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International financial institutions
in the 21st century



BANQUE EUROPEENNE D'INVESTISSEMENT
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The evolving role of multilateral development banks: History and prospects

Jannik Lindbaek, Guy Pfeffermann and Neil Gregory

1. Introduction

Like all institutions, international financial institutions (IFIs) (1) are creatures of their past. Their organisation and orientation reflect the economic and political contexts in which they were born and evolved. So, too, will their future be shaped by global trends and the ways they respond to them. In this paper, we trace some of the salient themes from the evolution of the role of IFIs, and identify emerging challenges and future directions as they move into the 21st century. Reflecting our background, we give particular emphasis to their support for private enterprise in developing countries, and to the experience of the International Finance Corporation (IFC) and the World Bank Group.

2. The origins of the species - Before and after Bretton Woods

The notion that the governments of the more affluent nations should help poorer nations improve their standards of living is relatively novel. Until World War II, most of what came to be known as 'developing countries' were colonies. Colonial powers invested to varying degrees in infrastructure, institution-building and relief programs. In the 1930s, the League of Nations had initiated one of the earliest multilateral 'development assistance programs', notably in China (2). Ragnar Nurkse (1953) articulated the League of Nations' intellectual framework as it related to development (3). Thinking focused on publicly directed capital formation as the mainspring of economic advances. The League of Nations never spawned an institution capable of mobilising financial resources for investment in developing countries, but the emphasis on the public sector and physical investment was to dominate thinking about development for a generation.

The creation of the World Bank (International Bank for Reconstruction and Development or IBRD) alongside the International Monetary Fund (IMF) at Bretton Woods in the summer of 1944 - when Paris was still occupied - created the institutional means to translate multilateral financial aid into reality. However, the original draft proposal for an international bank, written in early 1942, made no mention of development. The proposal referred only to a Bank for Reconstruction. When Ed Bernstein of the US Treasury asked what they would do with the bank once reconstruction was over, Harry White threw the question back: "What would you suggest?" "Let's have it [development] there for after", Bernstein said. Out of this afterthought the International Bank for Reconstruction and Development was born (4).

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1) This paper discusses those institutions responsible for long-term development finance, also referred to as multilateral development banks. In order to be consistent with other papers in this volume, we use the abbreviation "IFIs" throughout to describe this group.

2) For example, the League of Nations offered Chinese customs officials technical assistance.

3) In one of the most famous passages he stated that "Capital is made at home", meaning that investment is financed primarily out of domestic savings; foreign savings in the form of development aid or private foreign investment only accounts for a small share of financing.

4) See Kapur et al. (1977). The authors also mention that Paul Samuelson's first edition of his classic textbook, published in 1948, "contained less than three sentences on development (vol. 1, p. 67)".

Not only were the developing countries virtually off the World Bank and Fund's original maps, but the IFIs soon were sidelined by massive Marshall Plan aid. Churchill gave his 'Iron Curtain' speech at Fulton, Missouri, and in early 1947 President Truman pledged US support to anti-Communist forces in Greece, inaugurating the era of containment. The Cold War had begun. Soon thereafter the European Recovery Program, later called 'the Marshall Plan', the 'mother of all economic assistance programs' was initiated. Bilateral US assistance to Europe took off in a spectacular manner, while the World Bank only began to lend substantial sums for development a decade later.

The architecture of the current international financial system has not entirely shaken off the marks of its origins. To say that it was designed for a Keynesian world is not to overplay the role of Lord Keynes in its creation, but rather to draw attention to the economic worldview that underlay it. This worldview was essentially based on a mixed economy, where private enterprise coexists with large, active governments, who take responsibility for aggregate economic outcomes. Governments - central, national governments, to be precise - were expected to regulate and direct economic activity to achieve social goals, such as stable prices and low unemployment.

Insofar as the private sector was considered at all, it was seen as a passive partner, responding to varying government stimuli. It was inherently unstable and short-term, and could not be relied upon for growth and development without heavy government intervention and guidance. Industries such as steel making, coal mining, electricity generation, railways and healthcare were widely perceived as being too important to be left to the private sector, and were generally brought under direct government ownership.

The international financial institutions created at the end of World War II were, and remain, intrinsically intergovernmental.

Hence, the international financial institutions created at the end of World War II were, and remain, intrinsically intergovernmental. The IMF, World Bank, regional development banks, UN, WTO and so on are directed by Boards or Assemblies of government officials. Their equity is wholly provided from government funds, and their goals are determined by public policy. Profitability was not a goal, nor were the interests of the private sector explicitly considered. Development banks could only lend to private enterprises with government sanction and with government guarantees of repayment. Equity financing was unheard of. In practice, they soon concentrated on lending to governments in a cosy symbiotic relationship.

In the early post-war years, this bias towards government-to-government relations seemed immaterial. Communism and socialism were at their zenith, particularly in the post-colonial states of Africa and Asia. Many industrial economies were heavily influenced by socialist movements. Even those, like the USA, which remained firmly wedded to capitalist principles, gave a larger role to the government than ever before - partly as a legacy of the Depression, partly as a legacy of the wartime economy. In most countries, the role of the private sector in the economy was at best neglected, at worst actively disregarded.

The Marshall Plan also influenced development assistance in at least three lasting ways. First, Europe's economic recovery suggested that the Marshall Plan had been effective. Indeed, while it is not possible to say how much credit was due to Marshall Plan assistance, Western Europe's economies recovered at spectacular rates. This perception of success infused development assistance to developing nations when it began in earnest with a 'can-do' spirit. Second, many Marshall Plan

officials later brought their experience to the World Bank. Former British and Dutch colonial officials who became senior officers of the early Bank may have been even more important carriers of development experience to the World Bank. Third, the Marshall Plan aided relatively developed countries, with strong institutional capacity, leading to a neglect of institution building, which proved to be an important barrier to development in less developed countries.

It did not take long for the World Bank and its shareholders to realise that its structure was not suitable for all the needs of its members. This led to the creation of two siblings explicitly designed to be different. First, the Bank's structure was not proving suitable for lending to the private sector. While Keynes' vision for the World Bank had been for it to be more entrepreneurial than other international institutions (5), in practice it had become another part of the international bureaucracy - its capital base subscribed by governments, its borrowing underpinned by additional capital callable from member governments, its directors mostly civil service appointees, its loans all guaranteed by host country governments.

Hence, in 1956, the IFC was formed with the express objective of financing private enterprises. While still wholly-owned by member governments (and hence with virtually the same board of directors as the World Bank), all the IFC's capital was paid in, rather than callable. This enabled it to make equity as well as loan investments (6), and to carry investment risks without sovereign guarantees. To avoid duplication with the World Bank, the IFC was explicitly prohibited from taking government guarantees, and was required to finance productive commercial enterprises, privately managed if not wholly privately owned. To prevent IFC bureaucrats substituting for host government bureaucrats, the IFC was also prohibited from sponsoring projects itself, or being more than a passive minority shareholder. For a long time the IFC remained unique amongst IFIs in this structure and role.

