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How relevant is the MDB reform discourse for Southern MDBs?

Presentation by
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1. Setting the Scene

There is a robust **ongoing discourse on reforms for MDBs centring largely on the “legacy banks”** (i.e., this group includes World Bank and Asian Development Bank) with reforms falling under the following five directions (CGD MDB Reform Tracker):

1. Maximise capital efficiency
2. Add capital to meet needs and manage risks
3. Expand mandates to include global challenges
4. Transform country engagement for efficiency and impact
5. Achieve major expansion in private finance mobilisation

In alignment with the first reform priority—maximising capital efficiency—the imperative to do **‘more with less’** has gained prominence. This has, in turn, **accelerated the development effectiveness discourse**, with the Global Partnership for Effective Development Co-operation (GPEDC) recently revising its monitoring framework to emphasise ‘collective accountability’.

*GPEDC is a global platform for promoting effective development cooperation based on four key principles: country ownership, results-orientation, partnerships, and transparency.

1. Setting the Scene

The ecosystem in which this discourse is taking place has been evolving even before 2020 and has only gained further momentum since.

1

Rising ODA levels

- ODA flows to all recipients peaked in 2023 (in absolute terms) at 214.4 billion USD in 2023, increasing by 124% from 95.5 billion USD in 2015.
- However, this increase has been attributed to the expanding definition of ODA
 - The largest increase in ODA flows from DAC members was in ODA flows to Ukraine from 1.3 billion USD in 2015 to 19.43 billion USD in 2023.

Low ODA as % of GNI

2

- Despite reaching a peak of 0.37% of GNI in 2022, **ODA as a percentage of GNI averaged a 0.33% between 2015 and 2023**, continually falling short of the 0.7% target.
- In 2023, ODA allocations increased in 14 countries but declined in 17. However, the decline was offset as the largest increases were seen in DAC member countries, which remain the biggest ODA providers (i.e., USA 29.7%, Japan 9.4%, UK 8.2%, Canada 3.9%).

1. Setting the Scene (contd.)

Humanitarian Aid Bulge

3

- Driven by a **118% increase in in-donor refugee costs**, a 65% rise in humanitarian aid, and a 30% increase in multilateral ODA between 2015-2023
- However, **share of multilateral ODA in total ODA decreased by 4 percentage points** between 2015 and 2023, while **humanitarian aid increased by 0.6 percentage points** and **in-donor refugee costs rose by 3.4 percentage points**.

4

Loans Outpacing Grants

- The trend toward increased lending to developing countries was pronounced, with **disbursed loans growing nearly four times faster than grants between 2015 and 2022**
- In **2022, grants made up 63% of total ODA, marking the smallest share in two decades**, aside from the first year of the COVID-19 pandemic (62%)

5

Falling Share of ODA Flows to LDCs

- Gross ODA flows to developing countries had grown by 18.2% between 2015-2022, however, it fell by 5.4% in LDCs during the same period.
- The **loan to grant ratio for LDCs approximately tripled between 2015 and 2022**, climbing from 0.06 to a substantial 0.17. Developing countries also experienced a significant uptick in the same period, jumping from 0.16 to 0.21.

1. Setting the Scene (contd.)

6

Growing Significance of Southern Providers

- Established in 2015, AIIB's ODA commitments experienced a significant growth surging from a modest 0.76 million USD in 2017 to a staggering 13.94 million USD by 2022,
- IsDB's ODA commitments saw a more leisurely 19% increase during the same period.
- Although the Southern MDBs' contribution to global ODA is relatively small compared to the DAC members, their share has grown significantly.

7

Graduating LDCs: An Emerging Challenge

- There is an emerging group of recipients — “graduating LDCs”,
 - Five countries are expected to graduate by 2027
 - Debt service costs in **LDCs have soared from 5% in 2011 to 20% of exports, goods, services and primary income in 2023**
 - Their impending loss of access to international support measures further intensify the challenges that LDCs are expected to confront in the near future.
- Developing countries have more choices when it comes to external development financing
 - Recipients are **increasingly choosing to pursue alternative sources of financing that may be costlier but impose less conditionalities** on the recipient (e.g., sovereign bond issuance and loans from Southern providers)

2. Why this study?

Amid competing development priorities and dwindling resources, ensuring aid reaches the most vulnerable recipients has never been more crucial. In view of this, active adherence to GPEDC Principles may be the way forward.

Yet, two significant areas remain relatively underserved in this discourse: reform issues related to **Southern MDBs** and the evolving needs of **graduating LDCs**

- “Southern providers” are well defined (e.g., India, China, and Brazil), but “Southern MDBs” may not be as readily understood. Southern MDBs are recognised as MDBs of Southern origin and that are not stemming from the Bretton Woods institutions
- Whereas Southern MDBs, such as AIIB and IsDB, are increasingly shaping development finance architecture through their ethos, practices and understanding of ‘effective development cooperation’.

Objective

To identify the reform issues within (two) Southern MDBs in the context of financial needs of two graduating LDCs

Scope

- Southern MDBs (AIIB and IsDB) and Graduating LDCs (Bangladesh and Nepal).

