Democratizing the International Monetary Fund and the World Bank: Governance and Accountability

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Much has been said about the failing policies of the International Monetary Fund (IMF). In this essay, I attempt to explain why the IMF has pursued policies that in many cases not only failed to promote the stated objectives of enhancing growth and stability, but were probably counterproductive and even flew in the face of a considerable body of theoretical and empirical work that suggested these poilcies would be counterproductive. I argue that the root of the problem lies in the IMF's system of governance. Thereafter, I discuss how the World Bank managed to reform its agenda in order to fulfill its goals of poverty reduction more successfully, and what lessons this reform holds for the IMF. I conclude by proposing needed reforms for the IMF that might mitigate some of the problems it has encountered in the past.[1]

Economists typically begin an analysis of the behavior of an organization or an individual by looking at the *incentives* they face—what is the nature and magnitude of their rewards and punishments, and who metes them out? Political discussions more commonly begin with a discussion of *accountability.* Before I discuss the specific problems of the IMF and the World Bank, it will be fruitful to first lay out what I mean by "accountability," relate this notion to incentives, and identify the key problems in designing accountability systems for international financial organizations.

ACCOUNTABILITY: A DEFINITION AND ILLUSTRATION

Accountability requires that: (1) people are given certain objectives; (2) there is a reliable way of assessing whether they have met those objectives; and (3) consequences exist for both the case in which they have done what they were supposed to do and the case in which they have not done so. In a sense, the political notion of accountability corresponds closely to the economists' concept of *incentives*.

Several key problems face a multilateral organization, such as the World Bank or IMF, in establishing a system of accountability. A first

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problem is created by the existence of a multiplicity of objectives. If organizations fail on one objective, they can always claim that they were trying to accomplish another objective. Whenever there is murkiness about an organization's real objectives, it will be difficult to assess whether the organization has been successful or not, and hence, it will be hard to hold the organization accountable. This is particularly problematic in public institutions because, in fact, different participants in the political process have different goals. As they represent the views of the members of society, public institutions almost inevitably involve a multiplicity of objectives. But that does not mean that in the design of public institutions, one cannot try to delineate specific objectives for particular organizations.

Second, it is often quite difficult to ascertain the reasons why an organization may not have met its objectives. This may have occurred because an intervening event took place that the organization or person responsible could not do anything about. In that case, the failure could not, of course, be attributed to the organization or person involved.

Finally, it is often difficult in large organizations to design incentives that lead to individual accountability, even when organizational accountability exists. If widespread consultation and diffuse responsibility exist within an organization, then everyone is "to blame" when things go wrong. But if everyone is to blame, then no one is: one cannot punish all individuals in an organization. Much bureaucratic behavior is designed to assure that there exists collective responsibility for failures, eroding individual responsibility.

Let me illustrate the issues discussed so far with reference to the IMF. The organization was founded in the aftermath of the Great Depression and World War II. The Great Depression represented the most significant downturn in the global economy since the beginning of capitalism. The war expenditures brought the global economy out of the Great Depression. At the end of the war, a worry existed that the world would sink back into a slump. In particular, John Maynard Keynes was concerned that countries would reintroduce the kinds of policies that they had pursued at the beginning of the depression. In pursuing "beggar-thy-neighbor" policies, countries had tried to protect their own aggregate demand by cutting back on imports, as a result of which their problems had spread to other countries. Keynes helped establish the IMF to address these concerns. He successfully argued that the cure for recessions was fiscal expansion. The IMF was to have two functions: (1) to provide money to countries in an economic downturn, so as to enable them to pursue more expansionary fiscal policies; and (2) to put pressure on countries to choose expansionary, rather than beggar-thy-neighbor, policies. He believed that an international organization was needed, because a global collective interest would be served by expansionary policies. Thus, the IMF seemed to have a clear set of objectives.

If we look at what happened in the financial crisis in East Asia, however, the IMF actually set forth conditions forcing countries to adopt more contractionary, rather than more expansionary, policies. To be sure, the countries did not engage in beggar-thy-neighbor policies. Rather, they followed what I call "beggar-thyself" policies that were even more detrimental. Both kinds of policies exacerbated the downward spiral within the region. But, unlike beggar-thy-neighbor policies, beggar-thyself policies did not even have the saving grace of benefiting the people of the country that engaged in them. These contractionary monetary and fiscal policies led countries to reduce their imports—other countries' exports—just as they would have been reduced by the imposition of tariffs and quotas (see Stiglitz 1997). The IMF was doing exactly the opposite of what Keynes had intended. Keynes must have been turning over in his grave thinking about what he had done.[2]

The question is, why was the IMF advocating and imposing these beggar-thyself policies? Was it a mistake, or was the IMF pursuing other objectives? If it was pursuing *other* objectives, then perhaps the failure in stabilizing East Asia was not a failure in the eyes of the organization. And indeed, the IMF claimed that there were other objectives. One of the *stated* objectives was to preserve global stability—that is, to prevent contagion, even if doing so meant that the countries in East Asia might have to suffer more than they would have with less contractionary policies.[3] Another was to make it more likely that creditors would be repaid. Senior IMF officials were very explicit in not wanting debtors to default on their loans. They viewed that as an abrogation of the sanctity of contracts.[4]

Consider another example. In October 1997, just as the East Asia crisis began, the IMF tried to change its charter in order to make capital market liberalization part of its mandate. Today, even the IMF recognizes that capital market liberalization presents considerable risks for many, if not most, developing countries, and it is now widely recognized that capital market liberalization has contributed to global economic instability. It played a central role in the East Asia crisis, and it helps explain why crises have been more frequent and deeper over the past quarter-century. The pursuit of capital market liberalization thus seems inconsistent with the mandate given to the IMF at its creation: to enhance global economic stability. One way of coming to grips with the seeming anomaly is to look for another objective: facilitating the opening of capital markets may be in the interest of certain financial circles in the developed countries, because it enhances their business opportunities.

The problems posed by the multiplicity of objectives are compounded by a tendency to confuse means and ends. Means that are supposed to be closely connected to well-accepted ends become goals in themselves, and little attention is paid to whether they do, in fact, advance the ultimate end. Privatization was supposed to contribute to economic growth; therefore, it was presumed that the countries in transition that privatized the fastest would grow the fastest. Accordingly, it was not surprising that the IMF put a host of privatization conditions on its loans to those countries and kept track of the number and value of state assets privatized. Those countries that privatized the fastest got the IMF's seal of approval, the teacher's gold stars for good performance. Yet it is now apparent that speed of privatization mattered little: the countries that seemed to be privatizing slowly—Hungary, Poland, and Slovenia—are the countries that have had the most successful transitions. Statistical studies suggest that privatization without restructuring and corporate governance does not contribute to economic growth. But these results are perfectly consistent with what was known *even at the beginning of the transition*. How privatization is conducted (i.e., the institutional infrastructure and macroeconomic policy framework that accompanied it) is every bit as important as privatization itself. Similarly, inflation and exchange-rate stability are not ends in themselves, but means to ends. Yet the IMF has repeatedly treated these as if they were goals in themselves. While a general consensus exists that eliminating hyperinflation is necessary for economic growth, there is no consensus that reducing inflation increases economic growth. The transition countries with the best economic performance have not necessarily been those that have pushed inflation lowest. Excessively tight monetary policy is one of the factors generally blamed for the high level of barter in Russia (in recent years, 60% or more of all transactions have been barter). While inflation interferes with the ability of the price mechanism to work, barter may be even more harmful.

The multiplicity of objectives—including the confusion of means with ends—thwarts the possibility of assessing success. Not long after the East Asian crisis began, the IMF claimed success for its interventions. To me, and to most of those in the affected countries, this seemed peculiar. Unemployment rates had soared and were still three to five times higher than they had been before the crisis. Real wages were down, and incomes remained below 1997 levels. Gross domestic product (GDP) in countries like Indonesia was more than fifteen percent lower than it had been before the crisis, and the countries were still in recession. In what sense, therefore, could the IMF's policies be called a success?

