INTRODUCTION

The Global Financial Crisis

The Beginning of the End of the "Development" Agenda?

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BETWEEN THE COLLAPSE of Lehman Brothers in September 2008 and the September 2009 meeting of the G-20 heads of government in Pittsburgh, the global economic system could have been said to have gone through emotional and psychological states similar to those that follow a personal trauma: panic, denial, anger, and, at some point, adjustment to a new reality.

Three characteristics of the 2008–9 trauma make it memorable: it was truly global, bringing a decline in pre-crisis growth rates to virtually every country in the world; it began in and was blamed mostly on the United States, which for most of the previous 60 years was the acknowledged world economic champion on the grounds of its size, flexibility, and innovative and entrepreneurial strength. The United States and the mature democracies of Western Europe took the biggest hit—both in relative and absolute terms—than in most of the world's middle-income emerging market and low-income economies.

Nor is it only the trauma itself that was special, but the rapid and largely coordinated international response was also largely unprecedented: the emergence of the G-20, a new global club at the head of government level eclipsing the G-7 and including the rising emerging market economies of the developing world; a globally coordinated stimulus package with the G-20 at the steering wheel; and a new impetus for making the International

Monetary Fund (IMF), the World Bank, and the newly formed Financial Stability Board more representative and legitimate in a global economy suddenly and stunningly more interconnected and vulnerable.

The nature of the crisis itself and the response to it already seemed remarkable in the early spring of 2009, when my co-editor Francis Fukuyama and I asked the contributors of this book to reflect on its implications for ideas about and models of the growth and development process. Would the prevailing model of successful development based on free and open markets espoused under the general rubric of what is known as the Washington consensus survive in Asia, Africa, and Latin America? What effect would the crisis have on the economic policies the international financial institutions—where for decades the American or Anglo-Saxon model of capitalism had dominated—would support in emerging markets and other developing countries?

In this introductory essay, reflecting on the contributions of the authors to this volume, I discuss two themes. The first is the pre-crisis subtle shift in the prevailing model of capitalism in developing countries—away from orthodoxy or so-called market fundamentalism—that the crisis is likely to reinforce. On the one hand, globalization—that is the global integration of nation-based domestic economies through trade, investment, and capital flows and the movement of people and ideas—will proceed apace. Despite the risks the crisis illustrated of an integrated and interdependent global market, globalization is here to stay. That is so completely taken for granted by the authors in this book that the point itself is rarely mentioned and certainly not contested; instead the contributors focus largely on changes in domestic policies in response to the risks the global market poses. Similarly, market-driven capitalism will remain the economic model of choice at the domestic level in many countries. Though the American or Anglo-Saxon version of capitalism has fallen from the pedestal it occupied for much of the latter half of the twentieth century, the contributions in this volume reflect the expectation that the market model will continue to dominate domestic policymaking in the developing world.

On the other hand, there will be a shift—in mind-set and in practical form—from what might be called the "mostly free" market (hereafter free market) to a "more managed" market (hereafter managed market) version of capitalism. The free market model is based on the notion that though market failures exist, government interventions to address them may well make the situation worse. Regulation of financial or labor markets is likely to introduce distortions more costly than the problems market failures pose in the first place (Friedman 1968) and may even put at risk liberty and freedom of individuals in the political sphere (Hayek 1941). In the managed market version of capitalism (Stiglitz 1989; and generalized in World Bank

1993), market failures justify specific interventions by the state, but, when there is no market failure, the market is left to fluctuate with little or no intervention.

In developing countries, the flexibility and efficiency associated with the American free market model is likely to be traded away in favor of domestic policies and interventions meant to ensure greater resilience in the face of competitive pressures in a global economy and of globally inflicted traumas. That implies more state involvement in financial and labor markets, more emphasis on the role of the state in catalyzing innovation in production, and a new round of attention to the domestic social contract, with higher public spending on social insurance programs and on universal health and education programs. In some countries, it is likely to mean a new round of twenty-first-century "new" industrial policy in the developing world.

Whether the outcome of a shift to a managed market model will be welfare enhancing is not clear. It may depend in the long run on what developing country leaders conclude about governance. In a crisis-prone global system, is there a trade-off between rapid and effective implementation of policy—the China model—and the messier but more accountable and responsive arrangements of mature Western democracies?

The second theme is better framed as a question than a prediction. It is a theme that is implicit in many of the chapters though like the reality of globalization rarely explicit: Will the financial crisis, which is likely to be remembered as marking the end of Western economic dominance, be a trigger for a new twenty-first-century approach to collective action on global problems? It is widely remarked that America's unipolar moment has passed; the global financial crisis verified for any doubters the rise of China and the reality of a "multipolar" world—with the United States still a leading power but no longer able to manage global affairs alone or even with a few close allies. A decade hence, will the financial crisis be viewed as a watershed in attitudes and practices with respect to global economic governance? Will it trigger a meaningful increase in the influence of China, India, and Brazil at the International Monetary Fund and the World Bank? Will it mark the beginning of the development of a more robust multipolar "polity" to cope with and better exploit the global market system? Or will efforts at global collective action falter in the absence of a single dominant player? What better presages the future: the successful coordination of a global stimulus at the London G-20 summit in March 2009 or the near-failure of a United Nations–led negotiation of a climate agreement, rescued at the last minute in the form of an "accord" agreed among a handful of countries in Copenhagen in December of the same year?

Whether and how global collective action proceeds on key challenges—

coordinated regulation of the financial services industry, climate change management, international migration, and correction of the global imbalance problem that helped precipitate the crisis in the first place—will matter tremendously for most of today's developing countries. The fact of uncertainty itself—whether the global economy can be managed in the absence of a global government—is already affecting approaches to development, as several of the chapters in this volume amply illustrate. A future in which global collective action is effective implies ultimately that the very idea of a "development" agenda (and the implied asymmetry of power and influence between developed and developing countries) will yield to the idea of a shared "global" agenda—across nation-states that cooperate in their own interests and in the interest of shared global stability and prosperity.

