THE PENNSYLVANIA STATE UNIVERSITY
SCHREYER HONORS COLLEGE

DEPARTMENT OF FINANCE

# IMPLICATIONS OF GLOBAL FINANCIAL INSTITUTIONS IN THE ASIA-PACIFIC REGION

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## ABSTRACT

In the last few decades, the expansion of the global economy and rapid innovations in technology have brought many changes to the way international business is conducted. With rising standards of living in the Asia-Pacific, the nations in this region, specifically China (also known as the Peoples Republic of China or PRC), have sought to expand their influence, or "soft-power", by enacting a set of initiatives to both further economic prosperity and build regional security. Much of the reason for this shift has been attributed to Chinese Communist Party (CCP) general secretary and President Xi Jinping, having been credited with launching a number of new foreign policy concepts. Of these new programs, The Asian Infrastructure Investment Bank (AIIB) and the One Belt, One Road (OBOR) are the most far reaching and controversial.

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# Chapter 1

## Information

Since the end of the second World War, the United States has been the world leader in international relations and financial investment. Through the United Nations (U.N.), the World Bank (WB), and International Monetary Fund (IMF), maintaining this strength has been a key part of American foreign policy. The U.S. has also been at the forefront militarily, comprising over 40% of total global military expenditures, roughly the combined budget of the next 10 countries. This has led to the dominance of the U.S. in many facets of trade, investment, and security, which has brought with it several allies, for example Western Europe and Asian partners like South Korea and Japan, as well as adversaries, of those namely China and Russia. With the collapse of the Soviet Union in the early 90's, the U.S. was left the single global superpower, defined as a nation with the military, economic, and cultural significance which can be projected simultaneously on a global scale. For all intents and purposes, this is still true today. However, due to sustained economic growth and swelling foreign reserves, there is another player exhibiting signs of a potential superpower- China. Since China's entry into the World Trade Organization (WTO) in 2001, the region has seen a level of growth that is unprecedented, achieving growth rates in excess of 8% per year, according to the WB. By the end of June 2014 Chinese foreign exchange reserves had swelled to almost US $4 trillion; in comparison, at the end of 2001, before China joined the WTO, they had stood at US $212 billion. (Ferdinand) It is also worth noting that figure includes at least US $1 trillion in U.S. Treasury Bonds, which, according to Treasury documents, as of the end of July 2017 has increased to US $1.17 trillion.

These conditions led to a revitalization of Chinese influence globally but most specifically in Asia, where it has replaced the U.S. as the continent's largest trading partner. China's economic growth in the past was based on foreign investments and intensification of exports. The financial crisis in 2008 brought a decrease in demand in many economies, which also had some, though ultimately a relatively small impact on economic growth in China. (Mlody) To combat these changes and to preserve its position is Asia, the U.S. in late 2013 and 2014 began to outline what became the Trans-Pacific Partnership (TPP) as a way of keeping a collection of South Asian countries as free trade area for American goods and services. (U.S. Congress) As this deal was scrapped in early 2017 by the Trump Administration, it is likely that without a major economy such as the U.S. involved, remaining countries may look elsewhere to fill the void, such as creating a similar deal with China.

This, as well as a strengthening of military ties with allies Japan and South Korea in the face of rising regional tensions, has also been a flashpoint in relations with China, as it sees American troops and military technology such as anti-missile batteries infringing on its ability to conduct military maneuvers in the region.

With these changing conditions in mind, China has sought to expand their influence, or "soft-power", by enacting a set of initiatives to both further economic prosperity and build regional security.  Of these new programs, The Asian Infrastructure Investment Bank (AIIB) and the One Belt, One Road (OBOR) are the most far reaching and controversial. These initiatives mark a shift in Chinese foreign policy, pivoting away from a more nationalist approach to a regional perspective.

