NEW IDEAS IN DEVELOPMENT AFTER THE FINANCIAL CRISIS

PANEL V: GOING FORWARD:
NEW IDEAS IN DEVELOPMENT FOR A NEW WORLD

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JESSICA EINHORN: Okay. Let's see. Is this on? It's on. I know there's a little bit of a traffic jam back there for coffee or tea but we'll ask people to come to their seats.

Once again, I'm Jessica Einhorn, dean of SAIS. There are some seats up here if people want to move up. I mean, if you're comfortable back there, fine, but otherwise there are seats and we'd welcome having you move up. So we'll just ask everybody to come in and take their seats and I'm going to start. Hello. I'm just waiting for Kemal. Great. Okay.

We've come to the last panel and this is the panel that has been asked how development thinking will be affected by the still unfolding crisis. In the whole post-World War II period, development theory and policy grew in breadth and complexity and that was largely because after each crisis, when we discovered what had caused the crisis, we added that and said, that's an input to development. If we only had done that, we would have avoided this crisis.

And so, it became pretty broad and pretty complex. We went from the early days of offering just financial capital for development to looking at macro, to looking at micro, to looking at institutions, and finally, of course, the role of such behavioral aspects as voice and participation.

Perhaps this crisis will only change our outlook in the most benign sense because we will have discovered that grossness management by the developed economies is definitely not good for development and that won't lead to too many new conditions. But I think that we'll find our panelists draw some more subtle conclusions from all this.

Let me introduce them to you briefly in the order they will speak. I am going to rely on the fact that you have their bios.

So we will begin with Tom Carothers of the Carnegie Endowment. Years ago, Tom decided to leave the private and public practice of law to study and become the expert in the subject of democratization. And he is renowned for his work on both democracy promotion and his analysis of state democratic practice around the world. Tom has been at this conference for all the sessions from the beginning, and he will give us the benefit of his personal summation of what we can take away and think about from the conference.

Lant Pritchett is a professor of practice in international development at the Kennedy School at Harvard. And the practice, I think, they're talking about comes from his years at the World Bank where he was a colleague to a number of us and also served in Indonesia and India. Lant is going to speak to us about how that problem of policy implementation may have jumped the boundary from less development to fully developed countries and what lessons we can learn from that in this financial crisis.

Michael Clemens is a research fellow at our partner in this conference at the Center for Global Development and he is a leader in research on the development consequences of migrations from the south to the north. This is also actually a topic of great interest to Lant who's worked with Michael on some of these issues. Today, Michael will explore how the financial crisis might affect those demographic trends and politics. And he's worked in Brazil, Columbia and Turkey.

And finally, Danny Leipziger who's head of the so-called PREM Network, which works on poverty reduction and economic management strategies – that's a reminder that we should all turn off our cell phones now – has also – Danny has also been very actively involved with the Growth Commission which is headquartered in the U.K., of course, and has co-edited a Brookings Institution book called "Stuck in the Middle," which will have its launch on May 15th. So if you're around on May 15th, Brookings is going to have a launch of Danny Leipziger's book. Danny is going to close out the formal remarks of the panel by raising some issues for us to consider in the discussion.

I'll leave it to the panelists, whether they want to come up to this podium or sit there. Either way, I have a terrific colleague who will be holding up a big sign for them when they've used up their 10 minutes to tell them that there are two and then one minute left.

So, Tom?

THOMAS CAROTHERS: Thanks very much, Jessica, and thanks to SAIS and the Center for Global Development for the invitation. Nancy and Frank were kind enough to sprinkle the mix with a couple of political people in this, what's been a distinguished array of economists.

We're kind of the olives in the salad if you will; the few of us political people. My fellow coconspirator Larry Diamond has left. Or I suppose in the view of an economist, we're sort of the nuts in the cake, if you will – (laughter) – which actually causes a reflection.

I'd have to say that we, political types, are always very flattered and humble to be asked to speak among economists because groping, as we do, in the analytic darkness with our sort of Bronze Age methodological tools – (laughter) – compared to the sort of titanium-plated tools that the economists have been employing in the last decade to predict the path of the world.

We feel humbled – (laughter) – not simply by the accomplishments of the economists but then having gotten everything wrong, they, you know, convene themselves and explain to you why they're wrong and how they're going to be right the next time. And so we, political types, are kind of in awe of economists in some ways.

Most of the conference has been looking at the effects of the current crisis on development thinking and the activities of development institutions. I want to broaden that perspective a little bit by adding a political angle to that. Larry also introduced some very valuable ideas about the effects of the economic crisis on global politics.

But I'd like to talk instead about what I think the effects of the crisis may be on what I think has been a very important line of thinking about development of the last 40 or 50 years. And I'm referring to the intersection of political and economic development. This conference is about ideas, and this is an area where ideas have been very powerful, I think, in the last generation, and I'd like to describe what I think those changes have been and how they might be affected.

Let me just summarize since our time is short in very gross terms what I'm talking about.

Basically, in the first generation of sort of modern development work, if you will, in the 1950s, '60s, and '70s, there was some separation of economic and political development in the sense that people felt that you do economic development first and then you get political development, the basic modernization thesis which said the political development will follow economic development so you don't need to give that much explicit attention to political development if you're trying to promote development.

The context, of course, for that was the Cold War in which if you wanted to get a consensus among global institutions about development, you had to step back from political ideas because that would be too ideologically divisive. It was also a time, particularly in the 1970s, when democracy was doing quite poorly in the world and most developing countries were stuck in authoritarian regime, whether of the left or the right, and so it didn't make very much sense to talk about political development when most countries seemed to be stuck politically.

This changed in the 1980s and '90s, and the donor community began doing a lot of work related to political development. Some of that was done by a new pro-democracy community or a community of democracy assistance actors who carried out political development and have been carrying out political development work for intrinsic purposes believing that democracy is intrinsically valuable.

But they also believed in a kind of expanded conception of development which includes democracy. And they believed very strongly that the two go together in some intrinsic way and they like to argue that and they like to fight against statistical studies by economists that try to assert that political systems don't matter.

Some of the people also – so you have in the 1980s and '90s the entry of political development very explicitly by democracy people, but then it also entered through the domain of governance. And as you know, in the 1990s, a lot of development organizations began doing governance work. And some of this governance work was fairly political both in the institutions that had worked with whether it was parliaments, or judiciaries, or presidential cabinets, and so forth, and some of it was fairly political in the kinds of values that were associated with good governance, particularly accountability, which is closely related to political processes in many cases, but also transparency and representivity of institutions and so forth.

Others doing governance work tried to put less of a political sort of emphasis on governance and tried to treat it as a technocratic practice and deemphasized the political side of governance. But both through the democracy community and through this rush of governance work, political development entered the development arena in a big way in the 1980s and 1990s.

The geopolitical context for this, of course, was with the end of the Cold War, the ideological fights and divisions in the world lessened, and so, it was easier within global institutions to talk about political values. You also had the spread of democracy which made it so that countries were not stuck politically anymore. If anything, they seemed to be rolling down a ramp towards democracy in many cases. And so, it would be odd not to talk about political development in such a context.

But it wasn't just the geopolitical context that changed this. It was also perceptions by traditional developmentalists who in the late 1980s came out of a lot of accumulated frustration with one-party states – particularly in Africa – and began pushing a governance agenda not because of their interest in democracy, but just out of pure frustration over the failures of traditional development work in Africa. And so the governance work wasn't only related to democracy and its origins. It was also related to just frustrations over socioeconomic work.

