



# RESEARCH BRIEF

No. 12/2019

## A Glimpse into Asian Infrastructure Investment Bank's Financing Practices

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October 7, 2019

### Key Points:

- The Asian Infrastructure Investment Bank exemplifies China's efforts to make the Belt and Road Initiative a multilateral platform.
- In the past three years, the AIIB has gradually increased its investments in infrastructure projects primarily through co-financing arrangements with other multilateral development banks.
- In those co-financed projects, the AIIB is willing to follow the lead of other MDBs and to agree to the application of other MDBs' standards, despite that the AIIB's

own standards are considered consistent with the other MDBs' standards.

- With experiences gained and capacities built, the AIIB should seek to exert influence through collaborations with banks in project financing along BRI routes to achieve the "clean, green, sustainable" development goal.

### Introduction

The Belt and Road Initiative (BRI),<sup>1</sup> the gigantic platform built for "a community of shared future for mankind," has entered into the second stage.<sup>2</sup> The BRI was announced to respond to the waning consensus-based multilateralism,<sup>3</sup> which was and

<sup>1</sup> The Belt and Road Initiative (BRI) was first brought up by Chinese President Xi Jinping during his visit to Kazakhstan and Indonesia and now consists of the Silk Road Economic Belt and the 21st Century Maritime Silk Road. Office of the Leading Group for Promoting the Belt and Road Initiative, *The Belt and Road Initiative Progress, Contributions and Prospects*, FOREIGN LANGUAGE PRESS (1<sup>st</sup> ed. 2019), at 1, <https://www.yidaiyilu.gov.cn/wcm.files/upload/CMSydy/gw/201904/201904220254037.pdf>.

<sup>2</sup> The entrance into the second stage is marked by the Second Belt and Road Forum for international Cooperation held from April 25-27, 2019 in Beijing. See generally Wang Yi

*Tan Dierjie Yidaiyilu Guoji Gaofeng Luntan Chengguo* (王毅谈第二届“一带一路”国际合作高峰论坛成果) [*Wang Yi Discusses Successful Outcome of the Second Belt and Road International Cooperation*], XINHUA, (Apr. 29, 2019), [http://www.gov.cn/guowuyuan/2019-04/29/content\\_5387258.htm](http://www.gov.cn/guowuyuan/2019-04/29/content_5387258.htm).

<sup>3</sup> *Supra* note 1, at 2,

<https://www.yidaiyilu.gov.cn/wcm.files/upload/CMSydy/gw/201904/201904220254037.pdf>. However, scholars and commentators have different opinions over the BRI and its motives.

continues to give way to a new form of “multilateralism,” emphasizing the consensus of “smaller groups of like-minded countries.”<sup>4</sup> Facing the new form of multilateralism,<sup>5</sup> the prolonged trade war with the U.S., and the slower domestic and global economic growth outlook,<sup>6</sup> it is now time to examine whether the BRI has achieved its goal in creating “peaceful ... open, inclusive and common development and economic cooperation.”<sup>7</sup>

### Financing Practice by the Asian Infrastructure Investment Bank

Unlike the orthodox, or Western, way of putting institutions first and infrastructure second as institutions set the rule and are the fundamental cause of economic growth and development,<sup>8</sup> the BRI is the reverse, starting from infrastructure and special economic zones (SEZs) and then moving

on to institution building. This unconventional approach makes people wonder whether the BRI conforms to global norms or actually presents a different model.<sup>9</sup> This Research Brief is one of a series that examine the BRI from its financing efforts, governance in SEZs and infrastructure, and international rule-making aspects. Specifically, this Research Brief provides a summary of financing arrangement practices of the Asian Infrastructure Investment Bank (AIIB), which is so far less well-explored despite the rich literature in the institution's governance structure. This Research Brief notes that while the AIIB's environmental and social safeguard standards and policies (ESSPs) are consistent with those of other multilateral development banks (MDBs), in practice, the AIIB nonetheless defers to the ESSPs of other MDBs in co-financed projects. This

