Rethinking Development Finance

Dr Jim Yong Kim
President of the World Bank Group

London School of Economics and Political Science

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Dame Shirley Pearce, Director David Webb, distinguished faculty, students, and guests.

Thank you for hosting me this evening. It's a great honor to be here with you, and with representatives from our close partners: the UK Government, including the Department for International Development and Her Majesty's Treasury.

And I want to commend the UK Government for its continued leadership in meeting the commitment to spend 0.7 percent of GNI on development assistance. Your commitment is a source of great hope for all of us in the world of development.

To the students in the room, you must take great pride in joining the ranks of some of the great business leaders, politicians, and economists who earned their degrees here: President Juan Manuel Santos of Colombia; Thomas Piketty; George Soros; and of course, Mick Jagger – how cool is that?

LSE is one of the world's great academic institutions, a fitting place to talk about the forces in the world that are making us fundamentally rethink our approach to development at the World Bank Group.

Last fall, before the IMF-World Bank Group annual meetings, I told the world about our two goals – to end extreme poverty and boost shared prosperity – and I talked about the three paths we would follow to get to our target.

The first path is to accelerate inclusive and sustainable economic growth. We're doing this by laying the foundations for more effective public services, by improving governance and tackling corruption, by accelerating infrastructure investment, by lowering real and perceived risks for private investment, by making trade work for everyone, and by creating markets to bring the benefits of private sector rigor and innovation to developing countries.

The second path is to invest more – and more effectively in people. We believe that the premium on human capital will get higher and higher every year. The demands for digital competency are accelerating, as indicators suggest that automation will replace many of the less complex and low-skilled jobs. The remaining jobs will demand new and more sophisticated skills.

So investing in human development has to start early – by ensuring that pregnant women have access to prenatal healthcare, including the right nutrition; by preventing malnutrition in children, so they can develop properly; by ensuring access to quality health care for all; by providing education that prepares students for the jobs of the future and by building social safety nets that meaningfully protect the poor.

And the third path is to foster resilience to global shocks and threats. We're living in a time of multiple overlapping crises: pandemics, climate change, refugees, famine. Right now, in parts of East Africa and Yemen, we're seeing what the UN is calling the worst famine in 70 years.

It's critically important to help countries prepare for these crises. The World Bank Group is now the world's largest funder of climate-related investments. We're pioneering a first of its kind pandemic insurance facility. We're working with the affected countries and partners to help end the famine – and we will use every tool we have, including financial tools, to prevent famine in the future.

" We believe that everyone in the development community should be an honest broker who helps find win-win outcomes – where owners of capital get a reasonable return, and developing countries maximize sustainable investments. There's never been a better time to find those win-win solutions. The trillions of dollars sitting on the sidelines, earning little interest, and the investors looking for better opportunities should be mobilized to help us meet the exploding aspirations of people all over the world. "
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World Bank Group President
We're also continuing our work on the global displacement crisis by allocating $2 billion under IDA18, our fund for the poorest, to support the low-income countries that are hosting refugees.

For the first time, we're also providing concessional, essentially below market interest financing to any middle income country hosting refugees through our new Global Concessional Financing Facility, starting with support to Jordan and Lebanon, who are hosting millions of Syrian refugees.

In the midst of these crises and our efforts to respond, the world is changing rapidly. In some quarters, we've seen a rejection of globalization, and there's debate about the benefits of the global market system.

It's true that many people feel they haven't experienced the benefits of globalization. Recent studies of the US and European job markets document the hollowing out of segments of the workforce. An analysis we just released with the IMF and the WTO shows that trade has greatly benefitted the poor, but its benefits have not been experienced by everyone. In many places, middle class incomes have stagnated and jobs have disappeared.

There's a discussion happening here in the UK right now about this very question.

Ensuring that the fruits of globalization are enjoyed by all is an urgent task for every country in the world, both rich and poor. But globalization is having other effects, especially on people's aspirations, that are forcing us to rethink our approach to development.

The Sustainable Development Goals, adopted by 193 states in 2015, are wildly aspirational in their vision of a world without poverty and hunger, safe from threats like environmental and social disasters.

Everywhere I go I see that ambition with my own eyes.