So the result was by the start of this decade, you had a very different configuration of the development community. And you had political and economic development trying to work together but a lot of basic fights over that.

One of the basic fights was is political development an intrinsic value or an instrumental value? And this is unsettled, I would say, in the development community. Some people just intrinsically believe that this is an intrinsic value, and others resist that and say, tell me about political development only to the effect that you can prove to me that this will increase socioeconomic outcomes or produce better socioeconomic outcomes.

The other big fight was whether or not governance should be related to democracy. Some people use the term democratic governance as a way of fudging the difference. Others just use governance, others use democracy, but there's a lot of divisions within people who work on governance over to what extent should it be explicitly linked to democratic values.

So the result was that you had several different positions within the development community in – I would say the middle years of this decade. You had some who believed in a full integration of democracy and development. If you go to sort of Swedish International Development Agency, for example, they say to you, we integrated democracy and development entirely. We see no difference between those two concepts. The minister for development in Sweden says development is about democracy, democracy is about development, full integration. I would say USAID, at least theoretically, has tried to integrate and also stands in the camp of integration.

You have some who believe in sort of a partial integration and they say that we believe in democratic governance but not necessarily democracy and so, you have development organizations doing democratic governance but not quite willing to go all the way to democracy. UNDP, for example, puts forward the belief in democratic governance. French cooperation also emphasis democratic governance, but does not say that they're really in the business of promoting democracy.

A third position is less integration. It says, we do governance but we really don't do politics and we don't attack democratic to governance. We just believe in good governance.

The World Bank is in that position and I would say British DFID has been in that position for a while, although they may be evolving.

So you have full integration, partial integration and trying to keep democracy and development a little bit further apart. And then you have also had some traditionalists who stepped back from all three of those and say, sorry, we just still are not convinced that governance is good for development. And they're, I would say, skeptical macroeconomist still at the World Bank and then other development institutions who have not bought on to this agenda. And there also people in authoritarian capitalist states who also don't believe in this agenda very much.

Given that panorama, how will this be affected by the current economic crisis? We're just guessing, but I think it will affect it in at least two major ways. I think it will actually – the economic crisis will strengthen the case that you can't talk about development without talking about politics. I mean, John Williamson started this conference by saying that the crisis was caused by poor or bad regulation. That's about governance.

And if that's the conclusion, which I think will be concluded as one of the main causes of this crisis, then it leads you to the question of well, I guess the quality of governance is very important to development.

So I think the crisis will actually strengthen the nexus, but it will do so, I would say, probably in a confused or confusing way because some people will say, "Okay, I see that it was bad governance, but isn't it funny that the bad governance occurred in the very countries that have been telling us what good governance is? So what does that say about the governance agenda?"

And so, I think there's going to be a debate about what the governance agenda is because I think there will be a question of, is it neutral, sort of content neutral principles like transparency, or it is content laden principles about how much you're supposed to govern or the amount of regulation in a society and so forth. So I think it will increase the nexus of governance and development but it will open a broader conversation about what do we really believe good governance is.

Secondly, I think the crisis will not strengthen the case that democracy is key to development because it will be seen that established democracies probably suffered more in the crisis and in some cases were partly the cause of it, the non-democracies, and that will generally hurt the case that democracy is sort of necessary for productive – for development and, of course, it's strengthening China's hand in some ways, as we've talked about in the conference, in saying that, well, there's an alternative route that's non-democratic that happens to be good for development.

So, in conclusion, we've been through two major phases in the last 50 years, an initial phase for 20 or 30 years of putting aside political development but in seeing it as the result of economic development. Then we entered into the second phase in the last 25 years or so of integrating the two.

We’re at a juncture now which might be marking a third phase, but I think it will be that we will continue this nexus between economic and political development, but this crisis sort of jolts us to break some of the common assumptions or standard wisdom both about democracy and about governance and will probably cause a more dense and probably interesting but as yet unresolved conversation about the future of these two basic developmental ideas.

Thank you.

(Applause.)

MS. EINHORN: That’s great.

Lant Pritchett.

LANT PRITCHETT: So I’m going to get back to many of the issues that Thomas raised, but I want to first start talking about the Spartans. There was a recent movie which was a – made a comic book into a movie, “The 300” in which the Spartans defended against the Persians at a place I can’t pronounce, Thermopylae or something, meaning “the hot spot.”

And you wonder: why is it that this has lived thousands and thousands of years, this one small event of 300 people? And I think it’s in part because it illustrates a phenomenon that’s really, really interesting which is the huge sort of nonlinearities to outcomes that small differences can make a huge difference.

And that’s particularly well illustrated with armies because armies can turn from masses of individuals acting as a collective that have enormous capability into a rabble that has no capability of doing anything instantaneously. A route is a common outcome of a battle. And if you actually read the U.S. war fighting doctrines, they will say, war is about imposing your will on the enemy and when their will is broken, they cease to be an effective fighting force. We don’t have to kill them. We don’t have to wound them. All we have to do is break their will to fight.

So there’s a nonlinear threshold of capacity such that if you push a fighting force beyond its capacity to endure the situation it’s in, it doesn’t become a mildly less effective army. It becomes a rabble. It disintegrates. It ceases to exist as an effective thing.

So implementation capacity is a really interesting phenomenon. Now, what is implementation capacity?

Implementation capacity is the ability to get the agents to act in the interest of the organization and not in their own self-interest. And again, the army couldn’t be a better illustration. Nothing is more in your self-interest, narrowly conceived, in a situation than not getting shot. And yet, an army exists to induce an organizational capability in which people are willing to get shot to promote the organizational good. And once that evaporates, it’s a rabble.

So implementation capacity is the ability to induce agents of the state to act in states of the world in ways that further the interests of the organization of the state and not necessarily the narrow self-interest of the agent at the time. That's implementation capacity.

Now, what does this got to do with development? Well, huge amounts of development debates are about policy: policy this, educational policy, health policy, macro policy, regulatory policy, tax policy.

Well, think of the ordering of sort of policies where – let's start by thinking of – by analogy with our army – what's the maximal policy that we can accomplish with our given organization? So you can imagine you have an organization devoted to collecting taxes.

As the tax system changes, like tax rates get higher, the pressure on that organization of individual tax collectors to deviate from the collection of taxes to take bribes, for instance, gets higher. And as that – and there's some feasible maximum of the tax rate after which your tax collection agency will likely move from a compliance equilibrium into a zero compliance equilibrium. Your tax collection agency will lose capability if you push it beyond its maximal capability.

Now, the beauty of living in a rich country is that almost no policy debate worries about that. We assume that the organizationally maximal feasible policy, that the optimal policy is well less than that, that we can sort of decide what the tax rate should be and never do we really have to worry about if we try and implement that tax rate will the IRS disintegrate into bribery and complete noncompliance because we're always debating a range of policies in which the needed policy and the feasible policy and the optimal policy is assumed to be well within the range of the institutional capability of the organizations that we roughly have at our disposal.

So all of the interest is in what should we do? What should we do is kind of the only policy question, right?

Now, if you've got to get a driver's license in India or Indonesia, both of which – well, to be honest, I lived three years in India and drove and never bothered to get a driver's license for reasons I'll explain in a minute. (Laughter.) Okay. But let's say I wanted to get a driver's license in India. My driver actually had a driver's license when I was in India. He knew how to get a driver's license.

You go to the driver's license, there's some guys hanging around outside the driver's license bureau who take a fee from you and then you can go home. A few days later, you get your driver's license.

