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Development without Miracles: The World Bank after Forty Years

by Otto G. Mayer, Hamburg*

Forty years after the signing of the final act of the Bretton Woods Conference on 22nd July 1944, which embodied the agreement on the World Bank and the International Monetary Fund, the World Bank now comprises three organisations: the International Bank for Reconstruction and Development (IBRD), the International Development Association (IDA) and the International Finance Corporation (IFC). In simplified terms, these three institutions jointly aim to help raise the standard of living in developing countries by mobilising finance in developed countries, channelling it to less developed countries and using it there as efficiently as possible in accordance with the stated objective. Given the difficulties involved, the virtually undisputed role played by the World Bank group in international development policy comes as a surprise.

The World Bank's function is described in these or in similar terms in every Annual Report of the Bank. At first glance it is a clear formulation and it undoubtedly enjoys universal acceptance, but it conceals serious problems of substance and institutional difficulties that have beset the activities of the World Bank over the years and which continue to do so. It must therefore appear all the more surprising that the World Bank has managed not only to win an undisputed reputation as an efficient international development aid organisation but also to maintain and strengthen it over several decades and that, individual cases and measures apart, the philosophy and principles underlying its actions have met with general approval in both industrial and developing countries. This contrasts with the situation of many other organisations in the United Nations family, whose efficiency or inefficiency has been the subject of whole libraries of works, at least in the main financing countries. It is also notable that the World Bank has rarely found itself embroiled in heated controversies over its philosophy and actions such as have afflicted its sister organisation, the International Monetary Fund.

One reason for this is probably that despite the steady extension of World Bank lending to new areas and the marked change in its development doctrine since the beginning of the seventies, the Bank has only recently stepped beyond its strongly project-oriented approach with the granting of structural adjustment loans. In this

way it was able to acquire a positive image as a "constructive institution", in contrast to the IMF, to which countries generally turn only when all other avenues are closed and which by virtue of this role as "troubleshooter" must make its assistance subject to conditions that rarely accord with the intentions of politicians in the countries concerned. Rightly or wrongly in individual cases, the Fund's "stabilisation demands" run fundamentally counter to the "development policy" argument that further "additional" burdens should not be placed on the poor countries.

The IBRD's project-oriented approach springs from its character as a bank that must itself be a first-class borrower if it wishes to live up to its role as an intermediary between the capital markets in industrial countries and the developing countries. For that reason, it must strive to keep defaults in its own loan portfolio to a minimum. Little wonder, therefore, that the Articles of Agreement of the World Bank contain clearly defined guidelines governing its business activities.

These guidelines include not only the prescribed gearing ratio of 1:1 between capital and liabilities but also the important requirement that it lend only for *productive* purposes, thereby promoting economic growth in the developing countries concerned. In so doing, it must also consider whether there is a well-founded expectation that the loans will be repaid. It is partly for that reason that loans are only made to governments or must be guaranteed by the government concerned. Finally, the Bank's lending decisions must

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be based solely on economic considerations. IBRD loans generally have a five-year redemption-free period and are repayable over 20 years or less. The rate of interest is calculated in accordance with a guideline related to the Bank's own borrowing costs. These guidelines would not enjoy such unanimous approval among the 140 or so countries whose governments own the IBRD if the potential conflicts to which they could give rise had not been alleviated in advance or resolved at the institutional level.

The treasurers of the World Bank point with justifiable pride to the fact that over the years the IBRD has suffered no true loan defaults. Without wishing to dispute the quality of the Bank's project identification, appraisal, implementation and evaluation, one wonders nonetheless whether the good lending record has been due solely to these rigorous procedures. The rapid increase in the debt of middle-income developing countries in the seventies and, in some cases, the acute worsening of their problems at the beginning of the eighties without their defaulting in the narrow sense on World Bank loans suggests not only that countries tend to evade scrutiny by the World Bank if they possibly can. This trend also highlights the problem of the fungibility of capital. The World Bank may well ensure that it lends only for productive and profitable projects, but if the country in question would have undertaken the project in any case it can divert the resources released by the Bank's participation to other, perhaps less viable purposes. Moreover, with many projects with long lead times – and not necessarily only infrastructure projects – there can be the problem that the burden of servicing the

debt to the World Bank is passed on to other areas of the economy. In the short term this can lead to liquidity crises or worse, because economic development is discontinuous for many reasons, despite substantial success in growth management, whereas debt servicing is a fixed commitment. If appropriate adjustment measures are not introduced in good time, the World Bank's sister organisation, the IMF, can find itself in the thankless position of having to impose stabilisation programmes to bring such adjustment about.

