DESK REVIEW ON THE

PROPOSED BUSINESS MODEL OF THE ASIAN INFRASTRUCTURE INVESTMENT BANK (AIIB)

By
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NGO Forum on ADB
Holding ADB accountable since 1992

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INTRODUCTION

RATIONALE

1. This report summarises and presents key points and findings based on documents, data/information and related literatures; speeches and news articles that have been written on the Asian Infrastructure Investment Bank's (hereafter AIIB) establishment and inner workings. The study was commissioned by NGO Forum on ADB (hereafter Forum) to explore the emerging investment model of AIIB using its experiences with the Asian Development Bank (ADB) and help address the knowledge gap. This desk-based review of documents and comparisons to existing Multi-Development Banks' (MDBs) operations were collected and analyzed to get possible insights into AIIB's model in Asia.

2. Consistent with the terms of reference (ToR), the report attempts to: (1) conduct a comparative focus of AIIB and ADB to identify possible structural "shortcomings" that could be taken up immediately in targeted advocacy efforts of the Forum. Beyond this, make comparisons with the business models of the Global Infrastructure Facility (GIF), the International Finance Corporation IFC (e.g. its Asset Management Corporation), and the European Investment Bank (EIB); and (2) make an analysis of the role, type, and implications of having Public Private Partnerships (PPPs) as a key element of the AIIB business model.

3. The study was conducted from February to April 2016. The report is informed by literature reviews, web searches, news articles and commentaries (where direct statements are quoted and serve as basis for analysis). There is a dearth of information that is available (as internal processes are being hastily developed by AIIB) and corresponding assessments, reactions, and critiques that are taking place even as this report is being written. Therefore, this overview does not and cannot assume to "be the end all and single approach" to understanding the workings of AIIB. As much as possible, the report attempts to be evidence-based while providing an objective overview of relevant observations and critiques. In the end, it provides some international principles, agreements and guidelines by which Forum can benchmark and leverage its actions and advocacies.

4. For a good understanding and judgment of AIIB's workings and possible effects, it is important to understand the very nature of the bank. AIIB is not just a multilateral financing institution (MFI) but likewise a "commercial enterprise"[1]; quite different from some official banking and lending institutions. It intends to operate in such a way that it will get returns, earn its investments back and use market mechanisms to generate further income. To this end, if Forum intends to focus some of its energy into this new bank aside from that of ADB, it will have to learn the "language and mechanisms" of business, investment and trade. Doing so will assist in developing customised engagement strategies and effective advocacy instruments.

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[1] In a way this is a similar model to that of IFC, which provides loans and equity financing, advice, and technical services to the private sector by mobilizing additional capital through loan syndication from participating private banks. The IFC accepts investment proposals directly from companies or entrepreneurs seeking to establish a new venture or expand an existing enterprise. Many of IFC's projects though, entail close coordination and relationships with government agencies in developing countries.

5. Forum has been advocating the principles of transparency, accountability and participatory decision-making since its establishment in 1991. It has engaged ADB on these principles and continues to work towards social and environmental justice and good governance. Through its members' oversight and capacity development in monitoring ADB's operations in their respective regions, Forum has provided a venue for information sharing and exchange of experiences and expertise. It supports advocacy activities related to ADB policies and projects, including the use of the Accountability Mechanism for complaints for projects that adversely affect communities.[2]

6. With its geographical focus, Forum recently positioned itself as the first international civil society coalition to officially engage another emerging MFI in Asia, the AIIB. A short historical overview of Forum's activities to date follows:

- April 2014 – A formal letter of introduction addressed to the president-designate and interim multilateral secretariat was sent to AIIB. The letter urged the Ministry of Finance, People's Bank of China, and China Banking Regulatory Commission to formulate and implement the highest standards of safeguards in view of the limits of the planet's growth and impacts of huge infrastructure projects on vulnerable communities in Asia.

- September 2014 – AIIB, through its Chief Officer responded and acknowledged that a 38-page draft Environmental and Social Framework (ESF)[3] that supposedly contains the proposed provisions of the Forum was released on September 7, 2015. These policies ultimately decide how clean and green AIIB shall be as this further sets a vision of "meeting the challenges of sustainable development in Asia.

- A follow-up letter, endorsed by over 60 groups around the world was sent, detailing civil society concerns on the flawed AIIB consultation plan on the ESF.[4] The third correspondence requested for Civil Society Organizations' (CSO) dialogue with AIIB's Chief Negotiators to redesign the consultation process and discuss the gaps in the ESF. This was signed by nearly 70 groups from 30 countries.

- November 2014 - Further, Forum's resident safeguards experts raised critical concerns about the gaps in the draft ESF and its flaws. Through a number of audio-video consultations, CSOs submitted a comprehensive critique on the draft ESF.[5] It has also critiqued AIIB's Articles of Agreements (AOA) which Forum noted as lacking in anti-poverty and sustainable development agenda.[6] Forum also conducted two international conference calls to strategize civil society's engagements on AIIB.■

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[2] www.forum-adb.org

[3] AIIB. Environmental and Social Framework, Consultation Draft. August 2015. (There is supposedly another version as of December 21, 2015 for discussion by the Board of Directors during the Inaugural Meeting on January 17-18, 2016 that has been released for restricted distribution). See Annex 1.
Related to this, AIIB's new 2nd Draft ESF safeguards do NOT require the WB to use WB safeguards in co-financed projects. This means that regardless of what the final new WB safeguards state; the WB must use its own safeguards in co-financing with AIIB. Based on latest reports as of April15, 2016, WB and AIIB have signed a co-financing framework agreement that would allow the two institutions to jointly develop projects in 2016. Under the agreement, WB will prepare and supervise the co-financed projects in accordance with its policies and procedures in areas like procurement, environment and social safeguards. The first batch of projects are expected to be approved in June and at the same time, discussions with ADB are also going.

[4] Forum Network. November 2014. A Comprehensive Critique on the Draft Environmental and Social Framework (ESF) of the Asian Infrastructure Investment Bank (AIIB). Manila, See Annex 2.

[5] Asian People's Safeguards. November 2014. Bangkok, Thailand.

[6] AIIB Articles of Agreement: A Civil Society Perspective. November 2014. See Annex 3.

SETTING THE SCENE

A. AIIB: TRACING ITS ROOTS AND CONCEPT

7. The concept of **AIIB as a bank** is to lend money and to *"utilize the resources at its disposal for financing the development of infrastructure and other productive sectors in Asia and Oceania as a whole and with special regard to the needs of less developed members in the region*". AIIB is **likewise a multilateral financing institution;** with a development "purpose," with members coming from ADB or the International Bank for Reconstruction and Development (IBRD), and which have shares in the capital stock *"in order to mobilize additional resources from inside and outside of Asia."*

8. *As an approach though,* **AIIB acts as a business enterprise** where *"it will invest in public and private capital in the region and encourage private investment in projects and enterprise and supplement private investment when private capital is not available on reasonable terms and conditions."* The Articles of Agreement (AOA) explicitly state that it is open to "special funds," or trust-fund arrangements that are separate from the bank's balance sheet and which do not appear to be restricted to participation by only bank members.

9. Different from other MFIs, AIIB was solely envisioned and conceptualized by China; it was not borne out of a common need among a group of countries that wish to address a common "challenge" and/or achieve a shared goal. It has come into existence through sequential steps and events that firmed up its vision and tested its viability:[7]

2007 – The inception and creation of Shanghai Cooperation Organization (SCO) was mainly a response to the increasing United States (US) presence in Central Asia, who has gained permission from Uzbekistan to base its air force assets for the Afghanistan campaign. The SCO is a multilateral organization that achieves three important strategic objectives for China; bring Russia into a regional security forum that China leads, increase China's influence in Central Asia, and provide something of a bulwark against US encroachment in Central Asia.[8]

2011 – The New Development Bank (NDB) idea was proposed in 2011 by the Nobel Laureate Joseph Stieglitz and initiated in 2012 during the 6th BRICS Summit in Brazil. The BRICS countries, composed of Brazil, Russia, India, China, and South Africa agreed to establish a $100-billion liquidity reserve to maintain the bank's financial stability. NDB was expected to become an alternative to Western-dominated financial institutions, such as the International Monetary Fund (IMF) and the World Bank (WB). It's founding is said to have "served as inspiration to the AIIB initiative" and provided momentum to AIIB's launch in 2013.[9]

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[7] Raby, Geoff. 2015. *"China's AIIB Bank: Part of a Much Bigger Master Plan".* This article first appeared in ASPI's The Strategist.

[8] The "SCO" includes China, Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Uzbekistan, with Afghanistan, India, Iran, Mongolia and Pakistan waiting in the wings as observer nations, and Belarus, Sri Lanka and Turkey as "dialogue partners." Originally known as the "Shanghai Five", they are signatories to the 1996 Treaty on Deepening Military Trust in Border Regions and have gone on with their military, intelligence and security ties, staging joint military exercises since 2003 and China-Russia war games since 2005. They are also coordinating on security matters, including a 2004 agreement on a Regional Antiterrorism Structure and the 2006 cooperation agreement called Collective Security Treaty Organization (CSTO), the NATO counterbalance in the region.

[9] One of the resolutions of the BRICS countries is to get money back from the Western banking system to finance their own infrastructure and development, and enhancing the resilience of their financial systems.

2013 - Chinese President Xi Jinping proposed in a speech to Indonesia's parliament to build the Asia infrastructure investment bank to *"provide financial support to infrastructure development in developing countries in the region."* Such an announcement caused a commotion and paved the way to a series of bilateral and multilateral discussions and consultations on core principles and key elements for establishing the AIIB.

October 2014 - Representatives from 22 countries signed the Memorandum of Understanding (MOU) establishing the AIIB, with Beijing as the host Bank headquarters and Mr. Jin Liqun as Secretary General of the Multilateral Interim Secretariat. The Secretariat is tasked to perform technical preparations for establishing the AIIB and provide technical support to the Chief Negotiator's Meetings (CNM). This serves as the forum for Prospective Founding Members (PFMs) to negotiate and agree on AIIB's Articles of Agreement (See Annex 4 Copy of AOA) and other issues related to AIIB's establishment.

November 2014 - The first CNM was held in Kunming, China. The second in Mumbai, India in January 2015 that launched discussions on the draft Articles of Agreement. A third took place in Almaty, Kazakhstan in March 2015 while the fourth took place in Beijing, China in April 2015.

May 2015 - The final text of the AOA (See Annex 4.1: Amendments to the AOA) was adopted by the 5th CNM on May 22, 2015 in Singapore. As a run up to March 31, 2015 being the deadline for the submission of membership applications, (See Annex 5: List of Founding Members) the number of PFMs had increased to 57. During the 4th CNM in Beijing, the Articles were signed by all 57 PFMs between June 29, 2015 and December 31, 2015.

