

Taken for granted?

US Proposals to Reform the World Bank's IDA Examined

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Introduction

US debt campaigners are siding with the Bush administration against European leaders and other non-governmental organisations (NGOs) over a key source of finance for the world's 79 poorest countries. Discussions on the pros and cons of providing grants instead of loans through the International Development Association (IDA), the World Bank's soft-loan arm, appear deadlocked – with no clear timetable to resolve them.

IDA is refinanced by the rich countries every three years. The concept of IDA grants has been discussed in previous IDA funding for some time. The 1996 IDA replenishment agreement said the Bank could use some resources (in exceptional cases and on a limited scale) for grants. The 1999 IDA agreement said that Bank could use some IDA grants in connection with the Highly Indebted Countries (HIPC) program. But it came as a surprise to many when the US government proposed last year that up to 50% of IDA's resources should be provided in the form of grants instead of loans. This proposal irritated other countries, particularly since the US is one of the least generous aid donors as a share of national income. European governments strongly oppose the US proposal and are reluctant to go much beyond, 10% of IDA going as grants. Some other countries, such as Canada and Japan, are reportedly willing to go as far as 16%.¹

The grants debate also has implications for the amount countries are willing to provide to IDA. France, Japan and Germany have indicated that they want to reduce their proportion of the contributions. The UK has offered to raise its own share of the total to compensate but made clear that the increase was dependent on the withdrawal of the US grants proposal. Clare Short, the UK Secretary of State for International Development has called the grants proposal "crazy" and said that if it goes through "we would look to give more bilaterally instead".²

At the G-7 Finance Ministers summit in Ottawa, Canada, donors agreed to continue discussing IDA to "resolve outstanding issues".³ But no date for a new meeting has been confirmed. A final decision on the IDA replenishment was supposed to be reached early in 2002 to leave time for national legislatures to approve the funds later in the year. This issue may be discussed in the lead up to the Financing for Development conference in Monterrey, Mexico. According to *Economic Justice News*, the US government has asked its embassies to lobby their host government to support the grants proposal and has also approached large NGOs to voice support for the plan.

What follows is a review of the main debates in favour and against the grants plan arranged by issues and concerns. This is not a comprehensive analysis of the issues surrounding the controversy, but it is a starting point for those interested in understanding more about the IDA-13 negotiations.

IDA Facts

- The International Development Association (IDA) is the World Bank Group concessional lending arm. It provides long-term loans at zero interest but with a service charge of 0.75%. Loan repayments start after 10 years and must be repaid within 40 years.
- IDA issued its first loan in 1961.
- IDA committed \$6 billion in new loans last year

- IDA is funded by repayments from previous loans and by contributions from the governments of the richer member countries. Donor governments appoint IDA deputies to negotiate contributions and conditions every 3 years.
- Re-payments by developing countries on existing loans in 1991 totalled \$274 million. By 2000 they were \$920 million and by 2005, may rise to \$1.95 billion.
- IDA and the International Bank for Reconstruction and Development (IBRD) share the same staff, the same headquarters, report to the same president and use the same social and environmental policies when selecting projects.
- IDA lends to countries that had a per capita income in 2000 of less than \$885 and lack the financial ability to borrow from the IBRD.
- At present, 79 countries are eligible to borrow from IDA. Together these countries are home to 2.5 billion people, of whom an estimated 1.1 billion people survive on incomes of less than \$1 a day.
- A two-thirds vote of the donor countries is needed to approve a new replenishment for IDA. The US presently contributes about 20% of IDA's new resources, but it has a 14.8% voting share.
- IDA's default rate is less than 5%.
- World Bank accountants estimate that, in net present value terms, IDA's loans are already 2/3 grants.

The grants proposal: background

Just before the G-8 Summit in Genoa, Italy, President Bush announced his proposal "that up to 50% of the funds provided by the development banks to the poorest countries be provided as grants".⁴ For the World Bank, this means that 50% of IDA's funds should be converted into grants. The rationale behind this proposal is that many developing countries cannot afford even one dollar of additional debt. Loans to chronically indebted and impoverished countries, even at low-interest rates, mean debt build up. In many instances, the US administration argued, grants are a more appropriate way of providing assistance for long-term needs. Investments in social sector programs are crucial, but their growth effects are not realized until many years in the future so generate little income to help repay the loans.⁵

The US grants proposal should be seen in the context of the general US policy approach to the World Bank. "Grants are not free. Grants can be easily be tied to measurable performance or results", stated John Taylor, US Undersecretary of the Treasury, in a recent speech in Washington.⁶ The US grants proposal is one of the three major World Bank reform plans of the Bush Administration in the post-September 11 period. Emphasising productivity growth and measurable results, the other two proposals are "Results-Based Replenishment" for IDA and the continuation of the World Bank's Private Sector Development (PSD) strategy.