Institutional Solutions

The founding of the two IBRD affiliates – the IDA and the IFC – can be seen as institutional measures to reduce the risk of default. The establishment of the IFC in 1956 took care of the risks of private-sector involvement. The Corporation has a mandate to assist the developing countries by fostering growth in the private sector of their economies and helping to mobilise domestic and foreign capital for that purpose. Membership of the IBRD is a condition for membership of the IFC, but the Bank and the Corporation are legally and financially independent of one another. The IFC has its own operating and legal staff, although it calls on the World Bank for administrative services and the like.

The IDA was set up in 1960 in order to give low-income countries assistance on preferential terms.¹ These countries could not obtain private capital and official aid was insufficient. The IBRD itself could not

¹ For a detailed treatment, see: IDA in Retrospect The First Two Decades of the International Development Association, Washington, D.C., August 1982.

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V E R L A G W E L T A R C H I V G M B H – H A M B U R G

lend to the poorest countries without jeopardising its own creditworthiness in the international credit markets. The risk of default would have been too great, as the countries with low incomes and sparse foreign currency receipts could hardly have afforded to take up loans at the Bank's market-related interest rates and relatively short maturities. The funds disbursed by the IDA, which are termed "credits" to distinguish them from World Bank loans, come from capital subscriptions, general replenishments of the IDA's capital (mainly by industrial countries), special contributions from its more wealthy member countries and the transfer of a part of the IBRD's net earnings. Like World Bank loans, IDA credits are granted exclusively to governments. They have a redemption-free period of 10 years, a maturity period of 50 years and bear no interest, although borrowers are charged an annual service fee of 0.75 % of the disbursed portion of credits. The IDA is legally and financially independent of the IBRD, but administered by the same staff.

Desire to Expand

In this context it should also be mentioned that in view of the energy problems of the non-oil developing countries the World Bank tried to cast off the financial and risk-related constraints imposed on its operations under the conservative guidelines by setting up an "energy bank". The proposal eventually foundered on the unwillingness or inability of potential providers of capital to finance such an institution.

In recent months, staff within the Bank again appear to have begun to consider the creation of a new affiliate. Given the debt problems of many developing countries and the great reluctance of the commercial banks to lend to Third World countries, this affiliate would be designed to stimulate the flow of commercial lending to developing countries that are following appropriate adjustment paths and direct such lending towards high-priority development purposes. However topical and justified the concern that in the face of the debt situation of so many developing countries the commercial banks are wrong in restricting lending too severely, over the medium to long term it must be asked whether a permanent institution is really needed to mobilise private flows of capital if the developing countries "are following appropriate adjustment paths and directing such lending towards high-priority development purposes". Such an affiliate would make sense if one were not convinced that borrowers were generally following these paths, and that lending should therefore be subject to the World Bank's strict assessment criteria.

If such an affiliated institution ever saw the light of day it would also mean that in addition to the IBRD's co-financing instrument a larger proportion of private capital would reach the developing countries via the World Bank; in other words, the more advanced middle-income developing countries would become more dependent on World Bank finance.

This fact and the associated need not only to take greater account of policy developments at the macroeconomic level but also to influence them – in other words, to go beyond the project and sector levels – is bound to draw the World Bank more closely into economic and political controversies such as the IMF already faces. The World Bank has been heading in this direction, it is true, ever since the introduction of structural adjustment loans in 1980, for the objective of such loans is to achieve a maximum feasible level of economic growth during and after the period of adjustment by raising the efficiency of resource use. However, this is generally conditional on wide-ranging policy reforms (such as reform of the trade regime and of the public investment programme, an appropriate level and structure of interest rates, price reforms and more besides), which the World Bank attempts to achieve through the so-called "policy dialogue" with the governments of the countries concerned.

Resurgence of Orthodox Ideas

As the purpose of the structural adjustment loans and the content of the policy reforms show, the idea of efficient resource allocation is shifting back into the forefront after having been somewhat neglected in development theory during the sixties and seventies. That being the case, the efficiency of the economic system, if not that of the order of society as a whole, is also being questioned more forcefully.

