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A New Global Agenda: Implications for the Role of the World Bank

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The new global agenda hammered out in 2015 is more comprehensive in scope, more universal in its relevance to countries across the income spectrum, and more ambitious in its targets than the MDG agenda of 2000-2015. The three central goals now are to reignite growth, deliver on the sustainable development goals (SDGs), and ramp up actions in line with the ambitions of the Paris climate agreement.

As focus shifts to implementation, the implications for the multilateral development system in general, and the World Bank Group (WBG) in particular, are being debated. Multilateral development banks (MDBs) have a comparative advantage in providing low-cost, long-term financing, both for projects and, when necessary, for counter-cyclical purposes. They also have a unique ability to deal with risk through their presence in a country, sector, or project.

The present time is one of urgency and opportunity. There is urgency in moving on the global agenda, as time is short to achieve the ambitious goals. There is an opportunity to chart a new course for sustainable development in many countries now, before urbanization and technology choices put countries on paths from which it will difficult and expensive to escape and which will put the global climate goals irrevocably out of reach, with high risks and costs, especially for the poor and vulnerable.

MDBs are the best-positioned agencies to take advantage of prevailing low real interest rates in global capital markets and of the rapid emergence of new technologies. Their ability to leverage official capital and to deploy it across the developing world with the help of new technological solutions is unparalleled.

The new global agenda has highlighted the central role of sustainable infrastructure to growth, to the delivery of the SDGs, and to climate action. Infrastructure is also a sector where private capital and new technologies can be deployed. Yet major gaps persist in developing countries across the income spectrum in the quantity and sustainability of infrastructure. New models are required to scale up. The MDBs, and the WBG in particular, are well placed to provide these new models.

We argue that, in the case of the WBG, a portfolio approach, rather than a country-by-country approach, is a useful device to optimize the overall development impact and the contribution to the sustainable finances for each multilateral institution. For the Bank Group, which is our focus in this note, a portfolio approach implies viewing the International Development Association (IDA), the International Bank for Reconstruction and Development (IBRD) and the International Finance Corporation (IFC) in an integrated way and developing approaches to managing the transition of support from one to the other.

In a portfolio approach, decisions have to be made on how resources are allocated. We suggest using two lenses: (i) a sectoral/thematic lens that can assess the contribution towards the SDGs; and (ii) a country/income group lens that can guide where investments should be made.

Lending to different sectors and different countries generates differences in risks (and financial returns), so these choices on resource allocations must also add up in a way that generates a sustainable financial model for the institution.

The value proposition for development impact we advance is comprised of three parts:

- A transfer of affordable and stable resources to recipient countries through access to low-cost (relative to alternative market access for the borrower) funds from the WBG and the mobilization of financing from other sources, especially from the private sector, through the ability to address impediments and de-risk programs and projects;

- A development benefit that is potentially maximized if a project or program organizes scaled up or transformative change, *or* if it helps build resilience and capacity to rapidly respond to or avoid shocks;

- A global/regional benefit to other countries from spill-overs, most importantly in the areas of climate action, disease surveillance and treatment, conflict prevention, and economic stabilization, all cases where “bads” from a country can seriously affect others.

A Shared Vision for Development

During 2015, the global community reached milestone agreements on the Addis Ababa Action Agenda on financing for development, Agenda 2030 along with 17 SDGs for the world, and the Paris Agreement on climate change. These milestones fundamentally changed the discourse and focus of development cooperation with ramifications much larger than those that prevailed in the MDG period of 2000-2015.

While poverty reduction remains a central overarching goal, the global development agenda embodied in the SDGs is far more ambitious in its articulation of reviving economic growth, achieving sustainable development, and delivering on climate action. The 2030 development agenda recognizes that poverty reduction can only be sustained if several interconnected objectives are simultaneously achieved and if the 17 SDGs are intrinsically connected one with the other. Thus, the expanded scope of the development agenda is not simply a matter of adding new priorities—it is a matter of recognizing that sustained poverty reduction can only happen when objectives and actions across a broad spectrum are aligned. It will be impossible to achieve sustained poverty reduction without strong foundations of growth or without tackling climate change, and it will not be possible to tackle climate change without more sustainable growth and poverty reduction.

The new development agenda establishes priorities and indicates areas where incremental spending needs are likely to be largest. These are clearly spelled out in the Addis Ababa Action Agenda. They are: (i) scaling up social protection and essential public services (estimated at upwards of $100 billion per year); (ii) scaling up efforts to end hunger and malnutrition and promote climate-smart agriculture (estimated at upwards of $100 billion); (iii) meeting the enormous needs for sustainable infrastructure (estimated at $3.5 trillion to $4.5 trillion annually in developing countries alone); (iv) boosting private sector development, including industrialization and job creation (estimated at $2.5 trillion for small and medium enterprises alone); and (v) promoting good governance and capable public sector management as a central foundation including to build peaceful and inclusive societies.[1] It is magnitudes like these, rough though they may be, that give rise to the phrase "from billions to trillions" and to the clear recognition that catalyzing private finance for development is of critical importance.

This understanding that a scaled up effort is required across a range of sectors applies equally to all developing countries, low-income and middle-income, but will differ in the details depending on country circumstances. Historically, social protection and public service delivery along with food security have been emphasized in low and lower middle-income countries (LICs and LMICs), while private sector development and infrastructure have been important for middle-income countries and even some high income countries (HICs). But this narrative is eroding. Private sector development is now seen as critical for LICs and even fragile and conflict states. Upper middle-income countries (UMICs) face important needs in human development. Countries across the spectrum need support in improving governance and public sector management. And all countries have large unmet investment requirements for sustainable infrastructure.

