The Future of Development Banks

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New world order sets a double goal

Global challenge: Jim Kim, president of the World Bank, visits a training initiative on the Ivory Coast Getty

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The idea of rich countries funding development in poor countries is becoming a thing of the past, explains *James Politi*

Bob Zoellick summed up the "new age of globalisation" faced by public policy students after they left the Pardee RAND Graduate school in Santa Monica, California, in June.

He said the balance of power in the world economy had shifted, with developing countries now the "engines of global growth" and desiring to be "stewards of their own futures".

Meanwhile, said Mr Zoellick, who was about to hand over the reins of the World Bank presidency, "policy makers will need to break free of old constraints to connect the private sector to public policies" – amid a new "pragmatism" in emerging markets regarding involving private businesses in development finance and projects.

That section of Mr Zoellick's speech – delivered shortly before he passed the mantle to Jim Kim, his successor as World Bank chief – offers a concise summary of the huge changes the global development banks have been grappling with over the past few years, and will continue to face over the coming decade.

First, they are adapting to the new global economic order. The old notion of rich countries funding development in poor countries is no longer appropriate, as emerging markets rise in economic clout and are as much sources of development cash as they are recipients.

"If you think of the old world, it was the OECD [wealthy] countries bequeathing funding to the rest of the world, and that's no longer the case," says Todd Moss, vice-president for programmes and senior fellow at the Center for Global Development, a Washington think-tank.

Caroline Anstey, managing director of the World Bank, says that while "the North no longer offers the model for development, it's much more about South to South". It is also the case that: "It's still a volatile world and it's a world in which we have to live with expectations of volatility."

Ms Anstey adds: "It's not as if the needs are any less. For an institution like us, there's still a need to focus on prosperity and poverty reduction."

> Emerging markets are as much sources of development cash as they are recipients

But even if the principal *raison d'être* for the global development banks has not been diminished, emerging market countries are demanding big shifts in governance – and a much bigger say in how development finance is carried out.

For instance, although Mr Kim – an American – ultimately prevailed in the race for the World Bank presidency, he faced stiffer competition than has been the case in the past, from Ngozi Okonjo-Iweala, the Nigerian finance minister, and José Antonio Ocampo, the former Colombian finance minister.

And at the staff level, there has been some movement.

For instance, the World Bank this month appointed Kaushik Basu of India as its chief economist, replacing Justin Lin, the first Chinese to serve in that role, which had previously been reserved for candidates from Europe and the US.

"I think the hold on the institutions by developed western economies is going to diminish over the next decade or two," says Tony Fratto, a former senior official in the George W Bush administration, who has worked extensively on international development policy.

Dr Lael Brainard, undersecretary of the Treasury for international affairs, adds: "There has been quite a substantial evolution in governance structure, and we have been out in front in terms of supporting the demand for larger responsibilities,

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Globalisation changed the movement of capital funds

Loans A change in financing the developing world is under way, says *John Paul Rathbone*

This August, Erika Sylva took a long flight around the world. The reason? Ecuador's health minister was travelling to Beijing to buy $50m worth of Chinese medical equipment for Ecuador's health system. Her spending came out of a $2bn credit China made available to Ecuador the year before.

Separately, but at the same time, the Washington-based Inter-American Development Bank (IDB) approved a $5m equity investment in a Mexican government sponsored venture capital fund that will provide seed capital and strategic advice to small- and medium-size Mexican companies.

Although the sums are small, these contrasting examples – one a government-to-government loan tied to purchases of Chinese goods, the other a multilateral initiative to foster private Mexican enterprise – show how development banking is changing globally, especially in Latin America.

"There is a revolution [in development finance], it is happening, and Latin America is one of the regions where that redefinition is most profound," says Augusto de la Torre, lead Latin America economist at the World Bank.

This "revolution" manifests itself in many ways, but is largely down to one factor.

Multilateral development finance is now "only a small drop in global financial flows," says Mr de la Torre.

One reason for that is the globalisation of financial markets.

"The original theory for development banks was that they helped closed countries' financing gaps. That theory no longer holds as most governments can raise money on international markets," Mr de la Torre adds.

In 2010, for example, total private capital inflows to Latin America topped $280bn, according to the Institute for International Finance. This was nearly 10 times the combined amount that the World Bank and the IDB loaned that year.

Another reason for the revolution is China, as it seeks to secure resources and influence in Latin America by deploying some of its massive foreign reserves.

In 2010, for example, China loaned some $37bn to Latin America, estimates Kevin Gallagher at Boston University, more than the World Bank and the IDB disbursed to the region that year.

That Chinese money does not come cheap, though. "By and large, borrowers have to pay a premium," says Mr Gallagher. It has also largely been loaned to only three countries – Venezuela, Ecuador and Argentina.

"So far, China is only really financing countries which lack access to capital markets, essentially because political risk creates a high premium," comments José Antonio Ocampo of Columbia University, a former Colombian Finance Minister and one of this year's candidates to head the World Bank.

