LXIV
SIXTY-FOURTH SESSION

Asian Infrastructure Investment Bank

Berkeley Model United Nations

Dear Delegates,

Welcome to the Asian Infrastructure Investment Bank! My name is Mischa Fritz and I am fortunate to be the head chair for AIIB at the Sixty-Fourth Session of the Berkeley Model United Nations (BMUN) conference. The AIIB is an incredibly unique committee that was founded less than a year ago, and BMUN is the very first Model United Nations conference to have it as a committee. China formed the Asian Infrastructure Investment Bank as a counterpart to the World Bank to address the large infrastructure gap in Asia. From highways to flood management systems, infrastructure projects vary greatly across the continent. This committee will explore different facets of this issue, such as China's initiative to build skyscrapers in 19 days, to the post-earthquake recovery in Nepal. I hope that you, as a delegate in this committee, will develop an understanding and take away from BMUN 64th Session a rewarding MUN experience.

Now a little bit about myself and the vice chairs without whom this committee would be unable to function. I am a third year student at UC Berkeley majoring in Business Administration at the Haas School of Business, with a minor in Public Policy from the Goldman School. I grew up in Northern California and began MUN in my sophomore year of high school. After attending BMUN three times as a delegate (59th—61st Sessions), I knew I wanted to join the BMUN Secretariat when I was accepted to Berkeley. As you will see through our topics in AIIB this year, I have integrated my personal experiences into the topics. The first topic on the Asian infrastructure gap stems from work at the Haas Garwood Center for Corporate Innovation. I worked in a team of engineers to transform Visakhapatnam, India into a smart city. I will be traveling to India in January 2016 to consult with the Chief Minister, investors, and Cisco executives. The second topic is the incidence of the unbanked where we will examine the disparity of financial inclusion across the world. I developed this interest in financial regulation by working at U.S. Department of the Treasury in Washington, D.C. and as a Finance Compliance intern at Salesforce, a large cloud computing company in San Francisco. My true passion lies at the intersection of finance, technology, and public policy. After reading the topic synopsis, I hope both topics illustrate how we can use create innovative infrastructure projects and the pressing issues for the AIIB. Outside of the classroom, I enjoy traveling through Europe and spending time with my BMUN family.

Now, I'd like to introduce my Vice Chair, Lilac Peterson. Lilac is a sophomore studying a double major in Economics and Chinese with a minor in Public Policy. She is half-Chinese and fluent in all aspects of Mandarin. This past summer Lilac also interned at the U.S. Department of the Treasury, and worked in finance and budget formulation. She loved her experience so wholeheartedly that she intends to return to work for Treasury in the future. Lilac is interested in improving relations between the U.S. and China through economic and political channels, and is therefore very excited to serve on the AIIB committee dais. She hopes it will be a valuable growth experience for all our delegates and herself.

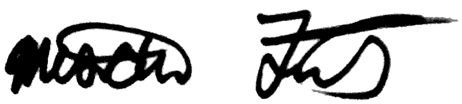
Michael Nakada is a junior transfer from the Sacramento Area who majors in Political Economy and minors in Scandinavian. His main emphasis of study is on comparative social policy between the Nordic countries and the US, and he hopes to be fluent in Danish by the time he graduates. Having both competed in and been a secretariat member for MUN for the past two years, he hopes to continue the strong traditions of

BMUN as a chair for the AIIB. His favorite memories of MUN are of all the connections he made with his fellow delegates and secretariat members at conference. Besides a passion for Scandinavian politics, particularly that of Denmark, Michael loves to bake graham cracker tortes and croissants while watching Nordic noir. *Hyggeligt at møde dig!*

As you embark on your research and position papers, ask yourself, "*How* specifically can we solve this problem? Is there a better way?" The AIIB is founded on changing World Bank traditions and generating truly innovative ideas, so I ask you to think critically about these issues.

We are looking forward to hearing your innovative ideas on the AIIB blog and at conference from March 4-6, 2016! As chairs, we are not only here to facilitate the committee, but also to assist you with any questions that come up during your research and position paper writing. If you have any questions at all about topics, position papers, Berkeley, (or the Treasury Department), please email me anytime at treasurer@bmun.org, Lilac at lpeterson@bmun.org, and Michael at mnakada@bmun.org. The BMUN blogs will go live in January, so you can post any questions you have there as well.

Best Regards,

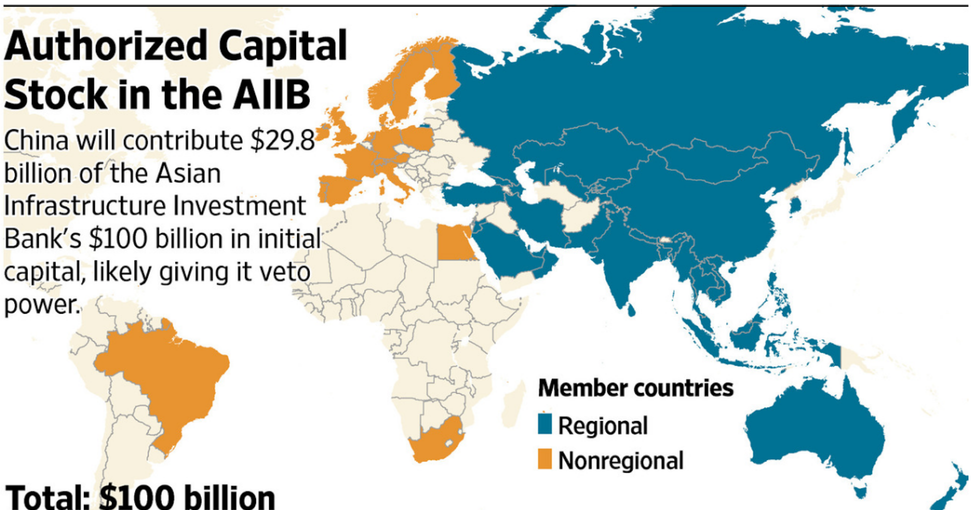


Mischa Fritz
Head Chair of the Asian Infrastructure Investment Bank
Berkeley Model United Nations, The 64th Session

Table of Contents

Parliamentary Procedure Addendum

The Asian Infrastructure Investment Bank will follow standard BMUN parliamentary procedure. Specific details can be found in the Delegate Guide on bmun.org. However, the dais has designed the committee such that Topic 1 will flow directly and into Topic 2. Therefore, we will not entertain any “motions to re-set the agenda to topic 2.”



