NEW IDEAS IN DEVELOPMENT AFTER THE FINANCIAL CRISIS

CLOSING REMARKS:

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FRANCIS FUKUYAMA: Okay. Thank you. Well, coming at the very end of a two-day conference like this imposes a duty on us to be brief. A lot of ideas were expressed here. This is going to turn into a book and hopefully lead to provoke a number of debates around a number of themes. And having just experienced the conference, it's very hard for me to in any way wrap things up.

But I did think – what Nancy and I have agreed to do is that we will talk about things we've heard and see whether there really are some new ideas here. So let me take a crack at this.

First, a general point of consensus is it's very early, and that could be a source of great paralysis because if it's genuinely too early and we genuinely don't know anything, we're not going to be able to say very much about what's new that's going to come out of this.

But I do think that there are already some points of agreement where we can already come to some tentative conclusions about things that will be new, regardless of whether this crisis drags on for another five years or whether we're back to gangbuster growth in 2010.

So let me just go down my list. The first one really has to do with financial sector liberalization. This is not exactly the same thing as countries developing based on foreign capital flows. I don't think that the utility of foreign capital in the form of FDI or certain kinds of portfolio investment anyone would complain about that.

But I think that the one thing that this crisis has probably killed is what Arvind yesterday referred to as the hyper open financial fetish which is to say – and Mitchell was talking about the Eastern Europeans having the most extreme version of this for you're so open and it's a kind of ideological commitment to wiping away any obstacle to Goldman-Sachs or Citigroup coming in and remaking your financial sector.

And I think, if we're honest with ourselves, this was never at all a core part of the Washington Consensus, but it is definitely an idea that came from Washington and from New York and from the leading centers of development thinking over the past 20 years. And I think it was actually a fairly damaging idea in a lot of cases for the reasons that Justin Lin suggested, which is that you get all this hot money coming in, you go gangbusters for seven or eight years, and then it leads to another disaster that then sets you back, and your overall growth pattern is kind of the hare and the tortoise. The tortoise is going along, plodding along, but at least he doesn't get hit by a freight train in the course of this.

So it does seem to me that that finance fetish is dead. There're some interesting intellectual questions about why this fetish occurred in the first place.

And I think that the issues that Devesh and Arvind and various other people have raised, it's a couple of things: it's the lack of diversity within people that have these ideas, but it's also, I think, interest – self-interest. And I do think that that aspect of it and the connection of people that were promoting – and during the Asian crisis, the Koreans would say this, that Robert Rubin is not promoting some universally valid rule. He wants to get Goldman-Sachs into Korea. And I don't know whether that was a correct charge, but that suspicion was in the minds of many people and I do think that it's something that we need to take account of.

But there's a very important political question that I don't think got fully raised in the discussion of this, which is to say, if you're going to put restriction on this kind of capital flow, what is the political regime and for what political ends are you going to do this, because you can do it well or you can do it badly. And you can politicize the kinds of capital controls to suit your own internal cronies, and you can misallocate capital just as well under a capital control regime as you can under a perfectly liberalized regime.

And so, again, that's a really critical issue. So if we're going to say, okay, that financial fetish model is dead, you really have to be careful about exactly what replaces it.

The second issue is one that we actually talked about among the panelists at dinner last night, but I wasn't quite fully satisfied that we got to the bottom of it, which is the future of the export led growth model. And I want to be careful in saying that by this I don't mean are export's good and should countries try to export, because, obviously, that's going to be a clear route to growth.

But what I'm talking about is a specific model practiced mostly in East Asia in which you had a high degree of government intervention, either industrial policy to subsidize through directed credit in certain sectors or the more broad Chinese policy of using your currency as a kind of general industrial policy. And what is the future of that model?

And I would say that at this point, you've got to say there's a lot of questions about it because it really was dependant on somebody absorbing all of those exports at the other end, and that somebody was the United States. And if it's the case that the United States is really not going to go back to that borrow-and-spend mode anytime soon, that means that that whole deliberate pumping up of exports through interventionism – that model has really got a lot of problems.

