CGD NOTES

Toward Better Multilateral Development Banks: Can the United States and China Lead Together?

November 21, 2017

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This CGD note is an updated version of an essay that first appeared here.

In the broadest sense, the multilateral development banks (MDBs) present the United States and China with the same value proposition. MDBs leverage development resources, helping both countries share the burden of financing development with others. MDBs promote growth and poverty reduction, increasing economic opportunity for both countries in frontier and emerging markets. They concentrate collective development experience, data, and technical expertise. MDBs are key actors in responding to global shocks, crises, or natural disasters that affect the economic performance of both countries. MDB work in vulnerable states can forestall conflict, reducing security risks that directly or indirectly impact both countries. And MDBs offer both countries convenient mechanisms for managing multi-donor contributions for addressing urgent global challenges.

Yet these overarching common interests have been overshadowed by differences in priorities with respect to operational means and development ends. MDB governance changes reflecting China's ascendant role in the global economy have been slow. China's interest in rapid increases in infrastructure funding, often tied to its own construction companies, has not meshed well with MDB environmental, social, fiduciary, and procurement safeguards. In response, China has ramped up its own bilateral development programs and led efforts to create two new development banks, the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB). But the creation of new institutions is a costly and time-consuming lift. They are certainly a reasonable outgrowth of the changing landscape of global economic power. But to regard them as substitutes for existing institutions would be to waste decades of accumulated human, institutional, and financial capital. Efforts by the two countries to strengthen both the existing and new institutions and focus them on agreed priorities offer, or should offer, attractive ways to pursue common aims.

This purpose of this note is to provide a realistic analysis of where MDBs have made progress in improving performance and governance, the risks and challenges they and their shareholders confront today, possible areas of US-China collaboration, and a specific recommendation for a joint effort. This note draws heavily from a recent Center for Global Development Panel Report.[1]

MDB reform progress

Despite criticism from both creditor and borrowing countries, the MDBs as a group are stronger institutions than they were a decade ago, as shareholders, clients, research, global needs, and resource constraints have driven change. While most would agree that the pace of change has been too slow, MDBs (along with the IMF) deserve substantial credit for important improvements in macroeconomic and financial management; the quality and efficiency of social transfers; an enhanced focus on women and girls (emerging from MDB research); unique cross-country databases in areas such as poverty, enterprise behavior, and financial inclusion; and better global standards for results measurement, environmental and social safeguards, and fiduciary and procurement systems.

All have more lending capacity—capital increases were negotiated in the World Bank and in the regional development banks in the wake of the global financial crisis. In fact, size and reform were very much intertwined; capital increases are always action forcing events for reform progress.

With support from the G20, some of the institutions are also using their balance sheets more efficiently. The merger of the Asian Development Fund balance sheet into the Asian Development Bank's core balance sheet has effectively tripled the ADB's capital and expanded overall lending capacity by 50 percent.[2] Similarly, the 18th replenishment of International Development Association (IDA) blends donor grant contributions with market-issued debt, secured by IDA's loan assets. With this innovation, IDA achieved its largest lending capacity in history—$75 billion.[3]

And the MDBs, particularly the World Bank, are still the go-to institutions for mobilizing, managing, and allocating resources to respond to urgent challenges—e.g., the global financial crisis, climate change (the Climate Investment Funds), global health (the Advance Market Commitment, the International Finance Facility for Immunizations), food security (the Global Agriculture and Food Security Program), and the refugee crisis (the Global Concessional Financing Facility).

Risks and challenges today

But the post-World War II world and the world of today are fundamentally different in ways that require the MDBs to evolve much further to remain core development actors.

First, there is the dramatic shift in the *distribution of economic power*. Countries that borrow from these institutions now account for two-thirds of the global economy. The logic of affording these countries a stronger voice at decision-making tables is obvious. Yet, governance systems at the MDBs have been slow to change.

Second, it is fair to say that there is *less confidence in traditional policy orthodoxy* from the North—both in the South and in the North. Asian countries regard their growth and poverty reduction track records as clear evidence of the validity of different development models. Rising populism in the North is undercutting trust in the value of open markets for trade and investment. MDB policy conditionality often places them at the center of these debates. Yet, despite policy differences, both China and the United States ought to share a strong interest in maintaining the MDB technocratic, evidence-based approach to policy advice. Multilateral institutions offer degrees of political separation from policy discussions that governments and bilateral institutions do not.