<sup>4</sup> Alex Lawson, *Lighthizer: WTO's All-Or-Nothing Model Presents Dilemma*, LAW360 (Mar. 12, 2019), [https://www.law360.com/internationaltrade/articles/1138143/lighthizer-wto-s-all-or-nothing-model-presents-dilemma-?nl\\_pk=17879009-9792-4fe2-9218-5a4d33bbd014&utm\\_source=newsletter&utm\\_medium=email&utm\\_campaign=internationaltrade](https://www.law360.com/internationaltrade/articles/1138143/lighthizer-wto-s-all-or-nothing-model-presents-dilemma-?nl_pk=17879009-9792-4fe2-9218-5a4d33bbd014&utm_source=newsletter&utm_medium=email&utm_campaign=internationaltrade).

<sup>5</sup> It is represented by the denial of remedies for investments held by non-market-economy people and curbing contracting countries' ability in entering into free trade agreements with non-market economy exemplified in the United States-Mexico-Canada Agreement, Art. 1 of Annex 14-D and Art. 32.10 respectively, Sergio Puig, *Can International Trade Law Recover? The United States-Mexico-Canada Agreement: A Glimpse into the Geoeconomic World Order?*, AJIL UNBOUND, 113, 56-60. doi:10.1017/aju.2019.6.

<sup>6</sup> *WTO lowers trade forecast as tensions unsettle global economy*, PRESS/840 Press Release (Oct. 1, 2019), [https://www.wto.org/english/news\\_e/pres19\\_e/pr840\\_e.htm](https://www.wto.org/english/news_e/pres19_e/pr840_e.htm). *China Seen Heading for Sub-6% Economic Growth as Tariffs Soar*, BLOOMBERG NEWS (Sept. 2, 2019, updated on Sept. 3, 2019), <https://www.bloomberg.com/news/articles/2019-09-03/china-s-economy-will-grow-at-5-7-in-2020-oxford-economics-says>.

<sup>7</sup> Despite the long list of deliverables documenting delivered promises made by China during the First Belt and Road Forum, <http://www.beltandroadforum.org/english/m100/2019/0427/>

[c36-1312.html](https://www.yidaiyilu.gov.cn/wcm.files/upload/CMSydy/gw/201904/201904220254037.pdf), which is quite remarkable, an in-depth analysis would provide a complete snapshot of the past and also a reliable prediction of future. The goals are listed in Office of the Leading Group for Promoting the Belt and Road Initiative, *The Belt and Road Initiative Progress, Contributions and Prospects*, FOREIGN LANGUAGE PRESS (1<sup>st</sup> ed. 2019), p2, <https://www.yidaiyilu.gov.cn/wcm.files/upload/CMSydy/gw/201904/201904220254037.pdf>.

<sup>8</sup> See Daron Acemoglu & James Robinson, *The Role of Institutions in Growth and Development*, GC-WP-010, pp 1-2, <https://siteresources.worldbank.org/EXTPREMNET/Resources/489960-1338997241035/Growth Commission Working Paper 10 Role Institutions Growth Development.pdf>.

<sup>9</sup> See Bruce Jones, *China's Belt and Road: The New Geopolitics of Global Infrastructure Development*, *A Brookings Interview*, BROOKINGS (Ryan Hass, Bruce Jones, and Jennifer Mason eds., April 2019), [https://www.brookings.edu/wp-content/uploads/2019/04/FP\\_20190419\\_bri\\_interview.pdf](https://www.brookings.edu/wp-content/uploads/2019/04/FP_20190419_bri_interview.pdf).

Gregory Shaffer and Henry Gao believe that China is “is incrementally developing a new, decentralized model of trade governance through a web of finance, trade, and investment initiatives.” Gregory Shaffer & Henry Gao, *A New Chinese Economic Law Order?*, p1, Legal Studies Research Paper Series No. 2019-21.

Research Brief further argues that in light of this co-financing framework, in the second stage of the BRI, the AIIB should seek to apply its experience in procurement and ESSPs to influence other financing institutions, especially the Chinese domestic banks, which are often criticized for their lack of adherence to internationally-agreed standards.