# One Belt One Road


Figure 1. One Belt, One Road Routes (Credit: CNN, Xinhua)

## Chapter 2

## The Asian Infrastructure Investment Bank

The Asian Infrastructure Investment Bank (AIIB) was formally recognized on October 24, 2014 and established on December 25, 2015. The AIIB is backed by 57 Asian Pacific and non-regional founding members with China having the largest voting stake at 30.34%, followed by India (8.52%), and Russia (6.66%). While founding members include European governments such as the U.K., Germany, and Italy, the United States has held out support. While the AIIB will effectively have 57-member countries, the voting stakes and financial commitments differ widely. This is one of the main concerns underlying why the U.S. hasn't more aggressively supported these initiatives, believing they will push Beijing's political agenda, something that could be extremely detrimental to U.S. influence in the region.

For the developing region, infrastructure investment is a new source of growth outside trade and manufacturing. However, the availability of infrastructure funding has become one of the major problems in the process of economic development in the countries of the region. Issues of development and infrastructure investment began to be discussed in Vladisvostok, Russia at the Asia-Pacific Economic Cooperation (APEC) Summit in 2012. APEC leaders realized that the development of regional infrastructure is a very important investment related to economic development and regional connectivity. (Syadullah) The AIIB officially cited the shortfall in funding for the Asia Pacific region as the pretext for the bank's creation, which experts at the World Resources Institute (WRI) estimate at US $8.22 trillion by 2020. Another reason is what China and other founding members consider undue western influence in financing, such as the control over the World Bank (WB), International Monetary Fund (IMF), and Asian Development Bank (ADB), which are effectively controlled by the U.S. and Japan. To explain how the AIIB will function once it becomes fully operational, one would need to understand the way existing institutions influence the monetary system and fund their projects as well as the governance behind them. These institutions all work towards basically the same goal, best exemplified by the IMF's mission statement, to "promote international monetary cooperation; facilitate the expansion and balanced growth of international trade; promote exchange stability; assist in the establishment of a multilateral system of payments; and make resources available (with adequate safeguards) to members experiencing balance of payments difficulties". (IMF) To fulfill the aforementioned goals, the IMF and others invest in infrastructure, such as constructing roads and improving technology and phone connectivity, as well as human capital, such as education and job training, in some of the most impoverished areas in anticipation of raising the standard of living for the population. This type of support is critical to the international community and will be increasingly important in the years going forward, as the developed world hasn't had a major infrastructure update in decades. These facts, coupled with the need to switch reliance from fossil fuels to renewable alternative energy sources, will cause the needed level of infrastructure investment to continue outpacing actual spending.

## Chapter 3

## One Belt, One Road

In late 2013, Chinese President Xi Jinping announced a pair of new development and trade initiatives for China and the surrounding region: the "Silk Road Economic Belt" and the "Twenty-First-Century Maritime Silk Road," together known as “One Belt, One Road” (OBOR). “Along with the Asian Infrastructure Investment Bank, the OBOR policies represent an ambitious spatial expansion of Chinese state capitalism, driven by an excess of industrial production capacity, as well as by emerging financial capital interests. The Chinese government has publicly stressed the lessons of the 1930s overcapacity crisis in the West that precipitated the Second World War, and promoted these new initiatives in the name of "peaceful development."” (Tsui). According to the Chinese State Council, the initiative aims “to promote the connectivity of Asian, European and African continents and their adjacent seas, establish and strengthen partnerships among the countries along the Belt and Road, set up all-dimensional, multitiered and composite connectivity networks, and realize diversified, independent, balanced and sustainable development in these countries” (State Council). The countries involved in the initiative account for 70% of the world’s population and 55% of global GNP. (Młody)

