The Asian Infrastructure Investment Bank: Multilateralism and Membership Diffusion

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Friday 9th June, 2017

Abstract

The first multilateral developmental bank initiated and led by China, the Asian Infrastructure Investment Bank (AIIB) has garnered international attention since its inception both due to its symbolic significance and its potential for multilateral cooperation. While the AIIB is a young multilateral organization, its potential for regional influence is partially promised by the expansive attraction of membership to countries. In this paper I first attempt to establish that the AIIB is not challenging but rather modifying the current institutional arrangements of multilateral development banks. I then seek to explain why countries accede to the AIIB within the theoretical framework of multilateralism and policy diffusion. Countries’ accessions to the AIIB is influenced by the accession decisions of their socio-economic peers who are "close" to them in economic conditions, political systems, and international networks. A spatial regression model is appropriate for testing my theory.

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1 Introduction

The Asian Infrastructure Investment Bank (AIIB) is significant on many fronts. For China, it not only signifies a shift from bilateralism to multilateralism in terms of China’s outward financing and investment, but also signifies a change in China’s global role. With anti-globalization tides high in the West, China is turning into a champion of globalization.1 The AIIB is a key component of this move towards leadership in regional

and global affairs. As the president of the AIIB Jin Linqun defines the AIIB’s role in China’s overall strategy on the world stage, “China needs to do something which can help it be recognized as a responsible member of the international economic community and maybe in the future be recognized as a responsible leader.”

Because of the AIIB’s prominent role in China’s budding aspiration to regional leadership and global influence, some interpret the AIIB as a challenge to existing multinational finance institutions established by the West (Mearsheimer 2001, Layne 2012, Callaghan and Hubbard 2016). Moreover, a bank led by a developing country generates worries that it will undercut current international financing standards and generate a "race to the bottom." However, this concern has not deterred a sizable number of countries from joining the organization. Since its establishment in December 2015, the AIIB has drawn 57 regional and non-regional countries into its membership as founding members. In addition, 13 prospective members were approved in March 2017, and 7 other countries were approved in May 2017. A few of the approved countries such as Brazil remain prospective members until they "complete the required domestic processes and deposit their first installment of capital with the bank."

2 Institutional Characteristics of the AIIB

Before I theorize further on the reasons for country accession to the AIIB, it is necessary to examine the institutional characteristics of the AIIB and clarify the institutional simi-

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2 "AIIB chief unveils aim to rival lenders such as ADB and World Bank." Financial Times. May 2017. https://www.ft.com/content/3a938ee4-0288-11e7-aa5b-6bb07f5c8e12.
larities and differences between the AIIB and other established western-led international development organizations. Judging from organizational structure and organization governance, the AIIB is a complement to current institutions and an attempt to improve institutionally.

First, in terms of governance structure, all powers of the Bank are vested in the Board of Governors, which is the highest decision-making body under the Articles of Agreement of the AIIB. The Board of Governors delegates power to the Board of Directors, which is responsible for the direction of the general operations of the Bank. They approve the Bank’s strategy and make decisions concerning Bank operations. The daily operations of the bank is handled by senior management, which is headed by the President, Jin Liqun, and includes a team including the General Counsel and five Vice Presidents. An International Advisory Panel (IAP) recruits global experts from mostly member countries to provide "management with impartial advice and perspectives." The Board of Governors meet annually, and the IAP meets in tandem with the Annual Meeting. What is different about AIIB’s board of directors from that of the World Bank and ADB in that it is non-residential, which helps to cut back costs on maintaining a residential board.

