THE ROLE AND EFFECTIVENESS OF THE WORLD BANK IN COMBATING GLOBAL POVERTY

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THE ROLE AND EFFECTIVENESS OF THE WORLD BANK IN COMBATING GLOBAL POVERTY

Tuesday, May 22, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 3 p.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Present: Representatives Frank, Velazquez, Watt, Sherman, Scott, Green, Cleaver, Moore of Wisconsin; Bachus, Castle, Paul, Gillmor, Garrett, Neugebauer, and Marchant.

The CHAIRMAN. The hearing will come to order. I apologize for the delay. We had votes scheduled at just the wrong time and I thank the panel for indulging us. This is the first in a series of hearings, and I do want to say—because obviously the World Bank has gotten somewhat more attention of late than it had previously. But I will say that this hearing began in a conversation that Dr. Stiglitz and I had at Davos in January. We have long had an interest here, the ranking member and myself, with two of the four members, along with a former colleague from Iowa, and our current colleague from California, who pushed hard for the debt relief at a time when there was some resistance to it.

This committee's concern and the concern of many of the members with a more effective use of the international financial institutions for the fight against poverty is long standing, and I do want to say that this is not an opportunistic hearing. I will say as an elected official, though, that I do not mean by that to denigrate opportunism as a mode of operation. I don't want to be saying something that could be used against me later. But in this case we really had been thinking about this for some time, and this is the first in a series of hearings we are going to have about the role that the international institutions, financial institutions, can play in the war against poverty. I think it is important to reaffirm that it is possible, through thoughtful action, to reduce poverty. Not to abolish it or eliminate it—we are not in the miracle business—but to substantially reduce it.

I believe, as do many others, that we have existing institutions which are, (A), imperfect and, (B), indispensable, and therefore it is our job to do what we can to improve them without going after them in a most negative way. When I first began involved in this we had the campaign called "50 Years Is Enough." Well, we now know that 60 years is too little, not in terms of duration, but in terms of activity, and there are some very important issues that we plan to deal with.

On the question of the Bank, there was a legitimate set of concerns about what role the IMF should be playing as things have evolved from when it was first set up. There were problems of excessive conditionality. Many of us, on the Democratic side in particular, have been concerned about what appears to be a bias against the rights of workers that has crept into some of the activity. There is a question about how you fight corruption effectively, and how you fight corruption in a way that does not make people who live in corrupt countries double victims of corruption—victims first when people steal money that was meant for them, and victims again when people then withhold any further money from them. We need to be able to sharpen that fight against corruption so that we go after those who are really the problem.

There is the question of the extractive industries, of the failure of mineral wealth to benefit the large numbers of people whom it ought to, and all of those are things we are going to study on an ongoing basis.

I have 2 minutes left in my statement, and I am going to yield it to the gentleman from California, and then in a step that the parliamentarian tells me is okay, I am going to give up my second 5 minutes. The ranking member and I have 10 minutes each, and we both agreed not to extend the time. I appreciate that because we do have a little bit of a truncation. I am going to divide my 5 minutes up among the witnesses because I don't know that all of the testimony will be summarized within 5 minutes. And at this point I recognize the ranking member, the gentleman from Alabama.

Mr. BACHUS. I thank the chairman. I welcome our panel, and I am going to make my remarks very brief because if I realize anything, it is that our four panelists all know more about this subject than I do, so I am going to spend my time listening.

I would make one comment. Dave Beckmann—who is one of the panelists—and I worked very hard on debt relief, and his book "Grace at the Table" was one of the books that inspired me to become involved. And in that book, one of the questions asked is, what will the United States and our generation be remembered for? Will it be—if we are leaders in the world, or we are to display leadership, what do we do with that leadership, what influence do we have? And I think it is becoming more and more apparent to all of us that it is in our best interest to improve the plight of people all over the world. Global poverty is a threat not only to the citizens of the poor countries, but it is a threat to the rest of us, as well.

And I will close with this one fact, prior to the Taliban's takeover in Afghanistan, according to many of the world surveys, Afghanistan was the poorest uneducated country in the world. Almost none of the young women in Afghanistan had ever seen a school and about 75 percent of young men had never set foot in a classroom. And it was into this vacuum that the Taliban came. And as we know, they filled that vacuum with something that was really a threat to all freedom-loving people. When they told the Afghan people that you are not educated—you are not capable of educating your children, you can't afford to do it, so we will educate them. And they taught the young children in Afghanistan really a doctrine of hate, and it didn't isolate that situation to Afghanistan. It affects all of us. And throughout many parts of our world today, that same doctrine, those same forces are going into countries where there is a lack of education and infrastructure, and they are taking advantage of that. As opposed to nothing happening in that country, in those countries, what is happening in those countries is dangerous, which is actually far worse than nothing happening.

So I think it is definitely in not only in the best interest of those countries, but in the best interest of our own national security to see that those countries are stable and that they have that basic education and as a consequence, as we know, different rights and freedoms are respected.

Thank you, Mr. Chairman.

The CHAIRMAN. I now recognize for 2 minutes the gentleman from California, Mr. Sherman.

Mr. SHERMAN. Thank you, Mr. Chairman. The world goes gaga because one guy at the World Bank gets $195,000 for his paramour. The press ignores the fact that the World Bank is on schedule to disburse $1.3 billion—a substantial portion of which is American money—to the Iranian government, and that some $270 million was disbursed to the Islamic republic during Wolfowitz's short tenure. The Administration has substantial clout with the World Bank purchased at the expense of the American taxpayer. It used it first to install Wolfowitz, then to back him as he tried to back the World Bank out of family planning, and then finally used up every bit of clout in an all-out effort to help him save his job.

The Administration has done nothing to try to stop the loan agreements or the disbursements. Now it is true that the Administration voted against the loans, but they were required to do so by law. So perhaps we should consider ourselves blessed that no one in the Administration was willing to commit a crime in order to assist the Islamic Republic of Iran. Not only do these laws provide resources to the government of Iran, they also give it the Good Housekeeping seal of approval. How can we convince the Iranian people that they will be cut off from the world if they continue to develop nuclear weapons when they are getting money from the World Bank, some of it ours?

In addition, governments stay in power by bringing home the bacon. We know how to stay in office, that is why we are sitting up here, and it is by bringing home the bacon even though it is not halal or kosher. The Islamic republic is bringing home the bacon from the World Bank, part of it ours.

We will go back to the Floor of the House, I hope, and vote for foreign aid as I have again and again and hope that our constituents don't realize that a portion of that foreign aid is going to a government that is developing nuclear weapons.

I yield back.

The CHAIRMAN. The ranking member of the Subcommittee on Domestic and International Monetary Policy, Trade, and Technology, the gentleman from Texas, is recognized for 3 minutes.

Mr. PAUL. Thank you, Mr. Chairman. Of all the elements of the Bretton Woods system, perhaps the most enduring has been the World Bank and its associated institutions. Although highly regarded in some circles, the Bank has been a significant failure in helping the residents of poor and developing nations. Like many bureaucracies, the World Bank has constantly attempted to reinvent itself and redefine its mission. Some critics have referred to this as mission creep. It is the reaction of self-interested bureaucrats who are intent on saving their jobs at all costs. The non-institutional elements of Bretton Woods, such as the gold backed dollar standard, have gone by the wayside, but the World Bank and IMF soldier on.

What is most annoying about the World Bank are the criticisms alleging that the Bank and its actions demonstrate the negative side of free market capitalism. Nothing could be further from the truth. The World Bank is not an organization devoted to capitalism or to the free market but to state-run corporate capitalism. Established and managed by a multitude of national governments, the World Bank promotes managed trade by which politically connected individuals and corporations enrich themselves at the expense of the poor and the middle class.

Western governments tax their citizens to fund the World Bank, lend this money to corrupt third-world dictators who abscond with the funds, and then demand repayment, which is extracted through taxation from the poor third-world citizens rather than from the government officials who are responsible for the embezzlement. It is in essence a global transfer of wealth from the poor to the rich. Taxpayers around the world are forced to subsidize the lavish lifestyle of third-world dictators and highly paid World Bank bureaucrats who don't even have to pay income taxes.

The World Bank has outlived its intended purpose. Capital markets are flush with money and well-developed enough to lend money not just to national governments but to local and regional development projects at competitive market rates.

In the aftermath of Mr. Wolfowitz's departure, much will be made of the question of his successor when the questioning instead should be directed toward the phasing out of the organization. And I yield back.

The CHAIRMAN. The gentleman from New Jersey is recognized for the remaining 2 minutes.

Mr. GARRETT. Thank you, Mr. Chairman, for holding this hearing today. I thank the witnesses in advance. While the World Bank was created with the direct mission to make loans and grant loans to low- and middle-income countries to reduce poverty and promote economic development, and that is an admirable goal and one I support, unfortunately the World Bank has become, as many have said already, a bloated bureaucracy that is increasingly moving its focus away from its core mission. Desmond Lachman, a resident fellow at the American Enterprise Institute, states, "By extending its mandate, the Bank has not only lost focus of its primary goal of poverty reduction, but has also made it difficult to hold the Bank accountable for its core activities." He goes on to say that it might be in the World Bank's best interest to narrow its focus, suggesting that "These narrow goals might include the eradication of debilitating illnesses like malaria, feeding the hungry and supplying clean water."

Another way that I believe the World Bank has ventured away from its original charter is by focusing too much of their resources on making loans to middle-income countries such as China and India. These countries already have access to vast amounts of private investment capital and should no longer need the World Bank's help in financing infrastructure improvement. Approximately 50 percent of the loans made in 2006 went to just five countries, China and India included.

Mr. Chairman, I believe the World Bank is an organization that is still trapped in the 20th century and has not moved forward with the times. Studies have shown that its past record shows that it is a failure in many of the countries it has been involved in. New York University concludes, studies show, that those countries that have been the largest recipients of World Bank loans have performed no better, and oftentimes worse, than those countries which did not receive the Bank's favor. And to make matters worse, those countries like China, India, which have ignored the Bank's nostrums, comfortably outperform those countries like Russia and Argentina, which were more receptive to the world advice, as has been stated.

Finally, I do applaud outgoing President Wolfowitz for trying to rein in the out-of-control corruption within the organization. The anti-corruption agenda has been a primary objective of this Administration, but I do hope that whoever his successor comes in line that he will continue to focus on this important problem.

And with that, Mr. Chairman, I yield back the balance of my time.

The CHAIRMAN. I thank the gentleman. I thank all of the members for their cooperation. We will begin with Dr. Stiglitz. I have 5 minutes remaining and I am going to yield a minute-and-a-quarter to each of the witnesses, so each witness will have 6.25 minutes. This is useful stuff. That may not seem like much, but it is when you start talking. So each witness will get 6.25 minutes. I will tell the timekeeper. Dr. Stiglitz.

STATEMENT OF DR. JOSEPH E. STIGLITZ, PROFESSOR, COLUMBIA UNIVERSITY, AND CHAIR, COLUMBIA UNIVERSITY'S COMMITTEE ON GLOBAL THOUGHT

Mr. STIGLITZ. Thank you very much for holding these hearings. I want to agree with the sentiment that you expressed in the beginning, that America and the world have a strong interest in contributing to reducing poverty and promoting growth in the developing world. Aid can be an effective instrument in achieving these objectives.

The multilateral institutions, of which the World Bank is the premier lending institution, play an important role in this global effort. For a variety of reasons, assistance administered through the World Bank and other multilateral institutions can be even more effective in achieving our objectives than assistance provided by the United States directly. This is especially true at the current time, when American credibility, especially in the developing countries, has sunk to an all-time low.

The question is, is the World Bank today playing the role that it should be playing? And if not, what can be done about it? Even before the recent turmoil within the institution, there was considerable concern about its direction. Large numbers of its senior people have departed in the past 2 years. The most important asset of the institution is its staff, its human capital, and it will take years to replace what has been lost.

I want this afternoon, however, to focus on broader, though not totally unrelated issues: How the World Bank should conduct its business, what the development agenda should be, and what the United States can do to help ensure that this happens.

It is in our interest that the World Bank remain strong, credible, and effective. The Bank has greatly emphasized good governance in corruption, but the Bank can only be effective if it is seen as having good governance itself. There has to be confidence that there is not corruption in the corruption agenda, that there is not a hidden political agenda with corruption in some countries being overlooked, while in other countries there is a policy of virtually zero tolerance.

Finally, part of democratic values is due process. The implementation of a corruption agenda itself must conform to the highest standards. With the resignation of its president, the question is the choice of successor and, most importantly, the process by which this is done.

Good governance and the commitment to basic democratic values requires that the head of the institution be chosen in an open and transparent process. It should be the most qualified person for the job regardless of race, gender, or nationality. It is in America's interest that the head of the institution not simply be chosen by the President of the United States.

There are other important changes in the governance of the World Bank and other multilateral institutions that will increase their effectiveness. These require careful balance, more democratic accountability, and strengthening procedural safeguards.

There are reforms to the governance of the Bank, the need for which the present scandal has highlighted. I want to comment briefly on them. On the positive side, the review process shows that the Board could exercise its fiduciary role even in a very difficult situation where the largest shareholder was not fully supportive, by setting up a committee that included four members from developing and transition economies. In spite of the pressures that were brought to bear, 22 of the 24 directors concurred with the finding of the panel and, realizing that the wellbeing of the Bank required that the President had to go, supported that action.

On the negative side, it is clear that the president of the World Bank had enormous elements of discretion in making appointments, in circumventing rules, in suspending loan programs, and in directing bank programs, with insufficient checks and balances in place and insufficient oversight. Some of the systems designed to provide the checks and balances are clearly flawed, with offices that might receive complaints about presidential abuses actually reporting to the president. Fears of retribution against whistleblowers or those raising complaints were not totally unfounded. The powers of the president had previously not been abused in this way, but the fact they could be abused also highlights a fundamental flaw in governance.

Reform will require careful balancing. There needs to be more accountability of the World Bank, both to the Board and to other stakeholders, including donor countries, but this has to be done in ways that avoid excessive politicization of the institution. The Bank has created one of the most talented and qualified bureaucracies around the world; bureaucratic procedures have been put into place that ensure that by and large they attract and choose highly qualified applicants. But left to themselves, the bureaucratic safeguards could lead to an entrenched bureaucracy pursuing its own agenda or insufficiently flexible to adapt to changing circumstances, including new learning about the costs and benefits of privatization and liberalization, new attitudes about country ownership, or new agendas, such as those concerning worker rights.

The Board, working with the president, must establish what the Bank's overall agenda and priorities will be. As I argue below, this agenda must be more balanced and more consistent with our own values and our own practices. While the Bank is likely to continue to be focused on promoting growth and poverty alleviation, it is inevitable that there will be changing views on how that can most effectively be done.

The Board, and not just the president, must play a central role in constructing and approving this agenda, and then ensuring that the president and the staff of the Bank implement that agenda in an effective and consistent way. At the same time, the checks and balances and safeguards against abuses by the president of the World Bank have to be strengthened. In the text, I provide details on how that might be done. There are problems in both internal and external governance that I discuss in the text.

International economic institutions like the World Bank are at some distance from direct accountability. To address this problem, at least three actions are required. Responsibility for the World Bank should shift from Treasury to USAID or should be shared with USAID. This is a practice followed by many other countries, and it is essential if the developmental perspective is to remain paramount in dealings with the World Bank.

Second, there needs to be more parliamentary/congressional oversight. The appropriate form of this oversight will need to be worked out. A committee of the parliaments/congresses, including donor and recipient countries, could be formed to review the agenda and procedures and to discuss widely perceived grievances.

Third, there needs to be more transparency and public oversight of decisions, both before and after they are made.

These reforms—and there are many other reforms in governance which I have discussed elsewhere—are, I would argue, as much in the interest of the United States as they are in the interests of the world as a whole.

No system is perfect. A president determined to evade the set of safeguards put into place may still be able to do so, even after those are strengthened. Humans are fallible and so are the institutions that they create.

I want to turn to more specific aspects of the World Bank agenda, beginning with corruption. Fighting corruption requires more than just speeches; it requires a comprehensive agenda that includes the development of policies that reduce the scope for corruption. There are ways that the United States and other advanced industrial countries can contribute to the fight against corruption, most notably strictly enforcing anti-bribery laws, eliminating bank secrecy, not just for terrorists but also for tax evasion and corruption, and demanding transparency in payments to governments by, for instance, using the Tax Code to enforce the Extractive Industries Transparency Initiatives.

Successful development requires, however, more than just attacking corruption. Aid effectiveness can be undermined not just by corruption but by incompetence or by the absence of the appropriate complementary policies. It requires a comprehensive development agenda.

There also needs to be country ownership of development policies, programs, and strategies. Excessive conditionality undermines this and development effectiveness. While the conditions that have been imposed have been reduced, in many cases they still remain excessive.

IMF cross-conditionality is especially problematic, and even as up-front conditionality has been reduced, new forms of hidden conditionality have been introduced through the IDA allocation formulae. These formulae fail to deliver aid to where it is likely to be either most needed or most effective.

The challenge to the World Bank and other aid agencies when confronting a country with poor governance is to find alternative delivery mechanisms for aid. It is bad enough that the people in these countries are suffering from poor governance. To be doubly punished by denying aid would seem unfair, especially if there are alternative ways by which assistance can be provided, especially in health and education—investments in the youth of these countries. The problem is that the conditionalities that—

The CHAIRMAN. You will need to sum up, please, Dr. Stiglitz. You need to sum up.

Mr. STIGLITZ. Okay. The problem is that the conditionalities that have been imposed in the past have in some cases actually reduced aid effectiveness. Moreover, these imposed policies represent values that are contrary to those that are held by the vast majority of Americans. The disparity between what we require of others and what we do ourselves further undermines the credibility of the institution and aid effectiveness.

Thank you.

[The prepared statement of Dr. Stiglitz can be found on page 53 of the appendix.]

The CHAIRMAN. Next, Dr. Robert Hunter Wade, who is a professor of political economy at the Development Studies Institute, London School of Economics and Political Science. Dr. Wade.

STATEMENT OF DR. ROBERT HUNTER WADE, PROFESSOR OF POLITICAL ECONOMY, THE DEVELOPMENT STUDIES INSTITUTE, LONDON SCHOOL OF ECONOMICS AND POLITICAL SCIENCE

Mr. WADE. Thank you. I want to step back from the concerns that Joe Stiglitz was talking about and address the current deep crisis of relevance that the World Bank is facing. The Bank's market has changed fundamentally in the past decade, but the Bank continues to operate in much the same way and with much the same products as a decade ago. The change in the Bank's market was dramatically symbolized just last week while the U.S. and European governments were fighting over President Wolfowitz's future. At that same time, the African Development Bank held its annual meeting not in Africa, but in Shanghai. This event will be looked back upon as a milestone in the history of the 21st century.

The main message of my testimony is that the World Bank can potentially add much more value to the solution of some of the world's most urgent problems than it has been doing and, secondly, that the U.S. Congress and the next Administration can help the Bank do so by signaling strong support for a revived World Bank.

In the immediate future, that signal of strong support means supporting the current Administration and selecting a first-rate candidate as the next president, a candidate with an excellent record as the leader and manager of a large complex organization. That criterion would knock out some of the names on the current short lists.

And secondly, congressional support means the Congress paying over the still outstanding U.S. payments on the IDA 14. Looking beyond the immediate future, the Congress should support the World Bank in taking more of a leadership role in several genuinely global areas. In its traditional products of aid projects and economic advice to governments of developing countries, the World Bank's market has changed in the sense that it now faces a whole array of new competitors supplying much the same kind of products, such as China and Korea, which have become big sources of financial assistance to poorer countries, such as private consulting firms which have developed superior skills in many of the Bank's traditional areas of expertise, such as banking and finance, and also such as the Gates Foundation and other private philanthropic foundations which have become big players in this financial assistance game.

But given all that, the Bank still retains a big comparative advantage over these other entities, which is based on its combination of: (A), intergovernmental guarantees; (B), its own large revenue base; and, (C), its global reach. This combination makes the World Bank almost unique. And in particular, I suggest that the Bank should take a leading role in addressing one of the biggest specific issues of our time, which is how to get economic growth with much less by way of carbon emissions, how to decouple economic growth from carbon emissions.

The Bank has a lot of experience in formulating economic policies, translating them into investment plans, and translating the plans into investments on the ground, and it should use this general experience to take the conclusions of reports like the IPCC reports and the Stern report and then translate those general conclusions into what they mean for specific countries, such as China, India, Bangladesh, Brazil, and so on, and then to help those governments work out country programs focused on decoupling their economic growth from their emissions. This task would be a relatively new task for the Bank and it would require the Bank to develop new financing instruments in order to accelerate the take-up of environmentally friendly technologies. For example, the Bank could establish a carbon fund, a fund which would, for example, allow a developing country such as China or India to borrow from the Bank for a power station and to choose a state-of-the-art technology for that power station, a state-of-the-art technology, reduction technology, even though that technology is more expensive. But with this fund, rather than the government of the country having to bear the incremental cost, such a fund could be used to accelerate the uptake of climate friendly investments in the power sector, in transportation, railways for Africa, for example, in forestry and land use practices, and in still other sectors.

