ECONOMIC DEVELOPMENT IN A GLOBALIZING WORLD ECONOMY: THE ROLE OF MULTILATERAL DEVELOPMENT BANKS

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I. INTRODUCTION: WHAT ARE MULTILATERAL DEVELPMENT BANKS?

There are a number of multilateral development banks (MDBs) in the world. The World Bank is the global MDB, while the Asian Development Bank (ADB), the Inter-American Development Bank (IDB), the African Development Bank (AfDB), and the European Bank for Reconstruction and Development (EBRD) are major regional MDBs (see Table 1). In addition to these there are several other and sub-regional MDBs.[1]

Financing for the construction of essentially public sector infrastructure such as transport, power generation and distribution, and irrigation and water supply was sought by MDB borrowing members and once became a mainstay of MDB operations for those that could have attracted private sector funding. More recently, the upsurge of financing capacity in the private capital markets has seen the MDBs withdrawing from some of their prominence in infrastructure financing in favor of private sector financing. The financial crises in the emerging market economies in the 1990s and the first two years of the 2000s have also posed new challenges for the MDBs in crisis prevention, management and resolution. The World Bank's relationships with the International Monetary Fund as well as with the regional MDBs are also focus issues.

The MDBs are in need of reforming their operations, particularly in order to enhance their aid effectiveness in assisting developing countries' development and growth strategies in the context of globalization.

II. FUNCTIONS OF THE MULTILATERAL DEVELOPMENT BANKS

The common characteristic of the multilateral development banks (MDBs) is that they are financial institutions with the objectives of funding reconstruction after disasters such as wars and conflicts, and financing the economic development in their poorer members, which involves then in a wide range of financial, sectoral, and institution building activities.

1. The World Bank

The *International Bank for Reconstruction and Development (IBRD)*, often called the World Bank, was created together with the International Monetary Fund following the 1944 Bretton Woods meetings held by the Ally Countries at the near-conclusion of World War II. Its initial task was to provide financing for the reconstruction of war-torn countries in Europe. Its role was subsequently expanded to cover wider development

[1] Other and sub-regional MDBs include Andean Development Bank, Arab Bank for Economic Development in Africa, Caribbean Development Bank, East African Development Bank, Islamic Development Bank, West African Development Bank.

financing especially as the decolonization process gathered pace. Over time the majority of the World Bank's project operations have been concentrated in the developing country members.

IBRD has been operating as a money bank by raising funds from the international capital markets at AAA terms and by lending such funds to members at more favorable terms than are available to them in the market. Considering the need to provide more concessional (or "soft") financing to the poorest members, World Bank members established the *International Development Association (IDA)* in 1960. IDA receives donated funds from richer members and lends such funds at zero interest with a lengthy grace period and repayments over forty years.

Recognizing the role of private sector investment in the development process, World Bank members established the International Finance Corporation (IFC), a lending institution to operate exclusively in the private sector, providing loans and equity investments for suitable projects. In 1985, World Bank members initiated a second agency to support private sector investment, the Multilateral Investment Guarantee Agency (MIGA), to offer investment insurance. The objective is to enhance the flow to developing countries of capital and technology for productive purposes under conditions consistent with their development needs.

The initial operational focus of the World Bank strongly reflected the conditions of the founding countries and their key representatives, creating an essentially North Atlantic and European institution. This was in a sense natural because the United States and Western European coalition was a major driver of European economic reconstruction. In addition, in terms of personnel, competent professional staff with adequate technical and analytical skills were available only in these countries.

2. Regional Development Banks

While the lending focus of the World Bank shifted towards developing countries, the US-European dominance made the "developing" post-colonial Asian, Latin American and African members feel that their economies should obtain complementary support that would give them greater priority for development. Consequently, moves began for establishing new regional development banks to provide additional assistance to Latin America, Africa, and Asia. Later when the trading and investment arrangements under the COMECON broke up, there arose a need to found a new regional development bank for the transition economies in the Former Soviet Union and Central and Eastern Europe.

The *Inter-American Development Bank (IDB)* was established in 1959. It began its operation as an essentially North-South American partnership with the United States as its largest shareholders (30.0 percent) followed by Japan (5.0 percent) and Canada (4.0 percent). The IDB adopted from the beginning both Ordinary Capital (OC) loans and Funds for Special Operations (FSO) loans, with the latter on very concessional terms. In 1983, IDB members created the Inter-American Investment Corporation (IIC) to provide loans and investments to private small and medium-sized enterprises (SMEs) at market rates.

The *African Development Bank (AfDB)* was created in 1964 based on the principle of self-sufficiency. While it did not admit non-African member countries initially, it later decided to enlarge membership by including non-regional developed countries.

The *Asian Development Bank (ADB)* was established in 1966 under the leadership of the Japanese government. Modeled itself closely with the World Bank, it welcomed members from North America, Europe and the Pacific. Japan and the United States have been the largest shareholders with equal shares (15.9 percent). The ADB also includes other major countries, notably China and India, although China joined later and India refrained from borrowing for many years. ADB adopted an arrangement with its Ordinary Capital Resource (OCR) loans and Asian Development Fund (ADF) loans, with the latter on very concessional terms. ADF finance is used only in the poorest countries or where there are special circumstances that require a low level of concessionality. In order to operate more directly with the private sector, the ADB established a private sector lending division to facilitate private investment by sponsoring venture and capital funds.

The *European Bank for Reconstruction and Development (EBRD)* was established in 1990 in order to foster private sector investment in the transition economies. Unlike other MDBs, the EBRD incorporates a political mandate of promoting democracy and an exclusive economic mission of assisting economic transition to market economy. It is not required to make sovereign loans or loans with government guarantees.