As President of the World Bank Group, I've traveled to 6 continents and met people from most of our 189 member countries. In almost every country, I see people on their cell phones and computers. The internet and social media allow them to know exactly how everyone else lives. To some extent that's been possible for a long time through newspapers and television.

The difference is that now someone in Butare, Rwanda can Facebook message their cousin in Kigali and become immersed in detail about life 80 miles away. Both of them can talk every day with a friend studying in Paris, and learn about life 4,000 miles away. Depending on connectivity, which happens to be excellent throughout Rwanda, they can send emails, pictures, videos, snaps, tweets and texts back and forth at lightning speed.

Knowing exactly how everyone else lives, in their own countries and abroad, is leading to a convergence of aspirations. Let me explain what I mean.

As I traveled, it seemed to me that everyone was aspiring for what they could see – not just in their immediate environment, but even for what they're connected to digitally.

I wanted to know if my impressions were supported by data, so I asked our economists Bill Maloney and Laura Chioda to dig into the numbers. Are we witnessing a global convergence of aspirations?

Using data from the World Values Survey and the Gallup World Poll, they looked at how people across the economic spectrum felt about their financial situation fifteen years ago and today.

They looked at trends in internet connectivity, and they looked at whether people expressed interest in living abroad, as a proxy for whether their aspirations are informed by how people live in other countries.

This research is preliminary, but here's what we found.

Your relative happiness depends on where you are in the income distribution. It also depends on how your income compares to your reference income – the income to which you compare your own.

Looking at the data on satisfaction with standard of living, we found that if your reference income goes up 10 percent, your own income has to go up at least 5 percent for you to maintain the same level of satisfaction.

The trade-off is even larger for poorer people – if you're poorer, your income has to rise even more just to maintain satisfaction.

We also found that as internet access becomes more widespread, people are increasingly looking outward for their reference income. And this correlation has grown over time.

Keeping up with the Jones's used to be about keeping up with your neighbors. But it's no longer only about the Jones's living around you – because of connectivity, the Jones's could be anywhere in the world.

And connectivity in the developing world has expanded. According to the Gallup data, internet access for the poorest 20 percent nearly doubled, from 11 percent in 2009 to 21 percent today.

Why does this matter? In Africa – home to 1.2 billion people – 226 million smart phones were connected to the internet at the end of 2015. By 2020, that number will triple, to three quarters of a billion. We think that as more people connect to the internet, aspirations will continue to rise.

It's important to remember, rising aspirations aren't just for things that other people have; they're demands for opportunities that too many don't have.

A poor child in Quibdo, Colombia can text message with her friend in Bogota and hear all about her school, what she's learning, and the jobs she'll have when she graduates. She looks at her own school and job prospects, and she will likely want the same opportunities.

We found that if people are satisfied with the quality of education, early childhood programs, security, and healthcare, they report much higher satisfaction with their standard of living. These are areas where the World Bank Group has invested heavily and accumulated expertise.

As someone who was born in South Korea when it was one of the poorest countries in the world, the rise in aspirations is something that I celebrate. But I'm worried about the ability of those of us who work in development to keep up with them.

Aspirations, linked to opportunity, can breed dynamism and inclusive, sustainable economic growth. But I worry, and studies suggest, that if there's no opportunity to achieve those aspirations, frustration may very well lead to fragility, conflict, violence, extremism, and eventually migration.

We're already seeing worrying trends – 2 billion people live in countries affected by fragility, conflict, and violence. After a period of decline since the end of the Cold War, violent conflicts have increased rapidly since 2010. Terrorism incidents have increased by 120 percent since 2012.

By 2030, 50 percent of the global poor will live in areas affected by conflict and fragility. We cannot meet our goal to end extreme poverty by 2030 unless we tackle this challenge.

At the World Bank Group, we believe we all have a moral responsibility to do more to help people lift themselves out of both fragility and extreme poverty, to help stabilize the countries they live in, and to give them hope for the future.

That's why we have doubled the allocation for fragile states under IDA18 to more than 14 billion dollars. We need to continue to find new and innovative ways to reach the poor, and make the world more secure and stable through development finance.

