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Shut Down the World Bank: Jin Yong Kim Should Be Its Last President

Jim Yong Kim has started as president of the World Bank. His first and last act should be to close the organization.

The International Bank for Reconstruction and Development was established in 1944 as the victorious allies prepared to reorder the international economic system in the aftermath of World War II. The institution was to help developing countries when the global capital markets proved inadequate.

Explained economists Edward Mason and Robert Asher, the Bank "thought of itself as a temporary institution bridging the gap until international capital markets would revive." Lending was to be limited to "productive" projects which could pay for themselves. Borrowers were to demonstrate both an ability and willingness to repay their debts. The Bank's article of agreement stated that organization would only be a "lender of last resort."

In its early years the Bank was a conservative investor. It observed that "money alone is no solution. … Perhaps the most striking single lesson which the Bank has learned in the course of its operations is how limited is the capacity of the underdeveloped countries to absorb capital quickly for productive purposes." The organization required settlement of private loan defaults before extending credit, barred loans to nations which expropriated property without adequate compensation, and refused to back industrial projects not intended to be transferred into private hands.

Over time, however, the Bank changed. In 1960 it created the International Development Association to act as a "soft lending window" providing heavily-subsidized loans that act more like foreign aid than commercial credit. Worse was the appointment of Robert McNamara, Lyndon Johnson's failed Secretary of Defense during the Vietnam War, as Bank president in 1968. In contrast to the stolid conservatism of his predecessors, McNamara, editorialized the *Los Angeles Times*, provided "innovative and aggressive leadership."

McNamara essentially turned the Bank into an extension of President Lyndon Johnson's "Great Society," attempting to solve long-term economic and social problems with ever-larger cash transfers. Between 1968 and 1981, when McNamara retired, total Bank (IBRD and IDA) lending jumped from $954 million to $12.3 billion. Indeed, from the Bank's founding to McNamara's hiring the Bank lent just $13.035 billion; the year after he departed the Bank lent as much in one year.

Admitted one Bank official near the end of McNamara's tenure: "We're like a Soviet factory. The push is to maximize lending." He added that "the pressures to lend are enormous and a lot of people spend sleepless nights wondering how they can unload projects. Our ability to influence projects in a way that makes sense is completely undermined."

McNamara was reported to be "almost obsessed with redistribution of income" and was determined to remake Third World societies. Combined with a commitment to social engineering was a devotion to state-led development. During the 1970s roughly 80 percent of Bank funds were committed to public enterprises; that share grew as developing nations increased the scope of state economic intervention. The Bank contributed to the widely discredited philosophy that the success of Third World states is largely determined by outside aid.

The institution even funded the worst fantasies of Third World thugs and utopians. For instance, the Bank underwrote Tanzania's "ujamaa villages"—Julius Nyerere's forced collectivization program that brutalized peasants and destroyed the nation's agricultural economy. Years later the Bank admitted that "Tanzania's unprecedented access to concessionary flows of external capital has allowed it … to maintain a high rate of largely ill conceived and uneconomical industrial development."

By the end of the 1970s even the Bank acknowledged that state-led development programs had their faults. But the institution still didn't understand why. In its 1980 report the Bank observed that, despite setbacks—surely a generous description of pervasive Third World poverty, indebtedness, and social collapse—"lessons were learned and experience was gained." The Bank went on to explain that some countries were planning "to define the role of the public sector more selectively than before; elsewhere, however, it will be necessary to rationalize the policy framework of parastatal entities and revamp institutional relationships so that public enterprises might achieve the objectives for which they were created." In short, the answer to past failure was more effective implementation of past plans.

Reality and the Reagan administration finally had an impact. In 1987 the Bank discussed its willingness to tackle what had once been the great unmentionable—borrowers' domestic economic policies, such as price controls, regulation, distorted financial policies, and protectionist labor rules. Yet money continued to flow to collectivist and dictatorial governments, including for inefficient industrial enterprises and social development projects. Many public enterprises acted as fiscal black holes, draining otherwise productive resources into political operations.

