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A Global Perspective: Tackling Three 'Intractable' Challenges Facing the World

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Vielen Dank für Ihre freundliche Begrüßung. I'm grateful to be here at Goethe University Frankfurt at the invitation of the Bundesbank. As a former university president, I always enjoy returning to the open and lively atmosphere of universities – places that are so rich in the currency of ideas.

This university, in particular, is named after a man whose ideas were not only rich, but seemed to know no boundaries. As a lawyer, novelist, poet, government official, scientist and playwright, Johann Wolfgang Von Goethe was devoted to both the intellectual and the practical. He once said, "Knowing is not enough; we must apply. Willing is not enough; we must do."

At the World Bank Group, we share this commitment. Our goal is to apply the world's best ideas, knowledge, and experience in development to accomplish our twin goals: ending extreme poverty by 2030 and boosting shared prosperity. To achieve these objectives, we must raise the incomes of those living on less than $1.25 dollars a day and the poorest 40 percent, as well as deliver important advances in areas like health and education that will give an equal opportunity for all.

Today, I'll address what some may see as three intractable challenges in the world, and how I believe strongly that these challenges can be met. I'll also have some reflections on the G-7 meeting that just ended yesterday not so far from here, and Chancellor Angela Merkel's leadership in bringing together the world's leaders to face head on the toughest issues.

First, some perspective on the World Bank Group's focus – helping the poor and vulnerable in low- and middle-income countries. These developing countries have been critical engines for the global economy. Over the last 10 years, roughly one-third of the world's economic expansion has come from one country – China. Another third – roughly – has come from all the other developing countries combined. And the last third of global growth in the past decade has come from all developed countries, including Germany.

Taken together, the developing countries accounted for 20 percent of the global GDP in 2000. In 2013, their share of global economic activity increased to about 40 percent – a doubling in just 13 years.

Low-, middle-income and emerging countries' share of world exports rose from 25 percent in 2000 to 40 percent in 2013. And for advanced economies like Germany, France, Japan and the United States, the developing countries have become a key source of growth: their share of advanced economies' exports was 20 percent in 2000 and rose to 34 percent in 2013. For Germany, the third largest export market is China, with $83 billion dollars worth of exports sent last year, behind only France and the United States. China has become a bigger export market for Germany than the United Kingdom, the Netherlands, or Italy.

While long term projections involve a measure of speculation, demographic trends and patterns of capital accumulation and productivity growth suggest that developing countries' future role in the global economy will only increase. In 2011, for example, we proposed a 15-year baseline growth scenario that estimated emerging economies would grow at more than twice the average rate of advanced economies – 4.7 percent compared to 2.3 percent.[1] This forecast has been accurate so far for the period between 2011 and 2014, where growth averaged 4.5 percent for developing countries and 2.5 percent for advanced countries.

In the aggregate, this data means that economic growth in developing countries matters not only for poverty reduction within their borders, but is important for growth around the world, especially going forward.

Despite developing countries' positive long-term prospects, economic growth in virtually all-developing regions has slowed, especially among some of the group's largest middle-income countries. There are some notable bright spots, however. India could see accelerated growth, potentially exceeding China's for the first time in 15 years. Excluding

BRIC countries, we expect that the aggregate growth rate of the developing world will be 4.6 percent.

To emerge from this period of relatively slow growth, developing countries will have to manage macroeconomic risks. For example, the outcome of negotiations between Greece and its creditors will likely have spillover effects beyond the borders of the Euro Area. It's difficult to say more about their impact – whether positive or negative – without knowing more about the resolution of on-going discussions. There are four current challenges, however, where the impact is more clear: (1) currency risk; (2) interest rate risk; (3) the decline in global oil prices; and (4) more balanced but slower growth in China.

Substantial divergences in economic cycles and policies, both across regions and within regions, are the drivers of the currency and interest rate risks confronting developing countries.

In the Euro Area, the post-crisis recovery has been slow. The region's aggregate GDP approached its pre-crisis level only recently. While unemployment is declining, at 12.7 percent, it is still 3 percentage points higher than in September 2008. Progress within the Euro Area has also varied: Germany, Spain, France, and the Netherlands have experienced upward trends in growth, while countries like Austria and Finland have seen much weaker outcomes.

By contrast, the recovery in the United States is well advanced. GDP is now almost 9 percent higher than before the crisis; unemployment, at 5.5 percent, is lower than it was prior to the crisis. Moreover, wage inflation shows signs of increasing.

