The World Bank in a 'Globalising' World

Shahid Javed Burki[1]

For almost a decade there has been pressure on both the World Bank and the community of nations that support the institution to change in a significant way the structure and mission of the Bank. It is argued that the World Bank has outgrown its original mandate of (a) becoming an intermediary between a capital-starved developing world and international financial markets, and (b) providing technical assistance, management and finance for implementing large infrastructure projects without which – according to thinking on development at the time the Bank was established – economic growth would not occur.

There is no doubt that the global economic and financial system has been radically transformed since the Bretton Woods Conference and the establishment of the World Bank and its sister institutions. Three developments are worth noting:

- Several developing countries have grown rapidly and have reached a stage of development not much below that of the industrialised world. If multilateral development banks played a role in the performance of these 'miracle economies' it was, at best, a marginal one.
- Trade has become a larger part of global product, with the developing world having secured important positions as suppliers of a number of important products. Resources generated in export markets have been much more important stimulants of economic growth in a number of successful countries than the capital flows provided by the multilateral development banks (MDBs).
- Development of global finance has brought a number of developing countries into the financial markets. They have begun to receive large amounts of capital flows without the need for intermediation by official development banks. Today, private capital flows are more than five times the flow of official development assistance, including lending by MDBs.

---

[1]The author is the Chief Executive Officer of EMP-Financial Advisors. Before he took up his present position in October 1999, he was at the World Bank. His last two positions at the World Bank were Vice President of Latin America and the Caribbean (January 1994–August 1999) and Director of the China and Mongolia Department (May 1987–January 1994).

Do these changes in the structure of world economy imply a radical redefinition of the role of multilateral development institutions? Do these developments mean that the MDBs, having lost their original *raison d'être*, have become largely redundant? These questions have been asked for many years – by the Brandt Commission in the early 1980s; by a group of non-governmental organisations in the mid-1990s; and, more recently, by the commission headed by Alan Meltzer. The Brandt Commission recommended refocusing development assistance on poverty alleviation. The NGOs, gathering under the umbrella of 'fifty years is enough', proposed the abolition of development banks and the IMF. The Meltzer Commission, convened by the US Congress, has suggested a significant change in the organisation and mandate of international financial institutions, including the World Bank.

Since the Meltzer Commission is the most recent exercise, we will discuss its recommendations at some length. The Commission's suggestions draw upon a simple three-point logic that could be summed up as follows:

- Since many developing countries have reasonable access to international financial markets, they do not need multinational development bank financing. They should not, therefore, receive any funding from these institutions, at least not from the World Bank. If any MDB assistance is to flow to these creditworthy countries, it should come from regional banks such as the Inter-American Development Bank (IADB) and the Asian Development Bank (ADB).
- Since there are still a very large number of poor countries in the world with no immediate prospect of gaining access to world financial markets, and since these countries have very little capacity to save, they need external capital flows. These flows, coming in as loans, create repayment problems and a very heavy burden of debt. Poor countries should, therefore, be provided with grants.
- To clear the decks for the poor countries, the debt they have accumulated from both multilateral and bilateral sources should be written off.

Following this logic, the Meltzer Commission proposed the following changes in the way the World Bank and two regional banks, the Inter-American Development Bank and the Asian Development Bank, conduct their business:

- The Development Banks should be renamed Development Agencies;
- All resource transfers to countries with either an investment-grade bond rating or per capita income of $4000 should be phased out over a period of five years;

- In poor countries without capital market access (less than $4000 per capita income *and* a junk bond rating), MDB loans and guarantees for infrastructure and social services should be replaced by grants;
- The Development Agencies should be precluded from crisis lending, which should be made the sole responsibility of the IMF;
- All World Bank country and regional programmes in Latin America and Asia should be transferred to the IADB and ADB respectively, also within a period of five years;
- The World Bank should become the principal source of aid (*aid, not loans, investment or guarantees*) for Africa until the African Development Bank is ready to take full responsibility;
- The World Development Agency should concentrate on the provision of global and regional public goods (i.e. measures to help counter the effects of AIDS, protect the environment, promote best practices, build inter-country infrastructure, etc.);
- Some of the World Development Agency's callable capital should be reallocated to the regional development agencies and some should be reduced (presumably returned to shareholders);
- The Development Agencies should no longer provide investment, loans or guarantees to the private sector. The International Finance Corporation (IFC) should be merged into the World Development Agency and its capital base should be returned to shareholders. Likewise, the Inter-American Investment Corporation (IIC) should be merged with the IADB, and its capital base should be absorbed by the IADB. The Multilateral Investment Guarantee Agency (MIGA) should be eliminated;
- The World Bank and regional development banks should write off in their entirety their claims against all heavily indebted poor countries that implement an effective development strategy under the banks' combined supervision.

