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**U.S. – CHINA COMPETITION IN ASIA-PACIFIC REGION:  
THE AIIB AND THE NEW GLOBAL ORDER?**

Insill Park

May 2016

Master's Thesis  
Submitted in Partial Fulfillment of the Requirement for the Degree of Master of  
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## Abbreviations

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AIIB	Asian Infrastructure Investment Bank
ADB	Asian Development Bank
AOA	Article of Agreement
APEC	Asia Pacific Economic cooperation
ASEAN	Association of Southeast Asian Nation
BCIMEC	Bangladesh, China, India, Myanmar Corridor
BRICS	Brazil, Russia, India, China, South Africa
CEE	China Central Eastern European
CICPEC	China, Indochina Peninsula Economic Corridor
EBRD	European Economic Union
EEU	Eurasian Economic Union
FDI	Foreign Direct Investment
IFIs	International Financial Institution
IMF	International Monetary Fund
MDB	Multilateral Development Bank
MOU	Memorandum of Understanding
NATO	North Atlantic Treaty Organization
NDB	New Development Bank
OBOR	One Belt, One Road
RECP	Regional Comprehensive Economic Partnership
SCO	Shanghai Cooperation Organization
TPP	Trans Pacific Partnership

# Abstract

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## US – China Competition in Asia Pacific Region : The AIIB and the New Global Order?

China's initiation of the New Silk Road plan in late 2013 has a potentially huge impact on global development. The purpose of this thesis is to understand, the impacts of the China-led on the global financial system.

This paper highlights key issues related to finances and governance at the AIIB. The paper focuses on China's Silk Road Economic Belt framework and on how China's efforts to increase its economic integration in Asia Pacific Region.

The "One Belt and One Road" program is China's major strategic measure in response to the emerging trends in economic globalization, with the objectives of increasing convergence between nations and constructing a new open economic system.

To make this argument, I will focus on the China's high-speed rail investment around the world and examine available evidence to make a case for a paradigm change in global financing development system. I argue that China is establishing a new international financial architecture, which is shifting the regional economic order and fundamentally changing global economic governance.

# I . What is AIIB?

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## 1.1 Introduction

Since Chinese President Xi Jinping proposed the establishment of an Asian Infrastructure Investment Bank (AIIB) during his trip to Southeast Asia in October 2013, China has dedicated significant political, economic and diplomatic efforts toward paving the way for a successful new financial institution. China has made the AIIB a priority and has pushed for its successful debut by rallying regional support, broadening the membership base, and refining the bank's role.<sup>1</sup>

These efforts led to the signing of a Memorandum of Understanding (MOU) on AIIB's establishment by 21 Asian countries in October 2014 as well as applications by 57 other countries to become founding members of the bank before the deadline of March 31, 2015. After five rounds of intensive negotiations, 57 countries signed the Articles of Agreement (AOA) for the Asian Infrastructure Investment Bank on June 29, 2015 in Beijing.<sup>2</sup>

The new Asian Infrastructure Investment Bank (AIIB) will boost investment in the region while contributing to "fairer" global economic governance, Chinese President Xi Jinping said on Jan 16 at the formal opening ceremony in Beijing.<sup>3</sup> The China-backed

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<sup>1</sup> Website DW Institution, "China officially launches new development bank AIIB", Last accessed Jan 17, 2016. <http://www.dw.com/en/china-officially-launches-new-development-bank-aiib/a-18985025>,

<sup>2</sup> Yun Sun, "China and the Evolving Asian Infrastructure Investment Bank", *Sasakawa Peace Foundation USA*, ISBN: 978-0-9966567-0-2, 2015, p 27.

<sup>3</sup> AFP, "AIIB will boost investment in region: Xi", Last accessed Jan 16, 2016. <https://www.yahoo.com/news/aiib-boost-investment-region-xi-111758659--finance.html?ref=gs>

AIIB — which includes major economies such as Australia and South Korea but notably excluding the US and Japan — is viewed by some as a rival to the World Bank and Asian Development Bank (ADB).<sup>4</sup>

Beijing will be by far the largest AIIB shareholder with about a 30% stake, according to the legal framework signed by founding member countries. With authorized capital of \$100 billion, it expects to offer its first batch of project loans later this year 2016.<sup>5</sup>

This thesis analyzes the dynamics influencing the international system. This paper's research questions are two – fold.

First, what does china hope to gain from establishing the AIIB?

Second, how does the AIIB change China's place in geopolitics? Does the AIIB represent a fundamental challenge to the new existing international multilateral order?

Beijing has already sought to expand its influence through Xi's signature foreign policy initiative, known as “One Belt One Road”(OBOR), a massive investment scheme that aims to increase China's role in central Asia and in Europe through loans that build infrastructure and transport networks. Touted as a revival of ancient Silk Road trade routes, the initiative underscores China's ambition to wield increased geopolitical power.

China has had multiple aims in establishing AIIB. The most important (and arguably

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<sup>4</sup> Yun sun., p. 27.

<sup>5</sup> rt.com Institution, “China-led AIIB development bank officially launched, elects first president”, Last accessed Jan 16, 2016. <https://www.rt.com/business/329208-china-aiib-development-bank/>. The Board of Governors of the Asian Infrastructure Investment Bank (AIIB) has held its inaugural meeting, declaring the bank open for business and electing its first president, Jin Lique.



altruistic) one has been to help meet East Asia's need for increased infrastructure development funds. In addition, AIIB represents part of China's effort to "democratize" the international order, and has been described as Beijing's "first serious challenge to the U.S.-led global economic order established at Bretton Woods 70 years ago." Perhaps most importantly, AIIB could have important strategic implications for China's relations with countries in the region.

China's goals in forming AIIB are not free of internal inconsistencies and external controversies. Indeed, since China's initial announcement to establish the bank, the AIIB has raised many questions, touched on many sensitive issues and led to serious policy debates in and outside China. For example, there is an intrinsic tension between China's ambitious claims that AIIB will provide funding for necessary infrastructure projects — some of which may be financially risky— and the bank's identity as a multilateral development bank.<sup>6</sup>

With China the largest shareholder in AIIB and Beijing clearly pursuing some of its national interests through the bank, questions have also been raised about the extent to which AIIB's decision-making process and operations will be truly multilateral. The negotiation process that led to the AOA made China keenly aware of the incompatibility of some of its goals, in turn leading Beijing to adjust its expectations in key areas. The unexpected embrace of the bank by developed European countries, for example, created an opportunity to move AIIB toward prevailing international norms and standards.<sup>7</sup>

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<sup>6</sup> EPSC Strategic Notes, "A New Multilateral Financial Institution or a Vehicle for China's Geostrategic Goals", Apr 24, 2015. p 3.

<sup>7</sup> Tim Maverick, "TPP Versus AIIB: Obama's Uphill Battle", Last accessed Jul 21, 2015. [http://www.wallstreetdaily.com/2015/07/21/china-aiib-obama-tpp/](http://www.wallstreetdaily.com/2015/07/21/china-aiib-obama-tp/)

As a result, the AIIB reflected in the AOA today is quite different from the AIIB China envisioned before March 2015. In this sense, the evolution of AIIB may provide a model of how China's behavior can be shaped by the collective efforts of the international community and how China's ambitions can be accommodated without overturning the existing international order.

In sum, China has set out on a path to become a global super power and to achieve this objective it needs considerable leverage on the developing economies in Asia (and rest of the world). One of the ways to achieve this influence is by funding development projects in the nations with which it has trade ties or with which it wants to improve trade ties. A development bank with China being the major share holder will give China a great tool through which it can fund projects of its trade partners.

## **1.2 Significance of the AIIB**

How significant is China's challenge? Many view the AIIB as competition for existing International Financial Institutions (IFIs). As such the AIIB now also stands to divide the United States, Japan, and other Western countries. The most significant outcome of this ordeal is that the international community is finally,

“...rejecting the United States' obsession with being number one. Multilateralism is in vogue and in looking askance at the AIIB and China's efforts to assume global responsibility, the United States screwed up. It lost an opportunity for voting rights in the new bank and continued economic influence in the region, but more troublingly, the United States lost its first fair battle for global influence against

China”.<sup>8</sup>

This paper highlights key issues related to finances and governance at the AIIB. I focus on China’s Silk Road Economic Belt framework and the country’s efforts to increase economic integration in Asia Pacific Region.

Within such a strategic framework, China proposes a new approach to promoting worldwide economic prosperity and to benefiting other regions in terms of driving forward cross-regional economic integration through economic growth in China and Asia.

From a regional integration perspective, I argue that **The One Belt, One Road initiative** offers considerable potential in several economic, political, cultural, and strategic realms. Specifically, there will be new opportunities for China’s outbound investment and demanded improvements in infrastructure access and interconnection with China’s neighboring countries.

I argue that **Beijing is challenging the current global financial architecture**. It is reshaping an international norm, rules and institutions. The AIIB shifts the balance of economic power. China’s economic presence in Africa, Latin America and Europe challenges the long-standing economic primacy of the United States.

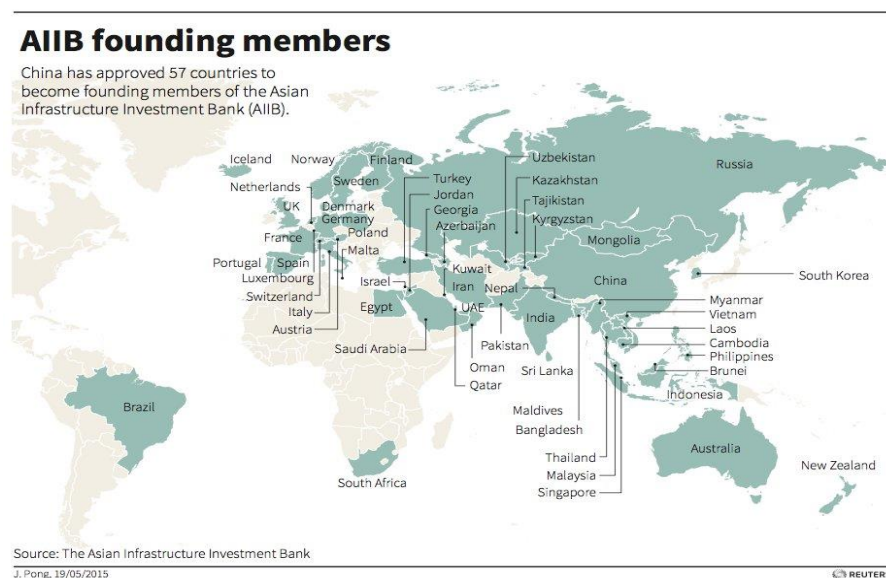
Existing work provides ways to understand the current situation. Historically, hegemonic stability theory said that the (neoliberal) international economic order relies on the

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<sup>8</sup> Brittney Farrar, “The AIIB: What Happens When the World Grows Weary of Waiting”, Last accessed Apr 12, 2015. <http://georgetownsecuritystudiesreview.org/2015/04/12/the-aiib-what-happens-when-the-world-grows-weary-of-waiting/>

leadership of a dominant economic power (the US). On this theoretical foundation, the rise of the China—along with the purported decline of U.S. hegemony—might be seen as the unraveling of the global economic order. BRIC economies rely to a large extent on state intervention, their governments are far less concerned with promoting democracy and liberalism internationally and are, in some cases, creating institutions that actively challenge the ‘Washington Consensus.’

**Figure 1.1**



This thesis departs from the HST tradition. It analyzes regionalism, which is more appropriate for understanding china’s recent organizational initiatives, postwar U.S. policies toward regional institutions, the role of U.S. allies and partners, and current U.S. goals. Recent economic and security developments threaten to fragment Asia’s institutional landscape, erode regional stability, and undermine Asian confidence in the legitimacy of the institutions and values underpinning the existing liberal economic order. These are patterns

that HST cannot fully explain.

“Rival regionalisms”<sup>9</sup>— new or re-energized regional groupings initiated or heavily supported by China and Russia—are on the rise. Their goals include providing alternatives to U.S.-led institutions, thereby avoiding Western-backed conditionality and reducing U.S. influence. As a result, a slow crisis both of regional and global order and of institutional legitimacy is emerging.

**Figure 1.2**



Source: World Institute

The Obama administration’s efforts led a number of countries to hold back from

<sup>9</sup> Ellen L. Frost, “rival regionalisms and regional order A Slow Crisis of Legitimacy”, *NBR special report #48* | Dec 2014. “*Rival Regionalisms*.” These regionalisms take the form of new or revitalized regional groupings led by governments that are cool or even hostile to the United States. Such initiatives are designed to provide alternatives to U.S. and Western leadership by creating (or revitalizing) non-Western organizations.

signing on the AIIB.<sup>10</sup> The decision by the UK, and subsequently, France, Germany, and Italy, to participate is therefore significant not only because they will be major shareholders, but also because the decision by traditional U.S. allies signals that Washington is increasingly isolated.<sup>11</sup>

China seeks to leverage this new Pan-Asianism<sup>12</sup> as its foreign and economic policies converge in unprecedented ways. Beijing has pledged significant sums of money, leveraging state-backed financial vehicles for diplomatic and economic ends. But Beijing has more than just capital. Surrounded by rivals, it also benefits from very favorable economic geography.<sup>13</sup> The US's concern is that other countries may look China as an alternative for economic leadership. It is seen as a China increase "soft power"<sup>14</sup> in the region.

### 1.3 Summary

This thesis argues (and finds) that China could use AIIB as an instrument for realizing its major foreign policy objectives, which include: (i) political stability; (ii) sovereign security, territorial integrity and national unification; and (iii) sustainable economic and social development. In pursuing these objectives from the 1990s until recently, China abided by Deng Xiaoping's famous approach on foreign policy: keep a low profile and

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<sup>10</sup> Mercy A. Kuo & Angelica O. Tang, "China's AIIB and the US Reputation Risk", Last accessed Apr 16, 2015. <http://thediplomat.com/2015/04/chinas-aiib-and-the-us-reputation-risk/>

<sup>11</sup> CFR, Robert Kahn & Steven A, "A Bank Too Far?" Last accessed Mar 17, 2015. <http://www.cfr.org/global-governance/bank-too-far/p36290>

<sup>12</sup> China, the project will aim to achieve what Asian countries have so far been unable to do: to channel Asia's impressive savings and foreign exchange reserves into long-term strategic pan-Asian investments.,

<sup>13</sup> Evan A Feigenbaum, "The US must adapt to Asia's new order", *Paulson Institute*, Last accessed Mar 22, 2015. <http://www.eastasiaforum.org/2015/03/22/the-us-must-adapt-to-asias-new-order/>

<sup>14</sup> Xi's ambitious initiative has three drivers: (1) energy, (2) security, (3) markets. *American Foreign Policy Interests*, "The New Silk Road: Xi Jinping's Grand Strategy for Eurasia", 37:140–147, 2015, ISSN: 1080-3920, p140.

achieve something.

Over the last several years, however, Deng's approach has been replaced by a more confident and assertive posture. China now seeks to establish a new type of great power relations with the United States. It aggressively claims territories in the South and East China Seas; it attempts to connect China with Europe through two Silk Roads; and it leads initiatives to create new international financial institutions, such as AIIB.<sup>15</sup>

I also find that the strategic use of economic incentives to pursue 'One Belt, One Road' will assist China in fulfilling its foreign policy objectives of improving diplomatic relations with its Asian neighbors and expanding its regional and global influence. The 'One Belt, One Road' initiative highlights China's ability to use its enormous financial resources for infrastructure investment in Asian neighbors, including cooperation with Beijing. If successful, the initiative will deepen economic integration by boosting cross border trade, investment and financial flows. It provides economic benefits for both China and other countries that use or form part of the new transport systems. Thus, the initiative will strengthen China's importance as an economic partner for its neighbors and enhance Beijing's diplomatic leverage in the region. Greater investment in energy and mineral resources, particularly in Central Asia, could also help strengthen China's energy and resource security.

Beyond the pursuit of geo-economic interests, China may also use AIIB as an instrument to realize its own geopolitical objectives, including expanding its sphere of political influence. Potential adversaries surround China, with Japan in the east (and the U.S.

