Financial Institutions and Services

Multilateral Development Banks and International Finance

Leah M. Groffe
Editor

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MULTILATERAL DEVELOPMENT BANKS AND INTERNATIONAL FINANCE

LEAH M. GROFFE
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PREFACE

Multilateral Development Banks (MDBs) are institutions that provide loans and grants to developing countries in order to promote economic and social development. Congressional interest in the MDBs has increased since the outbreak of the current global financial crisis. Following the crisis, the MDBs ramped up financial assistance to developing countries, and each of the MDBs has requested increased funding from their member states to increase lending to middle-income countries. This book explores the history of the MDBs, their operations, major donor contributions, their organization, and debates the effectiveness of MDB financial assistance.

Chapter 1 - Overview: The multilateral development banks (MDBs) include the World Bank and four smaller regional development banks: the African Development Bank (AfDB), the Asian Development Bank (AsDB), the European Bank for Reconstruction and Development (EBRD), and the Inter- American Development Bank (IDB). The United States is a member of each of the MDBs. The MDBs provide financial assistance to developing countries to promote economic and social development. They primarily fund large infrastructure and other development projects and, increasingly, provide loans tied to policy reforms by the government. Most of the MDBs have two facilities from which they make loans (loan windows): a non-concessional lending window that provides loans to middle-income countries at market-based interest rates, and a concessional lending window that provides loans at below-market interest rates and grants to low-income countries.

Debate over the effectiveness of MDB financial assistance is contentious. Critics argue that the MDBs focus on "getting money out the door" (rather than delivering results in developing countries), are not transparent, and lack a clear division of labor. They also argue that providing aid multilaterally relinquishes U.S. control over where and how the money is spent. Proponents argue that providing aid to poor countries is the "right" thing to do and has been successful in helping developing countries make strides in health and education over the past four decades. They also argue that providing foreign aid to the MDBs is important for leveraging funds from other donors, tying policy reforms to financial assistance, and enhancing U.S. leadership. Most U.S. aid for economic and social development is provided directly to projects and programs in developing countries (bilateral aid) rather than to multilateral organizations, like the MDBs (multilateral aid).

Issues for Congress: Congressional legislation is required for U.S. financial contributions to the MDBs. Replenishments of the concessional windows occur regularly; capital increases for the non-concessional windows happen more infrequently. Unusually, all the MDBs have currently requested capital increases, generally because MDB lending has increased following the global financial crisis.

In addition to congressional hearings on the MDBs, Congress exercises oversight over U.S. participation in the MDBs through legislative mandates. These mandates direct the U.S. Executive Directors to the MDBs to advocate certain policies and how they should vote at the MDBs on various issues. Congress also issues reporting requirements for the Treasury Department on issues related to MDB activities. Finally, Congress can withhold funding for the MDBs unless certain institutional reforms are met ("power of the purse").

More than $30 billion in contracts are awarded each year to complete projects financed by the MDBs. Some of these contracts are awarded to U.S. companies. Major changes are underway at the World Bank, the biggest MDB, that would alter how companies bid on World Bank projects. The World Bank argues that these changes will strengthen national institutions, while opponents argue that they will weaken existing procurement standards. Finally, the G-20 has proposed voting reform at the World Bank to reflect the increased role of emerging-markets in the world economy. While the voting power of the United States is unlikely to be affected, these proposals are likely to be a focus of discussion about the World Bank moving forward.

Chapter 2 - The African Development Bank (AfDB) Group is a regional development bank currently based in Tunis, Tunisia. It comprises three lending facilities: the market rate facility, the AfDB; a concessional lending facility, the African Development Fund; and a trust fund established by Nigeria to lend to low-income African countries. The Bank has 53 African members, as well as 24 non-regional members, including the United States.

Chapter 3 - This chapter shows in tabular form how much the Administration requested and how much Congress appropriated during the past 11 years for U.S. payments to the multilateral development banks (MDBs). It also provides a brief description of the MDBs and the ways they fund their operations.

Chapter 4 - The International Monetary Fund, World Bank, African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, and Inter-American Development Bank are foreign policy tools that allow the United States to leverage the contributions of other countries to promote our national security and humanitarian interests in alleviating poverty and promoting progress around the world. For this reason, the U.S. Congress regularly supports appropriations for subsidized loan and grant programs through the multilateral development banks and recently provided a loan to the IMF. As one of the largest shareholders in these institutions, the United States enjoys an opportunity to influence their policies and programs. We must be cautious about forfeiting our leadership positions at these institutions.

Chapter 5 - The World Bank is a Multilateral Development Bank (MDB) that makes loans and grants to low and middle-income countries to reduce poverty and promote economic development. Both the World Bank and the International Monetary Fund (IMF) were founded at the Bretton Woods Conference in 1944. Two of the World Bank facilities, the International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA) lend directly to governments to finance projects and programs.

