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››› Shaping the landscape of development finance institutions - World Bank reform as another component of a new world order?

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Global challenges such as terrorism, Ebola, climate change, migration and streams of refugees “call for global governance, which is no longer limited to ensuring that nation-state ships do not collide; rather, it aims to coordinate a global policy where we are all in the same boat for the long-haul”. This the urgent appeal made by former German President Horst Köhler. A new world order is not possible without strong multilateral institutions. Without them, global crises cannot be solved. The standards and rules governing the global economy can only be defined in multilateral institutions. Only here can countries agree to "share burdens" to prevent individual countries from shirking responsibility when acute crises occur (as is currently the case, e.g. with the refugee crisis). But the multilateral system has been in crisis for quite some time. There are many reasons for this. Over the last few years, it has become apparent that governments are participating less in multilateral organisations – both financially and in terms of content. This may have to do with the fact that multilateral solutions always involve compromises that are difficult to sell "at home", especially because some UN organisations are considered inefficient This has led to an increase in "cherry picking": basic financing has been scaled back and instead funding provided for individual projects with specific purposes. This applies to the United Nations World Food Programme for example, which found itself forced to suspend food for 1.7 million Syrian refugees in 2014 due to a lack of funding. The World Health Organisation had a similar experience; when the Ebola crisis broke out the organisation was no longer able to fulfil its core mandate. This also weakens the world order because the balance of the global economy has shifted in the direction of China and other emerging economies, and these countries do not feel adequately represented in the multilateral institutions. Some attempted reforms have been at a standstill for many years; such as the reform of the International Monetary Fund (IMF) in the US Congress.

The G20 which acts as a coordinating mechanism cannot replace a functioning multilateral system. While the G20 countries only represent a slight majority of the world's population (54 %), they dominate the global economy (85 %) and global trade (75 %). But they cannot define any generally applicable rules and enforce them at an international level. They do not have their own financing instruments either. Instead their function is to facilitate the decision-making process in multilateral institutions by clarifying certain positions between them ahead of time. This also worked well right after the 2007/2008 financial crisis, but is increasingly reaching its limits.

New institutions are changing the financial architecture

The imbalance in the system between votes and representation increases the pressure to create structures that operate in parallel to the established development banks. Two China-dominated development banks will take up their business activities in 2016: the Asian Infrastructure Investment Bank (AIIB) and the New Development Bank (NDB); there is also the "Silk Road Fund". These initiatives should first be seen as a response to the shortcomings of the existing financial architecture criticised by China and the other BRICS countries:

- the insufficient influence of the developing countries in the decision-making bodies of the existing multilateral development banks, particularly in the World Bank and the Asian Development Bank;

- the insufficient range of possibilities for long-term (infrastructure) financing;

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- inadequate insurance mechanisms against the withdrawal of short-term capital and thus against currency and financial crises;

- the perceived inappropriate interference by international financing institutions in their economic and social policy through the imposition of requirements and specifications.

There is another important factor: the BRICS countries, China in particular, have considerable national savings. China holds a majority of its approximately USD 3.3 trillion in currency reserves in (low-interest) US government bonds - which depend heavily on the decisions of the US government and the Federal Reserve. The new banks and "Silk Road Fund" give China an opportunity to put these national savings to work, bringing about an economic transformation of the region – with high returns and largely independent of the USA.

The new institutions were interpreted as an attempt to establish an extensive global financial system that revolves around China – as a kind of counterpart to the US-dominated Bretton-Woods system. Do these institutions pose a threat to the existing financing and development architecture that was created after World War II and – after the destruction of National Socialism and fascism – made a significant contribution to the post-war recovery?

How will these institutions affect the existing multilateral development banks? This is first a question of their relative size. The new banks will mainly operate in Asia. Together, the AIIB and NDB will have USD 150 billion in share capital at their disposal. In comparison, the Asian Development Bank has capital resources of USD 174 billion and the World Bank of USD 223 billion. It must be kept in mind that these two new banks are still being set up and will expand their business activities gradually. The capital will be paid in little by little and the portfolio created. The institutions will then have to slowly establish their reputation on the capital markets. This means that it will take some time for these financial institutions to reach their full lending capacity. In addition, the long-term lending capacity and the available capital resources depend on many factors, particularly on the rating of the banks, the risk profile of their loans and their business policies. It is estimated that the AIIB could have a lending volume similar to the Asian Development Bank. The impact of the new banks, however, in addition to the lending volume, depends on to what extent they can successfully mobilise co-financing. There is certainly considerable potential here in view of the high liquidity in some of these countries and the high potential for synergies between the new institutions and the national development banks (China and Brazil in particular).

