# Foundations for a More Stable Global System

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Remarks at the Symposium on
Global Finance and Development
(prepared text)

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For over eighteen months we have all been witness to an extraordinary period of global financial turmoil. This has imposed huge social and economic costs on the countries affected. It has also shown us just how truly global and thoroughly interconnected our world is now. Crises in a number of countries have created risks for the entire global financial system.

And so we have focused in recent months on the causes of this instability, and on what we might do to prevent and deal with such crises in future. We are engaged in a debate about what is being called "the global financial architecture": we are revisiting our blueprints.

As the attendance at this seminar attests, our debate continues and I believe we all recognize its seriousness and the very different world that is the context for our deliberations. Many big ideas have been canvassed and there are proposals out there for radical institutional reforms. But behind this a good deal of common ground has emerged on the more pragmatic steps that should be taken to reduce future risks, to handle crises better when they happen, and to help countries recovering from crisis.

What I want to address today, as we think about financial architecture, is the need for us to establish really solid foundations to underpin that architecture. To create solid foundations on which something lasting might be built, I think you need to address a whole set of issues which are not typically addressed in the financial analysis alone. A stable financial architecture cannot be achieved without the proper structural, institutional, social and human foundations needed to make a modern market economy work. Without these underpinnings, our building will collapse. It will also collapse if we are not joined in our labors by hands and voices from every corner of the globe. Our architecture must be one for developing countries too; a plan to include the most vulnerable and those who, most recently, have felt the greatest pain.

And let me add right at the start what I believe our goal to be in all of this. Why do we want a stable financial architecture or, as I am arguing, a more complex and inclusive foundation on which to build this and all

the other elements we need to sustain our world? Simply because we want to fight poverty with passion, to establish equitable development, stability and peace right across our world. I cannot think of it any other way, nor believe it should be otherwise.

What do I mean by foundations?

If there is a single cross-cutting lesson that we have learned over the past eighteen months and more, it is not simply one of getting the macroeconomic numbers right or of ensuring transparency or of revising the way in which capital flows are regulated. It is all of these and they are important but it is also much, much more.

It is a lesson of how deep and complex our foundations need to be. It is a lesson of how interconnected each and every element is in our building process. And it is a lesson of how inclusive we must be in consulting not just an elite group of architects but the widest possible spectrum of a global society, each and every element of which now matters as never before. If we do not learn these lessons - and now is surely the time to show that we can - our foundations will be shallow and our house insecure and at risk.

So it is not just a matter of getting exchange rates right or fixing fiscal or monetary policy. As important as these are, in some ways they make up the easy part of the agenda although I do not intend to trivialize them. The hard part is recognizing what it takes beyond a macroeconomic fix and then putting in place the real foundations.

I am talking about the institutional underpinnings of a market economy that advanced countries take for granted. In the countries of the developed world these took generations to put in place; they were wrestled out of the lessons learned at the cost of financial and economic catastrophes. And still these institutional underpinnings need constant maintenance and improvement as the working of our world evolves and changes. And I do not want anyone to take away from this thought the idea that the developed world has it exclusively right. You need only consider the banking disasters of the Scandinavian countries and of the US with the Savings & Loans debacle to find examples of the fact that there will be crises as a matter of fact. But what made them a little easier to handle in both these instances were the institutional underpinnings that were in place, that facilitated recovery and protected vulnerable citizens.

So let us look at what it takes. My list is not exhaustive but I do want to identify the range of the vision that we need, so forgive me if I fail to name some of the particularities. There are many different elements involved and some will concern and interest some of you more than others. That is fine too as long as between us we do not overlook or neglect a layer in the foundation that will find us wanting in the future.

A global framework, with global rules and standards in which we all have a part, is just as important for the security of an individual country as is the sum of functioning national parts to the security of the global whole. It is clear to me that my list might too easily be seen as an

agenda for individual countries. And surely I am identifying elements that should helpfully guide the choices of national governments and the work that international institutions can do to assist them. But we cannot have a well-managed global whole if we do not have viable national - and regional - entities. If the crises and contagions of East Asia, Russia and Brazil have taught us anything, it is surely that we must be able to think both globally and nationally. This is not something about which we should be having a turf battle, not when we consider that 2 billion people will swell our total numbers over the next quarter century.

