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## **The Asian Infrastructure Investment Bank (AIIB)**

A Multilateral Bank where China sets the Rules

A study by Korinna Horta



# THE ASIAN INFRASTRUCTURE INVESTMENT BANK (AIIB)



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VOLUME 52**

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A Multilateral Bank where China sets the Rules

**A study by Korinna Horta**

**Edited by the Heinrich Böll Foundation in cooperation with Urgewald**

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# FOREWORD

In 2014–16, a number of countries who pride themselves in their commitment to democracy and human rights – among them Germany – decided to join the Asia Infrastructure Investment Bank (AIIB). In Germany, the relevant decision by parliament required the German government to press for high environmental, social, human rights and governance standards, to match at least those of the World Bank.

Korinna Horta's analysis of the situation regarding the respective standards after three years of AIIB in operation is very sobering. What can be done now? Is it time to admit a complete failure and leave the Bank? What influence do shareholders still exert, and what should they press for? Indeed, if the AIIB were considered in isolation from any political and economic context, withdrawal could be justified. But such a step would deprive countries like Germany of the bit of influence they have, weaken other like-minded members and also have geopolitically damaging effects. So the task at hand is to continue to fight for strong environmental and social standards, maximum access to information, transparency, a robust and independent complaints mechanism and tight reins on the power of the Bank's management. In order to pursue these goals further, it is the task of parliaments to scrutinize the role their governments play in the AIIB. Ongoing monitoring of the AIIB, its projects, strategies and policies can only be ensured if civil society contributes its share of information on developments and problems. Constant parliamentary monitoring supports the position of a country's representatives at the Bank, whether as Executive Director or Alternate. Only through a strong positioning of shareholder representatives in the AIIB board and their full backing by the respective shareholder governments will it be possible to fend off further weakening of standards. Providing timely and comprehensive information to those affected by projects and offering them a simple, impartial way to claim their rights must remain a central concern. In addition, it must be ensured that management remains accountable: An expansion of the president's decision-making power must therefore be fended off and contained.

There is much at stake in infrastructure: The infrastructure we build today decisively shapes our lives tomorrow. A public infrastructure bank must live up to the highest standards regarding the environment, human rights and governance. So far, the AIIB is setting a bad precedent. It is high time to correct its course.

Berlin, March 2019

Jörg Haas

*Head of International Politics Division*

*Heinrich Böll Foundation*

Headquarter of AIIB in Beijing



## EXECUTIVE SUMMARY

The AIIB has developed into a major player in the global financial architecture in record time: It first became operational in January 2016, and as it completes its third anniversary in 2019, the Beijing-based institution counts 70 member states with a further 23 countries seeking to join. Two of the world's leading economies, the United States and Japan, have not joined the AIIB to date. Their concern is that the AIIB could largely be an instrument conceived to support China's geopolitical and economic expansion. However, European governments did not want to stand on the sidelines and argued that they could influence the institution from the inside. They joined the AIIB as founding members and lent the institution an international credibility that otherwise it would not have had.

During its initial three-year phase, a combination of in-depth knowledge of the functioning of existing multilateral banks, highly strategic and intelligent leadership and support from global public relations agencies have allowed the AIIB to position itself as being on a par with the other banks. The fact that to date it has mostly participated in co-financing operations led by other multilateral banks, such as the World Bank, has further contributed to it being perceived as being equal to the other actors in the field.

The AIIB's discourse is adjusted to Western sensibilities by emphasizing transparency and environmental and social standards. China's own domestic track record in these areas is dismal, but the AIIB was cast as a multilateral entity with a diverse membership disconnected from China's political system.

The AIIB promises to be «lean, clean and green.» At the time of its inception, it adopted an «Environmental and Social Framework» designed to broadly reflect the main subject areas of comparable policies at other banks. This is a very open-ended and flexible document. There is as yet no track record of how it has been applied. In addition, the AIIB's governance structures largely mirror those at other institutions. In the summer of 2017, the world's leading rating agencies attributed to the AIIB the same Triple-A credit rating as the World Bank and its sister institutions. This was the highly successful outcome of well-orchestrated image creation, since the AIIB at that time had no track record of stand-alone projects, and major governance pillars, such as a final policy on the public disclosure of information, had not yet been put in place.

In its initial phase, the AIIB cultivated a careful distance from China's Belt and Road Initiative (BRI). Emphasizing that it was a multilateral institution committed to following international standards, it clearly sought to distinguish itself from controversial BRI investments. This discourse has shifted and more recently

the AIIB President has described the BRI and the AIIB as being twin engines of an aircraft, where both are needed for the aircraft to fly smoothly and high.<sup>1</sup>

This paper examines the Environmental and Social Framework of 2016 and fundamental policies related to AIIB governance, which were only adopted in 2018 and did not become effective before 2019. These policies concern the misnamed «Accountability Framework,» which concentrates decision-making power in the hands of the AIIB President, the Public Information Policy, which is based on principles and does not contain clear rules on time-bound requirements for the disclosure of information to the public, and finally, the AIIB's Project-Affected People's Mechanism (PPM). The latter is meant to be the AIIB's counterpart to the Independent Accountability Mechanisms at other banks, which were established to serve as bottom-up channels of communication and as independent entities designed to address concerns raised by communities which are or may be harmed by bank-financed projects. The PPM, however, departs from best international practice in this area by posing burdensome, and in many situations unrealistic, preconditions for affected people before they can even access the PPM. Furthermore, the PPM's institutional setting and procedures are not designed to ensure that reviews of complaints submitted by affected people are carried out in an independent manner.

Now firmly established, the AIIB will enter a new phase. According to its strategy, the AIIB will increasingly cast itself as an alternative to other banks. Moving away from co-financing arrangements, its goal is to focus on the expansion of its stand-alone portfolio.<sup>2</sup> In order to attract business and investment opportunities, it is marketing itself as being more flexible, more efficient and more responsive to the needs of its clients than the competing multilateral banks. While gains in efficiency, flexibility and responsiveness are certainly desirable, the sub-text here is a message to potential clients that the AIIB will be faster in approving their loans and not meddle in their internal affairs by talking about good public governance, mandatory standards and accountability.

With the establishment of the AIIB, China has created a multilateral instrument where it sets the rules. It has also created an instrument with the potential to better advance Chinese interests than pursuing a unilateral course, which relies solely on its own economic might.<sup>3</sup> It would be highly disingenuous to consider the AIIB as just one more multilateral player that is separate from China's opaque political system.

The risks of large-scale infrastructure projects built under such constraints can hardly be overstated. They include irreversible environmental destruction, social disruption, repression, pervasive corruption and indebtedness.

Then there is another risk which requires urgent attention: In light of the competition among multilateral banks, there are first signs that the AIIB can have a corrosive influence on the standards of other institutions. Afraid of losing clients

1 China Daily, «AIIB Vows Support to Connect African Continent,» 4 September 2018.

2 AIIB, Strategy on Mobilizing Private Capital for Infrastructure, 9 February 2018.

3 Prasad, E., «China takes aim at West's global clout,» New York Times, 2–3 September 2017.



to the AIIB, they may weaken their hard-won requirements on public information, participation and environmental sustainability, all of which will increasingly be considered to be obstacles in the race to win business.

The AIIB's shareholders, especially the European countries that provided it with international credibility, have the responsibility to closely monitor planned investments and the implementation of AIIB-financed projects. Robust supervision and ensuring the quality of AIIB investments is the obligation of shareholding governments. They must also be willing to confront AIIB leadership when necessary and not be intimidated by the possibility of angry reactions from China. This is about more than the money and power related to large-scale infrastructure development: it is also about democratic values. A failure to stand up for these values carries the risk that European and other shareholders will, even if unintentionally, become handmaidens for the export of an approach to global governance that rejects human rights and the rule of law.

In addition, governments must not only prevent the erosion of standards at the other multilateral banks, but work to improve the way these institutions function in order to strengthen a rules-based international system. These institutions are often rightly criticized for promoting elite interests while paying little attention to the real costs to communities and to the environment of ill-conceived investments. Reinvigorated and accountable multilateral institutions are the international community's best response to unilateral strongman rule.



