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SUCCESSES AND FAILURES OF DEVELOPMENT EXPERIENCE SINCE THE 1980S

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<u>Successes and Failures of Development Experience Since the 1980s</u>

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<u>Abstract</u>

This paper reviews the development experience since the 1980's and finds room for guarded optimism about what we can learn from it. Firstly, a global consensus is emerging on the need for macro-economic stability through prudent fiscal, monetary and foreign exchange policies. However, at the micro or structural level, while governments need to decentralize their decision-making authority more fully than they have thus far, in reaction to the recent reappraisal of the East Asian model there is some danger that development policy will swing too far in rejecting liberalization and returning to government intervention.

Secondly, the paper points out that, while there exists a well-recognized causal nexus between exports and growth, the reverse causation also holds, i.e. domestic growth patterns conditioned by education and R&D expenditures and policies determine whether or not a country can take full advantage of existing export opportunities.

Finally, although fast-disbursing policy-based loans have not been as successful as they could be, largely because of the World Bank's chosen *modus operandi*, they represent potentially highly effective instruments that should not be abandoned. Rather, the Bank should help render such loans more fully "owned" by recipients, replace country-specific lending quotas by aid ballooning related to carefully worked out reform packages, and develop a better division of labor with other multilateral and bilateral donors.

Key words: development, structural adjustment, stabilization, multi-lateral development banks, East Asian miracle

Successes and Failures of Development Experience Since the 1980s*

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I. Introduction

The '80s has generally been a forgettable decade for the developing world. It began with the debt crisis and ended with a crisis of confidence in important components of the Washington Consensus package. The overall failure of growth in Sub-Saharan Africa, well established earlier, continued; but even Latin America found itself with a per capita income in 1990 7% below 1980 levels, while "miraculous" East Asia continued on its way, if at generally somewhat reduced levels of speed. Unemployment and underemployment rates appear to be on the rise virtually everywhere—as a consequence of macro-economic restraint combined with micro-economic restructuring and privatization efforts—and the willingness or ability of governments to worry about worsening income distributions and large holes in the social safety net is clearly on the wane.

At the same time the international community, while demonstrating its ability to respond with alacrity to the clear and present danger (including to itself) arising from the debt crisis, has equally clearly absconded with any of the hoped for post-Cold War peace dividends domestically and moved the development problem to increasingly back burners. Debt relief for Sub-Saharan Africa, not subject to the usual moral hazard arguments, is in danger of getting stuck and even the stalwarts of development cooperation, the multi-lateral development banks, able to resist the unfavorable tide in the past, are coming under increasing budgetary pressure and are asked to yield the field to private capital, including in places not yet ready to attract such flows.

Nevertheless, I believe the development glass to be more than half full and the aforementioned

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thumb-nail sketch to have been somewhat overdrawn. There are two main reasons for this. For one, while distributional equity has generally worsened, wherever growth has occurred the percentage of people in absolute poverty seems to be on the wane. Largely as a consequence, in spite of the uneven growth performance of the past, the developing world has experienced continuous improvements in the basic quality of life of its citizens; for example, even in Sub-Saharan Africa, taken as a whole, life expectancy has advanced from 46 to 51 years and infant mortality has declined by 1/5 during the '80s. This clearly does not give cause for complacency since these levels are still abysmally low and, with decent growth, much more could and should have been accomplished in the past. But it does underline how little it would take to make a big difference in the future.

But the primary reason why I remain optimistic is that we have learned a good deal during this difficult decade, both about the trade-offs and complementarities among societal objectives and about the do's and don'ts of getting to some societally preferred combination—learning which can hopefully be put to good use in the years ahead. I am, indeed, convinced that some of the adverse exogenous shocks of the past decade have contributed materially to the kind of new political economy setting needed to convert an improved understanding into a more successful development performance by more countries at the turn of the century. While we clearly don't have all the answers, the problem has become less technical in character and more one of determining the extent to which countries really have poverty reduction and development as their fundamental objective.

In Section II I intend to review what I perceive to have been some of these lessons as they have emerged from the successes and failures of recent development practice. Section III will briefly summarize the reasons for my cautious optimism with respect to the development project.

II. The 1980s and Early 1990s: Successes and Failures of Thought and of Action.

The debt crisis of the early '80s undoubtedly led to a consensus on the fiscal and monetary "fundamentals" which needed to be in place if anything else—whatever the mixture of markets and government—was to work. While there is still disagreement on whether inflation needs to be brought down to 20% or to 5% annual rates—and at what sacrifice (see current Argentinean rates of unemployment)—hardly anyone still questions the need for proximate macro-economic stability. Hidden deficits, e.g. in the form of subsidies to state enterprises, are being made more transparent and reduced, and borrowing from the non-bank public at high rates of interest is increasingly being recognized as only postponing the day of reckoning—and not by very long at that.

That there has been this major change in LDC, especially Latin American, policy makers' views on the importance of macro-economic balance and the inflationary threat is uncontroversial, i.e., fiscal and monetary policy constraints have become part of the accepted catechism, with explanations based on structuralism and cost/push inflation generally relegated to the sidelines. If there is major unfinished macro business today it is much more likely to reside in arguments about the maintenance of exchange rate credibility, i.e., between viewing the exchange rate as a steadying anti-inflationary anchor rather than as a flexibly adjusting absorber of exogenous shocks, along with other prices.

