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Asheesh Bhalla, American University Washington College of Law

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Development Lending to Municipalities by the World Bank Group

Asheesh Bhalla, MPH

I. Abstract

The World Bank Group (“the Bank”) has assisted Borrowing countries with investment and lending for the past half century. During the 1980’s the Bank utilized conditional lending and investment as a tool to improve the economic stability of low-income countries. The philosophy was based on the assumption that unregulated markets would best serve the interests of beneficiaries, and lead to overall improvements in national GDP and well-being of individuals. However, lessons have been learned from the over reliance on markets to improve infrastructure, accountability and delivery of public services. As such, the Bank is seeking to improve the outcomes of lending by amending Operational Policy 8.60 to approve sub-national entities as eligible for development policy loans. This strategic shift is representative of a broader transition in the philosophy of law and economics. Though municipal development loans have traditionally been considered riskier than loans to sovereign central governments, international customary law holds sovereign governments responsible for the financial liabilities of sub-national institutions and governments. The desire to protect the flow of international aid and foreign investment is a strong incentive for central governments to uphold loan agreements. Given the marked improvements in governance, sustainability and efficiency of public services where development projects are implemented through local institutions as opposed to national institutions, the Bank should seek to expand these loans where they are financially and politically feasible.
As such, development policy lending operations by the World Bank Group to sub-national government institutions, when coupled with strong governance, accountability and transparency policies, is a positive force for increasing access and use of capital, promoting greater participation in democratic institutions, and increasing the incomes of poor people.

II. Introduction

In 2010 the World Bank Group committed a record $72.9 billion in loans, grants, equity investments, and guarantees to its members and to private businesses in member countries.¹ On April 6, 2011, in light of the momentous events taking place across the Arab world, President Robert Zoellick delivered a speech entitled, “The Middle East and North Africa: A New Social Contract for Development,” with a simple message, “[O]ur message to our clients, whatever their political system, is that you cannot have successful development without good governance and without the participation of your citizens.”²

Almost a week later Dominique Strauss-Kahn, IMF Managing Director, re-iterated President Zoellick’s sentiments by stating,

“we need to link more, what is traditionally seen as important economic and financial [indicators], and what is really important to the people in the street. This has not been part of our mandate so far, but we need to expand it. There’s no way we can go on if on one side we have experts talking about economics and taking

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The “Washington Consensus” framework of the World Bank and other international financial institutions provided the foundation for an international development philosophy that advocated for the generation economic growth to alleviate poverty. This framework was subject to a range of internal critiques, which mostly stated that the Bank failed in its efforts to generate economic growth and to alleviate poverty by ignoring and arguably damaging the aggregate welfare of the societies in which they operated.

Following the publishing of Amartya Sen’s *Development as Freedom* in 1999, the Bank and other international financial institutions began to articulate development as a project to promote not simply economic growth but a broader set of human freedoms along with the capacities to realize them. To Sen, imagining development as freedom, rather than economic growth, seemed to both authorize the approach to development policy and market reform on which the international financial institutions had already embarked as well as signal a shift in the direction of a more humane, responsive, and mature concept of development. As such, the shift to a more humanist oriented strategy of development is not completely new, as the paradigm shift is the result of lessons learned from international lending under the neoliberal economic philosophy from the 1980’s to the present.

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5 Id. at 207.

6 Id. at 207.
The Bank estimates that one billion people live in urban slums in developing countries today.\(^7\) Urban growth is rapid in the developing world, where approximately 70 million new residents are added to urban areas each year, accounting for over 90 percent of global urban growth.\(^8\) Rapid urban growth and the historical strength of cities as catalysts for collective action, decision making and accountability require the World Bank to focus on lending and investment to sub-national entities, such as cities, to fulfill its basic mission of alleviating global poverty.