Efforts to make the BRI a multilateral platform and conform to the orthodox way of institution-building can be seen from the establishment of the AIIB. The AIIB, a multilateral development bank first proposed in October 2013 (coinciding with the timing of the proposal of the BRI), complements the BRI, a much larger initiative, in terms of infrastructure financing. The Beijing, China-based MDB began operations in January 2016, and now has 100 approved members worldwide.<sup>10</sup> Tasked to “foster sustainable economic development, create wealth and improve infrastructure connectivity in Asia by investing in infrastructure and other productive sectors,”<sup>11</sup> the AIIB’s financing activities in the BRI are nonetheless dwarfed by Chinese domestic

policy and commercial banks. As of July 2019, a total investment of \$8.53 billion has been approved by the AIIB,<sup>12</sup> a small fraction when compared to the \$200 billion of investment made by Chinese policy and commercial banks between 2014 and 2017.<sup>13</sup> While the pace of investment has accelerated<sup>14</sup> - the AIIB expects to finance \$4 billion worth of projects in 2019, a 20% jump from the \$3.3 billion it made in 2018<sup>15</sup> - given the fact that the AIIB is still in its start-up phase and will stay in that phase for another year,<sup>16</sup> the majority of financing is still expected to come from other sources like other MDBs, Chinese domestic banks, and multinational banks and private funds.

By way of overview, as of July 2019, 18 countries received AIIB financing and the top-three recipient countries of AIIB-approved projects are India, Indonesia, and Turkey.<sup>17</sup> The top-three sectors that received most AIIB financing are Energy, Transportation, and Water and Wastes.<sup>18</sup> In terms of its specific commitments to the BRI, when the AIIB finances infrastructure along the BRI routes, it often does so through co-financing arrangements with other MDBs.<sup>19</sup> When co-

<sup>10</sup> *About AIIB*, ASIAN INFRASTRUCTURE INVESTMENT BANK, <https://www.aiib.org/en/about-aiib/index.html>.

<sup>11</sup> Articles of Agreement, Asian Infrastructure Investment Bank, Art. 11, <https://www.aiib.org/en/about-aiib/basic-documents/download/articles-of-agreement/basic-document-english-bank-articles-of-agreement.pdf>.

<sup>12</sup> *Asian Infrastructure Investment Bank Update*, AIIB (Aug. 2019), at 17, <https://www.aiib.org/en/treasury/common/download/IP-Red-August-2019.pdf>.

<sup>13</sup> Zhao Meng, “Zhongguo Yinghangye Leiji xiang “Yidai Yilu” Fafang Daikuan Chao 2000 Yi Meiyuan (*Chinese Banks Issued Loans totaling over 200 billion USD*),” *China Financial News* (Apr. 27, 2018), <https://www.yidaiyilu.gov.cn/xwzx/gnxw/54181.htm>.

<sup>14</sup> By December 2018, the total amount of investments approved by AIIB is \$7.5 billion, *Our First Three Years*, ASIAN INFRASTRUCTURE INVESTMENT BANK,

<https://www.aiib.org/en/about-aiib/who-we-are/third-anniversary/index.html>.

<sup>15</sup> Kevin Yao, *China’s AIIB eyes \$10-12 billion a year in project financing, steady growth*, REUTERS (June 30, 2019), <https://www.reuters.com/article/us-china-aiib-investment/chinas-aiib-eyes-10-12-billion-a-year-in-project-financing-steady-growth-idUSKCN1TW1OL>.

<sup>16</sup> *See supra* note 12.

<sup>17</sup> *Id.* at 18.

