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Editor's Note

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Part One

This is the next to last issue of the *New England Journal of Public Policy* before we usher in the new millennium. In the coming year the word itself will go through many uses, many permutations of meaning, be subject of so much tendentious punditry, idiotic speculation, inane commentary, and pompous prognostications that it will have been sucked dry of meaning, and we will be left with a plethora of "millennium specials" and "the top one hundred of the millennium" in everything from cat food to human diet fads, and of course your perennial millennium "special sales" and "personalities of the millennium."

And being the next to last issue of the journal in this century, it will also be a first of its kind: a venture into the global village to ascertain how or whether we, as a species, are improving the ways in which we govern ourselves, the lives of the six billion–plus inhabitants of this small planet, in securing the liberty and freedom of the individual, the primacy of law and dispensation of justice, the enhancing of human potential, the provision of work for the able, the construction of the groundwork for a better life for all — dignity and respect, freedom from hunger, tolerance, adequate shelter, elimination of illiteracy, proliferation of the new literacy, ending dictatorial and authoritarian rule, promoting the inviolability of human rights, stemming the flow of hundreds of millions of refugees who live in little more than badly upgraded concentration camps, countryless and uncared for except for the unstinting efforts of underappreciated and underfunded nongovernmental organizations and the like, and improving the health and sanitary conditions in which three-quarters of the world is mired in cycles of disease and poverty, in making some headway in closing the gap between the rich and the poor.

All of which, in this strange new world of ours, will have an impact on the way we live in New England.

In the past twenty years, we have been suffused with words and phrases like *globalization, democratization, free and fair elections, emerging markets, participatory democracy, consensual decision-making,* and a proliferation of other catchphrases that suggest improvement in governance systems both *within* countries and *between* countries, yet the improvement more often remains in the promise, not in the reality.

In particular, in this issue we will look at the experiences of countries that have undergone or are trying to undergo the transition to democracy from either totalitarian or authoritarian regimes, or some dictatorial point in between to what we call free-market economies with all the accouterments of democracy. I use the word *accouterments* deliberately, since what constitutes the "accouterments" necessary for democracy has come under increasing scrutiny as societies, once the scourge of civil libertarians and advocates of human rights, try to abandon old ways and become members in good

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standing in the new global order. Notions of what constitutes national sovereignty are more problematic than ever, and one person, one vote does not necessarily a democracy make.

Even in this limited regard there is a wry irony. The century began with Herbert Asquith, leader of the Liberal Party in Britain, campaigning successfully for the abolition of the veto powers of the House of Lords. (At the time, legislation could be passed by the House of Commons, whose members were elected by the people, but it could be vetoed by the House of Lords, composed for the most part of hereditary peers. The century ends with Labour Prime Minister Tony Blair introducing legislation to abolish whatever residual voting powers, mostly delaying powers, hereditary peers have.) Were an African country to vest such powers in, say, traditional chiefs for the better part of a century, it would be pilloried by the fastidious custodians of democracy, themselves often paragons of moral rot and obsequious decay, for its dereliction in adhering to "proper" democratic norms. In politics, no matter how wide one cuts the swath, what's good for the goose is not necessarily good for the gander.

Nor, of course, can notions of democratic governance be divorced from notions of economic empowerment of the masses and sustainable development in poor countries, which constitute the greater number of the countries under study in this issue. For years, they have been instructed by the mandarins in the International Monetary Fund (IMF) and the World Bank how to run their affairs. Maintain a stable currency to attract foreign exchange. Keep inflation low. To attract foreign exchange flows, especially in the form of fixed inward investment to stimulate growth, cut government expenditure and reduce the ratio of the budget deficit to gross domestic product (GDP) to some arbitrarily chosen figure, which means that when the technical jargon is decoded those countries are left with social safety nets full of holes. In short, get the government out of the way and the market in all its glorious manifestations will allocate resources efficiently and productively and for the benefit of all.

If matters start to go a little awry, either through circumstances beyond their control, or failure to hold government expenditure in check, or to strike a balance between monetary and fiscal policy, or widespread inefficiency, lack of capacity or bountiful corruption, they are "encouraged" to jack up interest rates to maintain the stream of capital inflows necessary to keep the foreign exchange rates pegged at their current levels. Exorbitant interest rates, unfortunately, choke off economic growth, leaving borrowing countries damned if they do and damned if they don't. Naughty countries get slapped with structural adjustment programs that punish the wicked and leave them even more indebted to their would-be benefactors. (This regimen of deficit cutting and anti-inflationary measures that have been the hallmark of IMF structural adjustment programs since the 1980s is called, for want of better nomenclature, "the Washington consensus.")

Jeffrey Sachs put the matter very succinctly.

> The IMF bought into the investment bankers' mantra: exchange rate stability above all else. If central bankers devote their reserves to a defence of the exchange rate, and if the IMF dedicates its funds to a defence of the central banks, lending to emerging markets is like shooting fish in a barrel. Or so it seemed — until a stampede began in the other direction.
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> The IMF encouraged central banks from Jakarta to Moscow to Brasilia to raise interest rates to catastrophic levels to protect their currencies, lest they lose the confidence of the money managers. Of course, the money managers could see one step beyond the IMF: investors do not gain confidence when short term rates are

> pushed to dozens of per cent, as they have been in Russia, South Korea, South Africa, and Brazil at some points this year. Yet the more these countries tried to defend their currencies, the more they incited panic.[1]

One model — the prize exhibit, so to speak — of how a developing democracy should run its affairs — the Asian model with its Thailands and South Koreas and Indonesias — the pride and joy of the international supra-sovereign financial institutions — has, alas, collapsed.

The implications for these countries in terms of the *regulatory reform* they will have to make in their *financial service institutions,* are as important, if not more important, than *the structural reforms* they will have to make in their *governance practices* if they are to weather the ruin that rained down on their economies in the last eighteen months. Or perhaps there will be a growing realization that structural reform in the public and private sectors are intertwined, that regulation and transparency are necessary to both, that there is a symmetrical relation between the two. They are quintessential sides of the same coin. You can't flip just one side of the coin and leave the other in the palm of your hand.

Some years ago, Francis Fukuyama argued in *The End of History and the Last Man*[2] that with the collapse of communism and the triumph of capitalism, the battle for "ideas" was over, and that in that sense we had arrived at the cul-de-sac of history itself — a millennium of peace and prosperity was at hand with the emergence of pan-global liberal capitalistic democracy.[3] The fact that such a preposterous hypothesis could be taken seriously, never mind being the subject of countless conferences, seminars, workshops, and reams of befuddling gibberish, is perhaps as good an indicator as any that the more outrageous the thought the more seriously it is taken, and that the predicaments we now face in world markets are as much a result of our consummate hubris as the unpredictability of the future.

Until recently, the collective wisdom assured us that free-market capitalism plus a decent dollop of democracy had finally routed all other forms of economic and political organization. But with the Asian economies somersaulting from boom to bust, and the financial equivalent of AIDS — appropriately named "contagion" — infecting one economy after another, inducing the collapse of financial markets in dominolike fashion as the system imploded under the weight of its inherent contradictions, the triumph of free-market capitalism has been called into question. Does the emperor ever have clothes? History, it seems, has not quite finished with itself — or us.

Traditional remedies have proved ineffective, leading one of the world's more eminent advocates of free markets, Paul Krugman, to publicly address the vexed question of the emperor's clothes.[4] Should we, he asks, given the seriousness of the current crisis, not temporarily "scupper" reliance on the market.[5] Traditional economic nostrums simply haven't worked, he argues. If an afflicted country raises interest rates and taxes to protect its currency, economic growth comes to a grinding halt, and even fundamentally sound companies are brought to ruin. If instead a country caught in the vortex of a downward spiral keeps interest rates low and lets its currency collapse, it will trigger capital flight and inflation. What Krugman suggests is heresy to free-marketeers: "[The only way out] is a solution so stigmatized," he writes, not with the conviction of a convert but with the resigned doggedness of one who must follow his own conclusions to their logical end, "that hardly anyone has dared suggest it."[6] The unsayable words are "exchange controls."[7]

Globalization and the onward march of the free market, guided by the mysterious, even divine wisdom of the Invisible Hand, have made nation-states virtually irrelevant; we queue up to apply for our visas to enter this new global village, where the pastures are greener, the land more fertile, and there is room for all to flourish. All this is, as events of the last year so vividly illustrate, an extension of the end-of-history hype, erroneous in the extreme, even subversive in the sense that rather than proving to be an instrument that would reduce disparities in income and wealth distributions between nations, it has proved itself an adept instrument for the opposite.

Many of the assumptions underlying democratization that were articles of faith in the mid-eighties and early nineties would be regarded, and rightly so, as sheer hogwash in the era of the global marketplace and instantaneous capital flows. Others, still part of the received orthodoxy, require a thorough reexamination. Emerging democracies, especially those in Africa, and more especially those in sub-Sahara Africa, devastated by war, famine, disease, and without even the pretense of a tarred road, to say nothing of an infrastructure, or parts of Asia and Latin America with low incomes and no savings, have little or no control over their economic fate in a free-for-all market system. They are the procession of ghosts that follow their funeral corteges, the sad echoes of their hollow frames a dirge to the victims of travails beyond their own making.

