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## The World Bank and poverty: Cause or cure?

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# **The World Bank and poverty: cause or cure?**

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Dr Wilfred Candler

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NZ Trade Consortium Working Paper No. 11

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# 1. INTRODUCTION<sup>1</sup>

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This essay discusses the role of the World Bank (hereafter, the Bank) in the generation and prevention of poverty. Although major reference is made to the activities and structure of the Bank, it is believed that the points made, apply with little or no modification to many international development assistance agencies. Three reasons underlie the focus on the Bank, (a) by some metrics it is the largest of the aid agencies, and certainly does not shrink from the title of "the premier development agency", (b) despite the essays accusations of "opacity", the Bank is the most transparent of the aid agencies, and (c) the author has spent a substantial time working for the Bank<sup>2</sup>.

Provision of "development assistance" (or foreign aid) from richer, developed countries to poorer, developing ("third world") countries is a relatively new phenomena. Prior to the Second World War, most developing countries had a colonial relationship to one of the great powers. Even Latin America, which was nominally free, was clearly recognized as a United States sphere of influence. With most countries achieving independence, and the evident success of the Marshal Plan in fostering European recovery, the rich countries sought to assist poor countries to alleviate or abolish poverty. In part this assistance was provided bilaterally (country to country) and in part multilaterally (with donor countries supporting international development agencies, which provided assistance to individual poor countries on behalf of the developed world as a whole). In part this assistance was commercially motivated, since funds donated were spent on developed country exports (in some cases bilateral assistance was directly tied to purchases from the donor country), on occasion it reflected Cold War political priorities, but despite these distortions, the primary political support for aid came from a charitable desire to improve the lot of the very poor.

Initially it was thought that the key to improving the lot of the poor was to transfer capital, since almost by definition, the poor had little capital. Later it was thought that the need was to transfer technology, thus allowing poor countries to bring the efficiency of their operations in line with the developed world. Still later Government policies took center stage, poor policies being identified as the roots of poor economic performance. Intermingled with these approaches attempts were made to by-pass the incidence of poverty itself by supplying people's "basic needs" (variously defined) directly. In some cases development assistance was associated with spectacular economic performance (South Korea being the prime example, but the Asian Tigers as a whole being almost equally impressive). However, Asian progress has been accompanied by African regression, until today there are many countries, most of them in Africa, which are billions in debt: Debt that they have little prospect of repaying. These are the Highly Indebted Poor Countries (HIPC) for which the donors have designed a special initiative to forgive their debts to commercial lenders and to bilateral and multilateral agencies. It is by no means clear that Asian progress nor African regression is due to foreign assistance. What is clear is that many African countries, which at independence could pay their debts can no longer do so.

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<sup>1</sup> Dr Wilfred Candler is a former World Bank Analyst, Annapolis, Maryland, US. He is also a former Professor of Agricultural Economics of Massey University and Purdue University, USA.

<sup>2</sup> Quotations and other direct evidence advanced are taken from publicly available documents. A much stronger case could be made based on internal documents.

Debate as to whether development assistance helps or hinders is not new. It dates back at least to Bauer and Paish's skepticism as to the claimed developmental role of African Agricultural Marketing Boards<sup>3</sup> (1954), and Little and Mirrlees's<sup>4</sup> (1974) hubris that by choosing the right shadow prices "good projects" could be designed in the presence of "bad policies". Recently (April, 2000) this intellectual debate has been replaced by a more anarchistic<sup>5</sup> direct action approach, when demonstrators disrupted the annual meetings of the Bank and the IMF (International Monetary Fund), and advocated boycotting the bonds that the Bank uses to finance its lending.

In 1996 the Bank and the donor community<sup>6</sup> generally recognized that full repayment of the debts of some developing countries was unlikely. It was claimed that repayment would involve undue hardship for the poor in the countries concerned. Accordingly the Bank and the IMF proposed a comprehensive approach to reduce the debt of the poorest most heavily indebted countries. This initiative was called HIPC (for Highly Indebted Poor Countries). This initiative is very much a "work in progress". So far 9 countries have been approved to take part with expected write-off of \$14 billion, a further 5 countries are under active consideration with an expected write-off of \$9 billion. The program could eventually be extended to over 30 countries with write-off of as much as \$50 billion. The Bank is expected to contribute as much as \$12 billion to the write-off. Since multilateral agencies are likely to have difficulty meeting their write-off commitments (see below), a Trust Fund (currently worth \$2.4 billion) has been established to compensate them for some of their needed write-offs.

There has been a great deal of debate about the scope of this initiative (which countries, pre-conditions for relief and how much relief would be provided) and who would pay for it. There has been very little discussion as to why the initiative has become necessary, and how the need for similar initiatives can be avoided in the future.

In particular, the need for as much as \$50 billion of debt relief, indicates at least \$50 billion of missing assets that the original lending was intended to generate. Absent any convincing explanation for the disappearance (or perhaps, non-appearance) of these assets, it is doubtful if there is any reason for lenders to be "made whole".

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<sup>3</sup> Bauer, P.T. and Paish, F.W., "The Reduction in Fluctuations in the Incomes of Primary Producers Further Considered", *Economic Journal*, Vol. 64, pp 704-729, (1954). Bauer, P.T. "West African Trade: A Study of Competition Oligopoly and Monopoly in a Changing Economy", Cambridge University Press, 1954.

<sup>4</sup> Little, I.M.D and Mirrlees, J.A., "Project Appraisal and Planning for Developing Countries", Basic Books, New York, (1974).

