DevTech Sphere

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The Invisible Hand of Underdevelopment (Part 2)

As announced in the last issue of *Sphere*, we will now discuss development strategies to confront the obstacles to development, those that are generally neglected in traditional and nonconfrontational approaches. The approach presented here is not to be considered as a radical and complete alternative to traditional approaches of economic analysis, but as a complement.

Our proposed strategy is based on the following activities:

1. A thorough, in-depth analysis of the country's economy, including the sources of price distortions and general barriers to free markets.
2. An economic analysis of the previous exercise, including an estimation of losses to the economy, consumers, and workers under the current regime and a projection of gains under a reformed economy.
3. A sustained and consistent public education and information

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Who Will Monitor the Economies of the World?

The weaknesses of the international financial system were nearly fully exposed back in 1982 when Mexico defaulted on its foreign obligations and much of the rest of the developing world followed suit. (Actually, Costa Rica experienced difficulties repaying its international debt in 1979, but no one seems to have taken much notice.) Despite a decade of debt relief, increased policy reform, and monitoring by international agencies, especially the International Monetary Fund, we continued to experience great turbulence in the world's economies. Mexico nearly crashed again in 1994, the "Asian flu" almost got us all in 1997-98, and Brazil, then Ecuador, started down the slippery slope of currency crises and inability to service foreign debt.

> *Clearly we cannot rely on the IMF, the World Bank, and the U.S. Treasury to adequately monitor and report on the world's economies*

What is going on here? Isn't somebody watching what is happening in these countries? According to Article IV of the IMF's constitution, to which most countries of the world are signatories, countries are subject to supervision or vigilance by the IMF. The IMF issues what are called its "Article IV Consultations" documents for member countries almost annually. Until recently these documents had been considered confidential, although this was honored more in the breach than in practice. Recent reforms at the IMF are leading to greater "transparency" and the open publication of the Article IV documents for those "participating" countries — presumably these are countries in relatively good economic health, no?

In talks with colleagues at the IMF we hear that the problems in Indonesia and Thailand were not really surprises to them — however, the rest of the world seems to have been surprised. In an interview with a Washington newspaper, a World Bank official intimated that he and the World Bank top management knew that Indonesia was in trouble. U.S. Treasury officials have stated, without letting their names be published, that the Mexico crisis was no shock to them and that Secretary Rubin knew the country was in extreme unbalance.

While all these clever people supposedly had such important inside information, they did not make this information publicly available. Commercial banks, suppliers, and

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Who Will Monitor?

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others continued to lend to governments or businesses in these countries, and foreign investors kept placing money either in poorly governed capital markets or directly into enterprises. Hence, as these countries were experiencing chronic imbalances, international lenders and investors continued to lend and invest, getting both themselves and their host countries into deeper trouble. These deepening troubles eventually led to these countries, governments, lenders, and investors having to be bailed out by the international financial institutions or by rich country governments' taxpayers.

The IMF, the World Bank, and the U.S. Treasury cannot be counted on to properly exercise vigilance over the world's economies. They suffer from institutional conflict of interest. Too much candor on the part of a World Bank official, for example, may make it difficult for him to get his latest loan signed up, or even cause the client government to find it difficult to continue to service its debt to the World Bank. Public tsk-tsking by Treasury officials could have precipitated the Mexico crisis one year earlier.

Clearly we cannot rely on these institutions to adequately monitor and objectively report on the world's economies, especially those economies most in need of monitoring. The sense of comfort provided in the past by such international vigilance has led us down the garden path of lending and debt-forgiveness.

Can the private sector be relied upon to make up for the shortcomings of the quasi-public IMF and other international financial institutions?

The Institute for International Finance (IIF), a private-sector agency created in 1983 in response to the 1982 debt crisis, provides country monitoring services at the behest of its 300+ members, most of which are European financial institutions. While the IIF should not face the same internal conflicts as the IMF, World Bank, and U.S. Treasury, its focus is rather narrow, its client base is quite specific, and it too had not made public concerns over the quality of the Asian economies and the real systematic risks and uncertainties faced by foreign investors and lenders to those countries.

Stratfor, Inc., established in 1995, is another private-sector organization that monitors economic performance and policies around the world. Stratfor serves clients in a wide array of industries, including petrochemicals, media, telecommunications, investment banking, defense law, textiles, and forestry industries, as well as regional governments and other organizations. At the moment, it is difficult to assess the biases that may be found in Stratfor's reporting and forecasting; however, it is important to note that while it is not at all a government agency, some of its clients are, in fact, governments — some of them in the countries Stratfor reports on. In addition, Stratfor's reporting is more journalistic in nature. It does not provide the hard data and rigorous analyses that the international public needs to properly conduct its affairs.

There are other organizations, too, that provide intelligence on the performance and prospects of economies around the world. Perhaps the best known of these is the Economist Intelligence Unit (EIU), which produces regular reports on countries or groups of countries. Of course, the EIU's reporting is often not too timely given that it produces reports on quarterly or annual schedules.

The list of other private organizations could go on, but the point is that while the private sector has access to these alternative sources of information, the IMF and the World Bank continue to be the organizations that give the seal of approval (a sort of international, economic "Good Housekeeping" seal) to the world's economies, especially the emerging markets.