II

Last September, much of the world waited with apprehensive anticipation to see how Alan Greenspan, chairman of the United States Federal Reserve Bank, would act to deal with the global financial crisis threatening to plunge the world into recession. It may as well have waited for Godot. Which in itself is a sufficient commentary on who is the ultimate arbiter of what's good for the world, never mind individual countries, of who should suffer the "pains and arrows of outrageous fortune," the consequences of the fallout of decisions made by rapacious speculators, opportunistic financial institutions, and countries that have become old hands at manipulating the IMF and its ilk. Borrowing heavily puts the onus for repayment not on the borrower but on the lender. The threat of large-scale default with the "contagion" it spreads, is the best weapon borrowers have for further assistance to preclude economic meltdown, a form of blackmail in which the continued viability of an interdependent world economy makes the strong beholden to the weak.

But blackmail, insidious creature that it is, has a penchant for enmeshing blackmailer as well as blackmailed in its greedy claws.

III

There is an increasingly invoked view that an IMF bailout does little for the poor and the underclass in a stricken country, but is of most assistance to the First World creditor banks and currency speculators whose self-serving actions are often responsible for the country's dire predicament in the first place. As long as First World banks and investors can count on an IMF bailout to countries that go into an economic free fall, they have a safety chute that enables them to make risky loans and investments without having to worry about the consequences of their financial transactions going wrong, and the countries that can rely on the IMF as the lender of last resort have little incentive to reform their often crony-oriented banking systems and address the corruption that corrodes their economies.

The IMF itself has come under increasing scrutiny since 1998. In the year since the start of the Asian crisis in September 1997, the IMF disbursed $120 billion in international bailouts. One year later, all the countries it had attempted to rescue from the financial holes they had dug themselves into with such careless abandon were in worse shape. IMF prescriptions, or other IMF conditions for loans, had only exacerbated the economic woes of the countries in question. Thailand, Indonesia, Korea, and Russia, rather than being out of intensive care, were still struggling to survive on IMF respirators that were themselves experiencing severe power outages. After its massive disbursement of funds, the IMF had less than $10 billion on hand to contain future contingencies and found itself going, cap in hand, to tap a line of credit to the tune of $24 billion from the ultimate lender of last resort, a faceless entity operating under the suitably anonymous cover of the General Arrangement to Borrow.

In terms of policy, the organization, once the oracle before which poor countries humbled themselves in trepidation, is becoming the focus for severe criticism. To prescribe for any one country tight monetary policy which leads to higher interest rates, cuts in government expenditure, and a reduction in consumer demand might be the correct "treatment" for the ailing patient; but when every patient swallows the same economic medicine at the same time, the result is a collective overdose: Jonestown-like deflation. Unless an antidote is quickly found for resuscitation a worldwide slowdown will further harden the global economy's arteries and recession will litter the landscape with dead economies.

Economies asphyxiating on the last whiffs of financial oxygen are clutching desperately at the empty canisters. One feature of the global economy in the final year of a century not particularly distinguished for its regard for human life, is that technology has in fact made human labor replaceable as a factor of production in ever increasing areas of economic activity, and most tyrannically in emerging markets or those for which the word *emerging* is an aspiration well beyond their reach. One-third of the eligible workforce in the world is either unemployed or underemployed, that is, there are at least one billion people across the globe who cannot provide the wherewithal for their own survival or the survival of their families.[8] Nor will they ever be in a position to do so. Economic growth is increasingly of the non–job creating kind. The problem the world faces as it straddles the cusp of the twenty-first century is what to do with people.

"For its swiftness and confounding of experts, the evaporation of the Asian 'economic miracle' probably ranks only second to the unraveling of soviet socialism as the greatest surprise of the last half century," says Walden Berro, a member of the Social Research Institute at Chulalongkorn University in Bangkok.[9] And with the evaporation of the miracle some of the world's most cherished shibboleths regarding *the building blocks for economic growth* and the *consolidation of democratic governance* crumbled as the foundations upon which they were constructed collapsed in the financial mud slide that swept away everything in its accelerating path.

What should have been of most immediate concern is why the international financial institutions — the IMF and the World Bank in particular, institutions which had guided and in some cases been the prime movers in the remarkable transformation of these economies — could have been so uncomprehending of what was happening around them, so inept in their forecasting, so blind to the fault lines at the economic seams of these countries, so impercipient of the financial practices that flourished under their very noses, and yet so dogmatically sure of themselves when it came to prescribing the "adjustments" countries the world over, especially the poorer ones, would have to put into practice before they could receive the aid vital to keeping open their lifelines to the rest of the global economy, could have gotten it so wrong, that the collapses across Asia, which send one-quarter of the global economy into recession, found them flat-footed, bewildered, and at a loss to give a reason for it all, until, of course, they discovered in hindsight that the symptoms of imminent disintegration were there all the time, only we were too busy applauding success to see the rotten apple at the core.

We were treated to the wise words of the senior IMF official who told the Royal Academy of Morocco that Indonesia was within reach of eliminating poverty. Four months later the World Bank's Indonesia specialist was predicting that up to one in four Indonesians, or some 50 million people, might lose their jobs in a catastrophic economic meltdown.[10]

Or more incomprehensible still: the IMF, in its 1997 annual report, wrote that "directors welcomed Korea's continued macroeconomic performance [and] praised the authorities for [its] enviable fiscal record."[11] Three months later, the Korean government was negotiating with the same IMF for a $57 billion bailout to prevent the world's eleventh largest economy from going down the global drain.

Or who was held to account in the IMF, that most circumspect of organizations for the most noncircumspect report that "in [Southeast Asia], the region is poised to extend its success into the twenty-first century and governments still have a major role in driving this process"? This confidence was rooted in "the region's strong macroeconomic principles, in [Southeast Asia's] tradition of, and commitment to, efficient allocation of investment, and in the widespread belief that the external environment would continue to be supportive."[12] Less than a year later, the IMF decried Asia's "fundamentals" as severely wanting. The crisis, it argued, was "mostly home-grown."

The "Asian Tigers," the IMF's models of probity, before their ignominious implosions, for all emerging markets, were now harshly condemned for the laxity of their banking systems, and a new phrase, "crony capitalism," was coined to describe their disgrace. The tigers were quarantined, confined to their cages before the contagion could spread. But the damage was done; the red meat of their financial entrails poisoned, and the contagion spread: hence the fear and loathing in other emerging markets.

Some analysts sought more profound meanings:

> After all [they expostulated], capitalism is supposed to excel at allocating investment funds efficiently. In this case, it didn't. *The deeper explanation is that market capitalism is not just an economic system. It is also a set of cultural values that emphasizes the virtue of competition, the legitimacy of profit, and the value of freedom. These values are not universally shared. Other countries have organized economic systems around different values and politics.*
>
> *As a result, spreading capitalism is not simply an exercise in economic engineering. It is an assault on other nations' culture and politics that almost guarantees a collision.. Even when some countries adopt some of the trappings of capitalism, they do not embrace the basic values that make the system work.* This is what happened. Led by the U.S., global agencies (the World Trade Organization, the International Monetary Fund) sought to persuade poorer countries to become more open to trade and global capital. These countries tried to maximise the benefits of the process while minimizing changes to their politics and commerce. [My italics]

Thus:

> Mutual deception flourished. Countries like Korea and Russia pretended that they had. American, European, and Japanese bankers, executives, and government

> officials pretended the claims were true — or might become true. Loans were made on the basis of incomplete or faulty statements. Or they were made on the faith that, if a loan went sour, someone (the government, the IMF) would cover the losses.[13]

And thus:

> Global capitalism has become a dangerous hybrid. On the one hand, investors committed huge sums and expected high returns. On the other, the money often went — through bank loans, bond issues, and stock offerings — to borrowers who were not operating according to the strict rules of efficiency or profit and loss. Crony capitalism often meant corruption: contracts won with bribes; favoritism for the well-connected. In 1997, a group called Transparency International ranked corruption in fifty-two countries as judged by global executives and country specialists. Not surprisingly, Russia ranked fourth, Indonesia seventh, and Thailand fourteenth.
>
> But capital flowed freely, and self-deception prevailed. Banks collected interest on loans. "Emerging market" mutual funds rose, because local stocks were buoyed by new investment money. While everyone enjoyed profits, there was a suspension of belief. Now comes the reckoning. Capital flight has forced most developing countries to conserve scarce foreign exchange.
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> Countries cannot expand their economies unless they replenish their foreign exchange reserves of hard currencies.[14]

Not much mention is made here of the fact that every time the IMF bails out one more emerging market economy that has hit the economic dust, it is using the tax dollars of the developed world, not to bail out the countries in distress but the commercial financial institutions in the developed countries that made the questionable loans in the first place. Thus, the commercial loans of financial institutions in the First World to emerging markets are virtually risk-free, since if things go sour, they can count on the IMF to step in and more or less secure their "bad" loans, while the cost of the defective and unwise decisions of these supposedly free-market institutions are channeled via taxpayers in the wealthy countries through the IMF onto the backs of the miserable millions in the poor countries, once the beneficiaries of Western financial largess, who have to shoulder the burden of the stringent repayment conditions the IMF attaches to making the bailout loans. Something is wrong here — not merely wrong but, if one were conspiratorially inclined, deviously wrong. The poor ultimately pay for the mistakes of the rich.

IV

Some of the variables that had yet to make their full weight felt.

