INTERGOVERNMENTAL GROUP OF TWENTY FOUR
G-24

Roundtable on Reforming the MDBs for The Challenges of the 21st Century
November 17, 2023

BACKGROUND

The virtual Roundtable focused on the progress on the Multilateral Development Banks (MDBs) reform agenda. Policymakers, distinguished development practitioners, esteemed members of think tanks, and academia delve into substantive discussions on the challenges and opportunities presented by the two main reform agenda, focusing especially on the unique needs and aspirations of the Global South. This summary of the discussions focuses on the key issues identified and the areas for further action.

SUMMARY OF PROCEEDINGS AND KEY MESSAGES

Panel 1: Capital Adequacy Framework (CAF) Reform Agenda

Speakers concurred that there is a significant shift in perception by the MDBs regarding the CAF reform proposal, from initial disapproval of the proposal to generally accepting it. This shift has significant implications for the MDB reforms, as almost all the CAF reforms are now on the agenda – at varying stages - of all major institutions, thanks to the unified and resolute stance of shareholders.

Key message

- ***Capital adequacy standards in MDBs.*** Unlike commercial banks, there is no regulator (such as The Basel Committee and National banking regulators) or standard on the level of capital adequacy that MDBs should aim for to cover risks. The collective efforts of MDBs, with the active backing of shareholders, can fix the problem. As an interim measure pending the initiation of Basel-type regulations, the MDBs can commit to a common framework including an annual joint report on benchmarks of capital adequacy across institutions based on the same methodology and the same indicators. Such a benchmark does not exist, or at least it is not shared.

- Credit Rating Agencies (CRA) should strive to gain a deeper understanding of the potential risks associated with the loan exposure of Multilateral Development Banks (MDBs). It is unlikely that MDBs will lose their triple-A rating because of changes to the CAF. The CAF report does not propose a downgrade of triple-A ratings, it aims to redefine the meaning of triple-A for MDBs. Callable capital, concentration risks and financial innovations such as hybrid capital, make MDBs even more resilient to the risk of a downgrade. Furthermore, unlike commercial banks, MDBs receive Preferential Creditor Treatment (PCT), which ensures they are always repaid. This is why MDBs require less capital to support their loans compared to commercial banks, and CRAs need to deepen their understanding of these issues.
- ***Execution follow-through.*** There is need for faster progress on the recommendation to have shareholders define risk appetite and account adequately for PCT. Faster progress is also needed on the issue of periodic capital review, every five years using comparable methodologies and data.

Panel 2: The G-20 Independent Experts Group Report (The Triple Agenda)

A key assumption is that even with balance sheet optimization based on CAF recommendations, MDBs still require **capital increase** in different ways across the regions since the resources from paid-in capital are relatively small. For example, the paid-in capital of the World Bank, since its establishment, has been able to generate more than 40 times its initial amount, but optimizing the balance sheet can increase lending capacity by only 15% of the current capital base and innovative instruments like hybrid financing have limits and constraints. This supports the need for capital increase to significantly increase lending capacity at the MDBs to achieve ambitious goals. Furthermore, the focus on both concessional and non-concessional financing also sets the Triple Agenda apart from the CAF.

Key message

- To increase lending to a diverse range of low and middle-income countries, MDBs, particularly the World Bank, must be held accountable for both concessional and non-concessional financing.

- A plan for a prospective capital increase should consider at least three years of intensive consultations, and it is crucial to ensure adequate representation of developing countries. The process of a capital increase for MDBs, particularly in WBG, will be a complex one. It will be challenging to reach a consensus not only on the volume of the increase but also on changes to the shareholding structures.
- Part of the greater ambition of MDBs must include improving the financing terms, such as managing foreign exchange risk, mainstreaming state-contingent instruments, and possibly extending maturities.
- Cooperation has increased among MDBs, but working together in a systematic way needs further work. Prioritization of convergence of standards and procedures among MDBs through country-led and country-owned platforms, creating project pipelines and sharing costs, like The Global Infrastructure Facility, could be useful.
- Reforms of MDBs should also address how expanding the borrowing capacity of client countries changes development outcomes. While sizing a development bank based on development and climate financing needs is quite appropriate and definitely ambitious, there are doubts about the absorptive capacity of countries to expand their investments since country programs do not scale up quickly for many reasons.
- At least one MDB has demonstrated that the use of SDRs as hybrid capital is feasible. Resolving the political and technical constraints to its implementation would further enhance the available financing for development and climate action.

Panel 3: Private sector capital option

In developing countries, the sectors with the highest investment gaps are those that are primarily funded by the private sector, and include energy, water, sanitation, infrastructure, food, and agriculture. Despite the progress of private investment mobilization in the last three years, only around 2% of the SDGs and climate investment needs was covered. The main challenge lies not in willingness of private sector investors, but often perceived risks in low and middle-income countries, which goes beyond their fiduciary and regulatory obligations.

Given its ability to combine lending and leveraging functions, MIGA has an important role to play in boosting private capital mobilization. While it has the potential to do close to double the current portfolio of US$25 billion (at same risk profile) without the need for more capital replenishment, its ambition is limited by the lack of a liquidity facility. Whenever MIGA's guarantees are called upon, the flow of investment comes to a halt during the arbitration period, a feature that many institutional investors find too risky. This creates a gap in the availability of funds, which can be detrimental to the investment process. One of MIGA's ongoing discussions is to create its own liquidity facility to deepen its ability to de-risk. Furthermore, internal reforms within the WBG would bring the guarantee programs under one roof to give it a really big impact.

