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# THE NEW DEVELOPMENT BANK: TOWARDS GREATER EFFICIENCY

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## EXECUTIVE SUMMARY

Multilateral development banks (MDBs) increasingly struggle to respond effectively to the needs of middle-income countries (MICs). This has influenced not only their potential development impact but also their own financial stability. Part of the challenge has been internal business processes that deter greater borrowing by countries, especially in the presence of other financiers with less strenuous requirements. These processes include lengthy loan approval processes, limited use of in-country management systems and sensitivities around environmental and social safeguards. There is also a need for greater responsiveness and an emphasis on the importance of knowledge services. This policy briefing (drawing on a more in-depth discussion paper) highlights some of these challenges and offers some alternative solutions. The New Development Bank (NDB), as a new entrant to the development finance milieu, will do well to draw on the experiences of existing MDBs to improve its offerings to countries.

## RECOMMENDATIONS

1. By simplifying and decentralising loan approval processes or creating simplified and standardised procedures for loans, MDBs can be more efficient, making their services more attractive to borrowing countries.
2. The NDB cannot divorce its operations from global discourse and pressures (from countries and non-state actors alike) related to environmental and social safeguards and should ensure adherence to international best practices.
3. There is a clear preference for the use of country systems from borrowing countries and thus the UCS approach should be prioritised. Where countries lack capacity, the NDB should provide the additional capacity-building support.
4. Technical knowledge sharing should be a priority focus area of the NDB, as such services are greatly valued by borrowers, more so than 'soft' knowledge services such as reports or databanks.
5. To ensure greater inclusive development, the NDB needs to ensure gender considerations are included throughout the lifecycle of infrastructure financing and in institutional arrangements.

## INTRODUCTION

Informed by the clear link between infrastructure development, growth and poverty alleviation, Sustainable Development Goal 9 (SDG 9) calls for increased infrastructure financing in all developing countries. MDBs have played an important role in infrastructure financing in the post-Second World War era. Investing in areas where other financiers have been reluctant to operate, MDB interventions have mostly been deemed successful. This success has partly been attributed to the effective model employed by these institutions: by leveraging paid-in capital from their members on international debt markets, MDBs have been able to secure additional capital relatively cost effectively to extend to borrowers at low interest rates with long maturities. Attractive borrowing options, combined with decades of development knowledge and know-how, have made MDBs a preferred infrastructure development partner for many countries. This model has changed little over the past six decades.

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More recently, instead of ramping up investments to keep pace with the growing need for infrastructure financing on the African continent, MDBs have increasingly found it difficult to adequately respond to the needs of MICs. MICs are of particular importance to MDBs for three reasons: they often make up the bulk of the income-generating business of MDBs, cover operating costs, and supplement their concessional windows. Nonetheless, MDBs' business practices have limitations in their response to the needs of MICs. These inhibiting factors ultimately negatively influence their development impact and poverty reduction abilities, as well as the sustainability of the institutions themselves.

The Global Economic Governance Africa Programme undertook a study to identify some of the key business processes that constrain MDBs' operations. This approach was adopted to present recommendations to new MDB entrants in the market, specifically the NDB, on best practices that could enhance their development impact through financing infrastructure. The African Development Bank (AfDB) was used as a case study, as it has become one of the largest infrastructure financiers in Africa. The experiences of two MICs, Botswana and Nigeria, were used to illustrate where constraints and challenges have been identified in the literature. Specific country experiences are not discussed here, but are presented in more detail in the extended discussion paper from which this briefing draws.[2]

## INTERNAL CONSTRAINTS

### Loan approval process

One of the biggest complaints from MICs in their engagement with the AfDB is the onerous loan approval process. Considered both overly bureaucratic and inflexible, it ultimately results in lengthy and costly delays. The AfDB's loan approval process involves more than 20 formal review and approval steps that include an 'initial screening by the country economist; writing and approving the project brief; writing and approving the project identification report (two approvals); writing and approving the project preparation report; writing and approving the project concept note (seven approvals needed); and writing and approving the project appraisal report (nine approvals including board), requiring as many as four or five country visits for a single project'.[3]

