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Economic Viewpoint

Notes by Danny Leipziger*

Is the World Bank's Case so Difficult to Make?

The current crisis has yielded a windfall gain for the IMF in terms of new resources and enlarged mandate. This makes sense, especially since the Fund has retreated from its stance of being a troublesome lender of last resort to being a preemptive lender in times of capital market stress. Whether it will end up being the world's central bank is unclear, but it clearly has been recast as the secretariat to the G20 as well as a potential channel of funds derived from financial transactions taxes towards developing countries. Where does this leave the World Bank? So far, out in left field, despite the fact that it was the Bank to whom Indonesia, Mexico, Hungary and other emerging market economies turned to in the first instance when their financial outlook worsened, and despite the fact that the World Bank has almost tripled its lending during the crisis, thereby weakening its capital position.

Nonetheless, whether because of personalities and politics or because the worst of the 2009 crisis has yet to hit the poorest countries, or because the large emerging market economies seem now to be overcoming liquidity problems with access to unconditional Fund resources, the Bank seems to be faltering in making its case. The initial reaction to calls for a capital increase at the Istanbul Annual Meetings were decidedly negative. All attention was focused on the Fund. This is short-sighted.

The case for additional resources for the Bank should be based on the fact that in dealing with the economic crisis, most emerging and developing economies have had to either cut into their fiscal space or been forced to create new short-term fiscal room to finance domestic consumption, provide domestic credit to firms frozen out of international markets or expand safety nets to populations previously uncovered. All of these uses of future fiscal space can be seen in Brazil, for instance. This has taken the form of tax cuts, additional subsidies for consumer durables, and large infusions of credit to public banks. In Colombia, it has taken the form of increased expenditures for public works projects to substitute for fleeing international investors. These government reactions to the crisis are valid, although their efficacy may vary, but they imperil future fiscal balances and add to public debt.

This is where the World Bank comes into the picture. The Bank lends longer term, usually around 15 year loans that exceed by far the usual domestic debt maturities. The Bank's loans can provide the means to bring fiscal accounts back under control. At the same time, large infusions of foreign exchange obtained from the Fund will need to be repaid since these involve access windows of limited duration. The main argument, however, for additional Bank capital is that countries will be facing increasingly difficult fiscal pressure in coming years, at a time when investment needs are rising and the availability and cost of international capital will be more difficult. Capital costs will rise because of de-leveraging and increased attention to capital adequacy. Availability is more uncertain because of risk aversion in the aftermath of the crisis and because capital importers themselves are more wary. If financial transactions taxes are imposed, this will just re-inforce both tendencies. These trends all point to the need for more domestic financing, greater strains on budgets, and the increased attractiveness of the Bank's cheaper and longer term funds. In addition, governments, now faced with increasing expenditures, have shown that they continue to value the role of the Bank in helping to examine the efficiency and transparency of those outlays. The Bank is perhaps uniquely positioned in this regard.

Why haven't the Finance Ministers yet picked this up? It may be that they are still reeling from the crisis at hand or perhaps it is that the case has not been forcefully put forward. Going forward, weaker global growth prospects will force governments to use fiscal means to stimulate domestic employment, bolster public investment where the private sector has lost enthusiasm, and provide additional safety nets to those most affected by slower world growth. Under these circumstances, it would be short-sighted to write the World Bank off the agenda.

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