Independent Commission for Aid Impact

The UK's support to the African Development Bank Group

Literature Review

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Introduction

The African Development Bank Group (the Bank) is a multilateral development bank that aims to promote sustainable economic development and poverty reduction in Africa. It aims to achieve this through mobilising and allocating resources for investment in its regional member countries and providing policy advice and technical assistance in support of development efforts. It is made up of regional and non-regional members. The Group comprises three entities: the African Development Bank (AfDB), the African Development Fund (ADF) and the Nigeria Trust Fund.[1] The AfDB and ADF are responsible for the vast majority of the Bank's lending operations in the region, and are therefore the primary focus of this review. The ADF provides concessional assistance and is funded via replenishment rounds, whereas the AfDB is non-concessional and borrows from capital markets.[2]

The UK has been a donor to the Bank since joining the African Development Fund on 20 June 1973. It currently has the 14th largest shareholding in the AfDB, representing approximately 1.8% of the AfDB's capital and providing it with limited voting powers in the Bank. The rationale of the Department for International Development (DFID) for working with the Bank includes the financial and technical support that the Group provides to the poorest countries in Africa as well as middle-income countries (DFID, 2019).

The **purpose** of this literature review is to summarise key features of the academic and grey literature concerning the Bank and to answer the following questions:

1. What is the context of multilateral aid and what are the relative merits of multilateral vs bilateral aid?
2. How is the Bank financed and governed, and how does this affect its ability to deliver its mandate?
3. Which geographies, sectors and themes are the focus of the Bank and what evidence is there that they are appropriate?
4. How well does the Bank compare with other institutions regarding development effectiveness?
5. What are the current debates around the strategy and operations of the Bank?

This paper is a review of 135 published documents. The main **limitation** of this review is the limited number of academic articles and peer-reviewed papers included. This is due to the subject matter being specialist and the limited contributions of academic literature in recent years. The dominance of grey literature (such as formal publications of think tanks) and institutional publications made it challenging to assess the strength of the evidence in many cases.

In Section 1, we give a summary of the history, purpose and current landscape of multilateral aid, including the governance of multilateral institutions and the factors that affect donors' decisions on allocations to multilateral aid. We also outline the arguments and evidence in the literature on the relative merits of multilateral vs bilateral aid, as well as the relative merits of earmarking and trust funds in relation to bilateral funding. In Section 2, we detail the history, mandate, membership and sources of finance of the Bank, as well as its financial instruments. In Section 3, we detail the geographies, sectors and themes that are the focus of the Bank, the evidence for how appropriate they are, and whether the Bank exploits its comparative advantage. In Section 4, we present

[1] Since 2009, approved funding for the Nigeria Trust Fund has represented less than 0.5% of approved funding for the AfDB Group. Due to its small size, this review does not look specifically at the Nigeria Trust Fund (AfDB, 2018a), link.
[2] Concessionality is a measure of the 'softness' of a loan, reflecting the benefit to the borrower compared to a loan at market rate.

literature on how the Bank compares with other institutions regarding development effectiveness. Section 5 explores existing debates on the Bank that are relevant to our review questions.

1. The multilateral aid context

1.1 The multilateral development bank landscape

In this sub-section, we first describe the distinction between bilateral and multilateral aid and detail the core recipients of multilateral funding. We then explain what multilateral development banks (MDBs) are and their general evolution over time. We present the literature discussing the link between governance arrangements, rating agencies and the decision-making and strategic direction of MDBs. We then explore the factors affecting donor decisions on the relative allocation of official development assistance (ODA)[3] to multilateral or bilateral aid. We conclude with an overview of the arguments in favour of innovations in the financial instruments of MDBs.

Multilateral and bilateral aid

Aid flows from official (government) sources directly to official sources in a recipient country are classified as **bilateral aid**, whereas flows to multilateral agencies are classified as **multilateral aid** (OECD, 2019d). The share of worldwide ODA allocated to multilateral organisations in 2018 was 40% ($62.3 billion) (OECD, 2019c). This money flowed to over 200 multilateral organisations worldwide, which are typically clustered into the following groups: the European Union, the World Bank Group, the International Monetary Fund (IMF), the regional development banks, the United Nations programmes, funds and specialised agencies, and the Global Fund to Fight Aids, Tuberculosis and Malaria (OECD, 2019a).

Multilateral and bilateral funding is **increasingly earmarked** by donors for specific purposes (OECD, 2019b). This earmarking is also referred to as multi-bi aid and usually flows via trust funds (Reinsberg, 2017). In 2018, 31% ($19.43 billion) of all multilateral funding came through earmarked (non-core) contributions.[4] We discuss the relative merits of multi-bi aid in a later sub-section.

The total ODA provided by the UK in 2018 was £14.55 billion, 36% (£5.28 billion) of which was allocated to multilaterals. The multilateral agencies receiving this were: the United Nations (26%), the World Bank (23%), EU institutions (21%), other multilateral institutions (23%) and regional development banks (7%) (OECD, 2019b). Of the £5.28 billion provided to multilaterals, £1.63 billion (31%) was earmarked.

Multilateral development banks

Multilateral development banks are defined as those owned by two or more sovereign nations (Engen & Prizzon, 2018). It is possible to classify MDBs into three types.[5] **Global MDBs** encompass a wide geography across multiple regions (for example, the World Bank Group, the European Investment Bank (EIB), the International Fund for Agricultural Development and the Islamic Development Bank). **Regional development banks** (RDBs) are membership organisations and cover a single region (for example, the African Development Bank, the Inter-American Development Bank (IADB) and the Asian Development Bank (AsDB). **Sub-regional banks** cover a

[3] Official development assistance is the term used by Development Assistance Committee members to refer to what most people would call aid. To be counted as ODA, public money must be given outright or loaned on concessional (non-commercial) terms and be used to support the welfare or development of developing countries (OECD, 2019).
[4] Author calculations (OECD, 2018), link.
[5] We follow the classification of Engen and Prizzon (2018) but there are other ways to classify MDBs, link.

sub-set of countries in a region (for example, the Caribbean Development Bank and the East African Development Bank). In 2018 there were at least 25 multilateral development banks in operation (Engen & Prizzon, 2018).

Engen and Prizzon (2018) distinguish **five main phases** in the evolution of the MDB landscape. The first is the establishment of the International Bank for Reconstruction and Development in 1944, which was set up to address a market failure in long-term capital flows to Europe and developing countries in the aftermath of World War II. The second phase was the establishment of the regional development banks, which were partly a response to a perceived lack of attention to developing countries on the part of the World Bank (Engen & Prizzon, 2018). The establishment of the Inter-American Development Bank (1959), the African Development Bank (1964) and the Asian Development Bank (1966) was also a response of the United States and other western countries to the Cold War, and a desire to influence countries in the fight against communism (Ben-Artzi, 2016). The third phase of MDBs, in the late 1960s and 1970s, saw the establishment of sub-regional development banks in Latin America, Africa and the Arab states. The collapse of the Soviet Union saw the fourth phase of MDBs emerge with the creation of the European Bank for Reconstruction and Development (1991) and other banks created by post-Soviet states, including the Black Sea Trade and Development Bank (1997) and the Eurasian Development Bank (2006). The fifth phase saw the creation of two China-based infrastructure-focused MDBs: the New Development Bank (2014) and the Asian Infrastructure Investment Bank (2016). These new institutions were in part established because developed country shareholders of the existing multilateral development banks refused to allow developing countries to invest more capital, or give significantly greater voice to the emerging and developing countries. They were also unwilling to use a large enough share of their resources to fund infrastructure, especially for interconnectivity between countries (Humphrey et al., 2015).

Mandates

Over these five phases, the MDBs have combined financial strength and technical knowledge to support their borrowing members' investments in post-conflict reconstruction, growth stimulation and poverty reduction (Ahluwalia, Summers & Velasco, 2016). Most mandates of MDBs highlight two common areas: fostering sustainable economic development, and supporting regional cooperation, economic cooperation and intra-regional trade (Engen & Prizzon, 2018).