In addition to specific country needs, the new global agenda also recognizes that spillovers between countries are an externality that international public financing is well-suited to support. There is considerable debate as to whether to cast the WBG as a provider of public goods (meaning goods that the public sector should provide, not the classic economic meaning) in general, or as supporting the national development interest of individual countries in areas that have global spillovers. In reality, these will blur into each other—selected interventions at the country level will be the means to pursue national development goals while simultaneously addressing global challenges. Arguably the most important example of this is the role that the WBG and other MDBs can play in boosting the quantity and quality of investments in sustainable infrastructure. Sustainable infrastructure deserves special consideration

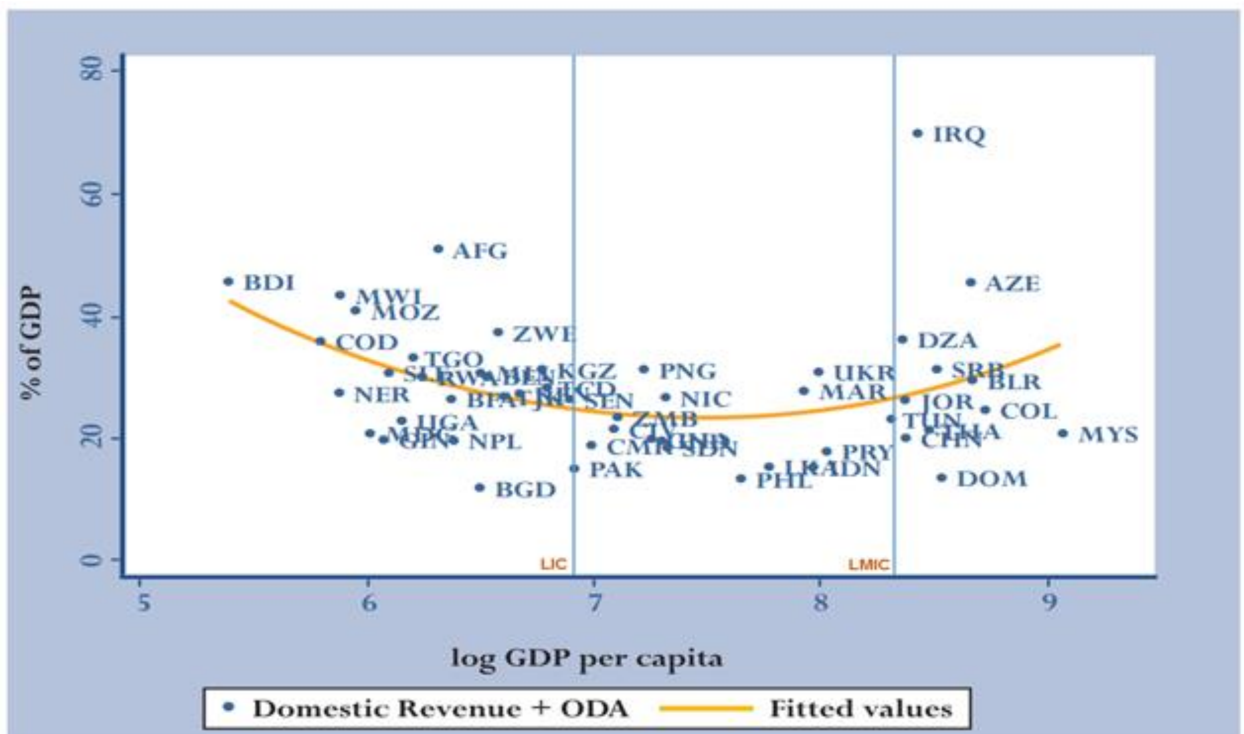
[1] Estimates should be considered rough magnitudes spelled out in Intergovernmental Committee of Experts on Sustainable Development Financing, August 2014. Infrastructure estimates are from Bhattacharya, "Delivering on Sustainable Infrastructure for Better Development and Better Climate." http://www.un.org/ga/search/view_doc.asp?symbol=A/69/315&Lang=E

because this is where the largest financing requirements lie, and because infrastructure will lock in place patterns of sustainable consumption and production for decades to come, so there is a one-time opportunity to get it right in the next decade or two.

While development challenges will remain more daunting in poorer and more vulnerable countries, middle-income countries are critical to the successful implementation of the new global development agenda. The multilateral development system can play a significant role in advancing the shared vision and goals of the global development community, but its principal comparative advantage lies in doing this through specific investments in each client country.

At a macroeconomic level, LMICs face a challenge in expanding public spending. Their domestic resource capabilities are often underdeveloped, and at the same time they face a reduction in access to official development assistance (ODA). The figure below shows the resulting trough faced by LMICs. When available public resources, defined as domestic revenues plus ODA, are plotted as a share of GDP against GDP per capita levels, it is LMICs that have the smallest access to resources. At upper middle-income levels, domestic resource mobilization (DRM) fully compensates for graduation from ODA.

