More lessons from the Trenches:
From Indonesia to Vietnam to Central Asia

By

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On his retirement from the World Bank
23 February, 2006

Thanks you all very much for joining us today. I want especially to thank Shigeo for honoring me as what I believe is the first speaker in a series that the Europe and Central Asia Region is setting up as part of its learning agenda. One of my criticisms of the Bank in the past, and it remains as true today as it was in '99 when I last gave a departure speech, is that we are a knowledge based institution that doesn't take advantage of the knowledge we generate, which I find really quite remarkable. We simply do not tap into the vast knowledge that our senior staff has before or when they leave, and I'm not talking about myself. You will be the judge at the end of this talk as to whether or not I'm a fountain of wisdom and knowledge, but given the lack of interest in capturing experience, I do sometimes wonder if the Bank is afraid to learn about its past through its senior staff and what that might say about the future.

This is my second farewell speech, my first coming when I left Bank after my Indonesian days, in August of 1999. The title of that earlier talk was "Why Did Things Go Wrong: Lessons From The Trenches of Indonesia" which explains the title of this talk.

Today's talk is an interesting empirical test of what draws attention in the Bank. While I am utterly delighted to see all of you here, I will tell you that notoriety draws better than wisdom. When I last gave a departure speech following my time in Indonesia, this auditorium was packed—standing room only, with people outside who couldn't get in.

Being at the Bank for nearly a quarter of a century does not set me aside from many others. What is unusual about my Bank career is that for most of the last half of that time I was out of Washington. What I want to do today is to give you a sense of what a field-based director thinks—or at least what this field-based director thinks—about the challenges facing the Bank today.

I'd like to introduce three topics and then have a discussion with you about them. The first issue is the way the Bank is addressing the so-called middle-income country (MIC) agenda. The second is what I call the LTD agenda, the long-term development agenda the Bank faces that encompasses a host of country types. The third topic is a set of issues around performance-based allocations and related issues such as corruption, governance, and the need, at least in my judgment, for some balance in the way we approach this agenda.

An important underlying assumption for what I have to say is my view that the Bank as an institution is not going to get by with marginal changes in the way it does business in the future. I don't know how many of you read Mervyn King, the head of the Bank of England's view of

what needs to happen to the IMF going forward, but I think the same set of issues, the same fundamental discussion beyond the margins is going to take place for the Bank. There is a difference between the Fund and the Bank and it is that the Fund is struggling to figure out what its role is in today's world. For the Bank, your goals haven't changed but the challenge to come up with effective approaches and instruments remains.

<u>The middle income agenda</u>

Let me turn first to the middle-income agenda. While I don't think it would comes as news to this audience, the debate on this issue is often muddied by a confusion between to related but very different issues, *whether* we should stay engaged in middle income countries and *how* we should stay engaged. Anyone who understands well what the Bank does as an institution and the needs of middle-income countries would agree that we need to stay engaged in these countries. The question the Bank faces today is how best to stay engaged.

The variety of countries that fall into the MIC means that you need to differentiate your approach depending on the problem. Middle income countries range from countries that I would characterize as being on a par with the Bank in terms of development expertise to countries that are middle income in income status but lower income in institutional infrastructure and process status. Countries in the first category must be treated as full partners in the process of seeking better solutions to development challenges. Countries in the second category need a different approach. While the work the Bank has done on the MIC agenda does recognize these differences, often the discussions I have heard lump these different challenges together, which is not helpful in clarifying the Bank's role in MICs.

For countries that are at the full partnership end of the spectrum, countries in which we're dealing with counterparts and institutions that are fully capable of managing their own development agendas, we are facing a partner that wants to be fully engaged in the development debate, that wants to explore new options for achieving long-standing challenges, that will settle only for the best advice available. A key question for the Bank is how to provide that advice. I am now at an institution, the Center for Global Development, that has a staff of around 30 people. Thirty people, and yet, in the short four and a half years it's been in existence, it has been remarkably effective in influencing many of the debates in which we, the development community, are engaged. How do 30 people do this? They do it by tapping the best experts outside of CGD, putting together the best and the brightest, working groups are built around specific topics and themes. This has been a remarkably effective, agile way of addressing development issues while they are hot. If the Bank is going to be relevant in the upper end of the middle-income country spectrum, I think it needs to move to this model. The Bank's human resource structure is just not flexible enough to deal with the shifting demands of high-end middle-income countries, nor does it allow the Bank to move with the times sufficiently quickly to stay in a leadership position.

