European Institute for Asian Studies

EU-Asia at a Glance

Notes on the 3rd Annual Meeting of the Asian Infrastructure Investment Bank, Mumbai, India

June 2018

Erik Famaey[1]

Asia's needs for infrastructure finance rise to USD 2 trillion a year. Under the theme of "Mobilizing finance for infrastructure: innovation and collaboration" the AIIB's President Jin Liqun called on all stakeholders to take responsibility and act.

President Jin is shaping 'his' AIIB into a nimble and innovative multilateral development bank that is distinct from China and that reaches out to the whole world.

The AIIB pushes its core values: 'lean, clean and green'.

India grabs a quarter of the AIIB's initial lending portfolio to finance its bullish infrastructure plans.

EU-Asia at a Glance is a publication series about the current state of affairs in Asia and EU-Asia relations

[1] Erik Famaey is Senior Associate at the European Institute for Asian Studies

Holding its annual meeting in Mumbai, the AIIB made a political, a policy, as well as a practical statement. This was only the third meeting since the new Multilateral Development Bank (MDB) was set up by China. [2]

India's relations with China are fraught with strategic rivalry, and the former has not endorsed China's Belt and Road Initiative (BRI). Yet India is the AIIB's main recipient of AIIB loans, and its second biggest shareholder. The AIIB's President, Jin Liqun, himself a Chinese citizen, was not shy about it: "President Xi has said that the BRI would connect with other initiatives in Asia, and that is what we are doing". Asia is to remain the focus area as 75 percent of the shareholders are Asian. But "Asia cannot sustain its growth without continuing cooperation with the rest of the world. [The AIIB's] benefit is for all people of the world".

Unlike the Asian Development Bank, its venerable sister MDB which keeps poverty reduction as a focus aim, the AIIB is singly pursuing infrastructure related projects. Again, President Jin defends the strategy: "you definitely have to invest in infrastructure otherwise countries cannot increase their exports and generate revenues". Jin admits poverty is still a problem, keeping "11 percent of the Asian population" in throes.

India's poverty as well as its infrastructure shortcomings are glaring and the AIIB's assistance is a welcome help. Progress is being made. In the latest international survey India is being replaced by Nigeria as the world's most impoverished nation. [3]Every minute 44 Indian citizens are lifted out of extreme poverty, hailed the Times of India. And every day, India lays 27 km of national highway[4], the conference was told. "Infrastructure is the biggest driver of growth" said Devendra Fadnavis. The Chief Minister of Maharashtra, which has Mumbai as the capital, runs India's economically most important of India's 29 states. The ambition is staggering. Maharashtra already boasts a USD 400 billion economy and aspires to be a trillion economy by 2025. To that end, the state is building new airports, metro systems in Mumbai and Pune to be ready in four years, and a million houses to be built by next year, to name just a few of the projects mentioned.

The plans for infrastructure investment on a national scale are equally bullish. Finance Minister Piyush Goyal said he had budgeted USD 90 billion for this fiscal year. For the five-year period through 2022, USD 750 billion is needed in energy, transportation, and urban development. "The AIIB will be an important pillar in meeting this requirement", he added. So far, India has already received more than a quarter of the USD 4.4 billion total loan disbursement made by the AIIB. The Bank also participates with USD 200 million in India's 'National Investment and Infrastructure Fund', a USD 6 billion 'fund of funds' that invests in infra projects across all sectors.

Minister Goyal's untempered ambition was matched with characteristic Indian optimism, and the credit goes to the BJP government, he says: "People used to distrust

---

[2] The AIIB started operations in January 2016 with a subscribed capital of USD 100 billion. Asian countries hold minimum 75 percent of the shares. China with 31 percent is the biggest shareholder followed by India with 8.7 percent. Non-regional members include European, African and American nations.

