AN ANALYSIS ON THE POTENTIAL COMPETITIVENESS OF THE ASIAN INFRASTRUCTURE INVESTMENT BANK

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The establishment of the Asian Infrastructure Investment Bank (AIIB) is a response to the wide gap between the financing need and supply of global infrastructure investment, especially in Asia. The potential competitiveness of AIIB, as compared to other multilateral development banks, is that it has a more focused function, better balanced governance structure and sound financing and can strike a balance between the requirements of developing countries and conducting operations efficiently.

JEL classification: G29, O18.

Keywords: Asian Infrastructure Investment Bank, AIIB, infrastructure, competitiveness, multilateral development banks.

I. INTRODUCTION

Multilateral Development Banks are transnational financial institutions that provide loans to developing countries and contribute to achieving regional financial integration in specific areas (Eric and Richard, 2010). The construction of an international development financing system began after World War II. The system consists of global and regional multilateral development banks. The World Bank is the global multilateral development bank as well as oldest and most influential multilateral
development bank. The most renowned regional multilateral development banks are the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), the Inter-American Development Bank (IDB), the Asian Development Bank (ADB), the African Development Bank (AfDB) and the Corporación Andina de Fomento (CAF).

Since the beginning of the twenty-first century, the global development financing environment has changed considerably, especially after the global financial crisis of 2007-2008. The demand for capital has increased significantly with additional pressure coming from the large financing need from emerging economies and other developing countries for their economic development needs. Developed countries are a major source of capital under the current international development system, but it is difficult for them to provide large amounts of funds to emerging economies and other developing countries because of their lagging economic performance. On the other hand, some developing countries with surplus funds, such as China, cannot provide the amounts of capital needed through the existing international development financing system. This has prompted China to establish a new multilateral development financing institution with the objectives to close the funding gap and to promote the reform of the international development financing system.

Xi Jinping, President of China, proposed to establish the Asian Infrastructure Investment Bank (AIIB), at the twenty-first Asia-Pacific Economic Cooperation (APEC) informal economic leaders’ meeting after State visits to Indonesia and Malaysia, all of which took place from 2 to 8 October 2013. Then, from 9 to 15 October 2013, Premier Li Keqiang reiterated this proposal at a summit of East Asian leaders and during visits to Brunei Darussalam, Thailand and Viet Nam. A little more than a year later, on 24 October 2014, finance ministers and authorized representatives from 21 countries, the first batch of prospective founding members, signed the Intergovernmental Framework Memorandum for Building Asian Infrastructure Investment Bank.

Subsequently, five meetings of the prospective founding members of AIIB negotiated the draft AIIB charter between late November 2014 and the end of March 2015. The Asian Infrastructure Investment Bank Agreement was signed at the end of June 2015 and the Bank began operating on 16 January 2016.

Adhering to the two principles of “inside first, outside later” and “open regionalism”, AIIB is being developed step by step. Up until 16 September 2016, AIIB had 57 prospective founding members, including 37 countries from inside Asia and 20 countries from outside the region.

Taking into consideration existing global and regional multilateral development banks, is there operating space left for AIIB? Can AIIB compete with the other
multilateral development banks, such as the World Bank and ADB, and if so, what are its competitive advantages? These points are the major concerns of China and many other developing countries.

II. THE POTENTIAL COMPETITIVENESS OF THE ASIAN INFRASTRUCTURE INVESTMENT BANK

The large infrastructure funding gap may offer great opportunities for AIIB, but it is facing the challenges of ensuring the bank’s function and promoting economic and social development in Asia. AIIB must have its own unique niche to ensure its development and usefulness. The traditional multilateral development banks have already accumulated rich financing and operating experience, which AIIB should draw on to develop its own practices. However, based on analyses of the other multilateral development banks, it appears that some obstacles are impeding further development of these institutions. How to avoid similar problems is the key determinant for the success of AIIB. Apart from wide-scale participation of members inside and outside Asia and its clear objectives, AIIB has several characteristics, which make it different from other multilateral development banks. These characteristics can potentially make AIIB competitive.

