The World Bank in Historical Perspective

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Of the three pillars of the postwar international economic order, the IMF, the GATT, and the World Bank, the last was arguably the institution that required for its creation the greatest leap of imagination. Maintenance of a stable monetary system was well understood to be a primary responsibility of national governments, and the monetary disorder of the interwar period had taught policymakers the value of international monetary cooperation. Similarly, trade policy was an obvious responsibility of national governments, and the unhappy experience with the restrictive and discriminatory policies of the interwar period had made obvious the need for a multilateral mechanism to induce national governments to commit themselves to open and nondiscriminatory trade policies. Perhaps for these reasons, debate over the shape that the IMF and the GATT should take were primarily debates over how they should operate, not over what they should do.

However, the need for a public, multilateral institution devoted to channeling capital from areas where it was plentiful to areas in need of economic reconstruction and development followed far less obviously from the conventional understanding of the 1940’s about the role of government and the need for international cooperation. Capital had long been so channeled through private capital markets, and official loans, grants, and guaranties were commonly extended on a bilateral basis. There were, furthermore, well understood economic and political advantages of these arrangements. The magnitude of the conceptual break represented by the World Bank is indicated by the fact that the debate surrounding its creation was very much about what it should do, not just how it should do it. In this sense the World Bank—and the regional development banks that followed its precedent—can be viewed as the most impressive of the institutional monuments to the vision that informed the Bretton Woods system.

This paper discusses the evolution of the World Bank, focusing on two aspects of the institution that make it exceptional. The first is its character as a public, multilateral institution responsible for directing credit toward developing economies. This feature was very much intended by the Bank’s founders, though there was substantial debate over exactly what it would mean for, in particular, the Bank’s relationship to private lenders, a debate that is if anything more pertinent today than it was in the 1940’s. Our second focus is on the major role played by the Bank as a source of ideas on economic and social development, a role that was not anticipated by its founders, but which has become increasingly important as the scope of the Bank’s activities and of its influence over economic policy in borrowing countries has broadened.

I. The World Bank as a Public, Multilateral Lender for Development Projects

Building a truly international organization, in which all members had some stake and felt responsible for decision-making, was a central objective of the World Bank’s intellectual father, Harry Dexter White, from the very beginning. It was not obvious to all that this objective was in fact desirable or that it would be achieved. In early discussions over the shape of the Bank, its multilateral character came under fire from several directions. On the one hand, it being understood that the United States would, in its crucial early years, be the only

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significant creditor of the Bank, questions arose why any country other than the United States should have a say in its lending decisions. On the other hand, some European countries wondered why they should commit their extremely scarce reserves of gold and foreign exchange to an enterprise that was supposed to relieve such scarcities, while others wondered about the economic logic of requiring the contribution of currencies for which there was little likelihood of demand by borrowers. To these arguments White replied that debtor countries would feel responsible for the success of the enterprise only if they, as well as creditors, had some say in decision-making, and if they had contributed something to it (Robert Oliver, 1975 p. 126). In the end, White's original conception of the Bank as a truly international institution prevailed.

The implications for the Bank were, of course, enormous. The Bank is not generally considered the "property" of any country or group of countries. The Bank's policies often attract enormous hostility from both governmental and nongovernmental observers, but because of its international character the hostility generated by unpopular advice and conditionality is almost certainly less, and its ability to withstand political pressures substantially greater, than could be true of any national development agency.

Though they obviously felt the need for a public presence in development lending, the Bank's creators were also keenly aware that, whatever its deficiencies, private investment would have to remain an essential part of the international lending scene. And policymakers were anxious to ensure that the Bank proved complementary to private international lending, though it was not obvious how to ensure this, or how best to structure the Bank's relationship to the private lending community.

A policy decision that decisively shaped the Bank's structure in this regard was whether the Bank should primarily operate by participating in and guaranteeing private loans or should instead make loans on its own account, from its capital and borrowed resources. This issue was discussed at much length in the negotiations that preceded the Bretton Woods agreements. The Europeans, and Keynes in particular, argued strongly that the guarantee function should predominate. This attitude stemmed in part from a desire to minimize capital contributions to the Bank that would be required during a period of extreme scarcity of foreign exchange. It was also motivated by a desire to avoid what Keynes termed "...the absurd proposition of debtor countries being responsible for international investment" (Oliver, 1975 p. 151).

There was little disagreement about the desirability of the Bank using its power to provide full or partial guarantees of private loans, and there is considerable evidence to suggest that these were expected to be important. However, within a year of the Bank's inauguration, it was obvious that the Bank would place almost total emphasis on direct lending rather than guarantees or participation in private loans. Consequently, the Bank could develop greater independence from financial markets in determining the projects to be financed and the terms of the loans that it provided to its borrowers.

The desirability of a public Bank that substitutes its judgment for that of the market in so many aspects of its lending program, if controversial in the 1940's, is even more so today. Did the imperfections in international capital markets of the postwar era, as perceived by the founders of the Bretton Woods institutions, justify an international bank of this sort? Do they continue to do so?

