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Final Term Paper
Writing Seminar

The Asian Infrastructure Investment Bank: A New Standard of MDBs

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Introduction

Since the 2008 financial crash, the multilateral development banks (MDBs) have neglected their duties of funding developing nations.[1] The Asian Infrastructure Investment Bank (AIIB) quickly filled the power vacuum left by these lethargic MDBs with its, in what I argue are, innovative features. Through research done by the scholarly works of Weiss, Callaghan, Chin, and more, I aim to answer the questions of if and how the AIIB is an innovative MDB. With its innovative traits, I believe that the AIIB represents a new standard of what a MDB should be. Section I explains the objective of the AIIB, Section II explains the inclusive and transparent board structure, Section III explains the decentralized board arrangement, Section IV explains the efficient capital structure, Section V explains the appointments through merit, Section VI explains the sound operation policies and procedures, and Section VII is the conclusion.

Objective of the Bank: a Voice for the People

While not a tangible trait, one of the AIIB's most important innovative feature is their approach on the objective of the bank. The ineptitude of the overly bureaucratic MDBs and the failure of the banks to account for every region they encompass has led the AIIB to focus on fixing the problems that plague many MDBs, such as the "often slow and overly bureaucratic ways of the traditional lenders and their slow pace of representational and operational reform," and the lack of an "adequate voice to emerging and developing countries."[2] As seen in the "Articles of Agreement of the Asian Infrastructure Investment Bank," the AIIB was launched

[1] Weiss 2017 12
[2] Chin 2016 1

with the purpose to "(i) foster sustainable economic development, create wealth and improve infrastructure connectivity in Asia by investing in infrastructure and other productive sectors; and (ii) promote regional cooperation and partnership in addressing development challenges by working in close collaboration with other multilateral and bilateral development institutions."[3] While easier said than done, I believe that these objectives embody the innovative nature of the AIIB and their divergence from traditional MDBs.

Board Structure: an Inclusive and Transparent Bank

A key innovative feature of the AIIB is the structure of the board. For most MDBs, the board structure of these banks revolves around a host country. In the case of the IMF and the World Bank, the board structures of these banks revolve around the United States. In contrast, the AIIB does not revolve around a host country and I believe that this innovative board structure allows the bank to be fluid and flexible in transition from one leading country to another. Simply put, there is nothing in the bylaws of the AIIB that prevent regional countries, such as India, from contributing more capital and acquiring more voting shares, allowing them to mold the bank in their own image.[6] I believe that this feature is innovative in that it allows other regional nations to take initiative and adapt the AIIB to future scenarios, preventing scenarios that plague many stagnant MDBs.

Of course, there are criticizers that cry hearsay once they see the current structure of the AIIB. Currently, China has a 28.7% voting share in the AIIB, which promotes the argument

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[3] Weiss 2017 1
[6] Chin 2016 13

that China will use their influence in the AIIB to push their political ideologies and shut down dissenters.[7] However, I believe these criticizers do not truly understand the board structure of the AIIB and in any case, Beijing offered to forgo veto power and reduce their own voting shares to less than one-quarter (if the United States or Japan agreed to join) to assuage fears of China utilizing the AIIB for their own political agenda.[8] While neither countries joined the AIIB by the opening deadline, President Jin Liqun was quick to assert China will forgo their veto ability anyways to reassert the AIIB's objective of creating a bank that is "inclusive and transparent" with a focus on the "achievement of common development."[9]

Board Arrangement: Decentralization and Fiscal Responsibility

This feature of the AIIB is where the AIIB diverges away from traditional MDBs the most. Unlike other MDBs, the AIIB sports a dual board arrangement with delegated authorities from a Board of Governors, which consists of fifty-seven governors from every region, to a smaller Board of Directors, which consists of twelve directors.[16] The AIIB's Board of Governors consists of senior government officials from each member nation and is responsible for making major decisions involving changes in AIIB membership, the election of the president, and whether to increase the capital of the institution.[17] The powers and responsibilities delegated to the AIIB's Board of Directors are much more modest when in comparison to other MDBs. The Board of Directors is limited to "establishing AIIB policies, supervising management and operations, and

