The End of the Third World?
Modernizing Multilateralism for a Multipolar World

Robert B. Zoellick

President
The World Bank Group

Woodrow Wilson Center for International Scholars

April 14, 2010

<u>As prepared for delivery – embargoed for 10 a.m. Eastern time (1500 GMT) on Wednesday April 14, 2010</u>

Introduction: The End of the Third World?

For decades, students of security and international politics have debated the emergence of a multipolar system. It's time we recognize the new economic parallel.

If 1989 saw the end of the "Second World" with Communism's demise, then 2009 saw the end of what was known as the "Third World": We are now in a new, fast-evolving multipolar world economy – in which some developing countries are emerging as economic powers; others are moving towards becoming additional poles of growth; and some are struggling to attain their potential within this new system – where North and South, East and West, are now points on a compass, not economic destinies.

Poverty remains and must be addressed. Failed states remain and must be addressed. Global challenges are intensifying and must be addressed. But the manner in which we must address these issues is shifting. The outdated categorizations of First and Third Worlds, donor and supplicant, leader and led, no longer fit.

The implications are profound: For multilateralism, for global cooperative action, for power relationships, for development, and for international institutions.

Multilateralism Matters

The global economic crisis has shown that multilateralism matters. Staring into the abyss, countries pulled together to save the global economy. The modern G-20 was borne out of crisis. It showed its potential by quickly acting to shore up confidence. The question now is whether this was an aberration, a blip?

Will historians look back on 2009 and see it as a singular case of international cooperation or the start of something new? Some now view Woodrow Wilson's attempt to create a new international system after World War One as an opportunity lost that left the world adrift amidst dangers. Will this be a similar moment?

The danger now is that as the fear of the crisis recedes, the willingness to cooperate will too. Already we feel gravitational forces pulling a world of nation-states back to the pursuit of narrower interests.

This would be a mistake. Economic and political tectonic plates are shifting. We can shift with them, or we can continue to see a new world through the prism of the old. We must recognize new realities. And act on them.

What is Different? New Sources of Demand

What is different?

The developing world was not the cause of the crisis, but it could be an important part of the solution. Our world will look very different in 10 years, with demand coming not just from the United States but from around the globe.

Already we see the shifts. Asia's share of the global economy in purchasing power parity terms has risen steadily from 7 percent in 1980 to 21 percent in 2008. Asia's stock markets now account for 32 percent of global market capitalization, ahead of the United States at 30 percent and Europe at 25 percent. Last year, China overtook Germany to become the world's biggest exporter. It also overtook the United States to become the world's largest market for cars.

Import numbers tell a revealing story: the developing world is becoming a driver of the global economy. Much of the recovery in world trade has been due to strong demand for imports among developing countries. Developing country imports are already 2 percent higher than their pre-crisis peak in April 2008. In contrast, the imports of high-income countries are still 19 percent below that earlier high. Even though developing world imports are about half of the imports of high-income countries, they are growing at a much faster rate. As a result, they accounted for more than half of the increase in world import demand since 2000.

New Poles of Growth

The world economy is rebalancing. Some of this is new. Some represents a restoration. According to Angus Maddison, Asia accounted for over half of world output for 18 of the last 20 centuries. We are witnessing a move towards multiple poles of growth as middle classes grow in developing countries, billions of people join the world economy, and new patterns of integration combine regional intensification with global openness.

This change is not just about China or India. The developing world's share of global GDP in purchasing power parity terms has increased from 33.7 percent in 1980 to 43.4 percent in 2010. Developing countries are likely to show robust growth rates over the next five years and beyond. Sub-Saharan Africa could grow by an average of over 6 percent to 2015 while South Asia, where half the world's poor live, could grow by as much as 7 percent a year over the same period.

Southeast Asia has become a middle income region of almost 600 million people, with growing ties to India and China, deepening ties with Japan, Korea, and Australia, and continuing links through global sourcing to North America and Europe.

The Middle East region is an important source of capital for the rest of the world, and increasingly a business-service hub between Asia – East and South – and Euro-Africa. Gross official reserves of the Gulf Cooperation Council countries were over $500 billion at the end of 2008, with estimates of sovereign wealth fund assets of as much as $1 trillion. If the Maghreb can move beyond historical fault lines, it can be part of a Euro-Med integration linked to both the Mideast and Africa.

