# Our Wish List for the World Bank's Evolution Roadmap

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The assignment is clear. During this year's Annual Meetings of the IMF and World Bank, shareholders instructed the World Bank to develop a work program for its own evolution ("to identify gaps in the Bank's current institutional and operational framework...") by the end of the year. Secretary Yellen led the evolution charge, noting, "We do not yet have a sufficiently robust toolkit to address, with scale and urgency, our global and cross-border challenges."

World Bank announcements of rising volumes and shares of climate finance before the meetings did not suffice to convince shareholders that it is well positioned to meet needs for global climate and health challenges. Shareholders and the world's vulnerable populations need a World Bank that not only deploys more finance and other kinds of support to meet global challenges, but also deploys them more efficiently, with demonstrable impact, and in productive collaboration with regional development banks.

Yet global challenges—climate, pandemic preparedness, fragility and conflict—are far from the only pressing issues on the agenda. In addition to the pandemic backlog in health and education, countries now face serious cyclical risks. They already face higher borrowing costs, and more than two-thirds of developing countries are at or near debt distress. Reconstruction in Ukraine will also add massive finance demands on top of ongoing support for an economy and fiscal balances in freefall.

Based on many discussions during the Annual Meetings, including at CGD, the broad contours of reform priorities are beginning to take shape. There is no mistaking the deep distrust and resentment between the countries most vulnerable to mounting crises and the rich countries that drove climate change and failed to provide enough vaccines for the rest of the world. But we see at least two reasons for optimism regarding the path forward.

First, the twin climate and health crises are driving more agreement across borrowing and non-borrowing multilateral development bank (MDB) shareholders on spending priorities: climate adaptation and mitigation, recovery from the damage already evident from climate change (including to food security), and pandemic response and resilience. We are seeing a partial convergence across countries of threat analysis and therefore interests: most favor more finance for global public goods (GPGs) where collective action is essential for success.

Second, there is a shared desire that the poverty, equality, and GPG agendas not be treated as a zero-sum game. They must be pursued together and can be mutually reinforcing. Certainly, the mix of the World Bank's activities will differ in different countries. But a smallholder farmer receiving support for shifting to more sustainable and climate-resilient crops or production techniques cares little whether that support is labeled a climate project or a poverty reduction project.

Adding a GPG mandate to the World Bank's twin goals (ending extreme poverty and promoting shared prosperity) inevitably requires mobilizing more resources. Without more MDB finance capacity, including concessional finance, trade-offs may not be conceptually warranted but they will be forced by the arithmetic. But some ways of resource mobilization are considerably more efficient and productive than others. And borrowing countries need different financial instruments than they did before they had market access. The World Bank and regional development banks have to demonstrate to shareholders that they gain more from putting their funding in MDBs than in bilateral channels or separate "vertical" funds. MDBs should not assume that case is at all obvious amidst shrinking foreign assistance budgets in our polarized world.

What follows pulls together a set of mutually reinforcing reform priorities, many of which were previewed in this Call to Action and further articulated during the Annual Meetings. Some of this agenda represents a significant departure from the model that has prevailed for decades, while other elements require scaling up new initiatives that some MDBs are already undertaking. Some of the regional development banks have already pioneered useful financial and balance sheet innovations that the World Bank can now take up.

The plan includes both changing the model and increasing its financial capacity. The model changes cover shifting toward more catalytic instruments to help countries mobilize more GPG finance from both public and private sources; consolidating and rationalizing donor concessional finance for GPGs; building a structure for collaboration across MDBs; and targeting impact and outcomes, not just finance inputs. Boosting MDB financial capacity includes implementing the recommendations of the capital adequacy report to the G20 for greater capital efficiency, starting work on general capital increases, putting IDA's equity to better use, and finding a way to use special drawing rights (SDRs) to increase MDB lending.