A second issue that we need to address on the middle-income agenda is whether or not we should charge for our services. Based on my experience in the field, it is my view that we should charge. I base this view on two observations. The first is that analytic work has often become the refuge of under-employed Bank staff. When you can't lend, you can always write a report. That

is why you have so much supply-driven economic and sector work that has so little impact on clients. A good way of using budget, but not a good way of adding value to the development process. That situation couldn't happen if we subjected our work to a market test. But not only would charging, at least something, for our work put that work to a market test, my own experience tells me that it would also create a very, very valuable synergy between country counterparts and Bank staff, and for this I draw on my experience in Kazakhstan.

When I started working on our program in Kazakhstan in 2001 the Bank's program with the government was at a very low ebb. We were not seen as relevant, as providing the right level of advice, as being quick enough, as understanding the changes that were taking place in Kazakhstan and the pace of those changes. We built a program in Kazakhstan that now, I think, is among the best in terms of relationships with clients. We built it around a *jointly* financed economic and research program. That program has been remarkably successful not just in terms of analytic output, but in the relationship it has built between the Bank and the government. This is not reimbursable technical assistance, a model that I do not support. It is a model of engagement that makes both side take analytical work seriously. No, we did not always agree either on the agenda or on the output, but we did always find a core set of important issues on which to work. This is a model that needs to be explored in other countries. Its externalities far exceed the value of the direct output.

For some middle-income countries the issue is implementation capacity, which presents a different set of challenges. When I arrived in the Bank in 1983, I arrived thinking that lending, the pressure on staff to lend, was a distorted factor for the Bank. Lending targets were a bad thing that forced us into projects and relationships that maybe weren't in the best interest of our countries and ourselves.

Over time, I came to learn that what distinguishes the Bank from any other, from many other purveyors of knowledge, is its lending. It is the need to get, if you will, down and dirty, to figure out how to move from the perfection of design to the reality of local institutions and local political processes. That is what distinguishes the Bank. That is as close as we can get to a bottom line. It's that bottom line that makes us different from hired gun that comes in and puts a report on the table. Because of lending we have to come to closure on the details, and it is the details that matter. The challenge in middle income countries with weak implementation capacity is that these countries are not going to continue to borrow. I don't even think the "we'll take a little piece of the action" program that we were trying to sell in Kazakhstan—where the Bank says, "borrow 10 percent of what the project is and you'll get everything the Bank has to offer"—will work for very long. It's not going to happen because it's not worth it to the government to go through the hassle of working through our and their processes.

What we have to do is to figure out a way to "projectize" our activities in these countries without making them borrow. Before I left the Bank I was working with my colleagues on ways to do this in Kazakhstan. But this is an issue that deserves Bank-wide attention. How do we meet the challenge of preserving the enormous value added by a project relationship in a country that is unwilling to borrow? Finding a solution to this quandary is one of the important elements of moving our middle income agenda forward. Kazakhstan doesn't need our money, yet for us to advise Kazakhstan on the issues of civil service reform, or how to manage their project, or

procurement, isn't the same as sitting across the table and being accountable for helping them do it. We need the project context to do that.

One of the interesting issues that Mr. King raised in his comments on the IMF is whether or not the Fund's sitting Board should be replaced with a non-resident Board that meets several times a year to discuss key policy issues. The same question applies for the Bank, but that has to be a conversation for another time. However, the constraints that our institution put on our middle income countries is one that we need to take front-on and this is, as well, a Board issue. If you look at the middle income strategy report, it does suggest ways to try to ease the hassle-factor going forward, but if you talk to any field-based director or operations staff, you will be told that the recommendations "don't even come close." The Board needs to recognize it cannot have it both ways. On the one hand, it cannot insist on country ownership and a respected relationship between the Bank and its middle-income clients, and on the other insist on a whole variety of safeguard measures that are driven by donor countries and special interests.

