The IMF, World Bank and Policy Reform

Edited by
Alberto Paloni and
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Routledge Studies in Development Economics

Routledge
Taylor & Francis Group

Also available as a printed book
see title verso for ISBN details

The IMF, World Bank and Policy Reform

Globalization is presenting the World Bank and the IMF with new challenges by imposing a rethinking of the nature of development and a reassessment of the appropriateness of current development policies. The International Financial Institutions (IFIs) have responded by redefining their international roles, their priorities and their forms of intervention.

In particular, they have made the achievement of poverty reduction and other Millennium Development Goals their overriding objective. In addition, they have redefined their role as that of providing support for locally owned pro-poor reform programmes.

This book examines the extent to which the new emphasis on poverty reduction and local ownership has been accompanied by true changes in the IFIs' assistance to developing countries. The book also evaluates the respective roles of internal and external forces, such as the commitment to 'neo-liberalism' and the influence of the United States, in shaping the IFIs' policy agenda.

This impressive collection uses an interdisciplinary approach to present a leading-edge analysis of topical and controversial issues which are critical for the effectiveness of financial assistance to developing countries, and examines the ensuing policy implications and required actions. *The IMF, World Bank and Policy Reform* will be essential reading for students, academics and practitioners of development economics, development studies and political economy.

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47 Microfinance
Perils and prospects
Edited by Jude L.Fernando

48 The IMF, World Bank and Policy Reform
Edited by Alberto Paloni and Maurizio Zanardi

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Taylor & Francis Group

LONDON AND NEW YORK

First published 2006 by Routledge 2 Park Square, Milton Park, Abingdon, Oxon OX14 4RN

Simultaneously published in the USA and Canada by Routledge 270 Madison Ave, New York, NY 10016

Routledge is an imprint of the Taylor & Francis Group
This edition published in the Taylor & Francis e-Library, 2006.
"To purchase your own copy of this or any of Taylor & Francis or Routledge's collection of thousands of eBooks please go to http://www.ebookstore.tandf.co.uk/."

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British Library Cataloguing in Publication Data A catalogue record for this book is available from the British Library

Library of Congress Cataloging in Publication Data A catalog record for this book has been requested

ISBN 0-203-00041-2 Master e-book ISBN

ISBN 0-415-35399-8 (Print Edition)

Contents

Figures

Tables

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Foreword

Robert Chambers famously observed—one imagines with a sigh of frustration—that natural scientists are trained to act, but that social scientists are trained to criticize. There's a 'merely' implied here, which does not refer to the natural scientists. The argument is that we social scientists—and that includes the authors of this book, though not necessarily all its readers—criticize but do not act. We are, allegedly, adept at deconstructing narratives, expert in speaking truth to power (though mainly from the safety of papers in academic journals), and world class in offering policy-makers so many options that they find themselves unable to move forward. Most of the jokes about economists capture exactly this idea: the African President who insisted that all his economic advisers be one-handed, to stop them saying 'on the one hand…on the other hand'; or the economist on a desert island with a can of beans but no can-opener, whose suggestion was 'let us assume we have a can opener'.

There are two kinds of answer one might make to such a critique of social science, and this book illustrates both. The first is that criticism—or dispassionate analysis as we might prefer to call it—is an essential foundation for better policy. The second is that social scientists are actually pretty good at policy. Take these in turn, and relate both to the core question tackled in the book—the reform of international institutions which should and could help reduce poverty in the world, and could and should do better.

On the first question, we need to know not just whether or to what extent the World Bank and the IMF contribute to poverty reduction, but why their record is as it is. That job is about explanation—and explanation needs theory. As the social psychologist Kurt Lewin observed, 'there's nothing so practical as a good theory'. We learn here that the record is patchy, but we also learn why: the ideology of the institutions, the power structures which run them, the geo-politics of aid allocation, the technical weaknesses of programme design—and also, if we are to be fair, the severity of the underlying problems and the diversity of country situations. These are important findings, and they stem from the careful application of theory, whether discourse analysis to unpack the politics of policy making in the Bretton Woods Institutions, or more technically the implications of asymmetric access to information for the use of conditionality in aid relationships.

Of course, all this would be interesting but essentially useless if it did not lead to practical policy. The acid test of applied research is that it should redirect energy and lead to change. Here, the book also scores well. We are shown how to integrate poverty concerns into macro-economic planning, told about the importance of safety nets in managing adjustment programmes, and reminded, repeatedly, about the importance of gradual approaches, of learning-by-doing, and of the need for international institutions to be responsive to varying conditions in developing countries.

The power of these conclusions lies partly in their aggregate impact: we have here the elements of a story-line on international development as a whole, what Roe calls a 'narrative'. There should be no doubt about the impact of such narratives: think of the power of narratives about structural adjustment, the Washington Consensus, or what Joe Stiglitz has termed the post-Washington Consensus. Narratives simplify, of course. But they also help policy-makers handle complexity and find solutions. In the title of Diane Stone's book about think-tanks, they 'capture the political imagination'.

