ABCDE: TENTH CONFERENCE ADDRESS

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It is a privilege to speak at this tenth ABCDE, and I would like to thank Joe Stiglitz for inviting me to help celebrate the ninth anniversary and the tenth conference. I cannot think back to the start of these conferences without reflecting on my brief and happy years in the Bank, and I hope you will excuse me if I start by straying beyond the ABCDE to say a few words of thanks to the Bank and the people who serve in it.

Let me say first how grateful and how proud I am to have served as Chief Economist of this remarkable institution, and thus to be part of a chain that includes Hollis Chenery, Anne Krueger, Larry Summers, Michael Bruno, and Joe Stiglitz, from all of whom we have all learned so much -- I started learning from Joe more than thirty years ago, when I was a graduate student at MIT and he was an Assistant Professor, back from his initial foray into the study of development in Nairobi. I would in particular like to pay tribute to my predecessor, Anne Krueger, whose then controversial insistence on the centrality of trade liberalization has been amply borne out by subsequent research.

It was not only an education but also a pleasure to be able to work with so many talented and devoted people in the Bank -- the dedicated leadership and staff of DEC, and other friends and colleagues throughout the institution. Although any list is bound to be invidious, I would like in particular to thank some of my closest associates: my advisers, first Johannes Linn and then Andrew Steer; Dennis de Tray, Research Director and co-conspirator in setting up the ABCDE, who is now laboring in the palm and clove plantations of Indonesia; the leaders of the WDR teams for 1989, 1990 and 1991, Millard Long, Lyn Squire, and Vinod Thomas; and Kate Oram. Although I would like to go on and on in this vein, I shall now turn to the topic of the ABCDE.

I. ABCDE

According to the introduction to the first volume of conference proceedings, the ABCDE was set up with the ultimate objective of improving both member country and Bank policymaking, by enhancing the knowledge base.[2] The goals were to open up the Bank to outside ideas and problems, and if possible to help shape the research agendas of those

thinking about development outside the Bank.
When the conference series was formally evaluated in 1995, after seven conferences, the goals were described more precisely as being:

- to expose Bank economists to fresh insights and recent developments in economics, which are influencing views outside the Bank and may potentially alter Bank policy advice;
- to direct attention to a set of issues that are of critical interest to a wide spectrum of development practitioners;
- to induce leading researchers to explore and account for the real-world implications of their work, and to incorporate the Bank's practical knowledge of developing and transitional countries in their analyses; and
- to improve policymaking in the Bank and its member countries by enhancing our understanding of economic processes.

The title assigned for my address, "ABCDE: Past Ten Years, Next Ten Years" suggests that I should review the record of the past nine conferences, and then look ahead. I will look back, but not to review the record. That was done by the 1995 evaluators, who pronounced themselves on the whole satisfied. Based on a selective reading of the conference volumes, I would agree.

Rather than review the ABCDE, I will instead reflect on the development consensus when I left the Bank in 1990, and how if at all the emphasis would change today. Looking forward, the assigned title "ABCDE: Next Ten Years" violates the fundamental rule of forecasting, which is to forecast either an event or a date, but not both. Rather than attempt to forecast the content of future ABCDEs, I will end by speculating on the implications of globalization for the developing countries.

II. DEVELOPMENT ISSUES AT THE START OF THE DECADE

When the first ABCDE took place nine years ago, four important developments stood out among the developing countries:

- the debt crisis was on its way to resolution, and the lost Latin American decade was drawing to its end;
- the transition process was beginning in Eastern Europe, though even as late as 1989, hardly anyone anticipated that the Soviet Union would soon disintegrate;
- the East Asian miracle was in full swing, with per capita growth over the previous quarter century averaging more than 6 percent, and per capita GDP in China having more than doubled during the previous decade;
- average per capita GDP in Sub-Saharan Africa had declined over the past decade, nearly offsetting the gains since independence -- indeed in some African countries per capita incomes had been falling for a quarter of a century.

In thinking about economic development, there was a growing consensus about many of the policies needed to produce growth. At the time of its original presentation in 1989, John Williamson's Washington Consensus[3] summarized views that were held in much of official Washington, including the Bank; but in the next few years the consensus broadened to include many researchers and policymakers in developing countries in Latin

America and elsewhere.