3. MDBs as Money and Knowledge Banks

The MDBs are often said to perform two different, though related, functions:

- Money bank
- Knowledge bank

As a money bank or a development finance institution, the MDBs provide primarily long-term capital for development to their client countries at rates more favorable than those available in the market. The capital-scarce poor countries are particularly in need of this type of financing, and even some middle-income developing countries need additional financing due to their limited access to international capital markets. Second, the MDBs as a money bank are also called upon to provide fiscal support at times of financial and economic crises in developing countries in order to respond to and resolve the crises. This type of financing, i.e., a structural adjustment loan, is almost always accompanied by IMF programs. Third, the MDBs provide financial assistance for economic reconstruction when civil war, natural disasters, or other events devastate an economy. Recent examples include Kosovo, East Timor and Afghanistan.

As a knowledge bank, the MDBs mobilize global or regional knowledge on best practices (and bad examples and failed attempts as well) on particular issues—such as financial sector supervision, corporate governance, pension schemes, anti-corruption measures, water and forestry resource management—and tailor them to the reality and specific needs of a particular country. The MDBs act as a knowledge bank either in conjunction with its role as a money bank or independently of such a function. The

MDBs, particularly the World Bank, are placing an increasing emphasis on knowledge, because without it they cannot identify high-value added investment projects (i.e., those projects that induce significant policy and institutional reforms) nor can they provide effective policy advice to their client countries. The World Bank has some advantage in this area because of its global nature of its operations.

III. DEVELOPMENT, TRANSITION AND POVERTY REDUCTION

The objectives of most of the MDBs, including those of the World Bank, IDB, ADB and AfDB, are to help developing countries achieve sustainable economic development and reduce poverty. These objectives are only implicit for the EBRD in its special mandate to foster transition to market economy and democracy. Even the IMF has begun to focus on poverty reduction as an important objective for low-income developing countries.[2]

1. Sustainable Economic Development

Economic development. Economic development is often captured by increases in per capita income and improvements in social indicators. In addition, it also involves a series of societal transformations at all levels:

- Shifts of economic resources (capital, labor, and management skills) away from traditional rural sectors towards industrial and services sectors, particularly in the urban areas;
- Greater weight of private sector economic activity;
- Emergence of more educated, richer middle-class population in the urban areas; and
- Institutional developments that support the functioning of a market-based economy, including a newly-defined role of the government, the rule of law, a sound financial system, human resource management (education, health, and nutrition), and economic infrastructure.

Factors affecting growth and economic development. There are various factors affecting economic growth, an underlying trend whenever economic development takes place. Growth rises when productive activity becomes efficient (i.e., production takes place along the production possibility frontier reflecting the relative prices of the products and factor inputs), when factors of production are accumulated, and when total factor productivity rises. One of the most important prerequisites for growth is to create an economic environment where the consequences of the optimizing behavior on the part of private economic agents are socially desirable outcomes. This requires elimination of any distortions affecting economic agents' decision making.

[2] The IMF transformed the Enhanced Structural Adjustment Facility (ESAF) into the Poverty Reduction and Growth Facility (PRGF) in 1998??? By underlining the importance of poverty reduction in IMF programs in poor countries. The World Bank also renamed the Structural Adjustment Credit (SAC) to the Poverty Reduction Support Credit (PRSC) in 1998???.

Changing emphases over time. In previous decades, the international development community focused on physical capital accumulation and construction of hard infrastructure (1950s-60s), improvements in social sector and human conditions in such areas as education and health (1970s), economic management in the macro and structural policies (1980s), and institution building and institutional quality (1990s) as the most important elements affecting economic development. In particular in the aftermath of the collapse of the socialist system in Eastern Europe and the Former Soviet Union, the international community has begun to focus on the need to set up sound institutions for a market economy. As a result, the MDBs are now increasingly focused more on economic management, social sector protection, human resource developments, environment protection, and infrastructure sectors with emphasis on policy and institutional reforms.

2. Transition to Market Economy

Transition to market economy is another important objective for many countries that were once socialist economies. Replacing plan by market requires a wholesale institutional change, including market infrastructure that supports the functioning of a market economy, legal systems that facilitate market transactions, and social sector protection systems to absorb risks associated with market adjustment.

Some countries are undergoing both economic development and economic transition at the same time. For them, a comprehensive strategy is needed to minimize the time to achieve both without incurring undue risks of adjustment costs.

3. Poverty Reduction

Poverty reduction is now the most important objective for many MDBs. This concept is hard to reject even for many market-oriented economists.

Strategies for poverty reduction. There are basically two views on poverty reduction. The mainstream view is that systematic poverty reduction is possible only through sustained economic growth and productivity increases. Without economic growth, there will be no systematic poverty reduction. The other view is that economic growth does not necessarily alleviate poverty and that poverty reduction is possible through microeconomic interventions that target the poor, such as community-based social programs, micro credit schemes, and provision of social services that are essential to the poor. According to this view, poverty reduction requires a marked increase in the provision of basic services for the poor in the areas of education, health and nutrition.

A balanced view would be that while there must be sustained economic growth for systematic poverty reduction, growth is only a necessary—though not a sufficient—condition for countrywide poverty reduction. In order for economic growth to lead to poverty reduction, growth must be accompanied by higher demand for labor. Economic growth accompanied by the development of labor-intensive sectors, particularly in manufacturing, is likely to result in poverty reduction. Poverty reduction is only possible through raising the rate of return on assets the poor have or have access to, such as unskilled labor and small plots of land.

