

Mario Draghi: In memory of Enzo Grilli

Memorial lecture by Mr Mario Draghi, Governor of the Bank of Italy and Chairman of the Financial Stability Board, at the Johns Hopkins University, Bologna, 21 February 2011.

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1. Introduction

Enzo was not a neoclassical economist, or a Keynesian one, a conservative or a liberal. What I miss most is Enzo's tendency to challenge intellectual clichés and fads, which made every conversation with him a learning and eye opening experience. He was a truly independent minded person and scholar, passionate at defending his opinions but ready to accept others' points of view, if based on sound economic thinking or empirical research. He was a strong believer in free trade but also a firm advocate of market regulation. He defended the global institutions at the time of the antiglobal movement but also openly criticized the influence that the main shareholders exert on those institutions.

Enzo held important leadership positions both in academic institutions and international organizations. As an official or government representative in these organizations he always resisted political pressures on the decision making process, a factor that made his life difficult on many occasions, but which helped him gain high respect. His brief experience at the Italian Ministry of Budget in the early eighties was one of these episodes. He had a distinctive ability to *combine research with actual policy making*. In his own words, "the two aspects – theory and economic policy – cannot be distinguished too clearly from each other"¹.

Most of Enzo's life was spent in the US but he remained passionately attached to his own country with which he communicated mainly through his opinion pieces on the "Sole 24 Ore". His last book, "Crescita e Sviluppo delle Nazioni" was written in Italian in order to "enhance also in our country the reflection on economic development, whose presence or absence has fundamental consequences for "humanity"².

2. The environment, economic and institutional

Enzo Grilli's thinking as an academic was certainly influenced by his unique exposure, during his many years at the World Bank and particularly in the mid-nineties, to the debate on the evolution of the world trade system with an increasing number of developing countries.

Enzo was a convinced supporter of multilateral trade liberalization. This process culminated at the end of 1994 with the conclusion of the Uruguay Round and the subsequent establishment of the World Trade Organization in 1995. For the first time developing countries committed to partly opening their markets and to well-defined international trade rules; in exchange, they could benefit from more open export markets and a greater possibility to protect their stakes through the new mechanism of trade dispute settlement.

However, the Uruguay Round Agreement left open a number of unfinished issues: large agricultural markets in rich countries are still relatively closed; international trade rules are costly to abide by for a number of developing countries; poor countries need foreign aid to develop their supply capabilities and engage successfully in international trade.

¹ "Prospettive sullo sviluppo economico dei paesi emergenti", Banca Popolare dell'Etruria e del Lazio – Studi e Ricerche, 1999.

² "Crescita e Sviluppo delle Nazioni", Libreria UTET, Torino, 2005, page VII.

The Doha Round of multilateral trade negotiations, which was launched in 2001 was partly devoted to address these issues. Yet, negotiations have been stalemated for a long time. As stressed with foresight by Enzo³, the failure to conclude the Round poses dangers, particularly in two respects. Firstly, by inducing as a defensive response a more widespread pursuit of bilateral and regional trade agreements it could result in a loss of bargaining power of the weakest and poorest countries. Secondly, a failure could threaten the very process of rebalancing of the global economy in which the international community is engaged.

3. Enzo Grilli's analytical contributions

Enzo firmly believed that international trade by contributing to economic development could significantly reduce poverty by fostering specialization of national production of goods according to countries' comparative advantages and by increasing knowledge that would help less developed countries to overcome their significant technological gaps.

Enzo stressed particularly two facts. At the global level, greater efficiency of production raises the return to capital. At the national level, trade in capital-intensive commodities tends to equalize the domestic and global return to capital. Both effects stimulate investment, which is an extremely powerful engine of economic growth. The spectacular performance of export-oriented economies mainly in East Asia is a good example of how trade can unleash economic development.

The importance of trade was confirmed during the recent crisis. World trade collapsed in 2009 as a consequence of the recession, then recovered to pre-crisis levels, and it is poised to revert to strong trends. World economic integration is continuing. Emerging and developing countries have become engines of growth for the economy of the world. According to World Bank's estimates about 60 per cent of the increase in world trade in the recovery has been brought about by the rapidly growing demand from emerging countries, especially for capital goods and consumer durables. The surge of those exports has been an important contributor to the recovery in high-income countries, in particular in Germany⁴.

In order to help transform the aftermath of the crisis into an opportunity it is necessary to proceed now more than ever to the structural reforms already envisaged by Enzo Grilli in a number of articles. Reforms capable of enhancing high and sustainable growth rates in developed as well as in developing countries, which may also be conducive to rebalancing of domestic absorption in deficit and surplus countries, most notably US and China.⁵

He emphasized accumulation of human capital, education and Research & Development as essential elements to raise countries' productivity and to drive endogenous technological change.