The consensus within the Bank, no doubt also representative of views within a large part of the profession, was best captured in the 1991 World Development Report, *The Challenge of Development,*[4] which summarized its preferred approach as market-friendly. WDR91 had been preceded by the 1990 WDR on *Poverty*, which is an essential companion to its successor, and whose message -- critical to the mission of the Bank -- is no less relevant today than it was nearly a decade ago. If I focus today on WDR91, it is because I want to examine the overall view of the strategy of development that was held in the Bank at that time, and because sustained reductions in poverty are best attained in a growing economy.

In summarizing its message (p. 11), WDR91 argued that the prime responsibility for development rests with the developing countries, which should emphasize:[5]

- investment in people;
- improving the climate for enterprise;
- opening economies to international trade and investment; and
- getting macroeconomic policy right.
- It argued too (p. 9) for a reappraisal of the respective roles of the market and the state:
- "Put simply, governments need to do less in those areas where markets work, or can be made to work, reasonably well. In many countries it would help to privatize many of the state-owned enterprises. Governments need to let domestic and international competition flourish. . . . [They] need to do more in those areas where markets alone cannot be relied upon. Above all, this means investing in education, health, nutrition, family planning, and poverty alleviation; building social, physical, administrative, regulatory, and legal infrastructure of better quality; mobilizing the resources to finance public expenditures; and providing a stable macroeconomic foundation, without which little can be achieved."

How did the message of the WDR relate to the four issues -- the end of the lost decade, the start of the transition process, the East Asian miracle, and negative per capita growth in Africa -- then dominant on the development agenda? The message was clearly relevant for all these situations, particularly Latin America. But it needed further development and specificity to provide a practical guide for action for the transition economies. And what precisely the role of the state had been in the East Asian miracle countries and how, if at all, that fitted into the paradigm that had been so eloquently defined by the WDR team, remained as major question marks.[6]

About the same time as the 1991 WDR was published, a mainstream position began to emerge on the strategy for reform in the transition countries.[7] Despite agreement on the reforms needed in different sectors, issues of the speed and sequencing of reforms provided ample room for debate, especially over whether, and in what areas of reform, very rapid adjustment -- shock treatment -- might be preferable. This issue gained particular salience in light of the contrast between the negative growth of the reforming east European countries and the stellar performance of China, with its more gradualist strategy, particularly in privatization.[8]

The East Asian Miracle, published in 1993, sought to answer the questions about the development strategies followed in the eight high-performing Asian economies, a group that includes Japan but excluded China. These economies had succeeded not only in producing unprecedentedly high rates of growth, but also in maintaining relatively equal distributions of income. Their superb growth records had been accompanied in most, though not all of the high performing economies, by high rates of saving and investment.

The study concluded that these economies had succeeded by in the first instance getting the basics right, particularly in investment in human capital and in assuring macroeconomic stability. Further, all these economies had kept price distortions within bounds, especially in limiting the bias against agriculture found in many developing countries. They had also encouraged the import and absorption of technology. But this was not the whole story, for in some of the eight economies, government had intervened systematically and in many ways to foster development -- most importantly through various measures of export promotion, but also through significant financial sector interventions, in some cases through import protection, by subsidizing declining domestic industries, and by making investments in applied research. These interventions were more pervasive in Japan, Korea, Singapore, and Taiwan, China than in the remaining high performing Asian economies -- indeed, one of the striking results of the *East Asian Miracle* study is how few generalizations apply to all eight of the economies.

The answers to questions beget further questions, in this case what makes for successful interventions, and whether other countries can hope to succeed by pursuing a similar approach. Here the study emphasized the creation of institutions, including capable and reputable bureaucracies, whose procedures were shielded from political interference; and mechanisms of consultation among government, business, and others, including academics and journalists. In most cases these took the form of deliberation councils. Export promotion strategies generally keyed off world prices, and in some cases used export targets and contests among local firms to provide incentives. Although all the economies except Hong Kong went through a phase of import substitution, these policies were abandoned at a later stage. Attitudes to foreign direct investment varied, but in those cases where it was encouraged, the focus was on export promotion rather than import substitution. The study concluded that the promotion of particular industries did not generally succeed, while the repression of financial systems and directed credit had succeeded in some cases. In all cases, the *Miracle* study emphasized, subsidies and distortions were kept limited, and were modified or abandoned if they threatened macroeconomic stability.

The *East Asian Miracle* study produced mixed reactions, some believing that it had not sufficiently emphasized the positive role of the state. But no reader could have come away from the volume without a reinforced belief in the importance of getting the fundamentals right, while at the same time thinking that export promotion strategies had played an important role in development, and that the quality of institutions matters a great deal.

