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Multilateral Development Banks' Governance and the new global challenges

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Abstract: The Board of Directors (BOD) of multilateral development banks (MDBs) differs significantly from private corporations' BODs. MDBs face governance challenges due to geopolitical tensions and the need to address global challenges. Unlike corporate BODs, MDB Executive Directors (EDs) have lower fiduciary duties and are appointed directly by shareholder countries, often representing national interests. MDB BODs are usually full-time and resident, sharing managerial responsibilities with Management, potentially reducing oversight effectiveness. MDBs also feature multicultural BODs, fostering diverse perspectives but complicating decision-making. MDBs are crucial for providing global public goods (GPGs) like climate change mitigation, but under-provision persists due to free riding. Proposals for reform of MDBs' governance include professionalizing BOD recruitment, transforming resident Boards to non-resident, appointing independent Directors, and enhancing member countries' power. These reforms aim to strengthen governance and address challenges posed by geopolitical tensions and the provision of GPGs. Without reform, MDB BODs risk losing power to Management and third parties, hampering their mission. Overall, the evolving role of MDBs and their governance structure require careful consideration to effectively tackle global challenges.

Keywords: Multilateral Development Banks, governance, multiculturalism, global public goods, reform.

Introductions

There are many differences between the Board of Directors (BOD) of a private corporation and the BOD of a multilateral development bank (MDB). Some of the differences are fundamental, to such an extent that even the meaningfulness of the very comparison between the two may be questioned. However, examining these differences may help in better understanding some of the challenges to MDB governance. The paper identified two main differences, as per the analysis and one relevant similarity. in addition, the BOD of an MDB has a unique characteristic shared only by some corporate BODs.

Multilateral Development Banks (such as the World Bank, Asian Development Bank, African Development Banks, etc.) are international public institutions

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intended to support developing countries in achieving internationally agreed social goals. The shareholders are member countries, usually represented by a Governor and a Vice Governor, usually at the Ministerial level. In most cases, MDB governance structures have three levels: (i) the Board of Governors (BOGs), (ii) the BODs, which both oversee (iii) Management, headed by a President. The BOD is usually full-time and resident.

The governance of MDBs is facing two new challenges: increasing geopolitical divisions (political conflicts between shareholders) and the call to upgrade MDBs' mission to address global challenges. This paperargues that MDB governance, namely BODs, needs to be reformed.

The first difference between the BOD of MDBs and the BOD of a corporation is that the fiduciary duty of the Executive Directors (EDs) of MDBs is lower than that of Corporate EDs. In the theory of corporate governance, the fiduciary duty of the Board is to maximize the mission of the organization. In fulfilling that duty, directors must exercise their judgment in considering and reconciling the interests of various stakeholders—including shareholders, employees, customers, suppliers, the environment, and communities—and the associated risks and opportunities for the institution.

However, EDs of MDBs are not elected by the General Meeting of shareholders, but directly by the shareholders they represent. Some of the multilateral banks' Directors have de jure or de facto roles as ambassadors of their member states. Most of them represent constituencies of not necessarily homogeneous and like-minded member countries, so they have to mediate among represented countries. As the High-Level Commission on Modernization of World Bank Group Governance noted in 2009:

Current governance arrangements create strong incentives for Directors to prioritize only their duties as the representatives of governments. Directors are routinely evaluated by their national authorities on how well they are defending the national interest and face sanctions if they under-perform. Appointed Directors may be recalled at any time, while elected Directors can be denied re-election at the end of their two-year term or be pressured to resign. Even Directors who do not serve long enough to seek re-election are motivated by the prospects of promotion or demotion in their home government upon return. Meanwhile, Directors have few incentives to observe their fiduciary duties. With no standards or processes in place for evaluating their performance in this area, neither Directors nor the Board as a whole face consequences for failing to observe their fiduciary duties.

The national interest of the country might not necessarily be in line with the priorities and benefits of the institution. Being appointed as a representative of

a government or group of governments closely linked with their administrations, rather than being independent, raises the likelihood of this potential conflict of interest. Furthermore, the experience and expertise of prospective Directors are rarely assessed against job descriptions or in view of the skills required to complement those of existing members.[1]

The second difference is that the multilateral banks' Board of Directors is usually resident and engaged full-time. This makes the Board co-responsible for management and potentially less strategic. :

"the Board shares a managerial role with the President and therefore in many cases it cannot hold the President accountable without also passing judgment on its own performance. This gives rise to a conflict of interest that reduces the Board's incentives to carry out its oversight function effectively. If things go wrong, Management can conceivably hide behind the Board's co-responsibility, while the Board can place the blame with Management. With everyone responsible in principle, no one is accountable in practice.