## Chapter 4

## Funding and Governance

Law and development scholars have analyzed the postwar project of building an international financial architecture, and have revealed the political underpinnings of World Bank and IMF rule-of-law orthodoxy, and of the liberal agenda underpinning much modern development economics. (De Jonge) The AIIB will begin operations with an initial $50 billion in subscribed capital with another $50 billion in authorized capital, about half of which will be provided by China. However, the IMF, WB, and ADB have significantly more capital, with committed capital of $863B, $160B, and $223B respectively. The AIIB's operational policy on financing begins by restating the bank's desire to promote 'regional cooperation and partnership in addressing development challenges by working in close collaboration with other multilateral and bilateral development institutions'. Its first 18 months have accordingly been devoted not only to building internal AIIB governance structures, but also to forging a network of global alliances with other development finance institutions. (De Jonge) One could argue it may make more sense to invest in an existing institution rather than establish a new one. China realizes this reality, and promotes the AIIB as a complement, rather than a competitor, to the existing institutions. The President of the AIIB, Jin Liqun, has responded to these concerns by comparing the situation to a new restaurant opening near existing restaurants, saying it is "up to customers to decide its relevance" not the existing restaurants. While he may have a point, the analysis must really be one of cost-benefit. On one hand, the AIIB could use its capital in more innovative ways than existing institutions, and likely collect more capital if the projects are successful. On the other, the AIIB will have to build up its own infrastructure through spending on offices and officials, all of which the existing institutions already have. While the funding gap for the region was the official reason for the establishment, it is more likely that it was out of frustration at the politics involved with existing lenders. For example, plans to reform the IMF are stalled in the U.S. Congress, who also happens to be the biggest backer of the fund with over $200B in committed capital. The ADB, which is based in Manila, is widely known to be made up of mostly Japanese bureaucrats and other western-aligned policy makers, which would clearly be a source of conflict with the Chinese government.

## Chapter 5

## Issues

The United States has other motives in opposing these initiatives; the possibility of the Chinese yuan replacing the U.S. dollar as the global reserve currency. Since the 1940's, the U.S. dollar has consistently maintained a status as the world's reserve currency and the global benchmark against which all currencies are valued. Demand for the dollar as a reserve allows the U.S. to avoid depreciation in its currency. With China's economy continuing to expand with regional partnerships and as the yuan gains strength against the dollar, the AIIB and OBOR could enhance this possibility.

Another interesting topic is how many staunch American allies have joined the bank, effectively giving the U.S. Government's boycott the cold shoulder. For example, in March 2015, Britain announced plans to join the AIIB as a founding shareholder, shortly after which Japan, South Korea, Australia, and Germany, who acquired the fourth largest stake at 4.1%, followed suit. This begs the question of why would these allies shrug off the U.S. when they rely on it heavily in most circumstances, such as defense and investment? This may have been done with the idea that it is better to have a seat at the table rather than not, and rather give a back channel to the Americans about the developments in the bank's lending and other practices.

While the U.S. doesn't formally oppose these initiatives, and recognizes they would serve a purpose in Asia, it questions whether the bank will be held to the same environmental, corruption, and governance standards as other international lenders and whether the OBOR will be used as justification for some of Beijing's most controversial foreign policies, such as building military bases in the South China Sea and making territorial claims over other nations in central Asia such as India. The OBOR initiative has more of its own issues, some of which do not involve the U.S., but neighboring countries and other nations the belt will encompass. At the forefront of these is India, which is currently in the middle of a policy battle between Beijing and Washington regarding OBOR and the U.S. "Rebalancing to Asia" initiative. OBOR is a grand geo-economic vision as well as a long-term geopolitical strategy. It aspires to strengthen the connectivity between China and Eurasian countries through several land economic corridors, including one called 'Bangladesh–China–India–Myanmar economic corridor' between China and the Indian Ocean. (Hu)

These are only a few of the many initiatives by China to enhance its global position. Being that China has the world's largest foreign exchange reserves, many economists believe these investments are just the beginning of the extension of Chinese "soft power" abroad, alluding to further economic and military alliances from Beijing. In addition to the AIIB and OBOR, China has planned to launch a New Development Bank in cooperation with Brazil, Russia, India, and South Africa, commonly referred to as the BRICS countries.