Total: $100 billion

Nonregional members		Regional members	
$25 billion		**$75 billion**	
Top-10 contributors		**Top-10 contributors**	
Germany	$4.5 bil.	**China**	**$29.8 billion**
France	3.4	India	8.4
Brazil	3.2	Russia	6.5
U.K.	3.1	South Korea	3.7
Italy	2.6	Australia	3.7
Spain	1.8	Indonesia	3.4
Netherlands	1.0	Turkey	2.6
Poland	0.8	Saudi Arabia	2.5
Switzerland	0.7	Iran	1.6
Egypt	0.7	Thailand	1.4
Others*	3.4	Others†	11.4

*Sweden, South Africa, Norway, Austria, Denmark, Finland, Luxembourg, Portugal, Iceland, Malta
†United Arab Emirates, Pakistan, Philippines, Israel, Kazakhstan, Vietnam, Bangladesh, Qatar, Kuwait, New Zealand, Sri Lanka, Myanmar, Oman, Azerbaijan, Singapore, Uzbekistan, Jordan, Malaysia, Nepal, Cambodia, Georgia, Brunei, Laos, Mongolia, Tajikistan, Kyrgyzstan, Maldives

Source: staff reports

THE WALL STREET JOURNAL.

Observer States

The Asian Infrastructure Investment Bank will have all 57 Founding Members and 4 observer states (United States, Japan, Nigeria, and Kenya).

Developing the Frameworks to Address the Asian Infrastructure Gap

Topic Background

History of Asian Infrastructure Investment Bank

The Asian Infrastructure Investment Bank (AIIB) is the newest international organization focused on solving the infrastructure gap in Asia. The committee will be meeting for the first time in late 2015 to discuss its goals. With $100 billion in funding, the AIIB has the power to create drastic change in South Asia. China's leader Xi Jinping first introduced the concept of an Asian Infrastructure Investment Bank in a meeting with Indonesian President Susilo Bambang Yudhoyono in October 2013 (*The Economist*, "Only Connect"). This discussion sparked the creation of a bank that would invest China's wealth of financial and technical resources, and collaborate with other Asian governments and financial institutions, to improve infrastructure in weaker economies across Asia.

This innovative mission was a part of China's "One Belt, One Road" policy to improve rail, road, and maritime transport links between China, Central Asia, the Middle East and Europe, an area encompassing a total population of 4.4 billion people (Kynge). It also reflected a collective desire among Asian leaders to improve infrastructure for better "connectivity" and growth rates across Asia. In 2009, the Asian Development Bank (ADB) estimated that Asia will need to invest about $8 trillion in national infrastructure and $290 billion in regional infrastructure between 2010 and 2020 to sustain its growth trajectory (Giovannini and Emanuele). From 1992 to 2011, China has averaged 8 percent of its GDP on infrastructure spending, outpacing both developed and developing nations (Talley).

As the second-largest economy in the world, with an estimated 12.4 percent of world GDP, China is well-positioned economically to help improve infrastructure across Asia. However, it lacks the clout within existing financial institutions to execute its vision to give developing nations greater influence in global development financing. Despite being the second-largest economy, China has only 5 percent of the vote in the World Bank while the United States has 15 percent. Even in the Asian Development Bank, Japan maintains more than double the voting power than China (Kuo; Domínguez*;* and *Wharton*). This was one the primary reasons China decided to formally establish the AIIB. In October 2014, representatives from 22 countries signed a Memorandum of Understanding (MOU) to formally establish the AIIB with headquarters in Beijing ("What Is the Asian Infrastructure Investment Bank", *AIIB*).

When the bank closed its membership application on March 31, 2015, 57 nations had registered to join. These 57 nations are known as the founding members. The bank launched on June 29 with capital of $100 billion. The charter requires that at least $70 billion come from within Asia. China allocated itself a significantly larger share of power: headquarters in Beijing, 26 percent voting share, 30 percent equity stakes, and veto power. However, China's position in the AIIB is not entirely dominating: the bank requires a supermajority vote of 75 percent for important decisions, and has equally distributed 15 percent of voting rights amongst founding members regardless of equity stakes (Wildau). Important decisions include those affecting the Board of Governors structure and regional capital requirements (AIIB Charter, Art. 4) In order to convince key members to join, China offered to forgo veto power in day-to-day operations (Magnier); however, it maintains veto power for supermajority votes.

The AIIB is also improving on policies established by existing financial institutions by granting oversight to an unpaid, nonresident board of directors. Unlike the structure of the World Bank and the ADB, the AIIB allows for the bidding for projects to all countries, instead of only allowing member nations to execute contracts (Magnier).

Conflict with Washington

While leaders of the ADB and the World Bank both endorsed the AIIB, Washington feared that the AIIB would use its international influence to sidestep both the U.S.- and Japan-led regional and global banks like the World Bank and the ADB. They also worried whether the AIIB would respect international standards of transparency, debt sustainability, and environmental and social protections, or become a tool of Chinese "soft power" (Kuo). The U.S. engaged in a tense bid to prevent its allies from joining the AIIB. While AIIB leader Jin Liqun, a former Vice President of the Asian Development Bank, asked American experts in the World Bank for advice (Zoellick), the White House, the Treasury Department, and think tank experts tried convincing U.S. allies not to register. They called out the AIIB as a further move to end U.S. "dollar dominance" and supersede existing financial institutions like the World Bank and the IMF, whose voting power allocations favor the U.S. and Japan. They viewed China's recruiting of Southeast Asian countries as a soft power mechanism to bolster these members' economies, while allaying fears of China's territorial aggressions in the South China Sea. Treasury Department officials had concluded the AIIB would fail to meet environmental standards, procurement requirements and other safeguards adopted by the World Bank and the ADB, including protections against forced removal of marginalized people from their homes. (Perlez).

