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THE POST-2015 AGENDA AND THE EVOLUTION OF THE WORLD BANK GROUP

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and Development
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EXECUTIVE SUMMARY

The Addis Ababa Action Agenda reaffirms the central role of development banks in providing concessional and non-concessional long-term financing, countercyclical financing, guarantees and leverage, policy advice, capacity building, and other support to the post-2015 agenda. "We recognize the significant potential of multilateral development banks and other international development banks in financing sustainable development and providing know-how. … We stress that development banks should make optimal use of their resources and balance sheets, consistent with maintaining their financial integrity, and should update and develop their policies in support of the post-2015 development agenda, including the sustainable development goals (SDGs)."[1]

This paper argues that the Addis Action plan and the SDGs represent a milestone in the changed thinking about the role of the multilateral development banks (MDBs) and the World Bank Group (WBG) in particular. By elaborating on a universal agenda for sustainable development, rather than a narrow focus on reducing poverty, the scope and ambition of support needed by low and middle-income countries has widened substantially. This paper looks at how the WBG might respond to these new challenges.

The SDGs cover a far broader scope than the Millennium Development Goals, and represent, in many ways, a validation of what the WBG has been doing for many years. The Addis Ababa Action Agenda for the third U.N. financing for development conference shows why:

- It puts the responsibility for development squarely on countries themselves; "Cohesive nationally owned sustainable development strategies, supported by integrated national financing frameworks, will be at the heart of our efforts."[2] The role of development agencies, in this view, is to support country-led processes, not replace them. This favors organizations like the World Bank Group with country-based operational structures and strong country presence, compared to, for example, vertical funds that have a global thematic focus but weaker country footprints.
- It gives prominence to "blended finance" and the leveraging of grants and other support with money raised on private capital markets. The Bank has always done this, with particular success in partnering with the Global Environment Facility (GEF), various climate trust funds, the Global Partnership for Education, and the Global Agriculture and Food Security Program.

- It calls for multifaceted interventions. The WBG's credits and loans have typically been accompanied by capacity building, technical assistance, evaluation, policy reform, and other elements of a package of interventions that are needed to have an impact. This is now recognized as how development must be done.

- It promotes risk-mitigation mechanisms; the WBG's Multilateral Investment Guarantee Agency (MIGA) is the largest provider of these instruments in the world and is expressly recognized in the Addis document; the International Bank for Reconstruction and Development (IBRD) too has the ability to provide guarantees, although actual use of this instrument has been limited.[3]

- It brings private business to the center of development; "foreign direct investment [is a] vital complement to national development efforts."[4] The International Finance Corporation (IFC) is by far the largest official lender to private business; IBRD and International Development Association (IDA) provide help with improving the investment climate.

- It emphasizes the importance of delivery of public social services ("a new global social compact"), infrastructure, sound policies and institutions, and good governance, all areas that the WBG has emphasized for some time.

- It recognizes that "countries in conflict and post-conflict situations also need special attention." The WBG was one of the earliest development organizations to specifically focus on this issue, applying recommendations of a 2002 Task Force report.

Internally, the WBG has reorganized itself into global practices that match well with the SDGs,[5] and has articulated "Twin Goals" to end poverty by 2030 and to boost shared prosperity for the bottom 40 percent of the population in each country. These goals in turn resonate with the ambition of the SDGs to end poverty and hunger and to promote peaceful and inclusive societies.

Evaluations by bilateral donors and independent groups suggest the WBG is still one of the most effective development institutions. Donors rely on it as a channel for trust funds as well as core resources.

At one level, therefore, the WBG is well positioned to contribute more to the post-2015 agenda. However, it must adapt to a changing world that is shaping both what the WBG should do (its value proposition) and how much it can do. One of the biggest changes is in global capital markets. With low interest rates expected to prevail for a decade or more, the revenue model of the IBRD and IFC, reliant on income from invested paid-in capital and retained earnings, is under stress. So the ability to self-finance growth and to cross-subsidize activities like knowledge and advisory services that are central to the value proposition has been impaired. Other changes that impact on the WBG include:

- Its basic business model that uses income categories to determine the terms of financing that countries get from the WBG is no longer matched to a reality where low-income countries have access to private capital markets, middle-income countries are looking for grants to help them provide global public goods, and all countries are looking for private investments.

- Graduation of many low-income countries to middle-income levels has left lower middle-income countries, in particular, facing sharp reductions in their overall access to financing, at a time when all countries are seeking to expand public investment to meet the SDGs.

- It has de-leveraged over time, transferring resources from more highly leveraged institutions like IBRD and IFC to IDA, an unleveraged institution.

- Its guarantees and risk mitigation programs (about $3 billion annually) are small in global terms.

- There is more competition in the provision of analytical work and advisory services.

- The approach toward post-conflict countries is evolving from one that emphasized capacity building to a renewed focus on the importance of accompanying resource flows and job-creating investments as part of statebuilding.

- New institutions are emerging as competitors to the WBG in infrastructure, agriculture, and social services—the core of its project lending activities.

- Its creditworthiness assessment toolkit is analytically unsound and unduly restricting business opportunities.

- Staff morale is low, yet the staff is increasingly challenged to provide a wide range of lending, capacity building, trust fund administration, safeguards, and analytical work; capacity to deliver in each of these areas is being eroded.

- Net income in IBRD and IFC is low (and possibly negative, depending on interpretation of changing market values for derivatives); is unlikely to rebound quickly given the prevailing view of low global real interest rates for the medium term; and is insufficient to provide enough retained earnings to propel strong growth of lending or knowledge activities in either institution.

How should the WBG evolve given these constraints? The dominant theme of the post-2015 agenda is that there is a significant need for greater public investment and for mobilizing private finance for developmental purposes—from "billions to trillions."[6] Given its strong comparative advantage in blending different types of capital, along with knowledge and the convening power to build and lead partnerships, the WBG is well-positioned to do more, not less. With many commercial banks also turning away from doing business in developing countries as a result of Basel III and other regulations, the WBG has an even stronger case for expansion in middle-income countries. To turn this into reality, the WBG will need much stronger support from its shareholders. It is already contemplating several reforms, many of which would put it on the right track for an expanded contribution to the SDGs.

Suggestions for Consideration

The most important reforms involve scaling up the WBG's development contributions in lending, knowledge and an appropriate division of labor.

Lending

There is demand from all countries to access concessional and non-concessional resources from the WBG, to finance government investments as well as private business. To meet this demand, the WBG could consider:

- An IDA+ agenda to leverage the $180 billion of assets currently on IDA's balance sheet. Several options are available, including a merge between IDA and IBRD balance sheets, or approval for IDA to borrow, including potentially from capital markets. An IDA+ agenda could accomplish three important objectives:

    - Permit a reallocation of grant funds to those countries and activities where grants are most needed *relative to* other resources—for example, this could include vulnerable small island states.

    - Reduce the sharp drop-off in resources available to lower middle-income countries when they graduate from IDA-only status by expanding the available volume of IDA credits based on borrowed funds.

    - Provide IDA with flexibility to provide large-scale countercyclical financing to low-income countries in the event of a significant multi-country crisis.

- Remove thresholds for access to IBRD funds, while ensuring retention of IBRD's AAA credit rating. Many low-income countries are creditworthy and could benefit from IBRD funds, especially for projects where commercial returns are reasonable, such as in infrastructure or natural resource ventures. Access for these countries to IBRD should be permitted. At present, "enclave projects" in low-income countries can be financed by IBRD, but only if project revenues are ring-fenced to ensure debt repayment. This has proven difficult to do in practice. The recent experience of the merger of the Asian Development Fund and the Ordinary Capital Resources of the Asian Development Bank suggests that the impact on the IBRD's credit rating of taking on the credit risk of low-income countries might be negligible. At the other end of the scale, several high-income countries that have graduated from IBRD could continue to benefit from IBRD resources, selectively and flexibly applied. The European Investment Bank (EIB), for example, has built a successful business in providing long-term financing to support small and medium enterprises, infrastructure and innovation, climate action, and other programs in high-income countries; IBRD could emulate this. Broadening country access to IBRD could:

    - Reverse the loss of market share to much higher cost private capital markets where many developing countries are borrowing, with benefits to both clients and the WBG;
    - Diversify IBRD assets to improve the quality of its portfolio and permit the relaxation of single borrower limits in absolute dollar volume terms;
    - Generate stronger profits for IBRD to permit sustained growth from retained earnings.

(Note that expanding IBRD access to low-income countries is analytically equivalent—from the recipient point of view—to leveraging IDA assets by permitting IDA to access private capital markets. Technical and political considerations would dictate which is the preferred option or if both are desirable.)

- Build sufficient equity for IFC and IBRD through a combination of (i) reducing transfers to IDA; (ii) increasing net income by expanding the volume of operations and, potentially, spreads and fees, as well as cost reductions; and (iii) capital increases from shareholders.

- Use IDA's flexibility to lend to non-government clients by making it a core investor in a fund for business investment in low-income, least-developed or post-conflict countries, to be managed by IFC's Asset Management Company. Providing a demonstration effect that profitable business opportunities exist in such countries could be a key contribution to the post-2015 agenda.

- Adapt the Debt Sustainability Framework (DSF) in a flexible way. The DSF uses thresholds of debt to GDP and simulation models to classify countries as to the risk of debt distress. The models, however, are potentially biased, have little analytical basis, and are not sufficiently flexible in application, leading to a highly conservative assessment of debt financing. A country-by-country creditworthiness analysis, including assessment of the effectiveness of public investments, would be a preferred approach to determining the degree of access of a country to IBRD resources. Absent this, a large expansion of infrastructure or other lending will not be feasible.

- Scale up program-oriented development operations including the Program for Results (P4R) financing while adapting procurement and safeguards policies to contribute more to results than compliance.

Knowledge

A major source of the WBG's comparative advantage is in knowledge and advisory services. With the reduction in net income, however, the provision of knowledge can no longer be cross-subsidized to the same extent. The World Bank could consider:

- Using knowledge more explicitly as an instrument for scaling up development impact.
- Allocating budget resources for knowledge across all countries to maximize development impact.
- Costing knowledge contributions to lending more explicitly in order to link loan fees and margins to the actual cost of preparation; for example, development policy operations draw on knowledge products, but these are not explicitly included as part of the costs of lending.
- Proactively seeking Trust Funds to finance knowledge and advisory services, particularly for global public goods like data.
- Formalizing (with budgets) capacity building programs in procurement, financial management, domestic resource mobilization, debt management, and other areas.

