

# Multilateral Development Banks and Financial Institutions: Additional Power in Turbulence Economic Conditions

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## ABSTRACT

In this scientific paper the role of multilateral development banks and financial institutions in member countries' economies is considered. The comparative analysis was carried out, videlicet the characteristics and peculiarities of the functioning and investment opportunities were analyzed by the example of the largest MDBs and MFIs. The analysis contributed to suggesting the idea of the application of multilateral development banks and institutions as an additional power for supporting member countries' economies, counting on the development of not high demand economical spheres. Taking into account current turbulent situation in the world economy, way of mobilization of financial and economic cooperation between member countries was found out, and usefulness for foreign partners is estimated.

**Keywords:** De-globalization, Financial Support, Economic Development, Investment Attractiveness, Additional Power

## INTRODUCTION

The modern world development is characterized by the growth of global challenges which require from the international community to consolidate resources at the national, regional and global levels to resolve them in the interests of all mankind and not only the selfish interests of a certain group of states. Increasingly questioned the rationality of globalization: there are various crises and global turmoil, leading to processes of economical separation. The mode of interdependence of the states increases their vulnerability. In this regards, through de-globalization, there are calls to bring global development into the mainstream of equal cooperation based on the principles of respect for national interests, recognition of the states' rights to choose their own development model – taking into account the national traditions, mores and customs.

Under such conditions of uncertainty, the world economy is functioning at present. The only possible scenario at this stage is the ability to adapt and to move forward despite difficulties. Financial markets are being constantly shaken by unforeseen events and crises on the global market. There is an opinion that the financial markets are already depleted and they need additional support to develop important industries. This additional support already exists – multilateral development banks and financial institutions. Their influence on the development of the economies of member countries very rarely covered in public, but the scale is really huge.

The aim of this scientific work is to re-open multilateral development banks and financial institutions as a way of development of low-invested economical spheres of member countries by virtue of studying already existing experience. The authors' objectives are to identify the current situation on the world market, to investigate the experience of cooperation between multilateral development banks and financial institutions and economies of developing countries and carry out the analysis of their investment support. The timeliness of the topic is contingent on the relationship of the sustainable finance-economic development of the world economy with the unforeseen economic collapses, therefore, the aim and objectives, which are in an effort to abandon the existing 'cliches', are directed to familiarizing with the information rarely publicized previously. The object is formed by the system analysis and comparison of the available data.

## The Turbulence of the World Economy

The development of international trade and information technology, change of political conditions led (at the end of the 20<sup>th</sup> century) to the emergence of a single global economic and information space, to the active interpenetration of knowledge and technology.

All these phenomena are collectively referred to “globalization”. This concept was one of the most popular at the beginning of 21<sup>st</sup> century. Any tandem, conglomerate, cooperation in the frame of cross-border or international relations took place under the aegis of globalization. Since the removal of artificial barriers to international trade, the renouncement of voluntary isolation enabled many countries to show a significantly higher economic growth than it might have been in case of a different development scenario.

However, in the second decade of the 21<sup>st</sup> century, there were obvious trends towards the opposite process – de-globalization. This paper regards de-globalization as the process of diminishing interdependence and integration between certain units around the world as the scale of individual enterprises and states. The western society today cannot be called monolithic; there are objective contradictions between its members, taking into account their differences in a geographical, economic, military and political situation.

De-globalization means a return to the situation where the state is responsible for the state of affairs within its territory and for its relations with other members of the international community. The western community faces a dilemma: either to *follow its monocentrism policy* in the world (de-globalization), forcing its own rules of life and values upon the international community, or to *follow the way of searching for a new balance of interests in international relations*, building up a *constructive* rather than confrontational *model of cooperation* with the already formed tandems and financial institutions (globalization).

