DCF Policy Briefs
September 2017, No. 18

Multilateral Development Banks (MDBs) support projects, programmes and policies for sustainable infrastructure, climate efforts, energy, agriculture, industrialization, science, technology and innovation, as well as financial inclusion and financing of micro, small and medium-sized enterprises. Acting in close collaboration with other stakeholders, MDBs help address gaps in trade, transport and transit-related regional infrastructure, helping to connect vulnerable countries and communities within regional networks. They foster regional and sub-regional integration, enhance the participation and integration of small-scale industrial and other enterprises into global value chains and markets. They are also active agents in promoting climate resilience, by supporting national, sub-national and regional efforts to achieve long-term adaptation; mobilizing international and bilateral funds; and fostering the interchange of knowledge and lessons.

The Addis Ababa Action Agenda outlines priority areas where MDBs hold comparative advantage, and suggests ways through which they could boost their contribution. For instance, MDBs are called to establish a process through which they could examine their own role, scale and functioning to enable them to adapt and be fully responsive to the sustainable development agenda.

This policy brief examines the distinct role that multilateral development banks play in the context of South-South cooperation and potential links to implementation of the Sustainable Development Goals.

It is independently authored by Francisco Sagasti and Fernando Prada (with the assistance of Lucía Málaga, Mario Bazán, Gonzalo Alcalde and Fernando Romero).

The brief is commissioned by the United Nations Department of Economic and Social Affairs (UNDESA) for the Development Cooperation Forum. It informs the preparations for the 2018 DCF, including the DCF Argentina High-level Symposium (Buenos Aires, 6-8 September 2017). The views do not necessarily reflect those of the United Nations.

United Nations Department of
Economic and Social Affairs

An evolving landscape: South-owned and led MDBs

The multilateral development bank (MDB) model for mobilizing development finance has proved effective and resilient. John M. Keynes first suggested its outline a century ago, and institutions following this model now form a large network of international development finance organizations (Figure 1). At present, there are about thirty MDBs, some of them with several affiliates, the first of which — the World Bank — was founded in 1944. Subsequently, several regional development banks formed during the mid-1950s to mid-1970s; some similar to the World Bank in terms of governance and operations (the Inter-American Development Bank, the African Development Bank and the Asian Development Bank) and some quite distinct (the Andean Development Corporation and the Islamic Development Bank).[1] A dozen MDBs formed after 1980, and the last three (the Facility for Euro-Mediterranean Investment and Partnership, the New Development Bank and the Asian Infrastructure Investment Bank) after 2000 (2002, 2015 and 2016 respectively). A fourth, Banco del Sur, was launched in 2013; however, it is yet to commence operations. A few key features explain the resilience of the MDB model over time (discussed in Box 1).

The first South-owned and led MDB — the Andean Development Corporation (CAF) — was created in 1970 by Bolivia, Chile, Colombia, Ecuador, Peru and Venezuela. Although none of its member countries had investment grade, in a short time CAF reached this rating and could issue bonds in more favorable terms than its member countries. CAF has now expanded its membership to include other Latin American and non-borrowing developed countries, and changed its name to Latin America Development Bank. It has signed a collaboration agreement with the New Development Bank led by BRICS countries (see below). Two South

American countries (Venezuela and Peru) have become prospective members of the Chinese-led Asian Infrastructure Investment Bank.[2]

Since the CAF, other majority South-led and owned MDBs have emerged: the Islamic Development Bank (IsDB) established by members of the Organization of Islamic Cooperation to support its member countries and Muslim communities; the New Development Bank (NDB) by BRICS countries (Brazil, Russia, India, China and South Africa) to facilitate infrastructure and sustainable development among developing countries; and the Asian Infrastructure Investment Bank (AIIB) by China and 57 member states to address Asian infrastructure (Box 3). The New Development Bank has made a significant departure from the World Bank and others in terms of its governance and ownership structure; with shares and voting rights distributed equally among its five founding members.[3] NDB announced in 2017 intentions to increase its membership.[4] Both AIIB and NDB have also opted for streamlined operations through a non-resident board of directors.

BOX 1: Main features of the MDB model

MDBs are international financial intermediaries whose shareholders include both borrowing-developing countries and donor-developed countries, although a few of them have eliminated this distinction. They mobilize resources from private capital markets and from official sources to make loans to developing countries usually on better than market terms, provide technical assistance and advice for economic and social development, and also provide a range of services to developing countries and to the international development community. Other features include their preferred creditor status in relation to private lenders, and their low gearing ratios in comparison with private financial institutions. As a result, a number of MDBs enjoy high ratings from bond rating agencies, which allow them to raise funds on favorable terms in international capital markets.

