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World Bank: IDA Loans or IDA Grants?

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Summary

On July 17, 2001, President Bush proposed that the World Bank implement a plan where half of all its assistance to the world's poorest countries would be grants rather than low-interest loans. He said this would enable the Bank increase its levels of assistance for education, health, and other programs aimed at poverty alleviation. It would also keep poor countries from falling further into debt. The increased funding would be tied, he said, to clear and measurable results. The International Development Association (IDA) is the part of the Bank that currently makes low-cost loans (long repayment periods, very low service charge) to poor countries. IDA loans are funded with money contributed annually by donor countries.

Although there has been widespread support for the concept of IDA grants among other donors, multilateral agencies, and the public, many have indicated that they prefer a much smaller program than the President has proposed. Many are concerned about the long-term financial impact a large grant program might have on IDA. IDA funds a substantial portion of its new lending (40% of all commitments planned during the period 1999-2001) with repayments from prior loans. (These are often called "reflows".) Over time, if reflows are not available to help cover the cost of future IDA assistance, the cost of the World Bank's concessional aid program to poor countries will gradually rise. The President did not indicate, in his original proposal, that the Administration would support increased funding for IDA to help support the cost of new grants. In December, the Administration said it would be willing to raise the U.S. contribution level by up to 18% if certain institutional changes were made in the World Bank, but it did not link the projected increase to the issue of grants. Some people are concerned that the grant proposal is ultimately a plan to "defund" the World Bank, to bring about the ultimate termination of IDA either because it is too costly to donors or because it does not have sufficient funds.

In 2000, a congressionally-appointed study panel, the Meltzer Commission, made several proposals to replace World Bank IDA loans with grants. One of these would create a large grant program (funded with new contributions) to address poverty alleviation and policy reform issues. A second proposal, though, would basically dissolve the World Bank and use its residual assets to fund a special program – at no cost to anyone – addressing global needs. Many of those with reservations about the President's proposal hear echos of the Meltzer Commission's recommendation – particularly the second recommendation – in his grant plan.

The issue is being negotiated in the series of talks currently taking place on terms for a new replenishment (IDA 13) of IDA resources. In the foreseeable future, the costs and the benefits from a 50% grant program are not dramatically different than those available from the present IDA program. Most of the costs and benefits occur thirty to forty years hence, in a context which may or may not be similar to that faced by developing countries today. Some analysts believe that the underlying controversy may be less about IDA finances and more about influence in the international financial institutions. Should the Europeans develop a common policy front on IFI matters (as they have in this case), they will be the "largest single member country" and their leadership role will be substantially enhanced.

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Bush's Proposal and the Response

On July 17, 2001, prior to his trip to Genoa for a meeting with the top leaders of the seven leading industrial countries (G-7), President George W. Bush called on the World Bank and other multilateral development banks (MDBs) to provide a major share of their assistance to poor countries in the form of grants rather than low-cost loans. Speaking before several hundred World Bank employees, Bush claimed that his plan would help poor countries without adding to their heavy burden of debt. "I propose," he said, "that up to 50 percent of the funds provided by the development banks to the poorest countries be provided as grants for education, health, nutrition, water supply, sanitation, and other human needs." This would be, he said, compassionate conservatism at the international level. Alluding to protestors who have been calling for a major cancellation of debt owed by poor countries, the President said that his proposal "doesn't merely 'drop the debt' – it helps stop the debt." The increased funding would be tied, the President said, to clear and measurable results. [1]

The White House noted later that the President sought to convert to grants half the money the Bank lends to poor countries annually through its concessional loan facility, the International Development Association (IDA). A few countries borrow both from IDA and from the Bank's regular loan window, the International Bank for Reconstruction and Development (IBRD). Because these "blend" countries would not be eligible for grants, the President's plan would actually involve only about 40% of total IDA funding.

A grant program would have clear benefits, the Administration argued, for economic development and long-run poverty reduction. Besides, spokesmen said, a grant program would allow better assessments ex-ante of project effectiveness. Grants could be tied to clear and measurable policy instruments, to require more prior commitment to achievement of program goals and to link the actual payment of the grant to clear ex-post output measures.[2] The Administration did not explain at

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[1] Quoted in Michael Phillips, "Bush Wants World Bank to Make Grants–Switching from Loans has Large Catch if U.S. Fails to Boost Contributions." *Wall Street Journal*. (July 17, 2001), p. A2. For the full text, see George W. Bush, "Remarks by the President to the World Bank," Washington, D.C. July 17, 2001. Available from the White House web site at [http://whitehouse.cov/news/releases/2001/07/20010717-2.htm]

[2] White House. (2001) "Fact Sheet on U.S. Proposal to Increase World Bank Grants to the Poorest Countries."*U.S. Newswire* (Washington) July 20, 2001. The U.S. Treasury Department later released a fact sheet supplying additional points supporting a grant program.

(continued...)

the time what the President meant by the comment that grant aid should be tied to ex-ante assessments or that the payment of the grant should be linked to ex-post output measures.

The President's summit colleagues had little comment on his proposal. The G-8 called on the World Bank and other MDBs to take further steps to help poor countries.[3] They did not mention, however, the issue of IDA grants. In a separate communique, the G-7 countries – the major MDB donor countries comprising the G-8 less Russia – said that they might be willing to discuss the concept further. "We support a meaningful replenishment of IDA and, in that context, we will explore the increased use of grants for priority social investments, such as education and health." They made no comment on the President' proposal.[4]

Separately, many other G-7 countries expressed opposition to the plan. "It's not something that we agree with," indicated Beverly Warmington, spokeswoman for the British Department for International Development. "The World Bank is actually a bank and there are development agencies to give grants. It's important that the World Bank work alongside them instead of competing with them."[5] Michael Hofmann, director general for Germany's Ministry of Economic Cooperation and Development, was also quoted as saying that he thought an important element was missing from the President's proposal. If it had been accompanied by an announcement that the President would ask Congress to increase the American contribution by a specific amount, he said, "then the whole thing would have had a very different melody." If none of the G-7 countries really want to increase their IDA contributions, he said "such a suggestion can mean only one thing: reducing the business of the bank." The French noted that, while they supported the idea of grants, the U.S. proposal went further than they could support. The German government told a meeting of World

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[2](...continued)
It claimed that the President's proposal would make possible a major new increase in funding for education. This would be consistent, it noted, with the President's theme that no child should be left behind, that every child must be educated. "It is often difficult for [the world's poorest countries] to generate the economic returns with which to pay back funds borrowed for education and other development priorities," the Department observed. It makes little sense, either for the borrower countries or the MDBs to be financing projects "with loans that cannot be repaid," it said. More assistance could be provided, with grants, it argued, for health, education, nutrition, water supply and sanitation projects in poor countries benefitting children. In a subtle change, it noted that, under the President's proposal, "*up to* fifty percent" of IDA assistance to the world's poorest countries could be provided in the form of grants rather than loans. [Emphasis added.] U.S. Treasury Department. Fact sheet titled "Increasing Grants and Improving Education in Poor Countries." Dated July 10, 2001 but released after the President's speech.

[3] Communique. Group of 8 (G-8) heads of state and government. Genoa, July 21, 2001. Available from [http://www.G7.utoronto.ca/g7/summit/2001genoa/finalcommunique.html], provided by the G-7 resource center at the University of Toronto..

[4] Communique. Group of 7 (G-7) heads of state and government. Genoa, July 21,2001. Available at [http://www.G7.utoronto.ca/g7/summit/2001genoa/g7statement.html].

[5] Joseph Curl. "Bush asks billions for poor nations; Takes proposals to World Bank." Washington Times. (July 18, 2001), p. A1.

Bank donors (negotiating terms for a new IDA replenishment) in June 2001 that it could not go beyond 10% grants without breaking a promise to its parliament.[6]

Others have also expressed doubts about the President's plan. Jerome Booth, an emerging markets fund manager, argued, for instance, that the proposal for 50% IDA grants was either a preposterous example of ignorance about IDA finances or a ploy to cut the World Bank down in size. He suggested that the effort to expand the flow of grants through IDA might be an attempt by the Administration to cover the fact that the United States was reducing its overall level of bilateral foreign aid.[7] Others questioned whether the IDA donor countries would be willing to contribute the additional funds necessary to make the new plan feasible.[8] Columnist Milan Vesely claims that the new proposal was "posturing." He noted that Condoleezza Rice, the President's National Security Advisor, had said that the grant plan would have no financial impact on IDA for ten years. He observed, that she had not said when or whether the Administration planned to ask Congress for money to help fund future costs.[9] Nancy Alexander , spokesperson for an NGO critical of globalization, suggested that, when combined with the World Bank's proposed Private Sector Development Strategy, the President's plan for IDA grants poses serious risks to the well-being of poor people by reducing their access to the education, health, and clean water services it presumably wishes to support.[10]

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[6] Sanger, David E. (2001) "Rich nations Offer a Hand, But the Poor Hope for More." New York Times. (July 21, 2001), p. 7. This may be a consequence of the German system of budgeting for IDA contributions. The United States Congress appropriates money for IDA contributions (budget authority), which is available for many years and can be drawn by IDA when needed (outlays) to help fund disbursements for IDA projects. By contrast, according to World Bank sources, the Germans vote money each year for their share of IDA's expected annual disbursements. Considerable care must be taken to match the amount voted with the amount IDA will actually need to draw in the coming year from the German pledge. The German government has less reason to be concerned than does the U.S. Administration that its will refuse to provide the money.

[7] Jerome Booth. "Burdens that can't be passed on." Euromoney, September 2001, pp. 341-43. This article was published in the London-based magazine about the same time that the British government was seeking to persuade other IDA donor countries to resist the Administration's plan. Booth is head of research for Ashmore Investment Management in London, an emerging markets fund manager, and a frequent commentator in the press.