Some colleagues of mine actually did an experimental study of getting a driver's license in New Delhi and learned from that experimental study what my driver knew – I never admitted this to my driver. He would have thought much less of our relative pays if he'd known what my friends get paid for. And they found that of the people that paid an agent, none of them took the legally required drivers examination to get a driver's license.

So the law is very clear. The policy is very clear. The policy to get a driver's license in India, you have to be this age, you have to demonstrate your identity, you have to demonstrate your residence, you have to demonstrate your capability to drive a car, and then we'll give you a driver's license. That's the policy.

The implementation capacity of the driver's license bureau doesn't extend to actually giving a driver's license exam. So if you pay the agent, you get the driver's license – full stop. So the policy implementation capability of this Indian state doesn't extend to resisting the temptation to just give people driver's licenses without giving them a driver's exam. Just to get – make again concrete.

So in the developing world, the issue really isn't what. It's how. And if there is a question that's what it's what can we do, not should we do. So if you think of the ordering of sort of here's the needed regulation, here's the optimal regulation, here's the absurdly too tight regulation, here's the feasible regulation, they're roughly in that order in developed countries. Developed countries are capable organizationally of imposing regulation that almost certainly are counterproductive but they could do it if they felt like it.

The ordering is almost exactly the opposite in most of the countries of the world. They don't have the capability in a policy implementation sense of having the organizations with the capability of inducing their agents to act in the interest of the state in policy implementation even for really, really simple things that are needed. So the ordering is feasible, organizationally feasible, needed, optimal, too stringent. Right?

And India, by the way, is an enormously high capability country in the range of developing countries, right? I'm looking around the audience, lots of really high-capability Indians in the world and many of them work in the Indian government.

So this isn't an absurd example. India is probably in a median of poor countries in terms of their implementation capability and they can't get people's driver's licenses. Okay.

So how does this relate to the financial crisis? Well, I think in a sense, idea sense this is – the financial crisis to a large extent is the developed world experiencing the developing countries' problems for the first time.

Here was some big picture of the world that we just didn't have the capability or chose not to exercise it, and I think it was really tough. It would have been really tough to have in place the appropriate regulatory structures around what turned out were very complex deals that even people that lost a lot of money by pricing them, lost money pricing them. So it was a really complicated thing such that our feasible capability of regulating this was outstripped by the complexity of the phenomena and it came back to really super-bite even the richest, most sophisticated, highest policy implementation countries in the world, right?

There was a little bit of wrong policy choice but a lot of it was this is just the complexity of the world. People didn't let Lehman go broke because it was exclusively a policy choice. It was just too damn complicated to figure out what Lehman was worth because they had a million transactions on their books. No one could – we just didn't have the capability to decide what it was worth in the timescale that we needed to make the decision.

So for the first time, the U.S. experienced what is a routine experience, if you're working in a developing country: We just can't do it. We have to let Lehman go bankrupt because we just can't value it in the time that it would take to make the decision.

Now, I have two minutes left, so I want to say something controversial – (laughter) – which is, I think – and this is where I relate to what Thomas is saying, but I take in some sense the opposite view – development has always been a stepchild of modernization.

Modernization has always considered a fourfold transition: economic, political, administrative capability from two sort of – from sort of localized two kind of formal civil services, and social, a transmission from kith and clan to country, crudely put, right?
And the development process was called "development" because it was a natural process to go from where you were to modernization.

Now, to defend my tribe, kith and clan of economists, we have rethought our part of development at least twice. So since the 1950s crude modernization theory, we have rethought out basic approaches and what was the middle center of the conventional wisdom was two gap models in the '50s and '60s, trended over towards being sort of what we call the neoliberal orthodoxy in the '80s, and have swung back very much to where the center kind of conventional wisdom is one size doesn't fit all, things need to be tailored, a much less orthodox position about what appropriate economic policies were.

So we have changed our minds about appropriate components of development at least twice, whereas, on the other three components of development, it's exactly the same orthodoxy that it ever was.

Modernization means liberal multiparty democracy and modernization means civil services carry out the functions of government, full stop. There has not been anything like the intellectual fervor and guilt inducing we got this wrong, and in spite of the fact that for most countries in the world, economic policies are not the problem. They have failed administratively. They have failed to implement the administrative civil services such they can't give driver's licenses in the median country in the world. Implementation capacity through the formal civil services that we thought would be the be all and end state of modernization have not produced the goods. And I don't see the intellectual ferment in that side of it about what replaces that, what's our response to that?

The same thing with democracy. Democracy has not delivered the goods, just has not delivered the goods. And the huge counterexamples against democracy have never been addressed. All of the most rapid episodes of poverty reduction in the world have happened in authoritarian states, full stop. Has there been any deep re-thinking about –

MS. EINHORN: Zero minutes.

MR. PRITCHETT: Okay. Zero minutes? Okay. Has there been any deep re-thinking that, or even more deeply, the social transformation. What does it really mean to be a modern society? And the fact that we're up against Afghanistan, it's really a deeply social problem and I don't see the same level of intellectual ferment about what does it mean to have a modern Afghanistan that we, economist, have really have. We have re-thought our entire discipline at least twice in response to events. I'd like to see that from the other components of development.

(Applause.)

MS. EINHORN: Thank you. We were a little rough on the time there, but I have to say you made some extraordinary points and I think you hit your mark on being provocative at the end. So I think you'll have a lot of discussion to come back to. So let me invite Michael Clemens to the podium.

MICHAEL CLEMENS: Thank you very much, Nancy. Frank, thanks a lot for the invitation. Jessica started out this session saying that crises are a time to re-evaluate development policies so I'm going to back way, way up, way up, and not talk about why people in developing countries might be yearning 4 percent less next year than this year, but why people in developing countries are still poor. Why is it that lots of Brazilian people – Jessica mentioned I lived in Brazil – work way harder than I do and make 1 percent of what I earn?

So to think about this, I want to break down the wages. If I have wages on the one hand, what I earn for doing what I do, a way that economists like to break up wages is into some components, some determinants of wages. Why I earn what I earn could be because of the tools I work with, the capital that I have. It could be because of my human capital, my skills, talents, abilities. It could be because of the price that I get for what I do, what I make. Or it could be because of the environment I work in, the technology I use, the institutions within which I function.

And I'll put forward that what I just laid out is the grand development experiment of the last 50 years, the agenda of development policy is in order to get some convergence of the wages that people make in developing countries with ours, with mine, let's work on getting convergence on some of those things that I just listed. Let's get capital to developing countries. We'll make an overseas private investment cooperation. We'll make a World Bank. We'll liberalize capital flows to make it easier to get capital. We will move heaven and earth to get kids into school. We will liberalize trade and eliminate barriers to developing countries getting the price that we get for outputs. And we'll do lots of technical cooperation, lots of technology transfer, lots on pushing on institution building.

So I want to point out that a lot of progress has been made in all of those areas. There's an interesting paper by Francesco Caselli recently pointing out that the marginal product of capital is surprisingly homogenous across countries now. Capital flows are much more liberalized than they were decades ago. Certainly, trade flows are much more open than they were decades ago – a massive convergence on schooling, massive. The fraction of kids in Senegal or Nicaragua, Madagascar, Nepal who are getting basic, primary education is much, much closer to what we have in this country than it was 40 years ago.

So I have a question about that, and it's Dr. Phil's question: How's that working out for you? (Laughter.) You've gotten a lot of convergence on all of these things to some degrees in different areas. Are you getting convergence on the wages? And we're not. So there are some exceptions. Korea has left the ranks of the poor countries. It's now a rich country, and if you look at wages, if you look at income per capita, it is converging with us. Most people in most countries aren't. If you look at what you get in terms of living standard for driving a bus in lots of poor countries – I was running these numbers last night – they're diverging from ours. They're getting further away. They're not getting closer.

