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## The Context and Implications of AIIB Policy Conditionality Practices

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**Key Points:**

- The AIIB, while appearing to conform to international practices regarding environmental and social conditions, has so far made good on its framers' initial promise to avoid conditioning financing on broader policy changes.
- This practice, however, may be more a consequence of the AIIB's infrastructure-focused development approach rather than ideological opposition to policy conditions.
- Accordingly, the degree to which the AIIB influences underlying legal environments may depend on the types of projects it finances. While those projects are currently limited to infrastructure projects, the AIIB's influence on underlying legal environments may grow should the scope of its mission expand in the future.

In 2013, President Xi Jinping of China announced his government's intention to lead the creation of the Asian Infrastructure Investment Bank (AIIB), a new multilateral development bank that would be charged with supporting economic development throughout Asia. Despite some initial scepticism from western countries in general, and lasting opposition from Japan and the United States in particular, the AIIB began operations in early 2016 and now counts more than 80 countries as member states. Included in that number are several of the western states that had initially expressed scepticism.

The creation of the AIIB was a significant event in the world of development finance. It is still a young institution, however, and its creation coincides with, and at least in part reflects, a changing development finance environment and a growing Chinese role in global development. Scholars and commentators have produced a significant volume of work on AIIB-related topics in the years since President Xi Jinping's 2013 announcement, though questions regarding the nature and extent of any influence the AIIB will ultimately exercise over global and regional legal environments as well as the national legal environments of borrower countries remain open. This Research Brief, in light of how a development bank's conditionality practices may influence underlying legal environments, considers the AIIB's current conditionality practices in context and concludes that regardless of its stated policy, the AIIB's current avoidance of policy conditions may be a natural result of its financing choices. It further highlights a few factors that may determine the degree to which future AIIB practices influence underlying legal environments.

While the AIIB is a multilateral institution with members from across the world, China currently holds a dominant position within the AIIB. China holds enough votes to veto any decision that would require a supermajority, the President of the AIIB is a Chinese national, and the AIIB itself is headquartered in Beijing.[1] Of course, this may change over time. China's voting power may become diluted as more shares are issued, and there is no requirement that the AIIB's president be a Chinese national. This is not necessarily to say that the AIIB is a mere vehicle for Chinese policy or interests, however. Rather, China's central role in the establishment and ongoing operation of the AIIB has simply provided ample opportunity for China's views on certain development topics to guide AIIB policy.

In particular, the AIIB's rejection of the use of certain conditions in its lending should come as no surprise given China's previous criticism of other development institutions for requiring policy reform as a condition to receive loans.[2] In general, development institutions sometimes require borrowers to take action or make certain promises in order to receive funds. For example, a loan for the construction of a new dam may require that the construction meet or exceed certain environmental standards. The AIIB has policies in place requiring projects to meet certain such environmental and social standards and is actively working to improve its environmental and social conditionality framework. The AIIB also frequently works in concert with other development institutions, bringing the environmental and social policies of those institutions into play as well and increasing the likelihood that projects are undertaken with conditions that conform to international standards.[3] While the AIIB appears to be fully on board with the use of such environmental and social conditions, its framers initially articulated a policy rejecting the use of conditions requiring broader policy reforms.[4] The AIIB so far seems to have made good on that promise.[5] This conditionality policy arguably limits the AIIB's influence in matters related to a borrower's legal environment, though the ultimate effects of course remain to be seen.

The AIIB's adoption of such conditionality practices is likely at least in part a response to the perceived shortcomings of the development institutions that preceded it. The AIIB was created in an environment of broad dissatisfaction with the Bretton Woods institutions (the World Bank, the IMF, and the WTO), which made up the core of the pre-existing global financial order. The AIIB, with its mantra of running "lean, clean, and green," aims to improve on the Bretton Woods institutions' methods of doing business by operating with a leaner structure, approving projects more quickly, and giving a larger voice to emerging economies.[6] That is not to say, however, that the AIIB's structure and operations are wholly different from those of the Bretton Woods institutions. The AIIB's Articles of Agreement were not cut from whole cloth; rather, they are based in

[1] Gregory T. Chin, *Asian Infrastructure Investment Bank: Governance Innovation and Prospects*, 22 GLOBAL GOVERNANCE 11, 11 (2016); AIIB GOVERNANCE: SENIOR MANAGEMENT, https://www.aiib.org/en/about-aiib/governance/senior-management/index.html (last visited Jun. 30, 2019).

