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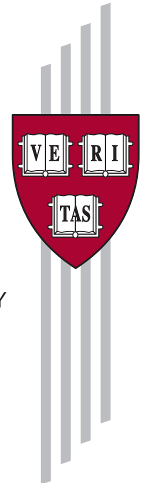

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G-24 Discussion Paper Series

Do As I Say Not As I Do: A Critique of G-7 Proposals on Reforming the Multilateral Development Banks

Devesh Kapur

No. 20, February 2003

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

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PREFACE

The *G-24 Discussion Paper Series* is a collection of research papers prepared under the UNCTAD Project of Technical Support to the Intergovernmental Group of Twenty-Four on International Monetary Affairs (G-24). The G-24 was established in 1971 with a view to increasing the analytical capacity and the negotiating strength of the developing countries in discussions and negotiations in the international financial institutions. The G-24 is the only formal developing-country grouping within the IMF and the World Bank. Its meetings are open to all developing countries.

The G-24 Project, which is administered by UNCTAD's Macroeconomic and Development Policies Branch, aims at enhancing the understanding of policy makers in developing countries of the complex issues in the international monetary and financial system, and at raising awareness outside developing countries of the need to introduce a development dimension into the discussion of international financial and institutional reform.

The research carried out under the project is coordinated by Professor Dani Rodrik, John F. Kennedy School of Government, Harvard University. The research papers are discussed among experts and policy makers at the meetings of the G-24 Technical Group, and provide inputs to the meetings of the G-24 Ministers and Deputies in their preparations for negotiations and discussions in the framework of the IMF's International Monetary and Financial Committee (formerly Interim Committee) and the Joint IMF/IBRD Development Committee, as well as in other forums. Previously, the research papers for the G-24 were published by UNCTAD in the collection *International Monetary and Financial Issues for the 1990s.* Between 1992 and 1999 more than 80 papers were published in 11 volumes of this collection, covering a wide range of monetary and financial issues of major interest to developing countries. Since the beginning of 2000 the studies are published jointly by UNCTAD and the Center for International Development at Harvard University in the *G-24 Discussion Paper Series.*

The Project of Technical Support to the G-24 receives generous financial support from the International Development Research Centre of Canada and the Government of Denmark, as well as contributions from the countries participating in the meetings of the G-24.

DO AS I SAY NOT AS I DO: A CRITIQUE OF G-7 PROPOSALS ON REFORMING THE MULTILATERAL DEVELOPMENT BANKS

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G-24 Discussion Paper No. 20

February 2003

Abstract

The paper addresses three key issues raised by the G-7 in its proposals in 2001 to reform the multilateral development banks: (i) the restructuring of the International Development Association (IDA), with a part of its lending in the form of grants rather than loans; (ii) the harmonization of procedures, policies and overlapping mandates among multilateral development banks (MDBs;) and (iii) the volume of support by MDBs for global public goods (GPGs) and the rankings and priorities among them.

The paper argues that while in principle shifting a fraction of IDA's resources to grants can address some of the problems associated with loans, these gains are limited. At the same time it poses long-term political risks for the World Bank. Moreover, the paper cautions that the more fundamental problem with IDA is the manner in which the IDA Deputies – the representatives of the donor countries – have been making policy decisions relating not just to IDA but also to the institution as a whole. The result has been a creeping constitutional coup that has fundamentally subverted the role of the Executive Board in the institution's governance. The paper also questions whether developing countries in their quest for a larger IDA may not be sacrificing their larger interests in the global system.

With regard to GPGs, the paper questions the degree to which the Bank's research contributes to GPGs. It argues that there is little analytical and empirical evidence that the G-7's priorities for GPGs would maximize the well-being of the poor relative to a host of notional alternatives. With regard to the harmonization of procedures and policies among the MDBs, the paper supports the harmonization of ***procedures****, especially those related to procurement and financial reporting, while arguing that harmonization of* ***policies*** *and overlapping of jurisdictions should* ***not*** *be formalized. The paper further argues that increasingly stringent compliance standards of the international financial institutions are imposing high financial and opportunity costs on their borrowers. It is easy for the major shareholders to insist on standards whose costs they do not bear. The most inimical aspect of this pressure is that it has forced the Bank to shift lending towards sectors where it has little comparative advantage and away from the very sectors where it does have comparative advantage.*

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DO AS I SAY NOT AS I DO: A CRITIQUE OF G-7 PROPOSALS ON REFORMING THE MULTILATERAL DEVELOPMENT BANKS

Devesh Kapur*

I. Introduction

In recent years, reforming the multilateral development banks (MDBs) has engaged the attention of a variety of blue-ribboned commissions and groups. The most recent of these proposals were made by the G-7 at its summit in 2001. A year later the G-7 finally reached a consensus on the most contentious of the proposals, namely the United States' insistence that IDA resources be provided as grants and not loans. Considering the source, the G-7 proposals are also the most noteworthy. While most of these reports and recommendations have focused on the key MDB – the World Bank – others have focused on the MDB system and, more broadly and ambitiously, the workings of the international financial system. The principal recommendations of these different reports, including the G-7's recommendations, are summarized in the Appendix.[1]

This paper first addresses three key issues raised by the G-7:

1. The restructuring of IDA, with a part of its lending in the form of grants rather than loans.
2. Harmonization of procedures, policies and overlapping mandates among MDBs.
3. The volume of support by MDBs for global public goods (GPGs) and the rankings and priorities among them.

But like the dog that did not bark, the G-7 proposals are just as interesting for the issues they are silent on, as for those issues they emphasize. This paper highlights three omissions: (i) the Bank's research and whether it contributes to GPGs; (ii) the high transaction and opportunity costs of World Bank lending and their implications for harmonization of the MDBs procedures and policies; and (iii) issues of governance and accountability that fundamentally affect the "what" and "how" these institutions go about their business. Finally, the paper examines the structural realities of the developing countries, and questions two strongly held beliefs about the MDBs that are deemed axiomatic. First, whether the MDBs goal of poverty alleviation is best achieved by their lending for social sectors; and second, whether in their quest for a larger IDA, developing countries may not be sacrificing their larger interests in the global system.

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Renewed attention to the MDBs is occurring in a geopolitical and economic context that presents developing countries, especially the poorest ones, with limited and bleak options. The end of the Cold War removed much of the rationale for foreign aid and recent studies questioning its efficacy have further vitiated the atmosphere for foreign aid. The steady decline of bilateral foreign aid has correspondingly increased financial pressures on multilateral institutions. As a result, multilateral institutions with greater financial autonomy, in particular those less dependent on direct appropriations of public funds, have become relatively more important. Since a swift response to crisis requires rapid access to additional financial resources, the increased financial stringency coupled with an increase in disasters and crises, both natural and man-made, has enhanced the "liquidity premium" of multilateral institutions. Consequently, multilateral institutions that can commit new resources rapidly without recourse to budgetary appropriations from member governments – essentially the international financial institutions (IFIs) – are becoming more important, and consequently more prone to political pressure from major shareholders. As a result, the MDBs' status as *multilateral* institutions is facing greater stress.

The developing countries themselves are more divided than ever. The compact between the larger and stronger developing countries and their weaker counterparts has weakened considerably. Weaker developing countries have few options and are less unwilling to be bought out. The stronger ones are less willing to spend their political capital to speak for the former, forcing them to agree to international rules for even less. The result has been a downward spiral of the capacity for collective action by developing countries. The larger developing countries have implicitly taken the foreign policy advice the late Deng Xiaoping gave his compatriots as he launched China on its growth path more than two decades ago: "keep a cool head, maintain a low profile, and never take the lead". Just as China, shedding Maoist exhortations of pursuing a "revolutionary foreign policy" aligned itself with the United States at the turn of the 1980s in pursuit of hard-nosed national interest, the larger developing countries (Brazil, China, India, Mexico, Pakistan, to name a few) are less willing to expend their political capital championing "Third World" causes.

The structural reality that developing country preferences are more heterogeneous than before and the resulting collective action problems among developing countries (as exemplified also by the G-24) must be kept in mind in examining the G-7 proposals. Any alternative to the G-7 proposals must be seen to be in the interest of borrowers from *both* the hard and the soft windows of the MDBs. Else the recurring reality of fragmented developing country interests will result in the G-7 proposals once again carrying the day.