The lessons of the earlier Southern Cone's adjustment process have still not been fully digested. For example, until crisis struck, Mexico adhered to a fixed exchange rate-based stabilization package, which admittedly was helpful for a time, but only as long as there was confidence that rising current account deficits, accompanied by modest relative inflation and overvaluation, would be covered by (mostly portfolio) foreign capital inflows. Once it became clear that 8% current account deficits, even in the presence of minimal (1%) public sector fiscal deficits, were being used for a private consumption binge, the bloom quickly came off the rose—and probably only Mexico's membership in NAFTA and GATT prevented a return to "temporary" import controls and other assorted "stop" measures. As the East Asian experience of the late '80s has made abundantly clear, continuing on a path of adjustment via monetary restraint and increased exports, rather than additional borrowing, represents a much safer, if initially more painful, path. Once the all-important credibility of policy is lost, the cumulative gains of almost a decade of policy change can indeed be dissipated virtually overnight.

Much less agreement, however, has emerged on the micro-economic or structural changes needed to take advantage of that often painfully secured macro-economic balance. Increasingly the IMF/World

Bank "set pieces" in this arena are being questioned and there is an increasing insistence on more nuanced packages and sequences. In this context, a reassessment of the possible relevance of the clearly successful East Asian experience to other parts of the third world has become a popular parlor game. What had previously been summarily dismissed as entirely irrelevant to, say, the Latin American, the South Asian or even the African cases, are now being seriously scrutinized. Questions concerning varying interpretations of what really happened in East Asia, including inter alia the role of government relative to markets, the role of trade and the role of foreign capital, are now being critically reexamined, often really for the first time. The successes and failures of the past and, more importantly, the chances for improved outcomes in the future, are clearly tied to our ability to cast a fresh look at some of these issues.

Turning, first, to the role of government, a debate has been raging of late on the importance of industrial policy in East Asia, including post-war Japan. The World Bank, in its 1991 World Development Report, has acknowledged that "market friendly" interventions undoubtedly played a positive role, but without defining the concept. Then, in the context of the East Asian Miracle study, initiated and substantially financed by Japan, the Bank acknowledged that directed credit, an important instrument of industrial policy, may have made a contribution to successful industrialization efforts in East Asia; but it waffled on just what this meant in terms of the needed liberalization of various markets—including credit markets—a view which it has clearly held on to. The controversy continues to simmer, especially in Japan, which finds itself generally dissatisfied with the conclusions of the Miracle study and is supporting a number of follow-up seminars, critiques and further studies.

Undoubtedly, a mistake was made in asking the World Bank to play a central role in examining the historical validity of its own doctrines when applied to East Asia's experience. Moreover, the role of East Asian governments, even after they emerged from their common early import substitution phase, clearly went substantially beyond pure neo-classical prescriptions of "law and order plus infrastructure". But it is equally true that the current murky re-evaluation of the merits of industrial policy is giving unwarranted aid and comfort to vested interest groups eager to reject liberalization entirely and start on a second round of import substituting industrialization. Though clearly not intended to have this effect, both Stiglitz's reference to non-market "contests" and elements of Krugman's "new trade theory" have been eagerly seized upon and often misapplied in this context. One hears frequent references to South Korea's Pohang steel mill which was originally condemned by World Bank experts and later presumably became an internationally competitive producer. Simultaneously, Robert Wade's views of government interventions "governing" markets and Alice Amsden's advice to "get prices wrong," supposedly based on Taiwan and South Korean experience, respectively, are gaining currency and adherents. As is so often the case in the development arena, there is some danger that the policy pendulum, having undoubtedly swung too far in a religious *laissez faire* direction in the heyday of the "Washington Consensus," is now in danger of swinging too far in an anti-orthodox or revisionist direction.

While I freely admit to not being in possession of an integrated, defensible model, let me offer my own views as to where this particular pendulum ought to come to rest—denoting balance, not inertia. Any controversy is not about fundamentals but about the extent and nature of strategic market-friendly or supportive interventions. What I take away from the East Asian experience is that comparative advantage can indeed be usefully "stretched" but only if some specific conditions are adhered to: 1) Interventions ought not to ignore price signals, certainly not follow Amsden's advice to purposely move against them. 2) Interventions on behalf of particular industries which extend beyond rectifying other distortions should be highly selective; the main method of selection in East Asia was looking down the road at what Japan had moved to earlier on, as well as looking over one's shoulder at the other East Asian NICs. The Pohang story-tellers neglect to mention that other portions of that Heavy and Chemical Industries push in South Korea did not fare as well in terms of predicting the path of dynamic comparative advantage. 3) Interventions should be transparent, time-constrained and reversible; this ensures that their costs are visible and can be debated along with their possible benefits and that these rents are clearly viewed as temporary by both the civil servants who give them out and the private recipients. 4) Avoidance of mistakes and the encrustation of such mistakes, all too common in recent development experience, may be assisted by deliberation councils or similar devices permitting governments to engage the private sector in some form of indicative planning.