As a result, while the Euro Area and Japan are engaged in unprecedented exercises of quantitative easing, the United States has withdrawn extraordinary measures, and is preparing to tighten its still extremely loose monetary policy stance – albeit cautiously.

The resulting currency movements are affecting growth in developing countries through two principal channels—revaluation effects on external debt stocks and trade. Changing monetary policy is also expected to drive an increase in the US federal funds rate, which may reverse the unprecedented capital flows. Since 2008, portfolio flows to developing countries have more than doubled, and, within portfolio flows, bond flows have been particularly sizable. The average annual issuance over the last five years has been about $250 billion dollars – that's three times higher on average than preceding years. The recent decline in oil prices will have a negative impact on growth for oil exporters. Overall, the

approximately 50 percent decline from a year ago could mean that oil importers will pay up to $750 billion dollars less this year for oil compared to last year.

As for slower growth in China, the country's more balanced economic development, evident in data showing slowing rates of growth, may have repercussions for other developing countries. In particular, China has been an important source of export demand for low-income countries: It is now their largest export destination, whereas in 2000, it accounted for less than half a percent of their exports. China's growth is projected to slow to around 7 percent per year over the next three years, after close to three decades of double digit expansion. Nonetheless, its current economic slowdown seems to be more cyclical than structural. A period of economic overheating tends to be followed by a correction.

These challenges suggest that economic growth in developing countries is likely to be less robust in the short term.

That leads me to what could be called three intractable challenges facing the world – the problems that keep me awake at night. The first is ending extreme poverty in just 15 years. The second is preparing for the next pandemic that could be much more deadly than any we have experienced in recent years. And the third is battling climate change so that we can preserve the planet for future generations.

For each of these problems, I will argue that finance is a key to success. How do you finance development at a level equal to the challenge? Today, there's a much broader and richer set of options for developing countries. First, all countries today know they must be committed to mobilize more domestic resources – largely by increasing tax revenues. Second, countries are keenly working toward stopping huge amounts of illicit financial flows out of their nations – we must work with them to stop these corrupt practices and ensure that this money is captured and invested in improved public services. And third, overseas development assistance will have even more impact in many cases by leveraging private sector investments, especially in low-income countries.

While more funding is critical, applying knowledge also is indispensable. Some say it's impossible to end extreme poverty – especially in just 15 years. But we know it's possible. We know in part because of our past success – in the past 25 years countries have helped one billion people lift themselves out of poverty. We also know it's possible because we have learned from 50 years of experience about what has worked in particular contexts and

what has not.. Our strategy to end extreme poverty, based on the best global knowledge now available, can be summed up in just three words:

Grow. Invest. And insure.

The world economy needs to grow faster, and grow more sustainably. It needs to grow in a way that ensures that the poor receive a greater share of the benefits of that growth. We can reach the end of extreme poverty only if we mark a path toward a more robust and inclusive growth that is unparalleled in modern times. Sustained growth requires macroeconomic stability in the form of low inflation, manageable debt levels and reliable exchange rates. Government policies also must prioritize growth in sectors that increase the incomes of the poor. In most of the developing world, though, efforts to end extreme poverty will require us to focus on boosting agricultural productivity. Despite the massive global migration to urban areas, 70 percent of the world's extreme poor still live in rural villages. They are mostly farmers or work in informal jobs – providing services to rural populations. Helping farmers improve yields requires increasing access to better seeds, water, electricity and markets. According to one study in Bangladesh, six years after constructing 3,000 kilometers of roads to connect communities to markets, household incomes increased by an average of 74 percent.

The second part of the strategy is to invest – and by that, I mean investing in people, especially through education and health. The opportunity to get children off to the right start happens just once. Investments made in children early in life bring far greater returns than those made later on. Poor nutrition and disease can have life-long implications for mental and physical health, educational achievement, and adult earnings. Investments in girls and women are particularly important because they have a multiplier effect on the well-being of the extreme poor. When empowered through education, mothers have healthier children; and, when they have financial resources, they're more likely to invest in the next generation.

The final part of the strategy is to insure. This means that governments must provide social safety nets such as cash transfer programs. Brazil's Bolsa Familia has cut extreme poverty by 28 percent in a decade, for a cost of just 0.5 percent of GDP. These safety nets also mean we must build systems to protect against disasters and the rapid spread of disease.