That depends crucially on the definition of the intended goals. The IMF said its interventions were successful, because exchange rates had stabilized. If that was the objective, then the IMF had indeed succeeded, as exchange rates had stabilized. But if the IMF's objectives had been the ones about which Keynes had talked—namely, stabilizing GDP and preventing workers from facing mass unemployment—then the programs had been outright failures. If the objective had been ensuring repayment of creditors, the picture was mixed: the IMF had succeeded in avoiding a unilateral declaration of suspension of payments, a debt moratorium or standstill, and Korea had been able to negotiate a debt rollover, but the creditors were really given little choice—there was more to the form than the substance. In any case, whether there was a formal moratorium or not, creditors were not being repaid. In Thailand, over fifty percent of the loans were in nonrepayment in 1997, and the picture did not improve much during the succeeding two years.

The second problem in assessing the successes and failures of the IMF concerns the extent to which the organization was able to influence events. This is related to another question: what would have happened in the absence of the IMF action—what is the appropriate counterfactual? I have watched the IMF closely over the years, and there is a certain consistency in its responses. When things go well, the IMF claims the credit. When things go badly, it is because others did not do what the IMF told them to do in the manner that they were supposed to, they did not show adequate resolve, and, in any case, matters would have been even worse but for the IMF's intervention. Any seeming failure is not because of mistaken policies but arises from faulty implementation, governments not doing enough, and lack of commitment. At least in its public stance, the IMF seldom moves away from this position of organizational infallibility. Indeed, it often seems to take the position as part of its credo: only if the markets believe that the IMF is infallible will it be able to affect market psychology and to restore confidence. Thus, the IMF has consistently discouraged public discussion of alternative strategies. For example, during and after the East Asia crisis, even after that situation had calmed down, the IMF refused to engage in processes of public evaluation. The IMF holds that transparency could undermine its effectiveness, a view it shares with the central bankers who play such a large role in its governance. With few exceptions, most of them are committed to the proposition that public discussions of monetary policy would not contribute to economic stability and believe that even public disclosure of the IMF's deliberations would be counterproductive. Remarkably, there is little empirical evidence in support of these strongly held views. On the contrary, few untoward consequences have resulted from the Bank of England's movement towards improved transparency and disclosure.

In the few instances in which the IMF engaged in self-criticism, it appeared directed at limiting the scope of outside criticism as much as it was directed at understanding the sources of the failure. In the face of mounting criticisms of the failures in East Asia, the IMF finally admitted that it had imposed excessively contractionary fiscal policies, but it never addressed the appropriateness of its monetary policies.[5] More fundamentally, it never attempted to explain *why* it had pursued these excessively contractionary fiscal policies. Were its forecasting models at fault, or was the problem with its overall policy framework? And the IMF (and the U.S. Treasury) reacted vehemently (though secretly) to a more thorough World Bank review (1998b) that identified part of the problem as a failure to be attentive to the microeconomic structures of the affected countries. For instance, in Thailand, much of the foreign debt was associated with the real-estate sector, which was already bankrupt. Contrary to what the IMF claimed, further devaluation would therefore not have had significant adverse effects. At the same time, the IMF preference for raising interest rates to high levels predictably did have a significant adverse effect on every sector of the economy, in particular on small and medium-sized businesses. This followed from the high level of domestic indebtedness.

Thus, the IMF was not open to a true evaluation of its performance. The complexity of economic phenomena, however, made it easier for it to claim success for itself when the source of success lay elsewhere and to shift blame to others when their policies played at least a part in the failures. For example, the IMF has frequently claimed Mexico as a success. This country recovered, at least in the sense that the exchange rate stabilized after the intervention. The IMF claimed that the Mexican bail-out program was the reason for this. But if we look more carefully at what happened in Mexico, we find a simple explanation for why Mexico recovered. The exchange rate devalued, and the United States was going through an economic boom. The North American Free Trade Agreement, which had lowered trade barriers with the United States, had recently been signed. In other words, Mexico enjoyed an export-led recovery that had little, if anything, to do with the IMF's bail-out packages (see Lederman, Menendez, Perry, and Stiglitz). The weaknesses of Mexico's financial institutions also comprised an essential part of its problems. The IMF did not really address these shortcomings. Years after the crisis, the Mexican banks remained in weak condition. This did not hamper Mexico's recovery, as its export industries could tap into the American financial markets. The companies supplying products to American automobile companies could obtain money from these car manufacturers or their banks; indeed, many of them were American firms themselves. In short, Mexico's recovery had little to do with the IMF program.

A second example is the stabilization of the exchange rate and economic turnaround in East Asia after the crisis. Every economic downturn comes to an end. The fact that this occurs does not mean that the policies were right. The issue that has to be addressed is whether the economic downturn was as short and as shallow as it could have been. Nowadays, most people agree that the excessively contractionary fiscal policies preferred by the IMF made the downturn in East Asia significantly deeper and longer-lived than it had to be. Even the IMF agrees that the way it went about restructuring the financial system in Indonesia contributed to a run on the banking system, further weakening that economy. The IMF also recognizes that Malaysia's capital controls did not have the adverse effects that it had once predicted. It is less willing to admit that the controls in Malaysia resulted in a shorter recession and created less debt than would otherwise have been the case. Similarly, the IMF never mentions that Korea's recovery was partly caused by the fact that it did not follow the IMF's advice to get rid of its excess capacity in chip production. The recovery of the chip industry played a central role in the recovery of

Korea's economy. Nor does the IMF mention that Korea followed quite a different strategy in restructuring its banks than the one the IMF would have recommended—a far different strategy from that pursued in either Thailand or Indonesia, where recovery has yet to come, four years after the crisis.

One has to be careful in assessing the excuses for the failures. For instance, it is often argued that while the IMF's advice was good, implementation was bad. If only the country had done what it was told to do, recovery would have come sooner. Still, an increasing number of governments are governed by democracies, and democracies do not necessarily obey instantaneously the dictates of international organizations. Their decision-making processes often take time. In the United States, for example, we have been talking about problems in our Medicare system and our social security system for years. Nonetheless, much weaker and younger democracies are somehow expected to change basic institutions within their society—including their basic social safety nets—in a matter of weeks, rather than years or decades. This seems simply unreasonable to me. In any case, whether the IMF likes it or not, there will always be public discussions and criticisms of policies in democracies, especially of policies that are as problematic as the ones the IMF pushes. To argue that policies would have been successful if only they had not been undermined by public discussions is to claim that the policies would have been successful if only the countries involved had not been democratic.

It is similarly indefensible to argue that policies would have worked if they had been implemented better. This argument is only plausible if a record exists of countries in similar situations that have been able to implement these policies successfully. Policies have to be designed so that they can be implemented by the kinds of institutions and individuals existing in the developing world. Otherwise, the IMF is simply saying that its policies might have worked in a world different than the one in which we live. In fact, an awareness of the implementation problems should be a central part of the program design.

By the same token, it is beside the point to state that policies would have worked if not for political problems or social instability. The riots that occurred in Indonesia as a result of the policies imposed by the IMF were predictable, especially given the society's ethnic fragmentation. The IMF might have preferred working in a different environment, but it had a responsibility to take the situation as it stood. Trying to balance Indonesia's budget by cutting out food and fuel subsidies for the poor—at a time when the contractionary monetary and fiscal policies and the misguided financial market restructuring strategy were taking its toll on unemployment and real wages—most probably was the spark that set off the explosion. It will take years for the economic damage to be repaired. The IMF has to bear some responsibility for these events.