Division of Labor

The SDGs provide a set of priorities where the WBG has a comparative advantage. These are:

- Provision of infrastructure (including at municipal levels)
- Support for food and nutrition security
- Climate mitigation and adaptation (especially in agriculture, forestry, power, and transport)
- Safety-nets and social service provision
- Managing vulnerability and shocks (including countercyclical lending, access to financial services, and access to remittances)
- Support to fragile states
- Better governance and domestic resource mobilization
- Investment climate improvement

I. INTRODUCTION: NEW OPPORTUNITIES FOR THE WORLD BANK

The post-2015 agenda reaffirms the development approach pursued by the World Bank and other multilateral development banks (MDBs). Compared to the Millennium Development Goals' focus on poverty reduction and access to social services, the Sustainable Development Goals (SDGs) are broader and more ambitious, encompassing areas where multilaterals have extensive experience: infrastructure and energy, governance and institutions, domestic resource mobilization, leverage of the private sector, and improved business environments, and more. There is now a very high degree of overlap between the SDGs and the agenda pursued by multilateral banks and the WBG.

Similarly, the post-2015 agenda is an "aid and beyond" agenda. It recognizes that aid, or concessional development finance, is only one instrument for achieving global sustainable development, and that other long-term financing and risk mitigation instruments will be needed to move from "billions to trillions." The World Bank Group (WBG) has the greatest range of such instruments available and the longest experience. It includes the largest official lender to the private sector in the world in the International Finance Corporation (IFC), the largest official guarantee agency in the world in the Multilateral Investment Guarantee Agency (MIGA), and the largest provider of non-concessional loans to developing countries in the International Bank for Reconstruction and Development (IBRD).

The WBG consistently ranks favorably among multilateral institutions in bilateral reviews and independent evaluations. It has an organizational structure well-suited to deliver on the SDGs, with a strong country presence and focus on support for national development plans, coupled with technical global practices that are matched to the SDGs. Donors channel around $4 billion per year through the WBG in the form of trust funds, suggesting they value the WBG financial and technical expertise in managing development finance effectively on their behalf.

Yet the WBG is facing constraints on expanding its contribution. Internally, it faces issues of the erosion of some core skills and of retaining sufficient staffing expertise to deliver on a broad agenda that is placing more emphasis on building local capacity and finding solutions in difficult conflict-affected areas. Staff experience is also a key ingredient for maintaining the quality of operations that may be slipping in the face of budget cuts and loss of key personnel. Different skills are needed to foster external partnerships. And the business and financial model on which the WBG has long relied is under stress due to the long period of very low real interest rates in global capital markets.

Externally, the Bank Group is facing intensified competition. The relevance of the Bank has long been built on providing developing countries with two inputs that were in short supply: capital and knowledge. But the supply of both has rapidly expanded, and competition has increased from a very broad range of actors: regional development banks and vertical funds, South-South cooperation, commercial capital markets, and academia, think tanks, foundations, and civil society. And, perhaps most strikingly, domestic resources and capabilities at the disposal of developing country governments have increased exponentially. Of particular concern is the sense among large client countries that new institutions are required in order to service their needs properly—hence the establishment of the Asian Infrastructure Investment Bank and the New Development Bank, the first two international institutions of significant scale to have been established without a dominant G-7 country presence.

This is not the first time the Bank has faced an existential crisis. Soon after its formation, Bank President John McCloy found himself testifying in favor of the Marshall Plan for aid to post-war Europe "in full knowledge that passage of the measure would put the Bank out of business in one of the two principal fields [reconstruction, versus development] in which it was set up to operate."[7] In the early 1990s, during the heart of anti-globalization protests worldwide, *The Economist* quipped: "the Bank's goal is to work itself out of a job—and faster progress towards that goal is needed."[8]

This view has receded. The idea that the WBG and the MDBs should focus on poverty reduction and the poorest countries has been supplanted by a new recognition—articulated in the SDGs and the Addis Ababa Action Agenda—that MDBs have a critical role in supporting country actions to foster growth, sustainability and social stability, as well as in supporting global efforts to act collectively in selected areas. Sustainable development has become a universal agenda. Last year, the *Financial Times* opined: "if the World Bank fades, the alternative is a future of individual countries jockeying for influence via bilateral aid, with less regard for the needs of the poor."[9] The remainder of this paper looks at where the World Bank continues to be relevant, what it is doing well and less well, and the key issues now confronting it as it seeks to refresh its business model. The paper argues that the WBG should see itself as a "sunrise" institution that can contribute substantially to the ambitious agenda laid out in the SDGs.

II. THE REVEALED COMPARATIVE ADVANTAGE OF THE WORLD BANK GROUP

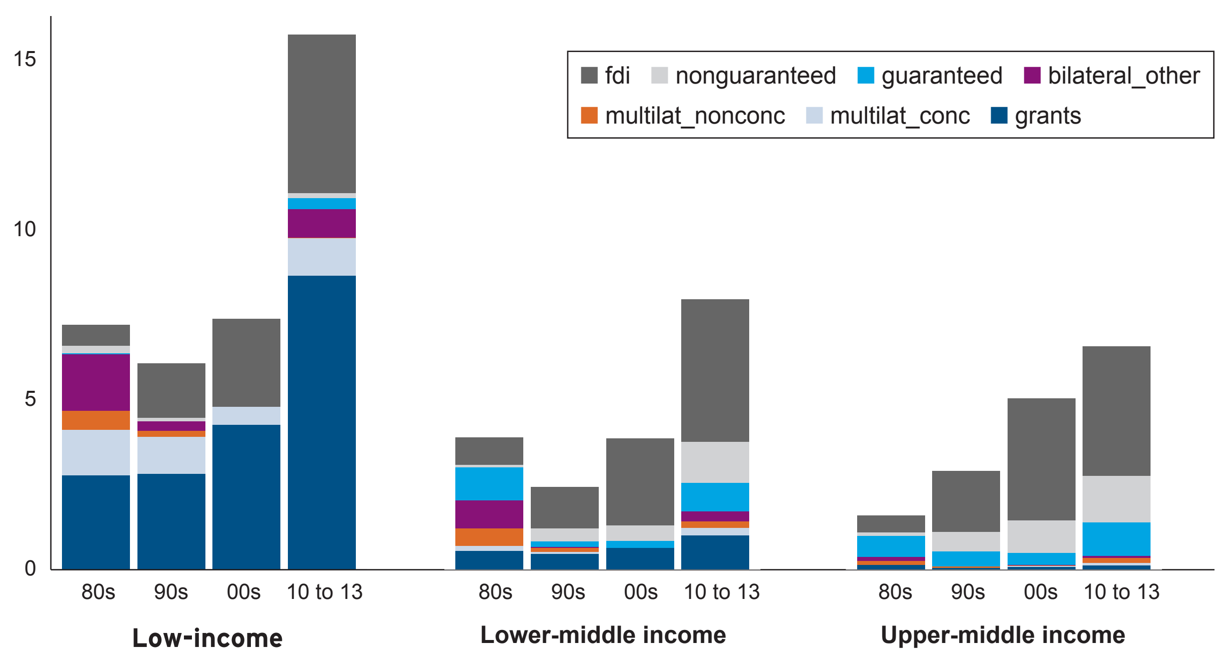
Where can the World Bank Group best contribute to the SDGs? Should it continue to provide broad-based services covering all the goals, or specialize to achieve greater impact, especially in light of the comparative advantages of other institutions? Are there gaps that need to be filled to deliver on the SDGs?

To start to address these questions, albeit partially, it is instructive to review what the World Bank actually does, in practice. This section provides an empirical estimation of the drivers of IDA and IBRD credits and loans.

Financing

At heart, the WBG is a financing institution, bundling knowledge, capacity building, and other instruments with money in the form of a specific project or program. But the scale of financing has declined in relative terms. The WBG classifies countries by income level and tailors its products accordingly. IDA gives concessional credits to low-income countries (and also some to lower middle-income countries; IDA also provides grants to select countries, but the aggregate level is small—12 percent of total commitments in FY14).[10] IBRD provides non-concessional credits to middle-income countries. IFC provides mostly debt finance (some equity) to businesses with a relatively high concentration in upper middle-income countries.

Figure 1. Sources of net financing flows to developing countries (% of GDP)



Source: World Development Indicators (2015).

Note: a dynamic approach to country classifications has been taken above. In other words, countries are placed in each income category in each year, prior to taking decadal averages Pakistan, for example, was classified as a low-income country until 2008 (FY10), and it has been classified as a lower middle income country since then. China and India are excluded as they are large countries that are sui generis cases. Bilateral other contains the sum of bilateral concessional and bilateral non-concessional.

Figure 1 presents the financing picture from the perspective of partner countries—the WBG's clients (excluding China and India that are *sui generis* and excluded here). It shows net flows as a percentage of partner country GDP for three categories of countries. A dynamic categorization is taken. That is, the figures for the 1980s for low income countries show the net flow percentages for those countries that were low-income during that time period. Thus the country composition changes between periods as countries move from one category to another.

Figure 1 shows that the multilateral system as a whole, providing concessional credits and non-concessional loans, is very small today in all country groupings. The WBG, just one of the multilaterals, is even smaller. In addition, the share of multilaterals and the WBG has been falling over time, in relative terms. Today, the multilateral system provides net financing flows of just tenths of a percentage point of GDP in most countries.

Multilaterals, and the WBG, have the greatest relative share of net flows in low income countries, but even in these countries, grants, foreign direct investment (FDI) and guaranteed sovereign borrowing from markets have taken away market share from the multilaterals. Grants, mostly from bilateral donors, have doubled from about 3 percent of GDP in the 1980s and 1990s to around 8 percent between 2010 and 2013. Concessional credits have correspondingly dropped. Multilateral concessional credits accounted for 1.4 percent of GDP in low-income countries in the 1980s, but only 0.9 percent during the 2000s and 1.2 percent between 2010 and 2013.