For instance, the president-elect Donald Trump approached the decision radically. Already during the first days of his work he began to put his election campaign into life, and made a number of intentions, aimed at “protecting” the US economy. In particular, 23 January 2017 he signed executive order withdrawing US from the Trans-Pacific Partnership in terms of which the creation of a free trade area in the Pacific Rim was planned. In fact the Pacific countries have 40% of the world economy and one third of the world trade. Some experts connect such decision with the global trend towards protectionism, in terms of which isolation of the worlds’ leading economy is equivalent of de-globalization. In turn, more and more European leaders express their concerns about this policy, presenting it as a serious threat to the development of the world economy.

Despite many controversies about which policy of functioning is more acceptable to the world economy it is important to evaluate from the perspective of a quantitative parameter: to analyze the world economy annual growth rate. According to the World Bank, there has been no growth for the last 5 years - which is considered to be the period of de-globalization (Figure 1).

However, the adherents of de-globalization continue to insist on the fact that the world economy in its globalized “holistic” form and total interaction is currently facing a flurry of risks, contingencies and even global financial catastrophes, and became the subject to the strongest shocks. For instance:

- 4 years ago: US Federal Reserve decision to gradually stop the quantitative easing policy;
- 3 years ago: Fall in world oil prices;
- 2 years ago: Market volatility due to the reassessment of risks related to the economic downturn in China;
- Last year: Brexit.

All these and many other events in the era of globalization have caused economic turbulence. According to the American researcher N. N. Taleb, such events can be called and defined as the Black Swan.

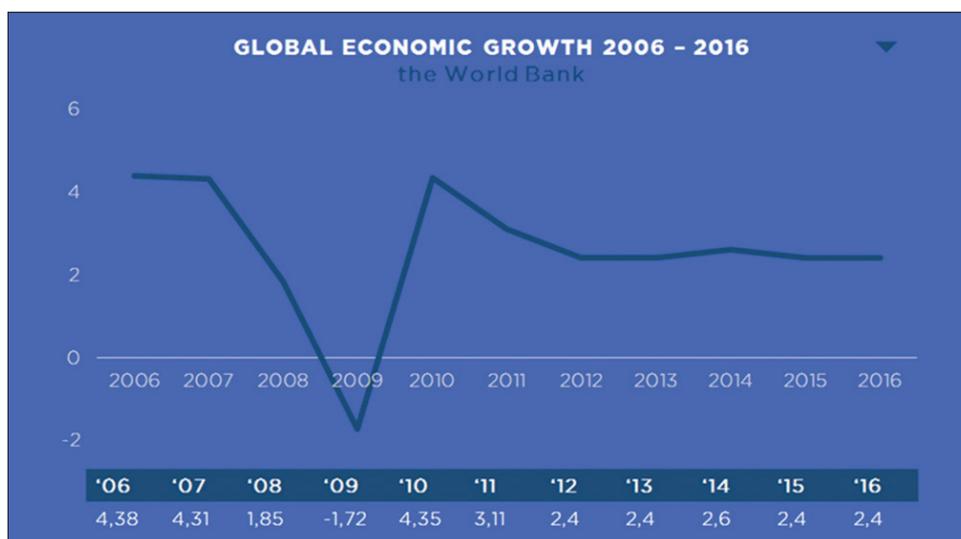


Figure 1: Global economic growth 2006 – 2016 years

In short, it is a combination of low predictability with the impact force. First, such an event is abnormal, because nothing in the past foreboded that. Second, it has a huge impact force. Third, the human nature forces us to find explanations of what happened after it has happened, which makes the event, first perceived as a surprise, explainable and predictable. For instance Brexit – was it predictable? Brexit (and any “Black Swan” alike event) acts as a request for changes existing in society that are related not only to the politics, but to the economy in a greater extent. Since a slow growth of the global economy causes the loss of confidence and the feeling of dissatisfaction among people in many countries around the world a closed circle of turbulence formation appeared (Figure 2).

Moreover, each event of such kind unsettles the world economy, namely the global financial markets, for a long time. That is why today it is so important to ensure the stability of the financial system in the face of all sorts of risks, in particular the unforeseen ones.

The world economy and associated financial markets need additional capacities and stabilizers that are able to operate in crisis conditions.