Clear objectives and more focused function positioning

The founding objectives and functions of the other multilateral development banks can be divided into the following four areas: to reduce poverty and develop the global economy and regional economies, which has become the basic and traditional objectives; to accelerate regional development and integration; to promote the development of small and medium-sized enterprises; and to ensure sustainable development. From these objectives, it appears that most multilateral development banks, including the World Bank and ADB, have broad functions. The functions of the World Bank have undergone dramatic changes since it was founded. The World Bank made “eradicating extreme poverty and hunger” its new overall goal after a United Nations conference in 2000. It has set two ambitious goals to push extreme poverty to no more than 3 per cent by 2030, and to promote shared prosperity and greater equity in the developing world. As a global multilateral development bank, the function of the World Bank covers a wide geographical area, and its major financing area varies among regions based on specific circumstances. Compared with the World Bank, the functions of ADB are more concentrated, namely to help members in the Asia-Pacific region to eliminate poverty through development assistance and to promote economic and social development in the Asia-Pacific region. Moreover, its priority areas are economic growth, human promotion, gender and development, environmental
protection, the development of private sectors and regional collaboration (Huang and others, 2013). Looking at the sectoral distribution of loans, the proportion of the commitments of the World Bank directed to the infrastructure sector was 35 per cent in 2015, while that of ADB was about 71 per cent. Although the amount of loans of ADB to the infrastructure sector is much higher than that of the World Bank, the flow to non-infrastructure projects also occupies a considerable proportion, and this situation will not change in the short term.

The function of AIIB is more concentrated, with its objectives being to enhance interconnectivity and regional economic cooperation and to accelerate economic development for its members through supporting infrastructure construction in Asia (focusing on communication infrastructure, such as dams, port logistics, highways, bridges, and railways, as well as energy, urban development and communication networks) and investments in relative areas. Its main business scopes include providing direct loans or participation loans for its members, financing infrastructure construction projects, extending technical assistance for these projects in Asia and attracting infrastructure investments by cooperating with other international institutions or through public-private partnerships in order to promote regional cooperation and partnerships (Bai and Zhao, 2015). The focus of AIIB on the infrastructure sector could make it more professional in infrastructure financing and enable it to make better use of its funds in meeting the extensive need for infrastructure investment in Asia. With this focus, AIIB could concentrate on exploring ways to better finance infrastructure through its own experience or by drawing on those of other multilateral development banks, making it more professional overall in infrastructure financing. In addition, as the dominant member of AIIB, China has been building infrastructure (including railways, highways, airports and power plants) throughout Africa, Asia, Eastern Europe and Latin America. The country has already gained considerable experience in project planning, building and financing with strong international competitiveness. Therefore, AIIB will gradually be in a position to conduct business that clearly related to its objective and function, and use the infrastructure construction experience of China and other countries to improve the infrastructure in Asia.

Properly allocated voting power and balanced governance structure

A review of the voting distribution of the other multilateral development banks shows that in most of the regional ones, the voting proportion of regional members accounts for more than 60 per cent (AfDB is an exception) (table 1). From the perspective of dominance or power of regional members, regional members of ADB account for 65.15 per cent of the total votes, which fully ensure that they control the power. Most multilateral banks have received criticism over the dominance of a few members, especially by several non-borrowing members, with lenders playing an
increasingly important role in multilateral development financing. In addition, strong shareholders always have political influence in the decision-making process and results of multilateral development institutions. This kind of influence is more significant when the economic strength of recipient countries is weak. Humphrey and Michaelowa (2013) pointed out that lenders are playing an increasingly important role in multilateral financing for development. In terms of equity distribution, the voting power of ADB is mainly dominated by the United States of America and Japan, each with a 15.6 per cent voting share. Lending countries, such as Australia, Japan, those in the Eurozone and the United States, hold 50.6 per cent of the voting power, so it is difficult to judge whether the vital decisions made by ADB reflect the needs of developing countries (Ming, 2014). From 2010 to 2020, demand for infrastructure investment in China accounted for 53.12 per cent of the total needs in Asia in non-cross-border infrastructure and in India, 26.42 per cent. Therefore, the total demand for infrastructure investment in these two countries together accounted for almost 80 per cent of the total needs in Asia in non-cross-border infrastructure. Apart from the large financing demand, thanks to their large savings rates, China and many emerging countries are in a position to provide funds for countries in need of financing. Therefore, either in terms of demand or supply, China, India and other emerging developing countries should hold greater voting power in the governance of multilateral development banks and in deciding how to provide funds more efficiently. Currently, the voting power of China and India in ADB are 5.5 per cent and 5.4 per cent, respectively.