What distinguishes MDBs from other financing institutions? First, their shareholders are governments and their Articles of Association are international treaties between sovereign states, with all the weight this carries. Second, the total outstanding loan book can be no more than its subscribed capital plus reserves, even though only a portion of the subscribed capital needs to be paid in cash and the rest remains as a pledged obligation to be made effective in the unlikely event the MDB should require it. Therefore, even in the extreme case of every borrower defaulting with no recovery of principal, shareholders would absorb the entire loss leaving MDB bondholders unaffected.

Third, their multilateral nature means that default by one borrowing member country would have repercussions on all other shareholders, with broader consequences for international economic relations. This is a more powerful deterrent to prevent loan defaulting than would be possible in bilateral deals between borrowers and lenders. Thus, the international agreements that give rise to MDBs, together with their governance, shareholding, and operational structures, confer them a preferred creditor status that cannot be credibly duplicated by private sector lenders.

Source: Adapted from Sagasti and Bezanson (2000)

A South-South perspective on the role of the MDBs in achieving the SDGs

The coordination and collaboration among this dense network of financing institutions is coming into focus through the 2030 Agenda. In addition to providing loans and other forms of financial support, MDBs, and particularly those that are Southern-led, are also sharing and providing specialized knowledge that is appropriate for developing country contexts. MDBs are actively engaged in collaborative relations between themselves, exploring complementarities, providing technical assistance to one another, and carrying out joint projects (Box 2). At the same time, a certain degree of overlap between activities can provide borrowing countries alternatives; for instance, when conditions for policy-based loans differ, countries may prefer to borrow from MDBs whose conditions better reflect their own economic views or that are less burdensome.

BOX 2: Examples of collaboration between MDBs

Policy dialogues. The Asian Development Bank (ADB) and the Inter-American Development Bank (IADB) started in 2001 a series of policy dialogue to promote trade between both regions. More recently, this initiative has supported dialogues within the framework of the Pacific Alliance (Peru, Chile, México and Colombia) and the broader Asia Pacific Economic Cooperation Forum (APEC).[5]

Co-financing and knowledge exchange. The Asian Development Bank (ADB) and the Islamic Development Bank (IDB) have established a cooperation agreement that includes the exchange of experts, co-financing schemes, and sharing administrative and human resources in specific countries. Their three-year Framework Co-financing agreement (FCA) for 2012–2014 was renewed up to 2017. The common loan pipeline target is US$6 billion—up to US$2.5 billion from ADB and up to US$3.5 billion from IDB—for projects in transport, energy, urban development and services, education, agriculture, health, regional cooperation, private sector development, and promotion of public–private partnerships. The African Development Bank (AfDB) and the Islamic Development Bank (IDB) have entered into a similar agreement, in which both banks have pledged contributions of US$2 billion to co-finance projects.[6]

Support for development infrastructure. The Second Global Infrastructure Forum met in April 2017 in Washington DC to coordinate MDB support for initiatives in infrastructure. Participants included the Global Infrastructure Facility at the World Bank Group, the Asia Pacific Project Preparation Facility at the Asian Development Bank, Infrafund at the Inter-American Development Bank, the Programme for Infrastructure Development in Africa at the African Development Bank Group, and the Infrastructure Project Preparation Facility at the European Bank for Reconstruction and Development. The objective was to find ways of mobilizing public and private financing to deliver inclusive, sustainable infrastructure worldwide.[7]

The MDB model is a powerful mechanism to leverage and mobilize development financing. Since their foundation until 2015, the World Bank Group and the three major regional banks (IADB, AsDB and AfDB) have mobilized around US$1,145 billion in cumulative operations, based on a total paid-in capital of US$33.2 billion.[8] The World Bank accounts for 55% of this total (US$628 billion), and the IDB, AsDB and AfDB represent 20% (US$230 billion), 18% (US$170 billion) and 7% (US$114 billion) respectively. Two Southern-majority owned MDBS have followed closely in their steps: the Latin American Development Bank (CAF) has accumulated US$158 billion in loans, guarantees and equity investments, and the Islamic Development Bank (IsDB) has loaned around US$88 billion, the first with US$2.8 billion and the second with US$3.9 billion of paid-in capital.[9]