So let me get to my list and begin by naming first good governance, strong public institutions and a system that fights corruption. If you do not have good governance and you have corruption, your financial architecture will not save you. And just as countries need this element, surely our interconnected world is improved by getting this right.

Second, you need a strong legal system and a justice system able to guarantee the execution of those laws. This applies equally to the laws which allow a vigorous business sector to flourish as it does to the laws which protect citizens, strong and weak alike. This is good for countries; it is good for the world.

A third element, which relates most closely perhaps to financial architecture proper, is a robust and well-regulated financial superstructure in which there is supervision of banks, of capital markets, of stock exchanges, of financial institutions that are not banks. This too is good for all of us, internationally, in developed countries and in developing countries. And financial sector regulation is of course only part of the story here. Stability requires a sound corporate sector based on strong corporate governance and legal systems and accounting systems that work. No country is going to have a sound financial system without company accounts that make sense, rules of company behavior and disclosure that are applied, legal systems and bankruptcy procedures that work. Governments, especially in the developing world, would do well in this respect too to develop a private sector strategy that assists the efforts of their business people as they go out into the world.

These are all elements of the mix for the foundations of a market economy that will enable developing countries to multiply the opportunities of the global marketplace. Equally, their absence will multiply the risks of crises in the new financial environment.

And now my list turns to the social agenda and I do ask here that we get beyond the set pieces that have us thinking of the numbers as "hard stuff" and the social as "soft". I have traveled to too many countries now - 84 in my three and a half years at the World Bank - and seen the images of poverty too starkly etched to imagine that we can successfully relegate the social to the second rung on the agenda.

Our social agenda should begin with those elements at the very heart of ensuring an opportunity at all levels of society: a good health system and an education system available to boys and girls equally, that is unconstrained by the borders of a single country, that is linked to our

wealth of global knowledge. It is not at all soft to argue that these are fundamental to our foundations and that it is not too much of a leap to make a connection between decent health and education systems and the stability we are all seeking to reduce the global risks of financial turbulence.

There seem to me such obvious linkages, too, to all the other elements needed to secure the equitable development of society. Like communications systems, from the most high-tech satellite connections to the simple rural road along which the farmer takes his goods to the market. Like clean water, accessible clean water to free the millions of developing country women who spend four to five hours each day fetching this commodity. The same point can be made about power. Presently 2 billion people have no access to power; 1.3 billion have no clean water.

The environment is a crucial element in our foundation that most seem to accept now has both global and domestic implications. And so does the need for urban strategies as cities grow to bursting beyond their capacity; and rural strategies as countrysides feel pressure and food security threatens in the years ahead. In the next three decades the world will have to double its current food production. And lastly, and I mean this very seriously, as we globalize let us also not forget our legacies, let us have strategies to protect our cultures so that we might preserve their riches for our children. There can be no real development without cultural continuity and enrichment.

If our goal is equitable development and peace, what we must have learned recently is that stability also requires action to protect the most vulnerable. And because we are not going to be able to install all the elements I have just listed overnight, or even over the next decade, we need social safety nets that are in place for times of crisis. In addition, each society needs some form of permanent social protection to take care of the elderly, the disabled and the children and those that do not have work. These are also institutional underpinnings that we must consider when we examine the institutions we need to secure a functioning global economy. When you look at the transition economies one way you might see a list of successful privatizations. But look at them another way and you see where the social safety nets provided by the lumbering state corporation of old have been stripped away and not always replaced. This creates extreme vulnerabilities which can lead to political disturbance and a dangerous sense of disillusion among those left out in the cold. We have seen elements of a backlash against globalization and there are real and deeply human reasons people feel this way. Social systems can vary across societies and history - they can be governmental, tribal or based on family.

I name all these elements not to beat a path away from our engaging debate on the financial architecture which we surely must attend to. I name them because I believe they should be an integral part of our debate as we seek solutions. And in so many of the areas I have identified, it is helpful to proceed by defining international standards and principles of best practice. These efforts should not be seen as prescriptions. Indeed, the major contributors to our global store of knowledge as we

develop and reassess our principles should be the very countries with which we work.