Blowing in the wind: Mexican renewable energy projects have received IDB help Reuters

The third reason for the revolution is the rise of regional development banks, such as Brazil's BNDES (which has a balance sheet larger than the World Bank's) and the Venezuela-based but pan-Latin American lender, CAF. As their shareholders are also local governments, their loans are often also quick to disburse as they lack the same conditionality that western civil society places on Washington-based multilaterals. "Twenty years ago, it seemed regional development banks were doomed," adds Mr Ocampo. "Now it seems everyone wants them, even Europe."

The effects of this revolution – which has refocused thinking away from "shortages of finance" towards how to best harness available finance – are ongoing. On the one hand, multilaterals still have a valuable role to play as providers of counter-cyclical funds. During the 2008-9 global financial crisis, for example, the World Bank and IADB ramped up disbursements as private markets shut down.

"Our clients still want maximum exposure to us as they know capital markets open and close," says Kaldo Echebarría, head of strategic planning at the IDB. "They also value our advisory services," he adds, noting the IDB faces annual loan demand of $18bn, versus its $12bn capacity.

In more normal times, however, a profound redefinition is required.

It is no longer enough for development banks to ply their traditional role of financial intermediaries, using their AAA rating to borrow cheap from international markets then lending on to countries at a narrow spread. It also requires a philosophical redefinition.

Until the 1970s, it was generally assumed "bureaucrats knew best". In the 1980s and 1990s, the "market knew best". Now, after the global financial crisis, they are both seen as playing supporting roles.

$280bn
Total capital inflows to Latin America in 2010

$18bn
Loan demand faced by the Inter-American Development Bank

A good example of the change is Mexican development bank Nafin, which has set up an open electronic platform that allows hundreds of local Walmart suppliers to sell on their receivable accounts to private investors. Now, instead of being paid in 180 days, as per WalMart's usual payment system, they can collect money immediately.

But philosophical redefinition is also required of who is lending to whom. This has been most visible in the emerging world's demands for a greater say in running the IMF, World Bank and IDB, and the willingness of countries such as China and Brazil to pay more into their capital increases.

If both have largely been refused, however, it is because industrialised countries have been reluctant to cede power or, in the World Bank's case, stump up the extra matching capital that would allow the bank to expand lending with all the traditional safeguards this entails.

The effectiveness of this approach is moot. As China's increased financial presence in Latin America shows, the world's emerging powers are diluting the west anyway.

ADB and China still in partnership

Funding

Paul J Davies asks why China borrows when it is in a position to make loans of its own

The Diamer-Bhasha Dam, in a region of Pakistan formerly known as the Northern Areas, near the border with Indian-administered Jammu and Kashmir, is a planned $12bn, 4,500MW hydropower and reservoir project.

It would help significantly with both water and power shortages, according to the government.

But as the project struggles to secure funding from foreign governments and multilateral donors, it is providing a fascinating insight into the strange, double-edged relationship between the Asian Development Bank and China.

The two are in effect competitors in the Pakistan project and, if China wins, the concern of international groups would be that it may undermine the kind of standards the ADB would look to guarantee.

The multilateral bank has been criticised in Pakistan for dragging its feet over the deal and even faced claims it had walked away.

But its country head told local press that it needed to ensure that backing from other lenders is also in place before it can commit partial funds and that the project complies with safeguards relating to environment, resettlement and procurement, as well as meeting transparency standards.

China is deeply interested in Pakistan as an overland supply route for energy from the Gulf and looks likely to become more involved in projects such as the deepwater port at Gwadar on the Arabian Sea.

With Diamer-Bhasha, as with other projects outside China historically, Beijing is expected to overlook some of the more costly and awkward aspects of higher standards if it is handed the work through an uncompetitive tender. Russia, incidentally, is pitching for the same arrangement.