The world certainly needs inspiring narratives, if the Millennium Development Goals and the wider ambitions of the UN's Millennium Declaration are to be reached. The widespread adoption of the MDGs signals political commitment. So does the investment in initiatives like the Africa Commission. The challenge we face as researchers and policy analysts is to stand ready in support, with theory, with explanation, and with practical proposals.

My own take is inspired by the kind of discussion found in the pages of this book. With due acknowledgement to the risk of over-generalization and the importance of path dependency, I call it the 'meta-narrative'. There are three ways in which a new meta-narrative might develop current conventional wisdom.

First, the MDGs provide a powerful and politically attractive frame within which to approach international development, but they are incomplete. In addition to the MDGs, the Millennium Declaration includes a statement of values and a commitment to peace, security and the rule of law. The additional material widens and internationalizes the frame. It also provides the basis for saying that there is more to poverty than lack of income: equity and social justice also matter, for intrinsic as well as instrumental reasons.

Second, there is evidence that the story about how to get to poverty reduction, equity and social justice is more nuanced than the current donor narrative suggests. As the papers in the book illustrate, a crude characterization of the current approach is to encourage internal and external liberalisation, and simultaneously to invest in health and education, so that people are able to take advantage of new economic opportunities. Stiglitz has not been the only one to worry that supply side constraints and high levels of vulnerability make this strategy both difficult and risky. The recent British Government White Paper on trade and investment, published in 2004, illustrates a new approach in one of its key themes: 'same destination, different speeds'.

Third, there are issues about how well the current approach guides international support to the development process. The approach involves channelling more aid to well-governed countries with good policies—using the MDGs as an objective, Poverty Reduction Strategies as both a guide to policy and an indicator of ownership, better public expenditure as the main instrument, and budget support as the main vehicle for aid. This approach faces especially big problems in dealing with failed states and poorly performing countries. There are also more general issues about what 'partnership' might mean in international development, especially in terms of the accountability of developed countries for their policies on trade, aid, finance and security. A new development cooperation regime will require close cooperation between ministries and international institutions dealing with finance, foreign affairs and security, as well as development aid, and will need a mechanism which holds rich countries to account.

And how is this going to happen? What about the ideology, the power structures, the geo-politics and other themes emphasized in the book? One answer is to say that if the political will is in place, which it seems to be, then the institutional changes will follow—for example, to voting structures in the World Bank and the IMF. That may be too easy an answer. My own approach has been to tackle the problem head-on as a research issue in its own right, using ideas from collective action theory to try and understand why people cooperate and what incentives might decrease the probability of defection. For example, Elinor Ostrom teaches that the risk of defection lessens when the cost of doing so rises. Does this suggest that donors committed to harmonization or UN reform should find ways to sanction the non-cooperators?

That is the kind of question the book inspires. It illustrates a final point, that the problems we are dealing with cannot be resolved by one discipline alone. Collective action theory draws on the insights of economists, sociologists, political scientists, psychologists—and, of course, biologists. Development studies are necessarily and proudly multi-disciplinary.

The book you are about to read draws on the multi-disciplinary tradition of development studies. Its combination of applied theory and practical policy is also characteristic in our field. All this makes it especially appropriate that the papers were presented at the 2003 conference, held at the University of Strathclyde, of the Development Studies Association of the UK and Ireland.

Simon Maxwell
Director of the Overseas Development Institute
and
President of the Development Studies Association
of the UK and Ireland

The IMF, World Bank and policy reform

Introduction and overview

Alberto Paloni and Maurizio Zanardi

This book is a collection of papers prepared for the Development Studies Association (DSA) annual conference held in Glasgow (UK) in September 2003. The theme of the conference was 'Globalization and Development'. The choice of this topic needs little explanation, as the process of globalization is transforming the world and presenting new challenges for all donors, international organizations, developing as well as industrialized countries. We are assisting in a major rethinking of the nature of development and of development policy, which is remodelling the relationships between the different parties. Within the context of the conference, the editors of this book organized a set of parallel sessions on the 'IMF, World Bank and policy reform'. These institutions have shown throughout their history an extraordinary capacity for change. Whether they can rise to the new challenges and their intervention strategies can stimulate economic growth and help reduce poverty on a significant scale are fundamental questions that deserve careful debate. The papers collected in this volume were prepared for these parallel sessions. The issues that they raise are as topical today as they were at the conference.

In the face of the increasing importance of private sources of finance, it goes often unnoticed that the loans from the International Financial Institutions (IFIs) have in fact been the fastest growing source of debt for developing countries over the last twenty years. Recognizing this, one might convincingly argue that an association of academics and practitioners sharing expertise and concerns in the area of development studies should always be reflecting about the role of the IMF and the World Bank and about the effects of their assistance on developing countries. However, these parallel sessions at the DSA conference were not an instance of such routine evaluations. The reason is that we are currently assisting in a radical redefinition by both the IMF and the World Bank of their international roles, their priorities, and their forms of intervention.

