WORLD BANK GROUP

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT
INTERNATIONAL FINANCE CORPORATION
INTERNATIONAL DEVELOPMENT ASSOCIATION
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Address by **ROBERT B. ZOELLICK,**
President of the World Bank Group,
to the Board of Governors of the World Bank Group,
at the Joint Annual Discussion

Annual Meetings

Board of Governors of the World Bank Group
Remarks of

Robert B. Zoellick
President
The World Bank Group

Istanbul, Turkey
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"The World Bank Group Beyond the Crisis"

Mr. Chairman, Governors, and Distinguished Guests:

Thank you for joining us at these Annual Meetings. I want to express my particular thanks to the Chairman of the Board of Governors, Nguyen Van Giau, and to Agustín Carstens for his leadership of the Development Committee. Agustín and I have worked ever more closely over the last two years. I have deep respect for his skills as a Minister and as a thoughtful leader, and benefited greatly from his partnership and friendship. This is Agustín's last meeting as Chair of the Development Committee, although I know I will wish to call on his advice and judgment in days to come.

I look forward to working with Minister Al-Khalifa of Bahrain, who has graciously agreed to assume the Chair of the Committee. Minister Al-Khalifa and I have worked together in earlier capacities, and I am delighted he has agreed to join us at this critical time.

I also want to thank my colleague Dominique Strauss-Kahn. Our two institutions have partnered closely over the last year, and I have much appreciated his insight, practicality and good humor.

I am grateful too, to the Turkish Government and the people of Turkey, who have been exemplary hosts for our Annual Meetings this year. We have enjoyed seeing this fascinating city in a country that has accomplished so much. Most of all, we thank the wonderful people of Istanbul and Turkey.

I would like to take this opportunity to recall former World Bank President Robert McNamara. He led and shaped the Bank for 13 incredible years. He brought to this institution enormous energy along with the firm belief that the problems of the developing world could be solved. He left behind him a formidable record: the effort to eradicate and prevent river blindness; the Bank's first loan for nutrition; a focus on the rural poor; increased lending to agriculture; the publishing of the first ever *World Development Report*; and the opening of relations between the

Bank and China at a crucial time in that country's development – a reflection of both his foresight and leadership.

Robert McNamara shifted the focus of the World Bank Group toward the goal of overcoming poverty worldwide. It remains our core mission today, and ensures that Mr. McNamara's legacy in international development – and to the World Bank Group – lives on.

In his final years, when I spoke to Mr. McNamara, he remembered fondly the tremendous staff of the World Bank Group, a true collection of talents across cultures and lands. His successors have expressed the same appreciation. I want to add my thanks to theirs. The people of the World Bank Group have risen to the challenge of crisis over the last year – with energy, creativity and strong sense of purpose for the client countries and people we are privileged to serve.

We are also saddened by the recent passing of Minister Futa of the Democratic of Republic of Congo. I would like to join the Chairman in extending my condolence to his family and the government of DRC.

I would also like to express my deepest sympathies to the family of the former Finance Minister of Japan, Mr. Nakagawa.

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A year ago, we came together at a time of turmoil. Today, that turbulence is far from over.

As a result of the global crisis, we estimate that 90 million more people will be living in extreme poverty by the end of next year; up to 59 million more people will lose their jobs this year; and an additional 30,000 to 50,000 babies may die in Sub-Saharan Africa.

Behind these numbers lie human stories:

-- Aoy Puon is a garment factory worker in Cambodia. Since the crisis hit, her monthly salary has been cut in half. Today she can't make enough to send money home to her family who depend on her income. 48 garment factories have had to close in Cambodia over the past year, and 62,000 workers have lost their jobs – 90 percent of them women. Aoy is now worried that <u>she</u> will lose her job.

-- Zagd is a herder in Mongolia, where the financial crisis has caused livestock prices to plummet. Meanwhile, food costs increase daily, so Zagd can no longer afford to buy flour, rice, or sugar. For herders like Zagd, there is no pension or social benefit money – instead, with decreased income, the only recourse is to cut consumption. As one herder says, "I do not buy sugar because it is expensive. We do not use vegetables. We do not go out, therefore we do not need many clothes…In the winter time, we do not buy wood and coal."

-- Lindiwe is 28 and lives in a shanty town in southern Africa. She's HIV positive and has TB. She was turned away from the NGO clinic that provides treatment for these diseases, because donor funding has dried up as a result of the financial crisis, and the NGO has run out of drugs. Prospects for additional funding look bleak: a recent World Bank and UNAIDS survey found that 1 in 5 developing countries have experienced cutbacks on anti-retroviral treatment programs, and 33 countries expect the impact to worsen over the next year. For Lindiwe, time is running out: "I am scared of dying and leaving my little girl alone," she says.

