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Forging an MDB System: Strategy and Governance

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WHY MDB COLLABORATION MATTERS BUT DOESN'T OFTEN HAPPEN

The need for collaboration and cooperation across the multilateral development banks (MDBs) seems obvious. Donor governments set up these institutions to multiply their development dollars, to concentrate global development expertise, and to spread knowledge and evidence of effective development policies and practices around the globe. If MDBs work together, they can achieve greater scale and impact, share risks and transaction costs for greater capital efficiency, and jointly pursue a race to the top for development policy, development effectiveness, and environmental, social, and governance standards. In short, there is every reason to believe the whole would be greater than the sum of the parts.

For their part, MDB country clients want consistency and complementarity across the MDBs—in policy advice and conditionality, processes for developing and approving transactions, and results metrics. It is hard to establish "country ownership" over development policies, strategies, and priorities when the MDBs themselves sometimes pull governments in different directions. Governments in low-income countries and fragile states struggle to manage complex and time-consuming relations with multiple MDBs, bilateral development banks, and aid agencies.

Indeed, many voices regularly call on the MDBs to focus on working as a system. Prominent among these was the G20 Eminent Persons Group (EPG) on Global Financial Governance, which noted in its 2018 report[1] the "largely untapped potential for collaboration among the IFIs…to maximize their contributions as a group." They called for a "new multilateralism," a "new harmony," to "make this decentralized system more resilient and much stronger than the sum of its parts."

Moreover, the MDBs are critical sources of finance for global public goods, which by their nature require collective action across borders, country actors, and multilateral institutions. Climate change, pandemics, and migration need to be addressed with shared strategies and efforts. It hardly makes sense for MDBs to engage individually with countries on these issues and not much with each other.

In a world where there are already major forces arrayed against multilateralism, this lack of MDB joint action adds to skepticism about the efficacy of multilateral institutions. It fosters a nationalistic tendency to direct aid resources to bilateral agencies and institutions. If shareholders do not see MDBs as capable of acting together on a large scale, they will be more interested in funding their own institutions that give them more direct control and freedom to pursue their own foreign policy interests. This effect is magnified when a dominant development actor like China deploys much larger volumes of finance than individual MDBs either can commit themselves or help to mobilize from the private sector.

And yet, MDBs were set up and are judged in a way that strongly weighs against collaboration. Their performance is assessed principally by the volume of finance they themselves commit and disburse every year, not by how much space they create for other actors—public or private—to invest. They must make the case for increases in their own capital to shareholders based on their own lending volumes and projected constraints on their lending capacity. They each have their own boards; fiduciary standards; capital adequacy benchmarks; environmental, social and governance (ESG) standards; project preparation and approval processes; and results measurement frameworks. Their boards of governors and executive boards do not meet jointly. The institutions do not specialize by sector or financial instrument so they often compete for business when they have overlapping regions of operations, both in sovereign lending and in financing the private sector.

In theory, the largest shareholders of all of the MDBs are mostly the same countries, which should make it easier for their executive directors to prioritize collaboration. In practice, boards of governors and executive directors focus on policies, strategies, and financial and leadership decisions specific to each institution. There is no overarching strategy for MDB collaboration and no joint governance body to oversee implementation of such a strategy.

The G20 and the G7 are the closest we have to fora that offer direction to MDBs as a group. But they do so on an ad hoc basis, most often during periods of crisis. Outside of crisis years, there is limited continuity from one G20 or G7 country chair to the next on priority MDB issues and no unified long-term strategy for collective MDB action. Importantly, the G7 and G20 also lack representation from some of the most important MDB partners—the governments of the poorest countries.

Other bodies similarly fall short. The Development Committee that meets at the time of the IMF/World Bank annual meetings reviews broad development issues, but its communiqués are generally directed at the World Bank and IMF, rather than the MDBs or international financial institutions as a system. The Finance for Development forum during the annual meetings of the UN General Assembly addresses many finance challenges of the Sustainable Development Goals (SDGs) that are central to MDB goals and operations, but it lacks the mandate to direct or oversee MDBs. Participation by finance ministers, which are often the shareholders of MDBs, is limited. The heads of the MDBs meet twice a year around the IMF/World Bank annual meetings but without shareholders, with limited decision-making authority, and with no joint communiqué.