II. IDA and the "aidization" of the Bank

With regard to IDA the United States called for an increased use of grants within IDA-13 and a review of lending terms for the blend countries, such that the terms for blend countries are hardened while those for the IDA-only borrowers are further softened. The issue proved deeply contentious among the G-7 and other donors, but when eventually the IDA-13 replenishment was approved in mid-2002, it was agreed that between 18–21 per cent of its overall resources, SDR 18 billion, of which approximately SDR 10 billion was in new donor contributions, would be provided in the form of grants.

At first glance the idea that IDA resources be provided in the form of grants (instead of soft loans) seems obviously worthy of strong support. However, a strategic review of what IDA has done to the Bank, and by implication the developing countries, might give pause. The creation of IDA transformed both the scale and content of the World Bank's operations. On the one hand it helped finance repayments to the International Bank for Reconstruction and Development (IBRD) while also mitigating pressures on the IBRD to make loans to countries with low creditworthiness. It also made the Bank less risk averse and more willing to experiment, especially in sectors that were more poverty-oriented. At the same time, IDA expanded the institution's administrative budget, further softening what was already a not very hard budget constraint. The institution now had administrative resources to undertake a plethora of studies, analysis, reflections, conferences – all of which leveraged it head and shoulder above any alternative by the mid-1970s.

But what IDA gave to the Bank in the short run, it took away in the long. In particular, IDA reduced institutional autonomy and fundamentally

subverted the institution's governance. The market-based autonomy that the IBRD had gained for itself began to be eroded slowly, but surely, by the public funds that were the mainstay of IDA. The seeds were contained in the replenishment procedures of IDA – its periodicity and burden-sharing procedures – which rendered it extremely susceptible to the goodwill of major shareholders. In any burden-sharing scheme, the most powerful member sets the tone. From the late 1960s onwards, as the United States began a long process of reducing its financial share, other donors began to link their contributions to that of the United States – which paradoxically increased the bargaining power of United States even as its contributions declined. The periodicity meant that every three or four years, new demands could be made of the institution. The peculiarities of the United States budgetary process, wherein annual Congressional authorizations were an additional chokepoint, not only ensured that the exercise became perennial but further enhanced United States influence. Slowly but surely IDA became the tail that wagged the Bank dog with increasing vigour.

Through the 1960s and especially the 1970s the Bank managed to secure increases in IDA while maintaining a considerable degree of operational autonomy. This state of affairs began to change from the early 1980s onwards when the United States began to exercise its muscle in a much more unilateral and pre-emptory manner. Any occasion when the World Bank Group asked its shareholders for additional funds was now seized by its non-borrowing shareholders as an opportunity to exercise leverage. Since capital increases for the IBRD, International Finance Corporation (IFC) and Multilateral Investment Guarantee Agency (MIGA) were increasingly rare, i.e. just twice each in the last two decades, IDA replenishments became the principal mechanism for exercising leverage. The Bank both oversold the benefits of IDA and complied with each additional demand. The many small and poor developing countries, desperate to obtain any money, signed on to conditionalities without much intention and even less capacity to see them through. Other governments soon began to imitate the United States and donor interference in Bank decision-making increased in the 1980s. IDA-9 was particularly significant coming as it did at the end of the Cold War. IDA Deputies explicitly linked IDA replenishments to changes in the World Bank Group's *policies*. As a result the locus of major policy decisions de facto shifted from the IBRD's Executive Board – the body charged by its Articles to make policy decisions – to the IDA Deputies, and by extension to the richer countries. It is also one reason why donor countries have refused to lengthen the replenishment cycle of IDA from three to five years as called for in the initial guidelines, since that allows the Bank to be kept on a shorter leash (Kapur et al., 1997, footnote 19).

Financial autonomy is the key to bureaucratic autonomy and a lack of it can be a crucial instrument to leverage change. Indeed, the IFIs' relative financial autonomy from their member governments annual or biannual budgetary vicissitudes has been central in giving them greater salience relative to the United Nations family. As the international community tried to give developing countries greater financial resources, IDA's – and hence the Bank Group's – reliance on governmental funds increased. This not only amplified the power of major shareholders but also resulted in a greater role, most acutely in the United States, of the legislative branch and non-government actors. Given the reality that "the dynamics of the transnational advocacy process itself campaigns to focus on available pressure points – for example, in the case of United States environmental non-governmental organizations (NGOs) lobbying the United States Congress to pressure the Bank" (Fox and Brown, 1998: 15) what is made "available" whether by Congress or another legislature is hardly necessarily designed to enhance the welfare of poor countries. To begin with, indirect channels of United States influence are unsurpassed relative to any other shareholder: the much higher percentage of Bank staff educated in the United States than in its early years; the shaping of key Bank policies by a wide array of United States non-governmental actors – academia, think-tanks, NGOs and the like – a natural corollary both of the institution's geographical location but also the intellectual strength of United States institutions.

Many of the latter factors had been true throughout the Bank's history. But with the end of the Cold War and the withering of United States bilateral aid programs as well as the Bank's own perceived vulnerabilities, they exercised substantially greater influence in the 1990s. The stress on "participation" worked in favor of the United States vis-à-vis other countries, particularly in policy formulation. Participatory institutions can often yield highly inequitable outcomes as a result of the inequality of the participation process in already unequal settings, resulting from unequal conscious-

ness of needs and the unequal ability to articulate demands or transform these demands into decisions. While the growth of NGOs is, on balance, a welcome trend, with thousands of NGOs globally to choose from, it should come as no surprise that the agenda of only the most vocal and media and political-savvy matters.

This review of IDA holds several lessons for evaluating the G-7 proposals. At one level, the belief that a switch to grants will necessarily improve developmental prospects has weak analytical and empirical foundations. The debt problems of the heavily indebted poor countries (HIPC) occurred for a variety of causes ranging from the Cold War to egregious domestic leadership to exogenous shocks to poorly designed and executed foreign aid policies, not because IDA was not an outright grant. There is, however, a case to be made for the move from loans to grants in that it would help ensure that these IDA funds do not become part of the endless merry-go-round of debt servicing, if HIPC is implemented. However, budgets are fungible and external resources, no matter what their terms, will be used for debt servicing, whether past or future, if there is a debt overhang. It is not clear in those cases where IDA resources are made available to governments as grants, if they would be conditional on these countries not taking on any other forms of external debt. Such a conditionality would significantly increase the leverage of IDA vis-à-vis the borrowing country. However, in its absence, there is a danger that the IDA grants may simply end up servicing a loan from some other creditor.

Perhaps the strongest argument for grants is that it makes it easier to fund projects and programs run by non-governmental actors which is important in "failed states" or states where the government is clearly not interested in the welfare of its citizens. However, IDA's articles already permit lending without government guarantees, and although the institution has scarcely exercised this option, it could move further in this direction, without a shift from credits to grants. There is a valid apprehension that if the grants were used simply to go "around" governments, it would further underline poor country governments. But a small amount used as venture capital for activities with a high social but low private rate of return would encourage innovation and competition and not undermine the already strained resources of the state.

The most contentious debate on the use of IDA as grants has been around the criticism, especially by the European countries, that a move to grants would jeopardize the Bank's long-term finances. Birdsall (2002) has countered by arguing that "it would be a decade before the change made a difference to the Bank's balance sheet (since even IDA loans have a 10-year grace period before any repayment begins) and it would be 20 or more years before the amount of foregone loan repayments became substantial". However, the logic of this argument holds both ways: if the "lost" resources would be marginal to the Bank's balance sheet, the countries are unlikely to see more than marginal additional resources over the next decade and very little in the subsequent decade as well.

Probably the biggest risks of grants stem from their long term consequences for the political autonomy of the Bank. Increasing grants would reduce reflows. As a series of IDA briefing notes that were prepared for IDA-13 has made clear, the principal implications of grants is that the long-term financial future of IDA is much bleaker, especially after a decade. This stems from the fact that just over half of IDA resources are from fresh donor contributions, i.e. 55 per cent in the case of IDA-13. Another 10 per cent are from transfers from IBRD net income and the rest are from repayments of earlier loans. Given the reality of development over the past four decades, one would need to stretch credulity to believe that the need for IDA (or some equivalent) would severely drop after a decade. It is equally unlikely that the additional funds to supplement the loss of reflows to IDA would be easily forthcoming. Consequently this would either increase the dependence on donor contributions, making the Bank more susceptible to pressure from major countries, and/or increase the pressure on IBRD borrowers to agree to a sharp increase in loan charges to make for increased net income and thereby transfers to IDA. Indeed, the IDA-13 draft document makes it clear that the IDA Deputies "placed great importance on continued and substantial transfers to IDA and the HIPC program out of available IBRD net income during IDA-13" (para. 5).

