Development Finance for Growth and Investment:
The Multilateral System of Development Finance

Amar Bhattacharya & Rogério Studart

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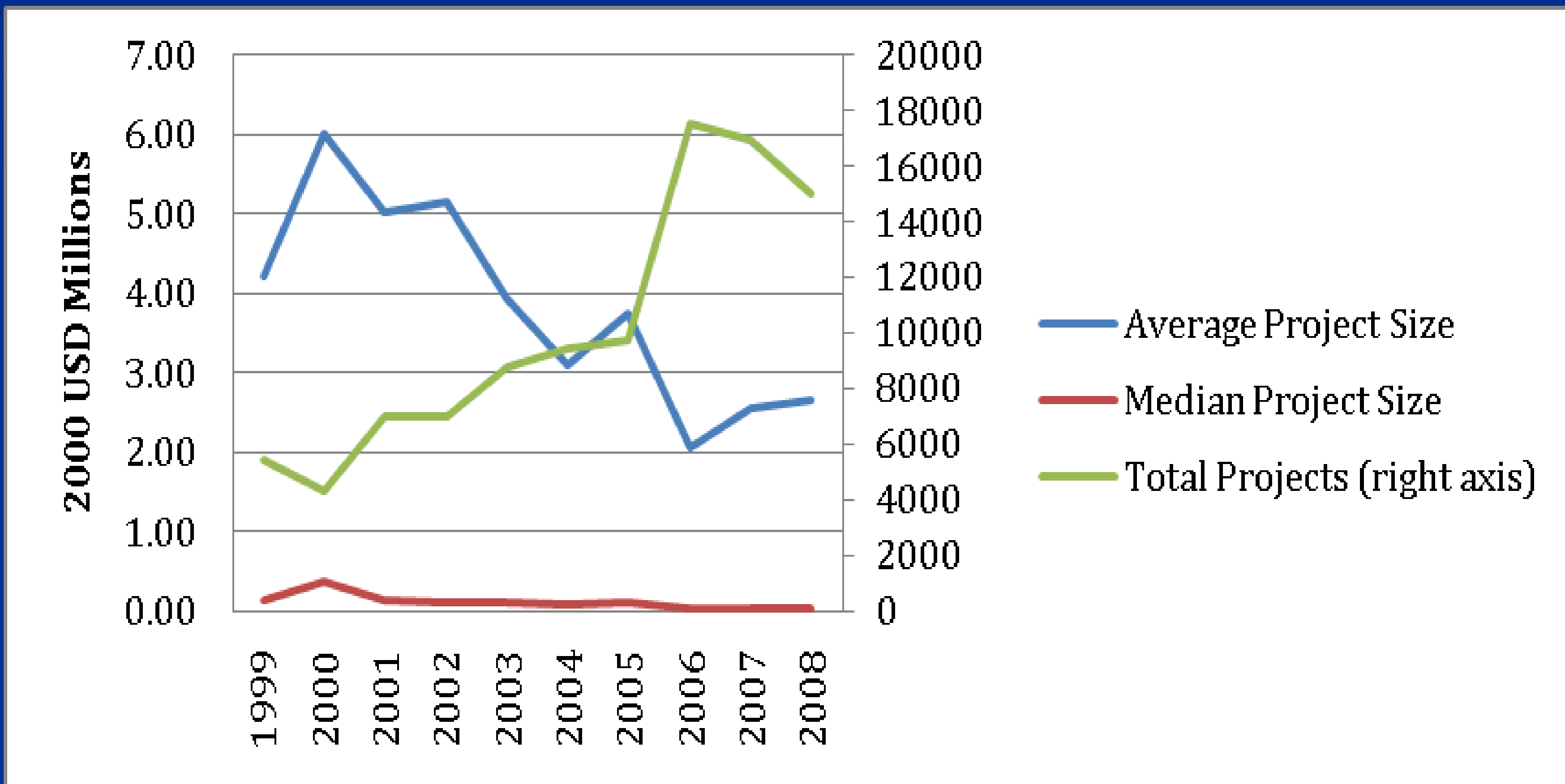
Evolution of Multilateral Development Finance

- Multilateral development finance was a central pillar of the framework of development cooperation established in the post-World War II period
- MDB model of market-based financing: IBRD (1945), IFC (1956), IADB (1959), AfDB (1964), AsDB (1966), EBRD (1991)
- Concessional financing through concessional windows starting with IDA (1960); other regional banks in the 1970s

Evolution of Multilateral Development Finance

- Proliferation of multilateral institutions and funds since the 1980s (200 today compared with 50 in 1950)
- Increased fragmentation within institutions (1000 trust funds within World Bank)
- Many of these are vertical funds designed to address “priority” objectives including the millennium development goals

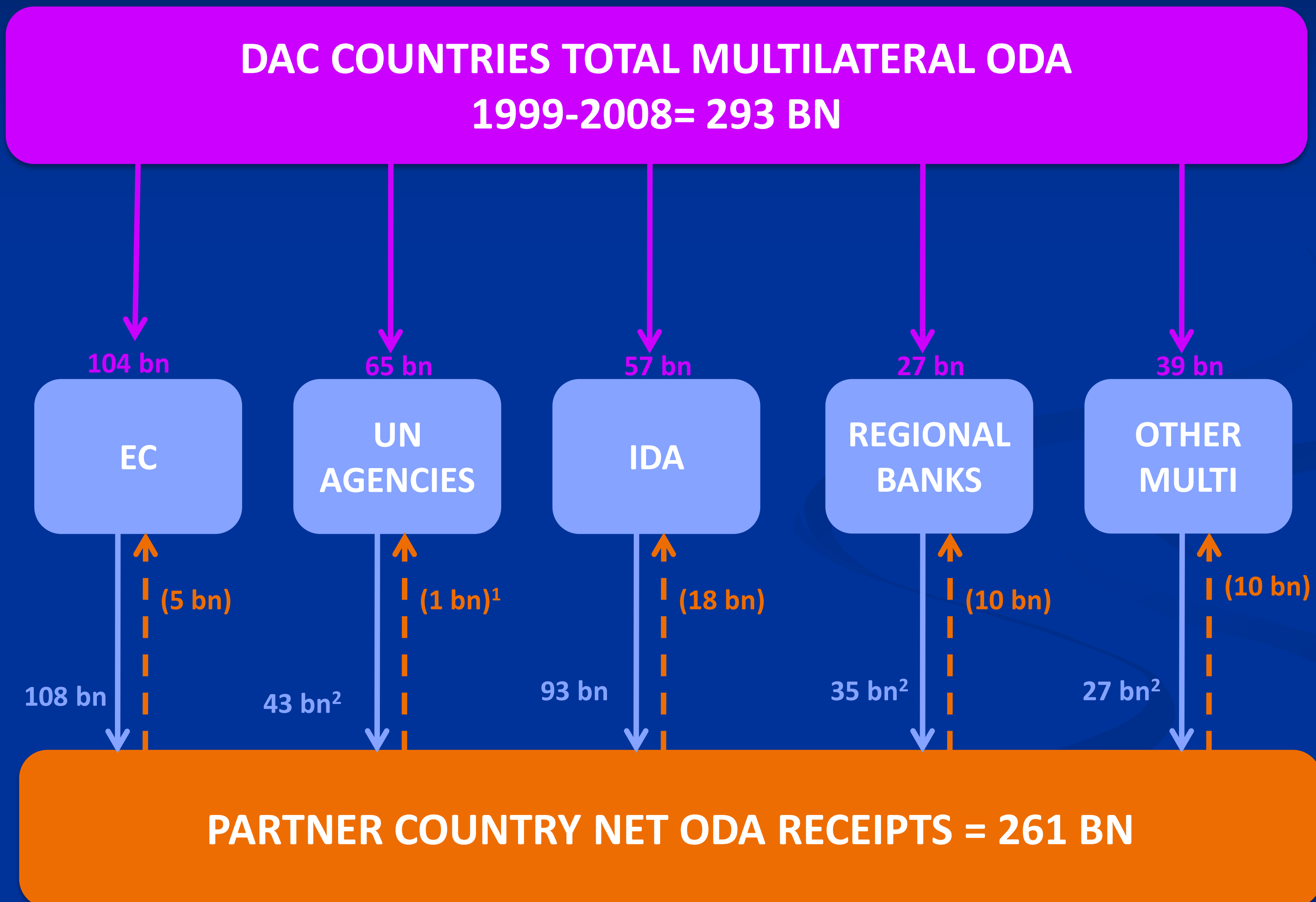
Project Numbers, Average Size and Median size for all Multilateral Donors, 1999-2008



