7 Budget Management and Administrative Cost control

Introduction: Why is it Necessary to focus on MDB Budgets?

This penultimate chapter attempts to bring into focus the *budget management and administrative cost control* practices and procedures of the MDBs which have come under scrutiny in recent years. Strictly speaking budget management and cost control are not matters of financial policy in MDBs. Nevertheless, most MDBs entrust the programming and budgeting function as well as the cost control and monitoring function to their financial organisations and managers. The policies which govern MDB budgets fall into a range of different categories including: administrative, human resource management, information technology, operational, research, information dissemination, and financial; not all of which can be adequately dealt with in a book of this nature. The financial policies which might affect MDB budgets have already been discussed at some length in the previous six chapters. MDB budgets are, however, most profoundly influenced by policies on staffing and recruitment, use of consultants, compensation, travel and communications, research and non-operational programme priorities, and other similar matters which do not fall within the general purview of financial policies. They are therefore more appropriately the subject of detailed consideration elsewhere.[1]

Obviously, *all* policies which affect MDB budgets have a profound influence on determining their overall cost structure and, therefore, on their overall financial situation and their net incomes. Consequently, they also have a bearing on the capacity of the MDBs to: (a) make provisions and generate adequate *reserves* commensurate with the growth rate of their loan portfolios; and (b) deploy their residual net incomes for other developmental purposes. Moreover, there has been a strongly growing impression among OECD shareholders, borrowers, the private sector, non-governmental organisations, and the public at large, that MDBs – along with UN agencies – have become opaque and unaccountable in their annual expenditures.[2] They are not, for

1 But there can be little question that they should be subject to effective external scrutiny outside of the confines of their managements and Executive Boards. The evidence seems to suggest that, on the issue of cost control, Executive Directors in the MDBs may be in a conflict-of-interest situation and are perhaps susceptible to regulatory capture; i.e. serving the interests of those whom they are supposed to regulate rather than those whom they are supposed to serve.

2 To enhance transparency, the MDBs could make a good start by emulating the World Bank but going much further than it by including a detailed section on budgets and→

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instance, subject to the intensive public and parliamentary scrutiny that government departments and public enterprises are usually subjected to in most democratically run nation states. Nor are they subject to the competitive pressures of the marketplace and the discipline that is ostensibly supposed to be exercised in most commercial, profit-making corporations. Therefore, with their sources of income being assured by their privileged position as preferred creditors, and with the adoption of financial policies which are designed to pass on virtually all the costs and risks of what they do to their borrowers or shareholders, without any obligations to pay out dividends or to increase the value of their shares, there are no compelling *natural incentives* for them to control their costs.

Media exposure now focuses almost daily worldwide public attention on the seemingly excessive expenditures which MDBs make on: their new office buildings, staff, travel and communications costs, as well as on various other perks and privileges which their staff enjoy such as tax-free salaries, home-leave benefits, educational allowances, and generous pension plans which are funded in considerable part by the MDBs. These expenditures frequently pale in comparison with the egregious excesses of top managers in private industrial and financial corporations in the developed and developing worlds. But they are quite generous in comparison with most, if not all, OECD governments. Such public attention and unfavourable comparisons (invariably and inevitably seen as invidious by the MDBs themselves) have become particularly troubling and sensitive at a time when the MDBs have come under criticism for poor performance or even failure on many fronts. They were much less of an issue when the primacy and role of MDBs was not subjected to such intense scrutiny and when there was little public doubt about the focus or effectiveness of their activities. Part of the concern about MDB budgets and expenditures is unquestionably linked to changing perceptions (in the wrong direction) about the usefulness and efficiency of these institutions both as financial intermediaries and as development institutions and about the overall quality of their managements. But a portion of concern is also linked to the more general loss of faith in governments and governmental institutions as solutions to national or global problems.

Many NGOs of various hues have now mounted highly effective public campaigns pointing to the failure of MDBs on several fronts e.g. the environmental damage their infrastructural investment projects are alleged to have

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administrative expenditures in their published Annual Reports with tables, ratios and explanations to facilitate understanding of how MDBs justify their administrative expenditures. At present the World Bank has the most detailed section on this issue in its Annual Report although even it obscures more than it reveals. The other MDBs provide very little information. Much of this information should be required by shareholders to be published in standard table form which would facilitate cross-MDB comparisons.

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done in the developing world. Such publicity raises questions as to whether these institutions are too removed from reality by the internally comfortable environments they create. The apparent inability of MDBs *as public institutions* to control their costs, and their inclination towards compensating their staff too well, is perceived as reflecting blatant dual standards at a time when the same institutions publicly proclaim their concerns about poverty alleviation in the developing world. The same is the case when MDBs which have proven themselves incapable of *internal* structural adjustment of a fairly simple nature, regularly suggest dramatic public expenditure cuts and civil service reductions to a large number of their borrowing countries under structural adjustment programmes. That image is exacerbated when the same institutions, which are trusted by the international community for supervising and monitoring the manner in which billions of dollars are spent annually on projects all over the developing world, are seemingly incapable of constructing or furnishing even their headquarters buildings within relatively untaxing time and cost constraints. Even so, these complaints are often trivial and exaggerated if not irrelevant in judging the overall efficiency of the MDBs and the *value-for-money* that they represent relative to many other forms of public expenditure. But the germs of truth they contain do disproportionate damage by bringing into question the basic competence of these institutions in managing their own affairs, and thus diminish their credibility which should be vital to the functioning of the world financial system. They constitute a serious failure of MDB management which cannot go unremarked.

Most disconcertingly, questions are now being raised as to whether large annual budgetary expenditures on MDBs as financial intermediaries can possibly be justified when they have entered an era of extracting resources (via large negative net transfers) from developing countries through their intermediation functions. As noted earlier, negative net transfers are not, *per se*, an indication of performance failure on the part of MDBs. Often, negative net transfers are perfectly justified when MDB borrowers have developed sufficiently either to avail directly of market borrowings on favourable terms or have even become net exporters of capital. Either or both of these conditions were met when European countries which had completed reconstruction experienced negative net transfers vis-à-vis the World Bank in the 1960s or when countries such as Japan, Finland, Spain and New Zealand financed negative net transfers in the 1970s and 1980s, i.e. when they too had reached a sufficiently advanced stage of economic development.

