THE WORLD BANK AND THE IMF IN A CHANGED WORLD

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Abstract

This article will focus on the changing roles of the Bretton Woods institutions, the World Bank and the International Monetary Fund (IMF). After more than sixty years of operation the original vision under which these institutions were founded is outdated and in a rapidly changing world their future roles need clarification. This article will assess some of the criticism and proposals for reform of these two institutions. As regards the World Bank the focus will mainly be on its efforts to improve economic policy, promote economic growth and reduce poverty in developing countries. A more recent challenge faced by the World Bank which is its contribution to the battle against climate change will also be discussed and assessed. As regards the IMF the focus will be on its assistance to developing countries in promoting stability and economic growth and also on the expanded role that the IMF has had in crisis management during the current economic and financial crisis. The article will attempt to answer what role these institutions should play in the next several decades in the changed international economy. The article is based on a review of theoretical literature, secondary data and the author’s experience as a staff member of the World Bank Group for 12 years in three continents.

Keywords: World Bank, IMF, economic policy, climate change, economic and financial crisis.

Introduction

In July 1944 delegates from 44 nations assembled at Bretton Woods in New Hampshire U.S.A. to create a new post-war global arrangement. During only a few weeks they developed a system of rules, institutions, and procedures for financial and commercial relations for the world economy. Two key institutions, the World Bank1 (the Bank) and the International Monetary Fund (IMF or the Fund), established at Bretton Woods still exist
today. Virtually every country on earth is now a member of both institutions. The role of those twin pillars still supporting the structure of the world’s economic and financial order has evolved over time. In fact, the world has changed enormously over the past 67 years.

The current global crisis that started in 2008 and upheavals associated with it is changing the economic and political landscape yet again and these global institutions must continue to evolve and adjust to changing time and needs.

Initially the World Bank was concerned with raising and allocating resources for post war reconstruction in Europe. After a few years of operations it turned its attention to assisting developing countries, both low and middle income, which it still does today. Later on it established institutions to cooperate with the private sector and an institution to serve its poorest member countries. Now the World Bank that has become the World Bank Group, consisting of five institutions.

The purpose of the IMF was to encourage international monetary cooperation, facilitate the expansion and balanced growth of international trade, assist member countries in correcting balance of payments deficits and promote foreign exchange stability. The role of the Fund has also changed and as Krueger put it “By 1973, fixed exchange rates were abandoned, and the Fund had lost much of its original rationale” (Krueger 1997, p. 11) and “as the IMF role with fixed exchange rates among developed countries was seen to terminate, an expanded role for facilitating balance of payments adjustment in developing countries emerged” (Krueger 1997, p. 16). So after 1973 the IMF turned its attention to developing countries, but unlike the World Bank it still had a role albeit diminished to serve developed countries including during the current crisis.

The last 20 years have witnessed major political shifts. This includes the peaceful revolution of 1989. Upheavals across Europe that year brought an end to the Cold War. They led to the fall of the Berlin Wall, the freedom of Central and Eastern Europe, the unification of Germany, the break-up of the Soviet Union, and the return of Russia. The reunification of Europe followed with the enlargement of the European Union and expended membership in NATO.

The last two decades have also witnessed a huge economic shift. The breakdown of the planned economies in the Soviet Union and Central and Eastern Europe, the economic reforms in China and India, and the export-driven growth strategies of East Asia all contributed to a world
market economy that vaulted from about 1 billion to 4 or 5 billion people. This shift offers enormous opportunities. But also it has shaken an international economic system forged in the middle of the 20th Century.

At Bretton Woods only 44 allied powers gathered and this meeting was lead by the USA and the UK governments. Post war powers thus ran the show at Bretton Woods. Since then new powers have emerged and are emerging. As Dominique Strauss-Kahn, Managing Director of the International Monetary Fund recently put it „the world has changed significantly. Rapid growth in emerging and developing economies has redefined the balance of economic power. The global financial crisis has swept away so much of the old economic order“ (Strauss-Kahn 2010a). Robert B. Zoellick President of the World Bank Group has also recently discussed the shift in economic power that has taken place since Bretton Woods and has become more visible during the current economic and financial crisis. In a recent speech at Georgetown University Zoellick told the audience that „Emerging economies are now key variables in the global growth equation. The developing world is becoming a driver of the global economy. Much of the recovery in world trade has been due to strong demand for imports among developing countries. Led by the emerging markets, developing countries now account for half of global growth and are leading the recovery in world trade.“ (Zoellick 2010). At John Hopkins University Zoellick also discussed the diminished role of the USA. „The current assumption is that the post-crisis political economy will reflect the rising influence of China, probably of India, and of other large emerging economies. Supposedly, the United States, the epicenter of the financial crisis, will see its economic power and influence diminish,“ (Zoellick 2009a). This can certainly affect U.S.A. influence within the Bretton Woods institutions, whose headquarters are located in Washington, D.C. and with a World Bank Group’s president so far always nominated by the president of U.S.A.

