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Creating a Twenty-first-Century Business Model for the IBRD

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As of late February 2018, the World Bank Group is seeking a capital increase from its shareholders for the International Bank for Reconstruction and Development (IBRD), the lending arm of middle-income countries, and for the International Finance Corporation (IFC), the World Bank Group's private-sector arm. This paper focuses primarily on a potential capital increase for the IBRD because most of the attention will be on the IBRD. If the capital increase is approved, it would represent an almost immediate follow-on to the IBRD capital increase of 2010, when the IBRD received an additional $5.1 billion in paid-in capital from shareholders that allowed an $86.2 billion increase in callable capital.[1] This new request also comes at a time when the World Bank's shareholders recently agreed to the 18th replenishment for the International Development Association (IDA)—that is, "IDA-18." The recent IDA-18 replenishment is instructive for the World Bank's new IBRD request: as part of the negotiations, shareholders sought and received several reform pledges including greater commitments for the IDA funds to leverage the private sector and to work more in fragile states. Any capital increase should not dilute U.S. shareholding or U.S. leadership of the World Bank Group as the United States has traditionally played an important role in making the institution a more effective and accountable organization. It is unclear whether a capital increase is needed now for the World Bank Group and for IBRD and IFC in particular, and shareholders are right to question whether the IBRD and IFC need more capital and how it would use additional capital. Key questions to consider are:

1. Is a capital increase by shareholders the only way the IBRD could generate additional financing for lending?
2. If a capital increase is necessary, then what reforms should shareholders ask for in return?
3. How will the IBRD deploy the additional resources secured through a capital increase?

Why a capital increase now? In many ways, it can be argued that this capital increase is inappropriate: IBRD received a capital increase in 2010 and there is likely still room to leverage the existing capital of the IBRD and IDA. IDA will likely see a potential windfall of money over the next 10 years as low-income countries graduate from its financing window and under IDA-18, the Bank can now borrow

[1] World Bank, "World Bank Reforms Voting Power, Gets $86 Billion Boost," April 25, 2010, http://www.worldbank.org/en/news/press-release/2010/04/25/world-bank-reforms-voting-power-gets-86-billion-boost.

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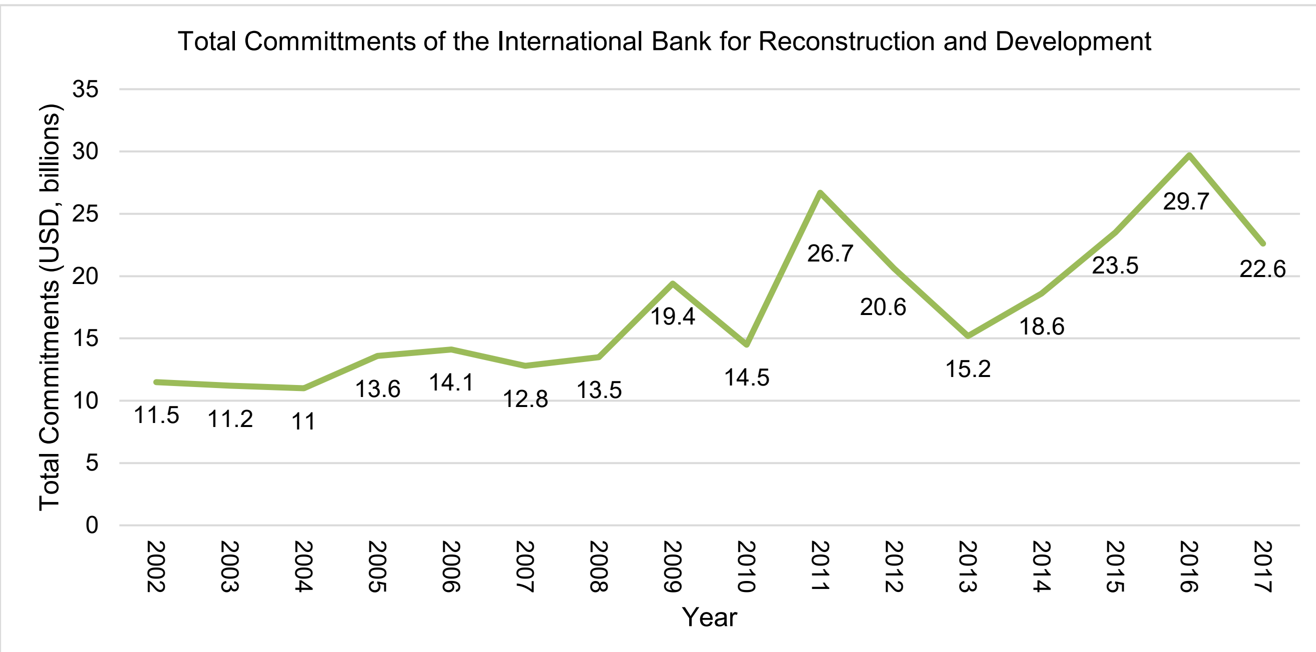
against its flows allowing for a further 50 percent increase in its resources. In 2010, the World Bank argued that it needed to replenish IBRD's resources following an increase in its lending during the global financial crisis.[2] The Bank noted that this counter-cyclical lending was vital to helping stem the impact of the crisis in emerging and developing market countries. The 2010 capital increase represented the first time that the World Bank had asked for additional capital for the IBRD. At the time this was a reasonable request, but no such existential issue currently exists that would warrant a similar request. The reality is that the World Bank faces a lending "cliff" where at some point in the near future it will hit its IBRD credit card limit and IBRD will be forced to lend less to its IBRD clients as a result. This cliff is of its own making: it has continued to lend at a high volume and not fundamentally adjust the number of countries to which it lends.