December 2015 - The AOA entered into force on December 25, 2015, when instruments of ratification had been deposited by 17 signatories with initial capital subscriptions totaling 50.1% of the shares allocated. Remaining signatories that have not yet deposited their instruments of ratification were expected to do so by December 31, 2016. (See Annex 6: Signing and Ratification Status of the AOA of the AIIB.)

January 16-17, 2016 – AIIB officially kicked off with the first meeting of its Board of Governors (BoG). Thirty of the bank's governors representing over 74 percent of the AIIB's capital stock met (Refer to Table 1: Country Contributions) at the Diaoyutai State Guesthouse in Beijing to approve the bank's by-laws, code of conduct, and rules. AIIB's doors officially opened on January 16, 2016, and the first meeting of the bank's Board of Directors (BoD) took place on January 17-18, 2016.

The Shanghai municipal government has given strong support to the NDB as the first international organization headquartered in Shanghai and the first international financial organization headquartered in China.
http://sputniknews.com/asia/20160116/1033232015/aiib-global-economic-governance-reforms-xi-jinping.html#ixzz40JonZbHB

OBSERVATION

10. Two things can be gleaned: 1) In contrast to other MFIs, AIIB was conceived by one country, China and other countries followed suit. AIIB, as stipulated by its AOA is a "new MDB" with China playing a large but not dominant role. It aims to differentiate itself from both commercial banks and aid agencies by becoming a "quasi-commercial bank" that has to generate returns. 2) With reference to its AOA, its characteristics as a financing institution is sometimes marred by its so-called business approach that it is hard to predict its actual operations and effects.

WHAT IS IN IT FOR CHINA AND THE REGION?

11. China, during the last decade has emerged as a dominant economic power and has been a critical factor in re-shaping the Asia-Pacific region.[10] Data show that it is the third-**largest shareholder** in WB. And as such, makes it an important contributor to the International Development Association (IDA), the institution's fund for the poor, and the Global Infrastructure Facility (GIF), an international platform that facilitates the preparation and structuring of infrastructure public-private partnerships.[11]

12. In 2013, Chinese foreign aid was placed at $7.1 billion making it the world's sixth largest **bilateral donor,** just after France. China's aid focus is distinctly in the productive sector, particularly in energy, transport and storage. Between 2000 and 2013, China committed $39 billion to projects in these sectors. *(Aid Data's Tracking Underreported Financial Flows (TUFF) methodology that tracks over 2,500 Chinese projects and activities in Africa).* In the Pacific, China is now the third largest aid provider, following Australia and the U.S. It is number one in Fiji, investing $332.96 million from 2006 to 2013. Eighty percent of Chinese assistance in the Pacific is in the form of concessional loans[12], mostly in the transport sector.[13]

13. In 2015, the Chinese government kicked off **several investments** along its much-vaunted New Silk Road[14] flooding these into countries in Central Asia and Africa. Over the third quarter of 2015 alone, 17 out of 19 **government loans** were disbursed, constituting some 90% of China's overseas lending over the period. The majority of the loans went to countries that had larger framework investment treaties with China. Kazakhstan received four loans totaling more than US$2bn. VTB Company of Belarus received US$1.884bn in trade finance credit, while Turk cell Company of Turkey was given a US$1.25bn loan by China Development Bank. Perhaps the most significant was the largest defense deal China has ever agreed with a single country; a total of US$4.5bn was pledged to Pakistan through the sale of eight submarines. The remaining loans totaling US$3.5bn were to African countries. (*Data from Grison's Peak, a merchant banking firm).*

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[10] Morris, Scott and Higashikokubaru, Mamorou. February 2, 2015. *"Doing the Math on AIIB Governance".*

[11] 2015. "Multilateral organizations to promote effective ways of member nations working together".

[12] These are loans that are extended on terms substantially more generous than market loans. The concessionality is achieved either through interest rates below those available on the market or by grace periods, or a combination of these. Concessional loans typically have long grace periods.

[13] These data were included in a report by Asia Foundation for its forum that brought together leading Chinese researchers and policy makers with international development experts for *China's Overseas Development Policy in a World "Beyond Aid,"* the latest in its *Asian Approaches to Development Cooperation* dialogue series as reported by Mulakala, Anthea. June 17, 2015.

[14] Launched by China in 2013, nowadays known as "One Belt, One Road" (OBOR) with the aim to connect major Eurasian economies through infrastructure, trade and investment. It contains two international trade connections: the land-based "Silk Road Economic Belt" and oceangoing "Maritime Silk Road".

14. Based on reports (which would need to be systematically documented), China has been building **joint economic zones** and ports in partnership with countries that include Vietnam, Laos, Kazakhstan, Myanmar, Cambodia, Greece and Sri Lanka. The Almaty Ring Road, which skirts Kazakhstan's largest city, is a PPP and the first of its kind in the whole of Central Asia that is fully Chinese supported. Another ongoing major infrastructure project is the Eurasia tunnel connecting Europe and Asia under the Bosphorus that links the road networks of these two continents.

15. China has already signed 12 **free-trade agreements** and plans to negotiate with 65 more countries along the Silk Route. Those already in place include Singapore, Pakistan, Chile, Peru, Costa Rica, Iceland, Switzerland, Hong Kong and Taiwan and a further eight are under negotiation with Japan, Korea, Australia, Sri Lanka, Norway, the Regional Comprehensive Economic Partnership (RCEP), the Association of Southeast Asian Nations (ASEAN) and the Gulf Cooperation Council (GCC).[15]

OBSERVATION

16. It is not just "aid but trade". The above overview of China's recent aid, investments and trade agreements in Asia show the importance of differentiating between aid and loans, on the one hand, and trade investments, on the other. China aims to benefit economically and politically from its existing projects and given its controlling interest, AIIB is "conceived to be China's instrument", allowing it to generate and direct investments to strengthen such interests.[16] In-depth analyses of the countries, sectors and projects in the pipeline or those already being implemented – as well as the underlying selection-processes- would allow a better understanding of the aid-trade links and AIIB's role.

AIIB OPINIONS, EFFECTS AND CONCERNS

17. Through quotes and respective discourse, this set of paragraphs aim to exemplify the emerging Asian/AIIB perspective on the international aid financing vis-à-vis trade:[17]

- *"Aid and trade are no longer viewed as discrete domains in the West, but as part of a single fabric of bilateral cooperation, where mutual benefit is increasingly accepted as a core principle of development partnerships"; (from Chinese scholars during Asia Foundation's forum);*

- *"Western aid has traditionally come with conditions, while Chinese aid comes with no strings attached. China focuses on productive sectors, while the West tends to prioritize governance; and the Chinese paradigm is based on mutual benefit rather than philanthropy"; (Gu Jing of the Centre for Rising Powers at the Institute of Development Studies, University of Sussex);*

- *"It seems that development finance has now taken on a more "recipient-centered direction". Development finance today is a collage of different sources, just one of which is "aid" in a narrow sense. A new concept of "total official support for sustainable development" (TOSSD), which includes other sources such as remittances, concessional*

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[15] Cheung, Francis, Head of China-HK strategy, Lee, Alexious, Head of China Industrial Research for CLSA, an independent brokerage and investment group. 2015*. "A Brilliant Plan One Belt One Road".*

[16] From the Consultant's view, this notion of AIIB becoming an instrument of China remains contentious given that no evidence has proven this nor have any investigations been conducted to support this. It is vital though, to identify these project sites, as these will be where advocacy actions will be most needed.

[17] Mulakala, Anthea. June 17, 2015. *China's Development Policy and the West: Convergence or Parallel Play?* (Comments were based on the results of a meeting by Asia Foundation in Bangkok, June 9-10, 20125 for its *Asian Approaches to Development Cooperation* dialogue series; "*China's Overseas Development Policy in a World Beyond Aid")*

loans, and private finance may complement and even replace the current narrow parameters of "official development assistance." (Thomas Beloe, United Nations Development Programme).

18. On geopolitics of democracy, discourse includes:

- "*In public, the concern cited by the US has been the lack of clarity about AIIB's governance. Critics warn that the China-led bank may fail to live up to the environmental, labor and procurement standards that are essential to the mission of development lenders. The unstated tension though, stems from a deeper issue where China will "use" the new bank to expand its influence at the expense of America and Japan, Asia's established powers".*

- *"China's decision to fund a new multilateral bank rather than give more to existing ones reflects its exasperation with the slow pace of global economic governance reform".*[18]

19. On other MDBs, the following developments have been noted:

- *"The AIIB has already played a pivotal role in "strengthening the global economy" by getting Congress to approve more resources for the International Monetary Fund (IMF)". U.S. lawmakers approved changes to IMF governance that gives bigger voice to emerging-market nations including China and India, which are behind U.S., Japan, Germany, France and the U.K. Under the plan, which has awaited ratification since 2010, China would jump to third, while India would climb to eighth from 11th and Brazil would move up four spots to 10th.*[19]

- *President Takehiko Nakao of the ADB announced a major restructuring of the bank's financial model in early 2015.*[20] *The Asian Development Fund (ADF)—the IDA-like window of the bank which lends on concessional terms to the region's poorer countries—would be merged with the ordinary capital and non-concessional lending activities of the bank (OCR).*[21]

- *What are the broader implications of the proposal, not only for the ADB, but also for all of the MDBs that employ a similar model? The proposed changes at the ADB are a healthy step toward greater flexibility—in particular giving the ADB the opportunity to (1) revisit the balance between country-based activities and regional and global pursuits, (2) redefine lending terms and eligibilities, and (3) better engage the bank's borrowers, whose economic success is not yet fully reflected in the bank's management and governance, in mobilizing and managing the bank's resources.*[22]

20. On financial markets and how commodities are going to be traded:

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[18] S.R., The Economist. November 11, 2014. *Why China is creating a new "World Bank" for Asia*, Shanghai.

[19] Bloomberg News. January 17, 2016. *"China-Led AIIB Will Have Compliance Unit to Oversee Management".*

[20] By beefing up the capital base of the bank, the merger would increase ADB's lending capacity for middle-income borrowers like the Philippines and Indonesia, while making more resources (now relying on the capital base, not direct unleveraged contributions of donors) available to low-income ADF countries like Vietnam and Bangladesh. Donor contributions during periodic replenishments would still be needed to provide grants to some low-income countries, but they would be up to 50% smaller. Approval requires ratification by all ADF donors and most of the ADB's 67 members.

[21] Civil Society raised its concern on this move to merge these 2 funds. Increased support to private sector in ADF countries could prove detrimental to most of these countries since they are faced with weak institutional frameworks, higher susceptibility to financial vulnerabilities and political instability. (NGO Forum on ADB. BankWatch. 2014).