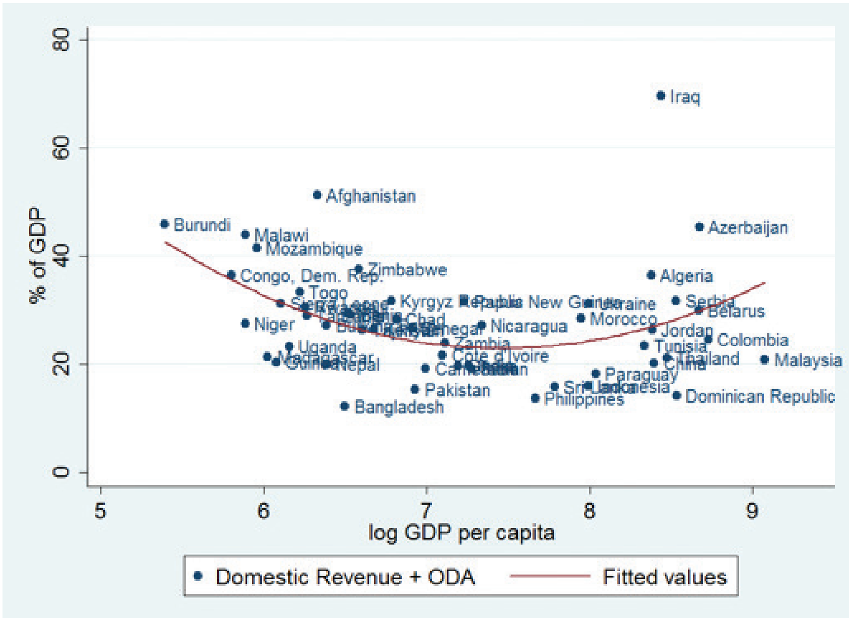
Another trend is for low-income countries to tap private commercial markets through guaranteed and non-guaranteed borrowings, while being excluded from (or avoiding) multilateral non-concessional loans even though these are available at far more favorable terms than commercial loans.

Low-income countries have also seen a surge in access to foreign direct investment. This has grown from 0.9 percent of low-income countries' GDP in the 1980s to 5.3 percent since 2010. It is no longer reasonable to assume that low-income countries cannot access private capital on their own.

For lower middle-income countries, the trends are different. In the 1980s, half their financing came from the official sector, roughly evenly divided among grants, concessional credits, and non-concessional loans. The other half came from direct sovereign borrowing (largely from banks) and from FDI. Multilateral non-concessional lending alone accounted for 0.5 percent of GDP. Since 2010, the pattern is far different. Multilateral non-concessional lending has fallen to a miniscule amount, while private sector financing—sovereign, non-guaranteed debt and FDI––accounted for the bulk of total financing, amounting to over 5 percent of GDP. This pattern is even more accentuated in upper middle-income countries; there, multilateral non-concessional lending is a small share of GDP (0.2 percent from 2010 to 2013).

In fact, while most sources of development finance have risen strongly over time, public non-concessional lending from IBRD has been flat. In constant 2005 dollars, IBRD commitments in 2013 were $11 billion; Thirty-seven years ago, in 1976 they were actually higher, at $12.6 billion. Net flows from IBRD were $7.5 billion in 2013; in 1981 they were an identical $7.5 billion. IBRD as a financing institution has stood still in absolute terms for over 30 years. In that period, the development landscape has been transformed.

Figure 2. Domestic revenue plus ODA across income levels, 2010



Source: Authors' calculations based on World Development Indicators (2014) and International Centre for Tax and Development (2014).

What is clear from Figure 1 is that countries at all income levels have many different options for accessing capital, particularly from private capital markets. In fact, 74 developing countries today have a rating from a major international rating agency, indicating they are active borrowers in private capital markets. Of these, 24 are lower middle-income countries (about half the 50 in this category), and 11 (out of 34) are low-income countries. Six low-income countries receive more from FDI than from ODA.

Looking forward, very low real interest rates in private capital markets continue to make borrowing there attractive for many developing countries. Market access has also improved as result of debt forgiveness and far better macroeconomic performance in developing countries since 2000. Many IDA and blend countries are classified as having low to medium levels of debt distress, based on the IMF's debt sustainability analyses.[11] Meanwhile, FDI continues to increase and to become more widespread, although some of this may not be sustained as commodity investments (agriculture and minerals) have lost some momentum with the fall of prices. Much FDI, however, is from developing countries themselves; Southern firms appear more able to manage the risks associated with operating in developing countries, perhaps because of their own domestic experiences.

A particular concern surrounds the financing gaps that have opened up for lower middle-income countries. These countries face a unique problem in obtaining fiscal resources. They lose aid rapidly as they pass the threshold classifying them as middle-income, but they have neither the diverse domestic economic tax base nor the mature administrative capacity in tax institutions to compensate. As a consequence, the revenues at the disposal of lower middle-income countries are the lowest among all countries.[12] Research suggests that this can lead to a slowdown in growth.[13]

There has been a downward trend in the growth of IBRD lending to lower middle-income countries since the 1980s, but this was reversed during the crisis period. Multilateral flows have again increased but remain at a level far lower than sovereign and non-sovereign borrowing by these clients from private capital markets. Multilateral non-concessional flows only account for 1-3 percent of total net flows to lower middle-income countries today, compared to 13 percent in the 1980s.

A big challenge presented by the SDGs, therefore, is "how much" the WBG and other multilateral organizations can contribute. A joint report by the international financial institutions, "From Billions to Trillions—Transforming Development Finance," presents a succinct case that "achieving the SDGs will require moving from billions to trillions in resource flows." The report pays particular attention to the need for policy change in developing countries along with higher leverage and mobilization of private finance through the activities of the MDBs.

Crisis lender, development bank, or development institution?

The three main functions of the World Bank Group are as a crisis lender, a development bank, and a development institution. In the first role, the WBG can provide resources to maintain financial stability and to sustain public investments for its clients when they are faced with external shocks.[14] In the second role, the WBG can help finance investments in human capital or infrastructure, usually as a credit or loan in order to assure sustainability. In the third role, the WBG can share knowledge, build capacity, and provide advice.

An empirical estimation of what drives WBG disbursements suggests that IBRD has become a crisis lender, IDA is predominantly a development bank, and both have aspects of a development institution (Appendix 1 has the regression details.).

Looking first at IBRD, it is clear that it has responded to crises: the Latin American debt crises of the mid-1980s, the Asian financial crisis in 1997/98, the dot-com global downturn around 2001 and, most recently, the global financial crisis of 2008/9. During each of these episodes, IBRD clients were faced with large debt service payments, low foreign exchange reserves and limited access to alternative liquidity. They turned to IBRD and received substantial net flows, largely from policy-based operations but also from investment lending.

There has been no relationship, however, between countries with high investment rates and those with high levels of IBRD disbursements, even when only project loans are considered. In fact, IBRD project lending appears to be driven by the same factors as private investment projects, proxied by foreign direct investment. Probably both reflect the nature of a country's investment climate—the better it is, the more likelihood of attracting FDI and the easier it is to develop new IBRD projects.

Curiously, given the country income thresholds within which IBRD operates, there is no association between a country's per capita income and the amount of IBRD lending it gets relative to its GDP. There does not appear to be a tapering off as countries approach graduation, nor a tapering in as countries are newly given access to IBRD.

Identical analysis was done for IDA with opposite results. The levels of debt service and foreign exchange reserves, proxying balance of payments pressures potentially facing IDA countries, are not significant. IDA countries do not receive any additional disbursements when they have high debt service needs.

The contrast with IBRD is also apparent in the impact of investments in IDA countries on disbursements. National country investment rates and IDA flows are highly correlated, especially when project lending is considered on its own. Unlike in IBRD countries, where FDI and IBRD project disbursements are correlated, this is not the case in IDA clients. Also unlike IBRD, IDA flows do depend on a country's per capita income level. As countries get richer and approach the IDA threshold they receive less funding.

The difference between IBRD and IDA is particularly remarkable as the operational structures for them are identical—the same regional management, same shared staff, same procedures. The only difference is the procedure for allocating funds.

With its large staff and field presence, one of the most significant contributions the Bank makes is as "a conveyor belt of ideas about development policy."[15] The World Bank's strength lies not just in providing policies and advice on the current best practices in development, but also in its ability to spread development ideas rapidly across the globe. For example, the Bank has been a leader in highlighting and promoting basic needs in the 1970s, outward orientation and structural adjustment in the 1980s, gender, environmental sustainability, the private sector and public-private partnerships in the 1990s, governance and anti-corruption in the 2000s, and, more recently, transparency and social safety-nets. It has looked at specific problems facing different types of countries, like post-conflict states, those re-engaging after protracted arrears, middle-income countries, and small islands. As Mason and Asher (1973) put it: "Good advice is rare, and good advice that is listened to is even rarer. But the Bank provides a powerful amplifier—the prospect of capital assistance to finance its recommendations."[16]

More recently, however, the trend is for development ideas to become unbundled from finance. Academic organizations like the Abdul Latif Jameel Poverty Action Lab at MIT, the Blum Center for Developing Economies at University of California, Berkeley, or the International Growth Center at the London School of Economics, along with think tanks, international and national NGOs, foundations, and numerous other actors and organizations (like the International Initiative for Impact Evaluation) have emerged as powerful drivers of new thinking on development. Social enterprises like GiveDirectly and Bridge International Academies are bringing practice and theory together, often based on rigorous evaluations, thanks to the falling cost of generating and analyzing data. Furthermore, large consultancies, such as McKinsey and the Boston Consulting Group, have significant, profitable businesses providing knowledge and advice to many developing countries.

The Bank is an acknowledged leader in some, but not all, of the areas in which it operates. Its database on the private provision of infrastructure is the standard for comparative analysis of public versus private financing choices, and the WBG remains one of the leading institutions in terms of expertise on the planning, procurement, maintenance and operation of infrastructure assets and on strengthening regulatory agencies. It has become a leading agency in providing data on personal and small- and medium-sized enterprise (SME) financial inclusion through FINDEX. It is the leading source of information on remittances, now one of the largest sources of financing for development. It is the analytical leader on social safety nets and has helped accelerate the transmission of successful programs like Opportunidades in Mexico and Bolsa Familia in Brazil throughout the world. It has also been the intellectual leader in defining approaches toward fragile and conflict-affected states.

