Governance in an International Institution - The World Bank and its Reorganisations

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I. Abstract

The governance of an institution is normally partly ensured by other institutions, which depend on yet other institutions for their governance. But who ultimately guards the guardians? For the liberal electoral democracies of Europe and America the answer that evolved from the political thought of the eighteenth century and the limited liability joint stock company of the nineteenth was, crudely put, checks and balances and voters, who could be the electorate or shareholders. Its limitation is that it presupposes a state and the right of the voters to vote in their own interest. How, then, can good governance be ensured for international organisations, especially the World Bank and the International Monetary Fund, in which the representatives of the developed countries hold the majority of the votes on the Boards and are expected to cast them, not in their own immediate interests, but in the long term interest of the developing countries that borrow from these institutions?

For a long time the question did not seem to arise, the only departures from good governance that the Bank was accused of was that its decisions were on occasion influenced by politics, an accusation that did not seem to hurt the institution. The major shareholders, notably the US, were widely believed to have used their power in the Bank to help, deny help or even harm a country or government for motives other than the economic development of the country. Such behaviour is contrary to the Articles of Agreement of the Bank, but the financial markets on which the Bank depended were, if anything, inclined to share the same political biases. Nor were major shareholders of the Bank who disapproved likely to make an issue of it, while the governments that thought they had been treated unfairly and in violation of the Bank's statutes refrained from breaking off with the Bank. Invariably, once such a government had been replaced by one the major shareholders approved, the country resumed borrowing from the Bank. Politically influenced behaviour, provided it was only occasional, did not jeopardise the governance of the Bank and could be tolerated.

The question of governance was finally raised for the Bank in 1986, when allegations that it was over-staffed and cumbersome led to a succession of changes in its internal organisation imposed from outside. Upon

becoming President of the Bank that year, Mr. Conable began preparation for a reorganisation that was carried out in 1987. Some of the salient features of the new organisation were changed soon after and, when Mr. Wolfensohn became President in 1995, a further reorganisation was started that culminated in 1997. The history of the Bank in recent years is, therefore, unlike that of the IMF, which, despite having practically the same external governance mechanisms, has remained unchanged in all important respects; rather it resembles that of UNESCO, the ILO, and the United Nations Secretariat, bodies that have all gone through some reorganisation.

But the requirements of governance at the Bank are different to those of the other UN bodies that have been reorganised; because of the large amounts that it lends to developing countries and the governance functions it itself performs in these countries as a consequence, the Bank is subject to pressures that these bodies are not. To the extent that it was successful in carrying out its mission despite the pressures, it was because it had robust mechanisms of governance. Taken together, developing countries can borrow over $ 20 billion a year. To ensure that this money is correctly used, the Bank must often exercise governance over individual government agencies that implement the projects being financed and sometimes over the government itself. Its governance is also frequently demanded because the Bank's approval of a country's economic management can be needed for obtaining aid from other sources, for rescheduling external debt or for reassuring financial markets. This often means that measures must be carried out that powerful interest groups in the country oppose or that cause widespread discontent. Almost all governments of borrowing countries have found that, at some time or other, perhaps all the time, their relations with the Bank involved high stakes. There has always been motive enough for governments or interest groups to influence the Bank's decisions by offering inducements to its staff.

Yet this did not happen. Up to 1987 the governance of the Bank coped with the pressures. The most obvious evidence, perhaps, was the Bank's reputation for being rigid in applying its methods and standards. To its critics it was doctrinaire and heartless. Neither they nor its supporters suggested that the organisation had become lax in imposing its economic doctrines or that its staff was amenable to personal favours.

In place of a watchful external authority, the Bank relied on internal controls, what can be termed for present purposes, “internal governance”, as opposed to the “external governance” deriving from bodies that do not come under the authority of the Bank's management. Their most elaborate form was reached when Mr. MacNamara, as president, reorganised the Bank in 1972 to cope with a rapid growth of its lending and a wider range of

purposes for which it would lend. Some of its features are described below, but its basic logic was straightforward. A substantial part of the Bank was occupied with watching over the activities of the other parts and almost no decision that committed the Bank could be made by a staff member without referral to some other member answering to managers in a different line of command. There was close and independent scrutiny; but it was also collaborative, the scrutinising staff provided expert advice case by case and formulated guidelines, usually in the form of policy notes or papers, for dealing with the myriad specific and general issues that arose in the course of operations and seemed to warrant special attention.

As will be seen, the author believes that the Bank has greatly helped the developing countries, through its loans, its technical expertise in preparing projects, its advice on managing their economies in its reports and, most of all, the governance it provides. Developing economies usually do not have the governance mechanisms of the developed countries, notably the checks balances and voting systems of the democratic market economies, and the Bank often substituted for them. It was bound to fail often, given the magnitude and complexity of the task, but overall its successes were greater than is commonly realised. Some of its failures might be attributed to its economic doctrines - and the author has reservations of his own about some of them - but doctrines are not the subject of this discussion. The subject is how the governance of the Bank affects the governance the institution performs for the developing countries. These countries are still putting their own governance mechanisms in place and, for a long time, they will need a World Bank that can help them there.