This paper argues that the Commission's logic does not necessarily lead to the structural changes proposed by it. To focus on the future evolution of the MDBs, we should first look at the way they have developed since their establishment. In terms of their structure and the areas they seek to reach, the MDBs are very different institutions today from those envisaged by their founding fathers at Bretton Woods. In arriving at their present situation they have passed several milestones. Of these the following eight are worth noting:

The switch from reconstruction to development. This occurred quickly as first Europe, and then Japan, quickly recovered from the ravages of World War II. The countries in Europe that had created large colonial empires withdrew from Asia and Africa, giving independence to scores of new nations. Some of these countries were seen as sufficiently creditworthy to borrow from multilateral development banks. Accordingly, the World Bank and two regional banks, the IADB and the ADB, developed large lending programmes in several newly independent countries.

Creation of the International Development Association (IDA), as a soft-lending arm of the World Bank. This resulted from the recognition that even the large countries of South Asia – India and Pakistan – were only marginally creditworthy to borrow large amounts of funds from multilateral institutions. They needed less burdensome sources of development finance. Initially, developing countries wished to create a soft-loan institution under the auspices of the UN. To be called SUNFED, this institution, with a one-country one-vote mode of governance, would have been more responsive to the developing world. Instead, the donor community agreed to establish the IDA as a World Bank associate. IDA's governance gave a greater voice to the donors, as compared to the borrowers.

Creation of the International Finance Corporation (IFC). The recognition that the private sector has an important developmental role dates back to the 1950s and led to the creation of the IFC as a World Bank affiliate. Unlike the parent World Bank, the IFC does not receive government guarantees for lending to the private sector.

The move from infrastructure to more broad-based development. Initial thinking on development was influenced by the success of the reconstruction efforts in Europe where investment in rebuilding physical infrastructure paid off handsomely. Accordingly, multilateral development banks initially focused their resources on large infrastructure projects. Roads, bridges, railways, ports and irrigation systems received large amounts of funding. However, as empirical evidence began to be gathered and analysed, it became clear that development needed a more broad-based approach. Industry and agriculture in particular needed funds and these were provided through development finance corporations (DFCs). The DFCs, working primarily as intermediaries, were supposed to replicate the work of the multilateral development banks. They received funds from the MDBs and provided these to the private sector in industry and agriculture.

The focus on poverty. Two decades of MDB involvement in development did not produce dramatic results in either accelerating growth or alleviating poverty. In the early 1970s, the development community began to focus attention on poverty alleviation. There was consensus that the trickle down approach had not worked – the poor had not benefited even in countries where growth had been rapid. Rather than wait for growth to have an impact on poverty and improve the welfare of the poor, attention was increasingly paid to direct intervention to alleviate poverty. The World Bank, in particular, began to focus its resources on the sectors on which the poor depended for their livelihood. Rural and urban development became the favoured approach towards improving the condition of the poor. Later, following the 'basic needs approach', the World Bank and other development agencies brought other sectors into their expanding portfolios. It was now understood that without improving the quality of human capital, the poor would not reap much benefit from the emphasis on rural and urban development.