Ilham Aliyev, President of Azerbaijan, attending the Belt and Road Initiative China's Trillion Dollar Vision session in Davos, January 2019

# The Asian Infrastructure Investment Bank (AIIB): A Multilateral Bank where China sets the Rules

## The Establishment of the AIIB – A Diplomatic Victory for Beijing

China announced plans to create the AIIB as early as 2013. A symbolic milestone was reached on 12 March 2015, the day that the United Kingdom decided to join the AIIB as the first European country to do so. This was a dramatic step, given the Obama administration's pleas with European governments not to join the institution. Here was the United Kingdom, traditionally the closest ally of the U.S. in Europe, ignoring the concerns of the U.S. administration. Among those concerns were certainly the expansion of China's soft power and the challenge the AIIB might represent to other multilateral banks where Western countries and Japan formally dominate. Furthermore, it was clear that the U.S. Congress would not authorize funding for the AIIB given the stringent requirements it places on the U.S. contributions to multilateral banks. These relate to hard-won gains made by civil society organizations working with members of the U.S. Congress, such as a law requiring environmental impact assessments to be made public within established time frames. The AIIB does not have such rules.

Once the United Kingdom broke ranks, Germany, France and other European countries soon followed. It was a major diplomatic victory for Beijing to split the G7, showing the world a fragmented West and the pull of attraction coming from China.

What about the argument that China's under-representation at the World Bank and other multilateral banks led the Chinese government to establishing the AIIB? While we cannot know the motivations of the Chinese leadership, this argument sounds plausible, but may not be the whole story. The refusal of the U.S. Congress to allow a considerable dilution of U.S. voting shares and the intransigence of European governments in not wanting to give up one of their chairs on the World Bank's Board have prevented China from having a formal representation commensurate with its economic power. But China also continues to be a top borrower from the World Bank, and as such wields considerable power. It is clearly the case that the World Bank needs China more than China needs the World Bank. China's influence in the World Bank is significant and has, for example, been a key factor in blocking proposals to include human rights due diligence for high-risk projects in the

World Bank standards.<sup>4</sup> In sum, we do not know whether the establishment of the AIIB is the result of China's frustration with being under-represented at established multilateral banks, or whether the AIIB was conceived independently of such considerations to create an instrument more suited to projecting Chinese power and influence.

## **AIIB Governance – Concentrating Power at the Top**

The AIIB officially opened for business in January 2016. The AIIB's Articles of Agreement are the foundational document that lays out the Bank's purpose, functions, membership, operations, and most importantly, its governance structures and procedures.<sup>5</sup> Much of the document's language is again designed to mirror analogous documents at other multilateral banks, but it also clearly establishes China's de facto veto right on all matters of importance.

Each of the AIIB members is represented on its Board of Governors, which as a matter of routine meets once a year unless a special meeting is called. The Board of Governors delegates the powers of establishing the Bank's policies, annual plan and budget, as well as the supervision of the management and operations of the Bank, to a Board of Directors. This turns the Board of Directors into the AIIB's most important governing body. This Board is composed of twelve directors elected by their respective constituencies; nine of these members are from regional and three from non-regional members. Europe occupies two of these directorships. One European director represents the constituency made up of eurozone member countries, of which Germany is the largest shareholder. The other European director represents a wider-Europe group, including Scandinavian countries and Switzerland, which is led by the United Kingdom.

Voting shares of Board members are based on the sum of basic voting shares for each director, plus extra shares for founding members, and importantly, shares that are proportional to the member's contribution to the Bank's capital stock.

The combined voting share of all non-regional countries is currently just slightly over 25 % of the total and includes countries such as Sudan, Ethiopia and Egypt. Among non-regional members, Germany comes first with 4.19 %, followed by France with 3.21 % and the UK with 2.93 % of voting shares.

Among regional members, China alone has 26.52 % of the voting shares, to which we might add the 0.85 % of Hong Kong's shares, which for the purposes of the AIIB is considered to be a separate country. Well behind China, India is the second largest shareholder with 7.63 %, followed by Russia with 6.01 % of voting shares.

Since all major decisions require a majority of not less than three-quarters of the total voting power, nothing can be decided against China's wishes. But European

<sup>4</sup> During the World Bank's Safeguard Review (2012–2017), the United States, Germany and other countries proposed including the evaluation of human rights impacts in high-risk projects as part of the Bank's procedures. World Bank sources have told NGOs that these proposals were blocked by important borrowing countries led by China.

<sup>5</sup> [www.aiib.org/en/about-aiib/basic-documents/articles-of-agreement/index.html](http://www.aiib.org/en/about-aiib/basic-documents/articles-of-agreement/index.html)



shareholders jointly hold 23.9% of voting power. If they act jointly with other like-minded countries, they could still achieve a lot. Unfortunately, joint positions of a group of like-minded countries have been difficult to achieve to date.

The AIIB's Board of Directors is a non-resident board. It only meets periodically during the year and can opt to hold electronic meetings or decide on a matter without holding a meeting. Germany, the largest non-regional shareholder, would have preferred to have a resident board in order to exercise its oversight functions at AIIB headquarters and not from distant Berlin, but its proposal was overruled. In an attempt to address the situation, Germany, which led the eurozone constituency from January 2016 to June 2018, placed its director at the German embassy in Beijing. Austria, which took over eurozone leadership at the AIIB in June 2018 for the period of one year, also opted for locating its representative at its Beijing embassy. Germany continues to occupy the position of alternate director for the eurozone based at its Beijing embassy. The wider-Europe constituency continues to be led by the United Kingdom and has its base in London.

Key roles of the Board of Directors include the establishment of AIIB policies and the supervision of AIIB management and operations. To what degree the far-flung Board can access detailed information on specific AIIB-financed projects in a timely fashion is open to question. In its drive to be an efficient institution that is unencumbered by what are considered to be time-consuming processes, the AIIB's tendency has clearly been to keep Board involvement at a distance and concentrate decision-making in the Bank's top management, namely the President of the Bank.

The AIIB's early decision to be governed by a non-resident board presaged trends we are witnessing now. In a later section we will examine the AIIB's «Accountability Framework,» which effectively delegates decision-making power on the financing of projects to the Bank's President in a way that is meant to increase over time. The trend is for the role of the Board to be limited to broad strategic considerations. Strategies, however, are often about lofty goals designed to satisfy a variety of interests. An example is the AIIB's Energy Strategy of 2017, which emphasizes the need to combat climate change, but does not exclude the financing of coal and other fossil-fuel projects.

## **The AIIB and China's Belt and Road Initiative**

Three years before the AIIB first became operational in January 2016, China announced its plans for a new Silk Road, which commonly is referred to as the Belt and Road Initiative (BRI). In 2013, China's President Xi Jinping first laid out his country's grand vision to build massive infrastructure linking China with Central Asia, West Asia, the Middle East and Europe, as well as a maritime Silk Road bringing together Southeast Asia, the Indian Ocean, Oceania and parts of Africa.

The plan is to invest US\$ 1 trillion or more in vast grids of highways, railways, ports, oil pipelines, energy and extractive industry projects.<sup>6</sup> Yet BRI to date does not have an overarching master plan. It appears to be more like a broad directive issued by the central government meant to be translated into concrete investments as economic and political opportunities arise. BRI's geographical scope is constantly expanding, covering as many as 70 countries to date that account for 65 % of the world's population.<sup>7</sup>

China has marketed its initiative as a platform for international cooperation. There is no question that building infrastructure that is sustainable and addresses the needs and priorities of local populations in participating countries contributes to social development and overall greater well-being. However, a number of conditions need to be fulfilled if environmental sustainability and social goals are to be met. Among them are full transparency, a free press and public debate. To date there are no indications that BRI is moving in this direction.

Policy-makers in Washington and Brussels are increasingly concerned that BRI will serve to extend China's geopolitical and economic reach on a global scale, while securing natural resources that China needs and simultaneously exporting its vast over-capacity in infrastructure construction. Western governments are now struggling to articulate their own investment strategies to contain China's influence abroad.

Critics note that BRI projects are engaged in so-called debt-trap diplomacy, which means that China is leveraging its loans to exert political influence wherever it is able to reach. In the process, it would fuel corruption and autocratic rule. Furthermore, Chinese money comes with conditions. Borrowers are required to use Chinese companies and technologies to build their projects. Some potential borrowers are concerned that BRI projects may neither be viable nor necessary, except for China.

China's financing of Sri Lanka's Hambantota Port is a case in point. Although the project was initiated before BRI was officially launched, China has claimed it to be a milestone along the Belt and Road. Construction of the port generated so much debt that Sri Lanka was forced to hand over the port and its surrounding land to China for a period of 99 years, turning into it into a valuable geostrategic asset just a few hundred miles from the shores of India.<sup>8</sup>

While BRI has captured the headlines, much less public attention has been paid to the AIIB. What then is the relationship between the two? The AIIB's discourse on this subject has shifted over time. In its early phase, senior AIIB officials emphasized that while there might be some coincidental overlap between the two since both are investing in infrastructure, the AIIB was really something entirely

<sup>6</sup> See, for example, Kuo, L. and Kommenda, N., «What is China's Belt and Road Initiative?», *The Guardian*, 30 July 2018.

