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Briefing Paper

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THE WORLD BANK: RETHINKING ITS ROLE

When the World Bank holds its annual meeting this month (24-27 September 1984) it will consider how its strategy should be adjusted not just to react to the deteriorating economic problems of the Third World but also, and of more immediate concern, to a change in the attitude of its key industrialised country members. This year, for the first time in two decades, the funds of the World Bank's soft loan affiliate, the International Development Association (IDA), have been cut in both nominal and real terms. This will result in a significant cut in the total aid receipts of the poorest countries, since IDA is an important donor — in 1980 it provided 16% of the official aid to low income countries. But equally important will be the effect on the World Bank's role as an architect of development policy. The World Bank has seen itself not only as a supplier of funds but also as a purveyor of advice and a co-ordinator of other aid donors. Its ability to play this role depends partly on its intellectual capital but also on its importance as a lender. Hence, the IDA cut may reduce its influence with recipients and with aid agencies, particularly if the World Bank's other finances also fail to keep pace with demand.

This Briefing Paper describes the role of the World Bank institutions, and explains the mechanics of their complicated financing arrangements, the reasons for the recent cuts, their likely impact, and innovations currently under consideration by the World Bank.

The Expansionary Years

During the 1950s, the policies of the International Bank for Reconstruction and Development (IBRD) were cautious and conservative and even by the mid-decade over half of its outstanding loans were to developed countries. The International Finance Corporation (IFC) also began life slowly given the difficulty of finding investments that satisfied both of its key criteria: that they be commercially profitable, and that there be insufficient availability of private capital.

From the late 1960s, however, the World Bank began to expand rapidly due, *inter alia* to the creation of IDA, international economic buoyancy, the enlargement of the Third World group and, not least, the influence of its then President, Robert McNamara. In the period 1961-65, total disbursements were $2668 million from IBRD and $415 million from IDA; by 1979-83 they had risen to $26171 million and $9174 million respectively. In real terms, this represents a combined annual rate of increase of some 6% between 1965 and 1982.[1] At the same time the professional staff increased from 496 in 1965 to 2821 by 1983.

1. Nominal figures deflated by IMF index of world import unit values.

The World Bank Family

The term 'the World Bank' as it is commonly used refers to three closely linked institutions: the International Bank for Reconstruction and Development (IBRD) and IDA, which share the same staff, plus the International Finance Corporation (IFC). The IBRD, the oldest of the three, was established in 1945 under the Bretton Woods agreement with the principal objective of channelling US assistance to war-ravaged Europe. By degrees, it shifted its attention to the Third World states as decolonisation increased their number, and as Europe's recovery got underway. The IFC was created in 1956, with a separate operational staff, to assist private sector projects. It can provide loans and/or equity and aims to act as a catalyst, encouraging other private sector finance to the projects that it supports. Both the IBRD and the IFC raise the bulk of their money from the capital markets and hence on-lend on quasi-commercial terms to acceptable credit worthy countries and projects. This rules out lending to the poorest countries. IDA was created in 1960 to fill this gap: its funds are provided by supporting governments from their aid budgets, enabling it to provide soft credits (50 years repayment including 10 years grace, with no interest but only a small service charge). But, while the terms are softer, the criteria used for appraising the viability of projects are intended to be the same as those applied by the IBRD. Because they share the same staff and methods, the IBRD and IDA are often referred to jointly as 'The World Bank', while the IFC is referred to separately. This Briefing Paper follows the same convention except where otherwise stated.

The IBRD and IDA

There have also been shifts in the pattern of IBRD and IDA activities. The first change was in the sectoral direction of project lending. In its early days, the World Bank concentrated on lending for public utilities, transport and economic infrastructure projects which were relatively easy to appraise in terms of financial and economic viability, had high foreign exchange components, and were believed to make a direct contribution to higher aggregate growth. The Bank became the leading proponent of the view that investment in these sectors was a precondition for the development of the rest of the economy. During the 1970s, however, it began to turn its attention to the sectors that had previously been neglected — agricultural and social infrastructure (education, health etc.) — while the focus on aggregate growth became tempered with a concern for the distribution of income and wealth. During the period 1977-82, 42% of IDA credits were for agriculture and rural development. The shift in lending was accompanied by a change in the Bank's policy prescriptions and advice, and its research became increasingly concerned with poverty alleviation and basic needs issues. The extent to which it pioneered new ideas or was merely a vocal adherent to views that were already gaining acceptance among other donors is open to debate. In either case the combination of its substantial lending capacity with coherently formulated and aggressively marketed views made the Bank a powerful advocate of the new approach.