Currently, the multiplicity of objectives, the difficulties of assessing the extent to which objectives have been met, and the problems of ascertaining who is responsible for a failure all contribute to a situation in which the word “accountability” is more a matter of rhetoric than of reality. But this need not be the case. Two of the reforms discussed in the final section of this article could improve the IMF’s accountability: clearly identifying its *objectives*, as well as creating a framework *ex ante* for assessing the ex post performance of the IMF.

GOVERNANCE: ACCOUNTABLE TO WHOM?

Before turning to the reform agenda, I want to argue that the IMF’s basic problems derive from its governance structure. The IMF was established to pursue a far different set of objectives than the ones it subsequently pursued. This switch took place because the IMF was captured by financial interests, and the capture was the inevitable consequence of the IMF’s original governance structure.

Both the IMF and the World Bank deny that they are not accountable. In one sense, they are right. When the organizations were created, they were made accountable to an executive board, which maintains closer oversight than the board of directors of virtually any company. While boards of directors usually meet quarterly, the IMF and the World Bank are overseen by full-time boards. These boards, in turn, are accountable to governments.

Still, one has to recognize how frail these links are. The executive directors are accountable not so much to the governments themselves as to particular agencies within those governments. To be sure, these agencies are accountable to the government, and the government—at least in democracies—is accountable to the people. Yet, because of the length of the chain of accountability and the weaknesses in each link of that chain, an attenuation of accountability occurs. From this perspective, the view that there is a lack of meaningful accountability has some validity. The IMF responds more to those to whom it is directly accountable than to whom it ultimately ought to be responsible. Its governors are finance ministers and central-bank governors, and they represent a particular segment of society. Their interests are very different from those of labor ministers. The whole culture of the IMF would be markedly different if it was accountable to different agencies within the government. Anybody who has worked, as I have, within a democratic government recognizes the vast differences in the interests and cultures of the various government agencies. Even though the Department of State, the Treasury, the Council of Economic Advisers, the Trade Representative, and the Department of Labor are all part of the U.S. government, they report to different constituencies and end up being accountable to those constituencies.

In democratic societies, it is recognized that public decisions are affected by who has a seat at the table. That is why, when the U.S. government makes a decision about economic policy, it does not delegate that decision to the Treasury. Rather, the National Economic Council brings together all the relevant parties. Of course, the Treasury takes the lead on issues on which it is supposed to have expertise. But it always remains only one voice, albeit a powerful one. In the case of the IMF, however, the U.S. Treasury guards its powers jealously. It seeks to prevent others, including the president, from participating in the decisions, or at least to limit their role. On one occasion, President Clinton expressed surprise at and apparent disapproval of an action undertaken by the IMF about which he had learned from the *New York Times*. He seemed unaware that the action was being taken at the behest of *his* Treasury. Perhaps the Treasury thought the matter of too little importance to "bother" him with it. More likely, they realized that if they had discussed the matter with the president, he might not have agreed on the course being followed, especially if others had been called in to express their views. In responding to the East Asian crisis, the State Department shared my views of the risks to Indonesia's political and social stability of the policies being pursued, but the Treasury pushed ahead with its policies nonetheless.

All of this might be of little importance if the IMF were merely entrusted with technical decisions, such as arrangements for interbank check clearing. But the IMF's decisions have enormous effects on economies throughout the world. The IMF is not accountable to those who are significantly affected by its policies. The people in East Asia who were thrown out of jobs as a result of the excessively contractionary monetary and fiscal polices, or whose firms were thrown into bankruptcy, have no recourse. They have no way of expressing their dissatisfaction with the policies that were pursued other than to throw out of office the governments responsible for implementing them. But the IMF—the organization that puts the policies into place—and its officials, remain relatively immune and, in that sense, unaccountable. Only when broader global outrage occurs—or when the interests of those to whom the IMF and its officials are directly accountable are adversely affected—will there be consequences.

The problem of accountability is even deeper than the above analysis suggests. I mentioned earlier that the IMF is overseen by finance ministers and central-bank governors. One of the IMF's missions in recent years has been to make central banks more independent—that is, to make them less directly accountable to democratic processes. Whether this is required for ensuring good economic performance is an issue that need not detain us here.[6] The point is that as a result of these efforts, the IMF is becoming more accountable to people who are increasingly less accountable themselves.

Moreover, macroissues are far from merely technical matters; they involve trade-offs requiring political judgments. Even if there are arguments for depoliticalization, this does not mean that decision-making should be unrepresentative. Yet, in most countries, financial interests have a much larger say than do other stakeholders. Indeed, in many countries, key stakeholders have no say at all. Thus, the board of the IMF not only lacks an adequate degree of *direct* political accountability, but also fails the test of representativeness. Not all affected parties have a seat at the table.

The IMF board lacks representativeness in another manner as well. Voting shares in the IMF are in proportion to an outdated and imperfectly measured economic weight of a country. For more than a century, in other democratic processes, wealth has not been a qualification for voting. Richer individuals do not have more votes, even when it comes to issues of economic import. The justification for a system of "one-dollar-one-vote," rather than "one-man-one-vote," is that the IMF is ostensibly a commercial enterprise with shareholders. Larger shareholders (i.e., the richer countries) have more votes, just as they would in a private corporation. This analogy is far from persuasive. In the case of a private firm, a shareholder displeased with the actions of the company can sell his shares. Those who approve of the company's actions may thus wind up holding a larger share. In the case of the IMF, voting shares were determined half a century ago. Since then, economic weights have changed dramatically, but the adjustment of voting rights to reflect these changes has been far from adequate. The IMF is an international public organization, but the lack of legitimacy in its allocation of voting rights undermines its political validity.

That leads me to the view that one has to change the governing structure of the international financial organizations in order to close the gap between rhetoric and reality in democratic accountability of these bodies. One has to make them accountable to more than the financial markets and their representatives. In this respect, I think that the World Bank is substantially better off than the IMF. Its executive directors belong to aid agencies as well as finance ministries. The political perspectives of aid agencies tend to focus more on issues of social justice and equity than do those of finance ministries. Regardless of the political color of the government, aid agencies tend to be more liberal, counterbalancing the usually more conservative finance ministries. As a result, the spectrum of perspectives represented in the World Bank is broader than that in the IMF. Also, in its day-to-day operations, the World Bank has to deal with environmental ministers, education ministers, and health ministers. Therefore, it has to confront a much broader swath of society than does the IMF, and it has thus become more sensitive to the broader spectrum of society. However, in negotiations of policies that have an enormous effect on workers or small businesses, the IMF still does not deal with labor ministries or unions.

The IMF's evolution, and its failures, especially in terms of its original objectives, are best understood when looking at its system of accountability. The financial markets are more interested in ensuring that they get repaid than in ensuring that there be full employment in Thailand or Indonesia. A debt moratorium is anathema to them. Building up reserves to facilitate the repayment of foreign debts makes sense, even if it requires a major recession in the country. Capital market liberalization opens up new markets for the financial industry, even if it contributes to global economic instability. There is a confluence here of interests and ideology, with both serving to override economic analysis. Those I talked to in the IMF genuinely believed that capital market liberalization was good for the countries involved. Many even genuinely believed that they were doing countries a favor by pushing for capital market liberalization, that they were helping to overcome the special interests that were resisting liberalization within developing countries. They held these beliefs so strongly that they simply shunted aside contradictory evidence and theory. Their discussions with those in financial markets, whose interests might be well served by capital market liberalization, reinforced these beliefs.

The shift in the IMF's objectives to which I referred earlier is not the only reason for its failure to pursue its original objective. The IMF's inability to openly discuss the changes in its objectives—it could not say, for instance, that one of its objectives was ensuring that lenders got repaid—caused it to deal with a disparity between what it *said* it was doing and what it was actually *trying* to do. This led to a kind of cognitive dissonance and intellectual incoherency. For instance, the IMF argued for the virtues of free markets and against government intervention, but in fact its main activity was intervening in exchange-rate markets. In addition, the IMF appeared highly concerned about the government's limitations, yet refused to discuss its own limitations and incentives (for a fuller discussion of this point, see Stiglitz 1998a).

