



# THE SCHOOL OF PUBLIC POLICY

## SPP Communiqué

Volume 7 • Issue 2  
April 2015

SPP Communiqués are brief articles that deal with a singular public policy issue and are intended to provide the reader with a focused, concise critical analysis of a specific policy issue.

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## WHY DELAY THE INEVITABLE: WHY THE AIIB MATTERS TO CANADA'S FUTURE

Eugene Beaulieu and Wendy Dobson

### INTRODUCTION

Yesterday was the deadline to join the Asian Infrastructure Investment Bank (AIIB) as a founding member. Once again Canada is on the sidelines as Asia and most of the rest of the world moves forward while Canada watches.

When Chinese President Xi Jinping announced plans for the AIIB at the APEC summit in Indonesia in 2013 and launched the initiative in Beijing at the China-hosted APEC summit a year later, who would have predicted that such an idea would cause an international furor. The new Bank has garnered significant headlines for two reasons. One is American opposition to the China-led Bank; and two is that some see it as a rival to the World Bank and other multilateral banks. The official U.S. position is that the AIIB is a rival to these institutions and that the funds would be better channeled through the World Bank and the Asia Development Bank.

We argue that the AIIB is a welcome Chinese initiative, in line with American calls for China to become a 'responsible stakeholder' in the international system. The AIIB will become a multilateral development bank that finances programs addressing huge infrastructure deficits in the Asian region. Myanmar, Cambodia, Laos, the smaller and newer members of the ten-country Association of Southeast Asian Nations (ASEAN), for example, are emerging from years of economic and political isolation to join the region's economy. Connecting them to each other and their larger neighbours, including China and India, requires major investments to create modern transportation corridors and other infrastructure, including electronic connectivity. Infrastructure development is also integral to a shared vision of integration of the region's economies to be an engine of global growth.

We also argue that The AIIB reflects a world where the majority of global GDP will soon be produced in Asia, and where the infrastructure needs in the region are enormous. Canada has much to offer in terms of skills and expertise in building infrastructure. For Canada it is important to look west, as well as south and east in this century. Failure to join the AIIB would be another failure to make inroads in Asia.

## WHAT IS AIIB?

The Asian Infrastructure Investment Bank (AIIB) is a new regional multilateral development bank that was announced by China at the APEC summit in Indonesia in 2013 and was launched at the 2014 APEC summit in Beijing. The new regional bank has been the subject of considerable scrutiny and media attention – more than would be expected for this kind of institution – because it signifies a change in the international relations. As a new regional bank it likely would have flown under the radar, but it also represents a major new development in US-China power transition.

As a new regional bank, some people have seen it as competition, or a rival, to the World Bank, the IMF (International Monetary Fund) and the Asia Development Bank (ADB). However, its mission is to focus on infrastructure investments in the region and is set to complement their work – rather than supplant it. For example, the World Bank's mission is to eradicate poverty. The AIIB will focus on much needed infrastructure projects in the region. There is a well-known and serious infrastructure deficit in the region and the required spending goes beyond the capability and focus of the World Bank and the ADB. The crucial shortage of investment in infrastructure has been identified as a key priority for the G20.<sup>1</sup> As Callaghan (2014) points out, a priority of the G20 should be to strengthen the multilateral development banks to enable them to play a major role in infrastructure investment. He argues that infrastructure investment has lost its priority in the development banks over the past two decades. In principle the AIIB can address this need and provide a complementary service to current multilateral development banks that lack the capacity and/or focus on infrastructure spending in Asia.

For example, some of the small and poor countries from the ten-country ASEAN such as Myanmar, Cambodia, and Laos are emerging from years of economic and political isolation to join the region's economy. These countries require major investments to create modern transportation corridors and other infrastructure including electronic connectivity to connect them to each other and their larger neighbors, including China and India. Infrastructure development is also integral to a shared vision of integration of the region's economies to be an engine of global growth.