And then, if you want to replace that model, you've got to replace it with something. Demand has got to come from somewhere. I mean, not just in this conference but in a number of other events that I've been to lately, you know, this question of who's going to replace the American consumer as a source of final demand has been raised. I've still not seen any good answers to it. Everybody's praying for the Chinese to come rescue us by doing social spending, but this conference didn't give me a good sense of optimism that that rescue is going to happen.

A third issue is the one that came up with Devesh and Lant and a number of other people which is my personal favorite issue, which is public-sector reform. Lant, it is not true that political scientists have been ignoring this issue. I'm a political scientist and this is only issue I've really been thinking about for the last several years.

But it does seem to me that Devesh was right yesterday. He was saying, you know, if you put sustainability or gender or ethnic violence or anything in a project proposal, foundations will fund it immediately, but if you put public administration in anything, people will immediately fall asleep.

And that is too bad because I think that is the unifying key to so many of the issues that have been raised here – that if you want to manage your capital account, if you want to manage an industrial policy, if you want to preside over policies directed towards increasing equality, and so forth, if you cannot count on a public sector with adequate capacity, you're probably better off just leaving it alone because otherwise it will be subject to capture and rent-seeking and all of the other ills that we've been through in previous cycles where you had heavy state involvement.

By the way, this is a big issue for the United States. You know, we're swinging now to a period in which the American state is going to grow very, very rapidly, and we don't have the capacity to implement – we don't have the capacity to implement TARP. We don't have the capacity to do the kind of sophisticated financial sector regulation that Geithner and before him Paulson were talking about. And we don't really even know how to start re-building that state in a way that's actually going to be sufficiently flexible to deal with the sorts of challenges that are ahead.

And when you get to – actually, a way of illustrating Lant's point that my colleague, Melissa Thomas, has written about recently is that in the United States, the per capita spending on government services is about $17,500. And so, with that amount of money, you can actually – even it's wasted on pointy-headed bureaucrats that can't park bicycles straight, you still get something for it. You get all the aircraft carriers and DMVs and that sort of thing.

But the average in sub-Saharan Africa is more like about $30 per capita. In Afghanistan it's $9 per capita. And you ask, what can any country do in terms of providing public services with $9 per person to spend on that sector? Even if they're the most efficient – you know, they've all gone through McKinsey and everything – they're not going to provide much.

And that does mean, I think, that you've got to really adjust the model of what it is you expect these governments to do in light of those tremendous capacity constraints and figure out where it is that you can fix the capacity and focus on that, and maybe move to a system in which other actors in the international system provide some of that missing capacity. So I think this is something definitely that needs to be thought.

I guess my final new idea was one that came up in several different panels, which is ideology versus pragmatism. But in a way, it gets to the title of this conference itself, which is new ideas.

And maybe part of the problem here in America is we've got too many ideas. You know, it's great to be able to conceptualize. In many ways, the West – the rise of the West was all – and this is something that's very commonly said about China, that in Asian cultural systems there's a lot of particular knowledge, but it's very hard for people to generalize and produce universal laws of social behavior or so forth. And people in the West and Americans more recently really excel at this and they're always coming up with great new conceptual ways of understanding the world.

And sometimes that's good, but maybe sometimes that imposes an excessive amount of rigidity when people develop a big political stake in seeing the world existing in a certain way, and then the world changes and they're just not willing to part with those big ideas, whereas if you're in a sense much – well, this is a point about humility. If you don't have big ideas, you're probably a little bit more humble but it's also probably a little bit easier to make adjustments when things happen.

I just have to make one point. I was going to say this in my opening remarks and I thought I'd leave it off, but I just want to say it. Okay, Jessica, you said in the Asian financial crisis we learned something important which is the sequencing business – that you shouldn't have opened up yourself to foreign capital until you had the adequate state capacity in place to regulate and so forth, and that was a valuable lesson.

In my view, we did not learn this lesson because we let this happen to ourselves. And there's a kind of ironic justice to it because in the Asian crisis, you had all this hot money going into Asia. Their banking systems couldn't regulate and handle that. And in this crisis, all this hot money came from Asia, the opposite direction, crossed the Pacific and went into this shadow financial sector that we couldn't adequately regulate and we got into exactly the same kind of trouble that the Asians got into.