Second, the World Bank's lending terms, while finer than available commercially, were still at near market levels. These terms were determined by the rate at which IBRD could borrow in international finance markets, plus a mark-up (7), to cover the World Bank's administrative costs. This was beyond the capacity of many poor countries to afford. Thus, the Bank's role in poor countries was heavily constrained by limited repayment capacity. The UN floated the idea of a multilateral trust fund to provide finance on highly concessional terms to the poorest countries, funded by the rich countries. While the World Bank was initially reluctant to consider lending at concessional (i.e., subsidised) rates, international pressure to do something for poor countries grew, until the Bank decided that if an international agency was going to do this, "it would be better for it to be done under the work habits and style of the Bank than of some New York-based UN agency" (8). The main donor countries agreed. Hence, the International Development Association (IDA) was born, as a trust fund replenished periodically by donor governments, administered by IBRD. Armed with this new financing 'window', the Bank expanded its lending to poor countries.

Between 1958 and 1966, the World Bank was joined in its mission by a set of regional IFIs, including the Inter-American Development Bank (IDB), the Asian Development Bank (ADB) and the African Development Bank (AfDB). The newly formed European Community launched a multilateral development

5) "I should like to see the Board of the Fund composed of cautious bankers, and the Board of the Bank of imaginative expansionists (Keynes, 1980)".

6) Although the IFC was only permitted to take equity stakes after an amendment to the Articles in 1961.

7) Currently a 0.5 percent spread plus a 0.75 percent commitment fee.

8) See Kapur et al. (1977, vol. 1, p. 12).

program in 1958, and established the European Investment Bank with a mandate which extended to developing countries. At the same time, large bilateral aid programs were directed at the developing countries in the wake of the transition from colonial to independent states. Development assistance had become a large-scale activity, sustained in part by Cold War rivalry.

3. Glory days - The era of investment projects

World Bank activities increased progressively during the 1950s and 1960s. Under the leadership of George Woods (1963-1968) the portfolio of projects branched out into new areas such as agriculture, water supply and education, all the time working through, and lending to, public agencies. A 'big push' occurred during the McNamara years (1968-1981).

As in the case of Marshall aid, this big push in development assistance was accompanied by impressive improvements. Between 1950 and 1975, most developing countries experienced rapid growth. Sub-Saharan Africa was growing at the respectable rate of 2.4 percent per capita per year, and among the developing regions only South Asia was lagging behind. Not only did the developing countries' per capita growth match that in the industrial countries, but social indicators improved markedly. These trends are documented in Morawetz (1977).

During the 1960s and 1970s, the IFIs emphasised the financing of basic public sector infrastructure.

During these decades IFIs emphasised the financing of basic public sector infrastructure 'projects' such as hydroelectric dams, roads and irrigation, some of which played an important role in removing strategic obstacles to economic growth (9). During the McNamara years the World Bank moved into new areas, notably education, health, rural and urban development, and so did the regional IFIs.

4. Years of malaise - The rise of policy-based lending

This 'idyllic' era came to an end in the late 1970s. Inflationary financing of the Vietnam War and of the 'Great Society' followed by two consecutive oil price shocks changed the world economic environment profoundly for the worse. Many industrialised economies, including the United States, experienced slow growth as well as inflation (a combination known as stagflation). With the exception of Japan, the East Asian 'Tigers' and a few oil-exporting countries, most countries went through painful years of slow economic growth. Indeed, growth in most developing countries was not to pick up before the early 1990s (10).

Economic malaise affected development assistance in a number of ways. First, the serious economic problems of most industrial countries (and of the US in particular) (11) overshadowed what interest the public had shown for overseas development issues. Putting one's own house in order came first (12). Second, the damaging oil price hikes of 1973 and 1979, as well as increasingly vocal demands for

9) Focus on public agencies and enterprises is a direct result of the IBRD's Articles of Agreement, which require loans to be guaranteed by borrowing governments.

10) Interestingly (and most importantly), social indicators of development, and first and foremost average life expectancy at birth, continued to improve in spite of adverse economic circumstances. Among the reasons for continued social progress were increased availability of inexpensive medical devices (e.g., rehydration kits), and the fact that knowledge (e.g., boiling drinking water, contraceptive methods, etc.) once acquired is not eroded by economic downturns.

11) European and Japanese support for development assistance was less negatively affected.

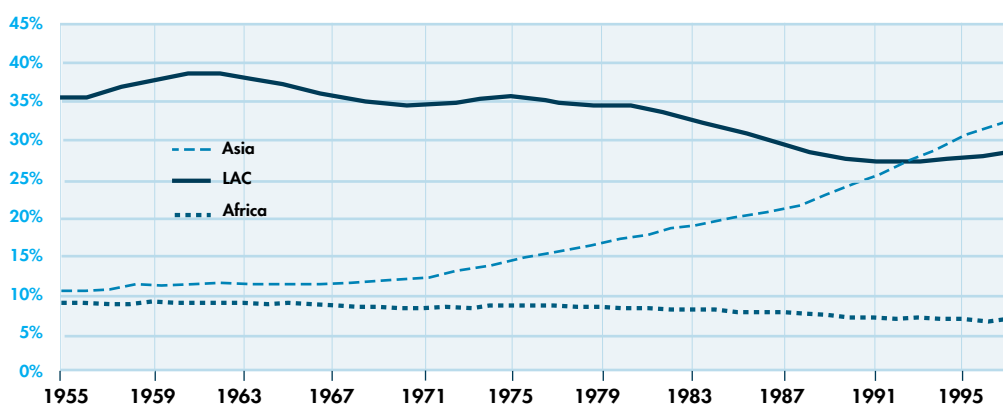
12) Perhaps the most dramatic illustration was the decision by the US government to hike interest rates sharply in 1979. This broke the back of double-digit inflation and laid the foundation of US economic recovery, but also led to the 'debt crisis' and a 'lost decade' for Latin America.

Inflationary financing of the Vietnam War followed by two consecutive oil price shocks changed the world economic environment profoundly for the worse.

a 'New International Economic Order' on the part of developing nations (including members of OPEC) (13), polarised opinion and, on balance, eroded political support for development assistance. Third, poor economic performance in many developing countries (as well as civil unrest and armed conflicts) led to increased scepticism about the efficacy of development assistance IFIs.

Figure 1 shows trends in GDP per capita of developing countries measured in purchasing power parity terms as a proportion of that in the United States. It suggests that of the major developing regions only East Asia managed to reduce the gap with the United States. In other regions slower economic growth and rapid population increases combined to keep the 'development gap' with the industrialised countries widening. Of course, IFIs played only a secondary role in the ups and downs of developing country growth and could not by themselves have prevented the widening of the gap (as noted, "capital is made at home", not by IFIs, and so are economic policies). Still, living conditions in the poorer countries would have been worse in the absence of IFI-supported projects and programs.

