

# **Asia Infrastructure Investment Bank**

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**The KEIC**  
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**Abstract:**

Asia Infrastructure Investment Bank 亚洲基础设施投资银行 (AIIB) is a financial institution proposed by China on October 2013. It is an institution for large-scale infrastructure investments in Asia-Pacific area. Currently, by August 2015, 37 regional and 20 non-regional members are prospective founding members and 50 of which have signed the Articles of Agreement including South Korea, Australia, India. Official establishment of AIIB is announced to be at the end of 2015.

This report would focus on general introduction of AIIB and its impacts on South Korean economy as South Korea decides to join AIIB as a member.

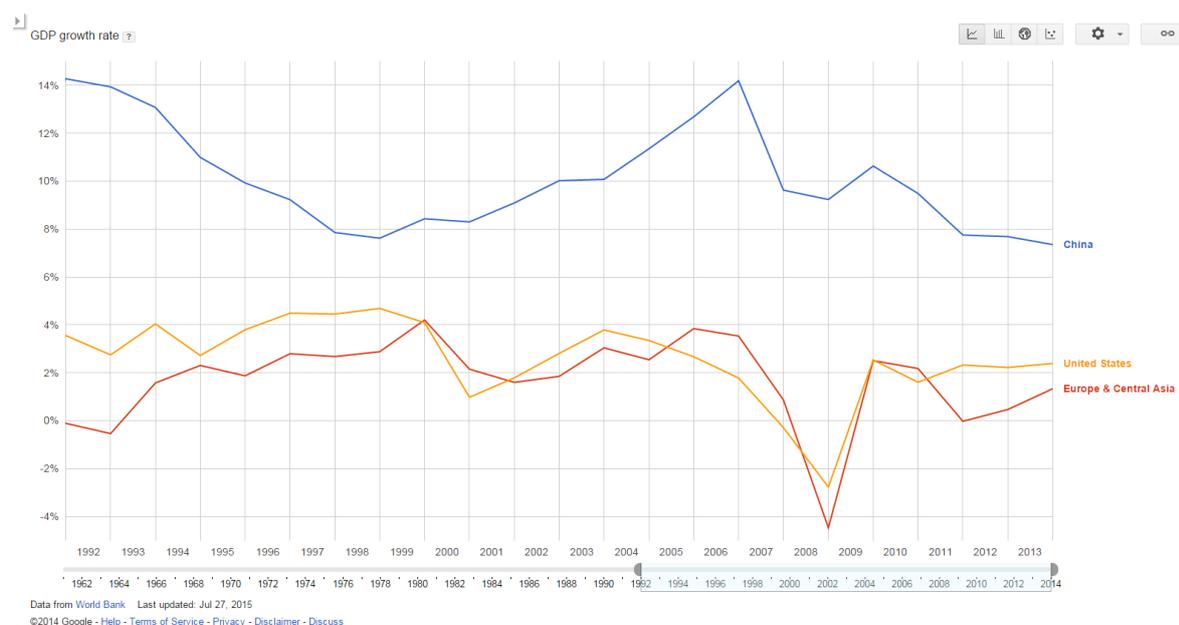
## 1. Background

- The Asian Infrastructure Investment Bank (AIIB) is introduced as follows:

“The Asian Infrastructure Investment Bank is a multilateral development bank (MDB). ... It is built on the lessons of existing MDBs and the private sector. ... The AIIB, a modern knowledge-based institution, will focus on the development of infrastructure and other productive sectors in Asia, including energy and power, transportation and telecommunications, rural infrastructure and agriculture development, water supply and sanitation, environmental protection, urban development and logistics, etc.”

“Chinese President Xi Jinping and Premier Li Keqiang announced the AIIB initiative during their visits to Southeast Asian countries in October 2013. ...”

However, there is more than what the bank looks like. With over 50 countries funding for the bank, China has contributed over 30% of its shares. The underlying economics and politics behind the establishment of the China-led bank is more complicated.