The IMF borrowed the culture of secrecy from the financial market as well. As it dealt with some of the most difficult problems, for which there was no obvious solution, it tried to pretend that there existed a single solution that was best for all groups within society. Economic advisers are supposed to analyze trade-offs—that is, the risks associated with alternative policies for different groups, and to leave the ultimate choice to the political process. The IMF pretended that there was a single, Pareto-dominant policy and tried to foist that policy on developing countries. There probably was not a single policy that served the interests of the financial market as a whole, although there may have been a single policy that best served the interests of foreign lenders. Both a culture of secrecy and vested interests served to successfully keep discussions of alternatives and trade-offs out of the public domain. The irony is that the IMF's culture of secrecy, its lack of in-depth interaction with countries, and the dissonance between its "new" objectives and the objectives for which it was founded all contributed to its failure to achieve its new goals. Thus, it even failed to serve the interests of those to whom it was accountable.

REFORMING THE WORLD BANK

During the 1980s, the World Bank and the IMF advocated similar policies, and there were many similarities in the ways in which they interacted with the developing countries. The organizations worked closely together in the structural adjustment programs, they were both committed to the principles of the Washington consensus, each believed that conditionality was an effective way for improving economic performance, and neither monitored closely the impacts of the programs on poverty or the environment. Still, there were important differences, especially in organizational design and behavior. The Bank has always been less hierarchical than the IMF and more accepting of alternative views, even when certain orthodoxies dominated policy. By the time I arrived in 1997, the new president of the Bank, James Wolfensohn, was well on his way to changing its course. Though the new direction was not always clear, the intellectual foundations not always firm, and support within the Bank far from universal, the Bank had begun to seriously address the fundamental criticisms levied at it. Reforms involved changes in philosophy in three areas: development, aid in general and the Bank's aid in particular, and relationships between the Bank and developing countries.

New Thinking about Development

In reassessing its course, the Bank examined how successful development had occurred.[7] Most examples of successful development—for example, China and Botswana—were countries without IMF programs. The lessons that emerged from this reassessment included ones that the World Bank had long recognized: the importance of living within one's budget constraints; the importance of education (including education of females); and macroeconomic stability. However, some new themes emerged: Success comes not only from promoting primary education, but also from establishing a strong technological basis that includes support for advanced training. It is possible to promote equality and rapid growth at the same time. In fact, more egalitarian policies seem to help growth. Support for trade and openness is important,[8] but it is most effective when it encourages exports rather than merely reduces trade barriers on imports. Government plays a pivotal role in successful development by encouraging particular sectors and helping create institutions that promote savings and efficient investment allocation. Successful countries also emphasize competition and the creation of enterprise over privatization and the restructuring of existing enterprises.

Other factors were also studied. While no economy can succeed under hyperinflation, there is no evidence that pushing inflation to ever lower levels yields gains commensurate with the costs.[9] Privatization without the necessary institutional infrastructure in transition countries led to asset-stripping rather than wealth creation. In other countries, privatized firms showed themselves more capable of exploiting consumers than did state monopolies. By contrast, privatization accompanied by regulation and corporate restructuring leads to higher growth. Social capital and cohesion are important to maintain output, spur growth, and ensure that reforms can withstand the vicissitudes of the political process. Predation from the Mafia turns out to be even worse than predation from government bureaucrats. Government makes a difference. Good public institutions—from an independent, qualified judiciary to effective regulation of monopolies and the financial sector—are required. As many countries suffer from too weak a government as from a too-intrusive one. The Asian financial crisis had been brought on by a lack of adequate regulation of the financial sector. Mafia capitalism in Russia was caused by a failure to enforce the basics of law and order. Overall, successful countries pursued a comprehensive development approach that went well beyond technical issues.

Thirty years ago, economists of the left and right agreed that the improvement in the efficiency of resource allocation and the increase in the supply of capital were at the heart of development. They differed only as to whether those changes should be realized through government-led planning or through unfettered markets. In the end neither worked. Today, we recognize that what separates developed countries from less developed ones not only concerns the amount of capital, but also involves knowledge and organization. This includes knowledge of how to produce more efficiently and how to live healthier lives. It also involves the organizational capacity to use the limited resources in the most efficient way possible. Gaps in knowledge and organization, both between more and less developed countries and within developed countries, account for much of the differences in incomes. Closing those gaps has thus become one of the main foci of development strategies. More broadly, development today is considered a transformation of society, which requires more than a solution to technical problems. Projects—such as dams, new schools, or health clinics—alone cannot make a dent in pervasive poverty. Only broad-based policies and institutions can wage a serious war on poverty, the kind of war that might lift up the lives of billions of individuals.

Thinking about Aid and the Role of the World Bank

This reassessment of development put the World Bank in a difficult position. Although it is a development organization, it is organized as a bank, has many bank attributes—even to the extent of referring to the countries that provide funds as "shareholders," and to those who borrow funds as "clients." Some argue, on the basis of the reassessment, that the Bank should do less, others that it should do more, and most that it should do something different.

The Bank was originally founded to facilitate the flow of capital from more developed countries to the less developed, on the premise that capital markets work far from perfectly and that there is a role for government to address this market failure. But the 1980s and 1990s saw a flood of private capital to developing countries. As a result, many ask whether the Bank is still needed. Some of these critics divide the world into two groups, middle-income countries and lower-income countries, and argue that middle-income countries do not need the Bank. In this view, *all* Bank services—both lending and non-lending—should be provided privately, and low-income countries need grants, not loans.[10] Lending them money for schools and health clinics—activities that do not generate direct returns—is what has gotten low-income countries into their present predicament, in which many face overbearing debt burdens.

Though there is a grain of truth in these criticisms, they go too far. Private capital markets do not work perfectly. Some would say that they do not work well, even for middle-income emerging markets. This means that there is a role for a "credit cooperative" that allows them better access to international capital markets at more favorable terms.[11] Although it makes sense to provide more funds to low-income countries in the form of grants rather than loans, a need for loans (for infrastructure projects, for instance) remains.[12] Furthermore, the financial markets are fair-weather friends, lending when the countries are doing well and less needy of funds, but nowhere to be seen when the going gets rough. The World Bank is needed for countercyclical lending, even for middle-income countries. Finally, capital has gone to relatively few countries, and then only to sectors within these countries—such as infrastructure—that can generate returns. The Bank is still needed to fund other important sectors, such as health and education. Reflecting these new insights, Bank lending has shifted enormously towards health and education.[13]

Interactions between the World Bank and Developing Countries

At the same time, the World Bank asked an even more potentially disturbing question: did its aid make any difference at all? The answer was only partially reassuring. Aid could lead to higher growth only if the country receiving aid had put into place "sound" policies and institutions (such as stable macroeconomic policies and governments with limited corruption) (see, e.g., World Bank 1998a). This finding led to greater selectivity in the direction of Bank aid flows, directing more to countries that had good policies and institutions. For countries without these qualities, the Bank placed an increasing focus on creating such policies and institutions and finding alternative venues, such as nongovernmental organizations, through which aid funds could be channeled in the interim.

Research also convincingly demonstrated that countries did not move to better policies if promised increased aid. When policies were imposed, the governments worked hard to get around them, and opposition parties quickly dismantled such policies when they came into office. This conclusion questioned the efficacy of the policy of aid-conditionality used by the IMF and the World Bank, which was intended to bring about better policies.

