Remarks from a Panel Discussion on Strengthening Multilateral Development Banks (MDBs) to Address Shared Challenges of the 21st Century

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Comments delivered by Mauricio Cárdenas (Columbia University and the Center for Global Development)

1. As a former Finance Minister, what do you believe are the critical gaps in MDBs, particularly MDBs responding to the needs of middle-income countries?

The distinction between middle-income (MICs) and low-income countries (LICs) is not the most useful when approaching development issues. A number of MICs have very high levels of inequality and large populations, meaning that a significant share of the world's poor and vulnerable live in MICs. Rather than getting caught up in the distinction between MIC and LIC, it is more useful to focus on their commonalities and synergies. There are positive spillovers from MDB support to MICs to LIC's. Trade and investment channels are one aspect of this interdependence. Also, MIC lending generates substantial net income for MDBs. MIC loans strengthen MDB balance sheets in the eyes of bondholders and Credit Rating Agencies (CRAs).

The global economy is entering one of the most complex phases in decades not just because of the many overlapping crises. Low GDP growth projections, high fiscal deficits and high interest rates restrict the ability of governments to respond. As public debt continues to increase (recent scenarios from the IMF suggest that public debt can reach 100% of GDP globally in 2030), long-term interest rates will remain higher for longer, much longer. Debt service will take an increasing share in national budgets.

In this context, ministers of finance will face a growing number of tensions and will need to resolve very complex tradeoffs. Beyond financial engineering, MDBs must leverage their knowledge and provide a framework to help guide the tough decisions that need to be made. Hard choices need to be made now on what to prioritize. In the past, finance ministers dealt with the Global Financial Crisis and Covid-19 with more degrees of freedom relative to today as debt levels and interest rates were much lower.

The interdependencies between multiple global challenges (climate, health threats, food security, energy, geoeconomics fragmentation, etc.) is one key where more analysis is needed. When addressed separately, as many taskforces and panel reports have done, the case is compelling on the need of greater investing in all of these areas. But when everything is important nothing is important. MDBs should provide a better understanding of the interaction among these challenges with the eye of helping policymakers prioritize and define the right approach.

Not all these crises can be solved with debt. Increasing the lending capacity of MDBs is clearly an important step, and the need for bigger MDBs is urgent. The numbers provided by the Expert Group's recommendation are well supported, reasonable, and viable. But a crucial aspect is domestic resource mobilization. Increasing tax revenues is the hardest part of the job of any finance minister, especially in a world where the idea that additional debt-financed government expenditures "pay for themselves" is becoming mainstream in advanced economies. MDBs and the IMF should actively question this view.

What MDBs need to do is help ministries of finance determine how to best finance the greater demands for government action. There are only three options: (1) improve overall public expenditure efficiency and reduce current government expenditures in non-priority areas; (2) increase tax collections; and (3) borrow additional resources. Each country should have a formula. My benchmark would be to assign a weight of 1/3 to each option, just as we did in Colombia to accommodate for the oil shock in 2014-2015 that led to a loss of 20% in government revenues and 50% in exports.

2. Which do you think are the priorities for MDBs in MICs?

I think the more critical areas for MDBs engagement are precisely the ones where there is less private investment, such as:

a) Climate adaptation
b) Climate mitigation (in areas closer to public goods such as nature-based solutions)
c) Pandemic preparedness and response.

Mobilizing private sector investments to scale up ambitious climate change adaptation projects has been difficult and the gap between actual and needed flows is rapidly increasing. There are multiple reasons for this, including the high risks associated with adaptation projects, the lack of immediate short-term financial returns, and difficulty in structuring financially viable and bankable projects.

Building a strong international system for pandemic prevention, preparedness, and response, is a global good. A new Pandemic accord and amended International Health Regulations (IHR) are needed, specially at a time of ever-increasing global travel, elevated risks of outbreaks, including those associated with climate change. The world needs to reduce the risk of future pandemics dramatically. Should a pandemic arise, all countries should have the means to mitigate the damage to people, societies, and economies.

I have not highlighted the areas where the mobilization of private capital is more likely, but this does not mean that there is role for MDBs. On the contrary, this can actually be the most crucial aspect of MDBs engagement in MICs.

3. What is your view in terms of mitigation of risks and catalyzing private investment flows? MDBs' responses to the middle-income countries without overlooking the needs of the lower income countries is a challenging issue. Do you have any comments as to how these two can be balanced?

There are many ways to approach this question but let me just mention three ideas.

