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The World Bank and the Asian Development Bank: Should Asia Have Both?

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Abstract

This paper examines the complementary and competitive roles of the World Bank and the Asian Development Bank (ADB) in Asia given the backdrop of a changing world in which development priorities and challenges are changing rapidly and the rapid expansion of financial flows to developing countries is challenging the influence of these organizations. The paper highlights changes to the international aid architecture, its increasing fragmentation, the rise of non-traditional donors, and recent efforts at improving aid coordination. With this background, the paper examines the roles of the World Bank and ADB in Asia, provides some comparisons of their performance, notes their overlapping responsibilities, and explains current approaches to coordination and cooperation between them. After examining alternative approaches toward improving the division of labor between the two organizations, the author concludes that the most likely scenario will be one of “muddling through” in which stakeholders are likely to tinker at the margins at sharpening the specialization of each institution rather than push through any radical reallocation of financial and knowledge management responsibilities.

JEL Classification: F34, O1, O19

In this paper, “$” refers to US dollars.

Contents

1. INTRODUCTION

The World Bank and the Asian Development Bank (ADB) face three sets of challenges: those that are common to others in the official development finance community; those that are common to the World Bank's relations with other multilateral regional development banks (the European Bank for Reconstruction and Development, the African Development Bank, and the Inter-American Development Bank), several multilateral subregional development banks, and multilateral financial institutions (MFIs);[1] and finally, those related to operating as multilateral development banks in the most dynamic region in the world—Asia.

This paper examines all three challenges and asks whether it may be an opportune time to rethink the configuration of the world's multilateral development banking system. The current configuration—like the rest of the global aid architecture—has grown organically, responding to emerging challenges with new institutional and procedural "fixes". The result is a complex and unwieldy set of institutions that, despite their best efforts at coordination and cooperation, sometimes work against each other and often add to the administrative burden of the member governments they serve.

The paper begins with an overview of how a rapidly changing world is altering development priorities and giving rise to new development challenges that are stretching the capabilities of the development community, including development finance institutions. At the same time, the contribution of multilateral development banks to total net financial flows to developing countries is falling. Section 3 describes changes to the international aid architecture, its increasing fragmentation, the rise of non-traditional donors, and recent efforts at improving aid coordination. Section 4 describes the roles of the World Bank and ADB in Asia, provides some comparisons, notes their overlapping responsibilities, and explains current approaches to coordination and cooperation.

2. THE WORLD OF—AND AROUND —DEVELOPMENT FINANCE IS CHANGING

Output, trade, and finance. The global economic landscape is undergoing a profound transformation. The structure of world output, trade, and finance is shifting rapidly. The rise of Asia, especially the People's Republic of China (PRC) and to a lesser extent India, is inexorably shifting the global economy's center of gravity away from Europe and the United States. This trend was clearly visible in the 1990s, accelerated in the 2000s, and has been amplified by the 2008–2009 global financial crisis. As a result, emerging economies have become an influential force in the global economy. The share of developing countries in global trade has climbed from 30% in 1995 to 45% in 2010. Much of this increased trade has been among developing countries. Similarly, over a third of foreign direct investment in developing countries now comes from other developing countries. Indeed, since the global financial crisis, the investment risk

[1] The multilateral development bank system is composed of the World Bank, the multilateral regional development banks, and the multilateral sub-regional development banks. Multilateral sub-regional development banks include Corporacion Andina de Fomento; Caribbean Development Bank; Central American Bank for Economic Integration; East African Development Bank and West African Development Bank. Multilateral financial institutions include the European Commission and the European Investment Bank, International Fund for Agricultural Development, the Islamic Development Bank, the Nordic Development Fund, the Nordic Investment Bank, and the OPEC Fund for International Development.

premium in many emerging economies is below that in some European countries. Reflecting the strong external payments position in many developing countries, international reserves held by emerging economies reached $7.4 trillion in 2010, well over three times the $2.1 trillion in reserves held by advanced economies (World Bank 2011).

Capital flows. Another dimension of change in the global economic landscape has been the level and volatility of capital flows. International trade in financial assets has grown much more rapidly than international trade in goods and services. Indeed, the volume of assets traded internationally climbed over 15-fold in the two decades prior to the financial crisis—with bank loans, bonds, and portfolio flows growing at roughly the same pace as each other while derivatives grew much faster. This growth is likely to accelerate as global savings is expected to rise rapidly—because savings will rise in advanced countries and there will be little corresponding decline in savings in developing countries. The size of the foreign asset market has already significantly complicated macroeconomic management, especially in emerging market economies where capital inflows and outflows tend to be particularly volatile—and the size and volatility of such flows is only likely to increase.

Multiple growth poles and global governance mechanisms. Going forward, emerging economies are expected to outperform advanced countries and become important drivers of global growth and trade. By 2030, global economic projections show emerging economies are likely to contribute two-thirds of global growth, half of global output, and will be the main destinations of world trade. Just as the rise of the United States in the late 19th century altered the balance of power and influenced the course of events in the 20th century, so to will the rise of emerging economies affect the distribution of global economic and geopolitical power in the 21st century.

The emergence of multiple growth poles and centers of economic power will need to be reflected in global governance mechanisms responsible for the management of global economic affairs including global economic and financial stability, economic development, and global trade in goods and services. While there has been considerable discussion on how these shifts should be reflected in the world's governance arrangements, agreement has been difficult to reach and progress has been slow.

