REFORMING THE WORLD BANK

In the many studies of the World Bank, a critical issue has been missed. While writers have looked at the Bank's political economy, lending, conditions, advice, ownership, and accounting for issues such as the environment, this study looks at the Bank as an *organization* – whether it is set up to do the job it is supposed to do and, if not, what should be done about it. This book is about the problems of organization and reorganization as much as it is about the problems of assisting third-world development, and it is a case study in flawed organizational reform as much as a critique of the way development assistance is managed. It covers the period that starts at the time of the first major reorganization, in 1987 under President Barber Conable, and ends at the time of the resignation of Paul Wolfowitz, in 2007, but it focuses especially on what happened during the tenure of James Wolfensohn.

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Reforming the World Bank

Twenty Years of Trial – and Error

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Contents

Preface

The Search for Effectiveness in the World's Premier Development Institution

Why write another book about the World Bank?

Many studies have been conducted and books have been written over the past few decades about the World Bank, which I refer to from here on as 'the Bank'.[1] But what has been written about up to now has largely missed a critical issue. Writers have been concerned mainly, and justifiably, with the Bank's external role within world development, that is, its political economy, its place within the process of globalization, the character of its lending, to whom it lends, what conditions it imposes, how far it accounts for socioeconomic concerns such as the natural environment, the kind of advice it gives, and, most recently, who should own it. This study, without ignoring the wealth of wider issues, looks at the Bank as an *organization*. That is, is it configured organizationally to

[1] Some major recent works focusing on the Bank include: Kapur, Devesh, J. Lewis, and R. Webb, *The World Bank: Its First Half Century*, Brookings, 1997; Gilbert, Christopher L. and David Vines, *The World Bank: Structure and Policies*, Cambridge University Press, 2000; Pincus, Jonathan R., and Jeffery A. Winters, *Reinventing the World Bank*, Cornell University Press,2002; Easterly, William, *The Elusive Quest for Growth: An Economist's Adventures and Misadventures in the Tropics*, MIT, 2001; Easterly, William, *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good*, Penguin, 2006; Mallaby, Sebastian, *The World's Banker: A Story of Failed States, Financial Crises, and the Wealth and Poverty of Nations*, Penguin, 2004; Ritzen, Josef, *A Chance for the World Bank*, Anthem, 2005; Buira, Axel, ed., *Reforming the Governance of the IMF and the World Bank*, Anthem, 2005; Woods, Ngaire, *The Globalizers: The IMF, the World Bank and Their Borrowers*, Cornell Studies in Money, Cornell University Press, March 2006; Birdsall, Nancy, ed., *Rescuing the World Bank: A CGD Working Group Report and Selected Essays'*, Center for Global Development, 2006; and Wolfensohn, James, *A Global Life: My Journey among Rich and Poor, from Wall Street to the World Bank*, Public Affairs Press, 2008 (forthcoming).

do the job it is supposed to do and, if not, what should be done about it? In particular, the question is whether the *reorganizations* that have taken place over about the past twenty years have made the Bank more capable of doing the job it is supposed to do, as they have each laid claim. This book is thus about the problems of organization and reorganization as much as it is about the problems of assisting third-world development, and perhaps it would serve as a case study in organizational reform as much as a critique of the way development assistance is conceived and managed. The period that the story covers starts at about the time of the first major reorganization, which took place in 1987 under President Barber Conable, and ends at about the time of the resignation of Paul Wolfowitz, the tenth president, in 2007.

During fourteen years working in the operations side of the Bank from 1987 to 2001, I, like many others, often had questions about the way the organization was being run, but I was not in the right place, nor did I have the time or the understanding, to answer them. I was managing Bank projects and studies in Africa and the former Soviet Republics, mainly in Tanzania, Mozambique, Belarus, and Armenia, with occasional sorties outside. It was a demanding task to navigate continuously through the conflicting and sometimes counterintuitive internal organizational and external pressures and requirements, to try to arrive at an effective solution for matters on the ground. Generally, I spent my time heavily engaged in what I was supposed to do rather than in questioning how or why I did it. Yet answers were needed more and more, especially as the organization went though increasingly complicated changes, and so I finally decided, when I left, to see if I could tell a story that I thought needed to be told and arrive at some answers that needed to be arrived at. Perhaps the answers I come to will inform other organizations similar to the Bank.