The current economic and financial crisis has changed the world’s economic landscape. Unlike the 1997/98 East Asian crisis that was mostly regional, this crisis is global, affecting every corner of the world. As shown by table 1 below, the growth rates in high income countries have been severely affected including Europe and the United States. In Europe the recovery still is sluggish, and in the United States, it remains subdued. The emerging powers in East Asia are performing well in spite of initial slowdown and have in 2010 fully recovered to post crisis growth rates. Most of this growth is carried by China which not only is an engine of growth for Asia but now also acts as a stabilizing force in the global
The structure of the world economy has changed dramatically since the Bretton Woods meeting in 1944. This needs to be reflected in the organization and in the management of the World Bank and the IMF. The current heads of those institutions recognize this and encourage change and reform. At the same time they seem nervous about the fate of their own institutions and what coordination role they can play in the world economy, and what roles G7\(^8\) and G20\(^9\) will assume. It seems clear that the G7 countries must transfer more power to the new emerging market economies that are members of G20, including China, India, Brazil and Russia.

**What impact can one expect the Bank and the Fund to have in a changed world?**

In spite of the important role assigned to the Bretton Woods institutions the overall funds that they have had available to assist member countries have always been very limited so one can wonder what can be fairly expected and demanded from those institution in the future. In her article “Whither the World Bank and the IMF?” written shortly after the fiftieth anniversary of the Bank and the Fund, Anne O. Krueger discussed what difference the Bank and the Fund might reasonably have been expected to make on economic growth.\(^{10}\) According to Krueger “A plausible upper bound on that difference can be estimated by noting that there is no country outside Subsaharan Africa where the total capital inflow has amounted to more than 2 percent of GDP annually, and in most it has been significantly smaller. If one estimates that the net real rate of return (i.e., net of whatever loan repayments or dividend repatriation occurred) to that capital inflow was 10 percent – surely a high number - then the total capital inflow could have
resulted in a higher rate of economic growth (both total and per capita) of no more than 0.2 percent per annum.

While two-tenths of a percent per year is significant in the context of poverty, given the imprecision with which weights can be assigned to factors contributing to growth, it is difficult to understand how IFIs, or capital inflows in general, might have been expected to result in a quantum leap in economic performance. To the extent that their contribution was any greater than this two-tenths of a percentage point, it surely resulted from the fruits of policy advice, technical assistance, training and the more rapid spread of knowledge, and other informational services provided by the IFIs. Expecting more of the IFIs would therefore imply a very high product of the research-information-policy-advice functions.” (Krueger 1998, p. 2001-2).

Given this limited impact one can certainly question if an institution like the World Bank deserves to be called the World Bank. And even if one looks at total Official Development Assistance (ODA), it was for example only about US$123 billion in 2009, of which less than US$40 billion was multilateral ODA (OECD 2010) it seems quite limited. This is an amount comparable to the size of the economy of Peru which remains a developing country (World Bank 2010b).

Given these limited financial flows one can ask if the World Bank and the IMF can: (i) increase their impact by engaging in policy dialogue with their member countries and through advisory services, technical assistance and conditionality, stimulate economic growth beyond what their own funding capacity could allow them to do, and (ii) what those institutions, especially the World Bank Group, could do to stimulate private capital flows to emerging market economies which the private sector perceives too risky to invest in. This could for example help stimulate investment in clean energy resources and thus contribute to the battle against climate change. The main goal of this paper is to answer those two questions also in the context of a changed post crisis world economy with new emerging powers (discussed above in the introduction).

“Good” policy and economic growth. Is there a relationship?

If the Bank and the Fund are to stimulate economic growth by encouraging what they prescribe as good economic policy there needs to be some certainty that there is a positive relationship between that prescribed policy and economic growth. But do those IFIs have any clue as to what constitutes a good economic policy?
The so-called Washington Consensus attempted to summarize the outcome of the debate on what policy stances are conducive to economic development and growth (Williamson 2000, Center for International Development, Harvard University 2003). The IFIs have often been heavily criticized for interpreting this policy prescription too literally, without country-specific circumstances, institutional conditions, or effects on poverty. The leaders of the Bank and the Fund have now lost faith in the Washington Consensus. In recent speeches one can see the following statements: “in the 1980s, the idea took hold that we knew how to manage developed economies. A simple doctrine gradually emerged, comprising a few common-sense rules (fiscal and monetary) underpinned by the idea that markets were infallible. This was the heyday of deregulation, at least in the advanced economies. The others—the emerging and poor countries—would gradually embrace what appeared to be sound management, and, in the meantime, the IMF would advise rules that seemed to benefit them. This was the doctrine referred to as the “Washington Consensus.”” (Strauss-Kahn 2010a) And recently the current president of the World Bank said „Many see the economic policy prescriptions of the Washington Consensus as incomplete -- lacking attention to institutional, environmental or social issues, or simply lacking as a guiding philosophy.“ (Zoellick 2010).

The debate about the relationship between good policy environment and economic growth has been ongoing for a long time. David Dollar and Craig Burnside published a famous article a decade ago where the case was made that aid had positive impact on economic growth in countries with good economic policies (Burnside and Dollar 2000). This was good news for the Bank and the Fund. According to Burnside and Dollar one could conclude that making aid more systematically conditional on the quality of policies would likely increase its impact on developing countries growth. Other authors have been more cautious (see for example Easterly, Levine and Roodman 2004) and emphasize that the seminal paper of Burnside and Dollar does not provide the final answer on this critical issue.

