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New Multilateral Structures

IN FOCUS

The Rise of an Alternative Order or More of the Same?

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Executive summary

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With the global governance system becoming increasingly unrepresentative of the changed realities of the twenty-first century, the emerging powers have been all the more proactive in seeking to reshape it. This paper focuses on three multilateral structures recently created by the emerging powers and asks whether they represent an emerging alternative international order or rather the (re)ascendance of international liberalism. More specifically, the paper assesses the development of the Asian Infrastructure Investment Bank, the New Development Bank and the Contingent Reserve Arrangement. I argue that these bodies aspire, not to eclipse their established counterparts, but to complement them, by building on their best practices and omitting their shortcomings.

Keywords Global governance – BRICS countries – Asian Infrastructure Investment Bank – Multilateralism – New Development Bank – Liberal order

Introduction

For the global governance system to maintain its relevance and legitimacy, it must constantly be adapted to reflect the changing realities of power relations on the ground. This is, however, easier said than done. Much of the current international system still reflects the power relations that characterised the post–Second World War era, when the so-called Bretton Woods institutions, such as the International Monetary Fund (IMF) and the World Bank, were put in place. In recent decades, however, the global political economy landscape has changed significantly. The G7's share of global GDP (in terms of purchasing-power parity) dropped from 44% in 2000 to just 31% in 2015.[1] In the same year, the share of global GDP held by Brazil, Russia, India, China and South Africa (the BRICS countries) had grown from 18% in 2003 to 31%.[2] In the past two years this dynamic has withered somewhat due to weak global consumption, plunging commodity prices, and a range of other economic and political problems that have led two of the BRICS—Russia and Brazil—into recession while slowing growth in China and South Africa.[3] Nonetheless, the above shifts in economic power remain largely unreflected in global governance.

It is true that some of the international institutions have undergone—mainly symbolic—reforms, especially in the aftermath of the 2008–9 financial crisis. All the BRICS countries have now become members of key international financial bodies such as the Financial Stability Board and the Basel Committee for Banking Supervision, and have also seen their voting power increase somewhat in both the IMF and the World Bank. The main beneficiary of these reforms, China, is now the third most powerful member of both institutions in terms of votes and also forms part of the European Bank for Reconstruction and Development (EBRD). In general, however, the scale and pace of reforms have left emerging powers disappointed, which has ushered in a new dynamic in global governance: the creation of new multilateral structures. Three

1 *Economywatch.com,* 'Major Advanced Economies (G7)—GDP Share of World Total (PPP)', accessed at http://www.economywatch.com/economic-statistics/Major-advanced-economies-(G7)/GDP_Share_of_World_Total_PPP/ on 4 May 2017.

2 *Investmentwatchblog.com,* 'BRICS and G7 Share of World GDP (PPP)', 10 March 2016, accessed at http://investmentwatchblog.com/brics-and-g7-share-of-world-gdp-ppp/ on 4 May 2017.

3 I. Talley, 'Brics New World Order is Now on Hold', *The Wall Street Journal,* 19 January 2016, accessed at http://www.wsj.com/articles/brics-new-world-order-is-now-on-hold-1453240108 on 4 May 2017.

examples are worth mentioning. The BRICS-owned New Development Bank (NDB) and the China-initiated Asian Infrastructure and Investment Bank (AIIB) represent new sources of development finance while building on the experience of established multilateral development banks (MDBs). In addition, the BRICS's Contingent Reserve Arrangement (CRA) is intended to strengthen the global financial safety net by offering a framework to its members for the provision of support through liquidity and the use of precautionary instruments in response to short-term balance of payments issues—a role which is very similar to that of the IMF.

This paper asks whether these three new structures can be seen as challenging established international financial institutions and, by extension, whether they represent the pillars of an emerging order that is an alternative to liberal internationalism.

Liberal order: decline or ascendance?

Arguably, the shift of wealth and power from the North and the West to the East and the South is providing ground for the emerging powers to shape the international order hitherto dominated by the US and Europe. Questions, however, arise as to the sort of political order that will emerge out of the new power relations of the twenty-first century.