## Chapter 6

## Analysis and Future Expectations

Much has been studied about the rise of China as a possible superpower, exhibiting the financial means, rapidly military expansion, as well as the world's largest population and status as the top manufactured goods exporter. The AIIB and OBOR initiatives are two of the most recent indicators of a blossoming superpower, similar to the way the U.S. handled global financial investment after WWII with the establishment of the World Bank and IMF. In my opinion, this may not be so much a hostile act towards existing regional entities, but an intelligent next step in a bid to extend the influence of a traditionally nationalist country that has become overly reliant on domestic investment. It is also fair to note that the long-term financial effects of these policies, if successful, will likely disproportionately benefit China over the countries that will be invested in. This is the biggest area of concern for many who have questioned the new initiatives, as U.S. government policy has been to maintain a large presence in Asia as the area is a vital economic and national security concern, these programs could severely dampen U.S. influence in the region and abroad. As the existing international financing institutions (World Bank, IMF, and ADB) have put extensive resources into economic development, the IMF alone has US $206 billion in lending commitments out of total available resources of US $986.9 billion as of October 26, 2017, the Asia-Pacific region has not received nearly a proportional share of the pie, less than 10% according to the IMF. This has resulted in anger on the part of regional governments who see undue western, and specifically U.S., influence in project selection. This begs the argument that it is an attempt to bring greater prosperity to a region in which, according to the U.N., is home to almost 60% of the world's population. But with only US $100 billion in authorized capital, it is difficult to see how AIIB can be effective in trying to close Asia's over US $6 trillion investment gap without additional capital injections. To me, this is less of an issue than it is made out to be by critics because while China has already pledged about 30% of total authorized capital per the AIIB audited 2016 financial statements, that represents less than 1% of total foreign exchange reserves, which according to the World Bank stand at approximately US $3 trillion at the end of 2016. The following chart shows how significant these reserves are compared to the next 4 largest holders, which in 2016 were Japan, Saudi Arabia, Switzerland, and the Russian Federation.