For an IFI it is very important to have at least some guidelines when engaging in a policy dialogue with a recipient government. The World Bank country directors must, for example, make decisions and provide advice when they cooperate with governments on the ground. Below are the opinions of two experienced country directors, James Adams and Edwin Lim. Those articles appeared in a World Bank publication titled “At the Frontlines of Development – Reflections from the World Bank” (World Bank 2005).
In his article James Adams, a former World Bank Country Director for Tanzania, discussed Tanzania’s economic reform program under President Benjamin Mkapa. From 1995 to 2002 Tanzania grew 4.6 percent on an average annualized basis. According to Adams “Tanzania’s success with a set of Washington Consensus – inspired policies reflects, in (his) view, the tremendous importance of getting the economic fundamentals – fiscal discipline, low inflation, and market-driven exchange rates - right in any successful economic program” (Adams 2005, p. 287). In his article Adams argues that the Washington Consensus provides very useful benchmarks for a successful economic reform program. He concludes his article by stating “Let us hope that other developing countries in Africa can follow this model – and with equally successful results” (Adams 2005, p. 287). Thus Adams speaks strongly in favor of the Washington Consensus principles and their applicability not only for Tanzania but for the African continent in general and presumably for other developing countries in the world.

In contrast another former World Bank Country Director, Edwin Lim, discussing China, argues that “there is no unique path to economic growth and poverty reduction. Each country has the opportunity and the need to determine its own strategy, depending on its own capacity and conditions (Lim 2005, p. 118). Lim warns countries against following textbook prescriptions or external advice with inadequate considerations of their own capabilities and conditions. Furthermore Lim argues that too many economists still try to develop standard prescriptions for economic success and to advise countries without adequately understanding the country's capabilities and conditions.

According to Edwin Lim there are conditions without which sustained economic growth and poverty reduction seem impossible. One is a minimum level of basic human development - basic education and health for the bulk of the population. Another is a reasonable level of governance and of institutions. According to Lim these conditions are necessary but not sufficient for economic progress. And again Lim emphasizes the need for pragmatic approach, which is based on actual country conditions and capabilities (Lim 2005).

In his book the Elusive Quest for Growth published by the MIT press in 2002, William Easterly who had worked for the World Bank’s research department for years criticized the Bank heavily for its use of the Harrod-Domar model and the Solow model of growth in planning aid to developing countries. According to Easterly “Domar’s model was not
intended as a growth model, made no sense as a growth model, and was repudiated as a growth model over forty years ago by its creator. So it was ironic that Domar’s growth model became, and continues to be today, the most widely applied growth model in economic history.” (Easterly 2002, p. 28). The other model widely used by the World Bank is that of Nobel laureate Robert Solow who in fact was Easterly’s teacher at the Massachusetts Institute of Technology. In this book Easterly argued that “The most important evidence against Solow vision applied across countries was the failure of growth in many poor countries” (Easterly 2002, p. 59). The current World Bank president mentioned the Nobel Prize for Economic Sciences in a recent speech at Georgetown University. There he made the following remark “But it has also been given to those whose love of mathematical models was based on heroic and unrealistic assumptions about humankind” (Zoellick 2010).

The relationship between “good” economic policy and economic growth is still widely debated and there is no consensus at all on this issue among economists. The current crisis with increased uncertainty has only made things worse. IFIs will have to learn to live with this messiness and for now there is no guarantee that what they present as “good” economic policy in their dialogue with client countries will result in increased growth. Furthermore the high income countries that ran the IFIs prior to and during the crisis experienced sharper decline in economic growth than most emerging market economies, see table 1. They also have made mistakes and they have the scars to proof it. More modesty needs to be exercised in the policy dialogue with the developing world.

**IFIs and crisis management**

The IFIs, including the Bank and the Fund, have received additional funding to respond to the global economic and financial crisis. These crisis contributions, largely provided to the IMF to assist developed EU member countries, are hopefully temporary.

In addition to the problem of providing a sound prescription of what may constitute an economic policy conducive to economic growth the IFIs also have problem in predicting crisis, in fact they have been unable to do so altogether. The head of the IMF recently admitted that the Fund did not predict the current crisis. But according to him it was first to gauge its gravity. In its April 2008 spring meetings the Fund shifted from warning to alarm. According the IMF the G7 did not take the alarm seriously. „But what was most striking at the G7, which was meeting at the time, was the refusal to face reality. With one voice, the G7 finance ministers criticized
the Fund, claiming we were too pessimistic, and that growth would hold. We know our economies better than you do, was their refrain.“ (Strauss-Kahn 2010a). The President of the World Bank made the following statement „The one certitude we can draw from events over the past year is our inability to predict what is to come, and how it may trigger other unexpected events.“ (Zoellick 2009 p. 5)

In spite of the difficulty for the Bank and the Fund to prescribe “good” economic policy or to predict a crisis many believe strongly in the importance and value of their advice. For example according to Galvin and Rodrik “the Bank is the single most important external source of ideas and advice to developing-country policy makers.” (Galvin and Rodrik 1995, 332) and on crisis management Krueger says “IFIs probably constitute a platform that enables coordination in times of crisis more rapidly, and more effectively, than would otherwise be possible” (Krueger 1997, p. 49)

However, given the experience from the current crisis it seems clear that the ability of IFIs to predict what is to come remains very limited.

