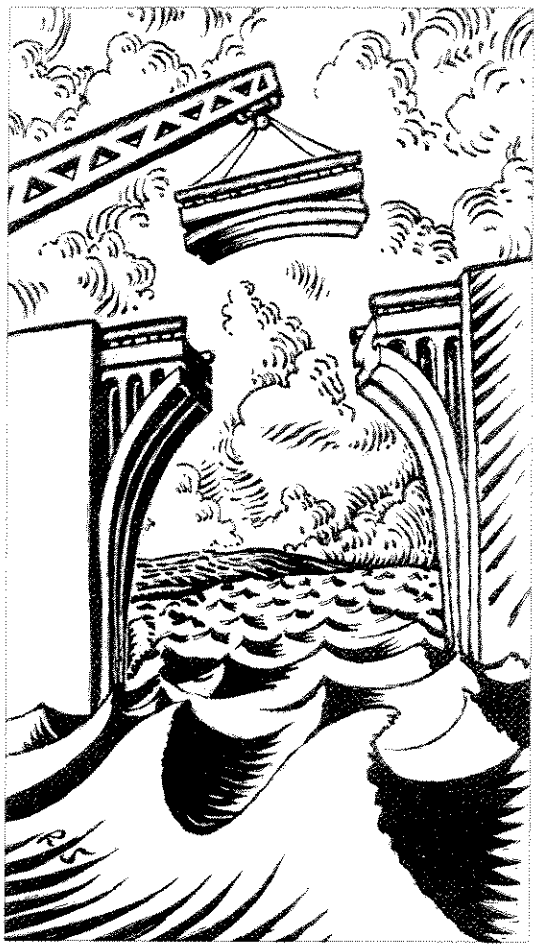
A REVIEW OF IDEAS AND EXPERIENCES

EDI FORUM

ECONOMIC DEVELOPMENT INSTITUTE · WORLD BANK · VOLUME ONE



INSIDE

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CORRUPTION: NO LONGER THE MISSING PIECE IN DEVELOPMENT DISCUSSIONS

How can development organizations help governments fight corruption? Long avoided as a taboo, corruption is increasingly the focus of attention. EDI's public sector reform group is working not only within the state sector but also with civil society to change expectations and build a consensus against bribery, extortion, and cronyism.

Corruption is an impressive spoiler. It can turn a good policy into a messy failure. It can infect civil society, splitting it into rent-seeking elites and helpless spectators. It can increase costs, ruin efficiencies, and frustrate change.

It can also be fought. Among international organizations and national governments, there's a new willingness to deal pragmatically with chronic malfeasance in government. According to the Global Coalition for Africa: "Good governance, which emerged five years ago as an incipient, vaguely defined issue of donor conditionality, is now a major subject of debate and definition within Africa, and is recognized as the reform that underpins all other reforms." As more international organizations and more courageous political leaders work to combat corruption, it will become harder for societies to condone it.

Although many African leaders have found there is much to gain from trying to root out extortions and bribery, corruption is not unique to any country or region. Indeed, at a recent EDI workshop in Jordan, speakers offered experiences combating corruption in Britain, Hong Kong, Bolivia, Uganda, Singapore and the U.S.

The anti-corruption movement is tightly linked to the proliferation of democratic societies and free presses. By raising expectations that elected officials not exploit public position for private advantage, the media can create a standard to which current and prospective political leaders can be held.

However, the transition to openness and accountability is fraught with difficulties. Countries emerging from closed, secretive autocracies often find themselves deluged with published reports of corruption and official wrongdoing. It can seem, in such circumstances, that corruption has become a new pandemic, a sign that change has unleashed mostly unhealthy forces. In recently democratic Malawi, for example, amid increasingly shrill charges and countercharges of bribery and malfeasance, an exasperated parliamentarian declared, "We are all corrupt."

Oscar Arias Sanchez, Nobel Laureate from Costa Rica, recently warned that people can become "so disenchanted with the corruption in democratic regimes that they have even welcomed a new dictatorship."

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JAMAICA: REPOSITIONING A SMALL, OPEN ECONOMY

By Richard L. Bernal

In a number of EDI seminars, policymakers are encouraged to pursue a vision for their country's growth. The process involves looking beyond stabilizing the economy. Once the budgets have been brought under control and the distortions removed, strategists need to identify sources of prosperity, based on inherent strengths. Richard Bernal, Jamaica's ambassador to the U.S., and permanent representative to the Organization of American States, explores sources of growth for his country in a global economy increasingly dominated by service industries.