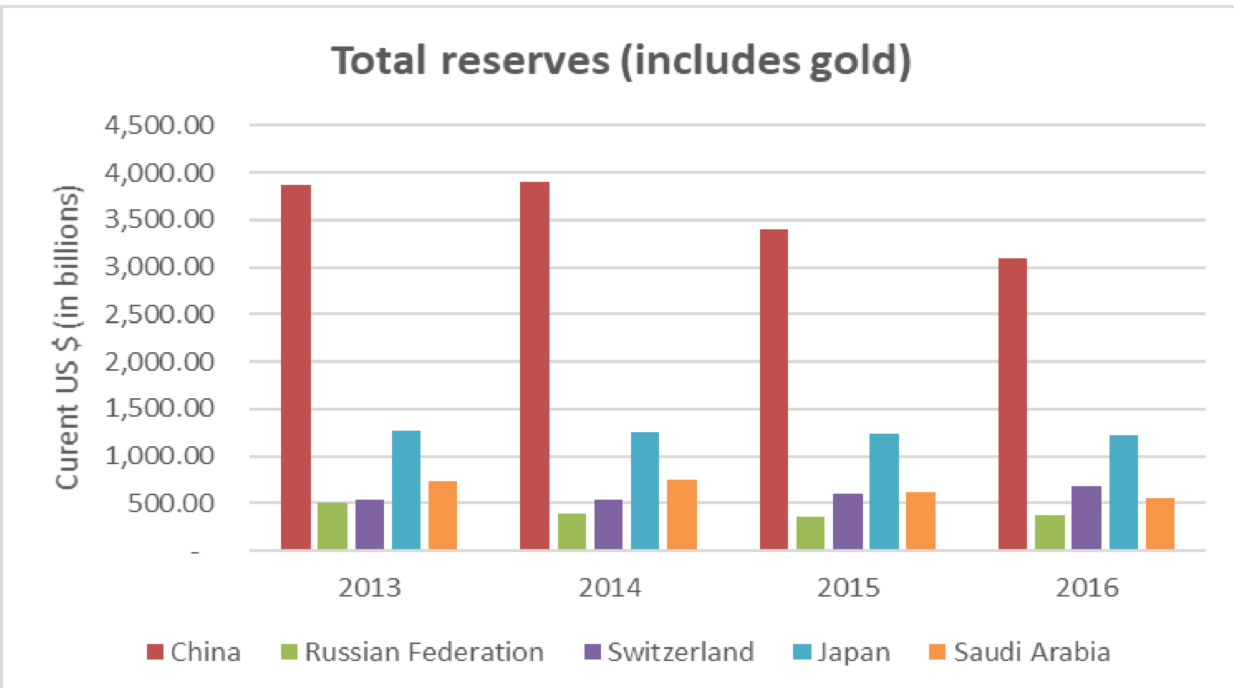


**Figure 2 Top Foreign Exchange Reserves (Data: World Bank)**

This raises another issue - assessing the true economic position of China is difficult due the secrecy of their government. Recently, AidData, a research lab at The College of William & Mary, reported that between 2000 and 2014, China's official financing, including foreign aid, concessional and non-concessional state financing totaled US $354.3 billion to 140 countries, but with only US $81.1 billion in official Development Assistance (ODA), which AidData defines as primarily intended for development and welfare with over 25% grant included. The largest portion of reported aid is classified as Other Official Flows (OOF), described as intended for commercial or representational purposes, totaling US $216.3 billion. In comparison, U.S. official finance stood at US $394.6 billion, with US $366.4 billion in ODA. The same group acknowledged that “the government considers its international development finance program to be a "state secret"” and included a final category in the Chinese figure, consisting of US $57 billion in Vague Official Finance (VOF), which is described as “clearly official finance, but insufficient information to assign to either ODA or OOF”.

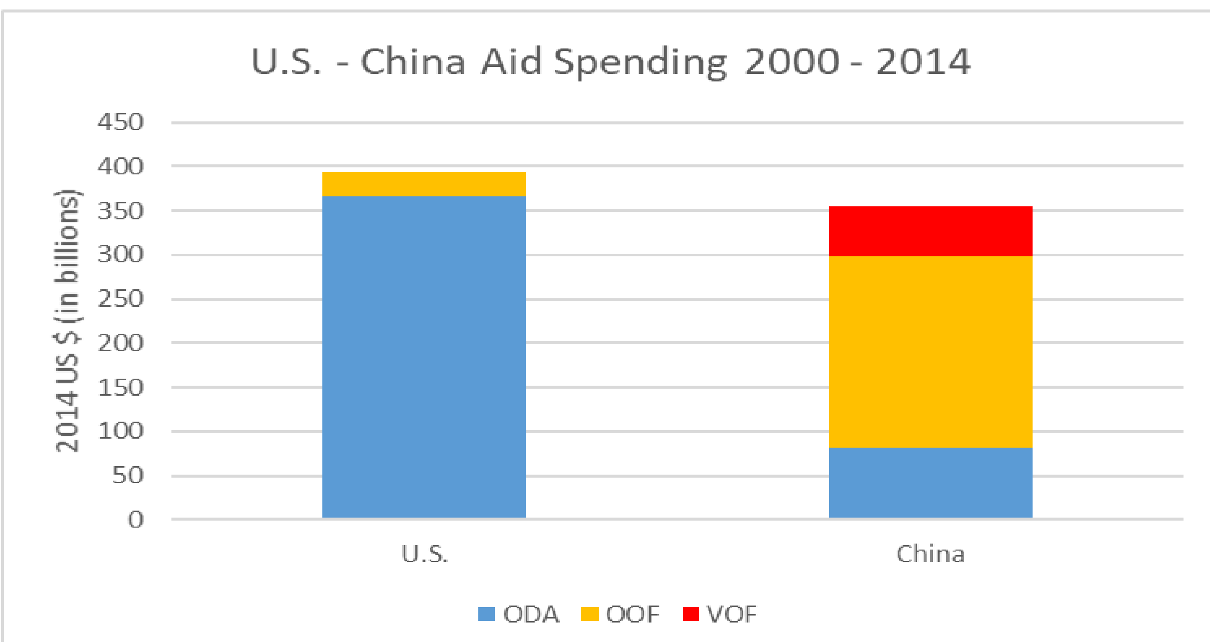


**Figure 3 U.S.-China Spending Comparison (Data: AidData)**

The second controversial policy to examine is the OBOR initiative, which is widely viewed as a sort of 21st Century Marshall Plan for Eastern Asia. This consists of a maritime belt and an on-land trade route spanning more than 68 countries and encompassing over 4.4 billion people and approximately 40% of the global GDP. The controversies surrounding this initiative include military, financial, cultural, and humanitarian concerns for the participating nations. In the last 10 years, China has increased its military expenditures to an estimated US $215 billion according to the Stockholm International Peace Research Institute (SIPRI), second to only the United States at US $611 billion. In addition, they have begun an unusual island building strategy in the South China Sea, laying claims to areas and angering neighbors, some of which are major ports in the belt. Recent reporting by CNBC notes that China has "built seven man-made islands in disputed waters, three of them equipped with runways, surface-to-air missiles and radars."