At the present time, however, large negative net transfers (taking into account wide regional differences) between the MDBs[3] and developing

For footnote 3, see next page.

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countries do not generally reflect those conditions. The circumstances of most MDB borrowers today certainly do not suggest that their development has reached the point where large, extractive resource transfers can be justified. Instead, these negative net transfers signal the dangers of MDB portfolios which have matured before their time. As a result the amount of new lending necessary just to keep pace with the debt service being collected is taxing the capacity of both the MDBs and borrowers to keep in a neutral resource transfer position (*the treadmill effect*). It also suggests that a large amount of MDB lending – and particularly fast-disbursing adjustment lending – has not as been efficacious as anticipated in generating the developmental returns necessary within the expected time frame. That has resulted in an overhang of unproductive MDB debt which a large number of developing countries owe and which they are straining themselves to service.[4] Finally, large negative net transfers between the MDBs and their borrowers are occurring at the same time as positive net transfers between developing countries and global capital markets. That *may* indicate that private capital markets are becoming more efficient than the MDBs in performing *resource transfer* functions, and possibly even some *developmental* functions (such as domestic capital market development and infrastructure financing), thus raising serious questions about the continuing raison d'être for the MDBs, and especially for their hard windows.

Many of the criticisms of the laxity of sufficient cost control by MDBs are driven by motives other than the desire to see genuine improvements in the efficiency of their functioning. Many are ill-informed and unjustified. But, unfortunately, far too many of the criticisms which have been levelled (and many that should be but, as yet, have not) are legitimate and need to be dealt with more satisfactorily than the MDBs have so far done. Their usual responses to criticism about their lack of sufficient cost-consciousness are to: attempt ineffectual though unceasing annual reorganisations; co-opt their critics in somewhat unsubtle ways; attempt deliberate obfuscation and cover-up of serious budgetary lapses; and complicate their already overcomplicated budget preparation and control processes even more. By and large all the MDBs have sophisticated budget preparation guidelines and devote a considerable amount of staff time (perhaps even too much) to budget control. However, the way in which they go about preparing their budgets and controlling their expenditures is in some instances (e.g. in the case of the

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3 As noted in Chapter 1 the problem of large negative net transfers affects mainly the World Bank which dominates the MDB system. It does not as yet affect the more established regional banks, although it could do so before too long, and will not affect the EBRD for some time to come while its portfolio matures.

4 For a fuller discussion of this issue, see Mistry, P.S., "Multilateral Debt: An Emerging Crisis?", FONDAD, The Hague, 1994.

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World Bank) so elaborate that the budget process itself may have now become a major source of unnecessary expenditure and inefficiency.

The problem of excessive expenditure, however, lies less with the budget and monitoring *process* (except perhaps in the case of the AfDB and until last year the EBRD) than with the nature of core policies which drive MDB budgets and with the plethora of functions which shareholders demand MDBs should carry out without due concern for the cost implications of such *mission overload.* MDBs have generally been reluctant to reconsider their staff compensation levels as well as their benefit and travel policies except under extreme shareholder pressure. Nor have they been particularly mindful of: making essential staff reductions, redeploying staff more effectively and relying more on local staff with substantive decentralisation of their organisations and operations. In dealing with their budgets MDB managements appeared, until very recently, to have imbibed implicitly the disturbing ethos that the preferred creditor status of their institutions vis-à-vis borrowers must automatically be accompanied by the same privileged and preferred treatment of their individual staff vis-à-vis the rest of the world. Consequently, despite the incessant reviews commissioned internally by MDB managements and Executive Boards aimed at reducing costs, improving efficiency, and reducing throughput time (between identification of a project and approval of a loan) these objectives have rarely been met. Some of these reviews have achieved the opposite of what was intended. MDBs therefore remain stubbornly resistant to budget control.

Comparative Analysis of MDB Administrative Expenditures

The annual administrative expenditures of the various MDBs are portrayed in Table 8. The comparisons made and the ratios provided in that table need to be interpreted with particular discretion and care although the table does highlight some points which are worthy of careful scrutiny. To develop more appropriate benchmarks of relative cost and efficiency across the different MDBs, their budgets need to be broken down and re-synthesised in different ways to arrive at more pointed and valid conclusions about relative efficiency in undertaking specific activities and operations rather than rely on aggregates which cover a multitude of sins. Nonetheless, even the crude ratios provided on the basis of budgetary aggregates available from their published Annual Reports underline some important points which MDB shareholders rarely look at in a comparative framework; nor do they analyse their implications with sufficient care. A detailed comparative analysis of MDB budgets and administrative expenses at relevant levels of disaggregation and detail is clearly outside the terms of reference of this book. Administrative budget breakdowns are needed in fine detail of the sort that

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MDBs are reluctant to release publicly. Nevertheless such detailed comparisons need to be made to evaluate the relative and absolute efficiency with which MDBs deploy budgeted funds. Such analysis should be undertaken by qualified independent assessors (not subject to regulatory capture) on a regular basis to enable more effective shareholder control over the spending habits of these institutions.[5]

Table 8 Administrative Expenditures of the MDBs (1993/94)
(millions of U.S.dollars, unless indicated differently)

Total Institution	**IBRD**	**AfDB**	**AsDB**	**IDB**	**EBRD**
Total Admin Exp.	1,388.4*	134.2	151.8	271.2	153.2
o/w Staff Costs	851.8	93.6	106.3	197.9	77.9
Consultants	133.7	n.a.	6.4	n.a.	n.a.
Travel	129.8	n.a.	9.4	33.6**	34.4***
Other/O'head	297.9	40.6	29.7	39.7	40.9
No. of Staff	(6,338)	(1,224)	(1,898)	(1,818)	(795)
Admin Cost/Staff ($)	219,060	109,641	79,979	149,175	192,704
Staff Costs/Staff „	134,396	76,471	56,006	108,856	97,987
Other Costs/Staff „	84,001	33,170	23,973	40,319	94,717