2. Why this study? (contd.)

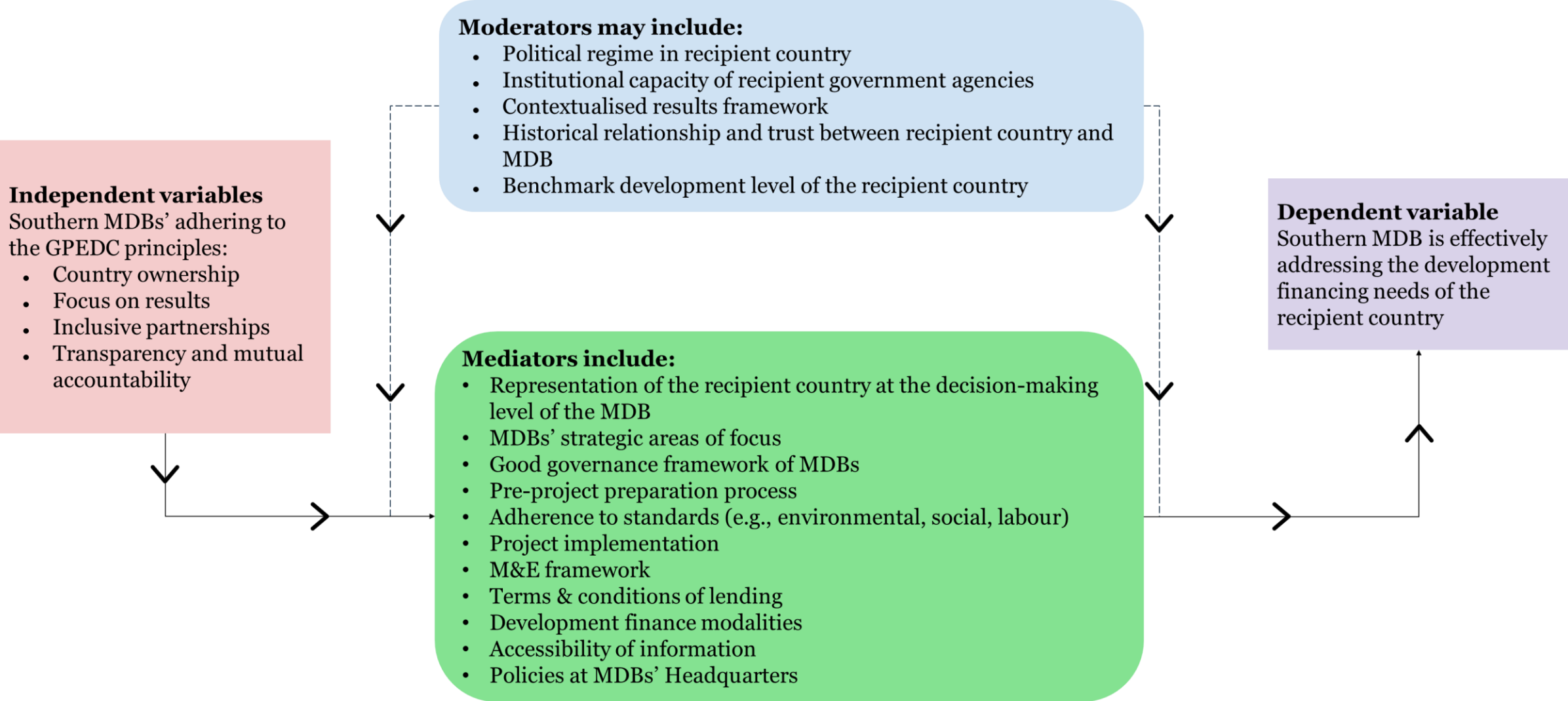
Research Questions

1. What are the factors that prompt Bangladesh/Nepal to seek funding from Southern MDBs (AIIB and IsDB)?
2. What are the revealed roles and/or suitability of Southern MDBs (AIIB and IsDB) in addressing the development financing needs of Bangladesh and Nepal in the era of the poly-crisis?
3. Does AIIB and IsDB take into cognisance the GPEDC Principles (country ownership, results-orientation, inclusive partnerships, transparency and accountability) as a frame of reference in their operational modalities?
4. To what extent are the key reform lessons derived from the study applicable to other MDBs, and how well do they address the needs of LDCs?

3. Analytical Framework & Methodology (contd.)

- This study draws on the “**mediator-moderator**” framework, which is widely used in social-psychological and business research
 - ‘Southern MDBs’ adhering to the GPEDC Principles’ is identified as the independent variable
 - Southern MDBs effectively meeting the ‘development financing’ needs of the recipient country as the dependent variable.
- **Moderator:** any variable that may affect the direction and/or strength of the relationship between an independent variable and a dependent variable
- **Mediator:** intervening/process variables positioned between independent and dependent variables

3. Analytical Framework & Methodology (contd.)



Source: Mediator-Moderator Framework adapted from Namazi & Namazi (2016) & Baron & Kenny (1986)

3. Analytical Framework & Methodology (contd.)



Literature Review

- Global reports
- Scholarly articles
- MDB-specific reports
- Country-specific official documents

To examine

- key areas for MDB reforms
- organisational frameworks and operational modalities of MDBs in focus
- Bangladesh and Nepal contexts and experiences of MDBs in these countries



Secondary Data Analysis

- (i) Official data from national surveys
- (ii) MDB specific secondary data from OECD and official sources

To explore:

- macroeconomic outlook of Bangladesh and Nepal,
- development financing landscape, including their external finance composition, debt scenario and fiscal positions, and
- LDC graduation outlook



Key Informant Interviews

Four key stakeholder groups:

1. Relevant government officials of Bangladesh and Nepal
2. Representatives of Southern and Legacy MDBs
3. Academics and researchers from Bangladesh and Nepal
4. Global experts on development finance

**38 KIIs conducted
between February-April
2024**

4. IsDB's Strategic Relevance

- IsDB's financial engagement with Bangladesh began in March 1977, with **operations coordinated from a regional hub in Dhaka, which also covers the Maldives.**
- Bangladesh is the 14th largest shareholder of IsDB with a 0.96% stake. The top shareholders are Saudi Arabia (22.50%), Libya (9.03%), and Indonesia (7.94%) (IsDB Official Website, 2024)
- As a non-member country, **Nepal's engagement with IsDB is limited, primarily through the IsDB Scholarship Program for Muslim Communities in Non-Member Countries (SPMC).** (IsDB Official Website, 2024)
- **IsDB uses a market-based lending model** tied to Secured Overnight Financing Rate (SOFR), with Ordinary Capital Resources (OCR) lending at SOFR + up to 1.5% p.a. service fee and ISFD financing at SOFR + up to 2.0% p.a. service fee (IsDB Modes of Finance 2014).

4. IsDB's Strategic Relevance (contd.)

Financing Overview in Bangladesh

- The **bulk of IsDB's financing in Bangladesh is in trade** (primarily for fuel imports via ITFC) accounting for 90.8% during 1977-22. Rest of 9.2% non-trade financing include project, technical and special assistance. (IsDB Annual Report 2022)
- This trade support is going to continue as IsDB's 2024-26 Member Country Partnership Strategy (MCPS) **allocation for ITFC has incrementally grown by 43.75% from 2020-22 period** (IsDB Annual Reports 2020-22, MCPS 2024-26)
- However, **our study predominantly focuses on development finance**, specifically IsDB's OCR financing aimed at key infrastructure and human capital development constraints.
- Historical data from 1977-22 show that this OCR financing is distributed across energy (45.8%), industry and mining (11.3%), water, sanitation, and urban development (9.1%), agriculture (8.7%), health (7.5%), transport (6.0%), information and communication (5.9%), education (5.2%), and other sectors (0.4%). (IsDB Annual Report 2022)
- Importantly, 2024-26 MCPS holds promises regarding OCR financing, with an incremental increase of 52.1% from 2020-22 period. This highlights **IsDB's expanding role in Bangladesh's development financing**. (IsDB Annual Reports 2020-22, MCPS 2024-26)

Note: IsDB's annual report 2022 cites OCR financing value as zero.

4. AIIB's Strategic Relevance

- **AIIB's operations commenced** in both Bangladesh and Nepal **in 2016**.
- Within 5 years of commencing operations, **AIIB rapidly expanded its financing volume in Bangladesh, becoming a key player in infrastructural financing**. However, its **engagement in Nepal remains limited**.
- Bangladesh holds a 0.8% capital share, ranking 27th, while Nepal holds 0.3%, ranking 47th. (AIIB Official Website, 2024)
- AIIB's major shareholders include China with 26.6% of voting shares, followed by India (7.6%) and Russia (6.0%). (AIIB Official Website, 2024)
- AIIB does not have country offices in Bangladesh or Nepal and **operates from its headquarters in Beijing and an overseas office in Abu Dhabi**.
- **AIIB follows market-based lending model tied to SOFR** with lending rates for its sovereign-backed financing at SOFR + variable spread (0.91%-1.41%) depending on the grace period. (AIIB Sovereign Backed Financing, July 2024)

4. AIIB's Strategic Relevance (contd.)

Financing in Bangladesh

- Approximately USD 4.4 billion was approved from 2016 to 2022, with a 60% increase year-on-year in approved funds from 2023 to 2024. (AIIB Official Website, 2024)
- Sectoral financing allocation includes 25.9% for economic resilience/PBF, 19.7% for energy, 16.6% for transport, 10.6% for water, 6.8% for liquidity support, 4.5% each for multisector and public health, and 9% for other sectors. (AIIB Official Website, 2024)
- AIIB provided USD 650 million in COVID-19 support during 2020-21 through its crisis recovery facility. (AIIB Official Website, 2024)

Financing in Nepal

- AIIB approved USD 202.3 million for two energy sector projects in 2019. (AIIB Official Website, 2024)
- No new projects have been proposed or approved since 2019, with the scale of financing remaining relatively limited compared to Bangladesh. (AIIB Official Website, 2024)

4. Bangladesh & Nepal: Comparative Perspectives



Similarities



- Set to graduate from the LDC group by 2026
- Transitioned to Lower-Middle-Income Countries (LMICs): Bangladesh in 2015 and Nepal in 2020
- External financing is crucial to deal with ‘twin deficits’, fiscal deficit and external account deficit
- Import dependence is significant (trade balance as % of GDP for Bangladesh: -3.79% and Nepal: -26% in FY23)
- Remittance inflows play a critical role in these economies (Nepal: 6.6 times and Bangladesh: 41.29% of export earnings in FY23)
- Both Bangladesh and Nepal's STS indicate that LDC graduation will not significantly affect their external financing, as major development partners do not base their aid on LDC criteria. Bangladesh notes that historical and bilateral relationships largely drive aid allocation, while Nepal states that financing will remain stable except for LDC-specific funds.

