Borrowing Country-Oriented or Donor Country-Oriented? Comparing the BRICS New Development Bank and the Asian Infrastructure Investment Bank

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Abstract

Why have the New Development Bank (NDB), established by the BRICS grouping of Brazil, Russia, India, China and South Africa, and the Asian Infrastructure Investment Bank (AIIB), both created by emerging economies, taken different operational institutions? The NDB has adopted a borrowing country-oriented operational modality, while the AIIB’s operational modality is still donor country-oriented. This article examines the structural factors leading to the creation of these new banks and different institutional proposals during the establishment negotiation processes to explain the operational differences. In the establishment of the NDB, the competition between India and China for leadership made the principle of equality a basic feature of the bank. All the founding members are the borrowing countries. The NDB is a borrowing country-oriented new multilateral development bank (MDB) with equal shareholding and the use of country systems as two prominent institutional innovations. In the case of the AIIB, after being joined by non-regional European powers, China pushed it toward an internationalized and high standards approach, in the face of political pressure toward multilateralism, especially from the European founding members, and market pressure from the international credit rating agencies in America. As a result the AIIB was similar to existing MDBs in terms of operational modality. This research shows the different institutional approaches to participation in global economic governance for emerging economies.

Keywords: NDB; AIIB; Operational Institutions; Borrowing Country-oriented; Donor Country-oriented


Introduction

Both the New Development Bank (NDB) established by the BRICS grouping of Brazil, Russia, India, China and South Africa and the Asian Infrastructure Investment Bank (AIIB) were initiated and created by emerging economies, promoting infrastructure investment and global governance reform as two institutional mandates. However, they have taken different operational modalities and approaches: the NDB is a borrowing country-led multilateral development bank (MDB) which is localized in its operation, while the AIIB’s operation is shareholding country-oriented and internationalized — in the words of the Chinese government, the AIIB is a normative, multilateral development bank with international best practices.

1 The editorial board received the article in September 2018.
NDB founding members equally share quotas and all founding members are both borrower and donor countries, while the AIIB’s quota allocation is similar to existing multilateral development banks; although there is no explicit division of borrowing and non-borrowing countries, the AIIB is composed of both, especially the European non-borrowing countries. On the environmental and social framework, in contrast to the practice of existing MDBs, the NDB actively uses country systems to promote borrowing countries’ capacity-building and development effectiveness, while the AIIB applies international best practices for environmental and social protection through co-financing with existing MDBs. On financing, the NDB uses local currency financing and capital markets, while the AIIB is focused on the international capital market and denominates projects in U.S. dollars. Regarding partnerships, the NDB has paid more attention to building partnerships with local financial institutions, including national development banks and commercial banks, while the AIIB is eager to build partnerships with existing MDBs.

Why do the NDB and the AIIB apply different operational models? Both were initiated and created by emerging economies with infrastructure investment and global governance reform as their institutional mandates. The main finding of this analysis is that power politics mattered in the establishment process of these two banks. India and China were competing for leadership of the NDB, making equality the prominent institutional feature. All of the founding members are borrowing countries and they agreed that the bank should be localized in its operation. In the case of the AIIB, with the joining of European founding members, China was more concerned with international legitimacy than the interests of borrowing countries, so the political pressure toward multilateralism from European powers and market pressure of credit rating agencies from the U.S. were the driving forces shaping the design of the bank, thus making it similar to existing MDBs. Although the AIIB has made some innovations to improve efficiency, such as a non-resident board of directors and global procurement, it is still a donor country-led MDB.

Since their establishment, the NDB and the AIIB have been popular topics for research in international political economy; however, most scholars have paid attention to the background, governance structure, strategic positioning and role of China in these banks [Griffith-Jones, 2014; He, 2016; Lichtenstein, 2018; Ming, 2016; Zhu, 2015]. Very little research has been done on the different operational institutions adopted by these two banks and the reasons why this difference exists. However, in order to assess the effectiveness of these banks, it is important to understand the difference in their operational institutions.

In addition, the operational models of these two new international institutions represent the different approaches emerging economies take toward reform of global economic governance. The AIIB represents a “change from within” approach, adopting similar operational models with several small changes to increase the efficiency of the institution, while the NDB represents a paradigm shift from donor country-oriented to borrowing country-oriented approaches. In the short term, it is easier for the AIIB to obtain a higher international credit rating and reputation in international financial markets; however, in the long term, the NDB can provide more institutional choices for the reform of global economic governance in favour of developing countries.

2 There are many misjudgments about these two banks, with most observers concluding that the AIIB is more effective than the NDB. In the first two years, the AIIB has expanded to 84 members, invested $4.2 billion in projects, and has a AAA credit rating from the big three international credit rating agencies. The NDB only has five members, $3 billion in projects and a AAA credit rating from two major domestic credit rating agencies in China. However, from the perspective of their different operational modalities, the AIIB and NDB both have advantages and disadvantages.
This article discusses the significance of the NDB and AIIB in promoting infrastructure investment and global governance reform. It analyzes the operational model of the NDB and explains its adoption by examining the establishment negotiations, and especially the roles of India and China. Finally, it discusses how the AIIB’s institutional design was influenced by political pressure toward multilateralism and market pressure from credit rating agencies through an analysis of power politics between China and the European powers. It concludes with a consideration of the advantages and disadvantages of these two operational institutions and their implications for global governance reform.