Source: Data compiled by Jonathan Adams, based on Findley et al. (2010)

DAC countries' Multilateral ODA (core, excluding Korea: Gross Disbursements, Outflows and Reflows, 199-2008

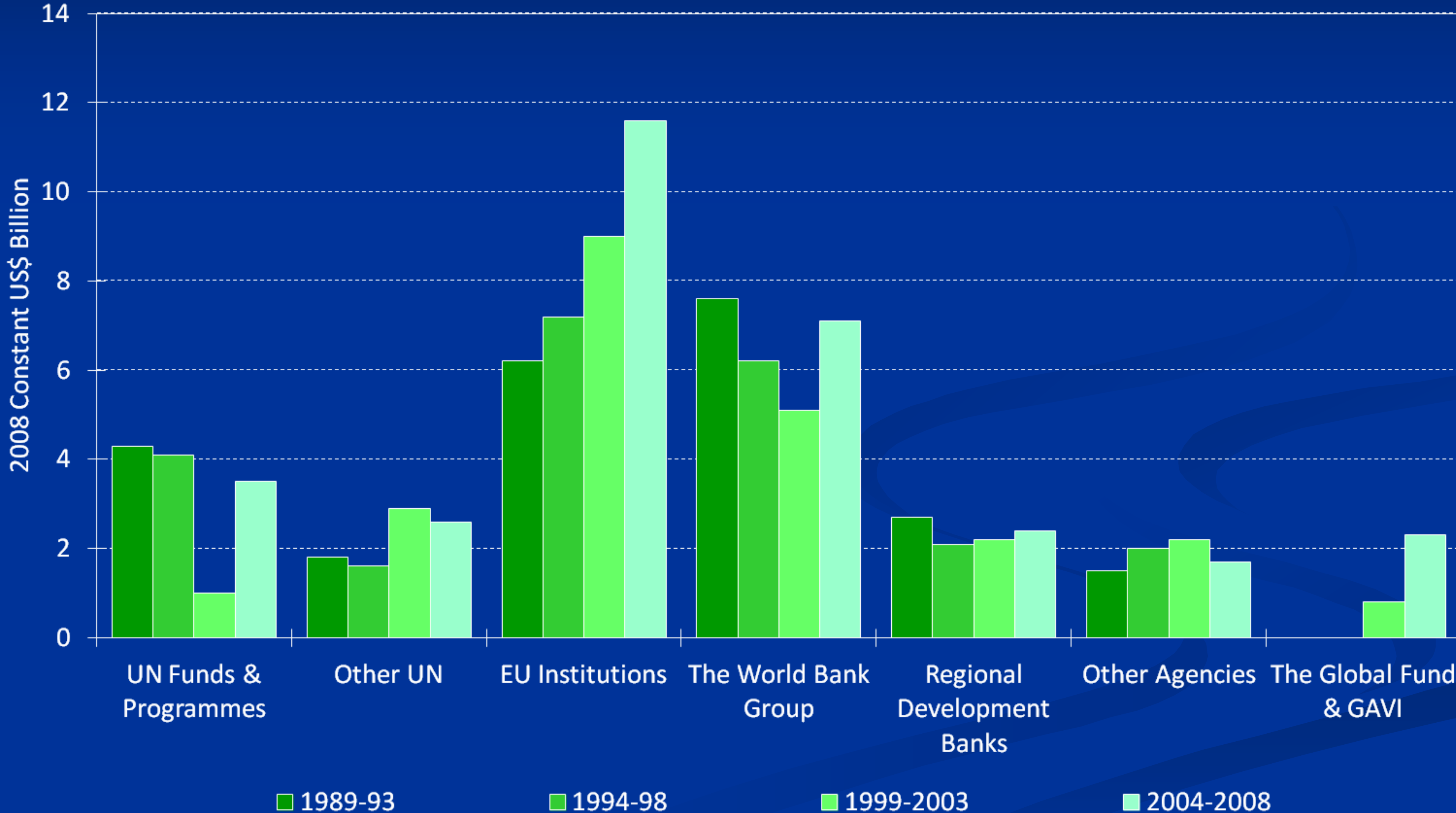
(Cumulative total, excluding debt relief, in USD Billions at 2008 constant prices)



Source: DAC Aggregate Statistics

Average Aid Provided by DAC Countries to Select Multilaterals Over Five-year Periods

(US$ billion)