The model changes and expanded MDB financial capacity must be pursued together. The kinds of major reforms described here can only be realistically achieved in the context of discussions of general capital increases for MDBs. Historically, gaining agreement on significant changes in MDB financial and operational models has only been successful if linked to decisions on additional capital.

# A 10-step evolutionary plan

## 1. Agree on purpose and expected outcomes.

A first step is to articulate the purpose of the reform: (i) to help governments deal more rapidly and effectively with the pressing and much larger scale needs associated with an historic poly-crisis that is setting back development by decades, and (ii) to face global challenges with a new set of instruments and incentives that can make a measurable difference on climate, pandemic risks, and fragility. These purposes must be articulated in easy-to-understand terms that resonate with leaders and legislatures around the world; while many of the strategies below are technical and precise, the package of reforms should enable us to articulate how/how much these changes will redound to shared-priority outcomes (Paris targets; SDGs; etc.).

## 2. Add more catalytic financial instruments for funding global public goods.

MDBs for some time have not been the principal external source of public finance for developing countries. As we saw during the depths of the pandemic when many emerging markets issued new sovereign debt, many middle-income countries (MICs) and some low-income countries (LICs) turned to market borrowing rather than borrowing from MDBs to meet their budget needs.

Now, as global interest rates rise and cross-border capital flows reverse, terms are worsening dramatically. But even before the change in monetary conditions, MIC and lower-middle-income country (LMIC) sovereigns interested in issuing green, social, and sustainable (GSS) bonds are in the words of one finance minister "punished by markets." They gain little benefit in terms of the cost of capital. And they face significant costs in building the more complicated transactions necessary and then monitoring and verifying GSS performance.

MDBs can and should play a central role in helping governments (and developing country corporates) issue GSS bonds. MDBs can use guarantees to take on some of the country risk and help lower the cost of capital to incentivize sovereign borrowing for these purposes. Such instruments mobilize more private finance than direct sovereign lending as shown in this CGD analysis. Countries could be incentivized to access MDB guarantees rather than loans by more favorable treatment of guarantees against country borrowing limits and other pricing incentives. More broadly MDBs should prioritize the use of results-based financing instruments, including by subsidizing the capital cost to fund a "step-down" in interest rates if governments achieve GSS performance targets

Just as important as lowering capital costs, MDBs can build the market infrastructure for measuring and verifying performance on GSS commitments. The infrastructure should be made available to market actors as a public good, with fees to help cover costs. It should operate independently, uninfluenced by any MDB involvement in bond transactions. No institutions are better placed to define, monitor, and verify GSS performance metrics. As many have observed, the lack of credible, independent arbiters/certifiers of performance is undermining both the growth of the market and GSS impact.

These activities are likely less profitable than sovereign loans and would therefore have effects on MDB balance sheets. Donor resources would be needed to blend with MDB resources. But the overriding goal should be expanding the market for credible GSS bond issuances (sovereign and non-sovereign) by emerging and frontier markets, which will ultimately have greater impact than expanding GSS assets on MDB balance sheets.

For MDB loans on their own accounts, as Secretary Yellen and others have suggested, finance terms—interest rates and tenors—can be calibrated to positive spillovers beyond country borders rather than country income levels. Many of the MDB hard loan windows have introduced differentiated pricing based on the borrower's income. This dynamic pricing mechanism should also be used to incentivize countries to borrow for projects with positive global externalities by defraying some of their cost. The same logic should be applied to MDB transactions with private companies and financial institutions that cannot capture all of the benefits of GSS finance.

## 3. Offer donor concessional support for GPGs in more efficient, scalable ways.

Donors, not just MDBs, need to make their support more efficient and catalytic. Borrowing countries find the fragmented, complicated architecture for climate finance hard to navigate and slow to disburse. In the World Bank alone, there are over 50 entities that do climate finance, including trust funds and financial intermediaries, with all mostly using bank staff for project origination and execution. Likewise, global health concessional finance is unlinked to MDB lending, resulting in large off-budget outlays that may or may not strengthen systems and response for the medium term. The architecture was built to ensure donor control and to respond to particular donor interests, not for speed, scale, and impact.