Table 1. Voting power concentration of multilateral development banks

<table>
<thead>
<tr>
<th>Distribution of voting power</th>
<th>World Bank</th>
<th>Regional multilateral development banks</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>IBRD</td>
<td>IDB</td>
</tr>
<tr>
<td>Regional members</td>
<td>–</td>
<td>84.06</td>
</tr>
<tr>
<td>Non-regional members</td>
<td>–</td>
<td>15.94</td>
</tr>
<tr>
<td>Borrowing members</td>
<td>36.92</td>
<td>50.01</td>
</tr>
<tr>
<td>Non-borrowing members</td>
<td>63.08</td>
<td>49.99</td>
</tr>
</tbody>
</table>

Source: The official website of each multilateral development bank.

Note: EIB and EU are also the shareholders of EBRD, so the voting proportions of these borrowing/non-borrowing countries and regional/non-regional countries include the ratio of these two institutions.
The governance structure of most multilateral development banks are also under scrutiny. For example, the resident (executive) directors arrangement applied by multilateral banks, except for EIB, is popular in multilateral development banks because of special historical and realistic reasons. Specifically, the resident (executive) directors arrangement in the World Bank was the result of competition for hegemony in the establishment of the Bretton Woods system between the United Kingdom of Great Britain and Northern Ireland and the United States; at the same time, the transportation and communication technology (mainly in shipping and telegraph) was developed to the point that non-resident (executive) directors could effectively participate in decision-making at the World Bank. The political and economic environment has changed significantly since then. Deficiencies among resident (executive) directors have become more and more prominent: full-time jobs result in high staffing cost. According to Dollar (2015a), the resident board is both a large financial burden to the World Bank (US$70 million per year) and an extra layer of management that slows down project preparation and renders the bank less efficient.

The Asia Infrastructure Investment Bank is trying to prevent similar defects by ensuring an effective voice of all members and limiting dominance by only a few members.

First, the voting power of AIIB is linked to financial contributions. Each member’s voting power is the sum of its basic vote, share vote and, where applicable, founding member vote. Basic votes for all members constitute 12 per cent of the total number of votes (basic votes, share votes and founding member votes) at any time; an equal number of basic votes is allocated to each member. The distribution of share votes (up to 85 per cent of the total number of votes) is based on the funding ratio. Each member has one vote for each share of capital stock held. Each of the 57 founding members is allocated 600 founding member votes.1

The Asian Infrastructure Investment Bank endeavors to see a more balanced voting power between the regional and non-regional members to ensure the dominance of regional members. As a regional multilateral bank, AIIB allocates about 73 per cent of its voting power to regional members to guarantee the absolute leading status of regional members.2 AIIB also provides enough voting power to non-regional members to improve its financing competence at the same time.

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1 See www.aiib.org/html/pagefaq/Key_Provisions/.
2 See www.aiib.org/html/aboutus/Basic_Documents/?show=0.
The Asian Infrastructure Investment Bank is also striving for a more balanced voting power between the borrowing members and non-borrowing members to ensure that borrowing members have a voice in the operation. It assesses each country’s economic scale, investment demand in infrastructure, financing competence and other factors objectively and comprehensively, so that the allocated voting power can better reflect the actual supply as well as demand situation of Asia-Pacific infrastructure and better facilitate its development.

