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Who Needs the World Bank: The Future of China, India and the Middle-Income Countries?

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[TRANSCRIPT PREPARED FROM A TAPE RECORDING]

MR. MacDONALD: I just want to thank our audience for their incredible perseverance. I must say this certainly must reflect very well on the quality of our distinguished panelists that you have been so incredibly patient. We are, however, coming towards the end. We have one more two-personal panel on the role of the Bank in middle-income countries, and then Michael Kremer will be speaking to us about global public goods. I hope that you'll be able to stick with us until the end.

On the middle-income countries, borrowing in middle-income countries has declined dramatically. The CGD Working Group on the Future of the World Bank had a very specific and emphatic recommendation that the Bank should continue to be active in middle-income countries and in such emerging markets as China and India.

Most of our panels so far have had a disappointingly large degree of agreement. I'm hopeful that for our next panel we may have differing points of view. It's my pleasure to invite the panelists to join me up here. I'll introduce you and you can get your microphones on.

Adam Lerrick and David de Ferranti, if you'd like to take your seats here. Again, I'll introduce our second speaker first.

David de Ferranti is a Distinguished Visiting Fellow at the Brookings Institution and an Adjunct Professor at Georgetown University, and was previously the Bank's Regional Vice President in Latin America, so he knows from involvement in middle-income countries. I'm very pleased that you can join us today, David.

Adam Lerrick is the Friends of Allan H. Meltzer Professor of Economics at the Tepper School of Business at Carnegie Mellon University and Director of the University's Galliot Center for Public Policy. He was also the Senior Advisor to the

Chairman of the International Financial Institution Advisory Commission which is known to all of us as the Meltzer Commission. Adam, thank you very much for joining to us today. The floor is yours.

MR. LERRICK: I'm very pleased to be here and I was very grateful to Nancy for inviting me. One of the principal reasons is it's going to be one of the first times in 3 years I get to speak about something else than Argentina.

[Laughter.]

MR. LERRICK: One of the issues that I always am amused that when I'm quoted in the newspaper it says Adam Lerrick, outspoken critic of the World Bank or the IMF, whereas when anyone says something nice about the Bank, they're an economist.

[Laughter.]

MR. LERRICK: I don't consider myself to be an outspoken critic, I consider myself to be a member of the loyal opposition. I think the Bank has an important role to play. Unfortunately, it's not the role it's playing now. The clearest exposition of this problem is in the Bank's activities in the middle-income and emerging market countries.

I'd first like to start and go over a series of what I call fictions about the World Bank. The first one is that the Bank lends to countries without access to private capital. I wrote a study as part of the work for the Meltzer Commission in 1999 where it showed that 70 percent of private sector flows went to 11 countries, and the Bank said you see, that's the problem, we lend to the world whereas the private sector only lends to these 11 countries. Unfortunately, when we did the analysis we found that 70 percent of what the World Bank lends went to 11 countries, and it was the same 11 countries. What was even more disquieting was that World Bank funds were less than 1 percent of what the private sector was sending to these economies.

When I wrote this study in 1999, the World Bank's Vice President for Strategy and Policy obtained an early copy and sent an Email to the Bank's Chief Financial Officer saying, Is this true? The CFO then told me that she actually was so upset by this that she arrived six floors down and across the entire building before her Email did in person to find out whether it was true, and he said, yes, it's true. The numbers are the number. And it's still true today.

If you look over the last 7 years, 90 percent of what IBRD lends goes to 20 countries that have ready access to the capital markets, and what they receive from the capital markets is more than 100 times what the World Bank sends. So the Bank has now become an insignificant source of funds to the borrowers that receive 90 percent of its loans.

China is probably the most extreme example. China, as you all know, has $700 billion in foreign exchange reserves, has an "A" which is a medium investment grade

bond rating, could borrow hundreds of billions of dollars in the capital markets if it needed it, and receives $50 billion in net foreign direct investment every year. There is no project in China that the Bank could finance that the Chinese government cannot finance itself.

The second fiction is that the Bank lends to projects that the private sector has no interest in. The problem with this argument is that the Bank only lends with a government guarantee and once you have a government guarantee, the private sector couldn't care less what the use of proceeds is. They don't care whether you're vaccinating Indians in the Amazon or you're building nuclear weapons. If you look at any prospectus for a bond issue it simply says "The use of proceeds is for general government purposes." There again there's a basic fallacy is lending for projects that the private sector has no interest in.

