Theme: Governance in Development: The World Bank and IMF at the crossroads

By

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Summary Memo

A major question pertaining to quasi-governmental organizations (QGOs) like the World Bank and IMF is whether they are outdated in terms of their original and/or presently stated objectives. For example, the IMF was set up to "regulate" capital markets and trade; globalization has made a human referee less than influential. Analogously with the World Bank, which, interestingly, had managed to change with the times in an earlier era. It was originally established as the "International Bank for Reconstruction and Development" i.e. to help Europe rebuild after World War II. It then changed in the early seventies into a development bank, an organization dedicated to facilitate capital flows to developing countries (take money where private capital would not go) and remove poverty. Excepting Sub-Saharan Africa, the role of the World Bank is mightily reduced today.

How should the performance of these institutions be evaluated? For both organizations, the criteria are straightforward. For the IMF, performance depends largely upon the frequency of financial crises, and trade imbalances. For example, Thailand current account deficit being large in 1997, or the Chinese trade surplus being large in 2005, are both symptoms of identifiable disorder. What is not well appreciated is that both indicate a failure i.e. Thailand's profligacy and Chinese mercantilism.

Poverty removal is a clearly defined performance criteria for the World Bank. A related criteria is the efficacy of foreign aid (grants by the World Bank) towards development broadly, and poverty removal specifically. While straightforward, the nature of the two institutions makes such evaluations difficult. The two have near monopolistic control over funding, and access to unlimited resources to limit the evaluation of governance at these institutions. A question of who will, or can, regulate the regulator.
Accountability of international organizations like the UN, IMF and the World Bank: The near Impossibility of measurement and execution

This memo is about the standards of evaluation for development institutions. Only recently, in 2001, the IMF set up an operations evaluation unit. Among the first issues this department investigated was the role the IMF played in Argentina, a country that had received numerous loans from the IMF, loans contingent on the policies it had to enact to get these loans. One of the issues examined in the IMF report was whether the advice given to the Argentineans was appropriate to the crisis.

The World Bank has had an Operations Evaluation Unit for about two decades, but it does not have, nor has it had, any real investigative powers. At the UN, the recently concluded Volcker report raised several issues pertaining to governance, and corruption.

These organizations have considerable power and influence to do both right, and wrong. It is difficult to set up an accountability measure for such organizations precisely because they are so powerful and influential. In addition, data or empirical evidence that can be used to evaluate the functioning of these organizations is by itself incomplete, uncertain, and controversial. Which is why precious little has so far been attempted, let alone achieved, with regard to accountability at the QGOs (quasi-governmental organizations). But maybe now is an appropriate time to ask questions.

In his recent book, “The End of Poverty”, Jeffrey Sachs asks for a doubling of aid to the developing countries. The purpose: elimination of absolute poverty in our time. Along with a doubling of aid (from US $ 64 billion annually to US $ 124 billion), the author asks for a tripling of funds (from $ 10 billion to $ 31 billion) to QGOs in the next fifteen years. Sachs also offers a calculation (he calls it “The Simplest Calculation”) to show that this magnitude of funds, if provided, would theoretically eliminate poverty on an ongoing basis.

This example can provide us with several insights regarding the theme of our conference, “Normative and Empirical Evaluation of Global Governance”. The goal of the World Bank is normative: we all believe that poverty should be eradicated. The
World Bank has pursued this goal actively for the last thirty years (since President McNamara’s speech in Nairobi in 1973). Can we empirically evaluate its performance? Yes, we can, and several authors (e.g. Easterly, Raghurajan) have attempted to do just that. The conclusions point to a near zero contribution of aid towards the elimination of absolute poverty. In my book, Imagine there’s no country, I reached the result that some of the World Bank’s findings on the level of absolute poverty could not be replicated. This was especially the case for India, which, according to World Bank, had 35% poverty in 2000, and contributed a third to the global poverty level of 1.1 billion in the same year. For the same poverty line and the same year, the government of India itself, officially, claimed poverty to be a 100 million less, at 26 percent of the population.

Nevertheless, the World Bank’s estimate of poverty is claimed to be accurate, and this by several individuals and organizations, both in India and elsewhere. An example of a straightforward measure of governance e.g. does the QGO lie, or does it brazenly fudge the data. The World Bank also has a near monopoly on the funding of development research, either through its own funding or the funding provided by its sister organizations. Which means that steps to make QGOs accountable are difficult.

In a recent paper, Bhalla(2005), I take the Sachs suggestion seriously and examine the following proposition: since $124 billion is needed today to eliminate poverty, how much was needed, and provided, in the past two decades, both to the developing world, in general, and sub-Saharan Africa, in particular. Somewhat surprisingly, an unambiguous factual answer is that both (developing world and sub-Saharan Africa) have received aid of a magnitude greater than that needed to eliminate absolute poverty for at least the last fifteen years (since 1990!). Given this collective evidence provided by several researchers (most with experience at the QGOs, Raghurajan is presently a managing Director at the IMF) it would seem that defining standards of evaluation, and empirical measures of the same, was a relatively straightforward matter. But it is not.

**Accountability of the IMF**

A clear mandate, purpose, of the IMF is to be an arbiter, a “regulator”, of matters pertaining to exchange rates, international trade, etc. The US currently faces a large balance of payments deficit, and some have contended that a part, perhaps a major part, of the problem is the low, undervalued, exchange rate of the Chinese yuan. The
yuan is currently trading at 8.1 yuan to the US dollar; this is considered a very “cheap” rate, a rate that allows American consumers to import Chinese goods cheaply. This cost advantage to the Chinese means more jobs in China, less elsewhere. Now an exchange rate affects both sides (one man’s ceiling is another woman’s floor) and so it is unclear a priori whether the US dollar is too expensive of the Chinese yuan too cheap. The IMF should have the powers to regulate the exchange rate war; certainly, it is accountable to the community of nations to do so. This regulation is its mandate, yet for the last three years it has been unable to do anything. (See Bhalla(2006) for a detailed analysis).

This example shows that when accountability is clear, and even the preferred path is somewhat unambiguous, it still is nevertheless difficult for a QGO to act. Why? Because accountability and governance runs counter to the wishes of a major “sponsor” of the organization, in this case China.

The above examples illustrate the difficulty not of defining standards, nor of the setting up of standards, but of holding global institutions accountable. These examples pertain to economics, rather than domestic or international politics (e.g. at the UN). As such, greater clarity and accountability should be forthcoming; so far, like the invisible hand, accountability is nowhere to be seen.
References:


