1 The Role and Intermediation Functions of the MDBs

Introduction: The Role of MDBs in the International Financial System

Multilateral development banks (MDBs), owned by the governments of the developed and developing worlds, are now an entrenched feature of the international financial system. They are the premier, specialised long-term lending intermediaries for developing countries at global and regional levels. Structurally they usually comprise a core bank or 'hard-window' with a number of affiliates attached (e.g. soft loan windows, private sector financing arms, and guarantee agencies). The key MDBs include:

- **The World Bank**, formally known as the International Bank for Reconstruction and Development (IBRD). As of August 1994, it had 178 member countries and operates world-wide.

- **The Inter-American Development Bank** (IDB) with 46 members operates in all Western Hemispheric countries south of the United States as well as in the islands of the West Atlantic Ocean and the Caribbean Sea.

- **The African Development Bank** (AfDB) with 76 members whose ambit is continental Africa as well as the islands of the Eastern Atlantic and Indian Oceans;

- **The Asian Development Bank** (AsDB) has 56 members, including three of the recently independent Asian republics of the former Soviet Union (FSU). It operates across continental Asia and islands in the Pacific Ocean and South China Sea; and

- **The European Bank for Reconstruction and Development** (EBRD) which operates in Eastern Europe and Central Asia (i.e. it serves the Asian republics of the former Soviet Union). It presently has 59 members; but with the kaleidoscopic changes still taking place in the political evolution of the FSU and the former Republic of Yugoslavia, this membership is subject to further change.

From: Multilateral Development Banks: An Assessment of their Financial Structures, Policies and Practices, FONDAD, The Hague, 1995, www.fondad.org

These five MDBs[1] are the subject of this book. Together they constitute the main *official* international channel through which capital resources (mainly in the form of loans) are intermediated between *developed*[2] and *developing* countries (often referred to as the South or the Third World) as well as the *economies in transition*.[3] With the exception of Yugoslavia and Romania, which had both borrowed heavily from the World Bank during the 1970s and early 1980s, economies in transition (mainly from the former East Bloc) have become significant recipients of MDB lending only in the 1990s.

All the MDBs (except the EBRD, which is the youngest and constitutionally the most different of the MDB family) have grown significantly in the size of their lending operations, staff and balance sheets since their inception. However, the role and importance of the MDBs as intermediators of global capital flows to the developing world, *relative* to other *private* sources and intermediaries, has fluctuated over time. In the 1950s and 1960s, with the World Bank setting the lead, they were the primary source of finance for **infrastructural** (mainly power, transport and water supply) and **industrial** investment in the developing world. Industrial investment was financed directly by the MDBs as well as indirectly, through domestic development finance institutions which they helped to establish.

1 There are a host of other multilateral lending institutions which are prominent though much smaller. They include several international organizations such as the International Fund for Agricultural & Rural Development (IFAD); sub-regional institutions such as the Caribbean, Pacific, East African, West African, PTA and other similar development banks; and several Arab institutions such as the Islamic Development Bank (IsDB), the Arab Fund for Economic and Social Development (AFESD); the Arab-African Development Bank (BADEA); the OPEC Fund etc. While all of these institutions are, in their own context and milieu, significant, they are very diverse in their ownership, functions, orientation and political colouration. Also they are individually and collectively quite small. The five MDBs referred to above account for over 85% of all multilateral bank lending with the World Bank Group alone accounting for nearly 60%. For these reasons, these smaller institutions cannot be covered easily in a book of this nature and have accordingly been omitted.

2 Developed countries (often referred to as Part I countries in the lexicon of the World Bank) are mainly those which are members of the Organisation for Economic Co-operation and Development – the OECD – also referred to in colloquial terminology as the First World.

3 This phrase refers to the middle-income countries, mainly in Eastern Europe and the former Soviet Union which were formerly members of the Council for Mutual Economic Assistance (CMEA or Comecon) colloquially known as the East Bloc or, until 1989, the Second World. As an economic or geopolitical identity the Second World has of course disappeared. Parts of it aspire to be ranked as *developed* as soon as possible. Other parts will remain *developing* for some time to come. The term *economies in transition* excludes CMEA members such as Cuba, Mongolia and Vietnam which are developing countries. From the viewpoint of the MDBs the distinction between developing economies and those in transition is moot. For ease of reference throughout this handbook the term *developing countries* will be used to embrace borrowing countries of both the Second and Third Worlds. All these economies are, in a sense, *in transition* though not all confront the transition from command to market economies.

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In the late 1960s and 1970s they branched out into financing **agriculture** and the **social sectors** (such as education, health, nutrition and population) embarking on visionary programmes of **poverty alleviation** through integrated **rural and urban development** projects and programmes. In the midst of the successive large oil price increases the 1970s, the MDBs focused some of their attention to increasing investments in hydrocarbon and other **energy** resources in the developing world. In the 1980s, when the debt crisis emerged, their emphasis shifted yet again from financing mainly projects in various economic sectors to financing an increasing proportion of fast-disbursing, balance-of-payments support under **structural and sectoral adjustment programmes** aimed at wide-ranging reform of economic policies and at improving the quality of economic management at sector and economy-wide levels. In the late 1980s and 1990s, the MDBs have been compelled by external pressures from developed country governments and NGOs into incorporating newer developmental priorities (e.g. environmental protection, gender sensitivity, good governance requirements etc.) in their project and programme lending operations.