First, whether the turnabout in the fortunes of the yen assumes a critical mass that conveys a permanence. A stronger yen is the precise antidote for Asia's malaise, for unless Pacific Rim exports become more competitive, thus taking the pressure off China to devalue and boosting the buying power of Japanese consumers, recovery of any substantial extent will remain problematical.

Second, the reform of Japan's banking system must be seen to be getting off to a real start. Japan's government has committed itself to injecting $600 billion into the banking system, a sum that is equal to almost all of Japan's bad loans. But many are dubious, and if past practices are anything to go by, the well-chronicled pattern of false starts feeds skepticism.

However, the known but unacknowledged and unspoken fact is that Japan's banks are bankrupt, with bad loans and defaults amounting to one trillion dollars – an amount equal to roughly 25 percent of gross national product (GNP). (For a comparative yardstick use the Savings and Loans crash in the late 1980s in the United States.) The bailout, huge though it was, amounted to 2 per cent of GNP. If the Japanese government were to "refinance" the banking system, it would drive the country into a possible depression, and as goes Japan, so goes the rest of Asia.

The impact of the world's second largest economy going belly-up, followed by pervasive depression throughout Asia, which accounts for one-third of the world's output, would, at the least, induce recession in the United States, and most probably in the rest of the world. If Japan were to try to deal with its banking crisis by calling in loans due from the United States, Europe, and much of the rest of the world — it is in the ironic position of having a banking system that is functional only in name while being the world's largest creditor nation — banks all over the world would teeter and fall as they would be unable to cover their repayments, thus triggering a worldwide recession, which in the long-run would do little to help Japan.[15]

Third, after the IMF and twenty of the world's richest countries reluctantly (the fact that they did so reluctantly was a harbinger of eventual failure) agreed to finance a $41.5 billion loan package for Brazil in return for massive austerity cuts on the parts of the Brazilians (Brazil's foreign reserves had fallen from $75 billion to $43 billion between August and November 1998), the deal did not close the financial dikes, and two months after the bailout was put together, Brazil's currency, the real, was effectively devalued by 8 percent: the repercussions will be felt throughout the Americas, including Mexico, Venezuela, Chile; indeed, in all countries with weak current account balances. And the repercussions will be felt in the United States. The question again is whether the consequences will "merely" envelop most of the Americas in a recession or whether an impending financial implosion might trigger an economic meltdown. One way or another, the question will lure speculators, once again emerging from their safe havens.

Fourth, the most watched, and befittingly the least open to scrutiny: What will happen in China? Despite its continued insistence that it would meet the targeted growth rate of 8 percent for both 1998 and 1999 and that devaluation of the yuan, which would trigger a new financial panic in East Asia, is out of the question, all indicators point to a severe economic slowdown. A growth rate of even 4 percent this year or next would, in China's circumstances, amount to a recession, given that every percentage point drop in GDP means 5 million more unemployed, that some reliable estimates already predict 18 to 20 million unemployed within a year, a recipe for political unrest.[16] In addition, there are signs that China's financial institutions are becoming a little unstuck. China's banks are burdened with bad debts, both to state enterprises and to property speculators, made during the boom days of the early 1990s. Many state enterprises are themselves bankrupt and face closure, unpalatable though that course of action is to the Chinese.[17]

A devaluation of the Chinese yuan or the Hong Kong dollar would devastate Asian markets, crushing their efforts to pick themselves up following the East Asian debacle, send the usual "shock waves" through the developed world, harden predictions of a global recession to the point where the near certainty attached to the predictions create situations in which the predictions become inevitable certainties, and lead to a global crisis of liquidity. In these circumstances, or even less consequential ones, as the bite of economic slowdown begins to clench its teeth on the West's economies, developed countries will do what is best for themselves — the resuscitation of foreign markets to absorb their exports and cushion unemployment will be the first order of business, and hence an even more ambitious emphasis on pulling Asia, in particular, and the more important emerging markets in the Americas out of their quagmires.

V

In the face of overwhelming poverty, exacerbated by AIDS, the devastation of endemic wars, dysfunctional education, the virtual nonexistence of electricity, sanitation, and clean water, rudimentary and unhygienic health care, recurrent famine, Africa owes some $227 billion to international creditors, which amounts to about $600 for each person on the continent. Of the forty-one most heavily indebted low-income countries in the world, no fewer than thirty-four are in sub-Sahara Africa.

In 1996, the World Bank and the IMF announced a plan to reduce the debt burdens of the world's poorest countries. Two years later, a confidential report to the World Bank's executive board said that "considerable progress had been made."[18] One shudders to think what the World Bank might construe as lack of progress. Some forty countries, again mostly in Africa, were sufficiently poor and indebted to qualify for assistance under the 1996 debt-relief plan. Of those, ten have had their cases reviewed, and six, three of which were African — Burkina Faso, Côte d'Ivoire, and Mozambique — have been promised help.

Only one, Uganda, has had any debt forgiven. And only a handful more will qualify for aid before the end of the century, despite the bank's having agreed to relax its restrictions at the September 8 meeting to enable countries which had put economic reform programs in place by 2000 to become eligible for assistance, thus opening the door for war-torn countries such as Democratic Republic of the Congo, Angola, and Sudan. However, even with the relaxed restrictions in place, and assuming that all debt-relief conditions are met — a big assumption, only a handful of countries will receive any relief by the end of the century.[19]

One reason is that debt relief raises the cost to creditor governments, and about half is owed to rich-country governments which also pick up much of the outstanding debts of multilateral institutions that lack the resources to do so themselves. The cost to creditor countries would become much greater if the pool of countries eligible for benefits is further increased.

Moreover, with large and economically important areas slowly succumbing to the impact of the global financial crisis, the effects of which may take two years to work its way through the global market, developed countries have become more circumspect. Adding to the caution and uncertainty is the huge cost of financing the bailout of Brazil, the increasing uncertainty regarding Brazil's capacity to meet its obligations under the bailout, continuing economic and political instability, which can only worsen, and the looming crisis in China.

Unfortunately, the less developed emerging markets or the undeveloped markets of the rest of the world, the world of the chronically poor and for the most part forgotten, will not be part of recovery programs, because not having had much to begin with, there is little to recover, and there is no comparison between the short-term return on one billion dollars spent on debt relief or one billion dollars spent in bailing out the markets that count.

This leaves South Africa, for example, in a no-man's-land. An emerging market, yes, but one that has not lived up to its potential and shows little signs of doing so, especially as it has to contend with recession in an election year in which the election results will be more pivotal than the elections in 1994 since they will point to the direction of South Africa's future well into the twenty-first century. But also an emerging market surrounded by some of the poorest countries in the world, hostage to the uncertain, or in a number of cases, the absence of a future in many, to the endemic strife that the continent seems unable to stem, and with a culture of corruption that has led many donor countries to abandon their efforts to help when the only real tangible results of relief is the enrichment of elites and the further impoverishment of the masses.

In *How Africa Was Brought Low,* an essay for the African Renaissance Conference, Dr. Peter Ewang writes:

> Bilateral and multilateral organizations have made certain policy interventions as a direct precondition for loan effectiveness. However, these activities ignore the fact that in African countries the constraints for development are not caused solely by economic factors but by institutional weakness, low-level social awareness, education, and health care.
>
> Most of the time the constraints have been ignored. Nowadays decisions are dominated by or influenced by international organizations with very limited technical and socio-cultural expertise and insight concerning African countries. Development is something that means something distinctly different to those being developed and those doing the developing. The economic structure of African countries has been developed not to feed their own people but to meet the import needs of development that have made Africa a site of recurring famine, unpayable debts, and in need of a renaissance.
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> There is ample evidence that international development programmes have failed in most of the African countries. Since 1980 Africa has received billions of dollars as aid through development programmes, yet Africa today produces less food and has more hungry people. It is no coincidence that over the past decades, some of the largest recipients of the USA and the former Soviet Union's aid in Sub-Sahara Africa, particularly Sudan, Ethiopia, Mozambique, Somalia, and Angola, have been nations where war, famine, and hunger are most common.
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> At best the aid programmes of the past were not effective, at worst they have been part of the problem. Development has often helped destroy people's ability to feed themselves. Offers of food pour in but obtaining financial resources for rehabilitation is usually difficult. Dumping food as relief has not solved the developmental problems of Africa. Food aid extended by developed countries, following devastating famines caused by civil strife and natural calamities, has adversely affected the capacity of the continent to deal with its problems. Generally food aid programmes have introduced a harmful spirit of submissiveness and dependency into these poor societies and inefficiency and corruption into governments of most of these countries.
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> The hunger and debt caused by the huge debts are difficult to accept. Governments in Sub-Sahara Africa have been pressured by the IMF and the World Bank into implementing structural adjustment programmes in order to acquire loans for development. These countries are made to pay their debts by surrendering the bulk of their export earnings, leasing out valuable resources at throwaway prices to earn extra income, and sacrificing social and environmental considerations to earn enough to pay their debts.
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> Many countries in Sub-Sahara Africa owe more money today than they did ten or twenty years ago. In fact, in 1992 African external debt had reached $290 billion, about 2.4 times greater than in 1980. In the Sub-Saharan African countries alone the debt increased from $6 billion in 1970 to $243 billion in 1994. The big question is why the big institutions (the World Bank, IMF, and others) let this unbearable debt accrue.[20]

That such an essay should be one of the showcase features introducing the conference is cause for reflection. The insinuation is that developed countries not only plundered Africa in the past but continue to do so in the guise of development programs, which although ostensibly tailored to the needs of the country in question are in effect instruments of measured interference, designed to service the needs of the developed countries. Even humanitarian aid — food to alleviate famine — is viewed in a sinister light. For every dollar given in aid, there is a condition, an unspoken agenda to mold the economies of the poorer countries according to the dictates and, needless to say, advantage of the donor country.