It is not easy to measure the development impact of the [MDB'] operations, and thanks to its preferred lender status the [MDBs] almost always gets repaid, regardless of the quality of its loans, programs, or policy advice. Thus, there is no price for failure—the organization does not suffer consequences for errors of judgment, policy, or implementation. Those costs are borne only by the borrowers themselves and their citizens.

Without a clear framework for setting priorities and balancing tradeoffs, the institution expands continuously into new areas and assumes new missions in response to external demands and pressures. This increases the probability that resources will be spread too thin, or that resources will continue to be allocated to activities that are no longer delivering results. Without a clearly defined institutional direction, it also becomes more difficult for shareholders to hold Management accountable. (High-Level Commission on Modernization of World Bank Group Governance).

The Board members of a private corporation and the Board members of a multilateral development bank have one important similarity: they both have a huge information deficit with respect to Management. Despite residing at headquarters and being full-time engaged, the Executive Director of a multilateral bank holds his or her position for a short period, usually two or three years, shorter than the term of a corporate ED. Top Managers of MDBs, instead, usually have behind them a long career in the institution: they know the machine, have access to all information, and over time developed a system of reporting to the Board, which is often fragmented and opaque. This makes MDBs EDs dependent on top Management expertise and experience and therefore vulnerable to be captured by them. Of course, we

are talking about behaviour based on incentives, not morals.

Finally, the Board of Directors of a multilateral bank has a characteristic that only a few Boards of Directors of a corporation may have: multiculturalism. The Board of Directors of a multilateral bank is composed of members from different countries; in the corporate space, only the BODs of big and multinational corporations have this characteristic. Multiculturalism makes the relationship among EDs more challenging and the Board less united and weaker toward Management.

Considering the two main differences and the one similarity between the Board of Directors of a corporation and the intrinsic characteristic of the Board of Directors of a multilateral bank, the characteristic of the latter is the tripartite negotiation (among member states, among directors, and with management) in a multicultural environment. Tripartite negotiations can be complex, as each party usually has its own set of interests, priorities, and concerns, and its own culture. Patience is essential to allow for thorough discussions, information exchange, and consideration of different perspectives. Negotiations often involve give-and-take, adapting positions, and exploring alternative solutions to reach a mutually acceptable outcome.

Negotiations in a multiparty and multicultural environment may take longer due to the need for cultural understanding and relationship-building. Even nonverbal cues like gestures, body language, and eye contact can vary widely across cultures. A very interesting book on cultural differences[2] identifies eight scales of cultural differences: communicating (low-context vs. high-context), evaluating (direct negative feedback vs. indirect negative feedback), persuading (principle-first versus application-first), leading (egalitarian vs. hierarchical), deciding (consensual vs. top-down), trusting (task-based vs. relationship-based), disagreeing (confrontational vs. avoid confrontation), scheduling (linear-time vs. flexible-time). For example, Westerners tend to speak and not to listen, and Asians tend to listen and not to speak.

Geopolitical tensions have recently increased. Economic sanctions are widely used. Supply chains and international trade are affected, and operational and reputational risks have increased for MDBs. They have usually adopted a sanction framework and guidelines on forced labour (a contentious issue between Western countries and China), and are actively monitoring the evolution of supply chains and of international and regional trade.

The fact that all EDs are representative of government shareholders changes the nature of the oversight that they provide, adding a political dimension that allows shareholders to bring in their national interests. MDBs' Boards have tried so far to maintain geopolitical tensions outside the door as much as possible. It may become more difficult

in the future. Some of the factors of successful negotiations in a multicultural environment (effective communication, preparation and research, trust) will be crucial. However, when positions are irreconcilable, only the management has the room to find pragmatic solutions. Therefore, in this situation, the balance of power in governance tends to shift, even more than on the simple basis of the information gap, from the BOD to Management.

The most relevant and meaningful global challenges that MDBs are facing is the provision of global and regional public goods (GPGs). While climate change mitigation is without a doubt a global public good, others have to be well-defined. Probably they include pandemic preparedness and biodiversity.[3] The typical problem of the provision of public goods is that, because of free riding, if left to the voluntary and independent decision of single countries, the (called Nash) equilibrium is suboptimal and results in under-provision of the public good. Of course, if the income of one country increases, more of the GPG will be supplied by that country. MDBs supporting economic development would indirectly increase GPG provision. However, clearly this is not enough. Multilateral matching, i.e. committing to add some multilateral financed GPG contributions to those of others would make all countries better off.[4]

Unfortunately, country preferences for GPGs vary. This is due to two main factors: 1) different exposure to externalities; and 2) domestic citizens' and politicians' preferences, which are conditional to the economic structure of the country. There is no single institution that has extensive power to intervene on a global level, as there is no supranational equivalent to a national government with binding powers to avoid free riding and address the issue of under-provisioning of public goods.

