’s success with the AIIB is convincing other members that the bank is not exclusively for China’s interests. Jin Liqun emphasized that the AIIB is not exclusively being set up to serve the One Belt, One Road Initiative, but that through establishing the AIIB, China is building a high-standard multilateral bank through which it can invest heavily both economically and politically. The bank also serves to help convince the rest of the world that China is capable of leading and governing an international organization and of adhering to high standards, with the ultimate goal of playing a larger role in the governance of the international financial system.

**Financing Mechanism at the AIIB**

China had vowed on a variety of occasions to bring high standards to the AIIB. For a multilateral financial institution, a high credit rating that guarantees its capacity for financing via international markets is one of the key standards. Unlike the NDB, which will basically seek financing from domestic markets among its member countries, the AIIB will primarily rely on financing from international capital markets, just as other international financial institutions such as ADB and IADB do. Issuing bonds in international financial markets would be the major channel of financing for the AIIB. The cost of financing — for example, the cost of issuing bonds for the AIIB as a whole (mainly denominated in US dollars) — will be decided by the sovereign credit rating of each founding member — specifically, the credit rating of sovereign bonds of each founding member (Huang and Chen 2015). The accession of the United Kingdom, Germany, Australia, Singapore and other countries with their AAA credit ratings by Standard & Poor’s will improve the AIIB’s credit rating as a whole and its ability to use international capital markets for financing.

The second channel of financing can be setting up special funds to attract idle capital. Some trusts can be established in the AIIB to raise pension, sovereign wealth or other funds through a public-private partnership model. For this approach to work, the AIIB would need to develop some suitable investment products and programs in which private capital could participate (Zhang 2015). Interbank borrowing from large commercial banks could be another way of financing for the AIIB; however, not too much should...
be expected from this approach. Hong Kong could be an ideal place for issuing bonds in US dollars, RMB or Hong Kong dollars, due to its status as a mature international financial centre and the biggest offshore RMB trading centre. Similarly, London and other European financial centres would be ideal for issuing euro-denominated bonds. All this reiterates Jin Linqun’s statement at the AIIB opening ceremony on January 16, 2016, when he said that the bank may raise capital in other currencies, including the euro and yuan, although the loans would be made in US dollars (Han and Hou 2016).

While the World Bank and the ADB prioritize social programs targeting poverty relief and world health, the AIIB will focus on infrastructure investment in the Asia-Pacific region. As typical infrastructure projects, characterized by long-term, higher-risk but higher-profit returns, the AIIB projects would possess relatively high profit margins for investors. This means that the AIIB will operate, to a great extent, as a commercial bank and will try to make a profit in order to achieve a balanced budget and encourage private capital financing. If the bank runs smoothly and is profitable, it can be more flexible in setting loan rates in the future (Huang and Chen 2015).

THE FUTURE OF THE AIIB

The AIIB opened for business on January 16, 2016, after more than two years of preparation — a relatively short period for establishing a multilateral bank with 57 founding members worldwide. The key move to build up the AIIB was China’s low-profile lobby to convince several European powers — the United Kingdom, in particular — to join the bank before the deadline for membership on March 31, 2015. Jin Linqun, now the president of the AIIB, and then the secretary general of the Multilateral Interim Secretariat of the bank, made great efforts in persuading these major Western countries to join. The breakthrough of the United Kingdom agreeing to become a founding member of the bank led to a domino effect, in which other European financial powers such as Germany, France and Italy followed. Other important allies of the United States, namely Australia and South Korea, followed suit and joined the bank despite Washington’s strong opposition.

According to Jin (2015), Chinese leaders had, for a while, intended to create a first-class multilateral development institution with twenty-first-century governance. It was for this reason that he had begun to lobby European countries, Japan and the United States as early as May 2014, when he gave a speech in London to representatives of hundreds of wealth funds from the United Kingdom and other European countries (Perlez 2015). However, this all may have occurred before China developed a clear vision of what the AIIB would turn out to be. While it may not have been decided so early, China did not clearly show the world its intent to develop the AIIB into a genuine multilateral development bank. Chinese media and elites used to talk with great fanfare about shifting China’s overcapacity outside and to serve the One Belt, One Road Initiative. Some even described it as a Chinese version of the Marshall Plan.18 The AIIB was included by some analysts in the great vision of the strategy to supply financial support for a Chinese version of the Marshall Plan (Lei 2014; He 2014).