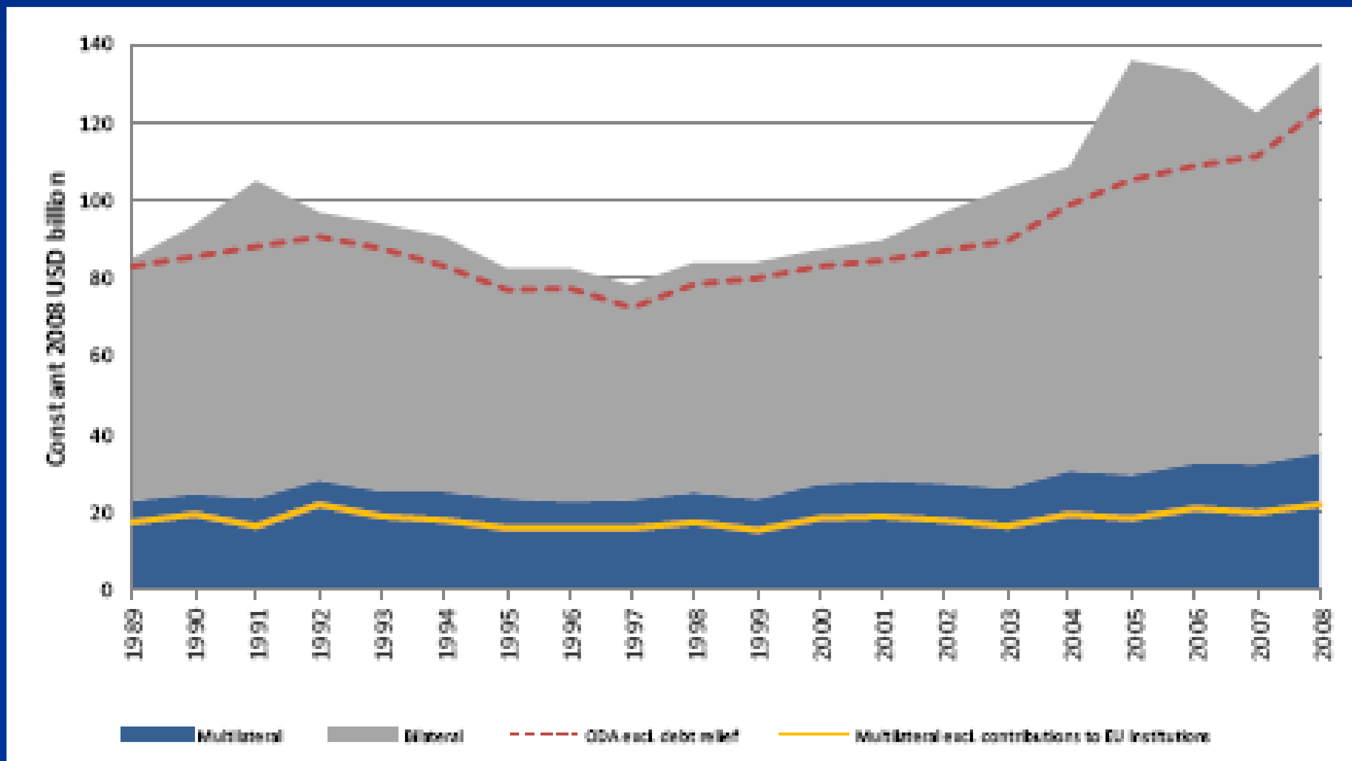
Source: DAC Aggregates

Evolution of Multilateral Development Finance

- Despite the huge expansion of the multilateral system, overall importance and role of multilateral development finance has actually declined
- Total ODA increased from $85 billion in 1990 to $120 billion in 2010, this has been primarily in the form of bilateral ODA
- Multilateral ODA increased modestly since Monterrey with the emphasis on additional financing to meet the MDGs
- IDA14 saw the largest real increase in over two decades, but no real increase under IDA14
- Emphasis on stretching resources and shifting focus to the poorest

Gross ODA Provided by DAC Member Countries, 1989-2008

(US$ billion)

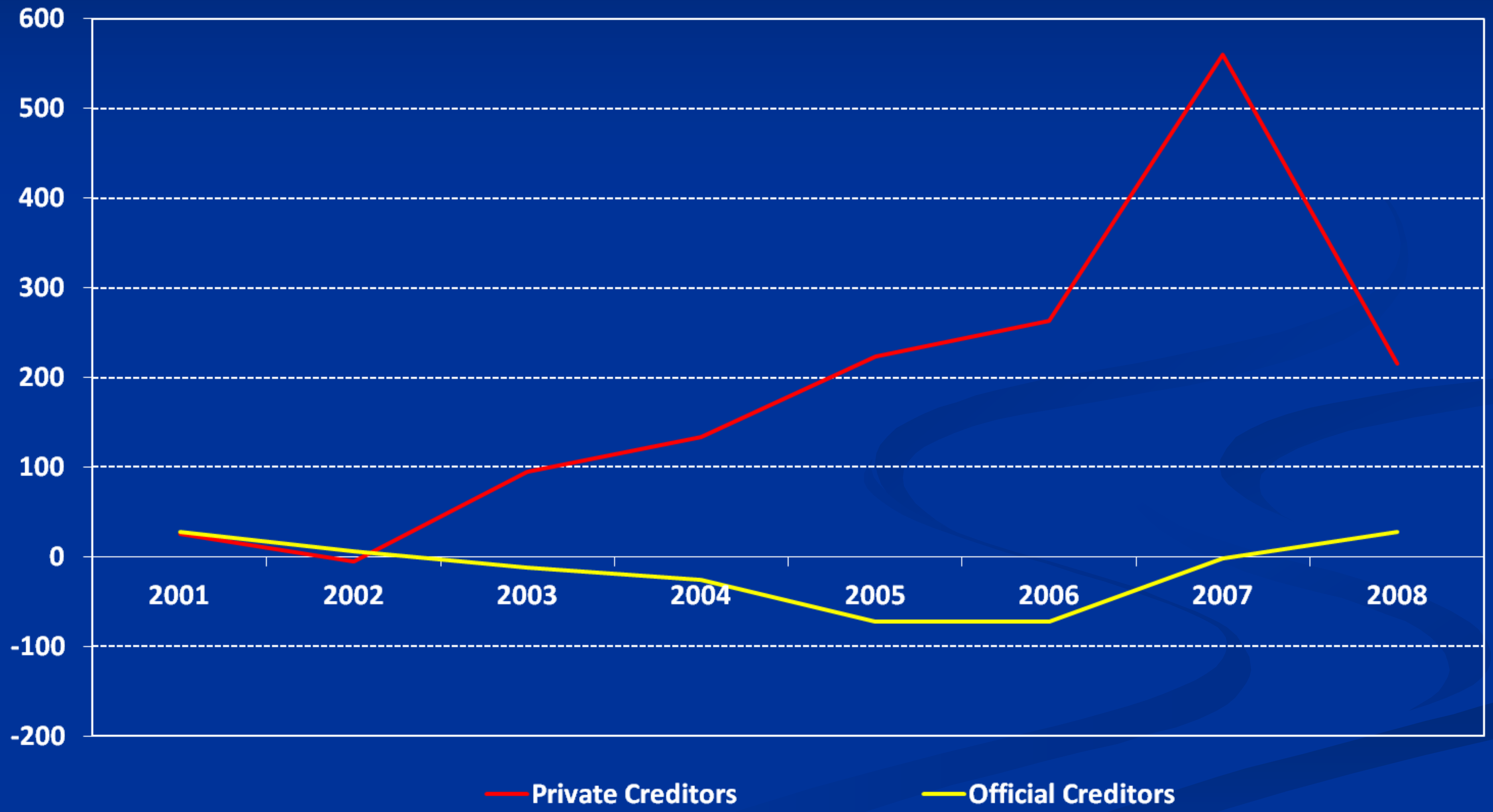


Source: DAC Aggregates

Evolution of Multilateral Development Finance

- Role of market-based MDB finance has declined sharply since the 1990s and the relative role of the World Bank (IBRD) has been diminished
- Net flows of MDB finance declined from 1.5-2.0 percent of investment spending by developing countries in in the 1980s and early 1990s to less than 0.5 percent in the decade before the recent financial crisis
- Net flows from IBRD were substantially negative for most of the decade prior to the crisis