II. The Reorganisation of 1987

The organisation put in place by Mr. MacNamara can be said to have been a success in the sense that it lasted, with only minor changes, through a large increase in the volume of the Bank's operations until 1987, without damage to the Bank's reputation. Design of the organisation that replaced it was entrusted in 1986 to a number of committees composed of Bank staff members. In mid-1987 the new organisation began to function, while roughly 600 staff members left with separation packages. It was not a success in the same sense, major changes were made almost immediately and it did not last ten years.

Most of the following discussion concerns the reorganisation of 1987 and the questions of governance that arose from it. Since the reorganisation of 1997 does not address these questions, and what has been said and written in its justification shows no awareness of them, there is no need to discuss it in the same detail. Of the two, that of 1987 was the more

important since it dismantled a successful set of internal governance mechanisms, whereas that of 1997 merely failed to replace them. The important questions of the Bank's internal governance can be understood by comparing incentives and constraints faced by the staff, including the managers, before and after 1987. Specific discussion of the changes made in connection with the reorganisation of 1997 will be mainly confined to those that aggravate existing problems or which purport to remedy a defect identified in this discussion.

What ensued is simple. Before 1987 the staff who prepared projects in developing countries for Bank financing and various types of economic reports had, along with their managers, an incentive to meet targets in terms of numbers of projects and reports prepared. They also faced a constraint, namely that the projects and reports had to meet certain standards. The reorganisation of 1987 eliminated the sections of the Bank that enforced the constraint, but did not alter the incentive. As a result, the same staff and managers responsible for preparing a project or report now decided whether or not the standards were being met.

The First Step

The avowed aim of those who devised the new organisation was to simplify procedures, in particular by uniting all the responsibilities for the Bank's operations in a country under one head. A logical first step was to eliminate two of the three independent sections that scrutinised projects or reports, and had the authority to stop them if they did not meet the Bank's standards. All three and the staff who prepared the projects and reports were under separate lines of authority.

One comprised the central projects departments, which scrutinised projects to ensure that they met the Bank's standards of quality and integrity, i.e. that they satisfied certain criteria for economic justification, soundness of analysis and clarity of exposition, and that they did so through the correct use of the best available information. Without their approval, the project's preparation could not be completed. An analogous system existed for reports.

The second consisted of the Loan Committee and its advisory staff. The Loan Committee was the final and highest level of scrutiny before a project could be presented to the Bank's board of directors for approval, and it was briefed on everything that came before it by its advisory staff, the "Development Policy Staff". The Loan Committee stayed in existence after its advisory staff had been disbanded, but the final scrutiny of most projects was transferred from it to the managers of the staff responsible for preparing

the projects.

From then on, obtaining approval to send a project to the Bank's board was easier. Managers had less incentive to be strict with projects prepared by their own staff. The Bank Loan Committee, bereft of its advisory staff, also had less incentive to be strict; the briefs that had been prepared by the advisory staff were common knowledge for the members of the Loan Committee and had to be respected. But briefs prepared for them individually by their own subordinates were private knowledge, hence criticisms which members of the committee might voice would be at their own initiative. Since most of the members were managers who would also be bringing projects for the Loan Committee's approval in the future, each had an incentive to be lenient and keep on good terms with the other members.

The principle of close, independent scrutiny was narrowed to the third section, the legal departments, which cannot replace the technical specialists and economists. The lawyers from the legal departments are responsible for drafting the legal agreement (loan agreement) governing each project and for verifying that any steps taken by the country authorities and Bank staff conform to it. Loan agreements are the Bank's main formal means for influencing the policies and institutions of a country, and their scope can be wide, but the lawyers cannot judge the economics of their provisions and must depend on the advice of technical professionals from the regions or the central projects staff to judge if they are being observed. Typical of the obligations that countries enter into under loan agreements are raising electricity tariffs to cover costs, improving the tax system or setting up an autonomous institution to manage sanitation in a specified area. The lawyer concerned might not need the advice of a professional in the case of electricity tariffs, since they are precise numbers, not matters of judgement; nor, possibly, for the autonomous institution, whose statutes and the laws of the country may suffice for him to determine if the autonomy is real. But a reform of taxation, entailing a mass of technicalities and, perhaps, a reorganisation of the tax authorities, can usually only be judged by an expert.

The Second Step

A second step in simplifying procedures was taken by maintaining the old division of the borrowing countries into five or six regions headed by Regional Vice Presidents (e.g. the countries of Latin America and the Caribbean, or the countries of Sub-Saharan Africa), but changing the organisation within the regions; Country Departments were created, with Country Directors as their heads, to manage the Bank's operations in set

groups of countries or in single very large countries. To keep the country departments small and to introduce competition, the technical specialists (agronomists, engineers of various kinds, education specialists, economic model builders and so on), including most of the central projects staff, were grouped into Technical Departments attached to the regions and were expected to act as consultants seeking assignments from the country departments. Those who did not get enough assignments to keep them busy were to be dismissed.

