6-2001

Comments on the Report: The United States and the MDBs

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The draft final report is a serious effort to reconcile the many divergent views expressed in Task Force Meetings while retaining substance. The report makes many recommendations and observations that we share wholeheartedly. Examples are:

(1) The report recognizes that the role of the multilateral development banks (MDBs) has declined relatively and absolutely as capital markets have expanded to service developing and emerging countries. Much of the capital flows to a small subset of countries. One reason for this concentration is the absolute size of some developing countries. A more relevant measure, for many purposes, is the number of countries that now have access to the capital markets. This raises the issue of the MDBs core competencies or competitive advantages that the report does not discuss.

(2) The report recommends terminating or phasing out some programs and expanding others such as microlending. In most cases, proposals for new programs are not based on any evidence that markets or local governments cannot or will not supply these services. Competitive advantage, core competency, or some other reason should be advanced to justify MDB programs.

(3) There are many references early in the report to the poor record of MDB accomplishments. The report does not follow by recommending changes in incentive structures to overcome these problems. Similarly, except for recommendation (11c), emphasis on the need for greater transparency and
evaluation of successes and failures does not lead to suggestions for changes in incentives. Good discussions of accountability and audit (Recs. 10, 11b, and 14) are not followed by proposals for changing reward or organizational structures to improve performance. The main exception is recommendation (15) to introduce independent evaluations. This subcontracts the problem but does not resolve it.

(4) There is a good discussion (p. 42) of the reasons micro enterprises have had problems in the past. There is also a good discussion of property rights in rural land (p. 46), but there are no proposals to vest property rights.

(5) The report properly recognizes that there is no consistent and identifiable relationship between MDB effort and progress against poverty. (In some areas of long and intense MDB involvement, such as sub-Saharan Africa, prolonged economic retrogression has in fact been the norm.) The report calls for a higher level of commitment instead of opting for changes such as democratic government -- in which the poor would be represented and their voices heard -- property rights, and the rule of law. The report opts for subsidies and MDB programs instead of empowerment and ownership. Recommendation (8b) does little more than exhort the MDBs to do better.

What Should Be Changed?

When the World Bank was established as one of the Bretton Woods institutions, the widespread belief was that, unless dramatic changes were made, the postwar political and economic order would replicate large parts of the interwar order. One of the Bank’s tasks was to stimulate capital flows and
overcome barriers to private lending from developed to emerging and developing nations.

The facts of postwar experience do not support this reasoning. Developing countries have had difficulty adjusting to too much lending, not too little. The debt crisis of the 1980s and Mexico’s problems in the 1990s are examples. Moreover, countries that have opened their economies and embarked or promised reforms of budgets, regulations, and trade policies have had few difficulties entering the markets for debt, equity, or bank loans.

The report fails to explore the implications of this difference between early anticipations and experience in the past quarter century. It does not inquire whether annual lending at the level of the MDBs is desirable or useful. It does not ask whether U.S. policy should seek to restrict lending to those cases where private markets fail to support governments that open their markets and reform their economies.

Property Rights and the Rule of Law

The U.S. public supports the rule of law, property rights, personal freedom, and representative government. Where countries have moved toward these goals, opened their economies to trade and capital, and reduced regulation and state ownership, progress has followed. The report mentions several of these factors, some more than once. But it does not connect future U.S. support of the MDBs to these objectives. The report, therefore, misses the opportunity to redirect U.S. policy toward the MDBs in a way that is consistent with the public’s widely shared objectives.
Redirection is in our interest and in the interest of the poorest countries. Introducing or greatly strengthening the rule of law, property rights, and political accountability reduces tyranny, corruption, and waste of resources on “prestige” projects and unnecessary military equipment.

U.S. POLICY SHOULD PRESS THE MDBs TO DEMAND SUSTAINED PROGRESS TOWARD THE RULE OF LAW, VESTED AND SECURE PROPERTY RIGHTS, AND REPRESENTATIVE GOVERNMENT.

Environment

The report makes repeated mention of “sustainable development” and protection of the environment. These terms, however, are never defined. No rational person would oppose steps toward environmental protection that raise living standards. No recognition is given, to the trade-off between a better environment and a higher living standard that must often be made.

The proper trade-off for each country cannot be imposed from Washington or by MDBs. We believe that there is a minimum acceptable standard that should be established jointly with representative governments in the developing countries.

The minimum acceptable standard should be the basis for defining “sustainable development.” The minimal acceptable standard should not be the same in countries heavily dependent on extractive industries as in countries with mainly light industry and tourist services. U.S. policy should encourage the establishment of regional and international tradable pollution permits to
encourage economic growth while reducing pollution to the acceptable standard. This is a rational program for resolving conflicts between environmental and developmental concerns.

The report expresses concern about the “alarm” many people feel about the future environment. Such emotive reactions are a poor basis for policy and a poor reason for action. There are many unresolved cognitive and scientific issues about global warming and other environmental risks. These unresolved issues contribute to the difficulty of defining “sustainable development.”

Interagency Duplication

The MDBs have overlapping responsibilities and, at times, duplication of effort. There are costs of duplication without the benefits of effective competition.

Pages 55-57 treat issues of organization and make useful suggestions. But the report does not propose that individual MDBs develop separate areas of competence and excellence. If the MDBs do not specialize, there should be standards for comparing performance. These comparisons should affect funding.

Marginal Returns

The report sets out some of the experience in sustaining projects after MDB funding ends. The record is not good. Many projects terminate or deteriorate after funding stops. (p. 52)

Despite this poor record of sustaining objectives, the report (and the MDBs) greatly overstate their achievements. The reason is that often the most
promising projects are presented for funding at the MDBs. Some of these projects would have high priority, so they are not on the margin.

Since funding can be transferred, within limits, between programs and projects, the marginal project funded by the MDB often differs from the projects in the application. The marginal projects may have lower success rates than the projects for which funds are granted. As a result, it is difficult to know within a wide range what the development banks achieve. It is less than they report.

Charges for Services

The MDBs provide consulting services to governments. Private consultants provide competing services. A major difference is that the private consultants charge for their service, and the MDBs do not. Why does this persist? Should the MDBs charge for their consulting services and meet a market test?

Moral Hazard

The top half of p. 32 discusses loan guarantees. Guarantees raise issues of moral hazard, in this case the hazard of encouraging the behavior that they wish to avoid. Is there reason to believe that loan guarantees will not subsidize risky behavior? Why not insist on political and economic reforms to reduce the risk of default?

Conclusion

We believe that the U.S. should take the lead to:

(1) increase the role of capital markets;
(2) phase out the MDBs over time;
(3) provide incentives to improve performance and achievements;
(4) eliminate duplication by developing core competencies at the
World Bank and the regional banks; and
(5) encourage representative government, rule of law, property rights,
and open markets.

Nicholas Eberstadt asks to be associated with these comments.
Victor Frank asks to be associated with these comments except as noted in
his submission.