

“Seizing Opportunity from Crisis: Making Multilateralism Work”

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Introduction

Almost eighty years ago, one of the 20th Century’s great economists and a leading Englishman of his day, John Maynard Keynes, appeared before a British government committee. The world was sliding into the Great Depression. In his testimony, delivered a few miles from here, Keynes appealed to his audience to rise above bureaucratic small-mindedness, to see the bigger picture.

Keynes was still six years away from publishing his landmark *General Theory*, yet he was already anticipating its insights: “We get into a vicious circle, we do nothing because we have not the money; but it is precisely because we do not do anything that we have not the money.”

Keynes wanted to save the market economy and feared the political consequences – in an era of Communism and Fascism – of failing to do so. His calls to overcome narrow interest went unheeded. Governments reacted ineffectively to the Depression. Countries indulged in competitive beggar-thy-neighbor policies. And catastrophe came.

Yet Keynes’ ideas, borne out of the opportunity forced by crisis, are still influential today. He and others of his generation created the multilateral system that survives and which we must remake anew to address the challenges of our era.

What Keynes and others achieved, even as World War II raged, combined ideas backed by actions. They helped create the economic architecture of the post-war era. They laid the cornerstones for the World Bank Group, the International Monetary Fund, and what later became the World Trade Organization.

Today we must not shrink from unifying ideas and actions. At a time of lost confidence, we need deeds that restore the public trust that governments are up to the challenge. There is a greater risk in doing too little than in doing too much.

Today's Crisis

Leaders meet this week in London in a world that would not seem unfamiliar to Keynes. The World Bank's latest estimate of global economic growth in 2009, released today, forecasts a contraction of 1.7 percent compared to economic growth last year of 1.9 percent. This would be the first decline in the global economy since World War II. We also face a 6 percent drop in the volume of world trade in goods and services, the largest decline in 80 years.

What started in 2007 as a financial crisis quickly spiraled into an economic crisis. Today, it is an unemployment crisis. We forecast economic growth in developing countries to slow sharply this year, to 2.1 percent. We expect actual declines in Central and Eastern Europe, Central Asia, and Latin America and the Caribbean.

In this crisis, developing countries are being battered by successive waves. These waves emanate from the sharp contraction in economic growth and tightening of credit in the developed world. Just as the global economy once helped to lift hundreds of millions out of poverty, today there is a risk of development in reverse, as our interconnected world transmits negative shocks with greater power and velocity.

Private capital flows to the developing world are slumping sharply, with net inflows dropping in 2009 to about one-third of the peak \$1.2 trillion reached two years ago. Remittances are on the decline, with a fall of at least 5 percent forecast for 2009.

Moreover, some actions of developed countries, even if understandable, are making it harder for developing nations. As developed governments issue large volumes of guaranteed debt, they are crowding out financing for well-run developing countries. Developing countries, even those with modest deficits, either are not able to borrow at all or are confronting much higher spreads.

We estimate that 84 out of 109 developing countries we surveyed face a financing shortfall of \$270 to \$700 billion this year. The two largest question marks reflected in this wide range are how much private debt is rolled over and the extent of capital flight.

At the same time, falling demand is depressing industrial production, and declining commodity prices are squeezing the fiscal position of many export-dependent economies. Only one quarter of developing countries can afford to finance programs to blunt the effects of the downturn.

These events could next become a social and human crisis, with political implications. Most attention has been focused on developed countries, where people face the loss of homes, assets, and jobs. These are real hardships. But people in developing countries have much less cushion: no savings, no insurance, no unemployment benefits, and often no food.

We estimate that 53 million more people will be trapped in poverty this year, subsisting on less than \$1.25 a day, because of the crisis. This comes after soaring food and fuel prices of recent

years, which pushed 130 to 155 million people into extreme poverty, many of whom have still not recovered.

The world was already struggling to reach the eight Millennium Development Goals by 2015. These targets now look even more distant. Take infant mortality, one of the most compelling causes: We now estimate that an additional 200,000 to 400,000 babies will die this year because of the drop in growth.

Around the World

We live in an interconnected world, but the crisis is felt differently across the globe.

- Countries in **Central and Eastern Europe** may be the most at risk, even though their income levels are higher than those of other states. Since the end of the Cold War, growth strategies in this region were based on integration with the European Union and the global economy through trade, investment, movement of people, and remittances. So the withdrawal of these factors hits particularly hard.