So factor price equalization failed. One of those great economic ideas from 50 years ago, Samuelson theorem, it didn't work. It hasn't worked out.

So we have a choice now for the next 50 years. We can, on the one hand, try harder over here. We can think of new ways to equalize prices although there's not that much further to go unfortunately. We can think of ways to get more capital mobility. There's not that much further to go there. We can think about institutional change which is a crucial agenda that is very, very, very difficult to do, but there's an alternative and it's to directly liberalize wages over here, and the way that you do that is moving people from one place to another.

And to me, this is an astonishing fact is that the Ethiopians who are driving taxies by outside right now are as productive as I would be doing that the first year they arrive. They step off the plane and they are as productive as me. It's incredible. That's an astonishing fact about the world. And I calculate that a Haitian stepping off a boat into Florida immediately raises his wages – and I say his because we did it for male workers – by 680 percent, immediately, 680 percent. There's nothing we can do in Haiti that even comes close to that, for that person's wages.

And when you start talking about this stuff, people say, well, that's got to hurt us. And that's a plausible hypothesis but the evidence is in on that, the evidence is in. The academic debate is between George Borjas on one hand, and Giovanni Peri on the other hand with one person saying that the last 20 years of immigration to the U.S. much of it from poor countries has lowered the wages of the average American worker cumulatively, legal and illegal immigration by 3 percent, Giovanni Peri arguing that actually the labor market is more segmented and it's actually a 1 percent increase.

They're both about zero. We're talking about 1 percent versus negative 3 percent. For the Haitians it's 680 percent. This stuff doesn't need to hurt us. And how do I know that, because this experiment has been tried. It's not even hypothetical.

And I want to talk about South Africa. You walk through downtown Johannesburg and you'll see black faces all over the place. And who let those people in? The South Africans let them in. In the late '80s and the early '90s, they completely dismantled the vast system of restrictions on who could move where, who could live where, and who could work where doing what job. They eliminated it. They dropped it.

And what happened? What happened is convergence of this: wages between black and whites in South Africa are much closer now and astonishingly, astonishingly to me, it's not because the white wages came down. It's because the black wages are going up and it's going to take a while for them to converge, but they've converged quite a lot, 50-percent increase in the government's comprehensive welfare index for black people in 10 years – huge thing. What could they have done by investing directly in the – (inaudible) –that would even come close to comparing to that?

So what I want to urge you to do is contemplate, not for everyone, not for all countries, not all of the time, but think not just about what you can do on this side, the traditional development agenda but on the other side over the next 50 years. How could we get more people moving?

(Applause.)

MS. EINHORN: Danny.

DANNY LEIPZIGER: Thank you very much. I guess for person less timid than I being the last speaker on the last day would be intimidating, but I have hopes that if I say something interesting, it would stick with you.

So on the topic of new ideas for development coming out of the crisis, I think we should start with the fact that our confidence has been shaken. You can't look at the FT without worrying about the future of capitalism where the markets are still functioning and why should we stop with the general? Why not also worry about what do we think we know about development?

I just came from Boston where the Growth Commission, which is headed by Mike Spence, reconvened because of the crisis to see whether or not we thought that what we had put out in May under the Growth Commission report was still valid. And I think largely we think that it is, nevertheless we will issue some sort of supplemental views because a few things have changed. And I think – let me focus on four that I think have changed.

One has to do with the role of capital. Unfortunately, this is one occasion where a PowerPoint would be good, but I have a nice graph here, which I can show you later, which shows three peaks of capital flows with big drops in 1981, 1997, the East Asia crisis, and now, 2008.

And what's remarkable about these peaks in terms of capital flows to developing countries is that they get larger and they get steeper and the only part of capital flows that remain somewhat constant overtime or at least less susceptible is foreign direct investment. The rest of capital, dead capital, equity capital is extremely volatile, and in this last peak went up to about 8 percent of GDP of developing countries starting at one, and three, and eight.

So a logical question is should developing countries still rely on foreign capital as one of the major drivers of their development? And more to the point, should they discriminate between types of capital? And as many of you know, Chile, in the 1980s, had a way of discriminating against short-term capital. They were widely criticized by the U.S. Treasury, by the less gentler IMF at the time, but I think they were right.

So the question is what to do about capital? The alternative to imported capital is developing local capital markets. Obviously, that takes a long time. It's a perennial development question.

But there are some things that can be done in terms of intermediating savings. There's no reason why East Asians need to save in Singapore and Latin Americans need to save in Miami. It has to do with certain rules of the game, governance, et cetera. Taking away pension plans in Argentina doesn't inspire confidence of Argentines to keep their money at home. So if you actually look at the amount of savings, there's much more savings being generated in developing countries than is being invested for these types of reasons.

Second, somewhat traditional, is tax collection: Tax collection in developing countries is about 14 percent of GDP, in the OECD countries, 21 percent of GDP, and even within regions very variable. East Asia generates twice as much taxes as South Asia. So you can do a lot there.

But let's look at newer mechanisms, recycling mechanisms involving sovereign wealth funds. We heard about the IMF. There could be other regional recycling mechanisms for areas that generate surpluses. If you look in any part of the world, there are countries that are generating surpluses that don't have a good way to intermediate them.

So I think one of the areas that needs to be looked at a little bit more critically is how do you use foreign capital for its benefit without taking on quite the level of risk that many countries have now taken. This is very serious because according to the IMF, a few blocks away, capital flows to developing countries in 2007 was close to $1 trillion and in 2009 they'll be lucky to reach $150 billion. So going from a trillion to 150, a tremendous drop in two years most of it in the debt side.

Issue number two, trade: I think it's pretty clear that there are new forms of protectionism out there, and when you see that growth is going to be minus 1.3 according to the IMF next year and world trade volumes are projected by various people like the WTO or the OECD to fall somewhere between seven- and 13-percent trade volumes falling, growth dropping, what does this mean for an export-oriented model? What does it mean for countries that are looking to make large gains? I think there is a possibility that there will be a resurgence of bad ideas, import substitution and old fashion industrial policy.

So the question is: What does one advise countries? And we in the Growth Commission are facing that challenge. I think one thing to say is we think the strategy that the Growth Commission and others have laid out for leveraging the global economy is still correct. However, the payoff from that strategy, at least in the next three to five years will be considerably lower than it would have been before. As U.S. consumption drops, savings goes up, and also, as we wait for the Chinese middle class to all of a sudden start consuming in a really big way.

How confident are we of this? Reasonably, although it should be noted that of the 19 in the G-20 – there's one that's not a country, by the way, misnomer – but of 19 of the G-20 countries, 17 of them are on the list at the World Bank and the WTO independently put together of countries putting in new protectionist measures of one form or another.

So I think that combined with the fact that in the fourth quarter of 2008 we saw a 30-percent increase in antidumping suits leads to some concern about the export oriented model. And we don't know what exactly countries with large surpluses are going to do.

One area that could be of interest is increasing efficient south-south trade. As you may know, the largest segment of trade prior to this crisis in terms of growth was between emerging market economies. There are a number of regional trade agreements, some of them very inefficient that could be more efficient, particularly for 2009 and 2010 when that's the only part of the planet that is actually still growing. If you look at the rich countries, we're declining and the emerging markets are still keeping overall growth from being lower than would normally be.

