Vision and Governance of Asian Infrastructure Investment Bank

By Liu Dongmin

China International Publishing Group
中国国际出版集团
FOREIGN LANGUAGES PRESS

First Edition 2016

ISBN 978-7-119-10349-5

Published by Foreign Languages Press Co. Ltd

24 Baiwanzhuang Road, Beijing 100037, China

Distributed by China International Book Trading Corporation

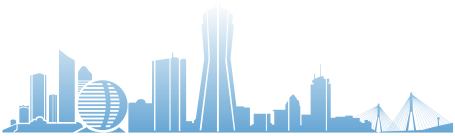
35 Chegongzhuang Xilu, Beijing 100044, China

P.O. Box 399, Beijing, China

Printed in the People's Republic of China

Introduction

On December 25, 2015 the Asian Infrastructure Investment Bank (AIIB) – a multilateral development bank (MDB) initiated by China and joined by 57 nations – was officially founded. The multilateral development financial system thereby ushered in a new member led by developing countries. With an open, constructive, and innovative attitude, the AIIB will contribute greatly to Asia's regional economy and the global economy as a whole.



Contents

The Background to the Initiation of the AIIB by China

1. Global economic growth and people's well-being are constrained by inadequate investment in infrastructure

Creating demand in the short run and supply in the long run, infrastructure investment is a crucial tool that promotes economic growth and improves people's well-being. However, the payback period of infrastructure investment is longer, usually 15 to 25 years. Apart from that, the market mechanism itself is less than capable of meeting the financing needs of many infrastructure projects, which have relatively lower rates of return (Asian Development Bank – ADB, 2015). As a result, inadequate infrastructure investment has long been an issue concerning the global economy. After the financial crisis of 2008 the lack of infrastructure investment became a more prominent problem, as the global economy has faced stagnant growth and soaring public and private debts since then. According to a study by the Organization for Economic Co-operation and Development (OECD), demand for infrastructure investment every year between 2015 and 2030 will make up 3.5% of the world's GDP (OECD, 2015). However, the post-crisis reality shows that many big economies have all-time-low infrastructure-investment-to-GDP ratios. Asia has a particularly large supply-and-demand gap in infrastructure investment. According to an estimate by the ADB, there are approximately 1.4 billion people in Asia lacking access to electricity, 1.2 billion lacking efficient transportation, and nearly 1 billion people lacking access to clean water and basic sanitary facilities (ADB, 2015). From 2010 to 2020 Asia's economy will need almost US$8.2 trillion of investment, which is equivalent to US$747 billion per year, in energy, transportation, telecommunications, water conservancy and sanitary fittings. In such a context, building a regional multilateral financial institution and promoting infrastructure investment in Asia through developmental finance were the essential motives for China to initiate AIIB.

2. China can and should take up more responsibility as it contributes more to the governance of the regional economy

From 1978 to 2008 the reform and opening-up policies helped China become integrated into the globalizing economy. During this period China's role in the global market was mainly as a participant, not a generator; a passive follower instead of a proactive selector in the global value chain. After the financial crisis of 2008, the economic gap between developed economies and emerging economies changed drastically. China has become the second-largest economy in the world since 2010, and the leading country in aggregate trade volume since 2013. Needless to say, China has become one of the countries with systemic importance in the world. As one of the major drivers of the world's economy, China's economic policy has some form of spillover effect on other countries. Likewise, regional and global economic development also impacts China greatly. In both the need to develop and the international community's expectations of China, this country needs to be a responsible nation in both regional and global economic governance. China can and should, to a certain extent, become the generator in the regional and global markets, contributing more to regional and global economic growth. It is in this context that China initiated the AIIB to provide capital for Asia's economic growth. Initiating the AIIB marked a change in China's role as it takes up its responsibility in the regional economy.

3. The existing multilateral development banking system has room for considerable improvement

The strength of current MDBs' reputations has allowed them to leverage both public and private sector capital, and utilize their pool of professional knowledge of international business and economic development. Through effective project engineering and technical support, they help countries grow their economies, promote regional economic integration and improve social welfare. However, the World Bank and regional MDBs face many operational challenges. Common problems in current MDBs include rigid development concepts, complex missions and relatively low operational efficiency.