Furthermore, as countries moved toward joining the Eurozone, some made domestic loans in Euros or Swiss Francs, raising the risk of default if local currency values fell. Most Central and Eastern European banks are now owned by their neighbors to the West, raising the risk of withdrawal of support. Loan losses in the East, in turn, can undermine banks across Europe.

Of course, one needs to differentiate among countries. But the very logic of European integration – one of the most successful economic and political achievements of the past 60 years – suggests that the European whole will only be greater than the sum of its parts if Europeans stand with one another. Similarly, throughout history, countries in Central and Eastern Europe have tried to distinguish their circumstances from those of their neighbors, only to find that weakness in one creates dangers for all.

Further east, Ukraine's economic crisis poses a test of political coherence, and perhaps even sustainability. Kiev's empty billboards offer a metaphor for the disappearance of in direction. Where less than three months ago, consumers were urged to spend more, now one third of the signs are empty, with only blank cardboard and metal replacing the enticements of better days.

- In **Central Asia**, poor economies, just starting to reopen the old "Silk Road" after centuries of isolation, face precarious prospects. Last year, remittances from migrant labor supplied 43 percent of GDP in Tajikistan and 28 percent in the Kyrgyz Republic. But the slowdowns in Russia and Kazakhstan will send migrant labor home. In Kazakhstan, the government expects the unemployment figure to double to 12 percent by the end of this year. Almaty, once flush with oil boom revenues, is now a city of

unfinished construction sites, stilled cranes, and ghost buildings without occupants – an unintended monument to unrealized expectations.

- **Latin America**, with stronger fiscal, currency, and financial fundamentals than in the past, is feeling the crisis first through trade and the real economy. Whereas dangers in developed economies started in finance and spread to manufacturing and other services, the blow to developing countries is beginning with productive sectors and may then infect the banks that loan to them. Mexico and Central America have been hit because of the drop in U.S. demand and declining remittances. The slump in commodity prices is hurting Brazil; though its large domestic market has offered some cushion, Brazil will be increasingly squeezed if trade continues to slide. Countries such as Chile and Peru have used good years to improve their fiscal and reserve positions, offering some comfort, but an extended, deep recession will pull all toward a downward spiral. Vulnerable Caribbean economies are suffering as tourism dries up.
- The financial crisis has severely constrained **South Asia**'s limited room to maneuver. India lost \$45 billion of reserves due to capital outflows, the exchange rate depreciated by more than 20 percent, and stock prices plunged by 50 percent. Social costs are rising too. The Indian Government estimates a loss of 500,000 jobs in the formal sector between October and December of last year. In Bangladesh, in the past month, more than 4,000 workers are reported to have returned to the country, which has just restored a fragile democracy. Pakistan has tightened its belt to remain with an IMF program as its new government struggles with both violent groups and constitutional conflict.
- **East Asia** has been hit by the crisis through its well-developed interconnections with global sourcing and supply chains. Smaller, poorer countries, such as Cambodia, are especially vulnerable to falloffs in key sectors and markets. Cambodia has lost about 50,000 jobs in the garment industry, its only significant export industry. Young women, who particularly benefited from garment sector jobs, are now most at risk. Nomadic herder families, which still make up one-third of the population of Mongolia, saw the price of cashmere, their main cash product, drop 40 percent.

The bigger economies in East Asia are also coping with massive shifts. In China, an estimated 20 million migrant workers have lost manufacturing and construction jobs. Some are returning to the interior, but staying in cities instead of returning to tiny farm plots. China has launched a large stimulus plan, but even so, we forecast growth to slow from 9 percent in 2008 to 6.5 percent this year.

- **Africa**, though a small part of globalization's trade and investment, has not been shielded from the world crisis. An official in the Democratic Republic of Congo warned there could be an additional 350,000 unemployed in the Katanga province as mineral companies slash production. With diamond prices dropping, the Central African Republic expects a 50 percent cut in revenues compared to 2008. Remittances are drying up in Kenya. And with tourism revenues likely to decline fast, there are gloomy

prospects for a country such as Seychelles, where tourism, its main source of employment and foreign exchange, is projected to contract by 25 percent in 2009 alone.

- So far, the countries of the **Middle East and North Africa** have been less affected by the credit crunch. But reformers in the Maghreb are likely to lose tourism from and export markets in Europe. Countries depending on migrant workers are now likely to have to figure out how to cope with lower remittances and the influx of returning labor. Even energy producers are now facing huge uncertainties as they seek to address the challenge of connecting unemployed young people, schooling, and productive work in an environment where job opportunities in the private sector are likely to be constrained and commodity prices remain volatile.

