SUSTAINABLE FINANCING FOR SUSTAINABLE DEVELOPMENT

Report to Governors at 2018 Spring Meetings

Sustainable Financing for Sustainable Development:

World Bank Group Capital Package Proposal

April 2018
For Public Disclosure
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<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>AIMM</td>
<td>Anticipated Impact Measurement and Monitoring</td>
</tr>
<tr>
<td>AMC</td>
<td>Asset Management Company</td>
</tr>
<tr>
<td>BPS</td>
<td>Budget, Performance Review and Strategic Planning</td>
</tr>
<tr>
<td>CMAW</td>
<td>Creating Markets Advisory Window</td>
</tr>
<tr>
<td>CPF</td>
<td>Country Partnership Framework</td>
</tr>
<tr>
<td>CPSDs</td>
<td>Country Private Sector Diagnostic</td>
</tr>
<tr>
<td>CRO</td>
<td>Chief Risk Officer</td>
</tr>
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<td>DC</td>
<td>Development Committee</td>
</tr>
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<td>DEC</td>
<td>Development Economics</td>
</tr>
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<td>DFI</td>
<td>Development Finance</td>
</tr>
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<td>DPL</td>
<td>Development Policy Loan</td>
</tr>
<tr>
<td>DSC</td>
<td>Deployable Strategic Capital</td>
</tr>
<tr>
<td>E/L</td>
<td>Equity to Loans Ratio</td>
</tr>
<tr>
<td>EAP</td>
<td>East Asia and Pacific Region</td>
</tr>
<tr>
<td>ECA</td>
<td>Europe and Central Asia Region</td>
</tr>
<tr>
<td>EDs</td>
<td>Executive Directors</td>
</tr>
<tr>
<td>EMF</td>
<td>Equity Management Framework</td>
</tr>
<tr>
<td>ER</td>
<td>Expenditure Review</td>
</tr>
<tr>
<td>FCS</td>
<td>Fragile and Conflict-Affected Situations</td>
</tr>
<tr>
<td>FCV</td>
<td>Fragility, Conflict and Violence</td>
</tr>
<tr>
<td>FY</td>
<td>Fiscal Year</td>
</tr>
<tr>
<td>GCFF</td>
<td>Global Concessional Financing Facility</td>
</tr>
<tr>
<td>GCI</td>
<td>General Capital Increase</td>
</tr>
<tr>
<td>GCMP</td>
<td>Global Crisis Risk Management Platform</td>
</tr>
<tr>
<td>GDI</td>
<td>Graduation Discussion Income</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>GHG</td>
<td>Greenhouse Gas</td>
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<tr>
<td>GNI</td>
<td>Gross National Income</td>
</tr>
<tr>
<td>GPGs</td>
<td>Global Public Goods</td>
</tr>
<tr>
<td>HICs</td>
<td>High Income Countries</td>
</tr>
<tr>
<td>IAD</td>
<td>Internal Audit</td>
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<td>International Bank for Reconstruction and Development</td>
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<td>ICT</td>
<td>Information and Communication Technologies</td>
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<td>IDA</td>
<td>International Development Association</td>
</tr>
<tr>
<td>IFC</td>
<td>International Finance Corporation</td>
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<tr>
<td>IFL</td>
<td>IBRD Flexible Loan</td>
</tr>
<tr>
<td>IPF</td>
<td>Investment Project Financing</td>
</tr>
<tr>
<td>ITS</td>
<td>Information and Technology Services</td>
</tr>
<tr>
<td>LCR</td>
<td>Latin America and Caribbean Region</td>
</tr>
<tr>
<td>LEG</td>
<td>Legal</td>
</tr>
<tr>
<td>LICs</td>
<td>Low Income Countries</td>
</tr>
<tr>
<td>LLP</td>
<td>Loan Loss Provisions</td>
</tr>
<tr>
<td>LMICs</td>
<td>Lower Middle-Income Countries</td>
</tr>
<tr>
<td>LTF</td>
<td>Long Term Finance</td>
</tr>
<tr>
<td>MAS</td>
<td>Manufacturing, Agribusiness and Services</td>
</tr>
<tr>
<td>MCPP</td>
<td>Managed Co-Lending Portfolio Platform</td>
</tr>
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<td>MDBs</td>
<td>Multilateral Development Banks</td>
</tr>
<tr>
<td>MENA</td>
<td>Middle East and North Africa Region</td>
</tr>
<tr>
<td>MFD</td>
<td>Maximizing Finance for Development</td>
</tr>
<tr>
<td>MICs</td>
<td>Middle Income Countries</td>
</tr>
<tr>
<td>MIGA</td>
<td>Multilateral Investment Guarantee Agency</td>
</tr>
<tr>
<td>MTR</td>
<td>Mid-Term Review</td>
</tr>
<tr>
<td>NCPC</td>
<td>National Currency Paid-in Capital</td>
</tr>
<tr>
<td>NDC</td>
<td>Nationally Determined Contribution</td>
</tr>
<tr>
<td>NGOs</td>
<td>Non-Governmental Organizations</td>
</tr>
<tr>
<td>OPCS</td>
<td>Operational Policy and Country Services</td>
</tr>
<tr>
<td>PCT</td>
<td>Preferred Creditor Treatment</td>
</tr>
<tr>
<td>PEF</td>
<td>Pandemic Emergency Facility</td>
</tr>
<tr>
<td>PLR</td>
<td>Performance and Learning Review</td>
</tr>
<tr>
<td>PSW</td>
<td>Private Sector Window</td>
</tr>
<tr>
<td>PwC</td>
<td>Pricewaterhouse Coopers</td>
</tr>
<tr>
<td>RAS</td>
<td>Reimbursable Advisory Services</td>
</tr>
<tr>
<td>RE</td>
<td>Retained Earnings</td>
</tr>
<tr>
<td>SALL</td>
<td>Sustainable Annual Lending Limit</td>
</tr>
<tr>
<td>SAR</td>
<td>South Asia Region</td>
</tr>
<tr>
<td>SCDs</td>
<td>Systematic Country Diagnostics</td>
</tr>
<tr>
<td>SCI</td>
<td>Selective Capital Increase</td>
</tr>
<tr>
<td>SDGs</td>
<td>Sustainable Development Goals</td>
</tr>
<tr>
<td>SDPL</td>
<td>Special Development Policy Loans</td>
</tr>
<tr>
<td>SEC</td>
<td>Corporate Secretariat</td>
</tr>
<tr>
<td>SLL</td>
<td>Statutory Lending Limit</td>
</tr>
<tr>
<td>SMEs</td>
<td>Small and Medium Enterprises</td>
</tr>
<tr>
<td>SOEs</td>
<td>State-owned Enterprises</td>
</tr>
<tr>
<td>SPPB</td>
<td>Special Private Placement Bonds</td>
</tr>
<tr>
<td>TRE</td>
<td>Treasury</td>
</tr>
<tr>
<td>UMICs</td>
<td>Upper Middle-Income Countries</td>
</tr>
<tr>
<td>VFS</td>
<td>Value for Shareholders</td>
</tr>
<tr>
<td>VPUs</td>
<td>Vice Presidential Units</td>
</tr>
<tr>
<td>WBG</td>
<td>World Bank Group</td>
</tr>
<tr>
<td>WFA</td>
<td>World Bank Finance and Accounting</td>
</tr>
</tbody>
</table>
This page is intentionally left blank.
# TABLE OF CONTENTS

**Executive Summary** .................................................................................................................. i

**I. Introduction** ............................................................................................................................ 1

**II. External Environment and Development Challenges** ............................................................. 1
   A. Key trends in the global economy and the evolving landscape of global development finance 1
   B. Key development challenges ................................................................................................. 4

**III. WBG Value Proposition: Development at Scale** ............................................................... 6
   A. WBG value proposition ........................................................................................................ 6
   B. Synergy between WBG’s support to public and private sectors ........................................ 8
   C. WBG engagement along the income spectrum and its evolving client structure .......... 11

**IV. WBG Policy Package Proposal: Translating Forward Look Objectives into Policy Targets** .................................................................................................................. 13
   A. WBG policy package proposal ............................................................................................ 13
      *Serving all clients* ................................................................................................................... 13
      *Leading on global issues* ...................................................................................................... 17
      (1) *Crisis management and FCV* ......................................................................................... 17
      (2) *Climate change* ............................................................................................................... 18
      (3) *Gender* ............................................................................................................................ 20
      (4) *Knowledge and convening* ............................................................................................ 21
      (5) *Regional Integration* ....................................................................................................... 21
      *Mobilization and creating markets* ..................................................................................... 22
      *Improving effectiveness of internal model* .......................................................................... 23
   B. Reporting and monitoring mechanisms ............................................................................... 26
   C. Summary of WBG policy package ....................................................................................... 27

**V. WBG Financing Package Proposal** ................................................................................... 28
   A. WBG financing package proposal ........................................................................................ 28
   B. IBRD financing package proposal ....................................................................................... 29
      *Evolution of IBRD financial capacity since 2010* .............................................................. 29
      *Options to enhance IBRD financial capacity* ...................................................................... 30
         (1) *Balance sheet optimization* ......................................................................................... 30
         (2) *Loan pricing* ................................................................................................................ 30
         (3) *Income transfer to IDA* .............................................................................................. 31
         (4) *Administrative expense* ............................................................................................ 32
         (5) *Capital increase* ......................................................................................................... 33
   C. IFC financing package proposal ........................................................................................ 33
      *IFC current financial outlook* ............................................................................................ 33
      *Options to enhance financial capacity* ................................................................................ 34
      *Capital package proposal* .................................................................................................. 36
VI. Conclusion

FIGURES:
Figure 1: Global Context ................................................................. 3
Figure 2: IBRD and IFC’s Track Record of Generating Value for Shareholders .......... 7
Figure 3: WBG Comparative Advantage.................................................. 9

BOXES:
Box 1: Examples Illustrate the Significant Track Record of the WBG in Creating Markets ..... 11
Box 2: Graduation Discussion Income (GDI) ................................................................ 14
EXECUTIVE SUMMARY

“Prosperity, like peace, must therefore be viewed as indivisible. And even from the narrowest considerations of self-interest, each of us must be concerned with the economic development of the world as a whole. For we shall prosper individually only as we prosper collectively.”

- From address by Eugene Meyer, President of the IBRD, at the first Annual Meetings, October 3, 1946

1. The World Bank Group (WBG) has set out an ambitious strategy to support the achievement of the 2030 development agenda. Management and staff are committed to implementing the necessary operational and cultural changes to make the WBG operationally fit for purpose to follow the strategic directions set forth in the Forward Look and for achieving the Sustainable Development Goals (SDGs). Implementing the Forward Look requires a WBG with the appropriate financial capacity. With the successful completion of the IDA18 replenishment in 2017, which includes the unprecedented transformation of IDA’s financial model, the capacity of the WBG to support Low Income Countries (LICs) is significantly strengthened. To ensure that the WBG is able to support the development challenges of a growing number of Middle Income Countries (MICs), and to deploy private sector solutions at scale in both MICs and LICs, as well as deliver on the global public goods (GPG) agenda, the Executive Board and Management have now prepared a transformative package of capital measures and integrated policy reforms for both IBRD and IFC.

2. This “Capital Package” responds to the request that Governors made at the 2017 Annual Meetings. It is based on a careful analysis of all possible options to strengthen the financial capacity of the WBG, including internal levers and increased capital. The package also aims to increase the effectiveness of WBG operations, including through mutual leveraging of the delivery channels of all of its institutions. The combined impact of the Capital Package measures will transform how the WBG enhances, calibrates and delivers development services to its diverse membership. The proposal takes account of the needs, circumstances and ability to contribute of all its members, and puts in place a new governance and management framework that supports the long-term financial sustainability of the WBG.

3. The Capital Package is based on the strategy set out in the Forward Look. The Forward Look calls on the WBG to serve all its clients, maximize finance for development through mobilization of private sector solutions, lead on global issues, and improve its business model. The proposed package represents a major shift in approaches to address development challenges and in the scale of engagement in many areas, including by using innovative private sector solutions and by addressing global public goods. The working culture of management and staff and the WBG operating model will be aligned to support the WBG that the Forward Look calls for. Strengthening the capital base for both IBRD and IFC is necessary to position the WBG for the 21st century and to meet the aspirations of shareholders, mobilize global capital at scale from institutional investors, and respond to future crises.

4. The Capital Package is developed against the backdrop of a changing and increasingly complex development landscape. Despite impressive gains in recent decades,
development progress remains uneven. Keeping up with the pace of past progress and addressing emerging challenges will require stepped up efforts in the face of persistent global headwinds, structural changes to the global economy, and narrower paths to prosperity. It also requires a paradigm shift in the resources and approaches deployed to address these challenges. Furthermore, demographic change, urbanization, climate change, conflicts, technological disruptions, and other forces create pressing needs, including the need to create millions of jobs each month to absorb the four million monthly increase in working age populations. Slowed progress amid rising aspirations in the developing world could produce pressures that spill over to the rest of the world.

5. **Sustaining and accelerating progress toward global goals will require a strong WBG that can provide innovative solutions and advice combined with financial firepower that is commensurate to the size of the challenge.** For this reason, the Board and Management have focused on creating both a “better WBG” and a “bigger WBG”. Internal reforms to build a better WBG through fiscal prudence, productivity gains, and promotion of drivers of innovation and cutting-edge solutions have already delivered value for shareholders. Financial capacity has also expanded, in particular for LICs through the transformation of IDA’s financial model and other innovations. Since public sector resources alone will never be sufficient, the WBG has also stepped up efforts to maximize resources for development and deploy private sector solutions at scale, and is working with clients to improve their own domestic resource mobilization and the effectiveness of their public spending.