The Bank has moved away from the failed policy of loan- and project-conditionality and towards letting each individual country take responsibility for its own development program. Since Bank research has shown that more active participation in a development program by the borrowing country improves its effectiveness, the Bank set out to change the fundamental relationship between itself and the recipient countries. It has stated that it wants to put the country in the driver's seat, though many in developing countries question whether this will in fact occur. Does the Bank have in mind a "dual control" car or a car in which the true driver is the instructor, with the pupil's steering wheel, brakes, and accelerator for little more than show? The real test will come when the country proposes doing something different from what the Bank wants. How much leeway will the Bank provide? Will it be able to distinguish between cases where its fiduciary responsibilities—its responsibility to those that provide the funds to make sure that they are reasonably well spent—are at issue and those where reasonable people might well differ about the desirability of alternative policies?

Redefining the Mandate

The World Bank's honest reassessment of development has put it into a difficult position. The Bank recognizes the central importance of matters that are not within its core competence. It emphasizes the importance of "governance"—the rules by which public and private institutions are governed—yet it has on its staff few people that know much about the subject beyond the ability to recite the latest mantra. It could help build good water projects, but could it really help build a good judicial system? And was this what the Bank was supposed to do? If the core mission of the Bank is not lending money, then its own governance structure makes little sense. Why should finance ministers, who know little about poverty, play such a pivotal role? Why should developing countries not be in the driver's seat on the board of the Bank, or at least have a far larger vote there?

The Bank has made enormous strides in its reform. Its rhetoric has changed enormously. It now voices the need to go beyond projects—beyond even policies—to change institutions. It talks not just about limiting the role of the state, but about creating a more effective state. It discusses the impact of corruption on development, when only a few years ago this would have been viewed as crossing the dividing line between economics and politics. It articulates the need to take a comprehensive approach to development that sees development as a transformation of society (see, e.g., Stiglitz 1998b; Wolfsensohn). And it talks about putting the country in the driver's seat, about participation and ownership, and about the salience of poverty. This change in rhetoric has had an impact on thinking about development both in developing countries and inside the Bank itself.

If the Bank has not fully changed, then no one should be surprised. It is not easy for those who entered the Bank in the days when the Washington consensus reigned supreme to buy into the new Bank. They see all the new rhetoric as soft fluff, distracting the Bank from its *core* mission involving tough and often painful decisions. Many in the finance ministries in the more developed countries, and some in academia, say amen to these concerns (see, e.g., Bhagwati; Srinivasan). The risk that soft talk could replace hard analysis certainly exists. However, the Bank is far from that place today. It has changed, both in what it does and how it does it. Earlier I described the changes in the Bank's loan portfolio. Safeguards have been put into place to make it less likely that there will be large adverse effects on the environment, or on minorities within countries. The dialogue between the Bank and governments is now on a far more equal footing—there is less of the colonial overtone left. The Bank is a far more open and transparent organization than it was a decade ago.

But the reforms are fragile and could be reversed easily. Evidence of their precariousness abounds. The Bank refuses to openly discuss economic policies when those policies conflict with the views of its "sister" organization, the IMF. As a result, it is rightly seen as a "partner in crime" in the often-misguided structural adjustment policies—such as those in East Asia and the economies in transition—in which the IMF sets the overall framework. As a result, its reputation in much of the developing world does not stand much higher than that of the IMF. The Bank's reputation gets tarnished when policies of financial-market liberalization lead to soaring interest rates, as they did in Kenya, regardless of whether the Bank or the IMF was responsible. In recent controversies, as we have seen, the Bank's management and board have equivocated on a commitment to openness and transparency. This backfired in the case of a recent report over the Bank's handling of a resettlement project in Western China. In the report, an independent assessment concluded that the Bank had failed to follow its own procedures. The Bank voted not to release the report, but the report was leaked to the press nonetheless and thus became fully available.[14]

Changing a large organization entails redefining both its mission and culture and is not easy to achieve. From this perspective, the World Bank reforms, as incomplete as they may be, are impressive. The contrast between the limited successes of the Bank and the broader failures of the IMF may be instructive.

AN AGENDA FOR REFORM OF THE IMF

The IMF has failed to accomplish the goals set out for it at its creation. In response, five non-mutually-exclusive reform strategies have received extensive attention. Some conclude that the IMF failures are so endemic and the hostility toward it so strong that the IMF should simply be dismantled. Others blame the IMF's failures on its politicization and conclude that a more independent IMF is the solution. A third group believes that the severity of the global problems outpaced the IMF's resources and argues that the IMF's mandate should be extended and its resource base increased. A fourth group argues that the IMF's problems arose because it lost its clear sense of mission. In this case, the solution is a refocusing of attention on crisis resolution. Finally, there are those who suggest that none of these solutions are enough. They conclude that the IMF will need improved governance, even if its mission is greatly restricted. I would argue strongly in favor of the fourth and fifth strategies.

Abolishing the IMF

At one level, the first position has much merit. With a flexible exchange-rate system, what purposes do the bail-outs serve? They have enabled countries to maintain their exchange rates at artificially high levels for a bit longer than would otherwise have been the case (as in Brazil and Russia). The gains from this are not obvious. Typically, only the readjustment of the exchange rate has allowed growth in these countries to resume. Prolonging the overvalued exchange rate simply gave wealthy individuals time to get their money out of the country at the more favorable terms. The IMF has actually argued that the intervention is necessary because of the tendency of markets to "overshoot." But there is little evidence that IMF bureaucrats (or the government officials in the countries requesting assistance) do a better job than the markets in assessing the equilibrium exchange rates. The IMF's recent track record certainly does not lend much credibility to the view that they can do so.[15] IMF funds often serve a second purpose: they facilitate the repayment of foreign banks' loans by giving countries the wherewithal to do so in a process that frequently entails the nationalization of private liabilities. In effect, the taxpayers in debtor countries are made to repay foreign banks' loans that were often made to private parties. Furthermore, the mere existence of the IMF as a provider of funds contributes to the problems that it is supposed to address: (1) it helps feed speculative sharks; (2) it undermines lenders' incentives to engage in sound lending (this is the often-discussed moral-hazard problem); and (3) it undermines borrowers' incentives to obtain cover for their foreign-exchange risk (this is, in fact, a moral-hazard problem of equal or greater severity than the lender moral-hazard problem that has been the subject of so much discussion).

Yet, having watched the political dynamics behind the Mexican bail-out from the vantage point of the White House, I do not think that this first position is politically tenable. If there was no IMF, someone would reinvent it, though perhaps in a more humane form. In times of crisis, people and their political leaders want to feel that someone is in charge and that action is being taken. Saying that market forces will eventually take care of the problem provides too little comfort. Effective or not, action is required. Perhaps because it is so hard to tell whether any particular action is wrong, politicians would rather be blamed for taking the wrong action than for taking no action. In such circumstances, the IMF is ideal. For example, the U.S. administration can claim that action is being taken and claim credit if things go well. If things go poorly, the U.S. government can shift blame either to the IMF or to the crisis country. The IMF has the further virtue of costing the U.S. taxpayer almost nothing.

Once created, such an organization will take action even when the more appropriate action is to do nothing. There will be a bureaucratic imperative for it to expand its mandate. The goal of reform is to minimize the mischief—the damage, especially to the poor—that such an organization can do and to maximize the chances that it actually contributes to achieving its mandate. That is the objective of the reform agenda set forth below: narrow its scope, limit its range of action, and enhance the safeguards. Before turning to those reforms, I want to dispense with a reform that would go in the exact opposite direction and that some within the IMF are pushing. The attention that this proposal has received is symptomatic of the lack of understanding of the problems of global financial markets today.

Lender of Last Resort

The IMF's deputy managing director, Stan Fischer, has argued for changing the IMF into a lender of last resort (see, e.g., Fischer), a central bank for central banks, performing a function analogous to that performed by the Federal Reserve Bank (Fed) for banks within the United States. The reasoning is simple—indeed, simplistic. In this view, runs on banks are caused by a lack of confidence that the banks have sufficient resources to meet their obligations. The knowledge that the central bank will provide a source of funds gives depositors the confidence required to keep funds in the banking system. With this confidence in place, the funds would not actually have to be drawn upon.