Governance

The composition of shareholders on the board of MDBs can have important effects on strategic decisions and **powerful shareholders can exert significant influence on MDB practice**. For example, the US has by far the largest percentage of voting power on the board of the International Finance Corporation (IFC) with 20.98%, followed by Japan (6.01%) and Germany (4.77%), and is currently using its influence to push the IFC to be more accountable (Ramachandran, 2019). Historically, fiduciary safeguards and, more recently, environmental and social safeguards have been promoted in MDBs, where the United States is the largest shareholder, and these issues were shaped by pressure from US Congress and American non-governmental organisations (Birdsall et al., 2016). China, as the largest shareholder in the Asian Infrastructure Investment Bank (AIIB), can form coalitions with either creditors or borrowers in the Bank, and Birdsall (2018) argues that this allows China to use the AIIB as a tool to expand its influence worldwide.

An alternative way to categorise the ownership structure of an MDB is to look at blocs of members and compare, for example, influential borrower countries with non-borrowers. When MDBs are combined by asset, roughly 60% of MDB funds are controlled by borrowers. However, there is significant variation in this ratio of power-sharing across types of MDB. While less than a third of

World Bank funding is controlled by country borrowers, over three quarters of the regional development bank funds are controlled by borrowers (Ray, 2019).

Because MDBs raise most of their resources from international capital markets rather than government budgets, they are less reliant on government capital contributions. The reliance on international bond markets means MDBs must pay close attention to the perceptions of bond investors. Humphrey (2014b) finds that MDBs, such as the World Bank and Inter-American Development Bank, find it relatively easy to raise resources in capital markets, and argues that this is due to the backing they have of wealthy countries. Although borrower-led governance can lead to substantial disadvantages in terms of access to finance, it also allows for greater operational flexibility. In a case study of the Trade and Development Bank, Humphrey (2019) finds that borrower-led governance allows for the Trade and Development Bank and other multinational development banks to have more leeway in operations, which somewhat compensates for the negative financial implications.

Credit rating agencies play an important role in assessing the financial strength of institutions, and their ratings determine the financial terms that institutions can borrow at. Humphrey (2017a) explores the influence of credit rating agencies on MDB operations and finds that the methodology used by S&P Global Ratings undervalues the financial strength of MDBs, and this in turn limits the ability of MDBs to raise capital and pursue their development mandate.

Replenishment decisions

The concessional windows of MDBs need to be regularly replenished by their shareholders, and each time this happens shareholders must make decisions on how much funding to give. There are often many government entities involved in decisions on multilateral allocations. Among Development Assistance Committee (DAC) members, an average of five government entities are involved, and in most cases the split between bilateral and multilateral funding is explicitly discussed, usually when development policies are being funded or when the ODA budget is being developed (OECD, 2015).

These decisions have a significant impact on how MDBs can operate, and **unpredictable funding streams have harmful effects on their operations** (OECD, 2018). That is why one of the six key recommendations of the Multilateral Development Finance Review was to "increase predictability of funding by making multi-annual commitments linked to the strategic plans of multilateral organisations" (OECD, 2018, p.23).

Just two DAC members have quantitative targets that shape the allocation of funding between bilateral and multilateral agencies: Ireland has a fixed 70/30 bilateral-to-multilateral ratio and Switzerland a 60/40 ratio. However, even without targets, there is emerging evidence that allocation decisions tend to lean towards 'path dependency', whereby delegation decisions are heavily influenced by previous allocation decisions with limited room for manoeuvre, at least in the short term (Greenhill & Rabinowitz, 2016).

Other factors bearing on MDB allocations include the manner in which countries budget for them. Greenhill and Rabinowitz (2016) note, for example, that the US provides funding to MDBs through a singular funding line managed by the US Treasury. Therefore, to increase an allocation, either the budget must increase, which is difficult, or another MDB must receive less funding to cover the cost. The same authors note that sector and geographical priorities can also influence allocations. In their case studies they found that countries prioritised multilateral organisations that focused on their own country's priority sectors, and were less likely to support multilaterals located in their own regions. For example, Australia provides greater support to Asia–Pacific multilaterals.

Financial instruments

As countries grow and per capita GDP increases, the share of external finance provided through ODA decreases, and **countries are vulnerable to high indebtedness during this transition** (Piemonte et al., 2019). For example, the number of developing countries at high risk of debt distress, or in debt distress, rose sharply from 13 to 24 between 2013 and 2018 (IMF, 2018). Although maintaining sustainable debt levels is primarily the responsibility of borrowing countries, there is consensus that **lenders also have a responsibility to lend in a way that does not undermine a country's debt sustainability** (Addis Ababa Action Agenda, 2015). The share of loans has increased over the last decade from 11% of gross bilateral ODA in 2008 to 18% in 2017 (OECD, 2019b). Aligned with this increase and the need for responsible lending, the new 'grant-equivalent' methodology for measuring ODA, introduced in 2018, means that only the amount the provider gives away by lending below market rates (the 'grant portion') counts as ODA. The loan parameters are set such that only loans provided to poor countries on very generous terms will be counted as ODA. This in turn will "incentivise donors to send the most concessional loans, and more grants, to the countries that need them the most" (OECD, 2019e).

The Debt Sustainability Framework, developed by the World Bank and the IMF, shows that the **terms of the loans of MDBs interact with the financial stability of borrowing countries especially in relation to hard-currency loans** (IMF, 2019). Borrowing countries collect taxes in local currency to repay debt, however multilateral development banks offer primarily hard-currency loans, pushing currency risk to borrowing countries. Because external shocks to developing countries can result in frequent currency depreciations (which in turn cause instability and risk of debt distress), some argue that MDBs should take on more of the risk of lending and lend in local currencies (Brouwer, 2019). Similarly, they should make their loan repayment structures more flexible to incentivise good practices on the part of governments (Brouwer, 2019). Although there are some facilities for issuing debt in local currencies, the majority of loans remain in hard currency. For example, the Asian Development Bank's (ADB) currency note facility is $10 billion (Asian Development Bank, 2006), representing only 6% of its total capital base of $147.9 billion (Asian Development Bank, 2019). In Africa, the equivalent Local Currency Bond facility is valued at only $47 million (see Dettoni (2018) and African Development Bank (2019)).

Another important aspect of sustainable financing is the development of new financial instruments (Coulibaly, Gandhi & Senbet, 2019). Institutional investors, including pension funds and insurance funds, offer a potentially huge pool of private investment in developing countries. However, international financial institutions (IFIs) do not currently meet the requirements of institutional investors for relatively low-risk investments that meet their fiduciary responsibilities. Tyson and Beck (2018) argue **that IFIs could be more proactive in creating securities** that more closely match their needs, such as greater syndication and securitisation to structure assets that meet credit and liquidity requirements. This argument is in line with the World Bank's Maximising Finance for Development Agenda which seeks to systematically leverage all sources of finance, expertise and solutions to support developing countries' sustainable growth (World Bank, 2019). Another financial innovation would be to create state contingent debt instruments (SCDIs) (Mustapha & Prizzon, 2018). However, it is unlikely that SCDIs can be issued at scale without official sector support, particularly from MDBs and RDBs (Mustapha & Prizzon, 2018).

Critics of a push for greater securitisation and privatisation, such as Critical Finance (2019), argue that this move will "bring shadow banking into development" and that encouraging countries to join the global supply of securities "exposes them to the rhythms of the global financial cycle over which they have little control" (Financial Times, 2018).

1.2 Relative merits of multilateral vs bilateral aid

What are the advantages of supporting multilateral agencies such as the Bank, as opposed to delivering aid through bilateral organisations such as DFID? In this sub-section, we present evidence on the relative merits of multilateral vs bilateral aid. We draw upon the comprehensive literature review of Gulrajani (2016) and complement it with additional recent literature on this question. We first look at the level of politicisation, the preferences of recipients and how selective each type of aid is with regards to how likely the aid is to be spent well. We then explore how effective each type of aid is at providing global public goods, before reviewing the evidence on which type is better value for money. We conclude this sub-section looking at the relative degree of fragmentation of bilateral and multilateral aid, before assessing the evidence on the use of trust funds.