6. **The WBG has developed its capacity to support the fight against poverty and address new challenges since its inception more than 70 years ago.** It is now active in almost every country including in fragile and conflict situations and offers the integrated development solutions that are needed to make headway on complex and interconnected development challenges. Drawing on the capabilities of its different members, the WBG mobilizes public and private resources that are needed to support the creation of markets and enable the private sector to bring about innovative solutions to development challenges, and provides intensive support to countries affected by crises and emergencies. It supports the dissemination and adoption of global standards on issues ranging from gender and social inclusion to procurement and budget transparency. It also supports the protection of global commons, including by integrating global concerns such as climate change into local actions, thus offering a unique platform for coordinated international action. Finally, the WBG is a highly efficient financial leverage machine that delivers extraordinary returns for shareholders: IBRD and IFC have turned US$19 billion of paid-in capital into over US$900 billion, or US$1.5 trillion in real terms, in financing for clients, nearly US$50 billion of reserves and retained earnings, and US$28 billion of grants mostly to the poorest countries, and catalyzed almost US$1 trillion of private sector investments.

7. **The Capital Package that the Board and Management propose for decision at the Spring Meetings is underpinned by a track record of successful reforms and delivery in the course of the past few years.** The success of these reform efforts was explicitly recognized through the IDA18 replenishment, which delivered on the promise of a bigger and better WBG for LICs. The Capital Package is designed to do the same for MICs, as well as to ensure that IFC has the financial means to create markets and expand deployment of private sector solutions, especially in IDA and fragile and conflict-affected situations (FCS).
8. **The Capital Package would** advance each of the dimensions of the Forward Look agenda as follows:

9. **First, the package will serve all clients.**
   - To complement the strong delivery expected from the IDA replenishment, IFC aims to reach a 40 percent share of its commitments in IDA and FCS countries by FY30, out of which 15 to 20 percent of commitments in LIC IDA and IDA FCS. As such, IFC aims to deliver 75 percent more in cumulative commitments in IDA/FCS between FY19 and FY30 than if there were no package. IBRD expects increasing transfers to IDA along with higher retentions in its own reserves as its income grows.
   - IBRD targets a rise in the share of its non-crisis lending to middle-income countries below the income level where IBRD graduation starts being discussed (the Graduation Discussion Income, GDI), to 70 percent by FY30. It will target an average share of 67 percent over the FY19-FY30 period, and aim for a gradual and linear rise in the lending share. IBRD also aims to make available resources to fully replace the IDA financing for IDA graduates. Overall, IBRD could deliver 70 percent more in cumulative financing to below GDI countries over FY19-30 than if there were no package. IFC aims to deliver 35 percent more in cumulative commitments to below-GDI countries between FY19 and FY30 than without a package.
   - For above GDI countries, IBRD could deliver 45 percent more in cumulative lending over FY19-30 than without a package. IFC expects to deliver 35 percent more in cumulative commitments in above-GDI countries between FY19 and FY30 than without a package. In addition, IBRD commits to a more systematic application of its graduation policy. In consultation with the borrowing country, new IBRD activities in CPFs for above-GDI countries will have a primary focus on interventions to strengthen policies and institutions required for sustainable IBRD graduation. IFC commits to apply rigorous additionality assessment for its investments, and aims to focus on global public goods, frontier regions, capital markets, and south-south partnerships in countries above the GDI.
   - Enhanced WBG support to small states across the income spectrum, recognizing the particular vulnerabilities and challenges faced by these countries.
   - A substantial financial buffer that would allow IBRD financing to scale up rapidly in response to crises.

10. **Second, the package will support WBG leadership on global issues for the benefit of all shareholders.**
    - IBRD aims to deliver climate co-benefits averaging at least 30 percent over FY20-FY23, with this ambition maintained or increasing to FY30, while IFC aims to grow the share of its climate investments, including mitigation and adaptation, to 35 percent by 2030, by leveraging policy work done by the World Bank and applying the Cascade approach that prioritizes use of private sector solutions to address climate issues. IFC aims to also gradually increase the average share of its climate investments over FY20-FY30 to 32 percent.
Continuous implementation of the gender action plan, with at least 55 percent of IBRD operations contributing to narrowing the gender gap by FY23, and 60 percent of operations with financial sector components narrowing gaps in access to financial services by FY23, with this ambition maintained or increasing to FY30. IFC will quadruple the amount of annual financing dedicated to women and women-led Small and Medium Enterprises (SMEs) by 2030.

Increasing WBG financing to FCS countries and focus on crisis prevention.

Dedicating a modest part of IBRD income to provide concessional financing for GPGs upon evaluation of IBRD’s annual financial results and reserve retentions needs.

Leveraging WBG knowledge and convening role for greater impact, including demonstration effects of implementing the Cascade approach. IBRD will develop a Strategic Framework for Knowledge Generation and Sharing to preserve and enhance its comparative advantage in this area.

Supporting inclusive and sustainable regional integration, that fosters growth of businesses and creation of good local jobs and value addition in all participating countries, through connective infrastructure and complementary policy and institutional reforms.

11. **Third, the package will maximize finance for development through:**

- The adoption of a systematic approach to creating markets across the WBG by linking policy reform, advisory, investment, and mobilization to deliver “solutions packages” and using the Cascade approach as the “operating system” to Maximize Finance for Development (MFD).

- IBRD and IFC aim to increase their respective mobilization ratios to 25 percent and 80 percent on average over FY19-30. A “bigger and better” WBG will also support growth of MIGA’s mobilization products, as MIGA relies heavily on the IBRD and IFC for operational support.

12. **Fourth, the WBG will continue to improve its business model, including:**

- Intensifying efforts to build a “better WBG” that is more agile, effective and responsive.

- Introducing a range of new efficiency measures including managing salary growth and workforce growth, corporate procurement and real estate efficiencies, as well as administrative simplification and agile approaches and other expense control measures. These measures, in addition to the continuous implementation of the Expenditure Review measures, will help maintain budget discipline.

- Implementing a comprehensive financial sustainability framework for ensuring that IBRD’s lending is automatically aligned to sustainable capacity. The framework would include a transparent metric of a 10-year Sustainable Annual Lending Limit (SALL) and a set of rules to size the lending program, with self-correcting mechanisms to ensure that tradeoff decisions are made between volume and lending terms and that a crisis buffer is maintained to respond to unanticipated needs.
13. To finance these policy ambitions and deliver on the Forward Look, the Board and Management are proposing a financing package that is consistent with WBG practice of looking first to internal measures and then to paid-in capital and continuing to rely primarily on internal reserve retention to finance WBG’s growth. The proposed internal measures include:

- Steepening maturity premium for IBRD clients, with discounts and surcharges adapted to client countries’ income level and other circumstances.
- Maintaining the Expenditures Review measures, and deploying further WBG efficiency measures. For IBRD, this will be complemented by tighter targets zones for the budget anchor.
- Continuing balance sheet optimization through loan and, for IFC, equity sales, active portfolio management, private sector mobilization, and other innovative measures.
- Suspending IFC transfers to IDA and redeploying this income transfer to support expanded IFC activities in IDA countries, while continuing IBRD transfers to IDA.

In addition to these internal measures, the financing package would include:

- A US$13 billion paid-in capital increase, consisting of US$7.5 billion for IBRD and US$5.5 billion for IFC, via selective and general capital increases.

14. The proposed Capital Package will be transformative as it will set the WBG on a sustainable path to reach the ambitious global objectives set by the Forward Look. It will transform WBG’s engagement to assist all clients, lead on global issues, and create markets to maximize finance for development. The package offers a win-win solution, bringing high leverage and value for all shareholders, borrowers and non-borrowers alike, in terms of both development outcomes and financial returns.

15. Against this background, we ask that Governors:

- Endorse the joint IBRD and IFC policy package that translates Forward Look objectives into policy targets;
- Endorse the package of financing measures necessary to implement the policy commitments, including the internal measures listed above, as well as:
  i. A capital increase of US$60.1 billion for IBRD, with US$7.5 billion in paid-in and fully usable, and the remainder callable, through a combination of a selective capital increase and a general capital increase.
  ii. A US$5.5 billion paid-in capital increase for IFC through a cash injection using a combination of a selective capital increase and a general capital increase.
I. INTRODUCTION

1. The “Forward Look -- A Vision for the World Bank Group” sets out an ambitious strategy to support the achievement of the 2030 development agenda\(^1\). With the successful completion of the IDA18 replenishment in 2017, which includes the unprecedented transformation of IDA’s financial model, the capacity of the WBG to support LICs is significantly strengthened. To ensure that the WBG is fully fit for purpose and able to support the development challenges of middle income countries (MICs), to scale up private sector solutions in all client countries – with increased focus on IDA countries and FCS, and to deliver on the global public goods agenda, the Board and Management have now prepared a transformative package of capital measures and integrated policy reforms for IBRD and IFC.

2. This “Capital Package” responds to the request that Governors made at the 2017 Annual Meetings.\(^2\) It is based on careful analysis of all possible options to strengthen the financial capacity of the WBG, including internal levers and increased capital. The package also aims to increase the effectiveness of WBG operations, including through the mutual leverage of the delivery channels of all its institutions. The combined impact of the Capital Package measures will transform how the WBG enhances, calibrates and delivers development services to its diverse membership. The proposal takes account of the needs, circumstances and ability to contribute of all its members, and puts in place a new governance and management framework that supports the long-term financial sustainability of the WBG.

3. The paper is organized as follows. Section II describes trends in the external environment and development challenges. Section III describes WBG value proposition. Section IV sets out how the Forward Look objectives are translated into policy measures that form an integral part of the Capital Package. Section V sets out the financing package, including detailed analysis of the different options for enhancing the financial capacity of IBRD and IFC. Section VI concludes and sets out the request for the Development Committee.

II. EXTERNAL ENVIRONMENT AND DEVELOPMENT CHALLENGES

A. Key trends in the global economy and the evolving landscape of global development finance

4. The world has made impressive development progress in recent decades, but this progress has been uneven. Globally, the share of people in extreme poverty based on income below US$1.90 per day has recently, and for the first time, dropped into single digits. Over the past 25 years, life expectancy has increased by over six years, the share of children out of school has been reduced by close to 50 percent, and maternal mortality is down 44 percent.\(^3\) Despite this

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\(^1\) See Forward Look – A Vision for the World Bank Group in 2030. DC2016-0008
\(^2\) See Communiqué of the Development Committee, October 14, 2017.
\(^3\) “A Stronger World Bank Group for All” prepared for the April 22, 2017 Development Committee Meeting.
significant progress, the agenda on the Sustainable Development Goals (SDGs) and the WBG Twin Goals remains large across the income spectrum, as indicated by an extreme poverty headcount of about 40 percent in Sub-Saharan Africa. Inequality levels, despite recent declines, are on average greater now than 25 years ago, giving rise to instability. Despite rising average incomes, MICs still accounted for around 500 million of the extreme poor versus 280 million in low income countries (LICs). Around 1.6 billion still live on less than US$3.20 per day in MICs.

5. **Looking ahead, a number of changes in the global context suggest that future poverty reduction may be more difficult** (see Figure 1):

- **Inequality is high and poverty harder to eradicate.** High inequality threatens social cohesion, and increases the risk of violence, often beyond country borders. The remaining poor are more deeply deprived and tend to be harder to reach, and are increasingly concentrated in fragile and conflict-affected regions. Non-income dimensions of poverty—such as limited access to quality education and health services—have proven much harder to tackle and pose a bottleneck to sustained poverty reduction and shared prosperity.

- **The traditional model of growth and development is being questioned.** Due to changes in technology and the structure of globalization. Export-led manufacturing has been the development model most responsible for the post-World War II growth miracles, providing avenues for productivity escalation and skills absorption. However, new technologies are changing what it means to be competitive, and availability of low-cost labor is becoming comparatively less important.

- **Demographic change, urbanization, climate change, conflicts, and other forces continue to create pressing needs and population movements.** In lower-income countries, where poverty is most prevalent, rapid population growth outpaces job creation. Sub-Saharan Africa, the Middle East and North Africa (MENA) and South Asia regions are, for instance, expected to see a 3.4 million monthly increase in working age population. Urbanization is proceeding rapidly, but needs to be better managed as people flock into low-productivity service jobs, and slums continue to expand. Climate change is having a disproportionate effect on the poor both in terms of their exposure to risks and their ability to adapt. Situations of conflicts are likely to remain frequent by historical standards, and to continue their recent trend of impacting a wider spectrum of countries. Other forces, such as increased global connectedness, could also unleash more frequent disruptions to countries across the development path, such as via the spread of pandemics, humanitarian crises, or economic shocks. These often generate large spillovers across borders and can set countries backward by decades. Environmental issues, including water scarcity and soil degradation, are reducing productivity in many regions, threatening livelihoods and food security.

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Figure 1: Global Context

Meeting Development Goals Requires Increased Financing and Innovative Solutions to Manage Global Risks in a Changing Landscape

More than 3 million monthly increase in the working age population of Africa, MENA and South Asia.


$3 trillion per year are needed to reach SDG goals.


Trillions of investments needed to mitigate and adapt to climate change.

Source: Center for Global Development, “Quantifying Vulnerability to Climate Change”

Increased fragility and conflicts that are not contained by borders

More countries experienced violent conflict in 2016 than at any time in nearly 30 years.

65.6 million people forcibly displaced globally.