5. Bangladesh & Nepal: Comparative Perspectives (contd.)



Similarities



- Reliance on taxes at import level with tariff level being quite high (Bangladesh: import duty 11.04% of total tax revenue and Nepal: customs 21.09% of total tax revenue in FY23)
- Pressing need for long-term and concessional development finance
- During the last decade (FY11-22), both countries received a significant amount of their total external financing through MDBs – Bangladesh (54.53%) and Nepal (43.11%)
- Domestic debt is significant; 55.6% of total (outstanding) debt in Bangladesh (FY23) and 50.5% in Nepal (2021)
- MDBs are the dominant source of external borrowing (e.g., in FY23, about half of the external borrowing was from MDBs)
- 52.44% of total outstanding external debt in Bangladesh (FY23) and 87.9% in Nepal (2021) originated from MDBs, predominantly legacy MDBs

5. Bangladesh & Nepal: Comparative Perspectives (contd.)



Differences



- Bangladesh is a larger economy with a higher per capita income of \$2750 compared to Nepal (\$1410) in 2023
- Nepal is a landlocked country and situated between two Asian giants (China and India) – no wonder geopolitics plays a much more important role
- While Nepal's revenue-GDP ratio (19.88% in 2021) is high compared to Bangladesh (9.54% in 2021), it also experiences high expenditure levels, leading to substantial fiscal challenges limited fiscal space - fiscal deficit was (-) 9% of GDP in 2023 (Bangladesh's fiscal deficit in FY23: -5.22%)
- Bangladesh is going through a forex reserves crisis, whereas Nepal's reserves remain relatively stable
- Bangladesh is currently under the IMF programme due to forex crisis, however, Nepal last sought IMF support during COVID-19

5. Bangladesh & Nepal: Comparative Perspectives (contd.)



Differences



- Over the last decade (FY2011-22), Bangladesh prioritised energy infrastructure, receiving the most external financing (22%) in Power & Energy, while Nepal focused on human capital, allocating the highest external financing (13%) to Education
- Bangladesh's escalating debt service to revenue ratio (71.8% in FY23 to projected 101.1% in FY24) indicates growing fiscal distress; in contrast, Nepal's ratio was 26.6% as of 2021
- This is also evident from IMF's 2023 rating of Bangladesh's debt-carrying capacity as "medium" and Nepal's as "strong"

6. Key Findings from the Study

A. The Overarching Findings

B. Legacy MDBs vs Southern MDBs

C. The LDC perspectives

A. The Overarching Findings

1. The recipient countries expect Southern MDBs to understand the national context better

Recipient countries expect Southern-led MDBs to **better understand their needs due to shared governmental and institutional contexts and development paths.** Greater recipient representation in MDBs may lead to less of a compliance rules-based culture and a stronger focus on balancing safeguards with development goals (Kharas, 2015; Barrowclough & Gottschalk, 2018).

As a result, Southern MDBs are expected to operate differently from Legacy MDBs.

2. The recipient countries expect their higher representation at the Southern MDBs' decision-making level to better reflect their needs

Legacy MDBs have long been criticised for the **underrepresentation of Southern countries in their governance structures**, and consequently for **policies being skewed towards the interests of creditors** (Reisen, 2015; Ray, 2021). For example, in ADB, Japan and the USA each hold 12.8% of voting shares, while China, now the world's second-largest economy, holds just 5.5%, and India 5.4%.

Thus, a borrower-led or **Southern MDB, on the other hand, is expected to shift governance** towards the Global South through their increased representation, and ultimately **give Southern countries a greater voice and control over development financing decisions** (Yu, 2024). At the AIIB, China wields 26.53% of voting power, followed by India, Russia, Germany, and South Korea. The IsDB sees Saudi Arabia, Libya, Iran, the UAE, and Qatar as its leading shareholders.

2. The recipient countries expect their higher representation at the Southern MDBs' decision-making level to better reflect their needs
(contd.)

However, in the case of AIIB, **China holds majority (26.6%) of voting shares** (& veto power) **but borrows very little from the MDB**, which makes **AIIB appear to be creditor-led**, much like its Legacy counterparts.

Thus, despite expectations, Southern MDBs have primarily increased the amount of development financing under control of smaller BRICS countries rather than significantly impact the global MDB governance landscape (Ray,2021).

*A means to go about ensuring recipient representation and inclusion of voice may be to **introduce a new class of shareholding members — “non-voting” class** (which would also help to not disrupt or dilute governance control in MDBs.*

3. Southern MDBs perceive the recipient government as the sole client

“clients” or “borrowers” for the following banks are defined as follows:

AIIB: recipient, guarantor, beneficiary, and/or sponsor of the Bank’s financing for a Project.

IsDB: beneficiary of the IsDB’s financing for a Project and any other entity responsible for implementing the Project.

World Bank: Borrower may not be the entity directly implementing the project but is responsible for ensuring that the project is prepared and implemented [...] in a manner and timeframe agreed with the Bank .

ADB: borrowers, recipients, guarantors, or other beneficiaries, and may also include executing agencies, as applicable, of ADB-financed

3. Southern MDBs perceive the recipient government as the sole client (contd.)

It is clearly evident that **beneficiaries, i.e., citizens of the recipient country, of financing are included in all definitions.** However, in practice, Southern (and Legacy) MDBs **primarily consider the recipient government to be the client** to whom they are accountable.

This is based on the assumption that **the elected recipient government represents an assurance of democratic accountability in the country, which may not always be the case.** This suggests that **both Legacy and Southern MDBs may be failing to fully hold themselves accountable to the broader group of beneficiaries they intend to serve as mandated** (Bissel & Nanwani, 2009; Lorenzo, 2024)

*Important areas to engage **representatives of beneficiaries** would be at three levels: (1) **Project preparation consultation**, (2) **Information dissemination** and (3) **Independent impact evaluation.***

4. The passive disclosure of information, fundamentally a policy issue at the headquarter level, is undercutting the transparency and accountability aspect of Southern MDBs

AIIB and IsDB have disclosure policies, but with significant limitations. AIIB's data is governed by its 2018 Policy on Public Information and 2016 Environmental and Social Framework, with much available online. However, data published is limited to project-level data. This policy also has exceptions allow withholding of critical information, including details on potentially harmful impacts, and the final disclosure decision rests with the president.

Similarly, IsDB adhered to its Public Information Disclosure Policy which emphasises regular, timely publication of data, *subject to confidentiality* in specific cases.

4. The passive disclosure of information, fundamentally a policy issue at the headquarter level, is undercutting the transparency and accountability aspect of Southern MDBs (contd.)

As such, there is **no robust framework to support proactive information disclosure**. IsDB, until recently, had shared data primarily with partners and recipient governments. However, on April 29, 2024, IsDB joined the International Aid Transparency Initiative (IATI) Platform to share project data from 2005-2024, marking a shift towards greater transparency.

In practice, project-level documents from both the IsDB and AIIB are not consistently made available to the public in a timely manner. Although both institutions share data through the OECD database, detailed project and sector-specific data remain difficult to access.

Both the AIIB and the IsDB should enhance their data dissemination and transparency by establishing clear timelines for the release of project documents and ensuring these are consistently shared on their respective online platforms.

5. The recipient governments expect concessional and soft financing and accelerated approvals for projects that they deem priority, including in the areas where legacy MDBs are not focusing anymore

First, AIIB's emphasis on being "lean, clean and green," as outlined in its articles of agreement, likely **contributes to faster project preparation and approval processes compared to Legacy Banks**. This efficiency is particularly valued by recipient countries such as Bangladesh and Nepal.

