The World Bank: Toward a Global Club

By Nancy Birdsall*

In *Global Governance Reform: Breaking the Stalemate*
Eds. Colin I. Bradford Jr. and Johannes F. Linn.
Washington, DC: Brookings Institution, 2006.

* President, Center for Global Development, Washington D.C. (nbirdsall@cgdev.org).

3

The World Bank: Toward a Global Club

NANCY BIRDSALL

The World Bank can be thought of as a particular type of global club, with a structure close to that of a credit union in which the members are nations.[1] Its mission, as originally conceived—to promote broadly shared and sustainable global prosperity—serves the common interests of all its country members. The World Bank is not, of course, the only global club (the largest in number of members is obviously the United Nations), and it is not the only credit union whose members are countries—there are, for example, regional development banks, the European Investment Bank, and, for some aspects of development, the International Monetary Fund. However, it is the only truly global club that has the financial structure of a credit union. Let us think of it for the purposes of this chapter as a "global credit club."

This chapter is based heavily on excerpts from Nancy Birdsall, "A Global Credit Club, Not Another Development Agency," in *Rescuing the World Bank: A CGD Working Group Report and Selected Essays,* edited by Nancy Birdsall (Washington: Center for Global Development, 2006), 69–85.

Bretton Woods: Creating a Credit Club, Not a Development Agency

The financing mechanism conceived by John Maynard Keynes, Harry Dexter White, and others at Bretton Woods in 1944 for this global credit club did not rely on "contributions" to finance "transfers" from rich to poor nations (although, of course, the club members created a separate club for that purpose later, called the International Development Association (IDA), in which only the rich country contributors have membership rights).[2] Keynes and his colleagues did not invent a development agency, and they did not conceive of the resulting financing as a transfer. On the contrary, the borrowers (at that time primarily Western Europeans) were thought of as full members and partners in the venture.

In the light of this simple idea of the bank as a global credit club, what are the issues that arise with respect to its current governance structure? How might various proposals for reform strengthen the bank by returning it to its spirit as a "club of nations" whose objectives are shared by all club members?

In the World Bank "club," different members have different amounts of "deposits" and provide different amounts of guarantees. The biggest depositor is the U.S. government, and the United States, Japan, and Germany are the World Bank's biggest guarantors. The rich country guarantors back all the borrowing from this credit union of member countries, whether the credit union makes good loans or bad loans and whether member country borrowers pay up or not (though history indicates that only rarely do they fail to pay on time).[3] The guarantees (and perhaps the extraordinarily low default rate) mean that this credit union, even with relatively low deposits in the form of paid-in capital, can borrow outside at good rates and lend at good rates to its less wealthy members.

The founders in short conceived of a global club that, at low financial cost to the big depositors and guarantors (only the United States at that time, for all practical purposes), would reduce borrowing costs for the poorer members (at that time war-torn European countries) and make the world a richer and safer place.

The boundaries within which the club would operate were well understood and fully embraced by the members at the World Bank's founding. The club was established to promote an open and liberal international economic system, based on market-driven growth and trade—in notable contrast to the system espoused by the Soviet Union, in 1944 a wartime ally. It would do so by helping the war-ravaged countries of Europe—and the poorer countries of

Asia, Latin America, and Africa—to finance investments that would enable them to prosper as partners in this open system, in the interests of global stability and security.

Today: An Aid Agency?

It is surprising how far the World Bank of today has strayed, in spirit at least, from its original conception. Today the bank has "borrowers" (the developing countries) and "non-borrowers" (the advanced countries). The bank's mission is now framed explicitly as reducing global poverty—by which is meant poverty in borrowing countries—not as supporting and encouraging global prosperity and security through trade and investment in an open, liberal global economy.[4] Of course, market-led growth and poverty reduction generally are mutually reinforcing. So what is the practical difference between a credit club whose objective is to promote shared global prosperity in an open, liberal economy and a development agency whose objective is to battle poverty? Perhaps the key difference that has emerged over more than fifty years is that between a cooperative whose common mission is in every member's interest (global security and prosperity in an open system) and an aid agency in which some parties "contribute," in principle to "help" others.