Fragility threatens to slow – or reverse – recent gains in poverty reduction. If current trends persist, by 2030, more than half of the world’s poor will live in countries affected by high levels of violence.

Source: UCDP/PRIO Armed Conflict Dataset - UNHCR Global Trends 2017, as of end-2016 - OECD 2015
• In many countries the macroeconomic policy space to react to crises, such as economic shocks or natural disasters, has been reduced since 2008 by large increases in public indebtedness amidst a generally accommodative global monetary policy environment. In responding to the large global shocks of the past decade, including the global financial crisis and the great recession, and the crash in key commodity prices, many countries have accumulated public (and private) debt, while central banks across the world pursued aggressive and sustained expansionary monetary policies.

• The global economy is facing serious downside risks especially related to the heightened valuations in financial markets and high levels of private and public indebtedness. These risks could materialize as some major central banks are now gradually withdrawing ultra-accommodative policies that have been in place over the past decade. Given the limited policy space currently available in many countries, a crisis now risks steeper than usual output losses and hardship.

6. Slower progress amid rising aspirations in the developing world will likely produce pressures that will spill over to the rest of the world. New information technologies increase people’s awareness of, and aspirations for better lives. At the same time, slower growth could dampen development progress and lead to greater inequality between countries, adding to migration pressures and limiting trade. Such trends would have a direct economic impact on higher income countries given middle income countries’ high and rising importance as a destination for exports and global demand. Indirect impacts would also be significant. Job creation in developing countries may be at risk due to automation, both directly (jobs becoming obsolete in home countries) and indirectly (jobs more likely to re-shore and less likely to be outsourced to developing countries). These trends, in combination with rapid population growth, can lead to conflict and fragility, contributing to displacement and migration, with regional and global spillovers. Other indirect spillovers to higher income countries come from the critical role that developing countries, particularly middle-income countries, play in many global public goods.

B. Key development challenges

7. To address these challenges and meet the Twin Goals, the Forward Look sets out three complementary strategies: to accelerate sustainable and inclusive growth, invest in people to build human capital, and foster resilience to global shocks and threats. These well-established principles of development will need to reflect the new realities of the emerging economic environment. For example:

• Inclusive and sustainable growth. Countries will need to find paths for growth that take into account factors such as rapidly changing technology, and are able to bring into the economy people previously left behind, including via jobs for young people, enhanced opportunities for women, and in some cases employment for displaced people. Investments are still needed in basic and essential development needs, from water and

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shelter to transport and energy which must be done sustainably to avoid depletion of resource flows needed for future incomes and assets.

- **Invest more effectively in people.** Investing in people (e.g. health, education and sanitation) will be required to both provide for better solutions to non-income poverty, but also to provide for enhanced skills for the new economy, opportunity for all to participate, and greater growth through higher levels of human capital.

- **Foster resilience to global shocks and threats.** Countries need to enhance their resilience, not only with safety nets for those left behind, but also by helping those who have recently risen out of poverty to keep from slipping back due to risks from economic cycles, pandemics, natural disasters, climate change, environmental risks, weather, or crime. Increasingly problems will need to be addressed at both global and local levels, and governments will need to connect and act together.

8. **In addressing these challenges, the WBG’s ambitions align with the Sustainable Development Goals and the 2030 Agenda.** The WBG’s goal of ending extreme poverty contributes directly to SDG 1 (Ending poverty in all its forms everywhere). The WBG’s goal of boosting shared prosperity is also expected to contribute to—and be driven by—progress on several of the SDGs, spanning from quality education (SDG 4), to reduced inequalities (SDG 10), taking action to combat climate change (SDG 13), and promoting decent work and economic growth (SDG 8). The WBG is committed to work with governments, international institutions, non-governmental organizations, the private sector and others to achieve the SDGs. It expects to help meet these targets by supporting their implementation including through new and improved technologies, providing finance, and sharing data.\(^6\)

9. **The scale of the challenges ahead demands that the scope of resources directed to address them is meaningfully broadened.** The scale of development challenges is enormous: US$2 trillion of annual investment needed for infrastructure in developing countries, US$4 trillion annual investment to meet all the SDGs, and US$23 trillion of investment needed across diverse sectors to address climate change.\(^7\)

10. **Against this backdrop, there is an urgent need to build public finance buffers and enhance the quality of public spending.** To alleviate stretched government balance sheets, a combination of strengthened domestic resource mobilization and improved spending efficiency and selectivity is required. On the revenue front, too many low and middle-income countries have too low a tax effort to be able to sustainably finance government operations and essential investments. An efficient and equitable tax and expenditure system is needed for economies to adapt to the above-mentioned ongoing major transformations: both to seize opportunities for development as they arise but also to cushion its effect on those negatively affected. In such an environment, fiscal policy has a greater role to play in fostering sustainable and inclusive growth.

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\(^6\) Details of progress in the implementation of the 2030 agenda, as well as mainstreaming disaster risk management in WBG work, are detailed in accompanying documents to the Development Committee. See “Forward Look – A Vision for the World Bank Group in 2030 – Implementation Update” and “Progress Report on Mainstreaming Disaster Risk Management in World Bank Group Operations.”

but it also has the difficult task of achieving more and better in a more constrained environment. Restoring public finance buffers is also an important policy tool to de-risk countries.

11. **It is also urgent to step up the essential role of the private sector and develop new solutions-oriented approaches to development.** The scale of investment needed cannot be addressed by the public sector alone, and use of innovative private sector solutions should be expanded to address these challenges. The private sector is also the only mechanism able to productively and sustainably create the millions of monthly new jobs that growing working-age populations demand. And while the traditional development model is under stress in part due to technological change, new "leapfrogging" technologies also offer potential solutions: for example, innovative solutions to climate change such as off-grid power and floating solar energy, digital solutions to finance, and new models for education and health care. The public and the private sector both have a key role to play to promote the discovery, diffusion and deployment of new technologies. In addition, there is a US$100 trillion global pool of savings that could be harnessed to invest in developing countries with the development of a pipeline of sound private sector projects, improvements in developing country investment climates, and the creation of adequate “skin-in-the-game” and de-risking mechanisms, where needed, to match investors with projects that meet their risk/return requirements.

### III. WBG VALUE PROPOSITION: DEVELOPMENT AT SCALE

**A. WBG value proposition**

12. **The WBG is uniquely placed to address global challenges.** The strength of the WBG derives from: (1) both global and local depth that allows diffusion and customization of best practices and technologies from anywhere in the world to the local context; (2) a combination of deep analytical skills, hands-on experience, and knowledge embedded in financing; and (3) a multi-disciplinary and multi-sector approach, and ability to work with both the public and private sectors. Its engagement model ensures that client countries drive and own reform initiatives and investments that support sustainable development. A strong emphasis on accountability and results enhances the development impact of interventions. Due to its global reach and broad capabilities, the WBG is frequently called upon to convene diverse actors, connect partners across regions and countries, and catalyze action on global agendas. The WBG is unique in being able to provide all these capabilities and do so at significant scale and efficiency.

13. **The WBG can provide these services with very efficient use of public resources by extensively leveraging and mobilizing capital.** The WBG model as a financial intermediary allows it to provide extensive finance for both governments and the private sector by leveraging a limited amount of shareholder capital on its balance sheet. Since inception, shareholders have provided a total of US$19 billion of paid-in capital to IBRD and IFC (see Figure 2). This, in turn, has yielded cumulatively over US$900 billion, or US$1.5 trillion in real terms, of financing for development, nearly US$50 billion in funds retained for reserves, and US$28 billion in income transfers to IDA and other grant funded programs. The global character of the WBG brings unique benefits, for example its diversified portfolio allows for a higher financial leverage. When engaging with the private sector, this leverage is multiplied again by the co-financing mobilized
and catalyzed from other investors. For example, at IFC, while capital is leveraged on its balance sheet about four times, at the project level, co-investments by third parties account for leverage of another five times. This has enabled IFC to catalyze close to US$1 trillion of private sector investments since inception and be the leading MDB in terms of mobilizing private sector solutions and financing.

Figure 2. IBRD and IFC’s Track Record of Generating Value for Shareholders

14. The WBG engagement on global public goods and collaboration with partners to address the complex and interconnected nature of today’s development challenges is a key part of its value proposition. The WBG brings its knowledge, convening power, and implementation capacity to bear on some of the toughest global issues highlighted above. These issues require coordinated global action across all income groups. Strengthened partnerships with other development stakeholders, including civil society organizations and the private sector, are critical for effective action in these areas. The WBG has forged stronger partnerships between development and humanitarian communities, mobilized additional resources for global initiatives, such as climate finance, and moved forward key development standards, such as the new Environmental and Social Framework. The WBG has transformed its relationship with the UN and its agencies, which is critical for ensuring consistency in setting global objectives and for coordinating work to achieve them, and for effective responses to the most complex challenges, such as humanitarian aid and the development response to crises. Partnerships with multilateral and bilateral development institutions, both new and established, are also critical for global, as well as country, engagements while working with academia and research institutions enables the WBG to push the knowledge frontier in key areas. The WBG has also stepped up its
contribution to the G20 and G7 agendas on a broad range of issues from climate change to mobilization of resources.

15. Across its activities, the WBG is cognizant that achievement of the 2030 development agenda requires the best possible use of limited resources. The WBG continues to emphasize core principles of Value for Shareholders (VfS) in its operations and policies, its strategy and organizational structure, its use of balance sheet and financial instruments – ultimately reflected in development results supported along with the knowledge and learning shared across countries. Recognizing the value of the MDBs working more systematically together, the WBG has also been actively coordinating with other MDBs to harmonize on VfS principles, along with key metrics such as Private Capital Mobilized and Climate Co-Benefits, and principles for use of blended finance instruments. Thanks to this continued focus on VfS, the WBG benefits from sustained client demand for financing and partner demand for engagement. Recent external reviews\(^8\) concluded that the World Bank is a top performing organization which has played a critical role in tackling some of the worlds’ biggest problems such as conflict, fragility, migration, climate change, and crisis response.

B. Synergy between WBG’s support to public and private sectors

16. As highlighted in the Forward Look, the most enduring, sustainable, and scalable solutions to development problems involve the interplay of private investment and public policy. In many developing countries, market and institutional failures severely constrain the potential for private sector-led growth and development. For example, long-term finance is often limited due to perceived risks and lack of sufficiently developed financial intermediaries and markets. Regulatory risks may be high, and gaps in the legal and regulatory framework and uncompetitive market structures can limit business opportunities. There are often significant limitations in infrastructure and supply chains, and improvements are needed in worker and managerial skills. As a result, a large share of the private capital that flows to developing countries goes to larger and less risky investments. Private capital does not flow at the scale needed to close development gaps, especially in LICs and Lower-MICs.

17. To provide sustainable solutions to development problems, the WBG offers a coordinated and holistic approach, with complementary support to public and private sectors (see Figure 3). Support to the public sector helps, for example, to establish a supportive investment climate to mobilize private capital for development, to address market failures and de-risk investments, to improve domestic resource mobilization, from tax revenues to capital markets, and to enhance public expenditure management. WBG support is important both for identifying good practice in these areas and for building the capacity of the public sector to meaningfully engage with the private sector for the benefit of everyone, especially the poor, so that no one is left behind. The WBG is also able to provide evidence-based advice on where private sector solutions can create sustainable impact. Working with the private sector, WBG institutions provide capacity building, de-risking and financing instruments to help demonstrate the viability of private sector solutions that create jobs in a sustainable manner, improve access

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\(^8\) See, for example, the 2016 Multilateral Development Review of the UK Department for International Development and the Quality of Official Development Assistance assessments of the Center for Global Development and the Brookings Institution.
to services, support innovation and technology, demonstrate commercial viability of new markets, strengthen financial intermediation and local capital markets, mobilize third party capital, increase competition, set standards, and improve sector performance.

**Figure 3. WBG Comparative Advantage**

![Diagram showing the WBG business model with three dimensions of engagement: Global reach, Country-led, Public & Private. Three dimensions of leverage: Convening Power & Partnership, Financing, Knowledge.]

... maximizes development impact, and ...

... is uniquely positioned to mobilize domestic resources, attract private capital, and create markets.

*Both private and public sector arms play an equally important role*

**Use of private sector solutions helps to:**
- Create jobs in a sustainable manner
- Improve access to services, innovation and technology
- Demonstrate commercial viability of new markets
- Strengthen financial intermediation & expand local capital markets
- Generate tax revenues
- Mobilize third party capital
- Increase competition, set standards & improve sector performance

**Support to public sector helps to:**
- Establish a supportive investment climate to mobilize private capital for Investment In development
- Address market failures & reduce risks.
- Improve domestic resource mobilization, from tax revenues to capital markets
- Enhance public expenditure management

18. **Maximizing Finance for Development (MFD) framework and the Cascade approach** support the Creating Markets objectives as outlined in the Forward Look, whereby the WBG substantially enhances its support to private sector solutions (see Box 1). This is achieved through a comprehensive process that allows each WBG institution to contribute
according to its comparative advantage, efficiently utilize scarce resources, and significantly scale up the pace of private sector engagement in developing economies.

- Under the *Cascade approach*, which is the “Operating System” to MFD, the WBG prioritizes private sector solutions when possible, to promote judicious use of scarce public resources. Where markets are not conducive to private investment, the WBG focuses on reforms that address market failures and constraints to private sector solutions at the country and sector level. Where risks remain high, the priority will be to apply de-risking instruments such as guarantees and risk-sharing instruments. Only where market solutions are not possible through sector reform and risk mitigation would official and public resources be used.

