



The Future of International Development Finance

Pieter Bottelier

Emerging Global Governance

Introduction

The system of Multilateral Development Banks (MDBs) as it has developed since the Bretton Woods conference of 1944 has performed better than is usually recognized. Partly because of the Bretton Woods institutions and the activities of *regional* MDBs that have emerged since the late 1950s, global inequality as measured by national average p.c. income across countries, has declined for the last four to five decades. However, in recent years the trend toward *convergence* has stalled or reversed for the poorest countries, probably including India.¹ Despite some earlier *convergence* of p.c. incomes, poverty, underdevelopment and excessive inequality remain serious problems in today's world. Although several of the world's fastest growing economies are now in Africa, the African continent as a whole remains terribly underdeveloped.

Some of the most striking underdevelopment- and poverty-related statistics are that 39 of the world's 75 poorest countries are in Africa, almost 800

million adults in the developing world are illiterate and 65% of abject poverty in the world is concentrated in middle-income countries, including China.² Inequality of opportunity, including racial- and sexual discrimination, remain some of worst forms of inequality in many parts of the world. MDBs and national development institutions must remain focused on reducing poverty and inequality, both within and between nations. The international community must ensure that there is a path to prosperity for all.

While much of the criticism of the World Bank³ and other MDBs (such as "mission creep" and insufficient understanding of political realities or social needs of client countries) is often justified, we should not lose sight of the fact that the Bretton Woods institutions (IMF and World Bank) brought important benefits that were not originally intended or envisaged, including:

1. A readily accessible pool of knowledge on development and best practices – before Bretton Woods

¹ See e.g. an article by Arvind Subramanian in the *Financial Times* of 20 April 2018, "Today's workers from catch-up nations face a tougher market."

² Various World Bank sources.

³ The term World Bank in this paper stands for World Bank Group. Where appropriate, individual members of the Group (IBRD, IFC, MIGA and ISCID) are identified.

such centralized pools of information were not available;

2. The role of the IMF and the World Bank in monitoring the effectiveness of economic institutions and -policies of member countries, as well as risks to financial stability;
3. The role of the IMF and the World Bank as arbiters and providers of economic information and -forecasts for member countries, regions and the world;
4. Standards (developed by the World Bank and other MDBs) for protecting the environment, ethnic minorities, the resettlement of people displaced by large infrastructure projects, etc. Such standards should be recognized as global public goods (GPGs) that probably would not otherwise exist;
5. Networks of former IMF and World Bank staff members who occupy leading positions in many countries around the world. This intangible benefit derives from the fact that those leaders understand the same “language”.

Finally, we should not forget that the World Bank and most other MDBs are indeed successfully providing large amounts of development finance. For example, IBRD and IFC together have turned \$19 billion of paid-in capital into over \$928 billion support (mainly loans) for development projects and programs in client countries (as a result of leveraging, loan repayments and retained

earnings), without ever mobilizing any “callable capital”. At the same time, they catalyzed almost \$1 trillion of private sector investments.⁴ Moreover, two new MDBs, the Asian Infrastructure Investment Bank (AIIB) in Beijing and the New Development Bank (NDB), created by the five BRICS countries and established in Shanghai, opened for business in 2016, supplementing the resource transfer capacity of twelve existing MDBs involved in (co)financing projects and programs in development countries.⁵

About the IMF, despite the change in its main function in 1971 when the US abandoned the Bretton Woods Gold-Exchange Standard, we can say with confidence that the institution has contributed to improved global welfare and financial stability while helping to redress financial crises that did occur.⁶

Multilateralism

The most urgent need for protecting and improving the existing system for international development assistance is *political* and *cultural* in nature, namely reviving the spirit of multilateralism that characterized earlier decades. The current US Administration seems to have turned its back on multilateral approaches to problem solving. The international community must push back hard on this, while guarding against the emerging popular backlash against *globalization* in the US and other developed countries. Since the US was the leader in the conceptualization and development of successful multilateral institutions after WWII, the Trump Administration’s anti-multilateral attitude is a matter of *international* concern. Although

⁴ Development Committee Document DC2018-0002 “Sustaining Financing for Sustainable Development”, April 21, 2018.

⁵IBRD, IFC, IDA, IADB, AfDB, AsDB, IsDB, EIB, EBRD, BSTDB, CAF, CDB.