Second, AIIB and the IsDB are seen to invest in areas that the World Bank and ADB may not necessarily engage in, specifically financing fossil fuels. Despite AIIB's stated intent to deliver renewable energy financing, more than half of its investments in the energy sector goes towards fossil fuels (reported in 2018). Between 2018 and 2020, AIIB spending on fossil fuels reportedly did not decline (IISD, 2021). Similarly, IsDB also emphasises going "green" through their Sustainable Finance Framework. However, there are no policies to restrict financing of fossil fuels at IsDB, although the framework does include significant exclusions, such as upstream fossil fuel extraction and production (E3G, 2020) .

5. The recipient governments expect concessional and soft financing and accelerated approvals for projects that they deem priority, including in the areas where legacy MDBs are not focusing anymore (contd.)

Third, both IsDB and AIIB primarily rely on market-based lending rather than concessional lending. Future expectations from recipient countries largely include introducing softer financing windows.

Recognising the needs of recipient countries like Bangladesh and Nepal, both AIIB and IsDB should explore the introduction of concessional financing windows. This would better align with the development needs of graduating LDCs and support their transition to sustainable energy without burdening them with high debt levels.

B. Legacy MDBs vs Southern MDBs

6. Southern MDB's scope of engagement, in terms of scale of financing, sectoral exposure, portfolio of instruments, is narrow compared to the legacy MDBs

Table: Capital base, priority sectors and financial instruments of Legacy and Southern MDBs

	Southern MDBs					Legacy MDBs																								
	IsDB		AIIB		World Bank (IBRD)		World Bank (IDA)		ADB (OCR)		ADB (ADF)																			
Subscribed Capital (as of FY2023)	\$70 billion		\$100 billion		\$296 billion		n/a		\$135.6 billion		n/a																			
Priority Sectors	1. Energy	2. Transport	3. Education	4. Agriculture	5. Population	1. Energy and Power	2. Transportation & Telecom	3. Water Supply & Sanitation	4. Rural infrastructure	5. Urban Development & Logistics	6. Environmental Protection	1. Agriculture	2. Education	3. Energy	4. Finance	5. Health & social protection	6. Industry & trade	7. Multi-sector management	8. Public sector	9. Transport & ICT	10. Water Supply	1. Agriculture	2. Climate	3. Disaster recovery	4. Education	5. Energy	6. Gender	7. Health	8. Infrastructure	9. Technology
Instruments	(1) Grants	(2) Loans	(3) Technical assistance	(4) Equity	(1) Grants	(2) Loans	(3) Guarantees	(4) Equity	(1) Grants	(2) Loans	(3) Technical assistance	(4) Equity	(1) Grant	(2) Credits	(3) Technical assistance	(4) Guarantees	(5) Equity	Grants	Loans	Lines of credit	Technical assistance	Guarantees	Equity	(1) Grants	(2) Concessional Loans					

Source: Author's compilation

6. Southern MDB's scope of engagement, in terms of scale of financing, sectoral exposure, portfolio of instruments, is narrow compared to the legacy MDBs (contd.)

- **Perceived Limitations of Southern Banks:** There is a prevailing belief among recipient stakeholders that Southern Banks, unlike Legacy Banks, operate with a smaller capital base, limiting their capacity for large-scale financing.
 - This view was challenged during the 2022 Pakistan floods when the IsDB pledged \$4.2 billion and the AIIB committed \$1 billion, alongside the World Bank's \$2.7 billion and ADB's \$1.5 billion.
- **Sectoral Focus:** Southern MDBs have concentrated their efforts more narrowly on infrastructure and energy, unlike the broader portfolios of Legacy MDBs, which include significant investments in social sectors.
 - The narrower focus of Southern MDBs is often attributed to their limited in-country presence and perceived lack of local knowledge, which may restrict their effectiveness in addressing diverse needs.

6. Southern MDB's scope of engagement, in terms of scale of financing, sectoral exposure, portfolio of instruments, is narrow compared to the legacy MDBs (contd.)

- **Limited array of Financial Instruments:** Southern MDBs are also seen to offer a more limited array of financial instruments, primarily relying on market-based lending, which can reduce their attractiveness as development partners.
 - While AIIB and IsDB do not have separate windows for concessional lending, Legacy MDBs offer a wider variety of financial instruments, highlighting their greater flexibility in meeting diverse financing needs.

To solidify their position as key development partners in countries like Bangladesh and Nepal, the AIIB and IsDB should consider **expanding their capital base and diversifying their funding sources to reduce borrowing costs** for recipient countries. Additionally, they should **introduce concessional lending windows and broaden their sectoral engagement through increased co-financing with Legacy MDBs**. These steps would enhance their financial flexibility and deepen their impact in recipient countries.

7. The project-oriented approach (in comparison to programme approach) of Southern MDBs may be exacerbating low predictability of financing volume for the recipient country

The prevailing perception is that, unlike legacy banks and even older Southern MDBs, such as IsDB, that emphasise the development of country strategies to guide national development trajectories, new Southern MDBs prefer a project-oriented approach.

AIIB explicitly defines itself as a “project finance bank” with a clear emphasis on “Financing Infrastructure for Tomorrow in Asia”. As for IsDB, the perception remains that despite the country framework, delivery of development outcomes don’t always align with the strategic plan.

This shift towards a project-centric approach has raised concerns among recipient countries about the predictability of financing across sectors—already a weak point in the development effectiveness framework as well as the recipient country’s ability to effectively plan development programmes.

8. Southern MDBs are not involved in knowledge generation (e.g., diagnostic studies, policy papers, sectoral analyses)

Recipient countries highly value the policy guidance and knowledge products provided by Legacy MDBs, which are essential for understanding local contexts and baseline conditions and challenges. However, Southern MDBs like AIIB and IsDB, despite emphasising their roles as knowledge producers in their respective strategy documents, have been less engaged in this area. This may be largely attributed to their smaller staff capacity and reliance on the limited institutional capabilities of recipient countries.

To strengthen their role in knowledge production, Southern MDBs have two pathways: collaborating with other MDBs or commissioning local knowledge actors to conduct studies, potentially strengthening their partnerships and presence in recipient countries.

9. Cost of borrowing is higher than the concessional windows of legacy MDBs.

Neither IsDB nor AIIB offer concessional financing or grants akin to their legacy counterparts, both AIIB and IsDB rely on market-based lending in recipient countries. In this respect, Southern MDBs' lending may be more comparable to that of IBRD and ADB, which also focus on market-based lending, rather than to the concession financing offered through IDA or ADF.

Table: Lending rates between Legacy and Southern

	Legacy Banks		Southern Banks				
	ADB (OCR)	ADB(Asian Development Fund)	World Bank (IDA)	World Bank (IBRD)	AIIB	IsDB (OCR)	IsDB (Islamic Solidarity Fund for Development)
Project Duration	16+ to 19 yrs	Upto 32 yrs	Upto 38 yrs	18+ to 20 yrs	18+ to 20 yrs	Upto 25 yrs	Upto 25 yrs
Grace Period	n/a	8 yrs	6 yrs	n/a	n/a	7 yrs	3-10 yrs
One-time charge	n/a	n/a	0.75%	0.25%	0.25%	n/a	n/a
Interest Rate (Grace)	SOFR+	1.00%	1.25%	SOFR+	SOFR+	SOFR+	SOFR+
Interest Rate (Amortization)		1.50%	3.125%				
Commitment fee p.a.	0.15%	0%	0%	0.50%	0.50%	n/a	n/a
Lending Spread	0.80%	0.75%	n/a	1.44%	1.41%	1.50%	2.00%
Borrowing cost margin	0.30%	n/a	n/a	n/a	0.41%	n/a	n/a
Contractual lending spread	0.50%	n/a	n/a	0.50%	0.50%	n/a	n/a
Maturity Premium	0%	n/a	n/a	0.50%	0.50%	n/a	n/a

