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FAST TRACK BRIEF

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# The World Bank Group's Response to the Global Economic Crisis – Phase I

- **The global economic crisis that began in 2008 threatened to erase years of progress in developing countries. In response, the World Bank Group increased lending to unprecedented levels. The World Bank posted a large increase in middle-income countries (MICs), and a much smaller one in low-income countries (LICs). The International Finance Corporation (IFC) focused on trade finance, mainly in LICs. Its new business initially fell in MICs, rebounding only in late FY10. The Multilateral Investment Guarantee Agency (MIGA) concentrated on guarantees in Eastern Europe. Analytic and advisory work helped inform government and private sector responses to the crisis.**

- **Increases in financing volume must be matched by quality to achieve sustained economic results. Quality-at-entry indicators have generally been positive. But certain areas—the financial sector specifically and results on the ground more generally—are a cause for concern, particularly given continued tight budgets. The financial headroom available to the International Bank for Reconstruction and Development (IBRD) enabled it to launch a large response in a few MICs, driven by country demand, while the more modest International Development Association (IDA) response reflected an inelastic funding envelope and performance-based resource allocation. Most crisis-related Bank financing was channeled to economic policy, social protection, and the financial sector through record levels of development policy lending, while slower-disbursing investment operations supported longer-term investment, especially in infrastructure. Whether a more tailored, short-maturity instrument would have helped the response, and the Bank's own financial sustainability, is an open question.**

- **IFC's financial capacity, though impaired by the crisis, could still have supported a moderate countercyclical response. Ultimately, IFC's response was largely procyclical, following a v-shaped pattern overall. Its crisis initiatives showed creativity and strategic positioning in soliciting funds from external partners and creating a new subsidiary, the Asset Management Company. Overall, the response has delivered some positive effects, mostly in LICs, with existing clients, and in cofinanced operations. But opportunities were missed, and the effectiveness of the initiatives has been diluted by design and implementations weaknesses—such as the time needed for fund-raising and internal capacity building. MIGA helped several key financial institutions in Eastern Europe through guarantees.**

- **A crisis originating in Organization for Economic Cooperation and Development (OECD) countries tests the readiness of the International Monetary Fund (IMF) first, but global interdependence also requires a high state of Bank Group readiness. Three aspects contributing to the Bank's readiness were knowledge of poverty impacts, long-term relationships with country authorities, and IBRD's inherited financial headroom. Areas of weakness included dissemination of global economic forecasting updates**

**at the onset of the crisis and early recognition of, and action on, country financial sector vulnerabilities. With IDA, greater effort may have been warranted to secure a midterm increase in resources. IFC lessons include the need for financial headroom, sufficient risk appetite, leveraging existing partnerships and platforms, and staying focused on development effectiveness. MIGA urgently needs greater product flexibility and enhanced business development.**

- **This assessment underscores the strong countercyclical role that the Bank Group has eventually played, with partners and countries, to help withstand the global downturn. Its expansionary nature fit the profile of the crisis, but the emerging deficits, debt, and financial sector vulnerabilities place a premium on effectiveness of resource use, generation of sustainable growth, and macroeconomic stability. The assessment does not address the open question of whether an alternative response, involving a lower level of financing in FY09-10 coupled with a greater financial capacity going forward might have better optimized the Bank Group's capital use over the coming years.**

This report presents an initial real-time evaluation of the readiness, relevance, quality-at-entry, short-term results, and likely sustainability of the Bank Group response from the start of the crisis through FY10. This evaluation builds on a 2008 IEG assessment of Bank Group interventions during past crises and draws extensively on 11 country case studies and field visits. Given the short time since the crisis response started, the evaluation is geared more to raising flags than to presenting definitive conclusions.

The evaluation begins with a review of the impact of the crisis on developing countries, before describing and assessing the Bank Group response, and inferring lessons and implications for the future.

## Impact on Developing Countries

**The first signs of crisis in the developing world were sharp contractions in private capital flows and trade.** From a peak of around $1,200 billion in 2007, net private capital flows to developing countries fell by over a third in 2008, as the liquidity squeeze in advanced economies led investors to pull back from emerging markets. Private flows weakened further in 2009. There are indications of a rebound in 2010, however, with the expectation that flows will increase by 30 percent over 2009. Trade also fell sharply, as export markets collapsed, although these volumes are also starting to recover.

**The severity of the crisis has varied across countries, reflecting differences in geography, country policies, and global integration.** The Latin America and the Caribbean and Europe and Central Asia Regions were the most affected. Countries in Latin America and the Caribbean were highly integrated with the U.S. economy, the epicenter of the crisis, while Europe and Central Asia countries had fiscal and external imbalances and financial sector vulnerabilities. MICs were more affected than LICs, although LICs had greater vulnerability to negative shocks. Experience gained during the crises of the 1990s increased the preparedness of several countries, often with Bank Group help in reforms.