The Crisis and Domestic Policy in Developing Countries

At the World Economic Forum in Davos, Switzerland, in January 2009, at the near height of the panic among the global private and public leaders, it was Prime Minister Vladimir Putin of Russia and Premier Wen Jiabao of China who were most adamant about allegiance to the capitalist model. By the beginning of 2010 it was the United States, Europe, and other advanced industrial economies that were suffering a loss of faith in the benefits of a mostly free market—as they contemplated enormous public debt, populist fervor for punishing the bankers, and the long-run implications for the balance between market and state of having intervened heavily in their own markets. Indeed in 2010 at Davos French President Nicolas Sarkozy, while acknowledging the value of markets, studded his speech with multiple pained allusions to the risks and costs of market-led globalization.

Even in the throes of the global panic—before the March 2009 London G-20 Summit—Russia and China, the former communist states, had made clear to their domestic and foreign investors that they had no intention of abandoning the capitalist model. The BRICS—shorthand for Brazil, Russia, China, and India—and other emerging markets, and the developing world as a group, saw the United States as perpetrator and epicenter of the crisis; why would they alter an approach that for them was producing not only rapid growth but a visible increase in their geopolitical influence? These four countries, after all, had "emerged" not only as economic but also as geopolitical powers during the latest round of globalization—the two decades since the end of the Cold War.

In chapter 3, which was written early in the crisis in April 2009, Arvind Subramanian makes the point that globalization and market capitalism were working for emerging markets; they could afford to be smug about what were seen as financial excesses—not fundamental to the capitalist

Table I.1. Estimates of percentage growth in GDP, constant prices

		IMF 2009 estimates	
Country	Year	*April 09*	*October 09*
Brazil	2009	–1.301	–0.662
	2010	2.165	3.464
China	2009	6.52	8.504
	2010	7.51	9.028
Indonesia	2009	2.495	3.99
	2010	3.5	4.752
India	2009	4.523	5.355
	2010	5.607	6.421
Russia	2009	–5.977	–7.545
	2010	0.5	1.535
Thailand	2009	–2.969	–3.456
	2010	1.039	3.708

Source: International Monetary Fund 2009.

model—in the United States. Liliana Rojas-Suarez points out in chapter 7 that most emerging market economies in Latin America are and will remain firmly wedded to the capitalist model. Despite their greater vulnerability—given their far greater dependence on foreign capital inflows compared with Asia—Brazil, and Peru, among others, were reasonably well prepared to weather the initial round of financial contagion from the north. They had learned from the financial crises they endured in the late 1990s the logic, given their low domestic savings rates and resulting dependence on external capital, of shoring up reserves and maintaining flexible exchange rates.

The ensuing eight months (writing in January 2010) have apparently vindicated those reactions in Asia and Latin America. Except in Eastern Europe (with its heavy reliance on capital inflows from its European western neighbors) and in Mexico (with its heavy reliance on the American market for its exports), the emerging markets were the first to recover and recovered not only sooner but also more robustly than expected. The IMF's upward revisions of its GDP growth estimates for 2009 and 2010 (made in early and late 2009) for many emerging economies are summarized in table I.1.

What are the implications for attitudes, ideas, and actual economic policy practices in developing countries? With the American version of capitalism in disrepute, both emerging market and low-income developing countries are likely to modify their approach to economic policy, and their modifications are likely to be tolerated and perhaps even applauded in the Washington institutions associated with the Washington consensus.

"Modification," not "reversal," is the appropriate word. The modifications will be neither dramatic nor universal across developing countries and will hardly represent a new capitalist "model." To some extent, modifications had already emerged as the norm prior to the crisis, as confidence grew within many developing countries benefiting from the pre-crisis boom that they could safely ignore "Washington" economic nostrums. Still in the next several years, modifications to the mainstream pre-crisis market model are likely to be more widely embraced and more deeply applied than they might have been without the crisis.

Modifications can be put into four categories:

1. The nail in the coffin of financial orthodoxy. The pre-crisis direction of avoiding premature opening of the capital account and of heavy reliance on regulatory and prudential "insurance" to gird economies against external financial shocks will be reinforced.
2. The vindication of progressive social and distributional policies as critical to reducing inequality and restoring social cohesion. A more European-style state approach to employment and social policy with greater attention to distributional measures.
3. New respect for "new" industrial policy. Greater admiration for and experiments with various forms of industrial policy—that is, engagement of the state as facilitator and coordinator, albeit in a twenty-first-century market-friendly manner, with an eye on the early success of the East Asian "tigers."
4. Increasing assertion, if not of the Chinese-style authoritarian state, then certainly of greater executive power and discretion in the implementation of economic policy, particularly in low-income countries, with an implicit nod to the impressive policy decision and implementation capability of China's top-down state system. For low-income countries, this could come at the risk of increasing tension with the traditional donors and the Washington institutions about any weakening of the rule of law and of the constraints on executive power associated with democracy and open political systems.

These four categories mirror to some extent the three capitalist models Mitchell Orenstein defines in chapter 1. However, they are also best seen in a particular light: the underlying rationale for them, post-crisis, is to increase the resilience of the economy and the protection of jobs and welfare in the face of external economic and other shocks. The global financial and economic crisis was a wake-up call—that periodic shocks and resulting uncertainty for individual countries are intrinsic to their integration into a globally integrated market. Vulnerability to poor policies and decisions elsewhere is a reality that emerging markets and low-income countries are now far more likely to take into account in their economic policies and implies a greater role for the state in managing the market and protecting people from its failings.

On the one hand, the benefits of integration into global markets and of embracing the free-market capitalist model are self-evident—higher growth.

The End of Orthodoxy

To the extent free market "orthodoxy" (or market fundamentalism or what is sometimes called neoliberalism, seen as the most disparaging label) includes an open capital account and a thoroughly liberalized domestic financial sector, most emerging market economies even before the global crisis were hedging their bets—with the exception of Eastern Europe. In Asia, India was moving slowly and cautiously if at all to liberalize domestic interest rates; in China, there is no sign the renminbi will become freely exchangeable on international capital markets anytime soon, despite the advantage having a reserve currency would provide in economic as well as geostrategic terms (as Minxin Pei notes in chapter 5). Latin America's liberalized economies (Brazil, Chile, Mexico, and Peru, but not Venezuela, Ecuador, or Bolivia, which by 2008–9 were revisiting state-led policies) had benefited from a dramatic increase in foreign capital inflows in the decade preceding the crisis. Self-insurance had taken the form of reserve accumulation, especially in Brazil, and of the begrudging acceptance of the costs to diversification of exports and export competitiveness overall of ongoing pressure on exchange rate appreciation—particularly given the offsetting advantages of flexible exchange rates and the inflation-dampening impact of strong currencies.