However, it is not just a question of financing, but also of "soft power", e.g. the possibility of introducing structural reports that extend beyond the scope of the direct financing project (policies, laws, regulations, etc.) in dialogue with borrowers. Furthermore the multilateral development banks, particularly the World Bank, see themselves today as "knowledge banks". They invest considerable resources in "knowledge production" – to gain a better understanding of development problems and identify solutions and best practices. It will be difficult to achieve a similar impact in the new banks, especially because this has not been the focus of their business models to date.

The new banks hold opportunities as well as risks for Germany and the traditional donor countries. Generally speaking these institutions also serve the interests of the western countries and the traditional donor countries. More capital is being mobilised for development and global activities which "lightens the load" on the traditional donor countries. New opportunities for dialogue are also opening up.

Still, the risks should not be underestimated:

- It is possible that the BRIC countries will be less involved in the existing multilateral development banks or not increase their involvement consistent with their growing economic importance. This would undermine the legitimacy and relevance of these institutions. There would also be a risk that the multilateral development architecture increasingly dissolved into institutions dominated by western countries (including Japan) on the one hand and those heavily influenced by the BRICs on the other. This would further weaken the capacity of the international community for action.

- It could result in a race to weaken environmental and social standards and avoid projects that are more ambitious, riskier and "more challenging". It is not the role of development banks to do the projects that can also be financed by private banks. They must make a visible contribution to development and step in when they can add value compared to purely private activities. Private banks finance for example ferry boats and power stations. Development banks can do this as well, but they should concentrate on ferry connections which might be commercially less attractive but derive their justification from linking disadvantaged regions to commercial centers and central services within the framework of a larger regional development strategy. In the same sence, development banks should not necessarily head for the commercially least-cost power station technology which might have strong adverse effects on climate and the environment, but rather promote solutions which are in the long run economically more beneficial and sustainable (e.g. renewable energy) and transfer respective knowledge.There is a danger that these complex functions will fade into the background as the competition between the banks intensifies.

- Another concern is that the privileged creditor status of the existing multilateral banks erodes. In an extreme case, the debtor of a loan to the World Bank could decide not to service the debt and instead change lender by accepting new loans from the AIIB or NDB. The erosion of good payment practices, however, could not just affect the established institutions over the long run, but also the development banks. Multilateral development banks, be it the established organisations or the new parallel structures, therefore have a greater incentive to include "cross-default clauses" into their loan agreements despite their competitive situation (whereby, e.g. the Asian Development Bank suspends its payments to a country if this country defaults with the AIIB).

These risks have to be taken seriously. Western countries stand to lose their influence on setting the global economic and political agenda; as an instrument of "soft power, the multilateral banks would be less efficient on their own behalf. The 2015 results give reason to be hopeful: the successful conclusion of the Paris Climate Conference on the one hand and, on the other, the decision of the US Congress to approve the IMF reform which will substantially increase the voting power of the emerging nations and double the fund's financial resources. Can the resulting momentum be capitalised on to considerably strengthen the multilateral system? What options do Germany and the western countries have? How can the multilateral system be strengthened in such a way that our concerns and values are firmly embedded in the multilateral system?

The World Bank as a test case?

There are processes that need to be adjusted to reflect this situation in all banks. The problem becomes more evident when we look at the World Bank. Over the next two years, important decisions need to be made that will be very important for the realignment of the global financial architecture.

- The voting rights in the World Bank are reviewed every five years. Preparations are currently underway for the next review which will include a discussion about a new voting rights formula. The factor that determines a country's voting power is its economic strength (Germany, as the fourth largest shareholder, currently has 4.5% of the votes). However, thanks to a German initiative during the last voting rights reform in 2010, another criterion was adopted: the contributions that the member states make to the IDA, an affiliate of the World Bank that lends money on concessional terms. The more a country contributes to IDA, the stronger its voting rights in the IBRD are.

- Negotiations are currently underway to discuss how the IDA capital could be used more effectively. Unlike the IBRD which is also part of the World Bank Group (International Bank for Reconstruction and Development) and lends to middle-income countries on non-concessional terms, IDA has not raised any funds on the capital market to date. A kind of "capital leveraging" could mobilise an estimated USD 20-30 billion annually which could be then be lent for the poor countries (without needing one cent more in public funding). If this reform comes about, the question arises as to what the additional lending potential could be used for.

- The developing countries and the BRICS countries have been asking for a capital increase to raise the lending volume for quite some time. They point out, in particular, the large deficit in the financing of infrastructure investments. Until now, the industrialised countries have refused requests of this kind. But there now appears to be greater open-mindedness about the issue. Particularly in the USA, the change of heart could also have to do with the fact that the AIIB has now been founded, and a blockade mentality about the capital increase would further weaken the World Bank. The World Bank has agreed to review a capital increase. The first step is to determine which tasks the World Bank will be confronted with over the next 10-20 years and how high the need for additional loans will be. A decision is scheduled to be reached at the annual conference of the IMF and the World Bank in autumn 2017.