III. LOOKING BACK

If WDR91 were to be rewritten -- possibly in time for the start of the next millennium -- the basic message would probably not change very much. That is not because there is nothing new under the sun, but because most of what is in the 1991 WDR is both analytically and empirically well-based. Although we should always emphasize the tenuous nature of our knowledge, we should also acknowledge that the field of development economics -- which was born less than sixty years ago[9] -- continues to mature as the stock of theory, data and country experiences on which it can draw increases. In the characteristically measured words of Michael Bruno's keynote address to this conference four years ago, "... a hard core of knowledge -- small but increasing -- has been sustained and buttressed through the turbulence."[10]

At the same time, the experiences, reflections and research of this decade -- much of it presented in the *East Asian Miracle* study and in post-1991 WDRs -- should lead to some changes in emphasis and views. What are they? The experience of the transition economies, some of it studied in WDR96 as well as in the excellent *Transition Reports* of the EBRD, by and large supports the consensus view of WDR91. Some controversy might remain over the speed of adjustment: I believe that should be very fast for bringing macroeconomic stability, and price and trade liberalization, and that other reforms, which are bound to take longer, should proceed as fast as possible.

We will need in coming years also to draw lessons from the Asian crisis for the development consensus. It is far too early at this stage to tell what they will be. But some elements are clear, none of them clearer than the need for a robust banking and financial system. The Basle Committee's *Core Principles* go a long way towards summarizing what is needed, and more details are provided in the IMF's *Framework for Financial Stability*.[11] In this area, weak supervision and regulation sow the seeds of future crises, reemphasizing the point that government needs not only to get out of certain areas of regulation, but also to strengthen regulations and their efficiency in others. The importance of the financial sector is not a new theme for the World Bank, for it was the subject matter of the 1989 *World Development Report*. But the devastation that has been propagated through weak banking systems in the Asian crisis -- and we should include in this the Japanese banking system -- would surely strengthen the emphasis on the need for healthy financial systems in any future WDR on development strategies.

It is an interesting question whether the current crisis would lead to a modification of the agnostic views on financial repression expressed in the *East Asian Miracle* study. The answer should be related to the conclusions to be drawn from the East Asian experience for capital account liberalization. Recent experience should reinforce the widely-held view that capital accounts should not be liberalized until domestic financial systems, including their regulation, are strengthened. It should also reinforce the urgency of strengthening domestic financial systems. Given that, I doubt that there remains a strong case for financial repression. But vulnerability to short-term capital outflows should be controlled through strong prudential regulations for the financial system, and close monitoring of corporate borrowing from abroad; there is also a case for countries to use market-based measures to control the pace and volume of short-term capital inflows, as is now done in several countries.

The role of the exchange rate regime is another topic that will be intensively examined in the wake of the East Asian crisis. One striking fact needs to be emphasized. Countries that chose to defend their exchange rates through the active use of monetary (and in some cases also fiscal) policy did not experience extreme crises. This should reinforce the view that there is no easy way out when a currency is attacked: although a floating rate provides a safety valve, a country that shows no willingness to defend any particular value or range of values of the currency will face greater difficulties than one that demonstrates that policy will react to defend the value of the currency.

Beyond the financial system, the East Asian crisis will lead to a reexamination of the benefits of the close relations among government, business, and the financial sector that have been practiced in several of the East Asian countries. We are likely to conclude that the opacity of financial relations within the corporate sector and among the three sectors that has become so apparent during this crisis should not survive. That does not necessarily rule out a continuation of processes of close consultation among the three sectors, and labor as well.

Let me now list a few other topics that would deserve more attention in a future WDR on development strategies: efficient regulation; institutional development; governance; environmental regulation; urbanization; and income distribution.

