**PROSPERITY FUND BUSINESS CASE**

**PROJECT TITLE: “UK CONTRIBUTION TO ASIAN INFRASTRUCTURE INVESTMENT BANK’S SPECIAL FUND FOR PROJECT PREPARATION, WITH THE AIM OF ACCELERATING INFRASTRUCTURE DEVELOPMENT IN ASIAN DEVELOPING COUNTRIES”**

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| **Summary** |
| The Asian Infrastructure Investment Bank (AIIB) is a new Multilateral Development Bank (MDB) based in Beijing and focused on developing infrastructure in Asia. Like other MDBs (eg World Bank, Asian Development Bank, European Bank for Reconstruction & Development), the AIIB has established a project preparation facility to help potential borrowers to prepare high-quality projects for financing. Project preparation facilities are particularly needed for developing country borrowers, which often lack the necessary administrative capacity and expertise to prepare high-quality projects, and in the infrastructure sector, where projects are typically large and complex. This business case assesses the case for the UK to make a $50 million grant contribution to the AIIB’s Special Fund for Project Preparation over a three-year period from 2017-18 to 2019-20.  By accelerating infrastructure development, the UK’s contribution will raise economic growth and living standards in potentially fast-growing developing Asian economies. We estimate the present value of these primary benefits to be $4.9 – 8.2 billion. The resulting boost to the Asian regional economy will durably increase the market for UK exports: we estimate extra UK exports of $62 – 103 million over eight years. In addition, UK infrastructure advisory firms will be well placed to win contracts financed by the UK’s contribution to the Special Fund: we estimate these contracts at $9 million over five years.  The AIIB’s Special Fund is financed by grant contributions from donor members. It will be used to provide internationally-procured technical assistance and consultancy to Asian developing countries to help them to prepare high-quality infrastructure projects for AIIB financing. The UK’s contribution to the Special Fund would be used to help prepare energy, environmental, water, transport, telecoms and rural development projects in countries like India, Indonesia, Myanmar, Pakistan and Vietnam. An illustrative case study is included below. The Special Fund would not directly benefit China itself, because China does not intend to borrow from the AIIB in order to avoid “crowding out” the resources available for other Asian countries.  The UK will be the second contributor to the Fund after China, which has also committed $50 million over 3 years. The UK’s contribution will be classified as ODA, and the AIIB has provided an assurance that it will be spent only in ODA-eligible countries.  The UK’s contribution will also strengthen the UK’s relationship with China, paving the way for potential gains in the UK’s economic and commercial interests there. The UK’s contribution was announced by the Chancellor at the annual UK-China Economic & Financial Dialogue (EFD) meeting in London in November 2016[[1]](#footnote-2). The UK’s involvement in developing the AIIB is part of the government’s strategy of building a closer political and economic relationship with China and the wider Asia region, to maximise opportunities for British businesses. |
| **Strategic Case** |
| Context & rationale  Asia has seen strong economic growth and a reduction in income poverty over the last decade, despite the global economic crisis in 2007-09. However, while regional income poverty rates have fallen, absolute numbers of poor have not fallen at the same rate due to population growth. More than 300 million people in the poorest Asian developing countries live on less than US$2 a day. In some countries, the numbers of extreme and vulnerable poor have been increasing[[2]](#footnote-3).  In the aftermath of the global economic crisis, a growing consensus has established about the importance of infrastructure as a driver of economic growth. A G20 High-Level Panel in 2010 recommended a review of the MDB policy framework for infrastructure with a more explicit recognition of the sector’s role in boosting growth[[3]](#footnote-4). A joint MDB report in 2012 recommended an increase in the supply of bankable infrastructure projects[[4]](#footnote-5). A report by the business coalition B20, for the G20 Summit in 2014, stated that $60-70 trillion of additional infrastructure capacity would be needed globally by 2030, but that only $45 trillion was likely to be realised under current conditions[[5]](#footnote-6). Closing this gap of $15-20 trillion could create up to 100 million additional jobs and and generate $6 trillion in economic activity every year. The World Bank estimates that the strong unmet demand for infrastructure investment in emerging markets and developing economies is over $1 trillion a year[[6]](#footnote-7).  A report by Boston Consulting Group in 2014 showed the scale of the global infrastructure investment requirements and attributed much of the shortfall to a lack of project preparation and delivery skills as well as a suitable enabling environment and financing[[7]](#footnote-8). More generally, the report noted that successful and sustained infrastructure development can take place only in a context of strong public institutions, appropriate policy, legal and regulatory frameworks, private sector involvement, resource efficiency, and financial market capabilities.  The B20 report found that the greatest barrier to more private involvement in public infrastructure is the absence of a credible pipeline of productive, bankable, investment-ready projects offering acceptable risk-adjusted returns to public and private investors. This stems from: inadequate project selection and prioritisation; weak project preparation and execution capabilities; weak and unstable investment and regulatory environments; and corruption and lack of transparency.  Poor infrastructure has been identified as a key constraint on economic growth in the Asia region, and infrastructure development has been shown to support poverty reduction. The Asian Development Bank (ADB) estimated in 2010 that developing countries in Asia required financing of $8 trillion over 10 years to improve infrastructure to meet growing demand, of which $4.1 trillion in energy, $2.5 trillion in transport, $1.1 trillion in telecoms and $0.4 trillion in water and sanitation[[8]](#footnote-9). In a new report in 2017, the ADB estimated that infrastructure needs in developing Asia and the Pacific would exceed $22.6 trillion in the period to 2030 ($1.5 trillion per year) if the region is to maintain its growth momentum. The estimate rises to over $26 trillion ($1.7 trillion per year) when climate change mitigation and adaptation costs are incorporated, and the shortfall is most acute outside China[[9]](#footnote-10). HSBC has estimated that emerging Asian economies require $11.5 trillion infrastructure investment over 10 years to support growing urbanisation[[10]](#footnote-11). McKinsey estimates that five ASEAN countries alone require $7 trillion infrastructure investment over 15 years[[11]](#footnote-12).  There are various pathways in which new or improved infrastructure can lead to reductions in poverty. Early research was comprehensively addressed in the World Bank’s World Development Report “Infrastructure for Development” (1994). Subsequent studies have confirmed the link[[12]](#footnote-13). The key sectors are: trade and connectivity, climate resilience; sustainable urbanisation (including housing); energy access; water, sanitation and hygiene.  Background to the AIIB  The AIIB was established as a new regional MDB in 2014, initially at China’s initiative, primarily to invest in infrastructure development in Asia, in response to the development needs and financing gap identified by the G20 and others. The mandate of the AIIB, which is based in Beijing, is to foster sustainable economic development, create wealth and improve infrastructure connectivity in Asia by investing in infrastructure and other productive sectors; and to promote regional cooperation and partnership in addressing development challenges by working in close collaboration with other multilateral and bilateral development institutions. It carries out its operations using a variety of instruments - including direct loans, equity investments and loan guarantees - to boost investment across a range of sectors, such as transport, agriculture, energy, water, environmental protection, and rural and urban development.  The AIIB complements and cooperates in the region with other MDBs such as the World Bank, ADB and European Bank for Reconstruction & Development (EBRD). According to the Overseas Development Institute, the AIIB has the potential to achieve a lending portfolio of $120 billion within 10 years, which would make it one of the largest MDBs[[13]](#footnote-14). Although the AIIB does not lend at concessional rates to the poorest countries, its cost of capital and lending rates are low. At the current time, it is well capitalised, following two rounds of capital subscriptions by its members. In terms of its business model, the AIIB deliberately aims to have a leaner structure and less bureaucratic procedures than existing MDBs, enabling it to be a more agile development bank while also being an exemplar of best practice. The UK has supported this business model from our position on the Bank’s Board.  The AIIB has authorised capital of $100 billion, which will be fully paid-in by 2020[[14]](#footnote-15). This is provided by contributions from individual member countries, proportionate to their economic size. The UK was the first major Western country to announce that it would join the AIIB, and became a founding member in June 2015. The UK’s agreed total capital contribution is $3.05 billion, of which 20% will be paid-in and the remainder could be called upon if the situation arises.. The UK currently heads a constituency of AIIB members[[15]](#footnote-16) and has a Director on the AIIB Board. Although the Board is non-resident, Board meetings are routinely held in Beijing four times a year and the UK Director attends these in person. The UK Director also takes part in Board visits to AIIB-financed projects in developing countries.  The AIIB’s infrastructure investment strategy has three strategic priorities: green infrastucture (green energy, green transport, sustainable cities); cross-country connectivity (transport, energy, trade logistics, special economic zones); and private capital mobilisation for infrastructure. Project quality and readiness are key criteria for lending. In its early years, many projects are being co-financed with other MDBs to help build the AIIB’s own capacity. Gradually the AIIB will increase its share of stand-alone projects. Depending on the project, the AIIB provides “additionality” by enhancing project quality and adherence to international standards; lowering the cost of finance; crowding-in private finance; and implementing strategic agendas.  