Third is the *proliferation of alternatives to MDBs* for both finance and technical expertise. As many have noted, private global capital flows dwarf official flows, and the gap between official flows and what is needed to achieve the Sustainable Development Goals (SDGs) will never be filled with public development funds. This recognition is driving a fundamental shift in thinking about how to assess MDB performance. Where MDBs were once judged by the volume of finance they themselves offered and disbursed, they are now increasingly judged by how much they catalyze from other sources—from the private sector and from domestic resource mobilization.

A fourth difference is in the *geographic distribution of the poor*. The poverty reduction success of China, India, and other emerging markets means that 21st century poverty will increasingly be concentrated in countries with the most difficult environments and the weakest records in sustaining growth. By 2030, an estimated 40 to 60 percent of the world's poor will be living in states now deemed fragile.[4] MDB poverty reduction performance, therefore, will increasingly be judged in places where effectiveness is hardest to achieve.

Finally, the US administration is clearly signaling diminished support for *multilateral global governance and institutions*. The "America First" approach to economic and security matters place more emphasis on bilateral relations and arrangements, and more reliance on "hard" investments in defense than on "soft power." The US retreat from its unique role in leading and supporting the multilateral system risks seismic consequences. The damage done is compounded by a Europe inwardly focused on its own internal divisions. While these developments clearly create opportunities for China, they come at a time of significant instability, danger of expanded conflict, and global fragmentation—a risky time to take more responsibility for leadership of the global multilateral system.

Prospects for US-China cooperation

At this moment of high uncertainty in US-China relations, proposals for cooperation in the MDB context need to be grounded in areas where mutual interest is strong. Such areas might be found where there is:

- a desire on the part of both countries for financial burden sharing on an urgent issue(s);
- a common view of MDB weaknesses for which both countries seek a solution; or

- an internal challenge of political significance where multilateral efforts might be of some help to both countries.

Here are a few illustrative possibilities.

A strong case can be made for mutual interest in *sharing the burden* of financing challenges that are global in scope but now seriously underfunded because no one country is able, or has the incentive, to take them on alone: examples are *global public goods* in areas like climate change, health, and agricultural research. While the United States and China are likely to assign different priorities to different global public goods—e.g., climate change—the economic and political logic of using multilateral institutions to pool and share funding responsibility is clear.

A second issue of shared interest is enhancing MDB effectiveness in *mobilizing private finance* for investments. China wants greater leverage from its MDB contributions and its co-investments in MDB projects by state institutions, as well more growth-enhancing MDB activity in frontier markets where its presence is expanding. For its part, the United States, given its private-sector-led economy and market perspective, is better placed to advance innovative ideas for greater leverage.

A third shared objective is increasing investment in *sustainable infrastructure,* including regional infrastructure, central to growth and economic opportunity. The estimated gap in finance for developing country infrastructure of $1-1.5 trillion per year dwarfs annual MDB infrastructure support of $50 billion.[5] And private finance for infrastructure largely bypasses poor countries: IDA countries received less than 4 percent of the value of infrastructure projects with private participation in developing countries from 2011-2015.[6]

China and the United States could take the lead in urging the MDBs to achieve greater scale by strengthening their collaboration on: (1) early stage project investment to help countries choose and design investments with the highest economic returns; (2) support for policy and institutional reforms essential for making infrastructure sectors investable; (3) more and better use of risk-sharing and mitigation instruments; and (4) pooling standardized yet diversified infrastructure assets capable of attracting institutional investors.[7]

A fourth issue concerns an internal challenge for both countries: *higher inequality* and its political consequences. Both countries struggle to connect marginalized populations to the benefits of growth. The MDBs are well placed to help both high- and low-income countries craft the complex strategies needed in response.

Finally, both countries confront *rapid changes in the 21st century composition of jobs and skills*, related to globalization and technological change. An estimated 38 percent of current US jobs will not exist in 2030.[8] As incomes in China continue to grow, it will confront these issues, likely sooner than expected. China and the United States could take the lead in urging the MDBs to develop tools to help countries adapt proactively and prophylactically.

Recommendation

This is a time to set limited and achievable goals for cooperation in the MDB area, which is greatly overshadowed in bilateral relations by security issues and trade. It would be best to choose one area where the case for collaboration is relatively easy to make, where chances for success are reasonable, and where there is a need for US-China leadership.

I would suggest that the establishment of a *World Bank window for global public goods* is one such area. As proposed in the CGD Panel Report, this new window could be established in a way that addresses US interests in avoiding additional contributions to the Bank as well as Chinese interests in an enhanced governance role.[9] The Report proposes a funding level of $10 billion a year for the window. There would be no increase in traditional donor assistance budgets. Rather, the funding would come from expanded World Bank income as IDA reflows are leveraged, reallocation of some donor contributions to the window as countries graduate from IDA, emerging market donor contributions, and perhaps capital contributions from emerging markets to endow the window. A separate governance structure could be established that gives China an enhanced role, along with other emerging markets.