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<sup>15</sup> Masahiro Kawai, "Asian Infrastructure Investment Bank in the Evolving International Financial Order", *Sasakawa Peace Foundation USA*, ISBN: 978-0-9966567-0-2, 2015, p 13.

beyond it), the Philippines and Vietnam in the southeast and India in the south. Thus, China seeks closer ties with Central Asian countries through overland routes and with friendly Southeast Asian, South Asian and Middle Eastern countries through maritime routes. China may use AIIB in addition to the Silk Road Fund and even the BRICS' New Development Bank to expand its geopolitical influence.<sup>16</sup>

Although Beijing has not yet imposed any preconditions, special commitments or requirements on the Silk Road nations with which it works, some nations believe that China has significant political, security and military motives underlying the initiative.<sup>17</sup>

I conclude that China's desire to make the Yuan the world's top currency, potentially eclipses the dollar. It is rarely recognized that such a role would require a dramatic change in China's relationship with the rest of the global economy.<sup>18</sup> Rather than importing foreign currency by running trade surpluses and absorbing foreign capital, China would need to become a currency exporter, supplying Yuan to the world either by running trade deficits or channeling its own capital abroad. This means turning China's own development model on its head, something it's not clear the Chinese have seriously wrapped their minds around.<sup>19</sup>

The years since the 2007–2008 financial crises, however, have seen more demand for transformative change than has been the norm, and more debate between major economies

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<sup>16</sup> Kawai, p 14.

<sup>17</sup> Silvercrest.com Institution, "Rivaling the World Bank and Asian Development Bank", Last accessed Oct 9, 2015. <http://www.silvercrest.com>,

<sup>18</sup> Ibid.,

<sup>19</sup> CSFP, "Parallel Structures Challenge the Established International Order", *China's Shadow Foreign Policy*, Current challenges to the post-cold war order such as the Ukraine crisis and the protracted reform blockades in the WTO, the IMF, and the World Bank are favoring China's shadow foreign policy., p 1-9.



about the nature of those changes.<sup>20</sup> The US and China, as the world's two largest economies, are at the center of these developments. One way or another, these two countries are responsible for much of how the global economic order evolves.

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<sup>20</sup> CSIS, "The United States and China in the Global Economic Order", Sep 2015. p 1-2.

## II. Literature and Background on the AIIB?

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### : Motivations behind the AIIB and China's Goals?

The AIIB links Europe and Asia through three developmental banks. They have emerged outside the post-war Bretton Woods framework, and are changing the global geopolitical architecture. China is the linchpin of the evolving world financial architecture. It led the launch of the AIIB.

Here, I discuss the formation of the bank, China's goals, and some of the implications the AIIB's creation has for traditional economic and political relationships. For example, I note that the run up to the formation of the bank opened cracks within the Atlantic Alliance. Despite U.S. objections, European countries including Britain, France and Germany joined the AIIB. Australia and South Korea top U.S. allies in the Asia-Pacific — also decided to participate in the development bank as its founding members.<sup>21</sup>

This chapter analyzes “why China built the AIIB, and will focus on China's foreign policy objectives.

### **2.1 Financing Regional Infrastructure Development**

President Xi Jinping has launched a new international development bank, marking a milestone in the reform of global economic governance system. The AIIB will boost investment in the region while contributing to fairer global economic governance, Xi said on Jan 16 at the formal opening ceremony in Beijing.

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<sup>21</sup> GS2, “AIIB formation signals structural alignment of Europe and Asia”, p. 1-2.

“Asia’s financing needs for basic infrastructure are absolutely enormous,” adding that the new bank will seek to invest in projects that are “high-quality, low-cost.” “The funding and inauguration of the AIIB will effectively boost investment to support infrastructure development in Asia. It will serve to channel more resources, particularly private investment, into infrastructure projects,” “the AIIB becomes a truly international, rule-based and high standard institution in all aspects, involving its governance structure, operation policy, procurement policy and human resources management.” (ShanghaiDaily, Jan 16)<sup>22</sup>

China pledged to put up most of the bank’s US\$50 billion in capital and said the total will rise as high as US\$100 billion. Also, Xi unveiled an extra US\$50 billion fund for infrastructure projects in less-developed countries. The AIIB, which is expected to start operations in the second quarter, is expected to lend between US\$10 billion and US\$15 billion a year for the first five or six years.

“We already have a very good pipeline of co-financing projects (with other international development banks) and standalone projects,” adding that while loans will be made in US dollars, the bank may raise capital in other currencies, including the euro and Yuan. “Asia faces severe connectivity gaps and significant infrastructure bottlenecks. It is critical to address these needs, because good infrastructure is a foundation for robust economic growth, and expand economic opportunities and improve the quality of life for everybody,” (AIIB president, Jin Lique)<sup>23</sup>

Asia has a massive infrastructure development gap. Rapid development and urbanization is expected to move 44 million to people to the cities every year from 2009-2050 according to the UN.<sup>24</sup> Financing this infrastructure deficit is beyond the resources of

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<sup>22</sup> LAROCHE PAC institution, “President Xi Jinping Addresses Official Opening of AIIB”, Last accessed Jan 16, 2016. <https://larouche.org/2016/01/17/president-xi-jinping-addresses-official-opening-aiib>

<sup>23</sup> Website Project-syndicate.org, “The AIIB is Ready for Business”, Last accessed Jan 19, 2016. <https://www.project-syndicate.org/commentary/asian-infrastructure-investment-bank-aiib-opens-by-liquor-jin-2016-01?barrier=true>

<sup>24</sup> World Bank, “Anemic recovery in emerging markets to weigh heavily on global growth in 2016”, Last accessed Jan 6, 2016. <http://www.worldbank.org/en/news/press-release/2016/01/06/anemic-recovery-in-emerging-markets-to-weigh-heavily-on-global-growth-in-2016>

the individual governments and therefore international support is highly important. The ADB has a capital base of just over \$160 billion while the World Bank has \$223 billion. Adding the additional \$50 billion from the Asian Infrastructure Investment Bank, it is still a very significant gap to fill.<sup>25</sup>

The World Bank previously failed to resolve these problems, sometimes complicating them further. In the post-Washington Consensus shift in 1997, heavily emphasis was placed on the importance of appropriate institutions for growth China has pointed to the funding shortage for infrastructure development in Asia as its primary motivation for founding AIIB. The World Bank estimates a \$1 trillion infrastructure shortfall in low- and middle-income countries, and suggests that the demand for infrastructure will continue to grow as countries develop. According to a more Asia-specific report by ADB in 2009, between 2010 and 2020,<sup>26</sup> Asia will need to invest \$8 trillion in national infrastructure and an additional \$290 billion in regional infrastructure projects in transport and energy. Indeed, AIIB will provide increased funding for infrastructure in such areas as energy, telecommunications and transportation, which are of particular importance for Asian countries undergoing rapid industrialization and urbanization.<sup>27</sup>

## **2.2 Reform of the Existing International Financial Institutions**

The AIIB will challenge the World Bank and IMF led by US and other OECD members. As the largest power in both organizations, the US wants to maintain its controlling

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<sup>25</sup> Uwmun in house Institution. , p. 11.

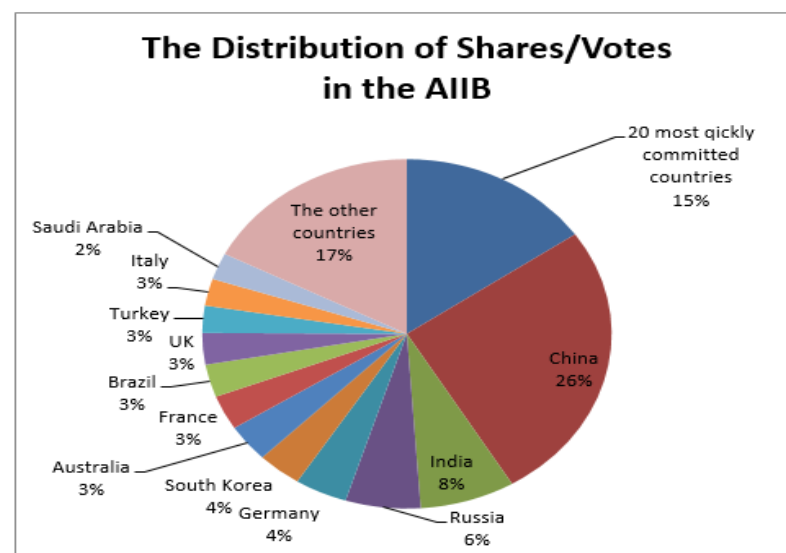
<sup>26</sup> Agatha Kratz, p. 14-15.

<sup>27</sup> Ibid.

position, while China, the fast-growing economic over the last decade, wants to set up a new rule for world economy. To do so, China is looking beyond existing Bretton Woods institutions.

On the other hand, China faces a recession in the future: markets have been volatile in early 2016. As a result, the government tries to invest the surplus in last few years to boom the economy by investing in infrastructure. In either case, a still-growing Chinese economy will be a great challenge to America.<sup>28</sup>

**Figure 2.1:**



Source: AIIB <http://www.aiib.org/>

China has led the initiative for the AIIB despite the existence of the other similar institutions like World Bank and ADB.<sup>29</sup> Their funding alone is not enough to cover infrastructure projects in Asia. But while the funding gap is the original impetus for the AIIB,

<sup>28</sup> Ernest H. Preeg, "The Decline of U.S. Export Competitiveness for Manufactures And Its Consequences for the World Economic Order", *Policy Analysis*, Apr 2015, p. 1-3. since 2000 the U.S. share of global exports of manufactures has declined sharply, from 18% in 2000 to 12% in 2013, while the Chinese share almost quadrupled, from 6% to 23%, and the EU share (in trade with non-members) was down only slightly, from 21% to 20%.

<sup>29</sup> AFP, "ADB to work with China-backed AIIB", Last accessed Jan 8, 2016. <http://www.gulf-times.com/story/474315/ADB-to-work-with-China-backed-AIIB>

China and AIIB supporters are also motivated by frustration with the ‘politics’ that go into secure funding through the ADB and World Bank.

The US retains 16.75% of the votes in the IMF, while China holds only 3.81%. As a Financial Times article explains, the IMF’s,

“quota system, which determines what each country pays in and how many votes they are given, fails to reflect the reality of a changing world. The BRICS nations, which account for more than a fifth of global output, have a quota of just 10.3%. European countries, by contrast, are allocated 27.5% for 18% of output. To add insult to injury, the IMF presidency is reserved for a European, while that of the World Bank routinely goes to an American.”<sup>30</sup>

As Brookings Scholar David Dollar explains, China is “frustrated with the lack of governance reform, slow pace of project implementation and reluctance to expand lending on the part of the existing development banks [and thus is] starting its own.” Since announcing its plan to establish AIIB, Beijing has had to address how the new bank will handle relationships with existing multilateral development banks (MDBs). Most Chinese officials and analysts have downplayed competition, instead emphasizing the potential for mutually complementary relationships among AIIB, the World Bank and ADB. Highlighting complementarities, however, fails to address the reality of the market for infrastructure finance. While the demand is large enough to accommodate all three banks, the competition for good quality projects is steep.<sup>31</sup>

Thus there is an important role for the AIIB to play in the development of Asia (and the rest of the world). There is some skepticism surrounding the organization. However, the issue

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<sup>30</sup> Yun Sun, p. 31.

<sup>31</sup> Ibid., p. 32.

at the heart of this project is how the AIIB promotes Chinese interests, and affects the distribution of global economic power. China is developing its own, alternative institutions for ordering the world, which will ultimately rival or even displace U.S.-dominated institutions.

## **2.3 Foreign Policy Objectives**

Henry Kissinger anticipated China's initiative to create the first new international organization of the 21st century. He didn't foresee the AIIB as such, but argued that as China continued to increase its global economic weight, it would inevitably seek its security, in part, by building international organizations in which it sat at the center. This would — rightly or wrongly — be seen as a challenge to the post-World War II US-centric international architecture.<sup>32</sup>

Kissinger explains,<sup>33</sup>

“China and other major developing economies have long expressed their dissatisfaction with US and European dominated international institutions created at the end of WWII. China's efforts to increase its contributions and hence voting power in the IMF, for instance, have been stalled for years in the US Congress. The reservation of the top job in each of the World Bank and the IMF for citizens of the US and EU, respectively, is offensive. The deal between the two that has stuck for over sixty years smacks of a global Tammany Hall racket. That China would build its own international bodies, and will continue to do so, shouldn't be a surprise”.

The true significance is more political. AIIB is China's project; it is the first major international monetary organization to be formed without the American leadership since

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<sup>32</sup> Henry Kissinger, *World Order*, a member of Penguin Group (USA) LLC, 2014, Published in Penguin Books 2015, p. 212-233.

<sup>33</sup> Tim Maverick, “TPP Versus AIIB: Obama's Uphill Battle”, Last accessed Jul 21, 2015.  
<http://www.wallstreetdaily.com/2015/07/21/china-aiib-obama-tpp/>

WWII. It tells the world that China is now officially an economic superpower with influence and prestige on par with the US.

China's official answer is that Asia has a massive infrastructure funding gap. The AIIB will start with \$50 billion in capital not enough for what is needed but still a helpful boost. Moreover, while ADB and World Bank loans support everything from environmental protection to gender equality, the AIIB will concentrate its firepower on infrastructure. Officially at least, ADB and World Bank officials have extended a cautious welcome to the new China-led bank, saying they see room for collaboration.<sup>34</sup>

However, unstated tensions stems from a deeper shift: China will use the new bank to expand its influence at the expense of America and Japan, Asia's established powers. China's decision to fund a new multilateral bank rather than give more to existing ones reflects its exasperation with the glacial pace of global economic governance reform. The same motivation lies behind the New Development Bank established by the BRICS (Brazil, Russia, India, China and South Africa). Although China is the biggest economy in Asia, the ADB is dominated by Japan; Japan's voting share is more than twice China's and the bank's president has always been Japanese. Reforms to give China a little more say at the IMF have been delayed for years, and even if they go through America will still retain far more power. China is, understandably, impatient for change.<sup>35</sup>

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<sup>34</sup> *China Development Forum*, Foreign Minister Wang Yi said that "economic imbalances" are the root causes of conflict and that China should provide more "public goods" to mitigate them. Antoine Bondaz, "Rebalancing China's geopolitics, ecfre.eu", Jun 2015, p. 7.

<sup>35</sup> S.R., "Why China is creating a new "World Bank" for Asia", Last accessed Nov 11, 2014, p. 1-2. <http://www.economist.com/blogs/economist-explains/2014/11/economist-explains-6>



## 2.4 Internationalization of the Chinese Yuan

China sees the status of the U.S. dollar as the main reserve currency in international trade and finance as the basis for American “financial hegemony,” which hinders the expansion of Chinese economic influence. The internationalization of the Yuan is part of China’s broader strategic goal of democratizing the global order, which requires, in part, a decrease in the dollar’s influence.<sup>36</sup>

Since 2009, China has actively sought to internationalize the Yuan, largely by establishing the so-called “dim sum bond market” and the Cross-Border Trade Yuan Settlement Pilot Project, which established pools of offshore Yuan liquidity. China hopes AIIB will strengthen these efforts through increased and diversified channels. Most important, infrastructure development financing by AIIB could popularize the Yuan as a traded currency, thereby boosting its position.

Economists are saying that<sup>37</sup> Asia needs \$8 trillion in infrastructure (i.e., roads, power, electricity, communication) investment. Infrastructure projects typically get higher leverage because they have real physical assets to back. With \$100 billion initial capitalization, AIIB can get \$1 trillion through issuance of AAA bonds. The countries that are part of the founding members of AIIB will get favorable treatment on the related construction and service contracts. That means they get a slice of the \$1 trillion cash flow.

In addition, each European country has its own reason as well. Britain has been

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<sup>36</sup> The Dollar Business Bureau Institution, “its official China led AIIB established” Last accessed Dec 26, 2015.. <https://www.thedollarbusiness.com/news/china-sets-up-aiib-to-begin-operation-in-january/37363>

<sup>37</sup> World Economic and Financial, “Asia and Pacific Stabilizing and Outperforming Other Regions”, Apr 2015, *World economic and financial surveys*, 0258-7440, p. 93

courting China since 2013 in a bid to make UK the largest destination in Europe for Chinese investment. In addition, China is pushing to have Yuan in the basket of reserve currency, and which place is better than London to issue the first Yuan-denominated bond.