A country’s voting power in the AIIB is perfectly correlated with the total amount of capital that a country subscribes to it. The capital stock to countries is allocated by “the relative share of the global economy of members within the regional and non-regional groupings.” China contributed the most funds to the organization by far, and is dominant in the voting power of member states. Table 1 shows the summary statistics for the voting power and total capital subscriptions of countries in AIIB, and figure 2 shows a side-by-side comparison of the voting rights of the major stakeholders in the AIIB. China’s 28.7% voting share is larger than the %16.36 voting power of the U.S. at the World Bank, and the 15.6% voting share it holds at the Asian Development Bank. Its voting power gives it effective veto over major decisions at the bank requiring a super

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majority of 75 per cent. However, this is also similar to the US veto over World Bank decisions requiring an 85 percent super majority. As an institution focused on regional development, the AIIB’s voting rights structure gives regional members 75% of voting rights.\textsuperscript{10}

Table 1: Summary statistics of AIIB members voting rights and capital subscription

<table>
<thead>
<tr>
<th>Variable</th>
<th>Obs</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Min</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>Voting power</td>
<td>52</td>
<td>20781.08</td>
<td>43190.76</td>
<td>3166</td>
<td>300898</td>
</tr>
<tr>
<td>Total subscriptions</td>
<td>52</td>
<td>1768.708</td>
<td>4319.076</td>
<td>7.2</td>
<td>29780.4</td>
</tr>
</tbody>
</table>

In terms of personnel, the AIIB has a great degree of congruence with existing multilateral institutions. AIIB staff is drawn from the talent pool of existing multilateral financial institutions, and is also hired from non-membership countries. Two high-profile staff who are U.S. citizens serve as an example. Stephen Lindner, a veteran on quality assurance for the World Bank, serves as senior advisor on quality assurance for the AIIB. Natalie Lichtenstein, who spend 30 years at the World Bank as chief counsel and in other roles, is the inaugural general counsel of the AIIB.

A further sign that the AIIB operates under similar institutional frameworks and seeks to complement the World Bank and the Asian Development Bank (ADB) is its

\textsuperscript{10}Martin A. Weiss. February 2017. "Asian Infrastructure Investment Bank (AIIB)." \textit{Congressional Research Service}.
cooperation with both institutions. The AIIB has a co-financing framework agreement with the World Bank and memoranda of understanding on joint cooperation and co-financing with the Asian Development Bank, the European Bank for Reconstruction and Development, the European Investment Bank, the New Development Bank, and the World Bank Group.\textsuperscript{11} The Chinese also pledge to increase their contribution to the World Bank, a signal that they are not seeking to undermine existing institutions that essentially work towards the same end of regional development that the AIIB does.\textsuperscript{12} The financing cooperation on projects with the World Bank and other institutions is well underway. Table 2 shows the projects that have been approved by the AIIB. Of the 13 projects already approved, 10 projects are co-financed with the other development banks. The World Bank is co-financier for 6 of them.