Figure 1. GDP per capita, 1955-1996 (as a percentage of the US)



Note: LAC is Latin America and the Caribbean.

Source: Maddison (1995).

The oil price shocks played havoc with the development plans of the majority of oil-importing developing countries. The share of export earnings needed for oil imports suddenly shot up, often leaving little left for capital goods imports, let alone for servicing foreign debts. The international financial institutions responded vigorously. The IMF took the lead. A special oil facility was created under its aegis and IMF programs were extended to a large number of oil-importing developing countries. The World Bank (IBRD and IDA) followed suit, extending an increasing number of 'structural adjustment loans' and 'sectoral adjustment loans' (14). Investment loans typically were disbursed over many years as dams, irrigation districts and other infrastructure projects were built. Much of the aid flows so extended were used for capital goods imports related to the projects, and hence did not

13) For example, the Brundt Commission report recommended a 'development tax' to be levied in OECD countries and to be transferred to developing countries.

14) Structural adjustment loans harked back to the late 1960s when US AID and the World Bank (the latter in the case of Colombia) extended 'program loans'. The essence of such loans was a quid pro quo: foreign exchange and budgetary resources were provided by aid donors while the government of the borrowing country committed itself to carrying out an agreed economic program. As a rule these loans supplemented IMF programs. Sectoral adjustment loans involve similar balance of payments support in exchange for understandings about development programs in particular sectors, e.g., agriculture.

help much in increasing import capacity for oil, food, and other immediate necessities as well as for debt service. The objective of adjustment lending was to restore sustained economic growth as soon as possible, given limited amounts of external financing.

While the World Bank shifted towards adjustment lending, the other IFIs continued to focus on project financing. The essence of adjustment lending (which came to be known as 'policy-based lending') is conditionality; i.e., agreements between IFIs and the borrowing countries that funds will be released only as specific policies are being implemented. Macroeconomic policy changes are typically the most politically sensitive of all. Conditionality requires strong economic staffs as well as the ability to withhold disbursements unless conditions are met. The Bretton Woods institutions are better equipped than the regional IFIs in both respects. Hence, regional IFIs have generally only extended adjustment loans in close co-ordination with the Bretton Woods institutions.

Investment projects were unlikely to yield the expected benefits amidst high inflation, low savings and frequent balance of payments crises.

IFI shareholders, and many in the development community, came to realise increasingly that investment projects were unlikely to yield the expected benefits amidst high inflation, low savings and frequent balance of payments crises. Indeed, sluggish economic growth itself often undermined economic benefits (for example, because expected demand for electric power did not materialise). As attention turned increasingly from project issues to the macro-policy environment (15), engineers, financial analysts and sector economists, who had played a dominant role in shaping development projects, yielded influence to macroeconomists (16). Because of its much greater involvement in macro-policy loans, this shift was more pronounced in the World Bank than in the other development banks. The difference in skill mixes between the World Bank and the other IFIs persists to this day; it has serious implications for the future role of IFIs, which are mentioned below.

With the shift to policy lending the question arose of what policies were to be supported. The World Bank's structural adjustment operations reflect, in the main, economic orthodoxy, which has come

15) Some parts of the World Bank, in particular those dealing with Latin America, had focused on policy conditionality long before 'structural adjustment' appeared on the scene. It had become common practice in the late 1960s to relate large projects as well as - sometimes - the entire lending program in a particular country to economic policy. Hence a tradition of policy conditionality existed in Latin America, which made the shift to structural adjustment lending much easier in that region after 1979.

16) Economists did not always enjoy such prominence. When in the late 1940s Hans Singer, one of the 'pioneers of development', told Joseph Schumpeter that his work in the UN was to be on the problems of underdeveloped countries, his surprised response was: "... but I thought you were an economist". This, in retrospect, may have been a most perceptive reaction. As we note later on, the quality of institutions and of organisations is being recognised as one of the foundations of prosperity; the economics profession may yield to institutional specialists.

17) Consensus policies were summarised by Williamson (1994) as follows:

- Fiscal discipline
- Public expenditure prioritisation, e.g., killing 'white elephants' (uneconomic investment projects), reducing or eliminating subsidies
- Tax reform
- Financial liberalisation
- Unified and competitive exchange rate
- Trade liberalisation
- Liberal foreign direct investment regime
- Privatisation
- Weeding out regulations which do not serve the public interest, and strengthening those that do, such as banking supervision
- Secure property rights without excessive transaction cost.

to be known as the “Washington Consensus” (17). This consensus is built on the new economic paradigm, with governments playing a supporting role to private enterprise-led growth. Empirical evidence shows that towing the consensus line has paid off in more rapid and more sustained growth. In turn, better economic performance enhances aid effectiveness (18). Recognition that aid effectiveness is to no small extent dependent on the quality of policies poses a difficult challenge to aid agencies including IFIs. We mention some of the implications below.

Aid agencies have come a long way from the ‘can-do’ resource transfer days of the Marshall Plan. As large volumes of financing have yielded limited impact, unfulfilled expectations have multiplied, and more challenging questions have been raised about the effectiveness of economic assistance programs. The end of Cold War competition has increased the donors’ willingness to take issues of aid effectiveness seriously.

5. The balance shifts - IFIs and the private sector

The disappointing performance of state-led economic policies throughout the world in the 1950s and 1960s, which was thrown into sharp relief by the crises of the 1970s, led to a gradual disenchantment with the ability of governments to generate growth and development through direct control of the economy. The failure of post-war attempts at government-led growth and development were particularly marked in the less developed countries. Soviet/Chinese-style central planning led to disastrous inefficiencies and shortages; African socialism created dualistic economies where an uncompetitive modern state lived a parasitic existence on the backs of a primitive informal sector; and Latin American protectionism fostered large but weak state enterprises which destroyed value.

These outcomes stood in strong contrast to the rapid progress that took place concurrently in those few countries which let the private sector play more of a leading role in the economy. It is not entirely coincidental that these included countries such as West Germany and Japan where government powers had been deliberately limited following World War II, and capitalist processes transferred from the USA. They also included post-colonial countries which had chosen to build on their colonial legacies as freeports, e.g., Hong Kong and Singapore, and countries which opposed communism for political reasons, and hence rejected its economic approach too, e.g., Taiwan. For a long time, the special circumstances which led these countries to adopt a different approach to economic development disguised the general applicability of their growth experience, but by the 1980s it became clear to most observers that the larger role played by private enterprises in these economies was an important contribution to rapid economic growth.

