

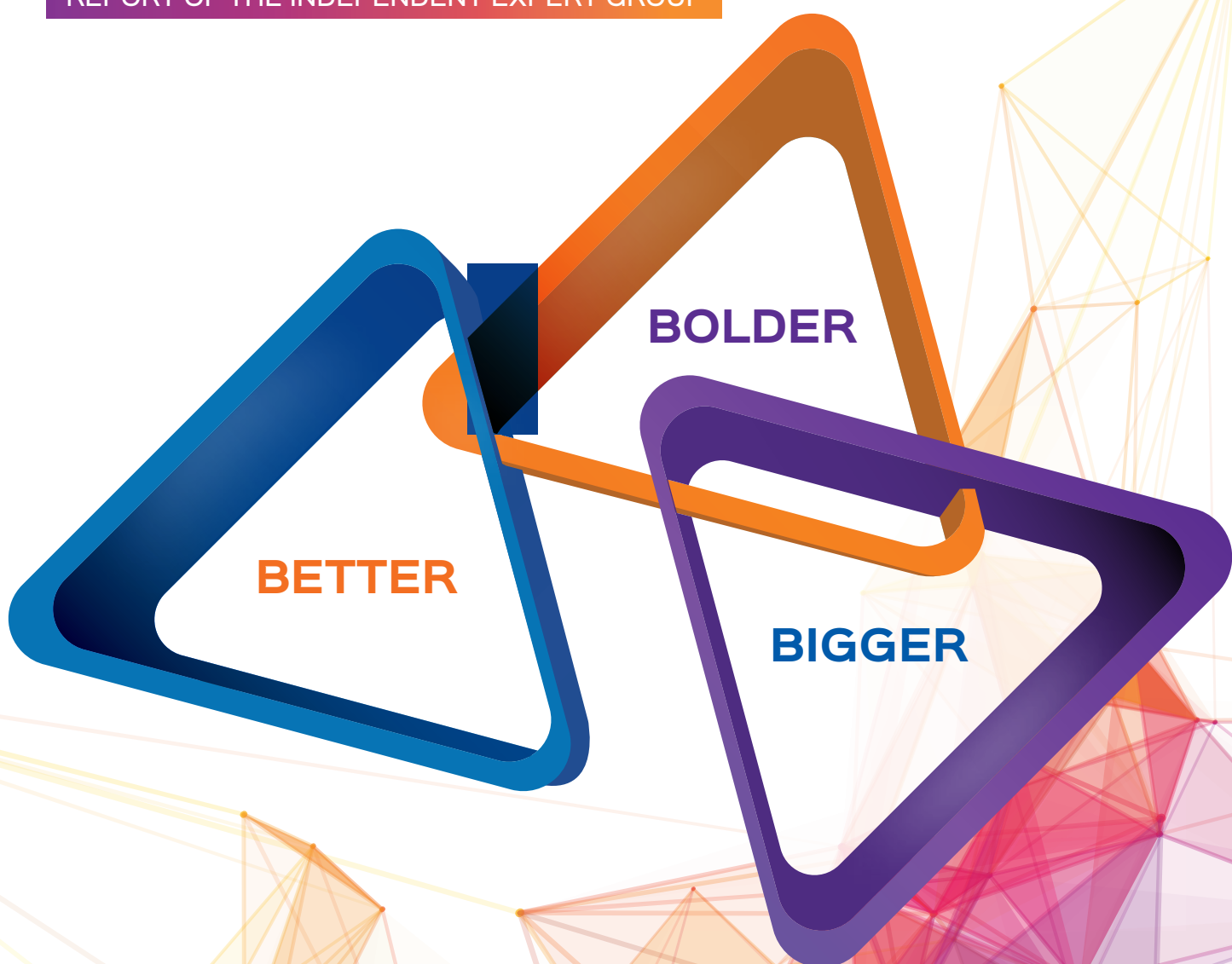
VOLUME 2

STRENGTHENING
MULTILATERAL DEVELOPMENT BANKS

THE TRIPLE AGENDA

A ROADMAP FOR BETTER, BOLDER AND BIGGER MDBs

REPORT OF THE INDEPENDENT EXPERT GROUP





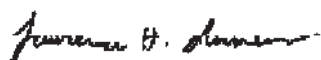
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BETTER | BIGGER | BOLDER

The Independent Expert Group (IEG) is grateful to the
Honourable Finance Minister of India, Nirmala Sitharaman for her leadership and guidance.



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ONE EARTH • ONE FAMILY • ONE FUTURE

¹ Tharman Shanmugaratnam contributed to the IEG's work until his retirement from the Group on 14 September 2023, when he was sworn in as the President of Singapore.

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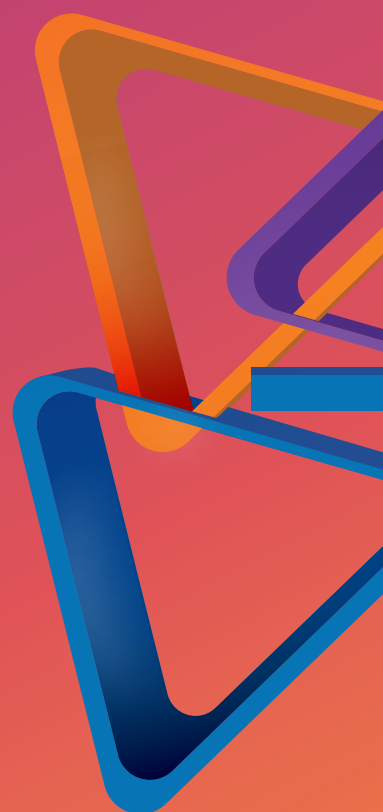
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² Tharman Shanmugaratnam contributed to the IEG's work until his retirement from the Group on 14 September 2023, when he was sworn in as the President of Singapore.

LIST OF ABBREVIATIONS

ADB	Asian Development Bank	IEG	Independent Expert Group
ADF	African Development Fund	IFC	International Finance Corporation
AfDB	African Development Bank	IF-CAP	Innovative Finance Facility for Climate in Asia and the Pacific
AI	Artificial Intelligence	IFFEd	International Finance Facility for Education
AIIB	Asian Infrastructure Investment Bank	IMF	International Monetary Fund
AsDB	Asian Development Bank	IMG	Independent Monitoring Group
BSO	Balance Sheet Optimization	INR	Indian Rupee
CAF	Capital Adequacy Framework	IsDB	Islamic Development Bank
CCDR	Country Climate and Development Reports	JETP	Just Energy Transition Partnership
COP	Conference of the Parties	KPIs	Key Performance Indicators
CRA s	Credit Rating Agencies	LICs	Low-Income Countries
CRS	Credit Reporting Systems	LMICs	Low and Middle Income Countries
CSR	Corporate Social Responsibility	LTS s	Long Term Strategies
DFIs	Development Finance Institutions	MDB	Multilateral Development Banks
EBRD	European Bank for Reconstruction and Development	MFF	Multitranchise Financing Facility
EIB	European Investment Bank	MICs	Middle Income Countries
EMDE s	Emerging Market and Developing Economy	MIGA	Multilateral Investment Guarantee Agency
ESF	Environmental and Social Framework	NDC	Nationally Determined Contributions
ESG	Environmental, Social and Governance	NHFO	Non-Honoring Financial Obligations
FICS	Finance in Common Summit	OECD	Organization for Economic Co-operation and Development
FX	Foreign Exchange	PCM	Private Capital Mobilization
FY	Financial Year	PDB	Public Development Bank
GB-TAP	Green Bond Technical Assistance Program	PEF	Pandemic Emergency Financing
GCFM	Global Challenges Funding Mechanism	PRG	Partial Risk Guarantee
GCI	General Capital Increase	PRGT	Poverty Reduction and Growth Trust
GDP	Gross Domestic Product	PRI	Political Risk Insurance
GEMs Database	Global Emerging Markets Database	RST	Resilience and Sustainability Trust
GIF	Global Infrastructure Facility	SDGs	Sustainable Development Goals
GHG	Greenhouse Gases	SDR	Special Drawing Rights
GI Hub	Global Infrastructure Hub	SOFR	Secured Overnight Financing Rate
GIF	Global Infrastructure Facility	TCX	The Currency Exchange
GPGs	Global Public Goods	T&C	Transfer and Convertibility
GRPP	Global and Regional Priority Programs	UMICs	Upper Middle Income Countries
IADB	Inter-American Development Bank	UN	United Nations
IAG	Independent Advisory Group	UNCTAD	United Nations Conference on Trade and Development
IBRD	International Bank for Reconstruction and Development	US	United States
IDA	International Development Association	WB	World Bank
IDB Invest	Inter-American Development Bank Invest	WBG	World Bank Group
		WHO	World Health Organisation





EXECUTIVE SUMMARY

The world is on fire, literally and figuratively. This is a uniquely challenging moment. The global economy is fracturing, growth is decelerating, and trust is eroding. There is no hope for meeting global or most national ambitions, or avoiding the immense risks we face, along current paths and plans. There is, however, an alternative path that requires decisive action and transformative investments. It is based on unlocking key investments in emerging markets and developing economies (EMDEs). This can both manage and radically reduce the risks and offers a huge opportunity for sustainable, resilient, and inclusive growth for all.

A world on fire requires the multilateral development banks (MDBs) to be at center stage in creating an effective response and bringing diverse actors to support a shared agenda of transformative development. MDBs have a distinctive comparative advantage in playing a catalytic role in fostering government and private sector investments. They bring together a package of knowledge, affordable financing and efficient risk management. They are long-term partners who, in an increasingly fractured world, have a long history of working with countries and bringing all stakeholders together in a cooperative framework.

In the Delhi Declaration, the G20 Leaders recognized a need for a “big push on investments” to deliver on national development priorities, to respond to global challenges and to meet agreed international objectives, including the Paris COP21 agreement and the SDGs. They therefore called for strengthened MDBs to support this.³ To that end, our first volume set out a triple agenda of reform for the MDBs that would:⁴

- triple annual sustainable lending levels to \$390 billion per year by 2030;
- adopt a triple mandate of eliminating extreme poverty, boosting shared prosperity, and contributing to global public goods (GPGs);⁵ and
- expand and modernize funding models to broaden the investor base in flexible and innovative ways.

³ See G20 (2023), *New Delhi Leaders Declaration*, https://www.g20.org/content/dam/gtwenty/gtwenty_new/document/G20-New-Delhi-Leaders-Declaration.pdf

⁴ IEG (2023), *Strengthening Multilateral Development Banks: The Triple Agenda*, https://www.g20.org/content/dam/gtwenty/gtwenty_new/document/Strengthening-MDBs-The-Triple-Agenda_G20-IEG-Report-Volume.pdf

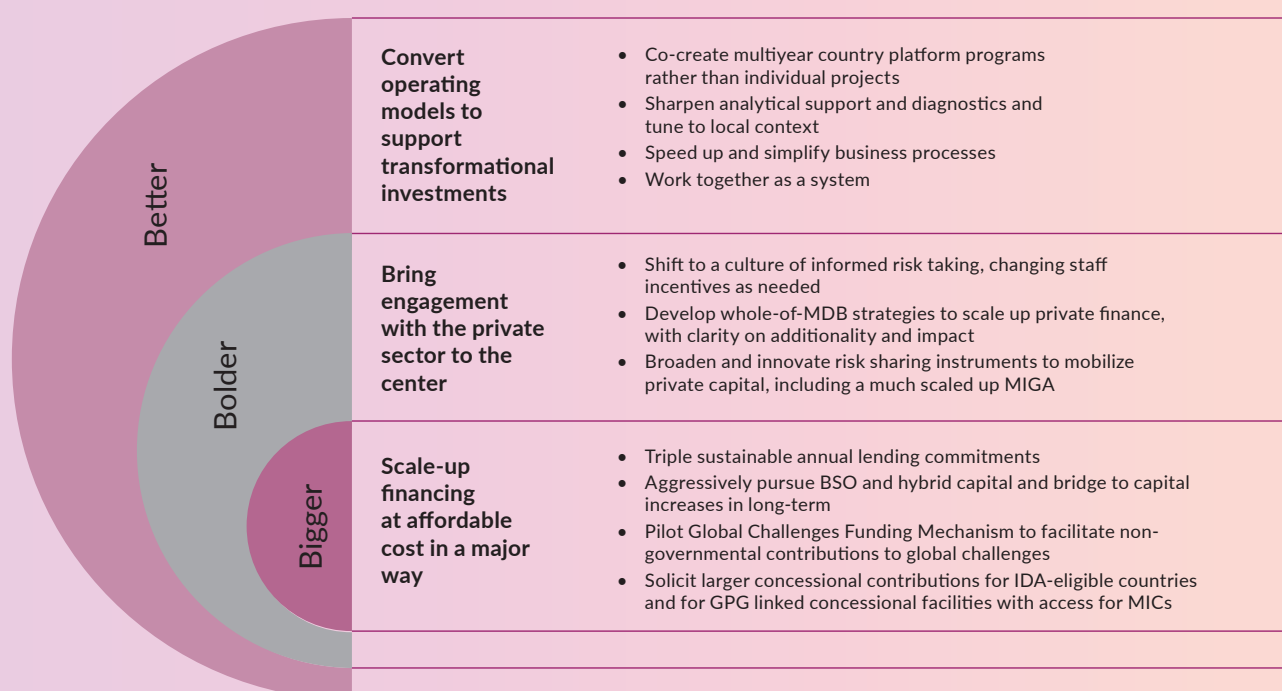
⁵ In Volume 1, we interpreted GPGs in a broad sense going beyond its conventional description, focused especially on climate change, the preservation of biodiversity and the global water cycle, and pandemic preparedness and response. Investing in these GPGs goes together with addressing closely-related transboundary challenges such as conflict and fragility, food security, cyber security and energy security.

This second volume focuses on the changes that will be needed to implement the G20 Leaders' vision of a strengthened MDB system. The G20 was exceptional in its determination to be more inclusive, as demonstrated by the inclusion of the African Union. The MDBs must reflect this same sense of inclusion and collaboration by working better together and building on country owned programs. We call this making MDBs better, bolder and bigger (Figure ES1).

- **Better** in supporting transformative programs in client countries, by providing clarity on the policy and financial conditions for investments, by streamlining processes so that they are easier to work with, and by collaborating with each other and with local and foreign investors;
- **Bolder** in taking on and managing risk effectively and in engagements with the private sector; and
- **Bigger** in helping clients reach the scale needed to deliver economy-wide results quicker.

This volume also provides a roadmap for rapid implementation of MDB reforms. It offers greater detail on the logic behind the investment numbers required in different country contexts, the resulting financing gaps, and how these can be best filled through a combination of MDB non-concessional financing, concessional financing from bilateral donors channeled in part through MDBs, and private financing with MDB support. Given the urgency of what is needed, the roadmap of recommendations starts now, but has an eye towards having an MDB system that is fit for purpose by 2030.

Figure ES1: Organizing framework for Volume 2



Source: IEG Core team

Our first set of recommendations is that MDBs convert their operational model to shift away from individual projects towards programs where national governments take a strong lead in identifying multi-year transformations with sectoral focus, achieved through scaled-up investments. Governments have the primary responsibility for ensuring that the enabling conditions for private investment are sound, transparent and stable over the horizon of investors. They must also help address multiple coordination failures among domestic and international stakeholders, public and private, to unlock and scale up investment for urgent priorities such as rapid energy transition, building resilience to climate change, tackling fragility, and closing major gaps in reaching the SDGs. A home-grown unified vision of goals, policies, investments and financing required is one way of addressing such failures.

An example of an institutional coordination mechanism that offers a promising way forward is a “country platform” approach, previously recognized and supported by the G20.⁶ In 2020, the G20 Reference Framework for Effective Country Platforms considered country platforms to be “voluntary country-level mechanisms, set out by governments and designed to foster collaboration among development partners, based on a shared strategic vision and priorities.” A key purpose of country platforms is to create an environment where investors have confidence in the realization of returns and management of costs where each depends on the actions of other investors. The Just Energy Transition Partnerships (JETPs) announced by South Africa, Indonesia, Vietnam and Senegal, and the Egypt Nexus of Water, Food and Energy are initial examples of these new-style country platforms.

We recommend that MDBs focus their operations, both financial and analytical, on helping countries create and operationalize such platforms for the highest priority SDG and GPG sectors or themes, as evidenced by the commitment of country leadership and degree of national investment. There are many details of MDB activities that would need to adapt to support country platforms, including institutional designs, pipeline development, use of country systems, speed of implementation, and modalities of technical assistance and diagnostics.

Country platforms are a natural entry point for MDBs to work together better as a system, but their collaboration should be deepened in a number of areas, particularly around global and regional priorities. MDB collaboration has long been held back by lack of incentives and conflicting requirements from shareholders. This culture can best be reformed through institutional mechanisms of dialogue and joint strategy formulation by leadership teams at the highest level. Going forward, the ambitions set out for the MDB system will be much harder to achieve without collaboration to exploit potential synergies, cost savings and efficiency gains for their clients. Some early wins can come from the use of shared diagnostic tools, mutual recognition of standards and setting up shared co-financing and project preparation platforms. Diagnostics for catalyzing investments include sector-specific issues and general enabling conditions including domestic resource mobilization, public expenditure, investment management and subsidy review, debt

⁶ Report of the G20 Eminent Persons Group on Global Financial Governance (2018), *Making the Global Financial System Work for All*, <https://www.globalfinancialgovernance.org/report-of-the-g20-epg-on-gfg/>.

sustainability and business conditions. MDBs can also generate greater firepower by pooling risks, creating common asset classes and learning from each other in the dialogue with credit rating agencies (CRAs).

Our second set of recommendations is to bring engagement with the private sector to the center of MDB operations. Despite the rhetoric, and notwithstanding a few oft-cited examples of success, private financial flows to EMDEs remain disappointingly low. Some MDBs have separate private and sovereign arms, such as IFC and IDB Invest. The default approach has been one of limited operational interaction between these private financing arms and the sovereign activities of MDBs. This must now change. The private financing arms must do much more to crowd-in private investments for transformational change. They must be complemented by a whole-of-MDB approach to co-create investment opportunities with the private sector, develop project pipelines including through a revamped and expanded role of the Global Infrastructure Facility (GIF), and crucially, to mobilize and catalyze much higher volumes of private finance. To this end, MDBs need to shift their own culture from one of risk avoidance to informed risk taking and reduce significantly the time for decision making. They also need to diversify their instruments, in particular by expanding the use of guarantees and foreign exchange risk management tools. The MDBs also have a significant database of their own activities that can be made available to private investors to permit them to analyze risk in a granular fashion.⁷

MIGA can play a much larger role for the MDB system by tripling its annual guarantee and distribution activities by 2030. We are convinced that MIGA can be scaled up significantly and work more effectively across the whole MDB system. To do so, MIGA should be building partnership with other MDBs at scale, establishing a liquidity facility to boost political risk insurance coverage, and harmonizing approaches to guarantees across the World Bank Group.

Finally, MDBs can help countries manage sudden, large shocks, such as those related to natural disasters and pandemics. In such instances, fiscal constraints bind tightly, and liquidity dries up. MDBs can help by introducing automatic, rules-based revisions to the time profile of repayments falling due into their loan contracts.

Our third set of recommendations revolve around sizing MDBs to make a material difference at scale. A target to triple MDB financing to \$390 billion annually – \$300 billion non-concessional and \$90 billion concessional – by 2030 may seem ambitious but is essential if the EMDEs are to make adequate progress towards the SDGs and cope with climate change. The MDBs as a system will barely transfer any positive net resources to EMDEs in 2023, largely because the rise in nominal interest charges will likely more than offset any increase in disbursements.

To triple their lending, MDBs should make use of all their funding avenues. Initial measures to implement the Capital Adequacy Frameworks (CAF) recommendations for balance sheet optimization have already yielded some headroom in MDBs. Further

⁷ The Global Emerging Markets (GEMs) database covers credit performance of 17,000 sovereign and non-sovereign loan transactions of 24 MDBs and DFIs.

balance sheet optimization, and new opportunities to innovate with different forms of shareholder support, including portfolio guarantees and hybrid capital offer significant potential. These measures can be implemented rapidly, providing an immediate boost to lending firepower, lasting for a decade or so. This boost would be further strengthened by a clear commitment and plan for shareholder capital increases that will be essential in any event to support sustained financing over decades at the necessary scale. Together, such a funding package would allow MDBs to quickly reach the scale warranted by the challenges ahead.⁸

The precise amounts of capital increases required for different institutions will depend on their existing situation and evolving needs, which should be informed through a capital resources review process, using standardized metrics, whereby capital adequacy is regularly assessed by shareholders with a view to ensuring that lending volumes can reach needed levels without jeopardizing credit ratings. Initiating such a process would solidify the shareholder-support uplift to MDB credit ratings and would provide legitimacy to MDBs from effective long-term governance reforms.

There is now a significant opportunity to broaden funding support beyond shareholders. A potential breakthrough in MDB funding could emerge by opening up opportunities to non-government investors—sovereign wealth funds, foundations, impact investors and businesses contributing funds as part of their corporate social responsibility programs. We recommend establishing a pilot Global Challenges Funding Mechanism (GCFM) as a platform to facilitate the process for investors wishing to provide additional resources for priority goals that can be leveraged by MDBs for scale and impact.

EMDEs will also need access to concessional funds and grants channeled through MDBs, even though most MDB financing will be provided at rates determined by global capital markets. Low-income countries would not be able to sustain the debt levels that higher non-concessional borrowing would necessitate, so we urgently advocate for larger donor contributions to the African Development Fund and IDA. Middle-income countries, too, will need access to concessional financing, partly to facilitate their provision of global public goods. These must be incremental to concessional support to LICs. One recommendation we make is to clearly distinguish the funds by establishing global public goods concessional facilities within MDBs, accessible to MICs, that can be funded in part through the voluntary designation for this purpose of coupon payments on hybrid capital.