Global public goods. Notwithstanding the global financial crisis and the increased risk of protectionism, especially in developed countries, the forces of globalization will remain irresistible. As a result, global public goods—a global agreement for trade of goods and services, climate change mitigation, international financial stability, anti-money laundering and countering the financing of terrorism, food and energy security, intellectual property rights, a legal framework for commercialization of space and the sea bed, among others—are only going to increase in value. There is little doubt that the world's demand for these global public goods will increase. The major question is whether there is sufficient global will for collective action that will ensure their supply.

International aid architecture. It is within this global context that the current international aid architecture will need to evolve. Official aid flows to developing countries peaked in 1991, driven in large part by bilateral aid. Multilateral aid grew only modestly, at about 4% a year in the two decades before 1991. Aid flows slowed after 1991, again largely owing to bilateral aid, falling by as much as 22% by 1997. But this period also saw increased poverty in Sub-Saharan Africa and an expanding group of fragile states. In 2002, spurred by the Millennium Development Goals, the international community committed to doubling aid by 2010. Actual aid flows have since climbed by more than 50%, but the amount of aid that recipients can actually use is barely above the level of 1991 (Kharas 2007).[2]

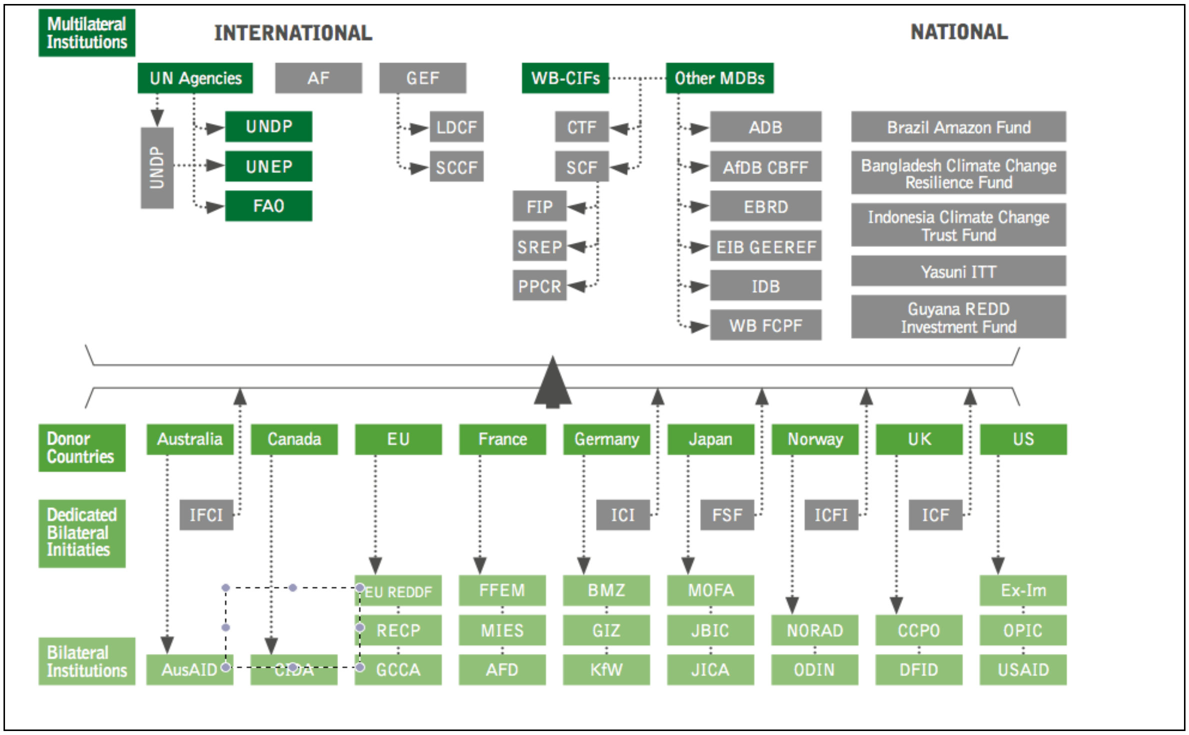
While multilateral aid has climbed steadily in nominal terms, its composition shifted in two ways. First, the share of IDA and regional banks fell from 47% of total multilateral aid in 1995 to 36% in 2005, while the share of UN agencies fell from 25% to 17% over the same period. The European Commission, which became the largest source of multilateral aid in 1997, largely filled the gap (Kharas 2007). Second, the last two decades have seen the birth of an increasing number of vertical funds—such as the Global Environmental Facility, GAVI, and GFATM—some of which have themselves become bewilderingly complex (Figure 1).