The experience of Japan's MITI is often cited in this connection—incidentally, given the Honda story, by both adherents and critics of industrial policy. But my main complaint with the World Bank's Miracle study, as well as with much of the commentary which followed, is that it focussed almost entirely on the Japanese post-war experience which was indeed one of substantial interventionism only gradually yielding to liberalization efforts. In my view, the relevant period for comparative purposes is pre-war Japan, which was indeed a developing country moving through various sub-phases of transition, while post-war Japan should be viewed as a developed economy recovering from the interventionism of the '30s and the destruction of World War II. If one wants to compare the transition, from the earlier, heavily interventionist, import substitution sub-phases of Korea, Taiwan and Singapore, into their generally more market-oriented export substitution phase by the late '60s, with the comparable transition period in Japan, it is the era before and after the turn of the century which is relevant. An examination of Japan's industrial policy between 1880 and 1930 would provide much better guidance to what worked and what didn't work once the system opened up more fully to the rest of the world. Those who have studied the period prior to the take-over by the military describe it as increasingly non-interventionist in character, in particular as far as the credit markets are concerned. In contemporary Taiwan, in recent years, two organized credit-market interest rates, both positive, applied: a lower rate for public enterprise and a higher rate for private enterprises. Exporters, large or small, public or private, obtained access at the same lower rates.

The conclusion I draw from the above is that, while a correction to World Bank orthodoxy on industrial policy was clearly in order, current statements describing Latin America as actually less intervened with than East Asia are considerably wide of the mark. Latin American industrial policy has, in the past, been much more across the board, much more deeply ingrained and much more resistant to change. It would indeed be a tragedy, just as Latin America is beginning to emerge from its inward orientation of long standing, to have the aforementioned misinterpretation of the East Asian experience provide the rationale for yet another oscillation in policy.

Indeed, if there is one dimension of governance which seems to stand out above all others, it is the need to achieve stability and credibility and avoid such traditional stop-and-go patterns, alternating between more liberal and more interventionist policy spells, consequently probably achieving the worst of both worlds.

This need for policy credibility also extends importantly to adherence to property rights and regulatory even-handedness, to reducing the overwhelming power of the central government's executive branch relative to those of parliament and the judiciary, i.e. the rule of law, as well as to the devolution of more fiscal and resource allocation powers to local governments. While there is a lot of discussion and evidence concerning the merits of decentralization, especially of the vertical type, in today's developing world, practice generally still lags considerably behind. One can detect an increasing tendency for deconcentration or delegation of power; but real devolution is generally not yet encountered, certainly not in unitary states and not even in many federal states. More than many other regions of the developing world, Latin America, for example, remains fairly centralized, i.e., the decision-making process as to what to do, where and how to do it, in terms of both infrastructural and social sector allocations, is generally still heavily dominated by administrations working through central government finance and other line ministries. One does not have to be an adherent of a romantic view, ignoring the presence of power elites at the local level, to maintain that such officials are likely to be more knowledgeable about where the proverbial "shoe" pinches, and also more capable of translating such knowledge into effective implementation, than distant central government officials managing large "black box" projects. While there clearly exist both nonfeasance and malfeasance at all levels, the "goldfish bowl" or relative transparency effect sets some limits at the local level. The usual counter-argument, that local governments are not yet "ready" because of deficient technical or administrative capacities, is painfully reminiscent of arguments of the past concerning the ignorant peasantry; in both instances, the response yielded by a more pressured environment in which economic actors are forced to produce and are given a chance to learn by doing (and sometimes failing) is likely to surprise, but central authorities' unwillingness to relinquish additional fiscal power to local bodies undoubtedly constitutes the main obstacle.

Similarly, the executive branches of LDC governments generally retain their relatively predominant position inherited from the early post-colonial days, with scattered evidence of the gradual growth of countervailing power in the legislative branch and generally even less in the form of a truly independent judiciary. One might even assert that it is the finance ministries which continue to play an inordinately dominant role in most cases, relative to the central banks and the social ministries. There can, of course, be legitimate room for doubt as to whether various forms of enhanced participation and democratization are intrinsically stabilizing or destabilizing in the short run; but there can be little doubt about their positive impact over the longer term. This undoubtedly represents an area of much unfinished business, but also one in which change—while it will surely come—will undoubtedly have to proceed in ways sensitive to individualized institutional and political circumstances. The aforementioned debate on the respective roles of governments versus market failure can be rescued from becoming quite sterile via much greater effort to disaggregate not only markets but also the government.

A second area in which recent development experience has been adversely affected by conceptual misunderstandings concerns the role of international trade. There can be little doubt of the important facilitating or "hand-maiden" role, as Kravis put it, of trade for successful development, but the drum-beat for "openness" orchestrated by the Bretton Woods institutions has led to the view that exports constitute the main "engine of growth" and that export promotion, in particular of non-traditional commodities, represents "the" solution in virtually all circumstances.