Table 2. Regional Breakdown of Poverty in Developing and Transition Countries

a. Population living below $1 per day, 1987-99

Region	Population covered by at least one survey (percent)	Number of people living on less than $1 per day (millions)					Headcount index (percent)				
		1987	1990	1993	1996	1999	1987	1990	1993	1996	1999
East Asia and Pacific	90.8	417.5	452.4	431.9	265.1	260	26.6	27.6	25.2	14.9	14.2
Excluding China		114.1	92.0	83.5	55.1	46	23.9	18.5	15.9	10.0	7.9
Europe and Central Asia	81.7	1.1	7.1	18.3	23.8	17	0.2	1.6	4.0	5.1	3.6
Latin America and the Caribbean	88.0	63.7	73.8	70.8	76.0	77	15.3	16.8	15.3	15.6	15.1
Middle East and North Africa	52.5	9.3	5.7	5.0	5.0	7	4.3	2.4	1.9	1.8	2.3
South Asia	97.9	474.4	495.1	505.1	531.7	490	44.9	44.0	42.4	42.3	36.9
Sub-Saharan Africa	72.9	217.2	242.3	273.3	289.0	300	46.6	47.7	49.7	48.5	46.7
Total	88.1	1,183.2	1,276.4	1,304.3	1,190.6	1,151	28.3	29.0	28.1	24.5	22.7
Excluding China		879.8	915.9	955.9	980.5	936	28.5	28.1	27.7	27.0	24.5

b. Population living below $2 per day, 1987-99

Region	Population covered by at least one survey (percent)	Number of people living on less than $2 per day (million)					Headcount index (percent)				
		1987	1990	1993	1996	1999	1987	1990	1993	1996	1999
East Asia and Pacific	90.8	1,052.3	1,084.4	1,035.8	863.9	849	67.0	66.1	60.5	48.6	46.2
Excluding China		299.9	284.8	271.6	236.3	236	62.9	57.3	51.6	42.8	40.4
Europe and Central Asia	81.7	16.3	43.8	79.4	92.7	91	3.6	9.6	17.2	19.9	19.3
Latin America and the Caribbean	88.0	147.6	167.2	162.2	179.8	168	35.5	38.1	35.1	37.0	33.1
Middle East and North Africa	52.5	65.1	58.7	61.7	60.6	87	30.0	24.8	24.1	22.2	29.9
South Asia	97.9	911.0	976.0	1,017.8	1,069.5	1,098	86.3	86.8	85.4	85.0	82.6
Sub-Saharan Africa	72.9	356.6	388.2	427.8	457.7	484	76.5	76.4	77.8	76.9	75.3
Total	88.1	2,549.0	2,718.4	2,784.8	2,724.1	2,777	61.0	61.7	60.1	56.4	54.7
Excluding China		1,796.6	1,918.8	2,020.5	2,096.5	2,164	58.2	58.8	58.6	57.7	56.5

Note: The numbers are estimated from those countries in each region for which at least one household survey was available during the period 1985-98 (for many countries more than one survey was available). The proportion of the population covered by such surveys is given in the first column. Survey dates often do not coincide with the dates in the above table. To line up with the above dates, the survey estimates were adjusted using the closest available surveys for each country and applying the consumption growth rate from the national accounts. Using the assumption that the sample of countries covered by surveys is representative of the region as a whole, the numbers of poor are then estimated by region. This assumption is obviously less reliable in the regions with the lower survey coverage. The headcount index is the percentage of the population below the poverty line.
Source: World Bank, *Global Economic Prospects and the Developing Countries*, 2000, p.29; and 2002, p.30.

Measuring poverty. Poverty reduction is often measured by a reduction in the number of people—or the share of such people in the total population—living below a certain threshold level of income or consumption, such as $1 a day or $2 a day. Though there are several problems associated with these measures,[3] the general trend is captured by World Bank data summarized in Table 2.

Table 2 reveals that between 1987 and 1999, there has been some reduction in poverty for the world as a whole. The most successful region has been East Asia and Pacific, whether China is included or excluded, while other parts of the developing world, particularly Sub-Saharan Africa and to some extent Latin America and the Caribbean and South Asia, have shown disappointing performance. The table indicates that there are still 1.15 billion people living in the world on less than $1 a day and 2.78 billion people on less than $2 a day (see Table 2).

Box 1: The International Development Goals (IDGs)

The IDGs are a contract between responsible development partners expressing their shared commitment to bringing hope to poor people worldwide—hope for a future of peace, shelter, food, opportunity, participation, and security for all, but in particular for children. The contract obliges all partners to do their utmost to promote the IDGs.

Formally endorsed by the donor community at the UN Millennium in September 2000 the IDGs are formulated as goals to be achieved by the year 2005 or 2015:

- Reduce the proportion of people living in extreme poverty by half between 1990 and 2015.
- Enroll all children in primary school by 2015.
- Make progress towards gender equality and empowering women by eliminating gender disparities in primary and secondary education by 2005.
- Reduce infant and child mortality rates by two-thirds between 1990 and 2015.
- Reduce maternal mortality ratios by three-quarters between 1990 and 2015.
- Provide access for all who need reproductive health services by 2015.
- Implement national strategies for sustainable development by 2005.

The IDGs are endorsed by the multilateral financial institutions, bilateral and other development partners, and are underpinned by a common set of agreed principles. Many MDBs, including the WB, are now focused on aligning their actions with IDGs.

Poverty reduction is also accompanied by improvements in various social and human indicators concerning education, health, and nutrition. Some of these are captured

[3] Measurement of per-capita income (or consumption) and its interpretation, however simple they appear at first sight, can be fraught with problems. For example, the poverty headcount in developing countries is very sensitive to: the precise level of the poverty line because income distribution in the vicinity of developing country poverty lines is typically flat; the PPP conversion rate used because the implied consumption basket may be inappropriate for the poor due to the inclusion of many non-essentials that are cheap in developing countries but are irrelevant to the poor; and the assumed rate of change in the consumption of the poor—which tend to be overestimated particularly in Asia—because there are large discrepancies between consumption estimates from household expenditure surveys and estimates from the national income accounts. In addition, the application of a $1 (or $2) per day standard to both urban and rural areas in a given country may be misleading because of differences in consumption baskets. Based on some of these observations, Wade (2002) claims that the margin of error is so large that we do not have definitive knowledge as to whether there has been real progress on poverty reduction, and that the number of people in extreme poverty may be significantly higher than the World Bank's estimate.

by the International Developmental Goals, which the international community shares (see Box 1).