<sup>5</sup> The demonstrations against the annual meetings in Washington were characterized by a desire to tear down the Bank, without any evident thought as to what, if anything should be put in its place. While it may be a defensible position that the Bank should be shut down without any replacement, it is quite indefensible and anarchistic to take the position that "the Bank should be shut down, and I have not thought about what the consequences would be". ("Protest Too Much: Meet the New New Left: bold, fun and stupid." Franklin Foer, *The New Republic*, May 1, 2000).

<sup>6</sup> Principally bilateral agencies, other multilateral Banks and some agencies of the United Nations.

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## 2. HIGH DEBT OR LOW ASSETS?

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The HIPC initiative has been described almost entirely in terms of the too heavy debt burden of the poor countries; but this is only half the story. There is nothing wrong with being highly indebted, *if there are high yielding assets to match*. The problem of countries that are unable to pay their debts is not only that they borrowed or were lent (depending whether the lending is thought to have been demand or supply driven) money, thus building up their debts, but also that *the assets that the borrowing was expected to finance have not materialized*.

Lack of assets, puts a very different spin on the HIPC problem than focusing simply on the debt side of the balance sheet and even worse treating the accumulated debt as if it was an Act of God. The debt accumulated without matching assets, because faulty lending (and borrowing) decisions were made.

Focusing on the asset side of the problem raises two questions, so far not addressed by the HIPC program. Namely what is the total amount of borrowing unaccompanied by corresponding assets? And, what safeguards have been put in place to prevent widespread repetition of the phenomenon of *lending without asset creation*?

Before turning to the consideration of these questions, it is important to understand the something of the basis for developmental lending, and the structure of the Bank: that help explain the peculiar difficulty the Bank has in debt forgiveness.

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### 3. PUBLIC GOODS, PRIVATE GOODS AND FEEL GOODS

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Economists typically distinguish between "private" goods, where an individual or organization can capture the benefits of the good (such as ownership of a tractor) and public goods, where the benefits are not enjoyed solely by one individual or organization (such as a road)<sup>7</sup>. There are well reasoned and accepted arguments that for private goods, the private sector can be expected to provide them as efficiently, in many cases much more efficiently, than the public sector. For public goods, on the other hand, inability of private investors to capture the entire benefits, leads to "market-failure" and inadequate provision if left entirely to the private sector. There is thus an argument for such goods to be paid for by the public sector<sup>8</sup>.

Provision of either public or private goods may well be financed by borrowing. For private goods, the key issue is whether the investment will generate sufficient cash flow to repay the loan. (Occasionally, as in lending to a big company, it may be sufficient to know that the company as a whole is well placed to service the debt, although the company itself should, in theory at least, be concerned that each project undertaken would be self-financing). For public goods, there is seldom an opportunity for the public sector to recover the cost of service provision (since this would imply that it was a private good). This means that in lending for public goods, it is the capacity of the borrower to repay out of total income, which should underpin a lending decision.

In addition to these widely recognized public and private goods, development projects frequently provide "feelgoods"<sup>9</sup>. A "feelgood" is a good (whether public or private) for which there may be substantial demand (even need) *but no expectation that it will either generate the revenue needed to amortize its cost nor that the borrower has sufficient other income that will be used to pay-off the loan*<sup>10</sup>. A current example of a "feelgood" would be lending for a low-cost HIV vaccination program to a country where neither the citizens, nor the government could afford it. "The implementation of (donor financed, government provided) primary health care has created a new set of images. Empty rural health clinics without staff, drugs or working equipment; the poor bypassing free primary public clinics to pay for services from private providers, drugs being sold on

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<sup>7</sup> This is by no means a simple distinction, since a toll-road where the owner can charge a fee for use of the road might be described as a private good. Indeed differences in legal systems may lead to differences in definition of which goods are private and which public.

<sup>8</sup> Note that the argument is for provision to be paid for by the public sector. Actual delivery of the service, or construction of the investment, may still be best done by the private sector.

<sup>9</sup> The author is indebted to Susan Stout, both for this term and the underlying concept.

<sup>10</sup> In some cases, "feelgood lending" may be for a poor project that will not provide significant benefits. However, even in cases where a substantial benefit is created as in *some* health and education projects, this is still "feelgood lending" if there is no way to ensure either that the benefits translate into an income stream to amortize the debt, or that the borrower has an alternative income stream that can be used to amortize the debt. The external costs of eradication of Guinea worm disease, which when studied in 1997 was estimated to have had a 29% ERR (Internal Economic Rate of Return) was grant financed, as it should have been, since there was no prospect that the almost two million people who did not get the disease each year due to eradication could be persuaded to pay for their relief; even if it had been possible to identify the individuals who would have been affected. Cost benefit Analysis of the Global Dracunculiasis Eradication Campaign (GDEAC), A. Kim, A. Tandon and E. Ruiz-Tibson,, World Bank, 1997.

the black market."<sup>11</sup> If the clinics were built with funds borrowed from the Bank, then the Government remains obligated to pay for the costs of clinics, whether or not they are used. It may feel good to lend to build health clinics in poor countries, but if they go unused, the result is a borrower who may be unable to repay, leading to a Highly Indebted Poor Country (HIPC).