IDA was established in 1960, 16 years after the creation of the World Bank to address concern that the poorest countries could not afford to borrow at the near- market rate terms offered by the IBRD. Consequently, IDA was established as a revolving fund, providing concessional loans to the poorest countries subsidized by donor contributions and transfers from the IBRD. IDA assistance is highly discounted, it is increasingly provided as grants, and only available to low-income member countries. Since IDA provides loans and grants to the poorest countries at subsidized rates, its resources must be periodically replenished. Donor nations have replenished IDA 14 times since its founding.

On March 5, 2007, donor nations began to discuss a possible fifteenth replenishment of funds for IDA. This is the first replenishment since the G8 summit at the Gleneagles Resort in Scotland in 2005 where world leaders proposed the creation of the Multilateral Debt Relief Initiative (MDRI). The MDRI cancels the remaining debt of the world's poorest countries and pledges to double the amount of aid to Sub-Saharan Africa between 2004 and 2010, primarily in the form of grant- based assistance.

Donor governments selected three themes for IDA-15: (1) IDA's role in the international foreign aid system, (2) the role of the World Bank in post-conflict reconstruction and fragile states, and (3) the need to improve the effectiveness of IDA assistance. This chapter provides brief background material on the World Bank's IDA, the U.S. role at the institution, and information on the status of the current IDA-14 replenishment. It then examines the negotiations for IDA-15, and analyzes the three core themes identified for IDA-15.

Chapter 6 - In June 2005, G8 finance ministers proposed the new Multilateral Debt Relief Initiative (MDRI). The MDRI proposes to cancel debts of some of the world's poorest countries owed to the International Monetary Fund, World Bank, and African Development Bank. This chapter discusses MDRI's implementation and raises some issues regarding debt relief's effectiveness as a form of foreign assistance for possible congressional consideration.

The Multilateral Debt Relief Initiative (MDRI) is the most recent effort by the International Monetary Fund (IMF), World Bank, and African Development Bank (AfDB) to provide poor country debt relief. Proposed by G8 finance ministers in June 2005, the MDRI provides 100% debt relief to select countries that are already participating in the joint-IMF/World Bank Heavily Indebted Poor Countries (HIPC) program.[1] The goal of the MDRI program is to free up additional resources for the poorest countries in order to help them reach the United Nations' Millennium Development Goals (MDGs), which are focused, among other things, on reducing world poverty by half by 2015.[2]

Chapter 7 - In 1996, the Heavily Indebted Poor Countries (HIPC) Initiative was created to provide debt relief to poor countries that had reached unsustainable levels of debt. In 2005, the Multilateral Debt Relief Initiative (MDRI) expanded upon the HIPC Initiative by eliminating additional debt owed to four international financial institutions (IFI): the International Monetary Fund (IMF), World Bank's International Development Association (IDA), African Development Fund (ADF), and Inter-American Development Bank (IaDB). These four IFIs are projected to provide \$58 billion in total debt relief to 41 countries. GAO (1) analyzed the U.S. financing approach for debt relief efforts; (2) reviewed the extent to which MDRI might affect resources available to countries for poverty-reducing activities; and (3) assessed revisions to the analyses conducted by the World Bank and IMF to review and promote future debt sustainability. GAO analyzed Treasury, IFI, and country documents and data, and interviewed officials at Treasury and the four IFIs.

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Chapter 1

MULTILATERAL DEVELOPMENT BANKS: OVERVIEW AND ISSUES FOR CONGRESS*

Rebecca M. Nelson

SUMMARY

Overview: The multilateral development banks (MDBs) include the World Bank and four smaller regional development banks: the African Development Bank (AfDB), the Asian Development Bank (AsDB), the European Bank for Reconstruction and Development (EBRD), and the Inter- American Development Bank (IDB). The United States is a member of each of the MDBs. The MDBs provide financial assistance to developing countries to promote economic and social development. They primarily fund large infrastructure and other development projects and, increasingly, provide loans tied to policy reforms by the government. Most of the MDBs havetwo facilities from which they make loans (loan windows): a non-concessional lending window that provides loans to middle-income countries at market-based interest rates, and a concessional lending window that provides loans at below-market interest rates and grants to low-income countries.

Debate over the effectiveness of MDB financial assistance is contentious. Critics argue that the MDBs focus on "getting money out the door" (rather than delivering results in developing countries), are not transparent, and lack a clear division of labor. They also argue that providing aid multilaterally relinquishes U.S. control over where and how the money is spent. Proponents argue that providing aid to poor countries is the "right" thing to do and has been successful in helping developing countries make strides in health and education over the past four decades. They also argue that providing foreign aid to the MDBs is important for leveraging funds from other donors, tying policy reforms to financial assistance, and enhancing U.S. leadership. Most U.S. aid for economic and social development is provided

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* This is an edited, reformatted and augmented version of a CRS Report for Congress publication, Report #R41170, dated April 9, 2010.

directly to projects and programs in developing countries (bilateral aid) rather than to multilateral organizations, like the MDBs (multilateral aid).

