How the AIIB is Different

offer a regional alternative to the multilateral institutions of the Bretton Woods system that left...
Germany, South Korea, and the United Kingdom, China realized that it had a potential vanguard for an alternative economic world order.

The creation of the AIIB means that the International Monetary Fund (IMF) and the World Bank—the two dominant players in development lending and international financial regulation—now have an Asian counterpart. Although all three banks seek to ensure global financial stability and foster economic growth in the developing world, they also actively promote the national interests and political worldviews of their most powerful members.

The similarities between the AIIB, the IMF, and the World Bank are apparent. But there are a few key differences. Western aid and development efforts are geared toward spreading liberal democracy and their own institutional frameworks. China, on the other hand, has stuck to its policy of distancing itself from the domestic affairs of other nations. In fact, the AIIB’s Articles of Agreement have remarkably similar (and broad) operating guidelines to banks within the Bretton Woods framework, but bar members from influencing political affairs.

Has the world reached a point at which political persuasion by dominant countries no longer has a place in development lending? If the AIIB provides any indication, major economies and less developed countries are open to the idea. In this new era, the Bretton Woods system cannot continue its promulgation of liberal democracy, free markets, and Western governance.
neoliberal orthodoxy.

FRUSTRATION WITH BRETTON WOODS

The AIIB was born out of two main grievances about the World Bank and the IMF shared by China and less developed nations. First, as the economies of these countries grew in the last 30 years, their voting powers within both organizations remained flat—which led to disproportionately low influence in both policy initiatives and lending programs.

In the World Bank and the IMF, the number of votes assigned to member countries is determined by a combination of their contributed capital and the size and stability of their economies. Currently, China’s vote share is lower than that of the United Kingdom, despite its larger economy. India is just shy of the list of top ten voting blocs, while Italy is smack in the middle. By 2013, emerging market economies accounted for more than half of the global GDP on the basis of purchasing power. However, voting power at the IMF and World Bank between advanced and developing economies is still split at around 60–40, and Washington’s voting bloc has remained constant at around 17 percent, even though 73 percent of developing countries have grown faster than the U.S. since the 1990s, to the tune of 3.3 percent a year.
The second grievance has to do with the conditionality of IMF and World Bank loans. Good institutions and economic policies, the thinking went, would lead to a greater likelihood that loans would be repaid and decrease the chances that a bailout would be needed in the future. And so loans were given only to those who promised to slash national budgets to avoid running deficits (with welfare programs usually the first to go), lower tariffs, and increase the openness of financial markets. Within the World Bank, the set of informal criteria known as the Millennium Development Goals evaluate how well a country has put its funds to use: humanitarian measures, such as infant mortality and the prevalence of epidemics, are benchmarked alongside assessments of a nation’s democratic practices and government transparency.

During the Asian financial crisis of 1997, criticism of conditionality reached a head. When the Thai bhat collapsed in
Thai economy became vulnerable to speculation, and it paid the price when investors lost their bets. That same program of openness was applied through IMF lending in much of Asia, including programs in Indonesia and South Korea that subjected those countries to financial contagion. The IMF’s solution to the crisis was to implement austerity measures in the countries most heavily affected. As a condition of IMF bailouts, Indonesia and Thailand both had to slash their fiscal budgets, doing away with critical social services in the process, so that the interest on the loans could be repaid. Unemployment skyrocketed as a result, and Indonesians then took to the streets to protest the loss of jobs, stagnation in real wages (due to inflation), and the abolition of the nation’s fuel subsidy. In addition, the IMF recommended to South Korea that it immediately focus its central bank on independence and controlling inflation, a policy that would have done very little to further the recovery and would have instead encouraged the bank to remain unresponsive to politically popular measures, even if they were beneficial. South Korea decided to ignore the advice. For its part, Indonesia closed 16 private banks, leaving depositors without cover and driving them from the financial system altogether.

Latin America was perhaps the hardest-hit economic region outside of Asia in 1997. The IMF instituted the same policies there, and the reaction from local populations was even more pronounced. Without a safety net in the face of skyrocketing unemployment, urban violence and the rise of shadow economies spread throughout Argentina, Brazil, and Mexico,
Checking in a few years after these crises, IMF rescue policies yielded disappointing results. In the early 2000s, the affected East Asian countries had incomes that were 30 percent lower than what would have been expected if the economy continued to grow at pre-crisis rates. For example, Indonesia had 5.3 percent less output in 2001 than it did in 1997. Thailand, which seemed to fare better under the IMF emergency measures than its neighbors, still had not returned to its pre-1997 level of growth. After Latin American countries began their IMF-guided transition to free markets following the hyperinflation of the 1980s, annual growth fell from 2.8 percent to 0.3 percent.