Without unduly downplaying the significance of the new agendas on health and education, environmental protection and institutional building—to mention just a few—there can be little doubt that the most important change in both institutions is their commitment to poverty reduction (and to the achievement of all the other Millennium Development Goals) as their overriding objective. Moreover, there is now consensus—shared by the IMF and the World Bank—that operationally, effective poverty reduction is only possible if the poor countries themselves take this as their objective and implement appropriate policies. Both institutions have accordingly redefined their role as that of providing financial assistance and technical expertise to support locally owned pro-poor reform programmes. If truly meant and put into practice, the new emphases on poverty reduction and reform ownership represent a dramatic transformation compared with the years of structural adjustment.

With the exception of a few years in the 1970s under McNamara's presidency, when the World Bank took poverty reduction as its priority and became concerned with income distribution and basic needs, poverty reduction per se had never been high on the Bank's agenda. Attention to distributional and poverty issues had often been seen as a useless diversion of resources from the central objective of economic growth, which was regarded as the only mechanism through which poverty could be reduced. This trickle down doctrine also characterized the Bank's insistence on structural adjustment, with its focus on stabilization, privatization and liberalization. Despite a greater appreciation of the trade-offs between poverty reduction and growth in the 1990s, it was only in 1999, with the launch of the Enhanced-Highly Indebted Poor Countries (HIPC) initiative and the Poverty Reduction Strategy process, that poverty reduction became once again a priority for the Bank.

The journey towards preoccupation with poverty reduction by the IMF is even more remarkable, since the Fund has a long history of orthodox policies and has never been a development agency. While after the oil crisis in 1973 low-income countries had become its main customers, the debt crisis in 1982 saw the Fund restarting to lend to emerging countries. Moreover, particularly after the financial crises in East Asia towards the end of the 1990s, there was significant pressure on the IMF to disengage from low-income countries and cease its lending activities to them. The Fund responded by joining the World Bank in launching the Enhanced-HIPC and by designing a new facility directed to poor countries, namely, the Poverty Reduction and Growth Facility (PRGF), which replaced the Enhanced Structural Adjustment Facility (ESAF). Outspokenly and unambiguously, the then Managing Director of the IMF, Michel Camdessus, declared that the IMF was 'the best friend of the poor'.

During the life of the two institutions, changes to their views about conditionality have also been radical. The principle of conditionality is central to the relationship between the IFIs and recipient countries, that is, recipient countries should commit to an agreed set of policies (conditions) if they are to receive funding from the IFIs. The World Bank has always imposed some conditionality, though under project-based lending this had a more macroeconomic focus. In contrast, the principle of conditionality was formally included in the IMF's Articles of Agreement only in 1969. Even then IMF conditionality remained relatively loose, though it started to intensify with the introduction of the Extended Fund Facility in 1974. The World Bank extended its conditionality when it shifted from project-based to policy-based lending with its Structural Adjustment Lending, which included detailed microeconomic conditionality. The debt crisis marked a profound change in the use of conditionality by IFIs, as both the IMF and, especially, the World Bank attached more and more conditions to their programmes.

During the 1980s and most of the 1990s conditionality exploded both in detail and scope, as the IFIs extended their conditions from traditional areas of expertise to new ones. Conditionality came to affect macroeconomic stabilization, structural reforms of the trade and financial sectors, privatization, governance (the expansion of conditions in this area is particularly relevant), the environment, gender issues and the labour market. Moreover, the conditionality of the two institutions has converged as a result of their decision to pursue similar aims, namely, economic growth and poverty reduction in their member countries. Often, developing countries had no option but to accept such conditionality in order to obtain access to new funding. Such financial incentives have remained at least as strong with the HIPC initiative for debt relief.

Despite the increase in the use of conditionality (but, according to some critics, because of such an increase), there is overwhelming evidence that conditionality has not accomplished the role that was intended, proving to be unable to persuade reluctant governments to undertake the recommended policy reforms. This has led to calls from all quarters for the IFIs to pay far greater attention to local ownership of the reform process, a call which the IFIs claim to have acceded to. Both institutions have committed to a drastic streamlining of conditionality by focusing only on those reforms that are crucial for programme success.

The question arises as to whether the new priority on poverty reduction and the associated emphasis on borrower ownership represent an authentic redefinition of the institutions' roles or whether such changes are merely a cosmetic exercise. Are the institutions 'masters of reinvention' (an expression which, turning upside down its usual meaning, is given here a positive connotation as it is meant to reflect the institutions' capacity to learn from experience and adapt to changing environments) or 'masters of illusion'?

In their own way, all the chapters in this book provide some elements for an answer to this question. They attempt to evaluate the significance of the changes in the institutions' direction, raise concerns over some of their limitations, highlight some of the obstacles to greater effectiveness of the institutions' intervention and point to important areas for future research. They do so from different perspectives: some are theoretical, others are methodological or empirical contributions and, while all are written by economists, they make use of insights from other disciplines, particularly public policy and political science. Remaining true to the tradition in the area of development studies, where theory is married to practice, all chapters also have important policy implications. The chapters are grouped around three main themes, which are essential for the understanding of the redefinition of the institutions' roles, namely, 'Geopolitics and ideology', 'Poverty reduction strategies' and 'Borrower ownership and the reform of conditionality'.