⁶ It should be noted, however, that the IMF’s approach to crisis resolution during the Asian Financial Crisis of 1997-98, was very controversial in several East Asian countries.

China may emerge as a regional leader, there is at present no alternative country (or group of countries) able and willing to take over the US' global leadership role.

Successful multilateralism requires a willingness on the part of national governments to surrender small amounts of national sovereignty in the interest of promoting *global governance*. That's why and how the UN system (including especially the Security Council), IMF, World Bank, WTO, WHO, regional MDBs and various security-oriented treaties and –organizations (such as e.g. NPT and NATO) became such important institutions. Ideally, we should be working toward better *global governance* through multilateral institutions.

Global Public Goods (GPGs)

Even if “multilateralism” is not revived, the international community must do more to identify and develop GPGs, such as international financial stability, avoidance of armed conflict and harmful climate change, space exploration for peaceful purposes, capacity to deal with natural disasters, fight pandemics and the spread of communicable diseases, protecting endangered species, biodiversity and natural- or cultural heritage sites, promoting equal opportunity, creating administrative and financial capacity to resettle refugees etc.

It is worth considering whether the world needs a multilateral institution specializing in GPGs. I am inclined to say “no”. The various specialized UN agencies should continue to take the lead in identifying, developing and protecting GPGs, but MDBs must become more active in this critically important area through the provision of finance. The more

successful we are in promoting economic development, the more we'll realize how important it is to identify, develop and protect GPGs.

China's BRI

A major new factor in the world of international development finance is China's “Belt and Road Initiative” or BRI. It is potentially an extremely important development scheme; perhaps even more important than the highly successful US-sponsored Marshall Plan after WWII. At this stage, however, BRI remains a rather ill-defined program to build infrastructure (and promote the development of cultural bridges) across Asia, Europe and Africa. It is more a vision than a program. The vision is based on the idea that improved infrastructure connectivity often creates economic synergies and multiplier effects that benefit the development of countries and regions beyond narrow project investment returns. The idea is rooted in China's own development experience. BRI has predecessors in China's earlier “Going-Out” and “Go-West” policies.

A government-supported infrastructure-oriented development strategy is based on the well-known fact that long-term *public* returns on infrastructure investments are often much higher than short- term *private* returns.⁷ The gap may justify large-scale public investments when private commercial capital is not available or too expensive. Some cross-border infrastructure is like regional or even global public goods. Unless such projects are developed and financed by public sector agencies (based on international agreement), they will not materialize.

⁷ In US economic history, there are many examples of private companies that built and operated long-distance (including some transcontinental) railway companies that

went bankrupt, while longer-term national economic development benefitted greatly from those railway connections.

Since China has enormous capacity for and experience in infrastructure development, as well as financial resources to support a series of projects, BRI is potentially an economic game changer in Asia and beyond. However, some critics have argued that in reality, BRI is about enabling Chinese state engineering firms win construction contracts abroad, funded by loans from Chinese state banks to foreign governments. Others have warned that some beneficiary countries may become overly dependent on, and/or over-indebted to China. Be that as it may, BRI is gradually evolving from a *vision* to a series of *concrete project*.⁸

As there is no clear definition of what constitutes a BRI project, debates over the financial size of the program are largely meaningless. Whatever definition is used, the scheme is huge. Journalists' estimates range from \$1-8 trillion. The near-certainty that China's BRI is not only intended to promote economic development, but also Chinese influence in Asia and beyond, should not deter the international community from supporting the underlying *vision*.

It is important to note that some 80 developing countries are participating in, or have registered interest in, BRI, but that India is absent from that list. It fears to be encircled by China-dominated port projects around the Indian Ocean ("String of Pearls").⁹ The fact that Pakistan is one of the main beneficiaries of BRI and that part of the

⁸ Under BRI, several overland and maritime transport corridors are to be developed from China, to Southeast Asia, Russia, the Middle East, Northeast Africa and Europe. Arctic routes to Europe and North America have recently been added. More than a dozen BRI projects are already under implementation in Pakistan, Kazakhstan, Laos, Indonesia, Sri Lanka, Maldives, Turkey, Greece, Hungary and Serbia, while some 2,000 projects are reported to be on the drawing board. An upgraded, (electric) railway connection between Addis Ababa and Djibouti was opened in 2017.