In sum, we should not be surprised that MDBs do not systematically collaborate to achieve shared goals. Their managements are incentivized to prioritize individual over collective MDB performance. Shareholders have not agreed on either collective goals or a strategy to achieve such goals. Nor do shareholders have a body to oversee collective MDB performance.

This note explores three questions that need to be addressed if this gap in the international financial architecture is to be usefully filled:

1. If a new governance structure is added to the system, what should be its principal purposes?

2. What kind of strategy should be developed for the operation of MDBs as a system?

3. What should such a governance body look like?

ADDING A GOVERNANCE STRUCTURE TO THE MULTILATERAL ARCHITECTURE: FOR WHAT PURPOSES?

First and foremost, the purpose of a collective MDB governing body would be to forge a common, long-term strategy for MDB performance as a system. Such a strategy would not replace the strategies of individual institutions. Rather it would focus on how the MDBs would work together collectively to achieve development goals common to all MDBs.

The international community already has the SDGs, which are well suited to the mission of MDBs. There is no need to develop a set of new global goals for this purpose. Rather, the challenge is to identify how and how much the MDBs can together contribute to achieving those goals.

"How much" here refers to inputs, outputs, and outcomes. Individual MDBs already track country macroeconomic development indicators for both diagnostic and progress measurement purposes. But few believe that MDBs are likely individually to drive macroeconomic progress. It is not so unreasonable, however, to think that they can do so collectively, especially if they are working together toward the same measurable outputs and outcomes. And working together here does not mean only finance, it means all of the other things that MDBs bring to the table: cross-country evidence, technical assistance and support for policy and institutional reform, on-the-ground project development and implementation capacity, deep private sector and civil society engagement, ESG standards and safeguards, and a focus on results measurement.

For example, for SDG 13 (*take urgent action to combat climate change and its impacts*), MDBs as a group are the largest source of multilateral climate finance. In 2019, MDBs together provided over $61 billion in climate finance, much more than that coming from dedicated multilateral climate funds.[2] The MDBs have developed a common methodology to assess how much of their financial input is climate-related. Similarly, on the climate output and outcome side, the MDBs are working toward quantifying their alignment with the Paris Agreement goal of net zero emissions.

The second purpose of a collective governing body would be to rapidly mount and oversee a countercyclical finance surge capacity for MDBs as a group during crises. In this century we have already experienced two deep global crises and, in both cases, the international community, including the MDBs, has struggled to respond fast enough and at a sufficient scale to forestall avoidable suffering and long-term damage. The G20 and G7 have been proactive in both crises, but the MDBs individually and as a system are ships that turn slowly. Having in place the financial capacity and agile processes for a rapid finance surge, targeted as required by the nature of the crisis, is clearly needed. The collective MDB governing body could play a key role in shaping this surge capacity and triggering its deployment.

The third purpose would be to oversee execution of the long-term collective strategy and crisis-related surges. Oversight of implementation cannot be left only to individual MDB boards. A governing body responsible for monitoring cross-MDB performance and holding MDBs as a group accountable is needed. In any strategy, short or long term, course corrections are inevitably needed. A governing body should be empowered to flag problems and call for corrective action or adjustments to the strategy.

POSSIBLE ELEMENTS OF A COLLECTIVE MDB STRATEGY

Careful thought must be given to the right elements of a cross-MDB strategy, as compared to those elements that belong in strategies for individual institutions. Such a strategy should focus on areas where collective efforts are additional. The list below is built around that purpose—that is, concentrating on and overseeing challenges and activities that cannot be addressed at the individual institution level.

Assess collective MDB capital adequacy and finance capacity

Shareholders consult and decide on capital needs institution-by-institution. But there is no common decision-making framework or criteria, no established timeframe for periodic capital reviews, or common metrics for comparing performance across institutions. And there is also no way to assess whether the MDB system as a whole is right-sized in terms of capital and lending/financing capacity. What tends to happen is that the leaders of individual MDBs seek more capital during crises, arguing that financing capacity is inadequate. Capital is added after lengthy shareholder negotiations regarding issues that are specific to each institution. No entity is responsible for assessing whether the financial capacity of the overall system is capable of playing a meaningful role in either SDG finance or crisis response. The collective MDB strategy would include such a mandate and define criteria and processes for pursuing periodic reviews of collective MDB financial capacity.