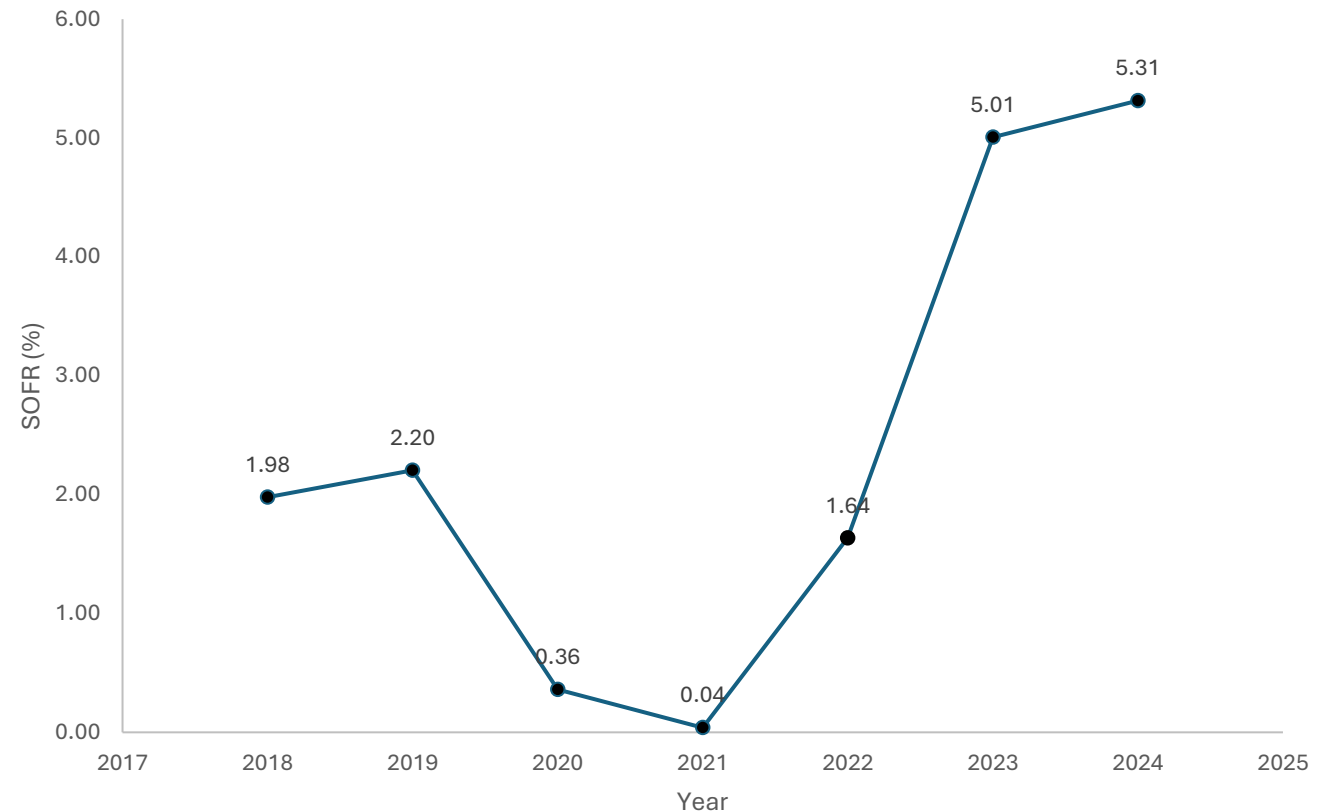
Source: Author's compilation

10. Southern MDBs' are using a variable interest rate leading to lesser predictability for the recipient countries

Southern MDBs use the SOFR for sovereign loans to countries like Bangladesh and Nepal.

Since replacing LIBOR in June 2023 at 5.08%, SOFR rose to 5.3% by July 2024.

Table: Secured Overnight Financing Rate (%)



Source: Fed Reserve of NY

10. Southern MDBs' are using a variable interest rate leading to lesser predictability for the recipient countries (contd.)

To manage interest rate volatility and ease borrowing costs, Southern MDBs offered the *option of hedging against SOFR*, though Bangladesh did not take advantage of them.

While Southern MDBs may offer favourable lending terms and conditions, the absence of a concessional and grant window remains a deterrent for recipients.

Moreover, the technical capacity of recipient government officials to negotiate terms remains a significant challenge.

11. Financial sustainability of the bank is a greater consideration for Southern MDBs vis-à-vis legacy MDBs, given its base and composition of funding

Table: Sources of Funding

	Southern MDBs		Legacy MDBs			
	IsDB	AIIB	World Bank (IBRD)	World Bank (IDA)	ADB (OCR)	ADB (ADF)
Financing Sources	(1) Shareholder capital (2) Retained earnings (3) Issuance of (Shari'ah-compliant) bonds, i.e., Sukuk (4) Borrowing from Islamic money markets	(1) Shareholder capital (2) Retained earnings	(1) Shareholder capital (2) Retained earnings (3) Bond issuance (4) Borrowings (5) Derivatives	(1) Capital replenishment cycles	(1) Shareholder capital (2) Bond issuance (3) Borrowing (4) Investments (liquidity portfolio) (5) Retained earnings	(1) Capital replenishment cycles

Source: Author's compilation

Comparing the financing sources as delineated by each of the banks, the primary sources of fundings for both Legacy and Southern Banks are similar, i.e., a combination of shareholder capital, bond issuance and other debt instruments, and reinvesting of the MDB's earnings.

11. Financial sustainability of the bank is a greater consideration for Southern MDBs vis-à-vis legacy MDBs, given its base and composition of funding (contd.)

A key takeaway from consultations with Southern MDBs is their increased focus on balance sheet optimisation compared to Legacy MDBs, especially as majority of shareholding is held by Southern countries.

As such, banks like AIIB are even more focused on ensuring adequate risk-return profile of projects and transactions that can potentially be scaled up and generate repeat investments, i.e., financing bankable projects (AIIB, 2020).

12. Southern MDBs are less connected to broader stakeholders, including key non-state actors and other IDPs, at the country level

Both AIIB and IsDB are often seen as disconnected from non-state stakeholders, including other MDBs and civil society. Both AIIB's corporate strategy and IsDB's 2023-2025 Strategic Realignment documents stress the importance of building effective partnerships with all stakeholders (state and non-state) within the recipient country

In practice, these commitments are less apparent: AIIB and IsDB focus on project-level grievance redress, unlike the World Bank and ADB, which also have corporate-level systems.

12. Southern MDBs are less connected to broader stakeholders, including key non-state actors and other IDPs, at the country level
(contd.)

Moreover, **IsDB places GRS responsibility on the recipient government**. Although AIIB has a Project Affected People's Mechanism (PPM) and Environmental and Social Framework (ESF), **AIIB defers to co-financiers' GRS**, exempting itself from complaints via its PPM (no other MDB avoids accountability for its own investments in this way). There is an exception, in the case of AIIB's financing of the Upper Trishuli Hydropower Project (Nepal), AIIB was cofinancing alongside IFC and ADB, its own PPM was applied. No explanation was provided for this and inconsistency in practices will affect the predictability of such the mechanism.

The lack of in-country presence contributes to the lack of engagement and visibility among recipient country stakeholders.

13. Southern MDBs are less engaged in the overall external development finance eco-system at the country level

Both IsDB and AIIB emphasise the importance of collaboration with other development partners.

For example, IsDB produces an Annual Development Effectiveness Report (ADER) that briefly mentions the GPEDC, it primarily adheres to its own results-based management framework (RBMF) to assess development effectiveness. IsDB mentions four guiding Principles: (1) Responsiveness to recipients' needs, (2) Results culture, (3) Empowerment and Accountability and (4) Group Synergy which is aligned with the four GPEDC Principles.