The answer to the first question depends upon the underlying market imperfection that is supposed to have distorted private lending decisions. The rationale that most often appears in early discussions of relation between the Bank and private investors, is an assertion that there are "special risks" involved in international lending, and that private investors will not be sufficiently willing to accept those risks. Policymakers were seldom explicit about exactly what these risks were, and when they were they were often unconvincing. An early statement of Bank policies (International
Bank for Reconstruction and Development, 1954) argued:

This does not mean, of course, that the Bank adopts the standards of the market place in determining how much it can lend to individual countries. On the contrary, as already noted, one of the principal purposes of creating the Bank was to have an agency which could accept the special risks inherent in international investment in cases where, by reason of those risks, private investors were unwilling or unable to act unaided. For example, so long as the danger of a third world war remains, the Bank must accept this risk if it is to achieve the purposes envisaged in its Articles of Agreement. Similarly, the Bank has to accept the risk of a recurrence of a world-wide depression of the type experienced in the 1930's…. (p. 42)

Of course, "special risks" like these provide no legitimate justification for a public role in international lending. Wars and depressions clearly affect the returns on investment of all kinds, but it is far from obvious that they drive a wedge between private and public returns. And there is something more than a little schizophrenic about an agency that preempts potential private lenders because they are allegedly too risk-averse, then demands that its loans be senior to any others, thereby shifting most of the risk onto private investors in unrelated projects, whose loans have thereby been subordinated.

But elsewhere in the document a different kind of risk is discussed, which we would today label "policy risk." The Bank recognized very early that a country's overall policy environment has a material influence on the productivity of specific investments, and on prospects for repayment. It sought to encourage desirable policies by requiring "...as a condition to Bank financing, that the borrowing country institute measures designed to restore stability to its economy" (International Bank for Reconstruction and Development, 1954 p. 54). It counted among undesirable policies a hostile or discriminatory attitude toward private international investment, and in particular endured considerable opprobrium by refusing to make loans to countries that remained in default of their international lending obligations, thus attempting, at any rate, to reduce the risk of expropriation and default faced by international investors. It argued that its attempts to improve the policy environment through such conditionality, and through its technical assistance efforts on behalf of borrowing governments, served to improve the climate for private international investment.2

In this it was probably correct, for the fact that the Bank is owned by the very governments that it is attempting to influence provides it with an ability to help governments overcome domestic political constraints that could not be matched by private lenders. Ironically, it is more plausible to locate the Bank's comparative advantage in assisting development in the presence of weaknesses and distortions in member countries' domestic political processes than in overcoming the international capital-market imperfections that so concerned its founders. If so, this suggests that, much more than its lending operations per se, the Bank's role as policy advisor and institution-builder has been the key to its impact on economic development.

It also suggests a future role for the Bank even more durable than some of its early advocates imagined. John J. McCloy, the Bank's influential second president, thought that the Bank was a temporary institution,

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1If the probability of war or depression were exogenous to the amount of international lending, then there would be a rationale for a governmental role. This does not seem to be what policymakers had in mind when discussing inadequacies of international capital markets. Indeed, from very early on the Bank dropped the idea of making its lending program responsive to the international business cycle, as had been proposed.

2The requirement that members of the World Bank also be members of the International Monetary Fund provided an additional incentive for countries to accept the financial disciplines implied by such membership.
the need for which would disappear as international capital markets became more nearly perfect. To the extent that the Bank's role stems from its unique capacity to influence the domestic policy environment, it remains as important an influence for economic development today as it did in days of more limited international capital mobility.

II. The World Bank as a Source of (and Proselytizer of) Ideas on Development

This brings us to the second distinguishing feature of the World Bank, its role as a conveyor belt of ideas about development policy to the borrowing countries. It is difficult to overemphasize the part played by the Bank in this regard. Thanks to its far-flung lending operations, the Bank is the single most important external source of ideas and advice to developing-country policymakers. World Bank research and publications such as the influential World Development Report are widely distributed and read around the world, are well covered in the media, and are disproportionately represented in the syllabi of graduate programs in development economics around the world.

The Bank's ideas about development have changed over time, as have the keywords used to describe them. But at least since the mid-1960's, the Bank's name has always been associated with a particular set of ideas about what constitutes important development priorities facing poor countries. These views have been quite influential, as can be gauged by the fact that the Bank has been second only to the IMF in the amount of criticism it has drawn from both the right and the left. As Edward Mason and Robert Asher (1973 p. 331) put it: "Good advice is rare, and good advice that is listened to is even rarer. But the Bank provides a powerful amplifier—the prospect of capital assistance to finance its recommendations."

Neither White nor Keynes foresaw that the Bank would play such an important intellectual role, and nothing in the Bank's charter actually required that it would do so. In fact, the Bank had a rather inauspicious beginning in this regard. In its first few years, the institution was dominated by bankers who had little faith in economics and economists. The first director of the Bank's Research Department (later renamed Economics Department), Leonard Rist, had by his own admission only a limited knowledge of economics and was selected in part because of that. Probably the most prominent economist on the staff in these early days was Paul Rosenstein-Rodan, who continuously sparred with the management on issues of lending policy. Rosenstein-Rodan was eventually to resign in exasperation and take a professorship at MIT, to the relief of many at the Bank.

