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Trends in Southeast Asia

THE POLITICS OF THE ASIAN INFRASTRUCTURE INVESTMENT BANK (AIIB)

TANG SIEW MUN

ISEAS Publishing
INSTITUTE OF SOUTHEAST ASIAN STUDIES

Trends in Southeast Asia

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FOREWORD

The economic, political, strategic and cultural dynamism in Southeast Asia has gained added relevance in recent years with the spectacular rise of giant economies in East and South Asia. This has drawn greater attention to the region and to the enhanced role it now plays in international relations and global economics.

The sustained effort made by Southeast Asian nations since 1967 towards a peaceful and gradual integration of their economies has had indubitable success, and perhaps as a consequence of this, most of these countries are undergoing deep political and social changes domestically and are constructing innovative solutions to meet new international challenges. Big Power tensions continue to be played out in the neighbourhood despite the tradition of neutrality exercised by the Association of Southeast Asian Nations (ASEAN).

The **Trends in Southeast Asia** series acts as a platform for serious analyses by selected authors who are experts in their fields. It is aimed at encouraging policy makers and scholars to contemplate the diversity and dynamism of this exciting region.

THE EDITORS

The Politics of the Asian Infrastructure Investment Bank (AIIB)

By Tang Siew Mun

EXECUTIVE SUMMARY

- Asia needs US$8.22 trillion to fund its infrastructure investment from 2010 to 2020, and existing lending institutions such as the Asian Development Bank (ADB) are unable to meet these requirements. Asia's annual funding requirement of US$747.5 billion is 4.5 times more than the ADB's subscribed capital.
- The Asian Infrastructure Investment Bank (AIIB) can potentially provide up to US$30 billion of funding a year. This would be on average three times more than the loans approved by the ADB in 2011–13.
- Every geographical region — except North and Central America — is represented in the AIIB. The United States and Japan are the only East Asia Summit members not in the AIIB. Japan is also the only major Asian economy that has not committed to joining.
- The participation of European countries transforms the AIIB from a regional institution with a singular power base (China) to an entity that is broad-based and inclusive. The "European weight" was particularly important in redressing the institutional imbalance skewed in China's favour and may reduce small states' concerns about Chinese domination.
- Washington's response to the AIIB initiative has been a strategic misreading that failed to anticipate its allies' reactions in warming up to and eventually supporting the proposal. East Asian countries will now be watching what effect the Chinese initiative and American non-participation will have on the U.S. rebalance to Asia.
- The AIIB effectively breaks the American, European and Japanese monopoly on global financing, and concomitantly provides China

with a new mechanism to expand its political influence in the region and make a bid for regional leadership. It signals the changing order in Asia.

- China's management of the AIIB will indicate to Southeast Asia how China exercises its large and still growing power. Whether China will opt for just and benevolent leadership or one exercised with an iron fist will decide the region's perceptions of China.
- In bankrolling the AIIB, China is stepping up to assume its responsibility as a major power in committing financial resources, having political will, and espousing a long-term view and sustained interest to drive and lead regional development.

The Politics of the Asian Infrastructure Investment Bank (AIIB)[1]

By Tang Siew Mun[2]

INTRODUCTION

The idea of establishing the Asian Infrastructure Investment Bank (AIIB) was officially announced by Chinese President Xi Jinping during his state visit to Indonesia on 2 October 2013. He offered Chinese financial assistance to drive infrastructure development and noted that China "will cooperate with existing multilateral development banks to make full use of their respective advantages and jointly promote the sustained and stable growth of the Asian economy".[3] About a year later, twenty-one countries inked the Memorandum of Understanding on Establishing AIIB in Beijing, on 24 October 2014.[4] China also announced an open invitation to interested states, and set 31 March 2015 as the deadline for founding membership.

AIIB brings together a diverse range of countries that span beyond East Asia. The twenty-one signatories of the MOU are Bangladesh, Brunei, Cambodia, China, India, Kazakhstan, Kuwait, Laos, Malaysia, Mongolia, Myanmar, Nepal, Oman, Pakistan, the Philippines, Qatar,

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[1] This paper draws its analysis from the official membership listing as of 15 April 2015. The author thanks and acknowledges Mr Daljit Singh and Dr Malcolm Cook for their insightful comments and useful suggestions to improve this paper. Any remaining omissions are my own.

[2] Tang Siew Mun is a Senior Fellow at the Institute of Southeast Asian Studies (ISEAS), Singapore.

[3] <http://news.xinhuanet.com/english/china/2013-10/02/c_132769208.htm>.

[4] <http://news.xinhuanet.com/english/business/2014-10/24/c_133740149.htm>.

Singapore, Sri Lanka, Thailand, Uzbekistan and Vietnam. The deadline for founding membership has now passed, and fifty-seven countries have joined the bank in that capacity. The number of ordinary members is set to rise in the near term.

This article approaches the establishment of the AIIB from a political-strategic angle, and discusses the significance and impact the bank has on regional and global politics.

ASIA'S THIRST FOR INFRASTRUCTURE FUNDING

The story of the twenty-first century is one of the re-emergence of Asia, especially China. The 2015 PwC's *World in 2050* reported that China has overtaken the United States as the world's largest economy (in PPP terms) in 2014.[5] The other equally important part of the Asian Century story is the rise of the "rest of Asia". India could see its GDP (PPP) rising from US$7,277 billion in 2014 to US$42,205 billion by the middle of the century.[6] By 2050, Asia[7] will have eleven countries placed among the top twenty-five in the world in terms of GDP (PPP).[8]

But Asia's rise is not a foregone conclusion and is premised on various factors, including the fostering of a business-friendly environment, the nurturing of innovativeness, the combating of corruption and the maintenance of political stability. One major factor that has lagged behind the otherwise sterling economic achievements is infrastructure development. The Asian Development Bank (ADB) reported that "1.5 billion people in Asia and the Pacific have no access to improved sanitation, 638 million have no access to improved drinking water, and

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[5] <http://www.pwc.com/gx/en/issues/the-economy/assets/world-in-2050-february-2015.pdf>.

