The Role and Influence of International Financial Institutions

Danny Leipziger

Abstract

Development thinking has evolved from the early works of W. Arthur Lewis and Paul Rosenstein-Rodan and has been influenced by new and varied schools of thought. Emphases have shifted from capital accumulation and technical progress to human capital investment and social inclusion. Institutions have come into the equation, as has a prominent role for markets and for the state as drivers of development. Underlying these views were practicalities that shaped the way countries dealt with their need for foreign capital, the management of the macro-economy, and their responses to economic and financial crises. There was a prominent role for the so-called Bretton Woods institutions, namely, the World Bank and the International Monetary Fund, in shaping prevailing views of development and putting them into practice. This
has been important, both directly and indirectly, in affecting policy choices made by developing
country governments over past decades.

**Keywords:** Bretton Woods Institutions; World Bank ideology toward development; IMF
ideology and development; changing development paradigms; international financial institutions;
Bank-Fund Collaboration; Bank-Fund Concordat.
Introduction

International financial institutions (IFIs) have strongly influenced development thinking and practice in recent decades. IFIs have exerted direct influence through the volume of their financial transfers, and indirectly, for example, through their impact on the resource transfers of others, including donors and the private sector. Even more important, IFI analysis and ideas have dominated aspects of development strategy and ideology. This chapter discusses the Bretton Woods institutions—the International Monetary Fund (IMF) and the World Bank. Arguably, no development debate can take place without talk of the Washington Consensus and IMF conditionality, without reference to the number of people living below the poverty line according to World Bank data, or, more recently, without discussion of how IFI leaders are selected. The intellectual contributions of both major Bretton Woods institutions have declined in recent years, but for many decades, it has been difficult to separate national development plans from the views, funds, and influence of the IFIs.

This chapter explores how the IMF and World Bank have influenced thinking on global development by governments, donors, and the international community. The first section focuses on the period 1970–2000, when IFI resource transfers were large, and these institutions
had a major influence on paradigm shifts in development thinking. When governments were debating economic strategies, when aid programs were being designed or trade agreements were being negotiated, or when central bank agreements were being signed, the positions of the Bretton Woods institutions were seriously considered. The intellectual contributions of both institutions were unparalleled in their early decades; they included the Fleming-Mundell model (Boughton 2003) that underpinned international macroeconomic thinking, and the Chenery and Syrquin (1975) evidence that growth and distribution need not be at odds in development.

Next, we examine how the IMF and World Bank have fared in the past decade, and especially since the recent global financial crisis. We focus in particular on how global developments have affected IMF and Bank influence on thinking and practice, which we will argue has materially declined. We conclude with a few thoughts on whether the declining influence of the IMF and World Bank may be reversed.

The role of the IMF

Developing economies (DEs) have had unequal relations with the IMF. Unlike developed countries in crisis, DEs have been short of foreign exchange, exposed to commodity price
fluctuations, and prone to balance-of-payments crises—and thus have been compelled to take advice without argument. The core IMF admonition has always been to keep the balance of payments (BOP) in line, inflation low, and fiscal accounts balanced—in order words, to pursue prudent macroeconomic policies. Although the tone of this advice was never pleasant (until very recently), it was not inherently harmful to development objectives. Indeed macroeconomic stability has long been identified as a necessary but not sufficient condition for economic progress. For example, the Spence Commission’s *Growth Report* identifies strong macroeconomic management as one of the five essential ingredients to high and sustained growth rates (Commission on Growth and Development 2008).

Much has been written about the role of the IMF during economic crises (Woods 2008; Zagha and Nankani 2005). But Fund influence has been stronger in non-crisis times, as the voice of both macroeconomic prudence and economic conservatism (Bretton Woods Committee 2009). As the voice of prudence, often articulated through “Article IV” consultations with governments, the IMF frequently had allies in central banks or ministries of finance. They were happy to let the Fund take responsibility for fiscal and monetary rigidity that was deemed necessary but difficult to enact, given a recalcitrant government or hostile domestic political environment. Hence, even proud and talented bureaucracies (as in India) valued harsh IMF prescriptions that
helped contain spending pressures. Even nonmembers have benefited from Fund advice. For example, the anti-inflationary program of the Government of Vietnam in 1989–90 was designed with Fund advice but not a single penny of IMF or Bank resources, since Vietnam was blocked from Bretton Woods membership until 1993. The admonition to follow prudent macroeconomic policies has been largely accepted in most developing and emerging-market economies, and the positive role of the Fund in this trend is hard to ignore.