Figure 1: Domestic revenue plus ODA across income levels, 2010



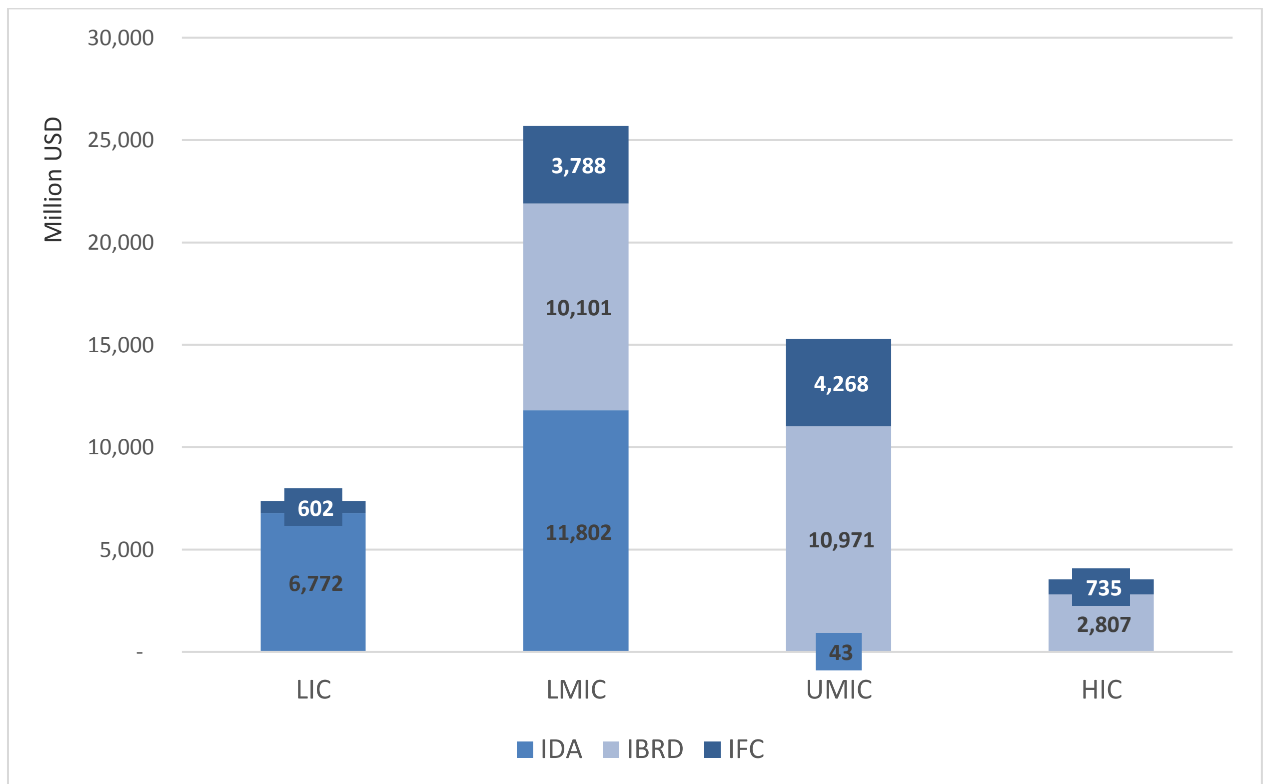
Source: Authors' calculations based on World Development Indicators (2014) and International Centre for Tax and Development (2014)

Note: Figure reproduced and adapted from Kharas and McArthur, "Nine Priorities for Action at Addis"

The mix of countries within each income classification is changing rapidly over time. A rough analysis suggests that, although IBRD clients are roughly evenly split between lower-middle-income (52 countries) and upper-middle countries (55 countries) at present, by 2025, perhaps 14 countries will graduate from lower-middle-income to upper-middle-income status; another 14 will graduate from upper-middle-income to high-income status. Developing a shared vision for managing these transitions, as well as the transition from IDA to IBRD, will be important.

The starting point (FY2015) for the WBG is shown in the figure below. The WBG as a whole committed some $50 billion in FY 2015 to specific countries, excluding multi-regional and global projects. LICs receive a small dollar amount, almost entirely from IDA. The roughly $7 billion per year they receive should be compared to an aggregate GDP level of $400 billion (about 1.8 percent, or $11 per capita). LMICs receive the highest total flows, over $25 billion per year, but their GDP is $5.8 trillion, so the WBG commitments are well under 0.5 percent of GDP or $8.5 per capita. UMICs receive about $15 billion, but their aggregate GDP is $20 trillion. So the commitments are under 0.1 percent of GDP or $5.9 per capita.

Figure 2: World Bank Group Commitments 2015 (Income group and lending Entity)



Source: Authors' calculations based on published WBG data

Note: Excludes global and multi-regional funds and projects.

Set against the scale of SDG needs, it is clear that a substantial expansion of WBG resources would be welcomed by developing countries. The proposals to expand IDA significantly by mobilizing private funds while maintaining a AAA rating are a good first step. Expansions in IBRD and IFC should now follow suit. Equally clear is that it is not realistic to imagine that the WBG or the multilateral bank system as a whole can provide the full scale of needed resources. This implies that catalyzing private finance, and allocating scarce MDB resources, should occupy center stage, regardless of the size of any capital increase that shareholders may agree on.

Value Proposition I: Low-cost affordable resource transfers and de-risking private capital

The expansion of IBRD and IFC commitments in the past few years suggest that non-concessional public financing is highly desirable to clients in current market conditions.[2] This is not surprising. Although global real interest rates are low, the same is not true in development finance. Globally, long-term finance

[2] Although important for the discussion, we do not discuss IDA allocations here.

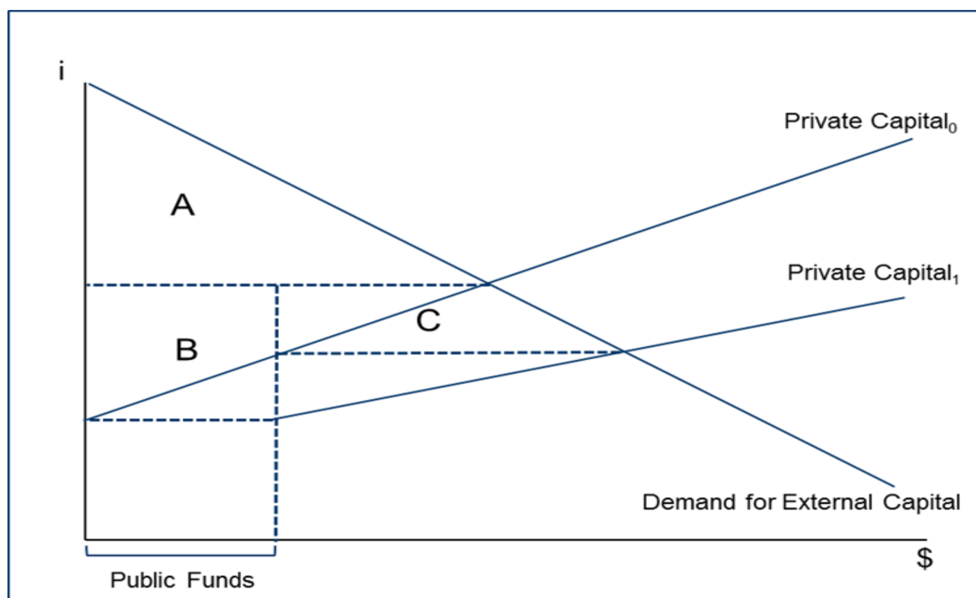
is a segmented portion of capital markets, that is hard to access at scale, and it commands a premium price. Developing countries pay an additional premium for their long-term debt. And in selected sectors, such as sustainable infrastructure, there is yet another risk premium that is added. These features of the current private capital market make the value proposition of multilateral financing highly attractive even today.