<sup>7</sup> See, for example, Mercator Institute for China Studies, «Mapping the Belt and Road Initiative: This is where we stand,» 7 June 2018.

<sup>8</sup> For a detailed investigative report on Hambantota, see New York Times, «Paying China with Territory,» 28 June 2018. [www.nytimes.com/2018/06/25/world/asia/china-sri-lanka-port.html](http://www.nytimes.com/2018/06/25/world/asia/china-sri-lanka-port.html)

separate. They made a point of stressing that the AIIB was not a Chinese, but rather a multilateral entity, and that it distinguished itself by applying the highest, world-class standards.

More recently, however, the tone has changed. Following the AIIB's consolidation with the rapid growth in the number of countries joining the institution and the attainment of the coveted Triple-A credit rating from the world's leading credit rating agencies, the AIIB is characterizing its relationship to BRI differently. AIIB President Jin Liqun made the point that both China and the AIIB had very high standards, therefore it was natural for them to cooperate. In an interview with China Daily on AIIB investments in Africa, President Jin referred to the partnership between AIIB and BRI. Previously he had described AIIB and BRI as being two engines of an aircraft, both of which are needed for it to fly smoothly and high.<sup>9</sup> Observers expect the AIIB to contribute to the financing of BRI projects.<sup>10</sup>

What seems clear, however, is that the establishment of the AIIB has potentially created a screen of multilateralism for BRI-related investments. Now a large number of governments, all with seemingly significant roles in the governance of the AIIB, will be involved in infrastructure financing schemes they might otherwise have been reluctant to support. This adds further weight to the need for robust prior screening and supervision of AIIB investments on the part of shareholder governments. However, as the following section shows, the trend is moving toward decision-making at the top level of the Bank, with a more limited role for the Bank's Board of Directors. This abdication of power is presented as the efficiency of a truly modern bank for the 21st century.

### **The Misnamed «Accountability Framework»**

The AIIB's Accountability Framework formalizes the delegation of decision-making power on project financing from the Board of Directors to the AIIB's President. It took effect in January 2019 and initially only applies under certain conditions, which are listed below under the initial exemptions.<sup>11</sup> Words do matter, however, and the term «Accountability Framework» lends itself to sowing a confusing message. At the other multilateral development banks, such as the World Bank Group and the Asian Development Bank, the institutional term «accountability» is linked to «Accountability Mechanisms,» which are independent entities within the institutions. These entities are charged with investigating complaints about lack of compliance with environmental and social policies and with facilitating mediation in situations of conflict. Independent Accountability Mechanisms have become

<sup>9</sup> China Daily, 7 September 2018 [www.chinadaily.com.cn/a/201809/07/WS5b91e867a31033b-4f4654cd3.html](http://www.chinadaily.com.cn/a/201809/07/WS5b91e867a31033b-4f4654cd3.html)

<sup>10</sup> Rowley, A., «The new «Great Game» in infrastructure lacks a game plan,» South China Morning Post, 12 October 2019.

<sup>11</sup> AIIB, Accountability Framework, [www.aiib.org/en/about-aiib/governance/accountability-framework/index.html](http://www.aiib.org/en/about-aiib/governance/accountability-framework/index.html) (accessed 30 October 2018).

an important governance pillar at many multilateral entities ever since the World Bank first established its Inspection Panel more than 25 years ago.

The AIIB's Accountability Framework uses the term «accountability» in a very different sense: It sets out the conditions under which the President can approve financing for projects without involving the Board of Directors. Although it contains exceptions, reporting requirements and a review of its functioning, the Accountability Framework represents a radical departure from the established procedures at multilateral development banks where the role of the Board includes a detailed review of loan proposals, including environmental assessments and plans for involuntary resettlement, and the final decision on whether a project is to be financed or not.

In the AIIB's own words, the Accountability Framework «[...] provides the AIIB with a new model of governance [...]».<sup>12</sup> The overriding goal of this new model is to serve the Bank's clients effectively and efficiently by having the President decide on the financing of projects up to a certain threshold which is set to grow over time.

There are exemptions from this delegation of decision-making. The first project in a given country, the first project in a given sector and projects in non-regional member countries are still to be decided by the Board. Other than that, the President will decide on projects with initial limits of up to US\$ 200 million for the public sector, US\$ 100 million for the private sector and US\$ 35 million for equity investments. Both the amounts of lending and the proportion of projects proposed for approval by the President are set to increase over time.

The Accountability Framework seeks to establish a clear line of demarcation between the responsibilities of the Board of Directors and the AIIB President. While the President is responsible for operations, i.e. decisions on projects, the Board is meant to be responsible for overall strategic direction (paragraph 6).

This division of responsibility is highly problematic. A focus on overall direction and on strategies is overly broad and non-specific. Strategies are meant to contain something for everyone. The AIIB's Energy Strategy is a case in point: It supports the Paris Climate Agreement and the U.N. goals of Energy for All, as well as financing for fossil-fuel projects, including coal, and the building of large hydro-power dams.

More importantly, this division of responsibility undermines the chain of accountability that is a hallmark of democratic systems. Board members are accountable to their constituent governments, which are shareholders of the AIIB. Shareholder governments in turn are responsible to their citizens for ensuring that the use of public funds upholds environmental, social and human rights standards. Via these linkages, the project approval process by the Board of Directors creates the political space for civil society and potentially affected communities to voice their concerns to their representatives and thereby help ensure that decisions are well-informed and take account of potential harm. This political space is critically important given that investments in large-scale infrastructure are by their very

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<sup>12</sup> AIIB, Paper on the Accountability Framework (no date), p. 1, paragraph 3.

nature high risk in terms of the environment, impacts on communities and societies at large.

The AIIB's Board of Directors adopted the Accountability Framework in April 2018 in the absence of clear rules of public access to information on projects. Even the level of detail of information provided to the Board is not clear. The Accountability Framework states that the Board will have «[...] visibility of essential project information throughout the entire project cycle» (paragraph 22). Prior to a financing decision, the Board will have access to a revolving two-year pipeline of proposed projects, which is limited to basic information such as listing the name, sector, country and amount of the proposed loan. At a later stage, the Board will be provided with a final Project Summary Document (PSD). The question is whether a brief summary is adequate to reflect on the high risks associated with large infrastructure projects, including far-reaching environmental and social impacts. According to European Board members, it is highly unlikely that the two-year project pipeline and Project Summary Document will be made publicly available.

When the Board of Directors adopted the Accountability Framework, it appears to have been swayed by the AIIB's efficiency arguments. The AIIB seeks to be more «modern» than traditional multilateral development banks by being more efficient in responding to the needs of its public-sector and corporate clients. This translates into a more rapid approval of loans. But efficiency cannot be an end in itself and is likely to be in conflict with overarching transparency objectives and supervision.

While the Accountability Framework also refers to the AIIB President being held responsible and accountable to the Board of Directors, it is unclear what this might amount to in practice.

It would be very problematic to ignore the underlying political realities in which the AIIB is embedded. The President of the Bank is nominated by the government of the People's Republic of China. Given the increasingly totalitarian tendencies and the demands of absolute loyalty to the top of the Chinese leadership, the AIIB President cannot but be expected to fulfill his role in strict accordance with his government's geopolitical and economic strategies.

The far-flung non-resident Board will scarcely be in a position to function as a countervailing force and is unlikely to provide the necessary checks and balances. Many regional and non-regional Board members are keen on AIIB investments and the economies they represent are to varying degrees dependent on Chinese investment or access to Chinese markets. They will hardly be inclined to ask tough questions.

European governments point out that they were able to establish the so-called «One-Director Rule» in the Accountability Framework. According to this rule, a single Director can request that a project be discussed by the Board. This rule is being touted as an achievement. Under normal circumstances, however, discussing project proposals would be a routine part of a Board meeting its supervision functions.

In practical terms, it is unclear what this rule will amount to. It is predictable that most Directors will side with China's position. Their main interest is likely to be the fast and frictionless approval of financing for projects, while critical issues

related to transparency and environmental and social sustainability are largely viewed as time-consuming obstacles.

## **Public Access to Information: Principles versus Specific Requirements**

The public availability of information on projects proposed for financing by the AIIB is fundamental to public participation and to avoiding or mitigating potentially irreversible environmental impacts and social disruption. Operational transparency is also critical to combatting corruption, which is all too often associated with large-scale infrastructure investments. More broadly, transparency is the very foundation of higher quality investment and development results.