The MDBs, led by the developed economies, usually impose rigid and tedious standards of economic growth on developing countries based on developed countries' experience, not recognizing different countries' systems and environmental differences. Relatively rigid development concepts may provide unrealistic solutions for developing countries on the one hand, and on the other, increase the number of strategic missions for multilateral institutions, which may result in ever-more complicated requirements to borrowers. When some MDBs provide project loans they often interfere in borrowing countries' policies, including not only fiscal and monetary policies, but also state-owned department reforms, governance reforms, industrial policies, ethnic policy, etc. To a certain extent, it is reasonable to set goals for borrowing countries, because these goals affect the borrowers' economic growth and social development. However, too many strategic missions are guilty of over-interference. While it may break the trust between borrowing countries and MDBs, it will also blur the boundaries and responsibilities taken by MDBs. As a result, limited resources are over-stretched, and the role of development banks in critical areas that promote developing countries' economic growth and social development are weakened. Apart from that, as MDBs grow and become more complicated, redundancy and compartmentalization will not only reduce their operational efficiency, but also result in overstaffing. Each department has a tendency to expand its own sphere, which is usually easy to set up but difficult to disband, creating a bureaucratized mechanism. Many departments have overlapping duties but different reporting channels; unnecessary disputes between departments and operational costs thus arise. In addition, because the loan programs need to go through more departments, examination and approval time is longer, lowering the incentives for borrowing countries to cooperate.

Initiated by developing countries, the AIIB will better cater to the development needs of these countries as it is more inclusive and practical in carrying out in-depth cooperation with developing countries. Over the past 30 years of reform and opening up, China's economy has grown rapidly, and social welfare has improved. It has also gained some experience that can be shared with other shareholders in the AIIB. It can provide new ideas for the governance of the AIIB, and potentially form a positive competition mechanism for reform and development of the multilateral development system.

4. China's huge foreign exchange reserve has enormous potential for investment

In 2006 China outran Japan as the largest foreign-reserve country. As of May 2016, China held US$3.19 trillion-worth of foreign exchange reserves, which is equivalent to nearly 30% of the world's total foreign exchange reserves. China's reserve figure was US$1.94 trillion more than that of Japan, which had the second-largest foreign exchange reserve. Up from US$11 billion in 1990 to US$3.19 trillion now, China's foreign exchange reserve rose dramatically despite unchanged investment channels. Besides maintaining a certain amount of liquidity for household and enterprise exchange, international settlements and preventative measures against crises, the majority of the foreign exchange reserve are invested in dollar-denominated assets, which mainly include US treasury bonds. According to the US Treasury Department, as of the end of December 2015, China held US$1.25 trillion-worth of American treasury bonds. If most of the foreign exchange reserve is invested in treasury bonds, which have a low rate of return, this will not only be against the risk management principle of "diversified investment," it will also restrict the range of application of foreign exchange reserves, lowering investment returns. At a time when the world infrastructure investment is inadequate, and when Chinese businesses are going global, China's huge foreign exchange reserve could be invested in economic growth overseas. Therefore, in recent years, the Chinese government has been actively pushing for a diversified utilization of its foreign exchange reserve. The AIIB and the New Development Bank (NDB, formerly referred to as the BRICS Development Bank) provide opportunities for the Chinese government to expand its usage of its foreign exchange reserve. Using a part of it to invest in the AIIB and the NDB, China's foreign exchange reserve can be used to stimulate economic growth overseas, contributing significantly to the development of the global economy as well as its own economy.

The Origin and Planning of the AIIB

1. Three planning stages

In October 2013 Chinese President Xi Jinping proposed the setting up of the AIIB when he visited Southeast Asia. It took more than two years of planning before the AIIB was officially established on December 25, 2015. The planning process can be divided into three stages:

The first stage was from October 2013 to October 2014, during which the memorandum for setting up the AIIB was signed. In the same month as President Xi Jinping formally proposed the establishment of the AIIB, Premier Li Keqiang also supported the AIIB when he visited Southeast Asia. Ten Asian countries, including China, held the first multilateral work consultation meeting in Beijing in January 2014. Ideas for the framework of the AIIB were exchanged. Later, there were four rounds of multilateral consultation meetings and one ministerial working dinner between China and related countries. Issues such as purpose, governance, headquarters location and shareholding structure were discussed in detail. On October 24, 2014, the 21 representatives of prospective founding members, including China, India, and Singapore, agreed to set up the AIIB by signing the Memorandum of Understanding on Establishing the Asian Infrastructure Investment Bank, in the Great Hall of the People in Beijing.