**The Bank and the Fund and the importance of private capital flows**

Given the limited official resources available from the IFIs, including the Bank and the Fund, private capital flows to emerging markets and developing countries are critical for their growth and prosperity. The private sector often perceives emerging investment environments too risky to invest and has limited means to mitigate those risks. This is especially true for the poorest development countries and is an impediment for their development. In his book the Elusive Quest of Growth, William Easterly compares the volume of capital flows to the richest versus the poorest countries in the world. According to Easterly “In 1990, the richest 20 percent of world population received 92 percent of portfolio capital gross inflows; the poorest 20 percent received 0.1 percent of portfolio capital inflows. The richest 20 percent of the world population received 79 percent of foreign direct investment; the poorest 20 percent received 0.7 percent of foreign direct investment. Altogether, the richest 20 percent of the world population received 88 percent of private capital gross inflows; the poorest 20 percent received 1 percent of private capital gross inflows” (Easterly 2002, p. 58 - 59). There is thus a sharp division between those countries that receive versus those who do not receive capital inflows.

At the Bretton Woods conference the focus was on official capital flows that would come from the Bank and the Fund. According to Krueger it was widely held at Bretton Woods that “official capital flows would be
essential for reconstruction and development, since private international capital flows had been devastated by the Great Depression” (Krueger 1997, p. 5). Furthermore “it was generally thought that long-term private international capital flows would not resume after the experience of the 1930s” (Krueger 1997, p. 8). This situation has changed radically since the Bretton Woods and according to Krueger “it is the observation that private international capital flows have greatly increased in importance and sophistication for middle-income countries that leads to much of the questioning of the Bank” (Krueger 1997, p. 39). The Meltzer report even recommended that the World Bank should focus only on Africa and few remaining poor countries in Europe and the Middle East (Meltzer 2000). But how have those flows been affected during a global crisis? As Zoellick recently pointed out „Private capital flows to the developing world are slumping sharply, with net inflows dropping in 2009 to about one-third of the peak $1.2 trillion reached two years ago“ (Zoellick 2009b, p. 2).

The World Bank Group recently published its Global Development Finance 2011 report that provides information about the most recent trends in financial flows to developing countries during the global crisis. According to the report international capital flows to the 128 developing countries reporting to the World Bank Debtor Reporting System fell by 20 percent in 2009 to US$598 billion, compared with US$744 billion in 2008 and a little over half of the peak level of US$1,111 billion realized in 2007, i.e. prior to the global crisis, see table 2. (World Bank 2011).

Net equity inflows totaled US$462 billion in 2009, down 13 percent from the US$534 billion total recorded in 2008 and close to 30 percent lower than the US$643 billion recorded in 2007. FDI inflow in 2009 fell to US$354 billion from US$587 in 2008, see table 2. (World Bank 2011) This is the sharpest drop in 20 years.

The global financial crisis severely reduced developing countries’ access to international capital markets. Debt flows from private creditors fell 70 percent in 2009 to US$59 billion, one eight of the US$467 billion net inflow from private creditors in 2007. Medium-term commercial bank lending to both public and private sector borrowers almost disappeared in 2009, with the net inflows to all developing countries reduced to a mere US$1.6 billion, compared to US$172 billion in 2008 and US$194.9 billion in 2007, see table 2.
What are the recent trends in financing from official creditors? Net inflows of capital from official creditors\textsuperscript{14} were estimated at US$171 billion in 2009, an increase of about 50 percent over the figure for 2008, see table 3. This increase was mostly due to the rapid rise in the net inflows of loans from the IMF and the MDBs following the decision of G20 to accord these institutions a central role in crisis response for developing countries (World Bank 2011).

The recent shift from grants to loans in financing from official sources is significant. In 2007, grants constituted almost 100 percent of the combined net inflows of loans and grants from official bilateral and multilateral sources. By 2009, grants, as a share of the net inflow of official

| Table 2. Net Capital Inflows to Developing Countries, 2007 – 2009. US$ billions |
|-----------------------------------------------|-----|-----|-----|
| **Inflows**                                  | 2007 | 2008 | 2009 |
| Net private and official inflows              | 1,110.5 | 743.9 | 597.8 |
| Percentage of GNI                            | 8.0  | 4.5  | 3.7  |
| Net equity inflows                           | 643.2 | 533.9 | 462.2 |
| Net FDI inflows                              | 508.1 | 587.1 | 354.1 |
| Net portfolio equity inflows                  | 135.1 | -53.2 | 108.2 |
| Net debt flows                               | 467.3 | 209.9 | 135.5 |
| Official creditors                           | 0.0  | 27.8 | 76.4 |
| World Bank                                   | 5.2  | 7.3  | 17.7 |
| IMF                                          | -5.1 | 10.0 | 26.5 |
| Other official creditors                     | 0.0  | 10.6 | 32.2 |
| Private creditors                            | 467.3 | 182.1 | 59.1 |
| Net medium- and long-term debt flows          | 283.1 | 196.1 | 52.7 |
| Bonds                                        | 88.2  | 24.1 | 51.1 |
| Banks and other private Creditors            | 194.9 | 172.0 | 1.6 |
| Net short-term debt flows                    | 184.2 | -14.0 | 6.4 |
| Change in reserves (- = increase)            | -1,083.7 | -452.7 | -673.8 |
| Memorandum items                             | 76.1  | 86.4 | 95.0 |
| Official grants excluding technical cooperation | 76.1  | 86.4 | 95.0 |
| Worker remittances                           | 277.2 | 323.5 | 305.2 |