In September 2018 the AIIB adopted its much-anticipated Policy on Public Information (PPI).<sup>13</sup> The PPI's importance can hardly be overstated. It is a foundational document for AIIB governance, since so much else flows from there. For example, the implementation of the AIIB's Environmental and Social Framework and the functioning of the Project-Affected People's Mechanism depend on public access to specific project documents within given time frames.

In the press release accompanying publication of the PPI, AIIB President Jin Lique emphasizes that «Transparency and accountability are the two main pillars of AIIB's governance [...]».<sup>14</sup> But while the PPI contains many of the key buzzwords, it does not ensure that the public has access to project documents at points in time when adjustments and corrections are still feasible.

While the PPI's intention of providing for maximum disclosure and transparency is certainly laudable (paragraph 4.2), implementation of the policy is conditioned by considerations of operational efficiency and financial resources (paragraph 4.3). Obviously, efficiency and the best use of financial resources are important considerations of all publicly funded institutions. But efficiency is not a goal in itself and cannot be allowed to serve as an incentive to limit public access to information.

The PPI is a «principles-based» as opposed to a «list-based» policy. This means that it is focused on overarching principles and on listing exceptions of where the principles do not apply. The PPI does not include a list of specific documents to be disclosed and the timing of their disclosure, as is, for example, the case with the World Bank's Policy on Public Access to Information.

Principles are certainly important, but by themselves they are insufficient. What lends substance to a policy on information disclosure are precise rules on the public release of specific project documents, including the time frames of when documents are made publicly available during the project cycle.

The PPI's Principle No. 1, «Presumption in Favor of Disclosure,» is certainly very welcome. But NGOs have already been made aware through communication with eurozone government representatives that its applicability will be limited.

<sup>13</sup> [www.aiib.org/en/policies-strategies/public-information/policy/index.html](http://www.aiib.org/en/policies-strategies/public-information/policy/index.html)

<sup>14</sup> AIIB Press Release, «AIIB Modernizes its Policy to Increase Transparency,» 11 October 2018.

For example, the AIIB will not publish the Pipeline of Proposed Projects, Project Summary Documents or Quarterly Monitoring Reports. These documents will only be provided to the Board, although their public release would be in the interest of an informed dialogue between all stakeholders.

The policy falls far short of what both some shareholder governments and civil society had called for. For example, the eurozone constituency at the AIIB had called on the PPI to include clearly spelled out time frames for the public release of project information in order to make active stakeholder participation possible.<sup>15</sup>

Active participation by civil society organizations, including potentially affected communities, requires the public release of information prior to when decisions on financing are taken. Among the documents of greatest importance are:

- environmental impact assessments, including a detailed analysis of gender impacts
- resettlement plans in cases of involuntary and voluntary displacement
- documentation on public consultations
- assessments of equivalency when the standards of government or corporate clients replace AIIB standards
- documentation on lending to financial intermediaries (FIs), such as private banks and equity funds, when AIIB funding may be used to indirectly support high-risk projects
- implementation monitoring reports, especially concerning the implementation of measures to protect the environment and communities.

The PPI sidesteps rules on the public release of such critically important information by stating that requirements on provision of information to project-affected people, other stakeholders and the general public are already being dealt with in two paragraphs in the Environmental and Social Framework (ESF), which was published in February 2016.

Indeed, the ESF's paragraphs 57 and 58 refer to information disclosure requirements by the client and by the AIIB respectively. While they again contain the right wording, they do not include specific time-bound requirements for the public release of documents such as environmental impact assessments. They call for the «timely» release of documents, and in the case of sovereign-backed loans specify that this ought to occur prior to appraisal, while for other loans (i.e. loans to the private sector) this should occur as early as possible during appraisal.<sup>16</sup>

This contrasts sharply with international best practice at other multilateral banks, such as the Asian Development Bank and the World Bank. At these institutions and their regional sister organizations, the required practice is that environmental impact assessments be released 120 days prior to a Board decision in the

<sup>15</sup> German Federal Ministry of Finance, letter addressed to the Finance Committee of the German Parliament, 24 January 2017.

<sup>16</sup> AIIB, Environmental and Social Framework, paragraphs 57 and 58, February 2016.



case of public-sector loans. In the case of private-sector loans, the World Bank's private-sector branch, the International Finance Corporation, requires that documentation on environmental and social information for high-risk projects be released no later than 60 days, and for projects with lesser risks, 30 days in advance.<sup>17</sup> The AIIB's focus on large-scale infrastructure means that most of its projects will have high environmental and social risks. High-risk projects require these time frames in order to provide a basis for informed dialogue between all stakeholders, especially the affected communities, which often have limited access to information technology and live in remote areas.

Another important component of the PPI is a list of exceptions. While exceptions to information disclosure are entirely legitimate, these need to be clearly defined. Among the exceptions is information that could compromise the Bank's creditworthiness or access to capital markets at prices the Bank deems reasonable (Exception 5). In its submission on the draft PPI, which contained the same exception, the Office of the United Nations High Commissioner for Human Rights described this provision as seeming to be «particularly subjective and amenable to misunderstanding or misuse and contrary to the Bank's transparency objectives.»<sup>18</sup>

Similarly, the PPI's exception for information that would compromise the international character of the Bank is inconsistent with the Bank's duty of due respect to national laws and regulations (Exception 6) and leaves plenty of room for ambiguity. The international character of the Bank and its obligation not to interfere in the internal affairs of its member countries is clearly laid out in the AIIB's Articles of Agreement.<sup>19</sup> There is no need to repeat it here. Moreover, referring to due regard for national laws and regulations in the PPI opens the possibility that public information on AIIB loans and project impacts could be withheld entirely if a given government deems such information to be sensitive.

The PPI does include the possibility of appeal when the disclosure of information has been denied (paragraph 10). Such an appeal would have to be addressed to the Managing Director of the AIIB's Complaints-Resolution, Effectiveness and Integrity Unit (CEIU). The CEIU has multiple mandates, which include the monitoring and evaluation of AIIB operations, as well as managing the AIIB's Project-Affected People's Mechanism (PPM). There are numerous built-in conflicts of interest in this accumulation of tasks that are handled separately by other multilateral banks. The CEIU can hardly be expected to independently assess an appeal as its findings might be at odds with its own monitoring and evaluation results.

<sup>17</sup> International Finance Corporation, Access to Information Policy, 1 January 2012. The policy also indicates that exceptions are only possible under very limited circumstances and that the Board of Directors would have to be informed about any delay. [www.ifc.org/wps/wcm/connect/98d8ae004997936f9b7bffb2b4b33c15/IFCPolicyDisclosureInformation.pdf?MOD=AJPERES](http://www.ifc.org/wps/wcm/connect/98d8ae004997936f9b7bffb2b4b33c15/IFCPolicyDisclosureInformation.pdf?MOD=AJPERES) (accessed 8 November 2018).

<sup>18</sup> Office of the United Nations High Commissioner for Human Rights, Recommendations for AIIB Policy on Public Information, Submission 1, 16 March 2018, paragraph 32.

<sup>19</sup> AIIB, Articles of Agreement, Article 31 (The International Character of the Bank).



Furthermore, the CEIU would be limited to making a recommendation to the AIIB's President, who would then decide on how and in which time frame to respond.

Overall, the AIIB President is vested with considerable decision-making power. In the case of external requests for information, he determines the timetable (paragraph 7.2), decides whether exceptions can be overruled (paragraph 9.1.1) and makes recommendations to the Board concerning non-disclosure of information that under the policy would be disclosed (paragraph 9.1.2). He can adopt an internal classification system for information which is meant to be consistent with the policy (paragraph 11), ensure observance of the policy and assign Bank resources for its implementation (paragraph 13.1).

## **The Environmental and Social Framework**

Building large-scale infrastructure such as major pipeline, road, rail, port, coal and hydropower projects, by definition carries high environmental and social risks. In addition to the direct impacts, the unintended consequences of infrastructure finance all too often create a space where abuse and social injustice flourish and where environmental resources are irreversibly damaged. New transport projects open up wild and remote regions to a host of uncontrolled environmental pressures, including deforestation, illegal mining and land grabs. Forced displacement and loss of livelihoods are often the result of land acquisition required by infrastructure projects.

The AIIB adopted its Environmental and Social Framework (ESF) shortly after it opened for business in 2016. The ESF was a key element in portraying the AIIB as being on a par with other multilateral banks and helped preempt criticism that a Chinese-led bank would ride roughshod over the environmental and social impacts of its investments. Non-regional shareholders were convinced that the ESF would protect the AIIB from reputational risk.