So I think we have to rethink a bit on capital. We have to rethink a bit on trade although I wouldn't radically change course.

A third issue, what does one do about increased volatility and uncertainty? Obviously, we'd like to see the mature markets, as we call them, be better regulated, et cetera.

I think one of the lessons of the crisis is that those with fiscal space did a lot better. Chile is doing quite well under the circumstances. Countries that ran deficits of 2 percent of GDP have 1 or 2 percent that they can spare.

Secondly, those that self-ensured had more options. And that's not to say that we necessarily believe that $2 trillion of reserves is the optimal number, but clearly, self-insurance in the absence of the new and kindler fund that Dominique Strauss-Kahn described was a sensible strategy and it has allowed countries to look at choices.

Some of these choices involved what is the role of government after the crisis, and let me say a word or two about that as the fourth area.

In the Growth Commission report, we put the role of government back in the middle of development policy. We said we did not see countries that were successful in generating a long-term growth that did not have effective governments, and I think it's even more the case now during the crisis where you expect governments to worry much more about distributional issues coping strategies, safety nets, et cetera.

But governments also in developing countries have additional demands that are being placed on them by the crisis: number one, infrastructure, private provision of infrastructure has fallen off the charts and you have to rely much more on domestic sources of finance; trade finance, normally the safest form of finance, 90-day, 120 days backed by goods falling dramatically so that the G-20 had to make some pronouncements on it – those countries with reserves, Brazil, China, et cetera, able to provide trade finance. Recapitalization of local banks, hopefully, it won't be that many but it could be; and possibly corporate rollovers. The big issue for developing countries is how to roll over corporate debt in 2009. So I think governments are going to have to be more flexible in terms of their macro management and hopefully the fund will be more open to that.

So far, I would say most developing countries have behaved impeccably. We haven't seen great inflationary financing, et cetera, even though they were the innocent bystanders of this crisis.

So let me end with the following thought, and I should say that this Growth Commission that I keep referring to had Kemal Dervis, who unfortunately had to leave, as one of its commissioners, as was I. I think one of the things that we tried in the Growth Commission to do was to be a bit more humble about what we thought we knew about development policy, and I think after this crisis, perhaps humbler still.

I think there's a lot of room for a less ideological and more evidence-based approach to development policy and ideas. And the reason I say that is if you look back on this Chilean policy of taxing, short-term capital and you look back on the reluctance of Korea to open its capital account very quickly, or you look at the cavalier acceptance of a rating agency ratings as part of the Basel regulatory structure.

Or if you look at the tremendous criticism that Korea withstood when their leveraging of their Chaebol, as they were known, the conglomerates in Korea, when their leverage was two or three to one, that was pillared throughout this town less so when hedge funds were leveraged at 20 to one.

And if you look, basically, at the fact that the IMF prior to this recent period allowed very large and unsustainable deficits to persist and did not exercise proper surveillance either of exchange rates or deficits. I think that given all of these types of factoids that I'm throwing at you, humility is the right word.

Thank you.

(Applause.)

MS. EINHORN: All right. You heard it here. You heard it twice. Economists believe in humility.

We're going to open it up. If any of the panelists want to speak at the outset, otherwise I'll open up. And we're not going to have our social stratus in terms of the panelists and the open audience. So everybody is welcome, and we will start with Arvind and do think about what you want to say during our last session. I'm sorry. Okay.

Q: Lant, for your information, I actually drove for a whole year in Switzerland with an Indian driver's license for which I had not had a driver's license test. So I was doing internationally what you did in India.

I have just two questions, one for Lant and one for Danny. And let me begin with the question to Danny because it's something – and let me be honest and frank and you know curmudgeonly.

It kind of really irritates me a little bit when people say we've suddenly seen that the role of capital has changed. You know, it's kind of akin – when the facts have changed, I've changed my opinion. So it kind of lends respective to that view. But the point is that lots of people said before this that foreign capital had serious problems, that it was a lot of evidence against that especially for – and John is not here – especially for portfolio and debt.

And yet, the world community embraced capital account liberalization for two reasons, one of which was spelled out by Jagdish yesterday which is that, you know, academics have these – are really compromised to some extent because of their interest with finance, so they had an agenda which was unrelated from their interest. And the second point which was what Jagdish said many years ago that Wall Street-Treasury conflicts pushing capital account liberalization.

And so, to say that, you know, oh, this is all, we've got new information and we should change this is I think being a little bit very convenient reading of the evidence. And I really would like you to respond to that.

For Lant, my question is, you know, I began my presentation, I began by saying, one of the reasons this crisis will not have such a big impact in developing countries because you know, the big issue is not states versus markets but exactly state capacity, what you just said.

But my question to you is that, you know, I take your point about the Indian driver's license thing. But the interesting thing about, at least in India, is not you know that things don't work but why do some things work and some things don't work? And you know, for every driver's license that doesn't work, we have a central election commission that conducts elections much better in the United States. We have a Supreme Court that can get monkeys out of the streets of New Delhi. It shouldn't be doing that, but some things do get done whereas other things don't.

So I think, in some ways, that is the interesting question and you know, what does this crisis tells about how to examine that question rather than just saying state capacity is weak as a kind of a general proposition.

MS. EINHORN: Okay. Why don't we take some answers and then we'll have clarity.

MR. PRITCHETT: I'll start. I mean, in the paper that I've actually written on India I addressed precisely that question because one of the things about India is at the – I think it's actually quite simple which is there's two factors: the more elite an institution is in India, the better it works; and the second is, the less it relies on what I call discretionary transaction intensive actions by agents of the state, the better it works.

So what does that mean? India can run great monetary policy because you can get a few smart economists gathered in Mumbai and they can kind of make some decisions. They have a really tough time getting the police to not be corrupt because the police are out there engaged in activities that are highly discretionary, very difficult to observe.

And so kind of the Supreme Court works, the IITs work, but even within sectors like education, the IITs, the institutes of technology are fantastic – you know, 50 percent of kids in India after four years of education still can't read. So I think the more transaction intensive it is, which is more state capacity absorbing, the more difficult it is, and the more sort of elite the function is.

So, again, the Supreme Court works fantastically well, try getting anything enforced by a lower court, lower than the Supreme Court, so every court decision essentially takes nine years to get to the Supreme Court where a reasonable decision often gets taken.

So the real question is as we imagine taking on additional functions, what do they look like in terms of their state capacity utilization and what do the forces look like, is this the kind of thing that the state, be it India or Somalia – if it had one – South Africa or Argentina, does this look like the kind of thing that this state has the capacity to implement, if not, we ought to think twice about are we going to push it over the brink in terms of its capability?

MR. LEIPZIGER: Well, on the question of this information is not new, my intention in bringing this to your attention was not to offend you, Arvind, but that's an externality. (Laughter.) I guess what I meant to say, and I'll repeat, is that these peaks of credit boom and bust cycles to developing countries have been going on for a number of decades. They just have gotten considerably larger and sharper.

But the flipside is that the FDI component has been actually very stable in these drops. FDI doesn't really fall off the charts. So it's nothing new to say that FDI is to be preferred to short-term hot capital. And I'm going to point to who said what when. And you're right. That's not a new finding. The point is that in a crisis as severe as this, sometimes people pay attention to information that was formerly available.

MS. EINHORN: I think I will come in if I may on that one, as to who said what, because I do think that to the extent that there are facts, the Bretton Woods institutions take account of them, and probably the best advice is don't go and develop your country on the basis of a theory but after the facts, they do take account of them.

