Stone bearing the name of Asian Infrastructure Investment Bank outside the bank's headquarters in Beijing. PC: (CC) Yan Han.

Is the Asian Infrastructure Investment Bank a Responsible Investor?

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When the Asian Infrastructure Investment Bank (AIIB) was first announced by China in 2013, a flurry of speculation erupted around which countries would join and how closely the new institution would follow the path trodden by traditional multilateral development banks such as the World Bank. Human rights advocates and environmentalists were particularly concerned that the gains they had made in accountability in development finance over the past decades would be shunned by the AIIB, generating a new race to the bottom in social and environmental standards.

From the outset, the secretary-general and later president of the bank, Jin Liqun, proclaimed the AIIB would be 'lean, clean, and green' (Zheng 2015). But the slogan contained an inherent conflict: how would a lean bank, with a small staff, be equipped to conduct the rigorous due diligence necessary to ensure that its clients operating in high-risk countries implement international environmental and social standards in their infrastructure projects?

Power generation, transport, telecommunications, and water infrastructure are badly needed across Asia and beyond, but their development comes with risks to people and the environment, including forced displacement, destruction of forests and biodiversity, and pollution of air and waterways. In many countries, those who raise concerns or objections regarding investment projects that threaten the rights of communities face reprisals (Coalition for Human Rights in Development 2019). Since the 1980s, development banks such as the World Bank have required governments and companies to agree to a set of environmental and social standards to secure financing to develop infrastructure projects. While they are not perfect, when applied properly, they help mitigate the harm that infrastructure projects can cause.

In 2015, a few months before becoming operational, the AIIB began to develop its own environmental and social framework to guide its investments. To the surprise of some pundits who anticipated that it would reject the approaches of Western-led development banks, the AIIB brought on board seasoned veterans from established institutions. Jin Liqun himself was previously vice-president at the Asian Development Bank, the AIIB's general counsel and chief financial officer both previously worked with the World Bank Group, and development of the AIIB's Environmental and Social Framework (ESF) was led by an advisor who had worked for more than 25 years at the World Bank, where he also developed institutional safeguard policies. Following a contentious initial drafting process in 2015, the ESF adopted in 2016 was ultimately a scaled-back version of the environmental and social policies of the World Bank and other multilateral development banks (Humphrey and Chen 2021). This was reviewed and updated over the past year, and a revised version came into force in October 2021 (AIIB 2021).

The World Bank's environmental and social framework, like that of most other development finance institutions, contains a broad set of standards to which clients must adhere to avoid and manage risks their operations pose. These standards include tailored requirements on labour and working conditions, resource efficiency and pollution prevention, community health and safety, land acquisition and involuntary resettlement, biodiversity conservation, protection of the rights of Indigenous peoples, cultural heritage, and stakeholder engagement. In contrast, the AIIB chose to impose specific requirements on its clients only in relation to two areas: resettlement and Indigenous peoples. Both frameworks contain a general 'catch-all' standard on environmental and social management, but the generalised nature of the requirements, which apply to all types of risk, means that much discretion is left to the bank's clients to decide which types of risks to consider (and which ones to ignore) and how precisely to manage those risks. This is likely to result in weaker protections on the ground and ultimately an increased risk of harm to communities and the environment.

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Financial Intermediaries

One area where the AIIB has adopted a robust policy relative to other development banks is in its financial intermediary investments. As the bank's lending has expanded, financial intermediary investments have begun to occupy a significant portion of its portfolio. This form of lending, which has previously been described as 'outsourcing development', has become increasingly popular in development finance (Roasa 2016)—a trend that started in the 2000s, when institutions like the International Finance Corporation (IFC), the private sector arm of the World Bank Group, began to redirect much of its financing away from direct investment in projects and towards commercial banks and private investment funds. These intermediaries then on-lend this financing to end users.

While this 'financial intermediary' approach is justified as a way to broaden the reach of development banks to small and medium-sized businesses, it also makes it much more difficult to trace funds and ensure that institutional environmental and social standards are met where the rubber hits the road. For instance, investigations by our organisation, Inclusive Development International (IDI), revealed that the IFC was exposed to a host of harmful projects via its financial intermediary investments. This included projects linked to land rights abuses, state violence, deforestation, pollution, and a vast expansion of climate-wrecking coal-fired power plants, among others (IDI 2020).

The AIIB did not originally envision a large financial intermediary portfolio, but by October 2021, these types of investments made up almost one-quarter of the bank's approved projects. This increased investment in commercial banks and funds came with attendant risk: civil society groups have raised concerns regarding intermediary investments through which the AIIB is exposed to problematic projects in countries including Myanmar (BIC Europe et al. 2018) and Bangladesh (BIC Europe et al. 2019), and the risk of the bank supporting fossil fuels via the 'back door' (BIC Europe and IDI 2018).

With its revised environmental and social framework, the bank should in theory be able to avoid indirectly backing these types of harmful projects. The framework expands the AIIB's role in reviewing and approving—or excluding—the highest-risk projects from intermediary portfolios and adds important requirements for clients to develop environmental and social management systems (AIIB 2021). Whether or not the 'lean' AIIB will have the capacity to rigorously assess and monitor the potential investments of its clients and reject projects that will violate human rights or damage the environment is yet to be seen.