EMDEs also receive significant concessional finance through the IMF's PRGT and RST facilities. Donors have promised to reallocate \$100 billion of surplus SDRs to these facilities. It is important, however, that these scarce funds be used to maximum impact. As of March 2023, only SDR2.5 billion of the SDR 20 billion in pledged RST funds had been committed, of which less than a billion has been disbursed, and IMF staff estimate a medium-term demand for such funds at SDR 22 billion.⁹ Similarly, the scale

⁸ Such a capital increase would put a small demand on the public finance of the shareholders while yielding a high value for money.
⁹ IMF (2023), 2023 Review of Resource Adequacy of the Poverty Reduction and Growth Trust, Resilience and Sustainability Trust, and Debt Relief Trusts, <https://www.imf.org/en/Publications/Policy-Papers/Issues/2023/04/25/2023-Review-of-Resource-Adequacy-of-the-Poverty-Reduction-and-Growth-Trust-Resilience-and-532788>

of operations for the IMF's PRGT is also being held back by inadequate subsidy resources. While raising the commitment capacity of the PRGT and RST is a necessary step, attention should also be paid to making sure that funds reach intended beneficiaries as rapidly as possible.

The reforms outlined here will only work with a change of mindset and attitudes - to risk appetite, working with each other, working with the private sector, and with accompanying changes in incentives and accountability indicators. Applying these changes at all levels, starting with the shareholders and their representatives on the Boards, will foster a needed change in culture.

The set of recommendations made in this report are clustered around five elements (Box ES1 and Annex 1). These constitute a roadmap for an updated MDB ecosystem for the twenty-first century. The full implementation of milestones and timelines touching upon all aspects of MDB evolution would go a long way towards adequate financing of SDGs, GPGs and transboundary challenges. We therefore recommend that the G20 establish a mechanism to independently assess the first-year implementation of the proposed roadmap.

Box ES1: Key Policy Recommendations for MDBs

- I. Convert operating models to co-create multi-year programs for transformative change.
- II. Streamline and simplify business processes to halve processing time.
- III. Work together better as a system with individual and collective KPIs, shared diagnostic tools and pool risks.
- IV. Bring a whole-of-institution approach to mobilize \$240 billion in private capital and catalyze private finance by shifting culture from risk avoidance to informed risk taking.
- V. Triple financing levels to \$390 billion per year to achieve the transformational change required to meet national and global priorities.

In addition, the G20 Finance Ministers should establish a mechanism to advise and independently assess the first-year implementation of the proposed roadmap.

These reforms would position EMDEs to sharply increase investments to achieve sustainable and inclusive growth for the benefit of all. In our estimation, reforming the MDB agenda and scaling them appropriately are urgent issues requiring action now. Delay is dangerous. Weak or slow reaction is neither more practical and realistic, nor less risky. To the contrary, costs and the pressures to provide more money for necessary interventions will rise over time. Strong action now is, in this very real sense, less costly and risky.

I. A World on Fire

This is a uniquely challenging moment that requires dramatic action and transformative investments. The global economy is fracturing, growth is decelerating, and trust is eroding. There is no hope for meeting global or most national ambitions along the current path. There is, however, an alternative path that delivers sustainable, resilient, and inclusive growth for all. It is based on unlocking key investments in EMDEs.

A time for action

The world is on fire, literally and figuratively. In July 2023, the world recorded the hottest month in the global temperature record going back to 1880.¹⁰ Major wildfires and extreme weather events are no longer once-in-a-century natural disasters. They have become commonplace. Scientists warn that the planet is reaching tipping points for climate and biodiversity that will have massive impact for everyone and everything.¹¹ The window for avoiding these tipping points through appropriate policy reforms and investments is still open but closing fast. We now know considerably more about what must be done, and where the investments and reforms are needed, but we lack mechanisms to make this happen on a global scale, especially in EMDEs.

A world on fire needs the MDBs to accelerate new investments in EMDEs. In Volume 1 of the Independent Expert Group on strengthening multilateral development banks, we reasoned that EMDEs should be investing an additional \$3 trillion (10% of their GDP) by 2030 in key areas that would transition them onto a path of low-carbon, equitable, resilient, and rapid economic growth. Some of this would come from a re-orientation of existing spending, and some through incremental spending financed by a mix of domestic (\$2 trillion) and external resources (\$1 trillion) depending on country circumstances. A tripling of MDB financing support to \$390 billion per year by 2030, plus their role in mobilizing and catalyzing private investment, is essential to meeting these financing needs.

In the Delhi Declaration, the G20 Leaders recognized a need for a “big push” on investments.¹² As a result of cross-border spillovers of GHG emissions, pandemics, conflict and other global challenges, failure in any one country to make such investments can mean failure in all countries to create stable growth. Conversely, when many countries transition simultaneously to sustainable growth, there are positive spillovers everywhere, as innovation and technological maturity drive down costs. For example, the average levelized cost of electricity from solar photovoltaics and onshore wind has fallen below 5 cents/KwH

¹⁰ NASA, Goddard Institute for Space Studies (August 14, 2023), NASA Closes July 2023 as Hottest Month on Record Ever Since 1880, <https://www.nasa.gov/press-release/nasa-closes-july-2023-as-hottest-month-on-record-ever-since-1880>

¹¹ McKay et al. (2022), Exceeding 1.5°C global warming could trigger multiple climate tipping points, *Science*, Vol 377, Issue 6611 <https://www.science.org/doi/abs/10.1126/science.abn7950>

¹² G20 (2023), New Delhi Leaders Declaration, https://www.g20.org/content/dam/gtwenty/gtwenty_new/document/G20-New-Delhi-Leaders-Declaration.pdf



in 2021 from double digit levels in 2010.¹³ If there is faster deployment in EMDEs, the long-awaited goal of universal access to modern energy services can be achieved and a major impediment to job-creating small and medium enterprise growth can be removed.

However, we also believe that the likelihood of an investment acceleration is low without scaled up international support and that a major effort is needed going well beyond pledges that have so far been made at forums where MDBs' role has been discussed.¹⁴

The G20 has committed to: “accelerate the full and effective implementation of the 2030 Agenda on Sustainable Development;” “accelerate efforts and enhance resources towards achieving the Paris Agreement;” and to “pursue reforms for better, bigger and more effective multilateral development banks (MDBs),”¹⁵ but without specifying details. This Volume 2 of our report makes recommendations for how to realize such commitments. While acknowledging and applauding the several initial steps that have been taken, we believe that a far more significant push on multiple reform and funding fronts is required.

The challenge we address in this report is how to move from individual sustainable projects to systematic programs of transformative change by 2030, matched with the right type and scale of financing. We hear many examples of the huge benefits from investing more in making people and infrastructure more resilient to the disasters they face; of the adaptation investments needed to help farmers raise crop productivity; of how to invest efficiently in nature, whether through the expansion of global trade in carbon credits, debt-for-nature swaps or other innovations; of the potential for generating electricity in renewable ways. But there are few examples of countries doing this at scale while successfully transforming their economic structures towards sustainability and inclusion.

EMDEs seeking to transform their economies have the primary responsibility to ensure that the policy and governance framework for all investors is transparent, incentive aligned and stable over the horizon of investors. Beyond these general responsibilities, they face three specific challenges:

1. How to best create effective country platforms that bring together all stakeholders around a common, home-grown vision of time-bound change, usually with a sectoral or thematic focus, with the objectives of identifying needed projects and enabling policy reforms, assigning responsibilities to each public and private development partner, and learning and adapting over time to speed up impact and effectiveness.

¹³ IRENA (2023), *Low-Cost Finance For The Energy Transition*, https://mc-cd8320d4-36a1-40ac-83cc-3389-cdn-endpoint.azureedge.net/-/media/Files/IRENA/Agency/Publication/2023/May/IRENA_Low_cost_finance_energy_transition_2023.pdf?rev=02ba5ca271cc40e7a0c9d76586fd209f

¹⁴ Most recently, world leaders adopted a Political Declaration under the auspices of the UN General Assembly, calling for “multilateral development bank reform as a key for large-scale Sustainable Development Goal-related investments in order to better address global challenges.” Para. t) viii. https://hlpf.un.org/sites/default/files/2023-09/PD%2030%20Aug.pdf?_gl=1*1jwruuc_ga*MTA1NDgxNDg2MC4xNjkwMjIwNzIx*_ga_TK9BQL5X7Z*MTY5NTA4MzIzMS41LjEuMTY5NTA4MzIzNS4wLjAuMA..

¹⁵ G20 (2023), *New Delhi Leaders Declaration*, https://www.g20.org/content/dam/gtwenty/gtwenty_new/document/G20-New-Delhi-Leaders-Declaration.pdf

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2. How to best engage with the private sector and mitigate the most important risks—sovereign country risk and policy/regulatory risk—that are currently making the cost of capital too high to support major expansion of sustainable infrastructure in most EMDEs.
 3. How to put together a financing package at affordable cost that matches the ambitions of the investment program under consideration.

MDBs are uniquely positioned to help address each of these challenges. There is much discussion about whether to create new institutions for the new challenges we face, but we think these proposals are a distraction. The only realistic chance of getting international support at the scale required by 2030 is by using the channels, relationships and expertise developed by the MDBs. But, as we argued in Volume 1, “MDBs need to transform themselves to transform development.”¹⁶ To transform themselves to better, bolder, and bigger MDBs, they should:

- i. **convert their operating model to support transformational investments;**
- ii. **put engagement with the private sector at the center; and**
- iii. **provide sharply scaled-up financing at affordable cost to their EMDE clients.**

Better MDBs would devote a large share of their activities to supporting country-led and country-owned platforms (Section II). They should change operational practices to:

- i. focus on multi-year transformative programs rather than individual projects.
- ii. provide analytical support and diagnostics at macro and sectoral levels, based on deep understanding of, and consultation with, local partners, in a format that facilitates policy change in client countries.
- iii. speed up and simplify business processes.
- iv. work together, and with all public development banks, to link country programs to global and regional initiatives, and to develop enabling conditions (bankable project pipeline development, policy reform) for success.

Bolder MDBs would help mobilize and catalyze the considerable capital and technological know-how of the private sector (Section III). They should change their approach of risk management to:

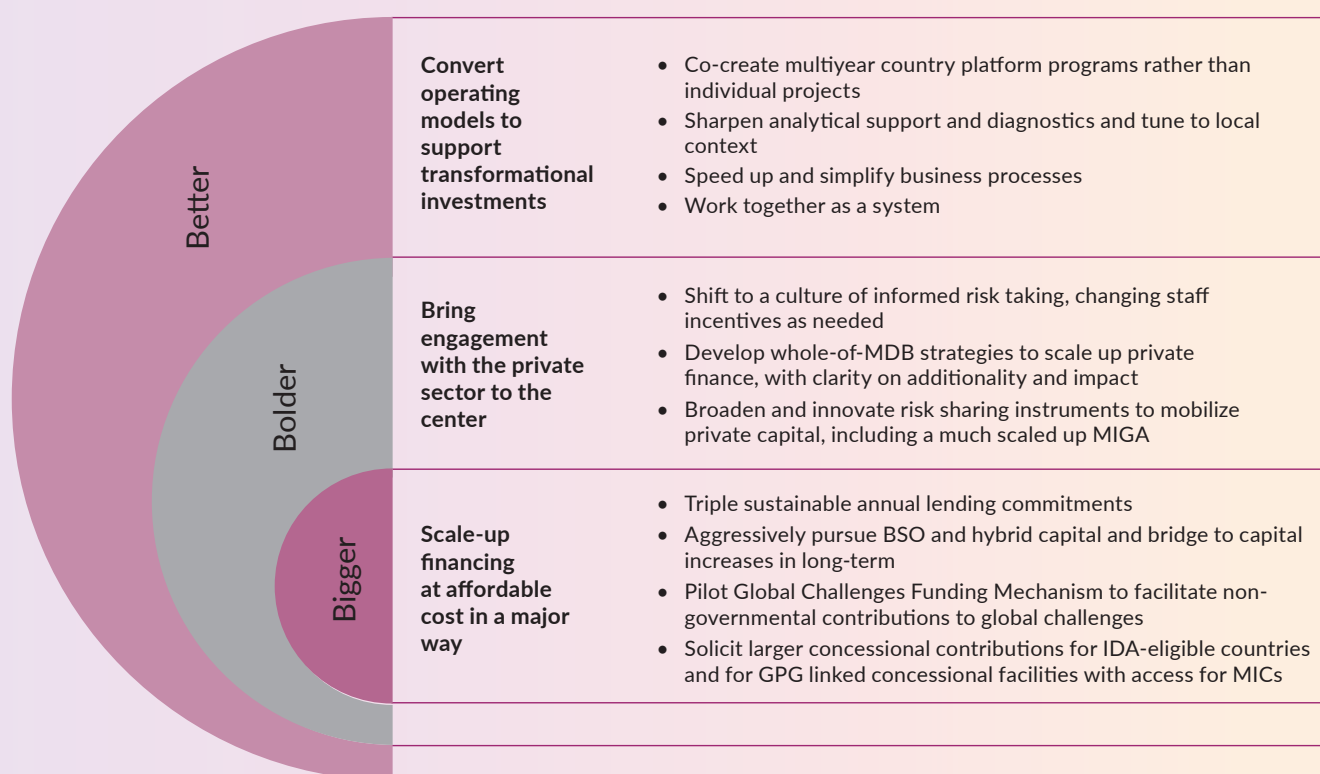
- i. shift from a culture of risk aversion to one of informed risk taking, changing staff incentives as needed.
- ii. develop whole-of-MDB strategies to scale up private finance, with clarity on additionality and impact.
- iii. broaden and innovate risk sharing instruments to mobilize private capital, including through a much scaled-up MIGA.

¹⁶ IEG (2023), *Strengthening Multilateral Development Banks: the Triple Agenda*, p. 11, https://www.g20.org/content/dam/gtwenty/gtwenty_new/document/Strengthening-MDBs-The-Triple-Agenda_G20-IEG-Report-Volume.pdf

Bigger MDBs would help mobilize the financial resources at affordable terms that countries need to raise investment volumes sufficiently to achieve transformational change (Section IV). They should:

- i. triple sustainable annual commitment levels to around \$390 billion per year (of which \$300 billion in non-concessional lending).
- ii. aggressively pursue all efforts at balance sheet optimization in the short-term, pilot then mainstream portfolio guarantee and hybrid capital structures, and bridge to capital increases to sustain lending volumes in the longer-term.
- iii. develop simple funding mechanisms to facilitate non-governmental contributions to global challenges, linked to MDB activities.
- iv. advocate for scaled-up concessional financing for IDA-eligible countries and establish and expand separate concessional GPG facilities that MICs can also access.

Figure 1: Organizing framework for Volume 2



Source: IEG Core team



Business as Usual will not work to transform MDBs. The central premise of this second volume of our report is that a business-as-usual approach will not result in the transformation of MDBs we seek. The roadmap to better, bolder and bigger MDBs will entail a sharp discontinuity in the financial scale of the MDBs and in their operational models – the way in which they operate internally, with their clients, with the private sector and with each other.

A wholesale rethinking of the MDB operational model will be required, including a change of institutional culture and mindset about how they operate individually and as a system. Governments have the primary responsibility for ensuring that the enabling conditions for private investment are sound, transparent and stable over the horizon of investors. They must also help address multiple coordination failures among domestic and international stakeholders, public and private, to unlock and scale up investment for urgent priorities such as rapid energy transition, building resilience to climate change, tackling fragility, and closing major gaps in reaching the SDGs. A home-grown unified vision of goals, policies, investments and financing is one way of addressing such failures.

The historical experience with country platforms, and MDBs' role in them, is mixed. New-style platforms, such as Just Energy Transition partnerships, have greater sectoral focus and political support, but implementation is slower than hoped-for. Analytical support and diagnostics in key areas including domestic resource mobilization has been ad hoc. Client assessment of MDB performance on key operational metrics, including speed of approval and use of local knowledge, is sub-par. MDBs largely operate as individual institutions rather than as a system.

There will be a temptation to see the list of changes as incremental improvements, some of which have been on the agenda for years but with limited results. Citing a few examples where MDBs have cooperated well in a country, the one program where innovative mechanisms for engaging the private sector have delivered results, or the emergency loans processed at rapid speed is no longer a satisfactory response in the context we face.

MDBs need a whole-of-institution approach to engage effectively with the private sector.

It is clear what the private sector needs: a conducive macroeconomic and sectoral policy environment, and financial toolkits to help manage risk appropriately. However, MDBs are too often seen as bureaucratic and unreliable partners by the private sector. They have a history of risk aversion and there are frequent complaints that MDBs undercut the private sector in deals where their only value is in cheaper financing. The harsh reality is that despite all the talk about blended finance, only 10 cents of private sector money was mobilized for each dollar of official finance in 2021, according to the OECD.¹⁷ Only 20% of clean tech investments is going to developing economies.¹⁸ We cannot continue to cite the few examples of how the private sector is contributing to sustainable development in

¹⁷ OECD, *Total Official Support for Sustainable Development*, online, <https://tossd.online/> Data for 2021 was downloaded on August 25, 2023. The TOSSD definition of mobilized private finance may differ from other definitions, and citation of this data does not indicate any position on the preferred metric for mobilized private finance. It is used here for purely illustrative purposes.

¹⁸ IMF (April 11, 2023), *Statement from International Monetary Fund Managing Director, COP28 President-Designate, and UN Special Envoy for Climate Action and Finance* [Press Release], <https://www.imf.org/en/News/Articles/2023/04/11/pr23116-statement-imf-md-cop28-pres-un-sp-envoy-clim-action-finance>



EMDEs as evidence that new trends are emerging. Overall success depends on MDBs embracing partnerships with the private sector, taking on more risk—especially credit risk and policy risk—and then managing it properly.

Affordable financing from MDBs is nowhere close to the scale needed for crucial investments. In the current environment of relatively high nominal interest rates, we estimate that the net non-concessional resource transfer from MDBs to middle-income EMDEs in 2023 will be close to zero. Net transfers of concessional resources to low-income countries remain positive and important, but cannot be readily scaled up, given fiscal constraints and competing priorities for donor attention.

In October 2021, G20 economies pledged to recycle \$100 billion of surplus SDR funds to EMDEs through the IMF's PRGT and RST facilities and to keep the promise to provide \$100 billion of financing for climate action. As of March 2023, only SDR 2.5 billion of the SDR 20 billion in pledged RST funds had been committed and only about 600 million SDRs had been disbursed to EMDEs. IMF Staff estimate the medium-term demand for RST funds at SDR 22 billion, a fraction of the resources being pledged. Similarly, the scale of operations for the IMF's PRGT is also being held back by inadequate subsidy resources. While raising the commitment capacity of the PRGT and RST is a necessary step, the slowness with which funds are actually reaching intended beneficiaries points to large gaps in the financial architecture that should be filled as a matter of urgency.

Difficult tradeoffs will need to be made along the route to better, bolder and bigger MDBs and key shareholder support, maintained over several years to follow a clear roadmap, will be essential to ensure the right choices, not the easy ones, are made (Section V). We recognize that transforming international organizations is a complex and multi-year endeavor given the need to forge consensus not just within the organization but also among shareholders and stakeholders with diverse views. That is why, while the principal responsibility for delivering on the MDB transformation agenda lies with their managements and boards, we urge the G20 to carefully engage with and assess MDB reform progress to provide additional guidance and support where warranted to achieve the necessary impact.

Investment with a purpose

In Volume 1, we focused on the quantum of new investments needed in EMDEs. Here, we disaggregate to identify different types of investment. Some have well-defined financial returns and are suited to private investors: generation of renewable electric power, electrification of industrial processes, electric vehicles production, energy efficiency of buildings. Others have sound economic returns, but limited financial returns: health and education, adaptation, and resilience. Still others have economic returns that spillover across borders and are captured by the global community: biodiversity, and nature preservation and conservation. All these types of investment are needed to create prosperity, but because the returns and risks are so different, the type of financing required, and the most likely source of this financing, is also different.



MDBs cannot be all things to all people. Understanding the purpose of investments is therefore critical to understanding the most effective role for MDBs. They can use specific instruments to facilitate different types of investment—guarantees to lower the cost of capital, own-account lending for high social return projects, concessional aid for low-income countries and for activities with large cross-border spillovers.

China is a special case because of its size. It is almost as large as other EMDEs put together in terms of its investment requirements by 2030 but has a far lower investment gap because it was already investing heavily in climate and other SDGs in 2019 (Figure 2). In China, total investments of about \$4 trillion per year are required by 2030, an increment of about \$1 trillion over 2019 levels. The balance of investments in China is tilted towards climate and nature-related areas, with slightly smaller amounts required for other SDGs. As presented in Volume 1, however, the reverse is true in other developing countries. There, just over 44% of the \$5.4 trillion in annual investments should be in climate and nature-related areas, while 56% of spending is needed for other SDGs. The Figure also shows that a very large fraction of climate-related spending is for the energy transition, although in EMDEs there is also a sizeable component of investments in adaptation and resilience.