And with high aspirations – embodied in the Sustainable Development Goals, and evident in every country I've traveled to – we have to move quickly to ensure that these aspirations don't turn into anger, resentment, and ultimately even extremism and migration.

Morally and ethically, it's the right thing to do. But because of rising aspirations, the task is much more urgent than we ever thought.

So, how do we move with the unprecedented speed and scale we'll need to meet these aspirations?

In 2015, before the world adopted the Sustainable Development Goals, the UN and the development banks met in Addis Ababa to discuss how we would find the resources to achieve them.

We knew that to meet what are now called the global goals, the world had to move the discussion from 'Billions' in official development assistance to 'Trillions' in investments of all kinds: public and private, national and global, in both capital and capacity.

'Billions to trillions' was the shorthand we used to describe the scale of finance we needed.

But to get to the trillions, we needed to change the way we do our work.

Now, to be honest, we haven't changed the way we do our work enough – not yet.

To succeed with the immense tasks ahead of us, we have to fundamentally change our approach to development finance.

In our conversations with investors, nearly all of them say they would consider investing in emerging markets if it were less risky. Given the low returns so many owners of capital are receiving from their investments, there should be potential for many win-win scenarios where capital earns a higher return and developing countries receive much-needed investment and expertise.

So our top priority should be to systematically de-risk both projects and countries to enable private sector financing, while at the same time ensuring that these investments benefit poor countries and poor people.

We should do this by crowding in the private sector, whenever possible. And we should combine this with our knowledge – technical expertise, knowledge about the countries and the economy – so that the capital really works for poor countries and poor people.

We should use our own capital and our knowledge to serve as an honest broker sitting between the global market system and the interests of emerging countries and poor people, ensuring that both sides win.

We believe that all development finance institutions should be working to crowd in private capital through a set of principles that will maximize resources and benefits for the poor. We're not there yet, but this is how we think we should proceed in order to get there.

First, for every project we support, we have to ask the question, "Can the private sector finance this on commercial terms?"

In 2006, the Government of Jordan was working with the World Bank Group to finance improvements to the Queen Alia International Airport in Amman. This could have been financed solely by public money, but the government was interested to see if they could bring in the private sector.

The World Bank employee in charge of the project, John Speakman, reached out to his counterpart at IFC, our private sector arm, who had worked on a similar project in Saudi Arabia and knew the market.

Together, they worked with the Jordanian government to lay the ground work for private investment. When IFC put an appropriate deal structure in place, and invested 270 million dollars of its own capital, we were able to attract enough commercial financing to cover the rest of the project.

The government contracted the airport's operations to a French company, who pays Jordan an annual fee. It's a genuine public-private partnership. Jordan receives 54 percent of the net revenue and they're making money every year.

Over the last nine years, without any direct investments to improve the airport, Jordan has received more than one billion dollars in revenue – and they don't have project loans to pay back.

We have to look everywhere for more opportunities like the Queen Alia Airport.

That will mean that when something is commercially viable, we have to agree across the entire international development finance system – multilaterals and bilaterals – that we will help the government negotiate a private sector deal that provides value for money, ensures good governance, and adheres to environmental and social standards. Now, I can tell you, getting agreement on this hasn't been easy.

Second, we have to encourage upstream reforms. We saw this work in Turkey in the energy sector. Over a decade, with other partners, we supported the creation of power and gas markets – with a focus on regulations and pricing structure. We used public finance for public-good investments like transmission expansion and advised on regulatory changes for energy efficiency.

As the market liberalized, IFC led investments in renewable energy. And MIGA, our Multilateral Investment Guarantee Agency that specializes in political risk insurance and credit enhancement, provided coverage. With just 5 billion dollars of public investment and policy loans, Turkey was able to attract more than 55 billion dollars in private power and gas investments.

Our goal isn't just to de-risk projects; it is to de-risk entire countries. To achieve this, with all of our projects, especially those that are not commercially viable because of market failures or perceived risks, we will work with governments on regulatory and policy reforms to make these projects commercially viable, whenever possible.

Third, we have to use public or concessional finance in innovative ways to mitigate risk, and blended finance to support private sector investment. Here's what we're working on now – a risk mitigation mechanism called the Managed Co-Lending Portfolio Program. This platform allows institutional investors in OECD countries to invest in projects in the developing world and get a return on their investment.