Geographically, through the 1950s-80s, MDB financing has been concentrated largely in Asia, Latin America and Africa. In the 1990s the attention of the World Bank and the newly established EBRD has been captured by the economic crises in Eastern Europe caused by the collapse of command-economy regimes. With rapid geopolitical transformations occurring elsewhere in the aftermath of that collapse, other significant claimants for reconstruction and development assistance have also emerged. Global and regional MDBs will therefore need to focus henceforth on meeting the reconstruction and economic transformation financing needs not just of Eastern Europe, but also of several countries in the Middle East, Indo-China, West and Central Asia. After the South African elections of April 1994, the World Bank and the African Development Bank are now engaged in financing the rapid extension of basic development benefits to the hitherto deprived majority in South Africa. In confronting these challenges the MDBs will be faced with the relatively recent phenomenon of capital markets being more willing (and more able) than they have so far to share in taking the risks involved in financing developmental opportunities in these areas.

Thus from a period of relative stability between 1945-73 the MDBs have, between 1974-94, had to respond to different and shifting demands from their clientele caused by the *oil shocks* of the 1970s, the *debt shock* of the 1980s, and the *transition shock* of the 1990s, resulting in the emergence of a large number of new claimants for their products and services. Although these successive impulses have created new demands, the role of MDBs *vis-à-vis* private capital markets in meeting the external finance requirements of developing countries has fluctuated unpredictably between 1970-94. Since

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1989, private sources of international capital have become increasingly familiar with financing all kinds of investment in *emerging markets*, including long-gestating infrastructural investment. Consequently, the *financial* role and importance of MDBs might be expected to diminish in *relative* if not in *absolute* terms, as private markets penetrate terrain which was formerly the exclusive preserve of MDBs such as infrastructure financing, and even the financing of education and health (e.g. through private hospitals and universities).

Present trends suggest that the role of MDBs in the next century may be focused progressively on: (a) the *poorest developing economies* (e.g. those in Africa and South Asia) which global capital markets are unprepared to finance until higher levels of economic, financial, institutional and social development have been achieved; (b) *investment in human capital* – which is now seen as the key constraint to rapid development – of the non-cash flow generating kind which capital markets do not finance (e.g. public primary and secondary education and rural health care); and (c) investments in the basic *institutional infrastructure* essential for market economies to function properly (e.g. in legal and judicial systems and institutions, enforcement of property rights, transparent accounting systems, essential business support systems and services, improved systems of public administration and of political governance etc.).

This recent focus apart, in their traditional areas of activity MDBs may need to consider a shift from financing governments and their agencies to financing investments undertaken directly by the private sector. This will become an important line of activity especially for catalysing investments involving the kind of risks and gestation periods which may require MDB participation to provide comfort to private market financiers.[4] Rapid movement in that direction is to be expected and is long overdue. As *private* international capital market conditions and propensities change so should the functions and resource transfers of *public* institutions which were designed initially to overcome the shortcomings of imperfect capital markets. This point requires some historical elaboration. Though they were principally *political* creations, whose emergence owed more to geopolitical exigencies rather than purely economic and financial considerations, the five major MDBs – global and regional – were established, ostensibly at least, to provide

4 This may require amendment of the Articles of Agreement of some of these MDBs which, with the exception of the EBRD, generally require MDBs to lend directly only or mainly to governments or their instrumentalities. Lending to non-governmental entities is of course permitted by their Articles but only if accompanied by an explicit government guarantee. By contrast, the Articles of the International Finance Corporation (IFC) – the World Bank's private sector financing affiliate – prohibit it from requiring a government guarantee for its loans of equity investments.

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developing countries with long-term capital for investment in development; capital of the kind that they would not otherwise have had access to. Until quite recently, capital markets in developed countries were mainly domestic and fragmented. Influenced by the memory of defaults on bonds by several Latin American countries in the 1890s and again in the 1930s, capital markets in the US and Europe were disinclined from the 1940s upto the 1980s to assume the risks involved in providing long-term capital for investment in developing countries[5].

With the benefit of hindsight, it is now clear that these risks were heightened unnecessarily by the nationalistic, inward-looking economic policies which all too many developing countries chose to follow in the first flushes of independence when unshackled from their colonial heritage, most of which were based on market economy regimes. These nationalistic policies gave rise to the kind of expropriation risks, commercial risks and transfer risks which were much too high for capital markets to contemplate taking. Such reluctance made it difficult for developing nations – especially those just emerging from colonial rule – to obtain sufficient international capital i.e. foreign savings in the form of foreign exchange.

With the development theory of the day ruling that domestic savings and foreign exchange (the two gaps) were the key constraints to development,[6] MDBs seemed the most practical way of providing developing countries with access to foreign capital under conditions which were controlled and carefully monitored. The capital structure of MDBs – about which more will be said later – was designed specifically to use a relatively small amount of government provided *cash* (as paid-in equity in usable and non-usable currencies) accompanied by a much larger guarantee (or *callable* capital) to cover the perceived risk of lending to developing countries. Government-provided capital was the pivot on which a large amount of borrowings by MDBs (mainly in the form of bond issues) could take place in international capital

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5 To avoid any confusion this statement may cause it should be remembered that the orgy of private lending to developing countries in the 1970s was undertaken by global money centre *banks.* It was not coursed through capital markets. Capital markets only stepped into the breach after 1987-88 when these loans were eventually written down to discounted values and the residual values were credit-enhanced, securitised and traded.

6 Though it has evolved considerably since 1945, it should be recalled that early *development theory* rested heavily on *the two-gap* model; i.e. it was firmly believed that economic development in the Third World was hindered by two gaps (i) the gap in savings which the domestic economy, being underdeveloped, was incapable of generating a sufficiency of in the early phases of development; and (ii) foreign exchange, which was needed to import capital and intermediate goods in order for the developing economy to undertake incipient industrialisation by domestically producing consumer goods under protective regimes. Currencies were made inconvertible and capital controls were imposed to prevent capital outflows from capital-short countries.

markets. Such borrowings were then on-lent to developing countries as long-term loans.

