THE BROOKINGS INSTITUTION

TURNAROUND:

THIRD WORLD LESSONS FOR FIRST WORLD GROWTH

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PROCEEDINGS

MS. WROUGHTON: Well, thank you very much for joining us today. We're here with Professor Henry for the New York University, Stern School of Business, whose -- the focus today is his wonderful new book, which is called *Turnaround: Third World Lessons for First World Growth*. Welcome. We're looking forward to hearing all about it.

We have Uri Dadush next to him, Senior Associate and Director of the International Economics Program at Carnegie Endowment. Welcome, Uri.

MR. DADUSH: Thanks, Lesley.

MS. WROUGHTON: And then we have Domenico Lombardi, a Senior Fellow here at Brookings, specializing in global economy and development. And both of you, I've known from the World Bank, where you were previously. So -- good.

So, just to set it up, you know, the rise of emerging economies, and the development in developing economies is the focus of everyone, considering what's going on -- low growth, high unemployment and so on -- in the developed world. What can they learn from the policies, and from the development in these emerging economies? And that's the focus of your book.

So, we're interested to hear what you have to say, you're story -- a compelling one. I was actually reading it before I was asked to moderate this panel. So it had caught my attention. And I was actually looking at some of the reviews, which call it, "A concise and controversial statement of what needs to be overcome if the world economy is to return to the path of growth and stability."

So we're going to give you an opportunity to set it up for us, and then we'll follow with comments by Uri, and then Domenico, and then we'll go into a Q&A.

Thank you.

MR. HENRY: Thank you, Lesley. And I'm hoping that your interest in the book before being asked to be on the panel is a leading indicator of its future sales. So, thank you very much.

The first-world nations -- the United States, Western Europe, Japan -- the central argument in the book is the first-world nations look very similar to what the third-world nations -- quote-unquote "third world nations -- looked like three decades ago: high debt, slow growth, and a lack of direction. And the central argument in *Turnaround* is that there's much that the first-world can learn from the third-world in order to right our own economic ship. And, in particular, the third-world's struggle with economic reforms can teach us what we need to do to get back on track.

So, specifically, I argue that the third-world's struggle with economic reforms teaches us about three things, three things we need, to see a more prosperous future. And those three things are what I call "discipline," "clarity," and "trust."

So I'm going to try to be disciplined, myself. I'm going to hold to my 15-minute allotment. And so what I will do is just give you the very sort of top-line view of the main arguments.

So, I've already made three claims: high debt, slow growth, lack of direction. Just very briefly, what are those?

So, from 2002 to 2007, we had one of the most prosperous periods in world history, the fastest five-year period of global growth ever -- 4.9 percent per year for the global economy as a whole, with emerging markets leading the way. In 2012, a very different situation: 1.3 percent growth in advanced nations, emerging markets at 5.3 percent. And, in particular, if you look at Europe, Europe contracted last year.

Debt -- through that boom period, from 2002 to 2007, contrary to what standard economic policy teaches us -- and this is the point about discipline -- "discipline" doesn't mean what you think it means. "Discipline" doesn't mean austerity, nor does it mean wasteful spending. "Discipline" means a sustained commitment to prosperity. Now, in the context of fiscal policy, discipline means countercyclical fiscal policy. So, from 2002 to 2007, we did see countercyclical fiscal policy in emerging countries. On average, they ran fiscal surpluses of about 1 percent of GDP. In contrast, advanced nations were running deficits on the order of 3 percent of GDP. And as a result of that, we now see average debt levels in advanced nations in excess of 100 percent, and in emerging nations debt levels are substantially lower, on the order of 30 percent, on average.

So, the first thing I'd like to do is to talk about what does "discipline" actually mean? So, as I said, "discipline" does not mean austerity. It doesn't mean wasteful spending. To put it in what I like to call sort of "dietary" terms, discipline isn't crash dieting, nor is it binge eating -- or sugary sodas if you're from New York.

In the book, I say discipline is a sustained commitment to a long-term, to long-term prosperity, that is both vigilant and flexible, and values what's good for the country as a whole, over what's good for any individual, interest group, or person running for political office. And the history of the third-world struggle with economic reform teaches what discipline means in everything from the context of fiscal policy to international trade, to international capital flows, for example.

So, let me give you a specific example, in terms of fiscal policy. Countercyclical fiscal policy, let's take two contrasting countries.

In 2001, the United States ran a $236 billion fiscal surplus. We made a conscious -- and we had record fiscal surplus in 2000, as well. We made a conscious decision to not be countercyclical, to be procyclical, and to give back that surplus in the form of tax cuts. We know where that's gotten us today.

In contrast, Chile -- in 2008, Chile experienced a boom. The treasury was taking in record amounts of revenue as a result of the commodity boom, in particular, the surge in the price of copper. Andrés Velasco, the Finance Minister, was burned in effigy in 2008 for refusing to give back the people's money, as it were. He said, no, this money is for a rainy day. The financial crisis hit, Chile was able to institute a $4 billion tax-cut package to cushion the blow of the financial crisis. Countercyclical fiscal policy.

Third-world ants, first-world grasshoppers, if you will. Okay. That's discipline. And we can talk perhaps later about what discipline means in the context of trade policy, in the context of international capital flows.

The second point -- clarity. So, third-world countries were able to turn themselves around and become emerging markets when their leaders displayed a clear commitment to a change of direction. The example I'd like to use here is, again, a broader example from Latin America.

So, in 1984, a year before James A. Baker, III, made his very famous speech in Seoul, South Korea, at the World Bank and IMF meetings, where he unveiled his -- quote-unquote -- "program for sustained growth," which became the basis for the "Washington Consensus," as it was later coined by John Williamson from across the street -- the year before James Baker made that famous speech, which really set off a firestorm about what discipline actually means in the context of economic policy -- and I think I've laid out a definition in the book which I think is a useful one -- but in the year before Baker made that speech, if you were to look at the price-earnings ratio in Latin America, the average price-earnings ratio was 3.5, so the stock market was in the tank.

Now, why is this relevant? Well, part of the argument, a central part of the argument in the book, is that we can actually get, the best barometer we can get for whether a given policy change is likely to create or destroy value, is to look at how the stock market responds to the announcement of an economic policy change, or set of economic policy changes.

And so, as of 1984, stock markets in the emerging world were at a price-earnings ratio of 3.5 due to, among other things, uncertainty about the future, inflation risk, expropriation risk, closed markets, and a general lack of direction about economic policy in the future.

Over the course of the next decade, as post-Baker speech, as Latin America began to really struggle with the issue of reform, and finally, in 1994, I would argue, really made a very clear shift in direction -- if you look at the inflation numbers, on average, in Latin America as a whole, 1994 is the year in which inflation really dropped off the cliff. In particular, I'm thinking now about the stabilization program in Brazil, the Real Program initiated by Fernando Henrique Cardoso, continued by Lula da Silva, when he became president, the price-earnings ratios in Latin America went from 3.5 in 1984, to 14 -- very close to world averages -- which is what theory would predict would happen as a result of opening up to the rest of the world, and implementing a whole range of policy changes.

