

THE WALL STREET JOURNAL

June 1, 2005

Why Can't the World Bank Be More Like a Bank?

by

James S. Henry and Laurence J. Kotlikoff

Today begins Paul Wolfowitz's tenure as president of the World Bank. And if he doesn't have first-day jitters, he should.

Mr. Wolfowitz faces a huge challenge -- delivering massive amounts of development aid in a way that can't be expropriated or exploited by corrupt Third World bureaucrats or the avaricious development industry. This "aid delivery tax," evidenced most recently in the U.N. food-for-oil scandal, rips off intended recipients by limiting not only what they get, but also what donors are willing to give. In addition, the form of aid is often distorted to satisfy the "development" priorities of local officials and businessmen. The World Bank has often supported huge infrastructure projects, when buying mosquito nets or organizing vaccinations would have been much more cost-effective.

Fortunately, thanks to new technology, there is now a direct way to assist people in the Third World, namely via World Bank accounts. Under this proposed policy, the Bank would establish, manage, and oversee individual accounts for citizens or institutions in Third World countries, as well as directly contribute to those accounts. New technology - - electronic fingerprint recognition -- can be used to ensure that only one account is opened for any given Third Worlder.

The accounts would serve three functions: checking, saving and investing. All account balances would be invested by the World Bank in a market-weighted global index fund of stocks, bonds and real estate securities. The accounts would be the private property of their owners, who would be free to add to or withdraw from their balances via ATMs located at home or abroad. Since portfolio holdings would be marked-to-market, account owners would be able to write checks against their account balances. Balances in the account could also be used to secure micro-lending, which is working very well in countries like Bangladesh, Mexico and Colombia. Finally, the accounts would be free: The World Bank would charge no fees.

Overnight, developed countries, other development banks, NGOs, private charities, and private individuals would have a means of directly helping Third Worlders. They'd simply write out a check to the World Bank, designating the country they wanted to help. The Bank would then uniformly increase the balances of all account holders from that country. Recipients could either save the money and have it automatically invested in the global capital market, withdraw the money in local currency or a major currency of their

choosing, electronically instruct the Bank to issue payments, or use their account balances to make electronic purchases. The purchases could include subsidized medications and other essential items, which the World Bank could sell through an electronic store accessible, via ATMs, only to Third World account holders.

The World Bank would also accept and deposit checks made out to individual account holders. This would allow employers to help their workers save. It would also provide a secure and inexpensive conduit for worker remittances. Remittances from Third World "guest workers" now exceed official development assistance by a factor of two. But most of these transfers are made at incredibly high transactions costs.

Our "show-them-the-money" approach to development assistance might be dubbed "financial populism." It provides the world's poorest inhabitants not only with direct access to development aid, but also with free access to four financial services that have heretofore been available only to First Worlders and the Third World's richest: a safe depository of savings; portfolio diversification; access to the world financial market's high average rate of return; and easy access to credit.

As any Argentine will explain, these services are vital to individuals and the economy. Four years ago, Argentina's financial system collapsed. Its banks reneged on their deposits; its treasury reneged on its debt; and its central bank reneged on its currency. Millions of ordinary people, with every peso or dollar invested in Argentina, lost their life's savings -- followed by their jobs -- as the economy headed down the tubes. Argentina's fiasco is just the latest case of financial abuse meted out to the world's poor by local bureaucrats and bankers who routinely limit financial freedom for their own political and rapacious ends and then make a hash of their country's fiscal and monetary affairs.

Prior to Argentina there was Turkey in 2000, Russia in 1998, Thailand in 1997, Mexico in 1994, Bolivia in 1984, Chile in 1982, and others. The common thread in these crises is that the common man has had no place to hide. The World Bank's misguided policy of "domestic capital market development" has operated under the absurd presumption that each country has a comparative advantage in providing financial services and that each should have its own stock exchange, bond market, pension industry, insurance companies, not to mention banking system and regulatory institutions. And to ensure that homegrown financial institutions have customers, the Bank has forcefully, if subtly, supported restrictions on foreign investment by domestic residents. Were Rhode Island a Bank client, the Bank would be doing its level best to ensure no Rhode Islanders ever invested a penny outside that tiny state. Were that the law, the Rhode Island government would quickly find it could sell lots of state bonds at low interest rates to its financially captive public. This, in turn, would facilitate additional government spending.

Hard to believe? Well, just look at Kazakhstan, Mexico and Uruguay, whose Bank-supported "pension reforms" have ended up with pension companies holding nothing but

government paper and charging their coerced participants large fees for what is ludicrously called "investment management."

By establishing World Bank accounts, the World Bank would end, rather than contribute to, Third World financial servitude. This would limit excessive borrowing and spending by Third World countries and force domestic financial institutions to meet the international market test, i.e. to compete. By breaking the chains of financial bondage, the new policy would also force developing countries to adopt the legal and accounting norms needed to attract foreign investment. In plain terms, countries like Argentina would find they have to start acting like Luxembourg if they want to have either their own citizens or anyone else invest at home. And once they did, they'd experience a flood of First World capital ready to work in their countries.

Thus World Bank accounts hold the promise not just of revolutionizing the delivery of aid, but also of limiting the potential for banking, currency, and fiscal crises in the developing world. Banking crises in places like Argentina will either become a thing of the past or there will be no banks left in Argentina to go into crisis. The government would no longer have a captive market for its bonds, and would either get its fiscal house in order or find no takers for its paper. And the Argentine central bank would either maintain a stable value of its currency or quickly learn that no one wants or needs to use it. In short, it's time for the World Bank to fulfill its obligations to the world's poor. The path is simple. It just needs to start acting like a bank.

Mr. Henry is editor of Submergingmarkets.com. Mr. Kotlikoff is chairman of the department of economics at Boston University.