In the same spirit of concentrating responsibilities within the country department, the responsibility for preparing a project was entrusted to a single person in the department, the Task Manager of that project. Formerly, projects had been prepared by two persons, a Loan Officer and a Project Officer, both belonging to the same region, hence under the same vice president, but in different lines of authority below that level. If, however, they were going to be in the same department, one of the two seemed redundant,

Thus the 1987 reorganisation jettisoned the mechanisms on which the MacNamara Bank had depended to ensure adherence to its standards ot quality and integrity. Now the preparation of a project was entirely within the purview of the country department and the decision as to whether or not it met the standards was taken within the region. The new structure of incentives and constraints faced by managers and staff was predictable; indeed it had been evident to those who -designed the various organisations of the Bank of 1972 and before, and an understanding of its incentives and constraints underlies the design of any sound institution.

This does not mean that people's behaviour has been entirely determined by these incentives. Many Bank staff had their own motivation for their work, often they had chosen that work for humanitarian and idealistic reasons, and as professionals they had the urge to live up to their professional standards. Peer pressure was also important: as long as professionals with long experience of the Bank from before the reorganisation had much influence, there were commonly known standards and the expectation that they should be met. So behaviour that might, on the face of it, be "rational" could still be uncommon, or at least, not prevalent. What follows is an attempt to examine what the incentives and constraints in the reorganised institution were, and not necessarily what has actually been normal behaviour.

The Effects on Quality and Integrity

Project preparation was immediately affected in two ways: one was

that it had, in many ways, become more difficult and the other that it suffered a hidden loss of quality. Eliminating the loan officer undid the easing of project preparation that could have been expected from the elimination of scrutiny from outside the region. In the division of labour between the loan officer and the project officer, the former saw to the procedures, adherence to the Bank's policies and strategy for the country concerned, relations with the borrowing country's officials and conformity to the Bank's guidelines on a number of matters; the latter to the substance and economic justification of the project, to the selection of staff and consultants working with him and to satisfying the central projects staff that the project was the best of the available choices. Both jobs were specialised and demanding, which the Bank recognised by the practice of making it the loan officer who presented the project to the board for approval, while giving the project officer the task of answering any questions on the substance of the project. The division of labour between them was a natural one, corresponding to the differences in training and experience between people with degrees in economics, business and law, on the one hand, and technical specialists, on the other.

The reorganisation handed the loan officer's responsibilities to the project officer, now called the Task Manager. In theory, holding one person accountable for delivering the project in time and within the budget for staff time and other costs would result in more efficient and faster project preparation. In any case, the mutual support and surveillance between two different departments in the old system seemed to have no place in the simplified new system. As will be seen, there were several reasons why this simple-minded, textbook arrangement could not work. One was that the designers of the reorganisation had put a greater burden on the task manager than they seem to have realised; he now had to be technical specialist, administrator proficient in the Bank's and the borrowing country's procedures, manager and diplomat. To the extent that he did not succeed as all of these, project quality suffered or there were delays. Some experienced former project officers still succeeded in meeting the challenge, but it was harder for those with less experience. In the meantime, the former loan officers, who embodied much of the Bank's administrative skill and its experience in dealing with the administrative systems and procedures of the borrowing countries, gradually disappeared.

The quality of projects was bound to suffer after the disbanding of the central projects staff, who had exercised the scrutiny. These staff were specialists, experienced in development projects, who also provided advice and help. They followed the preparation of a project from its conception to its approval by the Bank's board of directors, they raised questions that might otherwise have been overlooked or left unanswered and they provided

expert advice. They would, for instance, know what problems had been encountered by similar projects in other countries and how best to deal with them. If the project under preparation had been preceded by similar projects in the same country, they would know on what assumptions (e.g. regarding consumption trends or the costs of construction) the projects had been found to have been economically justified and how reliable these assumptions had been. They would then advise as to what the most realistic assumptions might be for the new project. They might also see alternative ways of achieving the goals of the project (e.g. better river transport instead of a new road) and would require that the alternatives be evaluated and compared.

In the difficult and complicated task of preparing a project even seasoned staff members found that such advice from experienced professionals almost always brought improvement. For less experienced staff the advice and the scrutiny were indispensable and part of the learning process. Consequently, many projects after reorganisation were less well prepared than they would have been before and some would not even have been considered viable. Experienced staff could often see this when looking at individual projects whose preparation had been completed; they could point out improvements that could have been made, but were not, and that would certainly have been insisted on by the staff of the central departments. By their nature, such losses are noticed, if at all, only by those who look at the projects closely.