Like many other small, open economies, Jamaica relies on a limited number of products for its foreign exchange earnings. Tourism and bauxite/alumina bring in almost 75 percent of the country's exchange, a limited export portfolio that potentially subjects Jamaica's economy to external events such as price and demand fluctuations.

The conventional solution would be to develop a manufacturing sector for export markets. And the island's governments for the last 40 years have seen development as a progression from import substitution to the export of manufactured goods. Despite protection and government incentives, an industrialized economy has not been achieved. Moreover, this may no longer be a viable strategy given world trends. It is self-defeating to attempt to protect industries whose products can be assembled more cheaply elsewhere.

Instead, Jamaica should pursue a balanced development program that focuses greater attention on the export of services, while improving competitiveness in traditional sectors.

RICHARD L. BERNAL

Jamaica should pursue a balanced development program that focuses greater attention on the export of services, while improving competitiveness in traditional sectors.

Services are the fastest growing part of world trade. In the United States, services are expected to provide half of all the jobs created over the next decade. Similar jobs created in Jamaica would be relatively high-wage and environmentally safe. The country also should examine the most dynamic sectors in the global economy: microelectronics, biotechnology, telecommunications, robotics, and information.

The move toward higher wage activity will depend on the quality of human resources education and management skill. Raising productivity of people will require changes throughout society. The government must make the education budget its first priority. The private sector will need to devote more attention to vocational training. Trade unions should expand their advocacy beyond wages and working conditions to job creation and training. With reports of growing numbers of Jamaicans returning from abroad (2,587 in 1994, up from 1,152 two years before), the government should create incentives for overseas nationals to return home to help build the 21st-century economy. Firms should seek strategic alliances to expand their markets. The reorientation of policy requires the government, business and trade unions to work together to design and implement the new development strategy. This is one of the lessons of the East Asian economic boom.

In expanding its capacity to supply services, Jamaica has a number of opportunities. They include the following:

Tourism. The industry accounts for 72,000 jobs—8 percent of the work force. That will grow, but it can be further encouraged by more aggressive marketing and by developing niche services like health tourism.

Health Care. Because of its lower health-care costs and proximity to the U. S., Jamaica can be sold as a destination for physiotherapy, cosmetic surgery, and spa treatments. Individuals can fly to Jamaica, have treatment, take a holiday, and still save. Cuba and Mexico have succeeded with similar plans. Catering to foreign clients would also help to upgrade the health care system and raise wages of health care workers.

Retirement. Similarly, because of its warm climate and lower cost of living, Jamaica can take advantage of Americans' growing trend to retire abroad. *Fortune* magazine has noted that the cost of living in Montego Bay is little more than a fourth of that in Sarasota, Florida.

Back Offices. Swissair has moved its accounting department to Bombay. Cigna has moved 20 percent of its insurance claims processing to Ireland. Jamaica has an advantageous factor mix to attract similar operations. About 45 Jamaican companies provide electronic data processing for overseas markets, employing 6,000 people, up from 4,000 in only two years. Additional tax-free zones for foreign companies and the government's commitment to computer training can attract more business.

Shipping/Air Travel. Through its modern international air and seaports, Jamaica ranks high as a transit point for passengers and cargo. Kingston, home of the world's seventh largest natural harbor, has a first-rate container port. The island's location makes it a natural hub for airlines traversing the Caribbean.

Entertainment Industry. Despite the international success of Reggae music, the industry has little formal organization. The government should help create an international satellite channel to promote the music and the industry. Film-making also has potential on the island, given past successes, provided the right incentives are created.

These and other industries can build on Jamaica's strengths—its open economy, English-speaking population, favorable labor costs, and location in the center of the Caribbean and near the United States to transform its economy. Jamaica should consolidate its exports and focus on being competitive in an expanded range of services, taking advantage of the revolution in technology, communications, and transportation. □

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an income-generating group or a microbusiness, how to choose an activity, how to market a product. She needs credit, and she needs to understand how to manage her money better.

Third, she needs to know how to read and write. Maybe this could be connected to management training, as we have tried to do with PEFGA. The themes have changed. Women are economic agents now, and they must learn more about doing business.