That's not to say safeguards are bad things; it is to say we need more flexibility, that we need to keep the objectives in mind, that we need to be flexible in terms of instruments.

Finally, a pitch for decentralization. I am quite sure that our relationship in Kazakhstan would not have revived if we hadn't decentralized. The fact that I was in Almaty and my team was in Almaty and Astana was fundamental to signaling to the Kazakhstan authorities that we were serious, that we were responsive, and that we were there on their terms not ours.

<u>The long term development challenge</u>

As difficult as dealing with middle-income countries is, the core issue facing the Bank for the future is how it deals with the bottom half of the developing country distribution. We've all heard a great deal lately about the Bank's role in delivering global public goods. My new institution, CGD, has suggested that the international community should create a fund that allows the Bank to work on global public goods and also that the Bank, as the key institution, should manage that process. I agree with that recommendation but I want to make sure that we do not lose sight of what is the most critical public goods issue for the Bank: keeping fragile states from becoming failed states, working to turn failed states into functioning states.

If fragile states are allowed to fail, they create environments of discontent. They create local crises that become regional crises. They create regional crises that become global crises. If we as a development community don't take the long term development challenges that these countries represent seriously, more seriously than we're currently taking them, the world will end up paying many multiples of the current development needs when these countries collapse and send yet another shockwave around the world.

Long-term development countries are a mixed bag. They range from non-states—countries with no governments, no institutions, no borders—to fragile states, some of which are just coming out of conflicts, some of which are in long term decline, some of which are poor, but functioning—I would include, for example, Tajikistan in that final category. I am personally less worried about the conflict and post-conflict countries, which do seem to get attention in the international

community, than am I about fragile states and fragile states in the making. In my view, the great challenge for the World Bank going forward is to create an incentive system that gets the right people and the right money working on these countries.

This is an issue near and dear to my heart. I have been privileged to work for the past four years on the five Central Asian states. I have loved it. It was, as I have said to many people, the ideal place to be for my last assignment at the Bank. It gave me one of everything: middle income, LICUS, a closed state, a reluctant reformer. Central Asia is a wonderful laboratory if you are in the development business. Big and diverse enough to be interesting, small enough to be allowed to get on with the job. While I enjoyed my time in Almaty immensely, there was one continuing frustration: nobody could give me a measuring rod against which my success would be judged, a basis to compete with the big lenders for more resources. People could tell my IBRD colleagues if you lend more, we'll give you more resources. But in countries that are IDA constrained (or don't want to borrow) with small lending envelopes, with weak institutional settings, that are rife with corruption, with governments that themselves are very fragile, it's very difficult to imagine how you compete for space against colleagues whose annual lending is measured in billions. Unless we address that perennial measurement problem, we are not in my judgment going to be solving the key issue of how to ensure the best staffing for these difficult countries.

The Bank's incentive system is broken, and it needs fixing. I know from personal experience that our normal channels don't work for many of these countries. I am exceedingly proud of the staff I put together in Central Asia, but I put it together. I found each one of those people. I convinced them to come to Central Asia, and sometimes I had to fight the Bank's systems to get them there. The system didn't work.

Let me give you a couple of examples. When I first arrived on the job in early 2002, ECA did a batch recruitment for country managers. While the Bosnias and Croatias of the world got 15 or 20 applicants, Tajikistan got one. In the same vein, ten months ago I was talking to Jim Adams about who was going to replace me when I left. I told Jim that Central Asia is a tough part of the world to work in, and that the Bank needed to start thinking about finding a suitable candidate. He told me, "Dennis, not a problem. Country directorships are the most sought after position in the Bank, they'll be lined up at the door to take this on." When the vacancy announcement went out there were six applicants. Only one of those applicants was an I-level person. I'm not commenting on quality per se, but six applicants for a country director position? Hardly an outpouring of interest. This, in one of the most interesting parts of the world, one the most geo-politically sensitive parts of the world, a part of the world in which we built an effective program over the course of four years that now is functioning well. I'm sorry, something is wrong with the incentive structure that does not produce interest in these countries. So what can we do?