Mixed Responses

The grants proposal has been welcomed by some US NGOs. In a joint statement, for example, Friends of the Earth, the American Federation of Labor and Congress of Industrial Organisations, the US Conference of Catholic Bishops and RESULTS urged the US Congress to legislate to require the Treasury Secretary to instruct the US representative at the World Bank to promote the 50% grants target.⁷ Likewise, Oxfam America stated that it "supports the Bush administration's position that half of the IDA funds be grants." Bread for the World expressed support only "on the understanding that the US government will also agree to provide additional funding for the next replenishment".⁸ 50 Years is Enough! Said they favoured grants over loans, but were suspicious of the World Bank as the institution to deliver grants.⁹

Many European governments and NGOs, however, opposed the proposal. Their main concern is that a large grants scheme would deplete IDA's resources over time. NGOs expressed doubts about the implications of and motives behind the US proposal.

Issues and Concerns

Limited Resources

European governments and European NGOs maintain that the grants proposal would "defund" IDA. The UK, backed by several other European countries, argues that a switch to grants on this scale would deprive the World Bank of future income.¹⁰ The UK pointed out that "40% of IDA's resources come from reflows from previous loans. If IDA provided grants, this gap would have to be filled by a substantial increase in donors contributions".¹¹ If overall development assistance budgets continue to shrink it is unrealistic to assume that it will be possible to sustain a substantial grant window within IDA. Michael Hofmann, director general of Germany's Ministry of Economic Cooperation and Development, commented that the grants proposal "can mean only thing: reducing the business of the bank".¹² European NGOs agree that the US cannot be relied on for future pledges.¹³

In the January edition of *Economic Justice News*, the 50 Years is Enough! movement recorded that they do not mind the idea of a weakened World Bank.¹⁴ A US Treasury statement in December 2001 said that the US government might increase its contributions to IDA by 18% compared to the previous IDA round. If performance benchmarks were met, US contributions to IDA would be stepped up from \$850 million the first year, to \$950 million in the second year and then to \$1.05 billion in the third year. Mr. Taylor said the plan would reduce IDA income by only 4% over 20 years.¹⁵ The US government's performance targets are, however, controversial, as they imply that a neutral methodology can be found to assess the impact of IDA funding in poor countries.

Debt Build up and the HIPC Initiative

Grants are advocated as a means to stop debt build up or enhance debt forgiveness. Some supporters of the grants plan point out that services like health care and education do not generate hard currency economic returns, so governments with few resources have to drain other sources of hard currency income to repay IDA loans. Nancy Birdsall, president of the Center for Global Development, a new Washington DC thinktank, said the Bush Administration's proposal would reduce the likelihood of another embarrassing round of writing off unsustainable debt.¹⁶

US IDA negotiators asserted that IDA's good repayment record is misleading.¹⁷ They said that in the past decade, the G-7 and others have agreed to forgive most or all of the repayments due from earlier bilateral aid loans. IDA has become, in effect, a preferred creditor. Donor countries have been willing to forego repayments of their old bilateral loans in order to ensure that debts to IDA can be repaid. IDA's high repayment record is not an accurate reflection of its financial situation.

In contrast, opponents of the grants plan stated that supporters of grants should focus on the merits of the Heavily Indebted Poor Countries (HIPC) program. The UK government argues that the HIPC process "is a much more immediate way to help

the poorest countries than converting new IDA loans into grants, which would only have an impact on debt servicing in 10 years' time".¹⁸

The Meltzer Commission Report

Opponents of the US proposal say that converting IDA loans to grants is only the first step on a slippery slope of implementing the recommendations of the Meltzer Commission. The Commission – which reported to Congress in 2000 – recommended that the World Bank Group be transformed into a grant-making institution.¹⁹ It proposed that the World Bank should cease making loans (except in certain circumstances), focusing instead on special purpose grants, increased aid effectiveness and evaluation of results, proposals that seem to resemble the reform agenda of the current US administration.