[3] Brookings Institute, 'Future Development Blog' @ https://www.brookings.edu/blog/future-development/2018/06/19/the-start-of-a-new-poverty-narrative/

[4] Linear: a 6-lane highway counts for only 1 km.

governments and how projects were awarded. Private capital ran away. Now, governance has changed and accountability has increased. Hence, getting finance is not going to be too difficult". His Indonesian counterpart, Bambang Brodjonegoro, presented a more sober assessment, admitting "the availability of feasible projects is critical. We always point to the good potential but lack solid feasibility studies".

"Unfortunately", said Piyush Gupta, CEO of DBS Bank, "both India and Indonesia are democracies which means that policies change together with regimes" and, therefore, the needed medium to long-term money is not easy to come by.

Prime Minister Narendra Modi in his speech to the AIIB annual meeting urged the Bank to adopt "simple procedures and faster approvals" as well as "reasonable rates". For his part, Modi said, "We have simplified rules and regulations for businesses and undertaken bold reforms". As a result, "India is one of the most investment friendly countries in the world" and "has emerged as a bright spot in the world economy". "7.4 percent GDP growth is expected in 2018, the fiscal situation is under control, and government debt as a percentage of GDP is consistently declining."[5] The potential is enormous: "We have over 300 million middle income consumers. This number is expected to double in the next 10 years. The size and scale of requirement in India gives the added advantage of economies of scale for investors", Modi said.

Whether the message reaches the targeted audience is doubtful. On the same day that the Prime Minister spoke at the AIIB, the Financial Times carried a rather bleak full page analysis on India under the banner "the economy is growing faster than that of any other major country. Yet critics say the expansion is not enough to raise incomes or create the jobs promised by the Modi government ahead of elections next year". That may or may not be so, an objective judgement of the economic record of the Modi government must wait longer. It cannot be disputed that several structural reform measures have been pushed through, most notably a 'bankruptcy law' that makes it easier to clean up the bad loans in the banking sector,[6] the 'demonetisation' measure boosting digital payments, [7] and - last but not least - the replacement of state-by-state consumption tax by a nationwide 'Goods and Services Tax (GST)" that will improve tax collection. [8]

How to "Put India to Work" and how to get "Make in India" ahead in a competitive world, does not leave much time for visionary or lyrical talk. Except for proclaiming "a new India is rising", Modi's address was devoid of theatrical rhetoric and loaded with hands-on policy matters and facts. Prime Minister Modi's focus on action rhymes well with the philosophy of the AIIB. The Bank's mission is articulated with punch by its President Jin Liqun. Jin combines a Chinese practical approach with a drive to mould 'his' AIIB into a

---

[5] India was upgraded to Baa2 (stable outlook) by Moody's in Nov. 2017. Estimates by Fitch put the ratio of government debt to GDP at 68 percent and the fiscal deficit at 6.8 percent when the states are included. The Institute of International Finance forecasts 7.5 percent real growth this fiscal year to a GDP reaching USD 2.8 trillion.

[6] The Reserve Bank of India on 26th June said the Indian banks' Non-Performing-Assets may rise from 11.6 percent in March 2018 to 12.2 percent in March 2019.

[7]In November 2016, the Modi government cancelled overnight 86 percent of the physical currency in circulation in an attempt to drive out the black economy and prevent election bribes.

[8] The GST is an indirect tax, but the need for better collection is illustrated by the fact that only about 28 million Indians (out of 1.3 billion) have filed tax returns in the fiscal year ended March, 31, 2017.

nimble and innovative multilateral development bank that is distinct from China and that reaches out to the whole world, whether it is as shareholders, other lenders, procurement contractors, or employees.

Its openness for cooperation extends to other MDB's, including the Asian Development Bank with which it has already co-financed projects. Jin previously worked for the ADB and has copied best practices from peers. Yet the AIIB is determined to set its own modus operandi. For example, the AIIB has a non-resident board and wants to be faster in approving projects. Innovative operations such as equity participation in funds that invest in projects that are too small for an MDB can also be considered.