Hard Window	***IBRD***	***AfDB***	***AsDB***	***IDB***	***EBRD***
Total Admin Exp.	731.0	54.5	88.9	178.6	153.2
No. of Operations	(124)	(28)	(38)	(69)	(91)****
Dollars Lent ($Bn)	14.2	1.6	4.0	5.5	2.5
Dollars Disb („)	10.4	1.4	2.0	3.3	0.5
Cost per $ Lent	5.1¢	3.4¢	2.2¢	3.2¢	6.1¢
Cost per $ Disb	7.0¢	3.8¢	4.4¢	5.4¢	30.6¢
Cost per Op ($Mn)	5.90	1.95	2.34	2.59	1.68

5 Some MDB managers argue, however, that since these are independent profit-making organisations their budgets do not need to be controlled or monitored in the same way as those of government departments or parastatals. There is some merit in that argument although the ability of MDBs to generate profits depends on the provision of free funds by member governments and on the willingness of borrowers to pay whatever charges MDBs levy. For those reasons, it is essential that MDBs are seen to be controlling their costs and their expenditures on themselves as tightly as possible. They are public institutions with public responsibilities and obligations which should be subject to the same rules of transparency as other public organisations especially when they create the strong impression that they are not effective controllers of their own costs.

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Table 8 (continued)

Soft Window	IDA	AfDF	AsDF	FSO
Total Admin Exp.	545.0	76.8	74.7	93.2
No. of Operations	(104)	(41)	(40)	(23)
Dollars Lent ($Bn)	8.3	0.8	1.3	0.5
Dollars Disb („)	9.9	0.7	0.9	0.4
Cost per $ Lent	6.9¢	9.6¢	5.2¢	18.6¢
Cost per $ Disb	9.4¢	11.0¢	7.3¢	23.3¢
Cost per Op ($Mn)	5.24	1.87	1.68	4.05

* Totals may not add up to those for the main hard and soft windows because administrative expenses cover items other than those allocated to these two windows; e.g. support for private sector arms and guarantee agencies, special funds and trust funds. These costs are recovered to a degree but show up as totals in the MDBs annual budgets.

** This item includes travel plus consultants.

*** This item includes travel and other direct operating costs.

****This figure includes equity investments and is not directly comparable to the operations numbers for the other MDBs.

Note: The World Bank's FY ends on June 30, 1993.

Sources: MDB Annual Reports for 1993.

Issues raised by MDB Expenditures

Table 8 raises some interesting points. *First*, the five MDBs taken together cost nearly US$2.1 billion to run in 1993/94 (compared with substantially less than US$1 billion in 1983) with the World Bank alone accounting for over 66% of that amount.[6] *Second*, the new EBRD already costs more to run than the older and more established AsDB even though it has only 40% of the number of staff and its present operational level is far lower. *Third*, average staff costs per staff member employed are much higher in the Washington and London based institutions than in the Abidjan and Manila based institutions. This is explained largely by the much lower cost of support and para-professional staff,[7] along with a much higher proportion of support and

6 The World Bank accounts for only 52% of the total staff resources within the MDB system although it does account for nearly 60% of the system's total lending but then it also accounts for the MDB system's overall negative net transfer position vis-à-vis developing country borrowers.

7 There is a much higher ratio **of support** staff to professional staff in the AfDB and AsDB reflecting the employment characteristics of their locales than in the other three MDBs. The overall compensation and benefit levels of **professional** staff in the MDBs is roughly similar,→

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para-professional staff in the total staff mix, in the two developing country locations as well as their significantly lower level of overheads. *Fourth*, the overall overheads of the IBRD are much higher than those of the other banks other than the EBRD (but that is for an entirely different reason related to the way in which the costs of acquiring the lease on its building were charged in the 1993 budget). *Fifth*, staff costs (including those for long-term consultants) and benefits absorb around 70% of the total administrative expenditures of the established MDBs. *Sixth*, institutional overheads account for between 15-20% with other directly related operating costs (e.g. travel and communications) accounting for the remaining 10-15%.[8] What the Table makes clear is that there is little scope for achieving significant reductions in the operating cost structure of MDBs unless fundamentally different approaches to the use of human resources are considered. That point will be returned to shortly.

The World Bank's Overheads: The main reason for its much higher overheads is that the World Bank has a much more wide ranging *non-operational* programme of activities than the other MDBs. This includes its extensive research work and publications on development issues, its data and information services on matters such as debt statistics, development indicators, social indicators, population projections and its world development reports as well as its public education programmes. The Bank has also assumed the burden of (or improperly taken over, depending on one's perspectives) much of the technical assistance work that was once undertaken by agencies in the UN system. Such technical assistance programmes gravitated to the World Bank and other MDBs mainly because of the unwillingness of the larger donor countries to continue funding such programmes through UN agencies in the face of effective default by the UN system in managing these programmes.[9] It is, of course, accepted as axiomatic by the World Bank's management, staff and shareholders that all the elements of its expanding non-operational programmes are critical or

with EBRD staff commanding a 10% premium over their IBRD counterparts while the IBRD staff are 10-15% better off than the staff of the regional banks who are compensated at about the same levels although their standards of living may differ based on their locations.

8 The newly established EBRD is an exception to which these roughly similar ratios for the other MDBs do not yet apply. Staff costs in the EBRD account for about 51% of total expenditures while overheads account for an uncharacteristically high 27% largely due to the financing of start-up costs. When the EBRD settles down to a steady-state its ratios should approximate those of the other MDBs.

9 For a deeper discussion of this issue see Mistry, P.S. and Thyness P., "Options for Funding the UN System and the Development Banks" and the four other studies contained in "The United Nations: Issues and Options", The Nordic UN Project, Stockholm, 1991.