In the smaller low-income countries, open capital markets attracted relatively less capital and of incoming capital less in the form of footloose portfolio and other flows compared with investment. In most of sub-Saharan Africa, for example, financial and banking practices remained relatively conservative. In addition, public debt levels were relatively low when the crisis hit because sovereign governments had benefited from the debt relief movement of the previous 15 years, which saw major write-offs of external public debt by the IMF and the multilateral banks (the international financial institutions, or IFIs); internal debt was relatively low as local capital markets were small and governments had eschewed bad fiscal and quasi-fiscal policies as part of the IFI-led debt relief programs. As a result, these countries were less vulnerable to the financial contagion that hit the middle-income emerging markets in late 2008 and early 2009 (though within a few months they were of course hurt through trade and remittance losses).

Here it is important to distinguish between the free market fundamentalism including open capital markets that Stiglitz (2010) and others decry, and Williamson's original Washington consensus (Williamson 1990). Williamson's ten points included openness to foreign direct investment but no reference to the opening of capital markets. On liberalizing domestic financial arrangements, he was cautious, calling for abolition of preferential interest rates for privileged borrowers, for example, and only gradual introduction of modestly positive market-determined interest rates (Birdsall, de la Torre, and Valencia forthcoming). And it is true that the IMF (and the U.S. Treasury), which had pushed for opening of capital markets in developing countries in the 1990s, had already backed off from fundamentalism in this domain earlier in the 2000s, well prior to the crisis, as research at the IMF itself suggested there was no evidence that open capital markets were associated with faster growth and plenty of evidence that they are associated with high volatility, which, in turn, reduces steady state growth (e.g., Kose, Prasad, Rogoff, and Wei 2006; International Monetary Fund 2009).

Still it would be wrong to assume that throughout the mid-2000s IMF policy and practice was "heterodox" on financial market issues. It was accepted that developing countries would with good reason want to proceed with caution in liberalizing their financial markets and opening their capital markets; they should sequence reforms so that opening would come only after sound and stable regulatory and prudential arrangements and the macroeconomic policies associated with long-term price stability were firmly in place. However, to some extent the vision was still of a thoroughly integrated global financial system in which at some point developing countries would ideally open their capital markets completely. Indeed whether and to what extent operational guidance shifted toward helping countries manage moving slowly is not clear; Subramanian's plea that the IMF be more systematic on this issue suggests orthodoxy still dominated—at least until the crisis hit.

Post-crisis it seems far less likely that a temporary use of capital controls (as occurred in Malaysia during the late 1990s Asian financial crisis), or even a temporary closing of the capital market, will be so readily and completely condemned in Washington;[1] equally we will hear fewer squawks in the United States, at least in policy circles, if and when Chile or other Latin American countries reintroduce taxes on short-term capital outflows of the kind the United States tried to prohibit in the U.S.-Chile Free Trade agreement.

In a more concrete sign of growing tolerance of the managed market model, the World Bank and the other multilateral development banks are likely to become more supportive of domestic development banks, particularly following the success of BNDS (Brazilian National Development Bank) in supporting initial stimulus in Brazil in 2009. That is likely to be the case even if development banks are used from time to time for political purposes, for example, to stimulate jobs or growth in election years. (After all, how different is that from interventions of the advanced countries to help their automobile and banking sectors at the height of the crisis?) Tanzanian Central Bank Governor Benno Ndulu argued strongly during the conference that development banks should be supported and strengthened and laid out the kinds of policy rules that would prevent the misdirected and regressive subsidies and abuses of quasi-fiscal powers of the past.

During the food price hike of 2008 that preceded the global financial crisis, some developing countries including India, Indonesia, China, Vietnam, Cambodia, and Egypt restricted food exports—a step broadly condemned in official circles. Lustig (2009) argues that such temporary heterodox quantity restraints can be justified as optimal, as they take into account the possibility that the hike is temporary and recognize the trade-off of costly adjustment to highly volatile prices as well as the economic logic of maintaining political stability. As with the financial and capital market issue, the challenge is developing resilience or robustness in the face of volatility that is often externally imposed.

It would be unreasonable for market-driven economies subject to external shocks that are out of their control and for which they are not the offending party to choose free market maximum "efficiency" over managed market policies that favor some measure of robustness. Surely that is the way countries in Eastern Europe countries, hit hard by the crisis because of the huge capital inflows they had welcomed, would see it. In fact, except in Eastern Europe, robustness was favored already by most developing countries before the global financial crisis; its origins and the resilience of many emerging markets to its effects suggests that managed market heterodox programs and policies—in the financial sector but also in other areas as the food and trade example suggests—will be more prevalent and in policy circles will be seen as increasingly sensible as well as legitimate (which will in turn make them more prevalent). Whether that will be a good thing overall in countries with weak governance will only become clear with time.

Vindication of Progressive Social and Distributional Policies

The second shift in domestic policy following the crisis is likely to come in the approach to employment and social policy. As with financial policy, a shift had already begun prior to the crisis but is likely to intensify post-crisis despite the fiscal challenges implied. Here the contrast between the American and European models of capitalism is relevant. For example Western Europe's success in quick and deep implementation of countercyclical policies—because of its preexisting automatic stabilizers in the form of guaranteed employment and other welfare programs—will not go unremarked on the part of developing country policymakers, particularly those increasingly subject to the political pressures to attend to the needs of the middle-income majority that democracy entails. That is likely to be the case even in countries where tax revenues as a percent of GDP are lower than in Europe and even if the U.S. economy recovers more quickly than those in Europe, especially if it is a relatively jobless recovery.

