

# GREAT DECISIONS

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**I want to start off asking you how the current financial crisis became a global crisis.**

You know, we live in an increasingly integrated international economy and you have effects of capital flows, of trade for poor countries. It affects tourism; it affects remittances which people are used to in the Western Hemisphere. It is very important for Africa as well and the nature of this crisis is that you need to see it coming in waves so what might have started with bad loans in the US means that you get a global slow down which starts to hurt the economy and the developing world and then bad loans from a bad economy in poor countries will start to hurt the banks in developing countries even though they didn't hold the debt. So in the nature of the response you have to a cooperative response but it also has to recognize that you're going to have different stages of this crisis that you have to keep attached.

**I wonder if you could expand a little bit on how the crisis has impacted developing countries.**

Well you have a great range of developing countries and so for some of the larger developing countries that have had the ability to have their own stimulus packages such as China, they and India have started to become poles of growth and stability in this system because they, like the United States had a rather aggressive state of stabilization program, they've had monetary policies that tried to make credit available. But, other very large developing countries like Mexico got hit very hard in part because they are dependent on trade to the US and in Mexico's case they also had the swine flu issue, but they've also been hurt because the government guaranteed debt in the developed world has made it harder for the Mexico's, and the Indonesia's, and other good sized developing countries to be able to issue their own debt. So where the US might have a deficit that is over 10% of GDP as part of a stimulus program, the Mexico's and the Indonesia's has had trouble trying to finance the 3% of GDP.

And that's one way the World Bank can help because we help provide some of that financing. Then you have some of the poorest countries. And of course the very poorest don't have as much of a connection with the international economy and so in some ironic fashion they're more insulated but then you really have to look at each individual case. If they are a commodity

producer and prices of commodities fell, well then the exports are going to go down. If the were producer of services such as tourism, some of the island economies, they obviously get hammered very hard. In the case of many countries in Central Asia, they have been dependent maybe 20 maybe 40% of their GDP on returns from their workers in Russia so as Russia went down, they came down. And, in economy after economy you see the interconnections of a spiraling down or hopefully spiral back.

**In Africa for the past ten years a number of economies have shown a significant growth. How is Africa being specifically impacted?**

Well, its interesting that you highlight that because I think a lot of people have been unaware that about 1/3 of the African sub continent - or Sub-Saharan Africa is based on population, is actually grown in pretty good rates in the past ten years and the other third that had resource industries has also grown well. So it's the last third that are often the post conflict or the fragile countries struggling to hold themselves together have kind of held back some of the over all numbers.

In terms of the countries in Africa, again, it depends. If you're a commodity producer you've been hurt to a certain degree [in areas such as] tourism remittances. In general what I say is that in looking at those economies one has to recognize that you have less of a cushion. So, if you're in the US or even if you're in some of the middle income countries there is a little bit more room to have safety net programs. But In a lot of the poorer countries the margin is non existent and so there many of these countries were already hit my higher food and fuel prices last year. In some of the places the fuel price did not come down as much as they did in the developed world and then on top of that if you have a lot of people losing their jobs you no longer have to income food. So it's not just a price issue it's an income issue.

Where we are most concerned is in some of the countries that have been struggling heroically to climb their way back up. The Liberia's of the world. I was juts in Uganda and Rwanda and DRC. Each one of those is coming out of conflict in the near term or did so in the past 10 or 15 years and there the challenge is also can they maintain the economic integration they need to be economies that will draw investment.

Maybe from the US and Europe, maybe from China. So what we've been trying to do is to support them not only through some of the funds we have called the IDA for the poorest countries where they use grants or long term interest loans but also, try to be innovative with other tools. Trade liquidity, some of them for example couldn't get trade financed even where they could export. We put together a program where we could deal that. Infrastructure development, infrastructure as we saw in China in the late 90's can create jobs but also create the future productivity for growth.

Micro finance is very important for a lot of smaller, poor players but a lot of micro finance institutions depend on cross border funding on the deposits like regular banks do, so we put

together a special revolving fund for that. We also want to try to address issues of distress debt in the private sector because one of the challenges whether is be developed or developing world is how do you make the move from a stimulus type of growth to getting the private sector back and fully engaged and that's true for the developing world as well and critically too for the trading system. Trying to hold off the forces of protectionism because of course one of the key distinguishing characteristics of a recession that became a depression in the 1930's was a retreat to protectionism into isolationism. We have to try and keep markets open and in doing so hoping that recovery can then help pull these countries back out of their difficulties.