However, Washington's campaign against the AIIB was not working. By late March, the only bright spot was that major U.S. ally Japan did not seem likely to join. When two major pivot nations, South Korea and Australia, as well as key U.S. allies, Germany, France and the United Kingdom, decided to join the AIIB (Aiyar), Washington tried to shift its tactic. The Treasury Department's Under Secretary of International Affairs Nathan Sheets encouraged partnerships between the AIIB, the World Bank and the ADB to "strengthen international financial architecture" and ensure quality standards (*Wharton*). In April, President Obama attempted to further clarify Washington's stance on the AIIB, explaining that the U.S. would be "all for it" if the Bank's practices would confer solid infrastructure and benefits on the borrowing countries. Ultimately, Washington doubted this and did not want to be “providing cover for an institution that does not end up doing right by its people” (Talley).

Infrastructure Gap in Asia

The World Bank defines the infrastructure gap as the “difference between South Asia’s development goals and its actual capability to obtain those goals” ("South Asia's $2.5 Trillion Infrastructure Gap", *The World Bank*). South Asia refers to the countries of Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan, Sri Lanka, and Afghanistan. It does not imply that Southeast Asia is not affected, but the majority of World Bank research compares South Asia with East Asia (i.e. South Korea, China, Japan).

In a 2014 World Bank policy memo, Luis Andrés and Dan Biller identify the the current disparities and pragmatic targets to bridge the gap. The researchers argue that “uneven economic growth, a population boom, and slow urbanization” (“Reducing Poverty”, Andrés 1) contribute to the infrastructure gap in South Asia. For the past decade, the region experienced 6 percent economic growth rate, but only 31 percent urbanization rate. In contrast, East Asia grew 9 percent with 50 percent urbanization rate. As more people moved to cities, it creates a demand for new infrastructure projects such as new roads, sanitation facilities, and power plants.

Sanitation facilities represent a major barrier towards urbanization. 690 million people do have access to sanitation facilities, ranking South Asia “with the highest incidence of open defecation in the world” (“Infrastructure Gap in South Asia”, Andrés, Biller, and Dappe 6). Not surprising, poor facilities correlate to higher percentage of waterborne diseases such as cholera and dysentery ("Access to Sanitation”, *UN News Center*). Andrés and Biller also identified that while 90 percent of people have access to water, “only 25 percent of the population has access to piped water and 24/7 water supply is a rare exception in South Asian cities” (Andrés 3). Andrés argues that improving water access and sanitation facilities would reduce healthcare costs and support the economic growth of these nations.

By 2050, the population of South and Southeast Asia is expected to grow by 1 billion people to a total of 3.2 billion ("World Population Data Sheet 2013”, PBR). The

Asian Development Bank also notes that the majority will be living in urban cities. (Kohli, Sharma, and Sood 4). Once a substantial population lives in cities, there are several economic benefits of this urbanization. For example, "proximity and diversity of people can spark innovation and create employment as exchanging ideas breeds new ideas" ("Global Risks 2015" 31). This economic growth increases a city's production possibility curve and contribution to GDP. Currently, cities account for 80 percent of the global GDP, according to the World Economic Form. For the city government, infrastructure projects (e.g. public transportation systems) become more cost-effective through economics of scale and a larger tax base. Despite the large economic growth in South and Southeast Asia, current infrastructure investment does not meet future needs.

Luis Andrés and Dan Biller argue governments in South Asia must prioritize the investments to close the gap. The prioritization goes beyond a simple cost-benefit analysis because countries must quantify the benefits from positive economic externalities. These externalities exist when multiple individuals or society benefits from an economic decision. For example, improved sanitation facilities reduce healthcare costs, decrease pollution, and improve quality of life. Quantifying these benefits is difficult since they are not easily measurable. Weighing different factors such as geography, economic benefit, environment impact, and equity determines the prioritization of infrastructure projects. Moving forward, Andrés and Biller discuss that "connective infrastructure" such as transportation and electricity have largest impact on economic growth ("Infrastructure Gap in South Asia", Andrés 20). Roads connect people and facilitate the transport of goods and services, generating employment opportunities. Reliable access to electricity reduces expensive power outages that can affect manufacturing plants or important public services such as hospitals. Lastly, the authors state that national governments will not be able to fund these projects, but will likely need external funding from international organizations.

Past UN Action

On September 27, 2015, the United Nations adopted the 17 Sustainable Development Goals that will replace the Millennium Development Goals. The ninth goal is to “Build resilient infrastructure, promote inclusive and sustainable industrialization and foster innovation” (“Sustainable Development Goals”, United Nations). It exemplifies the United Nations’ commitment to improving infrastructure all around the world.

The World Bank is the primary international organization in this funding infrastructure projects. In 2015, the organization manages $30 billion in approximately 100 countries (Lowrey). Given the disparity of the Asian infrastructure gap, the World Bank, Asian Development Bank, and the European Bank for Reconstruction Development (ERBD) set up the Infrastructure Project Preparation Facility. Not only will this facility streamline communication between public policy consultants, but it will also expedite public-private partnerships to solve local infrastructure projects (Maier). The Managing Director of the ERBD argues that “private-sector finance is critical, but the public sector still finances some 90% of all infrastructure investment worldwide” (Maier). Given the large public sector investment, it can make it difficult for developing nations with smaller taxes bases to front the cost of projects. For that reason, the international development focus is on local, cheaper solutions.

The Group of 20 (G20) announced a multi-year infrastructure agenda in November 2014. In order to facilitate communication, the organization created the Global Infrastructure Hub. The leaders of the Hub have backgrounds in investment banking and government finance ministries. This knowledge network promotes the standardization of the project data and sharing this information across organizations. From a macroeconomic perspective, the Hub hopes to consolidate information from public agencies, private sector investors, and international organizations to generate efficient growth in developing nations (“Global Infrastructure Hub Overview")

The AIIB is expected to be up and running by the end of 2015 (“Articles of Agreement”, *AIIB*). In the meantime, the seven remaining nations have until the end of the year to sign the bank’s Articles of Agreement. The bank’s governance body expects that the first official meeting will occur once these Articles enter into force sometime in late fall 2015 ("AIIB President-designate*", AIIB)*.

China faces significant challenges in overcoming its reputation for heavy-handedness and corruption, and establish AIIB policies that will hold up under scrutiny. It needs to create a clear and transparent prudential regulatory structure and allocate responsibilities fairly among its members. If done properly, China and other founding members of the AIIB have the potential to significantly increase the total multilateral financing available for economic development in the medium-term, and will give developing countries a greater voice in governing global development finance in the next decade and beyond (Biswas).