Emerging Economies and the Fourth Wave of MDBs

There have been four waves of multilateral development banks, each linked with a significant event in international politics [Wang, 2017]. The first wave was in the 1940s, linked with the end of World War II. At the Bretton Woods conference, the U.S. proposed the establishment of a new multilateral development bank to support European reconstruction and thus named the bank the International Bank for Reconstruction. But soon after, the Marshall Plan, also initiated by the U.S., took over the task of European reconstruction, allowing the bank to refocus its attention to developing countries; it was renamed the International Bank for Reconstruction and Development (IBRD).

The second wave was in the 1960s with the tide of decolonization. In response to demands from many new developing countries, several regional development banks were created, including the Asian Development Bank (ADB), the African Development Bank (AfDB), the Inter-American Development Bank (IDB), the Islamic Development Bank (IsDB), the Development Bank of Latin America (CAF) and also the International Development Association (IDA) and International Financial Corporation (IFC), affiliated with the World Bank Group (WBG). Among these MDBs, only the CAF and IsDB have operational modalities different from the IBRD.

The third wave was in the 1990s with the end of the Cold War. When the Soviet Union collapsed and many East European countries were transitioning from the socialist to the democratic market system, West European powers proposed the establishment of the European Bank for Reconstruction and Development (EBRD). At the same time, the European Investment Bank (EIB) also expanded its businesses to support the integration of East European countries.

The fourth wave followed the 2008 global financial crisis. The rise of emerging economies brought a change to the world economic and political architecture. Since 2001, the gross domestic product (GDP) of BRICS countries has risen from 8% to 23%, while the Group of 7 (G7) countries decreased from 65% to 45%. To improve their voice and status in global economic governance, emerging economies initiated two new multilateral development banks, one by India at the BRICS leaders’ summit in 2012, the other by Chinese president Xi Jinping during his trip to Southeast Asian countries in 2013. The four waves of MDBs are summarized in Table 1.

Both the NDB and AIIB are entrusted with two institutional mandates – promoting infrastructure investment in developing countries and global economic governance reform in favour of developing countries. There is a huge deficit in infrastructure investment in the developing world. It is also no secret that heavy investment in infrastructure was a key factor in driving sustained growth and modernization for all the traditional economic powers, as well as the “newly industrialized countries” of Northeast Asia. Yet there are major shortfalls in infrastructure financing for developing countries. According to Dr. N. Kumar, then director of the UN Economic and Social Commission for Asia and the Pacific (ESCAP) Office (Bangkok) and the
consultant to the ADB, the investment needed to close the infrastructure gaps in developing economies in Asia is estimated to be $800 billion per year. The African continent had only started to put its infrastructure in place, despite the many decades of support from northern donors. The AfDB reported as early as 2011 that only about a third of the continent’s rural population has access to roads, less than 40% of Africans have access to electricity, only 5% of agriculture is under irrigation, only 34% of the population has access to improved sanitation and only about 65% to clean water [Kaberuka, 2011]. Then AfDB president D. Kaberuka estimated that Africa would need at least $93 billion per year until 2020 to bring the continent’s infrastructure on par with that of other low- and middle-income countries. But even the major emerging BRICS economies have major infrastructure investment needs. At the 2013 BRICS summit in Durban, South African president Jacob Zuma stated that the infrastructure investment needs of the BRICS countries amounted to $4.5 trillion over five years to 2018 [Smith, 2013].

Table 1. The Four Waves of Multilateral Development Banks (MDBs)

<table>
<thead>
<tr>
<th>Time</th>
<th>Significant Event in International Politics</th>
<th>Establishment of MDBs</th>
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<tbody>
<tr>
<td>1940s</td>
<td>End of World War II</td>
<td>IBRD</td>
</tr>
<tr>
<td>1960s</td>
<td>Decolonization</td>
<td>ADB, AfDB, IDB, IsDB, CAF, IDA, IFC</td>
</tr>
<tr>
<td>1990s</td>
<td>End of the Cold War</td>
<td>EBRD, EIB expansion</td>
</tr>
<tr>
<td>2010s</td>
<td>Rise of emerging economies</td>
<td>NDB, AIIB</td>
</tr>
</tbody>
</table>

Source: compiled by the author.

The Group of 24 (G24) Secretariat, which is the coordinating body for a group of 24 developing countries (and China) based at the International Monetary Fund (IMF) headquarters, estimated in 2013 that around $1—1.5 trillion in infrastructure investment per year would be needed to sustain the growth trajectory in the developing world, while the total amount actually invested was about $800 billion [Bhattacharya, Romani, 2013]. The bulk was still provided via public (state) budgets. The amount contributed per year from private sources of finance and development institutions was only about $250 billion. A. Bhattacharya, then director of the G24 Secretariat further noted that private finance for infrastructure had fallen sharply since the 2008—2009 great financial crisis, and that European banks were undergoing major deleveraging, which reduced their lending capacity. New Basel III capital requirements for banks also likely cut further into financing for infrastructure. Private bank financing was reportedly at one third of the amount before the great crisis. As such, traditional debt financing was seen as no longer viable. There were and are newer sources of finance, e.g. sovereign wealth funds and pension funds, with around $75 trillion in pension fund assets, but almost none of which goes to infrastructure. It has proven exceedingly difficult to get these fund managers to invest in infrastructure in the developing world.