The third fiction is that World Bank advice must be packaged with subsidized financing to be credible. Otherwise, countries won't listen. This makes the Bank along with the other IFIs the only consultants in the world who pay their clients to take their advice. This is a basic fallacy. The problem here is, if the advice is good, there should be no need to pay them to take it, and if the advice is bad, they shouldn't take it no matter what the payment is.

The next fiction is that somehow Bank money is different than private sector funding. Former Bank President Wolfensohn once testified that there was a fundamental difference between Bank financing and capital market financing. He stated that in his previous career as an investment banker he discussed the economic terms of financing with ministers of finance but never what they were going to use the money for. But as head of the World Bank, he never discussed the terms of the financing, but only how the minister or the president should use that money to better the lives of their people.

I was asked about this qualitative deference in a Senate Banking Committee hearing and I answered that both of Mr. Wolfensohn's statements was true, but the conclusion was wrong. Listening does not mean agreeing. At the time, Bank carried an interest rate that was 6 to 7 per annum below the cost of financing in the capital markets. For a country that borrows $1 billion a year, that translated into a savings of $600 million over the life of the loan. Any minister of finance would consider it a valuable use of his time to be rewarded $10 million per minute to listen to a speech from the President of the World Bank. The compensation is for listening, it's not for actually implementing what the World Bank President is telling him to do.

The next fiction is one that's been brought up again quite recently which is the World Bank makes money from its lending to middle-income countries and emerging market economies and that these profits are used to subsidize loans and grants to the poor countries through income transfer. There is a basic fallacy in this argument. The Bank makes no money at all on its loans to middle-income countries. The Bank charges the same interest rate to all its borrowers regardless of credit risk, and this interest rate is

simply the Bank's own cost of funds plus the spread of 0.5 percent per annum to cover the Bank's administrative costs.

But where does the Bank actually make its money? The Bank doesn't make it on its lending, the Bank makes it on the investment income on its zero interest capital. The Bank currently holds almost $40 billion in cash on its balance sheet that it pays no remuneration on. This is the original initial paid-in capital from its members and the accumulated retained earnings. The investment of this pool of funds generates between $1-1/2 and $3-1/2 billion per year depending on the level of interest rates. It would generate the same net income whether it's used as lending and financing for middle-income countries or it was simply invested in AAA Government Bonds in the capital markets.

This is why the Bank's net income depends on the level of interest rates. If the Bank's net income were derived from its lending activities, it would make the same net income whether interest rates were at 1 percent or interest rates were at 15 percent because the lending interest rates are simply a spread above the Bank's own cost of funds.

The final fiction I want to talk about is that the Bank actually wants countries to graduate from its lending programs. This is written in in all the Bank's documents going back many years. In the two most recently available years, 2002 and 2003, the emerging economies actually repaid a net $10 billion to the Bank. Unfortunately, the Bank thinks of itself and a bank and not as a development agency. No bank wants to lose its best clients, and because the Bank charges the same interest rate to all of its borrowers, it has every incentive to lend to its best lowest-risk clients and retain their business.

As the cost of borrowing in the capital markets for emerging countries has declined, the subsidy in Bank loans has fallen and the Bank has lost its cost advantage. Instead of applauding these countries' success in attracting private capital and refocusing its resources on the poorest countries without access to private financing, the Bank is pursuing its former clients. It's attempting to woo them back by reducing the financial costs of the loans and by reducing the noneconomic conditions that are attached to them. Only 6 weeks ago the Bank actually reduced its commitment charges and its lending spread in order to attempt to bring back the middle-income countries.

So the final question is, what is the role of the Bank in emerging economies? The Bank has accumulated a significant stock of knowledge. This intellectual stock can provide extraordinary benefits to emerging economies in areas of regulation, legal systems, the environment, enactment of laws, but this knowledge transfer must be divorced from the financial resource transfer.

Again China is the best example. There are many poor people in China. There are many worthy projects in China. The Chinese government can benefit from technical assistance, but there is no basis to argue that China needs financial assistance from the Bank. A billion dollars a year is insignificant to China; it could have a major impact in

sub-Saharan Africa. The criterion for Bank resource transfers should not be poor people, but poor people in countries without access to private capital.

