Financial and Political Impacts of AIIB on China’s Belt & Road Initiative

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ABSTRACT. China put forward its One Belt and One Road trade strategy and set up the Asian infrastructure investment bank. These two near-simultaneous events underscored China’s ambition for a new world status and higher international influence. This literature review aims to discuss the influence of AIIB on One Belt and One Road politically and financially, and simply analyze the positive and negative impacts of the combination. Meanwhile, in the process of analysis, the comparison between AIIB and established multilateral financial institutions is provided to reflect its particularity.

KEYWORDS: AIIB, Multilateral Financial Institutions, OBOR, International Influence

1. Introduction

When President Xi Jinping visited Indonesia and Kazakhstan in 2013, he publicly announced the Belt and Road Initiative (Also known as the One Belt One Road Initiative (OBOR)) for the first time, a trade initiative covering the region of China and western Asia, the ancient Silk Road formed in Han dynasty and a newly developed 21st century maritime route. The Belt and Road Initiative is a new model of international regional economic cooperation proposed by China to promote the in-depth development of economic globalization. Its core goal is to promote the orderly and free flow of economic elements, efficient resources allocation, in-depth market integration, promote greater scope, higher levels and deeper regional cooperation and jointly create an open and balanced and inclusive regional economic cooperation structure. Follow by the establishment and some achievements of the project, China gains a gradual increase in its international influence, and the world’s economy and politics experienced a sudden change affected by the OBOR initiative.

On January 16 of 2016, China officially announced the set-up of the Asian Infrastructure Investment Bank (AIIB), a multilateral financial bank with the fundamental purpose of promoting the process of interconnection and economic

integration in the Asian region\(^2\), by sponsoring and advocating the construction of infrastructure in Asian countries.

The occurrence of the OBOR initiative and the establishment of AIIB lead by China, has a mutual and common interest in promoting the economy of Asia, similarly by their approaches aimed on the construction and utilization of infrastructures. The mutual interest and similar goal of them reveals deeper relationship and integration among them. This essay, by analysis of the history and achievements of OBOR and AIIB, interpret how AIIB affects the Belt & Road initiative financially and politically.

2. The Aim and Specialty of AIIB

On January 16\(^{th}\) 2016, China officially opened the Asia Infrastructure Investment Bank (AIIB).\(^3\) This is the first multilateral financial organization China led, and this act caused seismic impact on the world's economy and political relationship. China, from the proposal of AIIB and the announcement of the OBOR initiative, reveals its ambition to change the current global economic and political situation.

Before the establishment of AIIB, there are two fundamental and famous multilateral financial organizations, the World Bank and International Monetary Fund (IMF) respectively. The World Bank and IMF were both ultimately designed to facilitate world trade.\(^4\) The World Bank was to make loan first for the reconstruction of Europe, devastated by WW2, then focuses on developing countries to alleviate poverty and assist in economic development.\(^5\) The IMF was to facilitate the currency flows across nation borders and to ensure stability of the international financial system by encouraging the free convertibility of currencies.\(^6\) It is worth mentioning that the United States is the largest subscriber to both the World Bank and IMF, as a result having the largest voting power in both institutions.\(^7\)

China has experienced fast growth in recent years and is now the second largest


\(^3\) Daniel C.K. Chow., 2016. Why China Established the Asia Infrastructure Investment Bank, Vanderbilt Journal of Transnational Law, Volume 14, pp.1, 1256-1296

\(^4\) Bird Mike. 2015. China’s New Development Bank is Becoming a Massive Embarrassment for Obama, Bus Insider


\(^6\) See id. at 5

\(^7\) See id. at 4 (The United States continues to wield the most power in these organizations with a 16.36 percent voting share in the World Bank and 17 percent quota share in the IMF)
economy in the world. Its international economic position has greatly improved, but its political and international influence has not experienced the same rise as its economic status. This can be shown by China’s 6.09 and 4.61 percent voting share in IMF and the World Bank respectively. As the second largest economy in the world, the voting power of China in authorized multilateral financial institutions does not match its current economic position. The old and long tradition of these institutions built since the success of western countries in WW2 seems unbreakable, the dominant role US plays in these institutions is irreplaceable. Thus, rather than gaining any real clout in the World Bank and IMF, which is doomed to be a failure, China decided to establish a new bank where they can play a vital role.8