In terms of governance structure, AIIB has learned a lot from the success of the EIB Statute and the Agreement Establishing the Asian Development Bank (the ADB Charter). The aim of AIIB is to build a “lean” multilateral bank, which intends to avoid overstaffing and excessive bureaucracy, reduce layers of management, and build a non-resident board. For example, to overcome the drawbacks of the resident (executive) director’s arrangement and simplify the bureaucracy, AIIB is adopting the non-resident directors system applied by EIB, according to the provisions of the Asian Infrastructure Investment Bank Articles of Agreement. The non-resident directors of the AIIB are responsible for setting a development strategy, lending policies and standards. At the same time, AIIB will not pay the directors. The power of the AIIB directors is evidently weaker than those of the World Bank and other multilateral development banks (International Bank for Reconstruction and Development Articles of Agreement, Article V, Section 4 (g); the Asian Infrastructure Investment Bank Articles of Agreement, Articles 28, Section 3; and the Agreement Establishing the Asian Development Bank, Articles 33, Section 3). Similar to EIB, the management of AIIB has greater power and plays a more important role in governance structure. The management committee (the president and vice presidents) is responsible for the daily operations of AIIB, including examination and approval of projects according to the established rules. The number and composition of the directors of AIIB are more similar to those of ADB and the World Bank. The EIB model could result in a large number of board of directors in AIIB. According to the EIB Statute, the board of directors shall consist of 29 directors (one nominated by each member State, and one nominated by the Commission) and 19 alternate directors (some seats shared by several members). The board of directors shall co-opt six non-voting experts: three as members and three as alternates. Each director has one vote on the board of directors, and the voting share is in accordance with the funding ratio. AIIB is carrying out a “constituency” arrangement implemented by ADB and the World Bank. The board of directors of AIIB is composed of 12 members (each appointing an alternate), of whom nine shall be elected by the regional members and three by the non-regional members.
Sound financing structure and financial sustainability

At present, EIB is the largest multilateral development bank in the world in terms of subscribed capital and outstanding loans, followed by IBRD. Table 2 show the wide variation in capital and operation scale among the multilateral development banks.

Table 2. Capital and operation scale of the multilateral development banks

<table>
<thead>
<tr>
<th>Multilateral development banks</th>
<th>Subscribed capital</th>
<th>Paid-in capital</th>
<th>Callable capital</th>
<th>Paid-in/subscribed (per cent)</th>
<th>Equity</th>
<th>Loans outstanding</th>
</tr>
</thead>
<tbody>
<tr>
<td>IBRD&lt;sup&gt;a&lt;/sup&gt;</td>
<td>232.80</td>
<td>14.00</td>
<td>218.80</td>
<td>6.00</td>
<td>40.00</td>
<td>154.00</td>
</tr>
<tr>
<td>ADB</td>
<td>153.10</td>
<td>7.70</td>
<td>145.40</td>
<td>5.30</td>
<td>16.90</td>
<td>55.90</td>
</tr>
<tr>
<td>EBRD&lt;sup&gt;b&lt;/sup&gt;</td>
<td>29.70</td>
<td>6.20</td>
<td>23.50</td>
<td>21.00</td>
<td>14.10</td>
<td>21.00</td>
</tr>
<tr>
<td>EIB&lt;sup&gt;b&lt;/sup&gt;</td>
<td>243.30</td>
<td>21.70</td>
<td>221.60</td>
<td>8.90</td>
<td>60.60</td>
<td>449.40</td>
</tr>
<tr>
<td>CAF&lt;sup&gt;c&lt;/sup&gt;</td>
<td>10.00</td>
<td>6.16</td>
<td>3.84</td>
<td>61.60</td>
<td>8.80</td>
<td>19.10</td>
</tr>
<tr>
<td>IDB</td>
<td>144.30</td>
<td>5.40</td>
<td>138.90</td>
<td>3.90</td>
<td>23.70</td>
<td>74.60</td>
</tr>
<tr>
<td>AfDB</td>
<td>94.40</td>
<td>7.10</td>
<td>87.30</td>
<td>8.10</td>
<td>10.90</td>
<td>18.30</td>
</tr>
</tbody>
</table>

Source: Annual Reports of the multilateral development banks and rating reports of Standard and Poors, Fitch and Moody’s.