**Moving forward to the global response, I wonder if you could comment both on the response from say the wealthy countries and the poorer countries.**

Well, it's interesting that some of these for example, G20 meetings that I attended at the summit or at a ministerial level, the first response from a number of the developing countries was that the developed countries have to get their act together. In other words, you have to get the US, or Europe, or Japan going again and that was in part monetary policies stabilizing the financial system and in many countries a stimulus program.

People can debate the timing of the stimulus, how effective it was, but that was the initial face. I think what one saw later in 2009 was the fact that you had an overall, in a sense, broken the fall on the financial markets, then the questions become, what is the basis for recovery and growth? And that is an issue of keeping trading markets open, encouraging the private sector to continue to grow and recognizing that what is different in this period than the one ten or twenty years ago is that we're going to be dependent on multiple poles of growth.

In the 97 financial crisis people looked to China to hold the currency to stop further breakdowns of currencies. The interventions and support for the IMF and some of it's added resources prevented that type of currency breakdown so far in this crisis but then the question would be, can in this time, will we look to China and India to be sources of demand and one of the other opportunities and this is an area that we're trying to help at the World Bank is that if you look at the recovery, most people were forecasting a slower growth path. If you get demand from the developing countries you can actually boost that growth but they need the financing. And over the median and long term if you look at the changing international economic system, you would be better off if you have additional poles of growth not only in China and India and Europe, but SE Asia and Africa. But to do that you have to invest in productive capacity. You have to have the infrastructure. You have the governance rules. You have developed the equity investments in the private market and that's part of the agenda that we need to have for Africa and other parts of the developing countries.

**Some folks have called for reform in the Breton Woods Institution as a result of the financial crisis and you've outline a number of policy responses you all have made. Where would you**

**say that you've done well and where would you say that some reform or some changes might need to be made?**

Well, I think that the call for reform is actually predated the financial crisis and there is a desire to modernize the multilateral institutions that were created after WWII to fit the whole different set of international circumstances. So while we have been trying to boost up our financial response so for example in our fiscal year that ended in the summer of 09 we had about 59 billion dollars worth of business. A big increase over the past and that was private sector, the poorest, the middle income countries and the outlook for the next fiscal year is going to be very, very strong. There is a continued demand.

But, what we also need to do is reform the legitimacy of the institutions to the participation of the developing countries. Seats on the boards, voting chairs, other aspects that give them a sense that they are full stakeholders in these institutions.

Some of that of course depends on some of the 186 shareholders we have but we're trying to nudge them in the right direction within our control we can do it through appointments so the first chief economist from a developing country is Justin Lin from China. We have appointed most of the new officers from the developing world so this is a way to build that capability. There are other aspects of reform. Governance and anti-corruption are key to that development and there's a whole series of things we need to do on the preventive side but also to make sure that we go after and sanction people that do something wrong and stop doing business with them and work with national authorities to take law enforcement action where we can. Transparency, we tried to through our own internal processes to open up the institution more, our contacts with civil society groups. Our work was with the regional development banks and the UN agencies.

I tend to look at the international system as a network of players. So how does the World Bank that deals with developed and developing countries of different sizes try to interconnect across a range of issues? We're involved with climate change, we're involved with post conflict countries, Afghanistan, Liberia, and Haiti, how do we work well with other players in the system. So in that sense what this deals with is everything that this deals with is everything from financial resources to human resources to procedures to a transformation of an institution that's mission is not only finance but how we talk the knowledge of learning from around the world and be able to customize it for new circumstances and new continents.

**I know there is no silver bullet that would resolve or prevent another global financial crisis from occurring? What if there was one fundamental change or one aspect of prevention that could be taken, what would that be?**

Well I'm always reluctant to take on one point but I think it is in the nature of capitalism to have booms and busts but I think one of the lessons that the central banks have learned from this crisis is that you have a responsibility to deal with asset price inflation as well as goods inflation.