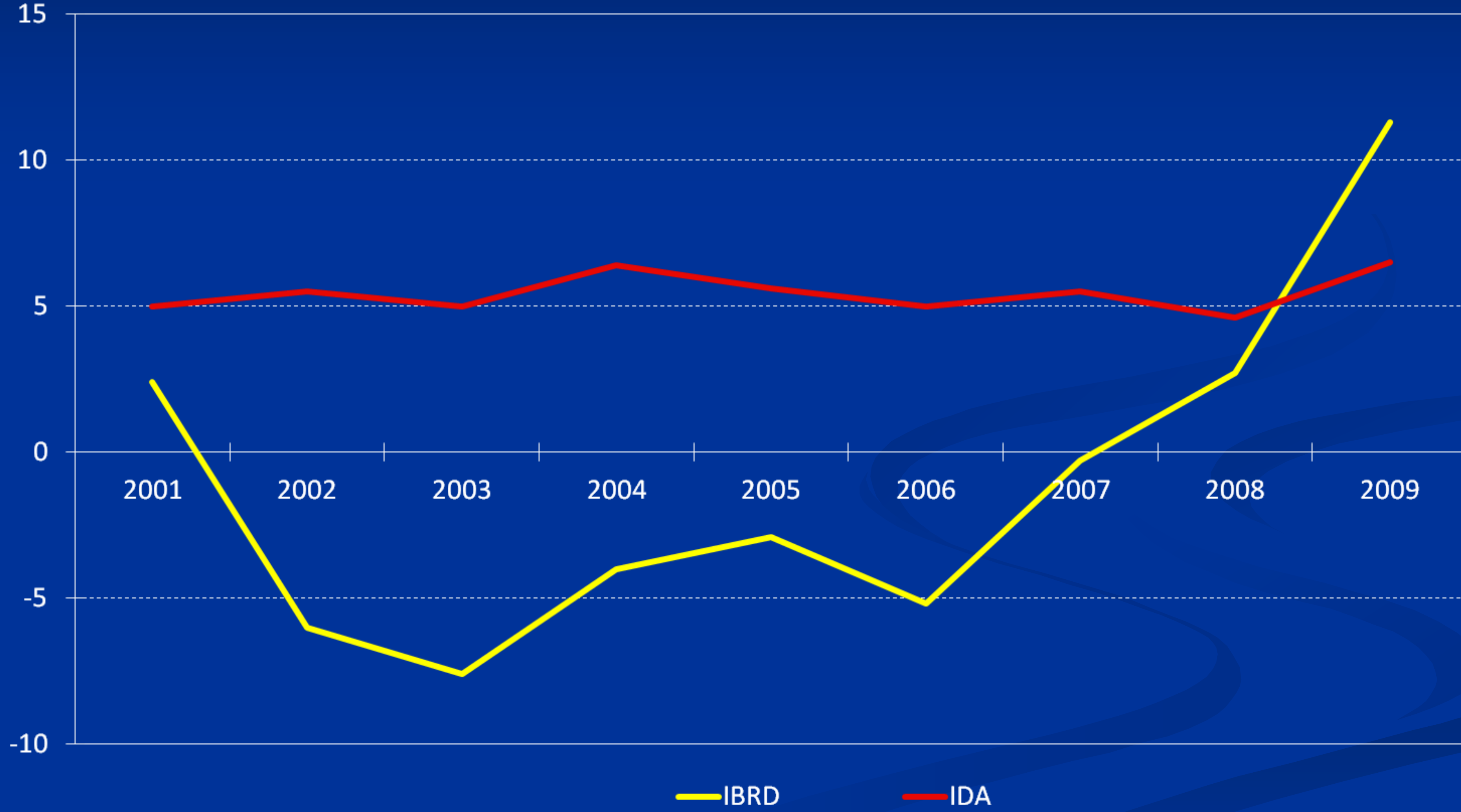
Net Debt Flows by Creditor Type, 2001-2008
(US$, Billions)



Source:: GDF 2010, World Bank

Net Official Financing to Developing Country from World Bank, 2001-09

(US$ Billions)



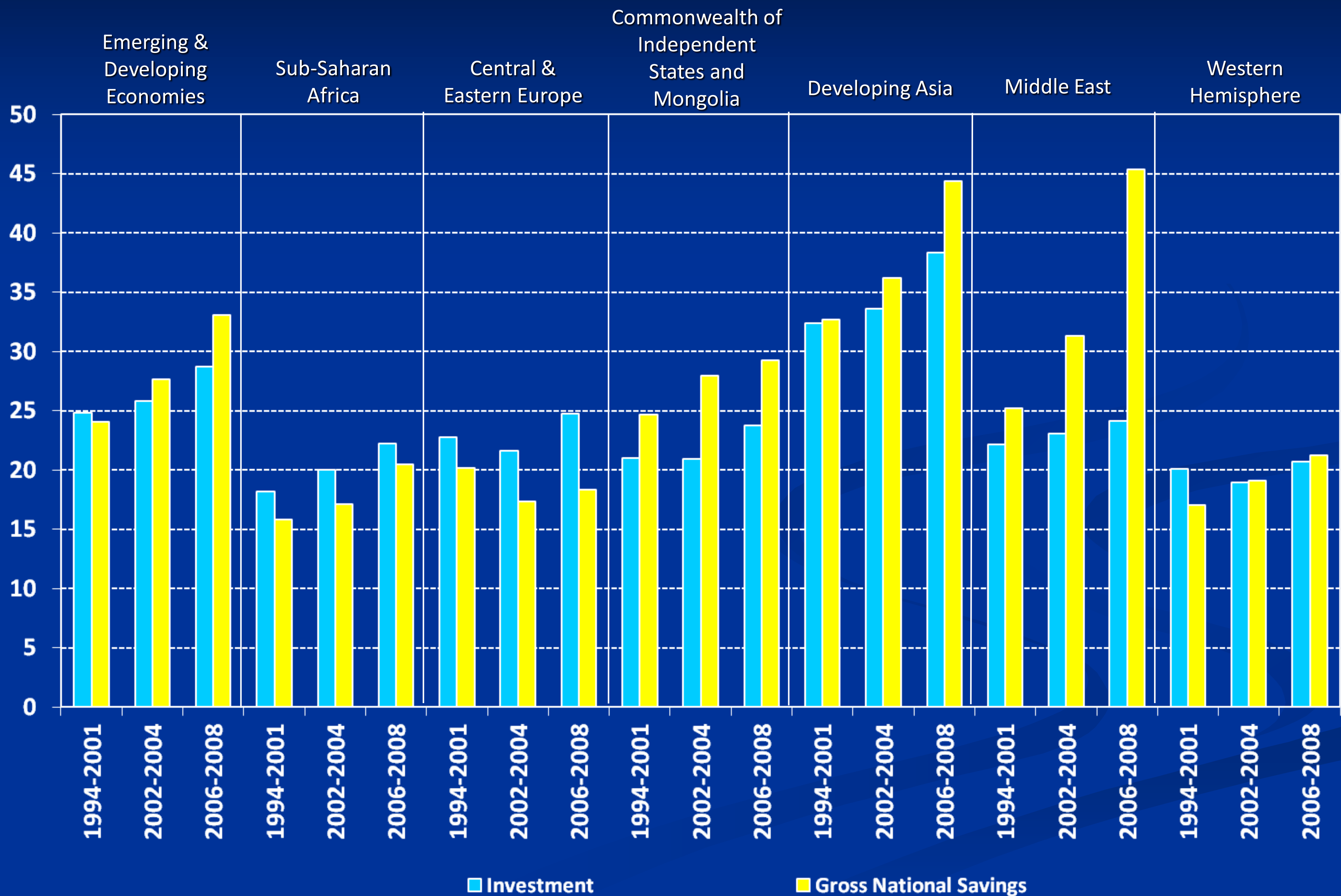
Source: World Bank Debtor Reporting System and OECD

Evolution of Multilateral Development Finance

Four principal factors explain the decline in the role of MDB finance:

- First, the improvement in domestic savings and export performance of developing countries in all developing regions since the mid-1990s (domestic savings rate of developing countries increased from around 20 percent of GDP in the early 1990s to 35 percent in 2008, and exports increased more than five-fold in dollar terms from $1.1 trillion in 1995 to $5.9 trillion in 2008 reflecting the success of policy and institutional reforms across the developing world)

Investment and Savings Trends in Developing Countries, 1994-2008 (Percent)