[22] Birdsall, Nancy, Morris, Scott and Rueda-Sabater, Enrique. January 21, 2015.*"A Big, Bold Restructuring at the Asian Development Bank".*

– “*AIIB is said to fit well in another far-reaching, ambitious project of China, the “New Silk Road” initiative. For years, Beijing has been building pipelines across Central Asia and Myanmar, train lines from Chongqing to Duisburg in Germany, and road links into Pakistan and a new port near Karachi. For countries along the Silk Road, especially those with underdeveloped infrastructure, low investment rates, and low per-capita incomes, they could experience a boost in trade flows, strengthen bilateral cooperation and improve existing regional cooperation mechanisms. Goods and services can be traded and as such indeed boost the economy”.*[23]

OBSERVATION

21. Based on these citations, the following can be observed; that AIIB’s establishment:

a) Is being critically watched by ADB and other MFIs, having a business model that is infused by debates on financing for aid and trade

b) Has triggered economic governance reform and economic support that is now favoring Asia

c) Offers Asian countries new trade and economic opportunities, but at the same time

d)

e) Raises concerns from developmental lenders with regards to essential environmental, labor and procurement standards.

A. THE ONE BELT ONE ROAD (OBOR) PROJECT VIS-À-VIS AIIB

SO WHAT IS THIS NEW SILK ROUTE? SOME BASIC FACTS

22. China’s “One Belt, One Road” (OBOR) initiative, launched on September 2013 is aimed at connecting major Eurasian economies through infrastructure, trade and investment. The initiative was later specified to contain two international trade connections; the land-based "Silk Road Economic Belt and the ocean-going “Maritime Silk Road.

– ”**The “Belt”** is a network of overland road and rail routes, oil and natural gas pipelines, and other infrastructure projects that will stretch from Xi’an in central China through Central Asia and ultimately reach as far as Moscow, Rotterdam, and Venice. Rather than one route, belt corridors are set to run along the major Eurasian Land Bridges, through China-Mongolia-Russia, China-Central and West Asia, China-Indochina Peninsula, China-Pakistan, and Bangladesh-China-India-Myanmar. The **One “Road”** component is a “21st Century Maritime Silk Road” stretching from Fujian on China’s coast, through the Malacca Straits, around the horn of Africa and up through the Red Sea into the Mediterranean, ending in Venice.[24]

[23] Hoffman, Bert. The World Bank. 2015, “China’s One Belt One Road Initiative: What we know thus far”.

[24] Ibid, Hoffman, Bert. The World Bank. 2015.

In its full scale, OBOR would include 65 countries, 4.4 billion people or 70 percent of global population, about 55 percent of global GDP and *75 percent of known energy reserves*. Implementation will span as much as 35 years, and is said to reach its completion in time for the 100th anniversary of the People's Republic of China in 2049.

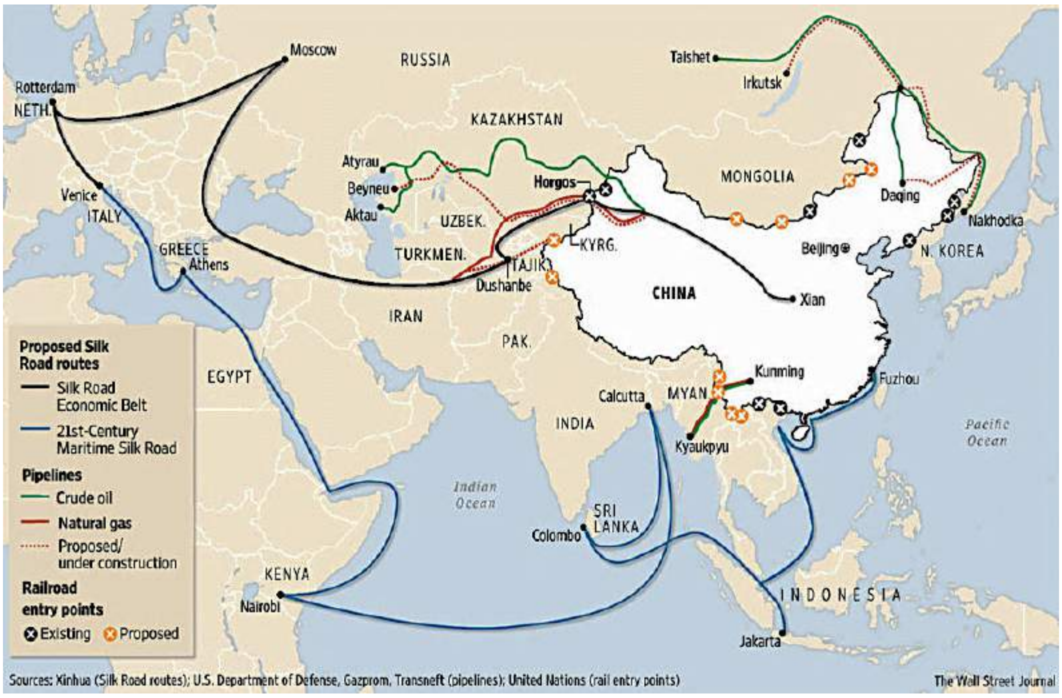

Figure 1. Proposed Routes for China's One Belt, One Road Initiative
Image Source: Wall Street Journal[25]

It has committed a total amount of about $100 billion to 3 new infrastructure funds to initiate the OBOR project.Through China's National Development and Reform Commission (NDRC), an action plan[26] was released in early 2015 that stipulated the building of a network of roads, railways and gas pipelines.

According to the Action Plan, OBOR's vision goes well beyond infrastructure, *"envisioning closer coordination of economic development policies, harmonization of technical standards for infrastructure, removal of investment and trade barriers, establishment of free trade areas, financial cooperation and "people to people bonds" involving cultural and academic exchanges, personnel exchanges and cooperation, media cooperation, youth and women exchanges, and volunteer services."*

[25] Based on the article published by FrontierStrategyGroup *Written by Danyi Yang & Mark McNamee.*
[26] "Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road" (2015/03/28), issued by the National Development and Reform Commission, Ministry of Foreign Affairs, and Ministry of Commerce of the People's Republic of China, with State Council authorization.

POLITICAL AND ECONOMIC UNDERPINNINGS

23. An interesting element of OBOR is that it is said to be well integrated into China's provincial government objectives; where all 31 Chinese provinces have indicated that they will actively participate. Two-thirds of these provinces have included it as a development priority and have featured it in their annual work plans for 2015. These provincial governments have committed to raising the "support level of credit" to help participating enterprises, offer training to local enterprises to apply for national funds, and provide further subsidy. It is said that a three-year action plan will soon be issued that would include trade and bilateral investment targets.

24. OBOR is being viewed as China's Marshall Plan[27] with a long-term goal of gaining geopolitical pre-eminence and creating a new geostrategic landscape in the Eurasian continent. In this context, the OBOR is also deemed as an economic countermeasure to USA's rebalancing in the Asia Pacific.[28] At the same time it is pointed out that "with the expansion of the Eurasian transport infrastructure", the Chinese Government is laying the foundations for a "new China-centered production networks" with Chinese companies moving production to

    Southeast Asia and opening up new trade routes, markets and "*sources of energy"* that China needs to sustain its growth.

25. But domestically, OBOR is seen as a quick solution to the problem of overcapacity (not to mention oversupply and overproduction) in China. The long years of artificially supported and credit-fueled growth have entrenched local government interests, revenue channels, jobs, and industries. Cutting down overcapacity would involve slashing jobs, shutting down plants, and closing factories. Reports indicate that this situation have impacted jobs. Reports *"showed earlier this year that worker strikes and labor unrest have increased significantly in 2014 compared to the previous year and this is linked to the economic slowdown. Given the vast amount of people employed in export-related industries, as well as in hard industrial and infrastructural production (the construction sector alone accounts for over 30 million jobs), boosting export figures and/or buying crucial time for these jobs and livelihoods to be transferred is a critical concern of Chinese leaders". (China Labor Bulletin).*

[27] The "Marshall Plan" or European Recovery Program aimed to help in the recovery of European economy after the end of the WWII and was a short-term program (1947-1951). Similarly, the Chinese OBOR proposal attempts to attain a win-win situation for China and participating countries.
See more at: http://www.chinausfocus.com/finance-economy/china-advances-its-one-belt-one-road-strategy/#sthash.ufZjOEGm.dpuf.

[28] There are existing Agreements where China is not included such as the Trans-Pacific Partnership countries, the Transatlantic Trade and Investment Partnership and the EU-Japan agreement that show comprehensive liberalization agenda and have the potential to increase trading costs.

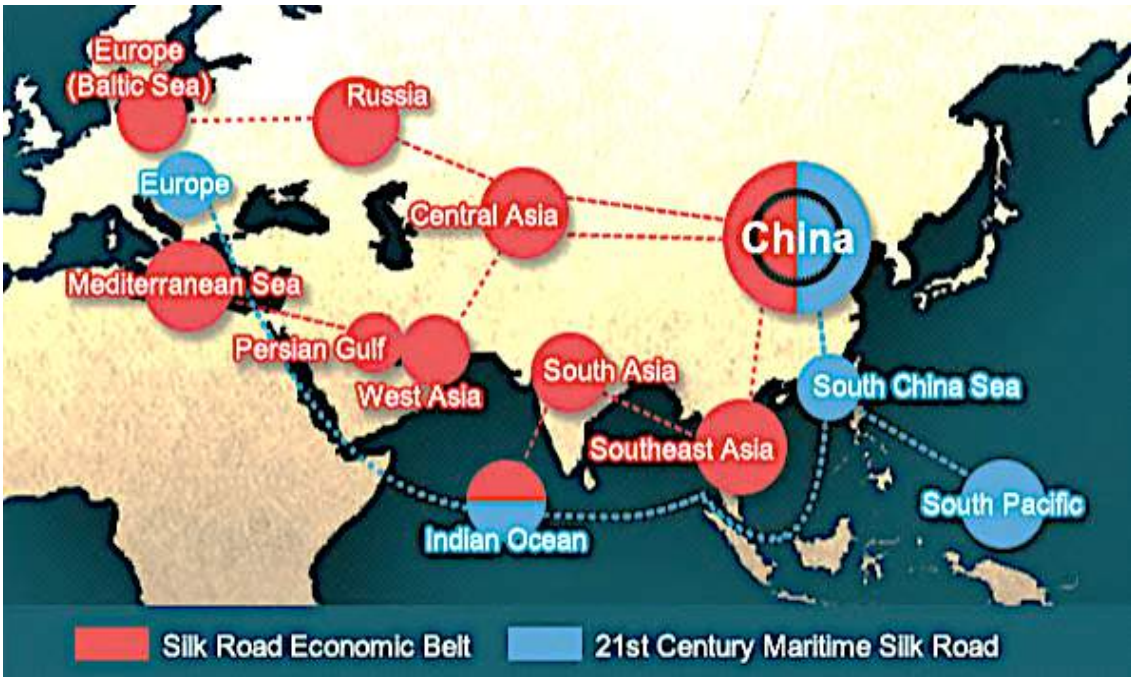

Figure 2. Circle of influence - China is working with 60 nations to construct a modern-day Silk Road – by land and *sea.*
Map Courtesy of China Dialogue