There are at least two problems with this reasoning. First, the existence of America's lender of last resort, the Fed, did not avert the financial crisis of the Great Depression. Since then, America has averted major bank runs, but not just because of the existence of a lender of last resort. Two other factors—deposit insurance and adequate government regulation—have been crucial. Deposit insurance guarantees an individual investor's bank account up to a given limit. Because depositors know that they are insured, they do not have to rush to take their money out of a bank when the economy is doing poorly. Deposit insurance creates its own problems, as evidenced by the S&L debacle. Depositors have much less incentive to examine the soundness of the institution in which they deposit their money, and they concentrate instead on the interest paid. Banks that engage in high return but risky lending can offer depositors higher interest rates and attract funds away from more prudent banks. The simple solution to the problem is to remove deposit insurance and return to a pre-Depression world of bank runs and financial collapses. However, ordinary depositors are simply not in a position to inspect a bank's books and ascertain its financial position. Given the huge changes that can occur overnight in a bank's financial position with derivatives, individuals would have to constantly monitor the bank into which they had put their funds. In this case, the more likely scenario is that investors would simply pull their money out of the banks and put it into safe mutual funds that invested in Treasury bills, thereby weakening, if not destroying, the banking system. The correct solution to the problem of deposit insurance is government regulation, imperfect as it may be. Such oversight is a classic example of a public good, since all depositors benefit by knowing that the bank is sound.

This recitation of the role of the central bank (lender of last resort) in ensuring domestic financial stability should make obvious the problems at the international level. Surely no one is proposing to accompany it with some form of insurance? What would such insurance even mean? Would it include insurance against default or exchange-rate fluctuations, against private or public default? Would sovereign governments be willing to cede authority to the IMF—or any other international body—for regulation?[16] And what would such regulation embrace—presumably the banking system, but what else? What would be the standards? And who has the competence? Certainly not the IMF!

The second criticism of the analogy between the IMF and the Fed as the lender of last resort goes deeper. Domestic banks need a lender of last resort because they promise to pay out a fixed amount of the deposit plus interest. Mutual funds do not require a lender of last resort because they agree to pay their shareholders whatever the value of their shares is. (In this case, the government still has the role of preventing fraud by levying criminal penalties on managers of funds that engage in fraudulent practices.) In the international arena, a lender of last resort would be required if a government guaranteed a particular exchange rate. In the case of a country with a fixed exchange rate, if enough individuals and corporations pull their funds out of the country, there would be no reserves left to buy back funds for those who wait. This worry would induce a panic, and this is why a lender of last resort might be useful under the fixed-exchange-rate system.

However, the world abandoned the fixed-exchange-rate system almost thirty years ago. With a flexible exchange-rate system, a country makes no guarantee about the exchange rate. Establishing a lender of last resort is tantamount to providing a guarantee. The IMF might argue that as a lender of last resort, it would not seek to defend any arbitrarily chosen exchange rate, but rather would ensure that exchange rates did not become extremely over- or undervalued. However, no organization has yet determined a price more accurately than the market, and there is no reason to believe that the IMF will be the first. It was a clever gambit on the part of those who had failed to address the problems of the global financial crisis to suggest that their powers had been too limited and that the organization needed to be enhanced by making it a lender of last resort. But enhancing the powers of the organization would be a move in exactly the wrong direction.

Increasing the IMF's Political Independence and Expanding Its Resource Basis

Two other proposed reforms would, I think, also be a move in the wrong direction. First, giving the IMF more resources without undertaking the broader reforms described below would lead it to intervene more aggressively, and to create bigger blunders with more adverse consequences. The bail-out packages have not worked, and there is no reason to believe that the reason for the failures was lack of resources.

Second, while I have argued that many of the IMF's problems are caused by a lack of accountability, some see too much political interference as the main cause. They wish to make the IMF more independent. There is some merit in their argument. Some of the worst lending programs—those to Russia, for instance—were politically motivated. Many of the staff at the IMF (and most at the World Bank) did not think that the 1998 loan to Russia made any sense. At most it would stave off a devaluation by a few months, at great cost. At worst, it would allow the oligarchs to put more of their money into foreign bank accounts. In the end, the latter turned out to be the case. Yet the IMF is a hierarchical organization, and the people at the top actually believed that the program would work. More importantly, organization has broadly supported the market fundamentalist/ Washington consensus policies that have been at the root of many of the failures. In short, I believe that the IMF's core problems would be exacerbated by reforms that gave it more independence. It would worsen all the problems of accountability discussed above.

MY PROPOSED REFORMS

Three basic sets of IMF reforms are required: (1) returning to its original mandate—that is, focusing on crises; (2) changing its *mode* of operations; and (3) most importantly, changing its governance.

Focus on Crisis

On the first item of reform, almost universal agreement exists. The IMF should return to its original mandate and focus its attention on the prevention and resolution of crises. It should discontinue its program of assistance to the post-Soviet and extremely poor countries that face chronic development problems.[17] These problems are more appropriately the province of the World Bank. Three independent reviews of the IMF have agreed with this proposition: those of the Council for Foreign Relations, the Overseas Development Council, and the bipartisan Congressional Commission chaired by Alan Meltzer. Their reasons go beyond just the IMF's demonstrated failures in these areas. Just as firms do better when they focus, hopefully the IMF's performance will also improve if it focuses on its central mission. Most importantly, from the perspective of this article, a clearer focus would allow a clearer system of accountability.[18] It should be emphasized that *focusing* on crises does not mean *ignoring* poverty. There are different ways of responding to crises, with different effects on poverty, and some of the reforms are intended to enhance the attention that the IMF pays to its impact on poverty.

Changing Modes of Operation

A focus on crisis prevention and resolution, however, will hardly resolve the IMF's problems. Few would claim that the reason the IMF failed in addressing the East Asian crisis was that its top management was too busy dealing with the problems of Africa! One would like to be able to wave a magic wand over the IMF to ensure that it uses "better" or "more up-to-date" economics. One will have to be content with more modest interventions that circumscribe how it operates. The size of bail-out packages, the circumstances in which those packages can be provided, and the kinds of policies that can and should be imposed as part of those packages should be restricted.[19] If the IMF cannot bail out creditors, and if it allows exchange rates to be determined by market forces, then there is little need for large bail-out packages. Instead, there will be a greater emphasis on using standstills and enhanced bankruptcy procedures, especially when (as was the case in East Asia) private-sector indebtedness is involved. Conditionality has, by and large, been ineffective, and the IMF seems to find it difficult to restrict itself to conditionality that is directly related to the crisis. Certainly the conditionalities it has imposed have not been related to enhancing the likelihood of repayment. That should be the only form of conditionality allowed.

Other procedural reforms would help reduce the adverse effects of IMF programs on the poor and enhance democratic processes. Today, before the IMF adopts a program, it attempts to make a macroeconomic forecast of the program's impact on variables such as growth and inflation. It should also provide a forecast of the program's impact on poverty, unemployment, and wages. Such impact analyses serve two functions. First, by focusing attention, they affect choices. If the projected poverty impacts are large, then there will be a demand for alternative policies. Second, they provide a basis of accountability. If the IMF consistently underestimates its impacts on poverty, then it should be asked why. Is something wrong with its models? Is it trying to hide the adverse effects of it programs? A final procedural reform would require that the IMF present governments with alternative courses of action (with estimates of the consequences of each strategy on various groups). There is almost never a single program that is best for all groups. Presenting alternatives will help delineate the economic and political roles. The economic advisor should set forth the analysis of alternatives, while the choices should be made within the political process.