That's the second thing that keeps me awake at night – something dear to my heart, protecting people from deadly pandemics. Ebola revealed the shortcomings of international and national systems to prevent, detect, and respond to infectious disease outbreaks. We

must never allow this to happen again. The next pandemic could be far deadlier and move much more rapidly than Ebola. The Spanish Flu of 1918 killed an estimated 25 million people in 25 weeks. Bill Gates asked researchers to model the effect of a Spanish Flu-like illness on the modern world, and they predicted a similar disease would kill 33 million people in 250 days. It should come as no surprise, then, that in a global survey of insurance industry executives in 2013, they said their biggest worry was a global pandemic.

The World Bank Group has been working with partners on a new concept that would provide much needed rapid response financing in the face of an outbreak. The idea behind a pandemic emergency facility is to mobilize and leverage public and private sector resources through public funding, and through market and private insurance mechanisms. In the event of an outbreak, countries would receive rapid disbursements of funding, which would, in turn, help contain outbreaks, save lives, and protect economies. We are very grateful to the G-7 leaders, and especially Chancellor Merkel, for giving this concept their endorsement. We expect to present a more fully developed plan to G-20 leaders later this year.

The G7 leaders also issued a powerful statement on climate change – the third seemingly intractable challenge that keeps me awake at night.

Over the past 30 years, natural disasters took over 2.5 million lives, and caused almost $4 trillion dollars in damage. Almost 75 percent of the losses were from extreme weather events. Climate change's rising global temperatures are making these storms, floods and droughts more frequent and intense.

Each year, the damage inflicted on many small-island states and other developing countries often amounts to more than a percentage point of national GDP. And, according to our assessments, the future economic effects of additional warming may be severe. Caribbean countries and the southern Philippines could both lose as much as 50 percent of their fish catch by 2050 to warmer temperatures and ocean acidification. In Brazil, crop yields could decrease by up to 70 percent for soybean and up to 50 percent for wheat. A warmer world will also make the spread of vector borne diseases like malaria accelerate, undermining worker productivity and health.

Putting a robust price on carbon and eliminating fuel subsidies are two critically important steps to mitigating temperature rises and threats of economic harm. It is also critical that

governments deliver on their pledge to ensure advanced economies invest $100 billion dollars a year in developing countries for climate action by 2020.

World leaders will gather in Paris for the climate summit in less than six months from today. G7 leaders yesterday committed themselves to aggressive action to reduce greenhouse gas emissions and to lead the decarbonization of the global economy. We welcome their call for multilateral development banks like ours to use to the fullest extent our balance sheets and capacity to leverage finance for climate action. We also welcome their call for the World Bank Group and partners to establish a platform for strategic dialogue on carbon markets and regulatory instruments.

All of us sitting here today in this great university hall can agree that the world must take substantial action if we are to meet these so-called intractable challenges.

It brings me back to the words of Goethe, whom I'll quote again: He said, "Knowing is not enough; we must apply. Willing is not enough; we must do."

It's not enough to know about and fret over the existence of extreme poverty; we have to end it by taking the vast knowledge that we've accumulated over the years and apply what has been successful. It's not enough to wonder if the world is prepared for the next pandemic; it's up to all of us – whether we are central bankers or university students – to insist that we must not forget that more than 11,000 people died in Guinea, Liberia, and Sierra Leone to a slow-moving epidemic and that we must fully prepare before the next deadly pandemic arrives. And it's not enough to agree with the 97 percent of scientists that man-made emissions are changing our climate patterns to dangerous degrees; it's our shared responsibility to insist, as six major European oil and gas companies did last week, for a price on carbon, and to find a path to end regressive fossil fuel subsidies.

On the day after the G7 leaders' meeting, where Chancellor Merkel urged all of us to take concrete action with targets and deadlines, I feel privileged to be a guest at this great institution, and to invoke the name of Goethe, who today should inspire us to not just sit back and think. We must apply and we must do, for the sake of the poorest, for our children, and for the sake of our humanity.

I'd like to leave you with two other sayings from Goethe. The first one is for students. Goethe said, quote: "Magic is believing in yourself. If you can do that, you can make anything happen."

The second saying is one for the central bankers here in the audience and elsewhere around the world. Goethe said, quote: “When a human awakens to a great dream and throws the full force of his soul over it, all the universe conspires in your favor.”

May all the universe conspire in your favor, and may all of us heed those wise words, and act.

Thank you very much.

[1] Global Development Horizons 2011