The UK has worked closely with China and other members to ensure that the AIIB has the best standards of accountability, transparency and governance. Sir Danny Alexander, former Chief Secretary to the Treasury, is the AIIB’s Vice President and Corporate Secretary. Lord Nicholas Stern, former World Bank Chief Economist, is a member of AIIB’s International Advisory Panel. HM Treasury leads on the UK’s relations with the AIIB. The Chancellor of the Exchequer is the UK’s Governor of the AIIB. A senior HM Treasury official acts as the UK’s non-resident Director to the AIIB (heading a constituency of smaller AIIB members) and attends in person the AIIB’s Board meetings four times a year.  The AIIB was not included in DFID’s Multilateral Development Review (2016) due to its new status. However, the Review set out the key benefits of working with MDBs, both for the UK and developing countries. HM Treasury and DFID are working closely with other departments to ensure that the AIIB develops according to overall UK objectives on international development, infrastructure and global prosperity.  The AIIB’s Articles of Agreement[[16]](#footnote-17) ensure that key decisions, including on operational and financial policies, can only be made by a super-majority of shareholders. This ensures that no single country is able to force through decisions that do not have widespread support.  The AIIB, which has not yet completed its first full year of normal operations (2017), had by the end of 2016 committed $1.7bn for nine lending operations with a total project value of $12.7bn. These projects were:   * a $1.7bn slum upgrading project in Indonesia (AIIB loan $217m plus co-financing from World Bank) * a $106m road improvement project in Tajikistan (AIIB loan $28m plus co-financing from EBRD) * a $273m motorway project in Pakistan (AIIB loan $100m plus co-financing from ADB and DFID) * a $262m electricity distribution project in Bangladesh (AIIB loan $165m); * a $824m hydropower project in Pakistan (AIIB loan $300m plus co-financing from World Bank) * a $300m power plant project in Myanmar (AIIB loan $20m plus co-financing from ADB and IFC) * a $413m port terminal and railway system project in Oman (AIIB loan $301m); * a $8.6bn gas pipeline project in Azerbaijan (AIIB loan $600m plus co-financing from World Bank, EBRD and EIB).   Operations on which the AIIB is currently working (some in collaboration with other MDBs), and which could be approved in 2017, include a dam rehabilitation and regional infrastucture fund in Indonesia; several power projects in India; a road project and solar energy installation in Kazakhstan; and a natural gas project in Bangladesh.  As of the end of 2016, 52% of AIIB loans committed or programmed are in the transport sector; 25% in the energy sector; 13% in the water sector; and 10% in other sectors. 52% are in Southern Asia, 25% in SE Asia, and 23% in Western or Central Asia. 92% of loans committed or programmed are to sovereign borrowers: the proportion of AIIB non-sovereign lending and equity investment is projected to increase gradually in future. 73% of loans committed or programmed are to projects in lower-income or lower-middle-income countries, and 69% are co-financed with other MDBs.  It should be noted that, although China itself is eligible to borrow from the AIIB, no projects in China have yet been approved for financing. China has indicated that it will not make sovereign-backed borrowings from the AIIB in order to avoid “crowding out” other Asian beneficiaries. Nor is it expected that the AIIB will lend to developed countries in Asia.  The issue that the UK intervention seeks to address  In addition to the financing gap for infrastructure development outlined above, many developing countries in Asia lack the administrative capacity to prepare project proposals for AIIB financing to the high standards that the AIIB demands. Recognising this challenge, the AIIB therefore established a Special Fund for Project Preparation to provide technical assistance to Asian developing countries to help them to prepare high-quality infrastructure projects for AIIB financing. Other longer-established MDBs already have project preparation facilities (see below). The UK and other AIIB members supported the creation of the AIIB Special Fund.  As the AIIB itself says: “The size and importance of infrastructure projects and the considerable volume of financing they require make it essential that they are well and efficiently prepared from the start. Yet it has been often observed that the capacity to prepare and deliver projects up to the standards necessary to attract the required financing is limited in many of the less developed countries around the world, including some Bank members. In recognition of these members’ need for financial support for project preparation on a concessional basis, the Bank has proposed the establishment of a Project Preparation Special Fund”[[17]](#footnote-18).  The AIIB Special Fund is financed by bilateral grant contributions. The first such contribution came from China itself, which has pledged $50 million over three years from 2016. The UK’s contribution of $50m over three years from 2017 would be the second. The Fund remains open to further contributions, and it is thought possible (but unconfirmed) that South Korea may contribute in due course. The AIIB is not aware that any other donor member country is planning to make a bilateral contribution. The likely size of the Fund in the period 2017-2020 is thus $100 million, assuming that the UK makes its pledged $50m contribution and depending on South Korea’s eventual decision.  The AIIB has said that the Fund will start making technical assistance grants in 2017 to help prospective AIIB borrowers prepare infrastructure projects for financing. It will benefit mainly the preparation of sovereign backed projects undertaken by national or local governments. The AIIB announced on 31 December 2016 that the Fund was open for applications[[18]](#footnote-19). AIIB staff report that there has already been strong interest in the possibility of Fund assistance from project entities in Myanmar, India, Pakistan, Bangladesh, Maldives, Nepal and Sri Lanka. The UK has strong historical links and bilateral interests in these countries, all of which are ODA eligible. The AIIB expects that grants made by the Fund could range from $500,000 to $3m (in exceptional cases), depending on the nature of the project and the capacity of the project entity. They expect the Fund to make about 20-30 grants in 2017, the first full year of operation. In most cases, these projects will be additional (ie they would not take place in the absence of technical assistance to help prepare them). In other cases, the availability of technical assistance will accelerate the project preparation, improve project quality and allow the infrastructure to be developed sooner than would otherwise be the case. The AIIB has estimated that a $50 million contribution to the Special Fund could help bring forward 30-50 additional new infrastructure projects in developing countries. This estimate seems plausible judging by the experience of project preparation facilities managed by other MDBs, taking into account differences in the geographical and sectoral characteristics of their lending activities.  The technical assistance to be financed by the Special Fund includes feasibility studies across environmental, financial, legal, social and technical compliance assessments and analyses of; procurement, transaction and contract management advice; and project implementation plans and schedules. The assistance will be contracted using open tender arrangements.  The rules of the Fund say that “the Fund’s resources will be used primarily for projects intended to benefit low and middle income countries that are classified as International Development Assistance (IDA) recipients, including IDA Blend countries. However, in exceptional circumstances, it will also be possible to use the Funds resources that are for the benefit of other members, such as innovative and complex projects and regional or cross-border projects with significant regional impacts”[[19]](#footnote-20). It has been agreed with the AIIB that the UK’s contribution will only be used to develop projects in ODA-eligible countries[[20]](#footnote-21).  Project preparation facilities at other MDBs  Most other MDBs now operate project preparation facilities that are similar to the AIIB’s Special Fund, though these facilities differ in some respects: notably the extent to which they see the creation of a positive enabling environment as the first stage of project preparation.  The World Bank has a Global Infrastructure Facility and Public-Private Infrastructure Advisory Facility. The Asian Development Bank (ADB) has a Technical Assistance Special Fund. The African (AfDB) and Inter-American (IaDB) Development Banks and the European Bank for Reconstruction and Development (EBRD) all have Infrastructure Project Preparation Facilities. The UK is a member of and donor to all these MDBs and their associated project preparation facilities.  The World Bank estimates that the share of project preparation cost in total project cost is between 5% and 10%. The AfDB aims to use its infrastructure project preparation facility to reduce the time span from project development to financial closure from around 7 years to no more than 3 years. The Private Infrastructure Development Group (which is not an MDB) finances assistance of up to $1m to support project preparation from a special facility.  A report of the G20 Development Working Group found that project preparation facilities in Asia, most of which are hosted by MDBs, are generally effective in preparing transformative infrastructure projects[[21]](#footnote-22). The fact that most MDBs have project preparation facilities of comparable size to that envisaged by the AIIB tends to confirm that the AIIB, as a new MDB focused on infrastructure projects, needs a similar facility to operate effectively. Moreover, the complexity of potential infrastructure projects and the limited institutional capacity of developing countries to prepare them both argue in favour of the AIIB’s Special Fund.    