The second stage was from November 2014 to March 2015, during which the AIIB recruited new members. Within six months after the Memorandum was signed, the number of prospective founding members increased to include Indonesia, New Zealand, Saudi Arabia, Tajikistan and Jordan. However, at this stage the AIIB was still a regional MDB with no major developed country as a member. In addition, some founding members were cautious about the AIIB's development, and there was little media coverage of the AIIB in Western media. Yet, the tide turned as the deadline for prospective founding member application was announced by China's Ministry of Finance (March 13, 2015). On March 12, 2015, Britain formally filed an application to join the AIIB, which drew unprecedented global attention to the AIIB. Later, the European countries of Germany, France and Italy joined successively. As of the end of March 2015, all the major developed countries except the

US, Japan and Canada had become prospective founding members of the AIIB, making a total of 57 such members.

The third stage was from April 2015 to January 2016, when the AIIB concluded its preparation work and formally went into operation. After the accession of developed countries represented by Britain, the AIIB's shareholding structure changed from that of a regional financial institution to that of a global financial institution. The AIIB also proposed three goals – "Lean, Clean, and Green" – to build itself into an open and efficient multilateral institution meeting international standards (Jin Liqun, 2015b). Based on this consensus, on June 29, 2015 the 50 countries the applications of which had been approved formally signed the Articles of Agreement of the Asian Infrastructure Investment Bank (hereinafter referred as as the Agreement), which marked a new stage for the AIIB as it began operation. According to the Agreement, the AIIB had subscribed capital totaling US$98.1514 billion, of which China subscribed US$29.7804 billion, or 30.34% (AIIB, 2015). On December 25, 2015 the Agreement went into force after it was approved by the requisite number of countries, and the AIIB was formally established. In January 2016 it went into operation.

2. The impact on the AIIB of European countries' joining

In March 2015 European countries represented by Britain acceded to the AIIB after most Asian countries had already become members. This attracted a lot of attention worldwide.

The accession of European countries will positively influence the future development of the AIIB. First, it can strengthen the AIIB's reputation in the West. With the accession of developed Western economies, the shareholding structure of the AIIB was changed significantly. Originally, its stock was mainly limited to Asian countries, but now the AIIB has become a global financial institution participated in by many Western countries. Second, it can help increase the credit rating of the AIIB. Based on the sovereign rating systems by three major international credit rating agencies, AIIB members had relatively low credit ratings prior to the accession of Western countries. Therefore, the AIIB's rating was likely to be the same as that of China's sovereign rating – lower than that of many MDBs. With the accession of developed Western economies, the AIIB ratings would go up. Third, it can improve the governance and development model of the AIIB. Developed economies brought much expertise from existing multilateral financial institutions. Within a short period of time, the AIIB can fully absorb international experience, creating a momentum for future development. As the AIIB becomes a multilateral financial platform on a global scale, reflected by its shareholding structure, the investment risks decrease, since many AIIB stockholders can coordinate with borrowing countries in policymaking. At the same time, with the accession of many countries outside Asia, it will be convenient for the AIIB to invest outside the region.

The Vision of AIIB Development

1. Respecting the demands of developing countries

The post-World-War-II economic development concepts are mostly based on the experience gained by developed countries, and several MDBs, which are more influential on a global scale, are mostly run by developed countries. The development concepts of these multilateral institutions are mainly formulated by developed countries as well. Their missions continue to expand from economies, political reform, statutory system, to governance of companies and ethnic policy. The rigidity of the development goals and the complexity of missions have interfered with borrowing countries, lowering the readiness of those countries to cooperate with multilateral institutions. At the same time, multilateral institutions set up too many goals, some of which overlap, resulting in low efficiency in resource allocation, and weakening the support for developing countries in key areas.