It is useful to decompose the benefit of official lending into one component that reflects the implicit gain from directly accessing official lending at below-market interest rates and a second component that reflects the catalytic impact on private financing that can be generated. Official financing carries favorable terms: IDA remains the most important source of multilateral concessional finance, IBRD has long offered finance at low interest rates, and IFC offers favorable terms to private sector clients compared to market alternatives for its clients. Borrowing from the WBG therefore represents a resource transfer that is valuable and given the leverage of the institution it is a very efficient model for transferring resources at scale.

At the same time, more can be done to add value through mobilizing and catalyzing additional private financing as described below. Mobilizing capital, through direct co-financing, guarantees and other forms of structured project finance, is one way of crowding-in private capital, but has been used rather modestly to date. OECD estimates that all international official agencies mobilized about $14 billion of private capital in 2014. Catalyzing private capital, by improving the investment climate, or supporting reforms in public sector management that permit countries to issue bonds directly, is perhaps quantitatively more significant, but still limited to a few countries.

The two benefits are illustrated in the figure below. Without official lending, a borrower's welfare gains from borrowing in international private markets is given by area A, where the interest rate and the volume of financing is given by the intersection of supply and demand curves. When official lending is added, the supply curve is shifted to the right, and the shape of the supply curve is changed. This happens if, for example, the official lending improves the rule of law or other conditions making for more favorable access to private capital, or if private capital is de-risked through the provision of public funds. In the figure below, the supply of private capital is flattened in both cases.

Figure 3: Welfare gains from foreign borrowing



The marginal benefit of official lending to the borrowing country is given by areas B and C. Area B is a measure of the direct benefit of official lending compared to borrowing from the market. Area B is therefore greater when (i) the opportunity cost of borrowing from the market is higher (less creditworthy and usually lower income countries); and (ii) the degree of concessionality of the official lending is higher. Area C is a measure of the catalytic impact of public funding. It is higher when the impact on the supply curve is higher. It is also higher when the demand for capital is flatter. This will tend to expand the volumes of private capital catalyzed by a given shift in the shape of the supply curve.

The gains to clients have implications for allocations to countries and sectors. In general, the higher the alternative cost of capital for a specific investment in a specific country, the greater is the direct benefit from providing official finance (area B). This implies that lending could be allocated, in part, as a negative function of per capita income, as GNI per capita is typically also closely related to the spread a country pays. But GNI per capita is only one variable that goes into spreads. Small island economies that are vulnerable to external shocks, for example, tend to face higher spreads than their GNI per capita would suggest. Similarly, fragile states face higher spreads than their income levels. Some sectors may also be perceived as riskier than others. As suggested above, this seems to apply to infrastructure where construction and policy risks are commonly cited as obstacles. Furthermore, the potential to mobilize and catalyze additional private capital must also be factored in (area C). In some middle-income countries, the catalytic role of international financial institutions (IFIs) might unlock significant amounts of private capital, for example if investments in a particular sector can be opened up through policy or institutional reforms or through risk mitigation measures at the project level.

In practice, most middle income countries (and a dozen or more low income countries) already have a sovereign credit rating and this can be used as a proxy for understanding where foreign exchange is most scarce, and therefore where WBG lending could add most value. But of course an allocation strategy that directs capital to where it is most scarce implies lending more to riskier borrowers, so would have to be tempered with appropriate safeguards to protect the quality of the overall portfolio. Since financing requirements will remain large in absolute terms for middle income countries (especially for faster growing and more populous countries facing large infrastructure deficits), the WBG can allocate relatively more capital and lending to the least creditworthy borrowers while preserving a balanced portfolio.

This stylized depiction of gains from catalytic financing associated with public lending mask a range of specific actions around de-risking. Policy changes associated with public funding, perhaps including those in the *Doing Business* indicators, can be a powerful force in inducing additional private capital flows. So can de-risking link to the presence of official lending and its role in structured financing for large-scale infrastructure or scaled up platforms. De-risking can take the form of improved due diligence in project identification and supervision to improve implementation. It can take the form of strengthening of key institutions that regulate private investments or implement public investments. It can also be dynamic, when risks change as projects mature. MDBs can target and mitigate early stage risks during construction, crowding in private equity and debt finance, and mitigate revenue risks (including currency risk) once projects reach completion, facilitating private take-out financing.

The WBG has a suite of instruments—public financing, private financing, insurance, guarantees and advisory services—to crowd-in private capital, but tends to deploy them individually and idiosyncratically rather than strategically and as part of a concerted solution at scale to tackle a given development challenge. We want to stress that de-risking and crowding-in can be achieved with advisory services, technical assistance, and capacity building, as well as by deploying financial instruments like guarantees. In many areas, from small and medium enterprises (SMEs) to financial inclusion to infrastructure, development impact is magnified when a concerted bundle of advisory services and finance is prepared as a solution for clients—either through support to strengthen the enabling environment, or through measures to mitigate risks and enhance effectiveness of programs and projects.

It is also worth keeping in mind that the catalytic impact of official lending depends on implementation. The theory of how to catalyze private finance may not always work in practice. If catalytic financing is to

become an operational criterion for assessing interventions *ex ante,* it will need a body of evidence to support the link between actions and outcomes. Indeed, one major complaint from developing countries today is that private capital is not yet flowing to key sectors despite more projects being identified and policies improved.

The arguments above are couched in macroeconomic terms, but increasingly, the lower cost of capital itself is an important variable in altering the microeconomic choices that countries make at the project level. For example, a typical least-cost power plant may be fossil-fuel based if the cost of capital is 10 percent, but renewable energy will be more attractive if the cost of capital is 3 percent simply because of the different profiles of fixed investment and operating costs between the two choices. The lower cost of official funding can also be used to extend coverage of essential services to low-income regions, or to otherwise ensure affordable access to basic utilities. Thus, through the allocation of WBG capital, the global community can alter incentives so that individual country choices contribute to the inclusive solutions and low-carbon outcomes that the global community would like to see.