The AIIB’s projected resourcing ($100 million over four years: see above) and use of the Special Fund is broadly comparable to the similar funds established by other MDBs. The EBRD’s Project Preparation Fund was allocated EUR 40m in its first two years, with an estimated outcome of 15-20 additional projects: EBRD’s focus is however more on middle-income than poor developing countries. The World Bank’s Global Infrastructure Facility was allocated $80m in its initial 3-year phase to prepare up to 10 major projects. The ADB facility (which is arguably the most closely comparable to the AIIB Special Fund in terms of beneficiary profile) has resources of $150m over 5 years and aims to spend 3% of each project’s value on preparatory technical assistance with a total of at least 10 complex new projects to be prepared. The UK has also encouraged the AIIB to ensure that the creation of the Special Fund builds on the experience and lessons of similar facilities at other MDBs.  ODA eligibility of the UK’s contribution  The funding provided by the UK to the AIIB Special Fund will, like all other donor contributions to the Fund, be “untied”: technical assistance financed by the Fund will be procured openly and transparently, without restriction on the nationality of the supplier. Announcing the UK’s contribution, the Chancellor made clear that it was designed to help accelerate much-needed economic development in the poorest Asian countries by accelerating delivery of their infrastructure plans.  ODA eligibility depends on two criteria: the spending route and the destination of the spending. In a letter to the Chancellor, the AIIB President provided an undertaking that the UK’s contribution to the Special Fund will only be used to benefit ODA-eligible countries[[22]](#footnote-23). This means that DFID, as the UK’s reporting authority on ODA to the OECD Development Assistance Committee (DAC) which monitors and reports on ODA spend, can classify the UK contribution as ODA.  Furthermore, the DAC Secretariat has recommended that the AIIB be added to the OECD’s list of ODA-eligible international organisations[[23]](#footnote-24). It is expected that the ODA status of the AIIB will be confirmed during 2017, probably by the summer.  Strategic orientation and fit  *National Security Strategy*[[24]](#footnote-25) – The NSS notes that the Asia-Pacific region has significant economic opportunities for the UK and considerable influence on the future integrity and credibility of the rules-based international order. It explains that the UK’s aim is to build a deeper partnership with China by working more closely together to address global challenges, and that we strongly support China’s greater integration into more of the world’s key institutions and organisations as its global role and responsibilities grow. The NSS also highlights the importance to the UK of strengthened partnership with, and economic growth of, Asian developing countries including Bangladesh, India, Indonesia, Malaysia and Pakistan.  The UK contribution to the AIIB Special Fund sits comfortably with these NSS priorities. It will help unlock economic opportunities in Asian developing countries by bringing forward key infrastructure development; and help make the AIIB, in which China has a special stake, a successful new regional MDB that is effective and meets global standards, and in which China perceives the UK as a key partner. On the latter, the UK’s commitment to the Special Fund, potentially matching China’s own contribution, will help to develop further this strategic partnership.  *Development* – DFID has a commitment to supporting infrastructure as part of a range of priority actions to scale-up and focus DFID’s resources on economic development. DFID’s policy framework on infrastructure notes that improved and expanded delivery of infrastructure is central to the delivery of the UK’s international development objectives, and that reliable, accessible transport and energy services support increased productivity, facilitate trade and create an environment in which business can flourish[[25]](#footnote-26). DFID’s latest Economic Development Strategy noted that advancing economic development in the poorest countries is a hallmark of building Global Britain, and DFID would do so by stimulating investment in developing countries, supporting countries to mobilise their own domestic resources, and focusing on sectors such as infrastructure which can unlock growth[[26]](#footnote-27).  *Sustainable Development Goals*[[27]](#footnote-28) – The AIIB is aligned to the Sustainable Development goals. This intervention will help to meet SDGs, in particular target 9.1 of SDG 9: “Develop quality, reliable, sustainable and resilient infrastructure, including regional and transborder infrastructure, to support economic development and human well-being, with a focus on affordable and equitable access for all”. Other SDGs aligned to the Special Fund include SDGs 1 (no poverty), 5 (gender equality), 7 (affordable and clean energy), 8 (decent work and economic growth) 9 (industry, innovation and infrastructure) and 13 (climate action)  *UK Comparative Advantage* – The UK has been at the forefront of innovative infrastructure development in recent years, and has established global leadership in infrastructure development services including architecture, surveying, engineering, project management, regulatory policy, private finance and legal services[[28]](#footnote-29).  *Geographical*- The bid is consistent with the geographic steers from the Prosperity Fund Ministerial Board (namely SE Asia) and the sectoral steer (infrastructure and financial services). Of the 18 countries prioritised by the Board, nine are AIIB borrowing members.  *Bilateral political* - The UK’s commitment to the AIIB will send China a strong signal of our reliability as a partner and help strengthen our broad and growing range of policy and commercial collaboration with the world’s second-largest economy. It also demonstrates the UK’s commitment to economic development in poorer Asian countries, including high priority bilateral partners like India. Finally, it will be seen within and beyond the AIIB’s membership as a further sign of the UK’s support for the AIIB as an institution and for its objectives, especially as it continues to grow and establish itself as an important and effective element of the global financial architecture.  *Theory of Change* – This bid fits within the overall Theory of Change for the Prosperity Fund. It will support both structural reforms that promote a sustainable growth path (through support for infrastructure investment) and mutually beneficial economic relationships (relationships between companies and Asian economies).  *Prosperity Fund strategy & coherence* – The purpose of the AIIB Special Fund is to accelerate infrastructure development and hence economic growth in Asian developing countries. This fits well with the strategy of the Prosperity Fund. The bid complements (but is not dependent on) several other PF bids under consideration, including the National Investment & Infrastucture Fund (India), and the Infrastructure Capacity Building.  Primary and secondary benefits  The primary benefit of the UK’s contribution is to accelerate infrastructure development and thus raise sustainable economic growth and reduce poverty in ODA-eligible Asian developing countries. This should be associated with a narrowing of inequalities, including those related to gender. The evidence for this is well documented in the World Bank’s World Development Report “Infrastructure for Development” (1994) and subsequent research[[29]](#footnote-30). These primary benefits will accrue to ODA-eligible Asian developing countries during the construction and use of the new infrastructure, which could typically have a lifespan of 25 years.  The secondary benefits are threefold and will accrue to UK exporters and the UK economy more generally. First, the UK’s contribution would lead to faster growth of the Asian regional economy, generating higher potential demand for UK exports. Secondly, as the UK is a leader in the provision of advice on infrastructure development, UK companies and consultancies will be well placed to benefit from technical assistance contracts financed by the Special Fund. HM Treasury will work with DIT officials in London and overseas to ensure that these tender opportunities are flagged to UK businesses. Finally, the UK’s contribution will further strengthen the UK’s relationship with China as its leading partner in developing the AIIB, which should in turn make it easier to advance the UK’s economic and commercial interests in China, including more ambitious outcomes from the annual UK-China Economic & Financial Dialogue meetings.  An estimation of these primary and secondary benefits is included in the appraisal case section of the business case, below.  Additionality  The AIIB has been established as a new regional MDB focused on infrastructure development in the context of a significant shortfall in the amounts of public and private sector funding available to meet the region’s identified medium-term infrastructure requirements. Although many of the AIIB’s early lending operations have been co-financed in partnership with other MDBs (notably the World Bank, ADB and EBRD), the AIIB expects to bring forward an increasing proportion of projects for which it is the sole or main source of finance, as it acquires the necessary skills and capacity to do so.  The Special Fund has been designed to meet an identified market failure: AIIB borrowers (which are usually national or local governments in developing Asian countries) often lack the skills and experience to prepare high-quality infrastructure projects, and private sector participants are unwilling to finance assistance for projects which may not come to fruition. Infrastructure in developing countries is therefore developed much more slowly than is optimal. The Special Fund will lead, as with similar project preparation facilities at other MDBs, to a higher volume and higher quality of infrastructure development financed by the AIIB and other lenders.  An evaluation performed by EBRD, prior to establishing its current Project Preparation Facility, found that systematic project preparation and implementation support results in an expanded pool of bankable infrastructure projects, and project preparation facilities help raise local capacity by involving local expertise and ensuring more standardisation and replicability of structures and regulation[[30]](#footnote-31). The AIIB aims to replicate this positive experience by ensuring that the Special Fund provides similar added value, and helps to build capacity and capability in Asian developing countries.  