[8] See, for example, remarks to this effect by Mikesell, a professor of economics at the University of Oregon, in his summary of the Commission report.. Raymond Mikesell, "Review Article: the Meltzer Commission Report on International Institutions." *Economic Development and Cultural Change* 49:4 (July 2001), p. 887. Likewise, remarks by C. Fred Bergsten, formerly a former high Treasury official during the Carter Administration. Quoted in Alan Friedman, "'Shadow' Group Seeks to Open G-8 to Poor Nations." *International Herald Tribune*. (July 20, 2001), p. 18.

[9] Milan Vesely, "Will Bush Back Words with Deeds?" *African Business*, London. September 2001, pp. 2021.

[10] Nancy Alexander, Director of the Globalization Challenge Initiative, telephone interview with author, January 24, 2002. See the GCI publication "Growing Dangers of Service Apartheid: How the World Bank Group's Private Sector (PSD) Strategy Threatens (continued...)

On the other hand, the Administration's proposal for 50% IDA grants has elicited strong support from many groups that are deeply concerned about poverty and strongly in favor of programs to promote equitable and sustainable development. Cardinal Bernard Law, Archbishop of Boston, announced that the U.S. Conference of Catholic Bishops "welcomes President Bush's initiative on poverty alleviation." In particular, he said, the Conference welcomed the proposal that "up to 50% of funds provided by development banks to the poorest countries [be] given in the form of grants rather than loans."[11] John Ruthrauff, senior policy analyst for Oxfam America, stated that "Oxfam America supports the Bush administration's position that half of the IDA funds be grants."[12] Increased grant assistance is particularly important, he said, in order to meet the 2015 development goals, help countries invest in their growth, and avoid increasing their debt. David Beckmann, President of Bread for the World, an aid advocacy group, expressed a somewhat more restrained level of support. "Bread for the World supports President Bush's proposal that some of the next replenishment of IDA should be grants," he stated, "with the understanding that

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[10](...continued)
Infrastructure and Basic Service Provision." *News and Notices for IMF and World Bank Watchers* 2:5 (Winter 2002). Available from [www.challengeglobalization.org].

[11] Cardinal Bernard Law. *Statement on the President's Initiative on Global Poverty Alleviation and Increase in World Bank Grants to the Poorest Countries.* Office of Social Development and World Peace, United States Conference of Catholic Bishops, July 19, 2001. Available at: [http://www.nccbuscc.org/sdwp/international/gloprov.htm]. Cardinal Law is Chairman of the Conference's Committee on International Policy. Catholic Relief Services and Cafod, the overseas development and relief agencies of the Catholic Church in the U.S. and U.K., expressed later a somewhat more muted level of support for the grant plan. The U.S. plan would prevent the accumulation of unsustainable debt by poor countries, said spokesmen for the two organizations, and it would make maximal use of development funds. However, the plan is viable only if donors agree "to offset the cost of reduced repayments to the World Bank resulting from the conversion of loans to grants." The United States could be most persuasive in its advocacy of a grant program, they said, if it would make an "upfront commitment of funds" to allay suspicions that its proposal was merely "posturing in support of the world's poor while continuing to starve them for development resources." They noted that, compared to the size of its economy, the United States provides less foreign aid to poor countries than does 21 other donor countries. See: Loans-to-grants plan needs upfront funds." *Financial Times* [Europe and US editions], January 22, 2002, p. 14. Letter to the editor from the executive officers of both agencies.

[12] John Ruthrauff. *Oxfam America Position on IDA Loans and Grants.* Electronic message to author, January 11, 2002. His statement was approved by Oxfam America's top leadership. It might be noted, though, that Oxfam International, the London-based organization, has expressed more conditional support for the President's plan. Kevin Watkins, a senior policy advisor, was quoted as saying that "We broadly support increased use fo grants in very poor countries, but not the US proposal because of its failure to guarantee funding in the long term." The real problem with the United States, he said, was "that they never put their money where their mouth is." Alan Beattie, "NGOs pressed to back US grant scheme; World Bank move to Replace Loans." *Financial Times* [London Edition], January 17, 2002, p. 9.

the U.S. government will also agree to provide additional funding for the next replenishment."[13]

This report explores the different ways a switch from IDA loans to IDA grants might affect recipient and donor countries and the IDA program itself. The report looks at the role which debt repayments for old loans now play in funding IDA's current loan program and identifies some arguments for and against a switch from loans to grants. It also discusses some earlier proposals for shifting IDA to a grant basis and suggests issues that may be relevant to reaching an agreement among the donor countries on this matter.

Initiation of a program of IDA grants might offer opportunities for increased flows of assistance for education, health, and other social programs. However, as discussed below, the operational effects of a shift from IDA loans to grants may be felt only in the second decade after the change occurred and its full impact would be phased in slowly over a period of up to 40 years. A grant program might allow donors to require that recipients give them more opportunities for monitoring program implementation than might be available for programs financed by loans. However, it might also force the donors to choose between increasing their contribution levels or seeing the IDA program shrink in size. Likewise, the change might offer recipient countries some relief from their debt payment burden over the next forty years (since they would not have to repay the grant.) The efficiency of grant-funded programs might be enhanced but the recipient country might also feel less "ownership" for programs when it has little say in their implementation. Some observers believe that this may have a negative effect on its willingness to continue funding for the program or to keep the original policies in place once the donor withdraws and the program becomes its responsibility.

The Difference Between Loans and Grants

The Terms for IDA Loans

The World Bank provides assistance to its countries through two loan "windows." Legally, they are separate organizations, though in fact they share a common staff, management, policies, and rules. The International Bank for Reconstruction and Development (IBRD) lends mainly to middle-income countries using funds borrowed at commercial rates in world capital markets. Most IBRD borrowers have annual per capita incomes well below the $5,280 ceiling on eligibility. IBRD loans are repayable over a 10 to 20 year period at interest rates slightly higher than those the Bank pays to borrow funds.

The International Development Association (IDA), by contrast, makes loans to the world's poorest countries. Most IDA borrowers have annual per capita incomes well below the $885 ceiling for eligibility. Some small countries – mostly island countries – with marginally higher income levels and low creditworthiness may also

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[13] David Beckmann. Electronic message to author, January 11, 2002.

qualify. IDA loans are funded with money contributed by donor countries. The United States presently contributes about 20% of IDA's new resources. As IDA's uncommitted funds are used up, the donors negotiate new plans every three years to replenish its resources. IDA lends without interest and with principal repayments stretching (after a 10 year grace period) over a 20 to 30 years. The borrower pays a 3/4 of 1% service charge to IDA, which the World Bank uses to cover IDA administrative costs. There is no grace period for the service charge obligation. Except for fast disbursing adjustment loans (which go out over 1 to 3 years), IDA loans are disbursed over a period of 8 to 10 years, as work on their projects is completed.

An Earlier Debate on Loans or Grants

There is no impediment in the IDA Articles of Agreement to grants. The IDA Articles specify that "Financing by the Association shall take the form of loans." However, subsequent language authorizes IDA to provide other types of financing in "special circumstances." Deciding whether such circumstances exist is the responsibility of the Executive Board.[14] Perusal of the IDA Articles and IDA operations will show that a number of activities possible only in "special circumstances" (local cost financing or non-project assistance, for example) are now common (if sometimes implicit) procedures.[15]

As Edward Mason and Robert Asher noted, in their official history of the World Bank, IDA is "simply a fund administered by the World Bank."[16] It was created because most poorer developing countries could not afford to borrow from the IBRD. A U.S. government advisory board, headed by Nelson Rockefeller, and a panel of experts at the United Nations both proposed, in the early 1950s, establishment of a new international development agency or authority to provide assistance on a grant basis for activities that were "desirable on social grounds [but] could not bear the full burden of loan finance." Eventually the proponents abandoned the concept of grants in favor of concessional-rate loans, on the expectation that this would be more acceptable to the prospective donor countries.

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[14] IDA Articles of Agreement, at Article V, Section 3. *Articles of Agreement of the International Development Association*. Entered into force September 24, 1960. Available from the Bank's web site at [http://www.worldbank.org/ida/idaart.htm].

[15] IDA's Articles of Agreement say, at Article V, Section 1(b), that, except in special circumstances, assistance from IDA "shall be for specific projects." In some years, balance of payments support through structural adjustment loans, sectoral adjustment loans, and reconstruction or rehabilitation loans may comprise upwards of a quarter of IDA lending. Article V, Section 3(e) says that, in special cases, IDA "may make foreign exchange available for local expenditures." This is a regular element of many IDA loans and is embodied in the IDA rules allowing potential suppliers in the recipient country a marginal advantage in price when they seek, through international competitive bidding, contracts to supply goods for IDA projects.

[16] Edward Mason and Robert E. Asher, *The World Bank Since Bretton Woods*. The Brookings Institution. Washington, D.C.: 1973. The discussion here is based on chapter twelve, an account of the history and operations of IDA.

IDA originated in a proposal by Senator A.S. Mike Monroney (D-OK) in 1958 to create a new international body that would finance development in poor countries by lending to them excess foreign currencies of other poor countries that were currently owned by aid donor nations. Though economically impractical, the Monroney plan was transformed by the Eisenhower Administration into an agency capable of making hard currency loans to poor countries on easy-repayment terms. Monroney's original concept, loans of excess foreign currencies, though a dead letter, is included in the IDA charter. Some donor countries supported Monroney's idea that IDA loans might be repaid in local currency. As Mason and Asher note, the IDA charter "did not foreclose it; but no use has been made of the provision authorizing such loans."