Perhaps the most significant development in recent years has been the rise of non-traditional donors: non-DAC (Development Assistance Committee of the Organisation for Economic Co-operation and Development) bilateral donors, foundations, nongovernment organizations (NGOs), religious organizations, and private voluntary organizations. Non-traditional donors are the fastest growing component of aid flows. Of these, private giving (by foundations, NGOs, religious organizations, and private voluntary organizations) is by far the most significant, surpassing official aid flows in recent years. Non-DAC bilateral donors include Brazil; the PRC; India; Taipei,China; Turkey; and Thailand. Of these, aid from the PRC has grown the fastest.[3]
In summary, the international aid architecture has become a complex behemoth (Figure 2). Some 37 bilateral donor countries report their aid to DAC and many others do not; there are 233 multilateral agencies, more than there are bilateral donors and recipient countries (155) combined. Dozens of international NGOs receive funds from bilateral donors, and thousands of private organizations have joined the aid community, some of them, like the Gates Foundation, rival the largest bilateral and multilateral organizations in size and reach.

[2] A significant amount of aid is composed of administrative costs of aid agencies, humanitarian and emergency relief, food aid, and technical cooperation, none of which is a transfer of resources to recipient governments for development purposes.

[3] Recent press reports noted that the PRC’s foreign aid had surpassed that of the World Bank, but the PRC does not issue a definitive estimate of foreign aid and some PRC “aid” projects, executed as turnkey investments by the PRC state enterprises, have characteristics more akin to foreign direct investment.

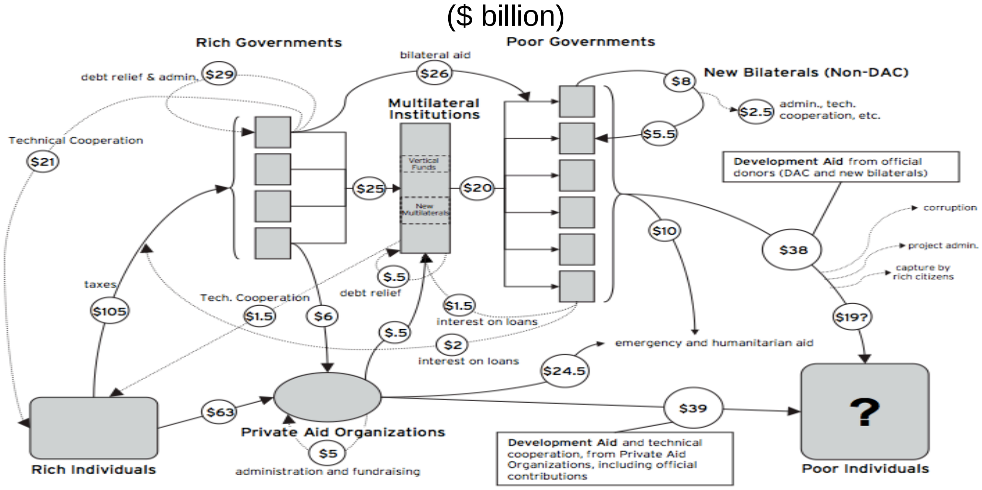
Figure 1: The Increasingly Complicated Architecture for Global Climate Funds



Source: Overseas Development Institute (2011). Climate Finance Fundamentals. The Evolving Global Climate Finance Architecture. London: Overseas Development Institute.

Figure 2: The Increasingly Complicated New International Aid Architecture

($ billion)



Source: Kharas (2007).

More donors have meant greater fragmentation of aid. In 1996, DAC bilateral donors financed 15,750 new aid activities with an average size of almost $3 million. By 2008, this had climbed to 84,764 activities, and the average size had shrunk to $1.35 million—with a median size of only $87,499 (Kharas and Fengler 2011).

Notwithstanding the rapid growth in aid from private givers, the prevailing view is that overall official development assistance (ODA) flows fall significantly short of what is desirable. But there are differing views on how much incremental ODA should flow to developing countries. Estimates range from $50 billion (United Nations 2002) to $200 billion (by those who argue that aid should reach the 0.7% of GDP target of developed countries). Detractors, however, respond that further aid will only spawn additional corruption, and unless aid effectiveness is increased, channeling additional aid will do little for promoting sustainable and inclusive development.

The challenge for the international aid community is to improve the current system (starting from a clean slate is not an option) and configure it in a way that channels aid through the most efficient organizations, ensures that it is provided for optimal-sized programs, projects, and activities with high development impact, and deliver it to countries where need is greatest.

One way to do this would be to tailor aid in accordance with a country's circumstances. To achieve this will require country ownership of aid-financed projects and the discipline of supporting country priorities and strategies. Another way is to better coordinate aid so donors don't work at cross-purposes or add to the administrative burden of the recipients. To achieve this will require acceleration in implementing the Paris Declaration on Aid Coordination—and expand it to cover non-traditional donors. Finally, national development agencies should insist on rigorous evaluations that identify successful projects for scaling up and delivering systemic change, while ensuring unsuccessful ones are discontinued or redesigned.

3. ADB AND THE WORLD BANK: FUNCTIONS, STRUCTURES, ROLES, AND RESPONSIBILITIES

ADB and the World Bank operate within a broad, evolving, and increasingly complicated global aid architecture.