Set and oversee achievement of aggregate MDB targets for supporting global public goods

Just as in the case of climate change, global targets are needed for some global public goods (GPGs) where the risks are global and solutions cannot be achieved unless all countries participate. In pandemic responses, for example, the vaccination strategy must aim for global herd immunity.

With respect to climate change, it is already evident that collaboration on the input side, that is, aggregating MDB climate-related finance, is no longer sufficient. Shareholders are asking MDBs for a clear, time-bound plan for aligning their finance with the Paris Agreement and net zero emissions, for both risk management as well as climate impact reasons. Credible and comparable measurement standards and methodologies are critical here. Shareholders and stakeholders cannot long afford uncertainty about whether different MDB emissions results are comparable, as has been the case with other MDB results metrics. MDBs are working on a common methodology that would allow them to set consistent alignment targets and aggregate their emissions outcomes. They can and should share that methodology with other finance providers, public and private, to build a broader circle of aggregated outcomes.

The MDB governance body could have the role of overseeing MDB collective performance in meeting such GPG targets.

Promote harmonization of MDB project development processes and shared transaction costs

MDB pursuit of impact and efficiency would be well served by building a common set of best practices in areas like ESG standards and safeguards and by sharing project development costs to expand the overall supply of viable projects, especially in difficult environments. Both governments and private actors seeking MDB finance now face a wide diversity of policies and practices across different MDBs that is costly and time-consuming to navigate; this is part of the reason governments find the simpler Chinese model more attractive, even if the financial terms offered are less favorable.

The collective MDB governance body could play an important role in driving harmonization and streamlining efforts in ways that do not weaken standards. A critical aspect of this role is to create incentives that reward MDBs for building the collective pipeline and mobilizing others' finance, rather than focusing only on the volume of their own operations.

In addition, the collective governance body could grapple with the challenge of mobilizing grant finance for transaction development. Consideration of the right ways to generate these resources is especially important if shareholders are serious about significantly ramping up operations in poor and fragile states, including finance for the private sector.

Support MDB investment funding pools

On the finance supply side, many point to tapping into institutional investor funding as essential for moving the "billions to trillions" vision forward. And the growing private investor interest in climate and SDG investing offers unmistakable opportunities on the investor demand side. Yet it is equally clear that institutional investors need large pools of viable assets with credible SDG impact to fit their investing model. They are not interested in assessing large numbers of infrastructure projects spread all over the globe.

MDBs could start standardizing and bundling their assets to facilitate the sale of asset-backed securities or to transfer the risks of asset bundles to private investors (for a fee) in order to free up their capital for new lending. Such assets would offer institutional investors the opportunity to invest at scale in regionally diversified SDG-related projects that have benefited from MDB due diligence. Support for this idea has come from a number of places, including the G20. But there is no entity, such as a collective MDB governance body, consistently pressing the MDBs to move forward with the difficult work of making this happen.

Foster risk-sharing across MDBs and shared access to concessional finance

The ability to manage risk is essential to development finance with development impact, and, if MDBs worked as a system, they would be able to take on more risk. On the public lending side, they have begun swapping sovereign loans to deal with country exposure limits and stretch their capital. On the private finance side, blended (concessional + commercial) finance is touted as the solution to addressing the risks of investing in difficult investment climates. Concessional finance from the public sector plays the role of taking on or mitigating enough risk to generate risk-adjusted returns acceptable to the private sector. Yet blended finance remains tiny as a share of MDB private finance transactions; concessional finance is scarce and fragmented into numerous small donor trust or guarantee funds. The result is disappointing performance in mobilizing private capital, especially in poor countries.

Only $2.3 billion in private finance was mobilized by development finance institutions for all poor countries together, for example, in the years 2017 and 2018.

What would make more sense is to make larger pools of concessional finance available to multiple MDBs so that they could compete for access based on expected development impact and mobilization performance. Such larger concessional facilities would need to be coupled with specialized staff expertise in deploying high-risk/high-impact/high-mobilization financial instruments as in this CGD Stretch Fund proposal.[3] But individual MDBs currently have no incentive to pool their concessional funds and have limited staff expertise in difficult but highly catalytic instruments like early stage equity. The collective MDB governance body could drive and oversee the creation of such a multi-MDB concessional funding facility or facilities and monitor performance against agreed targets.