The essay is an expression of anger at developed countries: at their hubris, their "we-know-it-all" attitude; their condescension inherited from the lingering sense of conquest and the unstated but silently held conviction that things were better in "their" day. Indeed, even today, and perhaps to a greater degree in the post–Cold War era, former colonial powers vie with one another for "parental" control over what used to be "their" Africa, and when the children are naughty, they are not above sending in their troops to sort things out, all under the pretense of having to "protect" their citizens who are still residents of whatever godforsaken piece of earth is being scorched in the interests of some tin-pot dictator or the would-be usurper of his much coveted position. It is a manifestation of deep resentment of the developed countries' self-perceived sense of going out of the way to help, at the altruism they smother themselves in, when the help really only makes recipients more roiled that they have to turn to their former "masters" or clones of their erstwhile masters for help in the first place; bitterness that the help encourages a culture of helplessness, thus fostering the dependency the help is supposed to eradicate.

It is noteworthy, too, for what it fails to say. That every other country in large swaths of the continent is embroiled in civil conflict or party to the civil conflicts of others; that famine is often self-induced; that food relief is used as a weapon to leverage concessions from the enemy; that food is often withheld from the starving and mysteriously finds its way into the hands of the warmongers; that corruption is pervasive.

Given that many of Africa's conflicts have their roots in borders arbitrarily drawn by conquering powers with little regard to natural alignments, ethnic demarcations, or history, and that fears of domination by one ethnic group, often justified, are never far from the surface, that natural disasters have taken an inordinate toll, that the 12 million refugees who are permanently homeless — and countryless — have nowhere to go and create a permanent source of instability in the region, and that indebtedness cripples the prospects for development, one can easily empathize with the rage of Africa.

But the failure of Ewang to acknowledge that Africans may have anything to do with the plight they are in, that the actions of their elites or of those who stoked ethnic antagonisms and fanned the flames of hatred for personal ambition, of those who looted their countries of their wealth on a scale almost unimaginable to imagine, who have exploited their own people to a degree that not even the colonial imperialists of the past could match, to fail to hold Africa accountable for many of the ills that beset it is to sink into the self-pity that is the hallmark of the submissiveness and dependency he goes to such great lengths to warn against.

Commenting on the renaissance conference, Thabo Kobokoane observed that "the conflicts plaguing Africa did not dominate the proceedings." (In the past year, one of four countries in Africa was engaged in conflict; half the worldwide deaths occurred in Africa.)

> Surely discussion on these wars and rebellions should have been at the centre of any debate about a reawakening Africa? After all, it is the continent's all-too-familiar problems that fly in the face of a so-called renaissance; a massive stumbling block to those who will eventually oversee its regeneration.
>
> Yet to the bulk of African Renaissance delegates, the festering conflicts did not appear important. [An equally] pressing question that needed addressing concerned the nature of Africa's governments. How will the African renaissance "movement," an essentially private-driven initiative, relate to those states that have no tolerance of civil society?[21]

VI

The Gini coefficient is the standard tool for measuring the degree of inequality in a society. On a scale of 0 to 1, where 0 represents absolute equality and 1 absolute inequality, South Africa currently ranks second in the world in terms of income inequality with a coefficient of 0.58; only Brazil, with a coefficient of 0.63, ranks worse. According to one argument, countries in the throes of development should undergo an increase in levels of income inequality, since growth by its very nature is an uneven process, and hence the inequities to which it gives rise are a function of growth itself — a dynamic process in which the variables that drive it are themselves changing at differential rates — important components of growth such as the movement of labor from less productive sectors of the economy to the more productive, patterns of migration from rural areas to urban areas, the distribution of capital with a preponderance going to capital-intensive industries, the unequal rates of technological change, the gestation of "new" industries, all ensure that inequalities increase as society is in a perpetual state of transformation.

It is not unsurprising therefore that Gini coefficients tend to be highest in the emerging economies — Chile (0.56), Panama (0.57), Thailand (0.46), Malaysia (0.56), and closer to South Africa, Zimbabwe (0.57) and Kenya (0.58). On the other end of the scale, countries with the highest degrees of inequality tend to be the poorest countries, trapped in unbreakable chains of pervasive poverty — Bangladesh (0.28), Rwanda (0.29), and Laos (0.30).[22] The capitalist view: "inequality, despite its perceived inequity, is nothing more than growth in progress."[23] Which would appear to suggest that the greater the degree of inequality, the more growth in progress, and that if we value growth, we should be prepared to tolerate the inequalities it breeds.

The transfer of technology may also increase inequality. Although some innovations benefit the worst off, much technological progress raises the marginal products of those who are already more productive. Even when it does not, the opportunity cost of public investment in technology might be forgone investment in antipoverty programs. By increasing output, however, these investments can benefit the entire society. The potential trickle down, however, is not necessarily rapid or comprehensive.[24]

VII

If the white view of inequality is that white affluence relative to blacks is not attributable to white exploitation of blacks, which has contributed to the relative and absolute poverty of blacks, then South African Deputy President Thabo Mbeki's argument that there are two nations in South Africa — one white and well off, the other black and poor — is lost on whites and one more instance of the refusal on the part of whites to acknowledge the damage that apartheid did, especially in confining the education of blacks to a level that ensured that they could not rise above a certain functional level — of serving as the human fuel for the white industrial machines and as the underground excavators of the mineral wealth that enriched the white fraternity. If whites cannot bring themselves to see — and acknowledge — that they exploited blacks in the past, and especially under apartheid, then the future for improved race relations is bleak, and an increasingly resentful black elite will seek retribution through the means whites fear most — redistribution through taxation. How can one speak of nation building when the people who are supposedly the rudimentary core of the nation engage each other with such silent enmity?

VIII

In the United States, unchallenged in its role as the global economy's financial policeman, Alan Greenspan's decisions reflect U.S. interests, in this case how best to balance the country's vulnerability to deflation in markets that are of most concern to it, that are destinations for its exports against the risks of inflation at home which would result from increasing the money supply, thereby triggering a reduction in interest rates. It was universally agreed — as if universal agreement on anything counts for much in a world in which the capacity to produce instantaneous information on any issue at any point far outweighs the capacity of its recipients to assimilate it — that the concomitant domino effects which would follow a cut in interests rates in the United States would save many countries from free fall into recession.

What kind of New World Order are we building when the economic fate of the struggling countries that account for the overwhelming proportion of the world's population lies in the hands of a reserve bank that makes its decisions on rates reduction on the basis of what's best for the United States, not on the basis of what is best for the world economy, on the basis of how deflation in many parts of the world would impinge on American interests and open the economy to possible exposure to the deflation virus, on the basis of what's good for America is good for the rest of the world, an indicator of the hubris of a country which has had to suffer the least, and whose response to addressing the increasing disparities in world inequities is to cut the relatively small percentage of GDP it contributes in aid to distressed nations struggling to emerge from centuries of oppression and exploitation. (It already contributes the least — at 0.11 percent of GDP, it ranks at the bottom of the list compared with what other developed and the upper tier of developing countries contribute, and it has steadfastly refused to pay its arrears to the United Nations.)[25]

To talk of the need to build multiparty democracies in such circumstances or to go on millimeter-measuring exercises to determine whether a country is slipping from being a one-party dominant state to a one-party state would be farcical were they not so pervasively practiced by the savants of the United States' perceived national interest.

(Former national security adviser Zbigniew Brzezinski, who refers to America's allies and friends as "vassals and tributaries," argues the case for a grand geostrategy that would "prevent collusion and maintain security dependence among the vassals, keep the tributaries pliant and protected, and keep the barbarians from coming together."[26] And David Rothkopf, a former senior member of the Clinton administration, in a burst of moral fervor and patriotic humility was moved to write that "Americans should not deny the fact that of all the nations in the world, theirs is the most just and the best model for the future."[27] The proposition that we have reached the end of history still has its adherents; history, it seems, is somehow synonymous with the American destiny.)

Indeed, when Greenspan made the "by-the-way" acknowledgment before the U.S. Senate on September 22, 1998, that Reserve Bank policymakers were fully aware of the widening financial crisis that had spread from Asia to the rest of the world and its impact on the U.S. economy ("Deteriorating foreign economies and their spillover to domestic markets have increased the possibility that the slowdown in the growth of the American economy will be more than sufficient to hold inflation in check"),[28] financial analysts profoundly proclaimed that this was the clearest indication yet that Greenspan would fight the prospect of a spreading recession by lowering U.S. interest rates. Asian markets soared, and some of the capital that had fled some of the more sophisticated emerging markets in search of safer or more lucrative rewards returned to local bourses. In South Africa, the rand recovered to close the day's trading at R5.8 to the dollar — the "symbolic" R6.00 to the dollar benchmark had been breached, and in the euphoria that followed many market analysts predicted a quick recovery, overlooking the fact that not too long ago an exchange rate of R5.00 to the dollar was cause for the market to develop a severe case of the jitters.