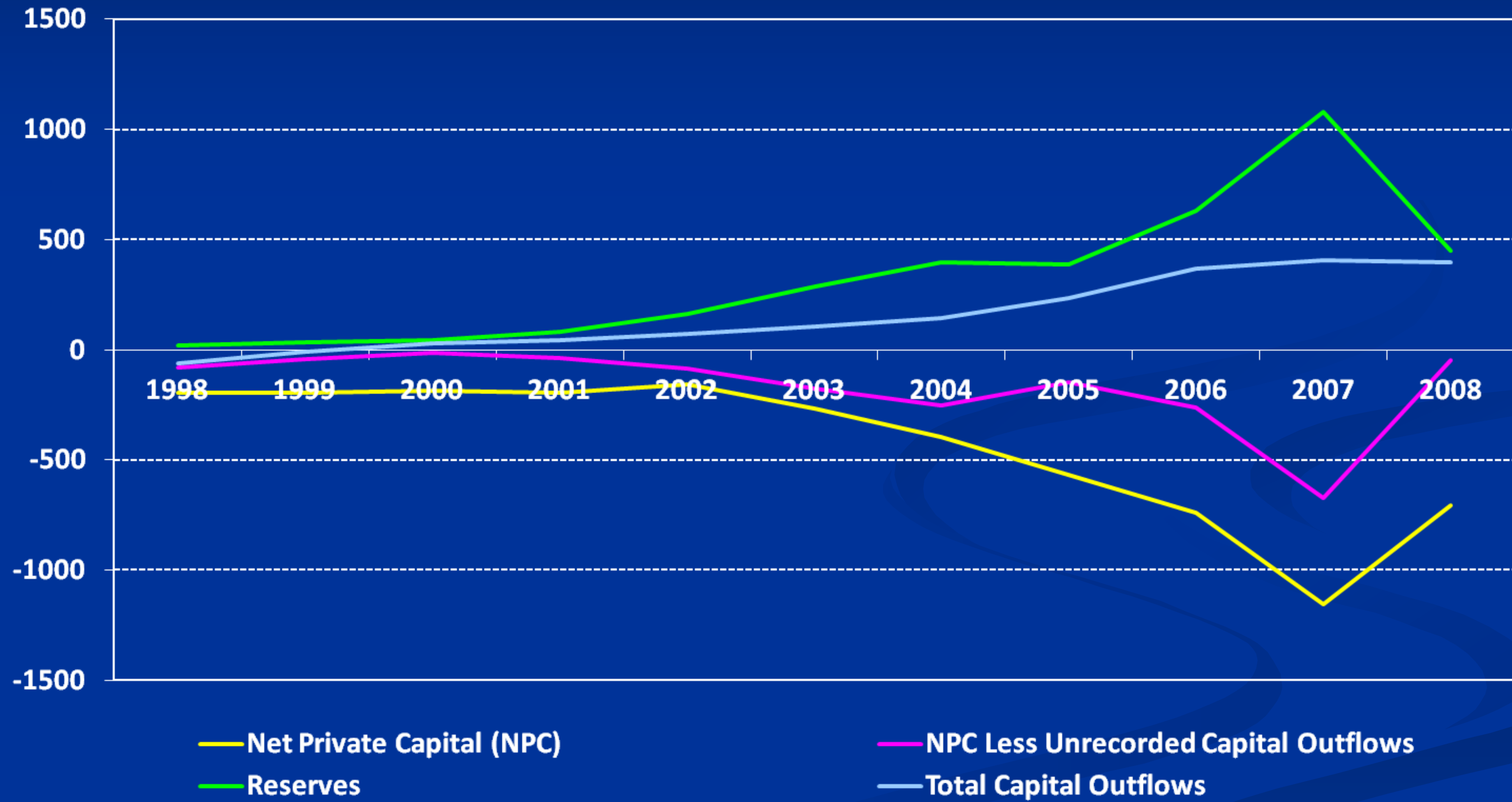


Source: International Monetary Fund, World Economic Outlook Database

Evolution of Multilateral Development Finance

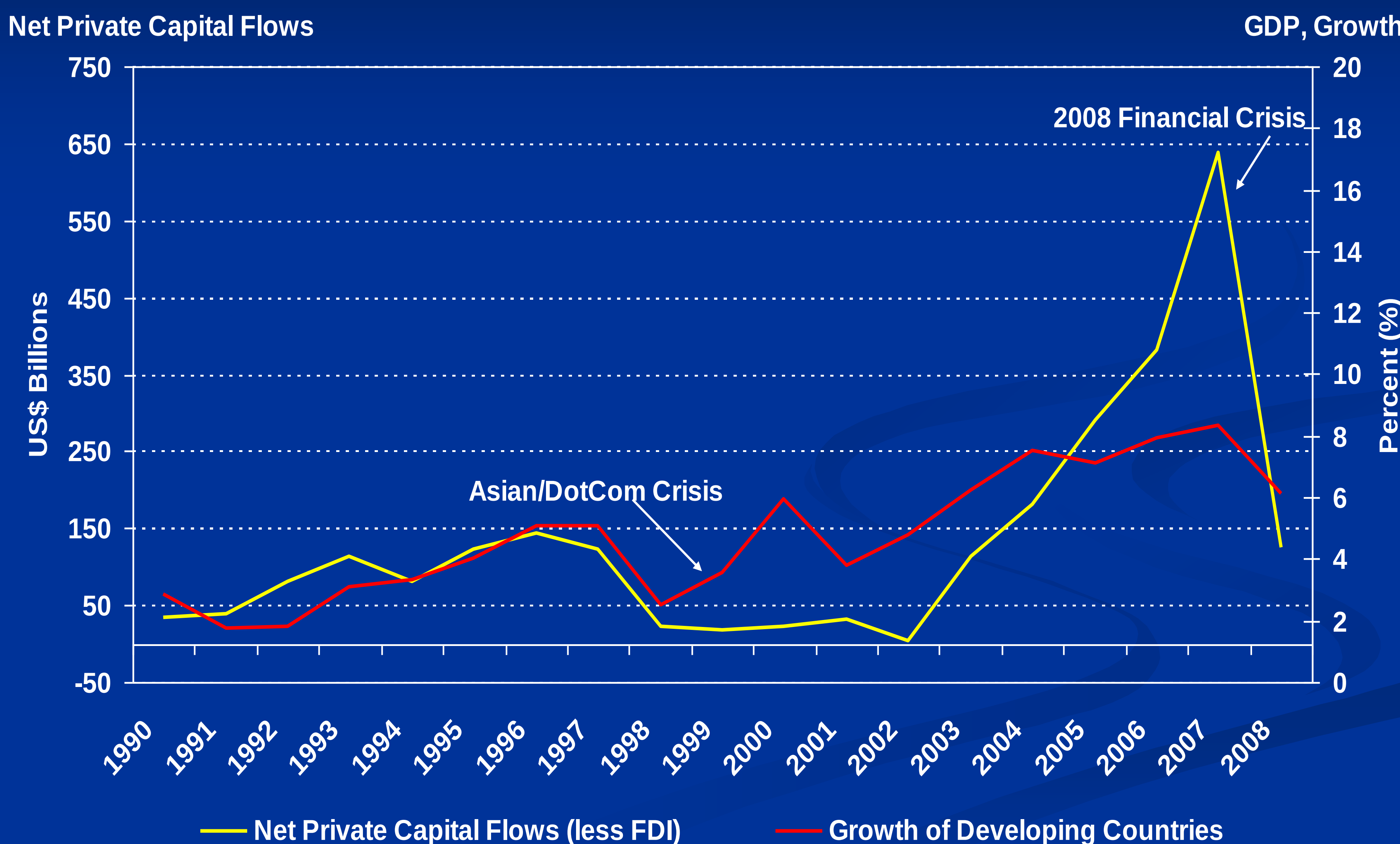
- Second, the surge in private capital flows which increased in two waves, in the run up to the Asian financial crisis in the 1990s and in the 2000s in the run up to the recent financial crisis.
- At its peak in 2007, net private capital flows to developing countries were in excess of $1 trillion compared with $12 billion of net flows from *all* multilateral creditors
- Large inflows of private capital were however offset by unrecorded private capital outflows and the buildup of official reserves, so that net capital flowed “uphill” from developing to developed countries
- Private capital flows have also tended to be procyclical and subject to sudden reversals

The Uphill Flow of Capital, 1998-2008
(US$ billions)



