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Lecture

on

**'The Asian Infrastructure Investment Bank – Changing
The Contours Of Infrastructure Financing In Asia'**

by



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**Ambassador T.C.A.Raghavan, DG, ICWA,
Lieutenant General S. L. Narasimhan, DG, Center for China Studies, MEA
Deputy Director General ICWA Ambassador Soumen Bagchi,
Joint Secretary ICWA Ambassador Smt. Nutan Kapoor Mahawar,
Distinguished Research Fellows of ICWA,
Ladies and Gentlemen,**

It gives me immense pleasure to speak at the Indian Council of World Affairs on a subject that has enthused scholars on multilateralism across the world – China’s establishment of the Asian Infrastructure Investment Bank and the extent to which the contours of infrastructure financing in Asia have changed thereafter. I am grateful to Ambassador T.C.A.Raghavan for encouraging me to study this subject and present my research findings.

I was at the Kyoto University recently, and many Japanese scholars expressed interest in understanding the rise of Asian Infrastructure Investment Bank and the impact it could have on infrastructure financing in Asia. Quite clearly international interest in the AIIB was very high. I do hope that my paper, would help address the present gap in research work in India on the new multilateral development bank. I would like to acknowledge the support and guidance of Dr. D.J.Pandian, Vice President and Chief Investment Officer AIIB in writing this paper.

Introduction

The Asian Infrastructure Investment Bank (AIIB), is a China led a multilateral investment bank, headquartered in Beijing, commenced operations in January 2016 and has 97 member countries. The AIIB seeks to invest in sustainable infrastructure and other productive sectors that will better connect people, services and markets that over time will impact the lives of billions of people. On April 22, 2019, the AIIB approved the membership of Cote d’Ivoire, Guinea, Tunisia and Uruguay. 57 member countries signed the AIIB charter before the Bank was launched in January 2016, 36 member countries joined the Bank in 2017 and 2018.

The AIIB represents the first major new multilateral development bank in a generation, the last being the European Bank for Reconstruction and Development established in 1991. The AIIB has till end 2018 approved projects with an investment financing of US \$ 7.5 billion. In 2019, the AIIB has sanctioned 2 projects in Sri Lanka amounting to USD 280 million – for construction of 5500 affordable housing units and for reducing the risk of landslides. Another important project sanctioned in South Asia is the USD 120 million Expansion of Power Transmission System in Chittagong region of Bangladesh. According to Dr. Pandian, AIIB financing is expected to reach US \$ 10 billion over the next 3 years with the existing pipeline of projects.

The AIIB represents the first multilateral investment bank, which does not have the United States or Japan as members. China has 26.63 percent vote share and India has 7.65 percent vote share. The other large shareholders are Russian Federation, Korea and Australia. The United Kingdom became the first major developed country to join the AIIB followed by Switzerland. India's participation in the AIIB represents New Delhi's open approach to the Bank and its commitment to multilateralism. It is quite striking that virtually every country has quickly accepted China's leading role in the AIIB, and it should be noted that the AIIB uses English as its working language.

There were several concerns that the AIIB would be competing against the World Bank and the Asian Development Bank. The Chinese argued that the AIIB should be viewed as complementing the efforts of existing institutions like the World Bank and the Asian Development Bank for co-financed projects. Besides the Chinese said that the AIIB does not compete with the World Bank and Asian Development Bank as these institutions focus on poverty alleviation. Quite clearly it takes more than mere financial power to make a multilateral financial institution work effectively. It can be said that, China's approach to the AIIB has been liberal institutionalism, transparency and a considerable degree international responsibility for development of infrastructure in Asian and global economies.

The AIIB's investments in projects has increased from US \$ 1.69 billion end 2016 to US\$ 4.22 billion end 2017 to US \$ 7.5 billion end 2018 which is an increase of 343 percent. So far, the AIIB's lending policies have been prudent and in accordance with the global governance, environmental and social safeguards. The AIIB is intent on developing a wider portfolio of projects in areas such as smart cities, renewable energy, urban transport, clean coal technology, waste management and urban water supply.

The speed with which AIIB is approving projects has compelled the ADB to cut its project approval time from 3 years to 18 months. Further Japan, has through the ADB committed to provide US \$ 110 billion funding for innovative infrastructure. Quite clearly, the AIIB has established a healthy competition with its peers.