The UK’s contribution to the Special Fund will allow a larger pipeline of new infrastructure projects to be prepared for AIIB financing. There is currently no evidence that any other AIIB donor member countries is preparing to make a contribution to the Fund, apart from unconfirmed suggestions that South Korea may in due course contribute $30m. It is however possible that other AIIB donor members may contribute to the Fund after 2020, after the Fund has achieved a demonstrable track record. In this respect, the UK’s contribution should be regarded as both additional and catalytic.  Sustainability  *Political* - The AIIB is a broadly based new regional MDB. It currently has 57 members (37 regional and 20 regional) drawn from high-income and developing countries. Around 25 further countries are in discussion on membership, with 13 of them dure for formal confirmation in spring 2017[[31]](#footnote-32). The initial financial support for the Special Fund came from China, which is AIIB’s largest shareholder and hosts the AIIB. China in particular is strongly committed to the AIIB’s success.  *Capacity development* – The technical assistance financed by the Fund to help developing countries to design infrastructure projects should lead to an enhanced capacity in those countries for project design, management and implementation.  *Financial* – The UK’s contribution to the Fund will be transferred to AIIB over a three year period ending in 2020. If the Fund is by then a proven success, it should be possible to attract new contributions from other AIIB donor member countries at future replenishments of the Fund.  *Environmental & social* – All AIIB projects must undergo a full Environmental and Social Impact Assessment (which includes poverty and gender impacts). AIIB is establishing itself as a leader in Green Finance and expert in green energy projects. Its slogan is “lean, clean and green” and work is underway on an energy strategy that will identify opportunities for supporting low-carbon growth.  *UN Guiding Principles on Business & Human Rights* – The environmental and social impact assessments will address and comply with the UN Guiding Principles. They will make clear who holds the risks of damage (winners and losers) from infrastructure projects, including when risks are transferred to national governments or contractors. The UK’s contribution to the Fund does not imply risk ownership or risk-sharing.  Gender impact  The International Development (Gender Equality) Act 2014 requires UK development assistance to promote gender equality. Despite significant economic growth in Asia over the last twenty years, gender and inequality remain key challenges in the region. As noted, for example, by the ADB, Asia has made impressive strides over the last decade on narrowing gender gaps in education, health, employment and political participation. But, the progress and achievements are not spread widely and evenly across the entire region; disparities remain in many areas. Many women are still denied access to basic services and essential assets such as land, and excluded from decision-making. In some countries and among some groups, women still suffer from entrenched gender discrimination and exclusion that diminishes their life expectancy, education prospects, access to clean water, sanitation, and employment, and exposes them to gender-based violence. Empowering women economically and socially and giving them `voice’ is crucial for achieving the sustainable development goals (SDG 2030) of poverty reduction and inclusive development[[32]](#footnote-33).    The AIIB Special Fund aims to accelerate infrastructure development and thus raise sustainable economic growth and reduce poverty in Asian developing countries. This should, if well managed and monitored, lead to a narrowing of inequalities, including those related to gender, helping to meet SDG 5 (gender equality). Infrastructure is a key factor in women’s access to the labour market. In developing countries, women and girls are often responsible in their households for food, fuel and water. Women can spend large amounts of time obtaining these resources which limits their ability to join the workforce. Provision of infrastructure, particularly improving access to water, energy and transport, can increase rates of female labour participation and promote gender equality[[33]](#footnote-34).  However, infrastructure developments may also have consequences that unfairly impact on women. For example, the construction process may restrict women’s ability to carry out their normal tasks. The location, price or other factors may unfairly affect women’s ability to benefit from the infrastructure. The burden of resettlement or adjustment may fall disproportionately on women[[34]](#footnote-35). Economic growth as a consequence of improved infrastructure does not always lead to inclusive growth and women or other marginalised groups can sometimes be further excluded. Also, the issue of land rights - ownership and access – including water and farming can be fundamentally affected by large infrastructure projects. The AIIB subscribes to the “Do no harm” principle and the UK will seek to uphold this.  The UK has already pushed the AIIB Board on gender issues. For example, the AIIB now considers gender equality explicitly under its Environmental and Social Framework[[35]](#footnote-36). In that framework, the Bank recognises the importance of gender equality for successful and sustainable economic development and the need for inclusiveness and gender responsiveness in the projects it supports. The Bank aims to support its clients to identify potential gender-specific opportunities as well as gender-specific adverse risks and impacts under their projects and to develop mitigation measures to avoid or reduce such impacts and risks. The Bank’s guidelines encourage clients to enhance the design of their projects in an inclusive and gender-responsive manner to promote equality of opportunity and women’s socioeconomic empowerment, particularly with respect to access to finance, services and employment, and otherwise to promote positive impacts on women’s economic status, with particular regard to financial resources and property ownership and control.[[36]](#footnote-37) However, as operational experience is still new, it is too early for the Bank to provide evidence in its operations of the gender impact. The UK will follow this closely and, using our position on the Board and through bilateral channels with the Bank’s management, will continue to push the AIIB to demonstrate its operations on gender related issues.  The AIIB’s Environmental & Social Framework states that “AIIB believes that gender equality is fundamental to successful and sustainable economic development. AIIB considers it desirable for its Clients to identify potential gender-specific adverse impacts and develop mitigation measures to reduce these. Where relevant, AIIB encourages Clients to enhance the design of their Operations to promote equality of opportunity and women’s socioeconomic empowerment, particularly with respect to finance, services and employment”. Moreover, AIIB Clients are required to undertake an environmental and social impact of a proposed Operation: this assessment must include direct and indirect effects on gender and the identification of mitigation measures to address these effects.  The UK will also seek to establish and apply gender policies in order to promote gender awareness and gender balance in membership of the Board and at senior management level.  We have assessed the gender impacts of the UK’s proposed contribution to the AIIB Special Fund. Our view is that the programme will promote gender equality by accelerating infrastructure in developing countries. In its capacity as a Board member of the AIIB, the UK will continue to scrutinise carefully the environmental & social impact assessments of proposed AIIB operations to ensure that gender issues are being given proper weight and consideration.   |  | | --- | | **CASE STUDY: HOW THE SPECIAL FUND WILL WORK IN PRACTICE**  *The AIIB Special Fund has only recently started accepting bids from project entities in AIIB member countries, and so this case study is necessarily hypothetical. Actual examples of current AIIB projects in preparation include: improved energy supply in Andhra Pradesh state in India; dam rehabilitation in Indonesia; natural gas infrastructure in Bangladesh; and hydropower development in Tajikistan.*  The energy ministry of an Asian developing country wishes to improve the supply and efficiency of electric power to its rural communities. If realised, the project would significantly improve the livelihoods of many thousands of poor rural citizens.  The country intends to apply to the AIIB for a loan to cover 50% of the project’s costs. But the energy ministry does not have the administrative capacity or resources to design the project to the high standards required by the AIIB. It requires advice on the financial, legal, engineering, environmental and energy efficiency aspects of the proposed project. The ministry therefore requests assistance from the AIIB’s Special Fund for Project Preparation.  The application is considered by the AIIB’s Special Fund Committee (comprising senior AIIB management), on the basis of a detailed appraisal by expert AIIB staff. The staff may recommend changes to the scale or scope of the requested assistance, in order to optimise its impact. When and if the Committee is satisfied that the proposed assistance represents good use of the Fund and is likely to achieve its objectives, it makes a recommendation to the AIIB President for approval. The President has delegated authority to approve grants of up to $1 million from the Fund. Grants of larger amounts require in addition the approval of the AIIB Board.  If the grant is approved, the AIIB’s legal department concludes a grant agreement with the project entity: the energy ministry in the country concerned. The ministry then launches an open international tender process, which is advertised on AIIB’s and UNDP’s websites as well as other channels, for one or more firms of consultants to assist in designing the project and making a high-quality proposal for AIIB financing. DIT colleagues in London and overseas alert relevant UK companies to the tender opportunity. The duration of the consultancy project might be between 3 months and a year. The AIIB would be closely involved in supervising the consultants.  As a result of the assistance financed by the Special Fund, the country is subsequently able to submit a rigorous and robust proposal for AIIB financing, which it would have been unable to develop on its own. Following further scrutiny by AIIB staff and management, a proposal is made to the AIIB Board for a loan of, say, $200 million. The Board is able to approve this loan, on the basis of the strength of the project proposal. The energy project starts to be implemented shortly afterwards.  AIIB staff report to the Board on a quarterly basis on the use of the Special Fund, based on monitoring and audit reports, and make recommendations based on experience about how the use of the Fund can be refined and optimised in future. | |