Source: World Bank 2011
financing, are estimated to have fallen to 55 percent. By contrast, net official financing provided by multilateral institutions, rose from US$ 11.4 billion in 2007 to US$ 70.8 billion in 2009, see table 3. Middle-income countries received 90 percent of net official loan financing, i.e. US$ 68 billion (World Bank 2011).

<table>
<thead>
<tr>
<th>Financing</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total</td>
<td>76.1</td>
<td>114.2</td>
<td>171.4</td>
</tr>
<tr>
<td>Official grants</td>
<td>76.1</td>
<td>86.4</td>
<td>95.0</td>
</tr>
<tr>
<td>IDA</td>
<td>1.9</td>
<td>2.1</td>
<td>2.5</td>
</tr>
<tr>
<td>Loans</td>
<td>-0.1</td>
<td>27.8</td>
<td>76.4</td>
</tr>
<tr>
<td>Bilateral</td>
<td>-11.4</td>
<td>-2.5</td>
<td>5.6</td>
</tr>
<tr>
<td>Multilateral</td>
<td>11.4</td>
<td>30.3</td>
<td>70.8</td>
</tr>
<tr>
<td>IBRD</td>
<td>-0.3</td>
<td>2.7</td>
<td>11.3</td>
</tr>
<tr>
<td>IDA</td>
<td>5.5</td>
<td>4.6</td>
<td>6.5</td>
</tr>
<tr>
<td>IMF</td>
<td>-5.2</td>
<td>9.9</td>
<td>26.5</td>
</tr>
</tbody>
</table>

Source: World Bank 2011

Again, according to Krueger “it is the observation that private international capital flows have greatly increased in importance and sophistication for middle-income countries that leads to much of the questioning of the Bank” (Krueger 1997, p. 39). As the above data shows the growing need of middle income countries for official financing during the current economic and financial crisis and the decline in private capital flows weakens Krueger’s argument made in 1997.

Private capital flows, clean energy and climate change

It is widely known that investment needs in infrastructure in emerging markets and developing countries are large. This includes clean energy investments. The IFC estimates that electricity sector investment needs in developing countries from 2007 to 2030 will be US$7.9 Trillion (IFC 2009). This is about half of the Gross National Income of the U.S.A. in 2009 (World Bank 2010b). Those investment requirements are so large that it is necessary to pool private funding with official flows from IFIs as well as with host government resources. The World Bank president recently said that “Climate change poses as early test. A key task at Copenhagen in December will be to create incentives for developing countries to participate in low carbon growth. The decision-makers will need to frame an ongoing process that cuts greenhouse gases while encouraging technological change, adaptation, and growth” (Zoellick 2009a). Official financial flows are small.
compared with these funding needs and here an institution like the World Bank Group has a role both as a provider of funds as well as an institution that can help mobilize private funds. A large share of clean energy resources are located in developing countries. Meanwhile world electricity demand is expected to double through 2030, with the largest increase coming from developing countries (Tooman 2004). The growth in Asia is particularly strong. Here the Bank has funding tools such as loans, equity contributions as well as guarantee instruments to help mobilize private funds. However, as Krueger points out “In practice, the IBRD has lent and made little use of its guarantee powers” (Krueger 1997, p. 8).

The use of guarantees to facilitate private investment in emerging and developing countries has been on the agenda in the World Bank from time to time, unfortunately without much follow-up and only with limited results. A memorandum signed by then the World Bank’s president, Lewis T. Preston, titled „Mainstreaming of Guarantees as an Operational Tool of the World Bank“ went to the World Bank’s Executive Directors on July 14, 1994 (World Bank, 1994). In this memo guarantees are recognized as an important complement to World Bank loans and considered a highly flexible instrument that could be customized to suit varying country and project circumstances. In fact, as the memorandum stated, the World Bank’s Articles of Agreement had envisaged IBRD to be primarily in the guarantee business (World Bank, 1994) although they never found a widespread role in Bank operations.

Written in 1994 the memorandum recognized that recent developments in financing requirements of many of the World Bank borrowing countries indicated that guarantees should become much more significant form of Bank support. Among the reasons mentioned was that the financing needs for development of infrastructure in developing countries was estimated to be very large and well beyond the capacity of the official sources alone to support. Also many World Bank borrowers were turning to the private sector to invest in infrastructure projects through a variety of private ownership arrangements which would attract not only private sector resources but also allow a greater transfer of technical and operational assistance (World Bank, 1994).