Issues for Congress: Congressional legislation is required for U.S. financial contributions to the MDBs. Replenishments of the concessional windows occur regularly; capital increases for the non-concessional windows happen more infrequently. Unusually, all the MDBs have currently requested capital increases, generally because MDB lending has increased following the global financial crisis.

In addition to congressional hearings on the MDBs, Congress exercises oversight over U.S. participation in the MDBs through legislative mandates. These mandates direct the U.S. Executive Directors to the MDBs to advocate certain policies and how they should vote at the MDBs on various issues. Congress also issues reporting requirements for the Treasury Department on issues related to MDB activities. Finally, Congress can withhold funding for the MDBs unless certain institutional reforms are met ("power of the purse").

More than $30 billion in contracts are awarded each year to complete projects financed by the MDBs. Some of these contracts are awarded to U.S. companies. Major changes are underway at the World Bank, the biggest MDB, that would alter how companies bid on World Bank projects. The World Bank argues that these changes will strengthen national institutions, while opponents argue that they will weaken existing procurement standards. Finally, the G-20 has proposed voting reform at the World Bank to reflect the increased role of emerging-markets in the world economy. While the voting power of the United States is unlikely to be affected, these proposals are likely to be a focus of discussion about the World Bank moving forward.

INTRODUCTION

Multilateral Development Banks (MDBs) are international institutions that provide loans and grants to developing countries in order to promote economic and social development. The term MDBs typically refers to the World Bank and four smaller regional development banks:

- the African Development Bank (AfDB);
- the Asian Development Bank (AsDB);
- the European Bank for Reconstruction and Development (EBRD); and
- the Inter-American Development Bank (IDB).[1]

The United States is a member of each of these institutions.[2]

Congressional interest in the MDBs has increased since the outbreak of the current global financial crisis. Following the onset of the crisis in fall 2008, the MDBs ramped up financial assistance to developing countries, and each of the MDBs has requested increased funding from their member states to increase lending to middle-income countries. A capital increase for an MDB is unusual and simultaneous requests for capital increases by all the MDBs has not happened since the 1970s. Any U.S. financial contribution to the MDBs requires congressional authorization and appropriation legislation. Negotiations for increasing MDB resources are currently underway, and it is expected that any increases would be included in the FY2011 budget (for the AsDB) or FY2012 budget (for the other MDBs). Hearings may be held in 2010.

This chapter provides an overview of the MDBs and highlights major current issues for Congress. The first section discusses the history of the MDBs, their operations, major donor contributions, their organization, and debates about the effectiveness of MDB financial assistance. The second section discusses issues of particular interest to Congress, including congressional legislation authorizing and appropriating U.S. contributions to the MDBs, congressional oversight of the MDBs, and U.S. commercial interests in the MDBs. It also discusses recent proposals for increasing the voting power of emerging-markets at the World Bank.

OVERVIEW OF THE MULTILATERAL DEVELOPMENT BANKS

The MDBs provide financial assistance to developing countries, typically in the form of loans and grants, for investment projects and policy-based loans. Project loans include large infrastructure projects, such as highways, power plants, port facilities, and dams, as well as social projects, including health and education initiatives. Policy-based loans provide governments with financing simultaneous with agreement by the borrower country government that it will undertake particular policy reforms, such as the privatization of state-owned industries or reform in agriculture or electricity sector policies. Policy-based loans can also provide budgetary support to developing country governments. In order for the disbursement of a policy-based loan tocontinue, the borrower must implement the specified economic or financial policies. Some have expressed concern over the increasing budgetary support provided to developing countries by the MDBs. Traditionally, this has been the province of the International Monetary Fund (IMF).

Most of the MDBs have two funds, often called lending windows or lending facilities. One type of lending window is used to make loans at market-based interest rates.[3] Such non-concessional loans are, depending on the MDB, extended to governments and private sector firms in middle- income and some creditworthy low-income countries. The other type of lending window is used to make loans at below-market interest rates (concessional loans) and grants to the governments of low-income countries.

Historical Background

World Bank

The World Bank is the oldest and largest of the MDBs. The World Bank Group comprises three sub-institutions that make loans and grants to developing countries: the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), and the International Finance Corporation (IFC).[4]

The famous 1944 Bretton Woods Conference led to the establishment of the World Bank, the IMF, and the institution that would eventually become the World Trade Organization (WTO). The IBRD was the first World Bank affiliate created, when its Articles of Agreement became effective in 1945 with the signatures of 28 member governments. Today, the IBRD has near universal membership with 186 member nations. Only Cuba and North Korea, and a few micro-states suchas the Vatican, Monaco, and Andorra, are non-members. The IBRD lends mainly to the governments of middle-income countries at market-based interest rates.