Value Proposition 2: Maximizing development impact through scaling up and building resilience

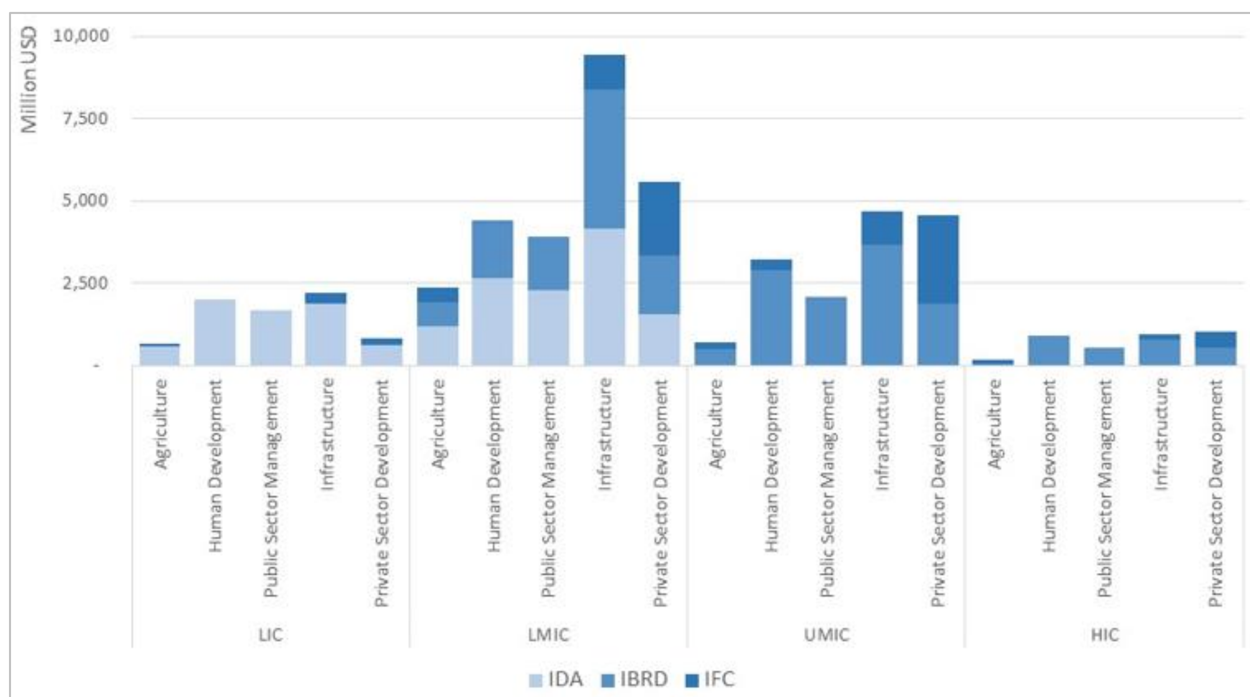
How should WBG resources be allocated to maximize the contribution to the SDGs and other development objectives? We suggest that the highest impact comes when projects or programs are scaled up nationally or when they have a transformational development impact in a selected sector. A second criterion to use in assessing development impact is whether an intervention builds a capability to address fragility and provide resilience to an increasingly broad range of crises, shocks, and negative spill-overs from neighbors. One of the key findings of the *Growth Report*[3] was that avoiding large negative outcomes was more important for sustainable development than achieving growth spurts.

The WBG addresses many issues, but, as noted above, the greatest need for scaled up impact among the SDGs is in (i) delivery of essential public services (poverty reduction, social assistance, education, health, water and sanitation); (ii) resilient agriculture (to end hunger and malnutrition); (iii) sustainable infrastructure, especially in energy, transport and cities; and (iv) private sector development for industrialization, jobs and SMEs. These sectors account for the vast bulk of the investments needed for achievement of the SDGs. They are also sectors where scaled up development impact is necessary and an immediate imperative. In addition, the WBG has a long and successful tradition of structural reform through improvements in public sector management, improved governance, strengthened institutions and better policy frameworks across all sectors and in cross-cutting areas like gender, transparency, and accountability.

The allocation of funding by sector cannot be considered in isolation from the allocation of funding by countries (or country groups). To show this, the figure below approximately configures WBG commitments in 2015 by the main SDG priority sectors across country categories. The totals for the whole WBG are as follows: agriculture/food security 8 percent; human development 20 percent; public sector management 16 percent; infrastructure 33 percent; private sector development 23 percent.

[3] Commission on Growth and Development, 2008, *The Growth Report: Strategies for Sustained Growth and Inclusive Development,* *https://openknowledge.worldbank.org/bitstream/handle/10986/6507/449860PUB0Box3101OFFICIAL0USE0ONLY1.pdf*

Figure 4: World Bank Group Commitments (Income group, sector, and lending entity)



Source: Authors' calculations based on publicly available data.

Note: Some assumptions have been made to organize the data in this form, and so the numbers should be treated as approximations, but we believe they are a fair representation of actual commitments.

The figure suggests that both sector composition and source of financing varies across income groups. In LICs, public sector management and human development are relatively more important. In LMICs, infrastructure dominates. In UMICs, the focus shifts to private sector development. Human development and public sector management are important themes across the spectrum of countries.

About one-half of WBG resources are currently focused on LMICs. But for both IBRD and IFC, UMICs represent more than half of total lending.

This decomposition suggests there is a certain logic to the existing system of resource allocation. But it also reveals considerable overlap between IDA, IBRD, and IFC, especially in LMICs. This overlap presents an interesting opportunity: Could a blend of IDA, IBRD, and IFC provide for a more scaled up solution, especially in LMICs where all three agencies have a major footprint? Which is the best instrument to use? Could greater engagement of IBRD and IFC in LICs in infrastructure and private sector development, say, allow IDA to scale up in other areas?