First, EMDEs (ex-China) make up less than 6% of the total amount of green bonds issued and 1% of global green bonds when denominated in their local currencies. This is huge gap as cumulative issuance of green bonds has risen from around $100 billion in 2015 to over $2.5 trillion now. EMDEs haven't fully capitalized on the growth of this asset class.

Projects don't always have clear revenue streams, as is the case with climate adaptation, making it challenging to prove they are "bankable" or "investable." And when they do, revenues are often in local currency, as with many climate mitigation projects such as renewable energy.

As Gautam Jaim at Columbia has proposed, a blended finance structure wherein an intermediary takes on the local currency risk of an EMDE green bond, effectively converting it to a dollar bond that settles internationally, could potentially stimulate more issuances and expand the pool of international investors with access to these bonds. Diversifying across a number of EMDE currencies the intermediary could likely mitigate much of the risk.

MDBs could be that intermediary, while also playing a role in ensuring the integrity of use of proceeds. They know the countries well, have influence over policies, and can exercise the necessary oversight.

Pushing the idea further to stimulate even more the use of the asset class, MDBs could provide a guarantee on interest-rate payments in the spirit of the Brady bonds (which guaranteed principal and interest payments). For countries not facing debt or market access problems, this could lower the interest-rate cost for the issuer relative to a conventional bond, then it may provide enough of an incentive for some EMDE sovereigns (or corporates) to issue green, or more broadly, thematic bonds.

Second, MDBs could help in issuing regional bonds. Pooling projects across countries without requiring governments to directly coordinate with each other but ensuring that proceeds are used for the provision of global or regional public goods. This green bond would reflect the weighted average credit risk of the underlying issuing sovereigns, and would create a diversified currency portfolio for the intermediary. For example, an "Amazon bond" could offer great advantages to directing resources for the protection of the world largest tropical rainforest.

Third, MDBs need to gain the trust of pension funds and other large institutional investors and compete with private asset managers for the mandate to invest this capital. That means viewing private investors as their clients and partners, even as MDBs continue to operate within a policy-defined mandate.

4. Do you believe that the ambitious program laid out in better, bigger and bolder banks can be implemented between now and 2030?

The Experts Panel recommends that MDBs formally adopt a new mandate in addition to provide support to the poorest people within each country and foster national economic growth and shared prosperity. The new mandate to expand borrowing countries' contribution to Global Public Goods (GPGs) is the right approach, but one that requires a fundamental rethinking of the role of MDBs.

As the leaders that met in Paris this summer said, this is "*A now or never moment*". The estimated fresh capital that G20 members will have to contribute to IBRD and IDA in order to help MICs and LICs attain SDGs and contribute to GPGs is realistic and viable. The decision on the part of the US government to request Congress 2.25bn for the World Bank ($1bn for IDA, $756m for the global goods solutions trust and $494m for loan guarantees) in the supplemental bill sets a precedent and is clearly a step in the right direction.

Geopolitical fragmentation and international conflicts are an obstacle to longer-term thinking and international cooperation when it comes to MDBs. A bigger effort should be made to isolate these institutions from geo-economic rivalries.

5. As a community, is the G20 sending the right signal for radical and transformative action by the MDBs?

The G20 is sending a mixed signal for MDBs radical and transformative action. On the one hand, the G20 has endorsed the Independent Expert Group on Strengthening Multilateral Development Banks (IEG) recommendations, which has call for a radical transformation of the MDBs to triple their mandates, finances, and instruments. This is a clear signal that the G20 recognizes the need for the MDBs to play a more ambitious role in addressing the shared challenges of the 21st century.

On the other hand, the G20 has not yet provided concrete commitments to support the IEG's recommendations. For example, the G20 has not yet agreed to increase its financial contributions to the MDBs and has not yet committed to addressing some of the key structural challenges facing the MDBs, such as their risk-averse culture.

One crucial element where progress can be made is the use of SDRs that remain idle in advanced countries. Although the IMF's Resilience and Sustainability Trust (RST) has become the de facto long-term climate finance facility, its resources will be exhausted, has a specific focus, and its catalytic character is not guaranteed. The RST is an important first step in the IMF's climate finance portfolio for which it deserves considerable credit, but it will not substitute for the much needed capitalization of the MDBs. SDRs can help to accelerate that process.

Finally, in a world with many demands for government action, there is a mismatch between state capacities and citizens' expectations. This growing mismatch is at the core of the lack of trust that fuels political polarization and weakens democratic values. This should be an additional reason for immediate action in strengthening MDBs.