Key message

- MDBs should be required to show performance on their annual commitments, and should actively distribute such reports to prospective investors.
- The governance structure of MDBs, DFIs, and ODA need to prioritize total investment and therefore mobilization at the risk level that investors will be prepared to invest in, if the $4 trillion investment gap is to be narrowed substantially. Currently, there is not a prioritization towards total SDG investment or substantially narrowing this SDG investment gap.
- There are challenges to de-risking for the ***MDB as a system*** as a whole, and these should not be underestimated.
- MDB reform analysis and reports would benefit from honest discussion of the political economy of change. An understanding of the drivers of change and the political economy that makes change succeed could improve understanding of where the challenges truly lie.
- Developing countries should be required to demonstrate high financial additionality.

Panel 4: Lending Operations, Governance and Country Engagement

The volume and scale of capital is important, considering the investment requirement for sustainable development and climate action in MICs and LICs. Ongoing discussions on the optimization of MDBs balance sheets based on the CAF review and proposals to introduce hybrid capital are welcome. General capital increase is the most powerful tool, and the process of capital increase puts forth a conversation about the direction, targets, and goals of the institutions, very valuable conversations that increase the voice of member countries. The affordability of capital is also important, especially in an environment of rising interest rates, which is making it hard for many LICs and MICs to keep net flows positive. Increasing concessionality would make it more affordable for countries to finance their development and invest in global public goods. This calls for a clear role for the advanced economies to step in to provide the necessary resources.

Lending and the pipeline of lending projects would benefit from better integration, but at the same time, the allocation of the resources should align with the institutional priorities of the World Bank, as contained in the eight global challenges, and the diverse challenges and priorities of each countries, which can be determined by listening to their needs. Ultimately, this approach will ensure that resources are used effectively and efficiently for the benefit of the people, and not just the preferences set through mechanism dedicated to one part of the mission or vision only.

A key issue that is missing from the reform agenda is what MDBs need to contribute to the reform of the global sovereign debt architecture. Many MICs borrow from MDBs at floating interest rates, and with global interest rates on the rise, mostly on account of policies of advanced economies, the cost of existing debt becomes an obstacle for many struggling economies. The conversation must center around providing affordable capital for development to support these countries and mitigate the risk of default. In this regard, levels of debt concessionality should be part of the discussion of reforming MDBs to keep financing development strategies and global public goods. The current legal debt restructuring frameworks, such as Common Framework (CF), need to include MDBs, since it explicitly calls on MDBs to develop options to share the burden of debt relief in a sustainable manner.

MDBs’ work on blending and de-risking capital to enhance private sector investment in developing countries needs to be put in proper context, because the effectiveness of the Public Private Partnership (PPP) model in providing public goods is subject to debate. The experience of the United Kingdom, which has been experimenting with the PPP framework for 30 years, has demonstrated that when it comes to delivering public goods, PPP projects can only achieve CCC ratings in the best scenario. If this mode of service delivery is to result in better outcomes for developing countries, the framework needs to be more robust and the monitoring more effective.

Key message

- Integrating the use of all funds, including trust funds, more effectively into the lending pipeline of MDBs can increase resource utilization efficiency, reduce bureaucratic costs, and avoid fragmented efforts.
- Lending operations at MDBs should show stronger country ownership, engagement, and be demand-driven. This will mitigate project risks and ensure that the benefits of the investments and resources are distributed fairly.
- Rethinking the debt architecture must be at the fore front of discussion. There are significant gaps in the debt restructuring process for developing countries under debt default or debt distress. Hence, appropriate rules and mechanisms must be established to ensure swift, fair, and efficient debt relief and MDBs should participate in ongoing debt relief initiatives. Moreover, debt relief would facilitate debt restructuring with other creditors such as China and private bond holders.
- Global south countries should develop peer learning platforms for learning about debt restructuring.
- SDR backed options like the Sustainable Future Bonds are contributing to improved liquidity at many central banks, and MDBs should consider participating.
- Ongoing interest in PPP type arrangements provide an opportunity to further illuminate global policy risks issues that impact on development financing. These include lending in domestic currencies by MDBs and incorporating exchange rates hedging mechanisms.
- The G20 Brazil 2024 policy priorities is welcome. The focus on inequality and distributional issues will have profound economic consequences.

Overall, the roundtable highlighted significant progress in MDB reform, but also emphasized the need for continued efforts to address ongoing challenges and ensure that reforms genuinely benefit developing countries.

Appendix

Moderator and Speakers

Moderator

Iyabo Masha, Director, G-24

Speakers

Chris Humphrey, Senior Research Associate, ODI and member of the G20 Panel on Independent Review of MDBs’ Capital Adequacy Frameworks

Nancy Lee, Director, Sustainable Development Finance and Senior Policy Fellow, Center for Global Development; member G20 Panel on Independent Review of MDBs’ Capital Adequacy Frameworks, member Technical Team of G20 The Independent Expert Group (IEG) on Strengthening Multilateral Development Banks: The Triple Agenda

Otaviano Canuto, Nonresident Senior Fellow, Brookings Institution, former Vice President, World Bank and IDB, and former Executive Director, IMF

Annalisa Prizzon, Principal Research Fellow, ODI, member Technical Team of G20 The Independent Expert Group (IEG) on Strengthening Multilateral Development Banks: The Triple Agenda

Marilou Uy, Senior Fellow, Global Development Policy Center, Boston University

Daouda Sembene, Distinguished Nonresident Fellow, Center for Global Development

Chris Clubb, Managing Director, Convergence Capital; former Director, European Bank for Reconstruction and Development’s (EBRD)

Junaid Kamal Ahmad, Vice President of Operations, Multilateral Investment Guarantee Agency (MIGA), world Bank Group

Cecilia Nahon, Executive Director, World Bank Group

Kevin Gallagher, Director, Global Development Policy Center, Boston University

Richard Kozul-Wright, Director, Globalization and Development Strategies Division, UNCTAD