If we view all these elements as necessary to our foundations, which I do believe they are, then we have ourselves a very broad agenda. These things cannot be tackled in isolation and they will not be achieved quickly. Although our architectural metaphor suggests we should have blueprints, we must resist a one-size-fits-all approach. If you think about applying this framework at the country or regional level, it is obvious developing countries face enormous challenges. We have to look with extreme sensitivity at the sequencing of reform and the pace at which we urge a country to integrate into the global markets. Entry into the global financial capital system takes managing, for example. Our architecture has to allow for the differences that exist across and between countries.

At the World Bank we think of this a comprehensive development framework. But it is not just an agenda for the developing world. It is a key to reducing risk and ensuring greater stability that should make sense to all of us.

What needs to be done to reduce the risk?

Let me distill the message I take from viewing our challenge in this holistic way: the actions needed to bring about greater global stability are the very same actions needed for successful development. And that of course is the heart of the Banks mandate, and these are subjects, the structural and the social, where the Bank is already working, and has experience and expertise. So, if we are here to formulate an international response to the crises we see around us, it is right for the Bank to be at the heart of the response, along with our partners. Sometimes the Bank can lead an initiative, sometimes it should follow and on other occasions be content to leave the task to others better suited to the issue at hand.

Let us think about what we need to begin putting in place some of the items on my list. We need international guidelines and benchmarks to help policymakers go about building the institutions I have suggested. And different institutions need to participate. In some areas, for example, the IMF should take the lead, in others the Bank, in others still, various international bodies. In all cases, however, the decision as to organization should be taken by Governments which must be in the drivers seat. This is a learning process for all of us. In our searches for global best practice and benchmarks so far, the area of macroeconomics got the earliest attention. Now we need to concentrate too on the institutional framework needed to buttress our global world, be this in good, fair labor standards that we help hammer out with the ILO or in solid accounting practices, the soundness of which we can all recognize, from Tokyo to New York, from Harare to La Paz.

As you know, the Bank was asked by the G7 to draft a set of principles of good social policy. We are not reinventing the wheel here. We are mining the very good work done by the UN through its series of broadly consultative conferences and we are looking at development goals and

indicators as established cooperatively between ourselves, the OECD and UN agencies.

We expect existing international agreements on development goals, service provision, social protection, employment and labor standards and social development will provide the underlying basis for our work. Crucial to me in all of this, though, is that we commit ourselves to developing these principles as a result of our dialogue with our client countries. We will have achieved nothing if these principles cannot be embraced by the very countries they are meant to assist. They will also mean nothing if they are seen as a set of new conditions for World Bank credits and loans. Our work so far is acutely aware of the fact that how these principles are used and applied - and by whom - is at least as important as their content. We intend to put a draft to the Development Committee at the Spring meetings but this must be seen as a work in progress if it is to be at all meaningful. I am pleased to tell you that our working group is consulting widely from the UN, G7, and OECD partners to the union movement, client countries and NGOs.

The Bank is also at the table on standards of corporate governance for which we are participating in the OECD Advisory Committee to produce guidelines and a companion paper which focuses on principles and practices in developing countries. You will have all noticed and welcomed the entry into force of the OECD Anti-Bribery Convention just two weeks ago.

A number of groups in which we are involved are looking at financial management issues like disclosure, financial accounting, auditing and reporting. It is critical to develop new standards appropriate for governments and private firms in developing countries as they grapple with globalization and both the opportunities and the shocks that this means.

We have to acknowledge though that no matter how good our benchmarks and no matter how much consensus we have gathered to support them, the long-term task of institution building lies with each and every country. The countries themselves must make the choices. And we will support them. In this area of social and institutional reform and development, we really are at the core of the Banks work. The crises have made us focus on our mandate with even greater urgency but it is going to take solid and effective partnerships with our clients to put these long-term institutions in place. There are really no quick fixes here.

One of the instruments we are developing to help us in our work with partner countries is the Social and Structural Policy Review. This will help us to inventory a countrys "stock" of social and structural assets. It will also guide our Country Assistance Strategy in focusing on exactly where to help a country put its social and structural underpinnings in place. In the wake of crisis we obviously look at corporate and financial restructuring, we look at corporate governance, competition policies, accounting and legal systems.

But all of these worthy and important things will mean little by themselves. If we do not see them as part of the greater whole and if we

do not assist in looking after not just the financial and the structural but the people too. Before the crisis, East Asia had made unrivaled gains in reducing poverty from about six in every 10 people in 1970 to two in 10 in the 1990s. Now, looking at Indonesia, for example, we are expecting poverty rates to slide from 10 percent to 15 percent. This is less than was initially expected but let us not celebrate: 30 million Indonesians will be in poverty. Unemployment is a very serious problem.

