Introduction

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The 1990s have seen radical changes in thinking about development policy, as compared with the ideas inherited from the 1980s. At the end of that decade an approach to development emerged which became known as the 'Washington consensus': its aim was, roughly, 'to promote sound money and free trade, to free up domestic markets, and to encourage policy-makers to go home early and stop interfering with markets'. The experience in the 1990s of both the Asian miracle and the Asian crisis has shown without a doubt the inadequacy of this approach as a guide to development policy.

During the 'Asian miracle' period, the governments of Asian high-growth economies had clear priorities and did not hesitate to intervene (through subsidies, trade restrictions, administrative guidance, public enterprises, or credit allocation) (see World Bank, 1993; Stiglitz, 1996). More than this, the successful high-growth economies systematically subsidised investment; '[t]he . . . realistic presumption is that a range of market failures kept investment at a level below what would have been socially sub-optimal' (Rodrik, 1999: 55). And it is now widely agreed that the crisis of 1997–8 was largely created by the liberalisation of credit markets in the absence of adequate regulatory frameworks (Furman and Stiglitz, 1998; Stiglitz, 1999b). Both of these events – Asia's miracle boom and its unprecedented crash – have brought home the inadequacy of the simplistic Washington consensus as a framework for thinking about development policy.

Thinking on the Bank's role in delivering good development policy advice and assistance in this new 'post-Washington-consensus' climate is still in its infancy. The rejection of the 'Washington consensus' entails not only a questioning of the policies (and underlying assumptions) required for successful growth, but also a re-examination of development objectives, strategies, and processes (Stiglitz, 1998, 1999a).

The earlier theories saw development as a result of the solution to certain technical problems – improved resource allocation and increased resources. To be sure, at different times, emphases concerning what was the principal source of inefficiencies and what was the principal resource gap changed. In the era of development planning, attention focused on market failures: how, for instance, in the absence of a complete set of markets, government planning was needed to ensure the efficient allocation of resources, and how imperfections in capital markets prevented the efficient flow of capital from developed countries to less developed countries (hence the rationale for international lending institutions such as the World Bank). In the Reaganite–Thatcher years, government (including private rent-seeking activities directed at obtaining the largesse of government) was the chief culprit, with the obvious prescription – get the government out of the way. In the years following the oil price shocks, with the resulting macroeconomic instability (including huge variations in interest rates and in the developed countries which induced macro-instability in developing countries, especially those with heavy short-term indebtedness) it was this instability that was the core problem that had to be addressed.

The new development paradigm sees development as a more fundamental transformation, and one which will not necessarily be achieved simply by the solution to these technical problems. A mine in a remote corner of a country might lead to increased GDP, but is likely to have little impact on the development transformation. More generally, a country that has isolated pockets of, say, heavy industry, but whose rural sector remains largely untouched, is not undergoing a development transformation. As I put it in my Prebisch lecture (Stiglitz, 1998): 'A dual economy is not a developed economy.' Development entails changes in ways of thinking, in economic and social organisation, entailing, among other things, an acceptance of change.

The new paradigm puts greater emphasis on a variety of aspects of social and political organisation – it was, for instance, the deterioration of social and informational capital that in part accounted for the dismal performance of so many economies in transition in the past decade. Thus, the fact that the development transformation entails massive changes in society does not imply that traditional culture should be rejected outright; rather, successful development is evolution, building on existing institutions. Similarly, since changes in ways of thinking cannot be imposed, successful development cannot be based on conditionality. And successful development requires that the changes withstand the vicissitudes of the political process, that they be politically sustainable. Accordingly, greater emphasis is being placed on ownership and participation in the decision-making processes, and the development of capacities within countries to create and direct their own development programmes. And greater emphasis is being placed on the necessity of those programmes being (and being viewed as) equitable.