Certainly, the IMF’s advice has not always been right, and nor has it always found the optimal balance between macroeconomic stability and economic development. IMF remedies may have slowed development in some countries, especially those too small or strategically unimportant to have representation at the IMF Board of Governors or the U.S. Treasury. Sometimes the counterbalancing argument for development objectives came from “the other side of 19th Street,” namely, the World Bank. The IMF’s mis-steps in the name of macroeconomic stability were driven by poor management during crises and by ideology during non-crisis times.

Beginning with crisis management, the IMF’s uniform model of adjustment—often backed by much-needed financing—has in retrospect drawn criticism from many, including the IMF’s own Independent Evaluation Office. Management of the banking crisis in Indonesia and the
subsequent measures imposed has sidelined the Fund from any meaningful role in East Asia since the financial crisis of 1997 (Sussangkarn 2010). The “IMF approach” to liquidity crises, applied in the Republic of Korea in late 1997, was correctly disparaged by Stiglitz (2002). In retrospect, the Fund clearly was thinking only of currency flows and not considering structural parameters, such as the high leverage of Korean firms (Stiglitz 2002). During the crisis, interest rates were raised to levels that bankrupted many Korean conglomerates (chaebols), while not halting capital flight; this was a colossal blunder by the IMF. Luckily, Korea recovered quickly and exhibited strong macro fundamentals throughout, including a fiscal surplus entering the crisis. But other countries facing BOP problems not of their own making did not fare so well.

The casualty of harshly administered austerity programs was always economic growth, often set back for many years, usually led by precipitous cuts in infrastructure spending. As shown by Calderon and Serven (2004), Latin America’s growth rates suffered particularly due to fiscal contractions that hit infrastructure hardest. Economic growth rates were invariably taken as exogenous variables when their endogeneity was obvious; the reason was that although Fund programs are of short duration, their impact can be long lasting. Similarly, in today’s crisis in Greece, an economy with neither monetary nor exchange rate levers, the fiscal contraction being advocated is incompatible with the resurgence of growth necessary to halt the decline.
Past IMF financial models were impervious to growth concerns, and often to social issues as well. This led many DEs to follow rigid and slow growth paths. Others ignored the Fund and followed heterodox, rebellious paths that often led to worse economic outcomes, including high inflation, inflated currencies, and poor economic management; examples include periods of hyperinflation in Latin America and poor adjustment policies in the Philippines and elsewhere. Other programs failed because IMF adjustment financing lasted two to three years, whereas structural adjustments often took at least twice as long. The Fund’s one-size-fits-all approach of the 1970s and 1980s has been roundly criticized, because it led in many cases to a low-level equilibrium associated with low growth and economic underperformance.

The Fund’s interventions did lead to some favorable economic outcomes. In crisis management, for example, the Uruguay bailout of 1995 pooled enough resources to effectively cover a broad definition of M1, which saved the banks. (Ironically, the banks were hit again when the convertibility plan collapsed in Argentina six years later). In 1994, effective credit lines helped Brazil avoid serious damage after the “Tequila Crisis,” and bailouts of serious banking failures in Thailand were also well managed. Of course, strong fundamentals lessened the pain of IMF interventions: large countries with sound underlying institutions and strong international political
backing got more generously constructed bailout programs and better trade-offs between short-
term adjustment and long-term development.

Banking crises are among the most damaging to economic growth and development prospects
(Caprio and Klingebiel 1996; Perry and Leipziger 1999). One way that IFIs have helped
countries avoid banking crises is through the Financial Sector Assessment Program (FSAP),
which is jointly managed by IMF and the World Bank. Started after the 1999 economic crises in
East Asia and the Russian Federation, FSAP is a diagnostic exercise which looks at
vulnerabilities and financial sector impediments to growth. Over 1999–2009, more than 140
FSAPs were completed. Most were done confidentially for governments, usually at the behest of
central banks or ministries of finance (IMF 2012). Long before the current crisis raised concerns
about the quality of banking supervision, FSAPs were helping countries to identify and deal with
banking problems. Large economies like Brazil, Mexico, and Indonesia requested FSAPs in the
early 2000s, and central bankers privately praised the exercise and stressed its importance.

