Thank you very much for inviting me to comment on this extremely interesting and comprehensive new book.

Let me start with a big compliment to Otaviano and his team: This book is truly thought-inspiring, and it takes a multi-faceted view of the post crisis world from the perspective of developing countries. I found it very refreshing that the editors asked the 40 development economists to tell what they see on the horizon of their technical disciplines, to visualize how key economic policy issues will be dealt with over the next 5 years, and that explicitly it did not seek agreements or to propose universal recipes or invent new paradigms. I also found refreshing and very honest the explicit recognition that the crisis has questioned a lot of accepted wisdom which is now in doubt and discredited, what Otaviano in his synthesis very elegantly refers to as “subprime truths”. And I also agree, as the book suggests, that it is important for developing countries to not throw the baby out with the bathwater and recognize that some policies before the crisis had good aspects that should not be abandoned.

The subtitle “A handbook on the future of economic policy in the developing world” raises an expectation and places a high responsibility on the World Bank colleagues.

The responsibility is that a handbook is a manual or guide. A guide serves to navigate, to understand the terrain, to take us to where presumably we want to go. I find this book does a great job in helping us understand the policy terrain in a number of subjects, but I find a certain vacuum as regards the final destination. The main orientation is explicit in some individual chapters, in some this is characterized as inclusive growth, this is good progress

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1 Executive Director, Employment Sector, International Labour Organization. I would like to thank Yan Islam, Marion Jansen, Erik von Uexkull and Graeme Buckley for useful feedback and discussion on specific topics dealt with in the book.
from just growth; in others it is catching up and climbing the ladder; only one or two
chapters talk explicitly about human development and the MDGs.

I think it would have been good to have more clarity on where does the guide wants to take
policy makers? Last Monday I commented on the Human Development Report 2010 – the
objective of that report is clear, human development. I think the day after tomorrow we all
want human development, and perhaps the book would have benefitted from being more
explicit about the ultimate destination. This is not an idle thought, it is rather profound,
because if the target is human development for instance, not just growth or even inclusive
growth, then this has an impact on the policies and then on fundamental aspects of the
handbook!

Having said this, the book chapters are usefully organized in four categories: Markets,
Governments, People and Regions. I will follow this structure in my comments, except on
regions for that would make this comment much too long, and I will focus on key issues in
the book around what is new after the crisis, what has changed or needs to change, and
what not. In distinguishing these issues is where the handbook is potentially most useful.

But before proceeding I must say that I feel uncomfortable speaking, as the book does,
about “after the crisis”. True, technically, most of the world is in recovery, but as we know
this is very fragile, full of downside risks, (think of Greece and now Ireland); balance sheets
of many developed countries are in very bad shape, and so are financial systems. And most
important the situation of labour markets is dire: millions of people are affected by
unemployment, working poverty, informal employment, youth unemployment. We should
not talk about recovery until there is jobs recovery. So even though I will sometimes follow
the book in talking about “after the crisis” policies, let me say that from a labour market
perspective, large parts of the world we are still very much in crisis.

MARKETS

The section on markets has a rich set of 8 chapters ranging from the possibility of a
switchover to developing countries as main engines of global growth; to issues of
technological learning and catching up; to the prospects for continuing international
integration after the crisis; policies to support the private sector, exports and
competitiveness; the role of natural resources in growth; and three interesting chapters on financial policy and financial markets.

The re-coupling or switchover chapter (1), by Otaviano himself, is particularly illuminating, and I would say convincing, in providing reasons why growth prospects in advanced economies are not good, (such as the bad shape of balanced sheets, the jobless nature of the recovery; the likely higher costs of financial intermediation) while at the same time autonomous sources of growth in developing countries promise to be quite dynamic, because of the much better balance sheet and macroeconomic conditions; the prospects for vigorous South-South trade; the growth of middle classes; high commodity prices and the vast opportunities for technological learning and catching up, with corresponding positive impacts on local productivity. So I am persuaded by the evidence that the trend rate of growth has decoupled and that in the foreseeable future the growth engine has moved to Developing Countries, particularly the large emerging ones, fuelled by technological learning and South-South trade and investment.