Paralleling these changes in the nature and processes of development are changes in perspectives on development strategies. It has come to be recognised that successful, isolated projects, as valuable as each might be to those who benefited directly from them, are simply not up to the scale of the problem facing the developing world, even if goals are modest, such as preventing the increase in absolute poverty; they are surely not up to the Development Assistance Committee goals, which include halving the number of those in extreme poverty by the year 2015. One has to go beyond projects towards policies. But good policies, as necessary as they are to successful development, also do not suffice. There need to be good institutions – such as judicial institutions which fairly and efficiently arbitrate disputes; good regulatory institutions, which ensure that markets, where possible, are competitive; and good financial institutions, which mobilise savings and allocate them efficiently. Where there is a natural monopoly, that monopoly power needs not to be abused, and so forth. While it is easy to identify the outcomes of good institutions, and to cite examples of institutions which work well and those which do not, it remains far from clear how to go about creating these 'good' institutions. As a result, the international community has increasingly resorted to exhortations for 'good governance in the public and private sector' but without correspondingly clear prescriptions of how to achieve that goal in general. In one area, in particular, however, there has been increasing consensus: corruption, and its adverse effects on growth and investment. Earlier, discussions of corruption would have been off limits for the World Bank, which was generally proscribed from engaging in political matters not directly related to development. But the new thinking argues that there is no bright line of demarcation: corruption, though a matter of politics, is at the heart of underdevelopment. But once that line has been broached, the limits of what should be in the Bank's purview are no longer clear. Openness, transparency, and democratic processes provide an important check on the operation of special interest groups and the extent of corruption.

Increasingly, the changes in the ways of approaching development, including the new relationships between the international financial institutions and the developing countries, have come to be seen from a broader historical perspective: 50 years after the supposed beginning of the end of colonialism, it appears that many vestiges of the colonial mentality have remained. For their part, nations in the developing world have had to struggle with overcoming their colonial heritage; it is not necessarily the case that everything that the colonists left behind – including their economic theories – was flawed; and it is not necessarily the case that the economic theories of those that supported the struggle for independence were sound. This was brought home forcefully by the collapse of the Soviet empire, which made those countries which had not yet become disillusioned by the failure of socialist development strategies re-examine their approach to development. Conditionality – including the manner in which conditions have often been imposed – has come to be seen by many, especially within the developing world, as part of the new economic colonialism which has succeeded the old.

With democratic institutions in an increasingly large number of developing countries, there is an increasingly strong imperative that the international financial institutions find ways to support democratic processes. An essential aspect of that is *democratic pluralism*. This has two central features. When the evidence concerning the consequences of a policy or the design of an institution is ambiguous, and there are alternative views, the country should be presented both with the alternative perspectives and with a realistic assessment of the risks and uncertainties. And when different policies impact different groups differently, as they almost inevitably do, the choice of the appropriate policy should be left entirely in the hands of the country and its political system. Outside advisers can clearly take strong positions against Pareto-inferior policies but, even then, a word of caution is necessary. The reform process is a dynamic one, occurring over time. What appears to be a Pareto-dominant policy in a static context may not be in a more dynamic one, and conversely. The country (its political leaders, its civil society) is likely to be in a better position to judge – and affect – those dynamic consequences, which often entail the formation of new political coalitions and/or the dissolution of old ones. This approach of democratic pluralism stands in marked contrast to the policy which has characterised the institutions during the first half-century of their existence. When the system worked 'well', the International Monetary Fund (IMF) and the World Bank would meet behind closed doors to decide on a unified view concerning what conditions to impose on the country, or what policies to recommend to the country. Divergences in views were frowned upon; it was suggested that such disagreements were confusing to the country. Views about the appropriateness of the policies were presented with a false sense of confidence in their efficacy. Alternatives, with different risk and distribution consequences, were not presented to the country for its own choice. To be sure, this characterisation is an exaggeration, as the actual programme was typically negotiated, but it was a bargaining process in which the power was one-sided, especially when a desperately poor country frantically needed funds. The only saving grace was that the conditions were typically only imperfectly enforced.

In the approach of democratic pluralism, not only is it acceptable that different courses of actions be offered up ('recommended') by different international agencies, but also it should be expected that this would frequently be the case, since the different international agencies have different objectives and different governance structures. Indeed, if they had the same objectives and the same governance structures, it would be hard to justify the existence of separate agencies, except as competitive producers of similar products. But then again, it is desirable that alternative courses of action be proffered, partly for reasons of *competitive pluralism*, in the terms that the Asian Development Bank (ADB) has used. To be sure, those in any market have a desire to reduce competition, to reduce the information base on which one can judge their competency and effectiveness. But these attempts to suppress competition should be recognised for what they are: self-serving attempts by the agency to reduce the effectiveness of accountability. This is especially the case for the IMF, whose governance structure includes a large role for Central Bank governors, who typically are neither representative of the population as a whole nor, increasingly, directly accountable to the electorate. Indeed, it is ironic that in an era in which we increasingly speak of democratic accountability, one of the major international organisations, with a tremendous potential effect on the global economy, has been striving hard to reduce its accountability. In effect, it has been waging a campaign to reduce its own direct accountability to democratic processes. These are matters of controversy, but it is a controversy which, unfortunately, has been suppressed for too long.