### Table 2: Projects approved by the AIIB

<table>
<thead>
<tr>
<th>Country</th>
<th>Description</th>
<th>Approval date</th>
<th>Sector</th>
<th>Co-financing agency</th>
<th>Total cost</th>
<th>Co-financial loan</th>
<th>AIIB loan</th>
<th>Other funding</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>Andhra Pradesh Power for All</td>
<td>2-May-17</td>
<td>Energy</td>
<td>World Bank</td>
<td>571</td>
<td>240</td>
<td>160</td>
<td>171</td>
</tr>
<tr>
<td>AIIB loan terms</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bangladesh</td>
<td>Natural Gas Infrastructure and Efficiency Improvement</td>
<td>3/22/2017</td>
<td>Energy</td>
<td>ADB</td>
<td>453</td>
<td>167</td>
<td>60</td>
<td>226</td>
</tr>
<tr>
<td>AIIB loan terms</td>
<td></td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Indonesia</td>
<td>Dam Operations</td>
<td>3/22/2017</td>
<td>Energy</td>
<td>World Bank (IBRD)</td>
<td>300</td>
<td>125</td>
<td>125</td>
<td>50</td>
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<tr>
<td>AIIB loan terms</td>
<td></td>
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<table>
<thead>
<tr>
<th>Country</th>
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<th>Co-financing agency</th>
<th>Total cost</th>
<th>Co-financing loan</th>
<th>AIIB loan</th>
<th>Other funding</th>
<th>AIIB loan terms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>Regional Infrastructure Development Fund</td>
<td>3/22/2017</td>
<td>Multisector</td>
<td>World Bank</td>
<td>406</td>
<td>100</td>
<td>100</td>
<td>206</td>
<td>A final maturity of 10 years, including a grace period grace period of 5 years at the Bank's standard interest rate for sovereign backed loans</td>
</tr>
<tr>
<td>Azerbaijan</td>
<td>Trans Anatolian Natural Gas Pipeline</td>
<td>12/21/2016</td>
<td>Energy</td>
<td>World Bank</td>
<td>1400</td>
<td>800</td>
<td>600</td>
<td>other sources</td>
<td>30-year term, including a grace period of 5 years, at the Bank’s standard interest rate for sovereign-backed loans</td>
</tr>
<tr>
<td>Oman</td>
<td>Duqm Port Commercial Terminal</td>
<td>12/8/2016</td>
<td>Transport</td>
<td></td>
<td>353.33</td>
<td>265</td>
<td>88.33</td>
<td>88.33</td>
<td>25-year term, including a grace period of 5 years, at the AIIB’s standard interest rate for sovereign-backed loans</td>
</tr>
<tr>
<td>Oman</td>
<td>Railway System Preparation</td>
<td>12/8/2016</td>
<td>Transport</td>
<td></td>
<td>60</td>
<td>36</td>
<td>24</td>
<td>OGLG 24</td>
<td>The loan will have a single repayment at the end of loan term by June 15, 2023, and will be made on standard terms for sovereign-backed loans with the corresponding average maturity</td>
</tr>
<tr>
<td>Pakistan</td>
<td>Tarbela 5 Hydropower Extension Project</td>
<td>9/27/2016</td>
<td>Energy</td>
<td>World Bank</td>
<td>823.5</td>
<td>390</td>
<td>300</td>
<td>GoP 124.5</td>
<td>A sovereign backed loan with a maturity of 20 years including a grace period of 6 years at the Bank’s standard interest rate for sovereign guaranteed loans. Repayment is on a non-level basis with a corresponding weighted average maturity of 14.9 years. The fixed rate is therefore determined as six month LIBOR plus 1.15%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>National Slum Upgrading</td>
<td>6/24/2016</td>
<td>Multisector</td>
<td>World Bank</td>
<td>1743</td>
<td>216.5</td>
<td>216.5</td>
<td>1310</td>
<td>Sovereign backed loan with a maturity of 16.5 years including a grace period grace period of 7 years at the Bank’s standard interest rate for sovereign guaranteed loans with the corresponding weighted average maturity</td>
</tr>
<tr>
<td>Pakistan</td>
<td>National Motorway M-4 Project</td>
<td>6/24/2016</td>
<td>Transport</td>
<td>ADB</td>
<td>273</td>
<td>100</td>
<td>100</td>
<td>39 and other</td>
<td>20-year term (including a grace period of 5 years) at AIIB’s standard interest rate for sovereign-backed loans with an average maturity of 12.75 years, a commitment charge of 0.25% per year, a front-end fee of 0.25%, and a semiannual equal amortization scheme</td>
</tr>
<tr>
<td>Country</td>
<td>Description</td>
<td>Approval date</td>
<td>Sector</td>
<td>Co-financing agency</td>
<td>Total cost</td>
<td>Co-financer loan</td>
<td>AIIB loan</td>
<td>Other funding</td>
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<tr>
<td>Bangladesh</td>
<td>Distribution System Upgrade and Expansion</td>
<td>6/24/2016</td>
<td>Energy</td>
<td></td>
<td>262.29</td>
<td></td>
<td>165</td>
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<td></td>
<td>AIIB loan terms</td>
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<td>With a 25-year term, including a grace period of 5 years, at the Bank’s standard interest rate for sovereign-backed loans with this weighted average maturity</td>
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<tr>
<td>Tajikistan</td>
<td>Dushanbe-Uzbekistan Border Road Improvement</td>
<td>6/24/2016</td>
<td>Transport</td>
<td>European Bank for Reconstruction and Development</td>
<td>105.9</td>
<td>62.5</td>
<td>27.5</td>
<td>15.9</td>
<td></td>
</tr>
<tr>
<td></td>
<td>AIIB loan terms</td>
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<tr>
<td></td>
<td>15-year term (including a grace period of 3 years) at AIIB’s standard interest rate for sovereign-backed loans with an average maturity of 9.25 years, a commitment charge of 0.25% per year, a front-end fee of 0.25%, and a semiannual equal amortization scheme</td>
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The Chinese government itself has acknowledged that the AIIB will “operate with the operational mode and principles of existing multilateral development banks.” At present the institutional structure of the AIIB provides evidence for this statement. But one issue on which conclusion could not be drawn so early is the issue of conditionality. Lending institutions like the International Monetary Fund (IMF) maintain strict conditionality. In contrast the Articles of Agreement of the AIIB limits conditionality. There will still be guarantees of legal transparency, social welfare and environmental sustainability, but privatization, deregulation and other free market measures will not be required as conditions for loans. On the one hand, limited conditionality shortens the time needed