In the event, when Greenspan did make his "momentous" decision, he cut the Reserve Bank's prime rate 0.25 percent, well below anticipation and already well discounted in the markets. The result: "An immense cloud of despondency hung over local markets as the Johannesburg Stock Exchange all share index took a further 3.337 percent tumble . . . and the rand once again slid relentlessly against the dollar, breaking through the R6 barrier."[29] So much for euphoria and its afterglow.

What annoyed, frustrated, indeed angered other countries, especially the emerging markets, was Greenspan's seeming myopia or indifference, or worse, ignorance regarding what was happening in the world around him.

Greenspan's second intervention in the market in October, when he unexpectedly cut short-term interest rates by another quarter of a percent, the second such cut in the space of sixteen days, had at least the salutary benefit of being unanticipated. Its impact was not prematurely discounted in the markets and therefore was a more effective booster to market indexes, bringing with it the usual clamor of the collective pundits that the worst was behind us, and "recovery" — How can one talk of recovery when the full extent of the illness has not yet been fully diagnosed? — was on the way. Besides, when a person of Greenspan's preeminence is so unnerved by market developments that he finds himself publicly admitting that "I've never seen anything like this," when the oracle himself starts to eat — gobble — humble pie, it behooves policymakers everywhere to hold their breath — and their appetite. Interest rate cuts in other countries — Britain, Spain, Canada, China, Japan, and Ireland — provided a floor to cushion or forestall global recession. But Germany continued to resist a cut, creating sufficient uncertainty to keep the edge of volatility in the ascendant.

Greenspan's surprising remark is precisely the issue. Why had he been blind to what had been so apparent to the rest of the world for some time? Some months ago economist Lester Thurow wrote,

> Fear is rising and so is anger at do-nothing Americans . . . Having been at financial and economic conferences in Latin America, Asia, and Europe in the past few weeks, I find enormous anger at the entire United States. The rest of the world

believes that an enormous economic hurricane is building up its strength and that the captain of the ship, the ship's senior officers, and those who ride in first class aren't paying attention to the dangers that are developing . . . They feel we are just not focused on the dangers that are about to strike inland and lay waste the global economy.[30]

This, of course, is why Alan Greenspan's first quarter of a percentage point cut in interest rates was greeted so negatively in the world capital markets, and why he had to make an emergency second cut just two weeks later, and why he had to promise that he was thinking of yet a third cut in the not-too-distant future.

To the rest of the world, that trivial first cut first looked as though Greenspan did not know what was going on. The economic hurricane was about to arrive, and he, as the leader of the world's central bank of last resort, was not willing to signal with a big interest rate cut that, if necessary, he would provide the world with the liquidity the world's markets needed to avoid a disaster. He did not seem to understand that issues are no longer those of fine-tuning inflation but avoiding a global meltdown.

Thurow concludes,

When fear takes over in the financial markets, they fall apart very rapidly. Fears are now growing like mushrooms. How big will the {worldwide] bank losses be? How many more huge losses like those at Long-term Capital Investment will suddenly appear? How many more countries like Russia and Malaysia are simply going to let their companies violate [the pledges] they have signed and not force them to repay legitimate debts? What happens if the stock market goes down and Americans begin to cut back on their spending? What happens if Japan fails to continue to deal with its problems? Rational or irrational, fear is clearly on the rise.[31]

And imagine the fear if Brazil's much touted bailout becomes seriously derailed.

The signs that something is clearly out of kilter are everywhere. Policymakers make statements as though hermetically sealed from each other. In the world's respected financial organs legends like "US begins to catch a cold,"[32] "China crisis,"[33] "A world in the woods,"[34] "currency vacuum: gaping hole at the centre of the G7's plan to prevent recurrence of the recent financial crisis,"[35] "Turmoil hits US consumer confidence,"[36] "Global bulls suffer crisis of confidence,"[37] "Russia's bleak future,"[38] "US consumers score negative savings rates,"[39] "Ominous symptoms of recession are apparent,"[40] "Yen depositrates fall to below zero,"[41] "Chancellor paints gloomy world picture,"[42] and on the same page of *The New York Times*, "Greenspan Sees Calming of Markets" and "Growth in Jobs Slowed Sharply Last Month,"[43] "Chinese Investment Trust Defaults on Bond Payments, Stirring Fear;"[44] "Fears over Brazil roll-over,"[45] follow each other helter-skelter and the United States continues its roller-coaster ride on the markets, sure that "God's in his heaven — All's right with the world."

Globalization is here to stay, Thabo Mbeki somberly informed the Non-Aligned Summit. The crisis South Africa faced, indeed that they all were facing, was not of their own making; rather it was a case of their being caught in the fallout following the collapse of the Asian markets. "The stark reality," Mbeki concluded, "is that the power to influence markets lies exclusively in the hands of those who dominate those markets, which we, even collectively, do not."[46]

In October 1998, the glitterati of the financial world gathered in Washington, D.C., at the annual meetings of the International Monetary Fund and the World Bank to discuss what was now being routinely described as the worst financial crisis to engulf the world economy in fifty years. What lent gravitas to the occasion was the fact that the crisis they had gathered to discuss was never supposed to happen. Hadn't the integration of global capital markets, the sophistication of the instruments that allowed for risk diversification management, disclosure requirements, financial regulation and supervision, the omnipresence of rating agencies, the plethora of complex risk models, real-time transactions, and instantaneous communications prevented the kind of collapse that was gathering speed as they pondered the question: What had gone wrong?

Great minds knitted their brows and looked for fairy-tale remedies. But there were none. In symposiums, workshops, plenary sessions, and one-on-ones, the mighty and the not-so-mighty clustered together, applying their collective wisdom to unraveling the monetary mess that was causing financial gyrations in world markets and threatening economic chaos. It was if the free market had gotten away from them, had discovered that its power was unbounded, that the unfettered movement of rapacious capital, as it zigzagged from market to market and from markets to havens of shelter, could devour whole economies, yet find its appetite still insatiable, searching in apoplectic fits and starts for the carcasses of other bankrupt countries.

"This year, as currencies and bourses have crashed and people in the more damaged economies have taken to the streets," writes Paul Bell, "the moral and theoretical pendulum of political economics has begun to swing away from the neo-liberalism prescriptions of the Thatcher/Reagan era, and back toward the social democratic construct that was displaced by Thatcherism and is being reasserted now under a new neo-Keynesian rubric of 'people- centered' development."[47]

> In Asia state driven capitalism had long been held up to other emerging economies (not least South Africa) as the best available model of rapid growth and poverty reduction. But the crisis first exposed in the world in Thailand and South Korea a year ago is discovered now to be long in the making as was the mythology of the myth of their success. While the Asian economies were growing at 6–8 percent a year, who cared that the *chaebols* were overprotected, or cronies overrewarded, or financial institutions under regulated and increasingly reliant on short-term investment, or profits directed away from R&D into the overheated property markets of those countries?[48]

Part Two

In Helsinki, Finland, on January 7, 1998, Joseph Stiglitz, senior vice president and chief economist of the World Bank, delivered the 1998 WIDER Annual Lecture, *More Instruments and Broader Goals: Moving Toward the Post-Washington Consensus*. This was, of course, months before the full dimensions of the Asian crisis had brought a wave of devaluations in its wake, before the full impact of "Asian contagion" had made itself felt, before the collapse of the Japanese banking system, before many currencies went into free fall, their economies littered with the detritus of economic collapse.

In the course of his remarks, he offered the following "world view," a glance, as it were, into "new world thinking," or a thinking man's guide to how to put the brakes on a free-market capitalism about to go berserk, an ax murderer abroad in a kindergarten.

His thoughts:

- The Washington consensus held that good economic performance required liberalized trade, macroeconomic stability, and getting prices right. Once the government dealt with these issues — essentially, once the government "got out of the way" — private markets would allocate resources efficiently and generate robust growth. But the policies advanced by the Washington consensus were not complete, and they were sometimes misguided.

An admission that the mandarins of Washington, D.C., might on occasion screw it up? A dent in the aura of infallibility?

- Making markets work requires more than just low inflation; it requires, inter alia, sound financial regulation, competition policy, and policies to facilitate the transfer of technology and to encourage transparency.
- The Bank's understanding of the instruments to promote well-functioning markets had improved. They had broadened the objectives of development to include other goals, such as sustainable development, egalitarian development, and democratic development.

What, might we timidly ask, did the Bank consider to be the "objectives of development" before lightning struck on the road to Damascus?

- Since the financial crisis the East Asian economies had been widely condemned for their misguided economic policies, which were seen as responsible for the mess in which those economies found themselves. Some ideologues had taken advantage of the current problems in East Asia to suggest that the system of active state intervention is the root of the problem. They kept pointing to the government-directed loans and the cozy relations between the government and the large *chaebol* in the Republic of Korea. In doing so, they overlooked the successes of the past three decades, to which the government, despite occasional mistakes, had certainly contributed. These achievements, which included not only large increases in per capita GDP but also increases in life expectancy, the extension of education, and a dramatic reduction in poverty, were real and would prove more lasting than the current financial turmoil.