Source: World Bank Annual Reports 2002–2017.

The current request stems in part from a realization that the number of countries that will be IBRD eligible will dramatically increase in the coming years; by one estimate, half of all IDA countries will "graduate" and become IBRD-eligible by 2025.[3]

[2] Ernesto Zedillo Commission, *Repowering the World Bank for the 21st Century: Report of the High-Level Commission on Modernization of the World Bank Group Governance* (Washington, DC: World Bank, October 2009), http://siteresources.worldbank.org/NEWS/Resources/WBGovernanceCOMMISSIONREPORT.pdf.

[3] Todd Moss and Benjamin Leo, *IDA at 65: Heading Toward Retirement or a Fragile Lease on Life?* (Washington, DC: Center for Global Development, March 2011), https://www.cgdev.org/sites/default/files/1424903_file_Moss_Leo_IDA_Retirement_FINAL.pdf.

List of Countries Currently Eligible to Borrow from IDA[4]

Afghanistan	Gambia	Marshall Islands	Solomon Islands
Bangladesh	Ghana	Mauritania	Somalia
Benin	Grenada	Micronesia	South Sudan
Bhutan	Guinea	Moldova	St. Lucia
Burkina Faso	Guinea-Bissau	Mongolia	St. Vincent
Burundi	Guyana	Mozambique	Sudan
Cambodia	Haiti	Myanmar	Syria
Cameroon	Honduras	Nepal	Tajikistan
Cape Verde	Kenya	Nicaragua	Tanzania
Central African Republic	Kiribati	Niger	Timor-Leste
Chad	Kosovo	Nigeria	Togo
Comoros	Kyrgyzstan	Pakistan	Tonga
Congo	Laos	Papua New Guinea	Tuvalu
Cote d'Ivoire	Lesotho	Republic of the Congo,	Uganda
Dem. Rep. of the Congo	Liberia	Rwanda	Uzbekistan
Djibouti	Madagascar	Samoa	Vanuatu
Dominica	Malawi	Sao Tome and Principe	Yemen
Eritrea	Maldives	Senegal	Zambia
Ethiopia	Mali	Sierra Leone	Zimbabwe

The current president of the World Bank, Jim Yong Kim, noted in a recent speech that for IBRD to maintain its current levels of lending and meet the coming demand, more capital is needed.[5] It is not clear what the exact amount Kim is seeking, but sources point to as much as an additional $10 billion of paid-in capital for the IBRD, which would require the United States to provide $1.7 billion based on its ownership share of the IBRD.[6] This assumes, though, that there will be no corresponding decrease in the number of IBRD-eligible countries as they graduate.

