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The EU in the AIIB: taming China's influence from within

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With the recent approval of the membership request of Belgium, Cyprus, Greece, Hungary, Ireland and Romania, the Asian Infrastructure Investment Bank (AIIB) will soon count 20 EU countries among its members. But how could the EU make the most of this presence in the bank? Apart from direct business opportunities for its private sector, there are strategic, long-term considerations too. It will be imperative that the EU exploit the link between the AIIB and the Belt and Road Initiative and ensure that the bank's functioning remains consistent with EU development standards through a carefully co-ordinated voice within the institution.

With the global governance system becoming increasingly unrepresentative of the changed realities of the 21st century, emerging powers have been all the more proactive in seeking to reshape the system. Led by China, the so-called BRICS countries (including also Brazil, Russia, India and South Africa) initially sought – often through co-ordinated action – to increase their influence over established global governance institutions such as the International Monetary Fund (IMF), the World Bank or the Financial Stability Board through reforms affecting membership and voting power considerations. Disenchanted with the pace and scale of reforms, however, their collaborative efforts recently acquired a new dimension: creation of international bodies from scratch.[1] Most prominent examples include the China-initiated Asian Infrastructure Investment Bank (AIIB) and the BRICS-launched New Development Bank (NDB) as well as the Contingent Reserve Arrangement (CRA). Of the three new structures, most analytical attention has focused on the AIIB (proposed unilaterally by China) whose operational phase started in January 2016 with 57 founding members (including 14 from the EU). This policy brief aims to explore how the EU could deal with the institution and, by extension, China's growing assertiveness in the international system, by engaging the country from within the Beijing-based bank.

Arguably, the EU has, in the past decade, gradually come to adopt a more accommodating approach towards China. This has not amounted to the EU letting go of its approach in its external relations as a 'normative power'. Rather, the 28-country bloc has become more strategic about its engagement with emerging powers, including China. This can, among others, be exemplified by the EU's pragmatic change of negotiation strategy with the country since the 2009 Copenhagen Summit or, more recently, by the strong focus of the EU's 'China strategy' on 'engagement' and 'reciprocity'. In view of the ambivalent (though yet to be consolidated) attitude of the Trump administration in the United States (US) towards multilateral co-operation, it is of even greater importance now that the EU find ways of developing further its strategic relations with China, which also cherishes vested interests in ensuring the viability of the multilateral system.

As both the EU and China view socio-economic development as a means to stability and security, the AIIB provides a good platform for the EU to engage with China from within and strengthen their strategic relations. For the EU to exploit its presence through its member states (whose number is soon to reach 20)[2] in the AIIB, this policy brief argues that it will be imperative to focus on three issue areas: geopolitical aspects of the bank's activities and their links to the Belt and Road Initiative (BRI), the AIIB's adherence to EU-championed standards in international development policy, and finally the design of an effective representation pattern for EU member states conducive to joint action within the bank.

Geopolitics of the AIIB

From an EU perspective, the AIIB's operation has a number of potential geopolitical implications. A key EU interest, for instance, concerns the AIIB's potential to gradually alter the situation where the overwhelming majority of land routes (including railway and road connections) between East Asia and Europe pass through Russia. In view of the AIIB being one of the channels financing BRI (whose main objective is to boost physical connectivity between East Asia and Europe on land), the EU may use its leverage within the bank to push for projects consistent with the above goal. Should EU-China trade shift gradually to land routes as a result of the unfolding BRI, it may be critical to ensure that not all such routes cross Russia lest Moscow acquire an additional lever of influence vis-à-vis the EU (or China for that matter) in geopolitical terms thus further limiting Europeans' room for maneuver in dealing with Moscow.

Interestingly enough, when the first BRI maps were circulated by the Chinese, the 'belt' indeed bypassed Russia by connecting China to Europe via Central Asia, the Caspian Sea/Iran, the South Caucasus and Turkey – one explanation of which may be the initial fears of 'incompatibility' between the Eurasian Economic Union and BRI. Only later on were a railway line from Istanbul to Moscow and two other railway routes through Russia added to the map. Nevertheless, any aspiration to secure China's support within the AIIB for connectivity projects bypassing Russia must be looked at against the background of presumably contrary intentions from the Russian side.[3]