The intrinsic difficulty with this position is that it seems to put aside the notion that developmental success—or failure—continues to be largely determined "at home," with the open economy aspects, including trade—as well as associated international movements of capital and technology—admittedly of potentially great help but only in a complementary sense, i.e. as an assist to the domestic effort. One should not, I believe, accept the notion that exports somehow "explain" success, even in the case of relatively small countries. One important causal chain admittedly runs from exports to growth via the contribution of enhanced competitiveness as well as via the direct impact of imported technology embodied in machines, patents, and human capital, often associated with direct foreign investment; but there is also another which runs from the particular type of domestic growth that has been generated to trade; this extends beyond such obvious elements as investments reducing transport costs to the all-important contribution of domestic human capital formation and R&D, which, together with domestic macro- and micro-policy, critically affect the responsiveness of an economy to existing international trade opportunities.

In a large number of countries, not yet in NIC or near-NIC status, this point can perhaps be made most convincingly with respect to the agricultural sector. Even in a place like Taiwan, associated in most people's minds with rapid industrial export-led growth, the initial export boom, between 1954 and 1967, was, to the extent of 70%, composed of processed agricultural goods, including pineapples, mushrooms, and asparagus—all heavily promoted by agricultural research under the JCRR-farmers' association structure. Assisted by land reform, agriculture thus played a critical role at the early stages of development. A bit later East Asia's ability to quickly become a major competitive industrial exporter was again directly related to domestic educational and R&D strategies. With respect to education, the flexibility demonstrated in shifting from compulsory primary to secondary vocational, to science and technology-oriented university training at just the right time enabled the system to continuously follow a dynamic comparative advantage-dominated growth and export path. This was complemented by a whole array of government-sponsored specialized research institutes, science parks, etc., which were forced to meet their budgetary requirements increasingly by selling their services to private entrepreneurs.

The large role of public sector research, especially in cash crop agricultural exports, e.g. sugar, has long been recognized. But it is much less true for non-traditional agricultural and non-agricultural exports. Especially in the case of countries which need to rely on the rapid expansion of medium and small-scale firms which cannot afford to do their own R&D, e.g. as in the case of China's t.v.e.'s and Taiwan's S&M's, this need is only gradually coming to the fore. There are admittedly many horror stories to be told concerning the "white elephant" characteristics of many LDC science and technology institutes which seem to set their own agendas, quite independent of the needs of the economy. But this does not obviate the point that, when increasingly "hard budgets" can be made credible, R&D as a public good can have an important role to play in permitting the continuous realization of a dynamic comparative advantage driven export drive.

Achieving balanced growth between domestically oriented agricultural and non-agricultural sectors thus remains at the heart of the development problem in many countries, certainly at a relatively early stage of development. The notion that food producing agriculture can somehow be carelessly neglected, or that industrial exports can somehow by themselves pull an economic system into modern economic growth, are dangerously misleading and plain wrong. The recent relative neglect of the domestic, especially rural, economy can perhaps be better understood as a consequence of the debt crisis which, superficially at least, seemed to represent an "external" problem rather than the visible tip of a deep-seated domestic development problem.

No one is, of course, suggesting that the rural dynamism of East Asia can somehow be duplicated in Latin America or Africa, given their very different population densities, human capital, institutional and physical infrastructure, as well as other dimensions of the famous "initial conditions." But I am convinced that if one analyzes not only the total allocation of physical overhead capital but also the allocation of scarce organizational and institutional energies in, say, Latin America, both continue to be heavily traditional cash crop export or large-scale urban industry-biased. Within agriculture proper the allocation of current R&D and extension expenditures remains a particularly serious problem. Good examples abound. For example, large irrigation projects continue to have priority over the unsilting of local waterways; super highways crowd out feeder roads; and in non-agriculture basic research-oriented private R&D and "big science"-focussed institutes continue to take oxygen away from adaptive research and learning-by-doing-focussed innovative activities.

The same holds true for the impact of most price support programs affecting staples. While overall budget constraints create a tendency to curtail urban consumer subsidies which so often burden LDC treasuries, the differential impact of other interventions in commodity markets often remains to be addressed. Intersectoral commodity markets in all too many cases continue to be biased against domestic food producing agriculture and, at best, exempt only the cash crop subsector. Since one is realistically dealing here with the possible reallocation of given public goods and energies, rather than asking for additional dispensations from already overburdened and constrained budgets, it should not be impossible to act; but powerful vested interest groups usually need to be overcome.

A closely related area worthy of attention is that of possible reforms of the patent system and of R&D incentives in general. One need only point to the substantial discrepancy in total factor productivity or, as some observers, e.g. Krugman, seem to prefer, in the efficiency of investment allocation among developing countries, to be convinced that an increased emphasis on indigenous applied science and technology is bound to pay off. Tax codes can be modified to encourage greater risk-taking, and flexibility in the legal and implementation dimensions of intellectual property rights assured as a country moves up the development ladder. The possibility of instituting an additional patent option, e.g., the utility model, with its shorter periods of protection and lower threshold for discovery, represents a related area worthy of much additional attention. It is my impression that Latin America still relies too heavily on imported patents and imported technology and has not yet sufficiently mobilized its own adaptive or "blue collar" technological change capacity.