### Public financial management

MDBs, including the AfDB, have unique financial management and procurement requirements that often differ from each other, and differ from domestic processes.[4] Introducing another layer of control above existing country policies, guidelines and practices results in significant delays in project development and implementation.[5] While this rigorous business practice is aimed at improving project quality, the available evidence

MDBs' business practices have limitations in their response to the needs of MICs. These inhibiting factors ultimately negatively influence their development impact and poverty reduction abilities, as well as the sustainability of the institutions themselves suggests that it is a major deterrent to external financing for borrowing countries, in sharp contrast with domestic and private financing. In an effort to overcome the delays caused by MDB procurement practices there has been a concerted effort from MDBs to adopt the 'use of country systems' (UCS) approach to facilitate development financing. While the AfDB has increased its adoption of UCS for operations, a survey of stakeholders engaging with the bank 'views progress as too slow, especially on procurement systems'.[6]

## Environmental and social safeguards

A key trend that continues to exert significant influence on the operations of MDBs is the emphasis on sufficient environmental and social protection. MDB operations increasingly come under pressure to improve related safeguards in the projects they finance, not only from the governments that provide the paid-in capital (funded from taxpayers' money) but also from civil society. However, the additional safeguards implemented in response to these pressures are often extremely long and costly – they require specialised studies and lengthy consultation times with affected communities, usually at the expense of the borrowing government. This may discourage engagement with MDBs. For these reasons, some projects such as dams, electricity, slum upgrades and transportation are diverted from MDBs. This could mean that alternative lenders might be approached that are less concerned about these measures, potentially leading to more damage. An assessment of clients of the World Bank's non-concessional lending window (the International Bank for Reconstruction and Development) indicates that in order to avoid the costs and inconvenience that these processes place on lending, countries would rather opt for alternative sources of financing. Their order of preference for alternatives ranks domestic sources first, followed by bilateral donors, regional banks and in the last place MDBs.[7] However, experiences in the case studies indicate that the key challenge is not necessarily the time and cost burdens to which countries tend to object but rather the lack of domestic capacity to undertake these operations.

An equally important aspect typically neglected by traditional MDBs is gender equity at a management level. In the AfDB, for example, fewer than 15% of the executive directors are female. This is an important consideration, as this is likely to heavily bias the policy frameworks (such as the environmental and social policy frameworks) agreed on by the directors, and therefore the projects they fund. Evidence from the World Bank suggests that realising gender equity in the outcome of projects requires an explicit focus on ensuring gender considerations throughout the life cycle of a project and beyond. For example, gender considerations need to be accounted for in institutional policies, country strategy papers, loan approval processes, the design and implementation of projects, and monitoring mechanisms.[8]

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## Responsiveness

One area where the AfDB has received both praise and criticism has been the way in which it has dealt with countries facing rapid exogenous shocks or domestic crises. Praise has been given specifically for the AfDB's prompt reaction in intervening in crisis situations, especially where high-level political leaders have become involved. Criticism, however, has been directed at the manner in which the AfDB responds to these crises, for example where the approval and disbursement of 'emergency' funds often takes more than a year to materialise.[9]

## Knowledge services

Knowledge services are extremely important for MDBs. The experience gained from working across different countries with differing conditions gives MDBs a comparative advantage over many other financiers when countries seek knowledge and expertise to implement technically complex projects. This experience allows MDBs to offer their members timely and relevant policy advice and, in the case of the AfDB, provide context-relevant policy guidance appropriate to the African environment.[10] However, with regard to knowledge services, a distinction needs to be made between 'soft' services such as reports, databanks and other knowledge products, and technical and policy advice offered by institutional advisors to countries. Evidence from the case studies suggests that the latter aspect is much more important. Countries often reach out to MDBs to access both their financing and their expertise in this regard.[11]

## LEARNING LESSONS AND FUTURE RECOMMENDATIONS

As the NDB starts to operate in Africa, it is important for the institution to consider the accumulated knowledge of other MDBs with more extensive experience on the continent. Specific institutional constraints, namely lengthy loan approval processes, limited use of country systems, sensitivities around environmental and social safeguards, excessive conditionalities, the need for responsiveness and the importance of knowledge services, have been highlighted in the briefing. In this regard, some of the key recommendations include:

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- Lengthy and costly loan approval processes have been flagged as one of the most significant business practices discouraging countries from borrowing from MDBs. There are a number of ways in which to improve this, including easing the approval process, for example where approvals can be given by the institution's senior management (as opposed to board approval for every project). Equally, the NDB could have simplified and standardised procedures for smaller loans, which will assist in facilitating the process. Additional capacity building and assistance should be offered to borrowers where capacity gaps hinder greater borrowing.

- UCS (eg, environmental and social frameworks or procurement) is already a key focus of the NDB, highlighted in various policy documents. It is recommended that the focus should be on supplementing existing systems in member states, which will inevitably differ, rather than on duplicating efforts. Here it is also important to explore linkages with local development finance institutions with the view to access local learning and experience and complement existing infrastructure development initiatives.

- The NDB cannot divorce itself from global discourses related to environmental and social safeguards, and equally cannot escape the pressure from non-state actors to ensure adherence to international best practice. It should institute suitable mechanisms aimed at frequent and timely communication with such groups to adequately address related concerns. Transparency could also, for example, be enhanced by setting up an independent accountability mechanism.

- The NDB should promote greater equality in its governance processes, including gender equality. Greater inclusive development can be achieved if gender considerations are taken into account from institutional arrangements and policies throughout the lifecycle of infrastructure financing. The NDB is unlikely to respond adequately to gender inequality issues in the implementation of its projects if there is not an equitable gender distribution in its senior management.

- Knowledge services remain an important and, in many respects, a niche service provided by MDBs. However, a distinction needs to be made between 'soft' knowledge services and more technical assistance. The former tends to be less valued by some clients, while technical know-how should be a key offering of the NDB to ensure ownership and the sustainability of the projects it finances. Nevertheless, it is important that it attracts the necessary expertise as it develops its niche in the sustainable infrastructure financing landscape.

- The NDB will have little influence, at least initially, over the credit rating it is assigned by international credit rating agencies. However, indications are that the bank will, at least initially, not achieve the highest rating, which will influence its ability to extend loans at similar rates as higher rated counterparts. It could mitigate for this in other ways, for example by reducing red tape on approving loans (making them quicker, and hence more attractive) or ensuring organisational and project overheads are minimal without sacrificing quality, which will in turn lower the interest rate it charges on loans.

The NDB states that its objective is to fund infrastructure in developing countries and to 'meet the aspirations of millions through sustainable development'.[12] In order for the institution to realise this ambition, it needs to learn from the experiences of existing MDBs and, based on this, chart a new way forward pursuing context-specific solutions and a flexible engagement process.

## ENDNOTES

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2 See Prinsloo C, 'Partnering with the New Development Bank: What Improved Services Can It Offer Middle-Income Countries?', Discussion Paper, October 2016; GEG Africa (Global Economic Governance Africa), http://www.gegafrica.org/.

3 Humphrey C, 'Challenges and Opportunities for Multilateral Development Banks in the 21st Century Infrastructure Finance', Intergovernmental Group of Twenty-Four, June 2015.

4 *Ibid.*

5 World Bank, 'Corporate Scorecard', 2013.

6 Woods N & M Martin, 'The preferred partner? A client assessment of the African Development Bank', African Development Bank Group, 2012.

7 Humphrey C, *op. cit*.

8 Fofack H, 'Overview of Gender Mainstreaming in the World Bank', African Development Bank, Evaluation Matters, http://www.afdb.org/fileadmin/uploads/opev/Documents/Evaluation_Matters_March_2014_-_Gender_Inequality_and_You_-_article__14_.pdf, accessed 19 October 2016.

9 Woods N & M Martin M, *op. cit*.

10 *Ibid.*

11 Humphrey C, Scoping Workshop: Development Finance in Africa, 24 August 2016.

12 NDB (New Development Bank), 'About us', http://ndb.int/about-us.php, accessed 19 October 2016.


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