In Latin America, a political move to the left was evident already early in the new century, as José Antonio Ocampo notes in chapter 6, when fatigue with the liberalizing reforms of the 1990s set in. Fatigue was not surprising, since the structural reforms had not produced high growth or reduced unyielding poverty and inequality (that the counterfactual might have been even less growth and greater increases in poverty was politically irrelevant). Populist governments in Bolivia, Venezuela, and Ecuador reasserted the primacy of the state in managing the economy directly for the benefit of the people, assuming control of their natural gas and oil resources. In Brazil, Chile, and Uruguay, center left governments put increasing emphasis on targeted redistributive cash transfer programs to reduce poverty and income inequality, while hewing to macroeconomic programs that assured external investors stable prices and predictable returns.

The financial crisis will reinforce the growing attention to social policy in Latin America, with more emphasis on social protection and fairness for the majority (compared with the traditional association of social policy with simply more public spending on health and education) in market-oriented democracies. Ocampo suggests it will be increasingly politically attractive to introduce more European-style universal social programs in Latin America, in contrast to highly targeted programs for the poor. The success of the automatic countercyclical stabilizers in minimizing social disruption and political instability in middle-class Europe as the global crisis unfolded may well influence policy views in Brazil, Mexico, India, and other developing countries, given the growth of the middle class in those countries (Birdsall 2010). That is likely to be the case despite the rigidities European social policies impose. Even in the United States, where unemployment rates are likely to remain high for several years after the financial shock, the European emphasis on social solidarity and the policy implication of more progressive revenue and expenditure policies is likely to be more politically salient.

Ideally the crisis will also help move the government in China toward an increase in social spending and greater emphasis on social insurance. For the global economy, such a shift would have the advantage of increasing domestic consumption relative to export-oriented investment in infrastructure; for the Chinese it might help minimize the risks of social unrest due to the growing gap between rural and urban incomes and within urban areas as well. In chapter 4, Yasheng Huang suggests rural incomes in China stagnated for more than a decade—contributing to the inequality gap—primarily due to a reversal of financial sector liberalizing reforms beginning in the mid-1990s, combined with increasing pressure on local authorities in rural areas to raise tax revenue. He argues that the global imbalance problem (Chinese do all the saving and lending, Americans and others do all the borrowing and spending) is in part due to stagnation of rural incomes and consumption power (as opposed to any increase in savings rates in the past decade or more). For the Chinese perhaps a trade-off will emerge between investments to keep the machine creating urban export-driven jobs greased and spending on more progressive social programs and distributional transfers.

As with financial sector policy, growing emphasis in some developing countries on the logic of the state leavening the injustices of the market did not arise out of nowhere in 2008–9. The development literature was extraordinarily thin on the inequality issue and its implications for sustainable growth for much of the post–World War II period. Only in the 1990s, after the fall of the Berlin Wall, did mainstream economists seriously revisit the distributional consequences of capitalism that Karl Marx had raised 150 years earlier. However the popular outcry in the United States and Europe over bankers' bonuses marks a kind of consolidation in the OECD countries of resentment of high levels of income inequality, which are viewed as grossly unfair because they are seen as not reflecting differences in skills or effort. The concern about inequality grew throughout the 1990s even in the United States, as the benefits of growth accrued to a tiny portion of the population while the median wage stagnated. This concern was also evident in the 2008 presidential election in which the Obama campaign in particular appealed to the beleaguered middle class as losers in a market-obsessed system in which the state had failed to provide such basic protections as access to universal health insurance.

Policy interest in reducing income and other inequalities may grow in developing countries (as in the United States—though so far more in the talk than in reality) also as a result of the backlash everywhere against the bankers and other financiers. Whether justified by the evidence or not, the idea that income concentration on Wall Street contributed (along with cheap money, regulatory failures, and so on) to a sense of impunity and thus to excessive risk taking is likely to affect not only banking reform but also broader social policy change. In the emerging markets, including in China and Eastern Europe as well as in Latin America, perhaps there will be more interest post-crisis in the role of the state in ensuring minimal social protections for all—the universal programs Ocampo predicts. Where average income is still low—in South Asia and Africa—the crisis is likely to reinforce interest in replicating the success of Latin American countries with poverty mapping and direct cash transfers to poor households—if not universal programs. The crisis has already locked in what was growing policy and financial support for safety net programs of all kinds, including direct cash transfers to households, on the part of the international financial institutions.

On the one hand, markets will still reign across the developing world. On the other hand, at least for some years, politicians in the developing world will be less oblivious to the gap between the very rich minority and the large and increasingly politically salient poor and middle-income majority. In the rich world, we are seeing the end of smugness if not of big bonuses among free market fundamentalists. American pride in the United States's flexible and efficient labor market compared with that of Europe will diminish. In the developing world, it would not be surprising if future domestic policies and programs reflect, more than before the crisis, some experimentation with the European approach—both as morally responsible and in a volatile global economy as economically and politically smart.[2]

New Respect for "New" Industrial Policy

As with financial orthodoxy and inequality concerns, ideas about new, modernized, industrial policies were percolating in the late 1990s and the 2000s; the crisis could have the effect of increasing their currency. I referred above to development banks, written off as dangerous failures for subsidizing insiders at high fiscal cost in the 1980s but now back on the agenda. The ability of Brazil's development banks and those of other emerging markets to provide a quick and easy channel for quasi-fiscal stimulus in the first months of 2009 was noted by policymakers in low-income African countries. A government-sponsored development bank, as long as it avoids the sins of the past,[3] looks to be a market- and democracy-friendly vehicle for imitating China's remarkable ability, in a top-down policy system, to have so quickly and effectively implemented a major economic stimulus in late 2008 and 2009. More fundamentally, a modernized development bank is an institutional response to the interest of many developing country governments in jump-starting economic growth by underwriting or guaranteeing major private investments in high-risk sectors or regions. As Justin Lin outlines in chapter 2, that kind of public policy is a reasonable response to failures in the market—of coordination among private players where economies of scale cannot be achieved by single investors, of high costs to first movers and innovators in new sectors,[4] and of policy risks (creeping expropriation) that discourage investments in energy, water, and other areas in countries without a long track record of permitting adequate pricing of key public services and in general of honoring property rights.