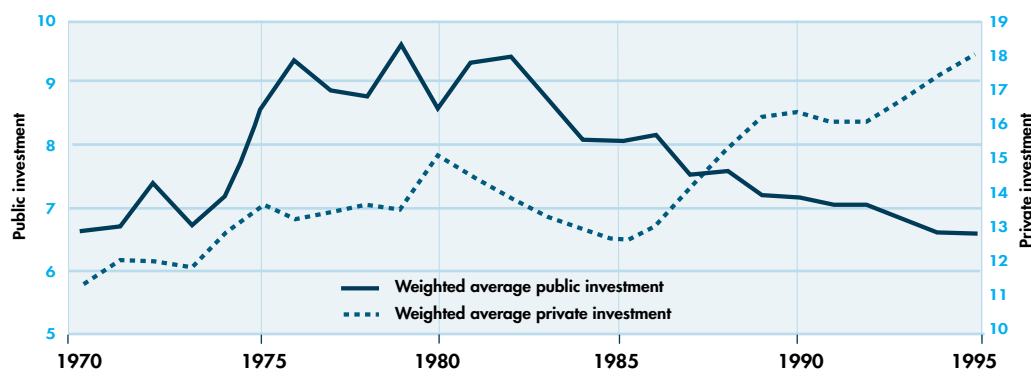
By the late 1970s, the spread of economic stagnation from communist and socialist economies to mixed economies led to an economic paradigm shift from the post-war consensus of state-led growth to the current consensus of private enterprise-led growth. Roles were to be reversed, with governments now in the passive role, simply providing a stable macroeconomic environment and a liberal regulatory framework, with private enterprises providing the dynamic for growth.

Governments were to be in a passive role, with private enterprises providing the dynamic for growth.

18) See, in particular, Burnside and Dollar (1997). The abstract reads: “Foreign aid to developing countries has been criticised as wasteful and even counterproductive. Careful examination of the recent experience with foreign aid shows, however, that it can be an effective investment when a recipient country’s economic policies are sound before aid is provided”.

The results are striking. Figure 2 shows trends in public and private fixed capital formation (note the two different scales) (19).

Figure 2. Annual public vs. private investment growth rates in 30 developing countries, 1970-1995 (in percent)



Source: Bouton and Sumlinski (1996).

Until the mid-1980s, private and public investment tended to move together. In prosperous years both went up as public spending stimulated private demand and private growth increased public revenues, and vice versa. This pattern changed after 1985. Fiscal penury caused in part by high debt service payments forced governments to pare their spending. Typically, current spending (in particular public salaries) were cut less than investment. Consequently, public investment declined by over one-fifth. IFIs have not compensated for this decline by stepping up project lending, in part because borrowers cannot afford the share of project costs, or do not have the institutional capacity to manage the investments (20). Furthermore, the construction of large-scale infrastructure projects has become more problematic and more costly owing to environmental and social concerns. At the same time, the level of private investment has risen, as industries have been transferred to the private sector, deregulation and economic stabilisation have increased growth opportunities, and new sectors such as infrastructure have opened to private investment.

From the beginning, the World Bank and IMF had argued for a larger role for private enterprise than many of its borrowing countries allowed. In its early work in reconstruction, World Bank loans to private enterprises were not uncommon (e.g., Toyota Motors of Japan), but were always guaranteed by the host country government. However, beyond reconstruction needs, governments were reluctant to guarantee loans to private enterprises, preferring to guarantee loans for public enterprises. Once the IFC was created, the World Bank turned its back on financing private enterprises directly. However, it maintained an indirect interest by financing financial intermediaries (development banks and the like) which made loans to private enterprises. Typically, these were structured as lines of credit, with

19) Figure 2 does not capture privatisation, i.e., sales of existing public assets. The focus is on gross fixed capital formation, or new investment. Note, however, the quantitative importance of privatisation: during the period from 1990 to 1996, government revenues from sales of assets totalled nearly USD 160 billion, of which USD 70 billion came from foreign investors, not including the value of assets privatised by way of vouchers (which yielded no direct government revenue). Among the privatised companies are many of the IFIs' traditional public sector borrowers.

20) Not only the poorest countries but most developing countries are showing increasing reluctance to add to public sector debt or to incur guarantees or to take commercial risk, all of which create contingent payment obligations.

government guarantees of repayment from the intermediary. How could the intermediary bear the risk? Often, by being government-owned itself. Implicit government underwriting of losses, lack of profit motive and inability to take credit risks undermined these intermediaries' business judgement. This type of intermediary lending fell into discredit, due to high levels of political interference in the allocation of credit and low repayment rates. The institutions themselves mostly ended up insolvent.

Reflecting the paradigm shift of the early 1980s, recently established IFIs have been more consciously oriented towards financing private investment.

Underlying these lines of credit was the mixed economy philosophy, which legitimised government direction of the allocation of credit. Unfortunately, this provided a cloak for illegitimate diversion of funds to enterprises favoured by politicians or civil servants, for both noble and base reasons. Legitimate direction of credit was based on the mistaken notion that cheap credit, along with protection from imports, would promote faster growth in domestic industries. This growth rarely occurred in a sustained fashion.

Over time, the imperative to lend to developing countries with heavy state dominance of the economy led the World Bank to accept a larger role for public enterprises and financial institutions, all the while arguing for commercial disciplines. When it became apparent that these disciplines were unlikely to emerge, the World Bank became a leading proponent of privatisation, and 'rolling back the frontiers of the state'.

Reflecting the paradigm shift of the early 1980s, recently established IFIs have been more consciously oriented towards financing private investment. The European Bank for Reconstruction and Development's (EBRD) Articles require that 60 percent of its financing be private, non-guaranteed. In recent years, it has consistently exceeded these requirements. In 1989, the IDB spawned an IFC-like affiliate, the Inter-American Investment Corporation. In addition, in the mid-1990s the IDB, ADB and AfDB obtained authorisation to lend for non-guaranteed private investments. At the same time, bilateral support has increased through export credit and guarantee agencies. In total, private sector financing by IFIs and export credit agencies has grown from USD 9.5 billion in 1991 to USD 26.5 billion in 1997.

Direct IFI financial support for the private sector in developing countries has played a key role in facilitating the shift in economic structure towards private investment. Because of their mandate to invest in developing countries even where country risk is high, and their willingness to pioneer new instruments and new sectors, IFI support has opened up a number of new countries and sectors for private investment. Advisory work has focused on improving the environment for foreign direct investment (FDI) (21). A key part of this process has been support for privatisation, which has transformed the economic landscape of the transition economies in particular (22).

IFIs also helped establish the framework for private investment in infrastructure, by working through the difficulties in pioneering transactions. In many countries, the first private power generation plant, or the first cellular telecom franchise, has been supported by an IFI, most often the IFC or EBRD. But very quickly, follow-on transactions are able to proceed without the support of the IFIs (23).

21) See Weigel et al., (1997).

22) For example, from 1992 to 1994, the IFC assisted with the first mass privatisation program in Russia, which sold 14,000 enterprises employing 10.5 million people and created 40 million new shareholders. See Donaldson and Wagle (1995).