**Consensus emerged on the need for fiscal stimulus, within budget constraints.** Those with limited fiscal space had less room to respond and suffered more severe impacts. But as a group, developing countries have grown quicker than industrial countries, and they are leading the global recovery. Developing country debt-to-GDP ratios were lower at end-2009 than at end-2000, though higher than in 2007. But fiscal deficits in both developed and developing countries have worsened over the past two years (by a sharp 5 percentage points in developing countries). Countercyclical spending programs are starting to be rolled back as the recovery takes hold.

**The crisis reversed the decline in poverty of the past decade.** The Bank Group estimates that by end-2010, an additional 114 million people worldwide will have fallen below the $1.25 a day poverty line since the onset of the crisis. Even with a rapid recovery, some 71 million people would remain in extreme poverty by 2020 who would have escaped it had the crisis not occurred. Unemployment rates remain high in several countries.

## World Bank Group Response

**Once triggered by high-profile events, the crisis spread quickly, taking many—including the Bank Group—by surprise.** The Bank Group responded to the crisis in waves. Its initial response narrowly focused on increasing Bank lending, especially in MICs. As the scale of the demand became apparent, the Bank rationed available IBRD capital and obtained Board approval for an IDA Fast-Track Facility. IFC and MIGA developed initiatives to leverage their impact and (in IFC's case) mobilize funds.

**After initially underscoring only the volume of financial support, the Bank Group over time set out linkages across programs.** In March 2009, the Bank Group announced that it was "stepping up…financial assistance to help its member countries mitigate the impact of the crisis" to $100 billion for IBRD, $42 billion for IDA, and $36 billion for IFC. The financial assistance would fall under three operational crisis-response pillars: protect the most vulnerable; maintain long-term infrastructure investment; and sustain the potential for private sector–led growth, with "an over-arching focus on macroeconomic stability."

**International financial institutions (IFIs) responded strongly to the crisis and posted the largest-ever financial flows to the developing world—with the WBG registering the largest disbursements.** All IFIs have seen sharp increases in financing, though the total amounts of the IMF and Bank Group are much larger than those of the other IFIs. Between fiscal years 2009 and 2010, the IMF committed $219 billion and disbursed $67 billion, the notable difference reflecting the contingent nature of much of its support. In the same period, the Bank Group committed $128.7 billion and disbursed a record $80.6 billion—a larger amount than other IFIs, including the IMF. Bilateral development assistance also increased, by nearly $20 billion between 2007 and 2009.

**Capital headroom was a determining factor.** Low pre-crisis demand for IBRD funding left it with the headroom to increase lending nearly threefold during FY09-10. In contrast, the IDA funding envelope, determined before the crisis, enabled a lesser increase (25 percent). Given equity write-downs and an increase in nonperforming loans, and transfers to IDA from surplus, IFC's capital was more constrained, allowing—based on internal estimates—a rise in annual investments of the order of 5 percent.

**Approaches to pricing varied.** IFC and MIGA loan and guarantee pricing is built on the premise that they should complement and not displace private capital, factoring in project and country risk premiums. As a result, prices tended to rise most in countries hit hardest by the crisis. IBRD pricing does not discriminate among borrowers, and was historically low at the onset of the crisis.

### *World Bank*

**Bank commitments and disbursements reached an all-time high.** During FY09-10, the Bank committed over $105.6 billion and disbursed $68.1 billion, compared with $49.4 billion and $39.2 billion during FY07-08. The vast majority of the increase was through IBRD. Sixty-five percent of IBRD disbursements were from commitments approved since July 2008; the ratio for IDA was 36 percent. The majority of disbursements from pre-crisis commitments were investment loans, which showed little evidence of faster disbursement than in previous years.

**The distribution of lending broadly mirrored differential crisis impact and financing needs, as well as differences in IBRD and IDA resources.** Latin America and the Caribbean and Europe and Central Asia, the most severely impacted Regions, saw their shares rise. The focus was on social protection and other countercyclical programs in Latin America and the Caribbean, and on fiscal and debt sustainability in Europe and Central Asia. Conversely, the shares of Sub-Saharan Africa and East Asia and the Pacific declined, while the share of the Middle East and North Africa remained broadly unchanged, and the South Asia share declined in FY09, before bouncing back in FY10. The decline in Sub-Saharan Africa's share reflects the sharp increase in IBRD lending relative to IDA, rather than any diminution of lending to Sub-Saharan Africa.

**The sector allocation of resources was consistent with the Bank's goals for the crisis response.** Economic policy, the financial sector, and social protection represented 65 percent of the $28.8 billion increase in disbursements in FY09-10. Social protection, 17 percent of the increase, was mainly development policy operations (DPOs) and quick-disbursing investment loans, and was concentrated in a few loans and few countries, with 60 percent going to Colombia, Ethiopia, Mexico, and Poland. Infrastructure operations accounted only 18 percent of the increase in disbursements, despite being 30 percent of new commitments, reflecting longer lead times.

