

## **-Suggested Outline of EPG Report: Development**

### **A. Foundations: Analysis, Assessment and Action**

Proposals for action should have foundations in articulated objectives, in an analysis of the world in which MDBs operate, and in an understanding of their past and potential performance. Recommendations should be explicit and build on these foundations. There should be a proposed game plan for implementation. This is the three-part structure proposed here.

We now have an internationally agreed global agenda (SDGs plus COP 21 and the Addis Action Agenda, of 2015, with more than 190 countries signed up to each of them) to identify a common sense of purpose for international institutions and their shareholders. As the G20 has underscored, strong, sustainable, balanced and inclusive growth is the highest priority. We can also anticipate profound changes in the coming decades that will define the challenges and opportunities in achieving the new global agenda. In this setting, international cooperation and the role of MDBs have never been more important.

#### **Analysis**

We are in the midst of ***radical change in the structure of the world economy***: with great increase in share in world economic activity in emerging market and developing countries; the largest wave of urbanization in human history; major demographic shifts and the rise of Africa; and uncertain impacts of a new technological age. The private sector has emerged as the principal driver of economic activity. Growing interconnectedness has brought the world closer together but has also seen the emergence of new or intensified risks, including pandemics, cyber-security and weapons of mass destruction. There are also intense and growing pressures on the global commons because of economic and population growth. Most of these elements will continue and some, such as climate change and technology, are likely to intensify strongly.

Our ***learning from past experience*** has identified some core lessons for economic development and policy. These include: (i) the importance of investment in human, physical and natural capital; (ii) the necessary scale of investment in all three and the urgency of much of the investment over the next two decades in the context of its centrality to the achievement of the SDGs and Paris COP 21; (iii) the centrality of governance and sound institutions (these are linked to social capital) to the quality and quantity of investment, private and public, across the board; and (iv) the need and tremendous opportunities to tap the potential of the private sector.

There are striking differences in the development landscape and in the development agenda in the two decades since the MDGs were put together. Sustainability is the hallmark of the new agenda. The MDGs provided a cohesive agenda and guided the work of the MDBs and the world's development agencies. The SDGs should play a corresponding role in the coming years; so too the G20 growth agenda.

## Assessment

Although the world has made important progress on development outcomes, there is continuing deep poverty in many parts of the world and we are far from the goal of broad-based and shared prosperity. And we are facing new challenges because of rapid technological change, growing interconnectedness and spillovers, and intense pressures on the global commons.

***How have the MDBs been performing and how well are they positioned to respond as a group to the ambitions of the new global agenda in a changing world?*** Independent evaluations suggest that each MDB individually has been generally performing well, but the system as whole is falling short of its potential and is not well positioned to respond to the challenges and needs ahead. To be effective the MDB system will need to tackle several shortcomings:

- (i) The lack of cohesion. As a group, the MDBs do not have as well coordinated objectives, instruments, skills and investments as they should. Nor common assessment of priorities. Nor shared investment platforms.
- (ii) Costly and burdensome procedures often due to conflicting shareholder mandates.
- (iii) Weak multipliers especially in mobilizing private finance.
- (iv) Insufficient scale for the magnitude and urgency of the challenges of the 2030 agenda for both human and physical capital (particularly infrastructure).
- (v) Problems of governance: excessive involvement and micromanagement by Boards; insufficient involvement of senior ministers in strategy and accountability; lack of representativeness in shareholdings in a radically changed world; dominance of leadership by certain groups and countries.

## Action

The proposals in the five areas below are designed to respond to the realities of the changed and changing world, take on the intense challenges of the global commons, and deliver on the shared world objectives for economic development and growth. And they are designed to overcome the current obstacles and performance issues of the MDBs as a group.

These recommendations are also based on the opportunities and duties that arise from the ***special and mutually reinforcing strengths of the MDBs***. These include: (i) their development mandate and long-term view; (ii) the individual and collective economic and financial strength of their shareholders; (iii) the capital structures, gearing ratios and borrower commitment that enable them to use small shareholder contributions to mobilize financing at scale and at very low-cost; (iv) the ability to be trusted conveners; (v) their ability to influence policy and support institution building; (vi) their presence itself can reduce risks, and they can deploy a range of instruments for risk management (including equity, guarantees as well as long-term loans and hybrids) to attract private investment at scale; (vii) they have developed a unique repository of skills that they can bring to tackle development challenges. These features are not subsidies

but real institutional strengths. Taken together these seven features make MDBs very different from other financial institutions and make the MDB system a powerful catalyst for transformative change.

