

China, Multilateral Banking and Geopolitics

China's recent foray into multilateral banking brings the country multiple financial and geopolitical benefits. The early years of operations suggest that the potential of the Asian Infrastructure Investment Bank and the New Development Bank is considerable – both as international funding mechanisms and as platforms of international cooperation, including with Europe.

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China is a rising great power, seeking its position in a pre-existing and highly institutionalized global order. In this situation, China faces a number of institutional choices, ranging from participating in the existing international order and accepting its rules and norms, to openly opposing it. Thus far, China has used the full spectrum of these choices. It has joined international and regional multilateral organizations as a regular member, challenged existing international arrangements and taken “in-between” positions such as efforts to alter voting power at international financial institutions or human rights standards within UN institutions.

China recently opted for another in-between strategy: the creation of alternative institutions. China was actively involved in launching the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB), two new multilateral development banks (MDBs) that both became operational in 2016 and have 103 and five member countries, respectively. Building new institutions falls short of outright opposition to the existing regime, but – if successful – has the potential to pose a challenge to the Western-led international status quo and act as nodes of a new international governance structure led by China. The AIIB and NDB are clearly more multilateral and more institutionalized



Journalists ask questions to the president of the Asian Infrastructure Investment Bank (AIIB), Jin Liqun, at a news conference in January 2016 in Beijing. *Kim Kyung-Hoon / Reuters*

than previous cooperation formats launched or actively supported by China, including the Shanghai Cooperation Organization (SCO), the Conference on Interaction and Confidence-Building Measures in Asia (CICA), or China's flagship Belt and Road Initiative (BRI).

A number of puzzles and uncertainties surround the new institutions, including China's motivation and the larger geopolitical

implications, including for Europe. China initiated two development finance institutions with sharply differing operational styles almost at the same time. The country has embarked on this multilateral development path, although it could have simply continued using its own, financially much more powerful, national policy banks to support its overseas investment. Some benefits, which the new MDBs bring for China and other emerging economies, are im-

mediate and evident, such as channeling greater investments for their own development priorities. Other benefits, such as growing geopolitical influence, are more indirect and hinge on the new MDBs' evolving profiles and their future success. Europeans should continue to engage actively and strategically with the AIIB and NDB.

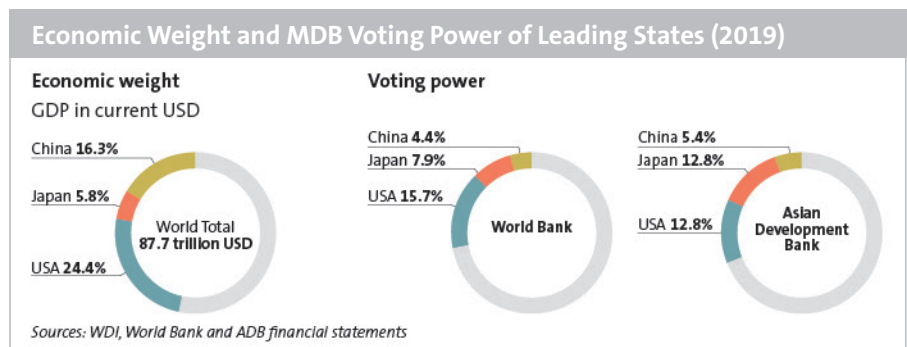
2016: New Banks for China

A key motivation to set up the AIIB and NDB (headquartered in Beijing and Shanghai, respectively) was to afford greater decision-making power to emerging economies. Today, these economies, especially China, remain under-represented in the existing international financial institutions, such as the World Bank and the International Monetary Fund (IMF), which the US has historically led. Emerging economies have pressed for an adjustment of shareholding and voting power in international institutions to reflect their growing weight in the global economy. As the second-largest global economy behind the US since 2010, China has led these demands. Despite some improvements in recent years, China has not been able to substantially increase its voting shares at the IMF and major MDBs in line with its growing weight in the world economy.

By creating two new MDBs in which they have a bigger say, emerging economies can design approaches and policies that better

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respond to their development needs. The financing of basic infrastructure is a key priority for China and other emerging economies, from which the World Bank and regional MDBs have moved away since the 1980s. Instead, the US and other non-borrowing MDB shareholder countries prioritized institutional reform and poverty reduction. MDB borrowers have also criticized bureaucratic and political bottlenecks at existing major MDBs as well as policy conditions attached to project funding, such as macroeconomic policies and environmental and social safeguards. As infrastructure banks with a lean administration and faster business processes, the new MDBs are an attractive model for borrowers. Countries that were previously on the receiving end of development



aid now have new tools to shape the landscape of developing finance and gain international clout.

Multilateral Banks: What For?