Therefore the fundamental question of this article is, whether an increase in development policy loans to municipalities by the Bank which are conditioned on social and budgetary reforms at the local level are a positive force for alleviating poverty. This article argues that the use of development policy loans at the municipal level improves “buy-in” from the local community and the availability of local credit. These conditions help create local markets and public institutions which can be sustained without international development capital.

Part III explores the fundamental problem of centralized political and fiscal power and the need for decentralized funding. Part IV explains the history of the World Bank development lending operations policy and the evolution from structural adjustment programs which defined the Bank’s work in the 1980’s and 1990’s. Part V addresses the issue of privatization resulting from development policy loans. Part VI explains how municipal development funds assist the development of local credit markets critical to the sustainability of municipal institutions. Part VII argues that urban centers should be the primary focus of municipal development lending operations. Part VIII reviews the Bank’s development policy loans in Brazil to the municipality of Rio de Janeiro. Part IX argues that increased use of municipal development operations will improve a community’s health and nutrition status. Part X argues that empowering local


\(^8\) Id.
governments and municipalities through sub-national development policy lending will increase economic stability by improving accountability, sustainability and transparency.

III. The Problem of Centralized Control Over Development Funds

Neo-liberal economic philosophy has been thrown into disarray following the financial crisis of 2008. The initial shock of the global financial system’s vulnerabilities has passed, but the crisis has caused a significant shift away from the unquestioned acceptance of free market theories and practices which sustained the global financial system. The practice of providing loans, grants and credits to centralized authorities does not guarantee that the fruits of a developed financial system will trickle down to local communities or the average individual. As such, to increase the efficiency of lending capital, the Executive Directors of the Bank have recently authorized the expansion development policy lending to political subdivisions of sovereign states to improve physical infrastructure, local access to credit and delivery of social services.

Economic disparities between centralized governments and marginalized peripheral communities and individuals has driven recent political change across the Middle East and North Africa (MENA). In MENA, individuals have been marginalized as a result of policies which divert foreign investment and international development funds to the networks of figures supporting the central regime. As a result, peripheral communities and individuals outside the reigning power structure have been prevented from adequately accessing and utilizing international development capital for the benefit of local communities. The Bank has recognized

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that community economic development policies used to alleviate poverty cannot be detached from political sentiments demanding greater economic, social and political rights. As such, the Bank should respond to the political sentiments of shareholder populations with a philosophical shift towards increased local public sector lending policies.

Sub-national lending can circumvent many bureaucratic, financial and political impediments which cause funds intended for local beneficiaries to be misallocated. Institutions housed within the ministry of finance or other government ministries have difficulty giving weight to this extra governmental objective of market building.\textsuperscript{11} In some cases, authorities have utilized public-private partnerships to improve the management of public services because these business structures enable institutions to issue bonds, attract direct private sector investments, and sell off mature assets so proceeds may be reinvested in the institution.\textsuperscript{12}

Urban growth has multiplied demand for investment in local infrastructure such as water systems, wastewater collection and treatment, roads and other facilities.\textsuperscript{13} Simultaneously, decentralization strategies have shifted much of the responsibility for infrastructure investment to local governments, creating a chasm between the responsibilities and capabilities of municipal governments in impoverished urban environments.\textsuperscript{14}

The goal of this piece is to evaluate the benefits and risks of expanded development policy lending operations to sub-national government institutions. Further, I argue that development policy lending operations by the World Bank Group to sub-national government institutions, when coupled with strong governance, accountability and transparency policies, is a

\textsuperscript{12} Id.  
\textsuperscript{13} Id. at 3.  
\textsuperscript{14} Id.
positive force for increasing access and use of capital, promoting greater participation in
democratic institutions, and increasing the incomes of poor people.