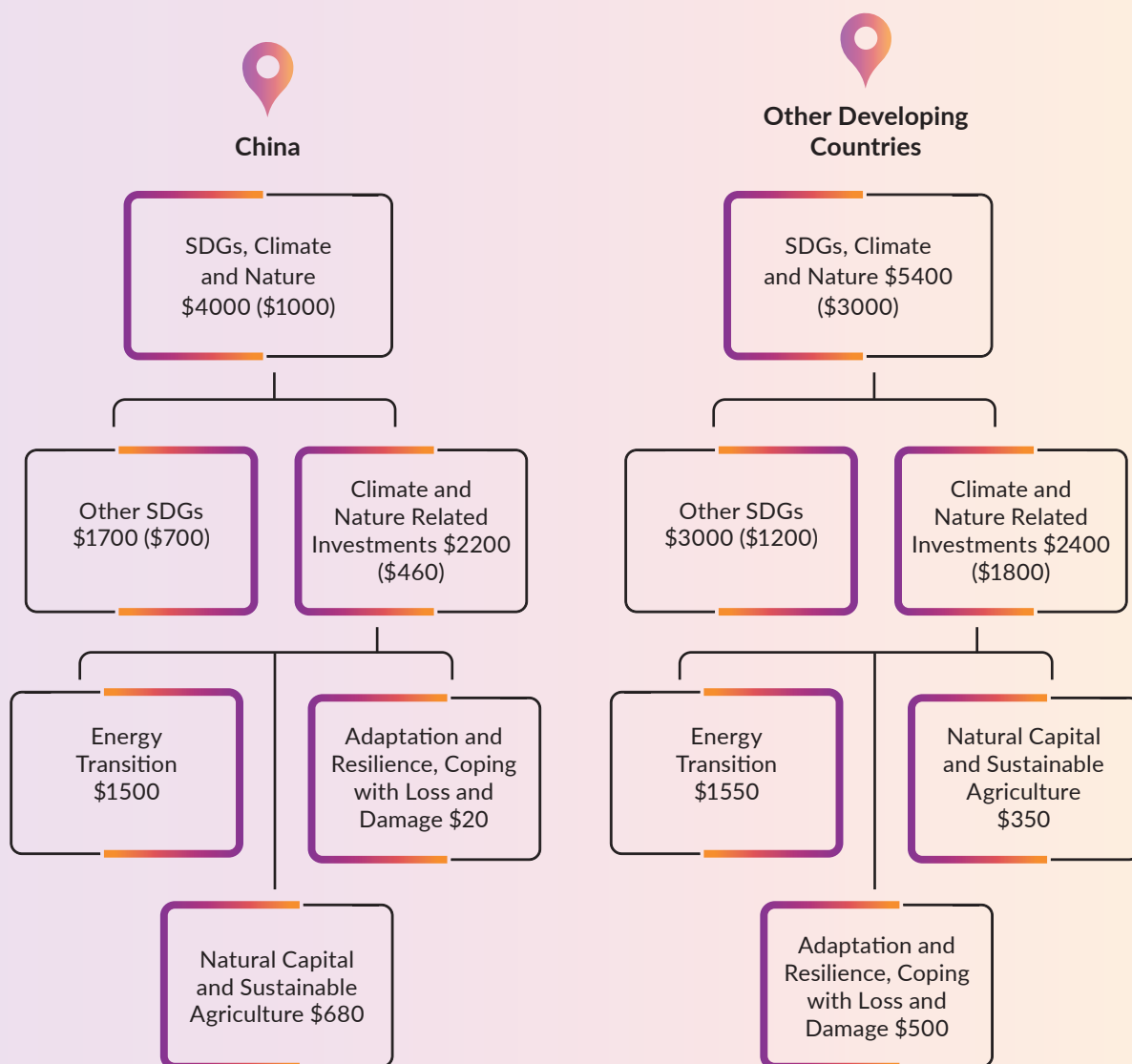
There is considerable convergence in various published estimates of investment needs, providing reasonable confidence in the order of magnitude of the investment numbers required in EMDEs to meet global goals by 2030. The figures used in this report have been built up through a country-by-country, issue-by-issue approach. There is, naturally, a degree of uncertainty about the forecast level of investment needs, with the estimates for human capital and the energy transition being relatively firm, while estimates for adaptation, resilience, loss and damage and nature-related programs are less solidly grounded in granular empirical work. We have chosen to present a single set of numbers, consistent with those used by the Songwe-Stern independent high level expert group on climate finance, to provide best available estimates.¹⁹ There are other publicly available estimates, but these differ in country coverage and thematic coverage, so in Annex 2 we undertake a comparison between our figures and these other public sources, after matching coverage to the extent possible. Our core finding that EMDEs ex-China should invest about \$3 trillion more in 2030 compared to 2019 is fully compatible with the partial incremental investment needs cited by others.

The premise of this report is that MDBs should reform in a way that supports their EMDE clients to sharply increase their investment levels by 2030 to meet their transformational goals. We estimate EMDEs will require external official and private finance of about 3% of their GDP by 2030. G20 members have individually embarked on programs to deliver SDGs and GPGs in their own economies, to partner with the private sector and to build trust and support among domestic stakeholders for the multi-year transformations that are needed. By supporting MDBs, they would internationalize their commitments.

¹⁹ Songwe V, Stern N. & Bhattacharya A. (2022). *Finance for climate action: Scaling up investment for climate and development*. London: Grantham Research Institute on Climate Change and the Environment, London School of Economics and Political Science. Retrieved from: <https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2022/11/IHLEGFinance-for-Climate-Action-1.pdf>

Figure 2: Investment Requirements in EMDEs for Climate and Sustainable Development

\$ Billion (constant 2019 prices) Per Annum by 2030 (increment from 2019 in parentheses)



Source: Bhattacharya, Songwe, Stern, remarks at the Paris Summit

Note: Totals may not add due to rounding

II. Better MDBs: Helping clients scale investments to provide SDGs and GPGs

...we need to stop, at the international level, help[ing] this little thing here... this little thing over there, when in fact we need to take a leap in quality, and invest in structural things that change the lives of countries.

President Luiz Inacio Lula da Silva²⁰

President Lula spoke for many middle-income countries when he argued in Paris that MDBs do not focus sufficiently on transformative change that can accelerate growth, reduce inequality and contribute to SDGs and GPG delivery. MDBs are no longer monopoly providers of development finance, so they must rediscover where they can add the most value. They must become more client responsive, with borrowers firmly in the driver's seat. They must move faster, become cheaper and join forces with each other. They must serve middle-income countries as well as low-income countries, albeit with a different mix of instruments.

Country platforms and changing mindsets for transformational change

The idea that high-level political agreements are needed to support transformative change to achieve specific long-term objectives is increasingly gathering momentum in many different country contexts, ranging from post-tsunami and post-earthquake responses in Indonesia and Haiti, to Just Energy Transition Partnerships in South Africa, Indonesia, Vietnam and Senegal. Egypt has an innovative nexus of food, water and energy programs. The most successful of these programs share a few characteristics: a high-level steering group of development partners, convened in many cases by the President or Prime Minister, to set outcomes and vision; a Ministerial level structure to establish technical working groups and coordinate a plan detailing who does what; and a secretariat level group to monitor progress, trouble shoot, and learn lessons.

The core function of such a structure is to present a strategic vision of change and a tactical operational plan to achieve this, with clear responsibilities assigned to development partners including MDBs. Country platforms have been repeatedly recognized and supported by the G20. Creating country platforms was a core recommendation of the G20 Eminent Persons Group on Global Financial Governance (2018): "Proposal 2: Build effective country platforms to mobilize all development partners to unlock investments, and maximize their contributions as a group, including by convergence around core standards."²¹ The G20 Finance Ministers also endorsed a

²⁰ President Luiz Inacio Lula da Silva (June 2023), speech at the Paris Summit for a New Global Financial Pact, <https://www.gov.br/planalto/en/follow-the-government/speeches/speech-by-president-luiz-inacio-lula-da-silva-during-the-summit-for-a-new-global-financial-pact-in-france>

²¹ Report of the G20 Eminent Persons Group on Global Financial Governance (2018), *Making the Global Financial System Work for All*, <https://www.globalfinancialgovernance.org/report-of-the-g20-epg-on-gfg/>



Reference Framework for Effective Country Platforms in 2020 as a process that can be transformational in enhancing development impact.²² This framework stressed the benefits of government ownership, flexibility, and “learning by doing” over time. It encouraged MDBs to continue to develop and support such platforms.

However, implementation has lagged. MDBs cannot easily square internal three-year country strategies with the decade-long transformations envisaged in country platforms. They compete (with each other and with the private sector) to undertake the easiest projects. They have processes for local consultation that can lengthen approval time horizons. Some operate outside the core structure, by choice or necessity.²³

MDBs must learn to adapt to country platforms and change their mindset for how they work together and with national development banks and financial institutions. They need to take a supportive role not a leadership role. This means focusing on high-stake, urgent issues where governments have their own money and high-level commitment on the table. It requires focusing policy and regulatory advice on areas directly linked to program success (while equally important indirect reforms are pursued outside the platform). It signifies the need to include investments in institutional capacity and local consultation.

When properly designed, platforms identify the type of finance that is most appropriate for the designated purpose. Figure 3 is an illustration. It shows that in a complex platform, such as transforming the energy system, there can be over a dozen different components. In some areas, the private sector plays the lead role, with perhaps a need for credit enhancements in difficult environments, which MDBs could provide. The primary areas for MDB own-account financing should be in programs where there are solid economic returns (although not necessarily financial returns), where assets are long-lived (hence requiring long-term financing to fully amortize them) and have large spillovers (hence a distinct public purpose). The examples in the figure point to transmission and storage of power, low-emission public transport, and the just transition as areas where MDBs have a comparative advantage in the energy transition. In simpler platforms, such as investing in adaptation and resilience, or in health and education, MDBs are more likely to play a decisive role, especially where they can draw upon concessional funding sources.

²² Country platforms are considered to be “voluntary country-level mechanisms, set out by governments and designed to foster collaboration among development partners, based on a shared strategic vision and priorities” G20 Reference Framework for Effective Country Platforms (2020), <http://www.g20.utoronto.ca/2020/2020-g20-finance-0223.html>

²³ For example, the Asian Infrastructure Investment Bank’s proposed Dak Lak Wind Power project in Vietnam is not part of that country’s JET-P.

Figure 3: The comparative advantage of MDBs in different country platforms

Investment and Spending Priorities		External financing sources needed to support investing and spending					Needs by 2030
		Largely autonomous private finance	Private finance with risk mitigation	Long -term MDB finance	Concessional finance (bilateral and multilateral)	Debt free finance	
	Primary source of finance	Well defined returns, shorter duration maturities	Longer maturities, policy and technology risks	Solid economic returns, long durations and spillover effects	Lack of well-defined returns, weak country creditworthiness	Limited monetised returns, global externalities	
	Secondary source of finance						
Transforming the energy system	Power system	Zero carbon generation					\$300-400bn
		Transmission and distribution					\$200-250bn
		Storage and back up capacity					\$50-75bn
	Transport system	Early phase out of coal					\$40-50bn
		Transport infrastructure (low emission)					\$400-500bn
	Industry	Fleet electrification/hydrogen					\$100-150bn
		Energy efficiency					\$10-20bn
	Buildings	Industrial processes					\$10-20bn
		Electrification					\$20-40bn
	Green Hydrogen	Energy efficiency, GHG abatement					\$70-80bn
		Production					\$20-30bn
		Transport and storage					\$20-30bn
Just transition	Target programs, safety nets					\$50-100bn	
Coping with loss and damage						\$200-400bn	
Investing in adaptation and resilience						\$200-250bn	
Investing in natural capital	Sustainable agriculture						\$100-150bn
	Afforestation and conservation						\$100-150bn
Mitigating methane emissions from fossil fuels and waste	Biodiversity						\$75-100bn
	Education						\$40-60bn
Investing in human capital	Health						\$1700bn
							\$1100bn

Source: Songwe-Stem-Bhattacharya (2022), Kharas and McArthur (2019) for human capital

This concept of comparative advantage is an important backdrop to the discussion of how MDBs should evolve. It emphasizes the idea that MDBs must do more in conjunction with other partners to achieve truly transformational results. For example, the case for MDB expansion based on the idea that they are needed to finance zero-carbon, renewable power generation in upper middle-income countries (potentially the easiest way for them to scale up climate activities), is not compelling because there are alternative financing sources available for that. A large MDB focus on UMICs would leave too many other gaps in the system for lower middle-income and low-income countries that are equally important for overall success. It could then run the risk of crowding-out private finance. It would ignore the priority expressed by many EMDEs for access to affordable financing for adaptation and resilience where the MDB impact would be higher.

Mind the Gaps

New-style country platforms have a sectoral focus, a greater sense of urgency, a limited membership and are anchored in a political agreement. They are a practical way to “put countries in the driver’s seat.” Originally, developing countries developed aid coordination platforms to voice their priorities, but the experience has been decidedly mixed, with limited accountability of any development partner. The developing country hopes that donors would provide more assistance in the form of budget support and make use of national procurement and fiduciary systems never materialized.

Country platforms are now moving from aid coordination in LICs to investment coordination in MICs. Table 1 provides an estimate of how the incremental investment needs articulated in Volume 1 might be broken down by country income grouping and associated theme. It shows that 90% of incremental investments will be in middle-income countries. The table further shows that although the absolute level of spending on climate in EMDEs in 2030 is expected to be below the level of spending on other SDGs, the increment in spending between 2019 and 2030 is largest in climate because of low spending levels in the 2019 base year.

The largest external financing gaps are in LMICs (Table 1) and MDBs should concentrate their non-concessional lending in these countries. The LMIC financing gap could be more than double the gap in UMICs because UMICs have far more capacity to raise domestic resources through tax revenues and by accessing local capital markets and national development banks.



Table 1: Investment needs and financing commitments, by country group and theme, 2019 and 2030 (billion 2019 \$)

	2019 spending	2030 spending	2030-2019 gap	Domestic financing	External financing gap	Concessional	Non-concessional	Private
LICs	50	350	300	150	150	90	45	15
SDGs	30	200	170	100	70	65	5	-
Climate	20	150	130	50	80	25	40	15
LMICs	800	2500	1700	1100	600	75	190	335
SDGs	550	1300	750	550	200	45	50	105
Climate	250	1200	950	550	400	30	140	230
UMICs	1550	2500	950	700	250	15	85	150
SDGs	1250	1450	200	150	50	-	35	15
Climate	300	1050	750	550	200	15	50	135
Grand Total	2400	5400	3000	2000	1000	180	320	500
SDGs	1800	3000	1200	850	350	110	90	120
Climate	600	2400	1800	1150	650	70	230	380

Note: Totals may not add due to rounding. Climate is defined as energy transition, adaptation and resilience, sustainable infrastructure, and agriculture, forestry and land use. SDGs refers to other SDGs, largely health and education.

Most incremental non-concessional MDB finance is likely to be needed in climate action (mitigation, adaptation, loss and damage and forestry and land use). Even though MICs are expected to be investing more in other SDGs than in climate action in 2030, their incremental investments will likely be concentrated on climate action because the initial base of spending in 2019 was so low.

MDB concessional finance, however, will likely be concentrated on other SDG areas.

Most concessional finance should support low-income countries where the gaps in SDG-related areas (health and education) are larger than the climate related gaps. Some concessional funding will also be needed in middle-income countries for activities such as early coal phase-out that address global challenges, as well as for managing large sudden shocks from natural disasters, conflict or pandemics.

MDBs also need to mobilize and catalyze private capital flows, mostly in the area of climate finance. Half of the external finance gap could potentially come from private sources. Little private capital is expected to flow to LICs. Mobilization ratios in UMICs should be higher than in LMICs.

KPIs can be important tools to steer MDB finance to the right areas in the right places, but they must be applied and interpreted within a broader frame of MDB comparative advantage as laid out in Table 1. There are inherent complexities involved in general statements about what MDBs should do that should be carefully weighed. For example, a broad KPI of an MDB target for a minimum share of climate activity could lead the MDB to chase lending to renewables in UMICs, resulting in an undesirable crowding-out of private finance. Similarly, a target for mobilizing private capital could inadvertently shift MDB

lending towards climate where mobilization opportunities are higher, rather than towards other core SDGs. This is not to say that KPIs should not be used, but to argue that they be set in a granular way that avoids distorting MDBs from their true comparative advantage.

Converting MDB operational models to support transformative investments

The current MDB operational model must be converted to deliver support to country platforms at the needed scale and urgency. MDBs strike a balance in their operational models between time to market and consultation, waiting for policy reforms and moving forward in a second-best environment, adding value through innovation and replication, reliance on expert knowledge and on local knowledge. In such a complex context, there is no single operational model that is most effective. The country-based approaches of MDBs work well for the most part in reflecting country priorities, ownership, local knowledge and accountability. Indeed, previous efforts at internal structural reforms to move away from a country-based model have had mixed success in MDBs. Yet it is hard to imagine that the current model can deliver the necessary support to clients.

MDBs must improve the quality of their offerings across five priority areas. Many of the elements below appear incremental, but regularly applied small steps resulting in continuous process improvements are more likely to cumulate into major change than taking massive leaps (Box 1).

Box 1: Five priority areas for converting MDB operational models to support transformative investments

- Redesign delivery of policy and institutional support, and the knowledge and learning agenda, with sharp metrics on improving the enabling environment for public and private investment.
- Radically speed up project and program approvals and simplify rules and procedures by using a risk-based tailored approach.
- Scale national transformations by integrating them into global and regional programs.
- Engage local communities and civil societies.
- Deepen collaboration across MDBs and with national public development banks.

The details will vary by institution (Annex 3 expands on options), but across the system there is a need for improvement in:

1. **Policy and institutional support, and the knowledge and learning agenda.** This includes support at both the detailed sectoral level and the broader macroeconomic level dealing with the enabling environment for efficient public and private investment. A fresh look at how technical assistance is delivered is needed to upgrade quality and impact. “Knowledge” banks go beyond the delivery of reports to help countries use information and analysis. On important issues of policy change, it is appropriate to have reasoned analyses from different parts of the MDB system, but processes are needed to resolve inconsistencies and harmonize MDB micro views with the IMF’s macro analysis.

Changing the approach to technical cooperation, policy advice, knowledge generation, and learning requires redesigning how advice and analysis are funded, when and how they are offered and delivered, who generates knowledge and how it is communicated. Too often, these activities rely on a range of ad hoc trust fund arrangements, rather than core MDB budget allocations. MDBs must attract and deploy a wider range of expertise, including policy research institutes in the developing world. They should build analytical capacity in client countries and encourage greater use of local knowledge and solutions. They should bring together government officials from different countries to share lessons of implementation successes and failures.

Beyond focused platform support, MDBs must engage more systematically with general policy areas. Several will take on far higher priority in the next decade: domestic resource mobilization, public investment management and improvements in the business environment stand out as areas where MDBs do not have a systematic toolkit that is applied as part of their core diagnostics. There may be selected improvements in these areas, to be sure,²⁴ but precise assessments of progress in each area should be available. Other areas, notably debt sustainability assessments, also need to jointly consider macro and micro perspectives.

2. **Speed and simplification.** Several MDBs could halve the time to market by taking a risk-adjusted lens to the application of financial, social and environmental safeguards that also considers opportunity costs of delay. More use of multiphase programs, preferably with approval of individual projects decentralized to country directors, could help.²⁵ MDBs should consistently and more widely apply a risk-based approach to project and program approvals, with certain decisions delegated to management (low-risk and below a certain amount) and greater use of country systems where they are adequate and strong enough. Across institutions, MDBs should harmonize rules and procedures to the extent practical, in safeguards, procurement, audit, reporting requirements, monitoring and evaluation. On joint projects, and particularly in the context of country platforms, MDBs should mutually recognize their standards and jointly report on co-financed projects.
3. **Integration of national and global priorities.** MDBs need a new playbook to work together to build Global and Regional Priority Programs (GRPPs) to address various global challenges. Each MDB should consider putting in place an arrangement (not necessarily a physical unit) where actions in support of GPPs are conceived, prepared and integrated across MDBs and country clients with the objective of adding to resources that would normally be available to each client. The World Bank is in the process of rolling out GPPs along these lines, following a successful trial with the multi-country response to COVID-19. Joined-up GPPs can help achieve scale economies and learning that improves the effectiveness of each intervention, especially in smaller countries that otherwise may not have sufficient access to financial and technical resources.

²⁴ For example, between 1997 and 2018, the OECD's FDI Restrictiveness Index declined from 0.367 to 0.128 in EMDEs, partly due to MDB support for reforms in this area.

²⁵ The ADB has used its multitranchise financing facility (MFF) to provide predictable and large financing to clients over extended periods of time, with considerable satisfaction from clients. However, value added in efficiency and impact did not commensurately increase, despite delegation of tranches to management. Although the quality of MFF operations has been comparable to that of other projects, the addition of more complex processes over time has led to declining demand. Corporate Evaluation: ADB's Multitranchise financing facility, 2005-2018. <https://www.adb.org/sites/default/files/evaluation-document/470651/files/ce-mff.pdf>

4. **Transparency and local consultation.** Engaging local communities and civil society in advocacy, monitoring and problem-solving, through transparent and publicly available project data, can mitigate risks of waste and misuse of public funds.
5. **Working together as a system.** Two 90-minute meetings per year of MDB heads to think together about global challenges and to identify new ways to collaborate is not enough to generate deep collaboration. MDB heads should dedicate a full day together annually, perhaps starting with a meeting at COP 28, so that they have the time for open, frank and substantive exchanges on key issues. MDB heads should form common positions and discuss joint proposals put forward by their senior management strategy groups on priority programs in several SDG areas, drawing from the example of work being done by the coordinating group on Climate Change. This group, with rotating leadership among MDBs, is already advancing proposals for a joint MDB Long Term Strategies window, and for clear joint reporting on climate impact (see Annex 4 for further discussion of opportunities for working together). It could further join up with the network of public development banks to augment partnerships and scale impact still further (Box 2). This is not collaboration for the sake of collaboration, but a deliberate effort to improve results and impact.

Box 2: MDBs should work with the Finance in Common Coalition

The Finance in Common (FiCS) coalition is a global movement of all 530 public development banks (PDBs) with \$23 trillion in assets and about \$2.5 trillion in annual investments. A 26-member sub-set of PDBs, the International Development Finance Club, is the largest provider of public development and climate finance globally, with annual commitments of \$600 billion, including \$150 billion in climate finance. FiCS intends to unleash its potential to make sustainability the new normal of finance, from origination to deployment, from the first mile to the last mile.

By working as a cooperative system, FiCS and the MDBs could be further recognized, structured and activated to renew the public global financial architecture, forming a vast and seamless architecture of public investment. All PDBs, be they multilateral, international, regional, national or sub-national, should play a critical role in aligning their financing and operations with the SDGs, the Paris Agreement and the Global Biodiversity Framework. If properly mandated and incentivized, such a system can also mobilize private finance and all their stakeholders to contribute to reorient the financial system towards the SDGs.