Feelgood lending is often the result of confusing the intention to do good with actually achieving the desired outcome. It may feel good to lend for "Free School Meals for Under-Weight Poor Children". However, such a project may well end up (a) supporting a large bureaucracy, (b) providing food to all students, and (c) missing the poorest children who have already had to drop out of school. A project with a feel good title may, or may not, deliver a result that the donor can feel good about.

This is not to say that aid organizations should not provide low-cost HIV inoculation programs even to countries which cannot afford them. But it is to say that *such programs should be provided on a hard-headed grant basis*; with no pretense that the government and beneficiaries are to be held responsible for repaying the cost. "Hard-headed" in the sense of requiring a whole program to complement the vaccination to be implemented (an educational program, condom availability, and even introducing and enforcing a law governing the age of consent for younger girls and older men). It is much better to announce a program as a grant program, than to present it initially as loan program, only later to have to forgive the debt, thus converting it into a grant program. If grant funds are not available, then the country should do it with its own resources, or not do it at all.

The crucial difference between what is planned, described in Staff Appraisal Reports and debated (and approved) by the Board; and what is actually delivered on the ground, has been well captured for primary health care (PHC) projects:

*"First, too often the impact of PHC was calculated as if health status were a technocratic affair and individual were the passive recipients of government action. But individual actively use their knowledge and resources to enhance their own (and their children's) health. Incorporating choices into the analysis can completely change both the expected impact of PHC and the ranking of the importance of various actions. The impact of PHC cannot be assessed from medical knowledge, but depends both on how it impacts on the demand for services and how it interacts with existing (and potential) supply and prices in the private sector.*

*Second, PHC advocates often assumed the public sector could be made to deliver whatever was decided in the capital (or at an international forum in someone else's capital) ought to be delivered. In practice, the quality of public sector health services ranged from excellent to truly horrific. While an idealized, well run network of community workers and rural health clinics might have a dramatic effect on health status, the real policy issue is the impact of the services a country's public sector is actually capable of providing. Public sector failures in health are not random but are the result of a systemic mismatch between the incentive structure in the traditional civil service mode of public sector organization and tasks in the health sector."*

And

*"While it might seem obvious that the private sector is an important part of the health sector that cannot be ignored in analysis of the potential impact of public sector interventions, it often is ignored. A recent review of appraisals of World Bank projects, an institution with a large*

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<sup>11</sup> "Health Policy in Poor Countries: Weak Links in the Chain", D. Filmer, J. Hammer, and L. Pritchett, Policy Research Working Paper #1874, World Bank, January, 1998.

*number of economists, found that out of 180 appraisal reports, none, that is not one, referred to the implications for, and of, the private sector."*<sup>12</sup>

If you want to know what the Bank would like to be doing, then by all means look at Staff Appraisal Reports. If you want to know what the Bank is actually doing, then look at Implementation Completion Reports and especially Audits. One is not a good guide to the other.

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<sup>12</sup> "Health Policy in Poor Countries: Weak Links in the Chain", D. Filmer, J. Hammer, and L. Pritchett, Policy Research Working Paper #1874, World Bank, January, 1998.



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## 4. BANK STRUCTURE AND WHO PAYS FOR FORGIVENESS?

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The World Bank encompasses *inter alia* three lending organizations:

i) The International Bank for Reconstruction and Development (IBRD): This is the main part of the Bank. It borrows about \$20 billion a year on financial markets, and re-lends to governments with a small mark-up on its cost of borrowing (\$29 billion committed in the 1999 Financial Year). The expectation is that this will allow borrowing governments to get access to credit on substantially better terms than they could obtain by borrowing directly (see below however, for a discussion of the actual impact or exchange rate risk on the cost of Bank money). In so doing, the Bank carries the risk that governments will fail to repay their loans.

ii) The International Development Agency (IDA): This part of the Bank lends only about \$3.5 billion a year on highly concessional terms. The money to be lent is contributed by developed country governments (and from Bank profits), with no requirement that IDA repay the contributing governments.

iii) International Finance Corporation (IFC): This part of the Bank invests about \$ 3.5 billion annually, in private companies in developing countries. It aims to sell its equity position once the company is established; and writes off its poor (or unlucky) investments, as it goes. IFC borrows from world financial markets and is self-financing.

Private lenders thus have two ways of lending to foreign governments. They can lend directly thus accepting the risk of default, or they can lend to the IBRD part of the Bank, thus letting the Bank accept the risk of default (or incapacity to pay).

If private lenders choose to lend to governments directly, and a borrower is unable or unwilling to pay, the private lender has little option but to negotiate a work-out arrangements, even if this returns less than 100 cents in the dollar.

A write-off by IDA or bilateral agencies basically reduces the money coming into the agency, and reduces the number of new projects that can be financed. Since new lending can be reduced, failure to be repaid does not lead to cash-flow problems.

A write-off by IBRD poses much greater problems. The write-down cannot simply be passed on to the private sector lenders from whom the IBRD borrowed. In order to repay its borrowing, the IBRD needs a corresponding income/repayment. Failure of governments to repay their debts thus creates a cash-flow problem for the Bank. The Bank's profits, of about \$ 1 billion a year, and its reserves against bad debts (\$ 3.5 billion) can be used to help pay for any deficit. However, the Bank has made other commitments against these profits, including support of the Consultative Group for International Agricultural Research (CGIAR) that made major contributions to the Green Revolution. Thus it is not certain that the Bank will have sufficient free cash-flow from its profits to fund the proposed debt forgiveness of its borrowers. To overcome this, IDA will be called upon to advance the money to pay for the forgone interest payments, if needed, and the Bank will repay IDA as profits permit. (For the period of the loan, IDA concessional lending will be correspondingly reduced. It is to reduce the probability of having to borrow from IDA that the previously mentioned Trust Fund was set up).

