What impact has the global financial crisis had on the role of the multilateral financial institutions in development?

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The World Bank (hereafter WB) was set up after World War II to support the promotion of post-war European reconstruction[1]. Shares in voting are determined by the economic weight of each country and their contribution to the International Development Association (IDA), which provides grants and low interest loans (soft lending) to the poorest countries. The other major lending arm of the WB is the International Bank for Reconstruction and Development (IBRD), which provides near-market rate lending to middle-income countries (Winters, 2011:20). Extra votes are given for nations willing to make additional contributions to WB capital, however countries must demonstrate a commitment to a more equitable voting system between Part 1 (developed countries) and Part II (developing or transition countries) over time[2]. This essay attempts to give a short but holistic overview of the impact of the Financial Crisis (hereafter FC8) on the WB by comparing the pre-crisis and post FC8 WB. It finds the increase in capital to the WB was modest and went to middle income countries and voice reforms have stagnated at inequitable levels. Thus, overall diverting the WB away from its mandate to fight poverty and rendering it ineffective at combating the financial problems of the poor.

Pre-Crisis World Bank

Between the 1940s and 2000s, the US was undoubtedly the primary account holder of power over the WB. WB presidency has remained a US national and the US has

[1] For a comprehensive overview of the WB, see Ngaire Woods (2006).
[2] For Part I and II countries see World Bank (2013).

power of veto over decisions requiring a super majority. This allows the US to independently reject or block changes alone, further consolidating US power to direct global policies. The US and the WB was highly influential in its global reach. Specifically, the WB had a leading role in development by bridging capital flows in post-war reconstruction countries (Rajan, 2008:110).

From the 2000's the WB's seemed like it was becoming increasing obsolete and irrelevant as the leading lender to the World. Growing financial globalisation and integration eroded WB finance as 'the missing ingredient' in development projects (Rajan, 2008:110). Mishkin (2009) has shown that increased financial globalisation has been important in freeing the flow of capital around the world such that developing countries have benefited from Foreign Direct Investment, encouraging what Arvind Subramanian (2010) has coined 'the foreign finance fetish'. Subsequently, there was a shift in demand for the WB to focus its efforts on the liberalisation of capital-account flows globally.

Furthermore, the shift from a US led Unipolar to a multipolar system has meant that private capital markets can provide developing countries with finance on favourable terms and fewer conditions (Birdsall & Fukuyama, 2011). Robert Wade (2011:351) calls this the 'rise of Multipolarity …a fall in the concentration of economic activity in the international system and within this the rise of concentrations outside the previous core'. This may be attributed to China's 'rise', for example, in terms of output per head compared with the US (it increased from 6 percent to 22 percent between 1980 and 2008) and the rise of emerging markets such as the BRICs (Brazil, Russia, India and China) (Wade, 2011:251). This new group of global economic players left the role of the WB increasingly antiquated in the pre-crisis era (Birdsall & Fukuyama, 2011).

Post FC8

FC8 was created by a myriad of causes amongst which US regulators allowed Lehman Brothers to go bankrupt leading to ensuing global panic and an almost complete seizure of trust in the real economies of the World (Economist, 2013). Ironically, non-intervention in the Lehman downfall meant that regulators had to rescue many other companies to curb the panic, not just in America but also across the globe.

The FC8 imposed stringent constraints on the developing world in terms of government spending, private property, corporate bonds and capital infrastructure. This lead to increasing demands for WB loans as central bankers and governments attempted to restore trust to their domestic markets. In response, on 25th April 2010 the WB announced a general capital increase (GCI) of US$86.2 billion for the IBRD reaching nearly US$1 trillion overall (Birdsall & Fukuyama, 2011:53). Additionally, there would be a reform in the voting structure to favour Part II countries, and progress in equitable voting would be reviewed every five years.

Lending to Middle Income Countries

Birdsall & Fukuyama (2011:52) argue the GCI 'breathed new life and legitimacy' into the WB as the G-20 leaders agreed to the additional resources to help countries weather their domestic finance. However, the real impact of the GCI was relatively frugal. According to Wade (2011:361) the increase in capital was small and 'probably only big enough to allow the Bank to sustain beyond 2014 the same level of lending in real terms as in the early 1980s'.

Overall, lending did increase significantly post FC8 but mostly to middle income countries. By the 2009 fiscal year, WB lending rose 90 percent from 2008 levels where loans from IBRD increased 144 percent but in contrast, IDA lending increased by only 25 percent (Winters, 2011:22). This reflects the Banks changing focus to development policy loans to middle income countries[3]. Countries receiving loans (US$1billion plus) from IBRD during the FC8 include Brazil, Hungary, India, Kazakhstan, Mexico, Poland and Turkey (WB, 2009; Winters, 2011). Compared to the IDA, the IBRD became increasingly responsive to middle income countries demands for loans. Winter (2011) claims this will have positive developmental spill over effects for the poorest countries, if true at all, these will not be realised for decades. Thus, the WB's role in development has shifted away from supporting poor country development in favour of middle-income countries.

Voice Reform

The real impact of the FC8 was that the need for capital increased the legitimacy of voice reform claims by middle-income countries being asked for an injection. As Wade (2011:360) points out,

> 'the main driver of the reform package at the World Bank was demands by the external shareholders, led by the United States, for reforms that looked bold and could be sold to legislators as quid pro quo for more capital at a time of fiscal stringency'.

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[3] Development Policy loans support the budgets of governments in order to aid institutional and policy reform.

This is one reason the biggest supporters of the CGI were middle-income countries such as Argentina, Brazil, India, Russia and China, each of which hope for greater demand in participation and norms (voice) at the Bank (Bretton Woods Project, 2009). Richer countries, which view themselves as under-represented, also wanted greater political say and showed their support for voice reform, for example South Korea.

After reform the WB claimed Part II countries at the IBRD would increase voting share by 3.13 percentage points to 47.19 percent as of March 2010 signifying an aggregate shift of 4.59 percent since the start of discussions in April 2008 (Parliamentary Network, 2010). There were no new voting shares created for the IDA, however, according to the WB (2010) Part II IDA member countries voting power had increased up to 45.59 percent from 40.1 percent since the start of reform discussion. Officials claimed this represents ‘significant progress’ (WB, 2010).

In reality, the reform package was far from ‘significant’. Once high-income countries in Part II have been excluded, only 4.3 percent of voting power at IDA has shifted towards low-income countries (Bretton Woods Project, 2010). Furthermore, this apparent re-structuring of voice reform in ‘favor of developing countries’ has set a worrying precedent. It now places a heavy emphasis on economic weight (75 percent), followed by countries contributions to IDA (20 percent) where both of these criteria favor middle-income and rich countries (Bretton Woods Project, 2010). Since no further reform is on the cards within five years, it is likely that voting shares will plateau at these inequitable levels. At this snail rate of change, it becomes clear that the FC8 did not spur the WB to reform its institutions such that developing countries could have parity of vote with developed nations. This disappointing path renders the WB's role in development largely ineffective in its mission to combat poverty.

Conclusion

Against the background of an increasingly multipolar global financial system, the FC8 had a disappointing impact in terms of pushing the WB to give greater power and voice to the poorest countries. Despite some voting reforms, the capital increases were modest and were directed at middle-income countries. It is yet to be fully determined if the positive spill over effects from these loans will have any impact on the poorest people. Thus, in the wake of the FC8 there has been no real intent to reform the WB to fight poverty. Let us hope it will not take another financial crisis to see meaningful reform.

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