IV. GLOBALIZATION, GROWTH AND POVERTY REDUCTION

In recent years, there has been a wide range of criticisms against international organizations, such as the WTO, the IMF, the World Bank and ADB, which promote globalization. These organizations are now facing a challenge greater than ever before, to enable poorer countries to catalyze successful integration into the global economy and, at the same time, help to reduce the socio-economic tensions created by such integration.

Box 2: Five Trends on Poverty and Income Distribution

There are five statistical trends in growth, poverty and income distribution in the developing countries:

- *Poor country growth rates have accelerated.* During the period 1980-1997, the population-weighted average growth rate of the poorest one-fifth of countries in 1980 (4 percent per capita per annum) has been higher than that of the richest one-fifth of countries (1.7 percent per capita per annum). This is in contrast with the experiences for the prior two decades (1960-1980), where the growth rate for the poor group (1.8 percent) was lower than that for the rich group (3.3 percent)..
- *The number of poor people in the world has declined significantly, the first such decline in history*. Over the period 1977/78 to 1997/98, there has been a large net decline in the number of poor due to massive poverty reduction achieved in China and India, which more than offsets an increase in poverty in sub-Saharan Africa. The only exception over the past 20 years is found for the period 1987 to 1993, when poverty in China and India rose due to temporary setbacks.
- *Global inequality (among citizens of the world) has declined modestly over the last 20 years.* Measures of global inequality, such as the global Gini coefficients, have declined modestly since 1980, reversing a 200-year-old historical trend toward higher inequality. Rapid growth in Asia (China, India, Bangladesh, and Vietnam) has been a force for greater global equality because that is where the majority of the world's extreme poor lived in 1980 and they benefited from the growth.
- *There is no general trend toward higher or lower inequality within countries; in particular, among developing countries inequality has decreased in about as many cases as it has increased.* There is no pattern of rising or declining inequality within countries, though there are some notable cases in which inequality has risen.
- *Wage inequality is rising worldwide.* There is a general pattern of rising wage inequality, i.e., larger wage increases for skilled and/or educated workers relative to those for unskilled and/or less educated workers. This does not contradict trend (4) because wages are a small part of threshold income in developing countries, which make up the bulk of the world in terms of countries and population.

Source: Dollar (2002)

1. Globalization, Growth, Poverty Reduction and Income Distribution

Implications of globalization for developing countries have attracted considerable attention among policymakers, international organizations, academics and researchers, mass media, and civil society from both developed and developing countries. While globalization appears successful in raising standards of living of a large number of people around the globe, there is a fear that its benefits are distributed unevenly in favor of the rich and not the poor, that it has been widening the income disparity between rich and poor nations as well as between the rich and the poor within nations, and that it makes many developing countries vulnerable to the vagaries of global capitalism. Opponents of globalization often argue that it has harmed developing countries by increasing poverty and widening income inequality across countries and within countries.

The preponderance of statistical evidence appears to support the proposition that a group of "globalizing" developing countries that have integrated their economies with the rest of the world has achieved faster economic growth and significant poverty reduction. Assessment of global poverty conditions and global income inequality is a complex matter statistically because it involves various types of aggregation problems. Nonetheless, if countries are population-weighted and incomes and consumptions are expressed at the internationally comparable PPP dollar—which is a well-accepted procedure for many economists—then there have been improvements in poverty reduction and income inequality reduction at the global level (see Box 2).

Growth, poverty and global inequality Nonetheless, experts agree that there is no definitive relationship among globalization, economic growth, poverty, and income inequality. It is also hard to establish that globalization is always good for growth, for the poor, and for fair income distribution (Birdsall 2002).

As noted by Dollar (2002), five successful countries—China, Vietnam, India, Bangladesh and Uganda—have all benefited from increased integration in terms of faster economic growth and significant poverty reduction, while many Sub-Saharan African countries have failed to integrate themselves with the world economy, to grow and to reduce poverty. Faster growth and significant poverty reduction in low-income Asia contributed to a reduction of global income inequality while slow growth in Africa contributed to a rise in global inequality. The net result is a modest global decline in inequality with the former outweighing the latter.

The net results from the average are important, but it would be more informative to uncover what is happening behind the average. The relevant questions are: why certain countries such as China, India, Vietnam and Bangladesh have been successful in generating growth and poverty reduction under globalization and why others such as Sub-Saharan countries have not done so. The issue here is not only whether and how countries have implemented external liberalization policies and other complementary policy reforms—such as domestic deregulation and institution building—but also how they have nurtured private sector-led development, particularly private investment in labor-intensive manufacturing industries, under globalization.

National income inequality One of the common claims about globalization is that it leads to greater inequality within countries and hence fosters social and political polarization. Dollar finds that changes in national income inequality are not related to any of the measures of integration. For example, greater trade integration is associated with rises in national inequality in some countries and declines in others. Among the five success countries—China, Vietnam, India, Bangladesh and Uganda—that have actively pursued integration with the world economy, only two (Vietnam and Uganda) have revealed an improvement in national income distribution in favor of the poor.

One may argue that national income inequality induced by globalization may be a natural phenomenon that takes place anyway in the course of economic development and structural changes. Labor, capital and other productive resources naturally migrate away from less productive sectors of the economy to more productive ones. Income inequality facilitates such resource re-allocation and would eventually disappear in the long run. So it appears that there is nothing to worry about it. Nonetheless, to the extent that rising income inequality becomes a source of social tension, there is room for public policy to play to mitigate the negative effects of globalization through social protection and investment in education and health.

2. Policy Implications of Globalization

On balance, globalization can be a driving force for economic growth, poverty reduction, and global income inequality reduction, if accompanied by complementary policy and institutional reforms and better investment climate. On the other hand, globalization may aggravate national income inequality and can be disruptive, by producing winners and losers.