Clearly, the IMF role in development has been complicated. It has usefully enforced better
macroeconomic management and destructively perpetrated flawed or draconian adjustment
policies. But hanging over the IMF’s operations for several decades has been a cloud of
ideology. In the 1980s, one department of the Fund boasted that its leadership included the “high priest” of the Fund known for his monetary orthodoxy, while more generally implementation of the so-called Washington Consensus fell to the Fund. Nobel laureate Robert Lucas’s admonition to “stabilize, liberalize, and privatize” had many adherents at the Fund. This ideology, similar to trickle-down economics, preaches that economic probity and market-based solutions will generate their own rewards. Few economies can afford to invest in this mantra, and even those with impeccable macroeconomic discipline have pursued additional nonmarket policies for growth (Amsden 1989; Kim and Leipziger 1993; Leipziger and Petri 1993). The Washington Consensus may have partly originated in the U.S. Treasury, which at the time advocated against state involvement in the economy and which took advantage of crises to promote neo-liberal reforms via Fund programs. Some countries were forced to choose between the policies advocated by the Fund and those promoted by development banks, like the World Bank. More fortunate countries played off one IFI against the other; the less fortunate were fed strong doses of draconian adjustment.

IFIs have always been governed and influenced by developed nations, and this has been somewhat controversial in terms of policy. As a developed nation, France was able to press the argument that the CFA zone (an exchange-rate regime tied to French franc) enhanced
development in Francophone Africa; the U.S. government intervened with impunity on behalf of political friends. “Realpolitik” has interfered with policy decisions, and arguably still does, despite reforms. Recent developed-nation bias may be discerned in the bailouts of Greece and the Eurozone (Münchau 2012).

Nevertheless, in difficult times, the Fund has had the credibility and the clout to make workouts happen and to stop the hemorrhaging of reserves by instituting adjustment programs. Successful interventions include Thailand in the 1980s (Chaipat 1992), Korea in the late 1990s (World Bank 1999), and even in Africa, though the record is mixed (World Bank 2001). Moreover, the Fund has helped build central banking institutions. With the World Bank, it has managed the Public Expenditure and Financial Accountability (PEFA) program since 2001 to help improve fiscal accountability. Every dollar that PEFA saves is a dollar spent on development, and we know that many dollars go missing in national treasuries (Lewis 2006). The IMF, along with the OECD Tax Center, has also been a leader in reform of tax enforcement and collection. Improved tax revenues supply domestic resources for development that far exceed donor assistance.

The IMF and the World Bank: cooperation across 19th Street
When founded, the Bretton Woods institutions had distinct mandates. The IMF was to manage international financial matters, and the World Bank was to handle reconstruction leading for renewed growth and development. However, as the Bank began to focus more on development than reconstruction, responsibilities began to overlap with the IMF operations. After all, issues in the development sphere, like export promotion, are affected by issues in the financial sphere, like exchange rates. Similarly, poverty is affected by inflation and investment by the cost of capital. Macroeconomic conditions matter greatly for the achievement of development goals.

Nevertheless, the Fund avoided consideration of poverty and social outcomes. It preferred to mandate austerity to restore fiscal balances, and asked the Bank to advise on spending cuts. This division of labor was awkward for the IFIs and DEs alike. Governments had to host “missions” from both institutions. Often these missions were poorly integrated, both logistically and analytically, and not conducive to economic development.

This contrived dichotomy ended after the oil shocks of the 1970s, when it became clear that significant adjustments were needed to reflect quadrupling oil prices. Oil shocks affected short-term BOP problems and also longer-term development concerns. Moreover, the Bank became a
major instrument in the triangulation process whereby surpluses from OPEC were in effect intermediated through private capital markets for on-lending to oil-importing countries. To make it more likely that oil-importing DEs could manage and repay debt, and to facilitate necessary structural changes in the economy, the World Bank began as of 1980 to provide Structural Adjustment Loans (SALs). SALs were cheaper, long-term transfers to facilitate macroeconomic adjustment—and as such encroached on IMF turf. At first limited to 25 percent of Bank lending, but at times climbing to a third, these large, recycled flows put the Bank in the macroeconomic game. Many DEs benefited from SALs and used them to deal with structural impediments to growth and development, including trade liberalization and industrial restructuring (World Bank 1999).

World Bank SALs had better terms than capital markets or IMF lending. Moreover, lending arrangements took note of distributional and social impacts. Trade-offs between expenditure cuts and growth objectives were discussed with a sympathetic institution. Among other aspects, SALs had a new emphasis on energy efficiency, and DEs, new to the issue, received advice and additional lending for energy conservation and alternative energy development. SALs also had many Fund-like conditions, such as cutting unnecessary expenditures, redeploying subsidies, and selling unneeded state assets to pay for oil imports. The SAL process tended to involve all
stakeholders: aid recipients got coherent advice; the Bank received the Fund’s “imprimatur” that its structural programs made financial sense; and the Fund’s short-term BOP management was linked to medium-term adjustment. Nevertheless, DEs began to sense that the Bretton Woods institutions were “ganging up” on aid recipients.