- Enough has already been said about the combination of strong state intervention in some aspects of the East Asian economies with inadequate financial sector regulation and supervision, to make the point that any future WDR on development strategies would have to focus more closely on the types of **regulation** that are needed to strengthen economic performance.[12] For this purpose, it could draw on some of the excellent material in WDR97, *The State in a Changing World.*
- By emphasizing the needs for efficient bureaucracies and human capital creation, WDR91 directed attention to the **role of institutions** in economic development. The question of how to build the institutions needed for economic development is another topic that should be taken further in a future WDR. Among these institutions are the educational system, and an efficient government. The question of institutional development is one with which development economics has struggled for some time, but there should be further insights from the experience of the transition economies, in many of which technically well-trained individuals were already available. This made it possible to develop some institutions, such as central banks, quickly. The development of other institutions, including in Russia the tax system, has proved more difficult. We need to find out why, and see whether it is possible to do better, also in countries where the overall level of technical training is much lower.[13]
- The ability to run the government well is one meaning of **governance**, a topic that has gained increasing attention since the turn of this decade. Governance in its other meaning - as a synonym for corruption -- would also deserve more attention in a future WDR on development strategies.
- WDR91 wrestled with the issue of the **environment** -- which seemed to get more attention towards the end of the volume than at the beginning, and of course WDR92 was devoted to that topic. It too would need more attention in future, and could certainly draw on work done for WDR92 and subsequently in the Bank and elsewhere.
- Anyone who has visited the capitals of developing countries recently must have been impressed by the problems of **urbanization**. This issue, incidentally, was discussed at some length in both the first and second WDRs, for 1978 and 1979. It interacts with problems of population growth, and surely would deserve more attention in a

future WDR on development strategies.

- The **distribution of income** in many developing countries, especially in Latin America, has been very unequal. Social justice, as well as the sustainability of the development effort, requires that we find ways of making development more equitable.

The elements that I have referred to so far as needing greater emphasis in an update of WDR91 have almost all been worked on extensively in the Bank and in the profession subsequently, and it is unlikely that their inclusion would produce major surprises or a major change in message. I turn next to a subject that could produce major changes -- globalization.

IV. GLOBALIZATION

For the last fifty years, the volume of world trade has increased more rapidly than GDP, and most economies have become ever more open to international trade. Despite the obstacles to trade against which we regularly and rightly inveigh, this trend is likely to continue, particularly since the ardor for regional trading arrangements has not diminished, and as the WTO begins to operate. This is part of the process of globalization, including the globalization of production, which will shape the world economy in the decades to come.

At the same time, the pace of globalization of international capital markets has accelerated at an extraordinary pace in this decade. Provided Korea and Thailand stay on their present reform tracks, even the East Asian financial crisis -- like the Mexican crisis before it -- is likely to have only a passing effect on the volume of international capital flows. However, increases in interest rates in the advanced countries, which should not be ruled out, will probably cause a pullback of funds from emerging markets.

The Mexican and East Asian crises have demonstrated the power of the international capital markets. While some countries will conclude that they want to stay out, most will not. Two of the countries hardest hit in the tequila crisis, Mexico and Argentina, have continued to open their markets to foreign capital. Similarly, Korea and Thailand will be more, not less, open to international capital flows after this crisis than before.

Countries that want to participate in the international capital markets will have to strengthen both their macroeconomic policies and their financial systems. Capital market liberalization should be gradual, and should take place only as the domestic financial system is strengthened and prudential and other controls put in place -- but most countries *will* liberalize, more or less gradually.

To deal with the risks posed by the globalization of capital markets, actions will be needed by advanced and developing country governments, not only to strengthen the international economic system, but also in their respective domestic economies. I would like to focus on one aspect of the recent discussions about the strengthening of the international economic system: the notion that a variety of **standards** should be developed and put in place.

The Basle *core principles* provide an agreed standard for banking system behavior and supervision. Similarly, the IMF's Special Data Dissemination Standard constitutes an agreed international standard for statistical data. Codes of good practice can be envisaged for accounting standards, for corporate governance, for securities markets, and for other aspects of private sector behavior. The IMF has recently produced a code of good practices on fiscal transparency,[14] and has been asked to develop a code of good practices with respect to monetary policies.

Such codes will constitute a comprehensive set of standards or rules[15] that countries could implement to improve the performance of their own economies, and that could also serve to guide international capital flows. If the bank regulators in creditor countries cooperate, a system of risk weighting for investments in developing countries could emerge, based on the extent to which such standards are observed. This would of course require that the implementation of the standards be monitored and certified. In a rational world, observance of the standards would also help determine the terms on which corporations and governments would have access to the international capital markets. In this way, the performance of macroeconomic policy, corporate transparency, and financial market regulation in developing countries could be improved, using the discipline of the international capital markets.

As globalization proceeds, the question of the optimal exchange rate arrangement and of the desirability of maintaining a national money will again come to the fore. The arguments on these issues are well-known. To cut them short, let me simply predict that if the Euro succeeds -- and I expect it to succeed -- we are likely to see the development of several large currency blocs, associated with large trading areas. These in turn could eventually -- in the Keynesian long run -- coalesce into a single currency.