There is not much difference in the sectoral allocations between IDA and IBRD, suggesting considerable opportunities for blending resources when desirable to incentivize governments to adopt more platform approaches to their challenges. This applies in three major sectors: climate-smart agriculture/food security, human development, and infrastructure.

IDA may be a better-suited instrument of choice for institutional strengthening, capacity development and other innovations in public sector management, while IBRD might focus more on private sector development and issues such as debt management and DRM where returns to the treasury would be more immediate.

Looking ahead, the proposed expansion of IDA would likely provide an even greater volume of resources to 'blend' LMICs (those receiving both IDA and IBRD funding) as these would be best positioned to absorb the private funds that IDA is planning to mobilize. If current allocations remain the same as those of FY2015, IBRD and IFC expansion would channel a majority of resources towards UMICs.

Given its current size and focus, a larger WBG could make a considerable contribution to the needed investments in climate-smart agriculture and in human development if the right platforms are developed. The report of the International Commission on Financing Global Education Opportunity makes a similar point: "no country that has committed itself to investing in and reforming its education system should be prevented from achieving its objectives because of a lack of resources."[4]

The largest gaps relative to need are in the areas of sustainable infrastructure and private sector development, especially for SME development.

Infrastructure is the largest major sector for the WBG, yet also poses the largest challenge in terms of scaling up. Surprisingly, considering the attention devoted to public-private partnerships in infrastructure, IFC had the lowest share of infrastructure in its 2015 commitments among the WBG entities. If sustainable infrastructure is to be scaled up, it will require a determined push to mobilize and catalyze far greater volumes of private finance. The rationale for public involvement is both the externality created from moving towards low-carbon systems and the externality attendant from ensuring equitable, inclusive, and affordable access to infrastructure services.

One argument for a major push on sustainable infrastructure today is that there is a unique window of new infrastructure construction that will be put in place over the next two decades in response to urbanization. Over the next 20 years, about 2 billion people will move to cities. The shape of urban investments will dictate whether these become centers of squalor or platforms for prosperity. In middle-income countries alone, the new infrastructure in urban areas will be 1.5 times as large as the accumulated stock of current urban infrastructure. Once locked in place, urban investments will determine the degree of sustainability of future consumption and production patterns. Emerging markets and developing countries will account for almost all of the incremental global carbon emissions; a shift towards more sustainable infrastructure will be critical to meeting the global climate goals given the shrinking carbon budget.

In each sector, scaling up development impact requires a platform or programmatic approach that back-casts from the target set for 2030 to the current situation and thereby deduces the required trajectory of change. Scaling up can be constrained by many factors, but some are common to all sectors. It requires up-front investments in planning and policy change; a major effort to identify and prepare bankable, sustainable projects; a focused approach to implementation, often associated with governance improvements in major implementing institutions, and mechanisms for raising financing—public and/or private—at sufficient scale. Those countries that can put in place such platforms or programs probably merit greater financing and other support from MDBs.

The conditions for scaling up will not be present in all countries, nor in all sectors within a country. Thus, using the potential for scaling up to achieve transformational change as a criterion for effectively allocating WBG resources would not necessarily correspond to any *ex ante* country allocation. One would need to consider evolving country-specific conditions.

We would underline that sustainable infrastructure needs do not decline with income, and the scale required could exceed the domestic resources even of UMICs. As a practical matter, the absolute amounts of investments into sustainable infrastructure will be largest in today's UMICs. Even if these countries have greater scope to mobilize public and private resources, IFIs can play an important catalytic role in

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[4] Report by the International Commission on Financing Global Education Opportunity, 2016, p. 11, "The Learning generation: investing in education for a changing world" http://report.educationcommission.org/wp-content/uploads/2016/08/Learning_Generation_Exec_Summary.pdf

mobilizing and reducing the costs of long-term capital. As indicated above, by improving access to and reducing the cost of capital, MDBs can help promote more sustainable investment strategies across the range of energy, transport, and urban systems. Support for sustainable infrastructure in these countries could have important global spillovers in terms of impact on growth, trade and climate.

Scaling-up is one of the criteria we propose for assessing development impact. The other is building resilience and reducing risk. Repeated studies suggest that the costs of shocks are magnified when there is no institutional ability to respond at the speed and scale required. Natural hazards can be transformed into disasters without adequate preparedness. The Sendai Framework, for example, provides toolkits for global response and the WBG has established a strong track record of disaster risk reduction. Pandemics are less costly when stopped early, as Nigeria showed during the Ebola epidemic. Fragility to weather related shocks like El Nino can be offset by strong social assistance programs (as in Ethiopia) and better climate-smart agriculture. Stabilization programs, commodity stabilization funds and sound debt management frameworks are ways of institutionalizing policy responses to economic shocks and avoiding crises.

In each of these examples, IDA and IBRD have demonstrated strong track records that have helped clients respond quickly to natural hazards, pandemics, or sudden stops in private capital. The resources provided by IDA and IBRD have permitted counter-cyclical government spending that helps avoid major waste associated with stop-go investment planning and helps reduce the human costs suffered in the event of disaster. Prevention has been more cost-effective than reaction.

Institutional capacities need to be scaled up to achieve resilience. For the most part, the challenges are largest in LICs and LMICs, and the focus of WBG activities in building resilience can be concentrated there. Other economic shocks, however, cannot be predicted and hence the *ex post* allocation of resources to countries will be equally unpredictable. This is an example of a situation where a country-allocation approach would not be appropriate.