Some of the finance for this fund could come immediately, tomorrow, straight from the World Bank's current reserves. The World Bank currently has $36 billion in reserves. It needs only $25 billion in order to retain its all-important AAA credit rating, so the balance between—or much of the balance between the $25 billion that it needs and the $36 billion in reserves that it has could go into such a climate stabilizing fund. This fund could also receive grants from OECD governments, from private foundations and the like.

This is just one small example of how the Bank could be playing a significant catalytic role in addressing international environmental issues generally and climate change in particular. To do this, to reposition itself in this way, it would have to undertake some pretty big internal changes and to develop some new streams of revenue. I leave the details of how I think the Bank could do these two things to the written testimony.

The bottom line of what I am saying is that even though, if we were starting fresh in 1944, we would surely not start with the present World Bank. But the present World Bank is what we have to work with, and I suggest that the present World Bank does need U.S. support to reposition itself in order to fulfill the valuable role that it is almost uniquely able to play in the world.

And just to address directly Mr. Paul's point about how capital markets, private capital markets are now growing to the point where they can take care of all the tasks that the World Bank might do, I suggest that in this area of meeting these genuinely global problems, providing what economists call global public goods, capital markets, private capital markets are not going to do the job. For that job to be met, there is plenty of scope for a multilateral public institution like the World Bank.

Thank you.

[The prepared statement of Dr. Wade can be found on page 67 of the appendix.]

The CHAIRMAN. Thank you, Dr. Wade.

Next, Mr. David Beckmann, the president of Bread for the World.

STATEMENT OF DAVID BECKMANN, PRESIDENT, BREAD FOR THE WORLD

Mr. BECKMANN. Thank you, Chairman Frank, Ranking Member Bachus, and members of the committee. I am honored by this opportunity to testify before you on the role of the World Bank in overcoming world poverty.

The world is making progress against poverty. The Bank just announced that we are now down below 1 billion people in the world who are living in what it calls extreme poverty. That is still a terrible number, but in 1980, they estimated that the number was 1.5 billion. So we live at a time where we can see dramatic progress against hunger, poverty, and disease, and the World Bank is playing a critical role in that great liberation.

I have a relatively positive view of the World Bank, and it is built on 30 years of working with the Bank in various capacities. I worked in the Bank for 15 years in operations, and then I was a speech writer for the president of the Bank in the early 1980's. Then I led the Bank's engagement with civil society around the world. In the late 1980's, it was a fringy idea that the Bank should not just deal with governments.

I have been at Bread for the World for 15 years. I think you know that Bread for the World is a large citizens' movement that organizes people and churches across the country to lobby Congress on issues that are important to poor people around the world and also in our own country.

At Bread for the World, we have continued to focus on the World Bank, and in the early 1990's, we did our part to try to get the Bank to focus more explicitly on poverty reduction, and to make the Bank more transparent and accountable. At the end of the decade, we chaired the legislative coalition for the Jubilee campaign. On all of those issues, this committee has played an important leadership role, and, in fact, the Bank today is more focused on poverty than it was when I worked there.

It is more accountable and more participatory than it used to be, and I think the Bank's leadership of the debt reduction initiative in general has been just excellent in reducing impossible debts, and doing it in a way that really has fostered economic growth, especially among poor people. Right now, Bread for the World is campaigning to change the U.S. farm bill in ways that would be good for rural America and rural Africa, too, and some of the analysis behind that campaign comes straight out of the World Bank.

It is hard to figure out the World Bank. It is a complicated institution. But I have been feeling different limbs of this beast for 30 years, and I have come to a deep appreciation for the Bank. Now any institution has its weaknesses, but I want to highlight five strengths. First, the World Bank is focused on reducing poverty. You can see the effect of that most clearly by where the money goes. If you compare the Bank to, say, AID, the Bank's aid money goes much more to low-income developing countries. The Bank does all kinds of things. It may be working on policies that facilitate the private sector, to develop capital markets, but staff always have to link that back to the overarching purpose of poverty reduction.

A second strength is that the Bank has improved and adapted over time. Dr. Stiglitz has criticized the Bank, and I think it is clear that the Bank listened to that criticism and has made some adaptations so it is a stronger institution now. He is probably not satisfied with all that they have done, but it is clear that they have listened to him and have made some adaptations. That is one example.

Third, the Bank is an extraordinary center of knowledge. Even when I don't agree with the Bank, I check what they are thinking.

Fourth, the Bank's governance structure works fairly well. It is a compromise. The governments that put in the most money get the most power, but all the governments that are members get to sit at the table and be part of the discussion. And it seems to me that, remarkably, most decisions are made on the basis of reasoned debate.

And finally, the Bank evaluates itself. The independent operations evaluation department concludes that three-quarters of the Bank's operations are satisfactory, so there is a lot of room for improvement. But I don't know of any other institution in international development that is so self-critical and so open to learning from its own experience.

Now, looking to the future, I would highlight three recommendations. First, I think the binding constraint on progress against world poverty is still a lack of political commitment in developing countries and also in the industrialized countries, and there are things that you can do that build political commitment over time. For example, you can set up institutions—strengthen non-governmental and governmental institutions that represent the interests of the poor. The Bank does a lot to build political commitment, and I would like to see a systematic review of what it is doing to deal with this fundamental constraint and what it could appropriately do to provide stronger leadership.

Second, I would recommend that the Bank not adopt a bunch of new initiatives right now. In my judgment, Jim Wolfensohn launched more new initiatives than the Bank could effectively absorb. The Wolfowitz controversy has really caused some damage, so I think the Bank should focus on implementing the priorities that are already in place, notably, continuing the turnaround in Africa, changing the Bank's role in the middle-income countries, and curtailing corruption.

And then finally, the new president of the Bank needs to get all of the Bank's diverse stakeholders, notably the Board and staff of the Bank, to start working together again. I think the way to do that is fundamentally to focus on the mission, because the Bank's mission of reducing poverty is compelling to all different kinds of people. As the chairman and ranking member of this committee show, this is a mission that people of different political persuasions are drawn to. Virtually all the governments of the world say that they want to reduce poverty.

I am a minister of religion as well as an economist, and all of the world's religions and ethical traditions know that what is happening in the world to reduce extreme poverty is sacred business. The transition that is happening at the World Bank is a turning point not only for the Bank, but for the world's progress against poverty.

The CHAIRMAN. Sum up, please, Dr. Beckmann.

Mr. BECKMANN. I think it is incumbent on all of us to play our various roles to strengthen the Bank and to make it a yet more effective instrument in overcoming poverty.

[The prepared statement of Mr. Beckmann can be found on page 40 of the appendix.]

The CHAIRMAN. Thank you. And finally, our once and future witness, I know his face is familiar to many of us in a number of capacities, but he is here today as the co-chair of the Atlantic Council Commission on Transatlantic Leadership for a New Global Economy. Stuart Eizenstat.

STATEMENT OF AMBASSADOR STUART E. EIZENSTAT, CO-CHAIR, ATLANTIC COUNCIL COMMISSION ON TRANSATLANTIC LEADERSHIP FOR A NEW GLOBAL ECONOMY

Mr. EIZENSTAT. Mr. Chairman, and Ranking Member Bachus, I am appearing as co-chair of a bipartisan commission with Grant Aldonas from the Atlantic Council, looking at ways in which Europe and the United States can transform all of the international financial institutions in light of the major changes that have occurred in the world's economy. I will focus on the World Bank, and to some extent, the IMF.

The international economy has undergone radical changes in the past 50 years, with economic power shifting south and east, but the World Bank and IMF have not sufficiently taken this into account. Today, China, India, Brazil, Russia, and other emerging countries represent 45 percent of global GDP, 40 percent of world exports, and 65 percent of the world's foreign exchanges. And yet they have much less of a central role in global economic governance than their economic importance dictates.

Another major change is the remarkable growth of global private financial markets increasingly available to developing nations without the time delays and conditionality from the World Bank and IMF. For example, in 2005, the amount of private debt and equity flows to sub-Saharan Africa, one of the poorest places in the world, dwarfed the amount of money spent by the World Bank. Another development is the new entrants into overseas development assistance, particularly from China, which is building infrastructure projects all over the world for political and economic reasons, not to benefit the countries involved, with no conditionality, using oftentimes their own workers, not the indigenous workers, to build the very projects they are funding.

All of these changes impose significant challenges for the World Bank and the IMF, including the desire of emerging economies to have more input into their governance. At the same time, our Commission strongly believes that the Bank and the Fund continue to be highly relevant. No other private or public institution, for example, can do the kind of macroeconomic surveillance as the IMF to prevent future global crises. And for the Bank, over half-a-billion people have risen above the poverty line over the last decade. While there are many reasons for that, the Bank's programs have played a role.

In addition, private lenders want their borrowing country clients to belong to the IMF and World Bank, and the World Bank still has a major role in long term financing for infrastructure. I was doing work for BP on the BTC pipeline in Azerbaijan, Georgia, and Turkey. There is no question but that having gotten World Bank financing in part for that project elevated the social and environmental standards of the project.

No private capital will finance many of the projects that are now financed through the world's IDA program. It is the world's premiere poverty focused aid agency, with 81 of the world's poorest countries, 40 in Africa, IDA-eligible. IDA has a greater capacity to deliver developmental assistance on a larger scale and in more sectors than any other agency in the world, and certainly than the private sector. No other private or public institution can address complex cross-sectoral issues like IDA, like, for example, linkages between macrostabilization and banking sector reform. Nevertheless, the World Bank faces challenges which require significant reform.

And permit me to summarize briefly our Atlantic Council Commission's recommendations. Number one, the top leadership of the World Bank and IMF should be chosen on the basis of merit, not nationality. Since their creations, this has been a monopoly for Europe and the United States—Europe for the IMF, the United States for the World Bank. This is antiquated and unfair. It doesn't recognize the growth of African, Latin American, and Asian countries. And moreover, with the special focus of the World Bank on development and poverty alleviation, it doesn't produce leaders who have the expertise in those areas. Indeed, it can lead nations to go the other way, like Chavez is trying to do, by creating a new body called the Bank of the South.

With Paul Wolfowitz's departure, President Bush can send a powerful signal to the world that he is turning a corner on American unilateralism by throwing open the contest to the entire world and supporting the best candidate, regardless of nationality. That would turn the tragedy of the Wolfowitz incident into a plus for America's image in the world and for the future management of the world economy.

Second, the World Bank and IMF governance should reflect actual economic power and influence. Emerging economic powers in Asia and Latin America are seriously underrepresented in voting power and board representation. If developing countries and emerging economic powerhouses are to take these institutions seriously, they must be given a genuine leadership role.

And we recommended, therefore, in our Commission, two reforms to rectify this imbalance. First, European representation should be consolidated into two seats, an EU Euro zone, and an EU non-Euro zone seat. European countries are highly overrepresented, with 7 directorships out of the total of 24.

Second, we recommend that the U.S. and European representation be rebalanced in terms of voting shares. Third, there is serious confusion and overlap in the World Bank and IMF programs, with inadequate consultation and coordination. The Bank and the Fund have responded to changes in the international environment by reaching out beyond their mandates. Since they work in many of the same countries at the same time, this leads to inefficient overlap in their programs. We found that there was insufficient coordination between staffs, often going to the same countries at the same time. This costs public assets, gives conflicting advice to recipient nations, and fails to meet the needs of members.

For example, the Fund's financing activities in low-income countries have moved beyond their core responsibilities, and overlap with the Bank's work in development finance. The Fund, for example, is moving into areas beyond their core capability, like civil service reform, land and energy sector reform, privatization, and judicial reform that are the Bank's responsibilities. We recommend to rectify this the following: A clear delineation of responsibilities between the Bank and the Fund, each focusing on their core strengths, not based on the income of the recipient countries. We felt, for example, that the IMF should gradually withdraw from providing long-term baseline financing in low-income countries, and focus instead on short-term balance of payments financing and global imbalances.

Next, the Atlantic Council recommended closer coordination between the Fund and the Bank by double-hatting executive directors. It does not make sense, at a time when there is a lack of cooperation, Mr. Chairman, to have separate executive directors serving for the board of the Bank and for the Fund. By appointing the same person to serve as an executive director at both, you assure greater coordination and collaboration and reduce duplication of programs.

Third, even with this, we think that is not enough, and that there should be an eventual merger of the organizations no later than 2030. The Malan Report suggests a number of ways to achieve greater collaboration, but these simply will not achieve the degree of coordination without a merger. There are simply inherent overlaps only a merger could alleviate. For example, the Fund needs to take into account the sectoral level and composition of public funding, which is within the Bank's responsibility, to achieve macroeconomic stability. Their work overlaps and duplicates of necessity. This means that the IMF and the—

The CHAIRMAN. We will need you to sum up, Mr. Eizenstat.

Mr. EIZENSTAT. —Bank should be under the same roof. And last, greater accountability. The way to achieve greater accountability is to follow a recommendation of the Meltzer Commission for an independent performance audit, or even better, a group like the GAO, the Government Accounting Office, inside the Bank for continuous evaluation of its programs. Also, the emphasis that both Jim Wolfensohn and Paul Wolfowitz placed on anti-corruption efforts is essential for sustainable development. The World Bank estimates there are a trillion dollars a year paid in bribes to all countries. The approach may be open to debate, but the necessity is clearly there.

[The prepared statement of Mr. Eizenstat can be found on page 44 of the appendix.]

The CHAIRMAN. Let me apologize to the witnesses, but ask a favor of them. We have some votes that are going to take probably about 40 minutes. I would hope the witnesses could stay. If you have to get back and out of town, I understand that. If you are from Washington, the day's probably shot anyway, so you might as well hang out. This is a very important hearing. We have had very good testimony. I promise you this committee plans to stay with this. If you can stay, I appreciate it. I plan to come back. Some others will. We will have maybe another hour when we come back. And if not, obviously you are entitled, you were already here, you thought you were at 2:00. But I just want to thank all of you.

If you can stay, this has been very insightful. I promise you your time is not going to be wasted. I think you are going to find this committee engaging very seriously with the range of things that you said. So we are going to recess for about 40 minutes, but we are going to come back. And if you can stay, I appreciate it, and thank you.

[Recess]

The CHAIRMAN. I am going to begin with some questions. As I listened to the testimony, I believe there is a piece of legislation here, maybe several. For example, the President could appoint the same person, I assume, to be the ED, but we could also change the law to make that an appointment. That could be done statutorily. Dr. Stiglitz had a number of legislative suggestions, and I think we can work with those. There are some restrictions, obviously, in terms of members of the Bank staff themselves testifying. But one of the things that I did in 1993, when I chaired this subcommittee, was to convene a meeting of parliamentarians who were interested in the World Bank. I am going to indulge both myself and the ranking member, and we can make this more of a conversation, if that is acceptable to everybody. One of the things that struck me when I was first a member and then when I became subcommittee chairman was the point that Dr. Stiglitz talked about, that these important institutions, and you all talked about the political and economic and social aspects of them, but they are run entirely by finance ministries. Neither the diplomatic side nor the social justice side are involved, and the parliamentarians were excluded.

I remember at one point suggesting during the Clinton Administration that we invite the State Department to testify on some things, because some members had some concerns about this. And the Treasury Department was very unhappy about that and reacted, I thought, unfortunately, in a kind of turf way. Well, we are not going to deal with that anymore. And one of the things I did was to convene a meeting of parliamentarians from 25 countries or so. There were some people very interested. And we had a meeting in this room and it seemed, in my mind, to be the beginning of a parliamentarians group. We did have officials of the Bank and the IMF come before us, because it was not any one parliament. That is when we began talking about what we had already begun to work on—the inspection panel and some other things.

Unfortunately, from my standpoint, from a number of perspectives, that meeting was the first and the last, because I called that meeting in the summer of 1994 as chairman, and presided over it in December of 1994 as the lame duck, soon to be ex-chairman. But I think there is a great deal of bipartisanship in the respect I mentioned. I said that Mr. Bachus and I, Mr. Leach, and Ms. Waters, worked closely together. And we are going to get back in this business in a serious way. So let me just ask a couple of these questions, and then I would share the time with my colleague.

Let me ask Dr. Stiglitz, Dr. Wade correctly pointed out the challenge of trying to promote growth without increasing carbon emissions. And obviously, the World Bank seems to be one of the forums in which we can deal with that, because you have the problem—Dr. Stiglitz talked about it in his testimony, and others have talked about it—obviously, you have this dilemma of how do you treat the disparity in carbon emissions between the rich countries and the poor countries? And clearly great growth will come there. What is the ratio? How do you meet the argument that no, you can't just treat everybody equally when they start so unequally? It would seem to me that the Bank would be a very important place in which we could do this, including the environmental fund. Is that still functional? And that could be a piece of it.

But another one that I am particularly interested in is important domestically and also internationally, and I will ask Dr. Stiglitz, and that is equally important is to show that we can make growth compatible—that growth does not mean increasing inequality. And there is the question of equality or increased inequality, since nobody is talking about equality in this system, but what degree of inequality you get. There is inequality between and among countries. But it seems to me increasingly here that unless we can deal with inequality within countries, we will not have the political support we need to try to diminish equality between nations. And I have talked about a bargain between business and some of us on the liberal side. I think we are beginning to see the possibilities here, but it is still in the early stages. Trade and immigration are two areas where there are the beginnings of compromise between liberals and the business community, two elements that I think would be in the interests of what we are trying to promote, but there is a lot of resistance to them by people who are still skeptical that they are not going to get burned.

Now one of the areas that did strike me was a kind of cultural lag or is it the vampire reappearing? There had been this view, we had hoped that the World Bank and the IMF would stop trying to impose a particular kind of political economic orthodoxy, the Washington consensus, on countries, and we did seem to be making progress. It seemed that the picture of Mr. Camdessus standing over the president of Indonesia with his arms folded would not be repeated. And it wasn't—obviously, it was a picture taken out of context, but it came at a time when there were these attacks.

Some people have argued, and I would ask all of you who watched this, that the Bank and IMF, to some extent, but the Bank particularly, is slipping back into that, that we are seeing a kind of conditionality that represents a set of particular policy choices, in this case, ideologically conservative ones, but ideologically, liberal ones could be as much of a problem both because they interfere with the notion the countries are really deciding what to do. But also for any of us because they, in my judgment, exacerbate some of the problems we have had of growth and inequality.

Are we getting back into the kind of conditionality, Dr. Stiglitz, that you complained about, and we thought was receding?

Mr. STIGLITZ. Yes, I think there is some concern about that. One of the things I emphasized in my talk that we have become aware of in recent years is that in the IDA allocation formula, there were some hidden conditionalities. That is to say, the formula that determined who got aid was based on how well countries were doing on certain measures, and how well they were doing in those measures was, in effect, determined by how well they were doing in conforming to the Washington consensus policies.

One of the ironies is that a lot of these measures are about good governance, and part of good governance is being transparent, but the measures themselves were not transparent, so there is almost an internal inconsistency. But when they became transparent, we realized the extent to which they were actually advancing some of the old-style conditionalities.

I think the point that you raised is correct, that there has been a step backwards, that there had been a reduction in the set of conditionalities. There is a sense that in the last couple of years conditionalities have increased, or at least pressure has increased. What is particularly of concern is the fact that there are a number of conditions that have been imposed that are very inconsistent with the way that we, in fact, conduct economic policy in the United States. For instance, we have a central bank, a Federal Reserve, that focuses on inflation, unemployment, and economic growth. There is a three-partite macromonetary policy. One of the conditions that is often imposed, particularly with IMF cross-conditionality, is that central banks in other countries are supposed to only focus on inflation. The conditionalities require that they don't pay any attention to employment or to economic growth.

As another example, something which in the past has been a great deal of trouble and is still, to some extent, is that the IMF and the World Bank push privatization of Social Security. The United States had a big debate about privatization of Social Security. Different people came out with different views, but the country as a whole came out on the side that we didn't want to privatize Social Security. Thus, the question is, are we forcing other countries to do something that we rejected, in the sense that a very significant fraction of Americans said no, this is not the right economic policy. Incidentally, as an economist, I also thought that privatization was a bad economic policy.

The third topic that I talked about in my written testimony is this issue of worker rights and worker conditions. There is a lot—

The CHAIRMAN. Which I put into the country policy example.

Mr. STIGLITZ. Exactly. The point is that they put on things like labor market flexibility, which is often a code word for letting labor wages go down and unions being weakened, but nothing was said about core labor standards, so there was nothing to balance the debate. My view is that there should be discussions about the pros and cons and an awareness of the economic and political arguments, but labor market flexibility should not be demanded as a matter of conditionality.

The CHAIRMAN. Thank you. I find that flexibility is often a quality that people find very desirable in others. Any of the other panelists? Mr. Eizenstat.

Mr. EIZENSTAT. Well, I was in the Administration as Under Secretary of State at the time of the Asian financial crisis, and I certainly saw some of the negative impacts of the conditions that were imposed and the manner in which they were imposed. And we ended up trying to pull together programs to ameliorate some of the cuts in social programs. At the same time, I think we shouldn't go to the other extreme and think that IDA or other grants and loans should be made without conditions. That is exactly what the Chinese are doing. There need to be conditions to assure that the funds are properly used—transparency, anti-corruption, good macroeconomic policy—or the money simply goes down a hole. So I think that there needs to be a proper balance.