<Figure 1.1 Economic Growth of China>

China’s GDP growth gradually fell in 1990s, marked 8.3% in 2001. After the nation became a member of the World Trade Organization on December 11, 2001, its economy grows rapidly, reaching a two-digit growth rate from 2003 (10.02%) to 2007 (14.19%). However, during the world economic crisis when those of the U.S and EU plunged, that of China also ended its two-digit growth rate era. Though not as severe as the world economy, China’s economy underwent decline in investment and exports. Rising nationalism of Abe’s Japan and the weakening influence of the U.S. on IMF and the World Bank. (U.S. has a 17.68 % share of IMF still making the nation the most powerful veto; however, developing countries including BRICs are making movements to increase their voting power. A reform proposal in 2010 has yet to be passed by the U.S. council.)

- The following is the list of the countries that President and Premier of China has travelled since March, 2013:

Russia, Tanzania, South Africa, Democratic Republic of the Congo, Trinidad and Tobago, Costa Rica, Mexico, USA, Kazakhstan, Kyrgyzstan, Uzbekistan, Malaysia, Indonesia, ... , etc.

Since March, 2013, when Xi Jinping has been elected as President of China, China has been looking for cooperation and economic opportunities. President and the premier Li Keqiang travelled around the globe, and focused on exporting surplus capacity and labor and facilitating investment and infrastructure construction.

Obviously, China is building influence over the globe. President of China initiated its One Belt, One Road initiative to connect the continent with Europe. The two components of the initiative, the land-based Silk-Road Economic Belt and the ocean-based Maritime Silk Road, will work as channels through which surplus capital, labor force and raw materials produced from China will be exported. And the AIIB will be the nation's instrument to achieve its position as veto of the world economy.

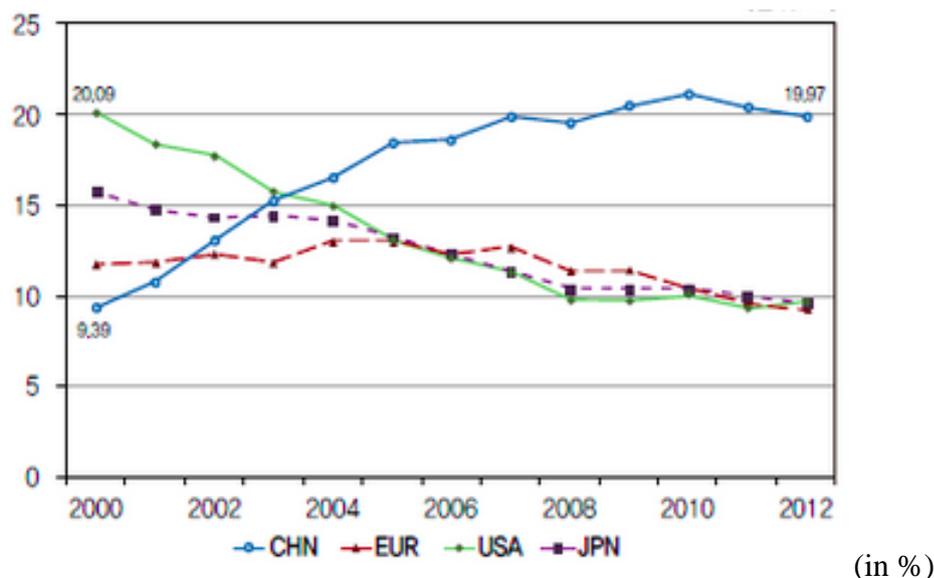
## **2. AIIB's Influence on Korean Economy**

Although the AIIB does not only have economic but also geopolitical influences on Korea, this part would focus on economic prospects that may be brought by Korea's participation in AIIB.