So after the Asian financial crisis, before the Asian financial crisis, there was a move actually by a beloved colleague now deceased Manoil Gitiam (ph) was probably the sponsor and the biggest name of it, but pushing very, very hard for wholesale financial liberalization in ways that would have chastised what Shelly (sp) was doing.

But after the Asian financial crisis, there was a whole reevaluation, and quite soon, the new knowledge was, be very careful about the sequencing of your financial liberalization, welcome foreign direct investment. We'll see whether that backfires in some way. But in any event, it was welcome foreign direct investment and then welcomed portfolios, long-term portfolios and be very careful about liberalization of short-term flows and, in any event, don't do it until your banking system is strong enough which led the wonderfully liberal Peterson Institute along with the official institutions to say China should not liberalize its foreign exchange regime because it doesn't have a banking system that could take an open liberalization of foreign exchange flows. So I think it was some distance traveled on that.

Okay. Larry, you get to respond if you wish.

Q: Well, as another recipient of an externality, I would like to make a brief response to Lant. It would really take an afternoon to debate this or even to begin to. But I do think you've pretty seriously caricatured political science thinking and research here. (Laughter.) And I think that the evolution, if not clear stages, but we heard stages of political science thinking on these issues was really much better expressed by Tom Carothers.

I'd also like to note that to dismiss the work on political development as having not moved beyond thinking of liberal democracy as a destination, that's not an analytic or a theoretical point of view. That is a normative choice that's sort of paramount to saying, well, the goal of economic development is improved income.

For some people, they would challenge that and say the goal of economic development should be environmental sustainability or something. So normative choices enter in here. It's not just what theory says. And you can have a normative point of view that liberal democracy is less important than political order. And indeed, we had that in a couple of generations ago in Huntington's work.

Let me just make my question now, which is different. We are assuming kind of here – I kind of made this point in a different way at dinner last night – that the global financial crisis is the only thing going on in the world now and maybe over the coming decade that's going to possibly effect a rethinking about development.

But there are other things going on, cyclical trends and long-term secular trends, and one of them, which was kind of implied by what Michael Clemens said, is globalization. And there are other dimensions of it that were implicit in what you're saying, but the big one is rising inequality, it seems, everywhere – including in the highly industrialized countries and increasing differentials in terms of return to knowledge.

Now, you know, it seems to me that that could be as great or greater in the long run a source of rethinking about development strategies as this and it may be useful for us to ponder how this potentially cyclical development, however deep it may be, and that long-term secular one may interact with one another in affecting the search for new models that you are searching for.

MS. EINHORN: Thank you. I just want to see if Tom Carothers wants to come in on this at all now or not at all. I don't mean to put you on the spot.

MR. CAROTHERS: Well, it was more directed at Lant.

MS. EINHORN: Lant, yes. But Lant can answer you both.

MR. CAROTHERS: Let me just make a comment on what you said, Lant. (Laughter.) I was puzzled when you said about all successful experiences of rapid economic growth have been under authoritarian regimes.

MR. PRITCHETT: Poverty reduction.

MR. CAROTHERS: Poverty reduction. Okay. That qualifies it, because I was thinking of Japan from 1945 to 1990 as an example of a democratic country that did pretty well economically in terms of increasing its overall economic development.

But more broadly, I was thinking of Latin America where there certainly have been certain authoritarian hotspots of fast economic growth, Brazil in the late 1960s, Chile in the late 1970s. But it's interesting when you look at Latin America over the last 100 years, not the last 20 or 30 years, three countries that really have done well, socially, economically are Uruguay, Costa Rica, and Chile, and those have been the three countries that throughout the 20th century were the most democratic. And they didn't start as heavy authoritarian regimes which then because democratic as a result of development, but from the beginning had less concentrated forms of political power. And they're really the only three Latin American countries that sustained democratic experiments for most of the 20th century, and they're by far the most successful socio-economically in terms of the quality of life in the countries.

So I think we have to be careful about immediately putting sort of zinger lines about poverty reduction only occurs under authoritarian governments. You know, that's –

MR. PRITCHETT: All of the most rapid (epicenters ?).

MR. CAROTHERS: Yes. But I'm puzzled why economists care so much about rapidity. (Laughter.) I would rather live in Chile today, and Chile's had its ups and downs, but why not look over 100 years? Why is rapidity so important as opposed to sustainability and depth?

MS. EINHORN: Why is what so important?

MR. CAROTHERS: Rapidity as opposed to sustainability and depth. Look at Sweden from the 1890s to the 1990s, a pretty good story. But why discount those and say, I want rapid? You know, if I'm a developing country, I'd say – I'd like Sweden. So I'm puzzled why there's this emphasis on has to happen very fast given that there have been a lot of bad experiences with rapidity.

MS. EINHORN: Actually I think of we're marking down for a volume of questions on new ideas for development, that notion of rapidity versus sustainability is actually a very interesting one in terms of long-term ideas.

Lant, would you like the floor for a bit? (Laughter.) Okay. All right. Then we're going to open it up again. And I am going to stay with our panelists, so go ahead.

Q: Yes. Well, just a comment that Uruguay and Chile had long breaks of democracy in the 20th century – long. I mean, Costa Rica did not. Actually, my country, Colombia, has a much better history of democracy. Okay?

MS. EINHORN (?): (Off mike.)

Q: No. No. No. No. Venezuela has short democracy periods in its republican period. Only two spells of democracy in the 20th century. So it's not a – just a clarification. And some of the best success stories, which actually have been during the so-called import substitution era, were with long periods of dictatorship.

One is that Mexican story which, I guess, I don't consider a dictatorship but many people do, okay, under PRI, which was a very successful period of development in Mexico. But you know, that was just a part.

But you know, I wanted to go back to the – I think there is something fundamentally wrong about the way we economists discuss issues which I've come to see us as what I call a recurrent amnesia. But you know, you think about this issue of capital account liberalization. The issue of sequencing – actually was raised in relation to the sudden account liberalizations of the 1970s. And therefore, sometime it was orthodoxy – you know, that you have to sequence. Then came the 1990s and we forgot altogether that was – so it again came with the Asian crisis. And then – okay. Yes, yes. We have to have regulation. I think that part was okay. But then, everyone continued liberalizing.

I think Danny is correct. I think the part of the orthodoxy should be actually now that, you know, foreign capital is not such a good route to development. But that's a case of recurrent amnesia. Every time it's like appreciations of the exchange rate in Latin America. Every time we say, oh, no, no, we have to have a competitive exchange rate, and then every boom of foreign exchange, we appreciate.

So there is something fundamental. And I must say that, again, in certain parts of the debate there is a tendency – I really think this is – there is a fundamental problem which is it's probably a mix of ideology and lack of pluralism because when you have ideologies behind thinking, the only way to correct that is pluralism. So there is something fundamental about the lack of pluralism which was the point, again, of the morning session that I think it is important.

And again, look at this issue of, do industrial policies ever work? You know, like East Asia miracle, you know, after the Japanese insisted, it should be seriously researched. There was some assiduous research. And now, in the Growth Commission, the issue comes in a more balanced way.

But you know, Lant, is that – has that become corrected, or has it been corrected or not? I tend to think that it's still, at least in the main stream of the professional phrase that is not correct.

Or look at the issue of countercyclical policies. Now it's orthodoxy. Come on. When the managing director of the IMF presented his medium term plan just three years ago, where is the word "countercyclical"? I didn't find it. It was not used at all by the IMF just a couple of years ago. Now it's broadly used.