The differences in the institutional mandates of the World Bank, the IMF, and the UNDP and the other international organisations are as apparent as the differences in their governance. For instance, the IMF is charged with maintaining the stability of the global financial system: in practice, in the past, it has seemed to have had a strong concern to ensure the creditors got repaid, resisting the use of bankruptcy and bankruptcy-like proceedings even in private-to-private credit flows, as in the 1997–8 East Asia crisis. (Though this is not formally part of its mandate, the assumption of this responsibility is not surprising, given its governance structure). By contrast, the World Bank's mandate is to enhance developing country growth and reduce poverty. Policies that are well designed for one objective (and that minimise risks to that objective) may be poorly designed for another. Indeed, one of the long-standing criticisms of IMF programmes is that in many countries they have led to increased poverty – higher levels of poverty than would have occurred in programmes with alternative designs.

Differences in mandates in turn lead to differences in views of the world, differences in models. This can be seen once we recognise the importance of uncertainty: as Bayesians, the probability judgements depend on loss functions, and institutions with different mandates will have different loss functions. Different models – views of the world – may also arise for other reasons, just as different firms in an economy may have different business strategies, based on different judgements concerning the evolution of markets. It is in this arena that competitive pluralism again takes on central importance. There is, for instance, a widespread view that the particular set of models that the IMF uses have been inappropriate in many situations (in the crisis in East Asia, for example, it is clear that their forecasts concerning the countries affected by the crisis were badly misguided). Within the World Bank, an alternative perspective, which turned out to be far more accurate, was stressed. But, regrettably given the official stance that such disagreements be not aired in public, there was no public debate about the appropriateness of the alternative perspectives. Even after the fact, debate within the institutions has been relatively muted though, fortunately, within academia, such a debate is now emerging.

One critical component of new thinking on development is the World Bank's new 'Comprehensive Development Framework', or CDF (see Wolfensohn, 1999; World Bank, 1999). The CDF approach to development attempts to be comprehensive in two respects: across different aspects of development, and across participants in the development process. The Bank clearly cannot do everything, and coordination among donors can ensure complementarity in the development effort within a coherent overall approach. Comprehensiveness across participants is envisaged: if government, the private sector and 'civil society' all become participants in the process, then identification with, and ownership of, the development process will be the outcome.

Some have argued that the Bank faces two big challenges in implementing the CDF. The first is how to coordinate, and prioritise, within the Bank, the Bank's own contributions to this comprehensive 'big-push' approach to development assistance. The second is how actually to coordinate the many other stakeholders who are to be involved in this approach to development policy. Who will be in charge when there are disagreements of analysis between the stakeholders, and – what is worse – straight conflicts of interest between them? But the very formulation of the challenges in this way reveals how hard it will be to change thinking about the aid process. The developing country should be in charge of its own aid strategy, and it should play the pivotal role in coordination and dispute resolution. To be sure, each donor has its own accountability: public agencies have fiduciary responsibilities, and must decide whether the funds allocated to a country – given that country's development programme – satisfy its own fiduciary standards.

This book brings together some of the latest thinking about these vital contemporary debates. It comes at an opportune moment: because of these debates the future of the World Bank is under more detailed scrutiny than at any time in the recent past. The authors have assembled an international group of front-rank writers to help carry these debates forward. A number of the chapters in the book are by members of the staff of the World Bank itself. These authors set out their vision for the role of the institution – its structure and its policies – and the ways in which they see these evolving. Their contributions take forward the task of putting Bank thinking about its reorientation as an institution into the public domain. In addition, the editors have commissioned a number of studies which provide an 'outside view' of the Bank.