According to the memorandum the objective of the World Bank in offering guarantees was to help mobilize private sector financing for individual projects through targeted and limited support, and to leverage Bank’s participation. “Guarantees are a particularly well-suited form of Bank support for economically important private sector project finance
transactions, where they can be targeted to mitigate against specific risks—generally risks of political, regulatory and governmental performance—which in particular projects the private sector may not be in position to absorb or manage” (World Bank, 1994, p. 3). The comparative advantage of guarantees was seen as most apparent in infrastructure investments that require large amounts of funds with extended maturities to match the long pay-back periods normally associated with such projects (World Bank, 1994). Furthermore the Presidents memo noted that “Even though there have been several successful private financings of infrastructure projects in developing countries in recent years, these have only amounted to a small fraction of the total needs” (World Bank, 1994, p. 3). Unfortunately the same situation applies today more than 15 years later.

The president’s memo also considered the potential demand for guarantees and reported the results of discussions with a number of international investors and commercial and investment banks. The memorandum states that “Their reactions have been almost uniformly positive towards the prospect of Bank guarantees, particularly to cover government performance risks in private sector infrastructure projects” (World Bank, 1994, p. 7). It was argued that many projects “would simply not materialize within a reasonable time period without Bank support” (World Bank, 1994, p. 7). The view was also expressed that “once the existence of the Bank’s guarantee program became better known and understood by the investors and the financers, investors would show renewed interest in many more projects in a much wider range of countries than in the past” (World Bank, 1994, p. 7). According to the president’s memorandum, coordination within the WBG “would be strengthened through more structured consultations between each country department and IFC’s infrastructure department and MIGA” (World Bank, 1994, p. 12).

When it came to discussing the potential to leverage more funds through guarantee instruments vis-à-vis loans and equity contributions the memo stated as follows: “In practice, since partial risk guarantees represent a contingent obligation to disburse, the likelihood that the Bank would disburse against a guarantee would depend on the probability of occurrence of the event triggering the call, which is likely to be less than one. It should, therefore, in principle be possible to support a larger volume of partial risk guarantees than loans within the same country risk exposure” (World Bank, 1994, p. 16). This must be classified as an admirably conservative statement by the World Bank’s president but confirms nevertheless the potential to leverage larger funds with guarantee instruments then via loans and equity contributions only.
The memo concludes as follows: “Guarantees potentially represent a useful and flexible instrument of Bank support for specific projects and country assistance strategies. Recent developments in the financing needs of Bank borrowers and their increasing interest in promoting private sector investments in infrastructure open the possibilities of utilizing Bank guarantees as a mainstream instrument, complementing the support provided by MIGA and IFC” (World Bank, 1994, p. 18).

An Independent Evaluation titled: “The World Bank Group Guarantee Instruments 1990 to 2007” was recently published by the Bank (World Bank 2009). Part of this evaluation was done via a WBG Guarantee Staff Survey. According to the survey “A high proportion of staff felt that changes are needed to improve the WBG’s guarantees instruments.” And “Overall, most staff felt that reducing time and cost of processing guarantees and improving marketing are important for improving WBG guarantee instruments” (World Bank 2009, p.104).

The World Economic Forum has recently called for more use of guarantees to support investments in emerging and developing economies. They argue that Development Finance Institutions (including the World Bank) should “adapt their services, culture and capital allocation to the imperative of ‘crowding in’ domestic and foreign private investment by placing much more emphasis on such risk mitigation instruments as partial guarantees as a transition strategy“ (World Economic Forum, 2006 p. 10). They also emphasize that a “deeper partnership between the public and private sectors is needed if we are to achieve common objectives.” (World Economic Forum 2006, p. 10). In 2005 the World Economic Forum also issued a report about the growing role of public-private partnerships in mobilizing resources for development (World Economic Forum 2005).

It seems clear that it would be possible to mobilize more private sector funds to emerging market economies if the IFIs were making more use of their guarantee powers. In spite of stated intensions, long processing times, costly instruments, poor marketing and coordination problems are standing in the way. This is disappointing especially during an era where increased investment in clean energy is critical for mankind. Here the IFIs must do better and need reform.

The World Bank and the IMF - The need for change and the vision of their current leaders

The roles of the Bank and the Fund have evolved since the Bretton Woods agreement was signed. Initially the IMF had an important role of
macroeconomic policy coordination for all its members. In her 1997 article “Whither the World Bank and the IMF?” Krueger noted that “the G-7 (or an even smaller group of ministers) is the group that in fact orchestrates whatever coordination is achieved, and the Bank for International Settlements has assumed a coordination role for central banks. It is therefore academic to discuss a major role for the Fund.” (Krueger 1998, p. 2005). This changed yet again during the current crisis. The coordination now moved from G7 to G20 to include major emerging market economies – new powerhouses. G7 now needs their help to bring an end to the current slump. This is a clear reversal from previous crises when the G7 was in the driver’s seat of the recovery effort. As Paul Martin Canada’s former prime and finance minister put it “The G-20 reflects the realities of the global economy. Its finance ministers are becoming the dominant policy-making body” (Martin 2009). Nobel laureate Josep Stiglitz talks about the power of G20 as recognition of new realities “It’s effectively recognition by the G-7 that they don’t have the money. The money is in Asia, the Middle East.” (Stiglitz 2009). And finally the then U.K. Prime Minister Gordon Brown said “The world economy is bigger than the G-7,” and “You cannot talk about the world economy and what you want to do without involving a whole range of countries.” (Brown 2009)