On one end of the argument are those who make the case for an emerging 'illiberal order', which, they argue, is gradually superseding the liberal international order and its key hallmarks, which include openness, free markets, democratisation, rules-based relations backed by international institutions and norms such as multilateralism. Emerging powers and especially China, goes the argument, will exploit their increased economic weight to shape the global order in line with their own agendas, which draw on ideas such as competing blocs, spheres of influence, mercantilist networks and regional rivalries.[4]

On the other end of the spectrum are those who argue that the relative decline in world affairs of the main protagonists of the liberal order (the US and Europe) should not be equated with the weakening of the liberal

[4] G. John Ikenberry, 'The Future of the Liberal World Order', *Foreign Affairs,* May/June 2011.

international order itself. Accordingly, the unfolding scramble to shape the international order is not about calling into question the underlying principles and rules of the system. Instead, the emerging powers are simply seeking to acquire more authority and leadership within it. Having recognised the benefits that they have derived from international rules, practices and institutions such as the WTO and the World Bank, China, India, Brazil and the like now intend to better reflect their increased economic might within the system (including through greater voting power in multilateral institutions), so as to stand a better chance of bringing its functioning more in line with their agendas.[5] In other words, the BRICS countries' economic successes in recent years are highly intertwined with the liberal internationalist organisation of world politics, which is why their interest lies in preserving the system. Accordingly, not only is there no newly emerging viable alternative to the liberal international order, but quite to the contrary, the rise of non-Western powers represents a new constituency for the current order.

In view of the recent wave of new multilateral structures (emanating from emerging powers) taking shape, the above intellectual debate on the impact of changing power relations on the world order becomes all the more relevant. This paper argues that the design and evolution of the AIIB, NDB and CRA thus far appears to underpin the second of the two strands of argument presented above. This is because, as will be demonstrated below, these new institutions have embraced many of the principles and ideas that inform the liberal international order and, by extension, the established global/regional governance institutions. Thus, the AIIB, NDB and CRA can be seen as complementing, rather than rivalling, institutions such as the Asian Development Bank (ADB), the World Bank and the IMF. I will explain this in more detail below.

[5] Ibid.

Complementarity, rather than rivalry

Asian Infrastructure Investment Bankn

Of the three new initiatives, most analytical attention has focused on the AIIB—a Beijing-based MDB proposed unilaterally by China, which began operations in January 2016 with 57 founding members (including 14 from the EU). China's suspected motives behind the creation of the bank, whose mandate focuses on financing physical infrastructure and sustainable development, initially spurred wide-ranging fears in the West. Despite the bank's declared intention to be 'lean, clean and green' from the outset, observers, notably in the US and Japan, feared that the AIIB would operate with lenient social and environmental policies (thus placing orthodox MDBs' standards under downward pressure). There was also concern that it would further Chinese domestic policy objectives (e.g. mitigating industrial overcapacities, creating business opportunities for state-owned companies) by making use of Beijing's veto power (26.06%) over substantive decisions (requiring 75% of the total votes) and by benefiting from the non-resident nature of the board of directors.[6]

Arguably, however, the AIIB's evolution has proved most—if not all—of these allegations wrong. In fact, there is now an increasingly broad agreement across Western capitals on the AIIB's close alignment with the policies and standards of established MDBs. To begin with, the AIIB's Articles of Agreement is, for the most part, highly reflective of the charter of the International Bank for Reconstruction and Development and the ADB in terms of its structure and language. Moreover, the role of principal drafter was assumed by an American legal expert on international financial institutions, Natalie Lichtenstein, who has three decades of experience at the World Bank. Furthermore, the bank's top management comprises several officials with significant experience in West-dominated development finance institutions. Three of the five vice-presidents are, for example, from EU countries (the UK, Germany and France), and the German national Joachim von Amsberg, who previously served as vice-president of the World Bank,

[6] Certain member countries have opted to permanently place their director at their respective embassies in Beijing.

has assumed responsibility for the AIIB's policies on procurement, financial management, and social and environmental safeguards.

