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WORLD BANK **GROUP**

STATEMENT ON BEHALF OF THE WORLD BANK GROUP TO THE INTERNATIONAL MONETARY AND FINANCIAL COMMITTEE

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The global economy is showing tentative signs of recovery thanks to the extraordinary measures deployed by many advanced and emerging market countries. But as G-20 Leaders stated at the Pittsburgh Summit, "a sense of normalcy should not lead to complacency". Many developing countries–and low-income countries (LICs) in particular–have suffered a severe economic shock as a result of the financial crisis and subsequent economic recession and they lack the resources to mount an effective fiscal response. Revenues have declined and access to international capital markets has become more difficult, if not impossible. At the same time, more resources are needed to combat the impact of the crisis on economic growth and poverty. Without additional support, many developing countries face a potentially long and muted recovery. Failure to respond to their needs will jeopardize years of progress in combating poverty and improving macroeconomic policy, public-sector governance and the environment for private-sector investment.

Recent data suggest that the global recovery is underway, tentatively, with industrial production in high-income countries stabilizing, albeit at a depressed level. Growth in many advanced countries is expected to strengthen over the next few quarters underpinned by substantial fiscal and monetary stimulus and the inventory cycle. Global GDP is expected to recover modestly in 2010, as banking sector consolidation, negative wealth effects, and risk aversion weigh on demand. The recovery of employment is expected to lag that of output, with predictable consequences for consumer confidence and demand. Against this backdrop, the recovery in trade which must underpin a recovery in poor countries will remain elusive. Add to this the uncertainty associated with the inevitable withdrawal of fiscal stimulus and the associated possibility of a second dip in growth, and the outlook for many developing countries continues to be precarious.

The crisis has slowed, and could potentially reverse, progress toward achieving the MDGs. Recent World Bank analysis suggests that 89 million more people will be living in extreme poverty (below $1.25 a day) in 2010 than would have been the case without the crisis, and the crisis may lead to 30 to 50 thousand additional infant deaths in Sub-Saharan Africa in 2009. Educational gains in many developing countries are threatened; teachers are the largest portion of many civil services, so deep public expenditure cuts that result in layoffs or deteriorating facilities are especially disruptive to the education sector. Experience from previous crises also indicates that health budgets also tend to suffer at the same time as demand for public health services goes up and as prices for pharmaceuticals increase due to currency depreciation.

Experience in previous crises shows that core spending should be sustained and, if possible, expanded during economic downturns to secure the viability of public programs essential for meeting development goals (especially when households may be forced to curb their own spending on basic education and health services). Priority should be given to maintaining existing public infrastructure to prevent a further, and potentially costly, widening of infrastructure gaps, and meeting the additional costs of social protection during the crisis. Bank staff estimate that the global recession is estimated to have put at risk core spending of $11.6

billion (equivalent to about 1.1 percent of GDP) in the poorest countries in 2009. Fragile states, including those in SSA and those emerging from conflict, account for 58 percent of the total.

There are indications that spending on infrastructure may be at risk as countries approach borrowing limits and, understandably, prioritize spending on social safety nets and recurrent expenditures over maintenance and investment in infrastructure. Experience from earlier crises points to the need to preserve existing infrastructure by protecting spending on operations and maintenance. If neglected, costs of replacement in the longer term can be considerably higher. World Bank estimates indicate that every dollar spent on road maintenance in Africa saves four dollars in rehabilitation. Annual preservation requirements (not including new roads) are estimated to be about $3 billion over the next 20 years.

Even as some developing countries are regaining access to private capital markets, the majority are struggling to mobilize additional, and sufficiently concessional, resources. But, particularly if they are to avoid a reemergence of debt distress, options are limited, pointing to the inescapable conclusion that making further progress in achieving development goals will require supplemental support, largely from external sources. In this environment, the development community should reaffirm commitments to provide appropriate international assistance in the form of aid, debt relief, global financial stability, and investment.

While donors face their own domestic fiscal pressures, increased and more effective concessional assistance is critical to continued progress toward the MDGs in many countries. Some donors have been forthcoming (ODA from OECD members reached a record $120 billion in 2008). But the latest OECD/DAC survey suggests that donors are lagging well behind their Gleneagles commitments and with a little over one year in which to deliver on their promises, they show "little sign yet of such raised levels of ambition." LICs require financing beyond existing ODA commitments to meet the incremental needs arising from the global recession. To this end, and as a means to facilitate a more rapid and targeted response to shocks, President Zoellick has called for the global community to establish a *Crisis Response Facility*, an initiative that G-20 Leaders have now mandated their ministers to explore in an effort to protect LICs from future crises.