If countries or economies attempt to obtain loan or finance from the World Bank and IMF, conditions covering fiscal, monetary and politic aspects for the recipient are required. These conditions are known as the Washington Consensus. Specifically:

- Fiscal discipline (limits on government spending);
- Redirection of public expenditures towards education, health, and infrastructure;
- Tax reform (broadening the tax base and reduction in overall taxes);
- Market-determined interest rates (no government set interest rates on borrowed money);
- Competitive exchange rates (no exchange rates pegged to a hard currency such as the U.S. dollar);
- Trade liberalization (reduction or elimination of tariffs and quotas on imports);
- Openness to foreign direct investment;
- Privatization of state-owned enterprises;
- Deregulation;
- Legal security for property rights, including intellectual property rights; and Reduced roles for the state.9

Critics of the Washington Consensus are legion. For instance, Nobel Prize Winner Joseph Stiglitz argued that these conditions are too rigidly and unthinkingly applied to countries regardless of their individual characteristics.10

These requirements set high and hard standard, for countries with different

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8 See id. at 5

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characteristics to follow, may affect the culture and development trait of the country. Not only worrying about the cultural and developing destruction “Washington Consensus” brings on a variety of countries, China also sees the “Washington Consensus” as political threat to China’s long-term national and global interests. The concern the “Washington Consensus” brings to China and debt-urgent countries are one of the key factors of the occurrence of AIIB.

Compare with the Washington Consensus the World Bank and IMF required, AIIB officially claimed that it follows a doctrine of non-interference, that is, China believes that the political characteristics of a borrower nation, or any nation with which it conducts business, is of no concern to anyone but then that nation itself. The non-interference doctrine of AIIB potentially attract a large group of clients, which can be regarded as good news for a financial institution, however the non-interference proposition hidden the risk of debt default of clients.

Between October 2014 and February 2015, Indonesia, Maldives, New Zealand, Saudi Arabia, Tajikistan and Jordan applied to join the AIIB. The number of prospective founding members has been increased to 27. On March 12, 2015, the UK announced its application to join the Asian Infrastructure Investment Bank (AIIB), thus becoming the first developed European economy to apply for the AIIB membership. Led by the UK, France, Germany, Italy, Luxembourg, Switzerland and Austria applied to join the AIIB in late March 2015. After much deliberation, South Korea and Australia also formally announced to join the AIIB before the end of March 2015. As of April 15, 2015, the number of founding members of the AIIB has expanded from 21 to 57, covering five continents. The involvement of European Developed countries shows the high expectation the globe has on AIIB, and even countries that tightly connected with the U.S.A., the most influential opponent against the launch of AIIB, choose to invest in the AIIB to be an internal stakeholder.

Compare with the monetary authorities built since the refurbishment of global economy after WW2, such as the World Bank and IMF, AIIB absorbs their prior experience of how to run a gigantic multilateral financial institution successfully, and also advocate its doctrine of “non-interference” which is different from them. AIIB is approaching to be a globally influential institution that can restructure the global economy and stimulate the rise of Asian economy (where 60% of human total population lives) by providing investment for infrastructure in Asian developing countries. The AIIB is similar to the World Bank and IMF in structure and aim, but special with its loan requirements and specific aim to promote infrastructure completion in Asian region to achieve the ultimate goal of economic growth in Asian economic community.

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11 See id. at 5
12 See id. at 5
13 Wang Da, 2015, AIIB: China’s Considerations and Global Significance, Northeast Asia forum
14 See id. at 5
3. Brief Introduction of the OBOR’s Goal

On March 27, 2015, China's National Development and Reform Commission, The Ministry of Foreign Affairs and the Ministry of Commerce jointly issued the vision and actions for jointly building the Silk Road Economic Belt and the 21st Century Maritime Silk Road at the Boao Forum for Asia in Hainan (National Development and Reform Commission et al., 2015). This marks that the "One Belt and One Road" strategy, which will have a historic impact on China's development, has entered the stage of comprehensively advancing its construction. "One Belt And One Road" is the longest economic corridor in the world and the most promising economic cooperation belt in the world. Originated in China "in all the way", well versed in central Asia, southeast Asia, South Asia, west Asia and parts of Europe, east Asia Pacific economic circle, west European economic circle, covering about 4.4 billion population, economic output of about $21 trillion, accounted for 63% and 29% of global Chinese "area" as a new period of Asia-Europe economic integration strategy, has extremely important practical significance and will have far-reaching influence. It is important to note that the OBOR initiative is not a specific entity or mechanism, but a concrete manifestation of the concept of cooperative development advocated by China for a long time in promoting economic integration between Europe and Europe.