**Figure 4 One Belt, One Road Routes (Credit: The Economist)**

To understand the reasoning behind these Chinese initiatives, they must not be analyzed individually, but collectively to recognize the benefits that come with building a comprehensive regional architecture based on national interests. When these initiatives are described as a 21st Century Marshall Plan, it is worthwhile to note that supporting an entire region to rebuild from a World war is significantly different than a similar initiative in relative peacetime. However, to predict the benefits and detriments of such policies there is little other precedent as far reaching and reformative as the Marshall Plan and the creation of the first major international financial institutions. These U.S. backed plans helped turn a largely destroyed Europe into an economic powerhouse, which in turn produced returns for American invested capital. This is similar to how China plans to shape the Asia Pacific region, by flexing military and financial muscle and providing much needed investments to critical areas such as infrastructure and energy.

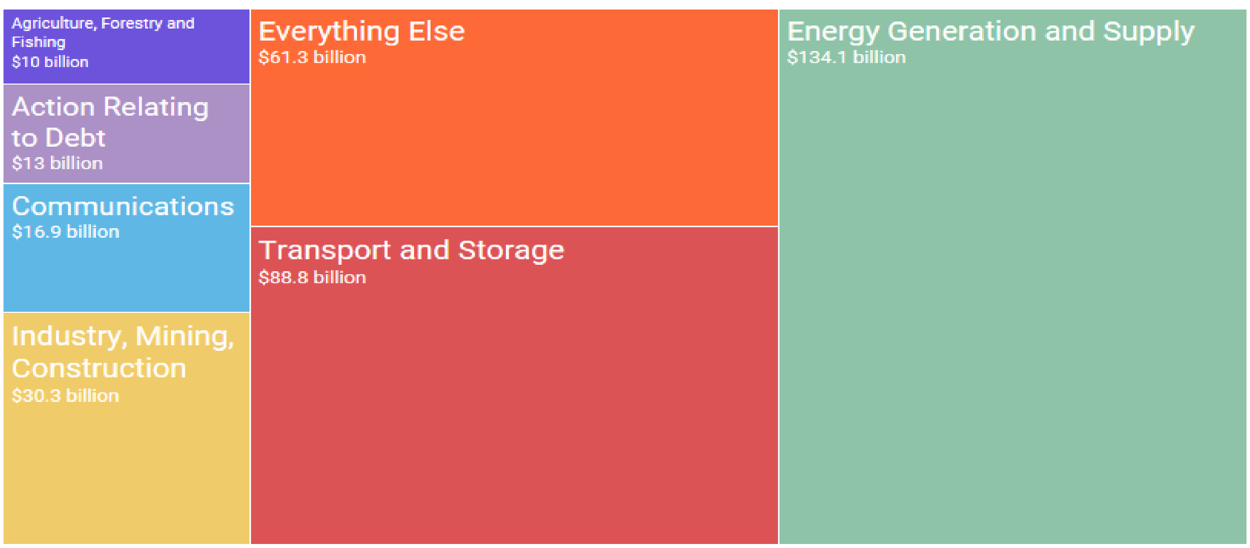


**Figure 5 Chinese Total Official Spending by Sector (Credit: AidData)**

While the rise of China has been met with increasing interest by those abroad, particularly the U.S., it will likely be viewed favorably by regional neighbors who will benefit from it. As with many international organizations, more oversight will be needed to make sure undue influence isn't exerted by one party or another, and also to alleviate the concerns of other nations as to governance standards. Ultimately these initiatives, while being very recent, have the opportunity to bring greater stability to a region that has seen many difficult times in the last half century, including war and political conflict. Existing institutions and governments around the world should do more to work with the Chinese and other partners to continue investing in the Asia Pacific, as well as to cooperate in military matters to prevent war brought on by differing visions on the future world order. I believe these changes, if implemented swiftly and completely, would lead to continued economic growth, a reduction in poverty, and the development of third world nations. In addition, if the commitments do have the more malicious alternative motives that some scholars and diplomats assume, there will be detrimental effects that span the globe and could quite possibly lead to a large regional or global conflict that would be catastrophic. Therefore, going forward a policy of observe and analyze should be implemented in the U.S. with the open mind to the possibility that these initiatives will be gauged toward spreading international prosperity, but also being cautiously, and vocally, critical of any governance or humanitarian concerns that arise.

# Chapter 7

## Conclusion

The AIIB, while in its infancy stages, is poised to be a source of continued debate in international finance. With the two largest economies in the world at ends over its purpose, until both sides can come to agreement upon the next steps for the bank and its cooperation with other financers. The OBOR initiative will also be a source of tension, but with some additional nations voicing concern, which for the time being will continue to hamper U.S.-China relations and will continue to pose risks to regional relationships if territorial and military disputes are not settled in equitable fashion.