It is time to think about consolidating as much of this concessional funding as possible so that it can be scaled for impact. One option is channeling concessional funding and some of the World Bank's net income through a new GPG window as proposed in a 2016 CGD report.

Another approach that has significant advantages in financial efficiency is to use donor funds to take risk off the balance sheet of the World Bank and other MDBs for GPG finance. That would free up capital that could be leveraged, generating multiples of additional lending capacity for GPGs.

Donor funds could be pooled for use in partial guarantees and improving the terms of MDB loans and other exposure. The International Finance Facility for Education (IFFEd) offers an attractive model. If countries choose additional borrowing for education, the guarantee covers any missed repayments and the grant funding buys down lending charges. The guarantee frees up MDB capital that can be leveraged to finance additional lending: $1 of freed-up capital mobilizes $4 of additional lending. An additional source of efficiency is that highly rated IFFEd contributors only pay in 15 percent of their guarantee commitment, with a contingent commitment covering the remaining 85 percent.

Such a guarantee could be offered for World Bank and other MDB GPG lending by consolidating some of the existing structures. It could be scaled as much as donors wish. It would not require all shareholders to participate, unlike a general capital increase. Just like the existing climate financial intermediary facility (FIFs), it would have no project origination function so its administrative costs would be limited.

Shareholders could decide to supplement and incentivize donor contributions with an allocation of net income from the IBRD and other MDBs to the pool, multiplying the impact of donor funding. In addition, private foundations and philanthropic investors should be able to contribute to the guarantee fund. It should be an attractive opportunity for them to use their funding more catalytically.

For health-specific GPGs, as a response to the scale of preventable deaths and economic losses during COVID-19, a pandemic FIF was established to co-invest in pandemic preparedness, hosted at the World Bank. Expected global losses from pandemics are newly estimated at over $800 billion annually yet as a classic GPG, pandemic preparedness and the new FIF remain dramatically underfunded. In building a World Bank that can better meet global challenges like pandemics, the bank-hosted FIF secretariat must work to build proof of concept and secure an adequate financial base as a first priority. But even if the pandemic FIF reaches the annual $10 billion needed and pandemic preparedness in every country is brought to a higher level, risky pathogen outbreaks will still occur and require rapid response to support the surge in manufacturing and delivery of medical countermeasures that can stop further spread of disease.

As part of its global challenges reforms, the World Bank should establish a facility to procure and support production of medical countermeasures on behalf of lower-income countries when pandemic risks emerge, as a complement to the FIF. While design elements merit further consideration, Agarwal and Reed have proposed a credit line for a $20 billion Advance Commitment Facility Fund (about the amount raised by ACT-A to date) that could serve as the financing component to a successor to ACT-A or alternatively to regional ACT-A equivalents focusing on distributed manufacturing investments that are connected to R&D investments. This would assure that firms and governments are clear that there will be early demand for medical countermeasures in lower-income countries, and will enable other investors to build the capacities to respond when public health emergencies are declared.

## 4. Put mobilization first in private finance.

For finance to governments, maximizing the volume of MDB finance maximizes the addition to fiscal space for development- and climate-related expenditures. The same is not necessarily true for the private finance arms of the MDBs. No matter how large the volume of their commitments, they cannot realistically aspire to fill gaps in capital markets. Their success depends on incentivizing private actors to do so. But the "billions to trillions" vision of SDG finance articulated in 2015 did not emerge in reality. Many shareholders called for better mobilization performance during the Annual Meetings, including in infrastructure investment.

As in the case of MDB sovereign lending, it is clear that changes in the business and financial models of these private windows are needed. Shareholders are unlikely to be receptive to calls for more capital or concessional contributions without those changes. In fact, just making large amounts of concessional finance available for blending does not in itself ensure that more viable transactions result, as we have seen in the case of the IDA Private Sector Window. The IFC has had to make major investments in "upstream" project development to build a pipeline. The jury is still out on whether these will produce significant increases in IFC commitments and private finance mobilization in IDA-eligible countries.