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essential. But is that so? To answer this important question it is clear that a major independent external review needs to be undertaken to examine whether all of the World Bank's diverse and numerous non-operational activities are indeed essential. In many instances it would appear that such programmes are being funded because of the vested interests of managers and staff employed in these areas, and the demands of one or two shareholders, rather than because of legitimate broadly-based demands across the borrower or OECD shareholder communities for such output. Budgeting systems which add incrementally to previous year programmes, in order to keep up with inflation and real increases in resources where these can be justified, are not particularly useful in controlling MDB costs; *zero-based budgeting* would perhaps be more appropriate in reconsidering entire categories of expenditure which the MDBs presently take for granted.

Focusing momentarily on just one important example, a large part of the World Bank's very extensive and growing *research and publication programme* appears to be undertaken more for gratifying the academic pretensions of its large number of intellectually inclined (but perhaps operationally not very useful) professional staff rather than to support the genuine developmental needs and priorities of its borrowers. Moreover, given the World Bank's cost structure and staff compensation policies such research, undertaken in-house and properly costed, is probably several times more expensive than research that is undertaken for the World Bank by the global academic and consulting communities. It is no secret that the all-inclusive cost of maintaining a research assistant at the World Bank is about the same as the all-inclusive cost of a professor at one of the better British universities and several such professors at well-known universities in developing countries. The World Bank's research – especially for example, its recent attempts at *proving* that structural adjustment is working in Africa – is also widely perceived (although sometimes unfairly) within the academic community as being biased, depending on the ideology or operational priorities which the Bank or its major shareholders happen to be purveying at that particular time.

Development economics researchers around the world depend heavily on the Bank's research output. Publicly they are quite complimentary about its obvious commitment to research in the development sphere. Privately, however, they are in agreement that much of the Bank's research is not always of particularly high quality. It is, as already observed, often intellectually inclined in support of the Bank's operational priorities, and is sometimes even misleading in an effort to justify the Bank's operational positions which have later been proven wrong, often because of independent research work done externally. A case in point concerned work done on the social dimensions of adjustment which the World Bank was forced to place attention on by the findings of external researchers and pressures applied by

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donors and the UN system. At the same time, external researchers cannot replicate much of the Bank's research work to confirm or refute its findings because of the latter's access to privileged information and its possession of perhaps the most comprehensive data banks (longitudinal, macro-economic, sectoral and cross-sectional) on all aspects of development that exist in the world today. Perhaps much greater efficiencies and quality improvements in the World Bank's research and publications programme could be achieved by *privatising* most of the analytical work being undertaken, for example by sub-contracting more extensively to established research institutions around the world.[10]

Similarly the Bank could spin-off and privatise many of its information dissemination functions and provide these services (e.g. access to debt statistics and other statistical data bases) on a commercial or quasi-commercial basis through independent private organisations with established reputations. Cost-wise, it may be far more appropriate for the Bank to permit legitimate access to its impressive data bases to independent researchers than attempt to do analytical research work itself, especially in view of the suspicions it has aroused about its intellectual honesty, independence, *bona fides* and motives in undertaking development research.

Other examples abound to justify serious questioning of the need for all the MDBs (and even the IMF) undertaking similar non-operational activities. Many of the non-operational activities (especially of the Washington-based institutions) could be rationalised and done jointly rather than singly in order to achieve significant budgetary savings within the multilateral system. The same thought could be extended to the UN agencies as well.[11] This

10 At the moment the allocation of its external research contracts suggests that the Bank appears to favour sub-contracting research mainly to universities in OECD countries rather than to those in developing countries; even when excellent development economics research capacity exists in the latter. To an extent, given the relative distribution of research capabilities around the world, that bias may well be justified if not inevitable. But there are also some disconcerting suggestions and actions which indicate that the Bank's bias towards developed country research institutions may be being reinforced by: (i) the regular movement of research staff between the Bank and a limited number of developed country universities; (ii) a greater proclivity on the part of the Bank's preferred developed country researchers to see issues from the Bank's point of view; and (iii) conscious or inadvertent efforts at constituency-building in the academic and research communities of major shareholding countries in order to exert the appropriate influence when legislation supportive of the Bank comes up for consideration or to ensure that the Bank gets a better press than it presently seems to in most developed countries.

11 A plethora of publications from different parts of the MDB community on the same issues often reflects less a healthy competition of different ideas and more of a herd mentality reminiscent of the kind of research which is done by financial houses which have a securities selling bias. Moreover, different publications from different MDBs on the same subjects (for example on debt or structural adjustment) often serve to confound and confuse rather than→

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important issue needs to be explored thoroughly in a manner which cannot be attempted in this book (which must confine itself to using illustrative examples) in order to provoke more systematic, in-depth thinking about these issues by the MDB shareholding community. Clearly, the World Bank is not the only MDB whose non-operational programmes should be reviewed, although its relative high overhead cost ratios and the fact that it alone accounts for two-thirds of the total annual administrative costs of the MDB system suggest that the greatest scope for sensible pruning lies there.

From a *strategic* viewpoint – given that MDBs seem to find it difficult to adapt responsively to a rapidly changing operating environment because of their own internal labour market rigidities – achieving significant cost-reductions and efficiencies in MDB budgets and in the way that MDBs presently operate, requires attention on issues that are not really concerned with the administrative processes and protocols governing budget formulation and implementation. Tightening up the nuts and bolts of *budgeting systems* in the MDBs, which is what their managements usually resort to in the face of criticism of their free-spending habits, usually yield marginal and insignificant results at best. For example, despite unrelenting pressure from all external sources to control its budget and annual tinkering with its budgeting systems and procedures, the World Bank's annual operating budget in nominal (current) dollars has increased from US$406 million in FY81 to nearly US$1.4 billion in FY94 with the total budget proposal for FY95 (which started on June 1, 1994) being US$1,420 million! The compound annual rate of growth in *nominal* dollars over the FY81-94 period was nearly 10% (when the average applicable annual inflation rate was 4%) whereas staff grew annually at a rate of 1.5%, the overall volume of lending (for both IBRD and IDA) grew at a rate of just over 4%, the number of operations remained level at between 220-254 per year while net transfers from the World Bank Group as a whole declined dramatically from positive to negative levels.