Level of politicisation

There is evidence that **bilateral channels are more politicised than multilateral channels**. There is a growing body of evidence that bilateral donor interests (such as strategic and political considerations) have greater influence on aid allocation decisions than country needs or potential for development impact (Nunnenkamp & Thiele, 2006; Sippel & Neuhoff, 2009) and this can have negative effects on economic growth compared with multilateral channels (Girod, 2008). Multilateral assistance is less prone to electoral pressures and public opinion compared with bilateral donors (Reinsberg, 2015), however there is some evidence that the national interests of executive directors at multilaterals can influence aid allocations (Anwar, 2006).

Politicisation of bilateral aid can also have positive effects. For example, DAC member states reward political reforms and transitions in recipient states with more country programmable aid (Reinsberg, 2015), and bilateral donors appear to have the capacity to advance moral visions at the expense of their material interests (Lumsdaine & Schopf, 2007).

Recipient preferences

There is strong evidence that **aid recipients prefer multilateral channels**. Two extensive and recent surveys of aid recipients show that multilateral channels are preferred to bilateral channels (Custer et al., 2015; Andreopoulos & Panayides, 2011). According to Davies and Pickering (2015), MDBs are the most popular source of funding due to being more effective and efficient than bilateral donors (for further evidence see Gulrajani (2016)). In the case of the Bank, it is the preferred lender of African countries (Woods & Martin, 2012).

Selectivity

Moderate evidence indicates that bilateral donors direct their aid towards better-governed countries, while multilaterals tend to direct aid according to countries with the greatest need. A number of studies find that bilateral donors are selective on the basis of governance criteria such as corruption (Palagashvili & Williamson, 2014; Christensen, Homer & Nielson, 2011). On the other hand, there is moderate evidence that **multilaterals exhibit greater emphasis on targeting the countries with the greatest need**, as measured by indicators such as income level (Dollar & Levin, 2004). In a comprehensive analysis of multilateral aid selectivity, Palagashvili and Williamson (2014) show that bilateral agencies give only about 19% of their aid to low-income countries, whereas multilaterals provide on average 55%.

Provision of global public goods

Resolving global border-transcending challenges (such as climate change, the spread of communicable diseases, illicit trade and forced migration) requires effective international cooperation. As many challenges affect all nations and possess the properties of public goods, they are known as **global public goods (GPG)**, and there is agreement that the provision of GPGs is one of aid's primary purposes (Deaton, 2013; Wickstead, 2015). Kaul (2012) puts forward the argument that GPGs are perennially underfunded due to aid being dominated by sovereign nations. These sovereign nations (bilateral aid) **will inevitably underfund GPGs**, according to economic theory, because the benefit to each individual country – as opposed to its global benefit – will be outweighed by its cost. In a similar argument, Birdsall and Diofasi (2015) highlight why GPGs are underfunded – because bilateral countries do not receive a suitable return on their donations, and the universal benefits of GPGs promote the economic concept of freeriding.

Multilaterals are perceived as more effective than bilateral donors at providing GPGs due to their international reach, inter-governmental structures and ability to act as information clearinghouses with international reach (Gulrajani, 2016). **MDBs currently support initiatives in several GPG policy fields** with an emphasis on climate change, communicable diseases, and situations of fragility, conflict and cross-border violence (Kaul, 2017). Despite this, their main shortcoming is that they address GPG problems through the traditional country-focused development approach, using standard tools of development assistance and finance which do not resolve these problems (Kaul, 2017). On the whole, there is moderate evidence that **multilaterals are better suppliers of global public goods than bilateral donors.** However, this comes with the caveat that even multilaterals tend to under-provide global public goods.

Efficiency

Six MDBs (ADB, AfDB, EBRD, EIB, IADB, and the World Bank Group) have been coordinating on a value for money framework over the past few years. Collectively, they have established a strong foundation for a common approach to value for money. In a joint report they acknowledge that an MDB's value "goes beyond the pure provision of financing, and that development value is often cumulative, catalytic, multifaced, and not readily captured in full through quantitative metrics (AfDB et al, 2019, p.4)". The proposed framework's three organisational categories and eight components summarise some of the ways that most, or all, MDBs deliver value for money by balancing the needs for economy and efficiency in resource use with the imperative of effectively delivering the intended development outcomes (AfDB et al, 2019). These categories and components are:

- Financial capacity and resources: Optimising and prudently managing MDB resources:
    - resource optimisation and financial sustainability
    - corporate cost management.
- Operational delivery: Deploying resources in line with mandates and priorities:
    - strategic alignment of resources
    - management of operations
    - standards
    - knowledge, policy dialogue and convening.
- Results: Achieving and measuring development results:
    - results
    - mobilising finance.

In this framework of value for money, a key argument in favour of multilateral aid is that multilaterals are more efficient than bilateral donors. In theory, there are efficiency gains to be made by exploiting economies of scale, coordinating interventions and achieving common standards, yet, large multilateral organisations can be very expensive to operate (Andreopoulos, Campanelli

Andreopoulos & Panayides, 2011). Palagashvili and Williamson (2018) use data on three measures of overheads (administrative costs, the ratio of salaries and benefits to aid flows, and total aid disbursements per employee) to create an index for the efficiency of an institution. They find that bilateral DAC members perform best, followed by non-DAC members and multilaterals.

Another explanation is that by disbursing aid multilaterally, **bilateral donors are partly outsourcing their overhead costs** (Easterly & Pfutze, 2008). This is exemplified by how there were 128 bilateral assessments and reviews of multilateral organisations over the period 2015-18, according to the OECD/DAC 2018 Survey on Policies and Practices in relation to the Multilateral Development System (OECD, 2018). The perceived inefficiencies of the multilateral system have driven a rise in earmarked funding, which in turn can exacerbate rather than alleviate real cost burdens (Tortora & Steensen, 2014). Presently, **there is inconclusive evidence on whether bilateral or multilateral institutions are more efficient.**

Fragmentation of donors

The proliferation of a large number of aid donors and channels is widely believed to reduce the value of aid significantly. The negative consequences stemming from aid from a variety of sources include: a decrease in bureaucratic quality, an increase in transaction costs, hampered growth and increases in corruption (Han & Koenig-Archiburi, 2015; Palagashvili & Williamson, 2014).

There is strong evidence that **multilaterals are less fragmented than DAC bilateral donors** (Acharya, Fuzzo de Lima & Moore, 2006; Knack, Rogers & Eubank, 2011; and Easterly & Williamson, 2011). In a comprehensive review of fragmentation across bilateral donors and multilaterals, Palagashvili and Williamson (2014) conclude that multilaterals are increasingly specialised in their geographic and sectoral focus, whereas DAC donors are becoming less so. They identify that despite being a champion of the principle of donor specialisation, the UK is not very specialised and is fragmenting over time. The implication of funding to multilaterals such as the Bank is that this supports geographic and sectoral specialisation (for example, infrastructure in Africa), while reducing aid fragmentation.

Multi-bi aid

The high proportion of earmarked non-core support for multilaterals is part of a general trend among donors of the Organisation for Economic Co-operation and Development (OECD) that has been termed **'bilateralisation' of multilateral aid** (Tortora & Steensen, 2014). In a comprehensive evaluation of the World Bank's trust fund support, the Independent Evaluation Group (2011) noted that trust funds add value as a distinct aid vehicle by providing coordinated financing and grant resources for individual countries, targeted development problems and global public goods. Investing through multi-bi channels helps donors maintain power through influencing the governments that receive investments, and Reinsberg, Michaelowa and Eichenauer (2015) argue that this desire for visibility and influence is the main factor driving donors to channel their assistance through multi-bi channels.

Despite these benefits, the growth in multi-bi aid can threaten the core principles of multilateral aid. There is a potential trade-off for donors between investing financial and political capital, time and energy to reform existing multilateral institutions versus creating new institutions or channels. Multi-bi assistance usually flows into international organisations via trust funds, and in the case of the World Bank, core concessional funding could be increased by 40% if donors redirected their money from the trust funds they finance (Barder, Ritchie & Rogerson, 2019). The same authors created an index of countries according to how responsible they are at using multi-bi funding. Their index was a composite of how much the donor resorts to trust funds rather than core multilateral funding, and how often the donor tends to 'do it alone' rather than combining with others. The

European Commission ranked as the least responsible donor and the UK was the second least responsible. They also found that the UK often sees the World Bank as the most effective delivery partner, and that the decision to establish a trust fund partnership with World Bank staff is quite decentralised (Barder, Ritchie & Rogerson, 2019, p.23).

