The World Bank at Sixty-Three

Searching for a strategy in today's economic order

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Thorsten Benner | **There has probably never been a more powerful case for a strong World Bank. Fighting poverty, managing international crises, and financing global public goods are among the world's highest priorities—at least rhetorically. Yet at the onset of the Zoellick presidency the world's premier development organization finds itself in a crisis that goes deeper than the controversy over its failed chief, Paul Wolfowitz.**

On the face of it, the *raison d'être* of the World Bank has never been as clear cut as it is today. As Robert Zoellick, former US assistant Secretary of State and chief US trade negotiator, took over the World Bank's helm in July 2007 from Paul Wolfowitz, almost one billion people were living in extreme poverty, surviving on less than $1 per day. Moreover, development ranks higher on the political agenda than ever before. Celebrity advocacy by the likes of rockstar Bono and actress Angelina Jolie has helped to move the concern for development into the center of society. Even more importantly, development policy has gained new currency as it merges with traditional foreign policy under the label "global public goods." Foreign and development policies are inextricably linked in global financial crises, climate change, pandemics, and terrorism.

In this new world of development, governments have turned to the World Bank to tackle some of the most pressing problems, including the reconstruction of Bosnia, emergency relief after the Tsunami, the design of a prototype carbon fund for the cost-effective reduction of greenhouse emissions, and the mitigation of the Asian financial crisis. This is very different from just ten years ago, when the Bank was facing a severe identity crisis. At the World Bank's 50th anniversary celebrations in Madrid in 1994, an NGO coalition scored a major publicity coup under the banner "Fifty Years Is Enough." Yet a sustained image campaign, the adoption of progressive positions on debt

relief, and dialogues with civil society have since helped the Bank refurbish its image and rebuild confidence in the institution.

However, even in light of the renaissance of development policy and the pressing need for a manager of global interdependence, uncertainty and disorientation dominate within the World Bank today. The questions that confront it are enormous. Is it still sufficiently attractive as a lender for middle income countries (MICs) that increasingly have access to the private markets for meeting their credit needs? If so, should the World Bank continue to lend to MICs like China and India, for example? Or should it focus on providing assistance to the poorest and least developed countries? Does it make sense to run a motley mix of programs, ranging from public health, education, and gender to infrastructure, or should the Bank become more selective and focused? Many ask whether the Bank is capable of squaring its traditional country-centered approach with the tackling of crossborder challenges like climate change and pandemics. Moreover, there is the issue of whether the World Bank will adjust to a new environment characterized by the growing importance of private donors like the Gates Foundation, private philanthropic venture capital funds such as the New York-based Acumen Fund, and new financing mechanisms such as the Global Fund to Fight Aids, Tuberculosis, and Malaria. And, not least, how can developing and emerging economies assume more responsibility in the Bank while at the same time preventing institutional deadlock? To get the World Bank back on track, its new president together with shareholders and staff need to develop a strategic framework that presents answers to these challenges.

Critics take issue with the World Bank doing business with emerging economies like Brazil, China, and India.

Challenges to Loan Programs

First and foremost, such a strategy needs to address the Bank's core business—the extension of loans through the International Bank for Reconstruction and Development (IBRD). The IBRD generates most of its capital by issuing bonds on the private financial markets. It can do so at very competitive interest rates thanks to the AAA credit rating guaranteed by the Bank's shareholders. This capital is then lent to developing countries where it is used to finance projects in a number of sectors, including infrastructure, public administration, education, and the development of local financial institutions and private business. MICs (those countries with a per capita income of $1,200 to $5,295) are eligible for IBRD loans. In recent years, Brazil, China, India, and Turkey together received more than 50 percent of all IBRD loans.

Critics take issue with the World Bank doing business with these emerging economies. They argue that the World Bank should focus solely on the poorest countries and let the financial markets cater to MICs. Private investors already pour over over $300 billion into MICs compared with a paltry $14 billion provided by the IBRD. In contrast to the situation after the end of World War II when private capital was not readily available even for credit-worthy middle-income countries, today, some argue, it is possible for MICs to rely exclusively

on private financing. Former World Bank managing director Jessica Einhorn predicts that ten years from now, "credit to middle-income countries will be just another derivative financial instrument—to be bought, sold, and managed in private portfolios."[1] Free-market purists like US economist Allan Meltzer claim that if this scenario becomes reality, loans vouched for by governments (as is the case with IBRD loans) would have distorting effects. Therefore, the IBRD should be abolished and the World Bank should focus on the poorest countries and act as a "knowledge bank" that provides expertise on development.