In 1960, at the suggestion of the United States, IDA was created to make concessional loans (with low interest rates and long repayment periods) to the poorest countries. IDA also now provides grants to these countries. The IFC was created in 1955 to extend loans and equity investments to private firms in developing countries. The World Bank initially focused on providing financing for large infrastructure projects. Over time, this has broadened to also include social projects and policy-based loans.

Regional Development Banks

Inter-American Development Bank

The IDB was created in 1959 in response to a strong desire by Latin American countries for a bank that would be attentive to their needs, as well as U.S. concerns about the spread of communism in Latin America.[5] Consequently, the IDB has tended to focus more on social projects than large infrastructure projects, although the IDB began lending for infrastructure projects as well in the 1970s. From its founding, the IDB has had both non-concessional and concessional lending windows. The IDB's concessional lending window is called the Fund for Special Operations (F SO). The IDB Group also includes the Inter-American Investment Corporation (IIC) and the Multilateral Investment Fund (MIF), which extend loans to private sector firms in developing countries, much like the World Bank's IFC.

African Development Bank

The AfDB was created in 1964 and was for nearly two decades an African-only institution, reflecting the desire of African governments to promote stronger unity and cooperation among the countries of their region. In 1973, the AfDB created a concessional lending window, the African Development Fund (AfDF), to which non-regional countries could become members and contribute. The U.S. joined the AfDF in 1976. In 1982, membership in the AfDB nonconcessional lending window was officially opened to non-regional members. The AfDB makes loans to private sector firms through its non-concessional window and does not have a separate fund specifically for financing private sector projects with a development focus in the region.

Asian Development Bank

The AsDB was created in 1965 to promote regional cooperation. Similar to the World Bank, and unlike the IDB, the AsDB's original mandate focused on large infrastructure projects, rather than social projects or direct poverty alleviation. The AsDB's concessional lending facility, the Asian Development Fund (AsDF), was created in 1973. Like the AfDF, the AsDB does not have a separate fund specifically for financing private sector projects, and makes loans to private sector firms in the region through its non-concessional window.

Table 1. Overview of MDB Lending Windows

MDB	Type of Financing	Type of Borrower	Year Founded	Commitments, 2008 or FY2009 (Billion US$)
World Bank Group				
International Bank for Reconstruction and Development (IBRD)	Non-concessional loans	Primarily middle-income governments, also some creditworthy low-income countries	1944	32.9
International Development Association (IDA)	Concessional loans and grants	Low-income governments	1960	14.0
International Finance Corporation (IFC)	Non-concessional loans and equity investments	Private sector firms in developing countries	1955	10.5
African Development Bank (AfDB)	Non-concessional loans	Middle-income governments, some creditworthy low- income governments, and private sector firms in the region	1964	2.8
African Development Fund (AfDF)	Concessional loans and grants	Low-income governments in the region	1973	2.6
Asian Development Bank (AsDB)	Non-concessional loans	Middle-income governments, some creditworthy low- income governments, and private sector firms in the region	1965	8.7
Asian Development Fund (AsDF)	Concessional loans and grants	Low-income governments in the region	1973	1.8
European Bank for Reconstruction and Development (EBRD)	Non-concessional loansand equity investments	Primarily private sector firmsin developing countries in the region, also developing- country governments in the region	1990	7.4
Inter-American Development Bank (IDB)	Non-concessional loans	Middle-income governments, some creditworthy low-income governments, and private sector firms in the region	1959	11.1
Fund for Special Operations (FSO)	Concessional loans and grants	Low-income governments in the region	1959	0.1

Source:MDB Annual Reports. World Bank data is for FY2009 (July 2008 – June 2009). Regional development bank data is for 2008 (calendar year). Most of the MDBs also have additional funds that they administer, typically funded by a specific donor and/or targeted towards narrowly defined projects. These special funds tend to be very small in value and are not included in this chapter.

European Bank for Reconstruction and Development

The EBRD is the youngest MDB, founded in 1990. The motivation for creating the EBRD was to ease the transition of the former communist countries of Central and Eastern Europe (CEE) and the former Soviet Union from planned economies to free-market economies. The EBRD differs from the other regional banks in two fundamental ways. First, the EBRD has an explicitly political mandate: to support democracy-building activities. Second, the EBRD does not have a concessional loan window. The EBRD's financial assistance is heavily targeted on the private sector, although the EBRD does also extend some loans to governments in CEE and the former Soviet Union.

Table 1 summarizes the different lending windows for the MDBs, noting what types of financial assistance they provide, who they lend to, when they were founded, and how much financial assistance they committed to developing countries in 2008 or FY2009.[6] The World Bank accounted for more than 60% of total MDB financial assistance commitments to developing countries in 2008 or FY2009.[7] Also, more than 60% of the financial assistance provided by the MDBs to developing countries in 2008 or FY2009 was on non-concessional terms.