There will also be special problems that cut across regions. We are already seeing the effects of the crisis on women and girls. Women suffer disproportionately. When families have to tighten their belts, girls are more likely to be pulled out of school. And when someone has to go without a meal, young girls are most often the ones who will suffer malnutrition.

Innovation and Action

Despite some economic conditions that echo the past, this is not the 1930s. Central Banks have supplied ample liquidity and some have stepped in with creative ways to keep credit flowing. Developed countries have acted much faster than in Keynes' day to boost demand with stimulus packages. The supervisors of financial institutions have generally been alert to the systemic risks of collapses that freeze investors with fear. The multilateral financial institutions created at Bretton Woods have stepped in to help countries avert or address the crises. To date, we have not seen the wholesale retreat into protectionism that was so poisonous in the 1930s.

But 2009 will be a dangerous year. This is not a moment for complacency. It is not a day for expressing false confidence that all has been done that can be done. It is not a time for narrow nationalist or even regional responses. The one certitude we can draw from events over the past year is our inability to predict what is to come, and how it may trigger other unexpected events.

To address the challenges ahead requires a spirit of innovation backed by action.

We need to be fast and flexible. We need to be devising solutions to problems that draw together the resources and skills of multiple partners – governments, international institutions, civil society, and the private sector.

We need catalysts to forge these new partnerships.

Last month the Bank Group joined forces with the European Bank for Reconstruction and Development (EBRD) and the European Investment Bank (EIB) to support the banking sectors in Central and Eastern Europe, with a funding package of up to €24.5 billion.

The Bank's private sector arm, IFC, and the Japan Bank for International Cooperation have contributed \$3 billion to a Capitalization Fund to help strengthen banks in smaller emerging markets and keep credit flowing to small businesses and individuals.

IFC has joined with KfW, Germany's development agency, to create a \$500 million liquidity revolving fund to support microfinance institutions, because entrepreneurs and small businesses offer the best safety net in troubled times: new jobs.

And we are now assessing the effects of the global recession on companies in the developing world and considering how we might help mobilize private capital to help restructure firms and handle distressed assets.

Today, the World Bank Group's Board is considering a new proposal: the launch of a \$50 billion Global Trade Liquidity Program.

The huge drop in trade has been exacerbated by a shortage of trade finance. To assist, we first boosted trade credit guarantee coverage to \$3 billion for developing country banks, many of them in Africa. But we learned guarantees are insufficient, because many small lenders cannot get the currency financing.

Our new Global Trade Liquidity Program will combine our own \$1 billion investment with financing from governments and Regional Development Banks. These public funds can be leveraged through a risk-sharing arrangement with major private sector partners, such as Standard Chartered, Standard Bank, and Rabobank. And then the trade loans can be recycled, as earlier loans are paid off. Working with the WTO, we also will seek to tap the resources and experiences of national export credit agencies.

I hope the G-20 leaders will endorse this trade liquidity initiative. G-20 backing will help us gain more momentum, so that we can build towards the goal set by Prime Minister Brown.

A Call to the G-20: Make Multilateralism Work

Unlike economic crises in the past sixty years, this is a global crisis. It will require a global solution.

We live in a global economy driven by private individuals, companies, unions, and national governments. They trade, invest, work, invent, bargain, and build within and across nation-states, which set the rules and sometimes agree to abide by negotiated terms and procedures. The G-20 will not change that reality of the international system. But a strengthened multilateralism can magnify the advantages, and temper the downside risks of economic interdependence.

The vogue is to talk of new institutions or new fora for global governance. Perhaps. I say we should start by reforming and empowering the institutions we already have.

The WTO, IMF, World Bank Group, and the Regional Development Banks – along with the UN agencies, can play a larger role. With over 180 members, and further reform to boost the voice and decision-making power of developing and emerging economies, these institutions can help bridge the divide between nation-states and economic interdependence by interconnecting national, regional and global interests.

If leaders are serious about creating new global responsibilities or governance, let them start by modernizing multilateralism to empower the WTO, the IMF, and the World Bank Group to monitor national policies. Bringing sunlight to national decision-making would contribute to transparency, accountability, and consistency across national policies.

As a first step, the G-20 should endorse a WTO monitoring system to advance trade and resist economic isolationism, while working to complete the Doha negotiations to open markets, cut subsidies, and resist backsliding. We are already seeing creeping protectionism – measures taken at the expense of other countries: “Buy this” or “Buy that” campaigns, “jobs for these workers” or “no visas for those.”