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| **Appraisal Case** |
| The objective of the intervention is to raise sustainable economic growth and living standards in Asian developing countries. This will be achieved through accelerated infrastructure development that will have direct effects during the construction phase and subsequent effects in enhancing the supply potential of the countries’ economies. The activities to be financed and undertaken are technical assistance for infrastructure project preparation, financed by the UK’s contribution to the AIIB Special Fund for Project Preparation.  We have considered the following feasible options for intervention:   1. The UK makes a $50m contribution, phased over three years, to the AIIB’s Special Fund for Project Preparation. 2. The UK makes a smaller contribution to the Special Fund, again phased over three years,: we assume a contribution of $20m over three years. 3. The UK makes no contribution to the AIIB Special Fund. 4. The UK makes grants direct to selected Asian developing countries to help them prepare infrastructure projects for AIIB financing.   Primary and secondary benefits  The primary benefits of any UK contribution would be to accelerate infrastructure development and thus raise sustainable economic growth and reduce poverty in Asian developing countries[[37]](#footnote-38). This should be associated with a narrowing of inequalities, including those related to gender. In assessing the primary benefits, we have estimated separately the principal primary benefits (ie the short-term increase in regional GDP arising directly from the construction of the new infrastructure) and the additional primary benefits (ie the longer-term increase in regional GDP arising from the additional supply capacity which the new infrastructure makes possible).  The secondary benefits to the UK are threefold. First, there would be higher demand for UK exports, resulting from faster growth in the Asian regional economy. Secondly, there would be additional UK exports arising from UK companies winning contracts for technical assistance financed by the Special Fund. Thirdly, there would be goodwill earned from China in response to the UK’s contribution, which would in turn make it easier to advance the UK’s economic and commercial interests in China. More generally, there would be a wider positive impact for the UK’s strategic relationships in Asia and beyond, stemming from the UK’s participation in the Special Fund and our commitment to the success of the AIIB.  The different types of benefit (eg GDP growth in Asian developing countries, UK export growth) cannot be added together, as they are conceptually different. No attempt has been made to quantify the benefits arising from the goodwill earned from China: we have instead made a qualitative assessment of the scale of these benefits. We summarise below the results for each option, concentrating on the first option and then adjusting the estimates as appropriate for the subsequent options. All figures are shown is US dollars, which is the currency of the AIIB and its Special Fund.  Option (i): The UK makes a $50m contribution, phased over 3 years, to the Special Fund  We estimate that the UK’s contribution of $50 million would mobilise additional infrastructure investment of between $9 billion and $15 billion, including multiplier effects, over eight years.  The net present value of primary benefits, in terms of additional GDP arising directly from the construction of the new infrastructure, would be between $4.9 billion and $8.2 billion over eight years.  The secondary benefits, in terms of additional UK exports arising from faster growth of the Asian economy, would cumulatively be between $62 million and $103 million over the eight year period during which the additional infrastructure is developed.  The secondary benefits, in terms of technical assistance contracts financed by the UK contribution that are won by UK companies, are estimated to be $9 million over five years.  The unquantified secondary benefits, in terms of goodwill earned from China, the AIIB and its other members, are assessed as “significant”. By positioning itself as China’s partner of choice among the high-income economies, the UK has already made significant strides in advancing its economic and commercial interests in China, as testified by the impressive range of outcomes secured at the annual UK-China Economic & Financial Dialogue (EFD) meetings since 2008. For example, the UK has already used “win-win” cooperation with China under the EFD to secure London’s place as the leading financial centre (outside mainland China and Hong Kong) for renminbi denominated transactions as well as the site of overseas offices of China’s two reserve management and sovereign wealth funds (CIC and SAFE). In a similar manner, the UK’s contribution to the AIIB Special Fund might, for example, encourage greater links between the AIIB and London as a centre for financial business. This would further boost the City’s reputation as the world’s leading international financial centre. The AIIB has already expressed gratitude for the UK’s intention to contribute to the Special Fund.  Summary of option (i):   * Additional infrastructure investment: between $9 billion and $15 billion. * Primary benefits: additional GDP during infrastructure development of between $4.9 billion and $8.2 billion (NPV). * Secondary benefits: total additional UK exports of between $62 million and $103 million over eight years arising from faster growth in Asian economies. * Additional secondary benefits: UK companies win technical assistance contracts worth $9 million over five years. * Goodwill secondary benefits: Significant.   Option (ii): The UK makes a $20m contribution, phased over 3 years, to the Special Fund  This option is a scaled-down version of option (i). The Fund would, under this option, have less resource for making technical assistance grants, which would impact infrastructure development in Asia and reduce the expected primary benefits unless take-up of grants from the Fund turns out to be less than expected or other bilateral contributions to the Fund are greater than expected. On take-up of grants from the Fund, most other MDBs have well-resourced project preparation funds of a broadly similar scale (or, in the case of the ADB, larger scale) than the AIIB. On contributions to the Fund, there are currently no other potential contributors to the Special Fund except possibly South Korea, which is considering a $30m contribution. In addition to a scaling down of quantified primary and secondary benefits, there would be diplomatic impacts if the UK decided not to contribute to the Special Fund The unquantified secondary benefits arising from goodwill earned from China, the AIIB and its other members are therefore rated as “modest”.  Summary of option (ii):   * Additional infrastructure investment: between $3.6 billion and $6 billion. * Primary benefits: additional GDP during infrastructure development of between $2.0 billion and $3.3 billion (NPV). * Secondary benefits: total additional UK exports of between $25 million and $41 million over eight years arising from faster growth in Asian economies. * Additional secondary benefits: UK companies win technical assistance contracts worth $4 million. * Goodwill secondary benefits: Modest.   Option (iii): The UK makes no contribution to the Special Fund  This option would have no primary or secondary benefits. The Fund would, under this option, have much less resource for making technical assistance grants, which would impact infrastructure development in Asia. The prospects for attracting bilateral contributions to the Fund from other AIIB donor members would be poor: indeed, we judge it possible that South Korea, the only other known potential contributor, might decide not to contribute if the UK did not do so. In addition, the public announcement on the UK’s intention to contribute to the AIIB Special Fund was received positively, there would be diplomatic impacts if the UK decided not to contribute to the Special Fund. The unquantified secondary benefits arising from goodwill earned from China, the AIIB and its other members are therefore rated as “negative”.  Summary of option (iii):   * Additional infrastructure investment: nil. * Primary and secondary benefits: nil. * Goodwill secondary benefits: negative.   Option (iv): The UK makes $50m technical assistance grants, phased over 3 years, direct to Asian developing countries  This option would require the UK to establish its own mechanisms for reviewing, selecting, managing and auditing grant applications and usage, and new coordination arrangements with AIIB. Compared with option (i), there would be serious duplication of administrative overheads, and a lower proportion of UK funding would be available to achieve the expected primary and secondary benefits. Unlike option (i), this option would not assist the AIIB to develop the in-house expertise in managing Special Funds and Project Preparation that is now common in other MDBs. We therefore estimate that this option would achieve only 90% of the quantified primary and secondary benefits of option (i), because a proportion of the available funding would be lost in additional and administration that would duplicate processes in the AIIB[[38]](#footnote-39). The synergies with the AIIB’s wider activities would also be lost. We judge that China would view the self-standing arrangements pursued by the UK under this option as illogical and with suspicion. The unquantified secondary benefits arising from goodwill earned from China, the AIIB and its other members are therefore rated as “nil or negative”.  Summary of option (iv):   * Additional infrastructure investment: between $8.1 billion and $13.5 billion. * Primary benefits: additional GDP during infrastructure development of between $4.4 billion and $7.4 billion (NPV). * Secondary benefits: total additional UK exports of between $56 million and $93 million over eight years arising from faster growth in Asian economies. * Additional secondary benefits: UK companies win technical assistance contracts worth $8 million. * Goodwill secondary benefits: nil or negative.   Preferred option  The above appraisal leads to conclusion that the preferred option should be option (i): the UK’s $50m contribution, phased over 3 years, to the AIIB Special Fund.  Theory of Change for Preferred Option  The theory of change for the preferred option is as follows.  *Input*: UK financial contribution to the AIIB Special Fund for Project Preparation.  *Process*: Transparent commissioning of technical assistance by AIIB borrowing countries.  *Outputs*: High-quality infrastructure bids by Asian developing countries that are ready for AIIB and other financing. These bids include robust financing and project implementation plans, and environmental & social impact assessments.  *Outcomes*: Faster development of quality infrastructure in Asian developing countries supported by AIIB and other financing.  *Impact*: Faster economic growth, rising living standards and reduced inequalities in Asian developing countries. Secondary benefits include faster growth in regional trade and greater opportunities for UK exporters. |