<sup>18</sup> *Id.*

<sup>19</sup> *Fact Sheet*, ASIAN INFRASTRUCTURE INVESTMENT BANK (Aug. 26, 2019), <https://www.aiib.org/en/treasury/common/download/AIIB-fact-sheet.pdf>. For a list of MDBs that have signed co-financing framework agreements with AIIB, please see *Partnerships*, ASIAN INFRASTRUCTURE INVESTMENT BANK, <https://www.aiib.org/en/about-aiib/who-we-are/partnership/index.html>.

financing projects, the AIIB generally uses the ESSPs of partner MDBs' and will defer to the partner MDBs as the lead co-financier(s) and administrator(s) of the project.<sup>20</sup>

For example, in the \$105.9 million Tajikistan: Dushanbe-Uzbekistan Border Road Improvement Project ("Tajikistan Project"), co-financed with the European Bank for Reconstruction and Development (EBRD), the EBRD was the lead co-financier and administered the project on behalf of the AIIB.<sup>21</sup> Moreover, the EBRD's Environmental and Social Policy of 2008, instead of the AIIB's own ESSPs, was used in assessing the project's environmental and social impacts, despite the acknowledgement of consistency between EBRD's policy and the AIIB's policy.<sup>22</sup>

Another example is the \$273 million Pakistan National Motorway M-4 (Shorkot-Khanewal Section) Project ("Pakistan Project"), co-financed with the Asian Development Bank (ADB) and the UK Department for International Development in 2016.<sup>23</sup> Similar to the Tajikistan Project, in the Pakistan Project, the AIIB deferred to the ADB as

the lead co-financier and the administrator of the project. The ADB's Safeguard Policy Statement of 2009 was used to assess the project's social and environmental impacts and monitoring implementations recommended by the assessment. Yet a consistent conclusion of the assessment of environmental and social impacts would have been made if the AIIB's own ESSPs were applied.<sup>24</sup>

As the AIIB was relatively new to the world - both the Tajikistan and the Pakistan projects were made in 2016, the same year as the AIIB began operations - such co-financing frameworks help the AIIB gain experience in infrastructure financing and adjust its own policies and standards to commonly-adopted international standards.<sup>25</sup>

As the AIIB grows, the same arrangements still apply. In the 2018 Egypt Sustainable Rural Sanitation Services Program, the AIIB again deferred to the World Bank (WB) and adopted the WB's ESSPs.<sup>26</sup> This arrangement, however, must be seen through a broader lens as the project is a

<sup>20</sup> This practice is done despite researches finding that AIIB's own ESSPs align with other major MDBs'. See generally, NATALIE LICHTENSTEIN, A COMPARATIVE GUIDE TO THE ASIAN INFRASTRUCTURE INVESTMENT BANK, OXFORD UNIVERSITY PRESS (2018). See also Steven Wang, *Is the AIIB a Challenger or Harmonizer?*, CHINA, LAW AND DEVELOPMENT, No. 3/2019, at 2 (July 10, 2019),

<https://cld.web.ox.ac.uk/files/wangfinalrb3pdf>.

<sup>21</sup> *Tajikistan: Dushanbe-Uzbekistan Border Road Improvement Project (Cofinanced with the European Bank for Reconstruction and Development)*, at 1, [https://www.aiib.org/en/projects/approved/2016/download/tajikistan/summary/approved\\_project\\_summary\\_tajikistan\\_border\\_road\\_improvement.pdf](https://www.aiib.org/en/projects/approved/2016/download/tajikistan/summary/approved_project_summary_tajikistan_border_road_improvement.pdf).

<sup>22</sup> *Id.*

<sup>23</sup> *Pakistan: National Motorway M-4 (Shorkot-Khanewal Section) Project (Co-financed with the Asian Development Bank)*, at 1, <https://www.aiib.org/en/projects/approved/2016/download>

[/pakistan-national-motorway/summary/approved\\_project\\_summary\\_pakistan-national-motorway.pdf](/pakistan-national-motorway/summary/approved_project_summary_pakistan-national-motorway.pdf).

<sup>24</sup> *Id.*

<sup>25</sup> Similarly financed project include the 2016 Indonesia: National Slum Upgrading Project (NSUP), co-financed by AIIB and the World Bank (WB), under which the WB is the lead co-financier and its procurement policy and environmental and social safeguard policies and procedures are used. *Project Summary Information (PSI) Report No:0004*,

[https://www.aiib.org/en/projects/approved/2016/download/indonesia/summary/approved\\_project\\_summary\\_national\\_slum\\_upgrading.pdf](https://www.aiib.org/en/projects/approved/2016/download/indonesia/summary/approved_project_summary_national_slum_upgrading.pdf).