[7] Chin 2016 12
[8] Chin 2016 13
[9] Wei 2015
[16] Chin 2016 15
[17] Weiss 2017 9

approving strategic and planning documents and budgets."[18] While this may not seem like a significant change, this arrangement decentralizes the bank and gives "a higher degree of decision-making authority to regional countries [and branches]," which is simply not seen in most centralized MDBs and allows the AIIB to be tailored to specific nations.[19]

Perhaps the most polarizing feature of these two executive boards is that these boards "function on a non-resident basis."[20] In general, the role of a resident board is to act as another layer of control on management. While John Maynard Keynes, creator of the Keynesian Theory and advisor during the conception of the World Bank and the IMF, argued for a non-resident board as it allows the board to focus on the strategic direction of these institutions, the World Bank and the IMF were still established with full-time resident executive boards to act as a check on every decision.[21] The AIIB has no need to follow this antiquated practice from the Cold War and as seen in the World Bank and the IMF, the resident boards do more bad than good. More often than not, resident boards in various MDBs act as a political check on every decision taken, confusing the role of the board and management.

The AIIB aims to streamline processes by adopting a non-resident board. By cutting down on a resident board, the AIIB hopes to open the possibility of a "more effective board that provides strategic oversight and direction to the AIIB."[26] The money spent on the resident

[18] Weiss 2017 9
[19] Weiss 2017 8
[20] Chin 2016 15
[21] Callaghan 2016 132
[26] Callaghan 2016 132

board of current banks, which costs between 3% and 7% of an institution's operating budgets,[27] will be better spent on loans, investments, technical assistance, policy advisory, and training purposes. While I consider the lack of a resident board an innovating trait of the AIIB, it says a lot about the current state of traditional MDBs that simple fiscal responsibility by a bank can be seen as groundbreaking.

Of course, there are concerns that the lack of the resident board in the AIIB will lead to corruption. The United States and a few other advanced countries just "do not trust the likely management" according to Edward Truman, a former senior U.S. Treasury official.[28] If looking at just China, it is hard to disagree with the United States due to China's track record. The evolution of China's political ruling class into a "plutocratic and aristocratic political elite group"[29] and countless human and environmental rights violations[30] is enough to distrust anything from that nation. As stated before, China is not in sole control of the AIIB and all these concerns can be alleviated from previous arguments. The AIIB's dual board arrangement of a Board of Directors and a Board of Governors helps prevent corruption with its decentralized approach. Because this structure gives more power to the regional branches, the spread of influence among approximately sixty governors helps prevent corruption. In addition, the cons of a resident board outweigh the pros as the benefits of the resident board, which is minimal, is much less than the waste of time and money a resident board imparts.

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[27] Weiss 2017 11
[28] Chin 2016 16
[29] Cabestan 2017
[30] Wong 2017

In the World Bank, the resident board costs some $70 million annually.[31] In addition to being a waste of money, that money could be better redirected for loans, investments, technical assistance, policy advisory, and training purposes. While also being a drain on resources, David Dollar states that "that resident boards often slow down decision-making, sometimes unnecessarily, and that having nonresident boards may help to streamline decision-making processes."[32] He also claims, from his work at the World Bank, that there was a "certain tension between the management and board members, as the resident board wanted to find out about projects at an early stage."[33] Moreover, the Zedillo Report, a product by the High Level Commission on the Modernization of the World Bank Group, is very critical of the arrangement of the resident board in the World Bank.[34] The report concluded that the extra layer of management provided by the resident board of the World Bank only slowed down project preparation and made the bank less efficient. The omission of a resident board by the AIIB is a simple, but wildly innovating feature of the AIIB that increases the efficiency of the bank while also saving money.