World Bank-IMF cooperation also showed signs of stress. Efforts to align programs included Policy Framework Papers, which aimed to create inter-temporal coherence among BOP management (including cutting trade deficits and fiscal spending), long-term adjustments (such as the need to maintain imports for growth), and spending for priority social purposes. Executive Board members, led by the U.S. government and other OECD chairs, insisted that the IMF certify the macroeconomic soundness of Bank SALs. The Board also strongly advocated that the Bank should conduct Public Expenditure Reviews to prioritize cuts for restoring fiscal balances. DEs, needing the support of both institutions, often a necessary condition for capital market access, were forced to outsource many economic decisions. The term “cross-conditionality” gained prominence as issues of coherence and overlap became prevalent and charges of ideological bullying were voiced (Oxfam 2006).
More difficulties arose in 1989 when the Bank proceeded with a SAL for Argentina without the blessing of the Fund. The resulting brouhaha led to a formal understanding between the World Bank and the IMF, the so-called Concordat, which lasted for almost twenty years. The Concordat indicated that the Fund had primacy on matters of macroeconomics and that the Bank had responsibility for development. These matters were discussed by the respective Boards, but borrowing countries lacked the power to have their voices effectively heard. Eventually the Concordat was reviewed by a joint Committee led by Pedro Malan, former Minister of Finance of Brazil. The Committee advised that Bank-IMF cooperation should be more fluid and organic than prescribed in the Concordat (Malan et al. 2007). A major change was that three of the six members of the Committee represented DEs (Brazil, Indonesia, and Nigeria). Governance was beginning to change.¹

The World Bank and its influence

From 1970 to 2000, the World Bank was the global institution most influential in setting the development agenda through its lending, its co-financing, and its analytic work. During this period, Bank lending came to account for a large part of concessional financing available to DEs. Lending by multilateral development banks has rarely been the primary investment driver for
developing countries. However, MDBs have had a major influence on development priorities for national governments and other donors, as well as providing cover for the lending of the private sector. The type and role of financing has varied: the poorest countries were eligible for International Development Association (IDA) credits, which are highly concessional, grant-like funding (Leipziger 1983); wealthier countries qualified for the World Bank’s longer-term, subsidized loans. Prior to the advent of adjustment lending (that is, programmatic lending), lending was for projects, often large or strategically important infrastructure works that laid the basis for economic growth and development.

Major dams, roads, energy projects, and irrigation systems requiring both financing and technical expertise were usually Bank financed. Often, having a Bank project enabled countries to seek funding from other sources, such as the U.S. Agency for International Development (USAID), other bilateral donors, or the private sector. Projects so financed required international competitive bidding, which ensured greater transparency and laid the basis for national procurement regulations, project analysis, and domestic institutions that liaised the multilateral project teams. These institutions later became the core of national planning and implementation functions in DEs. If one asks the Korean bureaucracy what they valued most from the World Bank, the answer is usually the training of a cadre of experts, the creation of administrative
apparatus for development, or the formation of a regulatory agency or local development bank. Funds were important, but institution-building efforts left a longer legacy.

Having a partner in development is important. Planning ministries worked intensively with the MDBs in setting priorities and the latter provided a sounding board or validation. Korea’s Economic Planning Board, Thailand’s National Economic and Social Development Board, and Malaysia’s Economic Planning Unit all benefited from interaction with MDBs. This included Bank economic advisory work (so-called Economic and Sector Work), which provided early support when DE staffing was thin and access to best practice was limited. These services were particularly valuable for fast-growing economies (as in East Asia) where structural transformation was extremely rapid, transition economies (as in Eastern Europe, China, or Vietnam) where paradigm shifts were undertaken, and very poor countries where expertise was especially scarce.

The role of coordinating flows via consultative groups, formal or informal, was valuable and well recognized in Indonesia, for example. Exposure to practical policy experience was also highly valued, and so Vietnamese policy-makers meeting with counterparts from Korea, Indonesia, and Malaysia under Bank auspices in the early 1980s helped shape policy toward
Russian debt, toward five-year economic development plans, and toward FDI. The Bank also played a coordinating role for many poorer DEs in need of foreign capital. For example, in the Lao Peoples Democratic Republic, the Nam Thun II Hydro-electric Project used the World Bank as late at 2002 to vouch for environment, social, and expenditure management to private sector financiers (World Bank 2009b). In these cases, the Bank and other MDBs crowded in private investment flows and integrated sound development objectives for the inflows.