The Asian Development Bank estimates that US\$8 - trillion is required to make this vision a reality. Estimates from Beijing are that infrastructure spending in Asia will be US\$730 - billion annually, well exceeding the combined capacity of the World Bank, the IMF and the ADB in this region.<sup>2</sup> The new development bank is poised to narrow the structural financing gap for infrastructure in the region, fostering long-term growth. Yet the scale of available funding available through the World Bank and the Asian Development Bank, which is dominated by Japan, has actually declined in recent years. To its credit, the ADB has been at the forefront of identifying and quantifying the massive infrastructure investment needs of the region, but it has been woefully inadequate in providing the funds to support such investment.

President Xi Jinping initially pledged that Beijing would contribute much of the \$50 billion in initial capital, but the initial capital has increased to \$100 billion. Significantly, the AIIB is an international institution that will facilitate access to China's plentiful savings. China is already a major bilateral donor to existing programs, a major beneficiary of World Bank advice and assistance since opening up in 1980, and in 2007 became a net contributor to the World Bank's International Development Mechanism.

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<sup>1</sup> Mike Callaghan (2014) "The role of international cooperation in increasing infrastructure investment," JASSA, The Finsia Journal of Applied Finance, Issue 3, 2014. p. 43-49.

<sup>2</sup> Hui Feng "Stakes are high for Australia in Asian infrastructure bank," The Conversation, March 29, 2015. <http://theconversation.com/stakes-are-high-for-australia-in-asian-infrastructure-bank-39247>

For these reasons, the ADB, the World Bank and the IMF have welcomed the AIIB as a new source of funding that intermediates Asian savings and encourages much-needed commercial financing of these investments.<sup>3</sup> The AIIB will differ from traditional development banks in that it is open to shareholding by any government, by private investors and will see participants shape its governance and operations.

Undoubtedly China's push for the new bank and leadership in getting it running is in part motivated by its desire to address the infrastructure needs and developing the region, but is also based on its interests in establishing a stronger role in the region, and is a response to the way it has been treated in the western and Japanese dominated World Bank, IMF and ADB. As China and other emerging market economies have increased their shares of the world economy, the World Bank and International Monetary Fund (IMF) have come under pressure to reform their membership structures to give these economies, and most prominently China, more say in how they are run. China is not happy about how it has been treated by the Bretton Woods Institutions that are designed with the power based in the west and Japan and have not been able to reform their governance structures to reflect the emergence of countries such as China. Thus China's role in these institutions does not reflect its current standing in the world economy. For example, the voting shares of the United States, Japan and China are set at 16.75 percent, 6.23 percent and 3.81 percent respectively in the IMF. Reforms agreed to in 2010 would increase China's voting share but it would still be below that of Japan and these reforms are still not in effect.<sup>4</sup> While the IMF members have approved such reforms, U.S. congressional approval that is necessary for U.S. support, has not been forthcoming. The power structure in the ADB is similarly stacked against China with less voting power (5.4 percent) than Japan (12.8 percent) and the United States (12.7 percent). Moreover, the United States has also opposed increasing the capital of the Asian Development Bank.

China is, at least in part, responding to critics, notably the United States, who have long argued that China needs to take on greater responsibilities as a world power. It is ironic, and hypocritical for the United States to vocally oppose the new bank when it has called for China to play a bigger role in the world and has thwarted attempted reforms at the IMF that would give China a bigger role in that institution. It is an understatement to say that the world economy has changed dramatically since the creation of the Bretton Woods institutions and the multilateral development banks. There are large pools of savings and foreign exchange reserves originating in developing countries such as China. The AIIB can play an important role in leveraging these available funds. A new financial institution like the AIIB is crucial for increasing their say in the allocation of these resources. In 2008, a United Nations report concluded that "there is a need for new or expanded regional development banks to fill gaps in the international financial architecture."<sup>5</sup> The report goes on to argue that in the case of Asia the ADB is the only effective regional bank and that there is a clear lack of development bank funding in the region.<sup>6</sup> This need has only grown since that report was issued. The AIIB reflects a world where the majority of global GDP will soon be produced in Asia, and where the infrastructure needs in the region are enormous. An institution like the AIIB is badly needed and, as discussed above, the focus of the new bank is complementary to the existing banks.