The AIIB hired a consultant who had recently retired from the World Bank after many years of experience of environmental and social safeguards. The consultant had led the early phases of the review of the World Bank's Safeguard system, which led to the adoption of a new system of environmental and social standards at the World Bank which became effective in October 2018. This review was very much shaped by the competition of growing Chinese investment and designed to lend the World Bank greater flexibility in dealing with environmental and social impacts as a way of attracting more investment opportunities.

Largely based on the language of early drafts of the World Bank's Safeguards review, the consultant created a more condensed version, which became the Environmental and Social Framework (ESF) adopted by the AIIB in February 2016. The ESF contains all the right language, which seems to be specifically tailored to addressing the sensitivities of Western governments. It covers a whole range of key issues from the need to protect the climate and biodiversity, to labor rights, public participation in resettlement operations and having indigenous peoples share



Peoples' Convention on Infrastructure Financing during the AIIB Annual Meeting, June 2018, Mumbai

in project benefits. It also includes the AIIB's approach to addressing the gender impacts of its lending.

The consultant described the ESF as «aspirational.»<sup>20</sup> This seems to be a correct description, although the ESF itself claims that its Environmental and Social Policy and Standards represent mandatory requirements. A close reading of the ESF shows that there is plenty of latitude to handle «mandatory» requirements in a rather flexible manner. Projects at the time of their approval are not required to meet specific standards, since important aspects of a project may not be known at this stage. Deferring adherence to standards lessens up-front preparatory work and adds to «efficiency» by speeding up loan approval. It also carries significant risks of overestimating project benefits, while ignoring environmental and social costs. With financing approved and construction fully underway, a project sponsor will have few incentives to address emerging environmental and social risks, especially since this may be time-consuming and costly.

Scientists from numerous countries who have monitored large-scale infrastructure development, especially in the context of the Belt and Road Initiative, have referred to the ESF as a framework that is «[...] overly vague and toothless. As scientists, we have witnessed far too many infrastructure calamities across the planet to accept such platitudes at face value.»<sup>21</sup>

While some of the characteristics of the ESF are similar to the environmental and social systems at other banks, there is an underlying fundamental difference: The AIIB has no independent investigation and evaluation units to help correct course when need be. Given the repression of civil society voices in China, public protests and independent media investigations will also be extremely limited. The public pressure faced by Western-dominated banks to adopt reforms will largely be absent in the AIIB's home country.

#### *Outsourcing of Environmental and Social Management*

The ESF also foresees the outsourcing of environmental and social standards. It may be replaced by the environmental and social management systems of the AIIB's public sector or corporate clients as long these systems are deemed to be materially consistent with the objectives of the ESF. This is known as «the use of country and corporate systems.» While using the client's system could rightly strengthen local capabilities and systems, there is no indication of how consistency with the ESF would be established. In the case where there are gaps in the client's system, the AIIB is meant to identify actions that need to be undertaken in consultation with the client. Again it is open to question how such gap-filling measures would be evaluated.

Another form of outsourcing occurs by lending to financial intermediaries (FIs), such as commercial banks and private equity funds. In FI loans, the AIIB delegates

<sup>20</sup> Notes by the author, statement by the consultant during a meeting with civil society organizations during the AIIB's Annual Meeting in Mumbai, 25 June 2018.

<sup>21</sup> Laurance, W., «Why Scientists Fear the AIIB,» China Dialogue, 12 July 2018.

the decision-making on the use of the funds provided by the AIIB to the borrower. The client is also in charge of all due diligence relating to environmental and social risks and the monitoring of the performance, all of which is meant to occur in a manner that is consistent with the ESF.

Other lenders, such as the International Finance Corporation (IFC), the private-sector branch of the World Bank Group, have recently committed to introducing major reforms in their lending to FIs.<sup>22</sup> The IFC's Compliance Advisor Ombudsman (CAO) had carried out several extensive investigations and concluded that the IFC knew very little about how FIs were using the funds it provided. There was also increasing evidence that lending to FIs had been used to circumvent environmental and social standards. In response the IFC has committed to improved oversight with more staff, greater selectivity and transparency in the way FI funds are used.

The problem is that the AIIB has no comparable body to the CAO and therefore independent findings that can lead to corrective action will be difficult to obtain.

#### *Lack of Time-Bound Public Information Disclosure Requirements*

In the previous section we already saw that the AIIB's Public Information Policy defers to the ESF when it comes to disclosing project documents to affected people and the public. While the ESF includes two paragraphs on information disclosure, it does not list specific time frames for the release of such information. Stating that documents should be released before appraisal, or as early as possible during appraisal or in a timely manner does not ensure adequate time frames for informed and meaningful public participation.

The ESF admits that the AIIB itself may have different levels of information regarding environmental and social risks. In the absence of full information on risks, it can simply extrapolate from the risks and impacts of similar projects elsewhere and submit this information when the decision on financing a project is taken.<sup>23</sup>

Furthermore, the ESF includes a «phased approach» for special circumstances. Under this approach the client can undertake its environmental and social assessment after a project already has been approved for financing.<sup>24</sup>

All of these loopholes add up to a situation where the emphasis is once again on «efficiency» and speeding up loan approvals to the detriment of public access to information and participation.

<sup>22</sup> See, for example, article by the IFC's Managing Director Philippe Le Houérou, [www.devex.com/news/opinion-here-s-how-the-ifc-is-working-with-financial-institutions-91223](http://www.devex.com/news/opinion-here-s-how-the-ifc-is-working-with-financial-institutions-91223) (accessed 25 November 2018).

<sup>23</sup> AIIB, Environmental and Social Framework, paragraph 19, p. 12.

<sup>24</sup> Ibid., paragraph 50, p. 18.

## A Test Case for Information Disclosure: Beijing Gas

In December 2017 the AIIB approved a US\$ 250 million loan to Beijing Gas, a private sector company. The project's goal is to improve air quality in Beijing by replacing coal with natural gas in rural areas surrounding the city. Since there are no co-financing banks, it is one of the few free-standing AIIB projects to date. This means that the ESF and the information disclosure requirements of its Public Interim Information Policy, which was then in effect, are applicable. These include the requirement to publish reports on consultations held with affected communities.

As a project right on the doorsteps of AIIB headquarters in Beijing, it could be assumed that detailed information would be relatively easy to obtain. This has not turned out to be the case. Although the AIIB published the Environmental and Social Management Plan (ESMP) of the project on its website, it omits crucial information, notably the list and location of the 510 affected villages and a map of its construction, including its associated facilities.<sup>25</sup>

The ESMP includes pictures of meetings with villagers as evidence of public consultations. Most of the pictures do not name the villages and seem to refer to meetings on general gas safety. Picture 6.3 supposedly shows the minutes of such a meeting. However, the minutes refer to a discussion of expenditure for the last quarters of 2016 and it is unclear how they relate to the project.

There are no transcripts of any concerns raised by the villagers about the design and operation of the project. There are also no indications about the affordability of the gas for the more than 200,000 mainly poor households that are affected. For many, it may simply mean that access to energy for heating and cooking will be beyond reach.

Both government shareholders and civil society organizations have requested information on the location of the villages from the AIIB. This information has not been provided with the argument that Beijing Gas has adhered to the ESF and that as a private-sector company it is not required to release more detailed information.<sup>26</sup>

25 [www.aiib.org/en/projects/approved/2017/\\_download/beijing/environment-social-management-plan.pdf](http://www.aiib.org/en/projects/approved/2017/_download/beijing/environment-social-management-plan.pdf) (accessed 25 November 2018).

26 Notes by the author, meetings of eurozone constituency governments with NGOs on 1 June 2018 (Berlin) and 18 September 2018 (Vienna). For an exchange between NGOs and the AIIB, see Green Watershed, China, CEE Bankwatch, Europe and Eurasia, NGO Forum on the ADB, Philippines, «Concerns Relating to AIIB Standalone Beijing Air Quality Improvement Project,» summer 2018.

### *Biodiversity*

Biodiversity is increasingly threatened by the expansion of ill-conceived infrastructure construction. Roads through forests fragment habitat and may cut off the migratory routes of endangered species. Dams may divert fresh water from habitats already struggling with drought. While the ESF recognizes the need to avoid negative impacts on biodiversity, its provisions are riddled with loopholes which open the door to adverse impacts on even the most important natural habitats. An example is its approach to «critical habitats,» which are defined as areas that are home to significant biodiversity, including critically endangered and endemic species and threatened and unique ecosystems. The ESF states that activities in critical habitats are forbidden unless there are no predictable measurable impacts, such as the reduction of critically endangered species, or unless the impacts can be mitigated.<sup>27</sup> Obviously, project sponsors will claim that impacts can be mitigated, even if there is no track record or scientific evidence that mitigation can be achieved. The ESF provisions on critical habitats, as well as protected areas, open the door to the loss of effectively irreplaceable biodiversity.