In the Latin American and Caribbean region, 60 million people were lifted from poverty between 2002-2008 and a growing middle class boosted import volumes at an annual rate of 15 percent.

Africa as a Potential Pole of Growth

Tectonic plates could shift further. Africa missed out on the manufacturing revolution that lifted East Asia's economies out of poverty and into prosperity. But Africa no longer needs to be left behind.

Today, in many African countries even small, inexpensive items, such as soap or slippers, or basic tools or consumer goods, are imported. If Africans remove the barriers to producing these goods domestically and to local entrepreneurship, while creating conditions for outside investors to shift production to Africa, then African development could begin to look very different. Unlike past failed efforts to favor import-substitution interests behind protectionism, this approach can capture benefits from regional integration within global markets.

What would it take? As a first step, the 80 percent of Africans earning $2 a day or less need to earn enough income so they will be able to buy basic consumer goods. Agriculture is the main source of jobs and an early opportunity to boost productivity and income. To do so, investment is needed all across the agricultural value chain: property rights; seeds; irrigation; fertilizer; finance; basic technologies; storage and getting product to market. Since about two-thirds of African farmers are women, we need to help them get legal and property rights, and access to services.

With slightly higher incomes and living standards, local manufacturers can target or customize for the local market, and eventually for export.

To grow further, Africans need the things that Europe and Japan needed after World War Two: infrastructure; energy; integrated markets linked to a global economy; and the conditions for a vibrant private sector. These public goods will foster much more than local manufacturing.

Today's shifts open new opportunities. As the global crisis hit, some Chinese recognized that it was time to move beyond toys and footwear; China could move up the value chain, increase wages and consumption, and expand its "harmonious society." Chinese companies, in turn, could move lower value-added manufacturing elsewhere, including to Africa, following China's resource developers and construction enterprises.

Chinese companies can be encouraged to relocate manufacturing for both domestic production and export. These manufacturers bring know-how, machinery, as well as access to marketing and distribution networks. The World Bank is working with Africans and Chinese to create industrial zones.

Early investors are sensing the promise in Africa and are not dissuaded by the risks – after Lehman Brothers and Greece, investors know developed markets can be risky, too.

Changes in government policies can create opportunities for private sector growth, which in turn offers services to other entrepreneurs. In the ten years to 2008, the private sector has invested more than $60 billion in information and communications technology in Africa; 65 percent of Africans are now within reach of wireless voice services, and there are 400 million mobile phones in use in Africa.

IFC, the World Bank Group's private sector arm, is helping catalyze this business revolution. A new IFC equity fund has attracted $800 million from sovereign wealth and pension funds to invest in companies in Africa, Latin America and the Caribbean.

Economic Shifts Mean Potential Power Shifts

Increased income and growth in the developing world means increasing influence. The old world of fireside chats among G-7 leaders is gone. Today's discussion requires a big table to accommodate the key participants, and developing countries must have seats at it.

Last year's G-20 Summit at Pittsburgh recognized that change. But it will take more than words on paper. Woodrow Wilson's words on paper did not realize their lofty ideals. Arranging a new sharing of responsibilities among mutual stakeholders in international systems will not be easy. But happen it must. The failure of 1919 led to countries that could not cooperate in 1929 and the start of a new war in Europe in 1939.

Today, we already see the strains. The Doha World Trade Organization round and the climate change talks in Copenhagen revealed how hard it will be to share mutual benefits and responsibilities between developed and developing countries. Those debates also exposed the diversity of challenges faced by different developing countries.

If it is no longer possible to solve big international issues without developing and transition country involvement, it is also no longer possible to presume that their biggest members, the so-called BRICs -- Brazil, Russia, India and China -- will represent all.

And this will be the case for a host of other looming challenges: water; diseases; migration; demographics; and fragile and post-conflict states.

In discovering a new forum in the G-20, we must be careful not to impose a new, inflexible hierarchy on the world. Instead, the G-20 should operate as a "Steering Group" across a network of countries and international institutions. It should recognize the interconnections among issues and foster points of mutual interest. This system cannot be hierarchical, and it should not be bureaucratic. It also must prove effective by getting things done.