After the creation of the World Bank in 1945,[7] only marginal refinements took place in the constitutional make-up of the three MDBs established between 1955-66 when the Inter-American, African and Asian banks were created (in that order). Since then, of course, the MDBs themselves and the global financial environment in which they operate have both evolved and changed quite dramatically. Not unexpectedly,[8] the environment has changed far more rapidly than the MDBs have adapted.

Partly for that reason there was considerable controversy surrounding the creation of the EBRD in the early 1990s. It was not obvious that another MDB was needed at this juncture to address the long-term financing and *marketisation* needs of the Eastern European and former Soviet economies in transition. It is now commonly acknowledged that the EBRD's establishment in the first flushes of euphoria over the fall of the Berlin Wall reflected perhaps the triumph of political over economic sense. A genuflection to the realities of a changed marketplace was essential nevertheless. Major alterations were made in the constitution and mandate of the EBRD vis-à-vis those of the other MDBs, signifying how much things have changed in the operating environment of the MDBs.

The limitations of private capital markets which existed when the MDBs were created and flourished are difficult to imagine or recall against the situation which exists today. Despite the debt debacle of the 1980s, or perhaps because of it, private capital markets are now much less imperfect than they used to be; also they are rapidly becoming globally seamless. Their ambit now embraces an increasing number of developing countries, euphemistically referred to in a new lexicon as *emerging markets*. They operate across a much wider and deeper spectrum of risk and reward with the pricing of such risk being more finely tuned and being made more manageable through an array of financial instruments which did not even exist prior to the mid-1980s. Today, private capital is willing to invest in the

7 The World Bank and the International Monetary Fund were established as part of the architecture of a post-World War II global order under the Bretton Woods Agreement of 1945 which involved a regime of fixed exchange rates and open trading regimes accompanied by a massive effort at reconstructing the war-devastated economies of Europe and Japan under the Marshall and Dodge Plans.

8 Departure from channelling long-term resources flows to developing countries mainly through the MDBs in the 1970s, with petrodollar surpluses being recycled through the global banking system, led to the debt debacle of the 1980s. In the aftermath of that crisis, and due to the role played by the International Monetary Fund (IMF) and the MDBs in averting systemic default risk, private capital markets have, in the 1990s, replaced commercial banks in becoming the most prominent private providers of finance to emerging markets.

equity and debt structures of complex, long-gestating projects and to take risks which would have appeared unthinkable even a decade ago.

Of course, this turnaround cannot be attributed simply to evolutionary trends in capital markets themselves. It is as much the result of a profound change in global development thinking and development policy which has occurred and accelerated since mid-1985. That change has resulted in a progressive redressing of the imbalance that had arisen from excessive state intrusion into economic life. In too many developing countries (not to mention a number of developed ones as well) dirigiste states had succeeded in dominating development and capital investment while shrinking ever more narrowly the economic space in which the private sector and the market were permitted to function. After nearly five decades of experience with the underperformance of state-dominated, closed, inward-looking economies – with their high rates of protection, increasingly ineffective capital controls, inconvertible currencies and fiscal profligacy – the developing world has shifted decisively in favour of greater openness, liberalisation, market orientation and fiscal discipline.

Financial system liberalisation through the abandonment of interest and exchange controls and the adoption of convertible currency regimes, is resulting in an acceleration of the pace at which many developing economies are becoming integrated into the global market for money and capital thus concomitantly reducing their dependence on specialised financing mechanisms such as the MDBs. Many developing countries can now raise funds directly on international capital markets at lower cost and risk (i.e. exchange risk) than those they incur in borrowing from the MDBs. Nor do they need to incur the development conditionalities or the administrative burdens and costs of dealing with institutions whose bureaucratic ways of working impose onerous demands on their own governments.

As development agencies, MDBs have received the greatest exposure and visibility for their lending orientation and operations, for their technical assistance and advisory functions, and, more recently, in the era of policy reform and adjustment, for their delphic policy pronouncements and exacting conditionalities. Rightly or wrongly, since the 1980s, they have taken on the complexion of becoming instruments of economic and political governance over the developing world instead of being simply international financial intermediaries. Very little is known publicly about their *financial* policies and operations. Apart from some knowledgeable insiders, a few capital market specialists who sell and trade multilateral agency bonds, and even fewer rating agency analysts whose job it is to track these matters, very few members of MDB staff, or those of the governments that own these banks, really know about or attempt to influence MDB financial policies.

Until recently, these policies have been portrayed, especially by the

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financial managements of MDBs themselves (often for self-serving reasons), as too complex and arcane for any but the initiated to comprehend and therefore dangerous to be made transparent or be opened to public scrutiny and exposure. Fortunately however, the degree of opacity that has enshrouded the financial operations of MDBs, coupled with rising concern about arrears in their portfolios, have led to calls for greater understanding, more public exposure (for accountability reasons) and transparency in the financial policies of the MDBs. Obviously, the MDBs cannot be evaluated only as *financial institutions* in the normal sense of the term because that is not what they were intended to be.[9] Their financial operations are undertaken to support their developmental role. For that reason, this book attempts to render understandable, in terms comprehensible to those who are not financial experts, the main financial policies and practices of the MDBs as well as the implications and consequences of those policies/practices.