We recommend that MDBs agree on a range of key performance indicators, for each institution individually as well as for MDBs as a system, covering these 5 areas, including client assessments of MDB performance that should be measured through a survey administered by an independent body reporting back to the G20. The areas we have highlighted are not new issues for the MDBs. What is different now is that improvement in internal operating models is urgently needed if MDBs are to truly help countries step up transformative investments. The opportunity to take advantage of the momentum behind country platforms and other coordinating mechanisms will pass if there is delay or procrastination in the quality of MDB offerings. This is why MDBs should be willing to be held accountable, individually and collectively, for restructuring their operating models.

III. Bolder MDBs: Helping clients manage risk and leveraging private finance

The viability of infrastructure as an asset class requires that ... risks are addressed, mitigated and allocated to relevant stakeholders.²⁶

Risk is the main reason for limited private investment in EMDEs. In today's world, most EMDE governments need a partner to help mitigate and allocate risk among the myriad players in global capital markets in an efficient way. MDBs can play this role by creating seamless public-private operating models and taking informed risks on their own books. They are well-placed to offset the two most important sources of risk that private investors face, namely sovereign credit risk and policy/regulatory risk. As developing country clients seek to expand access to different pools of capital, particularly for their large infrastructure financing needs, they are finding that few private financiers are willing to take on these risks. The MDBs can, and must, help.

Creating seamless public-private operating models

Traditional MDB approaches have had limited impact on attracting private investment at scale. For example, only 10% of sustainable bond finance is presently going to developing countries other than China. MDBs' initial expectations were that improvements in areas such as macroeconomic stability, the licensing regime, or energy sector reforms, would boost private investments. They therefore focused on provision of advisory and technical assistance services and policy loans, with some success in reducing practices that restrict foreign investment. However, there has generally been a disconnect between this top-down approach, and the bottom-up perspective of investors.²⁷ Advisory services have been delivered in a fragmented way, with MDBs offering competing models with little linkage between policy reform and the direct impact on private investment.

Public and private arms of MDBs should now work systematically and in a coordinated way to 'co-create' markets suitable for private investments. Despite the rhetoric, and notwithstanding a few oft-cited examples of success, private financial flows to EMDEs remain disappointingly low. Some MDBs have separate private and sovereign arms, such as IFC and IDB Invest. The default approach has been one of limited operational interaction between these private arms and sovereign activities, partly because such engagement, for example on policy-based lending, could be viewed as a conflict of interest. The idea of putting engagement with the private sector at the center of their activities is still seen as far-fetched in many MDBs. But that is exactly what is now required, if MDBs are to become more effective at catalyzing private finance. The private financing arms must do much more to crowd-in private investments for transformational change. They must be complemented by a whole-of-MDB approach to co-create investment opportunities with

²⁶ G20 (2018), *Roadmap to infrastructure as an asset class*, https://www.oecd.org/g20/roadmap_to_infrastructure_as_an_asset_class_argentina_presidency_1_0.pdf

²⁷ This discussion draws on Le Houérou and Lankes (2023), *Mustering the private sector for development and climate in the Global South – Is it realistic? Lessons and recommendations from an on-going experiment at the World Bank Group*



the private sector, develop project pipelines including through a revamped and expanded role of the Global Infrastructure Facility (GIF), and crucially, to mobilize and catalyze much higher volumes of private finance. A diagnostic of how to create markets and unlock private investment at scale should be part of core MDB analytical products.

Sector-specific regulatory gaps--“upstream” of investments—will require active market creation before theoretical opportunities can be turned into real investments. For instance, in the energy sector, regulators and governments can strengthen investment signals by opening the way for clean energy offtake and enabling power generators to charge cost-reflective energy tariffs.²⁸ Similar issues are present in other sectors, and government action and MDB support will need to be based on diagnostics and measures tailored to suit the source of the problem, the opportunity, and the circumstances.

A special case is the development of local capital markets, which remain shallow even in many of the more advanced emerging markets. Better-functioning local capital markets, with an understanding of modern ESG practices, can help to source financing solutions across sectors and provide a connecting tissue with external finance. Themed bond issuance has grown rapidly in recent years but remains concentrated in a few EMDEs that have the appropriate regulatory framework and capital market infrastructure in place. Supply can be increased through cooperation between policymakers, MDB technical support for capital markets authorities and issuers, and adoption of green taxonomies and frameworks aligned with leading standards (Box 3).

Box 3: IFC and EBRD supporting development of local bond markets²⁹

IFC launched the Green Bond Technical Assistance Program (GB-TAP) in 2018 to develop the green bond market in developing countries, and EBRD has a similar program. GB-TAP provides technical assistance to financial institutions on green bond issuances and delivers global public goods through a range of activities and initiatives. The program is estimated to have deployed \$50m of grant funding which catalyzed \$4bn of green bond issuance.

The starting point for a new MDB engagement with the private sector should be to reinforce the Cascade principle. The Cascade is a subsidiarity principle according to which the public sector part of the MDBs should refrain from financing what could and should be done by the private sector and private finance, thus avoiding the creation of additional public debt. This simple idea, however, has faced resistance in its implementation. Sovereign project lending is driven by relationships between MDB loan officers and line-ministry clients in which neither side has much interest in probing whether private solutions might be more appropriate. It has re-emerged in the context of the World Bank’s “Evolution Roadmap” as one way of moving scarce sovereign loan resources to areas where MDB comparative advantage lies. But most management and staff incentives are still

²⁸ CFLI, EDFI and GFI, *Unlocking Private Climate Finance in Emerging Markets*, 2021. Today, just half the emerging markets tracked by BNEF allow power generators to charge cost-reflective energy tariffs, and only 16% allow them to supply electricity directly at cost, compared with 52% in OECD markets.

²⁹ Gregory (2023), *Taking Stock of MDB and DFI Innovations for Mobilizing Private Capital for Development*, <https://www.cgdev.org/sites/default/files/taking-stock-mdb-and-dfi-innovations-mobilizing-private-capital-development.pdf>



linked to discrete deals involving sovereign loans. Without impact metrics which place a greater weight on comparative advantage, the culture of looking first at whether private sector engagement makes sense will be hard to create.

All MDBs must abide by the same “rules of the game,” else competition between MDBs will result in the easiest solutions, being chosen, not the most efficient solutions.

MDBs need a set of overarching principles to help guide risk management with clarity on the sight line to additionality and impact. The only way an MDB can have a catalytic impact is if it has a clear logic as to why the project would not have happened absent its intervention. Using this logic would reshape MDB culture and ensure viable private solutions are given preference over approaches that add to public debt.

Taking informed risks aligned with the urgency of delivering on the triple mandate

MDBs have historically been highly risk averse. They have retained AAA or near AAA ratings to keep their cost of capital and on-lending rates to clients very low. We strongly support the need for such strong credit ratings, especially in light of the countercyclical role played by many MDBs at times of global crisis. However, effective risk management is not a static concept. It should be constantly evolving in response to changing business needs and models. This is not happening among MDBs where the evolution of risk management has been slow and current risk management practices are strongly impacted by legacy. For much of their history, MDB risk aversion has been a virtue to underpin a business model of providing loans to non-investment grade countries. MDB practices have deliberately limited their financial and operational risk (preferred creditor status, callable capital, high equity/loan ratios, strong safeguards) to demonstrate financial viability alongside economic and social impact. At the present time, however, given the urgency of delivering on the triple mandate, MDBs must take more risks in an informed manner.

Although MDBs have the instruments needed to take on more and different kinds of risks, these are not widely used. The main MDB risk management instrument is control over the nominal value of loans outstanding to a country as a share in the total loan portfolio. Through this, MDBs can maintain a diversified pool of development assets and manage concentration risk. When MDBs issue guarantees, however, they treat them in the same way as an increase in a loan to a country, so there is no internal incentive for an MDB country manager to offer a guarantee rather than a loan. This can be inefficient for the client. A risk-based approach could permit a country manager to expand the nominal country envelope when guarantees are a higher share. Some types of guarantee (partial, first-loss), or guarantees for portfolios rather than individual transactions, may also leverage additional amounts of private capital, offering further benefits to clients.

Going forward, a central element of MDB success will be their willingness to take on more risk and allocate it better. In the current environment, clients are looking to MDBs to move beyond being gap fillers for specific projects to unlock private finance by taking

on selected risks (Box 4). To play this role, MDBs need to change operating models to catalyse and mobilize the private sector by systematically combining diagnostics, strategy and the full range of sovereign and non-sovereign instruments to that effect.

Box 4: A Step-Change in Private Finance Mobilization: Transforming the MDB Role in Risk Sharing and Risk Reduction

Weak mobilization performance cannot be fairly ascribed simply to staff or management inaction. Its sources are deeply embedded in MDB financial and operational models, with an array of forces constraining mobilization:

- A culture of avoiding, not managing, risk;
- Mixed shareholder signals on risk tolerance;
- Performance incentives dominated by own-account volume;
- A set of financial tools that often compete with, not complement, those of commercial finance actors;
- Internal silos that prevent effective support for risk reduction through stronger enabling environments and better project pipelines;
- A weak private sector voice in shaping MDB country strategies and country platforms, including JETPs;
- An inefficient and unscalable transaction-by-transaction approach to blended finance that fails to allocate scarce concessional finance to maximize mobilization, impact, and additionality.

Viewed from this perspective, limited mobilization is no surprise and solutions are not simple. Transformation of the model has to be pursued on multiple fronts.

The golden thread of risk management

Taking more risk with public funds requires clarity and transparency about aims and goals. The winning trifecta is to demonstrate development and GPG impact, additionality, and private finance mobilization.

MDBs can:

- Intervene in ways that build markets and lower risks and the cost of capital for all market actors, not just transaction participants;
- Be fully transparent on their own operations to permit a better assessment of actual risk;
- Target demonstrable gaps in capital markets for maximum additionality;
- Focus on comparative advantage, by taking on costs and risks that are especially hard for the private sector to manage, like early-stage costs and risks, and macroeconomic or country level risks like sovereign credit risk, policy risk and currency volatility.

A range of products and activities follow these principles. Other possibilities will also emerge. Innovations such as the World Bank's Private Sector Investment Lab and the IDB Lab will pilot practical options. The precise choices will vary by institution and evolve over time, but some low-hanging fruit is already apparent (Box 5).

Box 5: ADB led loan syndication for financing of windfarms in Vietnam³⁰

The Asian Development Bank (ADB) signed a \$116 million green loan to build and operate three wind farms, totalling 144 MW, in Quang Tri Province, Viet Nam. The loan forms part of a \$173 million green loan project financing package arranged and syndicated by ADB as mandated lead arranger and bookrunner. The ADB loan comprises a \$35 million A loan directly funded by ADB and an \$81 million syndicated B loan. It is the first time that ADB has engaged with a group of international finance institutions and commercial banks. Its leadership in deal structuring, due diligence, and loan syndications was crucial for the success of this transaction. However, ADB could do far more with the private sector if it could move faster to mirror private sector timelines.

Co-creation and co-participation in projects—the halo effect. MDB participation in private finance transactions is generally credited with a “halo effect” that underpins better credit performance. MDB participation in projects can reduce risks for private partners in: (i) ensuring transaction quality, standards, and development impact; (ii) improving government policy/regulatory decisions and contract performance; and (iii) dispute intermediation, especially where transaction parties include governments that are MDB shareholders.

Project development support. Better prepared projects are less risky. MDBs should support investment climate and regulatory support, project concept development and then project preparation and development, at scale, by funding feasibility studies and technical assistance. Bottlenecks in the volume of bankable projects persist. The considerable attention on project pipeline development, at least since the 2012 G20, has resulted in a patchwork of facilities and the setting up of many donor-supported project preparation facilities. Technical assistance facilities are also numerous but fragmented, with varying mandates making them hard to access. Assistance is typically designed and negotiated on a project-by-project basis, which makes it hard to scale.

One way of moving towards flexible, harmonized systems of support is to **strengthen the Global Infrastructure Facility (GIF) to serve all MDBs and country clients**. The GIF needs funding and approval to work with national development banks, developers, utilities and the local banking system and private business in co-creating investment opportunities. These local actors account for most project development capacity already today, especially for smaller projects, so MDBs should take advantage of their experience.

A particular need is to provide early-stage finance to help private firms, particularly those preparing infrastructure projects, survive the “valley of death” between proof of concept and a profit-making operation.³¹ Such finance is now a significant source of IDB Invest’s project pipeline. IFC too is now increasing its venture capital portfolio, though this is still below \$1 billion. Building out these examples to other MDBs would require them to upgrade finance products and staff knowledge and skills. Shareholders interested in funding highly catalytic innovation with large down-stream mobilization potential, should consider capitalizing a fund or funds for this purpose.³²

³⁰ ADB (May 27, 2021), <https://www.adb.org/news/adb-signs-green-loan-develop-144-mw-wind-farms-viet-nam>

³¹ <https://www.alliedclimate.org/>

³² Lee et al. (2019), *The Stretch Fund*, <https://www.cgdev.org/stretchfund>



Make GEMs more transparent. Project risk cannot be assessed without granular data on the historical performance of similar activities. MDBs collectively maintain a credit performance database called the Global Emerging Markets (GEMs) database, among the largest in the world. Twenty-four institutions contribute. It contains credit default and loss data on more than 17,000 sovereign and non-sovereign credit transactions over a period of 33 years. Yet only contributing MDBs and DFIs can access the data. Private investors and credit rating agencies (CRAs) cannot therefore easily quantify the halo effect because they do not have access to this granular MDB credit performance data. In fact, MDBs themselves do not take full account of their own track records for probabilities of defaults and losses, in their capital adequacy frameworks and in their capital treatment of guarantees.

As recommended by the CAF report, the GEMs consortium is working on expanding public access to the data but progress has been slow and opaque, with fragmented governance, diverse membership, decisions made by consensus, and no legal entity that can contract with MDBs, service providers or data users.³³ There is a very real risk that a lowest common denominator outcome will emerge much later than hoped with too little data released for useful credit performance analysis. That would represent a significant and avoidable missed opportunity.

We recommend that the G20 should set a clear GEMs objective: to use a transparent, consultative process to create a publicly available, interactive (anonymized) database with annual data that permit granular analysis of MDB credit performance by country and detailed sector, and to do so by 2024.³⁴

Create value by transferring risk

MDBs have a range of policy-based and project sovereign guarantee instruments for sharing risk.³⁵ Some, such as EBRD, operate at sub-sovereign levels without sovereign guarantees, and others are learning to see if they can emulate this practice. Internal and external independent assessments over the last three decades have advocated greater use of guarantee instruments as powerful catalytic tools: on average, every dollar of World Bank guarantee has mobilized \$4 of investment project and investment finance. Yet, the average exposure taken by IBRD on sovereign guarantees has been less than 0.7% of annual commitments made in the form of loans and grants. The AsDB and IDB Invest report a slightly higher figure for non-sovereign guarantees, but there too guarantees represent only an average of 1.5% of long-term non-sovereign commitments. How to do better?

³³ Mathiasen (August 03, 2023), Mining for GEMs, <https://www.cgdev.org/blog/mining-gems>

³⁴ Citi stresses the importance of public access to the GEMs data: "This is perhaps the single highest dividend, lowest hanging fruit and most cost-efficient tool available to the G20 to scale private sector lending to emerging and developing economies...The power of this data to lower the overall risk perceptions of the bank, insurance and institutional investor market should not be underestimated." <https://media.licdn.com/dms/document/media/D4E1FAQGVMtj2XyXTqQ/feedshare-document-pdf-analyzed/0/1687283336497?e=1692835200&v=beta&t=xGgjw0yLpysxTYMdzHVXPIEpTquPEL0Md9rMrg6vgaU>

³⁵ Le Houérou and Lankes (2023), Mustering the private sector for development and climate in the Global South – Is it realistic? Lessons and recommendations from an on-going experiment at the World Bank Group, <https://ferdi.fr/en/publications/916ceb3c-906f-445e-99bf-43e5f06e2d50>

Sovereign guarantees. Sovereign guarantees by MDBs can mobilize private finance and improve its terms (Box 6). One analysis finds that guarantees have reduced funding costs by an average of 330 basis points compared to what governments would have achieved had they pursued unenhanced issuances.³⁶

Box 6: Use of Sovereign Guarantees for the Galapagos Bond

Ecuador is saving at least \$12 million annually that it will use to fund conservation of Galapagos biodiversity. This was accomplished by issuing a new \$656 million “Galapagos” bond with an IDB credit guarantee and political risk insurance from the US Development Finance Corporation, which reduced the coupon rate on its bond issuance to 5.645%. The bond proceeds are used to repurchase existing sovereign debt at a steep discount, freeing up the needed fiscal space.

Project guarantees. The Partial Risk Guarantee (PRG) is particularly useful for infrastructure financing by partially insuring the payment to a private company by public customers such as public utility off-takers. Any default by the government to the private sector has a sovereign counter-guarantee: if the guarantee is called, the amounts paid become a liability of the government to the MDB. This creates an incentive for the MDB and the government to work on the underlying problem of lack of creditworthiness of public utilities in many countries. Yet, over the last 10 years, only 18 such PRGs were issued by the World Bank, less than 2 on average per year. The trend is down: in FY21 only 1 such guarantee was provided, none in FY22.

On the supply side, internal incentives are currently stacked against provision of guarantees. Guarantees often involve multiple partners, are not standardized, entail lengthy bespoke negotiations, and require specialized skill sets that go beyond the zone of normal loan officers’ familiarity.³⁷ There are no offsetting benefits to staff or management. Simpler ways of determining when and how to use guarantees are needed. Adding to the problem is the fact that the capital charges for guarantees imposed by MDB treasuries are the same as for loans: the full nominal amount of the exposure, unadjusted for the expected call on the guarantee, is booked against capital.³⁸ As with many accounting practices of MDBs, whose activities do not neatly compare with other corporates, a full discussion with CRAs is warranted as to how best to reflect the potential liabilities associated with guarantees in overall risk assessment.

On the demand side, private borrowers and lenders view MDB guarantees as complex, highly variable across institutions, and time consuming to negotiate. In addition, investors have limited experience assessing the value of MDB partial guarantees which has caused confusion around pricing.³⁹ Coordinating the delivery of multiple guarantee instruments

³⁶ Landers & Aboneaaj (July, 2022), MDB Policy Based Guarantees : Has Their Time Come? <https://www.cgdev.org/sites/default/files/MDB-policy-based-guarantees.pdf>

³⁷ This may not be the case for all the private sector guarantees offered by MDBs. For example, IFC’s trade finance and SME portfolio guarantees have lower capital charges than loans. Choices on products are made by clients.

³⁸ Pereira (2018), Introductory Guide to Infrastructure Guarantee Products from Multilateral Development Banks, <https://publications.iadb.org/en/introductory-guide-infrastructure-guarantee-products-multilateral-development-banks>

³⁹ World Bank (August, 2016), Utilizing World Bank partial guarantees in support of sovereign or sub-sovereign commercial debt financings, <https://documents1.worldbank.org/curated/pt/293331492579395041/pdf/114407-WP-PUBLIC-Rothschild-report.pdf>



within each MDB, standardizing terms to permit aggregation and scaled platforms for risk sharing, and facilitating participation of multiple investors could make guarantees a far more attractive offering on both the demand and supply side.

Some investors also have concerns about risk coverage and the terms and timing of payouts that frequently fall short of what is needed for banks to qualify for reductions in capital requirements under Basel III. The Basel III framework does not treat infrastructure as a separate asset class with credit performance characteristics distinct from those of non-infrastructure project finance and non-financial corporate asset classes. In fact, current regulations are a triple whammy for banks' involvement in EMDE project finance. Long-term investments in developing countries for infrastructure are three characteristics which each get assigned a high-risk weight, making the cumulative capital charges for such projects very onerous for banks. Yet data show that loss-given-default rates for infrastructure investments are less than half those for investments in non-financial corporates.⁴⁰ The G20 Indian presidency has tasked the Global Infrastructure Hub, formed by the G20, with mapping infrastructure taxonomies and examining gaps in data collection. The GI Hub is also pursuing an initiative to advance regulatory reforms, including of Solvency 2, that support private investment in infrastructure while maintaining financial stability.⁴¹

Empowering MIGA. Unlike other MDB guarantees, MIGA has effective and standardized insurance products, a globally diversified portfolio, the ability to partner with sovereigns, municipalities, state-owned enterprises and the private sector, authority to work across the MDB system, a demonstrated track record, and excellent access to private reinsurance.

MIGA could become a heavyweight puncher. To do this, it must reverse its culture of risk aversion, developed over time by engagements between senior management and shareholder representatives at the Board. It has paid out claims only 11 times in its 35-year history. Its low risk tolerance drives down the costs of its products, while active use of reinsurance boosts its capital efficiency: capital of \$1.9 billion supports exposure of \$27.9 billion. But while MIGA has expanded in IDA contexts using the IDA Private Sector Window facility, it tightly constrains where it operates, in what projects, and with whom it partners.

MIGA's powerful tools can be deployed in ways that expand rather than diminish MDB opportunities. MIGA can offer insurance that off-loads MDB risk at the portfolio level, freeing up capital for more lending. This could be particularly valuable for regional development banks grappling with high country concentration ratios, especially as they seek to expand climate mitigation lending to large emerging economies. And for MDBs with limited guarantee and insurance expertise, partnerships with MIGA can tap into its well-designed and well-tested products, avoiding the high transactions costs of developing their own bespoke guarantee products. MIGA has started to explore such options, but the time to scale these pilots is now (Box 7).