As a substitute for the central projects staff, independent comment and advice were to be provided by "peer reviewers", but it was up to the department to decide what the task manager should accept or ignore. The peer reviewers could not, as the central projects staff had been able to, stop a project from going ahead until they were satisfied that their comments had been taken into account. They were supposed to be chosen because they could be relied up on to give objective, professional comments and advice, and as a rule they were; but their reviews were addressed to the country department, and if a peer reviewer thought that the department was ignoring some essential flaw in a project or report, he had no authority to turn to outside the department.

Friendships and understandings could also influence a peer reviewer, since he was chosen by the task manager responsible for the project or report. There might be the possibility of an interesting assignment from the country department for the peer reviewer, such as leading an important mission, or there might be prospects for a desirable position within the department. And the task manager who chose him could also be his peer reviewer when the occasion arose. The obvious remedy would have been to

take the choice of peer reviewer out of the country department, but although it was discussed in the Bank, the idea came to nothing.

The Proficiency of the Staff

At the same time as the slackening of controls after 1987 made it harder to prepare projects to the Bank's standards, it reduced the incentive to ensure that the staff preparing a project or a report were as well qualified as they had had to be before. As long as scrutiny had been rigorous and procedures rigid, a manager who entrusted the preparation of a project to inexperienced or incompetent staff ran the risk of damage to his own reputation as a manager since the preparation was almost certain to have numerous flaws that experienced staff would have avoided. In addition, he would have had to cope with the accompanying costs of the delays and changes. Consequently, a manager saw to it that only under special circumstances did a staff member who had not worked several years at the Bank take the responsibility for a project or a report.

In effect, a staff member used to undergo an apprenticeship, during which he acquired experience and knowledge through his own work in teams led by others and through assimilation of some of the Bank's accumulated experience transmitted by the central staff. The adage was that a run-of -the-mill economist could, after working at the Bank for some years, produce thoroughly professional reports. As much could have been said of project and loan officers.

The loss of the central staff has also led to a lowering of the proficiency of the Bank's regional staff. It was the central staff who systematically surveyed the Bank's experience across countries, analysed it and drew lessons that furnished guidelines for the regional staff. Centralisation was essential, the staff of a region could not have performed the same functions, except perhaps sporadically, and guidelines they might have prepared would have lacked authority in the other regions. To the extent that the Bank was distinguished by its competence in the problems of developing countries, this was due to a systematic accumulation over decades of analysis of its experience across much of the world. Without that, the Bank runs the risk that only its loans, whose terms remain more favourable than those of the markets, will be in demand and that in other respects, it will be irrelevant.

An attempt is being made under the reorganisation of 1997 to compensate for the lack of a central staff by improving the flow of knowledge. Clear accounts of the reasoning and how the new system is meant to work are not yet available, but it appears that staff in a given

discipline are to constitute "knowledge communities", sharing their knowledge through "knowledge networks" managed by knowledge managers". Apparently, the requisite flow of knowledge demands advanced and costly information technology. No mention is made of experience and, since the experienced permanent staff are being replaced by young people on contracts of, at most, a few years, the assumption seems to be that knowledge is instantly transmissible, or almost so, and that it therefore replaces experience. The officials of borrowing countries will no longer be dealing with experienced, sometimes elderly professionals, but with young people who do not expect to stay long in the institution and who have instant access to "cutting-edge knowledge".

The Concentration of Powers

With all the preparation of a project, or economic report, placed within the department headed by the country director, the question arises as to the extent to which the director's immediate superior, the RVP, had the incentive and the means to ensure that the Bank's standards were met. For the RVP was the only person in a position to scrutinise the department's work and to have the authority and responsibility to evaluate it.

However, he could only look closely at some of the work of the country departments under his authority; his office was not equipped to replace the central projects staff. For the most part he had to rely on the country director, who was closer to the staff preparing the project and the country officials concerned and, therefore, in a position to decide what information to make available to the RVP's office. A determined RVP could, of course, ensure that his office obtained all the information in a department and followed a department's activities closely, but he could not do the same for all the country departments in his region at once.

Nor did the RVP have an incentive to question the quality of the work produced by the country departments; he and the directors had a common interest in having the preparation of a project or economic report completed since they were all judged in theory, on the numbers of such completions under their authorities. Usually the RVP's incentive for interfering in the work of a department was political; he was closer to the political influences that beset the Bank and he might harbour political ambitions himself in the government of his country or in a supranational organisation, like the European Union. RVPs have been presidential candidates, prime ministers, finance ministers of large countries, and the like. A director might have similar ambitions and be just as busy pursuing them, but political pressures impinging on the countries of his department

would be transmitted through the RVP. For example, a major economic power might wish that some developing country carry out certain policies, say a privatisation programme. The RVP would then follow the department's work on the country closely to ensure that the policies were carried out satisfactorily. Conversely, the pressure might be to lend to a country in order to help its government, without looking too closely at the economic justification of the loans. In that case, a director who delayed projects for reasons of quality would have been risking his job.