On January 16, 2019, the AIIB celebrated its 3rd anniversary. India has been the bank's biggest beneficiary with a permanent seat on the Board of Directors and a quarter of the approved projects. The AIIB's success indicates that South-South cooperation is slowly supplanting the existing international financial order. The AIIB has announced plans to launch local currency financing in India and other Asian countries (Indonesia and Pakistan) to reduce exchange rate risks.

Infrastructure Financing Gaps in Asia

Despite strong economic growth, Asia's infrastructure remains far from adequate. 400 million Asians are without access to electricity, 300 million have no access to safe drinking water and 1.5 billion lack access to sanitation. Infrastructure inadequacies entail

huge costs. For example, City traffic congestions means huge costs in lost productivity, human stress and fuel costs. India, Indonesia, South Asia and select Central Asian countries are witnessing the largest infrastructure gaps. There exists a strong empirical relationship between a country's infrastructure and economic and demographic factors.

The AIIB's thrust in infrastructure financing is **Infrastructure 3.0** – how to use new technologies for intra-Asian trade and integration. The major areas of infrastructure financing are transport sector and information and communication technology and renewable energy sector. Increased regional rail connectivity in Central Asia, Eurasia have the potential to bring about more Europe-China trade and integrate Central Asia with other regions. Information and communications technology is seen as a great enabler to facilitate trade and integration, and Asian countries will require greater support from the international community. Further there exists potential to enhance cross-border renewable energy trade.

India's Golden Quadrilateral has had a significant impact with several districts located within 10 kilometers of the National Highway showing growth rates of 50 percent while those districts over 10 kilometers distance did not show similar growth rates. India's rural roads program, the Pradhan Mantri Gram Sadak Yojana has also had significant impact in reducing poverty and enabled a transition from agriculture to construction and manufacturing sectors.

China's expressway network has had a similar effect with lower costs between those countries and metropolitan areas through which the expressway passed. Empirical studies state that Railway infrastructure caused an increase in 0.2-0.4 percent increase in GDP growth in Central Asian countries. Enhancement in shipping infrastructure indicated a social return on investment reaches 10 percent annually in most conservative cases. Substantial investments in drinking water generated significant long-term benefits amongst rural youth.

The Asian Development Bank projections

The Asian Development Bank has projected Asia's infrastructure at US \$ 22.6 trillion through 2030 or US \$ 1.5 trillion a year, if the region is to sustain rapid economic growth. If climate change costs are added the infrastructure needs go up to US \$ 26 trillion from 2016 to 2030 or US \$ 1.7 trillion per year. Infrastructure investments are predominantly necessary in Power, Telecommunications, Transport, Water and Sanitation sectors. Power sector infrastructure investment has been projected at US \$ 14.7 trillion, transport sector infrastructure has been projected at US \$ 8.4 trillion and telecommunications infrastructure needs have been projected at US \$ 2.3 trillion. Water and sanitation infrastructure needs have been projected at US \$ 800 million. Asia is currently investing US \$ 881 billion per annum and there exists a significant infrastructure investment gap. The infrastructure investment gap is higher than 5 percent of projected GDP for almost all Asian countries outside China.

Public finance currently finances 92 percent of infrastructure investment in Asia. Private sector investments are necessary in telecommunications and power generation sectors. The private sector investments in roads, water and sanitation are quite limited. Fiscal reforms can generate up to 2 percent of GDP additional revenues, which can bridge 40 percent of the infrastructure-financing gap. Multilateral Development Banks are expected to finance infrastructure projects by another 10 percent of the infrastructure-financing gap.

In Asia, China invests above 5 percent of GDP in infrastructure, followed by Bhutan, Vietnam and India. The other Asian economies are witnessing medium to low infrastructure investments. These include Armenia, Bangladesh, Indonesia, Nepal, Pakistan, Philippines, Korea and Thailand. The Asian Development Bank has projected an annual infrastructure financing of USD 20 billion/ annum, which is 50 percent above its current capacity.