Contrary to appearances the debt "forgiven" under HIPC will be paid for by developing countries in reduced assistance<sup>13</sup>. For bilateral agencies and IDA this comes about because they will have less to lend or grant in future years. Bank profits used to pay for interest forgiven would otherwise have been available to give to IDA and hence would also have been available for concessional lending<sup>14</sup>.

In order to qualify for HIPC assistance, countries have to undertake to spend an amount equal to their forgiven payments on social expenditures mainly health and education. This provision has a strong whiff of feel good. Only countries that have been spending too little on social expenditures can qualify for HIPC? (Or, is it axiomatic that *all* highly indebted countries are spending "too little" on these services?) But it does, does it not, make one feel good to know that money forgiven will be spent on social services? *And, therefore that the initiative can be supported without further thought?* But what about the niggling suspicion that in some countries the real problem may be that *all* public services are inadequate, and especially revenue generation, primarily because of a shortage of well-trained professional, which in turn can be traced to inadequate public service salaries?<sup>15</sup> So HIPC may be demanding that expenditures be diverted from civil service reform and revenue collection where it would put the country on the road to sustained growth, to "feel good" expenditures on social services.

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<sup>13</sup> Depending on the benefits, if any, which would have been produced by this extra lending, a reduction may, of course, be a good thing.

<sup>14</sup> The direct competition for new IDA lending and contributions to HIPC can be seen from the Bank's disposition of its retained earnings (profits) in financial years 1997, 1998 and 1999 (\$ million):

Year →	1997	1998	1999
Contribution to IDA	600	304	352
Contribution to HIPC	500	250	100
Trust Fund for Gaza & West Bank	90	0	90
Multilateral Investment Guarantee Corp	0	150	0
Carried Forward	95	539	976
Total	1,285	1,243	1,518

Source: World Bank Annual Report for 1999 Financial Year

<sup>15</sup> The possibilities are myriad: the poor in many cases would be better served by expenditures on rural road, irrigation, small-scale credit schemes, and other directly income generating, situation specific, investments, than social services *per se*. Macro-policies that will allow the poor to sell their labor, such as market determined exchange rates, removal of internal and external barriers to trade, low inflation and a hospitable environment for private investment (both local and foreign), may be even more important.

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## 5. ACCOUNTABILITY AND TRANSPARENCY

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Up to \$12 billion of Bank lending is to be written off (forgiven) under HIPC, total forgiveness could be as much as \$50 billion (the balance will be forgiven by commercial creditors, developed country governments, and other multilateral lending agencies). That is \$50 billion of "missing assets". How could this much money go missing in poor countries? Systemic problems are discussed later, but the short answer is *lack of transparency and accountability*.

The Bank is accountable to the Board of Executive Directors. Some large contributors and borrowers have their own Executive Director, small countries are grouped and share an Executive Director. Executive Directors serve full time and have small staffs. Unfortunately, the Bank accounts for the wrong things. Every lending operation is approved by the Board, usually as a result of debating a 25 to 50 page Staff Appraisal Report detailing what the project is intended to do<sup>16</sup>. This gives countries a chance to "play politics" as when a project is rejected (or more often withdrawn because rejection is likely) on the basis of the country to which it will be lent, rather than any flaw in project design. However, by flooding the Board with details on every proposed project, the staff distract attention from (a) the policies which should determine the volume and direction of lending, and (b) what is actually achieved. The Board is encouraged to "look at the trees and not the wood."

Bank disclosure policy cannot be faulted:

*The Bank recognizes and endorses the fundamental importance of accountability and transparency in the development process. Accordingly, it is the Bank's policy to be open about its activities and to welcome and seek out opportunities to explain its work to the widest possible audience. World Bank Policy on Disclosure of Information.*

However, there is no connection between the Bank's policy and practice. No primary accountability documents (that is to say Implementation Completion Reports (ICRs) and Project Audits) have been put into the public domain. What has been put into the public domain are (a) Staff Appraisal Reports and other pre-project documents, which record what the Bank *hopes to achieve*, and (b) impact reports and studies which draw on the ICRs and Audits, and may involve additional field based information. These meta-studies are very selective and cover only a small fraction of Bank projects. Even in these cases, the document put into the public domain often differs from that actually sent to the Board. The result is that despite the disclosure policy, Bank practice is to report on outcomes only indirectly (and by no means comprehensively). Thus the Bank's excellent policy is honored in the breach<sup>17</sup>.

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<sup>16</sup> It used to be that every project was debated by the Board, now many are approved without debate on a "no objection" basis.

<sup>17</sup> On June 27th, 2000, the New York Times (page A7) reported that it had received a copy of a 160 page harshly worded internal Bank report on a proposed loan to China. The Times also reported: "The Bank had planned to release the report, but decided against it at the last moment". This sits ill with "it is the Bank's policy to be open about its activities and to welcome and seek out opportunities to explain its work to the widest possible audience." Ironically, the same article reported the President of the Bank as criticizing the Bank's inspection panel for trying to "push the Bank in the direction of literal and mechanistic interpretation of its rules" (sic). There thus seems to be some ambiguity even within the Bank's top management as to whether policies are to be followed, or are simply rhetoric directed at an external audience.