IV. The Evolution of Development Policy Lending

In the aftermath of the 1979 global oil crisis, the World Bank adopted structural
adjustment programs (SAPs) to provide quick-disbursing support to assist members coping with
structural changes to their economy. 15 Structural adjustment policies were initially intended to
provide balance of payment financing and support macroeconomic policy changes, but SAPs
were also used to support reforms in other areas such as restructuring state-owned enterprises,
de-regulating the financial sector, and privatizing the public sector to re-allocate public resources
more efficiently. 16 However, countries increasingly moved beyond stabilization and structural
adjustment policies, and toward fostering sustained growth and poverty reduction through more
complex and second-generation policy and institutional reforms. 17

In 2004, this evolution led to the adoption of Development Lending Policies in the place
of Structural Adjustment Policies. Development Policy Lending is rapidly disbursing policy-
based financing, which the Bank provides in the form of loans or grants to help a borrower
address actual or anticipated development financing requirements that have domestic or external

15 The World Bank Group, Operational Manual, OP 8.60, ¶1
Development Policy Lending to Political Subdivisions, at 4 (February 28, 2011).
Development Policy Lending to Political Subdivisions, at 6 (February 28, 2011).
origins. The Bank may provide development policy lending to a member country or to a sub-national division of a member country.  

In 2005, the Development Committee endorsed five good practice principles for conditionality in development policy lending: ownership, harmonization, customization, criticality, transparency and predictability. Conditionality in development policy lending states the procedures and framework under which the loan will be disbursed. The conditions seek to ensure a balance between the local stakeholder interests and the ideas and plans of international policy makers. These policy actions are intended to change development outcomes, and do have a positive effect. For example, under Ghana’s poverty reduction support credits, sustained changes to education, including measures to respond to gender imbalances, supported an increase in school enrollment rates, with a strong increase in girls’ enrollment. Similarly, a series of financial management reforms supported a significant improvement in the quality of Tanzania’s systems, as recognized in ratings prepared in 2001 and 2004 for the HIPC Initiative.

Development Policy Loans of the World Bank Group are used to help a Borrower achieve sustainable reductions in poverty through a program of policy and institutional actions that promote growth, enhance well-being, and increase the incomes of the poor. This strategic shift places greater importance on the provision of services to intended beneficiaries (rather than

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18 The World Bank Group, Operational Manual, OP 8.60, ¶1
20 Id.
21 Id.
22 The World Bank Group, Operational Manual, OP 8.60, ¶1
macroeconomic stability and growth), and practically, requires the Bank to increase lending to sub-national political entities to fulfill its mission. The shift does not change the Bank’s mission, but prioritizes decentralized operations which supports long-term community well-being over bottom-line financial output.

SAP’s have been the focus of intense criticism of the Bank’s work in balancing national budgets, reducing national debt and privatizing government services. While much of this criticism is justified, hindsight is 20/20. Though the Bank must be humble and recognize past mistakes, it also has a responsibility to use those lessons to restructure its own policies for the benefit of stakeholders. A Development Lending Policy that prioritizes lending which serves the long-term interests of local communities will increase the efficiency of public services and improve social stability. This policy recognizes that a country’s growth depends not only on macroeconomic stability, but on microeconomic, political and social stability as well.

V. Development Policy Loans Must Consider the Balance Between the Private and Public Nature of Local Government Institutions

The dual nature of cities, as both public and private entities creates a tension between the level of governance and private autonomy of cities. A city’s level of privatization is focal to improving the allocation, quality and efficient management of resources. Additionally, a city that has more local public institutions managing and delivering services is less vulnerable to external shocks, especially macroeconomic ones. As such, the sustainability of public service delivery is dependent on attaining a sufficient balance between regulations which promote public sector accountability, and private sector performance incentives.

Accountability and performance incentives are two key conditions that the Bank should prioritize when negotiating development policy loans. Development policy lending is
characterized by the idea that loans should promote growth, enhance well-being and increase the incomes of the poor. Under the “Washington Consensus” paradigm free market economists predicted that growth of national GDP would inherently result in wealth and resources being shared by the majority of people. This narrow focus on macroeconomic stability and the use of privatization to achieve that stability was misguided. The desired results have not occurred largely. This strategy viewed government regulation as an obstacle to the development of efficient markets and improving standards of living. However, this perspective overlooked the ability of markets to create and govern themselves. The gap between theory and practice resulted because successful economic development requires a balance between public and private entities so markets can not only flourish, but so they can also be controlled to attain desired results. Therefore conditions to improve accountability and performance incentives of public and private actors should be a critical consideration in negotiations of loan structure.