### **Additional Power**

In the modern world, any growing company, with a view on development, tries to build up its resource base: capital, equipment and staff. The same system already exists in developing and developed economies. They also come to the need of additional power, at least, to stand against the Black Swans that annually shake markets.

As is known, the basis of any country consists of its financial system. It defines directly the level of economical, political and social development of the country. That is why, when speaking about the stabilization of the economy, it can mean the stabilization of the financial system. Regarding the development of the world economy, it should be noted that countries need a catalyst that would not overburden their financial markets, but would serve as a support and accelerate their development. *Multilateral development banks and financial institutions* could become such a catalyst.

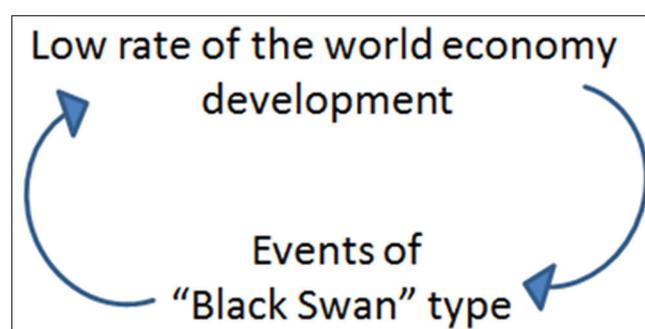
They are existing to improve the coordination of aid policies in the member countries, at regional and global levels.

*Multilateral development banks* (MDB) providing financial support and professional advice for economic and social development countries to have a high level of cooperation. MDBs typically refers to the World Bank Group and these four Regional Development Banks:

- The African Development Bank
- The Asian Development Bank
- The European Bank for Reconstruction and Development
- The Inter-American Development Bank Group

These banks have a broad membership (and not limited to member countries): borrowing developing countries and developed donor countries. Each bank has its own independent legal and operational status, but with a similar mandate and a considerable number of joint owners.

*Multilateral financial institutions* (MFI) are several other banks and funds that lend to developing countries. They differ from MDBs in that they have a narrower ownership/membership structure and the focus on special sectors or activities.



**Figure 2:** The endless process of economic turbulence formation

Examples of MFIs:

- The Islamic Development Bank
- The OPEC Fund for International Development
- The European Commission and the European Investment Bank
- International Fund for Agricultural Development.

Multilateral development banks and financial institutions play significant role in supporting developing economies of member countries by direct and indirect financial assistance.

The provision of traditional financial products and services (loans, grants, equity and guarantees) has been the primary mechanism to assist countries. They are able to provide developing countries with financial products and services at a price that those countries would not have been able to secure from financial markets independently. For some fragile and conflict-affected countries that have no access to formal financial markets, MDBs and MFIs are the only source of high quality financial products.

Just to name an example, in March 2016 after Russia, despite all the warnings, acknowledged the results of the all-Crimean referendum, supported the unilateral Declaration of independence of the Republic of Crimea and adopted its proposal on the membership of the Russian Federation the number of sanctions was imposed on Russia, which was widespread in the financial sector and actually blocked the access to the global financial markets. Some banks and companies have lost the opportunity to access the debt market in the U.S. and Europe, but still can make their payments or payments of their clients. Moreover some private banks and enterprises in the defense sector are restricted to conduct the monetary payments to or on behalf of these banks/enterprises.

However MFIs, operating on the territory of the Russian Federation are excluding from this list according to the Council Regulation (EU) # 883/2014 of 31 July 2014 concerning restrictive measures in view of Russia's actions destabilising the situation in Ukraine.

The loans that providing by the multilateral institutions usually offer a greater flexibility for member-countries in relation to interest rates, loan fees and repayment terms. For example some MFIs provides loans with a small interest and with repayment period as long as 40 years. Clients of multilateral development banks and financial institutions also benefit from their ability to issue products in foreign or local currencies, providing loans targeting public good and services that were not in demand among private sector.

