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Investing in Sustainable Development: The Value Question, International Corporate Governance Network (ICGN) Conference, Washington, D.C.

Paul Wolfowitz
World Bank President
July 6, 2006

John Wilcox : Hi! I am John Wilcox from TIAA-CREF and also Chair of the ICGN Cross Border Voting Practices Committee, and it is my honor and pleasure to be moderator of the panel on a subject, which I hope will stretch all of you in your thinking about how we define corporate governance. I have had a look at the comments that our featured speaker is going to share with you and I must say that what he has to say is of extreme importance to all of us in this room and expands the concept of corporate governance in ways that I think we have not yet fully confronted at the ICGN. So, I urge you to pay very close attention to what he has to say.

Mr. Wolfowitz is here only for a short time. He will be able to give his comments and then we will have just a couple of questions from our panelists here and from me and then he has to leave. So, after that we will have our comments by our panelists and Q&A at the end. And we will also have some of the questions for you to vote upon as well. With that, it is my pleasure to introduce Paul Wolfowitz, who is the President of The World Bank, a man who needs no introduction in this city or in the world really.

He has been in public service for more than 24 years, has held many very important offices, he knows this city, this government, this country extremely well and many countries of the world where he has served as an ambassador. He is the ideal man to be the President of The World Bank. We at the ICGN are working closely with The World Bank more and more, and so listen closely to what he says and Mr. Wolfowitz, the podium is yours.

Paul Wolfowitz: Thank you John. Probably a mistake ever to correct an introduction, especially a nice one like that, but as I was thinking, it is rather a definition you and I grew up with. And we were just comparing notes. We were Woodrow Wilson Fellows in graduate school in the mid 1960s, which will give you some idea of our age.

You know, working in government, I think I would like to add to those 24 years, the 7 years I spent as Dean of the Johns Hopkins School of International Studies. And I mention that because when I was Dean at SAIS as we called it in the 1990s, we were seeing a very important shift among our students who were very public service oriented, very committed to trying to make a difference in the world. But, by the time I left as Dean, I think roughly half of our students were going into the private sector, where traditionally we had been an institution that trained people for government and Foreign Service.

You know, I mention it because I need to set some important frame to the discussion I would like to have with you this afternoon, because more and more the private sector is the key to achieving public purposes. Through that, I think good corporate governance is a key part of doing it. So, thank you for the introduction, and thank you for giving me a chance to make a comment on it too. Let me thank Anne Simpson, your Executive Director, and the Board of the ICGN for organizing this event and for inviting me to speak here today.

I am pleased to mention that one of our staff, Philip Armstrong, who is the Head of the Global Governance Forum at the International Finance Corporation, is also a Board member of ICGN and an important part of this exchange of ideas. In case you are not familiar with The World Bank Group, we are a group. Sometimes people think it is just The World Bank. The World Bank describes The International

Bank for Reconstruction and Development and The International Development Association, IBRD and IDA, which were the two original elements of The World Bank Group. But 50 years ago, we started a private sector arm, The International Finance Corporation; they have just celebrated their 50th birthday and celebrated 50 billion dollars worth of commitments over those years.

And it went from a little lonely outfit that I think did four transactions in its first year to a very wide and active part of our Bank. They did 6 billion dollars of commitment in this past fiscal year. It's a measure of how the importance of the private sector in the development business has grown over that half a century. Indeed, we meet at a time when private capital flows are becoming perhaps the most powerful force for development. The basic structure of financing for developing countries has been transformed over the last 20 years. For every dollar now in official development assistance to developing countries, there is now more than $4 in cross-border private investment from rich to poor countries. And a significant portion of these flows are coming from institutional investors. In the last 10 years, pension funds, foundations, and endowments have increased the investments in emerging markets to nearly 10% of total assets 10 years ago, to more than 16% today, and that 16% now represents more than one trillion dollars in investments.

There are some similar fascinating trends unfolding in the global economy. Many developing countries are rapidly building up very large foreign reserves; these vast reserves totaling more than 2 trillion dollars today, could help unleash private sector led investment. And it's not only investments from rich countries to poor countries, by the way! IFC claims ownership for inventing the term emerging markets, it's not only from developed countries to developing countries, but what we call South-to-South foreign investment is growing, and growing roughly 5 times faster than investment from North-to-South. While it's still relatively small and I guess it's easier to grow faster when you are small, South-to-South flows have more than tripled from 14 billion dollars in 1995, to 47 billion dollars in 2003.