Operations: Financial Assistance to Developing Countries

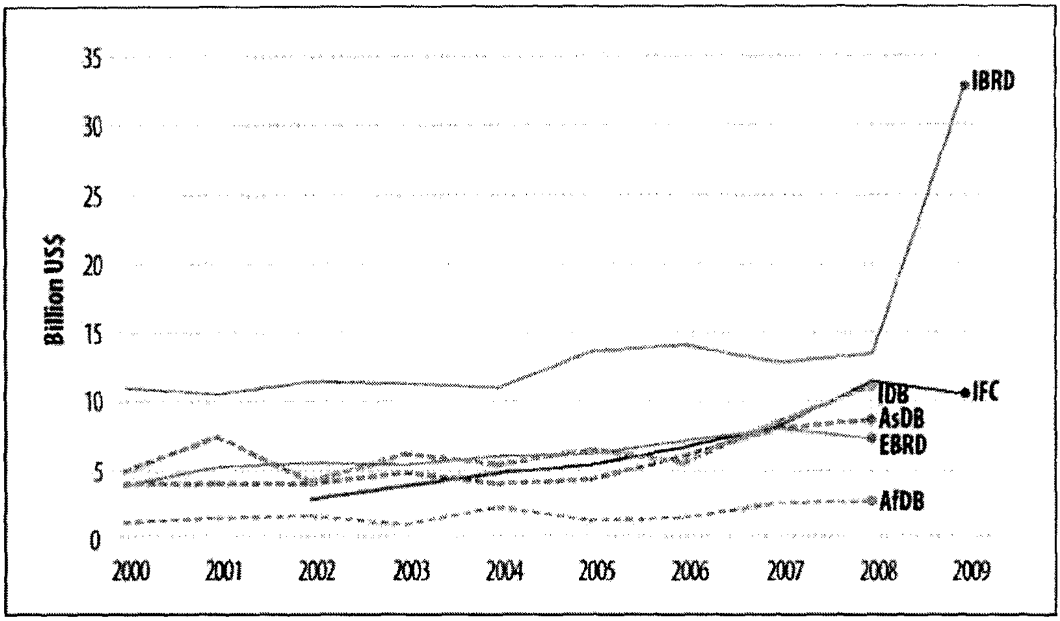
Financial Assistance over Time

Figure 1 shows MDB financial commitments to developing countries since 2000. As a whole, non-concessional MDB financial assistance was relatively flat until the current global financial crisis prompted major member countries to press for increased financial assistance. In response to the financial crisis and at the urging of its major member countries, the IBRD dramatically increased lending between FY2008 and FY2009. When the 2009 lending data for the regional development banks is released later this year (2010), they are also expected to show substantial upticks in lending.

Figure 2 shows concessional financial assistance provided by the MDBs to developing countries from 2000 to 2008-2009. The World Bank's concessional lending arm, IDA, has grown steadily over the decade in nominal terms, while the regional development bank concessional lending facilities, by contrast, have remained relatively stable in nominal terms over the past several years. When the 2009 data for the regional development banks becomes available, however, it is expected that these figures will show an increase in concessional assistance as the regional banks responded to the financial crisis.

Recipients of MDB Financial Assistance

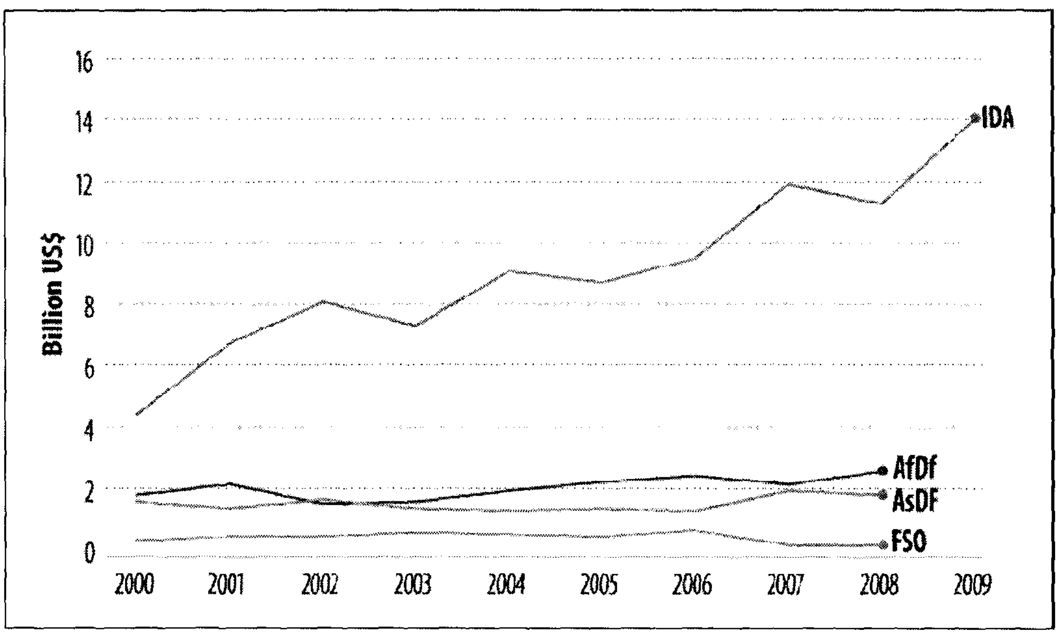
Figures 3-7 show which countries received commitments for financial assistance from the MDBs in the most recent year available (FY2009 for the World Bank and 2008 for the regional development banks). Additionally, Figure 3 shows how much, on a per capita basis, each country received. Darker regions in the graphs indicate higher levels of MDB financial assistance per capita. The data used is a sum of total financial assistance – concessional and non-concessional – for each MDB.