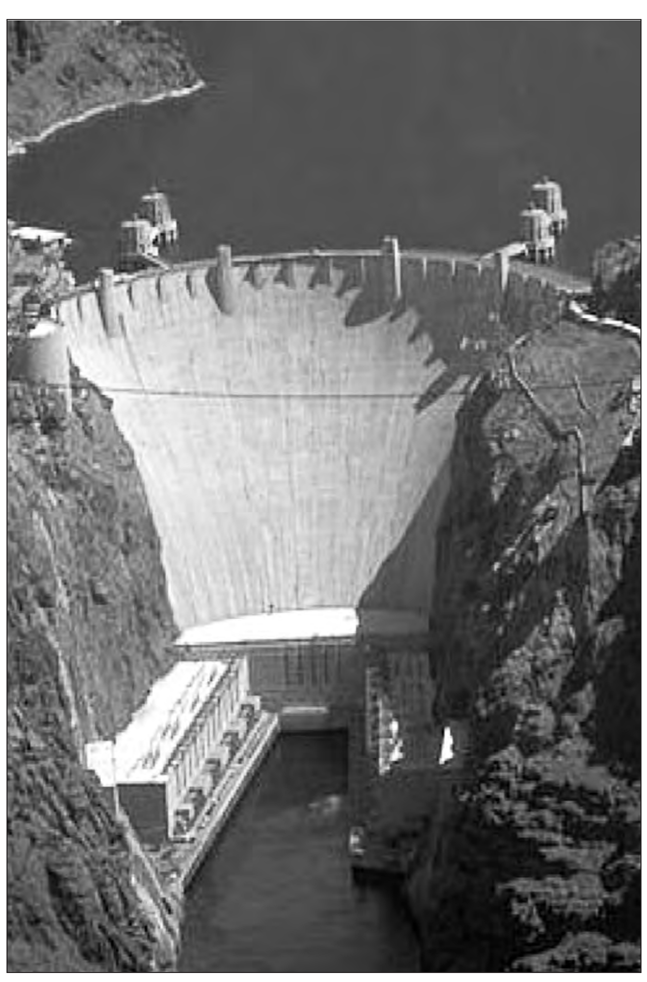
The great irony of this is that one of the main reasons why the ADB still lends money to China is to bring higher governance and safety standards to the country – and thereby legitimise some of its own infrastructure projects.

Rajat Nag, managing director-general of the ADB, says: "Why does China borrow from us? It is an important question which our shareholders, including China, constantly discuss."

China certainly does not need the money these days. It is the bank's third largest shareholder and the only other country alongside the US and Japan to have its own full-time seat on the board. Moreover, it has held that position since 1986.

Where things have been changing as China has grown rapidly over the past decade are in its borrowing.

For a long time it was the largest single borrower, but in the past two years it has begun to drift down the rankings, to second in 2010 and third in 2011. It still pulls down about $1.3bn a year from the bank, but has also become a donor, helping the bank increase its capital base by $110bn in 2009. Mr Nag says: "Over time it will become a major donor."



Capital flow: the Diamer-Bhasha Dam in Pakistan

China nowadays is more likely to borrow from the ADB to support investment in environmental technology and green measures, which accounts for two-thirds of the ADB money it gets, says Mr Nag.

The rest goes to poorer regions such as the far western Xinjiang province – which by coincidence is where any oil pipeline from Pakistan would arrive in China. Mr Nag says there are three important reasons why China still borrows from the ADB.

Firstly, the bank's presence in environmental projects and technology helps the country gain access to "best practice" and equipment.

The second reason – and this, he says is the one that the Chinese government itself most talks about – is that ADB guidelines will apply to the whole of a project in which it is involved. These include standards on environmental, social and economic safety and sustainability.

"This fact and our involvement make it easier for the government to impose those standards within its own country,"he says.

The final reason for lending to China is that it gives the country access to information and knowledge about how pension funds and other forms of institutional social savings work.

Mr Nag says, in spite of China's growing economic might on the world stage, the thing to remember is that it still a poor country.

In spite of China's growing economic might on the world stage, it is still a poor country

"Per capita income is still only about $3,700 and our cut-off is at about $7,000," he says. "Graduation from ADB assistance usually occurs within five years of reaching that cut-off income level."

As China's economic power continues to grow, and so its donations to the bank, what about its influence over the direction of the ADB?

Mr Nag plays down this aspect, particularly in light of the big reworking of how the bank functions and decides projects that was undertaken in 2008 and given the title of Strategy 2020.

This, he says, has limited the bank's focus to five project types: infrastructure, education, environment, financial sector development and regional co-operation and integration.

Individual countries are also handed multiyear budgets and the ADB teams then work with local governments to find suitable projects on which to spend the money.

As third-biggest shareholder China still holds only about a 6.5 per cent stake, significantly less than the US and Japan.

If China poses any threat to the ADB's mission, then it will do so as a competitor from the outside on projects like Diamer-Bhasha rather than from the inside as a member with growing economic clout.

New world order sets goal

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but it's a slow process."

The second big trend confronting the global development banks is how they should cope with the massive expansion of private capital in emerging markets, which has reduced the direct role of those banks as providers of development finance.

"No development agency can any more be in the business of plain vanilla development, or plain vanilla financial flows, or plain vanilla projects," says Ms Anstey.

Faced with more competition – and the possibility, and threat, that their role will be supplanted by the private sector, development banks are having to become more creative and innovative in the kinds of services they provide, as well as in their ability to collaborate with business in public-private partnerships.

Mr Fratto says that although this has "diminished the importance of official flows, they are still important", especially when it comes to financing projects that are not attracting private-sector attention – from primary education to healthcare to large infrastructure.

And the global development banks can be crucial in giving the "good housekeeping seal of approval" to a project as well as providing much needed technical expertise, he adds.

But it is often inevitable that funding from the global development banks will have more strings attached than if derived from the private sector – such as more stringent social and environmental standards that could mean longer approval times for projects.