| **Commercial Case** |
| The UK’s contribution will be transferred over 3 years to the AIIB, which will place it alongside other bilateral contributions in its Special Fund for Project Preparation.  The AIIB Special Fund is established as a grant-making fund to pay the full costs of technical assistance. This payment method contrasts with the AIIB’s main activity of providing loan finance for large infrastructure projects, structured in ways that spread the costs over many years (well beyond the construction timeline)[[39]](#footnote-40).  The AIIB is responsible for administering the Special Fund. The AIIB Board of Directors, on which the UK sits, has approved Rules & Regulations for the Fund and a standard Contribution Agreement for contributors to the Fund. The AIIB management has established a Special Committee, chaired by the Vice President (Policy & Strategy) and comprising other senior AIIB officials, to review and process applications for grants from the Fund by prospective AIIB borrowers. The AIIB Board has delegated to the President the power to take decisions on making grants of up to $1m from the Fund. Grants in excess of $1m require Board approval.[[40]](#footnote-41) While this is a high threshold for delegated authority, the UK and other members of the Board have taken the view that sufficient processes and transparency are in place to protect the integrity of the Fund.  In accordance with the AIIB’s articles, the full cost of administering the Fund is charged to the Fund itself, via a 1% administration fee on contributions and the recovery of expenses directly attributable to the Fund’s operations.  The AIIB’s procurement policies and rules apply to operations financed by the Fund. The AIIB will normally enter a grant agreement with the project entity or sponsor for each grant financed out of the Fund. The project entity or sponsor will procure the technical assistance in an open manner (International Competitive Bidding) and contract with the selected providers.  Procurement of services and goods financed by the Special Fund will follow the same procurement policies and procedures as AIIB loans. The tenders will be advertised on the AIIB website, UNDP business forum site, as well as websites of the client country. DIT officers in London and the UK’s overseas posts will draw tender opportunities to the attention of potential UK bidders, building on existing efforts to ensure that UK firms are engaging fully with the Bank’s procurement opportunities.  Key performance indicators: For the primary benefits, the aim is to realise the AIIB’s projection that $50m of Special Fund assistance leads over a three-year period to 30-50 additional projects being developed and approved for AIIB financing or cofinancing. The indicators monitored will be (i) amount of technical assistance contracted using Special Fund resources; and (ii) number of projects developed using Fund assistance that are approved by the AIIB Board for financing. For the secondary benefits, the indicators monitored would be: (i) technical assistance contracts won by UK firms financed by the Fund; (ii) changes to sustainable medium-term economic growth paths for countries using the Fund; (iii) new UK-China commercial deliverables that can be attributed to the UK’s contribution to the Special Fund. Some of these indicators will take time to show, and monitoring will therefore continue beyond the timeframe of the UK’s contributions. |

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| **Financial Case** |
| The UK’s contribution will be provided to the AIIB in US dollars, as this is the working currency of the AIIB and its Special Fund. As with any foreign currency commitment, the UK will need to manage the associated exchange rate risk. The UK’s public announcement of its contribution in November 2016 referred to a contribution of “up to £40 million” and “up to $50 million”, thereby providing some leeway in the event of seriously adverse exchange rate movements. The period over which the UK’s contribution would be released was not specified in the public announcement.  The UK’s contribution will be transferred to the AIIB using the same mechanism that has already been established for the UK’s capital contribution to the AIIB, which is being made in 3 annual instalments: the second of which was made in early 2017. The AIIB will, however, maintain a separate and dedicated destination account for contributions to the Special Fund, which is managed entirely separately from AIIB capital contributions and other AIIB resources.  It is proposed that the UK’s contribution will be transferred to AIIB in three annual instalments: $10m in 2017-18; $20m in 2018-19; and $20m in 2019-20. The size and timing of these instalments reflect the latest forecasts by AIIB of the Fund’s usage. The spend profile also helps to manage risk by providing time to monitor implementation. The amounts will be kept under review by HM Treasury, and can be re-profiled if Fund usage or performance differs substantially from forecasts. The AIIB will inform its members of the UK’s contribution, once all details have been finalised. These arrangements are broadly similar to those being adopted by China, the only other AIIB member that has so far announced a contribution to the Fund. It transferred the first $10m of its $50m contribution in November 2016. Its two subsequent contributions, each of $20m, are expected to be transferred in 2017 and 2018.  As the AIIB is still fairly new and lean organisation with a rapidly growing portfolio, there are fiduciary risks, including fraud and corruption. Early on, AIIB committed to the highest standards in the areas of anti-corruption, ethics and transparency. AIIB insists on zero tolerance for corruption. For example the purpose of its new Policy on Prohibited Practices[[41]](#footnote-42) is to ensure that the Bank’s financial support is used only for the purpose for which it has been given. The Bank has also established Codes of Conduct for all its Personnel[[42]](#footnote-43) and Board[[43]](#footnote-44) Staff in order to promote accountability, transparency and business ethics. In line with practice in other MDBs, the AIIB has established an Audit Committee, which will review the Bank’s financial statement and accounting, auditing and financial reporting practices, procedures and issues, among other responsibilities. The Committee will provide advice to the AIIB Board of Directors and guidance to AIIB Management.  The Special Fund is demand-led and the UK’s contribution will be pooled with other bilateral contributions. It is therefore not possible to predict in which countries or on which projects the UK’s contribution will be spent, though AIIB has confirmed that the UK’s contribution will be spent only in ODA eligible countries. We anticipate that these countries will include Bangladesh, India, Indonesia, Myanmar, Pakistan and Vietnam. A purely indicative budget for a typical request for project preparation assistance financed by the Special Fund might have a total budget $1m, of which the around 90% would be spent on external consultancy assistance (procured openly and transparently) and the remainder on administrative overheads including travel. The external consultancy might provide feasibility studies, environmental assessment, financial modelling, legal advice, technical and construction options, post-construction operational and charging plans, social & public engagement and consultation strategy, procurement planning, contract management advice, and project implementation plans. |
| **Management Case** |
| AIIB governance structure  The UK’s contribution to the AIIB Special Fund will be administered by the AIIB. AIIB is based in Beijing and led by the President, Mr Jin Liqun, who was elected for a five-year term in January 2016. The President is supported by five Vice Presidents (Chief Investment Officer, Corporate Secretary, Chief Administration Officer, Policy & Strategy, and Chief Financial Officer); the General Counsel; and Directors-General for Compliance, Integrity & Effectiveness; Investment Operations; Administration; Risk Management; Strategy, Policy & Budget; and Controller. Sir Danny Alexander, former Chief Secretary to the Treasury, is currently the AIIB’s Vice President and Corporate Secretary.  Every AIIB member country is represented on the Board of Governors and has one Governor and one Alternate Governor. In the case of the UK, the Governor is the Chancellor of the Exchequer and the Alternate Governor is HM Treasury’s Director-General International. The Board elects one of the Governors as Chairman: the current Chairman is the Governor for South Korea, and the Chancellor of the Exchequer is the current Vice Chair (2017). All powers of the Bank are vested in the Board of Governors and, with certain exceptions, these powers may be delegated to the Board of Directors.  The AIIB has established an International Advisory Panel to support the President and senior management on the Bank’s strategies and policies as well as on general operational issues. The Panel meets at the time of the Bank’s Annual Meeting or as requested by the President. The President selects and appoints Members of the Panel on two-year terms. Panelists receive a small honorarium and do not receive a salary, and the Bank pays the costs associated with Panel meetings. The Panel currently has 10 members, including Lord Nicholas Stern, Professor at the London School of Economics and former Chief Economist of the World Bank.  