In addition, there are already multilateral funds administered by the World Bank that offer other MDBs access to concessional funding for particular sectors and for gender, including the Climate Investment Funds, the Global Agriculture and Food Security Program, and the Women Entrepreneurs Finance Initiative. While these all have their own donor governing boards, the MDB collective governance body could broadly review their comparative performance to identify lessons for strengthening the operating policies and processes for funds accessible by multiple MDBs.

WHAT WOULD THE GOVERNING BODY LOOK LIKE?

The design and structure of the governing body should reflect the experience of other global steering groups, particularly the G20 and G7. It should be composed of a manageable number of countries. It could meet twice a year at the time of the meetings of the IMF and World Bank. Each country would be represented by its finance minister, economy minister, or development minister—whichever is the country's MDB governor. The heads of all the major MDBs would participate. The ministerial group could establish working-level groups to prepare issues and formulate proposals or recommendations for ministers, in consultation with MDB management. It could have a rotating country chair each year, but, to avoid the proliferating—sometime idiosyncratic—agendas and weak follow-through we often observe in the G7 and G20, the group would focus consistently on the three purposes outlined above: (1) develop and agree on a long-term strategy for MDB performance as a system; (2) when needed, mount and oversee a countercyclical MDB finance surge capacity during crises; and (3) oversee execution of the long-term collective MDB strategy and crisis-related surges.

For this group, there is no reason to tie the country composition of the governing body to capital shares in any particular MDB. But it should be geographically representative. And, in contrast to the G20 and G7, it should include significant representation from low- and lower-middle-income countries (LICs and LMICs) as the countries arguably with the highest stake in the success of the MDB system.

CROSS-MDB GOVERNING BODY OPTIONS

One could construct the governing body in a number of different ways. Here we suggest three options: (1) a new, purpose-built group of countries selected using relevant quantitative criteria; (2) a G20 plus group which adds LMIC and LIC representation; and (3) a group composed of leading countries with smaller country constituencies, similar to the composition of the boards of MDBs.

Purpose-built group

As in the case of IMF and World Bank shareholding formulae, it is possible to identify quantitative, objective criteria for selecting countries. But such formulae tend to favor relatively high-income countries with large populations. For this purpose, it would be useful to add criteria reflecting a country's importance for the global effort to fight poverty. For that reason, one could posit different criteria for countries in different income groups. Higher-income countries might be chosen based on their economic size and commitment to global aid, especially to poor countries. Lower-income countries might be included based on their share of the global poor, as well as their economic size.

As an experiment, we constructed a group of countries using a notional set of criteria for representation by high-income countries (HICs), upper-middle-income countries (UMICs), and lower-middle-income countries (LMICs) and low-income countries (LICs). Scores were calculated for each set of countries with equal weights for the criteria in each income category. Each of the three country income groups would be represented by the eight countries with the highest scores in that income group. The governing body would therefore consist of a total of 24 countries.

For this exercise, the country scores for each country income group (as defined by the World Bank) were calculated using the following formulas:

HIC country scores = [(Share of Global GDP * 0.33)] + [(ODA share of GNI *0.33)]+
[(Share of IDA donor contributions * 0.33)]

UMIC country scores = [(Share of Global GDP * 0.5)] + [(Share of Global Poor at $3.20/day*0.5)]

LMIC/LIC country scores = [(Share of Global GDP * 0.5)] +[(Share of Global Extreme Poor at $1.90/day*0.5)]

Shares are all in percentage terms, with calculated scores out of 100. Data sources are the World Development Indicators for GDP, the OECD for aid/GNI data, the IDA18 Report for cumulative IDA donor contributions, and the World Bank's PovcalNet data portal for poverty data.

The eight countries with the top scores in each income category based on these criteria are as follows.

HICs	Score
United States	14.6
Japan	7.21
United Kingdom	5.61
Germany	5.06
France	3.52
Canada	2.31
Italy	2.24
Sweden	1.75

UMICs	Score
China	9.29
Indonesia	2.30
Brazil	1.66
Russia	0.99
Mexico	0.95
South Africa	0.86
Turkey	0.49
Colombia	0.36

LMICs and LICs	Score
India	10.66
Nigeria	6.32
Dem. Rep. Congo	4.69
Tanzania	2.18
Ethiopia	2.07
Madagascar	1.55
Mozambique	1.43
Kenya	1.36

Note: Alternative UMIC scores were calculated using the World Bank poverty definition of $5.50/day for UMICs. The results were substantially the same: seven of the eight countries did not change using this definition.

