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Too much fuss about China's new development bank

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Bonn, 23 March 2015. Several European countries announced last week that they intend to become members of the Asian Infrastructure Investment Bank (AIIB). Germany, France, Italy, the UK and other nations will be joining a development bank that has China as its largest shareholder and is headquartered in Beijing. This is a step, albeit symbolic at this stage, towards a restructuring of the multilateral finance system. The shift in the balance of global economic and political power towards Asia is now having institutional consequences. In establishing the AIIB and the New Development Bank (BRICS bank) in Shanghai, China is demonstrating an intention to express its economic strength by taking a leading role in regional and plurilateral institutions as well.

For months now, the US Government has been working behind the scenes to try and dissuade its allies from joining the bank. Nonetheless, 21 Asian countries (excluding Japan, South Korea and Australia) did just that at the AIIB's launch ceremony in Beijing in October 2014. The number of founding members will now increase rapidly as the European countries come on board. As a result, the AIIB may soon equal the Asian Development Bank (ADB) in scale, which has 67 member countries (19 of them outside Asia), USD 162 billion in subscribed capital, and issues USD 20 billion in project finance each year. China initially proposed a sum of USD 100 billion for the AIIB's subscribed capital. Given that just a small proportion (perhaps only 10%) of this amount must be paid in, it may well increase further with European involvement. Setting up a development bank is straightforward and not particularly expensive.

The founding of the AIIB may be interpreted as signalling the end of US hegemony within the international system of development banks. Equally, however, it could be understood as a step towards normalisation, that is, towards a greater degree of regionalisation in development financing. Europe has two plurilateral development banks of its own: the European Investment Bank (EIB) in Luxembourg (28 member countries, EUR 243 billion in subscribed capital and EUR 70 billion in annual loans) and the European Bank for Reconstruction and Development (EBRD) in London (64 members, EUR 30 billion in subscribed capital and EUR 8.5 billion in annual loans). The EBRD is open to non-European members, with the United States, Japan and South Korea being minority shareholders. It is only a matter of time before China also acquires shares in the EBRD, as it has already done in the African Development Bank and the Inter-American Development Bank. As such, the regionalisation process is associated with an openness to non-regional member countries who express their political and economic interests by purchasing minority interests. In this regard, it is very much a normal process.

However, the regionalisation relates essentially to the governance of the banks; the majority shares, and by extension the key leadership positions, are held by regional members. Those who are there from the beginning can secure a greater share in the banks. Non-regional minority shareholders are represented in the official bodies and can attempt to exercise influence by forming coalitions and putting forward good arguments. Capital for refinancing loans comes from the international capital markets. With capital surpluses already being generated and set to continue in Asia, it is only logical that the Asian countries also wish to invest them outside of New York, London and Luxembourg.

The issue of standards for AIIB loans is the subject of much discussion. European countries in particular have been quick to provide assurances that they will use their position as founding members to push for high environmental, social and governance standards in projects financed by the AIIB. The preferable option would be for the AIIB to adopt the standards of the World Bank Group, as these are after all upheld by all World Bank members, including China. It would be a fatal mistake for international development banks to end up competing with one another in this area. The next G20 meeting in Turkey should take a clear position on this issue.

In all likelihood, however, the new bank will take the international development banks' existing approach to environmental, social and governance standards and simplify it. Following pressure from member countries and civil-society organisations, the implementation mechanisms for the development banks with regard to standards have now become so expensive and time-consuming that it is taking these banks too long to approve loans, resulting in them being issued too late. Besides, there is a need to delegate supervisory duties to the recipient countries, where public institutions and civil society should push for the implementation of environmental, social and governance standards in major investment projects. This is also an area in which the AIIB could help to achieve a greater degree of normalisation.

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