Maximizing the benefits and minimizing the costs of globalization There is no way to stop the globalization process. Doing so would be highly counterproductive. If globalization provides significant benefits as well as costs, policymakers should focus on how to manage the process of globalization, by maximizing its benefits and minimizing its costs. Table 3 summarizes the benefits and costs of globalization for developing and developed countries.

Table 3. Benefits and Costs of Globalization

	Benefits	**Costs**
Developed Countries	• Greater efficiency of resource allocation • Greater consumer benefits	• Pressure for domestic industrial adjustment and dislocation • Potential for greater domestic income inequality • Potential for loss of policy autonomy
Developing Countries	• Access to developed countries' product markets, capital, technology, and knowledge • Greater efficiency of resource allocation if accompanied by structural reforms	• Potential for greater domestic income inequality • Greater vulnerability to external shocks

The discussion in this section has focused on "real" globalization, that is, integration through trade and foreign direct investment with the world economy. In practice, it is quite important to make a clear distinction between "real" and "financial" globalization, the latter referring to integration through financial sector opening and capital account liberalization. Financial globalization calls for greater care on the part of policymakers, because it amplifies shocks and turbulence affecting the country. Sequencing of liberalization, provision of financial safeguards, and the choice of exchange rate regime are some of the added policy issues that the authorities must pay attention to.

Implications for developing countries If a country wishes to benefit from globalization, it must liberalize trade and FDI regimes, pursue a variety of complementary structural reforms—including privatization, deregulation, and increased competition—and strengthen policy capacity to manage economic and social risks due to globalization, including social protection and financial safeguards. Simply maintaining sound macroeconomic policy and pursuing external liberalization and domestic deregulation is not enough for this purpose. A country must go beyond the "Washington Consensus" (see below) and focus on wide-ranging reforms of institutions and policy frameworks and strengthen market infrastructure so as to be able to benefit from globalization at smaller costs.

In addition, the country must set market friendly environments for private sector activity, particularly private investment, by ensuring political and social stability, increasing business predictability, establishing the rule of law and intellectual property rights, and providing necessary industrial infrastructure. Globalization can be successful if accompanied by internal economic integration leading to a creation of a dense and spatially concentrated network of input-output linkages among firms and entrepreneurs, which can provide spillover benefits to the rest of the economy. Both external integration and internal market integration should deepen simultaneously and interact with each other.

At times, globalization can be disruptive, by forcing certain industries to shrink and others to prosper, which may call for public policies (social protection, investment in education and health) to mitigate these negative effects. Provision of social safety nets is clearly an important component of globalization policy and the associated market reforms—it cushions the damage done to the most severely affected, it helps the momentum of these reforms, and it avoids a backlash against the distributional and social consequences of globalization. Where informal social safety nets based on families and communities play an important role, the public sector must find a complementary mechanism to support the existing informal arrangement.

Implications for developed countries The developed countries can help developing countries benefit from trade and investment openness by maintaining a liberal trading system and providing market access to their exports of agricultural and labor-intensive manufacturing products. For this purpose, the developed countries must be ready to accept industrial adjustment on their part by making the labor markets more flexible. Transfers of production technology and organizational skills through foreign direct investment are also crucial to enabling developing countries to accumulate knowledge and participate in the innovation process.

Given that many developing countries have problems in their initial conditions—low levels of infrastructure, poor geography, poor health and agricultural problems—the developed countries should extend ODA to assist them overcome these unfavorable initial conditions and pursue private sector-led development. ODA can have greater positive impact on the recipient economies if it stimulates private investment, total factor productivity and economic growth.

3. The Post-Washington Consensus and Developmental Agendas

The World Bank is often blamed, together with the IMF, for forcing developing countries to pursue liberalization on the domestic and external front too hastily or prematurely, through imposing conditionalities attached to lending. The liberalization cum openness approach is often called the "Washington Consensus." The consensus emphasizes that once prices are right, sound macroeconomic environments are ensured, an open trade and investment regime is achieved, and government involvement in productive activity is minimized (see Table 4), economies will grow and develop.

With one exception (namely the protection of property rights), however, the policy prescriptions of the Washington Consensus ignored the potential role that institutional reforms could play in accelerating economic and social development and poverty reduction. It focused instead on the issues of fiscal discipline, liberalization of trade and investment, deregulation of domestic markets, and privatization of public enterprises.

The international community is now increasingly realizing that these prescriptions based on the traditional Washington Consensus alone cannot achieve economic development and poverty reduction in the medium-term unless domestic policies and institutions are adequate and supportive of the functioning of a market economy. In other words, the deregulation and opening of the economy does not automatically guarantee the emergence of a healthy market economy. For this, structural underpinnings supporting market-based activity need to be developed, including the rule of law (protection of property rights is an important part), effective bankruptcy procedures, a well-regulated and well-audited financial system, and competition policy to limit monopoly powers of privileged firms and individuals. This requires an active role of an effective and accountable government. Part of the reason for the failure of Russian transition can be attributed to inadequate attention given to institutional aspects of transition and development.

The post-Washington Consensus states that maintaining stable macroeconomic conditions and liberalizing and opening the economy would not be enough to make the economy develop; these must supported by complementary structural reforms and institutional underpinnings. This view also reflects the lesson that while the first-generation reforms were successful to some extent, deeper progress requires second-generation reforms (Table 5). Second-generation reforms go much deeper in terms of the nature of reforms and country stakeholders involved.