The formation of the NDB and AIIB, to focus primarily on developing country infrastructure, will provide additional financing options in a sector currently requiring large investment (Box 3). Since the 1980s, there has been considerable downsizing of infrastructure investment by traditional MDBs, like the World Bank, in favor of priorities in the wider development agenda (from poverty reduction and the environment to humanitarian affairs and good governance).[10] To illustrate, infrastructure financing as a share of total lending fell from 70% to 19% between the 1950s/1960s and 1999 for the World Bank and from 70% to 10% between 1981 and 2003 for the IADB.[11] Despite a subsequent increase in spending, as of 2016, the 8 largest MDBs provided 10% (nearly US$40 billion annually) of global infrastructure spending.[12]

The Addis Agenda calls 'for the establishment of a global infrastructure forum building on existing multilateral collaboration mechanisms, led by the multilateral development banks' to improve 'alignment and coordination among new and established infrastructure initiatives' not only of multilateral but also national development banks, and in which developing countries have a fair representation (AAAA, Para. 14) (see also Box 2). National development banks, such as the China Development Bank, the Export and Import Bank of China and the Brazilian National Development Bank, have taken a more prominent role in financing regional and sub-regional infrastructure. In 2014, the loans disbursed by these three banks amounted to US$1,762 billion.[13]

BOX 3: The new multilateral development banks

The *Facility for Euro-Mediterranean Investment and Partnership* was set up as a trust fund with resources from the European Investment Bank. Its main aim is fostering the development of the private sector in the Mediterranean region, by financing sectoral studies upstream of the project cycle and providing support for institutional reforms. Eligible countries are Algeria, Egypt, Israel, Jordan, Lebanon, Libya, Morocco, Palestine, Syria, and Tunisia. The FEMIP allocated US$1.4 billion in 2015.

The *Asian Infrastructure Investment Bank*, led by China that contributed with 34% of the subscribed capital, allocated US$1,000 million and signed agreements with other four MDBs in their first year of operations (October 2016). The AIIB started with US$100bn in authorized capital in the near future, and plans to allocate US$4–5 billion on a yearly basis.

The *New Development Bank*, founded by BRICS countries (Brazil, Russia, India, China and South Africa) in 2014 with a US$50 billion subscribed capital and US$10 billion paid-in, have already approved seven projects for a total of US$1.5 billion (as of December 2016), and plans to fund 15 other projects with a total value of between US$2.5 billion and US$3 billion.

In transboundary infrastructure development, South-led MDBs are actively engaging in dialogues to harmonize and make compatible development policies and institutional reforms. MDBs have had difficulties in providing loans for projects that involve two or more countries, such as common infrastructure undertakings, primarily because of the complexities and risks associated with joint repayments; this attitude extended in the past to other multi-country initiatives such as the provision of international public goods. However, this has been changing, and regional infrastructure initiatives are becoming a subject of interest for development finance institutions.[14] The recent creation of the Asian Infrastructure Investment Bank is a case in point, for it will finance infrastructure projects that span more than one country.[15] Yet, even smaller MDBs, such as the Caribbean Development Bank and the Central American Bank for Economic Integration, have done this by allocating resources to create a commercial hub that will serve several countries in their regions.[16]

MDBs have also promoted regional economic integration among their members, often through facilitating trade and investments in infrastructure. The Inter-American Development Bank and the Central American Bank for Economic Integration, for example, have supported the Meso-American Development and Integration Project, which facilitated investments in electricity and roads infrastructure through loans, grants, guarantees and public-private partnerships.[17] MDBs have also provided support to national development banks in member countries to provide loans for lending, technical assistance, engaging in capacity building programs and promoting cooperation between them. In several cases, they have helped develop local capital markets, primarily by issuing bonds in their domestic markets and by disseminating regulation best practices.

The larger MDBs have been engaged in discussions to find ways to mobilize additional finance needed to service the SDGs.[18] Larger and older MDBs have usually taken the lead in designing novel financial instruments, such as debt swaps, front-loaded debt instruments, guarantees, insurance and other market-based schemes, to tap international capital markets; these have been rapidly adopted by sub-regional MDBs in South Asia, South America and the Caribbean.[19] In addition, MDBs have been successful in mobilizing private investment. Between 2012 and 2014, they raised US$18.8 billion using guarantees, collective investment vehicles (such as shares and equities) and syndicated loans to support private sector entities — 10 percent more than all national development banks, other development finance institution, development cooperation agencies and private-public partnerships (PPP).[20]

Through trust funds, typically established by its developed country members, MDBs are also addressing specific development issues, such as promoting policy dialogues and the exchange of experience, carrying out research and feasibility studies for cross-border infrastructure, harmonizing regulatory systems to facilitate regional trade and investment, coping with the effects of climate change, coordinating and complementing joint science and technology research projects, managing cross-border watersheds, and sharing information on education, health and other social services.

