The New Development Bank: Identifying Strategic and Operational Priorities

Overview

At the 2014 BRICS[1] Summit held in July 2014 in Fortaleza, Brazil, the heads of the member states signed an agreement establishing a New Development Bank (NDB) that will finance infrastructure and sustainable development projects. The NDB is designed to represent all five member nations: it is headquartered in Shanghai, the first President is from India, the first regional office is in Johannesburg, the inaugural Chairman of the Board of Governors, from Russia, and the first Chairman of the Board of Directors, from Brazil.

To aggregate diverse and informed perspectives on both strategic and operational aspects of the bank's functioning, the Observer Research Foundation (ORF) and the National Institute of Public Finance and Policy (NIPFP) organised an intra-BRICS Experts Workshop* on 18-19 June 2015 in New Delhi. The workshop was convened with the support of the Department of Multi-Lateral Economic Relations, Ministry of External Affairs, India, as part of India's support to the Russian Presidency of BRICS and the new leadership at the NDB.

The following suggestions are based on the most relevant inputs shared during the workshop. Many of the suggestions are also potential areas for further research.

Key Principles of the NDB

I. Both the purpose of, and the need for the NDB are intrinsically linked to the imperative of efficiently channelling global savings (estimated to be USD 17 trillion in 2012)[2] into infrastructure and sustainable development. It is worth noting that the share in global savings of the BRICS countries is now larger than that of the United States, Japan and the EU, combined. Given the location and availability of global savings, the NDB is expected to mainstream development financing. It is expected to encourage not only broader participation of institutional investors that are managing a large share of these savings but also more efficient financial intermediation.

II. The NDB should also be used as a platform for BRICS countries and their partners in the future to bridge the gap between the global discourse on development finance and that on reform of the International Financial Architecture. This can be achieved through a demonstration effect. Currently, the two issues are discussed separately among governments; the development financing conversation is situated in New York and Paris

[1]Brazil, Russia, India, China, South Africa

[2]International Monetary Fund (IMF), World Economic Outlook 2012 (Washington, D.C.); TheCityUK, Fund Management Report 2012 (London, November 2012)

whereas the conversation on recalibrating the International Financial Architecture is located in Washington, DC and Basel.

III. Specifically, despite a softening of official rhetoric, the Washington-Basel discourse continues to project fiscal orthodoxy. This is enforced by the dominant institutions of global finance including credit rating agencies and defines the *de facto* environment in which both public and private finance operates in most developing countries. An example of this is the focus on capital adequacy as exemplified by the Basel III Accord, which contradicts the need for credit enhancement in developing countries. Some examples of activities with high social returns which are questioned by the Basel model include rural development (particularly smallholder systems), urban infrastructure, sustainable energy, and bottom of the pyramid health and education delivery. A prominent example is also the Micro Small and Medium Enterprises (MSMEs) sector in India, in which only 33 to 34 percent of total firms have access to institutional finance.[3]

IV. As a direct result of a growing cleavage between the discourse on development finance and the evolution of the International Financial Architecture reform process, many financial institutions in the OECD economies have begun to exclude critical sectors from their financing mix. For instance, the Export Import Bank of the United States voted in 2013 to shift its funding out of coal plants. Such disruptive policy shifts are not new. But multilateral and bilateral institutions must take into account the domestic context of recipient economies when making policy. Denying developing countries the opportunity to transition from inefficient, coal-based power to cleaner, coal-based generation technologies is suboptimal in terms of sustainable development. Table 1 illustrates the systemic dependence of developing countries such as China and India on coal for primary energy.

Table 1: Primary Energy Consumption of Coal as % of Total Energy Consumption (2014)

Country	% of Total Energy Consumption
China	66%
India	56%
South Africa	71%
OECD	19%
Non-OECD	38%
World	30%

Source: BP Energy Outlook, 2015

V. An excessive focus on prudential norms by its members will not allow the NDB to fulfil its mandate as a catalyst for infrastructure and sustainable development financing. In

[3]The Associated Chambers of Commerce & Industry of India, http://assocham.org/newsdetail.php?id=4203

order to harness multiplier affects through a diversified financing portfolio, the ethos of the bank should be imaginative and not fiscally restrictive. It should be clear that this is not an advocacy of profligate spending. The Chinese Development Bank experience is instructive. After initial problems with repayments, it has achieved financial stability without reducing its developmental imprint. The Brazilian Development Bank (BNDES) has also offered concessionary finance in a sustainable fashion. Developmental finance needs to consider the social returns and devise prudential norms accordingly. This will require political support. The NDB's pool of funds will not be large enough to enable a development transition on its own. It will have to look to play the role of an exemplar in the evolving multilateral financing space by optimally leveraging mobilised resources.