The first tangible sign of a commitment to international standards came in the form of the AIIB's Environmental and Social Framework (ESF), released in February 2016 following a round of public consultation with select non-governmental organisations the year before. Similarly to the ESFs of extant MDBs, the document acknowledges many of the topical issues framing development policy at present, including climate change (the Paris Agreement is referred to 4 times), gender (mentioned 21 times), biodiversity and ecosystems, resettlement, labour practices and indigenous peoples' rights. The AIIB also makes notable commitments on transparency, information disclosure and public participation, far exceeding those of China's main national development banks such as the China Development Bank, the China Export–Import Bank and the Agricultural Development Bank of China. In fact, on certain issues, the AIIB has taken an even more ambitious position than other MDBs. This is the case, for example, with regard to the exclusion of financing for commercial logging operations in tropical or old-growth forests, which is an area where the World Bank takes a more lenient approach.[7] Building on the recognition that country systems are strengthened through use, the AIIB does not necessarily prioritise its standards above national laws. Upon request from the client (whether public or private), the bank may decide to use all or part of the client's existing environmental and social management system for all or part of the project.[8] This is in tune with the recent efforts of peer MDBs (see the revision of the World Bank's ESF in August 2016) to render reliance on country systems more prevalent. What comes to the fore in this regard, however, is the necessity of providing technical assistance to boost enforcement capacity across developing countries[9]—an aspect that the AIIB's ESF does not address. The bank also launched a public consultation last April on its future Complaints Handling Mechanism

7 G. Larsen and S. Gilbert, 'Asian Infrastructure Investment Bank Releases New Environmental and Social Standards. How Do They Stack Up?', *World Resource Institute,* 4 March 2016, accessed at http://www.wri.org/blog/2016/03/asian-infrastructure-investment-bank-releases-new-environmental-and-social-standards on 4 May 2017.

8 This is, nevertheless, subject to a review by the bank of the client's existing environmental and social management. The review includes an assessment of the client's implementation practices, capacity and commitment, among other factors.

9 C. Humphrey, 'The Problem with Development Banks' Environmental and Social Safeguards', *Overseas Development Institute,* 14 April 2016, accessed at https://www.odi.org/comment/10379-problem-development-banks-environmental-social-safeguards-mdbs on 4 May 2017.

(a form of grievance mechanism), which will allow the institution to address issues raised by people adversely affected by AIIB projects.[10]

The institution—which has an initial capital base of $100 billion—has also signed a range of memorandums of understanding with established MDBs, including the World Bank Group, the EBRD and the European Investment Bank (EIB), with the aim of facilitating co-financing and fostering cooperation at the strategic and technical levels on the basis of complementarity. As of early May, the AIIB had approved 13 projects, none of which has yet been signed off. Of these 13, 11 are to be co-financed (in US dollars) with other MDBs. In these cases, the AIIB will mainly rely on its partners' safeguarding policies, be they about procurement, disbursements, environmental and social compliance or project monitoring and reporting.[11]

In light of the above, the question does not seem to be so much about whether the AIIB will adhere to the standards underlying international development policy, 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 there is no room for further improvement as far as the AIIB is concerned. The 14—soon to be 20[12]—EU member states which have joined the AIIB could leverage their relatively coherent presence in the bank to bring it further into line with EU development policy norms.[13] Drawing on the EIB's approaches, EU member states could, for example, push for a more direct link between international agendas such as the 2015 Paris Agreement and the UN's 2030 Agenda for Sustainable Development through the incorporation of climate action indicators (e.g. linking a certain percentage of annual AIIB lending to climate action) and the formulation of a dedicated Sustainable Development Goal or gender strategy for the bank. The AIIB's current performance indicators focus on overall annual lending volume ambitions and the expected contribution of AIIB-financed projects to the GDP growth of beneficiary countries, whereas, for example, the EIB is bound to dedicate a minimum of 25%

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[10] AIIB, 'AIIB Invites the Public to Help Design Its Complaints Handling Mechanism', 27 April 2017, accessed at https://www.aiib.org/en/news-events/news/2017/20170427_001.html on 4 May 2017.

[11] AIIB, 'Approved Projects', accessed at https://www.aiib.org/en/projects/approved/index.html on 4 May 2017.

[12] The membership requests of Belgium, Ireland and Hungary were approved by the board of governors on 23 March 2017. On 13 May, a further three EU member states (Cyprus, Greece and Romania) obtained the 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.