The WBG spends significant resources on knowledge activities: a reported $600 million in fiscal year 2010.[17] Around 40 percent is covered by Trust Funds, and an additional $40–50 million is received in reimbursements from clients. The remainder, however, must be financed out of the WBG's operational budget. The IFC, too, subsidizes its advisory work, although reimbursements from clients are a far higher share of total cost than is the case in the World Bank. The point is that knowledge remains a complementary activity for the WBG, one that accompanies financing, rather than a standalone activity. There is no business model as yet that would support a shift to a true "knowledge bank" that can sustain and grow the knowledge effort and allocate funds across countries to use knowledge as an instrument to scale up impact.

A "knowledge bank" would differentiate among general development knowledge, which has a public goods aspect, knowledge to support global efforts at collective action (like support to the G-20 and the myriad other partnerships the WBG is involved with), and knowledge of direct operational value for clients. Each has its own function, but only the last can potentially be funded through country-based fees (either standalone or built into loan margins). The other knowledge activities must be funded by other means; with its reduced net income, the cross-subsidization that used to happen is becoming harder to do.

III. THE SDGS AND THE VISION FOR THE WBG

The WBG has defined its vision in terms of the twin goals of ending extreme poverty and boosting the prosperity of the bottom 40 percent of the population in each country. This vision dovetails well with the goals and targets frame of the SDGs. Although it might appear as if the SDGs, with 17 goals and 169 targets, are more comprehensive and ambitious than the agenda of the WBG, in reality there is not much difference.

Importantly, the SDGs' universal approach supports a WBG that is active in all countries and that is revamped to contribute more to the ambitious SDG agenda.

A review of the new organizational structure of the World Bank shows that there is at least one global practice group or cross-cutting solution area that is directly related to each of the SDGs. Furthermore, only the SDGs on growth and on means of implementation are associated with more than two global practices, suggesting a strong degree of alignment between the WBG and the SDGs.[18]

But should the WBG be involved in all these areas? What about specializing in a few areas of comparative advantage? At one level, this is an attractive suggestion. Practically speaking, however, it is unrealistic. Indeed, the very strength of the WBG comes from the fact that it is the only organization that is truly global (and so can readily transmit lessons from one area to another) and that is truly comprehensive.

A key departure of the SDGs from the MDGs is in the determination to escape from a silo mentality in implementation. The goals intersect with each other. Girls' education (in SDG4) supports lower child and maternal mortality (in SDG3). Smart cities and human settlements (SDG11) help achieve an adequate delivery of social services (several SDGs). Only a comprehensive institution can draw out these links.

Just as importantly, however, are the cross-cutting themes. Sectors typically are advocates for greater funding for themselves. But there is an adding-up problem that needs to be addressed such that public expenditure fits into an affordable national financing plan, and is effective because of a sound policy and regulatory environment. Procurement, safeguards, budgeting, accounting, contracting, evaluation and other functions of efficient public spending must be developed in ways that support all sectors. Civil service reform, anti-corruption, and gender can best be pursued in comprehensive programs that can be applied in all sectors. The same is true for new approaches that can be used in fragile and conflict-affected areas. Effective institution building and policy reform often need insights from many sectors.

The WBG is particularly well-suited for taking on institutional and policy reform tasks. As such, it needs a presence in each sector (to help it understand the overall context in a country), but does not need to be the global leader in each sector. In some cases, as has happened in health, a vertical fund can lead on technical areas, but can be complemented by the WBG in cross-cutting ways.

Being present in a range of sectors does not imply that there are no priorities being set. Selected areas are emphasized in the Addis Ababa Action Agenda as needing transformative change on a global scale. The WBG should consider what it can do to contribute to these areas:

- There is a call for a new social compact, focused on those furthest below the poverty line, to provide social protection and quality investments in essential public services for all, including health, education, energy, and water and sanitation.
- Efforts to end hunger and malnutrition need to be scaled up. At current rates of progress the under-

nourishment rate will still be 8 percent by 2030. To end hunger, the rate of progress must be at least doubled. Much of this will come about through investments in sustainable agriculture, including in research and infrastructure.

- An annual global infrastructure gap of $1-1.5 trillion exists in developing countries and needs to be bridged. While there are many new initiatives to support infrastructure, the scale of the gap is so large that an “all hands on deck” approach is warranted, especially for the WBG, which is the largest infrastructure funder among the international financial institutions and the most important champion of the sustainability and inclusiveness components of infrastructure.
- Good governance has been made a central element of the SDGs, with specific components of justice, anti-corruption and curbing illicit financial flows, as well as more general concerns with institutional strengthening and the promotion of peace.
- The diverse needs of least developed countries, small islands, landlocked countries and conflict-affected and post-conflict countries are recognized with attention needed to their specific development issues.

In each of these areas, there is a major gap in the existing development finance architecture. Business-as-usual will not suffice to fill this gap. The WBG can do more. A gap analysis, with a sound understanding of the complementarities to be achieved by acting in partnership with others, could help the WBG to prioritize its activities.

The Addis Ababa Action Agenda also discusses the instruments and mechanisms of providing development support. It emphasizes the new reality of capital markets and the need to match financing and function in a diverse range of country circumstances. In this, organizations that have a range of instruments to deploy, like the WBG, are best positioned.

The Addis Agenda puts the responsibility for development squarely on countries themselves; the role of development agencies is to support country-led processes, not replace them. This favors organizations like the World Bank with country-based operational structures, compared to, for example, vertical funds that have a global thematic focus.

It gives prominence to “blended finance” and the leveraging of aid and commercial money. The WBG has long experience of blending its lending activities with a number of donor trust funds, including in education, agriculture, and climate change.

It calls for comprehensive approaches: both concessional and non-concessional lending in the WBG have typically been accompanied by capacity building, technical assistance, evaluation, policy reform, and other elements of a package of interventions that are needed to have an impact. This is now recognized as how development must be done.

It discusses new instruments of risk-sharing. The Bank has MIGA, as well as its own guarantee mechanisms (although these are not used to their full potential; only $1.7 billion in total as of June 30, 2014).

It brings private business to the center of development, including for low-income countries. In the Addis Agenda, job creation and industrial transformation are identified as priorities and the private sector’s role in achieving these goals is clear. The IFC is by far the largest official lender to private business but still tends to concentrate its activities in middle-income countries rather than in the poorest countries. It is systematically trying to rebalance its activities.

IV. GAPS AND SUGGESTIONS FOR CONSIDERATION

Looking forward, there are two priorities for the institution: how to scale up its development impact, given the more ambitious post-2015 agenda; and how to leverage more resources to help the transition from billions to trillions. As part of the latter commitment, the multilateral development banks along with the IMF have signaled that they plan to extend more than $400 billion in financing to achieve the Sustainable Development Goals over the next three years.[19] While an encouraging pledge, this is not a substantial deviation from business-as-usual, and a far cry from the incremental trillions that might be needed in net flows.[20]

In some areas, like the provision of social services, agriculture/nutrition, and good governance, the main requirement is for the WBG to see if there are possibilities for scaling up development impact, potentially through additional program and project financing and policy advice, capacity building, and systems strengthening. But in other areas, a more significant change in operations might be warranted.

The unmet demands for development finance

Infrastructure is perhaps the greatest unmet demand (in terms of investment dollars) where the World Bank Group appears to have a distinct comparative advantage that could be scaled up. Bhattacharya et al. suggest that the global demand for sustainable infrastructure is about $2–3 trillion per year, additional to current levels, of which upwards of two-thirds are in developing countries.[21] They call for multilateral development banks to scale up infrastructure lending fivefold over the next decade, from about $30–40 billion per year to at least $200 billion per year. The IMF estimates that the public capital stock in low-income countries has shrunk from about 120 percent of GDP in the mid-1980s to around 75 percent today.[22]

Infrastructure is central to the transformational change that countries are calling for. It is a basis for growth, structural change, urbanization, and climate mitigation and adaptation, as well as for providing access to social services in a more equitable way.

A particular gap is in support for municipalities. Annez and Linn (2010), analyzing the effects of urbanization in developing countries, estimate that "meeting the investment requirements of overall urban infrastructure needs in developing countries could be as much as $120 billion a year."[23] But the WBG mostly provides support with sovereign guarantees, while more and more countries are trying to wean municipalities off dependence on the central government. Providing sovereign guarantees sometimes goes against the thrust of decentralization in many clients.

A non-sovereign facility exists using an IFC platform, but this is sparingly used. Municipal finance is not an easy task for multilateral agencies, although some organizations, like the European Investment Bank and the Andean Development Corporation have been quite successful in this field. Lessons from their experiences and business models could be reviewed.

IBRD, IDA and IFC have significant contributions that can be made to the infrastructure agenda. Aside from the Global Infrastructure Facility that will help to prepare projects, IBRD has one of the largest infrastructure portfolios among multilateral institutions. It needs to assess the degree to which it can and should scale up. It may also need to reform procurement and simplify safeguards in ways that generate better development outcomes, including by speeding up implementation and approval. Viewing these processes in terms of their contribution to good development outcomes, rather than as compliance or risk mitigation for the institution is already a good step forward. IDA also does significant infrastructure financing, but its scale is limited by available resources. Grants and concessional funds may prove to be expensive resources to fully finance the provision of public infrastructure. They can be leveraged and stretched to go further. IDA shareholders should discuss options for expanding other forms of assistance for low-income countries. IFC brings institutional investors to the table, partly through its Asset Management Corporation. It also supports domestic financial institutions that are potentially important funders of infrastructure projects.

The WBG can be effective in raising its own contributions for infrastructure financing as well as intermediating other sources of private capital. Importantly, infrastructure finance is going through a significant transformation as banks (traditionally major funders) become more reluctant to take on risks (for example construction risk), partly in response to Basel III, while pension funds and institutional investors look for large investments that can be actively managed with very small staff and that do not require bespoke due diligence. Providing a platform that intermediates the scale and informational needs of pension funds with the needs of infrastructure projects would be helpful.