Capital Markets

While progress has been made in the way financial intermediary lending is handled under the AIIB's ESF, the bank is now piloting an entirely new form of financing in capital markets. In 2019, the AIIB launched a series of new operations aimed at attracting institutional investors to finance infrastructure development in Asia (AIIB 2019). These operations delegate portfolios to a third-party asset manager, which makes decisions about investments in securities (for example, bonds) traded through capital markets.

As we have previously written (Bugalski and Grimsditch 2021), the AIIB's new ESF expressly excludes capital market operations from its application, meaning that even its truncated standards on environmental and social management, resettlement, and indigenous peoples do not apply to these investments.

The AIIB argues that capital market operations cannot be subject to its regular environmental and social accountability system. Instead, it uses nebulous 'Environmental, Social, and Governance (ESG) Frameworks' to guide external asset managers. ESG began as a rudimentary way for investors to exclude from their portfolios companies that operate in controversial industries, such as tobacco and weapons, and has grown into a complex ecosystem in which dozens of ratings firms score companies using proprietary, big-data methodologies.

But as we articulated in our earlier article (Bugalski and Grimsditch 2021), ESG tools do not function as a risk-assessment and management system; they essentially help investors channel money towards companies that rate well across a range of criteria and limit investment in those that do not. While this may be an important goal for private investors, it is no substitute for the environmental and social safeguards that prevent harms from infrastructure development on the ground.

Although at present the AIIB has only approved four such projects, their total value is US\$1.1 billion, and the approach seeks to crowd in additional finance from the private sector. The bank is also in the 'proof of concept' stage, in which it is piloting the projects with a view to potential future expansion. AIIB's capital market operations seek to advance the bank's 'lean, clean, and green' strategy. This represents an attempt at a non-bureaucratic, efficient mode of investment that mobilises private capital for infrastructure. But while it may be lean, its clean and green credentials are questionable: the public is still in the dark about what is in the AIIB's capital market operations portfolio. With no public disclosure of portfolios by the bank, and no information published on how the bank interacts with fund managers, these projects effectively operate in a transparency and accountability void.

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Safeguarding the Rights of Those Impacted by AIIB Projects

With the new ESF now in effect, attention must turn to implementation and ensuring accountability for noncompliance. The AIIB has expressed a commitment to learning as it grows, and nowhere is this as important as environmental and social protection. The bank's portfolio has expanded to almost 150 projects worth close to US\$30 billion (as of October 2021), and the bank is increasingly financing projects alone—rather than co-financing with other established banks. When the AIIB co-finances projects with other banks, the policies of the co-financier are generally applied, rather than those of the AIIB (Geary and Schäfer 2021). Going forward, the AIIB's environmental and social standards will need to be interpreted and applied by its clients in an increasing number of projects across Asia and beyond.

Adequate disclosure is crucial to ensure that the public is informed when the AIIB is involved in a project—both directly and indirectly. This will require full transparency about projects and companies that receive AIIB support, as well as the recipients of its intermediary lending. A major question mark remains around the bank's capital market projects. At present, with minimal information available, there is no way for the public to assess the effectiveness of their ESG frameworks. What's more, because there has been extremely limited disclosure of specific portfolio investments, it is currently next to impossible for the public to trace where funds from these projects are flowing.

Another crucial test of the AIIB's commitment to responsible and sustainable investment will be the independence and effectiveness of the bank's accountability office, the Project-affected People's Mechanism (PPM). As its name suggests, the mechanism's mandate is to receive and address complaints from people affected by AIIB-backed projects who are seeking redress for harms. The office, which is yet to receive a complaint, has commenced outreach activities in several countries (World Bank Inspection Panel 2021), but remains relatively unknown. In several areas, it also falls short of the operating standards of the accountability mechanism of other development finance institutions (Pike 2019). Worryingly, the AIIB's capital market operations are immune from accountability through the PPM. Nonetheless, the office may ultimately play a central role in interpreting how the ESF should be implemented on the ground and whether the AIIB's standards are effective at protecting local people from the risks of development projects.

The AIIB's membership has now swelled from its 57 founding members to more than 100 countries, with membership expanding beyond Asia to include most EU countries, Australia, Canada, and others from Latin America and Africa. Policy developments at the AIIB reflect the fact that the bank's shareholding is structured in a way that gives Asian countries, including borrowing nations, a

much larger voting share than European countries (which, when combined, account for around 25 per cent of the votes). The lean approach of the bank and the stripped-back nature of its policies are likely welcomed by many borrowing members, who see bureaucracy at established institutions as cumbersome and imposing unwelcome conditions on them. However, if the AIIB is to build a reputation as a responsible infrastructure investor, it will ultimately have to reckon with the fact that high-risk infrastructure projects must have in place the strongest possible safeguards and corresponding mechanisms for addressing harms when they occur. The jury is still out on whether its policies and systems are yet up to the task. ■

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