Structural adjustment policies led the Bank to advocate for increased privatization of public services. Because governments of many Borrowing countries are unable to adequately manage the complicated and political nature of restructuring large sectors of the public economy, private sub-contractors and NGOs often replace local government agencies in the delivery of public services. These private entities are not publicly elected, have weak accountability mechanisms, and inconsistent capacities to carry out their new responsibilities. That said, some level of privatization is required because minimal progress can be made towards economic growth when the population is unable to access public services in an efficient and cost-effective manner.

VI. Municipal Development Funds are Critical to Developing the Local Credit Markets Necessary to Sustain Local Autonomy Over Public Services

Investment in urban areas, specifically to municipalities for development is typically accomplished through the use of municipal development funds, (MDFs). These funds provide credit to local governments and to other institutions investing in local infrastructure. Over 60 countries have established financial intermediaries of this kind, and in larger federal nations such as Brazil and India, individual states have established their own municipal development funds.\(^{24}\) The Bank is able assist local communities where private banks are unwilling to take risk by utilizing its own municipal development fund to provide credit at below market rates to municipalities. MDFs are typically owned and operated by governmental institutions, but their goal is to develop the credit market to a level where private banks are comfortable enough to directly lend to municipalities, thereby enabling long term sustainability without capital from the multi-lateral development banks.

The Bank’s willingness to loan to municipalities has been based on either a credit analysis, the establishment of borrowing ceilings, or guarantees from the central government. The first preference for lenders is a central government guarantee.\(^ {25}\) International customary law has concluded that the sovereign central government is responsible for actions and liabilities of sub-national entities. This paradigm, which is respected among international dispute settlement bodies, permits lenders to hold the central government accountable, and significantly reduces the Bank’s risk of lending to municipalities that have the greatest need for development lending.

\(^{25}\) Id. at 10.
Borrowing ceilings establish numerical guidelines that automatically identify prudent borrowing ceilings, based on a municipality’s capacity for debt repayment. These guidelines have been adopted from standards in developed countries, so while they have been useful in certain settings, their application is limited. Borrowing ceilings have not been effective at improving debt repayment where the local government has minimal budgetary control, the majority of revenue consists of revenue sharing and grants from the central government, and tax collection is inconsistent. Debt ceilings are inflexible and political and economic realities give them little weight without a sovereign guarantee.

The mission of most MDFs extends beyond credit supply to increasing the efficiency of local investment, promoting the development of service pricing and cost recovery in local investment projects, upgrading municipal financial management, and ensuring that critical investment projects are built even when full financial cost recovery is not feasible. The result is that MDFs are responsible for much more than simple disbursement of funds to local government, and as the pre-eminent institution dealing with local government investment, an MDF can assemble the critical mass of technical expertise necessary both to improve local investment practices and serve as a comprehensive counterpart for international funding.

MDF projects have suffered from problems associated with the integration of many development functions in one institution: lacking sufficient local consultation, squeezing out private market competition, and monopolizing the technical assistance market by requiring local governments to utilize MDF loans to gain access. The monopolistic nature of the lending

\[\text{Id. at 8.}\]
\[\text{Id. at 9.}\]
\[\text{Id. at 13.}\]
\[\text{Id. at 14.}\]
\[\text{Id.}\]
through MDFs should not be overlooked, but it should also not be overstated. The goal of the MDFs is to develop the necessary governance and financing institutions and structures for long-term sustainable markets. This philosophy does not exclude the private sector, and actually sees them as important partners. Where the private sector is unable, or unwilling to lend in the early stages of local government restructuring and development, they will be the institutions who finance and sustain the future budgetary capability and legislative authority of local governments.

