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U.S. Allies Split with Washington, Bank with China

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Key Findings

- China has created a regional bank among its Asian neighbors, in a move opposed by the Obama Administration.
- U.S. allies have sided with China despite Washington's concerns that China might be using the bank to circumvent more established international banks, such as the World Bank and the International Monetary Fund, long dominated by the United States and Europe.
- China's supporters in the effort contend that their participation in the new bank will ensure greater transparency while avoiding China's tendency to loan money without protecting the environment, local populations, and clean governance.

Do the Asian nations surrounding China need a new regional bank to fund their development? Or do existing international lenders, such as the World Bank, suffice? Would a regional bank founded and run by the Chinese government seek to curry influence in the region by foregoing sound banking principles in order to advance China's policy goals? The United States and China have arrived at two different answers to these questions. Meanwhile, in a rare rebuke to the Obama Administration, U.S. allies have come down firmly on China's side of the issue.

Since Chinese President Xi Jinping first proposed the Asian Infrastructure Investment Bank (AIIB) in October 2013, the Obama Administration has voiced misgivings regarding the bank's transparency, governance, and potential conflicts with existing institutions, including the 48-year-old, Manila-based Asian Development Bank (ADB). Nevertheless, on March 12, 2015, the United Kingdom became the first Western nation to announce its intention to join the China-initiated AIIB. Days later, the United Kingdom was followed by France, Germany, Italy, and Switzerland, bringing the bank's total prospective membership to 33 countries. Absent from this list of supporters are Japan, South Korea, and Australia—although the latter two are expected to announce their approval soon (see AIIB timeline in Box 1). Even banking rivals of the AIIB have welcomed the addition.

From Beijing to Britain: The AIIB Gains Momentum

In a 2013 meeting with Indonesia's then President Susilo Bambang Yudhoyono, President Xi proposed the creation of a multilateral investment bank that could finance infrastructure projects in developing countries across Asia.¹ The proposed regional bank would channel experience and funding into the improvement of railroads, highways, airports, seaports, telecommunication networks, electricity, waterworks, and urban development. Soon after,

China's Ministry of Finance formed a working group for the AIIB and chose as its head Jin Liqun, the former vice minister of finance and a former top official at the ADB (see brief biography in Box 2).

Meeting a year later in Beijing, 21 countries signed an agreement to become founding members of Asia's newest multilateral regional development institution.* They agreed to locate the bank's headquarters in Beijing, and they fixed the target authorized capital at \$100 billion, with initial subscribed capital at \$50 billion.† The application deadline for any additional countries to become founding members was set for March 31, 2015.‡ By February 2015, New Zealand, Indonesia, the Republic of Maldives, Tajikistan, Saudi Arabia, and Jordan announced they would join the AIIB.

Throughout their campaign for the AIIB, China's leaders underscored two key reasons why Asia needed a new development bank: the region severely lacked 1) **infrastructure finance**, and 2) **alternatives to the traditional multilateral development banks (MDBs)**.§

The ADB was the first existing bank to assert that the region lacked infrastructure funding. In a 2009 report, it estimated that to achieve stable growth over the next decade, Asia would require \$8 trillion in infrastructure; yet, the ADB only expected to provide about \$13 billion annually in new loans, suggesting a massive gap in financing.² Meanwhile, traditional MDBs shifted their funding away from infrastructure toward the "softer" realms of social development and poverty alleviation.

Five years later, the International Monetary Fund (IMF), closely associated with the World Bank, cited the ADB's original \$8 trillion estimate and noted that "shallow financial systems" and limited private sector participation had left many Asian economies without adequate infrastructure, impeding their growth.** Concerned that national and local public expenditure might not prove sufficient, the IMF working paper suggested tapping "aging savers in industrialized Asia to finance infrastructure investment in emerging Asia."³

China proposed to fill this gap in infrastructure finance and promote regional economic development with the AIIB. Moreover, it aimed to use the AIIB as a platform for sharing knowledge acquired during its own domestic development and rapid infrastructure-led growth. In his July 2014 keynote speech at the Bo'ao Forum for Asia, Jin Liqun explained:

*Since 1978 when China implemented the policy of reform and opening-up, the government has invested much in infrastructure construction. Thanks to the sustained infrastructure improvement, China has grown at a fast rate for more than three decades, and become one of the world's most competitive economies.... China's Experience can be transplanted to any other country. If China can make it, there is no reason why another country cannot.*⁴

* The 21 countries were Bangladesh, Brunei, Cambodia, China, India, Kazakhstan, Kuwait, Laos, Malaysia, Mongolia, Burma (Myanmar), Nepal, Oman, Pakistan, the Philippines, Qatar, Singapore, Sri Lanka, Thailand, Uzbekistan, and Vietnam. Xinhua (English edition), "21 Asian Countries Sign MOU on Establishing Asian Infrastructure Investment Bank," October 24, 2014. http://news.xinhuanet.com/english/business/2014-10/24/c_133740149.htm.