In nominal dollars the *total administrative cost per operation* (averaging both IBRD and IDA operations) in the World Bank has increased from US$1.57 million in FY81 to an estimated US$6.2 million in FY94 or a compound annual growth rate of 23%. In FY81, the IBRD's net profit exceeded total World Bank administrative expenses by a factor of 1.54. In FY94, the IBRD's

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elucidate and illuminate by using different data which then cause secondary concerns in the academic research community about relative data quality and create problems of information reconciliation. Similarly, there is little need for these multilateral institutions along with their cohorts in the UN system to produce their own individual reports on global economic outlooks, on debt, on trade and commodity prices and perspectives etc. Their research as well as their training activities (e.g. the EDI, the IMF Institute and similar undertakings by the IDB) could easily be rationalised and delivered perhaps even more effectively than is the case now.

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net income was actually US$338 million less than total World Bank Group administrative expenses with the net income-to-expenses ratio falling to 0.75 or less than half the ratio in FY81. These broad aggregates will be challenged by the World Bank's management as comparing apples and oranges. To the extent that a whole new range of non-operational activities have crept into the Bank's budget to cause its expenses to balloon, whereas the number of operations undertaken have declined for well over a decade, obviously inflates the cost per operation in a misleading fashion. But, nevertheless, the cost per operation is still useful indicator of the extent to which non-operational activities are intruding into the Bank's work programme and deflecting it from its core functions. The same general phenomenon of non-operational activities inflating budgets has occurred across all the MDBs but not to the same egregious extent.

The above example shows that tightening budgeting systems will not by itself enable administrative expenditures to be effectively controlled. Instead strategic measures are needed to restructure the nature of MDB operations and expenses. The issues which such measures might raise are the following: (i) *decentralising and localising* MDB activities as far into the field as possible and reducing the overhead burden of tiered headquarters organisations with unnecessary layers of middle-management; (ii) coping with a *changing operational and non-operational output mix*, especially in accommodating a better modus vivendi with private financiers and in *using MDB guarantee powers* much more extensively than relying on borrowing and lending powers; (iii) coping with a changing staff mix demanded by the above two propelling forces; (iv) correcting the apportionment of administrative costs between the hard and soft loan windows of the MDBs; and (v) dealing with the issue of institutional management of the budget process. The last point requires considering, in particular, the overlapping roles of the Executive Board, senior management and, increasingly, an intrusive group of Deputies from shareholder governments who convene on a regular basis to negotiate soft-window resource replenishments but use that opportunity (and power) to intervene in institution-wide matters including, not least, their unrelenting efforts to induce a greater degree of budget and cost-consciousness on the part of MDB managers. The first four of these issues will be elaborated upon further below while the fifth has already been dealt with at some length at the end of Chapter 4.

Decentralising and Localising the MDBs

The most significant way of achieving greater cost efficiency and operating effectiveness in the MDBs could lie in resorting to far greater decentralisation and *localisation* of the professional and support staff of the MDBs and in

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particular that of the World Bank. As can be seen from Table 6, there is a striking difference in the cost structure of the two MDBs based outside Washington and London and the three located in those cities. Cynics in the IBRD would argue that this difference shows up in the *quality* of the staff and output of these institutions. While that line of argument may have some validity in the case of the AfDB, it is certainly not valid in the case of the AsDB whose quality of staff and output is rapidly approaching (if not now in certain cases exceeding) that of the World Bank, and whose effectiveness in its region (outside of India and China where the AsDB is artificially constrained) is arguably at least as great. That is also true of the IDB whose staff cost structure (given its Washington based location) is higher than the AsDB but still significantly lower than that of the World Bank. The regional banks already resort to higher levels of decentralisation and localisation than the World Bank. The IDB and EBRD now have offices in every one of the countries in which they operate; but they do not go far enough and still rely much too heavily on the expatriation of headquarters staff.

When this issue has been raised before, the retort of the MDBs, and in particular the World Bank, has been that decentralisation and localisation would actually be *more* rather than *less* costly. That would certainly be true if the Bank and other MDBs continued to adhere to the operating postures of ex-colonial governments whose former foreign-service mentalities they occasionally emulate quite successfully if unwittingly. Those governments sent expatriate staff abroad to live in very favourable conditions. The MDBs have tried to do no less. But the Bank's argument would not be valid if the MDBs were to adopt the practices of normal transnational corporations operating around the globe which focus on maximising *local hiring* for both professional and support staff (and for senior managerial staff) to save on costs and resort to expatriation only if absolutely necessary. The current expatriate compensation and benefits packages provided to MDB staff are certainly not conducive to cost savings if the MDBs resorted simply to placing more headquarters staff in the field. Moreover in selecting staff for field assignments MDBs have in the past resorted to sending out their least competent staff treating field assignments as little more than convenient parking spaces. Fortunately this practice has become less common with time.

Greater decentralisation and localisation would have collateral benefits that would go beyond mere cost savings and operating efficiencies. These measures would expose MDB staff much more to the day-to-day realities of their operating environments and perhaps make their policy recommendations, their adjustment programme designs, their projects and their perspectives more pragmatic and realistic. It might prevent them from developing the inapt mentality which most of their staff unfortunately now have as a result of being in environs which seem almost disconnected from

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the reality they are to serve. It would attune them more to local political sensitivities, and subject them to a much wider variety of local views than those they are normally exposed to on quick, artificial visits. Most importantly, greater decentralisation and localisation could be effective ways of flattening out multi-tiered MDB organisation structures. Greater savings as well as greater efficiencies would result from eliminating levels of unnecessary intermediate management and the excessive inflation of vice-presidencies throughout the MDB system; but most especially in the World Bank where several functional Vice-Presidencies have recently been created with those Vice-Presidents doing jobs which were formerly handled quite adroitly at the division level.