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14 "IMF loan conditions grow despite vows to limit them: study." [Reuters](http://www.reuters.com/article/us-imf-conditions-idUSBREA311SZ20140402).


16 "Exclusive: China’s AIIB to offer loans with fewer strings attached - sources." [Reuters](http://www.reuters.com/article/us-aiib-china-loans-idUSKCN0R14UB20150901).
to approve loans, and on the other hand, it remains a question of whether or not the AIIB can maintain high standards on environmental, labor and humanitarianism issues after shedding a bulk of the normative standards of Western led institutions.

Further questions about the normative standards of the AIIB are raised through the fact that unlike the World Bank and the Asian Development Bank, the AIIB has no overarching mission. The World Bank’s mission is to "achieve the twin goals of ending extreme poverty and building shared prosperity" and the ADB’s mission is to "to help its developing member countries reduce poverty and improve the quality of life of their people." While the AIIB focuses on infrastructural improvement in Asia, it does not fix its sight on the more value-oriented and normative goals of prosperity building. It has pledged however, to implement “institutional best practices” and support highly needed infrastructure development in the region. The AIIB’s organizational motto is "lean, clean, green." According to its environmental and social framework document, its policies towards environmental and social issues build on policies of other multilateral development banks and "benefited from a review of the policies adopted by and in force at other multilateral development banks (MDBs)." However, the issue of whether or not to fund coal power plants is unresolved and the process of developing a full energy sector strategy that includes consideration of nuclear power, coal and other fossil fuels is still underway. The Exclusion List in the current environmental and social framework does not include any reference to these potentially high pollution energy sources and there are indications that coal-fired power plants are to remain within consideration for AIIB funding, especially for poor places where people have no access to power. Jin Liqun, in an interview with the New York Times, framed this as a “human rights issue.” It remains to be seen how the AIIB will strike the balance of development needs with environmental and social concerns when it does not seem to order its normative priorities.

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17 "AIIB chief unveils aim to rival lenders such as ADB and World Bank." May 2017. Financial Times. https://www.ft.com/content/3a938ee4-0288-11e7-aa5b-6bb07f5c8e12.
19 "China creates a World Bank of Its Own, and the U.S. balks."


3 Theory

According to Ruggie’s definition (1992, 571), multilateralism "is an institutional form which coordinates relations among three or more states on the basis of ‘generalized’ principles of conduct." Similarly, Keohane (1990) defines multilateralism as “the practice of co-ordinating national policies in groups of three or more state, through ad hoc arrangements or by means of institutions” (731). Accordingly, multilateral institutions are “multilateral arrangements with persistent set of rules” (Keohane 1990, 732). Both definitions emphasize the state as actors and the rule-based institutional arrangement of multilateralism, elements in multilateralism that are manifested by the arrangements of the AIIB. I also contend that the institution of the AIIB as it currently stands does not pose a scenario of “contested multilateralism” that Morse and Keohane (2014) theorized. According to Morse and Keohane (2014), three criteria define a situation as involving contested multilateralism. Firstly, "a multilateral institution exists within a defined issue area and with a mission and a set of established rules and institutionalized practices." Secondly, "a coalition of actors" that are dissatisfied with the status quo institution "shifts the focus of its activity to a challenging institution with different rules and practices." Thirdly, "the rules and institutionalized practices of the challenging institution conflict with or significantly modify the rules and institutionalized practices of the status quo institution." While the AIIB fulfills the first criteria, it does not fulfill the second. As I elaborated in the previous section of this paper, the AIIB follows institutionalized practices of the status quo institutions and the activities of the AIIB do not shift focus away from institutions like the World Bank but instead complement development efforts in Asia. In addition, many developed countries choose to join the bank and regard investing in Asian infrastructure through the AIIB as an opportunity instead of threat, constituting "a coalition of actors" that is not antagonist towards the status quo.

