

# Reforming the World Bank



# Origins of the Bank

“All of us have seen the great economic tragedy of our time. We saw the worldwide depression of the 1930s. We saw currency disorders develop and spread from land to land... We saw unemployment and wretchedness... We saw bewilderment and bitterness become the breeders of fascism, and, finally, of war.”

# Origins of the Bank

- In order to prevent the “unemployment and wretchedness” that plagued his generation, Morgenthau appointed Harry Dexter White to design the post-war economic order
- First incarnation of the World Bank was the “Bank for the Reconstruction of the United and Associated Nations,” making no direct reference to global poverty
- In July 1944, delegates from all of the 45 Allied nations during WWII attended the Bretton Woods Conference, which led to the creation of the IMF, the International Bank for Reconstruction and Development, and the General Agreement on Tariffs and Trade
- The Bank’s initial purpose was the reconstruction of Europe

# Structure and Purpose

- Currently composed of five distinct but related institutions: 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 Settlement of Investment Disputes (ICSID)
- President appointed by United States President (currently Paul Wolfowitz)
- Focus has shifted from reconstruction to development; at the headquarters in Washington, a sign reads, “Our Dream is a World Free of Poverty.”

# Criticism of the Bank

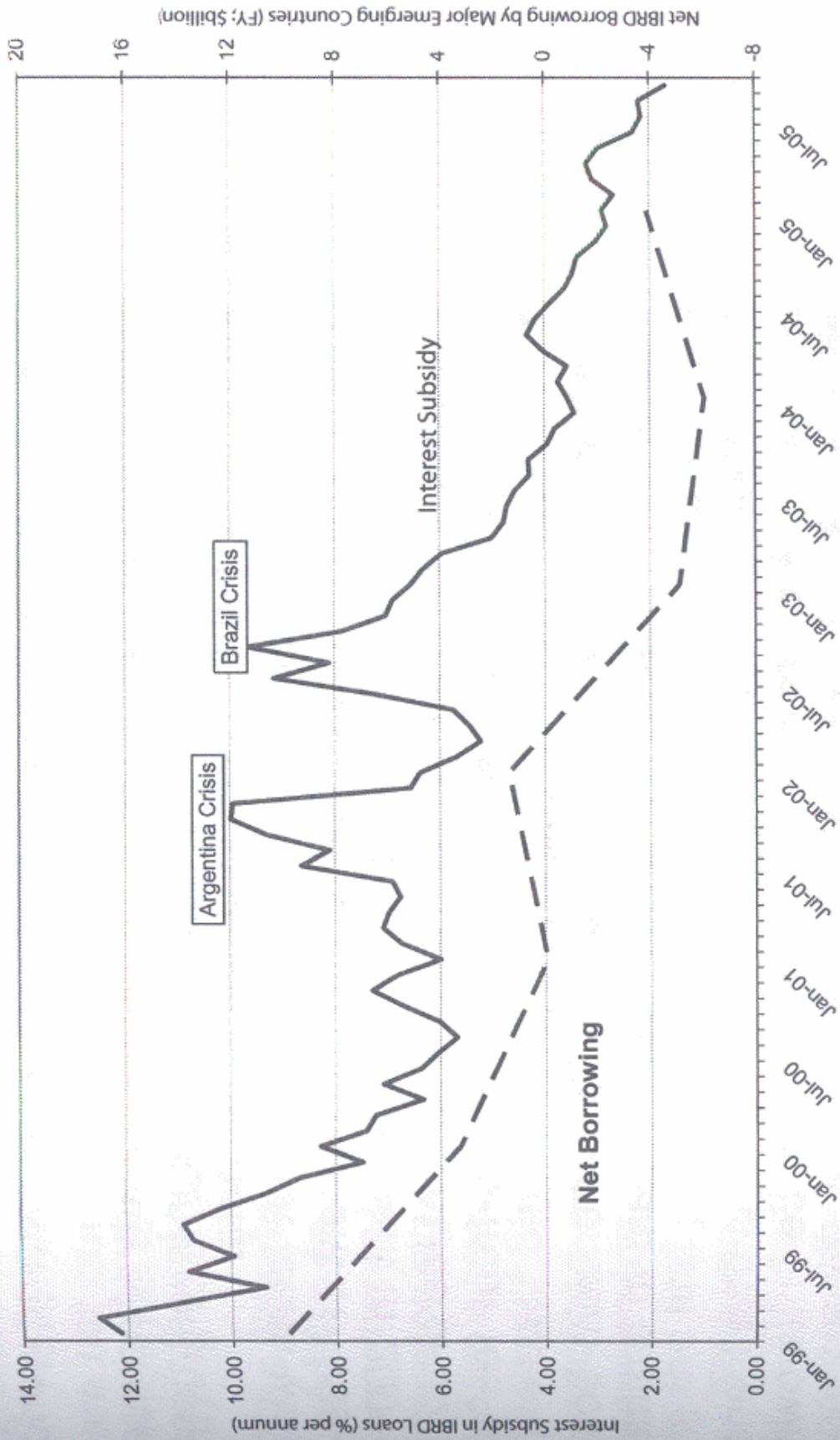
- The Bank has received criticism from all political camps, focusing on three main issues
  - 1) lack of relevance: in a world with free capital accounts, the Bank is unneeded
  - 2) lack of effectiveness: the Bank's poverty reducing projects have been poorly designed and implemented, exacerbating, rather than alleviating, poverty
  - 3) lack of accountability: the Bank, which receives most of its funding from the developed world, lacks proper oversight and accountability