- *Creating Markets* is a proactive and systematic approach to market creation and mobilization of private sector solutions across the WBG, that includes developing undeveloped markets, or fostering systemic changes to existing but underperforming markets. It demands an intensified focus on achieving structural reforms that facilitate private investment, address market and institutional failures, or strengthen the rules governing competition. Under the Creating Markets initiative, the World Bank, IFC and MIGA work closely together to enhance the WBG’s value chain – linking policy reform, advice, investment, and mobilization to deliver “solutions packages.” Sector diagnostics are used to deploy solutions that leverage WBG entities’ delivery channels from addressing policy and legal frameworks, to upstream project preparation works that deploy private sector solutions while mobilizing private capital.

- The World Bank supports economic management, policy and regulatory reforms, and building human resource capacity. With the IDA18 IFC-MIGA Private Sector Window (PSW), IDA, IFC and MIGA have created a dedicated mechanism to de-risk the private sector’s entry into the most challenging markets and sectors.

- IFC has a suite of investment and advisory products⁹ that reduce projects risks, set and implement sustainability standards, mobilize other investors and facilitate the private sector response. To implement the Forward Look, IFC has put in place a set of new tools to diagnose, evaluate and build clients’ capacity to create markets.

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⁹ These include: (1) the provision of scarce long-term debt, reducing asset/liability mismatches, including in local currency; (2) providing equity risk capital to reduce undercapitalization risks or provide capital relief; (3) advisory services to build capacity, share knowledge, and reduce implementation risks; (4) standards to reduce governance, environmental and social risks in projects; (5) due diligence to identify and mitigate integrity and reputational risks; (6) assistance in project development and structuring to create a viable pipeline of projects; and (7) mobilization: bringing in other investors through convening, risk reduction, and capital market development.
Box 1: Examples Illustrate the Significant Track Record of the WBG in Creating Markets

- **Agribusiness in Ukraine.** IFC and World Bank have worked to address binding constraints in the agriculture sector, through advisory services (food safety laws, regulations) and investment (US$500 million by IFC over three years), to help Ukraine increase its export business to the EU in line with its potential and provide credit to small farmers.
- **Infrastructure in Kenya and Colombia.** IFC has worked with the World Bank to develop infrastructure regulations and sector programs to facilitate a pipeline of viable infrastructure investments, and set up and provide anchor financing to projects and financial intermediaries that can crowd-in substantial institutional capital to finance infrastructure projects. MIGA has been able to leverage this work in Kenya by providing critical infrastructure guarantees and in Colombia by supporting a program that provides financing for urban infrastructure projects.
- **Housing in West Africa.** IFC and the World Bank helped develop regional housing finance through sector planning, targeted investment programs, and the development of the financial intermediary that can refinance mortgages throughout the region, and thereby significantly extend access to mortgage finance. This project uses the IDA Private Sector Window to provide an innovative local currency solution.

C. **WBG engagement along the income spectrum and its evolving client structure**

19. **WBG engagement along the income spectrum evolves with the continuum of development challenges that clients face.** In FCS, LICs, and even in many LMICs, the institutional environment, access to finance, and the strength of the private sector is often limited. In such situations, WBG engagement addresses basic institutional development, builds government and private sector capacity, de-risks projects and provides scarce financing. Advice and investment across many sectors may be necessary.

20. **In LMICs, WBG support helps to consolidate development achievements and move forward on the development trajectory.** Progress in LMICs will be critical to achieving success on the global SDG agenda. However, the challenges these countries face in achieving the twin goals and in accessing capital for sustainable development remain significant. Of the 500 million extreme poor living in MICs, LMICs are home to 450 million and the creation of quality jobs is a pressing economic and social challenge. Vulnerability to external shocks is often high, along with institutional weaknesses and human development challenges. Many LMICs are also commodity exporters, making them particularly vulnerable to shifts in global prices and demand. The WBG is well placed to support the necessary investments and policy reforms to address the challenges of these countries. For example, WBG support helps deepen public administration and governance reforms, modernize business regulation and trade logistics, strengthen policies and infrastructure to support urbanization or decentralization, improve the quality of health and education services, build social protection systems, and engage in frontier projects such as solar power. There is an emphasis on sustainable solutions for infrastructure financing, with increased private sector participation, as well as on country-specific issues such as supporting fiscal adjustment or addressing corporate or financial sector vulnerabilities.
21. **Moving up the income spectrum, the specific needs often become more focused, requiring much more than access to finance.** While the private sector in countries with higher incomes often has more capacity and access to financing, clients still require WBG assistance, and convening power, in areas with complex knowledge and financial issues. These include financial inclusion, support to underserved regions and populations, introduction of more sophisticated technology, capital markets development, and global public goods. As incomes rise, the instrument mix on offer evolves, for example, combining knowledge with more innovative financing, pilots and demonstration projects, or non-sovereign guarantee operations. For many countries, the attractiveness of IBRD financing terms relative to the market tends to decrease as incomes rise, and there is a greater reliance on Reimbursable Advisory Services (RAS).

22. **It is through this combination of financial, analytical, and technical support that the WBG is particularly effective in its convening role on complex reform agendas in Upper Middle Income Country (UMIC) clients.** Throughout the income spectrum, the selectivity filters in WBG Country Partnership Frameworks (the priorities of the country’s own development program, the priorities identified in the Systematic Country Diagnostics and the WBG’s comparative advantage) ensures continued value-added in the overall engagement.

23. **WBG engagement in the upper income range of clients also provides important benefits to other developing countries and to WBG financial sustainability.** For example, this engagement can improve WBG ability to help the private and public sectors in other countries via demonstration effects, knowledge transfer, and partnerships, including host clients for cross-border investments. Continued delivery in UMICs is also very important for IFC’s financial sustainability under its portfolio approach. UMICs provide IFC lower expenses and better return on capital than the IFC average and can offset underperformance in less financially sustainable environments, such as in FCS and low-income IDA countries.

24. **Through FY30, the changing composition of WBG clients will have a significant bearing on future demand for resources, capital usage and corporate goals.** Over this period countries that are currently IDA-eligible will transition to IBRD-eligibility. Likewise, with sustained growth, IBRD-eligible countries will move up the income spectrum. For those at the higher-end of the income spectrum with relatively stronger market access, this will be accompanied by reduced demand for WBG financing in normal times (but ongoing need for support in the event of crisis). In an illustrative scenario, active IBRD borrowers may number one fifth more in FY30 than in FY18, with new IBRD entrants accounting for one quarter of the FY30 total. Prospective new entrants to IBRD are likely to be particularly exposed to risks, with a greater prevalence of commodity exporters or higher vulnerability to natural disasters, requiring WBG support to build institutions to mitigate these risks. The likelihood of being in an ongoing fiscal crisis, or entering a new crisis, is also higher for LMICs compared with those at the upper end. However, UMICs are more exposed to global financial shocks given their greater integration in capital markets. The type and size of interventions to support the private sector

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11 Over the FY13-17 period, average return on deployed capital has reached 8.9 percent in UMICs, 5.8 percent in LMICs and 0.1 percent in IDA.
also vary depending on countries’ income level. All of these factors will impact resource and capital usage in delivering on the ambitions.

IV. WBG POLICY PACKAGE PROPOSAL: TRANSLATING FORWARD LOOK OBJECTIVES INTO POLICY TARGETS

A. WBG policy package proposal

25. With the Forward Look, the WBG Management and Board articulated an ambitious strategy on how the WBG would help address the global development challenges. Engagements with shareholders on the Forward Look strongly affirmed the WBG’s role as a premier institution in development. The Forward Look has helped shape a common view among shareholders on how the WBG can reach the Twin Goals and support the 2030 development agenda. Four key priorities were established:

- **Stay Engaged with All Clients**, while continually ensuring that WBG resources are strategically deployed to meet global and client needs and targeted to areas of the world that most need funding.

- **Lead on the Global Public Goods Agenda**, including robust implementation of the Climate Change Action Plan, enhancing the WBG approach to crisis preparedness, prevention, and response, and contributing to other global efforts. The WBG focus on achieving greater gender equality is also guided by its 2016-2023 Gender Strategy.

- **Mobilize Capital and “Create Markets,”** to broaden the reach and impact of private sector solutions, support economic growth, and multiply the impact of WBG resources.

- **Continually improve effectiveness** and the internal operational model.

26. **Significant progress has already been made on this agenda**, but much more remains to be done to meet the WBG goals. The sections below outline how the WBG proposes to advance the Forward Look priorities through specific policy measures (denoted in underlined text).

**Serving all clients**

27. **The WBG will continue to engage clients across the income spectrum, while prioritizing additional financing towards countries below the GDI.** The capital package will enable the WBG to channel more resources to countries at the lower to middle range of the client income spectrum while at the same time continue to engage with clients across the income spectrum. For example, for IFC, serving all clients remains vital because the private sector is central to addressing the substantial development challenges in all income groups. IFC aims, for instance, to increase the share of its investments in IDA and FCS, where the development needs

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12 See accompanying report to the Governors on Forward Look Implementation Update.
13 Below IBRD Graduation Discussion Income (GDI) represents category iii borrowers (US$1,165 - US$6,895 per capita GNI for FY18 according to World Bank Atlas method), and above represents category iv borrowers (over US$6,895).
are greatest. The nature of engagements will be adapted to specific development needs in all countries and interventions coordinated across WBG institutions to leverage each other and maximize WBG impact.

**Box 2: Graduation Discussion Income (GDI)**

The GDI (US$6,895 per capita for FY18, using World Bank Atlas method) is based on the IBRD Graduation Policy as defined by the 1982 Memorandum on “Graduation from the Bank” and the 1984 Board reformulation. The per capita GDI was first adopted in 1973 (US$1,000 in 1970 prices and subsequently updated with inflation). Over time, while the GDI has been updated for inflation, the GDI has fallen markedly against high income average incomes (from 29 percent in 1982 to 17 percent in 2016) and the world average (from 113 percent to 67 percent). A country’s income per capita exceeding the GDI is a “starting point” for Management review of the country’s overall economic situation and the non-income factors for graduation, progress on which often lags gains in absolute income levels. These non-income factors are (i) access to external capital markets on reasonable terms; and (ii) progress in establishing key institutions for economic and social development.

28. **Implementation of these objectives, and the changing client composition for IBRD and IFC, will have a significant bearing on future demand for resources and capital usage.** For example, as noted above, expanding IFC activities in IDA/FCS could impact long term financial sustainability given high risks and higher operating costs, thus low profitability in these countries. Prospective new entrants to IBRD are likely to be particularly exposed to downside risks (e.g., commodity-related shocks or natural disasters), and fragility is no longer confined to poorer countries. IBRD’s operational costs would rise with a rising share of fragile and less creditworthy countries. The capital charge for such countries tends to be higher, reflecting their relative riskiness.

29. **IDA-eligible countries will have support via IDA18 and subsequent replenishments, coupled with significant scale up by IFC in IDA/FCS countries.** As part of the policy package, IBRD will prioritize support to IDA graduates and new blends, aiming to make available resources to replace 100 percent of IDA financing for IDA graduates. These measures aim to ensure a sustainable IDA graduation. The WBG will further scale up private sector solutions in IDA countries by (1) deepening WBG collaboration for policy reform to eliminate obstacles to sustainable private investment; (2) building up the IFC pipeline of bankable projects; and (3) drawing in new private investors by IFC investing on its own account while creating new instruments and platforms to bring in other investors. IFC will also focus on addressing the lack of capacity and strengthening standards in many IDA and FCS countries through advisory services, and will take advantage of rapid technological progress to support "leapfrogging". The IDA18 IFC-MIGA Private Sector Window (PSW), which provides risk mitigation for high risk and pioneering projects, and the Creating Markets Advisory Window (CMAW), which provides advisory services in capacity building and regulatory improvements, are key new tools that will allow IFC to continue to scale up in these countries. IFC aims to expand commitments in IDA.
and FCS countries and reach up to 40 percent of all IFC commitments by 2030 and an average of 32.5 percent over FY19-FY30. This compares to a baseline of 24 percent today. IFC aims to deliver 75 percent more in own account and mobilization in IDA/FCS between FY19 and FY30 than if there were no package. IFC also aims to utilize the IDA PSW to substantially increase own account annual commitments in LIC IDA and IDA FCS countries, to 15-18 percent and 15-20 percent of total annual commitments by 2026 and 2030 respectively, compared to a baseline of about 7 percent in FY17 (subject to the continuation and sizing of the PSW).

30. **Countries in the lower to mid-range of the IBRD income spectrum will see a significant scale-up in their support from the WBG**, including through the building up of the respective IBRD and IFC portfolios. These countries can be grouped as IBRD-eligible countries below the GDI, the level of income at which IBRD graduation starts being discussed. In recent years these countries accounted for a little over 60 percent of IBRD commitments. The policy package targets a rise in the share of its non-crisis IBRD lending to countries below the GDI to 70 percent by FY30. It will target an average share of 67 percent over the FY19-FY30 period, and aim for a gradual and linear rise in the lending share. Furthermore, these countries would also be supported by an increase in the IBRD Single Borrower Limit (SBL) that is higher for countries below GDI, a price discount for below-GDI countries, and an exemption for blends and recent IDA graduates from the price increase. Overall, the package could deliver 70 percent more in cumulative IBRD financing to below GDI countries over FY19-30 than if there were no package. Of the total increase in IBRD financing under the package, around three-quarters would go to below-GDI countries. IFC aims to strengthen its engagement in these countries by creating markets, sharing knowledge, and providing a broad range of sectoral and product coverage. It aims to deliver 35 percent more in cumulative commitments to below-GDI countries between FY19 and FY30 than without a package.