The fact is that the distinction between club and aid agency, subtle as it may be, is important to the future of the World Bank. The bank is under tremendous pressure today. It is assailed by those on the left for lack of *legitimacy*—for promoting privileged "insider" financial and corporate interests instead of addressing the needs of the voiceless poor. It is assailed by those on the right for its refusal to admit to its lost *relevance.* With increasing flows of private capital to the developing world (and ample reserves in China, India, and many other emerging markets), they question the use of public resources to subsidize loans in those settings. Private markets and private transfers would be more efficient and effective.[5] Those at the center, inside as well as outside the World Bank, criticize the bank for its lack of *effectiveness* in attacking poverty in the poorest countries, for its lack of agility in responding to the real demands of its large- and middle-income borrowers (and thus its apparent loss of relevance), and for its loss of institutional focus as it responds to ever-expanding demands from (ironically, some would say) its more powerful members: demands to do everything from assessing needs in Gaza and Iraq, to managing a global program to "fast-track" education gains, to piloting cross-border trade in carbon emissions rights.

The pressures have to do with three problems: erosion of the bank's legitimacy as an institution, loss of faith in its effectiveness (in reducing poverty and promoting "balanced and externally oriented growth"), and its apparent growing irrelevance. Might the bank's shareholders, especially the United States, be better positioned to address these problems by embracing a vision of the bank as a club rather than a development agency? How might a return to the spirit of Bretton Woods, to the idea of a global credit club, change the outline of the current debates among the bank's critics about the institution? What would be the implications of a return to the spirit of Bretton Woods for reform of the bank's governance?

Legitimacy: Member Voice and Vote

How did the founders make the idea of a global credit club operational? They agreed that in their club, voting power would be related to members' "dues" (or deposits and guarantees) and that the dues would be broadly related to members' financial capacity. However, they wanted to avoid creating a perfect one-to-one relationship between financial capacity and influence in the club. On the one hand, members taking greater risk ought to have a substantial say in the rules and practices of the club, if only to secure their continued financial commitment. On the other hand, the overwhelming financial capacity of a very few countries to take that risk, if reflected fully in the allocation of votes, would undermine the spirit of a club. As Harry Dexter White of the United States noted at the time, referring to the International Monetary Fund (IMF), "to accord voting power strictly proportionate to the value of the subscription would give the one or two powers control over the Fund. To do that would destroy the truly international character of the Fund, and seriously jeopardize its success."[6]

Therefore, in the case of the World Bank and the IMF, the founders introduced such mechanisms as "basic votes," which were distributed equally to all members (in the bank, each member has 250 votes irrespective of shares, plus one additional vote for each share), and double majority voting (of shares and of member countries) to make certain fundamental changes in the Articles of Agreement.

The idea was that the country taking the main risk—at that time the United States—would define the key boundaries within which the club would operate. At the same time, to preserve the spirit of a club and to ensure that the club would be effective, other members, including active borrowers (initially the Europeans), would have opportunities to influence,

within those boundaries, specific priorities, policies, and detailed practices. On some key issues, they also would have the ability to resist changes that might reflect only the narrow interests of a few powerful members.

Over time, however, the ability of the bank's (initially mostly European) borrowers to affect the bank's priorities, policies, and practices has eroded. Today there are many more borrowers. In 1947–48 the bank made loans to six countries (France, the Netherlands, Denmark, Luxembourg, Chile, and India); the International Bank for Reconstruction and Development (IBRD) and the IDA now lend to almost 150 countries. And the world has changed in another respect. The political mechanisms of representation and voice in "democracies" and in international "clubs" of nations are now almost universally acknowledged as ideal in their own right (*Development as Freedom*, to use the title of Amartya Sen's book) and as effective in an instrumental sense—for promoting sustainable growth and reducing poverty because they demand accountability and provide checks on abuses of power. The idea of political freedom in a democracy is also now closely associated with the economic model of open markets and thus with the original "mission" of the club. These changes in norms have put pressure on the bank to function more in the manner envisioned at its founding.