In concluding, I'd like to reiterate something I've said many times which is the Bank has to stop thinking of itself as a bank and start thinking of itself as a development agency. It has to divorce intellectual capital transfer from financial capital transfer, it has to focus its financing on countries without access to private funding, and a group that now receives less than 30 percent of World Bank Group funds including IDA, and it must change the method of delivery of aid from loans to performance based grants.

If the Bank does not enact these reforms, it's simply going to be irrelevant in the 21st century. Thank you.

[Applause.]

MR. DE FERRANTI: Thank you, Adam, and thank you, Nancy. Since I'm hoping you'll concentrate on what I'm saying, I want to first remove one distraction which is the glamorous black eye that I have and explain that it is not from a difference of view that Adam and I may have had. I wish I could tell you it was some dramatic act of heroism, but shamefully I just have to say it was an ordinary household accident a few days ago.

I really want to focus on six points that I'd like to share with you about how I think the Bank could do a better job, improve what it's doing, a different job, in the middle-income countries. But let me start by saying that I have a very different view from Adam. I think that the Bank should remain involved financially in middle-income countries. This is now an old debate. Adam has mentioned several points. I want to mention several others which are very nicely laid out in the report that Nancy and her colleagues did.

The middle-income countries are quite diverse. They're not all like China. Some of them such as Guatemala are far from being in the China category. Access to markets is not an on or off, you pass a threshold and then you've got it great forever. It's volatile, it's limited, it could be procyclical so at the moments that you need it it isn't there. It can be taken away from you for reasons that have nothing to do with your country but from neighboring countries. So there may be a principle that we all could agree on which is there is a point at which countries have adequate assured market access for longer-term money at which point they should graduate, but how to apply that principle it sounds as though Adam and I would differ greatly.

On the point about the fact that over two-thirds of the world's poor live in middle-income countries, a fact depending on how you define poverty, where you cut the line, it's far more than that. I would agree that one should give special attention to countries that do not have market access, but I would then refer back to the point I was making about the extent of access.

I think it also needs to be remembered that the developed countries, indeed, all countries, the entire world community of countries, have agendas that they want to achieve and the World Bank is one of the instruments that they use to achieve those and they repeatedly reaffirm that this is an instrument that they want across all countries, middle-income as well as low-income. These agendas include reducing poverty directly where the poor are, reducing poverty because a healthy Brazil means a healthier Bolivia, environmental-social-equity pro-poor growth. And I think that a World Bank that's serving all countries is a more effective Bank for all countries, the cross-country experience, and I agree with Adam's analysis about net income that's been made by the financial complex within the Bank.

But to have the Bank withdraw completely from being financially present in the middle-income countries would radically change what it is and how it's seen by the donors and by the countries, and money does talk and I think it would be the death knell for the Bank or certainly would greatly diminish its role.

We should also keep in mind that the 184 countries that are members of the Bank have repeatedly had opportunities to vote with their feet, with their hands, with everything else they've got, about whether they want middle-income countries in or not, and overwhelmingly they do, so that means the really important question is how to improve what the Bank does. The parts of what Adam said that I liked I would turn around into the way it could improve its role, and I want to make six quick points which I'll have to do quickly in view of the time.

As one looks at, thinks about, reflects on the messages that come from developing countries, developed countries, all of the constituencies as to what they would like to see more of, less of, better from the Bank and middle-income countries particularly in regard to the financial products, there are several points. I want to mention three where I think the Bank could do some more thinking, and these will be three of my six points.

The first has to do with financial products. The objection or criticism being raised that it's not sufficiently responsive, that the loans as they are done now may have been appropriate in the past but for the world of today and especially the world of the next 10 years the Bank should catch up with the rest of the financial community in realizing that different kinds of instruments may be more responsive, may be more appropriate from the perspective of all the constituencies of the Bank, I think there is something to this. I think it's not well known that the Bank has very significantly modernized its products it can offer in recent years, but these products are not being used widely or aggressively, and I think that's the point, guarantees, ideas about insurance, local currency lending, and now the discussion about subnational lending, a lot more can be done than is realized, they're not being done, and I think this gets to a very important point about the internal culture of the Bank.

I think there is a part of the financial complex of the Bank that is not looking forward. I respect them. They're friends. They're doing their jobs. I just differ with them. I think the Bank needs to be more outward looking and less inward looking.

There is an opportunity now. A new Chief Financial Officer will be announced within days or has been, also a new head of the IFC, their roles and what instructions they get from the President could have a major impact on how the Bank uses the instruments it has.