ADB was established in 1966 "to foster economic growth and co-operation in the region of Asia and the Far East ... and to contribute to the acceleration of the process of economic development of the developing member countries in the region, collectively and individually." (ADB 1966: 4). Its initial focus was on food and rural development projects but it quickly diversified its operations to include education, health, and infrastructure development. During the 1970s oil crisis, ADB began financing energy projects to increase energy security in the region. ADB financed its first equity investment in the 1980s and was a major player, together with the International Monetary Fund (IMF) and the World Bank, in responding to the Asian financial crisis in the late 1990s by supporting financial sector development and strengthening social safety nets. It was during this period that ADB made poverty reduction its key objective. Starting with 31 members in 1966, ADB now has 67 members, of which 48 are from Asia and the Pacific and 19 are from outside this region (ADB Annual Reports various issues). The World Bank was created in 1944 to extend finance for the reconstruction of Europe following the Second World War and subsequently to overcome obstacles facing developing countries trying to access international capital for development purposes. It now consists of five separate entities—the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA), the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency (MIGA), and the International Center for the Settlement of Investment Disputes (ICSID). IBRD and IDA constitute the core of the World Bank Group and provide financial and technical assistance for development in low- and middle-income countries through a suite of loans and grants across the entire range of development challenges facing poor countries—including health, education, infrastructure, agriculture, public administration, macroeconomic management, institutional development, governance, financial and private-sector development, environmental protection, and natural resource management (World Bank Annual Reports various issues).

Both the World Bank and ADB are actively involved in every low- and middle-income country in Asia and the Pacific, except North Korea and Myanmar—although in Myanmar, the two institutions have begun to assess the economic situation and provide broad policy advice. There is a similar overlap in sectoral involvement.

Coordination is therefore a key issue. At the Group of Twenty (G20) summit in Pittsburgh in September 2009, leaders called for greater coordination and a clearer division of labor between the World Bank and the regional development banks. They further stated that the World Bank and regional development banks take into account their comparative advantage, while improving coordination and efficiency, and minimizing overlap with other international financial institutions and private financial institutions (World Bank 2010).

Notwithstanding their similar objectives and overlapping responsibilities, coordination between the World Bank and ADB in Asia is not a simple matter. ADB has to coordinate country strategies with three different regional vice presidents of the World Bank (East Asia and the Pacific, South Asia, and Europe and Central Asia) as well as the country directors in each country; and coordinate sector strategies with the World Bank's three major networks—poverty reduction and economic management, sustainable development, and human development. While procedures for coordination are elaborate and institutionalized, the quality of coordination depends on personalities in both institutions and, occasionally, the role of the country authorities.

The recent tripling of ADB's authorized capital from $55 billion to $165 billion has significantly increased its financial strength (ADB Annual Report 2010). It is now, by far, the largest of the regional development banks and some of its financial indicators are approaching those of the World Bank. ADB's authorized capital is some 60% of the World Bank's, its net income in 2010 was two-thirds, and its total assets abut a third (Table 1). The chief difference between the two institutions is that ADB's sustainable lending is significantly above its current level, while that of the World Bank is trending downward.

Table 1: ADB and the World Bank: Selected Financial Indicators

($ billion)

	ADB	World Bank [b]
Lending in 2010 [a]	8.2	44.2
Disbursements in 2010 [a]	5.3	28.9
Outstanding loans [a]	43.6	129.5
Authorized capital	163.8	278.3
Outstanding debt	51.8	135.2
Total assets	100.2	312.8
Net income.	0.6	0.9

[a] To sovereign borrowers only.

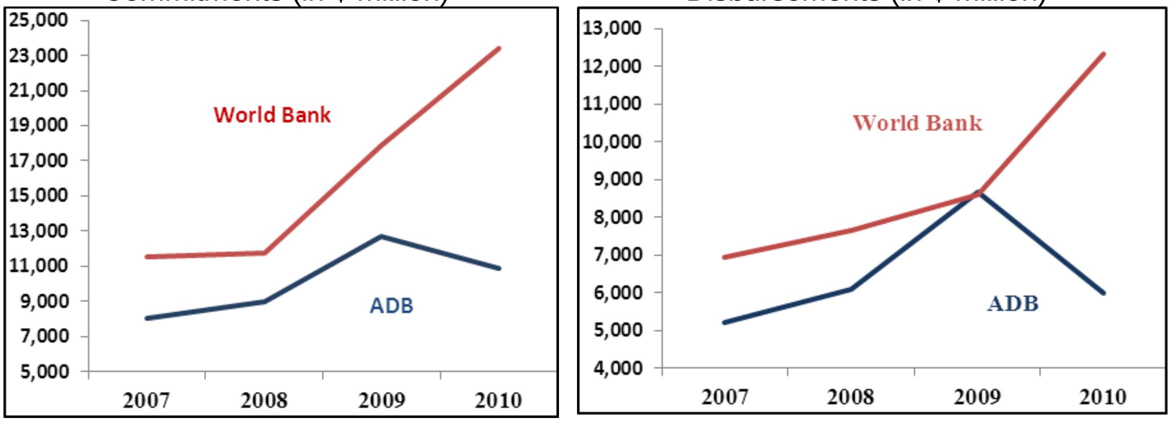
[b] Excludes IFC.

Sources: ADB Annual Report (2010); World Bank Annual Report (2010).

It is more difficult to do a detailed comparison of ADB's lending indicators with those of the World Bank's Asian operations. Comparisons could only be made for two variables—commitments and disbursements (Figure 3).[4] These show that ADB's commitments and disbursements declined in 2010 while those of the World Bank increased. But the World Bank's lending levels are not sustainable and are expected to decline in coming years, while ADB's commitment levels are likely to remain at about $10 billion a year. This will make ADB the dominant multilateral development bank lender in Asia, barring any further capital increase for the World Bank in the near future (an unlikely proposition).