So I think there is something fundamentally wrong about the way the economic debate goes on. We don't learn. We don't learn. We keep repeating the mistakes in the name of our wisdom. I guess I am on the side of being very skeptical of the profession. And I hope we can correct ourselves, but I think – so the political scientists may have some problems, but perhaps they have been more consistent.

MS. EINHORN: Thank you. Let me just say that I think when you talk about foreign capital, you really go back to the most basic concept in development because the flip side of foreign capital is a high savings rate.

And I well remember a colleague, some of you may remember, at the World Bank who was the vice president for East Asia where all the miracles came over and then he was the vice president for Latin America and the first time he addressed the board, he said, many of you asked me what are the differences? There are two major differences: one is the savings rate and the other is the investment in human infrastructure. And if those two things changed in Latin America, they would have more of a record.

So the whole idea of international development was that the savings rate couldn't be expected to be as high and that savings rate shouldn't be flowing from China to the United States but rather they should be flowing from the richer to the poorer. And I think it's an interesting question taken back to its basics for new ideas in development, whether we actually think that we should take that fundamental view about savings gaps and savings flows and say, no, the key to development is to make sure that there's a substantially high enough savings rate within the country such that you don't have to look upon the foreign flows in terms of your capital.

I know that you didn't mean anything that general, but I do think as we look at new ideas for development, this is something that's coming up on the table.

Okay. Let me look around for a couple of more questions. There will be one here and one here and then we'll continue on to Neva. And we will finish at 4:15 p.m. so that our chairs can come up to the panel.

Q: Yes. I think the focus of – the intention of the panel was to focus on lessons from the crisis, if that is leading to anything about new development thinking. Frankly, I'm disappointed.

Almost all the things that have been said are nothing I can't relate to the crisis. But there are a couple, or maybe I'm just – I came last night from India after spending two months there and maybe I'm colored by a different sort of ambiance.

There are two which are in the air here, but somehow in such panels they're never being raised. And I'm referring first – and these are two candidates – what Simon Johnson has been driving about which is not new, which is also exactly what Joe Stiglitz has been writing about for five, 10 years. And I think it's very, very relevant because I was recently discussing the politics of regulation in India and one if the criticisms of the Bretton Woods institutions has been the whole idea that you can think about regulation in an apolitical sense. This is about power regulation, but I think it's true for financial.

Regulation in this country, financial regulation reflected the distribution of power, of political power, and that's the interest itself. Now, it may have swung in different ways but I think this is an important lesson and it means a lot about policy and institutional design which is what all the development orthodoxy today is about. So I'd like to have anybody's comments on that. And this means you have to transcend your narrow disciplines here.

MR. PRITCHETT (?): You can't possibly be proposing that the idea that power influences policy is a new idea.

Q: No, it's not, but it has certain – but how come it's always –

MR. PRITCHETT (?): What we learn from the crisis – (inaudible, off mike).

Q: No, no. But it has meant that the design of policy and the instruments and all have been – at the level of generality that you all have been talking about it's the same.

MR. PRITCHETT (?): (Off mike.)

Q: Okay. Anyway, it is definitely not figuring the orthodoxy of the World Bank, which is where I worked and where many of you did, has always taken for granted as if this was apolitical. It's not. Number two. Let me – if you think that's banal, I would say, maybe it is. I don't believe so.

The second, I think, is a point that was raised by Kemal Dervis this morning and what was Jose-Antonio just said, the importance of the plurality of ideas and thinking of analysis. I think has been a major problem with all the institutions and this has been said even at the bank many times. Why is it?

And why is it that neither the IMF nor the World Bank were able to say or even talk about the nature of the crisis that was impending? It wasn't that it was not being discussed because it was very much in there. Let me tell you. I used to chair the Program Advisory Committee for the IMF and the World Bank program seminars. Two years ago, we invited Nouriel Roubini. I got a lot of pressure. Why Nouriel Roubini? There are certain institutional imperatives of the sort.

I think it's important that the institutional designs allows for plurality. And I think, again, these are the sorts of things that should be drawn from this crisis.

MS. EINHORN: Thank you.

MR. PRITCHETT: Can I speak directly to that in a two-handed kind of way?

MS. EINHORN: Sure, Lant. Go ahead.

MR. PRITCHETT: I mean, this was the entire point of what I was saying, though. I think if you look about where there's plurality and where there's not plurality, you should not be looking at economic policy as a place where there's sort of hyper-orthodoxy and lack of pluralism of views. Whereas, if you want to talk about where are we going with state building, what's the role of – the legitimate role of democratic modes of articulation of citizen preferences in different ways around different decisions? What are the appropriate implementation modalities?

There's enormously less vigorous pluralism around these other questions, I find, than around economic questions. Its civil service bureaucracies are the modality of delivering services of government and liberal democracy is the ultimate objective of the political transformation – full stop. And all the organizations that work on governance more or less have something like those two things in mind.

And the range of views being considered I, again – I listen to economic debates and hear enormously broader arrays from, you know, far to the left of Jose to far to the right of me, and don't hear on really important development questions anything like that array of views being openly expressed. I have yet to hear a single person from the U.N. openly question democracy's objective, openly question the role of the state in providing education, openly question the role of the state in a whole – or the modality of state delivery in a whole array of things. So I see the U.N. as being enormously more hyper-orthodox than the World Bank by orders of magnitude.

MS. EINHORN: Okay. I think the debate – I hope you'll understand that it's not as if I don't think that you actually really could engage in a wonderfully productive debate. We know that. And I think you've put this agenda on. So if we can, afterwards, we'll come back because this is rich, but I have to go on.

Danny, you wanted to say something, and then, I think I had already called on number two and then number three, and then we'll watch our clock.

MR. LEIPZIGER: (Off mike.)

MS. EINHORN: Okay. So then there was a question back there.

Q: Thank you. My name is Steve Parker with the DAI. Two quick comments that leads into a question: one comment on the tradeoffs between capital flows and the basic savings. I think, at least in my experience, it's been primarily countries that have high savings that also attract a lot of foreign investment. So it really happens I think the other way around.

But I'd like to give an example that I think lays out a lot of the innuendo – some of the discussion here. And that's Vietnam. And we were involved very strongly with mass reforms that Vietnam made after they opened up economic in the United States in 2001 and then eventually it acceded to the WTO in 2007. And there was a very large inflow of capital – a substantial amount of foreign direct investment, but also a lot of short-term money including hedge fund money.

For some of us that had been around Asia for a long time, been through the crisis, you could see very clearly the difficulties that the government was going to face managing all these capital inflows, the inability to sterilize them. And while we saw some inflation almost everywhere, inflation in Vietnam went up to almost 30 percent, which had very severe implications for the poor.

But there was almost – it was very, very difficult institutionally within the U.S., within the IMF and the World Bank to even bring up the idea that Vietnam should consider capital controls to reduce the amount of quick flow. And you could just see certainly that there was going to be problems.

So I'm wondering, to the degree that we really have learned lessons, and to the degree that the major institutions really are open to allow discussion about particularly the ability to really manage capital inflows. There are really countries where the U.S. Treasury, the IMF and the World Bank now are sanctioning restriction in capital inflows.

MS. EINHORN: Okay. Thank you. So capital flows, and maybe what we'll do is – Neva, and then – may I see how many more hands there are, because there are – five, five minutes. All right. Let's do three quick questions and then I'll have the panel close up.

Q: I'm Neva Goodwin from the Global Development and Environment Institute at Tuft's University. And given that there's some reasonable probability that we're facing a transition to a post-carbon energy system, I just wondered – and this may not be particularly relevant for this panel, but if any of the panelists here see that as a really important element in how development goes forward.