"The World Bank comes with other things bolted on – some are positive and some are not so positive," says Mr Moss of the CGD.

This means the global development banks themselves are often facing a tough balancing act, "trying to meet shareholder demands and also trying to be competitive in this environment", he says.

At the same time as they are figuring out how to position themselves in relation to private investments, the global development banks also have a duty to – and have been – helping countries to create the conditions necessary to foster as much private sector involvement as possible.

Funding from the global development banks often has strings attached

This can be awkward – in that it plays into one of the arguments that the global development banks are sometimes loath to hear: that their goal should ultimately be their own demise, as poor countries grow richer and private capital flows from around the world supplant their own.

But that scenario remains very distant – and in fact, when the financial crisis hit in 2008, the global development banks played critical roles by stepping up their lending, and providing a safety net for the poorest countries.

And while many of the lowest-income countries are expected to graduate to the "middle-income" category in the coming years, some development policy analysts say the big question for the multilateral banks is how to address uneven development in those countries that are growing strongly, but not meeting crucial milestones in terms of education, healthcare and institutions.

The fate of the "bottom billion" in this environment could have a huge impact on the legitimacy of the banks, they argue.

In the meantime, however, the twin imperatives of coping with the rebalancing of global economic power – and the inflow of private sector money into the developing world – will continue to dominate – and somewhat ironically for the emerging economies, says Mr Fratto.

"They will become more important members of institutions at the same point as the importance of these institutions is going to diminish – probably all for good reasons."

How to get more bangs for your buck

Aid funding The role of multilateral development banks in supporting poor countries received bipartisan support in Congress when President Obama went looking for funds, writes *James Politi*

An international road project linked Mali to Senegal, helping to cut transport times for agricultural products Getty

In early June, the US Treasury department hosted a big celebration of the role played by multilateral development banks. Tim Geithner, the treasury secretary, said their projects "often go unrecognised despite their importance" – as his agency handed out, for the first time, four awards to the best projects chosen after a lengthy competition.

But the party was not just about rewarding the best work of the global development banks. It was also about marking the successful conclusion – six months earlier – of a capital increase for the banks of which the Obama administration was able to secure nearly 100 per cent of the funding it was asking for from Congress.

It had not been an easy ride.

With the US running annual budget deficits in excess of $1tn and Republicans and Democrats at loggerheads over many aspects of fiscal policy, it was a bigger struggle than usual to secure the required monies.

"It was a major accomplishment," says Lael Brainard, under secretary of the Treasury for international affairs. "What is remarkable is the bipartisan support we got in Congress."

Todd Moss, vice-president for programmes at the Center for Global Development in Washington, says it was not just in the US that the desire to fund the banks was harder to muster, but across the developed world. "It was a very big lift because everyone was facing their own financial crisis," Mr Moss says.

Ultimately, however, the funds from the US were approved just before Christmas last year. The Obama administration's determination may have played a role in ensuring a successful outcome, suggests Ms Brainard: "The president made a very fundamental commitment to these institutions because he could see their value from his first days in office."

Ms Brainard says Mr Obama noticed – as early as the G20 in Pittsburgh in early 2009 – that the multilateral development banks (MDBs) had really "stepped up" in the face of the global downturn. "They deployed their balance sheets in a massive way during the financial crisis, amid shrinking and volatile private capital flows. For instance, they were central to the provision of trade finance – and in allowing poor countries to build their social safety nets", she says.

This same argument was put to Congress – but lawmakers were also persuaded that US spending on multilateral development banks delivered good "bang for your buck", since it could be leveraged very effectively.

At the June event, Mr Geithner said: "Even though we provide only 5 per cent of our international affairs budget to the MDBs, our funding supports many times that amount in program assistance. For example, we contributed $2.6bn to the MDBs this year, but the MDBs will make nearly $80bn in commitments". In addition, members on Capitol Hill were convinced that the multilateral development banks helped America's "security agenda" by fostering stronger democratic institutions.

And, according to one development analyst in Washington, there was also a fear that – if the US did not step in – China and other emerging market countries were more than willing to fill the gap, eroding US influence. The global development banks are also having to adapt to the changing trends in their funding.

Caroline Anstey, managing director of the World Bank, says she and her colleagues are not seeing "any sign" of less appetite for funding.

But Ms Anstey does acknowledge: "What it means is that we have to show the impact of development and value for money and we embrace that enthusiastically, and it means greater focus on accountability, which is something we welcome."

The next test for the World Bank is whether it can secure a new round of commitments for its International Development Association, supporting anti-poverty programmes in the poorest countries with zero-interest loans.

A number of rapidly growing economies are expected to "graduate" out of IDA in the coming years, which is causing much debate about its future and could lead to a decrease in its funding compared to earlier cycles.

