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Multilateral development banks in the age of Covid-19, with particular reference to the Asian Infrastructure Investment Bank, its governance and standards

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The responsiveness of multilateral development banks to changing circumstances, most recently Covid-19

Multilateral financial institutions have always played a key role in development. Over successive generations they have helped shape the development agenda and supported their client members, principally through financing programs and projects and providing other forms of assistance. To remain relevant, they have had to be adaptive, responding to the changing needs of members. We continue to see this today, with all the major institutions ramping up support to their members to address the impact of Covid-19. In the case of the Asian Infrastructure Investment Bank, for example, lending and other investments in 2020 more than doubled over the previous year, to approximately $10 billion of new approvals. Two-thirds of last year's investment has been in response to the pandemic, with much of the support having gone to the least developed members of AIIB. These poor countries are especially vulnerable to health and economic shocks and, particularly in times of crises, their alternative sources of financing are limited. This additionality, of the multilateral development banks being ready to contribute financing that others cannot, or will not, is a crucial test of their continuing relevance. As a demonstration of this readiness, we may note that after almost every global financial crisis in the last several decades, the MDBs have substantially increased operational investment in order to meet the resultant challenges.

Crises can also change priorities, both on the part of developmentally or financially distressed members and on the part of the institutions set up to support them. The current crisis, for example, has highlighted how important the health of the population is to the economy, with the AIIB for instance having ventured into providing emergency financing in the health sphere while developing a sector strategy for longer-term engagement in this area. The MDBs, then, are often most active in a crisis, at a time when other financiers are in retreat. The intensity of this counter-cyclicality is a further measure of the MDB's continuing relevance.

Indeed, MDBs have often been established in direct response to economic and sometimes political challenges. The

International Bank for Reconstruction and Development, at the heart of the World Bank Group, was created to help rebuild the economies damaged in the Second World War and to foster development of colonies that were becoming independent. The International Financial Corporation came about through a recognition that development would be better achieved by engaging the private sector more directly. The International Development Agency and the International Fund for Agricultural Development were born of the recognition that the needs of the least developed countries can be better met through concessional and grant financing.

Regional development banks, like the Inter-American Development Bank, the African Development Bank, the Asian Development Bank and the European Bank for Reconstruction and Development were a response to calls for development to be more localized in its articulation and delivery. This is true also of the most recent of the major international financial institutions, the Asian Infrastructure Investment Bank, although it defies easy characterization given that, with 103 approved members (and counting), its ownership is increasingly global and, unlike the regional development banks, the AIIB may invest in all its members and, in exceptional circumstances, in non-members too.

The family of MDBs: commonalities and differences

While the immediate reasons for their creation are varied, the multilateral financial institutions are all born into the family of international financial institutions and share the same broad purpose. The specific terms of their mandates may vary, but they are all ultimately concerned with improving lives, especially of people living in countries that need the most help. So, for example, the World Bank and the Asian Development Bank retain a focus on alleviating poverty, while the AIIB seeks to improve social and economic outcomes.

This consistency in purpose is accompanied by a further common feature of multilateral development banks, namely their alignment with certain global policy objectives, most notably the 2030 Sustainable Development Goals, the Addis Ababa Action Agenda for financing development and the Paris Agreement on climate change. This can be partly attributed to the close association that the major international financial institutions have with the United Nations, the world's principal development body, as sponsor of these three initiatives. Indeed, several multilateral development organizations are UN specialized agencies and a number have observer status at the United Nations, including the AIIB (whose status as an observer in the General Assembly and the Economic and Social Council was co-sponsored by Japan).

This notion of a family of MDBs is premised on their many similarities and their readiness to work together in a broadly common cause. We have already noted the shared concern with development. Furthermore, all MDBs are inter-governmental organizations whose membership is distinct from the institution itself. Control is a function of ownership, with the number of voting shares being allocated primarily with reference to economic power, but with adjustments to ensure that voice is given also to the less economically powerful members. Most MDBs have callable capital as well as paid-in capital, an arrangement that gives comfort to creditors, notably bondholders. The power to borrow along with other critical powers, such as the power to lend and invest, is usually stated expressly in the constituent agreement. Nonetheless, by virtue of public international law - the law under which all international organizations are created and by which they are governed - MDBs enjoy such implied powers, not inconsistent with the express terms of their constituent charters, as are necessary for the pursuit of their mandates.

