Seeds of a Modern Economic Empire

China is the world’s second largest economic power but lacks comparable voting power in the International Monetary Fund, which bases quotas mostly on GDP but also on openness, economic variability and international reserves. So China is throwing support behind another institution: The Asian Infrastructure Investment Bank, or AIIB, could “place China at the hub of a gigantic trade and economic web,” explains Nayan Chanda in his column for Businessworld. One estimate suggests that Asia could use $8 trillion in infrastructure investment. China will initially capitalize AIIB with $50 billion with plans to provide start operations by the end of 2015. With ample foreign-exchange reserves, China seeks new investment opportunities, and suggests the loans will come without IMF-style conditions. China is the largest foreign creditor to the United States, which questions the new bank’s lending policies and lack of transparency. Besides China, the bank’s 21 founding members also include India, Australia, Indonesia and South Korea could soon join. Chanda warns that tension over China’s territorial disputes with neighbors could hamper bank operations. – YaleGlobal

The AIIB is the logical outcome of China’s surging wealth and its limited influence in global financial institutions

Nayan Chanda
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On October 24, in a ceremony at the cavernous Great Hall of the People, China’s President Xi Jinping laid the foundation of an institution that historians might one day recall as the birth of modern China’s economic empire. If the Asian Infrastructure Investment Bank (AIIB) takes hold, the planned continent-spanning transportation network funded by the bank would place China at the hub of a gigantic trade and economic web. It would also expand Beijing’s strategic influence throughout Asia, reaching across Central Asia to Europe. The ambitious plan could falter, though, if China refuses to modify its aggressive posture along its borders and in the east and the South China Sea.

Although, other than China and India, most of the 21 founding members of AIIB are small regional players, Australia, Indonesia and South Korea are likely to join in the near future. The United States, which has cautioned its allies against participating in a China-dominated institution lacking transparency and sound lending policies, will be under pressure to relent. For years, China has sought to increase its share in the International Monetary Fund commensurate with its economic power. Although the US administration agrees, the proposal has been blocked by the Congress. Meanwhile, Washington has announced a ‘rebalancing’ of Asia and sought to develop the Trans-Pacific Partnership trade group excluding China.

In a way, AIIB is the logical outcome of China’s surging wealth and the obstructions it has faced in the exercise of its power in established global financial institutions. Thanks to nearly four decades of double-digit growth, China has not only built world-class infrastructure and industry but also amassed a mountain of foreign exchange reserves. With growth tapering off and funds held in reserve earning a minimal return, China needs to find new investment vehicles and create demand abroad for its industry and services.

At the same time, Asia is starved of the capital it requires to build its much-needed infrastructure. The Asian Development Bank (ADB), so far the only regional resource, says Asia needs at least $8 trillion worth of infrastructure in the next decade; India alone needs a trillion dollars. Indonesia needs $300 billion. But ADB lends just $10 billion a year for infrastructure. The AIIB will initially be capitalised with $50 billion, mostly by China, with promise to increase to $100 billion with operations starting before the end of 2015.

Not surprisingly, Xi Jinping’s promise to create a Silk Road Economic Belt on land and a Silk Road on the seas has sparked interest in the region. China has talked of laying a pan-Asian high-speed rail from Kunming to Singapore running through Laos, Vietnam and Thailand. Another plan is to build a Central Asian Line starting from Urumqi all the way across to Turkey and Germany. Yet another proposal is to create a road link between Kunming and Kolkata. It is fair to expect that the transportation network will facilitate investment. China’s aging population and rising labour costs make relocation
of its manufacturing and the laying of infrastructure in neighbouring states a logical course. Xi’s promise to lend money with “no strings attached” — a not-so subtle dig at the conditionalities attached by the World Bank and the IMF — is also attractive. In fact, the lack of clearly articulated terms and conditions has led the US to warn that AIIB may be engaging in a “race to the bottom” in environmental, governance and other international standards.

Asian countries being wooed by AIIB, however, may be less concerned about the absence of such conditionalities. What might still give them pause about taking Chinese loans is the potential impact on China’s military behaviour. As long as China refuses to sign a code of conduct in the South China Sea, and settle its border dispute with India, its Asian neighbours can be forgiven for closely examining the AIIB gift horse in the mouth.

Nayan Chanda is editor of chief at YaleGlobal Online at Yale University’s MacMillan Center. 
Read about quota and vote totals for IMF members and proposed reforms. [1]

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