VII. Trends Driving Increased Urbanization, Decentralization Initiatives and Fiscal Adjustments Make Urban Centers The Most Efficient Allocation of Lending Capital.

Urban areas are growing rapidly in the developing world, and they are the most important characteristic of human society in the globalized 21st century. Additionally, there has been a marked increase in decentralization initiatives, which transfer responsibilities to local governments, and fiscal adjustments due to budget deficits. These three trends require international financial institutions to adjust their strategies to account for the restructuring of political and economic power.

Agriculture has become more efficient, but economic opportunities in rural areas are stagnating and the trend will continue as low-income economies become more information and service oriented. Hence, cities have become attractive for the young, old, rich and poor. Increasingly, low-skilled jobs are no longer agricultural based, as improvements have come
through advances in technology. Low-skilled jobs which provide many of the world’s poorest with stable incomes will be based in the construction sector of urban areas.\textsuperscript{31}

The draw of cities is based on access to education opportunities, jobs and social services. Between 2000 and 2005, the average urban population growth for low-income countries was 3 percent a year, more than twice the rate for middle-income countries and more than three times that for high-income countries.\textsuperscript{32} This spatial transformation is directly linked to the restructuring of the economy from agrarian to industrial, and then to postindustrial economies.\textsuperscript{33} The growth of urban areas in low-income countries requires the Bank to adjust its lending policies to focus on urban centers, where the poor are densely concentrated.

A. Local government investment is necessary and beneficial to social development and macroeconomic stability

A prevailing thought in international development circles is that decentralization and local governance supports the protection of political rights. The connection to economic growth has been more tenuous, and it has been argued that shifts in local power have been a result of economic growth rather than a cause.\textsuperscript{34} While it is undeniable that economic growth is a force which does affect the level of centralization or decentralization in a given country, this does not reduce the significant impact that local democratic institutions have on the development of business regulations, transportation costs, telecommunication access, education and health policies and a whole host of zoning, property and contract issues which affect the investment and


\textsuperscript{33} Id.

lending climate. Regardless of the country examined, local communities have a strong stake in all of these areas, and their increased participation in the formulation of these policies will support lending operations which build sustainable markets.

**B. Children constitute 30% of individuals in low income countries living on $1 a day or less, and they are also the best investment for long-term development and economic stability.**

The children of the world, who constitute 30% of the global population living on $1 a day or less, are the direct beneficiaries of investment in health, education, and social services.\(^{35}\) They are also marginalized politically due to their inability to vote. Typically, many projects funded by foreign investment in local infrastructure and social programs fail to gain traction because of a lack of “buy in” from the local community. Increased allocation of capital to local government investment is therefore necessary to reduce the gap between legislators with control over policy decisions, and the beneficiaries of those programs. By improving the efficiency and capabilities of local government institutions, the Bank will directly improve the responsiveness of governments to the sentiments of the population.

To properly fulfill the Bank’s mission of alleviating poverty, the Bank must focus on the problems which face the increasingly young and marginalized populations of the world. Children do not have voting rights, and do not have political power in the traditional sense. Increased capital investment in projects which improve local governance, will improve the quality of health, education and public services because the legislators with direct policy and budgetary control over public services are part of the same community which receives the services. This

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personal connection to the daily lives of family, friends and community members is an important human aspect that should not be overlooked.

VIII. Development Policy Loans in Brazil Have Been Successful in Achieving Sustainable and Transparent Delivery of Services Through Municipal Lending.