⁴⁰ Juneja (2023), *Banks are critical for closing infrastructure deficits, but banking regulations are not supportive*, <https://www.gihub.org/articles/banks-are-critical-for-closing-infrastructure-deficits-but-banking-regulations-are-not-supportive/>

⁴¹ GIH (n.d.), <https://www.gihub.org/regulatory-treatment-of-infrastructure-as-an-asset-class/>

Box 7: Credit Enhancement undertaken by MIGA for crowding in institutional investment in Turkey⁴²

The Elazig Hospital in Turkey, a EUR 360 million project was financed through a EUR 288 million bond issued by ELZ Finance S.A. EBRD provided EUR 89 million liquidity facility to support construction and operational phases. MIGA provided a 20-year political risk guarantee to support the investment-grade portion of the bond and a MIGA guarantee to equity investment in the project. This credit enhancement led to a Moody's rating of Baa2, which was two points higher than Turkey's sovereign debt rating. The high rating enhanced institutional investment.

One of MIGA's most attractive products is non-honoring financial obligations (NHFO) insurance. NHFO insurance protects creditors from breaches of government obligations under off-take agreements, concessions, or sovereign guarantees. Insuring against revenue volatility in this way is especially catalytic in infrastructure transactions. MIGA could deploy this product in many more countries and entities if the instrument was coupled with a sovereign guarantee from an MDB to bring the credit risk to investment grade level. MIGA's product would also look far more attractive if it were supported by a stand-by liquidity facility that would maintain payments during on-going arbitration. Without that, it stands accused of taking the umbrella away when it starts to rain.

An attractive feature of MIGA is that it can pool existing MDB assets and distribute them to capital markets after a project is completed and construction risks are over. For country clients, this reduces their exposure with MDBs and makes them eligible for further lending. In theory, MIGA could act as a conveyor belt taking MDB loans to reinsurance markets after projects are completed and revenues start to flow. This would raise MDB capital turnover, but there are constraints such as pre-payment penalty fees and lack of any assurance that freed-up capital will be used for additional lending to the country concerned. More fundamentally, the standard 20-year, fixed mark-up pricing model that MDBs offer clients provides disincentives to move towards an originate-to-distribute model of this kind.

We recommend MIGA should:

- build partnerships with other MDBs at scale, including for portfolio risk transfers.
- adjust its risk tolerance in its new 2024-2027 strategy. The new strategy should aim for greater balance across 3 objectives: using reinsurance for less risky assets to free up MIGA capital, holding riskier assets with high development and climate impact on its own balance sheet, and partnering with other parts of the WBG and other MDBs to help free up and stretch their capital.
- establish a liquidity facility to boost PRI coverage, including through the private sector window.

⁴² Gregory (2023), *Taking Stock of MDB and DFI Innovations for mobilizing private capital for development*. Centre for Global Development, <https://www.cgdev.org/sites/default/files/taking-stock-mdb-and-dfi-innovations-mobilizing-private-capital-development.pdf>

- expand eligibility for non-honoring financial obligations (NHFO) insurance to countries and firms rated below BB- in close collaboration with WBG and other MDB support for stronger country enabling environments and performance in honoring contracts. Countries willing to act with MDB support to reduce contract risk should be eligible for NHFO insurance.
- Open discussions with IBRD on an originate-to-distribute loan pricing model, resolve issues of pre-payment penalties, and bring IBRD/IDA and MIGA guarantees under one management.

While we recommend that MIGA grow, and grow rapidly to achieve impact, the underlying challenge is to get credit enhancements quickly for many more countries. Credit enhancement by DFIs outside the system complements MIGA and can help fill the gap in markets that is so apparent today.

Forex guarantees. Tripling the size of annual MDB lending will result in a major increase in unhedged currency exposure in developing countries as almost all MDB sovereign lending is undertaken in foreign currency. Local currency devaluations can result from unchecked domestic imbalances as well as from global economic shocks. In situations of tight global liquidity, when major central banks raise interest rates, the resulting devaluations in EMDEs can add to debt burdens and threaten debt sustainability at the same time as refinancing becomes harder and more expensive.

It is clear that forex risk is a major pain point for many investors. At the project level, and for local partners, forex risk is too expensive to hedge and too large to ignore. Shallow domestic capital markets imply that any market-based options may be inefficient. In the past, MDBs have circumvented this issue by lending through intermediaries, such as national development banks, who in turn take on the forex risk usually with a fixed premium passed on to the final borrower. In other designs, the government itself plays this intermediary role.

Governments can position themselves better to manage forex risk from a macroeconomic perspective. For the most part, developing country clients need additional foreign exchange when expanding investments, so a foreign currency option can be attractive. Additionally, many sovereigns find they can borrow domestically at rates similar to what an MDB might be able to borrow at, whereas their costs of borrowing in foreign currency are far higher than borrowing from an MDB. From this perspective, governments may find that borrowing from MDBs in foreign currency is the choice that gives them the least-cost blend of foreign and domestic borrowing.

Notwithstanding these issues, the macroeconomic case for minimizing “original sin” in developing countries remains compelling. The least controversial intervention is to develop local capacity for sound debt management. Technical assistance from MDBs to build national debt management offices have focused on the management of external debt, rather than the management of currency risk and the introduction of regulations and practices that would permit hedging.



Despite the economic advantages of borrowing in local currency debt, the Debt Sustainability Assessment of the IMF and World Bank treat local currency and external debt in similar fashion. This should be revisited in the context of the Global Sovereign Debt Roundtable that will also discuss the risks of local debt restructuring as part of a package for debt resolution in highly-indebted countries. As country debt management offices develop sound strategies for their optimal currency mix, it would be useful if MDBs could develop a practical offer of an option for local currency lending. If countries chose to exercise such an option, MDB treasuries in turn could access global risk markets to pass through this risk.

While recognizing the considerable debate around this issue, and without prejudice as to the merits of various options being proposed, we believe that the first order issues for avoiding debt crises remain the quality of public investment and spending, the capacity to mobilize domestic resources, and the provision of rule of law and effective governance. MDBs can provide useful advisory services in these areas.

Forex risk management hurdles are greater for private finance, and forex risk is a commonly cited pain point. High FX hedging costs and local interest rates can compromise bankability. Even after hedging, investors may be exposed to residual risks, including Transfer and Convertibility (T&C), local spot market illiquidity, credit, legal and operational risk. There is insufficient capacity to address these issues, since today neither the offshore route, for instance via TCX (connection to international FX risk takers) nor the onshore route (local FX risk takers), can handle the larger sizes and longer maturities that private capital works with.

Faced with the same challenges, MDB private sector arms could facilitate systematic and comprehensive support for local currency risk management for themselves and for private capital. Stronger offshore mechanisms can immediately deliver hedges at scale and quote prices in the most difficult contexts, though they will not address the root causes of the problem. By contrast, active onshore hedging markets would constitute a sustainable solution, provide an important price reference, avoid T&C risk and, once established, may be less volatile than offshore investors.

Forex risk management is not a new issue, but it takes on an urgency today that has not been present in the past, given the need for MDBs to move swiftly on the triple mandate and to adapt their risk tolerance in light of this. MDBs should therefore consider:

- Building out off-shore hedging mechanisms, in particular TCX, to a scale commensurate with the challenge, allowing it to aggregate hedges of sufficient size to systematically sell down FX risk to capital markets. This may, for some geographies, require loss-absorbing guarantees to set lower bounds on hedging losses. At the same time, MDBs should work, for instance through MIGA or private insurance, to make comprehensive T&C risk cover available with adequate geographic coverage.

- Boosting onshore hedging options, through (i) technical assistance for money market development focused in the short term on legal reforms to ensure the enforceability of derivative and repo contracts and capacity building for bank balance sheet risk management; (ii) establishing a shared onshore MDB treasury platform acting as an interface between onshore markets and international investors, pooling onshore liquidity management, setting up the required local infrastructure and acting as an onshore “paying agent” for interested investors; and (iii) offering more local currency options to clients to increase demand for hedging and to build this market.

Many of these, especially local capital market development, are long-term options. Other options are on the table, including a proposal for a facility operated by the IMF or another international organization, that would offer hedges based on longer-term FX track records, or where it makes sense to provide a subsidy so as to facilitate provision of a GPG, but there are few institutional short-cuts to reducing the cost of forex hedging in contexts of shallow, or missing, markets.

Disaster and pandemic contingency clauses in debt contracts. In the aftermath of a severe natural disaster, EMDE governments face immediate fiscal pressures to provide emergency response, relief and reconstruction. The IMF estimates that 1 in 10 disasters carries a cost of more than 30% of GDP in small countries. These costs can be further amplified if countries are forced into inefficient, long drawn out and expensive debt restructurings.

Barbados has become the world’s poster child for climate-proofing its public debt stock.⁴³ It has introduced clauses to permit it to defer principal and interest payments on its sovereign bonds in the event of an insured natural disaster. The Barbados example has been codified by the International Capital Markets Association into a model clause that other countries can use. Because it is in the interests of both debtor and creditor to avoid the costs of a formal restructuring, the debt clauses have not resulted in any change in the cost of capital.

MDBs can draw an important lesson from these experiences. The new natural disaster clauses are specifically designed to provide automatic, rules-based and rapid liquidity relief. By contrast, the World Bank’s Pandemic Emergency Financing (PEF) bonds, first issued in 2017, focused on debt principal reductions in the event of a disaster. The trigger points for this take longer to determine. In the case of the PEF bonds, metrics of the number of deaths and the spread across international borders, based on WHO data, are required. Once the principal reduction is secured, funds get transferred to a Trust Fund on which IDA can draw to assist countries in need. Delays can be substantial.

During the COVID-19 pandemic, the PEF bonds paid out \$196 million to IDA countries in 2020, a tiny amount compared to the costs involved. If, instead, the World Bank had inserted pandemic related clauses into its regular bonds, with similar pass-throughs in its contracts with EMDEs, the liquidity provision would have been far larger and more automatic. If a number of large issuers, such as the MDBs, use such clauses, it would introduce new norms and standards to international bond markets, and make EMDE debt more resilient.

⁴³ Ho and Fontana (2021), *Sovereign Debt Evolution: The Natural Disaster Clause*, https://www.clearygotlieb.com/-/media/files/emrj-materials/issue-11-spring-2021/article_natural_disaster_clause_v3-pdf.pdf

IV. Bigger MDBs: Sizing MDBs to help transformative change

...since the pandemic, there has been a realization that MDBs need to integrate global challenges such as climate change, pandemics...within their core development mandate. This would need an...expansion of their existing financial resources. This is a felt need across the entire Global South.

Prime Minister Narendra Modi

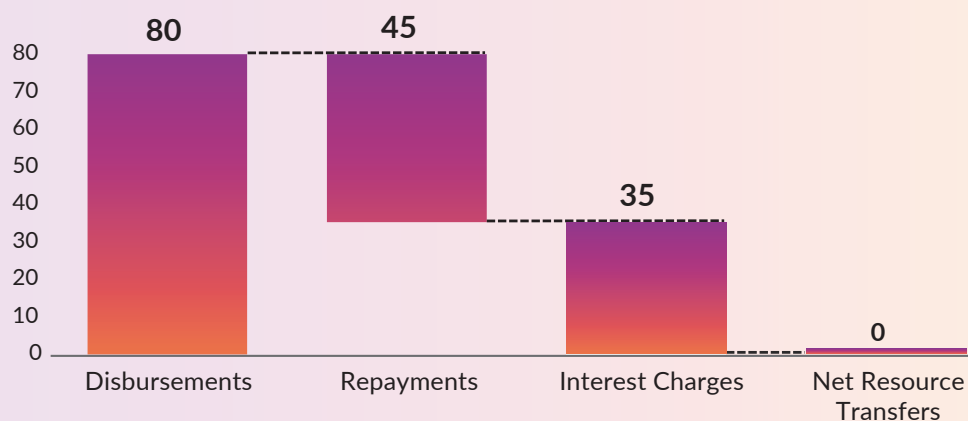
MDBs have shrunk in relevance as financiers for EMDEs. Around 2000, MDBs disbursed about \$30 billion to EMDEs, representing roughly 0.5% of their GDP.⁴⁴ By 2021, a year when MDBs had stepped up their lending as a countercyclical response to the COVID-19 induced global economic downturn, MDB disbursements were about \$80 billion, a large absolute number but a tiny 0.2% of EMDE GDP. The decline in the financial footprint of MDBs is evident across income groups, although it is less pronounced for LICs where MDB concessional financing has remained relatively strong.

In fact, MDBs are no longer providing significant net resource transfers to middle-income countries. The decline in MDB financing relevance is even more pronounced when viewed in terms of net transfers, the amount by which disbursements to EMDEs exceed repayments from them in amortization and interest charges. It is the size of net transfers that reflects the MDBs' contribution to relaxing fiscal pressure on client countries. In 2023, we estimate that MDBs as a system may collect as much money from middle-income countries as they disburse in new loans. Consider that in 2021, MDBs disbursed \$78 billion to MICs. Loan repayments were \$37 billion and interest charges were \$9 billion, resulting in a positive net transfer of \$32 billion. But in 2023, because of sharply higher interest rates (almost all MDB loans have floating interest rates of a fixed spread over SOFR), interest payments to MDBs could jump to \$35 billion, wiping out most of the net flows (Figure 4).⁴⁵ At a time when the world is looking to, and needing, middle-income countries to sharply increase spending on development and GPG-related areas, it is unacceptable that the major international financial institutions find themselves unable to provide supportive levels of net transfers.

⁴⁴ IDS World Bank. Note: EMDE's include all LIC, LMIC and UMIC.

⁴⁵ Low-income countries receive positive net transfers of around \$20 billion because interest charges and fees are so much lower on the concessional credits and grants they receive.

Figure 4: MDBs may not provide a significant net resource transfer to middle-income countries in 2023 (figures are approximations in billions of US dollars)



Source: WB International Debt Statistics, OECD Creditor Reporting System, IEG Core team
 Note: Interest rates for concessional debt are held constant at 2021 levels and for non-concessional debt are increased by 500 basis points. Disbursements are an approximation based on 2021 data.

To generate higher net transfers, MDBs need to sharply increase annual disbursements, so the time is ripe to disrupt the way they fund themselves. MDBs rely on paid-in equity capital from their sovereign shareholders, to which all members contribute, but which is only reviewed at ad hoc intervals.⁴⁶ A second funding mechanism has been through the provision of trust fund grants earmarked for specific purposes and geographies. This status-quo needs to be disrupted so that the financial footprint of MDBs can match their mandate and ambition to help countries achieve economy-wide transformational change. Trust funds, with zero-leverage and fragmented approaches, are not seen by MDBs or recipient countries as being efficient or as having scalable impact. And general capital increases are complex, multi-year undertakings linked to MDB governance reforms. Neither funding type intersects with the trends in private capital markets towards impact and sustainability investing, especially related to climate action and other GPGs.

There is a need for regular assessments of adequacy and optimal use of MDB capital. Non-concessional commitment levels are closely linked to MDBs' ability to optimize balance sheets and garner the support of shareholders for additional resources. Such support has been episodic. As we argued in Volume 1, and following the recommendation of the CAF report, it is time for shareholders to agree on a regular assessment of the adequacy of MDB capital, keeping in mind the evolving global situation and the national, regional and global goals that merit international financial support. At present, there are

⁴⁶ Shareholders also provide callable capital, which according to some studies could add up to as much as \$1 trillion. But the uncomfortable truth about MDB callable capital is that no one is entirely sure how much it is worth. Callable capital has never been called at any MDB, and the procedures for doing so are vague at best and therefore subject to interpretation that can reflect fiscal and political considerations in any given shareholder.



calls in 2023 for additional shareholder support for the EBRD, IDB Invest, the World Bank, and the Asian Development Bank for an Innovative Finance Facility for Climate in Asia and the Pacific. Taking concrete steps forward is useful but must be made with an eye on the prize—helping countries to scale investments in a material way. The criterion for success is not a negotiated agreement to increase support. It is whether enough resources are mobilized and effectively used to meet transformation objectives.

There is a compelling case for tripling MDBs' sustainable lending limits by 2030. To date, measures already being implemented, or under deliberation, could unlock \$200 billion of lending capacity over the next decade, or \$20 billion per year.⁴⁷ In our analysis, we believe that MDBs can move still further with balance sheet optimization (BSO), perhaps doubling this amount to yield annual increases of \$40 billion in lending headroom by 2030. The opportunities will vary by institution. Different MDBs have very different starting points in terms of their leverage, with EIB having a leverage ratio of approximately 6.5 while IDA's is 1.0. IDA's low ratio is all the more striking as its asset performance is as strong as that of IADB, an institution with 3 times IDA's leverage.⁴⁸

Shareholder support for MDB efforts to optimize their balance sheets and the corresponding increase in MDB risk-bearing is commendable and provides a clear signal that shareholders believe that MDBs offer significant value-for-money. However, there remains a large gap between the degree to which BSO can support sustainable lending levels and what they should be doing to support the expansive agenda laid out above. In Volume 1 of our report, we argue that MDBs should expand their commitment levels by \$200 billion each year by 2030, an order of magnitude greater than the \$20 billion per year now under consideration or the doubling of this amount that further BSO might conceivably yield.

It is imperative to rapidly expand MDBs' scale and financial capacity, and it is feasible without excessive budgetary strain. It is necessary because the costs of delaying investments in GPGs and adaptation and resilience are so high that the only feasible pathway to a stable and prospering world is by facilitating such investments with international financial and technical support. It is feasible because sovereigns can now get considerable leverage when they support MDBs in new ways and because options for funding have broadened to include non-sovereign stakeholders.

Hybrid solutions—innovations in MDB funding

After eighty years of status-quo, it is time to introduce new instruments – in the form of pooled portfolio guarantees and hybrid capital -- and new investors into the MDB capital stack. Several promising innovations are already under consideration and shareholders

⁴⁷ US Department of the Treasury (July 16, 2023), Remarks by Secretary of the Treasury Janet L. Yellen at Press Conference in Gandhinagar, India, <https://home.treasury.gov/news/press-releases/jy1617#:~:text=Yellen%20at%20Press%20Conference%20in%20Gandhinagar%2C%20India,-July%2016%2C%202023&text=Good%20morning%2C%20everyone.,other%20country%20as%20Treasury%20Secretary.>

⁴⁸ Moody's (2023), https://www.moody.com/research/Supranational-Global-2023-MDB-outlook-is-stable-despite-challenging-environment--PBC_1346351



have responded favorably.⁴⁹ If a small group of shareholders wishes to move forward now, a hybrid capital option is available. All shareholders no longer have to move in lockstep as is the case for traditional general capital increases for the MDBs. New instruments also allow for flexibility in preferences. Shareholders can use guarantees and other mechanisms to orient their support towards additionality in geographies or themes of their choosing. There is also flexibility to open up funding to non-government stakeholders: sovereign wealth funds, pension funds and other institutional investors, philanthropies, and others. These latter are as yet untested, but the growing appetite for themed capital – SDG bonds or green bonds—that aligns with MDB activities opens a door for innovation.

Portfolio guarantees. MDBs have two mechanisms through which bilateral shareholders can enable additional lending through the provision of guarantees. In one, a group of shareholders establishes a AAA-rated guarantee facility that commits to cover principal and interest payments falling due should a country default to the MDB. Shareholders can specify which loans are eligible. The International Financing Facility for Education, IFFEd, follows this model. In the case of IFFEd, shareholders leverage their contributions by contributing a relatively modest amount of capital to IFFEd alongside a guarantee for any obligations it may incur. In some countries, the guarantees are budgeted and appropriated on an expected-loss basis. IFFEd estimates it unlocks \$7 in additional lending for each \$1 of donor support.

The second option is for an MDB to create a portfolio guarantee platform under which participating donors provide first-loss coverage for default on specified portions of the MDB portfolio. The ADB's IF-CAP is designed to use such portfolio guarantees. One benefit is that no up-front cash is required. A portfolio guarantee further stretches shareholder leverage. For example, the US Administration's supplementary budget request to Congress in August 2023 requested \$494 million to cover the subsidy cost of a portfolio guarantee for IBRD which is expected to unlock \$25 billion in new headroom for the institution, or \$2.5 billion per year over 10 years.

One advantage of the portfolio guarantee program is that it can be set up relatively fast, with no need for a separate entity with its own credit rating to be established. However, MDBs will need to dialogue with credit rating agencies on the methodology to be used in assessing the treatment of such an instrument. Our assessment is that \$11 billion in annual lending could be achieved in the MDB system through aggressive solicitation of portfolio guarantees from highly rated shareholders.

Hybrid capital. The African Development Bank has become the first large MDB to incorporate hybrid capital into its capital structure.⁵⁰ Hybrid capital will be provided by a "coalition-of-the-willing" without altering the voting rights of existing shareholders. This feature also permits the sale of hybrid capital from one investor to another, a feature that can, in principle, satisfy the requirements needed to treat such investments as a reserve

⁴⁹ White House (August 2023), Letter regarding critical funding needs for FY 2024, <https://www.whitehouse.gov/wp-content/uploads/2023/08/Final-Supplemental-Funding-Request-Letter-and-Technical-Materials.pdf>; Prime Minister Sunak has announced a "conditional capital increase for the IBRD," <https://hansard.parliament.uk/commons/2023-09-11/debates/7D172DF9-C3C2-475A-A087-E6A69418D66E/G20Summit>

⁵⁰ The Trade and Development Bank of Africa also has such funding while the IADB is also exploring options.



asset for Central Banks. One implication is that central bank holders of SDRs may be able to use these to fund purchases of hybrid capital shares, an interpretation we strongly favor.

In some designs, hybrid capital can include a put option for shareholders to convert their holdings in the event of a general capital increase.⁵¹ The degree of leverage depends on still unresolved issues as to exactly how credit rating agencies will score hybrid capital, but in the case of IBRD, each dollar of hybrid capital is expected to unlock \$6-10 of additional lending over ten years. Credit rating agencies (CRAs) do not yet have an established methodology to treat hybrid capital and their judgments may depend on who the new investor is. Hybrid capital with a put option for a conversion into general capital at a future date may receive the same treatment from CRAs as general capital as it would not dilute the ratings uplift associated with strong shareholder support. We have conservatively assumed that hybrid capital should not exceed 30% of total MDB equity (paid-in capital plus reserves), so an extra \$29 billion per year in the sustainable annual lending limit could be available under this instrument for the MDB system, but the exact limits need to be tested in practice.

