All Eyes on the World Bank

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While China buys a $3 billion stake in private equity giant Blackstone, with the expectation of a 25% annual return, the World Bank is busy lending to China at a 5 % interest rate which does not even cover the Bank's real cost of borrowing. The Bank should not be lending to the world's third largest economy.

While India's corporate multinationals, many State-owned, acquire industrialized nation assets and invest in the developing world to fuel an economy exploding at 10% per annum, the Bank has just doubled its annual lending to India to $3.8 billion, most at a zero interest rate that adds up to a built-in gift of $1.5 billion from industrialized nation taxpayers. In a country where foreign investment is massed on the doorstep, the Bank should not be subsidizing projects the government does not think worth financing at market rates.

While the world reached out at the Millennium to forgive the debt of 18 of the globe's most impoverished economies, the Bank piled on another $10 billion in net new loans, raising their Bank indebtedness by 50%. The Bank should not continue to lend in the same old way with the expectation that its losses will always be made good by rich countries.

As globalization transforms the world economy, the Bank is one of the losers. Its historic comparative advantage is gone and its role inevitably diminished. There are powerful new competitors in the market that do not exact the social and economic strictures the Bank has always sought to impose. Private capital now channels 300 times the funds offered by the Bank to the emerging world and will finance any project the Bank would consider. Nations moving up the economic ladder--China, Brazil, India and Russia--are funding and building infrastructure and industry for even the poorest nations in exchange for access to raw materials and export markets. China alone will send $25 billion to Africa over the next 3 years, 50% more than the funds coming from the Bank.

Bank staffers label these latest lenders “rogue creditors”. But is the world instead dealing with a rogue institution? While presidents come and go, a bureaucracy, hostile to change and clever at manipulating an unwieldy multinational board, is flouting the Bank’s founding articles, bending the rules, distorting the facts, concealing losses and lowering standards. The Bank is desperate to maintain the illusion of relevance to emerging countries that no longer need its money and no longer want its advice.

The Bank was established sixty years ago in financial prehistory. Its core mission was to solve two shortcomings in the global economy: A shortage of money to finance development and a shortage of knowledge in developing nation governments. The Bank would borrow in the world’s financial centers and couple loans with advice to speed the growth of poor countries. In the last 20 years, the world has changed dramatically but the World Bank has refused to change with it. Today, the private sector dwarfs official funding and emerging nation leaders are just as smart, just as skilled and know their countries infinitely better than anyone at the Bank.

At its very inception, the Bank was enjoined from competing with the private sector. Developing economies were to be nourished only until they had gained the financial credentials to attract private capital on their own. This was called “graduating”. But the Bank won’t let go. Eighty percent of loans flow to just 12 middle-income governments led by Turkey, Brazil, Mexico and China. If the Bank stopped lending tomorrow to its big borrowers, no one would notice. It provides only 3/10 of 1% of the funds sent by the private sector.

The Bank is losing its best clients. As the interest subsidy compared to market borrowing has collapsed from 12% per annum to 3%, major emerging nations have shifted from net borrowers of $15 billion in the 1999-2002 period to actually repaying loans of $17 billion over the 2003-2006 timeframe. To stem the tide, the Bank has lowered its interest rates and all but done away with the policy conditions that were the very reason for its lending. When standard subsidies are not tempting enough, the Bank is paying countries to stay on the borrowing list. In behind-the scenes arrangements, rich donor governments pay the interest on behalf of prosperous middle-income borrowers, reducing loan costs to 55 cents on the dollar.

Loans to middle-income countries are clearly good for the Bank's balance sheet and beef up its image of influence. But Bank reasons for continuing to lend to the prosperous are specious and refuted by the facts.

The Bank does not lend as it claims where the poor live. More than half of Bank loans since 2000 flowed to six upper middle income nations where only 10 per cent of the developing world lives---Turkey, Brazil, Mexico, Argentina, Colombia and Romania enjoy a per capita income of more than $8,000 on a purchasing power parity basis.