# Is the Bank Irrelevant?

- Much of the criticism around the Bank's relevance emphasizes that Middle Income Countries have been consistently borrowing less from the Bank, suggesting that they are substituting to private capital markets
- Lerrick suggests that net loan flows have shifted \$30 billion in the last seven years (instead of borrowing \$14 billion from the bank in 1999-2002, MICs repaid the Bank a total of \$15 billion in 2003-2005)
- De Ferranti is more cautious, suggesting that critics use biased analytical techniques to exaggerate the Bank's diminishing relationship with MICs (for example, starting with data from an atypical base, ignoring pre-payment of older loans, etc.)
- What do you think?

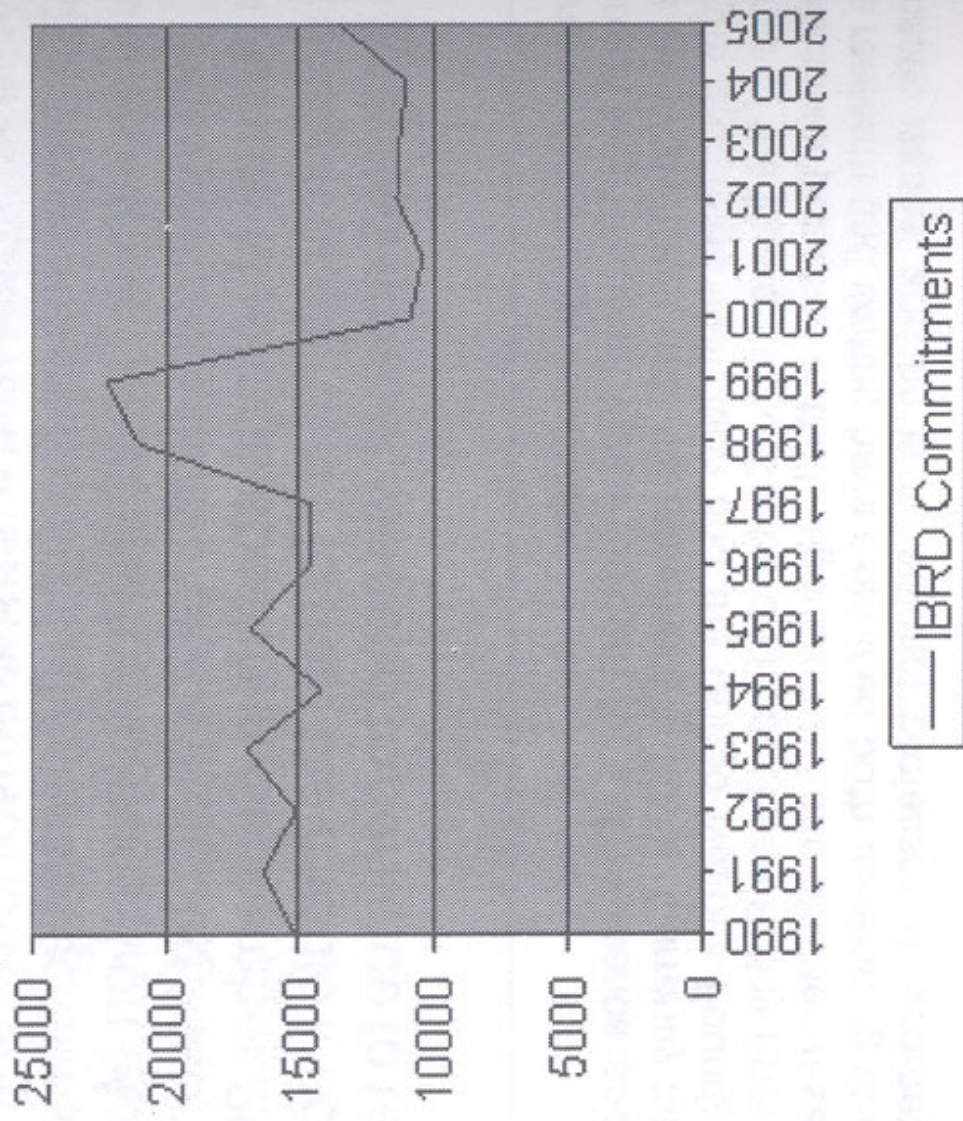
Graph III

### World Bank and Major Emerging Countries: Falling Subsidies; Falling Loans



Sources: World Bank, JPMorgan

**Figure I**  
IBRD Commitments  
(\$US Million)





# Explanations for the Decreased Borrowing

- The creation of open capital accounts has led to a switch away from Bank loans to private markets
- Financial volatility and the threat of crisis has made investors more prudent, has decreased the acceptable debt-to-GDP ratio
- Hassle costs associated with Bank loans, such as environmental and human rights protections, make it exceedingly difficult to borrow money
- The Bank's national sovereignty guarantee on its loans limits product diversity, as well as the viable actors eligible to receive loans

# More Prudent Investor Behavior

- Though recent financial crises have made investors more cautious when accruing foreign reserves, that cannot explain why net capital flows to emerging markets are now *negative*
- Some of this, then, can be explained by “graduation,” in which countries can switch to private capital markets for their financial resources

# Hassle Costs

- Long time lapse between initiating a loan request and having it approved
- Administrative burden of preparing, negotiating, and implementing Bank-funded projects
- Financial costs of dealing with Bank requirements to meet environmental and other standards in project implementation

# Hassle Costs

- The Bank is often under fire from single-issue NGOs
- In 2003, the Bank was planning to build a dam near Bujagali falls, at the mouth of the Nile in Uganda
- International Rivers Network, a Berkeley-based NGO dedicated to preventing “dams and the development model they represent” resisted the dam, delaying its construction for many years
- The dam, which Wolfowitz pledged to fund in 2005, would provide 250 Megawatts of electricity to Uganda’s energy-starved economy
- The dam was built, and was a disaster, cutting off too much flow to the Nile
- What do you think?