I would also say that for all the mistakes that were made during the Asian financial crisis, and there were mistakes made, that those countries did bounce back very quickly, and they now have, in many cases, current account surpluses, and good macroeconomic policies, much better than they did before. They are much more alert to exchange rate problems, in part because of the conditionality. So I would urge that we not throw the baby out with the bath water when we talk about conditionality and just look at what the Chinese are doing with no—

The CHAIRMAN. That is a fair point. I think it is something of a distinction to some extent, and I am talking a procedural, substantive one. The conditions you talk about are procedural, but not in a superficial sense, transparency and honesty. I think that is an appropriate overall balance. I think the kinds of conditionality to which I have objected and others, they were both too specific and too ideological, that you—that those are the kinds of conditions you want to avoid, that you want to recognize a legitimate set of policy choices, but yes, I think we should be clear that doesn't mean that you ignore whether the money is just being wasted, whether there is corruption, or whether there is a lack of any kind of openness to let you know that.

Any of the others? Yes, Dr. Wade.

Mr. WADE. In 2005, the World Bank published a 350-page report called "Economic Growth in the 1990's: Learning From a Decade of Reforms." So this was the Bank's effort to write down what had been learned from the experiences in the 1990's. And the main conclusion of this 350-page report was that we have learned that one size does not fit all. We must be more pragmatic in the kind of advice that is given, more contingent, make it more contingent on country circumstances, and so on. On the basis of this report, some economists declared that the Washington's consensus is dead; nobody believes it anymore. I think that is quite misleading, because if you look not at what the World Bank says in its reports, but at what country directors say to their counterparts in government, they still tend to be pushing a rather hard, and I have to say quite ideological, version of the Washington consensus.

The CHAIRMAN. And inappropriately, so you would say.

Mr. WADE. Yes, inappropriately. The idea that there must be completely free trade, just sort of get the government out, privatize everything that can be privatized, and so on, a hard version of the Washington consensus. So that is where you have to look. And that is—and when you look there, you see that bank country operatives are still pushing this agenda.

The second point I want to make is that quite a lot of the thrust for sort of homogenization of a one-size-fits-all kind these days, and since the Asian crisis, is coming from the IMF in the forms of the codification of standards of good or best practice in banking, in financial regulation, in corporate governance, and in data dissemination. These are universal standards, they are comprehensive standards, and the IMF's business now is undertaking surveillance of all economies to see to what extent these economies are complying with these standards. And that, I think, has some quite worrying negative consequences, as well as some desirable.

The CHAIRMAN. What is the enforcement? Is it that the Bank then picks up on the IMF standards and enforces them? Because the IMF by itself, absent a crisis, do they have any enforcement on those? What is the enforcement mechanism?

Mr. WADE. No. There is some formal enforcement through IMF conditionality and also cross-conditionality with the Bank, but the main enforcement mechanism is an informal one through market signals. That is, the idea is that this information of compliance with the standards is made available to market participants, and they will then react and will be more favorable towards countries that comply more and will punish countries that comply less. That is the mechanism, the main mechanism.

The CHAIRMAN. Yes, Mr. Beckmann.

Mr. BECKMANN. Can I address the first comment you made about governance, and how to get social concerns, equitable growth, and how the governance—

The CHAIRMAN. When we get down to five members, you can pretty much do whatever you want. Since you stayed so long, we owe you.

Mr. BECKMANN. Well, just on that, the governance of foreign assistance within the U.S. Government is a mess. We haven't had a reauthorization of foreign assistance since 1961, so the U.S. Government has been making its development assistance and foreign aid policy through the appropriations process in an ad hoc way, and that has been debilitating. The Bush Administration's response to some of the debilitation of AID has been to start new agencies, so we have now the MCA and PEPFAR and AID. And then the MDB's; the U.S.'s representative within the multilateral banks is from Treasury.

I think we ought to have a cabinet-level department, as the U.K. does, a Department of International Development. It wouldn't work, as Dr. Stiglitz suggested, that the MDB's should be governed from AID; AID is too low in the bureaucracy. And now especially, it is really dominated by the State Department's objectives, so that doesn't really work. But I am hoping that in 2009 we are going to see a comprehensive reauthorization of foreign assistance. Fundamentally, what is needed is for the President and the Congress of the United States to agree on what they want to do with all of our foreign aid, whether it goes through IDA or through AID. What do we want to achieve? And to get the job done, we will need a more integrated institutional structure. That would mean that this committee would need to work with the International Relations Committee.

The CHAIRMAN. Right. It is interesting. In the Senate, this jurisdiction is with the Foreign Relations Committee, where you might logically argue it belongs. I am very interested in this, so I am very happy that somebody, it seems to me quite mistakenly, said, "Oh, the World Bank, that is a bank, so it will go through the Banking Committee." That is why we have it. I am not giving it up with any—

Mr. BECKMANN. This committee has actually done a great job on World Bank issues.

The CHAIRMAN. Thank you. I appreciate it. But we have already collaborated with—it has gone back to being called the Foreign Affairs Committee now—with Congressman Lantos and others, and we will continue to do that. Thank you.

Let me turn to Mr. Bachus now.

Mr. BACHUS. I thank the chairman. In fact, my first question was going to be, is the World Bank a bank? And you sort of hit on that, but let me just sort of change it around a little bit. I will just start—I want each of you to answer this. What do you see was the purpose and the function of the World Bank in 1944 and what is its function and purpose today? And has it changed? If you will, touch on economic growth, economic development, and also poverty reduction, and poverty alleviation, and how they go together. Professor Stiglitz?

Mr. STIGLITZ. Sure. Remember that in 1944 it was called the International Bank of Reconstruction, and then they added the word "and Development," so it really began with helping Europe reconstruct. But fortunately, they added "and Development," and that has become the major focus. But it has gone from just a question of lending for development projects to a much broader focus, not just on development, but on poverty alleviation in developing countries. And that clearly is its focus. Some questions have been raised about capital markets. The fact is that capital markets are not going to be focused on poverty alleviation. They are not going to lend to the poorest countries. They are not going to lend for education or health. A little bit sometimes, but they just can't go into those areas. Thus, there is a vast need there.

Now, I think one of the things that has changed is a recognition that what separates developing and developed countries is not just money, but also knowledge. And with that has gone a change from being just a bank which lends money, to being sometimes called a knowledge bank, with a broader set of objectives.

Mr. BACHUS. The technical expertise and knowledge.

Mr. STIGLITZ. Exactly. There is an advantage of being a global institution that in principle is trying to learn from all the experiences, failures and successes all over the world, and then transmit that knowledge. It hasn't always done it as effectively as it should. It has come in, I think, often with blinders. But the idea of having an international institution that would learn from all over the world and then transmit to the whole world what has been learned, that principle seems to me one that makes a lot of sense.

Finally, I want to pick up on something that Dr. Wade said that I think is important. As the world has become more integrated, we have also become more interdependent; that means there are more areas where we need to act together. The World Bank is an important institution for acting together in areas that we call global public goods or global externalities, such as global warming, where there is an international interest in addressing this problem: It will affect all of us. How to help the developing countries do what they ought to be doing is at the current juncture potentially one of the most important ways that we can work together. If I were saying what are the new items in the agenda, that is one of the items that ought to be listed.

Mr. BACHUS. Okay. All right. Dr. Wade? Anything? Mr. Beckmann?

Mr. BECKMANN. Yes. If you go back to the charter of the Bank that was written in 1944, it talks about economic expansion. There is a reference to labor conditions; that is the way they talked about poverty. And there is a strong reference to promoting international trade. That provides a clear statement of what the Bank meant to do when they set it up, and those purposes are still relevant. The Bank still is promoting economic expansion, paying attention to labor conditions, and promoting international trade, but in the 1990's, the Bank adopted a new mission statement, which is pretty simple. If you go into the atrium of the Bank, up on the wall it says, "We dream of a world without poverty."

There has been a real evolution in the Bank's mission over the decades. When Robert McNamara was president of the World Bank, the mantra was that we promote economic growth and poverty reduction. And in the 1990's, there was a further shift, an agreement among the nations of the world that what we want this institution to do is to end poverty. I know that is a dream you share, and I find it to be a very exciting and compelling dream. What the charter says is still quite relevant; if you want to end poverty, you have to have economic growth, attention to labor conditions, and trade.

Mr. BACHUS. Sure. Okay.

Mr. EIZENSTAT. It is an excellent question. Let me just add to what has been said. I think the biggest change that has occurred since 1944 has been the remarkable growth of private capital and the access that developing countries have to that private capital. In 2005, for example, in sub-Saharan Africa, not in middle-income countries, you had almost $25 billion in new equity flows, compared to $3 billion in net disbursements by the World Bank. But having said that, I think what that means is that to deal with the issue of poverty alleviation, which is now the goal of the Bank, you need first closer collaboration between private sector donors and the World Bank on what kinds of projects each will fund. Because for poverty alleviation you do need infrastructure, you need electricity, the things that business needs to invest. You need an open investment climate, you need an open trading climate, or you are not going to the economic growth.

At the same time, you also need, as Joe and Dr. Wade were indicating, you need to have an institution, and that is what IDA particularly does, it focuses on things that the private sector won't do—energy security, communicable diseases, global warming, and refugee resettlement in developing areas where that is a drag on growth. And that is where the Bank should be placing its expertise. But it needs to work more closely with the private sector, which is willing to fund infrastructure projects and other things that also contribute to growth. And that lack of collaboration, I think, is a significant barrier to poverty alleviation and to achievement of the Bank's new mission statement.

Mr. BACHUS. One thing Mr. Beckmann said, and I don't know if the others agree with him, he said the expertise, the technical knowledge of the World Bank was probably one of its greatest strengths and values. Do you also—how would you grade their expertise and their knowledge of being able to supply that expertise? Dr. Wade?

Mr. WADE. I think it is true that in the past 10 to 20 years, private consulting firms have developed expertise in some of the areas that the Bank has long been in which excels that of the Bank. The Bank, I think, is no longer competitive in a lot of areas within banking and finance, probably within areas of private sector development. But on the other hand, there are some current activities that the Bank is in where the Bank's expertise is exceptionally high relative to anyone else's. There are many. But one of them would simply be resettlement. Resettlement of people who are involuntarily ousted from a project, a reservoir project, for example. But there are many others.

But my worry is, looking forward, that the Bank on the one hand has an opportunity to take a leadership role in the international environmental issues that I was talking about, but it seems to me—including climate change—but is not yet very well staffed up to take that role. But this is an obvious direction of expansion. As other players become more active in areas where the Bank was traditionally strong but is no longer so strong, the Bank's root of expansion, its comparative advantage is in these more strictly global issues, which nobody else is as well placed to deal with. But the Bank is not very well staffed up yet in those areas. So it has to expand in those areas and cut down in some of the more traditional ones.

Mr. BACHUS. Mr. Scott, if I could have 2 more minutes or something if that would be possible? I note the chairman took about 12 or—said we were going to have a little more—

Mr. SCOTT. [presiding] Two more minutes.

Mr. BACHUS. —relaxed atmosphere. The Administration is looking for a new president. Now Mr. Stiglitz, I read in the BBC, one of the articles, that you said they ought to be looking for an economist that understands development. And I would agree with that. What else would you add to that, any of you? Now, would you think that a passion for global poverty, or at least some expertise in that field would be at least a good qualification?

Mr. STIGLITZ. Of course. The major thrust that I think all of us agree on is helping countries grow and reducing poverty, and that requires a certain kind of expertise. That is why I said it was important to have somebody who knows economics. I also will argue that you need somebody who can work with all of the diverse constituencies of the Bank, both the contributing countries and the countries that you are giving aid to. The staff of the Bank is very important. This picks up with something that Dr. Wade talked about in his remarks, which is that you have to have somebody who has the confidence of the staff, the donors, and the countries.

One of the reasons that I suggested we ought to really think about how the head is chosen is because that process is going to affect that confidence. No matter who that person is, if he comes in through a process in which people have confidence, it is more likely that he will have an easier time of it.

Mr. BACHUS. Okay. Thank you. Ambassador Eizenstat has to leave in just a minute, I am told, so I appreciate you being here.

I appreciate your grandson's patience while you testified. But Dr. Wade or Mr. Beckmann?

Mr. WADE. Yes. I just wanted to add one thing to what Joe said. It seems to me really critically important, especially in the wake of current events, or recent past events, that the head of the organization have had—has an excellent record in running a large and complex organization. It is not enough simply to be sort of an academic expert economist in poverty reduction or something of the kind. You have to have had experience in running a large and complex organization. That seems to me to be a more important criterion probably than anything else.

Mr. BACHUS. Okay. Thank you.

Mr. BECKMANN. I think one criterion is clear, unalloyed commitment to the mission. There have been questions raised about Paul Wolfowitz's personal loyalties, or his political loyalties coming in in an inappropriate way. What we have to do now is to get people working together—working and working together again. That includes the staff of the Bank, the Board of the Bank, but also the Bank has diverse shareholders all over the world—people who disagree as much as people in this committee disagree with each other and who are spread all over the world. So I think the next president needs to be somebody who is just straight in terms of being committed to the purpose of the Bank. It is that purpose that can draw all these folks together. And then I do think management, having experience in managing a large and complex organization is important. I think knowledge of development is important, real expertise in the area of international development.

Ability to be a diplomat is clearly important. I think we have just seen that, in fact, we are not going to have the kind of international selection process that Dr. Stiglitz talked about. I don't think this Administration would go along with that. And we have just seen that the Board of the Bank wasn't willing to take on the Administration, so there is not the political will there to move to a completely different kind of process. But the Administration needs to put forward a candidate or candidates who are clearly qualified, and there needs to be some kind of process of consultation so that the next president can go into the Bank with support from the whole Board.

Mr. BACHUS. Thank you. Let me just close with a comment. You know, I think you are going to have to have a person who is a real diplomat, who knows how to work for people, particularly in that just last month they announced the anti-corruption strategy, and you are going to have to do that with a lot of diplomacy.

The CHAIRMAN. Thank you. The gentleman from North Carolina.

Mr. WATT. Thank you, Mr. Chairman. And I thank the chairman and ranking member for convening this hearing, which has been very interesting and informative. At some level, however, I guess the question of at least the conditionalities and the Washington consensus have kind of an academic component to them except for the obvious conditionalities of transparency and more process-related things. Sometimes the Washington consensus I agree with, and sometimes the Washington consensus I disagree with. When I agree with it, I want the World Bank to move in that direction.

When I disagree with it, I probably don't want it to move in that direction.

But that is kind of an intellectual academic discussion, and I would like to try to take this to a more practical discussion, because I don't think you can get there from here without doing some of the concrete things that you all have suggested.

As long as the United States is dictating who the leadership of the World Bank is, we basically will be setting the Washington consensus, whoever that person in the White House is who is sending that person there. How, as a practical matter, do we get from that posture to a position where the most qualified, the most—all of these criteria that you all talked about that you would want in a leadership is able to be named? How exactly is the naming process done now? I mean, does the Board have the authority, if they were willing to confront the president, to say we reject the notion that this person has to be a Washington former cabinet person or this person or that person? Or I mean, what is the process for getting us from where we are now to where it seems like everybody on this panel would like for us to get? Because I don't think you can change the conditionalities unless you change the leadership and change the attitude of the United States toward what this is all about. Anybody who wants to take a shot at that. That is the only question I have, interestingly enough.

Mr. STIGLITZ. The rules give the discretion to the Board to make the choice. It is nothing more than a convention, and it is an old boys' agreement that Europe gets to appoint the head of the IMF and the United States gets to appoint the head of the World Bank. There is nothing constitutional, so there wouldn't have to be any change in legislation. It is just the Board's decision. Now, the problem is that in the case of the World Bank, the United States does not have a veto power. It is the largest shareholder, but the Europeans as a whole have many more shares than we do. This means that they have many more votes. But there is a reluctance to engage in confrontation, so there is a sense in which one can ask the question if they knew that—

Mr. WATT. How do you move that?

Mr. STIGLITZ. Okay. There are a couple of possibilities. One of them is that if Congress made a strong statement and said, we disagree with that, it would obviously have a big impact. If they said this president, this appointee, or this process does not have their support, that they think the old boys' route does not make sense, while it may have made sense in 1944 but doesn't make sense in the 21st century, I think that would have a very big impact. I have talked to a number of the European Ministers of Development and they feel the same way that I do. They are nervous about a confrontation, having just had a confrontation. If one changed that balance and said, look, we actually agree with you, I think it might give them some energy to address that.

On the second issue, you can have more effect than you have on even the conditionalities. For instance, Congress instructed the American representative, the ED, to vote against cost recovery, which is this euphemism that the poorest kids in the world have to pay tuition. As a result of that, eventually the IMF and the World Bank gave up this requirement on cost recovery. I think that it is a delicate balance of this issue that I talked about. You don't want to have excessive politicalization of the process, as it is a multilateral institution. On the other hand, there are certain areas where you can say, look, we think there is a global consensus on conditionality.

Mr. WATT. I am focused less on the conditionalities than I am on the more practical, and Mr. Eizenstat seems to be having heartburn over some of the things that you said.

Mr. EIZENSTAT. I was Deputy Secretary of the Treasury—

Mr. WATT. So I better get him at the counter.

Mr. EIZENSTAT. I was Deputy Secretary of the Treasury when the head of the IMF was being chosen at that time, and the United States, in effect, vetoed the first European candidate, Ciao Koch-Weser, who was, I think, perfectly qualified. But it is more than what Joe indicated about lack of confrontation; it is mutual back-scratching. That is, it is not just that Europe doesn't want to confront the Administration now because of the whole Wolfowitz thing. It is that if they do, then they will lose the monopoly on taking the IMF post, and they need the U.S. vote for that.

So it is a mutual back-scratching between the United States and the European Union to keep this process going. The question is how to change it. I think that, you know, it is something perhaps to interject in the presidential campaign. It is something to get Congress and the European parliament to act on. It is one thing for the development ministers, Joe, to say that they want that, but when you talk about the political ministers, the finance ministers, the foreign ministers, and the prime ministers, they don't want to give that up. So you need to build support by the parliaments, particularly, I think, the European parliament, and the United States.

The second thing is on conditionality. Again, I saw this absolutely firsthand during the Asian financial crisis, where there were conditions like the cost recovery and things that were really unreasonable. But I think it is more than what the chairman called just process. One would be loathe to, in my estimation, to say that the World Bank could do its job unless you were also encouraging the country to open up their investment climate so that you could have foreign direct investment and know that you wouldn't have your profits expropriated, that there was an arbitration process. You would be wasting money if you didn't have an open trading environment, if you didn't have a good macroeconomic policy and good monetary policy and good governance policies. Now that's part of the Washington consensus. I think it was taken too far in some instances. But again, I am not prepared to say we should throw the baby out with the bath water, because I think those are all preconditions to economic growth and poverty alleviation, along with investing in public goods.

The CHAIRMAN. Just briefly on that good macroeconomic policy is what, roughly, at this level?

Mr. EIZENSTAT. Well, I think good macroeconomic policy, first of all, is having a transparent budget, one that's—

The CHAIRMAN. That is procedural, not substantive?

Mr. EIZENSTAT. That is substantive. It means running fiscal deficits that have some rational relationship to GDP, that don't expend so much that you inflate the economy and make your currency noncompetitive in terms of your products. Having an exchange rate that allows your products to be competitive on the world market. And one of the reasons I am sure everybody on this panel would agree on the Doha Round is to open up the markets of—

The CHAIRMAN. I agree with that.

Mr. EIZENSTAT. I don't consider macroeconomic—

Mr. WATT. Even on that, there is a connotation that goes with opening up markets that basically allows corporate—the corporate community a free run that doesn't always enure to the benefit of the country or the people in that country. So at some—I mean, to a point, I agree with you, but there are limits to that, too, unless you are going to put some constraints on that that make sure—I mean, I think what China, for example, is doing in Darfur is outrageous. You know, it is building like mad, but I don't see any benefit that the people of Sudan are getting from it other than the corrupt leadership there.

Mr. EIZENSTAT. Let me give, if I may, one concrete example. It was mentioned here briefly. One of the best things Tony Blair did was promote the so-called EITI, which is an Energy Industry Transparency Initiative, in which mineral companies and oil companies investing in poor countries have to publish what they pay to those governments.

Now, I had a specific instance with BP and the BTC pipeline. And Azerbaijan, which has significant corruption problems, is part of the EITI now, and deserves great credit for doing so. And that is being published, what BP and the BTC consortium pay to that government is being published and is audited. What is not being done is the next step—and here again, I think Congress has a role—and that is while you are publishing the inputs into the Fund, the government is not required to publish what they do with it. And that is the other half of it.

So you are certainly correct that just having foreign investment is not enough, but the EITI was a very powerful weapon to at least take a step to ensure that this investment begins to help the people, and not just the companies or the corrupt leaders.

The CHAIRMAN. Let me just say that to Mr. Eizenstat, I think you are underestimating the extent to which the objections to the Washington consensus went beyond what you are talking about. I think there is a genuine consensus, it is not just a Washington consensus. I think the Washington consensus, as many of us talked about had a more specific, very free market ideology beyond the more general level you are talking about, for instance, the labor and other kinds of things.

It did seem that the Washington consensus got much more specific, and to be honest, you, as a Democrat who served in the Administration of Bill Clinton, I thought that there was a point in which there was a real disparity, as Mr. Stiglitz suggested, or said, between the policies of the Clinton Administration which were being pursued at home, and those it was pushing abroad.