### *Indigenous Peoples*

The ESF again includes all the right catchwords on respecting the identity of indigenous peoples and their participation in projects that affect them. But it allows for «Indigenous Peoples Framework Planning» where the financing of projects likely to involve indigenous peoples is approved without plans on how they might be protected from harm.<sup>28</sup>

### *Involuntary Resettlement*

This standard also allows projects likely to involve involuntary resettlement to be approved without identifying the extent and details of forced evictions.<sup>29</sup>

Experience of projects involving indigenous peoples and involuntary resettlement shows that plans to protect them or ensure their fair treatment need to be part of upstream project preparation. The costs of implementing the plans must be an integral part of a project's budget. There is little evidence that measures to protect people from harm can be taken once the building of infrastructure is underway. Construction activities are likely to advance, while a project's soft components meant to protect vulnerable people from harm are a mere afterthought if not entirely forgotten.

### *Labor Rights*

The ESF lays out how the AIIB believes in the important role played by workers and lists a series of desirable measures to ensure safe working conditions and fair treatment. However, when it comes to respecting workers' rights to free assembly

<sup>27</sup> AIIB, Environmental and Social Framework, p. 32.

<sup>28</sup> Ibid. p. 43.

<sup>29</sup> Ibid. p. 39.



and collective bargaining, the ESF limits itself to requiring that its private-sector clients comply with national laws.<sup>30</sup>

Needless to say, even where such laws exist on paper, they often are not enforced. Given the severe restrictions on labor by the Chinese government, a Beijing-led Bank can hardly be expected to promote the rights of workers.

### *Gender*

In many countries, women are generally responsible for the well-being of their families. Infrastructure that would help bring water into the home, create access to sustainable and affordable sources of energy and make it easier for children to get to school and for sick people to get to a clinic would all improve women's lives, and by extension, their entire communities.

But this kind of infrastructure is usually not associated with the connectivity, transboundary transport and energy infrastructure of large-scale investments. This type of investment has by definition major environmental impacts on communities and women's domestic roles mean that they are particularly affected. Infrastructure usually means conversion of land for new uses. This can mean losing land necessary for subsistence farming, which is often in the hands of women, cutting them off from access to vegetable gardens, to fresh water and firewood. When there is compensation to affected households, it usually goes to the male head of household, which can leave women and their children deprived of their traditional means of sustaining themselves and render them utterly defenseless.

Among particular risks to women and girls are sexual assault, harassment and abuse by the workers who come into a region to build the infrastructure, such as rural transport and other construction. Furthermore, growing poverty and the lack of alternatives leaves women and girls very vulnerable to sexual exploitation. The spread of sexually transmitted diseases along major transport corridors is well documented.

Then there is a whole, largely invisible side to the impacts of infrastructure that also needs to receive attention. For example, building a rural road may lead the men to migrate away from their villages, while women stay behind because their ability to work outside their community is strictly limited and they have no permission to move.

The ESF includes several paragraphs addressing gender. It recognizes the importance of gender equality and requests that its clients identify opportunities and risks for women in AIIB-supported projects. Clients are also asked to enhance project design in order to promote women's socio-economic empowerment.<sup>31</sup>

The AIIB has hired a consultant specialized in gender and social issues. When asked about how the AIIB is implementing gender considerations, the consultant responded that the AIIB has only 200 staff, which would make it more efficient to

<sup>30</sup> Ibid. pp. 4–5 and 36.

<sup>31</sup> AIIB, Environmental and Social Framework, pp. 4 and 34.

partner with others in this area. She added that the AIIB will listen and learn from women stakeholders.<sup>32</sup>

However, well-meaning words are insufficient. Given the risks faced by women in infrastructure projects, gender must be addressed in more than a token way.

### *ESF Review*

According to the ESF, the policy is up for a review after three years of implementation, which would be in 2019. However, it is unclear if or when such a review is to take place. Furthermore, no commitment has been made by the AIIB to include meaningful public participation in the ESF review.

## **The Project-Affected People's Mechanism: A Bureaucratic Obstacle Course**

In 1993 the World Bank was the first multilateral bank to establish an independent accountability mechanism (IAM), the Inspection Panel. The idea of creating an IAM arose out of public pressure surrounding the failure of large-scale investments, such as the Sardar Sarovar dams in India, to properly consider their impacts on local communities.

The fundamental mission of an IAM is to bring the voices of people who suffer or may suffer harm as a result of projects supported by financial institutions to the highest levels of their governance structures. This creates the political space for addressing the concerns raised by affected people through improving or redesigning projects. IAMs also help change the culture of financial institutions from being single-mindedly focused on making loans to paying attention to environmental and social issues, including public participation and consultations. IAMs can render financial institutions more attuned to the priorities and needs of populations who ultimately are meant to be the beneficiaries of development and infrastructure financing.

Over the past 25 years, the establishment of IAMs has become a common practice at multilateral, and also increasingly at bilateral, financial institutions. Today there are 18 IAMs, which are gathered in a network that meets annually.

In order to meet international best practice, the AIIB established its own accountability mechanism. After three years of preparations and observing the IAM annual meetings, the AIIB adopted its own «Project-Affected People's Mechanism» (PPM) in December 2018.<sup>33</sup> The PPM is to be effective as of 31 March 2019.

Although there are considerable differences among IAMs, the PPM stands out as a mechanism that is particularly difficult and burdensome for affected communities to access. If we consider the World Bank's Inspection Panel and its

<sup>32</sup> Notes by the author, AIIB's gender expert statement at the «Infrastructure and Gender» workshop at the AIIB's Annual Meeting in Mumbai, 25 June 2018.

<sup>33</sup> AIIB, Policy on the Project-Affected People's Mechanism, 7 December 2018, published on 24 December 2018.



counterpart for private-sector lending, the Compliance Advisor Ombudsman (CAO) of the IFC, as prototypes, the PPM falls far short of what is considered to be best international practice. Unlike other IAMs, the PPM policy represents an unnecessarily complex obstacle course for affected communities apparently designed to deter them from submitting complaints to the PPM, especially when it comes to requesting a compliance review.

### *Conflict of Interest*

The PPM resides within what used to be called the Compliance, Evaluation and Integrity Unit. Since the term «compliance» apparently is deemed to be too controversial, the unit was renamed Complaints-Resolution, Evaluation and Integrity Unit (CEIU) in December 2018. The CEIU's mandate includes multiple functions that are handled by separate departments at other multilateral banks. The evaluation and monitoring of projects are among its functions. There is a built-in conflict of interest, since the PPM can hardly be expected to independently investigate complaints by affected people, as this might lead to findings that are at odds with the CEIU's own evaluation and monitoring results. The Director-General of the CEIU also directs the PPM and represents the PPM in all matters before the AIIB's Board of Directors and its President.

### *The Role of Information Disclosure*

An effective IAM requires clear rules on the time frames for public release of project documentation, such as environmental impact assessments. As we have seen in a previous section, the AIIB's Public Information Policy lacks such rules. Instead it refers to the AIIB's Environmental and Social Framework (ESF) as the policy that deals with making information publicly available. However, the ESF includes no time-bound requirements for the public release of information. As a result, affected communities may not even be aware of projects and the AIIB's role in supporting them in the early stages of project preparations when voicing their concerns to the PPM could still lead to corrective measures, such as modifications to the design of the project to avoid or at least mitigate potential harm.

### *Preconditions for Submitting a Complaint*

The PPM requires affected communities to undertake two prior initiatives before being allowed to make a submission. First they have to try to resolve their problems with a project-level Grievance Redress Mechanism (GRM). Obviously, affected communities want to see any potential harm addressed as soon as possible and if the AIIB's borrower, a government or a corporation, establishes an effective GRM this can only be welcomed. But there is no track record of the effectiveness of project-level GRMs that are managed by the very entities that are responsible for potential or actual harm. An effective local GRM presupposes respect for local people's rights and a lack of fear of retaliation and reprisals. Project-level GRMs under conditions of often very limited political space for civil society are not a promising venue to address the significant environmental and social harm that local

communities face when their land and livelihoods are threatened by large-scale infrastructure development.

