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World Bank: IDA Loans or IDA Grants?

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Summary. — This paper discusses President Bush's July 2001 proposal to convert a major share of IDA lending to grants. It presents arguments in favor of the proposal but also notes difficulties and points where other donor countries and supporters of the World Bank have reservations. It identifies issues which should be addressed in any final agreement among the donor countries. © 2002 Published by Elsevier Science Ltd.

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1. BUSH'S PROPOSAL AND THE RESPONSE

On July 17, 2001, on the eve of his trip to Genoa for a meeting of the top leaders of the eight leading industrial countries (G-8), 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. In a speech before several hundred World Bank employees, Bush maintained that his plan would help poor countries without adding to their already 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 protesters who have been calling for a major cancellation of debt owed by poor countries, the President claimed 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 indicated later that the President's plan 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 payoffs, the Administration argued, for economic development and long-run poverty reduction. In addition, the Administration said, a grant program would allow better assessments *ex-ante* of project effectiveness. Grant aid 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 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 proposal met with little overt response from his summit colleagues. In their joint communique at the close of the meeting in Genoa (and in their statement on Africa), the G-8 called on the World Bank and other MDBs to take numerous steps to help poor countries. [3] It did not discuss, however, the issue of

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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 US proposal went further than they could support. The German government told a meeting of World 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 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 claimed that the new proposal was merely "posturing" to silence the growing disquiet over the Administration's conservative and increasingly isolationist agenda. 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 10 years. Vesely observed that she had not indicated when or whether the Administration planned to ask Congress for money to help fund future costs (Vesely, 2001). 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. [9]

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 US 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." [10] 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." [11] 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, 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 the US government will also agree to provide additional funding for the next replenishment." [12]

This paper 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 which may need