One way to underpin a strategic EU approach towards the AIIB may concern the rethinking of the 2007 EU Strategy for Central Asia. Central Asia is a key region for both AIIB activities and the land dimension of BRI. Once updated, the strategy could formulate specific instructions as to how the EU intends to utilise its relations with the countries of the region to pursue the above objective. Bearing in mind the demand-driven nature of the AIIB, it is for project promoters to approach the bank with project plans and not vice-versa. In this regard, it will be critical for the EU to work with Central Asian governments and business actors on the ground, through its delegations and the EU Special Representative to Central Asia reinstated in April 2015, to identify connectivity projects consistent with the objective of enhancing land connections between Europe and Asia, bypassing Russia. In this regard, the EU could also make strategic use of the European Investment Bank (EIB) which operates in several Central Asian countries (Kazakhstan, Kyrgyzstan and Tajikistan) has also signed a memorandum of understanding with the AIIB with a view to paving the way towards co-financing projects. This could also form part of the development of an EU economic diplomacy towards the region and open up opportunities under the EU-China Connectivity Platform.

In addition, with European countries holding nearly a fifth of AIIB shares, it would not be unreasonable for the EU to advocate for expanding the geographical scope of AIIB activities towards Europe in the medium to long-term. Especially, Eastern Partnership countries, Central and Eastern Europe (grouped in the 16+1 cooperation format), but also other interested European countries with infrastructural needs, such as those in Southern Europe, could provide opportunities for the bank to do business. This would also be consistent with President Liqun's recent remark that the "AIIB can support infrastructure investment outside of Asia as long as the projects benefit the local and Asian development."[4] This could distinguish the bank from other regional multilateral development banks, such as the Asian Development Bank (ADB) or the African Development Bank, which tend to focus on the region of their location with non-regional members being able to benefit from their activities only through the participation of their businesses in project tenders.

A potential EU success in linking AIIB activities to its close neighbourhood as well as EU countries with infrastructure needs could also have a positive impact on the perception of EU institutions in these regions. Infrastructure shortage remains a pressing issue indeed in certain parts of the EU despite the availability of cohesion and structural funds (in the utilisation of which beneficiary countries face certain restrictions) and the more than five-year long existence of the China-financed 16+1 platform which has, so far, struggled to provide smooth financing for grandiose physical infrastructure projects (e.g. Budapest-Belgrade railway modernisation).

STANDARD STANDARDS?

Despite the AIIB's declared intention to be 'lean, clean and green' from the outset, Western observers, in general, followed the initial evolution of the bank with a sense of suspicion. They feared that the AIIB would operate with lenient social and environmental policies (thus placing orthodox MDBs' standards under downward pressure) and further Chinese domestic policy objectives (e.g. mitigating industrial overcapacities, creating business opportunities for state-owned companies) backed by Beijing's quasi veto power (27.84%) over substantive decisions (requiring 75% of total votes) and enabled also through the non-resident nature of the board of directors.

Arguably, however, the AIIB's evolution has proven most – if not all – of these allegations wrong. In fact, there is a now an increasingly broad agreement across Western capitals on the bank's close alignment with policies and standards of established MDBs. The bank's Environmental and Social Framework (ESF), for example, is largely reflective of extant MDBs' ESF. It recognises many of the topical issues framing development policy at present, including climate change, gender, biodiversity and ecosystems, resettlement, labour practices and indigenous peoples' rights. The document also lays significant emphasis on transparency, information disclosure and public participation, far exceeding those of China's main national development banks. Rather than operating exclusively based on its own standards, the AIIB, upon request from the client (whether public or private) may decide to use all or part of the client's existing environmental and social management system for all or part of the project. This is in line with recent efforts of peer MDBs (see the revision of the World Bank's ESF in August 2016) to opt for reliance on country systems whenever possible.

The institution – which has an initial capital base of USD 100 billion – has also signed a range of MoUs with established MDBs (e.g. the World Bank, the European Bank for Reconstruction and Development, ADB etc.) in order to facilitate co-financing and fostering co-operation at the strategic and technical levels on the basis of complementarity. Out of the 13 projects approved by the board by early May, 11 are to be co-financed (in US dollar) with other MDBs in which case the AIIB often relies on partners' safeguard policies be it about procurement, disbursements, environmental and social compliance, and project monitoring and reporting.

In light of the above, the question does not seem to be so much about whether the AIIB will abide by the general standards guiding the activities of established MDBs but whether China will use the AIIB as a learning experience and transpose its approaches to its own 'policy banks'. This, however, does not mean that EU member states present in the AIIB should sit on their hands as far as standards are concerned. Drawing on the practices of the EIB, EU member states could, for example, advocate for a stronger alignment of the bank's activities with international agendas such as the 2015 Paris Agreement and the Agenda 2030 through the incorporation of climate action indicators (e.g. linking certain percentage of annual AIIB lending to climate action) and the formulation of a dedicated SDG or gender strategy. The AIIB's current performance indicators focus on annual lending volume ambitions and the expected contribution of AIIB-financed projects to the GDP growth of beneficiary countries, whereas the EIB is, for example, bound to dedicate a minimum of 25% of its annual lending to climate action.