Many of the other people have already listed many valid economic reasons for AIIB. IMF and World Bank has been leaving money on the table in Asia by not financing developing Asian countries aggressively, and China is leading the efforts to meet this demand because it can.

US also concerned about the growing threat of the Chinese Yuan<sup>38</sup> as a global currency which can dent the dollar's hegemony. US dollar maintains its natural value over time due to its status as the world's reserve currency. Demand for the dollar as a reserve currency allows the US to avoid depreciation. Thus, the US fears AIIB creation because it risks losing influence in Asia generally, but also because it might lead to a devaluation of the dollar as the AIIB and China grow.

In short, china attracting investors from all over the world while gradually enhancing its impact on global economy, making developing countries more reliant on Chinese currency Yuan as a counterpart of the US dollar of the post Bretton Woods System. China is seeking for more allies and worldwide cooperation to strengthen its power.

Eastern Europe is an example of how the world has changed. Ten years ago, those countries would have been looking for investors from Western Europe; they are now

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<sup>38</sup> Marc to market website, "AIIB Launched, but Threat to Dollar Exaggerated", Last accessed Jan 19, 2016, <http://www.marctomarket.com/2016/01/aiib-launched-but-threat-to-dollar.html>

widening their portfolio and that includes China.

Yet, the move is likely to channelize China's foreign exchange reserves, which have so far been mainly siphoned into low-yielding U.S. treasury bonds. The AIIB also elected a 12-member board of directors, which would steer operations. Far from being a rival, the NDB of BRICS grouping is also set to work closely with the AIIB. Mr. Sharma told resident Indian media that "formal and informal" channels of communication for coordination had been established between the AIIB and the New Development Bank of the BRICS.<sup>39</sup>

## **2.5 Domestic Economic Needs**

After 30 years of double-digit GDP growth rates, China's growth decelerated due to the global financial crisis of 2008. Indeed, China attempted to maintain high growth in the face of that crisis by raising public investment spending by CNY4 trillion and easing monetary policy. While China achieved its goals through 2011, growth rates have since fallen to 7-8%, due to domestic over-investment, excess credit, excess capacity and a shrinking labor force, coupled with stagnant economic conditions in developed economies. Excess capacity has become massive even by Chinese standards, particularly in materials-producing sectors, such as steel and cement. Financial vulnerabilities have also risen due to large borrowing by local governments, housing bubbles and the spread of shadow banking.<sup>40</sup>

China admits that it has entered a "new normal," with permanently slower growth rates

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<sup>39</sup> Tyler Durden, "BRICS Bank, AIIB Pledge Partnership, Loans To Be Issued In Yuan", Last accessed July 25, 2015. <http://www.zerohedge.com/news/2015-07-25/brics-bank-aiib-pledge-partnership-loans-be-issued-yuan>

<sup>40</sup> Masahiro Kawai, "Asian Infrastructure Investment Bank in the Evolving International Financial Order", *Sasakawa Peace Foundation USA*, ISBN: 978-0-9966567-0-2, 2015, p. 13.

of 7-8%, which will require structural reforms to be maintained. A slowdown in China's infrastructure and property investment, which the Xi administration has pursued, would further aggravate the country's already low capacity utilization. Significantly, stimulating aggregate demand would also go against Xi's structural reform efforts.

In this context, expanding external demand through AIIB's operations, rather than a cheap Yuan, could be a useful way to support market-oriented reform of the Chinese economy. Infrastructure projects in AIIB member countries could provide them economic stimulus sufficient to offer export opportunities for manufacturing firms struggling with excess capacity. Similarly, infrastructure firms facing shrinking domestic opportunities could expand their activity abroad.

## **Conclusion**

This chapter explained the reasons behind the creation of the AIIB. My main argument is that the AIIB will likely challenge the World Bank and IMF, led primarily by the US.

China, which has experienced rapid growth, faces a recession in the future. As a result, the government tries to invest the surplus in last few years to boom the economy by investing in infrastructure. Thus, the Chinese are starting to develop their own, alternative institutions for ordering the world, in this view.

### III. Potential “One Belt, One Road” Initiative

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: What is the impact of the AIIB, Today?

President Xi Jinping first presented China’s vision for a “Silk Road Economic Belt” during a 2013 speech in Kazakhstan. The idea was to “forge closer economic ties, deepen cooperation, and expand development in the Euro-Asia region”.<sup>41</sup> The new Asian bank is one part of an ambitious Chinese push to create a new generation of financial and economic institutions that could give it greater political influence in the Asia-Pacific region and potentially in other parts of the world. The shape of the global economy shifts, elevating the relative importance of China and other emerging markets, the US has, in the past year, missed several chances to seal its economic strength for the century ahead.

In this chapter, the main objective is to understand that the AIIB will become a multilateral development bank that finances programs addressing huge infrastructure deficits in Asia, EU and Middle East. Infrastructure development is also integral to a shared vision of integration of the region’s economies to be an engine of global growth.

Moreover, I identify how China is becoming an economic superpower. Finally I will point out that what it means to compete with the US-China on a political and economic level in Asia-Pacific Region.

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<sup>41</sup> Kyle Churchman, “NBR China’s Vision for a New Asian Economic and Political Order”, p. 1-2.

### 3.1 OBOR Initiative

In early 2015, the contours of Beijing's strategy began to emerge as China's leadership laid out plans for this "Silk Road Economic Belt" through Central Asia, and a "21st Century Maritime Silk Road" through Southeast and South Asia. China referred to both collectively as "One Belt, One Road" (OBOR). Both are portrayed as an opportunity to reshape the economic and political order in Central Asia and the Asian Pacific region by promoting a network of trade routes, political cooperation, and cultural exchange. By so doing, China intends to place its sometimes-restive western and interior provinces at the heart of its engagement with Central and South Asia in an effort to accelerate development and promote stability.<sup>42</sup>

Beijing characterizes its initiatives as an effort to encourage integration and economic growth in Eurasia, rather than an attempt to expand its own political influence in the region. Chinese policy makers describe OBOR as a mechanism to promote peace and stability in the by strengthening China's bilateral relations with its neighbors and developing international organizations that are not dominated by Western powers.

The "One Belt, One Road" initiative hangs on four interrelated objectives: Improving regional infrastructure, increasing regional economic policy coordination, removing barriers to trade, and encouraging cultural ties to build support for the broader project. The blueprint lays out a set of transportation, energy, and telecommunication infrastructure projects, coupled with plans for increased regional diplomatic coordination, financial integration, and

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<sup>42</sup> Thomas Zimmerman, p. 9.

cultural exchange.

President Xi stated that China hopes its annual trade with countries involved will exceed \$2.5 trillion in roughly a decade. China's trade with the Central Asian region has grown dramatically in recent years, from roughly \$1 billion in 2000 to over \$50 billion in 2013. In July 2015, The Chinese Ministry of Commerce announced that in the first half of the year Chinese companies signed 1,401 contracts for projects in countries included in the OBOR framework. These contracts were said to be worth \$37.6 billion (an increase of 16.7% year on year) and equal to 43.3% of all overseas contracts signed during that period.<sup>43</sup>

**Figure 3.1: One Belt, One Road – New Silk Road**



Source: MERICS

The AIIB is a financial institution proposed by China to make way for investment in infrastructure in the Asian region. Bank is in consonance with China's OBOR initiative.

<sup>43</sup> Thomas Zimmerman, p. 6.

Considering China's 'One Belt, One Road' initiative and India's 'Spice Route' and 'Mausam' project, the need for massive demand for infrastructure funding becomes all the more evident. These projects will not only improve the collective GDP;s of the respective economies but produce employment opportunities, improve relations among the countries by boosting trade among them, facilitate technology transfer and finally enmesh the countries into the idea of globalization.

Foreign Minister Wang Yi states that<sup>44</sup> the OBOR was not a "tool of geopolitics". In a nod to Western critics' fears about China's real intentions, he said the project should not be viewed through an "out-dated Cold War mentality". China's Vice Foreign Minister, Zhang Yesui, echoed this message of reassurance at the China Development Forum later in March. He presented China as a satisfied power, fully integrated into the international system. Zhang said that China's OBOR is "not directed against any specific country or organization" but is a "useful complement" to existing international and regional institutions.<sup>45</sup>

Indirectly criticizing the US as a traditional power, Chinese officials and academics repeatedly stress that the OBOR is not like the Marshall Plan. Wang Yi states that comparing the OBOR to the Marshall Plan is like comparing "apples and oranges." The OBOR is based on "open cooperation"— which implicitly means that the Marshall Plan was not.<sup>46</sup>

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<sup>44</sup> Zha Daojiong, *Policy Report* "Chinese Economic diplomacy: New Initiatives", Mar 2015, p. 2-3. Since December 2012 when he delivered a speech at the "The Road to Revival" exhibition at the National Museum of History in Beijing, the "Chinese Dream" has become a standard reference in major policy discussions. The term is rather loosely defined but the leadership is obviously seeking to unify the people behind the party and government, as this catch-all phrase allows different groups within Chinese society to project their own ideas onto the new slogan.,

<sup>45</sup> Antoine Bondaz, "Rebalancing China's geopolitics, ecfre.eu", Jun 2015, p. 6.

<sup>46</sup> Ibid., p. 6.



However, the new Silk Road is also link to India, the Middle East, and to Europe. It is not just an effort to integrate East Asia. Expending further west presents core challenges. The OBOR is the largest coordinated infrastructure investment program in the world. According to current plan, Eurasia will be united infrastructural into a functional “mega-continent.” At the center is the AIIB, whose investments will accelerate this trend.

The Silk Road Economic Belt—OBOR’s land-based component—encompasses several economic corridors around China’s western rim, creating a grid of transportation routes rather than a single linear path. The belt project envisions the construction of new rail lines, highways, pipelines for oil and gas, telecommunications infrastructure, and fiber-optic cables. Two corridors will extend across the Eurasian landmass at different latitudes and terminate in Europe, while another will connect China’s southwestern provinces with mainland Southeast Asia. The proposed China-Pakistan and Bangladesh-China-India-Myanmar economic corridors will be closely integrated with the belt and provide port access to the Indian Ocean.<sup>47</sup>

While the Chinese government has couched the initiative in altruistic terms, OBOR is chiefly designed to benefit China’s economy. Most importantly, China seeks to spur economic development in its poorer western and southern regions, which lag far behind the prosperous coastal provinces. Whether China might eventually push for a free trade zone that covers OBOR countries in response to the recently concluded Trans-Pacific Partnership

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<sup>47</sup> Kyle Churchman, p. 1.

agreement is an important question.<sup>48</sup>

Geostrategic motivations also drive the OBOR initiative, with the overarching one being the desire to circumvent U.S. encirclement in the Western Pacific. U.S. political and military influence in the regions west of China is considerably weaker than around China's eastern rim, giving Beijing incentive to "go west" as Washington rebalances to the Asia-Pacific. The construction of new pipelines linking China with hydrocarbon-rich Central Asian states and the transport of Middle Eastern oil through Pakistan<sup>49</sup> instead of the South China Sea will improve Chinese energy security. Currently, more than 70% of China's oil imports from the Middle East and Africa pass through the Strait of Malacca—a chokepoint between the Malay Peninsula and Sumatra that is vulnerable to a U.S. blockade. A further geostrategic motivation is focused on soft power: China hopes to win the goodwill of OBOR nations by providing billions of dollars in financing for infrastructure projects that will likely benefit their economies.

The One Belt, One Road initiative offers considerable potential in several economic, political, cultural, and strategic realms. There will be new opportunities for China's outbound investment and infrastructure access as well as greater interconnection between China's neighboring countries.

### **3.2 AIIB and Brics NDB**

China's rise and the deepening integration of the emerging countries, especially the

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<sup>48</sup> Kyle churchman, p. 2.

<sup>49</sup> Chinese policy experts have described plans for the SCO to play a "driving role" in OBOR. The SCO granted Afghanistan observer status in the SCO in 2012 and, in July 2015, voted to grant full membership to India and Pakistan.

BRICS group into the global economy have been two of the most noticeable shifts at global level after the 1990s. However, the aftermath of the financial and economic crisis apex underscored many vulnerabilities, imbalances, uncertainties and risks, pointing out that economies worldwide are unlikely to come back to growth rates similar to those preceding the crisis and also that there is an urgent need for change, both internally and in the architecture of the institutions governing the world economy.<sup>50</sup>

The New Development Bank (NDB) was the first new Chinese-led institution to come online. It was established in July 2014 by Brazil, Russia, India, China, and South Africa at the annual BRICS Summit with \$100 billion in authorized capital and \$50 billion in subscribed capital.<sup>51</sup>

The NDB is structured to heavily favor the founding BRICS members, and any contributions from new members may not reduce the BRICS' voting shares below 55% (or increase the new members' shares beyond 7% of the total voting shares). The protected dominance in voting shares, along with a requirement that the president and vice president hail from BRICS countries, are likely to discourage other large economies from joining. While the BRICS claim that they are aiming for a more inclusive governance structure compared to existing institutions, their the design of the institution belie these claims.<sup>52</sup>

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<sup>50</sup> Research Gate, "BRICS' Current Economic Situation: An Adaptive Phase?", April 2015.

<sup>51</sup> Odi.org, "Developmental revolution or Bretton Woods revisited?" p. 11-13. The \$10 billion paid-in capital committed by the BRICS shareholders in July 2014 and the estimated \$15 billion by AIIB prospective shareholders are only the initial contributions to the equity capital of each bank. Realistically, the NDB and AIIB will build equity capital through additional capital paid in by new members and accumulated reserves derived from net income generated by the bank each year.

<sup>52</sup> Molly Elgin, "Coss art and Melanie Hart", *China's New International Financing Institutions*, Sep 22, 2015. p. 4.

In contrast, the AIIB is more open, with 57 founding members, compared to five for the BRICS bank. AIIB's Articles of Agreement specify an open procurement policy, which means non-AIIB members can provide goods and services for AIIB-funded projects. However, China will be the largest shareholder and host the headquarters of the AIIB.

Emerging powers<sup>53</sup> have criticized existing international institutions for not representing the actual division of power in the contemporary world. In the last decade, the global balance of power has changed significantly; a fundamental shift towards a multipolar world has been taking place. This shift is predominantly towards Asia and there has been a significant increase of South-South cooperation.

A recent Chinese initiative, the AIIB, could have an impact on the NDB. Moscow denies that the AIIB's role would overlap with that of the NDB, but it understands that both banks are China-centered and their interaction would depend to a degree on Chinese priorities. Attempts to combine these financial projects appear aimed at increasing their collective role and influence in the global financial system vis-à-vis the IMF and World Bank.

Why does India join in China-led AIIB? First of all, because India needs infrastructure and financing, and China has money to invest. It's a perfect fit. Secondly, both China and India have been on the same side with their struggle at IMF. Economists say that Asia needs \$8 trillion infrastructure development. The U.S. led IMF has not been too generous with Asian countries.

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<sup>53</sup> Robert Kappel, "global power shifts and challenges for the global order", Feb 2015. p. 5.