Despite substantial debt relief under various initiatives, maintaining debt sustainability in the face of growing fiscal pressures remains problematic for a number of countries, which are at high or moderate risk of debt distress. LICs, in particular, should proceed cautiously with regard to incurring additional non-concessional debt since they may face a prolonged period of uncertainty. The Bank and the Fund increased the flexibility of the *Debt Sustainability Framework for Low-Income Countries* but what LICs need most under current circumstances is additional concessional resources, such as those provided through the IDA framework, in which higher levels of debt distress trigger increased availability of grant financing. Unfortunately, the use of such mechanisms is limited by the availability of grant resources. Looking ahead, LICs need to strengthen their capacity to manage public debt. In that regard, IDA has scaled up its debt management technical assistance to LICs through the *Debt Management Facility* established in November 2008.

The World Bank Group has moved quickly to help countries respond to successive shocks: first, by addressing, in coordination with UN partners, the food crisis which began in 2007, then the energy crisis in mid-2008, and now the global economic recession. The result has been record levels of activity—nearly $60 billion committed in FY09 from IBRD, IDA, IFC and MIGA to support countries hit by the global crisis, a 54 percent increase over the previous year, and a record high.

- IBRD lending almost tripled in FY09, to $32.9 billion—a new record—from $13.5 billion in 2008, of which fast-disbursing *Development Policy Loans* (DPLs) comprised about 45 percent of the total. For FY10, the demand for IBRD lending is now projected to be in a range centered above $40 billion with another $55-60 billion projected over the following two years. Beyond FY12, developing countries' financing gaps are expected to remain high, particularly because important long-term development projects will have been delayed, while financing will be needed to address the increased numbers of newly poor in middle-income countries and accelerate progress on the MDGs.
- IDA commitments hit a record level of $14 billion in FY09, 25 percent above a year earlier. Results were driven by strong delivery to Africa (53 percent) and South Asia (33 percent). IDA can deliver $28 billion in additional financing in FY10 and FY11.
- IFC provided $14.5 billion in FY09, including $4 billion mobilized from other investors through syndications, structured and securitized products and crisis initiatives. Over half of the projects financed were in IDA-eligible countries, representing a tripling since FY05.

Projected lending requirements exceed the level that can be supported by IBRD's existing capital resources. With commitments of $33 billion already made in FY09 and the strong pipeline development for FY10, current expectations for crisis lending are now beyond IBRD's existing financial capacity. Under a reasonable forecast for lending demand, total new commitments are projected to reach about $136 billion over FY09-12. In a more prolonged recession scenario, lending commitments could be closer to $150 billion over FY09-12, well beyond the $100 billion called for in the Development Committee's Spring Communiqué.

To expand its financial capacity to support higher lending scenarios, IBRD has adopted various measures to stretch its existing capital to support lending. These include:

- allowing flexibility in its main capital adequacy measure (E/L ratio), relative to its long-term strategic range;
- introducing a new exposure management framework that makes more efficient use of existing capital through the allocation and reallocation of credit across countries;
- diverting risk capital intended for its pilot Long-Term Income Portfolio (LTIP) to support loan growth; and
- actively working with relevant shareholders to release their existing national currency paid-in capital (NCPIC) so that more of it can be used as risk capital in support of lending operations.

Options to enhance IBRD's financial capacity, including increases in paid-in capital (through a General Capital Increase or, in association with the governance reform agenda, through a Selective Capital Increase) as well as pricing increases on longer maturity loans, have been discussed by IBRD's Board. A review of IBRD and IFC financial capacity will be considered by the Development Committee in Istanbul. In August 2009, IBRD's Board increased its *Single Borrower Limit (SBL)* by $1 billion, to $16.5 billion, to be effective in FY10. This limit applies to IBRD's largest borrowing countries that have achieved investment-grade status. This is the second increase in the SBL in two years, following the $1 billion increase in FY08. A flexible mechanism is in place within the overall limit set by the SBL to allow countries with expressed demand above their allocated exposure share to go above their limit when demand from other countries is below their allocated exposure.