Internal audits routinely criticized Bank lending. The Operations Evaluation Department conceded in 1987 that "the Bank's drive to reach lending targets" had resulted in "poor project performance." The problem, however, was not just that some projects had not worked out well. Many countries should not have been borrowing much if anything, given their economic policies which discouraged success. Yet the Bank lent money to the very nations which its own economists were criticizing for the governments' "overambitious or inefficient investment programs."

Along the way Bank-backed projects sometimes had horrendous social and environmental consequences. Indeed, the institution underwrote some of the worst regimes on earth, including Mengistu's Ethiopia and Ceausescu's Romania, a regime bizarre even by communist standards. The Washington, D.C.-based Environmental Defense Fund estimated that during the 1980s nearly a hundred Bank projects forced the displacement of more than two million people, almost all poor.

Politics eventually forced the Bank to change. With opposition rising to new funding requests, the institution started talking about promoting markets and improving the environment. Many of the worst Third World governments disappeared, reducing the embarrassment of lending to them. The Bank even began promoting good governance in borrowing states.

Nevertheless, the fact that the Bank does less harm today does not mean that it plays a useful role. The organization's basic premise remains that inadequate capital hampers poorer nations. Yet the industrialized nations have transferred a couple of trillion (in today's) dollars to Third World nations in aid, and more in commercial loans, which is why borrowers have routinely run up debts which they cannot pay. Indeed, scores of developing states ended up economically dependent and worse off as they were collecting abundant aid and loans.

Unfortunately, most developing nations grossly mismanaged their economies. Indeed, too often maintaining power, rather than promoting economic growth, was the priority for borrowing governments. Where development would be destabilizing or where progress would accrue to opposition groups, regimes actively resisted economic reform.

In other cases, whether out of ignorance or ideology, countries adopted ruinous economic policies that retarded development. Restrictions on prices and production, perverse monetary, fiscal and trade policies, disincentives to foreign investment, and bloated public sectors prevented Third World peoples from advancing their lives. Political repression limited communication and association, thereby posing another barrier.

Yet no amount of aid could overcome the impact of bad economic policies. To the contrary, aid discouraged reform of growth-defeating policies since it minimized the pain of failure and enabled governments to protect their most important political constituencies.

For instance, Peter Boone of the London School of Economics surveyed developing economies, reporting that “Poverty is not caused by capital shortage, and it is not optimal for politicians to adjust distortionary policies when they receive aid flows.” Similarly, World Bank economists Craig Burnside and David Dollar concluded: ”we find no systematic influence of aid on our index of fiscal, monetary, and trade policies.”

Former World Bank economist William Easterly reviewed nearly 1000 “conditioned” Bank loans and concluded: ”government mismanagement usually continued in these countries. The growth rate of income per person of the typical member of this group during the past two decades was zero.”

Similar was the finding of IMF economists Raghuram G. Rajan and Arvind Subramanian in a 2005 study: “We find little evidence of a robust positive impact of aid on growth … we find some evidence for a negative relationship in the long run.” Moreover, “We find virtually no evidence that aid works better in better policy or institutional or geographic environments, or that certain kinds of aid work better than others.”

Nor is foreign aid an effective means to encourage reform. Noted my Cato Institute colleague Ian Vasquez: “Good policies will reap the rewards of growth.” Even assuming the Bank and other foreign aid providers are committed to rewarding the right governments for the right policies, warned Vasquez, “’Overrewarding’ those countries with foreign aid, by contrast, may have effects similar to those of traditional foreign aid programs: slowing the pace of reform and development.”

Finally, the rise of international capital markets superseded the Bank’s original purpose as a project lender. Foreign direct investment in the developing world hit an astounding $807 billion in 2008 before the international financial crash. Even as the industrialized West struggled to recover FDI in the Third World totaled $491 billion in 2009 and $520 billion in 2010. Today FDI and trade are the most powerful international engines of economic development. They dramatically spurred East Asia past South America, which once was the wealthier continent. Trade and investment also are better than official assistance, since they respond directly to policy reforms, impose no arbitrary requirements, and avoid political entanglements.