<sup>26</sup> *Program Document of the Asian Infrastructure Investment Bank: Arab Republic of Egypt Sustainable Rural Sanitation Services Program*, PD000052-EGY (Sept. 9, 2018), <https://www.aiib.org/en/projects/approved/2018/download/egypt/document/egypt-sustainable-rural.pdf>.

continuation (i.e., the second phase) of a prior project financed by the WB in 2015.<sup>27</sup> Therefore, it is both reasonable and efficient for the AIIB to adhere to the WB's ESSPs rather than to re-invent the wheel.

A more recent co-financing project approved by the AIIB - a \$128.0 million national road improvement and maintenance project - again follows the same framework. The Lao People's Democratic Republic's National Road 13 Improvement and Maintenance Project, approved in April 2019, is co-financed by the AIIB, the WB, Nordic Development Fund, and the Counterpart Fund.<sup>28</sup> Although the AIIB is the largest financing provider in this project,<sup>29</sup> the lead co-financier is the WB.<sup>30</sup> The WB's "policies and procedures on safeguards, procurement, financial management, disbursement, project monitoring, and reporting will be used for the project activities to be financed in whole or in part out of the loan proceeds (including activities to be financed by [the] AIIB)."<sup>31</sup>

The AIIB's adherence and deferral to the WB follow the pattern and requirements outlined in the Co-Financing Framework Agreement between the AIIB and the International Bank for Reconstruction and Development and the International Development Association, dated

April 13, 2016.<sup>32</sup> But the WB is the only outlier of the AIIB's co-financing arrangements. None of the Memoranda of Understanding signed between the AIIB and other MDBs, including the EBRD, the European Investment Bank, the Eurasia Development Bank, the New Development Bank, the African Development Bank, and the Inter-American Development Bank, imposed such co-financing arrangement. Yet, in the Efeler 97.6MWE Geothermal Power Plant Expansion Project co-financed with EBRD and approved by the AIIB on July 11, 2019,<sup>33</sup> the AIIB again deferred to the EBRD and applied the EBRD's Environmental and Social Policy and related Performance Requirements.<sup>34</sup> Two reasons may explain this arrangement. First, in this co-financed project, while the AIIB is a senior loan lender (a position that entitles the AIIB the legal right to claim from the collateral against all other lenders before the other lenders make their claims if and when the debtor defaults), the amount of financing it provides did not reach the majority of project financing,<sup>35</sup> therefore, the EBRD (which did provide that majority of project financing) is reasonably expected to assume the leading role. Secondly, this project is an expansion of an existing project financed by the EBRD,<sup>36</sup> which was already subject to the governance of the EBRD Environmental and Social Policy and related Performance Requirements. It is, therefore,

<sup>27</sup> *Id.* at 17.

<sup>28</sup> *Project Document of the Asian Infrastructure Investment Bank: Lao People's Democratic Republic National Road 13 Improvement and Maintenance Project*, PD000066-LAO (Apr. 4, 2019), at 4, <https://www.aiib.org/en/projects/approved/2019/download/lao/Lao-NR-13-Road-Improvement.pdf>.

<sup>29</sup> *Id.* at 14.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.* at 15.

<sup>32</sup> *The Co-Financing Framework Agreement between Asian Infrastructure Investment Bank and International Bank for*

*Reconstruction and Development and International Development Association*, Arts. 3.01-3.03, <http://pubdocs.worldbank.org/en/522801471875210501/AIIB.pdf>.

<sup>33</sup> *Project Summer Information*, at 1 <https://www.aiib.org/en/projects/approved/2019/download/turkey/turkey-effeler-july-17-2019.pdf>.

<sup>34</sup> *Id.* at 1, 2, and 6.

<sup>35</sup> *Id.* at 1.

<sup>36</sup> *Id.* at 2.



reasonable and efficient to continue applying the EBRD's standards.