At a deeper level, as another chapter argues, this switchover is part of the geopolitical tipping point that the world seems to be reaching aided by the crisis, and which underpins the ascendancy of the G20, where no country or country grouping can any longer claim the “high ground” in economic management, and where we are finding that “we all have something to learn from one another” (p 125).

I find myself in agreement with the optimism of the author about the continuing potential of the export-led growth model and the critique of those who think this model is dead. I agree with the argument that most developing country exports are so small that there is plenty of room for them to expand despite broad global rebalancing and less exuberant absorption in OECD countries. We learn from the chapter that 130 developing countries comprise only 15% of developing country exports, equivalent to just 2.5% of OECD imports. That the typical country in this group could increase its exports by 40% if it could capture 0.01% of OECD import market share. And that export-led growth does not necessarily mean current account-surplus-led growth. In the longer term, countries could continue to pursue balanced outward-oriented strategies with strong growth in both exports and imports. Furthermore, if there is real rebalancing in large surplus countries, as seems likely given the
growth of wages and middle classes, South-South trade can sustain another round of export-oriented growth. I think all of this is good diagnosis and wise advice for those 130 developing countries who today represent only 15% of developing country trade. In fact, for many low-income countries rebalancing means more exports, not less. So we must be careful not to use the term with a one-size-fits all connotation.

The chapter on trade by Haddad and Hoekman (Ch 3) further reinforces the message that the crisis has not in any way weakened the case for international integration and export diversification to be a core element of development strategies. What it has shown is that globalization has indeed increased volatility, and this calls for social policies, countercyclical policies and more efforts at export diversification. Therefore, post-crisis one would expect that these three issues will be at the top of the policy agenda: social protection policies, countercyclical macroeconomic policies and export diversification. The crisis has also shown that China and the seven other developing countries that comprise 85% of all developing country exports, do have to rebalance their growth paths and put more emphasis on the domestic market as a driver of growth. Again, good diagnosis and wise advice.

The book also highlights the importance of an increased focus on exports as an insurance against volatility. This is certainly an important point. However, I think we also have to be realistic here: While diversification certainly matters, the global crisis has proven that no degree of diversification is sufficient to isolate a country from global shocks. In fact, very diversified exporters such as Germany and Japan were among the countries that experienced very sharp drops in their exports. We will have to accept the fact that trade openness – diversified or not – leads to higher exposure to external shocks and thus increases volatility. Protection is certainly not the answer, but open markets have to be accompanied by strong and inclusive institutions for social protection and labour market policies that protect workers against volatility. As the crisis has shown, such policies have the added advantage that they act as automatic buffers and stabilize demand during a downturn.

I congratulate the editors for the emphasis in several chapters on technological learning (Ch 2), on innovation, on the role of the private sector (Ch 4) and on what I consider a refreshingly favourable view, coming from the World Bank, for a proactive role for the state
in promoting productive transformation and the private sector, the recognition that markets will not lead to a socially desirable level of technological learning and innovation, and the need for public policy to help developing countries climb the tall ladder they face in terms of technological upgrading and industrial development. Developing countries should certainly take note of this book’s argument for having an innovation policy agenda. I also very much welcome the stress of these chapters on the power of innovation policies to increase growth and jobs.

On support for the private sector, and the role of the state, the main factor in the new post-crisis era is what the book calls “the coming era of government activism”. Indeed the pendulum is swinging because of the shaken faith in markets, the need to cushion the impacts of volatility via social protection and productive diversification, and the need to promote competitiveness and private sector development. So industrial and competitiveness policies are back in the agenda. The debate is about what kinds of interventions are appropriate in different contexts and for different levels of development?