1 Geopolitics and ideology

An assessment of the true extent of the institutional and policy changes within the IMF and the World Bank cannot ignore the special role of the USA in shaping the IFIs' policy agenda. It has been argued, for example, that the important changes in policy within the IFIs have always largely reflected the shifting priorities of the US foreign policy. The USA has at its disposal a number of mechanisms and can take advantage of sets of rules and norms through which it can exercise influence over the IFIs. The USA nominates the World Bank president; it has by far the largest share of the votes and, on matters requiring special majority (e.g. constitutional matters), is the only country that has a veto power. It is the provider of one fifth of the International Development Association (IDA) funds (i.e. the single biggest contribution) and this gives it great influence not just on IDA but on the entire Bank.[1]

Even if, in practice, the Executive Boards both in the IMF and the World Bank work by consensus and formal votes are virtually never taken, work within the institutions reflects an awareness of member countries' relative voting strengths. Moreover, since the beginning of structural adjustment, the US Treasury has exercised a de facto veto on the appointment of the chief economist at the World Bank. This is a critical position, since the chief economist can shape what the Bank says by purposely using the findings of 'objective' research to underpin it.[2] In accordance with the Bank's president, the chief economist also appoints the director of the World Development Report, which is the Bank's flagship publication and reflects its ideological preferences.

Similarly, the USA has far greater influence than any other country in the IMF. As in the Bank, the USA is the largest single vote-holder in the Executive Board. While the IMF managing director is nominated by western Europe, the deputy managing director is always an American and most senior appointments are made only after US approval. In addition to this influence over appointments, the USA is able to exercise its authority through more indirect means. Woods (2002) reports that US representatives are the only ones to speak on all issues coming before the Executive Board and that the US representation comprises not one or two officials like many other countries but

> three dozen US Treasury officials [who are] regularly involved in working with, thinking about and offering advice concerning the IMF. As well as the Executive Director at the IMF…there is also the Deputy Assistant Secretary of the Treasury for international monetary and financial policy office who presides over an office of the IMF within the Treasury… Furthermore, most US Treasury country and regional offices spend time liaising with the IMF about analyses and programmes affecting their particular countries or regions. Additionally, staff working on G-7 coordination, as well as private sector involvement, capital account issues, crisis management, appropriate conditionality and so forth work regularly with the IMF. The US Federal Reserve also works closely with the staff and officials of the IMF.
>
> (pp. 959–960)

Despite the power of the USA in the IFIs, it would be too simplistic to conclude that the USA has the leverage to carry out its preferences. Even if signals of US displeasure have an impact on their staff, the USA may not enjoy full control over the IFI's activities, since the belief by member states that the institutions have a certain degree of independence is necessary for their legitimacy. Executive Directors are not only representatives of their countries but also officers of the IFI and, as such, do not take decisions only on the basis of narrow national interests. The provision that lending decisions should not be affected by political considerations is expressed in the IFIs' founding charters.

If changes in the IFIs' policies and priorities have been strongly affected by US interests and priorities and other external factors, such changes have also been a response to shifts in the understanding of economic development and in the preferences of their staff. The foundations of structural adjustment, for example, predated the Thatcher and Reagan elections, as internal evaluations at the Bank had already revealed disappointing results of poverty-oriented lending during McNamara's presidency and raised a radical criticism of state-led development and of poor institutions. Structural adjustment then moved to the top of the agenda with the appointment of conservatively minded staff in key positions. With structural adjustment and the increasing influence of neo-classical economists within the organization, the Bank became committed to the neo-liberal ideology and its policy came to coincide with the US agenda aimed at the liberalization of trade, foreign direct investment and portfolio flows. The IMF was less affected than the Bank by the shifting fashions of development theory and policy and its commitment to the neo-liberal model was in place long before 1981.

Moreover, the predominance of neo-liberalism and neo-classical economics in both IFIs has been institutionalized. Wade (2002) reports that in the World Bank pro-free market studies are rapidly disseminated while more critical studies are challenged and sent back for restudy. It is interesting to note in this context that the emergence of new policy agendas in the 1990s took place still within a general framework where the core principles behind macroeconomic stability, liberalization and privatization are reaffirmed and the new policies are seen as complements of adjustment.

The five chapters in this section of the book look at the influence of the USA and of neo-liberalism on the IFIs. The chapter entitled 'Voting power in the Bretton Woods institutions' by Dennis Leech and Robert Leech is an original investigation of the IFIs' systems of governance, which, despite substantial changes in the IFIs' roles and in the scale and scope of their activities, have remained basically unchanged.

Governance in the IFIs is based on a weighted voting system, according to which all member countries have the right to vote but cast different numbers of votes to reflect key differences between them. But the focus of the chapter is not on the allocation of voting weights or on the fact that often such weights do not reflect a country's importance in the world economy or population, resulting in a bias against developing and poor countries. Instead, the chapter introduces the distinction between voting weight and voting power. The former is simply the number of votes a country has the right to cast, while the latter is its capacity to be decisive in a decision taken by vote. Voting power can be measured by the frequency with which a country can change a losing vote to a winning one, which depends on all the other members' weights as well as the voting rule by which decisions are taken. A country's voting power, therefore, has a rather imprecise relation with its voting weight. Leech and Leech use Voting Power Analysis (a branch of the mathematical theory of games) to analyse power relations within the systems of governance of the IFIs.

