

# Challenges of New Multilateral Development Institutions and Their Countermeasures

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In October 2013, Chinese President Xi Jinping proposed the initiative of establishing the Asian Infrastructure Investment Bank (AIIB), which was well received by vast number of developing countries in Asia as well as supported by developed and developing countries in and outside Asia. Currently, the Articles of Agreement of the AIIB are under ratification by the prospective founding members and the preparatory work on establishing the Bank is in progress. In the meantime, thanks to the efforts of the BRICS countries, the New Development Bank (NDB) was inaugurated on July 27, 2015 in Shanghai. These two banks are scheduled to commence operation in 2016, which is a significant move that will bring multiple benefits to the world. However, in the early days of their operation, they may encounter many challenges. In response, they need to rise to the challenges while looking ahead to the future by preparing for their further development and expansion in the years to come.

## 1. The significance of the new multilateral development institutions

The emergence of the AIIB and the NDB, on the one hand, reflects the efforts of China, the world's second largest economy, to shoulder more international responsibilities; and on the other hand, as these banks are committed to the infrastructure development of developing countries, they will contribute to the upgrading of infrastructure in Asia and emerging countries and give new impetus to their economic growth. Specifically, the missions of the new multilateral development institutions include:

### a. Promoting infrastructure development in Asia

There is an enormous infrastructure financing gap in Asia. According to the estimate of the ADB, between 2010 and 2020, the infrastructure investment and financing needs in Asia are as high as USD 8 trillion,

or USD 750 billion per year. The existing multilateral development banks (MDBs) such as the World Bank and the ADB cannot meet the huge needs as their annual infrastructure portfolios in Asia are only around USD 20 billion. In this context, the AIIB and the NDB will offer new financing platforms for Asia's infrastructure and further ease the financial bottlenecks of emerging and developing countries.

### b. Strengthening the existing multilateral development system

The establishment of the AIIB and the NDB will usher in a new multilateral development system where the World Bank, the EBRD, the EIB, the ADB, the IDB, the AfDB, the AIIB and the NDB will work closely and complement each other. Therefore, the two new banks will strengthen and complement the existing multilateral development system and further enhance the collective strength of multilateral development finance.

### c. Complementing and improving the existing global economic governance system

After years of development, emerging economies and developing countries have substantially enhanced their economic strength and their weighting now collectively accounts for more than half of the world economy. Nevertheless, in the existing global economic governance system, they are severely under represented. Although the voice reform of the World Bank in 2010 raised the voting power of developing countries, their voting power still does not match their economic weight. Moreover, the reform plan of IMF, albeit five years on, is still not effectively implemented. In contrast, of the 57 prospective founding members of the AIIB, 36 are non-OECD developing countries and they collectively own 67% of voting power, which further strengthens the representation and voice of developing countries and improves the existing global economic governance system.

## **2. The challenges of the new multilateral development institutions and the policy suggestions**

### **a. How to raise more funds at lower costs**

The higher the credit rating they get, the lower the AIIB and the NDB's funding costs will be in the capital market. AAA is the highest credit rating, and the World Bank, the ADB and the EIB have all obtained AAA rating. There are many factors that may affect the rating, which include not only internal ones like capital adequacy ratio, liquidity, profitability, risk management level and operation capacity, but also external ones like the international financial market environment and the support of share-holding countries. To attain high credit ratings for the AIIB and the NDB, member countries need to address both internal and external factors by enhancing internal risk control and management on the one hand, and on the other hand, by proactively communicating with credit rating agencies such as S&P, Fitch and Moody's to ensure they have full and correct understanding of the two banks' institutional arrangements, including the mandates, governance structures, operation models and financial policies.

### **b. How to be more efficient**

The World Bank, as the prime example of the existing MDBs, has long been criticized for problems such as overstaffing, low efficiency and long project approval cycles. To grow and operate better, it is pivotal for the new MDBs such as the AIIB and the NDB to avert those problems. The AIIB and the NDB need to keep refining their governance structure, put in place transparent and highly efficient management systems, and have well-designed project approval processes.