The result is growing demand for reform of governance at the bank, especially to ensure much greater representation—in terms of voting power, board membership, staffing, and so on—of developing country borrowers, who are the members most affected by bank policies and practices. The spirit of an international club is particularly resonant in proposals for

—the current president of the bank to "push the Bank's member governments to make the Bank's governance more representative and thus more legitimate" and, as a first concrete step, to ask the bank governors to call for an independent assessment, to be made public, of voting shares and board representation, including options for changes[7]

—the current president of the bank to commit now to a more open and transparent process for selection of his successor, including by asking the bank governors to formalize a credible, rule-based process[8]

—use of double majority voting on many more issues to create an incentive for borrowers—who now see no point in debating institutional issues over which they have no influence—to build coalitions[9]

—a governance structure for a trust fund for global public goods at the bank in which middle- and low-income borrowers would have at least 50 percent of the votes, with the middle-income countries having more power

to set the agenda in return for the financing that they would provide by paying higher interest charges on their loans than they otherwise would[10]

—a rethinking of the "framework" for the IDA (the bank's facility for low-cost loans and grants to the poorest countries, funded by direct contributions from donors), separate from any reconfiguration of IBRD shares (which would have little impact on decisionmaking in the IDA), so that both borrowers and non-borrowers would "feel more ownership."[11]

With a more representative governance structure and broader engagement of borrowers, the bank would be returning to the original conception of its founders—in which borrowers and non-borrowers were full members of the club—and it would command more legitimacy as a global institution. It would still be a credit club, in which the big depositors have more say. But it also would provide much greater incentives for borrowing members to engage on key issues. To quote White once again: "Indeed it is very doubtful if many countries would be willing to participate in an international organization with wide powers if one or two countries were able to control its policies."[12]

Effectiveness in the Low-Income IDA Member Countries

In 1960 the bank's rich country non-borrowers established the IDA window at the bank for lending to the poorest countries at highly concessional interest rates. IDA lending is financed by outright contributions of the rich countries, creating what could be considered an "aid agency" inside the existing club.

The bank's effectiveness in the world's poorest countries is today highly questionable and increasingly questioned.[13] In the case of the IDA window, failure of the bank's shareholders to address the governance problem is undermining the bank's institutional effectiveness. Without governance reform, or at least reform of the IDA itself, the bank risks additional erosion not only of its legitimacy but its effectiveness, particularly in the poorest, most aid-dependent countries.[14]

Having learned the hard way that policies that are imposed or even simply "suggested" from outside often do not stick, the bank, along with virtually all official creditors and donors, is now committed to the principle of developing country "ownership" of their own policies and reforms. Yet as long as the bank itself is not seen as co-owned and legitimate in developing countries, it is too easy for bank-financed programs to become controversial and difficult for developing country leaders—enlightened and reform-minded as they may

be—to implement. The plight of bank adjustment programs (and of the benighted "Washington Consensus" reforms in general) is a compelling example.[15] Bank programs become politically controversial not only because they create losers as well as winners (which cannot be avoided), but because they are seen as being imposed from outside.

Returning to the spirit of Bretton Woods might help. In a club—but not in an aid agency—the recipients of financing have the power that comes with membership, and their agreement is more obviously required on the broad policies and practices that govern the club's operations.

Relevance: China, India, and Middle-Income Countries

Many observers argue that the World Bank should stop lending altogether to China, India, and many middle-income countries, on the grounds of the irrelevance of such lending in a world of sophisticated private markets. That argument is strengthened by the fact that China, among others, is awash in reserves—and is still transferring capital to the United States, rather than receiving capital from the United States and other capital-rich advanced economies.[16] There are counterarguments, including the volatility of markets, which puts middle-income borrowers who rely on private markets at risk in the event of a global crisis; the poor access to private markets of some poor and middle-income countries (such as Paraguay, Ecuador, and Morocco); and the broad-based analytical capacity that the bank brings to issues of global importance, such as protection of biodiversity. The report of the Center for Global Development Working Group notes also the legitimate interest of the rich country non-borrowers in promoting equitable growth in the countries where two-thirds of the world's poor live as well as their legitimate interest in supporting their own prosperity and security.[17]