[6] The report attached a caveat to India's rise which is premised on it implementing a ,"sustained programme of structural reforms".

[7] Defined loosely to include the countries of Northeast, Southeast and South Asia.

[8] The countries are as follows (ranking in parenthesis): China (1), India (2), Indonesia (3), Japan (7), Pakistan (15), South Korea (17), the Philippines (20), Thailand (21), Vietnam (22), Bangladesh (23) and Malaysia (24).

930 million have no access to electricity sources. Only three out of ten people have access to telephone services and only 53.4 per cent of the total road network in Asia of 5.66 million km is paved."[9]

With some exceptions, the state of infrastructure across South and Southeast Asia is clearly below par. Only five of the fourteen regional countries surveyed in the World Economic Forum's Global Competitiveness Report obtained scores above the mean of 3.50 for infrastructure (see Table 1). The regions' combined average score of 3.68 points highlights the pressing need for South and Southeast Asia to improve and bolster infrastructure development and public works.

More specifically, a joint study by the ADB and the Asian Development Bank Institute estimated that Asia's infrastructure investment needs in 2010–20 is at US$8.22 trillion (see Table 2). The thirty-two developing economies of Asia would require an average of US$747.5 billion annually to fund its infrastructure maintenance and modernization requirements.

To put this gargantuan sum into perspective, the ASEAN-5 countries (Indonesia, Malaysia, Philippines, Singapore and Thailand) have (as of January 2015) US$712.465 billion[10] in foreign reserves, which would barely cover the infrastructure funding requirements for a year. The ADB is an important source of funding for Asian states, but it lacks the financial resources to meet the region's infrastructure financial needs. In fact, the region's annual infrastructure financing needs of US$747.5 billion is about 4.5 times the ADB's subscribed capital.[11] In 2011–13, the ADB approved loans totalling an average of US$10.9 billion a year, which translates to 1.22 per cent of the total annual funding that Asia needs. In comparison, ANZ Research estimates that the AIIB could provide up to US$30 billion of funding a year.[12]

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[9] Biswa Nath Bhattacharyay, "Estimating demand for Infrastructure, 2010–2020", in *Infrastructure for Asian Connectivity*, edited by Biswa Nath Bhattacharyay, Masahiro Kawai and Rajat M. Nag (Cheltenham: Edward Elgar, 2012), p. 20.

[10] <https://www.imf.org/external/np/sta/ir/IRProcessWeb/colist.aspx>.

[11] The ADB's subscribed capital is US$162.8 billion (2013) <http://www.adb.org/site/investors/credit-fundamentals/capital-structure>.

[12] ANZ Research, *The AIIB: China's Rising Influence in Asian Development Finance*, 26 March 2015, p. 6.

Table 1: Global Competitiveness Index, 2014–15 (Infrastructure)

	Infrastructure	
Country	**Rank**	**Score**
Southeast Asia		
Brunei	n.a.	n.a.
Cambodia	107	3.05
Indonesia	56	4.37
Laos	94	3.38
Malaysia	25	5.46
Myanmar	137	2.05
Philippines	91	3.49
Singapore	2	6.54
Thailand	48	4.58
Vietnam	81	3.74
South Asia		
Bangladesh	127	2.45
India	87	3.58
Nepal	132	2.15
Pakistan	119	2.66
Sri Lanka	75	4.02

Source: World Economic Forum, *The Global Competitiveness Report 2014–2015* (Geneva: 2014), pp. 16–17.

The case for the AIIB boils down to demand outstripping supply. The high demand for quality financing is unlikely to be met by the ADB alone. The AIIB can therefore alleviate pressure on the ADB and provides an additional source of funding for Asian infrastructure development. Set up with an initial capitalization of US$50 billion,[13] it will serve to narrow the gap between the demand and supply sides of infrastructure financing.

[13] The authorized capitalization is US$100 billion.

Table 2: National Infrastructure Investment Needs in Asia: 2010–20

Sub Region	% of total Asian investment need	Estimated investment needs (US$ millions)	Investment as % of total		Total investment per year	Total investment per capita (US$)	2008 GDP per capita (constant 2000 US$)
			New capacity (%)	Maintenance (%)			
Central Asia	4.544	373,657	54	46	33,969	1,403	753
East and Southeast Asia	66.553	5,472,327	71	29	497,484	2,886	1,765
South Asia	28.829	2,370,497	63	37	215,500	1,756	685
The Pacific	0.073	6,023	30	70	548	625	840
Total Asia	100	8,222,503[a]	68	32	747,500[b]	2,335	1,272

Note: a. The apparent error in total estimated investment needs for Asia of US$8,222,503 is from the original. The total should read as US$8,222,504.
b. The total should add up to 747,501. The miscalculation is in the original.
Source: Adapted from Biswa Nath Bhattacharyay, "Estimating Demand for Infrastructure, 2010–2020", in *Infrastructure for Asian Connectivity*, edited by Biswa Nath Bhattacharyay, Masahiro Kawai and Rajat M. Nag (Cheltenham: Edward Elgar, 2012).

MEMBERSHIP: WHO'S IN, WHO'S OUT?

The process founding the AIIB started in Beijing on 24 October 2014 with the signing of the instrument of establishment. Twenty countries immediately joined China as founding members. Indonesia was the sole ASEAN member not among the original signatories. Other notable absentees were Australia, Japan, New Zealand, Russia, South Korea and the United States.