The grant proposal also has a potential to deepen an emerging rift between IBRD and IDA borrowers who would naturally be inclined to support the G-7 proposals. As this paper discusses later, IBRD borrowers are increasingly paying a high price – in the form of higher financial costs and much

higher transaction and opportunity costs – for the institution's IDA fix. The root of the problem is that policy decisions relating not just to IDA but also to the institution as a whole are increasingly being made by the IDA Deputies. The Bank's bureaucracy has been a willing accomplice because the institution is empowered by IDA resources. The result has been a creeping constitutional coup that has fundamentally subverted the role of the Executive Board in the institution's governance. Developing countries should insist on scrapping the mechanism of IDA deputies in future as a condition for accepting IDA-13. Furthermore, IBRD borrowers should if anything *sharply reduce* the amount transferred to a fund where, despite their financial contributions they are shut out from the policy making process. Instead of placing transfers from IBRD net income in the general IDA pool, these funds should be used for global public goods that benefit *poor people* more generally (as distinct from *poor countries*). These funds could also underwrite the Bank's role as a venture capitalist to support social entrepreneurship which benefit poor people in both IBRD and IDA countries. A good example of the latter is the innovative Development Marketplace program launched by the Bank a few years ago. Through this program which annually provides between $3–4 million the Bank has awarded more than $12 million in start-up funding for social entrepreneurs with previously no access to Bank funds.[2] If the Bank were to ratchet up funding for the program (say by 20 per cent a year for the next five years), the welfare implications for the world's poor would very likely be better than the status quo distribution of soft funds.

III. Governance and accountability

Debates on governance and accountability of the IFIs have focused on the borrowing countries and on the IFIs themselves. Governance and accountability in the major shareholders and "donors" has been glossed over. The governance structures of the Bretton Woods institutions had tried to balance power, represented by larger shareholdings, with accountability, in the form of larger financial contributions to the IBRD's capital. Over time, financial trends in the IBRD led to a weakening of this link to the extent that today, the marginal cost of influence is virtually negligible. Although the link is stronger in the case of IDA, even here with the growth of reflows this link has weakened as well. It is this delinking of power from accountability that has created a form of moral hazard that has emerged as the critical governance issue in all IFIs.[3]

The design of Bretton Woods had built-in accountability of major shareholders by imposing a larger financial burden on them through larger cash outlays and contingent liabilities. Over its history, as the MDBs financial strength grew and took firmer roots, the cost of "ownership" fell: easier access to capital markets and comfortable equity reduced the need for additional paid-in capital, and higher reserves and the track record on defaults diminished the risks to the callable part of subscribed capital. As a result, the influence that came with ownership has become less expensive – indeed almost cost-free – and therefore more attractive. If capital increases in the MDBs are really that much of a burden (relative to the benefits of influence), then the major shareholders should only have been too happy to agree to a reduction in their shareholding. The fierce intensity of disputes centered on even slight changes in capital share underscores the reality that the cost of influence is practically zero.

The growing disjunction between influence and accountability in the case of major shareholders and donors has become particularly problematic in the case of the World Bank. Thus, transfers from IBRD net income to IDA allow major shareholders to retain the power of their voting shares over IDA while limiting their financial outlays. The Bank transferred $150 million from its net income towards the capital increase of the affiliated Multilateral Investment Guarantee Agency (MIGA) in 1998. This transfer, which took place even as the Bank's management lamented the declining trend in net income meant that, in effect, IBRD borrowers paid for the Bank's non-borrowers to retain their voting power in MIGA.

The G-7 report understandably makes no mention of the governance of the MDBs and their own accountability for how they govern and pressure the MDBs. The rhetoric on the importance of governance and accountability of the MDBs and developing countries is in stark contrast to their determination that they not be subject to these same standards. This paper has argued that IDA has increasingly served to subvert both the governance of the World Bank as well as the donors' accountability since it allows them to distance themselves from any developmental failures. These are inevitably attributed to the Bank and/or to borrowers but never to donor fads

and political pressures. The Bank is hardly blameless, but it has also become a convenient scapegoat.

IDA donors (who are also the principal shareholders) have been particularly adept at shifting blame to multilateral institutions when the terrain gets rough, as the United Nations learnt in Somalia and Bosnia, and the Bank would learn in Africa, Bosnia, Gaza and Russia. It must be emphasized that the Bank's policy prescriptions and operational stances are all approved – more or less unanimously – by the Bank's owners, exercising their prerogatives through the executive directors. Even more, as was the case with the instructions of the IDA Deputies in the context of IDA replenishments, many were imposed on the institution by its major shareholders, for a variety of domestic reasons. The record on this is unambiguous. Consequently, to whatever extent the Bank has "failed", it is the wider Bank – its management, Board and, above all, its major shareholders – that bears the brunt of the responsibility.

Thus even as donors insist on "increasing selectivity" and urge the Bank to be more flexible and not be weighed down by bureaucratization, each IDA replenishment comes up with new objectives. These are imposed on the institution as a whole, including the IBRD, even as the donors sing hosannas on the importance of borrowing country "ownership". Observers of government bureaucracies have long recognized that multiplicity of missions impairs bureaucratic incentives and erodes institutional autonomy.[4] Insisting on high standards on multiple issues is at best pointless and in all likelihood inimical in countries with extremely limited institutional resources. In retrospect this was the case with the WTO agreements which were an "inappropriate diagnosis and an inappropriate remedy, one incompatible with the resources they [developing countries] have at their disposal" (Finger and Schuler, 1999). It has become the case with IDA as well. The donors would like IDA to put greater stress on post-conflict countries, an eminently sensible idea. But to ensure that the funds will be spent wisely, there are all sorts of progress indicators – no less than 29. IDA-13's recommendations/actions total no less than 53 (one of which is "increasing selectivity"). To the many noble goals has been added the laudable objective of "anti-money laundering" with the Deputies stressing that IDA "should help borrower countries improve the regulatory and supervisory systems for the financial sector, strengthen the legal framework for combating money laundering and similar crimes, and promote transparency and good governance principles (para. 57)". One might have thought that given the existence of other institutions with greater expertise and work in the financial sector, such as the IMF and the Financial Action Task Force, an institution whose core function is poverty reduction would be a tad more focused. Many of the same donors that insist on "curbing non-productive including [excessive] military expenditure reviews" are also the ones that line up on arms sales.

A reading of the IDA-13 document makes it clear that the need to feel good and be *seen* to do good has vastly outstripped any sense of realism. This can only happen in a context where accountability is severely asymmetrical; while donors cannot be held accountable in any substantively meaningful sense, recipients have to live up to 59 "recommendations" over the next three years. An additional problem arises from the fact that unless targets match underlying objectives precisely, they tend to create contrary incentives. They divert innovation from productive enterprises to the pursuit of targets. When the measure becomes a target, it ceases to be a good measure. The solution is not to produce yet more prescriptive rules, but unfortunately that is precisely what has happened.

That matters have come to this reflects, at least in part, the failures of the institution's management and Executive Board. The Board, long deprived of real power both by management and by their countries, has done little to improve governance, handicapped by the fact that few members appear to rise above the parochial interests of their constituencies to dwell on long-term institutional interests. Its calibre is often indifferent, with appointments from developing countries often reflecting complex political compromises both within countries as well among constituencies. Nominally, the Bank's principals – its Executive Board – act on behalf of the members to exercise oversight. But built-in structural features of the Board – ranging from the frequency of rotation for Executive Directors to widely varying agendas – make its task of oversight difficult (Naim, 1996). While asymmetric information between principals and agents can strengthen the agent's hand, the problem is particularly acute in the case of the Bank, where differing interests among principals and the inherent ambiguities in ascribing specific outcomes on the ground to specific institutional actions further strengthen the agents' hands. In any case, borrowing country mem-

bers of the Board are both principals and agents, which leads them to oppose, or at best reluctantly support, tight budgets.

The roots of this attitude lie in a collective action problem. Borrowing countries are individually unwilling to publicly cross swords with management on the budget, fearing that their programs will be singled out to bear the burden of cuts.[5] They are also wary of subjecting loans to critical analysis fearing that "what goes around comes around".[6] Consider for instance the recent (January 2002) announcement by President Wolfensohn at the Afghanistan reconstruction donors conference in Tokyo that the Bank would commit $500 million for the reconstruction of that country. That decision was announced without the approval of the Executive Board, even though a sum of that magnitude is bound to have repercussions for other IDA countries. Despite strong private reservations, publicly the Executive Board simply rubber-stamped the decision, given the political sensitivity of the issue.

