The World Bank and Development Assistance

Testimony Prepared by
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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.

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[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.