There are of course downsides to localisation, especially if MDB staff were to become subject to local government pressures of an inappropriate sort and to become partial in their perspectives because of their local sympathies (the *going native syndrome*). Private transnational corporations have managed to avoid these tendencies while capturing the strengths of a strong local presence. In theory, there is no reason why the MDBs cannot do the same. But, just as global multinationals had to transform their internal management cultures dramatically over time in order to cope with the necessities of decentralisation and localisation in the emerging global economy, so to will the present management structures and proclivities of the MDBs need to change and adapt in more fundamental ways than they are presently willing to contemplate. Given their entrenched views, and the resistance to change on the part of the tenacious personalities which have dominated the managements of these institutions for perhaps too long, it is unlikely that the reforms which are necessary in MDB management thinking and operating styles can be achieved without sweeping changes in their top managements. These changes are perhaps needed most in the World Bank where they are long overdue. Where the World Bank goes other MDBs are likely to follow; although, in this area as in some others it may be that the fledgling EBRD may lead the way in pointing to the future.

Accommodating the Changing MDB Output Mix

A second strategic factor which influences MDB budgets in fundamental ways is the relative thoughtlessness with which shareholders – responding to the domestic political pressures placed on them by single-issue pressure groups – have piled a number of conflicting operational and non-operational priorities and objectives on these institutions resulting in both *mission overload* and *circuit failure* on their part. In turn, MDB managements, anxious to please in order to protect the funding of their particular soft-window replenishments, have been somewhat supine in accepting these responsibilities without

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sufficient regard for their operational or cost implications, or for their effects on staff capacity, institutional resilience and staff morale. The result has been a combination of burgeoning MDB budgets coupled with an increasingly obvious incapacity on the part of MDBs to perform in achieving this plethora of confused developmental objectives; many of which often have less to do with development *per se* and more to do with pandering continually to changing fashions and fads in development theory and practice.

The excessive concern of shareholders and donors with relatively trivial issues is obscuring the fundamental question about what future role MDBs should play in global capital markets whose complexion and capacity is changing at a speed well beyond the capacity of most governments and MDB managers to comprehend, leave alone operate in, or regulate. That question remains unanswered. The operating frame of reference for the MDBs is now characterised by a world in which: (i) private capital markets, both international and domestic are playing a rapidly growing and significant role in financing an increasing number of developing countries; (ii) MDB hard-window portfolios are maturing rapidly with an adverse impact on their resource transfer functions; and (iii) MDF soft-window resources are becoming increasingly constrained.

In such a world the main question is how MDB operations should change so as to: (i) achieve symbiotic and synergistic combinations with sources of private finance in areas where such finance is willing to go voluntarily, e.g. in industry, capital markets, infrastructure and key services; while (ii) mobilising the right kinds of financial packages, involving much less reliance on foreign resources and much greater emphasis on *local currency resource mobilisation*, for social investments in human capital, institution building (in its widest sense), and in those supporting functions (accounting, legal, business support, media and information dissemination, governance and regulatory) which are crucial to making markets work competitively and efficiently.

Put that way, the operating vista for MDBs changes significantly from the sterile traditional concentration of MDBs on particular types of projects and sectors and on standardised currency-pooled, variable rate loans. Under new operating conditions MDBs will need to gear themselves (as the EBRD is doing) to:

- Transforming their *hard-window* financial operations so as to able to lend in any number of single convertible currencies, or any combination of currencies at the choice of the borrower rather than that of the MDB. MDBs must be able to lend at fixed or floating rates, with switching facilities from one to the other and vice-versa. Their loans may need to be packaged with or without attached derivatives (interest and currency caps, collars, options) to meet the particular risk profile chosen by the borrower

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for a particular purpose. MDBs should be prepared to lend for maturities ranging from 5-30 years from their hard windows.

- Being *demand-driven* rather than supply-driven, shifting away from operating as universal credit cooperatives which attempt to equalise everything across all borrowers in the name of equity and to act more as responsive financial intermediaries which tailor their financial products according to the specific needs and characteristics of borrowers and purposes.

- Transforming their *soft-window* facilities into much more flexible instruments which can finance credits of between 15-50 years at interest costs of 0-5% depending on the type of project, type of borrower and general development level of the country in which a project or programme is being financed.

- Loosening their eligibility and allocation criteria substantially to permit soft or intermediate term lending to a much wider range of low and lower-middle income countries and for high value social investments which are not best financed through hard-window loans.

- Undertaking *local currency resource mobilisation* and lending in a manner compatible with: (a) the development of local and regional capital markets, especially local and regional debt markets; and (b) the progressive liberalisation of exchange controls over a borrower's current and capital accounts.

- Operating *in real-time* in co-financing operations with private sector partners from OECD and developing countries, rather than behaving as the ultimate founts of knowledge and wisdom on project financing, yet being incapable of making a decision or reverting to their partners in the spans of time which are normally acceptable in the commercial marketplace.

- Using their *guarantee powers* much more extensively than their lending powers in order to catalyse a volume of resource flows which more than compensate for their own negative net transfers which will inevitably grow rapidly.

- Focusing on what they can do directly and usefully i.e. financing hard and soft projects, human capital development, institutional development and market development, as well as adjustment programmes under certain types of conditions in which these programmes are likely to succeed. At the

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same time MDBs need to disengage from what they cannot do directly with any proficiency despite their best intentions.

- Confining themselves to using their considerable influence with borrowing governments to ensure that critically important policies for balanced and sustainable development are dealt with in a manner which develops, enfranchises and empowers all citizens (regardless of gender, race colour or creed).

- Doing much more to support those institutions (such as NGOs and local levels of governments) which have the capacity to do some things much better than the MDBs. Unfortunately, MDB attempts at working productively with NGOs and with local levels of governments have so far had limited and mixed success largely because of incompatible staff attitudes between MDBs and NGOs.