The request also stems from a potential desire to evolve the IBRD and broader World Bank Group into a lender for so-called development-related "global public goods"—frequently defined as climate change, pandemics, migration, and other broad shocks to the international system.[7] The World Bank plays a role on each of these issues. For example, after the Ebola pandemic in West Africa, the World Bank provided the governments of Liberia, Sierra Leone, and Guinea with critical financing to get

[4] World Bank, "World Bank Country and Lending Groups," https://datahelpdesk.worldbank.org/knowledgebase/articles/906519-world-bank-country-and-lending-groups.
[5] World Bank, "World Bank Group President Jim Yong Kim Speech at the 2017 Annual Meetings Plenary," October 13, 2017, http://www.worldbank.org/en/news/speech/2017/10/13/wbg-president-jim-yong-kim-speech-2017-annual-meetings-plenary-session.
[6] U.S. Agency for International Development (USAID), *The Enterprise Funds in Europe and Eurasia: Successes and Lessons Learned* (Washington, DC: USAID, September 2013), https://www.usaid.gov/sites/default/files/documents/1863/EE_Enterprise_Funds-LessonsLearned.pdf.
[7] Nancy Birdsall and Scott Morris, *Multilateral Development Banking for This Century's Development Challenges* (Washington, DC: Center for Global Development, October 2016), https://www.cgdev.org/sites/default/files/multilateral-development-banking-report-five-recommendations.pdf.

List of Countries Currently Eligible to Borrow from IBRD[8]

Albania	Dominica	Malaysia	Seychelles
Algeria	Dominican Republic	Mauritius	South Africa
Angola	Ecuador	Mexico	Sri Lanka
Antigua and Barbuda	Egypt	Moldova	St. Kitts and Nevis
Argentina	El Salvador	Moldova	St. Lucia
Armenia	Equatorial Guinea	Mongolia	St. Vincent & Grenadines
Azerbaijan	Fiji	Montenegro	Suriname
Belarus	Gabon	Morocco	Swaziland
Belize	Georgia	Namibia	Thailand
Bolivia	Grenada	Nauru	Timor-Leste
Bosnia and Herzegovina	Guatemala	Nigeria	Trinidad and Tobago
Botswana	India	Pakistan	Tunisia
Brazil	Indonesia	Palau	Turkey
Bulgaria	Iran	Panama	Turkmenistan
Cabo Verde	Iraq	Papua New Guinea	Ukraine
Cameroon	Jamaica	Paraguay	Uruguay
Chile	Jordan	Peru	Uzbekistan
China	Kazakhstan	Philippines	Venezuela
Colombia	Kenya	Poland	Vietnam
Congo, Rep.	Lebanon	Romania	Zimbabwe
Costa Rica	Libya	Russia	
Croatia	Macedonia	Serbia	

their economies moving again. This is entirely reasonable and was done through existing country programs of the World Bank. Expanding the Bank's mission so dramatically seems inappropriate when so many countries are on the cusp of success and will need the Bank's resources to secure their own development successes. Moreover, there are many other organizations that may be better positioned to lead on the provision of global public goods.

In considering any capital increase or IBRD reforms, it is also important to note that the international development landscape is changing radically. Many developing countries are moving up the development ladder and are richer, freer, and more self-sufficient. There is now more private capital flowing into emerging and developing markets than in 1990: foreign direct investment to these countries has increased 10 times, from $60 billion in the mid-1990s to over $650 billion in 2016.[9] There is little remaining disagreement that the private sector plays a central role in driving economic growth and prosperity around the world. Those interested in development finance are now focused on the "billions to trillions" agenda where foreign aid is now see as a "catalyst" to mobilize additional

[8] World Bank, "World Bank Country and Lending Groups."
[9] UN Conference on Trade and Development (UNCTAD), *World Investment Report 2017: Investment and the Digital Economy* (New York: United Nations, 2017), http://unctad.org/en/PublicationsLibrary/wir2017_en.pdf.