**Much of the increased lending was delivered through DPOs, but investment lending was robust.** Investment lending accounted for about 60 percent of commitments and disbursements in FY09-10, and DPOs—a medium-term instrument whose suitability for a crisis is unclear—for approximately 40 percent. For IBRD, DPOs edged above 50 percent of commitments and disbursements in FY09-10. For IDA, more than 75 percent of commitments and disbursements were investment operations. The Bank's response to the East Asian crisis was similarly focused on IBRD policy-based lending. But unlike the Bank's pattern in that event, IBRD investment lending commitments grew rapidly during this crisis, fueled by large energy and transport loans to MICs that have disbursed little to date.

**The Bank's analytic response has had a relatively low profile.** Analytic work did not feature in the objectives (or instruments) of the Bank crisis-response strategy. But central units, especially Development Economics (DEC) and Poverty Reduction and Economic Management (PREM), did significant analytic work. There were also trust funds for diagnostic work. Analytic work was supported by Regional and country units, according to resource availability and the severity of the crisis impact.

### *IFC*

**IFC responded with new global initiatives —including the creation of a new subsidiary—and actions through its regular business.** The initiatives involved new delivery platforms targeting trade finance, infrastructure, microfinance, bank capitalization (overseen by a new subsidiary, the Asset Management Company), and distressed asset management. They were intended to leverage IFC's funds with up to $24 billion from external partners (development finance institutions in particular) by 2011. IFC also participated in joint IFI initiatives in Europe and Central Asia, Latin America and the Caribbean, and Sub-Saharan Africa. IFC made $20 billion in net commitments between FY09-FY10 from its own account, alongside efforts to ensure the financial sustainability of its portfolio.

**IFC's initiatives were designed for phased implementation, but have been well behind schedule.** Three stages of needs were envisaged: short-term liquidity (trade); longer-term liquidity and equity capital (microfinance, infrastructure, and bank capitalization platforms); and recovery support (distressed assets management). As of June 30, 2010, $9.2 billion had been approved for new initiatives, but only $1.9 billion had been disbursed. The new Global Trade Liquidity Program (GTLP) is the only one close to its target.

**IFC's new business during the crisis has followed a procyclical, v-shaped pattern.** New IFC business, which had more than doubled from 2005 to 2008, fell by 18 percent in FY09, before increasing 28 percent in FY10. The v-shaped pattern of investment largely mirrors that of private investment as a whole. Meanwhile, IFC doubled the number of portfolio staff and carried out stress tests on its portfolio clients.

**IFC's new business increased in LICs but, unlike the Bank's pattern, fell in MICs.** IFC's investments in IDA countries increased 24 percent between FY08 and FY10. Commitment increases were largest in Ghana and Pakistan. Conversely, IFC reduced its investment volumes in larger MICs, such as the Philippines, the Russian Federation, and Turkey. The focus in MICs was more on minimizing portfolio losses. New loan pricing rose sharply. Only in the final quarter of FY10 did MIC commitments start to rebound.

**The crisis accelerated a trend in IFC toward short-term financing.** Global Trade Finance Program (GTFP) guarantees have grown from a seventh to a third of new IFC commitments over the crisis period, contributing to a shift in resource allocation toward the financial sector. Longer-term infrastructure and real sector investments have declined considerably. Within these clusters, investments in physical infrastructure (particularly electric power) and agribusiness (agriculture and forestry in particular) declined most.

**Activities in advisory services increased.** Expenditures on new crisis-related advisory products (nonperforming loan management and insolvency regimes) have been relatively small to date, at $13 million, although expenditures on core products (such as corporate governance and business environment work, mostly approved prior to the crisis) increased by around $20 million in FY09 and were often linked to crisis needs.

### *MIGA*

**MIGA's response is built around but not limited to a new global Financial Sector Initiative, focused initially on Europe and Central Asia.** Under this initiative, part of the Joint IFI Action Plan for Central and Eastern Europe, MIGA agreed to commit up to $1 billion in net exposure ($2-3 billion in gross terms) for political risk insurance on cross-border investments by financial institutions to recapitalize or provide liquidity to subsidiaries. In FY10, guarantees totaling $918 million were issued under the initiative (six contracts issued in Serbia, Croatia, Latvia, and Kazakhstan), bringing MIGA's total cumulative support (net exposure) under the Financial Sector Initiative to $1,476 million.

**MIGA's guarantee issuance remained the same but became increasingly concentrated in the financial sector since the crisis began.** In line with the weakness in foreign direct investment flows, MIGA's guarantee activity remained at trend levels during the crisis, with some $1.4-$1.5 billion in new guarantees in FY09 and FY10. MIGA's crisis response initiative resulted in a large share of its guarantees issuance concentrated in the ECA region, and in the financial sector, while activity in infrastructure and other priority sectors fell sharply. Guarantees in IDA countries also declined as a share of guarantee volume. Guarantee issuance was concentrated in terms of clients (guarantee holders) and investor countries, with the top two clients accounting for 80 percent of guarantees in FY09 and FY10. At the same time, cancellations declined during the crisis period, and MIGA's gross outstanding portfolio of guarantees— a measure of the extent of MIGA's overall coverage—reached a peak level of $7.7 billion in FY10 (6 percent over FY09), as more investors held onto their guarantees.