To this end, China is making significant strides in marketing the AIIB as not an arm of Chinese foreign policy, but rather a forward-thinking and more efficient financial institution that will serve as a “new model of international cooperation”, according to China’s Ministry of Foreign Affairs spokesperson Hong Lei. Professor Cui Fan of Beijing’s University of International Business and Economics stated that the AIIB will try to shorten lengthy approval procedures relative to other development banks. The AIIB also plans to have a smaller staff and payroll in order to save money and friction among staff when they compete for projects (Magnier).

Given that many of the AIIB founding nations are also members of the IMF and World Bank, it seems more likely that these institutions will collaborate rather than compete (Domínguez). This is in line with China’s original intentions at the time of unveiling the AIIB concept (*The Economist*, “Only Connect”). As economics Professor Leslie Young of Beijing’s Cheung Kong Graduate School of Business explained, “China can’t lose from having an economically rational, transparent governing structure at the AIIB that it can showcase in response to the U.S. This is going to change the game and expand its soft power.” (Magnier).

Case Study: Nepal Earthquake Recovery and China's 19 Day Skyscraper

On April 25, 2015, a major 7.8 magnitude earthquake struck Nepal that took the lives of 9,000 people and injured 22,000. It also triggered an avalanche on Mount Everest that killed over 150 climbers. The Nepal Government estimated that 850,000 homes were destroyed and nearly 2.8 million people were displaced because of the earthquake (Taylor). Both the preparation and recovery illustrate infrastructure problems in Nepal.

Nepal is located in an earthquake-prone region between the Indian and Eurasian tectonic plates. The country experiences major earthquakes approximately every 80 years. The United Nations Development Programme implemented a new building code in 1994; however, slow adoption and lack of accountability in cities caused the construction of unsafe buildings. ("Nepal National Building Code") In 2015, "according to Engineers Without Borders UK, 80 [percent] of new buildings in Nepal are built informally, without engineering expertise" (Grinberg, Morgenstein). Consequently, scientists and geologists were not surprised by the catastrophe in April 2015 by saying "It was sort of a nightmare waiting to happen." (Politi)

In November 2015, roughly six months after the earthquake, the government struggles to recover. The country received approximately $4.1 billion in foreign donations, but there have been little plans on how to use the funding. While citizens in capital Katmandu is returning to normal, tens of thousands are still living in plastic tents in the rural villages. Non-profits such as Oxfam and the International Red Crescent Societies report that these inadequate shelters will not survive the winter (Oxfam). The Nepal government blames the current fuel shortage for the slow recovery. Bloomberg reports that "airlines have been forced to reroute flights to ensure they have adequate fuel, throwing Nepal's tourism-dependent economy into turmoil" (Pearson). The earthquake recovery exemplifies the consequences of poor infrastructure in South Asia.

In contrast, Chinese construction companies defies infrastructure norms. Zhang Yue, a Chinese tycoon, founded the Broad Group that builds modular buildings across Chinese cities (Aberdein). In early 2015, the company built Mini Sky City in Changsha, a 57-story tower, in 19 days! The tower has 800 apartments and office space for 4,000 people. By using prefabricated steel parts, the construction project hast sparked a revolution. Yue focuses on designing safe buildings that can withstand major earthquakes and other natural disasters. Mini Sky City truly illustrates both innovation and stark inequality across Asia. While the Nepal recovers, China prepares for the future when the majority of its population will be living in cities. In other words, closing the infrastructure gap is an opportunity for a new future of innovation.

Case Study: Smart Cities in India

India is the largest country in South Asia and is positioned to develop significantly over the next three decades. By 2050, approximately, one in five people of the global population will be living in India (Martin). In 2011, the Indian Ministry of Rural Development conducted the Socioeconomic and Caste Census (SECC). The results illustrated that magnitude of poverty with over 363 million people living on less than $2.50 per day; in absolute numbers, this is greater than the entire population of the United States and Canada combined. The Ministry summarized that only 5 percent of this population pays income taxes and approximately 35 percent are illiterate (SECC Data).

Isher Judge Ahluwalia, Chairperson of the Indian Council for Research on International Economic Relations, drafted a Report on Indian Urban Infrastructure and Services. She argues that "India's economic growth momentum cannot be sustained if urbanization is not actively facilitated." In other words, the state and central governments address the infrastructure gap, poverty, and lack of investment to continue its status as a global economic power. Moreover, the report identifies that policy decisions at the local level significantly affect development. Specifically, India's 74th amendment to the 1992 Constitution makes cities (instead of states) responsible for infrastructure such as roads, water, poverty, and sanitation. Ahluwalia argues that this amendment has limited urban development due to debates about financing between state and city governments.

As a result, Prime Minister Modi announced a bold mission to create 100 smart cities in India. These cities combine "internet of things" technologies to improve the lives of citizens and make the government more transparent (Tolan). For example, street lights are can be upgraded with sensors to change brightness levels based off foot traffic and amount of sunlight. They can even be equipped to detect gunshots and alert emergency services (Singh). Other examples include smart meters to monitor energy usage, carbon emissions, and water sanitation. The goal of a smart city is foster communication between the citizens and government officials over the common urban problems. PM Modi has invested $1.2 billion into the project, which also has support from President Obama (Tolan). The first city to become smart is Visakhapatnam (Vizag). As more technology companies move to Vizag, Chief Minister Chandrababu Naidu hopes to improve the city infrastructure and make it smart ("Vizag Will Be First to Be Made a Smart City" *The Hindu*).