Indonesia had then just completed its presidential and parliamentary elections, and inaugurated a new president just four days earlier, on 20 October 2014. President Susilo Bambang Yudhoyono had deferred the decision on Indonesia's ascension to his successor, and Indonesia, as expected, joined the AIIB about a month later. New Zealand had applied for membership two months before Indonesia and had its application approved on 5 January 2015.

The United States had, on the onset, expressed concerns on the bank's governance, transparency and provision for environmental safeguards. It also used its considerable diplomatic influence to apply pressure on its regional allies against supporting the AIIB. The *Australian Financial Review* reported that U.S. Secretary of State, John Kerry, "had personally asked Australian Prime Minister Tony Abbott to keep Australia out of the AIIB".[14] In a similar vein, the *Japan Times* quoted unnamed U.S. government official and diplomatic sources saying that the United States "has applied pressure behind the scenes on South Korea to refrain from joining the AIIB".[15]

Washington's lobbying succeeded in keeping its Pacific allies from committing to the AIIB. Beijing continued to court Seoul and Tokyo to join the initiative, but to no avail. The latter's Chief Cabinet Secretary, Yoshihide Suga, reinforced Japan's scepticism and remarked that "China has not given a clear response to Japan's concerns about the bank's

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[14] <http://www.reuters.com/article/2014/11/05/us-china-aiib-idUSKCN0ID08U20141105>.

[15] <http://www.japantimes.co.jp/news/2014/07/05/national/politics-diplomacy/japan-reluctant-join-china-led-investment-bank/>.

governance".[16] China may have the financial means to bankroll the AIIB, but getting Japan and South Korea on board would greatly enhance the bank's legitimacy and standing.

The announcement by the U.K. Chancellor of the Exchequer George Osborne on 12 March 2015 that the United Kingdom will join the AIIB, paved the way for other countries to join. Almost overnight, the AIIB was transformed from a low-profile Chinese-initiative supported by ASEAN and a sprinkling of countries from South Asia, Central Asia and the Middle East, into a major international financial institution.

By the end of the application deadline, nineteen European states were on the AIIB roster. Australia and South Korea applied to join in the United Kingdom's wake, leaving Japan and the United States as the only non-AIIB members from the East Asia Summit (EAS) grouping. The total membership of the AIIB had more than doubled, from twenty-one to fifty-seven (see Table 3). Every geographical region — except North and Central America — is represented.

Taiwan's application to join the AIIB as a founding member was rejected by Beijing but it left the door open for the former to join under a "different name". An official from China's Taiwan Affairs Office remarked that "a solution can be found regarding Taiwan's participation in the AIIB in a proper capacity through pragmatic consultation".[17] The international presses had reported that North Korea's application was also rejected but this contention was refuted by China. In response to a question on North Korea's rejected application, for example, Hua Chunying, a spokeswoman for the Ministry of Foreign Affairs remarked that she was unaware of the rejected application.[18]

Europe constitutes the largest geographical grouping within the bank with nineteen member states. Southeast Asia (10), Middle East (9)

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[16] <http://the-japan-news.com/news/article/0002048869>.

[17] <http://www.ft.com/cms/s/0/46745152-e1b1-11e4-8d5b-00144feab7de.html#axzz3XH2NOGiQ>.

[18] <http://www.ibtimes.com/china-clueless-about-rejecting-north-koreas-aiib-application-official-1865994>.

Table 3: AIIB Membership by Region and Country[a]

Region	Countries
Southeast Asia (10)	Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam
Northeast Asia (3)	China, Mongolia, South Korea
South Asia (6)	Bangladesh, India, Maldives, Nepal, Pakistan, Sri Lanka
Australasia (2)	Australia, New Zealand
Central Asia (5)	Azerbaijan, Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan
Middle East (9)	Israel, Iran, Jordan, Kuwait, Oman, Qatar, Saudi Arabia, Turkey, United Arab Emirates
Africa (2)	Egypt, South Africa
Europe (19)	Austria, Denmark, Finland, France, Georgia, Germany, Iceland, Italy, Luxembourg, Malta, the Netherlands, Norway, Poland, Portugal, Russia, Spain, Sweden, Switzerland, United Kingdom
South America (1)	Brazil
Others (1)	Hong Kong[b]

Notes:
a. As of 15 April 2015.
b. Hong Kong is not classified as a full member as its participation is managed through China.

and South Asia (6) are the other significant geographical clusters. The AIIB's geographical footprint is expected to expand as countries such as Argentina, Belgium, Canada, Mexico and Ukraine have either indicated their interest or are considering to join the bank.

IMPLICATIONS OF THE AIIB'S EXPANDING MEMBERSHIP

Among the nineteen European states that have become members, thirteen are members of the U.S.-led NATO alliance; four are G-7 members and four are permanent members of the UN Security Council (UNSC). Their participation in the new bank cannot but bring considerable strength, credibility and prestige to the bank, and may help mitigate strategic concerns harboured by small states in Asia.

The impact of Europe's participation in the AIIB is twofold. First, the breadth and depth of the political and financial weight that the nineteen European countries bring to the bank transforms the AIIB from a regional institution with a singular power base (China) to an entity that is broad-based and inclusive. The "European weight" will be particularly important in redressing the institutional imbalance skewed in China's favour and may reduce small states' concerns about Chinese domination.