OBSERVATION

26. OBOR's Vision and Action Plan mainly describes the initiative, which is a grand master plan to attract investors and countries to buy in. There is currently a lack of either information or provisions at the bilateral and implementation level. It fails to describe how "multilateral" processes will take place such as the establishment of formal treaty or partnership between countries. *The question is whether OBOR would take steps to have formal agreements and keep to its prescribed conditions— that include trade, investment and business climate issues — to maximize its benefits. For now, countries along the Belt and Road have highly diverse development conditions and some have challenging governance environment that makes investments in infrastructure a long and challenging one.* [29]

OBOR'S FINANCING THROUGH THE "NEW FINANCING INSTITUTIONS"

27. New China-led financial institutions and mechanisms have been established to provide much of OBOR's financing – these include the New Development Bank (US $50-100 b), the Contingent Reserve Facility (US $ 100b), the Asian Infrastructure and Investment Bank (US $ 100 b), and the New Silk Road Fund (US $ 40 b). These "new institutions" have not been setup to be part of the existing IFI framework; with China and other emerging countries mainly funding and expanding them as needs develop.[30] Their modalities are now being worked out and are now starting their operations, these institutions and mechanisms include:

- The NDB which is not directly linked to the OBOR policy but the bank's primary focus of lending will be on infrastructure projects with an authorized lending of up to $34 billion annually.

[29] Hoffman, Bert, World Bank. "China's One Belt One Road Initiative: What we know thus far".
[30] Chhibber, Ajay. September 2015. Working Paper 2015-155. "China's One Belt One Road Strategy: The New Financial Institutions and India's Options". National Institute of Public Finance and Policy, New Delhi.

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- In addition to the NDB, the BRICS countries agreed to set up a US $ 100 billion Contingent Reserve Agreement (CRA) to provide short-term liquidity support that provides protection against global liquidity pressures. This includes situations where members' national currencies are being adversely affected by global financial pressures. The CRA is not linked to an IMF program and attempts to break that link.

- The US$40bn Silk Road Fund which became active in February 2015 will directly support the OBOR mission. The fund is backed by the China Investment Corporation (China's sovereign wealth fund), China Development Bank, the Export-Import Bank of China and the State Administration of Foreign Exchange.[31] The fund operates much as a private equity venture, but with a smaller group of investors committed for longer terms. It is comparable to institutions such as the World Bank's International Finance Corporation in mission and scale, but it is financed by a small number of investors rather than by public funds. The private equity venture-type structure of the fund should help avoid riskier politically-driven deals.

- The AIIB which is viewed as the Asian equivalent of the European Investment Bank (EIB) aiming to fund Asia-wide projects and is expected to generate adequate returns and work in line with "market-oriented principles". Given the "huge" financing that the project requires, *China will need a financing institution* to handle its contracted projects, loan settlements, currency exchange, and cross-border transactions. AIIB and its establishment is to help finance construction along OBOR with the bank's stated aims *"to combine China's core competencies in building infrastructure with deep financial resources to help development in other parts of Asia.*[32]

28. Aside from China's financial commitments to the project -with some multilateral and bilateral pledges coming in- are possibly as high as $300 billion in the coming years.[33] This is excluding the leveraging effect on private investors and lenders, as well as the impact of competing countries and MDBs. Japan has just announced a $110 billion infrastructure fund for Asia, and ADB is hurriedly revising its disbursement rules to increase its lending capacity.[34] Europe itself is also setting up a €315 billion infrastructure investment plan that is contingent on market financing.

STRATEGY OF OBOR

29. OBOR's implementation strategy is to employ a "comprehensive, systematic and multi-tiered combination of intelligence leveraging and financing" to support the initiative. This involves by stages: country specific planning cooperation: China-Pakistan Economic Corridor, China-ASEAN cooperation, Greater Mekong Regional Cooperation, New Eurasian Continental Bridge. This will be followed by project specific planning: Asian Infrastructure, Overseas Industrial Cooperation Park/Zones, RMB regionalization and internalization, Border Construction and Port free trade zones.

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[31] The Economist Intelligence Unit. Prospects and Challenges on China's One Belt, One Road: A risk assessment report, 2015.

[32] AOA, Note that as of this writing, no projects and transactions have taken place; AIIB's connection to OBOR can be based only on speculation and documents such as the AOA.

[33] According to the source of this reference material, this figure does not include the $890 billion of public investment recently announced by China Development Bank, one of China's policy banks. See: He Yini, "China to invest $900b in Belt and Road Initiative", *China Daily*, 28 May 2015. Available at: http://usa.chinadaily.com.cn/business/2015-05/28/content_20845687.htm.

[34] Francois, Godement, June 2015. European Council on Foreign Relations China Analysis. One Bet, One Road: China's Great Leap Outward.

30. The Main ways for financial support and services in order to enhance the convenience of cross-border industrial, trade and investment cooperation include:[35]

- Bank credit support

- International bond market and full use of direct financing channels to serve the construction of the Silk Road Economic Belt

- Involvement of institutional investors and non-governmental capital

- Strengthened monetary cooperation

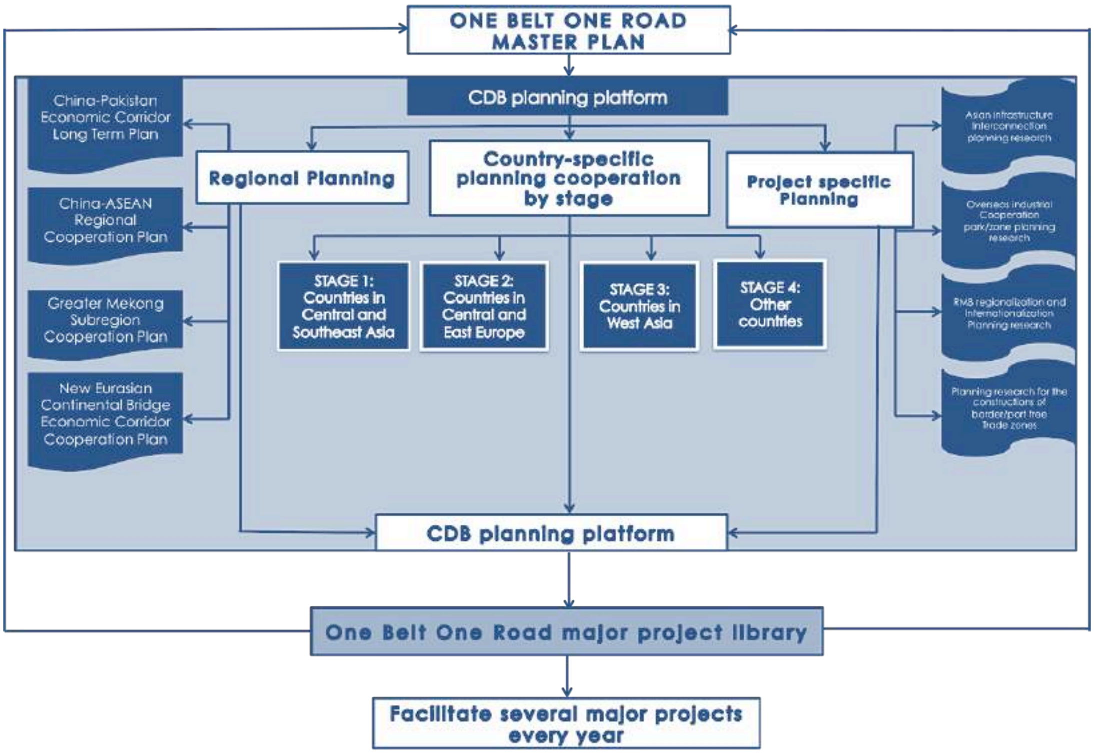

Table 1. One Belt and One Road planning system and overall structure
Source: China Development Bank, 2015

- Tighter cooperation between financial institutions and enterprises

- Strengthened cooperation in financial infrastructure

31. Many of the projects will be build-transfer-operate (BTO) schemes in which China's large State Owned Enterprises (SOEs) will lead the way and smaller companies are to follow. The domestic plan divides China into five regions with infrastructure plans to connect with neighboring countries and increase connectivity. Each zone will be led by a core province: Xinjiang in the Northwest, Inner Mongolia in the Northeast, Guangxi in the Southwest and Fujian on the coast.[36]

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[35] Dr. Jiang Zhigang, Head of China Development Bank. 2015. Promote One Belt and One Road Initiative with Pragmatic Measures. A power point presentation.
[36] Ibid, *Promote One Belt and One Road Initiative with Pragmatic Measures.*

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OBOR'S POTENTIALS FOR TRADE LINKS AND ECONOMIC OPPORTUNITIES

33. OBOR could have a lasting impact if it contributes to enhanced trade links. It is said that the areas it covers include about 50 percent of the world's GDP and roughly the same share of global trade. Reduced transport costs could increase trade flows and bring in the benefits of greater competition and efficiency through harmonized trading systems. Reduced tariffs and simplified customs administration would allow trade to flow seamlessly between countries including China.

34. With better infrastructure, lead times could be shortened and customs clearance procedures are streamlined. This will enable goods to transit from origin to destination by road in sealed load compartments. The shipments would be able to pass smoothly through customs of different countries since duties and taxes liable are covered by international guarantee. Using major EU countries under the Transports Internationaux Routiers (TIR) system as a basis for comparison, it is likely to boost trade; customs clearance may go paperless and procedures may be done in a single day.[38]

OBSERVATION

35. The action plan takes in every conceivable goal; from improving distributed supply chains to developing trade in services, to possibilities of increasing food security for the countries that participate in the project. In short, it is a statement of ambitions which could likely favor pet projects and bureaucratic leaders along the route.

PERCEIVED CHALLENGES: GOVERNANCE AND ACCOUNTABILITY

36. The OBOR vision and plan makes it clear that "infrastructure development" projects and investments are seldom *politically neutral, and not necessarily economically beneficial.* As far as direct economic gains go, the long-term benefits might not merit the shorter term political, economic and environmental factors and vulnerabilities.