Only after successfully winning the support of heavyweight players such as the United Kingdom, Germany, Australia and South Korea did the Chinese leaders become more confident that the AIIB could, in fact, be built into a real MDB. At that point, China seemed to experience a change of heart, whereby rather than establishing a China-oriented bank, it would strive for a genuine MDB subjected to high standards in environmental protection, human rights and governance. China undertook comprehensive negotiations with all the participants of the bank and signed the AIIB Articles of Agreement on June 29, 2015. This is when it became clearer that the AIIB was not meant to be a tool for serving narrow Chinese interests. That is, it was not explicitly established for transferring the country’s overcapacity to the rest of the world and to realize its national strategy, the One Belt, One Road Initiative. The Chinese media, accordingly, showed an apparent attitude change and the subject of exporting China’s overcapacity seemed to disappear from their coverage. In fact, media and scholars alike began to criticize and decry the concept of a Chinese version of the Marshall Plan (Mei 2015; Wang Yiwei 2015; Han et al. 2016).

The AIIB is aiming to develop into a quality international MDB with great influence in infrastructure investment and the global financial system more generally. While the future success of the AIIB relies on several factors, a crucial component is the ability to achieve and maintain a good governing structure with high environmental and financial standards. AIIB President Jin’s successes in global lobbying and communicating constituted a significant first good step toward this goal. Further, China’s promise to uphold these standards is evident in the MOU and Articles of Agreement of the AIIB. The next step — implementation — is going to be the key. In this respect, Jin has spoken eloquently of the “lean, clean, and green” (Jin 2015) — efficient, with zero tolerance for corruption and environmentally sensitive — modus operandi of the bank during the two-year-long setting-up process.

“Lean” staff is a concept emphasized by Jin on various occasions. It includes avoiding bureaucracy, realizing cost-effectiveness and allowing no redundant positions. Initially, there are only 50 staff members, a total that is set to only increase to between 100 and 150 (Zheng 2016). This is exceptionally “lean” in comparison to the 10,000-

18 For example, please refer to the large amount of special coverage on the Chinese version of the Marshall Plan at www.sina.com.cn:
companies have to compete with highly competitive companies from the United States, Japan, South Korea, Australia and Europe.

China also compromised on whether or not to set up a board of directors and how the board should operate. Initially, China did not plan to set up a board of directors and had proposed instead that a technical panel be formed to make final decisions. China finally compromised after negotiating with representatives from countries that intended to join the bank and agreed to establish a 12-member non-resident, unpaid board. The complaint from the United Kingdom that the decision making by a technical panel is not transparent is believed to be what made the difference. The bank’s openness and inclusiveness are also highlighted in how the bank chooses its staff: the AIIB will recruit staff members from all countries, including non-members. As Jin (2015) said, the AIIB will hire professionals of the highest talent from across the world and will not reject any nationals simply because they are from non-member countries. In fact, both Lichtenstein and Lintner, the respected retired senior officials from the World Bank hired by the AIIB, are American.

As China and the AIIB claim, the AIIB’s loans will not be decided based on political conditions. The bank will focus on promoting the infrastructure and will not be required to shoulder the task of pushing for economic and political liberalization, as the World Bank began shifting its assistance emphasis to implementing the Washington Consensus in the late 1980s. The AIIB’s loans will mainly be considered based on the financial and economic realities in recipient countries or regions. For example, on the case for whether the AIIB will approve highly polluting coal-fired power plants, Jin (ibid.) had said that the AIIB needs to take into consideration the local economic conditions, suggesting that the bank might make an exception for poor areas where there is no access to power, since the concern is basic human rights, such as access to power in any form. That is, human rights should be the first thing considered when making a decision, and not necessarily the negative impact it would have on the overall environment in the region. This perspective demonstrates, in part, the philosophy of the Chinese model in terms of its way of governing economic and social development.