The heads of the IMF and the World Bank Group have welcomed G-20 coordination but they also seem nervous about how this will affect their own institutions. As Strauss-Kahn put it „The good news is that global governance has been renewed by the crisis. Led by the G20, countries came together to face common challenges with common solutions focusing on the global common good.“ (Strauss-Kahn 2010a). But the head of the IMF is also concerned when he says „Renewed legitimacy is essential. The cooperation that has, so far, tamed the Great Recession originated with the G20—a small group that nevertheless accounts for more than 80 percent of the world’s output. But this is not enough. The IMF has 187 members. How can the G20 be legitimate when it excludes 167 countries—representing a third of the world’s population?“ (Strauss-Kahn 2010a). The World Bank president is also concerned when he says „If developing countries are going to be part of the solution they must have seats at the table. The G7 failed to expand in time to meet international economic realities. Now the G-20 has its chance. But some 20 at the table still leaves over 160 outside. The multilateral institutions – with much broader membership – can help connect the G-20 to the rest of the world„, (Zoellick 2009b, p. 10). And Zoellick sees a role for the existing multilateral organizations when he states that „The WTO, IMF, World Bank Group, and the Regional
Development Banks – along with the UN agencies, can play a larger role. With over 180 members, and further reform to boost the voice and decision-making power of developing and emerging economies, these institutions can help bridge the divide between nation-states and economic interdependence by interconnecting national, regional and global interests“ (Zoellick 2009 p. 7). But he also contradicts himself when he talks about the G20 and says „It is not easy for large groups to share responsibilities and generate a cohesive common purpose. Within the G-20 we already see the emergence of different blocks: the EU organizing a common position for its eight participants; the BRICs of Brazil, Russia, India, and China coordinating joint statements. This development may be expected, but it would be unfortunate if the new, broader G-Group created new fault lines between developed and developing countries.“ (Zoellick 2009b, p. 10). If coordination is difficult within G20 than it will also be problematic within the Bank and Fund with almost 200 member countries. And there are growing tensions between the United States and China „the United States, the largest developed country, and China, the largest developing country, should find common ground. China and the United States have had the two largest stimulus packages. Yet the U.S. stimulus relies heavily on consumption, whereas China looks to invest in building more capacity. Over time, this imbalance is unsustainable. The two countries will need to cooperate on a mutual readjustment as they recover from crisis – increased savings through fiscal and spending discipline in the United States, and increased consumption, services for the public, and opportunities for small enterprises in China. Their national interests can be combined to strengthen a common systemic interest“ (Zoellick 2009b, p. 10). And Zoellick argues that „A strong G-2 within the G-20, and cutting across development lines, could form the cornerstone of a new multilateralism – a multilateralism that recognizes the realities of an international system born, not of nation-states alone, but of nation-states linked through economic interdependence. That modern multilateralism will require that rising economic powers have a larger say in how institutions such as the World Bank and the IMF are run. This is both right and inevitable.” (Zoellick 2009 p. 10)

The world has changed and the IFIs must change with it as the head of the IMF says „A new balance has arisen between regulation and the markets, and the IMF has a role here. In the macroeconomic and macro financial arenas, the idea that it was possible to rely solely on the market to ensure strong, sustainable growth has lost credibility“ (Strauss-Kahn 2010a). The heads of the IFIs want this change not to include formation of new institutions but reforming and empowering the existing institutions. „If
leaders are serious about creating new global responsibilities or governance, let them start by modernizing multilateralism to empower the WTO, the IMF, and the World Bank Group to monitor national policies. Bringing sunlight to national decision-making would contribute to transparency, accountability, and consistency across national policies.“ (Zoellick 2009b, p. 7). And Zoellick calls for Bank Fund cooperation , „The G-20 should ask the IMF and the World Bank Group to monitor actions and results in the banking sector. We already work together in developing countries through the Financial Sector Assessment Program (FSAPs). We should be providing feedback on the developed countries too, with the results published, taken seriously, and followed up“ (Zoellick 2009b, p. 8). This would clearly expand the role of the World Bank whose work has in recent decades focused on low and middle income developing countries only, not developed countries.

As noted before the role of the World Bank in serving middle income countries was questioned by Krueger and in the Meltzer report (Krueger 1997, Meltzer 2000). The current crisis has changed the situation somewhat as private financial flows have reduced and at least some middle income countries have had to rely more on official capital flows and on assistance with crisis management. And even before the crisis a report prepared by the Center for Global Development stressed the importance for the Bank to revitalize its role in China, India, and the middle-income countries (Center for Global Development 2005, p. x). Zoellick has also emphasized that the middle income countries are home to 70 percent of the world’s extreme poor which would imply that the World Bank still has a role to play in these countries (Zoellick, 2009). At the same time some key middle income countries, e.g. China, India, Russia and Brazil, who still must fight poverty within their borders, are assuming more power within the Bank and the Fund, including via their participation in G20. Their role in shaping the Bank and the Fund will be greatly increased in coming years.

