

“A Challenge of Economic Statecraft”

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Last October, shortly after joining the World Bank Group, I proposed a vision to guide our work: to help build an inclusive and sustainable globalization – to overcome poverty, enhance growth with care for the environment, and create individual opportunity and hope.

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The next month, I flew to a meeting of the G-20 outside Cape Town, a gathering of Finance Ministers and Central Bankers from developed and developing countries, chaired on that occasion by South Africa’s able Trevor Manuel.

During the formal discussions, some participants, reviewing the financial tumult of the summer, began foreshadowing the run of events that would rock markets in the months to come; as is often the case, the informal exchanges during the coffee breaks were richer with warnings and questioning about risks.

The months that followed brought the recognition of huge losses in housing values and mortgages, credit losses, losses of CEOs, more losses recognized as new CEOs sought to clean up balance sheets, the trauma of monoline insurers with shock effects on structured transactions, concerns about counterparties, and eventually recapitalizations and takeovers. Most recently, we have witnessed the hits to balance sheets of commercial banks, which did not have to mark-to-market right away. Short-term liquidity dried up under the heat of the financial and information drought. Leveraged funders of all types – investment banks, private equity funds, hedge funds, and even companies’ commercial paper – were parched for liquidity. As thirsty financial institutions conserved their caches, the securitization model of tiered cash flows, subordinated losses, and credit enhancements shrunk back, leaving loan originators low and dry.

And we saw the human face of people struggling to cope with these seemingly impersonal forces.

The United States has been fortunate to have steady, practical financial stewards at this time of troubles: Secretary of Treasury Hank Paulson, Federal Reserve Chairman Ben Bernanke, and Tim Geithner, President of the New York Fed. Finance Ministers and Central Bankers around the world are in close and constant contact.

Part of their challenge – and ours – is understanding the effects of this financial tumult on the so-called “real” economy – on growth, jobs, prices, wages, profits, trade, homes, and businesses – on individuals and families. Moreover, the financial descent is combined with two other shifts: a rise in global energy and commodity prices, and a lessening of the price dampening that resulted over the past decade from bringing hundreds of millions of new developing country workers into the worldwide labor force. We know the macroeconomic effects of these reversals are not good, but the scope and exact types of influence remain murky.

The question of the effects on the “real” global economy is what links today’s financial agitation to our work on inclusive and sustainable globalization and development, with its effects on those seeking better lives.

The remarkable difference between this period of financial upheaval and those in the past is the performance of developed and developing countries. At an August seminar, a Mexican official wryly noted that this time his country was not responsible. Indeed, the United States will need to learn lessons about financial regulation and supervision in an ever-changing marketplace, even as it works with others to counter the damage and rebuild.

Not only has the epicenter of the quake shifted, but, so far, the tremors have shaken markets differently. The historically tight borrowing spreads on emerging market debt have widened somewhat, but modestly in comparison to most every other credit product. Of course, developing country financial markets will not be insulated; currency exchange rates have been in sharp flux, emerging market equity prices have suffered, and spreads for non-government debt have widened substantially, in line with their counterparts elsewhere.

Most important, there is something strikingly different about this downswing: China, India, and other rising economic powers are offering alternative poles of growth for the global economy. This is not a “decoupling,” because the interconnections of globalization will transmit effects from the developed world’s financial problems and slowdown; it represents instead a welcome diversification of the sources of growth. More than half of the growth in global demand for imports is now originating in developing countries, providing export opportunities for both developing and developed economies. This amounts to a rebalancing – not a decoupling – that supports an inclusive and sustainable globalization. Just as diversification is beneficial for an investment portfolio, so it is for sources of growth in the world economy.

There is a challenge of statecraft in times such as these: to recognize the changing landscape, often as events and fate rush by, so as to address pressing needs, while also planting seeds that may become the supportive timbers of the future. Today, we need to counter immediate threats while also building an inclusive and sustainable globalization that will offer more sources of growth and innovation for the future, enhance multilateral cooperation to deal with shocks and downturns, and maximize opportunity and hope for all.