The bank is an MDB that is mainly comprised of developing Asian countries, which could compromise the high standards on environmental and social development the AIIB strives for. Particular demands from some of the Asian developing countries would be considered based on the actual conditions in these countries. While China may not approve of all the “best practices” as defined by Western countries (Cai, Wang and Jin 2015), what is important is how it balances the need to meet the environmental and fiduciary standards with the need to adapt to the actual situations in receiving countries. In other words, to what extent can the bank bend its standards to meet the realities in recipient countries?
CHALLENGES FACING THE AIIB

First, how does China balance maintaining its influence over the bank as the biggest shareholder and avoiding abusing the veto? How does China maintain its influence and keep the bank’s decision-making process running smoothly when its share of power becomes diluted? The key is in the implementation. China promised repeatedly not to be a dominant member and not to abuse its power of veto. The bank will reach a consensus by comprehensive, democratic, open and transparent communication and negotiations before decisions are made. This poses great challenges to how the bank can guarantee decision-making efficiency.

Second, how does the bank achieve its goal of being an independent MDB and not a China-dominated tool? In other words, how can it best balance China’s national interests and maintaining a high standard while benefiting other members? In some cases, conflicts can arise between these different goals, and can usually concern political and security interests in Asia, South Asia, Southeast Asia and Central Asia, in particular.

For instance, it was reported by Pakistani media in 2014 that the AIIB would support the China-Pakistan Economic Corridor project (Daily Times 2014), which China believes will serve its strategic interests. At the same time, in China, the forthcoming AIIB was expected to provide financial support to projects under the One Belt, One Road Initiative, which includes the corridor project. India opposed the China-Pakistan Economic Corridor project because it believed it would hurt its strategic security interests, and had also already expressed great concern about the project in Pakistan. Some Indian scholars (see Mishra 2015) believed that it was the China-Pakistan Economic Corridor project that caused India to withdraw its support for the One Belt, One Road Initiative. 19

China and Pakistan maintained close cooperation on the corridor project and tried to allay India’s suspicion on this project. President-designate of the AIIB, Jin Liqun, visited Pakistan in October 2015 and said the corridor would be beneficial for other regional states beyond just China and Pakistan (Dawn 2015). He promised that the AIIB would support the infrastructure in Pakistan, and Finance Minister Mohammad Ishaq Dar clarified that investment from the AIIB would be independent from the financing arrangement of the China-Pakistan Economic Corridor, but that the two would be supplementary in nature (Liang 2015). When attending the inaugural ceremony of the AIIB on January 18, 2016, Pakistani Finance Minister Dar made clear that the corridor project would be funded by the US$40 billion Silk Road Fund and that the AIIB was excluded from financing the corridor project because the AIIB’s rules prohibit funding projects in controversial territories claimed by another country (The Economic Times 2016). The changing attitudes on the issue reflect Chinese leaders’ changing policies as to what kind of bank China wanted to operate within the AIIB, and suggest that in order to avoid provoking India, China probably reached a compromise with Pakistan that the AIIB would not finance the corridor project. In return, China promised full support for infrastructure in Pakistan with the Silk Road Fund and other channels.

Under the circumstances, the AIIB’s first batch of projects will be the focus of the international community and will be carefully scrutinized. A batch of projects subject to little political sensitivity and without any strategic security significance would be ideal if the AIIB intends to show the world its efforts to be a high-standard MDB. The implementation of its environmental and social framework should also be carefully considered in order for it to earn a good reputation for the bank.

Third, considering challenges from environmental and social development perspectives, the AIIB’s consultation draft document, “Environmental and Social Framework,” has aroused provoked complaints on the way the bank conducted the consultation, and doubts as to the seriousness of the bank in implementing its environmental and social framework. The consultation arrangements are criticized as hasty work and some non-governmental organizations (NGOs) complained that the AIIB did not take the stakeholders’ interests very seriously, and that the consultation arrangements were a mere formality (see Chen 2015; Asia Indigenous Peoples Pact [AIPP] 2015). The AIIB released the draft document on September 7 and the first consultation was scheduled for September 10. Such a time line is, arguably, too short for some of the participants to be fully prepared for the consultation. With respect to the consultation sessions, there was no face-to-face interaction scheduled; only video and audio were used for each session, which lasted about two hours and had a maximum of five connections with interested parties. It also prevented people who lacked Internet access and who did not speak English from participating, as the consultations were held in English only. All of these shortcomings make it hard for the bank to get the necessary results.