Source: MDB Annual Reports.

Notes: World Bank data is for FY2009 (July 2008 – June 2009). Regional development bank data is for 2008 (calendar year).

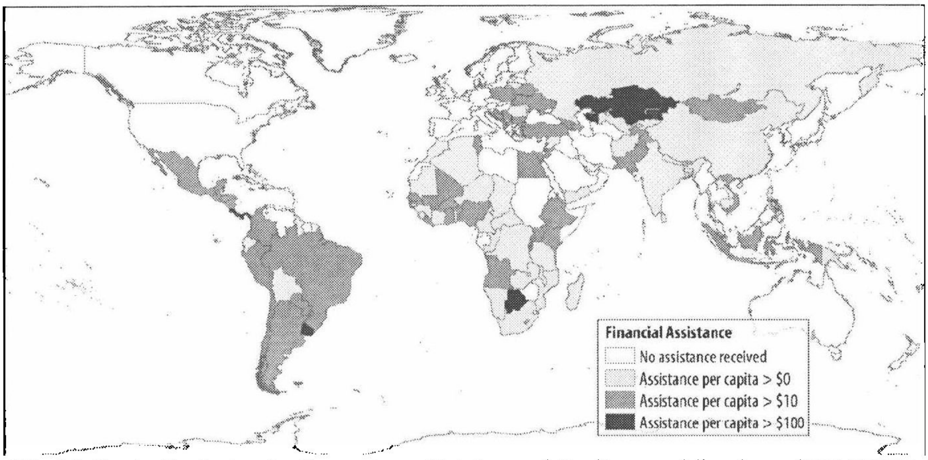
Figure 1. MDB Non-Concessional Financial Assistance, 2000-2009



Source: MDB Annual Reports.

Notes: World Bank data is for FY2009 (July 2008 – June 2009). Regional development bank data is for 2008 (calendar year).

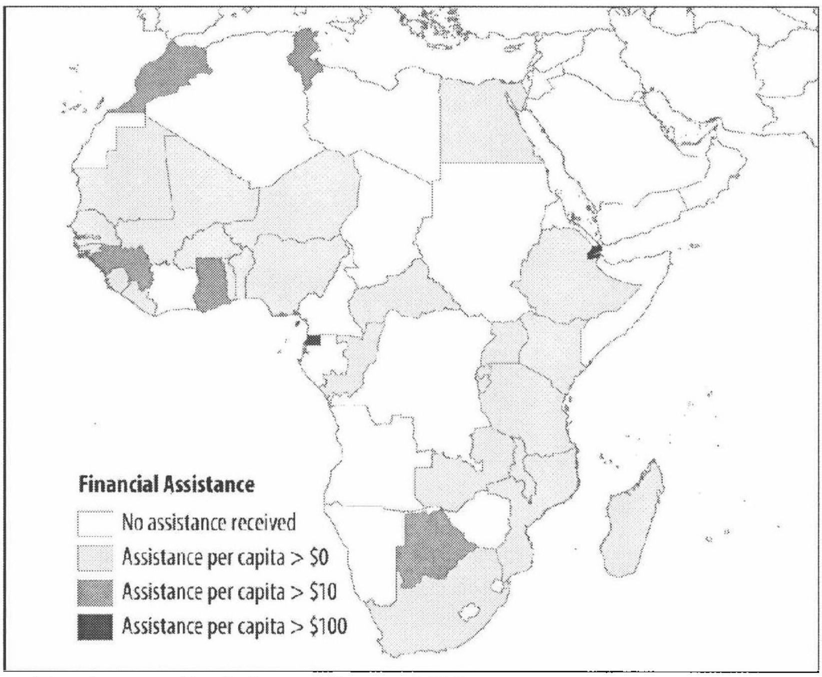
Figure 2. MDB Concessional Financial Assistance, 2000-2009



Source: World Bank Projects & Operations Database, http://go.worldbank.org/0FRO32VEI0. IFC FY09 Project & Portfolio Information, http://www.ifc.org/ifcext/annualreport.nsf/Content/AR2009_Projects_Portfolio.

