

AIIB Development: Forecast and Implications

LEE Hyuntai Research Fellow, China Team, Department of Northeast Asian Economies (htlee@kiep.go.kr)

KIM Junyoung Researcher, International Cooperation for Korean Unification Team, Department of Northeast Asian Economies (junyoung@kiep.go.kr)

1. Update

On June 24-26, 2016, the Asian Infrastructure Investment Bank (AIIB) held a board of directors meeting and its first annual meeting in Beijing, China. President Jin Liqun and 57 member state representatives (governors) were present, four projects were approved, and the second general meeting was settled to be held in June, 2017 on Jeju Island.

USD 509 million worth of loans will finance four projects approved by the AIIB (Pakistan M-4 Highway, Tajikistan Border Road, Indonesia Slum Improvement, and Bangladesh Electricity Grid Construction). Three of these are co-financing operations with other multilateral development banks (MDBs); only the Bangladesh Electric Grid Construction project

is a stand-alone venture. The AIIB has made speedy headway since its inception in 2016, and this can be attributed to the fact that these projects were ones already proposed by MDBs or recipient countries (Table 1).

The four projects can be defined by the following characteristics: 1) infrastructure investment in countries situated on the path connecting the Belt and Road Initiative, 2) proposals by recipient country governments, 3) co-financing with other MDBs, and 4) small loans.

As the AIIB's projects are expected to evolve over time, it will be necessary to consider policy implications in line with short-term and long-term forecasts on the AIIB's development.

Table 1. Financing Structure of Approved Projects

(USD million)						
Project (Country)	Period	Scale (Gross)	Body	Scale	Share (%)	AIIB redemption period
National Motorway M-4 Project (Pakistan)	JUNE 2016 - JUNE	273	AIIB	100	36.6	20 yr. (5-yr. grace period)
			ADB	100	36.6	
			UK DFID	34	34.0	
			Pakistan Government	39	39.0	

	2020					
Dushanbe-Uzbekistan Border Road Improvement Project (Tajikistan)	DEC 2016 - DEC 2020	106	AIIB	27.5	26.0	15 yr. (3-yr. grace period)
			EBRD	62.5	59.0	
			Tajikistan Government	15.9	15.0	
Distribution System Upgrade and Expansion Project (Bangladesh)	JULY 2016 - JUNE 2019	262	AIIB	165	62.9	25 yr. (5-yr. grace period)
			Bangladesh Government	79.4	30.3	
			SPC	17.9	6.8	
National Slum Upgrading Project (Indonesia)	NOV 2016 - JUNE 2021	1,743	AIIB	216.5	12.4	16.5 yr. (7-yr. grace period)
			WB	216.5	12.4	
			Indonesian Government	1310	75.2	

Source: AIIB Board of Governors (June 25, 2016).

2. Forecast

Short-term Forecast

The AIIB's projects in the short term are predicted to involve joint collaboration via co-financing with other MDBs. Progress will likely be focused in infrastructure investments in countries connected to the Belt and Road Initiative through co-financing with other MDBs, similar to the four recently approved projects. As for joint ventures, other MDBs and recipient governments will propose AIIB participation in existing projects, and the AIIB will do due diligence before making a final investment decision.

The reason behind this operational structure is that the AIIB is yet a newly-formed MDB and has a staff of only around 40 people in the working group. Consequently, it lacks the internal capacity to pursue a large-scale, stand-alone venture. Also, by setting its initial projects as collaborations with the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD) and the World Bank (WB), the AIIB can expect lower risk, seek to acquire business operation know-how, and build international public con-

fidence.

The number of stand-alone projects will grow alongside the bank's business capabilities, but are likely to be on a smaller scale than joint ventures for the time being. Furthermore, they will likely be in the form of participation in projects that have already been developed and reviewed by member governments and corporations, instead of engagement from project initiation. The AIIB has, however, approved the Project Preparation Special Fund, which will provide funds for low and middle-income member countries so they can develop their own profitable projects (China has decided to contribute USD 50 million as a start), and is expected to gradually encourage more and more solo projects.

The AIIB's key target region will be Southeast Asia, Southwest Asia, and Central Asia where there is big demand for infrastructure and where MDB investment has been actively taking place. While major MDBs such as the ADB have concentrated investment in these areas, infrastructure supply still lags behind demand. Thus, this is where the AIIB will focus its initial co-financing projects. Southeast Asian countries such as Vietnam, Cambodia,

Indonesia, Myanmar, and Bangladesh, South-west Asian countries such as India, Iran, Pakistan, and Central Asian countries such as Kazakhstan, Uzbekistan, Mongolia, and Russia will be major partners, and there is also anticipation for cross-border business among these countries.

The AIIB is expected to expand its membership, with the aim of winning international support and strengthening influence. The bank has vowed to receive new members under the principle of openness and inclusiveness; it has opened doors to semi-autonomous countries such as Hong Kong, and has invited ADB members such as the U.S. and Japan to participate. If these countries do indeed decide to join in 2017, the AIIB's membership will reach 90 countries, which exceeds the ADB's membership of 67.

On the inside, an aggressive expansion in staff and organization will lead to a boost in business capabilities. There is currently a severe lack of professional staff in each subdivision, but the staff headcount is projected to rise swiftly, with hopes for around 100 people on the payroll by the end of 2016. Candidates for recruitment will likely be from multiple nations, with expertise and working experience from other MDBs. Even with reinforcements of 100 staff members every year, it will take decades to reach the ADB's size of over 3000 employees. The welfare benefits being offered by the AIIB are not on par with other MDBs, and are proving to be an obstacle to hiring high-quality talent. Following reorganization and with better benefits, the supply of human resources will be brought up to speed.