Second, the U.K.'s participation in the AIIB had lowered the political cost for Washington's Pacific allies to follow suit. The fact that the United States had recently softened its stance suggests that Washington regards the AIIB as a fait accompli. Speaking at the Asia Society in San Francisco, U.S. Treasury Secretary Jacob Lew remarked that "the U.S. stands ready to welcome new additions to the international development architecture".[19] The larger challenge for Washington is its ability to sustain its Pacific allies' sight on the larger strategic picture. Unless the Chinese threat manifests itself in the near term much more starkly, Australia and South Korea will continue to have internal tensions between strategic considerations and their economic interests with China.

Tokyo has announced that a decision on the AIIB will be forthcoming in June. That decision is made more complicated by its rivalry with China, and compounded by anxieties of the AIIB outshining the Japanese-led ADB. Beijing has gone to considerable lengths to court Tokyo, even to the point of offering Japan the number two position in the bank. Beijing's AIIB point man, Jin Liqun, offered the position of "a top-ranking vice

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[19] <http://asiasociety.org/blog/asia/us-treasury-secretary-softens-view-china-led-infrastructure-bank-stresses-high-standards-a>.

president and the post of a director representing only Japan",[20] but these conciliatory overtures were rebuffed by Tokyo.

From Japan's vantage point, taking up the vice-presidency may infer that it will be playing second fiddle to China and be tantamount to it accepting Chinese leadership. This is not a pleasing proposition to the conservative end of Japan's political spectrum. In addition, the extant anxieties held in Tokyo over the diminishing influence of the Japanese-led ADB will also factor in the decision to support the AIIB. The specter of the "historical issues" may also come into play in Japan's prospective membership. It was thus unsurprising that Japan felt compelled to regain the initiative and to assert its leadership credentials through its own yen diplomacy. To counter the Chinese-led bank, the Japanese premier, Shinzo Abe recently announced that Japan will "offer roughly [US]$110 billion in the next five years to fund 'high-quality infrastructure investments' in Asia through various channels, including expanding the Asian Development Bank's lending capacity and yen loans from the Japanese government."[21] However, at the point of writing, Japan has not officially ruled out joining the AIIB.

The U.S. failure to impose its will on its close allies regarding the AIIB makes it the first credible challenge to American global leadership and power since the collapse of the Soviet Union. Lawrence Summers, Obama's former National Economic Council director, offers a critical view of what he perceives to be U.S. strategic and tactical mistakes as follows:

> This past month [March 2015] may be remembered as the moment the United States lost its role as the underwriter of the global economic system.… I can think of no event since Bretton Woods comparable to the combination of China's efforts to establish a major new institution and the failure of the U.S. to persuade

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[20] <http://asia.nikkei.com/Japan-Update/China-offered-Japan-No.-2-post-at-new-bank>.

[21] <http://www.wsj.com/articles/japan-plans-to-expand-infrastructure-investment-in-asia-1432206297>.

dozens of its traditional allies, starting with Britain, to stay out of it.[22]

To posit that the United States is in decline would be inaccurate as power is a relational concept and requires a referent object for it to have meaning. It bears reminding that U.S. power is still dominant. However, as Chinese power is growing at a faster rate than the U.S., one may say that the United States is in decline, *relative* to China.

EUROPE'S PARTICIPATION AS A GAME CHANGER

The Western European (E15)[23] states bring an immediate strategic impact to the AIIB. Without these states, China would dominate the bank by virtue of its GDP weight. In terms of GDP weight, Figure 1 shows China as the single largest voting block with 35 per cent. The inclusion of E15 changes the balance of power in the bank by reducing China's GDP weight in the bank from 35 per cent to 22 per cent. By the same token, the E15 states will make up 39 per cent of the total GDP weight (see Figure 2). To be sure, the E15's GDP weight will not translate en bloc into voting share as China has proposed limiting non-Asian voting shares to 25 per cent, while it takes up a 50 per cent share, with the remaining 25 per cent share going to the Asian members (see Figure 3).

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[22] <http://www.washingtonpost.com/opinions/a-global-wake-up-call-for-the-us/2015/04/05/6f847ca4-da34-11e4-b3f2-607bd612aeac_story.html>.

[23] For the purpose of this paper, Western Europe refers to the fifteen European and Scandinavian countries that have either joined or submitted their applications to join the AIIB by 31 March 2015. These states are Austria, Denmark, Finland, France, Germany, Iceland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom. When appropriate they will be referred to by the abbreviation "E15." The E15 countries are differentiated from other European countries (i.e., Georgia, Malta, Poland and Russia) as the former grouping is more cohesive in terms of their political culture and outlook on international issues.

Figure 1: Distribution of Shares by GDP without Western European and Scandinavian Members (E15)

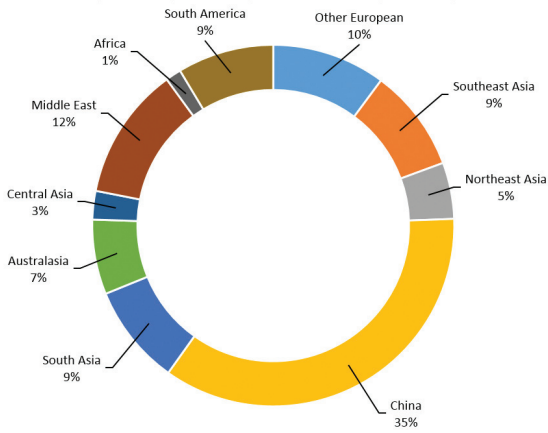


Figure 2: Distribution of Shares by GDP with Western European and Scandinavian Members (E15)