37. This is especially the case for fragile and conflict-affected countries where many of them have weak or absent systems of governance. Too single-minded economic and investment-driven decision-making is less concerned with the "externalities" related to the use of natural resources, inclusive growth, and impacts to societies and communities. "*Channeling additional resources without attention to complex and ever-shifting political dynamics could add further risks and serve to reinforce powerful interests. Supporting development progress in such complex and high-risk environments*

[37] Ibid, *Promote One Belt and One Road Initiative with Pragmatic Measures.*
[38] Mathai, John, BLOOMBERG INTELLIGENCE ANALYST, *"Improved Infrastructure to Streamline Shipping for Exporters".* June 29, 2015. (This article is part of the Bloomberg Brief, July 2, 2015). In January of this year, China started the Transports Internationaux Routiers (TIR), also known as the International Road Transport, accession process.

requires that any bank or private support adopts a politically informed approach to engagement".[39]

38. the same time, there are fears that this grand initiative might resemble such existing bilateral investment deals that are now being practiced by China: where state banks provide funding for the infrastructure development of the recipient country, while its state-owned corporations implement and build the projects. *This is the case for the Philippines' North Rail project, where China agreed to provide a concessional loan worth US$503 million to be financed by the Export-Import Bank of China. Meanwhile, the China National Machinery and Equipment Corporation and the China National Technical Import and Export Corporation were automatically designated as the project's contractors. Such an arrangement reinforces criticisms against Chinese loans and investments as basically self-serving since a significant portion of these funds eventually go back to China through its own corporations.*[40]

WITH LARGE INFRASTRUCTURE PROJECTS THAT ARE GOING TO BE BUILT, OBOR POSES SOCIAL AND ENVIRONMENTAL THREATS

39. Through OBOR's document itself, one can perceive the potential risks as far as social and environment aspects are concerned. There are several identified "loopholes" that include:

a) the **lack of any clear structured policy guidance on ways to advance** "green development", ensure environmental sustainability, and establish environmental safeguards to prevent negative impacts as a result of new infrastructure and industrial facilities;

b) there is a **lack of any operational environmental standards** to guide the implementation of projects;

c) there is **no single institution or policy-making** committee to oversee the monitoring of environmental policies which can be legally held accountable;

d) there are **no specified strategic environmental assessment and environmental impact assessment tools in a trans-boundary context** that have been adopted; and

e) many of the bilateral agreements **lack public participation and grievance procedure** where results of environmental and social assessments for funded projects are not published. All these create real problems for project oversight both from state entities and civil society.[41]

40. If OBOR continues to have large-scale outpouring of capital, enterprises, and building of large infrastructure projects as it promises, then consequences are clear and eminent. According to OXFAM data, large-scale infrastructure is one of the main causes

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[39] Stephen, Monica. International Alert. October 2014. Fragile Reforms: World Bank and Asian Development Bank Financing in fragile and conflict-affected situations.

[40] Wong A. Andrea Chloe. May 17, 2015. This type of financing has been practiced in the past; also called "tied aid" where aid is offered to a recipient country on the condition that it procures goods or services from the provider of the aid. But since January 2002, ODA to least developed countries has been "untied" in order for them to freely buy goods and services from all countries. Australia, Finland, France, Germany, Ireland, Japan, the Netherlands, Norway, Portugal, Sweden, Switzerland and the United Kingdom have now untied ODA that remove the legal and regulatory barriers to open competition for aid funded procurement.

[41] Simonov, Eugene. March 5, 2016. Dr. Simonov summarized the most important environmental precautions that should be taken in conjunction with the Chinese New Silk Road Initiative. The short report was entitled "Some Environmental Issues on the Silk Road".

of forced displacement globally. Dams have caused between 40-80 million people world-wide to lose their homes who depend on their land or on access to natural resources for their living. Displacement literally means losing their ability to support their families, grow crops, fish and continue their cultural and social practices. Environmental impacts on livelihoods are potentially the most devastating especially among vulnerable communities across borders.[42]

41. It is interesting as well to focus on China's need for vast amount of energy in order to finance its further growth. Through OBOR, a wide variety of energy projects will be implemented and in particular coal-fired plants will be a vital area. Chinese contractors in the last two decades have delivered large numbers of projects across China and Asia and in parts to Africa.

42. In conventional power projects involving Chinese contractors, project finance structure that has been adopted was the BOT (build-operate-transfer), where developers set up and arrange loans to a special purpose vehicle (SPV) in the host country. Some 70-80% of the capital costs of construction will come from these loans, and the remainder will be provided by the developers through equity and/or other loans. More recently, larger and more experienced Chinese contractors have begun the transition from a traditional contractor business model to a "contractor plus investment" model. And seeing a significant proportion of OBOR projects will involve Chinese contractors, they will make investments in the projects that they are engaged in and coal projects will be the first to use this structure.[43]
43. In the light of the above, CSOs have immediately raised their concerns demanding that AIIB's ESF include an exclusion policy that limits financing of power plants to only those that meet an emissions performance standard (EPS) of less than 500gCO2/kwh. This is in light of commitments such as the recent US-China pledge to ensure that new international finance institutions "uphold high environmental and governance standards" and consistent with the best practices reflected in the coal restrictions of other multilateral development banks and country governments.[44]

OBSERVATION

44. The OBOR vision is grand and inspiring indeed; if this initiative could help countries improve their investment climate, raise their technical standards, and improve customs and logistics procedures. But its actual rollout is going to depend on factors related to country conditions and investment interest. Consequently, the absence of clear cut plans, mechanisms for implementation and formal agreement procedures could lead to more issues and problems that may not necessarily favor beneficiary countries, in particular those fragile and conflict countries.

45. Risks have been identified and measures will have to be implemented to significantly improve the situation through a kind of a unified environmental and social requirements and criteria for all project investments made in OBOR countries. With this, it is vital for domestic and international policies to reinforce each other in monitoring and ensuring that the OBOR project will lead to sustainable development.

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[42] www.oxfam.org
[43] FOCUS. January 8, 2016. *"China's 'one belt one road' policy increasing the ambitions of its energy contractors".*
[44] 350.org East Asia, Philippines Movement for Climate Justice, Alyansa Tigil Mina, Sanlakas, Bank Information Center, Bankwatch, Village Infrastructure Angels, SEE Change Net, Maryknoll Office for Global Concerns, Center for Environment, National Ecological Centre of Ukraine, Gender Action, Earthlife Africa, Crude Accountability, E3G. October 22, 2015. *"Recommendations on AIIB's Environmental and Social Framework".*

C. PPP AS A FINANCING APPROACH

46. AIIB explicitly states that it intends to "*operate as an investment bank in Asia for earning dividends on its shareholders, through financing Infrastructure projects in the region"*. In its AOA under Article 2 Functions, the AIIB identifies the role of private capital, and looks to fund projects which target 'harmonious economic growth"...it states another goal: 'to encourage private capital' in projects, and AIIB will commit to 'supplement private investments when private capital is not available on reasonable terms and conditions'. This opens the way for AIIB to use PPPs to attract private investments in large-scale infrastructure projects.

WHAT ARE PUBLIC-PRIVATE PARTNERSHIPS (PPPS)?

47. Public-Private Partnerships (PPP) are collaborations between the public and private sectors aimed at the implementation of projects or provision of services traditionally provided by the public sector. With the division of tasks, responsibilities and risks under PPP, the most cost-effective way to create the infrastructure and delivery of public service can be achieved. Under a PPP, each party theoretically draws its own benefit, proportionate to its interest.

48. PPPs are classified according to their various contractual forms but generally involve one of the following types: DBFO (Design, Build, Finance, Operate), DCMF (Design, Construct, Manage, and Finance), BOO (Build, Own and Operate), BOT (Build, Operate and Transfer), BOOT (Build, Own, Operate and Transfer), Design, Build, Finance and Maintain (DBFM), and Concession-type PPPs[45].

49. Starting in the 1980s and dramatically increasing into the 1990s, the industrialized and developing world saw the need to liberalize and privatize infrastructure activities. With the economic crisis during the first decade of 2000, the period saw the consolidation of PPP programs, stagnation of others and the expansion to new markets, notably in Asia. Several developing countries in need of investments started pioneering improved forms of PPP. Market leaders among emerging economies such as Chile, Brazil, China, Hungary and, India have gone further than industrial countries by introducing the private sector in infrastructure development and maintenance. Currently, initiatives aiming at outsourcing maintenance activities to private firms are now being implemented in Africa, Asia and Latin America.[46]

THE PPP AND THE AIIB'S ROLE

50. The scale of investment required in Asia is so great that multiple sources of funding continue to be required to address this need; both in the form of sovereign loans (and through project finance and PPP models. A 2009 report from ADB estimates that between $8 and $13 trillion of investment would be needed through the course of this decade to keep Asia on its economic development path. As a result over the last decade, restrictions on foreign investments have eased and an increased number of infrastructure PPP projects have been carried out.
51. Ideally in this process, the state provides half of the financing for a specific investment project and foreign investors provide the other half. In practice and in reality though, this so called equal relationship does not happen and very often the state takes all or most of the risks and assumes contingent liabilities. In fact, deals are often made

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[45] Dr. Hearne, Rory. November 2009. Origins, Development and Outcomes of Public Private Partnerships in Ireland: The Case of PPPs in Social Housing Regeneration.
[46] PPIAF. 2015. Toolkit in PPP in Roads and Highways.

between the state and the private sector that lead to the transfer of vast scarce resources to the private sector in the guise of guaranteed returns. PPPs have often put burdens on public budgets and service users.

52. Initially, AIIB is expected to provide sovereign loans to countries for their infrastructure projects. For those projects which are not guaranteed by sovereign credit, the AIIB will provide financing through PPPs. Doing so will allow the sharing of risks and returns with the private sector, while at the same time unlocking more capital from sovereign wealth funds, pension funds and the private sector. For PPP investments, it is understood that the AIIB is considering setting up specific funds to provide such financing and possibly a specific window to carry this out. [47]

MDBS STEPPING UP COOPERATION FOR INVESTMENT FINANCING

53. Global and regional financing institutions are focusing on ways in which they can assist governments to remove the barriers to bringing bankable projects to market. The traditional portfolio of products for infrastructure development includes; non-sovereign financing windows, guarantees and other co-financing; risk-mitigation instruments, and specialized project preparation. MDBs are now looking into attracting additional financing from private sectors by using the combination of strong financial credentials; preferred creditor status; prudent risk management policies, and the supply of technical expertise. Established MDBs have ensured the application of well understood standards in project design, execution, and corporate governance.[48]

54. For this, MDBs have come together to support the G20 Global Infrastructure Hub and the WBG-hosted Global Infrastructure Facility (GIF). This will provide greater collaboration in preparing and structuring complex infrastructure projects to attract long-term financing from private investors. *MDBs are also strengthening their infrastructure pipeline through Project Preparation Facilities (PPFs) and project financing collaboration. Such collaborations include the Islamic Development Bank Group (IDBG's) InfraFund, African Development Bank's (AfDB's) NEPAD Infrastructure PPF, European Investment Bank (EIB)-hosted initiatives such as the Arab Financing Facility Technical Assistance Fund (co-managed by Islamic Development Bank and IFC); European Bank for Reconstruction and Development (EBRD's) Infrastructure PPF; ADB's Asia Pacific AP3F, as well as AfDB's Africa50 Initiative.*[49]

55. Further in 2014, the G20's Finance Ministers endorsed the Global Infrastructure Initiative (GII) which aims to increase long-term private investment in infrastructure. One of GII's key action items is to increase the availability of investment-ready projects. This includes facilitating knowledge sharing between governments and multilaterals, preparing model documentation, and building the capacity of officials to improve institutional arrangements. In 2016, China chairs the G20 and is launching the Global Infrastructure Connectivity (GIC) which will diversify financing approaches to attract more private sector investment and identify relevant practices in relation to key institutional elements and capacity building needed for implementing infrastructure projects, including PPPs.