The result would be a new piece of multilateral architecture that serves multiple purposes: (1) funding critical activities of urgent global importance that are now greatly underfunded, (2) shifting some IDA funding to better uses rather than have funding decline as the number of IDA countries declines, (3) giving China and emerging markets the opportunity to exercise significant control over the new entity without having to fight shareholder dilution battles, and (4) giving the US administration the political opportunity to point to China and others as shouldering more of the burden of financing these activities, an objective it has stressed in the cases of NATO and the UN.

Conclusion

The existing multilateral institutions are a global asset that can and should function cooperatively with each other and with the new institutions. But they must adapt in both function and governance to new global economic realities and challenges. The US and China share an interest in leading change in both dimensions. A new window in which China's role rivals that of the US is no threat. Rather increased Chinese political and financial buy-in to institutions that reflect US values is an important gain. From China's side, the opportunity for a leading role in formation of a new window to respond to urgent global needs, without having to shoulder most of the financing burden, should not be missed.

[1] "Multilateral Development Banking for This Century's Development Challenges: Five Recommendations to Shareholders of the Old and New Multilateral

Development Banks," *Center for Global Development* (2016), https://www.cgdev.org/sites/default/files/multilateral-development-banking-report-five-recommendations.pdf.

[2] Nancy Birdsall, Scott Morris, and Enrique Rueda-Sabater, "Review of 'Enhancing ADB's Financial Capacity to Achieve the Long-Term Strategic Vision for the ADF,'" *Center for Global Development* (2014), https://www.cgdev.org/sites/default/files/CGD-Assessment-Birdsall-Morris-RuedaSabater-ADB.pdf; Indu Bhushan and Alain Borghijs, "Innovatively using the Asian Development Bank's balance sheet to eradicate poverty," *Brookings Institution* (2015), https://www.brookings.edu/blog/future-development/2015/05/27/innovatively-using-the-asian-development-banks-balance-sheet-to-eradicate-poverty/.

[3] "Global Community Makes Record $75 Billion Commitment to End Extreme Poverty." *World Bank*, December 15, 2016, http://www.worldbank.org/en/news/press-release/2016/12/15/global-community-commitment-end-poverty-ida18.

[4] Laurence Chandy, Natasha Ledlie, and Veronika Penciakova, "The Final Countdown: Prospects for Ending Extreme Poverty by 2030," *Brookings Institution* (2013), https://www.brookings.edu/wp-content/uploads/2016/06/The_Final_Countdown.pdf; Alison Burt, Barry Hughes, and Gary Milante, "Eradicating Poverty in Fragile States: Prospects of Reaching The 'High-Hanging' Fruit by 2030," *World Bank Group* (2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2479667.

[5]Amar Bhattacharya, Jeremy Oppenheim, and Nicholas Stern, "Driving Sustainable Development Through Better Infrastructure: Key Elements of a Transformation Program," *Brookings Institution* (2015), https://www.brookings.edu/wp-content/uploads/2016/07/07-sustainable-development-infrastructure-v2.pdf; Chris Humphrey, "Infrastructure Finance in the Developing World: Challenges and Opportunities for Multilateral Development Banks in 21st Century Infrastructure Finance," *Global Green Growth Institute* (2015), https://www.g24.org/wp-content/uploads/2016/05/MARGGK-WP08.pdf.

[6] Fernanda Ruiz-Nunez, "PPI Investments in IDA Countries, 2011 to 2015," *World Bank Group* (2016), https://ppi.worldbank.org/~/media/GIAWB/PPI/Documents/Data-Notes/PPI-in-IDA-Countries-2011-2015.pdf.

[7] Nancy Lee, "Billions to Trillions? Issues on the Role of Development Banks in Mobilizing Private Finance," *Center for Global Development (2017)*, https://www.cgdev.org/publication/billions-trillions-issues-role-development-banks-mobilizing-private-finance.

[8] Richard Berriman and John Hawksworth, "Will robots steal our jobs? The potential impact of automation on the UK and other major economies," *UK*

Economic Outlook (2017), http://www.pwc.co.uk/economic-services/ukeo/pwcukeo-section-4-automation-march-2017-v2.pdf.

[9] Birdsall, Morris, and Rueda-Sabater, "Review of 'Enhancing ADB's Financial Capacity to Achieve the Long-Term Strategic Vision for the ADF.'"