### **c. How to select high-quality projects**

The AIIB and the NDB need to create project pipelines as soon as possible so as to select high-quality projects with demonstration effects once the banks start operation. Those projects should meet relevant policy requirements and standards such as the social and environmental standards; match the practical needs of Asian countries; deliver both economic and social benefits; and properly balance project efficiency and quality with debt sustainability.

### **d. How to attract more high-caliber talents**

The existing MDBs like the World Bank and the

ADB have grown rapidly in the past decades, which is largely the result of their efforts in attracting and developing talents. As new MDBs, the AIIB and the NDB have even more demands for professional talents to operate and grow their business, and thus must have well-designed HR policies for talent recruitment and development and select high-caliber talents in the fields of infrastructure, finance, HR and risk management from all over the world through an open, transparent and merit-based approach. What's more, multiple methods should also be taken to better develop and train professional talents.

### **e. How to forge stronger cooperation with the existing MDBs**

The World Bank, the ADB and other MDBs, after decades of development, have gained considerable experience in risk management and project operation, which are the weak areas for new MDBs like the AIIB and the NDB. Therefore, in the early days of operation, the two new banks need to strengthen cooperation with the existing MDBs, draw on their good experience and work closely with them in knowledge sharing, capacity building, personnel exchange and project financing. Given the immense infrastructure financing gap in Asia, the AIIB and the NDB alone cannot fully address the financing bottlenecks in Asia, and the new and existing MDBs should thus work together to consolidate resources to better meet the infrastructure investment and financing needs in Asia and to ultimately boost the economic and social development of Asia.

### **f. How to mobilize more private capital for infrastructure investment**

As the capitals of the AIIB and the NDB still fall short of the huge infrastructure financing needs in Asia, it is important to mobilize more private capital for infrastructure investment. The private sector in the Asia Pacific region owns abundant capital, which totals as high as USD 35 trillion, but only a limited amount of money goes to infrastructure projects. The reason is the lack of effective guidance and incentive mechanisms. In light of this, the AIIB and the NDB can use PPP and other models to create an enabling policy environment to boost the cooperation between them and the private sector and to mobilize more private capital from the Asia Pacific region and the wider world to invest in Asia's infrastructure projects.

### 3. The future of the new multilateral development institutions

As new MDBs, the AIIB and the NDB still have a long way to go. While meeting the challenges in front of them, they also need to think about their future path of development.

#### a. Striving to be a knowledge bank

Both the World Bank and the ADB place great emphasis on their knowledge function and they deliver useful intellectual support to the client countries. Over 30 years of China-World Bank cooperation, the World Bank has provided China with lots of valuable advice and suggestions in the areas of macroeconomic policies, rural development and financial and fiscal reform. The AIIB and the NDB should learn from the experience of the World Bank and the ADB to strengthen their knowledge function, for example, by exploring special mechanisms to develop knowledge partnerships with think tanks and universities across the world with a view to timely collection and sharing of advanced international experience and development ideas.

#### b. Driving institutional development with innovation

As new MDBs, the AIIB and the NDB should prioritize innovation and keep innovating. This is the fundamental source of strength for an institution to go far and grow stronger. In its 70-year history, the World Bank has kept coming up with new products in loan, guarantee, equity investment, etc., such as PRSC, DPL and P4R. If the AIIB and the NDB were to maintain their competitive edge, they need to make innovations in their development ideas, service models, lending products, financing channels and processes for project development and operation.

#### c. Expanding the business scope

In their initial stage of operation, the AIIB and the NDB should focus on energy, transport, rural development, urban development, logistics and other infrastructure sectors. With experience gained and ripe conditions in place, they would consider expanding their business to education, healthcare and other social infrastructure projects. The AIIB can also draw on the successful practice of the EIB by operating its lending business outside Asia to enhance its global influence.



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