## REACTION TO THE AIIB

The creation of the new development bank has drawn intense scrutiny from the international press in recent weeks driven by American resistance to the very existence of the bank. However, as Table 1 reveals, membership in the bank has been spreading. There were initially 21 members, including China, from Asia and the Middle East that signed up to be founding members in late 2014; India is the second-

<sup>3</sup> Matthew Miller and Brenda Goh "IMF, ADB add to supporters for China-led development bank," Reuters, March 22, 2015. <http://www.reuters.com/article/2015/03/22/us-china-finance-ministry-adb-idUSKBN0MI03I20150322>

<sup>4</sup> See Jin Kai (2015) "What the AIIB Means for the US-China Power Transition Is Washington determined to keep China isolated?" The Diplomat, March 27, 2015

<sup>5</sup> Stephany Griffith-Jones (2008, p. viii).

<sup>6</sup> Stephany Griffith-Jones (2008, p. 20).

largest shareholder. As of March 29, 37 countries had joined or applied for membership in the AIIB. As mentioned, the World Bank, IMF and ADB welcomed the emergence of the bank but the U.S. has been vocally and actively opposed. The U.S. has actively lobbied against the development bank and has tried to persuade its allies to boycott the new bank.<sup>7</sup>

But U.S. lobbying efforts have been increasingly falling on deaf ears. South Korea and Australia as well as Europeans including the United Kingdom, Germany and France followed in late March. The U.S. publicly rebuked British Prime Minister Cameron following his announcement that the United Kingdom would become a founding member.<sup>8</sup> As Table 1 indicates, a number of U.S. allies have applied to join the Bank before the March 31, 2015 deadline for founding members. Table 2 provides a summary of some of the countries that have joined and their estimated shares in the new bank.

**TABLE 1**

AIIB Members		
	Countries	Joined In
First members	China, India, Pakistan, Sri Lanka, Bangladesh, Nepal, Mongolia, Kazakhstan, Uzbekistan, Kuwait, Qatar, Oman, Brunei, Cambodia, Laos, Malaysia, Myanmar, Singapore, Vietnam, the Philippines and Thailand	October, 2014
Obtained membership	Indonesia	November, 2014
	New Zealand, Maldives, Saudi Arabia and Tajikistan	January, 2015
	Jordan	February, 2015
Applied for membership	UK, France, Germany, Italy, Switzerland, Luxembourg, Korea, Russia, Australia and the Netherlands	Application submitted in March, 2015

Source: *Seoul's clout in AIIB is still being negotiated*, Korea JoongAng Daily, March 28, 2015  
<http://koreajoongangdaily.joins.com/news/article/article.aspx?aid=3002439>

One of the American concerns about the Bank stems from issues of governance. However, Korea and other US-allies who are joining the Bank as founding members recognize this as a big advantage to joining now. As founding members, countries will participate in shaping the Bank's governance and operations. We are learning more about the governance structure as countries negotiate membership and the details of the Bank are rolled out. For example, it was recently announced that the new Bank will – perhaps not surprisingly - be located in Beijing.<sup>9</sup> As Table 2 indicates, the number of shares is not only based on the size of the country (i.e. GDP) but on other factors as well. Regional members will be treated differently in terms of shares, than non-regional members. Non-regional members are limited to a total of 25 percent of the voting rights of the Bank whereas Asian members will control 75 percent of the shares. There was initially some concern that China would impose a veto power on decisions made by the Bank. However, China is apparently foregoing veto power at the bank in an effort to attract European countries and other U.S. allies as founding members. Shi Yaobin, China's Vice Finance Minister, pointed out that the bank's shareholding structure is still under negotiation<sup>10</sup> - So the number of countries as founding members continues to increase. It looks like most of Europe and Asia, excluding Japan, will join, which account for around \$30-\$40 trillion (U.S. dollars) of global GDP.<sup>11</sup> There will likely be a formula for limiting non-Asian countries to three board seats (of something like 20). Australia's Prime Minister

<sup>7</sup> "U.S. Opposing China's Answer to World Bank" New York Times, October 9, 2014. [http://www.nytimes.com/2014/10/10/world/asia/chinas-plan-for-regional-development-bank-runs-into-us-opposition.html?\\_r=0](http://www.nytimes.com/2014/10/10/world/asia/chinas-plan-for-regional-development-bank-runs-into-us-opposition.html?_r=0)