A Global Challenges Funding Mechanism. The initial focus of hybrid capital and portfolio guarantee programs is to provide a wider menu of options to sovereign shareholders willing to support MDBs beyond current levels. At the same time, there are many other stakeholders that may have an interest in associating themselves with MDBs. The idea of a Global Challenges Funding Mechanism (GCFM) is to provide a wholesale approach to target institutional investors and indeed all eligible investors that are seeking a vehicle to earn a financial return while also supporting SDGs, GPGs and other impact areas. Like other forms of private capital mobilization, the GCFM would nest the projects it supports within broader MDB programs, particularly those based on country platforms where large-scale support is needed, and where the incremental resources could serve as an “accelerator” program for GPG delivery.

One option is to design GCFM as an on-lending platform to enable private funders and foundations to finance activities in parallel to MDBs. Such loans or contributions would benefit from the “halo” effect described above but would not have the same preferred creditor treatment as MDB own-account lending. Co-financing and parallel financing of this type has been a standard feature of MDB private sector arms (e.g., IFC) but almost non-existent for public sector arms (e.g., IBRD) investing in a program of transformative change in a particular country. For example, GCFM can be the link between private creditors and the country platforms where MDBs are heavily involved, with the assurance that cascade principles, additionality and impact are all being addressed. In countries such as India, such a platform could provide a cost-effective way of complying with regulations on corporate social responsibility requiring companies to set aside a portion of their profits for CSR activities in the country (Box 8).⁵² By linking to specific country platforms, the GCFM provides greater flexibility to investors to indicate the theme and geography they wish to support as compared to regular MDB bonds.

⁵¹ Conversely, there may also be a call option should the MDB find itself with a surplus of capital.

⁵² Of course, if Indian companies were to restrict their CSR to additional investments in India, they would be providing local currency support rather than foreign exchange support.

Box 8: Using corporate social responsibility (CSR) funds to provide for global public goods and address global challenges: The case of India

In 2014, India became the first major country to mandate corporate social responsibility (CSR) spending for its enterprises. All large companies in India are required to spend at least 2 per cent of their profit on social sectors.⁵³ In fiscal year 2021-22, Indian companies spent INR billion 259 (equivalent to \$3.5 billion) through CSR, 54 per cent of it being spent on health and education sectors.

The Business 20 (B20) Taskforce Report under India's G20 Presidency has proposed that 0.2 per cent of corporate profits of large enterprises in G20 countries be earmarked for a global fund. In the case of India, this would mean 10% of the CSR fund is reassigned for provisioning of GPGs. Assuming India's CSR spending grows at an annual average rate of 8 per cent in dollar terms, this would mean Indian companies could contribute a cumulative amount of \$4 billion to the global fund between 2023 and 2030. If this amount is invested through a GCFM type structure on the hybrid capital issued by IBRD, and leveraged through IBRD balance-sheet, then India alone could be responsible for additional loans worth \$3 billion each year to developing countries by 2030.

Following the B20 recommendation, G20 could consider requesting its member countries to mandate a small part of their CSR funding to fight global challenges. For example, China, Denmark, France, and South Africa require their companies to report CSR spending but have no mandated spending requirement. Other countries like the United States and United Kingdom have no CSR activities requirement for their companies. Interestingly, several developing countries including Mauritius and Nepal have legally established mandatory CSR spending of 2% and 1% of profits respectively.

A second, and more ambitious, mechanism would be for institutional investors to purchase hybrid capital bonds as described above. Because hybrid capital bonds have no voting rights, they can be readily extended to private investors and foundations. The benefit for the investor would be that leverage, and impact would be magnified considerably compared to investing in an MDB bond, while the coupon received would be the same.⁵⁴ Investors have already demonstrated an appetite for sustainable bonds issued by MDBs, benefiting from the strict project standards and low risk of these offerings. Hybrid bonds can also be themed to reflect investor preferences for participating in selected global challenges, although a balance between flexibility and fragmentation must be struck.

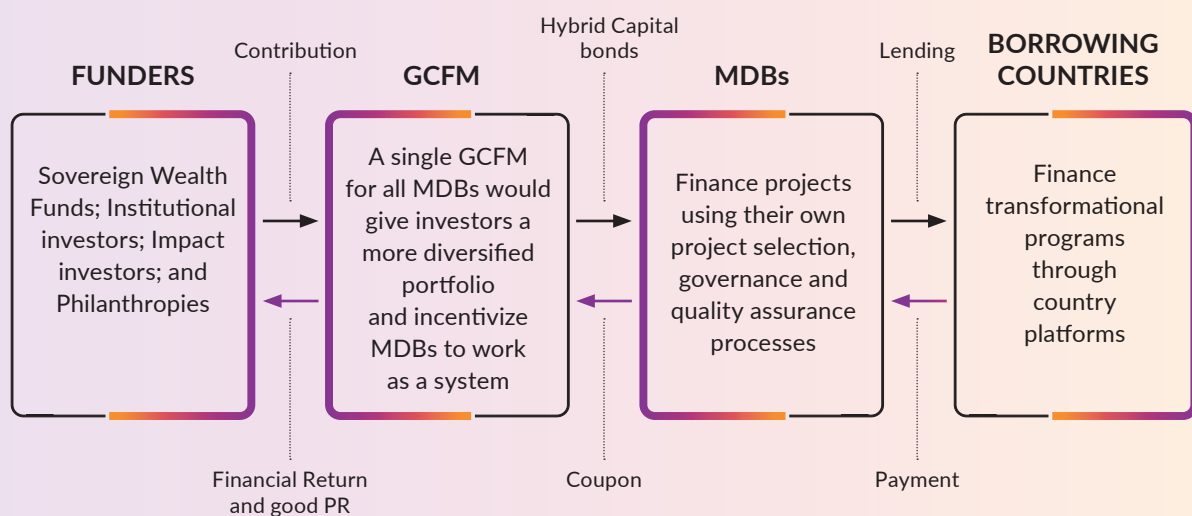
⁵³ Companies with net worth exceeding \$62 million or turnover exceeding \$124 million or net profit exceeding \$0.6 million are required to follow the CSR mandate.

⁵⁴ The hybrid capital bond, however, would not have a fixed maturity, unlike an MDB bond, and could have features such as an option to cancel the coupon in situations of major loss.

These two mechanisms are mutually supportive, though the latter could result in greater leverage than the former. In both instances, the GCFM would support projects nested in the activities of the MDB, using the project selection, governance, and quality assurances of the institution. The on-lending platform route would lead to a direct transfer from private investors to borrowers, while the hybrid capital route could result in at least a 1:6 leverage ratio, enabling MDBs to lend \$6 over a decade for every \$1 of hybrid capital raised.

Implementation details of eligibility criteria for investors and for programs to be supported need to be worked out and should be the subject of deliberations between MDB Treasuries and target investors. There are strong arguments for setting-up a single GCFM that buys hybrid capital in a number of MDBs. This would give investors a more diversified portfolio and provide an instrument to incentivize MDBs to work as a system. On the other hand, it may be administratively easier to establish individual GCFMs in each MDB on demand and start with one MDB as a proof of concept. A decentralized approach like this would also make it easier to nest the GCFM within each institution's ongoing program (Figure 5).

Figure 5: Key building blocks of the GCFM



Source: IEG Core Team

A capital increase is the strongest expression of shareholder support. In Volume 1 we argued that considerations for a GCI across multiple institutions are an inescapable result of the deductive process we have laid out, starting with investment needs. Without a GCI, EMDEs will not have access to a sufficient volume of affordable finance, although this assessment depends on how CRAs choose to assess hybrid capital and any limitations on



its expansion. Without access to MDB financing and guarantees, EMDEs will not meet the more ambitious reductions in GHGs that are in the NDC scenarios, nor will they be to restore strong growth. Without ambitious GHG reductions, the risk of tipping points for climate action become larger, global resources must take care of immediate humanitarian needs, and long-term investments get further squeezed.

We recognize that GCI's are multi-year, complex undertakings and that the likely sequencing of disbursements will follow the other options laid out above. Nevertheless, initiating the process is a needed step that would help augment the shareholder-support uplift to MDB credit ratings and provide the legitimacy to MDBs from effective long-term governance reforms.

In Volume 1, we made the case that MDB concessional finance should also be tripled. MDBs disburse a small share of total concessional funds. Additional amounts are channeled through MDBs in so-called multi-bi non-core trust funds, earmarked for a specific country, sector, theme or region. However, these trust funds are fragmented. A more effective scenario would be to raise donor contributions going directly to core MDB activities, such as IDA or the ADF.

The considerable needs of low-income and lower middle-income countries that continue to depend on IDA require an immediate donor response, first in pledges for the IDA Crisis Window, then in a generous IDA 21 replenishment, and followed by further increases. As we showed in Volume 1, IDA donors pledged \$25.1 billion for IDA 15 in 2009. In 2021, they pledged \$23.5 billion for IDA 20, a 25% reduction in real terms. IDA has been able to offset this in part through accessing capital markets, but such financial engineering cannot alter the concessional value of IDA activities. There is no scenario where IDA reaches the level of ambition needed to serve its eligible countries properly without at least a tripling of donor contributions. By 2030, IDA replenishments over a three-year period should reach \$279 billion, requiring around 0.04% of IDA donor gross national income in annual contributions. The G20 may want to consider how to encourage members to make commitments of this modest size to help meet the pressing challenges in the world's poorest economies.⁵⁵

Channeling aid money through multilateral core activities rather than small-sized, fragmented bilateral aid programs is one of the easiest ways of improving aid effectiveness and value for money with no additional financial cost to donors.

Middle-income countries, too, need access to concessional finance to accelerate investments in GPGs and manage the after-effects of large natural disasters. Coal decommissioning, pandemic surveillance, vaccinations, and biodiversity conservation are typical examples where cross-border subsidies are optimal because an individual country may bear the full cost of investments, while a considerable portion of the benefits is

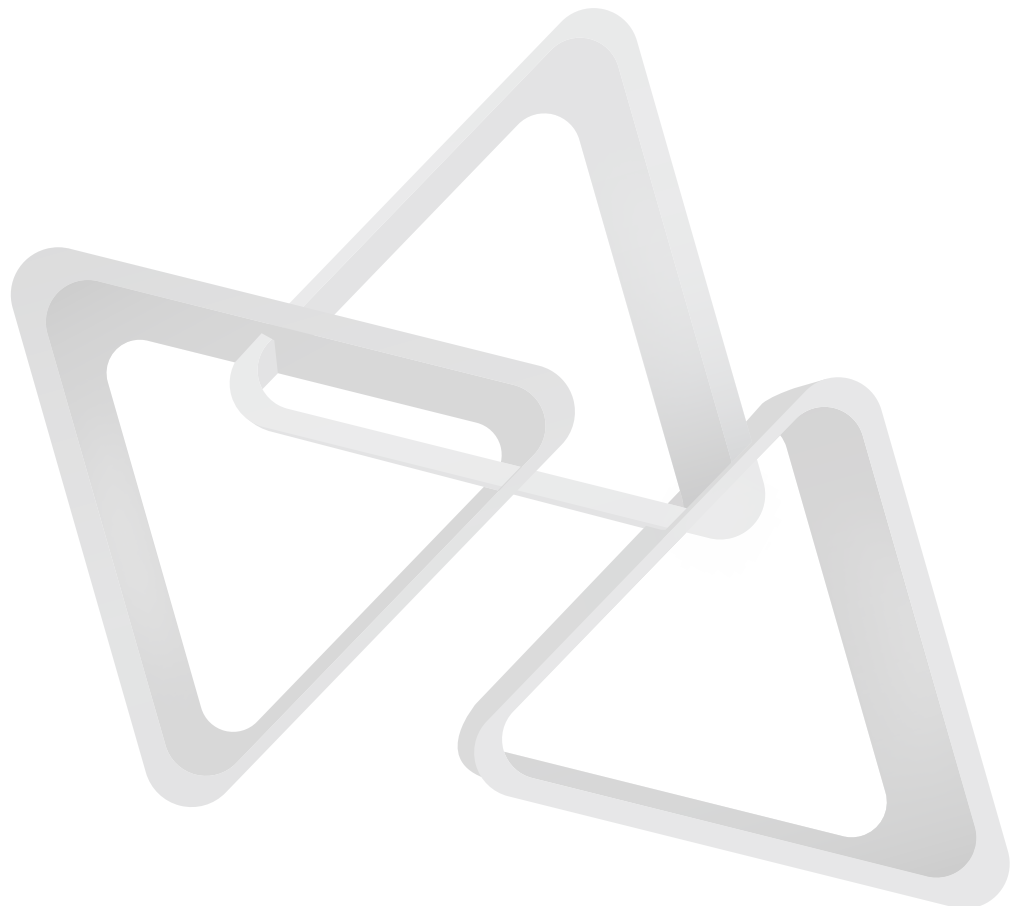
⁵⁵ Vera Songwe and Rakan Aboneaaj (2023), *An ambitious IDA for a decade of crisis*, CGD Note, July. <https://www.cgdev.org/sites/default/files/ambitious-ida-decade-crisis.pdf>



captured by others. Such subsidies may be channeled through multilateral entities outside the MDBs, such as the Green Climate Fund or the Global Environmental Facility, but their impact can be enhanced if they are deployed alongside MDB resources in transformative country platforms.

MDBs should, nevertheless, advocate for concessional funds to be administered through their own global public goods facilities. As a demonstration of this idea, IBRD has piloted a GPG Fund in 2019 to cover climate mitigation and adaptation, conflict spillovers, and the COVID-19 response. Other MDBs could emulate this idea. Looking forward, the thematic eligibility criteria for accessing such Funds should mirror the GPGs and global challenges adopted in each MDB's mandate. However, as with other trust funds, donors should be provided with a flexible menu of options they would like to support under the GPG Fund, while bearing in mind the considerable inefficiencies of the current structure of multiple, overlapping trust funds.

Concessional funds rely on donor contributions. It is important that any funds for which MICs are eligible be understood as additional to any contributions that are made to assist low-income countries. One option is therefore to encourage investors who participate in hybrid capital of the non-concessional arms of MDBs to simultaneously contribute to the GPG fund. Such contributions can be made in cash or by allocating the coupon payment on the hybrid bond to the GPG fund. In this latter case, it is MICs themselves that bear the funding cost, through the interest they pay on non-concessional loans, so it is natural that they should also be recipients of the Fund proceeds.



V. The triple agenda: a call for a better, bolder, bigger MDB system

If one starts from the proposition that a globalized 21st-century world needs capable global institutions that can provide long-term finance to meet critical physical and social infrastructure needs regionally and globally, and that can serve as critical knowledge hubs in an increasingly interconnected world, then it would be folly to let the current still considerable institutional and financial strengths of the MDBs wither away.⁵⁶

The foundations for economic growth and prosperity in EMDEs—human and physical capital accumulation, good governance, integration with the global economy—remain unchanged and MDBs have considerable experience in helping clients build this foundation. In the world of today, policymakers must also adapt and build resilience to negative headwinds from climate change, pandemic threats, conflict, protectionism, and food and energy insecurity. For MDBs to remain relevant to clients in framing strategies for national economic prosperity, they must broaden their offerings to these new areas. Because science is sounding alarm bells that tipping points are fast approaching, there is an urgency to scale up investments in EMDEs and MDB support starting now.

The need for collective action has never been greater. Yet UN Secretary-General Guterres warns that “the international community is not ready or willing to tackle the big, dramatic challenges of our age.”⁵⁷ His observation that geopolitical competition is constraining multilateral institutions and that the performance of these institutions reflects the preferences of their major shareholders must be kept in mind. In a multipolar world with broad perspectives, the diversity of the multilateral development bank system provides global legitimacy, equity and accountability. Working together as a system does not imply that all MDBs behave the same. It does mean they all share responsibility to act in concert towards common goals. By 2030, the MDB system must look quite different compared to today.

Dare to imagine—A snapshot of transformed MDBs in 2030

At its most basic level, our vision is that by 2030 the world economy would look very different. It would be a world of opportunity, hope and growth. A world where higher levels of sustainable investment in EMDEs results in faster growth, more human capital, resilient and sustainable economies, stronger institutions and improved creditworthiness.⁵⁸

By 2030, MDBs should become the lead implementing institutions to help client countries achieve their national and GPG goals. How will we know if MDBs become fit-for-purpose

⁵⁶ J. Linn (2013), *Realizing the potential of the multilateral development banks*, <https://www.brookings.edu/articles/realizing-the-potential-of-the-multilateral-development-banks/>

⁵⁷ United Nations (2022), <https://www.youtube.com/watch?v=wALUxkykL5k>

⁵⁸ *Simulations in Songwe*, Stern, Bhattacharya, 2022, suggest that the positive effect on creditworthiness of higher per capita income growth associated with higher investment outweighs the negative effect from higher levels of outstanding debt.



institutions by 2030 (or earlier)? What would they look like in such a world? They would be development partners of choice for the large range of clients they serve: LICs, LMICs and UMICs; fragile and conflict-affected states; small islands, least developed, and most vulnerable states. They would co-create, and then help implement, at scale and with speed and urgency, programs of transformative change in selected priority sectors articulated by client governments.⁵⁹ They would have a clear line of sight from their activities to the high-level outcomes being pursued. They would demonstrate additionality and catalytic activity. Advisory services and analytics would be judged on the basis of knowledge creation, not reports.

By 2030, scaling should be hardwired into MDB systems. Progress will have been made on integrating scaling into mission objectives, project design procedures, review and approval processes, and monitoring, evaluation and learning systems. Formal institutional incentives, access to coaching, and incubators and accelerators would support scaling. Top leadership and management champions would put their weight behind it.⁶⁰

By 2030, MDBs should have created strong partnerships with the private sector and with public development banks with clear principles for engagement and a sharing of data for better decision-making through GEMs. They will be co-creating investments with other stakeholders, in country platforms and in the Global Infrastructure Facility. They will have created new originate-to-share conveyor belts to improve capital turnover and use other improvements to tap into large pools of reinsurers and institutional investors through MIGA. They will have standardized guarantee instruments for sovereign and non-sovereign borrowers, and staff incentives to use them. They will innovate with debt contracts and loan agreements to better provide liquidity to clients who are hit by catastrophic global shocks.

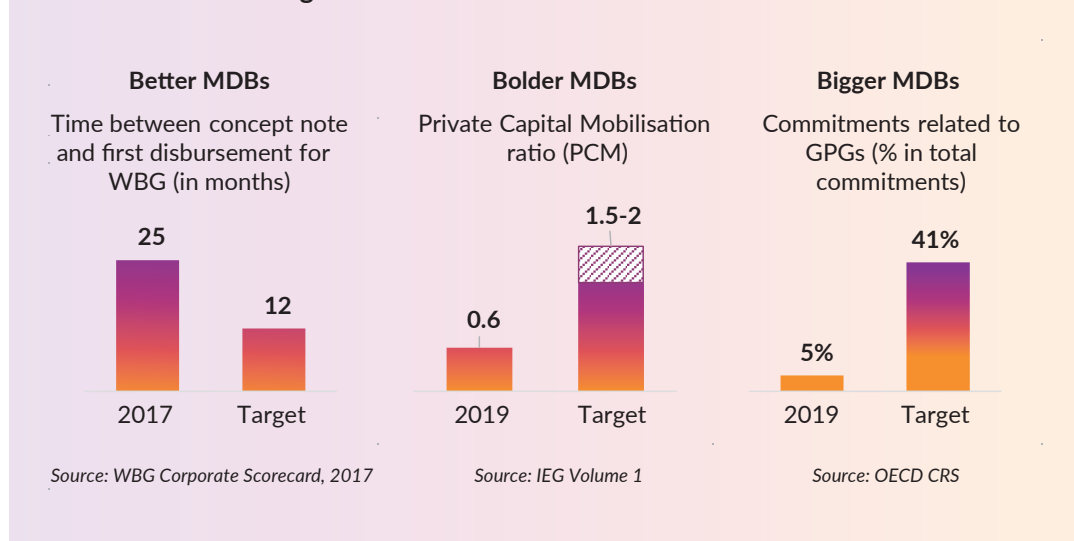
We would expect that by 2030, MDBs would (Figure 6):

- Be channeling considerable support through country platforms, developed to a high standard in a majority of clients;
- Process operations in half the time;
- Have joined-up business models for technical assistance, analysis and data;
- Work together as a system on bankable project pipeline development (through GIF);
- Work together as a system on regional and global approaches to GPGs;
- Triple lending volumes;
- Quintuple private mobilization and catalyzation;
- Significantly expand use of guarantees;
- Provide simplified financing mechanisms to allow impact and institutional investors to participate alongside official investors; and
- Provide automatic liquidity through debt and loan contracts when large disasters strike clients.

⁵⁹ Lee et al. (2023), *What Would the Ideal Development and Climate MDB Look Like?*, <https://www.cgdev.org/sites/default/files/what-would-ideal-development-and-climate-mdb-look.pdf>

⁶⁰ Linn, Johannes F. (2021), *Hardwiring the scaling-up habit in donor organizations*, The Brookings Institution. <https://www.brookings.edu/articles/hardwiring-the-scaling-up-habit-in-donor-organizations/>

Figure 6: What an ideal MDB should look like



A roadmap and a call for collective action

MDB reform is a change management process, not a one-time restructuring. We have argued for change along three dimensions: converting the operating model of MDBs to support transformational investments; bringing engagement with the private sector to the center of operations; and providing sharply scaled-up financing at affordable cost. This volume has detailed specific recommendations in each dimension, summarised in Table 2.

The recommendations are intertwined and require actions from multiple stakeholders over the short, medium and long-term, with varied intensity. MDBs cannot be solely responsible for effective implementation without support from stakeholders. Client countries need to strengthen absorptive capacity and provide business-friendly operating environments. MDB shareholders must adjust their risk tolerance and provide additional financial support. In our estimation, reforming the MDB agenda and scaling them appropriately are urgent issues requiring action now. Delay is dangerous. Weak or slow reaction is neither more practical and realistic, nor less risky. To the contrary, costs and the pressures to provide more money for necessary interventions will rise over time. Strong action now is, in this very real sense, less costly and risky.