Since 1980, there has also been a change in the pattern of lending, away from loans tied to individual projects towards programme assistance, of which structural adjustment loans (SALs) are the most fully developed variety. Programme assistance has grown in importance as a result of the balance of payments problems of oil importing ldcs which have both jeopardised traditional projects (eg by restricting an ldc's capacity to import fertilisers for an agricultural development project) and created the need to adjust to the adverse terms of trade movement, a process for which IMF loans and policy conditions provide, at best, only partial short-run support. The first SALs were approved in 1980, and by September 1983 they numbered 23, amounting to a total of $3.6 billion. They are designed to provide quick disbursing finance to support a medium term restructuring policy 'without severely constraining demand in a manner that unnecessarily sets back economic and social development'.[2] They are thus intended to be different from IMF standby facilities which are of shorter duration and closely linked to demand restraint, although in practice the Bank has made SALs conditional upon the recipient also reaching an understanding with the IMF. In addition more restricted sectoral credits are available to countries when a SAL is inappropriate because their problems are not economy wide or when agreement on macro-economic policy changes cannot be reached.

Finally there have been changes in the geographical allocation of World Bank lending. In the past Latin America and South Asia have been the main recipients, with India alone receiving some 40% of total IDA credits. But in recent years a conscious effort has been made to increase the proportion of IDA credits going to Sub-Saharan Africa, resulting in a rise from 27% of the total in 1980/81 to 37% by 1982/83. The change in lending reflects a growing concern with the deteriorating economic performance of Africa, and an increase in the attention given to economic analyses and policy prescriptons for African countries, a concern reflected in the publication by the Bank of *Accelerated Development in Sub-Saharan Africa* (the 'Berg Report') in 1981.

The IFC

Similar, if less marked, changes are evident in the activities of the IFC. In 1979 for the first time it adopted a long-term investment programme in response to a request from members that it diversify its activities both country and sectorwise. Net investments increased from $832 million in 1974-78 to $1927 million in 1979-83, and there was a shift in the pattern of lending in favour of poorer countries and of Africa and Asia. In the two time periods, the proportion of net investments in countries with a *per capita* GNP of $410 (at 1982 prices) or less rose from 11.2% to 17.0% of the total, while the proportion in sub-Saharan Africa and Asia rose respectively from 10.3% and 21.4% to 13.15% and 23.7%. The share of manufacturing, which was the IFC's dominant focus in its first two decades, fell to just over half of net investments. For the first time in 1979-83 the IFC became involved in lending to energy projects (which took 3.1% of net investments), and investments in the financial services, agro-industrial and non-fuel minerals sectors all increased.

2. Pierre Landell-Mills 'Structural adjustment lending: early experience' *Finance & Development,* December 1981, p.17.

The World Bank and its Critics

The criticism with which the Berg Report was greeted illustrates clearly one line of more general criticisms of the World Bank.[3] The Bank is seen by many to be dominated by the Western industrial countries in general, and by the USA in particular in respect of its lending activities, its policy advice and its mode of operations. It uses its intellectual and financial leverage (including its influence on other donors) in favour of export-oriented development

3. See for example, *IDS Bulletin,* Vol.14, No.1.

How the World Bank spends its money

The changes in lending policy described in the text are reflected in figures on the geographical and sectoral distribution of commitments.

Table A — Sectoral distribution of IBRD and IDA lending (per cent)

	1965/66		1974/75		1982/83	
	IBRD	IDA	IBRD	IDA	IBRD	IDA
Agriculture & rural development	14	11	28	40	21	39
Development finance companies	—	—	11	2	11	2
Education	0.3	11	3	6	3	8
Energy	28	8	11	2	23	9
Industry	13	44	15	8	6	2
Non-project	—	—	5	21	11	8
Population, health and nutrition	—	—	1	1	1	2
Transportation	37	25	19	11	13	16
Other	8	0.4	8	9	14	15

Columns may not add up due to rounding.

Source: World Bank *Annual Reports.*

Table B — Geographical distribution of IBRD and IDA lending (per cent)

	Average 1969/73		Average 1974/78		1983	
	IBRD	IDA	IBRD	IDA	IBRD	IDA
Africa	13	21	11	27	5	37
E. Asia & Pacific	15	16	25	3	32	5
South Asia	5	50	6	58	10	54
Europe, Middle East & North Africa	29	10	29	9	22	2
Latin America & Caribbean	39	3	30	3	31	2

Columns may not add up due to rounding.

Source: World Bank *Annual Reports.*

Table C — Geographical and sectoral distribution of IFC net lending

Area	1974-78	1979-83
Sub-Saharan Africa	10	14
North Africa	2	5
Asia	21	24
Europe and Middle East	27	20
Latin America	39	39
Sector		
Manufacturing	71	55
Financial Sector	9	14
Agro-Industry	10	12
Fuel minerals	—	3
Non-fuel minerals	8	11
Services	3	6
Total ($mn)	832	1927

Columns may not add up due to rounding.