So, as a result of a clear change in direction, there was a quadrupling of valuations of corporate assets in Latin America. And, very importantly, as the price-earnings ratio went from 3.5 to 14, the cost of capital fell -- right? The cost of capital is really just the inverse of the price-earnings ratio. And so as the cost of capital fell in Latin America, investment also surged. Projects that were negative net present-value projects, because of all the issues that I mentioned before, became positive net present-value projects. Investment surged -- in particular, as Latin America countries opened their capital markets to foreign investment, capital flowed into the stock market, facilitated foreign direct investment, and we also saw a substantial increase in wages and productivity.

So -- clarity, a clear change of direction towards lower inflation, more open markets for goods and services, more open capital markets, a smaller role for the state, and privatizing inefficiently operated state-owned enterprises really turned things around in Latin America.

So, let me come to the last point, then -- trust. Why is trust critical?

Well, back up for a second. We know that we are in a period of slow growth in advanced nations -- I mentioned 1.3 percent last year -- and we know that emerging nations, that advanced nations will grow more slowly, certainly, than emerging nations, for very good theoretical reasons: There's catch-up growth going on in the merging world, we don't expect advanced nations to grow at 5 percent per year. But 1.3 percent, as Martin Baily can tell you, is nowhere near trend growth in the advanced nations. We think that the United States is something closer to 2.7

percent, 2.8 percent; probably 2.2 percent or something like that in Europe. So we're underachieving right now.

And we've just -- we're de-leveraging. We've experienced a financial crisis, which we know, from the work of people like Reinhart and Rogoff, leads to much slower recoveries, typically. So, the emerging nations for the first time are driving the global recovery. So we need the emerging nations to continue to grow, and we would like them to grow even more quickly by continuing down this disciplined road of a clear change in policy direction so that they can grow even faster, and provide even more momentum to our economies.

But the question is, will that happen? And the argument in the book is that without trust, with greater trust between emerging nations -- the leadership, governments in emerging nations, and the leadership of advanced nations, we are undermining the possibility, the likelihood of emerging nations continuing down that road.

So, what do I mean by that, specifically? Let me give some examples.

So, I mentioned Latin America more broadly. I mentioned Chile. Expand now to thinking about the BRICs as a whole.

The BRICs account for roughly 20 percent of global GDP. In the international institutions that largely determine the rules of the game --

what "discipline" means, and so on, in international discussions, the IMF and the World Bank -- the BRICs account for only 11-1/2 percent of the voting shares. But contrast, the nations of the euro zone account for roughly 20 percent of global GDP, and account for 32 percent of the votes. So there's a great imbalance. If you want to talk about global imbalances, there's a great imbalance between voice and say in the international institutions, and contributions to the global economy, that really reflect, frankly, the antiquated allotments in the immediate aftermath of World War II.

And why does this matter? Well, there's what others have called "reform fatigue" in the emerging world, this lack of reciprocity. This lack of a willingness to give emerging nations their proportionate say in conversations about the global economy undermines their leaders' ability, frankly, to see to their electorate’s further reforms.

Let me give you another example. During the height of the crisis, at the height of the crisis, advanced nations came out and stated very strongly, "We are all committed to free trade. We have to continue to have open markets in order to ensure the stability of the world economy." And what did we get, between November 2008 and November 2010? According to the *World Trade Report* there were more than 800 instances of protectionist measures instigated. More than 40 percent of those came from G8 countries.

So, there are many other examples in the book of, essentially do-as-I-say-not-as-I-do. And I think there's a great risk that what I call, frankly, the "trust deficit" -- which, I think, is in many ways at least as important as the discussion about fiscal deficits right now -- undermines the ability of emerging nations' leaders to continue to push for the kinds of reforms that need to happen in order for them to grow even faster, and to help us in this recovery.

So, I think I've reached the end of my time, according to my watch here. So let me just close by saying that it's really quite striking to me that we now have a third-world Pope. And so if the most, arguably the most conservative institution in the world, the Catholic Church, can find the humility to acknowledge the growing importance of its base, so to speak, then can't the most important economic institutions in the world do something similar to ensure that we have the trust we need between countries to drive future prosperity?

So, let me stop there.

MS. WROUGHTON: Thank you, Professor. (Applause.)

It is a fascinating thought to think that the world -- you know, looking back to the '70s, '80s, and '90s, that everybody was talking down to these countries. And, now, you know, we're electing them as popes.

So, Uri, let's hear what you have to say. You know, the third-world was forced to live within its means. Should the developed world do that, too?

MR. DADUSH: Yes, is the answer. Thank you very much. Yes, the fact that we have a third-world Pope means that you have to have faith. You have to have faith. (Laughter.)

So, I very much enjoyed Peter's book, *Turnaround*. It's a great read. It's very well written. And it simultaneously takes a different and refreshing look at some important aspects of development thinking, and also challenges advanced countries to do better by learning from developing countries -- which, of course, is another novel endeavor.

Now, it is possible to quibble with details. Unfortunately, I do that a lot. There is a typo in the second sentence of your introduction, which says that Mexico has 1.9 million manufacturing workers. Well, Mexico has got to have a lot more than 1.9 million manufacturing workers -- maybe 10 times as much. So, I just want to alert you to that.

MS. WROUGHTON: The data still has to catch up.

MR. DADUSH: There is also a statement that low-income countries do not attract a lot of FDI, and the FDI they attract is just in mining. In fact, in recent years, they've attracted a lot of FDI in services.

There's also a statement that developing countries' and advanced countries' stock markets are uncorrelated. In fact, they are highly correlated, and increasingly so.

It is also possible to disagree with some broad claims made in the book. For example, the advanced countries were the real obstacle to a Doha deal. I, as Director of Trade at the World Bank, followed the negotiations over 10 years, and I assure you that there is plenty of blame to go around on the Doha debacle.

And even though Peter is careful in the way that he makes the case, I still think that he places too much stock in the stock market. I'm sure this is not the first time you hear that. The stock market is a source of confirmation that policies work -- I mean, after all, the long history of financial bubbles is a history of stock markets getting it wrong. And stock markets are enormously volatile, while policy is a long-term endeavor. So, you know, I find the information useful, interesting, but I think it has to be treated with great care -- the relationship to the stock market.

Anyway -- but for the most part, I found myself agreeing with Peter's analysis and his conclusions. I found his comparison of the performance of Jamaica and Barbados to be especially interesting, a very useful health warning against the predeterminism of Asimolow and Robinson. And I hope, at some point, you'll tell us if they ever reacted to that, because it is a striking example of two countries with very similar colonial, etcetera, history, and that have strikingly different outcomes.

The comparison you make between the Brady plan HIPC debt relief is also, I thought, very useful. Whether or not one agrees with the conclusion that the former worked very well, but the latter did not, that the HIPC did not, I think your analysis is a very good example of the need to think about the broader context whenever one is evaluating a specific policy, and especially important policy measures. You have to look at the broader context.

Of course, Peter Henry's message that the advanced countries are not giving the developing countries enough respect, now that the latter are the drivers of world growth, resonated strongly with me. And I know it's going to resonate even more strongly with Domenico, and with many here.

However, I was less convinced by Peter's attempt to draw lessons for the advanced countries from the developing countries -- which, after all, is the subtitle of the book. I was left to ask: Well, what exactly do you mean when you speak about "discipline?" What is "discipline?" Maybe I'm too much of an economist, and I forgot the basics.

And even if you define "discipline" in a way that I can grasp, is it, in fact, true that policy-making in Germany or the United Kingdom is less disciplined -- these are two relatively slow-growing advanced countries -- is less disciplined than it is in India, or Brazil, or Nigeria, which are relatively fast-growing countries?