Developing economies, large and small, have also benefited from the embedded advice and knowhow in World Bank lending. This is true even when resource transfers themselves are small, or, in some cases, beside the point. Sector development strategies may be more available and better understood than knowhow. Bank-designed projects can be replicated, with country-specific adjustment, in many DEs. Examples where external advice and experience helped development efforts succeed abound in the areas of environmental management, rural infrastructure, building subway systems, or designing social assistance programs (Brushett 2006; World Bank 2003, 2010, 2012).

It would be wrong to suggest that hardware, expertise, or institutions were more important to development thinking and strategy than intellectual contributions to development debate. There
were efforts by non-governmental organizations (NGOs) and others in the 1990s to disparage the Bank for its alleged ideological bias (Danaher 1994), but no other entity in the 1970s and 1980s wielded as much intellectual clout. Beginning with the presidency of Robert McNamara, the Bank’s pronouncements, whether on agricultural productivity, family planning, or income distribution, fashioned the development debate. Influential academics also played a large role, but putting theories to the test required laboratories and financing, which the MDBs could provide.

The Bank also began to collect systematic data to track progress and to bolster its arguments. Calculation of poverty numbers began in earnest in 1990 and to this day, the Bank is seen as the most legitimate source of many development statistics. Governments have used poverty and income distribution data originating from the Bank to bolster applications for assistance, to help shape domestic policies, and to frame the dialogue around strategy. Data collection begun under multilateral programs made possible the “Progresa” conditional cash transfer program in Mexico, the similar “Bolsa Familiar” program in Brazil, and other social assistance policies. Governments would not complain to the World Bank about its reported income distribution statistics if they did not have domestic and international significance.
No development strategy during this period could avoid the intellectual work of Syrquin and Chenery (1989) on growth with distribution. No economic planning model could be designed without looking at the work of Dervis, de Melo, and Robinson (1982). No project would be assessed without the benefit of Price Gittinger’s Guide to Project Analysis (Gittinger 1972). Major intellectual contributions abounded in the analysis of returns to education, optimal subsidy pricing, and the elements of cost-benefit analysis. These analytical tools had in common the measurement of who benefited from expenditures and how pricing could effectively be used to improve development outcomes. Practical manuals and models on road maintenance, electricity grid management, traffic safety, and many other infrastructure aspects were imported by DEs as best practices. Many governments sent officials to be trained or to be seconded to the World Bank. Many Bank officials returned to their home countries in high-level posts with experience drawn from actual country cases.

Critics complained that IFIs had an ideological bias that favored market solutions over government intervention, but this is not supported by the facts in many instances. Cross subsidies favoring the poor were a basic tool of analysis. Expenditure incidence analysis was commonplace to target service delivery. There were ideologies that favored getting the public sector out of nonessential economic arenas. But even in some critical areas such as the provision
of credit, fashions change in IFIs and in governments. National development banks are one such example. Most successful DEs have used national development banks to promote small and medium enterprises, agricultural development, or national champions. Efforts by IFIs to privatize national development have failed to alter the prominence of Banco de la Nacion in Argentina, BNDES in Brazil, or a host of similar institutions in East and South Asia. Governments usually reject advice that they abhor.

Major new strands of development thinking, such as the importance of institutions as explicated by North (1991), were used by IFIs to promote practical development activity. Outside ideas also found acceptance at the Bank, and were supported by a vibrant research department. Major publications such as the annual *World Development Report* carried tremendous import, particularly in the first ten to fifteen years of its publication (Yusuf and Deaton 2009). The *World Development Report* embraced ideas about key constraints to development (whether in infrastructure or the social sectors) and at times took on controversial topics (such as successful versus failed interventionist government policies). It distilled development knowledge and provided policy-makers with guidance on what was known and what tended to work in practice (World Bank 1991). The Bank’s special reports had similar importance. They included the *East Asia Miracle* (World Bank 1995b), which was ahead of its time in assessing the role of industrial
policies in promoting development in East Asia (see also Leipziger and Thomas 1993). Another important branch of Bank research in the 1990s was on privatization, led by the *Bureaucrats in Business* publication (World Bank 1995a).4

Under the presidency of James Wolfensohn, a number of important bridges were crossed that had strong impacts on development thinking and practice, none more important that his decision to acknowledge the corrosiveness, wastefulness, and immorality of corruption (Wolfensohn 1996; Wolfensohn and Kircher 2005). Examples of the new focus in practice included work by Kaufmann, Kraay, and Mastruzzi (2007) to systematically construct measures of corruption; the willingness of donors to include corruption measures in making assistance decisions; and new programs such as the Extractive Industries Transparency Initiative (EITI), the 2006 Stolen Asset Recovery initiative (StAR), and Bank-wide anti-corruption programs.