[4] I am grateful to Raymond Lu (Junior Fellow, Carnegie Endowment for International Peace) for putting together some of the numbers for this graph. The data include all Asian countries (East Asia, South Asia, and Central Asia) and cover all commitments of grants and loans by the two institutions. Lending to the Pacific island economies has not been included.

Figure 3: ADB and World Bank: Comparisons of Commitments and Disbursements (2007–2010)



Note: To sovereign borrowers only. IFC = International Finance Corporation.

Source: Aidflows. http://www.aidflows.org/

There are no head-to-head comparisons of operational performance indicators between ADB and the World Bank's Asian operations.[5] Even head-to-head staffing comparisons are not available, although one analysis of the PRC operations of the two institutions found that despite the much larger lending and non-lending (analytical and advisory) activities of the World Bank, the staffing numbers were virtually identical (ADB 2007).

There is available, however, a comparison of the institutional profile of private sector operations prepared by the Multilateral Development Banks' Common Performance Assessment (Table 2). But even this is of limited use since there is little regional breakdown available on IFC's private sector operations.

Table 2: Institutional Profile of Private Sector Operations: Comparisons between ADB and IFC

($ millions)

	ADB	IFC
Investment portfolio	4,284	38,841
New commitments	1,918	12,664
Advisory services/technical assistance	3	188

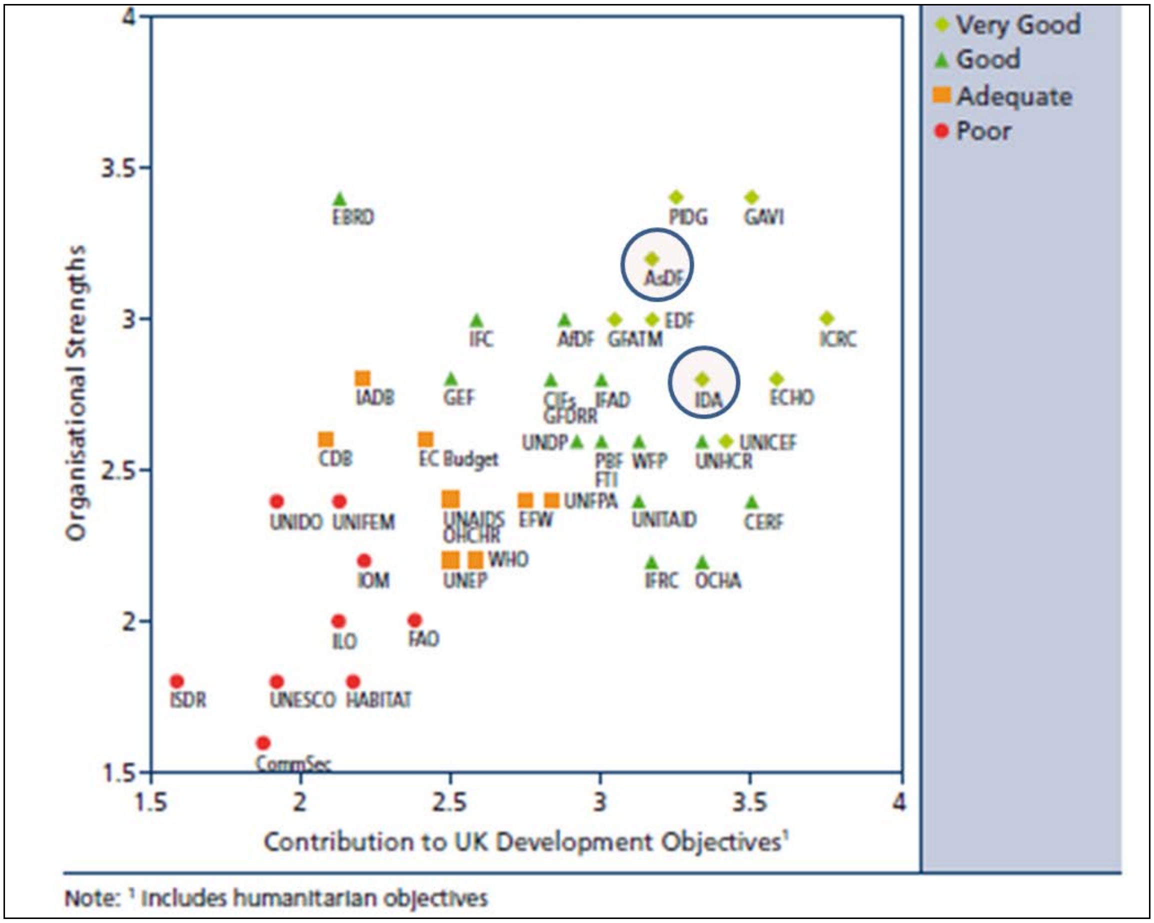
Source: Multilateral Development Banks' Common Performance Assessment System (2010). Annex 2.