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resources such as private capital and a country's own domestic resources (e.g., taxes, other government revenue, and local savings).

There are now competitors to the existing multilateral development banks, primarily in the form of China's new banks: the New Development Bank (NDB) and the Asian Infrastructure Investment Bank (AIIB). These institutions are both competing with and complementing the work of the traditional (Bretton Woods) Multilateral Development Banks (MDBs). The NDB is currently limited to projects in its five-member countries (Brazil, Russia, India, China, and South Africa), although there are other countries reportedly interested in joining. The AIIB, though, attracted 57 countries (including close U.S. allies) and with a total capital of $100 billion, eventually providing between $10–$15 billion per year in financing.[10] This new landscape means that if shareholders' and borrowers' needs are not met by the World Bank Group, the stakeholders can take their business and their money to capitalize new ventures to competitors.

How should the World Bank and other MDBs react to this changing landscape? How will these changes impact the World Bank's development objectives? What are the changes or reforms needed in IBRD's business model (and by extension other MDBs) to become more sustainable? The proposed capital increase is an opportune moment for World Bank shareholders to consider these questions. **Rather than simply provide additional capital to the IBRD, shareholders should demand that the World Bank undertake reforms that will ultimately create a new twenty-first-century business model for the IBRD.** This paper presents a series of reforms that are needed at the IBRD as part of any conversation around a future capital increase, but also provide an alternative to simply providing the IBRD with more capital. There are five main areas to consider:

1. "Sweating capital" or balance sheet optimization to produce additional capital without a shareholder capital increase.
2. Differentiation loan pricing and graduation of countries.
3. Shifting of focus areas to be more demand driven.
4. Improved coordination of MDBs and identification of comparative advantage. Shift functions from IBRD to regional development banks where appropriate.
5. Governance and internal process reforms.

[10] Hai Yang, "The Asian Infrastructure Investment Bank and Status-Seeking: China's Foray into Global Economic Governance," *China Political Science Review* 1, no. 4 (December 2016): 754–778, https://link.springer.com/article/10.1007/s41111-016-0043-x.

Reforms

1. Leverage Existing Capital

A capital increase for the IBRD assumes that the IBRD is maximizing its existing balance sheet. Although IBRD management claims that it cannot do more with its balance sheets, many shareholders believe IBRD is overly conservative and can do more to make better use of its existing capital to borrow and lend to its members. IBRD's AAA ratings allows the institution to borrow in the international market at inexpensive rates. Loosening capital adequacy metrics within prudent bounds and without risking the AAA ratings would allow the IBRD to increase its loan size. IBRD could lower its equity-to-loan (E/L) ratio to increase its lending capacity. Healthy commercial banking institutions have E/Ls that range between 10–15 percent. Although no one advises lowering the E/L to commercial levels, IBRD has room to bring down its E/L ratio, which currently stands at 23 percent to around 19 percent.

Other "sweating the capital" measures proposed by the G20 include exposure exchanges—financial innovations using concessional windows (as ADB and IDB recently underwent) and instruments that share risk in its non-sovereign operations with private investors, such as syndications, structured finance, mezzanine financing, credit guarantee programs, hedging structures, and equity exposure. For example, to increase its capital, the ADB merged its concessional window (Asian Development Fund) with its regular non-concessional window. This is projected to increase ADB's annual commitment from around $23 billion per year to $40 billion.

Any conversation about "sweating capital" should consider the resources that IDA will accrue as countries graduate and pay back their IDA loans. Although it is unclear how much and when this money would materialize, the World Bank should consider whether the money could be used to strengthen IBRD—a reverse of current practices, where IBRD's earnings are frequently used to shore up IDA—or to establish a bridge facility that would help countries move from IDA to IBRD similar to the recently created IFC-managed private-sector window included as part of IDA-18. At the very least, it is worth exploring whether IBRD and IFC should reduce their current transfers to IDA. The World Bank Group needs to put forward a more comprehensive and holistic capital framework that incorporates the needs and resources across each of the separate institutions.