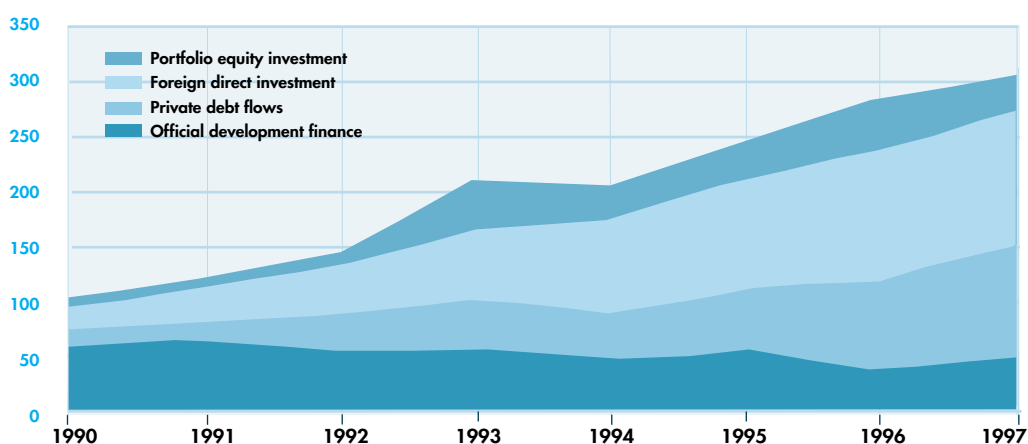
23) See Carter and Bond (1996).

In capital markets, IFIs have promoted new financial instruments, such as leasing (24). IFIs have also encouraged portfolio investment through development of local capital markets, investment funds and the sharing of investment information. The IFC first used the term emerging markets and invented the leading indexes tracking their performance, which have been vital for the development of the fund management industry in this area (25).

The private sector has been a vehicle for capital flows from developed to developing countries from before the beginning of official aid flows. From the oil fields of the Persian Gulf to India's tea plantations to Argentine railroads, foreign investment underpinned the development of industries and supporting infrastructure. During the post-war period, the role of foreign private capital shifted from direct investment to lending to governments. This reflected government antipathy to private enterprise, and particularly to foreign enterprises, which were feared as 'back-door colonisers' or thieves of national wealth. Sovereign lending dried up in the 1980s following the Latin American debt crisis, resulting in an effective disengagement between private investors in developed and developing countries.

In the 1990s, there has been renewed engagement, driven by the new market-friendly paradigm in many developing countries, the lowering of global trade and investment barriers, and the fall in communications and transport costs. These forces have led to the growing integration of world markets for goods, services and capital, a process that has become known as globalisation. As a result, private capital has displaced official development finance as the main source of external financing for developing countries, accounting for 85 percent of the total in 1997, compared to only 41 percent in 1990 (see Figure 3).

Figure 3. Foreign capital flows to developing countries, 1990-1997 (in USD billion)



Source: World Bank (1998).

Also, private investors in industrial countries are looking to diversify their risks internationally and are becoming more sophisticated in their treatment of emerging markets. Whereas ten years ago a mutual fund investor might have selected an emerging market fund, now he or she can select a regional fund, or a sector fund. As a result, the surge in FDI has been accompanied by a surge in portfolio invest-

24) See Carter (1996).

25) About USD 7.5 billion of passively managed funds currently track the IFC Investable and IFC Global Index.

ment. This offers domestic investors scope for raising capital on domestic capital markets, since foreign investors, where allowed in, dramatically increase the size and liquidity of these markets.

As the private sector becomes more experienced in working in emerging markets, this trend is likely to intensify. Private capital flows are increasingly long-term in nature, and are being made available to more private borrowers on increasingly competitive terms. Spreads on emerging markets corporate debt have fallen, while maturities available to borrowers in a number of developing countries have lengthened to over five years (26). Whereas a few years ago most privatisation transactions or private infrastructure concessions drew on IFI advice, now the majority proceeds with private advisors and investors.

Since IFIs generally aim not to displace private investment, they are being forced to push on into new sectors and countries.

This has generated something of a virtuous circle: greater IFI attention to private sector development has brought with it greater private investment. Since IFIs generally aim not to displace private investment, they are being forced to push on into new sectors and countries. Whereas ten years ago the IFC could claim a pioneering role by investing in infrastructure in Argentina, this is now mainstream private business. Today, the IFC's pioneering role involves financing health facilities in Kenya. Once private investors become comfortable with this, the IFC will need to move on again.

The shift in economic structure and the resurgence of private capital flows have challenged the work habits of IFIs in a number of ways. First, it has led to a reallocation of financing from the public project to private project windows, e.g., infrastructure financing. This has left some IFIs with an imbalance of capital and human resources, with the finance and staff still heavily weighted towards the public sector window. IFIs have not been as agile as they might have been in responding to this shift. A particular obstacle has been the constitutional difficulties in shifting capital between uses. For example, the IBRD, IDA and IFC are all legally distinct institutions, and capital transfers require the approval of their shareholders.

Second, private investment banks and venture capital companies have brought new work practices and standards of client service to developing countries. Whereas IFIs could once treat many clients as supplicants, who had no choice but to borrow from them, there is now a wider choice of options. IFIs have discovered that there is a limit to the premium (whether in loan spread, restrictive covenants or processing time) that the market will bear, before borrowers seek private alternatives. Even where there is no private financing available for the particular investment in question, expectations of client responsiveness, speed and quality of service have been raised by greater exposure to private banks.

6. The missing foundation - Institutions, and how to build them

More recently, the limitations of the market paradigm have become evident in many country settings, with weak private sector responses to change in the economic policy environment. The share of private fixed investment in GDP, for example, ranges from 25 percent in some countries to only five percent in others. Even where countries adopt similar, market-friendly policies, differences in private sector responsiveness remain. A key question for IFIs has been to understand why private enterprise

26) This trend appears to have only been temporarily interrupted by the 1997 financial crisis in some Southeast Asian countries.

One of the greatest unsolved challenges for IFIs is how to become more effective in supporting institution-building.

response varies so much. The answer seems to lie to a large extent in the quality of institutions (27). Recent research shows, for example, that two institutional factors are strongly related to investment levels, i.e., the rule of law and corruption (28).

This has helped draw attention to the importance of supporting institutions in fostering private sector growth, drawing on the work of economists such as Douglass North (29). Marshall aid to Europe was successful in large measure because recipient economies had been damaged by war but their institutional capacity remained intact. Post-war reconstruction in Germany and Japan succeeded because of a heavy emphasis on creating stable, effective institutions. Developing countries, especially the poorest ones, and some of the post-communist economies lack much of this institutional capital. These two institutional dimensions are by no means abstract: indexes are compiled routinely which make it possible to rank countries in these respects.

The quality of the institutional framework affects the performance of all forms of financial flows. The World Bank's self-evaluation department identified the quality of 'governance' as a major impact on aid effectiveness. It has become clear that the degree of success, whether in investment projects, adjustment loans or technical assistance, hinges largely on institutional factors. Most recently, the vulnerability of the economies of Southeast Asia have been linked to weak institutions, such as banking regulators, bankruptcy laws and commercial accounting.

Thus, IFIs have moved on from adjustment lending and policy dialogue to give renewed emphasis to building the capacity of domestic institutions (legal systems, customs services, etc.). In the light of the current Asian financial crisis, particular attention is now being given to the importance of strong financial institutions.