A third area which, I believe, warrants our attention in terms of diagnosing the reason for some of the successes and failures of the past relate to the role of public capital inflows, in particular that of the fast-disbursing policy-based loans (or SALs), provided mainly by the multi-lateral development banks. The instrument has become the subject of a lively debate, ranging from the cost effectiveness of the resources spent in support of developing country policy reforms to the implications of international financial institutions' conditionality lists affecting recipients' most sensitive internal affairs. Given the admittedly mixed record of past SALs—see the World Bank's own internal evaluations—the argument is now being made that it may be time to abandon the instrument and return to project lending.

Although structural adjustment or program lending can, in theory, support developing countries to help them achieve any agreed objective, such as growth accompanied by improvements in the level of human development, it must, of course, be admitted that, as in any multi-cook, multi-instrument context, it is extremely difficult to judge precisely what the contribution of fast-disbursing loans, coupled with conditionality, has been. Any honest assessment would have to compare outcomes in very similarly situated countries exposed to the same exogenous shocks that did and did not submit to such a program.

Such laboratory situations rarely exist and the counter-factual is typically unknowable. Moreover, there is the time element, i.e., the effects of program lending may be very different down the road than in the near term, making it difficult to determine the appropriate moment for rendering either a critical or congratulatory assessment.

The most that one can probably do, in all honesty, therefore, is to present some reasonably informed judgements on the way in which the instrument has been deployed in the recent past and how this may have affected the mixed record of success and failure. It may also be helpful to briefly contrast recent experience with the parameters of earlier (1960s) U.S./AID program loan initiatives. For example, in negotiations with Pakistan in the early '60s, the U.S. offered to provide substantial additional balance of payments support as import controls were shifted to an import bonus auction system and domestic agricultural price controls were lifted. A similar, if more comprehensive, pattern could be observed in the case of Taiwan when substantial aid ballooning between 1959 and 1963 was associated with the adoption of the famous "Nineteen Points" of negotiated reforms. According to one widely cited evaluation of U.S. assistance to Taiwan, "aid probably doubled the annual growth rate of GNP" (Neil Jacoby, 1966). It also helped in the improvement of income distribution and the level of human development. The elements of the program were a comprehensive dialogue, including via the Joint Commission on Rural Reconstruction, so that the Taiwan Government felt real ownership. The U.S., for its part, not only offered significant additional flows but also the salutary announcement that economic assistance would cease by 1965.

More recent experience focussing mainly on the World Bank's structural adjustment loans has produced relatively few success cases such as Ghana, Chile and Poland. Given the fact that we probably know more, technically speaking, about the necessary ingredients, macro and micro, for successful transition growth than ever before, it is of more than passing interest that, given the large volume of resources expended and the formidable array of human intelligence invested, the MDBs have not done better with their fast-disbursing loan programs.

One of the reasons for this, in my view, is that the World Bank, unlike A.I.D. and, of course, the regional MDBs, sports an unduly centralized structure. Only in a few borrower countries does it have fullfledged resident missions, and, even in such cases, the substantive decision-making locus for new commitments and policy advice is located principally in Washington. The Bank generally operates through many, relatively brief, visiting missions, some focused on the macro picture, others on specific sectors, still others on preparing program or project appraisals. The Volcker Commission found that the typical World Bank staff member spends less than 10% of her time on recipient country contacts. Under such circumstances, not only is it difficult to be sure about the quality of the data and the micro analysis but virtually impossible to guarantee full local understanding, jointness and agreement in the determination of resource requirements and reasonable conditions precedent. The Bank itself, given the substantial turnover in the composition of its mission personnel, is not always in a position to move beyond a relatively narrow, technocratic assessment of a country's macro, and especially its micro or structural, situation. Its advice consequently often lacks realism and nuanced depth with respect to the institutional and political economy dimensions of the situation.

Undoubtedly the most telling criticism of past MDB policy-based lending is that both parties are in too much of a hurry; there is all too frequently a rush to judgement, to put together a package that can be signed off on so that the money can flow. Bank staff and recipients are similarly motivated; the former see their rewards and promotions in terms of the number of agreements signed and the volume of resources committed; the latter in terms of the relief expected from quick disbursing funds. All the rhetoric about the importance of quality to the contrary, neither side necessarily wants to take the time and risk the flak by carefully assessing what precisely needs and can be done in a broader socio-political and institutional context, and ensuring that the package is more than superficially "owned" by the recipient. The banks, in other words, too often don't act like banks, and the borrowers too often have a strong incentive to simply go through the motions to obtain relief.

The fact that the desire to lend is overwhelmingly strong, while the list of conditions attached is often long but insufficiently differentiated, is well recognized by borrowers. There is frequently too little effort to set sensible priorities and to sequence a reform program in societies which cannot reasonably be expected to do much at any one time. Indeed, it is no exaggeration to say that both parties, having gone through this particular procedure many times in the past—with or without the benefit of a Consultative Group—already know full well that ultimately the need to lend will overcome the need to ensure that the conditions precedent are indeed met.