<sup>8</sup> "U.S. Allies, Lured by China's Bank" New York Times, by The Editorial Board, March 20, 2015

<sup>9</sup> "China ends guessing game on AIIB," China Spectator, March 26, 2015.  
<http://www.businessspectator.com.au/news/2015/3/26/china/china-ends-guessing-game-aiib>

<sup>10</sup> "China Quashes Speculation on Base for Beijing-Led Development Bank," The Wall Street Journal, March 25, 2015.  
<http://blogs.wsj.com/chinarealtime/2015/03/25/china-quashes-speculation-on-base-for-beijing-led-development-bank/?KEYWORDS=AIIB>

<sup>11</sup> Based on the World Development Indicators GDP data for 2013.

pointed out that the bank is an important development as long as the governance piece is adequately addressed. This is part of the reason Australia and so many other countries have stepped forward as founding members keen on negotiating the governance structure at the ground level.<sup>12</sup>

**TABLE 2**

Countries in AIIB: GDP and Shares in AIIB			
Asia Countries	GDP (\$ trillion)	Estimated Stake (%)	Joined in
China	10.35	39.2	October, 2014
India	2.05	7.7	October, 2015
Korea	1.30	4.9	March, 2015
Indonesia	0.87	3.3	October, 2015
Singapore	0.29	1.1	October, 2015
<b>Asia Country Total</b>	<b>14.86</b>	<b>56.3</b>	
Non-Asia Countries			
Germany	3.82	7.0	March, 2015
Australia	1.51	5.7	March, 2015
France	2.90	5.3	March, 2015
Britain	2.85	5.2	March, 2015
Italy	2.12	3.9	March, 2015
<b>Non-Asia Country Total</b>	<b>13.20</b>	<b>27.13</b>	
<b>Total</b>	<b>28.06</b>	<b>83.38</b>	

Source: *Seoul's clout in AIIB is still being negotiated*, Korea JoongAng Daily, March 28, 2015  
<http://koreajoongangdaily.joins.com/news/article/article.aspx?aid=3002439>

## U.S. OPPOSITION

The real issue, however, is fear of China, the shift of global power to Asia and the reality that the rise of new regional institutions and agreements in Asia and the Pacific could pose a threat to U.S. leadership in the region. This is the first of what will be many such skirmishes in the years ahead. China has accepted the international architecture of the WTO (World Trade Organization), World Bank and IMF constructed around western rules and values because they have served its interests. But since China had no role in writing these rules, that does not preclude the possibility that as China develops its own world view it will suggest new rules and form new institutions.

U.S. criticism of the AIIB initiative is hypocritical. The public position has been that there is no need for a new development lender. China should channel its resources into the existing international institutions that follow global standards – which of course would continue to be American-dominated and in which other shareholders and donors do not have much say. Further, it is argued a Chinese-dominated institution would not necessarily adhere to global standards of transparency and procurement. It could open the door to regional fragmentation of the global economy, to unwanted competition and the rise of more exclusive ‘spheres of influence’. This position is wrong. Competition is healthy. And the best way to ensure that rules and practices are transparent and efficient is to join the institution and play a role in writing and enforcing the rules.

<sup>12</sup> Alistair Gale and Rob Taylor “Decision to Join China-Led Bank Tests South Korea’s Ties to U.S.” The Wall Street Journal, March 24, 2015. <http://www.wsj.com/articles/decision-to-join-aiib-tests-south-koreas-ties-to-u-s-1427185565>

## CANADA'S STAKE IN THE AIIB

Canada's relationship with China has been warming in modest ways in the past year. Joining the AIIB would be a useful signal of engagement and support for China as a constructive international player. Canada should pay attention to other U.S. allies, who have decided to join as founding members in order to shape the Bank's governance structure. Joining the Bank as a founding member would have entitled Canada to ensure the institution is not only innovative but open and inclusive. Canada could also encourage close cooperation between the new institution and existing lenders. Failure to join signals that the Canadian government is following the U.S. lead – or has little interest in Asia and its economic priorities – and indifference or opposition to Chinese willingness to lead.