The chapter by Reis and Farole (Ch 4) calls for a “new competitiveness agenda” instead of “old industrial policy”. Personally, I don’t see the two as mutually exclusive, and I think a lot depends of context and level of development. I think that the “new competitiveness agenda” is fully appropriate for middle income countries, but I would not discard some moderate import-substitution, regional integration and two-track trade integration as useful in low income countries. Certainly, industrial policy has to learn from mistakes made in the past and this will include a much stronger focus on learning and incentives to innovate and compete. However, it is also clear that for policies to induce discovery and accelerate upgrading of value chains to take off from very low levels of development you need some critical mass from which to build on. A minimal industrial, managerial and skills base in the domestic private sector is necessary. De-industrializing by quickly and excessive trade liberalization can turn the clock backwards many years, as has happened in some African countries. So I would not easily discard using WTO-compatible moderate tariffs and fiscal incentives in the early stages of development.
GOVERNMENTS: MACROECONOMICS, FINANCIAL AND FISCAL POLICY

There is a lot of value in the chapters on governments that focus on trust in governments and the key issues of performance and accountability of public institutions; fiscal quality; trends and challenges in fiscal expenditure in the next five years; debt management, including the challenge of sub-national debt finance; and a very interesting chapter on sovereign debt funds.

One of the chapters (Ch 6) on macroeconomics and financial policy tells the story of the major rethinking of conventional wisdom going on, even in the IMF itself: now higher inflation targets are acceptable; and the field is open to discuss appropriate levels of inflation targets so that growth and jobs are not sacrificed; now capital controls are recognized as a useful instrument in the policy toolkit; monetary policy may concern itself with asset bubbles; countercyclical policies are now recommended, subject of course to fiscal and financial constraints; multilateral surveillance is beginning to complement bilateral surveillance as in the G20 Mutual Assessment Process; there is now a preference for floating exchange rate regimes, etc. So there is an intellectual and policy openness that was not there before the crisis. The chapter argues that it is to be hoped that this attitude does not change in the future towards dogma and complacency.

But I also miss something in these financial and macroeconomic chapters. The chapters review the rethinking going on, mostly in the IMF itself, but I do not get a sense about where the World Bank stands on some of these key issues: does the Bank support the flexibilization of the basic financing programming framework that recommends below 5% inflation targets in developing countries, similarly low fiscal deficits and debt to GDP ratios of under 60%? Do the authors of the financial and macroeconomic chapters favour the expansion of inflation targeting to multiple targets that more explicity take into account growth and employment targets? One is left wondering in respect of these important questions.

There is much wisdom in the chapters on fiscal quality and debt management, for instance. But the basic macroeconomic narrative that I find in the book is that developing countries have weathered the Great Recession far better than the developed world because they learnt the painful lessons inflicted on them during past crises. Hence, they relied heavily on
sound macroeconomic policies, most notably on aiming for price stability and fiscal probity. These policies provided them with the cushion to cope with the external demand shock unleashed by the Great Recession. So, the key lesson seems to be: let us do more of the same with some adjustments at the margin. These are: (1) continued emphasis on inflation targeting (2) enhanced macro-prudential regulations to reduce boom-bust financial cycles and anchor financial sector stability and (3) an agenda of ‘fiscal quality’ and better debt management.

One should, of course, uphold the principles of price stability, enhanced macro-prudential regulation, fiscal quality and smart debt management. The importance of these messages are worthy of reiteration. The chapter authors should be commended for that. What is missing in the book and I think badly needed in the post-crisis world when the need to improve the situation of people in labour markets and accelerate the achievement of the MDGs is paramount, is a more nuanced appraisal of the efficacy of inflation targeting and of fiscal policy challenges, and an urgent need to connect these macroeconomic policies to core development goals as enshrined in the MDGs, including poverty reduction, employment promotion and the UN social protection floor initiative.