The difficulties faced by the IFIs are not only reflected in tensions between G7 countries and the large emerging market economies. The fact that IFIs can neither predict economic crisis nor clearly identify what constitutes a good economic policy reduces the value that they can bring to the global economy. The World Bank’s failure in utilizing its guarantee powers to help mobilize private sector funding to developing countries is severely reducing its ability to respond to the vast needs in the developing world for investment in clean energy.
Conclusions

The world has changed since the Bretton Woods in 1944 and the system is being overhauled before our eyes. New emerging powers will increasingly demand a larger role in shaping the Bretton Woods institutions and in the decision making and are already exercising their influence through the G20. It remains to be seen how they will use this power. However, since they are mostly middle income countries, including China, India, Brazil and Russia, it is unlikely that they will support reforms that do not serve the interest of middle income countries. In fact, bulk of the poor also still reside in middle income countries.

The IFIs have quite limited funds but their impact would be much greater if they could guide developing countries in improving their economic policies. After the crisis it is less clear what constitutes a good economic policy and the Washington Consensus has been rejected publicly by both the leaders of the Bank and the Fund. The inability to describe what good economic policy is limits the Bank and Fund ability to engage effectively in policy dialogue with member countries and reduces the impact that those institutions can have on economic growth through their advisory role and policy conditionality.

On crisis management the Bank and the Fund would normally be expected to play the coordinating role but during the current crisis the G20 has been very prominent in coordinating the recovery efforts and this is a source concern for the IFIs. G7 countries who all are among the high income countries that suffered severely during the crisis and do not appear to have sufficient resources to take the lead. Instead emerging markets, especially in East Asia is leading the world out of the crisis. A large share of East Asian growth is carried by China which has become a stabilizing force for the global economy. The Bank and Fund seem unable to predict crisis as the World Bank president has recently pointed out.

Regarding capital flows the situation during the current global crisis is quite different from the time when private capital flows were buoyant over an extended period. The vagaries to which private capital flows seem prone to can imply a role for the Bank in middle income countries. This could apply to both good times and bad times. While the Bank's lending may be more important in bad times, it is the policy dialogue and analytical work on policy issues that may be more important in good times. Ideally, such analytical work could provide help to governments in insuring that they gain the most out of private flows, while reducing the country's vulnerabilities to their sudden reversal, and also to develop social
safety nets for the poor who for no fault of theirs tend to be exposed to external shocks. But this means that the Bank and the Fund must be able to help governments formulate policies conducive to economic growth and provide sound economic advice. Currently they seem unable to do so.

In addition to this, the Bank has been doing work on climate change issues that are highly relevant for developing countries and emerging markets and affects the whole world. However, its ability so far to mobilize large private funds is a source of concern. So far the Bank has not used its guarantee powers on a large scale to mobilize large capital resources for clean energy investments. The World Economic Forum has recently called for action from the IFIs to increase its use of guarantee instruments to mobilize private funds. A recent WBG staff survey suggests that the Bank’s guarantee program is poorly coordinated, with long processing times and high costs.

Coming out of this crisis there is an opportunity to reshape the world’s economic policies, financial architecture, and institutions. There is a need to craft a new global system for the 21st Century, one that would encourage balanced global growth and financial stability, embrace global efforts to counter climate change, and advance opportunity for the poorest. It means expanding the benefits of open markets and trade, investments and growth. It must be a globalization that is both inclusive and sustainable with care for the environment.

Reference


1 Then the International Bank for Reconstruction and Development (IBRD).
2 The third pillar was the GATT that later became the WTO is not discussed in this article.
3 The International Finance Corporation (IFC), and the Multilateral Investment Guarantee Agency (MIGA).
4 The International Development Agency (IDA).
5 World Bank Group currently consist of the following five institutions:
   i. International Bank for Reconstruction and Development, IBRD, 1944.
6 The Bretton Woods system was based upon a policy of fixed exchange rates which collapsed in 1973.
7 During the current crisis high income EU countries like Greece and Ireland have received assistance from the Fund and Iceland also turned to the IMF for support.
8 The G-7 includes the following countries: Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States. Prior to the current economic and
financial crisis this group did in fact orchestrates whatever economic coordination was achieved. This role has now to a large extent been shifted to G20.

9 G-20 includes the following countries: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, Republic of Korea, Turkey, United Kingdom, United States of America. This group includes major emerging economic powers like China, India, Brazil and Russia.

10 In her article Krueger refers to the World Bank Group and the International Monetary Fund (IMF) as the International Financial Institutions (IFIs).

11 In its original formulation, the Washington Consensus prescribed a policy that could be summarized in ten propositions as follows: (i) fiscal discipline, (ii) a redirection of public expenditure priorities toward fields offering both high economic returns and the potential to improve income distribution, such as primary health care, primary education, and infrastructure, (iii) tax reform (to lower marginal rates and broaden the tax base), (iv) interest rate liberalization, (v) a competitive exchange rate, (vi) trade liberalization, (vii) liberalization of FDI inflows, (viii) privatization, (ix) deregulation (in the sense of abolishing barriers to entry and exit), (x) secure property rights.

12 The focus on Africa would only until the African Development Bank is ready to take full responsibility.

13 Direct investment and portfolio investment combined.

14 Loans and grants.

15 Loans and grants.