A different tack in shaping institutional priorities has been the use of "trust funds", by some donors. By supplementing the institution's budgetary resources, countries have sought to influence institutional priorities and governance by bypassing the Bank's budgetary process.[7] To the extent that budgets reflect the priorities of an institution, the growing share of off-budgetary funds in financing administrative expenses changes micro-incentives within organizations. It provides a mechanism for change from below, even when change from above is stymied by the lack of change in formal institutional governance structures. But Trust Funds are fundamentally a form of off-balance sheet financing. And as Enron has proven, while off-balance sheet transactions offer considerable flexibility and foster entrepreneurship, their very seductiveness can carry large risks. And in this case, the risk is the governance of the Bank itself.

IV. Harmonization and cost of lending

The G-7 has called for greater MDB coordination and harmonization in policies and procedures. It is indeed surprising that in a variety of operational areas, ranging from procurement to financial and audit procedures, even today the MDBs do not have common procedures. In this specific regard the G-7 proposals can only be welcomed, and it is a measure of the collective action abilities of developing countries that even on an issue of such obvious importance they have been unable until now to press the MDBs to do more in this direction.

However, the G-7 call for harmonization goes beyond *procedures* to encompass *policies* as well. In particular, the G-7 is pressing for reducing the operational overlap among the MDBs as well as imposing common and higher standards in MDB policies, with the World Bank serving as the yardstick. For a variety of reasons, the G-7 has been unable to get the regional development banks to adopt as stringent safeguards as the World Bank was forced to adopt due to the pressures by the environmental NGOs and the United States Congress, using IDA as leverage (table 1).

At one level, pressure from the G-7 for the MDBs to identify their comparative advantages and provide justification for any overlapping seems an obvious way to cut flab from the MDB system. It would also be in concordance with the general consensus on the benefits of decentralization, with the MDB system reconfiguring by promoting the principle of subsidiarity allowing greater resources and responsibilities to devolve to regional (and sub-regional) organizations. And more coordination is usually better, especially in countries with limited coordinating capabilities.

But at the same time it is curious why, if competition is deemed so virtuous in economic and political markets, "planning" and not competition is the preferred solution to restructuring the MDB system. The argument that competition (or institutional overlap) is undesirable in the case of public institutions has weak analytical basis. Consider for instance theories of "polycentricity" (Ostrom et al. 1961; Ostrom 1999) where a political system has multiple coexisting centers of decision making that are formally independent of one another. In practice, however, they may function independently or form interdependent links, and they may support or thwart each other. However, the interdependence follows some set of general norms and can thus be somewhat predicted. In such systems, this ordered set of relationships underlies and reinforces the fragmentation of central authority and overlapping of jurisdiction that would otherwise be deemed chaotic. The fragmentation of authority inherent in such a system is often seen to be inefficient (most nota-

Table 1

POLICIES OF THE WORLD BANK AND OTHER MULTILATERAL DEVELOPMENT BANKS

Safeguard area	*African Development Bank*	*Asian Development Bank*	*European Bank for Reconstruction and Development*	*Inter-American Development Bank*	*World Bank/ IDA*
Environmental assessment	Guideline	Policy	Policy	Guideline	Policy
Forestry	Policy	Policy	NR	Policy	Policy
Involuntary resettlement	NR	Policy	NR	Policy	Policy
Indigenous peoples	Policy	Policy	NR	Guideline	Policy
International waterways	NR	NR	NR	NR	Policy
Dam safety	Guideline	Guideline	NR	NR	Policy
Natural habitats	NR	Guideline	NR	NR	Policy
Pest management	Guideline	NR	NR	NR	Policy
Cultural resources	Guideline	Guideline	NR	NR	OPN
Projects in disputed areas	NR	NR	NR	NR	Policy

Source: IBRD 2001a, table 3.
Note: NR: No Requirement; OPN: Operational Policy Note (in process of being converted into a policy).

bly in the case of metropolitan polities in the United States where the theory was first applied) with the presence of various governmental bodies at different levels and overlapping jurisdiction leading to the phenomenon of too many governments but too little government. In practice, however, it has been demonstrated that polycentrism can be as, if not more, efficient than monocentric political systems, especially in the provision of public goods.

Another desirable feature of overlapping mandates is that given the limited "voice" option available to poor countries in the IFIs, exit is the only weapon of the weak. Even then for a majority of poor countries exit is not a low-cost option – alternative mechanisms for acquiring legitimacy in the absence of voice do not exist. The "market" for international organizations is for the most part not contestable except in the few areas where both regional and global institutions exist. "Forum shopping" allows borrowers to have at least a modicum of choice between a regional development bank and the World Bank and harmonization can be slippery slope to cartelization.[8] For developing countries, overlapping (especially vertical) jurisdictions are preferable to non-competing cartel-like clauses.

That the MDB system is a high-cost system is not in doubt. But the costs are not just because of institutional overlap. They are also due to overregulation of the MDBs, and are manifest in borrowers facing higher budgetary expenditures, higher borrowing rates and higher overall borrowing costs. Furthermore borrowers also face high opportunity costs with lending dwindling in sectors and programs because of substantially greater transactional costs.

The regulatory burden is most onerous at the World Bank. There is no disputing the reality that many Bank projects have had problems and in some cases have created serious problems, both ecological and human. But there is another reality wherein the Bank is a small actor whose efforts for the most part have been dwarfed by much more powerful forces – whether the sheer scale of demographic pressures; the rising material aspirations of billions of people; the informatics revolution, external shocks both political and economic; technological scale and its own smallness (other than in the small poor countries). The physical and human costs of poor policies, poor investments and poor national leadership and the meddlings of the super powers have vastly exceeded the worst efforts of the World Bank. In

contrast, the benefits of the efforts of MDBs in persuading borrowers, donors and the private sector to eschew white elephant projects are seldom visible.

Beset by external pressures, the Bank has created innumerable safeguards to ring-fence itself from risk. The additional administrative costs of these new safeguard/fiduciary policies were estimated to be about $81 million in fiscal year 2001. Borrower costs in meeting these requirements were estimated to be $118–$215 million (IBRD 2001a, tables 1 and 2). But a different cost might be the most expensive for developing countries in terms of its development impact – the changing composition of lending. In the last five years, Bank lending for infrastructure has declined sharply – for electric power and energy from $2 billion to $0.75 billion; for transportation by 28 per cent over the same period; and for water and sanitation by 25 per cent. It is noteworthy that the decline began when the Inspection Panel was formed. Is there a connection?

In all international organizations, the principals (national governments) delegate a task to an agent (the Bank) but with imperfect information about how the agent is going about it. While shareholders need to monitor the Bank to ensure that it is going about it in the way they want, the institution has better information than anyone else on how good a job it is doing. Since the mid-1980s, a variety of well publicized Bank project disasters led to mounting skepticism about the ability and willingness of the Bank to monitor itself and eventually resulted in the creation of an independent Inspection Panel despite the presence of two internal monitoring mechanisms (Internal Audit and the Ombudsman) and one quasi-independent one (OED, the Operations Evaluation Department). The common assumption was that increased public scrutiny would keep the institution honest and save the world's poor from the depredations of the institution.

However, as Prendergast (2001) has argued, external monitoring may be no better because outside monitors (independent overseer departments, the press and so on) rely on complaints to initiate investigations. This means that the activities of the Inspection Panel will be skewed towards cases where complaints are filed. This will invariably be in cases where the project was poorly conceived and/or executed (and even there they may not all be justified), *not the cases where good projects were incorrectly not pursued*.

In the absence of full information available to the external overseers, Bank staff now face what appears to be a perverse choice: aggressively pushing loans at the risk of individually bearing the costs of complaints brought by outsiders, or letting things slide in the knowledge that the costs of loans forgone will be borne by the country, and any resulting criticism (e.g. stagnant lending) will be borne by the institution collectively, and not by them individually. This does not mean that institutions such as the Inspection Panel were necessarily a retrograde step, but rather that monitoring agents in the public sector, where outputs are often by their nature unclear and diffuse, are more complex than it may appear. Moreover, since the mandate of the Bank's Inspection Panel explicitly rules out investigating inappropriate major-shareholder pressure on Bank management and staff, its policing role is inherently limited.