Also, I felt there was a lack of distinguo in the book. I mean, there are some advanced countries that have actually done very well in recent years. Canada, Australia, Sweden, Israel are some of the ones that -- not all of them are commodity exporters -- some of those that spring to mind. And there are also many developing countries that have done terribly. I don't even mention the U.S., because I'm not, you know, I'm not sure there is any economic policy-making in the U.S. today, outside the Federal Reserve. So there, I agree with you, and I know you have the U.S. in mind.

But exhortation that the advanced countries need to get their act together, of which the book is full -- they need to stabilize their macro-picture, they need to liberalize and increase competition, due structural reforms, et cetera, et cetera -- that's all to the good, but it only takes you so far.

And so I was left to ask: What are the deeper causes of the acceleration of developing countries, and the sharp deceleration of advanced countries as a group over the last 20 years or so? We probably have a better explanation now, from the Growth Commission, a lot of the work that has been done in many places, about the acceleration of the developing countries, and why it happened, and why it should have happened earlier, but it happened now -- et cetera, et cetera. I think we have a pretty good picture.

I think there are a lot of questions of why Japan struggles, why Italy struggles, et cetera. And, you know, I call it the "rich country trap," is there a rich country trap? What is the nature of the trap? And we know that financial crises are part of the reason, of course. And we know that the sovereign debt crisis in Europe, the euro, is an enormous own-goal, to use a soccer analogy, which really didn't have to happen. We know that that's part of the reason.

But there are also deeper questions. One of them is, is technology, in fact -- are we running out of technology? This is one of the discussions that's going on at the moment.

There are also very deep questions about the income distribution plans, and the social cohesion in advanced countries, the workings of the welfare state, the ability of the welfare state to deal with globalization, et cetera, et cetera, the disfunctionality of the health system, et cetera. And why is it that these ills affect advanced countries disproportionally?

There have been some efforts to look into this -- I'm thinking of (inaudible) on the United States -- but really, not enough.

And so, I think this is a great book, but you need to write another book. Your next book should address these questions.

Thank you.

MS. WROUGHTON: Thank you, Uri.

Domenico, the Italian on the panel here, can a third-world Pope change the lives of many? Maybe we could put this into economics?

MR. LOMBARDI: Well, thank you, Lesley. And I really enjoyed reading your book, Henry, and I did find a lot of material, a lot of food for thought -- especially given that here at Brookings, in the program I am affiliated to, we have been working a lot on the euro zone crisis. And therefore, you know, if you will allow me, I'll try to sort of condense what the main lessons from your book are for someone like me, who comes from Europe, who has been focusing a lot on the IMF, but also on the euro zone crisis.

And, really, I would -- I found five lessons, you know, in reading your book. So, essentially, in order to run a successful economic reform program, a growth-enhancing reform program, you need five requirements: discipline, pragmatism, ownership, humility, and leadership.

So, let me go, you know, one by one, and see how I would try to characterize, and if I've understood your book correctly, you know, what are the features underpinning each requirement -- and also, letting me add a little bit, you know, from my own perspective.

So, clearly, discipline is a term that frequently recurs in your book. And I have to say that, you know, these times -- yesterday I was just flying from Madrid -- this is also a word that is heavily recurrent in Europe nowadays, unfortunately, for the wrong reasons though. In fact, you pointed out that "discipline" is essentially a sustained commitment to a long-term program of, you know, or to a long-term prosperity type of objective.

So, essentially, discipline is a means, it's not an objective in itself. Discipline cannot be a policy -- but it's something that, of course, is going to enhance the effectiveness of our policy. And I think, you know, with this in mind, I think we have to recognize that, you know, discipline might be a good thing if it is applied, you know, in an appropriate way -- otherwise, the risk is that you're going to hit the wall.

And this brings me to the second lesson that comes out from our book, that's "pragmatism." You know, and I'm glad that you are sort of coming up with this by looking at the lessons of successful developing economies. Because, clearly, if I say that from Italy, you know, I wouldn't have the same credibility. (Laughter.)

Yeah, at the core of economic reform, you say at its core, economic reform is not about ideology, but is a practical matter of triggering and sustaining (inaudible), where I would add, you know, economic growth more in general.

So, I very much enjoyed the part of your book where you talk about the approach by former Chinese leader Deng. You know, they invited the World Bank mission. They said, look, we have an objective, long-term prosperity. We can do it without you, however if we do it with you, it's going to be quicker and faster. And, look, now it may seem pretty normal, you know, that a Chinese leader might have said that. But I think that back in the '80s, it must have taken quite an effort, you know, including vis-a-vis his own party, party colleagues, and so on.

And let me try to find, you know, a couple of analogues, unfortunately that are not so successful. China, of course, has been very successful in that, in adopting a very pragmatic approach. Europe is not. And, again, I was mentioning yesterday, you know, I was coming back from Madrid where we had a very interesting workshop with (inaudible). There were senior political figures in this workshop, and some of us, you know, actually writing on the euro zone crisis. And, you know, I was a little bit surprised by the comments of a German colleague of mine. He was saying, look, you have to -- "you" meaning southern European economies -- you have to engineer some export-led growth.

I mean, essentially, this is a replication of the German mode. Well, as you know, Germany's current account now is higher than China's, both in respect to GDP, as well as in absolute terms.

Now, my question to him, my rebuff to him was: Look, this is okay if you are a smaller economy of the euro zone. Clearly, you can do whatever you want at the margin. But if you get relatively larger economies, like Italy, Spain, and the rest of southern Europe, engineering a so-called export boom, to whom are you going to sell your net exports? Because clearly, China has a surplus. The U.S., I heard not long ago, that it wants to be a little bit more like China. The Gulf, of course, runs a surplus.

I mean, clearly, there has to be some thematic adjustment within the euro zone. And therefore, you know, this really calls for some economic cooperation within the euro zone -- bearing in mind, of course, that the southern economies have to do their own adjustments. So this is not to discount that in any sense.

Then there is another case that, you know, I also found interesting, still on this issue of pragmatism: the cold-turkey approach, really slashing fiscal deficit. And, you know, you mention some cases of countries with hyperinflation.

And I think, really, so we have to think carefully, you know, when we apply the therapy, what is the disease? And there's always a risk of doing a misdiagnosis.

So, of course, whenever you have an hyperinflation economy, you might want to adopt a cold-turkey approach to shock expectations. But, again, if we look at the euro zone, and the southern economies of the euro zone, in the case of my own country, Italy, the problem is not the fiscal deficit. Actually -- and I have the data with me, just to be precise -- you know, Italy has been running, over the last decade, a deficit-to-GDP ratio about 3 percent. I'm not saying that it was tight, but it was not overspending, either.

If we look at the debt-to-GDP ratio, the debt-to-GDP ratio was 108 percent when Italy joined the euro zone. And it bottomed to 103, 104 percent in the middle of the last decade. And you know this year how much it's going to shoot? 130 percent.

So, since 2009, where Italy experienced a contraction of 5.5 percent, in this country where the crisis originated, contraction was 3.2 percent that year -- in Italy it was 5.5 percent. And since that moment onwards, the debt-to-GDP ratio has been escalating. And the irony is that this year there will be a balanced budget in Italy, and yet the debt-to-GDP ratio is going to hit this unprecedented threshold of 130 percent.