13. Southern MDBs are less engaged in the overall external development finance eco-system at the country level (contd.)

Yet in practice, their engagement is limited. They are largely absent from local consultative groups led by the World Bank and ADB and show little involvement in broader development financing efforts, such as the GPEDC and OECD. For instance, AIIB is neither part of the GPEDC processes nor holds official observer status.

As emerging players, Southern MDBs have not yet matched the level of engagement seen in legacy institutions. Encouragingly in April 2024, both banks signaled a shift by announcing plans to collaborate more closely with eight other MDBs, including the World Bank, to enhance the effectiveness of development financing efforts. *However, this will need to be operationalised at the recipient-country level.*

14. Recipients view Southern MDBs through a geopolitical lens

Legacy MDBs, like the World Bank and ADB, have faced criticism for American and Japanese influences but they have been able to build trust and neutrality over decades. However, Southern MDBs, e.g., AIIB, are newer and face more scrutiny. IsDB, operational since 1975, may be less scrutinised due to its distinct focus on Islamic finance in Muslim countries.

AIIB is seen as a rise in China's soft power, despite efforts to distance itself from the Belt and Road Initiative (BRI). This is exacerbated by the fact that AIIB is the administrator of the Multilateral Cooperation Center for Development Finance (MCDF), which is described by Chinese media as a platform for BRI investments.

Perceptions of AIIB and IsDB as "Chinese" (despite the EU's shareholding in AIIB) or "Saudi" funding can lead to geopolitical scrutiny, limiting their engagement in recipient countries and driving a preference for Legacy MDBs.

The limited visibility among recipient country stakeholders only fuel the perceptions.

15. Southern MDBs prefer to keep the organisation lean, leading to a lack of in-country presence implying lower engagements while shorter history also constrains understanding operational specificities

Both Southern MDBs have sought to streamline their processes to maximise efficiency and reduce bureaucracy by going “lean”. To illustrate, both Banks have opted for regional hubs or, in the case of AIIB, an overseas office in Abu Dhabi instead of establishing country offices in recipient countries. AIIB has taken the ‘lean’ concept one step further than IsDB by establishing a non-resident board (Humphrey, Griffith-Jones, Xu, Carey, & Prizzon, 2015).

While IsDB may benefit from better recognition in Bangladesh due to its regional hub there, AIIB is facing challenges of low visibility at the country-level in Bangladesh and other recipient countries.

Although keeping operations “lean” may be contributing to AIIB’s comparatively faster project preparation and approval stages, it is also potentially limiting the Bank’s visibility, outreach and may be slowing down its efforts to establish a stronger foothold in the development financing landscape at country, regional and international levels.

16. Southern MDBs generally follow established result frameworks, which are either aligned with the framework established by co-financiers or the recipient government. However, these frameworks are more project-oriented

IsDB, much like the legacy MDBs, operates under a comprehensive results framework as part of its 2023-2025 Strategic Realignment. It monitors development progress, operational efficiency, and organizational performance across member countries. The bank's approach includes adopting Key Performance Indicators (KPIs) and producing critical reports such as the Project Implementation Assessment and Support Report (PIASR), Project Completion Report (PCR), and Country Portfolio Performance Report (CPPR).

In contrast, AIIB places its emphasis on project-level results frameworks. AIIB's operational policy mandates that each project must establish a clear results framework to facilitate monitoring and evaluation. This often involves using either standard frameworks or those provided by co-financiers.

In practice, both IsDB and AIIB adopt the standard project results frameworks shaped by the Legacy MDBs.

17. Mutual accountability is not adequately upheld on the sides of both legacy MDBs and Southern MDBs

For both Legacy and Southern MDBs, recipient country **stakeholders increasingly perceive that recipient countries disproportionately bear the brunt of cost and time overruns.**

These overruns often stem from poor project management, inefficient procurement practices, and the costly safeguards imposed by MDBs. Additionally, strict adherence to outdated project elements that no longer contribute to development goals exacerbates the issue. *The absence of mechanisms to reassess such elements for time and cost-effectiveness further intensifies these challenges.*

The Melamchi Water Supply project exemplifies this problem—approved in 2000, completed in 2021, and already undergoing repairs by 2024—highlighting significant inefficiencies in project design and management.

C. The LDC perspectives

18. LDCs, much less ‘graduating’ LDCs are not considered as a category by both legacy and southern MDBs. IsDB does mention LDCs but do not consider it as a category.

The terms and conditions of financing vary across MDBs. The World Bank and ADB base their criteria on GNI per capita (Atlas method), updating annually. IsDB also uses per capita income but does not specify adherence to the Atlas method or regular updates.

IsDB is the only Bank here that incorporates the LDC criterion in its financing terms. Meanwhile, AIIB’s approach is less defined, stating only that it will "take fully into account the need to safeguard its income and financial position" (AIIB Articles of Agreement).

Table: Criterion for determining terms and conditions of financing

Legacy MDBs		Southern MDBs	
World Bank	Asian Development Bank	Islamic Development Bank	Asian Infrastructure Investment Bank
(1) GNI per capita (Atlas method) (2) Creditworthiness	(1) GNI per capita (Atlas method) (2) Creditworthiness	(1) GNI per capita (3) LDCs (UN classification)	n/a

Source: Author’s compilation

19. Income per capita is an inadequate measure for the banks to gauge the recipient country's level of socio-economic development.

Traditionally, income per capita has been the primary metric for determining development financing terms, based on the assumption that higher income indicates greater socio-economic progress and resilience. However, this view is increasingly criticised as overly simplistic, as it fails to address underlying issues like inequality and human development, nor does it accurately reflect a country's debt-servicing capacity.

The global conversation is increasingly shifting towards rethinking the Debt Sustainability Analysis (DSA) framework. Critics argue that the current DSA approach, which varies based on a country's income per capita, places disproportionate emphasis on narrow metrics like Debt-GDP ratios, especially in low-income countries despite the limited evidence available in those contexts.

There needs to be a multidimensional DSA that considers a country's broader context, including its development history, rather than focusing on using specific indicators.

20. Southern MDBs may be a better fit for countries better ability to repay- LDCs are less likely to feature in this group

Graduating from the LDC status, while significant, does not directly impact a nation's access to external financing. However, it does bring with it a host of issues that may constrain the country's debt sustainability and affect the terms of external borrowing, especially as both Bangladesh and Nepal's LDC STS documents have mentioned the need for favourable lending terms in view of the upcoming graduation. GNI per capita should not be considered the primary metric when determining a country's cost of borrowing. Though it is a good measure, it is inadequate