Various proposals have been made to help the bank retain its relevance and build greater allegiance among its middle-income members. Those proposals emphasize the need for risk sharing and other products to catalyze private flows to countries and reduction of the political or financial costs of the "hassle" associated with borrowing from the bank, whether due to excessive fiduciary obligations, including those to limit corruption; to excessive safeguards against environmental and other costs; or to excessive delays between requesting and receiving a loan. Similarly, Jessica Einhorn suggests that the bank's members agree to lock in now a twenty-five-year sunset clause for loan disbursements as an incentive for the bank management and

bureaucracy to adapt to the creative challenge of developing new non-loan services for middle-income countries more quickly.[18]

If we conceive of the bank as a club, managed by its members for their own benefit, then the substantive merits of these arguments and proposals for change, one way or another, yield to the question of whether particular members wish to avail themselves of the benefits of membership under existing conditions or use their influence to change those conditions—or perhaps do both. If China wants to borrow at the cost already agreed to by all members, for whatever reason (including because China trusts the bank's technical input more if it is bundled with a financial commitment), then so be it. If a country (Korea in 1998) that had eschewed borrowing for many years asks the bank for a loan during an emergency, then so be it. If non-borrowers wish to limit the subsidy implied in loans to relatively richer or more liquid (in terms of reserves) middle-income members, then they have the option of proposing a policy of smaller subsidies (higher interest charges on loans) for the relatively richer borrowers.[19]

To put it another way, let the members of the club decide. That, in effect, is the current situation—though it may reflect the inertia of failed cooperation as much as a positive decision. An interesting issue arises because some members, particularly the borrowers, have limited influence in changing the conditions (pricing, delays, conditions, and safeguards) under which they now participate as members. In that sense, the question of whether the bank can return to its roots as a global club may well bear on the question of whether it continues to be relevant in its current form for a large group of its members. In the absence of voice, some members may in effect choose the option of exit.[20]

Concluding Note

The problems of legitimacy, effectiveness, and relevance at the World Bank are all rooted in the failure of its members to adjust its governance structure to the economic, social, and normative changes in the global system over the last fifty years—and to "globalization" itself. One advantage of the L-20 concept discussed elsewhere in this book is that less institutional and more informal periodic interchange among heads of both rich and developing countries—the idea of the L-20—may be the best single substitute in the short run for politically difficult formal changes at the bank. It might also provide the best setting for promoting a franker and more productive

discourse that might finally inspire the fundamental changes in governance that so far have eluded the bank's members.

Notes

1. The word "club" has different connotations in different cultures and settings. I use it in the everyday North American sense, which implies open membership, not exclusivity—for example, the local Rotary Club, not the country club.

2. The global credit club was the brilliant invention of U.K. economist Keynes, along with the American Harry Dexter White and their colleagues from forty-two other countries who conceived the World Bank and the International Monetary Fund at the Bretton Woods Conference in 1944.

3. The relevance of the non-borrowers' guarantees to the bank's ability to borrow and borrowing costs is sometimes questioned, because bank financial policies since the early 1970s have included substantial provisioning and reserves and because it has been so rare that borrowers have delayed repayment, let alone defaulted. Since more than 80 percent of the bank's current reserves come from transfers from net income and only a small minority from paid-in capital, there is a sense in which the borrowers can now be said to be contributing to the bank's low borrowing cost and financial solidity. From the beginning, of course, the guarantees, like the nuclear option, were useful only when not used.