The official ideology behind OBOR is peaceful development-to sponsor infrastructure investments and facilitate economic development, promoting cooperation and minimizing conflict. Supporters will argue that this peaceful development is more sensible and sustainable than “American-style militarized security". (Tsui) Many experts disagree, instead arguing that these measures are part of an overall geopolitical strategy to put China on the same footing as the U.S. on the world stage, including militarily. It will certainly be interesting to see in the coming years how these measures impact trade, investment, and regional relations in the Asia Pacific.

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# Academic Vita
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## EDUCATION

The Pennsylvania State University — University Park, PA
Smeal College of Business, Bachelor of Science in Finance — December 2017

## HONORS AND AWARDS

Schreyer Honors Scholar

- Participated in extracurricular coursework in and out of major
- Thesis research focuses on the Financial Institutions in the Asia-Pacific

The Evan Pugh Junior Scholar Award (2016)

- Juniors in the upper 0.5% of their respective field of study

President Sparks Award Recipient (2015)

- Achieved a 4.00 GPA for 57 credits to receive award, awarded to only one 4.00 student per year

Beta Gamma Sigma

- International honor society for business scholars

## EXPERIENCE

SAP SE — June 2017 – August 2017
*M&A, Corporate Development Intern* — *Newtown Square, PA*

- Compiled and updated in-depth company profiles on M&A targets across several industries
- Employed both quantitative and qualitative techniques to value potential acquisition targets
- Identified and documented recent M&A, Venture Capital, and Private Equity activity to gauge the current competitive landscape
- Participated in several functional roles within Corporate Development such as Execution, Integration, Go-to-Market, and Valuation
- Worked in group units with other interns to complete time sensitive tasks used in high level M&A discussions with top management
- Compiled detailed analysis of major emerging technology markets such as Artificial Intelligence, Machine Learning, Internet of Things, and Virtual Reality Software

International Business Machines Corp. (IBM) — June 2016 – December 2016
*Financial Analyst Co-Op* — *Somers, NY*

- Used Microsoft Excel to analyze large information sets by combining Index & Match formulas
- Employed data analysis systems to extract and organize data for use by decision makers
- Built dynamic spreadsheets to project implied yields from weekly forecast data
- Analyzed metrics to predict performance based on growth, seasonality and historical actuals
- Updated pipeline and roadmap projections daily for individual product offerings
- Prepared statements used for reporting earnings in the Analytic Solutions business segment

Penn State Investment Association — September 2015 – Present
*Analyst* — *University Park, PA*

- Analyzed equities in the Technology Sector and overall market to make recommendations
- Evaluated financial statements to gauge firm performance and create valuations
- Developed Discounted-Cash-Flow (DCF) Analysis skills for valuation

## INTERESTS AND HOBBIES

- Domestic and International Politics
- Traveling
- Running/Exercising