Above all, in the short term the AIIB will seek collaboration with international financial organizations including other MDBs, and strive to settle itself in the international finan-

cial system. Since China has led the AIIB launch and has a 30.34% equity stake, which is high enough to veto crucial agenda items, there are concerns that China will virtually control the bank. China will guard against the view that the AIIB signals the beginning of a new financial order dominated by China, and for the moment seek to collaborate with other MDBs, state-owned banks, and global financial firms so as to blend in with the existing financial order. This has been reflected in President Jin Liqun's consistent emphasis on the AIIB's intention to seek collaboration, co-existence and complementation with other MDBs, rather than competition. To this end, China will probably continue to co-finance the AIIB's initial loans with other MDBs in a bid to alleviate concerns that China will have undue influence on AIIB projects, or that it will challenge the existing international financial order.

Mid to Long-term Forecast

From a mid- to long-term perspective, the AIIB will possibly lead a greater share of stand-alone projects and support the Belt and Road Initiative financially, on the back of accumulated experience and better project financing capabilities.¹ Projects related to the Belt and Road Initiative are expected to dominate, and economic corridor implementation projects (shipping, roads, bridges, railroads, and transportation infrastructure) that strengthen linkage among regions and countries will likely be considered a priority. The Chinese government has revealed that public-

¹ At present, the AIIB and Chinese government are officially maintaining that the AIIB does not merely cater to the needs of the Chinese *One Belt, One Road Initiative* (<http://www.emergingmarkets.org/Article/3553708/AIIBs-Jin-eyes-Central-Asia-co-operation-after-first-EBRD-tie-up.html>); just as the ADB has been dominated by the US and Japan in the mid- to long-term, China's influence on the AIIB is projected to increase over time.

private partnerships (PPP) will be employed as a key tool in the Belt and Road Initiative, and the AIIB is expected to participate in such PPPs, whether directly or indirectly.

There is also the possibility of collaboration with other new financial organizations founded under Chinese leadership. Aside from the AIIB, the BRICS-led New Development Bank (NDB), the Silk Road Fund, and the Shanghai Cooperation Organization (SCO) Development Bank have started operations or are under discussion to be launched (Table 2). These

China-led organizations will provide funds for the Belt and Road Initiative's implementation and pursue the internationalization of the renminbi, which will help increase China's financial influence globally. It will be interesting to see how China deals with disagreements among member countries, credit ratings and safeguard issues that may surface as the AIIB carries out its projects.

Table 2. New China-led International Financial Institutions

	AIIB	NDB	Silk Road Fund	SCO Development Bank (tentative)
Foundation	JUNE 29, 2015	JULY 21, 2015	DEC 29, 2014	On-going
Regional Scope	Asia-Pacific developing countries	BRICS, emerging and developing countries	Belt and Road Initiative countries	Membership countries of the Shanghai Cooperation Organization
Legal Capital	USD 100 billion	USD 100 billion	USD 40 billion	-
Key Projects	Infrastructure	Infrastructure, renewable energy	Infrastructure, energy, industry cooperation	Infrastructure, energy, industry, etc.

Source: Data acquired from each relevant institution

The AIIB has made clear that it will use US dollars as the main currency in its projects. In the mid- to long-term, however, the Chinese renminbi is a potential main currency given the trend of its internationalization within Asia. As seen in the arguments that the renminbi should be used in earnest for the Belt and Road Initiative projects so as to accelerate the currency's internationalization,² use of the renminbi in Asian infrastructure projects is projected to grow steadily. While renminbi internationalization is a long-term, progressive strategy, and the renminbi's international standing is lower compared to other key cur-

rencies, the process may be expedited when the AIIB and other new China-led financial organizations are well established.

3. Implications

Since the AIIB will undertake both collaborative projects with other MDBs and stand-alone projects, private corporations will need to tailor their strategies accordingly. In the case of co-financing projects, strong contenders are likely to be infrastructure projects related to the Belt and Road Initiative that have been developed and screened by other MDBs. Therefore, Korean companies will stand to

² RMB Internationalization Report (2015), International Monetary Institute, Renmin University of China (2015)

gain by seeking participation in such ventures. Meanwhile, for stand-alone projects the AIIB will assess the feasibility of infrastructure projects proposed by member governments and companies. This would call for a proactive approach, identifying in advance the infrastructure demands of recipient countries and then cooperating with local institutions.

As the AIIB will be run in a manner similar to existing MDBs in the long term, it will be necessary to study case examples of businesses that have successfully participated in MDB projects. Financial institutions should also respond appropriately to the AIIB's initial moves to pursue extensive cooperation with other MDBs, state-run financial institutions and global financial companies.

The Korean government should actively join in AIIB operations in 2016, seeking the opinions of businesses, private financial institutions and MDB experts so as to set a strategy for the 2017 Board of Governors meeting to be held in Korea. More specifically, Korea should be ready for the shift in the AIIB's standing in 2017, when the bank has a larger membership, and the ensuing adjustment of Korea's ownership (voting share). In the mid- to long-term, the Korean government must evaluate its AIIB strategy from a macro perspective, based on the shifting international financial order, and develop countermeasures accordingly. The government should approach new China-led international financial institutions including the AIIB, NDB, Silk Road Fund and SCO Development Bank from multiple directions, and continue financial cooperation with China so as to become the East Asian "Renminbi hub" in light of the currency's internationalization trend. **KIEP**