Resource Flow and Net Transfer Functions

For a long time, MDBs were judged qualitatively by the nature and responsiveness of their operations and activities to the development priorities of the day. Despite a continual shifting of the goal posts, such judgements remain important in assessing MDBs as effective *agents of development*. But, as specialised intermediaries with a critical *financial intermediation function* to perform (which indeed is their raison d'être) MDBs also need to be assessed on their performance in affecting real resource flows and net monetary transfers between developed and developing countries. Such evaluations must be made on the entirely reasonable premise that for development to occur at an accelerated pace in the poorer countries of the world, capital needs to flow from richer to poorer countries and that the MDBs should be at the forefront in inducing such flows.

Over the last decade of debt crisis and adjustment MDBs, and particularly the World Bank Group, have adopted a much higher profile as agents of policy reform through their structural and sectoral adjustment lending operations (SALs and SECALs). Yet, at the same time, their resource flow functions have paradoxically not been performed with distinction. This has led, inevitably, to considerable defensiveness, accompanied by much dissembling and disingenuous reasoning, on the part of MDB managements about the validity of judgements being made about their performance on the basis of *resource flow* and *net transfer* criteria.

9 It should be emphasised that although the MDBs are major *financial* institutions in their own right, they are beyond the reach or influence of any national or global *financial regulatory* authority.

The resource flow functions of MDBs cannot be judged by the *annual lending volumes* that these institutions invariably highlight and draw attention to in their annual reports, publications and the large number of speeches that their senior managers make in public to applaud the achievements of their institutions. They can only be judged on the basis of the MDBs' annual *disbursement* performance relative to the amount of their annual principal and interest collections on their outstanding loan portfolios. The *net resource flow* is the difference between their annual disbursements of loans and their annual collections of principal. The *net transfer* they achieve is the difference between their annual disbursements of loans and their annual collections of total debt service; i.e. principal *and interest*. As the figures quoted below suggest, these net resource flows and net transfers are a fraction of the annual lending volumes which the MDBs loudly trumpet.

Developing countries obtain financial flows from a vast variety of sources[10] which include:

- *Bilateral Assistance:* mainly from OECD governments in the form of grants, as well as concessional and non-concessional loans. Formerly, the Arab-OPEC and CMEA countries (mainly the former Soviet Union) were a major source of bilateral assistance. Arab-OPEC surplus nations have reduced their assistance drastically in the wake of the oil price falls of the 1980s. Assistance from CMEA has ceased altogether as its members have become recipients rather than donors of such largesse. More recently an increasing amount of bilateral assistance has come from some large developing countries – Brazil, India and China – as well as the newly industrialised countries (NICs such as Korea and Taiwan) – to other developing countries in their regions or in Africa. While most bilateral flows from all these sources is classified as *development assistance*, the bulk of it is in reality aimed at achieving the particular political, military, or commercial objectives of the *source* country rather than the development priorities of the *recipient* country. This factor leads to a considerable amount of confusion and disillusionment when judgements are attempted on whether the development assistance provided is effective or not.

  Between 1990-93, bilateral *grant* assistance has averaged about US$30 billion annually while bilateral *loans* (net of repayments) classified as official development assistance (ODA) – i.e. with a grant element of at least 25% – have averaged about US$12 billion annually. Since they

10 These are usually broken down into their respective components in the Annual Reports issued by the Chairman of the Development Assistance Committee (DAC) at the OECD and by the OECD's other Annual Report on Financing and External Debt of Developing Countries.

involve no interest or principal repayments the full amount of bilateral *grants* are a net transfer. After interest payments are taken into account, net transfers on bilateral *loans*, however, averaged US$4 to 5 billion between 1990-93, i.e. about a third of the gross amounts committed.

- *Multilateral Assistance:* emanates from the five MDBs (both their hard and soft windows), their sub-regional and other cohorts, from the International Monetary Fund (IMF), and from a plethora of development agencies within the UN system (which provide resources only on a grant basis). Between 1990-93, the MDBs achieved an annual average net resource flow of around US$15 billion annually but a net transfer of only US$2 billion annually after interest payments were accounted for. These figures combine the resource flows and net transfers from both their hard and soft windows. The *hard* windows of the five MDBs achieved a net resource flow of only around US$6 billion annually with a *negative* net transfer of around US$4.5 billion annually. The UN system of development assistance has averaged resource flows and positive net transfers of around US$4 billion annually in the early 1990s.

- *Private Financial Flows* of various types including grant flows from non-governmental organisations (NGOs – also known as private voluntary organisations – or PVOs); flows from commercial banks, as well as from capital markets (i.e. international bond markets and equity markets). Some bond market flows represent former commercial bank debt that has effectively become securitised and tradeable (e.g. the Brady Bonds of former severely indebted countries). Equity flows into developing countries can be in the form of both foreign *direct* investment as well as *portfolio* investment. Private flows which are repayable in some form or other may be either guaranteed by the government of the receiving country (or occasionally a third party like a bilateral or multilateral guarantee agency of one kind or another) or unguaranteed. Grant flows from NGOs/PVOs (partly supported by donor governments) have averaged around US$5 billion annually in the early 1990s while flows from the various private commercial sources (banks, bond markets and equity markets) have recently mushroomed. Between 1990-93 private resource flows have increased from around US$43 billion to around US$113 billion. Flows from commercial banks have increase from a negative (-) US$2.5 billion in 1990 to about +US$20 billion in 1993. Net resource flows from *international bond and fixed income markets* have increased from just under US$3 billion in 1990 to over US$30 billion in 1993 with the amount of bonds and other fixed income instruments outstanding having risen from a stock of US$5.6 billion in 1990 to a stock

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of US$42.6 billion in 1993. Net resource flows from *foreign direct investment* in developing countries rose from US$26.3 billion in 1990 to US$56.3 billion in 1993 while flows from *foreign portfolio investment* in emerging markets increased from just under US$4 billion in 1990 to over US$13 billion in 1993 with the outstanding stock of such investments exceeding US$65 billion at the end of 1993.

