



Do we still need a World Bank?

By Dennis de Tray
Vice President, Center for Global Development
Remarks at the American Enterprise Institute
June 14, 2007

It's a great pleasure to be here and to participate in this important conversation about the future of the World Bank. How one thinks about the World Bank depends in large part on the seat from which one has viewed the Bank (forgive me if I use this shorthand for the World Bank. I know there are other banks, but to almost everyone who has worked at the World Bank, "the Bank" is the World Bank). I worked at the Bank for 23 years and during that time had two very different "seats."

The first half of my Bank career was in an institutional seat in Washington in the Bank's research department, and eventually as the Bank's Research Administrator. The second half, I confess much the more rewarding half, was in the Bank's operations complex. Most of that time I spent overseas as a Country Director. Country Directors are the people in the Bank responsible for delivering the Bank's core business—development—on the ground.

The countries I worked and lived in—Indonesia, Vietnam, Central Asia—have done much to shape my thinking on development, and on how the international community should do development. This experience has also made me a critic of the current mode of operation for the Bank and the international aid community. Today, I want to ask not just "should the Bank exist" but what kind of Bank does the world need?

Before I turn to my talk, I want to respond to a point made by Congressman Kirk in his opening remarks. The Congressman said at one point that the World Bank has not taken on any of the great foreign policy challenges of this period. He cited its lack of presence in Iraq and its relationship with Iran, among other examples. I worry that this remark shows a lack of understanding of what the Bank was set up to do, a bit surprising for someone who was once a World Bank employee. The Bank is not a foreign policy institution. It should not, in fact, be involved in foreign policy issues. The Bank's core business is development. You have to start with that proposition to understand what I am about to say.

Let me go through my talk relatively quickly so that we have time for a discussion at the end. I want to ask and answer, in outlined form, five questions:

- Does the world need a World-Bank-like institution, and, if so, why?
- If yes, is the current World Bank that institution?
- If no, what should the World Bank's role be in today's world?
- How does the Bank need to change to play that role?

- Finally, what does Mr. Zoellick need to do to get the World Bank where it needs to go?

Does the world need a World-Bank-like organization? You probably won't be surprised that my answer is "yes." What I hope may be more interesting is why I think the world needs such an institution. The world needs a global institution like the World Bank because the principle issues facing the world today are global issues, in the vernacular of economists, global public goods and bads. If you stop and think about it, development itself is a global public good. The benefits of developing a country extend well beyond that country's borders. Had Afghanistan found a path to reasonable development 20 years ago, the world would have saved enormous amounts of money today, not Afghani money but global money, and, of course, avoided great pain and suffering.

Afghanistan may be a special case but it makes my point that the benefits of developing a country are felt beyond its borders. As any first year economics student knows, public goods need collective action to be produced in the right quantities. In other words, countries will underinvest in their own development because they will ignore the positive and negative spillover effects on the rest of the world. So, we need an institution that is engaged in ensuring that these public goods are produced in the right amounts from a global perspective.

Development is not the only global public good issue that needs attention. There are public health concerns—HIV/AIDS, Avian flu, tuberculosis, others. There is climate change and the issue of how the energy challenge that Congressman Kirk put on the table will be dealt with. China is planning to build more than one coal-fired power generation plant *a week* for the next ten years. That is global public issue that needs global attention.

Why do you need a multilateral institution like the Bank to deal with these issues? Because they are inherently multi-country and multi-sector, so you need an institution with country and sector breadth and depth that can coordinate country responses and make the difficult trade-offs inherent in many of these issues.

Is today's Bank, the Bank that can deliver on this global agenda? My answer to this question is a firm "no." The Bank as it is today is too big, too lending-driven (although that doesn't mean it shouldn't continue to lend to middle income countries—I will come to that in a minute). It has badly distorted internal incentives. It has lost its focus, diluted its core business. Its core operational business is too little changed from 30, 40 years ago in a world that has changed dramatically.

What should today's Bank look like? The developing world is a continuum, but for the sake of argument, let me divide it into two parts: There is the middle-income country agenda, on which there is an active debate as to how the Bank should engage in these countries. The question here is: should the International Bank for Reconstruction and Development, IBRD, the Bank's "hard" lending window, continue to lend to middle-income countries that have access to the world's capital markets? And, at the other end of the spectrum, there are the poor, weak and fragile states, the main clients of the International Development Association, IDA, the World Bank's development bank.

