Global Finance and Global Players: Getting the International System Back on Track

Remarks of
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at the
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Let me try and shift gears for you a little bit from yesterday. I understand that President Santer talked to you about the euro; that you had some impact of China yesterday; that there was discussion of Japan, and I would like to introduce you to a group of people who were mentioned, perhaps, less yesterday than they might be within the context of the world financial situation.

There are 5.6 billion people in the world, of whom 900 million live in the developed countries. But there are 4.7 billion people who live in the so-called developing world, and that is the world in which the Bank is involved and in which much of the discussion is centering in relation to the so-called international financial crisis which is being faced today.

In fact, Thailand, Korea and Indonesia, in varying ways, have been in that developing world. Korea almost emerged from it to become the 11th largest economy in the world but is now back again as a result of changes in parities to become a country in need of additional assistance to try to get it back on its feet to become, again, the 11th largest industrial country in the world.

And much discussion has taken place during these past days and months since last July, when we first saw evidence of the Thai situation reveal the fragility of the international situation.

We have heard discussion about the lack of capacity of the international community to deal with this situation; talks in recent weeks about a new architecture for the international financial system; the role of the International Monetary Fund, a subject which is, of course, very important in this city at this time. And I hope there are staffers and members of Congress here who will understand that it is essential to give additional funding to the International Monetary Fund, or we won't be able to meet here next year. The International Monetary Fund has come in for a lot of criticism but is, I believe, is due a lot of praise for being a stable and important force in this particular moment in history when the international financial system is being challenged.

You don't hear a lot about the World Bank, but you do hear that things are not going too well, that things need to be changed.

Well, let me remind you, first of all, that crises in the international financial system have not just started in this last year. We have had crises in international financial systems going back before the beginning of this century. In fact, I asked my colleagues to check my recollection as to dates and discovered that the first wave of international financial flows was from the United Kingdom to this country and to my own country of origin, Australia, and to Argentina and Brazil from 1870 to 1914. It was a singular source of funding by rich people and bankers who put money out there, and you know what happened.
The second wave came in the 1920s when, at that time, New York was already the center of this financial market, and money in bonds and in equities went to Latin America and Southern and Eastern Europe, and that lasted until the debt crisis, and there was a debt crisis, I remind you, in the 1930s, of some substantial portions. And at that time, countries started to turn inwards. There was a reaction by groups such as this: ‘Let's not get into international investing; It doesn't work. The risks are too high.’

And so, for a period of almost 40 years, the flow of international investing didn't recommence. We went through a war, but then we had the creation of the eurodollar markets and more liquidity in the international system, the creation of the Marshall Plan, which was essentially 1.5 percent of U.S. GDP flowing to reestablish Europe and, some 53 years ago, the creation of the so-called Bretton Woods twins, the International Monetary Fund and the World Bank, first to stabilize that situation and then, to move into the area of development.

And then, there was a third wave in the seventies. When we had the oil price rise, there were a lot of petrodollars running around. The banks started to do significant lending. There was a huge movement in international flows that you will remember, and a huge expansion of the euromarket. Practices increased to a point that in 1982, we were faced first with the Mexican crisis that many of you will remember, with the attendant result in 40 other countries, another crisis that we got ourselves into for a different series of reasons than the previous crises. Then came the new expansion that we are part of now in international investing. And now we have come up again with another set of problems in Southeast Asia, and we are wondering, what is the cause of all of these problems?

Well, when you stand back and look at it, there have been these waves, and there was no doubt that the pace of the movement of funding around the globe, the movement of information, and the pace of investing has clearly developed in a way that the domestic markets that we had in the late 1800s have now become global marketplaces, global marketplaces that are characterized by very quick movements of funds, by green screens, in which everybody has the necessary information to trade huge volumes of short-term flows. But also, in recent years, we have seen a major change in terms of the investment patterns in the countries of these 4.7 billion people.

These 4.7 billion people, the so-called developing world, is now 18 percent of the world's GDP. It is the fastest growing area of the world. It is the fastest growing area of OECD exports. It's 4 million jobs in our country alone and growing. And all of a sudden, we are starting to take an interest: an interest in these countries as a market and an interest in these countries as competitors to ourselves.
And the changes in the last 10 years have really been dramatic. Ten years ago, it was the international institutions like the World Bank, the IMF, and the bilateral institutions, which were providing the essential part of the funding to these countries. In fact, development assistance was running at a net flow of $60 billion a year, and private-sector funding was under $20 billion. Today, 7 years later, that has been reversed to a dramatic degree. $44 billion, roughly, comes now from the official institutions, and $260 billion comes from the private sector.

This change from being less than half to being five or six times of the flows of funds is the single most dramatic change that has happened in the structure of our international marketplace for decades. And so, the players are changing. The players are changing from the international institutions to private-sector institutions, and about $100 billion of that or a little more is from direct investment, another $100 billion from banks in terms of lending and $30- or $40 billion in terms of equity.

But 75 percent of it is going to 12 countries. So, it is not evenly distributed. 140 countries get less than 5 percent. Africa, including South Africa, gets less than 3 percent, and if you take out South Africa, Sub-Saharan Africa gets a little over 1 percent.

So, you are finding in this world—this world of 4.7 billion people that is growing at a rate of 80 to 90 million people a year so that, in another 30 years, that same developing world is not going to be 18 percent of the world's GDP but between 30 and 40 percent of the world's GDP—you have a new world, which we are seeking to face, which is a different world than just Europe and the United States but which is a world that is integrated and that is affecting us in every way, from environment to crime to migration to health to pressure on food and water.