Let me give you some other staggering statistics and these are not such happy ones. Today there are more than 1 billion people worldwide, living on less than a dollar a day, less than $365 a year. It's hard to imagine doing that in any country in the world, that is our definition of extreme poverty. Most of those people live in South Asia, and in Sub-Saharan Africa.

There are another 2.6 billion people around the world or nearly half the population of this planet who live on less than $2 a day, the official definition of poverty. For development institution like The World Bank Group, the surge in capital flows represents both an opportunity, and a challenge, in our efforts to help developing countries achieve growth, and combat poverty and give the poor people of the world, those chances in life, which everyone in this room is able to take for granted. It's true that vast amounts of international capital are potentially available to help developing countries grow and create jobs and provide opportunities for their people to escape poverty, but to access that capital, to attract investors, developing countries especially, the poorest ones, need to improve their investment climates and ensure that these resources, private and public, are managed in a transparent way. That's absolutely vital for harnessing the entrepreneurial energy of the private sector. Today the private sector accounts for 90% of jobs in the developing world, and ultimately it will be these jobs that offer the most promising path out of poverty. So, I believe the challenge of corporate governance, which you are focusing on at this conference, is really about the broader challenge of creating an investment climate in developing countries in which the private sector can thrive.

Corporate governance is one essential component of building a healthy investment climate and boosting investor confidence. We know that companies with well-defined shareholder rights, solid control environment, high levels of transparency, and disclosure, and an empowered board of directors, have no trouble attracting investors and lenders.

Studies including some of that we've done show over and over again that world-governed companies in fact perform better. One study of S &P500 firms over two year period show that companies with either strong or improving corporate governance, perform better by 19% than those of poor or deteriorating corporate governance. In Korea, well-governed firms trade at a premium of a 160% relative to poorly

governed ones. So, it should come as no surprise that when institutional investors want to invest in developing countries or lets call them the emerging markets; they will turn to well governed companies. A World Bank study shows that US mutual funds were more likely to invest in emerging markets with strong shareholder rights, legal frameworks and accounting policies.

Within developing countries, governments are also starting to pay more attention to corporate governance. To attract domestic and International investors, India unveiled a new set of major corporate governance reforms early this year for its public companies. And in Mexico, a new law introduced a series of reforms to raise corporate governance standards and to improve investor protection.

Enforcing strong corporate governance standards not only improves the company's performance, it also helps guide against corruption by encouraging greater transparency, disclosure of information and independent over sight. When corporate governance standards are weak or absent, that creates an opportunity for abuse and for the misuse of power in corporate practices. Corruption is one of the biggest obstacles to development today and it can undermine private sector growth, especially in the poorest countries. It drains resources and discourages investment; it benefits the privileged and robs the poor. Corruption though, isn't just a disease of developing countries. Stop and think about it, in every corrupt transaction, there are at least two parties involved - a bribe giver and a bribe taker.

Where most multinationals and their affiliates bring good corporate practice within to developing countries, there certainly are cases where they have tried to bribe governments for large procurement contracts or for influence on policy making. We must not let a few bad players undermine the high corporate standards set by most firms operating in developing countries. And we must also recognize that taking responsibility for cleaning up our own laundry if you want to use that expression, empowers leaders and there are a growing number of leaders in developing countries to take on the issue themselves. My visit to South Africa a year ago; and I gather you are going to be holding your meeting in South Africa next year; I arrived two days after President Mbeki had fired his Deputy President and not because the Deputy President took a bribe but because the deputy's financial advisor took a bribe and Mbeki's view was it's not purely a legal matter, it's a matter of political responsibility and without getting too deeply into the politics of another country, it seems to me that principle is one that should be applauded.

But we know that the bribe giver in that case was a company from a developed country and as far as I know, that company has paid no price, no penalty for giving that bribe -- that's a situation that should change. The World Bank group, we've made a strong commitment to battling corruption and we recognize that better corporate governance can be a very effective tool for that agenda. It protects investors against the abuse of corporate assets for personal gain through better internal controls, through disclosure of rules and through strong codes and ethics.