The resource intermediation role of the MDBs can be judged relative to the role played by other sources of funds available to developing countries as well as by the standard of how well they accommodate the external financing needs of any particular country. For that reason judgements about resource flows and net transfers are best made in the context of an individual country rather than in the context of resource transfers to the developing world as a whole. Yet, although judgements about the global resource transfer performance of MDBs need to be carefully qualified, they are not by themselves invalid. Clearly, country-by-country data represent too detailed a level for this handbook to examine in any depth; the paragraphs that follow therefore focus on the more readily available global resource flow and net transfer figures from sources such as the World Bank, the IMF, and the OECD.

Net Resource Flows from MDBs

Taking all the above sources of external finance for developing countries into account, the hard-windows (i.e. the core *banks* themselves) of the five MDBs accounted for about 2.5% of total *resource flows* to the developing world in the **1960s**[11] while their soft windows (i.e. the special funds financed directly by donors) accounted for a further 1.7%. Between **1970-74**, these shares remained at around 3% for the hard windows and increased to 2.6% for the soft windows. In the latter half of that decade **(1975-79)**, the hard window share (annual average) increased to around 4.2% while the soft window share edged up to just under 3%. Commercial bank petro-dollar recycling to developing countries was burgeoning at the time. Banks, which provided less than 5% of total resource flows to developing countries in the 1960s, increased this share to 21% between 1970-74 and 24% between 1975-79.

In the **1980s**, during the debt crisis when commercial banks withdrew their lending at a rapid rate, the MDBs' share of resource flows to developing countries increased substantially. The hard-window share of total resource

11 Source: "OECD: Twenty-Five Years of Development Cooperation. A Review", DAC Chairman's Report for 1985, OECD, Paris, 1986 (see Tables VI-2 and VI-3, pages 162 and 165).

flows increased to 6.6% between **1980-84** while the soft-window share increased to 3.3%. Between **1985-89** those shares rose even further to an annual average of over 8.5% for the hard windows and 5.4% for the soft windows. In the **1990s** (i.e.1990-93) that pattern has reversed dramatically with the hard-windows' share dropping sharply to 4.2% and the soft-window share stabilising at around 5%. Indeed the share of MDBs in total resource flows to developing countries has been dropping since 1987 when it was nearly 17% to an average level of 10-11% in the 1990s. Table 1 and Figure 1 below, depict these fluctuations.

Table 1 MDBs' Shares in Total Resource Flows to Developing Countries 1960-93 (billions of U.S. dollars)

Period/Year	Total Net Resource Flows	Net Resource Flows from MDBs					
		Hard	%	Soft	%	Total	%
1960-69*	24.2	0.6	2.5	0.4	1.7	1.0	4.2
1970-74*	30.7	0.9	2.9	0.8	2.6	1.7	5.5
1975-79*	77.8	3.3	4.2	2.3	3.0	5.6	7.2
1980-84*	111.2	7.3	6.6	3.7	3.3	11.0	9.9
1985	84.0	8.2	9.8	4.1	4.9	12.3	14.7
1986	82.0	9.5	11.6	4.7	5.7	15.2	17.3
1987	89.1	8.5	9.5	6.4	7.1	15.0	16.6
1988	102.3	6.1	6.1	5.0	5.0	11.1	11.1
1989	116.9	6.5	5.6	5.2	4.5	11.7	10.1
1990	127.3	8.5	6.8	6.3	4.9	14.8	11.7
1991	131.5	7.9	5.9	7.0	5.1	14.9	11.0
1992	156.6	4.9	3.1	7.3	4.7	12.2	7.8
1993(e)	176.7	9.8	5.4	8.5	5.0	18.3	10.4
(a)	176.7	3.1	1.8	6.6	3.4	9.7	5.2

* Annual average for five- or ten-year periods.
(e) Latest available estimates of 1993 figures as provided in the World Debt Tables 1993-94 series.
(a) Actuals from the Annual Reports of MDBs.
Sources: OECD, 'Annual Reports of the DAC Chairman' from 1985 through 1992. OECD, 'Annual Reports on Financing & External Debt of Developing Countries' from 1987 to 1992. World Bank, 'World Debt Tables' series 1988-89 through 1993-94.

Part of the reason for the dip in the share of total resource flows provided by MDBs to developing countries in the **1990s** has been the resurgence of flows from private capital markets. Total private resource flows to developing countries had fallen from a peak of nearly US$75 billion in 1981 (when banks