As a consequence, while the additional resources are supposed to ease the pain of adjustment, they may instead serve to take the pressure off and permit the recipient to avoid adjustment. What usually occurs, at the risk of some exaggeration, therefore, is a rather time-consuming and expensive ritual dance. Not many SAL tranche releases get cancelled—usually they are only delayed. Few countries, certainly not many large ones, have ever had prolonged break-downs in their relations with the World Bank. This in spite of the fact, reported by Tony Killick, that between 89/90 and 93/94, for example, only a quarter of the Bank's SALs have proceeded according to their intended schedule.

If both lender and borrower know that the MDB must commit to a fast-disbursing loan to meet its internal lending target, it clearly is difficult to maintain a credible threat of cutting off loans in case of non-compliance. Aware of this dynamic, both parties have an incentive to fashion a superficial agreement. The MDB achieves the desired commitment of resources and the LDC has the pressure for painful change actually relieved by the fast disbursing flow. Moreover, both parties can claim that reform and loan disbursement targets have been met, and, in the absence of externally verifiable measures of program effectiveness, declare the package a success.

One of the inherent difficulties which needs to be addressed is that, as Tinbergen tried to teach us generations ago, it is difficult to maximize two objectives with one instrument. If, in the wake of the Brady Plan, the MDBs are asked to pump out the money on behalf of debt relief, we should not expect the *obiter dicta* concerning policy change to be taken very seriously by either party. Ditto for the U.S. effort over several decades to use non-project lending to the Philippines to both secure continued military base rights and assist with policy reform.

But there are other impediments, internal to the culture of the MDBs, which need to be addressed. Concentrating a large number of unquestionably highly talented professionals in institutions which are defending somewhat standard and relatively insular views is bound to create problems of discouraging dissent and diversity. Especially the non-Anglo-Saxon academic and policy-making communities, in which subtle, area-specific modifications to relatively monolithic interpretations of the current paradigm are currently being advanced, are too often dismissed or taken lightly. It took considerable pressure for Japan, while not challenging the "basics" of fiscal and monetary policy restraint, to recently get the World Bank to revisit its views on the role of government in East Asia's success story.

Because of its position of predominance in gross public lending, as well as in applied research and the generation and diffusion of new developmental emphases and ideas, the World Bank often functions as a powerful (some would say unassailable) authority on development policy. The so-called "Washington Consensus," elsewhere discussed at this Conference, is undoubtedly less monolithic and more subtle and differentiated today than many critics have asserted. The acceptance of "market friendly" government interventions, plus the acknowledgment that governments may do well by organizing "contests" and rewarding (or punishing) performance is a case in point. But the kernel of truth remains: the Bank is populated by large numbers of highly talented professionals who have shown relatively little willingness to deviate from the in-house conventional wisdom by considering important differences in initial conditions and in the historical stage of development reached by a recipient.

Moreover, inadequate emphasis has all too often been given to the changing relationship between the MDBs and the private capital flows which are increasingly dwarfing MDB and bilateral ODA flows to the developing world, especially in Latin America. Quite aside from what the MDBs can do directly in supporting domestic private sector activities—given the charter restrictions relevant to most—their most important function remains one of signalling, i.e. providing information and "housekeeping seals of approval" on countries' economic conditions. Private DC investors depend heavily on both published and unpublished country analyses provided by the MDBs, especially the World Bank. Unfortunately, while "yellow" versions of country reports may contain more candid assessments of country conditions, by the time they reach "grey" and published stages, differences in the assessment between countries and the MDBs have often been sufficiently papered over to diminish their discriminatory value. The basic difficulty is that there is insufficient capillary action between the two circulatory systems within the Bank: on the one hand, the analytical network capable of providing high quality assessments of a country's status, prospects and additional reform requirements; on the other, the lenders in the regions, primarily interested in getting on with it and in maintaining good relations with the recipient. Thus, in the end, the grey books are sanitized, the ritual dance continues, and even the independent information flow to private capital markets is adversely affected.

But there is another set of MDB interactions with private capital flows which warrants our attention. Aside from the still small, if expanding, IFC and IFC equivalent activities in the regional banks and the growing opportunities for joint financing with private capital, there is the issue of how MDB lending can be directly supportive of private capital flows to the third world. A traditional area for this has been via government development banks which re-lend to the private sector. These two-step loans have received a bad reputation not so much, as is claimed, because such banks are intrinsically inefficient but because government credit policies governing the level of second step interest rates and collateral requirements have typically remained seriously deficient.

III. Reasons for Cautious Optimism Near the Turn of the Century.

The picture sketched above, while not one of unrelieved gloom, does point to a number of critical areas in which shortfalls in development thinking have caused inadequate performance in practice in many parts of the developing world. Why then, in the face of declining public resources and in the attention paid to the problems by the industrial countries, should one remain cautiously optimistic about development at the turn of the century?