I strongly believe that the Bank needs to continue to be active in middle-income developing countries. I use the term "active" advisably, because the nature of involvement in these countries is as complex and varied as the countries themselves. The middle-income developing countries

have several features in common: almost all face enormous development challenges and most have need of the knowledge base the Bank has built up over decades of trial and error in the development business. But they are a mixed bag in terms of the strength of their domestic institutions, and this brings us to the issue of lending to middle-income countries.

My position is that the Bank should continue to have the authority and ability to lend to middle-income countries, should those countries want to borrow. There has been much made of the Bank's lending to China. Why in heaven's name, we are asked, should the Bank lend to China, a country that has amassed more than a trillion dollars of reserves that it doesn't know what to do with? I would argue that is not the right question. What we should be asking is, why does China still borrow from the World Bank?

China borrows from the World Bank at interest rates that exceed what it earns on its reserves. It puts up with all the Bank's hassles, safeguards, bureaucracy. Why? China borrows from the Bank because the package of services that comes with the loans is seen as valuable, sufficiently valuable that China is willing to pay a little extra for Bank money than it would pay if it used its own reserves. Borrowing from the Bank is an important way for China to absorb years of project design and implementation experience that the Bank imbeds in each loan. For China, it's a learning experience. My time at the Bank taught me that you cannot transfer this knowledge through book learning, or technical assistance advice. This is the public sector equivalent of foreign direct investment. FDI is valued not for the money (most countries can borrow at reasonable rates), but for the managerial skills and technical knowledge that comes with FDI. The same argument can be made for Bank loans: it's not the money, it's the stuff that comes with it.

China is very clever in now it uses the Bank. It borrows, say, 10 percent of large projects in order to get the expertise the Bank brings to those projects. As it develops its own expertise, it stops borrowing in that sector and moves on to other areas. When I was Country Director for Central Asia, I tried to get Kazakhstan to adopt this model. My point was that using the Bank in this way is a terrific bargain, a very low-cost way of learning from experience how to create, supervise and manage projects, areas of expertise in which even middle-income developing countries often lack the necessary capacity.

The second role for the Bank in middle-income countries is in the promotion of private sector development. For most middle-income developing countries, this is probably their top priority. But the Bank has its approach to private sector development wrong. The great barriers to private sector development in most countries are not in the private sector, but in the public sector. We don't need to teach Brazilians or Turks or Indonesians how to be entrepreneurs or investment bankers. We do need to create the environment in which both national and international entrepreneurs can flourish.

This leads me to believe that the International Financial Corporation, the World Bank's private sector lending wing, is the right instrument to deliver on private sector development. In the Bank of the future, I would, at a minimum, combine the IFC with the other private sector activities in the Bank, get it out of the direct investment business, and use this new entity to focus on the policy environment for private sector development.

What about the development bank, IDA? If IDA is to succeed in its essential mandate, there needs to be an enormous shift in the incentives within the Bank. IDA's challenges are

development challenges, not lending challenges. When you are facing a country that's going to take 20, 30 or more years to develop—Afghanistan, parts of Central Asia, parts of Indochina, parts of East Asia and the Pacific, many parts of Africa—, you cannot have an incentive structure that says your promotion tomorrow depends on how much money you are able to lend today.

If we are going to move to an incentive structure based on development and not dollars, the starting point is that we have to be able to measure “development.” You cannot prioritize what you can't measure; you cannot “incentivize” what you don't measure. Right now we don't have even a modestly acceptable way of measuring progress in countries that represent long-term development challenges. We need to measure development better. This is one of the easiest things to say in the development business and one of the hardest things to deliver on, but if we don't crack that nut we are going to fall back on an incentive structure that is off target and distortive of the basic objectives of doing development.

How does the Bank need to change to become a 21st century institution? First, the IBRD part of the Bank needs to recognize the fact that its lending to middle-income countries should, and is going to, go down. Don't stop lending to middle-income countries, but stop making lending volume a priority in those countries. A move in this direction, while essential, will have important income and capital base implications.

The Bank's administrative budget comes from a mix of revenues on lending and returns on paid in capital, with the second far outweighing the first as a source of “profits.” If countries borrow less IBRD funds, and the shareholders were to decide to take away the unused capital base, the Bank would have less profits and less ability to fund administrative costs. Since, as I argue below, the Bank needs to shrink, losing its ability to fund administrative costs is not altogether a bad thing, so long as the right decisions are made on where to cut costs.