So in terms of the humility lesson, I think that we were so arrogant that we actually thought we had learned something from the Asian crisis, and I doubt that we actually in fact did learn the right lesson.

So with that, I'll turn it over to Nancy.

(Applause.)

NANCY BIRDSALL: Well, Frank and I didn't discuss ahead of time what we would say because the idea was that maybe we would come up with some things that are different. I think you'll notice that we're not all that different, but I will still burden you with some repetition.

Let me start by saying I had so much fun thinking about this battle between the economists and the political scientists in the last session. And I was thinking back to – you know, I became an economist rather late in life. I'm back home here at SAIS right now. But many years after I was at SAIS, I went and did a Ph.D. in economics, but I really hadn't – I didn't learn it in the same way you do if you learn it when you're 18 years old or 19 years old.

And in the first couple of years that I was at the World Bank, most people thought I was an anthropologist – (laughter) – because I had had a published article in this journal – I don't know if it still exists – called "Signs." So I count myself as liberated from any disciplinary blindfold.

Now, this conference was about – the idea was: Will there be new thinking about development models? Will we be re-thinking the way we think about development? And on the one hand, as Frank suggested again and as Larry said and others, it's too soon to tell.

On the other hand, I think I'll try to be a little more proactive in suggesting some things that I heard with a particular slant; namely, that I do see an outline emerging in terms of new thinking, must as Frank said.

And the way I would put it is that the new thinking is that government matters more and at the global level, government – but we're not allowed to say world government, but something that some people would call the global polity matters more. So let me explain what I mean.

At the domestic level, in terms of domestic policy in developing countries, this crisis will mark the end of the Washington Consensus, not John Williamson's Washington consensus – and if he's here, I apologize again – but John, you can't, once you have a good label on something, you can't control the way it's used out there. It does mark the end of the Washington Consensus as a kind of religious approach to market fundamentalism.

And the way to summarize that is that now we're back to government mattering more. And what I heard I'm going to put into three categories: the first category that I heard about in terms of government mattering more is what I'd call radical incrementalism – trying to be a little oxymoronic.

And there were two parts to that. One is the foreign finance fetish. It's gone. We heard it from Justin Lin, we heard it from Arvind, we heard it from others. And I think it had to do with, frankly, an intoxication by everybody about how great it was to have cheap capital. And so everybody included Washington and the IMF and the U.S. Treasury, but it also included the developing countries. So it wasn't only about ideology and belief systems. It was also because for 10 or 15 years, for most countries, it seemed to be great that they all this access to cheap capital.

But the context for radical incrementalism is very much as I think Arvind said, that in developing countries the market survives. Government matters, but the market survives. And this was actually the position very much made clear in Davos by President Hu and Putin. They were the great champions of the market in what they said in January when people were really getting worked up, obviously, about the problems of the market. But it survives with this proviso on capital account liberalization.

And I think what we heard today and yesterday is that there will be new emphasis, at least in some countries, on industrial policy. That's not so new either. Danny (Roderick ?) and others were talking about it, you know, self-discovery, not cookie-cutter approach as in the Spence commission. It's okay to try new things that are a little bit more strategic. And that will be the alternative view possibly to the export-push in the East Asian style since it implies you have more domestic savings or use your existing savings much more efficiently and strategically. So that's the first – radical incrementalism.

Then we might have something that I didn't know what it was. Frank called it the "Beijing Consensus." I think it's something like a new Asian consensus which says government matters so much that maybe there's something to this Chinese model where for some reason they seem to have overcome in China the problem that Lant raised, the problem that Devesh raised about capacity – capacity of governments to do what they want to do or do what the politicians want to get done: implementation capacity.

It's amazing to me how little I as a development economist understand from where that came from. China was just as poor as most parts of Africa 15 years ago, 20 years ago. Did it come from having the Cultural Revolution? Did it some from some trauma? I don't know. Is it because China is so big? But that seems kind of peculiar because you would think that things work better in terms of implementation capacity at the micro level than at the macro level.