China-financed Karakorum Highway in Northern Pakistan runs through the Aksai Chin (a border area disputed between India and China) may also have been reasons for India's decision to boycott the May 2017 "BRI Forum" in Beijing.¹⁰

China's future capacity to finance BRI projects may be limited by the country's expected economic slowdown; which is due in part to inadequate economic reform. Another risk is that poor BRI member countries may borrow too much and become over-indebted, especially to China.

The administration in China of BRI is still fragmented and opaque, but a recent government decision to create a central coordinating agency for foreign aid, including BRI-related investments, should improve the institutional/administrative framework. Apparently, standards for the design and implementation (including procurement) of BRI projects apparently do not exist at present.

MDBs and the mobilization of private commercial capital

There is undoubtedly room for expansion and improvement in the mobilization by MDBs of private commercial capital for projects and programs in developing countries. There is a risk, however, that this worthwhile objective is addressed in the wrong way (by giving too much priority to developing Wall Street connections). Much existing capacity for the

⁹ See for example "The Maritime Silk Road Initiative; Why India is Worried, What China Can Do" by Amitendu Palit, in Global Policy, 31 May 2017 9 (<https://www.globalpolicyjournal.com/blog/31/05/2017/maritime-silk-road-initiative-msri-why-india-worried-what-china-can-do>)

¹⁰ The Forum was attended by 29 heads of state, including Russia's Putin, while 63 other countries and many international agencies were represented.

mobilization of private commercial capital is underutilized. For example, many MDBs can guarantee private sector loans for development, but seem to be reluctant to use that capacity. Similarly, it should be possible to increase the availability of MDB financial resources for development through the sale of more of their own loan portfolios to private investors. The role of IFC (IBRD's subsidiary providing unguaranteed loans and equity for private sector projects in developing countries) can and should be enhanced. The World Bank's capacity to mobilize commercial capital for developing countries can also be enhanced through a more intensive use of ICSID (International Centre for the Settlement Investment Disputes) and MIGA (Multilateral Investment Guarantee Agency).

MDBs and the promotion of private non-commercial capital and development support¹¹

It would be equally or more important for MDBs to mobilize additional private *non-commercial capital* from private charities and philanthropic foundations. This would increase their capacity for providing grant financing to poor clients and support the development of GPGs. Private charities and philanthropic foundations have become very important for development in poor countries, but some lack capacity to prepare and prioritize projects.

Before considering whether they can meaningfully support such private non-commercial development assistance, MDBs should observe and learn from such activities more systematically. This also applies to the

¹¹ There are hundreds of private Charities and Philanthropic Foundations in OECD countries engaged in development work in developing countries. Many make important contributions, especially in agriculture and human development (including family planning and disease control). Some of the larger and more experienced ones are the Bill

activities of numerous small NGOs in OECD countries engaged in buying certain goods (e.g. coffee, handicrafts, handmade clothing) in developing countries for resale in developed markets. Some of those NGOs might benefit from some form of official or quasi-official assistance, e.g. marketing advice, finance or insurance. Some MDBs may be able to provide assistance to private NGOs, thus enhancing their overall development effectiveness. This needs to be explored.

World Bank Group (WBG)

The World Bank is the oldest, largest and still in many ways the most important of the MDBs. The WBG provides the most capital to developing member countries and many services to both developed and developing member countries as well as other MDBs. Most of those services are in the form of advice, information and standards.

For the future of international development finance, it is extremely important that the World Bank remain a vibrant leadership institution that is respected by other MDBs, national governments and their agencies, as well as private non-commercial organizations involved in development assistance.

While the provision of a wide range of non-financial services to the international development community is critical, the World Bank should never lose the capacity to undertake large and complex investment/development projects in poor countries, including infrastructure. It lost its leading position in infrastructure many years ago, but is now working on recovering it. The

and Melina Gates Foundation, the Ford Foundation, the Rockefeller Brothers Fund, the Aga Khan Foundation and the Global Alliance for Improved Nutrition. For an overview of the development work of such Charities and Foundations, see *Philanthropic Foundations and Development Co-operation*, OECD DAC Journal Volume 4, No.3, 2003.

WBG should also be able to design and support complex *institutions* needed for sustainable development such as urban transportation systems, water supply and/or waste-water treatment projects, etc.

Given the World Bank's position as the world's premier multilateral development institution, it is extremely important that the quality of its intellectual work (including country economic- and sectoral studies, regional and global economic studies and general perspective studies) is of the highest standard. Some say that the World Bank's role as a store of development knowledge and experience is now more important than its financial role. In practice the two roles are, of course, closely linked and cannot be separated.