And this was only January 1998. What would these "ideologues" be saying in January 1999, as the Republic of Korea remained mired in recession, and the chaebols *remained as resistant to restructuring as they did a year ago?*

- The heart of the current problem, at least in East Asia, in most cases is not that government has done too much in every area but that it has done too little in some areas. In Thailand the problem was not that the government directed investments into real estate; it was that government regulators failed to halt it. Similarly, the Republic of Korea suffered from problems including overlending to companies with excessively high leverage and weak corporate governance. The fault is not that the government misdirected credit — the fact that the current turmoil was precipitated by loans by so many U.S., European, and Japanese banks suggests that *market* entities also may have seriously misdirected credit. Instead, the problem was the government's lack of action, the fact that the government underestimated the importance of financial regulation and corporate governance.

- The current crisis in East Asia is not a refutation of the East Asian miracle. The basic facts remain: no other region in the world has ever had incomes rise so dramatically and seen so many people move out of poverty in such a short time.
- East Asian governments, for instance, were running budget surpluses; inflation was low and, before the devaluations, was falling. The origins of the current financial crises lay elsewhere and their solutions would not be found in the Washington consensus.
- The focus on inflation had detracted attention from other major sources of macroinstability, namely, weak financial sectors. In focusing on trade liberalization, deregulation, and privatization, policymakers ignored other important ingredients, most notably competition, that are required to make an effective market economy and which may be at least as important as the standard economic prescriptions in determining long-term economic success.
- Other essential ingredients were also left out or underemphasized by the Washington consensus. One, education, had been widely recognized within the development community; another, improvement of technology, had not received the attention it deserved.
- The success of the Washington consensus as an intellectual doctrine rested on its simplicity: its policy recommendations could be administered by economists using little more than simple accounting frameworks. A few economic indicators — inflation, money supply growth, interest rates, budget and trade deficits — could serve as the basis for a set of policy recommendations. Indeed, in some cases economists would fly into a country, look at and attempt to verify these data, and make macroeconomic recommendations for policy reforms all in the space of a couple of weeks.

Who are these people??

- There are no easy-to-read thermometers of the economy's health, and worse still, there may be trade-offs in which economists, especially outside economists, should limit their role to describing consequences of alternative policies. The political process may actually have an important say in the choices of economic direction. Economic policy may not be just a matter for technical experts!

Poor nations have to put up with the clap-trap of these "outside" economists for decades, and worse yet, have had to eat their words, even when the words stuck in the craw.

- The Washington consensus's messages in two core areas are at best incomplete and at worst misguided. While macrostability is important, for example, inflation is not always its most essential component. Trade liberalization and privatization are key parts of sound macroeconomic policies, but they are not ends in themselves. They are means to the end of a less distorted, more competitive, more efficient marketplace and must be complemented by effective regulation and competition policies.

How many countries in Africa, and underdeveloped parts of the Americas and Asia, *have suffered the consequences of such insufferable hubris and found themselves endlessly at the short end of the IMF stick? And for what?*

- *Controlling inflation.* Probably the most important policy prescription of the stabilization packages promoted by the Washington consensus was controlling inflation. The argument for aggressive, preemptive strikes against inflation is based on three premises. The most fundamental is that inflation is costly and should therefore be averted or lowered. The second premise is that once inflation starts to rise it has a tendency to accelerate out of control. This belief provides a strong motivation for preemptive strikes against inflation, with the risk of an increase in inflation being weighed far more heavily than the risk of adverse effects on output and unemployment. The third premise is that increases in inflation are very costly to reverse. This line of thought implies that even if maintaining low unemployment were valued more highly than maintaining low inflation, steps would still be taken to keep inflation from increasing today in order to avoid having to induce large recessions to bring the inflation rate down later on. All three of these premises can be tested empirically.
- The evidence has shown *only* that high inflation is costly. When countries cross the threshold of 40 percent annual inflation, they fall into a high-inflation/low-growth trap. Below that level, however, *there is little evidence that inflation is costly.* High inflation is, on average, deleterious for growth. Recent research suggests that low levels of inflation may even improve economic performance relative to what it would have been with zero inflation. Controlling high- and medium-rate inflation should be a fundamental policy priority, but pushing low inflation even lower is not likely to significantly improve the functioning of markets.

What false gods have we been serving? And for whom?

- In 1995, more than half the countries in the developing world had inflation rates of less than 15 percent a year. For these seventy-one countries controlling inflation should not be an overarching priority. Controlling inflation is probably an important component of stabilization and reform in the twenty-five countries, almost all of them in Africa, Eastern Europe, and the former Soviet Union, with inflation rates of more than 40 percent a year. The single-minded focus on inflation may not only distort economic policies, preventing the economy from living up to its full growth and output potentials, but also lead to institutional arrangements that reduce economic flexibility without gaining important growth benefits.

Yet, why this fixation with inflation? Why does it not drive the engine of policy in the developing countries, but in the developed ones? Has it become an election mantra, trotted out by bankers and businesspeople who know better?

- *Managing the budget deficit and the current account deficit.* A second component of macroeconomic stability has been reducing the size of government, the budget deficit, and the current account deficit. Much evidence shows that sustained, large-budget deficits are deleterious to economic performance.

- There is no simple formula for determining the optimum level of the budget deficit. The optimum deficit, or the range of sustainable deficits, depends on circumstances, including the cyclical state of the economy, prospects for future growth, the uses of government spending, the depth of financial markets, and the levels of national savings and national investment.

So much for all those writ-in-stone deficit-to-GDP ratios.

- The optimal level of the current account deficit is difficult to determine. Current account deficits occur when a country invests more than it saves. They are neither inherently good nor inherently bad but depend on circumstances and especially on the uses to which the funds are put. In many countries the rate of return on investment far exceeds the cost of international capital. In these circumstances current account deficits are sustainable.
- The form of the financing deficits matters. The advantage of foreign direct investment is not just the capital and knowledge that it supplies, but also the fact that it tends to be very stable. In contrast, Thailand's 8 percent current account deficit in 1996 was not only large but came in the form of short-term, dollar-denominated debt that was used to finance local-currency-denominated investment, often in excessive and unproductive uses like real estate. More generally, short-term debt and portfolio flows can bring the costs of high volatility without the benefits of knowledge spillovers.
- *Stabilizing output and promoting long-run growth.* Ironically, macroeconomic stability, as conceived by the Washington consensus, typically downplays stabilizing output or unemployment. Minimizing or avoiding major economic contractions should be one of the most important goals of policy. In the short run, large-scale involuntary unemployment is clearly inefficient — in purely economic terms it represents idle resources that could be used more productively. The social and economic costs of these downturns can be devastating: lives and families are disrupted, poverty increases, living standards decline, and, in the worst cases, social and economic costs translate into political and social turmoil.

If 40 percent of the employable population is unemployed and another 20 percent underemployed, what impact does a "downturn" have on their lives? It's not the economy, stupid, it's jobs, jobs, and more jobs until they ooze out of every pore of the country's being. Poor countries don't have financial sectors, but they do have people.

- A growing literature, both theoretical and empirical, has emphasized the important microeconomic underpinnings of macroeconomic stability. This literature emphasizes the importance of financial markets and explains economic downturns through such mechanisms as credit rationing and banking and firm failures.

In the nineteenth century, most of the major economic downturns in industrial countries resulted from financial panics that were sometimes preceded by and invariably led to precipitous declines in asset prices and widespread banking failures. In some countries improvement in regulation and supervision, the introduction of deposit insurance, and the shaping of incentives for financial institutions reduced the incidence and severity of financial panics. But financial crises continue to occur, and there is some evidence that they have become more frequent and more severe in recent years Even after adjusting for inflation, the losses from the savings and loan debacle in the United States were several times larger than the losses experienced in the Great Depression. Yet when measured relative to GDP, this debacle would not make the list of the top twenty-five international banking crises since the early 1980s.

- Banking crises have severe macroeconomic consequences, affecting growth over the five following years. During the period 1975–1994, growth edged up slightly in countries that did not experience banking crises; countries with banking crises saw growth slow by 1.3 percentage points in the five years following a crisis. Clearly, building robust financial systems is a crucial part of promoting macroeconomic stability.
- The importance of building robust financial systems goes beyond simply averting economic crises. The financial system can be likened to the "brain" of the economy. Financial markets serve a number of other functions, including reducing risk, increasing liquidity, and conveying information. All these functions are essential to both the growth of capital and the increase in total factor productivity.
- Left to themselves, financial systems will not do a very good job of performing these functions.
- The emphasis on "transparency" in recent discussions of East Asia demonstrates the growing recognition of the importance of good information for the effective functioning of markets. Capital markets, in particular, require auditing standards accompanied by effective legal systems to discourage fraud, provide investors with adequate information about the firms' assets and liabilities, and protect minority shareholders. But transparency by itself is not sufficient, in part because information is inevitably imperfect. A sound legal framework combined with regulation and oversight is necessary to mitigate these informational problems and foster the conditions for efficient financial markets.
- Regulation serves four purposes in successful financial markets: maintaining safety and soundness (prudential regulation), promoting competition, protecting consumers, and ensuring that underserved groups have some access to capital. In many cases the pursuit of social objectives, such as ensuring that minorities and poor communities receive funds, as the United States' Community Reinvestment Act does, or ensuring funds for mortgages, the essential mission of the government-created Federal National Mortgage Association, can, if done well, reinforce economic objectives. Similarly, protecting consumers is not only good social policy, it also builds confidence that there is a "level playing field" in economic markets. Without such confidence those

markets will remain thin and ineffective.