Articles of Agreement of AIIB

The Articles of Agreement of the AIIB envisages the Bank as a multilateral financial institution focused on infrastructure development. Membership of the AIIB is open to members of the World Bank or the Asian Development Bank. There are 2 categories of Members – (a) Regional Members and other Members in the Asia region and Non-Regional Members and (b) Founding Members. The Governance structure of the AIIB envisages a Board of Governors, a President, 4 Vice Presidents and other technical officers and staff. It is the responsibility of the Board of Governors to elect the President and the Directors of the Bank. The AIIB Board has 12 Directors, 9 representing the regional members and 3 representing the non-regional members. The Directors are, assisted by Alternate Directors and other staff. It is the responsibility of the Board of Directors to supervise the management and the operation of the Bank on a regular basis and establish an oversight mechanism for this purpose.

The AIIB carries out its lending operations by co-financing or participating in direct loans, by investment of funds in equity capital of an institution or enterprise, by guaranteeing loans for economic development and by providing technical assistance. The authorized capital stock of the AIIB is USD 100 billion. AIIB financing is available up to 250 percent of the Bank's subscribed capital, reserves and retained earnings included in its ordinary resources. The AIIB has also stated that it shall work in close cooperation with all its members and International Institutions and International Organizations concerned with economic development of the region and the Bank's operational areas.

AIIB's Financing Policies

The AIIB operational policy on financing lays down that the Bank will provide Sovereign Backed Financing and Non-Sovereign Backed Financing for Projects. The AIIB seeks to

utilize resources at its disposal for financing such projects and programs, which will contribute most effectively to the harmonious economic growth of the region as a whole. It will also seek to supplement private investment when private capital is not available on reasonable terms and conditions. The financing shall be guided by sound banking principles, shall provide financing of specific projects or specific investment programs, for equity investment and for technical assistance. AIIB financing principles place no restriction upon procurement of goods and services from any country from the proceeds of any financing. The AIIB also seeks to maintain reasonable diversification in its investments in equity capital.

AIIB loans are committed and repayable in United States Dollars. The interest rate is LIBOR and it resets semi-annually on each interest payment date. The AIIB loans have an average maturity limit of up to twenty (20) years and a final maturity limit of up to thirty (30) years. The payment schedules are semi-annual. A one-time front-end fee is charged on committed loan amount. Loans can be cancelled prior to the effective date with no front-end fees. However, if a loan is partially or fully cancelled on or after the effective date, no refund of front-end fee is made.

Procurement Policy of AIIB

The procurement policy of AIIB covers procurement of goods, works, non-consulting services and consulting services financed by the Bank. The procurement policy applies to all stages of the procurement cycle for a project. The AIIB places no restriction upon procurement of goods and services from any country from the proceeds of any financing undertaken in the ordinary or special operations of the Bank. Economy, efficiency and effectiveness along with transparency and fairness in procurement process have been the bedrocks of the AIIB procurement policy. The AIIB has also laid down specific procurement standards and there are provisions for use of country procurement systems. The procurement policy also contains provisions for development of domestic industry through preference margins, 'offsets', preference schemes or similar innovative approaches. There is a lot of emphasis on integrity and prohibited practices have been clearly laid down to ensure the highest standards of transparency, ethics and integrity during the procurement, administration and implementation of Bank financed contracts.

Sector Strategies

The AIIB has developed sector strategies for the following:

- a) **Strategy on mobilizing private capital for infrastructure** for developing credit enhancement and play an active role in bridging the gap between equity sponsor and commercial bank tolerance.

- b) **Energy sector strategy** which focuses on sustainable energy for Asia based on reduction in energy inequality, improved energy efficiency and reduction in carbon intensity of energy supply.
- c) **Transport sector strategy** aimed at economically viable trunk and strategic infrastructure that promotes trade and economic growth including trunk linkages between major urban centers, cross border connectivity, transport integration and upgradation of existing infrastructure. The transport sector strategy seeks to provide more support for PPPs and embrace innovative technologies.
- d) **Sustainable-Cities strategy** for financing solutions for developing sustainable cities in Asia. The infrastructure investments in cities being categorized as enhanced urban mobility, improving basic infrastructure, promoting integrated development and building freestanding health/ education facilities.
- e) **Strategy on Investing in Equity** under which the AIIB will seek to selectively invest in equity funds and platforms that are highly transparent, well managed and diversified and whose managers have a good reputation and track record.