As pointed out above, accountability stops with the Board. Board documents dealing with project outcomes are submitted on a confidential basis, only to be used by recipients "in the course of their official duties". The Staff Appraisal Reports, outlining what the Bank hopes to achieve are much more substantial documents than the Implementation Completion Reports, that describe what actually happened. Executive Directors also receive reports on lending priorities by country, reports on lending policies by sector, proposal for new lending criteria, surveys of the success of ongoing and completed projects, reports on poverty, gender issues, environmental policies, you name it. This flood of reports greatly exceeds anything that can be taken in by any one individual, even assisted by a small staff<sup>18</sup>. Thus, consciously or unconsciously, the Bank's reporting style is such that the Executive Directors are told so much about what is going on, that they can have little idea of what is going on. At the same time, the convention of treating accountability reports as Confidential prevents their study by a wider audience, which might provide the feedback needed to enable Executive Directors to function effectively.

Not only does the Board give too much attention to individual projects, but it looks at the wrong reports. As mentioned earlier, Staff Appraisal Reports stating what a project hopes to achieve customarily enjoy a 1 to 2 hour discussion by the full Board<sup>19</sup>. Implementation Completion Reports, and Audits that report what happened are hardly ever discussed by the full Board. Thus the Board is told a lot about what the staff expect and hope to do, and are left in almost total ignorance of actual project impact (good or bad).<sup>20</sup> In practice reports on individual project performance are used as building blocks for an annual review of project performance which is discussed at length by the Board, however the detail of what individual projects are achieving or failing to achieve is lost.

Clearly what is needed is a "sunshine policy" which would give real transparency to Bank operations, by allowing all (present and past) Board documents to be freely available. If this is felt to be too idealistic, provision could be made for Bank management or individual Executive Directors to request (on behalf of the country that they represent) that a document be retained as confidential. Even in such cases the title of the document should be made available, thus (a) allowing interested individual to go after it, and (b) throwing doubt on the wisdom of liberal lending to the country requesting confidentiality. As a result of agitation by NGOs in the context of governments agreeing to fund the 12th renewal of IDA, this "disclosure policy" is under review, with the expectation that it will be substantially liberalized. A draft of the proposed new policy is expected to be available for public comment in mid-July, 2000.

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<sup>18</sup> And way exceeds anything that would be submitted to a normal (part-time) Board of Directors, that would meet quarterly. As mentioned later, one of the Bank's organizational problems is that it has a full-time Board of Directors.

<sup>19</sup> Implementation Completion Reports, Audits and other "accountability products" are distributed to all Executive Directors. However, oversight of the quality of this work is delegated to a sub-committee (CODE, Committee on Development Effectiveness), which carries out its function by actually *reading* a dozen or so Implementation Completion Reports and Audits per year.

<sup>20</sup> To repeat, Implementation Completion Reports and Audits are amongst the flood of documents distributed to Executive Directors, so in principle an Executive Director could focus on achievements rather than intentions. The empirical fact, it that this does not seem to happen, and certainly the Board agenda focuses on new project proposals, not actual project performance.

With 300 plus projects a year, it is to be expected that such a sunshine policy would from time to time identify episodes of substantial embarrassment to the Bank<sup>21</sup>, as happened in the Chinese case cited in footnote 14. The threat of such embarrassment is a necessary condition to focus staff attention on the avoidance of embarrassing episodes; and is also needed to ensure that remedial action is taken rapidly and effectively. The avoidance of institutional embarrassment is dearly bought, if the result is \$12 billion of Bank lending (up to \$50 billion for donors as a whole) that may be written off.

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<sup>21</sup> Or to the donor community more generally, if widely adopted.

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## 6. SELF-EVALUATION AND AUDITING

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How to know and report project outcome, is a surprisingly difficult question. This is because the ideal evaluator is unbiased and deeply knowledgeable about the project. Get that firmly in mind, and the problem is evident. From some viewpoints the project manager is best suited to describing project performance, problems and achievements. He/she at least knows much of what went on. Three problems: There may be deep biases (unrealistic hopes, or bad personal chemistry with participants), and if the Bank's view of project success will influence the career prospects of the author, the temptation to guild the lily is all too evident; also it is unlikely that the task manager has been able to see project impacts fully from the viewpoint of intended beneficiaries. Another possibility is to use an in-house group, who are familiar with similar operations, and independent of Bank management. The Bank has in fact an independent evaluation group (OED, the Operations Evaluation Department) which reports directly to the Board of Directors (i.e. by-passing the President of the Bank). This arrangement has several attractions, especially if staffed by older staff who can expect to retire from the evaluation unit (i.e. who no longer have an incentive to "keep their nose clean" in order to find another position in the Bank proper).

An internal independent evaluation group (such as OED) has the advantage of providing a cadre of staff fully familiar with the organizations policies, procedures, record keeping, and in many cases a network of trusted friends who can provide either direct insights into the problems and triumphs of project implementation, or at least tell the OED evaluator who can provide these insights. The risk is that the Director, through whom all communication to the Board is channeled may have been appointed exactly because he/she was sensitive to organizational politics, and hence reluctant to take truly embarrassing messages to the Board.

The third alternative is to out-source the evaluation function employing organizationally independent Universities, NGOs, other multilateral agencies or consultants. However, this alternative also has its disadvantages. If the evaluating agency has not previously done work for the Bank, there may be a steep learning curve as the agency becomes familiar with Bank documentation, filing and staffing practices. Moreover, as soon as the independent agency decides to seek more work for the Bank, its independence becomes suspect.