Regional and sub-regional MDB platforms could offer more adequate solutions to common problems of the Global South and the localization of internationally agreed goals, including the SDGs, consistent with context-specific demands and levels of capacity. Proximity, close economic ties and cultural affinities reduce regional information asymmetries, more than can be done at the international level.[21] Yet, only a few regional institutions have devoted significant resources to provide technical assistance and knowledge services to their member countries. As an example, the Inter-American Development Bank has experimented with different approaches to promote collective action for common development problems. Table 1 shows some of the projects that this IADB program has supported in the past using its net income as a source of finance. The most recent project competition has allocated US$8 million to support ten projects, ranging from the use of big data for sustainable urban development in five Latin American countries, support for transport de-carbonization in the region, and the establishment of a regional network to exchange know-how and experience in pension management.[22]

MDBs have a value-added in their ability to convene global experts and experience unlike other institutions. This has taken the form of knowledge sharing initiatives; policy research projects; and the advancement of statistics, joint training programs, direct support of science and technology research, and mechanisms to promote collaboration. The scope of their engagement in technical assistance and knowledge brokering activities to support explicitly South-South development cooperation merits further research. This includes their reach in substantively engaging in dialogues and relevant development frameworks in partnership with Southern countries themselves.

TABLE 1: Examples of projects supported by the Regional Public Goods Program at the Inter-American Development Bank[23]

- System of regional surveillance for non-communicable diseases in the Caribbean

  Countries: Bahamas, Barbados, Belize, Guyana, Jamaica and Trinidad and Tobago

  Financing: IDB - RPG $650,000/Local counterpart $580,000/Total $1,230,000

  Description: The purpose of the project was to develop a Caribbean Region Surveillance System for non-communicable diseases, which would contribute to improvements in planning, distribution and monitoring of health programs and protocols focused on the prevention and control of chronic diseases.

- Promoting water management as a regional public good in the Upper Lempa River Basin (CARL) in the Trifinio region, Central America.

  Countries: El Salvador, Guatemala and Honduras.

  Financing: IDB - RPG $830,000 / Local counterpart $110,100 / Total $940,100

  Description: The project developed and promoted trinational mechanisms for integrated and sustainable water management as a regional public good in the Upper Lempa River Basin, promoting horizontal cooperation between El Salvador, Guatemala and Honduras.

- Single Social Security Base in MERCOSUR

  Countries: Argentina, Brazil, Paraguay and Uruguay.

  Financing: IDB-Regional Public Goods $1,300,000/counterpart $930,000/Total $2,230,000

  Description: The objective of the project was to integrate the social security systems of MERCOSUR countries by developing and implementing a Data Transfer and Validation System to process the benefits of pensioners under the Multilateral Agreement on Security.

- Improvement of the knowledge and institutional capacity of the public entities responsible for the administration of public debt

  Countries: Argentina, Bahamas, Barbados, Belize, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Dominican Republic, Suriname, Trinidad and Tobago, Uruguay and Venezuela.

Financing: IDB - RPG $500,000 / Local counterpart $200,000 / Total $700,000

Description: The objective of the project was to support LAC countries at creating mechanisms to share knowledge and best practices and thus to strengthening the technical capacity of their agencies in charge of public debt management.

» Facility for Dispute Resolution Investors-State

Countries: Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Peru and the Dominican Republic.

Financing: IDB - Regional Public Goods $300,000 / Local counterpart $80,000 / Total $380,000

Description: The increasing number of investor-state disputes has economic, administrative, institutional and policy implications, particularly for developing countries. These agreements are intended to promote economic development by providing a stable, predictable and transparent environment for foreign investors

---

[1] Wang, Hongying (2016). *New Multilateral Development Banks. Opportunities and Challenges for Global Governance*. Discussion Series on Global and Regional Governance; http://www.globalpolicyjournal.com/articles/development-inequality-and-poverty/new-multilateral-development-banks-opportunities-and-cha

[2] AIIB (2017), "AIIB welcomes new prospective members: Bank approves 13 new applicants and expands membership to 70." Available from https://www.aiib.org/en/news-events/news/2017/20170323_001.html

[3] http://www.globalpolicyjournal.com/articles/development-inequality-and-poverty/new-multilateral-development-banks-opportunities-and-cha

[4] https://qz.com/947981/new-development-bank-ndb-the-brics-may-be-sputtering-but-its-bank-is-keeping-the-dream-alive/