For the IDA agenda, aside from the incentive issue I raise above, one of the great mistakes of the last 50 years is that the international aid community has essentially made itself accountable for everything it does in developing countries, from project quality and implementation, to governance, to corruption, to institution building. If we want countries that work, we have to give that responsibility back to governments.

We need to start holding governments accountable for the agreed-on outcomes of their development assistance. Doing so would have two important benefits. It would make governments more careful about promising what they can't deliver. And, it would make performance-based resource allocation more forward looking. It would get the Bank out of the incredibly staff intensive micro-management of the Bank's operations and into the critical job of evaluating and assessing what is happening on the ground. It would also make clear to citizens that what is right and wrong in a country is not the international community's doing, but their leaders' doing.

This is not conditionality. It is simply agreeing up front on what is going to get done, whether it's more kids graduating from primary school, more roads, more potable water, fewer diseases, whatever, and then monitoring in a credible way whether anything is happening on the ground. If (modest) benchmarks are being met, in a certified way, the Bank and the international community will provide funds. If a country is not delivering, neither the country nor donors would have an excuse to continue to throw good money after bad. This is another one of those “easy to say, hard to do” recommendations but if we don't move in this direction, if we don't

stop micro-managing development and do get into the business of monitoring outcomes we are not going to change the nature of the Bank going forward, or create serious incentives for staff to take on the most critical development challenges..

Why am I so worried about incentives in the Bank? Let's look at my last job in the Bank as Country Director for Central Asia. It may one of the best jobs I had in my 23 years at the Bank. I got to work on almost every interesting issue the World Bank faces in the five countries for which I was responsible. I had an oil rich country, a donor darling, a post conflict country, a closed, reclusive mad man, a reluctant reformer. A great job if you're interested in exploring ways of doing development better.

Country Director jobs are among the most sought after in the Bank (vice presidents have been known to take them even though they are a grade below VP level). When my job went on the block a couple of months before I retired from the Bank, there were, I believe, five people who applied for the job, none of them qualified. Usually, dozens of the Bank's most senior and talented operations people vie for these jobs, but not Central Asia.

Let's be clear, Central Asia is a tough set of countries, but also a fascinating development challenge. The fact that no one of repute showed up as an applicant for my job is, in my view, a fundamental indictment of the Bank's incentive structure. Central Asia is an important part of the world that needs good people to help it develop, exactly the kind of the countries Bank staff should be flocking to. Something needs to change on the incentive front if the Bank is to get the best people to work on the hardest countries.

So, what does the Bank's President-elect, Bob Zoellick, need to do to get the Bank from where it is today to where it needs to be tomorrow? Four points here.

The starting point needs to be a recognition that fixing the Bank is a long-term process. Any move to reform the Bank quickly, in a year or two, will fail. Why? Because the Bank is too big and too multinational to fix quickly. The cost will be unacceptable in both dollar and human terms (remember, nearly 80 percent of the Bank are non-U.S. citizens, most on G-IV visas, many with families that have grown up in Washington. Corporate downsizing is a great deal more disruptive in this environment than for non-multilateral institutions).

With this in mind, Mr. Zoellick needs to build a consensus for change inside and outside the U.S. Since the needed reforms will take at least a full five-year presidential term, Mr. Zoellick will need strong support from the majority of the Bank's shareholders if he is to hold the line on change.

This consensus will need to rest on a clear and defensible vision of what the Bank needs to look like five, 10 years from now. To get to this vision, Mr. Zoellick will have to put together a small, knowledgeable group of *both* insiders and outsiders to advise him. The Bank's very smart staff are all-too-good at rationalizing the status quo to rely entirely on them for the future vision. Rationalization, is, after all, a bureaucrat's best friend. But outsiders often don't understand what the Bank is, or want it to be something very different than a development institution. The group has to be small, maybe six people, and knowledgeable about development and the Bank.

Although he is off to a very good start, as the honeymoon wears off, Mr. Zoellick's leadership will ride on whether or not staff and shareholders see him as a president for all of them...or as an

agent of the U.S. government. One of the best ways Mr. Zoellick can demonstrate that he works for all the Bank's shareholders is to take on the issue of the World Bank's governance. This would have to start with a serious look at how the Bank's president is selected. But it should include as well a review of the Executive Board structure, and a consideration of moving to a non-executive, non-resident board. Reforming the Bank's governance structure will do much more than demonstrate Mr. Zoellick's independence. It is an essential foundation for all other reforms the Bank needs to undertake.

Thank you.