Concerning indirect financial assistance MDBs and MFIs are playing a role of the catalyst. While providing services they can bring other financing partners into the transactions (e.g. through syndications or other co-financing arrangements). It could be the other MDBs, private companies and funds or commercial banks. As a lead financier or a first lender MDB (or MFI) is able to bring technical expertise, due diligence, and regional presence.

In addition to the financial support which MDBs and MFIs provide to its members, it is important to emphasize that they have a high level of resistance to the world financial crises and economic shocks in general. There is not a single historical example when such financial institution (in particular bank) was on the verge of bankruptcy due to the crisis in the financial markets. The reason is the shareholders of MDBs and MFIs are member countries that are interested in their smooth functioning.

Mobilization of financial and economic cooperation in between member countries is one of the key responsibilities of the MDBs and MFIs. They are playing very important role addressing the global issues. Promoting international economic cooperation and stability multilateral development banks and financial institutions are active in supporting programs that are global in scope, in addition to their primary role of financing and providing technical assistance to programs at the country level. That is why they could become an additional power for financial markets and supportive mechanism for member-countries.

### **Investments as a Counterweight to the Slowdown in the Global Economy**

The investment activities of all economic entities play the key role not only in the processes of capital accumulation and circulation of money. It is impossible to overestimate the role of investment in the economy; an active investment of finance allows avoiding protracted crises and making the economy more vibrant.

In the market economy, profit is the main stimulus and the main indicator of the effectiveness of any enterprise. Profit is the source of material welfare of the staff members and social and industrial development. Therefore, every entrepreneur, every private corporation strives to increase it.

However it is a fact that there are implicitly exist profitable and non-profitable sectors of the economy. As a rule, less attractive are such fields (and companies) as: education, culture, social projects, in other words, everything that is mainly supported by the State (otherwise these industries would not have funds for normal functioning because they do not target any profit maximization, but ensure social or public welfare). They are the most vulnerable sectors of the economy during recessions, wherethrough their already low funding is cut down then.

Then a paradox of multilateral banks appears. The primary purpose of these banks is a contribution to the development of member countries, rather than profit maximization. They are investors in “unpopular” sectors of the economy, in other words, they invest in development (Figure 3). Much more attention is paying to small and medium enterprises.

Reliable electricity supply, efficient transport systems, modern telecommunications and clean water supply improve the health and wellbeing of the people in countries all around the world. There is an advance that infrastructure services make a huge contribution to GDP, exceeding the cost of provision. The most of investment comes from domestic sources, but the MDBs and MFIs provide considerable support.

Multilateral development banks and financial institutions are important providers of financial and non-financial support to developing countries. Financing infrastructure and is a key area of MDB support because development of productive infrastructure encourages economic growth, private enterprise and employment. It contributes to reduction of poverty and improves the live conditions through access to basic services.

After the project database analysis of the number of MDBs it was revealed that in general practice their financial support for the project is on average accounts for half of the total budget. It is also important to note the interaction process between the member-countries. To clear illustrate this process it was taken the information of the European bank for reconstruction and development (EBRD). This bank (like all other MDBs) works on a principle of mutual help: ‘A chain is only as strong as its’ weakest link’. To understand the mechanism it is needed to answer two questions: *What* is funded? - the most vulnerable and poorly resourced industries, and *Where?* - in the countries that need it most. From year to year, the list of the countries is updated. The Bank has 65 shareholders (member-countries). However, with a detailed review of the activities it is noticed that not all countries receive funding. For instance in 2016 the project funding was received by 31 country. The other half of the shareholders, acted as a non-reciprocal ‘donor’ of capital.

For illustration purposes, it was taken five the most considerable shareholders of the Bank, which as donors have invested their capital in the development of the indigent countries and five recipient countries with the most funding over the same period (Figure 4).

It is important to note that the recipients’ countries share in authorized capital in comparison with the donor-countries is much less meanwhile they receive significant project funding. This project funding is nothing but international investments that directly influence on the banks’ member countries development in particular and on the development of the world economy in general.

