CHINA Hot Topics

The AIIB: a little competition never hurts anyone

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As the AIIB gains traction, US policymakers are reminded that they need to "step it up" in Asia

The Asian Infrastructure Investment Bank (AIIB), with an initial US$ 50Bn in lending, is basically a Chinese-led initiative supported by a number of emerging economies in the region. These include members of the Association of Southeast Asian Nations (ASEAN), Bangladesh, India, Kazakhstan, Kuwait, Nepal, Oman, Pakistan, Qatar, Sri Lanka and Uzbekistan.

The initiative was initially opposed by the United States (US), as it was perceived that it could impede the efforts of existing donors in the region, such as the World Bank, the Asian Development Bank (ADB) and the International Monetary Fund (IMF). However, a number of western economies have also joined the initiative in recent weeks despite the US's well-publicized admonitions to its allies (Corbett, 2015). These include Australia, Italy, France, Germany, New Zealand, South Korea, Spain and the United Kingdom.

Signing up to the AIIB at an early stage will grant these economies the opportunity to share best practices and work in collaboration with China to ensure that the bank does in fact operate in a manner which is "lean, clean and green", the now quasi-official motto of the AIIB. Early reports claimed that China managed to attract the participation of these economies by foregoing veto power. If this were true, it would be a blow to the Washington-based IMF and World Bank (the US has veto power in both institutions), but as nice as that may sound, China has not yet officially foregone its veto power in the AIIB.

China, who has a 50% stake in the bank, has pledged to eventually increase the bank's capitalization to US$ 100 Bn. It is expected that former Vice Minister of Finance Jin Liqun (who also worked at ADB) will head the institution, which will be based in Beijing. As China eases restrictions on capital and the RMB becomes convertible, the bank could be important for tapping China's approximately US$ 4 Tn in foreign reserves. Putting China's large foreign reserves to good use in developing Asia could potentially make the AIIB a serious alternative to traditional sources on financing in the region.

Other investment vehicles: the BRICS New Development Bank and 21st Century Silk Road

The same logic applies to the rest of China's less-publicized new investment vehicles. China's 21st Century Silk Road, also known as the "One-road, one-belt" (OROB) strategy, was announced in October 2013 and comprises the creation of a USD 40 billion Silk Road Fund, which will boost infrastructure investments and foster economic integration with countries along the historic Silk Road. The Silk Road Economic Belt (the land bound leg of the OROB), will target countries in Central Asia (many of which are important suppliers of oil and natural gas to China) and will finish in Turkey. The Maritime Silk Road (the sea bound leg of the OROB) will target ASEAN countries and will reach East Africa via the Malacca Strait as well as Sri Lanka, ending in Greece (the Greek port of Piraeus is now controlled by China Cosco).

Let's not forget that Beijing also spearheaded the creation of a USD 50 billion BRICS New Development Bank (NDB) in July 2014. In line with China's OROB strategy, the BRICS NDB will focus on the development of infrastructure in order to promote closer economic links along the ancient Silk Road as well as Latin America. BRICS are in dire need of funding for infrastructure, a deficit of investment which some experts have placed at USD 1 trillion per year beyond what is currently being financed (Bhattacharya and Romani, 2013). China's fast economic growth in the last decades, linked to high industrialization and infrastructure investments, gives it a comparative advantage when it comes to assisting these countries vis-à-vis the World Bank and the IMF. Having said this, the fact that China has decided to put all its diplomatic weight behind the AIIB (based in Beijing) just months after pushing for the NDB (based in Shanghai) to some extent gives the impression that Chinese foreign policy is poorly coordinated. This could be the reflection of the leadership's change of heart or even a rift amongst different factions of government.