The IMF reform bill in 2010 would have given both China and India bigger voting shares due to their growing economies. It had a rather modest measure that would shift about 6% of the voting right to developing countries, mostly from EU. In 2012, during the EU financial crisis, China put in an additional \$43 billion and India \$10 billion, with the understanding that the IMF reform bill would be approved. However, the US Congress blocked for the next 5 years. This created incentives to reconsider the suitability of the IMF and its role as the principal lender in the global economic system.<sup>54</sup>

China initially announced that, like the NDB, the AIIB would have authorized capital of \$100 billion, of which it would contribute \$50 billion. It remains to be seen how much of the remaining \$50 billion will be committed by the 39 other countries that expressed interest in joining. It will depend on the fiscal situation of potential shareholders as well as the course of negotiations on bank governance and policies, but clearly the AIIB will start off with a greater capital base than the NDB. Some estimates say, although the full \$100 billion could be feasible in view of the interest expressed by potential members.<sup>55</sup> Assuming a seven-year payment schedule, the AIIB is projected to have an outstanding loan portfolio of \$67-87 billion by 2025.<sup>56</sup>

Facing the slowdown of its economic growth, China recently became much more active in identifying new sources of development, including new markets for its goods as well as new places for investing its capital, largely in neighboring regions. The rapid rise of the “One Belt, One Road” project, accompanied by the creation of the AIIB—a direct

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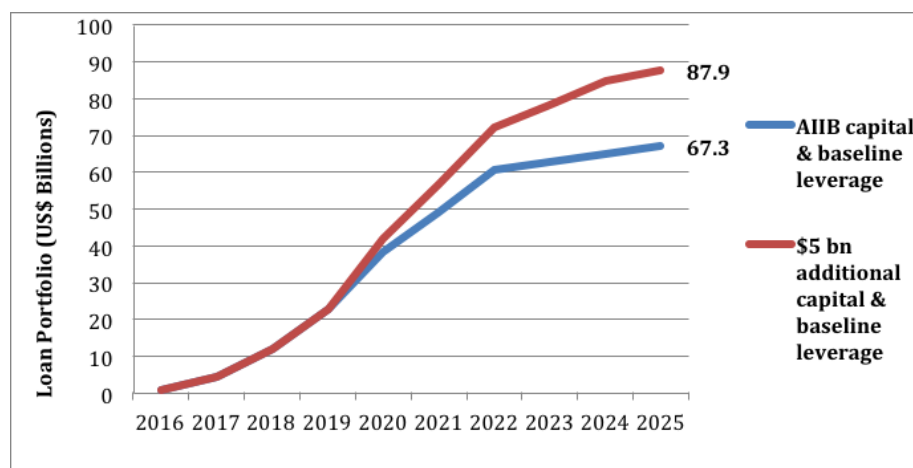
<sup>54</sup> China Leads Nations Boosting IMF’s Firewall to \$456 billion.

<sup>55</sup> ODI Institution, “Developmental revolution or Bretton Woods revisited?” April 2015. p. 9.

<sup>56</sup> Ibid., p. 11-13.

competitor to the NDB of the BRICS demonstrates that China is ready to make any decisions necessary and quickly deploy its own capital in the effort to reach its economic targets.

**Figure 3.2: Scenarios of AIIB Loan Portfolio, 2016–2025**



Source: Calculations by Judith Tyson, ODI

The possibility of future Asian economic integration occurring around the OBOR plan has a much stronger basis than potential BRICS-led integration. There should be no doubt that the main underlying idea of the OBOR plan is to benefit China: to support the country's economic growth by supplying investment goods and speed up the development of the problematic Xinjiang-Uygur province.

Due to geography, only one BRICS country—India—may directly benefit from this plan. Russia will not be an obvious beneficiary, as its eastern regions are rich in natural resources but lack the necessary connecting infrastructure, such as roads, and are located significantly to the north of any potential New Silk Road path.

The next generation of fast-growing emerging economies: namely Iran, Pakistan and

Turkey. As a point of comparison, the combined GDP of these three countries is equal to that of Russia, while their population is 2-3 times bigger. Therefore, it should not be a surprise if the world's new economic tigers soon emerge from this part of the world—or if one day they decide to launch new projects of economic integration, with China and India as their key engines.<sup>57</sup>

### **3.3 ASIA and ASEAN**

On Nov 2015, the IMF released their World Economic Outlook, which provides a middle-of-the-road starting place for looking at the global economy. The IMF expects the world overall to expand in 2016 by 3.6 percent inflation adjusted, up from this year's estimated 3.1 percent growth. Both advanced and emerging economies contribute to the improvement.<sup>58</sup>

East Asia is the wild card for the global economic outlook. China in particular is opaque. The official growth rate of GDP is 6.9 percent, down from 7.0 in previous quarters, but there is uncertainty over the accuracy of the official statistics.<sup>59</sup>

Since the Asian financial crisis, Asian policymakers have encouraged greater financial cooperation and integration within the region. Important steps taken include regional liquidity support arrangements through the Chiang Mai Initiative, the Asian Bond Fund, the Asian

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<sup>57</sup> Sergey Aleksashenko, p. 10.

<sup>58</sup> World Bank, "The Global Economy in Transition", June 2015, p. 152-153. Regional GDP growth is expected to remain firm at just over 7 percent during 2015, and rise at a moderate pace toward 7.5 percent in 2017, in line with the ongoing recovery in India and broadly stable growth in the rest of the region. In Bangladesh, Bhutan, India, and Pakistan hold back the recovery in credit growth.

<sup>59</sup> Bill Conerly, "global economic forecast 2016-2017", Last accessed Nov 24, 2015.

<http://www.forbes.com/sites/billconerly/2015/11/24/global-economic-forecast-2016-2017/#5a27448a43f4>

Bond Market Initiative, and financial forums such as the Association of Southeast Asian Nations plus Three and the Executives' Meeting of East Asia–Pacific central Banks. The Association of Southeast Asian Nations (ASEAN) has also outlined plans to foster capital market integration, including by building capital market infrastructure and harmonizing regulations.

While not an end in itself, regional financial integration is being pursued because it is expected to bring important benefits to Asia. Financial integration promises higher productivity and living standards, not least by improving the allocation of savings and investment. A diverse region with huge needs for infrastructure financing in the next decades Asia's medium-term demand for infrastructure investment is large. Even in the more developed economies, there is still substantial demand for upgrading and maintenance.<sup>60</sup>

Middle-income ASEAN countries such as Malaysia and Thailand are still investing heavily in the rail and public transport system. China, South Asia and lower-income ASEAN economies continue to have considerable gaps in the supply and quality of rail and road density as well as electricity provision, often complicated by large land mass and population size. As of 2012, the infrastructure stock in ASEAN-5 (Indonesia, Malaysia, Philippines, Singapore and Thailand) hovered 30% below the advanced economies' benchmark, which was calculated at 70% of GDP by the McKinsey Global Institute.<sup>61</sup>

The Philippines are particularly weak with regard to transport and trade-related

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<sup>60</sup> World Economic and Financial Institution, "Asia and Pacific Stabilizing and Outperforming Other Regions", Apr 2015, *World economic and financial surveys*, 0258-7440, p. 93-94.

<sup>61</sup> Syetarn Hansakul, *Deutsche Bank*, "Asia infrastructure financing Getting it right would lift medium-term growth", Jan 8, 2016, p. 2.



infrastructure.

In China, infrastructure needs vary considerably across regions, and range from high-profile projects (such as high-speed railways) to installing basic municipal infrastructure and environmental protection. China's highway length more than doubled between 2004 and 2014 and the share of high-speed railways was boosted from 33% to 50% of total railway kilometers, yet transport density still falls far short of that in advanced economies.

The ADB estimated that around USD 8.2 trillion was needed in Asia for national infrastructure investment projects between 2010 and 2020, equivalent to nearly 5% of the region's GDP. Another USD 300 billion was needed for regional projects. Building and upgrading of roads and energy/electricity infrastructure were deemed to have the largest financing requirements. HSBC quantified the need of infrastructure to support urbanization in emerging Asia at USD 11. trillion for the period 2010-2030.<sup>62</sup> And USD 7 trillion was estimated by McKinsey to be needed for infrastructure and real estate investment in ASEAN-5 alone between 2014 and 2030.<sup>63</sup>

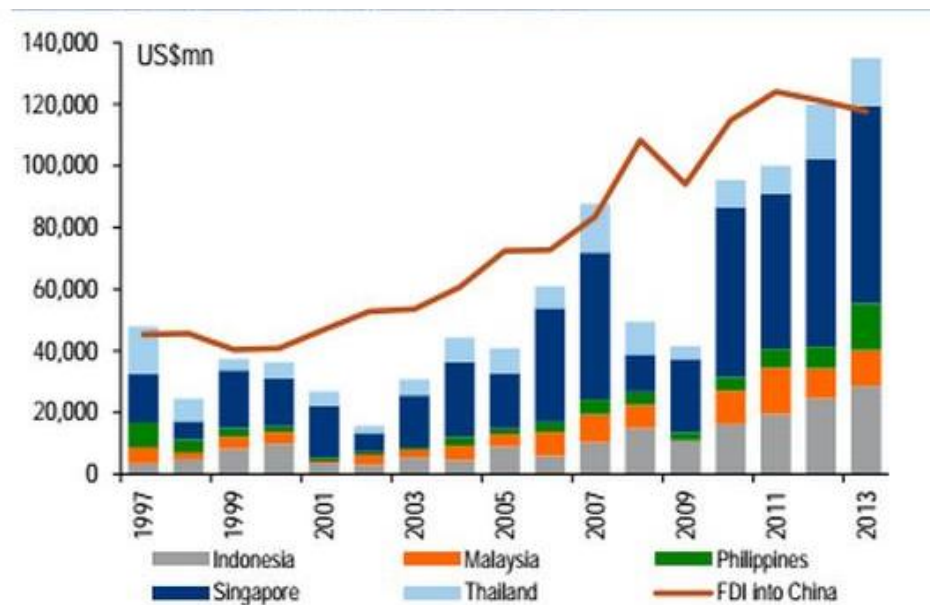
In any case, Asia's infrastructure needs likely make up a substantial portion of the USD 57 trillion funding required to finance infrastructure projects globally up to 2030 according to the B20 Task Force on Infrastructure. The Task Force also assessed that there was a gap of USD 500 billion annually between investment needs and available public funds.<sup>63</sup>

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<sup>62</sup> Syetarn Hansakul, p. 3.

<sup>63</sup> World Bank data show a big gap between infrastructure in Asia and developed countries. Compared with India's 2.3 telephone lines per 100 people, the U.S. has 42.2. While Indonesia has 1.3 fixed broadband Internet subscribers per 100 people, the U.S. has 29.3.

**Figure 3.3: FDI to ASEAN- 5 Surpassing to China**



Source: McKinsey Global Institute

If it can overcome operational and political challenges, the China-led AIIB may reduce infrastructure bottlenecks and boost developing Asia's potential output by more than 1% point. The AIIB is poised to emerge as Asia's biggest investment-focused multinational development bank. Though it's the world's fastest growing region, developing Asia remains impeded by rusting and inadequate transport, power and communications networks. AIIB resources will be targeted at remedying that situation. The bank will probably launch by the end of the year and has attracted interest from 57 nations worldwide.

Asia may need about \$750 billion per year from now until 2020 to finance projects in transportation, energy supply, water facilities and other areas, according to the ADB. A business taskforce reporting to the G20 forecasts that a third to a fourth of infrastructure investment needs in the coming 15 years may find difficulty in getting financing. The AIIB

would be well positioned to reduce that shortfall. The bank's initial subscribed capital will be at least \$50 billion and is expected to rise to \$100 billion.<sup>64</sup>

What sets the AIIB apart is its focus on infrastructure. The ADB committed about 60 percent of its \$21 billion in new loans in 2013 to infrastructure projects, or about \$12.6 billion. Given the AIIB's sole focus on infrastructure, its capacity to make loans toward building Asia's bridges and power plants might be 60 percent to 70 percent greater than its Manila-based rival's.

The result may be a boost to infrastructure investment in non-China developing Asia of up to 0.5 percent of GDP a year. Long term, that may boost potential GDP in these countries by 1 to 1.5 percentage points. According to the IMF, a 1 percentage point increase in infrastructure investment as a proportion of GDP can raise annual output by 2-to-3% point long term.

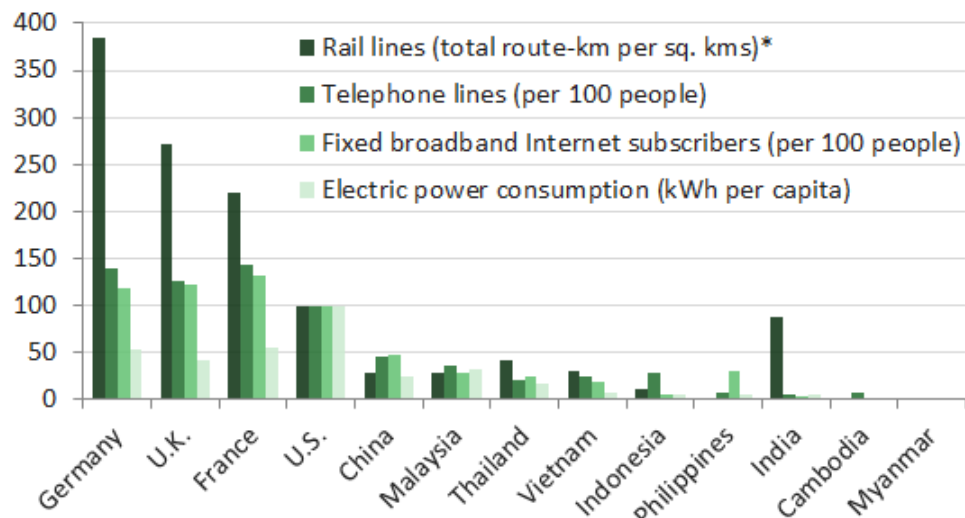
The OBOR initiative provides the framework for China's outbound trade and investment strategy over the medium term, and charts the course for foreign policy. The plan which was started in 2013 spans 40 countries from Central and Southern Asia to the Middle East and Europe. Apart from support to domestic industries, infrastructure financing along the Belt and the Road is a key priority. Below are some of the relevant China led investment deals into South and Southeast Asia under the OBOR plan:<sup>65</sup>

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<sup>64</sup> Chen, "China's New Development Bank Aims to Clear Underbrush from Asian Growth Track", *Bloomberg Brief*, April 2015, p. 9.

<sup>65</sup> Regional Comprehensive Economic Partnership involving ASEAN and Australia, China, India, Japan, Korea, and New Zealand. Further progress on these initiatives and toward the goal of establishing the ASEAN Economic Community could help financial and trade integration.

**Figure 3.4: Asia's Infrastructure Lags as % of U.S. Level**



Source: World Bank and BloombergBriefs.com

In Indonesia, China pledged up to \$100 billion investment, half of which is planned to be invested in the power, railway and smelting sectors. The Jokowi government also plans to invest \$429 billion in upgrading port infrastructure and construct 24 new ports over the next 5 years to facilitate China's maritime investment initiative.

In Sri Lanka, China participates in more than 10 overseas harbor projects as part of the OBOR Initiative. Colombo Port project was resumed in July 2015 after being halted for political reasons.

In Vietnam, we have seen the China Southern Power Grid construction of a coal-fired power generation plant. The project is China's first BOT power project in Vietnam and part of the 5-year Sino- Vietnam trading cooperation plan. Cambodia, Laos, Bangladesh, Myanmar.

Splitting up the loan amounts by region and sector, where available, highlights the

importance of infrastructure funding for MDBs' financing in Asia. For the ADB, loan and guarantee exposure is concentrated mostly on China (27%), India (23%) and Indonesia (14%) as of the end of 2014. ADB's largest non-sovereign exposures are in China, India and Thailand, with nearly 50% concentrated in the utilities sector, hence directly linked to infrastructure.<sup>66</sup>

Developing Asia (up 9%) saw FDI inflows grow to historically high levels. They reached nearly half a trillion dollars in 2014, further consolidating the region's position as the largest recipient in the world. FDI inflows to East and South-East Asia increased by 10% to \$381 billion. In recent years, MNEs have become a major force in enhancing regional connectivity in the sub region, through cross-border investment in infrastructure.

The security situation in West Asia has led to a six-year continuous decline of FDI flows (down 4% to \$43 billion in 2014); weakening private investment in parts of the region is compensated by increased public investment. In South Asia (up 16% to \$41 billion), FDI has increased in manufacturing, including in the automotive industry.<sup>67</sup>

China now surpasses the United States as the largest FDI recipient in the world. FDI inflows to China reached \$129 billion in 2014, an increase of about 4%. This was driven mainly by an increase in FDI to the services sector, particularly in retail, transport and finance, while FDI fell in manufacturing, especially in industries that are sensitive to rising

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<sup>66</sup> Syetarn Hansakul, p. 11.