The AIIB’s Board of Directors is composed of twelve members. Nine Directors represent regional members and three represent non-regional members. The UK currently holds the Director position for the Wider Europe constituency of non-regional members (which also comprises Denmark, Iceland, Norway, Poland, Sweden and Switzerland). The UK’s Director is the Deputy Director (Prosperity & Multilateral Investments) in HM Treasury’s International Directorate.  The main responsibilities of the Board (which is non-resident and meets four times a year) are to:   * prepare the work of the Board of Governors; * establish the policies of the Bank and, by a majority representing not less than three-fourths of the total voting power of members, take decisions on major operational and financial policies and on delegation of authority to the President; * take decisions concerning operations of the Bank and, by a majority representing not less than three-fourths of the total voting power of members, decide on the delegation of authority to the President; * supervise the management and operation of the Bank on a regular basis and establish an oversight mechanism for that purpose, in line with principles of transparency, openness, independence and accountability; * approve the strategy, annual plan and budget of the Bank; * appoint such Board committees as deemed advisable; * submit the audited accounts for each financial year for approval by the Board of Governors.   There are currently two Board committees under the Board of Directors: the Budget & Human Resources Committee, and the Policy & Strategy Committee. The UK Director sits on the latter.  AIIB produces an annual Budget and Business Plan which are approved by the Board of Directors. The Budget is reviewed midway through each year. For each project, the Bank uses a monitoring and evaluation framework. The framework enables the Bank and its partners to track progress in implementation, measure intermediate outcomes and evaluate project impacts. The framework sets out:   * the overall project objective; * the project development objective indicators; * intermediate results indicators (these include citizen engagement, gender, female employment, grievance resolution); * descriptions of the indicators, frequency of data collection, and the bodies responsible for data collection.   At the mid-term and end of projects, a process evaluation is carried out to assess implementation and understand outcomes relating to the project.  AIIB Special Fund  AIIB is responsible for managing the Special Fund, including deciding where and how it should be deployed, ensuring that beneficiary countries procure technical assistance openly and transparently, and providing annual reports to the AIIB Board on the use and impact of the Fund.  The AIIB Board has approved Rules & Regulations for the Fund and a standard Contribution Agreement for contributors to the Fund. The AIIB management has established a Special Committee, chaired by the Vice President (Policy & Strategy) and comprising other senior AIIB officials, to review and process applications for grants from the Fund by prospective AIIB borrowers. The AIIB Board has delegated to the President the power to take decisions on making grants of up to $1m from the Fund. Grants in excess of $1m require Board approval.[[44]](#footnote-45) In accordance with the AIIB’s articles, the full cost of administering the Fund is charged to the Fund itself, via a 1% administration fee on contributions and the recovery of expenses directly attributable to the Fund’s operations.  The AIIB’s procurement policies and rules apply to operations financed by the Fund. The AIIB will normally enter a grant agreement with the project entity or sponsor for each grant financed out of the Fund. The project entity or sponsor will procure the technical assistance in an open manner (International Competitive Bidding) and contract with the selected providers.  Procurement of services and goods financed by the Special Fund will follow the same procurement polices and procedures as AIIB loans. The tenders will be advertised on the AIIB website, UNDP business forum site, as well as websites of the client country. If the capacity of the client is very low, the AIIB project team will manage the grant and procurement will then follow AIIB’s corporate procurement policy and procedures. DIT officers in London and the UK’s overseas posts will draw tender opportunities to the attention of potential UK bidders.  Quarterly reports on the use of Fund resources will be provided to the AIIB Board. The first such report is expected to be presented at the end of the first quarter of 2017. The UK’s Director will seek to ensure the highest standards of monitoring and evaluation (including poverty and gender impacts and UN Guidelines on Business and Human Rights) by actively engaging other Board members and senior AIIB officials. The accounts of the Fund will be maintained in accordance with generally accepted accounting principles and the AIIB’s accounting policies, and will be audited by the AIIB’s internal and external auditors in accordance with the same audit requirements as are applied to the accounts of the AIIB’s ordinary resources. The UK’s Director will take a close interest in monitoring and evaluating the Fund’s effectiveness, and will use his/her position on the Board to ensure probity and value for money.  UK SRO for use of Prosperity Fund  HM Treasury’s International Director (SCS2) will be Senior Responsible Officer (SRO) for the UK’s contribution to the AIIB Special Fund, supported by HM Treasury’s Deputy Director (Prosperity & Multilateral Investments) (SCS1) who also acts as the UK’s Director of the AIIB. They and their teams will be responsible for ensuring that the funds are transferred to the AIIB in a timely manner, spent in a way that achieves value for money and in line with the objectives of the Prosperity Fund, monitoring and evaluating outcomes, and submitting any financial reports or spending forecasts required by the Prosperity Fund Management Office.  They will work with DIT officers in London and overseas posts to ensure that AIIB tender opportunities financed by the Special Fund are brought to the attention of relevant UK businesses. HM Treasury does not envisage charging to the Prosperity Fund budget any staff costs associated with the programming and monitoring of the UK’s contribution to the AIIB Special Fund. These responsibilities can be conducted within existing resources by the team in HM Treasury which manages the UK’s relationship with the AIIB and other MDBs.  Results framework  The monitoring, reporting, evaluation and learning (MREL) for this programme will be consistent with the Prosperity Fund-level approach to MREL. HM Treasury will work with the AIIB to develop critical indicators for Prosperity Fund and programme level reporting, identifying aggregatable indicators for regular reporting and management indicators to allow programme managers to assess progress and impacts. The programme MREL will be consistent with the programme theory of change and the logframe analysis that flows from this. HM Treasury will report expenditure monthly and impacts (results) quarterly in line with Prosperity Fund reporting rhythms.  Reporting frequency and costs  Consistent with Prosperity Fund requirements, HM Treasury will ask the AIIB to develop a quarterly results reporting system and will work with the Prosperity Fund Monitoring and Reporting contractor to ensure consistency with overall Prosperity Fund processes and systems – particularly around data quality and consistency. HM Treasury does not envisage charging to the Prosperity Fund budget any staff costs associated with the programming and monitoring of the UK’s contribution to the AIIB Special Fund.  Evaluation and Learning  If this programme is selected as one of the sample for Prosperity Fund level evaluation, HM Treasury will work with the Prosperity Fund Evaluation and Learning contractor to develop the strategic questions that will be required for both the fund evaluation and to provide feedback to programme managers on routes to impact. The overarching evaluation methodology will be decided by the Fund level evaluators and HM Treasury will work to deliver the required coordination between the various contractors at programme level. If the programme is not selected for Prosperity Fund level evaluation, HM Treasury will work with the programme level evaluation and learning contractor to develop a set of strategic questions that it will want to answer through the process. These question may include Prosperity Fund level questions if appropriate. HM Treasury further notes that not all programmes are evaluatable and as part of the coordination with the Prosperity Fund evaluation contractors we will assess this and decide on a way forward with the PFMO.  Monitoring & reporting  Responsibility for data capture, baselining and reporting sits with the AIIB and their implementers. Indicators will need to be agreed with the Prosperity Fund level monitoring and reporting contractor, the evaluators and the programme implementers. The monitoring and reporting contractor will identify the data requirement in terms of format and quality. HM Treasury will work with our stakeholders to ensure that reporting is done in a timely and useful manner.  Risks  The main risks foreseen by HM Treasury are:   * Lower than expected use of the Special Fund.   The AIIB is confident that the UK’s contribution will be fully used over the period which it is committed and paid. The resourcing and use of the Special Fund is comparable to that of similar project preparation funds operated by other MDBs: indeed the ADB (which is most closely comparable to the AIIB in terms of countries of operation) has a larger project preparation facility with higher technical assistance spend per project (resources of $150m over 5 years, aiming to spend 3% of each project’s value on preparatory technical assistance, with a target of 10 new projects). So far, the signs are positive that there is significant and growing interest in the Special Fund from potential beneficiaries. The UK Director of the AIIB will nonetheless monitor carefully the use of the UK’s contribution and will recommend re-profiling or reducing it if the use of the Fund proves less than expected. It will also be possible, for example in DFID countries of operation, to encourage potential beneficiaries to develop project proposals with the help of grants from the Special Fund.   * Mismanagement of Special Fund resources by the AIIB or beneficiary entities.   