But it will not rule out corruption completely, but it can act as an aid to what you might call, an immune boosting vitamin, to fight that disease. Many developing countries are taking steps to raise their corporate governance standards, but they face many challenges that are rooted in the broader governance environment.

Planning any sort of reforms, including corporate governance reforms is not easy, unless you have transparent and accountable public institutions, an independent judiciary or a government that enforces contracts. I think the evidence shows too that a free press and a vibrant civil society play an important role in increasing the public scrutiny of firms.

Investors need to know that they have access to information, that their rights are protected and that their investments will reap reasonable returns. Each year the World Bank Group issues a report called the Doing Business Report. It identifies regulatory obstacles that investors face in some 155 countries around that world and ranks them in 10 different categories according to the ease of doing business. This is not a

guide for foreign investors, but it is a guide for governments in our partner countries to identify areas for reform.

Few months back, I met with the Finance Minister in Mexico and my staff warned me he may complain about the fact that Mexico ranked 73rd out of 155 countries in the Doing

Business Report. Instead he said, “I want to thank you, I want to thank you for this report because I was able to take it to our Congress and by showing our Congress members where we ranked, we were able to get significant legislative reform passed by showing how we compare to other countries.” That’s what the Doing Business Report is supposed to do and it by the way gives credit to those countries not just for where they rank, but the improvements they’ve made over the course of the last year.

Rwanda, an African country that is still, I think, in the bottom half has nevertheless for 2 years in a row been one of the top 10 reformers. That means they’ll be in the upper half before much longer. And by the way, I think it’s perhaps worth pointing out that Rwanda is the top economic performer in Sub-Saharan Africa in the last 10 years. It amazed me when I visited last year because in case you don’t remember the history -- in 1994, 950,000 people were slaughtered in one of the worst genocides in modern history in that country, but its now a country that’s a peaceful country with sensible economic policies that are getting better and a country, which I guess as a result has produced 10% annual growth for the last 10 years. Some people will say well that’s easy if you start from this lower base as Rwanda did, but I would say it may be even harder when you start at a low base.

There are African countries that are starting to turn the corner and I think it can make a huge difference for the future of the world of our children and our grandchildren, if we can help make that come true.

Within the basket of indicators that we look at in the Doing Business Report, one clearly that demands concern is corporate governance and that’s investor protection against self-dealing. Let me briefly share with you some of the findings. On an average poor countries do not have adequate regulation to prevent self-dealing, especially in disclosure of information.

Up to 10 countries require no public disclosure what so ever on transactions in which a shareholder stands to gain personally. In fact the lack of information on related party transactions was cited as the major obstacle for protecting investors, but several developing countries protect investors well; Malaysia, South Africa and Mauritius rank among the top 10 countries of all in the world for investor protection. The need to reform everywhere is increasing disclosure, but it is also one of the ones that is most needed.

Today, a number of developing countries are taking significant steps to reform. For example, for listed companies, Thailand now requires both Directors and shareholders without personal interest in the business deal to approve any related party transaction.

In Turkey, companies are required to post information on ownership, board minutes and transactions on their website. And Pakistan introduced tough penalties against self-dealing with unlimited fines and up to 14 years in jail.

The challenge for Pakistan now would be to have a judiciary that is willing to put powerful people behind bars. More and more countries are recognizing the importance of good corporate governance and the vital role that it plays in fostering development and more of our partner countries are turning to us for help and strengthening their corporate governance practices.

At the World Bank group, we’re working closely with our public sectors and private sectors partners to cultivate better corporate governance practices along three levels At the global level, we’ve partnered with the OECD and you’ll be hearing from Secretary General Angel Gurria, I believe tomorrow to establish a global corporate governance forum to bring together reformers and corporate governance champions

and to share knowledge on effective corporate governance practices in developing an transitioned economies.

The forum produced the tool kit, which helped about a dozen countries develop a national code of good corporate governance practice and 50 world-class experts. Many of them I think they are here today, volunteer and provide valuable advice to developing countries.