Similar to the work on income distribution and poverty in the 1970s and 1980s, the period from 1995 onward has been marked by the Bank’s leadership in the area of governance. This leadership is evident in countries where anti-corruption surveys were conducted, public service scorecards were kept, and anti-corruption commissions or teams were formed. Success has been limited, but the global acceptance of transparency and anti-corruption efforts (aided also by the
Anti-Bribery Convention of the OECD in the mid-1990s) as an element of development programs is now unquestioned.

Many ideas that lead development efforts originated with the International Finance Corporation (IFC), the World Bank’s private sector arm that has successfully mobilized and leveraged funds for private enterprise investment. The IFC has succeeded by providing demonstration effects, including catastrophe bonds, local bond market development, and venture capital funds. Even more important has been the Bank/IFC product Doing Business, which ranks countries by ease of conducting business. Along with the Global Forum’s World Competitiveness Survey, it is a standard reference, and governments are keen to show improvement in their rankings (Schwab 2012).

IFI leadership in other areas continues, but its prominence in development has been surpassed by the emergence of stronger think tanks in DEs, broader efforts by NGOs, and a myriad of global initiatives. Notable contributions to the development debate, where IFI leadership has perhaps helped to mobilize greater support, include the Bank’s Gender Action Plan (2005–10), the work of the Commission on Growth and Development (2005–09) (Commission on Growth and Development 2008), and the Sustainable Development Network. But the rise of Brazil, the
Russian Federation, India, and China (the BRICs) has led to greater diversity of ideas on the right mix of market- and state-friendly policies. With the large resource-transfer role of China, development thinking and practice is no longer the hegemony of Washington D.C. or even of the MDBs. Their voice has diminished as the voices of the G20 (and within it the G5) have begun to grow. The prominent question now is where do DEs look for their role models?

The current state of development thinking and practice

Since the onset of the financial and then global economic crisis in 2008, IFIs have struggled to stay relevant. Global economic trends in the twenty-first century do not favor MDBs. The continued rise of China is foremost among these trends. The country’s astounding growth rate is driven by a favorable wage-productivity calculus, ambitious government-led export policies, prodigious savings, and the sheer size of the economy. This eastward shift has meant that south-south trade has become less a catchphrase and much more a market reality. At the same time, flush liquidity in global financial markets in the early 2000s made access to capital easier than ever for DEs. Even previously capital-starved regions like Africa began to attract foreign investment, and it looked like IFIs were losing their clients.\textsuperscript{5,6} Massive precautionary lending in 2009–10 reversed this course temporarily but the trend remains.
The IMF’s situation worsened after its failed management of the East Asia crises. Those countries and others with access to external capital began accumulating reserves in rainy day funds and the IMF lost much of its business. Countries began to feel that they no longer needed Fund advice or insurance. Prudent macroeconomics was a well-accepted principle; however, more heterodox policies also began to emerge. They appeared not only in anti-capitalist governments in Venezuela and Bolivia, but also in the state policies of Brazil, India, and others seeking to follow the high-growth path of China and finding much to emulate in the Asian model (Mahbubani 2008). The more stolid position of the World Bank and its preoccupations with social policies and anti-corruption efforts at the expense of growth made it less relevant to many DEs. Bank and IMF policies, which hadn’t changed much in the past decade, seemed more concerned with social policies and anti-corruption efforts than growth. The World Bank’s business model seemed to be about maximizing the transfer of IDA resources to the poorest countries, lending to middle-income countries in carefully circumscribed conditions and sectors, and decentralizing in an ambitious attempt to get closer to the client. The fact that James Wolfensohn was followed by a two-year president (Paul Wolfowitz) and a one-term president (Robert Zoellick) didn't help the Bank maintain its strategic edge or develop a strong global vision that would appeal to its clients.
At the global level, economic discourse had moved to the environment, risk management strategies, and activist industrial policies, and much of the thinking behind these notions did not emanate from IFIs. An exception was the voice of Justin Lin, the World Bank’s first Chinese Chief Economist, who advocated strongly for activist government policies in China (Lin 2012). There were international commissions on African Infrastructure (Commission for Africa 2005); global actions such as the Multilateral Debt Relief Initiative (IMF 2005), which the G8 produced and the Bank and Fund were told to implement; and the Stern Report on Climate Change (Stern 2007). Neither the Fund nor the Bank was leading this new global dialogue on development. Indeed, following a downsizing and internal reexamination, the Fund languished until the 2008–10 crisis gave it renewed relevance, an influx of resources, and a voice in the newly reinvigorated G20.9

