WebMemo
Published by The Heritage Foundation
No. 2337
March 11, 2009

# World Bank's Proposed Vulnerability Fund: A Gimmick for the Poor

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No group is more vulnerable to the international financial crisis and recession than the poor in developing countries. The World Bank has offered a gimmick to help them out. A proposed "Vulnerability Fund" seeks to siphon off 0.7 percent of developed countries' stimulus packages for World Bank and United Nations assistance to poor countries.[1]

Those familiar with foreign aid debates will recognize the 0.7 percent figure as a spin-off of the traditional call for rich countries to transfer 0.7 percent of their gross domestic product to developing countries. That proposal, though a favorite of the aid industry, has earned well-deserved criticism because of the lack of any empirical evidence linking it to actual needs in developing countries—or indeed any evidence that aid flows in general contribute substantially to development. Unfortunately, the 0.7 percent figure is no more justified in relation to stimulus payments than it is in the case of aid flows.

**Little Need for More Aid.** Developing countries have been prospering under the globalized free-market capitalism that has dominated the world economy since the fall of communism. Per capita incomes in poorer countries (with average incomes less than $5,000) have been growing over the last decade at an average annual rate of about 2.6 percent.[2]

Data collected from the United Nations' Human Poverty Index shows that about 4.7 percent of the world's people have escaped poverty over the last 10 years.[3] Countries that have committed more fully to the capitalist system (as evidenced by significant increases in economic freedom as measured in the *Index of Economic Freedom*) have done even better, moving about 5.8 percent of their populations out of poverty.[4]

Such gains are not surprising given the substantial sums that have been flowing to developing countries through the free market system. According to the Bank for International Settlements, emerging markets earned current account surpluses of about half a trillion dollars in 2007.[5] An additional $600 billion in investment flows that year helped swell developing world coffers. Some estimates show even higher flows.[6]

Remittances to developing countries from family members working in developed countries added another $300 billion or so to the capital flowing to developing countries.[7] Official development assistance kicked in another $100 billion. For those of you doing the math, that's over $1 trillion flowing through private sector channels versus about one-tenth of that amount through official government channels.

**The World Bank's "Solution."** The risk for all, in both developed and developing countries, is that in a time of trouble we will focus too much on what

This paper, in its entirety, can be found at:
*www.heritage.org/Research/TradeandEconomicFreedom/wm2337.cfm*

Produced by the Center for International Trade and Economics (CITE)

Published by The Heritage Foundation
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governments can do and not enough on what the private sector can do.

For developing countries, faced with total external financing needs of $1.4 trillion or more, the World Bank offers to "almost triple lending" to $35 billion in FY 2009[8] and calls on wealthier governments to donate 0.7 percent of their stimulus packages as aid to poorer countries. Assuming that stimulus packages might amount to $2–3 trillion through 2010, this would add $14–21 billion in assets for developing countries. Such sums are trivial compared to the needs.

Where then to turn? The answer is the same as it has been for the last 10 years, and indeed the last 200 years: the private sector. The World Bank acknowledges as much in its listing of "urgent priorities," which start with restoring confidence and aggregate demand. The key to this, as stated by the bank, is "renewed growth in global trade."

It is in this context that support by the Obama Administration and some in Congress for "Buy American" and other protectionist measures are so woefully off the mark. The Buy American provisions in the recent stimulus bill, while propping up a few non-competitive U.S. industries, will carry substantial costs borne by "the American public, who will fail to get the best value for their hard-earned taxpayer dollars; the U.S. workers who lose their jobs when the companies they work for go out of business as countries retaliate in kind; and the economy as a whole, which will become less productive."[9]

As bad as that is, the costs for the poor in developing countries are far worse. For those living on the margins of existence, bad policies adopted by their governments or ours can mean the difference between life and death. Here the World Bank gets it right: "One of the greatest threats to increased trade flows is protectionism and beggar-thy-neighbor policies, which need to be resolutely resisted."[10] Amen.

**A Treatment Worse Than the Ailment.** The proposal for a "Vulnerability Fund" with its all-too-familiar 0.7 percent price tag is sure to resonate with aid advocates and politicians looking to demonstrate their compassion for the poor. It is also a way for the World Bank to call attention to itself and try to demonstrate its relevance in this time of crisis. It is popular among those who look first to governments for answers to imagine that international intergovernmental agencies like the World Bank or the United Nations can solve our urgent problems. They are doomed to disappointment.

Beyond all questions of competence and efficiency, it's a problem of scale. The world economy is immense and immensely complex. International institutions like the World Bank and the United Nations are small. As expensive and wasteful as they are, they still bring minimal resources to the table. However smart their staffs, the knowledge they possess is miniscule compared to the knowledge distributed throughout our economies in the minds of all the private citizens working to better themselves.

1. World Bank, "Swimming Against the Tide: How Developing Countries Are Coping with the Global Crisis," paper prepared for the G-20 Finance Ministers and Central Bank Governors Meeting, Horsham, United Kingdom, on March 13–14, 2009, p. 13–14.
2. Terry Miller and Kim R. Holmes, 2009 *Index of Economic Freedom* (Washington, D.C.: The Heritage Foundation and Dow Jones & Company, Inc., 2009) at *http://www.heritage.org/index*.
3. See U.N. Development Programme, "Human Development Report 2007/2008," pp. 238–240, and previous editions.
4. Miller and Holmes, 2009 *Index of Economic Freedom*, p. 20.
5. Committee on the Global Financial System, "Capital Flows and Emerging Market Economies," Bank for International Settlements, January 2009.
6. International Monetary Fund, "World Economic Outlook," October, 2008.
7. World Bank, "Swimming Against the Tide," p. 7.
8. *Ibid.*, p. 13.
9. Daniella Markheim, "Buy American Hurts America," Heritage Foundation *WebMemo* No. 2256, January 30, 2009, at *http://www.heritage.org/Research/TradeanEeconomicFreedom/wm2256.cfm.*
10. World Bank, "Swimming Against the Tide," p. 17.


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The genius of the free market is that, with only occasional lapses, it organizes this knowledge efficiently without central direction or planning. No government or collection of governments can match the effectiveness or the cost.

**The Most Vulnerable Most at Risk.** What is needed by the world economy, and especially by its poorest citizens, is a renewed commitment by the governments of the G-20 (and the World Bank) to promoting and protecting free market capitalism, that engine of growth with a proven track record of promoting increased prosperity for all.

The U.S. and the rich countries of the West can perhaps afford a flirtation with socialism, as the Obama Administration seems to be proposing. It will hurt, but we will survive. But for the poor in developing countries, a turn away from the free market will be catastrophic. That is the message the World Bank needs to be delivering to the G-20, and that is the message the G-20 needs to deliver to the world.

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