Chapter 1 provides an introduction to the issues which are discussed in the body of the book. Part One discusses the Bank as an institution. Historically, the Bank has been a lending institution – as Keynes said, 'the Bank is a Fund'. But the editors, together with Andrew Powell, insist in chapter 2 that the Bank should instead see its core mission as that of a development agency. Chapter 3, by Kanbur and Vines, reviews the place of poverty alleviation within such a mission (something which we see currently as assuming a higher profile than recently). Many have argued that the Bank's worth as a development institution arises from its unparalleled knowledge of and experience in development, and its ability to deliver advice and assistance based on this knowledge – the Bank as a 'Knowledge Bank'. Lyn Squire, who was Director of the World Bank's Research Department from 1993 to 1997, provides a description and advocacy, of this aspect of the Bank's work in chapter 4. An organisation which does this kind of work will be intrinsically difficult to govern and to manage; Ngaire Woods in chapter 5 provides a thoughtful discussion of the issues which these difficulties raise.

Part Two is about the Bank's development assistance policies. A major debate is under way about the effectiveness of multilateral aid in stimulating growth and in assisting in poverty reduction (see World Bank, 1998). Some in this controversy have argued that policy conditionality is seldom effective, few now believe that it achieves all that its proponents once sought from it. This part of the book attempts to provide a balanced assessment of the debate on this issue. In chapter 6, Ferreira and Keely look at the early emergence, in the 1980s, of concerns about the effectiveness of structural adjustment lending. Chapter 8, by Burnside and Dollar, reviews the relationship between aid and growth, arguing that, on average, aid does not influence growth, and that there is a positive influence of this kind only in the presence of good policies. Chapter 7, by Devarajan and Swaroop, presents one reason why this is so: aid is fungible. Isham and Kaufmann in chapter 9 present further supporting evidence on how policies and institutions affect project performance, and Jones in chapter 10 examines the success of Sector Adjustment Programmes (SAPs) as one method of improving the effectiveness of development assistance. Two further chapters, chapter 11 by Hopkins, Powell, Roy and Gilbert, and chapter 12 by Collier, stand back from the issues raised by the earlier chapters, and attempt to present some conclusions. They advocate a radical reorientation of international aid policy away from a 'conditionality' that is detailed and micro-interventionist – and which saps the ability of borrowing countries to take ownership of their own development strategy – towards a conditionality based only on good policies and which encourages cooperative engagement between lender and borrower. This is a debate in which development economists are now deeply engaged: the present book will carry forward that debate to a wider audience.

The issues raised in this book will be central to the Bank's evolution in the first decade of the twenty-first century. They relate to questions which are being asked by the governments and taxpayers who currently fund the Bank's activities, and by the Bank's current and potential clients in the developing world. By taking a view from outside the Bank, and away from Washington but, at the same time, by drawing extensively on experience within the Bank, the book aims to make an important contribution to these discussions.

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1 The World Bank: an overview of some major issues[1]

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The World Bank (henceforth 'the Bank') is an institution whose objective is the promotion, world-wide, of sustainable economic development and poverty reduction.[2] It pursues these objectives through lending, through the production of research and economic analysis and through the provision of policy advice and technical assistance.[3] The purpose of this book is to critically examine the rationale of this institution and to describe the policies which it currently carries out, in order to examine whether its objectives are best served by its current mix of activities.

Our intention is not just to look backwards, but to examine future options and to advocate choices among them. It has often been said that the Bank lacks a coherent vision, and that, as a consequence, it suffers from a dysfunctional proliferation of objectives. We agree. In response to this, we argue that the Bank should be organised around a vision of itself as a 'Knowledge Bank'. To some extent, this has already happened. But it has only partly happened; making it really happen would radically transform the Bank's priorities, and its activities in the field, way beyond any changes currently in train. In particular, far less manpower would be devoted to analysing loan proposals and outcomes, and far more would be devoted to giving advice about development strategies and to providing help with their implementation.

The Bank recently celebrated its fiftieth anniversary. It has always been controversial. Throughout its life it has been seen variously as: promoting statist and socialist regimes and as imposing free market ideologies; as having far too little money to lend and as being profligate with taxpayers' funds; as being an arm of the US Treasury; and as being an institution which can protect aid allocations from donor government agendas.[4] Those on the left (see Wade, 1990) have viewed it as an imperialist institution for imposing one view of the development process, and have also criticised its record on the environment, poverty reduction and other social issues. Those on the right (see Walters, 1994) have also argued