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The World Bank must fix its business model

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In the wake of the global financial crisis, the need to deliver aid effectively is more urgent than ever. A new United Nations report finds that the working poor in developing countries have been hardest hit. Yet the World Bank is falling short of its potential. At the heart of the matter is a tension between its mission and its business model. Reconciling this tension, one of the most challenging in its 65-year history, is the critical task for its leaders who will gather in Istanbul on Tuesday.

The World Bank is the only global institution with the sole purpose of fighting poverty. To be effective, it needs to focus all its resources on achieving this mission. The bank's business model fails at the very foundations of its structure. Its two main sources of revenue, interest payments on loans from borrowing governments and contributions from wealthy member governments, both stand in conflict with its anti-poverty mission.

As with any lender, the bank relies on making loans so that interest payments can provide a steady stream of income. But this breeds a persistent problem that needs to be addressed. Because the poorest countries are often unable to keep up with payments, even on low-interest loans, the bank has steadily shifted its lending to those that can – middle-income countries such as Brazil, India and China. These countries could secure financing in private capital markets, but are attracted to the bank's more favourable terms for anti-poverty programmes. In addition, they know the bank needs them to survive. So they can push for even better conditions, such as reducing social and environmental safeguards intended to protect the most vulnerable communities and natural resources.

This growing dependence on large loans undermines the bank's anti-poverty mission by shifting its focus away from the poorest countries, while also eroding protections for the most marginalised. To complicate matters further, China has now become a big lender itself, offering loans to countries in sub-Saharan Africa for infrastructure and energy projects, often without the social protections that come attached to World Bank loans. This puts even greater pressure on bank staff to push for large loans to ensure a revenue flow.

The second main source of revenue for the bank, contributions from its wealthiest member governments, also compromises its mission to the poor. Based on a corporate shareholder model, this arrangement gives the strongest voice to its biggest donors. This governance model has been widely criticised for creating a moral hazard problem – the countries that wield the most voting power are not accountable to citizens who are affected by their decisions. The bank needs these infusions of money from the richest members, which support grants and interest-free loans to some of its poorest countries. But though the shareholder model may be useful for generating funds, it undermines a critical component of development – accountability to the people most affected.

The bank's sister institution, the International Monetary Fund, shares this conflict. But the IMF has begun to confront the issue of governance reform over the past year. It is surprising that the bank, which has historically been far more open and responsive to citizen groups than almost any other international financial institution, is adrift on this crucial issue of governance.

How is the bank to address these two fundamental problems in its business model? It can begin with three steps:

First, follow the lead of the IMF on governance reform. A commonly advocated first step is to change the voting formula to give developing countries more say in decisions which directly affect their lives. This is crucial, but deeper changes are needed. As Nobel prize winner Joseph Stiglitz suggested to Congress recently, given the bank's focus on poverty, it makes sense to broaden the system of accountability to go beyond the finance ministers and central bankers who currently sit on the board. An inter-agency process involving ministries of health, education, agriculture, and so on, would provide better expertise. Supervision by national parliaments, or even an international council of parliamentarians, would further enhance democratic accountability.

Second, scale back on large infrastructure loans to middle-income countries, while creating a smaller, more agile institution with a sharper focus. The bank's own assessments have shown that it needs to pay more attention to building the internal competencies of country governments, so they can take charge of their own development and respond to the needs of their citizens. Doing so would require the bank to play a more flexible background role, using its highly skilled staff for what they do best: technical assistance and managerial capacity building.

Third, provide staff with the right incentives for fighting poverty. Current performance incentives reward staff for huge loans, despite little evidence that this improves results on the ground. Here, too, the bank's own research points to a solution: greater public participation in the design and evaluation of projects. To this day, public consultations typically occur only after a project has been formulated and, in the bank's words, "in an arbitrary fashion with very short notice and/or very late in the process". Redesigning staff performance appraisals to reward participation – with governments, business, civil society, and the poor – would be a good place to start.

The financial crisis is stripping debt-burdened governments of much needed funds for fighting global poverty, at a time when such aid is critical. At the same time, governments and citizens have a right to demand that their money is well spent. Only by making fundamental changes to its business model will the World Bank live up to its vital mission, and ultimately ensure its own relevance.

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