Reformed Governance Structure

In the end, the IMF's bright bureaucrats will find a way of getting around whatever restrictions are imposed. True, permanent reform of the organization requires reforming its governance structure. Ultimately, the behavior of an organization is affected by the interests of those to whom the organization is accountable. In the case of the IMF, its direct accountability to central banks and finance ministries can explain much of its poor behavior. Today, the majority of IMF votes are in the hands of the G7, a small minority of the world's population. This must change. In the United Nations (UN), five countries have veto power; this is viewed as inequitable, a historical accident of the power of five states at the end of World War II, a time at which India and most Third World countries were but colonies. In the IMF, only one country—the United States—has effective veto. It is hard to think of any set of principles that could undergird the current distribution of voting powers. Undoubtedly, alternative voting schemes have their own problems. The one-country-one-vote system used in the UN General Assembly is hardly persuasive when countries differ so markedly in population. A system of one-man-one-vote would give enormous power to a two-country coalition of China and India. A more complicated voting system is clearly required. If the rights of minorities are to be protected, this voting system will require broad consensus for collective action. This will encourage the broader and more open discussions so lacking in the past.

Governance reform, however, must go beyond the issue of voting. Governments are represented at the IMF by finance ministers and central bankers, who tend to be directly accountable to only certain groups within a country. They are chosen because they are presumed to be the most knowledgeable in their countries about financial markets, the core responsibility of the IMF. All democracies must struggle with the issue of how best to combine expertise and political accountability. In the IMF's case, finance ministers and central bankers may have a degree of expertise, but they do not adequately represent the broad array of interests affected by IMF policies. The issue of representativeness is important, as we have seen, because different policies impose different risks on different groups. For instance, some may entail a greater risk of recession, others of a greater risk of inflation, and still others a greater risk that creditors may not be repaid. We have traced many of the IMF's failings back to the fact that the organization sees the world through the lens of the financial community, putting its interests and ideology above those of others.

At this point, I am often asked for concrete suggestions on how I would change the governance structure. I should be frank: there is no easy solution. Given that so much of the IMF's activity now deals with the developing world, expertise on that part of the world should be drawn upon. Developed countries should be represented by people drawn from both their finance ministry and their aid agencies. Developing countries should send representatives of the agency responsible for the overall functioning of the economy, whenever such agencies exist. Either alternatively or in addition, representatives from labor ministries and commerce or industry ministries should also sit in on the board. Finally, to ensure that broader national interests are taken into account, direct representation from the prime ministers' or presidents' offices should be sought as well.

Democratizing the IMF not only entails changing who is at the table, but also involves enhancing oversight of the IMF. That requires setting up an outside agency or agencies to assess the performance of the IMF, evaluate the accuracy of the assessments of the impacts of its programs, and help explain the failures. Surely, an organization that has made such a point of surveillance should allow surveillance of itself. One of the main functions of the IMF is to give countries advice. The notion of a monopoly of advice in macroeconomic policy, or in preventing or responding to crises, should be no more acceptable than that of a monopoly in any other part of the economy. Opening up the market for advice—allowing and even encouraging the IMF, the World Bank, and the other multilateral financial organizations to provide alternative views—would not only strengthen and help democratize the organizations themselves, but also promote democratic processes within the countries.

Increased Openness

I am not sanguine, however, about the likelihood of governance reform, particularly the deeper reforms of voting and representation. Those who control the organization are not likely to surrender control easily. It is unlikely that the United States will give up its effective veto. When direct democratic accountability is lacking, alternative control mechanisms must be sought. Of these, *openness* and *transparency* are the most important. It is not just that they are fundamental to democratic processes. Public scrutiny will put a check on the most abusive practices. It can increase the likelihood that the policies that are in the general interest—not just in the special interests of, say, the financial community—are pursued. To me, this is the key practical reform. The IMF, no less than democratic governments, should be subjected to Freedom of Information acts. Just as there are safeguards within such acts for certain types of exceptions, so, too, will it be necessary to carve out some exceptions. But they should be narrowly circumscribed. For instance, one does not want public disclosure of information that a bank has a high likelihood of insolvency, lest there be a run on the bank. Today, the IMF often states that it is willing to be more open, but that the member governments do not want to disclose information. The IMF never seemed hesitant before in imposing conditionality. In the East Asian crisis, it imposed a host of conditions that went well beyond those enhancing the likelihood of repayment or the speed of recovery. It went into long-term structural matters and even into political issues (see, for example, Feldstein 1998). It seems peculiar that the IMF is unwilling to impose conditions that ensure more democratic accountability—that is, until one understands the underlying governance structure, which not only is based on a culture of lack of transparency but almost *requires* secrecy for it to continue in the way that it has in the past.

CONCLUSION

So far, the debate about the reform of the international economic architecture in the aftermath of the global financial crisis has gone nowhere, other than a growing consensus that reforms need to be made and that at the center of those reforms must be changes in the IMF. But there has been something peculiar about those discussions. I have argued that the underlying problem lies in the IMF's governance structure, which gives finance ministers and central bankers *all* the seats at the table, and which allows for much of their business to be conducted in a nontransparent way. How strange, then, is the manner in which the reform discussion has been conducted: behind closed doors and at tables at which *all* of the seats have been taken by finance ministers and central bankers. Behind those closed doors, the same U.S. government officials who condemned the lack of transparency in East Asia oppose more transparency for American hedge funds. To me, the first reform should be reform of the reform debate itself. Discussions about the global economic architecture must embrace all affected parties. It is unacceptable that only central-bank governors and finance ministers have seats at the table when the decisions that they make have such vital effects on others. Is it any wonder that those who were, in some sense, ultimately responsible for the failed policies, and for an international regime which concentrates power in their hands, are less than enthusiastic about major reforms that would bring other voices to the table? This may be the most profound lesson to emerge from the global financial crisis: we cannot entrust reform of the global financial architecture to those who created it in the first place. Reforms must be based on more democratic principles. The voices of all those affected must be heard and must be heard clearly. This is the challenge to us and to our political leaders.

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NOTES

1. In this essay, I do not lay out the indictment against the IMF: its failure to manage the East Asia crisis (see, e.g., Furman and Stiglitz), to manage the transition from communism to the market economy (Stiglitz 1999, 2000), and to promote development (see the IMF's review of its ESAF facility).
2. Actually, Keynes himself expressed misgivings and worries not long after it was established about the organization he had helped to create.
3. My purpose here is not to assess the reasonableness of this objective (i.e., whether contagion was a real threat) or the consistency of the objective with the theories of well-functioning markets that seem to be at the center of much of the IMF's economic models, or to evaluate whether it succeeded in that objective (crises spread from country to country, arguably partly because of the policies that they pursued.) Rather, I simply wish to illustrate the difficulties of designing systems of accountability. This example illustrates the difficulty of ascertaining what it was that the organization was supposed to do.
4. To be sure, they argued that the abrogation of contracts would be bad for the economies involved. But there is little reason to believe that it would be worse than contractionary monetary and fiscal policies. Indeed, the standard argument they put forward was that if the countries defaulted, then they would not be able to get capital. Yet the facts, especially in East Asia, suggested that this was hardly a cogent argument: (1) the countries were unlikely to get additional funds in any case until their economies recovered, whether they defaulted or not; (2) given the high savings rate, the countries hardly needed an influx of foreign capital; (3) capital markets are forward looking—once the debt overhang was reduced by restructuring through bankruptcy and once the economy was growing again, capital would flow in (while capital markets might like to punish those who behave badly, there are large numbers of participants in the market, and even if those who have been hurt refuse to lend, new suppliers of capital will enter if they see a profitable opportunity); and (4) history suggests that capital flows do return rather quickly once the economic circumstances warrant it.
5. Thus, it never responded to the kinds of issues raised in Furman and Stiglitz.
6. The IMF believes that having macroeconomic policy determined by independent central banks is somehow better. While there is some evidence that an independent central bank with an exclusive focus on inflation does lead to lower inflation, little evidence exists that it leads to higher economic growth or even greater stability in terms of unemployment and real variables. Interestingly, though one of the arguments for an independent central bank is to bring in *expertise*, the boards of many, if not most, central banks are not dominated by those who have the greatest expertise in macroeconomics.
7. The reassessment actually began earlier, under pressure from the Japanese, and was reflected in the Bank's publication in 1993 of the landmark study *The East Asian Miracle*. The changes in thinking were reflected in the annual reports on development, called the World Development Report. For instance, the 1997 report re-examined the role of the state, the 1998 report focused on knowledge (including the importance of technology) and infor-

mation (including the imperfections of markets associated with imperfect information), the 1999 and 2001 reports emphasized the role of organizations (not just policies), and the 2000 report took a much broader perspective on poverty (World Bank 1998c, 1999c, 2000, 2001).