The concern with quality is not the issue. But there are trade-offs and while the changing pattern of Bank lending may satisfy major shareholders and their civil society, all of them enjoy the privileges of the infrastructural services that the Bank is now wary of supplying to developing countries. The Bank's involvement in infrastructure projects, more often than not, reduces both the scope of corruption and inappropriate policies, which can result in substantial costs on a country. It is a measure of the power of donor country interest groups that, in contrast to environmental costs, these opportunity costs are seldom highlighted even though their impact on the poor could well dwarf environmental costs.[9] Moreover, the multiple safeguards have turned the Bank to a high cost operation whose administrative costs have little to do with lending, and a lot to do with the bells and whistles that keep many other constituencies satisfied. Of the $1.44 billion administrative budget for fiscal year 2001, "client services" were $564 million, less than 40 per cent of the total budget. "Lending" (i.e. project preparation) was just 6.5 per cent of the total while expenditure on the corporate secretariat itself was $67 million, more than two-thirds than that on lending! The rest reflects major-shareholder driven mandates (whether directly or through their "stakeholders") and presidential proclivities which are not challenged by IBRD borrowers.[10]

The individual interests of all concerned parties have meant that opposition to this change has not occurred. IBRD borrowers have worried about private costs, management and staff about their live-

lihood, and major shareholders and western NGOs about the loss of a useful mechanism for putting pressure on borrowing governments. Major shareholders in particular have used their control rights to secure their particularistic objectives. By caving into such pressures, the Bank has raised its transactions costs and undermined an important comparative advantage built over the years: one of the finest global financial intermediaries, which is being under-utilized in the interests of the developing countries.

V. Global public goods

The IDA Deputies and the G-7 have pressed the Bank to focus on GPGs, and have asked that "fighting infectious diseases, promoting environmental improvement, facilitating trade and promoting financial stability" be the "MDBs main priorities in the field of GPGs". There is little evidence on why this list, and not some other, might be the institution's priorities. Despite much ado about GPGs, there is little substantive analysis that would help rank global public goods in order of their relative contribution to global welfare. This analytical hiatus gives both principals (the Bank's major shareholders) and agents (the Bank's management and staff) greater discretion. It allows them to press for private interests in the guise of GPGs. With foreign aid budgets declining and the remaining budgets further constrained by bilateral objectives, the resources of the World Bank – whether its administrative budget or its net income – have been viewed as a cash-cow by interest groups wishing to finance both genuine GPGs as well as narrower private goods.

At the same time, in seeking to reinvent the Bank's public image, its management and staff may tend to label all kinds of activities or "networks" as GPGs, meriting involvement on the basis of the moral claims that public goods invoke, and their ready slogan-appeal for Northern taxpayers. While many initiatives certainly do meet the criteria of public goods, the management also includes what one might call "Potemkin GPGs". A good example was the Bank's initiative related to the World Faiths Development Dialogue. The burden of financing GPGs in the case of the World Bank has fallen increasingly on IBRD borrowers. It is indeed true that IBRD loans have a subsidy element in that they are cheaper than market alternatives, but that is due in large part to the much lower default rates of IBRD loans and higher transaction costs faced by borrowers.

In recent years international financial institutions have witnessed a perceptible shift in burden sharing, with borrowers now picking up a greater part of the burden. The World Bank provides an excellent case in point. Over the past half century, the IBRD has witnessed a steady downward trend in the share of usable capital in total usable equity – more than two-thirds of its usable equity now comes from retained earnings and less than a third from usable capital. However, control rights have essentially remained unchanged in these institutions. Consequently, the priorities implicit in the selective support of global public goods reflect historical control rights in the IFIs, not the changing patterns of burden sharing in the past three decades.

Is research a global public good?[11]

A critical feature of the IMF and World Bank that distinguishes them from other international organizations is an extensive (and expensive) commitment to research. Developing countries for the most part have not critically examined the IFIs research activities, be it the quantum of resources devoted to research, the distribution of those resources among different research activities or the optimal institutional mechanisms to generate the research. Consider for instance the following hypothetical questions.

1. If the Bank's and Fund's budgets were cut by half and the resulting savings were put into research in those diseases, agriculture, and energy technologies that are *sui generis* to poor countries, would the global welfare of the poor improve or decline?

2. If the Bank were to double its funding for research in the health sciences and halve the expenditures in the social sciences, would the global welfare of the poor increase or decline?

3. If the Bank's research activities were more akin to a National Science Foundation (NSF) type funding activity rather than in-house research, would developing countries gain or lose?

A large array of studies has demonstrated the high rates of return in publicly funded research

(Salter and Martin, 2001). The knowledge that investments in R&D have high rates of social return do not, however, provide any guidance either on which areas to invest in nor the precise mechanism to undertake this task. Although most research show high rates of return to public research, average values are of little use when deciding whether to increase (or decrease) funding for public research or what mechanism would yield the best results (resource allocation decisions require some sense of marginal rather than average rates of return). Moreover, there is no analytical framework that would help answer if IFIs should themselves conduct research, outsource it (by funding universities or research centers), promote research joint ventures, promote exchange of personnel or build research networks.

The dilemmas are compounded by the reality that research capabilities are located in the North while many of the issue areas with the highest rates of social return to public investments in research are in resource-poor countries. Furthermore, even if the World Bank were to outsource its research and fund more research, what mechanisms should it follow? In areas where research is under-supplied because of severe market failures (such as tropical diseases, where pharmaceutical firms do not invest fearing that were they to actually develop a product, they would face severe public pressure to sell the product at a price that would not justify the initial investment), a novel mechanism is for public agencies to guarantee buying vaccines meeting predetermined specifications for a certain price (Kremer, 2000).

But while a "tournament" approach has much to speak for it, it does little to build developing countries' own capabilities. While this is not important in those areas where delay has high human costs, the issue is quite different in policy research. Consider for instance the participation of researchers at the flagship Annual World Bank Conference on Development Economics. As table 2 indicates, researchers based in developing countries are a very small minority.

The figures for the Annual IMF conference are better, but only modestly (table 3). One example is the IMF's conference on "Second Generation Reforms" in November 1999, which sought to understand "why stabilization and structural adjustment programs of the past, while successful in jump-starting economies, have not been able to ensure the quality and sustainability of renewed growth".[12] None of the 20 authors and discussants was based in a developing country, the ostensible object of the reforms over the past two decades. This is despite the reality that development economics is for the most part a peripheral field in mainstream economics.[13] The mainline prestigious journals, all edited in the United States, usually give articles with micro-data painstakingly collected in a developing country short shrift (Bardhan, 2000). These journals act as gatekeepers of knowledge as well as reputation, important for the who, how and the what that dominates the IFIs' research agenda. For the most part this service is positive, given the concentration of talent in these institutions. But the fact is that unless a researcher is part of this circuit he/she is marginalized.

The meager representation of developing country-based researchers in these conferences is

Table 2

ANNUAL WORLD BANK CONFERENCES ON DEVELOPMENT ECONOMICS, 1995–2000

	Location of affiliation			
	United States	*Non-US North*	*Developing countries*	*Total*
Papers				57
Authors	58	15	3	76
Discussants	53	12	16	81

Table 3

ANNUAL IMF RESEARCH CONFERENCES, 2000–2001

	Location of affiliation			
	United States	*Non-US North*	*Developing countries*	*Total*
Papers				24
Authors	46	7	4	57
Discussants	22	2	2	26

powerful testimony to the production of knowledge. And if knowledge is power, it underlies the powerlessness of developing countries. It is true that the IFIs organize conferences on issues in which there are many more participants from the countries who are the nominal beneficiaries of these exercises. However, on subjects that have *systemic* (as opposed to country-specific) implications, the contributors are invariably from a narrow base.

There are several good reasons why concerns on this score may not be warranted. First, there are typically participants from developing countries in these conferences. It just so happens that their institutional base is in the United States. Second, the idea that one's analytical position is an isomorphic reflection of one's nationality and/or geographical base is rather specious. Third, one could argue that the IFIs should only be drawing on the best talent to understand difficult issues, and if it so happens that the talent is North American based, so be it. Fourth, the fears of lack of diversity are misplaced given the vigorous debates and differences that are integral to academic and intellectual culture in the United States in particular. And finally, the skewed participation may simply reflect the realities of the global production of knowledge, in which developing countries themselves have played a not insignificant role by running their own universities and knowledge production systems to the ground.