It is heartening that World Bank President Kim's proposal for a major increase in the World Bank's paid-in capital was approved by shareholders on 20 April 2018.¹² Together with the very successful IDA18 replenishment (completed in 2017), these increased capital contributions from shareholders will enable the World Bank to almost double its annual financial commitments to developing member countries (mainly IBRD loans, IFC loans and equity investments, and IDA credits/grants (to around \$100 billion) through 2030.¹³

¹² The US contribution to the agreed \$13 billion increase in paid-in capital (\$7.5 billion for IBRD and \$5.5 billion for IFC) is subject to approval by Congress. (The capital increase, which is a combination of a *general*- and a *selective* capital increases – to allow for the adjustment of the voting power of China and some other member countries - was initially resisted by the Trump administration).

¹³ "World Bank Group Shareholders Endorse Transformative Capital Package", World Bank press release, 21 April 2018 and "Transfer of Real Resources to Developing Countries", press release of the Development Committee, 21 April 2018.

In my opinion, high priorities for improving the overall development effectiveness of the World Bank are:

1. As "knowledge" is probably the single most important factor driving development, ensure that the quality of its intellectual work remains top-notch;
2. Increase financial flows to developing member countries by using existing facilities and institutions more fully, by selling more of its loan portfolio to private investors and by catalyzing more private commercial and non-commercial capital;
3. Increase the grant component of its financial assistance to poor developing member countries;¹⁴
4. Promote the identification, development and financing of GPGs through its own effort and through the encouragement of other MDBs, specialized UN agencies and national aid agencies;
5. Monitor and learn from the activities of private non-commercial organizations (including NGOs, charities and philanthropic foundations) engaged in providing development assistance to poor countries.

¹⁴ The 18th replenishment of the International Development Association or IDA (the World Bank's soft loan- and main grant facility) was successfully completed in 2017. A record \$75 billion (SDR 54 billion) was pledged for commitments during the period July 1, 2017 – June 30, 2020). Several developing countries that received IDA assistance in the past have become donors to IDA. For example, China, which ceased to be eligible in 1999, contributed SDR428 million to IDA18 (almost 20% of Japan's contribution, typically the second largest after the US'). Grant contributions by IBRD have remained small, but will probably be increased (from expected private donations) in the years ahead.

The World Bank shareholders have just approved a transformative capital package¹⁵, including major increases in the paid-in capital of IBRD and IFC. This, together with the record IDA18 replenishment that was completed in 2017, the successful recent launch of IDA on capital markets and the expansion of MIGA¹⁶ resources, should enable the world's premier multilateral development institution to significantly increase financial assistance to developing member countries.

Concluding Remarks

Improvements in the system for international development finance are needed and possible, but there is in my view at present no need for fundamental change. In my view, the most urgent needs for systemic improvement are:

1. Revive the spirit of multilateralism of earlier decades;
2. Establish a deliberate institutional framework for the identification, development and financing of GPGs;
3. Use MDBs more effectively for the mobilization of private capital (both commercial and non-commercial) for development;

4. Increase the availability of grant financing for the preparation of development projects in very poor nations and at the provision of GPGs;
5. Monitor and consider making available official assistance to eligible NGOs and other private organizations engaged in development assistance to poor countries;
6. Abandon the tradition that the Managing Director of the IMF should be a European and the President of the World Bank an American. Those key positions, when vacant, should be open to qualified candidates from all member countries.

Pieter Bottelier was Adjunct Professor of China Studies, Johns Hopkins SAIS, 1999-2015; World Bank career, 1970-1998; Chief of the World Bank's resident mission in China, 1993-1997. The author thankfully acknowledges helpful comments on a draft version of this paper from Carla Freeman and Gregory Chin. This Essay is written for The Johns Hopkins University SAIS project on "The Future of Global Governance", and the Emerging Global Governance (EGG) program.

¹⁵ Development Committee meeting in Washington DC, 20 April 2018. The package approved includes general and selective capital increases (permitting adjustments in the voting power of China and some other member countries), loan pricing reforms and other measures to increase the

effectiveness of the World Bank. (The US capital contribution is subject to approval by Congress).

¹⁶ The World Bank's Multilateral Investment Guarantee Agency.