To try to find these answers I particularly focus on the reorganization that took place under James D. Wolfensohn, who was appointed to the Bank's presidency by President Bill Clinton in 1995 and who departed in 2005. The reorganization that he presided over is now in the past, but its effects live on. Paul Wolfowitz, during his short tenure from 2005 to 2007, did not have time to effect substantive additional changes to the organization, but those steps he did take built largely on foundations already established by Wolfensohn. Robert Zoellick, who succeeded to the office in 2007, has been developing an agenda as this is written.

Why is it important to ask this question about 'organization'? The answer is that the World Bank is a key global institution, and it is the prototype of all the other public international financial institutions, which, although smaller, have similar organizational features and similar capital and governance structures and do similar kinds of financing and advising. The efficient organization of the World Bank is important in the efficient delivery of foreign assistance and also in how effective that assistance is on the ground, which is the ultimate objective of delivering it. Effective development assistance also requires good organization within international financial institutions as a whole. The lack of effectively organized, as well as broadly owned and controlled, financial institutions will increase the probability of a splintering of world economic governance into geopolitical blocs as wealth increases outside the Organization of Economic Cooperation and Development (OECD) countries as a result of Eastern economic strength and high oil prices.

The Bank was a child of America's postwar foreign policy and a testament to the internationalist attitudes of the time. It is located in the capital city of the United States, Washington, DC, and has been a leader in, and a lightning rod for, criticism of the place of foreign economic aid in the world. In a world where globalization is a fait accompli, through the cross-border diffusion of products, capital, labor, and technology, there are still not enough truly global organizations that are mandated to, or capable of, dealing with multinational economic challenges, that is, those that cannot or will not be dealt with by private interests or national governments, and those that exist need to work properly. After years of costly and time-consuming reforms, is there any reason to believe that it now does?

This study is critical of what the reforms achieved. It is an on-the-ground examination of things that were generally not done right. Sometimes it is dismissive, but it does not question the existence of the institution. On the contrary, it is because, as a global institution, its role is probably now more important than ever, that defects in its makeup, and some of the history behind them, are worth understanding. Nor do I critique the actions of individuals per se, because that is not relevant. I try to maintain a balance, but my focus is on explaining the things that went wrong and why they went wrong, the problems that need to be fixed, not those that do not. Perhaps there is no need to pile on more pressure. But the more fully the issues are set out, the more chance there is that someone will be motivated constructively to take up the challenge of creating an effective organization that might serve as a better model for others as well.

Since the 1940s, the industrialized world has accepted that it has a responsibility to try to share the benefits of economic development with economies that have for various reasons not made much progress on the development ladder, in its own interests as well as those of the poorer countries themselves. But accepting such a responsibility, I believe, has not meant that industrialized countries are actually in a good position to assist them. In the past, some more extreme development pessimists even held that the rich countries by their very existence could not help poor countries because they preempted economic progress in those poor countries. There was a tendency, they thought, whereby rich countries increasingly monopolized worldwide resources and trade and entrenched a widening technological gap, which in turn increased their lead and the dependence of poorer countries on supplying materials to them and buying goods from them, making catch-up ever more difficult.[2] But the facts of the past few years suggest that at least in major parts of the once-very-poor world, like East Asia and now parts of China and India, this is not so, and the most pessimistic view does not hold true, except, at least up to now, in some of the most marginalized economies of the world, for example, in regions of Africa. Thus the most serious pessimism about development has proved wrong.

Nevertheless, while worldwide economic development is possible, this does not mean that effective aid for development is possible. After sixty years it is still not clear that rich countries actually know how best to assist poor countries. If there is doubt about whether economic assistance can be effective at all, then there is not much point in dwelling on the possibility of improving the effectiveness of economic assistance organizations,

[2] For an example of this view see Frank, Andre Gundar, 'Capitalism and Underdevelopment in Latin America,' *Monthly Review Press*, 1968.

whether they be the Bank or any other international financial institution. It might be better to close them down. So I want to start by considering this point further before moving ahead.