This is just to say that what looks like is a fiscal problem, this escalating debt-to-GDP ratio, has little to do, or less to do with the fiscal deficits, but actually has a lot to do with lack of growth. And this is really the problem. So, if you don't tackle that issue, that problem, you're going to have -- then this is going to fit into a fiscally unsustainable dynamics, with all the problems that we know of.

So this is really -- and what is the answer? The fiscal compact. So you have to run a balanced budget. So this year they're going to run a balanced budget but they're going to experience another contraction.

So, being flexible -- you know, if you are a sailor and the wind shifts, you can change your tack. That's not going to mean that you're going to dock your boat in a different harbor at the end of the day. So, that's really, you know, the main lesson.

The third lesson is "ownership." And, you know, clearly for those of us who are IMF scholars, who have been researching a lot on the IMF, ownership is very important. And it really comes out in your book very well. You know, you mention the fact that Chile had three IMF stabilization programs. No one of them really managed to bring their moderate inflation down, but in the end, you know, the Central Bank of Chile, in the '90s managers were, you know, teaming up with other international organizations -- couldn't really, wasn't really sort of successful.

And this is to say that, clearly, nothing can really substitute for ownership. There is no troika; there is nothing that can replace what ownership can lead you to.

And this is, of course, important. What we see now -- and, you know, again, we had general elections in Italy, it was actually that people overwhelmingly rejected these austerity-led policies imposed by Europe. They did not reject the euro or the idea of Europe, but they did reject overwhelmingly the sort of economic recipe that was imposed on them.

And then "humility" -- and I think this is really, you know, one of the lessons that I found most interesting. And, to be honest, it really forced me to think in those terms. I was not really -- you know, ownership, I'm familiar with.

"You may not get it right the first time." So, again, you mentioned, you know, that in cases of disinflation from hyperinflation, you may be more successful, you are more likely to be successful, but still you have to try a number of times. Again, when you disinflate from moderate inflation, your rate of success is even lower.

You know, you have to accept failure, basically. It's a trial and -- whatever -- yeah, I forgot the expression. But basically -- so this is also, you know, something that comes very strong from your book.

And, again, the same success stories in your book are of those economies who were applying the dependency theory, the import-substitution theory early on. And they, you know, they sort of realized the limits and the failures of those approaches, and they were sort of smart enough, and were open to new approaches.

And therefore, you know, again, if I have to translate this in terms of, you know, the European crisis, they haven't got it right this time, but it doesn't mean that, you know, Europe or the euro is going to disintegrate necessarily -- as, clearly, you know, there might be a feedback, and there might be a reevaluation, a reassessment of their policy failures. So, in a way, this is a reason of optimism, even if the data, you know, looks pretty bad.

And then the last lesson is, I would say, "leadership." And leadership is not just national leadership. Clearly, you need to have, you know, an enlightened leadership in China, or in Chile, for doing what they have done.

But it is also a unique combination of national and international leadership. Where would those economies be without the great leadership of, you know, the former U.S. Treasury Secretaries Brady, and James Baker, before Brady? You know, at the time China was trying to open up, the U.S. granted a special status to China, supported China's joining of the WTO. So, again, you need to -- these economies do not prosper in a vacuum. So you need a combination of national and international leadership.

If I were to translate this into the European, you know, crisis, maybe there might be some national leadership here and there, but I do not see any regional leadership. And, in fact, the only name that comes up when we talk about Europe, or the euro, is Mario Draghi, but he's not a politician -- at least, you know, yet, so far.

So, then if I have just one more minute to --

MS. WROUGHTON: One more minute.

MR. LOMBARDI: -- yes, one more minute.

You know, that said, you know, I don't think if I said that I agree with you it's very sort of, you know, it does well to the panel. So, you know -- (laughter) -- so an IMF reform, we all -- I mean, clearly, I agree with you. And, you know, Lesley knows that. And I have some public positions.

But what I, especially having read your book, what I don't really don't understand is, you know, a couple of years ago, when the IMF membership had to elect the 5th French Managing Director, out of 11 -- there have been 11 -- they are all from Western Europe, but 5 of them are French.

So how is it that a powerful economy like China, which is today the second largest economy -- according to Goldman Sachs, it could be the first in a few decades -- how is it that China, India, China is never going to borrow from the IMF, just because the IMF has not the financial capacity to lend to China. How is China or other, you know, very large economies, in the end, decided to support a European candidate?

So that, I found, you know, a little bit sort of difficult to understand. I mean, clearly, there are reasons, but they are not so compelling after all. It's not that if they had voted for someone else the

European Union would have heightened, you know, trade barriers, or anything like that.

One very final point -- it's not in your book, but actually, you know, it does strengthen the scope and the meaning and the sense of your book -- you don't refer to the experience of a very successful, relatively small, but very successful regional organization made up of developing countries, that's FLAR, the Latin American Reserve Fund. It was established a few decades ago, among Andean countries. And it has been providing loans to its members without conditionality. No one has ever defaulted. At times, members were in arrears with the IMF -- I'm referring to Peru in the '80s -- but Peru was fulfilling all its obligations vis-a-vis FLAR.

And likewise, you know, if you take the sister organization of CAF, again a very successful experience. Their ratings are higher than the ratings of their own member countries. I think this is also -- you are an expert on that, so you may want to look into that.

And I think, really, you know, the sense of ownership of peer, you know, pressure in a good sense is very strong. And this is something that, again, is not very well known, but I think, you know, deserves to be much better known.

With that, I'll stop here. Thank you.

MS. WROUGHTON: Thank you. Thank you, Domenico. Interesting thoughts from both of you.

Well, let's start us off looking at the crisis in the United States. We live it every day. We see it on TV. We live in Washington. We know it's -- sometimes we don't know what's going on.

But when you look at -- the issue here is trying to lift growth, and not to unsettle that very fragile recovery that we're on now. The question is, is it cutting -- should one cut taxes? Raise taxes? Or austerity?

What do you, from your research in the developed world, learned, or have a lesson for the U.S. as it goes through this?

MR. HENRY: So, I think, I'd like to focus on an issue of clarity, and others may have other things that they want to add. But just to point out that if you think about kind of a macro view of what's going on in the United States right now -- and the world, more broadly, actually, just to expand the discussion -- you have extemely expansionary monetary policy in outright monetary transactions in Europe, quantitative easing here, and effectively, and you have contractionary fiscal policy. So just from kind of a textbook point of view, you have monetary policy and fiscal policy working at cross purposes. That's a lack of clarity about what we're trying to do.

And so I think the discussion about fiscal policy really needs to be, first of all, seen in that context, and then ask the question: How do we think about a holistic approach? I mean, so rather than to be merely focusing on what's untouchable and what's touchable, let's agree that we want a pro-growth, holistic approach, that's, you know, progressive, and gives certainty about where we're headed.

So, I think if we could start at those principles, and then get to specific -- as Domenico you sort of -- tactics, which way we're going to tack, I think the discussion would be lot more productive. Right now we've gotten mired in this false tradeoff between austerity and stimulus, which just isn't very helpful.

MS. WROUGHTON: But isn't the -- Domenico, you look at Europe, you know, the Germans feel that they, you know, you need to stick to the goals. The IMF is actually backing a lot of the other countries in saying, "You can ease a bit on that. Let's push up growth. That should be the focus."

What is the solution here?

MR. LOMBARDI: You know, again, you know, my southern European angle, I think there is, you know, really too much emphasis on the deficit and, you know, how much deficit we're going to have this year or next year.