These are all things that you have to understand before you start to look at the issues of the functioning of the international financial system, and you have to understand that the international financial system today has to cope with issues that are different from the past issues: different in scale and different in complexity.

And you're not going to solve the issues of stability in that marketplace by either singular agreements with the BIS as to banking supervision and banking limits or by international fiats in terms of how we should conduct ourselves. The debate that you have been hearing is about the inadequacy of the international financial system, and there is no doubt that we need to have greater supervision, which the International Monetary Fund can give, greater monitoring, greater flow of information.
A debate which you will be hearing later from Jeff Sachs and others about flows of funds, whether we should have bumps in the road to ensure that we don't have these quick flows in and quick flows out, which exacerbate situations; levels of prudence that should be applied in international markets; accounting regulations to ensure that we have similarity of accounting principles, these are all the issues that we heard debated in the Interim and the Development Committee recently about restructuring of the international financial system.

But let me remind you that behind these important technical and economic framework aspects that need to be established—including the role of the Fund, the role of the World Bank, the role of multilateral institutions, the role of the BIS—there is still the issue of good sense and governance, both in those who are investing and in the countries themselves.

No one forced these banks, which are fully regulated in the United States and in Europe, to lend excessive amounts of money to Thailand, Korea, and Indonesia. They are regulated. They are subject to the BIS. They are subject to prudential rules. And yet, Indonesia, Korea, and Thailand were able to borrow without adequate information and without adequate disclosure very substantial amounts of money from people like us, if you like—not because we're not regulated, not because there isn't a Federal Reserve or a Bank of England, but because some dumb judgments were made and because people were caught up in the enthusiasm and didn't want to be left out.

And they loaned without adequate information. They loaned to companies on the basis of name. They didn't have international accounting principles; they didn't have consolidated accounts. We were lending into Thailand at a time when Thailand was subject to a huge real estate boom; when underlying principles of borrowing long-term and lending short were being ignored; when borrowing dollars and lending in local currency, unhedged, was the name of the game.

So, I simply point out to you that it is not just the international financial system and the structuring of the World Bank and the International Monetary Fund which is at the core of today's problems. There are some dumb judgments. There is lack of proper prudence. There is a herd instinct which has happened in four different ways and no doubt will happen a fifth time and a sixth time and a seventh time. So, don't just think in terms of structure.

And the second point I'd like to make with you is that when you get to the countries themselves -- and you'll hear more about this in Thailand, Korea, and
Indonesia -- is that it is not by administrative fiat that you are going to solve these problems. The issue of disclosure in Thailand, Korea, and Indonesia and the willingness to make known your wealth and be supervised is something that has not been a part of that social system.

I have been going to Asia since 1950. I know that part of the world very well. And it has not been part of the tradition to tell you about your own finances. It has not been a part of the tradition to accede to supervision or regulatory control. It has not parallel to what happens in the United States or the United Kingdom or the European system. And yet, now, each of these countries under the agreements which they have reached are saying we will have disclosure; we will have supervision; we will have internationally accepted accounting principles; we will have bankruptcy laws which work; we will have court systems which work.

Let me just tell you that the implications of this are not an instant fix. You have to train supervisors; you have to train people in the banks and the corporations who know how to be supervised. And you have to make sure that the culture will continue after the crisis is over, because the old pattern was a different pattern than the one that is being brought in, and that is just at the level of supervision.

What we are looking at in these countries is not just, again, at the level of monitoring and control. Yes, we at the World Bank are trying to help the countries strengthen financial systems. Yes, we are trying to make the securities markets work better. Yes, we are trying to get better accounting systems. We are trying to put in bankruptcy laws. We are trying to address the questions of judicial systems.

That is what you read about. But what you don't read about are the social issues. You don't read that 13 million are now unemployed in Indonesia. You don't read that Indonesia managed to bring the level of poverty from 60 percent to 11 percent, and you have a chance of it growing back to 20 percent before too long, which is another 18 million people in poverty.

You don't read about the inequities. You don't read about the social issues. Now, we are starting to read about unrest in Indonesia. We were the first people who went into Thailand and looked at the social implications of that crisis. The things that you do not read about but which are going to determine stability in these countries is not just a change in regulation; it is an approach to the social sector, where you have to deal with poverty, with unemployment, with social issues, which are at the center of financial stability and a return of confidence.

These are issues that we don't adequately talk about. We don't talk about it in Asia, and we don't adequately talk about it in other areas of the world where we
have problems. Even in Russia, the issues of the social underpinning is the issue
of the soft underbelly of the transition economies. We do not give enough
attention to it, and these are the issues of equity, of social justice, of
unemployment, of poverty, which need to be addressed when you're thinking
about stability of financial systems.

We do not give it enough attention, and I would just give it a pitch because I run
the World Bank.

I was given 15 minutes to try and cover the world. I know I haven't, but I'm
happy to answer questions. Thank you very much.

JAMES D. WOLFENSOHN, the World Bank Group’s ninth President since 1946,
established his career as an international investment banker with a parallel
involvement in development issues and the global environment. Since becoming
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experience of the challenges facing the World Bank, and its 181 member
countries, in the post-cold war era. In 1996, together with the IMF, Mr.
Wolfensohn initiated the multilateral debt relief proposal for the heavily
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Bank, Mr. Wolfensohn was an international investment banker on Wall Street.
His last position was as president and chief executive officer of James D.
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Wolfensohn held a series of senior positions in finance. He was executive partner
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