On recent projections, made before the 2008 food price increases, the number of people living in the worst poverty (less than $1 per day) will fall from 1.2 billion (28% of the world's population) in 1990 to about 620 million (10%) in 2015.[3] This is largely due to the awakening of the Indian and Chinese economies. But in Africa, in other parts of South Asia, in Central Asia, and in Latin America things have not generally improved. For forty countries, in which 900 million people live, poverty has continued to increase.[4] Infant mortality rates and primary school enrollment have improved everywhere, but they still remain bad in sub-Saharan Africa, where less than 60% of children complete primary school and nearly one in five still dies in early childhood. The situation has worsened with the world food shortages of 2008. Poverty is also based on an arbitrary measure. If the poverty line threshold was raised from $1 a day to $2 a day, then 1.9 billion people in Asia alone are in poverty, 30 percent of humanity, so there obviously remains a huge problem, and it is not certain whether development assistance can provide the solution.[5]

Former Bank economist Bill Easterly[6] wrote that economists are no closer than they were fifty years ago to figuring out how to accomplish the basic mission of making a poor economy grow. 'The genuine success stories, where poor countries have achieved long-term growth, have been pitifully few', he said. 'And in some of these it's far from clear that Bank

[3] Although this claim has been challenged as underestimating poverty and overestimating its rate of decline. Reddy, Sanjay G. and Pogge, Thomas, 'Shooting the Messenger of Good News: A Critical Look at the World Bank's Success Story of Effective Aid', *Third World Economics*, No. 287 (16–31 August 2002).

[4] A discussion of who are the poorest and why is in Collier, Paul, *The Bottom Billion – Why the Poorest Countries Are Failing and What Can Be Done About It*, Oxford University Press, 2007. Collier proposes that foreign aid should be concentrated in countries facing defined 'poverty traps'.

[5] In fact the World Bank reported in August 2008 that, as of 2005, 1.4 billion people were living under a revised poverty line of $1.25 a day.

[6] In *The Elusive Quest for Growth*, op cit, Easterly argued that many of the assumptions of the Bank and other donors about effective aid are fallacious – e.g., the relationship between growth and investment; the relationship between growth and education; and the relationship between growth and reform lending.

aid was a major factor, or even any factor at all'. Despite 'sixty years of countless reform schemes and dozens of different plans, the aid industry is still failing to reach the beautiful goal (of making poverty history)'. [7]

At an important Conference on Finance and Development in Monterrey in 2002, the Bank argued for the doubling of aid to $100 billion a year.[8] It cited success stories that included, for example, China, India, Poland, Uganda, Vietnam, and Mozambique.[9] But total aid to China, one of the greatest success stories, had only been 0.4% of its gross domestic product (GDP) (2 to 3% of investment) and it had paid little attention to the policy reform prescriptions of the Bank and the International Monetary Fund (IMF). So it cannot be claimed that external aid had anything to do with China's economic growth. Similarly, India received only 0.7% of its GDP in aid and has also been growing successfully, as has Poland, which got 1.5%. On the other hand, there were several other former socialist economies, like Moldova and Kyrgyzstan, which got more aid, and their economies declined. Mozambique and Uganda did well, but they were exceptions among fifty-four low-income countries that averaged zero per capita growth. Zambia received large inflows of aid and had minus 2% growth in the 1990s. Aid to African countries has been quite a large proportion of their economies, and in general they have followed the Bank and IMF prescriptions more closely but have grown very slowly, stagnated, or declined.