World Bank management was reportedly more opposed originally to the concept of IDA loans than it was to IDA grants, fearing that a concessional loan window would confuse potential bondholders and drive up the cost of IBRD capital. Officially, IDA provides aid in the form of "credits" in order to distinguish it from IBRD "loans." During negotiations on the IDA Articles of Agreement, many prospective donor countries spoke in favor of the concept that IDA should have the authority to make grants. Mason and Asher report that the United Kingdom, France, Canada and the Netherlands were leading advocates of this view, while the United States was in staunch opposition. The IDA charter specifies that all the assistance provided by IDA from original subscriptions must be used for loans, but it holds open the possibility that resources from future replenishments may be used for grants if specifically authorized by the donor countries at that time.[17]

A Decision to Make Grants

As noted above, an IDA grant program may be created only with the consent of the donor countries as expressed in the new replenishment agreement. The Bank's Board of Executive Directors has the authority to determine when "special circumstances" exist but it has no independent authority to create a formal grant program.[18] A two-thirds vote of the donor countries is needed to approve a new replenishment for IDA. The Administration will need broad support from other countries to bring about the establishment of an IDA grant program. In recent decades, the United States has provided about 20% of IDA's new resources but, for historical reasons, it has a 14.8% voting share. Altogether, the principal donor countries have a 61.3% voting share in IDA. As a practical matter, it is extremely unlikely that developing countries would oppose a new replenishment for IDA. As noted before, though, most other donor countries are – at best – lukewarm in their support for a major IDA grant program. The poor countries would likely also look askance on the suggestion if they believe it would reduce the flow of aid they receive from the Bank.[19]

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[17] IDA Articles of Agreement, at Article V, Section 2.

[18] The Articles specify that the Executive Board shall be responsible for IDA's general operations. IDA Articles of Agreement, at Article VI, Section 5 of the IDA.

[19] See, for example, comments to this effect in Alan Beattie, "Give and Take: European (continued...)

At one time, IDA replenishment agreements could not go forward without the consent of the United States (and therefore the consent of Congress). In recent decades, however, the U.S. contribution share had declined to the point where it no longer has a de facto veto over IDA replenishment plans. The United States also has limited leverage with other donors on these matters. In 1997, other IDA donor countries indicated that – if the United States did not bring its payment arrears up to date – they might create a new international agency to replace IDA. The United States would not be invited to join. Many in the United States believed that this would have serious negative implications for U.S. foreign policy. Congress appropriated $1.035 billion in fiscal 1998 to fully clear the IDA arrears. Many observers doubt that the United States will be able to persuade other donor countries to adopt an IDA replenishment plan whose provisions they do not support.

Comparing the Cost of Loans and Grants

Because of the grace period, IDA receives no reflows from its loans for 10 years. In that respect, IDA loans are the same as grants. Beginning in the 11th year and continuing for the life of the loan, however, IDA receives a stream of repayments of principal, roughly (for a 30 year loan) 3.3% of the amount lent initially.[20] Those repayments can be (and are) used to fund new IDA loans. If the IDA donor countries wanted to keep the IDA loan program at a constant level in nominal terms – $6 billion a year, for example – they could reduce their contributions annually at the end of the 10 year grace period by an amount equal to the new repayments being received. Ultimately, IDA would be able to provide a constant nominal level of assistance to borrower countries without any new contributions by donors. By contrast, if the donors want an IDA grant program to stay at a constant nominal level, they would have to contribute the same amount each year for as long as the program exists.

One might also compare the difference in the cost to the donors if they decided to keep the IDA program at a constant $6 billion annually for 20 years and to close it thereafter. If IDA were a grant program, the donors would need to contribute $6 billion annually (a total of $120 billion) during those two decades. By contrast, if IDA were a loan program, they would need to contribute $105 billion to support the same size program, since reflows would pick up some of the cost during the second decade. The donors could then choose what to do with the repayments IDA would continue receiving thereafter. If they chose to have the funds returned to them (rather than assigning them for another purpose), the donors would receive $105 billion in reflows during the next 30 years.

[19](...continued)
countries are worried that US proposals to replace half of the World Bank's loans to some developing countries with grants could undermine the organization." *Financial Times* , London. (July 20, 2001), p. 20.

[20] This assumes a loan with a ten year grace period and thirty years for repayment of principal. The annual repayment figure would be higher for IDA loans with shorter repayment terms. However, these comprise a minority of all IDA assistance.

The Benefit to Recipient Countries

The net-transfer of resources from an IDA grant program to the recipient countries would be 100%, since no repayments are expected. By contrast, on a face value basis, the net transfer of resources from an IDA loan is zero, since all the money lent must be repaid.

This calculation overlooks, however, the time value of money. Because the repayment terms for IDA loans are very easy, there is a substantial grant element to IDA loans. The net present value of the repayments from an IDA loan must be discounted substantially because of their negligible interest cost and their long payment terms. World Bank accountants estimate that the grant element of an IDA loan in 2001 was 44% or 47% or 67%, depending whether the comparison is made to G-7 official borrowing, private borrowing, or the standard 10% discount rate used by the Development Assistance Committee (DAC) of the OECD.

A grant program is a one-time transfer of money. By contrast, the IDA loan program is a revolving fund. Thus, it can recycle the grant element of its loans indefinitely as the repayments from old loans are used to fund new loans. (The real value of IDA's future loans will likely be lower in the future, because of exchange rate fluctuations and inflation.) Each subsequent IDA loan would have a positive developmental impact, so long as the projects are effectively designed and implemented. For grants, the money that would have been used for loan repayments would stay in the country. Its developmental impact will depend on the government and the economy's capacity for making effective use of those resources.

IDA's Repayment Record

Some supporters of the President's proposal argue that IDA should shift its assistance program to grants, as they believe there is little likelihood anyway that IDA's existing loans will be repaid.[21] Mary Ellen Countryman, White House assistant press secretary for foreign affairs, told the press that President's plan is simply plain speaking. "Let's call it what it is. A lot of the loans aren't getting paid back anyway."[22]

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[21] See, for example, remarks to this effect in *Newsday*, "Poor Nations Need More Grants, but Who Will Pay?" (Editorial). Long Island, N.Y. (July 19, 2001), p. A36. The *Chicago Sun-Times* opined, favoring Bush's grant plan, that there is "little difference between loans that aren't paid back and outright grants anyway." *Chicago Sun-Times.* "Call It What It IS." Editorial. (July 26, 2001), p.35. Felix Rohatyn also seems to believe that IDA loans are likely to be forgiven anyway. He says that grants are more straightforward and "can be tied to a number of conditions to make them more effective for the recipient country." Felix Rohatyn, "Back to Bretton Woods: the anti-globalization protesters have a point, argues Felix Rohatyn, It's time to reform the IMF and World Bank." *Financial Times*, London edition. (August 20, 2001), p. 17.

[22] Quoted in Joseph Curl. "World Bank contributors oppose Bush plan for grants." *Washington Times.* (July 19, 2001), p. A14.

Others point out, however, that by and large, IDA has a good repayment record. Seven countries are currently overdue in their loan payments. Together, Afghanistan, Congo/Zaire, Congo Republic, Liberia, Myanmar, Somalia, and Sudan are $469 million in arrears. Much of this balance has been accruing since the early 1990s (1988 for Liberia).[23] The total amount lent to these countries was $3.8 billion, most of which is not yet due. At the end of its fiscal year 2000, IDA had $85.8 billion in disbursed loans outstanding to all borrowers.

Those seven countries currently have no effective government or their government is at serious odds with most of the rest of the world. The World Bank expects that – as has been the case before – they will settle their overdue obligations once their current problems have ended or a new government takes the helm. The World Bank stops making disbursements on its existing loans and it ceases all consideration of possible new loans when a country becomes 6 months or more in arrears. Many IDA borrower countries have no real sources of international credit other than the World Bank.

In their argument that IDA loans are not repaid, the advocates of grants may be referring more to the HIPC program. Heavily indebted poor countries (HIPCs) may qualify to have much of their debt owed to bilateral creditors and multilateral banks forgiven. Qualifying for HIPC assistance remains – though it has been expedited for 20 countries in the past year – a rigorous process. Among other things, countries need to be current on their loan payments and adopt major programs of economic policy reform. HIPC debt is being forgiven, not because the borrowers are not paying, but because the donors are concerned about the human and development costs that will ensue as the debtors continue to service their debts. Except for debt expunged through HIPC, the World Bank does not forgive loans.

Reflows as a Share of IDA Usable Funds

The amount which IDA is receiving annually in principal repayments for prior loans has grown substantially in recent years. Ten years ago, during the World Bank's fiscal 1991, IDA reflows totaled $274 million. In 2000, by contrast, the flow of principal repayments totaled $920 million. By 2005, the amount will likely rise to $1.95 billion. As will be discussed below, a substantial share of those future reflows has been earmarked to fund new projects that have already been approved.

The inflow of these resources has enabled IDA to shift a greater part of the cost of funding its future loans onto reflows, reducing the amounts required from donor countries. Donors make their contributions in the form of non-interest bearing non-negotiable promissory notes. The balances on those notes are encashed as IDA needs money to fund the disbursements on its existing loans. Overall, in 2000, IDA had a cash flow of $5.6 billion supporting its current disbursement program. Of this, $920 million was from reflows and $4.68 billion was drawn from the donor's outstanding promissory notes. On this basis, in terms of its total operations, IDA loan repayments currently account for 20% of the resources available to fund IDA lending operations.

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[23] World Bank. *Annual Report, 2000.* Washington, D.C., 2000.. Volume 2, p. 88.