Value Proposition 3: Addressing cross-border spill-overs

A third criterion for assessing the contribution of the WBG is the impact on cross-border spill-overs. The most obvious and arguably the most important of these is the contribution that can be made to global climate action. The WBG is well positioned to contribute to both the mitigation and adaptation actions that were committed to under the Paris Agreement. Since the preponderant share of incremental global carbon emissions will come from middle income countries—both upper and lower middle income—the WBG can play an important role in the global agenda by supporting middle income countries to adopt low-carbon development paths. In practice this entails a significant scaling up of support for sustainable and climate-smart infrastructure. In the current economic environment, it is more difficult to make the case for low-carbon investments if the costs of market financing make these investments less attractive financially. The MDBs, including the WBG, have committed to significantly increasing their financing for climate-related investments as part of the global commitment to mobilize an additional $100 billion in financing per year by 2020 from public and private sources to help developing countries cope with climate change. That commitment to mobilize $100 billion was reaffirmed in the Paris climate agreement. As discussed earlier, financing from the WBG can tilt incentives towards more sustainable choices by reducing the cost of capital and by mobilizing much larger volumes of private finance needed to meet the scale of demands for sustainable infrastructure.

The WBG can also assist countries to adapt to the inevitable effects of climate change. The largest needs will be in poorer and more vulnerable countries, and have to be met therefore primarily from concessional sources of finance.

Beyond climate, many spill-overs relate to fragility. Large-scale migration and refugee flows have been linked to weather-related and conflict-related shocks. Affected countries are those in the neighborhood. Income levels are not a factor.

Given its substantial presence on the ground and ability to develop broad and coherent policy packages, we propose that the focus of the WBG efforts on global and regional public goods be placed on country-specific interventions, like low-carbon infrastructure or climate-smart agriculture. As the case of assisting refugees in Jordan has highlighted, this could require development of non-traditional packages of assistance, especially in UMICs.

A Sustainable Business Model

Both the sector and country approaches to assessing development finance suggest that the demands on the WBG will be much greater than in the past. Needs relative to economic size and population will be the greatest in poor and fragile countries, but absolute financing requirements will be much larger and roughly proportional between lower middle income and upper middle income countries.

The combination of the different arms provides the WBG a potent mix to respond to these needs across the different sectoral priorities and country groups.

An expanded IDA (by augmenting the envelope and increasing leverage) can play a key role in supporting scaling up in the poorest and most fragile countries, as well as in the bottom tier of LMICs whose needs cannot be fully met by IBRD because of creditworthiness. In terms of sectoral priorities, IDA has greatest comparative advantage in supporting human development and assisting poorest and most vulnerable countries cope with shocks.

IBRD and IFC will also face increased demands from all country groups. IBRD loans have a shorter maturity than IDA (usually 10-20 years). While in general this implies that IBRD loans are most beneficial in LMICs, where DRM can pick up the burden of debt service over time, they can also be used in LICs if the project itself generates reasonable financial returns. This is the case for many sustainable infrastructure projects, especially those where private sector investments ensure that positive cash flows are built into project design. This implies that there may be a case for IBRD lending even in poor countries, and scope for significant expansion in IBRD lending for sustainable infrastructure development and private sector development in LMICs where there are major opportunities for scaling up.

Similar arguments pertain to IFC. Experience suggests that good returns can be found even in LICs, but that de-risking through public funds might be needed in some cases. As a practical matter, the more involved IFC and other private co-financiers become, the more care will need to be taken to ensure competitive processes are in place to ensure that the allocation of public subsidies is appropriate. IFC does have business models in place to recover costs from directly mobilized private financiers, so can potentially scale rapidly in the right environment.

IBRD can continue to catalyze scaling up actions on human development in upper middle income countries even though the vast majority of funding will come from domestic resources. Both IBRD and IFC can also help scale up investments and financing for sustainable infrastructure through direct financing and risk mitigation. Although most of the financing will come from the private sector, the absolute scale of the needs and the importance of addressing policy and institutional impediments suggests that IBRD financing needs to expand both to support development needs and the spillover gains for global climate goals.

A significant challenge for the MDBs including the WBG is maintaining financial sustainability in a low interest rate environment that is likely to persist for the foreseeable future. The WBG has taken important internal reforms that permit scaling in this new environment. Most fundamentally, its pricing policy for individual activities is now more closely related to the cost of providing the service. With full cost recovery in place, at least for lending, scaling up can become consistent with a sustainable financial model.

However, there is no current business model for adequately recouping the cost of IBRD non-financial engagements that serve to catalyze private finance. For example, if IBRD helps establish a platform that other lenders can also use to scale-up financing in a sector, the costs of that cannot necessarily be

recouped through margins on IBRD loans themselves. It is easier to recoup costs in structured finance packages, but even there, the scale of IBRD due diligence required to provide the needed de-risking comfort around sustainability can be substantial.

If IBRD is going to become serious about helping countries establish scaling up platforms, it will need to refine this portion of its business model.

In the case of IBRD, the pricing of loans to individual countries does not reflect differences in creditworthiness, and indeed, the cooperative nature of the WBG, along with the implicit preferred creditor status its borrowers have conferred on it, suggests it should not. Loan pricing must therefore adequately reflect the average risk of the portfolio. Indeed, if, as we have argued above, the greatest financial benefit to clients comes from lending to the least creditworthy, then overall risk must be carefully considered.

The diversity of middle-income countries today permits the WBG to diversify and reduce average risk through a portfolio approach in a way that was not possible before. When all developing countries were impacted in similar ways by global economic conditions, there were limited opportunities for the WBG to diversify risk. But today, this is not the case. Developing countries have taken on their own risk characteristics and this allows far larger portfolio benefits from diversification across countries.

One example of this, in practice, is the minimal change in risk that rating agencies ascribed to the reforms in the Asian Development Bank (AsDB). The diversification benefits of taking over the assets of the Asian Development Fund outweighed the lower average credit quality of those assets. The new, expanded balance sheet of the AsDB remains as healthy as ever, while its capacity to leverage more has increased substantially.

Considerable diversification can be achieved even among LMICs, so diversification is not in itself a determining argument for lending to UMICs. Of course, the larger the pool of countries, the greater is the potential for diversification and the WBG will only remain a true World Bank if it continues to have a significant presence in all member countries.

