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A run on the World Bank

By Richard W. Rahn
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If you were a stockholder of a bank and its managers kept telling stockholders they would have to "write off" the loans they had made because the borrowers were in no position to repay them would you fire the management for incompetence? If you are a taxpayer, particularly an American taxpayer, you are a stockholder in such a bank -- the World Bank -- to be specific.

The World Bank was set up in 1944 (along with the International Monetary Fund) to assist with post-World War II reconstruction. Its mandate is to reduce world poverty and promote economic growth but, in fact, many of its activities have had precisely the opposite effect. It now has 184 member countries, but most of the $400 billion it has dispensed in loans, grants and credits have been underwritten or guaranteed by the taxpayers in a few rich nations.

Over the decades, numerous independent studies and official commissions (including some internal evaluations by World Bank staff) have found numerous activities of the Bank have not been cost-effective and often are counterproductive.

At the moment, many of the world's poor nations are demanding debt forgiveness by the World Bank and other aid institutions, and many political leaders in the rich countries have expressed sympathy with these demands.

Forgiving the debt may sound like the charitable and humane act, but the reality is not so simple. Some poor countries, like Bangladesh, have been very responsible in paying back their debts. If some countries have their debts forgiven, the message to the responsible countries is, "You are fools."

Also, if the debts are forgiven, the high-salaried World Bank officials who made the bad loans do not pay the price but taxpayers, many who are in fact not well off, even though their countries are viewed as rich. As the late, highly regarded development economist, Lord P.T. Bauer wrote, foreign aid is often "taking money from poor people in rich countries and giving it to rich people in poor countries." (The United Nations, the Organization for Economic Cooperation and Development and numerous public and private development organizations also keep demanding that taxpayers in rich nations pay more despite the overwhelming evidence it does not work and leads to corruption or worse.)

The basic problem is the World Bank is based on the false premise that the way to make poor countries rich is to give them money from rich countries. Instead, what has been created is the country equivalent of the "welfare queen," whereby corruption is encouraged and productive labor and investment discouraged. It was only through the activities of the World Bank and other aid institutions that Third World dictators were able to get extremely rich while their people slipped into ever deeper poverty.

Rich countries became rich not through foreign aid but by creating the proper institutions and incentives, including the rule of law, free markets and protection of private property.

Last year, the World Bank loaned $11 billion to developing countries, with the argument that loans for projects were not available from normal commercial sources or the interest rates would have been too high.

If the projects made economic sense, and if the borrowers were considered reliable and honest, the global capital market would have provided all of the money needed at competitive interest rates. It is easy for World Bank officials to make such loans, because it is not their money at risk. It is easy for Third World officials to take the money because they will spend much of it on themselves. When the loans go bad, others will be stuck with the liability.

This week, Paul Wolfowitz took over the World Bank presidency from James Wolfensohn. And the World Bank has just set a 60-year record of failure. If Mr. Wolfowitz decides he would like to break the mold and become a successful World Bank president, first he will need to get the bank out of the "lending" business.

Most of the lending has only propped up government monopolies and underwritten government inefficiencies and corruption. (Many objective observers, including several former high-ranking Bank officials, believe it should be abolished but, unfortunately, neither the Bush administration, nor Congress nor officials in other rich nations have the guts to do so.)

Without a responsible rule of law that protects private property rights, incentives and free markets, there can be no sustained development. The World Bank, to be at all successful, should limit itself to programs that support the responsible rule of law, such as underwriting "law and economics" programs, collecting and reporting statistics, and short-term humanitarian aid.

The Bank should make no loans, grants and provide no credits to countries that do not protect private property and free markets. Since the Bank is unlikely to do this on its own, the U.S. Congress should make it a condition of any future support.

Richard W. Rahn is a senior fellow of the Discovery Institute and an adjunct scholar of the Cato Institute.