VI. The NDB is well placed to harness the core competency available within BRICS countries, of being familiar with other emerging and developing countries. Moreover, the NDB may consider giving preference to developing countries other than those within the BRICS itself in terms of direction of project financing flows.

Means of Finance and Other Operational Aspects

VII. The NDB should ensure that important operational cost heads such as compliance, recovery and due diligence be minimised for maximising the efficiency of projects being undertaken. The International Development Association, part of the World Bank Group, alone incurred operational costs of around USD 1,612 million in 2014.[4] The balance between operational costs and the average size of projects will be critical in determining the operational efficiency of the NDB.

A suggestion for reducing operational costs is the adoption of the 'bank of banks' approach by partnering with local banking institutions and other development finance institutions (DFIs). An outcome of this approach would be risk sharing and therefore a dilution of the prudential concerns of NDB members.

VIII. The NDB has an inherent latecomer advantage in the landscape of multilateral development financing. New technologies such as internet finance and crowdfunding (used in Egypt where citizens have contributed over USD 8 billion towards the expansion of the Suez Canal[5]) can be used to leapfrog traditional modes of financial inclusion such as 'branch banking'. One specific suggestion that bridges both of these dimensions is for the NDB to issue bonds denominated in all five currencies, with averaged out interest rates and no intermediation fees.

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[4] International Development Association, Management's Discussion & Analysis and Financial Statements June 30th, 2014, http://www.worldbank.org/ida/articles-agreement/IDA_Financial_Statements_Jun_14.pdf

[5]Patch of Land, Crowdfunding the Suez Canal: A Byway of Opportunity",
https://patchofland.com/blog/growing-communities/2015/02/11/crowdfunding-suez-canal-byway-opportunity/

IX. In order to be considered a 'best in class' development bank, the staffing of the NDB should be based on merit and should in turn reflect 'best in class' recruitment practices. This, in turn, would mean that the NDB will need to institute democratised hiring practices and not restrict hiring to government officials and professionals from BRICS countries. Furthermore, connected to the operational efficiency imperative is also the need to keep the bank's staff to a minimum while simultaneously aiming at maximising the institutional footprint on the global development discourse. The World Bank Group, for instance, employs well over 10,000 staff and consultants with not much larger of a capitalisation than the NDB will have.[6]

X. The primary areas for the NDB's intervention should include energy, social infrastructure and basic services. Moreover, the NDB may consider a composite index measuring elements of the Sustainable Development Goals once they are finalised in order to benchmark disbursements and measure impact.

New Thinking and Knowledge Creation

XI. Public-Private Partnerships (PPPs) are premised on the imperative of private sector participation in critical investment areas where public financing may be less than adequate. However, for a number of reasons, PPPs are also becoming increasingly untenable for large projects in developing countries. For one, the private sector is unable to assess political risks and anticipate ground level implementation challenges.
Recent experiences of PPP in infrastructure projects in India are illustrative of such issues. Through NDB funding, the PPP model can potentially assume a significant role, although the modalities and interface with the state need to be carefully defined. For example, the NDB can direct financing into providing risk guarantees.

XII. The NDB will have to consistently strive to balance implementation efficiency and inclusiveness of ground-level stakeholders. In fact experts have suggested that, contrary to widely held notions, local stakeholder buy in and commercial viability of large projects is not negatively correlated.[7] An important question here is also how the NDB will receive and synthesise suggestions from within the BRICS Track II framework and civil society in general.

XIII. While resource mobilisation will be the key element of the NDB's functioning, it also has a pivotal role to play in terms of knowledge creation. While it can be nobody's case that the production of knowledge is a substitute for actual development interventions, the NDB should aim at shifting the premise of development discourse from that of generating consensus to promoting constructive debate over the most suitable model

[6] World Bank, Corporate Responsibility, https://crinfo.worldbank.org/wbcrinfo/node/19
[7] Strengthening Participation For Development Results, Asian Development Bank, 2012, http://www.adb.org/sites/default/files/institutional-document/33349/files/strengthening-participation-development-results.pdf

for development in specific sectors and geographies. The NDB therefore must become the nerve centre for knowledge production as well as the leader in the useful implementation of such knowledge. It should provide an avenue for the discussion and dissemination of alternative development alternatives by developing and emerging economies.

XIV. What is seen in many parts of the world is that 20th century knowledge on global finance and sustainable development knowledge is still relied upon heavily for development interventions. One of the key aspects of the NDB's knowledge creation should be to transition the development discourse towards 21st century solutions. This in turn would mean that the NDB would have to focus on niche yet key areas such as the digital economy and data generation on the informal economy. It would also have to regularly solicit inputs from civil society and the private sector as it begins to define its knowledge creation programmes and outputs. Moreover, knowledge outputs should be published in the languages of all member countries in order to achieve wider dissemination.

Disclaimer:

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