Table 4. The New and Old Washington Consensus

The Washington Consensus	The Post-Washington Consensus
Objective: Standard economic goals of maintaining low inflation, fiscal discipline, a viable balance of payments, economic growth, domestic and external liberalization, and equitable income distribution	**Objective**: Institutional reforms to support market-based economy and promote development and poverty reduction while securing macroeconomic stability.
Maintaining macroeconomic stability	**Maintaining macroeconomic stability**
1. *Fiscal discipline*: Public sector budget deficits should be small to be financed without recourse to the inflation tax. Public expenditures should be redirected from politically driven areas (defense, indiscriminate subsidies, white elephants) towards areas with high economic returns and the potential to improve income distribution (primary health, education and infrastructure)	1. *Fiscal policy*: Limited fiscal deficits. Increased domestic savings through fiscal discipline. Increased educational spending, especially at the primary and secondary level. Reinvestment of public resources in well-designed social programs.
2. *Monetary policy discipline*: Low inflation through money supply control.	2. *Monetary policy discipline:* Low inflation through an independent central bank.
3. Tax reform: Broadening the tax base with improved tax administration and lower marginal tax rates to sharpen incentives and improve horizontal equity without lowering realized progressivity.	*3. Tax reform*: Tax system reform, introducing, among other elements, a land-use tax that takes ecological considerations into account.
4. Exchange rate discipline: A unified exchange rate (at least for trade transactions) set at a level sufficiently competitive to induce a rapid growth in non-traditional exports.	4. *Exchange rate policy:* No "one-size-fits- all" exchange rate regimes, bringing back floating rates or using fixed rates as nominal anchors. Maintenance of competitive exchange rates.
Three pillars of structural reform	**Structural reform and institution building**
A. Abolition of protectionist policies	
5. *Trade liberalization*: Replacement of quantitative trade restrictions by tariffs and progressive reduction of tariffs to a uniform low rate in the range of 10-20 percent.	5. *Trade and investment liberalization*: Continued liberalization of trade and foreign direct investment within multilateral and regional arrangements.
6. *Financial liberalization*: Abolition of preferential interest rates for privileged borrowers, achievement of a moderately positive interest rate, and market-determined interest rates.	6. *Financial system reform*: Well-sequenced liberalization of the financial system. Effective regulatory/supervisory frameworks to be put in place, and consolidation of banking supervision.
7. *Foreign direct investment liberalization*: Abolition of entry barriers of foreign firms and opportunities for competition between foreign and domestic firms on equal terms.	7. *Capital account liberalization*: Well-sequenced liberalization of capital account to maximize its benefits and minimize the costs.
B. Deregulation 8. *Deregulation of domestic markets*: Abolition of regulations that restrict entry of new firms or competition, and adoption of regulations that can be justified by solid criteria such as safety, environmental protection, or prudential supervision of financial institutions.	8. *A competitive market economy*: Creation of a competitive market economy through privatization and liberalization, including the labor market.
9. *Property rights*: Provision of secure property rights.	9. *Redefining property rights*: Provision of access to property rights for all society members.
C. Abolition of government intervention 10. *Privatization of public enterprises*	10. *Institution building*: Creation of strategic institutions such as independent central banks, strong budget commissions, an independent, non-corrupt judiciary, and regulatory/supervisory agencies to support sound competition.
11. *Reduction of the government size*	11. *Good governance:* Clean government without corruption, absorbing social risks.

Note: Produced by the author from Williamson (1990, 1994), etc.

Table 5. First- and Second-Generation Reforms

	First–Generation Reform	Second-Generation Reform
Main Objectives	Macroeconomic stabilization (lower inflation and smaller budget deficit) and selected structural reforms to promote economic growth.	Improvement of competitiveness and social conditions, while maintaining macroeconomic stability.
Instruments	Budget cuts, tax reform, price liberalization, trade and foreign investment liberalization, deregulation, social funds, autonomous contracting agencies, some privatization.	Civil service reform, labor reform, restructuring of social ministries, judicial reform, modernizing of the legislature, upgrading of regulatory capacity, improved tax collection, large-scale privatization, restructuring of central-local government relationship
Actors	Presidency, economic cabinet, central bank, multilateral financial institutions, private financial groups, foreign investors.	Presidency and cabinet, legislature, civil service, judiciary, labor unions, political parties, news media, central and local governments, private sector, multilateral financial institutions.
Main Challenges	Macroeconomic management by insulated technocratic elite.	Institutional development that is highly dependent on middle management in the public sector

Source: World Bank, *World Development Report: The State in a Changing World, 1997,* p. 152.

V. THE WORLD BANK APPROACH: CDF AND PRSP

The World Bank's approach now extends well beyond the traditional Washington Consensus, the "agreed" set of measures that are typically called for in the first stage of policy reform.[4] To accelerate the process of economic development and poverty reduction, deeper policy and institutional reforms are needed—the reason for the need for the second-generation reforms. These reforms include the need to focus on improving the quality of investments in human development, promoting the development of sound and efficient financial markets, enhancing the legal and regulatory environment, improving the quality of the public sector, and consolidating the gains in macroeconomic stability

[4] As Williamson (1994) himself acknowledges, there were many policy issues on which different views existed, including:

-The speed of trade liberalization;
-The desirability of maintaining capital controls;
-The need to target the current account;
-The pace and extent of inflation reduction;
-The advisability of attempting to stabilize the business cycle;
-The usefulness of incomes policy and wage and price freezes (sometimes called "heterodox policies");
-The need to eliminate indexation;
-The propriety of attempting to correct market failures through such techniques as compensatory taxation;
-The size of tax revenue and public sector spending as a ratio of GDP;
-The desirability and extent of deliberate income redistribution;
-The role for industrial policy;
-The diverse models of a market economy—Anglo-Saxon laissez-faire, European social market economy, or Japanese-style responsibility of the corporation to multiple stakeholders; and
-The priority of population control and environmental preservation.

thorough fiscal strengthening. Such institutional reforms take time and are complex. A well-functioning market economy cannot be created overnight.

1. Comprehensive Development Framework (CDF)

The Comprehensive Development Framework (CDF) has been put forward by the World Bank under the leadership of its president, Mr. James Wolfensohn. This initiative suggests a broad, holistic, and long-term approach to development. It supports a balanced approach to development in line with each country's specific current needs, and seeks to respond to a broader development agenda through stronger partnerships in order to achieve greater development effectiveness. Table 6 summarizes its conceptual framework.