These features enable the MDBs to be both *additional* in the sense of the ability to do what others cannot do, whilst following *sound banking principles* in terms of risk and return. That ability to be additional must be used to pursue their development mandate and projects and programs must therefore have *development impact*. This means that MDB projects and programs can and must be at the *frontiers* of development and investment initiatives. In so doing they can innovate and push out the frontiers. The examples they can help create can therefore themselves have powerful multipliers as proof points of new activities. The three operating principles of additionality, sound banking and development impact are fundamental.

## **B. Recommendations for Action**

### **B1. Serving all clients effectively**

The challenge of strong, sustainable, balanced and inclusive growth and national and international action to deliver on the sustainable development goals encompasses all countries. The challenge will be most intense in countries with deep seated poverty, conflict and fragility. Some 30 countries with a population of 500 million mainly in Africa are most at risk of falling behind. The MDB system should give high priority to development in these countries in cooperation with other partners including the UN and bilateral agencies. The changing world, the shift in the global agenda from the MDGs to the SDGs and the intense pressures on the global commons all imply that the MDBs must remain engaged across all income groups including the full spectrum of middle and even upper-income countries. Of course, the nature of the involvement should indeed change as countries develop and advance, and some reductions in volumes are to be expected after sustained development over a period of time and movement up the income scale. But the main guide must be national and international development impact in relation to the global agenda taking into account additionality and sound banking. As argued above, the special strengths of MDBs mean that that they should work on the frontiers, move the frontiers, and move as the frontiers move. This includes upgrading of skills and institutions and promoting and harnessing the potential of technology and innovation.

Recommendations:

- a) **We need to move away from the premise of graduation based on a narrow and simplistic per capita income-based model of MDB support.** Investment in countries and sectors should be guided by the above three principles. They should recognize that the allocation of effort and resources in the IFI system between countries is *not a zero-sum game*. The reasons for this are clear and must be articulated since they are insufficiently understood: (i) the agenda of shared prosperity and leaving no one behind embodied in the SDGs; (ii) the global commons, e.g. the nature of infrastructure investment in Asia

profoundly affects the future of Africa; (iii) South-South interconnectedness; (iv) knowledge generation and learning; and (v) the returns from financing in MICs contribute to the abilities to support the poorest.

- b) These principles imply the need to **rethink allocation of financing from non-concessional windows**. While the volume of lending would decline, and multipliers should expand as countries incomes rise, setting limits to the support of middle-income countries is counterproductive. Instead pricing policies and the expansion of balance sheets should be used to provide effective support of all clients while ensuring that the returns from financing to MICs contributes to the poorest.
- c) **Given the limited pool of concessional resources across the MDB system, clearer allocation rules for concessional finance should be agreed across different needs and delivery channels**. A system-wide review of concessional financing is needed to assess the adequacy and effectiveness of current allocations between competing country needs, global commons, spillovers and global public goods. In addition to providing support for the poorest and most vulnerable countries, and specific global public goods, as the experience of the climate investment funds and the UK BEIS partnership with the Inter-American Development Bank shows, concessional financing can help leverage the impact and risk taking capacity of the MDBs.

## **B2. Scaling up and enhancing the quality of investments**

MDBs have played an important role in stimulating private investment through helping to strengthen the investment climate and the financial sector. While this role is fundamental and remains of continuing value, the areas now requiring urgent action are ***scaling up and enhancing the quality of investments in infrastructure and human capital***. The magnitudes of the investment that will be needed, the urgency to shift investments towards greater sustainability, and the necessity and tremendous opportunity to tap the potential of the private sector all underline the critical contribution that can be made by the MDB system. The MDBs are well positioned to play this role but a significant strengthening will be needed in their skills sets, instruments, incentive structures and modalities of collaboration.

Recommendations:

- a) ***MDBs should ramp up and better coordinate their support to help countries unlock and enhance the quantity and quality of investments especially in sustainable infrastructure and human capital***. This will require concerted and systematic efforts to accelerate reforms in governance and the business environment and to strengthen ***policy and institutional foundations***—from planning to project prioritization, procurement and PPP frameworks and the institutional capacity in the public and private sectors to implement projects and programs. MDBs can play a powerful catalytic role through the pursuit of innovation and the power of the example and the creation of replicable and scalable approaches. While each institution needs to upgrade its skills and capabilities, there is tremendous potential for the system to collaborate

together to exploit economies of scale and scope and harness complementary strengths.