Bilateral official development assistance (ODA) and the MDBs are now providing very limited infrastructure financing, especially for greenfield projects. The traditional bilateral donors have moved away from infrastructure dramatically and have been pulling their aid from emerging economies for the past two decades. Their donor institutions now allocate less than 10% of their resources to infrastructure projects, with most going instead to social sectors such as health and education. The World Bank (WB) and the regional development banks (the ADB

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3 For a discussion of traditional donor graduation see Chin [2012].
is the exception) also moved away from infrastructure in the 1980s and 1990s and channeled their resources instead toward so-called “pro-poor poverty alleviation,” focused especially on health, education, social protection (“human development”), and agriculture, including some investment in water and sanitation (“sustainable development”).

Why are the existing MDBs not able to contribute more to infrastructure investment in the developing world? The main reason is the obstruction of the developed countries which dominate the decision-making process of the existing MDBs and stick to the Washington Consensus, intentionally neglecting the infrastructure investment needs of developing countries. In this sense, the NDB and AIIB represent the new ideas and aspirations of emerging economies in global economic governance.

From the perspective of emerging economies, there are “three dilemmas” in global governance reform: the knowledge dilemma, the advanced countries’ opportunistic behaviour dilemma and the emerging economies’ collective action dilemma. With the NDB and AIIB, emerging economies have the potential to lessen the three dilemmas and play larger role in the new global economic governance.

First, the NDB and AIIB can help emerging economies provide their own knowledge to global development thinking. How to go beyond the Washington Consensus is a major challenge for the reform of current practices of global governance. Liberalism and neoliberalism inform the dominant approaches to international development which universalize the development experiences of the advanced countries. In 1998, J. Stiglitz, the chief economist of the World Bank, delivered a now-famous speech on diversifying development thinking [1999]. It was popular among the developing countries but was resisted by the board of directors of the WB. One year later, Stiglitz was forced to leave the World Bank. The emerging economies must contribute new development knowledge to the mainstream thinking if they want to play a bigger role in global development governance. As noted by X. Zhu, former World Bank vice president and current NDB vice president, the main purpose of the NDB is to provide new development knowledge for the developing countries. New MDBs will focus on infrastructure investment and sustainable development. The level of development is different, so the development need is different. The new MDBs will accumulate different development knowledge and share it with more members.

Second, the NDB and AIIB can help constrain the opportunistic behaviour of advanced countries. Most of the existing MDBs were established by advanced countries and have provided considerable help to developing countries in terms of development finance and technology transfer. However, they sometimes are used by advanced countries as diplomatic tools [Wei, 2016]. In this sense, the NDB and AIIB can be seen as the institutional balancing and partial exit strategy of the emerging economies, constraining the opportunistic behaviour of the advanced countries. A. Hirschman’s theory of voice and exit can help us understand this logic. When members are dissatisfied with an organization, they will make complaints, and if their complaints are not well received by the leader of the organization, they will exit. So, if members can complain with partial exit, then their complaints will be more effective [1970].

Third, the NDB and AIIB can also help solve the collective action problem faced by emerging economies. The collective action problem is another dilemma for emerging economies as they seek to reform global economic governance. Every emerging economy wants to improve its own voice but does not want to pay for this. M. Olson’s theory shows how the rationality of individuals leads to the irrationality of the collective due to free riders [1971]. For emerging economies, advanced countries may make concessions toward some developing countries, such as giving WB and IMF vice presidencies to developing countries in 2011 and 2012. Under such circumstances, the question of how to overcome the dilemma of individual rationality and collective irrationality is important. With the creation of the NDB and AIIB, emerging economies
can undertake long-term thinking about their national interests and develop an integrated vision of future global economic governance.

Both the NDB and AIIB are important in terms of infrastructure investment and global governance reform, but as asked previously, why did these two banks adopt different operational institutions?

The NDB: Equal Shareholding, Country Systems and Borrowing Country-Oriented

At the first G20 summit in Washington DC on 14–15 November 2008, Indian prime minister Manmohan Singh proposed to strengthen infrastructure investment in developing countries in his speech at the summit table, but his suggestion was almost entirely neglected by the advanced countries and existing MDBs [Embassy of India, 2008]. In March 2012, Prime Minister Singh proposed the establishment of a new developing country-led multilateral development bank at the 4th BRICS summit in New Delhi, which was basically agreed to by other BRICS leaders. “We have considered the possibility of setting up a new Development Bank for mobilizing resources for infrastructure and sustainable development projects in BRICS and other emerging economies and developing countries, to supplement the existing efforts of multilateral and regional financial institutions for global growth and development. We direct our Finance Ministers to examine the feasibility and viability of such an initiative, set up a joint working group for further study, and report back to us by the next Summit” [BRICS, 2012], said the BRICS leaders in their summit declaration. Thus, the BRICS New Delhi summit signified the beginning of the establishment of the NDB.