In the creditworthy countries the Bank courts, the "hard-hearted" private sector is ready and willing to finance pro-poor projects on the same guarantee the Bank demands. If Brazil's full faith and credit is on the line, private capital does not care if the proceeds are used to vaccinate Indians in the Amazon or to build nuclear warheads.

Nor is the Bank the sole source of funds for development projects with long-term horizons. During the past six years, 30 emerging World Bank borrowers have issued bonds in the market with maturities stretching into the future 25 years and more, well beyond the limits of Bank terms.

An outdated ambition, counter-cyclical stabilization of volatile market financing, requires more resources than the Bank can muster. If private flows were to collapse by 50%, Bank funds would still represent less than 1/100th of the total capital moving into middle-income economies.

Far from generating a surplus for the poorest, lending to middle-income nations is draining resources. To compete with the market, the Bank has waived fees and interest spreads reducing its operating margin by 50%. All-in, the Bank does not cover its administrative costs and now loses $500 million per annum on its emerging economy loans. The Bank's reported $1.7 billion net income comes from the $2 billion return on its $37 billion of zero-cost capital.

The Bank must recognize that it is in the development business not the lending business.

Every three years, the industrialized world is required to write a big check to the World Bank to fund the International Development Association (IDA), the arm of the Bank that focuses on 81 of the globe's most underprivileged countries. Zero-interest rates make these loans a 70% gift. The price tag for the 2008 cycle will be $32 billion of which $10 billion is the first installment on a $46 billion debt relief promise to reimburse the Bank for past bad loans. Total US share will be $4-5 billion. A dangerous precedent has been set: Whenever rich nation taxpayers fund the Bank, there is an open-ended obligation to cover future Bank mistakes.

The Bank is not here today to answer hard questions. Like all multilaterals, it is protected by diplomatic immunity. But, at the Bank, the Need to Know is an insider's prerogative that does not extend to world taxpayers---those in the industrialized world that provide the funds and those in the developing world that assume the debt. Governments that borrow are equally content to leave failure and its causes in the shadows.

What do we know about Bank lending to the poor and what doesn't it want us to know? We know that after 60 years and $600 billion, there is little to show for Bank efforts. Bank aid was not behind the impressive economic gains in China, India and Indonesia where all the progress in poverty reduction has been concentrated. We know that for two decades, the Bank continued to pour money into countries clearly unable to repay and concealed the truth by rolling over worthless loans with enough added to cover interest owed until the G-7 governments were forced to assume the debts and to make the Bank whole. We know that the Bank continues to tolerate corruption which, in Africa alone, has diverted between $100 and $500 billion into off-shore bank accounts. We know that the lack of effectiveness of Bank projects is startling. By the Bank's own numbers, 59% of investment programs world-wide and 75% in Africa failed to achieve satisfactory sustainable results over the 1990-99 decade. There is a common thread. The overwhelming priority has been to ship off funds even when there is no deserving destination.

Before handing over for the 15th time still another IDA replenishment, we need to know more and should not be deterred by claims of confidentiality or the cost and complexity of documentation. The Bank's internal Independent Evaluation Group is captive and its findings suspect. Calls for an external performance audit have been stonewalled. We want the answers to questions the Bank is afraid to ask. How many babies were vaccinated? How many miles of roads are functional? How many cubic meters of wastewater are treated? How many children can read?

Transparency and accountability are close at hand on the internet. For every one of the 280 projects the Bank approves each year, there already exist detailed reports in electronic form ready to be delivered to a public website. Disclosure would not be a burden for the Bank. Exhaustive loan approvals set out objectives, technical specifications and estimated costs. Loan completion reports by lending officers are delivered to senior management. Complete audits on 25-30% of programs are executed by the internal evaluation group.

Ghanaian parents will monitor World Bank funding of their children's schools. Zambian farmers will look for roads ready to carry their produce to market. Africa Fighting Malaria and other NGOs will see if the mosquito nets are hanging in place. Opposition politicians and political watchdogs will know if funds and equipment have been spirited away. A whole universe of activist shareholders will keep count every step of the way. The world will be the independent evaluator of the World Bank and reach a collective judgment.