Capital Structure: Efficient and Impartial

It is mind-boggling that a simple change in percentage can mean so much for member nations of the AIIB. In terms of significance to developing member nations of the AIIB, the innovative capital structure of the AIIB is the most tangible difference between the AIIB and

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[31] Chin 2016 16
[32] Chin 2016 16
[33] Chin 2016 16
[34] Chin 2016 16

other traditional MDBs. The AIIB's initial capital base of $100 billion indicates it is a medium-size MDB. In comparison to the Asian Development Bank's (ADB) capital base of about $160 billion and the World Bank's 223 billion, the AIIB's capital base seems insufficient and lacking.[35] However, the AIIB spans the gap between capital bases through capital structure set up. For reference, shareholders pay MDBs through either paid-in capital or callable capital. Paid-in capital is the payment of the capital to the MDB from the onset, while callable capital is funds that shareholders agree to provide when necessary. Essentially, callable capital acts as an IOU where their promised number of funds is only given up when needed for a project.[36] Paid-in capital is the preferred form of contribution to MDBs as it speeds up the loan process and distribution of capital for projects. Most MDBs have approximately a 5% paid-in capital fund, limiting the bank's efficiency and speed on development projects. In contrast, the AIIB's larger 20% paid-in capital fund exponentially raises their efficiency, allowing the AIIB to ramp up lending quickly.[37] To help visualize it, the ADB has an immediately available fund of $8 billion, the World Bank has $11.2 billion, and the AIB holds a paid-in capital fund of $20 billion. This gap only increases every year with nearly 30 nations waiting to join the AIIB while the World Bank and ADB's growth has become stagnant.[38] In projects where time is of the utmost essence, AIIB's innovative capital structure allows them to be efficient in lending and project developments, whereas other MDBs would delay payments and projects until all the necessary

[35] Weiss 2017 11
[36] Weiss 2017 12
[37] Weiss 2017 12
[38] Chin 2016 16

capital has been acquired from the callable capitals of shareholders, wasting months of precious time.

However, some critics argue that this structure only allows China to funnel money into her allies even more efficiently.[39] With memories of Pakistan's Chinese-funded nuclear program fresh in the world's mind, it is not a stretch to believe that many nations are afraid due to China's track record in funding rather volatile nations, such as North Korea and Pakistan. Fortunately, this statement can easily be refuted by looking at the projects in the bank's first two years of operation. India, China's democratic rival in the area, has been a constant source of headaches and border conflicts for years. A growing superpower, India's rise directly rivals China's. However, in the AIIB's first two years of operation, half of all proposed projects are in India.[40] Ranging from highways to power plants, a majority of the AIIB's focus is on India, negating arguments that China will use the AIIB to fund their own allies such as Myanmar. In addition, there are multiple projects in indirect rival countries, such as NATO ally Turkey and NATO partner Georgia. There are also two projects in Indonesia, a rival in the South China Sea conflict.[41] All in all, there is only one proposed project in a Chinese-allied nation, a $155 million garbage dump in Sri Lanka. Unless Sri Lanka's new garbage dump somehow contains nuclear warheads, the AIIB's innovative capital structure allows quality of life projects in developing nations to be funded quickly and efficiently, a luxury not present in traditional MDBs.

[39] Callaghan 2016 132
[40] Babones 2018
[41] Babones 2018

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Appointments through Merit: Brains over Brawn

In addition to the AIIB's less stringent application process for nations, the AIIB has made it clear that the AIIB will stray from the traditional process of executive appointment of other MDBs by promoting a fair and merit-based election for officials. In other MDBs, it is clear that their respective founding nations have major influence over the banks. In fact, there has been controversies that the president of the World Bank has always been an American, the director of the IMF a European, and the governor of the ADB from Japan.[51] These actions have raised questions about the fairness and transparency of the selection process. On matters such as the merit vs. nationality of the candidate, the evenhandedness, or lack thereof, of the senior management in carrying out their duties has been a source for controversies for years.[52] Due to the demands of founding nations, the Article 29(1) states that the "Board of Governors, through an open, transparent and merit-based process, shall elect a president of the Bank by a Super Majority."[53] After months of deliberation, the Board of Governors has voted on, now president, Jin Liqun. While some may argue that China pulled some strings, it is clear that Jin Liqun was the most qualified to serve the first five year term as the first president of the AIIB through his extensive experience serving as the Chairman of the International Capital Corporation, the Vice President of the ADB, Vice Minister of Finance, and the Directory General of the World Bank.[54] Following the precedent of an appointment process that focuses on merit,