Source: IFC

in which the private sector plays a prominent role. According to this criticism, the Bank is guilty, at best of a naive faith in economic textbook descriptions of international comparative advantage and of committing the fallacy of composition in assuming that all less developed countries can grow by exporting commodities that are often competitive with each other.

A more fundamental criticism concerns the extent to which it is able to improve the income of the poor. The allocation of funds to poor countries is not in itself a guarantee that those funds will reach the poor people, nor that they will be used in the interests of 'beneficiaries'. Since the Bank's definition of success in a project emphasises overall economic returns to the Bank a major constraint in the allocation of loans concerns the extent to which the project and its beneficiaries will be able to repay them. For this reason it is exceptional to see Bank funds being allocated to those without adequate security, for example the landless. In a clear reference to the World Bank, the EEC Commission's 1982 statement of development policy remarked acidly that: "One might be forgiven for thinking that the point of aid is not to put an end to intolerable hardships, but to fund the safest, most profitable investment."[4]

According to this view, the poor, while they remain in theory the major target group and justification for such intervention, often in practice find themselves largely by-passed by the whole process.[5]

It has been criticism from a quite different direction, though, that has been the main source of the World Bank's current financial difficulties. Despite the fact that American influence within the Bank has always been considerable, the institution has influential critics within the US government. This conflict long pre-dates the Reagan Administration and is underpinned by the doubts of some influential Congressmen about the virtues of foreign aid. However, the impact of US criticism has been particularly severe since the election of President Reagan who became personally involved in the decision on IDA 7, siding in favour of the Treasury (which opposed a £12 billion IDA 7) and against the State Department (which favoured it). Underlying this opposition is a philosophical belief that financial flows should be organised by 'the market' and that public expenditure should be cut. This was also buttressed by more specific concerns. In the case of IDA 7, the USA was influenced particularly by the view that India has received too much assistance, based on political disagreements between the two countries and on a belief that India can 'afford' more expensive credit.

The problems of IDA

The USA's lack of enthusiasm for the World Bank has been most visible in relation to IDA and, in particular to its seventh replenishment, which provides funds for the period July 1984 to June 1987. The replenishment of IDA, which occurs at roughly triennial intervals, has never been easy. There have been problems over voting rights, the influence of exchange rates flunctuations on different donor contributions, and the pattern of IDA lending, as well as on two particular vexatious, recurring issues: 'burden sharing' and delays in US contributions, both of which have been particularly marked in relation to IDAs 6 and 7.

The initial IDA fund was subscribed by 17 industrialised countries in proportion to their contribution to overall World Bank funding which meant that the two largest contributors were the USA (42%) and UK (17%). In subsequent replenishments, these two have sought to reduce their share but, until IDA 7, this did not result in an absolute fall in commitments. A number of original subscribers were willing to increase their share (particularly Japan and W. Germany) and new contributors (most notably OPEC) were also found so that there are now 34 donors, including 10 developing countries. Hence, each replenishment apart from the first resulted in an increase in IDA in both nominal and real terms. This trend has been reversed sharply for IDA 7, which will total only $9 billion, because the USA refused to subscribe more than $750 million pa or to provide more than 25% of the total. Although the other donors stated that they were willing, without exception, to contribute to an IDA 7 of £12 billion (or more in some cases), they were unwilling to let the USA share drop below 25% because it would set a precedent and hence threaten future funding. Attempts to shift the USA position having failed, it was finally agreed in January 1984 that IDA 7 would go ahead at $9 billion, but that further discussions would be held to encourage donors to provide the additional money that would have been subscribed to a £12 billion IDA 7 through some form of supplementary funding. The USA stated that it would not contribute to such a fund but would not oppose it. In the event, however, the attempt has so far failed and, while it has not been formally abandoned, it is currently moribund. Instead, the Bank is now concentrating on efforts to raise a special fund for Africa. The main stumbling block was the desire for 'burden-sharing', ie that all donors should contribute an appropriate share. Germany and Japan were unwiling to contribute to a parallel fund without US involvement. The other European donors and Canada were willing to support a fund without the USA, but were not willing to do so without Germany and Japan.

IDA 7 was due to run from 1 July 1984 but has not yet come into effect. A perennial problem is that US contributions are often delayed, which can threaten to paralyse the whole operation. A replenishment does not become effective until the donor countries have between them committed 80% of the total. Since the USA contributes more than 20%, it is not possible to reach this target until its commitment has been made. The delays in US commitments and payments arise from its system of government. Three separate actions are required for money to flow. The executive branch must approve the subscription; Congress must authorise the full amount for the triennium; and each year Congress must also appropriate the annual tranche. This has not yet happened, although the expectation is that Congress will appropriate the first annual tranche in the near future.