Through the theme of OBOR, within the purpose of peace development and mutual benefits, China wants to strengthen the interaction among Asian countries and to achieve the ultimate goal of building an Asian economic, politic and cultural entity. The ultimate goal is set to promote the long-term interrelationship among Asian countries and stimulate the potential of Asian economy.

4. AIIB’s Financial and Political Impact on OBOR

After interpreting the long-term goal of the AIIB and OBOR initiative, it is obvious to figure out the similarity of them. The two China-leading bank and initiative shows the ambition of Chinese to reform the international economic system. The combination of the two entities demonstrate China’s goal to promote economic development of Asia thus to gain more international influence and economic promotion. For this literature review, I will use existing data and qualitative explanation (both personal explanation and explanations from secondary research sources), to demonstrate the financial and political impact of the Asian Infrastructure Investment Bank on the One Belt One Road initiative.

15 See id. at 1
16 See id. at 12
17 See id. at 12
4.1 Financial and Political Benefits AIIB Brings to OBOR

- Monetary Support for the OBOR

Follow by the rapid rise of China economically, the 40 years economic reform and opening up assists China to build a national infrastructure comprehensively. The current situation is that China is facing overcapacity in the construction of infrastructure, the domestic market has sufficient and over-amount of capital to construct infrastructure. In 2011, The Chinese government reported the existence of 144,700 SOEs (State-owned Enterprises), excluding financial institutions, with assets worth over $13.6 trillion. These SOEs are with the world highest amount of capital to invest and operate, it is a good method for the AIIB to deliver their over-amount of capital into foreign markets to earn extra profits and release the overcapacity pressure. The establishment of the AIIB can solve the overcapacity issue by distributing these capitals to foreign market.

The OBOR initiative is covering the Asian region, while most countries in the coverage of the OBOR are currently still developing countries, some are even poor countries. These countries are urgently needing investment to stimulate economic growth, especially needing investment to construct infrastructures, which theories have already justified that infrastructure is fundamental elements for economic growth.

The western countries are less willing to assist these countries financially, as infrastructure investment is having long capital recovery cycle and high risk (political risk and environmental risk). Therefore, they set requirements for debt such as the Washington Consensus to lower the risk of debt defaulting. On the contrary, the Chinese government is willing to support these economies to show its positive international influences and also lessen the pressure of overcapacity in domestic market. As a newly established multilateral financial institution, the AIIB, which is urgently seeking chances to assist developing countries’ infrastructure and find entrances to release its over-amount of capital.

Thus, from the demand-side for infrastructure investment, a large amount of Asian developing countries is seeking foreign investment to support domestic infrastructure system completion; from the supply-side for infrastructure investment, the AIIB can help to distribute the domestic over-amount of capital to foreign countries to lessen the issue of overcapacity, including both financial and labor capital from SOEs and private sector. The reason that the demand can be satisfied, AIIB’s role of distributing and providing capital is crucial.

Also, the OBOR focuses on infrastructure investment projects in Asia, where

18 See id. at 3
19 See id at 1
20 Ren Chun Tao, 2018, Brief analysis of the influence of AIIB on "One Belt and One Road" policy, Time Finance, no.7, pp 1
21 See id. at 1
most countries are developing and with low credit rating, for instance Pakistan has obtained large amount of investment from OBOR (46 billion dollars project investment), while it is rated B- from Standard Poor’s. Famous and influential financial institutions from western countries will be less willing to invest for these countries. So, the reliable and possible source of finance for OBOR will only be the AIIB, which is also led by China.

Therefore, the AIIB provides monetary support for the OBOR initiative, and is the most possible financial supporter for risky projects in the OBOR initiative.

- Risk Reduction

The AIIB is not only an organization singly run and direct by Chinese government, but also a multilateral financial institution where a wide range of stakeholders involved in. The AIIB is not only fund up by developing countries, typical developed countries with high international influence such as the United Kingdom, Germany have also taken part in the foundation of AIIB.

When these developed countries take part and share interest in the AIIB, they will have responsibility to share the risk of their invested projects.