# Are Hassle Costs Necessary?

- Are such “safeguard” costs—including environmental and human rights concerns—reasonable, or excessively burdensome?
- Should the Bank adhere to the regulations of borrowing governments or activist NGOs?
- How can the Bank promote prudent, environmentally sound policies while decreasing costs?

# Diversifying Financial Products

- All Bank loans require a sovereign guarantee
- Some new approaches might include: Risk management products; loans in local currencies; borrow in a synthetic unit (similar to the IMF's Special Drawing Rights); remove the sovereign guarantee
- Create a new loan product that would limit hassle costs for borrowers with previously good performance

# Other Suggestions (from the CGD Report)

- Introducing differential pricing among IBRD borrowers, encouraging “graduation”
- Similarly, reduce transaction costs for borrowers with higher credit ratings
- Encourage investment in pro-poor projects and global public goods through reduced loan charges on those transactions

# Should the World Bank Still Give Loans to MICs?

- CGD report argues that maintaining financial relationships with MICs will ensure the Bank's knowledge base in those countries
- Also, loans to emerging economies will protect infrastructure projects when private markets crash
- 2/3 of world poor live in MICs
- CGD also suggests that lending allows the Bank to be involved in policy and



# Are Policy/Loan Bundles

## Effective?

- CGD Report: lending with policy attached allows the Bank to foster global governance and democracy, as well as encourage the implementation of global public goods
- Dani Rodrik: argues that aid conditionality is not a viable means of implementing economic reform (using the example of the cashew industry in Mozambique)
- What do you think?

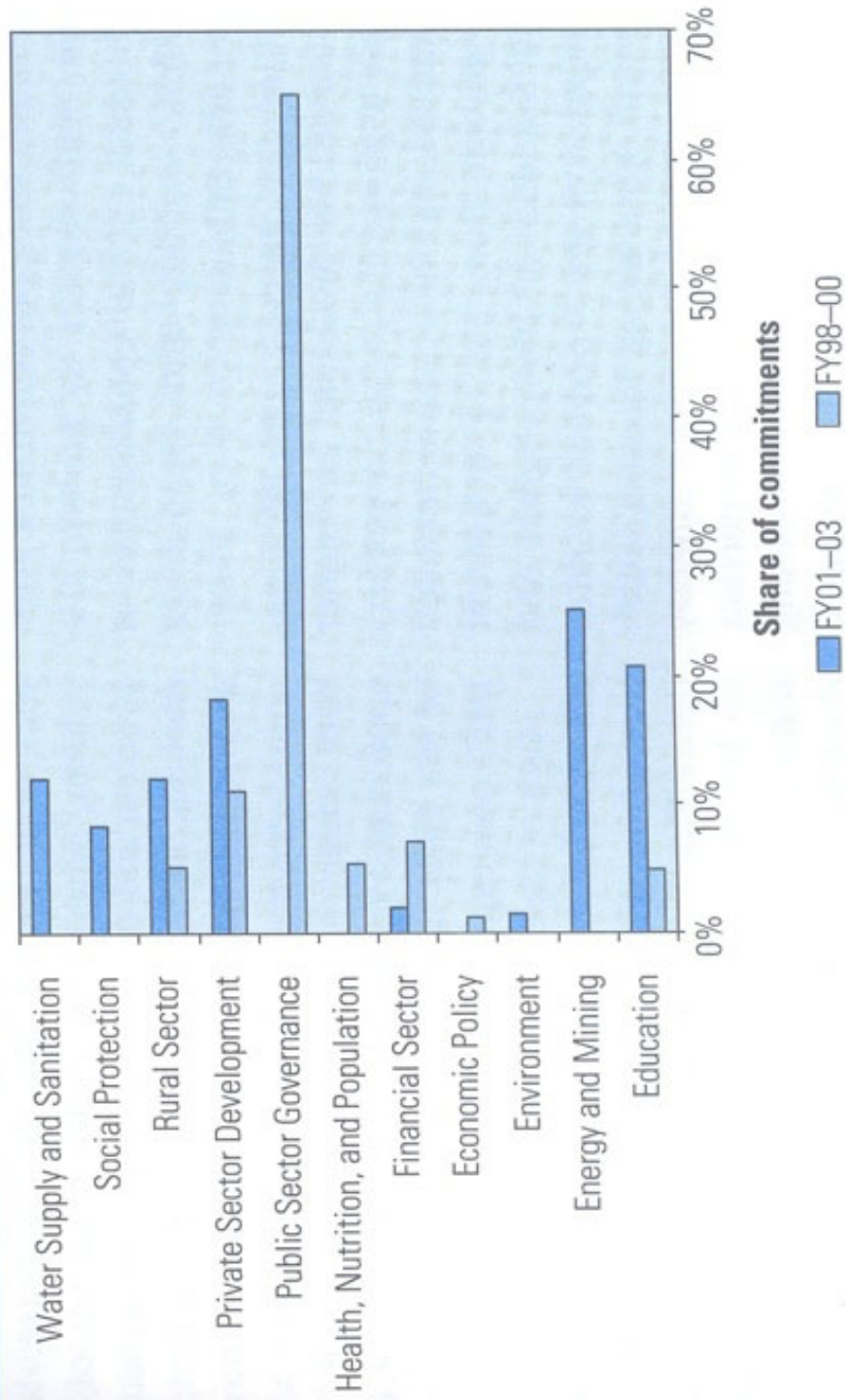
# Is the Bank Alleviating Poverty?