8. Not surprisingly, the Bank has still not taken seriously the theoretical and empirical critiques of trade liberalization, such as those provided by Rodrik solo and Rodriguez and Rodrik together. Whatever the intellectual merits of that view, it runs counter to the "official" position of the United States and other G7 governments that trade is good. Given the emphasis on trade expansion in both the Clinton and Bush administrations, the Bank's official position is no surprise.
9. World Bank studies, including those coauthored by my predecessor as Chief Economist at the World Bank, Michael Bruno (formerly head of Israel's central bank), helped provide the empirical validation of this perspective. See Bruno and Easterly.
10. The Meltzer Commission has argued that the World Bank should get out of the business of lending to middle-income countries. (This body was an eleven-person International Financial Institutions Advisory Commission created by the U.S. Congress that submitted its final report to the Congress and the Treasury Department on 8 March 2000, evaluating the past, present, and future of the IMF and the World Bank.) Ironically, many middle-income countries contend that the World Bank should get out of the business of providing funds to low-income countries. They see the World Bank as a credit cooperative for middle-income countries, not as an aid agency, and believe that many of the problems of the World Bank can be traced to the confusion over these two roles. Moreover, they believe that the World Bank has been used by the more developed countries to force the middle-income countries to subsidize low-income countries. They argue that the margins that they have to pay on their loans include a substantial subsidy for low-income countries. The issue is complicated by a nontransparent accounting system that does not allow a clear tracing of the implicit subsidies arising from return on the Bank's "endowment." One more critique of the views of the Meltzer Commission should be mentioned: net, middle-income countries are not borrowing—new loans just provide the funds to repay old loans as they come due.
11. Contrary to the popular impression, the World Bank receives no significant subsidy from the United States or other developed-country taxpayers. The Bank borrows money on international capital markets and lends it to middle-income countries at a slight mark-up. While the World Bank does borrow at more favorable terms than do developed countries, little evidence exists that the advantageous interest rates that it can then pass on to developing countries result from the effective guarantees from the U.S. and other developed-country governments. There is even some question about how advantageous these interest rates really are for developing countries (though there is less doubt that the Bank gives them access to funds when they are credit-rationed, particularly in crises such as the global financial crisis of 1998). Interest rates are low because the loans have "preferred creditor status"—that is, the Bank gets repaid even if others do not. Extending more preferred-creditor-status loans typically results in other loans paying higher interest rates—implying that the *total* savings in interest payments may be less than meets the eye.
12. The Meltzer Commission would have us believe that capital markets function so well that there is no need for such lending. If the infrastructure project yields sufficient returns to repay the loan, it should be undertaken by the private sector. However, the commission underestimates the role of

government in financial markets in more advanced industrialized countries. It was a government-sponsored agency, Fannie Mae, that effectively created the national mortgage market in the United States. And in recent years, as much as a quarter of all lending in industrial countries has been through government-sponsored enterprises or with government guarantees.

13. Since its first education loan in 1963—to Tunisia, for vocational training—the World Bank has been expanding its financing of education projects for decades. The proportion of new education commitments in the total Bank new commitments (annual average) has increased from 2.9% between 1963 and 1969 to 8.2% between 1990 and 1998, a 1.8-billion-dollar (constant 1996) increase in terms of annual average (see World Bank 1999a). The Bank's expenditure on health-related projects has also increased significantly. For example, spending on fighting communicable diseases (AIDS and tuberculosis) has averaged \$270 million annually in recent years, while for fiscal year 2001, the Bank spent \$1.3 billion (World Bank Annual Report 2001).
14. See also the discussion in the *Financial Times* of the handling of the U.S. Treasury Secretary's highly unusual intervention in the World Bank's 2000 World Development Report on Poverty.
15. There is a curious intellectual incoherence in the IMF's position on this issue, because it constitutes an exception to its usual faith in market economics. Evidently exchange-rate markets do not function well, and government intervention is desirable. Yet the IMF has never articulated well why *these* markets are more subject to market failures than any others, why government intervention in *these* markets is more warranted than in any others, or why government intervention should take the form that it does, rather than, for instance, impeding the short-term capital flows which are a major factor in any overshooting.
16. Indeed, regulation itself requires delicate balancing: good regulation needs to be politically sensitive. Too little forbearance in a recession can exacerbate the downturn; too much can lead to weak banks and a crisis down the line.
17. Focusing on crises does not only entail cutting the IMF's programs for developing and transition economies. The IMF has also been entrusted with statistical-data collection and surveillance of economic performance. Neither of these should be its responsibility. Statistical-data collection is a critical task, and there is growing recognition throughout the world that statistical agencies should be separated from operating agencies. Having the two combined offers some savings, as the operating agency may be better informed about what data is needed and better able to collect it. But the dangers outweigh these slight advantages. Inevitably, the data collected is tainted by operating imperatives and institutional interests. For example, the IMF regularly distorts some of its published statistics, simply because its published growth forecasts must conform to those it uses in its programs, and those numbers do not represent the economists' best estimates, but rather numbers that will make the program "add up"—that is, produce a budget deficit that is "acceptable" to the IMF. Remarkably, many people who use IMF projections do not realize that in many cases, the numbers are simply "negotiated" as part of the IMF program. They are not the result of a sophisticated—or even an unsophisticated—statistical analysis. In contrast, an independent statistical agency has as its sole interest obtaining the most accurate statistics possible in the timeliest way possible.

    The IMF's second additional task is reviewing each country's economic performance. This surveillance has several functions: (1) social pressure to ensure that countries do not "export" their recessions; (2) provision of information to private and public actors operating in the country; and (3) offer-ing advice to the country about what it might do to improve economic performance. In many cases, private parties already perform many, if not most, of these functions far better than the IMF does. To be sure, there is some value in surveillance in those economies in which no private gathering of information and assessing of performance exists. But assessing economic performance entails looking at more than just macroeconomic statistics, which are the province of the IMF. And peer reviews—such as those by similar or neighboring countries—are likely to have more credibility than reviews by international bureaucrats based in Washington, DC, wedded to a particular ideology that is increasingly being discredited and with limited knowledge of the particular characteristics of the country under review.

18. It should be clear that I am not criticizing the IMF on the grounds that its activities in this area duplicate those of the Bank. I believe that there is a role for competition in the public arena, just as there is in the private realm. If meaningful competition were possible—in providing alternative macroeconomic advice, for example—then one might be able to make an argument for having more than one organization engaged in these activities. But the IMF's position that all the international organizations should speak with "one voice" is an attempt to suppress all competition in the arena of ideas. In its patronizing way, it claims that poor developed countries will be unable to sort out the different views, and only the international experts can be entrusted with that task!

19. This is one of the Meltzer Commission's main recommendations, though I would differ from the commission in the particular restrictions that it recommends. The commission seems to believe that certain preconditions (relating mainly to the banking sector) exist that can easily be ascertained and that will reduce the likelihood of a crisis. I am less sanguine. Even countries with well-regulated banks have had crises.

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