Project finance is a way of investment that bears various types of risk, for instance sovereign risk, political risk, etc. When AIIB invested in projects belong to the OBOR initiative, its globally influential stakeholders will utilize their global influence to reduce various types of risks. This act will protect the interest of their invested capital in the AIIB and raise the potential of less expected return’s variance and standard deviation affected from high project risk.

The AIIB now has 57 countries as participants, these 57 countries have all invested significant amount of money into the institution. In the future, the figure of participants looks promising to rise, due to the increasing global influence of China and its allies. The AIIB will gain more influence from its allies and stakeholders, the continuously enlarging influence of AIIB assists it to reduce the risk of its projects by external force (such as political, social pressure from stakeholders).

This claim has not yet been justified in reality but is feasible to be deduced and explained in theory.

- Achievements of Mutual Interest & Goals

As above claimed, the mutual interest and similar goal of OBOR initiative and the AIIB is obvious. The president of AIIB has commented that, “the AIIB and the

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22 Zahid Hussain, 2017, The China-Pakistan Economic Corridor and the New Regional Geopolitics, Centre for Asian Studies, pp 6
24 Jerry C, 2020, A Brief Introduction for Portfolio Theory & CAPM, pp 8
25 See id. at 3
OBOR initiative are the 2 engines of an aircraft.”26 According to this, the AIIB and the OBOR initiative can be regarded as two tools set for achieving a same ultimate aim of Beijing. Both the AIIB and OBOR has claimed that the ultimate goal of both is to promote the long-term interrelationship among Asian countries and stimulate the potential of the Asian economy.27 This goal shows the ambition of China to gain global influence and the determination to reform the global economy.

By the assistance of the AIIB, the OBOR can achieve its goal more efficiently, ultimately the two entities achieve their goal simultaneously.

The OBOR is currently using US dollars as the main currency for investment. After China joined the WTO in 2001, it gained a very stable exchange rate environment by pegging its currency to the US dollar. On this basis, it vigorously developed the export-oriented economy, thus achieving rapid catch-up development and accumulating a huge reserve of US dollars (most of which are US Treasury bonds). The downside of this development model, however, is that the Chinese economy has become heavily dependent on the dollar system and is thus at great risk.28 The large amount of quantitative ease strategies implemented by the Federal Reserve impulse value decline of US dollar, triggering China to spend its huge amount of US dollar reserve to maintain interest. By the AIIB which can distribute the US reserves from the Chinese Central Bank, to invest in projects of the OBOR. The combination of OBOR and AIIB helps to reduce the risk of over-storage of US dollar of China by distributing the currency in foreign infrastructure construction, this indirectly help China to maintain its interest and keeps its influence in the globe. Furthermore, this act increases the flowing amount of US dollar in the free market thus causing US dollar to depreciate more subsequently. A depreciation of USD can be regarded as good news for Beijing who treat the US as a main competitor in political and economic aspects.29

In addition, the combination of OBOR and AIIB maximize the economic influence of China. Since the WW2, the United States led the establishment of the Bretton Woods system characterized by "double linking". For the first time in human history, the dollar, the currency of sovereign states, has become the global currency by means of international covenants. Through the so-called "three pillars" – The International Monetary Fund, the World Bank and the General Agreement on Tariffs and Trade (GATT), the US has mastered the dominance of the global economic and financial system. And in the following 40 years, the global economic system remains almost constant while financial crisis and financial-led political conflicts have already justified that the system is urgent to reform. China has experienced significant economic growth for 40 years, and is doomed to reform and adjust the

26 Liqun Jin, 2019, Interview with Liqun Jin: AIIB and the “Belt and Road” are two engines of an aircraft, The Paper, pp 1
27 See id. at 12
28 WeiXing X, Liying Y. 2014. The influence of dollar standard system on Sino-us economic relations, Northeast Asian Forum, pp 53
29 See id. at 12
inappropriate global economic system. By combining the AIIB, where a vast amount of countries can participate, and the OBOR initiative, where rising Asian economies are been assisted, China gathered sufficient global influence to affect and adjust the global economy. Rather than singly using the OBOR as an approach to gain influence, the involvement of the AIIB maximizes it.

4.2 Financial and Political Limitation AIIB brings to OBOR

By the assistance AIIB give to OBOR, the OBOR gains benefits to approach its goal. However, limitations exist to, in somehow, restrict OBOR.