Comparisons of the quality of aid by agency—bilateral and multilateral—tend to give the World Bank (mainly IDA) and ADB (mainly Asian Development Fund or AsDF) high marks. In four studies, the World Bank appears in the top five agencies in all four, while

5 Conducting fresh research for the purposes of this paper was not possible, given time constraints.

ADB appears in two of the four (Knack, Rogers, and Eubank 2010; Easterly and Pfutze 2008; Roodman 2006; 2009; Birdsall and Kharas 2010. The latest of these studies measures the quality of aid on four different dimensions—maximizing efficiency, fostering institutions, reducing burdens, and transparency and learning (Birdsall and Kharas 2010). It finds that IDA is the only multilateral agency that ranks in the top 10 in all four indicators (Ireland is the only bilateral aid agency to do so). ADB appears in the top 10 for two of the four measures. In a fifth study that includes AsDF and IDA, both institutions were rated "very good", with AsDF better on partnerships, strategic management, and operations in fragile contexts, and IDA better at focusing on poor countries (Figure 4) (DFID 2011). Similarly, in studies using a common performance assessment methodology, both institutions emerged with high performance ratings in the strategic, operational, relationship, and knowledge management areas (MOPAN 2009; 2010).

Figure 4: Comparison of Effectiveness of Aid Agencies (UK Perspective)



Source: DFID (2011).

Unfortunately, there is no head-to-head comparison of the two institutions for the quality of knowledge services provided to client countries—arguably the most important contribution these two institutions make to development efforts. The closest such indicator is the publications record of the research of the two institutions (Table 3). The

World Bank now ranks second only to Harvard University in terms of the volume of journal articles it publishes each year on development economics (Ravallion and Wagstaff 2010).

Table 3: Comparison of the Publications Record of the World Bank and ADB

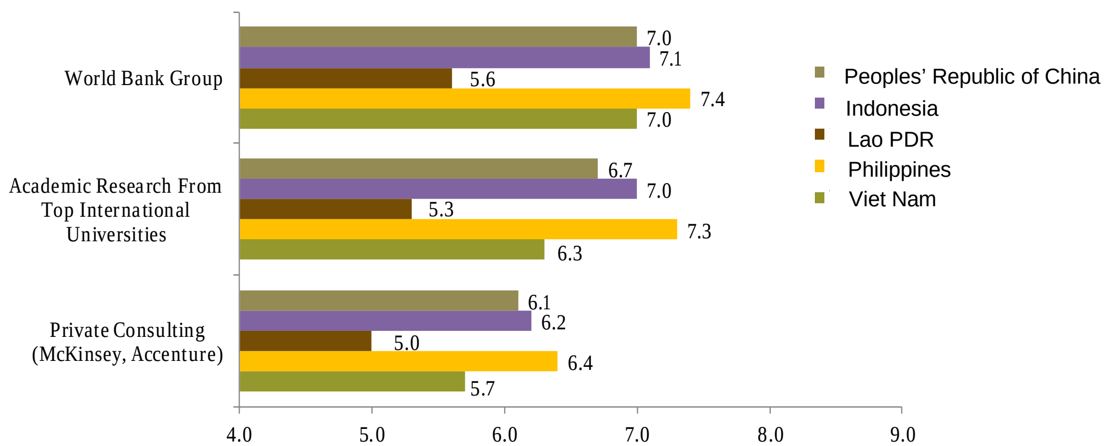
	Articles		
	mentioning a developing country	in 16 top development economic journals	in 27 specialized development journals
World Bank	1757	1343	1702
ADB	69	..	56

Source: Ravallion and Wagstaff (2010).

In East Asia, it is not just the volume of the World Bank's research output that has been important, but also its relevance, A Gallup poll conducted in East Asia found that the World Bank's knowledge, research, and data outputs were given higher ratings compared to international universities and private consulting firms in all the countries surveyed (Figure 5).

Figure 5: Impact of Knowledge and Research in East Asia

How much impact does the knowledge, research, data produced by the following organizations have? MEAN SCORE



10-point scale, 10 is high level of impact and 1 is no impact at all

Source: World Bank. 2008. 2008 World Bank Group Global Poll. East Asia/Pacific: Full Results. (data provided by Gallup Consulting).

4. ISSUES AND OPTIONS CONFRONTING THE WORLD BANK AND ADB

Going forward, there are three issues that confront the World Bank and ADB in Asia that are more broadly symptomatic of the role of the World Bank and its relationships to all the regional development banks.

The first is the very fundamental issue of relevance. Given the declining role of official development assistance in overall capital flows to developing countries, and the diminishing role of multilateral development banks within that space, the World Bank and ADB should constantly re-evaluate the value they bring to developing countries through their operations. While there are biting critiques of aid in general, (Easterly 2006; Moyo 2009) within the international aid community, the overall assessment of the World Bank and ADB remains broadly positive.

Nevertheless, the two institutions face competition from two directions. The first is the growing importance of non-traditional donors, some of whom provide resources without the strings that come attached to World Bank and ADB lending. But the two institutions argue that their resources also come packaged with development knowledge and global experience—and this contention is backed by surveys of client countries on the effectiveness of the two institutions.