The AIIB respects developing countries' development paths. It will minimize conditions attached to investment that are not related to economic activities. On a practical level, it is natural for financial institutions to add additional terms for their investment and financing activities, but these additional terms and conditions should be limited to areas related to project operations and loan repayment. Simply copying some other country's development model will bring many social and political problems: It will not only break the trust between borrowers and multilateral financial institutions, but substantially reduce the operational efficiency of the institution itself. In this case, the loss outweighs the gains for both borrowers and financial institutions.

The AIIB will be scrupulous with its missions, taking infrastructure investment as the core mission, while taking the projects' economic feasibility as the main consideration when it comes to investment allocation. This has three benefits: First, focusing on infrastructure investment can make sure that resources are efficiently allocated, increase operational efficiency, and provide strong support for the long-term development of Asia's regional economies. Second, the AIIB can quickly gain experience based on the implementation of infrastructure projects, which could build a solid foundation for the long-term development of the AIIB. Third, the AIIB can create a non-political organizational culture that stresses professional expertise and technology. This is closer to the preliminary request made by the developing countries. That way, the AIIB can win more clients and business partners from developing countries and around the world in general.

2. Maintaining financial sustainability

As a developmental financial institution with developing countries as major shareholders, the AIIB will focus on moderate profitability to ensure financial sustainability, which can maintain the eagerness of developing countries and shareholders to participate, as well as contributing substantially to the international developmental financing system.

Based on the operational experience gained by multilateral development institutions, financial sustainability is achievable. Examples are the ADB and European Investment Bank (EIB) (See

Chart 1)[1]. For the AIIB, most of its business is focused on the Asian region, which has a dynamic economy. With professional program selections, stringent risk management and lean institution operation, moderate profitability is more than achievable. Different from commercial banks, the AIIB will not take maximization of profitability as its main goal. Unlike commercial financial institutions, which strive for short-term returns on investment, the AIIB will mainly focus on medium- and long-term investment. With the guidance of such an operational concept, the AIIB can maintain financial sustainability while acquiring the kind of competitive advantages that commercial banks do not have, creating robust economic and social value.

3. Setting a high standard

The AIIB will respect international rules, learning from the experience of other MDBs and adhering to high standards in areas such as gover-

1 The World Bank is unique in the sense that it takes on the task of global poverty eradication. That is why its rate of return is usually low, sometimes even negative.

Chart 1: Performance of three major multilateral development banks

	World Bank		
	2013	2014	2015
Return on Assets (ROA)	-0.02%	-0.43%	0.10%
Return on Equity (ROE)	-0.17%	-4.08%	0.85%
	Asian Development Bank		
	2013	2014	2015
ROA	0.49%	0.33%	0.47%
ROE	3.15%	2.28%	3.19%
	European Investment Bank		
	2013	2014	2015
ROA	0.49%	0.48%	0.48%
ROE	4.34%	4.34%	4.35%

Source: EIB Financial Report 2013/2014/2015, WB Financial Statements (Fiscal Year 2013/2014/2015), ADB Financial Report 2013/2014/2015. In the chart, the numbers for the World Bank only refer to the International Bank for Reconstruction and Development (IBRD), not the International Development Association (IDA).

nance structure, business operation and security policies.

During the planning stage, the AIIB Multilateral Interim Secretariat hired professionals experienced in international institutions and governmental departments. Together with the AIIB, they will discuss with representatives of the AIIB shareholder countries the relative governance structure, business operation model, security policies and legal documents. The process of planning demonstrated a sense of openness, transparency, inclusiveness and democratic negotiations. Not only did China win every country's trust and support, it also helped the AIIB fully learn and take as reference international experience at the very beginning to ensure high-standard operation.

Currently the AIIB is made up of an exceptionally diversified shareholder structure at three organizational levels: Board of Governors, Board of Directors and management. This is a sound modern governance model that ensures the highest standard for the AIIB. On multiple public occasions, President of the AIIB Jin Liqun said that the bank would build a high-standard governance system that meets the standards of the 21st century, and achieve the best international innovation practice. His speech reflected the determination and confidence in the AIIB in achieving high-standard operations on a global scale. The AIIB hires people based on the principle of openness, transparency and merit. Only a high-quality team can effectively carry out efficient operations at a perpetual high standard.