31. **Moving up the income spectrum, the policy package will enable strong, yet selective, WBG engagement in the upper income range of clients.** The Forward Look supported a “Continued engagement with upper-middle-income countries, which are important to learning, ensuring financial sustainability and income generation, and advancing on global issues.”

Strong, yet selective, WBG engagement in the mid to upper income range of clients is necessary to address a still-often significant agenda on the Twin Goals, increasingly sophisticated and complex financing challenges, knowledge generation and sharing, advancing on GPG issues, and strengthening WBG financial sustainability. The policy package would enable IBRD to provide above GDI countries 45 percent more in cumulative lending over FY19-30 than without a package. It would also allow lending to the above GDI countries for crisis response (which would be excluded from the lending share target). It is expected that, as income levels rise, lending to countries above the GDI should be on a declining trend, barring unforeseen shocks. IFC expects its commitment growth in non-IDA countries to be extensive, as private companies continue to value IFC’s contributions to financing and knowledge, and the implementation of the cascade approach and the IFC Creating Markets (IFC 3.0) strategy could lead to a significant

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14 IDA countries are those eligible for IDA financing as of July 1, 2016, including Blend and GAP countries as per prior commitments of November 2016, FCS list may vary overtime.

15 Note, IFC financing to IDA eligible countries includes financing to blend countries and FCS. IBRD financing to blend is included under financing to lower to mid-range of IBRD income spectrum.

16 LIC IDA countries are those categorized as such as of July 1, 2016 as per IFC Commitments of November 2016.

increase in the demand. In countries above the GDI, IFC commits to apply rigorous additionality assessment for its investments, and aims to focus on global public goods, frontier regions, capital markets, and south-south partnerships. Cumulatively, IFC expects to deliver 35 percent more in above-GDI countries between FY19 and FY30 than with a no-package scenario.

32. **WBG CPFs for countries above the IBRD GDI level will take a systematic approach to the trajectory towards IBRD graduation.** Borrowing countries’ decision to graduate from IBRD involves a dialogue between the country and the Bank, and takes place on a case-by-case basis reflecting country context. The key elements of the IBRD graduation policy are the non-income factors, namely, extent of access to external capital markets on reasonable terms, and progress in establishing key institutions for economic and social development.\(^{18}\) Going forward, in close cooperation with the borrowing country, there will be a systematic analysis and assessment of the key elements of the IBRD graduation policy, reflected in the CPFs, and updated in Performance and Learning Reviews (PLRs). In consultation with the borrowing country, new IBRD activities will have a primary focus on interventions to strengthen policies and institutions required for sustainable IBRD graduation. Rigorous additional will be applied to IFC investments, to ensure that critical services are provided, both financial and non-financial, that are currently not available on the market. In the context of the CPF, WBG engagements will include: (1) managing potential crisis risks that can have regional or global spillovers; (2) delivery of regional and global public goods; (3) IFC investments that benefit innovation, inclusion and frontier areas and set best practice examples; (4) innovative solutions to poverty and shared prosperity challenges than can be scaled up with non-WBG resources and generate lessons for lower income countries; and (5) interventions that catalyze private sector solutions, foster innovation, promote inclusion, strengthen domestic capital markets and support resource mobilization; and (6) creating knowledge. Subject to country demand, there will be an increased effort to use reimbursable advisory services (RAS). New operations presented to the Board will articulate their consistency with the CPF’s focus areas.

33. **The capital package will also enable the WBG to scale up its support to the particular development challenges of small states.** These include their high vulnerability to economic shocks and natural disasters, the imperative to build resilience to climate change, and the handicaps that they face in attracting public and private financing, for example, due to limited creditworthiness and often high debt levels. At the operational level, challenges include low capacity, remoteness and higher operational costs, and the complexity of regional solutions for such situations. Reflecting these challenges, the Forward Look strategy highlights that “Small States will receive attention due to their special development challenges and vulnerability.” Under the policy package, the access of small states to IBRD resources will be doubled, subject to prudential limits, and they will be exempted from the proposed maturity premium increase.\(^{19}\) The IFC would also promote a regional approach to investments in middle to upper income small states and will aim to leverage the use of de-risking tools for the lower income and FCV ones.

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\(^{18}\) As set out in the 1982 Memorandum on “Graduation from the Bank”, these are the two substantive factors underlying the two relevant conditions for IBRD Graduation of a country’s overall economic situation and its ability to sustain a long-term development process without further financial support from the Bank.

\(^{19}\) Small states defined as countries with a population of 1.5 million or less, as in Bank Directive, Financial Terms and Conditions of Bank Financing.
34. Putting the above together, the policy package represents a win-win-win across the income spectrum, relative to a no-package scenario. WBG management will periodically assess progress on client coverage, to ensure that resources are deployed across the income spectrum to maximize development impact.

Leading on global issues

35. The WBG will enhance its leadership role in promoting innovative responses to issues where coordinated global action is critical. Key areas for engagement identified in the Forward Look include crisis management and FCV, climate change including both adaptation and mitigation measures, gender, knowledge and convening, and regional integration. Actions taken in these areas, in collaboration with development partners and the private sector, will support the achievement of the SDGs.

(I) Crisis management and FCV

36. The world faces major threats that undermine progress in developing and developed countries alike. The huge human and economic costs of the damage caused by climate change and related natural disasters, fragility, conflict and the associated displacement of people, and pandemics, are increasingly evident. Financial and economic shocks rapidly spill across national borders in an inter-connected global economy. All of these crises are occurring with increasing frequency, intensity and duration, wiping away decades of hard-earned economic and social gains.

37. FCV countries are central to the current development agenda. The number of individuals living in FCV countries, and their poverty headcount, is growing, while poverty is declining in the rest of the world. By 2030, based on current trends, more than half of the poor will be living in FCV countries. Also, the extent and scope of conflict has been increasing. More countries experienced violent conflict in 2016 than at any time in nearly 30 years, and recent crises have illustrated that FCV shocks are not confined to low income countries. Refugee movements show that conflict spillovers can extend well beyond the borders of a country. In FCV countries, the institutional environment, access to finance, and the strength of the private sector may be very limited.

38. To address FCV risks and crises, the WBG is engaging with member countries across the income spectrum. The WBG has established the Global Crisis Management Platform to enhance support to client countries that face an increasingly complex and interconnected set of crisis risks. It aims to strengthen cooperation and leverage complementarities across units working on risk mitigation and crisis management. Building on this platform, the WBG proposes to strengthen its efforts to support FCV situations, with a view to reinforcing country, regional and global stability and development. The approach strongly emphasizes crisis prevention – when crisis risks can be mitigated – and crisis preparedness – when the scope for such mitigation is limited. This “pivot to prevention” aims to prevent

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20 Management will present an enhanced version of the platform to the Board in FY18.
escalation of FCV situations and their spillovers through increased allocation of WBG resources, including support to the private sector to create economic opportunities.

39. **The WBG will employ a range of innovative financing solutions and analytical capacities to address crisis risks and enhance crisis response capacity.** On the analytical side, WBG capacity in monitoring key crisis risks through a coordinated approach across different areas of expertise will be enhanced. This will be reinforced by IBRD’s crisis response capacity incorporated in the Financial Sustainability Framework and the IFC’s upstream diagnostic work to guide its investments in high-risk FCV markets. Working closely with the IMF and other MDBs, the World Bank will continue to monitor financial and economic risks, and support policy reforms for macroeconomic stability. On the financing side, innovative solutions include the Global Concessional Financing Facility (GCFF), the Pandemic Emergency Financing Facility (PEF), the IDA’s Crisis Response Window, catastrophe bonds, and insurance products. The private sector has an important role to play in preventing further instability through creation of jobs and provision of services during crisis. IFC has established a dedicated unit to provide strategy, operations support and promote learning to help scale up IFC’s operations in FCS and IDA countries. The following special tools and instruments contribute to these efforts: FCS Risk Envelope, Blended finance programs, PSW, CMAW, and FCS Africa Program. The IBRD and IFC, along with MIGA, are strengthening their partnerships to ensure a coordinated approach to opening up FCV countries to domestic and foreign investors.

40. **An enhanced WBG engagement in FCV countries is critical, yet has operational and security cost implications.** Preventing entry and relapse into a cycle of conflict holds the potential to save lives and avoid the immense losses in human and economic capital that accompany conflict—and safeguard considerable development gains; it is also cost-effective when targeting high risk contexts. There is thus a great need to build capacity in FCV countries, both of government (through IBRD/IDA support) and the private sector (through IFC/MIGA support), and to crowd in the private sector, such as by using new tools to de-risk projects. However, costs of operating in FCV countries can be high, due to the need for more capital per dollar of lending, and more expensive operations. Greater resources are needed for prevention activities, including for job creation and access to infrastructure services, given that experience has shown that such investments in prevention and preparedness are cost effective.

(2) **Climate change**

41. **Climate change is a threat to the core mission of the WBG to eliminate extreme poverty and increase shared prosperity in a sustainable way.** Climate change could push 100 million or more people into poverty, and developing countries are likely to be disproportionately affected. Climate action can also represent an opportunity for economic growth, job creation, and green industry development. The WBG Climate Change Action Plan 2016-2020 sets out the WBG response to these challenges focusing on four main priorities: (1) support transformational policies and institutions; (2) leverage resources; (3) scale up climate action; and (4) align internal processes and work with others. This includes supporting implementation of Nationally Determined Contributions (NDCs) via addressing policy constraints and supporting public and private investments, mobilizing private innovations and technology with de-risking and venture capital, increasing WBG investments with climate co-benefits, and increased focus on adaptation and resilience.
42. The WBG is breaking new ground on the climate agenda through policy advice, global advocacy and lending/investment operations, in line with SDG 13. In FY17, the WBG committed nearly US$13 billion to over 200 climate related projects and announced further steps on climate action at the One Planet Summit in December 2017. These include committing to ramp up its climate ambition and, together with the UN and others, to implement the Investig4Climate platform – which brings together national governments, financial institutions, investors, philanthropists, and MDBs to identify investment opportunities, support policy reform and crowd in private investment. This is part of the broader WBG cooperation with other MDBs, which includes global advocacy, developing and sharing knowledge and solutions and aligning internal process to support climate program implementation. In line with countries submitting updated and potentially more ambitious NDCs, the WBG will present a stock-take of its Climate Change Action Plan and announce new commitments and targets beyond 2020 at COP24 in Poland in 2018.

43. The policy package will enable the WBG to substantially scale up its financing to tackle climate change and to continue to lead on this global agenda. In addition to sustaining the above activities to tackle climate change challenges, the policy package would enable the IBRD to increase the share of climate lending and investments to at least 30 percent and IFC to increase to 32 percent on average over FY20-FY30.

44. For IBRD, the package would support increasing the climate co-benefit target of 28 percent by FY20 to an average of at least 30 percent over FY20-FY23, with this ambition maintained or increasing to FY30.\(^{21}\) In addition to the enhanced co-benefits target, all projects would be screened for climate risk, and investment operations in key emission-producing sectors would incorporate the shadow price of carbon in economic analysis and apply GHG accounting, with annual disclosure of GHG emissions. The latter items would hold for both IFC and the WB. In co-operation with other MDBs, the WBG will review the methodology used for computing climate co-benefits with a view to better capturing adaptation benefits. Furthermore, the financing package includes a proposal that a portion of IBRD surplus resources be used to provide direct support to finance GPG projects, such as those addressing climate change, for example through interest rate buydowns.

45. Under the package proposed in this paper, IFC would increase climate investments, including mitigation and adaptation projects, to 35 percent of commitments by 2030\(^{22}\) vs. 28 percent in the no capital increase scenario while ensuring that the average share between FY20 and FY30 gradually increases to 32 percent. IFC’s climate investments have been growing about three times faster than the IFC total and are on track to meet the 28 percent target for 2020. Going forward, IFC will leverage World Bank policy work (under the cascade approach) and expand the use of private sector solutions that cut across sectors and country groups. As a whole,

\(^{21}\) In achieving this higher level of co-benefits IBRD will need to be cognizant of the trade-offs within its lending portfolio. Climate co-benefits are largely available from sectors such as energy and extractives, transport, environment and natural resources, water and sanitation, agriculture, urban, rural and social development. Lending to such sectors will need to be balanced with other priority areas, such as education, health, social protection, and building institutions to support inclusive growth and sustainable graduation. Furthermore, tilting financing towards lower income countries alters the ratio of mitigation versus adaptation in WBG climate financing towards adaptation.

\(^{22}\) Over FY19 to FY30 the average would be 32%.
the WBG will focus on new technologies, opportunities in the Cities Initiative to reduce carbon intensity and costs of energy consumption, green buildings, green bonds, climate finance, waste and water management, and climate smart agribusiness. IDA countries and FCS are highly vulnerable to climate change effects, including droughts, floods, falling water tables, and rising sea levels. The WBG will bring its climate adaptation experience in other markets to these countries including support for infrastructure that meets disaster and climate resilience standards.