Also looming on the horizon is the possibility that US funding to global development banks could be sharply curtailed if Congress does not reach a budget deal by the end of the year. Last week, the White House outlined which spending programmes would be subject to "sequestration" – $109bn in automatic across-the-board reductions in 2013 that will occur if the US tumbles off the "fiscal cliff". Among them were the development banks – which would take an 8.2 per cent cut – including $122m for IDA, $17m for the Inter-American Development Bank, and $17m for the African Development Bank. But most political analysts in Washington still believe a deal after the election will be released.

Back at the Treasury event in June, all the talk was about the four MDB projects that had won awards. In no particular order, an African Development Bank international road project linked Mali to Senegal, helping to shrink transport times for agricultural products and cutting shipping costs. The second was an Asian Development Bank plan for loans and guarantees to the private sector for investments in mobile phone operations across Afghanistan. Third was an Inter-American Development Bank plan to counter anaemia and malnutrition among poor infants and toddlers, offering them an iron supplement and a food coupon. A fourth award was given to a programme by the World Bank and the Global Environment Facility to curb deforestation in the Amazon.

> There was a fear that if the US did not step in, China and other countries were more than willing to fill the gap

The Treasury's Mr Geithner said. "We hope that by singling out these projects and the teams behind them, we can help promote the highest standards for design and implementation of development programs, raise awareness about this work, and reinforce support for the MDBs."

A bank too big to be beautiful

Brazil

Critics say BNDES spends too much on companies doing well, writes *Samantha Pearson*

When it emerged that Brazil's development bank BNDES was helping to finance a controversial merger between the country's biggest supermarket chain and Carrefour's local operations last year, many were outraged.

Abilio Diniz, the well-connected billionaire who controlled the Pão de Açúcar chain, was already facing criticism for having set up the deal behind the back of his partner, and Carrefour's arch-rival, the French supermarket group Casino.

The idea that Brazilian taxpayers' money would be used to finance the 74-year-old's daring plan, which Casino claimed was "illegal" under their shareholding agreement, was one step too far for BNDES's critics.

BNDES promptly withdrew its support for the deal, which it said had been conditional on an agreement between all parties.

The episode added to unease in the country about the influence of the bank, which has amassed a loan book nearly four times the size of the World Bank's.

Aside from covertly creating national champions, BNDES has been accused of crowding out the private sector and hampering the development of the local financial industry. Its funding of projects such as a vast highway to Peru has also raised suspicions.

In 2011, BNDES disbursed R$139.7bn ($69.5bn) and had allocated another R$67.9bn by July this year. Since the beginning of 2007, it has allocated more than R$670bn – over a quarter of the country's current GDP.

As well as lending to businesses – both directly and via commercial banks – BNDES also invests in companies through its shareholding arm, finances export activities and even lends to foreign governments, mostly in Africa.

As of the end of last year, BNDES was responsible for 72.4 per cent of all loans to companies with maturities longer than three years.

However, for João Carlos Ferraz, BNDES's vice-president, neither the size nor the ambitions of the bank should be anything to fear.

"We're so big because Brazil is a big place," he says, adding that comparisons with the World Bank make little sense. "It's a different type of bank. We're still smaller than the European Investment Bank, smaller than China's development bank, and smaller than Germany's development bank," he says.

On the question of creating national champions, he is also far from apologetic.

"I don't want to create national champions; I want to create international champions," he says.

For example, BNDES now controls 30 per cent of the Brazilian company JBS, the world's biggest exporter of meat by sales, having invested more than R$8bn in the group since 2007.

With the cash, JBS went on an acquisition spree, which included buying Pilgrim's Pride in the US.

Mr Ferraz says BNDES invests only in companies with a viable business plan and avoids getting involved at the management level or buying majority stakes.

"We see ourselves as a facilitator: that's to say that we back the winners, we don't pick the winners."

For some, BNDES's strategy of lending to already large and well-connected companies could be doing more harm than good.

Professor Sérgio Lazzarini of Insper business school in São Paulo says: "When it was founded in 1952 BNDES was very important because it was a time when there was little capital available for companies and this was true right up until the beginning of this century."

> 'The best strategy for BNDES now would be to invest in smaller, higher-risk companies'

"After this we saw huge growth in the emerging markets and big Brazilian companies were able to capitalise themselves [in the markets]. At this point BNDES should have reduced its emphasis on these big groups, but it did exactly the opposite."

Prof Lazzarini says 60 per cent of BNDES's portfolio is large companies. He adds the best strategy for BNDES would be to invest in smaller, higher-risk companies such as technology start-ups, and back infrastructure projects unattractive to private investors.

The real test is likely to come in the next few years, as the country adapts to what some economists believe could be the beginning of a new low-interest rate environment.

Over the past year, the government has taken measures – from cutting savings rates to slashing energy tariffs – to give the central bank room to bring down traditionally high interest rates. The benchmark Selic rate stands at an all-time low of 7.5 per cent – high by international standards but down 5 percentage points from its peak in August last year.