I'd like to thank all of you who do participate for your dedication and your efforts in making this forum a useful channel for dialogue in improving corporate governance in the developing world. At the national level, we have conducted corporate governance assessments in some 50 countries through diagnostic evaluations known - we like acronyms - as ROSC - which stands for Reports on the Observance of Standards and Codes but they are not just reports, they are action agendas for reform. This represents the most significant body of knowledge in the world in this field and at the company level, our private sector arm, the IFC works with firms from more than 80 countries on Board practices, shareholder rights, internal control environment, transparency, and disclosure. We evaluate the corporate governance risks and opportunities of roughly 300 companies each year. In Brazil and Korea, the IFC has created a special corporate governance fund that invests in companies and strengthens their corporate governance so they can attract greater investment premiums. Time and time again, we have seen the value of proposition for corporate governance reforms demonstrated in our own operations.

Not so long ago, the IFC invested in a Romanian Bank, focusing its value addition solely on corporate governance. In less than two years, IFC sold its share of the Bank for nine times our original investment. So, we are convinced that the value proposition of corporate governance reform is not only strong, it is still growing and that it why we are looking to broaden our own corporate governance agenda. The Doing Business Report, I just mentioned for example has proven extremely valuable in helping to jump-start investment climate reforms.

It not only provides new competitive data, it shows how much more we can be doing by improving the transparency of transactions, director liability for self-dealing and share

holders ability to sue for misconduct. Regulators in developing countries are looking for more help in addressing the corporate governance in their financial sectors; among banks, insurance companies, pension funds and collective investment vehicles such as mutual funds.

We are seeing more and more demand to work on corporate government issues associated with state owned enterprises and natural resource companies which face politically difficult governance challenges.

Looking forward, the increasing number of smaller, hybrid enterprises such as public private partnerships and social entrepreneurships, as well as NGO's will likely generate greater demand for corporate governance expertise. Taking organizations like the Grameen Bank in Bangladesh, a micro-finance, non-profit, non-governmental organization, with a balance sheet of I believe of several billion dollars, it's technically a non-profit, but its thousands of shareholders generated an income of more than 50 million dollars last year. It is an area we cannot ignore because so many of the corporate governance principles apply to these non-profits as well.

We are seeing the private sectors in developing countries focus their attention on stronger corporate governance and they are trying to figure out how they can do that best. The amount of interest is really quite exciting. Our goal is to capture this energetic spirit to build a vibrant global investment climate where businesses can grow and generate jobs. Our goal is to increase development impact. But ultimately, it's going to be the power of markets and capital that will be stronger than any financing from a multi-lateral developing institution even one as big as ours. So we are constantly looking for ways to partner with institutional investors and then when that works, with experts, to strengthen our advocacy work.

Our hope is that institutional investors both within the developed world and in the developing world can play an even more active role in shaping the corporate governance landscape. We need foreign shareholders to be just as engaged in developing countries as they are elsewhere and to work in partnership with reforming countries and with companies in emerging markets. The so-called emerging champion firms in the developing countries that are seeking to become world-class companies should also become part of the global voice for corporate governance reform.

For example, 13 companies that are members of the Companies Circle in Latin America, have signed on to a Progressive Governance Agenda supported by the IFC and the OECD. These companies offer valuable and practical input to policy makers and promote good corporate governance practices among firms in their regions. I don't know if anyone in this room thinks so, but I am sure there are a lot of people, who have read articles about Sarbanes-Oxley and think corporate governance, that's an awfully dull and dry subject. I've been on a couple of Corporate Boards and Mutual Fund Boards and I know at times you can start to feel like you're going through a long checklist of procedures that we have go through, but this is about a lot more than just procedures, it's not just a box checking exercise.

In fact, our corporate governance unit within the bank group has a model. It's - we're a united front against window dressing. But it's about a lot more and it's bigger even than getting the corporate governance piece right.

I would ask you to think about it this way - the last 25 years have been probably the most successful quarter century in the global fight against poverty and you may be sitting there and thinking, well, that's an easy record to beat. Most of human history has been not a fight against poverty with a fairly steady growth in poverty but that has turned around. In the last quarter century, some 400 million people have been able to escape extreme poverty. Roughly three quarters of those in China but there's another 100 million in India and other successful developing countries. Most of that success can be attributed to reforms that have made it possible for private businesses to grow and in growing to create jobs and not just profits for rich people but jobs and better lives for people.

Hopefully the next 25 years will beat or exceed that record. We can't afford to have a world in which 1.2 billion people are left behind in extreme poverty. Getting better corporate governance is one way to keep that from happening. Thank you very much.