The next hurdle for affected people is that they will have to work with AIIB Management before being allowed to submit a complaint to the PPM. Finally, they will have to demonstrate to the PPM that they have made «good-faith efforts» to resolve their problems with the project-level GRM and AIIB Management and «indicate to the satisfaction of the PPM» why they have been unable to do so.<sup>34</sup>

#### *Exclusion of Complaints*

If substantive issues raised by a complaint to the PPM are also subject to arbitral or judicial proceedings in the borrowing country, the complaint will not be eligible for PPM consideration unless the AIIB's Board authorizes the complaint to be processed. Obviously, the PPM should not interfere in domestic arbitration or judicial proceedings. But by its very nature the mandate of the PPM is distinct from any such proceedings because it is strictly limited to considering issues that relate to the AIIB adhering to its own set of environmental and social policies. Domestic proceedings will relate to actions or omissions of government agencies or corporations, which are excluded from the PPM's mandate. People fearing or suffering harm that will profoundly affect their lives must have the right to access all available legal means to have their problems addressed. It is disturbing that having access to the PPM forecloses other possibilities of obtaining redress.

#### *Compliance Reviews – Difficult Recourse*

Once all these hurdles are taken, affected communities have three modalities by which to submit a complaint. The first is a so-called «Project Processing Query» for problems arising during project preparation. Second is «Dispute Resolution,» which requests the PPM to facilitate a dialogue between the different parties to address environmental and social impacts during project preparation and implementation. Third is a «Compliance Review,» a request to the PPM to investigate allegations that the AIIB has not complied with its own Environmental and Social Policy, thereby causing or being likely to cause harm. A Compliance Review may only be requested after a project has been approved. In cases where the Compliance Review confirms non-compliance, AIIB Management is supposed to prepare an action plan to address the potential or real harm.

The PPM inherently favors the first two modalities and they may in fact be the preferred course of action of affected communities who fear or suffer real harm. But Compliance Reviews are a hallmark of IAMs because they are meant to fulfill two essential functions: Obtain redress for affected people and facilitate institutional learning so that the same mistakes are not repeated. In addition, Compliance Reviews send a clear signal to Bank staff about the importance of adhering to environmental and social standards as opposed to simply bowing to institutional pressures to get loans approved quickly.

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<sup>34</sup> AIIB, Policy on the Project-Affected People's Mechanism, 7 December 2018, paragraph 5.1.8.

There are several serious setbacks to best international practice in the way the PPM approaches Compliance Reviews. The PPM forecloses the possibility of requesting a Compliance Review *prior* to project approval. Yet corrections and modifications to project design are most feasible before a decision to finance a project has been taken. Furthermore, once a project has been approved and affected people submit a request for a Compliance Review, the PPM still has the power to unilaterally decide on another course of action which is not further specified.<sup>35</sup> This contradicts good international practice which allows the requesters to decide on the course of action they prefer.

#### *Restriction of External Representation*

Given the capacity constraints and often difficult political atmosphere that local organizations have to navigate, it is not unusual for international organizations to assist local communities with their submissions to IAMs. However, in the case of the PPM, representation by organizations outside the country is only permissible in exceptional situations when in-country representation is not available. The decision on who may represent them should lie with the affected people themselves, but the PPM is silent on this point.

IAMs are meant to serve as channels of communication from affected people to the top of financial institutions. They are meant to be a valuable instrument in the hands of the Board of Directors of a bank to capture the human impact of its investments. But the way the PPM is set up severely limits the accessibility and effectiveness of the mechanism. If an IAM makes things too complicated, it simply eliminates the voices of the people it is meant to serve.

### **The Risk of Contagion and a Downward Spiral**

There is no lack of capital in the world to finance infrastructure. Real long-term interest rates are low and there is an ample supply of money in search of profitable investments. The problem is rather that it is difficult to find «bankable» projects, which are projects with a risk profile acceptable to investors. The challenge of identifying bankable projects is common to all multilateral banks. All of them seek to attract private capital to the projects they finance, which further adds to the pressure of finding investment opportunities where risks appear to be manageable.

The fact that the AIIB has signed memoranda of understanding with the leading multilateral banks, and has to date mainly participated in co-financing arrangements with other banks, should not obscure the fact that the banks are in intense competition with each other. The AIIB states clearly that its participation in co-financing arrangements serves to develop its operations and build its capacity, but that its goal over the medium and long term is to become a leading lender for stand-alone projects. In order to achieve this, it seeks to distinguish itself from

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<sup>35</sup> AIIB, Policy on the Project-Affected People's Mechanism, 7 December 2018, paragraph 6.8.2.

other lenders by offering products that are «implemented with flexibility» and that achieve an «efficient client experience.»<sup>36</sup>

Clear and mandatory rules are necessary in order to protect the environment and people from the degradation of ecosystems, fisheries and woodlands, erosion, adverse impacts on the availability and quality of fresh water and other often irreversible problems that are associated with the construction of large-scale infrastructure. The flexible approach and efficiency with which the AIIB seeks to promote its business are not easily reconcilable with such rules. As we have seen in the preceding sections, the AIIB's policies on transparency, the environment and the complaint mechanism use language tailored to please Western audiences. But a closer reading reveals that they lack substantive commitments and mandatory requirements. The absence of such requirements can only be meant to appeal to potential borrowers, who consider them as unduly onerous.

The risk is that in the competition for clients, other multilateral banks may seek to emulate the AIIB. Instead of working to ensure better implementation of existing institutional rules designed to promote environmental sustainability and good governance, they may gradually abandon them.

A first sign of this occurring is the World Bank's Environmental and Social Framework, which became effective in October 2018. Although much more detailed and comprehensive, it is no surprise that it is in many ways similar to the AIIB's ESF. This is not only because one of the main authors served both the World Bank and the AIIB. More important are two other factors: On the one hand, the establishment of the AIIB added to the already tough competition of «no strings attached» loans from Chinese banks. The fear is that requirements on issues such as the environment and good governance deter clients from seeking World Bank loans. On the other hand, the influence of China, India and other important borrowers within the World Bank should not be underestimated. While their formal voting shares are limited, given the insistence of the U.S. and Europe in not having their own voting shares diluted, their informal power as the World Bank's largest borrowers is significant: They successfully blocked efforts to include human rights due diligence and other measures meant to strengthen the World Bank's ESF. As a result, the World Bank's ESF reflects the perception that adhering to environmental and social standards is an obstacle to lending and that borrowers will go look for funding elsewhere if they feel burdened by procedural requirements.

But whatever the weaknesses of the World Bank's ESF, the institution has robust policies on information disclosure and its accountability mechanism. Both allow for corrective measures to be introduced early on. The AIIB does not have these. Also, the World Bank functions in a political context in which people can organize and engage in peaceful protests, express themselves freely in media outlets and work with legislators to advocate for reform. None of this is possible under the severe restrictions on freedom of assembly and free speech in China.

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36 AIIB, Strategy on Mobilizing Private Capital for Infrastructure, 9 February 2018.

The risk that the AIIB's approach will lead other multilateral banks to downgrade their own requirements is real. As they compete for investment and business opportunities, other banks may succumb to the pressure to reduce transparency and dilute environmental and social standards.

## How Did We Get Here?

Much hope is pinned on European participation in the AIIB as a means of ensuring that investments will be financially, environmentally and socially responsible. European members have a stated commitment to promoting high international standards and best practices at the Bank. Indeed, European participation has been critical to establishing the AIIB as a credible institution in the global financial architecture and on international capital markets.

In terms of influencing AIIB policies, Germany, as head of the eurozone constituency, has made important demands, but the response, so far as is publicly known, has been rather limited, consisting mainly of more buzzwords with little substantive change. The AIIB's Policy on Public Information is a case in point. The German Ministry of Finance laid out Germany's position on information disclosure in a letter to the German Parliament. It called on the AIIB to explicitly include time frames for the release of specific project documentation as a means of ensuring communication with all stakeholders and promoting civil society participation.<sup>37</sup> As we have seen in previous sections, the AIIB's PPI was adopted without including any such requirement. Nor does the Environmental and Social Framework to which it refers.

In meetings with civil society organizations, European government representatives now often state that «we can only push so far» and «we are only one voice on the AIIB's Board.»<sup>38</sup> There are clear signs of the limits to what European members are able to accomplish. Furthermore, it has not been helpful that the eurozone and the wider-Europe constituencies have not always spoken with the same voice. It is vital that both European constituencies form a like-minded group with other countries in order to work together to achieve higher standards of transparency and accountability. Theoretically, together they could block decisions that are not in line with international best practice.

The AIIB says it stands for transparency and accountability, although both are incompatible with China's own domestic order. Although led by Beijing, the AIIB cast itself as separate from the domestic realities of a dictatorship. But given the tight ideological grip and primacy of the Communist party, it is inconceivable that the AIIB would be a largely apolitical institution.

Despite all the evidence that Communist Party rule demands absolute loyalty to its goals at home and abroad, the Beijing-led AIIB has gained international recognition as a multilateral actor on a par with other institutions.