On one thing President Jin is adamant: "Quality is the first priority. Projects should be financially sustainable, environmentally friendly, and accepted by the local population." Jin dismisses allegations that the pricing of AIIB loans is somewhat high: "A few basis points difference in borrowing rates does not matter, what is important is that projects move timely". He appeals to governments to "not just have a good macro policy but to concentrate on practical detailed issues". A lack of focus on aspects such as resettlement can lead projects to be delayed, bringing on "lawyers who often do not understand that problems need to be solved. Then even the wires will be eaten by the rats". "In road projects, think forward and avoid repeat land acquisitions by for instance keeping land reserve in the middle between the two lanes. Acquire space for six lanes and start with only two." Jin urges governments to "set adequate pricing for infrastructure services that assure cost recovery, and even build in creeping tariff increases in good years in order to mitigate unforeseen setbacks from currency depreciation or inflation". Ultimately, even if governments set a good policy and regulatory framework, and also help overcome practical difficulties,"if you do not have finance arranged, no project can be called shovel ready".

In the eyes of President Jin "a good project is a cash cow which MDB's should be willing to sell, and the private sector should be willing to buy". However, one troubling common feature in infrastructure finance is that investors looking for opportunities to redeploy their long term funding in assets that yield stable earnings, will only come in when the projects are finished. How to bridge the first few years of design and construction is a perennial problem. This is where commercial banks should come in but, often,"definitely in India" says DBS CEO Gupta, banks are unable to do the job. Either they are too weak or they are unwilling to take on the asset. On this matter, a panel led by the Vice-Chairman of Citibank, Alan MacDonald, blasted the Basel international banking rule setters for maintaining "risk adjusted capital requirements that are no more appropriate". Said fellow ex-Citibanker and former Pakistani Prime Minister Shaukat Aziz: "Basel is a bureaucracy. Convincing a bureaucracy is walking up a mountain. But we must get into the culture of raising issues and challenging the status quo. This is a time for dynamic regulatory regimes. If they refuse to change they will lose influence."

The AIIB's CFO, Thierry de Longuemar, displayed the Bank's innovative thinking by suggesting "an instrument where the MDBs would take on 100 percent during construction and then sell to the private sector should be considered". Equally frank and controversial, the classic remark that MDB's should be willing to take the "first loss" was fiercely rejected by President Jin: "MDBs have preferred status, are privileged creditors in Paris club default cases. That is fair. Picking the first loss is anathema. We should be the first repaid in order to safeguard our triple A status so that we can continue our work."

Risk of many kinds keeps investors reluctant in emerging and frontier markets, said Nigerian former Minister of Finance, Ngozi Okonjo-Iweali, "but the risk is not always real, often there is a lack of information". "We expect the private sector to manage their own expectations, sometimes they even want cover of commercial risks. I would want to be in that business". Other panelists called on the industry and the MDB's to standardize documentation, and on governments to adopt lower and unified taxation on dividends derived from investments in infrastructure.

In conclusion, the conference under the theme of "Mobilizing finance for infrastructure, innovation and collaboration" doled out homework to all. The task is urgent as liquidity gets less abundant due to rising interest rates and dollars flowing back to the US. All the while the needs are rising. The AIIB estimates Asia requires USD 2 trillion every year until 2030 for infrastructure financing. That is even higher than the ADB's calculation of USD 1.7 trillion. Against this backdrop and alluding to India's own massive needs, Prime Minister Modi called on the AIIB "to expand financing from (last year's) USD 4.4 billion to USD 40 billion by 2020 and USD 100 billion by 2025".

The AIIB's President Jin gently acknowledged "India was setting a high standard but that stimulates". Then Jin was his determined self when, during the debates, he said: "we do not look at the big number of infrastructure needs, I look at the quality of every project we do."

European Institute for Asian Studies – EIAS a.s.b.l.
26 Rue de la Loi, 10th Floor, 1040 Brussels/Belgium
Tel.: +32 2 230 81 22 E-mail: eias@eias.org Website: www.eias.org

EiasBrussels European Institute for Asian Studies @EIASBrussels