The focus on macro-economic stability. While the direct focus on poverty was still being experimented with by the MDBs, the attention of the development community moved throughout the 1980s to the problem created by the debt crisis in Latin America. During this period, the development community arrived at a new agreement on the dynamics of development. Termed 'the Washington Consensus', since it represented the collective views of the Washington-based multilateral financial institutions and some think tanks, this approach emphasised economic openness and macro-economic stability (objectives that had previously been left to the IMF). In instituting this change in focus, the Bank developed new lending instruments – most notably, the Structural Adjustment Loan (SAL). Unlike traditional project loans, SALs produce not roads, clinics or power grids, but something intangible – the means to facilitate changes in policy. Consequently, it is more difficult to identify the net result of a SAL than that of a project loan. A number of structural adjustment programmes were devised and funded by the IFIs. In these programmes poverty alleviation and concerns about income distribution were put on the back-burner. The policies associated with the Washington Consensus had their most profound impact on the countries of Latin America. They brought about stability by eliminating hyperinflation. Notwithstanding this success, this approach to development did not restore growth, reduce the incidence of poverty and improve income distribution.

New fiduciary responsibilities and safeguards. In the late 1980s and early 1990s the growing power of the civil society movement resulted in mounting pressure on the MDBs to introduce 'safeguard' policies aimed at preserving physical environment, protecting the livelihood of the people likely to be affected or displaced by development projects, and preserving native cultures. The MDBs used their considerable leverage to promote these safeguards in implementing their own programmes.

Expansion of the mandates (corruption, governance, partnership, etc.) carried out with new instruments (Adaptable Program Loan (APL), Learning and Innovation Loan (LIL), Comprehensive Development Framework (CDF), etc.). In the late 1990s, led by the World Bank's new management and prompted further by civil society, the multilateral banks began to take cognisance of the quality of governance among their clients. Corruption, rampant in several areas of the world, received special attention and, as was the case with the safeguards associated with environment, resettlement and native cultures, the MDBs put their clients on notice that good governance was expected of them.

Given the way the MDBs have evolved over time, are they relevant in today's world or do they need to be changed in many significant ways? This question is at the heart of the current debate on the role and relevance of these institutions. The Meltzer Commission reached two important conclusions. The first was that given the dramatic change in the global economic and financial system, the World Bank had largely lost its relevance. The second was that even if the Bank's mission, as recently reinterpreted, is accepted as a reason for its continued survival in its present form, it is not a good enough reason for not introducing significant changes. Alan Meltzer, the chairman of the commission that is referred to by his name, is not impressed with the MDBs' performance in the area of poverty. As he has pointed out: 'the percentage living in poverty is approximately the same as 40 years ago; the absolute number has doubled'.

In disagreeing with both conclusions, this paper takes an entirely different view. It argues that the MDBs have as important a role to play in today's world as they did when the World Bank – the most senior of the MDBs – was originally conceived. As demonstrated above, the MDBs have shown the capacity to change with the times; they should be able to do so again as the process of globalisation transforms the global financial and economic system in a very profound way.

There are three additional questions that need to be asked in order to determine whether the MDBs still have a role to play. Firstly, what are the changes that have occurred as a result of globalisation that need to be looked at in determining the future direction of the MDBs? Secondly, in a world dominated by the private sector, is there a role for publicly owned institutions such as the World Bank and the regional development banks? Thirdly, given the growing diversity of the developing world, can the role of a development bank be performed by a multilateral system dominated by one large institution such as the World Bank? Let us take up each of these questions in turn.

Globalisation: Globalisation is a complex process with many facets. The one that most impresses those who see multilateral development banks as increasingly irrelevant – or, if not irrelevant, at least marginal – is the enormous increase in private capital flows to the developing world. These flows now dwarf the money lent by MDBs. The fact that these flows are concentrated in a few countries does not deter the detractors of MDBs. They maintain that if a dozen or so countries account for approximately 80 per cent of private capital flows, then it should be recognised that the population of developing countries is similarly concentrated in a few large countries. In fact, as the Meltzer report emphasises, development bank lending is similarly concentrated in these same countries – a fact that unnerves the authors of that report. The Meltzer Commission recommends that the MDBs withdraw from lending to these emerging markets, and instead concentrate solely on the poorest countries that lack access to private capital and, because of their small size, are home to a relatively small proportion of the world's poor. Furthermore, it proposes that MDB involvement in the poorest countries should be constrained to grant-giving; multilateral lending would be abandoned. There are a number of flaws in this approach. Some of them (though certainly not all) are addressed below, first in the context of emerging markets, and then in the context of the poorer developing countries (defined as those with sub-investment-grade bond ratings and per capita income of below $2500).