In the establishment process of the NDB, India and China were the key players. India was an initiating power and China was the de facto veto power because of its huge foreign exchange reserves and considerable experience on infrastructure investment. Although India and China had a basic consensus on establishing the bank, their concerns and preferences differed. India was more concerned with borrowing countries’ interests and saw the NDB as a new source for meeting its own massive infrastructure development needs. Delhi had traditionally relied heavily on the World Bank for infrastructure financing. But India faced the prospect of no longer being eligible for IDA loans. It is therefore not surprising that India was the major advocate for the NDB. However, China was more concerned with the donor countries’ interests and saw the NDB as a new source for infrastructure investment. At the same time, China was trying to be a real new donor that could better understand the needs of borrowing countries based on its own experience with the WB and ADB over the past 30 years. The Chinese took a long-term view on the NDB, seeing it as useful for driving sustained growth in developing countries and thereby cultivating the new market for Chinese business [Chin, 2014]. Therefore, India and China competed for the leadership and institutional modality of this new bank.

At the same time, the change of distribution of power between India and China also had some influence on the establishment process. In 2006 when BRICS began its cooperation, India’s GDP was $0.8 trillion and China’s was $2.6 trillion – 3.25 times that of India. However, in 2012 when India proposed the NDB, India’s GDP was $1.83 trillion and China’s was $8.56 trillion, which is 4.68 times that of India. This power shift made India more cautious toward China’s role in the bank. Moreover, the trust deficit due to national security interests was another factor for India’s calculation. China’s growing military and diplomatic power was a security threat to India’s regional aspirations. Indian commentator J. Malhotra suggested that Delhi was worried about China’s dominance in the bank: India had joined BRICS enthusiasti-
cally, motivated by its anti-western tradition, but China’s rising global influence in BRICS was making Delhi increasingly nervous [Malhotra, 2013].

Given this concern, India emphasized the principle of equality as the key feature of this new bank. The intensity to which India held this position reflected not only its frustration toward the lack of fairness in dealing with the Bretton Woods system, but also the sensitivity that its ideational leadership on the NDB initiative was being threatened by China’s financial clout. It is important to note that it was India rather than China which took the lead in exploring alternative strategies for development financing in the aftermath of the 2008 global financial crisis [Cooper, 2017, p. 3]. However, China’s support for this initiative was necessary given China’s structural heft in infrastructure investment.

In the Indian proposal, the initial capital was $10 billion equally shared by the five BRICS members. China did not block this proposal but showed hesitation especially toward this kind of quota allocation. China emphasized that this kind of political mistrust may cause trouble for the efficiency of the bank. N. Zhu, an influential scholar at the Shanghai Advanced Institute of Finance, was quoted as saying in an interview with China Central Television that “if the five BRICS countries have an equal share in the same entity, there will be coordination problem” [Cooper, 2017]. The main concern remained the efficiency of the new bank. J. Wang, the leading economist of China Exim Bank, noted: “There are only two kinds of quota allocation, one is according to GDP and financial contribution, the other is according to the political equality, one country one vote. Until now, all the international financial institutions are taking the former one. So the NDB’s quota allocation modality needs to do more feasibility studies” [Cooper, Farooq, 2015].

China’s hesitation and concern about making the NDB work smoothly, however, further strengthened India’s concern that China may dominate the decision-making of the NDB. Ultimately, with the help of other members, India was able to mobilize a successful defense of the principle of equality, a condition embedded in the declaration of the NDB.

China provided three suggestions for the bank’s operation in terms of improving efficiency which were accepted by India and other BRICS members. First, it suggested that the headquarters of the NDB should be in Shanghai, China. Although the principle of equality reflected the aspiration of BRICS countries for a new world order, it also limited China’s financial contribution to this bank. The ability to borrow the money from local capital markets by issuing bonds is an important tool for expanding the NDB’s capital base. For this reason, Shanghai, one of the best financial centres in the BRICS countries, was a good choice for the NDB headquarters.

Second, China suggested that the NDB should be more ambitious in terms of capital base, and specifically that the authorized capital of the NDB should be expanded from $10 billion to $100 billion. At the same time, in order not to increase the financial burden for those BRICS members that have less foreign exchange reserves than China, the paid-in capital of the NDB could remain $10 billion. This was a good balance between the $100 billion authorized capital and $10 billion paid-in capital.

Third, China suggested that the bank should lend money to all developing countries rather than just founding members. To get more money from the bank, India had proposed that it should be focused on BRICS countries, while China took the view that the bank should lend globally to increase its influence in the developing world. To balance China’s influence as the hosting country of the bank’s headquarters, India insisted that the first president should come from India, to which China agreed. A summary of the different institutional proposals is presented in Table 2.
Table 2. The Indian Proposal, the Chinese Proposal and the BRICS Proposal for the NDB

<table>
<thead>
<tr>
<th></th>
<th>Quota Allocation</th>
<th>Capital Base</th>
<th>Headquarters</th>
<th>President</th>
<th>Scope of Lending</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indian Proposal</td>
<td>According to the principle of equality</td>
<td>$10 billion</td>
<td>New Delhi</td>
<td>First president from India</td>
<td>BRICS countries</td>
</tr>
<tr>
<td>Chinese Proposal</td>
<td>According to GDP size</td>
<td>$100 billion</td>
<td>Shanghai</td>
<td>First president from China</td>
<td>All the developing countries</td>
</tr>
<tr>
<td>BRICS Proposal</td>
<td>According to the principle of equality</td>
<td>$10 billion as paid-in capital, and $100 billion as authorized capital</td>
<td>Shanghai</td>
<td>First president from India</td>
<td>All the developing countries</td>
</tr>
</tbody>
</table>

Source: compiled by the author.