However, the loudest of the abolitionists tend to overlook that 40 percent of the world's poor (those living on less than $2 a day) live in MICs—in India, Brazil, China, and Pakistan. Moreover, private financial markets are often volatile and pro-cyclical. The Asian financial crisis demonstrated the fatal consequences this can have. It is also uncertain that the World Bank would have much policy leverage in MICs if it were reduced to a mere "knowledge bank." In this case, the Bank would be little more than a development consultancy selling its recommendations without actually having a stake in their implementation. It is only by combining advocacy with the provision of loans (signaling a long-term commitment) that the World Bank becomes an attractive partner. Moreover, the Bank would cease to be a truly global organization if the IBRD were to end lending to MICs. Its work would then be confined to sub-Saharan Africa and a few Asian countries. Such a policy would also spell the end of the Bank's relative financial autonomy, as it would lack its own capital base and depend entirely on periodic contributions by donor countries, which are in turn subject to short-sighted political whims and preferences.

Some think that the World Bank should focus on the poorest countries.

Both the Bank's incoming president and its most powerful shareholders, especially many EU countries, have come out in favor of continuing the Bank's engagement in "advanced" developing countries. In recent years, however, they have failed to push resolutely for the modernization of the IBRD to ensure that the World Bank remains an attractive partner for MICs. While many of the environmental and social safeguards are sensible and based on lessons drawn from past mistakes, the Bank should make every effort to reduce transaction costs and to speed up internal processes.

Even more importantly, the IBRD's statutes, which date back to 1944, urgently need to be updated so that the Bank can cooperate with partners on all levels of government—not just central government—in accordance with the principle of subsidiarity. At the moment this is impossible because of the provisions regarding sovereign lending. It would also be advisable to extend loans in local currencies, so that provincial governments do not have to bear the risks of exchange rate volatilities. Finally, the IBRD should make greater use of innovative financing mechanisms and, in this regard, cooperate more closely with the International Finance Corporation (IFC), the branch of the

1) Jessica Einhorn, "Reforming the World Bank," *Foreign Affairs* Vol. 1, No. 85 (2006), p. 21.

World Bank that provides loans to the private sector and takes equity stakes in business ventures in developing countries.

The IFC has expanded rapidly in recent years. Until 2003, it was the IBRD's ugly little sister with a budget of only around $6 billion but by 2006 that figure had almost doubled to $11 billion. Highly successful investments made in the 1990s have increased the volume of the IFC's capital reserve and engendered a desire to expand even further. But it remains unclear whether the IFC has also increased its added value for development accordingly. Because of its organizational culture and the internal incentive structure, the IFC tends to invest in large, low-risk projects. Smaller, higher-risk projects (such as investments in medium-sized projects, for example in water provision, not to mention the promotion of the private sector in rural, landlocked areas of China or in least developed countries) are usually considered less attractive. If the IFC strives to maximize not only its volume and operating profits, but also its developmental impact, this will have to change. Some modest progress has been achieved over the past years. The IFC's investments in Africa have increased from $200 million in 2003 to $1.3 billion in 2007. So far, however, shareholders have failed to critically assess the IFC's expanding work. They should push for a change in the incentive structure and the organizational culture. The latter could be achieved by drawing recruits from a larger pool of graduates, not just those with a business school background. Channeling the IFC's profits into the Bank's overall work in the poorest countries is also an option worth considering.

Today's debt relief is a consequence of the failure of the Structural Adjustment programs of the 1980s.

From "Soft Loans" to Grants

There is also a great deal of uncertainty about the future of the second most important part of the World Bank, the International Development Association (IDA), founded in 1960 to offer "soft loans" to the poorest countries. In 2006, the IDA was responsible for $9.5 billion worth of soft loans and grants. The interest rates for IDA loans are, depending on a country's per capita income, low, nominal, or zero percent. IDA loans therefore inevitably incur a loss for the World Bank, even if the least developed countries repay the loans. Still, many of the poorest countries cannot repay their accumulated IDA debts even at zero percent interest; this is especially true for many of the loans taken out in the 1980s during the heyday of Structural Adjustment Programs (SAPs). In this light, today's debt relief for the most heavily indebted countries is a consequence of the failure of the Washington Consensus-inspired SAPs of the 1980s and early 1990s. As it turned out, the mantra of the Washington Consensus (a minimal state, a balanced budget, and overall liberalization) did not translate into development successes across the board and had severe side effects, further undermining the capacity of public institutions. As a consequence, many countries that underwent SAPs proved to be unable to repay their debt.

Debt relief creates considerable financial troubles for the Bank. The generous pledges made by member states are a drain on the resources of the IDA.

When the time for the replenishment of the IDA's war chest comes, as it does every three years, the financial requirements are thus considerably higher than before, also in view of the IDA's increased reliance on grants instead of soft loans. It is currently unclear, however, whether the World Bank's shareholders will provide the $39 billion needed to refill the IDA's empty coffers for the next three-year period. If they fail to do so, the IDA might lose its financial independence and leeway to make grants.