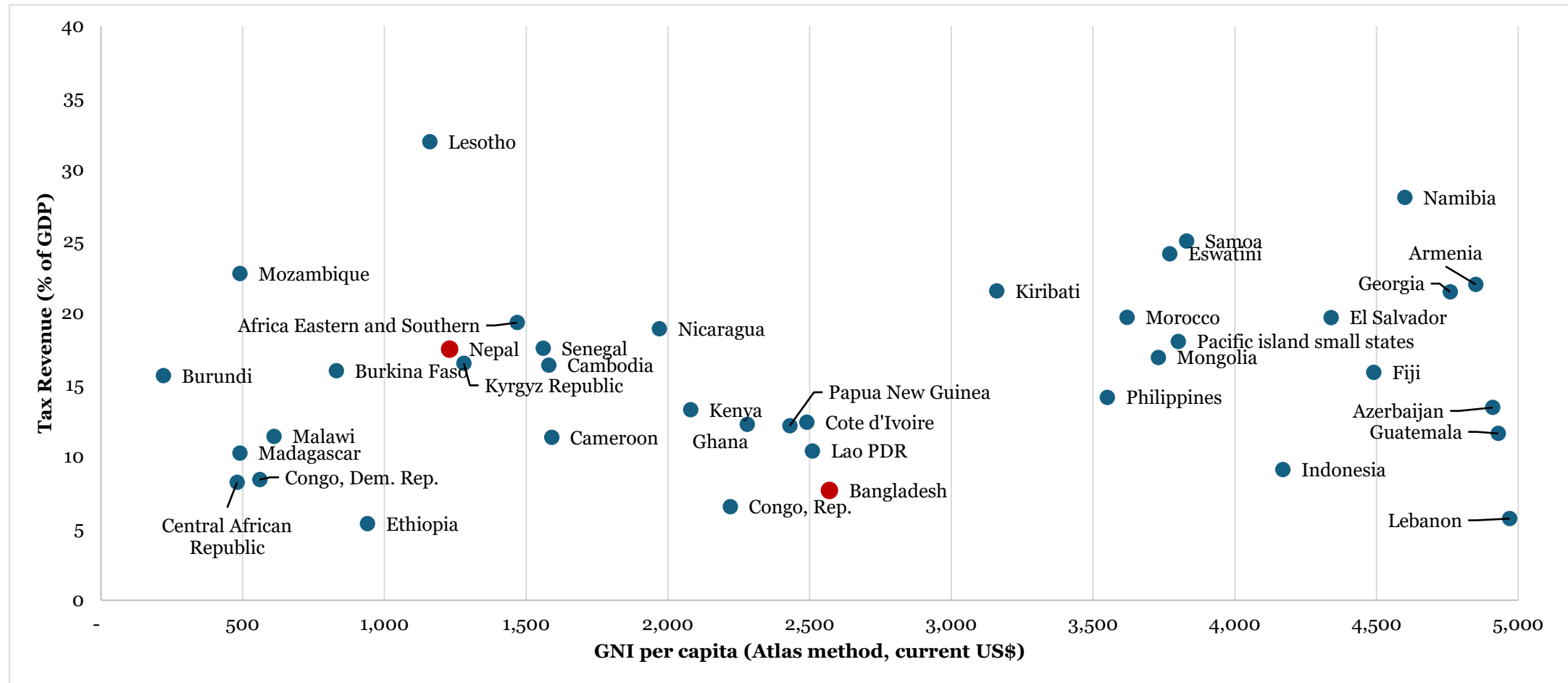
The assumption that increasing GNI per capita leads to improved debt sustainability and expanded fiscal space (through higher revenue mobilisation, as measured by the tax-to-GDP ratio and foreign exchange reserves) is not universally true.

While higher GNI per capita may suggest a better capacity to manage twin deficits, this is not always the case for all countries. Relying solely on debt-to-GDP ratio indicators can provide an incomplete picture of a country's debt-carrying capacity.

Given that AIIB's lending terms have been seen as comparable to IBRD (GNI per capita between \$4,516 and \$14,005) rather than IDA (GNI per capita \$1,145 or less), and that IsDB also uses the SOFR rate as well to lend to its least-developed members, graduating LDCs are less likely to be the primary target for Southern MDBs.

20. Southern MDBs may be a better fit for countries better ability to repay- LDCs are less likely to feature in this group

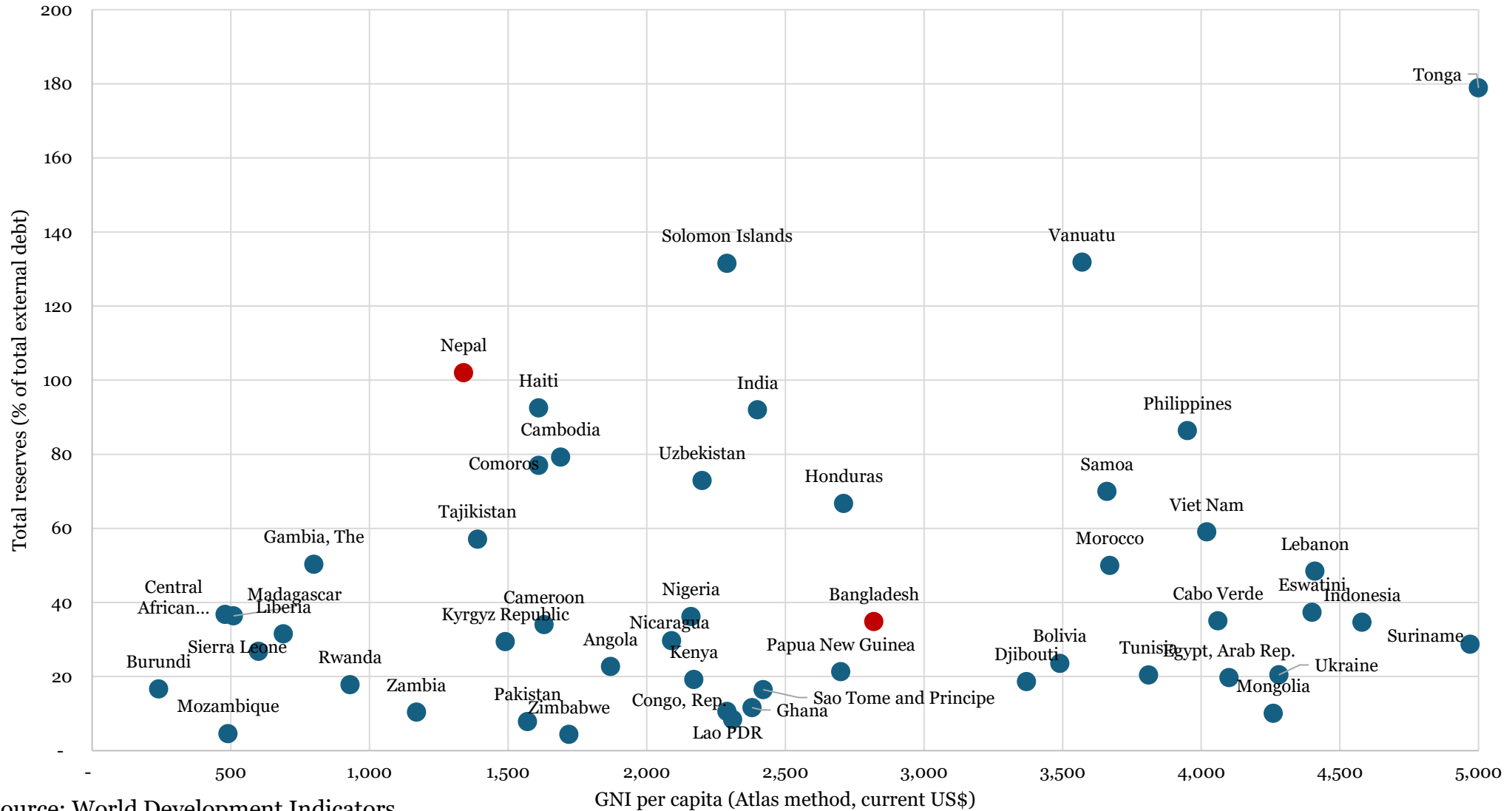
Figure: Tax revenue-GDP ratio vs GNI per capita (Atlas method, current US\$, 2021)



Source: World Development Indicators

20. Southern MDBs may be a better fit for countries better ability to repay- LDCs are less likely to feature in this group

Figure: Total reserves (% of total external debt) vs GNI per capita (Atlas method, current US\$, 2022)



Source: World Development Indicators

7. Preferred Reforms

1. Southern MDBs should **prioritise diversifying their portfolio of instruments and introduce a concessional financing window to better serve the graduating LDCs**

Neither AIIB nor IsDB currently offer concessional financing windows. These Southern MDBs borrow at market rates and lend at rates higher than the market to all member countries, including the least developed members (in the case of IsDB).

Recipient countries expect to receive loans from Southern MDBs at a **fixed, lower than market rate**.