The level of investment required for Canadian membership into the Bank would be around \$3 billion (US). This is in line with the reported investment by Australia. In terms of the mandate of the new bank, this is a perfect match for Canada. Investment in infrastructure is identified as a key priority for the G20. The ADB estimated in 2010, that about US\$8 - trillion of infrastructure investment will be required in Asia over the ten years to 2020. According to Hui Feng (2015), this gap in infrastructure spending in Asia includes US\$2.5 - trillion for roads and railroads, US\$4.1 - trillion for power plants and transmission, US\$1.1 - trillion for telecommunications and US\$400 - billion for water and sanitation investments.<sup>13</sup> The countries that are lining up to join the AIIB recognize the importance of the mission – and understand that this kind of investment in infrastructure in Asia would draw upon expertise of their domestic firms. Once again Canada is missing out on this opportunity.

Most observers are focusing on the relationships among Canada, China and the United States. But failure to join the Bank is a broader loss for Canada in achieving the goals of its Global Commerce Strategy. While arguing for the need to improve relations with Asian economies and trying to forge better relationship with trade agreements such as the recently signed Canada-Korea Free Trade Agreement this is arguably a more important initiative. Canada has been very slow to recognize the importance of Asia in the world economy and is behind in efforts to build strong economic and diplomatic relationships in the region. Canada's agreement with Korea is important, but it came late after Korea had already signed agreements with major trading partners.

Woo (2014) argues that membership in the AIIB should be part of Canada's broader Asian strategy. He argues that Canada's silence on AIIB will be a set back for all of Ottawa's efforts to promote trade and investment with Asian countries. Canada has of late been putting more emphasis on the ASEAN countries and has even set up a modest fund for ASEAN infrastructure-related services. To not participate in the most important new initiative to address infrastructure gaps in Southeast Asia will undo all of the goodwill that Minister Fast and others have been building up in recent years.

The AIIB reflects a world where the majority of global GDP will soon be produced in Asia, and where the infrastructure needs in the region are enormous. Canada has much to offer in terms of skills and expertise in building infrastructure. For Canada it is important to look west, as well as south and east in this century. Failure to join the AIIB would be another failure to make in-roads in Asia.

## CONCLUSION

The AIIB is a welcome Chinese initiative, in line with American calls for China to become a 'responsible stakeholder' in the international system. The AIIB will become a multilateral development bank that finances programs addressing huge infrastructure deficits in the Asian region. Myanmar, Cambodia, Laos, the smaller and newer members of the ten-country ASEAN, for example, are emerging from years of economic and political isolation to join the region's economy. Connecting them to each other and their

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<sup>13</sup> Feng (2015).

larger neighbours, including China and India, requires major investments to create modern transportation corridors and other infrastructure including electronic connectivity. Infrastructure development is also integral to a shared vision of integration of the region's economies to be an engine of global growth.

The Asian Development Bank estimates that US\$8 - trillion is required to make this vision a reality. Yet the scale of funding available through the World Bank and the Asian Development Bank, which is dominated by Japan, has actually declined in recent years. The latter has welcomed the AIIB as a new source of funding that intermediates Asian savings and encourages badly-needed commercial financing of these investments. The AIIB will differ from traditional development banks in that it is open to shareholding by any government and by private investors and will see participants shape its governance and operations.

Almost forty countries and counting have joined the AIIB including all Asian countries except Japan and several European countries. The U.S. has refused to join and has called upon other allies to follow suit. The UK and Australia have joined anyway. The IMF, the World Bank and the ADB support the AIIB.

Of course, none of this explains Canada being silent and missing-in-action. Canada should join the AIIB. Now. Canada's relationship with China has been warming in modest ways in the past year. Joining the AIIB would be a useful signal of engagement and support for China as a constructive international player. Joining as a founding member would have entitled Canada to ensure the institution is not only innovative but open and inclusive. Canada could also encourage close cooperation between the new institution and existing lenders. Failure to join signals that the Canadian government is following the U.S. lead – or has little interest in Asia and its economic priorities – and indifference or opposition to Chinese willingness to lead.

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