What's needed?

- Stronger project pipelines
- Expanded IDA, IBRD and IFC lending for infrastructure in all countries, including a specific municipal lending program
- Better use of guarantees to provide additional leverage (4:1 is a historical average for the World Bank)[24]
- Specific focus on inclusivity and sustainability as a rationale for concessional funding in blended finance packages
- Partnership platforms that can attract capital from new sources

Fragile and conflict-affected states need special support, especially given strong global agreement that no country should be left behind. While projections differ, some facts are clear: (1) within a decade the bulk of global poverty will be located in fragile states, (2) the share of poverty attributable to fragile and conflict-affected states has grown strongly over time, and (3) ending poverty will be hardest in fragile and conflict-affected states.[25]

There is still little agreement on exactly what the most effective interventions in fragile state environments could be, but a new approach is evolving. Writing in *A Case for Aid* (2002), former World Bank President Jim Wolfensohn argued that "large scale financial transfers are unlikely to work well [in low-income countries under stress], because the absorptive capacity in these environments is quite limited." In such settings, he said, capacity-building and knowledge transfer should be the focus, and support for critical basic needs like health and education should be channeled through civil society rather than the government.

Today, the thinking has changed. While absorptive capacity constraints are still a concern, there is a drive by donors to sharply scale up activities in the "Least Developed Countries (LDCs)," a grouping with a substantial overlap with fragile states.[26] The Addis Ababa Action Agenda calls for at least 50 percent of all official development assistance (ODA) to be channeled to LDCs.

IDA has recognized this change with a new allocation approach to post-conflict and re-engagement countries, consolidated into a notion of exceptional support for "turnaround" countries. World Bank President Jim Yong Kim (2013) announced a target of increasing IDA allocations to fragile states by 50 percent in three years.[27] Thankfully, IDA's portfolio in fragile states has improved. Hellman (2013) reports the following: "Since 2009, projects in fragile and conflict affected states (FCS) have out-performed projects in the rest of the portfolio as judged by both internal and independent evaluations. The share of "satisfactory or better" projects has been 5–10 percentage points higher in FCS versus non-FCS over a three year moving average."[28] However, he goes on to warn that doing projects better is only one component of development effectiveness: another component is doing the right projects, something that has not yet been assessed. More recent evidence suggests that the improved FCS project success ratings have not been sustained. The 2014 Review of Annual Performance suggests that between 2011 and 2013 the historical pattern of worse results in fragile states has reappeared.[29] Other MDBs also find worse project performance in fragile states.

Three areas stand out where IDA and IFC could do more in fragile states: raising domestic resources; engaging in institution building (including in security and justice areas); and supporting business and job creation. Domestic resources, and the other side of the coin, and provision of public services, are at the heart of the contract between states and citizens that ultimately leads to stable societies. In the medium-term, the key issue for conflict-affected states is how to successfully transition from peacekeeping to robust institutions capable of halting drifts into conflict.[30] Unfortunately, IDA has constraints on what it can do stemming from the nonpolitical charter of the Bank. For example, it has taken the view that it should not get involved in financing and reform of national police institutions (although community policing can be supported). As achieving political settlement, especially elite pacts, in an inclusive way is critical to securing stability, IDA's restrictions on activities that could have political consequences limit its effectiveness in fragile states.

IFC can also play a role. Research shows that conflict destroys assets and erodes business confidence and investments. Entrepreneurs in conflict-affected settings tend to have smaller start-ups than is the case in non-fragile countries. Their firms grow more slowly, are less likely to upgrade services and products and face significant credit constraints.[31] They need more support.

What's needed?

- IDA must keep (or exceed) its pledge to focus resources on the poorest countries
- IDA should become a global leader in effective delivery of development solutions in fragile contexts and review the boundaries of what constitute "political" activities
- IFC could set up an equity fund for low-income countries in its Asset Management Company that could help entrepreneurs in conflict-affected states and showcase the business opportunities available to those who choose to invest in these difficult situations.

Crisis response in low-income countries. During the 2008/9 crisis, IBRD was able to significantly ramp up its disbursements by 2010 (Figure 3) and this allowed client countries to finance some fiscal easing where necessary. IDA countries, on the other hand, did not get access to significantly more net additional resources. Mostly, IDA's response took the form of project restructuring, frontloading, accelerating disbursements, and other reallocations of existing IDA funds. In other words, long-term project financing was ultimately diverted to meet immediate needs. Without access to substantial new resources, IDA countries had to adjust fiscal policy accordingly. The 2014 West Africa Ebola outbreak again highlighted the problems individual countries can have in responding to large shocks.

Analytically, temporary shocks for any country are best smoothed by borrowing. IBRD lending is therefore a very effective way for countries to smooth resource flows. But concessional funds are not as effectively used for smoothing. If they are to be made available during a crisis, they have to be held back in good times, and that is costly for a resource that is in scarce supply.

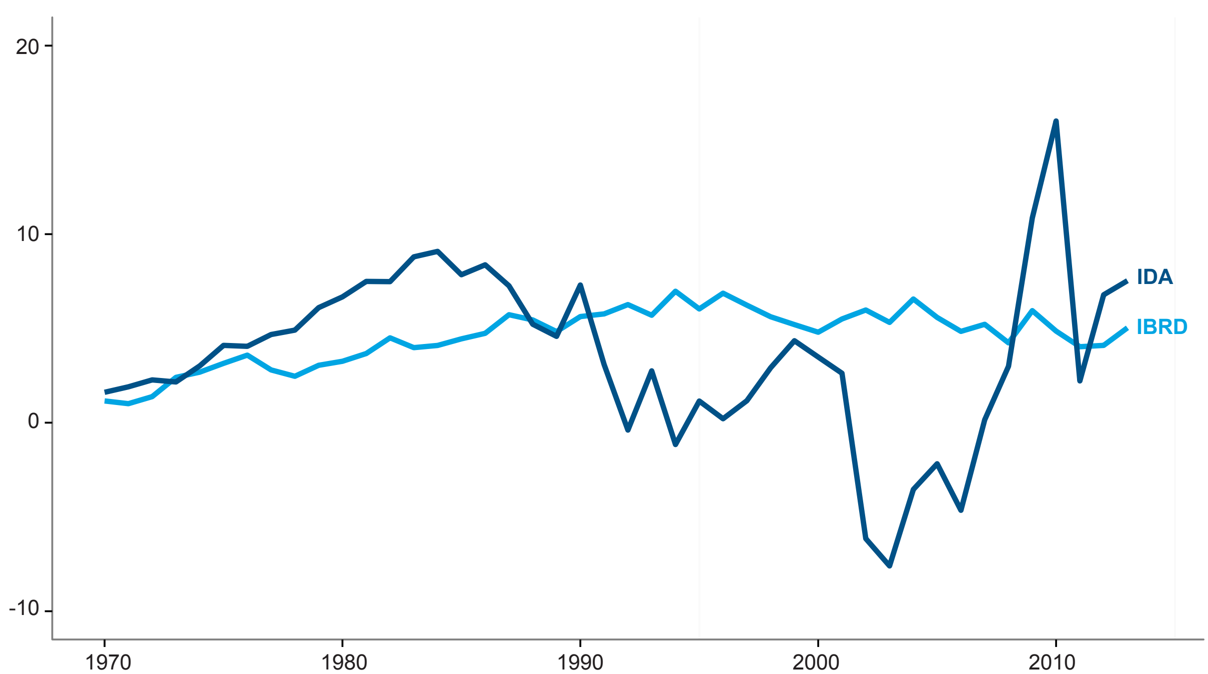
The IDA crisis response window (CRW) illustrates the problem. It requires a set-aside of IDA resources (4.2 percent in the pilot program) to be allocated to countries when predetermined triggers are met. There are considerable benefits from having a crisis response window, as the Ebola episode showed, but by requiring *ex ante* set-asides, the CRW has become a self-insurance scheme among IDA borrowers. It is not an efficient way for IDA countries to adjust to external shocks.

Is it necessary for the WBG to play this function of a counter-cyclical lender? Probably yes. Others do provide countercyclical support; for example, the IMF has concessional credit lines and has announced its readiness to expand these by 50 percent. But these resources are to smooth the balance of payments, not to smooth fiscal expenditures. There is considerable evidence that stop-go fiscal spending is inefficient (especially when infrastructure projects are delayed) and this provides the rationale for the use of instruments other than balance of payments support of the sort provided by the WBG program loans.[32]

What's needed?

- An IDA borrowing facility would allow countries to smooth fiscal adjustments over time.

Figure 3. IDA and IBRD net financial flows, 1970 to 2013 ($2005 billions)



Source: World Development Indicators (2015).

V. CONSTRAINTS

In order for the WBG to do more, it has to overcome some important financial, staffing, governance, and risk tolerance constraints. Perhaps the most underappreciated issue now confronting the WBG is the reduction in its net income on paid-in capital and retained earnings. This income has long been used to cross-subsidize core development activities (lending, knowledge, advisory services, capacity building, convening, and partnerships) that do not currently pay for themselves.

Financial constraints

Each of the three main agencies in the World Bank Group has a unique business model. IDA has relied on a three-year replenishment of donations, mostly from OECD countries. It is now in its 17th round. The IDA model has had considerable success in providing a mechanism through which burden-sharing can be equitably resolved among rich countries. However, it has found it hard to engage with emerging market economy providers of South-South cooperation, like China. It has also had to balance the desire of some donors to provide money in the form of concessional (off-budget) loans, while others provide pure grants. IDA now has to compete with many more funds, including vertical funds such as the Global Fund to Fight Aids, Tuberculosis and Malaria and, potentially, the Green Climate Fund. It must also counter the preferences of many donors to commit development funds bilaterally, or through trust funds where they can enjoy more control and identify impact through a shorter results chain.