Its approach can be summarized as follows:

- A ***comprehensive, long-term approach*** to development. The approach has to be holistic in nature, addressing the multidimensional nature of sustainable, equitable growth and poverty reduction. Such an approach involves promoting macroeconomic stability, a transition to open markets, good governance and sound institutions, investing in people through education and health, protecting the environment, and creating a business climate to attract foreign and domestic investments.
- ***Country ownership*** is an objective in itself and a necessary condition for sustainability of development and poverty reduction efforts. Country-owned reforms, based on broad societal foundation and participation, are more likely to survive periods of hardship.
- ***Partnership*** of all development actors, with country governments at the apex, and external partners participating where they add value and have a comparative advantage, to ensure efficient use of development resources.
- ***Outcome focused***, *linked to* ***performance*** and built on ***transparency*** on the part of donors and recipient countries alike.

Focus on country ownership. Policy and institutional reforms for economic development and poverty reduction cannot be effective without strong country ownership. Such reforms often require elimination of rents on the part of privileged sectors, firms, and individuals so that they are likely to encounter political resistance. Hence, for it to be successful, the government must be committed to such reforms. If the political base of the country is strong, the reforms can be successful—as in the case of Korea under Kim Dae-Jung. If the political base is weak, on the other hand, the reforms encounter difficulties—as in the case of Indonesia. Unilateral conditionality that is imposed upon a country from external forces would not work without country ownership. To deepen country ownership, consultation processes involving parliaments, business community, academics, news media, labor unions, and civil society are important, thereby encouraging participation and forming a broad-based coalition for reform.

2. Poverty Reduction Strategy Paper (PRSP) Initiative

In the low-income developing countries, the CDF and the Poverty Reduction Strategy Paper (PRSP) have become recognized as the major instruments to focus on pro-poor growth. The PRSPs are prepared by the member country in collaboration with the staffs of the World Bank and the International Monetary Fund as well as with civil society and development partners. The PRSP describes a country's macroeconomic, structural and social policies and programs to promote growth and reduce poverty in a framework of enhanced country ownership, transparency and stakeholder participation. It also presents an assessment of associated external financing needs and major sources of financing required. The PRSPs have thus become a vehicle for addressing the same multidimensional poverty concerns that inspired the IDGs.

Vietnam is East Asia's pilot of the CDF approach.[5] The Vietnam initiative reflected the government's concern that fragmented donor programs were having less impact than they would as part of a coordinated framework. In FY00, the government promoted awareness of the new approach, strengthened partnerships among donors, government and civil society; began to tackle the harmonizing of procedures across donors; and established a joint donor-government working group to begin addressing governance issues. The coordinated approach has generated a shared perspective on the nature of poverty and its causes, and an agreed agenda for future work.

VI. MDB REFORM AGENDA

1. MDB Reform Proposals

There is a wide range of criticisms on the role of the MDBs, both from the left and the right. Those on the left claim that the MDBs are a vehicle for globalization that is dominated by multilateral corporations, large banks and financial institutions, imposing needless "conditionality" and hurting the poor. Those on the right claim that MDBs are ineffective in alleviating poverty in poor countries and are crowding out private investment in middle-income countries. The G7 countries have also been proposing measures to reform the MDBs.

The so-called Meltzer Commission (International Financial Institution Advisory Commission 2000) made one of the most radical recommendations. They include:

- The World Bank should get out of loans and move to grants and small technical assistance programs for the poorer countries—to become a "World Development Agency."
- The World Bank and the regional MDBs should withdraw altogether from lending to middle-income countries with investment grade ratings or per capital

[5] Although Vietnam is the only official pilot CDF country in EAP, other countries are beginning to adopt the approach in their dialogue with the Bank and other donors. In FY00, assistance strategies were also prepared for the Pacific Island states. Long-term assistance strategies in the spirit of the CDF, were outlined in the Pacific Regional Strategy (May 2000) and the Papua New Guinea Country Assistance Strategy (December 1999). They focus on sustainable utilization of natural resources in meeting development aspirations of these countries, and emphasize the critical role of Pacific institutions, traditions and customs in reducing poverty in those countries.

income over $4,000 and scale back lending to countries with per capital income over $2,500.
- The World Bank should focus its operations on poverty reduction for African nations, and the IDB and ADB should take over World Bank tasks in their respective regions.
- The MDBs should adopt a performance-based assistance in order to ensure that aid resources are used effectively.

Considering the important role of the MDBs in the promotion of growth, stability, and poverty reduction, the G7 countries have made a number of proposals, including: the MDBs should focus more on poverty reduction; the MDBs should sharpen strategic principles based on country strategies; and the MDBs should better coordinate with one another.

2. Enhancing Aid Effectiveness

Impact of aid on savings, investment and growth. In the early literature on the effectiveness of aid, foreign aid was perceived as an exogenous increment to the financial resources of the recipient country, which would eventually contribute to growth.[6] The simplest hypothesis was that each dollar of foreign resources in the form of aid would result in an increase of one dollar in total savings and investment. The underlying theoretical framework was the Harrod-Domar growth model or the two-gap model. In the Harrod-Domar model, foreign aid was considered to raise both savings and investment by relaxing a savings constraint. In the two-gap model, foreign aid would contribute to greater savings or imports or both by relaxing savings and/or import capacity constraints. In this simple world, fungibility of aid resources was not allowed for, and aid for consumption was not considered in this aid-effectiveness analysis. In a later model, these two factors were incorporated and the impact of aid on economic growth was empirically analyzed.

Over the last few years, a new set of aid-effectiveness studies have appeared. First, these studies work with panel data for a number of years and a large number of countries. Second, measures of economic policy and institutional environments are included directly in the reduced form growth regressions alongside traditional macroeconomic variables, reflecting recent shifts in thinking over development assistance. Third, endogeneity of aid and other variables is often addressed explicitly. Fourth, the aid-growth relationship is often allowed to be non-linear.