[2] Larry Greenwood, *AIIB: Now Comes the Hard Part*, CENTER FOR STRATEGIC AND INTERNATIONAL STUDIES, Feb. 18, 2016, https://www.csis.org/analysis/aiib-now-comes-hard-part.

[3] *See* Steven Wang, *Is the AIIB a Challenger or a Harmonizer?*, CHINA, LAW AND DEVELOPMENT (Jul. 10, 2019), https://cld.web.ox.ac.uk/file/430536.

[4] *See, e.g.,* Koh Gui Qing, *Exclusive: China's AIIB to Offer Loans with Fewer Strings Attached – Sources*, REUTERS, Sept. 1, 2015, https://www.reuters.com/article/us-aiib-china-loans/exclusive-chinas-aiib-to-offer-loans-with-fewer-strings-attached-sources-idUSKCN0R14UB20150901.

[5] Hongying Wang, *The New Development Bank and the Asian Infrastructure Investment Bank: China's Ambiguous Approach to Global Financial Governance*, 50 DEVELOPMENT AND CHANGE 221, 232 (2019).

[6] David M. Ong, *The Asian Infrastructure Investment Bank: Bringing 'Asian Values' to Global Economic Governance?*, 20 J. OF INT'L ECON. L. 535, 551 (2017).

significant part on the charters of the World Bank and other existing multilateral development banks.[7] They of course contain some differences reflecting the AIIB's specific purpose and the lessons learned since the establishment of the older institutions, but with respect to conditionality practices, however, the AIIB's Articles of Agreement have no more to say than the World Bank's, for example.[8]

To understand the context of the AIIB's conditionality practices then, it is instructive to consider a few aspects of the World Bank's history. Today's World Bank grew out of (and still includes) the International Bank for Reconstruction and Development (IBRD), which was formed along with the other Bretton Woods institutions near the end of the Second World War to rebuild a war-torn Europe and to eliminate, or at least mitigate, the factors that had led to the devastating wars of the previous half-century. Over time, the IBRD and associated institutions expanded their focus to world-wide development.[9] In addition to a change in its geographical focus, the World Bank's financing patterns have also changed over the years. In its early decades, it directed roughly 70% of the funds it lent to infrastructure projects.[10] By the end of the century, however, the World Bank directed less than 20% of those funds to such projects.[11] Instead, funding has been redirected to other development priorities, including economic policy, environment and resource management, and human capital development.[12]

The World Bank's conditionality practices have evolved over that same period. By the turn of the 21st century, the World Bank was including a wide variety of conditions in its financing agreements, a practice that generated a fair amount of controversy.[13] Of course, some conditions, particularly environmental and social conditions, are less controversial than others, such as conditions related to deregulation or privatization.[14]

The AIIB has articulated a conditionality policy that differentiates it from the World Bank. While it allows for environmental and social conditions related to the infrastructure projects it finances, it refrains from imposing policy conditions such as deregulation or privatization.[15] This conditionality policy, however, may be less an ideological choice than a consequence of the AIIB's other operational choices.

The AIIB is more similar in its financing patterns to the World Bank of the mid-twentieth century than it is to today's World Bank, in that it almost exclusively focuses on financing infrastructure projects. This difference in focus, and the development philosophy underlying it, may in turn help explain the differing conditionality practices. Under a development approach that emphasizes infrastructure investment versus more comprehensive reform of infrastructure sectors or investment in non-infrastructure initiatives, policy conditions are seemingly unnecessary. For example, policy conditions have little to do with the actual construction of a power plant, though environmental and social conditions are likely still

[7] For a general discussion of the AIIB's Articles of Agreement and their relationship with the charters of other multilateral development banks, see NATALIE LICHTENSTEIN, A COMPARATIVE GUIDE TO THE ASIAN INFRASTRUCTURE INVESTMENT BANK (2018).