Jobs lost and lives destroyed. Girls forced out of school. Families who need to decide which meal to cut out of their day. Children malnourished. Human progress reversed, often irretrievably.

While we talk of recovery, the personal pain of poverty is all around us.

In cities, villages, valleys, and plains; on Main Streets and communities with no streets we hear a common refrain: "Don't let this happen again."

Sadly, we cannot make that promise. We cannot crisis-proof our world. Indeed, if there is one thing that is assured about the future, it is that there <u>will</u> be another upheaval. But with leadership and cooperation, we can learn lessons from the past crisis, and we can look ahead.

We need to look beyond emergency response, to actions to "build back better" -- actions that can endure. That work is up to us in this room. Cooperation at times of crisis is the easier part. Cooperation when no longer staring into the abyss is the challenge.

<u>Seeds of Crisis</u>

Before looking to the future, we need to understand the past. Today's upheaval did not occur from nowhere. The seeds were planted earlier.

The last 20 years have witnessed a huge economic shift. The breakdown of the planned economies in the Soviet Union and Central and Eastern Europe, the economic reforms in China and India, and the export-driven growth strategies of East Asia all contributed to a world market economy that vaulted from about 1 billion to 4 or 5 billion people. This shift offers enormous opportunities. But it has also shaken an international economic system forged in the middle of the 20th Century, with patched-up changes in the decades since.

Some seeds of today's troubles were sown by the responses – or lack of them – to the financial crises of the late 1990s. After the Asian financial crisis, developing countries determined they never again wanted to be exposed to the tempests of globalization. Many "insured" themselves through managing exchange rates and building huge currency reserves. Some of these changes contributed to imbalances and tensions in the global economy, but for years governments muddled through amidst generally good growth.

Central banks failed to address risks building in the new economy. They seemingly mastered product price inflation in the 1980s, but most decided that asset price bubbles were difficult to identify and to restrain with monetary policy. They argued that damage to the "real economy" of jobs, production, savings, and consumption could be contained once bubbles burst, through aggressive easing of interest rates. They turned out to be wrong.

Regulators and supervisors of financial institutions were no longer grounded in reality. Financial innovation and competition vastly expanded services – including to companies and families often shunted aside in the past – but the alluringly simple design of "rational markets theory" led regulators to take a holiday from the realities of psychology, organizational behavior, systemic risks, and the complexities of markets and humans.

Even as we learn these harsh lessons, we need to anticipate and build.

In 1944, the delegates at Bretton Woods seized a moment to shape a new global arrangement. They spent three weeks in New Hampshire developing a system of rules, institutions, and procedures for financial and commercial relations in the world economy.

That world has changed enormously over the past 65 years. The current upheaval is changing the landscape yet again.

Already, we can see potential shifts in power and institutions and international cooperation. In part, the shifts will depend upon how the parties adapt to new circumstances; in part, upon the rapidity of the recovery; in part, upon changes in who holds the world's capital, technology, and human resources and what they do with them; in part, upon how countries cooperate – or do not.

The Changing Context

Just over 10 years ago, during the Asian financial crisis, the world's primary concern was whether China would hold its currency peg to help stabilize the falling economic dominoes. Today, China ranks with the world's major economies and acts as a stabilizing force in the global economy. Together, China and India account for 8.5 percent of world output. They and other developing countries are growing substantially more rapidly than developed countries.

The United States has been hit hard by the crisis. But it is a resilient nation. Its future will depend on whether and how it will address large deficits, recover without inflation that could undermine its credit and currency, and overhaul its financial system to preserve innovation while adding to safety and soundness. The United States also needs to help people adjust to change, so that it can maintain its greatest trump card: openness to trade, investment, people, and ideas.

Japan is the first leading industrial power to experience a political upheaval in the wake of the crisis. The election of the Democratic Party of Japan could create a sustainable two-party democracy for the first time in the country's history.

It is not clear that the old export model of growth will meet Japan's and the world's needs or be sustainable in a more "balanced" global economy that does not rely so heavily on the U.S. consumer. An aging Japan will have new consumption needs. A global economy with more poles of growth could offer Japan new markets, especially for its impressive capabilities to use energy efficiently.

Central and Eastern European economies suffered strong blows. And their problems are far from over. The good strategic news is that the European states, for all their internal debates and negotiations, have recognized their interdependence. Under stress, this time, Europe did not splinter.