A large part of the difficulties that the World Bank faced as a result of the dispute with the US Administration over the recent replenishment of IDA resources and the increase in its capital can be attributed to the fact that in these respects the underlying principle that the Bank grants credit solely on the basis of *economic* criteria cannot be interpreted without reaching fundamental decisions about the shape of society, even if purely political or foreign policy aspects could be excluded. It is not merely the case that in recent years there has been an increase in development policy literature showing that less market-oriented developing economies generally perform less well than more market-oriented ones² (while admittedly

² See for example Axel J. Halbach: A Performance Analysis of the Third World, in: INTERECONOMICS, No. 2 (March/April) 1982, pp. 75 ff.

ignoring the fundamental problem that the political system in these countries rarely accords with the Western conception that market orientation is associated with democratic forms of government); at the very latest since the arrival of A. W. Clausen as President of the World Bank group in July 1981 the World Bank has also laid increasing emphasis on the development role of the private sector.

This tendency to return to what Albert O. Hirschman³ would consider orthodox economics, which attempts to increase the efficiency and productivity of domestic resources by making more intensive use of market-oriented allocation mechanisms, can certainly not be interpreted solely as an indication that the development strategies and theories applied hitherto have failed. It is more a question that the optimism that investing quite substantial sums in certain key sectors can lead to decisive development progress in a relatively short space of time was dampened at the beginning of the eighties, if not before, by the fact that the industrial countries would not or could not provide the sums considered necessary and that an economic strategy based on external debt entails substantial risks if insufficient regard is paid to the volume, quality and composition of domestic resources.⁴ The attention once again being paid to the mobilisation and efficient use of domestic resources is therefore a logical consequence of this development and is only to be welcomed, given the relative neglect of price and other market allocation mechanisms in the past development decades.

The Role of Theory and Experience

Against this background there arises an interesting question that is rarely discussed in works on the subject, namely the extent to which the World Bank, as the largest practising exponent of development finance and aid, has been influenced by development theory and has reflected that influence in its lending operations or, reversely, the extent to which the success or failure of implemented projects has been substantiated in theoretical terms a posteriori on the basis of World Bank evaluations. In the opinion of many observers, the majority of the World Bank staff feel that the World Bank learns from experience and does not follow any particular theory.⁵ This is not the place for a detailed discussion of the question, though both possibilities probably apply here, in other words the collective thinking of World Bank staff is undoubtedly influenced

not only by practical experience but also by current theories of economic development.

From this point of view the almost uncontested role of the World Bank in development policy is all the more surprising, particularly if its position is compared with that of the International Monetary Fund. For, on the one hand, there is almost bound to be friction between political pragmatism and whatever strategic concepts are chosen. On the other hand, the changes in paradigms that have affected the work of the IMF since the end of the war (fixed versus floating exchange rates, Keynesianism versus Monetarism, and so forth) have not been notably more numerous than those in the debate on development theory.

Absence of a General Theory

There is of course no comprehensive theory to fit the problems of the developing countries. Such a theory would firstly have to identify the structural characteristics of underdevelopment and its causes and secondly indicate the theoretical possibilities for setting the development process in motion.⁶ Only by this means could the causal relationships of the entire social structure, comprising not only economic, social and political factors but also institutional, religious and cultural elements, be summarised in a self-contained whole, thereby at the same time revealing the crucial determinants of development. Instead, there is a confusing array of propositions and hypotheses that are often unconnected or even contradictory. This is only partly due to the different approaches and views of development adopted by the various disciplines concerned, which make many a "monoeconomist" (Hirschman) sceptical about development theory as a discipline.

Despite this confusing abundance of hypotheses, a number of tendencies can be discerned that have had a not inconsiderable influence on international development policy as a whole and hence on the policy of the World Bank.⁷ From the end of the second world war until well into the sixties there was a conviction that external capital investment was the "motor of growth" in

³ See Albert O. Hirschman: *The Rise and Decline of Development Economics*, in: Mark Gersovitz, Carlos F. Diaz-Alejandro, Gustav Ranis, Mark R. Rosenzweig: *The Theory and Experience of Economic Development*, London 1982, pp. 372 ff.

⁴ Cf. Armin Gutowski: *Auslandsverschuldung der Entwicklungsländer, realer Kapitaltransfer und Investitionen*, in: Wolfram Engels, Armin Gutowski, Henry C. Wallich (eds.): *Internationale Kapitalbewegungen, Verschuldung und Währungssystem*, Mainz 1984, pp. 171 ff.

⁵ Cf. Bettina Hurni: *Die Weltbank. Funktion und Kreditvergabepolitik nach 1970*, Diessenhofen 1980, p. 35.