- Curbing sharply their different *non-operational programmes*, spinning them off and privatising these to the extent possible while providing continuing symbiotic support to private providers of these services in terms of data and information.

- Working out a more appropriate balance between themselves and the UN system on *technical assistance activities* so as to lessen the present overload on their management systems in coping with these functions.

For MDBs to change their output mix in the directions suggested by the foregoing general axioms they will clearly need to make major changes in the quality and skill mixes of their staff and to overhaul the quality of their managements. Fundamental changes will also need to be made in the nexus between MDB managements and Executive Boards to ensure more effective institutional governance. For that to occur successfully, shareholders will need to be much more responsible and careful in their choices of the Executive Directors representing their interests. These critical positions cannot be looked upon as sinecures for the loyal, or be filled by governments making compromises among themselves which result in the election of EDs who are not sufficiently competent nor substantively accomplished in fields concerning the business of the MDBs to command the respect and attention of senior management and staff in these institutions. It is odd that in selecting EDs or even the Presidents of these institutions less thought is given to the qualifications, competence and relevant experience of prospective incumbents than is routinely given to hiring the lowest levels of support staff in these institutions. A continuation of that mode of ED and Presidential selection can only

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diminish both the quality and effectiveness of Executive Boards and the institutions they are supposed to direct. As suggested earlier, these changes need to be accompanied by a fundamentally different approach to human resource acquisition and development through decentralisation and localisation. Such a strategy will require entirely new frameworks to be developed for MDB governance and for budget monitoring and control as well as for objective-setting and ensuring greater responsiveness to client needs.

Coping with a Changing Staff Mix

If MDB budgets are ever to be brought under proper control staff costs need to be tackled in three ways, one of which has already been dealt with: (i) a review and revision of compensation and benefit levels to align them better with comparable private and public institutions; (ii) cutbacks in levels of staffing through cutbacks in non-operational programmes as well as changes in the skill-mix of professional and support staff; and (iii) greater decentralisation and localisation of professional and support staff with substantially reduced reliance on the use of expatriate staff from headquarters in field locations (with curtailment of expatriate benefits) and much more extensive use of nationals in borrowing countries. A concerted drive to reduce MDB staff is now essential and long overdue. Headquarters staff need to be reduced to about one-third of their present levels to perform only core headquarters management functions. Such a measure needs to be coupled with a drive to increase field staff to between 40-50% of total MDB staff at current levels. This would permit a scale-back, which should be achieved mainly through natural attrition, of between 17-27% in current levels of staffing across all MDBs other than the EBRD. Because it has just been established that institution may need a continuing staff build-up. Given how critically they rely on their professional staff, it is surprising how little effort MDBs make to renew and refresh their professional staff skills and knowledge. For example, despite having had financial analysts with expertise in creating development finance institutions for several decades it is astonishing how few staff MDBs have with all-round expertise in capital market development. Hence cutbacks in staffing levels by MDBs should be accompanied by much better efforts at developing and maintaining their human resources.

Such measures are essential to streamline and reshape MDBs into institutions which are more capable of addressing future realities. In addition to such aggregate cutbacks and realignments MDBs need to change their staff skill mix. For example, they need to consider reducing the number of general macroeconomists they employ and increasing the number of financial experts with direct experience in project financing, capital market operations and institutional development. They also need to lighten their technical staff in

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their traditional sectors of project financing activity and in those areas from which they ought to disengage, while increasing staff with expertise in developing and regulating regulatory regimes in various sectors to guide market functioning and institution-building in key areas which are critical in supporting the functioning of markets. The MDBs need a dispersion of fewer, but more tactile and more flexible staff with a much greater diversity of skills and with multi-disciplinary capabilities rather than continue to suffer from the often too narrow perspective of well-trained macroeconomists who have so far been incapable of interacting effectively with other disciplines in an effective manner.

To effect the needed changes, MDBs need to develop imaginative staff-exchange programmes with public and private agencies across a wide spectrum, both to facilitate effective MDB interaction with the outside world but also to make the strong and rigid internal cultures of these organisations more open, accommodating and resilient This approach is far more difficult to design and implement than to conceive; but it can be done and done effectively. Internal MDB cultures have now become far too closed and tight for their own survival in a world that is changing much faster than their ability or willingness to adapt. They do not easily accommodate the entry of senior level management personnel from outside their organisations. And, increasingly, they are being managed almost entirely by staff developed under the *young professionals programmes* of the MDBs who have virtually no working experience outside the MDB nor any interest in acquiring it. Most institutions in the private sector with these types of characteristics come to grief sooner or later in a competitive marketplace. But, the unusual positions of the MDBs with their high degrees of *internal protection* sustained by their relative independence in deciding what they can spend to insulate themselves from reality has cushioned them from adjusting to changing external circumstances rapidly enough. Hence the pace of essential change, which the MDBs have understandably resisted, needs to be forced by external pressures and in particular by the more responsible shareholders who are less interested in using the MDBs for their own ends and more interested in enabling these institutions to confront the future more capably than they seem to be coping with the present.

Apportioning Costs between Hard and Soft Loan Windows

A further issue that arises in connection with the administrative costs of the MDBs concerns the manner in which they are apportioned between the major hard and soft-loan windows of these institutions. If improperly biased in one direction or the other, the basis of apportionment may give a misleading impression of the true costs of certain types of operations in

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certain countries. In assessing the overall financial performance of MDBs, it also raises questions about whether their net income is being overstated or understated by artificial if inadvertent arbitrariness in allocating costs. For example, in a recent study of the financial condition of the AfDB[12] it was noted that the basis of cost apportionment appeared to understate the true administrative costs in running the AfDB while concomitantly inflating the costs apportioned to AfDF. As that indeed proved to be the case when a separate study was undertaken on this specific issue, it became apparent that the financial performance of the AfDB was actually worse than the published figures depicted. Conversely the AfDB's published profit position appeared to be better than it was because of inadequate cost accounting while, by the same token, the AfDF's income position was worse.[13] The cost-sharing formula between the AfDB and AfDF is negotiated with donors during AfDF replenishments rather than being determined by proper costings. As the study into cost apportionment established, it was an inappropriate formula because it shifted too large a portion of overall administrative costs to AfDF thus reducing scarce concessional funds available for disbursements.