I think politics stopped at the water's edge, it seemed, before Bill Clinton liberalism. And he was Franklin Roosevelt until he hit the water and he became Ronald Reagan in terms of some of what got pushed. I think that got turned around some, but I do think we can differentiate.

But, Mr. Beckmann or Dr. Wade, do you want to talk about that subject? Or we can go to Mr. Scott.

Go ahead, Mr. Beckmann.

Mr. BECKMANN. One thing that is good about the Bank's governance is that there is a real recognition of the distribution of economic power in the world—where the money comes from—so that in the councils of the Bank, when a decision is made to do something on debt reduction for poor countries, there is a good chance that there is actually going to be money and power behind the decision.

Just like the Security Council recognizes that some countries have a lot more power than other countries, and if there is going to be a decision about the direction of the United Nations, those powerful countries need to be part of the decision.

In the councils of the Bank and the IMF, the countries that have more money, that put more money on the table, have more power. I thought Ambassador Eizenstat made a good point about the need for adjustments over time. There is no excuse for presidents of the World Bank who are not very well qualified; we need a qualified person in that position. It can't just be an Administration official that they are trying to move someplace.

But I think there is something to be said for moderation in moving toward a more democratic, egalitarian governance of the Bank. The way we have it now—and it is partly by having an American at the top of the Bank and a European at the top of the Fund—those institutions have been able to mobilize money to do things for poor countries, whereas other institutions that are governed in a different way sometimes don't have money or power to do anything. They may have more democratice processes, but they are not sufficiently ground in the political realities.

The CHAIRMAN. Mr. Scott.

Mr. SCOTT. Thank you very much, Mr. Chairman. First off, I want to extend an extra welcome to Mr. Eizenstat. We both share the Atlanta connection, going back to the early days when we both had more hair and it certainly wasn't as white as both of ours are, and in our starting out with then-Congressman Andrew Young. And you moved on up and served President Jimmy Carter and President Bill Clinton, and I followed your career.

I just want to take a moment to welcome you. It is a pleasure to have this opportunity to interchange with a long-time friend, and to all of you, certainly this has been a very, very informative hearing.

Let me start by taking a look at the situation that I think presents an opening for us here with the situation involving the resignation of Mr. Wolfowitz, because I think, in the course of accountability and transparency, here lies an opportunity.

I noticed when, I think Mr. Watt asked a question relative to this, you, I think—someone, I think it was you, Mr. Stiglitz; I hope I pronounced that right—referred to the reason we have an American at the helm is because normally you have an American at the helm of the World Bank and we have a European at the helm of the IMF, and that—but it is a little bit more than that, I think, in—a little in addition to that. And, in fact, when it was first started, it was because of the fact that the United States was a key guarantor of the bonds and put the World Bank in a much more reliable financial position.

Now we have an opportunity. There is some discussion that it is not democratic to have that there and that maybe there would be added transparency if we chose not to have an American there for the first time.

What would we lose in terms of that financial stability to move forward on—that having an American at the helm of the World Bank presents, compared to any added transparency or accountability one might achieve by not having an American at the helm?

Anyone up here, I would like to have your comments on that. Would we lose anything? Gain anything?

Mr. STIGLITZ. In financial terms, it would make absolutely no difference. The Bank has built up what might be viewed as a large endowment. Dr. Wade referred to that.

It has a very conservative financial model that lies behind it, and it would likely continue that. So long as it continued that, the so-called "backing" that might come, extra backing that would come from having the President come from the United States, has no significant value.

You also have to remember that much of the money that the World Bank gets today is raised from the markets in a real sense, and it is based on that endowment and a track record.

To give you just one other example, some of the regional development banks, like CAF, which is an Andean bank, are able to borrow at very low interest rates because they are well managed. So as long as the Bank is well managed, then I think it will not have any real trouble raising money. The democratic advantages that we can talk about, and the ability for it to convey effectively the message that it can be trusted, will actually enhance its effectiveness.

Mr. SCOTT. Do you think this is an opportunity we should seize and that it would be in the best interests of the Bank, going forward on some of these issues, that we not have an American at the helm?

Mr. STIGLITZ. Very much so. I think it is in the interest of the Bank; I think it is also in the interest of the United States that the way presidents are chosen is changed.

Mr. SCOTT. Is that the consensus? Does anyone have a different opinion?

Mr. EIZENSTAT. I think it is. This was an essential feature of our Atlantic Council report.

May I just add one caveat to that? I agree with everything. This was in our report. I think it should be based on merit without nationality. It would be good for the Bank, good for the United States, but—the only "but" is the congressional reaction. That is, you would need to have a leader in addition to all the other attributes that we mentioned, who could come up to Capitol Hill and convincingly argue when there needed to be an IDA replenishment when the United States needed to be goaded into paying its fair share. There is a question of whether Congress would receive a non-American in the same way that they would an American.

Now, I have to say that since we are behind on a lot of our payments anyway, that may not be the most major factor. But in a serious vein, it would be important that whomever is chosen—and I do think it is on the basis of not nationality, but merit—be able to relate to the Congress and deal with the Congress and not just be Secretary General of the U.N., who has sort of a Third World agenda and is not sensitive to the major stakeholders and payers of the system.

Mr. SCOTT. Thank you.

Another line of questioning, if I may continue: Does the World Bank plan to implement improved strategies to reduce poverty in countries by aiming strategies only on boosting overall growth, as it is evident that this strategy may miss opportunities to reduce poverty?

For example, I understand the reasoning behind focusing on sectors with growth potential, allowing for relatively quick payoffs. However, my question is, do these strategies impact poverty reduction in the most efficient way?

While you are thinking about that, there is a recent report in the Washington Post which is entitled "The Persistently Poor," and a report has come out where it really strikes a mixed message. If I may share, Mr. Chairman, just so you, as you are thinking about this, this is where this question comes from. It is written by Mr. Peter S. Goodman, and it came out late last year, in case you read it.

It says, an internal report criticizes the World Bank's efforts on poverty despite an intensified campaign against poverty. World Bank programs have failed to lift incomes in many poor countries over the past decade, leaving tens of millions of people suffering, stagnating or declining living standards, according to a report that was released by the Bank's autonomous assessment arm.

Are you familiar with that report? It says among 25—

The CHAIRMAN. Get to the answers now, Mr. Scott.

Mr. Beckmann, do you want to start in the middle this time?

Mr. BECKMANN. The Bank doesn't just support growth. The Bank is also heavily investing in primary education, and in improving health systems.

Now, in general what they are trying to do is to promote the productivity of poor people, so this is not a Mother Teresa kind of operation. What they are trying to do, even in the social sectors, is to help kids get a decent education so they can be more productive, and in very poor countries, there really is no other option. You need to have growth among the poor.

But it would be a caricature of the Bank to say that it is driven by a growth-only model; I don't think that has been the case for a long time.

I didn't read the article that you are quoting, but the Bank has had limited success in many of the poorest countries, especially in Africa. There has been a clear case where the Bank had a cookie-cutter liberalism approach—open markets, cut government—and for many African countries, that was just not—

The CHAIRMAN. Mr. Beckmann, I assume you are talking about a kind of 19th century liberalism, not the way—

Mr. BECKMANN. No. Maybe 1980's liberalism.

The CHAIRMAN. But in the 1980's, most people called it conservatism.

Mr. BECKMANN. That's right. And I think it is clear that some of the Bank's structural adjustment lending worked for countries like Turkey fairly well, but it didn't work at all for low-income countries, partly because you eliminate government programs. And the idea was that the private sector was going to spring out of the closet and take care of the problems, and there was no private sector capacity to replace public programs that were being dismantled. A lot of the poorest countries in the world have not succeeded in getting onto a growth path, and the Bank has been there and has been unable to change that.

On the other hand, there have been improvements in governance and economic productivity in some of the poorest countries in the would: 15 African countries have reduced undernutrition in this decade; and 19 African countries have had elections this decade. The Bank is not in the business of promoting elections, but it is in the business of promoting transparency and good governance. And so some good things are happening also among the poorest countries, and I think the Bank has been part of that mix, too.

Mr. SCOTT. Let me ask you this—if I may, Mr. Chairman—on that point, because I wanted to get at Africa because I believe, when you look at many of these other countries where you have had some success—but in Africa there has been a stubborn problem there.

To what degree is the political instability, the violent regimes—I am reminded of scenes where even with food being dropped at an airport, the regimes were going to blow up the food, people coming in, trying to help the communities, were unacceptable.

Sort of reminds me of that scene in the "Apocalypse Now"—I don't know if you have seen that scene where Marlon Brando says, well, you know I remember this time—and they came and they had inoculated all these children against a vaccine, and then they left the village, and they came back, and he said he saw a very pathetic sight, he saw all of these inoculated arms cut off in a heap.

And in some places within Africa, I am wondering what role, what impact does the violence and the instability of the political situation and the dictators in the regimes have in being a hindrance to your—

The CHAIRMAN. Dr. Wade.

Mr. WADE. I want to be a contrarian for a moment and to say that the World Bank has focused too much on poverty reduction, specifically poverty reduction, and on the social sectors like primary education, primary healthcare, and governance agenda.

You will see almost nothing in World Bank publications for the past 20 or more years on how to develop manufacturing, how to develop industry, or how to improve technology. These kinds of things should be central in any discussion of how to get countries onto a growth path.

As you suggested, many African countries are not on growth paths. Any discussion of how to improve rates of growth should be placed at the center of that discussion—how to improve manufacturing, industry, how to upgrade technology and the like—the Bank is almost silent. And it is silent even on university education as distinct from primary schools. The Bank only deals with primary schools; it won't touch universities. I think this is incredibly shortsighted.

The CHAIRMAN. Thank you. And we thought there was an interesting article in the New York Times a couple of days ago, making just that point about African universities.

Mr. Stiglitz and then Mr. Cleaver.

Mr. STIGLITZ. Both agree with the sentiment that Dr. Wade has put forward, but also note that there was, during the time I was there, a recognition of that. It was the beginning of a move, but it was very difficult, and it was moving against the prevalent thought, so—

The CHAIRMAN. Internal resistance in the Bank?

Mr. STIGLITZ. Yes, and some from the outside.

One of the reports of WDR that came out in 1998 was on knowledge for development. One of the points that we made was that we needed to move from just focusing on elementary education to focusing on secondary and universities. For a report like that, it had to get a consensus.

In terms of the actual operations, there wasn't really the kind of change that should have followed upon that.

The CHAIRMAN. Mr. Cleaver.

Mr. CLEAVER. Thank you, Mr. Chairman. I want to follow along with this kind of discussion. The World Bank came into existence in the post-World War II era to try to make sure that Europe was rebuilt and that many of the countries that had been devastated in the war were rebuilt.

We are now in the post-9/11 world. And I know that the World Bank is not a political agency; it has no responsibility for dealing with the major political issues, at least not in the sense that we would traditionally view it. However, my concern is that in the post-9/11 world, when we look at the amount of the loans made in sub-Saharan Africa compared to what we are doing in other parts of the globe, it leads me to have some concern that poverty, just as it does in the United States, breeds all kinds of possibilities for tragedy. And my concern is that if we continue to spend the GDP at such a low level in sub-Saharan Africa, that we are in fact tilling the soil for some despot and for possible terrorism to spread. It is like opening a door, saying, please, you know, why don't you make overtures to Osama bin Laden or whomever.

And so, is that the kind of thinking that goes on? And if not, don't you think maybe we need to think in terms of what is going on, or rather what is not going on, in sub-Saharan Africa with the World Bank? Anyone.

Mr. EIZENSTAT. First of all, in this fiscal year, half of the IDA lending, about $5.5 billion, will go to Africa. So it is not an insignificant amount.

Second, in answer to the previous question of Congressman Scott, you can't have economic development and growth when you have violence and political instability.

Third, I fully agree with you. And I chaired another commission for the Center for Global Development on failed states and U.S. national security. If you have failed states—Sudan and others, Somalia—they become a haven for terrorist groups, narcotraffickers, and others that directly affect our national security. So trying to invest in preventing those countries from becoming failed states is something that directly relates, in my estimation, to the issue of terrorism and may make it politically easier to try to convince Members of Congress and others to support Bank efforts in these kind of countries. Because I think, if they fail, they do become havens for the very groups that you are talking about that are a direct threat to the United States and their own security.

Mr. CLEAVER. Well, $5 billion is no small amount of money; I agree with that. Most of us would not have that in our checking account. But $5 billion compared to what is being spent even in the Middle East means it is dwarfed.

Mr. EIZENSTAT. Yes, sir. But if I can give you the 2005 figure, private debt flows to sub-Saharan Africa in 2005 were $3.8 billion; private equity flows in sub-Saharan Africa were $24.7 billion, dwarfing what the World Bank did.

So there is a increasing amount of private-sector investment in sub-Saharan Africa, and what needs to be done is, the Bank needs to create the conditions in which those investments pay off and more private sector investments can be encouraged.

So there is a lot of capital going in not just from the World Bank, not just from IDA, but from the private sector into sub-Saharan Africa.

Mr. STIGLITZ. I still feel that if you look very carefully at where the money is going in the countries, there are countries that have good macroeconomic policies and good overall frameworks that are not getting as much private-sector investment as they need. Many of the countries have a shortage of funds in education, health, and other social sectors where the private sector isn't going. One area where the lack of money has a very big, direct impact is, for instance, in those parts of Africa where there is a strong Islamic community. If we don't provide good schools, children will go to schools organized by others who will not give them a good education in terms of modern society; they may get indoctrinated into views that most of us would say are probably antithetical to the ones in which we would like for them to be indoctrinated.

That is an example of where there is a strong imperative for us to be much more supportive of funds in Africa and elsewhere in the developing world.

Mr. CLEAVER. Mr. Beckmann.

Mr. BECKMANN. More money is going to reduce poverty. More U.S. Government and European government money is going to poverty reduction and going to Africa than, say, in 1999. In the late 1990's, we were fighting every year to keep Congress from cutting money for Africa. It was just brutal. If there were cuts in the foreign operations budget, it came out of Africa.

Since 1999, that trend has been reduced. Bread for the World keeps a list of poverty-focused development assistance programs, including IDA, the Bank's concessional affiliate, but then also the Millennium Challenge Account and certain accounts at AID and so forth. The funding from that set of programs from the U.S. Government was $4 billion in 1999. It is up to $12- $13 billion for the current fiscal year.

And the Europeans and the Japanese have also increased their funding for Africa and other poor parts of the world. That has happened partly because 9/11 made everyone aware that it is not smart to neglect misery in far-off places.

We know exactly what you are saying. There needs to be further increases in funding. There also needs to be improvements in the quality of funding. Now that we have substantially more money focused on trying to reduce poverty in the world, we need to have substantially more attention to the institutions that are channeling that money, including the World Bank, and also including the agencies of the U.S. Government that are charged with this purpose.

Mr. CLEAVER. Thank you. I yield back.

The CHAIRMAN. The gentlewoman from Wisconsin has been very patient, but I know has a very strong interest in this area, particularly in Africa.

Ms. MOORE. Thank you so very much, Mr. Chairman, and I thank the panel. I will get right to my questions. I want to start with Dr. Stiglitz.

You indicated in your written testimony, you talked briefly about the extractive industries' transparency initiatives. And I believe that the ambassador gave us an example of something that Tony Blair did by requiring that payments to governments be published as a reform that had some legs.

And I was disappointed in your paper that you didn't sort of delve into this extractive industries' transparency initiatives, what we can do, as policymakers, to stop some of the offshore banking, the—you know, the Swiss bank accounts, the secret investments.

Can you just share some of your ideas, and perhaps others will have something to say on this point as well?

Mr. STIGLITZ. Yes. It is a good question and I spend a lot of time talking about that in my book, "Making Globalization Work."

Ms. MOORE. Yes. I am going to read that.

Mr. STIGLITZ. For instance, one of the suggestions in terms of the Extractive Industry Transparency Initiative is very simple. It used to be that companies got a tax deduction for bribes; governments were paying effectively half of the bribe. We could use the power of the tax system and say, you don't get any tax deduction if you don't publish what you pay.

You have to make payments to governments transparent. If American companies or those from any of the other G8 countries give a check to a developing country for an extractive industry and they don't make it public, they should not get a tax deduction. That, overnight, could change things.

Ms. MOORE. Could it just be a part of the cost of doing business, that you don't get a tax deduction? The value of a tax deduction may just be the cost of doing business?

I guess the point that I want you to confirm, the whole panel, is that part of the reason in a lot of our aid and assistance, the billions that we have given to some of the poorest countries in the world, is because the money never makes it into the mouths and hands, quite frankly, of the people because we are enriching the leadership at the top. And if they are getting paid billion-dollar bribes, or half-billion-dollar bribes, and if the benefit of extracting oil and gold and so on and gaining mineral rights forever is the loss of a tax deduction, they may see it as a cost of doing business.

But I love the idea of some transparency, which leads me to the following question—

Mr. EIZENSTAT. Can I just intervene?

If I may, Joe was right. Before the OECD convention, which I helped negotiate, Germany and France, for example, allowed tax deductions for bribes. The World Bank itself estimates that there are a trillion dollars in bribes paid each year to developing countries, so it is a major problem.

We have an Antibribery Act that I also negotiated in the Carter Administration which applied to U.S. companies. The OECD Convention bans the extension of bribes by all OECD countries to developing countries. Our Antibribery Act is quite well enforced; the OECD Convention is not as well enforced by European countries. There is still a lot of bribery going on by European companies in the developing world. So one thing is to put more pressure on those countries to live up to the very convention that they have signed on to.

And second, as I mentioned earlier, is extending the EITI so that it not only captures what is publicly paid into the fund, but gets the governments to publish what they used those funds for.

Mr. STIGLITZ. One more thing you allude to is the secret bank accounts. We could stop those secret bank accounts overnight. If we said, our banks can't deal with other banks in territories that don't conform to certain basic standards, they would shut down. In the Cayman Islands, this bank secrecy survives because of our tolerance. We have shut it down for terrorism; we have chosen not to shut it down for corruption.

This committee could make legislation that would shut that down.

Ms. MOORE. Did you hear that, Mr. Chairman?

The CHAIRMAN. Funny you should mention that, because that is very much under consideration.

Ms. MOORE. Thank you very much, Mr. Chairman.

My next question relates to the—Dr. Wade, I think you really elucidated this point that the Bank, the World Bank's market has changed in the last decade, and indeed other countries are going to China and other places for financing; that very few companies or corporations will participate, private investment just will not participate where the World Bank or the International Monetary Fund is not involved; and we just have been sort of asleep at the switch, and that—really, that China and Brazil and other places are now getting that business. In fact, you talked about the African Development Bank meeting occurring in Shanghai.

What are you proposing that we—you know, the World Bank does have the IDA. Are you proposing a change in underwriting criteria? What exactly are you suggesting for—and also, perhaps, we are lending to middle-class countries and not lending to the poorest of the poor countries.

I think there has been a healthy discussion about conditionality and other sorts of impediments. So what—and I am asking others on the panel, too—but, Dr. Wade, I was really interested in hearing from you first since you spent a lot of time in your written testimony talking about the change in the market.

Mr. WADE. Well, on the middle countries, this is the subject of a lot of discussion inside the Bank at the moment, and some people who take the Bank's poverty reduction plan, who take the Bank's poverty reduction mandate in a very narrow and literal way say, the Bank should simply pull out of middle-income countries.

But that is, I think, quite wrong, and especially when you consider that within 4 to 5 years, China will probably be a middle-income country, even though it has hundreds of millions of people who are poor by South Asian standards.

The question, though, is how the Bank can be relevant in those countries which don't need so much cheap finance, because they can get access just to finance from world capital markets.

But they have a strong interest in getting access to knowledge, and the question is, can the Bank do much more by way of developing new revenue streams in fee-for-service activities in middle-income countries where the Bank asks the government of China or Brazil or Russia what kind of studies those governments are interested in?

For example, studies of railway organization, let us say, that might be a subject that these governments would want disinterested advice, not necessarily advice from McKinsey, because McKinsey or some other private consulting firm is not necessarily disinterested because it has various kinds of tie-ups. But the Bank does have a reputation for being disinterested.

And then the Bank's question is, how it is going to charge for that kind of knowledge? That is a very relevant question in middle-income countries. But it does lead to the further question of how, if the Bank does develop in this way of charging fee-for-service for bringing knowledge to bear from around the world on the problems or the tasks of specific countries, how will it differentiate itself from the private consulting firms? That is a very real issue that the Bank has to deal with.

Ms. MOORE. I appreciate that. I don't want you to stray too far from it, because I want others to be able to answer it. Because I guess the ultimate question that I have is, if we are not reaching the poorest of the poor, with the current World Bank problems, with our current underwriting criteria, what can we do to create products that will attract investment and change the World Bank products so that we can lend to more needy countries than we do presently?

The CHAIRMAN. I have to make this the last answer. We have—the hearing room is going to be used at 6:30, and everybody has had over 10 minutes, so I don't think we have cheated anybody.

Let me just take these last answers.

Mr. BECKMANN. I think what the Bank is doing is helping a lot of the poorest of the poor. And specifically, in Africa, I think there is a set of 15 or 20 countries that have really benefited from some trade liberalization and from more development assistance. They are working with the World Bank. Countries like Ghana, for example, are making progress both in terms of economic growth and for poor people.