The western countries and Germany need to make a fundamental decision about whether to go on the offensive or defensive in these discussions. A defensive strategy would mean an attempt to prevent a capital increase and to delay a voting rights reform which would likely lead to a further loss of votes for the industrialised countries. This would allow the status quo to be maintained a while longer and prevent having to contribute to a capital increase. The danger is that the World Bank will become even less important, that the multilateral system becomes further fragmented and weak and that important global challenges are possibly not sufficiently addressed in the process.

Alternatively, the goal could be to strive for a reform package with the following elements:

- A voting rights reform that takes into account the dynamic economic development in many developing countries in recent years and reflects this development in the voting rights. The economic power of the countries, however, should not be the sole criterion. The multilateral system is only strong if enough resources are provided to finance communal tasks. This includes support for the poorest countries. Consequently, the second criterion in the voting rights formula should be strengthened: the contributions that the countries pay into the IDA funds (and thus for the poorest countries).

- A capital increase for the IBRD as well as capital leveraging for IDA that substantially increases the importance of the World Bank Group in the international finance architecture and strengthens the World Bank mandate; the additional lending potential should primarily be used to finance "global public goods". This would allow the World Bank to play a more important role in overcoming global challenges: pandemics, international terrorism, fragility and regional conflicts, refugee crises, raw material and food crises as well as natural disasters.

These kinds of crises are on the rise, both in intensity and frequency. Due to the increasing interdependence of national economies – through trade, investments, communication, finances and human mobility – problems are increasingly transferred from a country to the regions and beyond. Climate change plays a key role here – also because it overlaps with other problems and intensifies them. The number of climate-related natural disasters has risen from its level of fewer than 100 in the 1970s to 350 in the last decade.

The current financial architecture is not well-positioned to jointly address global threats. It is divided into traditional development organisations (such as the multilateral development banks) and organisations that focus on global common goods, e.g. the Green Climate Fund. The problem becomes very clear if we look at climate change. In order to reach the climate targets and decarbonise the world in the next few decades, most of the planet's fossil energy sources cannot be used. Poor countries play an extremely important role in this calculation. While China, for instance, will soon reach its maximum CO^2 emissions, this is still far from being the case for poorer countries. However, poor countries with rapidly growing economies and populations (such as India, Nigeria, Ethiopia) are particularly critical to the climate agenda. The aim should be to prevent these countries from going down the "dirty" development path followed by the west and China. International institutions would needed a coordinated process that aims, on the one hand, to align the overall framework in developing countries with clean technologies and development paths and, on the other, to support the developing countries in financing the transformation process. Currently, however, the responsibilities between the international institutions – Green Climate Fund, multilateral development banks, United Nations – are not clear

Poverty reduction and climate protection are inextricably linked with one another. On the one hand, poor countries are more affected by climate change and they are less able to protect themselves and adjust (lack of "resilience"). On the other hand, many investments in climate protection and resource conservation also contribute to development (known as "co-benefits"). Local air pollution, for example, is already extremely high in many poor countries: 13 of the 20 most polluted cities are found in India. It is estimated that a minimum of 500,000 people a year die in India every year[2] because they have no alternative to cooking with wood, rubbish or manure. In concentrated urban areas, this is compounded by car emissions and emissions from industrial plants which, for example, causes the rate of respiratory disease to rise rapidly. Improving local air pollution would improve the health situation and contribute to global climate protection as a "co-benefit". The same applies to expanding public transportation and "smart" urban development concepts.[3]

The multilateral development banks have to do a lot more in these areas ("resilience" and "co-benefits"). They will have to work much more closely with the GCF in these efforts. This mainly has to do with the joint financing of climate projects whereby the GCF would have to cover the associated additional costs by using environmentally friendly technologies. In addition, the roles of the GCF, the World Bank and other institutions in supporting developing countries in the implementation of their national climate programmes have to be clarified.

The current discussion in the World Bank should be seen against the backdrop of the scenario described. "We need a new world order that creates corrective justice at a global level – politically, economically, socially and environmentally." [4] The year 2016 presents the opportunity to set a new course toward a functioning world order: by making the World Bank more representative and embedding sustainability more effectively in business policy.

[2] The global figure is 4 million people, most of them in Asia. The economic costs for the countries are enormous.

[3] These kinds of urban development concepts could even lower the costs of the urban infrastructure for the developing countries by USD 3 billion in the next 15 years; carbon emissions would decline by 1.5 billion tonnes per year as a "side effect" (World Bank 2015).

[4] Minister Müller in the Handelsblatt newspaper on 30 October 2015.