The best solution is probably to have the project manager write a Implementation Completion Report (ICR) for each project, but to have an independent internal evaluation group audit<sup>22</sup> (i.e. check) on say 25% of the ICRs, and an outside organization to provide an evaluation of 25% of the audits.

There is a need for the NGO community, concerned development agencies and Foundations to establish a web site which can host discussion groups on developmental issues and individual Bank supported projects. Such a site, could usefully allow interested readers to provide reviews of Bank documents, thus providing guidance as to which documents deal particularly well with topical issues.

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<sup>22</sup> "Audit" here means a study to see if the project achieved its stated objectives, if not why not, and whether it has positive or negative lessons which can be useful in the design of future projects. It does not mean a financial audit. Financial faults should be caught by the routine annual financial audit of all projects. However, in the event that the "achievement of objectives" audit senses the possibility of fraud or corruption, there is a separate Internal Auditing Department which should be alerted to double check the results of the financial audits of the project.

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## 7. MAJOR FLAWS

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The lack of Bank outcome reporting to anyone beyond the Board, precludes assembling a complete list of explanatory factors that could explain the missing assets for HIPC participants. Nevertheless a partial list of possibilities with respect to Bank lending is easily assembled.

Borrowing Strategy: Until recently, the Bank made a practice of lending its borrowers a "basket" of currencies corresponding to the currencies that the Bank itself had borrowed. Borrowers were then responsible for repaying in the borrowed currencies at the prevailing exchange rates at the time of repayment. (This practice has, fortunately, been modified by Jim Wolfensohn, the current President of the Bank. He has added options allowing borrowers to opt for a single currency loan, in the currency of their choice. The choice being limited only by the major currencies borrowed by the Bank. The Bank has also introduced a much more flexible "fixed spread loan" where the Bank takes the risk of changed borrowing margins over LIBOR (London Inter-Bank Offer Rate), and allows borrowers to hedge their interest rate, or swap the currency of the loan during the repayment period). Earlier it was the Bank's policy was to borrow most heavily in the currencies with the lowest interest rate, thus minimizing the interest cost of borrowing. Unfortunately, there was a reason for the lower interest rate. It represented the market expectation that the borrowed currency would appreciate relative to the dollar. Usually the market was right, and borrowers found themselves having to repay more (in some cases substantially more) dollars than they borrowed. This "lowest nominal interest rate" strategy was pursued for several years. As shown in Table 1, the result has been to require borrowers from the IBRD (International Bank for Reconstruction and Development, the "hard money" part of the Bank) to repay substantially more than they borrowed.

The Bank has not published a complete series of debt levels, borrowing and repayments from 1970 to date. Rather it has published annually the most recent five to eight years. Unfortunately, when debt and other levels are given for the same year in successive publications, there are discrepancies. Assuming that that data in any one publication is computed on a consistent basis, Table 1 draws on five tabulation, the first running from 1977 to 1980, the second from 1980 to 1984, etc. The result is that two estimates are reported for the overlapping years. In particular the earlier publication reported that total debt to the IBRD 1980 was \$21.3 billion, while the later publication put the estimate at \$22.1 billion.

Estimates of the impact of exchange rate changes on borrower indebtedness are calculated only from data published in the same report, (i.e. the above noted discrepancy of different figures for the same year, does not affect the estimates). Reading the first line of data in Table 1, we can see that opening debt to the IBRD was \$12.8 billion, a further \$2.5 billion was disbursed, and \$0.6 billion was repaid. If there had been no change in the (dollar) value of the other currencies lent, then the end of year indebtedness would have been \$14.7 billion ( $12.8 + 2.5 - 0.6$ ). In fact, looking at the opening debt for 1978 we see that this had grown to \$15.0 billion, implying that the increased value of non-dollar currencies lent, had raised borrower indebtedness by \$0.3 billion or 2.3%.

Taking the figures at face value, they show that borrowers from IBRD, over the period 1977 to 1999 have repaid the Bank \$34.7 billion more than they borrowed. There is one number that looks like a typo. For 1984 the earlier estimate of opening indebtedness is

\$42.9 billion, which is reported as only \$36.6 billion in the later series. It seems likely that this should have been \$46.6 billion, which would reduce the dollars repaid, in excess of dollars borrowed, to "only" \$26.6 billion. However, it may also be noted that the above estimates have not been compounded to present value<sup>23</sup>.

**Table 1: Cross-currency cost of Bank lending**

1977-1999 (\$B)