There is another set of countries in Africa. Many of them are plagued by violence, and where there is violence, the Bank has not had good instruments. One of the main initiatives that the Bank is pursuing is how can it be effectively involved in those countries, like the Democratic Republic of Congo, where there is violence.

As you said, the poverty contributes to the violence and then, as Mr. Scott said, the violence contributes to more poverty. In those countries, the Bank is not doing very well.

Chairman Frank, may I offer advice in terms of what the committee might do?

The CHAIRMAN. Sure. I assume beyond letting you go home, which is what we are about to do.

Mr. BECKMANN. I think it is a tremendous advantage that you have, Mr. Bachus, as the ranking member. The combination of Mr. Frank and Mr. Bachus is extraordinary. Global poverty reduction is one of the only areas where there can really be bipartisan collaboration in this Congress.

President Bush's record is a good record on development assistance, overall. So if this committee does something related to the World Bank, doing it in a bipartisan way would be good. I think you can encourage the Administration to send over a qualified nominee. I think hearings on debt relief, this committee—

The CHAIRMAN. We have planned them, yes.

Mr. BECKMANN. —would be great, because I think it is a big success story and we ought to know what made it work.

You are not going to like this, maybe, but I think you ought to give the Bank some space. There has been a mess and they have to repair that mess, so I would give them a little space.

You are going to authorize the next IDA, so you can make it clear that you will want to see certain improvements in the quality of the Bank or they are not going to get the authorization of the next IDA.

I would hesitate a bit to actually pass legislation that is going to bind the Bank and the Treasury in new ways at a time when there have been some obvious mistakes made. We need to let the new management of the Bank try to get people working together.

The CHAIRMAN. We will take a look at it. We have tended to work in a bipartisan way here in a number of things, including not just the World Bank, but some of the other IFIs we have worked with.

Our colleagues in the Appropriations Committee, I think made some real improvements in transparency. And I do want to reiterate the statement I made talking with Mr. Eizenstat. There is a genuine consensus. I don't know about procedural stuff, but it is deeply procedural; it is the basic rules of the game, and we have pushed towards that. Where we have held off are some things that I think are more ideological in the liberal/conservative sense.

I will say this in terms of the Administration, and you mentioned it, I think; it is a good news/bad news story. Within the budget constraints, the Administration has been generous. But they created those budget constraints, and the budget constraints are a $500 billion war; and in my judgment, excessive tax cuts for very wealthy people, I think, do more harm than the relative improvement within that constraint to do good. But, yes, it has been bipartisan, and we intend to continue that.

I will close by saying that I am going to be looking for a president, but I am generally reinforced in my view now that insisting that the next president of the Bank be an American expends a lot of American influence for no measurable gain. That is, we want a good president; we want a president who shares the values that are widespread in America; and we want a president who wants to do what America thinks is in the interest of the world. Whether or not he or she is an American is irrelevant.

What I fear is that we will give up too much in terms of nationality; we will bind nationality by trading off policy. And so I am encouraged by what you said today, and I intend to ask some of my colleagues to join me in sending precisely that message to our colleagues.

We want a good World Bank president. We want someone who will do the things we think most Americans would want that president to do, but that person doesn't necessarily have to be an American.

With that, I really am very appreciative. This is making a very serious impression on matters where we intend to act. I thank my colleagues for staying. And usually we have seven or eight members who stayed after the last votes, which is what we have had. But we now do have a staff caucus, a staff briefing, that claims the room, and so I thank you all very much.

Thank you.

[Whereupon, at 6:30 p.m., the hearing was adjourned.]

A P P E N D I X

May 22, 2007

Testimony of David Beckmann, Bread for the World
"The Role and Effectiveness of the World Bank in Combating Global Poverty"
House of Representatives Financial Services Committee Hearing

May 22, 2007

Chairman Frank, Ranking Member Bachus and Members of the Committee, thank you for this opportunity to testify about the World Bank's role in overcoming global poverty.

The world is making progress against poverty. The World Bank just announced that the number of people who live in extreme poverty has finally dropped below 1 billion. That is still a horrific number, but there were 1.5 billion people in extreme poverty in 1980 and 1.25 billion in 1990. The proportion of people in developing countries who are extremely poor has dropped from two-fifths in 1980 to less than one-fifth now.

It is feasible to reduce hunger, poverty and disease dramatically over the next decade or two, and the World Bank is a playing a crucial part in this great liberation. The effectiveness of the World Bank is of life and death importance to many struggling families, and a better future for them will make the world a more wholesome place for all of us.

* * *

I have a generally positive view of the World Bank, and this view has been formed through 30 years of different kinds of experience with the Bank.

I served on the staff of the World Bank for 15 years. I worked in operations in Asia, Africa and Latin America – on some projects that failed, and on other projects that benefited hundreds of thousands of poor families. I wrote speeches for the president of the World Bank, working with the president and other top managers as they grappled with the international debt crisis of the early 1980s. Finally, I led the World Bank's early efforts to connect with civil society all over the world, including work on policies that concerned NGOs – the poverty impact of structural adjustment and the participation of poor people in development planning.

For the last 15 years, I have been president of Bread for the World. Bread for the World is a nationwide citizens' lobby on hunger and poverty issues. We organize people and churches all over the country to urge Congress to take actions that are important to poor people in this country and worldwide. When I moved to Bread for the World, I kept working on ways to make the World Bank more effective for poor people. Bread for the World campaigned to get the World Bank to focus on the reduction of poverty as its mission and to make its activities transparent and accountable. These have also been long-standing concerns of this committee, and during the 1990s the Bank indeed shifted to a sharper focus on poverty and increased transparency and participation. Practice often falls short of policy. But when I visit developing countries and check in on what the Bank is now saying and doing in the field, I am impressed by the practical ways that the Bank has become more effective in combating poverty and more supportive of democratic participation – much more emphasis on poverty reduction in the Bank's policy dialogue with governments, for example, and active outreach to both civil-society organizations and business people.

In 1999, Bread for the World campaigned to reduce the unpayable debt of some of the world's poorest countries. Bono started working with us at that time. This committee helped move the U.S. government to support debt relief. The World Bank has led the implementation of this initiative, with considerable success by all accounts. Thanks to international debt relief, a lot more children are in school and more medicines are in rural clinics in many of the world's poorest countries. More recently, Bread for the World has campaigned to help increase U.S. funding for development assistance, including the World Bank's concessional affiliate (IDA), and for changes in U.S. trade and farm policies that will open opportunity to poor families around the world.

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Through all these diverse interactions, I have come to a deep appreciation of the World Bank. All human institutions have their weaknesses, but I would like to highlight five strengths of the World Bank:

1. **The World Bank focuses on reducing poverty.** The World Bank and other multilateral agencies allocate much more of their aid funding to low-income countries than USAID or other bilateral agencies do. All the World Bank's activities, from basic education to policy work to encourage private investment, need to be justified in relation to the Bank's overarching goal of combating poverty. Governments, including our own government, sometimes try to use the Bank for other purposes. But the fact that the stated goal of the Bank is poverty reduction is a major strength.

2. **The World Bank has improved and adapted over time.** The Bank's sharpened focus on poverty and its increased transparency are major improvements. The Bank has also adopted new emphases and strategies in response to changing needs and the lessons of experience. For example, the first witness in this hearing, Joseph Stiglitz, famously critiqued the "Washington Consensus." The Bank learned from his critique. It continues to recommend that governments take advantage of what free markets can do, but the Bank also helps to develop effective governmental institutions and works to adapt its advice to each country situation.

3. **The World Bank is a unique center of knowledge.** The Bank's staff are highly qualified. They come from all over the world, and they work in all corners of the world, so the Bank can compare the experiences of different countries. The

Bank's multilateral character tends to insulate its thinking from the ideologies and interests of particular countries. The governments of the world and lots of other organizations involved in international development rely heavily on the World Bank's knowledge. Even when we don't agree with the World Bank's conclusions, its analysis is valuable.

4. **The World Bank's governance structure works fairly well.** The United States and other high-income countries have power in relation to their financial contributions to the Bank, but all the member countries are represented in the board. Remarkably, issues are usually settled by reasoned debate. The Bank is able to get consensus support from its member governments for most of its policies and projects.

5. **The World Bank evaluates its effectiveness.** I don't know of any other international development agency that is more rigorous in evaluating itself. The Bank's independent evaluation unit estimates that three-quarters of the Bank's operations have satisfactory outcomes. That leaves plenty of room for improvement, but the Bank works in many difficult environments and tackles daunting problems.

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Looking ahead, I hope the Bank will become more effective in building political commitment to overcoming poverty. In my view, the main constraint on progress against poverty is that poor people are not a high political priority. Within developing countries, opportunity for very poor people is more prominent in political rhetoric than in government budgets. And while the United States and other industrialized countries have increased their development assistance during this decade, reducing global poverty is still not a high political priority for us either. Political commitment does not just happen; it can be built over time – notably by strengthening governmental and nongovernmental institutions that represent the interests of poor people. The World Bank can appropriately help to build political commitment – through its policy dialogue, through its projects, and through stronger programs of public outreach. The Bank can also help to build political backing for development assistance by using the resources it is given efficiently. Yet the Bank has never systematically thought about all that it does to build political commitment and how it could provide stronger leadership.

Right now, the World Bank should restrain ambitious top-down initiatives. Jim Wolfensohn, the Bank's previous president, probably launched more initiatives than the Bank could effectively pursue, and the controversy around Paul Wolfowitz has done real damage. The Bank needs to effectively pursue the priorities it has already established, notably Africa, updating the Bank's role in middle-income countries, and developing new strategies to attack corruption.

Above all, the Bank's diverse stakeholders, notably the Bank's own board and staff, need to be drawn back together around the Bank's compelling purpose. The next president of the Bank must demonstrate deep and unalloyed commitment to the Bank's mission of reducing poverty.

This is a unifying purpose. It is a purpose toward which President Bush and both parties in Congress have worked together. It is a cause to which all the nations on earth are drawn. I am a minister of religion as well as an economist, and virtually all of the religious and ethical traditions of the world know that overcoming poverty is sacred business.

The World Bank is an important ally to hundreds of millions of people who are working hard to escape from misery. But this is a vulnerable moment in the Bank's history. So all of its stakeholders, including all of us here today, need to join forces to renew the World Bank and make it more effective in combating global poverty.

David Beckmann is one of the foremost U.S. advocates for policies and programs to reduce poverty in the United States and worldwide. He has been president of Bread for the World for 15 years, leading large-scale and successful campaigning to strengthen U.S. political commitment to overcoming hunger and poverty. He previously served in operation and policy positions at the World Bank for 15 years. He played a leadership role in the Bank's engagement with civil society around the world.

TESTIMONY OF STUART E. EIZENSTAT
UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

WASHINGTON, D.C.
MAY 22, 2007

Thank you for the invitation to testify before your Committee on the issue of the future of the World Bank. I am appearing before you in my capacity as co-chair , with former Under Secretary of Commerce Grant Aldonas, of the Atlantic Council Commission on Transatlantic Leadership of the Global Economy, which issued a report in April of this year on ways in which the United States and European Union (EU) should work together to reform the major institutions created after World War II to manage the world economy--the World Bank and International Monetary Fund (IMF), the G-8 (originally the G-5), the International Energy Agency (IEA), the Organization for Economic Cooperation and Development (OECD), and the World Trade Organization (WTO), originally the General Agreement on Tariffs and Trade (GATT). We came to the conclusion that major changes in governance and focus of these international institutions were necessary in light of the enormous transformations in the world economy which have occurred since these institutions were created, or they risked being antiquated. Because the World Bank is the focus of this hearing, I will stress our recommendations for the Bank, and to an extent, the IMF, as well as reference recommendations others have made. To the extent that I go beyond the Atlantic Council recommendations, these would be mine alone.

In the past 50 years, the international economy has undergone major changes. For one thing, economic power has shifted east and south, but these organizations, and certainly the World Bank and IMF, have not sufficiently taken this shift into account. Today, China, India, Brazil, Russia and other emerging countries represent 45 percent of global GDP (on a purchasing power parity basis), up from 39 percent in 1995. They also represent 40 percent of world exports and 65 percent of foreign exchanges. Their economic position is now comparable to the combined positions of the U.S. and EU. Yet these countries have a much less central role in global economic governance than their economic importance dictates.

Another major change is the remarkable growth of global private financial markets that are increasingly available to developing nations, without the time delays, and conditionality of funds from the World Bank and IMF. In part this is a function of the success of the Bank and Fund in reducing poverty and encouraging good macro-economic practices by developing countries. These private funds overwhelm the amount of money available through traditional foreign assistance, and from public funds through the Bank and Fund. National finance ministers can often secure a loan for a major infrastructure project in matter of weeks from the private sector, instead of waiting a year or more for World Bank approval. For example, in 2005, private debt flows and new equity flows to sub-Saharan Africa in 2005 were \$3.8 billion and \$24.7 billion respectively, while the World Bank's net disbursements to sub-Saharan Arica in 2005 were \$3.1 billion. (See Report of the External Review Committee on Bank-Fund Collaboration, February 2007, "The Malan Report," p. 15).

A third development is the new entrants into overseas development assistance, particularly from countries like China, which has started funding roads, energy projects and other infrastructure projects in Africa and elsewhere, often for political or narrow economic interests, and without any interest in the political and human rights conditions in the countries, like Sudan, and often using their own workers, rather than those of the host countries, to build the projects they finance.

All of these factors impose significant challenges to the World Bank and IMF, including the desire by emerging economies to have more input into their governance. The Fund is doing far less lending to far fewer countries than in the past, in part a victim of its own success, as developing countries employ sound fiscal and monetary policies, build up currency reserves, and have less reason to borrow from the Fund, with its tough conditionality, and in part because of an aversion to the tough, though necessary medicine, the IMF administered during the Asian financial crisis in the late 1970s. Now, in a significant contraction, the IMF has only 10 non-concessional programs currently in place, with five of them precautionary. (Malan Report, p.15). The Bank is seeing many of its projects financed more quickly by the private sector or by aggressive ODA funding from countries like China. Moreover, many of its low income client countries have graduated into middle income status.

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We believe that the World Bank and the IMF both continue to be highly relevant, however. No other private or public institution can do the kind of macro-economic surveillance that the IMF employs, to prevent future crises. For the Bank, in the past 10 years or so some one billion people have risen above the poverty line. While much of this reduction has come from countries like China and India, that have begun to employ sounder economic policies of encouraging foreign investment, entering into the global trading system through the WTO, and running foreign reserve surpluses, the Bank's programs have played a role as well, with its $20 billion mixture of grants and loans.

Private lenders prefer their borrowing country-clients to be members of the IMF and World Bank. As The Economist Magazine noted, "Poorer countries (in Asia and Latin America) still rely on aid. In the richer ones, the development banks (The World Bank and its regional equivalents) still have a big role in long-term financing for infrastructure." I saw this personally in the work I did with BP on the BTC pipeline project, where IFC financing helped elevate environmental and social protections for Azerbaijan, Georgia, and Turkey, the three BTC countries. Moreover, development countries "are wise to diversify their borrowing." And, "Above all, the conditions attached by multilateral lenders provide reasonable assurance that money will not be wasted." (May 12, 2007, Vol. 383, No. 8528, p. 14).

No private capital will finance many of the projects financed through the World Bank's IDA program. It is the world's most poverty-focused aid agency, with 81 of the world's poorest countries, 40 in Africa, IDA-eligible. IDA has a presence on the ground in 64 of the 81 IDA-eligible countries, supporting countries that range in income from $100 per capita to $1025, spanning four continents and 2.5 billion people. A main factor in allocating IDA resources is the performance of countries in implementing policies and developing the institutional framework necessary to promote economic growth and reduce poverty. Performance is assessed through a publicly disclosed Country Policy and Institutional Assessment system.

Moreover, IDA has a greater capacity to deliver development assistance on a larger scale and in more sectors than any other aid agency, and certainly than the private sector. It finances projects and programs, services and capacity building across all areas of development policy--from macroeconomic policy, infrastructure, human, social, urban and rural development, the environment, and governance.

IDA is playing a major role in African development. In FY 07, half of IDA lending, or about $5.5 billion, will go to Africa, more than a third to infrastructure essential to sustainable development.

In addition, IDA works on a country-based business model aligned with the country's own Poverty Reduction Strategies, working with both borrowers and other donors to promote integration and coordination of macro- and micro- reform, and helps countries formulate sector-specific strategies and reforms. IDA allows partner countries to draw on lessons learned from other IDA and IBRD countries.

No other private or public institution can address complex cross-sectoral issues like IDA,--such as linkages between exchange rate policy and export diversification; macro-stabilization and banking sector reform; energy, agricultural policies and deforestation; environmental conservation and development of an eco-tourism industry; micro-finance and women's empowerment; access to clear water and pubic health benefits.

Another reason that the Bank and Fund continue to be relevant, is the rise of new issues arising from globalization, beyond traditional trade and capital flows, which require their assistance, and cannot be satisfied by the private sector alone, such as "global warming, energy security, the spread of communicable diseases, and demographic changes." (See "The Malan Report.")

Some critics state that one of the World Bank's major flaws is its continued lending to middle income countries like China, that can now access international capital market at a lower interest rate than the Bank charges. The majority report of the International Financial Institution Advisory Commission established by Congress in 1998 (Report, March 8, 2000), chaired by Professor Allan Meltzer, called for dramatic changes. (See also, "Reforming the IMF and World Bank" by Allan H. Meltzer and Jeffrey Sachs, AEI Online, March 8, 2000) They concluded that even more than the IMF, the Bank has failed to adjust to fundamental changes in the world economy by continuing to lend to countries like Argentina, Mexico, Brazil, and China that have access to private capital markets, and has fallen short of the helping the poorest countries, who need to Bank the most. The majority recommended phasing out lending operations to the richer developing countries with access to private capital, and providing grants rather than loans for poverty relief to poor countries. They also suggested moving much of the World Bank's regional efforts in Asia and Latin America to the regional development banks, leaving the World Bank primary responsibility for Africa until the African Development Bank is ready to take responsibility, and also dealing with the remaining poor countries in Europe and the Middle East

All claims should be written off against HIPCs that implement an effective economic and social development efforts under the Bank's supervision. For poor countries without capital market access, assistance for institutional reform should be conditional upon implementation of specific institutional and policy changes. They would phase out all assistance to countries with capital market access or per capita incomes more than $4000.

Following the release of the Meltzer Commission Report, the U.S. Treasury Department, which I was serving at the time as Deputy Secretary, released a rebuttal of parts of their recommendations. Some though not all of Treasury's comments related to the practicality of changes and the timing and pace of the recommendations. The Atlantic Council did not take a position on the details of either the Meltzer Commission report or the Treasury's rebuttal.

But because I would like to associate myself with the response by Treasury, permit me to summarize Treasury's points, specifically related to the World Bank.

Treasury noted that if the Commission's proposals had been in effect at the time of the Asian Finance crisis, neither the IMF nor World Bank would have been able to respond to the crisis that spread across emerging markets during the 1997-98 period. By essentially taking the World Bank out of the development finance business for countries with a per capita income above $4000, the Commission's reforms would have eliminated the most cost-efficient and effective international development institution, with the greatest concentration of development experience and expertise. They would have also precluded support for economic restructuring and private sector development in Easter Europe and the former Soviet Union, as well as in Asia and Latin America. The promotion of financial sector reform and capital market development, trade liberalization, privatization, and agricultural reform in emerging market economics that have the bulk of the world's population would have been precluded.

In addition, by eliminating the IFC and MIGA, the private sector financial operations of the Bank, an important part of the Bank's capacity to promote private enterprise, privatization of state-owned firms, and the development of domestic capital markets, would have been precluded.

Moreover, Treasury believed that by transferring financial capacity to the regional development banks, the effectiveness of the overall development effort would be compromised, by reducing the role of the institution with the most experience and competence in development and poverty reduction. By eliminating the capacity of the MDB's to provide emergency lending at times of financial crisis, the Commission would make the crisis response of the IMF less effective.

China will receive some $1.0 to $1.5 billion in IBRD lending this year. Why would countries like China remain interested in IBRD financing, and why should IBRD shareholders support such lending? China and other middle income countries get not only project loan financing, but technical knowledge that is not available from the private sector. The IBRD is a neutral, disinterested partner that acts in the best interests of the country, and has no other agenda, such as creating a new market for a particular good or service. China remains eligible because its per capita income of about $1300 is well below the $5685 IBRD graduation level. These countries are not eligible for IDA financing and do not crowd out other IDA recipients. Indeed, part of the income IBRD earnings is transferred to IDA.

The Bank's lending to China has achieved development results that are beneficial to China, East Asia, and the world, with the Bank's independent evaluation unit rating more than 90 percent of the over 200 projects the Bank has completed in China as successful in meeting their objective. For the world to reach the Millennium Challenge Goals, China, still home to the second largest group of extreme poor after India, has to do even more to address poverty.

