Rebuilding the Global Economy

A series outlining policy priorities and solutions

MEMORANDUM ON

INTERNATIONAL POLICY ADVICE FOR THE WORLD BANK

To: The President of the World Bank
From: Pinelopi (Penny) Koujianou Goldberg
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Background: The World Bank has always been a complex institution trying to balance the diverse needs and priorities of its member countries and its shareholders. As the last quarter of 2020 approaches, the World Bank faces global challenges (pandemic, increasing poverty, climate change) amidst a gradually deglobalizing world. Tensions between two of its major shareholders, the United States and China, have cast doubt on the future of global trade and multilateral cooperation. The runup to the 2020 US presidential election has added to this uncertainty, though regardless of the outcome, there does appear to be bipartisan support for turning inward, cutting ties to China, and reshoring economic activities.

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The current policy environment in combination with the pandemic—and against the backdrop of rising automation—makes it unlikely that policymakers can rely on the export-led model of growth and development that many international institutions have advocated in the past. The increasing use of robots makes developing countries' traditional comparative advantage in low-skilled manufacturing less relevant, while newly imposed protectionist measures in high-income countries may discourage imports from low-wage countries in the future. With trade and immigration tensions rising, cooperation among member countries and shareholders will become more difficult, making effective decisions even more arduous. Accordingly, it is best to adopt a pragmatic approach prioritizing those issues where progress can be achieved.

PRIORITY 1: Provide country-specific advice on the impact of trade tensions

The trade tensions between the United States and China are forcing many low- and middle-income countries to reach a new understanding of how the new trade climate will affect their economies. They are struggling to figure out what policies would help them reap benefits from the potential reallocation of global trade. The most affected countries are those in Southeast Asia (Vietnam, Thailand, Malaysia, Indonesia) as well as Mexico. Many of these nations have enjoyed a fruitful relationship with the World Bank in the past and would benefit from its advice. The World Bank could play a leading role in developing a research and policy agenda focused on the effects of the trade tensions tailored specifically to these countries.

PRIORITY 2: Rethink the World Bank's relationship with China

Some of the biggest successes of the World Bank have been in East Asia, China in particular, where policymakers credit the World Bank for useful advice and guidance and a significant, if only indirect, role in their development. It is unfortunate that the World Bank is caught in the middle of escalating tensions between China and the rest of the world, especially the United States. While managing the relationship with China is tricky, the World Bank must not pull out from the one region where its institutional impact has been consequential in the past. China still seeks engagement with international institutions and is receptive to advice on how to navigate the current tensions. By remaining engaged with China, the World Bank has an opportunity to influence future developments rather than being a frustrated bystander.

Given that China is now an upper-middle-income country, its relationship with the World Bank must be based on something other than lending. The general principle guiding interactions with China should be to push for reforms that are beneficial to both China and the rest of the world. Three specific areas of potentially fruitful engagement should be pursued. The first is climate change. As incomes in China are rising, its citizens are increasingly concerned about the environment, and leadership is interested in implementing policies consistent with the ideal of ecological civilization. The second area is intellectual property rights, where China has realized that further progress and growth require protection of the intellectual property of foreign as well as its own domestic firms. The third area concerns reforms of the social safety net in China, an area where China has sought World Bank advice in the past.

China's *Belt and Road Initiative* (BRI), an ambitious infrastructure investment project throughout the region and beyond, has been a source of contention with the World Bank. Concerns have focused on the sustainability of the projects and the amount of debt incurred by recipient countries. But constant attacks on the BRI by World Bank officials and in research papers are counterproductive and call the World Bank's objectivity into question. Many countries in which BRI-related investments have taken place view them as beneficial to their economies, their rising debt notwithstanding. A more impactful strategy for the World Bank would be to continue pushing for debt transparency while offering countries attractive alternatives to Chinese loans. To this end, it is important to consider investments that are attractive to recipient countries and not just to World Bank shareholders. Driving China out of its role of investing in developing countries without offering a realistic alternative will not work in the long run.

PRIORITY 3: Return to being an advocate for trade

A recent review of World Bank policy briefs and reports for the 2019 *World Development Report* on global value chains revealed that the words "trade policy" have all but disappeared from the advice the World Bank has given to countries in the past 10 years. A constructive starting point would be to acknowledge that open trade and foreign direct investment remain important for growth and poverty reduction, especially in small, low-income countries, and to revitalize the rich research and policy agenda that the World Bank once had in this area.

PRIORITY 4: Broaden the World Bank's role to include facilitating regional integration

A more general and challenging question is how countries should navigate the backlash against multilateralism and the World Bank's role in this process. Independent of the outcome of the US elections, a resurgence of support for multilaterism is unlikely any time soon. A pragmatic alternative is to pursue regional economic integration and—when the necessary conditions are present—potentially also plurilateral agreements spanning multiple regions. Such an approach would require a major change of mindset at the World Bank, but it could be a game changer that increases the World Bank's impact in the developing world.

Despite existing regional trade agreements and regional value chains, many countries remain suspect of trade with neighboring countries, viewing potential trading partners as competitors rather than potential markets. The prevailing thinking in many countries, especially in Southeast Asia, is based on traditional models of comparative advantage emphasizing differences in factor endowments, rather than on modern theories highlighting economies of scale and product differentiation. Put differently, the vision of the role of trade in development seems to look to the recent experience of China, ignoring alternative growth trajectories that were established in EU countries post World War II. Given that a repeat of the Chinese (or, more generally, East Asian) experience is highly unlikely in the present environment, the current mindset needs to change. The World Bank could play an active role in educating countries on the benefits of regional cooperation and integration and in promoting regional trade agreements. This approach would not come easily to the World Bank. The current setup—with country offices and country directors who are rewarded based on the performance of country-specific programs—encourages a focus on countries, not regions. But this focus can be debilitating when one deals with low-income, resource-starved countries.

Regional cooperation could make a big difference in many areas. The African Continental Free Trade Area (AfCFTA) is a step in the right direction, but much more needs to be done. As countries consider regional trade integration, they often perceive tradeoffs—for example, policymakers in Kenya feel they may have to weigh costs and benefits between more trade with the United States versus more trade with their neighbors within the AfCFTA. Advising countries on such issues is imperative. Beyond trade agreements, trade facilitation could lower the costs of crossing borders, which are significant in Africa. The World Bank already has an active program and excellent track record in this area.

Regional cooperation is also required in infrastructure investments to increase connectivity in Africa. Establishing and implementing an effective competition policy is necessary to curtail the market power of local monopolies, particularly in digital initiatives with cross-border implications—for example, spectrum allocation as 3G or 4G networks are rolled out. Individual countries can often make little progress in these areas on their own. They could achieve much more under a regional umbrella.

ACTIONABLE TO-DO LIST:

- Research the effects of US-China trade tensions on specific countries, especially those most affected in Southeast Asia and Mexico.

- Engage with China as more than a lender, specifically provide advice on:
  - policies relevant to combating climate change,
  - protecting intellectual property rights,
  - reforming China's social safety net, and
  - ensuring greater debt transparency for BRI investments.
- Educate developing countries on the benefits of regional trade agreements and provide advice on how best to weigh perceived costs and benefits of more trade with the United States versus with regional trading partners.