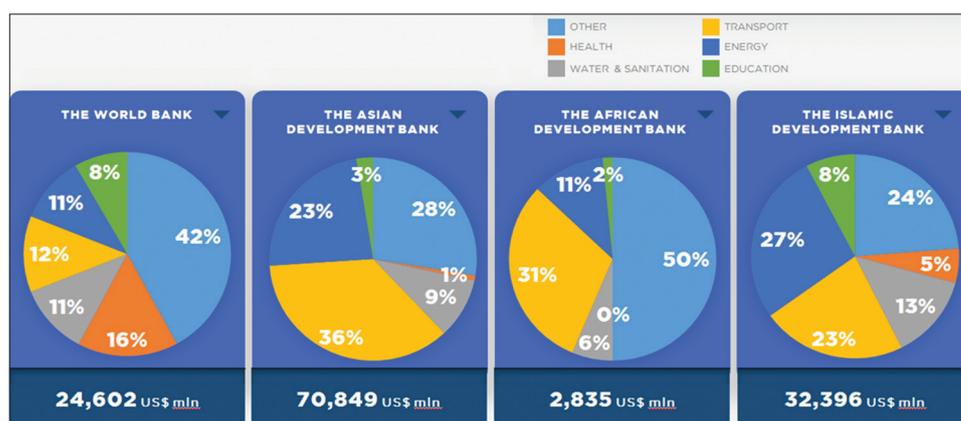


Figure 3: Target sectors for MDBs’ and MFIs’ investments

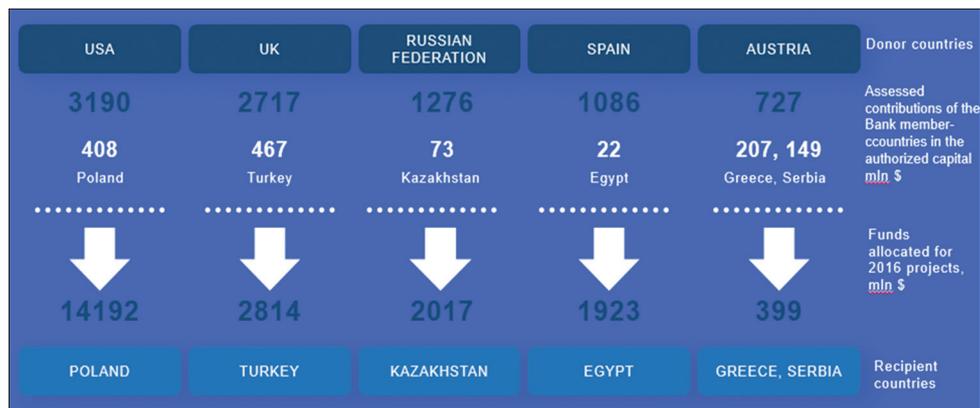


Figure 4: The most considerable donor and recipient countries of the European bank for reconstruction and development

## CONCLUSION

Due to unpredictable economic shocks exchange rates, statistical data, key macro and microeconomic indicators are changing in fractions of seconds. In this case there is no sense to summarize any preliminary results and even impossible clearly to say which of the two policies of functioning of the world economy more acceptable. With a hundred percent confidence it is possible to say only that today the task number one for the world economy is to learn how to act “here and now” in terms of recession, stagnation or rapid progress. In such conditions, organizations such as multilateral development banks and financial institutions are demonstrating the most stable functioning. Their experience demonstrates that in terms of possible de-globalization of the world economy countries still have brilliant alliances for mutual support.

In the modern economy the role of investment is huge, without it, enterprises would remain at the same stage of development over the years and the crises would have been really long. Subjects that are important for national economics have a lack of investments. In this scientific paper the author demonstrated how MDBs’ and MFIs’ project funding became sizable international investments and additional power. Financing from ¼ to 100% of the most important industrial projects for states, they directly affect the development of the Bank’s member states and in global - on the development of the world economy.

Interventions and programs financed by loans from the multilateral development banks and financial institutions are often a key to broader national strategies. By financing projects that cannot attract funding from commercial banks only, they can enable and support investments that would not come through. Aid channeled through MDBs and MFIs may, accordingly, have a large impact and be very effective.

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