EU VOICE

Finally, in order for the EU to maximise its influence and successfully promote the above objectives within the bank, an adequate co-ordination among EU members of the AIIB will be paramount. The AIIB's Articles of Agreement (AoA) currently does not allow for the membership (be it as a full member, enhanced observer or ordinary observer) of non-state actors (e.g. the EU) and changing this situation (through the incorporation of a Regional Integration Clause) would require an amendment of the AoA.[5] On the board of directors, AIIB members are currently divided into 12 constituencies, each of which is represented by a director on the board. In contrast to the World Bank and the IMF, EU member states are not scattered across the board but are grouped into just two constituencies. One of these comprises ten Eurozone members, which essentially constitutes the first instance of a unified representation arrangement for the single-currency area in an international organisation. The other includes four non-Eurozone EU members along with Norway, Iceland and Switzerland.

So far, EU-level discussions on AIIB business have mostly been carried out through COREPER meetings in Brussels. Furthermore, AIIB matters have also been discussed regularly at meetings of heads and deputy heads of mission in Beijing. In view of the growing number of EU member states edging towards membership, co-ordination could be strengthened further through a regular consultation between Brussels-based economic and financial counselors of EU member states as well as between their Beijing-based counterparts under the auspices of the EU delegation, possibly including also the head of EIB office in Beijing. Such meetings could also involve representatives from other European countries (Norway, Switzerland), and like-minded countries (New Zealand, Australia, Canada). Such face-to-face coordination on a regular basis would be of particular importance given the non-resident nature of the AIIB's board of directors.

In the medium term, the EU could also push for observer status for international financial institutions within the AIIB. This could, for example, pave the way for the EIB's presence in the body which could serve as an additional lever of influence for the EU to shape the standards and norms guiding AIIB-funded projects. As opposed to the AIIB, observer status is already possible for international financial institutions (IFIs) on the board of governors of the above-mentioned New Development Bank. Enabling observer status for IFIs would, nonetheless, require changing the AoA through a super majority vote of the board of governors, which requires "an affirmative vote of two-thirds of the total number of Governors, representing not less than three-fourths of the total voting power of the members."[6]

And, finally, the question arises: what influence will Brexit have on the EU's voice in the AIIB? On the board of directors, the UK currently represents the group that includes non-Eurozone EU members and three other European countries.[7] After Brexit, the UK will continue to be an important partner for the EU in trying to ensure the alignment of AIIB standards with those of established MDBs. At the same time, it can be expected that the country's China-friendly policy as initiated under former Prime Minister Cameron and former Chancellor Osborne will continue after the snap elections of this June. As a result, once divorced from the EU, the UK may also opt for taking a softer stance on AIIB standards in the hope of securing better relations with China post-Brexit. Hence, the importance of firmly involving the UK in EU coordination mechanisms both before and after Brexit, ensuring also close cooperation between the two European groupings in the AIIB.

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Endnotes

[1]Arguably, another reason China has put its support behind the AIIB and, in cooperation with other BRICS, the NDB is Beijing's realisation that multilateral negotiations through institutions often have a bigger chance of success at tackling development challenges than bilateral encounters, especially in Asia.

[2] The membership request of Belgium, Ireland and Hungary – along with that of another 10 states – was approved by the AIIB Board of Governors on 23 March 2017. On 13 May, a further three EU member states (Cyprus, Greece and Romania) obtained a green light. They will officially join the AIIB once they complete the required domestic processes and deposit the first instalment of capital with the Bank.

[3] Russia has the third largest voting power in the AIIB, holding 6.33% of total votes.

[4] Li, Xiang (25 March 2017) AIIB welcomes 13 new members, 15 to join the queue. Chinadaily. Available at http://www.chinadaily.com.cn/business/2017-03/25/content_28677254.htm

[5] It was such an amendment that allowed the EU, for example, to become a full member of the Food and Agriculture Organisation in 1991.

[6] AIIB Articles of Agreement, Art. 28

[7] Directors are elected for terms of two years, with the possibility of re-election. The British director represents the group of Denmark, Iceland, Norway, Poland, Sweden, Switzerland, and the UK.

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