If the government can keep rates low, commercial banks will be able to take over more of BNDES's activities, increasing lending to companies and offering loans with longer maturities. In theory, BNDES seems ready to step aside.

"We have never been against the market: we also want to see strong capital markets in Brazil," says Mr Ferraz, adding that the bank has always sought to act counter-cyclically.

However, those who are hoping BNDES will become a shadow of its former self over the next few decades, may be disappointed.

"Is there a trend for the bank to become smaller in absolute terms? No," says Mr Ferraz. "But is there a tendency for the bank to become smaller in relative terms? Yes."

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Africa is high on a packed priority list

Mission statement The World Bank head has passionate ambition, says *Robin Harding*

It is still early days for Jim Yong Kim, the public health expert who became head of the World Bank in July, but he has begun to give a few small hints about his concerns and priorities.

Three months into his term as head of the world's most important development bank, Mr Kim has taken steps to consolidate his authority, but as he heads to his first annual meeting of the bank's shareholders in Tokyo this October the big decisions about where he wants to lead the bank still lie ahead.

Mr Kim, the US candidate for a position that by convention always goes to the US, won the job after a contentious selection process in which developing countries put up two strong candidates of their own. Ngozi Okonjo-Iweala, the finance minister of Nigeria, stayed in the fight until the end. Her supporters included all three African directors on the bank's executive board.

Mr Kim seems to be working hard to smooth over any lingering ill feelings. The destinations for his first official overseas trip, which he made at the start of September, were South Africa and the Ivory Coast.

"I have worked in Africa, and it is one of my absolute top priorities," said Mr Kim on his visit. "So you can rest assured that on every level, I am deeply committed to the growth and the success of Africa."

Pravin Gordhan, South Africa's finance minister, made clear that any bitterness about the selection was in the past. "We know that democratisation processes are long processes generally," he said.

"We are very happy with, and impressed with, the vision that Dr Kim has for the World Bank."

The other concrete move that Mr Kim has made so far is the appointment of Kaushik Basu, a professor at Cornell University and an adviser to the Indian finance ministry, as the bank's chief economist.

Mr Basu follows on from Justin Yifu Lin of China. His selection means that the top research job at the World Bank has again gone to one of the largest developing economies and Mr Basu's background in mainstream development economics backs up Mr Kim's less conventional CV.

So far, however, Mr Kim has not given his answers to the deep questions about the bank's future that arose during his leadership campaign. As countries such as China and India rise in power and wealth, and become themselves lenders to other developing nations, the bank needs to find a new role and mandate.

In a speech to the Brookings Institution in July, Mr Kim set out four main challenges: to protect development gains from global economic risks; to broaden development to countries including fragile and conflict states; to ensure growth is sustainable; and to ensure that it is inclusive.

All of that is worthy – it is hard to imagine a World Bank president who wanted the opposite – but does not define a role for the Bank. In Mr Kim's response to questions, however, it was possible to see where some of his own interests lie.

Mr Kim showed his enthusiasm for randomised trials and a scientific approach to using the bank's resources. "We really want to turn the focus of the bank more toward what are the specific outcomes and results that we're achieving on the ground and how can we set up a system so that that is what you're rewarded for, actually delivering the results on the ground," he said.

He showed his passion for improving the health of the world's poorest people. "The real problems are setting up the delivery systems that cannot only protect people from the diseases of today but from the diseases of tomorrow, and there's enough money out there in the world that we can begin moving in that direction. That's how I would like to see the World Bank engage," he said.

Mr Kim also voiced clear concern about climate change. "I have to tell you that the data that I'm seeing about changes that are happening today that we didn't think would happen for three or four years . . . this is extremely disturbing to me, and I think we have to put the science of climate change in front of all of our member countries," he said.

"And I guarantee you that I will do that."

Now Mr Kim will have to take his ideas and turn them into a mission for the World Bank: deciding whether to concentrate on low or middle income countries; whether to seek more capital in order to meet the developing world's need for infrastructure or focus on technical advice; and whether to tackle the global perils of climate change and infectious disease or the individual problems of the world's poorest regions.

The choices that Mr Kim makes in the coming months may determine whether the World Bank remains the world's dominant development institution in the years to come.

'I think we have to put the science of climate change in front of all of our member countries'

Ideas man: Kaushik Basu, adviser to the Indian finance ministry, is the bank's chief economist Reuters

A new way of lending

China

Beijing's assistance to nations is nothing to be afraid of, writes *Simon Rabinovitch*

In 2010 China Development Bank lent $20bn to Venezuela, money that the Latin American country agreed to pay back with oil shipments to China.

CDB had been issuing more and more of this kind of loan: huge in scale; to a borrower largely cut off from international finance; and with few policy conditions mentioned in public.

This largesse was stirring concerns the loans were little more than blank cheques to badly run states, assistance that would undermine the efforts of the World Bank and International Monetary Fund.

But behind the scenes, China was working overtime to make sure that the money would be well used.