The ongoing globalization of goods and capital markets promises to bring profound changes to the global economy and to individual economies. Although most of the advanced economies will be well equipped to deal with these changes, even some of them will have to improve institutions and policies to meet international standards. Most developing economies will need to take actions on a wide front to meet international standards. They will need help to strengthen their institutions and their human capital. Some that may not have access to the international capital markets will need financial assistance. Here one thinks most of the needs of many Sub-Saharan African countries.

These are early days yet for the international economy that, spurred on by the liberalization of trade and capital flows, as well as technological change in the financial sector, is continuing to emerge from the destruction wrought by the Great Depression and World War II. The system is accident-prone, and lacks a regulatory authority and lender of last resort. We need to work both on the international architecture and in individual economies to make it safer. But at the same time, we should not forget that this is the system that has brought an era of unprecedented and sustained, though not uniformly shared, economic growth and prosperity -- and that it will continue to do so for countries that follow the right policies.

V. CONCLUDING COMMENT

Let me conclude with a confession. For a long time, even after WDR91 was published, I believed that there was an elixir of growth, a magic ingredient that was missing from the set of policies listed in the WDR, and that if included would make a miracle -- even an East Asian miracle -- possible. I no longer believe that. Or rather, I believe that I know the missing ingredient. It is hard work. For it is a long and arduous task, a matter of many people doing many things right, over many years, to make a country grow.

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[1]First Deputy Managing Director, International Monetary Fund. This paper was prepared for the World Bank's Annual Bank Conference on Development Economics, April 20, 1998. I am grateful to Boris Pleskovic and Vinod Thomas for helpful discussions.

[2]From the Introduction to *Proceedings of the World Bank Annual Conference on Development Economics*, 1989, p. 1.

[3]John Williamson (editor), *Latin American Adjustment: How Much Has Happened?*, Washington, DC: Institute of International Economics, 1990.

[4]This WDR was carried out under the general direction of Larry Summers, with Vinod Thomas as team leader.

[5]WDR91 also analyzed the contributions to the growth of developing countries that could be made by the industrialized countries and international financial agencies.

[6]Alice Amsden, in *Asia's Next Giant: South Korea and Late Industrialization*, New York: Oxford University Press (1989), challenged the IFIs' views by arguing that in South Korea, the government had contributed to fast growth by systematically distorting market incentives ("getting prices wrong "); see also Roger Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*, Princeton: Princeton University Press (1990).

[7]See for example David Lipton and Jeffrey Sachs, "Creating a Market Economy in Eastern Europe: The Case of Poland", *Brookings Papers on Economic Activity,* (1,1990), 75-134; and Stanley Fischer and Alan Gelb, "The Process of Socialist Economic Transformation", *Journal of Economic Perspectives,* (Fall 1991), 91-106.

[8]See Jeffrey Sachs and Wing Thye Woo, "Structural factors in the economic reforms of China, Eastern Europe, and the Former Soviet Union", *Economic Policy,* 18 (April 1994). See also the World Development Report for 1996, From *Plan to Market,* for a sophisticated interim appraisal of the process of transition, including lessons drawn for East Asian transition countries.

[9]Although Adam Smith and other founding fathers of economics can be thought of as fundamentally concerned with problems of economic growth and development, and although development economics draws on other branches of economics, especially trade theory, development economics as a field should probably be dated to the 1940s. Systematic empirical work had to wait for the development of a data base, which began in the 1950s.

[10]Michael Bruno, "Development Issues in a Changing World: New Lessons, Old Debates, Open Questions", *Proceedings of the World Bank Conference on Development Economics,* 1994, p. 17.

[11]David Folkerts-Landau and Carl Lindgren, "Toward a Framework for Financial Stability", International Monetary Fund, World Economic and Financial Survey series, January 1998.

[12]Some of these issues are taken up by Joe Stiglitz in his 1996 ABCDE keynote address, "The Role of Government in Economic Development", *Annual World Bank Conference on Development Economics,* 1996, 11-23.

[13]These issues are discussed in WDR97, which emphasizes focusing on the basics when the capacity of the state is limited.

[14]Both Australia and New Zealand have introduced their own codes of fiscal transparency.

[15]The idea that such a set of rules would improve economic performance is part of the German notion of *ordnungspolitik,* associated primarily with Walter Eucken in the 1940s.