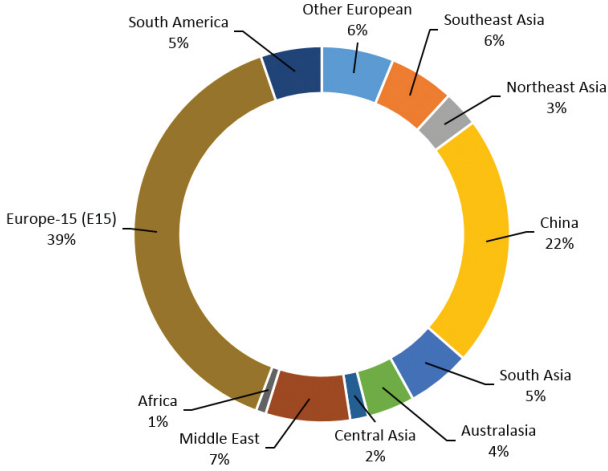
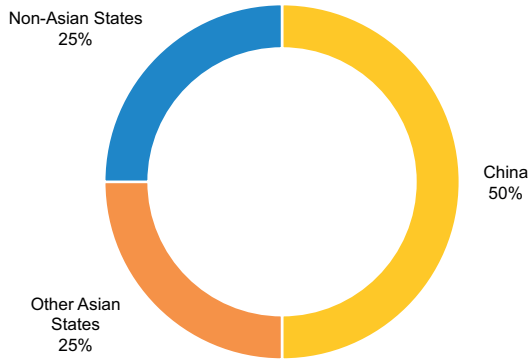


Figure 3: Distribution of Voting Shares (China's Proposal)



Europe's institutional power within the AIIB will thus be constrained if Beijing is able to push through the 50-25-25 ratio formula. The Secretary-General of the Multilateral Secretariat of Establishing the AIIB, Jin Liqun explained that "when China first invited developed European countries to join, it was not to raise capital but rather to capitalize on their experience in corporate governance and technical support in promoting the development of the AIIB."[24]

The capping of the voting share for non-Asian participants at 25 per cent is instructive in two aspects. First, the cap on non-Asian capital subscription provides Europe with a respectable allocation of voting rights to embed their interest within the bank, but not to a level that can seriously challenge China's leadership. At face value, Europe's standing may be circumscribed within the 25 per cent cap, but in fact, its influence can potentially go beyond the numerical threshold. The political and diplomatic weight of major European states like Germany, France and the United Kingdom rest with their financial and management expertise.

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[24] <http://www.wantchinatimes.com/news-subclass-cnt.aspx?id=20150404000097&cid=1101>.

Their importance also flows from their potential strategic partnerships with ASEAN states, Australia and South Korea to ensure high standards of bank governance and to keep Chinese political ambitions in check.

Second, Jin's statement can help to assuage criticisms of China's administrative and diplomatic inexperience in running a multilateral financial institution. In soliciting Europe's assistance to build the bank, China has effectively transformed the bank's erstwhile sceptics into stakeholders. The 25 per cent limit will minimize the European states' financial outlay and their payments to the bank. This provides in effect a low-risk and cost-effective means for Europe to earn China's goodwill and to engage Asia.

THE STRATEGIC IMPACT OF THE AIIB

The genesis and objectives of the bank are ostensibly economic. Its *raison d'être* is to sustain Asia's economic growth by providing funding for infrastructure development, broadly defined to include a geographical area that spans the entire Asian continent. The impact of the AIIB, however, goes beyond economics.

It is undeniably a manifestation of China's growing power and ambition. Decades of continuous growth have propelled China up the ranks of major powers. It overtook Japan as the world's second largest economy in 2010 and effectively became the largest economy in East Asia. However, Beijing has not seen its new economic power transformed into tangible political power as it found that most global and regional avenues of leadership were either closed or tightly controlled by the Western powers and Japan. This is true of the World Bank, the International Monetary Fund (IMF) and ADB. Reforms at the IMF intended to address the new global distribution of power that would increase the voting share of emerging economies, including increasing China's voting share from 3.81 per cent to 6.07 per cent, were effectively stymied by the U.S. Congress.

There is, however, growing acceptance by the Western powers that integrating China into the global financial architecture serves the common good. It was in this spirit that IMF Managing Director Christine Lagarde appointed a Chinese national to the bank's senior management in the newly created position of Deputy Managing Director in 2011.

Nevertheless, China remains underrepresented in the IMF and ADB (see Table 4). For example, China's voting share (3.81 per cent) at the IMF is just fractionally higher than the combined voting share of all ASEAN states (3.76 per cent) although the Chinese economy is about 375 per cent larger than ASEAN's (see Table 4). Similarly, ASEAN's combined voting power (13.637 per cent) in the ADB is almost 2.5 times larger than that of China's (5.474 per cent). In terms of leadership, the top post in the IMF, World Bank and ADB are, by tradition, held by an European, American and Japanese respectively. Notwithstanding the IMF's initiative to provide China a suitability appointed senior position at the bank, China's profile and stake in the ADB, IMF and World Bank trail that of the United States, Japan and the major European states.

The AIIB helps China to achieve several strategic objectives. First, China will use the AIIB's resources to finance and support the "one belt, one road" programme which covers the New Silk Road Economic Belt and Twenty-first Century Maritime Silk Road. The economic incentives for China to construct the two land and sea "highways" point to China's continental and maritime ambitions. Second, the AIIB provides the strategic space for China to exercise regional leadership and to cultivate friends and allies. Third and more importantly, by building and supporting regional architectures such as the AIIB, China is in fact institutionalizing its regional leadership. Fourth, the participation of United Kingdom, France, Germany and other major economies have the effect of an informal acceptance of China's regional leadership.

At its core, the AIIB is a challenge to the status quo. United States concerns that the AIIB will diminish its influence in the global financial architecture is valid as the latter provides an alternative to Bretton Woods institutions and the ADB. The AIIB effectively breaks the American, European and Japanese monopoly on global financing, and concomitantly provides China with a new mechanism to expand its political influence in the region. As Hugh White assessed it, the "AIIB was a very big deal for Asia's economic future, but the way its establishment has played out makes it an even bigger deal for Asia's changing political and strategic order."[25]

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[25] <http://en.people.cn/business/n/2015/0331/c90778-8871838.html>.