This study shows that the system of weighted voting—both in the IMF and the World Bank—creates a bias that favours the USA at the expense of all other member countries, for the USA actually has much more voting power than its voting weight (which is already by far the largest of any other country) while all other countries have less power than their weight. Moreover, in the Executive Boards, the system of electing directors by constituencies increases the voting power of a few—mainly rich European—countries, while 41 countries—mostly in the developing world—are found to have no voting power in their constituencies.[3] Leech and Leech also show that this bias in the IFIs' weighted voting system would persist even if the basic votes were restored to their percentage level at the time of the foundation of the institutions.[4] Finally, Leech and Leech argue that the distinction between voting power and voting weight strengthens the argument for breaking the link between the allocation of votes on one side and both the provision of and access to finance on the other.

The chapter by Graham Bird and Dane Rowlands 'What determines IMF arrangements?' is a review of the literature that attempts to empirically identify the factors that determine the pattern of IMF lending. Generally, whether an arrangement with the IMF is finalized or not depends both on demand-side factors, representing a government's decision to turn to the Fund for assistance, and supply-side factors, representing the IMF's response to the request for financial support.

More precisely, Bird and Rowlands propose a multi-stage framework for thinking about the determinants of IMF arrangements. The first stage involves factors making a country's balance of payments position unsustainable, since it is mostly in such circumstances that countries will contemplate negotiating an arrangement with the Fund. Other explanations for entering an IMF arrangement are the government's attempt to shift the public's blame on the IMF for reforms that the government itself intends to implement (the so-called 'scapegoat theory') or the government's resolve to weaken the opposition by committing to reforms within the context of an IMF arrangement. The second stage involves domestic political factors, which for example determine how an agreement with the IMF might affect the government's chances of re-election. The third stage involves factors relating to the Fund's response. Such factors may have a bearing on whether the IMF decides to ration lending or to discriminate against certain political regimes.

Bird and Rowlands warn that, while econometric research may help identify a set of potentially relevant economic, political and institutional factors, it will not be possible to specify any single model which is able to explain all IMF lending. The reason is that countries' specific circumstances are different and specific variables may be relevant in certain cases but not in others. Anyhow, Bird and Rowlands suggest, first, that the most common determinant of IMF arrangements in practice is the loss of balance of payments sustainability. Second, domestic political factors may not constitute a strong deterrent on a government's decision to refer to the Fund for assistance. This is because empirically governments have been able not to fully comply with conditionality without endangering their future access to IMF resources. Third, supply-side factors play a relatively limited role in explaining arrangements. Bird and Rowlands argue that an eventual institutional or political bias by the IMF is not likely to determine whether arrangements are reached or not. Such a bias will instead be reflected in the details of arrangements, the amount of finance provided and the specifics of conditionality.

The understanding of the circumstances under which countries enter into arrangements has implications for the granting of IMF assistance and for the design of conditionality. Bird and Rowlands suggest, firstly, that if IMF arrangements are largely demand-determined, the Fund may need to adopt a more active rationing policy in the future. By being more selective, the Fund could have a stronger catalytic effect on other capital flows into the programme country. Second, if different sets of circumstances lead governments to turn to the IMF, the Fund needs to ensure that it can offer a flexible response and, therefore, conditionality itself should be more flexible.

In the chapter 'The politics of IMF and World Bank lending: will it backfire in the Middle East and North Africa?' Jane Harrigan, Chengang Wang and Hamed El-Said assess the extent to which political factors have influenced the flow of funds from the IMF and the World Bank to the Middle East and North Africa (MENA) region.

While bilateral aid flows to the MENA region have been often influenced by donor interest, there is a question as to whether flows from the IMF and the World Bank are subjected to a similar influence. On the one hand, the Bank and the Fund Articles of Agreements explicitly state that lending decisions should not be influenced by political factors. On the other hand, it is often argued that these two institutions are strongly influenced by the economic and political needs of their major western shareholders, especially the USA. This may have even intensified after the terrorist attacks on September 11, since the USA has come to conceive the granting of aid and the fight against poverty as essential means in the War on Terror.

Harrigan, Wang and El-Said show that, although in some cases recipient economic need—as reflected by a deterioration in key macroeconomic variables—is a determinant of IMF and World Bank lending, political events in the recipients that carry favour with US policy in the region are also important. In particular, a shift towards a pro-western foreign policy, peace overtures to Israel, domestic political liberalization and the presence of strong Islamic opposition to the regime prompt an inflow of funds not just from the USA but also from the Bank and the Fund.