- Investment Restriction due to Stakeholders’ Conflict

The AIIB is a bank where vast numbers of influential stakeholders participate in. When the number of stakeholders increases, it is hard to avoid and solve current and previous conflicts among them. So, when the AIIB led an investment to support a country’s infrastructure while the country been invested has conflicts with specific shareholders in the AIIB, the shareholders will feel disrespect and subsequently causing internal conflicts in the AIIB. In order to prevent these events, the AIIB will choose investment project rigorously, while this act harms the OBOR as the financial capitals’ flow is restricted and some major projects the OBOR covered will be lack of financing support from the AIIB.

Follow by the launch of the AIIB and OBOR, the increasing amount of OBOR invested in Asian infrastructure projects triggers stakeholders’ conflict. A typical instance is the escalating conflict among China and India.

In 2015, China and the OBOR initiative announced an investment plan of 46 billion dollar, concluded under CPEC (China-Pakistan Economic Corridor). The figure of 46 billion dollar soon rose to an estimated value of 57 billion. This large investment from China to Pakistan annoyed India, as Pakistan is a major enemy of India.

The contradiction between India and Pakistan has a long history. Due to different historical traditions, cultural origins, development status and social systems, the contradiction between India and Pakistan is increasing. Under the guidance of the "two nations" theory, a Muslim nation distinguished from Hindus has emerged in the South Asian subcontinent. Islam is the basis of the identity of various ethnic groups and factions in Pakistan. Adherence to Islamic attributes is the difference between Pakistan and India. Cultural contradictions have led to the split of two supposedly unified groups into two countries with deep-rooted hatred.

30 See id. at 12
31 See id. at 20
As one of the earliest participants of the AIIB, India felt disrespect from the huge investment the institution made on its enemy. This behavior of China also cast a shadow on the already unstable political relations between China and India. For example, the growing border conflict between China and India. In June 2020, China accused Indian troops of crossing the border twice, and a clash among them occurred. This clash resulted in at least 20 death of Indian soldiers, and an unclear number of Chinese soldiers’ death.33

The tension and result of China-India conflicts alert the AIIB to avoid this type of situations. Thus, in future period, the AIIB will be more rigorous on choosing the projects to invest in, in order to ensure the interest and relations among its stakeholders.

It will harm the OBOR as it focuses on Asian developing countries’ infrastructure, thus concern less about political conflicts. The AIIB will be restricted to finance most projects under the OBOR initiative.

- Political Constraints of OBOR led by AIIB

Externally, the newly established multilateral financial institution will also be affected by the politicization of economic issues. Although the BRICS bank, the AIIB and the SCO development bank attracted many emerging economies and developing countries to actively participate in, to some extent, but it also weakened the dependency of emerging economies and developing countries on the United States and Japan dominated Asian financial system. 34 United States and Japan, in order to maintain their economic superpower status around Asian region and the globe, are bound to impose pressure to the China-leading multilateral development financial institutions.

The pressure is not only affecting AIIB singly, but likely to impact projects under the OBOR that AIIB has invested in. The political role of AIIB may affect its invested projects that are also under the OBOR initiative. Western authorities are likely to take approach to stop or affect the project from the international influences. This will cause failure or unexpected outcome to occur of OBOR, due to the special political role of the AIIB.

5. Conclusion

China launched the ambitious OBOR initiative and its first leading multilateral financial institution AIIB to achieve its economic and political goal. Specifically, an aim to become an economically and politically influential nation by promoting the

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34 See id. at 2
Asian economy. The president of AIIB Liqun Jin described the OBOR and the AIIB as two engines of an aircraft, which reveals the similarity and interrelationship among the two entities.

When operating, it is obvious to find the relation between the two entities. After analyzing and referencing previous papers and researches, this paper concludes few points of how the AIIB impact the OBOR initiative financially and politically.

Positively, the AIIB provides monetary support, risk reduction for the OBOR initiative, and by combining together, the AIIB assists the OBOR to achieve their identical goal.

Negatively, constraints led by the nature of a bank causes financial limitation. Also, the special political status of AIIB may affect the progress of particular OBOR projects from negative effects the western authorities bring, as they are feeling the escalating threat of their international status from the rise of China. Some other points have not been discussed in this paper due to the limited length.

It is controversial that whether setting up the two entities is good or bad for China, but the incentive was right. China aims to reform the inappropriate global economy system and encourage the rise of Asian developing economies. This promotes economic growth in the world’s less developed regions and eliminates poverty effectively by giving financial support to build the basic economic growth element for developing countries- Infrastructure.

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