Questions to Consider

1. Over the next fifteen years, hundreds of millions of people will be living in cities in South Asia without basic amenities such as food, water, electricity, sanitation. Given the limited scope of this committee, what projects should the Asian Infrastructure Investment Bank prioritize and why?
2. Jin Liqun, president-designate of the Asian Infrastructure Investment Bank, hopes to maintain a rate of return of 6 to 10 percent for its projects (Watts). As explained in the topic synopsis, there are some projects that do not provide direct monetary profit, but generate a positive externality in the community. How can the committee evaluate projects with the the tradeoff between profit and public goods?
3. Dr. Isher Judge Ahluwalia argues in her book *Transforming Our Cities: Postcards of Change* that "there is a lack of information on the state of service delivery [and] little research to make a case for the importance of planning for urbanization." How can developing nations in South Asia improve their information systems, especially in areas that do not have reliable access to electricity?
4. In contrast to other international organizations, the AIIB Articles of Agreement lacks the environmental constraints in dispersing loans. Should South Asia improve its infrastructure gap using fossil fuels? What are the disadvantages of using renewable sources of energy?
5. The AIIB strives to foster innovation in infrastructure projects through new funding methods. What are the primary funding methods of the World Bank and the Asian Development Bank? Which ones, if any, should the AIIB adopt? What are examples of new funding methods that the AIIB can use and have they succeed in other nations?
6. Many countries, particularly India, in South Asia have set lofty goals to improve infrastructure by 2020. How will the AIIB maintain that these goals and projects are actually implemented? How much regulation can China assert without infringing on national sovereignty in South Asia?

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Second Topic: Financial Inclusion and the Incidence of the Unbanked

Topic Background

Introduction

The 2011 World Bank Report on *Financial Inclusion* defines an unbanked individual as "a person who does not use or does not have access to commercial banking services" (Demirguc-Kunt, Klapper, and Singer xviii). In 2014, 38 percent of the world population--approximately 2 billion adults--was unbanked. More than half of this unbanked population lives in the South Asia and the East Asia and Pacific regions. In absolute numbers, four out of ten unbanked individuals live in China, India, or Indonesia.

The larger issue of "financial inclusion" encompasses the incidence of the unbanked. Financial inclusion means encouraging all populations in both rural and developed areas to actively utilize financial services. Numerous studies by the World Bank illustrate that financial inclusion is the foundation for individuals to invest in education, retirement, and personal economic wealth. Specifically, access to a line of credit such as a loan has shown to have positive effects on employment and on the economic growth of a country. For these reasons, the World Bank prioritized Universal Financial Access (UFA) by 2020. By providing a stable financial foundation, the international development community will be one step closer to meeting the 2015 Sustainable Development Goals of poverty eradication and inequality reduction.

History

In 2011, Asli Demirguc-Kunt and Leora Klapper at the World Bank researched the incidence of the unbanked in 130 countries, publishing the first comprehensive database. The results of the report were striking. In 2011, "50 percent of the adult population—more than 2.5 billion people—do not have a formal account" (Demirguc-Kunt, Klapper 1). The banked percentage varies across the globe from 12 percent in Cambodia to 98 percent in the United Kingdom (Global Findex). This disparity between developed and developing nations is a theme throughout the data. Less than 10 percent of the developing world has access to credit cards, which provide short-term loans to individuals (*The Economist*, "The Poor Are Different"). By compiling the country unbanked database called Global Findex, researchers analyzed how income inequality correlates with financial exclusion. In countries with high income inequality, the poorest 20 percent are twice as likely to be unbanked than richest 20 percent (Demirguc-Kunt 41). In addition, the researchers alarmingly discovered that 75 percent of the world's poor are unbanked! The United Nations defines "poverty" as living on under $2 per day. Demirguc-Kunt highlighted the magnitude of unbanked issue as well as its interdependence with global poverty.

In 2014, the Klapper and Demirguc-Kunt re-conducted the World Bank unbanked survey and found that the global banked population increased from 50 percent to 62 percent in only four years. Analysts attribute the growth to increase in mobile payment technologies, particularly in developing nations. In sub-Saharan Africa, mobile money accounts such as M-PESA and Orange Money allow consumers to transfer money and pay bills. A mobile money account is different from a bank account because the money is uniquely associated with a SIM card in a cell phone. As an analogy, if Verizon Wireless offered mobile money accounts, its customers could send payments to other Verizon customers. Customers can refill their accounts by meeting with a mobile M-PESA agent (Kangashi). For the purposes of the Global Findex data, account ownership is defined "as having an account either at a financial institution or through a mobile money provider" (Demirguc-Kunt 4). Even though mobile money accounts increase the banked population in a country, they lack the same regulatory benefits as traditional banks (See Case Study: "Mobile Money in Myanmar").

M-PESA had enormous success when the Kenyan government announced it would use the service for transfer payments; consequently, 17 million people use the service to move over $250 million annually (Kuipers, Michiels, and Seeberg). The Boston Consulting Group estimates mobile money accounts will grow to the $1.5-billion-dollar industry within the next 4 years. The report highlighted that digital transfer payments across the developing world is a strong incentive for financial inclusion. While the banked percentage increase, the gender gap remained constant, particularly in developing nations. In 2014, 65 percent of men own a bank account while only 58 percent of women had one (Demirguc-Kunt 5).

As a whole, both World Bank reports sparked to the development community that the incidence of the unbanked is a major problem. There are compelling interests for governments and NGOs to address the unbanked because it is interconnected with other development goals.

Benefits of Financial Inclusion

In order to analyze the roots of the issue, it is important to note the differences between financial inclusion and financial access. Financial access is the first step toward inclusion and relates to the physical barriers such as distance, fees, and laws. Universal inclusion is the ultimate goal where entire populations actively use financial services that are available to them. Financial services provide individuals with access to basic savings accounts, loan counseling, and secure payment processing (Demirguc-Kunt 16).

There are several reasons why individuals benefit from these services. This list is by no means exhaustive, but it highlights some of the major reasons. First, large investments including buying a home, starting a business, building a school often require basic loans due to the high upfront cost. Savings accounts help to budget education payments, retirement, and emergencies. Depending on the country's monetary policy, these savings accounts provide interest payment to help grow the principal amount.

Second, having a country's population operate on a cash basis is detrimental for both citizens and national financial regulation. For example, in 2010 Rwanda, it was common for individuals to carry large wads of cash for day-to-day payments ("Financial Inclusion: Helping Countries"). This idea of storing money outside the financial system as cash is known in economics as a "keeping money under your mattress." This liquidity preference causes individuals to take on a safety risk, and they forego the interest benefits of a savings account. From a government perspective, tax collection is difficult in a large unbanked population. Advanced tax collection systems such as the U.S. Internal Revenue Service and Swedish Tax Agency compare tax payments to bank account statements to ensure full tax collection.