Public international law also determines the status of MDB staff as international civil servants, whose loyalties are to the organization alone, and provides content to their contracts of employment. Additional content, as well as regulation, in this and other spheres, are also provided by members and reflected in the constituent agreements of MDBs. Of significance here are the status, privileges, immunities and exemptions extended by members to the organization, its personnel and assets, as well as its activities. Also important are core aspects of governance, in particular the vesting in the board of governors, however named, of all the powers of the institution, and the establishment of a board of directors and presidency with defined and limited powers and responsibilities. These features, then, are broadly shared by all MDBs.

But the notion of a family of MDBs does not imply that all members are identical. Some differences reflect choices made from competing operational models. For instance, the IBRD is confined to lending to sovereigns (or making loans with the benefit of a sovereign guarantee), while the IFC may invest only in the private sector. In the case of the EBRD, it may only invest in the public sector in limited cases, such as in support of privatization or infrastructure necessary for private sector development. The AIIB, by contrast, has substantial flexibility regarding clients, project nature, and investment instruments.

Sometimes differences among MDBs are attributable to institutional structures evolving. For example, the ADB was the first to introduce the concept of Special Funds, moneys held and controlled and expended by the institution, but separately so from the ordinary capital resources. Special Funds were subsequently adopted by the EBRD and in turn the AIIB.

Governance at AIIB: rules and processes

Changes in governance can also be explained in evolutionary terms. Turning to the most recent of the major IFIs, namely the AIIB, some governance features are those broadly shared by all MDBs and which were discussed earlier, for example the establishment of three tiers of governance bodies and the prescribed bases for allocating votes. Some governance features adopted by AIIB from other institutions represented innovations in their day. For instance, unlike the case at the IBRD, but as is the case at EBRD, a director at AIIB representing a constituency of several members need not cast all of the combined votes of the constituency in the same manner. Similarly, the AIIB has also copied IFAD in having a non-resident board and, like several other institutions, has members on its audit committee that are external to the institution.

However, other AIIB governance features are unique. Three are especially noteworthy:

- *Election of President*: While all MDBs provide a mechanism for the election of the executive head, the AIIB Articles go a step further and call for the election of the President in accordance with an open, transparent and merit-based process. Consistent with this provision, the board of governors has approved standing election rules which provide detailed content to this requirement. The election of the incumbent AIIB president to serve a second term followed these rules. Unlike at other MDBs, the election rules have been published, further underscoring the AIIB's commitment to transparency.

- *Oversight mechanism in charter*: While the experience of MDBs has led to the need to adopt various mechanisms to ensure oversight of the institution, the AIIB is unique in elevating this practice to a legal requirement and entrenching it in the Articles. Consistent with this provision, the AIIB has established a dedicated unit reporting directly to the board of directors and which is entrusted with evaluating projects and learning from them. The unit also handles complaints by third parties asserting that the AIIB has not adhered fully to its own safeguard policies, notably those in the social, environmental and procurement spheres. In addition, the oversight mechanism strengthens the AIIB's audit functions and staff grievance processes.

- *Accountability framework*: While power to approve financing proposals resides primarily with the board of directors at all MDBs, the constituent agreement of the AIIB is unique in specifically anticipating the possibility of delegating this authority to the president. Such delegation has now been put in place, with project approval authority being progressively transferred to the president. Accompanying this, a process has been adopted to assess the performance of the President in carrying out the responsibilities delegated to him and, indeed, in carrying out his duties generally. The scheme seeks to more clearly demarcate responsibilities of the two governance bodies, with the board of directors setting strategies and policies and holding the president to account, while the president is given the space to manage the work of the institution, including critically its investment operations.

Taken in their totality, the above-described features of AIIB, embedded in the charter of the institution or adopted by its governance bodies, represent a modern and, in my view, progressive governance framework. Governance is about the allocation and exercise of power in decision-making, the manner in which those decisions are informed, and the means by which the institution is held to account for its decisions.

Good governance, as reflected in the charter and decisions of AIIB, ensures that power is distributed rationally and that there are no structural impediments to it being exercised responsibly, that decisions are transparently and soundly made, and that the institution is accountable not only to its members but to those affected by its actions. Ultimately, good governance is demanded by the rule of law, a tenet which arguably is imbedded in customary international law and binding as such on all MDBs.