Year	Opening Debt	Paid out	Repaid	Ending Debt	Risk Outcome	Risk
1977a	12.8	2.5	0.6	14.7	0.3	2.3
1978	15.0	2.9	0.7	17.2	0.7	4.7
1979	17.9	3.8	0.8	20.9	0.4	2.2
1980	21.3	4.4	1.0	24.7		
1980b	22.1	4.6	1.1	25.6	0.8	3.6
1981	26.4	5.7	1.3	30.8	0.5	1.9
1982	31.3	6.7	1.8	36.2	0.8	2.6
1983	37.0	7.9	2.2	42.7	0.2	0.5
1984	42.9	8.6	2.8	48.7		
1984c	36.6	8.6	2.6	42.6	8.0	21.9
1985	50.6	8.4	3.1	55.9	12.4	24.5
1986	68.3	10.2	4.6	73.9	15.1	22.1
1987	89.0	11.3	6.6	93.7	-9.5	-10.7
1988	84.2	12.2	9.3	87.1	-2.4	-2.9
1989	84.7	10.8	8.0	87.5	8.3	9.8
1990	95.8	13.6	8.5	100.9		
1990d	92.3	13.4	8.5	97.2	0.0	0.0
1991	97.2	11.9	9.0	100.1	-4.8	-4.9
1992	95.3	10.2	9.9	95.6	4.7	4.9
1993	100.3	12.9	9.9	103.3		
1993e	102.7	13.1	10.4	105.4	4.7	4.6
1994	110.1	11.6	11.9	109.8	4.1	3.7
1995	113.9	13.2	12.1	115.0	-7.8	-6.8
1996	107.2	13.4	12.0	108.6	-2.6	-2.4
1997	106.0	17.7	10.9	112.8	3.1	2.9
1998	115.9	17.6	10.7	122.8	-2.3	-2.0
1999	120.5	14.6	10.1	125.0		
<b>Total</b>					<b>34.7</b>	

Notes: (a) World Bank Debt Tables: External Debt of Developing Countries, 1983-1984, World Bank, 1984. Total All Countries, p2. (b) World Bank Debt Tables: External Debt of Developing Countries, Vol 1, Analysis and Summary Tables, World Bank, 1988, Total All Countries, p2 (c) World Bank Debt Tables: 1991-1992, External Debt of World Bank, 1991 Total Countries, p121. (d) Global Development Finance, 1998, World Bank, 1998. All Developing Countries p15. (e) Global Development Finance, Country Tables, 2000, All Developing Countries p 25.

<sup>23</sup> Correcting the probably typo for 1984 to \$46.6 billion, rather than \$36.6 billion (resulting in total additional dollars paid of \$26.6 billion) and compounding at a 7% rate of interest gives a present day value of these payments of \$61.7 billion.



In the last decade, since 1990, the total impact of currency changes has been to *reduce* borrower indebtedness by \$2.3 billion. Thus although there have been big inter-year changes, these have balance out over the decade.

The bottom-line is that the Bank's borrowing strategy has resulted, in present value terms, in borrowers from IBRD having to repay more dollars to the Bank, than are currently envisaged as the upper bound on *total* debt to be forgiven (*by all involved lenders*) under HIPC<sup>24</sup>.

Definition of "Satisfactory" and Feel Goods: All completed projects are classified by OED (the internal independent Operations Evaluation Department) as Satisfactory (including Marginally Satisfactory) or Unsatisfactory (including Marginally Unsatisfactory). This is really an uncalibrated scale<sup>25</sup>. Moreover, it does not begin to address the key issue for HIPC projects: Will this project provide the foreign exchange needed to amortize the loan?<sup>26</sup> Because accountability is for all practical purposes limited to the members of the full-time and yet over-worked Board, the amortization question appears not to yet have been asked. The suspicion lingers that many "Satisfactory" projects would not have been able to amortize their cost, thus contributing to the "highly indebted" problem.

Related to the above is the belief that because education and health services to the poor are usually deficient, and because studies have shown a causal relations, in the situations studied, between these expenditures and higher incomes, that the Bank is justified in lending for these activities, and borrowers are justified in borrowing. There are three problems with this assumption. The first is that even if higher incomes are generated, these higher incomes may not be capable of being captured to amortize the loan (leading to "high indebtedness" on the part of the borrower). The second is the assumption that because a country borrows for education or health, the result will be better educated children or healthier people. However, the world is littered with projects where health or education building have been built, but have been unstaffed or have lacked the recurrent funding to allow the expected services to be provided. Moreover, there are circumstances where the poor are unable to take advantage of available free education or health services, because they cannot afford to keep children in school, or the time and cost of getting to the service, or indeed the service is so bad that even the poor prefer to use, and pay for, privately provided health services. The third is that few, if any, of the studies that show a relation between education and health; and income, have been based on Bank project experience. Given the vast sums

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<sup>24</sup> The above total refers to all borrowers from IBRD, of whom HIPC countries will have been a fairly minor share, since their poverty has recently debarred them from access to IBRD lending (they have had to rely on the Bank's soft-money arm IDA). However, in the mid-80's when the IBRD borrowing strategy was at its most expensive, many HIPC countries were borrowing from IBRD as well as IDA. It can also be argued, that had the Bank opted for any other borrowing strategy, then interest cost would have been higher. This is true, but the cost of borrowing from the Bank would then have been revealed in the interest rate, not hidden in currency appreciation. Higher, but how much higher? Moreover, it would be nice to think that the Bank knew what it was doing: If it did, the relevant studies and policy directives have not yet appeared in the public domain.

<sup>25</sup> Strenuous efforts have been to make this rating as "objective" as possible, including assigning individual rating for quality at entry, supervision, Bank and borrower performance, etc. However, a subjective element inevitably remains.

<sup>26</sup> It is not implied that the project needs to earn (or save) foreign exchange directly, but if earnings are denominated in domestic currency then to amortize the loan, the local currency earnings need to be sufficient for this purpose at the free market exchange rate.

that have now been spent, it is high time that a clear relationship, in the context of Bank project, be demonstrated.

The Bank (and donor community generally) seems to have forgotten that if you educate a poor person, you have an educated poor person (who may, or may not, be able to better him/her self), if you provide health services you have a healthier poor person, but if you provide remunerative employment, you have a person who is no longer poor. For an organization with a motto "Our dream is a world free of poverty", the Bank puts surprisingly little emphasis on raising incomes.