Emerging-market economies were no longer waiting for new ideas to emerge from the IFIs, but rather they were doing their own homework and designing home-grown development interventions.10 The African Development Bank (AfDB) had gained in expertise and was now a larger player on the continent, and the Inter-American Development Bank (IADB) had similarly gained stature to be a more credible partner in Latin America. The Asian Development Bank
(ADB) gained resources and influence, especially in infrastructure, that the World Bank had begun to neglect in the late 1990s and never regained. Indeed, DEs had become less interested in multilateral financing. They had experienced the Bank’s occasionally strident ideology concerning privatization; government pushback when privatization failed or was rejected by the citizenry, largely because of poor regulatory frameworks; and the Bank’s poor policy or poor public relations (Di Tella, Galiani, and Schargrodsky 2011; Foster and Leipziger 2002; Guasch 2004). Many stakeholders thought, in fact, that IFI boards had become advocates for welfare programs and mistrusting of investments leading to growth. Governments were now in a position to self-finance more and to attract foreign funding without the IFI umbrella. And inside the halls of the G20, the new global forum of consequence, the World Bank was not seen as the main advocate for development, since there were numerous emerging-market economies inside the G20 itself.11

What happened to the Bank and Fund to make them suddenly so inconsequential for development efforts? DEs now possessed the skills necessary to both design and implement development policies and a much stronger ability to learn from one another as well as from the OECD. Thus, the IFIs needed to lift their game, but in many respects they did the opposite (Leipziger et al. 2012; Strauss-Kahn 2010). The skills available at the IMF no longer outclass
those available in the private sector or in central banks and universities. As the supervisory and regulatory challenges of vastly integrated financial markets have grown, the IMF’s basic advisory services are no longer leading edge for many clients. And the World Bank, in its fervor to be close to the client by decentralizing to the maximum, lost the competitive edge that its highly technical staff once provided. It is now a minor leaguer in a major league game.

Furthermore, the development paradigm offered by both IFIs has lost its glamour. The Fund has not been able to show that it could design adjustment programs that were pro-growth. Indeed, even its commitment to precautionary lending services has gone largely unused because countries fear the stigma of a “Fund program” of any kind. Indeed, in the 2008–10 crisis, it was the Bank that provided “precautionary” lending to its preferred clients like Mexico, India, Brazil, and Indonesia in the forms of quick loans for budget support (World Bank 2008). The advent of more statist policies by many BRICs, and the success of some of these policies, has also left DEs with the sense that they have learned all they can from IFIs. Yet, there are major challenges in health care financing, environmental management, urbanization, and risk mitigation. However, unlike in past decades, the IFIs no longer seem to hold the answers, either intellectually or financially. The development agenda seems to have passed them by.
Who is Leading in Development Thinking?

A seismic shift has occurred. The IMF has struggled for relevance and has changed its advisory
tune to accommodate capital controls (such as Brazilian capital import taxes). The Fund has also
acquiesced to join failed adjustment programs within the Eurozone membership. It has been lax
on banking supervision issues, weak on imbalances, and inconsistent on exchange rate
management. Despite its precautionary lending windows, the Fund has not helped countries deal
with global uncertainty or capital flows. Therefore, it may well be true that a developing country
finance minister can learn very little from the IMF these days.

The World Bank, a previous leader in many areas of development strategy, has been turned into
a bystander in middle-income countries, a cheerleader in emerging economies, and reluctant
crisis manager in post-conflict countries. Countries are more on their own than ever. This is in
part because of paradigm shifts (see, for example, the notion of a new normal as espoused by El-
Erian 2008) and activist state policies (as espoused by Aghion 2012 and Rodrik 2011).
Countries are also taking new development paths because of new players (including flows from
BRICs) as well as OECD’s preoccupation with its homegrown problems. Many new
development approaches, such as the randomized trial approaches of the MIT Poverty Lab or the
Multidimensional Measures of Poverty, have been developed in academia and have gained considerable traction. Globally, the U.N. inspired Millennium Development Goals (MDG), a concretization of the basic human needs approach of the 1980s, is still a rallying cry for sustained social efforts. Clearly, intellectual leadership has migrated away from the IFIs.