† The World Bank maintains \$280 billion in authorized capital, the Inter-American Development Bank \$171 billion, the ADB \$164 billion, the African Development Bank \$103 billion, and the European Bank for Reconstruction and Development \$39 billion.

‡ Following the March deadline, the founding member countries would ratify the Articles of Agreement, and by the end of 2015, formally establish the AIIB. Xinhua (English edition), "21 Asian Countries Sign MOU on Establishing Asian Infrastructure Investment Bank," October 24, 2014. http://news.xinhuanet.com/english/business/2014-10/24/c_133740149.htm.

§ For more discussion of China's motivations for establishing the AIIB, see the USCC's Chinese Media Digest, Volume 2, Issue 4, March 27, 2015.

** The IMF working paper pointed to electricity generation as the largest infrastructure gap, calculating Asia's median electricity-generating capacity to be 90 percent of that in Latin America. Ding Ding, Raphael Lam, and Shanaka Peiris, "Future of Asia's Finance: How Can It Meet Challenges of Demographic Change and Infrastructure Needs?" *International Monetary Fund*, July 2014, 2-4.

To the concern of the Obama Administration, China envisioned the AIIB playing a key role in the establishment of a “new international financial order” that offered alternatives to U.S. and Japan-led institutions.⁵ While the World Bank is headquartered in Washington, DC, and since its founding has been led by a U.S. citizen, the Philippines-located ADB is led by a Japanese citizen; within the former, the United States holds the dominant voting share, and in the latter, Japan.* The IMF, also in Washington, DC, historically has been headed by a European. In each of these institutions, China and other emerging countries have attempted to rebalance the distribution of voting shares in accordance with their growing economic strength. They have been unsuccessful in these reforms—often as a result of U.S. opposition or inaction—and thus have begun to push for alternatives outside of the traditional institutions. As U.S. Treasury Secretary Jack Lew told Reuters, “It’s not an accident that emerging economies are looking at other places because they are frustrated that, frankly, the United States has stalled a very mild and reasonable set of reforms in the IMF.”⁶ Legislation to approve giving developing nations more say within the IMF and to provide China with voting power commensurate with its contributions has not passed Congress for four years. “Congress can abdicate its international responsibilities. What it can’t do is stop China from playing a bigger role in managing the global economy,” said David Loevinger, former U.S. Treasury Department senior coordinator for China affairs in the Obama Administration.⁷

For their part, World Bank, IMF, and ADB leadership have all issued statements welcoming the establishment of the AIIB and expressing interest in future cooperation.⁸ According to Bloomberg, ADB President Takehiko Nakao commented, “I understand the reason behind these banks, so they should be welcomed.”⁹ China has likewise maintained the AIIB would work with the existing MDBs. At the IMF and World Bank Annual Meetings in October 2014, China’s Alternate Governor of the Fund, Yi Gang,[†] called the AIIB “a necessary complement to current institutions.”¹⁰ He explained, “It will help develop joint forces to increase the overall capacity of international multilateral development aid.”¹¹

Other experts have suggested that by spearheading a multilateral, high-standards institution, China hopes to prove itself as a responsible global player. At the same time, in this capacity, China also could further its own strategic agenda—such as spreading its influence through the soft power of economic development among its neighbors. According to Erica Downs, a fellow at the Brookings Institution in Washington, DC, the multilateral AIIB could serve as a “less threatening” alternative to bilateral mechanisms such as China Development Bank and the Export-Import Bank of China. “China could use AIIB to legitimize its economic expansion,” Downs said.¹²

While the White House has not publicly criticized the AIIB, it reportedly has pressured U.S. allies to abstain from joining the new bank.¹³ According to the *Wall Street Journal*, the U.S. Administration regards the AIIB as “China’s vehicle for creating a rival to the U.S.-led World Bank.”¹⁴ In the *New York Times*, the U.S. Treasury Department expressed concerns about the AIIB’s ability to meet environmental and labor standards as well as to guarantee other international safeguards for vulnerable populations. Others have warned that China might use the bank as a mechanism for achieving regional political and territorial objectives.¹⁵