Three points are relevant with respect to the emerging markets. Firstly, MDB lending to these countries is counter-cyclical, whereas private capital flows are strongly pro-cyclical and disappear when they are most needed. The argument that MDB financing to these sectors/regions simply replaces government spending does not hold at a time when most fiscal and other constraints severely curtail the spending capacity of governments. Secondly, MDB lending reaches sectors and regions within these nations that private capital does not. Socioeconomic and financial returns to capital often differ sharply, but private capital is not the least bit interested in socioeconomic returns. Thirdly, MDB loans, insurance and guarantees catalyse private capital that would not, in the absence of MDB resources, reach these countries due to imperfections in the private financial markets. Despite the impressive growth in resources controlled by the private capital markets, these markets are far from perfectly efficient. The volume of capital flows alone tells us nothing about the efficiency of the markets. Investors continue to move in herds and there are certain risks that the private sector is still unwilling to accept.

With respect to the developing countries, there are also three points which should be stressed. Firstly, despite the assertions of the Meltzer Commission, the switch to grant giving would jeopardise and politicise – and thus, compromise – the allocation of overseas development aid, as the development banks would be entirely dependent on increasingly budget-conscious donor governments. Secondly, the switch would compromise efforts to build a 'credit culture' in these countries. Thirdly, the Meltzer Commission strongly discourages the allocation of MDB resources to countries with poor governance. But poor countries, almost by definition, lack good governance.[1] The withdrawal of MDB resources would not, in all likelihood, improve governance in countries where political and economic power is highly concentrated. Instead, the poor in these countries would be further marginalised.

Privatisation of capital flows: It is suggested that international financial markets' willingness to invest large amounts of capital in many parts of the developing world has reduced the original role of MDBs as financial intermediaries. The proponents of this view emphasise that capital markets have shown that they can operate in developing countries without the need for intermediation. There are a number of flaws in this line of thinking. The most obvious is that it treats private and public flows as substitutable, assuming that if there is a great deal of the latter then there is not much need for the former. It has been shown in the past that in many countries MDBs' close involvement with the process and direction of development created the environment in which the private sector could operate with profit. The following counter-factual could be suggested: if the MDBs had not acted as they did, private capital flows would not have reached the same level.

The second flaw in this line of thinking is that whereas private flows can be – and in fact in many situations have been – volatile, the services provided by the MDBs have come in a relatively stable stream. At times, the MDBs have acted in a counter-cyclical way, dampening the volatility caused by the sudden arrival and/or departure of private money.

The World Bank's dominance in the structure of multilateral development finance: It is arguable that the present MDB structure, with the World Bank having a global mandate, the regional development banks serving specific regional priorities and sub-regional banks dealing with the development problems of specific geographical regions, does not need to be changed dramatically. The system has evolved over a period of more than five decades in response to the challenges it has faced from time to time. With some adjustment, the system could deal with the opportunities created by globalisation, while helping the developing world to cope with the volatility associated with the increasing globalisation of financial markets.

---

[1]Forty of 41 low-income countries studied in the World Bank's 1998 *Annual Review of Development Effectiveness* are characterised by inadequate governance.

What additional changes could be made in the way the World Bank currently operates? This paper puts forward four suggestions:

- The Bank should concentrate on project lending, but should undertake projects within the framework of country and/or sectoral programmes. The justification for financing projects should not simply be on the basis of acceptable rates of economic and financial returns.
- The Bank should concentrate its resources in areas in which borrowers can benefit from its global experience, leaving other projects to be financed by the regional banks.
- In the sectors in which private capital is available, the Bank should work closely with institutions such as private equity funds. Clearly, synergies could arise from greater collaboration between private equity funds and the MDBs, as both are important suppliers of finance to the developing world. World Bank country, regional and sectoral expertise could assist these funds in their work. This relationship should be sustained over the long run.
- The Bank should leave structural adjustment lending to the IMF.

In conclusion, this paper emphasises the following point. There has been a dramatic change in the structure of the global economy; this change should be factored into the way multilateral development institutions such as the World Bank operate. However, the World Bank has shown an impressive capacity to change and further evolution in its structure and operational policies would enable it to retain its relevance. The Bank and the regional institutions created in its image still have a significant role to play.