At a time when budgetary grants are felt to be the scarcest resources in development finance, the IDA model is under pressure because it has no leverage, has not attracted new donors in a significant way, and has a complex story on results. It is also time-intensive, with a nearly continuous cycle of replenishments and reviews. IDA shareholders impose a large number of conditions that each feel strongly about, but that collectively constrain the institution from the most effective management of funds for development impact. Because there are a fewer number of truly low-income countries among its clients, IDA also faces a challenge of allocating its funds among clients in a way that satisfies all donors.

IBRD, too, is facing a challenge to its business model. Although its accounts are complicated by the large and active use of derivatives, whose mark-to-market value can fluctuate considerably with market conditions, the trend toward low earnings is clear. IBRD has long made money from three sources: earnings on its equity (paid-in capital and reserves), a net margin on its loans financed through borrowing, and fees on and resources from trust funds it manages on behalf of donors.[33] Its equity amounts to roughly $40 billion, while the outstanding loan balance was $152 billion (as of June 30, 2014). The weighted average interest rate of its loan portfolio was 0.9 percent, and the weighted average cost of borrowing was 0.2 percent.[34]

On equity, IBRD made $1.1 billion in revenue in 2014. On its borrowing-financed loan portfolio, it made $861 million. Trust fund resources contributed $465 million to covering expenses. Total revenues have been declining over time, with the earnings on equity contributions particularly susceptible to the prevailing low interest rate environment in global capital markets (Figure 4).

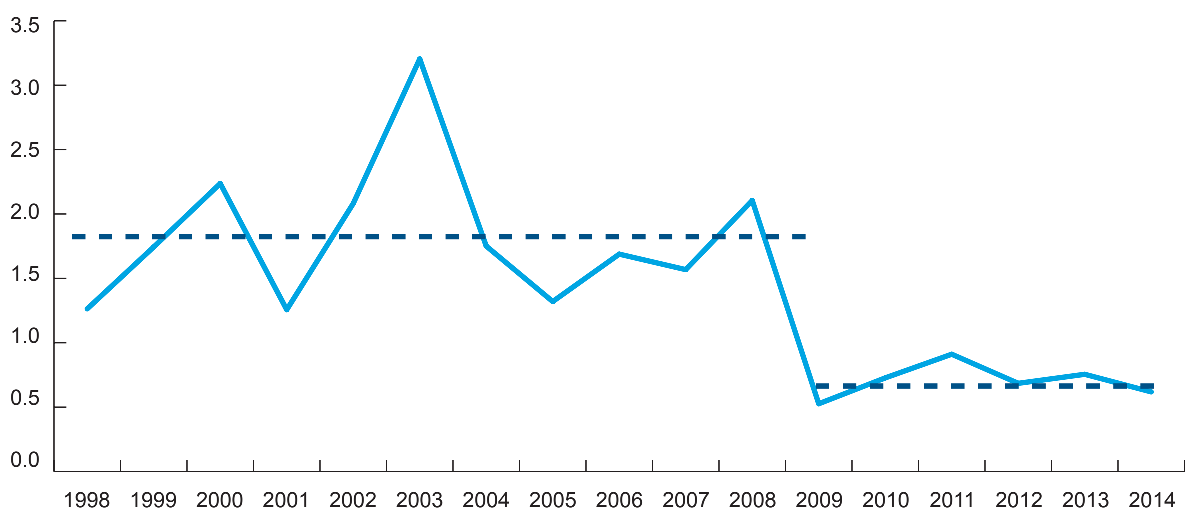
On the other side of the balance sheet, IBRD administrative costs have continued to rise. Staff costs, consultant fees, contractual services, and building-related costs have all outpaced inflation. At the same time, the board has continued to transfer IBRD income to IDA, as part of the Bank's contribution to helping the poorest countries. Unfortunately, it may be transferring money it is not earning in a sustainable way. IBRD has made a cumulative loss of $1.7 billion over the last five years, including unrealized losses on its non-trading portfolio.

Another way of looking at the data is to compare the non-interest administrative cost of IBRD with its net income on loans (the amounts raised through the margins and fees). The ratio is about 1.6, implying that on the margin, costs are far larger than the revenues they generate. In other words, IBRD loses money when it lends. The difference has historically been made up by income from paid-in capital and retained earnings, but this has fallen considerably and is not likely to rise in the medium term given prospects for real interest rate developments in global capital markets.

IBRD management has undertaken a number of measures to bolster net income, including higher fees, lower equity-loan ratios, and the introduction of maturity premiums. It has promised cost-cutting measures, but has yet to see strong results from these. It has benefited from the improved creditworthiness of many of its clients over the last two decades, and has also been able to lend considerably more to offset the negative impact of the 2008/09 crisis.

However, the financial challenge that IBRD faces is the following: with total (paid-in and callable) approved capital of $223.2 billion and a net interest margin of around 0.7 percent between loans and borrowed funds, IBRD revenues are set to stabilize at around $2 billion per year when spreads plus trust funds are aggregated. This is only slightly more than current administrative expenses of $1.8 billion (in 2014). It leaves little room for organic growth of equity and reserves, nor for other important uses of funds like transfers to IDA or other agencies with large development impact.[35] If interest rates were to rise significantly, IBRD would

Figure 4. IBRD operating income ($2005 billions)



Source: Author's calculations based on World Bank (2015, 2005, 2003, 2000) and World Development Indicators (2015).

earn more, especially on its equity. Alternatively, it could try to earn more by improving its net interest margin, but this strategy could backfire if better-performing clients then choose to borrow elsewhere, from regional MDBs, the new emerging market banks, or even in private capital markets. Indeed, higher interest rates could worsen IBRD's "middle-income" country problem of a declining demand for loans that are accompanied by conditions that borrowing countries find onerous.

It would seem that IBRD can best raise its net income by (1) sharply expanding its lending volume while (2) holding down administrative expenses relative to the size of lending. To do this, it would need shareholder approval for more capital and/or for higher leverage. It would also need to shift toward lending that is cheaper to prepare—for example, large investment loans for infrastructure, policy-based operations that rely on fixed-cost analytical work, or results-based operations like P4R.

IFC has a similar business model to IBRD, but it operates with higher margins and higher leverage. IFC total capital in 2014 was almost $24 billion, of which $20 billion came from retained earnings. Its return on capital was 6.4 percent.[36] Its net income was $1.5 billion, on a total disbursed investment portfolio of $36.6 billion. In much the same way as the IBRD earns revenue by charging fees for managing donor trust funds, IFC earns additional income by managing funds for other investors through its Asset Management Corporation.

Historically, both IBRD and IFC have been able to expand by allocating net income to reserves or equity. More recently, however, both organizations have been asked to contribute more to IDA, limiting this source of growth. Selected capital increases have been approved, but these have not yet allowed either institution to expand in a sustainable way.

Taken together, the World Bank Group has administrative expenses of about $5 billion per year. This permits it to support a disbursed portfolio of $324 billion ($152 billion for IBRD, $36 billion for IFC and $136 billion for IDA). Net margins (75 basis points service charge for IDA, and about 70 basis points margin for IBRD—or around 100 basis points when all fees are added in) do not fully cover these expenses. Management should be encouraged to bring lending revenues in line with the true cost of lending operations.

The following facts from FY14 accounts illustrate the nature of the problem:	
IBRD administrative costs (non-interest expenses)	= $1.821 billion
IBRD net interest revenue (after funding cost)	= $0.861 billion
IDA net administrative costs	= $1.369 billion
IDA revenue from service charges	= $1.015 billion

The gap between revenues and costs is filled with earnings on equity and earnings, and trust funds. This is a new and challenging financial environment for the World Bank Group.

What's needed?

There are several ways of expanding operations in IDA eligible countries, several of which have been tabled under the heading of the IDA+ discussions. In general, the common thread is to leverage the large volume of assets held by IDA (about $180 billion) in order to provide a greater volume of funds to IDA clients. This strategy is only viable if IDA service charges fully cover its marginal operating expenditures.

These reforms make considerable sense. If IDA had the authority to borrow, it could be far more effective and efficient in helping countries adjust to shocks in a smooth fashion. It could also sharply increase the volume of public investments in low-income countries.

The simplest solution is to permit IDA to borrow against its assets. IDA already accepts concessional credits from selected donors as part of its replenishment. Many of its clients, including all the blend countries as well as several low-income countries, are already active borrowers in private capital markets. Many are classified as having low risk of debt distress by the IMF. It would seem that this provides a simple and attractive way of increasing the volume of IDA activities by a multiple of two or more.

One risk is that donors might feel less pressure to contribute to IDA in the future if resources can be raised through borrowing. But this logic is inverted. Keeping countries poor in order to encourage donors to maintain their grants is backward thinking. Donors should be encouraged to raise their aid in total, as many have committed to doing in the context of the Addis Ababa Action Agenda and the proposed Sustainable Development Goals. IDA should then present itself as the most attractive channel for implementing aid programs.

An alternative solution, that offers better long-term prospects, is for IDA to follow the same route as the Asian Development Bank and merge with IBRD. If historical IDA contributions can be counted as WBG capital, it would provide even more opportunities for leverage. Such a move would position the WBG to respond more effectively with a full range of instruments to meet each country's needs.

However, a merger of IDA and IBRD would not be simple as these entities have separate statutes. It would require a new model for allocating grants (or grant equivalents from concessional credits) across countries. And it would also raise issues about the governance of the combined body. In the case of the ADB, shareholdings remained unchanged. In the case of a combined IDA/IBRD merger an allocation of financial ownership of equity might have to be separated from the allocation of voting shares in the new institution.

If an IDA/IBRD merger is not feasible, it will still be desirable to expand IBRD lending (again with the proviso that margins should cover full costs of lending). The two options for doing this with the highest probability of success are to make a case for a further capital increase and/or to leverage existing capital further by raising various prudential policy measures like the loan/equity ratio or the statutory 1:1 loans/subscribed capital ratio.

The advantage of a capital increase is that it provides a strong financial basis for IBRD for years to come. The disadvantage is that it can take several years to put in place, it opens difficult issues around governance, and it requires strong political support from the legislatures in shareholding countries.

The advantage of relaxing prudential requirements is that it can provide immediate expansion opportunities. The disadvantage is that these must be well implemented and communicated in order to maintain the AAA status of the institution—a *sine qua non* of any financial reform.