The Bank has also streamlined procedures and facilitated IDA project restructuring to speed disbursements through the *IDA Financial Crisis Response Fast-Track Facility*, which provides front-loading of up to 50 percent of country allocations and could fast-track an initial $2 billion of IDA15 resources, with the potential to increase the amount in the future depending on need. As of August 2009, $1.5 billion has been approved under the Facility. IDA also plans to adjust the implementation of its *Non-Concessional Borrowing Policy* to further enhance financial flexibility at the country level and ensure consistency with guidelines on debt limits in IMF-supported programs. To help tap the considerable potential for commercially viable and fiscally attractive foreign-exchange-earning projects in many IDA countries, the Bank is also developing an approach to expand the use of IBRD resources for specific projects in IDA countries based on the IBRD Enclave framework for loans and/or partial risk guarantees for critical infrastructure and natural resource projects.

To support private sector access to finance for investment and trade, both of which have contracted sharply over the last year, the IFC has focused attention on small and medium enterprises (SMEs), microfinance, trade finance, bank capitalization, and infrastructure support. IFC's crisis response initiatives launched over the past year are expected to provide significant financing over the next three years, especially in LICs, combining IFC funds with contributions mobilized from other sources. These include:

- An expanded *Global Trade Finance Program* and the *Global Trade Liquidity Program*, to support up to $50 billion in trade in the developing world over the next three years.
- The *Infrastructure Crisis Facility* providing short-to medium-term financing for infrastructure projects and Advisory Services for governments.
- The *Microfinance Enhancement Facility* to provide refinancing to more than 100 microfinance institutions in up to 40 countries.
- The *IFC Capitalization Fund* to support banks considered vital to the financial systems of emerging market countries.

The WBG's crisis response initiatives focus on (i) protecting the most vulnerable from the fallout of the crisis; (ii) maintaining long-term infrastructure investment programs; and (iii) sustaining the potential for private sector-led economic growth and employment creation, particularly through SMEs and microfinance. The *Vulnerability Financing Facility (VFF)* is a dedicated facility to streamline crisis support to the poor and vulnerable. To leverage its resources, the WBG sought additional grant assistance for LICs and poor and vulnerable groups under the VFF which organizes under one umbrella the *Global Food Crisis Response Program* and the *Rapid Social Response Program*. The VFF programs address two specific areas of crisis vulnerability: (i) agriculture, the main livelihood of over 75 percent of the world's poor; and (ii) employment, safety nets and protection of basic social services to help the poor and vulnerable cope with crisis.

- **Global Food Crisis Response Program (GFRP):** The GFRP, a $1.2 billion fast track financing facility supported by externally-funded trust funds, was launched in May 2008 to respond to the food crisis. In response to high demand, the Board raised the ceiling to $2 billion in April 2009. Focusing on social protection and priority food policy interventions, the GFRP encompasses the Food Price Crisis Response (FPCR) Trust Fund of $200 million from IBRD surplus, as well as $1.8 billion in IDA/IBRD resources. Total Bank-funded GFRP project commitments currently amount to almost $1.2 billion. As of mid-September, disbursements totaled $795 million for 31 countries.

- **Rapid Social Response (RSR):** RSR is designed to help countries build the institutional capacity necessary to address urgent social needs stemming from the crisis by establishing and scaling up targeted safety net programs, financing immediate interventions to stabilize demand for basic health and education services, and supporting active labor market policies and employment programs. WBG support for safety nets and other social protection programs totaled $6.2 billion in FY09.
- **Infrastructure Recovery and Assets Platform (INFRA):** INFRA is a multi-donor platform designed to focus attention and resources of the Bank Group and its development partners on the critical needs of infrastructure during the downturn, while helping to lay the groundwork for future growth and poverty reduction. IBRD/IDA committed $17.6 billion for infrastructure, a 48 percent increase over FY08 commitments. Of this, $4.6 billion was committed for IDA and within IDA; $2.7 billion was committed for Africa.

Coordination with other development partners is essential to leverage scarce resources and capacity. As with the food crisis, the Bank Group will continue to work closely with other multilateral organizations to ensure that countries receive the support needed, ensuring full coordination of our responses. All activity under the Bank Group's crisis response will ensure close collaboration with regional initiatives (such as the African Union's recently adopted *Social Policy Framework*), increased partnership with the UN (for instance, on food), as well as with the other MDBs. The current economic and financial environment has underscored the need for the WBG and the IMF to work closely together, drawing on one another's institutional mandates and comparative advantage in areas of mutual interest, as underlined at the recent G20 Summit. The Joint Management Action Plan (JMAP) on Bank-Fund collaboration–launched 2 years ago–continues to provide a framework for deepening collaboration in a complex and interconnected policy environment. A comprehensive assessment of JMAP implementation will be prepared for the Boards of both institutions by the end of the year.