4. To quote Jessica Einhorn in "Reforming the World Bank," *Foreign Affairs* 84, no. 1 (January-February 2006): 17–21: "Over time, the Bank has evolved from an organization focused on growth through trade and investment to an organization set on achieving a world without poverty. *Its core mission is no longer to partner with . . . countries in their pursuit of balanced and externally oriented growth; it is to alleviate poverty*" [emphasis added]. And to quote from a working group report sponsored by the Center for Global Development: "The Bank's mission is to reduce poverty in developing countries." CGD Working Group, "The Hardest Job in the World: Five Crucial Tasks for the New President of the World Bank," in *Rescuing the World Bank: A CGD Working Group Report and Selected Essays,* edited by Nancy Birdsall (Washington: Center for Global Development, 2006), pp. 1–65, quote on p. 15. The newer conception is not entirely recent. The non-borrowers established the IDA window in 1960. The speech of Robert McNamara, the bank's fifth president, in Nairobi in 1973 perhaps marks the official birth of the "poverty" mission for the IBRD and the bank group as a whole. Up to that time the World Bank was primarily a financier of bricks-and-mortar projects, with investment in infrastructure seen as the key to open, market-based growth. By the time of James Wolfensohn, the poverty objective had matured and was captured aptly in an inscription in the lobby of the bank's main building—"Our dream is a world free of poverty"—and in a noteworthy increase in the proportion of bank lending for social programs.

5. See CGD Working Group, "The Hardest Job in the World," for more detail and for citations to these critiques.

6. Joseph Gold, *Voting and Decisions in the International Monetary Fund: An Essay on the Law and Practice of the Fund* (Washington: International Monetary Fund, 1972), p. 19.

7. CGD Working Group, "The Hardest Job in the World," pp. 44–50.

8. Ibid., p. 48.

9. Ngaire Woods, "The Battle for the Bank," in *Rescuing the World Bank,* edited by Birdsall, p. 101.

10. CGD Working Group, "The Hardest Job in the World," pp. 42–44.

11. Masood Ahmed, "Votes and Voice: Reforming Governance at the World Bank," in *Rescuing the World Bank,* edited by Birdsall, p. 93.

12. Gold, *Voting and Decisions in the International Monetary Fund,* p. 19.

13. See William Easterly, "The World Bank and Low-Income Countries: The Escalating Agenda," pp. 103–108, and Steven Radelet, "The Role of the Bank in Low-Income Countries," pp. 109–15, in *Rescuing the World Bank,* edited by Birdsall, for a summary of the central issues.

14. On this point, see Kemal Dervis, with Ceren Ozer, *A Better Globalization: Legitimacy, Governance, and Reform* (Washington: Center for Global Development, 2005) and Ahmed, "Votes and Voice: Reforming Governance at the World Bank."

15. William Easterly, "What Did Structural Adjustment Adjust? The Association of Policies and Growth with Repeated IMF and World Bank Adjustment Loans," CGD Working Paper 11 (Washington: Center for Global Development, 2002), among other studies, documents the failures.

16. The irrelevance argument is set out in Adam Lerrick, "Has the World Bank Lost Control?" in *Rescuing the World Bank,* edited by Birdsall, pp. 117–32.

17. See CGD Working Group, "The Hardest Job in the World," and David de Ferranti, "The World Bank and the Middle-Income Countries," in *Rescuing the World Bank,* edited by Birdsall, pp. 133–51.

18. Einhorn, "Reforming the World Bank."

19. A key rationale for the Gurria-Volcker Commission's recommendation of differential loan pricing was to encourage graduation of richer borrowers with access to private markets. See Commission on the Role of the MDBs in Emerging Markets, *The Role of the Multilateral Development Banks in Emerging Market Economies: Findings of the Commission on the Role of the MDBs in Emerging Markets* (Washington: Carnegie Endowment for International Peace, 2001). For a different view, see the recommendations in the report approved by a majority of the Meltzer Commission, "Report of the International Financial Institution Advisory Commission," chaired by Allan H. Metzer (2000).

20. The risk that China and other Asian nations will set up a regional monetary fund is currently the key impetus for the United States and Europe to agree to some change in IMF quotas. A similar situation might arise at the bank, though in less dramatic form and creating less immediate pressure on non-borrowers.