Revisiting this negative correlation between aid and economic growth, researchers found that aid is still effective in countries with good institutions and good policies, including macroeconomic stability, fiscal discipline, trade openness, private property rights, and the rule of law – that is, mainly in relatively well-organized economies. It has had a poor record in countries with poor institutions and policies.[10] Further research then showed that, within the

[7] Easterly, William, *The White Man's Burden*, op cit.
[8] 'The Role and Effectiveness of Development Assistance', World Bank, March 2002.
[9] Easterly, William, *Washington Post*, March 14, 2002.
[10] For example Collier, Paul and David Dollar, 'Can the World Cut Poverty by Half? How Policy Reform and Effective Aid Can Meet International Development Goals', *World Development* 29(11), 2001; Dollar, David and Aart Kray, 'Growth Is Good for the Poor', World Bank discussion paper, February 2000.

good-policy category, high-aid-to-GDP economies grew faster than low-aid-to-GDP economies,[11] which would provide the justification for continuing to provide aid. However, the finding that there was a high correlation between aid and growth in 'good-policy' countries was itself challenged and then resurrected by other researchers. There was found to be a correlation between certain types of short-term directed assistance and growth, but this was also challenged and then resurrected.[12]

But whatever the merits of the see-sawing research findings, the suggestion that good-policy countries should be getting more foreign aid is odd. After all, strong-institution/good-policy countries do well because they tend to use *all* their resources more efficiently (e.g., capital, technology, skills, and natural resources), whether local or foreign, aid or investment. They are also more likely to have a culture and societal expectations that favor economic growth. Thus, many good-policy countries may tend not to face a foreign resource constraint. They may well be able to use foreign aid money in a beneficial way, but they may not need it. On the other hand, economies that have poor institutions and organizations tend to use all their resources poorly, not just foreign aid. These economies are the ones that, conservatives argue, become 'hooked' on aid, like welfare, to no useful effect, and should therefore not get it, except maybe as humanitarian assistance. Thus, countries with good institutions and policies do well with or without aid and they do not really need help, but they 'deserve it'; countries with poor institutions and policies do poorly with or without aid and they do really need help, but do not deserve it.

[11] *Assessing Aid*, World Bank, 1998, p. 14.

[12] Easterly provides a blow-by-blow account of the evolution of aid and growth research in *White Man's Burden*, op cit, pp. 38–57. Another problem facing foreign aid in the countries where it does play a major role is the so-called Dutch disease effect. As an illustration, in his farewell speech on October 31, 2001, one executive director, Valeriano Garcia, from Argentina, made the following statement: '[T]he Bank should take a new look at the effect of ODA (aid) on development. . . . ODA has the effect of appreciating the exchange rate, reducing export capacity; is negatively correlated with the rate of growth and negatively correlated with the country's savings rate . . . (what are we really financing in a World of fungible money?)'.

These points might well lead to a degree of aid-pessimism – that foreign aid really has little role to play in the grand scheme of things, that aid donors assisting good-policy, emerging economies really do little more than add to the general applause, while in low-income, poor-policy countries they may rush about energetically but for little purpose and at high cost. This is not a matter of pessimism about development, that is, the ability of the people of a country to help themselves with better social organization, political stability, institutions, and knowledge – not at all, because development has shown itself to be possible worldwide. It is pessimism only about the effect of subsidized outside assistance often based on outside initiatives and outside prescriptions.

But foreign aid has also shown some good results, at least on a more micro scale, for example, in areas like education and health. Australian aid doubled school enrollment in Papua New Guinea. Oral rehydration therapy provided by the United States reduced by 82% infant deaths from diarrhea in Egypt in the 1970s.[13] The elimination of river blindness in Niger was a significant achievement of the World Health Organization (WHO) and other agencies, helped by Bank money. There are numerous examples of cases where specific, well-targeted bits of advice or funding paid off through successful capacity changes or effective infrastructure in the recipient countries. Even the best-run business and the best-run economy can and does certainly gain from specific outside advice and specific investments and technology acquisition.[14]

The aid-optimistic view is represented by, among others, Jeffery Sachs,[15] who has written: '[T]he time to end poverty has arrived, although the hard work lies ahead. . . . I have shown that the costs of action are small and indeed a tiny fraction of the costs of inaction. I have identified a timetable to 2025, including the Millennium

[13] Levine, Ruth and Molly Kinder, *Millions Saved: Proven Successes in Global Health*, Center for Global Development, 2005.