Standards followed by AIIB

A natural consequence of an institution adhering to high standards of governance is that it should follow high standards in carrying out its functions, including its investment activities. This is manifested in several ways at AIIB:

- First, AIIB operates transparently. Its financial statements are prepared and presented in accordance with International Financial Reporting Standards and audited in accordance with International Standards on Auditing. It has a public disclosure policy whose basic premise is that all documents may be made public unless there are compelling and defined reasons for not disclosing. The

AIIB website provides comprehensive information about the institution, including the governance processes in action, strategies and policies under consideration, and investment and other decisions contemplated and made.

- Secondly, AIIB personnel are recruited following an open, transparent and merit-based process. Many of them come from comparator organizations and so are familiar with the standards demanded of an international organization. There are no national quotas at AIIB, although hiring decisions may take into account the desirability of recruiting on a wide geographical basis. Unlike at most other MDBs, recruitment is not confined to nationals of members states. AIIB's staff includes nationals of the United States and Japan, for example, even though neither country is a member.

- Thirdly, AIIB strategies and especially policies are broadly aligned with those of other MDBs. This is explained by several factors, including: the high degree of shareholder complementarity across the various institutions; the practice of seeking the views of an informed public when formulating these documents, especially the views of civil society organizations that increasingly operate internationally and have consistent demands of all MDBs; and the desire to set and follow standards that are demanded by all stakeholders, including donors and rating agencies.

Confidence shown by others in the governance and standards of AIIB

An important measure of the state of governance at the AIIB, and the level of standards it follows, is the judgement of others. Several aspects may be mentioned here:

- First, the AIIB now has 103 approved members, with other applicants expressing an interest in membership. Almost one half of these approved members applied for membership after the institution began operating, an action that suggests that the applicants are satisfied with the governance and standards operating at the institution they wish to join.

- Secondly, the AIIB has been granted observer status at the United Nations, a reflection of the respect of the international community generally towards the institution. That status was extended to AIIB based on consensual support at the Sixth Committee where all members of the UN are represented.

- Thirdly, AIIB is able to attract as members of its International Advisory Panel highly regarded individuals with a track record of achievement in carrying out senior governance functions. This includes former heads of government and central banks, including from non-member countries like Japan.

- Fourthly, several members have entrusted the AIIB with additional funds beyond their capital payments, suggesting confidence that the governance around the preservation, use and reporting on the resultant Special Funds will be to a high standard. (In passing, let me note that a country does not need to be a member to make a contribution to an AIIB Special Fund, a convenient means by which governance can be observed without having to commit capital.)

- Fifthly, AIIB works closely with the major MDBs, including in cofinancing projects. Cofinanciers have sufficient confidence in AIIB that, in many instances, there is agreement that the policies and accountability mechanisms of the cofinancier may be applied in relation to the funding provided by AIIB. (Here, let me add that the relationship among MDBs is one of collaboration rather than competition. This is because the operational standards are comparable, and the size or risks of projects are sometimes such that no MDB can finance them alone. An example of this is that AIIB extends, alongside IBRD and ADB, policy-based loans to countries most afflicted by Covid-19, with the AIIB relying on its cofinancier to prepare and implement the projects given their experience with this product.

- Sixthly, and finally, among the key factors considered by rating agencies when assessing MDBs is the quality of governance at the institution. In this respect, all three major rating agencies have assigned AIIB the highest possible rating.

Concluding remarks

The multilateral financial institutions have always played an important role in supporting development. This has never been more so than in times of crises. The current pandemic is a case in point, where MDBs have substantially increased the financial support available to their members, particularly the least developed countries. MDBs remain relevant. As other sources of development funding become scarce, the MDBs find themselves counter-cyclically more active than ever. A recent feature in this landscape is the substantial provision by AIIB of fast-disbursing, policy-based lending to its most needy members. This is a product, delivered through cofinancing with the IBRD and ADB, that the institution had not previously financed, but which a timely and meaningful response to the pandemic demanded.

This agility is traceable to the governance bodies of AIIB in action. The actions of the board of directors and of the president are simultaneously empowered by the governance arrangements in place at AIIB and constrained by them. An important constraining element is that approved financing must be structured and delivered in a manner consistent with high standards, including as they relate to environmental and social issues as well as modalities enabling the institution to be held accountable for its decisions. These dictates, of good governance and high standards, flow directly from the determination of the AIIB to be an effective and responsible MDB, and from the expectation and confidence placed in the institution by its members and other stakeholders.