Action point(s)/Recommendation(s):

1. Southern MDBs should *secure low-cost funding*. Member countries of AIIB and IsDB, particularly those that are key providers of concessional loans, should channel low-cost funds through these banks to enable them to offer concessional financing.
2. *Hedging against the SOFR* should be pursued as a secondary option. However, it's crucial to consider the technical capacity of recipient countries' public officials when they negotiate lending terms.

Implemented by/Responsible entity: Southern MDBs

Monitoring indicator(s):

1. By 2030, 30% of loans disbursed by AIIB and IsDB should be at a fixed, lower-than-market interest rate.
2. "LDC" and "graduating LDC" should be criteria for determining the cost of borrowing for these countries.

2. Establishing country offices will help Southern MDBs improve their **understanding of a recipient country's contexts and development needs and improve communication with the stakeholders**

AIIB has a "lean, clean and green" policy, operating primarily from its headquarters in Beijing. Recently, AIIB opened an overseas office in Abu Dhabi. In contrast, IsDB has established regional hubs, one of which is located in Bangladesh.

The rationale for choosing UAE over a recipient country remains unclear, though it is attributed to the city's strategic geographical location and its status as a financial hub.

This approach has fostered limited visibility, engagement and trust between Southern MDBs and beneficiaries in recipient countries, especially impeding upon the effectiveness of grievance redress mechanisms and transparency and accountability of the Bank. Periodic country visits are perceived more as a routine check-in than meaningful engagement with broader stakeholders at the country-level.

Action Point(s)/Recommendation(s):

- A regional hub should be piloted in a recipient country, acknowledging the financial feasibility of setting up an office in that location

Implemented by/Responsible entity: Southern MDBs

Monitoring Indicator(s):

- A regional hub should be piloted within five years (ideally by 2030).

3. Southern MDBs will be able to contribute more to the development financing needs of graduating LDCs if they co-finance or collaborate more with Legacy MDBs and other agencies

Co-financing can reduce overall borrowing costs for recipient countries by blending higher-cost financing from Southern MDBs with lower-cost funds from other sources. This collaboration not only scales up financing but also builds trust and deepens engagement in recipient countries. Additionally, it streamlines reporting requirements for the MDBs involved.

However, these benefits come at the cost of reduced flexibility in project management and reporting processes that would need to be conducted through partnering agencies, potentially complicating accountability mechanisms, as coordination between multiple MDBs may obscure accountability of projects.

3. Southern MDBs will be able to contribute more to the development financing needs of graduating LDCs if they co-finance or collaborate more with Legacy MDBs and other agencies (contd.)

Action Point(s)/ Recommendation(s):

1. While AIIB and IsDB have signed a joint statement on collaboration with other MDBs, this commitment must be operationalised at the country level, with a focus on the perspectives and needs of the Southern recipient country.
2. Southern MDBs should strategically pursue co-financing or collaboration with other MDBs or agencies within recipient countries.

Implemented by/Responsible entity: (1) Southern MDBs, (2) Legacy MDBs, and (3) recipient government

Monitoring Indicator(s):

•By 2030, 20-30% of Southern MDB financing in recipient countries should be channelled through co-financing arrangements with other MDBs or other agencies.

4. A country strategy approach instead of a project-oriented approach will help Southern MDBs **will give graduating LDCs improved predictability**

The AIIB's financing decisions are primarily project-oriented, and despite the IsDB's country framework, stakeholders in recipient countries perceive its approach as similarly focused on individual projects.

However, recipient countries are increasingly expecting MDBs to adopt a medium-term strategic approach that aligns with their LDC smooth transition strategy, including their debt-servicing capacities, and medium-term development plans.

Action Point(s)/Recommendation(s):

- Recipient governments should *lead and manage a development finance coordination mechanism*, with Southern MDBs taking a more proactive role.
- While global platforms like the Global Partnership for Effective Development Co-operation (GPEDC) and country-level platforms like the Bangladesh Development Forum and Local Consultative Groups (LCGs) exist, these platforms should be more effectively managed and consistently utilised.

4. A country strategy approach instead of a project-oriented approach will help Southern MDBs **will give graduating LDCs improved predictability** (contd.)

Action Point(s)/Recommendation(s):

- The recipient government must actively work to bridge the coordination gap between Southern MDBs and other International Development Partners (IDPs). For instance, if a development project is expected to receive 80% of its financing from Legacy MDBs, the recipient government should proactively seek additional financing from Southern MDBs (and other sources) to cover the remaining amount.
- Both Legacy and Southern MDBs must demonstrate an openness to negotiate development financing terms and conditions at the policy level within recipient countries.

Implemented by/Responsible entity: (1) Recipient government, (2) Southern MDBs, (3) Legacy MDBs and other IDPs

Monitoring Indicator(s):

- By 2030, AIIB and IsDB should have established a medium-term country-level strategies and be actively engaged in their implementation.

5. Proactively disclosing information, actively engaging with broader stakeholders (including NSAs), and promoting a mutual accountability mechanism will help bridge the trust deficit between recipient countries' stakeholders and Southern MDBs

AIIB and IsDB do not have strong frameworks for proactively sharing information with beneficiaries.

- For instance, AIIB has no specific time frame for release of information to the public, several exemptions allow them to withhold information, with the final decision resting with the AIIB President. IsDB only shares project details and reports with the recipient government and its shareholders, not with the broader public.

This situation is closely tied to **the understanding of who the real client is: Both Legacy and Southern MDBs assume that the elected recipient government represents an assurance of democratic accountability in the country**, which may not always be the case

- Engaging with a diverse range of stakeholders throughout the project cycle (from design to evaluation) can improve transparency, accountability, and coordination.

5. Proactively disclosing information, actively engaging with broader stakeholders (including NSAs), and promoting a mutual accountability mechanism will help bridge the trust deficit between recipient countries' stakeholders and Southern MDBs

When MDBs impose strict project requirements that are difficult to meet in the recipient country, it can delay project implementation. The resulting cost and time overruns, which are borne by the recipient country, can erode trust.

There is no mechanism to hold MDBs accountable when their imposed conditions lead to project delays and additional costs, further undermining trust between the recipient country and the MDB.

Action Point(s)/Recommendation(s):

1. Southern MDBs should proactively ensure that crucial project documents are translated properly and disseminated among beneficiary groups at the country-level
2. Southern MDBs should also ensure that a GRS is in place (as opposed to solely relying on the recipient system or co-financier's) and is effectively used with documentation on any consultations published within a specific timeframe.

5. Proactively disclosing information, actively engaging with broader stakeholders (including NSAs), and promoting a mutual accountability mechanism will help **bridge the trust deficit** between recipient countries' stakeholders and Southern MDBs

Action Point(s)/Recommendation(s):

3. Southern MDBs should also publish a specific timeframe for when to expect the publication of specific project documents and their dissemination to the public through their online platform or otherwise.

4. Legacy and Southern MDBs should introduce a mechanism by which the MDBs themselves may be approached regarding revising specific project elements that may be too burdensome for the recipient country.

Implemented by/Responsible entity: Southern MDBs and Legacy MDBs

5. Proactively disclosing information, actively engaging with broader stakeholders (including NSAs), and promoting a mutual accountability mechanism will help **bridge the trust deficit** between recipient countries' stakeholders and Southern MDBs

Monitoring Indicator(s):

1. By 2030, 100% of project documents should be translated into local languages and disseminated among beneficiary groups in recipient countries, through collaboration with local knowledge actor(s).
2. By 2030, 100% of Southern MDB financed projects should have an active and accessible GRS in place, with a documented process for handling grievances
3. By 2030, at least 90% of Southern MDB financed projects should have publicly available time frame for the release of specific project documents
4. By 2030, a formal mechanism should be established in 90% of both Legacy and Southern MDB-financed projects, allowing recipient countries to request revisions to project elements deemed too burdensome.

Thank you

