Will China’s Asian Infrastructure Investment Bank succeed?

by Robert Bestani

9 February 2015

One of the hot topics in the Ministries of Finance across Asia of late is what to make of China’s newly announced plans to create a new development institution to be named the Asian Infrastructure Investment Bank — the AIIB for short. What makes this fledgling institution so interesting is the political support it is receiving within China. The announcement was made by no less than China’s leader Xi Jinping at the annual meeting of the Asia-Pacific Economic Co-operation (APEC) forum in Bali last year.

Since then, there has been a great deal of speculation as to who will be joining, who was invited to join and who was not invited to join. At the same time, there has been considerable discussion about the true intent of the AIIB, with much speculation that the true purpose of the new bank to challenge Japan’s primacy with the Asian Development Bank in Manila.

The challenge to Japan is undoubtedly true as the essence of all such multinationals is political; they are at their heart political engines riding on the rails of development. As such, all of the countries that make up the ADB have been invited to join the AIIB including the United States, Japan, South Korea and India. Whether or not these countries join is getting a great deal of political attention, right up to and including that of the Oval Office in the White House.

The popular perception seems to be that the US is trying to block the AIIB. But that seems most unlikely as the US does not, frankly, have the wherewith all to do so. How can they really object when someone is in effect offering emerging countries cheap money, which they clearly need. If you cannot do something, then politically it makes no sense to even try.

The truth of the matter is more likely that the Obama Administration, or any Administration, could not persuade this Congress to pony up funds for another new multinational organization, particularly one run by the Chinese. In fact, the US is once again in arrears on its capital contribution to the ADB.

At the same time, if the US did support the creation of the AIIB, it would go a very long way to upsetting their most important ally at a time when they very much need Japan as a natural geopolitical counterweight to China. Moreover, one of the most important roles of the ADB is to serve as a political bridge between Japan and the rest of Asia. Why upset that apple cart?

For the countries of Asia, the question of whether or not to join is a relatively easy one. It is hard to see anyone abstaining. Why snub their giant neighbor China on this issue, particularly when they are offering money and developmental aid? There is also no downside risk. At worst, they will be getting a few projects with much needed cheap capital without the nettlesome constraints of conditionality.

But in order to be successful as a political institution, the AIIB will need to be successful as a development institution. This is where the subject gets really interesting. Because in order for the AIIB to be successful, the leader of the bank, i.e. China, will need to be an advocate for something that it is not particularly known for; it needs to be stressing good governance.

There has been a lot of talk of late about Asia's infrastructure needs and the amount of capital that will be required to address those needs. This is nothing new. Those numbers have been bounced around for decades without much progress. As such the numbers continue to grow year by year. The current ADB estimates suggest that Asia will need $8 trillion in national infrastructure and $290 billion in regional infrastructure through 2020 to sustain the region's growth trajectory.

With this, comes the standard focus on how much each institution brings to the table. In AIIB's case, the consensus seems to be that the initial target is around $100 billion of new capital. Everyone thus welcomes the idea of the AIIB and usually adds that the ADB can use some competition which is undoubtedly true.

But neither the ADB nor the AIIB can raise anywhere near the required sums. Indeed, the ADB finances less than 2 per cent of Asia's needs, something the AIIB can only hope to match in the next decade. As such, the only source of such funds can be the private sector. Public sector lending can only go so far. Of course, the development banks can, and do, support the private sector in their efforts to "catalyze" private sector investment flows, albeit half-heartedly — a testament to their political and big government instincts.

Yet the real issue is not how much money there is on the table. At the ADB we never turned down an infrastructure transaction for lack of money. It was usually for the absense of good projects and because may countries were frankly not ready for serious efforts at infrastructure programs. Most of the important infrastructure companies across a number of sectors (power, water, ports, airports, etc.) have backed away because of the difficulties they have faced in past years.

The real question is really who will now bring the much needed managerial and technical skills to the emerging countries which so clearly need the physical infrastructure as well as the goods and services considered standard features of a modern economy. This element will only follow the presence of good governance. Where these elements in place, the money would rush in of its own accord.

In order to entice the private sector to step up its investments into long term infrastructure projects, the countries of Asia must first improve their governance regimes. The rule of law, independent regulators and judiciaries, predictability, clean politics, political stability, etc. are all essential elements in the highly competitive race for private capital. Singapore and Hong Kong are good demonstrations of this reality. Absent these elements, all the money in the world will be of little use as it will not venture into the emerging economies. Indeed, the world is awash with money as it is; it just choses to sit idle for the time being for lack of attractive investment opportunities.

To a limited degree the ADB understands this and this has been an important element in the success of their private sector operations over the last dozen years. The real question is can China credibly press these governance issues when their own governance is hardly the model of transparency and predictablity.

If China can bring itself to stress governance as an essential requirement of development, the AIIB will have the ability to be a success. They say they are committed to doing so. And who knows, maybe some of this will rub off on China's own administration. But if not, the AIIB will become merely an embarrassing shill for China's own commercial interests. Indeed, China has made a habit of pushing projects that have none of the safeguards that the international community has come to regard as the norm. Without these in place, the AIIB's efforts could be counterproductive in the long run as the host governments treat the Chinese project managers with the same passive aggressive indifference they have treated everyone else.

With the visibility of Xi Jinping's personal endorsement and credibility on the line, this will be most interesting to watch.

This blog post was originally published in the Business Spectator, available here.

Robert Bestani is a former Director General for Private Sector Operations at the Asian Development Bank and a Visiting Scholar at Stanford University.

Author/s:

Robert Bestani
Robert Bestani teaches at the National Defense University in Washington, DC. He formerly worked as the Director General for Private Sector Finance at the Asian Development Bank as well as at Citibank and the Bank of America where he specialized in energy and infrastructure finance. He also served as Deputy Assistant Secretary for International Monetary Affairs at the U.S. Treasury and is a long standing member of the Council on Foreign Relations.

Link: https://devpolicy.org/will-chinas-aiib-succeed-20150209/