But, actually, again, if you look at Spanish data, if you look at Italian data, what you do see is that there is really a problem of composition of expenditures, and the relative efficiency. And I think this is really, this is really the issue. So, you know, this is what the regional community, the international community should make pressure on those countries, you know, in terms of making their expenditures and the relative composition of expenditures more efficient, rather than just cutting here or there.

And I think there is too much emphasis, you know, on the latter aspect, rather than on the former.

MS. WROUGHTON: Uri, what is your feeling about what you're watching on television every night going on in Congress? You know, is there an easy way for the United States to deal with what's going on?

MR. DADUSH: Well, I think a lot of countries, as Larry Summers likes to say repeatedly, would like to have the problem of the United States. I mean, I think the United States is supremely well positioned to deal with its own problems -- in so many respects.

But, the problem in the United States isn't that. The problem in the United States is its political cohesion.

And I agree with Domenico that far too much emphasis is being placed on the deficit, this year or next. And it's really consistent with my view that the United States is a very strong economy that can deal with its issues. It's a question of timing.

So, there is a, frankly, for me, not especially interesting short-term kind of demand-management issue, you know, the mix between monetary and fiscal policy, and the speed, et cetera, et cetera, of adjustment. Most people would agree that, you know, the adjustment in this situation needs to be gradual. Yah? We have a high unemployment. We don't have inflation -- et cetera, et cetera. But that's the least interesting question.

To me, the more questions in the U.S., very briefly, are, number one, the long-term trends on health care -- the issue of efficiency. The health care is the disaster of the United States economy. It is 18 percent of GDP, and it's not delivering results. You know, the white males that didn't finish high school are seeing a decline in their life expectancy in the United States, 4 years over the last 20, the life expectancy has gone down. It's the richest country in the world, and it's spending 18 percent on health care.

There are very, very fundamental issues. That's the most fundamental issue, which is actually affecting everything else.

The second is the savings rate. I know, I was just listening to Martin before, but I would have said it anyway, Martin -- the savings rate. Very big issue with the incentives to spend in this country, in the private sector, and particularly the household sector.

And the third issue is inequality. The inequality trends in the United States stand out. They're very striking. The middle class, in a country that has been growing faster than the average of the advanced countries, has seen a decline in its real per capita incomes over the last 13, 14 years. And I know there are people at Brookings who will do, you know, some adjustments, et cetera, that will show that that's not quite true. But, fundamentally, this is the broad trend.

And this goes back to the initial point that the United States doesn't have so much of an economic underlying fundamental problem, it has a cohesion problem. It has a political problem

MS. WROUGHTON: Professor Henry, what did you see, or what have you learned from prioritizing? I mean, if anything, in the developing world, they've had to prioritize. They've had few resources, and they've had to figure out what is important to them now, and then, as well as what's important over the long term.

What can you tell us about that?

MR. HENRY: Yes, I think "priorities" is a very important word. And I think "priorities" is a nice way of tying together what Uri and Domenico are saying.

So, in a broad sense, there's far too much focus on austerity, and not enough focus on reform, structural reforms. The key thing is what are the changes that will deliver the most bang for the buck in any given country?

And as Uri said, the issues in the United States are very different than they are, for example, in Italy. And what I think the developing countries have been most successful at turning around their economies, are those who have figured out, okay, what's the most kind of important, rate-limiting step, if you will, that we can address in our economy?

And I think the next example that I'd like to point to is the example of South Korea, because everyone talks about South Korea's export-led growth strategy. And as Domenico was saying, you know, the whole world can't have an export-led growth strategy. But I'd just like to sort of make a little addendum to that.

It's try we can't all run net surpluses, net trade surpluses. We know that. But if you look at the world as a whole, it's never run a new trade surplus, but the overall volume of world trade has increased dramatically over the last 40 years, and that has had a huge impact on growth. Why? Because the fundamental issue in trade is not whether you have a trade surplus, but whether you use your resources efficiently.

And so South Korea, during its period of most rapid growth, from 1965 to 1990, ran serial trade deficits. People don't realize that. It learned to export by importing. But it made priorities, in terms of, in thinking, okay, we can use the world market as a way to achieve economies of scale domestically and, for instance, you know, produce color televisions for the rest of the world, even if we don't have color television broadcasting locally.

So, prioritization is key. And we have to figure out what are the key priorities in the United States. And I think inequality is a big issue. And I think one of the key issues which drives inequality, frankly, is our lack of an adequate educational system. The scholars at Brookings, and almost any other first-rate academic institution will tell you there's an inexorable increase in the returns to being skilled, and that drives the wage gap.

So -- and unemployment's 7.7 percent, but if you have an MBA or some other form of education, the unemployment rate is 3.8 percent in that group. And the returns to education in that group are quite high.

So the question is: the males who aren't graduated from high school, how do we prepare them for the 21st century? Because as we create more skilled workers, their skill premium will drop, and the number of high-skilled, highly competent people will rise, and that will help us address some of these issues.

MS. WROUGHTON: Uri, as a trade expert, China has been told now the export-led model is not a good one. We've got Jack Lew going off to China soon to talk about the next part of the relationship between China and the U.S.

I mean, is there anything that the U.S. could learn about exporting more, you know, generating that growth that is needed from China's experience?

MR. DADUSH: Well, this is such a different situation. And I always struggle with export-led growth. I think there's a lot of misunderstanding about export-led growth. And the fundamental misunderstanding is that people think in demand terms, when they're thinking about long-term growth. So, if you think in demand terms, then it must be good to grow your exports. And that is the fundamental --

But, in fact, in the case of China, this effect had virtually no effect on Chinese growth, meaning that if you look at the change in the trade balance of China -- exports minus imports -- the contribution of the change in the current-account surplus in China to Chinese growth over a 10, 20-year period is essentially zero. It's 0.1 percent or something like that. It's a trivial part of the growth.

The fundamental importance of trade is as much import-led growth as it is export-led growth, by which I mean the effect of trade on the economy is to reposition the economy and make it more efficient, and make it more productive in all sorts of ways: increasing competition, driving innovation, et cetera, et cetera. That is the heart of the importance of trade.

And, yes, so the United States can learn from China. But it cannot learn from China about export-led growth. It can learn from China what happens when you allow an economy to restructure at the appropriate speed, and you allow it to learn from overseas, et cetera.

Yes, the United States is so far ahead of China. You know, United States income is five times what it is in China. So we have to be careful about learning lessons from China. So, the United States faces very, very different, very different challenges.

But, anyway, I go back to my point that I made before: The most important competitive threat facing the United States is not to be found in manufacturing, is not to be found in export services, it is to be found in its health care system that is dysfunctional, absorbing a huge amount of resources, making Americans poorer, and making Americans uncompetitive on international markets.

MS. WROUGHTON: Domenico, I've just come back from the G20. You know, a lot of this fight for growth in the developed world is causing a lot of competition. I mean, the so-called "currency wars," people rather like to call it "currency worries" right now, you know, a perception that some countries are forcing a devaluation in their currency to look more competitive.

I was very interested at the G20 that I didn't hear from the emerging economies a lot more anger over this. It seemed that the U.S. and the G7 dealt with it through the statement, you know, a week ahead of the G20.

What is this adjustment that's going on between, you know, the rise of the emerging -- it's a power adjustment -- what is that telling you about, you know, increased competitiveness, and how that's going to play into future cooperation between these economies?