One possible economic influence on Korea is led through strengthening the RMB's status in global economy. Through establishment of AIIB and having the largest shares in the bank, China would seek for the main influence on decisions in AIIB. One part of this influence would be the internationalization of RMB in the long run. Just as the U.S. achieved the internalization of US dollar through World Bank and International Monetary Fund, AIIB would play its role as a platform for China to internationalize RMB. Thereby, RMB would become one of the key currencies in the global market, along with US Dollar, Pound, Yen, and Euro.

As the result of growing power of RMB, Korea would increasingly fill the foreign currency reserve with RMB. Since the major foreign currency, USD, has become not as stable as it did in the past, Korean government will consider RMB as substitute. Also, Japanese Yen will weaken since the demand for it will decline due to its reduced role as a key currency. RMB will gradually replace Yen in the currency market, and gain economic power.

South Korea will become dependent on the Chinese RMB. The degree of dependence upon foreign trade with China has been rapidly growing since 2000, from 9.39% in 2000 to 19.97% in 2012.



(in %)  
<Figure 2.1 Trade Volume Shares of South Korea>

With the capital inflow from China to Korean market as RMB becomes universal, the value of RMB will greatly influence that of Korean Won. Though the Bank of Korea will also have an amount of dollar reserves as well, a slight fluctuation in the value of RMB will then generate a bull-whip effect on the Korean economy. Therefore, Korean government should get prepared for more diversified policies for the key currencies, especially for USD, as usual, and RMB.

Assuming the prospective impacts of fluctuations in RMB would be similar to what USD has on Korean economy nowadays:

When the Chinese RMB appreciates against Korean Won, the value of national debt of South Korea in RMB would also increase. Higher national debt would result in a lower credit rating of South Korea. Subsequent depreciation of the Korean Won against RMB is likely to lead to national financial crisis or even to a more extreme consequence — default. To protect the nation from that disastrous consequence, there is a need to increase currency reserve in RMB. Sufficient amount of reserve in RMB would help Korea to offset the debt in RMB when needed.

Furthermore, Korean firms would have comparative advantage to export to China if Chinese RMB appreciates. Specifically, from the perspective of Korean firms, appreciation of Chinese RMB against Korean Won means more money earned by selling the same products. Also, because of RMB appreciation, the price of the products produced by Korean firms would decrease and therefore the actual exports of Korean firms aim at Chinese market would also increase.

### **3. AIIB's Influence on Japanese Economy**

AIIB would not only have impacts on one of the four tigers- Taiwan, Singapore, South Korea, and Hong Kong - but also on Japan, which is considered to be China's main target of containment in Asia.

Japanese Yen currently has fairly significant impacts on global economy as one of the key currencies. Holding Yen as a key currency, Japan has been able to keep printing out Japanese Yen to purchase real assets in order to help their economy. This strategy is from so called 'Abenomics', the economic policy suggested by Japanese government with the Prime Minister, Abe Shinzo. If the AIIB becomes helpful to strengthen RMB in global market along with the increasing Gold reserve in China, the part of demand for Japanese Yen would decrease while that of RMB would increase. Japan would no longer be able to continue their monetary policy, leading to another recession of the economy.

### **4. Conclusion**

AIIB officially has 57 members by Sep 29th, 2015. The Articles of Agreement for AIIB is signed by 50 prospective founding members (PFM) while the remaining 7 of them have until December 31, 2015 to complete to sign the articles. Until December 31, 2016, PFMs could complete domestic procedures for ratification, acceptance or approval of the Articles. When at least ten countries with subscriptions totaling at least 50% of AIIB's total capital allocation have completed these procedures, the Articles will enter into force under Article 59, Entry Into Force.

Though the AIIB has not taken its first initiative as an international financial institution, its impacts on the world economy are obvious. It will be instrumental on internationalization of RMB and therefore influence Korean and Japanese economy. This report analyzes such impacts; however, they will be more complex in reality considering political and economic interactions between the U.S. and China.

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