Adam Lerrick and Alan Meltzer (co-authors of the report) stressed that grants would be project-linked, monitored for results and paid only for performance. "No results, no funds expended".²⁰ Similarly, Brett Schaefer wrote in a report for the US Heritage Foundation that President Bush's plan is "a variation of the Meltzer Commission Proposal".²¹ Yet US Treasury Department officials deny that the Administration's proposal was derived from the Meltzer Commission report. Rather, they argue, it is based on sound development principles. They remark that Secretary Paul O'Neill was strongly critical of the Meltzer report.

The Private Sector Development (PSD) Strategy Link

In its latest issue of *News and Notices for World Bank Watchers*²², the links between the World Bank's PSD Strategy and the US grants proposal are examined. The PSD Strategy adopts the view that the Bank should finance essential services with a market approach. "Output based aid" schemes are to be introduced where companies tender for projects and charge consumers the full cost of the services they use. Since impoverished people cannot afford fully costed services, grants are needed to subsidize the costs of fees to poor consumers. IDA could provide these grants to governments.

US officials have denied this link between the grants plan and the PSD. Mr. Schuerch from the US Treasury said that the Bush's proposal "has list of purposes for which grants might be used – education, health, water and sanitation and couple of other things. That list does not include private sector activities or private provisioning of services".²³

Grants in the Context of "Aid Architecture"

Challengers and supporters of the proposal also discuss the grants issue in the context of aid architecture. Critics of the grant proposal worry about "mission creep", a concern that IDA might unfairly compete with the smaller UN agencies if it has a sizable grant program. For instance, Beverly Warmington, spokesperson for the UK's Department for International Development (DFID), said that "World Bank is actually a bank and there are development agencies [such as the United Nations, the European Development Fund and bilateral donors] to give grants. It's important that the World Bank work alongside them instead of competing to give grants".²⁴ The UK government also believes that maintaining IDA as a lending institution promotes

effective cooperation between donor agencies, as well as selectivity and efficiency within agencies.

The US negotiators argued that increasingly most foreign aid is provided on grant terms. Almost 99% of bilateral Official Development Assistance (ODA) from richer countries now takes the form of grants, up from 78% in 1989. Many of the countries most resistant to IDA grants give most or all of their bilateral aid to poor countries as grants. They noted that, while the UK was strongly opposing the concept of IDA grants, the UK Chancellor of the Exchequer gave a speech in New York supporting the establishment of a new multi-billion dollar trust fund to address (through grants) the millennium development goals.²⁵

There is a great deal of overlap and similarity among the multilateral banks and the UN development agencies these days in the type of programs they all finance. Some believe that the grants plan “could further usurp the UN role”,²⁶ that is to say the Bank should leave the financing and monitoring of humanitarian and emergency relief programmes and support for NGOs, to the UN specialised agencies and private and bilateral donors. Whether IDA provides loans or grants, the overlap among the international aid agencies anyway merits closer examination.

Balance of Power in International Institutions

To some observers, like the author of the US Congressional Research Service report²⁷, the dispute about IDA loans and grants is not really one about finances. It is “more about the participants’ relative influence in international agencies.” In this regard, there have been calls for a tougher approach in the IDA-13 negotiations on the part of the US. For instance, Brett Schaefer argued that Congress should prohibit any future US participation in IDA replenishment plans until IDA implements the grant proposal. The Bush administration is anxious for an agreement where 50% of some type of IDA assistance will be allocated as grants. Otherwise, the new IDA 13 replenishment bill may face renewed criticism in Congress as well as opposition by the administration’s conservative allies. By contrast, with a 50% agreement of some type, the administration might be able to present the replenishment plan a victory and a demonstration that the World Bank can be “reformed”.

From a European perspective, the debate on IDA grants seems to indicate a situation where influence in international financial institutions (IFIs) will be more evenly distributed and where – unless the US makes major efforts to increase its financial support – the Europeans will seek and find a larger role. Interestingly, to many observers like Professor Robert Wade, that is what is already happening in Europe. He said that G-4 countries (France, Germany, Italy and Great Britain) are devising their policies more in consultation with one another than in separate consultations with the US. A “milestone” was achieved in mid-2000, he argued, when in mid-2000 at the G-7 Finance Minister meeting, the Finance Ministers of G-4 flew together and arrived together to the summit venue, something that shocked the US Treasury Secretary.²⁸

North-South Power Relations

From the recipient countries, Jubilee South claimed that grants would make the World Bank more powerful, since poor countries’ governments would be willing to agree to even more conditions, regardless of the consequences, to get free money.²⁹ Others said that the grant proposal would only further encourage a culture of

dependency. Concessional-rate loans appear more acceptable, in the context of power relations between the richest and the poorest countries, to the prospective recipients than do grants.