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The World Bank nevertheless faces challenges which we believe require significant reform. There have been positive changes at the Bank. For example, the Bush Administration and Congress have insisted on some of the reforms advocated by the majority report of the International Financial Institution Advisory Commission, such as substituting grants for loans to the poorest countries, setting explicit conditions that can be monitored, and introducing incentives for countries to meet those conditions. Also, Congress required an independent performance audit of some International Development Association (IDA) programs and insisted on greater transparency at the World Bank. (Allen H. Meltzer, "New Mandates for the IMF and World Bank", Cato Journal, Vol. 25, No. 1 (Winter 2005). p.15.

Our Atlantic Council Commission recommended a number of signficant reforms.

1. Selection of Top Leadership of the World Bank and IMF Should be Chosen on the Basis of Merit not Nationality.

Our Atlantic Council Commission concluded that it is far past time for Europe and the United States to give up their monopoly on naming the heads of the Bank and Fund, the former always an American, the latter always a European. We said that the "United States and the EU (should) give up their automatic leadership of these institutions." This is an antiquated and unfair precedent that fails to recognize the changes in the world economy and the growth of Asia, Latin American, and African nations. Moreover, with the special focus of the World Bank on development, it may not produce the best leaders, who are experts on development. It leads these nations to want to go their own way. For example, the Chiang Mai initiative has established a mechanism for lending among Asian governments.

The current duopoly by Europe and the U.S. feeds the capacity of radical leaders like Hugo Chavez of Venezuela to argue that they will leave the IMF and World Bank and to encourage Latin nations to create a new body, the Bank of the South, to make loans to Latin American governments without what he calls "neoliberal" strings.

With Paul Wolfowitz's departure at the end of June, President Bush can send a powerful signal to the world that he is turning a corner on American unilateralism by throwing open the contest to the entire world, and supporting the best candidate, regardless of nationality. That would turn the tragedy of the Wolfowitz incident into a plus for America's image in the world, and for the future management of the world. This would be consistent with our Atlantic Council's call for this change to be instituted at the time of the next election, then, of course, not anticipating the Wolfowitz episode.

2. World Bank and IMF Governance Should Reflect Actual Economic Power and Influence.

Emerging economic powers in Asia and Latin America are seriously under-represented in voting power and board representation. The Atlantic Council Commission report stated that "If developing countries and emerging economic powerhouses are to take these institutions seriously and become real stakeholders in their success, rather than give priority to regional institutions which compete, they must be given a genuine leadership role."

Our Atlantic Council Commission recommended two significant reforms to rectify this situation. First, European representation should be consolidated into two seats, an EU Euro zone and a EU non-Euro zone seat, to promote more European cohesion and more unified positions, and make room for new leaders. Because EU Member States are still represented in the IMF and World Bank by national governments, EU countries are over-represented, with seven directorships out of a total of 24, with Switzerland holding an eighth European directorship.

Second, we recommended that U.S. and European representation should be re-balanced in terms of voting shares and executive directors. The IMF has already embarked on a process of re-examining its current distribution of voting shares, and in September 2006, four countries—China, South Korea, Turkey, and Mexico—received slight increases in their shares. But this is widely seen as insufficient, and the Fund has pledged to overhaul its voting structure over the next two years. The representation at the Bank should follow suit.

3. There is Confusion and Overlap in the World Bank and IMF Programs, with Inadequate Consultation and Coordination.

Our Atlantic Council Committee found that the Bank and Fund have responded to the changes in the international economic environment in part by reaching out beyond their mandates, in effect seeking new business. Since they work in many of the same countries at the same time, this leads to inefficient overlap in their programs. We also concluded that there was insufficient coordination between staff efforts in the same nations. The lack of collaboration has costs in the wasting of public assets, conflicting advice to recipient nations, and a failure to meet the needs of members.

As the Malan Report notes, there are obvious links between the Fund's major mandate of macroeconomic stability, and the Banks concerns about improving the quality of public spending, or between the Fund's focus on global monetary stability and the overall development prospects of nations, which is the Banks' concerns.

While the Malan report notes examples of good collaboration and improvement in cooperation, citing the collaboration between the Financial Sector Assessment Program (FSAP), the Heavily Indebted Poor Countries (HIPC)—a Clinton Administration initiative--debt sustainability analysis and Reports on Standards and Codes, the Atlantic Council and the Malan Report felt there were significant gaps in cooperation.

But there are also overlapping efforts. For example the IMF's medium-term strategy and its role in low-income countries, especially in the financial sector, overlap with Bank programs. The Malan Report has noted that the Fund's financing activities in low income countries has moved beyond its core responsibilities and overlaps with Bank work in development finance, based upon the vague concept of "protracted balance of payments need." (Malan Report, p.10)). This has spread the Fund "too thinly across development-related work", by moving into areas beyond its core capability, such as "civil service, land and energy sector reforms; privatization; property rights; and judicial reforms", all of which should be the World Banks' responsibilities. (Malan Report, p.43).

Our Atlantic Council Commission made a number of recommendations to deal with these issues.

(1) We recommended a clearer delineation of responsibilities between the Bank and Fund, with each focusing on their core strengths so they are better able to cooperate in developing countries. This should not be based on the income of the recipient countries, with, for example, the Bank taking the lead for low-income countries, and the Fund with middle-income countries but on their specific needs.

The Meltzer Report of 2000 argues that the Fund should focus on global financial stability, including the quantity and quality of information available to private lenders and reducing the risk of financial crises, while the Bank should focus on sustainable development and poverty reduction.

By contrast, the IMF should focus on providing the policy advice, macroeconomic assessments, and surveillance that will encourage private capital markets to handle most imbalances, while remaining prepared to be the lender of last resort. As the Malan Report suggested, the IMF should gradually withdraw from providing long-term base-line financing to low income countries in the context of a development program.

The new Policy Support Instrument of the IMF, a non-financial instrument for low-income countries, can, in the words of the Malan Report, "facilitate the gradual withdrawal of the Fund from long-term financing in the absence of a present balance of payment need." The Fund should continue to provide short-term balance of payments financing. (Malan Report, page 11). The Fund should take on a more active role in addressing global economic imbalances and do more to prevent imbalances, especially among the poor and emerging economies.

Because of this Committee's focus on financial services, the Malan Report's recommendation is sound that a clearer delineation of responsibilities between the Fund and Bank would be interesting here, as well. Thus, the IMF would take the lead where there are domestic or global stability issues, such as the "soundness and stability of the financial system, macro-financial linkages, balance sheet and other risk analysis of systemic importance, capital account liberalization or channels of transmission of implementing monetary policy." The World Bank would take the lead where financial sector development issues are more important, such as "banking system reform, capital market development or specialized lending institutions focused on specific 'development' objective, such as agricultural and small to medium enterprises lending and institutions." (Malan Report, p.12).

In facilitating achievement of the UN's Millennium Development Goals and increased aid flows, the Fund needs to undertake analysis of the macroeconomic consequences in low-income countries of the Bank's poverty reduction strategies. As the Malan Report states, the Fund has the lead in managing the exchange rate and fiscal and monetary consequences of the increased aid flows the G8 has promised. (Malan Report, p.45).

(2) The Atlantic Council Commission recommended closer coordination between the Fund and Bank by "double-hatting" executive directors.

This would help foster close collaboration between IMF and World Bank teams working in individual countries. By seeking a greater alignment between the Fund and Bank boards, as the Malan Report suggests, appointing the same person to serve as executive directors at the Bank and Fund would help assure greater coordination and collaboration and reduce duplicative programs. The Malan report also recognizes the advantage of having the "same Director being on the Board of both the Fund and the Bank." (Malan Report, p. 8).

(3) The Atlantic Council Commission recommended that planning should begin now for an eventual merger, no later than 2030.

The Malan Report suggests a number of ways to achieve greater collaboration, such as a standing Bank-Fund working group (Malan Report, p.8); strengthening the review function of the World Bank's Poverty Reduction and Economic Management unit in the World Bank so it can work more effectively with the Fund's Policy Development and Review Department in dealing with low-income countries (Malan Report, p.11); and strengthening the Joint Implementation Committee to foster cooperation (Malan, p. 45).

But, these changes will not achieve the kind of coordination needed, without a merger. There are inherent overlaps that only a merger can alleviate. For example, the Fund needs to take into account the sectoral level and the composition of public spending, within the Bank's responsibility, in order to achieve macroeconomic stability. (Malan Report, p.10). The Fund must rely on the Bank's sectoral assessments for its work on macroeconomic stability and the aggregate effects of aid (Malan report, p.11). The Bank must provide the Fund with advice in analyzing the sectoral aspects of public expenditures, for the Fund to do its work on the quality of fiscal aggregates in considering the quality of public expenditures. (Malan Report, p. 12).

As the Malan Report notes, for the Fund to manage the macro-economic consequences of increased aid flows, there must be an assessment of the sectoral issues and how to effectively use resources freed up by debt relief. (Malan Report p.45).

More broadly, the IMF's "work on macroeconomic stability and the aggregate effects of aid and debt relief cannot be separated from what is happening at the sectoral level." (Malan Report, p.

43). Moreover, there is an obvious relationship between a macro and growth focus. In addition, the effort to invigorate the Joint Implementation Committee have not been successful.

All of this indicates the advantages of having the IMF and World Bank under one roof.

4. Greater Accountability of World Bank Programs.

There has been an improvement in the internal review of Bank programs. But I personally believe that more needs to be done to determine the effectiveness of the poverty reduction. The monitoring that Congress insisted upon for some IDA programs should be extended to the entire World Bank and its affiliates, (Meltzer, Cato Journal, p. 15). Here, the recommendation of the Meltzer Commission is on point in calling for an independent performance audit, or the establishment of an internal, independent group, like the Government Accounting Office, so that it is a more effective development bank.

Moreover, the emphasis that both Jim Wolfensohn and Paul Wolfowitz have placed on anti-corruption efforts, as well as by organizations like Transparency International (on whose advisory board I sit), is essential to sustainable development. The World Bank has estimated that $1 trillion a year is paid in bribes in all countries. (Meltzer, Cato Journal, p. 16). While the approach to be taken to dealing with corruption is open to debate, the need to make this a key feature of the Bank's work is essential to achieve the UN Millennium Goals on poverty reduction.

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The World Bank and Development Assistance

Testimony Prepared by
Joseph E. Stiglitz
For presentation before the House Financial Services Committee
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1. America, and the world, has a strong interest in contributing to reducing poverty and promoting growth in the developing world. Aid can be an effective instrument in achieving these objectives.

There is by now widespread agreement that poverty in the developing world is one of the major challenges facing the world today. The successes of the countries in East Asia and elsewhere during the past fifty years have shown that development is possible; the failures in Africa (including the doubling of the numbers in poverty during the past quarter century)[1] and elsewhere have shown that development is not inevitable.

What separates developed and developing countries is a gap in both resources and knowledge, and foreign assistance, properly designed, can reduce the size of those gaps. As Chief Economist of the World Bank, and in my many travels to developing countries during the past 7 years, I have seen many instances of successful assistance programs, programs that ameliorate poverty and help provide the foundations of sustained growth. Well-designed programs can help create more equitable societies and more stable democracies.

Before turning to the role of the World Bank and the reforms that are needed there, I should say a few words about why we, like other advanced industrial countries, do and should provide assistance to developing countries and why it was right that the advanced industrial countries should have committed to contributing .7% of GDP to assisting those less well off. I need not remind this Committee of how short we are in living up to that commitment—last year we spent less than 0.17% of GDP on development assistance, down from 0.22% in 2005[2], and much of that was directed at the Middle East. Africa, the region of the world most in need of assistance, received only $4.18billion, less than .04% of GDP.[3] I also need not remind this Committee that our performance in this respect puts us in the unenviable position of being near the bottom in carrying out our commitments. Nor does it enhance our credibility when the U.S. claims that providing substantially more funds is "out of the budget envelope," when we are simultaneously spending far more than these amounts on the War in Iraq—spending that I have estimated will eventually have a budgetary cost of nearly a trillion dollars, and a total cost to the economy in excess of two trillion.[4]

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[1] *African Development Indicators: 2005*, World Bank, Washington, DC

[2] *Table 1: Net Official Development Assistance in 2006*, available at http://www.oecd.org/dataoecd/14/5/38354517.pdf, Development Cooperation Directorate, OECD, Paris, 2007.

[3] *Development Assistance Committee Peer Review: The United States*, OECD, Paris, 2006.

[4] See J.E. Stiglitz and L. Bilmes, "The Economic Costs of the Iraq War," NBER Working Paper 12054, February 2006, and the updated version, "Encore: Iraq Hemorrhage," *Milken Institute Review*, Fourth Quarter, 2006, pp. 76-83. Both are available at www.josephstiglitz.com.

We recognized at the beginning of that War that success would require wining the hearts and minds of those in Iraq. One of the objectives of development assistance is similar: aid is important not only because it is the morally right thing to do, but there are a host of areas where cooperation is desirable, if not necessary. Such cooperation is more likely to be forthcoming from countries whose citizens share our values (including beliefs in democracy and democratic processes and in markets) and see a large commonality of interests. On the other side, there can be serious adverse effects from the failures of development. The forces of migration with which so many countries are trying to deal today are largely economic: most of the migrants who are leaving their families and friends to come to America today no more want to do so than those who left Ireland and other European countries to come to America in the nineteenth or early twentieth century. It was the push of poverty as much as the pull of opportunity. But in so many of the developing countries, there is too little opportunity and too much poverty. If we wish to reduce migration pressure, it is far better to raise the living standards of those in the poor countries than to build walls that divide.

America is fighting a war on terrorism, and while the forces that give rise to terrorism are complex, poverty and despair provide a fertile feeding ground. The trillion dollars spent in destroying Iraq would have done far more in the war against terrorism had it been spent in creating opportunity in the Middle East and elsewhere. The mind boggles at how such sums might have transformed some of these desperately poor countries, many of whom have high unemployment rates and ready access to arms—a combustible combination that is impeding development.

2. ***The multilateral institutions (of which the World Bank is the premier institution) play an important role in this global effort. For a variety of reasons, assistance administered through the World Bank (and other multilateral institutions) can be even more effective in achieving our objectives than assistance provided by the U.S. directly. This is especially true at the current time, when American credibility, especially in the developing countries, has sunk to an all time low.***

Today, development assistance is provided by a variety of private and public institutions. The rich ecology of providers of development assistance contributes to the vitality of the development efforts in many countries. Still, the World Bank is pre-eminent. It is the most important multilateral institution designed to raise the living standards of the more than 2 billion people living in poverty in the developing world. Its intellectual resources are so rich that it has sometimes been accused of having a position of market dominance in the area of development research. For several decades, it, perhaps more than any other institution, has set the agenda of development debates.

The question is, is the World Bank today playing the role that it should be playing, and, if not, what can be done about it? The United States has an especial responsibility in oversight: it played a central role in the founding of the institution and is still the single largest shareholder. It has, by tradition, appointed the President, and, for better or for worse, the President has, again by tradition, played a large role in shaping the institution. The U.S., while it has not contributed its fair share to the triennial IDA replenishments,[5] is still the largest contributor.

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[5] IDA provides concessional loans to the least developed countries. In the last replenishment, U.S. contributions as a percentage of its GDP was .02 %, compared to the UK, the next largest contributor, who gave .12% of its GDP. (From *Report from the Executive Directors of the International Development*

Even before the recent turmoil at the institution, there was considerable concern about its direction. Large numbers of its senior people have departed in the past two years, demoralized by what they saw happening to this institution to which so many have devoted years of their lives, in their commitment to improve the plight of those in the third world. (I should make it clear, that while I have sometimes disagreed with my colleagues at the World Bank about the direction of economic policy, I have always had enormous respect for their dedication and commitment. Indeed, I thought the debates we had within the Bank were the kinds of debates that should be going on in democracies around the world. Such debates, I believe, strengthen democratic processes.) The most important asset of the institution is its staff, its human capital, and it will take years to replace what has been lost.

I want this afternoon, however, to focus on broader (though not totally unrelated) issues—how the World Bank *should* conduct its business, what the development agenda *should* be, and what the U.S. can do to help ensure that this is brought about.

The World Bank, as I have said, is only one of many development institutions; it owes its pre-eminence to the fact that it is the only global *multilateral* development lending institution.[6] America, the U.K., and almost all of the other advanced industrial countries have their own assistance programs. Historically, many of these assistance programs have been (and have been seen to be) connected with particular national agendas and driven by particular historical relationships. A disproportionate share of American assistance goes to the Middle East, while the former French and British colonies receive large amounts of assistance from their former colonial masters.

Multilateral aid is often more effective than national assistance, because it is not so closely linked with the agenda of any particular country; that makes the aid more effective and the advice more readily accepted. Moreover, by bringing the brightest researchers in development from around the world together, there is a chance of greater progress in addressing what in some parts of the world seems an almost intractable problem. When multilateralism works well, the whole can be greater than the sum of its parts. Moreover, multilateralism helps "teach" democracy, by showing how countries can act, democratically, together to advance common ends: it provides an example for others to follow.

Even from a more narrow perspective of U.S. interests, multilateralism works to our benefit, for several reasons. The Iraq War has shown that we cannot prevail in getting done what we would like in a country with less than 10% of our population and 1% of our GDP. We need the help of others, and this is even truer today than it was 6 years ago, because of the decline in America's credibility. This is not a question of partisan politics; it is a reality verified by every poll and survey conducted in almost every country around the world, but especially in the developing countries. I spend a large fraction of my time traveling and working in developing countries,

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Association to the Board of Governors, Additions to IDA Resources: Fourteenth Replenishment, Table 1: Contributions to the Fourteenth Replenishment, International Development Association, Washington, DC, 2005)

[6] The UN system plays a critical role in technical cooperation and in running concrete development projects. For a number of reasons (some discussed later in this Testimony), the UN is often viewed as a better forum for reaching international consensus on key development issues, including the Millennium Development Goals, gender, environmental issues, and the international convention against corruption.

where I have the opportunity to talk to prime ministers and presidents, parliamentarians and businesspeople, academics, activists, and ordinary citizens. The polls simply confirm with even greater force what emerges from these conversations—a reality with which America must come to grips in coming years, a reality which is sometimes hidden or obfuscated by the diplomatic language that is used in official circles.

The loss of our credibility means that positions we take generate an immediate political backlash, *even when those positions may be in the best interests of the country.* We have lost our ability to give advice effectively. Advice and aid coming from a multilateral institution—especially if that institution is not seen simply as the handmaiden of the United States—is accordingly likely to be more effective than aid and advice coming directly from the United States.

Unfortunately, the last few years have seen a weakening of the commitment to multilateralism by the United States.

3. ***It is therefore in our interest that the World Bank remains strong, credible, and effective. The Bank has rightly emphasized good governance and corruption, but the Bank can only be effective if it is seen as having good governance itself, and if there is no cloud of corruption hanging over the head of that institution. There has to be confidence that there is not corruption in the corruption agenda; that there is not a hidden political agenda, with corruption in some countries being overlooked, while in other countries there is a policy of virtually zero tolerance. Finally, part of democratic values is due process; the implementation of a corruption agenda itself must conform to the highest standards.***

   Good governance—a commitment to basic, democratic values—requires that the head of the institution be chosen in an open and transparent process; it should be the most qualified person for the job, regardless of race, gender, or nationality. It is in America's interest that the head of the institution not simply be chosen by the President of the United States.

   There are other important changes in the governance of the World Bank and other multilateral institutions that will increase their effectiveness. These require a careful balancing of more democratic accountability and strengthening procedural safeguards.

Not surprisingly, we have also seen a weakening of *de facto* multilateralism at the World Bank: there is a widespread perception that the policies and practices of the Bank are disproportionately driven by the Administration. Those who lost favor with the Administration risked losing loans[7]; while countries in favor could engage in corruption, without losing funds.[8]

Spreading democracy entails engaging in democratic practices. Democracy, as we all know, is more than periodic elections. It includes participation in decision making and high standards of

[7] The case of Uzbekistan is often cited. The issue being addressed here is not whether Uzbekistan should or should not have had its program curtailed. The *timing* of the cut off, coinciding with the falling out of favor of that country, contributed to the perception described above. Human rights groups have, of course, long criticized assistance to that country. More generally, countries with high levels of corruption that continued to support American policies continued to get assistance, while those which seemingly had much lower levels of corruption faced cut-offs of assistance.

[8] Particular managerial practices contributed to these perceptions. Historically, presidents of the World Bank worked hard to contribute to a spirit of multilateralism by appointing close advisers from many countries. There is a strong feeling that this has not been the case in the last two years.

governance. That was why, for instance, during my tenure as Chief Economist of the World Bank, we began an emphasis on a comprehensive attack against corruption *and* a comprehensive approach to improving governance, including working to enhance participation in formulating development strategies. Attacking corruption is not just a matter of giving lectures. Credibility requires following the highest standards within the Bank. What is important is not just reality, but also perceptions. Of course, all individuals are fallible, and that is why the Bank has put into practice procedures and safeguards. These safeguards and bureaucratic procedures can be costly. Getting the balance right is not easy and requires constant reevaluation. In many ways, the World Bank has become the gold standard in its procedures—but, of course, it is not perfect. Countries sitting on billions of dollars of reserves, who have no need to come to the Bank for money, nonetheless have large Bank programs, because of the help of the Bank in providing technical assistance and limiting the scope for corruption.