However, there are grounds for unease as well. For long, an important ingredient of East Asian success was the "embeddedness" of the state manifest in "thick" networks of business-government relations. Following the crisis, the other side of these networks became apparent in what was termed as "crony capitalism". Intellectual networks are similarly double-edged. They reduce selection costs and can serve as reputational mechanisms but can also be prone to a form of "crony intellectualism". There is an inherent tendency to inbreeding, which has negative consequences for biological species or for intellectual advancement. Researchers, like other societal groups, also have interests. From research funding to access to data and visibility – research involvement with the IFIs has substantial payoffs. It also skews the priorities of research staff in these institutions – the cognitive payoffs of delivering a paper on Africa are substantially greater in Cambridge, Massachusetts, than in Côte d'Ivoire. In turn, that means that the questions and methodologies will, at least at the margin, be such as to ensure that it will be received well in the former, even though the latter audience might have a different set of priorities as to research questions and have more at stake.

An important strategic benefit – and potentially critical for developing countries – of publicly funded research is the creation of capabilities, in particular the vital linkage between research and the supply of skilled graduates. To put it differently, the process of research creates capabilities that allows for better consumption or use of knowledge. Additionally, public funding of research in different environments plays an important role in the creation of diverse options. The importance of diversity is particularly important in the context of an uncertain future (Stirling, 1998). Moreover, diversity may matter in and of itself on the grounds that there should be at least a minimum degree of participation by those likely to be affected by the consequences of the actions resulting from ideas emanating from these institutions. Diversity may also be important for its instrumentality – it diversifies risk, a not unimportant criterion given limited knowledge and the consequences of misplaced advice.

The virtual absence of researchers based in developing countries in the more prestigious development conferences cannot be attributed simply to exclusionary networks. Given the outpouring of reports on key global debates involving the IFIs, networks and reputation are critical screening mechanisms. On both counts, a base in a developing country virtually ensures extinction. The developing countries – especially the larger ones – have much to answer for themselves, having failed to develop and maintain reputational institutions in the social sciences. The poor quality of developing country academic institutions in the social sciences leads the IFIs to not only draw their research staff from universities in the United States which then creates research networks between these staff and faculty in those universities. But when these institutions want to train and support developing-country students or send their own staff for training, it is invariably again at United States universities.[14] Given the outstanding quality of the latter, the short-run compulsions of the Bretton Woods institutions are quite understandable, but their long-term consequences are inimical. These practices have strengthened already strong research institutions in the United States while further weakening developing country institutions – creating conditions for perpetuating the practice. The process has generated a vicious circle with results

that are in line with models of statistical discrimination. The more the World Bank and the IMF in effect discriminate against researchers from developing countries, the more the incentive of these researchers to migrate out of the countries either to these institutions themselves or to developed countries where their credibility is enhanced by their association with a developed country institution, furthering the decline of developing country research institutions.

Indeed, in some issue areas, the quest for supplying public goods at the global level may amplify the deficit at the national level. Agricultural research is a case in point. According to one estimate, while nearly a third of the hundreds of agricultural researchers who routinely attend the annual "Centres' Week" meetings of the Consultative Group on International Agricultural Research (CGIAR) at the World Bank were originally from developing countries, only one in twenty were still actually affiliated with developing country national research institutes or universities.[15] With donors viewing the building of research capacity in developing countries as "elitist", research as a public good is seen to be better supplied at the global rather than the national level. However, it may well be the case that in areas ranging from agricultural to economics research, developing country researchers faced with rewards that are much greater in international rather than national research organizations, gravitate towards the former. As a result, while the supply of global public goods (in the form of research in agriculture and economics) is reasonably adequate, the public goods deficits at the national level, involving the production of country specific knowledge, may be increasing.

As a result, a half century into "development", developing countries seem quite incapable of thinking for themselves on issues critical to their own welfare, at least as measured by the lack of meaningful contributions that would find a place at the high seats of social science research. What have the Bretton Woods institutions done in the last half-century to build institutions in developing countries that could help them think for themselves?

For the most part the answer is "not much". Research is centralized in both institutions – and to the extent that ideas shape agendas, centralized control of research is an excellent unobtrusive approach to set the agenda. Large salary differentials offered by these institutions and developing country research institutions (with the exception of some Latin American countries) means that they often draw out limited talent in developing countries. Moreover, for nearly two decades the IFIs have been chary of supporting institutions of higher learning, directing resources to primary and secondary education and justifying this shift both on equity and efficiency grounds. Foundations have also joined the bandwagon against supporting research institutions in developing countries on the grounds that they were elitist and that, instead, "grass-roots" institutions needed more support. In both cases there was more than ample justification for the shift – but in the process both the IFIs and the foundations have thrown the baby out with the bathwater. It has meant that developing country researchers are by and large restricted to data collection and country specific applied work, incapable of contributing anything meaningful to "big ideas" on debates ranging from global financial architecture to second-generation reforms.

The IFIs have never seriously attempted to subject these massive expenditures to rigorous rate-of-return calculations. Admittedly the task would be analytically difficult, but there are few incentives within the institutions to do so. Arguably, if even a third of this expenditure was instead redirected at creating endowments for regional research centers in developing countries, it is at least an open question if the welfare of those societies may not be better. It may help developing countries to think for themselves – and take responsibility for the actions resulting from their ideas – rather than be the perennial objects of received wisdom.

The rhetoric of the Word Bank and IMF on institutions notwithstanding, they have been tepid in supporting initiatives to develop research capacity in developing countries, although over the last decade the World Bank has made some efforts to support regional research centers.[16] Kanbur (2001) has argued that the World Bank's research as a global public good is undermined by its lack of independence, real or perceived, and without this independence, the Bank's research will always be found wanting as a global public good.

The Inter-American Development Bank (IDB) has been more creative in this regard. It has been coordinating the Latin American Research Network created in 1991, and funds leading research centers in the region to conduct original research on economic and social issues in Latin America and the

Caribbean. The research topics are determined through consultation with IDB and external professionals. The network annually sends requests for project proposals to all of its 240 members on a number of specific topics.[17]

The global development network (GDN) which was supported by the World Bank and which has now been spun off as an independent entity is an interesting innovation aimed at linking researchers and policy institutes involved in the field of development. The network also aims at skill- and reputation-building. This is a commendable effort, but its impact will be largely felt on "within-country" policy issues. This is undoubtedly important but it is unlikely to address the problem of how developing country researchers can overcome the high reputation barriers that exist on research and policies related to systemic issues. That requires a receptivity and openness in the IFIs themselves which is structurally difficult. Virtually all the links in the research websites of the IFIs are to researchers in developed countries, an indictment of the quality of research from developing countries but also an indication of the personal networks of research staff in these institutions. A potentially bigger weakness of the GDN is that to the extent its links are with developing-country think-tanks and research centers that are not university based, it is likely to undermine university research (and long-term training) even further, as researchers flee to the more flexible, connected and better paying think-tanks.

It should be emphasized that in-house research at the Bank is expensive, even when compared to universities in the United States, let alone in the developing countries. Consequently, it would appear that all factors, from operating costs to opportunity costs – the resources to build capabilities in developing countries – would seem to support a serious reconsideration of the allocation of research resources by the World Bank. The only reason why this may not be advantageous is if there are operational externalities for the World Bank in that the possibility of being able to undertake research at the Bank attracts higher quality personnel, especially economists, who then contribute positively to the operations side of the Bank.[18]

Research and international discourse on the international financial system have been dominated by the Bretton Woods Institutions and United States academia. This domination, reflecting in part the outstanding quality of the latter, has several undesirable consequences. It skews the questions, methodologies and other priorities of research toward the priorities and biases of the IFIs and the United States. As a result, those directly affected by the policies of the IFIs are under-represented in setting the research and policy agenda. Furthermore, it narrows the diversity of views, which, given limited knowledge and the possibility of wrong advice, escalates risk in the international system.

VI. Prospects for the future and what can be done

The bargaining hand of developing countries in international fora has weakened considerably in recent years. On the one hand, they face an adverse political and economic environment. On the other, developing countries increasingly have diverse political and economic interests which have reduced their capacity for collective action, be it international trade negotiations, concessional financing or IFI reform. Selectively targeting benefits to specific developing countries has ensured that money buys silence. The high discount rates of developing-country governments has led them to bargain away their interests in issues that affect their long-term future – barriers to their exports; intellectual property rights; environmental and labor standards – for very modest amounts of additional financial resources. An important lesson of IDA is that developing countries should be more wary of donors bearing gifts.