MR. LOMBARDI: Yes, what you have seen is that the G20 has, of course, been, you know, very successful at managing the crisis when the world economy was on the brink of a meltdown, and has been much less successful after then.

And, you know, there are, of course, various reasons. Certainly, there is some more incentive to cooperate when you are very close to the brink, and much less so when you have to reallocate, you know, a much smaller pie.

But the reason why I think we're going to see more and more tensions, you know, even in the context of the G20, between developed economies on the one hand, and developing or emerging economies on the other, is that the main, you know, some of the main advanced economies, mainly the euro zone and the United States currently are facing mainly domestic-led challenges that relate to the nature of their own policy-making process. So, just to be clear on that -- so we were just talking before, in the U.S. the main challenge is essentially how the presidency, how the Congress can affect the priorities of the budget.

And, clearly, you know, this balance, this battle of power, this fight, in terms of who's going to give more weight, in terms of picking up the priorities for the budget is not something that lends itself to international cooperation. The G20 cannot do anything on that.

If you look at the euro zone, there is a power, a fight going on between the national layers of the policy-making process or agencies with the regional layers. And, again, it's really a shift, you know, how much power should national authorities, or some national authorities have vis-a-vis others.

So, again, it's another fight in terms of shaping the future nature of the policy-making process at the European level. So, again, this lends itself very badly to some sort of, you know, peer review discussion in the context of the G20. And actually, it really, you know, pushes these countries away from the G20.

And, of course, you know, what is the alternative? The alternative is essentially to resort of some, you know, unilateral actions. And, of course everybody, you know, everyone will try to do as it best can.

But I think, really, it's not easy to figure out how this tension, how this gap that we see in the G20 can really be overcome, because the challenges that the U.S. and the euro zone are facing are really challenges at the heart of their own national sovereignty.

MS. WROUGHTON: Professor, I wanted to ask you, you know, in the developing world, you know, they were all under IMF programs, and were being, you know, told by the Western world what, you know, what to do.

Who tells the United States and Europe what to do? I mean, are they going to be willing listeners, you know, of your message, basically?

MR. HENRY: Yes. Well, Uri said we have to have faith, so -- (laughter) -- I'm hopeful that, given the current circumstances we're in, there's no misconception about the fact that we're underperforming relative to potential.

And I think the really important thing here is that a lot of the responsibility falls on leaders, but I also think there's an important responsibility of the electorate to hold their leaders to a higher standard. If we have low expectations, then we shouldn't be surprised at the low quality of the debate.

So, I'm hopeful. I think that there's some, there are some really extraordinary things the United States does particularly well. I'm a little biased, but I think higher education is one of the extraordinary things that we do quite well. And we know that because we see the flows that come into this country.

And the question is, how do we use the information we have to hold our leaders to a higher standard on things like delivering better outcomes on everything from health care to fiscal policy?

MS. WROUGHTON: One thing that, when I read your book, I thought to myself, well, you know, as a South African, and has lived all over Africa and Eastern Europe, I can't help but think that the political structures in these developing countries seem so much easier to deal with. You know, is there all that much debate going on? I mean, I know, now if you look at Egypt, for example, there's a lot of debate going on.

But it seems to me that it was so much easier for governments to put in place these policies. I mean, there was rioting in the streets, and so on, but there was a -- you know, they didn't have to deal with a congress in all these places.

Have I got --

MR. HENRY: Well, I mean checks-and-balances have pluses and minuses.

MS. WROUGHTON: Yes.

MR. HENRY: It's certainly -- I mean, take a country like, I mean, Jamaica's a good example, right? So you've got a parliamentary system. And so you have a leader in power who can more or less, for a period of time, get changes through fairly easily. But Jamaica in the 1970s, that freedom was used very irresponsibly, and drove Jamaica into recession for essentially a decade and a half. So, I think, you know, that there's probably a minor adjustment of Churchill's quote about democracy that applies here.

So, I think the main lesson is, whether you're in a parliamentary democracy, or a system of checks and balances like the United States, I think we can look at large democracies around the world that have made changes -- whether it be, you know, I mean, look at Brazil. I think as late as 1992, I think if you -- people were not very hopeful about Brazil. But somehow they found, as Domenico pointed out earlier, the leadership to actually make some tough choices and move forward.

So, I don't think, I'm not willing to accept that our system of checks and balances, which has served our country really well for over 200 years, is the root cause of our inability to move forward.

MS. WROUGHTON: Uri, you have a thought?

MR. DADUSH: Yeah, yeah, Lesley, on this.

MS. WROUGHTON: And then I'm going to turn it over to the --

MR. DADUSH: Yes, on this -- you may actually have it exactly wrong, Lesley.

MR. HENRY: I'm glad you said it to Lesley, not to me.

MR. DADUSH: You may actually have it exactly wrong. Sometimes I think that the reforms, the wave of reforms that we have seen in developing countries in the last 20, 30 years, have something to do with the fact that as people become more aware of what's going on, they become more connected to the world, their incomes begin to rise, et cetera, they ask for more. They ask for more. And the leaders, you know, then actually find it impossible not to take some of these steps that need to be taken.

So I believe that the guys in the middle class in the developing countries are a very important driver of these reforms, of these demands. And in the end, people vote with their feet. All the high-income countries of the world, virtually without exception -- I used to be able to say Singapore was an exception -- virtually without exception, are democracies. So people converge towards that.

And it's kind of part and parcel -- you know, it's my theory, I haven't demonstrated it or, you know, econometrically, but it's my thesis that these things happen together. There is a rise in income, there is a democratization, there are pressures, and there is more democratization.

Unfortunately, at the end, you end up with a lot of democracy, and still, in many cases, very large economic problems -- you know, of the ones we have been discussing in the advanced countries. And that makes it more complicated.

But here's the good news: At least you're doing this from a level of per capita income of $50,000 a year, instead of $5,000 a year.

MS. WROUGHTON: All right.

I'm going to open it to the audience. Is there a microphone?

Here -- your microphone's coming.

SPEAKER: I am a novice. I don't know what economics means. Forget about even spelling it. And I'm not interested in learning it, either.

But it has been a very educative experience for me to listen to this conversation.

But I still have an uneasiness with the whole premise on which you have just talked, about this idea of what advanced countries can learn from the developing countries, based on the three principles you've mentioned. First of all, I think much of the advanced -- and I only read newspapers, I don't read scholarly books, maybe I will now, but I haven't read -- so my impression is it is not certain that this economic growth which has taken place in various countries we have been thinking about, or talking about, is persistent. It seems to me it is a leadership-dependent phenomenon -- although you just mentioned it is the people who demand -- good luck for you.

So, I'm always concerned that maybe this is not going to be a long-lost phenomenon.

So you made three points. You made the point of discipline -- right? You made the point of clarity. And you made the point of trust.

I'm not sure there is any historical or cultural tradition in many of the countries you were just talking about for any one of these elements. I think, you know, you talk to people -- and I haven't lived in third-world countries, so I don't know any of this personally -- but, really, I don't think they have this idea of discipline that, okay, we make a decision, we stick with it. I'm assuming you (inaudible) that if things don't work out, we could change. It is a monotonic decision.

MS. WROUGHTON: What is the question? Because we're getting --

SPEAKER: Yes. So, I'd like to ask you -- I don't want you to make a complicated argument for all these elements, but are you convinced in your mind that these three elements can be the basis for us to learn something from developing countries, applicable to us here?

