Infrastructure Financing as Power Politics*

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Infrastructure lending may sound an innocuous political terrain of interest only to financiers. But it is proving to be the location for the play out of big power politics, involving especially the US and China. As of now, it appears to be one more battle the US will regret having fought.

When the deadline for applications to be a founding member of the China-mooted Asian Infrastructure Investment Bank (AIIB) passed on April 1, 2015, 47 countries had expressed an interest, about 30 of whom had already been accepted. The AIIB is a multilateral development bank to be headquartered in Beijing with paid-up capital of $100 billion, created with the special mandate to finance much-needed infrastructural projects in Asia. China is providing $50 billion to the bank's capital upfront. Other countries too would contribute, but China has promised to increase its contribution to $100 billion, if needed. Thus, though according to reports voting power in the bank will be proportional to the GDP of a member country, there can be little doubt that China will call the shots.

Initially, viewed as another global multilateral bank, the proposal appeared to be a bit of a non-starter. When the AIIB was formally established on October 24, 2014, there were only 20 countries that had agreed to sign in as founding members. The list did not include the US, UK and countries in Europe, and Japan, South Korea and Indonesia in Asia. It included a bunch of central Asian republics, a few countries from West Asia and members of the Association of Southeast Asian Nations, excluding Indonesia. India was among the biggest of non-Chinese founding members. This limited participation was despite the fact that Beijing had put out an open invitation to countries to join the board of the new initiative, and many like Australia, Indonesia and South Korea had expressed an interest in the beginning. Something or someone had dampened that interest, leading to the no-shows in October and the disinterest immediately thereafter.

However, matters changed hugely between October and April, with many countries that had expressed scepticism or said they would "wait and watch", changing their minds and joining the AIIB as members, with a rush of applications as the deadline for founding membership approached. The final tally of 47 applicants, and possibly almost as many members, though lower than the World Bank's membership of 188 and the Asian Development Bank's (ADB) 67, was significant because of a concerted US campaign against the bank. The US refused to join on the grounds that the governance of the bank would not meet 'required' standards, with China having a veto on decisions and international safeguards relating to the environmental, labour and human rights impacts of the projects financed not being met. But it did not stop there. It campaigned vigorously to keep its allies, principally the UK, European countries like Germany, France and Italy, and Asia-Pacific partners such as Japan, South Korea and Australia out of the AIIB.

When after the 1997 financial crisis Japan mooted the equivalent of an Asian Monetary Fund to provide balance of payments support to countries in the region in times of difficulty, the proposal died quickly because of US opposition. This time, however, the US is faced with isolation and abject failure. Not only did the UK decide to suffer rebuke from the US, which it has faithfully supported as a strategic partner in the past, and become a founding member, but many other US allies, like Germany, South Korea, and Australia, also opted to register as founding members. In the end, the list of founding members included all countries of importance in Asia, except for Japan, and the UK, Germany, France, Italy and Australia, among others.

The US, which criticised the UK for its "constant accommodation" of China when it decided to become a founding member, has reason to fear the Chinese move to establish the AIIB. The financial architecture that came out of the Bretton Woods conference, and evolved from there, had the US firmly in control. Despite the huge changes that have occurred in the relative economic presence and power of countries in the world economy since the Second World War, the US and Japan have 24.9 per cent of the voting power in the World Bank and 24.3 per cent in the IMF. Efforts to even marginally shift the distribution of quotas and voting power in the IMF, for example, which were agreed to by the administration have not gone through Congress. The US retains the right to nominate the leadership of the World Bank, and the head of the IMF is always European. In Asia, Japan, a faithful and subordinate ally of the US, has been given control over the Asian Development Bank (ADB). In sum, the US and its allies had tied up things in their favour, and more or less froze it thus.