For one, there can be little doubt that recent, post-debt crisis policy mixes in Latin America as well as in South Asia and elsewhere, have tended to move in the general direction of what might be more appropriately called a global rather than a Washington consensus. This is true mainly in the macro stabilization arena but, to some extent, also in terms of the agenda on micro-economic structural change. Growth is gradually resuming while the concern with distributional equity and building safety nets for the poor is generally at least part of the dialogue. While this should not lead us to conclude that these changes are necessarily irreversible, a more realistic view of the need for government interventions is required. Interventions should accommodate rather than obstruct the evolution of the system, with a secularly increasing role for markets as the number and complexity of decisions that need to be made rises geometrically with development. Given Latin America's past pattern of across-the-board and long term rather than selective and temporary interventions, the temptation to revert in the face of some exogenous shock seems to be on the wane. Failed heterodox stabilization programs, e.g. the Cruzado and Austral plans in Brazil and Argentina, respectively, have undoubtedly had an impact—as have NAFTA and MERCOSUR, placing limits on national stop-go reactions. As importantly, the more balanced view of the lessons to be drawn from East Asia concerning the relative roles of government and markets has had a very salutary effect. All the returns obviously aren't in, but recent Mexican experience seems to indicate that, while admittedly "the region has a history of reform and relapse" (<u>The Economist</u>, Nov. 26, 1994), stop-go in response to some external shock seems to be giving way to soft, if socially painful, landings. Enhanced international commitments, regional and global, are undoubtedly making a contribution to the return to international financial market access, but I view the current adherence and deepening of Mexican reforms as essentially "made in Mexico," not Washington.

Progress on the issue of export-led growth, as opposed to export-assisted growth, is clearly less universal or clear cut. But here also one can observe more attention being paid to agriculture and rural development than before—witness the politically daring ejido reforms in Mexico and recent decentralization efforts in India, to cite but two prominent examples. This particular East Asian lesson, that domestic balanced growth may well have to precede non-traditional export expansion may have particular relevance to Central America, South Asia and Sub-Saharan Africa.

Finally, turning to the role of foreign capital inflows and especially those of the multilateral development banks it is, of course, increasingly clear that while totals are mounting, private flows are dwarfing public flows in the aggregate. Yet it also remains true that access to DFI or portfolio investments is still highly concentrated in the more advanced developing countries, while substantial portions of the third world, preponderant certainly in terms of population, will still require concessional assistance of the

IDA type or, at a minimum, emanating from the harder term windows of the MDBs. The fact that the past performance of the MDBs, using fast disbursing loans *cum* conditionality as the chosen instrument, has been, as observed above, far from optimal should not, however, lead one to conclude that the instrument is itself inherently faulty. Quite the contrary, when deployed appropriately, such loans may represent a very good, if not the best way, to promote development/graduation objectives among the developing countries. Returning to a "projects only" approach, on the grounds that the structural adjustment concept has been found wanting, would be a large-sized mistake. While one should never be doctrinaire about the precise composition of any individual country program, structural adjustment or program lending, if combined with fully "owned" self-conditionality, probably remains the best device to help interested borrowers achieve graduation. This will not, however, occur easily or painlessly; if it is to work, present practice as described earlier will have to give way to a substantially altered way of doing business.

Most importantly, donors must recognize that, in the absence of full joint conceptualization and prior agreement as to what needs to be done in the way of reform, and as to what additional resources are required to get there, no amount of conditionality will really work. Recognition of this critical, if obvious, point implies, however, something less obvious, namely the abandonment of, at least implicit, annual country and regional or global lending targets. While it is institutionally and politically unrealistic to expect MDBs to be in a position to completely abandon some sort of routine minimum annual country loan levels, major "humps" in lending, associated with major changes in policy, should be negotiated on a "when and if" basis, with the MDBs more passive and the initiative shifted to the borrower.

Such a posture would require a non-trivial change in the underlying *modus operandi* of most MDBs. While some level of "business-as-usual" lending would, realistically, continue, a new window would need to be opened for major policy-based program lending activities. It would be necessary for the MDBs to become more bank-like, i.e., to be able to sit back, while encouraging would-be borrowers to approach them whenever ready, at their initiative, with plans for longer term reform packages. The MDBs, possibly working through CGs, could, of course, if requested, provide technical assistance to help fashion such plans, although financing a more extensive use of arms' length independent consultants, while drawing upon the substantial expertise and experience that has accumulated within the MDBs and in the developing world, might be preferable.

The important ingredient of such a new lending window would be the abandonment of the annual ritual dance—with or without Consultative Group music—which claims to focus on conditionality and quality but is mutually recognized to really focus on quantity in the end. What makes me optimistic is that all parties now increasingly recognize the need to abandon the dysfunctional, routinized nature of current procedures—even if they are not sure what to do next. The *sine qua non* of any credible change would clearly have to be the fullest possible prior agreement and commitment by both borrowing country and donor to a policy *cum* resources package over a longer, say five-year, period. Such a procedure would not only acknowledge the growing professional competence of LDC policy makers, as well as the need for a program to be *ab initio* fully "owned" and "self-conditioned" by the borrower, but it would also lend much needed freshness and credibility to a process which has become increasingly fatigued and stale. The fashioning of realistic programs of reform, supported over a period long enough for the borrower's economic and political risks to be matched by external resource commitments, would not, of course, be easy; nor would it typically occur more than once in a decade in most country cases. But this is what may well be required to achieve genuine change, along with the additional resources needed to hold off vested interest groups, ease the pain of adjustment, as well as provide the required psychological reassurance.