On 15 July 2014, BRICS leaders announced the establishment of the NDB, which belied built-in skepticism about the BRICS’ institutional capacity to produce real results. “We are pleased to announce the signing of the Agreement establishing the New Development Bank (NDB), with the purpose of mobilizing resources for infrastructure and sustainable development projects in BRICS and other emerging and developing economies. The Bank shall have an initial authorized capital of $100 billion. The initial subscribed capital shall be of $50 billion (paid-in capital shall be $10 billion), equally shared among founding members. The first chair of the Board of Governors shall be from Russia. The first chair of the Board of Directors shall be from Brazil. The first President of the Bank shall be from India. The headquarters of the Bank shall be located in Shanghai. The Africa Regional Center shall be established in South Africa concurrently with the headquarters” [BRICS, 2014].

Beside equal shareholding as a governance structure innovation, the use of country systems is another institutional innovation that favours borrowing countries. The idea of strengthening and using country systems came from many years of experience in development which shows that when donors bypass country systems and policies in favour of the donors’ own policies and procedures, the sustainability of their efforts is undermined along with the country’s ability to manage its own development. The use of country systems promises to alleviate the load on borrowing countries of having to deal with multiple policies, in particular procurement rules; makes it easier for donors to co-finance operations; and in the long run reduces the transaction costs for countries. Most importantly, it also provides a strong incentive for countries to bring their systems to an acceptable standard and thus scale-up development by improving the return on all government expenditures and not just those funded by donors.

For India, use of country systems can improve the borrowing countries’ development autonomy, while for China, use of country systems can improve the NDB’s influence and popularity in the developing world. Thus, both India and China achieved consensus on the use of country systems during the negotiation process. Use of country systems is a concept that has been discussed in the G20 and in the existing multilateral development financing system, but the implementation of a country system is very slow. In the 2010 G20 summit in Toronto, the leaders made the following commitment: “Existing MDBs should take specific actions for greater transparency, stronger accountability, improved institutional governance, deeper country ownership, more decentralization and use of country systems where appropriate” [G20, 2010]. However, although the G20 established a consensus, the use of country systems is still very limited.

In its 2012–2016 reform of the environmental and social framework, the World Bank also emphasized the use of country systems, but the process proved to be controversial and
slow. A. Dani, a former senior evaluator at the bank’s Internal Evaluation Group, said that the World Bank’s future influence lies in persuasion and capacity building rather than enforcement. “The only way that safeguards will work is if countries take this on board, and the bank no longer has the leverage to thrust this down the throats of countries like China and India and even in Africa” [Chavkin, 2016]. However, many international non-governmental organizations resist the WB’s use of country systems. N. Daar, programme director at Oxfam International, bluntly criticized the idea of country systems: “We are disappointed that the World Bank uses the country system. We have a high expectation toward the World Bank that it can set the highest standards in environmental and social protection, but the use of the country system will shift the responsibility to borrowing countries, which is an irresponsible behaviour” [Downan, 2016].

Nevertheless, the NDB is actively trying to use the country system in its operations. In the NDB’s first five-year general strategy, the NDB sees the country system as the best way to strengthen the borrowing country’s capacity and to achieve better long-term development results. As such, in every project, the NDB intends to verify ex ante the quality of borrowing country environmental, social, fiduciary and procurement systems, and to use them whenever they meet the NDB’s requirements. In cases where a country’s systems are not deemed acceptable, the NDB will fill gaps with additional requirements tailored to the specific needs of the project at hand. Importantly, use of country systems for the NDB is meant to encourage clients to thoroughly apply the country’s own legislation and procedures and to work together with relevant agencies to propose actions whenever compliance falls short of national and local requirements [NDB, 2017]. X. Zhu, the NDB’s vice president and chief operations officer, points out that every country is concerned with environmental and social protections, but the problem is that there are no unified standards suitable for every country. The World Bank, often under pressure from advanced counties, raises standards to the level of the advanced countries which makes them too high for some developing countries. This creates unnecessary operational costs for some projects. If the NDB uses the high standards of the WB it will be safer, but the NDB, based on its founding members’ experience, is committed to the view that projects will be most successful when borrowing countries are in charge of their own development path [NDB, 2017].

In sum, the NDB is a new South-South multilateral development bank with equal shareholding and the use of country systems as two prominent institutional features. The competition and compromise between India and China was an important reason for this. The final institutional design for the multilateral proposal of the NDB, emphasizing borrowing country-oriented and localized operational modalities was mainly a concession between the Indian proposal and the Chinese proposal. The process of establishing the NDB reflected the spirit of BRICS, namely mutual respect and understanding, equality, solidarity, openness, inclusiveness and mutually beneficial cooperation.

The AIIB: Chinese Proposal, European Proposal and Donor Country-Oriented Approach

In contrast to the NDB, the AIIB is a new multilateral development bank initiated by China; however, seeking to increase the international legitimacy of the AIIB and also to attract European countries as founding members, China faced the market pressure of credit ratings mainly from the U.S. and the political pressure toward multilateralism mainly from the European countries. These pressures pushed the AIIB into taking a donor country-oriented operational modality similar to existing MDBs.
In October 2013, Chinese president Xi Jinping proposed the establishment of the AIIB during his visit to Indonesia. His initiative was welcomed by the developing countries from Southeast Asia, South Asia and Central Asia, but the non-Asian developed countries, especially those from Europe and North America, were sceptical. Two main concerns were raised: first, whether the AIIB would be a Chinese bank or a multilateral bank; second, whether the AIIB would lower the high standards of the existing multilateral development banks, including the governance structure, environmental and social standards, transparency and procurement policies [Harpaz, 2016]. The core of these scepticisms was concern about what China really wanted to gain from the AIIB initiative.