South East Asia may also have been given a boost by the crisis – depending on how opportunities are seized. The region lies at a geographic crossroads between India and China, two rising powers. ASEAN seems to have recognized the moment, and has taken actions to deepen its integration even while reaching out to others. Given the sizeable weight of Indonesia and the rising influence of Vietnam, their sound performance amidst economic turmoil has stood in sharp contrast to a decade ago.

For others, the long-term impact of the crisis may depend upon commodities, especially oil prices, which, in recent years, gave high returns. When the oil price is at $100, these countries are strong. When it is at $30, most are in serious trouble. This reliance on oil and commodities is a precarious basis upon which to build an economy in a world that is struggling to reduce its reliance on fossil fuels, and in which commodity prices gyrate as investors move in and out of an "asset class." Will countries use these returns wisely – to diversify and build broader-based economic development? These are the questions for Russia, countries in the Gulf, and some countries in Latin America and Africa.

Prior to the crisis, the growth rates of a number of African countries were achieving impressive levels with consistency. Coming out of the crisis, there could be new opportunities. Some Chinese manufacturing firms are considering shifting their basic production to Africa. China's African prospects – which include resource development and infrastructure – are likely to be complemented by others. Brazil is interested in sharing its agricultural development experience. India is building railways. These are the early days of a trend that will build.

Understanding shifting power relations is fundamental for shaping the future -- as the Bretton Woods' delegates appreciated. The political basis for that system was forged through a shared experience in failed responsibility after World War I and a clear assessment of power after World War II. Change those power relations -- and the nature of the markets that connect them -- and the system looks out of touch.

What Next: Responsible Globalization?

The old order is gone. We should not waste our time and tears lamenting it. Today we must build anew. Today we can put in place the foundations for a "New Normal" of growth and responsible globalization.

Globalization has helped sustain high economic growth in many countries and lifted hundreds of millions out of poverty. Yet the growing linkages between economies have also played a central role in turning a financial crisis in the developed world into a global crisis that is driving millions back into poverty. The pace of climate change is accelerating, with poorest countries hardest hit.

Diseases such as SARS in 2004, or this year's H1N1 virus, start as localized outbreaks but quickly become global threats. Their virulence has only been intensified by increased travel and open borders.

We cannot and should not turn the clock back on globalization. Nor are publics demanding that we do so. But we can and must reform it to curb the damage it can wreak while expanding the enormous benefits that responsible globalization can provide to millions.

What Would it Take to Build Responsible Globalization?

First and foremost, we must recognize that developing countries are key to the solution today, progress tomorrow, and prosperity in years to come.

Two weeks ago, in Pittsburgh, world leaders embraced the G-20 as the premier forum for international economic cooperation among the advanced industrialized countries and rising powers. This is a good start. But the G-20 cannot be a stand-alone committee. Nor can it ignore the voices of the over 160 countries left outside. The G-20 should operate as a "Steering Group" across a network of countries and international institutions with a broader membership. It should recognize the interconnections among issues and foster points of mutual interest, without being either hierarchical or bureaucratic. It should be connected to our G-186 here in this room.

Forecasters expect lackluster growth and continued high unemployment for a number of years. The U.S. consumer can no longer be the main engine of economic demand. Europe and Japan appear constrained; China can assist, but its credit growth could pose problems next year. With access to finance, other developing economies can help boost a global recovery. Many have the fiscal space to borrow, but cannot get the volumes they need at reasonable prices without crowding out their private sectors. The World Bank Group and regional development banks can assist. Enhanced financial regulation and supervision that shift incentives from short-term casino capitalism to long-term productive investment will help.

Second, leaders must emphasize that a balanced and inclusive global economy needs multiple poles of growth – and not just adding China and India. Countries in Latin America, Southeast Asia, and a wider Middle East can assist in the future if they invest today. Over time, investments in Africa, a market of almost a billion people, can integrate its markets and become another source of growth.

To build multiple poles of growth, we need to remove bottlenecks and boost productivity through investments in infrastructure and energy, private sector expansion, and regional integration linked to open markets. New poles of growth can be customers for the capital goods, services, and technology of developed countries.

Third, leaders must commit to making growth sustainable. As the World Bank's recently released *World Development Report* on development and climate change points out, developing countries not only face 75-80 percent of the potential damage from climate change, but over 1.6 billion of their people still lack access to electricity. Developing countries – and their interests –

must be at the table. They need incentives and financing to encourage low carbon growth by adopting technologies, implementing energy efficiencies, and investing in forestation.