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[51] Chin 2016 14
[52] Chin 2016 14
[53] Chin 2016 14
[54] AIIB 2018

President Jin Liqun was quick to bring in experienced leaders such as Kyttack Hong, D.J. Pandian, Joachim von Amsberg who are Korean, Indian, and German respectively.[55] Once again, this shows that the AIIB is dedicated to promote a meritocracy that is lead by their member nations, not one country.

Operational Policies and Procedures: Lean, Clean, and Green

Of course, there will always be concerns about environmental and human violations by the AIIB due to China's track record. With China's largest coal power plant releasing dangerous nitrogen oxides at toxic levels and over 14,000 Chinese companies violating national environmental regulations, it is clear that China is not a shining example of a sustainable nation.[56] Fortunately, AIIB officials were quick to assert that the AIIB will be "lean, clean, and green."[57] The AIIB realizes that actions speak louder than words and have published many frameworks and treaties such as the AIIB's Environmental and Social Framework (ESF), where environmental organizations were invited to help review their framework. According to the World Resources Institute, a global environmental research organization:

> "The framework's vision recognizes many of the issues such as climate change, gender, biodiversity and ecosystems, resettlement, labor practices and indigenous peoples that the AIIB will encounter as it begins to make investments…"[58]

[55] Panda 2016
[56] Wong 2017
[57] Weiss 2017 12
[58] Weiss 2017 13

In addition, the AIIB joined statements by the IMF and other MDBs reassuring shareholders that their operations would satisfy the latest international agreements on sustainable development, such as the 2015 Paris Agreement on Climate Change and the United Nations 2030 Agenda for Sustainable Development.[59] While not innovative per se, the AIIB's commitment to upholding environmental and human agreements buries any fears that the AIIB will be used as a tool to continue Chinese environmental violations.

This leads to our last innovation by the AIIB. A key defining factor of the AIIB is the types of projects it takes on. Since the 2008-2009 financial crash, MDBs have refused to fund large infrastructure in developing nations, preferring risk-averse loans in stable countries that don't truly need the additional help.[60] Even by the 1980s, MDBs has already begun shifting their focus away from large infrastructure projects and into emphasizing the development of a robust investment climate such as legal and political ministries.[61] Simply put, MDBs have begun "ill-suited to dealing with the real needs of client borrowers."[62] Under the overwhelming support of developing nations, the AIIB will focus on "big-ticket investments" such as power plants, highways, seaports, railways, and bread-and-butter development work that greatly increase the quality of lives for afflicted citizens of these developing nations.[63] Countries such as the United States do not believe in the AIIB due to its affiliation with China, but the AIIB's innovative features cannot be ignored as it puts the power of the bank into the hands of the member

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[59] Weiss 2017 13
[60] Chin 2016 16
[61] Weiss 2017 4
[62] Weiss 2017 12
[63] Callaghan 2016 133

nations, where the benefits will be reaped by millions of citizens, neglected for years by traditional MDBs.

Conclusion

For years, the stagnancy of traditional MDBs has hurt innocent citizens of developing nations through its overly bureaucratic processes and lack of funding. While the AIIB has multiple innovating features that are not seen in existing MDBs, it most importantly gives a voice to developing nations that they just simply did not have before. Through innovations in its decentralized boarding arrangement, efficient capital structure, appointment through meritocracy, and sound operational policies, the AIIB represents a new standard of what a MDB should be. Although it is a relatively young bank, the AIIB represents a new golden standard that can be summarized by its modus operandi: “lean, clean and green: lean with a small efficient management team and highly skilled staff; clean, an ethical organization with zero tolerance for corruption; and green, an institution built on respect for the environment.”[65]

[65] Weiss 2017 12

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