As 2009 goes on, and unemployment increases, national leaders will come under more and more pressure to shift problems to others. A World Bank study has already shown that 17 of the G-20 countries have implemented trade-restricting measures since their public promise to reject protectionism last November.

No one should want isolated infringements to become a pattern – eroding one of the most important bulwarks between this crisis and the 1930s.

Empower the WTO, with World Bank support, to identify actions that may limit international trade even if they do not formally violate WTO rules. If the G-20 countries believe more global governance is appropriate, they should be willing to accept the “moral suasion” of public reviews that “name and shame.”

Second, many countries have now enacted stimulus packages. They should have some effect in curbing the worst impacts of this downturn. Yet no one can be certain whether these packages offer a large enough stimulus for a long enough time. There are also legitimate debates over the composition of packages and how they will be implemented. The IMF has suggested a global stimulus package of 2 percent of GDP. It estimates that actions taken so far amount to 1.8 percent for 2009 and 1.3 percent in 2010. There is a danger of a withdrawal of global stimulus in 2010.

The G-20 should institutionalize a monitoring role for the IMF, to review the execution of these stimulus packages and assess results, calling for further action if necessary.

A number of leaders have said that the IMF should have played an “Early Warning” role in the run-up to the crisis – so it would be reasonable for them to ask the IMF to assess how we are doing in getting out of this crisis.

Third, it is vital that governments clean up bad assets and recapitalize their banking systems. Economic rebounds driven by fiscal stimuli will not be self-sustaining without a fix of banking systems. In Keynes's day, governments permitted the global banking system to rip apart after the failure of Creditanstalt in Austria. Today, the Central Banks and Finance Ministers have sought to stabilize the system. But confidence remains low. New investors will be unwilling to risk private capital until losses are transparently recognized and the future of the banks is clarified. Recoveries are likely to begin outside the financial sector, but they will be stymied without credit.

The politics of allocating government funds to recapitalize banks is not easy. People do not like bankers, especially when they have to be bailed out. Yet leaders need to explain that a healthy Wall Street or City is necessary for a thriving main or high street.

The G-20 should ask the IMF and the World Bank Group to monitor actions and results in the banking sector. We already work together in developing countries through the Financial Sector Assessment Program (FSAPs). We should be providing feedback on the developed countries too, with the results published, taken seriously, and followed up.

Fourth, even as we clean up past mistakes, G-20 leaders rightfully expect an overhaul of the financial regulatory and supervisory system. Most of the actual authority over regulation will rest with national governments. But there is a need for better and deeper international cooperation. The Financial Stability Forum, ably chaired by Mario Draghi of the Bank of Italy, has started to fill this gap. With a broader membership, the FSF could become another important institution of a stronger multilateral system, working with the IMF and the World Bank Group on implementation.

Looking to the Future: Developing Countries must be part of the Solution.

There is a missing fifth dimension in our response to the global crisis: the developing world. In London, Washington, and Paris people talk of bonuses or no bonuses. In parts of Africa, South Asia, and Latin America, the struggle is for food or no food. Developing countries and peoples are endangered by today's crisis. But they can also be a key part of the solution.

This is why I have called on developed nations to invest 0.7 percent – not even one percent – of their stimulus packages in a Vulnerability Fund to help developing countries. The idea is to use existing multilateral mechanisms – not to create a new bureaucracy – to support safety net programs, infrastructure, and financing for small and medium size companies. Donors may use the rapid financing facilities of the World Bank Group, UN agencies, or Regional Development Banks. Germany, Japan, and Britain have already pledged money. I look forward to having more sign on.

During the Latin debt crisis in the 1980s and the Asian crisis in the late 1990s, governments were squeezed for cash, and they cut into social programs – which hurt the poor most. We saw the result in social unrest, deprivations, and even violence.

The G-20 must learn from those mistakes.

Social transfers have been effective in both stimulating spending and protecting the poor from the worst effects of the crisis. Conditional cash transfer or nutritious school meal programs can be targeted and effective at a relatively low cost, even of less than one percent of a country's GDP. Successful programs such as Mexico's *Oportunidades* or Brazil's *Bolsa Familia* cost on the order of 0.4 percent of GDP, while Ethiopia's largest safety net program, the Productive Safety Net, costs about 1.7 percent of GDP.

Leading G-20 countries are calling for the institutionalization of "early warning" systems for financial dangers, institutionalization of new financial regulatory structures, and institutionalization of more resources for the IMF for bigger interventions.

Isn't it time to institutionalize "early warning" systems for the poor? Isn't it time to institutionalize support for the most vulnerable during crises, especially those not of their own making?