Fourth, we must put in place mechanisms to protect the most vulnerable. Two weeks ago at the Pittsburgh Summit, the G-20 leaders re-iterated their support for a new $20 billion food security initiative launched at Italy's G-8 meeting. They called upon the World Bank Group to work with donors and organizations to develop a multilateral trust fund to scale-up agricultural assistance to low income countries. Too often, bilateral aid concentrates resources in specific sectors and countries. But with this more comprehensive, multilateral approach we can pool resources and better support innovative efforts to tackle food security all the way along the food chain and build sustainable agricultural systems. Paper pledges, however, will not put seeds in soil or food in hungry mouths. Hunger and famine – as the present drought in East Africa shows – are an ever-present threat. So we must move quickly to turn this initiative into reality.

Food, fuel, and now financial crises have derailed progress towards the Millennium Development Goals, reversing years of gains. We must fill a gap in the global financial architecture by offering insurance to the poorest countries that they will not be left defenseless in the face of overwhelming shocks. The World Bank Group will work to flesh out the proposal for a Crisis Response Facility, endorsed by the G-20 and the Development Committee, that can be ready to offer quick and effective assistance for the most vulnerable and fragile countries, many of which are just emerging from conflict. From targeted safety nets to SMEs and microfinance, we can help buffer those with the least cushion from the greatest upheavals.

We must also work toward a hand-off from government stimulus to private sector demand, investment, and trade, by offering a counterweight to financial and trade protectionism. IFC has just launched a new Asset Management Corporation that manages funds to invest in banks, equity, infrastructure, and debt restructuring. We can help build developing country financial markets, while channeling capital from sovereign, pension, and other asset management funds to productive private sectors in developing countries.

The Role of the World Bank Group

Last year, the Bank Group stepped up to the crisis and delivered a record $59 billion of financial assistance. IBRD commitments almost trebled to $33 billion. IDA also reached a record high of $14 billion; over 50 percent of new IFC projects were in IDA countries. Support for infrastructure – critical to recovery and jobs – reached $21 billion; we scaled up assistance of $4.5 billion for safety nets and other social protection programs to cushion the most vulnerable.

IFC combines strong innovation with resource mobilization; we have launched initiatives on bank capitalization, trade finance, infrastructure, and microfinance.

We expect a new IBRD record of $40 billion or more this fiscal year. Demand for IBRD lending is now clearly moving significantly beyond the $100 billion level that the Development Committee called for in its Communiqué last year. IDA countries are also facing significant financing gaps. We estimate that financing shortfalls to cover at-risk core spending on health, education, safety nets, and infrastructure amount to some $11.6 billion for the poorest countries.

I know that budgets in developed countries are constrained. But responsible globalization requires responsible stakeholders. We can and must do more.

What is the Role for the Bank Group in a New Post-Crisis World?

A well capitalized World Bank Group would be positioned to play a leading role in the global response to the challenges of globalization, development, and financial crisis.

We have a global, local, and cross-sectoral presence with the skills to work with public and private sectors, middle income and low income countries. We have a repository of global best practice in development that we continually upgrade; world-class risk management and banking competencies; and the capabilities to leverage our balance sheet. We have a leadership role in the growing global public goods agenda, and a worldwide catalytic and convening power. All these factors make the World Bank Group unique among the multilateral development banks.

Four key drivers are likely to shape the Group's post-crisis role:

Driver 1 will be traditional and innovative development finance. There is strong demand from the Bank Group's clients for the institution to come out of the crisis well-capitalized and to be able to sustain the delivery of a critical mass of financing to support global economic growth and to overcome poverty. The World Bank Group can play this role in several ways. We can contribute to fiscal stimulus and protecting core spending in countries that are not in a position to implement counter-cyclical policies; we can help to boost global demand to support global recovery; we can finance and support trade; we can assist the private sector to assume the critical handoff from the governments' crisis response actions; and through investment, we can help to build multiple poles of growth with responsive, accountable public sectors and dynamic private sectors.

The second driver will be delivering knowledge products. The Bank Group is a repository of global best practice in development, combining implementation experience, research, and learning, drawing on both public and private sectors. As such, clients are looking to us to connect and customize multiple sources of practitioner knowledge and innovation.

The third driver is the global public goods agenda – pressing global challenges such as climate change, and communicable diseases that require an institutional response that is multi-sectoral, combining policy advice and investments with a global reach grounded in country programs. Already the Bank Group is mobilizing significant financing through the Climate Investment Funds. We can play a key role in technology transfer, working with clients on low carbon growth strategies, and in strengthening health systems where we are now scaling-up our work. The Bank Group can also support the public goods of resilient and dynamic trading and financial systems, based on multilateral rules.

