Lessons from recent experience on Economic Growth.

The Philadelphia Fed Policy Forum

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It is ideas, not vested interests, which are dangerous for good or evil.

John Maynard Keynes (1883-1946)
1. Motivation

2. Approach

3. Main Lessons
Motivation

A Decade Propitious for Economic Growth in Developing Countries

- End of communism
- End of central planning in India, continuations of reforms in China
- End of inflation in Latin America
- Macro stabilization, trade openness, privatization, financial sector reform, X-rate liberalization
- Favorable external environment
Growth in the 1990s Challenged Expectations: Uneven Responses to Reform

- No set formula of success: China, India, Vietnam, Chile, Indonesia, Botswana, Tunisia, Egypt
- Growth below expectations in AFR & LAC, despite reform (Bolivia, Malawi, El Salvador, Brazil, Argentina)
- Length and depth of ECA recession, and uneven recovery (Poland v. Ukraine)
Motivation

LAC: Steady Reform, Erratic Growth

Distribution of reform index for 16 LAC countries
(Box plots showing mean, 10th, 25th, 75th and 90th percentiles)

LAC regional growth in GDP per capita
Motivation

Growth in the 1990s: A Mixed Record
(divergence “big time”)

Per capita GDP (1990=100)


EAP
SAR, Uganda
OECD
LAC
MNA
AFR
ECA

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Approach

Analysis Informed by Experience

Three perspectives, three publications:

- **Analytical**, (a report)
- **Policy** (lectures by “practitioners”)
- **Operational** (former country directors of the Bank)
Lessons from the 1990s

- Macroeconomic Stability: The More the Better?
- Trade Liberalization: Why So Much Controversy?
- Privatization and Deregulation: A Push Too Far?
- Financial Liberalization: What Went Right, What Went Wrong?
- Public Sector: The Gran Challenge?
- Political Systems: Does Democracy Help?
Macroeconomic Stability: The More The better?

- How stability is achieved is as important as stability itself—trade offs exist between short term stabilization objectives and longer run growth.

- The gains of opening of the capital account have been overestimated and the risks underestimated.

- Evaluating a macro economic situation requires going beyond simplistic indicators (i.e., inflation regardless of how it is achieved, fiscal deficits regardless of debt structure or returns on spending).
Trade Liberalization: Why So Much Controversy?

- **Unrealistic expectations** Trade reforms not a “panacea”: many countries in the 1990s did not experience higher growth following trade reforms. Why?

- **(a) Trade reform typically requires complementary reforms** (x-rate policy, infrastructure, other behind the border measures).

- **(b) Industrial country protection**: developing country exports (apparel, agricultural goods) are frequently restricted in industrial countries.

- **Trade reforms were not obviously pro-poor** nor did they promote unskilled workers, as predicted.
Privatization and Deregulation: A Push Too Far?

- Privatization of firms in competitive markets—unambiguous gains; sometimes counterproductive political consequences.

- Privatization of utilities—unambiguous gains in operating efficiency, customer service, reliability and access, including the poor...

- ... but unrealistic expectations regarding private investment in infrastructure....

- ... and...

- ... differential performance within state owned enterprises need to be better understood (this is an afterthought—a missed opportunity of this project)
Financial Liberalization: What Went Right, What Went Wrong?

- Benefits from financial liberalization are not self evident yet. They would be greater with better institutions (information, legal and judicial system etc.)

- Need better crisis response policies; bad policy responses (Argentina, Indonesia) contributed to the severity of crises

- Banking supervision and regulation are rarely effectively enforced— particularly but not only on state-owned banks.

- Even “independent” central banks (&/or supervisors) cannot keep governments and connected parties with vested interests in check
Lessons from Development Practitioners

- An impressive list of speakers enabling practical perspective to complement analytical findings

- Themes from Practitioners’ lectures:
  - **Rigor, no formula, country ownership and specificity:** Gaidar, Ahluwalia, Botchwey, Dervis, Blejer, Rima Khalaf
  - **Complexity and Learning by doing:** Ahluwalia
  - **Sharing the benefits of growth:** Foxley, Cardoso, Aninat
  - **Focus on the binding constraint:** Foxley
Lessons from the 1990s

Lessons from Former CDs

- **Unrealistic expectations** about what reforms could achieve (macro, finance, trade, finance, privatization)

- **Common principles, heterogeneous implementation:** no two successes are alike; policies and institutions perform functions, but function does not determine form.

- **Country specificity.** Successful growth strategies are country specific, *no formulae.* Successful growth experiences result from *strategy,* not universal policy packages. Need for selectivity: address *binding* constraints, in the right sequence, as they emerge.

- **Need to change the mindset:** expertise tempered by humility, strengthened by inquisitiveness
**Five Lessons About Growth: Reforms…**

1. ...focused on efficient use or resources, not on expansion of productive capacity

2. ... underestimated the value of growth oriented macro economic management

3. ... mistook sound principles for rigid rules

4. ... sought to roll back government role and discretion beyond pragmatically feasible.

5. ... sought to address any and all constraints, rather than *binding* constraints
What’s Next?

- Experimentation with the Hausmann-Rodrik-Velasco decision tree approach

- The Spence Commission on Growth and Development
Thank you