[13] All EU member states are grouped into two constituencies in the AIIB. One includes members of the eurozone, and the other comprises the rest, together with Norway, Switzerland and Turkey. The former constituency is currently represented by the German director on the board, while the other is represented by the UK's director.

of its annual lending volume to climate action. In addition, even though it has been repeatedly declared that the AIIB will not finance coal-related projects, its ESF does not specifically forbid the use of coal.

New Development Bank

Despite becoming operational in July 2015, half a year before the AIIB, the Shanghai-based NDB has provoked much less controversy than its Beijing-based counterpart. Arguably, there are at least two reasons for this. First, it is a five-party initiative from all the BRICS, including actors such as Brazil, which has a proven commitment to sustainable development and green growth. Second, the NDB has, so far, not been opened up to new members, thus it has not created dividing lines in the West in terms of membership considerations. In the absence of membership prospects in the short term, Western countries have also devoted less attention to the evolving lending policies of the institution.

The NDB, which has an initial capital base of $50 billion, focuses on financing sustainable development and sustainable infrastructure projects. The bank treats sustainability as a crucial cross-cutting objective and seeks to devote 60% of its annual lending to renewable projects while being 'fast, flexible and efficient'.[14] The NDB's ESF, just like that of the AIIB, places great emphasis on high social and environmental performance, gender equality, and inclusive and sustainable development, as well as the conservation of natural resources. The ESF 'encourage[s] the international good environmental and social practices' and 'recognizes the importance of maintaining policy and operating standards which … are aligned with international good practices'.[15] At the same time, similarly to the AIIB, the framework privileges the use of the beneficiary country's social and environmental management systems (laws and regulations), as well as corporate systems (policies), over the requirements of its own environmental and social standards, subject to review.[16]

While some shortcomings have been identified by the non-governmental organisations participating in the public consultation on the bank's ESF (e.g.

14 NDB, 'NDB President: 60% of Funding Will Be for Renewables', 21 November 2016, accessed at http://www.ndb.int/president_desk/ndb-president-60-funding-will-renewables/ on 4 May 2017.

15 NDB, 'New Development Bank—Environmental and Social Framework', March 2016, accessed at http://www.ndb.int/wp-content/uploads/2017/02/ndb-environment-social-framework-20160330.pdf on 4 May 2017, 4.

16 Ibid.

the lack of clear criteria for evaluating the adequacy of country systems, no rule for the application of the stronger set of standards when country systems and NDB standards diverge, and the fact that coal projects have not been ruled out formally[17]), the fact remains that the NDB, similarly to the AIIB, appears to further the rules and practices underlying the functioning of established MDBs. Moreover, in order to exchange knowledge and resources that support infrastructure development, the NDB has also signed memorandums of understanding with a number of established development finance institutions such as the Development Bank of Latin America and the World Bank Group. The NDB's board of directors had approved seven projects by early May 2017. Six of these concern the renewable energy sector and one the upgrading of major district roads.[18]

On 1 April 2017, the bank's board of governors also approved the terms, conditions and procedures for the admission of new members.[19] The original plan was for the bank to broaden membership after an initial operational phase of two years (expiring in July 2017). Regardless of whether this timeline will be kept, few—if any—countries have publicly indicated an interest in NDB membership thus far. Here it must be added that the NDB will remain a BRICS-driven institution even in the event of enlargement, as the Articles of Agreement stipulate that the collective voting share of the BRICS must total at least 55% of voting power at all times, while that of non-borrower countries must not exceed 20%.[20]

The two main differences between the NDB and extant MDBs may be that the Shanghai-based multilateral does not intend to link its lending operations to policy changes in the borrowing country and that it primarily lends in local currencies. While many have interpreted the latter policy as a conscious effort to challenge to prevalence of hard currencies, its main rationale is rather to make the cost of financing cheaper for borrowers.

So in sum, it is reasonable to argue that neither the AIIB nor the NDB take a competitive attitude towards established MDBs. First, they emulate the fundamental modus operandi of these institutions: leveraging paid-in capital from their members through international debt markets, thus

17 NDB President K. V. Kamath has, however, repeatedly emphasised that the NDB would only expect to undertake such projects rarely, which is similar to the policy of the ADB and the World Bank.