Some of the Administration’s concern might arise from China’s habit of direct lending to African nations over the past decade. Unlike the World Bank, IMF, and other regional lending institutions, China placed few restrictions on infrastructure, mining, and oil and gas exploration projects to protect the environment, worker safety, or indigenous

* Established in 1966, the ADB currently consists of 67 member states, with 48 from the Asia and Pacific regions. Within the ADB’s World Bank-like voting share system, Japan has maintained a dominant position with 15.67 percent of the voting share, followed by the U.S., China, India, and Australia, with 15.56, 6.47, 6.36, and 5.81 percent, respectively. As such, a Japanese citizen has consistently occupied the position of ADB president. Asian Development Bank, “ADB Financial Profile 2014,” 1, 7.
<http://www.adb.org/sites/default/files/institutional-document/42746/adb-financial-profile-2014.pdf>.

[†] Yi Gang is also the director of China’s State Administration of Foreign Exchange and deputy governor of the People’s Bank of China.

peoples.* Some of the loans found their way into the pockets and Swiss bank accounts of African leaders, or paid for elaborate official residences. Construction projects were often carried out by Chinese contractors rather than local workers, and were sometimes aimed at securing access to natural resources. The Brookings Institution noted:

Beijing requires that infrastructure construction and other contracts favor Chinese service providers: 70 percent of them go to 'approved,' mostly state-owned, Chinese companies, and the rest are open to local firms, many of which are also joint ventures with Chinese groups. In this sense, China's financing to Africa, including aid, creates business for Chinese companies and employment opportunities for Chinese laborers, a critical goal of Beijing's Going Out strategy.¹⁶

In a 2014 speech, AIIB's Jin Liqun responded to U.S. concerns: "With zero-tolerance of corruption, we have every confidence to establish a high-standard bank, and tackle security and environmental issues.... We will dutifully follow every standard set for a project or a product. We will observe the international standards while assessing the effects of a project on the local environment, culture, sustainable development and standards of living."¹⁷ China's Ministry of Foreign Affairs (MFA) Spokesperson Hong Lei stated that the new bank would draw on the experiences of other global development finance actors. He explained, "The AIIB will design its governance structure and operation policy following the principles of openness, inclusiveness, transparency, responsibility and fairness. It will learn from the good practices of the existing multilateral development banks, and meanwhile avoid the alike problems they have encountered to reduce the cost and operate more effectively."¹⁸

Until February 2015, China and India were the only major economies among the AIIB's prospective membership. On March 12, 2015, much to the surprise of the United States and the international press, the United Kingdom announced its intention to join the AIIB. According to an official statement released by the UK Treasury, Chancellor of the Exchequer George Osborne called the new bank "an unrivalled opportunity for the UK and Asia," as it would "give our companies the best opportunity to work and invest in the world's fastest growing markets."¹⁹ The statement also expressed that "as the first major Western country to apply ... the UK will play a key role in ensuring that the AIIB embodies the best standards in accountability, transparency and governance." Five days later, France, Germany, and Italy issued similar announcements, leading Chinese MFA Spokesperson Lei to remark, "The wide participation of countries in and out of this region exemplifies the representativeness of the AIIB."^{20,†} As the *Wall Street Journal* would reveal in late March, China's negotiations with European leaders reached a key turning point when China indicated it would not pursue veto power in the AIIB.²¹ The Chinese MFA has since refuted this report, stating that "there is no such proposition."²²

Critical Questions and Debate

The recent European announcements have generated debate regarding the U.S. stance toward the AIIB and the future of the new bank. According to the *Wall Street Journal*, former World Bank President Robert Zoellick‡ criticized the White House's handling of the AIIB as "mistaken both on policy and on execution."²³ Instead, he insisted, the U.S. government should have sought multilateral engagement with China, or at a minimum, presented

* The World Bank is currently revising its own environmental and social safeguards in an effort to increase lending for major infrastructure projects. The new draft regulation has been criticized for its "light touch" and lowering of standards related to the environment, labor, resettlement, and indigenous peoples. John Vidal, "World Bank Emails Reveal Internal Row over 'Light Touch' \$50bn Loans," *Guardian*, July 5, 2014.

† On March 19 and 20, 2015, Luxembourg and Switzerland respectively indicated their intention to join the AIIB. On March 23, 2015, the Australian federal cabinet voted to approve the country's application to the AIIB. RT (Russia), "Switzerland, Luxembourg Apply for China-Led Infrastructure Bank," March 21, 2015. <http://rt.com/business/242897-switzerland-luxembourg-aiib-china/>. Ross Buckley, "AIIB: Australia Does the Smart Thing, Finally," *Sydney Morning Herald*, March 23, 2015. <http://www.smh.com.au/comment/aiib-australia-does-the-smart-thing-finally-20150323-1m5gpr.html>.