The Danger of Geo-Politics as Usual

The danger of the political gravity dragging countries back to the pursuit of narrow interests is that we address this changing world through the prism of the old G-7; developed country interests, even if well-intentioned, cannot represent the perspective of the emerging economies. We cannot afford geo-politics as usual.

Nor can we retreat into an "Old Multilateralism" –a 19th Century Metternichian Congress of Vienna solution–that seeks to resist change. A "New Geopolitics of Multipolar Economy" needs to share responsibility while recognizing different perspectives and circumstances, so as to build more mutual interests.

Financial Reform

Take financial reform: the world has paid a big price for the breakdowns of the global financial system in lost jobs and ruined lives.

Of course we need better financial regulation, with stronger capital, liquidity, and supervisory standards. A new supervisory framework should consider systemic risks, reverse regulation that reinforces the ups and downs of cycles, consolidates supervision to avoid gaps, and considers inflation in asset prices as well as in goods and services.

But beware unintended consequences. We should not compound costs by encouraging financial protectionism or unfairly constraining financial services to the poor. Regulations agreed in Brussels, London, Paris or Washington might work for big banks in the developed world. But what about the smaller ones, whether in developed or developing countries?

These regulations could choke off the financial sector, innovation, and risk management in developing countries. They could make it harder to invest across national borders.

“Lend local” requirements could have the same effects as “buy local.” “Local physical presence” requirements could thwart services just as they can choke trade. “Local liquidity” requirements could fragment global liquidity management and add huge costs without strengthening safety.

Derivatives now have a bad name. This is understandable when one remembers AIG. But derivatives are used by farmers in the American Midwest to protect against volatility in grain prices. Mexico used energy options to lock in a price for the oil that pays for much of the government’s budget.

The World Bank pioneered currency swaps, and uses swaps to protect against foreign exchange and interest rate risk. Our loans offer hedging opportunities to protect borrowers from foreign exchange or interest rate risk and even other risks such as droughts and catastrophes. By helping to develop local currency borrowing, linked to global markets, we helped shelter developing countries from the financial tidal waves of the recent crisis.

Financial innovation, when used and supervised prudently, has brought efficiency gains and protected against risk: the World Bank has pioneered livestock insurance for Mongolian herders; a Malawi weather derivative against drought; and the Caribbean catastrophe insurance pool. The latter gave Haiti an immediate $8 million in January when its earthquake struck – faster money than from any other outside source.

As former President Zedillo of Mexico has cautioned, the problem for poor people is not too many markets, but too few: We need markets for microfinance or small and medium-sized enterprises, especially if run by women; markets to move, store, and sell goods; markets to save, insure, and invest.

Wall Street has exposed the dangers of financial innovation, and we need to take heed and serious actions. But development has shown its benefits. A G-7 populist prism can undercut opportunities for billions.

Climate Change

Take climate change: The danger is that we take a rule book from developed countries to impose a one-size-fits-all model on developing countries. And they will say no.

Climate change policy can be linked to development and win support from developing countries for low carbon growth – but not if it is imposed as a straitjacket.

This is not about lack of commitment to a greener future. People in developing countries want a clean environment, too.

Developing countries need support and finance to invest in cleaner growth paths. 1.6 billion people lack access to electricity. The challenge is to support transitions to cleaner energy without sacrificing access, productivity, and growth that can pull hundreds of millions out of poverty.

Avoiding geo-politics as usual means looking at issues differently. We need to move away from the binary choice of either power or environment. We need to pursue policies that reflect the price of carbon, increase energy efficiency, develop clean energy technologies with applications in poorer countries, promote off-grid solar, innovate with geothermal, and secure win-win benefits from forest and land use policies. In the process, we can create jobs and strengthen energy security.

The developed world has prospered through hydro electricity from dams. Some do not think the developing world should have the same access to the power sources used by developed economies. For them, thinking this is as easy as flicking a switch and letting the lights burn in an empty room.

While we must take care of the environment, we cannot consign African children to homework by candlelight or deny African workers manufacturing jobs. The old developed country prism is the surest way to lose developing country support for global environment goals.