Therefore, I will highlight four immediate needs that also offer longer-term opportunities. For each, I will aim for action.

High Food Prices: A New Deal for Global Food Policy

As financial markets have tumbled, food prices have soared. Since 2005, the prices of staples have jumped 80 percent. Last month, the real price of rice hit a 19-year high; the real price of wheat rose to a 28-year high and almost twice the average price of the last 25 years.

The good news for some farmers adds a crushing load to the most vulnerable – children, as young as four or five, forced to flee the safety of their rural communities to fight for food in teeming cities; food riots threatening societal breakdown; mothers deprived of nutrition for healthy babies. The World Bank Group estimates that 33 countries around the world face potential social unrest because of the acute hike in food and energy prices. For these countries, where food comprises from half to three quarters of consumption, there is no margin for survival.

The realities of demography, changing diets, energy prices and biofuels, and climate changes suggest that high -- and volatile -- food prices will be with us for years to come.

We need a New Deal for Global Food Policy. This New Deal should focus not only on hunger and malnutrition, access to food and its supply, but also the interconnections with energy, yields, climate change, investment, the marginalization of women and others, and economic resiliency and growth. Food policy needs to gain the attention of the highest political levels, because no one country or group can meet these interconnected challenges.

We should start by helping those whose needs are immediate. The UN’s World Food Program requires at least \$500 million of additional food supplies to meet emergency calls. The United States, the European Union, Japan, and other OECD countries must act now to fill this gap – or many more people will suffer and starve.

Skyrocketing food prices have increased attention to the larger challenge of overcoming hunger and malnutrition, the “Forgotten” U.N. Millennium Development Goal (MDG).

Even though hunger and malnutrition fall under the very first MDG, beyond traditional food aid, they receive only about one tenth of the resources appropriately directed to HIV/AIDS, another killer. Yet malnutrition is the MDG with the greatest “multiplier” effect: it is the largest risk factor for kids under five and the underlying cause of an estimated 3.5 million of their deaths each year. More than 20 percent of maternal deaths are traced to malnutrition. It weakens immunities to diseases. Research in Guatemala has shown that boys who received nutritional supplements during their first two years earned on average 46percent higher wages as adults. When impoverished

families cut back, young girls are the first to lose out. Hunger and malnutrition are a cause, not just a result, of poverty.

This New Deal requires a stronger delivery system, to overcome fragmentation in food security, health, agriculture, water, sanitation, rural infrastructure, and gender policies.

A shift from traditional food aid to a broader concept of food and nutrition assistance must be part of this New Deal. In many cases, cash or vouchers, as opposed to commodity support, is appropriate and can enable the assistance to build local food markets and farm production. When commodities are needed, purchasing from local farmers can strengthen communities. Funds can buy micro-nutrients customized to locations. School lunch programs draw children to classrooms, while helping healthy kids to learn, and some offer parents food, too.

The World Bank Group can help by backing emergency measures that support the poor while encouraging incentives to produce and market food as part of sustainable development. Countries as diverse as Bhutan and Brazil, Madagascar and Morocco, have feeding programs for vulnerable groups. Mozambique, Cambodia, and Bangladesh employ locally-selected public works programs in exchange for food – developing roads, wells, schools, protections against natural disasters, and forests. Others, such as China, Egypt, Ethiopia, and Mexico offer cash transfers conditional on self-help steps – sending children to school or preventive health checkups. Countries also have to stop dangerous border barriers to the trade in food, which put neighbors in need at greater risk and stifle signals to stimulate more production.

We will work with countries, especially in Africa, and partner institutions, to seize an opportunity from the higher demand for food. Our World Development Report 2008, on Agriculture for Development, points the way. We can help create a “Green Revolution” for sub-Saharan Africa by assisting countries to boost productivity throughout the agricultural value chain and help small-holder farmers to break the cycle of poverty. We will almost double our own lending for agriculture in Africa, from \$450 million to \$800 million, and can help countries and farmers manage systemic risks, including through financial innovations to counter weather variability, such as drought. We can offer access to technology and science to boost yields.