China has widely funded and built infrastructure in Asia, Africa, and Latin America. Its own national banks, the China Development Bank and the China Export Import Bank, play a key role in financing these large-scale projects. These two banks have significant financial capacity, with outstanding loan portfolios of 1.7 trillion USD and 490 billion USD, respectively; the AIIB and NDB pale in comparison. However, China's policy banks also face problems of corruption, poor lending practices and repayment problems. MDBs, by contrast, tend to have higher standards and can help improve the way China engages abroad and shares the risks with other member countries. MDBs by definition involve working in cooperation with other countries. This also provides China an opportunity to step out on the international stage and test out cooperation with other countries, within a controlled setting over which it has considerable influence.

As a type of international organization, MDBs offer several advantages. They are relatively easy to create, with a well-understood institutional design that can be easily replicated and adapted to suit the aims of members. They also do not require many financial resources, especially for a country with China's financial capacity. Once MDBs are capitalized by member countries, they raise most of their resources by issuing bonds on commercial capital markets. By funding themselves at low rates on capital markets and charging a slight margin to their borrowers, MDBs basically support themselves financially and do not require annual contributions from mem-

bers. This model is fundamentally different – and less expensive – from the budget-allocation model of other international or bilateral development agencies.

Two Banks, Two Logics

According to China, the new MDBs are set to complement – and not to compete with – the World Bank and the major regional development banks such as the African Development Bank, the Asian Development Bank (ADB), the European Bank for Reconstruction and Development, and the Inter-American Development Bank. In reality, it will probably be a bit of both. The new MDBs want a stronger focus on infrastructure and a more streamlined and borrower-friendly approach. But beyond that, it is interesting that the AIIB and NDB appear to be establishing two very different types of policy frameworks and operational approaches.

In many aspects, the AIIB is very similar to the existing major MDBs, but with China as the dominant shareholder instead of the US. In terms of membership, the AIIB is the second-largest MDB behind the World Bank, with 103 approved members as of September 2020. The bank fits right in with other major MDBs. It has committed itself to high transparency, environmental and social standards, as well as anti-corruption and procurement policies. Its top management is international with a strong MDB background. No national limits exist on hiring. The AIIB is present at major international meetings in the field with an internationally visible and well-regarded president. With an excellent international bond rating (AAA), the AIIB is furthermore financially well positioned.

The NDB, on the other hand, has almost an opposite governance style. It is opaque with limited or at least unclear standards. Compared to the AIIB, the NDB is more

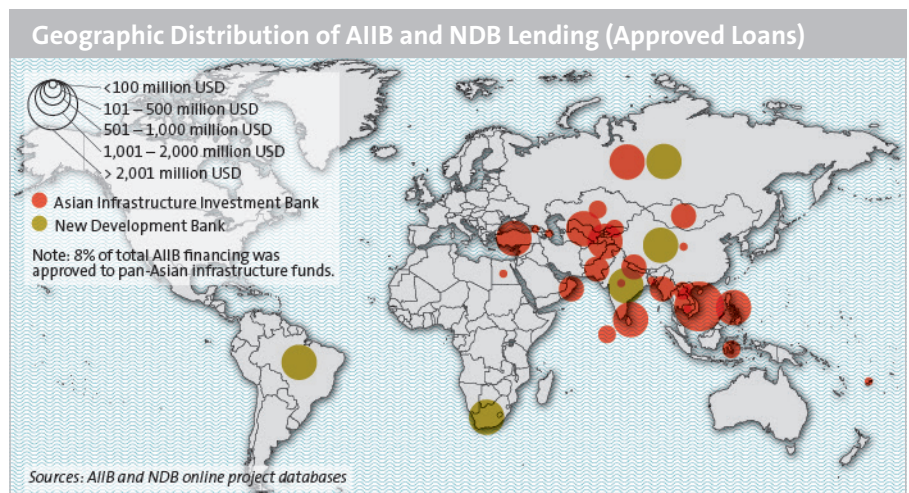
politicized and inward looking, with nationality defining its key characteristics, such as membership (the five founding BRICS nations only, i.e. Brazil, Russia, India, China, and South Africa), weak safeguard policies giving priority to national legislation and regulation, and procurement open only to firms from member countries. Internal administration is more politicized, with each of the five shareholders taking turns controlling the presidency and four vice-presidencies. Unlike within the AIIB, each of the five NDB-member has equal voting power. This has the merit of equality, but it can also complicate decision-making, especially in light of tensions between some of its members.

While this contrast may seem puzzling at first glance, in reality it suits the two sides of China's current geopolitical position as a rising power. China's engagement with the NDB aligns well with its past positioning in the global order since the late 1970s: China as a "leading developing country", an anti-Western imperialism force, seeking close ties with developing countries in Asia, Africa, and Latin America. By participating in the NDB on equal terms with the other BRICS, China shows its continuing solidarity with the developing world. It serves as a useful forum for China to shape its complex and at times challenging relations with countries like Russia and especially India.

The AIIB represents the new logic. China is a rising global power that wants to assume global responsibility and leadership. The AIIB is a tool to demonstrate and project power. Symbolically and politically, the establishment and enlargement of the AIIB has been a great success. China has shown that it is able to build a high-standard MDB, its own version of a World Bank. This brings international legitimacy and reputation. All G7 nations are members apart from the US and Japan, as well as countries from Europe, Latin America and Africa. The AIIB provides China with new opportunities to engage and compromise with Europe and Western states such as Australia and Canada, and to boost its voice in multilateral governance.