This paper has attempted to critically analyze the G-7's MDB reform proposals. It has argued that reconstituting IDA in the form of grants will have major financial repercussions for IDA in the medium term. Consequently, it would be best if only a modest fraction of IDA were in the form of grants. However, it has to be stated that it is the donors' prerogative to decide how much of their contributions should be used in the form of grants. Developing countries should, however, hold the line on the transfer of IBRD net income to IDA. Since the policy and strategic decisions with regard to IDA are being made de facto outside the Executive Board, which is the policy-making body of the World Bank, transfers from IBRD's net income should be placed in a separate pool whose principal objective would be to fund projects ranging from social entrepreneurship, such as the Global Marketplace program, to

global public goods. The key goal of this pool of funds is that it should support *poor people rather than poor countries*, and the allocation decisions should rest solely with the Executive Board.

The developing countries should also insist that the role of IDA deputies should be sharply curtailed, if not scrapped altogether. Additionally, the replenishment period of IDA should be increased to five years, coinciding approximately with the contractual term of the appointment of the World Bank's president. The short duration of the IDA replenishment process imposes high transaction costs on all parties. Senior managers and staff as well as officials from donor countries spend inordinate amounts of time on raising resources with no downtime between successive replenishments. The short cycle has also led the MDBs to be locked into short time-horizons that respond to the impatient demands of donors, changing academic fashions, and internal bureaucratic imperatives. The process has amplified donor country interest group pressures, thereby undermining the governance of the World Bank.

The G-7 has proposed that the Bank Group focus on four global public goods: infectious diseases, environment, trade and financial stability. While there is strong consensus on the first, the others are more problematic. It is unclear what precisely constitutes the "environment", and why the last two rank so high in priority relative to alternatives is a mystery. It is strange that there is no mention of support for the one GPG that the Bank can rightly be proud of, namely agriculture innovation through support for the CGIAR system. Support for research on tropical and dry-land agriculture, non-conventional energy and cheap water purification technologies are likely to affect the well-being of the poor in more fundamental ways than trade. In any case, developing countries should first insist on better analytical and empirical evidence before identifying GPG priorities.

With regard to the harmonization of procedures and policies among the MDBs, it is strongly in the interest of the developing countries that procedures, especially those related to procurement and financial reporting, be common to all MDBs. However, it is equally in their interest that harmonization of policies and overlapping of jurisdictions *not* be formalized. While informal coordination is welcome, each MDB should decide its own priorities rather than having them imposed from above.

Finally, this paper has argued that increasingly stringent compliance standards of the World Bank in particular are imposing high financial and opportunity costs on the Bank's borrowers. It is trivially easy for the major shareholders to insist on standards whose costs they do not bear. The most inimical aspect of this pressure is that it has forced the Bank to shift lending towards sectors where it has little comparative advantage; and indeed where it cannot have comparative advantage, and away from the very sectors where it does have comparative advantage.

In recent years it has become a matter of dogma that the MDBs' principal goal of poverty alleviation is best achieved through broadly defined "social development" projects. Developing countries should have serious misgivings about the *instruments* to exercise the universally accepted goals. International organizations with *universal* membership will invariably impose *universal* standards and norms. And more than ever, the universal standards that come attached to external resources, bring with them their own priorities, consultants, values and technologies. It is one thing to deploy these resources for physical infrastructure, for knowledge production especially in areas that affect the well-being of the poor in the low income countries (such as research on tropical diseases, tropical agriculture, non-conventional energy resources), but it is quite another for the resources to be focused almost exclusively on social development, which is much more context specific, being deeply rooted in a society's culture, norms and values.

The importance of social development and the need to give it greater priority cannot be overemphasized. But that priority should fundamentally be met by developing countries themselves. The case for *external* resources for social development is much weaker and involves substantial risks for developing countries because it will inevitably come with conditionalities that will have a particular bias. In recent years there is one truism of development – more money inevitably means more conditionality, implicit or explicit. The best that developing countries can hope for is that the budgetary envelope of foreign aid does not continue the decline apparent in recent years. If developing countries press for increased external financing for social development, there will be a large opportunity cost ranging from the crowding out of lending for other sectors to conditionalities on areas that societies regard as their core norms and values. And there is no evidence that

this will be better for the well-being of their citizens.

The interest of developing countries would be much better served if they prepared a strategic compact whereby they themselves would undertake to provide their citizens with the key elements of social development – basic education and basic health, legal frameworks that do not discriminate against sections of their citizenry – and in return donors would fund the complementary inputs for development (the sorts of areas mentioned earlier). Virtually all aspects of social development, for example basic education and basic health, are neither capital nor foreign exchange intensive. Regrettably we have conflated what is good for development with what the MDBs should do without much regard to the very issue that developing countries have been forced to confront: comparative advantage and the fungibility of public expenditures.

If a country is *unwilling* to act sufficiently vigorously on its own in the matter of primary education and health, that country is clearly uninterested in development and deserves little support from the international community. And if a country is *unable* to even undertake these basic tasks, then the problem is a much deeper one: is that country a viable state to begin with? And if not, is the Bank (and the IFIs in general) the appropriate institutional mechanism to deal with this issue or should the task be entrusted to the United Nations family and NGOs? By incessantly confusing what is good for development with what the Bank should be engaged in, borrower countries have been saddled with poverty projects with multiple criteria and implementation standards whose overall economic effects are often questionable. The results of these attitudes would thus be (i) projects reflecting donor preferences; (ii) foreign debt in sectors where it is quite unnecessary; and (iii) an undermining of efforts at self-reliance in areas that are the most basic responsibilities of a government. It is a lesson developing countries may well ponder as they reflect on their response to the G-7.

For long, obtaining greater concessional resources has been the highest priority of developing countries. This paper has argued that the developing countries have been paying increasingly higher non-pecuniary costs which have offset any gains in additional "concessional" resources. Consequently, it is time for developing countries to re-evaluate their priorities, and ponder whether their cause would be better served by asking rich countries not for more "positive freedoms" through, say, additional financial resources but fewer "negative freedoms" allowed them in the international system, such as (i) lower barriers to their exports; (ii) lower greenhouse gas emissions; (iii) weaker insistence that developing countries conform to imposed artificial high standards be it those on intellectual property rights or MDB lending; (iv) a strong international regime controlling exports of small arms that wreak havoc in the civil wars afflicting many developing countries, etc. The relative benefits of these measures for developing countries are likely to far exceed those from any politically feasible increase in concessional flows.

APPENDIX

A. International Financial Institution Advisory Commission (Meltzer Commission)

Issue	*Reform recommendations*
IDA	• Grants should replace loans for the provision of physical infrastructure and social services, and should increase when used productively. • Grants should be paid directly to legitimate and verified service providers to eliminate opportunities for government corruption. • Institutional Reform Loans should be offered at subsidized interest rates (10–90 per cent) to support reform strategies developed by borrowing governments and approved by the MDBs. • MDBs and creditor nations should write off all claims against the HIPCs, conditional on effective economic strategies.
IBRD	• Phase out lending to countries with capital market access (investment grade international bond rating), or with per capita incomes over $4000, over five years. • Limit official assistance to countries with a per capita income over $2500.
Global public goods	• Shift World Bank focus to provision of global public goods, including treatment of tropical diseases and acquired immune deficiency syndrome (AIDS), environmental management, and inter-country infrastructure. • World Bank should be technical assistance center to regional development banks. • MDB services should be awarded as accounts on a competitive basis to private and public sector agencies (including NGOs). Cost of service provision should be shared between the donor agency and recipient government, with the amount of subsidy varying between 10–90 per cent (depending on levels of development). • MDBs should not engage in financial crisis lending.
Governance/ representation	• (None applicable)
Financial windows	• MIGA should be eliminated.
Relations with regional development banks	• All country and regional programs should become the responsibility of the corresponding development bank. • World Bank should maintain care of African states and the poor countries of Europe and the Middle East until appropriate regional development banks are ready to assume responsibility. • Excess callable capital should be reallocated to regional development banks and should be reduced in line with declining World Bank loan portfolios.
Other	• The World Bank should change its name to ‘World Development Agency’ to reflect these reforms.

Source: www.econ.lsa.umich.edu/~alandear/topics/meltzer.html.