A simple comparative analysis of the cost apportionment between the hard and soft windows of the MDBs, based on relative outstanding asset sizes, indicates the degree to which cost sharing in the AfDB and IDB may be out of kilter on a prima facie basis.[14] The table below suggests that relative to the proportionate asset sizes of their hard and soft loan windows the apportionment of administrative costs appears to be reasonable and defensible in the case of the IBRD and AsDB.[15] Clearly a perfect matching of the ratios of loans outstanding to ratios of administrative costs would be unlikely and is

12 See Mistry, P.S., "A Report on the Financial Condition of the African Development Bank", Swedish Ministry for Foreign Affairs, Stockholm, 1993.

13 The rationale for doing so would be that AfDB financial statements need to impress financial markets and net income goes into generating usable reserves while it is not that critical if AfDF is depicted as making a loss.

14 MDBs do not usually apportion their costs on the basis of their *outstanding* portfolios of hard loans and soft credits. The IBRD and AsDB base their cost apportionment on the basis of proportionality between the number of IBRD vs IDA and AsDB vs AsDF loans/credits which are processed and supervised respectively in the fiscal year. These proportions are usually backed by some cost accounting data on a project-by-project basis. The basis for the division of administrative costs in the case of the AfDB and AfDF, and even more so in the case of the IDB and FSO, is less transparent. A common sense initial judgement suggests that in both these latter institutions the actual administrative costs involved in developing and managing the hard loan portfolio may be significantly *understated.*

15 This would be particularly true if one allowed for the fact that administrative costs per operation in IDA-only or AsDF-only countries may actually be higher than that for operations in blend countries or in IBRD or AsDB only countries given the generally higher level of sophistication in the more developed countries in this spectrum involving less expenditure of staff time on preparatory work prior to appraisal and less work in the supervision stage.

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not being suggested. But, in the case of the AfDB the ratios of apportioned costs to relative distribution of outstanding assets between AfDB and AfDF are sufficiently imbalanced as to raise concerns about misimpressions being conveyed to financial markets of AfDB's and IDB's true administrative costs. In the AfDB and IDB the issue of administrative costs, which should be an issue of straightforward cost accounting and good record keeping, was until recently a *political* issue involving compromises between the main providers of concessional funds and the borrowing members. As the basis of cost apportionment has implications for MDB net incomes, which is a financial matter of material importance to financial markets, both institutions have now decided that this matter should be depoliticised and settled with improved cost accounting.

Table 9 Administrative Cost Apportionment Indicators at the end of FY93/94
(billions of U.S. dollars)

	IBRD	AfDB	IDB	AsDB
A. Bank Loans Outst.	109.29	8.31	22.18	13.71
B. Fund Credits Outst.	62.81	4.96	5.93	9.38
C. Ratio of B:A	37:63	37:63	21:79	41:59
D. Bank Admin. Exp.	731.00	54.50	178.60	88.90
E. Fund Admin. Exp.	545.00	76.80	93.20	74.70
F. Ratio of E:D	43:57	58:42	34:66	46:54

Finally, reverting again to Table 8, some interesting results emerge from inter-MDB comparisons among the four established banks (leaving out the EBRD which, because of its start-up position, is something of an outlier at the present time although its administrative expenses for its level of operations are far too high). As the Table indicates, total administrative expenses for the IBRD are by far the highest of any MDB while those for the AsDB are generally the lowest. Total administrative expenses per permanent staff member come to over US$219,000 for the IBRD compared to a low for the AsDB of US$80,000 reflecting, as observed earlier, the IBRD's very large non-operational programme of activities. Salary costs and benefits expenses per staff member at the IBRD are also higher than for any other MDB at over US$134,000 compared to a low of US$56,000 for the AsDB and US$76,500 for the AfDB. Taking into account the IBRD's much more extensive non-operational programme, the number of total staff required to

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support operations seem to be roughly equivalent across all the established MDBs varying from (27.8 per operation in the IBRD to 17.7 in the AfDB, 24.3 in the AsDB and 19.8 in the IDB) – although this crude ratio needs to be interpreted with caution given the extensive but different patterns in the use of long-term consultants by these institutions.

There are also significant differences in the costs of these institutions per dollar lent or disbursed. Under its present cost structure, it costs the World Bank 5.1¢ for each IBRD dollar it lends and 7.0¢ for each dollar it disburses whereas IDA credits cost even more. The tendency for the soft-windows to be more expensive than the hard windows in terms of costs per dollar lent is generalised across all the MDBs although these costs are exaggeratedly high in the case of the AfDB and IDB because they apportion too large a proportion of their administrative costs to their soft windows. The IBRD on the other hand loads its non-operational programme costs more to the IBRD than to IDA which shows up in the relatively different costs per operation between the two. To the extent that soft windows genuinely do cost more to operate (per dollar lent) this reflects the additional staff inputs required to work in difficult low-income environments which absorb relatively smaller loans and credits (thus raising the costs per dollar lent).

As observed earlier, the temptation to read too much into these crude ratios needs to be eschewed although they are broadly indicative of the key problems associated with MDB cost structures. This chapter makes clear, however, that the whole question of MDB administrative costs, which are continuing to escalate even as the utility and resource intermediation role of these institutions diminishes, needs to be reviewed from a fundamental strategic perspective. Since their managements seem unwilling and incapable of addressing the more fundamental troubling issues which continually rising MDB budgets raise, it falls on those shareholders who mean well to take these issues up and deal with them in a way which secures the longer-term interests of the MDBs.

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