‡ Robert Zoellick was also the former U.S. trade representative and deputy secretary of state under George W. Bush.

an “alternative solution.”²⁴ Other experts and commentators have raised the following questions about the AIIB and the current U.S. position:

1. Should the United States seek to influence international rule-making from within China-led institutions or from the outside?²⁵ Similarly, should it “sit out” and leave the AIIB to manage its own fate?*
2. How will China deal with global pressure to make the AIIB a high-standards institution? How will it behave within a multilateral institution? Can it prove itself an effective negotiator and a responsible global player?
3. Will the inclusion of Europe’s four major economies in the AIIB tilt the bank’s power in their favor?[†] Will it prevent China from maintaining a dominant voice in bank operations, whether through governance structure, voting share, or veto power?
4. How will the AIIB change China’s engagement with developing countries? Will other AIIB member countries be able to participate in the provision of goods and services funded by the bank? Or will Chinese companies dominate bank projects?
5. How accurate is the assessment of infrastructure finance gaps in Asia? How many “bankable” infrastructure projects actually exist throughout the region?²⁶ Does Asia really need another development bank?
6. Should the United States seek to contain China’s influence among its neighbors by opposing Chinese soft power, such as development aid, even if that harms other nations in the region?

* Elizabeth Economy presents this option as a viable alternative. Elizabeth Economy, “The AIIB Debacle: What Washington Should Do Now,” *Asia Unbound* (Council on Foreign Relations blog), March 16, 2015. <http://blogs.cfr.org/asia/2015/03/16/the-aiib-debacle-what-washington-should-do-now/>.

[†] This concern has also been expressed in the Chinese media. For more detail, see the USCC’s Chinese Media Digest, Volume 2, Issue 4, March 27, 2015.

Box 1: Asian Infrastructure and Investment Bank – A Timeline

- October 2, 2013: President Xi Jinping first proposed the AIIB in Jakarta, Indonesia
- October 24, 2014: 21 countries met in Beijing to become founding members of the AIIB**
- November 3, 2014: **Indonesia** pledged support of the AIIB
- January 2015: **New Zealand, Saudi Arabia, Tajikistan,** and the **Republic of Maldives** joined
- February 2015: **Jordan** joined
- March 12, 2015: **United Kingdom** announced intention to join
- March 17, 2015: **France, Germany,** and **Italy** applied to join
- March 19, 2015: **Luxembourg** announced intention to join
- March 20, 2015: **Switzerland** announced intention to join
- March 23, 2015: **Australian** federal cabinet approved the country's membership in the AIIB
- March 29–31, 2015: Meeting in Almaty, Kazakhstan to draft the AIIB Articles of Agreement
- March 31, 2015: Application deadline for founding member countries

** **Bangladesh, Brunei, Cambodia, China, India, Kazakhstan, Kuwait, Laos, Malaysia, Mongolia, Burma (Myanmar), Nepal, Oman, Pakistan, the Philippines, Qatar, Singapore, Sri Lanka, Thailand, Uzbekistan, and Vietnam.**

Box 2: Jin Liqun – A Brief Biography

- M.A. in English, Beijing Foreign Studies University (1980)
- Vice Chief of the Foreign Affairs Division, Ministry of Finance (1984–1989)
- Hubert Humphrey Fellow, Economics Graduate Program, Boston University (1987–1988)
- Alternative Executive Director for China, World Bank Group (1988)
- Vice Director General of the World Bank Department, Ministry of Finance (1989–1994)
- Director General of the World Bank Department, Ministry of Finance (1994–1995)
- Assistant to the Minister, Ministry of Finance (1995–1998)
- Vice Minister of Finance (1998–2003)
 - Concurrent positions: Alternate Governor for the People’s Republic of China at the ADB, World Bank Group, and Global Environment Facility; Member of the State Monetary Policy Committee of the People’s Bank of China
- Vice President, Asian Development Bank (August 2003–July 2008)
- Chairman of Supervisory Board, China Investment Corporation (2008–2013)
- Chairman, China International Capital Corporation (May 2013–October 2014)
- Head of the Working Group for the Establishment of the AIIB (February–October 2014)
- Secretary-General, Multilateral Interim Secretariat for Establishing AIIB (October 2014–present)

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Endnotes

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- ³ Ding Ding, Raphael Lam, and Shanaka Peiris, "Future of Asia's Finance: How Can It Meet Challenges of Demographic Change and Infrastructure Needs?" *International Monetary Fund*, July 2014, 1.
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