Even in today’s difficult economy successful “emerging markets” continue to have access to credit. Turkey, Russia, Indonesia, and Brazil all enjoyed a more than 20 percent growth in credit over the last year. India, China, Mexico, and Poland had growth in the teens. Argued Arjun Divecha, chairman of GMO, an American fund manager: “Rapid expansion of credit plays a big part in the rise of the emerging world’s middle classes.”

Yet the Bank continues as before, seemingly unaffected by changes in the world around it. Kim was selected as part of the traditional division of the international spoils. Historically the Bank made new loan commitments in excess of $20 billion annually, but the financial crisis pushed its outflow up to nearly $60 billion in 2010. Last year lending was still above $40 billion.

Washington chooses the World Bank president while Europe names the International Monetary Fund managing director. A couple of outsiders from developing states announced their candidacy and were even interviewed by the Bank board, but the decision was a foregone conclusion. One quit shortly before the vote, complaining that the race "is not based on the merits of the candidates, but is a political exercise." But that always has been the case.

Kim was a controversial choice. His passion is improved health care—obviously a worthwhile objective. However, multiple international aid organizations already exist. "The world doesn't need another aid agency," observed Nancy Birdsall of the Center for Global Development.

Moreover, Kim has been a critic of economic growth. He was one of several authors of *Dying for Growth: Global Inequality and the Health of the Poor*. The book's chief target is "neoliberalism" which, the authors claimed, "asserts that economic growth is by definition good for everyone and that economic performance is optimized when governments refrain from interfering in markets." Kim and his co-authors contended that "In many cases policies guided by neoliberal agendas have worsened the economic situation of the middle classes and the poor."

It is a bizarre view. The most venal, destructive, even deadly enemy of the poor the world over for decades has been the state. Governments have squandered their people's wealth on projects designed to enrich favored interests. Ending such injustice is what establishing competitive markets and restraining government interference are all about. Generating self-sustaining growth is the only way to sustain better social services once they are established.

William Easterly, known for has powerful critiques of foreign aid, called Kim an "amateur" who had an "antiglobalization point of view." Most analysts agree that reform has not gone far enough, with too many people still locked into poverty. But Easterly complained of Kim: "His critique was much more radical, that the system itself was responsible for creating poverty."

Kim's opinion that the Third World has become some sort of "neoliberal" paradise does not reflect reality. For decades collectivism, often subsidized by Western foreign aid, wrecked Third World economies. The transition away from the failed dirigiste model was bound to be difficult and painful. But China and India offer the best examples of how even modest economic freedom can lift hundreds of millions of people out of poverty.

Obviously, growth alone does not ensure that societies will justly and adequately meet human needs. However, without growth there are no resources to improve health care around the world, as Kim desires. Or to "help countries in building cost-effective safety nets that can protect people against shocks," as he recently proclaimed to a Brookings Institution audience.

What will Kim do? Upon assuming office the new president announced: "My immediate priority will be to intensify the World Bank's efforts to help developing countries maintain progress against poverty in these volatile times." The best way to do that would be to stop pretending that foreign "aid" can promote self-sustaining economic growth.

No doubt Kim will feel pressure to assist the Europeans as they struggle to stabilize the Eurozone. However, the Europeans are grown-ups with large and well-developed economies. The continent hosts not only mature nation states but a large supra-national government, the European Union. Europe doesn't need money from others to save its currency union.

Whatever the merits of individual Bank projects—and the institution has backed some notable disasters over the years—only private sector development in Third World states will raise people out of poverty. And private sector development of the sort which reaches throughout society is possible only without government direction or control. Which means the less World Bank lending, the better.

Nancy Birdsall contended that "A new president needs to corral shareholders and disparate interests to create a fresh mandate for the bank." Best would be no mandate at all.

The World Bank was created in a different age and time. "The World Bank doesn't have any obvious role in the current world environment," observed Easterly: "It's in a state of crisis, losing its traditional market share."

In contrast, Kim argued that "the World Bank's best days are still ahead," pointing to: "The economic success of emerging market economies, the rise of citizen power led by young people and the unprecedented penetration of new technologies are challenging old development paradigms." All true—but all good reasons why the Bank is no longer needed. Kim could become the Bank's best president by becoming its last president.