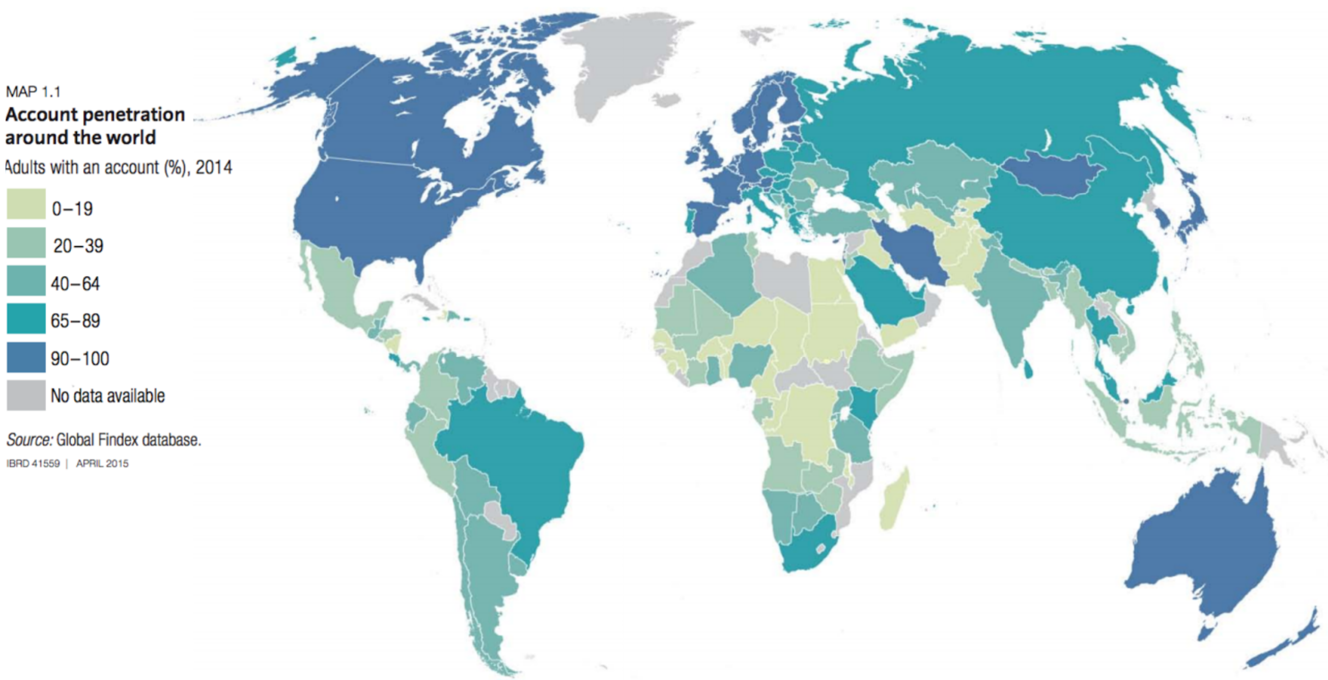
Third, national central banks are more effective in countries with banked populations. Under monetary policy, central banks manipulate interest rates to control inflation and unemployment, depending on the bank's mandate and independence. When interest rates are high, consumers are more likely to save whereas when interest rates are low, consumers and businesses are more likely to spend and invest into the economy. By spending, it increases national consumption and increases economic growth through the GDP multiplier effect (Hawkins). In countries with large unbanked populations, changing interest rates has a smaller or delayed effect because individuals store money outside the banking system. Senior Macroeconomist Aaron Mehrotra at the Bank for International Settlements in Switzerland argues that "increased financial inclusion facilitates consumption smoothing, as households have easier access to instruments for saving and borrowing." In other words, households are able to plan their spending by having a bank account. Instead of having "peaks" and "valleys" in their spending, individuals can "smooth" their consumption by saving for larger expenses. In turn, it is easier for a central bank to enact monetary policy because GDP is less volatile and inflation is more stable.

Fourth, financial inclusion supports poverty reduction. On September 27, 2015, the United Nations adopted the 17 Sustainable Development Goals that will replace the Millennium Development Goals ("Sustainable Development Goals", United Nations). The first goal is to eradicate all forms of poverty. Financial inclusion is one step towards achieving this goal. As Mehrotra argued, financial inclusion smoothes consumption. It allows households to save or borrow for larger investments including education and healthcare, both of which are tools to alleviate poverty. Poverty is interconnected with the concept of financial resilience, where individuals are able to manage shocks with emergency savings. The World Bank aims to have "emergency funds equal to 1/20 of gross national income (GNI) per capita in local currencies" (Demirguc-Kunt 8).

World Bank researchers Asli Demirguc-Kunt and Leora Klapper argued that "while inclusion has important benefits, the policy objective cannot be inclusion for inclusion's sake" (7). There are inherent risks for the stability of the financial system by encouraging everyone to borrow. For example, banks provide access to credit by evaluating the creditworthiness of an individual. The risk lies when a bank provides loans to too many uncreditworthy individuals. If these individuals default on the loan, then the bank itself could face bankruptcy. Moreover, there are populations that voluntarily exclude themselves from mainstream financial services. In sub-Saharan Africa, many villages participate in informal clubs to borrow funds (22). In these areas, governments will only waste funds trying to bank individuals where there is no demand for bank accounts.

Current Situation

The incidence of the unbanked proliferates throughout developed and developing nations. While financial access increases to the 2020 goal, each region faces new problems related to financial inclusion. Figure 2 highlights that developed nations such as the United States, Germany, South Korea, and France boost high banked percentages. In contrast, the Middle East and parts of Africa have an unbanked population of almost 80 percent.



The determinants of financial exclusion are interrelated and vary by region. In the 2014 World Bank Findex survey, 50 percent of individuals cited "not enough money" as the reason for being unbanked. Other reasons included the lack of need for a bank account (30 percent), family member already has an account (28 percent), cost of account (25 percent), and distance (21 percent). Individuals were able to select more than one reason, illustrating that the incidence of the unbanked goes beyond just poverty. Gallup researchers, Peter van Oudheusden and Jan Sonnenschein, also concluded that poverty is only one variable in the incidence of the unbanked. As a whole, the Global Findex exemplifies that the unbanked want to become banked, but it is up to governments on how to effectively use the data in public policy decisions.