Managing for Crisis Response

Take crisis response: in a world in transition, the danger is that developed countries focus on summits for financial systems, or concentrate on the mismanagement of developed countries such as Greece.

Developing countries need summits for the poor. One lesson from this crisis is that effective safety nets prevented the loss of a generation – unlike the Asian crisis in the 1990s.

Hearing the developing country perspective is no longer just a matter of charity or solidarity: It is self-interest. These developing countries are now sources of growth and importers of capital goods and developed countries' services.

Developing countries do not just want to discuss high debt in developed countries; they want to focus on productive investments in infrastructure and early childhood development. They want to free markets to create jobs, higher productivity, and growth. Many are exploring how to use the innovation and efficiency of private markets to help provide and maintain public sector infrastructure and services.

New Role for Rising Powers

But modernizing multilateralism isn't all about developed countries learning to adapt to the needs of rising powers. With power comes responsibility.

Developing countries need to recognize that they are now part of the global architecture. They have an interest in healthy, dynamic, flexible international systems for finance, trade, movement of ideas and people, the environment-- and strong multilateral institutions.

We need to find points of mutual advantage, making reciprocal gain possible. At the same time, we must recognize domestic political constraints and local fears. We need accords that every leader can sell at home.

What Does this Changing World Mean for Development?

What does this changing world mean for development?

Development is no longer just North-South. It is South-South, even South-North, with lessons for all with open minds. It is conditional cash transfer programs in Mexico being studied around the world. It's Indians in Africa explaining the so-called "white revolution" – that boosted milk production. It is a new world where developing countries are not only recipients but providers of aid and expertise. Nor is it about ideological panaceas, blue-prints, or one-size-fits all. In a multipolar economy, development is about pragmatism, learning from experience, recognizing how markets and business opportunities change, sharing ideas, and connecting knowledge, just as we connect markets, across innovative networks.

Nor is the future of development only about old concepts of aid: The sovereign and pension funds wanting to invest with the World Bank Group in Africa represent a new form of financial intermediation. This is not charity. This is investment looking for good returns. IFC is helping to lower information barriers and cut transaction costs. It is our aim to do nothing less than revolutionize financial flows to developing countries

Modernizing Multilateral Institutions

How will we manage a "new geopolitics for a multipolar economy" where all are fairly represented in Associations for the Many, not Clubs for the Few?

If the tectonic plates are shifting, multilateral institutions must shift too.
The crisis has shown the possibilities of international cooperation, but it has also underscored the need to modernize and strengthen multilateral institutions to reflect a different world.

The new world requires identifying mutual interests, negotiating common actions, and managing differences across a much wider spectrum of countries than ever before.

It requires institutions that are fast, flexible, and accountable, that can give voice to the voiceless with resources at the ready.

It requires institutions that reach out to partners, with humility and respect, ready to learn from others, that can act as global connectors pioneering a new world of South-South and South-North learning and exchange.

It requires institutions that can demonstrate real results and can be held accountable when they falter.

The World Bank Group must reform to help play this role. And it must do so continually at an ever quicker pace. Government and public institutions tend to be slower to change than private organizations facing competition. We recognize this risk. To address it, we have launched the most comprehensive reforms in the institution's history.

We are Reforming to Become More Representative and Legitimate

A modernized World Bank Group must represent the international economic realities of the 21st Century, recognizing the role and responsibility of growing stakeholders, but also their diversity and special needs, and provide a larger voice for Africa.

Reflecting these needs, we are urging our shareholders to keep their promise to move to 47 percent or more ownership by developing countries this month.

But we are not stopping there. In a model unique among International Financial Institutions, shareholdings will be reviewed every five years to allow for changes based on the continuing economic growth and evolution of our shareholders, with the goal of achieving equity over time. For the first time, shareholdings would be based on a formula specifically developed to reflect the needs and mandates of the World Bank Group: they will not only reflect economic power but also contributions to our fund for the world's poorest countries.

Senior management now includes a record number of executives from developing countries as well as women. And we need to do even more.

We need to work with developing countries as clients, not as objects of development models from textbooks. We need to help them solve problems, not test theories.