Now its easier to say that that to do it and that then goes to series of questions about supervisor rules, bank regulation issues of capital, of leverage, of making sure as the head of the bank of England said, a financial institution can go down without bringing down the whole system. He suggested that each institution have a living will so that you could be able to unwind it without bringing down the system.

I guess if I would summarize it in one point I would say something that I felt from my career which is that you have to understand the basis of economic theory that you also have to connect it to human psychology and to institutions. Theory tells you one thing but the institutions won't allow you to for example have the market clear or than the theory doesn't give you good enough guidance. If theory tells you one thing that human psychology may work in another direction you have to factor that in to your over all model and I think what the system is doing now is recognizing that you do have a global economy. These pieces are interconnected. They can grow up together or they can pull each other down so you have to try to have the international cooperation while respecting national sovereignty so as to get the best value and cooperation and good from the system and you have to avoid the downside risks.

**The Obama administration has made ample use of Special Envoys fro various global crisis around the world and given your past experience as a Special Envoy I wonder if you could talk a little about the challenges of a Special Envoy in general and more specifically in Sudan?**

Well the example actually kind of highlights the challenge. Sometimes historically Special Envoys can be used to convey a message; sometimes they're to bring back information. If they are to have an operating role so it's not just a communication role but to try and solve problems, the real challenge is two fold. One, the trust and confidence they can develop in the parties. And second, their own connection to their own institutions in government so they can get things done. So I was really not a special envoy when I worked with Darfur and Sudan. I was the Deputy Secretary of State - or when I did German unification I was an under secretary of state. And that highlights the issue, is that through those posts I had the advantage of being in a position of where I could operationalize things through my own government so therefore I could help carry the solutions I was trying to come up with. The disadvantage was that I had a line portfolio and a lot of different responsibilities so I think in general, if the very nature of a Special Envoy is that you have to however you do it, make sure that the parties go beyond their talking points; make sure that they go beyond what they say publicly.

You try to build sense that people want to address a problem and sometimes they don't. Sometimes they figure it is in their interest just to stonewall or hold off. But if you get that

sense than you have to be able to start to exchange ideas, probe, try different things, but your ability to do that with another country depends fundamentally on whether they think you can you can carry whatever your suggestion back in your own country or better yet with a group of other countries and that takes you back to the in institution position. Now these special Envoys that the Obama has, Senator Mitchell and Dick Holbrooke in particular are people who I think by nature of their personality and reputation are pretty well connected into the system so they should be able to have the follow through. But any time you use an Envoy it will raise a challenge of, for example in the case of the Middle East, whatever one is doing on the Middle East peace process, how does it connect with economic development issues, the security issues. And I suspect that that partly the role that the National Security Council will play in this administration.

**Finally, as you know the mission of the FPA is to inspire Americans to learn more about the world. You have had a long and illustrious career in the Foreign Service and now in the World Bank. Could you say a few words on the importance of education on international affairs.**

Look, I think in particular if we are taking this from a US perspective, individuals in the US have an incredible opportunity to serve not only their own country but others around the world because the US is an extremely powerful country in terms of economy and security and also its ability to shape political thinking. The challenge of course is that in understanding and being able to use that effectively you need first some appreciation and history of other cultures and people. And what I found fortuitously was because I always enjoyed history it put me in a position where I could learn more about the context of some of the issues so if you're talking about a country like China, one has to recognize the unequal treaties that they had years before or the sense that China feared about being broken up and each country has its own challenges that you have to have reflected. But a second element is that you're not going to be too effective in international affairs unless you understand your own country. Because you have to come back and implement things within your own political system whether is be the Congress with your executive branch or with state and local governments and so being able to bridge the two, to have sense of your own political system and with other histories and cultures and try to come up with constructive ideas to advance a larger goal or mission is an extraordinary challenge but also and interesting and intriguing tasks so it stretches and broadens people over time. So in that sense

I think that of this era part of the challenge will be how does the US use this influence in a way that build cooperative structures just as people did after WWI to be able to broaden the group of those that are stakeholders in the international system and together one can learn to listen to them and hear some of their ideas and build a whole that's greater than some if its parts.

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