The International Finance Corporation, or IFC, our private sector arm, will scale up investment and advisory support to agribusiness operations in Africa and elsewhere, including through working with the Bank on land titling and productivity, local currency financing, working capital, distribution and logistics, and support for the intermediary services on which farmers must rely.

To be most successful, we will need to integrate and mobilize a diverse range of partners – the FAO, WFP, and IFAD; other MDBs; private donors such as the Gates Foundation; agricultural research institutes; developing countries with great agricultural experience, such as Brazil; and most of all, the private sector.

A New Deal for Global Food Policy will contribute to inclusive and sustainable development. Poor, middle income, and developed countries will benefit together. Income gains from agriculture have three times the power in overcoming poverty than increases in other sectors, and 75 percent of the world’s poor are rural, with most involved in farming. Almost all rural women active in the economies of developing countries are engaged in agriculture. With support, women can seize the opportunities of globalized food demand.

Now or Never on a Global Trade Deal

The poor need lower food prices now. But the world’s agricultural trading system is stuck in the past. If ever there is a time to cut distorting agricultural subsidies and open markets for food imports, it must be now. If not now, when?

A fairer and more open global trading system for agriculture will give more opportunities – and confidence – to African and other developing country farmers to expand production. The Bank Group can assist developing countries seize the possibilities by expanding the capacity to trade, overcoming barriers to get to markets, and helping with trade finance. Taxpayers and governments can save the costs of subsidies, improving budgets.

The solution is to break the Doha Development Agenda impasse in 2008. WTO Director General Pascal Lamy is looking to convene a meeting of Trade Ministers in coming weeks. This is the moment of decision for the Doha

Round. Lamy has been patiently but persistently working with the WTO Committee Chairs of the negotiating groups to narrow differences. There is a good deal on the table. It's now or never.

It is an ambitious result: the cuts in tariffs in both agriculture and manufactured goods will be through formulae that cut higher figures more than through a straight percentage; higher farm subsidies will also be cut more deeply.

The key challenge now is to balance the deep, progressive tariff cuts with "flexibilities" that offer exceptions. These exceptions should not swallow the cuts; where possible, the flexibilities should still offer prospects to expand trade as economies grow.

Some have suggested that developing countries will gain in agriculture while giving up protection of manufactures. This is misleading. Considering the rise of developing country manufacturing and global sourcing, both developing and developed economies will gain from lower barriers to goods. The deal should also boost markets for services, which are an increasing share of global GDP, enablers of national development and infrastructure, and complement the measures to facilitate trade. The deal can also clarify "rules" that impede trade.

These negotiations are not worldwide poker contests, where Ministers hold cards tight, and a winner sweeps the pot of chips. They are complex problem-solving exercises. Everyone must return home with benefits and political explanations.

Political leaders need to push for "big picture" benefits too. This accord would contribute to inclusive and sustainable globalization: More opportunities for developing countries, big and small, middle income and poorer, to become more productive and to lower prices through trade; a greater sense of fairness for all in the international economy, achieved by modernizing a half century-old system. A breakthrough in the Doha Round would also infuse confidence in an economic system stressed by financial anxiety.

This moment of decision is not only for the Doha Round; it is for trade itself. Powerful voices across the political spectrum, including in my own country, are calling for, and rationalizing, protectionism. This economic isolationism signals a defeatism that will reap the losses, not the gains, of globalization.

In this era of globalization, the fate of the Doha negotiation extends beyond trade and traditional economics. These trade talks are a critical test for the challenge of striking a global deal on climate change. The economics underpinning trade negotiations have generally been accepted for many years. If negotiators of 150 economies cannot manage the political tradeoffs of the Doha Round to reap the clear benefits, it does not augur well for bringing developed and developing countries together on a new accord for climate change.