The allocation of aid funds according to donor interest rather than recipient need has, according to Harrigan, Wang and El-Said, two implications. First, it is likely to reduce the developmental impact of aid, for the countries that need aid the most or that can use aid to the best will not receive their due share. Second, it may well backfire, particularly in the MENA region. Harrigan, Wang and El-Said paint the prospect of a vicious circle in which the implementation of IMF and World Bank-supported reforms may lead in turn to declining social welfare, growing anti-reform movements opposing incumbent regimes and repression of such opposition by the regimes. This may enhance opposition movements' appeal to impoverished and disaffected groups and may lead to widespread unrest, not only directed at incumbent regimes but also anti-Western and more specifically anti-American and anti-globalization. Indeed, in some instances, such as in the case of riots in Jordan prompted by the IMF-induced lifting of price supports, the IMF and the World Bank have been viewed by many of the opponents of reform as synonymous with the American presence and interests in the region.

In the chapter 'A World Bank attempt to create a policy environment indirectly through an NGO support project: a case study of Palestine', John Cameron attempts to draw lessons for the World Bank's work with the NGO sector in a 'failing' state context. This case study focuses on a World Bank project, developed in the aftermath of the 1993 Oslo Accord, which intended to provide support to the Palestine NGO (PNGO) sector. This project was unusual in two interrelated ways. One, it was outside the framework of a Bank to sovereign state relationship, which is the normal protocol for World Bank assistance but cannot be followed when dealing with the people resident in the West Bank and Gaza. Two, it was designed so as to fund NGOs directly, while normally NGOs would receive Bank support indirectly, that is, from World Bank loans to the government, which in turn channels them to the NGOs.

The objectives of the project were threefold: to deliver services to the poor and marginalized in Palestinian society through NGOs; to provide financial and technical assistance to NGOs, increasing their capacities; to support efforts by the Palestinian Authority and the PNGO sector to strengthen their working relationship. The project, therefore, intended to address a wide range of needs, crossing the policy boundaries between welfare service delivery, developmental objectives and governance. If effective, it would have played a key role in setting the general policy environment in Palestine.

The chapter presents an analytical framework which was used for evaluation purposes in the Project Mid-Term Review and highlights some of the problems resulting from the World Bank 'involvement' in the project design. In particular, Cameron identifies two prerequisites that are essential to create the conditions for a suitable policy environment. The World Bank should be supportive of development of an effective Palestinian State and should be critical of States that by political acts damage livelihood opportunities for people who are not their citizens. However, for the Bank, meeting this condition is problematic, as the Article of Agreements forbids it to get involved in politics. Nonetheless, the World Bank may have to recognize that it cannot continue to conduct its policy under the pretence that States are equal in sovereignty, as demonstrated by the Israel/Palestine situation. A further difficulty for the Bank—for it inevitably raises the very issue of the Bank's governance—is that, as Cameron puts it, the State obstructing the Palestinian people's self-determination to build a genuinely owned policy environment is 'the superpower or a close client state of the superpower'.

The second lesson identified by Cameron is that the Bank should have provided much greater support for the PNGO sector on many dimensions. The funding was relatively small and the project was based on a competitive model for grant allocation, which antagonized the PNGOs, while what was needed in order to encourage the development of a healthy civil society was to foster their cooperation. This severely hindered the project's role of developing the capacities of the sector as a whole and the attainment of the governance objective. Cameron argues that these lessons from the experience with the PNGO project could be relevant for building a policy environment in all 'failing' State contexts.

In the chapter 'The World Bank and good governance: rethinking the state or consolidating neo-liberalism?' Gordon Crawford addresses the question whether the World Bank's emphasis on good governance and the importance of an 'effective' state represents a fundamental rethinking of the role of the state in the development process. Views about this role have gone through radical changes since the foundation of the Bretton Woods institutions. In the 1950s and 1960s, the state was perceived as the key agent of growth and development. The statist strategy came later to be regarded as a failure and a new orthodoxy, based on neo-liberal theory and the 'rolling back' of the state emerged in the 1980s. Since the early 1990s, there has been reassertion of the state as a crucial actor, which emphasizes the complementarities between state and market. The World Bank has promoted good governance as a key area of policy reform but in fact good governance has been adopted as a policy objective almost universally by multilateral institutions as well as by most bilateral agencies (including the UK's Department for International Development). Does this post-Washington consensus represent a shift away from the state minimizing agenda of the 1980s?

Crawford argues that no such shift has actually occurred. In particular, in the World Bank's conception, the role of government remains limited and subordinate to that of the market. 'Good governance' becomes defined as the ability of the state to facilitate private entrepreneurship and promote institutions that support a free market economy. Interestingly, Crawford finds a significant degree of correspondence between this vision of governance and classical political liberalism, especially as articulated by Hayek.

According to Crawford, this suggests that the World Bank's intention is to construct a liberal state and consolidate contemporary neo-liberalism, not to 'bring the state back in'.

That this interpretation is likely to be correct is illustrated by the World Bank's recommendations that the state should not intervene in business matters, especially those involving transnational corporations (for instance through regulations to protect the labour force and relatively small, indigenous firms) or play a redistributive role. The Bank has mostly addressed issues relating to economic efficiency and property rights, rather than distributional considerations, questions of access to justice, the enforcing of political and civil rights, and the strengthening of criminal law. While eliminating public corruption is a core element of the governance agenda, private sector corruption as a governance issue has remained largely ignored. Thus, in this chapter, Crawford reveals that notions such as 'good governance' and an 'effective state', while seemingly difficult to oppose, in fact perform an ideological role. The World Bank's worldview remains resolutely based on development as free market capitalism.