- From a Bank-sponsored evaluation of its activities in Tanzania: “There are continuing gaps between micro- and macro-economic policy, specifically in relation to: (1) the social and poverty impacts of macro-economic and structural policies; (2) the sources of growth; (3) the policy impact of alternative policy and strategy options”
- William Easterly: “The fact that [HIPC] could not pay back zero interest loans with a 40-year maturity is itself a completely compelling sign that structural adjustment lending had failed”

# Why has the Poverty Mission Failed?

- Easterly: “mission creep” --since its inception, the Bank has moved from supporting specific projects to structural adjustment, and now to institution building
- Broadening the scope of the Bank makes it increasingly difficult to measure its effectiveness

**Figure 10.3 World Bank commitments by sector, FY98-00 and FY01-03**



Source: World Bank.

# Some Potential Solutions: Grants

- Switch from loans to grants
- Many Bank loans have been used to pay off outstanding debt, rather than stimulate growth
- In 2002, EU and US agreed that 18-21% of IDA funds would be issued as grants
- This created the administrative problem in which governments received some aid in the form of grants and some as loans

## Grants (cont.)

- In March 2005, the Bank made debt sustainability the basis on which grants were issued
- Created a moral hazard problem in which governments with prudent loan policies are penalized and countries with bad debt histories are rewarded
- Also increases the Bank's administrative system, as it must evaluate each country's ability to pay

# Grants

- CGD report: base grant financing on country income
- Create a fully grant-based window for countries with very low per-capita incomes (less than \$500)
- This will, in a sense, prime the pump for larger investments in these countries

# Some Solutions: Global Public Goods

- Examples: energy conservation and global warming, disease eradication, communication technologies
- Full value of GPGs is not reflected in the utility function of a given country; thus the incentives for a global consensus to take on these issues are stronger than any given country



# Some Global Public Goods

- Michael Kremer suggests that the Bank should focus on the following four global public goods:
  - technologies for the poor, specifically related to health and agriculture
  - development of a knowledge base that addresses the impacts of public policies on the poor
  - African road network
  - Refugee support by giving financial support to countries willing to accept refugees

# A Global Public Good Trust Fund?

- The CGD report suggests that the creation of a trust fund to allocate capital to projects related to global public goods would help coordination
- The fund would be underwritten by earmarked donations from donor countries, allocations of Bank profits, which would increase as hassle costs decrease
- Could this work?