## Assessment of the World Bank Group Response

### *World Bank*

**Lags in the Bank's recognition of the impact of the crisis affected the early phases of the response.** At the 2008 Annual Meetings, the Bank was perceived to have focused on the need for a new multilateralism, rather than gearing up for a crisis response and seeing the capital implications of such a reaction, while the IMF called for an immediate and coordinated response to the crisis. Given that the crisis emerged in the financial sector of advanced economies, the IMF had a more natural role in leading and sounding the alarm, but the Bank still needed to—and eventually did—react strongly.

**Once the Bank recognized the crisis, the speed of its response was helped by several factors.** The Bank's ongoing relations and dialogue enabled more rapid engagement with country authorities. Speed was also facilitated by Bank Group leadership and the establishment of a central operational structure, with the Operations Committee and the newly formed Crisis Response Working Group chaired by Operations Policy and Country Services.

**Readiness was helped by the Bank's financial position at the start of the crisis.** IBRD went into the crisis with an equity-to-loans ratio of 38 percent, compared with a target range of 23-27 percent, giving it substantial room to expand lending. This reflected prudent financial management as well as stagnant demand from MICs during the previous years. IBRD commitments had declined by 5 percent during FY07-08. IDA15 had just become effective on July 1, 2008, increasing IDA resources by about 25 percent, on top of a 25 percent increase in FY06-08.

**Another positive factor was the Bank's ability to draw on its knowledge of poverty reduction—which now needs to be maintained.** This included surveys enabling better targeting. The accumulated knowledge reflected continuing investments by DEC, PREM, and the Human Development Network (HDN) over the years on poverty, social safety nets, and labor markets. Examples include Bank support for conditional cash transfer programs in Bangladesh, Colombia, and Mexico and labor market improvements in Poland, Turkey, and Vietnam. Ongoing monitoring of the poverty and social effects of the crisis could, however, have been more systematic.

**The increase in lending was concentrated in the MICs most hurt by the crisis, such as Colombia, Mexico, Turkey, and Ukraine.** There were important exceptions, however, such as the large increase in IBRD commitments to Indonesia, among the least-affected countries, which served as support for the country's crisis-prevention efforts. India, moderately affected by the crisis, has seen a record rise in commitments in FY10.

**The relevance of the Bank's analytic response is significant in some countries, but weak in others.** Earlier analytic work provided a platform for the Bank response in some countries, sometimes in conjunction with international support packages. Where limited prior work was available, the quality of lending suffered. In some countries, in Europe and Central Asia in particular, increased lending appears to have crowded out new analytic work, a critical determinant of the quality of policy dialogue and lending, while in many others trust funds and/or incremental allocations from the Bank's budget allowed continuation of the work.

**The design of programs appears to have been tailored to countries' diverse needs.** Quality of program design was high in Georgia, Indonesia, and Mexico. In Hungary, however, the Bank did not respond adequately to country needs. The quality of the Bank's prior engagement with the country seems to have been a determining factor. And coordination with other partners, including the IMF, helped enhance quality and relevance, and thus likely impact.

**Quality at entry of DPOs has been notably varied, reflecting sector strengths and weaknesses.** The evaluation made an initial assessment of quality at entry for 46 DPOs, covering 68 percent of DPO volumes approved during the crisis period. The ratings were satisfactory on average, but ranged from highly satisfactory to unsatisfactory. The substantive program policy content and results frameworks for financial sector DPOs were the weakest, followed by infrastructure. Results frameworks for economic policy work had the most acceptable levels of quality, followed by social protection.

**The Bank's flat overall administrative budget complicated delivery, which made the operational efforts all the more notable.** Administrative resources for Bank country services rose about 5 percent annually in FY09 and FY10, barely enough to cover the surge in the operational work program that was associated with the crisis response. The implied "productivity" increase was achieved in part through larger project size, which doubled for IBRD and increased by 30 percent for IDA. But economies of scale have limits, raising important concerns—now and going forward—about trade-offs with operational quality (at entry and in supervision) and analytic work. In Ukraine and elsewhere, there was a lack of funding for economic studies; but not in Indonesia or Mexico, given trust funds in the former and central contingency funds in the latter.

**Attention to poverty issues was greater than in previous crises.** The 2008 IEG review of lessons from previous crises emphasized the importance of identifying the poverty and social impact of a crisis, including measures directed to address these impacts. The focus on poverty issues at the country-level was apparent in the content of DPOs, other lending (and supplemental financing) for community-driven development projects, and analytic work on improved targeting of safety nets. At the same time, ongoing monitoring of the social and poverty effects of the crisis could be enhanced.