2 Poverty reduction strategies

An explicit focus on poverty reduction within the context of programmes supported by the World Bank and the IMF came in the aftermath of the East Asian crises (with the subsequent crisis contagion in other countries), which generated deep concern about the effect on poverty of their structural adjustment programmes.

The criticism that these programmes disproportionately hurt the poor is long standing. Throughout much of the 1980s the IFIs relegated the problem of poverty reduction to the background, as they embraced a new version of the 'trickle down' doctrine.[5] According to this, the only sustainable manner to reduce poverty is via economic growth. In turn, there can be a solid foundation for growth only with macroeconomic stability. The poor would automatically gain from adjustment not only through the aggregate growth process but also because devaluation and trade liberalization would remove the anti-export and the urban biases, which are deemed to hurt the poor for they are mostly in the rural sector.

However, despite the dominance of this neo-liberal economic doctrine, the promise of faster and sustainable economic growth did not materialize. Growth in developing countries has been not only disappointingly low but also lower than in the period between the 1950s and the 1970s, that is, a period dominated by interventionist policies that were supposedly inferior to the neo-liberal ones.[6]

Moreover, this low growth has been accompanied by growing inequality and increasing social problems, weakening of democratic consent, social unrest, and environmental degradation. Concerns about these issues led to a broadening of the development agenda. Poverty reduction, better health and education also become essential objectives, since human capital accumulation is an engine of growth.

Everyone welcomes the emphasis on poverty and most would accept that growth is necessary to reduce poverty in the long term. Nevertheless, there is still an acrimonious debate as to whether the policies advocated by the IFIs are the right ones to generate economic growth and whether the adoption of those policies is the right manner to set about reducing poverty. There is no convincing evidence that liberalization and structural adjustment—which still remain at the core of the Poverty Reduction Strategy Papers (PRSPs)—are the key to growth.[7]

The IFIs have maintained a firm commitment to macroeconomic stability and liberalization. Trade openness in particular continues to be seen as necessary to move economies on a higher growth path. On the basis of empirical research that has been widely disseminated by the World Bank showing that there is a one-to-one relationship between the growth rate of per capita income and the growth rate of income of the poor, it is concluded that increased trade is associated with improvements in the well-being of the poor (Dollar and Kraay, 2004). This argument has however been subjected to close scrutiny, as a result of which the optimistic conclusions about the effect of trade liberalization on poverty have been significantly weakened.

The positive relationship between trade and growth found in this study is blighted by serious methodological shortcomings that make this finding unconvincing (Nye *et al.,* 2002). In fact, the lack of robust evidence on this relationship is a rather typical result of the empirical literature in this area. Moreover, it is worth noting that the policy implication that trade reduces poverty would not necessarily stand even if trade increased economic growth and the one-to-one relationship between average income growth and the growth of income of the poor existed. First, the vast majority of countries deviate from the one-to-one relationship, which is only an average relationship. Therefore, growth would normally be associated with significant changes in income distribution, which depend on the structural characteristics of the individual countries. Second, since the incomes of the poor are lower than average incomes, their increase in proportion to the increase in average income would produce a smaller absolute income increase for the poor than for the non-poor. Consequently, income distribution would become more unequal. This raises legitimate doubts on the efficacy of promoting average growth as the core element of a poverty reduction strategy.

There is empirical evidence that since the 1980s there have been marked changes in world income distribution and that the increase in within-country inequality has been much more pronounced than the increase in between-country inequality. One possible explanation for these trends centres on the nature of the neo-liberal reform programmes, particularly the opening of the economy to free international movements of goods, services and capital (Cornia, 2004).[8]

Other empirical research fails to find any significant effect of IMF and World Bank programmes on poverty. Easterly (2003), however, also finds that these programmes have lowered the growth elasticity of poverty. While this implies that the programmes have somewhat protected the poor during economic contractions, it also means that periods of growth have contributed to worsen income distribution, at least for those near the poverty line. This is a matter for concern because in several countries the promotion of growth would reduce the stake of the poor in overall good economic performance and because high inequality might depress future growth. This is likely to prevent the achievement of halving world poverty.

One implication in terms of decision-making is that a certain policy cannot be justified simply on the basis of its mean outcome. The variance of outcomes must also be a relevant consideration in the policy-making process. The phenomenon of livelihood diversification, for example, is often explained by the presence of severe risk in the economic calculations of the poor. A second implication is that a Poverty Reduction

Strategy (PRS) cannot be centred only on the promotion of growth. Poverty is not simply a low level of income or consumption. Poverty is also related, for example, to obligations arising from family and other social relations, access to assets and public services and the right to use common resources. It has been suggested in the literature that opportunity, security and empowerment are also central components of poverty reduction.

This is not to say that economic growth should be pushed to the background. On the contrary, the growth slowdown in developing countries since the 1980s requires an urgent answer to the question of how rates of return in agriculture, industry and services could be increased. Moreover, as Wade (2002) points out, there is not much evidence that economic growth and productivity are raised by changes in decision-making which give greater power to local groups.