The view of Lin and others marks a return to the early literature on development (Hirschman 1958; Leibenstein 1966; Rosenstein-Rodan 1943), now more explicitly grounded in the barriers market failures represent, that the state needs to play a facilitating role in fostering the growth process in low-income economies. For the three decades following the oil and debt crises of the late 1970s and early 1980s in the developing world, the prevailing orthodoxy (as reflected in the popular understanding of the Washington consensus[5]) was that the risk of government failure (incompetence, corruption) dominated any risks to growth of market failures. That was true not just in Washington but—as the reforms and adjustments of the 1990s took hold, and as the 2003–8 commodity boom raised exports and income—throughout the developing world. Except in China and a few countries such as Venezuela where governments took control of oil or other natural resource wealth, policymakers hesitated to increase the role of the state in production, and even in China the state dramatically loosened its hold on the market. The privatization movement slowed, but in part because it was so successful; only in a few countries are there today the large state enterprises that prevailed 30 years ago.

Ideas of a new generation of development economists about the benefits of the state doing more—guaranteeing, investing, coordinating, innovating—are likely to get far more traction in the real world of policy following the downfall from its pedestal of the American-style free market capitalist model. Whether a reentry of the state will be successful, particularly in low-income countries with weak rule of law where abuse of executive power is still a constant threat to responsible economic policy, is far from clear. What does seem clear is that there will be more sympathy for that idea and increased attention to the key rules that would keep state interventions of the managed market variety, meant to address market failures, off the slippery slope to government failure.

Increasing Assertion of Executive Discretion in Economic Policy, Especially in Low-Income Countries

China's remarkable bounce back from the immediate aftermath of the crisis illustrates the benefits of its tightly managed top-down policymaking machinery. As noted below, that its recovery relies on an undervalued exchange rate and its stimulus relied heavily on investment not on increasing domestic consumption can be faulted. But for many low-income countries, what is likely to be remembered is China's ability to go from policy decisions to effective implementation of those policies. The leadership of weak governments in Africa, for example, is bound to note that Chinese authoritarianism gets better results than Indian democracy with all its checks and balances. This is one way to interpret Lant Pritchett's chapter 9: that in the realm of development ideas, it is time to focus on organizational capability of governments, especially in low-income countries, to implement policies—whatever those economic or other policies (industrial policy or back to the market) may be.

Pritchett associates organizational capability with a far more complex set of social dynamics, in which there are robust mechanisms that make the public sector accountable to its citizens, than is associated with the Chinese political system. But political leaders in low-income fragile democracies are likely to see a trade-off between the "capability" of a strong executive to get things done in an autocratic system and the accountability and responsiveness of electoral democracies. That was already the case before the crisis; China's effective crisis response is likely to make it more so. Larry Diamond in chapter 10 notes a kind of trend in low-income democracies to emphasize executive power to get things done over the freedoms associated with democratic systems. He suggests that though the financial crisis and ensuing economic hardship in developing countries had no marked effect on the state of democracy in the developing world, we should not be reassured that democratic gains are inevitable. He notes a pre-crisis trend of reduced "freedom" and accountability in low-income democracies in the last decade, even when economic growth was as high as 6 percent annually.

Orenstein emphasizes (and Pei and Lin seem to take almost as given) that the implementation capability of the state in China is associated with the lack of democratic accountability in a politically autocratic system. Huang provides an example; he links lack of private household savings in rural areas to local corruption, in turn associated with the lack of accountability of local officials to citizens. Perhaps this suggests that current policies cannot be sustained indefinitely in China without further political repression. Still, the lesson for ruling elites in many low-income countries is likely to be that executive discretion should not be too easily forsaken in the name of Western-style democratic accountability. What is likely to dominate as an idea in the developing world following the crisis is that China was succeeding before the crisis and succeeded in managing the pressures of the crisis very well indeed. Whether the right lesson or not, that will be associated with its ability to get things done without the perceived complications of more accountable political systems.

The Crisis and the Prospects for Global Collective Action

A key characteristic of the crisis is that it started in the United States and hurt the United States and the traditional Western European powers more—economically and psychologically—than most emerging market and developing economies. In fact, the crisis may be remembered more for marking the moment when the traditional transatlantic powers formally acknowledged the new reality: a multipolar global economy in which decisions and events in China, India, Brazil (of the BRICs), Nigeria (of OPEC), and Pakistan (of the nuclear club) among other "developing" countries (all except Brazil still low-income countries in per capita terms) have global, systemic implications. Will heightened awareness of systemic problems, including of many such problems that are fundamental to development, lead to new ideas and new approaches to global collective action? Will that matter for the way we think about development issues?

The possible implications of the crisis for global collective action, for development ideas, and for development prospects in developing countries, can be brought out in brief discussion of four topics:

1. The G-20 and governance reform of the IMF and the World Bank
2. Climate change and development
3. International migration and development
4. Changing views of traditional foreign aid

The G-20 and Governance Reform at the IFIs

Prior to the crisis, there were already clear signs that the post–World War II success of the Western allies in managing global challenges to peace and security and in building an open trade and investment system was under strain. The United Nations was from its beginnings weaker than it might have been because of its one-nation, one-vote governance structure, as Kemal Derviş points out in chapter 8, and because of fundamental differences in interests and ideology between the communist countries and the West. After the fall of the Berlin Wall, the UN's development contribution was blunted by the continuing tension on trade, human rights, and labor issues between the rich industrialized states led by the United States and the G-77 grouping of developing countries.

In contrast, the IMF and the World Bank (the original Bretton Woods institutions) had from their beginnings a more effective governance structure based on weighted votes; they also benefited for four decades from the ideological clarity associated with the absence of the Soviet Union and its satellites. By the end of the twentieth century, they were both well established as institutions in which the traditional Western powers used their financial clout to promote and support the market model in developing countries. It was the Western powers, grouped as the G-7 and after the Cold War with Russia as the G-8, that for all practical purposes constituted the informal steering committee for the two Bretton Woods institutions.

That situation began to change in the 1990s with the end of the Cold War. With the embrace of market reforms throughout the developing world and then the surge of growth with the 2002–7 boom, the Bretton Woods institutions came under increasing pressure to increase the voting power and other forms of influence of China and other emerging markets. But progress was minimal and painfully slow; when the crisis hit no meaningful changes in their governance had been made. The Europeans were unable to resolve among themselves how to share in a reasonable reduction in their voting power and seats given their reduced role in the global economy. The United States, during both the Bill Clinton and George W. Bush administrations, though generally supportive of greater voice and votes for developing countries, was not particularly eager to give up the prerogatives and power it had historically enjoyed, including its right to choose the president of the World Bank and to veto the Europeans' choice of the head of the IMF if it wanted.