Any such serious effort to enhance the quality of the fast-disbursing policy loan process must include donors' willingness to enhance its credibility by occasionally refusing to lend and by more than occasionally curtailing their lending in mid-stream. The suggested infrequent ballooning of resource flows would take place in only a handful of countries at any given time, while some level of "business-as-usual" lending, as previously defined, continues everywhere. It can also be assumed that the anticipated success of such a selective approach would itself serve to reverse the present malaise and lead to a greater willingness by the industrial countries to support the MDB role, in concert with bilateral donors, to bring more developing countries to graduation. The application of additional catalytic pressure to induce, usually reluctant, borrowers, to accept graduation from soft to hard loan windows and, eventually, to relying on private capital inflows exclusively would, of course, become part of the overall negotiating process, permitting the MDBs to turn their attention increasingly to the poorer countries and, at the same time, demonstrating the chances for success, one or two countries at a time.

I would also argue that a more imaginative division of labor among the MDBs is warranted. If "growth with poverty reduction" or, preferably, "growth with improvements in human development" is the objective, it is, I believe, generally agreed that country-specific measurements of income, poverty and human development indicators remain inadequate, especially with respect to their distributional dimensions. There exists an urgent need for more nuanced country-specific analysis here, focussing on how the links between the nature of the growth path and the basic societal objectives are affected by the extent of decentralization, the character of the fiscal system, the strength and direction of technology change, the labor force participation level of women, the role of NGOs, etc. Such analysis, really essential for fashioning effective reform cum lending programs, requires a detailed understanding of local institutions and human resource availabilities—a domain in which the regional development banks, working with indigenous institutions, would seem to have a comparative advantage—with the World Bank possibly contributing more on the macro analysis of growth, environmental implications, etc. The present system of everyone "in the act," drawing poverty lines, measuring human development levels, commissioning parallel data collection and analytical efforts, as well as gearing up their own technical assistance and lending programs, goes well beyond the limits of healthy competition.

At a minimum, where both the World Bank and a regional development bank or a bilateral donor are active, the latter can be brought more fully "into the loop" early on, not viewed as a World Bank sub-contract or piggy-back operation. While borrowers would rightly be concerned about anything approaching a monolithic stance by the international lending community, enhanced interplay between the World Bank, which will undoubtedly continue to be more centralized, and other relevant donors, concentrating on activities which require more local orientation and expertise, could be expected to improve efficiency. This is not to suggest that any precise, therefore rigid and confining, blueprint for an improved division of labor on a country or sectoral basis is in the offing, only that a more cooperative and less dismissive or paternalistic attitude by the World Bank seems to be in the wind under its current leadership.

James Wolfensohn recently expressed his frustration at the difficulty of getting the World Bank staff to "go along" with his ideas. He apparently recognizes the need to change the signals governing personnel evaluations and promotions, away from today's inputs, i.e. MDB lending, and towards the day after tomorrow's outputs, i.e. recipient performance. Since such outputs are likely to be diffuse and difficult to attribute to any one actor, the task of changing the internal MDB rewards system is not an easy one, requiring careful thought and a good deal of subtlety. But there is recent evidence of greater sensitivity to differences in country conditions, more openness to recipient as well as third party expertise, and a greater willingness to decentralize decision-making.

In spite of memories of the debt crisis, private capital flows to developing countries have quadrupled since 1990 and now constitute approximately 70% of the total. Nevertheless, since such flows are heavily concentrated on the upper or middle-income LDCs of Asia and Latin America, MDB policy-based lending, of the soft, mixed and hard loan varieties, continues to have an important role to play, especially in Central America, South Asia and Africa. Its mission: to gradually work itself out of a job as more and more countries graduate. Where foreign private capital is still largely absent, MDB attention is likely to be focussed on mobilizing complementary domestic private capital. Later on, joint financing with foreign equity or loan capital becomes possible. But all this is best accomplished by carefully negotiated sequential policy changes associated with program lending. Public sector lending which enhances private sector activity in this fashion is far superior to private sector lending which leaves the critical domestic policy environment untouched or, in fact, helps to preserve it by taking the pressure off.

If policies have indeed been undergoing dramatic change in some developing countries in recent years, I believe it is mainly because learning is going on, because the East Asian experience has had an impact, and because the debt crisis has concentrated borrowers' minds. It seems clear from such cases as Chile, Mexico, Poland and India that the lending *cum* conditionality process works better when local polities have decided to address their reform needs, effect certain policy changes sequentially, and approach the international community for financial help in getting there.

The Brady Plan, focussing on the most indebted middle income developing countries, claimed to have two objectives: to rescue countries with a quick infusion of foreign exchange and to achieve structural change. We learned the hard way that it is difficult to achieve two objectives with one instrument. In the '70s and early '80s petro-dollars in the form of commercial bank lending circumvented most quality discussion and took the pressure off LDC reform efforts. In the '90s, MDB and bilateral donors were tempted to do the same with the help of concessional capital, plus complementary private funds responding to their "signals." There is reason to hope—though admittedly no assurance as yet—that these lessons have not been lost on both parties as we approach the turn of the century.