The UK has also argued that IDA loans enhance borrowing country ownership in line with recent moves to encourage developing countries to set their priorities through national consultation processes.³⁰ The UK also argued that IDA's role is to provide a bridge between ODA and non-concessional borrowing and, in due course, access to private credit; it enables its clients to demonstrate their commitment to fiduciary responsibility. If the poorest countries are never able to look forward to responsible borrowing then they will remain locked in underdevelopment.

Finally, as Devesh Kapur, Professor Wade³¹ and other commentators have been arguing in recent years, the 3-year IDA replenishment system undermines the multilateral spirit of the Bank, because it makes IDA dependent on the rich countries' in general and US domestic politics in particular. One way to avoid this financial dependency would be for IDA to achieve financial independence through the reflows from past loans. During the next 10 to 15 years, IDA will likely find that the loan reflows will be sufficient to make IDA's resources independent from donors contributions. Moving to a grants system, would greatly delay any estimate to achieve IDA's financial independence in the coming years.

The Negotiations Ahead

Mr. Taylor is reported to have said that "we will go all the way to Bush's proposal – I don't see it as a bargaining situation".³² Meanwhile, Treasury Secretary Paul O'Neill said the US was indicating some flexibility in what percentage of aid should be made in the form of grants, but suggested that 10 percent is too low.³³ Both Mr. Taylor and Mr. O'Neill's firm language may be a negotiating ploy to push the other donor countries towards accepting a larger grant program than they might otherwise be willing to support. With the US seeking broad multilateral support in its efforts to combat international terrorism, there seems to be little room for successful application of a take-it-or-leave-it approach to IFIs issues.

As mentioned above, there have been calls for the Congress to prohibit any future US participation in IDA replenishment plans until IDA implements the grant proposal. This demand presumes that an IDA replenishment cannot go forward without the participation of the US. This was true a decade ago, but in recent years the US share has fallen below the minimal level necessary to block implementation of an IDA replenishment plan. In 1997, the US was in payment arrears, which led to other donor countries to suggest the creation of a new international agency to replace IDA and that the US would not be invited to join. The next year, the US Congress fully clear IDA arrears.

American officials had hoped to persuade European leaders to back the grants proposal before Mr. Bush attends the Financing for Development conference, but many observers doubt that the US will be able to do so and that any agreement will be much more modest than Mr. Bush and Mr. O'Neill once foresaw. Or as one Bank official put it "everyone knows its going to end up somewhere in the middle, but they haven't gotten to that point yet".³⁴

Conclusion

The Bush administration is drawing parallels between the post-September 11 period and the post-World War II period. They see the necessity to reform the international economic system, as their predecessor did at the end of the Second World War. As Mr. Taylor argued, to prevent any future terrorist attack it is "imperative" to find new ways to end the poverty that can be a breeding ground for terrorism. This apparent acceptance, among the general public as well as the political establishment, makes them anxious about getting measurable results. To this end, they want to use the World Bank's IDA to channel the necessary resources, in the form of grants, to reduce world poverty.

This proposal has generated a lot of concerns especially from European governments on the long-term financial impact a large grant program might have on IDA. In their opposition to the grants scheme, European leaders are showing a lack of confidence in the US commitment to the long-term viability of IDA's resources in particular and IFIs in general. In the meantime, perhaps more importantly, implementing the HIPC initiative and the opening up of rich-country import markets, especially eliminating restrictions on agricultural and textiles imports, could help put the poorest countries on sustainable growth paths. Moreover, this dispute should not distract us to campaign for a serious effort to increase the mean amounts the US spends on development assistance as a percentage of its GNP.

There is no single solution to the dispute between IDA grants and loans: neither 50% of IDA's resources in the form of grants, nor 90% of IDA's resources in the form of loans, nor more replenishment for the Bank, nor simply forgiving IDA's past loans, nor a better balance of power in international institutions, nor ensuring developing countries' ownership, nor increasing US development assistance, nor re-defining IDA's scope in comparison to UN development agencies, nor eliminating restrictions on imports from poor countries. The governments of the rich countries need to do all of these, over a period of years, in order to reduce the poverty that can be a breeding ground for terrorism. The IDA grants/loans dispute shines a light on current aid politics, but cannot not resolve them in itself. Rich country negotiators are taking for granted that the compromise they reach will be in the interest of the world's poorest people.

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