Reversing the Resource Curse: Launching an Extractive Industries Transparency Initiative ++

Today's high prices for energy and minerals, posing costs to some, offer great opportunities to others in the developing world. Some countries have used their natural resources as a springboard to development, but for others this treasure can become a curse. Both developed and developing countries have experienced the risks of these sectors: "dual" economies that leave most citizens excluded; corruption from licensing and sweetheart deals; volatile returns that tempt officials and weaken sustainable budgets and growth; the "Dutch disease" of exchange rates driven by resource exports, harming broader-based trade and employment; resource "rents" that fuel conflict among fortune-hunting factions; huge environmental costs; and even a sense of loss of sovereignty as a privileged few seem to benefit from the sale of "national patrimonies."

The Extractive Industries Transparency Initiative, or EITI, was launched by British Prime Minister Tony Blair in 2002, with the commitment of African leaders in the Partnership for African Development (NEPAD). EITI improves governance in resource rich countries by calling for the full publication and verification of company payments and government revenues from oil, gas, and mining. EITI has evolved into an international coalition of governments, the World Bank Group, oil, gas and mining companies, industry bodies, investors, and civil society organizations such as Transparency International, Oxfam, and Global Witness. Today, twenty-four countries are implementing EITI—seventeen of them in sub-Saharan Africa.

But transparency of revenues is not enough. To help ensure that the high prices of energy and mining resources translate into improvements in the lives of the poor, we will work with our developing country clients and other

partners to expand the transparency and good governance concepts of EITI both “upstream” and “downstream” – framing an EITI++ as a comprehensive approach to supplement the original project.

We are identifying steps to help extractive industries contribute to sustainable development by addressing risks all along the value chain. We will include the awarding of contracts, monitoring operations, collecting taxes, improving resource extraction and economic management decisions, better managing price volatility, and investing revenues effectively in sustainable development.

To get moving now, we are designing a facility to help build capacity of governments, with much quicker assistance than through our traditional lending operations; we will be working to develop and disseminate good practices, standards, and codes and to suggest fiscal, legal, and regulatory frameworks. We are seeking the strongest possible partnerships in developing these ideas with our clients, because “national ownership” of the EITI++ approach is critical to its success. We will also assemble an advisory committee of stakeholders to guide us.

For example, in concert with the African Development Bank, the African Union, the Economic Community of West African States, and the West African Monetary Union, we are working to launch an EITI ++ in Guinea. The successful development of Guinea’s rich resources can strengthen sustainable development for the entire region.

The EITI++ can advance inclusive and sustainable globalization by broadening the beneficiaries of resource development. Anti-corruption and transparency will strengthen citizens’ confidence in their governments as fiduciaries for a commonweal. Respect for the environment will add to sustainable growth. And effective access to these mineral and energy resources, across cycles, will strengthen the sustainability of globalization’s benefits for others.

A “One Percent Solution” for Equity Investment in Africa

The rising economies of China, India, Brazil, and others have strengthened and rebalanced the international economy, providing new poles of growth. They are new “stakeholders” in globalization. The Bank Group will also be alert to ways we can assist these clients if the credit storm and liquidity drought sweeps their way.

We also have a larger strategic goal: We should make it possible for the growth economies of Africa to become a complementary pole of growth over the next 10 to 15 years.

We are devising a “One Percent Solution” for Equity Investment in Africa to be a step towards the goal. Where some see sovereign funds as a source of concern, we see opportunity. Today, sovereign wealth funds hold an estimated \$3 trillion in assets. If the World Bank Group can create the equity investment platforms and benchmarks to attract these investors, the allocation of even one percent of their assets would draw \$30 billion to African growth, development, and opportunity. This one percent could be the start of something much bigger, across more types of funds and countries, because the investment of wealth into equity for development offers opportunity, not something to fear.

Doubters may shake their heads. But consider the uncertainties of China’s and India’s prospects in 1993. Five years later, the world looked to China only to maintain currency stability amidst East Asia’s turmoil. Today, China and India are engines, still facing complex and difficult problems, but driving motors of growth. Goals that one day seem impossible, the next day can seem inevitable.