(3) Gender

46. The WBG will significantly step up its financing to help close gender gaps. The WBG Gender strategy has four key pillars related to human endowments, jobs, ownership of assets, and voice and agency, and its ambitions are aligned with SDG 5 on gender equality. Improving human endowments (health, education and social protection) includes reducing maternal mortality, enhancing reproductive health and education, and ensuring healthcare for an aging population and for non-communicable diseases. The WBG will work to remove constraints to increasing the quantity and quality of jobs for women and closing earnings gaps with a focus on women’s labor force participation, occupational sex segregation, care services, and safe transport. The WBG will also work to improve conditions under which women can secure ownership of and control over productive assets and access the finance and insurance needed to acquire those assets. The WBG will strengthen its approach to help prevent and respond to gender-based violence and address adverse masculinity norms in FCS and elsewhere. Significant changes have already been made. Policies and operations are increasingly backed by deeper and rigorous analytical work, and better data. The strengthening of the country engagement model has enabled a clearer linkage on gender issues between Systematic Country Diagnostics (SCDs), Country Partnership Frameworks (CPFs), policy dialogue and projects. In addition, transformational interventions are being designed and replicated with more interventions also in fragile and conflict situations, including on gender-based violence and livelihoods. The quality of these interventions is being enhanced by cross-WBG collaboration.

47. Under the proposed policy package, IBRD will focus on designing and implementing operations to meaningfully narrow gaps between males and females in the four key pillars of the Gender Strategy. Specifically, the proportion of IBRD operations that narrow gender gaps (“gender tagged”) will increase from 42 percent to 55 percent by FY23 with ambition maintained or increasing to FY30. In addition, there will be an increase in the share of IBRD operations with financial sector components that include specific actions to close gender gaps in access to and use of financial services from 55 to 60 percent by FY23, again with ambition maintained or increasing to FY30.

48. IFC has a comprehensive approach to expanding access to financial services for women and women-led businesses as well as strengthening the role of women on the Boards of its investee companies. For example, for financial inclusion, IFC will expand collaboration with the WB targeted at removing barriers to women’s access to financial services and assets ownership. IFC’s Banking on Women Program uses data to make the case for providing financial services to women and women-led enterprises, builds the capacity of financial institutions to deliver such services, and facilitates women’s inclusion through targeted lines of credit and equity investments. IFC aims to quadruple the amount of annual financing dedicated to women and women-led SMEs. IFC will also flag all projects with Gender components by
2020, and aims to double the share of women directors that IFC nominates to boards of companies where it has an equity investment (from 26 percent currently to 50 percent).

(4) **Knowledge and convening**

49. **The WBG’s knowledge and convening role will increase to support the design and sharing of development solutions for greater impact.** This includes strengthening ongoing engagements and developing new ones, effectively utilizing the power of new technology and innovations that are critical to address the SDGs. The WBG effort’s will focus on sharing new research to underpin improved policymaking on emerging challenges; systematically harnessing and sharing knowledge (e.g., South-South exchange) embedded in financing operations across the income spectrum; supporting innovative approaches for data collection; continuing to strengthen public access to development data; helping countries share experience on maximizing finance for development; and convening the public and private sectors on pressing global challenges. The World Bank will develop a Strategic Framework for Knowledge Generation and Sharing to preserve and enhance its comparative advantage in this area, IFC will also invest with players that have the potential to become regional champions and facilitate transfer of new technologies to solve development issues. For example, the digital revolution is changing established markets while offering significant opportunities for better products and services. To scale up in this area, IFC will work more closely with the WB to advise and support policy improvements. The IFC will also focus on critical mentoring and financial infrastructure to support entrepreneurship and innovation.

(5) **Regional Integration**

50. **Over the years, the WBG has expanded its support for regional initiatives. It will continue this support to help strengthen regional cooperation and the needed connective and institutional infrastructure.** Regional integration aims at integrating goods, services and factor markets, thus facilitating the flow of trade, capital, energy, people and ideas. The WBG will continue to work with regional entities, other development partners and the private sector to help build the connective infrastructure in areas such as transport, Information and Communication Technologies (ICT) and energy. Importantly, WBG will support efforts on complementary policy and institutional reforms that are needed to ensure that gains from regional cooperation on infrastructure materialize fully, to foster growth of businesses and create good local jobs and value addition in all participating countries in an inclusive and sustainable manner. Such reforms could include improving the quality of customs administration, responsible application of non-tariff measures, improving the domestic business environment and labor market policies, and strengthening social protection systems and environmental management. They also include policies and institutions to administer benefits and resolve conflicts. The WBG’s toolbox to support regional cooperation and integration includes analytical work, convening power, advisory services, and lending, investing, and mobilization. These tools can also effectively support the provision of regional public goods such as shared natural resources.
Mobilization and creating markets

51. **To deliver on the SDGs** it is critical that the WBG mobilizes the private sector as a financier, operator, or service provider, bringing solutions that reduce poverty and boost shared prosperity in a sustainable manner. With its leading strengths in both the public and private sectors, the WBG is uniquely placed to create markets and maximize finance for development by implementing systematically the Cascade Approach that prioritizes private sector solutions, particularly in the most challenging settings such as IDA countries and FCS. Creating markets to help achieve the SDGs involves exploiting synergies among IDA, IBRD, IFC, and MIGA for (1) linking policy reform, advisory, investment and mobilization activities to deliver "solution packages"; (2) developing frameworks that promote competition, set standards, and enable markets to function efficiently; (3) enabling demonstration effects, replication, and new productive networks; and (4) building capacity and skills that open new market opportunities.

52. **The Creating Markets agenda and IFC 3.0 strategy** will provide a significant shift in the focus of WBG activities to proactively create markets by developing the conditions and enhancing the opportunities for private sector investments in the most challenging countries and regions. The WBG continues to implement many important processes and tools to deliver this agenda, focusing on WBG coordination, upstream sector prioritization and project development, improved metrics to assess and anticipate the potential for market development, and new tools for supporting high risk private sector projects and to enhance mobilization. To implement IFC 3.0, IFC has also put in place a new management structure and developed a set of new tools to enhance delivery. For example, IFC has developed and started implementing country private sector diagnostics (CPSDs), as inputs to SCDs and CPFs, to help identify key private sector constraints, industry deep dives that provide a global view of industry challenges, and the Anticipated Impact Measurement and Monitoring Framework (AIMM), which provides metrics for assessing the likely development and financial impact of projects at both the project and market levels. For high risk markets, the IDA18 Private Sector Window (PSW) and the Creating Markets Advisory Window will help create markets by providing critical government and project capacity as well as de-risking tools to allow pioneering projects to move forward in difficult environments.

53. **The cascade approach is the "operating system" of the MFD framework to expand the use of private sector solutions while mobilizing private capital.** From diagnostics through to investments, the WBG instruments will be leveraged to crowd-in the private sector. Measures are being taken to operationalize the cascade across the WBG, such as incentivizing teams to put MFD concepts into practice and to measure progress. In parallel with these institutional efforts, the MFD/cascade approach is being piloted in nine countries.

54. **The IFC is taking a leadership position among development institutions in developing platforms and risk mitigation techniques to crowd-in capital from institutional investors.** These programs provide an important way that IFC can continue to ramp up its mobilization activities. IFC’s Managed Co-Lending Portfolio Platform (MCP) provides a mechanism to allow institutional investors to invest with IFC on a portfolio basis. This program has expanded greatly in recent years and has now attracted more than US$6 billion from six institutional investors. The AMC, which crowds in equity investors to invest alongside IFC in its
projects, has also been leading the development of mobilization options for institutional investors. Under the policy package proposal in this paper, IFC expects to increase its mobilization ratio relative to its own account commitments to about 90 percent from about 70 percent today, reflecting the growth of these platforms and the great importance of the mobilization agenda (billions to trillions) for development and realizing the SDGs.

55. **Overall, the WBG will significantly expand the use of private sector solutions, multiplying the impact of its resources and opening opportunities for private investment.** The IBRD will increase its mobilization ratio to 25 percent on average over FY19-FY30 (vs. 18-20 percent with no capital increase). IFC also leverages the political risk insurance and credit enhancement of MIGA through the IFC-MIGA Business Development Agreement.

56. **Domestic resource mobilization is also critical to the MFD agenda.** WBG institutions play complementary roles in supporting enhanced domestic resource mobilization. On the public resource side, many low- and middle-income countries do not collect enough taxes to finance government operations and essential investments that are needed to reach the SDGs. For example, tax revenues in 70 percent of FCV countries are below 15 percent of GDP, the level needed to fund basic state functions for countries without major non-tax revenues (e.g., those linked to hydrocarbons). Sound public finances are critical to de-risk countries and boost aggregate private investment in the economy. The World Bank has created a Global Tax Team charged with broadening and deepening the tax base of client countries, working closely with the IMF. Tax engagements are organized around three strategic pillars: (1) international collaboration and coordination, focusing on enhanced cooperation by major international organizations to identify areas of comparative advantage and to preempt duplication; (2) global public goods, providing tools and data to identify weaknesses in country tax systems and entry points for reform; and (3) country-level activities, building on the above to deliver improvements in domestic resource mobilization. Complementing these activities, IFC aims to support domestic resource mobilization by investing in local capital market players (such as insurance companies and fund managers, etc.) as well as deploying innovative solutions to develop the local capital markets (including bond issuance, partial credit guarantees and securitizations).

*Improving effectiveness of internal model*

57. **The WBG continues to progress toward a “Better and Stronger WBG”**. A companion piece details the ongoing work to serve WBG clients more effectively and more efficiently. The new Environmental and Social Framework (ESF) is being rolled out to help improve the sustainability of investments. Procurement reforms make it easier to implement projects, while building the capacity of borrowers. A wide range of administrative reforms is trimming bureaucracy, simplifying procedures, and aiming to improve efficiency of shared services. Prudent management of resources is helping the WBG grow.

58. **To ensure tight budget discipline, while addressing rising cost pressures,** Management will keep in place the WBG savings achieved from the Expenditure Review: approximately US$400 million savings per year across IBRD, IDA, IFC and MIGA. In addition,

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23 Forward Look – A Vision for the World Bank Group in 2030, Implementation Update, February 2018
Management will implement efficiency measures across the WBG that are expected to result in further cost savings and cost avoidance.

59. **Key measures will include the following:**

- **Workforce costs:** Management will use a combination of work force planning, natural attrition and more active management of poor performance, to control overall staff numbers and optimize the grade mix, including target a steady reduction in the number of GH positions. In addition, Management will implement, after the Board approval, a revised compensation methodology, including a revised composition of baskets.

- **Corporate procurement:** Management will achieve annual savings and cost avoidance in the procurement/negotiation of corporate contracts by better benchmarking, targeting, and tracking of savings at the contract level, by clawing back savings achieved from unit budgets, and by introducing more transparent pricing and more economical standards for goods and services.

- **Global real estate and facilities:** Management will work aggressively to reduce its real estate and facilities costs in Washington and around the world. Key Headquarters (HQ) efficiency measures planned include more efficient space standards; creation of in-house conference space to accommodate large meetings currently held externally; and eliminating leased footprint. In country offices, Management will purchase rather than lease, where feasible and economical; increase co-location between the institutions; and take additional measures to optimize the use of office space around the world.

- **Agile and administrative simplification:** Management will further streamline processes (administrative simplification), facilitate faster decision-making, and leverage smart technology solutions. Related to this is the implementation of the WBG shared services strategy which will enhance the current shared services delivery model as implemented by various IG&A units, with the Chennai Center as a key driver of operational excellence and agility. Management will further strengthen portfolio management by reducing fragmentation in lending, and carrying out project restructuring in a more agile way. Average project size will increase and corporate overheads will be contained, so as to secure economies of scale as lending volumes expand.

- **Other expense control measures:** Further savings will be achieved through tighter oversight of travel policy exceptions; roll-out of a mandatory global travel credit card to travelling staff to reduce undue payment of hotel taxes; use of an external vendor to negotiate better hotel rates; rebidding the HQ travel agency contract; and tighter control over number of participants in global events and conferences. Management intends to reduce discretionary spending on food services and rationalize the use of external contractors – particularly in IT.

**IBRD Financial Sustainability Framework**

60. IBRD has strengthened its financial management tools in the recent past. Since 2008, the strategic capital adequacy framework sets a policy minimum for the Equity to Loans (E/L) ratio. Since 2014, IBRD has monitored its budget anchor (the ratio of IBRD administrative expenses to IBRD loan spread income). In FY18, for the first time in at least 20 years, this ratio will be under
100 percent on a sustainable basis and is projected to fall significantly further in the years ahead. In 2016, the Board approved an income-based approach to calibrate their proposal to Governors as regards IBRD annual income transfers to IDA. In terms of governance, Management and the Board have synchronized the decision-making process on budget, pricing, and income allocation to facilitate the financial management of IBRD.

61. In response to shareholders' request and based on Executive Directors' guidance, Management proposes to strengthen these tools with the introduction of an IBRD financial sustainability framework with the following objectives:

- Capital is used efficiently to support predictable lending level aligned with strategy in a prudent manner safeguarding IBRD’s triple-A rating and retaining flexibility to respond to crises;
- Lending remains automatically aligned to long-term sustainable capacity assuming no further capital injection and continuation of transfers based on the IDA18 approach; and
- Pressures for lending beyond the sustainable level force a tradeoff decision between volume and lending terms.

62. The framework is based on the following key elements:

- An objective and transparent metric of financial sustainability, the Sustainable Annual Lending Limit (SALL), that will translate the approved policy minimum E/L ratio, projected external conditions, and the assumption of no capital injection and continued transfers to IDA, into a level of lending that can be sustained in real terms over 10 years.
- A set of rules to size the lending program, ensuring automatic self-correcting mechanisms to stay aligned with the SALL, while automatically building up a crisis buffer to respond to unanticipated urgent demands such as crises. One of these rules is to introduce by default harder terms when accessing the crisis buffer to incorporate the trade-off between volumes and terms, while recognizing some access to crisis buffer may require regular terms (such as for a large multi-country natural disaster or pandemic). Another is to set a ceiling on the annual lending program, defined by what is available within the SALL while maintaining the crisis buffer.
- Approval by Governors of the objectives and principles of the framework, as part of the capital increase resolutions, as well as a 5-yearly review of the implementation of the framework and its alignment with strategy.
- An annual Board update on the lending program, synchronized with annual Board decision-making on budget, loan pricing, and income allocation; the Board update would include the updated SALL, and status of the buffer; and Board authorizations related to the buffer (its size, its use, and the speed at which to reconstitute it after its use).