From a geo-economic perspective, one critique was that China wished to use the AIIB to export its excess industrial capacity and promote the internationalization of the renminbi (RMB). The Chinese economy had significant overcapacity in many of its industrial sectors, including steel, energy and construction, where domestic returns were declining. As much of this could be put to use in infrastructure projects, several analysts argued that the AIIB was in part designed to create business for China’s heavy industrial sectors. More broadly, the AIIB could create opportunities to encourage Chinese companies to “go abroad” by expanding their access to new markets [Sun, 2015]. In addition, China held massive foreign exchange reserves, much of which were used to buy U.S. bonds. If the Chinese government used the AIIB to ensure that infrastructure contracts were awarded to its companies and were RMB-denominated, it could help the Chinese government to diversify its investment and also promote the internationalization of China’s currency. In the Chinese proposal, China would be the largest shareholder of the AIIB, its headquarters would be in Beijing and its president would be a Chinese citizen. So, some people saw the AIIB as a disguised cash register for Chinese state-owned enterprises [Roach, 2015].

From a geopolitical perspective, some contended that the AIIB would be the bank of the One Belt One Road (OBOR) initiative and would serve China’s foreign policy. Since both the AIIB and the OBOR were proposed by Chinese president Xi Jinping in 2013, and both emphasize infrastructure investment and economic connectivity, it was suggested that China may use the AIIB to channel capital to projects that politically align with the OBOR [Mark, Li, 2016]. In addition, the AIIB could be used as a diplomatic tool for China to “subsidize” those countries that are friendly to China in the escalating U.S.-China competition in the Asia Pacific area after the Obama administration released the “Pivot to Asia” strategy.

In fact, these critiques had a negative impact on the AIIB’s international legitimacy and the expansion of its membership. In October 2014, 21 countries signed a memorandum of understanding (MoU) to establish the AIIB, including Bangladesh, Brunei, Cambodia, China, India, Kazakhstan, Kuwait, Laos, Malaysia, Mongolia, Myanmar, Nepal, Oman, Pakistan, Philippines, Qatar, Singapore, Sri Lanka, Thailand, Uzbekistan and Vietnam. With the exception of China and India, most of the signatories were small, developing countries in South, Southeast and West Asia. Major economies, including Japan, Korea, Australia and Russia initially sat on the sidelines. Japan refused to join several times, expressing its concerns on the AIIB’s governance and transparency, and its possible competition with the ADB. The U.S. repeated its concern that the AIIB may lower the international standards of the WB and ADB and also discouraged its Asian allies, including Australia and Korea, from joining.

On 12 March 2015, the UK became the first major western country to seek AIIB membership. The chancellor of the exchequer, George Osborne, announced that the UK intended to become a prospective founding member of the AIIB. “UK will play a key role in ensuring that the AIIB embodies the best standards in accountability, transparency and governance, which will be essential to ensuring the success of the initiative and to unlocking the potential benefits for the wider global economy” [Gov.UK, 2015]. However, the U.S. government made clear its
displeasure about Osborne’s decision to join the AIIB. A U.S. official told the Financial Times: “We are wary about a trend toward constant accommodation of China, which is not the best way to engage a rising power” [Watt, Lewis, Branigan, 2015]. The UK’s joining set off a flood of other membership applications, including from Germany, France, Italy, Switzerland, Russia, Korea, Brazil and Turkey. Germany, France and Italy mentioned in their joint declaration to establish the AIIB that it follows the best standards and practices in terms of governance, safeguards, debt and procurement policies [LaRouchePAC, 2015]. K. Zhao, Chinese European studies scholar, argues that the joining of the AIIB by the main players of the existing MDBs to guarantee the high standards is a new approach of engagement [Zhao, 2015]. D. Fischer, a China expert in Germany, points out that it is a good division of labour for European countries to join the AIIB while the U.S. remains outside because Europeans have higher standards than the U.S. in terms of human rights and sustainable development.

By the deadline of 31 March 2015, 57 countries had signed up to be founding members, including 37 Asian countries and 20 non-Asian countries. The number was much higher than expected and was widely seen as a victory of Chinese economic diplomacy. L. Jin, director of the interim secretariat, points out that the Chinese government’s original expectation was around 20 countries, mainly from Southeast, South and West Asian developing countries. However, the unexpected growth in membership, especially with the admission of European powers, posed a dilemma for the AIIB: should it be a bank dominated by Asian developing economies and controlled by China or should it be an internationally legitimate bank similar to the existing MDBs in which China’s influence is relatively limited? If dominated by Asian developing countries and China in particular, the AIIB would be more concerned with developing countries’ needs and national circumstances, but its international influence and legitimacy would be more limited. If it was more broadly represented, especially with the participation of European powers, the AIIB would still be a donor country-oriented bank like the World Bank and the ADB, but it would be more influential and legitimate. During the negotiation process, Chinese negotiators chose the latter [Ikenberry, Lim, 2017; Kaya, Woo 2018].