The fact that the leadership of both institutions has remained unchanged—a European heading the Fund and an American heading the Bank—also has not improved the image of the Bretton Woods Institutions (BWIs). IMF members have witnessed its powerlessness to force China and the United States to deal with their imbalances; they have seen financing without a growth strategy for Greece; and they have seen the unmet gaps in international banking supervision. Bank borrowers sense the lack of vision at helm of the institution and see the pursuit of bilateral development fetishes funded by trust funds. Moreover, DEs are searching for the right forum to discuss crucial issues, since the G8 has lost its power and the G20 some of its luster, the UN has limited implementation capacity, and the MDBs seem pre-occupied with internal reforms. This is the unfortunate state of affairs at a time of global stress.

Note that neither BWI has been persuasive in providing advice on job creation or containment of health care costs. Neither institution has been quick to redesign new financial instruments to
reduce risk. While both are still sources data and projections, neither is any longer a major voice in the world of policy. And the fact that jobless growth and worsening distribution coexist with supposed recoveries, the fact that regulation on the advanced economies could be so poor, and the fact that many now advocate a more activist role for government in promoting growth has also taught DEs that some major paradigms may have flaws. If so, which other prescriptions might be faulty?

This cynicism about prevailing paradigms can lead to worse outcomes. Faced with difficult challenges, countries may decide to experiment with policies that are unlikely to yield better outcomes, and many mistakes can be made (Commission on Growth and Development 2008: 68–69 on Bad Ideas). Moreover, issues of jobless growth and distribution are creating discontent with globalization in rich countries. More active roles for the state are being contemplated, but are state institutions up to these new challenges?

The next decade may well be one dominated by risk management, new roles for the state, and greater expectations that distributional equity be addressed. How to square these concerns with market efficiency, proper regulation, and global economic management is where development thinking is headed today. Except for the very poorest countries, the challenges facing the
developed and developing worlds are more similar than ever before. This is partly due to convergence, partly to mismanagement in the rich countries, and partly to greater agreement on many aspects of development thinking. IFIs played a major role in the evolution of development thinking, but what role remains for them is now an open question.
References


Committee Members included: Pedro Malan, Michael Callaghan, Caio Koch-Weser, William McDonough, Sri Mulyani Indrawati, and Ngozi Okonjo-Iweala.

2 The subsidy element arises from the lower borrowing costs of the World Bank. With the backing of its shareholders, the Bank can issue debt at rates roughly comparable to those of the U.S. Treasury, and then pass on these low costs (with a small markup for administrative fees) to its borrowers.


4 The World Bank’s report on Korea (World Bank 1987) can be seen as an early example of a contrarian ideology later developed in the *East Asian Miracle* (World Bank 1995a) and resurrected in the *Growth Report of 2008* (Commission on Growth and Development 2008) that looks more favorably on the role of the state in leading an active development strategy. This more balanced view of the state was opposed by some governments. For example, the U.S. Treasury opposed some aspects of the *East Asia Miracle* report on ideological grounds. This pitted the U.S. government against Japan inside the Executive Board of the World Bank, but also influenced the policy advice provided to DEs.

5 This trend reinforces the view that attempts to make Bank lending more programmatic, more country driven, less cumbersome, and quicker have been insufficient.

6 MDBs have always had their critics. See, for example, Mikesell (2001).

7 The Growth Commission, while useful in attempting to reset priorities, may have appeared too late on the scene. Moreover, the *Growth Report* (Commission on Growth and Development 2008) was released just as the crisis hit the global economy.

8 Aggressive decentralization may have put World Bank staff closer to the client; however, the strategy proved costly, both in terms of budgets and in terms of maintaining core expertise at headquarters. Some have argued that this led to a decline in expertise that damaged the ability of the Bank to help its middle-income clients, who valued technical advice over either resource flows or implementation help (see Leipziger et al. 2012).

9 This reform was led by Dominique Strauss-Kahn, Managing Director during this period, who also positioned the Fund to be the primary source of global economic information.

10 Brazil executed Luz na Campo and Bolsa Familiar, China the Three Gorges Project, and India started ambitious infrastructure investment programs, all without major assistance.

11 The Bank’s claim to be the voice of the poorer and unrepresented countries seemed unheeded. Indeed, the G5 countries began talking about creating their own BRICS development bank.

12 Ironically, because the Bank’s president declined to seek a major capital increase, this lending burst has left the institution vulnerable to a low level, steady-state of future lending in a world of bigger flows and larger demand for capital.