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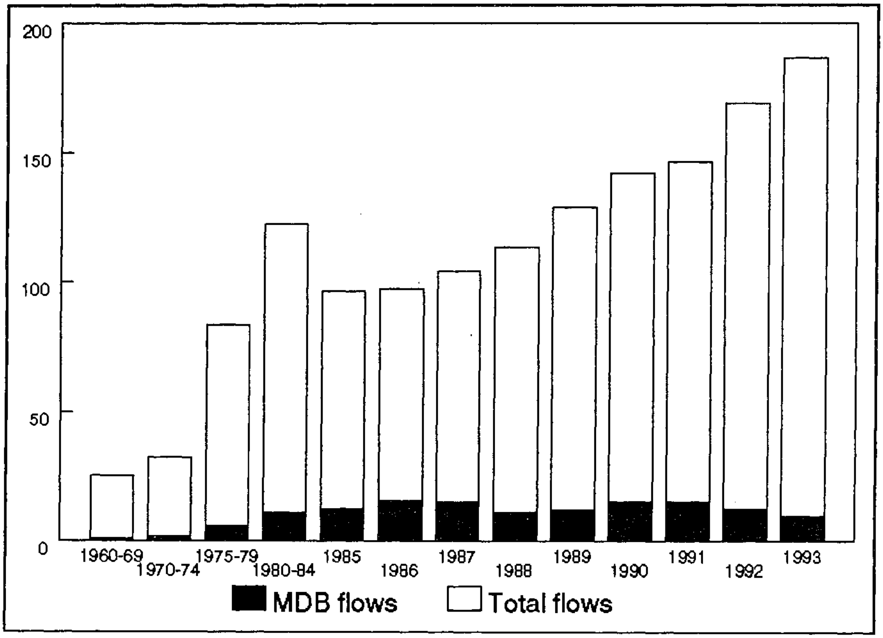
were the main providers of funds) to a nadir of US$26 billion in 1986. Recovering to an annual average level of US$50 billion between 1987-91, they have since ballooned to exceed US$102 billion in 1992 and an estimated US$113 billion in 1993. This time private flows are being driven not by bank lending but by *portfolio and direct foreign investment* in developing country bonds and equities. In 1992 and 1993, private capital flows accounted for about 65% of total capital flows to developing countries, a much higher proportion than has so far been recorded by the OECD's DAC secretariat; even at the peak of commercial bank lending, the share of private flows did not exceed 55% of total flows to developing countries.

Figure 1 MDB Share in Total Resource Flows to Developing Countries
(billions of U.S. dollars)



Net Transfers from MDBs

As observed, resource flows from MDBs are a fraction of annual commitments. For example, against total MDB commitments of over US$40 billion in 1993 (with US$24 billion from the World Bank alone) resource transfers in 1993 were estimated at US$18 billion. Net transfers from these institutions are even lower. Indeed the IBRD (the largest of the MDBs) has consistently recorded *negative net transfers* (i.e. after taking interest payments into account, it has been extracting monetary resources from its borrowers rather than providing them) since 1987 with such negative transfers escalating from about -US$1.5 billion in 1987 to over -US$7.7 billion in FY93 and -US$8.6 billion in FY94. Negative transfers are particularly large in the case of Latin America and East Asia; between FY90-94 the World Bank has extracted over US$11 billion from Latin America and US$2 billion from East Asia. The World Bank's soft-loan window IDA (i.e. the International Development Association) which provides funds on highly concessional terms has, however, recorded substantial positive net transfers which until 1990 enabled the World Bank as a group to show positive overall net transfers. However, between FY92-94 the negative transfers from IBRD were too large to be offset by IDA resulting in the group as a whole recording negative net transfers for those years. The negative net transfer from the World Bank Group in FY94 was -US$3.9 billion.

Between 1987-91, the rest of the multilateral hard-loan windows (primarily the three regional MDBs for Africa, Asia and Latin America) managed to maintain positive net transfers to their borrowers (averaging US$1 billion annually). But these were not sufficient to offset negative transfers from the IBRD, resulting in the multilateral hard-loan windows as a whole achieving a *negative* net transfer (averaging -US$2.3 billion annually). Overall net transfers from their soft windows (including IDA) over the same period averaged US$5 billion annually resulting in total combined net transfers (from the hard and soft windows) averaging a positive but desultory US$2.7 billion in that 5-year period. In 1992 and 1993, however, dragged down by the very large negative net transfers on the IBRD's accounts, the MDB system as a whole (including their soft-windows) recorded a negative net transfer of -US$0.4 billion in 1992 and -US$2.3 billion in 1993 despite the fact that the other MDBs (and IDA) recorded positive net transfers of nearly US$7.3 billion in 1992 and US$6.3 billion in 1993 respectively. For 1993 the World Bank had projected an overall positive net transfer from all MDBs of US$4.2 billion but its record of such projections which has been hopelessly over-optimistic upto now, was again proven wrong by an estimation error of over US$6.4 billion in the wrong direction (see Table 2).[12]

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12 For example, in the previous WDT 1992-93 series, the World Bank projected an overall positive net transfer from MDBs of about US$4.6 billion for 1992. The actual outcome was a *negative* transfer of -US$0.85 billion with the Bank's estimate being out by nearly US$5.5 billion on the optimistic side. The World Bank's Annual Report for 1994 suggests, in contrast to its WDT for 1993-94, that negative net transfers from the IBRD might actually increase rather than decrease over the foreseeable future.

From: Multilateral Development Banks: An Assessment of their Financial Structures, Policies and Practices, FONDAD, The Hague, 1995, www.fondad.org

Table 2 Net Transfers from MDBs to Developing Countries 1970-93
(billions of U.S. dollars)

Year	Total Net Transfers	MDB Net Transfers	Hard-Window Net Transfers	o/w IBRD Net Transfer	Soft-Window Net Transfer	o/w IDA Net Transfer
1970-74*	n.a.	1.00	n.a.	0.32	n.a.	0.46
1975-79*	n.a.	4.06	n.a.	1.12	n.a.	1.12
1980-84*	n.a.	7.52	n.a.	2.56	n.a.	2.04
1985	n.a.	6.77	3.28	1.74	n.a.	2.57
1986	-5.10	6.05	2.19	0.41	3.86	2.81
1987	-2.90	3.86	-0.89	-1.48	4.75	3.49
1988	-5.40	1.56	-3.05	-4.08	4.61	3.37
1989	2.30	2.41	-2.18	-3.49	4.59	3.11
1990	25.50	4.03	-1.45	-2.07	5.48	3.83
1991	44.50	1.87	-3.77	-5.45	5.64	3.95
1992	79.60	-0.43	-6.74	-7.73	6.31	4.43
1993(e)	91.60	4.20	n.a.	n.a.	n.a.	n.a.
(a)	n.a.	-2.28	-8.24	-8.55	5.96	4.69

* Annual average for five-year period.
(e) Estimated by the World Bank in World Debt Tables 1993-94.
(a) Actuals from the Annual Reports of MDBs.
Sources: OECD, 'Annual Reports of the DAC Chairman on Development Cooperation' 1985 through 1992. World Bank, 'World Debt Tables' series 1988-89 through 1993-94, 'Annual Reports' 1985-94.