Additionally, there have been major complaints concerning the environmental and social standards. Specifically, for category A — operations that are “likely to have significant adverse environmental and social impacts that are irreversible, diverse or unprecedented” (AIIB 2015, 8) — the draft fails to specify certain industries that have significant environmental and social risks. As a result, they cannot be prevented from being provided loans by the AIIB.

(Chen 2015). Category B is defined as projects that have “a limited number of potential adverse environmental and social impacts; [which] are neither unprecedented nor irreversible or cumulative” (ibid.). For this category, the draft only says that the AIIB determines the specific environmental and social assessment requirements on a “case-by-case basis” (ibid.). This means that there is no universal mandatory requirement for an environmental and social assessment for projects under this category, which will result in some high-risk projects under category B being approved without sufficient environmental and social assessment (NGO Forum on ADB 2015; AIPP 2015).

Other complaints concern the absence of an independent grievance mechanism for the AIIB, which makes the bank different from existing international financial institutions in a negative way (NGO Forum on ADB 2015; AIPP 2015; Chen 2015). International financial institutions, including the World Bank, the ADB and other major MDBs, generally have independent appeal and accountability mechanisms. The appeal mechanism in the AIIB is only for the clients. There are no stipulations of responsibilities and obligations. All the requirements in terms of transparency, information disclosure, and responsibilities and obligations are for the clients, not for the bank per se (Chen 2015). The provisions on the protection of the interests of vulnerable groups and indigenous people are not good enough to guarantee their interests. For example, the footnote to “forced eviction” requires “avoidance of the use of unnecessary, disproportionate or excessive force” when it comes to involuntary resettlement (AIIB 2015, 18). This vague wording can be interpreted as “necessary forces could be used for acquiring land or homes” (NGO Forum on ADB 2015).

Another issue concerning environmental and social impacts are the coal-fired power plants. As Jin (2015) indicated in his speech at the Brookings Institution in October 2015, the AIIB might consider investing in the coal-fired power plants in some areas where people still do not have access to power. Indonesian media had reported in November 2015 that an official from the Indonesian Ministry of Finance said that the AIIB will loan US$1 billion to the country for its infrastructure development over the next four years and its financing could be used for Indonesia’s coal-fired power plant projects (Jakarta Globe 2015). The source of the news report is not necessarily entirely credible. A conflicting new report, however, has already aroused suspicion as to whether the AIIB could stick to a high environmental standard. Together with the absence of the sector investment policy for coal and other industries with high environmental risks, the controversy on environmental and social matters is going to continue now that the AIIB is open for business. According to a recent report, Jin had expressed that the decision on coal-fired power plants should be discussed and decided by the board of governors (Caixin Media 2016).

Other challenges facing the AIIB include the risks posed by complicated political and security situations in Central Asia, South Asia, Southeast Asia and other Asian regions. Volatile countries such as Afghanistan and Syria and the spillover effect have caused instability in the entire Central Asian region. The bank’s operations will encounter turmoil, uprisings and other forms of chaos and security threats caused by terrorism, religious extremism, separatism, territorial disputes and geopolitical conflicts. Challenges can also arise from investment risks, which may be caused by financial failures, for instance, if the client or the client state defaults on loans because of insolvency and the AIIB fails to continue for financing its projects.

CONCLUSION

The establishment of the NDB and the AIIB represent milestones in China’s substantial participation in the international financial system. The creation of the AIIB symbolizes the first instance of China initiating and leading an MDB. Its role in the global recovery from the 2008 GFC helped springboard China onto the main stage of global economic governance, initially via the G20 platform. However, since the 2010 IMF and World Bank governance reform package, China’s voice has quieted. Major achievements and reforms of the initial financial system have been delayed, leaving an opportune time for China to further integrate itself into the governance of the global system.