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2. Pricing of Loans and Graduation

List of Top IBRD 10 Borrowers and Their Interest Rates on International Bond Market 10-year Government Bond Yield

Rank	Country	Interest Rate
1	Indonesia	6.52%
2	Brazil	9.72%
3	Mexico	7.61%
4	China	4.10%
5	India	7.68%
6	Turkey	5.75%
7	Colombia	6.53%
8	Poland	3.42%
9	Egypt	14.25%
10	Argentina	5.96%

Sources: Bloomberg Markets, Asian Development Bank.

All IBRD borrowers pay the same rates, regardless of a country's ability to raise funds on the international capital markets or ability to finance through domestic borrowing. IBRD loans are priced at the London Inter-Bank Offered Rate (LIBOR) plus a certain additional percentage based upon the maturity of the loan (the shorter the term, the lower the rate). For many top borrowers this results in a significant discount between what they pay on the capital markets and what they pay the IBRD. Although the focus here is frequently on China, there are several countries that borrow from the IBRD that have large economies that may not need the volume of IBRD loans they currently receive. Introducing price differentials that would raise the cost of borrowing for those countries that can more easily access the capital markets while maintaining a concessional rate for others is one solution. This would also have the effect of generating additional revenue for the IBRD that could be deployed for other priorities or to support the IDA.[11] This idea is not new nor is it radical—nearly every World Bank reform report since 2001 recommended changing IBRD's lending practices in some way. At the very least, upper-middle-income countries should borrow from the IBRD at a higher rate than lower-middle-income countries.

This is also tied to the Bank's graduation policy; to make room for the IBRD-eligible countries, the World Bank needs to consider its policy of graduation. At present, the IBRD states the following:

> According to World Bank policy, countries remain eligible to borrow from the International Bank for Reconstruction and Development until they are able to sustain long-term development without further recourse to Bank financing. Graduation from the Bank is not an automatic consequence of reaching a particular income level, but rather is supposed to be based on a determination of whether the country has reached a level of institutional

[11] Nancy Birdsall, "Getting to Yes on a World Bank Recapitalization," Center for Global Development, November 11, 2017, https://www.cgdev.org/blog/getting-yes-world-bank-recapitalization.

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development and capital-market access that enables it to sustain its own development process without recourse to Bank funding.[12]

This policy is far too ambiguous, creating an opening for countries that are clearly on the path to "sustain" their "own development process without resource to Bank funding" to remain long after that is true. The IBRD should identify ways to reduce these countries' borrowings through targeted capacity-building activities that would allow access to other sources of capital (e.g., international capital markets and domestic resources). This is also not a radical notion; most World Bank reform reports have identified graduation as being a needed reform to ensure the sustainability of the IBRD. The Volker-Gurria Commission suggested that the standard should remain "voluntary," but incentives must exist.[13] One such incentive is differential pricing of loans.

IBRD Top 10 Borrowers (commitments that year, in USD millions)

2005		2010		2015	
China	1,277	Brazil	5,400	Egypt	2,450
Turkey	1,232	Mexico	4,772	Ukraine	2,105
Colombia	953	South Africa	3,750	India	1,448
Mexico	921	Indonesia	3,010	Morocco	1,405
Brazil	851	Turkey	2,960	China	1,371
Indonesia	770	India	2,034	Argentina	1,337
Iran	688	Egypt	1,855	Colombia	700
Romania	619	China	1,774	Tunisia	700
Ukraine	543	Kazakhstan	1,124	Mexico	500
Morocco	466	Philippines	744	Indonesia	500

Source: World Bank Data (data.worldbank.org).