**IFC Financial Sustainability Framework**

63. IFC will continue to use operational and financial strategies to conserve capital. IFC’s financial sustainability framework aims to preserve the Corporation’s triple-A rating, use capital efficiently to support investments aligned with the strategy, and provide sustainable income to cover operating expenses. This will include:
• Balanced and diversified portfolio approach to investment. The product, geographic, and sectoral diversification of IFC's portfolio is an important contributor to income generation and IFC's triple-A rating. As IFC shifts to focus more on high risk regions, especially FCS and IDA, there is greater pressure on IFC profitability due to generally higher risk and higher costs in these regions. The impact can be mitigated to some extent by maintaining a portion of the portfolio in middle-income countries, where IFC can continue to generate strong income. This limits the amount of external capital necessary to support increased operations in IDA and FCS countries.

• Balance sheet optimization through mobilization and asset sales. IFC has over the years demonstrated significant expertise and success in optimizing the use of its own capital by mobilizing and catalyzing third parties to invest alongside its own account investments. This is in effect a way for IFC to leverage its capital even further than possible on its own balance sheet. For example, mobilization efforts through syndications and the AMC to date have saved US$6 billion of capital. As an innovator in mobilizing capital, IFC has the highest mobilization ratio among MDBs, driven by a full suite of products and platforms including B-loans, parallel loans, the MCPP, AMC, A-loan participations and unfunded risk participations. Under the package proposal in this paper, increased mobilization will contribute to increased IFC impact for a given amount of capital.

64. A number of other pricing and portfolio management principles further support the IFC Financial Sustainability Framework. These include use of risk adjusted and market based pricing, active portfolio management aimed at optimizing the balance sheet use, and anticipation and early warning signals with regards to specific pockets of risk (country, sectors, FX, equities, interest rates, etc.). A number of tools have been developed and are embedded within the framework:

• A strategic capital adequacy framework with minimum deployable strategic capital (DSC) ratio
• Risk and Market based pricing with minimum investment return targets for new projects
• Income-based formula for designations to advisory services
• Economic capital allocation framework to manage exposure limits

IFC also plans certain improvements in the framework through: 1) formal review and reaffirmation of the DSC ratio policy range annually; 2) applying modifications to the stress-testing framework and keeping abreast with evolving standards in risk and capital models; and 3) establishing more granular policy ratios.

B. Reporting and monitoring mechanisms

65. Progress towards the policy targets will be monitored and reported on a regular basis. In particular, progress against the ambitions will be provided via regular updates to the Board. This includes, for example, the WBG Corporate Scorecard, Strategy and Business Outlook, updates under the respective Financial Sustainability Frameworks, and Operations Updates. Financing to clients across the income spectrum will be periodically reported to ensure that financing is deployed for maximum development impact. For IBRD, the progress towards
the 70 percent target for the IBRD lending share to below GDI countries by FY30 will be reviewed annually, in light of lending trends, country debt sustainability and demand, and risk profiles. It will also recognize uncertainties due to country movements around income boundaries and IDA graduations. For countries above the GDI, CPFs will reflect a systematic analysis and assessment of the key elements of the IBRD graduation policy, developed in consultation with borrowing countries, and which will be updated in PLRs. The IBRD financial sustainability framework will include a 5-yearly review of its implementation. For IFC, the increase in IDA/FCS share of commitments is expected to be gradual, with expected year on year variations. IFC will report on progress on IFC engagements across the income spectrum (with specific emphasis on delivery in IDA and FCS as well as in LIC IDA and FCS IDA) in its annual operations report to the Board. IFC will also ensure that higher selectivity in UMICs is articulated in projects’ Board documents, and will gradually move to systematically use Country Private Sector Diagnostics as inputs to SCDs and CPFs.

66. In addition, continuing attention will also be given to Forward Look objectives that are not part of this policy package. This will be done through Forward Look implementation updates. As noted in the latest version of the Forward Look implementation update, “there remains much to be done including, inter alia, scaling up and mainstreaming MFD, tackling climate change issues with urgency, consolidating further platforms to mitigate fragility and risks, addressing issues such as gender, DRM and illicit financial flows, and ensuring that Agile and simplification reforms take hold as lasting cultural shifts. Not least, the WBG will continue the dialogue with shareholders and clients on how to make sure that resources are targeted to areas that are in most need of funding.” Coherence will be maintained between this policy package and the Forward Look results matrix. Independent assessment of progress towards the targets under the two frameworks will be conducted after five years, subsequent to the capital increase.

C. Summary of WBG policy package

67. The proposed policy package, which includes new and innovative solutions to development challenges identified in the Forward Look, would combine enhanced financing capacity with ramped-up ambition and a more effective WBG. The WBG’s financing capacity would rise significantly enabling a continued engagement with all clients. More resources will be devoted to countries at the low to middle range of the income spectrum. For countries above the IBRD’s GDI, engagement will focus on innovative solutions to increasingly sophisticated and complex challenges. New IBRD activities will have a primary focus on interventions to strengthen policies and institutions required for sustainable IBRD graduation. The WBG will also enhance its efforts for addressing the special development challenges and vulnerability of small states.

68. The proposed policy package will enable the WBG to strengthen its leadership on global matters of significance. This includes (1) crisis management and FCV where the WBG will have a stronger response to national, regional and global crises, focus on preventing escalation of FCV situations and their spillovers, and enhance its impact by increasing private sector involvement; (2) climate change where, among other dimensions, the WBG will substantially scale up its financing, aiming to increase the share of climate lending and investments to at least 30 percent in IBRD and 32 percent in IFC on average over the FY20-30
period; (3) gender where the focus will be on implementing the four pillars of the WBG Gender Strategy to meaningfully narrow gender gaps. An integral part of the policy package is also for the WBG to leverage its knowledge and convening role to support designing and sharing development solutions for greater impact.

69. **The package would enable the WBG to materially scale up its role in the mobilization of private sector solutions and finance, including the creation of markets.** To that end, the WBG will adopt a systematic use of the Cascade approach across the WBG by using reform, advisory, de-risking tools, and own account investment to mobilize private sector solutions and capital.

70. **In addition to its strengthened and expanded delivery to clients, the WBG will further improve its internal governance.** The focus of these improvements will be threefold: the financial sustainability framework, WBG effectiveness, and WBG efficiency. A strengthened IBRD financial sustainability framework will include an objective and transparent metric of financial sustainability, and rules to size the lending program. Improvement of the WBG effectiveness will be achieved by further implementing “Agile” reforms and administrative simplifications. On the efficiency front, the WBG will continue to pursue gains through (1) a revised WBG compensation methodology coupled with other HR measures aimed to enhance performance culture, reduce heaviness, control overall position count, optimize grade mix, and provide additional workforce flexibility; (2) corporate procurement savings; and (3) global real estate and facilities; and (4) other measures.

V. **WBG FINANCING PACKAGE PROPOSAL**

A. **WBG financing package proposal**

71. To implement the ambitious policy package and achieve Forward Look objectives, the WBG requires strengthened financial firepower to engage all clients, lead on global issues, and create markets and maximize finance for development. The proposed IBRD and IFC financing packages, as summarized in Figure 4 below, reflect the result of intensive and in-depth discussions and explorations of a wide range of different options by Management and Executive Directors. It represents a balanced package that seeks to maximize internal measures and aims to balance contributions and interests of different shareholder groups, with the goal of proposing a package that offers high leverage and good value for all shareholders.
B. IBRD financing package proposal

**Evolution of IBRD financial capacity since 2010**

72. In 2010, following a record ramp-up in IBRD lending in response to the worst global financial crisis in decades, shareholders agreed to recapitalize IBRD to its pre-crisis 10-year average lending level in nominal terms of US$15 billion per year. Since the crisis, IBRD has been facing elevated demand from its clients to help them close the output gap, support growth, and protect development gains in the same way that advanced economies stimulated public investment spending. IBRD almost doubled its lending portfolio since the 2008 crisis by deploying internally generated capital from retained earnings. This robust response to global needs over the past decade (while continuing IDA transfers) consumed IBRD’s financial firepower. IBRD’s equity-to-loans (E/L) ratio has fallen from 38 percent as of the end of FY08 to below 23 percent at the end of FY17 (declining from 18 to less than 3 percentage points above its 20 percent policy minimum).

73. Measures implemented by IBRD to strengthen its financial sustainability have allowed a response to increased client demand, despite prolonged low interest rates. These measures include reducing expenditures by 8 percent by FY18, multiple pricing increases, reducing the policy minimum E/L ratio from 23 percent to 20 percent, and taking balance sheet optimization measures. Due to the positive effect of these internal measures, despite prolonged record low USD interest rates negatively affecting income generation, IBRD managed to maintain its lending capacity at a level exceeding the US$15 billion that shareholders capitalized it for in 2010.

74. However, this is clearly far from enough to meet client demand and the ambitions shareholders placed on the institution as reflected in the Forward Look. Recent client
demand survey indicated demand for IBRD lending of up to US$36 billion per year in real terms. On the other hand, if no actions were taken, IBRD would have to reduce lending significantly relative to historical volumes. Its net disbursement to client countries would decline rapidly. The reduced lending would have significant consequences for IBRD’s ability to stay engaged with all clients, particularly in supporting new IDA graduates and LMICs, leading on global issues, and creating markets and mobilizing finance for development.

**Options to enhance IBRD financial capacity**

75. **IBRD has five main levers to enhance its financial capacity** – balance sheet optimization, loan pricing, IDA transfers, administrative expenses, and capital increase. Over the last two years, management and Executive Directors devoted significant effort to explore all options to enhance IBRD financial capacity. The following sections discuss the proposed elements of the financing package.

(1) **Balance sheet optimization**

76. **Management will continue to engage in active portfolio management and explore other balance sheet optimization measures.** Management will continue to engage the Board on options to further optimize shareholder capital investments in the WBG to maximize development impact.

(2) **Loan pricing**

77. **IBRD loan price underwent significant increases in recent years.** Since the 2008 crisis, prices were raised three times (in FY09, FY10 and FY14) with current price almost three times the price before the crisis. In formulating measures for the capital package, Management and Board discussed a large number of different loan pricing options.

78. **These discussions concluded with the recommendation to introduce, as part of the capital package, a standard set of maturity premium increases adapted to specific circumstances of different income groups.** This measure provides a substantial boost to IBRD’s capital while also offering borrowers with flexibility and choices. In particular, it maintains current maturity premium structure and introduces a 10-40 basis points maturity premium increase for loans with average maturity longer than 10 years (e.g. 5-year grace, 15-year final maturity) as described in Table 1. To adapt to specific circumstances of different income groups, a discount of 5-20 basis points is proposed for countries below GDI and a surcharge of 5-25 basis points is proposed for countries in the High-Income Category (HICs), as described in Table 2. Exemptions from the price increase are also proposed for blends, small states, FCS countries on the Harmonized List, and IDA graduates, with new graduates exempted for two replenishment cycles and recent IDA17-18 graduates exempted for six years starting from the implementation of the proposal.

79. **The discount and surcharge proposed is consistent with the essence of historical practice during 1975-2008 where borrowers’ access to longer maturity varied by borrower income.** For example, under the pre-2008 policy, Category III countries were provided longer maturity than Category IV countries. In comparison with the pre-2008 policy, the proposed approach offers more flexibility to borrowers as it continues to provide all maturity options to all
clients. Borrowers will also have the option of keeping current price levels by shortening the maturity of their loans.

Table 1: Proposed Changes to IBRD Maturity Premium

<table>
<thead>
<tr>
<th>Average Maturity Buckets (Final maturity of upper end of the bucket assuming 5-year grace period and uniform amortization)</th>
<th>Current Maturity Premium</th>
<th>Proposed Increase</th>
<th>Maturity Premium after Proposed Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 8 average (11 years final)</td>
<td>0</td>
<td>-</td>
<td>0</td>
</tr>
<tr>
<td>8-10 average (15 years final)</td>
<td>10</td>
<td>-</td>
<td>10</td>
</tr>
<tr>
<td>10-12 average (19 years final)</td>
<td>20</td>
<td>10</td>
<td>30</td>
</tr>
<tr>
<td>12-15 average (25 years final)</td>
<td>30</td>
<td>20</td>
<td>50</td>
</tr>
<tr>
<td>15-18 average (31 years final)</td>
<td>40</td>
<td>30</td>
<td>70</td>
</tr>
<tr>
<td>18-20 average (35 years final)</td>
<td>50</td>
<td>40</td>
<td>90</td>
</tr>
</tbody>
</table>

Table 2: Proposed Discount/Surcharge to IBRD Loan Pricing

<table>
<thead>
<tr>
<th></th>
<th>Discounts for Category Ill countries</th>
<th>Surcharges for High-Income Countries (HICs)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 8 average (11 years final)</td>
<td>0</td>
<td>+5</td>
</tr>
<tr>
<td>8-10 average (15 years final)</td>
<td>0</td>
<td>+5</td>
</tr>
<tr>
<td>10-12 average (19 years final)</td>
<td>-5</td>
<td>+10</td>
</tr>
<tr>
<td>12-15 average (25 years final)</td>
<td>-10</td>
<td>+15</td>
</tr>
<tr>
<td>15-18 average (31 years final)</td>
<td>-15</td>
<td>+20</td>
</tr>
<tr>
<td>18-20 average (35 years final)</td>
<td>-20</td>
<td>+25</td>
</tr>
</tbody>
</table>

1. Countries currently with GNI per capita between $1,165 and $6,895.
2. High-income countries refer to countries currently with GNI per capita above $12,235.