In any case, the creation of a network of institutions that promote infrastructure investments in Asia (and beyond) is by no means a zero-sum game. The infrastructure investment gap in emerging economies is huge. Investment requirements for infrastructure in Asia alone will exceed USD 8 trillion (Bhattacharyay, 2010) over the next decade. The current financing capabilities of the World Bank, IMF and ADB are not enough to meet the current investment needs of the region, so in this context, the AIIB will play an important role by helping APAC countries to bridge (port and pave) their infrastructure needs.

China's growing global influence is to be expected and not to be feared

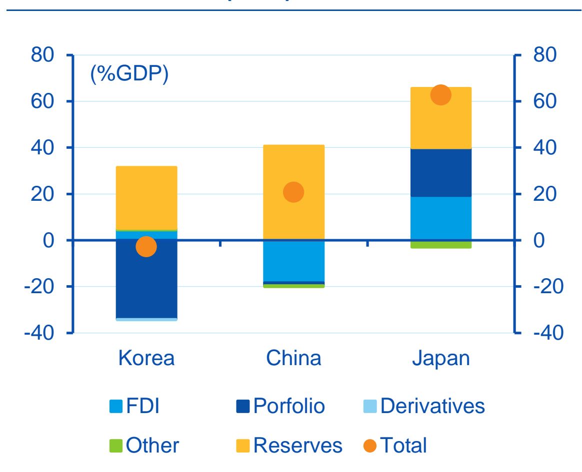
Yes, China's influence in the world is growing and yes, efforts to promote western-type governance and market liberalization will in many cases have to live with a new set of priorities with Chinese characteristics. But this is both to be expected and not to be feared, at least in principle. Here are some reasons why:

China is now the second largest economy in the world as well an important trading partner of many countries in Asia and beyond. China's investment-led growth model helped to fuel unprecedented growth rates over the past decades, but this model has started to prove unsustainable. China's rebalancing away from investments has left many sectors with excessive capacity (steel, cement, construction), and promoting infrastructure developments abroad conveniently helps China to outsource this excess capacity while boosting the market share of its multinational corporations overseas.

Thanks in part to its large capital account surplus; China has amassed an impressive USD 4 trillion in foreign reserves. An estimated two-thirds of these reserves are held in USD denominated assets. Beijing could use overseas investments as an alternative to holding government debt securities, diversifying its hugely positive international investment position away from reserve assets and towards FDI (Figure 1). But the share of Chinese investment in the world remains small when compared to other major economies (China 2.3%, Japan 4.5%, US 22%), reflecting the fact that this is still a relatively new phenomenon (Figure 2). As China's economy matures, so will its international investment position (which isn't a bad thing), and this will naturally have rippling effects on the rest of the global economy.

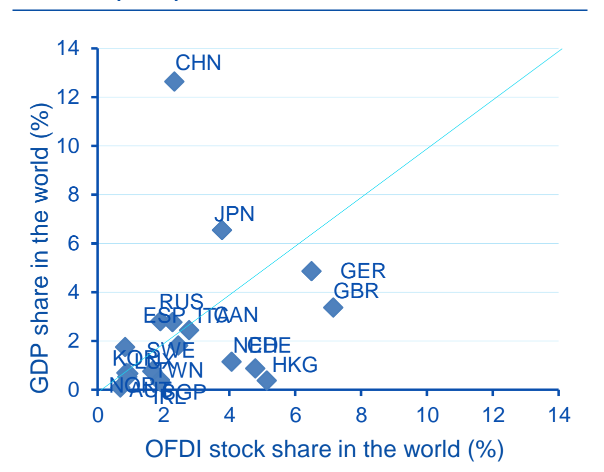
The AIIB has the potential to facilitate China's economic rebalancing while simultaneously improving the economic outlook of emerging Asia, but in order for this to happen the bank needs to be managed in a way which is cost-effective, transparent and moves away from political motivations.

Figure 1
International investment position (BPM6) of major economies in Asia (2013)



Source: Haver and BBVA Research

Figure 2
Chinese investments overseas offer no cause for concern (2013)



Source: UNCTAD and BBVA Research

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