To be sure, establishing a firm graduation policy is not an IBRD-only issue. Most of the other MDBs have ambiguous graduation requirements or, in the case of IDB, no formal graduation policy. When graduation and the IBRD is raised, most commentators immediately consider China's continued borrowing from the IBRD: China borrows approximately $2 billion per year from IBRD and currently owes nearly $14 billion to the IBRD.[14] This is despite large foreign exchange reserves, a gross national income (GNI) per capita of $14,000, large volumes of foreign direct investment, and the ability to easily tap the international capital markets. Beyond China, there are several upper-middle-income countries (e.g., Brazil, Turkey, Mexico, Argentina, and Kazakhstan) that borrow significant quantities from the IBRD and should be considered for graduation. This will free up space not only for new IBRD-eligible countries, but also for countries that remain further down the per capita income scale and continue to struggle with large pockets of poverty. And as David Malpass, undersecretary of the

[12] Jac C. Heckelman, Stephen Knack, and F. Halsey Rogers, *Crossing the Threshold: An Analysis of IBRD Graduation Policy* (Washington, DC: World Bank, January 2011), http://documents.worldbank.org/curated/en/244791468147851867/pdf/WPS5531.pdf.
[13] Carnegie Endowment for International Peace, "Volcker/Gurria Commission Urges World Bank Not to End Financing for Middle-Income Countries," press release, April 26, 2001, http://carnegieendowment.org/2001/04/26/volcker-gurria-commission-urges-world-bank-not-to-end-financing-for-middle-income-countries-pub-8792.
[14] Birdsall, "Getting to Yes on a World Bank Recapitalization."

treasury, recently noted in congressional testimony, "The World Bank's success should be marked by the number of countries that eventually graduate from borrowing altogether."[15]

3. IBRD Focus Areas

Two areas of increased focus for the IBRD would be welcome as part of any reform package: a move to provide subnational lending and a greater focus on fragile states.

> **Subnational lending:** For the first time in recorded history, more than 50 percent of the world lives in urban environments.[16] This was not true when the IBRD was set up and accordingly it has focused on sovereign lending; however, times change and in the coming years urban environments will need improved infrastructure (transportation, water and sanitation, etc.) and improved capacity. Often because of internal governing structures, these cities lack access to reliable sources of financing to support these projects. The IBRD should have additional capacities to make loans and provide advice to subnational governments (municipalities, provinces, or states) to help fill this gap, as well as build the capacity of local governments.
>
> **Fragile states:** As part of the IDA-18 replenishment, the World Bank agreed that it would improve its ability to work in fragile states, especially those that are IDA-eligible.[17] There are several fragile states that are IBRD eligible. The IBRD can and should do more in these contexts, especially from a reconstruction perspective post-conflict. The IBRD needs a different set of instruments, incentives, approaches, and people to work in these environments. From an organizational perspective, the World Bank should appoint a vice president for fragility and a "Vice Presidential Unit" that coordinates across the World Bank Group. In addition, the Bank needs to adopt a clear definition of what is and what is not a fragile state in order to ensure that financing goes to those fragile states most in need of support.

4. Coordination among MDBs

The World Bank needs much closer partnerships with the regional development banks, especially the African Development Bank (AfDB) and the Asian Development Bank (ADB). In 2000, the Meltzer Commission recommended a phasing out of activities that overlap between the World Bank and regional development banks, especially in higher-income countries. The World Bank should revisit whether to continue to play an overlapping financing role in countries where the ADB and IDB provide significant lending on their own. In these cases, the IBRD should continue to provide access to intellectual capital (e.g., policy and regulatory reform) but should very quickly reduce its lending footprint on the assumption that regional development banks will take on more of the direct

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[15] U.S. Department of Treasury, "Statement to the Subcommittee on Monetary Policy and Trade House Financial Services Committee," August 11, 2017, https://www.treasury.gov/press-center/press-releases/Pages/sm0211.aspx.
[16] World Bank, "Urban population %," https://data.worldbank.org/indicator/SP.URB.TOTL.IN.ZS.
[17] International Development Association (IDA), "Special Theme: Fragility, Conflict and Violence," May 31, 2016, http://documents.worldbank.org/curated/en/652991468196733026/pdf/106182-BR-IDA18-Fragility-Conflict-and-Violence-PUBLIC-IDA-R2016-0140.pdf.

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development financing of middle-income countries in their region. This also offers another graduation option for the IBRD: end lending to upper-middle-income countries with the understanding that they can continue to borrow from their regional development bank to meet remaining development challenges. Though under this structure, the regional development banks should set clear guidelines for graduation for the upper-middle-income countries that would continue to borrow. This would be especially helpful for Mexico, Brazil, Argentina, and Turkey.