The figure is different, however, for projects funded from the IDA 12 replenishment plan. In that replenishment, contributions from donor countries comprise about 60% of the funds available to fund IDA loan commitments approved during the period 2000 to 2002. Loan repayments account for the remaining 40%. The pool of IDA reflows earmarked to help fund loans funded with IDA 12 resources does not include only the repayments IDA expects to receive during that three year period. It also includes a major share of the loan repayments that IDA will receive during the following decade during which it will be making disbursements to implement IDA 12 loans.[24]

Reportedly, the IDA donor countries plan to use this same procedure in future replenishments to help reduce the budgetary cost to them from the IDA program. At some point, though, they will likely find that most of the loan repayments scheduled for receipt during a future replenishment period will have already been earmarked to fund loan commitments from earlier replenishments. If successive three-year IDA loan plans are funded in part with reflows that are scheduled for receipts during the next eight-to-ten years, the stream of uncommitted reflows will soon be exhausted. Presumably, at some point, the donors will need to decide whether the existing size of IDA's loan program should be maintained through increased payments or whether it program should shrink to a level that can be supported solely by the donors' contributions.

President Bush did not propose that IDA's existing loan portfolio should be converted retroactively into grants. The World Bank is writing off (through the HIPC program) some IDA debt owed by poor countries. However, no thought has been given to writing off all the IDA debt owed by all countries. Reflows would continue to be available from earlier IDA loans. The current talk about grants concerns the nature of IDA's *future* aid program.

Earlier Proposals for IDA Grants

General Support for the Concept

The concept of IDA grants had been under discussion for some time. There seems to be a broad base of international support for the basic concept that some IDA assistance should be provided on grant terms. Until President Bush made his proposal, however, few proposals seemed to contemplate that a large share of IDA resources would be allocated on such terms. The IDA eleventh replenishment agreement (IDA 11) said in 1996 that the World Bank could use some of the resources from the replenishment (in selected cases, in exceptional circumstances, and

[24] In effect, the current arrangement resembles a plan proposed earlier by the author. Both assume that future reflows can be pledged for use today either because they will not be needed in the distant future (because of developmental success) or because they will be in replaced by increased donor contributions. If these assumptions are not well founded, then the advisability of both plans may be subject to doubt. See Jonathan E. Sanford, "Feasibility of a World Bank Interest Subsidy Account to Supplement the Existing IDA Program." *World Development* 16:7 (1988), p. 787.

on a limited scale) for grants. The IDA 12 agreement (1999) said that the World Bank could make some IDA grants in connection with the HIPC program. Until late 2001, at least, most of the donor countries participating in talks about a new replenishment of IDA resources (IDA 13) had reportedly been willing to consider a grant program involving perhaps 10% to 20% of IDA funds. Meanwhile, Bank President James Wolfensohn reportedly favored the idea of an IDA grant program totaling up to $1 billion annually.[25]

U.S. Secretary of the Treasury Lawrence Summers proposed, at the World Bank-IMF annual meeting in September 2000, that IDA should provide more grant assistance to its recipient countries. Specifically, he said, precautions should be taken to avoid loading up heavily indebted poor countries (HIPCs) with new debt once the HIPC program had reduced their foreign debt to sustainable levels. "Further restraint on concessional lending may also be warranted," he said, "including though greater recourse to grant financing." IDA should also put more emphasis, he said, on education, health, and other social programs. Summers did not put a number on his recommendation. Treasury officials suggest, however, that, in private discussions, Summers was advocating a 20% grant level at the time.[26]

Discussion of an IDA grant program has taken place in context where, to an increasing degree, most foreign assistance is given to low-income countries on a grant basis. On the average, between 1971 and 1973, 55% of the official development assistance (ODA) the rich countries provided to poor countries on a bilateral basis took the form of grants.[27] Between 1988 and 1989, grants comprised on average 78% of their bilateral ODA. By 1999, almost 90% of the bilateral ODA from the richer countries was grant aid.[28] For many IDA donor countries, all of their bilateral foreign assistance is provided on grant terms.

Congress has spoken favorably on the question of IDA grants. In 2000, Congress included language in the fiscal 2001 foreign operations appropriations act – H.R. 5526, later incorporated by reference into H.R. 4811 (P.L. 106-429) – urging the World Bank to make IDA grants a component of its plan to assist heavily indebted poor countries (HIPCs). Specifically, it directed the Secretary of the Treasury to

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[25] John Donnelly "Change at World Bank Requires Donor Support; Some May Balk at Higher Costs." *Boston Globe* (July 18, 2001), p. A24. See also Phillips, *op. cit.*

[26] Interview with William E. Schuerch, Deputy Assistant Secretary of the Treasury for International Development, Debt, and Environment Policy, January 10, 2002. Schuerch served in the same position during the Clinton Administration.

[27] Rutherford Poats, Chairman. *Development Co-operation: Efforts and Policies of the Members of the Development Assistance Committee, 1982* .[Annual Report.]. Organization for Economic Cooperation and Development: Paris, 1982 Table II.A.14, p. 219. The rich countries included in these figures include the 22 members of the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD).

[28] Organization for Economic Cooperation and Development. Development Cooperation. Table [from *Development Cooperation, 2000,* the annual report of the OECD Development Assistance Committee (DAC).] Available from the OECD web site at [http://www.oecd.org/oecd/pages/home/displaygeneral/0,3380,EN-home-notheme-2-no-no-no-0,FF.html].

seek the adoption of a new policy at the World Bank specifying that all new assistance should be on grant terms for countries that have reached the completion point in the HIPC process.

In 2001, the U.S. Congress included language in H.R. 2506, the fiscal 2002 foreign operations appropriations act (P.L. 107-115) reiterating this concern. It directs the Treasury Secretary to give "high priority" and to "vigorously advocate" the adoption of policies (during the current talks about the terms for a new replenishment of IDA resources) which would enable IDA to provide grant assistance (rather than loans) for countries eligible for HIPC debt relief. The House Appropriations Committee said, in the report (H. Rept. 107-142) accompanying its legislation, that IDA should provide all-grant assistance to each HIPC beneficiary country for a three year period following its HIPC decision point. The Committee also said that it agreed with the recommendations of the Meltzer Commission (see below) "With respect to its support for multilateral debt forgiveness under certain conditions and conversion of IDA into an agency making poverty alleviation grants." It is not clear from the report language whether the Committee believed that all IDA assistance to all countries should be provided on grant terms or whether such grant assistance should be limited solely to HIPC countries.

Meltzer Commission Proposals

The Commission Report. The President's proposal was also proceeded by other proposals seeming major reductions (and sometimes elimination) in the international financial institutions (IFIs). Most prominent among these was the March 2000 report of the International Financial Institution Advisory Commission, chaired by Allan H. Meltzer.[29] Meltzer is an economics professor at Carnegie Mellon University. To some observers, many of the arguments voiced by the President – the points about increased effectiveness and ex-post evaluation, for example – resemble those made earlier by that panel. U.S. Treasury Department officials maintain that the Administration's proposal for 50% IDA grants was not derived from the Meltzer Commission report. Rather, they argue, it is based on sound development principles. Linking them together, they say, is guilt by association.

The IFI Advisory Commission was created in 1998, as part of legislation enacted that year authorizing U.S. participation in the most recent quota increase of the International Monetary Fund. The eleven members of the panel were appointed by the House and Senate leadership (six by the Republican majority and five by the Democratic minority.) The Commission issued its report on the strength of an 8 to 3 vote, although one member signed both the majority and minority reports. Many of the Commission's recommendations and findings were controversial. Among other things, it proposed that the World Bank should cease making loans (except in

[29] Meltzer, Alan H., Chairman. (2002) *Report of the International Financial Institution Advisory Commission*. March 2000. NP.

certain circumstances[30]), focusing instead on special purpose grants. Two kinds of grant programs were mentioned.[31]

The Commission recommended that the Bank replace its loan program with a program of grants aimed at alleviating poverty and promoting structural reform.[32] It would not fund the traditional types of development projects. Healthcare, primary education, and physical infrastructure were mentioned as possible areas of emphasis. Focusing on the poorest countries, those with per capita annual income levels below $2,500, it would be funded by contributions from the industrialized countries. The new program would be costly, the Commission said, and "[t]he amount of money requested from legislatures to fund explicit grants should rise." In addition, it said that "[t]he United States should significantly increase its support of effective programs to reduce poverty. The six dollars per capita currently spent is too much for ineffective programs but too little for effective programs."[33]

The Commission also proposed that another grant program should be created, terminating and replacing the existing World Bank.[34] Under this plan, the Bank would transfer all or most of its callable capital assets to the regional MDBs, to help them broaden their responsibilities. The World Bank's paid-in capital and retained earnings would be transferred, however, to a special trust fund. The income generated by that trust fund would underwrite a grant program addressing global public goods. These include environment, communicable disease, inter-country infrastructure systems, development of agricultural technology, and the creation of improved managerial and regulatory practices. The Commission did not say how large it thought the program should be. In 2000, IBRD paid-in capital totaled $11.4 billion and retained earnings totaled $19 billion. If this were invested in U.S. Government bonds at 5%, the yield would be in the range of $1.5 billion annually.

In both cases, in what may be the Commission's most innovative concept, the grants would be channeled through private suppliers who would be reimbursed for their costs only if independent auditors found that they had met specific quantitative performance goals which had been agreed to in advance. If the goals were not achieved, the service provider would not be paid. In both plans, reimbursement would be on a sliding scale, declining as a share of total costs as the income level and credit rating of the recipient country increased. Programs in the poorest countries would get a 90% subsidy; those in the most prosperous would get a 10% subsidy. The

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[28] The Commission said that, until the African Development Bank was ready to assume full responsibility for development lending in its region, the World Bank should continue making IDA loans to African countries. It also said that IDA should continue making loans to the low-income countries in the Middle East which currently qualify for IDA assistance. There is no development bank for that region. Commission report, p. 94.

[31] The Commission plan was also described later, with some elaboration, by Adam Lerrick, who served as Senior Advisor th Chairman Meltzer. See Adam Lerrick, "A better way to lend a hand." *The International Economy* (Washington), November/December 2000, p. 14.