<sup>67</sup> Ibid.

labor costs.<sup>68</sup>

By contrast, FDI flows from Japan and the United States declined by 39% and 21%, respectively. FDI outflows from China reached \$116 billion. They continued to grow faster than inflows. FDI outflows from China grew by 15% to a record-high \$116 billion; increasing faster than inflows into the country. Overseas acquisitions have become an increasingly important means of international expansion by some Chinese financial institutions.<sup>69</sup>

Inflows to South Asia raised to \$41 billion in 2014, primarily owing to growth in India, the dominant FDI recipient in the region. Both announced green field investments and cross-border mergers and acquisitions increased across the region: the value of the former jumped by 48% to \$39 billion, while that of the latter rose by about one quarter to \$6 billion. At the regional level, FDI in manufacturing has risen, as illustrated by the automotive industry. A number of South Asian countries saw rising FDI from China. FDI inflows to Pakistan increased by 31% to \$1.7 billion as a result of rising Chinese FDI flows in services, in particular a large investment made by China Mobile in telecommunications. In addition, Pakistan will benefit significantly from the China-Pakistan Industrial Corridor and the associated Chinese investment in infrastructure and manufacturing in the overall context of implementing China's OBOR.<sup>70</sup>

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<sup>68</sup> UNCTAD Institution, *World Investment Report 2015*, p X.

<sup>69</sup> Syetarn Hansakul, p. 12.

<sup>70</sup> UNCTAD, p. 48.

### 3.4 EU and Middle East

#### European Union

The reasons of Asian and emerging countries for joining the AIIB are quite straightforward. The AIIB project gathered 21 countries including China by the time the first “memorandum” was signed on 24 October 2014. Yet the “unexpected declaration” by Britain’s Chancellor George Osborne on 12 March 2015 that the UK wished to join the bank as a founding member provoked an “avalanche like wave of additions”, including Germany, France, Italy, and later on, Luxembourg, Denmark, and Switzerland. “In one night”, the AIIB project evolved from a mostly Asian initiative to a full-on global, multilateral institution.<sup>71</sup>

The European countries’ decision to join the bank is rational. Europe has experienced economic difficulties over the past few years, and it is looking to benefit from Asia’s impressive growth. Moreover, in spite of its own depressed economic environment, European Union member states have plenty of funds available for investment, and they are looking for more profitable opportunities than those available in Europe.

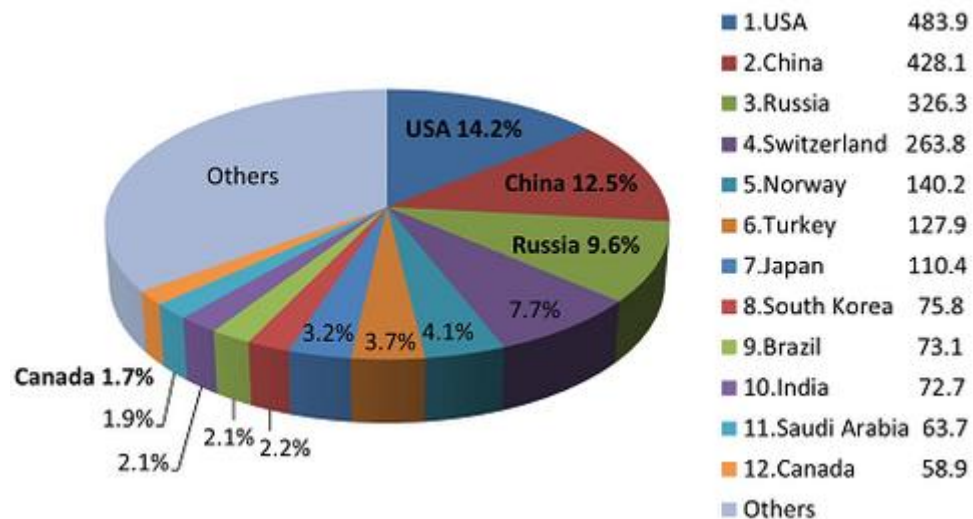
Finally, France and Germany could easily leverage their companies’ significant experience, technologies, and operational knowledge in the context of infrastructure building in Asia, and thus reap the benefits of the planned infrastructure projects. Therefore, investing in the AIIB is “profitable” and “in line with the countries’ national interests”. Since China’s

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<sup>71</sup> Theresa Fallon, “The New Silk Road: Xi Jinping’s Grand Strategy for Eurasia”, *American Foreign Policy Interests*, 2015, ISSN: 1080-3920 online37: p 140.

influence in the world is growing fast, EU countries see the AIIB as an opportunity to deepen their relations with China.<sup>72</sup>

**Figure 3.5: EU Trade main trading partners in 2013(in bn EUR)**



Source: <http://www.zerohedge.com>

In 2011, China launched a new forum for cooperation with Central and East European countries: the “16+1.” This includes 11 EU countries (Bulgaria, Croatia, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia) and five EU candidate countries (Albania, Bosnia and Herzegovina, FYROM [Macedonia], Montenegro, and Serbia). Although vastly different culturally, linguistically, and in terms of religion, these countries are united in their quest for Chinese investment.<sup>73</sup>

They are also all former communist states and thus share some common historical experience with China. China is careful to explain that the “16+1” does not supplant, but rather supplements, EU–China relations. However, the 11 countries that are members of the

<sup>72</sup> Agatha Kratz, p. 15.

<sup>73</sup> Theresa Fallon, p. 145



EU can influence policymaking in Brussels. At the “16+1” meeting in Warsaw in 2012, former Chinese Premier Wen Jiabao recommended 12 proposals in order to promote China–Central Eastern European (CEE) economic cooperation and friendship.<sup>74</sup>

The next China–CEE meeting was attended by new Premier Li and held in Bucharest in November 2013. The new Chinese leadership upgraded the “16+1” by formally institutionalizing it. The Chinese Foreign Ministry set up a China–CEE Cooperation Secretariat in Beijing. In response, some CEE countries organized counterpart departments, while others designated a national coordinator for communication with the Beijing-based secretariat.<sup>75</sup>

As U.S. Secretary of Defense in 2003, Donald Rumsfeld remarked on the “old and new Europe.” He maintained that “New Europe,” in 2003, was largely made up of the new member states of the EU from Eastern Europe that were formerly in the Soviet sphere of influence and traditionally supported the United States. Further, this is “New Europe” backed U.S. actions during the Iraq campaign.<sup>76</sup>

By contrast, Rumsfeld viewed the behavior of “Old Europe”—turning to China to counterbalance the United States because of its actions in Iraq—in a less favorable light. China’s investments and increasing influence in the CEE may, in the longer term, help to undermine the ties to a region long seen as supportive of U.S. policies.<sup>77</sup>

On 16 December 2014, at the third meeting of Heads of Government of China and

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<sup>74</sup> Theresa Fallon., p. 143.

<sup>75</sup> Ibid.

<sup>76</sup> Ibid., p. 144.

<sup>77</sup> Ibid., p. 145.

Central and Eastern European Countries, it was agreed that the nations would construct a new Asia–Europe maritime land combined transport passage, which would include building a new Belgrade–Budapest Railway and Greece’s Piraeus Port. China’s massive investment in the infrastructure of Piraeus testifies once more to the critical position of Europe in the building of the ‘‘Belt and Road.’’

However, the 16 Central and Eastern European countries have differing attitudes toward China. Some are skeptical, but most need bridges, railways, roads, and they are balancing different policy goals. The CEE nations are a particular target for lobbying by China and are more likely to support China’s position internationally and regionally. The ‘‘16+1’’ group is an important peg in support of the Western end of the ‘‘Belt and Road.’’ China’s activities in the region are greeted with ambivalence<sup>78</sup> by some officials in Brussels who see the investments as an attempt to gain political influence in the region and within the EU.

There was no coordination at the EU level about individual member states joining the AIIB. The United Kingdom, France, Germany and Italy decided to join in March 2015. Some member states suggested that the EU itself should become a party to the AIIB.<sup>79</sup> Some believed that the EU should coordinate a common position for the negotiations surrounding the founding of the Bank, in an effort to promote EU standards in the workings of the new institution. Further, more EU member states may join the AIIB in the future.

As People Liberation Army’s (PLA) Deputy Chief of the General Staff Sun Jianguo

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<sup>78</sup> Ibid.

<sup>79</sup> Ibid., p. 146.

stated recently, “ ‘No confrontation, no conflict’ does not mean ‘no struggle’ without the struggle the United States would still have no respect for China’s core interests.<sup>80</sup>” The Belt and Road initiative is a case in point. It is oriented toward China’s neighbors to the West and South, and it tacitly excludes the United States, even though the United States is also part of China’s greater neighborhood across the Pacific.<sup>81</sup>

The Belt and Road gained rapid traction and the business opportunities offered by China’s strategic design did not fail to attract some close U.S. allies in Europe, when in March 2015, the United Kingdom, France, Germany, and Italy decided to join the AIIB despite U.S. protests. After the UK decision, a senior U.S. official accused Britain of “‘constant accommodation’” of China.<sup>82</sup>

### **Middle East**

Chinese President Xi Jinping’s Middle Eastern tour—the first by a mainland leader in seven years—reveals the world’s second-largest economy may depart from its trade-oriented foreign policy as it seeks to become a superpower.

China-Arab ties date back to the early 1960s, during which the mainland has traditionally focused on energy, commerce and trade ties with the region, choosing to abstain from geopolitical tensions. But while Chinese energy imports and infrastructure projects around the OBOR trade initiative will likely form the bulk of Xi’s meetings on this trip, politics may be unusually high on the agenda as well.

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<sup>80</sup> Ibid., p. 146.

<sup>81</sup> Ibid., p. 147.

<sup>82</sup> Ibid.

“Xi's visit constitutes a recognition that China needs to become a player in the Middle East as part of the protection of its interests and if it wants to be taken seriously as a major power,” said James Dorsey, senior fellow at Singapore's Nanyang Technological University. “Arab officials and pundits have long demanded that China act as a superpower and adopt a more active role in the region.”<sup>83</sup> Last year, Yemen's civil war forced Xi to cancel plans to visit the region but since then, China has signaled a grudging recognition that it can longer ignore political issues, he added.

In one sign of increased engagement, China's Foreign Ministry announced last month that it invited members of the Syrian government and the opposition to Beijing, in an apparent effort to position China as a mediator in the Syrian conflict.<sup>84</sup>

Xi's visit also comes on the heels of publication of China's "Arab Policy Paper," the first articulation of a policy towards the Middle East, and one that emphasized growing China-Arab ties in a number field, including political cooperation, economics, energy and security. Beijing's newfound engagement comes as Washington, long the sole power capable of managing regional disputes, takes a step back to concentrate on Asia instead.

International ambitions and rivalries with Washington aside, there are more pressing reasons for Beijing to ramp up involvement in the region. Fears over terrorist attacks are likely a key factor behind Xi's visit, as the fundamentalist organization known as the Islamic State, increasingly targets the mainland amid rising ethnic strife in China's autonomous

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<sup>83</sup> Tomas Zimmerman, p. 4.

<sup>84</sup> Ibid., p. 5.

Xinjiang region.<sup>85</sup> China depends on the Middle East for its oil supplies but has long taken a back seat in the region's disputes, only recently beginning to expand its role, especially in the Syrian crisis.

“China is the biggest importer of Middle Eastern oil,” Zhu Feng, professor at Peking University's School of International Studies, told AFP. “So stability in the Middle East is what China would most like to see. “As China's economy has grown, its dependence on imported oil and natural gas has increased, making the Middle East a crucial part of Beijing's strategy as it seeks to expand its influence.”<sup>86</sup>

Last year, China helped broker a landmark nuclear deal with Iran, which has begun to emerge following years of international isolation. Days after the signing of the historic framework agreement, Iran was approved as a founding member of the Beijing-backed Asian Infrastructure Investment Bank, which is expected to provide funding for One Belt One Road. On Jan 15, China published its first official Arab Policy Paper, claiming a “broad consensus on safeguarding state sovereignty and territorial integrity, defending national dignity, seeking political resolution to hotspot issues, and promoting peace and stability in the Middle East.”<sup>87</sup>

Iran and China vow tighter ties that the Asian giant and the Middle East's foremost Shiite power aim to build economic ties worth up to \$600 billion within the next 10 years.

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<sup>85</sup> Nyshka Chandran, “It's not all oil: Xi's MidEast tour tests Chinese foreign policy”, Last accessed Jan 20, 2016. <http://www.cnbc.com/2016/01/20/xis-visit-to-middle-east-could-mean-deeper-political-ties.html>

<sup>86</sup> Ibid.

<sup>87</sup> AFP, “China's Xi to visit Saudi Arabia, Egypt, Iran”, Last accessed Jan 15, 2016. <https://www.yahoo.com/news/chinas-xi-visit-saudi-arabia-egypt-iran-next-102653591.html?ref=gs>

The two leaders oversaw the signing of 17 agreements in areas including politics, the economy, security and cooperation on peaceful nuclear energy. The two countries agreed to enhance cooperation including in fossil and renewable energy, transportation, railways, ports, industry, commerce and services.

In the statement Iran welcomed China's commercial “belt” and the “21st century Silk Seaway” projects, pledging to help the initiative. China has committed to invest and finance upstream and downstream energy projects in Iran, “acknowledges Iran's constructive role in the fight against terrorism and maintaining peace and stability in the region”, it added, while supporting Tehran's increased regional and international role.<sup>88</sup>

## **Conclusion**

This chapter shows that the top of Beijing’s regional diplomatic agenda is the OBOR initiative, a series of land- and sea-based trade routes intended to closely link China with regions to its west and south: Central Asia, South Asia, Southeast Asia, the Middle East, East Africa, and Europe. In addition, the AIIB including OBOR-related projects held its signing ceremony in June with the participation of 57 nations. Together, these two investment initiatives reflect Beijing’s proactive attempt to reshape the Asia and World economic to promoting the political order.

The strategic use of economic incentives to pursue OBOR assists China in fulfilling its foreign policy objectives of improving diplomatic relations with its Asian neighbors and

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<sup>88</sup> AFP, “China's Xi to visit Saudi Arabia, Egypt, Iran”, Last accessed Jan 15, 2016.

expanding its regional and global influence. The OBOR initiative highlights China's ability to use its enormous financial resources for infrastructure investment in Asian neighbors as an inducement for them to work with Beijing. If successful, the initiative will deepen infrastructure connectivity and economic integration by boosting cross border trade, investment and financial flows.

Moreover, it provided economic benefits for both China and other countries that use or form part of the new transport systems. Thus, the initiative will likely strengthen China's importance as an economic partner for its neighbors and enhance Beijing's diplomatic leverage in the region. Greater investment in energy and mineral resources, particularly in Central Asia, could also help strengthen China's energy and resource security.

## IV. Regional Integration, Regional Order, Global Governance

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: How will AIIB influence China and the World?

In this chapter, I explain how to China plans to construct both overland and maritime “OBOR and Silk Roads”.<sup>89</sup>

I focus on infrastructure investments, such as China’s high-speed rail program. This demonstrates a change in global development system. China is now a lead player in development in various regions around the world. In addition, I highlight the bigger implications for geopolitics. China is now central to the multilateral lending system, and it is an important hub international finance and development.

### 4.1 International Financial Architecture

In the post-Washington Consensus shift<sup>90</sup> in 1997, heavily emphasis was placed on the importance of appropriate institutions for growth. Literature has been unable to establish strong links between institutional design(s) and long-term economic performance. The institutional reforms demanded by the World Bank are rarely new, such as advising poor countries to improve the investment climate, invest in infrastructure and agriculture and educate girls. Institutions can become disabling for poor countries, because they are context-

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<sup>89</sup> Thomas Zimmerman, “The New Silk Roads: China, the U.S., and the Future of Central Asia”, Oct 2015, p. 6-7.

<sup>90</sup> Rajiv Biswas, LSE Global South Unit, “*Reshaping the Financial Architecture for Development Finance: The new development banks*”, Working Paper No. 2/2015, p. 8-9



specific and rigid overtime.<sup>91</sup>

Current voting power in the World Bank has also been called into question.