Source: International Monetary Fund, World Economic Outlook Database, April 2009

Procyclicality of Capital Flows, 1990-2007



Source: International Monetary Fund, World Economic Outlook Database, April 2009

Evolution of Multilateral Development Finance

- Third, increased “costs of doing business” with the MDBs, reduced attractiveness of financial terms and reorientation away from infrastructure financing has reduced demand for MDB financing from middle-income countries
- The increased costs of doing business arose because of the proliferation and cumbersome application of safeguards, and in some cases of intrusive conditionality

Evolution of Multilateral Development Finance

- Fourth, as noted, limited availability of financing under the concessional windows, including IDA, has rationed concessional financing to low-income countries

Response by MDBs to Financial Crisis

- MDBs called upon to play major role in the aftermath of the crisis in providing countercyclical finance
- MDBs response was commendable: since the crisis MDBs have provided $235 billion in lending, more than half of which has come from the World Bank Group, exceeding the target set at the London G20 Summit
- Frontloading of IDA by $2 billion in 2009-2010

Reassessment of Capital Adequacy

- The crisis also highlighted the need to boost the capital base of the MDBs
- Agreement reached on increasing the capital base of the MDBs by $350 billion, or 85 percent
- This included doubling of capital for AsDB, more modest increases in capital for IADB, AfDB and IBRD, and only a small increase for IFC
- Increase in capital has allowed MDBs to increase lending from $37 billion to $71 billion per year between 2009 and 2011 but future lending trajectories would have to decline in all cases

The Development Challenge: Crisis and Beyond

- Crisis preceded by most rapid and broad-based growth of the developing world in history
- Crisis has had lasting effects on the developing world, especially the poorest.
- Beyond the crisis, important development challenges remain. Despite unprecedented progress over the past three decades, world is still largely bi-modal, with diverse institutional and financing needs across developing countries.
- Managing globalization and the global commons adds new constraints and new imperatives

Growth Before, During and After the Crisis

	2003-08	2009	2010-15
World	4.4	-0.6	4.5
Advanced economies	2.3	-3.2	2.4
Emerging and developing economies	7.2	2.4	6.6
Central and eastern Europe	5.5	-3.7	3.7
Commonwealth of Independent States	7.5	-6.6	4.4
Developing Asia	9.0	6.6	8.6
Middle East and North Africa	5.7	2.4	4.7
Sub-Saharan Africa	6.2	2.1	5.4
Western Hemisphere	4.8	-1.8	4.1

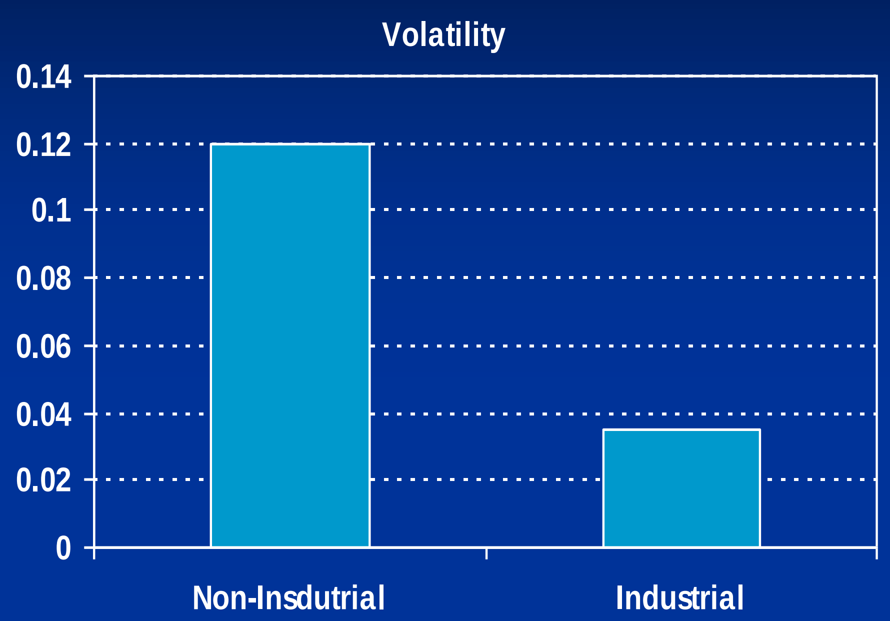
Dispersion of Growth

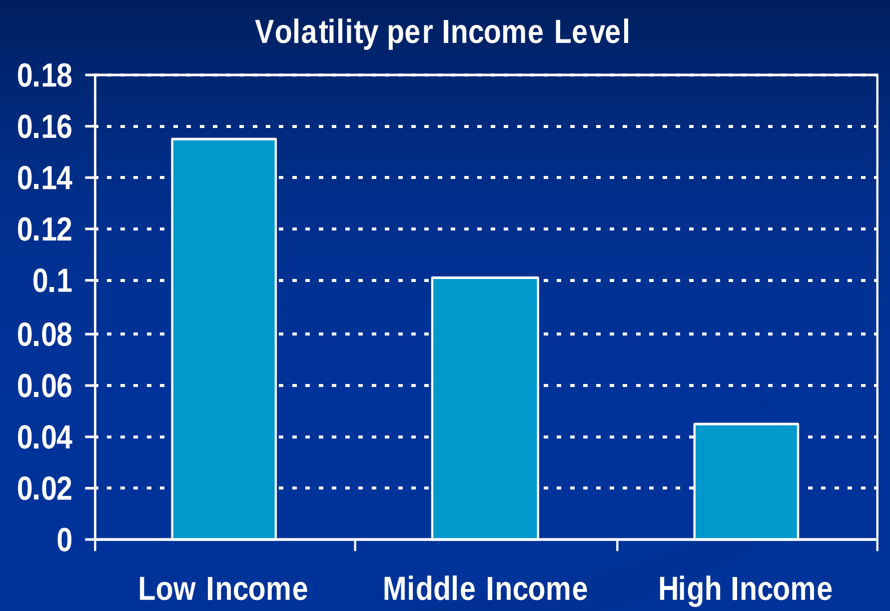
	Average Growth 2003-2008			Average Growth 2010-2015		
Growth	>5%	3-5%	<3%	>5%	3-5%	<3%
Advanced Economies	0	9	16	0	2	23
Emerging and Developing Countries	92	39	25	59	67	30
LIC	44	17	17	39	28	11
MIC	48	22	8	20	39	19
Total	92	48	41	59	69	53