The UK has, with members of our Board constituency and other like-minded AIIB members, successfully pressed the AIIB to develop and adopt standards, procedures, financial management and audit arrangements equivalent to those of other MDBs, including open and transparent procurement. As a new MDB, AIIB has not yet been able to demonstrate fully the effectiveness of these arrangements, though we are confident that they are based on best practice. It is possible that the AIIB’s preference for “lean” procedures could pose some additional risk of funds being mismanaged. The UK, through our position on the Board and strong relationship with the Bank’s management, will continue to exercise vigilance on AIIB procedures. As a founding member and contributor to the Fund, the UK is in a good position to ensure that any deficiencies are fully and promptly addressed. In a worst-case scenario, the UK’s contributions to the Fund could be suspended.   * Supported projects fail to get financed and project preparation assistance looks wasted.   This is a risk inherent to all MDB project preparation facilities. In order to mitigate it, the Special Fund will apply a thorough selection process before assistance is funded, and applications will need to satisfy rigorous criteria. It should not however necessarily be regarded as a complete failure if a project whose design has been assisted by the Special Fund fails to secure AIIB financing, because of doubts about the project’s viability or feasibility. The assistance financed by the Fund will have exposed these shortcomings and the use of the Fund will have thereby prevented the AIIB from financing a sub-standard and possibly wasteful project. Moreover, the national or local authorities to whom the assistance has been provided should have acquired a durably improved capacity for project design which will help in the development of future infrastructure projects.     * Supported projects are associated with corruption, environmental or social damage, poor VFM etc.   This is a risk inherent to all MDB project preparation facilities. However, the project preparation phase (funded by the Special Fund) seeks to mitigate the risks by requiring a systematic and transparent process for preparing projects and carrying out due diligence. AIIB-financed projects that are prepared carefully using technical assistance financed by the Special Fund should be less susceptible to these shortcomings. Moreover, the AIIB’s policies, rules and protocols, developed since its inception, are designed to ensure that the Bank maintains the highest standards on combating corruption and ensuring environmental and social sustainability. The UK, using our seat on the Board, has championed these standards and will press for them to be monitored and upheld.   * AIIB fails to secure 100% ODA status.   As long as the UK’s contribution to the AIIB Special Fund is spent exclusively on activities and recipients that are ODA-eligible, DFID has confirmed that the UK’s contribution will be classified as ODA. The AIIB’s President has written to the Chancellor confirming that the UK’s contribution to the Special Fund will be spent only in ODA-eligible countries. There is thus no risk to the ODA eligibility of the UK’s Special Fund contribution, irrespective of the outcome of the OECD DAC’s ongoing deliberations of the ODA eligibility of the AIIB as an institution. |

1. HM Treasury’s pre-EFD press release announced “up to £40 million of investment by the UK government in the Asian Infrastructure Investment Bank (AIIB) based in Beijing, for a fund to help developing countries to prepare infrastructure programmes”. The joint UK-China EFD policy outcomes paper said that “The UK welcomes the Chinese contribution that established the AIIB’s Project Preparation Special Fund and will consider a contribution”. The published HM Treasury EFD Fact Sheet said that “The UK has announced it will invest up to $50 million in the AIIB for a fund to help developing countries to prepare infrastructure programmes. The UK is only the second contributor to the fund after China, which aims to accelerate much-needed development in the poorest Asian countries. The UK’s contribution will also cement our reputation as China’s key partner in developing the AIIB as a 21st century international financial institution that meets global standards.” More information at: <https://www.gov.uk/government/news/uk-china-discuss-the-next-step-for-economic-and-trade-relations> [↑](#footnote-ref-2)
2. “Mid-term Review of Strategy 2020 – Changing scenario in Asia and Pacific since Stratetgy 2020” (ADB, 2014); “Growth: Building Jobs and Prosperity in Developing Countries” (DFID, 2008); “Trends in Growth & Poverty in Asia” (Oxford Policy Management, 2003). [↑](#footnote-ref-3)
3. Communique of G20 Summit in Seoul (2010). [↑](#footnote-ref-4)
4. G20 Infrastructure Action Plan Follow-up Report (2012). [↑](#footnote-ref-5)
5. The B20 comprises business leaders from the G20 countries and makes recommendationas to the G20 leaders. “Unlocking Investment in Infrastructure” (B20, 2014). [↑](#footnote-ref-6)
6. Website of the World Bank Global Infrastucture Facility (2017). [↑](#footnote-ref-7)
7. “Beyond Budgets: The Real Solution to the Global Infrastructure Gap” (Boston Consulting Group, 2014). [↑](#footnote-ref-8)
8. “Financing Asia’s Infrastucture” (ADB Institute, 2010). [↑](#footnote-ref-9)
9. *“*Meeting Asia’s Infrastructure Needs”(ADB, 2017). [↑](#footnote-ref-10)
10. “Asia’s trillion-dollar test” (HSBC, 2016). [↑](#footnote-ref-11)
11. “South East Asia at the Crossroads” (McKinsey Global Institute, 2014). [↑](#footnote-ref-12)
12. “Promoting Pro-Poor Growth: Infrastructure” (OECD, 2006); “Impact of Transport & Energy Infrastucture on Poverty Reduction” (ADB, 2008); “Safer Water, Better Health (WHO, 2011); “Infrastructure and the Millennium Development Goals” (Willoughby, 2004). [↑](#footnote-ref-13)
13. “China’s AIIB bank set to become major player” (ODI, 2015). [↑](#footnote-ref-14)
14. “The authorized capital stock of the AIIB will be US$100 billion, divided into 1 million shares having a par value of US$100,000 each … The authorized capital stock of the Bank may be increased by the Board of Governors” (AIIB website, 2017). [↑](#footnote-ref-15)
15. The AIIB Board constituency currently headed by the UK has the following other members: Denmark, Iceland, Norway, Poland, Sweden, Switzerland. It has been agreed that the UK will continue to lead the constituency (and thus occupy the Director position) until 2020. The Board seat will thence “rotate” to other constituency members but the UK will always occupy either the Director or Alternate Director position, and the UK representative will always attend AIIB Board meetings. [↑](#footnote-ref-16)
16. <https://www.aiib.org/en/about-aiib/basic-documents/articles-of-agreement/index.html> [↑](#footnote-ref-17)
17. “Rules and Regulations of the AIIB Project Preparation Special Fund” (submitted to AIIB Board, June 2016). [↑](#footnote-ref-18)
18. Announcement on AIIB website. [↑](#footnote-ref-19)
19. “Rules and Regulations of the AIIB Project Preparation Special Fund” (submitted to AIIB Board, June 2016). [↑](#footnote-ref-20)
20. Letter from AIIB President Jin to Chancellor of the Exchequer, November 2016. [↑](#footnote-ref-21)
21. G20 Development Working Group report “Infrastructure Agenda and Response to the Assessments of Project Preparation Facilities in Asia and Africa” (2014). [↑](#footnote-ref-22)
22. Letter from AIIB President Jin to Chancellor of the Exchequer, November 2016. [↑](#footnote-ref-23)
23. Note to the OECD Working Party on Development Finance Statistics (December 2016). [↑](#footnote-ref-24)
24. National Security Strategy and Strategic Defence & Security Review, published November 2015. [↑](#footnote-ref-25)
25. “Sustainable Infrastucture for Shared Prosperity and Poverty Reduction” (DFID, 2015). [↑](#footnote-ref-26)
26. “Economic Development Strategy: Prosperity, Poverty & Meeting Global Challenges” (DFID, 2017). [↑](#footnote-ref-27)
27. The Sustainable Development Goals are a set of 17 goals adopted by the United Nations in 2015. [↑](#footnote-ref-28)
28. See Nabarro LLP Infrastructure Index 2015 that rates the UK as top (out of 25 countries) for infrastructure invesrtment opportunities. See also Infrastructure & Projects Authority annual report (2016). [↑](#footnote-ref-29)
29. See footnote 11 above. [↑](#footnote-ref-30)
30. “Infrastructure Project Preparation Facility” , EBRD Board paper, October 2014. [↑](#footnote-ref-31)
31. The imminent new members are Afghanistan, Armenia, Fiji, Hong Kong and Timor Leste (regional); and Belgium, Canada, Ethiopia, Hungary, Ireland, Peru, Sudan and Venuezela (non-regional). [↑](#footnote-ref-32)
32. ADB Asian Development Fund 11 Mid-Term Review (2014). [↑](#footnote-ref-33)
33. “Making infrastructure work for women and men”, World Bank (2010). [↑](#footnote-ref-34)
34. “Why gender matters in infrastructure” OECD (2015). [↑](#footnote-ref-35)
35. AIIB Environmental and Social Framework (2016)on AIIB website. [↑](#footnote-ref-36)
36. [↑](#footnote-ref-37)
37. As China does not intend to make sovereign-backed borrowings from the AIIB, this business case assumes that the Special Fund would be deployed and have benefits only in ODA-eligible Asian countries other than China. [↑](#footnote-ref-38)
38. DFID officials have been consulted in reaching the estimate that 10% of the UK’s contribution would in these circumstances need to be devoted to administrative overheads (including extra UK and overseas staffing) to operate a self-standing bilateral fund. [↑](#footnote-ref-39)
39. It could be argued that the Special Fund ought not to provide 100% grants for the technical assistance, but instead provide limited grants and/or concessional loans that are added to the main debt of each final project. However, the grant-based method has been adopted by AIIB for the Special Fund in recognition that some projects will not get financed, and careful project preparation will improve the quality of those projects which proceed. This Business Case therefore follows the Special Fund approach of a 100% grant-based delivery mechanism. This is also the method adopted by the Project Preparation Facilities of other MDBs. [↑](#footnote-ref-40)
40. The Rules and Regulations of the AIIB Special Fund are displayed on the AIIB website. [↑](#footnote-ref-41)
41. <https://www.aiib.org/en/about-aiib/who-we-are/report-fraud-corruption/index.html>. https://www.aiib.org/en/policies-strategies/operational-policies/prohibited-practices.html [↑](#footnote-ref-42)
42. <https://www.aiib.org/en/about-aiib/basic-documents/conduct-personnel/index.html> [↑](#footnote-ref-43)
43. <https://www.aiib.org/en/about-aiib/basic-documents/conduct-officials/index.html> [↑](#footnote-ref-44)
44. The Rules and Regulations of the AIIB Special Fund are displayed on the AIIB website. [↑](#footnote-ref-45)