What factors then, induce countries to perceive the AIIB as relatively non-threatening and join the AIIB? I theorize that it is partly due to the diffusion effect of policy choices of countries within the same network. The decision of one country to join is not independent from that of another joining, as is evident in the case of joining the AIIB. With the UK
joining the AIIB despite pressuring from the U.S. to not join, South Korea, Australia and other U.S. allies quickly followed suit.\textsuperscript{20} Australia was offered a senior position in the AIIB and also urged by India and others to join early. At the same time, the United States was lobbying hard for Australia not to join the organization. Australia’s prime minister and foreign minister initially opposed joining, but UK’s accession acted as “a public signal of the AIIB’s institutional quality” and Australia “appeared to be playing catch-up” after the UK joined (Callaghan and Hubbard 2016, 127). Similar to Australia, South Korea applied before the end of the March 2015 deadline after the Europeans announced that they were joining the bank (Callaghan and Hubbard 2016, 128).

While countries’ decisions of whether or not to join a multilateral institution are interdependent, the weights that different countries have on the decision of one country is not equal. The policy choice of a country’s "socioeconomic peer" is more likely to be treated as credible information and factored into its consideration by this country (Simmons and Elkins 2004, 171). In the context of multilateralism, a country’s decision of whether or not to join a multilateral organization will depend partly on whether or not its "neighbors" join (Wang forthcoming). The "neighborhood" of a country here does not refer to geographical neighborhood, but countries with similar political and economic practices. For example, a G-7 country would be more within the neighborhoods of another G-7 country than a BRICS country given the G-7’s common economic status and political practices. The socio-economic proximities between countries that factor into organization accession decisions include economic proximity, political proximity and network proximity. Economic proximity includes both similarity in the level of development of the economy among countries and the similarity of their economic structures. Political proximity depends on the level of democracy of a country and domestic political decision structures. Network proximity is mainly the degree to which countries have bilateral alliances, or are involved in the same international and regional organizations.

4 Model

I will first use a spatial regression model to produce spatial variables that model the degree to which countries are socioeconomic "neighbors" with one another. I will then use Cox proportional hazard models to model the survival time of countries until they accede into the AIIB.

Spatial regression models assume that observations in the data are not independent of one another (Beck et al. 2006). They are increasingly used in international relations. Instead of interpreting spatial relationships as simply geographical relationships, non-geographic notions of space such as trade flows, bilateral agreements and other political economic concepts have been incorporated into the literature (Simmons and Elkins 2004, Elkins et al. 2006, Beck 2006, Baccini and Dur 2011).

There are two types of spatial regression models. The first kind specifies spatial dependence in the error term. The second kind is spatial lag models which treats "spatial dependence in the same way that time-series models treat serial correlation" (Simmons and Elkins 2004, 178). Since the variation in the model that I am interested in is the spatial dependence, the second model is appropriate. The rudimentary spatial-autoregressive (SAR) model is notated as follows:

\[ y_i = \lambda \sum_{j=1}^{n} w_{ij} y_j + \epsilon_i \]

\[ i = 1, \ldots, n \]

\( y_i \) denotes "the dependent variable corresponding to unit i," \( \lambda \) is a parameter, and \( \epsilon_i \) is a disturbance term (Drukker et al. 2013). \( \sum_{j=1}^{n} w_{ij} y_j \) makes up the connectivity matrix \( W_{yi} \), and \( W_{ij} \) is an element within this matrix. The connectivity matrix notates a N x N spatial weights matrix (Beck et al. 2006). \( w_{ij} \) is greater than 0 if observation i and j are connected (Beck el al. 2006). \( \sum_{j=1}^{n} w_{ij} y_j \) is also called a spatial lag, and the \( w_{ij} \) called spatial weights. The spatial lag of a variable is defined as “a weighted average of observations on the variable over neighboring units” (Drukker et al. 2013).