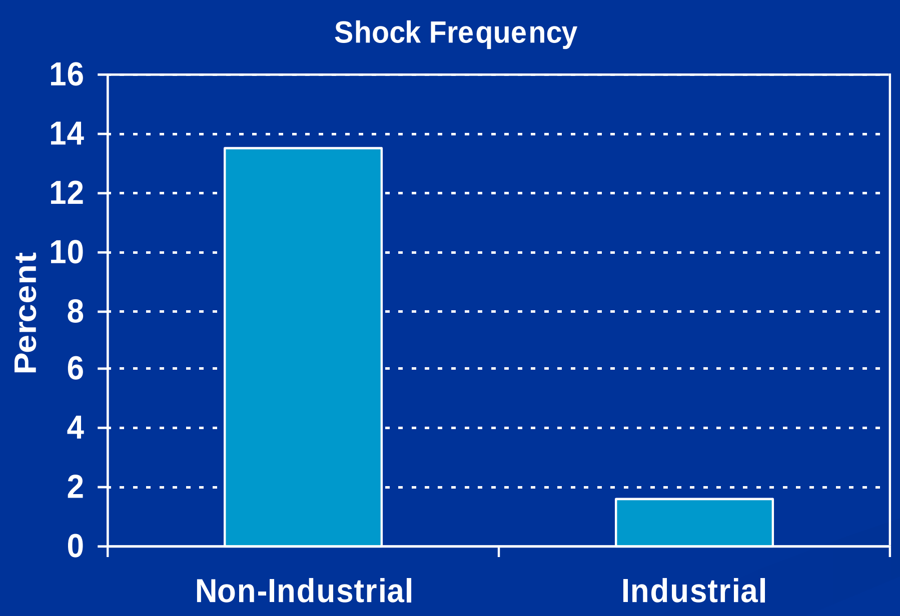
Coping with Volatility

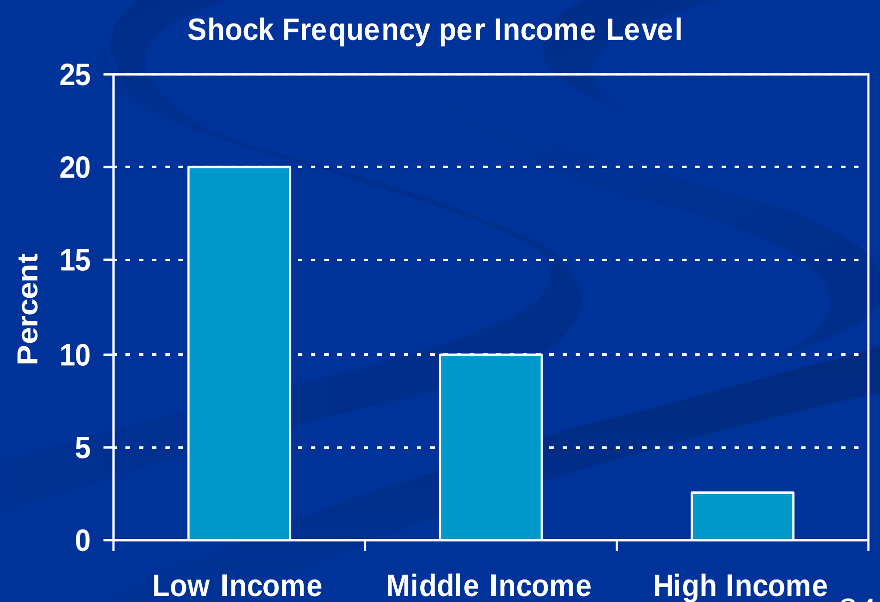
- Although the present crisis is perhaps broader in scope and severe in impact than any recent crisis, volatility is an endemic problem for developing countries.
- Sources of volatility are mostly exogenous
- For low income countries, terms of trade and natural disasters are the main external sources of volatility
- For emerging markets, procyclicality and sudden stops are main external sources of instability

Terms of Trade Volatility and Shock Frequency, 1975-2005









Source: CGD Brief, " The Age of Turbulence and Poor Countries", October 2008

Architecture to Assist Low Income Countries Cope with Shocks Needs Reform

- Reform of IMF facilities are a positive step, but IMF does not have adequate concessional resources to meet scale of needs
- IDA also not adequately resourced and lacks quick response capacity
- Bilateral assistance fragmented and not well linked to IFI signaling and response
- Private philanthropy plays important role in response to natural disasters, but with uneven quality and accountability

MDB Role in Responding to Financial Crises

While the IMF is the focal point for the response to the systemic liquidity threat, the MDBs can play a critical complementary role in curtailing the spread and impact of the crisis:

- Financing for counter-cyclical fiscal measures targeted towards maintenance of jobs and protection of the poor
- Closing gaps and mitigating rollover risks in project financing including infrastructure, directly and by crowding in private and other official financing
- Catalyzing trade financing
- Supporting financial systems and credit flows to private sector and SMEs

Four Types of Incremental Financing Needs

- MDGs +
- Agriculture and Food Security
- Infrastructure
- Climate Mitigation and Adaptation

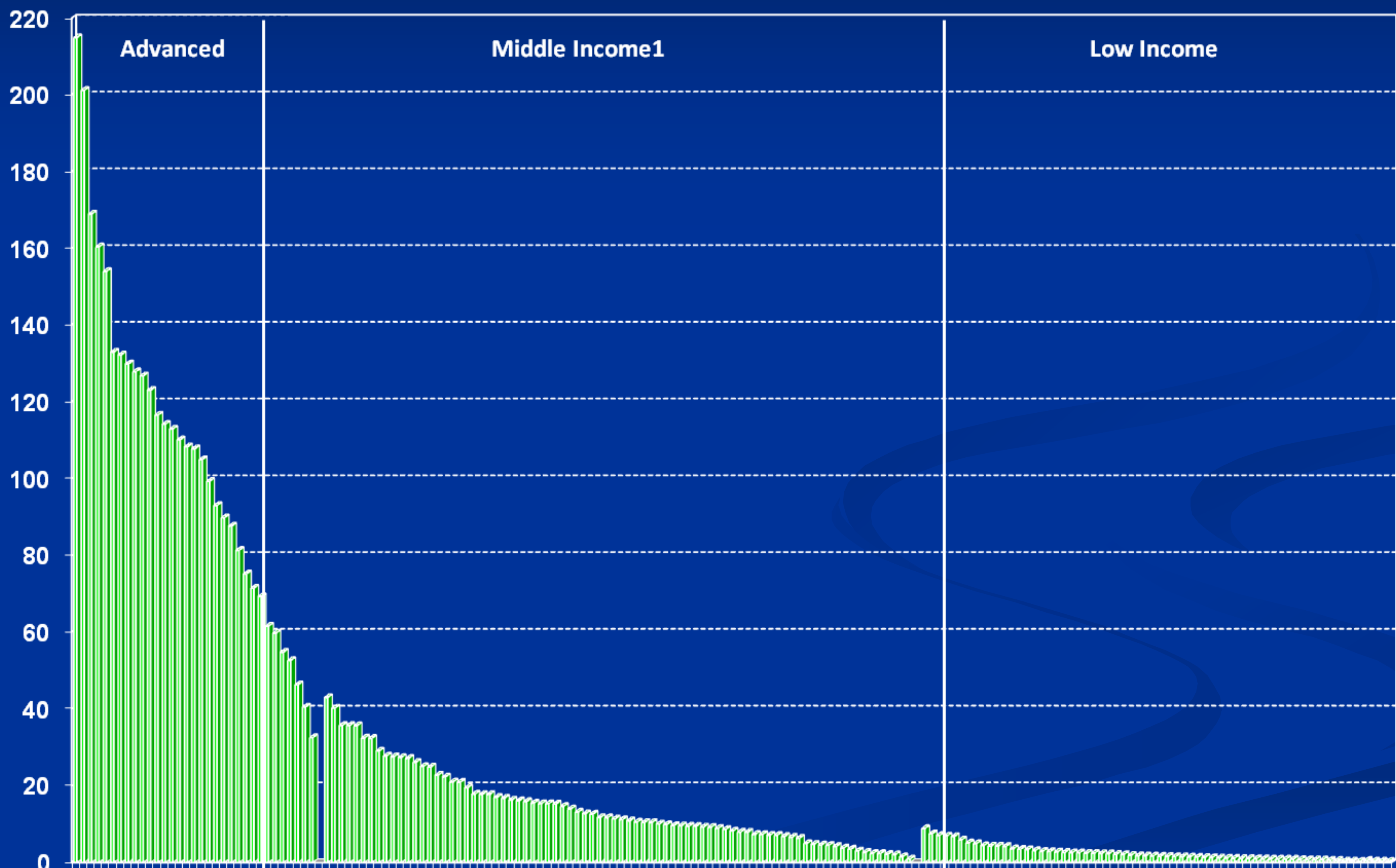
World Per Capita Income
(per day)

	Population (Billions)	Avg. Per Capita Income per day (Current US$)[1]	Proportion of World's Poor (Percent, %)
Advanced	1.0	104.9	0.1
Emerging Markets	4.5	12.3	77.8
Low Income	1.1	2.5	22.1