Notes: Includes concessional and non-concessional financial assistance from lending windows listed in Table 1 (IBRD, IDA, and IFC). Excludes regional assistance, which is typically a small portion of the banks' lending portfolios.

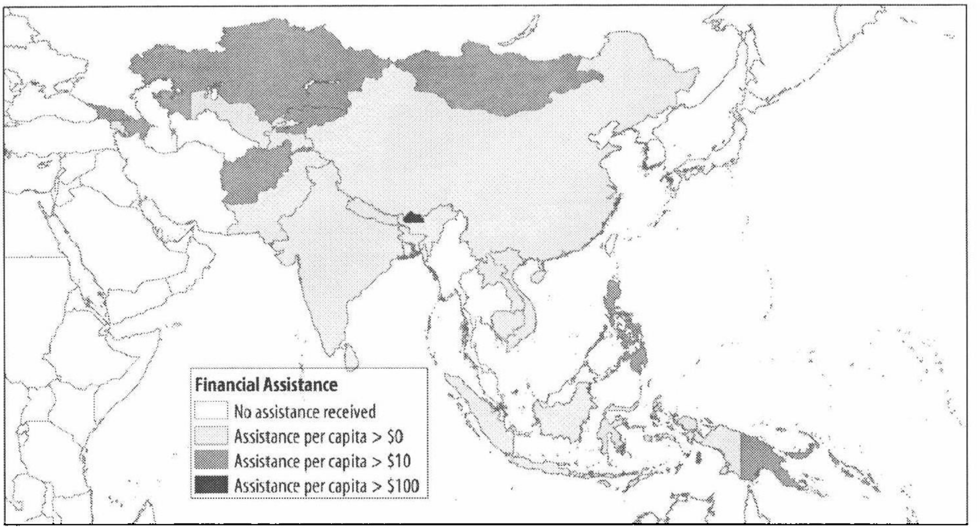
Figure 3. World Bank: Commitments of Financial Assistance, FY2009.



Source: African Development Bank Annual Report, 2008.

Notes: Includes concessional and non-concessional financial assistance from lending windows listed in Table 1. Excludes regional assistance, which is typically a small portion of the banks' lending portfolios.

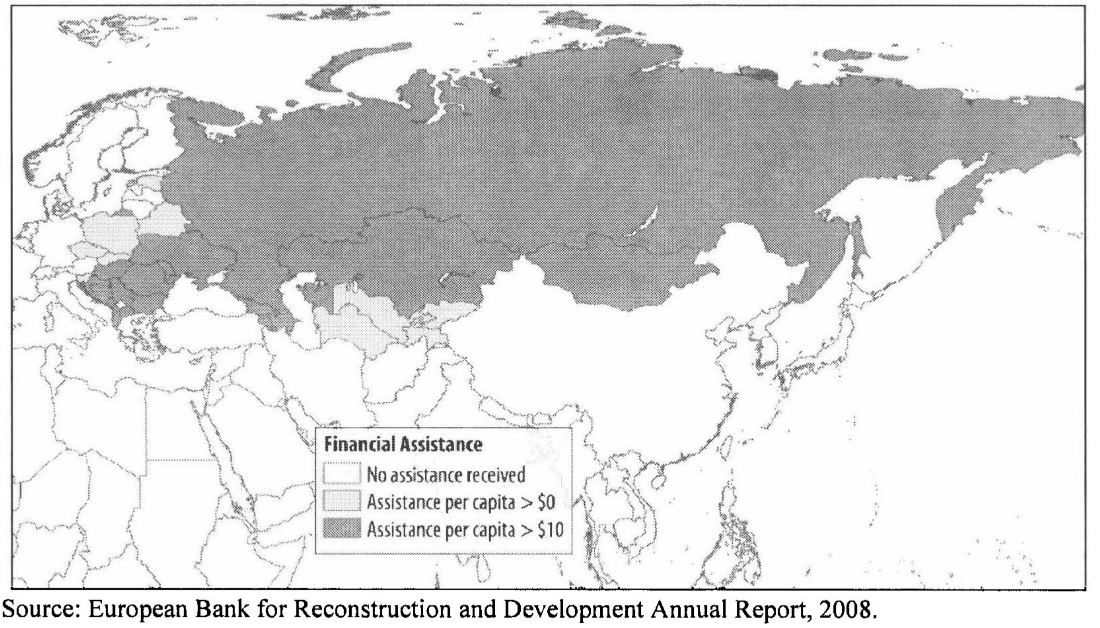
Figure 4. African Development Bank: Commitments of Financial Assistance, 2008.



Source: Asian Development Bank Annual Report, 2008.

Notes: Includes concessional and non-concessional financial assistance from lending windows listed in Table 1. Excludes regional assistance, which is typically a small portion of the banks' lending portfolios.