Other regions of the world that saw much IMF activity during the same period suffered similarly. Sub-Saharan Africa’s growth dropped to -0.8 percent per annum, in stark contrast to the 1.6 percent year on year growth in the twenty years prior. Postcommunist Eastern Europe only had five countries produce growth at 80 percent or more of their pre-1989 levels.
effectiveness as a true impetus for reform. Perhaps even more troubling is the lenience that the IMF and World Bank demonstrate toward democratic countries in enforcing the conditions of economic reform programs, allowing leaders to pause reforms ahead of elections to endear themselves to the public. According to a 2007 study by German economist Axel Dreher and George Washington University professor Nathan Jensen, U.S. allies also enjoy a lower number of conditions than other countries receiving loans.

ATTEMPTS AT REFORM

To the credit of the World Bank and the IMF, these organizations have recognized that their inability to understand local conditions is a problem. In response, the two organizations have attempted two major reforms. First, they have tried to increase the voting power of developing countries. Second, they have reworked structural adjustment programs to grant more ownership of a project to the local leaders and increase the voting power. Critics have rejected these new guidelines, however, claiming that they hew too closely to the framework of prior conditions. Greece is the latest example of austerity’s grip on the IMF, reversed only when the world realized the nation had been fast-tracked to bankruptcy. In acknowledging that its emergency loan package was likely not repayable, the IMF cited Greece’s outstanding debts, its inability to collect taxes, and the nation’s shadow economy.

Assuming that neoliberal and free-market programs will remain
The reform package proposed in 2008 and agreed to in 2011 would bring the voting shares at the World Bank and IMF closer to current economic realities, increasing the voting power of smaller countries. Six percent of current shares would shift from developed countries (mostly Europe and the oil-producing nations of the Middle East) to emerging markets. Afterward, 102 out of the 187 member nations of the IMF (most of which are developing countries) would see their shares rise. None of the poorest nations would need to give up any voting shares, and Brazil, China, India, and Russia would enter the top ten stakeholders of the banking organizations. None of these reforms, however, can be implemented without ratification from the United States, the largest IMF stakeholder. Congress so far has refused to approve the reform package, and those nations not provided a proper seat at the bargaining table have taken their fiscal futures into their own hands.
This is where the AIIB comes in. It has taken a crack at fixing inequity. First, the bank’s regional nature ensures that Asian nations will be the predominant voice of the organization. The bank’s charter also mandates that 70 percent of its capital must come from within Asia, ensuring that China will remain the largest stakeholder. Beijing will therefore retain veto power over all major decisions, which require 75 percent approval in order to pass. China’s influence will be checked, however, by the equal percentage of voting rights given to founding members. Other sources of voting shares include the amount of paid-in capital. If China pays in 30 percent of the bank’s capital, as it is slated to, it will still only receive 26 percent of the organization’s voting shares. This contrasts with the policies of the IMF and the World Bank, as these organizations aligned ownership shares with original paid-in capital at the expense of other relevant metrics.

In a sense, then, the AIIB is set up as an experiment for China’s
participate in the affairs of Asia, but on Asia’s terms. Last, and most important, the bank has vowed that politics should not enter into the discussion about whether and under what circumstances a development project is worth pursuing. China jealously guards its own internal affairs, and prides itself on having grown the fastest out of all developing nations in the post–World War II era. Beijing credits this to its steadfast rejection of neoliberal free-market orthodoxy. It firmly believes that its path may be a guide (though not a model) for other emerging countries that have not achieved the same levels of growth.

It is fair to ask how the AIID will judge whether a loan should be provided if it does not take these considerations into account, even if it plans to be more equitable than its Bretton Woods counterparts. The answer is uncannily simple: the AIIB is returning to bank fundamentals of judging a borrower based on pure economic considerations.

As a nation flush with foreign reserves that is experiencing diminishing returns on its manufacturing-centered economy,
investment (FDI) has increased at a compound annual growth rate of 16 percent—twice the global average. According to a study by Ernst and Young, Chinese investment can be found in 6,128 overseas companies across 156 countries and regions last year.

For China, following the money has resulted in valuable bilateral economic relationships with partners that are the prime recipients of correctional measures from the IMF and World Bank. The Silk Road initiative, which runs through North Africa and Central Asia, does not favor countries in the neoliberal world order. Investments in Southeast Asia, Africa, and Latin America touch upon both democratic and authoritarian regimes.

Southeast Asian investment in particular comes at a critical time for China as it transitions from a manufacturing economy into one that is service-based. Beijing must soon begin to import more of its industrial inputs, and Southeast Asia is a prime target to fulfill those needs. Even though China’s share of trade with Southeast Asia is still relatively small, the region continues to be a major supplier of manufactured goods—particularly machinery and electronics. The region as a whole ran a trade deficit of $45 billion in 2013 with China, but accounted for only 10.7 percent of China’s total trade volume.

Beijing wants to see these numbers increase. The AIIB allows it to pursue the endeavor with a multilateral effort. At the same
The bigger bet—a good one—with the AIIB investment is that by replacing ideology with a bank that prides itself on Asia-centric political agnosticism, it can uproot and outdo the Bretton Woods banking systems that have put politics ahead of development.