She also needs markets. Without access to markets she is lost. Her products go nowhere. Or she has to pay a huge fee to a middle-man who has an oxcart. In these rural villages without any means of transportation, she cannot go far. Where roads have been put in place, though, things change dramatically for the women.

She needs health services and clinics in her village. Very often there are no medicines, even aspirin. And if the women were taught to manage these clinics and were given training and responsibility, they could earn income while at the same time improve the lives of the village people.

She needs schools for her boys and her girls. I was in Mopti last week visiting one of our *Programme National de Vulgarisation Agricole* centers and I saw a small girl, a beautiful girl, separated from the others, and I went to talk to her. I asked if she was in school. She said no, she was needed at home, and anyway the school is too far—five kilometers, too far to walk. Such a beautiful girl, with no future. A small village school and a teacher would make all the difference.

When we were with you in Mbour, Senegal, we met many women who had created a network so they could buy products at low cost and sell them for a profit. Malian groups need this kind of network, both inside Mali and also with other nearby countries.

This is the kind of program women's groups could make great use of. They may seem like small things, but they are big things in the village. If we multiply them by thousands of villages and thousands of women, they make a huge difference.

There is an African proverb that describes why we do what we do as women. A woman can never sit down and do nothing. Sitting down leads nowhere. So, Mr. Wolfensohn, we never give up and we will never stop.

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The tesobonos did it. A number of observers have argued that the conversion of peso-denominated *cetes* into dollar-indexed *tesobonos* was a major contributor to the financial disorder that followed the devaluation in December 1994. Of course, after the devaluation, the cost of debt service would have been lower had its debts not been dollar-indexed. But that would have required higher interest payments in the months leading up to the devaluation. In hindsight we know that the issuance of dollar debt was a bad investment for Mexico, but that was less obvious in mid-1994. The dollar denomination of the *tesobonos* was far less significant than their short maturity, and was significant primarily as an indication of investors' diminished willingness to accept Mexican currency risk. The crucial policy mistake was not the issuance of dollar-indexed paper but the failure to respond to the apparent shock to the availability of foreign financing.

Let us consider three valid messages:

Shocks to the capital account demand a policy response. It is widely acknowledged that the policy response to the reduction in capital inflows that followed the February 1994 tightening of monetary policy in the United States was both too little and too late. But the politics of such an adjustment are difficult. Until a crisis emerges, a reduction in capital flows is an "invisible" shock, hard for citizens to detect. Interest rates rise, exchange rates come under pressure, asset prices decline, but it is hard for the government to point to a clear cause and therefore hard to justify painful macroeconomic measures. There is, moreover, typically room for debate whether the shock is permanent, requiring major adjustments. Officials are naturally tempted to hold policies constant and hope that the shock will be transitory.

I turn now to some lessons from Mexico about appropriate management of shocks to the capital account.

Fiscal equilibrium is elusive, balanced budgets may not be enough. An insidious fiscal "optical illusion" contributes to the difficulty of calibrating a response to capital account shocks such as the one that hit Mexico. When capital flows in, the fiscal accounts typically appear healthy. But this is often partly illusory, and fiscal accounts often deteriorate automatically when the capital flows vanish, because capital inflows are typically associated with spending and production booms that temporarily boost fiscal revenues. But when the inflows cease and the spending boom ends, an underlying fiscal deficit emerges, just when the country has lost its ability to finance it. This creates the need for sharp and pro-cyclical fiscal adjustments, as Mexico and Argentina have required in the past year. To avoid costly adjustments, authorities should set fiscal targets to account for cyclical phenomena and aim for a large enough surplus during good times so that fiscal accounts will remain viable when things get bad, without the need for a sharp, pro-cyclical fiscal response. Such a policy will also limit the current account deficits and appreciation of the real exchange rate that accompanies inflows, reducing the risk of a subsequent, disruptive outflow.

Bank lending booms often end up in tears. It is well understood that the current-account deficits that led up to the Mexican crisis resulted from a shortfall of private, not government, savings. One casualty of the crisis has been the idea that current-account deficits are not dangerous unless they reflect fiscal imbalances. While this idea has been discredited, there is no consensus on what can cause private decisions to go awry as they seem to have done in Mexico. There is little understanding of when private borrowing is entering a danger zone and how policy can respond.

