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Wolfowitz Isn't the World Bank's Biggest Problem

By Justin Fox
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The World Bank is undeniably in crisis. But not because its president, Paul Wolfowitz, got his girlfriend a raise.

It is the Wolfowitz saga that has been grabbing all the headlines, of course. The Iraq-war architect was plucked from the Defense Department and deposited by President George W. Bush at the World Bank in 2005 (by tradition, the U.S. President picks the bank's chief). At the time, Wolfowitz informed the bank's ethics committee that he was seeing Shaha Riza, a communications adviser at the bank, and the in-house ethicists told him she should be moved to another agency and given a raise for her troubles. But the size of the pay hike (from $133,000 to $180,000, tax free) and other details about Riza's transfer raised hackles among bank staff and sparked an investigation. The bank's board will decide any day now whether Wolfowitz stays or goes.

This dragged-out mess, though, is a distraction. The bigger issue is that the Washington-based bank and its sister organization, the International Monetary Fund (IMF), are struggling to justify their continued existence.

The situation is most pressing for the smaller IMF, which pays its bills with the profits it makes lending money to middle-income countries in financial trouble. With hardly any such countries in trouble these days, the organization is projecting a $224 million deficit for this fiscal year and asking its member nations if it can start selling off some of the gold they deposited with it after World War II (the answer so far: no).

The World Bank isn't that desperate, but it faces similar pressures. Both organizations were created in 1944 by the soon-to-be-victorious Allied powers. At the time, says Harvard professor and former IMF chief economist Kenneth Rogoff, "global financial markets barely existed, and domestic financial markets barely existed in Europe."

The World Bank's initial job was to finance reconstruction in Europe. The Marshall Plan rendered that task superfluous, so the bank--in the first of several reinventions--moved on to bankroll development in other countries. The idea was to lend to governments that were creditworthy but had no access to rich-country capital markets. "Now we live in a world where there are huge global capital markets, where, if anything, investors are too willing to invest in developing countries," says Adam Lerrick, a former investment banker who teaches economics at Carnegie Mellon University. The World Bank's net lending has plummeted over the past few years, even as it keeps shopping loans to the likes of Brazil, Turkey, Russia and China, sometimes on hugely generous terms.

This is the work of the biggest part of the World Bank, the International Bank for Reconstruction and Development. Member countries make deposits (the U.S. share is $2 billion down and $30 billion pledged); the bank sells bonds backed by those deposits and pledges, then lends the money out at a small profit. The other main arm of the World Bank, the International Development Association, gets regular infusions of cash from rich countries and lends funds on near giveaway terms to truly poor countries, mostly in Africa (the U.S. contribution is just under $1 billion a year, or 0.04% of federal spending).

Lerrick wants the World Bank to stop lending to middle-income countries and restructure its loans to the poorest nations as outright grants. Nancy Birdsall, a former World Banker who runs a Washington think tank called the Center for Global Development, argues that the bank could have more impact on poverty by making better use of its best assets: the expertise of its staff and its ability to coordinate global action. "Lending and grantmaking at the country level should not be the end-all and be-all," she says. "It should be the vehicle for advice and constant rebuilding of the bank's knowledge." Birdsall is a World Bank fan but agrees with critics like Lerrick that it must become smaller (it has a staff of 10,000) and less banklike to remain relevant.

Wolfowitz's allies say he is the victim of backlash from entrenched bank staff upset that he is turning up the heat on an anticorruption campaign begun by his predecessor, James Wolfensohn. That's probably overstating things. But the potential backlash against slashing the bank's staff and getting it out of lending would surely be epic. Which may explain why no World Bank president, Wolfowitz included, has attempted it.