Thus, the director had an almost free hand in deciding whether or not the preparation of a project or report should be presented as meeting the Bank's standards of quality and integrity. He was liable to close scrutiny from outside the department only if the RVP chose to look himself. The RVP might choose to do this as a matter of principle, or moral choice, though he lacked the means to do this for more than a few projects and reports.

The country director could, in practice, impose whatever decision he liked, provided it were not too egregious. At the main meetings to review the preparation and decide if and how it should be improved, it was he who presided and those attending, apart from the peer reviewers, the lawyer representing the legal departments and someone representing the office of the RVP, were either staff from the department, hence his subordinates, or other staff and consultants collaborating on the preparation. If, for instance, the director declared that a report was "excellent", disagreement was unlikely. The lawyer was not entitled to offer opinions on non-legal matters, while the representative of the RVP's office would be unwise to expect his office's backing in an open disagreement with the director. A peer reviewer who disagreed with the views expressed by the director or with the outcome of the meeting, could express his own views at the meeting and after, but being a peer reviewer in his personal capacity, without institutional backing, he risked making himself unpopular. He might prefer to say nothing or to limit himself to a few anodyne remarks. If he could find out in advance how the meeting was going to be conducted, he might stay away altogether.

The Country Director's Incentives

The country director has similar control over the interactions with the authorities of the countries with which his department deals. Before 1987, any opinions or intentions that Bank staff or managers expressed to the officials of a country concerning matters of importance were likely to need approval within the Bank, if they had not already been cleared, and the approval was not under the control of the country department; after 1987 the director had a free hand. Before 1987, an experienced country

official would have known that a professional or manager from the Bank could not, by himself, commit his institution and that pressures and blandishments to persuade him to deviate from the Bank's standards were usually pointless; after 1987 he knew the country director could take a decision without reference to anybody else.

There is consequently, an asymmetry between the country director and his counterparts among the country authorities, since he is almost a free agent while they are part of a hierarchy in which decision have to be approved by others. It matters little what personal preferences his counterparts may hold, they normally have instructions that have been drawn up and reviewed within the bureaucratic hierarchy or decided by ministers and political leaders in cabinet meetings. Only his principles and strength of character keep the director from allowing personal considerations enter into his decisions. The interaction is between one man's principles and a country's political and administrative structure.

The form of the interaction can, to some extent, be decided by the director. He can for example, send a signal that he intends to adhere to the Bank's standards as best he can by keeping a certain distance from the country officials. This would indicate that he expects his professional staff to deal with all matters of substance and that he will only act on important unresolved matters when they are referred to him by his staff. It may not be as convincing a deterrent to pressures and blandishments from the country authorities as were the central projects staff and Loan Committee, but it would still indicate how the director intends to act. Prudent as it is, a course like this may, nevertheless, be unappealing because it depends on an aloofness that is liable to be misinterpreted as a lack of concern or a bureaucratic mentality. It can also be difficult, since it requires faith in the department's staff and willingness to endure delays when the staffs work is unsatisfactory.

An ambitious director may prefer to appear to country officials to be in close touch with them and directly involved in all important decisions. He will be applauded for that by the higher levels of the management of the Bank. He may also believe that he can in this way circumvent his staffs shortcomings by replacing the staff at will and taking decisions himself. The more active the director, the more likely he is to go over the heads of his staff. He may not be able to avoid doing so even if he wishes to, since the country officials will have understood that there is no fixed rule as to whether the staff or the director make the decisions and that they can confront the director, by-passing his professional staff. Having already taken some decisions out of the hands of the staff, the director cannot, without appearing erratic, refuse to do so again. He may then be in the position of

having to choose between, on the one hand, supporting his own staff and displeasing the country officials and, on the other, disagreeing with his staff and confirming that their opinions as professionals as importance. In the extreme, an ambitious director bent o his power may make a point of choosing the latter.

How the authorities of a borrowing country could wish to persuade a country department director to override his staff's views is best seen from policy loans. In such loans the government agrees with the Bank to carry out certain reforms, which are specified in the loan agreement, as a condition for receiving the money of the loan. They are commonly made to help countries through balance of payments difficulties, the causes of which the reforms are meant to address. Usually the reforms arouse opposition, not surprisingly since they would otherwise in all likelihood have been carried out already, and it is supposed to be the need for the money that obliges a reluctant government to implement them. For instance, reducing food subsidies may be essential for budgetary reasons but it can provoke riots, lowering protection against competing imports angers industrial and agricultural groups and making taxes fairer upsets those who have to pay more, usually the rich.