This would have been partly justifiable during the era when the G7 countries were the main sources of global surpluses that had to be recycled to deficit countries largely through the bilateral and multilateral 'aid' network. They leveraged that power to influence the national policies of dependent governments and shape a world they desired. However, it is not any more true that these countries are the source of the world's surpluses. The United States is the world's largest debtor. Capital flows are dominantly private, and official flows are a falling fraction of the total. In the new environment, the success of the G7 lay in its ability to retain most of the international financial centres and control most of the financial institutions that mediate global capital flows. But a large part of those flows originate as surpluses that countries like China accumulate and then invest either in dollar denominated US assets or in institutions that recycle surpluses to developing country recipients. Despite these changes in financial flows and the shifts in economic power they reflected, history and military might allowed the US to retain its dominance over the global architecture and the dollar its supremacy.

The AIIB is perhaps one way in which China is calling this bluff. It clearly is an alternative to the ADB and the World Bank, with a voting structure that would be vastly different with a bias in China's favour. With start up capital from China alone of $50 billion and the promise of another $50 billion from that country, it promises to quickly equal the ADB's current capital of $165 billion. Moreover, the AIIB is only one among a slew of institutions that China is involved in launching. It is an important member and contributor of capital to the New Development Bank (NDB) or BRICS Bank with headquarters in Shanghai and to the contingent reserve arrangement that were announced at the BRICS Summit in Fortaleza, Brazil in July 2014. Soon after the creation of the AIIB was announced, President Xi Jinping announced the creation of a Silk Road Infrastructure Fund, to which China will contribute an initial $40 billion, but which will be "open" and welcome other investors from Asia and elsewhere. The Silk Road Fund will, according to its chief executive Jin Qi, function more like a private bank and "seek reasonable mid- and long-term investment returns and protect the rights of the shareholders." But it too will have a mandate to fund infrastructural projects that help "break the connectivity bottleneck'" in the Silk Road Economic Belt and along the 21st Century Maritime Silk Road that are China's focus. Finally, China has also initiated a plan to establish a Development Bank of the Shanghai Cooperation Organization, which has China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan, and Uzbekistan as its members (with others like India slated to join). Here too China will be contributing the bulk of the capital, and the bank would serve as a vehicle to strengthen its investments in central Asia.

It does not take much to recognise in all these moves an effort on the part of China to leverage its foreign exchange surpluses (estimated at $3.8 trillion currently) to advance its economic and strategic interests in the region. This decision to take control of the eventual deployment of its surpluses seems inevitable. What is remarkable, however, is the focus on infrastructure. This is an area where the deficit is huge globally and in Asia. The estimated requirement of infrastructure financing till 2020 is $8 trillion, with Asia alone requiring $800 billion a year for the foreseeable future. Much of that investment is not only central to growth but also for realising social and sustainable development goals post-2015.

Government's that have almost all resorted to fiscal contraction because of the fears of financial crises precipitated by inflation and balance of payments deficits have largely withdrawn from infrastructural funding. The private sector is not able to enter without government financial support directly or through public-private partnerships (PPPs), which defeats the purpose of bringing in the private sector. The PPP framework, which was much touted for long, has been recognised to be a failure. The multilateral development banks are nowhere near filling the breach—ADB, for example, allocates only about $10-13 billion a year to infrastructural projects.

Coming into a context like this with large volumes of infrastructural funding is a masterstroke. Countries desperately looking for infrastructural finance want to be in the game. Others that have seen capacities for producing equipment and raw materials for infrastructure lying unutilised don't want to be outsiders. So 'political' objections to the AIIB, influenced by a US that can offer little in return for support, have been quickly dropped.

From China's point of view the benefits are manifold. Chinese companies will be able to sell their goods and services to support the infrastructure push in the region. The infrastructure created will help China in by improving access to markets, raw materials and new locations for cost-competitive production (given rising costs at home). And, above all there is the influence and strategic gains that it would garner as an emerging global power.

Confronting this reality with objections relating to governance and global standards appears a pathetic response on the part of the US. There are few who would agree that the governance of the Bretton Woods institutions or the regional development banks is worthy of praise. And the environmental and human rights record of projects funded by the World Bank and ADB have been the target of much criticism from civil society organisations and other democratic forces. America has lost the battle to stop the AIIB very badly. It is yet to be seen whether it will have continued success with its effort to contain China.

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