⁶ See Dietrich Keschull, Karl Fasbender, Ahmad Naini: *Entwicklungspolitik. Eine Einführung*, 2nd ed., Opladen 1975, p. 134.

⁷ For an overview, cf. Jagdish N. Bhagwati: *Development Economics: What Have We Learned?* in: *Asian Development Review*, Vol. 2 (1984), No. 1, pp. 23 ff.

developing countries. This was based on Rosenstein-Rodan's "Big Push" theories and Rostow's theory of (four) growth stages.⁸ The "Big Push" is triggered by specific and massive capital investment which should set an economy on the road towards autonomous and self-sustained growth; this stimulus can be equated to Rostow's second stage, the take-off, during which productive investment should be greatly increased, the manufacturing sector developed and a social, political and institutional structure created whereby the expansionary forces can be harnessed, applied and made permanent. Nurkse's strategy of balanced growth⁹ qualified the "Big Push" investment theory in that it indicated how the necessary balanced creation of complementary sectors was to be achieved in a developing country.

On the other hand, in his theory of unbalanced growth Hirschman¹⁰ expressed the view that the available resources should be distributed in such a way that investment deliberately created sectoral imbalances that induced businessmen and/or the government to close the gap. (To Hirschman's predominantly sector-oriented strategy corresponded the regional approach of Perroux,¹¹ whose growth pole strategy required investment to foster regional growth centres from which stimuli to growth were to percolate into the hinterland and hence gradually cover the entire economy.)

These approaches were complemented by the conviction, based on the theories of Leibenstein¹² and Schumpeter, that the industrial sector played a key role in this regard. Lewis's theory of the dualistic economy¹³ postulated that in a developing economy growth would occur first of all in the modern industrialised sector, whereas the traditional agricultural sector would lag behind.

Planning Optimism

As far as World Bank lending was concerned, these ideas had, for instance, the result that until the 1967-68 financial year two-thirds of all World Bank loans and IDA credits went on power supply and transportation projects, one-quarter were granted to industry (including development financing companies) and as

programme credits, while the remainder went to agriculture.¹⁴

A further consequence was that the state sector was given pride of place in the development process and that a foundation was laid for a rather optimistic attitude towards planning. Notwithstanding the wide differences between the various approaches, such as those of balanced and unbalanced growth, the circumstances of the developing countries are such that government economic and development policies play a large role, either in making unbalanced investment and, if the private sector fails to react according to the model, taking over its role, too, or in ensuring smooth, proportional and simultaneous growth in both industry and agriculture in the sense of balanced growth.

With the balanced approach in particular, it was tempting to plan "development" using the Harrod-Domar model and the technique of input-output analysis. Apart from the fact that with this approach and the application in practice of these forecasting and planning instruments price-related allocation mechanisms were largely disregarded and more structuralist thinking (the planning of input and output volumes) found its way into the development strategy, a further consequence was the innumerable and still apparently unending calculations of how much capital would have to be transferred to the developing countries over a given period of years to achieve a given rate of growth and/or to close the income gap between developing and industrial countries. As the World Development Reports show, the World Bank has also used such calculations to lend weight to its call for a substantial increase in development aid from the Western industrial countries in the eighties.¹⁵

The Call for Decoupling

Apart from the futility of an approach that reduces the development problem to a given volume of one production factor – capital – it was also responsible for arousing unrealistic expectations about both the willingness of the industrial countries to assist and the time required to overcome underdevelopment or even to narrow the income gap between the developing and industrial worlds. No wonder that the sixties, the United Nations' first "Development Decade", were dubbed the

⁸ P. N. Rosenstein-Rodan: Notes on the Theory of the "Big Push", in: H. S. Ellich, H. C. Wallich (eds.): *Economic Development in Latin America*, London 1961, pp. 57 ff; Walt Whitman Rostow: *The Stages of Economic Growth*, New York 1960.

⁹ Ragnar Nurkse: *Problems of Capital Formation in Underdeveloped Countries*, Oxford 1953.

¹⁰ Albert O. Hirschman: *The Strategy of Economic Development*, New Haven 1958.

¹¹ François Perroux: Les pôles de développement et l'économie internationale, in: *The Challenge of Development. A Symposium*, Jerusalem 1957.

¹² H. Leibenstein: *Economic Backwardness and Economic Growth. Studies in the Theory of Economic Development*, New York 1963.

¹³ W. Arthur Lewis: *The Theory of Economic Growth*, London 1959.

¹⁴ Cf. World Bank Annual Report 1981, p. 13.