But this raises the second concern—that the development knowledge space is becoming increasingly crowded with regional and international think tanks and consultancy organizations, academic institutions with centers focused on development issues, specialized agencies, bilateral technical agencies, and organizations such as the OECD–DAC. Although the World Bank and ADB continue to enjoy unique access to policymakers in many Asian developing countries, their comparative advantage is rapidly diminishing—especially in middle-income countries which have less need for their financing (and, therefore, feel less pressure to engage in policy dialogue), and in any case can afford to access the best technical knowledge available in the world wherever it may reside. Sometimes, this knowledge may reside in the World Bank and ADB, but often it does not. Moreover, increasingly Asian policymakers and their staff are just as qualified as their World Bank or ADB counterparts, sometimes more so, and often with more hands-on experience of policy issues and policy implementation.

In Asia, the World Bank and ADB face a particularly challenging situation. The rapid growth of Asian countries has meant that many have moved from low-income to middle-income status and consequently need fewer resources from the World Bank and ADB while demanding more responsive and more sophisticated knowledge inputs. In many instances, policymakers in these countries look to examples and experience of the developed countries, not just in policy formulation but also in policy implementation. But such expertise is less likely to reside in ADB and the World Bank and more likely to be found in government departments and implementing agencies of these countries. True, ADB and the World Bank could act as conveners, matching demand for knowledge with those who have the best expertise available on the subject. But this space is highly contestable too, and other agencies—private and public—are increasingly providing these services, sometimes more efficiently than the World Bank or ADB.

The second key issue confronting both institutions is governance. This is perhaps more keenly felt in the World Bank—where there has been considerable concern that the voting structure does not represent the increasing influence of developing countries. Recent increases in the shares of developing countries, particularly the PRC, has raised the share of developing countries from 42.6% to 44.1% to 47%, still short of parity with the developed (Part I) countries. In addition, African countries were given an additional seat at the World Bank's Executive Board to bring the total number to 25.

The reality remains, however, that the voting power in the World Bank does not truly reflect the relative importance of member countries in the global economy. To boost its legitimacy, it will need to further revise its voting shares to bring the share of developing countries closer to their contribution to the global gross domestic product (GDP). A study has shown that whether a country has a seat on IBRD's board of directors appears to be important not just because it confers prestige but also because it increases its normal loan allocation by nearly $60 million on average (Kaja and Werker 2010). The analysis shows that this does not stem from voting rights but could result more from the informal powers that executive directors and their alternate directors exert on the institution's staff and management. Interestingly, the same result does not hold for IDA, suggesting that less discretionary mechanisms for allocating resources could overcome such governance problems.

Interestingly, ADB seems to have fewer criticisms on account of governance—even though the economy of the largest shareholder of the institution, Japan, is now smaller than that of the PRC, which has much fewer voting rights.

Moreover, in the selection of the heads of the two institutions, the United States has come under considerable criticism for continuing to push for its nominee to become the President of the World Bank even when the United States is both the largest economy in the world and is the World Bank's largest shareholder. Yet Japan has not been subjected to similar criticism, even though it is no longer the largest economy in Asia and yet remains the largest Asian shareholder, and the President of ADB has always been a Japanese national.[6]

The third challenge confronting the World Bank and ADB in Asia is their relationship with each other in operational matters and in advising their Asian clients on development policies and strategies. Some would suggest that the comparative advantage of the World Bank and ADB differ. The former has a clear comparative advantage of working on global public goods (climate change, global trade negotiations, global migration, among others). The latter has an advantage in delivering regional public goods—such as the development of the Greater Mekong Subregion, the Chiang Mai Initiative, and support for the formation of the ASEAN Economic Community.

Clearly, the two institutions can and must coordinate on all these issues, in part to reduce the cost of operations and the burdens of Asian clients, and increase their development impact. The G20 made this point in the 2009 Pittsburgh summit. To achieve better coordination, both institutions can leverage off each other, make sure their support for Asian client countries are aligned and reinforce each other, and ensure they don't duplicate services.

[6] Some observers argue that Japan's leadership of ADB is unquestioned because it is the largest contributor to the Asian Development Fund. By this measure, the US leadership of the World Bank should be also be unquestioned as it is the largest contributor to IDA.

In reality, however, coordination and cooperation between the two institutions masks a hidden and unrecognized subtext of competition. Where the two have coordinated, the results have been impressive—such as when they worked together with the IMF during the 1997–1998 Asian financial crisis. Indeed, in all East Asian countries, ADB and the World Bank have agreed to carve out "areas of primacy" in which one or the other institution takes the lead in crafting a country sector strategy jointly with the client government and the other institution accepts the policy framework in its future operations. But friction remains between the two institutions—especially if they take different positions on the adequacy (or lack thereof) of policy reforms sufficient to meet tranche conditions for budget support operations, or when they have differences on sector strategies. But such differences are healthy if they are acknowledged openly and there are mechanisms in place to resolve them amicably. Unfortunately, there is a tendency to mask such differences in the interest of showing a common front vis-à-vis the client and in ensuring shareholders—most of whom are the same in both institutions—see the two institutions as working closely together.

5. CAN ASIA AFFORD BOTH INSTITUTIONS?

Notwithstanding Asia's rapid economic progress, its growing access to capital markets and development expertise, and its own rapidly evolving capabilities, the reality is that the region still needs the presence of one—or more—multilateral development banks. For Asia's low-income countries, these banks will continue to be an important source of long-term finance, implementation know-how, and development knowledge based on global experience. In addition, middle-income countries have constantly expressed their appreciation for the objective policy advice and analytical insight the two institutions provide and continue to use their services even though they may have increased access to development knowledge from other sources.