Religious reasons are another barrier for financial inclusion. In countries with high Muslim populations, banks must adhere to Islamic finance regulations. According to Amin Mohseni-Cheraghlou, an Economics professor at American University, "the Islamic legal system has guidelines and regulations pertaining to the financial transactions of Muslim believer." The loans lack a "pre-defined interest-bearing rates" and follow the ""loss-sharing, profit-sharing" principle. Due to the low creditworthiness of poor unbanked individuals, banks cannot guarantee profit with Islamic finance rules. Few banks follow these regulations, causing individuals to be excluded from mainstream banking for religion reasons. For example, Pakistan is 96.4 percent Muslim and only 10 percent of the population has bank accounts (Global Findex). This correlation illustrates that there are other factors such as religion that can perpetuate the incidence of the unbanked. To solve this issue, it requires a balance between regulatory needs of the global financial system and religious requirements.

The Center for Financial Inclusion (CFI) predicts that financial access will continue to grow. Figure 1 illustrates the the amount of people excluded adults by country. By 2020, there will only be approximately 1 billion unbanked adults globally (Kelly and Rhyne 4). Similar to Demirguc-Kunt's research, mobile money accounts have increased banked percentages, particularly in Africa. The CFI also cites the World Bank's Universal Financial Access by 2020 initiative. Governments across the developing world support this goal and integrated it into policy decisions. For example, mobile-led programs and digital transfer payments in Kenya increased access. Digital transfer payments include welfare and social safety net payments. In Chile, the Banco del Estado provided simplified bank accounts to over 5 million users (14). As a result of these policy decisions, the CFI estimates that 40 countries will have universal financial access by 2020 (13).

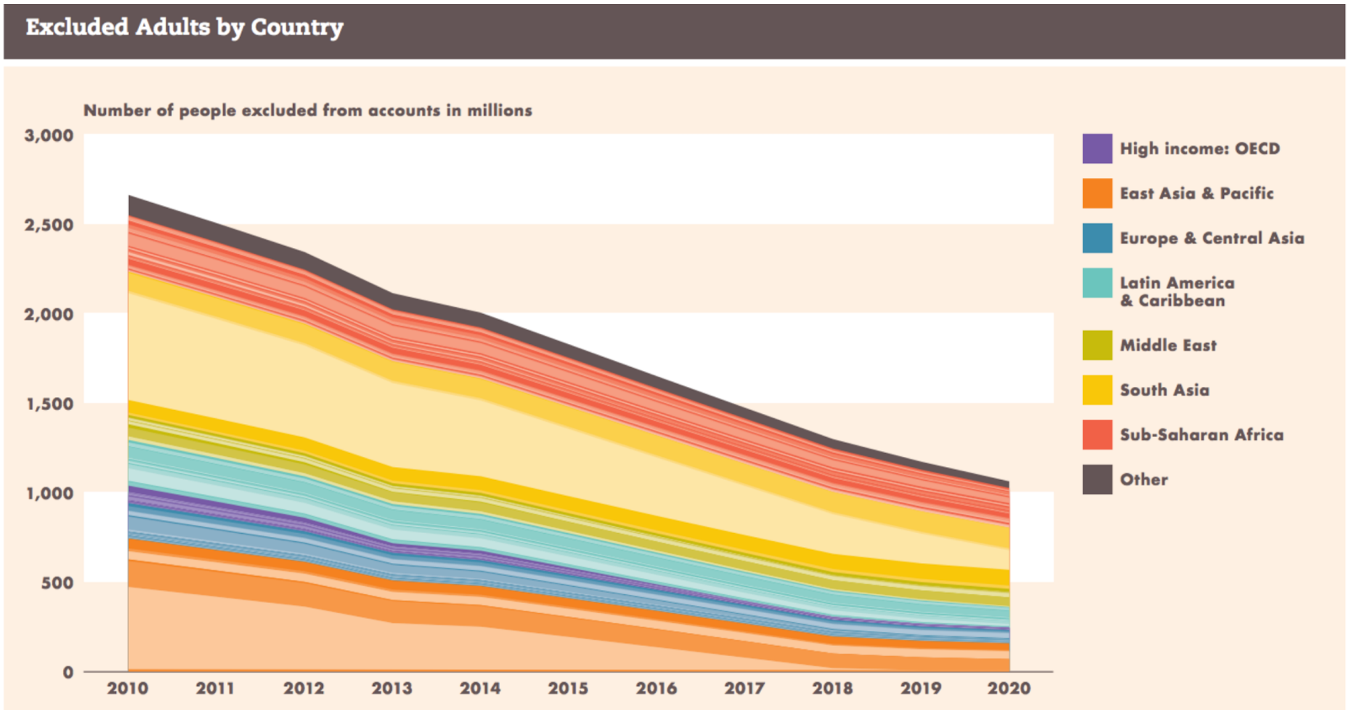


Figure 1: The incidence of the unbanked is decreasing by 2020. It illustrates the shift from financial access to financial inclusion.

While financial access increases, the inequality gaps still exist. The CFI cites that "younger people, women, migrants and refugees, minorities, the very poor, and people who live in rural areas" will still be more likely to unbanked by 2020 than their counterparts (17). For example, the gender gap will remain in specific regions. Particularly, the Middle East will only have a 20 percent banked population because of this gender gap and Islamic Finance regulations. Young people between the ages of 15 to 24 as well as those with only a primary education are more likely to be unbanked in 2020.

CFI researchers Sonja E. Kelly and Elisabeth Rhyne argue that financial access is growing at exponential pace across the world. For that reason, the international community will shift its focus in parts of the world toward financial inclusion. While having a bank account is the first step, actually using the banking services such as loans, counseling, and savings accounts will make a tangible impact. This research raises the question: how do international organizations increase account usage? Kelley and Rhyne argue that inclusion “requires building and maintaining an enabling ecosystem including policy, regulation, and industry infrastructure” (25). In other words, the government financial policy mechanisms influence account usage. Examples of these mechanisms include credit reporting and consumer protection policies (See Case Studies: MasterCard and Mobile Money).

Past UN Action

The United Nations did not address the issue of financial inclusion as fundamental issue until recently. National governments, particularly in developing nations, acknowledged and addressed the problem through public policy decisions. For example, India in the 1991 rapidly expanded nonbank institutions to provide microloans to the unbanked (Demirguc-Kunt 45). The plan had little success because borrowers withdrew multiple loans and falling into the cyclic debt trap. The United States currently has similar issues with payday lenders (Montezemolo).