In the past, the other donors have responded flexibly to ease constraints caused by internal US difficulties. During the negotiations for IDA 6 the Carter Administration agreed to subscribe $1.07 billion per annum, but this was initially rejected by Congress. Then the incoming Reagan Administration decided to spread the contribution over four instead of three years, and even this reduced annual target has not yet been achieved because of Congress' failure to approve new budgets in 1982 and 1983. As a result of the US decision to spread its contribution over four years, 1983-84 was a hiatus between IDAs 6 and 7. The other donors agreed to special compensating subscriptions equal to their IDA 6 contributions.

4. EEC Commission *Memorandum on the Community's Development Policy* COM (82) final, 5 October 1982, p.7.
5. For a criticism along these lines see C. Payer 'World Bank's assault on the small farmer' *Food Policy* February 1980, ppo.65-68.

IBRD and IFC Finance

As with IDA, the capital of the IBRD and the IFC is increased at intervals, with similar attendant problems. The last general IBRD increase was in FY 1980, when $40 billion was added to its capital. The next one is expected in FY 1987, and the debates at this month's annual meeting will take place with an eye on this increase. In addition to general increases, when there is a change in IMF quotas there is, by convention, a parallel, selective increase applied to the IBRD. Such a change has been approved in 1984 to take account of the IMF quota increase of 1983.

While it was accepted that a selective capital increase should occur in 1984, there was a disagreement over its size which had a direct link to IDA 7 since voting rights are linked to member states' capital shares, and Japan had made its large IDA contribution dependent upon its being elevated to number two in the Bank pecking order. The minimum capital increase required to take account of the IMF quota changes was $3 billion. But this would have been insufficient to allow Japan to rise to second place, which required an increase closer to £8 billion. The USA favoured the minimum increase of £3 billion, but was finally persuaded to accept a higher figure. In May the World Bank's board of executive directors approved a selective increase of $8.4 billion, to bring the total authorised capital to some $95 billion. This recommendation will be voted on by the Board of Governors (on which sit the finance and economic ministers of the 146 member countries) in the next few months.

The paid-in contributions of the members are in some cases, including the UK, drawn from their aid budgets. Hence, while a capital increase will raise the World Bank's lending it may reduce the level of aid flowing through other channels. Various proposals have been put foward to avoid this trade-off, including increasing IBRD's gearing ratio, the ratio of loans to capital, and establishing a 'bank within a bank', both of which have not been implemented. The only recent innovation that has been introduced is the 'new financial instrument' which was approved for a two-year trial period in July 1982. Under this arrangement, if the World Bank makes a traditional project loan (an 'A loan') it can now use the instrument to participate with the commercial banks in a 'B loan', using the IBRD funds in a variety of ways to soften the package. Several such loans have been made so far. In a Thailand telecommunication project, for example, the World Bank has taken a 24% participation in a commercial loan syndicated in Japan.

The IFC's capital has also been increased this year. It requested an increase of $750 million to finance its 1984-88 programme. This proposal also ran into opposition and the Bank cut its request to $650 million. This was approved at a meeting of the Executive Directors in June.

Next Steps

The resources of the World Bank are being reduced in real terms at a time when the needs of many ldcs are growing. Some opponents of an increase in resources, notably the USA, argue that the World Bank has not done enough to help cope with the international debt crisis. The key issue concerns how far the World Bank should move away from its traditional, project approach towards structural adjustment, programme lending, and the implications of such a shift for aid conditionality. In the past, the Bank has been tough in insisting upon conditions designed to ensure the success of the projects that it supports. It has also tendered macroeconomic advice which to a certain extent has been linked to project lending. But an increase in structural adjustment lending would imply a much stronger imposition of macroeconomic and sectoral policy conditionality than has been the case in the past. It also implies close liaison between the World Bank and the IMF in setting policy conditions. Developing countries fear that their freedom of manoeuvre will be limited, and that they will be forced to adopt policies that are strongly influenced by the USA.

With these criticisms in mind, the Bank has set up 12 working groups to re-examine its strategy to cope with the changing world environment. This re-examination will not be completed until Spring 1985, but the preliminary conclusions will get their first airing at this month's annual meeting. While the annual meeting will not resolve these issues, it will set in train a debate that should gather momentum over the next two years.

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The Overseas Development Institute was incorporated in 1960 to promote study, discussion and exchange of information on economic and social development issues. It is a registered charity and is financed by official grants and private donations from British and international sources.

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