A commitment to put in place structures to support and fund safety nets for those most at risk would go a long way to show that this G-group will not endorse a two tier world – with summits for financial systems, and silence for the poor.

We also need to invest in infrastructure projects that can create jobs while building a foundation for future productivity and growth.

During the 1997-98 crisis, China's investments in roads, ports, airports, energy, and telecommunications supported employment while boosting growth over the next decade. With financial support and good governance, other countries can do the same, building productive capacity to pay back loans. As they do so, developing countries will boost global demand, including for capital goods and services from developed countries. Indeed, investments in infrastructure in developing countries probably have a greater potential to boost productivity and growth than "bridges to nowhere" in developed economies.

Over the past decade, 25 countries in sub-Saharan Africa, comprising about two-thirds of the population, grew on average 6.6 percent. This presents an opportunity. But the lack of infrastructure has created a significant bottleneck, depressing firm productivity by around 40 percent. Regional integration suffers. With better infrastructure, we estimate growth in Africa could be boosted 2.2 percent.

Similarly in agriculture: Investments to boost the productivity of African agriculture across the value chain – property rights, provision of seeds and fertilizers, irrigation, roads and storage, marketing – could help small-holder farmers break the cycle of poverty.

It is time we recognized that an inclusive and sustainable globalization depends on encouraging multiple poles of growth, including developing countries.

If developing countries are going to be part of the solution they must have seats at the table. The G7 failed to expand in time to meet international economic realities. Now the G-20 has its chance. But some 20 at the table still leaves over 160 outside. The multilateral institutions – with much broader membership – can help connect the G-20 to the rest of the world.

It is not easy for large groups to share responsibilities and generate a cohesive common purpose. Within the G-20 we already see the emergence of different blocs: the EU organizing a common position for its eight participants; the BRICs of Brazil, Russia, India, and China coordinating joint statements. This development may be expected, but it would be unfortunate if the new, broader G-Group created new fault lines between developed and developing countries.

Instead, the United States, the largest developed country, and China, the largest developing country, should find common ground. China and the United States have had the two largest stimulus packages. Yet the U.S. stimulus relies heavily on consumption, whereas China looks to invest in building more capacity. Over time, this imbalance is unsustainable. The two countries will need to cooperate on a mutual readjustment as they recover from crisis – increased savings through fiscal and spending discipline in the United States, and increased consumption, services for the public, and opportunities for small enterprises in China. Their national interests can be combined to strengthen a common systemic interest.

A strong G-2 within the G-20, and cutting across development lines, could form the cornerstone of a new multilateralism – a multilateralism that recognizes the realities of an international system born, not of nation-states alone, but of nation-states linked through economic interdependence.

That modern multilateralism will require that rising economic powers have a larger say in how institutions such as the World Bank and the IMF are run. This is both right and inevitable. The world has changed radically since Keynes attended the Bretton Woods conference in 1944. We must change with it.

The World Bank's Board of Governors made a start this year with a first phase of reform to increase the influence of developing countries, but we must now go further to rebalance voting shares and Board seats. Making those changes will require that both Europe and the United States reconsider old prerogatives and controls. How they do this is a decision for governments. But I would urge them to be bold and far-sighted. The rising stakeholders must also recognize that with rights come responsibilities, including to boost development assistance. The recognition of new powers should not be at the expense of the powerless.

Reform is overdue. It is for this reason that some months ago I asked former President Zedillo of Mexico to chair a High Level Commission on World Bank Group Governance to make recommendations that I hope will provide a useful input to shareholder deliberations.

The Challenge Ahead

We have seen over the last six decades how markets can lift hundreds of millions of people out of poverty while expanding freedom. But we have also seen how unfettered greed and recklessness can squander those very gains. For the 21st Century, we need market economies with a human face. Human market economies must recognize their responsibility to the individual and society.

When Keynes gave his last speech at the Bretton Woods conference, the world was still at war. In the great scheme of things, the news of the founding of some obscure institutions did not seem that significant, yet they became cornerstones of the post-war architecture.

The upcoming G-20 Summit draws the key national leaders together. Their cooperative action is essential. The leaders should reform, build on, draw from, and employ the multilateral institutions they inherited. If the G-20 acts as a Steering Group, the multilateral institutions can help them solve this crisis through ideas and practical actions.

As we seize opportunity from the crisis of today, we would do well to remember Keynes' words in his closing remarks: "If we can continue in a larger task, as we have begun in this limited task, there is hope for the world."