The IMF and the World Bank suffered a loss not only of legitimacy (and that for many reasons, not just governance) but also of relevance, as rapid growth and their easy access to private capital reduced dramatically the borrowing of the big emerging markets and other developing countries, especially between 2002 and 2008. (To some extent, the success of major developing countries was, ironically, the outcome of their embrace of the macroeconomic and structural reforms the institutions had long advocated and supported.) By 2008, Turkey was the only major IMF borrower. The World Bank remained active in low-income countries but was becoming more of an aid agency, heavily reliant on contributions from the traditional Western donors for its activities in those countries, than the credit cooperative that John Maynard Keynes and its other founders envisioned. That in itself threatened its legitimacy with the new rising Asian and other emerging markets—since it continued to be dominated in its policies and governance by the advanced Western industrialized countries.

The crisis changed the situation dramatically, providing an opportunity for major strengthening of the system in two respects. First, it led to the elevation of the G-20 (first constituted in the late 1990s as a grouping of finance ministers with leadership from the U.S. Treasury) to its new status as a summit of heads of state. The first meeting of the G-20 group of countries at the head of state level in Washington, D.C., in November 2008 was a sudden and almost an ad hoc affair. But subsequent meetings in London in March 2009 and in Pittsburgh in September 2009 (after the conference on which this book is based) locked in the status of the G-20 as an obvious substitute for the G-8, at least on the global economy and financial system, and to some extent on global development challenges more broadly conceived as well.

Second, the crisis set the stage for a dramatic recovery in relevance of the IMF and the World Bank. This was especially true of the IMF, which, in retrospect, was rescued from what had looked like an inevitable slide into obscurity and irrelevance. In the first days after the collapse of Lehman Brothers, the IMF looked particularly irrelevant when the U.S. Federal Reserve Bank made quick and sizable lines of credit available to several large emerging markets. Within a few months, however, the IMF and the multilateral banks had a more representative new (if informal and unofficial) steering committee in the form of the G-20, which had endorsed for them a major role in ensuring adequate financial flows to developing countries to cope with the crisis. The replacement of the G-8 by the G-20 as the steering committee for the two institutions also helped somewhat to enhance their legitimacy in the developing world—though the modest pre-crisis adjustments in formal voting power and other governance changes were only slightly accelerated.

The switch of the G-20 from finance officials to heads of states, and the agreement at the London G-20 meeting in March 2009 on a coordinated stimulus, seemed at the time to be a breakthrough in the potential for global coordination. So did the commitment to ensure as much as $1 trillion of new resources would be available (primarily through the IMF and the multilateral banks) to help developing countries cope with the crisis. The same can be said of the resolutions at the G-20 summits, including in Pittsburgh in the fall of 2009, that all members would resist protectionist pressures at home.

However, within one year it was clear that global collective action in the interests of a larger global good had not suddenly become the norm. In retrospect, a coordinated global stimulus was relatively easy to agree to; it is not as politically difficult for governments to commit to spend more as it is to spend less. In the few countries that hesitated, such as Germany, the automatic stabilizers kicked in anyway. In addition the United States and Europe had considerable experience working together, including through multiple effective informal channels, and more easily so on issues like a global stimulus, where their immediate domestic interests and their customary role as chief stewards of the global system were well aligned. And of course an acute sense of urgency, including assurance that emerging market economies would continue to help fuel global demand, put the wind at their backs for the $1 trillion commitment.

As the urgency of the crisis diminished and the domestic political costs of any particular action rose, collective action faltered. As before the crisis, for example, the global collective was unable to address effectively the global imbalances that had contributed to the crisis in the first place, with the United States fueling imports and its consumption and housing boom with fiscal deficits and loose monetary policy and the Chinese fueling its investment and export booms with an increasingly undervalued renminbi and limited spending on social programs at home. A year after the Lehman collapse, the IMF still had no political ability to impose any kind of discipline on the major creditor, China, or the major debtor, the United States. Collective action of any kind at the global level was completely stalled. Decisions by the two big economies continued to be driven by domestic political and short-run economic concerns and not by even a small dose of concern about the risks of the imbalances to global stability and thus to their own long-term interests.

The stimulus China so effectively implemented with the emphasis on investment not consumption was driven by the same domestic imperatives to sustain job creation and experts as its pre-crisis stance; meanwhile it halted the minimal appreciation of its currency it allowed before the crisis hit. In the United States, the accumulation of public debt and effect of quantitative easing on global interest rates was also perverse from the point of view of a global adjustment (though few would argue there was any alternative as there was and continues to be in China); in particular there was the risk that U.S. policy was creating conditions for a dangerous bubble in emerging markets, as people and institutions holding capital sought higher returns in those markets than they could get in the United States.

Similarly, there was no real progress in coordinating new financial sector rules that would minimize the excesses that contributed to the crisis and ensure that the industry could not exploit differences in standards across major markets. The overall outcome a year after the crisis was that the risk of periodic financial collapse had not been reduced, and the policies in response to the crisis were adding to the risk of a long period of sluggish growth in the industrialized countries—with, as Peter Heller rightly emphasizes in chapter 12, attendant increased risks to the developing countries that depend on external demand for jobs and income gains.

In short, any benign effect of the crisis in inspiring global collective action on global economic challenges, including development, seemed limited and short-lived one year later. Better representation of some advanced developing countries in the global economy club—the G-20—did not provoke a sea change in global governance or the ability of nations to cooperate on fundamental economic problems that affect prospects for growth and development worldwide. Perhaps it is not surprising that the new ideas about development provoked by the crisis and set out in this book focus more on domestic policy within developing countries than on the inadequacies in what might be called a still-incipient or fragile global "polity." Though the increasingly integrated and thus increasingly risk-prone global economy lives on, more than two years after the Lehman Brothers collapse, it was hard to see much progress in creation of a global polity that would enhance its benefits and minimize its risks.