[32] Commission report, pp. 89-93.

[33] Commission report, pages 91 and 96.

[34] Commission report, pp. 93-95.

local government would have no role in the actual implementation of the programs, but it would be expected to pick up the cost not covered by these grants.

The two plans outlined by the Commission were intended to hold program managers to a higher standard of accountability and performance than is the case today. This might increase the efficiency and cost-effectiveness of programs. The donor countries might also be able to require that the implementing agencies allow them to monitor programs funded by grants more closely than might be possible for programs implemented by governments and funded by loans.

Critics contend that there are possibly serious drawbacks to these plans. For example, they say, it is doubtful that many private organizations would be willing to implement IDA grant programs if they have to provide the money to carry out the programs themselves, with no real guarantee that they would be reimbursed later. Few charitable organizations have such deep pockets. The cost of borrowing money to implement these programs (based solely on the prospect of a contingent guarantee) may be prohibitive. Too many things can go wrong – the original goals of the project may prove unattainable, close monitoring by donors may complicate the process, or factors beyond the implementing agency's control may hinder success. For-profit contractors might be willing to take the risk, critics note, but the cost (likely substantial) of that risk would need to be built into the price they would charge the international agency.

In any case, assistance programs channeled through private organizations will still need the permission and cooperation of governments. Private organizations (particularly those who are paid only if they succeed) may be vulnerable to demands by corrupt government officials or requirements that funds be spent for sub-optimal purposes. In addition, perhaps for legitimate reasons, governments may be reluctant to pay their share of the costs if they have no control over program operations.

The plan for a grant program addressing global public goods might be a valuable undertaking, particularly if it could be done at no cost to contributors. However, the use of World Bank resources in this manner would have major opportunity costs in terms of other alternatives not pursued. The World Bank and the regional banks already address many of these issues (particularly health) in their current loan programs. International agencies, such as the Global Environmental Fund, World Food Program, and World Health Program address many types of global problems.

The amounts available to fund a grant program for global public goods would also be much smaller than that envisioned by the Commission's plan, critics argue. The regional banks would be unable to make much use of callable capital transferred to them by the World Bank unless it was accompanied by the associated paid-in capital. Callable capital alone would not be a sufficient basis for expanding the regional banks' borrowing programs. Without matching paid in capital and additional reserves, such borrowing would increase their exposure. Too much lending funded in this manner could lead to reductions in their bond ratings. Transfers of paid-in capital would be needed before the regional banks could expand their operations and replace the World Bank, as the Commission recommended..

The amount available to fund the trust fund from IBRD retained earnings may also be less than expected. The Bank's Articles of Agreement say that, if the IBRD terminates operations, any funds remaining after all the Bank's debts have been paid shall be returned to the member countries. This presumably includes the accrued net income of the Bank as well as the paid-in capital. There is no assurance – particularly if major countries disagree with the plan – that many assets would remain after the breakup to fund a global trust fund.[35]

Subsequent Proposals. Some observers have expressed concern that the Bush Administration ultimately seeks the adoption of a plan for IDA somewhat along the lines recommended by the Meltzer Commission. If so, they wonder what effect this might have on future U.S. policy towards the World Bank and IDA.

Their concern was heightened by the appearance, in the week following the President's speech, of a proposal to shut down the World Bank and to use its assets to finance grants. On July 26, 2001, the *Wall Street Journal* published an oped article by Meltzer and Adam Lerrick, his principal advisor on the Commission.[36] It argued that IDA's loan program should be replaced by a self-financing grant system. Meltzer and Lerrick note that IDA currently has $108 billion in rich country contributions on its balance sheets, partly in loans and partly in cash.[37] They argue that IDA could invest these cash balances at what they claim is a conservative rate of 8%, producing a perpetual income stream which might be used to fund $8.6 billion in new grants every year without any further need for donor contributions. It is unclear whether they believe the full assets of IDA should be invested in this manner now or if the cash should be invested now and the reflows should be invested later as they are received Both approaches are implied in their article. They say the World Bank's resistance to their proposal is motivated by intransigence, institution arrogance, and its "lack of basic arithmetical skills."

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[35] World Bank Articles of Agreement, at Article VI, Section 5. Article V, Section 2 says that the Board of Governors has the authority to determine the distribution of the Bank's annual net income. Section 14 says that the Governors shall determine annually what share of the net income should be placed in reserves and what share should be distributed to members. Although the Governors have chosen annually to allocate all net income to reserves, the money nonetheless the collective property of the member country governments and could be distributed to them upon vote of the Governors. *Articles of Agreement of the International Bank for Reconstruction and Development.* Entered into force December 27, 1945. Available from the World Bank's web site at [http://www.worldbank.org/html/extdr/backgrd/ibrd/arttoc.htm].

[36] Adam Lerrick and Alan H. Meltzer, "The World Bank is Wrong to Oppose Grants." *Wall Street Journal*. (July 26, 2001), p. A14. See also the reply by the Bank's Senior Vice President and Chief Financial Officer, Gary L. Perlin. Letter to the Editor. *Wall Street Journal* (August 6, 2001), p. 13.

[37] In 2000, the face value of IDA's assets was $101 billion, after allowance for $7 billion in debt written off via the HIPC program. Technically, the $7 billion has not been booked against total assets and is being carried on IDA's books as a negative balance in reserves. See World Bank *IDA Special Purpose Financial Statements*, June 30, 2001.

The concept outlined in the Meltzer-Lerrick plan may be feasible. However, critics argue, its potential benefits should be compared with those available through continuation of the existing program, and that the amount of assistance which might be available through their plan is likely to be smaller than they presume. IDA's assets could be invested, as Meltzer and Lerrick propose, but the fair market value of IDA's portfolio is much smaller than they suggest. IDA does not have the contractual authority to recall its loans or to demand early payment of the balance due. If it wants to turn its loan portfolio into cash, those assets will have to be sold to another party.

According to this interpretation, if IDA were able to sell its assets and the purchasers paid what the Bank considers the "fair market price," it might be able to get $56 billion which it could invest.[38] Ten year U.S. Treasury notes currently yield 5%. Investing the full $56 billion on a no-load, no-cost basis, IDA might be able to realize something like $2.8 billion annually to fund a future grant program. On a grant-equivalency basis, this is less than half the size of the current IDA program. It is also about one-third the amount that Lerrick and Meltzer believe might be available from implementation of their plan.

Two other considerations might be assessed. First, potential purchasers may be unwilling to pay the amount the Bank considers to be the "fair market" value of IDA assets. They may worry that the former IDA borrowers will be less inclined to pay the new private owners of their notes, since the new owners are unlikely to make them future concessional loans. In that case, the amount generated by the proposed investment scheme would be less than that estimated above. Second, IDA's assets likely are worth more if IDA remains a functioning organization than they would be if it were liquidated. In the former case, the debtor countries are more likely to pay and IDA would not need to discount the value of its assets as it uses loan repayments to fund future loans.

Professor Meltzer has spoken out strongly in favor of the President's proposal, though he has given it his own interpretation. The plan will work, he says, and claims by Bank spokesmen that donations would have to increase dramatically are incorrect. "Despite what they say, the grant proposals would be more efficient; that is, they would be able to give more aid with the existing resources," he wrote. For instance, he observed, the World Bank could give half the amount it would normally lend and

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[38] The face value of IDA's disbursed loan portfolio is about $86.6 billion. According to World Bank accountants, its "fair market value" in June 2001 was between $46 billion and $49 billion. The face value of the portfolio must be discounted, not only for net present value, but also for credit risk, seasoning, multilateral and sovereign risk preferences and other factors. The promissory notes from donors and the IDA's liquidity pool (its remaining assets) are fully committed to finance existing loans. If someone buys those loans, the price would presumably be reduced to offset these undisbursed but committed funds, as IDA has already agreed to use them to cover the IDA share of projects currently being implemented. A new owner would presumably acquire this obligation as well as the funds. Thus, the value of IDA's "cash" resources must be discounted in a manner similar to that used for outstanding IDA loans. Including the discounted value of these funds would bring the total up to about $56 billion. See World Bank *IDA Special Purpose Financial Statements*, June 30, 2001, p. 24.

countries could borrow the rest commercially "because they would have the Bank's guarantee."[39] It might be noted that, under this interpretation of the President's plan, countries would pay commercial interest rates for half the money they used to fund a project and IDA grants would fund the rest. On average, the combined rate they would pay would be higher than the World Bank and other MDBs now charge for their ordinary near-market rate loans. Presumably, if the World Bank guarantees the repayment of the commercial loans, the recipient countries would have to pay the Bank its usual fee for such service.

Brett Schaefer also stated, in a report prepared for the Heritage Foundation, that "Clearly the time has come for the World Bank to implement performance-based grants." The Administration should make sure, he said, that new funding for the next IDA replenishment would be used for the grant proposal. He also proposed that the Administration seek agreement among other IDA member countries for an arrangement to use existing IDA resources for the grant proposal as they are repaid. He said that Congress should prohibit any future U.S. participation in IDA replenishment plans until IDA implements the grant proposal. He said that $873 million would be available to fund grants if the full resources of the next IDA replenishment (presumably $11 billion) were invested at 8% for that purpose.[40]

Schaefer's proposal would also go well beyond that proposed by President Bush. He would have the existing IDA program (which lends $6 billion a year) replaced by a grant program about 15% its size (less if – as suggested by critics – a more realistic interest rate for investments were used and allowance is made for reflows already committed to support previously approved IDA loans.).