Decisions on allocation of scarce IDA and other MDB concessional finance for LICs must be based on clear-eyed assessments of impact and mobilization. The evidence so far suggests that much of LIC finance will need to go to governments and will have to come from MDB balance sheets.

The reform agenda for the private finance arms of MDBs involves significant internal and client-facing change:

- a shift in instruments to more catalytic products like guarantees, equity, and insurance;
- targeting below-market but still sustainable financial returns at the portfolio level;
- building staff capacity for deploying new instruments;
- developing metrics for broader market impact in mobilization, not just the private finance share of each transaction;
- management and staff performance incentives tied to mobilization;
- offering private investment opportunities at scale at the MDB portfolio level;
- prioritization of relevant investment climate reforms by MDB public sector departments;
- requiring private recipients to compete for access to subsidies to maximize impact value for money; and
- greater transparency on MDB credit performance to build private sector interest through better information about risk adjusted returns.

These major changes need to be well understood and supported by shareholders, in part through concessional finance to cover some of the risk sharing and bankable project development. It is important to acknowledge that this agenda carries risks and costs. It means lower and more variable net income for the private finance parts of MDBs and more budget resources for broadening staff skills. It means an evolution from a bank model funded almost entirely by loan spreads to a more diversified financial institution that offers a wider array of products. And it requires skilled and committed management at the top of MDBs to bring the parts of the organization together into a more effective whole with mobilization as a critical corporate goal.

One hopes that the urgency of investing in SDGs that have global benefits can be harnessed to drive this agenda forward, and that the more path-breaking MDBs can lead the way. One analysis suggests that private finance has to double to build a credible path for financing sustainable, resilient, inclusive recovery and growth. The best hope of locking in these reforms in the World Bank's case is as part of this evolution, with more donor finance and more shareholder capital hanging in the balance.

## 5. Lead MDB collaboration on GPGs.

Despite periodic calls for the MDBs to operate as a system, MDBs typically engage individually with client countries and not much with each other. The reasons are not hard to understand. They are judged principally by the volume of finance they themselves commit and disburse every year. They each have their own boards, operational processes, fiduciary standards, environmental and social protection standards, institutional strategies, results frameworks, etc. Their boards do not meet jointly. And other multilateral bodies fall short of meaningful oversight of collective MDB performance. The G20 and G7 do not systematically mandate or monitor anything like a shared MDB strategy for GPGs or anything else.

That approach worked when the sources and solutions to urgent challenges were largely within country borders. But by definition, global public goods require collective action across countries and across MDBs and UN agencies with critical roles in finance for climate action and global health. So far, MDB collaboration at the institutional level on climate has chiefly been limited to a collective report on annual MDB climate finance.

The World Bank, with its size, global mandate, and broad toolkit, is the logical institution to lead the creation of a collaborative structure. It has not embraced this role to date, but the work plan for evolution should give the bank responsibility for doing so.

A collaborative structure, with oversight from shareholders, including the most vulnerable countries, needs a clearly defined collective strategy and purpose. Here are five areas where a shared strategy is needed—that is, challenges and activities that cannot be addressed at the level of individual institutions.

- Set and oversee achievement of aggregate MDB//UN targets for their contributions to net zero emissions and other aspects of Paris Agreement alignment, climate adaptation and resilience, pandemic response and resilience, and other global health goals.

- Target collective GPG outcomes and outputs, not finance inputs. This will require development of common definitions and measurement of outcomes for global climate and health goals, as well as collective monitoring capacity.

- Promote harmonization of MDB climate and health finance standards and processes and share transaction costs to scale the pipeline of projects and the size of the investments possible.

- Pool MDB climate and global health-related assets to attract large-scale institutional investment in SDGs.

- Share risk across MDBs and share access to concessional finance for incentivizing GPG investments.