Brazil’s federal structure provides a prime case study for the efficacy of development policy lending to sub-national entities. The Rio Grande do Sul Integrated Municipal Development Program aimed to support growth, income and job generation and infrastructure services in five municipalities.36 The first loan, to Pelotas, was approved in January 2008, loans to Bagé and Uruguaiana were approved in July 2008, and the loan for Rio Grande was disbursed in 2009. The loan marked the first time that the Executive Directors of the World Bank granted a development lending loan to a municipality. Through the provision of direct loans to municipalities, the World Bank was able to achieve a high success rate in job creation, infrastructure development, and service provision.37 Based on the success of these municipal loans in Brazil the World Bank signed a loan agreement with the municipality of Rio de Janeiro in August 2010 to improve municipal services and economic growth.38

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A. Conditions of the Rio de Janeiro Development Policy Loan

The 2010 Rio de Janeiro Development Policy Loan was structured into two tranches (disbursements) of $545 million and $500 million. The disbursement of these tranches was conditional on the budgetary and legislative actions agreed upon by the Bank and the Borrower. The lending of funds rested on three significant reforms: the creation fiscal space in the public budget, implementation of innovative public service delivery mechanisms, and strengthening of public institutions and public-private partnerships. These conditions constitute a continued recognition of the importance of economic growth to the positive development of nations, communities and individuals. However, this loan also takes into account and prioritizes social objectives which create the foundation for economies to “take off” and sustain themselves.

a. Creation of Fiscal Space

The creation of fiscal space is a technical term for the elimination of programs and positions which ineffectively use capital for the public interest—cut programs and jobs that are not necessary or efficient. The agreement between the Bank and the Borrower contained three specific reforms to create adequate fiscal space.\(^39\) First, calculate pension benefits based on the average wage.\(^40\) Second, indexation of pension benefits based on inflation.\(^41\) Third, reduction by 30% of survivors benefits for pensioners above the RGPS ceiling, as evidenced through the Borrower’s letter.\(^42\)

The condition to create fiscal space is a necessary condition, but one which many critics of the Bank will find intolerable. The “creation of fiscal space” they argue, is cover for the privatization of the public sector and the elimination of jobs which the poor and marginalized

\(^{39}\) Id. at 6.
\(^{40}\) Id.
\(^{41}\) Id.
\(^{42}\) Id.
rely upon for income. While some of this criticism is warranted, the bottom line is that new programs and projects cannot be implemented by the government unless there is money available to fund the program. Without the creation of fiscal space by the government, social programs funded by international financial institutions have little, if any, hope of becoming sustainable after international funds are finished. The agreed upon reforms between the Bank and the Borrower highlights the municipality’s recognition of the need to budget with long-term goals in mind. The Bank recognizes the need to plan for long-term sustainability, and what may seem indigestible at first, is exactly what is needed for long-term growth, sustainability, and poverty alleviation.

b. Innovative Public Service Delivery

The second condition of the loan requires the implementation of innovative public service delivery systems in both education and health care services and improving the licensing of municipal businesses. The first reform agreed to in the loan contract requires the municipality to develop an innovative and integrated early childhood and pre-school services. The second reform requires the execution of management contracts between the Rio Health Secretariat and qualified social services organizations to manage ten family health care clinics and three emergency care clinics. The third reform requires the municipality to simplify the registration process for business licenses.

These reforms are a direct recognition by the Bank that economic growth of a community depends not only on the creation of fiscal space, but on the quality of access to public services. The degree to which individuals can access quality health care, send their children to free public schools, and have the ability to start and run their own businesses are key factors to the

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43 Id.
44 Id.
45 Id.
development of any city, state or country. For Development Policy Loans, recognition of the
importance of innovative social services at the local level for creating sustainable economic
growth is a sign that the World Bank truly is moving away from the “Washington Consensus.”
Previous Development Policy Loans were based on the assumption that the availability of capital
and injection of said capital in the private sector would enable the development of markets which
provided efficient public services. However, this assumption has been debunked through the last
two decades of lending experience, and the practical changes regarding conditions for
development policy loans are key to understanding the philosophical shift in law and
development.