Note:  
<sup>a</sup> The data of IBRD are as of 30 June 2014; the data of other multilateral development banks are as of 31 December 2014.  
<sup>b</sup> For the data of EBRD and EIB, the unit is € billion, for the other multilateral development banks, the unit is US$ billion.  
<sup>c</sup> Statistical indicators of CAF are different from other multilateral banks. In the annual reports of CAF, as of 31 December 2014, the “subscribed and paid-in capital” was $6.16 billion, but in the rating reports of Moody’s and Standard & Poors, this amount is incorporated in “paid-in capital”.

To meet the enormous capital demand in global developing financing, multilateral development banks have increased their capital in varying degrees to expand their operation scale in recent years. From 2007 to 2014, capital growth of IBRD, ADB, EBRD, EIB, IDB, AfDB and CAF was 22.65 per cent (from $189.80 billion to $232.79 billion), 173.42 per cent (from $55.98 billion to $153.06 billion), 49.91 per cent (from €19.79 billion ($20.72 billion) to €29.67 billion), 47.62 per cent (from €164.81 billion to €243.28 billion), 42.90 per cent (from $100.95 billion to $144.26 billion), 175.27 per cent (from $34.28 billion to $94.37 billion), and 173.99 per cent (from $2.25 billion to $6.16 billion), respectively.<sup>3</sup> In 2015, the authorized capital

<sup>3</sup> Moody’s, Rating Reports on multilateral development banks in relevant years.
of CAF rose to $15 billion from $10 billion in 2014, and paid-in capital climbed to $10 billion, callable capital reached $5 billion.4

Despite this, there is still a wide gap between infrastructure financing need and supply. For example, the Asian Development Bank Institute expects the demand of the 32 developing members of ADB for non-cross-border infrastructure investment will amount to $8.22 trillion during the period of 2010-2020, accounting for 6.5 per cent of the Asian regional gross domestic product (GDP) forecast values, along with average annual investment needs of $747 billion. Among them, 68 per cent of the funds will be needed for new infrastructure investments, while the remaining 32 per cent will be required for maintenance and replacement of existing infrastructure (Bhattacharyay, 2010). Strategy 2020 of ADB emphasizes that multilateral development banks need to cooperate with the private sector through public-private partnerships (PPPs). These arrangements will also provide ADB with an opportunity to significantly leverage its limited resources in attracting private sector investments and commercial financing to meet the Asia and Pacific region’s vast and growing infrastructure investment needs (ADB, 2012). However, not all infrastructure projects are suitable for PPPs. Instead, serving as a replacement, PPPs can only complement the public sector, official development assistance and other sources in infrastructure and service delivery. Even in a mature market, such as the United Kingdom, PPPs play a small but important role in the government’s investment in public services and represent about 10-15 per cent of the overall public sector procurement (United Kingdom, 2016, p. 15).

The authorized capital of AIIB is expected to be $100 billion, contributed by members in installments. Although the authorized capital only comprised two thirds of the recent authorized capital of ADB, the authorized capital of ADB was only $55 billion prior to a capital increase in 2009. Therefore, AIIB is in a competitive position with regard to authorized capital. Specifically, the initial subscribed capital of AIIB is $50 billion, consisting of about $10 billion in paid-in shares, which should be completed in the early stage (within 5 years) and another $40 billion worth of callable shares, which can be called at any time. In addition, AIIB will seek appropriate opportunities to boost capital by attracting, so as to expand the business scope and promote business competence (Bai and Zhao, 2015). That is to say, with the increasing callable shares in total subscribed capital and the additional new members, the funding supply advantage of AIIB will be further enhanced. Moreover, the future financing models of AIIB will be classified in three ways: (a) interbank; (b) centralizing the founding members’ sovereign credits to issue bonds; and (c) establishing a special fund to attract idle investment. Among them, AIIB will consider to establish