MS. WROUGHTON: Is it sustainable, what's going on?

MR. HENRY: Yes, I'm convinced if you go back and look at the last three-and-a-half decades, the common threads that tie together all these experiences of successful turnaround is -- and, by definition, they were sustained, right? That's what turnaround means. The common three threads are discipline, clarity, and trust.

MS. WROUGHTON: So, do you think it is sustainable that these economies continue to grow at this rate? I mean, we're talking about this, there's already some kind of, you know, it looks like some slowdown going on in -- well, there is a slowdown in China.

How sustainable is this, Domenico? I mean, can they continue to grow at these rates? Which is needed to lift, you know, millions out of poverty.

MR. LOMBARDI: Well, clearly, that's a very tough question. I mean, certainly, especially economies like China and India, they have a huge potential for doing so for the years to come. But clearly, again, as we were talking before, I think they will have to change tack. They will have to shift gears. It doesn't mean that, you know, they're going to shift their end objective, but they will have -- their policy framework will allow for that.

And, you know, if you look at, right now, China is suffering a lot from the slowdown in Europe, or even the contraction we are witnessing in Europe, their export largest market. And, clearly, the uncertainty that the U.S. is going through.

So, if anything, this is going to push more and more the Chinese authorities, I believe, to where it's, you know, relying more and more on domestic sources for their own growth.

So, again, it will depend very much to the extent they will be able to (inaudible) as they have been doing pretty well so far.

MS. WROUGHTON: We have a question here.

SPEAKER: I love the free dynamics of stability -- sorry, discipline, clarity, and trust. They match most of the criteria my father used at the *Economist* for 40 years.

The two other ones he would maybe add would be: Always be pro-youth. For example, if you bail out old people's debts by putting young people out of jobs, that's not pro-youth.

And the fifth one would be, you know, map back the future from big win-wins, because financial transactions are often very zero-sum.

If you can't use the extraordinary time we own at the moment to unite the world around some bigger win-win goals.

So my question to you would be: Please don't write another book. Could you develop a mook so that millions of young people could share your constructs, and at least build with them? Because everyone needs to debate your ideas, I think.

MS. WROUGHTON: What -- that actually raises a question, you know, about the youth? I mean, all these young, unemployed people in many of these developing countries, you know, what's going to happen?

MR. HENRY: It's a great question, and a great point. So, let's leave the mook aside, but let me sort of generalize.

I think your general point is this point about how do we raise expectations? And I think raising expectations of the youth is critical.

SPEAKER: And involve young people in your debate.

MR. HENRY: Yes. Absolutely. And I think one of the ways in which we can hold our leaders accountable, frankly, is to get young people to care more about these issues.

So, I'll tell you about one movement which is currently going on, which I wasn't aware of it until just a week-and-a-half ago -- there's a movement called "Up to Us" in the United States, which is a movement across, I think it's five different universities. NYU is a part of it. And they're a group of, you know, 18 to 22-year-olds, undergraduates, are educating other undergraduates and young people about, frankly, the issues you just mentioned: the ways in which we're mortgaging the future of the youth on policies today, and raising awareness to get people to get out and vote and make noise about these issues.

And this is particularly important in the context of developing countries. We were talking earlier about the importance of youth unemployment, particularly male youth unemployment, is one of the most dangerous things you can have to jeopardize our country's future, because of the way it feeds into crime, low expectations, and other things.

And so I think your point is well taken. One of the reasons for writing the book, frankly, and what I hope to do, is to raise awareness of these issues precisely amongst the younger generation.

MS. WROUGHTON: Another question? Oh, I'll get back to you in a minute.

SPEAKER: Hi. If I can raise two related questions --

MS. WROUGHTON: Can you identify yourself, please?

SPEAKER: I'm Joe Guggenheim, just an interested person that retired.

Two related questions -- one is, do we really have to worry, in this country, about whether the national debt is 60 percent versus 80 percent of the GDP, given the fact that we have low inflation, and the experience of other countries around the world?

And my second question is, how does China do it? They seem to be investing an awful lot, and their whole history, their growth has been stimulated by direct investment, it seems to me, in infrastructure, and commercial manufacturing, and residential development. How do they finance that? Do they worry about budget deficits? Or do they have corporations, state-owned corporations that can finance it without having to worry about what the debt is within the government structure?

MS. WROUGHTON: Professor -- and I'll come to you, Zeno -- the reinvestment in infrastructure allowed China, in many ways, to deal with its constraints.

MR. HENRY: Well, I think Uri made the point very well. I mean, there are a lot of countries that would love to have the United States' problems. If you look at the interest rate, long-term interest rates, or bonds are about 2 percent. You've got -- even a debt at 100 percent of GDP, it's really not a terribly onerous borrowing cost.

So, the question that it really comes back to, the issues that I think that Uri and Domenico raised, how do we use our spending more efficiently?

MS. WROUGHTON: Domenico or Uri -- I don't know who wants to take this question -- but do you, I mean, when you look at the developing world, a lot of them were forced to live within their means because they couldn't then get the capital, you know, to develop. You know, they were held accountable. And I think the stock market thing comes in, although I look at the stock market these days, and I wonder what they're reading -- you know, record highs with stock markets, meanwhile there's a whole debate on sequester.

So, Domenico, any thoughts on, you know, how does China do it? Does this matter?

MR. LOMBARDI: Well, I think, you know, of course, if China develops farther, they will have to tackle the issue of, you know, having financial markets more efficient, the better (inaudible), with a better supervisory framework.

And, you know, again, there's a lot of talk about re-internationalization of the renminbi. If this is ever going to happen -- I mean, not that the renminbi can replace the dollar at any time at least in my life, but if this is ever going to happen, of course, China will have to work, you know, this more sort of governance-related aspects. Because otherwise, it's going to be really unable to sustain, you know, capital flows, and really become a premier economy in the world also from a financial standpoint.

Just picking up on one of the previous questions, you were asking about should the U.S. care about the debt, about whether it's 80 percent, 90 percent.

I mean, clearly, the U.S. is a very peculiar case, because the U.S. issues their reserve currency. So in the U.S., this concern is -- how can I say it? -- less overwhelming. But this cannot be readily generalized to the other, you know, advanced economies, or even developing economies.

If we look at the euro area, for instance, you know, it's a little bit like, for those countries, it's a little bit like issuing debt in a foreign currency, because they don't have their own central bank. Not completely like that, but very close to that. And, clearly, this is why, you know, debt ratios that once we thought were sustainable do not look like sustainable anymore, just because these countries face potential refinancing problems because of the lack of their own central bank.

MS. WROUGHTON: I want to get to the gentleman at the back.

MR. AMERICA: Hi. Dick America, Georgetown University School of Business. Hi, Peter.

MR. HENRY: How are you?

MR. AMERICA: The quality of management in the developed world -- some of us, myself included, believe that's a key constraint on progress. Would NYU put a branch in Sudan or Central African Republic? I'm being facetious about those places, but in Africa, upgrading the quality of management is crucial. I've been to Gibbs and Witts many times, in Johannesburg.

What is your view on how to accelerate the improvement in management quality, in Africa and elsewhere?

MR. HENRY: That's a great question.