First, we should move to a system of managed placement for staff in difficult development settings. What defines long term and difficult? Supply and demand. If there are 25 people applying for a job, the incentive structure is fine. If there's no one, there's clearly an incentives problem. That's not rocket science. We are market-based institution. Let's fix it. Let's shift the incentive structure so that we get serious applicants for these jobs. That will take more than just promising them that if they behave themselves and get through the assignment they will be in line for some other promotion or position that nobody can guarantee them. It will take both

monetary and career incentives, and it needs to managed in a credible and honest way. Ask anybody that's been overseas on the promise that, "it's good for your career." Very hard to find anybody that had a smooth re-entry, who wasn't frustrated by the out-of-sight, out-of-mind phenomena.

So, pillars one and two: managed placement and a focus on supply and demand as any market institution should. The Third pillar: we must get more resources into support for these countries. There are 35 LICUS countries in the Bank and while LICUS is just the subset of the countries that I'm talking about, it's the one I happen to have statistics on. Two-thirds of those countries have no or only one internationally recruited staff in the field. There are 50 or 55, I don't remember exactly, internationally recruited staff in all of these countries but half of these are in three countries, leaving something like 25 people in 32 countries. What about institutional support for LICUS? There are two people in the LICUS unit. They're terrific. Sarah Cliffs is one of the best and the brightest in the Bank and is doing a fantastic job, but she's half the institutional commitment to the LICUS agenda.

Lest you think this is a money issue, it is not. There was a study done a couple of years ago that did a functional audit of the Bank looking for overlapping responsibilities, etc. I don't remember the exact number but the order of magnitude is roughly right. The study identified something in the order of $300 million of activities that wouldn't be missed if they stopped tomorrow—either they were overlapping with other activities or they were so distant from the Bank's central business line that they couldn't be justified. It's not about money. It's about management, and it's about re-sourcing the Bank's core business.

Finally, I'd like to talk a bit about corruption and governance. I assure you it wasn't intentional, but I have had privilege in working in some of the most corrupt and governance-challenged countries in the Bank's portfolio. Although generalizations are never perfect, it has been my experience that there is almost no issue in the Bank on which the gap in perceptions between Washington based staff and field based staff about what we should do is greater than on corruption and governance. You talk to anyone sitting in the field and he or she will tell you, "we struggle with this every day – we know we can't eradicate corruption, but when is some too much?" Every country in the Bank's portfolio has corruption problems, most especially the long term, fragile state development challenges. It's not a matter of zero or one, or good or bad, it's a matter of degree. The question is not can we abolish corruption or should we only work in corruption free environments, but when and where can we improve the lives of the poor even in less than perfect environments.

Clearly there are outliers on the corruption scale that are so beyond pale the Bank should not be there. But for many others I worry that the corruption label is being used as a way of getting the Bank into a host of other areas of concern, including human rights and democracy. These are important issues, but to date have not been a part of the Bank's mandate. Whether or not they should be is a policy issue that needs careful and widespread consideration.

As an example, Uzbekistan is a country that has had a lot of bad press over the past year or so, much of it justified. The Bank's corporate management is considering whether or not to continue to work with Uzbekistan, having delayed the submission of a new country strategy to the Board

for the better part of a year. One issue being raised is that Uzbekistan is a corrupt regime. I am sure it is, but I find it difficult to believe that this is the real reason for the delay and discomfort. Uzbekistan is corrupt, but it is no more corrupt than a great many other countries in which the Bank works. Can the Bank work in Uzbekistan to the benefit of the poor? Yes—and it has demonstrated that. If we stopped working in Uzbekistan, who would be hurt? Not the elite, that's for sure. The poor, especially those in rural areas where the Bank is most active. The question has to be one of effectiveness, not morality. At least for the time being the Bank can't get up and say as an institution, "your human rights record is bad, your not a democracy, we won't work with you," at least not until the Bank's articles of agreement are changed. So, I worry that we are at risk of seeing a whole set of issues being lumped into the corruption and governance basket that may lead to paralysis and arbitrariness before reality sets in.