In her study of CDB's role in cross-border finance, Erica Downs, a scholar at the Brookings Institution, told how China sent 30 consultants, led by a former vice governor of CDB, to Venezuela for 18 days.

Their mission had two objectives. First, they wanted to check Venezuela would be able to deliver the natural resources it had promised. Second, they made proposals for how to reform its economy, from reining in inflation to creating a more open environment for foreign investors.

China's actions were hardly altruistic – it wanted to get its money back. But the fact that it was devoting so much attention to how Venezuela was managing its economy addressed the biggest concern about Chinese lending: that it cares little about the governance of recipient countries.

"As CDB and other Chinese banks continue to provide large loans to foreign countries, they will probably become more involved in trying to shape economic decision-making in borrowing countries to ensure repayment of their loans and to protect investments made by Chinese companies in conjunction with the loans," Downs said in her study, "Inside China, Inc."

The question of whether China is playing by international norms for development banks is hugely important. China is not just any country. In 2009 and 2010, it agreed to lend about $110bn to developing countries, $10bn more than the World Bank in that period.

CDB often attracts most of the attention, thanks in part to its high-profile chief, Chen Yuan, son of a revolutionary leader. But it originally focused on providing credit to domestic infrastructure projects and only got into international development in recent years.

Export-Import Bank of China was the lender at the forefront of China's international assistance efforts, with a mandate to provide trade finance. Interpreting that in the broadest way – for example, funding the construction of roads to serve Chinese mines in foreign countries – Eximbank has become a huge presence in the developing world.

Fitch Ratings calculated Eximbank lent $67.2bn to sub-Saharan Africa from 2001 to 2010, $12.5bn more than the $54.7bn lent by the World Bank. Eximbank is also the main conduit for concessional loans from China, while CDB often lends more at market rates.

A good window on to how Eximbank – and China – operate came through its establishment of a co-donor structure with the World Bank in the past few years.

Other bilateral donors had lined up behind the World Bank, but China has been unwilling to do so, according to Greg Chin, China research chair at the Centre for International Governance Innovation.

"China still self-identifies as part of the global south.

"The World Bank has a bad reputation in the south for its history of conditional loans. China is not going to subordinate itself to the World Bank," Mr Chin says.

Chinese loans often complement loans by the World Bank and IMF

And yet, in providing funding alongside the World Bank, China is supporting the bank's efforts, providing it with additional lending firepower and ultimately making it a more representative institution.

There have been examples of countries such as Angola and Chad opting for Chinese loans, with weaker conditions than the International Monetary Fund or the World Bank apply.

But in a study of Chinese finance in Latin America, researchers at Tufts University in Boston highlighted how CDB extended credit to Argentina at much higher rates than the World Bank's in 2010. Moreover, they showed Chinese loans often complement, rather than displace, loans from the World Bank and the IMF.

The Tufts researchers wrote: "They give different size loans to different sectors in different countries. Chinese banks have largely focused on loans to natural resource-based and infrastructure sectors."

China has been active in teaming up with regional development banks. It has greatly increased its funding for the Asian Development Bank, especially since the global financial crisis.

In 2007 it hosted the annual meeting of the African Development Bank in Shanghai. In 2009 it joined the Inter-American Development Bank. It also increased its contributions to the Caribbean Development Bank.

"It is clear that China is pursuing way more bilateral deals than it is going through any international banks," Mr Chin says. "But this doesn't mean it's undermining the established order. You could say that China is trying to reform the existing order by shifting to a regional, decentralised system."

Mutual aid works for Latin America

Multinational lending

CAF is a model of self-help in financing development, says *Benedict Mander*

As Latin America's economies have recovered since the so-called "lost decade" of the 1980s when hyperinflation and financial crises were the norm, so the region's development bank, the Corporación Andina de Fomento (Andean Development Corporation, or CAF), has gone from strength to strength.

The CAF's lending operations have doubled in the past five years to $15bn, and the bank's president, Enrique García, told the FT in an interview this year that he expected them to double again over the next five years, with a particular focus on supporting regional integration and infrastructure.

But the success of the 18-nation institution, which funds more Latin American infrastructure than the World Bank and the Inter-American Development Bank combined, is not simply explained by the fact that the region's economies are flourishing and becoming more integrated.

Liliana Rojas Suarez, is a senior fellow at the Centre for Global Development, where she heads its Latin America initiative.

She says: "The answer is simple: they have incredibly high standards of governance and minimise transaction costs."

The growth of Latin American economies over the past decade – spurred on thanks to the growth in demand for their commodity exports in Asia, especially China, but also made possible by governments' sound macroeconomic management – has created huge demand for power stations, roads, ports and railways.

Growth industry: the CAF's lending operations have doubled

Regional governments have preferred to borrow from the CAF, over half of whose lending is directed to infrastructure projects, rather than relatively unwieldy organisations such as the World Bank, which is slowed down by complex bureaucratic procedures and subject to intense scrutiny from rich-nation shareholders and environmentalists.