Consider the commercial bank lending boom that accompanied Mexico's inflation stabilization and capital inflows of the late 1980s and early 1990s. Between 1989 and 1994, bank credit to the private sector exploded from about 10 percent to nearly 40 percent of GDP. Why? Lower inflation raised the demand for domestic bank deposits, and capital inflows were partly intermediated through the banking system, thus providing banks with funds to lend. At the same time the government was sharply reducing its reliance upon domestic bank debt. These were beneficial developments, but the magnitude of the lending boom begged for trouble, and was almost certainly a key factor behind the private sector overspending that led up to the crisis.

Because bad debts from the lending boom had begun to make domestic banks vulnerable, authorities delayed responding to the decline in capital inflows; they feared that the required increase in domestic interest rates would undermine the banking system. This suggests that policymakers need to keep a vigilant eye on the banking system. In particular, they should lean against the wind of lending booms to ensure that bank lending does not grow too rapidly and should ensure that banks can weather the inevitable shocks. The Mexican policy of zero reserve requirements against commercial bank deposits probably amplified the lending boom and made banks more vulnerable to adverse macroeconomic shocks, thus exacerbating the crisis. □

SUMMERS ON MEXICO *continued from page 9*

Chile, whose fundamentals have been supported by capital controls, there are a fair number of "horror stories" that have occurred in countries whose bad policies have not been adjusted as quickly as they otherwise would have been because of capital controls.

Response of the international community. The right response to these kinds of problems has three elements. First is prevention, and an important part of prevention is surveillance. The World Bank, and particularly the International Monetary Fund, should look into the right mechanisms for surveillance. Twenty years ago, we would have sent teams of people annually to monitor activities, but in this age of information, that is no longer the right approach. Also, it would help if Central Bank balance sheets, the fiscal accounts, and information on the debt were published more frequently. This would enable us to have accurate information as well as discourage the practice of delaying the release of numbers when they are bad.

Second, we—the international community—have to act sooner. The Mexican experience has taught us that while we have managed this crisis successfully, it no doubt could have been managed at a lower cost, if the kinds of support that became available in February, had become available in January. Mexico's problem was one of illiquidity, which could have evolved into one of insolvency had it not been addressed decisively. What happened in Mexico could have happened to a country that was farther away from us, at a time when we had a less courageous president, or when the political situation made the managing director of the IMF less prepared to help. What would the consequences have been then?

Third, we need some institutionalized capacity to deal with crises of this kind. In our judgment, those who buy high-risk securities of countries whose policies go awry should have to bear the cost of their mistakes. If that had been accomplished systematically in Mexico, it might have been possible for the authorities to address the crisis in an orderly way without the need for the U.S. to provide extraordinary support. But there is now an absence of any mechanism for working these crises out. Hundreds of years ago, domestic bankruptcy law was invented in part to deal with situations of this kind. It's time now to think about international mechanisms that can address the problem of illiquidity.

IN BRIEF

Bankruptcy proceedings for sovereign governments is an idea that isn't gathering much steam. Some officials proposed this approach after Mexico's peso crisis. But a study by the London-based Centre for Economic Policy Research found it would have "insurmountable problems." William Cline of the Institute for International Economics warned that any established architecture for sovereign bankruptcy would jeopardize private flows to developing countries, which, even after Mexico, amount to $150 billion to $200 billion a year. "The more you go in the direction of a pre-announced machinery for forgiveness, the more you're choking off this private capital," Mr. Cline said at a recent Washington forum.

The CEPR study, "Crisis? What Crisis? Orderly Workouts for Sovereign Debtors," advocates modest steps, including the creation of bondholders' councils that would negotiate with financially beleaguered governments when they have problems meeting their obligations.

Urban sanitation is plummeting in Africa, the most rapidly urbanizing region in the world. The portion of urban residents with access to sanitation will have dropped to 43 percent by 2000, from 65 percent in 1990, predicts Len Abrams, a water specialist with LJA Development Services in South Africa, who addressed a recent EDI seminar in Capetown. Drought, degradation of arable land, and civil unrest have propelled more rural people to migrate to cities, which haven't been able to provide even basic services for the influx of people.

Early reformers are guiding late reformers through the Central and Eastern European Privatization Network, based in Portoroz, Slovenia. Launched 5 years ago with funding and other support from EDI, the group has provided practical help to about 2,700 officials involved in privatization programs throughout the region. CEEPN, which has a staff of 7, relies on experienced policymakers from early reformers such as the Czech Republic to provide tips and training to their less experienced counterparts. "Many institutions are supply driven, this one is really bottom-up," says

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