Keynote Address at the IMF Institute Conference on Second Generation Reforms

by
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Thank you very much, Mohsin Khan and Vito Tanzi, for the invitation to come here, and let me say at the outset what a pleasure it is to share the platform with my friend Michel Camdessus on this subject.

In his usual way, Michel has set forth more adequately than I the framework of these discussions, and so it is for me to try and perhaps embellish a little bit the framework that he has set out. I might also offer some observations about the need to take a coherent approach to development.

The first thing I would like to underline in what Mr. Camdessus said is the first observation he made about first and second generations not being sequential. When we talk about first and second generation reforms we do so in terms of a historic view of the process of development. It is one in which the fundamental attention is given to monetary policy and growth and stability as a precondition for attacking the questions of poverty. The second generation issues focus around the questions of the structure of the right institutions, of the improvement of the administrative, legal, and regulatory functions of the state, addressing the incentives and actions that are required to have private sector development and to develop the institutional capacity for reforms. But a moment's reflection would have you understand that you cannot have one without the other.

And so when we talk about second generation reforms, I would simply underline the point that Mr. Camdessus made, which is that first and second generation actually coalesce in terms of timing and because one without the other has been proven not to work.

The second point I would like to underline is the issue to which he referred of the virtuous circle. It is much the same point as that of sequencing. It is that if you want to have stable growth, then it is important to deal with the social and poverty issues, because if you do not deal with the social and poverty issues and the structural issues attendant to it, then you find that your growth is not stable. You have social and other eruptions in the society. There is no foundation on which a consensus might be built. And, therefore, the attention is given today, certainly between the Fund and ourselves, and I think increasingly in the development community, to the linkage between these two aspects of the problem of poverty.
As Mr. Camdessus articulated in the Annual Meetings speech, poverty is as central to the activities of the Fund as it is to the activities of the Bank. It is the focal point of our attention. And, therefore, as we approach this question today and tomorrow while discussing second generation reforms, I would simply underline that I think for both of us it is part of a circular activity, and each generation is essential for the success of each generation. That I believe is a very important aspect of your discussions and I know it is implicit in a number of the papers which have been presented to you.

Let me talk a little bit about the way in which we have seeking to approach this problem at the Bank and the newly expanded partnership we have with the Fund in terms of bringing together for some 75 countries a Poverty Reduction Strategy Paper. And let me say how pleased we are that this new institutional focus is now a reality and that it drives our joint endeavors.

The first thing that we realized in our analysis at the Bank was that this problem of development is becoming ever more complex and many more forces need to be engaged if one is to deal effectively with the overall question of poverty. I need hardly remind you that our planet now has 6 billion people, and as we look to the next 25 years, we are going to have 8 billion people. And that what happens over the next 25 years to the 1.2 billion people now in poverty is central to the interests of most of us in this room. Will the numbers grow, will they be stable, or will they decline? And if we are to hold them stable or if they are to decline, what is it that we must consider if we are going to make effective policy interventions that will allow us to attack this question?

The other descriptive aspect of this next 25 years is that we are also faced with a number of other dimensions which really continue trends from the last 10 years. The first, of course, is that the nature of poverty is changing in terms of the location and concentration of the groups of people with whom we work. Our estimates indicate that the number of people living in urban areas in the developing world will increase by more than 2 billion between 1995 and 2025. That poses us with a very important issue in terms of structure when one talks of second generation reforms because now you are faced with new problems of managing the issues of poverty within city areas to an extent that has been heretofore unknown.

Where previously we had central government, state governments, city and town governments, the growth of megacities and the concentration of people going into cities and towns is stretching the institutions of government and what used to be done centrally is now being forced to the local level. And with over 26 megacities likely to exist in the next 15 years, 22 of them in developing countries, we have a new issue in terms of this second generation of reform, which is brought upon us by the change in demographics. And we have seen a growing development of management by state-level entities. As one goes to a place like India and visits the states, one is conscious of the fact that many of the states are equivalent to the top ten countries in the world in terms of population.
So we have to think not just in terms of structure at the central level, but at the state level, and now at the city level. These very, very important demographic changes require us to look at the question of structure. So that is one point.

The second point, of course, is that of the additional 2 billion people on our planet over the next 25 years, 98 percent will be in the developing and transition economies. So the distribution in terms of the challenge that we are facing is all on the side of an increased distribution to our developing world. A second extraordinarily important development.

And the third very significant development and I give these by way of background because it is important to have this framework set before one can seriously address the questions of structure in the second generation reforms is that the influences on this framework have changed dramatically in the last years and are likely to change significantly more in the years to come.

When the Bretton Woods institutions were founded, we sat alone at the top of a mountain in terms of being able to influence development and reconstruction. Clearly, today, with the explosion of entities in the international field, multilateral and bilateral institutions, there is a need for a better form of partnership to exist between the official institutions that deal with aid than was necessary before. But, interestingly enough, while there is a growth in numbers, there is a decline in terms of transfer of resources. So you now have more institutions, more thinly spread and themselves reappraising their contribution as governments reappraise their contributions to say should we go with the multilaterals or should we go with bilaterals in terms of allocation of resources. And all this at a time when the numbers of the institutions are increasing and when the amount of funding is diminished. This is something that we face in parliaments throughout the world now.