We have found too that our help is needed not just among the poor in crisis-hit countries. In Jakarta and Indonesias other urban centers the non-poor are bearing the brunt of it with, for example, teenage girls dropping out of school at rates of up to 20 percent. That is not just a tragedy for today, it is a tragedy for Indonesias future. The Bank is supporting the Governments Stay in School Program with scholarships to some 2.6 million junior secondary students. In countries of crisis we must not only provide safety nets but do everything that we can to defend the gains made in health and education. Our lending to the region has nearly doubled in FY98 to $9 billion and we expect similar numbers in this financial year.

In Brazil, a good example of response to crisis is our part of a $4.2 billion program which focuses directly on social protection and structural elements of social security. It is designed specifically to protect the expenditures on the poor and on those groups made vulnerable by the crisis. These are children in poor families, the retired and disabled, children in primary school, families that need health care and those for whom the crisis has meant unemployment.

While we focus on crisis and while we seek ways to strengthen our systems and soften the blows that will surely fall in the future, we must look too beyond the emerging market countries of our focus and consider those which are not yet part of the global system. Many of these countries are in Africa and our foundations must include them, too, for if not, we will build a lopsided house. The experiences we are gaining now will of course provide valuable lessons for these countries as they integrate into the global economy. But there are many which are not on that threshold yet. We must not allow the global crisis to distract us from addressing the pressing development needs of these countries, both with development assistance and with special policies to tackle particular categories of problems like post-conflict reconstruction and the debt relief program, HIPC.

Partnerships and co-operation between institutions

Whether we are talking about our problems and their fixes on a global scale or whether we address these issues at the level of individual countries - and I think we have to do both as I have repeated here - it is very clear to me that the countries of our world must take the lead. International institutions like the World Bank, the IMF and others represented among us stand best as strong partners, supporters and advisors to the agendas in which countries, alone and collectively, find and take the lead. This seems an obvious insurance for both greater

stability and also more successful development. Each country is responsible for its own decisions.

Having seen the path that contagion can take in the case of the Asian crisis, following last August in Russia and now watching Brazil carefully as we all are, countries have a stake in their neighborssuccesses. And beyond the immediate neighborhood, all countries have a stake in the success of others. East Asia has shown us how events that started in a few emerging market countries can have a truly global impact. This is a new dimension to our world and demonstrates that managing the world economy can no longer be a matter involving only a small number of advanced countries. We have a number of fora in which we work together quite well and often a lot better than the media would have us believe. But we need to make sure that these meeting places of our planning and our work are truly inclusive. Are we satisfied that the emerging market economies have an equal seat at the table? And if not, let us fix that because there cannot be happy outsiders in a global world.

What is most striking to me about the agenda I have laid out - the foundation mix if you like - is how rich a mix it is and how interconnected all the elements of it are. Preventing future crises and handling them when they happen - and they will - involves getting all these elements right, not just some of them. This is not an agenda for the short term either. There are elements that may be put into place faster than others but this is long-term work.

And because it is so long term and because the elements are so interconnected, tackling them requires new kinds of co-operation between institutions and between institutions and those partners on center stage, governments. In all our areas of work we are finding we need to cooperate more closely with other institutions and to explore partnerships with less traditional friends like NGOs. I have given some examples above of our work with the IMF, and BIS, on a range of financial sector issues. I mentioned the OECD where we are exploring corporate governance standards but of course through the DAC our organizations are deeply linked. There is ILO on labor standards, other multilateral development banks and of course the various agencies of the UN. It makes a good headline when we quibble as often we do but it is heartening when you run down the list of our working relations to see just how much partnership there is going on. We need to build confidence in that.

And we need to show this face of partnership to the world. Each of us brings distinct sets of knowledge and experience to the table. You just cannot sensibly get good macroeconomic policy advice from one institution and a good structural plan from another without a lively cross-cutting dialogue. We have all seen the social pain created by policies applied in a vacuum and we cannot afford that anymore. The cost is too high, the human cost and we owe it to our children to tackle the complex issues in new, broad and cooperative ways not envisaged in earlier approaches to financial crisis.