The point I am emphasizing is that one needs to be careful in criticizing bureaucratic procedures: they are there for a reason. And one needs to be even more careful in evading these procedures, a point that those in America's intelligence community emphasized and which has been so amply demonstrated by the recent problems at the World Bank.

Part of democratic processes entail fair treatment and *due process*—principles such as innocent until proven guilty in open and transparent procedures. There is concern that in the last couple of years, these principles have sometimes been given shortschrift. Aid seemingly is cut off from "corrupt" countries that fall out of favor; but there is a push for increased aid for even more corrupt countries (by most standards) that are in favor. Charges of corruption have been leveled and aid is suspended before the evidence has been reviewed; in some cases, there seems to be a reluctance even to produce the evidence—perhaps out of fear that it would not hold up in the light of sunshine.

As I have repeatedly written, the emphasis on governance is deserved, but because the governance of the World Bank itself is so flawed, it cannot be a credible messenger. Recent problems have only made things worse. This is especially so because Paul Wolfowitz came from the Department of Defense which used sole source contracting procedures—precisely the kinds of procedures that are conducive to corruption and which I argued against when I was chief economist of the World Bank. Were it not for the strong action of Congress, there might have been even greater resort to sole source contracting. Today, many of those in the Bank have been concerned that these "sole sourcing" practices have been imported into the Bank, e.g. in the awarding of certain consultancies.

Whether the perceptions are accurate or not, this Administration is seen around the world as one of the most corrupt in the recent history of the United States, and it would be difficult at best for anyone from this Administration to be an effective carrier of the message of good governance.

It is in our interest that there be non-corrupt, democratic governments around the world; but if the World Bank is to play an effective role in that, then the head of the World Bank *cannot* be closely associated with this Administration.

More generally, if the World Bank is to have credibility in advocating good governance, there must be reform in its own governance, and in particular in the way that the head is chosen. It should be the most qualified person, chosen in an open and transparent process. Part of democratic processes entails choosing the most qualified people for jobs, regardless of race, sex, nationality, etc.; this should hold true, even more so, in choosing the head of the World Bank. Today, the way the head of the Bank is chosen highlights deficiencies in governance which undermine the Bank with each of the constituencies required for success—donor countries, recipient countries, civil society and NGO groups in both developed and less developed countries that are committed to the cause of eradicating poverty and promoting democracy, and the World Bank Staff. The support of all of these is required if there is to be adequate funding for an aggressive program for poverty alleviation and if programs, policies, and projects are to be designed and implemented in an effective way. No matter how well-suited the person nominated for the job may be, if he or she is seen as essentially an appointee of the American president, he or she will begin with a cloud overhanging him/her. The Bank will continue to be seen as an instrument of the policies of the current Administration, and this will impair the effectiveness of that institution in achieving its objectives.

There are other reforms to the governance of the Bank which the present scandal has highlighted, and I want to comment briefly on them. On the positive side, the review process showed that the Board could exercise its fiduciary role—even in a very difficult situation where the largest shareholder was not fully supportive—setting up a committee that included four members from developing and transition economies. In spite of the pressure that was brought to bear, twenty two of the twenty four directors concurred with the findings of the panel, and realizing that the well-being of the Bank required that Wolfowitz had to go, supported that action. On the negative side, both on what has already been disclosed and on information available through informal channels, it is clear that the President of the World Bank had enormous elements of discretion, in making appointments, in circumventing rules, in suspending loan programs, and in directing bank programs, with insufficient checks and balances in place and insufficient oversight. Some of the systems designed to provide the checks and balances are clearly flawed—with offices which might receive complaints about Presidential abuses actually reporting to the President. Fears of retribution against whistle blowers or those raising complaints were not totally unfounded. Had the President of the World Bank been elected in a global poll with a mandate to carry out the policies in the manner that they were carried out, he might have encountered resistance, but there would be some political legitimacy. As it was, there was no mandate, no political legitimacy. The "powers" of the President had previously not been abused in this way, but the fact that they could be so abused too highlights a fundamental flaw in governance.

Reform will require careful balancing. There needs to be more accountability of the World Bank, both to the Board and to other stakeholders (including donor countries.) But this has to be done in ways that avoid excessive politicization of the institution. The Bank has created one of the most talented and qualified bureaucracies around the world; bureaucratic procedures have been put into place that ensure that, by and large, they attract and choose highly qualified applicants. But left to themselves, the bureaucratic safeguards could lead to an entrenched bureaucracy pursuing its own agenda, or insufficiently flexible to adapt to changing circumstances—including new learning about the costs and benefits of privatization and liberalization, new attitudes about country ownership, or new agendas, such as those concerning worker rights.

The Board, working with the President, must establish what the Bank's overall agenda and priorities will be. As I argue below, this agenda must be more balanced, more consistent with our own values, and consistent with our own practices. While the Bank is likely to continue to be focused on promoting growth and poverty alleviation, it is inevitable that there will be changing views on how that can be most effectively done. Fifteen years ago, corruption was not on the agenda. Today, there is a concern that there is too much focus on corruption and too little focus on the other ingredients that are required for development effectiveness. There has been too much emphasis on privatization and liberalization and not enough on what is required to make a successful market economy; there has been too little focus on how to improve the quality of the public sector, technology, working conditions, the rights of workers, and security more generally.

The Board, and not just the President, must play a central role in constructing and approving this agenda, and then ensuring that the President and the Staff of the Bank implement that agenda in an effective and consistent way. At the same time, the checks and balances and safeguards against abuses by the President of the World Bank have to be strengthened. For instance, there should be competitive selection for positions up to and including the vice-presidential level, with selection committees vetting candidates for senior positions both in terms of their track record and in terms of their ability and willingness to carry forward the Bank agenda. For positions of Vice-president and country directors, the selection committees might present the President with three candidates, among which he could choose. Just as the OED (the operations evaluation department) reports directly to the Board, so too should various oversight offices, such as the office of the Ombudsman and the Office of Institutional Integrity. Current safeguards, which include putting into these positions individuals at the end of their career, need to be strengthened by appointing on a limited term basis individuals from outside the Bank; but such appointments should be made by the Board, not by the President, since they should be viewed as part of the mechanisms designed to provide oversight of the President and the Staff.

The current episode has also highlighted the need for having a Legal Counsel that is independent of the President. One of the responsibilities of the legal counsel is to ensure that the President is conforming to the rules of the Bank. A Counsel appointed by the President may lack the incentive or willingness to provide the necessary check. The Counsel should be appointed by and report to the Board.

International economic institutions, like the World Bank, are at some distance from direct democratic accountability. The issues of global governance play little role in American elections, though the President of the World Bank has been a virtual appointee of the United States. If those elsewhere in the world see that the direction the World Bank is taking under new leadership is astray, they have little recourse. Mistakes cannot be corrected at the next election: if the American president gets re-elected, his appointee is likely to be chosen again. Making matters worse is that typically, decisions of the U.S. with respect to the World Bank are made by the Secretary of Treasury—not even by the head of USAID, even though the World Bank is supposed to be a development institution. Often, there is little consultation within the U.S. government or with developing countries—highlighted so clearly by the Wolfowitz appointment.

To address these problems, at least three actions are required: (1) The responsibility for the World Bank should shift from Treasury to USAID, or should be shared with USAID. This is a practice followed by many other countries, and is essential if the developmental perspective is to remain paramount in dealings with the World Bank. (2) There needs to be more parliamentary (congressional) oversight. The appropriate form of this oversight will need to be worked out. A committee of the parliaments/congresses, including donor and recipient countries, could be formed to review the agenda and procedures, and to discuss widely perceived grievances. (3) There needs to be more transparency—public oversight of decisions, both *before* and after they are made.

These reforms (and there are many other reforms in its governance which I have discussed elsewhere) are, I would argue, as much in the interest of the United States as they are in the interests of the world as a whole.

No system is perfect. A president determined to evade the set of safeguards put into place may still be able to do so, even after those are strengthened. Humans are fallible, and so are the institutions that they create. The current system showed itself not up to the task of preventing abuses by a President not willing to obey long standing norms and codes of conduct; had it not been for the particular scandal that led to his resignation, practices that were enervating the Institution would almost certainly continued. The reforms discussed above represent an attempt to carefully balance institutional demands for flexibility and accountability. These and other governance reforms can reduce the likelihood of the recurrence of abuses and enhance the rapidity with which they are corrected. The challenge is to provide bureaucratic safeguards at reasonable costs while maintaining flexibility, to provide democratic accountability without subjecting the institution either to politicalization or to the necessity of responding to potentially excessive vagaries of the fads and fashions to which development thinking may be subjected. I believe that the reforms that I have suggested might constitute part of the step in the right direction.

It will take time and care to reform Bank governance. Another president chosen under the flawed conventions of the past may have a particularly difficult time reaching the required consensus for these reforms. The appropriate course of action at this juncture may be the appointment of an interim President, for the next 20 to 24 months, who, while continuing with oversight of the day to day operations of the bank, sees as his/her mandate reaching consensus on a new model of governance. A system that may have worked well at the end of World War II, when colonialism was still alive and well, is unsuited for the twenty-first century.

There are, fortunately, some excellent candidates, people from the Third World, who know about development and have proven their competency in both politics and economics. I hesitate to mention names, but one that quickly comes to mind is Ngozi Okonjo-Iweala, a scholar at the Brookings Institution, who proved her mettle during the difficult period of the East Asia crisis, while serving as the World Bank's country director for Malaysia, and who subsequently showed her effectiveness in promoting development and fighting corruption as Nigeria's Finance Minister and, later, Foreign Minister. It would send a wonderful message to the world that those who fight consistently and effectively for development and against corruption get rewarded, regardless of political connections, gender, and nation of origin.

A Comprehensive approach to corruption

4. ***Fighting corruption requires more than just speeches; it requires a comprehensive agenda that includes the development of policies that reduce the scope for corruption. There are ways that the U.S. and other advanced countries can contribute to the fight against corruption: most notably, strict enforcement of anti-bribery laws, eliminating bank secrecy, not just for terrorists, but also for tax evasion and corruption, and demanding transparency in payments to governments—for instance, by using the tax code to enforce the extractive industries transparency initiatives.***

When the World Bank is once again able to become an effective carrier of the message of good governance, it should do so in a comprehensive way. More than lectures are required. I referred earlier to corruption resistance procurement procedures. There are also corruption resistant taxes and procedures for tax collection.

America could do a great deal in the fight against corruption, by undertaking two simple actions. The first is make life more difficult for the secret bank accounts which facilitate corruption. The OECD had an initiative to curb bank secrecy—an initiative which this Administration vetoed in August 2001. We then discovered that bank secrecy was not only for money laundering, tax evasion, drugs, and corruption, but also for terrorism; we have since circumscribed the use of bank secrecy for terrorism—and thus we have shown that it can be done. But we have chosen not to deal with the problems of corruption and tax evasion which are so enervating to the developing countries and deprive them of so much needed money.

There is an old saying that transparency is the strongest antiseptic—and there is a consensus that there should be more transparency in the extractive industries (the Extractive Industries Transparency Initiative.) Not long ago, many countries provided tax deductions for bribes. In effect governments were paying half the costs of the bribes. We can use tax policy to promote transparency, simply by saying that transfers that are not fully disclosed are not tax deductible.

Development strategies that are consistent with our values and economic philosophies

5. ***Successful development requires more than attacking corruption; aid effectiveness can be undermined not just by corruption, but by incompetence or by the absence of the appropriate complementary policies. It requires a comprehensive development agenda.***

Development effectiveness is impaired by corruption; but it is also impaired by incompetence, or the lack of an effective development strategy. This is not the place to lay out what such a strategy should look like. But one of the lessons that we have learned from the failures of the past is that one needs a comprehensive development strategy and that development strategies premised on simplistic ideologies will almost surely fail. They will especially fail in the broader agenda of advancing our values and winning the hearts and minds of those in the developing world.

Conditionality

6. ***There also needs to be country ownership of the development policies, programs, and strategies. Excessive conditionality undermines this and development effectiveness. While the conditions that have been imposed have been reduced, in many cases, they still remain excessive; and even as up front conditionality has been reduced, new forms of hidden conditionality have been introduced through the IDA allocation formulae. These formulae fail to deliver aid to where it is likely to be either most needed or most effective.***

There has also emerged a broad consensus that for aid to be effective, there must be country ownership; country ownership is strengthened when the recipients participate meaningfully in the design of the policies and programs. Even the World Bank and the IMF now recognize that in the past they imposed *excessive* conditionality (the requirements that are imposed on countries as a condition for their receiving aid), and that this conditionality, because it undermines country ownership of these policies, also undermines democracy and the effectiveness of aid. But while the international financial institutions have improved, they have not improved enough. It may take Congressional action to get the desired result. Late last year, the U.K. government announced that it would withhold certain funds from the World Bank, unless it changes the extent of the conditionalities it imposed. The U.S. should join in these efforts in reforming the manner in which aid is given.

While up-front conditionality has been reduced, for the poorest countries, conditionality has been introduced through the back door, through the formulae used to allocate concessional loans under IDA. The idea behind the formula is reasonable: aid should be allocated to countries that need it most, and for which aid is most likely to make a difference. However, the formula is defective in at least two ways. First, the needs assessment is based simply on income per capita; there are a host of other important factors (such as drought and civil strife in neighboring countries) that should be brought into the calculus. But more important is the way that "aid effectiveness" is judged. Heavy weight is given to a set of "good governance" measures (through CPIA ratings). Ironically, while transparency is one of the important criteria for good governance, for years, these measures were kept secret. When they were finally made public, it became clear that they contained large elements of subjective judgment, and that "good governance" meant, in part, subscribing to the tenets of the Washington Consensus and going along with the agenda of privatization and liberalization.

Of course, money should be spent in ways that are effective. But there is no coherent economic model behind the aid allocation formula, no econometric study which would suggest that the measures used (with the weights assigned) provide the best estimate of the marginal returns. Moreover, the challenge to the World Bank and other aid agencies, when confronting a country with poor governance, is to find alternative delivery mechanisms for aid. It is bad enough that the people in these countries are suffering from poor governance; to be doubly punished by denying aid would seem unfair—especially if there exists alternative ways by which assistance can be provided (especially in health and education, investments in the youth in these countries). Bangladesh is a country whose governance is widely criticized; yet it has some very effective NGO's which have been successful in reducing poverty, increasing literacy, and advancing gender rights. It would be wrong to cut off Bangladesh from assistance simply because of poor governance. Aid can be delivered effectively through these NGO's. In other countries, we should work to create and strengthen alternative delivery mechanisms.

7. ***The conditionalities that have been imposed have, in some cases, actually reduced aid effectiveness. Moreover, these imposed policies represent values that are contrary to those that are held by the vast majority of Americans. The disparity between what we require of others and what we do ourselves further undermines the credibility of the institution and aid effectiveness.***

The problem is not just that that there have been an excessive number of conditions imposed on developing countries—reducing the scope of their policy space for making their own democratic decisions concerning economic policies—but that often the conditions imposed have been misconceived. Based on flawed economic models and flawed analyses, they have retarded, not promoted, growth and prosperity.

We should be particularly wary when the World Bank or the IMF pushes policies that democratic processes here in the United States would almost surely reject. We have often rejected them because they are bad policies; but even if we were wrong to have rejected them, the obvious inconsistency between what we say and what we do gives rise to charges of hypocrisy, and does not do our cause any good.

For instance, America had a debate two years ago concerning privatization of social security. There was a consensus that privatization would increase transactions cost, reduce the security of the elderly, and almost surely result in increased poverty among the elderly. This consensus was consistent with my own research findings. But the World Bank and the IMF have often pushed countries to privatize their social security systems. To be sure, many needed *some* reforms, but privatization was only one of several possible options, and not the one most likely to succeed in the broad objectives that social insurance serves.

As another example, America has consistently rejected the notion that its central bank (the Fed) should focus exclusively on inflation. This is an issue on which different economists have different views, though I believe that the overwhelming evidence is that a more balanced approach (focusing on employment, growth and inflation) leads to more *real* stability and greater long term prosperity for most citizens. But the international financial institutions have often pushed central banks in other countries to focus exclusively on inflation.

As a third example, this Congress has repeatedly affirmed its commitments to workers rights, to the core labor standards, including the rights of association. Over the years, Congress has passed, and presidents have signed, legislation providing for worker job protections. There may be disagreements about whether the protections currently provided are adequate. But the international economic institutions have emphasized "labor market flexibility"—code words for stripping away worker protections—and have done little to promote core labor standards. When conditions have been imposed on loans, they include conditions relating to labor market flexibilities, *not* to worker rights.

8. ***It is important for the U.S. Congress to take an active role in reforming the World Bank and the policies which it pursues, if necessary by imposing conditionality in the provision of funds to the World Bank. Such reforms should focus especially on principles which should receive bipartisan support, e.g. that the multilateral institutions should be especially careful in imposing as conditions (or more broadly, even pushing) policies which have been rejected in the United States, and that the World Bank can only be effective in conveying a message of good governance if there is a belief that its own governance conforms to the standards that it demands of others (including standards relating to the choice of personnel and due process).***

In the past, Congress has played an important role in shaping development policies. Its objections to cost recovery—the euphemism for requiring the poorest children in the world to pay for their education—finally brought an end to this policy. Some in these institutions had argued that such policies had little effect on educational enrollment and attainment; but as country after country provided free education, it became clear how flawed were the studies on which these policies were premised. It is time for Congress once again to raise its voice to make sure that these institutions do not push policies which are inconsistent with our values and with the desires of the citizens of these countries, and are not based on misconceived economic models and analysis. What matters is both what is on the agenda and what is not on the agenda. In the past, until Jim Wolfenson became the President of the Bank, for instance, corruption was kept off the agenda. Today, core labor standards and worker protections are typically kept off the agenda—except when it is argued that they are excessive.

In raising these issues, I am aware that I may be treading on dangerous territory. No one wants the agenda of the World Bank to be politicized. Issues like population are too important, for instance, to be excluded from the Bank's agenda, simply because citizens in some donor country might have opposing views on the subject. But I think that there are a solid core of views and perspectives around which a bipartisan and global consensus can be developed. The Millennium Development Goals represent one such global consensus; the economic rights embedded in the Universal Declaration of Human Rights another; the core labor standards a third. We should be supporting meaningful democracy and democratic processes—and the fact that excessive conditionality undermines democracy provides a common ground for opposition.

9. ***There have been some recent initiatives to explore innovative ways of financing development at the multilateral level, ways which could provide a more assured and reliable basis of support for development assistance. We should be more actively engaged in these multilateral efforts.***

I want to conclude by calling attention to recent multilateral efforts at finding innovative ways of financing development. Several countries have, for instance, committed themselves to a dedicated tax on international air transportation. This tax is what might be called a luxury tax, but it is also a tax on high levels of pollution in the upper atmosphere from the carbon emissions from jets. The same thing goes for international shipping, where there is a lot of dumping of waste. These taxes could provide a steady source of revenues that could be dedicated to development.9

While each of us could, perhaps, think of better sources of revenue, I want to urge you to consider the value of joining in a multilateral effort at addressing one of the world's most important global problems. Part of democracy is compromise: agreeing to actions that might not be (from our perspective) ideal, yet, for one reason or another, have garnered the support of others around the world.

There is a great deal of debate about tied aid and earmarking sources. In general, public finance economists do not like earmarking and tying. This is an area, however, where it may be desirable to do so. The advantage is that people can see that this is a tax that is going for a particular purpose. If a fund is earmarked for health or for education, it is likely to mobilize broader public support.

There are three broader innovative approaches to which I want to call attention. The first is the efficient management of "global" resources through market mechanisms that could generate considerable revenues; it makes a great deal of sense to use these for the provision of global public goods, including development. For example, one of the important global resources that need to be better managed are world fisheries. Currently, they are not being well-managed, and as a result there is a real risk of their depletion. We know the basic principles of fishery management, including auctioning off fishing rights. The revenues from the auctioning off of global fishing rights could be used to finance development.

A second source of revenues is, in many ways, related. There are a whole set of global negative externalities, and the standard way that economists recommend for dealing with these negative externalities is the imposition of a corrective tax. The revenues from these corrective taxes could also be used for supporting development. An example would be taxing those responsible for the greenhouse gas emissions which pollute the global atmosphere.

A third innovative source of revenue has to do with a proposal that I make in my book Making Globalization Work and which is an elaboration of an idea that Keynes talked about some 75 years ago: the creation of a global reserve system. Every year, the countries of the world bury somewhere between $400 and $600 billion in the ground. The global reserve system itself is fundamentally inequitable, flawed and unstable. Burying this amount of purchasing power in the ground adds to global deflationary pressures. It also means that the developing countries are lending something like three to four trillion dollars to the United States and, to a lesser extent, to Europe, at low interest rates. They then borrow it back at higher interest rates, so the net foreign aid of the developing countries to the United States is far larger than the aid that the United States gives to the developing countries. (This strengthens the moral argument given earlier for increased U.S. assistance). This is clearly a very peculiar situation that clearly needs to be rectified.

[9] The international air transportation tax illustrates an emerging new principle, involving nationally decreed but internationally coordinated taxes.

The dollar reserve system is fraying, and the system to which we are moving, where the Euro is becoming a reserve currency, may be worse than the current system. The history of two-reserve currency systems suggests that this new system may be very unstable: there is a need for a global reserve system. The issuance of these new bank reserves, this new money, could be used to help finance development; it would be a regular source of income of significant magnitude, making up a significant fraction of the amounts that have already been committed for assistance by the advanced industrial countries.

