"**I *think the thing that is extremely worrying is that we're not anywhere near understanding the depth of this financial crisis***"

-- **James D. Wolfensohn**, president of the World Bank (1995 to 2005) and chairman of Wolfensohn and Co., an investment and advisory firm focused on emerging market economies.

Mr. Wolfensohn came to IPI on Friday, Dec. 12 to brief a closed meeting of United Nations ambassadors and senior officials on the current economic crisis and afterwards was interviewed by Warren Hoge, IPI's Vice President and Director of External Relations. An edited version of his remarks follows.

Mr. Wolfensohn: I think that the economic crisis is being dealt with at the moment significantly by providing liquidity to the system. To some degree, we're purchasing bad assets, principally in the real estate industry. But we haven't yet gone through the overall question of cleaning out the quality of assets in any of the financial institutions. And that is the reason the financial institutions, despite the fact that they've had infusions of money, are not increasing their lending. They're building their reserves, because they're worried about the future.

So, I think that we have a continuing critical issue in the financial markets, and it is reflected not just in the banks, but in the pseudo banks—which in this country constitute 70% of the credit that's given—but also in the stock markets around the world, including the stock market in our country, where 40% is probably the average loss.

Mr. Hoge: Do you believe we are now seeing the consequences of this globally?

Mr. Wolfensohn: Yes, I think it is already happening. If it started in the US, it clearly is already in Europe. It is being recognized in China and in India, and certainly in Russia. The Russia/India/China sectors, which are part of the BRIC countries, are already showing signs of being affected. Brazil, the other member of the BRIC countries, is speaking with confidence of positive growth in 2009. But that will be heavily dependant not just on internal growth, but on exports.

Mr. Hoge: And the real [the Brazilian currency] has fallen an estimated 40%.

Mr. Wolfensohn: The real has absolutely been affected, and the market in Brazil has already been affected; the stock market's been affected. So, my own personal view is that I think everyone will be affected, including the Arab countries.

Mr. Hoge: Now, you also said you think that people ought to be aware that accidents can still happen, that bad things have happened, and some other ones may happen in the future.

Mr. Wolfensohn: Well, you woke up today and learned two things. That the federal government refused to intervene in the case of the automakers, and secondly, that an individual has lost money in the markets for his clients, with a headline of $50 billion. In earlier times, a year ago, that would have been emblazoned in a headline as the most important thing that had happened in months, or maybe in the year. Today it's a bit on page one, and the rest is carried in the back of the paper. So I think we're getting immune to these crisis events, but they're going to be there, and they're going to come with some frequency.

Mr. Hoge: Can you give me a judgment of what the US government has done so far and of how it has worked?

Mr. Wolfensohn: The US government thus far has avoided the trap of the 30's by keeping the financial institutions functioning. And it has provided $8 trillion plus of credit, of which $3 trillion has been drawn down by financial institutions, and it is providing liquidity for the functioning of the system in every sense, from commercial paper, mortgages to what have you and even loans, where the government is doing deals as it did recently for $300 billion with Citibank, in terms of off- taking loans of which it would share some of the loss in return for a portion of the equity of Citibank. So all the different structures are being looked at.

My deep concern is that whereas it started with mortgages, and it's starting to expand into some other instruments, we still have not faced the fundamental challenge of the quality of debt, or the quality of assets in the case of banks—or looked at the other way -- the quality of the debts owed to them, which are construed as assets. And there, you're looking at multi-trillion-dollar exposures, and the question is at what pace does that come in, and what is the level at which the federal government can in fact assist? They can't buy all the bad assets. They can't buy all the credit card assets. They can certainly own the banks, which some of the governments abroad are already doing, and that is the way that in the past, the governments have come into the financial institutions and basically nationalized them. And they've paid the piper by intermediating the losses to the general public. But while they're private, it's very hard to do it. I think the thing that is extremely worrying is that we're not anywhere near understanding the depth of this financial crisis yet.

Mr. Hoge: There's a public perception that when the banks were given money, they did not do anything with it.

Mr. Wolfensohn: That's correct.

Mr. Hoge: In other words, they did not start lending it, and so there is a credit crisis. Was that to be expected? Was it a mistake on the government's part not to have insisted that they do something with that money?

Mr. Wolfensohn: Yes, probably, but it would have been very hard for the government to put a postscript on it once it agreed to bail them out, because the concern of any sensible bank directors, in this climate where there is such uncertainty as to the quality of their assets, would be to build the extent of their equity because that's what banks do. And so they were trying to reduce the level of their lending, as compared to their equity. And when they got more equity put in by the government or had some of their debts removed, they all breathed a sigh of relief because they still feel they have a very long way to go down in terms of getting to a sensible relationship between the capital they have and the loans they're making.

Mr. Hoge: I want to ask you something that's of great concern here at the United Nations, and, I suspect, to you after your ten years at the head of the World Bank, where you were known as "the spokesman for global poverty". People here fear the consequences for development aid are going to be dreadful. They also, of course, fear that the consequences for the people that live in these countries, and African countries in particular, are going to be dreadful. Could you talk about that?

Mr. Wolfensohn: Well, I think you have a continuing problem of poverty. You still have 1.3 billion people living on under $1.25- a- day, and you've got 3 billion people living on under $2.50. When I was there, it was $1.00 and $2.00, so we've added a quarter to the lower end and 50 cents to the higher end. The truth of the matter is that the rich countries still don't give anywhere near the 0.7 percent [of gross national income to overseas development assistance] that they all believe they should, in terms not just of charity to developing countries but on the basis that if they can help those countries, they will develop their markets in the future. And so the idea of the aid is not just to have a handout, the idea is to build those countries, so that they can subsequently trade with the countries that are providing them with this money. But it has never really sunk in, and when it gets to the legislative process, in most countries, the last thing on the list is assistance. Now the nominal numbers have risen, but not if you take out aid to Afghanistan and Iraq. They declined last year, and my guess is they will decline again this year. And private aid, which is now 2/3 the amount of public aid, to the order of $60 billion dollars a year, will also decline. Because individuals who are making donations to those private enterprises, and the governments who are trying to support them, are all going to be in tough times and in my judgment, you'll see a hugely significant drop in aid over the next few years, at the very time when it should be expanding.