This exercise shows considerable overlap with the composition of the G20, ensuring that the new group would wield the political and financial authority of the largest providers of capital to the MDB system. Collectively, this group accounts for more than half of the capital shares of all of the major MDBs and an average share across all eight institutions of 60 percent.[4] At the same time, it offers an objective way to add the voices of poorer countries that must be active governance partners if the MDB system is to work effectively.

G20 plus group

An alternative to constituting an entirely new group is to add LMICs and LICs to the G20 to address this set of issues. This could be done by adding the seven countries, or a subset, in the LMIC/LIC group above to the G20. (India is already a member of the G20.) Building on an existing group clearly has practical and political advantages in avoiding the politics of excluding countries that are already in the G20, and building on the G20's established mandate and practices.

The G20 plus group could focus specifically and only on the MDB systems issues defined here rather than the full panoply of G20 issues where it is already sometimes difficult to reach agreement. But it may be hard to disentangle the MDB issues that fall under the G20 itself from those that would be addressed by the larger group.

Constituency model

One other alternative is to deploy the constituency model used in MDB shareholding, in which major shareholders lead and represent constituency groups of smaller shareholders. The World Bank executive board constituency structure makes the most sense for this purpose as the World Bank is the only MDB which is global in its operations and membership. There are 25 executive directors representing the 189 member countries. The member countries of these constituency groups consult to develop common positions. And the chair of the constituency group may rotate among the members.

The major advantage of this structure is that it is inclusive, offering a voice to all countries. The disadvantage is that it is constructed based on World Bank shareholding, which is different than that of other MDBs, and favors higher-income countries: country votes are weighted based on country capital shares. But for this purpose, as in the G20 and G7 cases, decisions could be made on a consensus basis.

START WITH CLIMATE CHANGE

Given the geopolitical difficulties of creating a new multilateral governing body, it would make sense to narrow the initial mandate and focus on a global public good where the rationale is most obvious and urgent: combatting climate change. MDBs have a critical role to play at the intersection of climate change and development, in scaling finance and in setting standards for measuring and reporting on Paris Agreement alignment.

The governing body could concentrate on the issues identified above as they relate to the climate agenda: MDB capital adequacy for climate finance, collective emissions target-setting, sharing of risks and transaction costs for climate-related investment, consolidation of concessional funding for climate finance, ensuring sufficient focus on adaptation to climate change in the poor countries heavily impacted, and pooling climate-related assets to attract large investors.

We are already seeing a fraying of cooperation between rich and poorer countries in the run-up to the 26th UN Climate Change Conference of the Parties. We should not assume that differences can be resolved inside bodies like the G20 and G7. Nor can we assume that MDB leaders will be sufficiently incentivized to collaborate or hold themselves accountable for their collective performance. The case for an MDB governing body specifically charged with driving progress in combatting climate change is strong, both because of the urgency and because of the long-term, sustained collective efforts required.

CONCLUSION

The current governance system has not produced the synergies and scale across MDBs that are urgently needed—by recipient countries and by the major shareholders responsible for the efficient and effective use of their capital. It is always hard to create a new piece of official international financial architecture. But it has also proven very costly to fail to do so. The unmet long-term SDG and GPG finance needs, repeated unsustainable debt buildups in poor countries, and the periodic imperatives of global crisis response have rendered that failure unacceptable. However the group is constituted, this is the time to rise to the challenge and develop an MDB steering group, with both shareholders and MDB heads, empowered to build collaborative strategies and hold institutions accountable for collective performance, starting with combatting climate change.

NOTES

1. G20 Eminent Persons Group on Global Financial Governance, 2018. *Making* the Global Financial System Work for All. https://www.globalfinancialgovernance.org/assets/pdf/G20EPG-Full%20Report.pdf

2. *Joint Report on Multilateral Development Banks' Climate Finance*, 2019. https://publications.iadb.org/publications/english/document/2019-Joint-Report-on-Multilateral-Development-Banks-Climate-Finance.pdf

3. Nancy Lee and Dan Preston, 2019. *The Stretch Fund: Bridging the Gap in the Development Finance Architecture*. Center for Global Development. https://www.cgdev.org/stretchfund

4. The major MDBs included here are the World Bank, the African Development Bank, the Asian Development Bank, the European Bank for Reconstruction and Development, the Inter-American Development Bank, the European Investment Bank, the Asian Infrastructure Investment Bank, and the New Development Bank.

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