Climate Change and Development

In other areas where there are more obvious and immediate trade-offs between short-term domestic interests and the long-run benefits of a more stable and sustainable global economy, there is even less reason for optimism. Consider climate change. Throughout 2009, nations struggled to negotiate a global climate treaty. The traditional post-WWII powers had to engage with and accommodate the demands of rising Asia and other emerging market economies to an unprecedented extent. They also had to grapple with the question of their financial responsibilities, in their own interests and in the interests of global prosperity, to developing countries for mitigation at home and for financing mitigation and adaptation abroad—at a time when their own fiscal problems were daunting given their exploding debt levels due to the crisis.

As it turns out, progress toward a climate change agreement was painfully slow during 2009; the global financial crisis was a constraint and a distraction, not an opportunity. The December 2009 accord agreed at Copenhagen was better than nothing but at its heart amounted to little more than the summing up of what individual countries, especially China and the United States, could manage politically at home.

Whether there will be more progress in 2010 and beyond (not only on climate but on terrorism, drug trafficking, pandemics, and other risks that compound the development challenge) increasingly depends on the stance of China, India, Brazil and other members of a newly named group of "advanced developing countries." On climate, China's stance is especially crucial. Pei in his chapter argues that China's response to the crisis was to adhere to "realism" with only modest signs of any move toward "international liberalism"; China still feels strategically vulnerable—for example in terms of access to raw materials—and is unlikely to assume any role in global stewardship anytime soon. A good example of its approach was its willingness to contribute to the financing of IMF crisis programs—but at a modest level and not with permanent funding—and its taking the position that additional contribution would be contingent on faster and more meaningful gains in its formal influence at the IMF.

Would a continuing failure of collective action to address climate change matter for development prospects around the world? Yes. The potential for unabated climate change to damage growth and destroy livelihoods in developing countries is huge; countries closer to the equator and more dependent on agriculture are particularly vulnerable (Cline 2007), and in general poorer people are less able to cope with the adjustments climate change will bring (Dasgupta, Laplante, Murray, and Wheeler 2009).[6]

The realities of climate change—including China's and other advanced developing countries own dramatically rising emissions due to their own rapid economic growth and population growth—and the mounting evidence of the high costs within China and other advanced developing countries—give them more incentives and more influence, as was evident in Copenhagen. These countries cannot afford to absent themselves from action, as their own contributions to greenhouse gas emissions assuming business-as-usual policy would alone be sufficient to put the planet at grave risk within a couple of decades (Wheeler and Ummel 2007). Nor can they insulate themselves from other global risks such as pandemics and nuclear proliferation. They are likely to insist in their own interests on more influence at major global institutions—and in the case of China, India, and Brazil, to see their own interests as increasingly aligned with sustaining stability and prosperity in the rest of the world.

Meanwhile, the United States and the Europeans may yet yield in their own interests to the pressure for more engagement of the advanced developing countries in the management of climate change initiatives, making climate the leading wedge of more fundamental institutional reforms. That is already the case with the shift from the G-8 to the G-20 as the key forum on global economic issues. At the institutional level, the new Climate Investment Funds are an example; these funds are housed at the World Bank and other multilateral banks and depend heavily still on contributions from the traditional donors. However their governance structure is already 50/50, in other words, 50 percent of votes are held by the developed and 50 percent by the developing world.

International Migration and Development

What does all this have to do with changes in ideas about development after the crisis? In a sense the crisis provided a wake-up call to the development community that the distinction between development issues and global issues is blurring. Already students of development were concerned with low-income fragile states because those states cannot be counted on to participate responsibly in dealing with cross-border problems. The crisis has driven home that the challenge to global collective action is bigger and more complicated. Emerging markets, especially China, may or may not take on global stewardship sooner or later. Even if they do, the traditional powers, especially the United States, may or may not be politically able to overcome their domestic problems sufficiently to cooperate even where their long-term prosperity depends on it.

The changing face of geopolitical power in the world, illustrated vividly by the crisis itself and its immediate aftermath, is bound to lead to a re-framing of many development issues. Global problems and challenges will rise on the agenda, because they are more relevant than ever for developing countries' prospects for growth, and because some countries, while still poor, are economically big enough (and as Heller documents will be proportionally far bigger relative to industrialized countries by mid-century), are now systemically important and are play makers not just takers in the global system.

Michael Clemens' chapter 11 provides a stunning example of a development issue already being framed differently than it was several decades ago because of the deep structural changes in both industrialized and developing countries. He and other development economists were calling attention to the logic of greater migration from poor to rich countries before the crisis. The crisis provided a reminder that though the United States, Europe, Japan, and a few other industrialized countries still dominate the global economy, their decisions alone no longer guide its fate. Among other changes, they are going to be dependent on immigration to maintain any reasonable measure of economic growth and vitality at home as their populations age (and this will be true of China in another couple of decades). Accepting greater immigration will also be sensible as a measure to increase social and political stability in the Middle East, Africa, and other settings where rapid increases in the number of young people will require stupendous efforts by relatively weak governments to create jobs and provide urban services—emigration can provide a safety valve where that process does not proceed smoothly and can contribute mightily through the return of human and social capital (what is sometimes called *circular migration*) and the spread of common norms and ideas, as well as obviously through remittances. The logic of increased migration as the last liberalizing force for a more prosperous and equitable global economy—after trade in goods and services and capital flows—is inescapable. Whether any collective global measures to minimize its social costs and maximize its benefits in both sending and receiving countries will follow is not clear.

Changing Attitudes about Aid and the Aid System

Ideas about development aid were not discussed at the conference where the chapters in this book were first presented. In retrospect that is surprising, since perhaps a decade hence looking back it will be remarked that the financial crisis undid forever the idea of aid as a vehicle for the rich, who know how to grow their economies and transform their societies, to the poor who apparently (or so it was assumed) did not.