56. ADB has as well established the Asia Pacific Project Preparation Facility (AP3F) to finance project preparation work, including due diligence covering technical, financial,

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[47] Ashurst Singapore May 2015. Asian Infrastructure Investment Bank: added momentum for Asian infrastructure? http://gjs.mof.gov.cn/pindaoliebiao/gongzuodongtai/201406/t20140 630_1106322.html

[48] Jeff Chelsky, Claire Morel, and Mabruk Kabir. The World Bank. Poverty Reduction and Economic Management Network (PREM). June 2013. Investment Financing in the Wake of the Crisis: The Role of Multilateral Development Banks.

[49] July 2015. From Billions to Trillions: MDB Contributions to Financing for Development.

legal and regulatory issues, as well as safeguards. This facility is to be managed by the ADB's Office of Public-Private Partnership (OPPP) and initially to be funded by the Governments of Japan, Canada, Australia, as well as ADB, with additional donors expected to join in the future.[50]

57. ADB has also recently announced that it has signed a PPP co-advisory agreement with eight global commercial banks, pursuant to which ADB and the eight banks will work together to provide independent advice to governments in the region on how best to structure PPPs to make them attractive to the private sector.

OBSERVATIONS

58. AIIB has paved the way to an increased use of PPPs to attract private investments in large-scale infrastructure projects that could step up the development in Asia. But then, PPP requires an enabling regulatory and policy environment to ensure the rights of communities.■

[50] http://www.finchannel.com/index.php/business/item/43567-japan-canada-and-australia-provide-64-million-for-adb-s-ppp-preparation-facility

WHAT IS IT? WHAT ARE ITS FEATURES?

59. AIIB is described in several ways; ranging from a new China-led "*infrastructure bank*", or "a *multilateral commercial bank*", which aims to differentiate itself from other lenders with a leaner, more efficient structure that ultimately gives veto power to China as the largest contributor over major decisions. Looking on the Chinese perspective, it has also been suggested that the wider aims of AIIB are *to enhance the integration of China with neighboring countries, fast track the buildup of its capital account, and internationalize the Renminbi (RMB)*.[51]

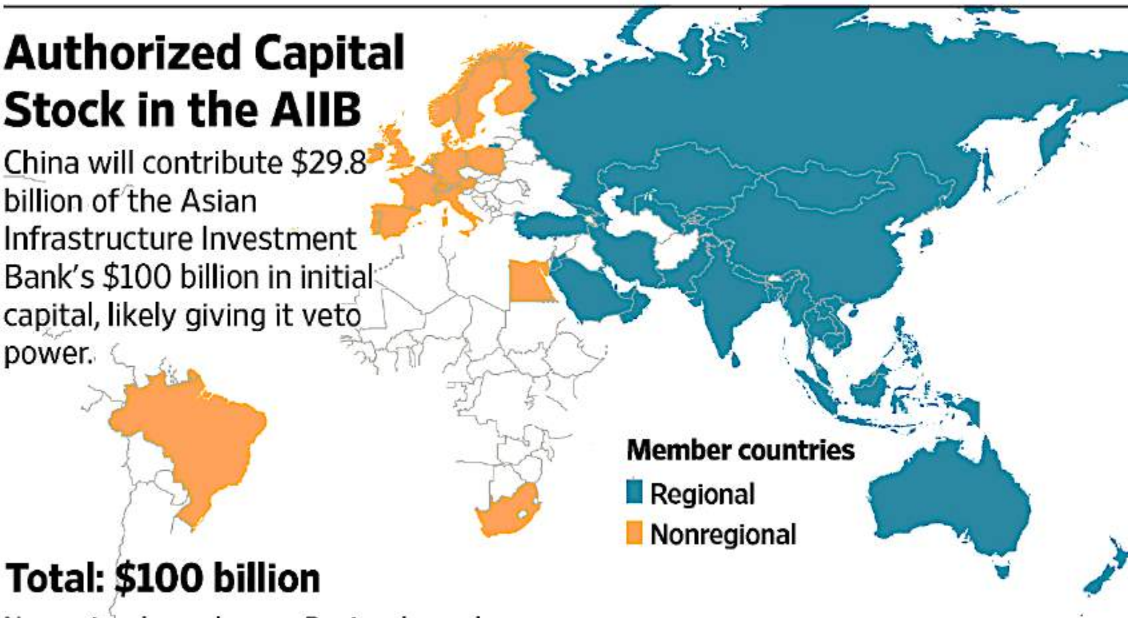
MANDATE AND OBJECTIVES

60. AIIB, as stipulated by its AOA introduces itself as *a new MDB with China playing a large but not dominant role. This differentiates it from both commercial banks and aid agencies, making it a "quasi-commercial bank" that has to generate returns. (Its origins have been traced in the earlier part of this report).* The central mandate of AIIB is *"to support investment in infrastructure and other manufacturing industries in Asia in order to promote economic development and regional co-operation across the region".* If conditions permit, AIIB "may also explore investments in non-regional projects".[52]

MEMBERS, CONTRIBUTIONS AND VOTING SHARES

61. By March 31, 2015 the deadline set for the submission of membership applications, there were a total of 57 PFMs; 34 from Asia and 23 from non-Asian countries. The Articles were signed by all 57 PFMs between June 29, 2015 and December 31, 2015. The AOA entered into force on December 25, 2015, where instruments of ratification had been deposited by 17 signatories with initial capital subscriptions totaling 50.1% of the shares allocated. Remaining signatories that have not yet deposited their instruments of ratification are expected to do so by December 31, 2016. AIIB officially kicked off with the first meeting of its Board of Governors and 30 of the bank's governors representing over 74 % of the AIIB's capital stock met.

[51] Ashurst Singapore, May 2015.
[52] AIIB's mandate does not currently appear to include poverty reduction, which differentiates it from other multilaterals such as the Asian Development Bank (ADB) and the International Finance Corporation (IFC).



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.

Table 2. Country Contributions
(Based on data published by the Wall Street Journal)

Analysis: *AIIB articles allow for non-sovereign membership, which is said to be an interesting departure from the traditional MDB model. But at the same time it does not permit nor allow non-sovereign members from countries that are not members of AIIB themselves. E.g. In this case, can any such entities as* a *China Investment Corporation become a member? This clause does not qualify or further define who these "non-sovereign members" are; and with a lack of monitoring mechanisms in a place, this could lead to all kinds of entities with their own interests to become members.*

62. As per Memorandum of Understanding (MOU), the authorized capital of the AIIB will be US$100bn and the initial subscribed capital is expected to be US$50bn. The paid-in ratio is expected to be 20 per cent, with capital paid by members in installments. Latest reports indicate that Asian countries will together hold 72- 75 per cent of the shares, with China and India as the largest and second largest shareholders with 25-30 per cent and 10-15 per cent respectively.

Analysis: *This leaves the remaining founding members (39 per cent of the founding members which are non-Asian countries) with less influence than they had hoped for.*

63. Voting shares are apportioned according to a complex formula that factors in each member's capital contribution, the size of its economy, and the basic votes each member equally receives plus another 600 votes allocated to each founding member.

Analysis: *At least 75% of share votes are reserved for members located in the Asia-Pacific region, giving smaller Asian countries a greater say than they have in other global organizations.*

64. Given its current contribution and according to the bank's articles, China is providing $29.78 billion of the bank's $100 billion capital base.

Analysis: *Under the voting formula, China controls 25% to 30% of the total votes, enough to block decisions involving structure, membership, capital increases and other significant issues laid out in the articles that require a "super majority" of at least 75% of votes.*

Figure 3. AIIBs Capital investments
Source: FAshurst LLP (a limited liability partnership registered in England)

GOVERNANCE STRUCTURE AND DECISION-MAKING

65. The current proposed form of the AIIB's governance structure is three-tiered, with a Board of Governors, a Board of Directors, and an Executive Management; with the following functions:

- *Board of Governors*: is the highest governing body, and is made up of representatives from all member countries of the AIIB. It is empowered to delegate decision-making power to the Board of Directors and Management. And has the power to elect a *non-resident Board of Directors, which* will determine budgets and projects.

Analysis: *With China being the largest shareholder, it has veto power on issues that require a supermajority vote, such as the board, the president, the capital, as well as the major operational and financial policies. The retention of a veto reflects China's determination to retain control on key aspects of the bank. It is said that among other institutions, the selection of the president is conducted through more "informal" arrangements.*

- *Board of Directors*: has one president and one or more vice-presidents. The presiding President is elected by the Board of Governors who is responsible for management decisions.[53] The Board of Directors comprises 9 representing regional members and 3 representing non-regional members. Directors will represent all members who voted for them and will serve for two years. They will be responsible for the general operations of the AIIB.

Analysis: *Based on the thresholds established in the AIIB articles, it appears that China, India, and Russia are among the regional members and Germany among the non-regional members who will be eligible for board seats. All other countries will be required to join multi-country constituencies. Specifically, 34 regional countries will have to organize themselves into 6 board seat constituencies, while 19 non-regional countries will have to organize themselves into 2 board seat constituencies. Perhaps more than any other governance standard, the rules and procedures around the 'non-resident board" clearly establishes AIIB as a regionally dominated institution.*

- It is also said that neither the Governors nor the Board of Directors will be paid, and are non-residents – that is, not located at the Bank's headquarters (in Beijing). They will periodically convene though, for annual meetings to decide on major policy matters. This is supposed to be part of China's aim to make the Bank more efficient than its counterparts. However, some member states have expressed a preference for a full-time resident board of directors.

Analysis: *The functions of the Board remain largely unspecified and when it comes to critical operational questions, China was careful to specify a "super majority decision-making threshold". As the largest shareholder, key decisions still remain in this area and China is not willing to throw those decisions open to a simple majority vote.*

- *President/Bank Management*: the executive management function will be responsible for the day-to-day operations of the AIIB and will comprise various departments such as lending and risk management. There will be a "division of power and responsibility between the board and management," through a Compliance Unit to Oversee Management.[54]The bank is expected to maintain a lean staff and set high standards for efficiency and transparency by cutting down on requirements and approval periods for projects.