18 NDB, 'Projects', accessed at http://www.ndb.int/projects on 3 May 2017.

19 As with the AIIB, the NDB's board of directors operates on a non-resident basis.

20 NDB, *Agreement on the New Development Bank—Fortaleza,* July 15, Art. 8., accessed at http://www.ndb.int/wp-content/themes/ndb/pdf/Agreement-on-the-New-Development-Bank.pdf on 3 May 2017.

securing additional capital relatively cost-effectively—capital that they extend to borrowers at low interest rates with long maturities. Second, they aim to do away with the shortcomings that have discouraged borrowers from seeking financing from MDBs: extensive and onerous loan approval processes; the employment of financial management systems with which client countries are unfamiliar; and the imposition of stringent environmental and social safeguards, as well as unique procurement processes where similar domestic mechanisms already exist.

Contingent Reserve Arrangement (CRA)

Though not—yet—a formal institution in itself, the CRA, put in place by the five BRICS countries in July 2014, is the third main new multilateral structure created by emerging powers of late. The CRA's objective is to offer a framework for the provision of support through liquidity and the use of precautionary instruments in response to actual or potential short-term balance of payments pressures. At this stage the BRICS countries have committed \$100 billion to the CRA, with China accounting for \$41 billion; Russia, Brazil and India, \$18 billion each; and South Africa, \$5 billion.[21] The CRA is modest in size in comparison to other similar arrangements such as the IMF (\$780 billion) and the Chiang Mai Initiative Multilateralisation (\$240 billion). Its key feature is that only 30% of the maximum amount a party is entitled to request can be made available by the other participants (the 'de-linked' portion). When an application is made for more than 30% of the maximum amount requestable, the provision of support (the 'IMF-linked' portion) is contingent upon the existence of a conditionality-based agreement between the IMF and the country concerned. The requesting party must also comply with a set of conditions and safeguards. These include a proscription on arrears with other parties (e.g. multilateral or regional financial institutions), and compliance with the surveillance and provision-of-information obligations outlined in the relevant IMF Articles of Agreement.[22] It is therefore clear that the conditions and safeguards that come with borrowing under the CRA are largely linked to those of the IMF. This goes some way towards downplaying accusations that the structure has been conceived to provide a counterweight to the Washington-based

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21 Ministry of External Relations of Brazil, *Treaty for the Establishment of a BRICS Contingent Reserve Arrangement—Fortaleza,* July 15, 15 July 2015, Art. 2(a), accessed at http://brics.itamaraty.gov.br/media2/press-releases/220-treaty-for-the-establishment-of-a-brics-contingent-reserve-arrangement-fortaleza-july-15 on 4 May 2017.

22 N. Cattaneo, M. Biziwick and D. Fryer, *The BRICS Contingent Reserve Arrangement and its Position in the Emerging Global Financial Architecture,* South African Institute for International Affairs, Policy Insights 10 (March 2015).

body, at least in the short term. It is worth noting, however, that the CRA's strong links to the IMF may be attributable to a set of conditions that are likely to change over time. Until October 2016 the CRA had no office or macroeconomic research facility, and hence it did not have the capacity to identify liquidity and solvency problems. This provided one of the motives for its links with the IMF. However, in October 2016, when the CRA became operational, a network of BRICS central banks' research units was set up to support the arrangement.[23] This was in line with the provisions of Article 3 of the treaty establishing the CRA, which stipulates that institutional and surveillance arrangements may evolve (along with the size of the pool and the nature of the CRA's links to the IMF).[24]

Conclusion

Overall, it appears clear that the three multilateral structures discussed above do not attest to the rise of a parallel layer in global governance. Instead, these bodies have embraced the majority of the principles guiding the functioning of established international financial institutions and also demonstrate their founders' commitment to multilateralism—one of the key building blocks of the international liberal order. The emerging powers' proactive action on the international scene is a manifestation of their desire to have their increased economic weight better reflected internationally and thus to stand a better chance of shaping the system according to their own preferences and needs—without, however, challenging its fundamental principles.

About the author

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23 Indianexpress.com, 'BRICS Contingent Reserve Arrangement Operational: Finance Minister Arun Jaitley', 7 October 2016, accessed at http://indianexpress.com/article/india/india-news-india/brics-contingent-reserve-arrangement-operational-finance-minister-arun-jaitley-3070448/ on 2 May 2017.

24 Ministry of External Relations of Brazil, *Treaty for the Establishment,* Art 3(b).

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