When it comes to effecting net transfers of financial resources, the unfortunate reality is that once hard-loan portfolios reach a size where annual principal and interest repayments to MDBs by their developing country borrowers become structurally very large, the hard-windows of MDBs become inefficient and inflexible devices as financial intermediaries. Interest payments by developing countries to MDBs (on both hard and soft window accounts) have increased from $0.3 billion in 1970 and $2.7 billion in 1980 to an average of nearly US$13 billion between 1990-93. That annual level will increase to US$16 billion between 1994-97 and, on present trajectories of lending, to US$20 billion towards the end of this century. Annual principal repayments to MDBs reached US$17 billion in 1993 and will escalate to over US$25 billion by the end of the century.

To maintain zero net transfers therefore, the MDBs as a system will need to increase gross disbursements from US$28 billion in 1992 to over US$45 billion by the end of the century. If they focus on slow-disbursing project lending (which experience suggests remains their real forte) this would require them to commit between US$100-120 billion by the year 1999. By comparison with these requirements of increasing gross disbursements by US$17 billion between 1994-99 (or by approximately US$3 billion each year), the MDBs as a whole increased gross disbursements by only US$3.5

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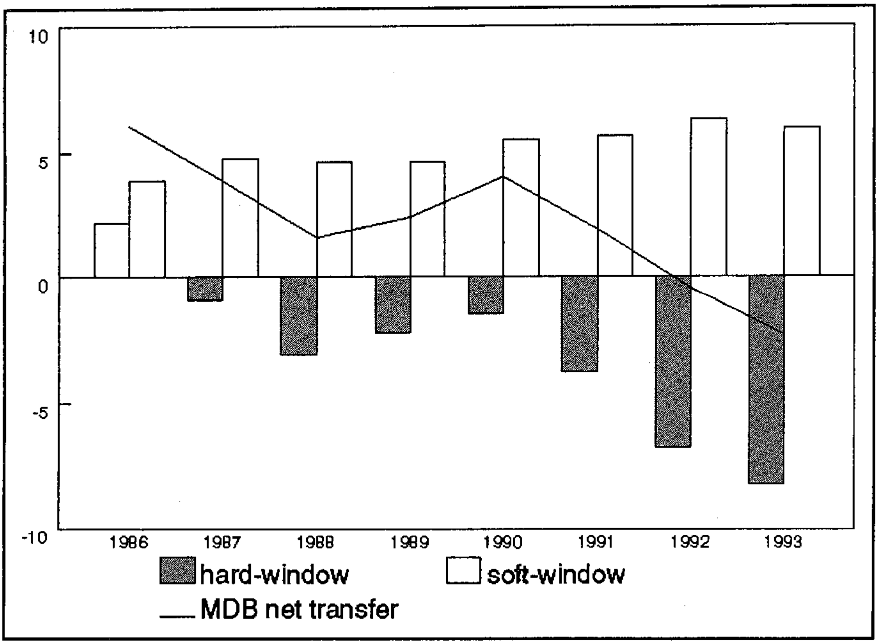
Figure 2 Net Transfers from MDBs to Developing Countries
(billions of U.S. dollars)



billion between 1987-92. If that track record is not improved substantially, the MDBs are likely to become less and less significant as resource transfer agents to the developing world. Since, in the final analysis, it is the financial dimension that governs relationships between MDBs and their borrowing countries, the influence of MDBs as a whole – even as agents of development and purveyors of policy prescriptions – is bound to diminish except in those countries which are dependent on borrowing from MDB soft-windows.

A final point on the subject of MDB net transfers. To avoid making themselves look bad, MDBs now portray their net transfers by combining the figures from both their hard and soft loan windows or try to avoid mentioning them altogether. This is misleading for two reasons. First, the annual commitments and gross disbursement levels from the soft-windows result in much larger net transfers than from the hard-windows. The reason is plain. Interest payments on soft loans are very low and annual principal repayments on these facilities are much smaller as they are spread out over

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longer maturity and grace periods. Second, these two windows are invariably orientated towards different groups of borrowers. Except in the case of the African Development Bank[13] the hard-windows of MDBs are orientated principally towards middle-income, creditworthy countries (mainly in Latin America and East Asia) while the soft-windows lend mainly to the poorer countries of Africa and South Asia. Today, the principal blend countries (i.e. those which receive funds from both hard and soft loan windows of the MDBs) are the large poor countries like China, India, Indonesia, Nigeria, Pakistan and Egypt. Hence, when the MDBs show combined net transfer figures for their hard and soft windows they obscure the degree to which their core hard-windows are failing in their resource transfer functions (especially to middle-income countries) thus deliberately obfuscating reality.

The Hard And Soft Loan Windows of MDBs

Frequent references have been made earlier to the *hard* and *soft* loan windows of the MDBs. The **hard loan window** comprises the core 'development bank' in each institution. It has a capital structure in two parts: *cash* capital and *callable* capital. MDB capital is subscribed and paid-in by *all* member governments in negotiated proportions. The basis for determining these proportions (over which much negotiation takes place each time there is an increase in capital) varies in the case of each multilateral bank; it is notably different in the case of the World Bank and the regional development banks. Against their capital base the *banks* borrow resources on world capital markets through public bond issues, private placements and syndicated loans, or, occasionally, facilities made available for lending by a single member country (e.g. Japan and Saudi Arabia) which has generated sudden large current account surpluses. These borrowings, which are raised on market terms, far exceed the amount of *cash* capital contributed to the MDBs and constitute the bulk of the resources they intermediate.