Microloans have the potential for success in targeted areas. In 2006, Muhammad Yunus was awarded the Nobel Peace Prize for his work on financial inclusion and poverty alleviation in Bangladesh. After the 1974 Bangladesh famine, he started an imitative to teach financial education and provide long-term microloans to the poor. This initiative led to the creation of Grameen Bank. He strongly believed that access to credit was a human right (“Muhammad Yunus - Facts”). Microloans in this example were a huge success with the focus on financial education; Grameen Bank prides itself with a 98 percent repayment rate (Al-Mahmood and Jamal Hossain).

World Bank researchers Asli Demirguc-Kunt and Leora Klapper sparked a new wave of UN legislation by creating the Global Findex, with the financial support of the Bill and Melinda Gates Foundation. The 2011 and 2014 reports illustrated the surprising magnitude of the global unbanked population. As a result of these reports, the World Bank launched the Universal Financial Access by 2020 imitative that focuses on mobile technologies to reduce the unbanked percentage ("UFA2020 Overview"). In April 2015, the World Bank President Jim Kim announced, “as early as 2020, such instruments as e-money accounts, along with debit cards and low-cost regular bank accounts, can significantly increase financial access for those who are now excluded” (Panajyan). Kim argues that these tools will achieve financial access and eventually led to financial inclusion.

The Asian Infrastructure Investment Bank will be meeting for the first in late 2015. It will begin to address the major infrastructure gaps within Asia. Given than half of the global unbanked population live in East Pacific and Southeast Asia regions, it represents a unique infrastructure problem. Moreover, the gender gap and inequality gap is most evident in Asia. {citation needed} Moving forward, the AIIB prides itself on innovative solutions to development and to diverge itself from previous World Bank initiatives. As the conversation shifts from financial access to financial inclusion, the AIIB is in the position to influence this development within Asia and around the world.

Case Studies

MasterCard in Nigeria

In 2013, the Central Bank of Nigeria announced the partnership with MasterCard as part of its Cashless Policy (MasterCard). MasterCard produced new national identify cards for anyone over the age of 16 with all the features of electronic payments. Unbanked Nigerians have the ability to use ATMs, receive digital transfer payments, and pay expenses. MasterCard produced 13 million ID cards and hopes to expand it to over 100 million.

Both the Boston Consulting Group and MasterCard identified Africa as a major area of growth for financial inclusion. Specifically, Nigeria has a population growth rate of 3 percent a year. At this rate, Nigeria will surpass the United States as the third most populated country by 2050; the Pew Research Center estimates the population to grow from 176 million to 440 million people (Kochhar). According to the Global Findex, only 44 percent of the country is banked. The Central Bank of Nigeria hopes to achieve 70 percent financial inclusion by the UFA2020 goal. These national identify cards are one step in its Cashless policy. Furthermore, the government increased regulation on microfinance banks by improving transparency and insuring customer deposits (Romeu).

Mobile Money in Myanmar

Myanmar is one of the poorest countries in the AIIB. Approximately 94 percent of the population—49 million people—does not have access to tap water (Shrader). One-fourth of the population lives on less then $2 per day (UNDP). According to the Global Findex, only 10 percent of the population has a bank account. Consequently, the country became a prime candidate for mobile money products. In late 2013, major companies Ooredoo and Teleno won the bidding war to expand the country's telecommunications network (Kate, Kyaw, and Ewing)

The Myanmar government strives to achieve the UFA2020 goal with these telecommunication companies. As of September 2015, Telenor had 9.5 million subscribers and Ooredoo claimed 4.5 million subscribers. It is important to note that these are not bank accounts, but rather mobile money accounts attached to a unique SIM card. Over the past year, the two firms competed in price wars in the mobile phone industry, causing account penetration growth to exceed that of India and China (Waring). Bloomberg analysts argue that the mobile money accounts are changing the country by removing individuals from isolation. According to the Consultative Group to Assist the Poor (CGAP), mobile money accounts "provide a critical leapfrog effect for financial inclusion through the provision of mobile money accounts, linking the unbanked more quickly to digital financial highways" (Shrader). It illustrates the added benefits of financial inclusion through mobile money accounts, rather than tradition bank accounts at mainstream institutions.

With mobile money non-bank accounts on the rise, the question of consumer protection also arises. Telecommunication companies, not banks, regulate these accounts. Consequently, there are strong risks of fraud and bankruptcy. Jonathan Greenacre at the University of New South Wales argues that the unbanked "may be particularly susceptible to mistreatment in an e-money scheme." E-money refers to the customer funds' that are controlled by the provider. Greenacre states that "without prudential oversight, a regulatory gap exists in relation to how the provider deals with customers' funds." He suggests regulation through legal trusts to restrict providers' misuse. On the other hand, the CGAP highlights that regulation could restrict e-money providers too much and place them in the same situation as banks that cannot lend to uncreditworthy individuals (Duflos, Luchtenburg, and Chen). In summary, e-money is a shift toward a new, but uncertain, future for Myanmar.

Questions to Consider

1. The Asian Infrastructure Investment Bank has a large disparity in account penetration. How will this committee come up with a solution that targets regions with their specific weaknesses?
2. How will the committee limit “adverse selection” and “moral hazard” issues in potential solutions? These are advanced economic terms that will require further research. What types of financial institutional safeguards can be used?
3. Consider the case of the South African TV Show Scandal! that taught individuals about financial literacy. How can the committee measure the success of financial education? What resources are necessary for financial education to be expanded nationally and sustained?
4. The Middle East has the lowest *percentages* of account penetration due to the Islamic finance regulation and cultural norms. Europe has issues with total financial inclusion while the East Pacific region has the largest *number* of unbanked individuals.
5. While this topic synopsis focused on unbanked individuals, unbanked firms is another major issue in developing countries in West Africa, particularly Nigeria. What are the benefits of banked firms? How does this relate to the GDP multiplier effect? These are advanced economic terms that will require further research.
6. In the 2014 World Bank report, the authors argued, “While inclusion has important benefits, the policy objective cannot be inclusion for inclusion’s sake, and the goal certainly cannot be to make everybody borrow.” From your country’s perspective, is “inclusion for inclusion's sake” a bad idea?

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