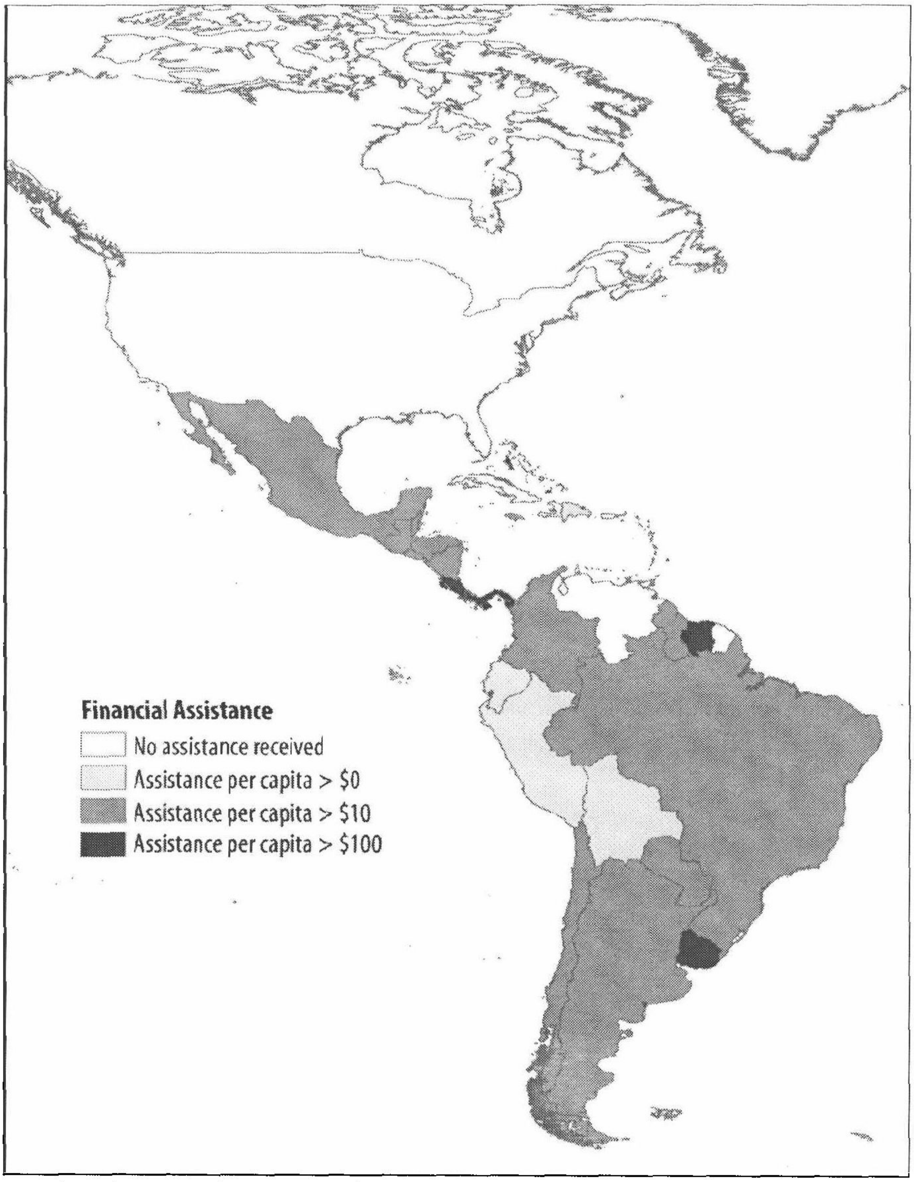
Figure 5. Asian Development Bank: Commitments of Financial Assistance, 2008



Source: European Bank for Reconstruction and Development Annual Report, 2008.

Notes: EBRD only provides non-concessional loans. Excludes regional assistance. Excludes regional assistance, which is typically a small portion of the banks' lending portfolios.

Figure 6. European Bank for Reconstruction and Development: Commitments of Financial Assistance, 2008



Source: Inter-American Development Bank Annual Report, 2008.

Notes: Includes concessional and non-concessional financial assistance from lending windows listed in Table 1. Excludes regional assistance, which is typically a small portion of the banks' lending portfolio.

Figure 7. Inter-American Development Bank: Commitments of Financial Assistance, 2008

Generally, Latin America and Eastern and Central Europe (CEE) received the highest levels of financial assistance per capita from the World Bank in FY2009, although there are notable instances in Asia and Africa, such as Kazakhstan and Botswana. For the AfDB, financial assistance per capita in 2008 was concentrated in Western and Eastern Africa, with some lending in Northern African (particularly Morocco and Egypt) and Southern Africa (particularly Botswana and South Africa). For the AsDB, Mongolia, Kazakhstan, Georgia, Papua New Guinea, and the Cook Islands were among the top recipients of financial assistance per capita in 2008. Regional economic powers China and India were also among