

# **GOOD OUTCOMES THROUGH GROWTH—PATHS TO DEVELOPMENT SUCCESS**

**Remarks by World Bank Group President David Malpass at Peterson Institute**

**Sept. 17, 2019**

*As Prepared for Delivery*

It's good to be back at the Peterson Institute. I'm eager to hear your views on the challenging subjects of growth and development. It's a timely discussion, given the many immediate challenges facing the world, including Brexit, negative interest rates, trade frictions, and rising poverty rates in many developing countries.

There's a range of development issues to tackle, including barriers facing the private sector, full inclusion of women, and severe problems in health, education, the environment and infrastructure, to name several.

I'd like to raise four topics today: the slowdown in world growth; the low rate of fixed-capital formation, especially in developing countries; negative yielding bonds as an indication of frozen capital; and the impact of these trends on developing countries and the World Bank. The problems are related, creating a growth environment that isn't supportive for development.

## **Slowdown in World Growth**

The global slowdown is apparent. In June, the World Bank Group's Global Economic Prospects (GEP) report lowered our estimate for 2019 real global growth to 2.6%. Given recent developments, I expect actual growth to fall short of that.

In nominal terms, dollar GDP growth looks set to slow to less than 3% in 2019, a big letdown from 6% growth in 2017 and 2018. World dollar GDP reached \$84.7 trillion in 2018, of which the U.S. was \$20.6 trillion, China \$13.6 trillion, the combined five biggest EU economies (Germany, the UK, France, Italy and Spain) \$13.1 trillion and Japan \$5 trillion.

The slowdown in global growth is broad based, including slowing growth in China; substantial downturns in Argentina, India, and Mexico; and disappointments in much of the developing world. Some parts of Europe are in recession or close to falling into recession. Germany and the United Kingdom have

experienced a quarter of recession, and Italy and Sweden have seen several quarters of stagnation.

## **Slowdown in Investment**

Let me turn to capital formation. The subtitle of our June GEP report was “Heightened Tensions, Sluggish Investment.” Investment growth worldwide decelerated after the global financial crisis from an average of about 6% during 1992-2007 to about 4% during 2010-2018.

In emerging market and developing economies, average investment growth slowed from about 10% per year during 1992-2007 to below 6% during 2010-2018. Excluding China, average investment growth in other emerging market and developing economies was only about 4% in the 2010-2018 period. The June GEP report anticipated a modest uptick in 2019 and 2020. But recent data suggests this is unlikely to materialize, leaving capital formation well below earlier averages and insufficient to create the growth and jobs needed to raise living standards.

## **Frozen Capital**

At the same time, over \$15 trillion of bonds have zero or negative yields, with some new issues carrying negative yields over the long term. This frozen capital implies slower future growth. In economic theory, yields should be related to the cost of capital and anticipated return on investment. Low or negative bond yields mean that many pools of capital are accepting the market’s premise of very low or even negative returns for years, even decades.

Last week, the European Central Bank announced a further push into negative interest rates, with open-ended bond purchases despite low yields. Rather than paying interest on its liabilities, the ECB will be charging the banks that provide the ECB with its liabilities an interest charge of 0.5%, weighing on growth.

What does it mean when a large amount of global capital is locked into low-yielding bonds; and the rate of gross fixed capital investment is slow by historical standards? The implication is that growth, especially in developing countries, will remain slow, as current capital stocks deteriorate and are exhausted. That’s a challenge for the World Bank Group, given our objective of helping countries move up the development ladder.

## **Development Challenges**

The combination of slow global growth and sluggish investment in developing countries creates the likelihood that poverty will rise in several countries and that many of our World Bank goals for poverty alleviation will not be met.

Compounding the problem, the distributional impact of slower global growth and frozen capital adds to inequality, undercutting our mission of shared prosperity and increases in median incomes.

The challenge is immense. In 2015, approximately one tenth of the world's population lived in extreme poverty. This was a substantial improvement over the past, but makes it urgent that more progress be made by countries and through development practices. Poverty reduction is strongly correlated to growth in developing countries, which itself is correlated to growth in developed countries and to growth-oriented policies. No country in history has been able to sustain poverty reduction for any length of time without economic growth. With aggregate investment rates in developing countries already slow, growth prospects are weakening, putting even more urgency on structural reforms.

At the recent G-7 summit in Biarritz, I noted that ineffective government spending and lack of debt transparency contribute to weak investment climates and the wide range of structural problems facing development. I urged coordination in tackling these problems: the World Bank is seeking good development outcomes through strong country programs, with broad workstreams oriented toward growth, sustainability, and broadly rising living standards.

I'm confident that structural reforms are available that would work in the right direction, but I'm also cognizant of the strong resistance many of the key reforms face. Problems include oligopolies; overly large government employment and pension promises; and subsidies for goods, services and financing, problems that are all hard for countries to repair. We've had some success in introducing contestability (for example, through auction markets), but the economies of many developing countries are still dominated by protectionism that undercuts their competitiveness; and by state-owned enterprises and banks, many of which are distortive and drain resources from more productive investment.

Lack of debt transparency and unsustainable debt loads are problems in a number of countries, especially in Africa. The lack of clean water, dependable electricity

and access to roads, basic health care and education still plagues many of our clients.

The good news side of low interest rates and low bond yields is that capital is available when countries improve their economic framework. Greece and the Philippines have seen rapid declines in their bond yields as better investment opportunities arose.

Ukraine may have entered that phase. I travelled to Kyiv on August 22-24 to discuss economic reform priorities with President Zelenskyy and his team. The government was forming and the new program still being shaped, so the timing was good for World Bank Group engagement. President Zelenskyy won a landslide 73 percent of the vote and his newly formed political party won a decisive majority in the parliamentary elections on a platform of substantial policy improvements.

President Zelenskyy's popularity gives him a solid opportunity to launch Ukraine on a faster and sustainable growth path. I urged him to move swiftly to execute reforms, with an emphasis on those that will quickly benefit people through liberalization. President Zelenskyy confirmed several key growth measures: to conduct land reform, liberalize the natural-gas sector, demonopolize SOEs and the banking sector, and respect the independence of the central bank. My op-ed encouraging this path appeared in the August 25 *Financial Times*.

I expect markets and investors to be opportunistic in evaluating reforms like this. For many emerging markets, the availability of global capital puts added emphasis on reforms that strengthen capital markets and attract capital from their diaspora, who are often the most eager to invest when improvements occur and the most aware of meaningful progress.

What can developing countries do? Well-designed structural reforms are urgently needed to unlock barriers to growth and build the foundations for future prosperity. Countries need to prioritize good policies:

- Market-based pricing;
- Aligning borrowing and investment decisions so that productive projects crowd in--rather than crowd out--the private sector;
- Debt transparency, which is a critical part of debt sustainability and the efficient allocation of capital;

- Participation in global value chains, which can be achieved through freer trade and investment within and between countries;
- Stable, market-based currencies, which are critical so investors can make long-term investments;
- Prudent fiscal management with reasonable tax levels and prudent spending—one of the most challenging reforms to achieve;
- Greater contestability, competitive pricing and market competition, which is a key reform for many countries, especially those with large numbers of state-owned enterprises.

As discussed, structural reforms to boost growth need many associated reforms to work. Steps forward include investment in human capital, health, and education, the full inclusion of women.

In sum, global growth and investment are slowing with a substantial amount of capital frozen in low-yielding bonds. This combination adds to the challenges facing many developing countries and to the urgency of policies that deliver broad benefits for growth, investment and living standards.

Thank you.