I would also hope that recent advances in financial markets could be looked at seriously from the standpoint of what else the Bank could do. Securitization, CDOs, collateralized debt obligations, I was holding one in my hand the other day, a completed successful offering, total private sector. It's reaching all continents including Africa. Investments in infrastructure, investments in projects and finance. These essentially take a diversified pool of investments, unpack the risks, repack them into traunches, not traunches in the Bank's sense, but into the least risky parts which are typically taken by institutional investors, maybe pension funds if they're investment grade, running down to the first loss which is by the local investors, and there's a second loss category in there, and I think the Bank should take a look at whether or not it should take positions in those areas. That's an example. There could be better, there could be other ways.

If the Bank is looking at two options, one is to make a loan of the vanilla variety of the past at $100 million and the other is to commit the same amount of money at the same degree of risk but it leverages five times that much money, it runs through the private sector, the Bank is not developing a project, it's supporting a project, that's what this securitization route should do. Should the Bank ignore that opportunity? Should the Bank not analyze whether it should be part of that?

That would be a bit step. Should it be the IFC? That would be the most natural. Or should the entire Would Bank Group think more seriously about how it helps the entire range of resources, private as well as public leverage to have resources, and my main point is that the culture inside the Bank and particularly inside the financial complex needs to take this on.

In my own experience at the Bank I felt that going to get approval to use some of these instruments was like going into a library and having the librarian say we've decided not to circulate the books because they get damaged. It's true that it's riskier if the books leave the library, but isn't there another side of the equation, namely, the books are supposed to leave the library?

MR. MacDONALD: Is this the second of six?

MR. DE FERRANTI: Yes, but it's quicker.

MR. MacDONALD: You're going to have to do them much more quickly, I'm afraid, David. I apologize.

MR. DE FERRANTI: I can do that. The second is the hassle factor. There do need to be better ways of honoring the intent of environmental and social safeguards without hobbling the process quite so much. Upstream country systems is a step in the right

direction. The fact that it's resisted by many Board members is a great concern, and it goes back to the Board governance issues that were raised before.

The third point, beyond products, beyond the hassle factor, one needs to have an explanation of the fact that although IBRD lending is declining in many countries, it's also not declining in many other countries. How does one explain that? I think the Bank has gone a long way through putting country directors in the field and through decentralizing to develop relationship management and the service side of its role, but I think a lot more could be done.

The acid test is whether a minister of finance wants to pick up the phone and talk to the person at the Bank. Sometimes language is a barrier. If you go to a city in Brazil, you talk to a Brazilian, and so language is important.

Quickly, those are three points that come up. Let me mention the three final ones.

MR. MacDONALD: If you can please make them brief, because I think we want to have some discussion here as well. I apologize.

MR. DE FERRANTI: Understood. Yes, more performance-based. That's the fourth point. The fifth point, different loan terms for different countries. Ideas on that, richer countries should pay more, richer countries should pay less. I think it's unlikely to go anywhere, but it's a good debate to continue.

The final point is I think the Bank has gone a long way in tamping down the tendency that any institution has to want to invent everything inside, but there is still a much longer way to go. The Bank instead of reinventing, instead of the high-cost way of project preparation, could rely on and draw on others much more. Thank you.

MR. MacDONALD: Thank you.

[Applause.]

MR. MacDONALD: Adam, David had a chance to respond to you. I want to give you the same courtesy of responding to him before I invite comments and questions.

MR. LERRICK: I'll just pick up two of David's points.

The first is this idea of somehow if you structure by financial engineering you can somehow leverage the Bank's resource. Let me try to make it very simple. My background is as an investment banker. I ran Salomon Brothers New Product Department for many years. There is no such thing as a free lunch. One of my mentors told me that years ago. He said, no matter how complicated you make the structure, you cannot change two things which are the cost and the risk. You can move them around, but you cannot change them.

When David is talking about let's say the Bank taking what he is describing in a collateralist debt obligation, the subordinated traunches, the ones where all the risk is concentrated, yes, the Bank is saying, it's a $100 million pool, I'm going to take $20 million of risk, the first loss provision. Therefore my exposure is only $20 million instead of $100 million. But the fact is the fact is, the risk is probably more than five times as great, the risk of loss, so you can't just go by the fact of what the leverage is.