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a trust fund by using a PPP to raise funds, sovereign wealth funds and other social capital. This kind of funds tends to be of a large scale and placed in investment projects with long-term and stable returns, which has similar characteristics to the funds used for infrastructure projects (Zhong, 2014). Special attention needs to be focused on two main bodies in a core position of the PPP mode, the public sector and the private sector; resolving any conflicts that arise between them is key to success in operating PPPs. The public sector concentrates on the provision of public services, while the private sector focuses on return on investment, and the longevity, complexity and systematicness on projects that involve PPPs. Therefore, the interests between the private and public sectors must be balanced when promoting PPPs. To solve the conflict of interest between the public and the private sectors, AIIB should follow three courses of action. First, the public sector’s role in PPP should shift from being investors, operators and managers to being providers, rule makers and regulators. The public sector should bring forward ideas, restrict power, cultivate camaraderie and set up an efficient supervision system. Second, the private sector’s economic activities could be carried out in a rational and normative institutional environment, and have a high degree of social responsibility. Third, the private sector should establish and improve the system of information disclosure and public participation mechanism to allow a third party to be involved in the project supervision, and thus increase the transparency of PPP.

In addition to funding capacity, AIIB can be competitive with regard to lending rates. Its annual lending volume is expected to initially reach $5 billion, and then gradually rise to $10 billion. With the expected increase in the loan amount, AIIB will need additional financing, and financing from international capital markets is one of the main channels. Its financing costs in the international markets will be determined by its credit rating; the lower the credit rating, the higher the risk, which translates to rising financing costs. If AIIB were to issue bonds in multiple currencies, the bank’s credit rating would be further affected by each founding member (Syadullah, 2014). Therefore, the participation of AAA rated countries, such as Australia, Germany, the United Kingdom, and Singapore, will improve the overall rating and financing conditions of AIIB to a certain extent. Furthermore, Humphrey (2014) has found that additional financing costs do not necessarily lead to a gap in loan interest, and this gap that exists is narrowing. Therefore, even if the credit rating of AIIB cannot reach the AAA level of ADB and the World Bank, the Bank’s loan interest may still be competitive. In addition, loans from the World Bank and ADB are prioritized towards poverty reduction and social development, while the objective of AIIB is to promote infrastructure development in the Asia-Pacific region with stronger commercial

5 Data were originated from the official website of Standard and Poors: www.standardandpoors.com/ratings/sovereigns/ratings-list/en/ap/?subSectorCode=39&start=0&range=5.
properties. This, in turn, will help AIIB to attain more scope for profitability and enable it to be more flexible in adjusting its lending rates to a certain extent.

Balance between the requirements of developing countries and operating efficiency

The projects financed by the other multilateral development banks have failed to satisfy the practical needs of the recipient countries. There is still large space to improve project design and implementation.

First, in traditional development financing institutions, developed countries emphasize the principles of fairness, transparency, accountability and participation during the development assistance “process”, and apply human rights and democracy as the foundation of sustainable development. In many cases, they combine development financing with the process of democratization in developing countries, set political conditions when extending loans for development projects, and focus on human rights, democracy and liberal market economic order all the time. These values are based on the practical experience of Western developed countries, ignoring the complicated history and reality of the developing countries, which makes it difficult for the latter to meet those requirements under their current situations. Second, multilateral development banks need to improve their project design and implementation. Currently, the project designs are too complex and fail to give adequate consideration to the local conditions and government capacity. During the implementation phase, a series of problems often arise, such as complex and ambiguous institutional arrangements, long working processes, low quality of consultants or contractors, delayed and inadequate responses and lack of government enforcement. For example, because of the problems in design and implementation, about 23 per cent of the ADB projects were not completed as expected during the period 2011-2013. Moreover, with regard to the successful projects in the same period, about 16 per cent of them encountered cost overruns problems and their expected results were lowered. Apart from problems with the project design and implementation, there are often delays in starting and completing the projects. With regard to ADB, the interval between project approval and first contract signed has been shortened to one year, however, it is still too long, while more than half of the first contracts are signed only with advisory agencies (ADB, 2013). Also of note, compared with the delayed start, the delayed completion was even more common; the actual finishing dates for about 47 per cent of the projects were postponed by more than a year. Nelson (2015) is of the view that multilateral development banks (including ADB, AfDB, ADB, EBRD, IDB and the World Bank focus more on lending funds instead of serving as a provider of funds to countries for worthwhile projects.
With regard to operating principles, concerns about ensuring the social and environmental suitability of projects should not be ignored. Environmental and social safeguard policies are international benchmarks for identifying and managing environmental and social risks within the private sector, which intend to help borrowers contribute towards efforts to achieve sustainable development.