Approved Projects and Proposed Projects

The AIIB has approved several important projects.

- **India based projects (8)** are Andhra Pradesh 24x7 – Power for All Project, India Infrastructure Fund, Transmission System Strengthening Project, Bangalore Metro Rail Project, National Investment and Infrastructure Fund, Andhra Pradesh Rural Roads Project, Andhra Pradesh Urban Water Supply and Seepage Management Improvement Project.
- **Bangladesh based projects (4)** are Distribution System Upgrade and Expansion Project, Natural Gas Infrastructure and Efficiency Improvement Project, Bangladesh Bhola IPP Project and Power System Upgrade and Expansion Project.
- **Sri Lanka based projects (2)** are Colombo Urban Regeneration Project and Reduction of Landslide Vulnerability
- **Pakistan based projects (2)** are National Motorway M-4 project, Tarbela 5 Hydropower Extension Project
- **Indonesia based projects are (3)** Regional Infrastructure Development Fund Project, Strategic Irrigation Modernization and Urgent Rehabilitation Project and Mandalika Urban and Tourism Infrastructure Project
- **Turkey based projects are (2)** TSKB Sustainable Energy and Infrastructure on-lending facility and Tuz Golu Gas Storage Expansion Project
- **Tajikistan based projects are (2)** Nurek Hydropower Rehabilitation Project Phase I and Dushanbe-Uzbekistan Border Road Improvement Project.
- **Egypt based projects are (2)** Sustainable Rural Sanitation Service Program and the Round II Solar PV Feed-in Tariffs Program

The AIIB has sanctioned a project each in **Lao PDR: National Road 13 Improvement and Maintenance Project**, **China: Beijing Air Quality Improvement and Coal Replacement Project**, **Oman: Broadband infrastructure Project**, **Egypt: Round II Solar PV Feed-in Tariffs Program**, **Georgia: Batumi Bypass Road Project**, **Azerbaijan: Trans Anatolian Natural Gas Pipeline Project (TANAP)**, **Oman: Duqm Port Commercial Terminal and Operational Zone Development Project**.

The AIIB has 19 proposed projects from Nepal (2), Bangladesh (4), India (3), Pakistan (4), Sri Lanka (1), Turkey (1), Uzbekistan (1), Georgia (1) and Nepal (2) as also the Asia Investment Fund.

Success Stories with AIIB Financing

- 1) **Turkey: Trans Anatolian Gas Pipeline Project (TANAP):** The AIIB approved and successfully disbursed US \$ 600 million for the US \$ 8 billion Trans Anatolian Natural Gas Project to transport natural gas from fields in Azerbaijan into Turkey and then onto markets in Southern Europe. The TANAP integrates Azerbaijan with new markets and enhances energy security for Turkey while also benefitting Europe. The construction of the TANAP created numerous employment opportunities in Azerbaijan and Turkey. The approval of TANAP demonstrated the AIIB's capacity to assess and provide loans in even the most complex of cases while co-financing the projects with a number of other donors. The pace of construction broke several records. An international ceremony for the inauguration of the TANAP was held on June 12, 2018 attended by Presidents of Turkey and Azerbaijan.
- 2) **Bangladesh: Distribution System Upgrade and Expansion Project:** The objective of the project is to enhance distribution capacity and to increase the number of rural and urban electricity consumers in Bangladesh. The loan was sanctioned in June 2016, for an amount of US \$ 165 million, and till date US \$ 90.6 million has been disbursed which is 55 percent. The project is on track and 2.5 million service connections have been installed in component 1. Construction works for upgradation of sub-stations and laying of underground cables is going on.
- 3) **Egypt: Round II Solar PV Feed-In Tariff Program:** The AIIB has approved US \$ 210 million in debt-financing to tap Egypt's renewable energy potential for 11 solar power projects. The solar power project will increase Egypt's power generation capacity, reduce the country's dependence on gas and fuel for electricity generation and will help the country meet its commitments under the Paris Agreement as it moves toward an environmentally sustainable energy mix. The project is cofinanced by European Bank for Reconstruction and Development by US \$ 116 million. The project reached a financial closure in October 2017.