We submit the following roadmap to Ministers for consideration (Table 2). The reforms needed are complex and will require time to implement. We therefore recommend that the G20 create an Independent Advisory Group to report regularly to Finance Ministers on the progress being made on the roadmap we have outlined.

Table 2: Recommendations for MDB transformation

S. No.	Recommendations	Short		Medium			Long		
		2023	2024	2025	2026	2027	2028	2029	2030
I. MDBs should convert operating models to co-create multi-year programs for transformative change									
1.	Focus client support on the highest priority SDG and GPG sectors								
2.	Redesign delivery of policy and institutional support, and the knowledge and learning agenda								
3.	Co-create investment opportunities with the private sector, NDBs, DFIs								
4.	Establish complementary GRPPs to add 20% to country financing envelopes								
5.	Triple pipeline of bankable projects and work to ensure its conversion to strong deal flow								
6.	Channel at least 50% of incremental lending activity through country and regional platforms								
II. MDBs should streamline and simplify business processes									
7.	Halve the processing time from concept note to first disbursement								
8.	Harmonize and mutually recognize safeguards and fiduciary requirements								
9.	Channel operations through country systems in at least 50% of country clients								
10.	Strengthen local capacity by allocating at least 25% of their technical assistance & work budget for this								
III. MDBs should work together better as a system									
11.	Agree to be held accountable, individually and collectively, on a range of KPIs to match the expanded mandate								
12.	Share diagnostic tools, mutually recognize standards & set up shared co-financing, project preparation & review platforms								
13.	Pool risks, create common asset classes and learn from each other in the dialogue with credit rating agencies								
IV. MDBs should bring a whole-of-institution approach to mobilize and catalyze private finance by shifting culture from risk avoidance to informed risk taking									
14.	Increase PCM from \$60 billion to \$240 billion, and make efforts to catalyze additional private finance								
15.	Make greater use of guarantees accounting for 25% of MDB portfolio								
16.	MIGA should triple its annual guarantee and distribution activities								
17.	Provide comprehensive support for forex risk management								

S. No.	Recommendations	Short		Medium			Long		
		2023	2024	2025	2026	2027	2028	2029	2030
18.	Include natural disaster and pandemic clauses in their own loan contracts and in projects with private co-financing								
19.	Make GEMs transparent & interactive								
20.	Reinforce the “cascade principle”								
21.	WBG and IMF should issue new guidelines for DSA to reduce the impact of shocks on country platform activities								
V. MDBs should be sized to achieve the transformational change required in client countries to meet national and global priorities.									
22.	Triple non-concessional lending to \$300 bn per year								
23.	Triple concessional funding to \$90 bn per year								
24.	Expand concessional finance facilities for GPGs, including at least \$15 bn for non-IDA-eligible MICs								
25.	Pursue all efforts at BSO and generate an incremental lending headroom of at least \$40 bn per year								
26.	Pilot mainstream portfolio guarantee & hybrid capital structures to boost lending capacity by additional \$40 bn per year								
27.	Establish a GCFM to lend at least \$20 bn per year based on institutional and other private investor funding								
28.	MDB Boards should undertake capital resources review process using standardised metrics consistent with tripling lending								
29.	Reach an understanding with CRAs on methodology for hybrid capital treatment and guarantee exposures								
In addition..									
30.	G20 Finance Ministers should establish a mechanism to advise and independently assess the first-year implementation of the proposed roadmap.								

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Annex 1: Policy Recommendations

I. MDBs should convert operating models to co-create multi-year programs for transformative change

1. MDBs must focus their client support on the highest priority SDG and GPG sectors or themes, as evidenced by government commitment to country platforms convened at the highest national level, or by government-led coordination of multiple investors to achieve transformational change. At least 75% of respondents to an independent client survey should be satisfied that MDBs are addressing the most relevant issues in their country.⁶¹
2. MDBs should redesign delivery of policy and institutional support, and the knowledge and learning agenda, with a clear eye on the impact of such activities on investment. They should build long-term relationships with clients and favor peer-to-peer knowledge exchanges over fly-in, fly-out standalone reports. At least 75% of respondents to an independent client survey should be satisfied with MDBs' technical assistance and policy advice.
3. MDBs should co-create investment opportunities with the private sector, national development banks, and bilateral development financial institutions (DFIs). The external financing gaps for each EMDE should be estimated, within an envelope averaging 3% of GDP in 2030, but higher for LICs and progressively lower with income level for MICs.
4. MDBs should establish complementary Global and Regional Priority Programs (GRPPs) that can add an additional 20% to financing envelopes normally available to each client, starting with energy transition plans for high-emitting countries and for Africa, within the joint MDB Long Term Strategies window.⁶²
5. MDBs should triple the pipeline of bankable projects and work to ensure its conversion to strong deal flow through stepped up support, along with bilateral donors, to the Global Infrastructure Facility (GIF) and through allocations of their own budgets on a reimbursable basis from the project implementer.
6. MDBs should channel at least 50% of incremental lending activity through country and regional platforms.

II. MDBs should streamline and simplify business processes

7. Each MDB should aim to at least halve the processing time from concept note to first disbursement.⁶³

⁶¹ We recommend an independent client survey be undertaken every two years to measure client satisfaction with MDB activities.

⁶² GRPPs are about providing Global Public Goods (GPGs) and addressing global challenges.

⁶³ For example, in case of the World Bank, the average processing time was around 25 months for the latest year available. For transparency reasons, all MDBs should report this number in their Annual Reports.

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8. MDBs should also harmonize and aim to mutually recognize their safeguards, procurement, audit, reporting requirements, monitoring and evaluation.
 9. MDBs should strengthen and accelerate the use of “country systems” aiming to channel operations through them in at least 50% of country clients by 2030.
 10. MDBs should aim to systematically strengthen local capacity in program and project design and implementation including by allocating at least 25% of their technical assistance and analytical work budget for this purpose.

III. MDBs should work together better as a system

11. MDBs should agree to be held accountable, individually and collectively, on a range of key performance indicators (KPIs) to match the expanded mandate, including as measured through an independent survey of client assessments of MDB performance, to expand and deepen institutional collaboration.
12. MDBs should share diagnostic tools, mutually recognize each other's standards and set up shared co-financing and project preparation and review platforms.
13. MDBs should pool risks, create common asset classes and learn from each other in the dialogue with credit rating agencies (CRAs).

IV. MDBs should bring a whole-of-institution approach to mobilize and catalyze private finance by shifting culture from risk avoidance to informed risk taking.

14. MDBs should work systematically with the private sector to increase private financing by an additional \$500 billion by 2030 including by increasing total private capital mobilization from \$60 billion to \$240 billion, and making concerted efforts to catalyze a significant volume of additional private finance.⁶⁴ This target will be higher or lower for different institutions depending on their context, with higher mobilization rates for private lending arms of MDBs and catalytic agencies like the Climate Investment Funds, and lower rates for agencies that focus more on LICs.
15. MDBs should make greater use of guarantees by: (i) creating appropriate incentive structures, setting performance targets and introducing accountability mechanisms for staff and management; (ii) standardizing guarantee contracts to facilitate faster and less costly transactions; (iii) counting sovereign debt guarantees against country borrowing limits more favourably than on a dollar-for-dollar basis; and (iv) bringing IBRD/IDA and MIGA guarantees under one management. By 2030, guarantees should account for 25% of MDBs portfolio.

⁶⁴ Metrics will have to be established, such as “private capital enabled” under pilot at the World Bank.

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16. MIGA should triple its annual guarantee and distribution activities by 2030 by building partnerships with other MDBs at scale, expanding eligibility for its credit enhancement products, distributing MDB assets to institutional capital markets, and establishing a liquidity facility to boost political risk insurance coverage.
 17. MDBs should provide comprehensive support for forex risk management for themselves as well as for the private sector by: (i) building out off-shore hedging mechanisms to a scale commensurate with the need (such as TCX); (ii) establishing a shared onshore MDB treasury platform; and (iii) offering more local currency options to clients.
 18. MDBs should improve resilience of client countries by including natural disaster and pandemic clauses in their own loan contracts and in projects with co-financing by the private sector.
 19. MDBs should make GEMs transparent, interactive (anonymized) database with annual data and make them publicly available by 2024.
 20. MDBs should reinforce the “cascade principle” by refraining from financing what could and should be done by the private sector and private finance, thus avoiding the creation of additional public debt.
 21. The World Bank and IMF should issue new guidelines for Debt Sustainability Assessments (DSA) to reduce the impact of cyclical and global shocks on transformative programs supported by country platforms and to properly differentiate between local and foreign currency debt.

V. MDBs should be sized to achieve the transformational change required in client countries to meet national and global priorities.

22. MDBs should triple their non-concessional lending to \$300 billion per year by 2030.
23. MDBs should triple their concessional funding to \$90 billion per year by 2030, with ramped up donor support for IDA.
24. MDBs should expand concessional finance facilities for middle-income countries to accelerate investments in GPGs and manage large natural disasters, including concessional grants for non-IDA-eligible MICs of at least \$15 billion for GPGs.
25. MDBs should aggressively pursue all efforts at balance sheet optimization. By enhancing the efficiency of use of existing capital, MDBs should generate an incremental lending headroom of at least \$40 billion per year by 2030.
26. MDBs should pilot then mainstream portfolio guarantee and hybrid capital structures to boost lending capacity by an additional \$40 billion per year by 2030.

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27. One or more MDB should establish a Global Challenges Funding Mechanism (GCFM) to target institutional investors and other private investors that are seeking a vehicle to earn a financial return while also supporting SDGs, GPGs and other impact areas, and leverage financing through such a mechanism by at least \$20 billion per year by 2030.⁶⁵
 28. MDB Boards should review capital increase requirements for each institution through a capital resources review process using standardized metrics. The precise amounts will vary, depending on the existing situation and evolving needs, but should be assessed by shareholders with a view to ensuring that lending volumes can reach and be sustained at the proposed level of triple the 2019 base, without jeopardizing credit ratings. Shareholders should initiate reviews for each MDB by end-2024.
 29. MDBs should reach an understanding with credit rating agencies (CRAs) by 2024 on the methodology to be applied to hybrid capital treatment and guarantee exposures.

In addition,

30. G20 Finance Ministers should establish a mechanism to advise and independently assess the first-year implementation of the proposed roadmap.



⁶⁵ One promising option is to explore the channelling of corporate social responsibility (CSR) funding to GCFM.

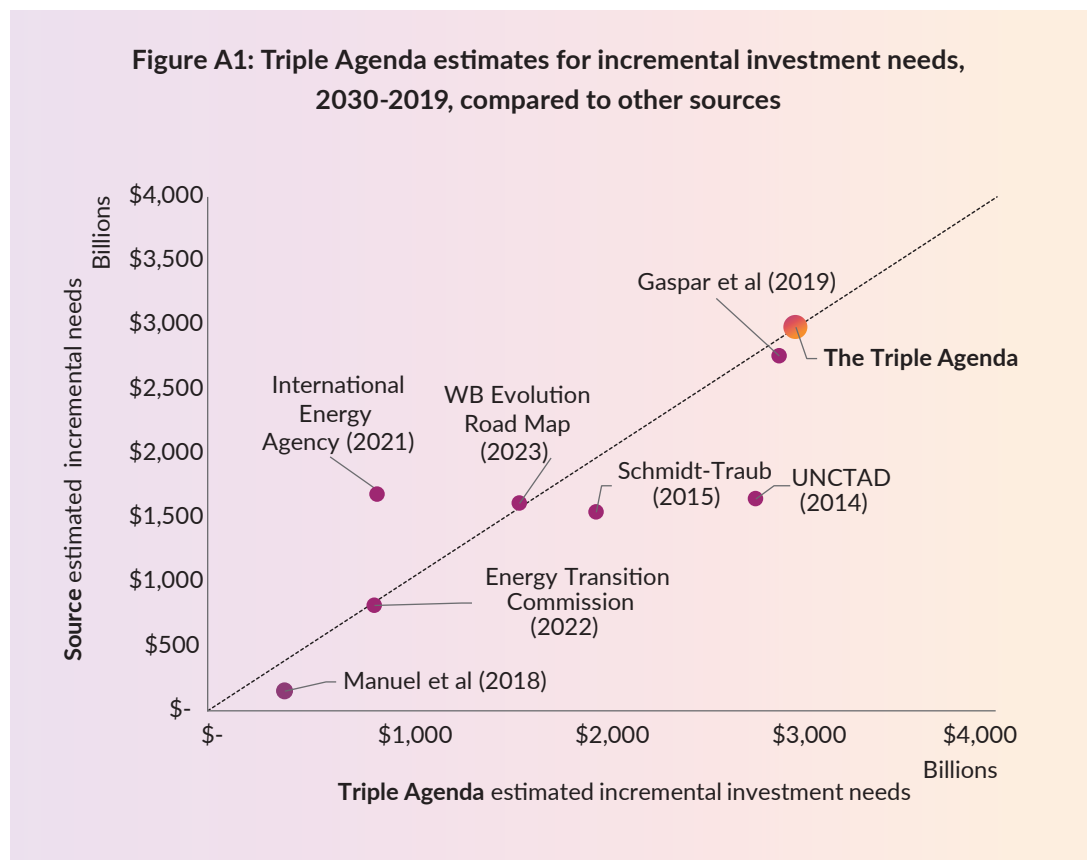
Annex 2: Comparing alternative estimates of investment needs and financing gaps

A large number of publicly available studies estimate investment needs for developing countries to meet one or more of the SDGs. These studies, however, are difficult to compare with each other because they have different country coverage, different sectoral coverage, use different units of value and cover different time periods.

The data base used in this study provides country-by-country estimates for human capital, sustainable infrastructure, adaptation and resilience, agriculture, forestry and land use, and nature. Using this disaggregation, we can construct a country/sector sample that closely resembles that used in other studies, facilitating the comparison.

Figure A1 plots the estimates from publicly available sources for investment needs (vertical axis) against equivalent estimates in the country/sector database underpinning the analysis in this report (horizontal axis). All numbers are converted into 2019 US dollars. Figures refer to incremental spending needs in 2030 over 2019 base levels. To illustrate, at the bottom left of the graph, we show the estimate provided by Manuel for education, health and social protection for 48 under resourced countries (vertical axis). On the horizontal axis, the point is placed on the value derived from our database of the investment needs for the same 48 countries for health and education.

The Triple Agenda point, (top right) covers all LICs, LMICs, UMICs and other EMDEs (IMF definition) for human capital, sustainable infrastructure, adaptation and resilience, and nature, land use and sustainable agriculture. It is larger than other estimates because it has the most complete country coverage and the most complete sectoral coverage.



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- **Manuel et al (2018)** estimates education, health, and social protection for 48 under resourced countries.
 - **Energy Transition Commission (2022)** estimates energy transition investment needs for low and middle income countries, excluding China
 - **International Energy Agency (2021)** estimates energy investment needs for Emerging Markets and Developing Economies (EMDEs) excluding China.
 - **WB Evolution Road Map (2023)** estimates climate and resilience, pandemics, and conflict for IDA and IBRD countries.
 - **Schmidt-Traub (2015)** estimates education, health, power, roads, water and sanitation, agriculture and food security, telecommunications, and ecosystems, for low and middle income countries.
 - **UNCTAD (2014)** estimates education, health, power, roads, water and sanitation, agriculture and food security, telecommunications, and ecosystems, for developing economies. We exclude China from their estimate to compare with the Triple Agenda.
 - **Gaspar et al (IMF, 2019)** estimates education, health, power, roads, water and sanitation for developing countries.



Annex 3: Better MDBs— Helping clients accelerate provision of SDGs and GPGs

Speed up and simplify business processes

Processes, safeguarding, and procurement rules are in place to ensure world-class standards, high-enough quality of projects at entry, protections for vulnerable groups and the environment, and transparency and accountability throughout the project cycle. In principle, these processes enable MDBs to be effective, efficient and sustainable.

For many countries, borrowing from MDBs can be a complex and resource-intensive exercise. Approving projects involves multiple steps, each requiring lengthy preparation and internal reviews. These procedures can become so complex that large projects, particularly for infrastructure development, might take several years to go through the entire approval process. Procedures are often not proportionate to the size of the operation.⁶⁶ Client countries value short processing times but MDBs are not perceived to be performing well in this area,⁶⁷ even in their own client surveys.⁶⁸ MDBs rarely publish this information, though, and when they do, they make different assumptions from each other so figures cannot be directly compared.⁶⁹

Borrowers have to cover the direct and indirect costs of safeguards, often representing a considerable share of the total loan.⁷⁰ Borrowing countries must often also learn how to navigate different rules across MDBs, changing over time. This toll on time and financial resources raises the effective cost of borrowing from MDBs.

Implementing measures for MDBs to be more responsive and agile will put each MDB onto a path to deliver on a much bigger scale for transformative change. While there is no appetite to reopen a time- and energy-consuming safeguard review process and we acknowledge a number of initiatives already taking place in various MDBs,⁷¹ MDBs, individually and as a group, could do more to streamline their procedures and processes.

MDBs must reduce processing time by half across the first stages of the project cycle. MDBs should release their baseline processing time from concept note to first disbursement publicly, commit to reducing this time by 50% and report updated and comparable figures each year. There are a number of measures that help MDBs achieve this goal without jeopardizing the rationale of why these processes were set up in the first place.

⁶⁶ See Gehan and Kenny (2023).

⁶⁷ The ODI survey found that almost 90% of government respondents rank 'short processing times (from concept to first disbursement)' as very or extremely important. However, fewer than half of respondents think that MDBs are performing well in this area (Prizzon et al., 2022).

⁶⁸ Gehan and Kenny (2023).

⁶⁹ Humphrey (2022) reports the average loan processing times to first disbursement from 17.8 months at the IADB up to 30.3 at the AsDB. Latest figures for the World Bank Group dates back to 2017.

⁷⁰ A study by the Independent Evaluation Group of the World Bank found that for borrowing countries, the average cost of safeguards in terms of staff time and consultations is around \$13 million, increasing to an average of \$19 million for risky Category A projects (IEG, 2010).

⁷¹ For public sector financing, there is a well-established framework for reliance and learning on procurement aspects among MDBs and the outsourcing of procurement and environmental aspects from certain MDBs to IBRD.



MDBs should consistently and more widely apply a risk-based approach to project and program approvals, with certain decisions delegated to management (low-risk and below a certain amount) and greater use of country systems where these are adequate and strong enough. Resources for safeguarding reviews should systematically concentrate on high-risk projects rather than across the board and be invested in building capacity in client countries, with the ultimate objective of relying on their own systems. The aim should be to maximize the impact of safeguarding resources and to concentrate attention on where they are most effective and generate the highest value for money. Furthermore, the steps and depth of the review process should be restructured to be proportional to the size of the operation and differentiated by type of risk, again more systematically (i.e. high-risk identified on one dimension should not trigger a full high-risk review across all aspects). MDBs could also implement single safeguard reviews covering multiple projects in the same country or sector and apply checks as the projects develop, rather than do an entire ex ante assessment each time. Processes and procedures can be accelerated by a further push on innovation and digitalisation, both in MDBs and in client countries, even involving AI for parts of project preparation to reduce transaction costs. A number of initiatives are already in place – particularly on procurement – and MDB staff should prioritise sharing best practices and learning across institutions more systematically in certain areas (e.g., safeguard/ESF).

Across institutions, MDBs should harmonize rules and procedures. As mentioned in Volume 1 and in Annex 3 of this report, the implementation of programs under each country platform should take place within a single set of rules, across MDBs as a priority. Harmonization and mutual recognition should apply to safeguarding, procurement, audit, reporting requirements, monitoring and evaluation. On joint projects and particularly in the context of country platforms, MDBs should mutually recognise their standards and report on co-financed projects. There are already examples across MDBs, particularly on procurement. However, harmonization and mutual recognition of standards require the alignment of shareholders across institutions to level differences in underlying policies and risk tolerance.

Greater speed of operations and simplified processes would be facilitated by greater delegation of authority to management and country offices. For example, the Boards of Directors (BoD) in most MDBs are considered too focused on day-to-day management rather than setting strategic directions and providing oversight.⁷² Within each MDB, country offices and country directors/managers will play a crucial role in the design and operations of country platforms. Several MDBs have clear policies for the delegation of authority from BoD to management, usually setting thresholds and criteria (which vary according to institution) for the type of projects that management can approve directly but this approach could be more transparent and systematic. Across MDBs, with the option of getting back to the Board for advice, management could be responsible for approval of low-risk projects that are consistent with Board-approved strategy, but without specific Board consultation below a certain threshold value of the project. This review could go in tandem

⁷² For example, resident Boards generate indirect and opportunity costs as they meet frequently. Meetings of resident Boards are frequent, from two to three times per month (EBRD) to more than twice a week (AfDB, World Bank) (see Table 3: IDEV, 2018). In addition, considerable time is spent in Board committee meetings. The report of the Zedillo Commission, published in 2009, noted that time spent in Board meetings at the World Bank was in the range of 500–600 hours a year between 2000 and 2005, with an additional 200–300 hours in Board committees (Prizzon, Bains, Chakrabarti and Puduserry, 2022)



with greater authority to country director/managers for project approval, accelerating the decentralisation process many MDBs have already started.

Sharpen analytical support and diagnostics and tune to local context

MDBs are not just banks. Their technical assistance facilitates the implementation of specific projects and their policy advice aims at strengthening institutions. Both are highly prized by clients. Clients value the depth and relevance of the technical expertise of MDBs, both locally and internationally, built across countries and regions.⁷³ The policy advice offered by MDB staff is considered to be the most useful compared to other development partners.⁷⁴ In some cases, technical assistance and policy advice have had greater influence in shaping the policy directions of middle-income borrower countries than financial support.⁷⁵ Most MDBs have world-class research centres, generate rigorous and well-respected research, offer open data, and contribute to data collection.