This section of the book on 'Poverty reduction strategies' contains five chapters, each providing a different insight into the matter. The first, 'The effects of compliance with structural adjustment programmes on human development in sub-Saharan Africa' by Farhad Noorbakhsh and Shadan Noorbakhsh, investigates whether the extent to which different countries have implemented World Bank conditionality has led to different results in terms of human development. The contribution of this work should be seen in the context of the cross-country literature assessing the effects of World Bank (and IMF) programmes. A standard finding of this literature—no matter whether the focus of the analysis is on economic growth, poverty or other economic/social indicators—is that the programmes appear to have produced negligible effects. This literature, however, suffers from a shortcoming in the methodology employed, due to the equal treatment of all programme countries. In reality, programme countries have implemented reforms and met conditionality to very different degrees. It is likely, therefore, that the procedure of jumbling together countries with limited compliance with conditionality and countries with far more extensive compliance may have produced a large downward bias on the estimated coefficient of programme effectiveness.

While this argument cannot be faulted, it is not easy to account for the different degrees of conditionality implementation in practice due to the lack of suitable data. However, in a report on structural adjustment programmes in sub-Saharan Africa, the Operations Evaluations Department (OED) of the World Bank published a high-quality data set that evaluates programme countries' compliance with conditionality (World Bank, 1997). Using this data set, Noorbakhsh and Paloni (2001) find that indeed in sub-Saharan Africa the effect of structural adjustment programmes on economic growth depended on the degree of compliance. In this chapter, Noorbakhsh and Noorbakhsh use the same data set and methodology to analyse whether the importance of compliance with conditionality also extends to the case of human development. The results reported in this chapter suggest that it does not.

Over the medium to the long run (which is the horizon over which adjustment programmes are supposed to have their strongest effects) neither overall compliance nor compliance with conditions in various policy areas have any significant effect on changes in human development (as measured by the Human Development Index (HDI)). It is only in the short run that compliance appears to be associated with improvements in HDI. However, Noorbakhsh and Noorbakhsh comment that such positive effects may have more to do with the financial assistance accompanying the programmes than with the benefits deriving from the implementation of adjustment policies.

The chapter on 'Trade liberalization and economic reform in developing countries: structural change or de-industrialization?' by Mehdi S.Shafaeddin is an analysis into the first link in the chain running from trade liberalization to growth to poverty reduction. More precisely, this chapter gives an assessment of the effect of trade liberalization on growth and on the factors driving sustainable growth, such as investment and industrial development.

Shafaeddin finds that, following the structural reforms of the 1980s, only a small number of countries, mostly East Asian, saw fast and sustained growth in manufactured exports, rapid expansion of industrial supply capacity and upgrading of the industrial base. By contrast, in the vast majority of countries, the growth of manufactured exports was low and the structure of GDP did not change in favour of the manufacturing sector. The private investment response, particularly in the manufacturing sector, to reform programmes was weak. In fact, in many countries, the investment to GDP ratio was lower at the end of the reform period than at the beginning, in some cases even where the country recorded significant increases in FDI. Moreover, about half of the countries—mostly low income—were affected by the process of de-industrialization.

According to Shafaeddin, the explanation for such contrasting experience is in the different initial conditions at the time of trade liberalization and in the different characteristics of the trade liberalization process itself in these groups of countries. The East Asian countries had already a substantial industrial base and capabilities in the exports of manufactured goods before the implementation of the reforms. Furthermore, liberalization has been gradual and selective as part of a long-term industrial policy. By contrast, the other countries embarked on a process of rapid and across-the-board liberalization, which led to the development and reorientation of the industrial sector in accordance with static, rather than dynamic, comparative advantage, with the exception of industries that were near maturity.

This demonstrates that, while trade liberalization can be beneficial when an industry reaches a certain level of maturity, it should be selective and gradual, or it may lead to destruction of the existing industries—particularly those that are at early stages of infancy—without necessarily leading to the emergence of new ones. Moreover, the ones that emerge would be in line with static, rather than dynamic, comparative advantage.

In the chapter 'Integrating poverty reduction in IMF-World Bank models', Brigitte Granville and Sushanta Mallick extend the growth-oriented adjustment framework—originally proposed by Khan *et al.* (1990) to represent traditional IMF and World Bank supported programmes—in order to incorporate the analysis of the effects of such programmes on poverty reduction. Khan *et al.* integrated the IMF's approach to short-run economic stabilization (also known as 'Financial Programming') with the World Bank's Revised Minimum Standards Model, which focuses on medium-term growth and its financing through domestic savings and foreign assistance. This integrated framework illustrates the importance of both demand and supply constraints in countries undertaking adjustment programmes, which are normally operating much below their capacity output. Nevertheless, this framework, as it stands, is inadequate for an analysis of the recent IMF and World Bank programmes because it ignores the issue of poverty reduction. Granville and Mallick extend it so that the resulting framework can be used to model the links between macroeconomic policy and poverty and to evaluate the possible trade-offs arising from the implementation of poverty-reducing macroeconomic policy.