The Administration's Argument for Grants

U.S. Treasury Department officials deny, as noted earlier, that the current U.S. proposal for 50% IDA grants is based in any way on the Meltzer Commission report. They note that Treasury Secretary Paul O'Neill was strongly critical of the Meltzer Commission's findings in his required report to Congress, discussing steps taken to implement the recommendations of the Meltzer Commission.[41] Virtually every argument and finding was refuted, they argued, in detail.

The developmental effects of IDA need to be enhanced, Treasury argues. The other donor countries say they want to do more, says the principal U.S. negotiator, but – except for the United States – none seem willing to increase their contributions. A grant program would intensify IDA's impact at a relatively modest indirect cost to donors. The World Bank found that a 40% IDA grant program would reduce repayments by approximately $570 million a year in the decade following the end of the 10 year grace period (see below), he mentioned. Considering the overall cost of

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[39] See Phillips, *op. cit.*

[40] Brett Schaefer, "Real Help for Poor Nations: President Bush's World Bank Grant Proposal." The Heritage Foundation. *Backgrounder*. No. 1466. (August 20, 2001).

[41] Interview with William E. Schuerch, January 10, 2002.

funding IDA, he argued, this would be a rather modest price to pay. He noted that, with the decline in commercial interest rates in recent years, the grant-equivalency of IDA loans has fallen substantially (to about 65%, he calculated) from much higher levels in the 1980s.

In many instances, he 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. Consequently, they generate little income to help countries repay the loans which financed them. Increasingly, he maintained, most foreign aid is provided on grant terms. Some 99% of the official development assistance that DAC countries provide to very low income developing countries now takes the form of grants. Many of the countries most resistant to IDA grants give most or all of their bilateral aid to poor countries as grants. He noted that, while the United Kingdom was strongly opposing the concept of IDA grants, the U.K. Chancellor of the Exchequer gave a speech in Ottawa supporting the establishment of a new multi-billion dollar trust fund to address (through grants) millennium development goals. He also recollected that a Scandinavian country now opposing IDA grants had advocated 100% grants a decade earlier.

There is no intrinsic reason to believe, he argued, that repayments for IDA loans needed to be recycled through the World Bank for them to be used effectively for development purposes. Arguably, he maintained, if the policies and institutions of recipient countries are sufficient, their governments and private sector should be better able to make effective use of the income and benefits generated by IDA projects to promote their own development. In any case, he asserted, the argument that IDA has an excellent repayment record is misleading. In the past decade, the G-7 countries and others have agreed to forgive most or all of the repayments due from earlier bilateral aid loans to heavily-indebted poor countries. IDA has become, in effect, a preferred creditor. The donor countries have been willing to forego repayment of their old bilateral loans in order to ensure that debts to IDA can be repaid. Since IDA has no bondholders (like the IBRD) who must be repaid, and since the countries forgiving bilateral debt are the same ones responsible for most IDA contributions, he argued, IDA's high repayment record is not an accurate reflection of its financial situation.

There is no relationship, the Treasury Department asserts, between the President's proposal for 50% grants and the World Bank's private sector development strategy. "Treasury is taking its policy leadership from the President's speech at the World Bank on grants," stated the official principally responsible for implementing U.S. policy.[42] "That speech has a list of purposes for which grants might be used – education, health, water and sanitation, and a couple other things. That list does not include private sector activities or private provisioning of services." He indicated that the IDA deputies had agreed, during their negotiating sessions, that nobody was against the concept of private provisioning of services *per se*, though several countries had reservations. Everybody also agreed, he said, that governments

[42] Interview with William E. Schuerch, February 6, 2002.

are responsible for these activities and any private programs would need to be monitored by them.

British and Other Views

Clare Short, the U.K. minister for international development, has taken the lead in mobilizing opposition to the U.S. proposal for expanded IDA grants. The Scandinavians and other European countries have also expressed strong reservations concerning the U.S. plan. Reportedly, they believe that poor countries will be less likely to squander World Bank aid if they know they will have to repay it some day. Some also reportedly suspect that Treasury Secretary O'Neill seeks to undermine IDA's financial base through advocacy of the 50% grant scheme.[43] Development Minister Short has reportedly stated that "IDA is very valuable and we are looking to increase our contribution substantially. But if it is compromised [by a large grant program], we would look to give more bilaterally instead." France, Germany and Japan have indicated, by contrast, that with the declining international value of the euro and yen, they cannot afford to contribute the same share to the new IDA replenishment as they gave to the last.[44]

The British government issued a statement in February 2002 further explaining its views on the issue of IDA grants or loans.[45] It made four points. First, it asserted, the current system makes more effective use of the limited aid funds which are available to help poor countries. Reflows from old loans are a major element of the procedure for financing IDA. With grants, there would be a gap – billions of dollars a year in the third and forth decades – that would have to be filled by major increases in donor contributions. "It seems reasonable to assume that there will be an ongoing need for IDA finance," it stated. "On this basis, we should be taking a long term-view."

IDA should remain a loan program, the statement argued, because this enhances ownership and promotes effective cooperation among donor agencies. The World Bank and the other international development agencies should work in partnership, not in competition. "A clear and selective strategy for IDA and effective collaboration amongst agencies are two of the great reforms we have all worked on in the past few years.[46]

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[43] Paul Blustein, "U.S.-Europe Clash Stalls World Bank Aid Plan; Bush Seeks Grants, Not Loans." *The Washington Post*, January 30, 2002, p. E1.

[44] Alan Beattie, "Deadlock in dispute over money for poor nations; World Bank Contributions." *Financial Times* [London edition], January 15, 2002, p. 10.

[45] [U.K. Department of International Development.]"Loans or Grants: IDA's Concessional Lending Role." ND. Provided to the author by the Office of the U.K. Executive Director to the World Bank and IMF, February 8, 2002.

[46] The British also emphasized this point in an earlier statement on IDA. "Substantial grant funds are available from other development agencies–particularly the UN, bilateral donors and the European Commission," it observed. "It is important that the World Bank should work in (continued...)

Third, said the statement from Ms. Short's department, "We do not accept that IDA's current terms are always inappropriate for interventions in health or education, or that cheaper finance would encourage countries to invest in these areas more." Donor countries should not try to dictate to developing countries what their priorities should be, it said. Rather, the donors should encourage countries to establish their spending priorities through a system of broad national consultation, such as is embodied in the Bank's Poverty Reduction Strategy process. Grants should be reserved for special situations – such as post-conflict recovery or regional programs to combat infectious disease – where IDA's normal loan program might be inappropriate.

Finally, the British disputed the argument that IDA countries could not afford to repay IDA loans. The statement noted that IDA's repayment record has been very good. IDA loans "provide a bridge," it said, "between grants and non-concessional borrowing." By demonstrating that they can repay concessional loans, countries help lay the groundwork for their future entry into the regular international financial system. Even the idea that IDA grants should be targeted to HIPC countries (after they have relieved debt relief) is a mistake, the statement argued. "If poor countries exiting from HIPC cannot even service new debt on IDA terms," it said, "then HIPC will have failed." Rather than planning for failure, it maintained, the international community should expect that HIPC graduates will grow, develop, and take their place in the world economy.

Negotiating IDA's Terms

During 2001, representatives from the IDA donor countries met on several occasions to discuss terms for the next IDA replenishment. The World Bank has reportedly suggested that an appropriate level for the IDA 13 replenishment would be SDR 18.1 billion (about $23 billion), including SDR 500 million for HIPC debt forgiveness. Of this amount, some $12.5 billion would be solicited as new contributions from donor countries. The remainder would be provided from IDA reflows and other sources.

At the first negotiating session in February, the World Bank presented an analysis of the potential effects a grant program might have on IDA finances. The Bank reported that a 20% grant program would drain IDA's resources by some $400 million during the first ten years and $4.3 billion during the next decade. On the other hand, the Bank reported, IDA's financial base could be strengthened if a 20% grant program were matched by a program hardening the repayment terms for 20% of IDA's remaining loans. The Bank suggested that higher interest charges and shorter

[46](...continued)
partnership with these other agencies not in competition with them, with each institution respecting each other's comparative advantages." See: Office of the U.K. Executive Director to the World Bank and IMF. Statement titled "Loans or Grants: IDA's Concessional Lending Role." ND (Provided to author on August 6, 2001.)

repayment periods might be appropriate anyway for countries approaching graduation or for countries with per capita income levels near the top of the eligible range.[47]

President Bush's proposal for a 50% grant program changed the context for the negotiations. Instead of 20% being the leading edge, it now became a level far lower than that preferred by IDA's largest donor country. The U.S. representatives reportedly told the other donor countries in October that a failure to move towards grants could jeopardize the size of the U.S. contribution. The 50% proposal widened the differences among the donor countries. As noted earlier, the British strongly opposed the U.S. proposal while some other countries were reportedly willing to go as far as the 20% figure presented in the February World Bank report. In November, Ms. Short was reportedly seeking to rally other countries to oppose the U.S. proposal and to isolate the United States.[48] As they prepared for the upcoming December negotiating session, the Europeans and Japanese lined up, almost without exception, in opposition to any large scale movement towards grants.[49] The Canadians were reportedly willing to consider steps that would increase the grant element of IDA lending (by lowering or waiving the service charge and extending the repayment period) while preserving the basic principle that IDA assistance must be repaid.

By the December negotiating session, in Montreux, Switzerland, the IDA deputies had reached agreement on all issues save the actual size and proportional distribution of the new replenishment and the share allocated for grants. The United States put on the table in Montreux a two part proposal[50]. "The U.S. is willing to *substantially* increase its individual contributions to the 13th replenishment of the International Development Association (IDA)," it said, "with agreement on two important issues." First, it stated, the United States wanted to see the adoption of a results-based contribution framework. Second, it wanted a substantial increase in the share of grants. "If the conditions were met, " Treasury said, "the full U.S. contribution would represent an 18% increase from IDA-12."[51]

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[47] World Bank. *IDA Eligibility, Terms and Graduation Policies.* International Development Association, January 2001. Prepared for the first IDA 13 negotiating session in Paris, February 28-March 1, 2001. Available from the World Bank web site at [http://www.worldbank.org/ida/ida13docs.html].