4. Valuing international cooperation

A new member of and a powerful addition to the multilateral development financing system on a global scale, the AIIB will collaborate with the existing MDBs, commercial financial institutions and countries around the world.

The MDBs have gained rich experience in operation over the past few decades. Overall, in terms of the number of projects, knowledge pool and people, MDBs have a lot of advantages. The AIIB can share knowledge, build capabilities, exchange professional personnel and finance projects, etc., with MDBs. In a relatively short period of time the AIIB can gain experience while increasing its management capabilities and reducing operational risk. The AIIB's increased funding and efficient operational model will incentivize other multilateral institutions to cooperate, and speed up the reform and development of the global multilateral development financing system. During the planning process, President of the World Bank Jim Yong Kim and ADB President Takehiko Nakao clearly expressed their interest in collaboration. In fact, the AIIB has been carrying out substantial cooperation with the World Bank, ADB, EIB and European Bank for Reconstruction and Development (EBRD).

The AIIB will cooperate with commercial financial institutions, maximize the leverage effect in the form of public-private partnership, and allocate market resources more effectively. The International Finance Corporation (IFC) under the World Bank and the Global Loans under the EIB are successful examples of cooperation between multilateral development institutions and commercial financial institutions around the world. The AIIB will strive to learn from these experiences, utilize global public and private capital, integrate its practices with client resources and projects of different financial institutions, and aim to become an outstanding partner in the international development financing market.

It is the AIIB's major goal to deepen cooperation with every government. Taking infrastructure investment as the major business direction and sovereign credit guaranteed loans as the major business model, the AIIB's core partners and service targets are central and local governments. The AIIB will maintain close communication with governments at different levels through understanding the needs of governmental departments. On the premise of respecting each country's development path, the AIIB will design and formulate appropriate projects of financing and operation, and collaborate with governmental departments for economic growth. As a multilateral financial institution, the AIIB will also take on the coordination and financing work of cross-border infrastructure projects. It is challenging to launch the initiation and implementation of cross-border projects which involve a cooperation mechanism between multilateral governments. The AIIB is irreplaceable in this respect as it has a role as a financial platform for the building of a multilateral mechanism. Therefore, the AIIB will work hard to contribute to multilateral intergovernmental cooperation.

The Governance and Operation of the AIIB

Even though the AIIB has just started its operation, in many ways we can see that the AIIB's governance and operation have been different from those of other multilateral development banks. Simply put, the AIIB is open and inclusive, lean and effective, practical and flexible.

1. Open and inclusive

Its openness is the AIIB's first difference between it and other multilateral financial institutions. Its openness and inclusiveness are demonstrated in the Agreement, which requires the AIIB to place no restriction upon the procurement of goods and services from any country. Recipient countries can then purchase products that most fit their needs when their projects are launched, as their profits are maximized. This is in stark contrast with some other existing multilateral financial institutions.

More importantly, the AIIB's openness is reflected as follows: As the initiator and largest shareholder in the AIIB, China does not plan to possess veto power. In accordance with the shareholding structure under the Agreement, China holds 30.34% of the AIIB's shares, making it the largest shareholder. Its share is even 6.94% higher than the sum of the shares of the second- to fifth-largest shareholders. The size of the share determines one's decision-making power. According to international rules, 30.34% of the shares grants China a corresponding size of voting power. However, in order to show China's good faith in cooperation, China moderately modified its voting power. According to the Agreement, China supposedly had 26.06% of the voting power. Considering the fact that the AIIB needs 3/4 support to pass major policies, China has the right to veto a policy. However, the AIIB is prepared to welcome the world community with open arms. Recently, AIIB President Jin Liqun said that after the AIIB was formally established, about 30 more countries expressed their interest in joining it. It is estimated that by the end of 2016 the number of shareholders will be close to 100. As more new members join the AIIB, China will probably lose its veto power, but continue to hold a faithful and open attitude toward other countries.