**Fiscal and debt sustainability analysis was present in DPOs, but could have paid greater attention to macro and political-economy risks.** As required, DPO program documents examined fiscal and debt sustainability, complemented in many country programs by analytic work on public expenditures, including public investment, and poverty alleviation. The objective of maintaining public investment in infrastructure was also accompanied, in some cases, with the objective of supporting employment (through labor-intensive infrastructure) and other social objectives. But many risks to sustainability remain, in some cases related to the underlying political economy of rollbacks in fiscal stimulus and rationalizations of social security, pension, and health system benefits.

**The Bank's financial sector capacity had deteriorated, with adverse consequences.** Starting in 2005, the Bank had subordinated its work on the financial sector to its efforts on private sector development more generally. Subsequently, with the exception of ECA, units covering the financial sector were integrated within PREM. When the crisis hit, current FSAPs were available for approximately one-third of client countries. The lost capacity in the financial sector proved to be costly in identifying and responding to sector vulnerabilities, as did an ill-designed 2007 strategy for the financial sector.

## *IFC*

**IFC's response was important, and creative, even as its execution did not match intentions.** IFC's $20 billion of investments in developing countries in FY09 and FY10 was greater than any other IFI with private sector operations over the same period. IFC also appropriately focused its response on key crisis vulnerabilities: trade, financial sector stabilization, and infrastructure. The initiatives showed some learning from past crises, in being targeted, phased, temporary (in most cases), and involving partnerships. However, IFC's added value has been less than expected, since most initiatives were not "ready for use" and IFC did not fully use its own capital.

**IFC underestimated the challenges associated with implementing new initiatives.** Obstacles included: accommodating partner preferences, building institutional capacity, demands on staff time (in the context of a hiring slowdown and large-scale internal reorganization), weak staff incentives to use the initiatives, limited ownership in the Regions, and difficult conditions for fundraising. The Global Trade Liquidity Program (GTLP) was the only new initiative able to adapt effectively to these constraints, notably through the establishment of a novel trust fund for investments and in extending relationships built up through the GTFP.

**IFC's capital position was impaired by the crisis, but could have supported a moderate countercyclical response overall.** In September 2008, IFC's balance sheet contained substantial unrealized equity gains, and write-downs were significant ($1 billion). Nonperforming loans were relatively low, but expected to rise. IFC had also committed to significant grants to IDA ($1.75 billion between FY08 and FY10). Nonetheless, IFC's estimate that it could invest 5 percent more per year in FY09-11 than in FY08 was conservative, given a rating agency assessment that IFC was well capitalized and experience that showed gains in investing countercyclically during a crisis. Ultimately, IFC investments fell nearly 20 percent in the first year of the crisis—well below expectation.

**Most comparator institutions delivered countercyclical responses.** Most other IFIs (European Bank for Reconstruction and Development, European Investment Bank, and Asian Development Bank) as well as Standard Chartered (a private financial institution focused on emerging markets) were able to increase their investments in the first year of the crisis, while, in the same Regions, IFC was not. In Europe and Central Asia, EBRD concentrated more on large-scale loans, while IFC focused on equity transactions, alongside trade finance.

**At the country level, IFC did little to refocus its top-down approach.** In Mexico, IFC's strategy reflected the pre-crisis preference for niche investments in upper MICs. IFC loan pricing rose substantially as a result of the crisis, as perceived country risk increased, which worked against the country team's efforts to help global leaders and first-tier companies in distress. In Indonesia, the approach was similarly cautious, and too defensive given the relatively mild impact of the crisis and the extent of external support. The exception was Georgia, where IFC provided support to two systemic banks as part of a massive IFI package to assist the country.

**Meanwhile, communications to investment staff were unclear, which promoted risk aversion.** Staff received mixed messages: to identify countercyclical investment opportunities, but to preserve the balance sheet at all costs. Ultimately, portfolio management crowded out new business development, which stagnated in mid FY09, notably in Europe and Central Asia.

**IFC was at its most responsive in low-income countries.** IFC's increased focus on IDA countries was sustained in the crisis period, a positive development in that IDA countries have a weaker economic base and have largely missed out on the influx of foreign capital prior to the crisis.

**IFC adapted its instrument mix, but more local currency financing was needed.** GTFP dominated the increase in financing, much of it to support banks in Bangladesh and Vietnam. Trade finance is a relatively low-risk pathway to reach small and medium enterprises (SMEs) in tough investment environments and requires limited capital. IFC's capacity for local currency finance was again limited, leading to gaps in addressing financing needs of medium and small enterprises.

**The drop in infrastructure and agribusiness investments reflected supply and demand constraints.** In infrastructure, the focus on IDA and renewable energy contributed to smaller deal size. External conditions led to some projects being cancelled or postponed. IFC nonetheless missed opportunities for impact, not least because the Infrastructure Crisis Facility was not ready to complement IFC's own account and help to address the infrastructure financing deficit in developing countries. In agribusiness, an unanticipated suspension of palm oil investments, together with a review of supply chain issues, meant lost projects. Trade finance helps agribusiness indirectly, although increases here did little more than offset the drop in IFC's direct agribusiness investments.