¹⁵ Cf. for example the World Development Report 1981 (National and International Adjustment), Chapter 2.

"Decade of Frustration", even though the developing countries as a group recorded growth rates that were unprecedented in the post-war period.

With increasing disillusionment about development and international efforts in this respect, an entirely new line of thinking emerged from the mid-sixties onwards,¹⁶ the most popular exponent of which was perhaps André Gunder Frank.¹⁷ According to this view the underdevelopment of the poor countries is induced and sustained by the international system of relations between rich and poor. The co-existence of rich and poor societies causes the poor societies to fail in their attempt to choose their development path, either because of exploitation or simply owing to the unintentional side-effects of the development and policies of the rich countries. The ruling cliques in the developing countries in turn seek to maintain the international system of inequality, conformity and underdevelopment to which they owe their position. International integration leads to national dissolution. Not only Marxists but also a growing number of non-Marxists now attribute underdevelopment and the obstacles to development largely to the very existence and/or the policies of industrialised countries in both the West and the East.

The practical inference to be drawn from this interpretation would be that the developing countries should strive to partition themselves off, to isolate themselves from the international system. Whether or not this view is valid, it was not put into practice by large numbers of developing countries at national level; nevertheless, it caused many of them to see their place in the international system in these terms and, at least from the beginning of the seventies onwards, to demand a change, a new international economic order.

At the same time, however, the advocates of "orthodox" ideas again began to make a greater impact. The work of Harry Johnson, Ian Little, Tibor Scitovsky and Maurice Scott, and not least the research carried

out by the World Bank itself, were conspicuous for their strong reservations about inefficient protectionism and an inward-looking development strategy.¹⁸

New-style Projects

Although the World Bank rejected the decoupling proposition and had serious misgivings, at least in principle, about the demand for a new international economic order, the experiences of the first two decades after the war and the theoretical analyses outlined above had a profound effect on its lending criteria and policy in the seventies. The Bank's new course was officially announced in a speech delivered by its President, Robert S. McNamara, at the Annual Meeting in Nairobi in 1973. Loans were to be used primarily to reduce "absolute poverty", for growth was a necessary but not sufficient requirement for overcoming such poverty. This policy led to the "new-style" projects aimed directly at raising the productivity, and thus the incomes, of the poorest in the world.¹⁹ Essentially, these projects are designed to prevent the Kuznet curve adopting a U-shape, whereby income inequality increases in the course of the growth process and only begins to decrease above a certain income level.²⁰ Those phases on the Kuznet curve during which income differentials increase should be avoided where possible, or at least attenuated.

As in view of the economic structure of the developing countries the majority of the poorest live in rural areas, these projects mainly relate to agriculture and the rural population. The change is reflected quite clearly in the structure of lending. For example, in the 1980-81 fiscal year these categories accounted for more than 35 % of World Bank loans; electricity generation and transportation received only 20 %, compared with more than 60 % in 1967-68. Moreover, lending operations were concerned increasingly with strengthening institutions and with "more general development goals", as it had become obvious that institution building and general policy reforms were necessary if the Bank's commitment in the new areas was not to be wasted.

Accordingly, not only have the scale and orientation of World Bank lending changed but also the style of political dialogue with the governments of the developing countries in which it operates. It will be interesting to see whether in these circumstances the World Bank will be able to continue to exert a stabilising and intermediary influence in international development policy or will increasingly have to justify its lending policy and criteria to member countries, as the International Monetary Fund must justify its stabilisation programmes.

¹⁶ Cf. Paul Streeten: *Changing Perceptions of Development*, in: *Finance and Development*, Vol. 14 (1977), No. 3, pp. 14 ff.

¹⁷ André Gunder Frank: *Capitalism and Underdevelopment in Latin America*, New York 1967. The more recent exponents of this view include Samir Amin, E. A. Brett, Johan Galtung, Keith Griffin and Oswaldo Sunkel.

¹⁸ See in this connection Bela Balassa et al.: *The Structure of Protection in Developing Countries*, Baltimore 1971; Harry G. Johnson: *Economic Policies Toward Less Developed Countries*, Washington 1967; Ian Little, Tibor Scitovsky, Maurice Scott: *Industry and Trade in Some Developing Countries*, London 1970.

¹⁹ Cf. Mabub ul Haq: *Changing emphasis of the Bank's lending policies*, in: *Finance and Development*, Vol. 15 (1978), No. 2, pp. 12 ff.

²⁰ Cf. Bettina Hünni, *op. cit.*, p. 49.