[5] https://www.adb.org/sites/default/files/institutional-document/33453/files/pf-idb.pdf; http://www.iadb.org/en/topics/trade/adb-idb-presidents-discuss-interregional-partnership-and-shared-challenges,9185.html; http://www.iadb.org/en/topics/trade/adb-idb-presidents-discuss-interregional-partnership-and-shared-challenges,9185.html; http://larepublica.pe/impresa/politica/823292-alianza-del-pacifico-y-apec-en-proceso-de-integracion

[6] https://www.adb.org/documents/adb-idb-partnership-and-cofinancing-guide; https://www.afdb.org/en/news-and-events/afdb-islamic-development-bank-sign-new-us-2-billion-deal-to-fund-energy-smes-human-development-programs-17173/

[7] http://www.iadb.org/en/news/announcements/2017-04-12/public-private-financing-for-global-infrastructure,11778.html

[8] Humphrey, C., "He who pays the piper calls the tune- Credit rating agencies and multilateral development banks", *Rev International Organizations* (2017) 12: 281. doi: .1007/s11558-017-9271-6

[9] See Griffith-Jones, S., D. Griffith-Jones and D. Hertova, "Enhancing the role of regional development banks", *G-24 Discussion Paper* No. 50 July 2008.

[10] http://www.globalpolicyjournal.com/articles/development-inequality-and-poverty/new-multilateral-development-banks-opportunities-and-cha

[11] Ibid.

[12] 30% of the World Bank's, 52% of ADB's and 60% of EIB's total investment. See Bhattacharya et al. "Infrastructure for development" as cited in http://www.globalpolicyjournal.com/articles/development-inequality-and-poverty/new-multilateral-development-banks-opportunities-and-cha.

[13] http://unctad.org/en/pages/PressRelease.aspx?OriginalVersionID=270

[14] Birdsall N (2006). Overcoming Coordination and Attribution Problems: Meeting the Challenge of Underfunded Regionalism, in: Kaul I. and Conceicao P. (eds), *The New Public Finance: Responding to Global Challenges*. New York, Oxford University Press.

[15] https://www.aiib.org/en/news-events/news/2017/20170116_001.html

[16] See J.A. Ocampo (Editor), *Regional and financial cooperation: experiences and challenges,* Brooking Institution Press and the Economic Commission for Latin America and the Caribbean (ECLAC).

[17] http://www.proyectomesoamerica.org/joomla/index.php?option=com_content&view=article&id=229&Itemid=57

[18] The World Bank and regional development banks (AfDB, AsDB, ERBD, EIB, IDBG), and the International Monetary Fund (IMF) http://documents.worldbank.org/curated/en/602761467999349576/pdf/98023-BR-SecM2015-0233-IDA-SecM2015-0147-IFC-SecM2015-0105-MIGA-SecM2015-0061-Box391499B-OUO-9.pdf

[19] Hurley, G. (2012), Innovative Financing for Development: A New Model for Development Finance? UNDP Discussion paper on poverty reduction, Available in http://www.undp.org explores different financial arrangements in place.

[20] Benn, J. et al. (2016), "Amounts mobilised from the private sector by official development finance interventions: Guarantees, syndicated loans and shares in collective investment vehicles", *OECD Development Co-operation Working Papers*, No. 26, OECD Publishing, Paris, available from http://dx.doi.org/10.1787/5jm3xh459n37-en

[21] Birdsall N. and Rojas-Suarez L. (2004). Financing Development: The Power of Regionalism. Washington DC, Center for Global Development; see also Ocampo (2006) Ocampo JA, "Regional Financial Cooperation: Experiences and Challenges", in JA Ocampo (editor), *Regional Financial cooperation*, Brookings Institution Press and the Economic Commission for Latin America and the Caribbean (ECLAC).

[22] http://www.iadb.org/en/topics/regional-integration/call-for-proposals-from-regional-public-goods/home,20747.html

[23] Programa Bienes Públicos Regionales (2014), Bienes Públicos regionales: Innovación en Cooperación SurSur, Washington D.C.: Banco Interamericano de Desarrollo, available from https://publications.iadb.org/bitstream/handle/11319/6469/Bienes%20Publicos%20Regionales%202014-Integracion%20y%20Comercio.pdf?sequence=2

Interested in the DCF?

DCF Website
Subscribe to the DCF Newsletter
Access the latest DCF analytical work

Contact: dcf@un.org

DCF Secretariat
Development Cooperation Policy Branch
Office for ECOSOC Support & Coordination, UNDESA
UN Secretariat Building, 25th floor, New York, NY 10017