### *MIGA*

**MIGA's heavy focus on the financial sector in Europe and Central Asia was in line with initial crisis needs.** The financial sector in Europe and Central Asia was at the heart of the crisis and needed urgent assistance. MIGA supported some key financial institutions in the Region, and helped keep down their borrowing costs. The drop in cancellations also meant that MIGA played a supportive crisis role with existing clients. At the same time, MIGA did not provide a significant countercyclical response elsewhere. Awareness of MIGA among major private sector parties in the countries visited for this evaluation was low, indicating a need for MIGA to revamp its business development, including stronger efforts to let clients know of the services that MIGA might be able to offer. And as IEG has highlighted elsewhere, MIGA needs in parallel to streamline its business processes and responsiveness.

## Early Outcomes and Risks

**At this stage, the focus is on the early results relative to stated objectives:** protecting vulnerable groups, maintaining infrastructure, and sustaining private sector–led growth, within an overarching focus on macroeconomic stability. Partnerships and, above all, actions taken by countries and companies, have been leading drivers of these early results.

**Bank Group disbursements helped countries maintain social programs and microfinance.** For example, in Colombia, the Families in Action Program expanded assistance, with Bank support, to approximately 2.7 million poor and displaced families. Similarly, in Mexico, the Bank supported Oportunidades, the national conditional cash transfer program that helps 5.8 million of the country's most vulnerable families to cope with poverty. In Bangladesh, an IDA loan was helpful in mitigating the impact of high food prices on the poor through an expansion of social safety net programs, including public works. IFC's trade initiatives have had a broad reach, supporting basic needs through food and energy trade. IFC's new microfinance facility has had a modest effect.

**The Bank Group supported investments in infrastructure, but there is little early evidence of any impact.** First, few of the Bank's large commitments for new investment loans have been disbursed. Meanwhile, the quality of the results frameworks for DPO support to the sector in Indonesia and Vietnam indicate risks to getting sustained results. Second, IFC's investments in infrastructure recorded one of the largest declines among all sectors, and its infrastructure facility has delivered only a handful of projects.

**The Bank Group provided strong support in trade finance but missed opportunities in other areas related to private sector growth.** IFC provided timely and sizeable liquidity support, especially in LICs, through its trade finance platforms. But it missed opportunities for strong additionality and development impact, especially in MICs. For MIGA, limited business development outside of Europe and Central Asia was a binding constraint on new guarantee volumes and results. The Bank provided sizeable support to the financial sector, but sustainability of results may be at risk due to insufficient attention to sector reforms in some cases.

**The Bank Group and partners contributed to confidence-building and macroeconomic stability, but crucial challenges remain.** Indonesia illustrates the value of contingency financing led by the Bank, with participation of the Asian Development Bank, Australia, and Japan. IFC and MIGA's new private sector initiatives may initially have had positive signaling effects on markets. Experience has shown the importance of timely, visible investments by IFC in companies of systemic importance to send market signals and for development impact—a standard only a few investments met during this crisis.

**The Bank Group helped authorities to think through fiscal and debt sustainability issues, but timely fiscal consolidation is still needed.** The Bank's advice through DPOs, analytic work, and policy dialogue—often together with that of the IMF, and including advice given in the years leading up to this externally driven crisis—was important in managing fiscal and debt vulnerabilities. The Bank also continued to support reforms in public financial management to make the budget more transparent, predictable, and performance oriented (for example, in Mexico, Poland, and Vietnam). Especially in view of the economic uncertainties and risks, there is a need for continuing investments in analytic work.

## Early Lessons

An overarching lesson emerging relates to the value of a strategic approach to the Bank Group's crisis-response effort, integrating six elements brought to the fore by this crisis experience.

First, in these uncertain times, early warning, preparedness and timeliness, including an eye on long-term capital adequacy, are key attributes for the WB, IFC and MIGA. Second, the benefits of the Bank's country focus go hand in hand with the need for a cross-country strategy to ensure consistency with global initiatives and to deploy scarce resources where they produce the best results.  Third, even as it responds to crisis, the WBG needs to keep the requisites of sustainable long-term growth—among others, fiscal and debt sustainability, the structural reform agenda, and the environmental and climate change agenda—in focus.

Fourth, particularly in averting a crisis, it is costly to let the Bank's expertise in key areas (in this case the financial sector) decline. Fifth, there is a need to balance innovations and new initiatives in the middle of a crisis with continuity of support using more established and proven approaches. And sixth, coordination is needed among the WB, IFC and MIGA (and with other partners) to capitalize on linkages across government and business and catalyze economic activity.

The findings also point to specific early lessons for each Bank Group institution.