The increasing reliance on grants in recent years is a lesson drawn from the debt crisis. It is based on the rationale that "when [the poorest countries facing the most considerable obstacles] do achieve growth, the resources should be reinvested, not repaid to the Bank to be re-lent elsewhere."[2] Almost half of the 82 countries eligible for IDA assistance are classified as "weak" or "fragile" states. It is therefore crucial that the member states put ample resources at the disposal of the IDA so these (typically small) poor countries can be helped effectively. The Bank should also change the internal incentive structure in such a way that the most qualified staff are tasked with the most difficult jobs.

A diverse portfolio has caused critics to speak of "mission creep."

At the same time, the World Bank must address another key challenge: selectivity. The past 15 years have seen an enormous diversification of the Bank's agenda, culminating in a portfolio that now ranges from infrastructure to gender programs. Critics speak of "mission creep." However, it is often the very same critics who, as member-state representatives, have been adding ever more tasks to the World Bank's mission. Bank staff, under James Wolfensohn's ambitious leadership from 1995-2005, have also contributed to this trend. The World Bank needs to consider very seriously whether it can and should cover such a wide variety of issues. And, regardless of the answer to this general question, there can be no doubt that within individual country programs greater prioritization is the order of the day.

Providing Global Public Goods

The World Bank's engagement in the provision of global public goods like tackling climate change or combating pandemics poses another challenge. These activities are at odds with the Bank's traditional country-centered approach and require far-reaching cooperation and coordination with private actors. The World Bank does not at present have a clear mandate for this and lacks the prerequisite control and financing mechanisms. As early as 2004, an internal assessment by the Independent Evaluation Group made the criticism that the Bank's strategy for global programs was ill-defined. In 2006 the Bank was involved in 125 global and 50 regional programs and spent a total of $3.5 billion. The adhoc character of most programs should be replaced with more concerted cooperation in the provision of global public goods.

2) Steven Radelet, "The Role of the Bank in Low-Income Countries," in: Center for Global Development (Ed.) *Rescuing the World Bank*, Washington 2006, p. 114.

Moreover, it is evident that it is not just the poorest countries that are in need of assistance with regard to global public goods. Emerging markets such as Brazil also require financial incentives if they are to make a greater contribution to, say, a sustainable climate policy. In addition, the Bank needs to strengthen coordination with other UN agencies, bilateral donors, and newly emerging private donors. As Robert Zoellick points out, "We are now in a much more networked world. We have got much better regional banks, vertical funds, private foundations, the private sector, and non-governmental organizations. We have to see how we can work more effectively together."[3]

Washington Consensus to Washington Confusion

While critics often berate the World Bank as the main pillar of a "neoliberal" economic order, the Bank portrays itself as a neutral "knowledge bank." Either way, its key role in the discussions around development is beyond doubt. No other institution brings together a comparable number of development economists from the most prestigious universities. The World Bank Group can count on a combined annual budget of $30 billion for grants and loans and on 10,000 highly qualified members of staff to fulfill this mission, most of them at its glass palace headquarters in the heart of Washington, D.C. As an over-confident advocate of the development fashions of the past decades, the World Bank does not have a reputation for modesty. The Washington Consensus of the 1980s is only the most famous, or as some might have it infamous, example.

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Recently, however, this self-confidence has given way to a more modest attitude. Today, those hoping for universal answers and easy recipes must look elsewhere. The World Bank is exhibiting previously unknown humility, for example in the 2005 report "Economic Growth in the 1990s—Learning from Reform," which warns against "universal blueprints, however well intended they might be."[4] Instead, the report argues, economic development analyses must be contextual and countries must adopt strategies tailored to the specific constraints of each case. Considering the detrimental impact of many of the development fashions of the last decades, this new modesty is a welcome development. The World Bank can make an important contribution as a self-reflective "knowledge bank," especially if it draws on the increasing wealth of local expertise and does not simply rely on the "view from Washington."

At the same time, the Bank is facing a dilemma as new donors such as China are challenging the recent realization that "good governance," as defined by Western donors, is an indispensable premise for development. The World Bank could play an important role in integrating China into the circle of established donors. However, the hands of the new president are at least partly tied since China is still an important borrower of the IBRD. Should China choose to stop borrowing

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3) Krishna Guha, "An Ear to Lend," *Financial Times*, 29 June 2007.
4) Dani Rodrik, "Goodbye Washington Consensus, Hello Washington Confusion?" *Journal of Economic Literature,* Vol. 4, No. 44 (2006), pp. 973-987.

from the IBRD, the consequences for the Bank's core business would be dire. The fact that Paul Wolfowitz had to publicly backtrack last fall after he had made several critical remarks on China's role in Africa shows how delicate the highly desirable inclusion of new donors like China will be for the World Bank.