For GPGs, there are layers of actors beyond single countries–individual citizens, local governments, and country collectives–whose interactions are relevant. With countries as the agents, sovereignty is a key GPG consideration with respect to provision and agreement. Alternative institutions–for example, local governments, public–private partnerships, non–governmental organizations (NGOs), as well as multilateral organizations–are important actors with respect to GPGs. Non-state actors (non-profit organizations, academia, think-tanks, etc.) are increasingly influential. This development, which Pascal Lamy has named Polylateralism,[5] may change the governance of MDBs. If unreformed, it may further weaken the role of the BOD, shifting the governance from tripartite to multipartite negotiations.

The structural under-provision of GPGs also stems from the fact that a part of the benefits from GPG provision does not benefit the providing country but other countries (cross-country externalities). The externalities of regional and global public goods may

justify concessional finance. However, despite the meritorious international effort to increase the lending capacity of MDBs through the G20 Review of their Capital Adequacy Framework, resources available to MDBs will remain well below the financial need to address climate change and other global and regional public goods. Therefore, they will need to be selectively focused on the most impactful projects and on the poorest and most fragile countries. This requires strong governance and strategic guidance from the BOD.

Faced with the challenges of increasing geopolitical tensions and increasing provision of global and regional public goods, the multilateral negotiation in a multicultural environment which characterizes the BODs of MDBs is going to become more difficult. Unless the MDBs' governance is reformed, BODs are likely to lose power in favour of Management and third parties and be less effective in pursuing their mission. On the contrary, as Gayle Smith has stated: "If we want to manage global public goods, we must design a more deliberate approach."[6]

Prizzon-Bains-Chakrabarti-Pudussery (2022) made some proposals worth discussing:

1. Professionalize the recruitment of Board Directors. Directors should be appointed with an assessment of their fit for a particular job description. Most Directors would be required to have a professional background in development, corporate leadership and management (and private sector experience if applicable to the particular MDB). Some Directors would be required to have more specific skills relevant to the institution, e.g., audit, finance, banking, development, economics. Appointments would continue to be made by constituency, but this should be based on a job description of required skills for the Board. Job descriptions – and subsequent amendments – should be approved, ideally by the BOG. Executive Directors would not be recruited only from the public administration and would have senior-level experience.

2. Transform current Boards (composed of representatives of government shareholders) from resident to non-resident. The less frequent the Board meets, the further removed it is from the day-to-day business of the institution, and the more likely it is to be engaging in strategic thinking at the country and thematic levels. In this case Directors should be appointed at a much more senior level, if possible at the Director-General level.

3. Replace the current Boards with non-resident independent Directors who are not representatives of government shareholders. Directors would be appointed by a nominations committee following a competitive process. The members of the nominations committee should be

experts in their field, proposed by MDB management and approved by the BOG. The BODs would be small, independent, and 'non-executive'. This option is also associated with less political interference in the operational decisions of the multilateral institution. Given that shareholders would no longer seek representation on the Board, this should allow for a smaller Board, which would have a higher quality of interaction among Directors and a more efficient decision-making process. The literature suggests that Boards are most effective when they have at most 12 members. In this case, the Board should be chaired by the Dean of the Board, not by the President. This would allow for much greater clarity in the division of labor between management and the Board and would ensure better oversight.

4. Include independent/non-governmental Directors on the Board and/or on Board committees. This option could also complement options 1 and 2 and would allow skills diversification, less geo-political interference, and polylateralism.

Other options could include enhanced power of member countries through a reformed BOG or longer ED terms, which would mitigate the information gap with Management. In any case, the welcome renewed attention to the role of MDBs and their evolution cannot avoid a review of their governance. Again, quoting Smith: "[Multilateralism is] not as effective as it has been in the past. But it is needed even more than it has been in the past."

Endnotes

1. Prizzon-Bains-Chakrabarti-Pudussery, 2022.
2. Meyer, 2014.
3. On a discussion on climate adaptation as GPG see Khan-Huq, 2023.
4. Buchholz-Sandler, 2021.
5. Lamy, 2021.
6. Bloj-Pezzini, 2023

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