There is also controversy associated with the degree of strictness in the safeguard policies of the traditional multilateral development banks. Civil society actors argue that safeguards tend to be too weak. In that regard, the following statement was made: the World Bank fails to recognize that strong safeguards are essential to ensuring that project benefits are fairly shared and that the costs are not borne by the poor and the marginalized.\(^6\) Meanwhile, some authorities maintain that weakening the existing safeguard policies would make the Bank’s goals of ending extreme poverty and promoting shared prosperity impossible to achieve. On the other hand, some borrowers and banks argue that safeguard policies now employed are stricter than necessary. Borrowers are finding it difficult to finance projects in compliance with the protocol, which results in the exacerbation of project design and implementation woes due to the disparate gap of expectations, resources, and abilities between them and the lenders. They hold that the safeguard policies increase project preparation costs by about $200 million to $300 million annually, and that social and environmental costs significantly outweigh the benefits of safeguard implementation when risks are underestimated or when communities do not benefit from the project. In addition, some policies may affect the motivation of bankers to take on certain projects, which can be viewed as a limitation of strict safeguards, as they are substantially less likely to take on projects that have high probabilities of delays and difficulties in implementation (Mourant and others, 2015). Additionally, many governments regard loans with governance conditions attached as intrusive political meddling.

Weak safeguard policies threaten to leave environmental and social risks unchecked, yet corrective safeguard policies that become too strict may actually become self-defeating by making projects costs prohibitive and could push borrowers towards choosing less stringent options. Similarly, countries that have the option to borrow from capital markets, rather than from multilateral development banks, are choosing to do so more often, resulting in processes that have even less scrutiny.

The World Bank has realized the drawbacks of its safeguard policies. On 4 August 2016, it approved a new environmental and social framework, which expands protection for people and the environment in bank-financed investment

projects. This framework was considered by the international society as a weaker version than the previous one (Biron, 2014). Through it, Country Safeguard Systems (CSS) of borrowers could play a more important role. To some extent, it means greater flexibility needed for poorer countries.

The Asian Infrastructure Investment Bank is trying to develop a more suitable, unbiased standard of development financing for developing countries based on South-South cooperation. It is aiming to meet the development needs of the borrower based on high environmental and social framework standards. Most developing countries tend to be against too much emphasis on “development assistance”, and put greater focus on the main incentive of economic growth. China has already formed a unique “China’s developing experience” and “development-oriented poverty reduction” during the process of reform and development, which has spanned more than 30 years. Similarly, other emerging economies and developing countries are also exploring extensively their process of development and poverty reduction. In other words, developing countries have a better understanding, to some extent, of their own development processes and difficulties. AIIB aspires to better respect the borrowers’ choice of development approaches, limit political conditions to the minimum, refrain from intervening in the borrowing countries’ internal affairs through development financing, and make its designs and implementation more flexible and loan programmes better targeted. According to Dollar (2015b), AIIB has attracted wide-scale participation of developing countries because its operating procedures are expected to be more efficient than those of other multilateral development banks. Developing countries, such as China, have accumulated rich experience in building infrastructure. That coupled with the fact that the developing members of AIIB are all Asian countries, the discrepancies of infrastructure financing needs among those countries are relatively small, and as AIIB has less difficulty in understanding the borrowers’ situation, it can better ensure the practicability of the design and implementation of projects.

This is by no means neglecting environmental and social safeguard in projects financed by AIIB. The president of AIIB, Jin Liqun, has pointed out several times in public speeches that AIIB will be a “green” multilateral development bank that encourages sustainable development through investments in renewable energy and energy efficiency. To clarify further, he has stated the following: AIIB would not conduct business with companies that have a record of not considering the more extensive implication of their projects on the environment and on society; and that projects should promote sustainability. He has also hinted that AIIB would consider investing in coal-burning power stations in order to bring electricity to places where it is most needed and where there is no greener alternative; however, instead of building new power stations, AIIB will soon invest in projects that can increase the
efficiency of power delivery and free up generated power for wider use (Howard, 2015).