The fourth driver is future crises – those that we can't foresee today but know will happen: it might be a pandemic, a natural or man-made disaster, or an economic or social crisis. In response, the Bank can mobilize its full range of skills and instruments for the benefit of its shareholders, as it has done recently in the food crises, or in response to the Indian Ocean tsunami or financial crises in Mexico and East Asia.

The World Bank is pursuing a number of financial measures to make the most of our capital, including a loan price increase; working with countries so we can use the shares they purchased with national currencies; a selective capital increase linked to changes in "voice"; tight budget discipline; and a possible increase in pricing for longer maturity loans. These measures emphasize the mutual responsibilities and contributions of all our members. But they may not be enough. If the IBRD continues its lending at the current rate, by mid-2010 it will be capital constrained. IFC is limited now.

Of course the future is uncertain. If the recovery falters, or simply struggles slowly, should we risk a World Bank Group already stretched to the limit and unable to lead? In the face of the next crisis – another food emergency, the next epidemic – can we afford to have a World Bank Group that has to hold back? I thank the Development Committee for committing yesterday that it will ensure that the World Bank Group has sufficient resources to meet further development challenges, and that it will reach a decision on this issue by Spring 2010. This is an important step forward in the first General Capital Increase for the World Bank in twenty years.

The Reform Agenda

To serve the changing global economy, the world needs agile, nimble, competent, and accountable institutions. The World Bank Group will improve its legitimacy, efficiency, effectiveness, and accountability, and further expand its cooperation with the UN, the IMF, the other Multilateral Development Banks, donors, civil society, and foundations which have become increasingly important development actors. We know well the importance of advancing multiple reforms to address shareholder requests, improve performance, and build support with your legislatures.

Our efforts include:

- Improving development effectiveness, with a focus on the results agenda, decentralization, gender, investment lending reform, and human resources;

- Promoting accountability and good governance, including with our global anti-corruption efforts, an improved transparency and disclosure policy, and the soon-to-be-released recommendations of the Zedillo Commission; and

- Continuing to increase cost efficiency.

But we must go further.

The Bretton Woods system was forged by 44 countries at a time when power was concentrated in a small number of states. The great waves of decolonization were just stirring; the few developing countries were seen as objects, not subjects, of history. That world is long passed. The new realities of political economy demand a different system.

If developing countries are part of the solution, they must also be part of the conversation. The international system needs a World Bank Group that represents the international economic realities of the 21st Century, recognizes the role and responsibility of growing stakeholders, and provides a larger voice for Africa.

The first phase of the reforms to enhance the voice and representation of developing and transition countries in the Bank Group was completed a year ago, with an additional Board seat for Sub-Saharan Africa and an increase in the voting power of developing countries at IBRD to 44 percent. I am pleased that yesterday the Development Committee stressed the importance of securing a further increase in voting power for developing countries of at least an additional 3 percent – bringing developing countries to at least 47 percent, for final decision at our Spring Meetings next year. We must continue to be ambitious. We should try to see if we can increase the share of the developing countries toward 50 percent over time, even as the emerging economies share the responsibilities of assisting poorer countries with their development. The World Bank Group should more accurately reflect the world around us.

Conclusion

Mr. Chairman: The old international economic order was struggling to keep up with change before the crisis. Today's upheaval has revealed the stark gaps and compelling needs. It is time we caught up and moved ahead.

We need a system of international political economy that reflects a new multipolarity of growth. It needs to integrate rising economic powers as "responsible stakeholders" while recognizing that these countries are still home to hundreds of millions of poor and face staggering challenges of development. It needs to engage the energies and support of developed countries, whose publics carry the heavy burdens of debt, competitive anxieties, and feel that the new powers must share responsibilities. It needs to help offer a hand to the poorest and weakest countries, the 900 million people who still live without access to safe water, and the "Bottom Billion" trapped in poverty because of conflict and broken governance.

Yet it won't happen by itself.

The question is whether leaders can cooperate in steering these changes. They will be drawn to the interests of the national publics they represent, as they should. Yet they will also be challenged to recognize and build common interests, not only case-by-case, but through institutions reflecting a "Responsible Globalization."

Bretton Woods is being overhauled before our eyes. This time, it will take longer than three weeks in New Hampshire. It will have more participants. But it is just as necessary. The next upheaval, whatever it may be, is taking form now. Shape it or be shaped by it.