“Inadequate voting reforms mean the World Bank will continue to be overwhelmingly dominated by rich countries for decades” despite the fact that “developing countries represent over 80% of the world’s population and Bank’s membership”. In the next 5 years, 60% of voting power across the World Bank Group will go to high-income countries. Global powers such as India, China and Brazil are part of the middle-income countries with only one third of the votes while low-income countries languish on just 6%.<sup>92</sup>

The latest reform in voting share reflects rising of emerging economies particularly China, but voting shares will continued to stagnate. Calculations of voting shares put heavy emphasis on economic weight (75%), followed by countries contributions to the International Development Association (IDA), which favors rich countries. At the current rate of change, it will take decades for developing countries to have a voice in World Bank policies. This reduces the World Bank’s legitimacy and effectiveness as an institution mandated to combat poverty. In the recent instability of the global financial system, developing countries are being pushed into a new debt crisis.

The power of the World Bank was not seriously challenged until recently. With the rise of the emerging economies, the voting share in the World Bank has seriously underrepresented countries such as China. Its failure to integrate new international economic

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<sup>91</sup> Uwmun in House institutionm, p. 9.

<sup>92</sup> Ibid, p 10.

powers into the current financial system has spurred the creation of new banking institutions. With the emergence of the NDB and AIIB, it signals “disgruntlement among developing nations with the largely US-dominated policies” in current international financial institutions. Although the World Bank have endorsed have endorsed the AIIB, active opposition from the United States remains. The interactions between these banks will have a huge impact on the future global economic order.<sup>93</sup>

How will AIIB influence China and the World?

First, The AIIB will end the dominance of the colonial era Bretton woods institutions. The emerging and poor economies will now flock to AIIB instead of World Bank and IMF due to the stricter conditions imposed by the two of the said global financial institutions.

China will also aim to curb the US’s and Japan's influence in Asia by diverting the nations from ADB and World Bank to AIIB.

Second, American and European domination of world finance institutions will degrade. From the Marshall Plan after World War II and IMF and World Bank, America has played a central role in world financial Institutions. They have used this as leverage in their foreign policy by influencing various decisions. These institutions lend to developing nations but with strings attached i.e., democracy, more liberalized market access to foreign firms, human rights, women empowerment, etc.

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<sup>93</sup> Ibid., p. 10.

China has been seeking for years to gain a bigger role in existing institutions such as the IMF, the World Bank and the ADB. China has only a 4.2% stake in the World Bank while the U.S. has a 15.8% stake and Japan has a 6.8% stake. The U.S. and Japan have 15.6% and 15.7% stakes, respectively, in the ADB, while China's is just 6.5%. "It is kind of strange that China is so underrepresented at the IMF and World Bank"... "it is not surprising that China is doing this." As former ADB president said.<sup>94</sup>

Another of Xi's aims is to undermine President Barack Obama's "pivot to Asia" and the push for the dozen-nation TPP, an Asia-Pacific rim trade zone that so far excludes China.<sup>95</sup>

Apart from pushing ahead with its own trade pact, the Free Trade Area of the Asia Pacific, Beijing is tapping its \$3.89 trillion in foreign exchange reserves to set up multinational bodies like the AIIB, the NDB and a bank for the Central Asian-oriented Shanghai Cooperation Organization (SCO) Bank, while still seeking to increase its influence at the ADB and the World Bank. In July 2015, the BRICS group, which also includes Brazil, Russia, India and South Africa, agreed to set up a bank to be based in Shanghai by 2016.

Questioning the need for yet another multilateral lender, Japan and the U.S. raised concerns over whether the AIIB would have a transparent governance structure and adequate

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<sup>94</sup> Website of knowledge.wharton, "China's AIIB recasts development finance and US influence", Last accessed Apr 16, 2015, p 1-3. <http://knowledge.wharton.upenn.edu/article/chinas-aiib-recasts-regional-development-finance-and-u-s-global-influence/>, Customarily, a Japanese official chairs the ADB — Japan's central bank governor, Haruhiko Kuroda, was president of the ADB before returning to Tokyo, when he was by a finance ministry official.

<sup>95</sup> Ibid.

standards for project selection, preparations, procurement, and environmental impact and resettlement. After years of working to reform and improve standards at the World Bank, the worry is that AIIB might undercut them for the sake of commercial or political expedience.<sup>96</sup>

The U.S. Treasury's concerns about the AIIB focused largely on two issues: standards and governance structures. On the question of governance, some feared that China's political system would mean that it would be unlikely to avoid using the bank to serve Chinese interests at the expense of recipient countries. There was concern that China's intent was to retain as much leverage as possible in the institution. That China would retain a veto power and that the first president of the bank would be Chinese was, to some extent, expected.

While the architects of the AIIB viewed this as a step toward greater accountability and efficiency, others saw it as an effort to escape meaningful oversight. This highlights the disagreement between the US and China, but a fundamental tension within existing development banks. While, in this case, the US prioritized strong checks and balances, the architects of the AIIB wanted to ensure that the management of the bank was held responsible for the success of projects, and that those projects.<sup>97</sup>

## **4.2 Regional Integration, Regional Order, Global Governance**

What is China's global economics' strategy? China building its own international bodies, shouldn't be a surprise. In response to the increasing US presence in Central Asia—especially after the American's gained permission from Uzbekistan to base air force assets

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<sup>96</sup> GS2, p. 4-5.

<sup>97</sup> CSIS, p. 8.

there for the Afghanistan campaign — China created the SCO. Since its inception in 2007, it has expanded its membership and increased its activities, including regular heads of state meetings and joint military exercises.

The formation of regional integration frameworks can best be understood as an attempt to create a preferred regional framework in which the lead state can exercise exclusive influence. In this context, it is important to observe not only which countries are included in a regional framework, but also which countries are excluded from it. For example, the distinct feature of the Trans-Pacific Partnership (TPP) is its exclusion of the China, and that of the Asian Infrastructure Investment Bank (AIIB) is its exclusion of the US.

The Shanghai Cooperation Organization (SCO) Bank is a multilateral organization that achieves three important strategic objectives for China: bringing Russia into a regional security forum that China leads; increasing China's influence in Central Asia; and providing something of a bulwark against further US encroachment in Central Asia.<sup>98</sup>

Beyond its frosty relations with China, Manila is already home to the Japanese-run Asian Development Bank. But the Philippines have decided to jump onboard the AIIB train. It will find a seat alongside other unlikely members, such as Britain, Germany, Australia and South Korea. What makes these nations a peculiar choice for the AIIB is the fact that one of their key allies, the United States, is morally opposed to the bank — even though it now publicly endorses it.

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<sup>98</sup> Geoff Raby, "China's AIIB Bank: Part of a Much Bigger Master Plan", Last accessed April 28, 2015, <http://nationalinterest.org/blog/the-buzz/chinas-aiib-bank-part-much-bigger-master-plan-12748>

President Obama is opposed to AIIB because the World Bank is a U.S.-run institution that provides international loans to countries for capital programs. It has served to promote U.S. interests in Southeast Asia and around the world since World War II. The AIIB is a direct threat to the influence of the World Bank — and subsequently U.S. primacy — in Southeast Asia. Chinese control of the AIIB means it can use the promise of funding as an incentive for “good behavior.”<sup>99</sup>

Consider the example of the Philippines. That country needs money to enhance supply lines and increase trade flow. As a result, it may be more willing to forget about China’s intrusive man-made islands in exchange for a favor from the AIIB. With the bank still very much in its formative years, how projects will be selected or refused is still murky. Regardless, it is a Chinese project from its inception and will undoubtedly be a tool for Beijing to entrench itself as the regional leader economically and politically.

In essence, countries are accommodating China’s ambitions in return for economic favors. The U.S. hoped that a fear of China’s ambitions might outweigh the potential economic gains for the nations of Southeast Asia. However, evidence suggests that the allure of cheap investments and trade increase outweigh fears of Chinese empowerment.

The Scholar Geoff Dyer says that, after decades of dominance in world geopolitics, the U.S. is now facing a growing rivalry with China that will be the major factor in world politics in the coming decades. But that rivalry is not likely to be as intense and bitter as the Cold War

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<sup>99</sup> Website of theTrumpet.com, “AIIB Gaining Momentum Into 2016”, Last accessed Jan 7, 2016. <https://www.thetrumpet.com/article/13439.2.0.0/economy/aiib-gaining-momentum-into-2016>

rivalry with the Soviet Union. Instead, it will be characterized by a constant balancing of power and shifting coalitions, according to Dyer, economics correspondent for the Financial Times. Dyer focuses on three phenomena: the rising Chinese challenge to U.S. power in military might in Asia, nationalist policies on the world stage, and the challenge to the U.S. dollar by the strengthening Chinese currency.<sup>100</sup>

That China is challenging the US on a primarily economic basis, but to a less extent, diplomatically. Militarily, China is focusing on regional dominance over the South China Sea, which the US is checking. Despite its occasional tough talks, China is not really seeking prolonged military confrontations, which is extremely costly and increases the risk of domestic instability. The main priority is still economic development and trade, then gradually leveraging that into soft power such as AIIB.

During the last year meeting between Xi Jinping and Obama in Washington, It remains to be seen whether a new administration will be capable and willing to expend some of its political capital in Washington in order to join the AIIB and make sure that its policies are aligned with the interests of American foreign policy, which the United States so well knows, can only happen from the inside. Decisions are made by those that show up; being in the room where they are actually made is a necessity, something that the United States has traditionally been aware of and used to its own advantage.

This time around however, it seemingly forgot this important lesson. Instead, the AIIB became a symbol of China's new found role in international politics. For its part, the United

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<sup>100</sup> Geoff Dyer , *The Contest of the Century: The New Era of Competition with China-and How America Can Win*, 2014.

States continuing decision not to participate as a founding member and its decision to cajole its allies in not signing up was written in this narrative as an example of the hegemonic power being petulant and unable to accommodate the changes in relative power taking place in global politics. Its decision to be particularly vocal in showing its displeasure with the UK's decision, the news regarding its diplomatic efforts to strong-arm allies in not joining the organization further added to this perception.

In turn, it only helped to solidify the narrative and framing process that China was intent on using in regards to its role in international society, that is, as a country that, given its power, has the motivation and finds the need to be an important factor in managing international society and maintaining systemic stability – a key role of a great power but is only willing to do so if its opinions are heard. This, in turn, can only happen when China has decision-making powers on the processes used inside the institutions that manage and serve as ultimate guarantors of international order.<sup>101</sup>

#### **4.3 Silk Road Fund, Rise of a Hegemon**

What is the “New Silk Road”? The OBOR initiative might be better translated "A road for each belt" where "belt" refers to east-west strips like the tropical zone and the North Temperate Zone. Developing economic ties with Central Asia is in large part an aid program for isolated Western China which was left behind in the coastal-led modernization. Like Italy, China will be aiding its less-developed pole for decades.

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<sup>101</sup> Daniel Rocha e Silva, “China's Contestation Practices of International Order: *The AIIB and OBOR initiatives as case studies*”, July 2015. p. 17-18.



Rail to Europe via Kazakhstan and Russia has long been under development but gone slowly compared to the huge volume of ship traffic between Asia and Europe. As with oil and gas pipelines, these require large investment but could be interrupted in any transit country, giving them leverage and increasing costs.

Gas from Turkmenistan and oil from Kazakhstan has already been a moderate success for China, again primarily for the benefit of Western China which is far from overloaded eastern ports anyway. OBOR was announced with a push to sell high speed rail across Eurasia. This is unlikely to be competitive with air travel for long distances or lightly traveled routes. Europe and even Middle East are more readily accessed via Central Asia toward the Gulf and Africa.

President Xi Jinping first presented China's vision for a "Silk Road Economic Belt" during a 2013 speech in Kazakhstan. The idea was to "forge closer economic ties, deepen cooperation, and expand development in the Euro-Asia region".

While Beijing stresses that the Silk Road framework will be built on an "inclusive and balanced regional economic cooperation architecture that benefits all",<sup>6</sup> it is part of a broader push to ensure that China has a say that is commensurate to the size of its economy and military in setting the strategic and economic agenda of the region. The Silk Road initiatives and the recently launched AIIB are part of a broader push by Beijing to develop the infrastructure necessary to connect China to trading partners in Europe, the Middle East, and

Africa.<sup>102</sup>

China identifies transportation bottlenecks as a primary barrier to regional economic integration. In its initial stages, the Silk Road Economic Belt is being framed as a series of transportation, energy, and telecommunication infrastructure projects. The blueprint describes the development of a “Eurasian Land Bridge” as well as “China-Central Asia-West Asia and China-Indochina Peninsula Economic Corridors” that will be constructed by connecting a series of “core cities” from China to Europe and the BRICS NDB.

China’s state-owned policy banks will play a critical role in financing OBOR-affiliated projects. In April 2015, reports indicated that Beijing intended to draw on its sizable foreign exchange reserves to inject at least \$62 billion dollars in capital into two of its policy banks to support OBOR. These capital investments included \$32 billion to the China Development Bank (CDB) and \$30 billion to the Export-Import Bank of China.

Additionally, China’s CITIC, a state-owned investment conglomerate, and its subsidiaries announced plans to provide over \$700 billion Yuan (approximately \$113 billion) in debt and equity to support roughly OBOR related projects. Bank of China has also made statements that it intends to significantly increase its support with a goal of extending \$20 billion in credit this year and \$100 billion over the next three years.

China’s planned \$40 billion Silk Road Fund, officially established in December 2014, is viewed as the primary bilateral investment vehicle for projects under OBOR. At least \$16

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<sup>102</sup> Thomas Zimmerman, p. 4.

billion will be dedicated to funding projects in Central Asia. The fund was initially capitalized with \$10 billion in contributions from China's foreign exchange reserves, the China Investment Corporation, the Export-Import Bank of China, and the China Development Bank. Chinese experts have said that this fund will more closely resemble a private equity fund than a sovereign wealth fund, comparing it to the World Bank's International Finance Corporation.<sup>103</sup>

The fund is to be profit-driven with a focus on delivering “reasonable mid- and long-term investment returns.” In mid-April, The People's Bank of China announced the first investment from this fund would be \$1.65 billion for the construction of a hydroelectric dam across the Jhelum River in northern Pakistan.

Finally, China has pushed for the Shanghai Cooperation Organization (SCO) to establish a financial institution that would provide an additional funding stream for OBOR projects. Russia has historically been concerned over the potential of an SCO development bank increasing China's leverage in Central Asia, but this dynamic appears to be shifting. In March 2015, SCO General Secretary Dmitry Mezentsev said that the organization would “combine its development strategies” with China's Silk Road strategy and that all members would be invited to participate in the initiative.<sup>104</sup>

How would China's Silk Road proposal affect the world in terms of trade, economy, and politics when it is completed? There are three broad outcomes:

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<sup>103</sup> Levy Economics institute, *Policy Note*, May 2015, p1-3.

<sup>104</sup> Thomas Zimmerman, p 4.

First, the China's interior will be opened up to more trade, bolstering development and economic growth of its western landlocked provinces. Second, the China secures an overland trade route free of any potential US blockade and bolsters its influence with its neighbors. Third, surrounding nations will benefit from more trade and Chinese investment, bolstering development of their economies and landlocked provinces without political interference from the outside.

The Silk Road proposal is, a marketing term for a regional trade agreement put forward by the china in reaction to the US led Trans-Pacific Partnership.