And then you have the two other aspects that have developed and will continue to develop. The first is, with increasing freedoms, the enormous growth in non-governmental organizations and civil society. The increase in the last 10 years has seen more than a doubling in 10 years of the number of non-governmental organizations registered globally, and that trend is increasing as you have NGOs registered for practically every known idea. And it is not just in the formal NGOs, but very happily, we are seeing groupings of people coming together in local communities.

And, finally, of course you know it well there is the issue that is referred to in this articulation of second generation reforms. How do you create an environment for the private sector a private sector which 10 years ago in terms of investment and transfer of funds was about half the amount of overseas development assistance and which in 1997 reached a peak of eight to nine times and has dropped back a bit now but is still five or six times the size of overseas development assistance.

You cannot think of second generation reforms unless you look at the context in which they are operating. I have just suggested some of the
changes which you need to consider in terms of the dynamics of this exercise and before you get to the question of prescription and of how you implement them.

Then the question is: if you are within that framework going to focus on these reforms, what should they be? And here what we have learned in this recent period is key.

The first thing that I guess we have all learned and it has been pointed to in some of the papers is that strengthening governance and the quality of government is an essential prerequisite to a continuation of stability in terms of the macroeconomic and growth policies of which the Managing Director spoke. Strengthening governance is something that is of deep concern to both the Bank and to the Fund, and indeed, last week Mr. Camdessus opened by satellite the Joint Africa Institute in Abidjan, where there is a further step forward in terms of our mutual attempts to try and deal with the question of strengthening the capacity of government. We need to strengthen government in terms of regulation, in terms of people, in terms of capacity. But we have also learned that in too many of the countries in which we are operating, in which we introduce our economic programs and our social programs, there is a huge gap where there is no legal and no justice system. It is very difficult to get protection for the poor and development of the poor on an equitable basis without the existence of an effective legal and justice system. And the justice system is as important as the legal system because if you have a legal system without appropriate administration of justice and by that I include also the legal profession, the training of the legal profession, even the administration of justice in terms of police unless you have that, it is very difficult to contemplate equitable development.

And the third and very important element which we have focused on ourselves and with the Fund is this question of financial supervision and control. It is very difficult to have, again, the sort of policies applied if you do not have an appropriate framework in terms of bank supervision, supervision of capital markets, integrity, consistency, transparency, all the things that we have been talking about in the context of the reform of the international financial architecture.

And, finally, of course, there is the question of corruption. Corruption is something that pervades each of these areas. It is surely something that is part of the considerations of the virtuous circle. You cannot contemplate having the system operate if you have diversions from it in terms of corruption. This really gets to the core of anything that you might describe in terms of second generation or first generation of reforms.

So these are primary issues that one needs to deal with. And I would add to the list of second generation reforms a social framework that can allow you to deal with the people that fall out of the loop. And so for me, as you address the questions in these coming days, I would urge you to think in terms of this structure without which it is hard to contemplate that any effective development and any effective attack on poverty can occur.
And there are, of course, other issues, and I am running out of time, but let me quickly say that there are then the programs themselves, the programs for education and knowledge, for health, for communications, for transportation, a rural strategy, an urban strategy, an environmental and a cultural strategy. All these issues become highlights and essential elements in terms of the actual programmatic thrusts that you need to have.

And I would make again, in the interest of time, just one very quick observation that, as the Managing Director said, none of us want to have this conceived of as being imposed from Washington or anywhere else. Second generation reforms must also address the very important question of how you build consensus in a society. How a society moves forward, both in terms of reforming its structure and in the programs it adopts, is something that must be owned by the society itself rather than something that is imposed. And with increased communications and increased access to knowledge, the problem is at the same time more easy to cure, but also more difficult because you have more participants in the game as a result of the accessibility of knowledge and the opportunity for input.

So do not overlook, as you think of second generation reforms in these coming two days, the question of how you build consensus. How do you address the question of mobilizing, under the leadership of the governments and the parliaments of the countries, this set of objectives which the second generation reforms seek to meet?

I wish I could be here for the two days to hear these discussions, because for me it is absolutely at the core of the challenge that we face in this next 25 years. We have to get to grips with the notion that macroeconomic issues and growth, key to poverty reduction, are closely linked in a virtuous circle with the social and the poverty issues to which many of the policies underpinning second generation reforms are directed. And, secondly, as you consider second generation reforms and factor in changing demographics and the increasing complexity in terms of input from the private sector and civil society, how is it possible and practical to bring together all these forces to get the programs and the policies adopted by the people of the countries who are their rightful owners and the rightful directors of the programs that are to be developed?

These are all extraordinarily interesting issues, and I wish you well in your discussions. I know I look forward to a set of conclusions and guidance two days from now to make my job easier in the next few years.

Thank you very much.