[14] Riddell, Roger, *Does Foreign Aid Really Work?* Oxford, 2007, is an exhaustive examination of the role of foreign aid, which concludes with reservations that it can be effective given changes in its delivery mechanism. For example, he recommends an international aid fund to circumvent the adverse effects of national interests on aid policy and allocation.

[15] Sachs, Jeffrey, *The End of Poverty – Economic Possibilities for Our Time*, Penguin, 2005.

Development Goals, as a mid-way station in 2015'. Further, he writes that the world community should commit to those goals and its leaders should adopt a specific global plan to meet them. Nicholas Stern, the Bank's former chief economist, is another aid-optimist. He believes that the understanding of how to deliver effective aid has improved in the past decade, especially as a result of the emphasis on capacity- and institution-building. '[W]hen we use what we have learned, aid works', he writes. 'The time is right for rich countries and developing countries to enter into a deep and lasting partnership to promote development and build a more inclusive world'.[16]

For our purposes here, we take a very cautious aid-optimist's view, that at least some foreign assistance can have a beneficial impact, if it is responding to the right needs in the right places, is conceived intelligently for additional benefit, and is implemented well. Thus, if we accept first that worldwide economic development is possible, and second that some form of assistance by rich countries to the poorest countries is needed to help them follow China and the other industrializing economies, then it is necessary to find ways to bring it about. This is likely to require global collective action, and global action requires effective global institutions. The Bank, and the other parallel public sector institutions, have to show that they can be cost-effective providers of 'public goods', and that they deal equitably with their client countries. The rest of this study thus concentrates on how the effectiveness of key existing assistance infrastructures can be improved rather than whether assistance should be given at all.

For sixty years, therefore, the Bank has been a key part of the infrastructure of assistance – a global financier, adviser, advocate, and, by intent, honest broker in international development. It has provided large amounts of loans and subsidized credit and now grants to its members, and each year it provides an additional $20 billion or more, an amount as large, or larger, than the gross national income of many small countries. Increasingly it has also acted as a provider of know-how.

[16] Stern, Nicholas, 'The Role and Effectiveness of Development Assistance,' in *A Case for Aid: Building Consensus for Development Assistance*, Ed. Stern, Nicholas and Wolfensohn, James D., United Nations International Conference on Financing for Development, World Bank, 2002.

It holds billions of dollars in assets and in debts to others, and it employs thousands of people. Its assets and its know-how are a resource that it holds in trust, and it is the world community's interest to hold accountable organizations that retain its trust, because of the money it manages, the advice that it gives, and the policies that it promotes on behalf of the world. This study is about the deployment of this capacity.

I have organized the study into three main parts. Part I contains two chapters that set out the role and achievements of the Bank since its founding, and the critique of it that developed. The second part contains seven chapters that form the bulk of the story. It starts with a brief review of the history of organizational reform within the Bank leading up to the 1990s reforms, and then it focuses on the reforms that took place in the late 1990s under James Wolfensohn and a little beyond, and the extent to which they succeeded or failed.

The story of these reforms covers the main changes – in organizational structure, culture, people, skills, development products, and their effectiveness; and it considers the financial underpinnings of the reforms. Part II concludes with a chapter examining reasons why most reforms did not succeed.

Part III looks ahead. In doing so, it focuses on two ingredients of reform that I believe are critical but which were essentially ignored in the reform process that actually took place, and which remain central parts of a continuing unmet agenda. They relate to governance. That is, the reform of the Bank's boards of governors and directors, and the reform of its leadership. Serious change in both these areas is the *sine qua non* for effective reform and the creation of a better organization in the future, in the Bank and perhaps in other international financial institutions.

Finally, this book went to press just as the 2008 financial crisis broke, but it might be worth saying a few words about its relevance. In fact, the World Bank is not a factor in the crisis, because of the nature of its assets – that is, long-term loans guaranteed by borrower goverments, and its liabilities, fully backed by its owner governments, as there will be occasion to discuss later. On the other hand, the crisis will tend to enhance the role of the Bank, in support of its partner institution, the IMF, as a source of investment funding and as an architect of a new international financial stabilization framework.

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