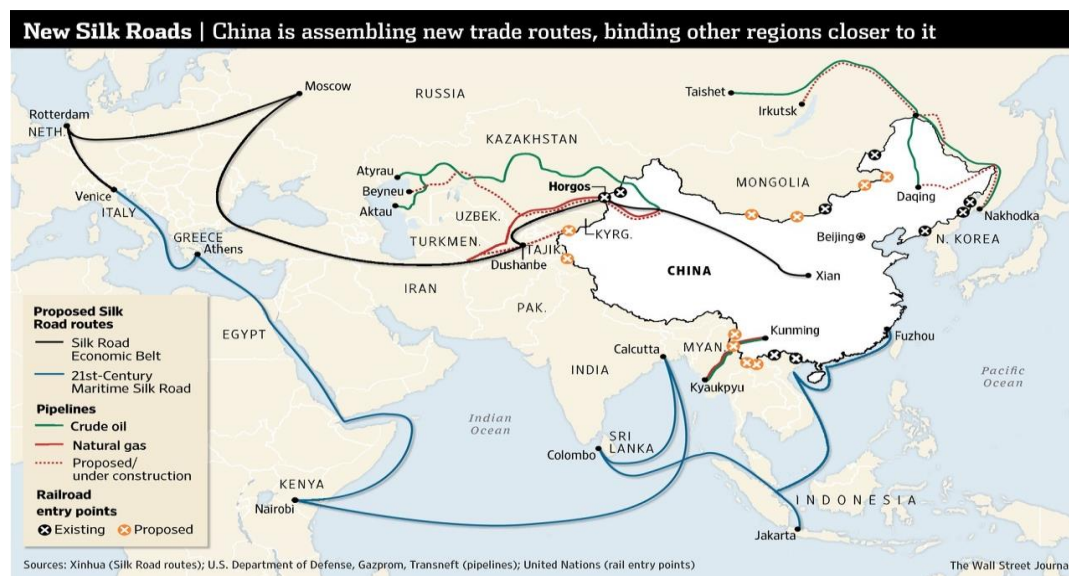
The china's interior will be opened up to more trade, bolstering development and economic growth of its western landlocked provinces. The China secures an overland trade route its influence with its neighbors. Surrounding nations will benefit from more trade and Chinese investment, bolstering development of their economies and landlocked provinces.

The Silk Road projects will connect countries that represent 55 percent of world GNP, 70% of global population, and 75 percent of known energy reserves. China is to launch five years of strategic planning next year, with implementation expected to begin in 2021.

China's era of high growth is gone. However, the Silk Road projects could provide China with a new opportunity for development. Through the usual discussion of mutually beneficial cooperation with neighboring countries and of sharing China's reform and opening experience to help partner countries promote economic development and address economic challenges. But the projects way to leverage to China's advantages in finance, markets,

technology and production capacity is in less developed markets.<sup>105</sup> The Silk Road plans could help Chinese companies improve their “capacity for transnational operations”, as well as to establish “foreign trade strongholds” and “production bases”.<sup>106</sup>

**Figure 4.1: New Silk Roads**



Source: Wall Street Journal

More prosaically, the People Liberation Army’s (PLA) Major General Ji Mingkui, a professor at China’s National Defense University, wrote that the “New Silk Road” provides a useful economic carrot to deal with the majority of security problems China has with its neighbors. This economic card is also an important one to play in the framework of China’s quiet strategic competition for influence with the United States and Japan.<sup>107</sup>

I think that the AIIB is a part of the wider “New Silk Road” initiative by China to deepen trade and investment both in the rest of Asia and the wider world. It could actually be

<sup>105</sup> David Cohen, p. 3.

<sup>106</sup> Agatha Kratz, “One Belt, One Road: What’s in it for China’s economic players?” *ecfr.eu*, Jun 2015, p. 8.

<sup>107</sup> Theresa Fallon, p. 140-147.

a positive thing for the region's stability.

I believe through the building of interdependent relationships based on shared economic interests, this New Silk Road plan should deepen political linkages, improve mutual understanding and foster long-term stability in the region.

The china's interior will be opened up to more trade, bolstering development and economic growth of its western landlocked provinces. The China secures an overland trade route free of any potential US blockade and bolsters its influence with its neighbors. Surrounding nations will benefit from more trade and Chinese investment, bolstering development of their economies and landlocked provinces without political interference from the outside.

The Silk Road proposal is a marketing term for a regional trade agreement put forward by the china in reaction to the US led Trans Pacific Partnership. The Silk Road Fund, new ventures are the BRICS bank, the AIIB and the Silk Road Fund. In short, they are a response not only to the IMF's failure to provide the world's most important emerging economies with representation that's commensurate with their economic clout, but also to the perceived shortcomings of the IMF and ADB. In other words, they are far more than a new foreign policy tool for Beijing to deploy on the way to cementing its status as regional hegemony.

#### **4-4. Rise of Yuan, Global Currency**

In 1960, Yale Professor Robert Triffin predicted that the exchange rate system adopted at Bretton Woods of currencies pegged to the dollar and the dollar convertible to gold would

soon end, and this became known as the Triffin Dilemma. It was a dilemma because either of the two alternative courses ahead—continued large U.S. trade deficits financed by others in dollars or a substantial devaluation of the dollar to reduce the deficit—would produce the same fatal result for the dollar peg / gold convertibility system. And this is what happened in August 1971, as described earlier.<sup>108</sup>

The financial system today, with historic irony, faces a similar dilemma, which can be called the dollar twilight dilemma. The same two alternative courses lie ahead: continued large U.S. trade deficits financed by others in dollars or a substantial devaluation of the dollar to reduce the deficit. The dilemma impact on the financial system this time, however, will be more far-reaching and involve transition from the dollarized system of the past seven decades into some form of multi-key currency relationship. And this, in turn, will have greater consequences for international trade and investment than occurred in the 1970s.<sup>109</sup>

The shift is from the dollar to other currencies in finance trade. This is the most clear and best-documented dimension of the decline of the dollarized financial system. Trade in the European region is shifting to financing in Euros and other European currencies, while the share of Chinese trade financed in Yuan has soared from almost nothing in 2009 to about 25% in 2014. The Yuan has risen to become the fifth largest currency for international payments from number 23 in 2013. In December 2014, 45% of international payments were in dollars, 28% in Euros, 8% in sterling, 3% in yen, and 2% in Yuan. Thus less than half of payments are now financed in dollars and this share will continue to decline.

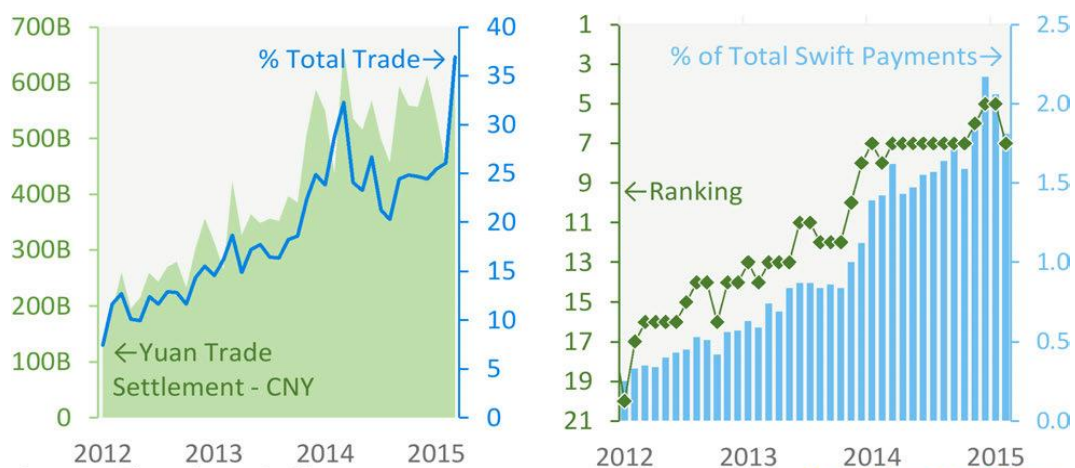
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<sup>108</sup> Ernest H. Preeg, “The Decline of U.S. Export Competitiveness for Manufactures And Its Consequences for the World Economic Order”, *Policy Analysis*, Apr 2015, p. 18.

<sup>109</sup> Ibid.

China has actively promoted this shift to Yuan financing through the recent establishment of a network of clearing banks that makes the Yuan convertible for financing trade. Such Yuan financing had been carried out principally through Hong Kong, but in March 2014 the Bank of England and the People's Bank of China signed such a clearing account, and eight other accounts were established in Frankfurt, Luxembourg, Sydney, and elsewhere during the course of the year. One provision related to the China–South Korea FTA, now in the final stages of negotiation, is that bilateral trade will be financed in the two currencies of the participants and no longer in dollars.<sup>110</sup>

**Figure 4.2: Growing Importance in Trade Settlements, Global Payments**



Source: Bloomberg, Swift

The outlook for the Yuan as a reserve currency is more important for the course ahead, and while also fraught with uncertainty, is likely over time to experience a rise to become one of three principal reserve currencies, together with the dollar and the euro. Chinese policy is

<sup>110</sup> Ernest H. Preeg, p. 19-20.



to have the Yuan become a major international currency, including as a reserve currency, and the central barrier to this is the lack of Yuan convertibility, which is maintained to prevent a rapid rise of the exchange rate and a consequent decline in export competitiveness. But small, cautious steps for convertible Yuan financial assets have been taken over the past several years and market pressures are building for such convertibility to accelerate.

The “dim sum bond” market for Yuan-denominated debt issues outside of China has soared from \$1 billion in 2010 to \$12 billion in 2013. The rapid rise of Yuan trade financing facilities has already been noted. In November 2014, the Shanghai-Hong Kong Stock Connect was launched. It allows offshore investors to buy \$49 billion in mainland stock shares, which is a first step toward opening the Chinese stock market to global investors. Together, these are still relatively small openings to currency convertibility, but they point to the direction being pursued by Chinese authorities.<sup>111</sup>

The new ventures are the BRICS bank, the AIIB, and the Silk Road Fund. We’ve discussed each of these at length and we’ve also shown that in one way or another, they all represent a shift away from the multilateral institutions that have dominated the post-war economic order. The perceived short comings of the IMF and ADB. In other words, they are far more than a new foreign policy tool for Beijing to deploy on the way to cementing its status as regional hegemony.<sup>112</sup>

The role of these new institutions in helping the Yuan to replace the dollar as the

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<sup>111</sup> Ernest H. Preeg, p. 20-21.

<sup>112</sup> Tyler Durden, “BRICS Bank, AIIB Pledge Partnership, Loans To Be Issued In Yuan” Last accessed July 25, 2015. <http://www.zerohedge.com/news/2015-07-25/brics-bank-aiib-pledge-partnership-loans-be-issued-yuan>

world's reserve currency was made clear when, in April, we noted that although Beijing has sought to play down the degree to which the ventures will serve to help establish a new world economic order with China at the helm, the fact that Beijing "may encourage the \$100b AIIB and \$40b Silk Road Fund to issue loans directly in Yuan" (via Bloomberg) and the fact that "the AIIB will establish a currency basket with China set to push for the Yuan to take a prominent role".<sup>113</sup>

At the IMF spring meetings in Washington D.C., the Yuan moved a step closer to reserve currency status. Managing director Christine Lagarde said China's financial reforms were "very positive steps" toward including the currency in the SDR basket. The Fund also edged toward removing its long-standing assessment of the Yuan as undervalued.<sup>114</sup>

China has played its cards effectively. In terms of international payments, the Yuan is not in the top ranks of global currencies. China's capital account remains controlled, which means it's a stretch to describe the currency as "freely usable" — a requirement for inclusion in the SDR basket. That means expectations and politics are playing a critical role in the SDR decision. Expectations are driven by China's continued rise, with potential to rival the U.S. as the world's largest economy in the next decade. The launch of the AIIB will help shift the substance and the politics.<sup>115</sup> AIIB loans might help push the Yuan as an international currency. If China does not get a bigger voice in the IMF, its leaders can focus on their own institutions.

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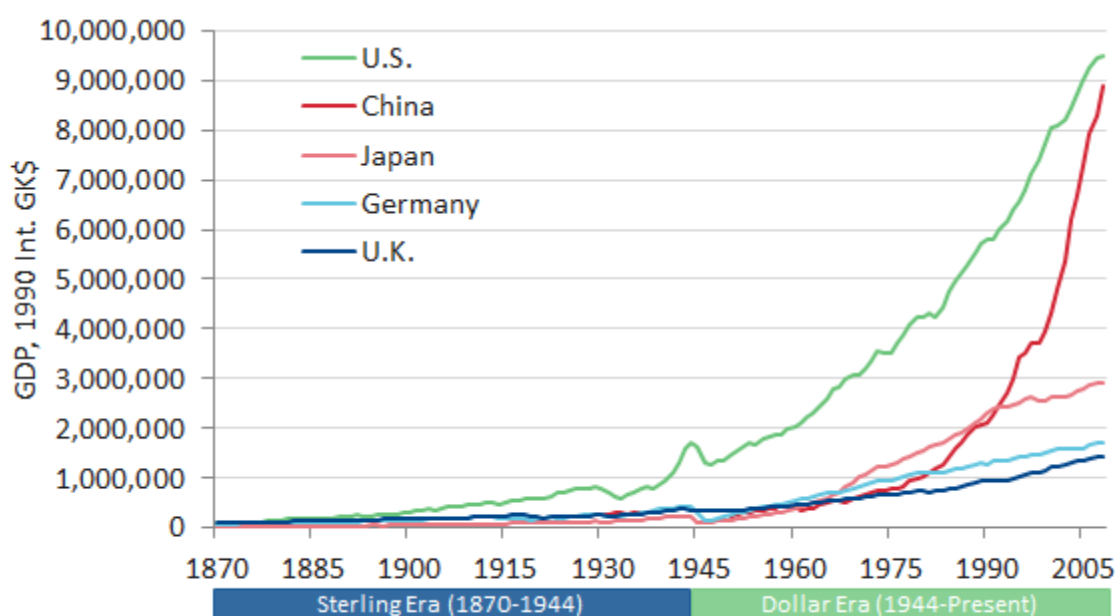
<sup>113</sup> Ibid.

<sup>114</sup> Tom Orlik, "China's Yuan and AIIB Wins Symbolic, Not Yet Substantive", *Bloomberg Brief*, Apr 2015. p. 2.

<sup>115</sup> Tom Orlik, p 2.

The U.S. overtook the U.K. as the world's main economic engine at the end of the 19th century. It wasn't until the creation of the Bretton Woods system after World War II that it emerged as the main power in the International Monetary Fund, with the dollar anchoring the global financial system. China's symbolic rise has been breathtaking. It may be a while before its substantial position catches up.<sup>116</sup>

**Figure 4.3: Currency Transition**



Source: BloombergBriefs.com

I think, use of China's currency in trade and foreign exchange transactions continues to rise. Limited foreign access to the mainland's markets remains a barrier to more rapid progress. As the world's largest exporter, China has a natural advantage when it comes to raising the importance of the Yuan in trade settlement. In 2014, 1.65 trillion Yuan of China's

<sup>116</sup> Ibid.

imports and exports were settled in Yuan in the first quarter, unchanged from the same period a year earlier. That's equal to about 30 percent of total trade.

The AIIB helping the Yuan to replace the dollar as a world's reserved currency. Beijing has sought to play down the degree to which the ventures will serve to help establish a new world economic order with China at the helm, the fact that Beijing "may encourage the \$100b AIIB and \$40b Silk Road Fund to issue loans directly in Yuan" (via Bloomberg) and the fact that the AIIB will establish a currency basket with China set to push for the Yuan to take a prominent role with the AIIB members. Therefore, the Yuan promoting an international reserved currency and potentially declined the dollar.

The Chinese Yuan is grossly underrepresented in global trade. It could quadruple in use and it would only put a marginal dent in the use of the US dollar. This deal with Russia alone will have virtually no impact on the dominance of the US dollar.

Nov 2014, the petro-dollar system is the heart and soul of America's domination over the global reserve currency, and their right to make all nations have to purchase U.S. dollars to be able to buy oil in the open market. Bound through an agreement with Saudi Arabia and OPEC in 1973, this de facto standard has lasted for over 41 years and has been the driving force behind America's economic, political, and military power.<sup>117</sup>

But on Nov 3, a new chink in the petro-dollar system was forged as China signed an agreement with Qatar to begin direct currency swaps between the two nations using the Yuan,

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<sup>117</sup> Wayne Arnold, "China Plays Long Game with Ruble Deal", Last accessed Dec 29, 2015. <http://www.barrons.com/articles/china-plays-long-game-with-ruble-deal-1419903339>.

and establishing the foundation for new direct trade with the OPEC nation in the very heart of the petro-dollar system.<sup>118</sup>

China, Russia, or one of the BRICS nations are finalizing agreements that supersede the old system of dollar trade and reliance on the petro-dollar system. And as many countries begin to reject the dollar due to the exported inflation that is growing in nations that are relegated to having to hold them for global oil purchases, alternatives such as the Chinese Yuan will become a more viable option, especially now that the Asian power has taken over the top spot as the world's biggest economy.