## 6. Consider outcomes and impact expected

The success of these reforms depends on how well upscaled financing can make a real difference for outcomes—in terms of fiscal sustainability, human well-being, and climate and pandemic risk mitigation. While the MDB have long been knowledge leaders, accountability for results remains diffuse and most operations are not rigorously evaluated. Especially in the area of global challenges like climate and pandemic risks, evidence on "what works" is sorely lacking.

The World Bank is both a funder and implementer of evaluations globally and is one of the largest players in the field. Its extensive role in knowledge production gives the World Bank a comparative advantage in generating and using evidence, and its focus on serving client governments often exemplifies the principles of demand-driven evaluation. The critical role of evaluation—and specifically impact evaluation to attribute causality—in assessing program effectiveness and promoting operational learning is a well-established institutional principle.

Still, less than 5 percent of World Bank projects have been subject to formal impact evaluation methods since 2010. Over the coming years, there is significant scope to improve how evidence and evaluation functions, notably for impact evaluation, are structured within the bank and to scale up efforts to generate greater value for policy use, mobilize additional financing, and achieve economies of scale. The 2021 Strategic Framework for Knowledge calls for the World Bank Group to better align financing with global knowledge to generate development solutions in a timely, contextualized, and integrated way. As the bank's leadership operationalizes this framework, now is the time for a reinvigorated commitment to evidence generation and use.

## 7. Reform MDB capital adequacy frameworks to boost lending and crowd in the private sector.

The independent panel convened by the G20 to assess MDB capital adequacy concludes that there is significant scope for MDBs to expand combined lending while maintaining institutional ratings. The panel offers a set of specific recommendations that, if implemented across the system and at scale, would increase collective lending capacity by hundreds of billions of dollars over the medium term.

The recommendations propose increasing shareholder involvement in defining institutional risk appetite; taking a prudent share of callable capital into account in capital adequacy frameworks; pursuing financial innovations that offload risk to free up MDB capital (including shareholder guarantees); offering non-voting hybrid capital to private investors; pooling callable capital to boost countercyclical lending capacity; benchmarking capital adequacy across institutions using common metrics; and engaging with credit rating agencies and private investors to promote more accurate risk assessment for MDB credits. All of the proposals have been tested in one or more institutions.

Two points bear emphasis. First, the reforms do not fundamentally change the MDB model and development mission. The report does not, for example, propose a quantum shift in MDB risk tolerance. In fact its recommendations are mutually reinforcing so that measures involving incremental changes in risk are balanced by measures that add to available capital. And second, the recommended innovations have strategic value beyond simply increasing MDB lending capacity. They offer ways to mobilize more of the wall of capital seeking credible SDG investment on a scale that MDBs have thus far been unable to achieve.

The report has broad shareholder support and, after some initial reluctance, growing interest from the MDBs themselves. But implementation of the proposals will require difficult internal changes, sustained effort and attention from MDB management and shareholders, and ongoing G20 oversight. The World Bank has an opportunity to be proactive rather than defensive by developing a time-bound plan for considering each of the recommendations and implementing them in ways that offer real benefits for World Bank lending capacity and mission.

## 8. Begin work now on general capital increases.

But more capital efficiency is not enough in an environment of ongoing crises compounded by the cyclical risk of a global downturn next year. MDBs collectively, even if they were to work coherently as a system, are just too small in relation to needs. Even before the pandemic, the IMF estimated that the average LIC needed to spend an additional 15 percentage points of GDP in 2030 to achieve the SDGs and the average MIC an additional 4 points. If, for example, the major MDBs collectively had enough lending capacity to add 5 percent of GDP to total LIC spending and 0.75 percent of GDP to MIC spending to help them meet these additional needs, that would amount to an additional $250 billion a year, 2.7 times MDB commitments in 2021.