### World Bank

**Continuing Bank involvement, policy dialogue, and analytic work are important prerequisites.** This is evident from the case study countries, both where the Bank response worked well, as in Indonesia, Mexico, Mauritius, and Ukraine, and where it did not, as in Hungary. It also points to the critical importance of keeping diagnostic work in key areas up to date.

**The Bank should balance advocating global priorities with country ownership.** The Bank's identified sector and thematic crisis-response priorities must be positioned as menus for country selection to avoid the possible impression of advocacy, especially where the Bank may be a possible financier.

**Greater clarity is needed in the use of instruments for crisis response**. This evaluation found that country teams used DPOs, Additional Financing and other instruments in innovative ways, with the endorsement of the Operations Committee and approval of the Board. However, greater clarity on policy conditionality of crisis operations would have facilitated the Bank's response.

**The Bank needs to anticipate crises and be ready to act quickly, taking into account quality trade-offs and considering benefits and costs across sectors.**

- The Bank should continue to play a proactive role in providing early warnings and alerts to clients and the broader international community. In hindsight, an example is the value that could have been derived from sharing updates at the Annual Meetings and Development Committee Meeting of October 2008.
- The Bank's capacity in the financial sector needs to be maintained, as was also learned from the East Asian crisis. Core capacity is needed in order to maintain steadfast attention to capital adequacy; independent supervision and regulations; timely and transparent reporting; and, on investment lending, to ensuring that financial intermediaries have balanced assets and liabilities with respect to maturities and foreign exchange exposure.
- It is vital to be up-to-date on diagnostic country economic and sector work in key areas. The public expenditure review is a signature Bank contribution, especially in order to support prioritization of sector aspects of the crisis response.
- IBRD capital headroom in a crisis is central. This experience reveals the importance of anticipating capital adequacy at the outset, as well as its use during the crisis. It remains an open question whether it was best for the Bank to use up virtually all of its capital headroom in responding to the crisis. MIC demand for countercyclical lending may remain significant, but IBRD response capacity may not be large, even with the recently agreed capital increase. New instruments need to be put in place, involving shorter maturities or a combination of pricing and maturities for early payback, possibly with a countercyclical financing facility as in other multilateral development banks (MDBs).

**IDA must remain the Bank's flagship resource-mobilization activity.** IDA fast-tracking helped to speed the processing of eligible operations, but it was no substitute for increased resources. IDA committed 24 percent more in FY09-10 than in FY07-08 and disbursed 15 percent more. IDA crisis financing had to be accommodated within the IDA15 resource envelope that was agreed in 2007. Though MICs have been more affected by the crisis given their greater global linkages, LICs are far less able to bear the costs of the crisis to them, and there is thus a need for greater Bank proactivity on their behalf.

**Finally, it is crucial to assess emerging impacts early to identify quality problems and risks and remedial action.** The evaluation identified quality risks and concerns in sector DPOs—especially in the financial sector and in infrastructure.

### IFC

**IFC's development role is vital, and looking beyond portfolio protection is essential.** IFC will need to have sufficient resources for a significant catalytic role when the next crisis strikes and be willing to take more investment risks—as it has done in Africa. Incentives and mechanisms for increased equity divestment could also be helpful in freeing up funds for a crisis response. Active, routine portfolio stress testing can be useful, as opposed to reactive portfolio management that may crowd out new business, as in this crisis.

**A crisis response has to be founded on partnerships, but cooperation needs the right incentives and support.** Given the vast financing needs a crisis can generate, no single development institution is likely to have sufficient capacity to respond. Partnerships are therefore essential. In some cases, partnerships allowed for strong leveraging of IFC funds, particularly where the initiatives were not seen solely as IFC programs and where IFC's sector expertise was well recognized. In other cases, cooperation stalled due to nonaligned interests and decision-making procedures, incentive problems, and legal issues. IFC will need to be sensitive to partner needs and institutional arrangements and create incentives for them to participate fully in joint programs.

**Responding to the crisis through existing platforms and partnerships has generally proved more effective than working through new ones.** Experience shows the benefits of having ready financing and advisory platforms. While innovation can be important, it is unwise to develop numerous new financing platforms on the run in a crisis, particularly platforms that are managed by third parties or involve fundraising from multiple new sources. New programs and relationships absorb time and resources that could be deployed to frontline operations.

**Finding the right level of adaptation to changing circumstances is fundamental for an effective crisis response**. IFC will need to find the right level of change, including determining which initiatives continue to have relevance and which might be dropped, as well as how new partnerships and platforms are best aligned with IFC's business model. In a future crisis, IFC may want to postpone rapid internal reorganization and develop mechanisms to incorporate local views and knowledge to enable differentiated responses.

**The shift in IFC instruments toward trade finance guarantees was useful, but the instrument mix will need to shift again.** Short-term trade finance was useful, because it could be ramped up through IFC's broad network of utilization banks. It also absorbed limited capital. As commercial providers enter the market, IFC will need to look to other instruments. Capacity to offer local currency finance was again lacking in this crisis, creating considerable risks for SME clients with local-currency revenue streams.