After the admission of European powers, the interim secretariat organized three important conferences to negotiate the AIIB’s articles of agreement (AOA) and operational policies (OP). Generally, although China and the European powers had reached a basic consensus on establishing the bank, there were also some differences regarding their concerns and preferences. China hoped the AIIB would contribute more to Asian infrastructure investment and export its own infrastructure industrial capacity. At the same time, China also wanted to be a new donor able to understand borrowing countries’ needs better and take some innovative measures to improve the efficiency of MDBs. However, for European countries, besides making profits and the material interests of its domestic infrastructure companies in Asian infrastructure investment, the concern was to maintain the AIIB’s high standards, avoiding its possible negative effects on international best practices for environmental and social protection, including environmental and social safeguards and procurement policies.

To analyze in more detail the differences among the key players during the establishment negotiations, the MoU of the AIIB in October 2014 can be taken as the Chinese proposal, because at that time most prospective founding members were small- and middle-sized Asian developing countries and because China’s institutional thinking and arguments were basically reflected in that MoU. The European suggestions after March 2015 [Wilson, 2019] to “polish” the Chinese proposal can be considered the European proposal. The final articles of agreement and operational policy of the AIIB can be taken as a multilateral proposal which was a compromise between China and the European powers. The differences between the Chinese proposal, the European proposal and the final multilateral proposal can be seen in Table 3.
Table 3. Chinese Proposal, European Proposal and Multilateral Proposal

<table>
<thead>
<tr>
<th>Shareholding Allocation</th>
<th>Governance Structure</th>
<th>Environmental and Social Framework</th>
<th>Procurement Policy</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chinese Proposal</td>
<td>More than 50%</td>
<td>Strengthen the power and efficiency of the management team and reduce the interference of board of directors</td>
<td>Environmental and social safeguards should be different according to different levels of development</td>
</tr>
<tr>
<td>European Proposal</td>
<td>Chinese veto power should be avoided</td>
<td>Strengthen the oversight mechanism by the board of directors in line with the principles of transparency and accountability</td>
<td>High environmental and social standards similar to existing MDBs</td>
</tr>
<tr>
<td>Multilateral Proposal</td>
<td>Chinese quota is 30.34%, but with new members joining, Chinese veto power will be diluted.</td>
<td>Board of directors is non-resident, but it will supervise the management team on a regular basis including audit, evaluation, fraud and corruption, projects complaints and staff grievances, and reflect the bank’s character as a multilateral financial institution.</td>
<td>International best environmental and social standards similar to existing MDBs</td>
</tr>
</tbody>
</table>

Source: compiled by the author.

On shareholding allocation, China would hold more than 50% of the shares in its original proposal. From China’s perspective, holding the majority share would guarantee that the bank would be established and well-functioning. With the joining of more countries, especially non-regional countries, Chinese shareholding would naturally be diluted although it would still hold the largest share. From the European perspective, the Chinese veto power concession was made to secure the involvement of European countries which from the outset had made this as a condition of their membership [Wilson, 2017]. In the end, both sides made compromises: Europeans agreed that China would have veto power at the starting period of the AIIB’s operation in order to play a supporting and leadership role. At the same time, China agreed to give up its veto power with more countries joining the bank rather than insisting on keeping it as had the U.S. in the World Bank.

On governance structure, Chinese thinking was to combine the advantages of MDBs and the private sector which usually delegates more power to the management team, whereas the existing MDBs had division of labour problems between the management team and board of directors. From the European perspective, it is important to supervise the management team and the operation of the bank on a regular basis. The bank should be a real multilateral and transparent one rather than a China-controlled or Chinese-style bank. On this, both sides made concessions: on the one hand, European countries agreed that the board of directors would be non-resident and would delegate project approval power to the management team. On the other hand, China agreed that the board of directors would establish an oversight mechanism to supervise the management team, in line with the principles of transparency, openness, independence and accountability. The oversight mechanism would address such areas as audit, evaluation, fraud and corruption, project complaints and staff grievances, reflecting the bank’s character as a multilateral development bank focused on infrastructure investment.
On environmental and social policies, the Chinese proposal was to simplify the existing MDB’s environmental and social safeguards to improve the development ownership of borrowing countries and reduce the lending cost. From the European perspective, MDBs, including the AIIB, should bear the responsibility of promoting high environmental and social standards in developing countries. The multilateral proposal noted that “Representatives emphasized that the operational polices would be subject to approval by the board of directors and should be based on international best practices. These policies, among others, would include environmental and social frameworks, disclosure, and debt sustainability” [AIIB, 2015a, Art. 13, Para. 4].

On procurement policy, the Chinese proposal was that it should be differentiated and diversified according to the different development stages and national circumstances of the borrowing countries. From the European perspective, to avoid the possibility that the AIIB would become a policy tool for China to export its industrial overcapacity and serve China’s interests in the OBOR, the AIIB should adopt a market-based approach to procurement policy and pay due regard to the desirability of avoiding a disproportionate amount of its resources being used for the benefit of one country. Finally, the multilateral proposal mentioned that “the AIIB procurement policy should be based on international best practices. The bank shall place no restriction upon the procurement of goods and services from any country from the proceeds of any financing undertaken in the ordinary or special operations of the bank” [AIIB, 2015b, Art. 13, Para. 8].