Another option, for both IFC and IBRD, would be for IDA to return a portion of the contributions made to these organizations. That money could then be put directly into shareholder equity. It might, however, appear to look as if poor countries are being asked to finance the development of middle-income countries, something that is at odds with the global consensus to do more for those countries that lag furthest behind.

It is worth noting that most independent analysts believe that IBRD is extremely conservative in its financial operations. Mark Ames of Oliver Wyman, a management consulting firm, concluded that "at current capital levels, MDBs appear to be AAAAA not just AAA."[37] The reasoning: probability of default metrics (credit risk of clients) are quite different for the WBG than for commercial banks because of the preferred creditor status of the WBG and its cooperative shareholding; loss-given-default assumptions are also inappropriately applied, as "losses" tend to be short periods of non-accrual, rather than actualized losses; and concentration ratios and other modelling techniques to minimize risk are unduly conservative in their assumptions.

Humphrey compares IBRD and other multilateral banks with private banks. He points out that the latter have far lower equity-loan ratios (ranging from 14–17 percent compared to IBRD's 30 percent in 2013), despite far higher portfolio risks (3–5 percent non-performing loans, compared to 0.3 percent for IBRD).[38]

The implication: it should be feasible to expand IBRD operations very substantially even without a capital increase if more appropriate financial policies were pursued. The prudential constraints could be relaxed, resulting in a considerable expansion of headroom, without jeopardizing the IBRD's AAA credit rating. The choice between higher leverage or more capital will ultimately be a political one on which shareholders must decide.

If IBRD were able to substantially expand its operations, it would have less need to have formulaic thresholds at its upper and lower ends to allocate scarce resources. It could expand its client base while still providing more support to existing clients. By doing this, it would reduce the restrictions implied by the single borrower limit and it could achieve a better portfolio diversification.

Abolishing the lower threshold limit (that is, the ineligibility of low-income countries to IBRD lending) could generate considerable development benefits. Many low-income countries have accessed private commercial markets at a cost of around 700 basis points, compared to IBRD loans of around 100 basis points. IBRD could surely afford to take the risk of lending to these admittedly poorer credit risk countries because of the benefits it enjoys from its preferred creditor status as well as the portfolio diversification benefits that such lending would bring about. Naturally, individual countries would need to be assessed in detail to determine whether or not they were viable for IBRD lending.[39]

At the same time, IBRD could usefully abolish the upper limit threshold at which it graduates countries. This threshold is not firmly fixed in any case, but there have been several cases of clients graduating only to again require support in the face of a crisis. With a large and expanding financial base, IBRD could instead develop specific products for lending to rich countries, perhaps emulating the successful EIB model where support for public investments in municipals, SMEs, innovation, and infrastructure has been provided.

To some degree, abolishing the lower limit on IBRD lending would be an alternative to the IDA+ expansion discussed above. A combination of grants and IBRD loans can approximate the terms of IDA concessional credits. But countries may not always need very long term maturities. Some projects, for example electricity generation or loans that permit countries to take equity stakes in natural resource exploitation, have pay back periods that are much shorter and that could, therefore be good candidates for IBRD lending.

Getting rid of thresholds would allow the WBG to adapt to a new "map" of client countries.[40]

In its latest update, the Bank shows that only 31 countries with a total population of 613 million (8.5 percent of the world) remain classified as "low-income."[41] This contrasts with 3.1 billion people (56 percent of the world) who lived in a low-income country in 1994. In 2014 alone, Bangladesh, Kenya, Myanmar and Tajikistan graduated to the lower middle-income category. At the other end of the scale, Argentina, Hungary, the Seychelles, and Venezuela graduated to high-income status.

All these countries need support for sustainable development. It is therefore important to address both sides of the spectrum. Strict graduation from IDA and IBRD thresholds no longer make sense.

This phenomenon of a new "map" of client countries for the Bank has been well-documented by Morris and Gleave (2015). They posit, however, that the changes have less to do with reduced development needs and more to do with an arbitrary institutional classification system (based on GNI per capita) that has lost its true relevance as a mechanism for allocating scarce resources.

What is clear is that Bank clients are becoming increasingly diverse in their needs and capabilities. Other factors, including conflict, domestic resource mobilization, growth prospects, economic policy, debt history, vulnerability to shocks, and institutional strength may be additional considerations to income level in determining where countries can tackle their own development problems and where they need support from the World Bank Group.

As countries become more diverse, their financing needs also become more diverse. IDA countries are now calling for more access to IBRD resources, while the IBRD's middle-income country clients are calling for access to concessional funds to help them address issues, like climate mitigation, that have global spill-over effects.

Staffing

High-quality staff has been a key source of comparative advantage of the WBG. The post-2015 agenda will place even more importance on strong staff work. In many areas, including domestic resource mobilization, governance, safeguards and procurement reform implementation, and the move toward reliance on country systems, the new agenda calls for more capacity building. This will have implications for staff and budgets that have not, to date, been fully examined. As one example, implementing the recently approved procurement reform will need significant capacity building, but the funding of this has not been secured—it has been left to a hopeful mobilization of additional trust fund resources in the future.

Getting staff aligned behind the vision of an expanded role for the WBG will be critical. But staff is under stress. Reports from an internal staff survey conducted in 2013 suggest that nearly half of the staff did not think that the Bank "makes institutional decisions in a timely manner," including a lack of trust in the ability of senior managers to lead and empower staff. Less than half felt they "[could] report unethical behavior without fear of reprisal."[42] Results from the latest survey highlight additional declines in staff morale.[43] Further, the 2014 review of the Independent Evaluation Group found that the Bank Group lacks a clear results chain linking activities to global goals, and is suffering from a decline in development outcomes in its lending portfolio.[44] This follows a less-than-stellar assessment in the 2013 review that concluded: "past experience with coordination between the Bank and IFC has been mixed … [and] synergies among and within the World Bank Group have not been systematically exploited."

In effect, WBG staff is being asked to do more with less. In addition to project preparation and analytical work, staff must secure resources from trust funds, ensure compliance with all policies, be partners and coordinate with others, and build capacity in country clients. At the same time, they must cut costs. In managing these difficult trade-offs, staff also are faced with constraints on career development stemming from the narrowness of global practices. Efforts to broaden mobility across practices could be useful.

One way of relieving pressure on staff and permitting them to focus more on capacity building and other substantive work would be to shift more decisively toward policy lending and away from investment projects, especially for small projects that tend to be more staff intensive. New policy instruments, like the Performance for Results program, are still capped in their application and IDA countries, in particular, have lower shares of policy-lending compared to IBRD countries.

If the WBG is to become larger, staff (and consultant) costs must expand relatively more slowly than lending volumes. Otherwise, administrative budget constraints will get steadily worse. However, it is important to retain the country-specific knowledge and advisory functions of the WBG. This implies selective cost reductions. One place to start may be by taking a far more disciplined approach to knowledge work, especially for general knowledge that cannot be readily associated with direct contributions to scaled-up development impact in a specific country. Another option is to rely more heavily on country systems; continued reliance on in-house expertise for all safeguards could put the WBG at a disadvantage compared to other agencies, like the Andean Development Bank, that rely more heavily on national standards and systems.

Governance and risk aversion

IBRD borrowers have less than 40 percent of votes, a share that has expanded by around 6 percentage points in the 35 years since 1980. This is far less than many regional organizations, like the African Development Bank (60 percent borrower voting share), or organizations formed by and for borrowers, like the Andean Development Bank, or the new development banks, the AIIB and the New Development Bank.

Governance affects the WBG in important ways, not least because of the risk tolerance of the organization. Non-borrowers have taken a highly risk averse approach to reforms, perhaps because of the callable capital they have at stake, and the wish to minimize any potential calls on this capital. Compared to organizations with higher borrower representation (and compared with most of its major bilateral shareholders), the WBG has:

- Less cost-effective linkage of safeguard and financial management procedures with development benefits, and greater reliance on a compliance rules-based culture.
- More conservative financial policies.
- Less flexibility in allocation procedures.
- More internal oversight.[45]

At issue is the degree to which non-borrowers support a major expansion in the delivery of development solutions through multilateral channels. Looking narrowly at aid as an example of competing multilateral and bilateral channels, the share of core funding passed through multilaterals (excluding the European Union) has fallen to less than 20 percent. An additional 13 percent of trust funds are channeled through multilaterals, implying that the share of total aid resources flowing through multilaterals (excluding the EU) has remained roughly constant at around one-third.

Some donors, like the United Kingdom, have historically made extensive use of multilaterals as a channel for their ODA disbursements as they moved toward an aid target of 0.7 percent of GNI. Others, including Australia and Canada, have integrated development assistance more closely with national foreign affairs, and so have decreased their use of the multilateral system. There is a wide range among donors, from 25 percent to 80 percent, in the share of aid channeled through multilaterals.

There are other signs of diminished interest in the West and among major borrowers in the importance of the WBG. Some skepticism is ideological. Public financial institutions in general, either domestic or international, have come under attack for simply subsidizing special corporate interests and competing with commercial banks. In the United States, the dramatic fall in Congressional support for the U.S. Export-Import Bank is a recent indication that this view is still widely held.

It is a position with long antecedents. The report of the Meltzer Commission, established by Congress in 1998, famously argued that the World Bank Group should cease lending to middle-income countries entirely and instead focus on providing grants (rather than loans) to the poorest countries. The Meltzer report was also blunt in its assessment of why the U.S. Treasury seemed to favor the expansion of the World Bank over that of regional development banks: “The U.S. Treasury does not wish to see power and responsibility shift to the countries in the region. I [Meltzer] believe a shift of this kind is likely in coming years, and it is best to make the transfer in an orderly way. Indeed, in Europe and Asia the movement toward greater regional control is well underway.”[46]

Another reason for declining U.S. political interest in the World Bank may be that U.S. firms no longer win significant shares of Bank-financed contracts. Zhang and Gutman (2015) show that regional contractors win most contracts for civil works, for instance, in every region except for Africa.[47] The share of internationally competitively bid contracts that is now won by non-borrowers has fallen to very low levels in each of three principal categories: civil works, capital equipment, and consulting and engineering services.