[8] *See id.* at 35 (prohibiting political interference and the use of political factors as a basis for making decisions).

[9] Hongying Wang, *New Multilateral Development Banks* 1, 1 (Sept. 2016) (unpublished discussion paper, Council of Foreign Relations).

[10] *Id.* at 3.

[11] *Id.*

[12] *See* PROJECTS & OPERATIONS, http://projects.worldbank.org/theme?lang=en&page= (last visited Dec. 20, 2018).

[13] *See, e.g.,* DANIEL CABELLO ET AL., WORLD BANK CONDITIONALITIES: POOR DEAL FOR POOR COUNTRIES (2008); HETTY KOVACH & YASMINA LANSMAN, EURODAD, WORLD BANK AND IMF CONDITIONALITY: A DEVELOPMENT INJUSTICE (2006).

[14] *See, e.g.,* CABELLO ET AL., *supra* note 10. That is not to say, however, that conditionality practices with respect to environmental and social issues do not also attract criticism. *See, e.g.,* KOVACH & LANSMAN, *supra* note 10.

[15] Qing, *supra* note 2.

relevant. A less granular development approach that seeks to promote development through more comprehensive reform or through investing in education, human capital development, or other non-infrastructure programs, however, may find policy conditions much more useful. Under the former approach, the institution's goal is to develop the borrower's infrastructure, in the hope that infrastructure development itself will spur broader economic development. Under the latter approach, the institution may insist on changes to the borrower's energy pricing mechanisms, for example, believing that infrastructure investment without policy reform may fail to spur development to the same degree as a more comprehensive approach. Policy conditions are thus much less logically associated with infrastructure-focused development. To be clear, this does not necessarily mean that an institution's policy choices reflected through its conditions are necessarily wise, nor does this Brief take a position on whether one development approach is more likely to be successful than the other. Rather, the point is simply that policy conditions, regardless of the merits of the exact requirements they impose, are a logical component of a development approach that seeks to encourage development through comprehensive reform and non-infrastructure investment, though they are much less logically included as a component of an infrastructure-focused development approach.

Accordingly, the AIIB's conditionality policy may be reflective of its focus on infrastructure development. It should be noted, however, that the AIIB is still a very young institution, and its financing and conditionality practices may evolve over time. It may be unlikely that the AIIB would require the same sort of conditions demanded by the Washington Consensus (e.g., privatization, deregulation, etc.) even if it follows the World Bank's path and eventually begins shifting its focus to financing policy projects. Even if it limits its involvement in policy projects to those directly related to infrastructure, however, it is possible that the AIIB, depending on how its financing practices and development philosophy change as it matures, may be inclined to include conditions it finds more palatable that nevertheless reduce borrower policy space.

It is true that the AIIB's Articles of Agreement contain a provision prohibiting interference in the political affairs of members and limiting allowable factors for financing decisions to economic considerations. This provision by itself does not necessarily guarantee that conditions attached to financing will not encroach on a borrower's policy space, however. The World Bank has a nearly identical provision, the interpretation of which has evolved over the years to allow the conditionality practices that have attracted so much criticism.

The extent to which the AIIB influences underlying legal environments may therefore be related, at least in part, to the types of projects it chooses to finance. An infrastructure-focused development philosophy may simply exert less influence on relevant legal environments than one that takes a more comprehensive approach. The AIIB's influence on underlying legal environments may therefore be relatively limited should it stick to its current infrastructure focus as it matures. It may, however, prove to be more influential with respect to underlying legal environments if it begins making policy loans as well, even if its preferred policy conditions differ from those of older development institutions.

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