[48] Alan Beattie, "UK minister aims to halt proposal to replace loans; World Bank aid." *Financial Times*, London edition. (November 17, 2001c), p. 8.

[49] Alan Beattie, "Feeling the pressure: World Bank, by Alan Beattie; the bank has been beset by criticism of its direction and management style." *Financial Times*, Surveys edition. (November 30, 2001), p. 4. See also: *Jiji Press English News Service.* "U.S. Out of Step with Japan, Europe on IDA Capital Hike Talks." Tokyo (December 11, 2001), p. 1.

[50] U.S. Treasury Department.(2001a) Paper titled "U.S. IDA-13 Objectives." ND Presented to the IDA deputies negotiating session in Montreux, Switzerland, December 8, 2001. Photocopy provided by Treasury Department to author.

[51] The 18% increase in U.S. contributions is calculated in dollar terms. In terms of the SDR, the unit of account for IDA replenishments, Treasury officials said the U.S. increase would be closer to 25% because of recent movements in the relative value of the U.S. dollar

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The U.S. proposal was somewhat vague as to the nature of the results-based contribution framework it desired. Basically, it said that the U.S. would increase its contribution in phases contingent on "explicit input actions (such as country fiduciary, investment climate and poverty diagnostics necessary to design and evaluate credible lending programs) and development results in areas most crucial to growth and poverty reduction (such as school enrollment rates, people with clean water, sustained productivity growth, per capita incomes, and poverty rates.)" The United States invited other countries to explore ideas for trigger mechanisms along these lines. The Treasury official heading the U.S. delegation commendted later that, in practical terms, this probably would require some type of institutional changes in the Bank, since changes in world poverty levels or the success of IDA programs would not be measurable (even with maximum effort) in just two years.[52]

The negotiations were adjourned from Montreux with no settlement of the outstanding issues. The other donor countries were reluctant to go to, or much beyond, the 10% level while the United States held firm for the 50% goal. The other countries had no clear response to the U.S. proposal for adoption of a results-based contribution system. Many countries were concerned that the changes sought by the United States might alter the multilateral banks in ways that ultimately would hurt the poor. Many still had deep reservations about the long-term impact a large grant program might have on IDA finances. The IDA donor countries plan to meet in late February 2002 for another negotiating session, if they believe that sufficient grounds for agreement on a final plan have been developed. The issue is likely to be discussed at various levels during the series of G-7 meetings scheduled during late January and early February. Some participants in the discussions are reportedly pessimistic. Others believe that adequate grounds for agreement will be found. "There is a general consensus," said a close World Bank observer, "that there will be a consensus."[53] He also noted that, until the British and Americans can work something out, "it will be hard to get a resolution." Ultimately, he observed, "Everybody knows its going to end up somewhere in the middle, but they haven't gotten to that point yet."[54]

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[51](...continued)
compared to the currencies of other donor countries.

[52] Interview with Schuerch, January 10, 2002. He said this was not a plan to make disbursements for IDA assistance contingent on the recipient meeting specific performance benchmarks (as proposed by the Meltzer Commission or Meltzer and Lerrick.) Rather, Treasury had in mind additional improvements in IDA's new (since 1998) country policy and institutional assessment procedure. The latter seeks to target the bulk of IDA resources to countries that score highly on twenty performance criteria. This tries to ensure that most IDA money goes to countries deemed most likely to use it effectively. Reference was made by Schuerch to several papers (not available to the public) prepared by World Bank research staff and to information on the Bank's web page. For the latter, see World Bank. *How IDA Resources are Allocated*. Updated November 2000. Available from the Bank's web site at [http://www.worldbank.org/ida/idaalloc.htm].

[53] John Donaldson, senior official in the Bank's external affairs office, in Julian Borger, "Short Blocks US Plan for World Bank Grants," *The Guardian* [Manchester, UK]. January 17, 2002, p. 16.

[54] John Donaldson, in Paul Blustein, "U.S.-Europe Clash Stalls World Bank Aid Plan; Bush
(continued...)

As requested by its stockholders, the World Bank prepared another paper for the December session analyzing the potential financial and program impact of several different kinds of IDA grant programs.[55] These included grants linked to certain uses, 50% grants limited to countries with annual per capita income levels below $350, both of these options with easier terms for remaining IDA loans, and 50% grants for all IDA-eligible countries. Substantial differences in the financial impact on IDA were noted. However, in certain cases (grants limited to certain uses, softening the terms and perhaps waiving the service charge), the Bank was able to present figures showing that only 10% of total IDA resources would be needed while 50% of the projects or programs in the group could be made available on grant terms. For the categories reserving IDA grants for low-income, however, the share of total IDA resources devoted to grants was upwards of 20% and for the U.S.-preferred option the total was (for reasons explained above) about 40%.

The Bank later reported that the U.S.-preferred IDA-only grant program would have major out-year costs. During the first decade, it said, the cost to donors would be about $30 million annually. During the second decade, the average annual cost would be $570 million. In the third decade, if the donors want to maintain IDA at its existing level, another $1.8 billion annually in new contributions would be required. During the forth decade, to keep IDA the same size, the donors would need to contribute an additional $3.5 billion annually.[56]

Where To Go From Here

Critics hear in the proposal by President Bush echos of the plans put forth by Professor Meltzer and his colleagues. The conditional reimbursement plan mentioned in the President's original speech – no payment to the private supplier of services unless goals are achieved – is similar to that proposed in the Meltzer Commission. The President's call for more IDA aid for education, health, and poverty alleviation programs reminds many of the Commission's plan to scrap the World Bank's other loan priorities in favor of a special concentration on poverty alleviation and global public goods. Also, by not discussing publicly the long-term costs or U.S. additional contributions, the President seemed to suggest in his speech that a major IDA grant program could be instituted at little or no cost to the donor countries. The Treasury Department's later initiatives during the IDA negotiations, including the suggestion that the U.S. contribution might be increased by 18% and the Secretary's criticism of

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[54](...continued)
Seeks Grants, Not Loans for Poor," *The Washington Post*. January 16, 2002, p. E1.

[55] World Bank. "Grants and Concessionality in IDA13." International Development Association, November 2001. Prepared for the fourth IDA 13 negotiating session in Montreux, Switzerland, December 6-7, 2001. Available from the Bank web site at [http://www.worldbank.org/ida/ida13docs.html].

[56] [World Bank]. "Measuring the Costs of IDA Grants." ND. Unpublicized memorandum sent to IDA donor countries after the December meeting. The amounts are larger than those reported in the November 2001 paper on grants and concessionality. Provided to author by World Bank on February 6, 2002.

the Meltzer Commission plan, were not publicized or given much public emphasis. In any case, it was (and remains) unclear how the Department's negotiating position comports with the goals announced in the President's speech.

Concern on this score is compounded by statements by some supporters of the President's plan. For example, Schaefer says that "In all respects, the grant system proposed by the Meltzer Commission would be superior to the current World Bank lending system." He believes that President Bush has endorsed the Meltzer plan. In the next sentence, he says that "[t]he Bush Administration recognizes this fact," in the President's July 17 proposal. The President's plan is, he says, "a variation of the Meltzer Commission proposal."[57]

The Global Challenge Initiative (GCI), a long-time critic of the IMF and World Bank, picked up on this point. "Many of the opponents of the U.S. [grant] proposal see the U.S. as potentially destroying the World Bank and supplanting it with a small grant-giving agency that spearheads output-based aid schemes," it stated. It observed that this model had been proposed earlier by the Meltzer Commission. A grant program linked to output-based aid and a broad emphasis on privatization in the health, education, and clean water sectors would substantially reduce future access by poor people to public services and open the field to unregulated activity in these (and other) areas by foreign investors, GCI concluded.[58]

A World Bank official was quoted as telling the press in mid-2001 that the President's decision to put a specific number on his proposal for IDA grants was "distracting."[59] From this perspective, it raised many extraneous issues and made the negotiations on the issue more difficult when he announced a figure much larger than those the other countries had considered. Concern, on the part of other donors, about the size, implications, and possible hidden motives behind the President's seems widespread.

From another perspective, though, the President's bold announcement pushed the discussion into new areas which might not have been explored otherwise. John Taylor, the current Undersecretary of the Treasury, is quoted as saying that the one-half figure is not negotiable and the other donor countries need to come around to the U.S. position. "We will go all the way to Bush's proposal – I don't see it as a bargaining situation."[60]

This may be an effective strategy, as a final decision on the IDA replenishment must be reached in early 2002 so there will be time for national legislatures to act during the year. Many people believe the Administration is less desirous than are other donors of achieving a large replenishment. On the other hand, Taylor's firm language may be a negotiating ploy, some observers note, especially in the light of a

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[57] Schaefer, *op. cit.*, pp. 7-8.

[58] See GCI, "Growing Dangers of Service Apartheid," *op. cit.*

[59] John Donaldson, quoted in Anna Willard, "USA to Stand Firm on World Bank Grant Proposal." *Reuters*. (August 6, 2001.)

[60] John Taylor, quoted by Willard, *op. cit.*

parallel U.S. campaign to win broad multilateral support in its efforts to combat international terrorism.

There would appear to be grounds for compromise on this issue. In money terms, the two sides seem far apart. In other ways, however, the difference between the parties may be smaller. IDA lent about $2.13 billion for health, education, social protection, and water and sanitation projects, about 32% of the total. Likewise, IDA lent $2.87 billion in 2001 to countries with per capita income levels below $350 annually. This comprised about 41% of the total. If half that assistance had been provided on a grant basis, either 15% or 20% of IDA resources would have been required. Either approach could be the basis for a split-the-difference type compromise.