I would try to make a very simple point. In terms of financing, the only thing the Bank can offer a middle-income or an emerging market country with access to the capital markets is a subsidy. It cannot offer them technical expertise. It cannot offer them new instruments. All these instruments are offered every day, 100 times a day from the private sector. The best example I can give you is the day after the G8 agreed to the HIPAA debt relief program in July, there were 27 investment bankers on the plane to Ghana to convince them to do a new bond issue.

[Laughter.]

MR. LERRICK: That is faster than the World Bank could get there by light years. So when you think about the Bank, the Bank can only offer a subsidy. In terms of knowledge and skill in the financial markets, the private sector is light years ahead of what the Bank could ever obtain.

MR. MacDONALD: I think we're going to open this up now. I imagine there are a number of questions and comments.

MS. RUBIN: I'm Nilmini Rubin from the Senate Foreign Relations Committee. Putting together two of the points that you made, one said that two-thirds of the world's poor were in the middle-income countries, the other said that 90 percent of IBR lending goes to middle-income countries. What's happening to the money? Why are two-thirds of the poor in middle-income countries when all of this money from the World Bank is still going there?

Is it that the projects are not being designed to address poverty? Are the projects being implemented ineffectively? Or is the money being stolen? And if the money is being stolen, if it's a corruption issue, why is the World Bank proposing that procurement rules actually be loosened for lending to middle-income countries?

MS. LEWIS: I'm Maureen Lewis. I'm at CGD, on leave from the World Bank. I wanted to go back to this question about the middle-income countries and the contribution of the Bank.

I think on the financial side you're right, it's offering a subsidy, but in terms of technical assistance, in terms of improving government, in terms of doing the things that the private sector is less good at doing, I think that the Bank is probably better able to do that than many other donors partly because they have a larger presence and they're dealing with more sophisticated issues.

As you will see in this week's Economist, there has been some deep evaluation of the welfare programs in Latin America, what has been done, what has been achieved, and it's those kinds of things to improve the efficiency there and to improve impact where I think the Bank provides a lot on the margin which is very hard to get in other places. And it's also in an area that is probably less relevant in IDA countries but is unique to the kinds of problems that middle-income countries face.

I think it's rather noteworthy that many of the countries that graduate from the World Bank come back asking for technical assistance on these kinds of issues that have to do with government and government effectiveness. Things like pension reform, health reform, the environment, those kinds of things where there is a technical capacity and a technical element to it that normally complements the loans but tends to have some traction over time. Thank you.

MR. MacDONALD: We'll take those two, and if you can both keep them very briefly, please, and then we'll let our panelists respond.

MR. SANFORD: John Sanford, Congressional Research Service.

I want to touch on a point that Adam made. Adam said that the only thing the Bank has to offer is subsidized capital. I would raise a question about that. I'm looking at the Bank's program in China. China as you may know has borrowed just about as much from the Bank as the Bank can lend to a single country. Indeed, this is an inhibition on expanding its loan program.

So what the Chinese are doing is repaying early the loans so they can bring down the Bank's exposure in China so that the Bank can make new loans. The reason for this is that, from what I read, the Chinese value the Bank's experience, the Bank's intellectual capital much more than they value the Bank's financial capital. Indeed, what they're doing here is by repaying early they're cutting off the Bank's being paid for the intellectual capital, getting then new loans where the Bank is sinking new intellectual capital for which it is now paying. So what you've got is I think, one, evidence that they're not just valuing the low-cost money, they're valuing the intellectual capital. Secondly, the Bank isn't being paid in fact for the value added which is the intellectual capital. Its business plan doesn't allow for that. So I would suggest that this might be a factor in this thinking.

MR. HERMAN: Chris Herman [ph]. I thought it was the role of the IMF to deal with shocks and helping countries get their way through shocks. I wonder if that was part of the rationale, and why is that part of the rationale for Bank involvement here?

A second question, if I may, it seems to me that the main function of the Bank, if there is one in these countries, would be to build domestic local capital markets. Is there a risk that continued Bank involvement would actually militate against the emergence and the strengthening of a local capital market? Or what role could the Bank play in encouraging that?

MR. MacDONALD: Thanks very much. Gentlemen?

MR. LERRICK: First, to address the question of why are there two-thirds of the world's poor in the emerging market countries. One of the principal reasons is that India and China have very large populations. I think it's difficult to tie or dangerous to tie the fact why are the poor still in these countries or why there are so many poor. But going back a step, and this touches upon some of the previous sessions, after 50 years and over a trillion dollars of aid, to paraphrase one of the CG board members, we have very little to show for it, and I think that's true.