But there's something about this authoritarian capitalism that Mitchell called it that seems to be working. And I think there's an interesting question whether more developing countries will try to understand why is China successful under authoritarian capitalism, which goes back a little bit to my crude understanding of the Beijing Consensus, one part of which is you get stuff done. You have political centralization in order to develop and then from that may eventually emerge democracy. So this is a little bit Tom Carothers' characterization of the – I think it was the first generation, he said, of development thinking.

Then the third way to characterize some of what I heard is what I'd called the Lula consensus, or the Lula approach, crudely generalizing that it's about this combination, very incremental; existed before the crisis, but may now be more locked in some parts of the developing world as the way to go, which is be fundamentalist on the macro side, but start worrying a lot more about equity, about social programs.

I think it's incomplete. Frankly, myself I think if I think of that Lula consensus and define it that way, it is still very targeted to reducing poverty, and as Santiago Levy implied, that doesn't address the fundamental question of how you increase the productivity of labor. It deals with the welfare problems of poverty but these conditional cash transfers and other re-distributional problems that are politically popular and part of what I would call the new approach that emphasizes social equity are not really getting at the heart of the problem that the authoritarian capitalist approach seems to have gotten to.

Then there's this more metaphysical business about is democracy – well, that's not metaphysical. Larry raised – it really worried me about is democracy at risk if the crisis is prolonged? And it goes back to the question: how is that the Chinese without democracy managed such a responsive approach in implementing policies?

Now, let me say one other thing because all that was about domestic policy in response to the crisis. How will ideas about domestic policies change within developing countries and what direction will they take? I think we didn't really hear enough about – we had one panel that focused on the international institutions. I think maybe the biggest change that may come out of this crisis is a new round – and it is more new than everything else – on a need for multilateral cooperation and for thinking about, if you have a global economy, how do you manage it in the global polity sense?

And the first set of responses have been, fortunately, to strengthen the IMF. And I think we'll come next to strengthen the multilateral banks with more capital. But it's still a little bit schizophrenic with some of the other things that we talked about in the last couple of days because when you have a highly centralized system at the global level to do collective insurance, for example, as Sebastian Mallaby put it, how do you retain pluralism, which is the big idea in a sense which also came out in the last couple of days – how important it is to have a pluralism approach, the wisdom of crowds, and not to be stuck in one paradigm, which was the Washington Consensus? That's another way we're getting away from the Washington Consensus.

And the initial idea seems to be that we will make the international institutions more democratic, more legitimate, and that will encourage them to be more pluralist in their thinking. But this is tough. So I think there's an issue that is not very well defined yet.

Still, my main point is that it's consistent – this issue of strengthening the multilateral institutions is consistent with the general direction locked in by the crisis in favor of government or international governance or collective decision-making or the state or whatever you want to call it, matters a lot more.

I'd say one other thing which is I think it's too bad that we didn't have climate change and environment discussed a little bit more because this is another reason, or another force behind the impetus for more thinking at the global level, and because climate change we know is going to have a tremendous impact on developing countries.

And the same thing must be said about international migration – that this is what Lant Pritchett called an immovable force, right? I mean, this isn't going away. And like climate change, we are not managing at the global level in a way that maximizes benefits for people and minimizes the cost, the incredible increases in people flows despite state-level restrictions on those flows.

So maybe the big challenge in terms of development thinking is going to be around thinking about global governance, global government, global polity. I'm not sure what to call it. And how to make sure that in a world where we need some centralization at the global level we will retain the spirit of pragmatism that seems to have worked best as opposed to ideology in the past, and the pluralism – and the ability to transcend the narrow disciplinary debates, and to be, as Danny Leipziger said, humble, to focus on humility.

So let me thank Frank, who's been a fabulous partner, and all of you for your participation in what has been really terrifically interesting. I think we may have to resolve to do it again when more time has passed. The only question is: Will it be one year, two years? Let's hope not more.

Thank you very much.

(Applause.)

(END)