In this regard, the IBRD needs to expand and revisit its "fee for services" advisory approach in these contexts, similar to what it does in Saudi Arabia and other wealthy Arab countries. Some middle-income countries are more interested in receiving advice than money from the IBRD and other MDBs and thus the MDBs should consider expanding their provision of advisory services. At present, the MDBs provide most of their advisory services as part of a broader financing package. The IBRD needs to explore and expand new business models for leveraging knowledge through the provision of direct advisory services.

5. Bank Governance and Internal Reforms

There are significant "principal/agent" problems at the World Bank Group. At the operational level the shareholders have limited ways to influence management and promote accountability. Several trends in the future are going to make this even harder. The IDA replenishment process has been an important way for shareholders to influence the management of the World Bank Group, but will likely diminish in importance as IDA shrinks. The size and structure of the current executive director board and the information asymmetry makes it difficult to hold executive vice presidents that run major parts of the organization accountable. In short, shareholders will need new ways to hold the World Bank's senior management accountable and demand other ways for management to be responsive to its shareholders and its shareholders' representatives: the board of directors.

If upper-middle-income countries accept pricing differentials for loans, then shareholders should consider how to increase their participation in ownership and leadership of the Bank. Some redlines should include that the United States retains the presidency of the World Bank as its largest shareholder, and that its overall stake should not be diluted below its ability to veto changes to the IBRD articles.

Finally, shareholders should seek reforms to staffing, resource allocation, and other personnel policies to make the IBRD leaner and efficient. This would include a review of all senior staff positions with an eye toward cutting any that are redundant and a review of existing country offices and whether these could be closed to generate savings.

Conclusions

Part of the debate around the need for a capital increase for the IBRD is driven by the question of what role should the IBRD—and World Bank Group—play in the next 15 years? The World Bank Group should remain a bank working with IDA and IBRD countries and largely respond to client-driven demands such as infrastructure, energy, and power. There are other approaches to dealing with

global public goods and the World Bank Group should not be taking on "mission creep" for global public goods. There are some—including at the Bank—who wish to see the World Bank become a financier of global public goods taking on a bigger and more prominent role. There are very real development challenges such as infrastructure, public service provision, public finance improvements, and others that need to be addressed and the World Bank should refocus on these issues. To be sure, some of these development challenges will have an impact on global public goods but increasing the Bank's scope would be a mistake and would not meet the direct needs of the Bank's borrowers. Ultimately the World Bank should remain focused on the country model and on supporting countries' economic growth as they move along the development spectrum.

These are not simply U.S. positions; indeed, many other large shareholders of the World Bank hold similar views on the need for reform and would agree with the recommended reforms outlined above. The administration should not "go it alone" on tying a capital increase to a reform agenda. The president stated clearly that "America first does not mean America alone"; reform offers the United States an opportunity to make good on that statement. The administration has a unique opportunity to use this capital increase to renew U.S. leadership of the World Bank—something that the last two administrations let lapse due to benign neglect. Along with the other Bretton Woods institutions, the World Bank is a U.S. creation that functions best with active U.S. involvement.

For the World Bank's shareholders to accept a second capital increase for the IBRD in less than 10 years, they should require the reforms outlined above. Moreover, the Bank must state clearly how it intends to use the additional financing. This should not be the demand of only the United States; it should include as many shareholders as the U.S. can bring along. Shareholders should want IDA, IBRD, and the broader World Bank Group to remain the leader of development policy and influence in a rapidly changing world. The reforms outlined are a starting point for a discussion and are by no means the only potential "ask" by shareholders in return for a capital increase. Shareholders do need to consider the consequences of not providing the World Bank Group with a capital increase as well, given the changing development landscape this could lead to a diminished role for the World Bank. For 70 years, the Bank has helped to set standards for environmental, social, and governance protections, and provided a source of capital and advice for developing countries. Who and how to fill that void are important to consider as part of this discussion.

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