Governance reforms are complex and will undoubtedly move slowly. But if the WBG is to play a more robust role in delivering on the SDG agenda it must develop a greater tolerance for risk and must receive greater support for this from all shareholders. Already the procurement reforms have moved toward allowing approaches that are more tailored to the needs of individual countries and different sectors. Safeguard reforms are also being debated.

One significant remaining constraint lies with creditworthiness analysis. Most of the increase in public investment that will be required to meet the SDGs will have to be financed through debt. Provided the returns are high (and for many SDG investments the benefits are 15 times larger than the costs),[48] more public investment should improve creditworthiness, not reduce it. However, the current approach to creditworthiness, based on a Debt Sustainability Framework (DSF), is extremely conservative. It uses threshold levels for debt/GDP and other ratios that are estimated from historical time periods when interest rates and capital markets were quite different.

Academics have long criticized the debt sustainability approach. Wyplosz (2011) suggests that *ex ante* debt sustainability rules are "mission impossible." This is because the assumptions required to make long-term debt projections, such as for growth, budget deficits and interest rates, are in turn endogenous to debt sustainability.[49] One way out, taken by the IMF and World Bank, is to define sustainability in terms of solvency without major adjustment. But this of course presumes that reform measures cannot be taken.

It is clear that growth plays an overwhelmingly important role in debt sustainability, and that growth in turn is affected by the range of policies and institutions, including the effectiveness of public spending, that determine the impact of external borrowing and public investment. To some extent, the DSF takes this into account, but only in a mechanical way—holding the probability of debt distress constant, it uses higher debt thresholds for well-governed countries. These thresholds, however, do not vary by country (nor over time), and so distortions are introduced.

Even within the IMF there is a questioning of the DSF. Berg et al. find that the DSF is too conservative because it classifies a country as having a high probability of debt distress if any of five indicators surpass a threshold. This "worst-case aggregation" methodology predicts rises too often and so imparts a bias against taking on more debt.[50]

What's needed?

Wyplosz concludes that "trading off growth and debt sustainability will always remain more art than science." If the WBG is to play a significantly larger role in supporting the SDGs, it will need to revisit its approach toward creditworthiness and conduct more country-specific analyses that reflect the credibility of policy-making in individual countries.

CONCLUDING REMARKS

The world is changing at extraordinary speed. Sources of capital and knowledge are proliferating, the Bank's client base has become richer and more diversified, and new institutions with different governance structures have emerged to meet the needs of developing countries. Most significantly, there is a new consensus around 17 sustainable development goals that are universally applicable. All countries will be in need of support for sustainable development. This new consensus is an important departure from the view of the WBG as a sunset institution. Instead it gives all MDBs an enhanced role. The World Bank Group must evolve in very significant ways to support this new agenda.

While all countries need support, there are two clearly identified groups of countries with large gaps. One is the group of Least Developed Countries (with significant overlap with fragile and conflict-affected states, land-locked developing countries, small islands and other constituencies) that primarily need a large incremental infusion of financial assistance, preferably on highly concessional terms in order to ensure debt sustainability, coupled with knowledge and advisory services on how to effectively develop state capacity, achieve structural transformation and deliver social services. The other is a group of lower middle-income countries that have large unmet needs for infrastructure finance in particular, but must also transition policy-making to continue reforms and sustain growth.

The core underserved areas are:

- Crisis finance for low-income countries
- Municipal finance (largely for middle-income countries)
- Blended finance for infrastructure in all countries
- Private finance in least developed countries
- Selected public investment in social services, agriculture, SMEs, and innovation
- Institution and capacity building in a range of sectors

A larger WBG, with a less conservative approach to risk, would be well placed to contribute to this agenda, with important roles for IDA, IBRD, IFC and MIGA.

In moving forward, however, the WBG must overcome three obstacles that constrain its room for maneuvering. Each of the following must be addressed:

- Financial and budgetary constraints
- Staffing constraints
- Governance and risk tolerance constraints

A number of reforms are under discussion that would help the institution move toward offering tailored support to each country, using a full array of instruments: grants, concessional credits, loans, guarantees, advisory work and capacity building. The World Bank Group could deliver more by leveraging its staff and financial resources, balancing the risks to the institution against the risk to clients of inaction (or slow action), and being more flexible in light of country circumstances.

APPENDIX 1. EMPIRICAL DETERMINANTS OF IBRD AND IDA LENDING

Table 1 shows the results of a cross-country, time-series panel regression[51] of the determinants of IBRD lending, covering 107 countries from 1980–2009. The table shows three separate types of IBRD flows: total gross disbursements, gross disbursements on investment lending, and gross disbursements from policy lending (or structural adjustment loans as they were first called).

Table 1. Determinants of IBRD disbursements, 1980/1985-2009

DEPENDENT VARIABLE →	**(gross disbursements / GDP)** *since 1980*	**(gross investment disbursements / GDP)** *since 1985*	**(gross development policy disbursements / GDP)** *since 1985*
↓ REGRESSSOR			
GDP per capita	0.0001	0.0002	-0.0006
	(0.0004)	(0.0002)	(0.0005)
debt service per capita	0.1739*	0.0858*	0.4281***
	(0.1047)	(0.0474)	(0.1031)
foreign reserves / GDP	-8.0940*	-0.2479	0.7096
	(4.3101)	(2.7746)	(8.1391)
investment / GDP	-2.6549	1.5675	-12.983
	(6.1969)	(3.7075)	(11.9791)
saving / GDP	9.7950*	5.5894	5.1278
	(5.1545)	(3.6941)	(7.5372)
net FDI / GDP	8.2522	9.0791**	-21.4379
	(6.0939)	(3.8434)	(15.0346)
real interest rate (%)	0.0000	0.0000	0.0000
	(0.00000)	(0.00000)	(0.00000)
Time FE	Y	Y	Y
Country FE	Y	Y	Y
Observations	2,093	1,862	1,862
Left Censored Obs	942	858	1507
Uncensored Obs	1151	1004	355
Number of Countries	107	107	107

Notes: Significant at the ***1, **5, *10 percent level. Standard errors are in parentheses. Standard errors are clustered by country. The estimated model uses tobit regressions, to account for the high number of country-time pairs that are zero at any particular time.

The first column shows that gross IBRD disbursements are associated with three factors: the amount of debt service a country faces to all creditors (a positive sign indicates that IBRD disbursements are higher in countries with high debt service), the amount of foreign reserves (a negative sign indicates that disbursements rise when reserves fall), and the savings rate.

The second and third columns of Table 2 show the same functional form for two components of IBRD lending: disbursements on investment loans and disbursements on policy-based (structural adjustment) loans. The significant positive coefficient on debt service suggests that IBRD disbursements rise regardless of the instrument used, but the effect of debt service is larger for policy operations. This can be construed positively in terms of the back-stopping role of IBRD in improving a country's access to private commercial financial markets, or negatively in terms of the moral hazard created.

The regressions in Table 1 are also interesting for the lack of significance of key variables. There is no indication that changes in investment rates in a country are correlated with higher levels of IBRD gross disbursements. It is also worth remarking on the lack of significance of the real interest rate variable. There is no indication that IBRD lending adjusts to global credit market conditions, as would be expected from a commercial lender.

IBRD lending is also not affected by a country's income per capita, an interesting finding given the strong role of per capita income in IBRD graduation thresholds, at both upper and lower ends.

Time dummies also show that since the early 1990s, IBRD lending has declined. For the decade from 2000 to 2009, IBRD lending has been 1–1.5 percentage points of GDP lower than in early years.

Taken together, these regressions are consistent with a story that IBRD lending responds to balance of payments and debt crises but does not respond to demand for investments in middle-income countries.

When the same analysis is done for IDA, the pattern is quite different (Table 2). Total IDA gross disbursements are significantly influenced by a country's per capita GDP, its debt service, investment levels, and savings rate. All the coefficients are of the expected sign.

Unlike IBRD, IDA disbursements are more strongly correlated with a country's real economy than its financial conditions. Poorer countries receive higher disbursements from IDA, across all instruments. The impact is more marked for policy operations. Countries with higher investment rates and lower savings rates (higher current account deficits) also get higher levels of IDA disbursements. Conversely, foreign reserves or FDI receipts have no bearing on IDA disbursements.

Table 2. Determinants of IDA disbursements, 1980/1985-2009			
	1	2	3
DEPENDENT VARIABLE →	**(gross disbursements / GDP)** *since 1980*	**(gross investment disbursements / GDP)** *since 1985*	**(gross development policy disbursements / GDP)** *since 1985*
↓ REGRESSSOR			
GDP per capita	-0.0022**	-0.0014**	-0.0047*
	(0.0011)	(0.0007)	(0.0027)
debt service per capita	1.0834***	0.0276	0.6422***
	(0.1995)	(0.0734)	(0.1801)
foreign reserves / GDP	9.5259	2.1979	32.1855
	(10.9685)	(4.9758)	(32.7261)
investment / GDP	18.6427**	11.0493**	34.2707
	(8.1387)	(5.1215)	(28.922)
saving / GDP	-26.1457***	-16.0606***	-13.1198
	(8.5879)	(5.0955)	(10.81)
net FDI / GDP	-19.3937	-4.1017	-24.74
	(14.3371)	(7.083)	(28.3454)
real interest rate (%)	0.0000	0.0000	0.0000
	(0.00000)	(0.00000)	(0.00000)
Country FE	Y	Y	Y
Year FE	Y	Y	Y
Observations	2,093	1,862	1,862
Left Censored Obs	915	856	1402
Uncensored Obs	1178	1006	460
Number of Countries	107	107	107

Notes: Significant at the ***1, **5, *10 percent level. Standard errors are in parentheses. Standard errors are clustered by country. The estimated model uses tobit regressions, to account for the high number of country-time pairs that are zero in any particular time.

These results suggest that IDA responds to the demand for funds from its clients. Poor countries who are trying to invest but lack domestic savings turn to IDA to fill the gap. In this sense, IDA has played a classic development banking function.

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51. We use a tobit specification, to include the large number of country-time pairs when IBRD did not have a positive loan amount. We also cluster errors by country. We did not have access to data after 2009, but casual evidence suggests that IBRD played the same crisis response function in 2010 and 2011 as earlier.

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