Caught between its need for the loan and domestic opposition to the conditions, a government may try to persuade the country department of the Bank to deviate from the agreement as initially understood. If there is an element of judgement in deciding whether or not a reform is satisfactory, the government can, for example, carry out a partial reform in a way that placates the reform's opponents and then try to persuade the director of the country department to accept that as satisfactory, even if his staff do not agree. An example might be a tax reform with exemptions that have no economic or social justification but favour specific groups. The government could go further; there being no constraint on the director making misleading statements of fact, as long as they cannot be discovered from the documents submitted to the Bank's legal department, it could attempt to persuade him to accept something as having been done when it has not. For instance, if the audit of a public sector bank did not conform to international norms as required, the legal department would not know unless told.

But the director has also an incentive to propose such deviations to the country authorities. His freedom to decide can be used to ingratiate himself with politicians and officials. The good will of powerful and influential people is always useful, and one may want it without an immediate use in mind. It can help a manager's career at the Bank, especially if he faces problems, it also helps for preparing future careers

outside the Bank, in other international organisations or in the director's home country, which might find his contacts useful. The director also benefits from the appearance that the country has carried out the reforms of the policy loan, especially if they were difficult.

Vanity is another incentive. A manager may set store by being treated as an important person when he visits a country. Politicians, being alive to the power of vanity, know that a manager may be influenced by whether or not he is received by a head of state or head of government and by the attention he is given in the news. He may also be influenced by marks of favour from a head of state or some other powerful person, such as an invitation to his family to be their personal guest. Before 1987 a manager would not have considered an invitation that included his family; he would have known that so much as asking permission from the Bank would have reflected on his judgement, if not worse. To the head of state, a week's visit by the manager's family might be a small price for the manager's pliability.

A by-product of the elimination of external scrutiny has been the gradual abandonment of the practice of not letting staff work in units dealing with their own countries, a practice that was also needed to ensure the quality and integrity of the Bank's work. It was not a written rule, but the only exceptions were some technical staff working on the countries of South Asia and a couple of RVPs. The practice was, otherwise, so strict that it even applied to secretaries. Its abandonment left the manager free to ingratiate himself with country officials by offering positions to their countrymen and evaluating their performance favourably. It also created a conflict of interest for the staff member; he would have the opportunity to gain favour with his own country's officials, for instance by being his government's advocate at internal discussions at the Bank or being lax in applying the Bank's standards to projects for his country.

The deterioration of Projects and the Reorganisation of 1997

The reorganisation of 1997 does not address the problems discussed here. It was not preceded by any systematic study of the Bank's functioning that could have brought them to light and allowed solutions to be found. Some of the consequences of these problems have grown evident, notably a deterioration of the Bank's projects, over which there is no dispute, it is given as a reason for the reorganisation of 1997. But a lack of understanding of the causes has resulted in ineffectual remedies. Some other problems with less visible effects, such as the freedom for staff to work on their own countries, have been aggravated. Rather than a comprehensive discussion of how incentives work in the new organisation, which will add little of importance to what has already been said, it suffices to use these two

examples as illustrations.

How great the deterioration has been and how far it has been due to poor preparation or to poor execution cannot be known, because in addition to the deficiencies in the scrutiny of preparation, less attention was paid to project supervision. As pointed out earlier, the quality and integrity of the preparation of a project can only be judged by following it from the start; the documentation prepared for the Loan Committee and the Board does not suffice. Some projects may have been up to the Bank's official standards, but there is no way of being certain. Alarm was raised over the quality of project supervision a few years after the reorganisation of 1987, by the number of projects in difficulties, estimated at 30%. By supervising a project, usually through two to four visits a year, the staff concerned followed the implementation of the project and addressed any difficulties. Their supervision reports were the Bank's source of information on the progress of its projects under way, i.e. on the bulk of its cash flow. Yet, in the new organisation of 1987 arrangements for supervision were initially omitted and, since there was no longer a central staff to monitor supervision, when arrangements for it were made country directors had little incentive to accord it importance.

The remedy of the reorganisation of 1997 for the deterioration of projects, to reward staff according to the quality of the project as determined from the project documents, will be ineffectual. It fails both to address the causes described earlier and to provide mechanism that ensure that the assessments of the quality of the projects can and will be reliable and that they will determine how the staff are rewarded. Since the preparation of a project cannot be reliably gauged unless there has been independent scrutiny from the start, gauging it from the documentation alone merely amounts to a beauty contest. If there were to be such scrutiny, it would have to apply to all projects; since the staff are being evaluated, and this would require a new central staff. Only, unlike the old central staff, which was collaborative, this one would be investigative. But there may be no incentive to penalise staff for poor project preparation if poorly prepared projects can still be approved. Managers have an incentive to get as many projects approved as possible, and they may reward staff for speed, even if quality suffers.

A mechanism to prevent poorly prepared projects from being approved, the quality assurance group has been established and is likely to prove equally ineffectual. The group has the authority to prevent a project from being presented to the Board unless it is satisfied with it. But it is too small to do more than peruse the documents of a sample of projects. Not being part of a separate hierarchy, its members are unlikely to forget that

their careers will depend on their relations with their colleagues, in particular with the higher managers whose projects they happen to judge. When a project has obvious serious defects, they are more likely to ace some modifications for appearances' sake than to insist on quality.