MS. EINHORN: Right. Thank you. It is interesting that we haven't hit on environment as we look at the future of development ideas. There were two more hands, I think. We're going to collect those questions and then we'll have the panelists close up.

Q: Thank you very much. I'm very thankful for everything, all of you for kind of – I did learn a lot. Very shortly I will give a scenario, a study of several cases. I know very well a person who used to – was born in a communist country, highly educated but not communist. Because he has very close family, friends, he got a good job but actually did not accept to become communist so he was a political refugee in one of the European countries where the elite is very important. He got a very good job there working for the president's office, whatever. But the elite did not accept him so he went to a Scandinavian country.

It's a concrete case of study. There, democracy is perfect. It's nice. It's good. You have no problem. Even the immigrants can vote at local community level. So there, he got a very good job, very good project. Two countries applied but he recommended – but then it became too far away from the Viking homogenous culture.

Then an experience in Japan, again, it's a very nice democracy. Maybe it's missing some of our nervous system. And he got very good results. For the first time ever, international project, original one. And then in an African country. So in Japan, you can't go too far for some other reason.

And then, I know another case. I'll be very short – bicultural family in Scandinavia, Iraqi and Scandinavian mother. Beautiful children. The social system helped them to educate their children. The parents can't get a job because one being Iraqi, Arab, straightforward, I was told on behalf of his family by officials, between Norwegians – sorry Scandinavians – and Arabs, we have problems. What shall we do about it? Three aspects question because this one –

MS. EINHORN: I'm going to have to close you off because we have only five minutes left with another question and the whole panel.

Q: I think this may just come from knowledge, Googlization (ph), if you allow me to put, it this way. The first word in English in many countries is "Google" they learn. So how information knowledge and what I would call democratic entrepreneurship and freedom don't touch, if I may put it, freedom, democracy, this is still even more important for the development. But let's have some new ideas. Thank you.

MS. EINHORN: Thank you very much. And actually, maybe Michael Clemens will come back to some of that as well when he comes back. There was one more question. Very quickly please and then we'll close.

Q: Hi. My name is Andrea Chartock. I'm also with DAI. Actually my question was also for Professor Clemens. I was just – one of the things that struck me yesterday in the panel about Asia was that there was a flow of 20 million rural workers that then led to the wage depreciations. So I guess I'd like to sort of believe this theory that was sort of put forth, but could it possibly just be a numbers game of supply and demand? So that's sort of my question. Thanks.

MS. EINHORN: Thank you very much. And now we'll give the panelists with a minute each the last word. And I'll start on this end.

Tom?

MR. CAROTHERS: The only comment that I'll make is on the comment that you made. I think you were reinforcing or maybe stating more clearly what I was getting to at the end, which is that I think discussions about governance will have to change because the idea of governance is a set of neutral values that are kind of content free is called into question here. So I think it's the same thing as what you were saying.

So I do think this shakes up the governance debate a bit, as I said, given that those countries which were following the neutral principles seem to end up with sorts of forms of governance that were inadequate here. That's all.

MS. EINHORN: Mike?

MR. CLEMENS: Thanks. Just briefly our friend from DAI, I forgot your name.

MS. EINHORN: Neva?

MR. CLEMENS: No, the questioner from –

MS. EINHORN: Andrea.

MR. CLEMENS: Andrea. So the astonishing thing about South Africa is that the blacks outnumber the whites five to one, five to one, and the whites' income, if you can make a GDP per capita for the white areas versus the black areas, it was something like eight times prior to the liberalization of movement. Incredible.

How could it possibly be that white incomes would not go down when blacks can suddenly compete with them? And I think one of the most powerful reasons is one of the reasons that Giovanni Peri asserts that George Borjas is wrong, and it's that when you have such great differentials in endowments – human capital, social networks, et cetera – the labor market, even when it's spatially integrated, it's segmented. Immigrants don't do the same jobs as I do for the most parts. They actually make me more productive and that's how you can escape the numbers game. It doesn't last forever. It doesn't apply to all groups of people in all settings, but at the margin, for the next million poor people that come here, that comes to France, that come to Japan, absolutely doesn't apply and the evidence shows that.

MS. EINHORN: Thank you. Danny?

MR. LEIPZIGER: Well, on the issue of Vietnam, for example, I think if Vietnam had had Joe Stiglitz as its adviser, they probably would have differentiated between what type of capital they preferred. The trouble with capital control is it's a very crude instrument. It's not just the Chilean type of excess reserve requirements. Usually, capital controls come with a pretty large other apparatus.

I wanted to come on – I guess Larry Diamond's question or comment, which I agree with and it may help – (inaudible) – to walk away with something new. And that is that I agree the distributional concerns are less of a problem when everyone's income is rising.

So let's come back to the Vietnam case. You know, the Gini coefficient in Vietnam over the last 15 years got considerably worse. But poverty in Vietnam dropped by two-thirds. So people, you know, legitimately would say, okay, let's not worry so much about distribution. The large chunk of the population is better off.

It's harder to make that case when income starts to drop and that's where your point, if I understood it correctly, about the cycle becomes more of a concern, which is that you have to reassure the public that this is really a cycle and they're going to recover their past incomes and it's not so clear that many governments can make that commitment because it's not clear that they can follow through on it.

So I think that's – if you're looking for new ideas, I think that's one that's worth exploring and it would put political science and economics back on a nice social footing.

(Laughter.)

MS. EINHORN: I think if the rising tide didn't live to all boats, has a lot of attention now to make sure that receding tide takes all the boats out.

So in any event, Lant?

MR. PRITCHETT: I just want to come back – the issue I think was on the table as an important issue and the financial crisis only highlighted it. It was the issue of policy implementation capacity which was what was actually the ability of the state to carry the ends which has set about to do. And that that rather than what it set about to do may well turn out to be the important determinant of outcomes. So it wasn't so important whether you had industrial policy or didn't have industrial policy of this type or that type. It was your capacity to actually induce a reasonably correct set of things in a strong implementation capacity you had self-limiting downsides anyway.

And then, the link to the financial crisis is merely that it highlights that in the same way the sort of the disaster around power liberalization in California sort of alerted us to the fact that if California can do this wrong, it must be pretty complicated. It shouldn't be entirely confident that Angola can do it – (laughter) – which puts a check on a lot of the ambitious things.

And then this relates them back to – I agree that the governance agenda becomes much more complicated because if in fact policy implementation capacity is influenced in some way, shape of form by governance, how exactly? I mean, and living in Indonesia and India, the striking thing is that if I would have told you that one country was going to have 30 years of an authoritarian government and one country was going to have continuous uninterrupted democracy, you might say, well, I would guess that one country will grow pretty fast but human development indicators might not improve so much, and the other country probably won't grow as fast but will good progress on human development indicators. And you would have got it exactly wrong.

The authoritarian government did amazingly better on every single human development indicator than did India during its entire period of democracy. And India is now growing faster. So it's a very puzzling paradoxical world out there and I think we need a lot of attention to how does governance actually lead to outcomes.

MS. EINHORN: And we got nowhere on environment today, but I think it's because we were looking at the financial crisis and its effect on some of those models of development. But I do hope we'll have another conference on how no-carbon footprint is being taken into account in development models.

This has been a wonderful panel and a terrific afternoon. And I'm going to turn this podium over to where it belongs, which is Frank Fukuyama and Nancy Birdsall.

(Applause.)