**37** Letter from the Parliamentary State Secretary to the Chair of the Finance Committee of the German Bundestag, 24 January 2017.

**38** Notes by the author, meeting of eurozone shareholders of the AIIB with European civil society, Vienna, 18 September 2018.

Among the factors that led to this successful image creation is that the AIIB uses the right words to appeal to international audiences, although these words are imbued with different meanings. These «right words» have been effectively communicated in highly strategic ways:

*The very capable and intelligent leadership of AIIB President Jin Liqun:* President Jin worked for many years at both the World Bank and at the Asian Development Bank before taking up his position at the helm of the AIIB. His experience and in-depth knowledge of the functioning of these institutions laid the ground work for designing the AIIB in a way that would superficially mirror existing multilateral banks, while creating a distinct institution more suited to Beijing's global agenda. His excellent communication skills have led him to be described as Beijing's chief «Barbarian handler,» meaning that he knows better than anyone how to talk to foreigners.<sup>39</sup>

*Strategic hiring for top AIIB positions:* Among the AIIB's five Vice Presidents are three Europeans:

- The Vice President and Corporate Secretary responsible for relations with the Board and other governance aspects is a UK national.
- The Vice President and Chief Financial Officer responsible for the design and implementation of the AIIB's financial strategies and policies is a French national.
- The Vice President for Policy and Strategy is a German national.

In addition to the skills these top-ranking officials bring to their positions, they were likely contracted to provide a measure of reassurance to their home countries and create smooth relationships with the AIIB's key European shareholders. Media reports have sometimes wrongly implied that these Vice Presidents represent their respective home countries, but they do not. The individuals in question are pursuing their own career interests. They have not been nominated by and do not have to answer to their home governments.

The AIIB's strategic hiring extends to its relationship with civil society: It appointed a former Greenpeace employee to become its Senior Stakeholder Relations Specialist. His tasks include dealing with nongovernmental organizations that – outside of China – can be very critical of the way the AIIB does business. Who better than someone coming from Greenpeace to take the wind out of their sails?

#### *Contracting a leading P.R. agency*

The AIIB has appointed one of the world's leading advertising agencies, Saatchi & Saatchi, to work on its communication strategy and turn the AIIB into a premium brand.<sup>40</sup> While no further details are publicly known about this contract, Saatchi & Saatchi advertises its work in China as creating world-changing brand experiences.

<sup>39</sup> Financial Times, «Barbarians, banks and BBC English,» 23–24 April 2016.

<sup>40</sup> Email from Flora Bell, M&C Saatchi World Services, to author, 18 July 2017.

The combination of these and other strategies has indeed helped the AIIB to apply «the right words» or «nice words» as in President Jin Liqun's probably unintended warning:

«If you induce countries to join with nice words, once they are on the boat and it is moored in the middle of the lake, what can they do? No lifejackets!»<sup>41</sup>

## A Reform Agenda

Now that European and other shareholders find themselves moored in the middle of the lake, there is much that needs to be done. The work must focus on both the AIIB and on reforms in the multilateral banks formally dominated by Western countries.

### *AIIB*

During its first three years when the AIIB was being built up, most of the AIIB-supported projects were co-financing operations where information disclosure and standards of the lead financing agency applied. Rightly or wrongly, this provided European shareholders with a modicum of assurance that someone else was responsible for these matters. But this will change with the AIIB increasingly seeking to distinguish itself from other banks and building up its own stand-alone portfolio.

Shareholder governments must create capacity to closely monitor the design and implementation of AIIB-supported projects. This requires staff, resources and expertise. An ex-ante assessment of potential environmental and social costs of proposed investments is critical to the avoidance of costly mistakes due to poorly conceived and corruption-ridden investments. They also must help create the political space for strong and independent voices in client countries, which provide a much-needed counterweight to the influence of vested interests. They have to ensure that there is transparency and accountability in large-scale infrastructure development. Everything else is short-sighted, since projects that do not meet these conditions are likely to be unsustainable.

This will not be easy, but the alternative is likely to be the bankrolling of autocrats, the degradation of the environment and social upheaval, while financing infrastructure that involves vital assets and strategic locations which China seeks to control. The end result would contribute to a redefinition of the international order in China's image, including the erosion of democratic norms everywhere.

When the AIIB invited European governments to join, it was not primarily interested in the amount of money that Europeans would bring to the table. What mattered was the international credibility and respectability that European

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<sup>41</sup> Asia Money, «Jin Liqun: China's Internationalist,» 5 April 2017.



governments lent the Beijing-led institution. These are assets that can be withdrawn and therein lie the leverage of European and other like-minded shareholders.

Governments may be afraid to stand up to the AIIB because China might react angrily by cutting access to Chinese markets and other retaliation. But there is no room for complacency if the rule of law and human rights are still to have meaning in the future.

#### *Other multilateral banks*

In addition to a robust agenda at the AIIB, governments must set out to carry out deep reforms in other multilateral banks. In many cases, the World Bank Group and its sister organizations stand rightly accused of failing to implement their own environmental and social safeguards and upholding the rule of law and human rights. These banks cannot be allowed to turn ever more into self-serving bureaucracies. There is a need for demand-driven sustainable infrastructure and investments in social sectors that they should identify and support.

Once again, this task will not be easy and requires strong international coordination among like-minded countries. But the alternative is too disturbing to contemplate: It would involve the downgrading of existing and hard-won protections for people and the environment as banks scramble to compete for business and investment opportunities. The very infrastructure of life on this planet would face even greater risks than at present from climate change and biodiversity loss.

#### *The Critical Role of Parliaments*

There is a critically important role for parliaments concerning both the AIIB and reforms in other multilateral banks. The close engagement of members of parliament, their monitoring and questioning, is fundamental to providing governments with the incentives to carry forward the needed actions and reforms.

A question remains: Will the AIIB be susceptible to being challenged on the environment, human rights and good governance more broadly? Or will it brush these off in the knowledge that weak and self-interested governments will in the end succumb to its way of doing business?

The media, civil society, and most of all our elected representatives in parliaments must be engaged to show that the political will to defend democratic values continues alive and well.



## SELECTED AIIB POLICY PAPERS

AIIB, Articles of Agreement, Beijing, no date.

AIIB, Environmental and Social Framework, Beijing, February 2016.

AIIB, Risk Management Framework, Beijing, November 2016.

AIIB, Energy Sector Strategy: Sustainable Energy for Asia, Beijing, 15 June 2017.

AIIB, Strategy on Mobilizing Private Capital for Infrastructure, Beijing, 8 February 2018.

AIIB, Policy on Public Information, Beijing, September 2018.

AIIB, Paper on Accountability Framework, Beijing, no date, approved in April 2018 and effective as of January 2019.

AIIB, Policy on the Project-Affected People's Mechanism, Beijing, 7 December 2018, published on 24 December 2018 and effective as of 31 March 2019.

AIIB, Directive on Project-Affected People's Mechanism, Beijing, 21 December 2018.

# ABBREVIATIONS

AIIB	Asian Infrastructure Investment Bank
BRI	Belt and Road Initiative
CAO	Compliance Advisor Ombudsman
CEIU	Complaints-Resolution, Evaluation and Integrity Unit
EIA	Environmental Impact Assessment
ESF	Environmental and Social Framework
ESMP	Environmental and Social Management Plan
FI	Financial Intermediary
GRM	Grievance Redress Mechanism
IAM	Independent Accountability Mechanism
IFC	International Finance Corporation
NGO	Nongovernmental Organization
OBOR	One Belt One Road
PPI	Policy on Public Information
PPM	Project-Affected People's Mechanism



## **The Asian Infrastructure Investment Bank (AIIB)** A Multilateral Bank where China sets the Rules

In the last years, a number of countries who pride themselves in their commitment to democracy and human rights – among them Germany – decided to join the Asia Infrastructure Investment Bank (AIIB), which has developed into a major player in the global financial architecture in record time. The AIIB promises to be «lean, clean and green».

The truth is that the AIIB will only be faster in approving their loans and not meddle in their internal affairs by talking about good public governance, mandatory standards and accountability. With the establishment of the AIIB, China has created an instrument with the potential to better advance Chinese interests than pursuing a unilateral course. But the infrastructure we build today decisively shapes our lives tomorrow. A public infrastructure bank must live up to the highest standards regarding the environment, human rights and governance.

Korinna Horta's analysis of the situation regarding the respective standards after three years of AIIB in operation is very sobering. What can be done now? Is it time to admit a complete failure and leave the Bank? What influence do shareholders still exert, and what should they press for?

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