The main proposal for improving the quality of project preparation is to assess the "total development impact". Admittedly, a method for this does not yet exist, but one is going to be devised. The new method must have the property of being usable well in advance of the completion of project, which may take several years, not to mention of of any development impact, because the Bank is replacing the permanent staff with young people on contracts of a few years, and they will want their efforts to be recognised before they leave. Moreover, the longer it takes to judge the impact of a successful project using the new method, the more people will have been associated with it and the mo0re difficult it becomes to apportion the credit. Unsuccessful projects will pose less of a problem.

III. The Bank's Governance Function

The discussion of the incentives inducing the country director to forego, the proper carrying out of the conditions behind the reforms of a policy loan describes one way in which the Bank's governance function in developing countries becomes ineffectual. Apart from such broad economic management, the Bank can perform its governance function for individual government agencies through its projects and for different parts of-.the economy as adviser through its economic reports. These too can lose their effectiveness,

When the Bank accepts as satisfying the conditions of a policy loan measures that are unsatisfactory, the consequences go beyond the reform at hand; people who would have taken the political risk of advocating an unpopular reform urged by the Bank may not do so in the future. Usually such a reform has supporters among the country's authorities, but the Bank is needed to overcome opposition, which could have various reasons, such as vested interests or fear of wider repercussions. In the debates within the government, the reform's advocates rely on the Bank both as scapegoat and as expert. It is scapegoat when the government has to meet the conditions for the loan that the country needs, or appears to need to be released, the Bank can be blamed within the government and before the public. It is expert when it supplies persuasive analysis and arguments showing the need for the reform and how to reduce its difficulties.

But, the advocates of the reform are proved wrong and its opponents right if the Bank allows the loan to be released without the

conditions having been met, except perhaps in appearance. The Bank loses its credibility and they will be careful about associating themselves with it in the future. Similarly, the Bank loses credibility if its analysis is unconvincing and its staff too inexperienced to manage the arguments for and against the reform.

The greatest and least obvious weakening in the Bank's governance, however, has been the diminution of the Bank's influence on the development and day to day management of the many organisations that are part of the administrative systems of developing countries. Almost every project is implemented through a government organisation, be it one that runs the sanitation of a city, builds low cost housing in a small town, manages small fishing ports or provides veterinary services in a rural area. Its success depends on how well the organisation concerned functions, so it is normal for projects to include steps to improve the functioning of that organisation and sometimes of related organisations as well.

The incentive for such time-consuming and difficult work has diminished with the decline in the quality of projects, especially with the diminution of supervision. Organisations involved in a project benefited from supervision, because this was the means for them to receive constant attention from the Bank's staff. The staff of the organisation benefited from an experienced Bank professional: getting advice on ways of improving their methods of operation, being informed of developments in other parts of the world in their area of work, and receiving training. He could help them formulate plans for the future of the organisation, plan another project that would help the organisation develop, and carry the concerns of the organisation to the higher levels of government, where its needs and difficulties were often misunderstood. Through repeated visits to supervise projects, a competent Bank professional won the trust of the staff of the organisation and the higher levels of administration, and was treated as a confidant.

The Bank's economic reports served to influence discussions of policy questions among the authorities so as to reach decisions that the Bank thought advisable. From the point of view of orthodox economists of the developed market economies, whose representatives dominate the Bank's board, this was a legitimate governance function since the Bank's doctrines were much the same as their own. The purpose of the reports was to provide the authorities with better analysis and advice along orthodox lines than they could otherwise obtain. No other institution matched the Bank's experience in analysing problems of economic development, its data on almost all developing countries or the staff and money it could devote to a report. Institutions like the IMF and some specialised United Nations

agencies are narrower in their ranges and usually confine themselves more to technical matters. Governments of developing countries rarely had enough qualified people to undertake work comparable to the Bank's and could not spare them or the money. Besides, the government often wanted the Bank to provide an outside view to counteract biases in the views they could obtain from their administration or local experts.

This part of the governance function has suffered both from a fall in the quality of the reports and from the new freedom the staff have in giving personal opinions to officials. In several countries the authorities have remarked that the quality of reports is not up to previous standards and they, therefore, take them less seriously. Moreover, the bank staff often ignored the procedures governing which reports could be given to a country's officials. Before 1987, a report could only be given if it had gone through the prescribed internal reviews and clearances. Now staff often give officials reports that turn out to be "informal", the personal views of the staff concerned, or early drafts. Inconsistencies occur and cause confusion, or worse, the Bank's views and the analysis is likely to be especially weak. This invites rebuttals of the Bank's views that hurt its reputation and credibility.