Gulrajani (2016) argues that although multi-bi assistance may be superior to bilateral channels, it has negative effects on the institutional functioning of the multilateral system and core multilateral funding is a better choice. This position is consistent with that of the G20, which sees strengthening the multilateral system as a priority, as demonstrated by the recommendation for MDBs to integrate trust fund activities into their core operations to avoid fragmentation (G20, 2018). For an overview of the challenges associated with multi-bi aid, see Reinsberg (2017). Given the prevalence of trust funds at the largest institutions (for example, the World Bank and the UN), the majority of analysis and criticism has focused on the workings of trust funds at these institutions. However, trust funds and multi-bi aid are relatively scarce at other institutions, including the African Development Bank, and there is relatively little literature examining the effectiveness of multi-bi aid in smaller institutions. It is therefore difficult to make inferences from the existing literature on the likely effectiveness of multi-bi aid in the African Development Bank.

2. The Bank's financing and governance

2.1 Overview

The Bank was founded on 10 September 1964 by 23 founding member states with an initial authorised capital of $250 million. Over time, it has evolved to have shareholders from 80 countries and capital of $208 billion (AfDB, 2019c). In 1972, the Bank and 13 non-regional countries established the African Development Fund, a concessional window for low-income countries with $327 million of funding in the first cycle, and in 1976 the government of Nigeria and the Bank established the Nigeria Trust Fund. As well as growing its membership and increasing its capital base, the Bank has been instrumental in the establishment and promotion of other African development institutions such as the Africa Reinsurance Corporation, the African Business Round Table, the African Export–Import Bank and the Network for Environment and Sustainable Development in Africa.

The Bank is headquartered in Abidjan, Ivory Coast, and in 2020 had a physical presence in 39 regional member countries across Africa, and regional research and resource centres that service member countries. From February 2003 until late 2013, the Bank operated from its Temporary Relocation Agency in Tunis, Tunisia, due to the prevailing political conflict in Ivory Coast, before returning to its headquarters in Abidjan.

The objective of the Bank is to catalyse sustainable economic development and social progress in Africa, and in turn contribute to poverty reduction (AfDB, 2019g). It aims to achieve this objective by mobilising and allocating capital for investment in regional member countries and providing technical assistance and policy advice. It is committed to the pursuit of the Sustainable Development Goals set out in 2015 (AfDB, 2019g) and has a ten-year strategy (2013-2022) that has the dual objectives of inclusive growth and transition to green growth (AfDB, 2013a).

The Bank comprises three entities, the African Development Bank (AfDB), the African Development Fund (ADF), and the Nigeria Trust Fund. The AfDB is the non-concessional arm of the Bank. Using its AAA credit rating, it borrows from financial markets to provide loans to eligible countries on terms that are more favourable than countries could access from markets on their own. The ADF is the concessional financing window of the Bank and provides concessional loans, grants, guarantees and technical assistance to eligible countries. From 2014 to 2018, the Bank approved $45.39 billion with $32.68 billion (72%) approved by the AfDB and $8.22 billion (18%) in concessional ADF funding (AfDB, 2018a). The remainder was approved through trust funds.

2.2 How the Bank is financed

In this sub-section, we explain how capital committed by shareholders allows the AfDB to issue bonds and derivatives, and in turn retain earnings. We then explain how the ADF is funded through regular replenishments from donors.

The central feature of the AfDB's funding is that it relies on the commitments of shareholder capital. States renew their membership of the AfDB by pledging money to the organisation that is held as capital. By holding capital, the AfDB is able to borrow money from international markets to help fund projects. Due to the sizeable amount of capital provided and the high credit ratings of non-regional members, the AfDB has a low risk of default, and therefore the lending rates offered are as low as those offered to developed countries. Of this capital, a small portion is actually paid in, with the majority being callable capital that the Bank can demand from its donors if it suddenly requires liquidity to pay back bonds. The majority of multilateral development banks (MDBs) now do not use paid-in capital for loans and keep it as reserves to improve their financial standing (Nelson, 2018). To date, no MDB has ever had to draw on its callable capital, however, this capital is periodically increased through general capital increases (GCI) where the Bank leverages voting power to donors to increase its capital and expand lending. The AfDB agreed a GCI with member states in 2010 (GCI 6) for $93 billion, and in November 2019 this was more than doubled to $208 billion (GCI 7), an increase of almost $115 billion – the largest in the Bank's history (AfDB, 2019c).

The main financing mechanism for the AfDB is through the issuance of bonds. The Bank makes use of its capital by raising resources through bond issuances and liabilities. Using its capital, the Bank is able to leverage funds from investors, which are then used either for projects or to meet its liquidity requirements. Using the capital adequacy framework approved by the board of directors, the Bank ensures that leverage is cost-effective across financial markets (AfDB, 2019b). MDBs raise most of their money on international capital markets, and to do so, require ratings from the 'Big Three' credit rating agencies – S&P Global Ratings, Fitch Ratings and Moody's.

These agencies use letter designations as a financial indicator to assess the credit worthiness of the institution's debt. Rating agencies assign a letter grade to each bond, which represents an opinion as to the likelihood that the organisation will be able to repay both the principal and interest as they become due. The highest rating is AAA, or equivalent, and rating agencies will award this rating only when the institution's capacity to meet its financial commitments is extremely strong (S&P Global Ratings, 2019). All major MDBs have a mandate to maintain a AAA bond rating because of the benefits that this rating confers, and as of January 2020 the Bank, the Asian Infrastructure Investment Bank (AIIB), the Asian Development Bank (ADB), the European Bank for Reconstruction and Development (EBRD), the European Investment Bank, the Inter-American Development Bank (IADB), the Islamic Development Bank and the International Bank for Reconstruction and Development all have AAA credit ratings. The Bank came close to collapse in the mid-1990s due to poor management and a loss of confidence from both borrowers and donors. In 1995, the Bank became the first international financial institution to lose its AAA credit rating (IDC, 2008) and did not regain it until 2003 (AfDB, 2015). As of July 2020, the Bank has the highest rating from 'the Big Three'.

The Bank is also funded by the earnings it retains (profits). The Bank has made a profit each year of operation, with 2018 income before transfers amounting to UA 124.68 million.[6] These profits are not shared out as dividends to donors. They are first used to replenish reserves, and are then allocated to commitments and conditional undertakings, a surplus account, or distributed to key initiatives (AfDB, 2019 - Information Sheet, 2019b).

The Bank also optimises the use of its capital using balance sheet operations managed by its treasury department. For example, the Bank engaged in an asset swap with other MDBs to exchange African assets that they had originated for assets from other regions, using structured financing. The result increased the diversification of the portfolio, thus reducing the capital that they require to hold against it. This then allowed capital to be released to support further new lending. This type of financial structuring is important in ensuring that the capital available is used efficiently.

The Bank's concessional window is regularly replenished by donor contributions and in 2017, the ADF completed the 14th replenishment in the amount of £4.41 billion. Of this, £3.48 billion was contributed by non-regional members, and the UK was the largest contributor (10.7%). DFID funds replenishments due to the Bank's comparative advantage and good track record delivering large-scale investments in infrastructure, roads and energy. The 15th, and most recent, replenishment occurred at the end of 2019 and saw a rise of 33% to £5.87 billion (AfDB, 2019c).

2.3 Financial instruments

The Bank's regional member countries are divided into five regional groups, for each of which a director general is responsible. It is the **smallest of the major regional development banks** in terms of lending volume, with total finance approved in 2018 of £7.79 billion (AfDB, 2018a). The Bank has a broad range of financial instruments: loans (both sovereign and non-sovereign guaranteed), grants, lines of credit, technical assistance, guarantees and equity (AfDB, 2019f). Aside from private-sector development loans, all loans are made to, or guaranteed by, regional member countries.