We recommend that these two organizations (IMF and World Bank) no longer provide such seals of approval since their biases are unlikely to be overcome in the future, or there is little reason to expect they will. Also, given that the private sector has been developing its own capacity to monitor and report on emerging mar-

Related Internet Sites

These sites relate to current monitoring of country conditions.

Institute for International Finance (IIF)

http://www.iif.org — *a private-sector agency that provides country monitoring services for its 300+ members, mostly European financial institutions*

Stratfor, Inc.

http://www.stratfor.org — *a private-sector organization that monitors economic performance and policies around the world*

Bank for International Settlements

http://www.bis.org — *the oldest international financial institution, based in Basel, Switzerland; issues reports on financial and banking sector standards* ket countries, there seems to be little use for this type of quasi-public institution to provide such assurances to the world. On the other hand, private organizations do not seem to have done a very good job of reporting on the quality of data coming from these countries, nor do these institutions seem to have the carrot and stick to encourage better quality and more timely data.

Therefore, we recommend that yet another, though small, quasi-public international institution be set up to take over these responsibilities. This new institution could be responsible for monitoring how well countries comply with a variety of international standards, some of which include transparency in public-sector accounts and in financial systems; regulation and compliance with corporate governance norms; adherence to international standards of intellectual property rights protection; and compliance with international standards of bank capital requirements. Obviously, the new institution would not have to create all of these standards and codes, but it could be an ideal agency for monitoring and reporting on countries' compliance with them.

The creation of a new international monitoring institution would not mean that the other international agencies need not continue to monitor these economies. What it would mean is that the rest of the world would have another agency, presumably one without internal conflicts of interest, upon which it could rely for objective evaluation and quality statistics. Creating a new monitoring institution would be helpful in avoiding the need to write off or finance future debt relief.

— Mark Gallagher
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[I thank Joe Ryan for comments on a draft of this paper. Any opinions expressed herein are solely my own.]

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campaign to explain how the distortions and barriers to development constrain growth and create inequities.

4. The formulation of a politically feasible short- and mid-term reform program and a long-term ambitious reform program that include the elimination of all price distortions and the dismantling of all barriers to development.
5. The development of civil society institutions that would monitor the programs and demand accountability from those in charge in the executive, legislative, and judicial branches of government.
6. The formulation and implementation of an educational reform that would include economic and business education as a significant part of the curriculum.

Activity 1 includes the mapping of the political economic geography of the country, with detailed descriptions of all coalitions and institutions representing or posing barriers to development, and explicit and positive identification of the corresponding individuals, enterprises, sectors, trade unions, syndicates, etc. This exercise includes the sources of price distortions and other barriers to growth such as: protectionist privileges in trade; transportation, intermediation, and other monopolies; inefficient state enterprises; obsolete labor codes; antiquated protection of property and contractual rights; inflated, incompetent, and corrupt bureaucracy; inadequate fiscal system; and excessive government subsidies.

As Activity 1 proceeds, Activity 2 can begin, consisting of preliminary estimates of losses to be carried out for the different areas of distortions, concentrating on losses to consumers and workers and, perhaps, to certain regions. Once Activity 1 is completed, an overall estimate of total losses and potential benefits from reform would be produced, taking into account inter-industry relationships. This exercise is not to be one of methodological virtuosity that would take forever to materialize, but an expedited one with an acceptable margin of error.

Activity 3 incorporates several phases, the earliest one starting with Activity 1 and consisting of a systematic public education campaign of wide coverage and consistency, explaining to the general public the advantages of a market economy and free enterprise, including international experience. As Activities 1 and 2 are completed, their results are explained to the public. The objective of this activity is to make the general public aware of the existing problems and prepare the ground for the eventual presentation of and public debate about the first stage of a reform process, represented by Activity 4, the formulation of short-, mid-, and long-term plans.

Under Activity 4, the public education campaign would enter a new phase — explaining the proposed reforms to the general public and to specific groups or constituencies. One objective of this activity is also to develop a national consensus that includes a high level of cooperation between the executive power and the legislative branch of government, since profound changes in the body of laws, even in the constitution of the country, might be necessary to reform the economy.

Activity 5, involving civil society, is implemented from the beginning of the effort. The objective is to give the ownership of the reform process to the civil society and not to a given government, since no short-term administration could complete a serious reform program during its tenure.

Activity 6 is only a part of what can be one profound reform process by itself, the reform of education. Traditionally, curricula in less developed countries (and even in more developed countries) lack enough material on the economy, business, and public policy issues. The objective of this activity is to significantly raise the level of economic and business literacy and understanding among the population at large, to facilitate the development of an efficient and competitive economy. Without raising the level of understanding of the workings of a market economy, it would be very difficult to achieve development in a democratic context. At the same time, public participation in the formulation and implementation of reform programs through civil society would help strengthen the democratic institutions of any country.

— Jorge A. Sanguinetty
DevTech Systems
President & CEO

DevTech is always interested in new ideas and new people. If you would like to comment on this publication, or if you would like more information about the firm, career opportunities, consulting positions, or our summer internship program, please contact our Washington office.

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