Weak Project Appraisal/Implementation: It is widely believed, but not well documented, that some part of foreign assistance has been diverted so as to benefit wealthy and powerful individuals, rather than the intended beneficiaries. Again the PHC study cited earlier provides some useful anecdotal evidence:

" While one of the authors was visiting one low income country a prominent newspaper accused the Ministry of Health of misappropriating \$50 million of donor financing. The ministry the next day accused the newspaper of exaggeration and irresponsibility for failing to make clear that this \$50 million was misappropriated over a period of three years, not a single year as the newspaper had implied. in nearly every country one can find rural health clinics completely without drugs while the government (or donor) financed medicines are easily available on the black market. For example, over 70 percent of the government supply of drugs disappeared in Guinea in 1984. Various studies in Cameroon, Uganda and Tanzania estimated that 30 percent of publicly supplied drugs were misappropriated, in one case 30 to 40 percent of public supply was 'withdrawn for private use' by staff."<sup>27</sup>

Such diversion represents a failure of project appraisal. Bank appraisal goes beyond the technical specifications of the project, to include the adequacy of the implementing organization and opportunities for diversion. Again, two views are possible (a) that the borrower failed to use the funds for their intended purpose, or (b) that the lender lent in circumstances where the funds would not be used for their intended purpose. Who is at fault? This depends on which of the above views is felt to dominate.

Pending a revision of the Bank's disclosure policy it is not possible to estimate which, if any, of the above hypotheses are most useful in explaining the emergence of the HIPC problem. It is not the intention of this paper to pick-on PHC. Rather it is thought that the situation in PHC is fairly typical of Bank investments and outcomes. The difference being that other sectors have not been as carefully studied. However, it is worrying that publicly provided PHC is one of the major approved uses for HIPC savings.

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<sup>27</sup> "Health Policy in Poor Countries: Weak Links in the Chain", D. Filmer, J. Hammer, and L. Pritchett, Policy Research Working Paper #1874, World Bank, January, 1998.

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## 8. REMEDIES

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It has been argued that the HIPC initiative will be paid for in the final analysis by poor countries, as funds which would have been devoted to new assistance projects are diverted to write-off the costs of earlier lending.

It has also been argued that sunshine laws provide the best guarantee to taxpayers in donor countries and beneficiaries in poor countries that assets commensurate with borrowing are being created. "Accountability" documents that cannot be read by the general public are a travesty: And all Bank primary reports on project outcomes are currently classified in this way<sup>28</sup>.

Donor agencies, particularly the Bank, need to clearly distinguish between "desirable expenditures" and those that are self-amortizing. Ideally it would be possible for the Bank to lend for desirable expenditures that are self-amortizing. However, substantial lending for non-amortizing desirable expenditures can only lead to more debt-trapped poor countries.

Poor countries also need to learn to say "No!". Loans for wildlife or cultural preservation may reflect donor priorities. Important as these are (and substantial as potential tourist income may be), they should be financed by *grants* from the wealthy countries whose citizens desire to see wildlife and culture preserved in foreign countries.

If an activity is felt to be valuable by donor countries, but is not self-amortizing, then it should be grant not loan financed. A part of the HIPC problem can be traced to the Bank, and other donors, lending for donor priorities rather than activities which would be wealth creating for the borrower.

In the immediate post-war world inter-continental travel (mostly by sea) and poor communications justified Executive Directors being resident in Washington. Today, travel is a minor cost and communications instantaneous. There is no longer a case for a full-time Board. Indeed, it has become counter-productive. Immersed in reports that should never reach the Board, it is distracted from the crucial policy questions such as: What has the Bank achieved? What can we tell the taxpayers? How is performance being measured? How can we improve borrower satisfaction? Where can the Bank add value? And, so on. Management would take more notice of the Board, if it saw them less often. At the very least, the Board should cease its narcissist preoccupation with appraisal reports. Absent this Board interest appraisal reports would go no higher than the country director, and be used primarily as a guide to project implementation.

The redirection asked for in third paragraph in this section (i.e. the need to clearly distinguish between "desirable expenditures" and those that are self-amortizing), requires a radical change in the power-structure within the Bank. Power and leadership needs to be shifted from those who see the Bank's mission as the provision of services needed by the poor (but which, almost by definition, poor countries cannot afford) to those whose expertise will allow poor countries (and particularly the poor within poor countries) to become wealthier. (In the American idiom, to move power from the Ivy League Universities, to the Land Grant Colleges.)

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<sup>28</sup> Some "impact" reports and studies, sometimes based on additional field data and always heavily dependent on the primary ICR and audit reports, are available in the public domain. Even these reports are often edited before being published.

In one area the Bank has moved decisively. It no longer limits its lending to a pool of Bank selected currencies. Single currency loans are now available, allowing the borrower to weigh differences in interest cost against possible currency movements, and to align borrowing with the countries existing dominant foreign exchange transactions. Moreover, the Bank has recently introduced "fixed spread" loans where the Bank carries the risk that its spread over LIBOR will vary. Such loans are initially tied to LIBOR's variable rate, but the Bank is offering swap and hedging facilities which will allow borrowers to switch to a fixed interest loan, to limit their exposure to interest rate changes, or to swap the currency in which their loan is denominated. These are very substantial improvements. They will not eliminate the risks documented in Table 1, but they will help focus the attention of Treasury officials on these risks, and allow them flexibility as to how they are handled.