The Asian Infrastructure Investment Bank could emphasize the following points in its future safeguard policy.

First, in project planning and designing, safeguards are integral component. When done correctly, safeguards actually prevent unnecessary delays and costs during implementation by appropriately accounting for contingencies during the planning phase. Cost overruns, instead, are often associated with poor planning due to the rush to fast track the project implementation. Rather than being an additional cost to the planning of a project, it is the integral role that planning for safeguards should play from the onset of project design (Syadullah, 2014). For example, projects financed by AIIB should take sensitivity into consideration during the design phrase. This entails coordinating between economy-promoting projects and ecological protection strategies for safeguarding biological diversity in the long term. As another example, it should promote green investment and financing, and set relatively high standards on environmental and social risk management for bilateral or multilateral investment projects, which entails motivating optimal resource-allocations through financial incentives, evaluating environmental risks thoroughly during the investment decision process and regulating polluting investments. Some multilateral development banks, such as the World Bank have required borrowers to develop socioenvironmental safeguard policies before the projects start, monitored the projects implementation, and carried out an in-depth assessment or impact assessment after the projects have been completed. AIIB is expected to establish high-standard safeguard systems to promote the implementation of green credits.

Second, AIIB should establish independent assessment bodies and corresponding information exchange and communication platforms. Based on past experience, Dollar (2015a) believes that evaluation and transparency are more important than the written policy, and consequently advocates independent and public project evaluation. Moreover, project evaluation and feedback after the completion of the project facilitates the conclusion of the successful experience of projects related to construction and management. In addition, they facilitate the project summary of the lessons learned in the implementation process. AIIB could refer to the performance evaluation standards of the other multilateral development banks, such as the Common Performance Assessment System (COMPAS) and the Evaluation Good Practice Standard from the Evaluation Cooperation Group (ECG). Also of note, some scholars suggest that AIIB use modern network communication technology and governance models (such as removal of the Board System), on the view that those measures can significantly reduce operation costs and enhance operating efficiency (Gao, 2015).
Third, efforts should be made to improve the capacity of borrowing countries in making and implementing their country safeguard systems. These systems refer to the laws, regulations, rules and procedures in policies relating to environment, involuntary resettlement and safeguards of indigenous peoples and their implementing institutions. That is, AIIB should provide technical assistance to help the borrowing countries to strengthen the legal and institutional framework to efficiently employ safeguard systems. In particular, AIIB should consider more flexible principle-based and use of country system approaches to safeguard policies, and ensure appropriate monitoring and reporting in which safeguard implementation is assessed on a regular basis (Mourant and others, 2015).

III. CONCLUSIONS

There is a large infrastructure investment demand in Asia, especially in China, India and other developing countries in East Asia, South-East Asia and South Asia. AIIB is being set up to help close this enormous financing gap.

Compared with the World Bank and ADB, AIIB has its own unique features, which are supported by its potential competitiveness. First, AIIB focuses on infrastructure investment in Asia, while other multilateral development banks have multiple priorities, which opens the door for AIIB to be more professional in infrastructure financing. Second, a more rational voting power allocation among regional and non-regional countries, borrowing and non-borrowing countries and the more reasonable governance structure of AIIB enable the financing to flow to the countries and sectors with urgent needs, so as to exert the maximum utility. Third, the operation scale of AIIB would be considerable, and the lending rate would be competitive, taking into consideration its authorized capital and number of members with high credit rating. Fourth, based on South-South cooperation, AIIB has its own characteristics, which is known as depoliticization, in its projects and loan conditions, and the business operations will be more catered to the demands of developing countries based on the development experience of developing countries, such as China.

Above all, the establishment and the development of the AIIB reflect the needs of the global development financing system. In terms of the competitiveness, the future is bright for AIIB, even though many challenges remain.

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7 See www.adb.org/site/safeguards/country-safeguard-systems.
REFERENCES


______ (2015b). What the AIIB can learn from World Bank shortcomings, 6 May.