B. G-7 Proposals on the Reform of the Multilateral Development Banks

Issue	*Reform recommendations*
IDA	• Analyze financial and practical implementation issues related to the increased use of grants within IDA-13, and review terms for blend countries.
IBRD	• Review lending instruments and pricing, including an assessment of rationalizing and streamlining existing intra- and inter-MDB instruments.
Global public goods	• MDBs' main priorities in this field should be to fight infectious diseases, promote environmental improvement, facilitate trade, and support financial stability. • The roles of the World Bank and regional development banks in this area should be defined clearly on the basis of comparative advantage.
Governance/ representation	• Establish and/or strengthen compliance and inspection mechanisms and enhance evaluation. • Institute reforms to promote wide consultation, coordination, and debate. Include an annual review of information disclosure policies to improve transparency. • Establish a more transparent budget process by better linking institutional priorities to resource allocations. • MDBs should institute periodic consultations between Executive Directors and senior management to better monitor organizational structure.
Financial windows	• All Country Assistance Strategies should eventually incorporate financial sector issues. • MDBs should assist borrowers in developing the capacity and strategies to meet international codes and standards, including the anti-money laundering standards of the Financial Action Task Force.
Relations with regional development banks	• MDBs should identify their comparative advantages and justify any overlap. Work Plans should be developed in accord with this comparative advantage.
Other	• Country Strategies should include a review of countries' governance, focusing on public sector management, accountability, and anti-corruption measures.

C. The Commonwealth Secretariat on IMF/World Bank Issues

Issue	*Reform recommendations*
IDA	• The criteria as set out by IDA-12 are sufficient. • Distribute IDA aid so as to reward good performance and penalize poor performance. • Carefully consider applying 'normal' performance to states emerging from conflict. Appropriate criteria should emphasize reconciliation processes, reconstruction attempts, and market promotion/liberalization projects. • On partially replacing IDA lending with grants, especially for AIDS programs and post-conflict states, the Secretariat recognizes concerns associated with the long-term viability of IDA, dependency on grants, and moral hazard.
IBRD	• Recent declines in IBRD and IDA lending or net transfers (to -$6.2 billion in 2001) are inappropriate. This decline should raise questions about the impact on IBRD's net income and its procedures and loan charges. • Resolve any lack of clarity on the level of conditionality to be attached to Bank loans.
Global public goods	• (None applicable)
Governance/ representation	• (None applicable)
Financial windows	• (None applicable)
Relations with regional development banks	• (No specific recommendations)
Other	• (None applicable)

Source: www.thecommonwealth.org/papers/_alandear/topics/meltzer.html.

D. Bretton Woods Committee Symposium: Reassessing the Role of Multilateral Development Banks in Emerging Market Economies

Issue	*Reform recommendations*
IDA	• Oppose the disbursement of grants, which would lead to major reductions in, and the eventual elimination of, Bank aid.
IBRD	• Phase out lending for projects that are privately financeable. • Increase interest rates as countries achieve graduation criteria. Perhaps implement price differentiation and create an internal credit rating system to graduate borrowers.
Global public goods	• Focus on sectors such as education and health that are crucial for development and that are neglected by the private sector. Such lending has been important for institution-building, infrastructure and policy development. • MDBs should continue as flexible tools in the resolution of economic crises. Such lending is an effective instrument in targeting expenditure, developing and maintaining monitoring systems and strengthening the private sector.
Governance/ representation	• (None applicable)
Financial windows	• (None applicable)
Relations with regional development banks	• Oppose a strict delineation of duties among MDBs – the competition created by the overlapping of duties is advantageous to both the borrowing countries and the private market.
Other	• (None applicable)

Source: www.brettonwoods.org/july13_2000symposium_report.htm.

E. Commission on the Role of the Multilateral Development Banks in Emerging Market Economies

(Carnegie Endowment for International Peace)

Issue	*Reform recommendations*
IDA	• (None applicable)
IBRD	• Continue lending to emerging market economies, as access to private capital remains risky, expensive, and unreliable. • As countries get richer, make declining dependence on MDB loans voluntary. This process should be joined by incentives that allow MDBs flexibility in addressing individual countries' needs. • Simplify conditionality and focus it on equity and growth issues. Conditions should be determined via transparent public debate that engages civil society.
Global public goods	• MDBs should lend in times of market and economic crises, but maintain their long-term development goals.
Governance/ representation	• (None applicable)
Financial windows	• (None applicable)
Relations with regional development banks	• (None applicable)
Other	• Emerging Market Economies should establish a borrower's club (on the model provided by the Andean Development and Nordic Investment Banks) to complement MDBs and enable members to 'own' policies and set their own development mandate.

F. Task Force on Multilateral Development Banks

Issue	*Reform recommendations*
IDA	• (None applicable)
IBRD	• To strengthen 'ownership' borrowers should take the lead in project and sector work, especially when this involves major policy reforms.
Global public goods	• (None applicable)
Governance/ representation	• Make information on MDB activities more readily available, in part to better justify MDBs' actions. • Open up and formalize new channels of dialogue to take account of advice and opinions from borrowing countries and international specialists. • Executive Boards should define the scope of the MDB activities, and demand a system that sets clear objectives at all policy levels. Establish clear and public benchmarks against which institutions' progress can be measured. • Boards should discuss and agree on country assistance strategies, to which Management should adhere. Measure results by generally accepted and comparable objective criteria. • Boards should ensure that MDBs' administrative resources are appropriate and used efficiently, and that budgetary practices allow for flexibility and greater responsiveness.
Financial windows	• (None applicable)
Relations with regional development banks	• Make objective evaluative criteria to improve MDB accountability common to the five MDBs. Meetings between the MDBs' evaluation units should develop shared evaluation standards and performance indicators.
Other	• (None applicable)

Source: Development Committee, Washington, DC (1996).

Notes

1 While this list is by no means exhaustive it gives a flavor of the more influential reports on this contentious issue. Other contributions include Birdsall and Deese (2001), and You (2000).

2 By 2001, more than 3,800 projects had been submitted to this program from more than 1,000 groups in 100 countries.

3 See Woods (2001) for a more thorough analysis of the links between global governance and accountability.

4 See Wilson (1989). For a more formal analysis of these results see Dewatripont, Jewitt and Tirole (1999).

5 Another alleged reason is the fear of developing countries that budget cuts would adversely affect their nationals employed in the Bank.

6 Whether moving from an open to secret voting rules in the Board would result in shareholders votes being more closely aligned to their "true" preferences, is an open question.

7 By the end of fiscal year 2001 the World Bank was administering 2,024 trust fund accounts whose fiduciary assets totalled $2.7 billion, of which the Bank Group itself provided $0.42 billion. Disbursements totalled $1.85 billion, of which nearly $1 billion was accounted for by just three programs – Heavily Indebted Poor Countries (HIPC), the Global Environmental Facility (GEF) and the Poverty and Human Resources Development Fund (PHRD). See World Bank, *Annual Report 2001*, Appendix Note H.

8 For instance, following the onset of the Asian crisis, the idea of an Asian Monetary Authority was shot down by the major powers and the Asian Development Bank was severely criticized when it attempted to adopt a position different from the prescriptions of the IMF. The monopoly power of the IMF was confirmed, and the possibility of exit denied.

9 On the power and influence of environmental lobbies on the World Bank see Wade (2001).

10 The figures are from tables 3.4 and 3.12, World Bank (2001).

11 This section draws on Kapur (2000).

12 http://www.imf.org/external/pubs/ft/seminar/1999/reforms/index.htm.

13 According to Ellison (2000), the fraction of development-related papers in the most prestigious journals has declined from 3.8 per cent in the 1970s to 1.6 per cent in the 1990s (Table 19, Appendix B).

14 At the beginning of the 1990s, 80 per cent of the research staff at the World Bank had graduate degrees from institutions in the United States and the United Kingdom (nearly two-thirds from the United States). While similar data from the IMF is unavailable, it is unlikely to be less. Since then, widening quality differences between the United States and developing-country academic institutions are likely to have increased the skewness (see Stern, 1977).

15 Robert Paarlberg, personal communication, 24 April 2002.

16 These include the Africa Economic Research Consortium (AERC) and the Joint Vienna Institute (co-sponsored with the BIS, the EBRD, the IMF and the OECD). But the output of these institutions is not geared to addressing systemic issues – as attested by the fact that it is rarely cited by the sponsoring institutions themselves on debates related to those issues.

17 Project funding runs around $35,000–$50,000 on average, with a few projects receiving up to $70,000.

18 I am grateful to Michael Kremer for pointing this out.

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