Table 4: Voting Power of Selected ADB and IMF Members

	ADB		IMF	
Country	**Subscribed Capital (%)**	**Voting Power (%)**	**Quota (%)**	**Votes (%)**
Total ASEAN	13.316	13.637	3.68	3.76
Brunei	0.354	0.581	0.09	0.11
Cambodia	0.05	0.338	0.04	0.06
Indonesia	5.173	4.437	0.87	0.85
Laos	0.014	0.310	0.02	0.05
Malaysia	2.734	2.486	0.74	0.73
Myanmar	0.547	0.736	0.11	0.13
Philippines	2.392	2.212	0.43	0.43
Singapore	0.342	0.572	0.59	0.59
Thailand	1.367	1.392	0.60	0.60
Vietnam	0.343	0.573	0.19	0.21
Total G-7	53.499	45.186	45.37	43.09
Canada	5.252	4.500	2.67	2.56
France	2.337	2.168	4.51	4.29
Germany	4.344	3.773	6.12	5.81
Italy	1.815	1.750	3.31	3.16
Japan	15.670	12.835	6.56	6.23
United Kingdom	2.051	1.939	4.51	4.29
United States	15.560	12.747	17.69	16.75
Australia	5.810	4.946	1.36	1.31
China	6.470	5.474	4.00	3.81
India	6.357	5.384	2.44	2.34
New Zealand	1.542	1.532	0.38	0.38
South Korea	5.058	4.345	1.41	1.37

Source: Asian Development Bank, International Monetary Fund.

THE DYNAMICS OF INSTITUTIONAL DESIGN

Institutions are constructed largely to reflect the interests of their patrons and designers. The AIIB is no different. As the progenitor of the proposal, China has reserved for itself several privileges. First, it has the prerogative over the question of membership. Until the Articles of Association (AOA) are negotiated and ratified, China has the singular authority to approve and reject membership applications. Second, China will hold the bank's presidency. Jin Liqun, is widely tipped to be the bank's first president. Third, the bank will be located in Beijing, despite reported interests from South Korea and Indonesia to host it.

At present, there are two categories of membership — founding members and ordinary members. Applications received by 31 March 2015 and subsequently approved will join the bank as founding members and participate in the Chief Negotiators' Meeting of Asian Infrastructure Investment Bank (AIIB) Establishment, which is tasked to draft the AOA. Applications received after the deadline will join as "ordinary" members. It is unclear at this point if the two-tier membership will be maintained after the ratification of the AOA. There is also no indication if ordinary members will have the same rights as the founding members. In all likelihood, the two-tier division will merge into a single membership category after the AOA is concluded, in order not to disincentivize new memberships.

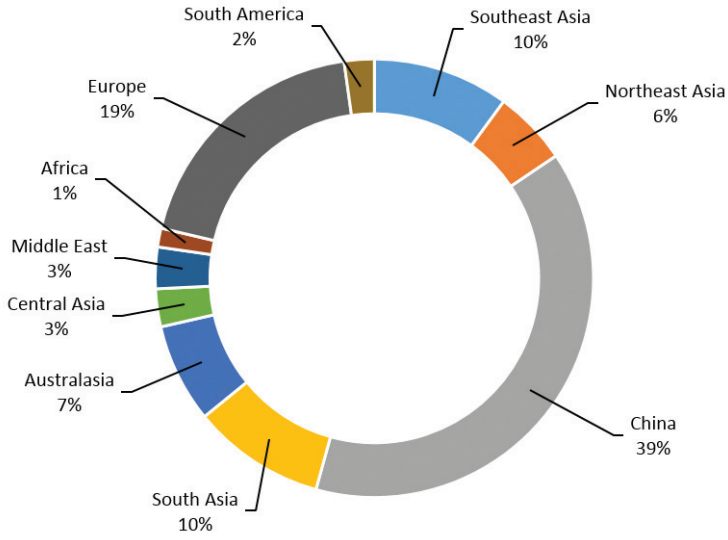
The formula for deriving the bank's voting share has not been made public at the time of writing. If GDP is the key component in determining the control and management of the bank, China's position as the world's second largest economy would ostensibly provide Beijing with considerable and unrivalled control of the bank. But this is not the case. While China will hold the single largest block of votes if the voting share is calculated based on its GDP (22 per cent), its influence could potentially be eclipsed by the collective action of the E15 states holding 39 per cent of the voting rights (see Figure 2).

China has initially proposed to anchor the bank by underwriting half of the bank's subscribed capital as a commitment to assist the region's infrastructure development, but this was also a calculated move

to address the potential problem of under-subscription of capital. The support received surprised Beijing, especially from among the advanced and high-income economies. Advanced economies like Germany, France and the United Kingdom will be net donors and provide more capital than the recipient countries from Southeast Asia and South Asia. However, the higher uptake of capital from Europe comes at a political cost to China which could potentially see its voting share fall to less than a quarter.

However, the formulation of the "75-25" split between Asian and non-Asian members swings the political pendulum back in China's favour. Limiting the voting share of non-Asian members to 25 per cent and reserving the remaining 75 per cent voting share to Asian states will see China increasing its voting share to 39 per cent (see Figure 4). By the same token, the E15 states' share will shrink to 17 per cent. The 75-25 formula allows for China to maintain the single largest voting block without approaching the majority threshold to pre-empt concerns of a Chinese veto and domination.