The Bank's non-concessional loans are provided as either **sovereign-guaranteed loans (SGLs) or non-sovereign-guaranteed loans (NSGLs)**. SGLs are loans provided to member countries or public-sector entities that are guaranteed by the regional member countries in whose territory the borrower resides. NSGLs are made to public-sector entities that do not require a sovereign guarantee, or to private-sector enterprises (AfDB, 2018b). The difference between these is centred on where the Bank is providing support, as riskier, more volatile and weaker economic markets will often require sovereign-guaranteed loans to ensure the Bank's risk is adequately covered. This is reflected in the nature of the loans, as SGLs provide less aggressive and more flexible repayment methods.

Sovereign-guaranteed loans are provided through the Fully Flexible Loan (FFL). The FFL embeds certain risk management features into the loan to lower the chance of defaulting. Borrowers are, at any time, able to convert the currency of the debt into another bank-approved currency, convert the base interest rate for disbursed and outstanding loan balances, and establish interest rate caps or collars for balances. **Non-sovereign loans** are provided through fixed-spread loans (FSLs). FSLs comprise a fixed base rate plus a risk-based spread, or a floating base rate plus a risk-based spread. The repayment periods are 15 years and their grace period cannot exceed five years (AfDB, 2018b).

[6] African Development financial figures are reported in UA millions (a special currency which is the value of a basket of other African currencies). We use 1:1.38 as a conversion ratio from UA to USD. This was the average exchange rate between the two currencies from 2014-present.

Grants are provided through special funds and trust funds. Donors input money into these funds that are to be provided directly to borrower countries for projects and not leveraged as loans. These funds are separate from the Bank's capital in that the money is provided to be used for specific circumstances and in specific thematic sectors (AfDB, 2018b).

Lines of credit support the development of small and medium-sized enterprises (SMEs). The Bank offers lines of credit for private finance initiatives for on-lending to SMEs. The terms specify the conditions under which Bank funds will be provided to the private finance initiative. These resources are also made available under agency arrangements with financial intermediaries (AfDB, 2018b).

Technical assistance grants, provided through the Technical Assistance Fund, are financial support given to regional member countries to improve capacity and financial management. Due to capacity problems and poor financial management practices, certain regional member countries are unable to apply for the right source of financing from both the Bank and private-sector lenders. Through this specific fund, the Bank is able to provide the support regional member countries need to lower transaction costs and be more attractive to foreign direct investments (AfDB, 2019b).

Guarantees enable eligible borrowers to make use of the Bank's status as a preferred creditor to borrow from private lenders and capital markets at more generous rates than would otherwise be available to them. Guarantees are either partial credit guarantees (PCGs) or partial risk guarantees (PRGs). PCGs cover a portion of scheduled repayments against all risks, ensuring the lender recoups some of the debt regardless of potential risks. PRGs protect private lenders against well-defined political risks that lead to failures of a government or public entity to meet contractual obligations.

The Bank invests in **equities**, either directly or indirectly. The aim of the investments is to promote the development of the regional member country the Bank is investing in and, specifically, the private sector in that country. The hope is that in doing so, it will promote African participation and be a catalyst for further investment from other actors and lenders. Total equity investment should not exceed 15% of the aggregate amount of the Bank's paid-in capital, reserves and surplus.

2.4 Governance of the Bank

The Bank is staffed by international civil servants and supervised by a board of governors, a board of executive directors and a president. The board of governors is the highest decision-making body and consists of one governor for each member country. There are 54 regional and 26 non-regional members, and the large total number of shareholders (80) is more than that of the next largest regional banks; the EBRD and the Asian Development Bank, both with 67 shareholders. Each governor represents their country and exercises a voting power proportionate to the capital subscription of their country. The governors delegate day-to-day authority over operational policy, lending and other business matters to the board of executive directors (Collinson, Gardner & Morris, 2019). The Bank's board comprises 20 executive directors representing the 80 shareholders. Smaller shareholders agree to share their executive directors through informal negotiations, based on the size of the shareholdings. The UK, due to its smaller shareholding, currently shares a constituency with Italy and the Netherlands, and only holds the executive director's position for five years in every 12-year period. As of June 2020, the current executive director on the Bank's board is British, represents the UK and has been in post since August 2019. The president of the Bank is responsible for the overall management of the institution and serves as the chair of the board of directors.

Unlike the International Finance Corporation, the AfDB has a **dispersed ownership structure** and the top shareholders are Nigeria (8.5%), the United States (6.6%), Egypt (5.6%), Japan (5.5%) and

South Africa (5.1%) (AfDB, 2019e). Of all the MDBs, the AfDB's top five shareholders have the second lowest share of total votes (approximately 30% in 2017) and only the International Fund for Agricultural Development has a more dispersed ownership structure than the AfDB (Engen & Prizzon, 2018).

Among the World Bank and five regional development banks (IADB, ADB, AfDB, EBRD and AIIB), the Bank is the only MDB where borrowers have 51% or more of the voting share (Birdsall, 2018). The same author argues that the Bank stands out as the one where governance arrangements, including the distribution of shares and votes between borrowers and non-borrowers, mostly favour borrowers. Although this structure may be preferred by member countries, Birdsall argues that the Bank's governance arrangements make it less competitive than other similar MDBs in sustaining the confidence of creditors. Using a number of financial indicators (creditworthiness based on sovereign members' vote shares and a measure of the capacity of each bank's member to engage in collective action or cooperation in raising financing), Birdsall argues that this lack of confidence in turn hinders the Bank's ability in the long run to raise substantial capital and concessional resources.

After interviewing staff at four MDBs, including the African Development Bank, Humphrey (2017a, p.13) argues that although the S&P methodology for assessing credit risk has an "explicit bias in favour of non-borrower-led MDBs", the overwhelming attention of MDB staff was paid to three other factors that affect the credit rating of their MDB. These are:

- concentration risk inherent in MDB portfolios
- preferred creditor treatment granted by borrowers to MDBs
- callable capital committed by shareholders to MDBs.

These three elements of the methodology have resulted in "substantial restrictions for MDBs, limiting their ability to pursue the development goals set by their government shareholder principles" (Humphrey, 2017a, p.25).

3. Geography and sector focus of the Bank

The Bank has both a geographic and sectoral approach in its support of member states. This reflects the need to respond to the specific requirements of its regional members while at the same time identifying commonalities across countries, whether geographic or sectoral, that can benefit individual members and facilitate effective and efficient delivery by the Bank.

3.1 Geography

The Bank's regional member countries are divided into five regional groups (North, South, East, West, Central), each of which is responsible to a director general. The Bank's portfolio is dominated by non-concessional lending. Countries that have received the largest amounts of lending since 2014 are Nigeria with $2.98 billion (11.7% of the total lending), Morocco with $2.14 billion (8.4%), Tunisia with $1.79 billion (7%), Egypt with $1.77 billion (6.9%) and Angola with $1.65 billion (6.5%).[7]

Most decisions taken by the AfDB board of directors, including lending decisions, are made by consensus. The AfDB, like other banks such as the World Bank, has increasingly moved towards setting conditions or triggers for disbursement to a country according to the achievement of prior policies and institutions. This also includes withholding funds from countries until they change their

[7] Figures from AfDB Data portal, link. Author's calculations. Figures exclude multi-country funding.

policies in line with these benchmarks. In the case of the Bank, approximately 62% of ADF resources are channelled to eligible countries through a performance-based allocation framework, whose main determinants are country performance and need. Country performance comprises governance, economic, structural and social policies, and portfolio performance, whereas need is a function of population size, per capita income, and quality of infrastructure (AfDB, 2013a). The Bank is therefore selective on both governance and need. Performance-based aid can push alignment of country policies with donor priorities and this can have significant ramifications for Africa. The argument has been made that if they are to be equal partners at the table, African countries must have a greater voice in aid allocation (Kararach et al., 2016).