Indeed, one of the CAF's biggest strengths is that, unlike the rest of the multilateral lenders in the region, it is the only one financed almost entirely by the same countries to which it lends.

That is, 97 per cent of its assets are provided by the 16 Latin American and Caribbean countries that make up its membership, with the remainder from Spain and Portugal.

Although Mr García says he would be interested in setting up trust funds with European and Asian countries, he plans to keep the bulk of the bank's borrowing within Latin America.

Ms Rojas Suarez describes the CAF as a "model of efficiency", which is one of the factors that has enabled it to attain an investment grade credit rating – despite being composed of member countries that are not investment grade – although having 14 private banks among its members has injected an element of market discipline.

This allows the CAF to provide quicker and easier answers for its borrowers than other lenders. Ms Rojas Suarez says: "Where do you go if you want to get the job done quickly? You go to the CAF."

A bank of and for the Brics is in the air

Global shift

Henry Mance asks if Brazil, Russia, India, China and South Africa could found a bank together

A case of life imitating art or a seminal shift in global power? The idea of a Brics development bank may be both. Few can have expected the Bric acronym – initially put forward in 2001 as an investment concept – to have inspired real-world alliances.

But Brazil, Russia, India and China, recently joined by South Africa, are increasingly adding diplomatic ambitions to their economic assertiveness.

Once an outlandish possibility, the proposed Brics development bank was first discussed at a meeting of the five countries in March.

If it becomes a reality, the institution would be the first major multilateral lender to emerge since the European Bank for Reconstruction and Development in 1991.

While the EBRD symbolised the post-Cold War order, the Brics bank could showcase the 21st century rise of emerging states.

Amrita Narlikar, director of Cambridge university's Centre for Rising Powers says: "This could be the first step towards more proactive agenda-setting by the Brics.

"It's one of the few instances we have when they have gone beyond telling us what they do not want, and offered an idea of how they could be responsible players contributing to the system."

Supporters of the bank have suggested various financing niches that it could fill. Those could include green technologies to counter climate change, as proposed by leading economists Nicholas Stern and Joseph Stiglitz.

Conversely, the bank could finance projects – such as biofuels, large dams and nuclear power plants – that do not meet the World Bank's environmental and social standards.

Nonetheless, reaction to the proposal has been mixed. Sceptics have pointed out the differing interests of China and India.

Jagannath Panda of the Institute for Defence Studies and Analyses, a New Delhi think-tank says: "India sees the Brics as an economic proposition, while the Chinese see it as more political.

"The Chinese are supporting heavily that the bank should be in South Africa, so they will have clout on that continent. India would still like to have the headquarters in India."

Wherever they are located, the bank's offices are unlikely to rival the World Bank's imposing presence in Washington.

Brazilian officials suggest the Brics bank should have a lean structure, like the Andean Development Corporation (CAF).

Other issues yet to be resolved include whether the bank would lend outside of the Brics countries – Brazil's foreign minister has suggested it focus on Africa – and whether it would lend to companies as well as governments.

$10bn

Member countries' capital and guarantees deposit

Domenico Lombardi, a former board member of the World Bank Group, and now a senior fellow of the Brookings Institution, says: "The question is: do these Brics countries have enough in common to make the bank instrumental to their objectives?

"They all have a huge need for infrastructure [investment] and share a dissatisfaction with the lending policies of the World Bank, so there's a base on which they could build."

There are some signs of modest progress. At preparatory meetings in Rio de Janeiro in August, the five countries agreed that the bank should raise money from the market, instead of acting merely as a fund.

Indeed, investors' willingness to lend to emerging markets may have emboldened the countries in the first place.

"Since the financial crisis, it's become clear that you don't need to have a triple-A credit rating to raise money. That is the trigger for the bank," says Mr Lombardi.

A ballpark proposal is that each country would contribute $10bn in initial capital and guarantees.

Equalising contributions would give the institution an equal voting structure, in sharp contrast to the World Bank. Yet it may also limit the eventual size of the bank – given that South Africa's pockets are not as deep as China's.

Negotiations between the Brics, which are usually conducted in English, are likely to continue on the fringes of the IMF and World Bank annual meetings in Toyko in October. Final feasibility studies are due to be presented at the Brics summit next year. "It's going to be at least two years before the bank is established," says Panda.

In the meantime, it remains to be seen what impact the embryonic development bank has on the Brics' commitment to existing international institutions.

The five countries are significant borrowers from the World Bank, with new loans of over $7bn approved in 2011 alone. They are also growing contributors to the IMF. But all have expressed frustration at their marginal role in those bodies' decision-making.

In that context, starting a new development bank provides a bargaining chip. "By entertaining the idea of a Brics bank, they have better negotiating power over voting rights in the IMF and World Bank, as they can always threaten to walk away," says Mr Lombardi.