Then we could have a long debate as to why it has failed, but it clearly has in most instances, and let me give you an example.

When we talked about the idea of doing an independent performance audit which is the World Bank has resisted adamately for many years, one of the concerns that the Bank expressed is, Mr. Wolfensohn said there were three reasons not to have an independent performance audit of the Bank. One is the results would be so bad that it would totally demoralize the institution.

[Laughter.]

MR. LERRICK: The second one was that it would cost too much money, and we have very scarce resources at the Bank. The third one was that because there is such a long life cycle of Bank projects that we would find terrible results for all these projects, but all those problems have been cured in between so it would be wasting our time as an idea.

I didn't find any of these arguments terribly compelling, but we actually asked three consultants to give us what their estimate would be of the cost of an independent audit of over a third of IDA projects over a 3-year period. The estimates ranged from a high of $5 million to a low of $1.8 million which in terms of the Bank's budget I thought was not terribly significant, probably less than the executive dining room each year.

But I called the president of the bidder with the $1.8 million bid and said this is very low to go out and actually review approximately 100 IDA projects in the field. He said we know these countries very well. We know the World Bank projects in these countries very well. This is our business. We expect that when we go, fully 50 percent of the projects we're going to find nothing, virtually nothing. There will be no road, there will be no school, there will be no vaccinations, so those audits are going to be very cheap to perform. So we're really only going to have to review 50 projects, so if you multiply that by two, that's approximately 3.6, that puts us in the ball part with the other bidders. I think that's a problem.

Your question as to why are they then relaxing procurement rules if corruption is so widespread, my answer is because they're desperately trying to get these clients back, and that's the hassle factor David talked about. World Bank loans carry a nonfinancial cost. It's long to get them, you have to fill out a lot of forms, you have to comply with all

their procurement rules. Therefore, to save 2 percent per anum, it's really not worth the aggravation. So the Bank to compete is going to reduce those noneconomic costs.

In terms of the question about China very quickly, it's absolutely true, China does value World Bank technical assistance and technical assistance is the most valuable thing the Bank has to offer to these countries. Agreed. But why must it be packaged with financial lending? It doesn't.

In fact, to go one step further, what the Chinese do even more is for every loan they get, they take the proceeds and buy World Bank bonds in the capital markets. So their net position vis-a-vis the Bank is zero, so they're only getting the technical expertise in addition to getting a large amount of influence at the Bank. As the largest borrower at the Bank, you do exert a lot of influence far beyond your shareholder.

Finally, when I said they only have subsidized capital to offer, I'm talking about what they have to offer in financial terms. They do have a lot to offer in terms of technical expertise.

One very interesting point was raised when we haven't talked about which is can Bank intervention actually militate against reform. This is a debate where I don't think it's very import ant in the middle-income countries, but where the Bank is a significant source of capital to a country, Bank lending can actually militate against reform because, very simply, if the private sector will not lend to a country it's because there's a problem. So if the government has an alternate source of funds, then the question is, does that alternative source of funds reduce the incentive to reform. This is an ongoing debate, does World Bank loaning encourage reform by encouraging the government and say you'll really get to like it once you try it type approach? As opposed to the private sector that says if you don't change, we're not lending. I think the second approach actually has more incentive value.

[Tape change, Tape 3A.]

I think there was a question, Where is the money going? We need to keep in mind that large countries with more people have more projects, get more money. That would be true of any institution. So that's a major factor.

Procurement. I'm no longer in the Bank and while I was there, there was nothing that I would have called loosening procurement. Maybe it's happened since. I can't speak for that part. But if you mean, if the question meant moving to country systems rather than individual project review, I would regard that not as loosening but getting more at the core of the problem.

There's a question about knowledge, and i would like to say, I think that countries that--not all, but those above certain income levels, should pay for Bank knowledge work, and more and more do, and Mexico, for example, a very significant part of the advice and services is on a fee basis right now.

There's a question about shocks, IMF. I think the role of others, beside the IMF, is that when shocks happen there are impacts, potentially devastating impacts on people, on poverty, on education, and also those are times when decisions are made, good or bad, that have enormous impacts on what happens to education and health and other things going forward. So it's very important for someone to be involved when crises happen.

I think on the independent evaluations or performance audits, you may have had an earlier session, my own view is that there should be independent evaluation of the Bank and I think that the president of the Bank should warmly welcome that. So I would move in that direction.