What can we do practically to further the anti-corruption agenda? We would to start with use more practical advice and less rhetoric. People rile against corruption all the time. Governments are told to "just stop it," but that can't happen. Why? Because corruption and weak governance are functions of poverty within governments—poverty in the traditional sense (extremely bad paid ministers and civil services), poverty of opportunity—badly incentivized civil services, poverty of institutional support in governments that have little to work with.

In other words, corruption and bad government are institutional issues. They do take a moral standard against which to judge them, but they cannot be solved by simply saying, "Don't be corrupt." If we take an absolute stance on corruption we are going to end up creating the problems we are trying to solve. We're going to end up generating failed states because we won't dirty our hands working with the tough cases. If we're going to deal with corruption and governance, we have to understand that it is a fundamental part of the development agenda. It is a long-term institutional challenge. As I said, it's reasonable to be tough, it's reasonable to push hard on these issues, it's reasonable to have basic minimum standards of behavior and transparency. But getting corruption out of a country's system and improving governance is inherently a process of improving institutions, particularly government institutions. And that, we know, takes a very long time regardless of commitment.

There is no question that in the fight against corruption, leadership is essential. Leadership in the World Bank and leadership in countries. But we need to be careful. My great fear is that in its enthusiasm to wipe out corruption, the Bank will set up leaders committed to fighting corruption for failure because it doesn't understand that their commitment alone is not even close to enough to make serious progress. Countries and institutions must develop as well.

This brings me to the issue of performance-based allocations and related instruments. My new institution, the Center for Global Development, was instrumental in setting up the Millennium Challenge Corporation. And while I am supportive of the MCC, it cannot be the only instrument in our development toolkit. If it were to be the only instrument we're going to leave behind exactly the people on which we need to focus most heavily, those who are not so fortunate as to be born in the "success" states that will achieve MCC status. If we are going to move forward on a performance based allocation system, we need to revisit an issue that has haunted the Bank and the development community long before I arrived here: how do you measure progress in countries where development is going to be measured in decades if not generations?

We can't use lending. Indeed, in difficult development settings, maintaining the status quo rather than slipping backwards may be the critical measure of success. If the argument is to be made for more resources in support of long term development challenges, if management is to be convinced to provide the needed resources, there has to be some way of measuring progress, of holding country directors accountable. But what is the benchmark, what are the measuring rods?

A final appeal. Much of what I've said today involves institutions, and institutional development is, for me, the great unmet challenge for the development community. Bono and Bill Gates are doing great things for the world but they're not doing development. They're not creating an institutional base in developing countries that will allow those countries to manage and pursue their own development. Creating capacity is development. And that is what the Bank is or should be about. It's great that we can be involved in helping the world deal with avian flu but that's not development. Development is creating a civil service that functions. Development is creating some intuitional basis for property rights in support of private sector development. Development is creating a financial system that can mobilize domestic resources in support of investment. When we reached the point where all a country needs is money, we have won because money is easy to get where basic institutions function. For decades the international community has been substituting for rather than creating domestic capacity in developing countries. As difficult as the challenge of creating sustainable institutions, we cannot and must not lose sight of it.

This institutional agenda is something that I hope to work on at the Center. It's something that I hope the Bank continues to struggle with.

I don't need to tell this group that there is nothing new under the development sun. I am quite sure that everything I've said today has been said before, maybe even better (not so sure about that). But the point is, these issues are still with us and this is a time of change for the Bank. It's time to step back and think and rethink.

Let me end with a note of thanks. First, thanks to the World Bank. The Bank has given me such a wonderfully satisfying career. At the Bank I have had an opportunity that most people never get, an opportunity to make a difference. Whether I did or didn't is not for me to answer, but I am eternally grateful that I was given the chance.

I'd also like to thank all of the wonderful colleagues I have had in the Bank who have helped make this 23 year journey so incredibly memorable. I will miss you all.

And, finally, I'd like to thank you for listening.