American Enterprise Institute for Public Policy Research

March 2005

Regime Change at the World Bank

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Paul Wolfowitz can provide effective leadership for the World Bank by expanding monitored performance grants to poor countries and by rewarding staff members who develop programs that genuinely improve the quality of life for the poor.

President George W. Bush's nomination of Paul Wolfowitz to lead the World Bank is an inspired choice. It suggests that the president's commitment to spreading democracy is not merely rhetorical. It shows also that he recognizes that democracy involves more than the ballot box. Institutional reforms that encourage development of markets, the rule of law, protection of human and property rights, and openness to trade—all these sustain democracy by giving people opportunity, hope, and higher living standards.

Competitive markets and the rule of law help to reduce corruption, which is a problem everywhere, but an especially acute one in developing countries. World Bank estimates suggest that $1 trillion a year is paid in bribes in all countries. Even a small fraction of this would do a lot to improve living standards if spent productively. Democracy, a free press, and the rule of law are antidotes to bribery and corruption.

The World Bank could, and should, play a leading role in making the case for democracy, improved living standards, and the quality of life in the poorest countries of the world. As part of its efforts to spread democracy around the world, the United States and its friends must encourage the bank to set standards for countries that receive its assistance. It should require evidence that loans do not go to tyrants and dictators and that they are used effectively. Democracy and institutional reform do not guarantee good outcomes, but they increase the probability of a good outcome.

Paul Wolfowitz is exceptionally bright, engaging, and imaginative. He knows the developing world and many of its problems from his very successful service as U.S. ambassador to Indonesia. At the time, Indonesia had rapid growth and rampant corruption and cronyism; the latter problems are repeated in many countries. He knows how to function and get things done in a large bureaucracy, as he has shown in his service as deputy secretary of defense. In these positions and others, he has demonstrated a rare ability to introduce new approaches and make them work.

The bank faces plenty of challenges. It is a dysfunctional organization. It has hundreds of programs but little understanding of which are effective, where they work well, and why. At present, the bank does not need a development expert to lead it. It has in its ranks some of the most knowledgeable members of that tribe. What it lacks is effective leadership—someone who asks for, and gets, answers to critical questions, and who marshals the bank's resources to achieve a limited number of important goals.

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Targeting Development Assistance

Development assistance works best when local officials commit to making it work. The success stories are rarely, if ever, the result of outside experts leading the way. The critical word is "incentives." If a local leader wants to improve living standards and the quality of life, the bank can provide support and technical assistance. It must give up the myth that it can negotiate some conditions on its loans and expect them to be implemented. That does not happen unless local leaders choose to make it happen. Often they take the money and run from reforms.

Poverty has declined dramatically in the last decade. The decline is most striking in Asia, especially China and India. Market opening, private investment, and protection of property rights contributed much to the improvement. Local political leaders made many of the reforms that sustained development. Where these spurs to growth and development are weak or absent, as in sub-Saharan Africa, poverty has often increased despite repeated World Bank loans and foreign aid.

The bank has lent \$15 billion–\$30 billion a year for many years. That is a lot of money in countries where many people live on \$1 a day or less. Yet in many of the bank's client countries, after years of lending, numerous villages lack potable water, sanitary sewers, rudimentary education, and immunization against common childhood diseases like measles. The Bush administration, to its credit, fought for monitored grants to work on some of these problems. It introduced the idea of pay for performance—more money comes if projects are completed—so that countries have an incentive to make projects succeed.

One of the most effective incentives is to stop lending to countries that achieve little. Also, the bank should stop lending to countries with investment-grade ratings. Countries like China can borrow in the capital markets at interest rates not much higher than the rates at which the bank borrows. Lending to investment-grade countries and to countries that achieve little should be reallocated to poor countries that undertake to raise their living standards. Of course, the bank should continue to provide technical assistance to countries that do not borrow. Private consultants charge for their services. The bank should do the same in countries that reach investment grade.

A perennial problem in development lending is to know how the country used the loan. Money is fungible. Projects with the highest social or economic return may be used to get a loan from the bank, but they would have been done in any case. The bank's loan supports the project that is at the margin, that would not have been done without the loan. This is a smaller problem for countries that cannot borrow in the capital markets or from international lenders.

In 2001, President Bush recommended, and got, an agreement to replace loans with monitored performance grants to very poor countries. That program should be expanded. Its objective is to achieve minimum standards in very poor countries without burdening them with debts that the poorest have been unable to discharge. The emphasis should be on monitored performance. The loans that the grants replaced were highly concessional, with very generous terms of repayment that represented subsidies of up to 75 percent of the value. The important change is the incentive to perform and succeed.

Bureaucratic Reform

The bank needs many internal changes to become a more successful development bank. Staff incentives should reward development. Almost fifteen years ago, the Wapenhans Report recognized that the bank rewarded lending, so officers and staff had a strong incentive to make loans. Nearly a decade later, the congressionally sponsored International Financial Institution Advisory Commission reached the same conclusion. This should change. Staff should be rewarded for developing programs that raise living standards and improve the quality of life.

Some years ago the bank adopted a matrix form of organization. Technical experts in substance or subject matter share responsibility for programs with country experts. This increases finger-pointing and reduces responsibility for success and failure. The bank should continue to draw on the different skills and sources of information, but centralizing authority and responsibility would improve performance.

The responsibilities of the bank and several regional development banks overlap. A new administration at the bank should consider devolving some of its responsibilities to the regional banks so that it can concentrate on the most difficult problems, such as effective development in sub-Saharan Africa. The bank has developed technical expertise in many areas. These should become a resource for the other development banks, but implementation in Asia or Latin America should become the responsibility of the regional banks.

Paul Wolfowitz can help to reduce poverty and spread democracy by replacing command and control with incentives to reach those goals.

2005-10 #18170