Figure 4: Distribution of Voting Share by the "75-25" formula



China has responded to veto concerns by clarifying that it does not seek such a privilege. Its Ministry of Foreign Affairs spokesperson, Hua Chunying explained that "[a]s the number of member states increases, the shares each country holds will decrease accordingly. Therefore the claim that China is seeking or giving up the right of a one-vote veto does not stand."[26] Whether China acquires veto power rests with the outcome of the AOA negotiations. The 75-25 formulation prevents China from gaining a mathematical veto (i.e., majority of 51 per cent), but the veto could be obtained from the provision of the decision-making process. The U.S. veto in the World Bank is a case in point. Whilst holding only 16.21 per cent of the voting rights, the United States commands a veto through Article VIII(b) which requires the concurrence of 85 per cent of the votes to pass amendments to the bank's Articles of Agreement.[27] The importance of the Chief Negotiators' Meeting becomes self-evident in ensuring that the distribution of power is not skewed towards any one party or group. If that proves to be the case, China could potentially win over many friends and sceptics by affirming the principles of democracy in the bank's governance by eschewing veto power, bearing in mind that it has long clamoured against the "undemocratic" nature of the Bretton Wood institutions.

China is not the only country using the AIIB to advance its political standing and influence. Indonesia and India have also made known their political aspirations in vying for the bank's vice-presidency post. India's case is boosted by the possible allocation of the second highest block of voting rights under the 75-25 formula at 7.94 per cent. According to Indian media reports, India is likely to be offered the vice-presidency on the basis of commanding the second largest share of voting rights based on a formula that incorporates GDP and GDP per capita figures.[28]

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[26] <http://english.cntv.cn/2015/03/25/VIDE1427282882317997.shtml>.

[27] <http://siteresources.worldbank.org/BODINT/Resources/278027-1215526322295/IBRDArticlesOfAgreement_English.pdf>.

[28] <http://www.business-standard.com/article/pti-stories/india-likely-to-become-vice-president-of-china-floated-aiib-115042200813_1.html>.

Indonesia's Finance Minister, Bambang Brodjonegoro, on the other hand, had presented the case that "Indonesia is an important country and possibly will become the biggest client for the new lender. At least we must have the post of vice president."[29] The fact that India will helm the BRICS Bank may work against its interest in securing the number two position in the AIIB. In selecting the bank's deputy, China will have to balance between the exigencies of geopolitics and institutional efficiency. Going by IMF and World Bank models, there is ample room for China to accommodate the diverging interests. The World Bank's senior leadership structure consists of, among others, two managing directors, three senior vice-presidents and twenty-two vice-presidents. The IMF has a more compact structure with one first deputy managing director and three deputy managing director posts. Increasing the number of senior leadership positions would allow for a more inclusive and representative structure. It would be useful for the bank to leverage on Europe's expertise and experience in international development by reserving a senior leadership position from one major European state. Singapore's status as a regional financial hub with stringent regulatory oversight and monitoring could also make it a contender for one of the senior positions.

As the jostling for the senior leadership positions continues, the founding members would have to decide between a resident or non-resident board of directors. In enunciating that the AIIB will be "lean, clean and green," China appears to be in favour of preventing a bloated bureaucracy that would also be expensive to maintain. There are pros and cons to the two options. Having a resident board of directors will increase the bank's operation and remuneration costs, but it will also mean that the board will be able to perform direct and immediate supervisory functions. From a political standpoint, a resident board will also act as a political counterweight to China's management of the bank. It would be prudent for China to accede to suggestions for a resident board of directors to make the point that Beijing's management style and leadership is transparent and open to scrutiny. By empowering the

[29] <http://asia.nikkei.com/print/article/83877>.

resident board of directors, China will be sending out a political message that it is providing a new brand of leadership that is inclusive and multilateral.

IMPLICATIONS AND LESSONS FOR SOUTHEAST ASIA

Moving beyond developmental issues, the AIIB is instructive in at least three aspects. First, as Chinese political power grows, so has the region's anxiety about the tone and nature of Chinese leadership. There is no precedence of contemporary Chinese regional leadership, and China's first foray into uncharted waters through the AIIB will provide ASEAN states with an insight into China's exercise of its large and still growing power. In this regard, the ongoing negotiations on the AOA will attract scrutiny. Will China push for veto power? Will it use the bank to reward friends and by the same token punish those who run afoul of Chinese interest? Will China use the AIIB as a mechanism to embrace ASEAN as a partner in regional development, or will China prove its critics right in using the financial institution for the singular purpose of extending and consolidating its national interest in the region? In sum, the bank will be a test of Chinese strategic intentions.

Second, the U.S. decision to stay out of the AIIB gives ASEAN pause to contemplate U.S. commitment to its rebalancing strategy. The crux of the strategy calls for Washington to renew its commitment to the region by deepening its relations across all fronts, including politics, economics, trade, people-to-people and military. With prospects for the Trans-Pacific Partnership uncertain, the United States may be hard pressed to deal with the Chinese leadership bid as evident from the AIIB and the two associated silk roads.