- The World Bank and others have tried to create better banking systems. But changing the system through institutional development, transformations in credit culture, and creation of regulatory structures that reduce the likelihood of excessive risk taking has proved more intractable than finding short-term solutions such as recapitalizing the banking system. In the worst cases the temporary fixes may even have undermined pressures for further reform. Since the fundamental problems were not addressed, some countries have required assistance again and again.

Translation: The World Bank and other international and supranational financial institutions have been a large part of the problem of the global predicament they now so grandiosely moralize about. Instead of becoming part of the solution, it was often more convenient to become part of the problem.

- The key issue should not be liberalization or deregulation but construction of the regulatory framework that ensures an effective financial system. In many countries this will require changing the regulatory framework by eliminating regulations that serve only to restrict competition but accompanying these changes with increased regulations to ensure competition and prudential behavior (and to ensure that banks have appropriate incentives).
- Even when the design of the desired financial system is in place, care will have to be exercised in the transition. Attempts to initiate overnight deregulation, sometimes known as the "big bang," ignore the very sensitive issues of sequencing. Thailand, for instance, used to have restrictions on bank lending for real estate. In the process of liberalization it got rid of these restrictions without establishing a more sophisticated risk-based regulatory regime. The result, together with other factors, was the large-scale misallocation of capital to fuel a real estate bubble, an important factor in the financial crisis.
- It is important to recognize how difficult it is to establish a vibrant financial sector. Even economies with sophisticated institutions, high levels of transparency, and good corporate governance like the United States and Sweden have faced serious problems with their financial sectors. The challenges facing developing countries are far greater, while the *institutional* base from which they start is far weaker.
- Without the appropriate legal framework, securities markets can simply fail to perform their vital functions to the detriment of a country's long-term economic growth. Laws are required to protect the interests of shareholders, especially minority shareholders.
- The focus on the microeconomic, particularly the financial, underpinnings of the macroeconomy also has implications for responses to currency turmoil. In particular, where currency turmoil is the consequence of a failing financial sector, the conventional policy response to rising interest rates may be counterproductive. Interest rate increases can lead to substantial reductions in bank net worth, further exacerbating the banking crisis. Empirical studies by IMF and World Bank economists have confirmed that interest rate rises tend to increase the

probability of banking crises and that currency devaluations have no significant effect.

This will be most reassuring to all those emerging markets, especially the likes of South Africa, which held their breath while Alan Greenspan held his serve! Not a single mention of the Federal Reserve Board?

- Advocates of high-interest-rate policies assert that such policies are necessary to restore confidence in the economy and thus stop the erosion of the currency's value. Halting the erosion of the currency, in turn, is important both to restore the underlying strength of the economy and to prevent a burst of inflation from the rise of the price of imported goods. This prescription is based on assumptions about market reactions — that is, what will restore confidence — and economic fundamentals. Ultimately confidence and economic fundamentals are inextricably intertwined. Are measures that weaken the economy, especially the financial system, likely to restore confidence?

South Africa, are you listening?

- Macroeconomic policy needs to be expanded beyond a single-minded focus on inflation and budget deficits; the set of policies that underlay the Washington consensus are not sufficient for macroeconomic stability or long-term development. Macroeconomic stability and long-term development require sound financial markets. But the agenda for creating sound financial markets should not confuse means with ends; redesigning the regulatory system, not financial liberalization, should be the issue.
- The fundamental theorems of welfare economics, the results that establish the efficiency of a market economy, assume that both private property and competitive markets exist in the economy. Many countries, especially developing and transition economies, lack both. Until recently, however, emphasis was placed almost exclusively on creating private property and liberalizing trade — trade liberalization being confused with establishing competitive markets. Trade liberalization is important, but we are unlikely to realize the full benefits of liberalizing trade without creating a competitive economy.
- *Facilitating privatization.* State monopolies in certain industries have stifled competition. But the emphasis on privatization over the past decade has stemmed less from concern over lack of competition than from a focus on profit incentives. In a sense, it was natural for the Washington consensus to focus more on privatization than on competition. Not only were state enterprises inefficient, their losses contributed to the government's budget deficit, adding to macroeconomic instability. Privatization would kill two birds with one stone, simultaneously improving economic efficiency and reducing fiscal deficits. The idea was that if property rights could be created, the profit-maximizing behavior of the owners would eliminate waste and inefficiency. At the same time the sale of the enterprises would raise much needed revenue.
- Although most people would have preferred a more orderly restructuring

and the establishment of an effective legal structure (covering contracts, bankruptcy, corporate governance, and competition) prior to or at least simultaneously with promulgations, no one knew how long the reform window would stay open. At the time, privatizing quickly and comprehensively, then fixing the problems later on, seemed a reasonable gamble. From today's vantage point, the advocates of privatization may have overestimated the benefits of privatization and underestimated the costs, particularly the political costs of the process itself and the impediments it has posed to further reform. Taking that same gamble today, with the benefit of seven more years of experience, would be much less justified.

- Many in the supranational financial institutions warned against hastily privatizing without creating the needed institutional infrastructure, including competitive markets and regulatory bodies. If, for instance, competition is lacking, creating a private, unregulated monopoly will likely result in even higher prices for consumers. And there is some evidence that insulated from competition, private monopolies may suffer from several forms of inefficiency and may not be highly innovative. In other words, why push ahead with privatization without promoting competition?
- The Washington consensus is right — privatization is important. The government needs to devote its scarce resources to areas the private sector does not and is not likely to enter. It makes no sense for the government to be running steel mills. But there are critical issues about both the sequencing and the scope of privatization. Even when privatization increases productive efficiency, it may be difficult to ensure that broader public objectives are attained, even with regulation. Should prisons, social services, or the making of atomic bombs (or the central ingredient of atomic bombs, highly enriched uranium) be privatized, as some in the United States have advocated? Where are the boundaries? More private-sector activity can be introduced into public activities (through contracting, for example, and incentive-based mechanisms such as auctions). How effective are such mechanisms as substitutes for outright privatization? These issues were not addressed by the Washington consensus. One must balance between the competing demands of private efficiency and public objectives.
- For much of this century people have looked to government to spend more and intervene more. Government spending as a share of GDP has grown with these demands. The Washington consensus policies were based on a rejection of the state's activist role and the promotion of a minimalist, noninterventionist state. The unspoken premise is that governments are worse than markets. Therefore the smaller the state the better the state.
- It is true that states are often involved in too many things, in an unfocused manner. This lack of focus reduces efficiency; trying to get government better focused on the fundamentals — economic policies, basic education, health, roads, law and order, environmental protection — is a vital step. But focusing on the fundamentals is not a recipe for

minimalist government. The state has an important role to play in appropriate regulation, social protection, and welfare. The choice should not be whether the state should be involved but how it gets involved. Thus the central question should not be the size of the government but the activities and methods of the government. Countries with successful economies have governments that are involved in a wide range of activities. In other words, the size of the state in the economy is not the issue; the issue is the manner of its involvement.

- More recently, there has been a growing recognition that the government and private sector are much more intimately entwined. The government should serve as a complement to markets, undertaking actions that make markets work better and correcting market failures. In some cases the government has proved to be an effective catalyst — its actions have helped solve the problem of undersupply of (social) innovation, for example. But once it has performed its catalytic role, the state needs to withdraw.
- There are two areas, among others, in which government can serve as an important complement to markets — building human capital and transferring technology.
- *Building human capital.* The role of human capital in economic growth has long been appreciated. The returns for an additional year of education in the United States, for example, have been estimated at 5 to 15 percent. The rate of return is even higher in developing countries: 24 percent for primary education in sub-Saharan Africa, for example, and an average of 23 percent for primary education in all low-income countries. Growth accounting also attributes a substantial portion of growth in developing countries to human capital accumulation. The East Asian economies, for instance, emphasized the role of government in providing universal education, which was a necessary part of their transformation from agrarian to rapidly industrializing economies.
- Left to itself, the market will tend not to provide adequate human capital. It is very difficult to borrow against the prospects of future earnings since human capital cannot be collateralized. These difficulties are especially severe for poorer families. The government thus plays an important role in providing public education, making education more affordable, and enhancing access to funding.
- *Transferring technology.* Studies of the returns for research and development (R&D) in industrial countries have consistently found individual returns of 20 to 30 percent and social returns of 50 percent or higher, far exceeding the returns for education. Most studies attribute the majority of per capita income growth to improvements in technical change. Robert Solow's pioneering analysis attributed 87.5 percent of the increase in output per man-hour between 1909 and 1949 to technical change. Another study provides strong evidence that per capita income in the Republic of Korea in 1990 would have been only $2,041 (in 1985 international dollars) if it had relied solely on capital accumulation, far lower than actual per capita income of $6,665. The difference comes from increasing the amount of output per unit of input,

which is partly the result of improvements in technology.