However, the performance so far of IFIs in institution-building has been modest. Large sums have been spent on 'technical assistance' with little lasting impact. Much of this money has been spent on expensive expatriate advisers and consultancy studies. Their advice, however technically strong, could not in itself create institutions, which is an inherently endogenous process. Nor can external advisers make much impact where (unlike in post-war Europe and Japan) existing institutions, however weak or dysfunctional, are well entrenched and protected by vested interests.

One of the greatest unsolved challenges for IFIs is how to become more effective in supporting institution-building. Their traditional structures, with an international staff based in one location, visiting clients for short missions, is not conducive to the context-sensitive, high intensity, long gestation work of institution-building. As of today most of them lack the capacity to deliver effective institution-building loans and advice. Even the World Bank, which spearheaded institution-building, first through its investment projects, then by means of policy lending and technical assistance, has only a limited capacity

27) The term 'institutions' refers to the 'rules of the game' - laws, regulations and how they are made and enforced (or not enforced). This includes such important aspects of economic life as enforcement of private contracts by the state, the judiciary, commercial dispute settlement, utilities and banking regulations, and of course, first and foremost the protection of life and property.

28) The rule of law is defined as the degree to which citizens are willing to accept established institutions to make and implement laws and adjudicate disputes, and the presence of 'sound political institutions', a strong court system and provisions for orderly succession of power. See Brunetti and Weder (1997).

29) See North (1990).

in this area. This was brought home when, in the wake of the crisis in East Asia, the World Bank was asked to field more banking and banking supervision experts than it commanded at the time. The same is true to an even greater extent when it comes to help reform judiciary systems, not to mention the broader legal environment. The challenge is greatest for the less broad-based IFIs.

Some, such as the World Bank, are responding by decentralising, changing their skill mix, and developing longer-term, more flexible lending instruments. Some are seeking partnership with local organisations, foundations and bilateral agencies that seem better equipped for this work. Other approaches may emerge.

7. Intellectual leadership - Analysis and advice

One aspect of limited institutional capacity within borrower governments has been the ability to analyse development policy problems, and formulate investment projects. When the World Bank was established, it was expected that borrowers would come forward with well-prepared proposals for appraisal by the Bank. Within a year or two, it became apparent that this was not happening, and the Bank took the fateful decision to take on the role of project preparation itself. This created the modern World Bank in two important senses.

First, project preparation is vastly more staff-intensive than project appraisal. It led the World Bank to build up large technical cadres, initially of engineers and agronomists, then latterly of economists. From there, the Bank worked upstream to develop its own capacity to do sector and country analyses, basic economic research and even data gathering. By the zenith of its staffing in the early 1990s, the Bank's research department had a staff whose quality, quantity and output outshone most university economics' departments. The Bank had become the intellectual leader in the analysis of developing countries. This emphasis on project preparation and economic analysis was emulated, on a narrower basis, by the other IFIs.

Second, it combined the functions of project preparation and appraisal in the same staff and management, without any effective separation. Thus, the Bank became both promoter and investor, or, to put it another way, it was both prosecutor and judge (30). Insofar as borrowing governments were liable for the loan repayments, they retained an independent review function, but even this discipline was weakened in countries receiving IDA finance on near-grant terms. This undermined project quality, due to the lack of disinterested critical review of project design (31). Equally importantly, it led to lack of borrower 'ownership' of project objectives and activities. Eventually, dissatisfaction with the quality of the resulting portfolio led to reviews of project cycles in IFIs, starting with the 1992 Portfolio Management Task Force at the World Bank, led by ex-World Bank Vice-President Willie Wapenhans. This reviewed the quality of the World Bank project portfolio, and found that many projects

30) "Weaker borrowers called for a greater degree of Bank involvement, and in more extreme cases the projects literally were 'Bank' projects. The institution's direct involvement in project identification and preparation was particularly marked in Africa, where, more often than not, the project ideas governments advanced were only peripherally represented in their official public investment programs. The formulation of a full project concept was in most cases the product of Bank identification and preparation missions and was done by Bank-financed or Bank-supervised consultants (Kapoor et al., 1977, vol. 1, p. 36)".

31) This does not mean projects were not subject to extensive scrutiny; on the contrary, the World Bank developed an extensive system of internal review as a substitute for effective external review. However, these reviews have limited influence over the final decision on whether to finance a project.

languished unwanted, unloved and undisbursed, once the Bank had finished its work of designing them and committing the funds.

The World Bank is moving to being a global clearing house of knowledge on development. It may come to separate its roles as supplier of expertise and of finance.

Following the Wapenhans report, the World Bank made explicit efforts to increase borrower ownership of projects, and to strengthen internal review functions to improve 'quality at entry' into the portfolio. At the same time, the Bank has been encouraged by its shareholders to impose more rigorous design standards on loans, particularly in the area of environmental and social impact, and to include a broader range of stakeholders in project design. These trends have tended to counter the aim of increasing borrower responsibility for, and ownership of, project designs.

The world has changed massively since the World Bank was established in the 1940s, such that there are now many universities with excellent development economics departments, and many consultancies offering expertise in the same fields as the Bank. Thus, borrowers and lenders alike are now able to look more outside themselves for expertise. However, they have been slow to do so, since IFIs have established large cadres of experts, whose services are offered free at the point of use by being packaged together with financial services. Thus, when you ask for a loan, you get a package of analytical work and advice with it, which you pay for in the fixed loan charges, whether you use it or not.

The growth in other sources of expertise on development offers scope for a greater plurality of thought and analysis on development, and greater interchange between IFIs and others working in the field. In response to this, the World Bank is moving from a position of being a universal provider of data and analysis to being a global clearing house of knowledge on development, both disseminating its own analytical work, and acting as a broker for the expertise of others. It is also moving towards 'unbundling' its loan and advisory services, allowing countries who do not want to borrow to pay directly for analytical work.

This parallels changes in the structure of private financial institutions, which are increasingly specialising either as arrangers of finance (e.g., investment banks), suppliers of finance (e.g., pension funds, mutual funds, securities markets) or suppliers of information and analysis (rating agencies, research services). Over time, the World Bank may come to separate its roles as a supplier of expertise and a supplier of finance, instead of bundling the two into a single product called a project.

The IFC has always kept a clearer distinction between these roles. Its Articles preclude it from acting as a project sponsor, so it has largely relied on others to develop investment proposals, which it then appraises. In its advisory work, such as on privatisation, it has kept a strict separation from its investment role. Thus, the IFC acts as an adviser on privatisation, or as an investor in the privatised company, but not both at the same time. This has helped it avoid some problems of poor project quality which have afflicted the World Bank. However, in areas like Sub-Saharan Africa, it has limited its ability to find bankable projects. Various schemes have been attempted to help sponsors with project development and implementation (32), but these have been kept at arm's length from the IFC.