For that reason the *bank* part of the MDBs has to lend on market-related *hard terms* (hence the term *hard-window*); i.e. its interest charges must cover its own *borrowing cost* plus a *spread* or interest margin to cover its internal administrative and operating costs. MDB loans must also have maturities (and grace periods) which match roughly the maturities of the MDB's own pooled long-term borrowings. Such matching of maturities is necessary to avoid the prospect of the MDBs taking an excessive *term transformation risk*; i.e. the risk of borrowing funds for shorter periods than it lends them thus exposing itself

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13 The AfDB has been lending too large a proportion of its hard loans to patently uncreditworthy poor countries in Africa when these countries, given their over-indebtedness, should be receiving only concessional soft funds.

From: Multilateral Development Banks: An Assessment of their Financial Structures, Policies and Practices, FONDAD, The Hague, 1995, www.fondad.org

to the possibility that, if capital market conditions change adversely, it may need to pay a much higher price to cover its funding requirements for loans it has committed to disburse over a long time frame. The term transformation risk is of course lessened to the extent that MDBs can lend to their borrowers at variable rates of interest which can be adjusted in tune with periodic changes in their own borrowing costs.

Since the Articles of Agreement of the MDBs do not permit them to take any *exchange risks*, these are also passed on to the borrower, adding a further element of cost and risk to the facilities that MDBs provide. Such risks arise when an MDB borrows in one currency and lends in another. In the case of most MDBs the practice that has developed over time is to borrow in a mix of currencies and to on-lend these currencies through a currency pool in which all borrowers share more or less the same risks.

The hard windows of MDBs are constrained in the amount of loans they can make only to the extent that their outstanding borrowings have reached nearly the same level as that of their existing capital resources (cash and callable). Their Articles of Agreement usually limit their outstanding borrowings to their capital in a 1:1 ratio. In practice MDBs never actually reach this limit because MDB managements alert their member governments to the need for a capital increase a considerable amount of time before the 1:1 limit risks being approached.

In contrast to the hard windows whose financial structure (with the exception of the callable capital feature) approximates that of any commercial long-term lending institution, the **soft loan windows** of the MDBs – i.e. their special multilateral development funds (MDFs) or associations – are legally set up and funded entirely differently, except in the case of the IDB where the Fund for Special Operations (FSO) is an integral part of the institutional structure. They are not banking entities with a limited capital structure on which borrowing leverage can be exercised as such. They are structured instead as separate funds in the case of the regional banks or as an association, in the case of IDA. Even borrowing member governments make insignificant, nominal contributions to these funds/associations to establish their membership and eligibility for borrowing and voting on their various functions and operations. The financial architecture of the MDFs is based on the concept of multilateral clubs of donors who collaborate in providing permanent grant resources to these respective funds. The resources thus provided are on-lent to borrowers on highly concessional terms. There is no interest cost as such levied on these facilities but a small service charge (usually between 0.5% to 1%) is applied to outstanding balances to cover administrative costs.

MDF resources are made available to borrowers for 35-50 year maturity periods with around 10 years grace. Such terms usually have a *grant element* of between 75-85% which is regarded as extremely concessional or *soft* (hence the term *soft-window*) compared to the alternative cost of market borrowings; assuming that access to financial markets was possible in the first place. Because these funds are financed by budgetary contributions from donor country governments, and because they cannot be leveraged with market borrowings (i.e. the amounts lent out to recipients are limited to the resources provided by donor governments), they are tightly constrained and carefully rationed out among eligible recipient countries. The funds are set up to be revolving in nature. Upto now they have been replenished regularly on a three or four year replenishment cycle depending on the MDF concerned. Table 3 shows the present level of capital and concessional resources available to the five MDBs.

Table 3 Hard and Soft Loan Windows of the MDBs
(billions of U.S. dollars)

	World Bank	**AfDB**	**AsDB**	**IDB**	**EBRD**
Hard Window	IBRD	AfDB	AsDB	IDB	EBRD
Established	*1945*	*1964*	*1966*	*1959*	*1991*
Capital -93/94 (Paid-In Capital)	170.00 (10.67)	22.25 (2.56)	23.08 (2.78)	54.20 (3.17)	11.03 (3.31)
Retained Earnings	14.47	0.57	4.94	4.76	0.005
Paid-In/Subscribed(%)	6.3%	11.5%	12.1%	5.9%	30.0%
Loans Outstanding	109.29	8.31	13.71	22.18	0.40
Loan Provisions	3.32	0.21	0.01	0.71	0.05
Total Reserves	14.47	0.57	4.35	4.75	0.01
Soft Window	IDA	AfDF	AsDF	FSO	None
Established	*1960*	*1972*	*1974*	*1960*	–
Resources -93/94	100.01	10.60	17.63	8.65	–
Disbursed Credits	62.81	4.96	9.38	5.93	–
Undisbursed Credits	25.07	4.33	6.00	1.98	–

Note: Figures for the World Bank relate to June 30, 1994; Figures for the other MDBs relate to December 31, 1993.
Sources: MDB Annual Reports for 1993. IBRD Annual Report for 1994.

From: Multilateral Development Banks: An Assessment of their Financial Structures, Policies and Practices, FONDAD, The Hague, 1995, www.fondad.org