**b) To support the scaling up of investment, MDBs should help countries mobilize finance at scale, especially in harnessing the large pools of private finance.** They can help countries establish robust **public finance foundations**. This should include strengthening **multi-level finance** given the decentralization of investment and the large and complex needs for urban development. The biggest challenge is to **scale up and crowd in private finance**, for which the MDB system will need to greatly improve the effectiveness of the use of their own balance sheets and work to increase private sector multipliers.

- i. Building on ongoing efforts much more needs to be done to more effectively utilize the balance sheets of individual MDBs and the system as a whole.** The MDB financing model based on fractional paid-in capital and strong borrower commitment has tremendous strengths but there needs to be greater exploration of options to increase leverage and risk tolerance. More rapid asset turnover by MDBs would allow for engagement in many more projects. One way to do this systematically would be through **system-wide securitization**. The need to adjust income models, capital structures and ability to mitigate risks also call for an assessment of the methodologies used by credit-rating agencies.
- ii. Expanding private sector multipliers must be a central goal for the MDB system.** The presence of MDBs itself helps reduce risk especially in the early and more complex phase of a project but the MDBs also need to develop a better suite of instruments and structures to tackle specific risks of concern to the private sector (such as construction or currency risk) and crowd in long-term institutional investors. Ongoing efforts in the G20 to build **infrastructure as an asset class** through development of project preparation platforms, standardization of contracts and documentation, enhanced risk mitigation instruments and improvement of data and benchmarks all call for a stepped up role by the MDBs. **Incentive structures in MDBs** should be aligned to achieve the highest possible impact and leverage compared to the historic focus on direct lending. We should not however present development impact and direct lending as an inherent conflict. Examples in health and education are important where we should not expect the same multipliers as for infrastructure.
- iii. A more comprehensive and systematic approach is needed to assess the capital adequacy of the MDB system and its appropriate expansion.** At present shareholders consider capital increases for each institution individually often through protracted and difficult negotiations. A shared perspective on how the system needs to expand to respond to the global agenda and across different demands can help guide individual bank discussions and ensure that the system as a whole is able to respond effectively to the scale and urgency of the global agenda. A similar approach and periodic review is needed for the concessional windows of the MDB system. Capital adequacy should be assessed institution by

institution but in relation to the system as a whole and recognizing the decisive importance of the next two decades for action on scale.

### **B3. Global commons, spillovers and transnational public goods**

The pressures on the global commons are immense and growing, with increasing interconnectedness and spillovers across countries. At the same time the public goods (transnational and local) to tackle these threats are severely under-provided. An effective response to these challenges requires ***strong action in countries and strong interaction and collaboration across countries***. The principal challenges that need to be confronted include: conflict and spillovers; migration and refugees; climate change (mitigation, adaptation and resilience that are themselves complementary and interwoven with each other and with economic development); pandemics; natural capital including oceans and biodiversity; cybersecurity; and technology development and sharing to promote development and tackle threats. The appropriate institutional structures and responsibilities to tackle challenges and needs will vary from area to area, with both overlapping mandates and gaps, and where the MDBs are part of a larger system. The lack of an effective financing framework to tackle many of these challenges is also a major impediment to an effective global response.

We must recognize two fundamental arguments with respect to the special challenge of climate change. First the nature of investments within countries will be the main driver of the pressure on and response to climate change. Thus we cannot separate out the issues into a separate organization or just one MDB. All the MDBs must be involved. Second the world's infrastructure will roughly double in the next 15 years and the world economy will double in around 20 years. If investment, in the next two decades are not radically different from the existing pattern, then any chance of meeting the Paris COP21 target will be lost and the world's climate future will be very dangerous. Making infrastructure sustainable is of profound urgency.

Recommendations:

- a) A comprehensive assessment of the impending pressures on the global commons and of spillovers in an interconnected world, and the capacity of the global community to respond, is warranted.*** There have been periodic reviews of the “global public goods agenda” and there has been from time to time more intensive focus on a specific issue area, such as recently on oceans. A proper system of governance that has the capacity to respond to the scale and urgency of the challenges requires high-level political commitment to review the challenges and risks and what is needed for effective response capacities to prevent and manage the different but related threats. This should seek to exploit comparative strengths and synergies while avoiding artificial division of roles. Coordination with the UN institutions will be vital. So too with the private sector and sub-national governments.