32) Including the Africa Project Development Facility, African Management Services Company and Enterprise Support Services for Africa (co-financed with the United Nations Development Program, the AfDB and others).

8. To boldly go ... - IFIs in the 21st century

A report, *Serving a Changing World - Report of the Task Force on Multilateral Development Banks*, was written at the request of the Development Committee in 1996. It contains a useful reminder of the IFIs' role. The role is articulated as follows: "Official development finance - including that of the IFIs - needs to remain an important part of external resource flows to a majority of developing countries. The IFIs must support the policies, the institutions, and the infrastructure necessary to promote broad-based economic growth and efficiency, improve the prospects of the poor, protect the environment, and encourage the development of the private sector. As countries achieve development success, their demands for IFI services are likely to change, and where they gain adequate and reliable access to international capital markets, the IFIs' financial role can be expected to decline" (33). This characterisation of the IFIs' role echoes many of the themes which we have touched upon. It provides a springboard for discussing the future of IFIs in the 21st century.

8.1 Financing development

Between 1990 and 1997, disbursements by official aid agencies have declined from nearly 60 per cent of net long-term resource flows to developing countries to 15 per cent, as well as in absolute terms (34). The decline reflects better access to capital markets by an increasing number of developing countries as well as lesser demand for official assistance in financing public sector investment, such as infrastructure projects.

However, private flows are heavily concentrated on a narrow range of countries, sectors and borrowers: 75 per cent of net private capital flows go to a dozen countries, albeit including the largest developing countries - this leaves over 100 developing countries with little access to private financing. Even in those countries which do receive private capital, borrowing is limited to a small set of 'top tier' countries, and is mainly for extractive industries, infrastructure and financial sector activities. Private flows would be unlikely to meet all the basic needs for better education, health, rural roads and other investments characterised by long gestation periods and low profitability. Thus, while many of the traditional destinations of IFI resources now have access to private finance, there remains a large set of companies, sectors and countries which continue to need IFI involvement to mobilise financing.

This suggests that IFIs will play a more selective role in financing development in the 21st century, focusing on areas not adequately financed from other sources. This poses a dilemma for IFIs, since the findings on aid effectiveness suggest that to achieve greater impact they concentrate assistance on countries where policies and institutions are reasonably supportive of development. These are likely to be the ones that are most attractive to private investors, too. Thus, IFIs will be pushed towards countries where the conditions for investment are more difficult, but at the same time will be more selective about investing in these countries where the prospects of success are poor. The outcome is likely to be a more selective and more limited range of lending opportunities.

This raises the question of whether developing countries with good access to private finance should 'graduate' from IFI borrowing. The tension here is between universality and selectivity. IFIs function best and

IFIs will play a more selective role in financing development in the 21st century.

33) *Summary and Recommendations*, par. 23.

34) See *World Bank (1998)*. *Official flows increased somewhat in the wake of the crisis in East Asia*.

enjoy the broadest political support with a broad set of borrowers. Shareholders like this, because it means IFIs are serving the countries of interest to them; borrowers like this because it means they are well placed to share best practice from a wide range of operational experience. The World Bank, with the widest borrowing membership, is widely regarded as the leading IFI source of knowledge on development.

The graduation point is likely to become more difficult to define, as disparities in the level of development and access to financing can be as great within countries as between countries. There is a huge gulf in living standards between coastal China and the interior, between Sao Paulo and Manaus. Blue chip companies in emerging markets can now access international financial markets, and sometimes obtain even finer terms than governments, while second-tier companies may still need IFI backing. Thus, graduation decisions will need to become more nuanced to reflect finer distinctions than simply whether a country should be eligible to borrow, and on what terms.

Demand for policy-based lending, which remains one of the World Bank's major capabilities, is likely to continue to fluctuate. The size of 'rescue packages' has increased in recent years with each major crisis (Mexico, East Asia). With further liberalisation might come even greater volatility. Some of the regional IFIs contributed to recent 'rescue packages', even though they lack the breadth and depth of the Bretton Woods institutions in this domain and are not in as strong a position to enforce policy conditions. The need for such financing has been felt as much, if not more, among graduates (e.g., Korea), since they are larger economies, and more integrated into the global economy. Thus, IFIs may retain a role as a lender of last resort to countries even where their role in financing investment is past.

8.2 Financing governments

The world of unitary nation states is breaking up under the centrifugal forces of regional blocs and the centripetal forces of decentralisation to subsovereign authorities. At the same time, the centrality of governments in directing economic development is being eroded in many countries by a more assertive civil society, which both seeks to participate in economic decision-making, and offer alternative channels through which financial resources can flow.

IFIs were based on an inter-governmental and international structure. They will have to adapt to work with governmental organisations at both supra-national and sub-national levels. For example, the IMF currently has no mechanism to give the European Central Bank a voice on its Board, yet it will become the most important monetary authority in the world. Only individual European countries have seats. Another example is the increased decentralisation of responsibility to municipal and local authorities. Traditionally, IFIs have only lent to these authorities with central government guarantees. As central governments grant greater fiscal autonomy to local government, this is no longer appropriate.

Already, they are struggling to adapt to the growing role of civil society. With the introduction of an independent inspection mechanism in 1993, the World Bank was the first to allow civil society a direct voice in its investment decisions, albeit only as a channel for complaints by affected parties. At the same time, IFIs have moved towards much greater disclosure of information to the public about their operations. In parallel with this formal approach, the World Bank also engaged more intensively with civil society in its analytical and project preparation work (e.g., poverty assessments with greater participation by the poor themselves), and began to intensify the use of non-governmental

organisations (NGOs) as participants in World Bank projects. However, the tension remains, with such collaboration subject to the host government's endorsement, not least because of the need for government guarantees of any loans. Hybrid multilateral organisations are beginning to bring together NGOs and IFIs in new ways, e.g., the Consultative Group for Assistance to the Poorest, which acts as a co-ordinating mechanism for microfinance schemes managed by NGOs.

8.3 Financing private enterprises

While it is difficult to disentangle cyclical and secular changes, the rise in private financing seems to be driven by fundamental changes in the global economy. For now, there is still a role for IFIs in investing alongside private investors, to provide expertise in appraising and structuring transactions, and a degree of 'comfort', or even formal guarantees, against country risks. There also remains a need to help structure and execute deals - even creditworthy infrastructure projects can prove difficult to close without IFI support. However, as financial markets are becoming more sophisticated about assessing and handling risk, these roles are also likely to diminish.

The roles of assessing and handling risk are also likely to diminish as financial markets become more sophisticated.

Since instability in Southeast Asia continues to emerge, it is too soon to draw conclusions on its impact. However, some initial trends are clear. First, IFIs have been drawn more than ever into supporting reform of institutional frameworks, from banking supervision to provision of government financial information. Second, the private sector has shown increased ability to discriminate between risks, so that the contagion effect on other countries has been limited, and investors are starting to bargain hunt for strong assets within classes of highly distressed assets.