To sum up, after a series of multilateral negotiations, the AIIB became a new “old” multilateral development bank with international best standards similar to the WB and ADB. Of course, the AIIB made some institutional innovations compared to the existing MDBs, such as its focus on infrastructure investment, a non-resident board of directors, global procurement and global recruitment. However, from the perspective of the relationship between borrowing countries and donor countries, the AIIB is still a traditional donor country-oriented, or North-South, cooperation bank, which is the biggest difference between the AIIB and NDB.

Besides the political pressure toward multilateralism from European countries, market pressure from the big three U.S. credit rating agencies was also an important driving force for China’s determination to ensure that the AIIB was internationalized and would operate with high standards similar to existing MDBs. Like the World Bank and the Asian Development Bank, the AIIB does not fund its projects mainly by the paid-in capital of its founding members, but rather from the capital raised in international financial markets. To reduce borrowing costs, it is important for the AIIB to apply similar standards to the existing MDBs. In the AIIB’s first series of projects, three of the four projects are co-financed with the WB, ADB and EBRD and apply similar environmental and social standards. This is a deliberate strategy to allow the AIIB to build up a portfolio of low-risk projects and a positive reputation in financial markets. The structural feature of relying on international capital markets to fund multilateral development loans inherently pushes the AIIB to take an operational modality similar to that of the WB and ADB [Ikenberry, Lim, 2017]. Just as L. Jin pointed out, an international credit rating is very important for the AIIB, and we need to take all these factors related to credit ratings into account, including governance structure, quota allocation and institution building. The AIIB will gradually be welcomed by the western powers because it operates with international high standards [Xinhua News Agency, 2018].

Conclusion

This analysis has explored the difference between the NDB and AIIB in their operational modalities focusing on the political interactions among the key players during the establishment processes. In the case of the NDB, India was the initiator while China was the veto player. The
competition between India and China for the leadership of the bank resulted in equal shareholding and the use of the country system as two prominent institutional features, resulting in a borrowing country-oriented or South-South cooperation style bank. In the case of the AIIB, China was the initiator while European countries were the veto players. After the joining of European powers, China was more concerned with the international legitimacy of the bank than the needs of borrowing countries, leading the AIIB to be a donor country-oriented bank similar to existing MDBs.

As emerging economies, BRICS countries, and especially China, have the capacity to create new multilateral development banks, while the choice of operational institutions reflects different approaches of emerging economies to participation in global economic governance. It is a strategic dilemma when choosing between creating a borrowing country-oriented bank reflecting developing countries’ thinking about international development like the NDB, or a donor country-oriented bank with international best practices like the AIIB. Each strategy has its own strengths and weaknesses.

On credit rating and borrowing costs, it is easier for the AIIB to get a higher credit rating and lower borrowing costs when it goes to the international capital market to issue its bonds; while on pushing the reform of the Bretton Woods system, the NDB can provide more institutional choices and ideas based on its practice of equal shareholding governance and use of country systems. The NDB is the first multilateral development bank of global scope set up exclusively by developing countries with no participation by advanced countries in the initial stage. This is a testament to the creation of a truly transformative development finance institution.

Beyond the study of operational modalities of the NDB and AIIB, this analysis also has implications for post-crisis global development governance reform. In terms of the relationship between borrowing country and donor country, the NDB represents a new type of South-South cooperation, while the AIIB represents a new type of “old” North-South cooperation. MDBs are one of the few areas in which global governance has transitioned from advanced country-dominated to co-leadership of advanced and emerging economies. However, several factors still affect emerging countries’ participation in global economic governance: one is the relationship among the emerging economies, especially the lack of mutual trust and confidence, such as between India and China; the other is the structural power of the advanced countries, whether in their ability to determine the legitimacy of the new international institution or in the form of market pressure to secure a strong credit rating. Only when the emerging economies can make progress to solve these problems can global governance really be “global” governance rather than “Western+” governance.

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Ориентация на заемщиков или доноров? Сравнение Нового банка развития БРИКС и Азиатского банка инфраструктурных инвестиций

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Почему Новый банк развития БРИКС (НБР) и Азиатский банк инфраструктурных инвестиций (АБИИ), созданные странами с формирующимися рынками, используют разные операционные подходы? Подход НБР ориентирован на страны-заемщики, в то время как операционная модальность АБИИ по-прежнему основана на ориентации на страны-доноры. В статье рассматриваются структурные факторы, которые привели к созданию данных новых банков, и различные предложения институционального характера, выдвинутые в ходе переговорных процессов, объясняющие различия операционных подходов. При создании НБР конкуренция между Индией и Китаем за лидерство в новом банке привела к тому, что принцип равенства стал его основной чертой. Все учредители НБР также являются его заемщиками. НБР ориентирован на страны-заемщики новым многосторонним банком развития (МБР), характеризующимся двумя важными институциональными инновациями: равными долями акционеров в капитале и использованием страновых систем. Что касается АБИИ, после присоединения к банку нерегиональных европейских стран Китай стал подталкивать его к использованию интернационализированного подхода и высоких стандартов на фоне политического давления в направлении многосторонности, особенно со стороны европейских стран-учредителей, и рыночного давления со стороны международных рейтинговых агентств со штаб-квартирой в США. В результате АБИИ схож с существующими МБР с точки зрения операционной модальности. Данное исследование демонстрирует различные институциональные подходы к участию развивающихся стран в глобальном экономическом управлении.

Ключевые слова: НБР; АБИИ; операционная модальность; ориентация на страны-заемщики; ориентация на страны-доноры


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