China’s unprecedented moves in the international financial arena stem also from the evolution of its national strategy and domestic economic development. Indeed, the creation of the AIIB closely coincided in timing with that of the One Belt, One Road proposal. Clearly they are complementary components of China’s national strategy design since President Xi came to power. The One Belt, One Road Initiative emphasizes the infrastructural connectivity between China and other Asian and European countries, and is expected to lay a solid foundation for further economic prosperity in the entire Asia-Europe region. Through advocating the strategy, China will interconnect its development with those of other countries in the same region and China believes this interconnection will benefit all parties.

Furthermore, China’s actions will contribute to the improvement of the existing international MDB system and present itself as the most powerful bargaining chip for China to squeeze into the mainstream of the international financial order. In a broad sense, it also implies a subtle change in China’s foreign policy priorities, indicating a shift away from its relationship with the United States toward its relationships with countries in South Asia, Southeast Asia and Central Asia as well as other BRICS
nations. From this point of view, the whole strategy that includes the AIIB and the One Belt, One Road initiative can be interpreted as a new approach and strategic reaction to the Obama administration’s pivot to Asia strategy since 2011. In other words, Chinese elites and leaders, to some extent, still believe the US pivot to Asia strategy, or Asia rebalancing strategy, is aiming to contain China, in which case China needs to counter with a reactive strategy.

During the process of pushing forward the establishment of the AIIB and the One Belt, One Road Initiative, Chinese policy makers appeared to unexpectedly be faced with a situation in which the two needed to be distance from one another to a certain extent. There exist some internal conflicts between the goals of the AIIB as a high-standard MDB and the One Belt, One Road Initiative — the policy implemented for seeking China’s national strategic interests. These two policy goals may be obstacles to each other. Statements such as “the AIIB serves the One Belt, One Road initiative” will push other countries, in particular the United States and Japan, to be even more suspicious of China’s intentions, with the bank potentially being another tool for serving national interests. Only by looking at the bank from an international, prestige-enhancing perspective can one understand the underlying goal behind the AIIB and why it is imperative that it operates under high standards.

Although Chinese leaders are currently aiming to set up a high-standard MDB, initially the most optimistic goal of Chinese officials with respect to the AIIB was for it to simply be a regional development bank consisting of roughly 20 Asian countries, according to Jin Liqun (Caixin Media 2016). European developed countries, led by the United Kingdom swarming into the bank, brought unexpected momentum and left China feeling more confident en route to developing the AIIB into a real international high-standard MDB.

The fact that China promotes the One Belt, One Road Initiative mainly in a traditional bilateral way while promoting the AIIB as an MDB needing to be governed in a multilateral way puts China in a complicated position, whereby it needs to separately deal with the two goals. Geopolitics, religion, resources, history and so on all could become problematic issues that arouse further suspicions and even conflicts between China and other relevant countries along the “belt” and the “road.” Certain problems may, in fact, pose a threat to the ultimate goals, and should this happen, Chinese leaders will have to consider the weight of the two goals. An independent, transparent MDB with high standards in environmental, social and governance areas would be expected to help China establish and maintain the AIIB’s reputation in the international financial system. For that purpose, China needs to distance the AIIB from its national grand strategy.

To announce “the AIIB is not exclusively for the One Belt, One Road Initiative” constitutes a clever approach in this regard.

The NDB is overshadowed by the establishment of the AIIB and has received less attention since its launch in the summer of 2015. It is a good sign that the NDB is going to cooperate with the AIIB in infrastructure financing. Kamath, president of the NDB, and Jin, president of the AIIB, had talked several times on the cooperation between the two banks (ibid.). One of the areas of cooperation is the decision to issue loans denominated in yuan. Through taking advantage of a significant amount of idle RMB-denominated capital, these RMB loans will help the two banks’ financing and will also help promote RMB internationalization. Together with the AIIB and Silk Road Fund, the NDB constitutes an important component of a China-led new development bank network in the international financial system, and is expected to contribute to the multilateral development financing regime.

WORKS CITED


CHINA IN THE INTERNATIONAL FINANCIAL SYSTEM: A STUDY OF THE NDB AND THE AIIB


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