There might be room for a functional compromise. In addition to a modest grant program, the replenishment might provide that a major share of IDA's loans to very poor countries would be repayable in local currency. This would retain the principal that loans must be repaid and – with a maintenance of value provision – the value of the repayments would be retained. The local currency could be used for loans to the issuing country covering local cost financing, recurring costs, or other similar activities. In effect, though loans, these repayments would not require that countries find foreign exchange to cover the cost of projects whose economic benefits will not be realized until many years in the future.

Likewise, there might be room for a procedural compromise which allows everyone to do what they want. Instead of the IDA 13th replenishment being a single account, the donors could establish two sub-accounts, with contributions to either being counted as contributions to the replenishment as a whole. The funds contributed to IDA 13A would be used to fund loans, as in the past. Those contributed to IDA 13B would be used to fund grants. If the other donors channeled 10% of their overall contribution to the grant account and the United States contributed its entire share, the amount available for grants would comprise 28% to 31% of the total replenishment (depending on the final U.S. share.) The grant component would be even larger if other countries contributed a larger share or if the World Bank put the entire amount it usually contributes (from IBRD net income) into the grant account. The latter might be done on the understanding that funds would be used for projects fighting AIDS and other endemic diseases, for assistance to the poorest, and for programs addressing global public goods. All have been priority concerns of the Bank and IDA in recent years.

There might even be room for a hybrid compromise. Half the IDA's loans to poor countries might be made on a conditional basis, where the repayments are automatically waived each year (as a contractual right) so long as the borrower meets certain specified criteria. For instance, no repayment would be required if the recipient continued to meet the education, health, poverty reduction or other performance requirements in the original loan plan. This would de facto convert future loan repayments into future grants and establish a 40 year incentive plan for recipient countries.

From the U.S. perspective, it appears that the Administration may need 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 supporters. By contrast, with a 50% agreement of some type, the Administration might be able to present the replenishment plan as a victory and a demonstration that the World Bank can be "reformed." This would be particularly so if the new replenishment required broadly-supported institutional changes or the adoption of improved methods for monitoring project implementation and outcomes.

From the perspective of the other donor countries, by contrast, it would appear important that any agreement for IDA grants should not threaten the financial integrity of the program. One possibility might be an IDA 13 replenishment plan in which a larger share of the new resources comes from donor contributions and a smaller share comes from the advanced commitment of future reflows. More reflows could be scheduled for use in financing new loan commitments only when they were actually received. This would leave available for future IDA replenishments a larger share of the remaining future reflows. On this basis, any long-term negative effects that a grant program might have on IDA finances would be limited in their impact and would be spread out over a longer period of time.

Several other observations might be made. First, it is not clear how much grant money the poor countries could afford to receive, particularly if the assistance requires increased spending for social sector programs. Grants will relieve countries of the need to budget for repayments. However, they can add to countries' budgetary costs in other ways. The MDBs usually finance the import costs of projects. The borrower normally pays the local costs as well as the recurring costs for programs or projects once they are established. The recipients would have to find room in their national budgets – often a difficult task – for these costs. Health and education programs generally require larger proportional inputs from the recipients than do many other kinds of projects. If the recipients cannot afford the counterpart and recurring costs of new health and education programs, it may be inappropriate for IDA to set aside large sums for grants to sponsor them.

Second, concern about the long-term implications of the Bank's prospective private sector development strategy need not be an impediment to adoption of a grant program. President Bush said, in his original speech, that performance based assistance should be part of his proposed grant program. However, it is not evident from his speech and subsequent Administration statements that all IDA grants need be provided on this basis. If the parties were willing, the new replenishment agreement could provide that none or only a small portion (perhaps up to 10%) of IDA grants could be used in this manner.

Third, the growth effects of different types of programs may merit consideration. Treasury Secretary O'Neill said earlier in 2001 that he believed the MDBs should put less emphasis on peripheral matters and more stress on programs that encourage economic growth and increased productivity. Investments in human capital (through education, health, and related programs) will improve the productivity of labor in the long run. However, investments in infrastructure (power, transportation, etc.) and capital facilities may boost efficiency levels and promote growth and development somewhat faster. Likewise, programs promoting economic policy reform, better governance, stronger institutions, and recovery from war or natural disaster can have strong medium-term growth effects. Also, improvements in infrastructure and reform are more likely to stimulate inflows of foreign investment. Unless the donors expand the size of the IDA program, more IDA assistance for humanitarian programs will necessarily mean less assistance for other types of programs.

Fourth, steps may be required to protect U.N. grant programs from competition from an IDA grant program. The terms and objectives of an IDA grant program will need to be coordinated with those of the U.N. Development Programme, World Food Program, and other international grant-making programs. Some critics of the President's proposal worry about "mission creep,"a concern that IDA might compete or undercut the other U.N. agencies if it has a sizable grant program. However, there is a great deal of overlap and similarity among the multilateral banks and the U.N. development agencies these days in the types of programs they all finance. The World Bank may have made incursions into the other agencies "turf," but there seem to have been at least as many incursions in the other direction as well. Supporters of the existing arrangement argue that an IDA loan program is desirable, if only because it teaches borrower countries that the repayment of debt has positive consequences. However, questions have been raised as to whether the principal difference between IDA and the U.N. development programs should be their repayment terms and not in the types of activities they support or the skills and priorities they bring to the table. IDA loans or IDA grants, the issue of overlap among the international aid agencies is one which merits closer examination.

Fifth, attention might also be paid to the equity effects of future changes in IDA's repayment formula. The World Bank has suggested, for example, that IDA might "harden" some of its repayment terms in order to offset the costs of a grant program. Caution should be exercised regarding plans for "gearing up" the creditworthiness of borrower countries or for promoting "efficiency" in IDA operations. In themselves, these may be worthy concerns. Countries may enhance their creditworthiness if they are able to pay a gradually increasing interest rate for their IDA loans. The efficient use of IDA resources may also be improved if less needy countries pay more for IDA loans. However, if the proceeds of the higher IDA interest costs are used to defray the costs of IDA grants, then some of the cost of the grant program will have been shifted from the rich donor countries to the poor countries who are only slightly better off than their poorer neighbors.

Sixth, the claim that recipient countries will be more likely to waste IDA resources if they receive assistance in the form of grants rather than loans might be questioned. This argument seems to presume that the Bank's normal oversight mechanisms would break down or the Bank would be more willing to fund weak projects through grants than it would through loans. There is no evident reason why the Bank would use different standards for evaluating or implementing grant projects than it would for loan projects. Likewise, there is no way of knowing beforehand whether the Bank will make better use of IDA resources if it gets them back as loan repayments than the recipient will do if it had them as a grant. Nobody knows whether the governments of IDA-recipient countries will be wise or foolish thirty years from now. An appropriate concern might be whether the poor in those countries are the principal beneficiary of the activities funded by the hypothetical loan repayments. In any case, future country performance issues can be addressed at least as easily through the Bank's country review process as through future loan programs.

Seventh, it seems apparent to most observers that little real progress can be made in a discussion about IDA grants if other participants harbor serious reservations about the long-term motivations of the United States. From press reports and discussions, it seems that some countries worry that the President's grant proposal would "defund" IDA, substantially increasing the future cost of the program and possibly leading to its closure or substantial reduction in size. Few people seem to know about the Administration's statement in December 2001 that it might support an 18% increase in U.S. contributions. Progress in the negotiations might be enhanced if all donors were willing to discuss and include language in the final report describing their long-term plans and expectations. In particular, they might state whether they believe their countries' future contribution levels to IDA should increase (as a decline in future reflows diminishes the amounts of money IDA has available to support new loans) or whether they believe the IDA program should shrink in size as the inflow of future debt repayments gradually declines.

In many respects, it appears that the controversy about IDA loans and grants is not really one about IDA finances. The costs and benefits of a grant program would be phased in gradually and would become significant only thirty to forty years hence. The real benefits from a grant accrue, not at the time of the award, but at the time the repayments for the alternative loan would need to have been made. In fact, IDA could reduce its assistance levels to former grant recipients by amounts comparable to the hypothetical loan repayments and countries would have the same amount available in future years to fund new development projects as they would have if all assistance had been financed through loans. Whether or not they would use it wisely and for anti-poverty purposes is a different concern.

The World Bank reports that a grant program would require billions of dollars in new annual contributions from donors thirty or forty years hence if IDA is to be kept at the same level as before. This presumes that the donor countries continue to include a 50% grant provision in future replenishments. It also assumes that the demand for development aid will be as great forty years from now as it is today and the World Bank will need those IDA reflows in 2040 to fund new IDA loan programs whose repayments would stretch to the end of the century and fund new loans going well into the next. All these contingencies are speculative. If they were agreed on basic principles, the donor countries and the Bank should be able to work them out over the coming decades.

On another level the controversy seems to be, not IDA finances, but the donor countries' relative influence in international agencies. Until recently, the United States has been the predominant voice and influence within the World Bank. Increasingly, however, it seems that the other donor countries are becoming more assertive in their views. In part, this may be due to concern about the direction of U.S. policy. In part, though, it also seems a function of their growing relative size. Already, it appears that the European countries are devising their policies more in consultation with one another than in separate consultations with the United States. Should the countries of the European Union ever develop a common policy position, they would be in effect the largest single "member country" in the Bank. The debate on IDA grants seems to presage a situation where influence in the multilateral banks will be more evenly distributed and where – unless the United States makes major efforts to increase its financial support and to reshape the way it tries to influence policy – the

Europeans in particular will seek and find a larger role. What effect this may have on the organization and operations of the multilateral agencies remains undetermined.