I think--and I just have two more points. I think that, you know, Adam has raised a number of points about things he didn't like in the past, and we could probably have a long debate and go through, well, this was true, wasn't true, this didn't happen, did happen, shouldn't have, and so on and so forth.

But if we are focusing on what the Bank should be for the future under a new president, President Wolfowitz, I think that some of the ideas that I have put out and that I think I interpret Adam's points to put out, move in the right direction.

I think, for example, more performance-based support is a good idea, if a country is not addressing fundamental problems in a credible way, is not imposing a blueprint, just asking a country, What is your plan? What's your vision? How are you going to dig yourself out? If it's not credible, then the Bank should be stronger about not going in.

And that is a problem of the board. It's something that management gets a lot of pressure on from a board, many of whose members want both things at once. They want both support to the country but not to have the Bank be stepping in and it's very difficult to resolve that. So that goes back to the earlier session.

I'd like to close with one final point, which is about subsidy. I think Adam raises the point, it's a very important point to debate, and to think about, and I would put it in the following way. The World Bank is about subsidy, and our lives, and everything we do are about making choices between which sorts of subsidies we want our public space, our governments, our international institutions to provide, and which are lower priority.

Everybody in this room is the product of huge subsidies. If you went to school, you were a product of subsidies. If you got health care, health insurance, you're a product of subsidies. So we make choices, and in this country we made choice about student loans. We made choices about mortgage markets.

We made choices about the GI Bill. We made choice about municipal bonds. And we could argue about whether those are the right or wrong choices, and we should, and we should also look very hard at what sorts of subsidies we do or do not want our international institutions to provide.

But I personally believe that the notion that we should move to a world where there are no subsidies at all is a unreal world that none of us has ever lived in.

MR. MacDONALD: Adam, I'm going to give you the prerogative to have a final closing remark.

MR. LERRICK: I would just say I cannot--Alan Meltzer [ph], whenever I get discouraged or Charlie Kalomiris gets discouraged about the amount of reform at The World Bank or the IMF, Alan turns and says, "You're a bunch of wimps. It took me 12 years to get the Federal Reserve to reform and you've only been at it for five or six."

It is amazing how much, at least the discussion has changed in the last six or seven years, about what the Bank should do or not do, and two good examples.

When we started this debate six years ago, most people would argue there was no subsidy in World Bank loans.

I remember, on the Goree [?] Volcker Commission, that Nancy was the chief of staff and I was a member of the commission, I had a long debate with Ricardo Hausmann as to whether there was a subsidy in World Bank loans, and Ricardo said absolutely not, there's no subsidy at all. All we found is this amazing mechanism to channel savings from the rich countries to the poor countries at no cost to anyone. And Paul Volcker, our co-chairman, without looking up, just said, "Spoken like the true chairman of Fannie Mae." I think that's true.

And the second point, this whole idea of performance-based evaluation, my view of it is much simpler than David's, and it's closer to what John Taylor was talking about. The very difficult part is evaluating, you know, is the country progressing, has aid helped the country progress? They're very simple evaluations also; you know.

We lent money or we gave grants to build a series of roads. You know, three years later, how many kilometers of roads are passable? We had a grant program to vaccinate children. Well, how many children got vaccinated? You know, this is very simple.

Especially in the poorest countries, the things we want to do are really which is just improve their standard of living to a minimally acceptable level, are easily quantifiable and easily monitored. There's not this huge debate, Has it helped the role of women in society? Has it done this for the environment? How do people feel about themselves?

We want to know how many children can read. We want to know how many cubic meters of potable water were delivered and consumed by the village. These are easily monitored and nonexpensive to do, and at least the Bank is talking about performance monitoring.

Whether they'll do it or not is another question.

MR. MacDONALD: I want to thank you both very much. I'm struck that this is the panel on which we've had the most controversy and of the five recommendations in the report, this is the only one on which I had seen Paul Wolfowitz actually come out and express and opinion, and that was yes, the Bank will be involved in middle-income countries.

So I don't know whether he got that idea from here or whether, you know, he would have done this anyway, but it's the one in which there seems to be the most debate, certainly today, and it's the only one that he's expressed a view on so far as I know.

MR. : I guess I'm condemned to being an outspoken critic again.

MR. MacDONALD: Well, we welcome you, and thank you for a stimulating discussion. Thank you both.

[Applause.]