While I have focused my remarks on innovative sources of aid, I want to remark on one of the innovative forms of aid: Aid for Trade. This has become part of the discussion of the World Trade Organization Development Round of trade talks. The fact is that trade liberalization has not brought the benefits to the developing countries that were promised. Even Europe's very generous Everything-But-Arms initiative, which eliminated all tariffs on the poorest countries, generated less new trade in the areas that were liberalized than had been hoped. The reason is that these external barriers to trade are small relative to what are sometimes called the internal barriers to trade. Even if there are no tariffs, if a country does not have ports it cannot export its goods. If it does not have roads to bring its goods to a port, it cannot export. Thus, if we are going to argue that trade liberalization is good because it enhances trade and enhanced trade promotes growth, there has to be aid for trade. The Aid for Trade agenda includes trade facilitation (such as improving customs procedures), building infrastructure and helping in the creation of productive capacities, e.g. by providing finance for new enterprises to take advantage of the new opportunities. There should be aid for trade commitments as part of the Development Round, and these commitments should be on par with other commitments made within the WTO and the Development Round. Just as countries commit to lower their tariffs, they would also commit to provide a certain amount of aid. In the past, there were no consequences when the United States and other developed countries did not live up to their commitments, but these would be enforceable within the WTO framework. For instance, a specific contribution structure could be used for countries that benefit most from trade, i.e. countries that export a great deal to the developing countries, so that they would pay more into this Aid for Trade Fund. Such an Aid for Trade Fund should have different governance than that of existing multilateral institutions, with greater voice for the developing countries.

Finally, as you consider aid and reforms in the World Bank, it is important to see assistance as part of a broader agenda. For instance, opening trade opportunities enhances developing countries possibilities to earn a living (to paraphrase past welfare debates, a helping hand up, rather than a hand out). But the trade regime is very unfair to the developing countries: the Uruguay Round was so unbalanced that it resulted in the poorest countries of the world, especially sub-Saharan Africa as a region, actually being made worse off. The asymmetries between capital and labor liberalization have meant that there is more mobility of capital than labor; these asymmetries also result in lower wages and greater inequality around the world. It is important to think about a fair trade regime as part of our commitments to the developing countries.

Miracle drugs have had a very important effect in extending longevity and in improving living standards, but the Uruguay Round, with its intellectual property provisions (called TRIPS), made access to generic medicines more difficult, which is particularly bad for developing countries, who simply cannot afford the brand name drugs. TRIPS succeeded in doing what it was designed to do, reducing access to generic; as a result, it had the effect of condemning thousands of people in developing countries to death. One of the important recommendations to emerge from the World Commission on the Social Dimension of Globalization, on which I served, was that we need to revisit TRIPS. Unfortunately, in the bilateral agreements that the United States has been signing, rather than correcting the failures of TRIPS, we have made things worse: it is now even more difficult for developing countries to have access to generic medicines.

TRIPS has also made it more difficult to close the gap in resources and knowledge between developed and developing countries that I mentioned before (page 1). The developing countries are demanding a more development oriented intellectual property regime. As part of our efforts in reengaging with the rest of the world, of restoring our commitment to multilateralism, so necessary if we are to win the hearts and minds of those in the developing countries, we should join in these efforts.

Yet another part of assistance is debt relief. The international community made significant commitments for debt relief, which should now be honored. But we cannot make the poor pay for the very poor. We, together with other advanced industrial countries, must fully fund the World Bank's debt write-off. To do otherwise would be to put at least a significant part of the cost of debt relief on other poor countries that otherwise would have been the beneficiary of Bank programs.

We also have to be careful to avoid the recurrence of these kinds of debt problems. Unfortunately, there has been too little discussion of why this is a recurrent problem and, unless we think about that more, the problem of excessive indebtedness will continue. Simply put, while part of the problem arises from excessive borrowing/lending, part arises because developing countries are left to bear the brunt of the risk of interest rate and exchange rate fluctuations. There needs to be a better way of managing risk. Wall Street and financial markets are very proud about how they have been able to slice-and-dice risk, moving the risk from those who are less able to those who are more able to bear it. But somehow, they have failed to shift the risk off the shoulders of developing countries. There are some indications that things are getting a little bit better. In the last two to three years, the amount of borrowing by developing countries in their own currency has increased significantly, as they have become more aware of the problems in borrowing in other currencies. However, the IMF and the international community need to take a better look at how they can bear more of the risk, and this shifting of risk to those more able to bear it ought to be one of the highest elements on the agenda. Unless that happens, we will find ourselves in a world in which the debt problems arise again. Even when countries borrow moderately, a moderate debt can quickly turn into debt that is beyond a country's ability to bear.

To conclude: there are few issues of more relevance to the future stability and prosperity of the world than poverty in the Third World. We need to do far more than we have been doing, and we need to do what we are currently doing more effectively. There is a broad agenda ahead: Reforming the World Bank, how it allocates aid, the conditions it imposes, and most importantly, its own governance, including how its President is chosen should be among the items that are at the top of that agenda. Congress has an important responsibility in encouraging these changes.

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Testimony to House Financial Services Committee, 22 May 07, chair Barney Frank, the first of several oversight hearings on the World Bank/IMF

WHAT TO DO ABOUT THE WORLD BANK

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ORAL TESTIMONY

The World Bank is currently facing a deep crisis of relevance. The Bank's market has changed fundamentally in the past decade, but the Bank continues to operate in much the same way and with much the same products as a decade ago and more.

The change in the Bank's market was dramatically symbolized just last week while the US and European governments were fighting over President Wolfowitz's future. The African Development Bank held its annual meeting not in Africa but in Shanghai. This event will be looked back on as a milestone in the history of the twenty first century.

The main message of my testimony is that the World Bank can potentially add much more value to the solution of some of the world's most urgent problems than it has been doing; and that the US Congress and the next administration can help it do so by signaling strong support for a revived World Bank.

In the immediate future, that means supporting the current administration in selecting a first rate candidate as the next president, who has an excellent record as a leader and manager of a large complex organization; and it means the Congress paying over the still outstanding US payments on IDA 14.

Looking beyond the immediate future, the Congress should support the World Bank in taking more of a leadership role in several genuinely global problem areas. In its *traditional* products of aid projects and economic advice to governments of developing countries, the Bank faces a whole array of new competitors – such as China and Korea, which have become big sources of financial assistance to poorer countries, private consulting firms, which have developed superior skills in many of the Bank's traditional areas of expertise (such as banking and finance, and private sector development), and also the Gates foundation and other private foundations have become major players. But the Bank retains a big comparative advantage over these other entities based on its combination of (a) its inter-governmental guarantees, (b) its own large revenue base, and above all, (c) its global reach.

The Bank can and should take a much bigger role in tackling one of the biggest questions of our time, namely, how to decouple economic growth from carbon emissions? The Bank has much experience of translating economic policies into investment plans and investment plans into investments on the ground. It should use its experience to take the general conclusions in reports like the IPCC report and the Stern report and spell out what the general conclusions mean for specific countries, like China, Russia, Brazil, Bangladesh; and then help these governments work out country programs focused on decoupling their economic growth from their emissions.

This would lead the Bank to develop new financing instruments in order to accelerate the take-up of climate-friendly technologies. For example, a carbon fund – or, since the fund should not be tied only to carbon, a "climate-stabilizing" fund. Such a fund would enable a developing country government – eg China and India– to borrow from the Bank for a power station and choose a state-of-the-art minimum carbon emission technology even though it is more costly than a standard technology, with the fund rather than the government bearing the incremental cost.

Such a fund could be used to accelerate the uptake of climate friendly investments in the power sector; in transportation (eg railways in Africa); in forestry; and in still other sectors.

Some of the finance should come straight from World Bank reserves. The reserves are currently around $36 bn., while the Bank needs only around $25 bn. to maintain its all-important AAA credit rating. Some of the difference between $25 bn. and $36 bn. should be diverted to the climate-stabilizing fund. The fund would also receive grants from OECD governments and private foundations.

This is just one small example of how the Bank could be playing a significant catalytic role in addressing climate change. For it to reposition itself in the new market it needs to undertake some organizational changes and develop new streams of revenue. I leave the details to my written testimony. The bottom line is that even though we would not start with the present World Bank if we were creating the post 1944 world anew, the present World Bank is what we have got to work with. It needs US support to reposition and restructure itself to fulfill the valuable role that it is almost uniquely able to play in the world.

....

This House committee hardly needs reminding that in much of the rest of the world the world's lone superpower is seen as arrogant, incompetent and indifferent. The present Congress and the next administration can help to restore American moral and political leadership in the world by, among many other ways, taking a constructive oversight role at the World Bank. And from the Bank's side, it urgently needs the Congress to signal its strong support for a revived and redirected World Bank with the requisite leadership and finance for it to help solve an array of genuinely global problems.

The fighting between Europeans and Americans over President Paul Wolfowitz's future has obscured the fact that the Bank faces a deep *crisis of relevance*, a crisis which pre-dates Wolfowitz but which his presidency did little to address. Last week's annual meeting of the African Development Bank in *Shanghai* – not Africa – dramatized how much the Bank's context has changed in the past decade. [1] Yet the Bank continues to operate in much the same way and with much the same products as a decade ago.

[1] William Wallis, "China changes dynamics of African loans", Financial Times, 19-20 May 2007.

The first big change in the Bank's market is that it is increasingly squeezed as a provider of finance and knowledge between:

(1) China and Korea as large new providers of unconditional financial assistance, especially but not only in Africa (China now gives more financial assistance to Africa than the World Bank does; and more to Cambodia and Laos than the Bank does);

(2) the regional development banks, which are often more trusted in their region than the World Bank;

(3) private consulting firms with superior skills and experience in many areas where the Bank has been active; and

(4) private foundations like the Gates Foundation.

The second big change in the Bank's market is that more and more of its borrowing countries are moving from low- to middle-income status. Within five years China's average income may have risen to the level which makes it ineligible to borrow from the World Bank Group; yet for more than a decade it has been the Bank's biggest borrower. Vietnam, the second biggest borrower from IDA (the soft-loan facility), will be ineligible for IDA funds within four years. Middle-income countries like China are less interested in the Bank's loans and more interested in the Bank's knowledge; which raises the question of whether and how the Bank should transition to making development knowledge rather than finance its main product. Middle-income countries tend to be less interested specifically in "poverty reduction" and more interested in how to generate prosperity in a more general way.

The third big change is that new and genuinely global problems have shot to the top of the agenda of world politics in the past decade. These include a whole gamut of international environmental issues, including climate change, deforestation and loss of biodiversity, and massive rural-to-urban migration (at the rate of 2 million people a month in East and South Asia). The World Bank, as the biggest and financially strongest of the multilateral organizations with global reach, should be well positioned to take a leading role in analyzing these problems and formulating lines of solution. But the Bank has yet to make this international environmental agenda and its ramifications into national policies central to its operations.

So the Bank should use the opportunity provided by the arrival of a new Bank president to step back and ask five basic questions:

(1) what kinds of "global public goods" does the world need;

(2) where – in what product lines -- can the Bank be competitive viz a viz private firms; in other words, what is the appropriate division of labor between the Bank (and other multilateral development banks), on the one hand, and the private sector, on the other;

(3) what role should the Bank play in middle-income countries (assuming that it continues to offer its existing products in low-income countries) – especially in China, which contains hundreds of millions of very poor people, is keen to draw on development

knowledge from the rest of the world, but is also rapidly emerging as a major source of financial assistance to poor countries;

(4) how should the Bank change its organizational structure, its product lines and its revenue sources to respond to the new challenges; and

(5) should the Bank continue to take "poverty reduction" as its central mission, when governments in much of the middle-income world think of the general spread of prosperity rather than "poverty reduction" per se as their major economic objective (even as the number of people in poverty is falling in many middle-income countries, notably China)?

IMMEDIATE ISSUES

1. *The presidency*

The Bank has been seriously damaged during the Wolfowitz presidency, and it must now get a president who is first rate. There are two issues. First, the search must be transparent, and unrestricted as to nationality. "We are not in 1944 anymore", to misquote the Wizard of Oz. The American monopoly on the presidency of the Bank and the European monopoly on the managing directorship of the Fund is a legacy of the Second World War. There is no good reason for the twin monopolies to continue. Put the other way around, there is no good reason why an Asian or a Latin American or anyone else cannot be the president of the World Bank. Even after giving up its monopoly America would still have the loudest voice at the Bank, because of its shareholding. Afterall, the US Treasury is by far the most important voice in the IMF, even though it appoints only the No. 2 position rather than the top.

Second, the new president must have an excellent record as a leader and manager of a large complex organization. Appointing someone with a high reputation as a policy advisor or financial technician is not good enough.

2. *IDA 15 (International Development Association)* IDA currently has a big hole in its finances as a result of (a) the multilateral debt relief initiative, and (b) US non-payment of all its pledged payments to IDA 14. Hence IDA's capacity to assist the poorest countries is hobbled.

LESS IMMEDIATE ISSUES

1. The central challenge of climate change

The Bank's big comparative advantage comes from its almost unique global reach. It should reposition itself to take a much stronger role in international environment issues than hitherto, and above all in climate change. Climate change is the biggest problem facing the world (bigger even than HIV/AIDs and nuclear proliferation). It affects us all, but it most affects poor countries of the tropics. Unless climate change solutions are applied in developing countries, the biggest problem facing humanity will not be solved.

The time is now ripe for a Big Push on climate change, because the key necessary ingredients are in place: (a) the science (eg IPCC reports), (b) the economics (eg Stern Report), and (c) public awareness of the imperative to act now to make the world safer from climate change and its consequences (including distress migration on a mass scale, and civil and inter-state wars).

So the question is, what should be the Bank's role in helping to decouple economic growth from carbon emissions? The Bank has much experience of translating economic policies into investment plans and investment plans into investments on the ground. It should use its experience to take the general conclusions in reports like the IPCC and Stern and spell out what the general conclusions mean for specific countries, like China, Russia, Brazil, Bangladesh; and then help these governments work out country programs focused on decoupling economic growth from emissions.

The Bank should develop new financing instruments in order to accelerate the take-up of climate-friendly technologies. For example, a carbon fund – or, since the fund should not be tied only to carbon, a "climate-stabilizing" fund. Such a fund would enable a developing country government – eg China – to borrow from the Bank for, say, a power station and choose a state-of-the-art minimum carbon emission technology even though it is more costly than a standard technology, with the fund rather than the government bearing the incremental cost.

Such a fund could be used to accelerate the uptake of climate friendly investments in the power sector; in transportation (eg railways in Africa); in forestry; and in still other sectors.

How could such a fund be capitalized? Some of the finance should come from World Bank reserves. The reserves are currently around $36 bn., while the Bank needs only around $25 bn. in reserves to maintain its all-important AAA credit rating. Some of the difference between $25 bn. and $36 bn. should be diverted to the climate-stabilizing fund. The fund would also receive grants from OECD governments and private foundations.

The fund would not depend only on altruism. Contributors would get carbon credits in return. And the fund would open new markets for private firms in environmental technologies (carbon capture technologies, for example, and wind power). So business would have a distinct interest in the fund too.

The Bank should also do more by way of piloting schemes for later scaling up by governments and the private sector. It has already played a catalytic role of this kind in the case of carbon trading. It spent $150 million on a pilot carbon trading scheme, which went on to become a $30 bn. market. This role of piloting experiments in ways of mitigating and adapting to climate change should be greatly expanded. One especially important direction of experimentation is carbon trading in the sectors of forestation and land use. 20-30% of carbon emissions come from land use practices and deforestation. Yet these sources have been quite neglected in mitigation schemes; less than 1% of carbon trading relates to these sectors. The Bank is well positioned to pilot schemes to expand this kind of carbon trading.

2. *Organizational change and new sources of revenue*

To enable it to be more effective in linking country programs to global issues such as climate change, the Bank should modify its organizational structure. The current structure is too much weighted towards countries as the unit of operations and budgeting, prompting country departments to operate in more or less separate silos, coordinating rather little with other country departments even in the same region. For example, the Russia country director based in Moscow in practice has little contact with the country directors of surrounding countries, each of whom burrow down into their own countries. The East Asia region works on forestry issues country by country, ignoring the dynamics of the regional forestry market. The management teams of the East and South Asia vice presidencies last met to coordinate their regional strategies more than 10 years ago – even as governmental and commercial contacts between China and India grow by the day.

If the Bank is to give much more emphasis to climate change and other global issues like HIV/AIDs it needs to organize itself with more staff and budget weight given to technical specializations of various kinds; and with the regional level given explicit recognition as a unit of strategy.

As part of this refocusing it could cut down on the number and staff of country offices.

The Bank should also be developing new sources of revenue. One is fee for service: in middle income countries (like Russia) it should be selling services, while in low income countries it should continue to provide such services for free. Until the Bank starts to put a price on its knowledge it will remain driven by the need to lend. Governments in China and Russia, for example, have a strong demand to learn about development experiences elsewhere for possible application at home. The Bank could offer to do studies on the relevant subjects (railway organization, for example) in return for an appropriate fee. Until now, by contrast, the Bank has undertaken studies more at its own initiative and without charging, as the hopeful basis for future *loans*. But in practice the Bank did not worry too much whether the governments actually read the reports; because the studies were driven less by the government's demand than by the supply-side spending imperatives and natural curiosity of the commissioning units of the Bank.

Fee for service in middle-income countries is one new kind of revenue stream. Another is lending to sub-national units, like regional governments, without a sovereign guarantee, charging a somewhat higher price than for loans with a sovereign guarantee.

The other side of this refocusing is a cut back in Bank activity in some sectors where it has been active, but where it no longer has an advantage in skills compared to private firms or other public agencies. Much of its work in banking and finance falls into this category; also in private sector development.

3. *The dilemma of the project model of aid*

Much of the Bank's work continues to be done in the form of discrete projects, as is also true of most bilateral aid donors. The map of Cambodia and many other poor countries is densely spotted with red flags, each representing an aid project. From the donor's perspective, the project model has several advantages over more general forms of assistance (like budget support), particularly in terms of accountability and impact assessment. And from the country's perspective, discrete aid projects with direct input from foreign experts can be very effective in delivering health care, schools, roads, drinking water to specific localities.

But there is a real dilemma. A little noticed disadvantage of the project model is its negative backwash effects on the capacity of the national civil service to steer development and implement projects without heavy reliance on foreign experts. Nationals who might otherwise strengthen the national civil service are employed by the aid projects, and frequently use the aid projects as a ladder into jobs in the international circuit. More general forms of assistance, such as budget support, have the advantage of potentially strengthening the capabilities of the state. The big question is how budget support can be given against rising standards of auditing of public accounts.

4. *The good governance agenda*

The Bank can play a useful role in pushing and advising on civil service reform and legal and judicial reform. But although the Bank talks a lot about good governance and has good governance country programs, it has few regular staff with skills in this area. For example, the East Asia and Pacific region has only one regular staff person in headquarters with skills in civil service reform, and a few other non-regular staff in country offices; and no regular staff person able to undertake programs in legal and judicial reform.

During the Wolfowitz presidency the governance agenda was widely discredited because Wolfowitz reduced governance to "corruption", as though the primary way to improve governance was to curb corruption. Moreover, the Bank under Wolfowitz used "corruption" selectively to advance geopolitical objectives, punishing some countries for "corruption" while not punishing others which scored equally badly on the Bank's corruption measures. Now that Wolfowitz has gone (or is going), the broader agenda needs to be staffed up.

5. *World Bank – IMF links*

The Bank is tied to the IMF through cross-conditionality, such that if an IDA – eligible country (of which there are over 80) is not "approved" by the Fund the World Bank's operations in the country are severely curbed as a result of an informal, not formal rule. This link should be broken. It may happen that the Bank agrees with the Fund's conditionality – but its hands should not be tied by a semi-automatic block on its operations if the Fund decides the country is not meeting its conditions. One reason is that the Fund's conditions can be developmentally very damaging. For example, in Sub-saharan

Africa the Fund imposes conditions via the targeting of inflation: if inflation rises above 5%, for example, tighter restrictions kick in on the amount and use of aid money, including from the Bank.

6. Governance of the World Bank

The Bank's Board of Governors should consider revising the existing formula for voting shares and capital contributions so as to give more weight to both economic size and population, and so as to adjust shares at regular (say five yearly) intervals in line with changes in economic size and population. This would mean, for example, a rise in China's share, and a fall in that of Russia and the US. The US should in any case give up its permanent veto (it is the only country able to veto certain kinds of actions without securing support from any other country, another 1944 legacy). These changes would shift the Bank towards a governance structure intermediate between the Security Council and the General Assembly: no permanent veto powers, but also not equal country weights.

Bank's board of executive directors could be made more effective by (a) enlarging it from 24 to 26, with the extra two seats going to Africa – so that Africa's 40 + countries would be represented by 4 executive directors rather than two. Also, all the constituencies should be rebalanced, so that each executive director would be responsible to a constituency of between 6 and 10 countries – as compared to the present, where eight executive directors represent only their own country and two others represent more than twenty each. Finally, the executive directors from developing countries should have terms of not less than 4 years and not more than 6 years.

END