# Global Public Goods and Grants

- The Bank's traditional tool of offering loans to governments is not effective in the context of global problems, as governments will not be willing to pay loans back on projects that benefit them little
- Thus, increasing the amount of grant money the Bank issues will increase its legitimacy in terms of global public goods

# Is the Bank Illegitimate?

- Our father who art in Washington
  - Whirled Bank be thy name.
- Thy kingdom come, thy will be done,
  - or else, there'll be no more lending.
- Give us this day our triple A credit rating,
  - and forgive us our past loans,  
as we remove all barriers to investment.
- Our economy is your economy,  
your economy is our economy,
  - we are all one,  
globally integrated,  
forever and ever.

•Amen

# Votes

- Votes proportional to size of share
  - no longer adequately represents borrowing countries
  - for example, Sub-Saharan Africa represents 27% of all member countries, but receives 8% of votes
  - Would increasing the number of votes that borrowing countries enjoy discourage rich countries from contributing to the bank?

# Governance

- Suggestions from the CGD report:
  - Transparency in selecting the World Bank president
  - establish two more seats for African countries
  - carry out a public assessment of vote allocations and other governance issues
  - Commission a review of the board to address the budget and effectiveness
- Are these reforms satisfactory?

# Governance

- Some suggestions from Masood Ahmed:
  - vigorously pursue disclosure of country policies
  - decentralization of policy options to the country level
  - reform funding sources, away from *ad hoc*, project-specific trust funds (one way to do this would be to create a large fund for global public goods)
  - Independent evaluation

# Research

- Bank considers itself a knowledge bank
- Of their 10,000 person staff, 77 work as full time researchers in the economics department
- Problem of bias
  - for example, following criticism of the Bank in the 1990s, it published several reports lauding the effects of aid on economic growth including one by Burnside and Dollar that proved show weak results



# Burnside and Dollar

- Argues that aid is good for growth under certain policy conditions
- 743 Cites in Google Scholar
- Uses index of policy that combines the government surplus, the inflation rate, and an openness measure, which are not direct policies, but outcomes
- Fails to account for causality issues (i.e. aid is not only determined by economic performance but determines it)

# Knowledge Bank?

- A review of World Bank research chaired by Angus Deaton argues that research at the Bank is fundamentally different than academic research
  - findings are expected to be directly applied to operations
  - Superiors feel pressure from the president and board to ensure that research adheres to policy line
  - strong relationships with donor countries makes it difficult to publish information potentially detrimental to their standing

# Some Solutions

- Foster relationships with academic researchers
- Integrate researchers from developing countries into Bank staff
- Involve research staff more directly in project planning
- Fund research at the Bank with an endowment, insulating it from institutional pressures from the board and president
- Maintain checks and balances; avoid making strong claims about weak research that supports Bank policy

# Conclusions

- The World Bank needs reform!
- Ngaire Woods outlines three models the Bank could take
  - The knowledge bank: does the World Bank play a unique role in the collection and dissemination of knowledge?
  - The listening bank: is the Bank uniquely placed to fulfill the needs of its member countries or is it interfering with other operations (by the UN and regional banks, for example)?
  - The dams and irrigation bank: should the Bank adhere to its initial mandate to develop infrastructure and growth, or is this an outdated development model?

# Conclusions

- In the presence of private capital, the Bank is increasingly irrelevant as a donor
- The poverty mission has heretofore been carried out in an ad hoc manner, relying too heavily on the neo-liberal paradigm
- Representation at the board mutes the voices of the poor--those that the Bank claims to serve

# Conclusions

- Focus on two things
  - Grants: the Bank is still relevant as a development institution; increasing small grants could serve many of the world's poorest
  - Global Public Goods: increasingly, country problems are becoming global; by spearheading projects on climate change and disease eradication, the Bank could pave the way for a new global governance system