- Left to itself, the market underprovides technology. Like investments in education, investments in technology cannot be used as collateral. Investments in R&D are also considerably riskier than other types of investment, and there are much larger asymmetries of information that can impede the effective workings of the market. Technology also has enormous positive externalities that the market does not reward. Indeed, in some respects, knowledge is like a classical public good. The benefits to society of increased investment in technology far outweigh the benefits to individual entrepreneurs. Without government action there will be too little investment in the production and adoption of new technology.
- For most countries, especially developing countries not at the technological frontier, the returns associated with facilitating the transfer of technology are much higher than the returns from undertaking original research and development. Policies to facilitate the transfer of technology are thus one of the keys to development. One aspect of these policies is investing in human capital, especially in tertiary education. Funding of universities is justified not because it increases the human capital of particular individuals but because of the major externalities that come from enabling the economy to import ideas. Of course, unemployment rates for university graduates are high in many developing countries, and many university graduates hold unproductive civil service jobs. These countries have probably overemphasized liberal arts education. In contrast, the Republic of Korea and Taiwan (China) have narrowed the productivity gap with the leading industrial countries by training scientists and engineers.
- Another policy that can promote the transfer of technology is foreign direct investment. Singapore, for example, was able to assimilate rapidly the knowledge that came from its large inflows of foreign direct investment.
- *Making government more effective.* How can policies be designed that increase the productivity of the economy? Again, ends must not be confused with means. The elements stressed by the Washington consensus may have been reasonable means for addressing the particular set of problems confronting the Latin American economies in the 1980s, but they may not be the only, or even the central, elements of policies aimed at addressing problems in other circumstances.

In which case, one must reasonably ask, why are such policies still the practice rather than the exception? Why are they embarked upon by the IMF with such callous abandon without consideration to the human costs involved?

- Part of the strategy for a more productive economy is ascertaining the appropriate role for government, identifying, for instance, the ways in which government can be a more effective complement to markets. How can one make government more effective in accomplishing whatever tasks it undertakes? The empirical evidence indicates that *an effective state* is vital for development Using data from ninety-four countries over three decades, a seminal World Bank study shows that it is not just economic policies and human capital but the *quality of a country's institutions* that determine economic outcomes. Those institutions in effect determine the environment within which markets operate. *A weak institutional environment allows greater arbitrariness on the part of state agencies and public officials.*

- Given very different starting points, unique histories, cultures, and societal factors, how can a state become effective? Part of the answer is that the state should match its role to its capability. What the government does, and how it does it, should reflect the capabilities of the government — and those of the private sector. Low-income countries often have weaker markets and weaker government institutions. It is especially important, therefore, that they focus on how they can most effectively complement markets.

In short, especially in newly emerging democracies, governments must take account of the capacity of the government to effect change. But there is another dimension to change more fundamental than the capacity of the government, the capacity of the society itself to absorb change. But there is also a suggestion here that in low-income countries with both weak government institutions and weak markets, the government should serve as the "agent" of the market rather than the other way around. How does the market sit with democratic governance?

- Capability is not destiny. States can improve their capabilities by reinvigorating their institutions. This means not only building administrative or technical capacity but instituting rules and norms that provide officials with incentives to act in the collective interest while restraining arbitrary action and corruption. An independent judiciary, institutional checks and balances through the separation of powers, and effective watchdogs can all restrain arbitrary state action and corruption. Competitive wages for civil servants can attract more talented people and increase professionalism and integrity.

In theory, not just laudable but more of the stuff of the "right thing." But many of the countries whose initial steps to transition, some successful, some not, we examine in this issue have no institutions to reinvigorate. Corruption is not only endemic but culturally ingrained, a necessary habit for survival. Effective law enforcement agencies are nonexistent or part of the law enforcement problem. The judiciary is for all legal purposes extant. Institutional checks presuppose institutions exist.

- Governments are more effective when they respond to the needs and interests of their citizens, at the same time giving them a sense of ownership and stake in the policies.

Which governments, new to the trappings of power, do not begin with such "people-centered" principles? Which soon find the process of consultation and consensus building time-consuming, inefficient, and an obstacle to getting things done? When do the sheer burdens of trying to balance so many interests against so few resources sap the limited energy to provide that sense of ownership when, again, no institutional structures are in place to accommodate them and when the resources and capacity to build these institutions are woefully absent?

- *Broadening the goals of development.* The Washington consensus advocated use of a small set of instruments (including macroeconomic stability, liberalized trade, and privatization) to achieve a relatively narrow goal (economic growth). The post-Washington consensus recognizes both that a broader set of instruments is necessary and that the goals are also much broader. *We seek increases in living standards, including improved health and education, not just increases in measured GDP. We seek sustainable development, which includes preserving natural resources and maintaining a healthy environment. We seek equitable development, which ensures that all groups in society, not just those at the top, enjoy the fruits of development. And we seek democratic development, in which citizens participate in a variety of ways in making the decisions that affect their lives.*
- Knowledge has not kept pace with this proliferation of goals. We are only beginning to understand the relationship between democratization, inequality, environmental protection, and growth. What we do know holds out the promise of developing complementary strategies that can move us toward meeting all of these objectives. But we must recognize that not all policies will contribute to all objectives. Many policies entail trade-offs. It is important to recognize these trade-offs and make choices about priorities. Concentrating solely on win-win policies can lead policymakers to ignore important decisions about win-lose policies.
- The World Bank's East Asian miracle project was a significant turning point in the discussion. It showed that the stunning success of the East Asian economies depended on much more than just macroeconomic stability or privatization. Without a robust financial system, which the government plays a huge role in creating and maintaining, it is difficult to mobilize savings or allocate capital efficiently. Unless the economy is competitive, the benefits of free trade and privatization will be dissipated in rent seeking, not directed toward wealth creation. And if public investment in human capital and technology transfers is insufficient, the market will not fill the gap.

One principle that emerges from the ideas he discusses, Stiglitz concludes, is that whatever the new consensus is, it cannot be based on Washington. If policies are to be sustainable, developing countries must claim ownership of them. It is relatively easier to monitor and set conditions for inflation rates and current account balances. Doing the same for financial sector regulation or competition policy is neither feasible nor desirable.
The proof of the pudding, et cetera.

A second principle of the emerging consensus is that a greater degree of humility is called for, acknowledgment of the fact that we do not have all the answers. Continued research and discussion, not just between the World Bank and the International Monetary Fund but throughout the world, is essential if we are to better understand how to achieve our many goals.
Amen.

For the record: In the course of his remarks, Stiglitz mentioned the word *democracy* three times, the word *egalitarian* twice, *unemployment* once, *direct foreign investment* once. The key variables are institutional: the overriding importance of a "robust" financial sector, a strong and regulated banking system, a responsive institutional capacity, building institutional capacity and restraints on arbitrary action and corruption, the promotion of competition, a balanced approach to privatization, an effective state, the primacy of the market. In his analysis, institution building would appear to take precedence over governance strengthening.

Part Three

In *Making Democracy Work,* Robert Putnam argues that the successful evolution of civic traditions is what makes democracy work. He analyzes what happened in Italy when the Italian government transferred almost 80 percent of the national budget from the central government to the regional and local governments. He concludes that the only really certain indicator of the potential effectiveness of government at a given level is the number of clubs, social organizations, unions, and the like per thousand heads of population. In short, what counts is the density of the institutional fabric within a community. The more dense the institutional fabric per unit of population, the more effective the governmental unit that has jurisdiction over the people in the area in question.

According to Putnam, well-developed institutional fabric is itself the manifestation of value systems and horizontal relationships within the community in question. Mutual trust, respect, and cooperation between people within a community result in societal structures and arrangements that facilitate economic activity and good government and "empower" the individual; that is, economic development does not generate a strong social fabric; rather it would appear that a strong social fabric is a precursor for economic development. Unwittingly, we may have been putting the cart before the horse.

Such "healthy" social structures, he points out, have to be distinguished from other structures, vertical structures in which individuals rely not so much on themselves but on "authorities" above them and on cheating or using "the system" to their own advantage. This type of arrangement invariably results in patronage, clientism, dependency, and inefficiency — poor governance and social fragmentation. Putnam writes,

> In areas of Italy long subjected to autocratic rule, the absence of a community sense resulted from a habit of insubordination learned from centuries of oppression.
>
> Even the nobles had become accustomed to obstruction, and thought that governments could be fairly cheated without moral obliquity so long as the cheating was successful . . .
>
> Insead of recognising that taxes had to be paid, the attitude was rather that if one group had discovered a profitable evasion, then the other groups had better look to their own interests.
>
> Each province, each class, each industry thus endeavoured to gain at the expense of the community.[49]

If one were to extrapolate Putnam's findings to any of the countries included in this review, whether South Africa, the Philippines, Mozambique, Nigeria, Slovakia, El Salvador, Angola, Kenya, Nicaragua, Oromia, Cambodia, and even Israel, and any country emerging from a postconflict situation, the conclusions might be strikingly similar. Emerging from hundreds of years of colonialism, oppression, ethnic or ideological strife, poverty-stricken, corrupt, with great disparities in wealth, with an under-abundance of resources, burdened by debt, they find themselves without the kind of institutional framework of which Putnam speaks. They lack a robust social fabric, in many cases a social fabric itself.

As they inch their ways into the twenty-first century, often blindly following paths of transition to forms of democracy that may be beyond their capacity to implement, buffeted by an uncaring world, fodder in a global economy, their concepts of sovereignty and national independence largely outmoded and illusory, their capacity to be "masters of their own fates" a thing of the past, their subjectivity to external constraints in almost every sphere of action further diminishing what they themselves can accomplish, at the caprice of whatever capital flows may arbitrarily, or perhaps more accurately, unwittingly, flatten their tin huts, their place in the pecking order of a more "genteel" global capitalism dependent on their obsequiousness in the face of its demands, they may wonder what this thing "democracy" is all about, and whether anyone ever heard of a level playing field, the supposed precursor for a more humane and equal world.

Or will the lesson of the next millennium be "To the victor belongs [all] the spoils"?

Notes

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