In April, 2006 PREM released an interim report on ‘fiscal policy for growth and development’ that had cast the link between macroeconomic policy and development in a way that was quite refreshing and even radical. This report observed that: ‘In a development context, fiscal policy serves both as an instrument of macroeconomic stabilization and as an instrument to achieve growth and poverty reduction objectives’. It noted that during the 1980s and 1990s, fiscal policy focused ‘...largely on the goal of stabilization. Correspondingly, growth and poverty reduction objectives were under-emphasized’. The report then proceeds to note that it is necessary to address ‘...the specific question of how governments may create fiscal space for growth’.² I do not find these messages coming across sufficiently strong from the book in the macro-sections. There are three good chapters on people that talk about poverty reduction, employment promotion, equity, gender equality and remittances, but the macroeconomic chapters are not well connected.

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with these people centred chapters. And given the enormous gaps in investments in people that the book itself recognizes, the reader is left wandering how a world of fiscal stringency and consolidation after the crisis will deal with the social challenges.

Improving fiscal quality, protecting core social expenditures, improving the functioning of the public investment system, improving debt management and tapping on the potential of Sovereign Wealth Funds are all good objectives to pursue, but I think post-crisis the fiscal challenge is even larger and more daunting than that. What is critical is to focus on how the fiscal framework can support the mobilization of resources on a sustainable basis for attaining the MDGs and a basic floor of social protection. This is where the message from PREM’s 2006 Interim Report becomes so relevant. How can governments create fiscal space for growth? How can they strengthen and diversify the tax base? These and related questions will be urgent in the next 5 or so years.

PEOPLE

Let me now be brief on the comments on the PEOPLE Part of the book. While the book has 8 chapters on markets, and 6 each on governments and regions, it only has 3 on people. I think the compass could have been better equilibrated by more attention on the people dimension. Still, these are three excellent chapters.

The Chapter by Revenga and Saavedra (Ch 15) reviews poverty trends before the crisis, the impact of the crisis on those trends and employment and social policy priorities in the next 5 years. Inclusive growth is set as the main objective. And three aspects are defined as critical for inclusive growth:

- First, equality of opportunity in access to basic goods and services. In fact, the authors talk of the need to define universal access to basic goods and services (education, health, water, sanitation and infrastructure) as a major development goal, and the need to carefully measure this, as in the Human Opportunity Index.
• Secondly, a pattern of growth that translates into good employment opportunities; in this respect the authors refer to the need to revisit the employment agenda in developing countries with a focus on increasing the employment content of growth; and on productivity increases to combat the prevalence of low-earning, low-productivity jobs in the informal economy;

• Third, effective social protection against shocks.

The emphasis on inequality and the policies to reduce it is also commendable. As the chapter shows, Brazil’s experience demonstrates how even in a highly unequal economy the combination of growth plus redistributive policies can help to ensure that growth does lead to a reduction of both poverty and inequality. And the chapter also refers to the crucial role of the state in advancing the equity and inclusion agendas, including the need for domestic resource mobilization via higher tax-to-GDP ratios and other ways of increasing fiscal space. The need to build a social contract perceived by most as fair and worth committing to financially and politically is also mentioned.

The thinking in this chapter is very close to ILO policy messages on these subjects except that instead of talking about safety nets the ILO proposes and is working on the objective of building a basic social protection floor in developing countries.

The chapter on gender equality is quite solid as is its main message on the need to scale up investments in girls and women in response to the crisis and to harness demographic opportunities for growth. The chapter on remittances is also state of the art on the subject and conveys a rich empirical base.

As I said, people-focused issues would have deserved a little more space in the book and what I miss most in the book is a stronger connection of the macro-chapters with all these subjects of employment, social protection and redistribution policies.

Let me close here, although the book certainly inspires enough thought to continue for a long time. Once again, I would like to thank Otaviano and his team for this important contribution, and for inviting me to share with you my thoughts on the book today.