**Monitoring and evaluation (M&E) for new programs will need to improve.** The importance of robust results frameworks is magnified where new delivery structures are being created to ensure quick feedback on what is working and what is not. M&E of new initiatives will need to be made more systematic. The difficulties in measuring the development impact of the GTFP and GTLP, not covered in IFC's M&E framework, need to be addressed.

### *MIGA*

**For MIGA, the crisis has amplified the need for product flexibility and business development.** MIGA's portfolio experienced a net increase during the crisis period (due to lower cancellations), and MIGA's focus on the financial sector in Europe and Central Asia was strong. Yet overall, MIGA did not provide a countercyclical crisis response. This reflected the inherent structural constraint of its Convention as well as weak business development. MIGA needs to revamp its business development function to reverse the current stagnation in guarantee issuance and enable the agency to meet its business volume targets and strategic priority goals. The recent approval of the changes to MIGA's Convention to allow greater product flexibility and more proactive business development is an important step.

## Issues Going Forward

The crisis created an immediate need for countercyclical spending in developing countries, which the Bank Group and others have supported. To help sustain the recovery, contribute to longer-term growth, and improve the response capacity of the Bank Group, attention needs to be given to two areas:  policy change and organizational effectiveness. Policy issues concern fiscal sustainability, public-private synergies, financial sector reform, poverty and unemployment alleviation, and greener growth. In terms of organizational effectiveness, preparedness, managing quality trade-offs, coordination, and a strong results focus will be crucial.

### *Policy Issues*

**Fiscal sustainability.** Economic slowdown and fiscal expansion have pushed debts and deficits in many advanced and some developing countries to unsustainably high levels. While fiscal or monetary stimulus may still be needed in some countries, policies need to reestablish sustainable macroeconomic conditions. Growth will depend on, among other things, the quality of public expenditures, where the World Bank can be valuable, for example, through more regular Public Expenditure Reviews.

**Public-private synergies.** A key policy task is to ensure a smooth transition of demand from government to the private sector. At the same time, there is a widespread need to strengthen government capacities to regulate private sector activities effectively. The private sector, as the main engine of growth, will need to be supported through policies, regulation, and access to finance. These reforms should not be left for later stages of crisis response.

**Financial sector reform.** Financial sector weaknesses persist in the global economy and continue to pose downside risks to recovery in advanced and developing countries. There is a pressing need to shift from emergency support to addressing the structural weaknesses exposed by the crisis. This would involve repairing or strengthening financial systems while reforming prudential policies. The Bank Group can help, but it needs to rebuild its capacity.

**Poverty and unemployment.** As in previous crises, unemployment, one of the main causes of worsening poverty levels, has lagged GDP growth. Monitoring of the poverty and social effects in this crisis has emerged in an ad-hoc manner, and higher- frequency tracking is needed going forward. A greater focus on low-income countries and inequities in middle-income countries is also required.

**Environmentally sustainable growth.** Climate change and environmental problems are tougher to deal with in the face of a financial crisis, yet the sustainability of global economic growth necessitates simultaneous actions. To be effective, such longer-term investments need to be factored into any crisis response: the Bank Group's strong participation in scaling up public sector spending provides a unique opportunity. The Bank Group must build on the momentum in mobilizing funds for climate change mitigation to integrate greener development in its mainstream activities.

## *Organizational Effectiveness*

**Preparedness.** As crisis-related events continue to evolve, the premium on early warning, financial preparedness, and operational readiness is at an all time high. Stronger forecasting, with greater country/global connectivity, is crucial. Tools to optimize capital availability will be important, given that the Bank Group's capital headroom has been virtually used up and the recent capital increase provides only limited new headroom. From an operational standpoint, rebuilding Bank Group financial sector capacity is fundamental.

**Quality trade-offs.** The risk that lending preparation (to rebuild a project pipeline that has been depleted as part of the crisis response) and supervision (of a now-larger stock of cumulative commitments) may, under an essentially flat administrative budget envelope, crowd out critical analytic and advisory work—with adverse consequences for the quality of future lending—needs to be carefully managed.

**Coordination.** The premium on partnership and coordination is particularly high at times of market uncertainty. Moreover, financial and capacity constraints make coordination with external partners—and the focus on selected areas where the Bank Group has comparative advantage—imperative. A significant part of the Bank Group's response has taken place in the context of partnerships with the IMF, regional banks, and others, but the challenge remains to sustain and deepen cooperation. Strong internal cooperation, to capitalize on unique linkages across public and private sector spaces, will also be important.

**Focus on results.** A sharp focus on results, which incorporates longer-term structural change, is critical when Bank lending is at an all-time high and concerns persist about the sustainability of the global recovery. This situation—together with the greater focus than in the past of conditionality based on a few prior actions, with country ownership—places a premium on ensuring clear and measurable objectives, M&E, and Bank Group commitment to implement corrective actions.

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