[1]Excluding Kuwait
Source: World Bank

Per Capita Income / day

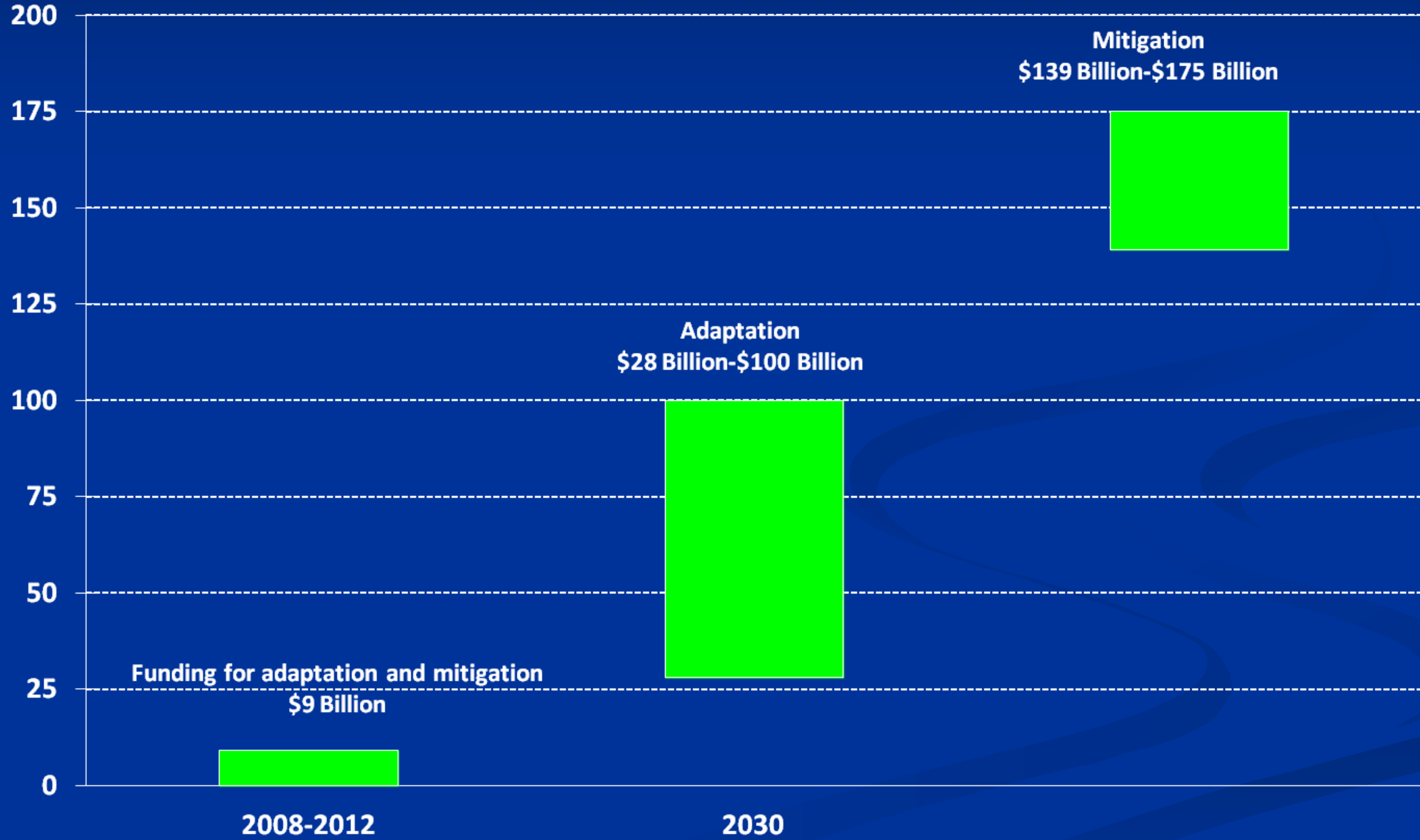
GNI per capita, (current US$)



[1]Excluding Kuwait

Source: World Development Indicators, World Bank

Estimate Annual Climate Funding Required for a 2ºC Trajectory Compared with Current Resources



Source: World Development Report, World Bank 2010

Incremental Financing Needs for Multipolar Growth and Development

($ billion)

	MDGs +	Agriculture/ Food Security	Infrastructure	Climate
Low Income	50-100	50-100	100-150	100-150
Emerging Markets	200-300	200-300	700-800	200-400

[1]Excluding Kuwait
Source: World Bank

Revitalizing the role of MDBs in Development Finance

- Development finance was in a process of change before the crisis:
  - A sustained process of economic growth *cum* financial and trade integration presented new opportunities for developing economies
  - Some were successful in expanding their participation in world trade, in widening their access to international financial markets and in reducing poverty as in accelerated trickle-down processes
- Clearly this create some justification for the shrinkage of the international multilateral systems and redirection:
  - Maintenance of lower levels of net transfers to developing economies
  - Redirecting flows from MICs to LICs, even though MICs continue to have the largest numbers of poor and development challenges
  - Opening new mandates for multilateral institutions: for instance climate change, governance and anti-corruption, gender equality, and so on
  - Tendency to count more on other sources of development finance
- The crisis changed substantially these trends

Development finance needs of a world in transition

- Challenges: old and new
  - Poverty and inequality still the main issues
  - Climate change and food prices hikes **<u>increase</u>** these challenges
  - For LICs the investment to overcome the problem of food security are keep
  - Need to overcome infrastructure gap fundamental for a multi-polar inclusive growth
  - **All that should indicate the need for <u>larger</u>, more flexible and more responsive MDBs (both in capital and concessional financing)**

However not still a priority…

- Capitalization of MDBs was below any reasonable target – particularly because of resistance of dilution from developed economies
- Replenishments of concessional windows was higher, but not that significant
- In the case of the WBG,
  - Words of the day: selectivity and graduation and
  - The business model is increasingly so that larger MICs play the role of net income providers (maturity and pricing) in exchange for more flexibility
- Whereas those who need the most (smaller MICs and LICs) continue with the *conditionalities as usual*

Therefore: developing countries should lead

- Pushing for the reopening of the discussion on recapitalization and on capital adequacy
- Reopen the discussion on voice and representation *and* corporate governance
- Open the discussion of the business model and the sustainability of concessional windows
- Start thinking of alternative multilateral arrangements, funded by developing countries (DC), to address the infrastructure gap
- The G-24 should take the lead in advocating for such alternative DC financing arrangements

Summing up 1

- The wave of financial crises and cycles in private market flows have highlighted the high costs of borrowing from private markets for development financing (for countries that relied on market financing, typical costs of 20-50 percent of GDP since 1995)
- MDBs can play a critical role in mobilizing long-term market financing through its direct borrowing and by catalyzing stable private sector financing, and reducing risks arising from potential shocks
- MDBs remain the most effective channel to provide concessional financing for low income countries, and the combination of market financing and concessional arms provide a powerful means for augmenting and leveraging financing for maximum development impact across the range of EMEs and LICs
- MDBs have not been able to play this role because of a lack of a collective vision and will, lack of agreement on key operational policies and safeguards, and a governance structure that is skewed against those that have the greatest stake in the institutions.

Summing up 2

- Grow the loan book to generate sustainable financing for concessional windows rather than mandate set levels of transfers.
- Introduce flexibility in debt sustainability frameworks and in mix of concessional and non-concessional financing.
- Move increasingly to output based measures to assess and allocate concessional aid.
- Commit necessary resources (capital, concessional funding) for MDBs to fulfill this mandate, including the ability to take on greater risk in their portfolios.