The Economist (2015) argues that the geographic focus of Bank operations (large, creditworthy countries) is too conservative, and that although it made sense when the Bank was trying to restore its credit rating (from 1995-2003), it should concentrate more on filling gaps left by private investors. Bhattacharya et al (2018) argue that multilateral development banks (MDBs), such as the Bank, should do more in fragile states and in high-debt countries. They argue that MDBs should also expand their current geographic focus to include more projects in upper middle-income countries.

The Overseas Development Institute carried out a study for the Transition Support Facility and proposed seven recommendations on how to further support Bank operations in fragile states (AfDB, 2016b). It is argued that it is also necessary for MDBs to elevate their work above individual projects and instead focus on national packages of investments (Humphrey, 2018b).

3.2 Sector focus

The five main priorities the Bank has focused on to deliver its mandate are known as the High 5 and are: Light up and power Africa (energy sector), Industrialise Africa (finance and transport sectors), Integrate Africa (cross-border energy and transport sectors), Feed Africa (agriculture and regional infrastructure sectors) and Improve the quality of life for the people of Africa (jobs, social sectors and WASH). In addition, the Bank has identified three special areas of emphasis: fragile states, agriculture and food security, and gender (AfDB, 2013b). The Bank recognises that in these sectors it has the "greatest comparative advantage and proven track record" (AfDB, 2013a, p.2).

There is a broad consensus that infrastructure is a priority in Africa.[8] The Bank estimates that infrastructure services for water and energy in Africa cost twice as much as other developing regions (UNECA, 2017). Africa has the highest share of electricity output from generators in the world at 9% of annual electricity consumption, more than four times the output of South Asia at second place with 2% (IFC, 2019). Infrastructure disruptions are a drag on people and economies (World Bank, 2019), and the need for improved infrastructure is both pressing (Blimpo & Cosgrove-Davies, 2019) and an investment opportunity (Jesse & Madden, 2019). Not only will improvements in infrastructure improve access to networks and services, but employment multipliers are usually quite large, especially in developing countries and in the power sector specifically (IFC, 2013, p.69). For example, the vibrant and growing technology sector in Nigeria, a key opportunity for economic growth and job creation, is hampered by unreliable electricity (Ramachandran et al., 2019). Tyson (2018), has compiled an overview of the current state of global infrastructure financing, its challenges and how to address them.

The Bank's focus on infrastructure is consistent with this need, and **close to 50% of its disbursements in 2018 were in economic infrastructure**, with transport at 25.1% and energy at

[8] See for example: ODI (2020), link; World Bank (2017), link.

21.8%.[9] Africa is technically the largest free trade area in the world but there are still key barriers to intra-regional trade (Patel, 2019; Gandhi, 2019). The focus on transport is therefore reasonable.

The Bank faces the significant challenge of mission creep. Authors, such as Runde (2019), have argued that the High 5 should be more precisely focused. It is unclear whether the increased focus of the Bank on infrastructure and associated capacity building in recent years will address these criticisms.

4. Relative effectiveness of the Bank versus other institutions

Reviews of the Bank

The Bank carries out internal evaluations of each capital increase, demonstrating its ability to deliver on the commitments of each increase (AfDB, 2015). An external review of the replenishment decisions of 2016 (including that of the African Development Fund) were reviewed by Manning (2017). The UK reviewed support to the Bank at the International Development Committee's hearing in 2008 (IDC, 2008). The committee report noted that the doubling of funding to the Bank showed it was implementing critical reforms that would drive development in line with the priorities of the Department for International Development (DFID). It recommended reconfiguring the board structure to enable DFID's leverage to be commensurate with its increased contribution, before concluding that the Bank has the potential to be a regional leader that DFID must continue to support. It also highlighted that the Bank's contribution to achieving the Millennium Development Goals "goes far beyond its direct expenditure of development resources to encompass its role as a bank for Africa and a collective voice for development on the continent" (IDC, 2008, p.3).

Similarly, ICAI's review of DFID's work through multilaterals was published in 2015 (ICAI, 2015). The overall findings of this review were that DFID has significant influence in the multilateral system and has used this leverage to promote reform, especially on impact and value for money. However, it also found that DFID lacked a clear strategy for its engagement with multilaterals and that its focus on improving agencies' organisational effectiveness and value for money was often at the expense of higher-level strategy. We made the following recommendations:

1. DFID should have a strategy for its engagement with the multilateral system as a whole at global level.
2. DFID needs clear objectives for its work with the multilateral system in its country-level strategies.
3. DFID should address the low proportion and limited seniority of its core staff resources devoted to managing its relationships with multilateral agencies.
4. DFID should continue to press for greater transparency and accountability of multilaterals.
5. DFID should promote more integrated working among multilateral institutions at country level.
6. DFID should work more collaboratively with other bilateral donors in its engagement with multilateral agencies.
7. DFID should communicate more effectively to taxpayers about the role, impact and importance of multilaterals.

Multilateral aid reviews (MARs), or multilateral development reviews, by donors from the Organisation for Economic Co-operation and Development's (OECD) Development Assistance

[9] In line with its mandate, less than 20% was dedicated to social sectors (education, WASH and health).

Committee were first started by the UK in 2010, and have since occurred in Australia (2012), Denmark (2013), Norway (2014), the Netherlands (2015) and again in the UK in 2016. Each country matched their own analyses with other inputs to create assessments of the individual multilateral institutions they fund. They do this with the intention of updating their own aid investments and adopt a data-driven approach. The assessments then become public goods to enhance learning in the assessed multilateral institutions and organisations as well. The results show how the work of these institutions can overlap with various foreign policy interests and drive results in development. The MARs collect evidence through surveys, consultations, interviews and documentary review to create a statistical foundation for analysing results and match investment priorities among donors. These MARs do not emphasise how well each multilateral actually delivers the expected benefits, but they focus instead more on their capacities. Furthermore, they do not reflect how well the system works as a whole to create maximum impact.

In DFID's 2016 Multilateral Aid Review, the Bank scored a 'good' rating regarding both its organisational strength and the extent of its alignment with UK development objectives. In comparison to the other five multilateral development banks (MDBs) DFID analysed, the Bank scored higher regarding contribution to UK international development objectives than the Inter-American Development Bank and the European Bank for Reconstruction and Development, was on par with the Asian Development Bank, and lower than the World Bank. However, it had the lowest organisational strength score among the MDBs analysed by DFID (DFID, 2016).

The Multilateral Organisation Performance Assessment Network (MOPAN), a network of 18 countries whose secretariat is hosted by the OECD, has been systematically undertaking assessments and updating its methodology since 2003. Its current methodology is a "serious attempt to provide a systematic and data-driven approach to assess the organizational strength and performance of selected multilateral organizations" (Pipa, Seidel & Conroy, 2018, p.5). The strengths of MOPAN are its focus on evidence-based and data-driven analysis to inform policy, which helps standardise a way to measure the delivery of objectives and policy value, and it can provide a useful foundation for a country's own MAR. The USA has not performed a MAR before and, therefore, Pipa, Seidel and Conroy (2018) used the results of these other organisational reviews of multilateral support to assess the strength of knowledge about the relevance and effectiveness of multilaterals to US interests. These multilateral aid reviews are data tools to improve results, and can enable healthy competition to achieve top scores, ultimately benefiting development goals. They found that the Bank and the World Bank are the only two multilaterals that perform in the top quartile for all three multilateral aid reviews performed. The comparison shows a fair amount of similarity at the top.

As well as multilateral aid reviews, the quality of official development assistance (QUODA) is an alternative for examining the relative effectiveness of the Bank in comparison to other international agencies and bilateral official development assistance (ODA). This index, developed by the Center for Global Development and the Brookings Institution, calculates indicators of aid effectiveness based on the principles of aid effectiveness agreed in the Paris Declaration on Aid Effectiveness (2005), the Accra Agenda for Action (OECD, 2008) and the Busan Partnership agreement (OECD, 2012). These indicators are largely based on the monitoring data of the Global Partnership for Effective Development Co-operation (GPE, 2019) and are grouped into four themes: maximising efficiency, fostering institutions, reducing burdens, and transparency and learning (Mitchell & McKee, 2018). The indicators are collated and compared across donors, including bilateral aid of donor countries and multilateral agencies. The QUODA index places the African Development Fund as the third best performing entity with UK bilateral aid ranking 24th.