Neoliberal economists regard such intervention by the government into the private sector
as debilitating and retarding economic growth. The neoliberal free market approach emphasized
that laws and regulations were tools which should be used sparingly, and removed where
possible. This approach assumed that markets created themselves when capital was available.
However, this theory failed to recognize that the development of markets and institutions
requires a certain level of political and social development which is lacking in many developing
contexts. As such, the conditions required by the Bank to implement innovative public service
delivery programs is a recognition that social objectives are tools to create sustainable economic
growth.

c. **Strengthening Public Institutions and Public-Private Partnerships**

The final condition of the loan requires that the municipality strengthen public
institutions by implementing results agreements with sixteen other municipalities and creating a
legal basis to enable public-private partnerships to invest in infrastructure and service delivery
partnerships. This condition is based on the recognized need for increased consultation at the
local level and cooperation with private partners. The fundamental assumption of this condition is that no actor works in a vacuum and achieving successful project outcomes requires active cooperation with other public institutions and incentives for private actors to engage in public project tenders. The privatization of public services is useful to improve efficiency and attract investment, but where private actors become involved in public projects, they must be subject to greater standards of accountability and transparency to ensure that public investment funds are used for the public interest above any private interests.

B. Results of the Rio de Janeiro Development Policy Loan

The decision to issue a municipal loan to Rio de Janeiro was based on the municipality’s budgetary and legislative competence as well as guarantees from the national government. The fiscal space required to expand public investment in Rio de Janeiro was made possible by Rio’s implementation of an electronic fiscal invoice system for the collection of the municipal tax on services, and creation of a database to facilitate the identification of the fiscal evasion related to said municipal tax on services. The development of an efficient tax system allows the public to retain a greater portion of the expected benefits from the Bank loan. Inefficient tax systems divert revenues intended to sustain public infrastructure and services to corrupt individuals and private actors. The implementation of an efficient electronic tax system improves accountability to the rule of law and increases confidence in the investment environment.

Significantly, municipal development loans have never been issued by the World Bank without a guarantee from the sovereign national government. Under international customary law, the national host government inevitably retains liability for the actions by municipalities, and

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47 Id. at 8.
therefore municipalities seeking development lending loans must have the support of sovereign national governments. The Rio de Janeiro loan exemplifies the feasibility of issuing a development policy loan to a municipality, and the positive economic and social impacts of such a loan.

IX. Increased use of Municipal Development Operations Will Improve Health and Nutrition.

Municipal development is inherently tied to a community’s health and nutrition status. The efficiency of public institutions affects not only the supply of food available for sale, but the level of demand as well. The United Nations has estimated that 1 billion people in the world are “hungry,” and the World Bank has tied this problem to the fact that food prices, specifically for grain, have risen dramatically. However, research has shown that while many poor people are undernourished, they are not necessarily “hungry,” and often excess income is not spent on increasing the amount of nutritious food eaten.48 The poor tend to spend excess money on better tasting food, or a new mobile phone, but not healthier foods. Lack of education, lack of information, or reasonable belief that the benefit of being slightly more productive will not be noticed by an employer paying $2 per day, all contribute to this behavior.

Some scholars argue that there is just not enough food in the world, but absolute scarcity of food is not the problem either. If we wanted to feed everyone in the Philippines the FAO standard of 2,400 calories, the government could, but not everyone wants to eat a diet of bananas and eggs day in and day out.49 The problem the poor face today in improving their health and

48 Abhijit Banerjee and Esther Duflo, More than 1 Billion People are Hungry in the World: But What if the Experts are Wrong?, Foreign Policy (May/June 2011), http://www.foreignpolicy.com/articles/2011/04/25/more_than_1_billion_people_are_hungry_in_the_world.
49 Id.
nutrition lies in the structural problems of public institutions. Many of the world’s poor from Egypt to India depend on subsidies for grain. This grain is typically subsidized by the central government, but distribution is always local at some point in time. Municipal institutions, as the point of service delivery, are often mismanaged, unaccountable, and lack transparency. Investment in local governance, infrastructure, schools, water and sanitation systems, roads and transportation will increase both the supply of and demand for healthier foods. The connection between efficient municipal governance, especially in large urban centers of the developing world, and feeding the poor, cannot be overstated.