IFC & Swedish Sida provide a first loss guarantee of 10 percent, creating an investment grade risk profile on a loan portfolio of emerging market infrastructure investments. This allows partners like the insurer Allianz, who have a relatively conservative risk appetite, to invest in emerging markets. Allianz is providing $500 million. This platform can mobilize 8 to 10 dollars for every dollar of public money.

One of the things we'd like to do, for example, is to find a way for a pension fund in the United Kingdom to be able to invest in building roads in Dar es Salaam, get a reasonable return on that investment, and do a lot of good in the process.

In a similar way, MIGA has been working with DFID, Sweden, and Canada over the past few years. Ninety-million dollars in donor funding is now allocated to catalyze 800 million dollars in private investment for projects in fragile and conflict affected countries.

Our new tools also include the 2.5 billion dollar IDA Private Sector Window, part of our record $75 billion replenishment of IDA. Among other things, it includes a Risk Mitigation Facility to provide project-based guarantees without sovereign indemnity, and a Local Currency Facility to mitigate currency risk when markets are not yet developed.

There are sectors that can only be funded with public financing, where objectives cannot be met by the cost recovery requirements of commercial financing, and our hope is that if we're successful at both creating markets and following these principles, countries can use scarce public resources to invest more in people, build resilience, and respond to crises.

We need to keep searching for pathways to bring the private sector into these areas as well, but only if it's in the best interest of everyone, especially those currently excluded from the benefits of development. Take for example the case of gender equality, and the boost it gets from opening up access to finance for women and unleashing their entrepreneurial potential. Providing access to capital for women is a no-brainer, but we also have work to do in reforming government policies so that women can make full use of their new resources.

These principles aren't just relevant in stable countries; they can work in fragile and conflict-affected states. In Iraq – years of war and neglect led to daily blackouts, crippling the economy. Even in Iraq we asked, can the private sector fund power generation and distribution in these circumstances?

The answer was yes to power production, but not yet to power distribution. We invested $250 million of IFC money, and helped the government enact policy reforms, mobilizing another $125 million in private capital for power production.

This investment expanded the capacity of an existing power plant by 50 percent, bringing power to 3 million people, and helped complete a new power plant that will supply about half of Baghdad's energy.

Getting the private sector engaged in creating jobs and growing economies may be one of the best ways to prevent conflicts in the future.

But let me be clear – this isn't like the bad old days of privatization. I was part of a group that protested those bad old days. We're not talking about reviving an approach where the answer to poorly run public services, or unprofitable state-owned enterprises, was often an over-simplified attempt at privatization.

For example, in the late 1990s, in one of our loans we prescribed the privatization of the Senegalese power company SENELEC. A few years later the privatization failed and the government had to buy the utility back.

Many similar privatization efforts were ill conceived – without clear understanding of the roles and obligations of the state and private managers. And they didn't include fundamental reforms of the overall sectors.

Today, we're much more focused on whether the regulatory context provides incentives for efficient management, whether commercial principles are being applied consistently, and whether subsidies for services are transparent and focused on the poor – and ideally, funded without interfering with commercial viability.

We're talking about a very different kind of approach. What emerged from Addis Ababa was a consensus that private capital was essential for development – but that development had to be country-led and always focused on benefitting the poor.

In every case, we have to ask ourselves the questions – what are the priorities of the government? What's in the best interest of poor countries and poor people? Can we find win-win situations? And do these investments align with our core values: access, inclusion, and equality?

It's easy to talk about this approach, but it's going to be very difficult to change the global development architecture to move in this direction.

The development world is not there yet. The World Bank Group is not there yet. But this is something we have to do, and at the World Bank Group, we know we have to start with ourselves.

Here's what we will do in our own organization:

1. We have to change the incentive structure.

When John Speakman helped set up private financing for the Queen Alia Airport, he was working against his own interest. The incentives were structured so that the best thing for him to have done was to try to structure a loan and quickly get it through the board.

If a World Bank employee spends years doing project preparation and does such a great job that the project becomes commercially viable, we should celebrate that achievement.

Right now we don't.