In 2012, the Future of the International Development Association (IDA) Working Group forecast that by 2025 more than 80% of remaining IDA recipients would be African and that 18 out of 31 fragile or post-conflict states would be in Africa (Manning, 2017). Given that the concentration of countries most in need of ODA are in Africa, the overlap of the Bank and World Bank activities in Africa, and the reviews of the multilateral system (such as the US MAR and QUODA), Birdsall et al (2016) make the point that it is surprising that the Bank does not receive more funding compared with the World Bank. They argue that it receives too little funding and recommend (Recommendation 3) that shareholders should commit to maintaining current levels of concessional support across all MDBs, and given the expected concentration of poor countries in sub-Saharan Africa, that there should be a shift in concessional financing from the World Bank to the Bank over the 2016-26 period.

5. Debates on the Bank

In this section, we explore existing debates on the Bank that are relevant to our review questions under the following headings: Financial innovation, Graduation models, Private finance mobilisation, Value for money and Coordination.

5.1 Financial innovation

The Bank is looking to find innovative ways to boost investment. There has been a long-standing plan to attract additional investment from emerging economies and from new funders and donors, as well as to use existing instruments better (Humphrey & Prizzon, 2014). The plan highlights the need to stay relevant and become more decentralised, integrated, efficient, effective and result-oriented, measuring its progress by real improvements on the ground (AfDB, 2013a).

Humphrey (2017b) argues that if the Bank's capital adequacy were to be reformed and the Bank pushed ahead with balance sheet mergers, then this would reap substantial gains in financial capacity as well as boost net income.

Securitisation is another option that some, such as Humphrey (2018a), see as a great first step towards scaling up multilateral lending. Others disagree, such as Critical Finance (2019), arguing that projects like the Bank's recent Room2Run securitisation "asks poor countries to use scarce fiscal resources and/or official aid to 'de-risk' bankable projects, by for instance providing guarantees/subsidies for demand risk or political risk" (AfDB, 2018c), and that "poor countries may easily be pressured to keep up de-risking payments or guarantees, even if it means cutting essential social spending" (Critical Finance, 2019).

Another way for the Bank to be more innovative is highlighted by Jones (2011) who argues that the Bank should attempt to bridge the gap between research and development policy by furthering its status as an African 'knowledge broker'. He advises that the Bank needs to place itself as a market for innovative ideas, but recognises that the internal research capacity of the Bank is not extensive enough to address all key knowledge gaps in Africa's development.

5.2 Graduation models

Classic graduation models

In much of official finance culture there is the idea that, as developing countries grow richer and so are more able to access and afford non-concessional finance, they should graduate from concessional to non-concessional finance and assistance (Prizzon et al., 2017, p.27). This can be framed as a transition from softer concessional windows of a multilateral development bank (MDB) to harder (non-concessional) windows. Soft funds are an opportunity to increase the effectiveness and efficiency of scarce donor-supplied capital. This dualistic framing of graduation is particularly apparent in the Bank compared to its peers (Prizzon et al., 2017). One risk of this type of model is that as countries cross the income threshold of the concessional window, this triggers a fuller graduation process in the MDB, and overall external support is withdrawn too quickly from recent graduates before their own fiscal resources can bridge the gap (Rogerson, Prizzon & Kharas, 2014).

Previously, it was desirable for the Bank to design incentives for countries to graduate out of the different windows because the terms and conditions for financing through the African Development Fund (ADF) compared to the African Development Bank (AfDB) presented the overall group with challenges (Okeahalam & Murinde, 2004). However, more recently, the opposite challenge that the AfDB window could lose its relevance to middle-income country members, and lose its viability as an institution, has been more evident. If the market-based operations face difficulties and members do not borrow, this threatens to undermine the financial solidity and developmental relevance of the Bank as a whole (Humphrey, 2014).

Innovations in graduation models

An alternative to this dual model is termed by Rogerson and Kharas (2017) as gradation and allows for a decline in grant-equivalent aid as countries grow wealthier. It also permits different aid allocations depending on the country's position (Rogerson, Prizzon & Kharas, 2014). In line with Angel Gurria and Volcker (2011), graduation should be voluntary and coupled with incentives to avoid prolonged dependence. A policy that ties borrowing costs to per capita income would ensure that richer countries receive smaller subsidies, although, because this would negatively affect richer borrowing countries, it would not be welcomed by upper middle-income countries (Birdsall, 2017).

In a closely related discussion on options for the Asian Development Bank (ADB), Prizzon, Mustapha and Rogerson (2016) present ideas for the design of improved graduation policies. They argue that a policy on graduation from regular assistance should be in place and this ultimately decreases discretionary political decisions, uses rare resources efficiently and helps measure future resource allocations. The graduation policy should include all three criteria: gross national income per capita above a threshold, availability of commercial capital at reasonable costs and attainment of a certain socioeconomic level. New approaches to lending and eligibility should also be considered to reflect the new circumstances of developing countries and the ADB's capacity to mobilise resources. Other possible approaches to lending and eligibility for the ADB include:

- MDBs should offer differentiated pricing for each developing member country.
- Non-sovereign lending operations should not cease after graduation from sovereign lending.
- There is scope to formalise a small island exception or a small economy exception in the graduation policy.
- An exception can be granted to projects supporting regional integration and cooperation that have positive externalities and spill over effects, independently of eligibility for regular ADB lending.

5.3 Private finance mobilisation

Multilateral development banks

A key concept when using taxpayer money to fund official development assistance is that of additionality. The idea is that the actions of multilateral development banks must be additional to those of the private sector. Recently, a group of the multilateral development banks developed a harmonised framework for understanding additionality in private-sector operations (AfDB et al, 2018). In a similar vein, Kenny (2019a) outlines the principles of using aid for subsidies to the private sector.

Benn, Sangare and Hos (2016) make the following distinctions between catalysing and mobilising additional finance.

1. **Catalyse** refers to actions aimed at stimulating positive change. The result of such actions may be financial (funds mobilised) or non-financial, such as the transfer of knowledge, sharing of new practices, or introduction of a policy.
2. **Mobilise** and **leverage** are used to refer to the ways in which specific mechanisms stimulate the allocation of additional financial resources to particular objectives. Leverage is usually associated with a quantitative indicator such as a leverage ratio, while mobilise refers to a causal link between private finance made available for a specific project and the official flows that were used to incentivise them.

A core concept related to the additionality of aid is that of **blended finance**, where public-sector development finance is used to leverage additional private investment in a bid to generate economic growth and create jobs, thus lifting people out of poverty (Attridge & Engen, 2019). The mobilisation of private finance for development has now become synonymous with the notion of 'billions to trillions' (World Bank, 2015), and there is agreement that there is a key role for MDBs to play in this agenda (Lee, 2017; Blended Finance Taskforce, 2018).

Despite the large number of instruments that MDBs have at their disposal, Benn, Sangare and Hos (2016) found that only $80 billion of private capital was mobilised over four years, and this was mostly using guarantees in middle-income countries (Bhattacharya et al., 2018). Against this disappointing track record of mobilisation, Bhattacharya et al (2018) go on to argue that each dollar of paid-in capital could reasonably translate into $50 of public investments, if properly allocated.

On the other hand, as Kenny (2019b) argues, there are signifcant challenges to development finance institutions achieving their ambitions. Kenny (2019b) presents evidence that private overseas investment in Sustainable Development Goal priority areas is low in the poorest countries, and that **most investment flows to middle-income countries**. For example, in 2017, low-income countries accounted for $3 billion out of $93 billion in infrastructure projects with private participation. Kenny goes on to state that a lack of investment is partly due to a lack of projects that are financially viable. Development finance institutions invest more than the private sector as a whole in low-income countries, but the total proportion in these countries is still small. For example, in 2016, only 2.6% of the International Finance Corporation's (IFC) total investments were in listed investment companies (Kenny & Ramachandran, 2018).