Banks for the Belt and Road?

The distinct profiles of the AIIB and NDB also translate into the banks' approved loan portfolios. With only five members, the NDB's lending is much more geographically concentrated compared to the AIIB.



The NDB cannot lend to non-members, except under restricted circumstances. China and India have been the bank's largest borrowers thus far with just under 30% of approved loans each. By contrast, the AIIB project approvals are spread across 25 countries. In addition, 8% of the AIIB's financing was approved to funds investing in multiple countries across Asia. India has been the AIIB's largest borrower to date, with 22% of total approvals, followed by Turkey with 10%.

The MDBs' initial lending patterns do not suggest that the banks have been steered by China to directly serve its foreign and economic policy priorities. While evidence is preliminary and not definitive yet, early ap-

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proval patterns indicate no clear and direct link between the MDBs and the BRI. India, being a main borrower of the banks and opposed to the BRI, is a case in point. In an early phase, Chinese officials referred to the AIIB as a (potential) funding mechanism for the BRI. However, China has since seen that it is in its interest to clearly distance the AIIB from the BRI to help strengthen the bank's international reputation. The AIIB's strategy to co-finance many of its early projects with established MDBs, following their standards and policies, has further served to strengthen its reputation as independent from China's immediate foreign policy goals. China has

sufficient voting power and informal influence within the AIIB administration to shape lending practices, but thus far, it has shown itself willing to compromise with other members and not use a heavy hand in terms of governance. Whether this continues in the future remains an open question.

Towards a New Global Order?

With the successful launch of two institutions, China's influence in the field of multilateral finance is rising. The very existence of new multilateral institutions championed by China is a challenge to the existing US-dominated global order. Since the 2008 financial crisis, China has increasingly positioned itself as a new, alternative source of international funding – a role that, in the immediate post-Cold War order, was almost exclusively reserved to the US and other Western states. Unsuccessful efforts by the US to lobby allies like Australia, the UK and South Korea against joining the AIIB show that they are taking China's multilateral efforts seriously. Some analysts interpret the stated commitment of the US to the ADB, renewed under the Trump administration, as an effort to counter the ever-growing influence of China in the region.

This shift in relative power and priorities in multilateral finance does not, however, automatically undermine the liberal character of the existing international order. In other policy areas, China has closely aligned its multilateral engagement with its national policy agenda with a strong focus on domestic economic and security priorities; for example, in regional security organizations, the country promotes norms and policies that undercut existing international rules and

Switzerland and MDBs

Switzerland is a member of the AIIB as well as of all major MDBs. Switzerland joined the AIIB as a founding member and is represented in its Board of Directors by an advisor. Like other European states, Switzerland has qualities that MDB managements and other shareholders value and will try to keep, notably its AAA sovereign bond rating and its credibility in international finance. Switzerland, as a medium-sized economy that is not part of a major political power bloc, considers cooperation within multilateral forums, such as the AIIB, as strategically important for its international positioning and its ability to influence international decision-making.

standards supported by liberal democracies. But China's strategy is varied. In some multilateral contexts, including international finance, China has thus far neither the capability nor the interest to change existing rules. International financial markets, from which China has largely benefitted in the past, would punish imprudent financial policies. For the new MDBs to function well, they need to stay trustworthy in the eyes of private sector actors, such as rating agencies and bond buyers.

Options for Europe

Europeans can help ensure that China stays committed to the existing standards and norms in development finance. Many

European countries joined the AIIB early on in order to secure a seat at the table when the bank's basic governance and operational structure was set up. This strategy has been successful so far. China has been willing to accommodate European needs in AIIB's negotiations. Examples are the AIIB's commitment to standards and norms in procurement and project oversight as well as environmental and social safeguards. Europeans have also been active in shaping relations between the AIIB and the existing Western-dominated MDBs, for example through co-financing projects – again with a positive impact on the new MDB's emerging standards and policies. With regard to the NDB, it is also worth for Europeans to consider ways of engagement should it open up for cooperation or new members. The participation of Europeans as AIIB members and as potential NDB members gives them leverage,

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due to their financial strength and the importance of a top bond rating for MDB operations. They should use this leverage strategically to maintain high standards and achieve global development goals.

It is still early days in the life of the AIIB and NDB. The banks' governance and operational styles are not set in stone. It will

be worth following how the relationship between the AIIB and China's domestic economic policy agenda evolves, that is to say whether the AIIB will keep its independence, which will be crucial for the AIIB's international stance and perception. Also, the AIIB's standards and policies, stated and implemented, have been mostly well received, but room for improvement still exists. Europeans should keep a close eye on the lending practices of the new MDBs in the future and act promptly when they go against their interests and principles.

For more on the Belt and Road Initiative: Trade and Security in Eurasia, see [CSS core theme page](#).

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