Fasten your seatbelts; 2015 will be a whirlwind pitting China, Russia and Iran against what I have described as the Empire of Chaos. So yes – it will be all about further moves towards the integration of Eurasia as the US is progressively squeezed out of Eurasia. We will see a complex geostrategic interplay progressively undermining the hegemony of the US dollar as a reserve currency and, most of all, the petrodollar.<sup>119</sup>

The Russians aren't the only ones involved, either. Beijing already has swap arrangements with a long list of co-conspirators in Southeast Asia and in November sealed a swaps deal with Australia. On Christmas day of 2011, it signed a swap agreement with regional rival Japan. And in June, it signed an MOU to get advice on currency derivatives from none other than the Chicago Mercantile Exchange.<sup>120</sup>

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<sup>118</sup> Ibid.

<sup>119</sup> Ibid.

<sup>120</sup> Wayne Arnold, website barrons.com. Last accessed Dec 29, 2015.

China gains power at IMF. Yuan Inclusion in SDRs likely. The US to lose IMF majority vote. The reforms are important for Asia as their purpose is to give China, along with other Asian and emerging market countries, a bigger say in the IMF's affairs. China has long advocated less reliance on a single reserve currency - the US dollar - and a move towards a reserve system based on a basket of currencies.

China would like the Yuan to be included in this basket of currencies and an important step in this direction will take place this year when the IMF considers the composition of the SDR basket. The planned changes to the IMF, along with the creation of the AIIB, another Chinese initiative, form part of a bigger picture, which is an alternative international financial framework with a stronger Chinese flavor.<sup>121</sup>

## **Conclusion**

This chapter addressed three main arguments that form the foundation of dominant china's foreign policy approaches in regional integration "Silk Road Belt", "new financing development international system", and the "rise of Yuan, global currency".

First, the Silk Road proposal is a marketing term for a regional trade agreement put forward by the china in reaction to the US led Trans Pacific Partnership. The Silk Road Fund, new ventures are the BRICS bank, the AIIB and the Silk Road Fund. In short, they are a response not only to the IMF's failure to provide the world's most important emerging economies with representation that's commensurate with their economic clout, but also to the

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<sup>121</sup> Ibid.

perceived shortcomings of the IMF and ADB. In other words, they are far more than a new foreign policy tool for Beijing to deploy on the way to cementing its status as regional order.

Second, beyond the pursuit of geo-economic interests, China may also use AIIB as an instrument to realize its own geopolitical objectives, including expanding its sphere of political and security influence westward through the new belt and road initiative. Potential adversaries surround China, with Japan in the east (and the U.S. beyond it), the Philippines and Vietnam in the southeast and India in the south. Thus, China seeks closer ties with Central Asian countries through overland routes and with friendly Southeast Asian, South Asian and Middle Eastern countries through maritime routes. China may use AIIB in addition to the Silk Road Fund and even the BRICS' New Development Bank to expand its geopolitical influence.<sup>122</sup>

Third, the launch of the AIIB will help shift the substance and the politics.<sup>123</sup> AIIB loans might help push the Yuan as an international currency. If China does not get a bigger voice in the IMF, its leaders can focus on their own institutions. The AIIB will establish a currency basket with China set to push for the Yuan to take a prominent role with the AIIB members. Therefore, the Yuan promoting an international reserved currency and potentially declined the dollar.

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<sup>122</sup> Masahiro Kawai, p. 14.

<sup>123</sup> Tom Orlik, p. 2.

## V. Conclusion

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### 5.1 US - China Power Transition

AIIB aims to lend funds for infrastructure development in Asia, and this can considerably increase the clout of China, since many Asian economies are infrastructure hungry. China has been doing lot of bilateral infrastructure development in recent years; with AIIB, it will be multi-lateralized and formalized. Till recently, IMF and World Bank are the de-facto development agencies of the world. However, they are disproportionately controlled by the developed world, and this rouses many a developing countries for not giving them a fair share of say.

The success of AIIB will depend on the impact that it can make to the infrastructure of the needy countries, and the cost that it extracts from them in return. It will also need to ensure that it learns from the strengths WB/IMF and co-operates rather than competing with these institutions. Naturally then, China can use its leverage in AIIB, to further its geopolitical goals vis-a-vis other countries including United States, It can also, increase its say in the global governance, while causing some concerns among China's neighbors.

It has been suggested that China might use the AIIB to develop new Silk Road, an overland and maritime route connecting Asia and Europe. While such a road will be undoubtedly help the regional economy by the virtue of increasing connectivity between China and EU and World. This is enabling to cause significant apprehensions among China's



neighbors, some of which are strong US allies, given that there is an ongoing dispute about South and East China seas. A successful AIIB might also fast-track the long over-due reform of World Bank and IMF in order to prevent further fragmentation of developmental funds.

In sum, AIIB definitely has the potential to give China a bigger chair at the world table, and help reinvigorate the Bretton Woods institutions (WB/IMF), but all the opportunities will open up only if it succeeds in its primary goal – that is solving infrastructure needs of the developing world.<sup>124</sup>

The Obama administration has made strengthening U.S. leadership in Asia a top priority of its foreign policy. Through its Asia “rebalance” strategy, – also known as the “pivot to Asia” the Obama administration has sought to preserve and extend the U.S. position in the Asia-Pacific region, correcting the imbalance that resulted from two protracted wars in Central and Western Asia. One observer summarized this when stating, “One of the most important tasks of American statecraft over the next decade will therefore be to lock in a substantially increased investment – diplomatic, economic, strategic, and otherwise in the Asia-Pacific region.”<sup>125</sup>

In the global distribution of economic power, over the course of the same decade the US will nonetheless remain the dominant regional and global military power, and by a massive margin. While China’s increasing defense spending will continue to close the gap, there is no serious prospect of it reaching military parity with the U.S. before mid-century, if

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<sup>124</sup> Jin Kai, “What the AIIB Means for the US-China Power Transition”, Last accessed Mar 27, 2015, <http://thediplomat.com/2015/03/what-the-aiib-means-for-the-us-china-power-transition/>

<sup>125</sup> Tobias Harris, “The U.S. Response to the Asian Infrastructure Investment Bank”, *Sasakawa Peace Foundation USA*, ISBN: 978-0-9966567-0-2, 2015, p. 44.

at all. China, like the rest of the world, will remain justifiably mindful of America's overwhelming military power. This is a core assumption in Chinese strategic thinking.

Accordingly, President Obama and other senior officials have repeatedly stated that the US does not aim to contain China's rise. In fact, Obama did so in a joint press conference with Chinese President Xi Jinping during the Asia Pacific Economic Cooperation (APEC) summit in Beijing in November 2014, shortly after two major U.S. allies decided not to join AIIB.

The president said, "I have repeatedly reiterated and displayed through the actions of our administration that we want China to succeed. And we actively encourage our friends and allies in the region to foster a strong and cooperative relationship with China." U.S. officials have, for years, called upon China to act as a "responsible stakeholder," that the international system sustains their peaceful prosperity, so they work to sustain that system."<sup>126</sup>

However, the US has not been as sensitive when it comes to multilateral political and economic institution building. Instead, Washington has, at times, seemed content to permit the emergence of "rival regionalisms." Rather than welcome a greater Chinese role in regional institutions, challenging Beijing to act as a responsible stakeholder, the US has seemed, at best, resigned and, at worst, hostile to China's efforts to create its own institutions outside the existing regional architecture. While China has its own reasons for wanting to build new regional institutions, Washington has failed to use multilateral organizations as a means to give China a greater stake in the existing order and to counter the argument that the

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<sup>126</sup> Tobias Harris, p. 44.

US seeks to contain or otherwise limit China's power in Asia.<sup>127</sup>

It is, to some extent, understandable that the US is defensive about the China challenge to existing institutions. The existing system of international financial institutions, built and sustained by the United States and its allies, is an important pillar of the global economy and a tool by which the disputes and promoting regional integration.

The notion of "Chinese Dream"<sup>128</sup> can also be understood as a new principle guiding China's own development and how China relates to the rest of the world.

At the APEC forum held in Beijing in November 2014, President Xi observed that leaders of the region "are duty-bound to create and fulfill an Asia-Pacific dream for our people".<sup>129</sup> He further elaborated that the Asia Pacific dream is about staying ahead of global development and making greater contribution to the well-being of mankind. Meanwhile, the idea of China offering to share its "dream" of wealth and power has yet to win the endorsements by those Western powers already in dominant positions of decision-making in global economic governance.

The consequences of this emerging strategic and economic asymmetry in the U.S.-China relationship will first manifest in the Asia-Pacific region. The shifting balance of economic power is also beginning to be seen globally, where China's economic presence in Africa, Latin America and Europe also challenges the long-standing economic primacy of the US. China's growing global economic and political role will also begin to reshape

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<sup>127</sup> Tobias Harris, p. 44.

<sup>128</sup> Zha Daojong, "Policy Report Chinese Economic diplomacy: New Initiatives", Mar 2015, p. 2.

<sup>129</sup> Ibid., p. 4.

international norms, rules and institutions. It will reverberate across geopolitics, global trade, investment, capital flows, reserve currency status, climate change, other environmental challenges and global people movements. And it will also influence the great questions of war and peace in the decades ahead.<sup>130</sup>

Entangling security challenges outside the Asia Pacific continue to add layers of difficulty to the Obama administration's plans to re-weight its commitment in its foreign and security policy toward economic, military and diplomatic engagement with the region. The shifts of naval assets to the region, deeper defense cooperation with allies, U.S. participation in the East Asia Summit, and diplomacy to support democracy in Myanmar are all among many new moves that can be attributed to the rebalance.

Some of the US's signature programs, namely the TPP, continue to stumble toward implementation, while China's recent regional initiatives, such as the AIIB, complicate the rebalance's objective of shaping the region's institutions and architecture. With the rebalance now framed as a set of sustained strategic goals to intensify and strengthen commercial interactions with the Asia-Pacific and to respond to security challenges in the region, the rebalance is going to be a work in progress for the long-term or until a new administration sets different policy priorities.<sup>131</sup>

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<sup>130</sup> Kevin Rudd, "U.S.-China 21: The Future of U.S.-China Relations under Xi Jinping", April 2015.

<sup>131</sup> Mercy A. Kuo and Angie O. Tang, "US Asia Strategy: emerging risks for the next US president", Last accessed Sep 4, 2015. <http://thediplomat.com/2015/09/us-asia-strategy-emerging-risks-for-the-next-us-president/>

## **5.2 Recommendations: Competition or Corporation**

The AIIB needs to be seen in a broader context: it is part of a larger Chinese effort to create a set of new economic and political institutions and an expanding network of physical infrastructure projects that will have Beijing at their center. China is attempting to build a new regional order in Asia that will be nested within, but also separate from, the existing global order.

I think the US made a strategic mistake in its opposition of the AIIB but also more broadly by strategically choosing to take a combative stance against China instead of engaging on a constructive basis.

Now there is a competing organization in which America will play no role and is likely to be successful given the recent inclusion of many leading economies as well as China's very lengthy track record of infrastructure development. This is going to have an impact on the ability for U.S. companies to compete on project bids when going up against companies from China and other member countries like the UK.

My view is that the US made a mistake, not as much in opposing the AIIB but in dragging its feet on the inclusion of China into existing organizations like the World Bank and IMF. China has little voice in these organizations relative to its economic weight and has been pressing for decades to gain more say. The establishment of the AIIB at this juncture was not inevitable instead.

It is the result of a strategic mistake. The US would be in a better position if it had engaged a rising China instead of trying to block it. If China were effectively elevated to the

second-highest position within the World Bank and IMF, then the United States would still have had a great deal of control and China would probably not have pushed so hard to establish the AIIB this early.

I believe that the decision to drag its feet on engaging vs. blocking a rising China is due in large part to the current political atmosphere. Moving forward much will depend on how China and US engage with one another. If the two countries do not approach each other, AIIB and the New Development Bank will become a challenge to the current order; but if they do, particularly if the existing power (that is, the United States) accommodates China in the current order, the two new banks can become complements to the current multilateral order.

The positive view sees China-led AIIB assisting Asia's developing countries in financing infrastructure development that not only benefits them but also has positive spillovers to firms and people outside of these countries. It finds value in China's willingness to assume leadership, and use its growing economic and financial power, in providing international public goods in the form of strengthened infrastructure development and connectivity in Asia, and in the opportunity the bank provides for China to become a responsible international player.

Accounting for one-third of the world's productivity, the relationship of the US and China will remain the focus of global politics for the foreseeable future. However, neither the US nor China—nor the two together— can enjoy the kind of hegemonic control that existed in earlier unipolar eras. The diffuse interdependence created by globalization gives every state broader alternative and raises the cost of hostility. Cold War camps are unlikely to form.

Despite apparent parity, the US and China do not face each other as hegemony and challenger, but rather as the largest players in a world that neither controls. As the primary nodes of a world order that they cannot dominate, the United States and China are likely to restrain their rivalry. If not, they will isolate themselves.

A stable and peaceful China-U.S. relationship is in the interest of both two countries and the world. The critical question now is how to solve the problem of mutual strategic trust deficit between them. Since neither country has a solution to it so far, the best way is to effectively manage the differences while create more opportunities for “cooperation”.

The New Silk Road Initiative (or the One Belt One Road Strategy) raised by the Chinese government two years ago offers an opportunity for the two countries to have practical cooperation in the economic and development sectors, especially in Central and South Asia, where the two countries share common interests, such as regional security and stability, sustainable economic development of the regional countries.<sup>132</sup>

China’s pivot westward could also alarm India and Russia. In attempting to break free from U.S. encirclement, Beijing may in fact stoke similar fears of encirclement in India, which considers the Indian Ocean its natural backyard. For Moscow, greater Chinese presence in Central Asia—both political and economic—could produce mixed blessings for Russia’s overall strategic position. On the one hand, Chinese engagement could ease strategic and economic pressure on Russia by sharing the burden of restricting U.S. influence and suppressing radical Islam in the region. On the other hand, it could reduce Russia’s soft

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<sup>132</sup> New Zealand Contemporary China Research Centre, “*China-US Relations in Global Perspective*”, Oct 2015, p. 2-3

power and influence within a region where it has traditionally exerted dominance.

China's expanding influence in Central and South Asia has significant implications for the US. Washington confronts a wide range of daunting security challenges abroad and tight fiscal constraints on defense spending at home. Whatever the future might hold, China will continue to be a major challenge for the United States. As part of the US "rebalance toward the Asia-Pacific," proclaimed in 2012, Washington seeks a constructive partnership with the most potent emerging power in the region. But such a relationship cannot be assumed.

Much of the attention to China's growing power and influence has focused on Northeast and Southeast Asia. China's star is also rising in Central and South Asia. Nevertheless, Beijing's strategy is driven by deep-seated insecurities. China's Communist Party rulers are preoccupied by perceived threats to domestic stability and national unity and acutely sensitive to the potential for ethnic and extremist instability on the periphery to spill over into China.

Beijing thus places a premium on maintaining stability just beyond its borders. China seeks peaceful, predictable, and secular regimes as neighbors. Moreover, China desires to expand its influence in neighboring states and limit the influence of other great powers, notably the US and India. Beijing tends to be intensely suspicious of the designs of Washington and New Delhi. Lastly, China is focused on sustaining economic growth in China and fears that a slowdown will threaten domestic stability.<sup>133</sup>

Therefore, US should work with China to formulate sustainable investment standards

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<sup>133</sup> Andrew Scobell and Ely and Beckley, *RAND Project*, ISBN: 978-0-8330-8542-9, p. 79-81.



that are acceptable to both developed and developing countries. The United States and China have already tackled the developed versus developing country divide under the United Nations Convention on Climate Change. The two nations can apply the same model to international development finance. If the United States and China can identify a set of common standards that both nations can accept, it is highly likely those standards will be acceptable to other nations as well. Washington and Beijing will need to think outside the box to find a model that indicates complementarily without requiring complete agreement across all parameters. For example, China—or the AIIB secretariat—could issue a lending policy on coal-fired power that parallels the U.S. policy, even if it does not perfectly match it.

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