Overall, it should be recognized that the question about the allocation of IBRD resources is intimately linked with the scale of resources. If IBRD can scale up substantially, it will be able to engage with the full range of clients, both in LMICs and in UMICs, without needing to confront the issue of trade-offs in terms of lending to one group or another. Indeed, in a dynamic sense, a scaled up IBRD would add profits and reserves to its balance sheet that would fuel a further expansion in lending. A smaller IBRD will force a more acute discussion on trade-offs in allocations.

Implications for IBRD

This brief overview of context and role suggests a core set of questions to address.

- How ambitious should shareholders be in the context of the new global agenda and its imperatives of reigniting global growth, delivering on the SDGs, and taking bold climate action in line with the Paris Agreement? We argue that, given its comparative strengths to mobilize financial resource transfers (public and private), to catalyze transformational development impact, and to help respond to fragility and shocks, it would be sensible to position the WBG to do much more. The scope and nature of required investments, especially over the next 20 years when sustainable infrastructure must be built, suggest that both public and private financing solutions must be brought to bear on a far greater scale than at present and that focus should shift to platforms that can be truly scaled up.
- How should IBRD adapt its strategy according to country context? There is sound logic to the idea that the direct benefit from higher financial transfers is larger in low income and lower middle-income countries. This is particularly true for investments in core public services that countries

can afford to fund themselves as they grow richer. However, the value proposition for WBG activities rests on several other criteria that are not closely linked to income per capita.

The benefit from financial transfers depends, as we argued above, not just on the lending from the WBG's own balance sheet, but also on the mobilized and catalyzed private capital that is crowded-in. The development impact, including the potential for scaling up, depends strongly on sector and country context. The huge needs for sustainable infrastructure in upper middle-income countries can benefit enormously from support from the WBG. Investments in sustainable infrastructure in these countries will be critical for their sustained growth and development and will have important global spillovers. And the need for flexibility to respond to crises and fragility, while perhaps focused on low income countries, will extend to many other countries at all income levels. From this perspective, traditional graduation models, or country allocation models based purely on per capita income, do not appear well-suited to the current context. Per capita income can be a useful starting point, but ultimately, country allocations should be based on an assessment of where the value added by the WBG is greatest. The implication is that individual projects and programs should be considered in terms of their broader development impact, as well as their potential global spillover benefit. It could be the case that, viewed with this lens, upper middle-income countries and even high income countries should remain WBG clients.

How should IBRD approach risk? IBRD lending in the past has been positively correlated with per capita GNI—more lending to richer, more creditworthy countries, partly because of the desire to retain a healthy portfolio quality and to protect (and expand) the capital base through retained earnings. But, as indicated above, a larger development impact could be had if lending into riskier situations (lending to risky countries or risky sectors) could be encouraged. Balancing risk and impact has long been a delicate issue for the institution—one that has been addressed to a certain degree through large, safe loans to less risky clients, opening the door to permit riskier lending to other clients.

This may no longer be as pertinent an argument as before. A portfolio approach to risk suggests that country allocations cannot be viewed as a zero-sum game—more for one country implying less for another. Rather, the dynamics of the business model suggests ample scope for a positive sum game—more lending to risky clients can reduce average portfolio risk through diversification, while more lending to more creditworthy clients can also do the same. It is this positive sum game that is the core attribute of a development finance cooperative institution such as IBRD and that can permit it to sustain an engagement across its whole range of members.

- How can the WBG, acting together, provide a better solution for its clients? The brief review of roles and functions suggests a natural division of labor of functions between parts of the WBG, rather than a division of labor in terms of clients. Take the example of transformational change through platforms. IBRD/IDA might have a comparative advantage in up-front policy support, and project identification and design, while financing, in sectors like sustainable infrastructure, could be provided or catalyzed by IFC or mobilized with guarantees from the Multilateral Investment Guarantee Agency (MIGA). In boom times, all countries might benefit more from greater access to private finance. In down-turns, more public capital might be needed. The point is simply that having each part of the WBG attempt to identify an *ex ante* country allocation of its scarce resources could limit opportunities to maximize effectiveness as conditions change.

At the end of the day, the troika of needs, country performance, and creditworthiness will dictate both the appropriate aggregate level of WBG activities and their allocation. Responding to need suggests a considerable expansion above current levels in IDA, IBRD, IFC and MIGA. Country performance could better be assessed by a greater focus on the potential to achieve scaled up impact, especially in core SDG sectors. Creditworthiness must be understood in a portfolio context and in terms of impact on the dynamic business model.

The ambitions of the new global agenda warrant a significant reinvigoration in the role of the WBG. The greatest needs and development impact will be in the poorer and more vulnerable countries. The Bank

can, however, make an important contribution to the development needs of upper middle income and even some high income countries, especially on scaling up and enhancing the sustainability of infrastructure—with important global spillovers. A dynamic development finance cooperative can benefit all clients, allow the bank to respond to shared global priorities, and establish a sustainable business model. All clients provide value to the WBG through the sharing of experiences, diversification of portfolio risk, and contribution to earnings. This development collaboration strengthens the WBG as an institution.

Seven Propositions for Consideration

1. For the first time since World War II, there is a truly global agenda with universal endorsement from all countries.
2. There is an urgency for scaled up action and a two-decade opportunity to change development trajectories.
3. The MDBs are uniquely positioned to support scaling up; they constitute the most efficient means of sharing the burden of international public finance, mobilizing private long-term capital, and developing scalable solutions through a mix of non-financial and financial tools that can de-risk investments and improve development impact.
4. MDBs add value across the income spectrum of countries.
5. They can contribute to investments at a national and regional level that offer the most powerful means of achieving global goals, especially on climate and inclusion.
6. Scaled up solutions in different sectors and countries can require participation of all instruments of the WBG; advisory services, concessional finance, risk mitigation, capacity building and mobilization of private finance. Different arms of the WBG have a comparative advantage in the deployment of each of these tools.
7. Scaling up WBG support requires both a larger volume of resources for each agency as well as allocation mechanisms that complement each other, that are suitable for different sectoral needs, and that address issues of transition as country circumstances change. A larger WBG can create a sustainable business model where the whole is greater than the sum of its parts and where support for development across all clients is a positive-sum game rather than a zero-sum game.