- b) *The adequacy of funding and of delivery mechanisms also needs to be assessed and acted upon.*** An overall single funding mechanism for “global public goods” is not appropriate given the differences in the nature of the challenges and the financing requirements. But a better assessment of needs and gaps can help build consensus on how to mobilize and improve the effectiveness of financing. For example, on pandemics, a grave risk, one possibility would be a specialized unit or agency to gather information in real time, based on enhanced country systems, so that interventions at the necessary pace can be undertaken.
- c) *Climate change and the role of the MDBs in catalyzing an effective response deserves distinct attention given the urgency and scale of the challenge and the close links to the growth and development agenda.*** MDBs have stepped up their individual and collective responses since the adoption of the Paris Agreement but there is an urgent need to catalyze an acceleration of actions and to scale up investments.

#### **B4. Harnessing the strengths of the MDB system**

The MDB system has evolved from one in which the World Bank played a dominant role to now a network of institutions with regional and subject matter differentiation. For key activities, such as infrastructure, financing from regional development banks, is now much larger in most regions than the World Bank. The diversity of the system requires coherence across institutions and shareholders, but competition can be healthy and offer members a broader range of choice. Better mechanisms of collaboration can allow sister institutions to share expertise and exploit economies of scale and scope in providing services. There are real opportunities for enhanced collaboration for all sectors and in tackling global challenges but particularly for infrastructure and climate because of scale and urgency. MDBs are collaborating not only on what they do, but how they do it, and how they can mobilize and enhance the impact of their financing. This needs to be built upon to create a more effective system that is able to respond dynamically to the global agenda and the changing world. The new banks should be welcomed into the system, past experience and lessons shared, and collaboration and innovation encouraged.

Recommendations:

- a) *The MDBs and their shareholders should agree on high-level shared principles that can create a healthy eco-system, avoid distortions and set strong incentives for collaboration.*** These could include: shared commitment to the global agenda; how to tailor support to country and market circumstances; use of country systems; harmonized approaches and inter-operability where appropriate, for example for procurement and ESG standards; and blending and use of concessional resources.
- b) *Each MDB should set out its strategy and operating principles.*** The strategy of the MDBs must reflect the goals, the intense challenges of scale and urgency and the comparative strengths of the institution. The operating principles must individually and collectively enable the MDBs to play an effective role given their special

strengths. They should include additionality, sound banking and development impact. Such clarity could greatly enhance collaboration.

- c) ***MDBs should identify, implement and monitor priorities and modalities for enhanced collaboration.*** This would both encompass collaboration on global collective actions and on enhancing collaboration at the country level through ***common platforms*** that can engage national stakeholders and the private sector. These platforms are likely to be country and sector specific but there is tremendous opportunity to accelerate learning and create replicable models that can be taken to scale. Such platforms could include shared diagnostics, policy and institutional support and capacity building, project preparation and standardization, and financing structures including for risk mitigation.

## **B5. Strengthening governance and shareholder alignment**

The effectiveness and legitimacy of the MDB system requires a shared vision and purpose across shareholders and the global community. These encompass modern corporate governance structures that ensure proper alignment of incentives and accountability including between Management and Board, leadership selection and representation that reflect the changing world and the multilateral character of the institutions. Shareholders should be able to set expectations for what and how the multilateral development system should contribute to the global agenda and whether progress on outcomes is rapid enough.

Recommendations:

- a) ***While it will be up to each institution and its shareholders to chart their paths on governance reform, agreement in the G20 and in other key fora on core principles can give impetus to and provide benchmarks to assess progress over time.*** These principles should include: corporate governance, including on the roles of the management and the board; principles for leadership selection (including principles of highest qualification and not narrowly restricted by country of origin); principles for evaluation including incentives to collaborate; how shareholding and representation should evolve to preserve legitimacy in a changing world; and how to draw in other stakeholders especially the private sector.
- b) ***There should be a periodic review of the system-wide performance, say every five years.*** This can provide a mechanism for strategy setting and long-term accountability and for making the adjustments that are needed to ensure that the system is able to deliver effectively and respond to changing priorities. This should include how the system is delivering on the agreed agenda, capital adequacy and performance including on multipliers, and progress on governance reform and shareholding.

### **C. Implementation**

The international financial system, of course, has many shareholders beyond the G20. And the global agenda applies to all. The recommendations of our report will provide a sense of direction but will require careful discussion and there will be details that will require development and examination.

We suggest that during 2019, there should be a gathering, carefully prepared, perhaps at the Bank/Fund Spring Meetings ( for example, a joint discussion amongst the IMFC and the Development Committee) which could set out a strategy and program for taking forward a process of further engagement and decisions. The report would also need careful discussion by the Governing Bodies and Boards of the individual MDBs.

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