(3) Income transfer

80. In November 2016, Executive Directors agreed an approach for IDA18 more closely connecting IBRD’s long-term financial strength with IDA transfer levels, allowing for higher transfers when IBRD is in a stronger financial position while also reducing the impact of downside income volatility on IBRD’s reserve retention.

81. Management and Executive Directors explored a number of alternatives for future IDA transfers. As part of the capital package, it was agreed to propose to extend the IDA18 approach to guide future IBRD transfers to IDA24. Under the proposed capital package, IBRD

24 This will be subject to Articles’ requirement that income allocation be decided by Governors at the end of every fiscal year and after first considering IBRD’s reserve needs.
transfer to IDA is currently estimated to rise over time as IBRD’s income continues to strengthen and to increase compared to the no-capital-package scenario.

82. In addition to IDA transfer, IBRD also transfers resources from its surplus account (which is funded from net income) to a range of high-priority development needs, which in recent years focused on the Trust Fund for West Bank and Gaza. The criteria for surplus use is detailed in the Board-approved policy in 2006, which supported the use of surplus resources to finance high-priority global public goods. In light of the prominent role GPGs play in IBRD’s Forward Look objectives and the importance of concessional resources for supporting GPG projects, it is proposed that a modest portion of the resources in the surplus account be used to provide direct support to finance GPG projects based upon evaluations of IBRD’s annual financial results, and considering reserve retention needs.

(4) Administrative expense

83. The IBRD capital package will require additional administrative budget. The cost pressure arises not only from the need to deliver higher lending volumes and to support and supervise growth in the IBRD portfolio, but also the need to accommodate an increased cost of doing business. The increased cost of doing business arises from such drivers as supporting the policy ambitions under the Capital Package for operational shifts to FCVs, low and lower income countries; funding the shifts to riskier, costlier sectors and lending instruments; implementing the new Environmental and Social Framework in more challenging environments; and ensuring staff security and safety.

84. However, these gross costs will be partially offset by a combination of economies of scale and efficiency savings, reducing the net additional budget need. In particular, the higher lending volumes will enable Management to generate economies of scale by increasing average project size and leveraging the IG&A units and other support costs to support the growth in volumes. In addition, efficiency savings and cost avoidance measures are being identified as part of the FY19-21 business planning process in consultation with the Board. Management anticipates claw-backs from World Bank budget trajectories. This is in addition to the US$300 million of annual savings to Bank Budget achieved during the Expenditure Review, which remain permanently removed from trajectories.25

85. Management will complement these commitments with a dashboard of indicators covering the strategic alignment, sustainability and efficiency of our budget – building on the budget indicators presented in the FY18 Budget Paper. A key indicator is the IBRD total administrative budget per billion dollars of portfolio under supervision.

86. Management has delivered on its commitment to bring the IBRD budget anchor (IBRD’s administrative expenses as a ratio of IBRD loan spread income) below 100 percent by FY18. To support the financial sustainability of IBRD, Management will move the IBRD budget anchor ceiling target zones steadily downward in steps.

25 The target of US$340 million in ER savings for the World Bank (US$300 million Bank Budget and US$40 million Bank Executed Trust Funds) was part of a broader savings target of US$400 million for WBG institutions.
(5) Capital increase

87. To support the proposed policy package, in addition to internal measures, a US$7.5 billion paid-in capital increase is proposed, consisting of a US$1.9 billion Selective Capital Increase (SCI) and a US$5.6 billion General Capital Increase (GCI). It is assumed that the payment period will be over five years (FY20-24), same as the 2010 capital increase. It is currently expected that IBRD’s SLL would remain above the projected loan and guarantee exposure in the projection horizon.

Summary of IBRD financing package

88. This package accompanies capital increase with significant measures on all of the four internal levers, which are in addition to the substantial measures already implemented in recent years. Supported by these internal measures, IBRD would continue to rely predominantly on its internal reserve generation to support its business growth.

C. IFC financing package proposal

IFC current financial outlook

89. IFC has had strong growth and profitability over the last decade, but its capital buffer has decreased to near its minimum threshold due to growth and other factors as noted below. Since 2008, IFC annual commitments (including mobilization) have grown at 4.6 percent per annum to US$19.3 billion in FY17, and IDA commitments have grown at 12.7 percent per annum to US$4.6 billion. IFC has generally had strong profits over this period, in most of the years exceeding US$1 billion for the year. Nevertheless, the Corporation’s deployable strategic capital (DSC), which is the amount of capital available to support new investments, has declined from its peak in FY07.

90. The drop in deployable strategic capital has been driven by growth, greater focus in high risk countries, and transfers from retained earnings. The primary driver of capital use in general is the increase in the outstanding portfolio driven by new investments, as each type of financial product requires a certain level of capital backing. Equity has a particularly high use of capital, about 3.5 times higher than loans. More investments in IDA and FCS also result in more capital use, as these investments require higher levels of capital backing due to higher risks, and they also contribute less to profitability, which over time reduces capital available. IFC’s capital has also been reduced due to the annual designation of portions of retained earnings to IDA, advisory services, and certain other uses.

91. Looking forward, the current financial situation greatly constrains IFC’s growth potential, particularly for IDA and equity investments. The potential for growth will vary depending upon many factors, such as IFC’s future profitability, and the share of investments in equity or IDA. Nevertheless, under a quite wide range of assumptions, IFC can grow robustly for only a few more years before the lack of capital would require a substantial slowdown to a static level of activity. This situation would also curtail the growth of mobilization, which is anchored by required co-investments by IFC. IFC has already decreased its annual equity investments over the past year to save capital. Reducing equity investments is, however, likely to reduce future growth as equity returns have historically contributed to retained earnings growth.
92. **Not only will IFC’s growth be restricted, but its ability to have a robust response to a crisis would be limited.** At the time of a potential financial crisis, the IFC role as a partner and investor is likely to be in high demand especially with existing clients. Under the current capital situation, IFC’s financial results would be vulnerable to market conditions, which could significantly limit its capacity to respond. With its DSC in low single digits, IFC is already more vulnerable to market shocks than in previous economic cycles. This lack of ability to be fully effective during crises would prevent IFC from providing one of the critical capabilities identified in the Forward Look.

93. **Without a capital increase, IFC’s outlook to 2030 is basically little to no growth.** IFC has modeled its future investment capabilities under current levels of capital with different assumptions for equity returns. At an average level of expected returns, IFC would be able to provide finance in 2030 at approximately the same level as today in real terms. Under more optimistic returns, IFC may be able to increase overall volumes by about 20 percent by 2030. And under a crisis scenario, with low equity returns, IFC would need to cut overall lending by over 30 percent.

94. **IFC would also be constrained in increasing focus on high risk countries and high development activities related to climate change, technology, and mobilization.** The flat growth outlook assumes business as usual with respect to IDA and equity focus. However, a greater focus on IDA and FCS as envisioned in the Forward Look would consume more capital, and thus be unfeasible or require a further curtailment in overall investment levels. More focus on technology change and entrepreneurship, including innovations related to climate change, would likely require more equity investments, which use a great deal of capital, and would therefore likely have to be scaled back. Finally, growth in mobilization would be limited by the overall volume constraints on IFC’s own account.

95. **These levels of potential engagement would be insufficient to address the vision in the Forward Look, MFD/Cascade Approach and IFC 3.0.** The Forward Look and IFC 3.0 commitments cannot be realized with current levels of capital. IFC would be unable to grow significantly in IDA and FCS, have higher impacts on development and creating markets such as through greater equity use, contribute more to global public goods such as climate change, or significantly increase mobilization to address the SDGs at scale. IFC would be unable to provide the leadership in the global community to help increase the contributions of the private sector in developing countries, and would be unable to fulfill its role within the World Bank Group to increase the contributions of the private sector.

**Options to enhance financial capacity**

96. **To address the delivery ambitions as profiled earlier in this paper, IFC will need an overall increase in capital of at least US$7.5 billion.**

- Relative IDA and FCS expansion: IDA/FCS at 40 percent of the program from 24 percent today, and 32.5 percent average over FY19-30. Thanks to IFC utilizing replenished PSWs, low income IDA and IDA FCS countries could reach 15-18 percent and 15-20 percent of the program by 2026 and 2030 respectively, up from about 7 percent in FY17.
• Climate investments, including mitigation and adaptation, at 35 percent in FY30 and an average of 32 percent between FY19 and FY30, from 25 percent today and 28 percent target for 2020.

• Balance sheet diversification: IFC maintains a robust engagement in non-IDA/FCS countries to create markets with development impact and to enhance overall income.

97. **IFC will raise the necessary capital to meet its policy ambitions using various instruments and mechanisms.** The financing mechanisms include various types of paid-in capital (through a cash injection of US$5.5 billion), the suspension of IFC transfers to IDA as well as additional measures such as risk sharing facilities in addition to internal measures to increase efficiency.

98. **US$5.5 billion Paid-in capital through a cash injection would be implemented through a three-step capital raising process: Conversion of a portion of the retained earnings into paid-in capital, a Selective Capital Increase (SCI), and a General Capital Increase (GCI).**

99. **Suspension of IDA transfers.** In November 2016, the IFC Board of Directors approved a new formula for designations for IFC. This formula covers the IDA18 period. If IDA transfers were suspended, IFC retained earnings could be increased thereby strengthening the Corporation’s capital position and reducing other capital requirements. There is a strong case to suspend IFC Income transfers to IDA as IFC intends to substantially increase its investments in IDA/FCS countries and is already providing “income transfers” between its IDA and non-IDA portfolios as investments in IDA provide a much lower than average return on deployed capital.

100. **Internal measures for increased efficiency could provide additional capital relief through savings on administrative expenses.** Delivering on commitments under the moderately scaled up scenario will require added resources to be deployed to deliver more and manage complexities and underlying risks (e.g. from increased focus on IDA/FCS and greater equity business). IFC has a series of efficiency programs and these are expected to reduce expenses. Also, with increased volumes, there could also be economies of scale through cost savings. IFC proposes to use savings from these internal measures to complement the capital package and reduce the need for capital. IFC will continue to ambitiously pursue efficiency gains through a more effective delivery model and several initiatives. Targeted efforts to scale up capacity and skill through workforce planning will pave the way for savings/tradeoffs from operations, in addition to efficiency gains sought from Finance, Facilities and Corporate Support Functions. IFC will also continue engaging in several WBG efforts, including compensation, corporate procurement and administrative simplifications.

101. **A net loan and fee coverage of administrative budget threshold will be among key indicators to ensure continued fiscal discipline.** Management has several measures in place to ensure that its financial and resource capacity is closely monitored and managed. These measures (both ex-ante and ex-post) will inform how best to maintain a sustainable resource trajectory. A key metric, minimum coverage ratio of its administrative budget from net loan and fee revenue alone, will demonstrate fiscal prudence while also affording operational growth from its additional sources of revenue, such as equity investments.
102. **IFC 3.0 will require further shifts to challenging and complex markets, and as a consequence, higher cost of doing business.** Under its strategy, resources will be carefully deployed toward creating markets, upstream work and implementation of cascade, whilst managing a significantly diversified and riskier portfolio to achieve continued growth (on average 3 times) and development impact. IFC closely measures effort, associated cost and output via its cost of doing business indicators, which, under IFC 3.0 will directionally place more strain on resources geared at delivering strategic priorities and managing risks.

*Capital package proposal*

103. **A package combining several of the options discussed above could provide the needed US$7.5 billion in minimum enhanced capital for IFC.** In combination with the efficiency measures discussed above, the IFC financing package would be as follows:

- Paid-in capital increase through a cash injection of US$5.5 billion using a combination of SCI and GCI;
- Suspension of IDA transfers;
- Additional measures to provide capital relief through risk sharing facilities.

**VI. CONCLUSION**

104. **The individual commitments, reforms and measures proposed in this paper are each significant, and together, they will be transformative,** reshaping not only how the WBG delivers development finance to its diverse membership, but also the future of international development.

105. **For WBG clients, the Capital Package will make a decisive contribution to the 2030 development agenda and the WBG Twin Goals.** It will make a real difference in the lives of hundreds of millions of people around the world, through creation of new jobs, to access to clean water, electricity and financial services, from provision of essential health and nutrition services to improving quality of education and building social safety nets. The paradigm shift embodied in the new Cascade approach within the MFD framework will lead to significant scale-up in mobilization and turn billions-to-trillions into reality. A “bigger”, “better” and “stronger” WBG that can stabilize, influence, leverage, convene, create markets, and respond to unexpected shocks will bring value to the global community that goes well beyond these results.

106. **Against this background, we ask that Governors:**

- Endorse the IBRD and IFC policy package, as described in Section IV, that translates the Forward Look objectives into policy targets;
- Endorse the package of financing measures, including a broad range of internal measures, as well as -
i. Capital increase of US$60.1 billion for IBRD, with US$7.5 billion in paid-in and fully usable, and the remainder callable, through a combination of a selective capital increase and a general capital increase.

ii. A US$5.5 billion paid-in capital increase for IFC through a cash injection using a combination of a selective capital increase and a general capital increase.

107. Following Governors’ endorsement of the proposed capital package, Management and Executive Directors will prepare draft Board of Governors’ Resolutions, with the aim of submitting them to the Governors before end-June 2018.