X. Empowering Local Governments and Municipalities Through Sub-national Development Policy Lending Will Increase Economic Stability by Improving Accountability, Sustainability and Transparency.

The proposed amendment to OP 8.60 by the Executive Directors of the World Bank group would require certain criteria (legislative competence and budgetary authority) to be met before financing could be extended to a municipality under a DPO. This decision is based on assessments of the central government’s policy and support for sub-national development, the strength and sustainability of the sub-national program to be supported by the operation, and the ownership of the program by both the sub-national unit and the member country.\textsuperscript{50} OP 8.60 states the current conditions for development lending:

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"The Bank determines which of the agreed policy and institutional actions by the country are critical for the implementation and expected results of the program supported by the development policy loan. The Bank makes the loan funds available to the borrower upon
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maintenance of an adequate macroeconomic policy framework, implementation of the overall program in a manner satisfactory to the Bank, and compliance with these critical program conditions. The Bank seeks to harmonize these conditions with other development partners in consultation with the country.\(^{51}\)

The current criteria used by the Bank to determine eligibility for development lending focuses on the borrower’s ability to maintain macroeconomic stability. This focus has resulted in a large portion of development lending being channeled through centralized state structures. These centralized state structures have a more visible connection to macroeconomic stability and have had greater budgetary and legislative capacities. However, with the growth of urbanization in the 21\(^{st}\) century, the capacity of sub-national institutions in budgetary and legislative matters has grown capable of receiving direct lending from the Bank. This is reflected by the success of the Bank’s recent municipal development lending projects in South America and Africa.

Expanding the eligibility of cities and local governments to access international development loans reflects a shift in our understanding of fundamental market economics. Macroeconomic stability does not depend solely on the budgetary and legislative competence of the central government authority, but largely on the ability of the government as a whole to sustain markets which provide necessary public services, jobs, and potential for economic growth. This responsibility does not fall solely on a central or local government, but is divided between every level of government depending on the specific context. Where the goal of lending is to improve the provision of public services and quality of infrastructure, greater proximity between control of services, and the intended beneficiaries, will increase the efficiency of resources and improve the well-being of individuals.

The new criteria, requiring greater budgetary and legislative competence for local government borrowers are only the starting points for determining whether a DPO should be implemented in a Borrowing country’s municipality. Sub-national lending can improve the efficiency and allocation of resources to improve the well-being of beneficiaries, increase the incomes of the poor and promote economic growth. However, this will not be accomplished without serious consideration of accountability, transparency and sustainability issues which will continue to be the main challenges to the Bank’s mission.

**XI. Conclusion**

The new Development Lending Policy by the World Bank is the result of lessons learned from both successes and failures of the “Washington Consensus” paradigm. Development lending policies should focus on improving community well-being and increasing incomes of the poor as a foundation of sustainable economic growth, rather than a result of economic growth. To protect local public institutions and communities, the Bank should be careful about the level of privatization that municipal development lending is promoting, and ensure that privatization does not occur unless there is a sufficient level of accountability which incentivizes results and outcomes for the public good. However, the Bank should not be risk averse to municipal lending because the guarantee of sovereign central governments is firmly agreed upon in international customary law. The fact that MIGA has only made five payments for losses on investments in its history is telling of the laws under which the Bank is operating. The development of local credit markets that sustain local financing for municipal institutions and individuals is key to long term prosperity of communities.

Implementation of municipal development lending in urban settings will have the greatest multiplier effect for improving the quality for life for the world’s poorest. As such, the World
Bank has embarked on a significant shift in development lending philosophy, and the amendments to OP 8.60 should be seen as a positive development in the responsiveness of the World Bank to shareholders and beneficiaries.