FUNDING AND IMPLEMENTATION

66. The AIIB business model allows financing to its members that include governments, agencies or enterprises; or to international and regional agencies operating in member countries. There are also special circumstances in which the AIIB may "provide assistance to non-members".

67. Assistance will primarily be in the form of direct loans, investment in equity capital and technical assistance. The actual terms and conditions of financing, including

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[53] At the inaugural meeting of the AIIB's Board of Governors, China's finance minister Lou Jiwei was elected chairman of the board of governors and the following were chosen as vice chairmen; Indonesia's finance minister, Bambang Brodjonegoro, and Germany's state secretary in the finance ministry, Thomas Steffen. (Angkit Panda. The Diplomat. February 15, 2016. *"Top Leadership at Asian Infrastructure Investment Bank Continues to Shape Up"*).

[54] Mr. Hamid Sharif was appointed as the first Director General of the Compliance, Effectiveness and Integrity (CEI) Unit according to AIIB's news from its website, April 14, 2016. The position reports to the Bank's Board of Directors. The CEI Unit's mandate includes monitoring and evaluating the Bank's portfolio, ensuring policy compliance, and overseeing internal and external grievance procedures.

interest rates and length of repayment, can be determined on a case to case basis depending on AIIB's credit rating. Financing can be provided in the currency of the country receiving the loan, if necessary. (For countries that struggle with the currency fluctuations associated with repaying China's Eximbank loans, this is considered favorable). At the same time, AIIB plans to raise capital in currencies including U.S. dollars, euros and the yuan, while making loans in US dollars.

68. There will be an open procurement policy, meaning goods and services (and companies) from non-member states can be engaged in AIIB-funded projects. The Agreement states that "the Bank, its President, officers and staff shall not interfere in the political affairs of any member, nor shall they be influenced in their decisions by the political character of the member concerned" and further states, "that only economic considerations shall be relevant to their decisions".

69. AIIB is creating a pipeline of projects and will work with institutions such as the Washington-based World Bank and Asian Development Bank on co-financing projects but "*will also engage on stand-alone projects."*

OBSERVATIONS

70. Although AIIB Articles state that operational financing must be drawn from returns on investments, loan repayments, and the leveraging of private finances, there is no "firm" plan in place for AIIB's fundraising model. China may have to lend money to some members for them to meet their initial paid-in capital requirements. Intra-bank lending, private-public partnerships (PPPs), and Asia's large private savings have all been discussed as future fundraising options. The credit rating and a loan guarantor system are important determinants to indicate AIIB's near-term capability.

PROGRAM PORTFOLIO AND FINANCING WINDOWS

71. AIIB will invest in recipient countries as per its AOA through the following modalities:

a) Co-financing or direct loans through other IFIs: ADB, WB, EIB, etc.

b) Investment funds in equity capital of an institution or enterprise or Financial Intermediary Projects

c) Guarantee provisions as primary or secondary obligor, in whole or partial loans for economic development. In acting as leverage for trans-boundary infrastructure projects with increased risk

d) Deploying Special Funds in specific agreements

e) Providing Technical Assistance. Open portfolio for consultancy firms and other agencies

f) Through other types of financing modalities invoking the Article on Special Majority Votes

D. ARTICLES OF AGREEMENT (AOA) INSIGHTS AND CRITIQUES

72. This chapter aims to systemize the critique on AOA. The main contentious issues of the AOA can be summarized in the areas of membership, capital contribution, veto power, its governance and standard issues, and the link between AIIB and China's own economic agenda.

WHAT DO THEY SAY? FROM THE INTERNATIONAL COMMUNITY AND INSTITUTIONS

73. *Big in vision but lacking in specifics and implementing guidelines:* The AOA does not offer specific mechanisms to safeguard against bid-rigging, environmental degradation and other potential fallout from huge infrastructure projects even as the bank articles pledge to heed environmental risks and promote transparency. On the other hand, Chinese leaders reiterate and likewise pledge to address all these concerns.[55]

74. *Question on credibility of operations and adoption of good governance:* There is doubt as to how "good governance" will be employed. This means that high standards and vigorous oversight and management are pre-conditions for a good credit rating and in turn determines the viability of AIIB's fundraising requirements. (Currently, ADB has an AAA rating)[56]. Any missteps specially with regards to governance, transparency and accountability; concerns already raised by the international community could result to significant withdrawal of support and undermine AIIB's credibility and legitimacy.[57]

75. *Question on compliance and adherence to high quality standards:* There is a perception that investment decisions that will be made by AIIB may not have the same level of scrutiny with regards to potential environmental and social impacts that one sees at existing international financial institutions or other jurisdictions. So far, a draft Environmental and Social Framework (ESF) and procurement policy documents have been published. The AOA also requires the establishment of monitoring and evaluation mechanisms, which would provide ongoing oversight for investment decisions and development outcomes. Whether there will be strict adherence and compliance with such mechanisms remains an open question.

FROM CIVIL SOCIETY ORGANIZATIONS (CSOS)

76. *Question on poverty alleviation and inclusive growth agenda:* The institution's overall mission statement clearly indicates that AIIB does NOT have a development agenda but rather is purely driven by economic concerns and motivations. There is no indication of inclusivity related to gender or marginalized communities nor the recognition of climate change in the entire AOA.

77. *Question on how AIIB is to operate*: The issue of accountability and transparency is for now vested in a non-resident Board of Directors (BoD) who in this case, cannot be held accountable on a direct and regular basis; thus it is envisioned as a very opaque Bank.

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[55] In a speech on the Establishment Progress of Asian Infrastructure Investment Bank by Mr Jin Liqun, Head of the Working Group for Establishment of AIIB in Boao Forum for Asia, he states, *"With zero-tolerance of corruption, we have every confidence to establish a high-standard bank, and tackle security and environmental issues. We will dutifully follow every standard set for a project or a product. We will observe the international standards while assessing the effects of a project on the local environment, culture, sustainable development and standards of living."*

[56] The credit rating is a financial indicator to potential investors of debt securities such as bonds. These are assigned by credit rating agencies such as Moody's, Standard and Poor's and Fitch Ratings to have letter designations (such as AAA, B, CC), which represent the quality of a bond.

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The BoD structure, which is to lead the compliance oversight mechanism and ensure AIIB's operations on accountability and transparency, is also very weak as it fails to indicate the scope, traction or reach of the policies, which will address social and environmental impacts of AIIB operations.

78. *Question on accountability and disclosure of information:* The AOA clearly states that the Bank "shall establish a policy on the disclosure of information in order to promote transparency in its operations". This will be a key area of CSO advocacy in addressing issues of accountability and transparency of all AIIB's operations, including those related to the private sector.

79. *Question on provisions regarding safeguards standards, applicability, and requirements:* CSOs should be on guard; watching for the nature and types of the projects in the pipeline, the move "to encourage private capital' investment and the commitment to 'supplement private investments when private capital is not available on reasonable terms and conditions'. Again, all these may undermine the communities' welfare and a disregard for environmental concerns. ■

80. At this point in time when actual AIIB operations and projects are not in full implementation yet, one can only systematically approach and analyze the potential risks and impacts of its workings through a set of internationally accepted guidelines. A few that are published and are now being adopted include:

- The G20/OECD *Principles of Corporate Governance*[58] is an international benchmark adopted as one of the Financial Stability Board's Key Standards for Sound Financial Systems and form the basis for the World Bank Reports on the Observance of Standards and Codes (ROSC). The "corporate governance" framework promotes transparent and fair markets, and the efficient allocation of resources. It is consistent with the rule of law and support effective supervision and enforcement and involves a set of relationships between a company's management, its board, its shareholders and other stakeholders.[59]

- The *Operational Risk Methodology*[60] assesses a country's overall business operating risk based on an operational risk model that provides a standard framework for analysis. There are 24 additional indices, in which indicators are weighted to reflect the concerns of a range of investors covering seven industrial sectors and thus provide more targeted risk assessments. The operational risk model considers ten separate risk criteria.

- ADB's Corporate Policies on Accountability Mechanism[61], Environmental Assessment Guidelines and Country Safeguard System/Safeguard Categories.[62]

- On infrastructure, there is the *Standard for Sustainable and Resilient Infrastructure by SuRe, December 9, 2015*.[63] It is a global voluntary standard which integrates sustainability and resilience aspects into infrastructure development and upgrade. SuRe® consists of 76 criteria divided into 14 themes spanning environmental, social and governance aspects. SuRe® applies to infrastructure projects, including assets and services, with a focus on infrastructure that meets public needs (i.e. beyond the needs of a corporation, individual or exclusive private group).

81. If and when AIIB starts to identify and implement project pipelines, the following factors will have to be considered even at the onset, (these will be useful for CSOs' country risk analysis for advocacy work):

- **Regulatory framework**; are there (i) transparent and fair bidding processes; (ii) security of their investment and enforceability of the contractual arrangements; and

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58 OECD (2015), G20/OECD Principles of Corporate Governance, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264236882-en See Annex 10.

59 These standards are intended to help policymakers evaluate and improve the legal, regulatory, and institutional framework for corporate governance, with a view to support economic efficiency, sustainable growth and financial stability. This is primarily achieved by providing shareholders, board members and executives as well as financial intermediaries and service providers with the right incentives to perform their roles within a framework of checks and balances.

60 (The Economist Intelligence Unit (EIU's) Risk Briefing service), 2015. See Annex 11.