What of Africa? Between 1995 and 2005, 17 countries of sub-Saharan Africa, representing 36 percent of the population, grew on average 5.5 percent without the impulse of great natural resources; eight oil producing nations, representing another 29 percent of the people, grew on average 7.4 percent over that decade.

These countries want to build on the social development foundation of the MDGs. They want to grow. They need low-cost, reliable energy; infrastructure; regional integration with access to global markets; and stronger private sectors.

They offer investment opportunities.

A lesson of the recycling of petrodollars in the 1970s is that equity investments are more sustainable than debt. Several emerging market funds have already started to invest long-term in Africa.

One of the ironies of today's global economy is that although short-term liquidity has dried up, long-term liquidity remains ample. Witness the sovereign wealth funds, another prominent feature of the new globalization and the growing influence of developing economies.

Some sovereign funds are built on demand for oil and other commodities. Others, especially in East Asia, arose out of the trauma of 1997-98: to "self-insure" against calamities in capital markets, governments built reserve cushions based on exchange rate policies, trade surpluses, and prudent fiscal management.

Sovereign funds are already serving as a brace for the recapitalization of financial institutions; I expect in coming months that they will continue to sustain globalization – and broaden its inclusiveness – through further equity investments as the deleveraging of the financial system runs its course and better information clarifies the best buys.

Yes, the sovereign funds need transparency and should be guided by best practices to avoid politicization. But I believe we should celebrate a possibility that government-sponsored funds will invest equity in development.

The World Bank Group, especially through the IFC, can help connect long-term global liquidity with the African investment opportunity. IFC has invested some \$8 billion in sub-Saharan Africa since inception, about \$160 million in equity last year alone. IFC is setting up two new \$100 million funds for infrastructure and microequity. We believe the equity prospects are expanding fast. IFC is now working on an open architecture platform for funds, drawing on IFC's access, knowledge, and capital, but also welcoming joint ventures with governments and their funds.

We can help other investors over the initial hurdles of investing in new equity opportunities in Africa. We can help countries resolve legal impediments and improve the regulatory and pricing regimes for infrastructure investments. MIGA can offer political risk insurance.

Then sovereign wealth funds can join us, even invest with us, not as another source of development assistance, but rather as long-term investors. Our position makes us a "preferred partner."

Just as the Bank's Group's GEMLOC project is helping accelerate development of domestic, local-currency debt markets in developing countries as a separate asset class, measured against a new index of performance, so we can encourage investors' allocations to African equity as a viable "frontier" asset class. These assets will add benefits in portfolio performance and diversification, both geographically and by type of investment.

By helping construct new indices for African investments, the Bank Group will also attract investors that need benchmarks for performance.

Then we or others can develop index funds for Africa. Over time, these vehicles can draw in a broader range of investors, including pension funds.

This "One Percent Solution" is a pathway to include Africa in the full gains of globalization. It is a strategy to strengthen the globalized system, add sources of growth, and promote the sustainability of globalization.

Conclusion

Bismarck once said that the mark of statesmen is recognizing Fate as she rushes by, so as to grab on to the mantle of her cloak.

This is a moment for statecraft in the political economy.

Old structures are breaking down. New sources of economic power are rising. But our views are blurred by the whirlwinds of markets, as firms and fortunes, the commercial "empires" of this era, are lost and made.

The World Bank Group has sketched six strategic themes to alert us to necessities and opportunities as Fate hurries past. They focus our attention on new development solutions for the poorest countries; states facing breakdown or coming out of conflict; middle income countries, integrating public goods, such as climate change, into our work; opportunity in the Arab world; and continually upgrading our knowledge and learning.

Our challenge is to take practical steps, now, that require work and will, guided by a strategic outlook.

What is more fundamental – in times past and years hence – than food, energy, minerals, trade, and channeling equity to productive investments in regions of opportunity, strengthened by good governance? To seize the opportunity of a changing global landscape: this is our challenge of economic statecraft.