Leadership for Reform

Earlier this year, UK Prime Minister Gordon Brown correctly pointed out that "the post-1945 system of international institutions—built for a world of sheltered economies and just 50 states—is not yet broken, but for a world of 200 states and an open globalization, is urgently in need of modernization and reform."[5] This also applies to the World Bank, at age 63 one of the most venerable institutions of the postwar order. Both the member states and the new president urgently need to demonstrate leadership for its own long overdue modernization. This is the central lesson to be learned from the disastrous failure of Wolfowitz's 2005-2007 presidency. Wolfowitz, whose role as the architect of the Iraq War was heavy baggage from the very beginning, failed to gain the trust of the highly qualified and demanding World Bank staff because of his uncooperative management style. He gathered around him a number of close aides from the Bush administration and showed disregard for internal expertise. His role in arranging a hefty pay rise for his partner, a long-time Bank staff member, was a welcome opportunity for Wolfowitz's opponents within the ranks of the Bank's staff and member states to stage an open revolt.

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However, Wolfowitz's failure to provide any answers to the big strategic questions facing the Bank—apart from the fight against corruption—is the much graver shortcoming of his presidency. It was not until April 2007, when he had been in office for two years, that Wolfowitz initiated an internal review of the Bank's strategy. Even then he made it clear that he did "not think there [was] urgent change of direction needed."[6] This failure, however, is equally that of the 24-member Board of Executive Directors, which made but minor corrections to Wolfowitz's policies and also failed to offer any overall strategic guidance.

Zoellick certainly has what it takes to lead the World Bank out of this mire. Unlike Wolfowitz, he is not known as an ideologue, even though he may be somewhat tainted by the fact that he was a close aide to President Bush, an early advocate of the Iraq War, and the handpicked candidate of the Bush administration. Most importantly, he is widely regarded as a tough negotiator and politically savvy diplomat and his experience in the areas of security policy, world trade, and business (most recently with Goldman Sachs) is almost unmatched.

But even a strong and politically astute president well liked and respected by the Bank's staff will not be enough to address all the Bank's woes. The World Bank's shareholders must also provide direction. Together with Zoellick and the Bank's staff, they need to develop a plan for a strategic reorientation. Ger-

5) Gordon Brown at the Confederation of Indian Industry in Bangalore, 17 January 2007.

6) Krishna Guha, "World Bank Chief Seeks Refocus," *Financial Times*, 4 July 2007.

many, and Europe in general, has a special role to play in this process. By forcing Wolfowitz's resignation, the European Union under German leadership demonstrated that it can make its voice heard in international organizations when it is united. Now the onus is on Europe to prove that it can also play a constructive role in the World Bank's strategic reorientation.

Given the increasingly important roles played by private donors like the Gates Foundation, countries with highly dubious motives such as Venezuela and Iran, and rising powers like China and India, it is in the European Union's own best interest to promote the independent, public, and multilateral development organization that is the World Bank. There should be a coherent EU position on the Bank's future and a united effort in support of this vision in Washington. This vision should include the modernization of the Bank's credit business, the strengthening of the programs for the poorest countries, and a concerted expansion of the World Bank's role in the provision of global public goods. It is important that the Bank is not mistaken for a pure development aid donor, but is recognized as a financial institution that provides poorer countries with better access to financial resources and helps raise money for the provision of global public goods.

A new strategy should include a blueprint for revamping the Bank's internal governance.

The strategy should also include a blueprint for revamping the Bank's internal governance. Given the Bank's emphasis on good governance and ownership, this is a question of credibility. The Bank should start to practice what it preaches by instituting a new, transparent selection process for the president, an enhanced role for independent evaluations of its work, and a gradual adjustment of the voting rights in the Boards of Governors and Executive Directors. On the last point, Europe should lead by example. At present, 8 of 24 Executive Directors are European; these governments should be ready to accept a diminished role so as to enable developing countries to exercise a greater role and more responsibility. At the same time, however, member states must take great care to ensure that the Bank remains politically viable. "One country, one vote" is not a feasible option. If implemented, the largest shareholders are likely to vote with their feet.

A degree of strategic ambiguity is necessary in order for large organizations like the World Bank to survive, but arbitrariness or the absence of a strategy would be fatal. At the beginning of the Zoellick presidency, it is up to the shareholders together with the new president and the staff to show the way forward—in conjunction with the IMF and the rest of the UN family. As veteran World Bank watcher Sebastian Mallaby aptly put it: As long as the shareholders do not live up to their responsibility but "veer schizophrenically between exhortation and contempt, it will be hard for the World Bank to be what it should be—the best source of development lending and advice there is for the world's neediest people."[7]

7) *The World's Banker. A Story of Failed States, Financial Crises, and the Wealth and Poverty of Nations* (Penguin Press, 2004), p. 393.