Importance of good policies and institutions. Following the new approach to the effectiveness of aid, a recent World Bank report (World Bank 1998) concludes that official aid achieves growth and poverty reduction only if it induces a country to reform economic policies and institutions. Data clearly show that countries with *strong economic policies* (defined as low inflation, budget balance or surplus, and trade openness) and *high quality institutions* (defined as existence of the rule of law, effective public bureaucracy, and minimal incidences of corruption) benefit the most from aid by achieving the highest growth rates. Moreover, ideas (or knowledge) are more effective

[6] See Hansen and Tarp (2000).

than financial flows in generating reforms and in improving the quality and efficiency of public services. The report concludes that "well-designed assistance can help countries find the policies that they need, and help communities improve important public services that make for a better life today and contribute to long-term development."

By now it is clear that economic development involves a multi-dimensional transformation of society; to the extent that funds are fungible, "the net benefit from financing any individual project is…the net benefit of the marginal government program" (Stiglitz 1999). What determines the success or failure of development assistance is not the choice of a particular project, but the whole set of policies and institutions adopted by the recipient country, including its own governance structure.

The G7 consensus. The G7 countries seem to share a consensus that aid works under the following conditions:

- *The policy environment in the recipient countries is right.* This means both a commitment to peace and political stability—development cannot take place in a conflict-ridden environment—and a commitment to sound macroeconomic, structural and social policies, good governance, and the rule of law. The resulting enabling environment would attract private capital, particularly foreign direct investment, which complements official aid.
- *Recipient countries take ownership of their development.* Strong country ownership of its own development strategy is instrumental because without it policy and institutional reforms for economic development and poverty reduction cannot be effective.
- *Donors cooperate and better coordinate their assistance efforts.* The donor community needs to pursue harmonization of policies and procedures in order to reduce transactions costs and focus its assistance efforts on the countries with sound economic management and good governance.
- *Development and poverty reduction are the only goals of aid.* This reflects the past experience that aid-effectiveness is reduced when aid is tied to other objectives of donors.

To achieve this, the G7 countries encourage the international financial institutions, including the MDBs, to enhance efficiency and effectiveness of their activity.

2. Development Strategies for Countries with Middle, Low and Lowest Incomes

A "one-size-fits-all" approach would not be appropriate, particularly when the recipient countries are different in their income levels, stages of institutional developments and policy capacities.

Middle income countries. Though the Meltzer Commission recommends that the MDBs should get out of middle-income developing countries—largely emerging market economies—there is a strong case for the MDBs to stay engaged.[7] For the middle income

[7] See also Commission on the Role of the MDBs in Emerging Markets (2001), which was co-chaired by Jose Angel Gurria and Paul Volcker.

countries that have investment grades at normal times, access to the international capital markets are often unstable and volatile as well as quite limited and costly at the time of global market turbulence or crisis, thereby exposing them to financial vulnerability. In this sense the MDBs must continue to assist middle income countries at the time of financial and economic crisis when access to international capital markets tend to be blocked. In addition, lending is an important instrument to induce policy and institutional reforms—through "conditionality"—to help support internationally desirable policy objectives, including poverty reduction, human resource development, environmental protection, and good governance. Though "conditionality" is no substitute for country "ownership," but if ownership is there

Low income countries. For low-income developing countries, the MDBs need to focus on economic development and poverty reduction. For these countries, country ownership of development and reforms, partnership among major stakeholders, and performance-based allocation of development resources should be the most important. Perhaps the World Bank's PRSP process is an important coordinating vehicle for these efforts. Performance-based allocation that is currently used by some MDBs to allocate concessional loans need to ensure consistency across MDBs and other donor institutions.

Lowest income (poorest) countries. For highly indebted poor countries (HIPCs), debt relief is an integral part of the external assistance package. Eliminating unsustainable debt would be needed for these countries to get on a development path. But simply eliminating debt would not be enough for development and poverty reduction. The most significant challenges arise because many poorest countries, particularly those in Sub-Sahara Africa, often lack the necessary prerequisites and institutional capacity—such as the rule of law, functioning government and economic institutions, and basic education and health facilities—to be able to mobilize resources effectively. The international community and the MDBs need to explore more creative mechanisms to induce them to launch effective policy and institutional reforms and capacity building. Given that a performance-based approach is unlikely to direct a large sum of aid resources to these countries, workable initiatives need to be developed in partnership between donors and recipients in order to ensure that limited aid—mainly in the form of grants—be well targeted.

3. Roles of the MDBs and Division of Labor among Them

Coordination among the MDBs is essential. Greater coordination in substance and timing of country strategies should be emphasized. One way to ensure this is to make each MDB's country strategies publicly available in draft in order to encourage consultation with major stakeholders, and even to hold a coordinated country strategy meeting among the MDBs.

Some healthy competition between the MDBs is desirable at the intellectual level as long as their collective outcome is mutually consistent with the promotion of economic development and poverty reduction. With undue competition at the strategic and operational levels, however, an appropriately rigorous approach taken by an MDB to conditionality and pricing could be undermined. The MDBs must avoid unproductive competition in terms of conditionality and pricing and ensure coherence and consistency.

VII. CONCLUDING REMARKS

The multilateral development banks are financial intermediaries that channel financial resources they raise in the international capital markets to developing countries at concessional terms. In this sense they function as a money bank. Recently they have also intensified their non-lending activities in recognition of the critical importance of ideas or knowledge, even more than financial assistance, in generating the necessary reforms to achieve sustainable development, transition, and poverty reduction. While recent research shores up continued relevance of the Washington consensus, the paper has argued that the old consensus reforms are not enough. Development assistance needs to extend well beyond the Washington consensus, to address multi-dimensional policy considerations, including the realignment of policies and institutions to maximize effectiveness of economic growth in reducing poverty and greatly improve the effectiveness of basic service provision to the poor.

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