Third, the AIIB is an affirmation of China's political commitment to the region. Infrastructure financing is a high-risk, low-returns venture that demands a long gestation period to bear fruit. In pledging to provide half of the bank's capitalization, China is framing the initiative as Beijing's long-term investment in the region. China has so far been a laggard in its foreign direct investment in Southeast Asia (see Table 5). Although China is the region's largest trade partner with some US$350.5

Table 5: Foreign Direct Investment Flows into ASEAN by Country, 2010–12

Source Country	2010		2011		2012	
	US$ million	% of total FDI	US$ million	% of total FDI	US$ million	% of total FDI
China	4,052	4.04	7,858	8.06	5,377	4.70
EU-28	19,018	18.95	29,693	30.44	18,085	15.82
Japan	11,171	11.13	9,709	9.95	23,777	20.81
USA	12,285	12.24	9,130	9.36	11,080	9.7

Source: ASEAN Secretariat, *ASEAN Economic Community in Figures (Special Edition 2014)* (Jakarta: ASEAN Secretariat, 2014).

billion trade in 2013,[30] it trails behind the EU and Japan in foreign direct investment in the region. For example, Japanese investments in Southeast Asia in 2012 were 4.4 times higher than China.[31] The 2013 preliminary FDI data[32] released by the ASEAN Secretariat showed China's share of FDI into ASEAN increasing to 7.1 per cent,[33] but China still has a long

[30] ASEAN Secretariat, *ASEAN Community in Figures (Special Edition 2014)* <http://www.asean.org/images/pdf/2014_upload/ACIF%20Special%20Edition%202014_web.pdf>.

[31] Japanese and Chinese investment in Southeast Asia for the year 2012 stood at US$23,777 million and US$5,377 million respectively. The corresponding numbers for 2013 (as of July) are US$22,904 million and US$8,644 million <http://www.asean.org/images/pdf/2014_upload/ACIF%20Special%20Edition%202014_web.pdf>.

[32] Does not include data for Laos.

[33] ASEAN Secretariat, *ASEAN Economic Community in Figures (Special Edition 2014)*, p. 85.

way to go in catching up with the EU-28 countries (22 per cent) and Japan (18.7 per cent).

China has also burnished its leadership credentials by initiating and carrying through the AIIB proposal. Most importantly, it is stepping up to assume its responsibility as a major power in committing financial resources, showing political will, and espousing a long-term view and sustained interest to drive and lead regional development. To be sure, the AIIB is still in its formative stage and it is thus premature to draw any inferences on its impact on China's regional leadership. At the same time, the United States continues to be well regarded in the region. A 2014 Pew Survey reported that respondents in four of the five Southeast Asian states (Indonesia – 47 per cent, Malaysia – 40 per cent, the Philippines – 68 per cent and Vietnam – 56 per cent) picked the United States as the world's leading economic power. The lone outlier is Thailand where 34 per cent of respondents favoured China.[34] On the other hand, a plurality of Indonesian (42 per cent), Malaysian (38 per cent) and Thai (44 per cent) respondents held the opinion that "China will replace or has replaced the United States as a superpower." Although the region's optimism on China is counteracted by a strong majority in the Philippines (74 per cent) and Vietnam (69 per cent) who think that China will never unseat the United States, the general perception points to an increasingly more powerful and influential China. The AIIB has the effect of reinforcing this perception and may help to sway Southeast Asia's attention towards Beijing and away from Tokyo, Washington and Brussels.

CONCLUSION

From China's vantage point, the AIIB has been a resounding success even before the total number of members went past fifty. For starters, it could claim a major political victory over the United States in attracting some of Washington's staunchest allies into its fold — against the express wishes of the United States. This may be a harbinger of future lapses in the U.S.-

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[34] http://www.pewglobal.org/2014/07/14/chapter-3-balance-of-power-u-s-vs-china/

led alliance system when Washington cannot as easily use the Chinese threat argument and have its allies fall in line unconditionally. China's economic magnetism is too powerful to ignore and the opportunity for the extra-regional states to strengthen their engagement with Asia is too important to pass over. China's growing political influence and activism is a new reality that Southeast Asia has to live with, and a fact that the United States has to come to grips with. The fact that the fifty-seven AIIB members represent 56.58 per cent of the world's GDP (2013) is an indication of the bank's potential as a viable international lender.

The AIIB conveys different strategic messages to different audiences. For Southeast Asia, the bank offers much more than an alternative funding for infrastructure investment. It brings additional resources to the region, and signals that China is willing to commit resources, political will and interest to undertake long-term and costly commitments to the region. It is also an important test of Chinese power. For non-Asian states (especially the European, Scandinavian, Brazil and Turkey), the AIIB is a golden opportunity to establish political in-roads in a region where they have not had much success in the past. The doors to the EAS and ASEAN Defence Ministerial Meeting Plus (ADMM+) remain closed, and the AIIB is thus an opportunity for them to build and strengthen political ties with Southeast Asia through economic diplomacy. The perception in Washington is less optimistic. The AIIB is a challenge to the Bretton Woods system and to the Western-led monopoly of international development financing. Having been dealt a diplomatic blow in seeing one ally after another joining the bank, the United States must contemplate doing the same or hold onto its original position to stay out. If Washington decides on the latter course of action, the question then arises if the United States will continue to opt out of all future Chinese-led initiatives. Doing so would be tantamount not only to turning its back on China but on Asia as well. The same question applies to Japan.

The AIIB is a sign that China is not content at being a "silent #2". In this regard, Beijing will work towards creating strategic space for it to pursue its national interests if the Western-dominated international order fails to adjust to a risen China. Although concerns of China's dominance has not entirely dissipated, it is a good sign for the region that fifty-six other countries see the wisdom in choosing the path of engaging China

in a constructive manner instead of criticizing Beijing from the outside. The AIIB is a timely and relevant initiative for the region. The potential benefits of the bank go beyond the construction of roads and bridges as it serves to lay a path for China to forge collaborative partnerships with its neighbors and beyond. This does not mean that Chinese national interest has taken on an altruistic turn. Beyond diplomacy, China will link the AIIB to supporting its national economy, especially in moving surplus and excess construction materials, as well as to internationalize the renminbi in the region. The AIIB's will only work if Beijing is able to harmonize Chinese national interests with that of the region. Privileging the former over the latter will mark China as opportunistic and mercantilist.

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