There are two types of connectivity matrices: contiguity matrices and inverse-distance matrices. Contiguity matrices only allow bordering countries to influence one another, and inverse-distance matrices can allow non-contiguous countries to influence one another.
(Drukker et al. 2013). Because I am looking at diffusion effects that reverberate through a network of countries, I will be using inverse-distance matrices to generate the spatial variables.

I will next use a Cox proportional hazard survival model to model the different times to accession of countries to the AIIB. The dependent variable in this model is a "survival object" that combines the number of days since the AIIB is established with the binary for whether the country acceded into the AIIB by the end of the timeline. The Cox proportional hazard model right-censors observations at June 1st, 2017. According to my theory, I should be able to generate survival graphs that present a discernible difference between the survival times of different groups of countries according to their spatial closeness with one another.

5 Operationalization

To gauge socioeconomic proximity in the categories of economic proximity, political proximity and network proximity and construct the spatial variables to use in the spatial regression model, I plan to use several indicators for each category. First, economic proximity would include indicators that measure the level of economic development and degree of economic openness. For level of economic development, I include GDP per capita and real GDP per capita at purchasing power parity. The real GDP per capita at purchasing power parity measures living standards within a country, and can be obtained from the UNDP’s Human Development Index.21 The degree of economic openness can be proxied by a country’s percentage of total trade compared with its GDP and by its total inflow of cross-border investment as percentage of GDP.22

In regards to political proximity, I conceptualize it as a spatial variable that can capture characteristics of governance and domestic decision processes. Indicators then include the Freedom House’s Freedom index as a measure for democracy that is more

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22The trade data can be obtained from the World Bank’s Trade (%GDP) measures at http://data.worldbank.org/indicator/NE.TRD.GNFS.ZS. Cross border investment includes foreign direct investment, portfolio investment and banking. Investment data can be obtained at the Global Opportunity Index http://www.globalopportunityindex.org/opportunity.taf?page=comparison.
granular than a division of democracy and non-democracy, and an indicator for domestic veto points that reflects the structure of domestic decision processes. A veto player is an “institutional or partisan actor whose consent is needed to alter policies,” and with the increase of domestic veto players who can effectively block policy changes, the possibility of forming a policy could decline (Mansfield et al. 2007, 403). The data for domestic veto points comes from the Political Constraint Index (POLYCON) dataset.

The network between countries are mainly institutionalized through bilateral agreements and common membership in multilateral organizations. To measure network proximity between countries, I include the number of bilateral security alliances and shared IGO memberships between them. This data can be obtained from the Correlates of War International Organizations dataset (Pevehouse et al. 2004).

I will also control for alternative explanations to accession into the AIIB. The first explanation is that countries geographically close to China will be more prone to China’s geopolitical influence and therefore be more likely to join. This explanation can be controlled for when estimating the Cox Proportional Hazard model using geographical distance between states. The second explanation is that countries accede to the AIIB because of economic dependence on China. China is becoming one of the top export markets for many countries, and joining the organization initiated by China will further ensure that these countries maintain good relations with China and have access to China’s domestic market. The UK for one, became the first G-7 country to join the AIIB in March of 2015, seeing it as an "unrivaled opportunity for the U.K. and Asia to invest and grow together." This explanation can be controlled through a variable measuring the dollar amount of export to China as a percentage of a country’s gdp. I also include dummy variables indicating whether or not a country that joined the AIIB is a founding member and whether or not it is a regional member. This accounts for the explanation that

countries might have been drawn towards accession by founding member privileges or by the voting power allotted to regional members.

6 Next Steps

This paper studies the AIIB and uses the case of the AIIB to inform the theory on multilateralism and policy diffusion. In the sections above I laid out my qualitative assessment of the AIIB’s institutional characteristics and relationship with existing multilateral development banks, theorized on multilateralism and the diffusion of multilateral organization membership through interdependency of policy decisions among countries, and proposed an empirical strategy for testing my theory using the case of the AIIB. The next steps on the paper would involve further strengthening my theory and empirical strategy before conducting the statistical analysis.

7 Bibliography