As with other issues, prior to the crisis development practitioners had been advocating a set of reforms of the aid system for at least two decades, focused heavily on better aligning assistance to low-income countries with those countries' own priorities, rather than with the own political, diplomatic, or commercial interests of donor nations. That reform was often expressed as "putting the country in the driver's seat." But for the most part the domestic politics of aid and bureaucratic constraints had largely frustrated good intentions, and the prevailing if implicit view was that the donors knew more about the programs and policies that would bring transformation and modernization to low-income countries than the countries' own leadership and citizens. Aid-recipient countries may have been in the driver's seat but they often had donor passengers grabbing the steering wheel or shouting instructions from the back seat.[7]

The crisis illustrated that the traditional donors might not be good drivers of their own cars. By the time of the crisis, some low-income countries were increasingly taking charge of the wheel anyway. Also foreign aid had become no longer a solely Western activity. China, India, and Brazil had become donors too and saw aid as one part of a larger set of relations in their own interests, including growing investment and trade ties with low-income Africa and Asia. And Korea, the host of the November 2010 G-20 summit, began wresting from the G-8 the development issue, bringing an emphasis on growth, investment, trade, and financial stability to the agenda, not just or mostly aid.

The effect of the crisis was to reinforce this democratization of the aid system and to reinforce the view that the traditional Western powers did not have all the answers anyway on how to develop. Perhaps looking back ten years hence, the crisis will mark the moment when the conception of aid for the two post–Cold War decades began to change—from aid as primarily charity (with a heavy focus since 2000 on aid as a key input to help poor countries achieve the Millennium Development Goals) to aid as one aspect of global public policy central to a safer and more prosperous global system (Severino and Ray 2009).

Conclusion

The global financial crisis provided a dramatic illustration of the risks of the global market. For developing countries it underlined their vulnerability not only to natural disasters and terms of trade shocks but also to a sudden economic collapse of the advanced industrial economies. The crisis will not induce developing countries to give up the opportunities for growth the global market provides; after all globalization and market capitalism were working well for them before the crisis and they recovered more quickly than the rich countries did from it. Adherence to the market and to capitalism will endure. But there will be a subtle shift to an increased role for the state in managing markets, with greater recourse to policies and mechanisms to minimize vulnerability and ensure robustness, even at the cost of maximum efficiency and flexibility. That will be obvious in the case of slower opening of capital accounts, but it will also affect labor and social policies and it could inspire—despite the risks, especially where governance is weak—increased interest in Asian-style "new" (rule-based) industrial policy. Traditional Western ideas about good politics may also lose their grip. The crisis and its aftermath may be seen in the developing world as an illustration of the apparent benefits of resorting in the manner of China to executive discretion in the interests of an effective state that can act quickly and effectively—in contrast to the checks and balances that delay and complicate policy implementation in typical consolidated democracies. In that sense, the traditional Western idea about political progress (my co-editor's "end of history") will no longer go unquestioned in the developing world.

The crisis may also mark an important watershed in whether and how the international community manages global challenges to its common welfare. In the new multipolar world, there is less likelihood of the kind of change wrought after World War II, when, with the United States the unrivaled lead in the Western world, came the creation of the United Nations, the World Bank, the International Monetary Fund, and what became the World Trade Organization. The current crisis will be remembered as marking the end of Western economic dominance. With the creation of the G-20 replacing the G-8, China and other emerging markets now sit at the table of global collective action. Will that finally trigger meaningful reform at the IMF, and real engagement of China and other emerging markets in decision making there and at the World Bank? Will it confound or advance the negotiation of a climate change treaty and a more sensible approach to maximizing the benefits of international migration for all countries and peoples? Will it mark the end of the twentieth-century understanding of aid? Will the low-income countries get a seat at the table too, and if so when? With new issues arising on the global development agenda, do we have an international system of institutions, rules, and habits in place to address the resulting challenges? As we pick up the pieces after the global financial crisis, there are new issues—changing power shifts, demography, and continuing financial and other risks in a global system—and the answer is far from clear.

Will we look back on the crisis as the beginning of the end of "development" as an idea in itself—as the development agenda ultimately merges in this century into a global agenda for cooperation across nations in the interests of a more just, sustainable, and equally shared prosperity? Well, probably not. But I hope readers will read this book with that question in mind.

Notes

I thank Frank Fukuyama, Seth Colby, Lawrence MacDonald, Moises Naim, and the authors of the essays in this book, especially Michael Clemens, Peter Heller and Mitchell Orenstein for their excellent comments on an earlier version of this introduction.

1. On February 19, 2010, the International Monetary Fund published a policy note on capital controls. Taxes and other restrictions on capital inflows, the IMF's economists wrote, can be helpful, and they constitute a "legitimate part" of policymakers' toolkit. Dani Rodrik wrote on his blog that this publication marked "the end of an era in finance." Available at http://rodrik.typepad.com/dani_rodriks_weblog/2010/03/the-end-of-an-era-in-finance.html
2. In his thoughtful comments on a draft of this chapter, Mitchell Orenstein suggested there is a change afoot about the objectives of development with the target of high growth rates no longer as widely shared. This was to some extent the case before the crisis, as the Millennium Development Goals agreed by more than 150 heads of state in 2000 would suggest, and see Sen (1999). However, I would say that developing country political leaders are still heavily focused on growth itself as the means to all the other good things that "development" implies.
3. At the conference, Tanzanian Central Bank Governor Benno Ndulu noted the potential benefits of development banks, and suggested the kinds of rules and constraints on their programs and policies, such as that would prevent the abuses that made them an economic liability in many developing countries in the 1970s and 1980s.
4. On the market failure due to risks that early adopters face, and the resulting logic of state interventions to encourage innovation, see Hausmann and Rodrik (2003).
5. On the popular understanding of the Washington consensus, and on the debate about its actual implementation, results and shortcomings, see Birdsall, de la Torre, and Valencia (forthcoming).

6. China's exchange rate policy is another example. A year after the financial crisis hit, in the absence of a rule-based arrangement on exchange rate management, or at least of prior agreed guidelines on good behavior as a basis for naming and shaming (in principle an IMF role; in fact a sign of the IMF's inability to discipline powerful members), protectionist pressures were rising in the United States, and wrangling between the two countries was creating a greater risk of disruptions to trade and investment flows around the world. To the extent the Chinese renminbi was undervalued in early 2010, it was undermining the competitiveness not only of the United States, but of many developing countries in Africa and Latin America whose rates were floating, as Subramanian (2010) among others argued.
7. For a discussion of the fundamental dilemma of making aid transfers from outside effective for development, and a summary of reform efforts and their limited traction, see Birdsall and Savedoff 2010.

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