IV. External Governance

If the internal governance of the Bank has been damaged by the reorganisations of 1987 and 1997, the reorganisations themselves show that there was something wrong with the Bank's external governance. No justification deriving from study of the Bank's functioning was provided for either reorganisation. Allegations that the Bank was over-staffed, costly, slow, overtaken by private capital flows, distant from its clients, not co-operative with non-government organisations and so on were not followed by cogent analyses to support them or to explain why total reorganisation, rather than modification, was necessary. The only studies that had been carried out, notably one by the US Treasury in 1982, concluded that the Bank was effective and that its costs were low.

Neither reorganisation was well planned. Some of their defects have been discussed here. The planning of the reorganisation of 1987 was entrusted to a group of Bank staff, all of whom had been recruited young and had little or no experience of private business or government. It took only a year which, in view of the complexity of the institution, would have been too little time even for a large team of experts. The reorganisation of 1997 was begun without a plan, Mr, Wolfensohn stated that he had no "blueprint" and the stair who devised the individual components as they went along hardly had more experience than those who did the planning for

1987. Few large private firms with wide ownership or public institutions would have undertaken reorganisations before obtaining their boards' approval of detailed plans and cost estimates. Both reorganisations have been costly; in addition to the explicit costs of dismissing staff and, in 1997, of acquiring high performance information technology, there were the costs of disrupting the Bank's work. The Bank was paralysed for almost a year in 1986-7, Although Mr. Conable and Mr. Wolfensohn brought experience with them, neither had run a large organisation. In contrast, Mr. McNamara had been the head of two large organisations, one in private industry and the other in government. He took two years to prepare his reorganisation, the costs were low and there was no disruption.

What the reorganisations show is that the paternalism of the developed countries on which the external governance of the Bank rested is being put in doubt by these countries themselves. As mentioned at the start, the developed countries hold the majority of the votes on the Board and thus take it upon themselves to ensure the good governance of the institution. Despite the ability of some of the major shareholders to interfere occasionally in the Bank's work, the arrangement worked well for a long time. It enabled the Bank to provide in turn a modicum of governance to countries that often lacked the institutions to provide governance for themselves. The dedication of the major shareholders could, however, waver at times and the Bank flourished in spite of that because it was led by a long succession of strong and able managers. But the two recent reorganisations cast doubt on the responsibility that the major shareholders feel for the institution.

The major shareholders have also been allowing greater political influence in the Bank's work. One example has been allowing the Board to discuss the Bank staff's document setting out the strategy for a country, originally the Country Policy Paper (CPP) and later the Country Assistance Strategy (CAS). The CPP/CAS was, every year or two, the occasion for a candid assessment of how the Bank had performed in the country and how it should proceed over the next few years. It was subject to stringent requirements intended to make sure that the assessment was realistic and it usually underwent several revisions before its final approval by the Loan Committee. Because it was a candid document, it was not available to the Board. Recently it was changed into a document for discussion at the Board and much of the candour has been lost.

A second example is the greater latitude allowed in special cases in interpreting the restrictions the statutes impose on the Bank's lending. According to them the Bank can only lend for development, the interpretation of which has been stretched wide by the recent Social Sector

Adjustment Loan to Russia. The principal measure under the loan is to raise the lower levels of pensions. Desirable though this may be, supporting consumption has not yet been included in the definition of development. In any case there is nothing to finance since other pensions are being held down to prevent an increase in budgetary outlays (otherwise the IMF would not have allowed it). The loan is unprecedented in that, for the first time, nothing is said about what the money is to be used for.

The Banks will continue to go through upheavals if the major shareholders do not commit themselves more strongly to the institution. Reorganisations that have not been fully justified and carefully prepared will be followed by others. Political influences on its work will increase and observance of the Bank's statutes will grow more casual. How the financial markets, on which the Bank depends for financing its own lending, will interpret all this a few years from now is not hard to foresee.

A strong commitment of the major shareholders is also the only way to escape the Bank's "moral hazard", the situation in which the developed countries make the decisions but the developing countries pay the costs. All the administrative costs of the Bank are defrayed out of the interest the developing countries pay on their loans from the Bank, but these countries have no say in practice in deciding these costs. Moreover, the poorest countries pay most of the costs of the reorganisation since part of the profits of the Bank are used for low interest, long term loans to these countries, and these costs reduce the profits. The developing countries can also look askance at the costs of the increased attention to public relations, much of which is used for favourable publicity for the reorganisations and seems to be self-serving.

The alternative to the dominance of the developed countries on the Bank's board, giving the developing countries at least an equal voice, is unlikely to work. Up to now, the Bank has had the highest possible credit ratings because the developed countries both dominate the board and guarantee the bulk of its bonds. It is conceivable that a way can be found to give the developing countries more say on the board without affecting the Bank's credit ratings, but it is not obvious how. It would have to avoid two moral hazards, one in which the developed countries guarantee the Bank's debts on the financial markets but the developing countries, determine how the Bank lends, and the other, related to the first, in which the developing countries control the board's governance of the Bank while the Bank performs a governance function for them.