So, again, I think to your point, Dick, the American higher educational system is, I think, one of the things that we do best. And our view is we want to continue to attract students from around the world. And the good news -- I mean, the bad news is, as you say, there's a long way to go. But I think the good news is that the marginal product of even just a few newly trained leaders in Africa can be extraordinarily high, because the stock is so low.

So, it's a priority for us to continue to attract the best students from wherever they are, particularly in the emerging world, irrespective of their need to pay. And we think we can make an enormous contribution over time if we stay focused on that.

MS. WROUGHTON: We have another 10 minutes to go. We don't want to keep you here longer.

Let's have a question -- there, thanks.

SPEAKER: Peter, I thought this was a terrific book and presentation. Thank you.

Just reading from the dust-cover, Bob Solo says, "Peter Henry had the original thought that the experience of emerging economies may contain lessons for advanced economies. He shows that they do, but not in any crude cookie-cutter way. The vital common thread is the capacity to form a future-oriented policy and stick to it with discipline. This is why we, all of us, need grownups."

You've been an advisor to the President and on the Transition Team. Do you have -- could you -- do you think we have enough grownups? It seems like we don't right now.

What might advice you give to Obama or his administration to try to increase the ability to behave like grownups, at least.

MR. HENRY: That's a great question.

So, I think, if I could, I'd like to borrow an example from the tiny island of Barbados here. So, and I won't give a long story, but basically if you go back and look in the book, there's a story in there of how Barbados overcame economic crisis in 1992 by forming bonds between the private sector, the government, and the unions. And the key to that was communication and conversation, and finding a way, in a very difficult situation, to have conversations about forming some kind of a social compact.

And I think the President has already begun to take important steps by having conversations. And I think it's going to be critical that we focus on principles of where we want to go before we get into, get mired in details which can get us locked into the traditional sort of ideological positions.

So, the short answer is, you know, the book is about economic policy, but it's also about relationships -- and relationships matter deeply. And so whatever we can do to build better relationships across the parties -- I mean, personal relationships. And I don't mean that in any inappropriate sense. But the ability to make hard decisions is critically enhanced, again, by trust, and trust comes from having better relationships.

So I think the President has started to try to do that. And it's not just a week's worth of lunch -- again, it's going to be a long road.

MS. WROUGHTON: Let's talk about the relationship between the north and the south, I mean, as far as allowing developing and emerging economies to have a greater say.

You're seeing that, you know, there is resistance. You know, Domenico knows, I've followed very closely governance issues in the IMF.

MR. LOMBARDI: Yes.

MS. WROUGHTON: I mean, you look at that relation, and there is very little trust. And there is also very little trust among the developing countries and the emerging economies, you know, which is why they can't agree to stand behind one emerging economy.

How do you see, you know, that trust being developed?

MR. HENRY: So, very good points.

I think there are two things that have to happen, as Domenico pointed out: One, you have to have better relationships between the north and the south, as you put it. But the south also -- or the former third-world, the emerging nations, have to think very seriously, "What is it that we want?" Right?

And so, again, the responsibility, the responsibility falls both ways here. It's two-way learning, two-way listening, two-way responsibility.

MS. WROUGHTON: Is there a danger at some time, you know, when there is a crisis, that countries look inwards, and there is a concern that, you know, that the U.S. is just focused on what's going on in the U.S. and, you know, should continue to look out, as well?

Uri, do you have a comment on that?

MR. DADUSH: Yes, I think it's absolutely --

MS. WROUGHTON: Especially when you look at trade policy --

MR. DADUSH: -- fundamental.

MS. WROUGHTON: When you look at trade policy?

MR. DADUSH: I think it's absolutely fundamental.

You look at the situation in Egypt, we were talking about. Twenty years ago, the United States would have had the capacity to do a lot more in Egypt. The European Union -- or, not the European Union, a concert of European powers would have had the capacity to help more. I'm not saying they would have solved the problem, but they could have done a lot more.

Now, we have the three -- okay, include Japan. Forget Japan. Japan is in trouble. But the United States, very inward looking, deep internal problems, very, very deep internal problems, largely of its own manufacture. And Europe, the own-goal of the euro, and other issues, and they're very inward looking.

And this is fundamentally important, because -- and I think, actually, putting a lot of the emphasis on the divide between developing and advanced countries is a bit misleading, because I have often sensed, in international discussions, negotiations, et cetera, et cetera, that the developing countries may very well be looking for leadership -- particularly, even today, particularly, I would say, from the United States, which has a lot of special things going for it.

But, you know, I mean, the United States has to be willing -- interested and willing to project its power, and be less absorbed by its own divisions.

MS. WROUGHTON: Even though it doesn't have the money or the might.

MR. DADUSH: Well, the money is a big problem. I think the money is a problem. And so, the money is a problem in two ways: A, because money is often needed to do stuff internationally, and it gives you a lot of weight, if you don't just talk about expanding IMF resources, but you actually contribute in a very significant way, et cetera, that makes a big difference -- or whatever you talk about, the Middle East crisis.

But money is also important because it's the shortage of money internally that is making the United States so divided, and makes it very, very difficult to project.

You know, this is not a completely new issue, right? But I think it's become more of an issue, much more of an issue, because of the economic problems, because of the inequality -- and, to a degree, because of the fact that now, you know, the challenges, the external challenges facing the United States are just not as prominent as they were during the Cold War. They're significant, but it's not in the same class of problem.

MS. WROUGHTON: Domenico, you wanted to --MR. LOMBARDI: Yes -- so, I wanted to pick up on this issue of the U.S. role in global governance. And I do think that this is critical, because what we have seen, you know, really in the latest few years is that when the U.S. has decided to engage, we did see some visible improvement in global governance.

Just a couple of examples: We wouldn't have the G20, as we have it today, without the decision made by President Bush to convene in Washington the Washington Summit. At the time, you know, it was the first Summit, so they didn't call it "G20 Summit," but it was essentially the same thing. And the subsequent decision by President Obama to institutionalize that summit -- and, more importantly, to pour all the U.S. political capital into that. Without that, we wouldn't have the G20 essentially, you know, having sort of replaced, in many ways, the G7 -- not completely, but in many ways -- and, giving the developing economies, emerging economies, an important platform through which to interact with, you know, Western leaders.

One more thing -- the G20 is not just the G7 plus whatever, 12 more countries -- because, it's 19 countries, not 20. But it's a different approach because, really, it is a forum that includes the heads of the international financial institutions. Never in the IMF history the IMF Managing Director has, you know, talked on a regular basis with the U.S. President, with the Chinese Premier, and so on and so forth.

And I think this is, you know, a fundamental improvement. Even if we don't have, as we spoke before, a ready outcome from each G20 -- you were mentioning "trust." You know, you have to know each other.

MR. HENRY: Yes.

MR. DADUSH: And the very fact that these leaders come together at least one a year with the heads of the international organizations is something that we should not underestimate.

On the money issue -- sorry, just two seconds -- you know, the very idea launched by President Obama, of building a big U.S.-EU trade area, you know, I think this is, again, very important. It doesn't mean that the U.S. has to put fresh money on the table, but this is, again, something that, of course, is going to be looked at as a potentially interesting growth driver in Europe, and even here in the U.S.

MS. WROUGHTON: Well, I'm going to try and impose self-discipline here and end this right now.

And thank you very much to Professor Henry for sharing his thoughts with us. Thank you to Uri Dadush, Domenico Lombardi. And thank you for your time.

Go out and get the book. It's all in there. (Applause.)

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I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

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