2. Lean and effective

Building on the experience of other multilateral development banks, the AIIB reformed and conducted innovations. First of all, the AIIB does not have a permanent Board of Directors. The Board of Directors directly supervises management in which work is divided clearly for efficient operation. At the same time, only a few branches outside China will be set up, apart from the headquarters in China. It is estimated that the number of staff will not exceed 500-600 people, i.e. approximately 1/6 and 5% of the number of staff of the ADB and World Bank respectively. The measures above cure the malady of overstaffing in MDBs, while reducing the operational cost of the AIIB. At same time, the AIIB will simplify its loan-review process. When the AIIB was first established, it was fully aware of the negative impact of complicated bureaucracies of international financial institutions on its long-term development. Therefore, reform of the project-review process will be carried out, entailing shortening the process of reviewing projects and improving their efficiency, so that the AIIB can become an institution with a simple and efficient structure.

Admittedly, there are criticisms of the above measures. Skeptics think that not setting up a permanent board of directors will affect the immediate communication between shareholders, and China will strengthen its control. However, no reforms are perfect. Not setting up a permanent board of directors is effective in defining duties clearly, increasing managerial efficiency, and cutting operational costs. In today's world, extremely well-developed ways of communications – video conferences, e-mails and phone calls – are effective ways to communicate aside from face-to-face interactions. Directors can convene speedily from around the world when a problem arises. That way, negative effects can be minimized.

3. Pragmatic and flexible

The AIIB, with developing countries as the major shareholders, will set financing standards that focus more on economic development, instead of intervening with the borrowing countries' overall development. In fact, some multilateral institutions have interfered too much with other countries' development models, making developing countries not very eager to apply for loans. In terms of environment and social welfare, the AIIB will uphold high international standards while making adjustments to some stringent terms that are not compatible with the national conditions of some developing countries (Jin Liqun, 2015a, 2015b).

The AIIB's investment approach will be more flexible, carrying out bank loans, equity investment and guarantee business concurrently. On top of the traditional sovereign credit guarantee loans, the AIIB will make direct investment, i.e. equity investment in public and private departments (AIIB, 2015). This type of investment is very flexible, favorable for adopting the public-private partnership mode, and, in some circumstances, bears higher risks for higher returns. On the other hand, the AIIB can also act as a guarantor to promote investment between supply and demand as an intermediate business. Collating these three types of investment can help the AIIB better adapt to the market, and speed contribution to regional development financing. At the same time, the AIIB will promote public-private partnership, which will facilitate the integration of market resources in infrastructure construction, the leverage effect of the AIIB, and the attractiveness of infrastructure projects to the private sector.

About the Author:

Liu Dongmin is a senior research fellow and director of the Division of International Finance, Institute of World Economics and Politics, Chinese Academy of Social Sciences. His research focuses on reform of the international monetary system. Since he joined the IWEP in 2009 Liu has completed a score of research projects.

Edited by: Yicai Research Institute
Published by: Foreign Languages Press

图书在版编目（CIP）数据

亚投行的愿景与治理：英文 / 刘东民著 . — 北京：外文出版社，2016
（G20 与中国）
ISBN 978-7-119-10349-5
I. ①亚… II. ①刘… III. ①国际投资银行 – 研究 – 亚洲 – 英文
IV. ① F833.03
中国版本图书馆 CIP 数据核字 (2016) 第 185699 号

出版策划：胡开敏
项目主编：杨燕青
出版统筹：于　瑛
项目执行：熊冰頔
特约编辑：王　韬　林纯洁　马　鑫　薛凯琳
责任编辑：熊冰頔
英文翻译：邓晓思
英文审定：Paul White　刘奎娟
英文编辑：刘奎娟
装帧设计：北京大盟文化艺术有限公司
内文排版：北京维诺传媒文化有限公司
印刷监制：冯　浩

亚投行的愿景与治理
刘东民　著

出 版 人：徐　步
出版发行：外文出版社有限责任公司
地　　址：中国北京西城区百万庄大街 24 号　邮政编码：100037
网　　址：http://www.flp.com.cn　电子邮箱：flp@cipg.org.cn
电　　话：008610-68320579（总编室）
008610-68327750（版权部）
008610-68995852（发行部）
008610-68996064（编辑部）
印　　刷：北京飞达印刷有限责任公司
经　　销：新华书店 / 外文书店
开　　本：787mm × 1092mm　1/32
字　　数：9 千
版　　次：2016 年 8 月 第 1 版 第 1 次印刷
书　　号：ISBN 978-7-119-10349-5
定　　价：48.00 元（英文）