But we're working to change the incentives – defining and tracking the direct mobilization of commercial capital, so we can reward every effort to crowd in private financing.

We're putting in place a tracking system that captures indirect forms of mobilization, and we're figuring out how to reward staff who focus on advisory programs, building markets, and creating the environment for investment.

2. We have to work much more effectively across the World Bank Group.

This is about asking the right questions – is the financial structure for a project viable for commercial funding? If not, what would it take to get it there?

It means IBRD/IDA staffers have to think more like private investors, and IFC and MIGA staffers have to think more like public policy reformers.

If staff from both institutions can walk in the shoes of the other, we can take a big step toward multiplying development finance.

3. We need to change how we see ourselves.

Right now, we see ourselves as a lender. We see ourselves as an investor.

We see ourselves tackling small parts of the development agenda, directly financing projects and working towards specific policy goals.

Instead, we have to think of ourselves as strategic advisors and honest brokers who link capital looking for greater returns to countries looking to achieve their highest aspirations.

One of our most important roles is to attach our knowledge to capital as it flows to the developing world. And not just knowledge about how to build a bridge, or generate energy, or sanitize water. We need to attach knowledge about how to do these things in specific developing countries. It's a very special set of skills, and it's what makes organizations like the World Bank Group unique.

And instead of just linking our knowledge to our own capital, we need to leverage our knowledge by linking it to the vast amounts of capital that we can mobilize from the private sector.

We have to become the honest broker that sits between the global market system and the interests of emerging countries and poor people.

We believe that everyone in the development community should be an honest broker who helps find win-win outcomes – where owners of capital get a reasonable return, and developing countries maximize sustainable investments.

There's never been a better time to find those win-win solutions. The trillions of dollars sitting on the sidelines, earning little interest, and the investors looking for better opportunities should be mobilized to help us meet the exploding aspirations of people all over the world.

This is a fundamental shift in our conception of who we are. In many instances, development finance institutions have competed with each other to finance projects – especially, the low-hanging fruit that the private sector, with a little help, could finance on commercial terms.

For too long, our first thought was, how can we get the loan or the grant out the door? But that's often not what's best for poor people and poor countries, and it's not what's best for the world.

We need to have a different and difficult conversation about how we approach development finance.

This is an urgent task. The clock is ticking on the Sustainable Development Goals.

With climate change, we're running out of time, and we need to rethink how to bring the private and public sectors together to move immediately on both mitigation and adaptation.

We need to do this in a coordinated way, so we can have the largest possible impact now, and stimulate the market to generate more investment in things like renewable energy.

This is a test for us. Can we take advantage of these huge potential win-wins?

Can we stop competing with each other for projects, and instead take an evidence-based approach to finance that maximizes outcomes for the poorest people; that maximizes outcomes for the planet; that redefines development in a fundamental way?

I want to leave you with a story from one of my recent trips. A few weeks ago, I visited a school in Tanzania. I asked the 11-year-old students, "What do you want to be when you grow up?"

Two children stood up and said, "I want to be president of the World Bank."

Here's what I told them. I was born in 1959 in a country that was one of the poorest in the world. That year, the World Bank said that without foreign aid, Korea would find it difficult to provide more than "the bare necessities of life." Korea did not qualify for a World Bank loan until 1963.

In 1963, when I was in preschool, if George David Woods, the World Bank president at that time, had visited my classroom, I doubt if he could have imagined that one of his successors was sitting in that room.

I told those girls and boys in Tanzania, "Don't let anyone tell you that you can't be president of the World Bank. And don't let anyone tell you that you can't be anything you want to be. You can."

I believe that. But it won't happen unless we all decide that we're not going to allow these aspirations to be thwarted by our inaction, or even worse, by bureaucratic inertia.

We need to embrace the notion that our greatest moral responsibility is to create equality of opportunity, so that everyone has a chance to achieve their highest aspirations.

Here today, at the London School of Economics, I want to issue a challenge: to ourselves – the World Bank Group; to the entire development community; and to all the future economic and political leaders in this room – to act with the speed and the scale that these times require, and fundamentally change the way we do development.

Aspirations are rising all around us; let's see if we can raise our own to meet them.

Thank you very much.

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