The AIIB's willingness to follow the lead of other MDBs and to agree to the application of other MDBs' standards is partly due to practical considerations when other MDBs are more established and well-equipped to take on responsibilities when the AIIB is still establishing itself and participating as a junior or minority lender. By adopting other MDBs' ESSPs, the AIIB avoids exposure to practices that might contradict its *modus operandi*: "lean, clean, green." On the other hand, such behavior suggests that the AIIB wants to address fears that it is applying low or inferior standards in project financing as cautioned by some states.<sup>37</sup>

The AIIB is about to enter into the growth phase. Alongside the AIIB's growth is the rise in demand for sustainable financing and investments in light of the United Nations Sustainable Development Goals (SDGs). The AIIB is well-situated to promote high-quality, sustainable development in Asia, thanks to its stated goals of investing in infrastructure in Asia, and to achieve SDGs when filling Asia's \$2 trillion per year investment need. With experiences gained and capacity built through the start-up phase, the AIIB should assume more responsibility in future co-financed

projects and collaborations with private investors and domestic banks. As the BRI continues its growth trajectory in the second stage, it is likely that many projects the AIIB will finance or co-finance will also fall under the BRI umbrella.

The issue of green and sustainable development and financing is especially relevant to the BRI, where the majority of financing comes from Chinese domestic policy banks and commercial banks that are slow to subscribe to international standards. For example, as of October 2019, only three domestic commercial banks<sup>38</sup> have signed onto the Equator Principles, a set of guidelines based on the World Bank Group policies that seek to increase public accountability of private lenders.<sup>39</sup> Granted, official membership or the lack thereof, in and by itself, does not necessarily support the proposition that Chinese domestic banks do not follow internationally accepted practices or standards.<sup>40</sup> As the BRI turns its focus to "high-quality," "clean, green, sustainable" development in the second stage,<sup>41</sup> the AIIB can help accomplish the goal by exerting its influence through collaborations with Chinese domestic banks in project financing. The AIIB's influence through co-financing can be achieved by seeking to apply its own ESSPs and accountability standards in co-financed projects and by hosting training sessions and personnel exchanges, just to

<sup>37</sup> For example, the U.S. Government is a vehement critic of AIIB and the BRI. Neither the U.S. nor Japan is a member of AIIB as of October 2019.

<sup>38</sup> *EP Association Members & Reporting*, THE EQUATOR PRINCIPLES, <https://equator-principles.com/members-reporting/>. The three domestic banks are the Industrial Bank Co., Ltd. (2008), the Bank of Jiangsu (2017), and the Bank of Huzhou (2019).

<sup>39</sup> See generally *The Equator Principles*, THE EQUATOR PRINCIPLES, <http://www.equatorprinciples.com/about/>.

<sup>40</sup> The Chinese government has issued guidance in environmental and social impact framework in 2017, see *The*

*Belt and Road Ecological and Environmental Cooperation Plan* (May 2017), <https://eng.yidaiyilu.gov.cn/zchj/qwfb/13392.htm> and *Guidance on Promoting Green Belt and Road* (May 2017), <https://www.yidaiyilu.gov.cn/wcm.files/upload/CMSydy/gw/201705/201705161104041.pdf>. It also established the International Coalition for Green Development on the Belt and Road, <https://www.unenvironment.org/regions/asia-and-pacific/regional-initiatives/belt-and-road-initiative-international-green>, to facilitate sustainable development.

<sup>41</sup> *Supra* note 1.

name a few. By engaging with private-sector investors and domestic banks, the AIIB can catalyze Chinese domestic banks' transition into and adoption of internationally-accepted ESSPs and complement the framework of the Green Investment Principles for the Belt and Road.<sup>42</sup> This approach, influencing through transactions, is flexible in nature as it permits both the AIIB and private investors and domestic banks to negotiate appropriate means of achieving positive ends. Additionally, this transaction-centered approach

is similar to the general approach of “transaction-first, institutional building next” employed in the BRI, which will be discussed in my next Research Brief.

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<sup>42</sup> <http://www.gflp.org.cn/public/ueditor/php/upload/file/20181201/1543598660333978.pdf>. This voluntary principle is

jointly promulgated by the Green Finance Committee of the China Society for Finance and Banking and the Green Finance Initiative of City of London.