Given the time and political effort required for general capital increases (GCIs), the Evolution Roadmap should begin to lay the foundations. Putting more capital in MDBs leverages much more financial capacity than creating or adding to trust funds and financial intermediary facilities. It will also generate more net income revenue that can be directed towards grants. In a world of increasingly scarce shareholder resources, MDB leverage multiplies their capital contributions many times over. For the World Bank, its total $20 billion in paid-in capital has leveraged cumulative finance of over $800 billion. GCIs also promote equitable burden-sharing by placing more of the finance responsibility on richer countries that are larger shareholders.

Shareholders should approach capital decisions in the World Bank and in other institutions using an objective methodology that allows them to compare capital adequacy across institutions on a consistent basis, such as the benchmarking proposed in the independent panel's report to the G20.

One specific CGD proposal suggests a green capital increase of $32 billion in paid-in capital for the IBRD and the IFC. Using the ratio of new capital to lending for the previous capital increase, the additional capital would allow for $100 billion in additional annual lending through 2030. Based on current shareholding in the IBRD and IFC, the proposal would require less than $6 billion from the United States subscribed over a six-year period and $1 billion from China. As argued above, the proposal urges shifting toward more guarantees of sovereign issuances for climate purposes to improve borrowing terms, with performance defined in terms of climate-related outcomes rather than the volume of finance inputs.

## 9. Put IDA's equity to greater use

A big boost in finance to IDA-eligible countries is essential given the economic headwinds facing low-income countries compounded by the underfinancing of climate adaptation in low-income countries. IDA has sustained large donor infusions—boosted by hefty loan reflows and some market borrowing—over the last several cycle. The fund also took the unprecedented step of accelerating its replenishment by a year to meet its membership's COVID financing needs. But with reverse graduation on the horizon and many countries seeing their external financing sources drying up, sustaining large IDA net flows is essential. Several CGD pieces argue that IDA could make significantly more use of its untapped equity, including through new debt issuances which could be concessionalized through grants. This position has become more expensive with rising interest rates, but the gap between what IDA can get on markets and concessional lending rates remains attractive at about 30 cents on the dollar. IDA currently has $179 billion in equity, $175 billion in net loans outstanding, and $21.9 billion in market borrowing. And while IBRD's 1:5 leverage ratio is not advisable for IDA given the lower credit quality of its portfolio, and its sizeable grant program, even a very conservative 1:2 ratio could generate significant new funds.

### 10. Find a way to use SDRs to support lending.

Several MDBs are exploring whether SDRs can be a source of financing for loan operations. The World Bank should follow these efforts closely to see if the models being used would be appropriate for its main balance sheet or for the various trust funds it administers. Two basic models are being considered. In the first model, SDRs are lent to the MDB and the MDB on-lends them to client countries for institution-specific purposes. This is similar to what the IMF is doing with its long-established Poverty Reduction and Growth Trust and its new Resilience and Sustainability Trust. In the second model, donor countries lend SDRs to the MDB as hybrid capital that can then be leveraged to mobilize three to five times the loanable funds. This is the model currently being explored by the African Development Bank and others.

Both models require auxiliary financial structures to complement the loanable funds account. These preserve the risk-free and redeemable nature of the SDR loans but reduce the actual leverage rate somewhat—for the first model, it brings the leverage rate below one and in the second, below the average leverage rate of the institution but still significantly above one. Thus, given the leverage capacity of the MDBs, the second model is preferable, although the first is more straightforward to implement.

## Conclusion

This list embodies an evolution, not a revolution. It builds on the existing and demonstrated strengths of the World Bank and other MDBs. It adds capacities that are urgently needed but also complementary to MDBs' current missions. It should surprise no one that significant modifications are necessary 70 years after the original MDB model was conceived.

In a very real sense, there is no viable alternative to this agenda. No other bilateral or multilateral institutions have the tools and scale to step up to these challenges. As others have noted, the MDBs are "the last stop" at a time when the global outlook is worsening, not improving. The spring meetings of the IMF and World Bank in 2023 will be a time for decisions and action, not more analysis of the scope and nature of the problems and risks.

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