Despite these strengths, the reality is that the toolkit of technical assistance and policy advice, and the way MDBs generate and communicate knowledge are no longer fit for purpose. Only a third of government officials actually think that MDBs are responsive to client demands and only around half feel government priorities were matched when providing technical assistance and policy advice.⁷⁶ More importantly, MDBs also struggle to adapt to local realities, and have a tendency to prioritise ideas and advice issued from headquarters at the expense of local expertise. Some forms of desirable institutional support only take place when there is an accompanying project. Because policy advice is often geared towards enabling new project approvals, financial imperatives often determine the nature of advice and leave some areas underfunded. Furthermore, the analytical products offered by MDBs may lack the nuance needed to address practical policy problems. Analysis often comes in the form of long, set-piece reports, often with 'best practice' off-the-shelf policy advice, rather than tailored solutions.

MDBs will not be in a position to deliver on the Triple Agenda if their offer of technical assistance, policy advice and knowledge generation is not rewired, putting clients and long-term sustainability at its heart. In the emerging context of new growth models that integrate climate, development, and nature, knowledge and sharing of experiences will be more valuable than ever. Upstream advice on policy reforms and support to programme implementation will play a decisive role both in operationalising country platforms and in building strong country systems. In this way, MDBs can be more agile and responsive and their interventions more sustainable in the long term.

Changing the approach to technical cooperation, policy advice, knowledge generation, and learning requires redesigning how advice and analysis are funded, when and how they are offered and delivered, who generates knowledge and how it is communicated. First and foremost, MDB advice and technical assistance must be carefully tailored to the needs of diverse types of borrower countries. This means ensuring that the advice reflects

⁷³ OECD (2020).

⁷⁴ Custer et al. (2021).

⁷⁵ Knack et al. (2020).

⁷⁶ Prizzon et al. (2022).



the current development needs of borrowers, ‘future-proofing’ the approach by avoiding solutions that ‘lock in’ the need for international consultants under lengthy contracts and supporting local inputs instead.

MDBs can achieve this by building longer-term relationships and peer-to-peer knowledge exchanges over fly-in, fly-out standalone reports. MDBs must attract a wider range of expertise. In fact, the core MDB comparative advantage should shift towards partnerships with policy research institutes in the developing world to take advantage of the extensive expertise now available outside the institutions, in academia, think-tanks, and client country governments themselves. This approach will also build analytical capacity in client countries and encourage greater use of local knowledge and solutions.

To put clients’ priorities at the heart of their offer, MDBs must also expand the offer of stand-alone technical assistance and policy advice that are not necessarily related to projects. Technical assistance and policy advice bundled with a project or a programme – i.e., only offered when a project or a programme was in place – was identified as the main weakness of the offer of MDBs, and across countries.⁷⁷ This would suggest a potentially strong demand for separate provisions from loans and grants. Financing them should include reimbursable assistance for upper-middle-income countries and a set-aside in country allocation budgets for other countries.

Ideas and research are powerful tools through which MDBs can support and inform policy in borrower countries. But MDBs must align the incentive of their research departments to work on issues relevant to their operations and clients. In this context, MDBs must also rethink the type of products and services provided to borrowers. Lengthy technical reports with a long publication lag may be useful to advance knowledge on development issues, but they are less user-friendly to busy senior-level policymakers. Short policy briefs distilling key insights and lessons, as well as intangible knowledge products such as support, dialogue and convening, tend to be more valuable to their clients.

Data provision is another public good provided by MDBs that is in short supply. Few MDBs allocate their own budgetary resources in any significant way to collection and dissemination of data. They rely on trust funds and other ad hoc resources.

Expand project preparation facilities

The Triple Agenda can only be achieved with a considerable ramp-up in investment in project preparation facilities in each MDB and across the system, with a radical shift towards upstream activities (policies, institutions, frameworks).

Pipelines of infrastructure projects are key for countries to meet climate and development targets. They are the backbone of country platforms. However, weak and sparse pipelines and not enough bankable projects on the books are often blamed for preventing MDBs from significantly scaling up their operations in infrastructure development, including those supporting low-carbon transition.

⁷⁷ Prizzon et al. (2022).



Building “better pipelines” is not straightforward. Projects need to reach the scale and the risk returns that interest and match investors. Project preparation takes time – generally going from three to eight years, with an average of six years.⁷⁸ It is expensive – up to 10 % of total project investment from project conception to commercial and financial closures.⁷⁹ Costs will go up even further as complex transformative programmes will require significantly greater project preparation costs and these are already under-resourced.

Several MDBs have set up their own project preparation facilities, some of them operational, others newer.⁸⁰ But these remain small and piecemeal: the AsDB of US\$ 73 million and 4 projects and the EBRD's of \$ 40 million with three projects as of 2019.⁸¹ Project preparation is also skewed toward downstream activities (i.e. project preparation and structuring; leveraging financing): very little is invested in upstream activities. Between 2006 and 2015 only 0.2% of total enabling environment operations and lending went to project preparation activities.⁸² A shift from project to program/country platforms will increase the importance of upstream activities, particularly in shared project preparation platforms.

To boost the project pipeline and its quality, MDBs must play a much bigger role in project preparation. Given their leverage effect, facilities need to be ramped up and harmonized across MDBs. The Global Infrastructure Facility, which works throughout the cycle including upstream activities, should be scaled up.

Independent client survey of MDB performance

MDBs were created with the ultimate goal of supporting the socioeconomic development of their client countries. Clients' demand and preferences for what MDBs offer should therefore in principle help inform and shape the lending volumes, strategies and operations of MDBs. However, we know little about the preferences of their client countries, what they value about the financing and operation models of MDBs, and what weaknesses could potentially curb their demand for assistance in the medium to long term.

Understanding how MDBs fare in the eyes of their client countries is not an academic exercise. Within an expanded triple mandate, the transformative impact of MDBs still lies in their ability to serve and work with client countries that have different institutional capabilities and priorities. These priorities evolve too. Strong and sustained demand for what MDBs offer is a necessary condition for MDBs to contribute to transformative change.

Client surveys are not new tools. Several MDBs have run their own client surveys for some time. Their independent evaluation offices regularly assess certain functions and operations as well as project effectiveness. But these surveys are usually intended to improve delivery and policies at the margin, rather than reflecting on or challenging the role of MDBs in financing, technical support, knowledge generation, and convening, all

⁷⁸ *Global Infrastructure Hub and World Bank (2022).*

⁷⁹ *Global Infrastructure Hub and World Bank (2022).*

⁸⁰ *Global Infrastructure Hub (2019).*

⁸¹ *Fioravanti et al. (2019).*

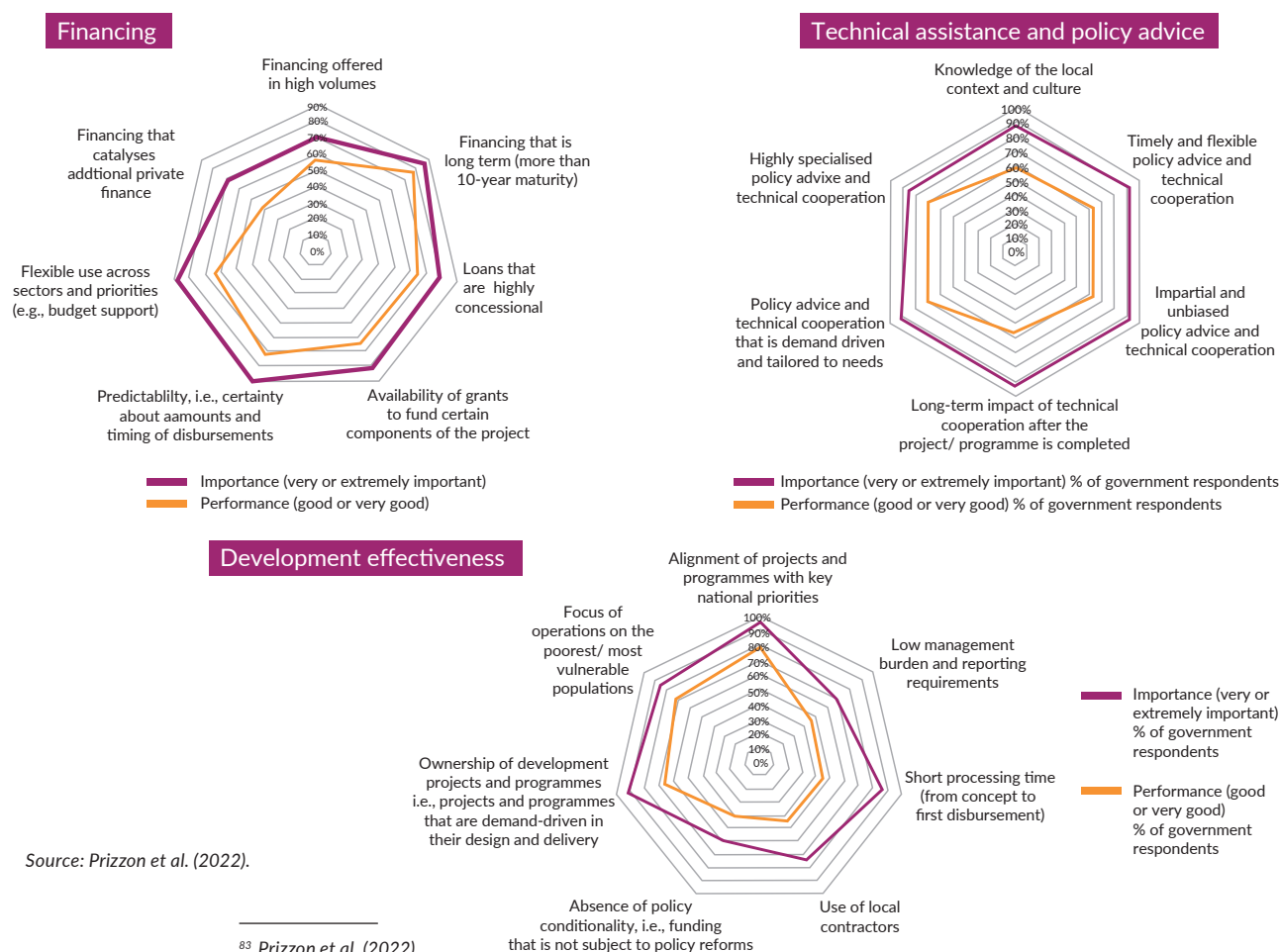
⁸² *Fioravanti et al. (2019).*

of them supporting socioeconomic development and helping address global challenges. Furthermore, MDB client surveys usually evaluate the performance of individual institutions rather than of MDBs as a group or comparatively. Countries are also reached at different survey cycles rather than simultaneously. Being administered directly or commissioned by the same institution under scrutiny could create a bias in the responses of informants.

Independent surveys indicate that in several areas MDBs are perceived by client stakeholders as operating on extremely relevant issues, but not always performing at desired standards. The ODI survey run in 2021 identified at least four areas where MDB performance in highly relevant areas fell well short of expectations.⁸³ These are: (i) catalyzation of private finance; (ii) processing time for projects; (iii) knowledge of local context and culture; and (iv) technical assistance and policy advice with long-term consequences (Figure A2).

MDBs should agree on a range of key performance indicators (KPIs), measured through an independent survey of client assessments of MDB performance, to expand and deepen institutional collaboration. The objective would be for each dimension and for each group of stakeholders (government; private sector working with MDBs; civil society) to score at least three-quarters of respondents rating it either good or very good. Initial consultations with representatives from client countries will inform the content and the design common performance indicators. The first survey will set the benchmark and be monitored over time.

Figure A2: Performance of MDBs on Different Areas



⁸³ Prizzon et al. (2022).

Annex 4: Better MDBs--Working together as a system

There is a strong case for MDBs to work better as a system, to achieve more than the sum of their parts.⁸⁴ It will not be possible to respond to the pressing development and global challenges with the scale and urgency needed unless the MDBs are able to collaborate in a much closer and different way than they have in the past. MDBs have somewhat different mandates, different shareholding and decision-making structures and different geographical contexts. But they share an overarching common purpose: the pursuit of the sustainable development goals and the urgent necessity to respond to pressing global challenges including climate. All MDBs committed to support the global agenda that emerged in 2015 and all have since ramped up their support for climate action. Climate and sustainable infrastructure now constitute more than 50% of lending in every MDB, which is also the area that requires greatest collaboration across MDBs.

There has been progress on MDB collaboration, but much more radical change is needed if the MDBs are to deliver the best results as a system. Reform is needed in four key areas: institutional collaboration, changes in the individual and collective operating model, cooperation with the private sector and the better utilization and scaling up of finance.

Strengthening Institutional Collaboration

MDBs have a long history of institutional collaboration. MDB Heads meet semi-annually but briefly to discuss common goals and challenges. Many high-level and working groups have been set up to foster collaboration on specific issues from procurement to sustainable infrastructure to risk management and finance. Nevertheless, MDBs have largely continued to operate largely as a fragmented system because of lack of incentives and conflicting requirements from shareholders. Even in the best cases, such as the MDB Climate Leaders Group, strong collective action has been held back by lack of support and incentives on the part of Senior Management and shareholders.

MDBs need to establish a much more systematic institutional structure for collaboration that sets out agreed priorities and processes for collaboration and regular reporting on common KPIs including progress on SDGs and climate goals. Given the pressing challenges we face and the new configuration of leadership in the MDBs this is a timely moment to consider innovations such as an annual retreat of MDB Heads, a standing MDB Strategy Group at VP level, and a periodic MDB general meeting that brings together managements and shareholders to identify and advance concrete proposals on collaboration.

MDBs and their shareholders must be incentivized to change through policies and accountability mechanisms that reward collaboration and disincentivize non-cooperative behavior. Internal incentives, including career progression, should explicitly reward MDB staff for cross-MDB cooperation. We need a more collaboratively-minded culture within the MDB system and amongst their shareholders.

⁸⁴ See for example: Suma Chakrabarti and Danny Alexander, *Devex Opinion: Multilateral development banks must collaborate better* (forthcoming).

A New Operating Model could be established between the two structures

As we have argued in Volume 1 and in this report, MDBs need to convert their operating model so that they can become effective agents of transformational change by shifting from a project by project and institution by institution approach to becoming active promoters and supporters of country/sector platforms and by greatly improving their operating efficiencies through streamlining processes, utilizing comparative strengths, and eliminating duplicative requirements.

MDBs must promote effective country platforms that bring together all stakeholders under the leadership of the country around a common vision of time-bound change, usually with a sectoral or thematic focus, with the objectives of identifying needed projects and enabling reforms, assigning responsibilities to each public and private development partner, and learning and adapting over time to speed up impact and effectiveness.

The Egypt water, food and energy nexus and the JETPs are emerging models of such platforms in which the MDBs can play well-structured and complementary roles, as is the case in the Egypt program. The MDB Climate Leaders Group is proposing to extend the country/sector platform approach to help accelerate transformative change with individual MDBs proposing to take the lead in offering system-wide support where countries have identified and are ready to proceed in priority sectors. Strong support and leadership from management and shareholders will be critical for the success of this important initiative.

This shift in the operating model can be supported in a number of ways:

- a) Common diagnostic work and coordinated policy and institutional support. Diagnostic tools like the World Bank's Country Climate and Development Reports (CCDRs), and country-led assessments such as long-term strategies (LTSs) and NDCs can help build common coherent country strategies, led by client country governments, thus bringing together MDBs behind climate and development goals and identifying key areas for complementary support.
- b) Streamlining and mutual recognition of standards. There are potential efficiency gains from harmonizing and converging on standards among MDBs (including ESG and integrity policies). At the same time, MDBs need to streamline safeguards following a risk-based approach and collectively support and rely on country systems. Mutual recognition of high-quality standards can help to reduce transactions costs and foster co-financing of projects.
- c) Co-financing platforms and marketplace for projects. The AIIB and the World Bank have proposed to set up co-financing platforms and the AIIB has proposed creating a marketplace for MDB projects where "investment concepts and proposals are matched with appropriate financing for project preparation, development and implementation across the MDB system."⁸⁵

⁸⁵ See for example: Suma Chakrabarti and Danny Alexander, *Devex Opinion: Multilateral development banks must collaborate better* (forthcoming).



Collaborating with the Private Sector

There are important synergies if the MDBs work together in strengthening their collaboration with the private sector. There is scope for greater effectiveness and scale solutions through MDB collaboration in the co-creation of investment opportunities with the private sector, tackling of impediments to private investment, implementation of better risk mitigation structures, and deployment of blended finance and system-wide approaches to reduce, manage and diversify risk.

The Global Infrastructure Facility can play an important role in fostering a system-wide approach in the crucial area of project preparation and building a more effective partnership with the private sector. The GIF has established a successful record in project development and in private capital mobilization, working with 10 MDB partners. But the GIF is currently far too small to realize its potential. The refreshed GIF strategy is geared towards acting as an effective enabler and gateway for PCM at transformative scale for sustainable infrastructure. It can also foster a more coordinated approach across the project preparation eco-system encompassing the MDBs and the private sector including through greater standardization.

MDBs are being called upon to greatly expand their role in the provision of guarantees to catalyze PCM and bring down the cost of capital. There is not only great scope for learning from different experiences across the MDBs, but also benefit from developing common instruments that can be more easily taken to scale. MIGA is well positioned to play a central role in the development and expansion of guarantees especially for policy risk and enabling risk transfer to the private sector. Although it has primarily worked with the World Bank, it is well positioned to be an instrument that works with the MDB system in transforming the architecture on guarantees.

Utilizing their combined financial strength

MDBs can generate greater firepower by pooling risks and taking a common approach to balance sheet optimization and scaling up capital. Some have already taken advantage from exposure swaps with further potential from pooling of risks. Although MDBs are implementing individually the recommendations of the review of capital adequacy frameworks (CAF), they could achieve more if they learn from each other and coordinate their dialogue with credit rating agencies (CRAs) more systematically. This includes coordinating further on the work highlighted in the CAF report (on callable capital and preferred creditor status) to inform the methodologies used by CRAs to assess MDBs; approaching CRAs as a group to get them to assess MDB risk and creditworthiness in a more consistent way; and standardizing approaches to innovations related to hybrid capital and risk transfer mechanisms. To increase lending capacity, MDBs should



collaborate on developing common asset classes of securitized MDB assets, taking advantage of the potential for diversification of risk across the system and the greater liquidity that a common asset class would represent. Through discussion with market participants and rating agencies, templates for these instruments will accelerate MDBs' ability to deploy them when needed, tailored to each bank's needs.

MDBs also need to coordinate on the establishment of a global challenges funding mechanism. Such a mechanism can be established in a single institution and eventually serve other MDBs, or similar mechanisms could be set up in different institutions. The scale of the anticipated needs for MDB finance requires a proactive and systematic approach to capital increases, tailored to individual institutions but that generates adequate capital for the system as a whole. A coordinated approach across MDBs and their shareholders can help build consensus for the necessary capital increases and make the process less protracted than it has usually been.



Annex 5: List of Organizations and Individuals Consulted

Consultation with GFANZ Session on MDB Reform on 10th August 2023
Alex Michie; Ben Weisman; Alan Levy; Alexis De Mones; Angge Roncal; Angus Wilson; Annika Brouwer; Ashley Dorrington ;Carla Cecilia Mata; Christopher de Vere Walker; Conor Ritchie; Dario Traum; Duncan Buchanan; Elke Pfeiffer; Frank Schroeder; Gustavo Medeiros; Henri Blas; Himesh Patel; Holly Roberts-Harry; Isabel Stainsby; Iselin Lummis; Jackie Lau; John Murton; Liv Cowgill; Lorenzo Saa; Louise Aagaard Jensen; Mahesh Roy; Richard Abadie; Rory Linehan; Seth Eshun; Thomas Christiansen; Tim Warlow; Timothée Jaulin; Tom Tayler; Valentina Ramirez; Vincius Nunes; Willam Young
Consultation with Islamic Development Bank on 15th August 2023
Syed Husain Quadri
Consultation with EBRD on 17th August 2023
Aldo Schmitt; Carlos San Basilio; Christian Kleboth; Zbigniew Kominek
Consultations with World Bank Group on 18th, 28th August and 8th September 2023
Junaid Ahmad; Ed Mountfield; Enzo De Laurentiis; Maninder S. Gill; Dirk Reinermann; Paloma Anos Casero; Anshula Kant; Trichur Sundararaman; Jorge Familiar Calderon; Lakshmi Iyer; Alexandre Borges de Oliveira
Consultations with Senior Officers from the Government of India and the Private Sector in August, 2023
Consultation with ADB on 21st, 28th Consultation August 2023
Bart Raemaekers; Claus Astrup; Masayuki Tachiiri; Tomoyuki Kimura
Consultation with AIIB on 25th August 2023
Danny Alexander; Urjit Patel; Rodrigo Salvado
Consultation with IADB on 29th August 2023
Alexandre Meira Rosa; Amanda Louise Glassman; Bar Ben Yakov; Francesca Castellani; Matias Bendersky; Miguel Aldaz Guallart
Consultation with EIB on 29th August 2023
Ambroise Fayolle; Carlota Cenalmor; Pedro de Lima

Consultation with the IDBG on 29th August 2023
Anderson Caputo Silva; Daniel Fernando Fonseca; Elizabeth M. Robberechts; Fabio Fagundes; Gustavo de Rosa; Ian MacDonald
Consultation with AfDB on 30th August 2023
Ahou Eleonor Catherine Brou; Caroline Kende-Robb; Namawu Aलो Alhassan; Nancy Beke; Victoria Chisala; Walter Odhiambo
Consultation with New Development Bank on 5th September 2023
Anil Kishora
Consultation with TCX on 6th September 2023
Ruurd Brouwer; Harald Hirschhofer
Consultation with FiCS on 16th September 2023
Remy Rioux
Consultation with the IFA Working Group on 21st September 2023

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