61 See Annex 8: ADB Accountability Mechanism.

62 See Annex 12 ADB Country Safeguard Categories.

63 See Annex 13: The Standard for Sustainable and Resilient Infrastructure.

(iii) the flow of funds out of the country in which the asset is located (to the extent that investors and/or financiers are located abroad)

- **Existing capacity**; are there adequate required resources to prepare, structure, and award transactions in accordance with international best practice

- **Project preparation**; adequate preparation needs to be completed prior to bringing projects to market, and **an appropriate allocation of risk**s to the party best able to manage them, which will always result in public sector assumption of risks

- **Clear and transparent tendering processes** should be implemented, with realistic timelines for bid submissions and adequate information made available for their due diligence and value assessment,

- **Published pipeline projects**; gives investors and lenders some assurance that a government is committed to private sector involvement

82. Looking at *Table 2, Comparison of bank business models*, the following can be gleaned:

CATEGORIES	AIIB	ADB, IFC, AMC, GIF, EIB*	REMARKS
Nature and History	○ AIIB is a "quasi-commercial bank" that has to generate returns whose establishment is mainly to support the building of infrastructure with no explicit development objectives.	○ ADB and IFC explicitly include a development agenda of poverty reduction in their mission. ○ EIB is a "policy-driven bank" focused on the EU and uses its financing for European integration and social cohesion. ○ While AMC and GIF (IFC facilities) are platforms to mobilize investments and the private sector with GIF focusing more on infrastructure.	1. Notably there is no explicit development agenda stated in AIIB's mission unlike the other 4 MDBs.
Mandate and Objectives	○ Its mandate is to "channel resources, particularly private investment, into infrastructure projects in Asia".	○ Both ADB and IFC are mandated to provide comprehensive solutions to the needs of their clients with IFC focusing on infrastructure and manufacturing. ○ AMC and GIF as facilities of IFC provide additional capital to private sector investments. ○ EIB supports sound investments, which further EU policy goals.	2. AIIB and the other MDBs aim to provide funding resources to its members mostly focusing on infrastructure investments.
Membership/ Shareholding contributions	○ AIIB has 57 Prospective Founding Members (PFMs); 37	○ ADB has 67 shareholding members including 48 from the	3. AIIB allows regional and non-regional membership; the other

	regional and 20 non-regional members. o Distribution of capital shares is between regional (75 percent) and non-regional (25 percent) members. o Shares are apportioned according to each member's capital contribution, the size of its economy, basic votes each member equally receives plus another 600 votes allocated to each founding member. o At least 75% of share votes are reserved for members located in the Asia-Pacific region.	Asia and Pacific region and 19 outside, IFC is open only to member countries of the World Bank, the shareholders of the EIB are the 28 member states of the EU. o ADB's weighted voting system is similar to the WB where votes are distributed in proportion with members' capital subscriptions. o Each state's share in the EIB's capital is based on its economic weight within the European Union (expressed in GDP) at the time of its accession.	MDBs only allow member countries. 4. All the banks follow a shareholding formula based on capital subscription. Voting is proportional to member's contribution; the bigger contribution, the bigger the vote.
Governance Structure/decision-making	o AIIB's governance structure is three-tiered, with a Board of Governors, a Board of Director, and Executive Management. o The Board of Governors has the power to elect a non-resident Board of Directors, which will determine budgets and projects.	o ADB Governors elect 12 members to form the Board of Directors, which performs its duties full time at the ADB headquarters. o The directors of IFC meet regularly at World Bank Group headquarters in Washington, D.C	5. All the MDBs plus AIIB follow the 3-tiered governance structures. Board of Directors reside full time in their Headquarters except for AIIB which has non-resident Board of Directors.
Business Model	AIIB invests in recipient countries as per its AOA: a) Co-financing or direct loans through other IFIs: ADB, WB, EIB, etc., b) Investment funds in equity capital of an institution or enterprise or Financial Intermediary Projects, c) Providing guarantees as primary or secondary obligor, in whole or partial loans for economic development, d) Deploying Special Funds in specific agreements,	o ADB provides loans, technical assistance, grants, advice and knowledge to governments and public sector. It also provides direct assistance to private enterprises of developing countries through equity investments. o IFC provides stand alone advisory services; product-based, focused, rapid and short term funding coming from internal budgets and trust funds. o EIB borrows money **on**	6. Basically, all these IFIs provide loans to governments; this also includes investment funds in equity capital, and special funds. Complementing these are advisory services and technical assistance. At this point in time, AIIB still lacks clear mechanisms on how these will be implemented.

	e) Providing Technical Assistance, and f) Through other types of financing modalities.	capital markets and lends it on favorable terms to projects that support EU objectives. About 90 % of loans are made within the EU. None of the money comes from the EU budget.	
Funding modalities	There seems to be no "firm" plans for AIIB's fundraising model yet, although the Articles state that operational financing must be drawn from returns on investments, loan repayments, and the leveraging of private finance.	○ ADB raises funds through bond issues on the world's capital markets and from members' contributions and retained earnings from lending operations. ○ IFC raises all funds for lending through the issuance of debt obligations in international capital markets and issues bonds in a variety of markets and formats. ○ The EIB funds its operations by borrowing on the capital markets rather than drawing on the EU budget. The Bank enjoys decision-making independence within the EU's institutional system.	7. All the MDBs have clear-cut funding modalities, giving them secure status. AIIB on the other hand is still in the process of firming up its funding model.
Corporate policies	AIIB released a 38-page draft Environmental Social Framework (ESF) for consultation purposes and procurement document.	○ ADB has the following: ○ Accountability Mechanism, [64] ○ Environment Policy, Environment Policy and Operations Manual (OM), [65] ○ Strengthening Country Safeguard Systems and the ○ Public Communications Policy.[66] ○ IFC has Access to Information Policy, Environmental and	8. Quite extensive corporate policies govern the other MDBs especially in the areas of accountability, environmental safeguards and disclosure. AIIB has so far drafted and released the ESF.

64 See Annex 8: ADBs Accountability Mechanism
65 See Annex 9: ENVIRONMENTAL ASSESSMENT GUIDELINES
66 ADB. Public Communications Policy 2011: Disclosure and Exchange of Information, 2011.

		Social Impact Assessment, and Environmental, Health and Safety Guidelines (EHSG). o EIB has the Transport Policy, o Transparency Policy, o Corporate Social Responsibility Policy, Governance at the EIB, Complaints Mechanism Policy (renewed in 2010), Anti-Fraud and Anti-Corruption Policy, Integrity Policy and Compliance Charter, Statement on Environmental and Social Principles and o Standards, EIB Whistle blowing Policy, EIB Policy towards weakly regulated, non-transparent and uncooperative jurisdictions.	

* As compiled by the Consultant through web searches, 2016.
*ADB - Asian Development Bank
IFC - International Finance Corporation
AMC - IFC Asset Management Company
GIF - Global Infrastructure Facility
EIB - European Investment Bank

83. To get a further glimpse on the nature of AIIB's operations, there is an interesting comparison in the following graphic representations done by the authors.[67] Figure 4 compares the voting shares of China in AIIB to that of the other countries in other MDBs such as WB and ADB. Allocation of voting shares has practical applications that determine "how much say each shareholder has over the institution's operations." Related to this, Figure 5 depicts the "aggregated voting power" that expresses total voting power across the MDBs weighted by the size (capital) of each institution.

84. Comparing the sizes of their contributions, *"China is now a much larger leading shareholder in the AIIB than either the United States or Japan is in the other MDBs". Its voting power of 26.06% is slightly more than the combined voting power of the United States and Japan in the ADB." At the same time with the creation of AIIB, it indicates that "China has surpassed Japan in the region's MDBs as a dominant country."*

[67] Morris, Scott and Higashikokubaru, Mamouro. July 2, 2015. Doing the Math on AIIB Governance.

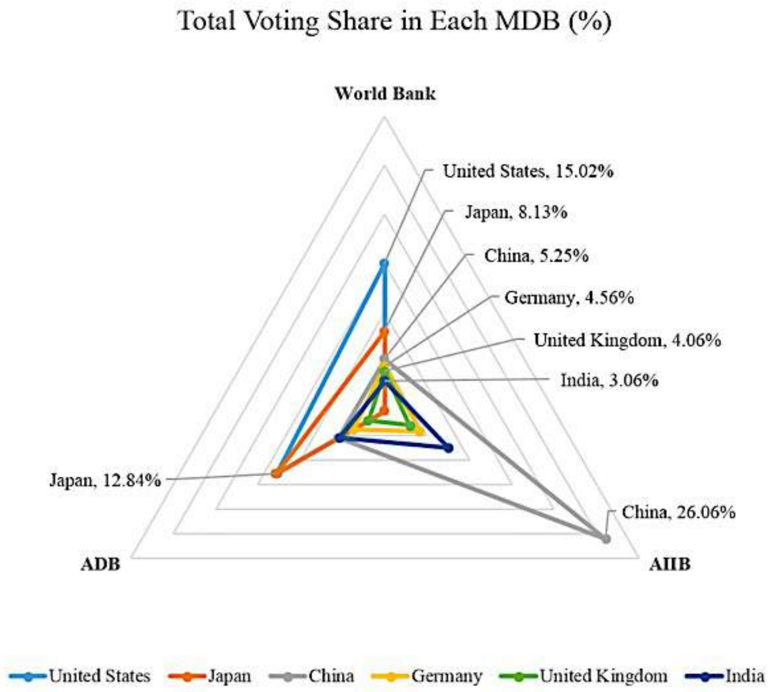

Figure 4. Voting Share in Each MDB (%)

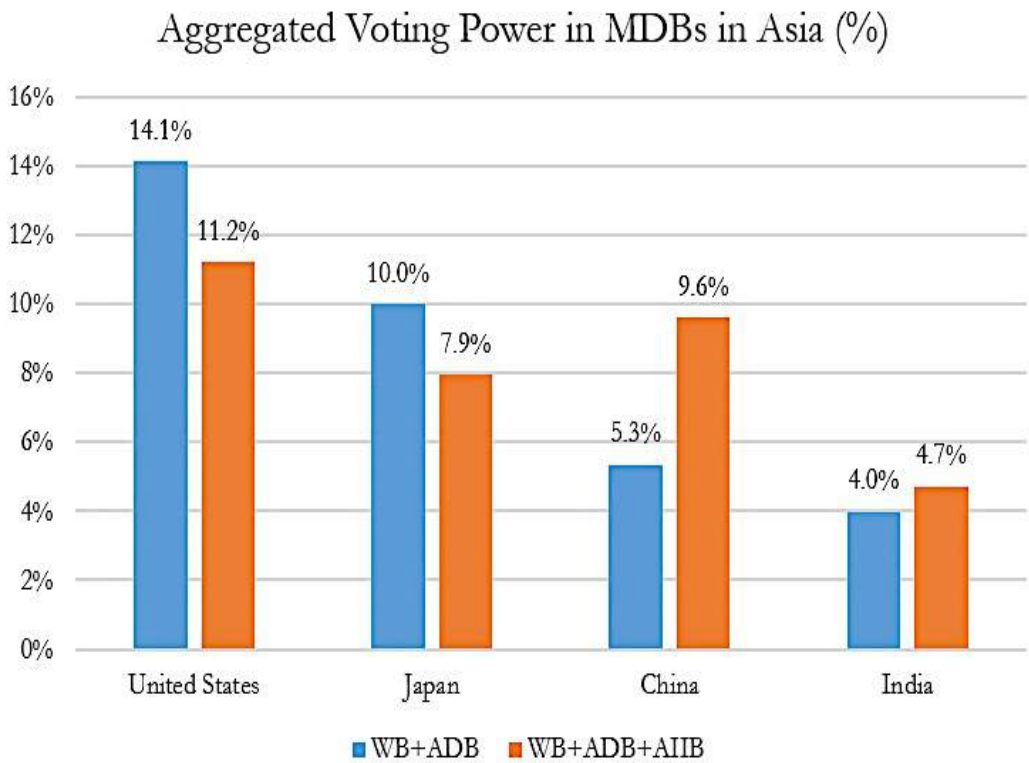

Figure 5. Aggregated Voting Power in MDB in Asia (%)

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