What forced the Bank to enter the business of development "ideas" was the environment in which it found itself operating. Borrowing countries sorely lacked the technical expertise needed to prepare project applications. In addition, the Bank had to be concerned about the repayability of the loans it was making, and the notion of sovereign creditworthiness was one which required serious thinking. Finally, the fact that the soundness of the projects to which the Bank lent money ultimately rested on the overall quality of policy-making was recognized very early on.

Hence, the Bank was required from the very beginning to have ideas about what constituted an appropriate policy context. This policy context was initially construed quite narrowly, but its scope broadened substantially over time. To the Bank's early concern with balanced budgets, sound tax systems, and monetary stability, were added in the 1950's the needs for national development plans. The Bank began to stress the role of the private sector during the 1960's, and of rural development and population policies in the 1970's. The 1980's in turn were the decade of "structural adjustment" and "outward orientation." One implication of this is that conditionality was part of the

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Bank’s approach to lending from practically day one. Bank money always came with ideas and advice attached.

Where do the ideas themselves come from? Early on, the Bank’s dependence on bond markets for financing its operations exerted a determining influence on its ideology. The view that lending should be done in a way that would not jeopardize the Bank’s access to private capital markets was dominant among the bankers who ran the institution. This had a number of consequences for the Bank’s thinking on development. For example, the early emphasis on infrastructure projects (transport and power, mainly) was in no small part a reflection of the need to demonstrate to Wall Street a portfolio of concrete, bankable projects. The neglect of social sectors (health and education) until the 1970’s was a result of the perception that projects in such sectors were not readily bankable in the sense of generating revenue to repay the debt. 4

Early conservatism on such matters may have increased the Bank’s autonomy later on. The Bank eventually attained triple-A credit rating in the mid-1950’s, and its management became less preoccupied with the need to appeal to bond markets. Still, the need to maintain the rating continues to act as a constraint on the nature of ideas about development that the Bank can generate and nurture.

As the Bank’s creditworthiness became more soundly established, the institution became more open to other influences. During Robert McNamara’s presidency (1968–1981), the Bank considerably reoriented its focus from infrastructure projects to antipoverty programs. At the same time, the reliance on economists within the institution and on economic ideas progressively increased. A number of prominent academic economists, starting with Hollis Chenery in the 1970’s, became chief economists and played high-profile roles within and outside the institution. It was during the 1970’s that Bank economists became significant contributors to the literature in development economics. In 1994, the Bank’s research budget stood at $26 million, an amount which vastly exceeds, for example, the National Science Foundation’s economics budget ($16 million).

Yet the Bank retained its conservative style in economic research. It is difficult to pinpoint a single important idea or method in development economics that has its origin in the World Bank. One has to agree with Mason and Asher’s (1973 p. 257) early evaluation: “it cannot be said that the Bank has been an outstanding leader in applying new techniques of project appraisal or analysis of development processes.” Where the Bank’s strength lies is in its tremendous powers to spread and popularize ideas that it latches on to. Once the Bank gets hold of an idea, its financial clout ensures that the idea will gain wide currency.

Hence, the Bank was slow to adopt some of the early innovations in the field of project evaluation. Mason and Asher (1973 p. 468) report that Bank staff began calculating discounted cash flows long after the technique had become standard procedure in the business world. Similarly, shadow pricing came to the Bank “slowly and haltingly” (Mason and Asher, 1973). The concepts of effective rate of protection (ERP) and domestic resource cost (DRC) were developed outside the Bank. Yet the Bank played a critical role in the dissemination of some of these techniques. 5 In the area of broad development strategy, the situation has been similar. The emphases on human resources and poverty in the 1970’s, and on outward orientation in the 1980’s, had their origin in research and ideas developed outside the Bank. But the Bank made these ideas its own and managed to transform the

4The Bank’s first loan in education was made in 1962; there were only three small loans in the area of health before 1971 (see Mason and Asher, 1973, pp. 204–5).

5For example, Bela Balassa’s influential work calculating ERP’s for a range of developing countries was done for the Bank and published by it (Balassa et al., 1971).
terms of ongoing development debates accordingly.

III. Is 50 Years Enough?

In 1951, a group of prominent outside experts (including two future Nobel-prize winners, Sir W. Arthur Lewis and Theodore W. Schultz) complained that the World Bank "has not adequately realized that it is an agency charged by the United Nations with the duty of promoting economic development" (cited in Mason and Asher [1973 p. 384]). The criticism is hardly valid today. The Bank may not be at the forefront of economic ideas, but it is certainly in the trenches when it comes to supplementing inadequate resources and fighting bad policies (and their consequences) in its member countries. The answer to the question of this section is, then, a solid "no." Economic development still needs all the friends it can get.

REFERENCES


