# World Bank Reform

**Statement Presented to the Joint Economic Committee**

**of the Congress of the United States**

**by**

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It is a privilege to address the Joint Economic Committee. First, Mr. Chairman, I would like to thank you and Majority Leader Armey for the strong support you provided when violent attack came from almost all sides.

Two years ago, Minority Leader Gephardt greeted the publication of the Meltzer Commission report with the following appraisal: "…an extreme neo-isolationist attitude…(that) will undermine development efforts in the world's poorest countries …(and) the stability of the world financial system." Then-Secretary of the Treasury Summers made a rare personal appearance on the pages of the Financial Times to claim that one of its key proposals, a shift from loans to grants, would "require an unworkable system for delivering assistance". World Bank President Wolfensohn deemed grants "unrealistic". One year ago, my fellow witness Mr. Bergsten stated that the Joint Economic Committee hearing on the first anniversary of the report's publication was appropriate as a burial service because none of the Commission's recommendations had been or would be adopted.

What a difference a year makes. Once branded "ivory tower" by some and "radical" by many, the report was recently termed the "blueprint" for international reform efforts by <u>The Economist</u> magazine. Today, we have a new Administration that supports international reform and a new International Monetary Fund with a disciplined approach to assistance. Many of the major recommendations of the Commission are on the way to becoming global public policy.

My remarks will focus on developments at the World Bank, particularly those current issues that would benefit from the intervention of the Congress. A critical look at the Bank is doubly important as the Bank assumes the leadership role in the United Nations campaign to double development aid flows to more than $100 billion each year.

When leaders from both the industrialized and developing world meet in Monterrey, Mexico on March 18 at the United Nations Conference on Financing for Development, two topics that originated in the Meltzer report will be high on the agenda. First, a change from loans to grants for the delivery of aid to the poorest countries. Second, a move to rigorous measures to increase the effectiveness of development assistance. President Bush launched these proposals at the Group of Seven meeting in Genoa last summer and the Secretary of the Treasury continues to speak out forcefully in support of the Administration's commitment to these policies.

Grants were proposed by the Commission to address the shortcomings endemic to the tradition of open-handed lending by the multilateral institutions. The poorest countries had accumulated debt they were clearly unable to repay. Funds had been diverted to unproductive ends. Donor contributions ended in write-offs instead of real improvements in the standard of living of the impoverished.

This grant format is new because it is performance-based. Counter to the trend of lending blanket sums for indeterminate government plans, grants will be project-linked and executed under competitive bid by private sector contractors and non-governmental organizations. For the easily quantified basic needs that improve the quality of life and are the preconditions for economic growth---health, primary education, water and sanitation--the grant system would count by independent audit and pay for output: numbers of babies vaccinated, children that can read and water and sewer services delivered to villages. No results: no funds expended. No funds diverted to off-shore bank accounts, vanity projects or private jets.

Opposition to the use of grants has been orchestrated by the World Bank around the faulty argument that grants will deplete its resources, together with its ability to help the poor, unless they are partnered with an immense infusion of new funding--$800 million more each year from the U.S. alone. It is worth taking the time to explode this false argument.

It would seem logical that if money is given away, instead of being lent, the stockpile of funds will eventually vanish. Not so. Grants will not cost more than loans. They deliver the same amount of aid without diminishing the funding pool and without asking for more taxpayer monies from the industrialized world.

The funding requirement is the same when the level of aid is the same. The arithmetic is straightforward.

The International Development Association (IDA), the arm of the Bank dedicated to 72 of the globe's neediest nations, extends 40-year loans at virtually zero interest. The interest free use of the money translates into a gift component equal to $73 out of every $100 loan. Although, ultimately $100 will be repaid, the real cost to the recipient is $27.

This is identical to an outright grant that pays $73 out of $100 of program outlays with the remaining $27 paid by the recipient. In both cases, the cost to the country is $27. Again, if the level of assistance is the same, grants cannot cost more than loans.

The grant format can produce the same reflows into the IDA pool of financial resources as traditional loans at the same level of aid. For each $100 of donor funds, $73 would be disbursed as grants and $27 invested in the capital markets. The proceeds of the investment will match the $100 of loan reflows over the life of a traditional 40-year IDA loan.

The effectiveness of World Bank performance has been another highly contested but not unrelated debate. Although the Bank claims 75-80% success rates, when the Meltzer Commission reviewed the Bank's own data, it found that more than half of World Bank programs overall and more than two thirds of projects in the poorest countries failed to achieve both satisfactory and sustainable results. Debate over the numbers is irrelevant because the Bank's auditors are captive, because the judgments are made too early--at the time of final loan disbursement but long before an operating history is established--and because sustainability, the sine qua non of development, is given little consideration in the evaluation.

After the publication of the Meltzer Commission report in 1999, World Bank sustainability ratings that had stagnated at 50% for years jumped to 72% in 2000. Was there such swift improvement or was the bar simply lowered?

Thinking has continued long after the official life of the Meltzer Commission. After 50 years and $500 billion of aid, we have no evaluation of World Bank performance except the one it chooses to promote. If the wrong people are applying the wrong criteria at the wrong time, how credible are the conclusions?

Why not establish a bona fide external audit by private sector firms, on site, to determine the lasting contribution of IDA projects after a credible operating history and to provide a continuing benchmark for Bank efforts in the poorest countries.

The World Bank is now seeking $13 billion in IDA replenishment funding. The U.S. share alone is $2.5-2.8 billion. $5-7 million dollars, or just ¼% of this commitment, would cover the cost of an audit. The condition of an external performance review of IDA programs, together with provision for its financing, should be written into the upcoming appropriation and into all funding going forward.[1]

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[1] Senator Crapo of Idaho and Senator Enzi of Wyoming focused on the issue of an external performance audit of World Bank programs in the 106th Congress. See S. Con. Res. 136 in the 2nd session.