Projects in progress:

- 1) **Indonesia: Regional Infrastructure Development Fund (RIDF):** The RIDF was sanctioned as a financial intermediary which lends directly to the subnational governments. The RIDF will increase subnational governments access to finance for basic infrastructures. The RIDF seeks to finance investments in urban transport, urban water supply and sanitation, drainage, flood and hazard risk and slum upgrading and affordable housing. The project has made slower than expected progress towards achieving the project objectives and as of October 2018 no disbursement from the March 22, 2017 loan of US \$ 100 million. Loan Disbursements as capital support for RIDF are expected to start on the 5 sub-projects soon.
- 2) **Pakistan: Tarbela 5 Hydropower Extension Project:** The AIIB sanctioned a loan amount of US \$ 300 million in September 2016 but disbursement has not commenced due to delays in the construction supervision consultant procurement process which is about to be completed.
- 3) **Turkey: Gas Storage Expansion Project:** The project objective is to increase the reliability and security of Turkey's gas supply by expanding underground gas storage capacity. The project duration is from 2018 to 2024. The loan sanctioned is US \$ 600 million and disbursement is US \$ 1.5 million. Bids for EPC contracts are under process.

Status of India based Projects:

- 1) **Gujarat Rural Roads (MMGSY):** The project objective is to improve the transport connectivity by providing all weather rural roads to about 4000 villages in all the 33 districts of Gujarat. Of the approved loan amount of US \$ 329 million, disbursements have reached US \$ 164 million (50 percent). The overall progress of the project is on track and as per original schedule. Construction and upgradation of non-plan roads and plan roads are 65 percent complete.
- 2) **Andhra Pradesh 24x7 – Power For All:** The project objective is to increase the delivery of electricity to customers and to improve the operational efficiency and system reliability in distribution of electricity in selected areas of Andhra Pradesh. Of the total approved commitment of US \$ 160 million by AIIB, the total disbursement as of November 2018 stands at US \$ 16 million. Procurement activities are at an advanced stage and both procurement and construction activities are on track and no major delays are expected.
- 3) **Madhya Pradesh Rural Connectivity:** The project objective is to improve durability and accessibility, and enhance the resilience to climate change of the gravel surfaced rural roads in Madhya Pradesh while building the capacity of the State to manage its rural road

network and road safety. The loan of US \$ 140 million was approved in April 2018 and till date US \$ 23 million has been disbursed. The construction progress is on schedule and no major risks have been identified.

- 4) **National Investment and Infrastructure Fund:** The objective of the Fund is to mobilize more private sector capital into infrastructure sectors, and increase infrastructure investment in India. These investments will include opening companies and new ventures. The platform could also consider investments into other commercially viable investments within the broader strategy of the Fund. The Fund will play the role of a catalyst for supporting investments in infrastructure. The AIIB is financing US \$ 100 million as a stand alone project in phase I with US \$ 500 million from Government of India.

AIIB – looking to the future

China has worked hard to make the AIIB work with considerable speed and nimbleness in a multilateral world order to mark a strong presence in the developmental financial scene. Most of AIIB's projects are co-financed with the existing international financial institutions. In South Asia, the AIIB seems to be gaining acceptance with a number of projects being approved or in pipeline. Success stories have been witnessed in a short period of time. The demand for infrastructure in Asia remains large and financing pipeline is quite significant. In the current macroeconomic scenario, the multilateral development banks would continue to have a significant lending role in supporting governments and private sector in financing infrastructure projects.

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AUTHOR INTRODUCTION

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V.Srinivas was the Chairman of the Board of Revenue for Rajasthan and Chairman of the Rajasthan Tax Board from 2017 to 2018. In the State Government he has served as Secretary to Government in the Departments of Planning, Family Welfare and Science & Technology and also as Mission Director National Rural Health Mission. In 2017 he was awarded the Indian Council of World Affairs Book Research Fellowship for “India’s Relations with International Monetary Fund 1991-2016 – 25 years in Perspective”. His second book “Towards a New India: India’s Welfare State Programs 2014-2019” is under publication with Konark Publishers. He has delivered 31 orations and published 118 papers. He is a senior administrator, a respected academician and an institution builder par excellence.