In this context, it is perhaps not surprising that the **combined leverage ratios of development finance institutions (DFIs) and MDBs are so low (1:0.37) in low-income countries** (Attridge & Engen, 2019). DFIs and donors have tried to improve deal flow but, for example, in the case of the IFC, these attempts have not markedly increased the number of bankable projects (Independent Evaluation Group, 2019). Kenny (2019b, p.12) concludes that the 'billions to trillions' agenda was based on the "faulty premise that DFIs and multilateral development banks could be a major force behind aggregate private investment decisions when they are only one factor amongst many in terms of investment flows".

Not only have MDBs failed to mobilise private finance at the rates they could, it is questionable whether financing in middle-income countries in sectors that are attractive to investors (such as financial services and telecommunications) is an appropriate use of additional taxpayer funds. Tyson and Beck (2018) argue that international financial institutions need to reorient their mandates to focus on work that brings significant and unique value. Their suggestion of such activities include: early-stage project planning and development, partnering with private investors to help them navigate complex governance and regulatory frameworks, making a positive contribution to the broader investment environment, providing financing, and partnering with private firms and governments to bring projects to the operational phase.

The Bank

A context-specific approach is required to assess the Bank's private finance mobilisation. The largest destination sector for blended investment is infrastructure because of its popularity with international investors (Attridge & Engen, 2019). This makes it particularly relevant for the Bank, which focuses on infrastructure investments (Humphrey, 2018b). However, it is also active in sub-Saharan Africa, which is a more difficult investment environment than other regions such as Asia and Latin America.

Against this context, the Bank mobilisation ratio (total direct and indirect co-financing vs own operations) is currently 1:0.2 – one of the lowest among MDBs (Tyson, 2018, p.15). For example, the private-sector windows of the World Bank (the International Finance Corporation and the Multilateral Investment Guarantee Agency) have a leverage ratio of 1:0.6. However, it remains necessary to adjust the comparison to the region, and so the best comparison (as not all MDBs publish Africa-specific figures) is to look at leverage ratios for low-income countries because of the strong overlap with sub-Saharan Africa. Here, the Bank's performance is poorer than the comparators. For example, the Bank has mobilised less private finance than any other regional development bank, including the Inter-American Development Bank, the European Bank for Reconstruction and Development, and the Asian Development Bank (Benn et al., 2017; World Bank, 2017). Furthermore, between 2012 and 2015 the Bank mobilised less private finance in low-income countries than bilateral development finance institutions from France, the US, Norway, and the Netherlands, although it did outperform those from Sweden, Denmark, the UK, and Germany (Attridge & Engen, 2019, p.42).

5.4 Value for money: decentralisation and internal reforms

As part of the recognition that the task at hand greatly outweighs the available resources, the Bank has recognised it needs to reform its internal processes to be as efficient as possible. The Bank must become more "flexible, responsive and results focused" (AfDB, 2013a, p.26). The goals are to align the Bank's operations more closely to the needs and systems of its regional member countries, promote deeper policy and sector dialogue, develop new business opportunities, improve donor coordination, enhance the efficiency and effectiveness of its interventions, and enhance impact in the countries in which the Bank intervenes.

As part of the Bank's attempts to maximise resources and efficiency, it introduced the Development and Business Delivery Model (DBDM) in April 2016 (AfDB, 2016). The DBDM's role is to maximise the Bank's achievements and reposition the institution for greater effectiveness and efficiency to deliver the High 5 priorities and the Sustainable Development Goals. The DBDM is intended to transform the Bank as an institution by:

- concentrating and scaling up resources behind the High 5 priorities, to accelerate Africa's transformation
- moving operations closer to clients through a new regional delivery model
- reconfiguring the headquarters to support the regions to deliver better outcomes
- attracting and retaining the right staff, and creating a stronger performance culture
- streamlining business processes to promote efficiency and effectiveness
- improving financial performance and enhancing income

- increasing development impact for all Africans.[10]

These overarching objectives to improve operational effectiveness and organisational efficiency are at the core of each of the eight value for money themes jointly identified by multilateral development banks (MDBs, 2019). A key component of these objectives aims to address the over-concentration of the Bank's resources in its headquarters, with the attendant negative impact on its development abilities. Related to the challenge of decentralisation is the Bank's goal of greater use of country systems (McKechnie, 2016).

The recognition of this over-concentration in the headquarters as a problem was confirmed in Bank client surveys, which showed a preference for decentralisation, as it brings better understanding of local conditions, faster access to those responsible for decisions at country level, and improved overall responsiveness (AfDB, Decentralisation Roadmap 2011-2015, 2011). This position is supported by McKechnie, who argues that if MDBs are to fulfil their important role in fragile and conflict-affected countries, then they must be further decentralised (McKechnie, 2016).

Another key focus of DBDM is operational efficiency. Nkamleu, Tourino and Edwin (2011) present an in-depth analysis of the drivers of delayed disbursement at the Bank. Their analysis reveals that long gestation periods and delays at start-up are common in agricultural sector projects and are a potential bottleneck. Almost half of the time, delays are due to the delay between commitments and the loan coming into effect.

The Bank is also closely focused on economic growth through international and regional trade. A key UK government and DFID policy goal includes the development of regional trade. The Bank is supporting trade more generally, including indirectly through infrastructure and directly through development of special economic zones as part of the Industrialise Africa development priority, as well as through the focus on regional integration. The latter is being led in partnership with the African Union and its 2019 Continental Free Trade Area, which will create a single market for goods and services, with growth in regional trade being seen as a key strategic opportunity for economic growth throughout the region (African Union, 2019).

The decentralisation plan has been updated to tie it to the DBDM. The Bank has recognised that decentralisation confronts a number of constraints. While they are aiming to provide field offices with more responsibilities over country projects, staffing problems remain. Many offices do not have the right number of staff members, or lack the skills required. The slow pace of staff deployment has been attributed to two problems. First, staff are unwilling to move away from the headquarters due to the perception that it will negatively affect their career path. Second, key departments like energy, climate change and private sector development have been reluctant to decentralise further (AfDB, 2016).

There is a $1 trillion per year financing gap in developing-country infrastructure investment and $100 trillion in institutional investor resources that is currently unused. Humphrey (2018b) argues that multilateral banks could solve this problem by leveraging their reputation and financial stability to help mitigate risks usually associated with development finance which often deter investors from financing needed infrastructure projects. To achieve this, changes are needed in MDBs, including strengthening their staff's understanding of, and engagement with, the private sector (Humphrey, 2018b).

The G20 (2018) has made a number of proposals on general MDB reform that are relevant to the Bank:

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[10] For further details on the AfDB's value for money performance, see *Multilateral Development Banks' Final Report on Value for Money*, AfDB, ADB, EBRD, EIB, EIF, IDB, World Bank, 2019, p. 73, link.

- refocus on governance capacity and human capital, as foundations for a stronger investment climate
- implement regional platforms to facilitate transformational cross-border investments and connectivity
- 'right-size' capital requirements for MDBs and other infrastructure investors, given their default experience
- strengthen joint capacity to tackle the challenges of the global commons
- plug shortfalls in data and research that hamper effective policymaking, especially in developing countries
- leverage more systematically on the ideas and operating networks of business alliances, non-governmental organisations and philanthropies.

5.5 Coordination

When MDBs operate in the same country as one another, there is the risk that their activities will duplicate each other, leading at best to wasted resources and at worst – to counter-productive inter-MDB competition (Bhattacharya et al., 2018). For example, each MDB has its own research department and independent evaluation office and each develops individual country strategies and assessment frameworks for development effectiveness. There is also emerging evidence of competition among MDBs on policy advice, pricing and financing modalities (Prizzon et al., 2017).

Compositionally, the regional development banks have grown to be commensurate in size and skills in relation to the regional departments of the World Bank Group (Bhattacharya et al., 2018) and often co-finance projects. For example, in 2018, the Bank amassed approximately $10.3 billion (UA 7.4 billion) in co-financing investments from multiple institutions, including the World Bank (Humphrey, 2018a).

To overcome some of these failures of coordination, a proposal for reform is to build effective country platforms to mobilise all development partners to unlock investments and maximise their contributions as a group, including by convergence around core standards. In particular, it is recommended that MDBs commit to engaging in implementation support of these country platforms (Berglof & Peters Jr, 2019).

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