Yet problems need resources to fix them.

We are Reforming by Adding Resources

Since the full force of the crisis hit in mid-2008, the World Bank Group has committed more than $100 billion to support developing countries.

This broke all historical records. And I want to especially thank the World Bank Group staff who have risen to this challenge.

We got money where it is needed –fast. Even though the World Bank Group has traditionally been a lender on long-term projects, our development disbursements have exceeded the IMF's crisis payments.

When the World Bank Group stepped up to confront dangers, we depended on the effective and efficient use of resources on hand.

We will need more resources to support renewed growth and to make a modernized multilateralism work in this new multipolar world economy. Should the recovery falter, we would have to stand on the sidelines.

The World Bank is therefore seeking its first capital increase in more than 20 years. Shareholders face a decision to strengthen the Bank Group, or allow it to wane in influence, losing an effective multilateral institution and leaving it poorly resourced to cope with whatever comes next.

In addition to providing critical financial resources, we have been demonstrating just how modernized multilateralism can work. We are building cooperation among 186 countries that are our members.

Over half the resources raised to strengthen our capital will come from developing countries, through price increases and greater capital investments. Agreement on this package of measures, if successful, would represent a multilateral success story that contrasts with recent stumbles in climate change and trade.

We are Reforming to Become More Effective, Innovative, and Accountable

Representation and resources alone are not enough. We must also be more effective, responsive, innovative, flexible, and accountable.

We are reforming to sharpen our strategic focus where we can add most value -- focusing on the poor and vulnerable, especially in Sub-Saharan Africa; on creating opportunities for growth; on promoting global collective action – such as in climate change, agriculture, water and health; strengthening governance; and preparing for crises.

We are reforming to modernize our products and services, fostering opportunities for innovation, and considering a new decentralization model that will enable us to apply cutting-edge skills closer to clients, while gathering, customizing and sharing knowledge and experience globally. We need global reach, but also local touch.

We are reforming to focus on results, strengthening our governance and anti-corruption efforts, including strong prevention, and leading other international institutions in becoming more transparent and accountable. We have a New Access to Information policy, based on the Indian and U.S. freedom of information laws, which will be the first – but we hope not last – of its kind among international institutions. We are launching a new open access policy for World Bank data. Just last week, we concluded an agreement with other multilateral development banks on the cross-debarment of corrupt individuals and companies.

And we are launching a corporate scorecard so we can be held more accountable.

We know we make mistakes; if overcoming poverty were easy, it would have been eliminated long ago. By opening the shades for others to see what we are doing, how we are doing it, and with what results, we will catch errors more quickly and improve faster.

Taken together, these reforms are transformational. This will no longer be your grandparents' World Bank. It won't even be your parents'.

Conclusion

Reform cannot be a one-time effort. It must be a constant --adaptation and re-adaptation, with continuous feedback loops to meet changing realities.

We cannot predict the future with assurance. But we can anticipate directions –and one is that the age of a multipolar global economy is coming into view.

This is no aberration, no blip. We still live in a world of nation-states. But there are now more states wielding influence on our common destiny. They are both developed and developing, spanning all regions of the globe. This can be all to the good. But the contours of this new multipolar economy are still forming. It needs to be shaped.

The modern multilateral system needs to fit these changes.

Modern multilateralism must be practical. It must recognize that most governmental authority still resides with nation-states. But many decisions and sources of influence flow around, through, and beyond governments.

Modern multilateralism must bring in new players, build cooperation among actors old and new, and harness global and regional institutions to help address threats and seize opportunities that surpass the capacities of individual states.

Modern multilateralism will not be a constricted club with more left outside the room than seated within. It will look more like the global sprawl of the Internet, interconnecting more and more countries, companies, individuals, and NGOs through a flexible network. Legitimate and effective multilateral institutions, backed by resources and capable of delivering results, can form an interconnecting tissue, reaching across the skeletal architecture of this dynamic, multipolar system.

Woodrow Wilson wished for a League of Nations. We need a League of Networks.

It is time we put old concepts of First and Third Worlds, leader and led, donor and supplicant, behind us.

We must support the rise of multiple poles of growth that can benefit all.