The challenge is how the two institutions can offer these services in the most efficient manner so that there is genuine value added in development support and that the burden for Asian client countries of dealing with these institutions is minimized.

So what would be the optimal configuration of multilateral development banks supporting Asia? There are a number of ways to approach this question—through the theory of clubs, the theory of fiscal federalism, or through the theory of cooperatives (Kawai and Petri 2010; Casella and Frey 1992). All of them broadly lead to the same conclusion. The World Bank and ADB provide critical public goods that are partially (or wholly) non-excludable and non-rivalrous in nature.[7] As such, the services they provide are unlikely to be replicated through private sector organizations. At the same time, these institutions, being cooperatives (formed by members to serve members and thereby achieve economies of scale) need to function in accordance with rules that ensure that the governance arrangements are acceptable to all members. The larger the number of members, the greater become the economies of scale, but also the greater is the likelihood of divergent interests among the membership and the greater the difficulty in fashioning a consensus.

[7] Non-excludability of a good or service implies that the property rights on them cannot be enforced—such as fish in the sea; non-rivalrous implies that consumption of the good or service does not diminish its availability to others (such as knowledge or clean air).

In the case of the World Bank and other regional development banks such as ADB, the natural specialization would be for the World Bank to focus on removing barriers to global agreements on the most important global issues—such as trade, climate change, international migration, global financial stability, disaster management (including health pandemics and natural hazards)—working in tandem with the specialized global agencies responsible for each of these areas. At the same time, the World Bank, using the advantages of economies of scale could also be responsible for development research and global knowledge management, as well as mobilization of development resources for itself and the family of regional development banks. ADB, on the other hand, could focus on crafting regional agreements on public goods and services, such as support for the ASEAN Economic Community, regional infrastructure corridors, the Asian Bond Market Initiative, and the Chiang Mai Initiative.

But such a division of labor has a fundamental problem. It is silent on financing operations in countries and responsibility for the policy dialogue. Clearly, neither one nor the other institution could become solely responsible for this important role. If ADB were responsible, then countries would be deprived of the global knowledge and research findings of the World Bank. But if the World Bank were to be made responsible, then countries would be deprived of ADB's regional expertise and its understanding of the relationship between regional initiatives and country development strategies.

Furthermore, the reality is that without lending operations, neither institution has the business model to pay for its non-lending activities. Yet it is in this area where the greatest duplication and overlaps exist. The World Bank has for many years expressed its intentions of becoming a "knowledge bank", but continues to be a "lending bank" because it has been unable to find a business model that could financially support knowledge activities in the absence of lending.

There are two possible business models that would permit the World Bank to specialize in being the world's premier development research agency and the key agency to push through global agreements on the delivery of global public goods and services. The first would be if the World Bank were to receive a financial endowment, the investment returns on which would finance knowledge activities. While this approach may sound appealing, it is impractical. There is, after all, the problem of mobilizing such an endowment and the probability of success in the current (and likely future) fiscal and financial environment appears next to negligible. Moreover, without development operations in its client countries, the World Bank would merely become like any other think tank with no direct involvement in development operations where it could draw insights into development constraints and opportunities and apply proposed solutions in country settings.

The second possible business model would be to formalize the links between the World Bank and ADB, effectively making them one decentralized bank in which the headquarters would be responsible for addressing global issues, knowledge management and research, and financial mobilization and allocation; while the regional "hub" would be responsible for lending operations and crafting regional agreements on regional public goods and services. Such an arrangement would follow an organizational structure of successful cooperative associations where the center uses economies of scale in providing overarching financial, research, and knowledge support, while individual cooperatives provide retail services to their members.

While such an arrangement may appear optimal from a theoretical perspective, its practical and political economy objections in the current global economic environment appear prohibitive. First, there is the possible concern that the resulting World Bank—which would be a combination of the current World Bank and all the regional development banks—would be too large and could exhibit diseconomies of scale. Second, it has proven to be very difficult to engineer minor adjustments in the voting structure of the World Bank (and the IMF); it is hard to believe that there is sufficient political appetite or collective will among either Part I or Part II countries to push through a wholesale merger of the World Bank and the regional development banks. Third, it is unclear if the benefit–cost ratio of a merger would be worthwhile, but this will require further empirical analysis. Fourth, some observers may argue that healthy competition between the World Bank and ADB (and other regional banks) actually improves the services of both.

There is, of course, a third way forward which is that the two institutions will continue to "muddle through" under the current arrangement while tinkering at the margins to increase some specialization. This is the most likely scenario to unfold. Vested interests that have accumulated behind the existing institutional configuration in the developing regions and in the developed countries will almost certainly be in favor of inertia. The current system, while imperfect, seems to satisfy a variety of stakeholder interests and there appears little urgency among the membership of either ADB or the World Bank to change the current order. Moreover, performance assessments rate both institutions highly, suggesting that both are providing value to their stakeholders, giving credence to the view that "if it isn't broken, don't fix it." Within the broader perspective of the global financial system, there is a more urgent priority to focus attention on global financial stability and develop global financial institutions that encourage sound financial management and apply effective measures to minimize contagion. Next to these daunting challenges, the task of improving the multilateral development banking system, while important, pales in comparison.

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