Demographic trends in rich countries - the imperative to save for retirement since taxation-funded schemes will be unable to provide adequate cover - will continue to drive savings rates up and investment returns down in industrial countries, hence encouraging investors to seek higher returns in emerging markets. Hence, IFIs are unlikely to be needed to do 'plain vanilla' investment transactions, but will have a continuing role in helping push the envelope wider, by sector, country and product.

8.4 Advice on development

Reduced demand for IFI services, the unbundling of advisory, transactional and financial services, and the increased selectivity in operations pose questions for the IFIs' future role as advisers to developing countries. In the past, the large scope of operations has enhanced their effectiveness in spreading best practice, i.e., the transfer of useful knowledge from one country to another (35). IFIs will find it more difficult to maintain and develop their knowledge base, which springs in large part from their own transactions experience, if demand for loans declines; likewise, for recipients, technical advice is usually most convincing when it is part of a real-world project. Disembodied or self-standing advice is less likely to convince. IFIs may therefore lose their pre-eminence as sources of expertise on development, and become more facilitators than generators of analysis.

8.5 Building institutions

Institution-building will be a central task in the development process in the 21st century. This poses an immense challenge to IFIs. On one hand, they could develop the structure and expertise to

35) The first question government officials usually ask IFI staff who recommend certain policies or institutional changes is: How did it work elsewhere? This is when real-life examples can be very persuasive.

support this effort. This would require unprecedented change in terms of staffing, organisational structure and financial instruments (36). On the other hand, they could learn to work in partnership with other agents of change, including bilateral agencies and NGOs. This too requires changes in the ways IFIs work, with greater openness and willingness to work as a partner, and more flexible means of financing collaborative work. Either way, IFIs will need to refine their understanding of the institutional context of their work, and improve their ability to assess institutional risk.

8.6 Standard setting

A new role for IFIs has emerged as a result of greater global economic integration, which has created a need for international standards of financial regulation, information and transparency. Since IFIs are already involved in financial market reform, they have been a natural choice for promoting better standards, through analysis and technical assistance.

Likewise, increased awareness of global environmental and social issues has led to the promotion of international standards in these areas, too. Here, IFIs have been targeted for attention due to the environmental and social impact of their own lending activities. Adoption of higher standards in their operations may promote better practice in these areas. It is also having the effect of deterring borrowing from IFIs for projects with significant impacts in these areas.

8.7 Reconstruction

Lastly, IFIs are being called back to their roots to help with reconstruction. In Rwanda, Bosnia, the Democratic Republic of Congo, the West Bank and Gaza, there is a renewed need for financial and institutional support for post-conflict economies. Rapid infusion of resources can play a critical role in creating the conditions for lasting peace, but is difficult to do when the most rudimentary institutions may be lacking. Since low-income countries have been particularly heavily affected by conflict (37), reconstruction will be an important element in achieving poverty reduction. Again, this will challenge the current structure and work processes of IFIs.

8.8 Financing the IFIs

In the light of the various directions in which IFIs might evolve, it is important to recognise the internal financial constraints they face. The IFIs' ability to grow and adapt over the past 50 years has been largely due to their robust financial structure. Endowed by their government shareholders with an equity base and shareholder guarantees (callable capital), they have been able to raise bond finance in large volumes at the finest rates. By charging borrowers a modest spread over these loan costs, they have been able to generate ample budgetary resources to support not only loan processing, but a range of ancillary services. This model does not extend to the concessional funds such as IDA, which remain subject to periodic replenishment. As a result, the room for manoeuvre and innovation in the use of concessional funds has been much more constrained.

36) *Perhaps the League of Nations had it right in the first place when they extended technical assistance to the Chinese customs administration in the 1930s?*

37) *Virtually every low-income country has had a major conflict or borders a country which has had one; 15 of the world's 20 poorest countries have had major conflicts in the past decade.*

The trends outlined above pose a number of threats to the financial structure of IFIs. As noted above, demand for large volumes of non-concessional project financing has declined in those countries with ready access to capital markets, while IFIs may become more selective in the projects they will support, and the countries in which they will operate. This has been partly masked by a temporary demand for policy-based lending. Over the longer term, we are likely to see a secular decline in demand for IFI financing in pure volume terms.

At the same time, there is increasing demand for IFI loans in areas which cost proportionately more to prepare and supervise, such as technical assistance for institution-building, and environmentally and socially sensitive activities. But the decline in private lending margins to developing country borrowers will limit the spread which IFIs can charge on loans. Moreover, there is continued demand for services which have traditionally been financed from the spread on lending: analytical and advisory services, knowledge broking services and data. IFIs are only now experimenting with ways to charge for these services in order to reflect ability to pay.

The net result is that the profitability of IFIs is likely to come under increasing strain, thereby constraining their ability to take on additional roles. Price pressures will encourage further unbundling of services, and direct charging for a greater proportion of services. This will reveal areas where willingness to pay is weak, and which may therefore decline (e.g., basic research, which as a public good is difficult to sell). Insofar as governments want IFIs to continue to provide global public goods such as research, new funding mechanisms may need to be found which share the financing burden amongst all member countries.

Insofar as IFIs continue to provide global public goods such as research, new funding mechanisms may be needed from member countries.

9. Conclusions

Despite enormous progress in many countries over the past half-century, many challenges remain. A growing and migrating population, environmental degradation and growing international integration have created new interdependencies between rich and poor countries. Thus, the imperative for international co-operation is likely to get stronger, rather than weaker. IFIs have proven themselves able to respond to shifting economic paradigms and global trends, and will need to do so again as the new century unfolds.

The business of development assistance has always been complex, even if its full complexity was not well understood at the beginning, and the institutions in existence have rarely been a perfect match for the roles they are required to play. This has led to a continuing process of creating new institutions and reinventing existing ones. It has also led to a continuing temptation for IFIs to take on new roles, without relinquishing old ones.

To some extent, they have been victims of their success: due to their relative efficiency compared to other vehicles of international co-operation, governments have tended to load new tasks onto them, whether or not they are inherently suited to them, while seldom relieving them of existing tasks. But this contains the seeds of their own downfall - an expanding mandate risks a loss of management focus, and clarity of purpose. At the time of the World Bank's 50th anniversary, this dilemma was widely discussed. One analogy offered was that the Bank could be the world's aircraft carrier - large and well-equipped, ready to rise to whatever international challenge its owners put before it. The discussants that mattered - the Governors and Executive Directors - rejected this model, and by pressing budgetary constraints, have encouraged a refocusing on core tasks.

IFIs will need to pursue selectivity and unbundle their services, while becoming more responsive to a changing world.

Looking ahead, IFIs will come under increasing pressure as alternative sources of finance, analysis and advice develop and their profitability declines. This will mitigate against temptations to over-expansion. To fulfil their mandates in the next century, IFIs will need to continue to pursue selectivity and unbundle their services, while becoming more responsive to a rapidly changing, pluralistic and integrated world. Adaptability will be as much a *sine qua non* for the 21st century as it has been until now.

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