In his analyses Enzo devoted much attention to China. To sustain high growth rates, China should move, he argued, on to a new development phase where accumulation of human capital would outpace that of physical capital. In the process a desirable rebalancing of the supply side of the economy (from manufacturing to services) would be coupled with a parallel development on the demand side (a rise in workers' incomes and in public and private consumption)⁶.

Enzo was also a passionate communicator. Whether in an IFI's boardroom or in a classroom he liked to establish a dialectic exchange with his interlocutors. It was only natural for him to

³ "Ritrovare la spinta del mercato". Il Sole 24 ore, November 12, 2005.

⁴ World Bank "Global Economic Prospects", January 2011.

⁵ See for example "Sugli USA il peso di tutta la crescita"; Il Sole 24 ore, April 20, 2006.

⁶ "Cina: la corsa e il rischio di una brusca frenata"; Il Sole 24 ore, September 5, 2006.

extend his audience through a regular collaboration with the main Italian newspapers, and since 2002 as a regular contributor to *Il Sole 24 Ore*. For over a decade he engaged in a dialogue with the public opinion, a fact that, following the example of Luigi Einaudi, was only common to a handful of Italian policymakers and academics. The word “dialogue” truly characterizes his newspapers contributions both for their frequency, almost monthly in his later years, and for their structure, a series of short questions and longer answers, that is mindful of Socratic conversations. The occasional reader was always provided with a key that helped him understand in a plain language the essence of the often complex technical and political issues being debated in international fora.

What were the dominant themes of these conversations? Perhaps oversimplifying, I would select three subjects which stand out both for their recurrent nature and for their relevance today.

A first subject, raised in his commentaries of G7 meetings or other important international gatherings, was the issue of coordination (or lack thereof) of economic policy decisions by major global players. Here he was often concerned with the inadequate or delayed European response to the global challenges that often left the US as the dominant or the only player. For example, at the time of China’s negotiations for admission into the WTO he complained for Europe’s notable silence or absence at the negotiating table. Similarly he was concerned with Japan’s protracted stagnation, which he attributed to the disconnect of politics from economics in that country, with the result of silencing another important player.

A second item of Enzo’s articles was debt management at times of economic crises where he suggested greater market involvement in sovereign debt restructuring through those very Collective Action Clauses (CACs) that are now being considered for future Euro area sovereign debt issues. Similarly, he took strong positions regarding the debt relief proposal for highly indebted emerging countries launched by the then UK Chancellor of Exchequer Gordon Brown and approved by the G7 and the IFIs. His view was that the accumulation of an unsustainable debt is in most cases the result of a wrong policy stance and that debt relief should therefore not be granted if the country had not taken a firm commitment to reverse that stance.

A third recurrent subject of Enzo’s articles, not surprisingly, was the IFIs themselves: their effectiveness and their governance. He defended IMF policies during and after the Asian crisis, at a time when the IMF was under heavy attack due to its crisis management strategies on the fiscal and on the monetary front. He claimed that in a world of free capital flows the IMF required a new mandate to be able to effectively pursue crises prevention and management. Such a mandate should encompass new information requirements, additional monitoring powers, as well as access to a broader volume of resources. All these issues are still at the top of the IMF reform agenda. No matter how passionate his defence of IFIs was, Enzo considered IFIs’ criticisms “a normal and even a positive fact” because of the IFIs’ own mandate to pursue public goods with public money.

In fact, Enzo was himself often on the critic’s bench, as when he vividly criticized the World Bank for lending to middle income countries without proof that these loans would achieve better and more effective (additional) development results than commercial loans. For those familiar with the aid debate, Enzo’s point was an early call for the certification of “additionality” of aid money.

To the IFIs’ governance Enzo devoted a paper, jointly written with another friend that prematurely left us, Riccardo Faini. The question raised by the paper’s title (“Who runs the IFIs?”) was addressed with straightforward intellectual honesty asking the data to reveal whether IFIs’ lending was aligned with the financial and commercial interests of their most influential shareholders. The empirical evidence showed the US influence to be pervasive, while Europe appeared to limit its influence to its trading partners and Japan to Asian countries. Despite the unequal distribution of power, coalitions were nevertheless necessary to run both IFIs. He and Riccardo really foresaw the debate on the reform of the IFIs.

Shouldn't developing countries' voting power be better aligned with their economic weight? Should the objective of greater weight be pursued by promoting regional initiatives, such as the proposal of an Asian Monetary Fund? Could new broader groups such as the G20 provide a better coordination?

After the crisis there is a growing need of coordination of economic policies in order to reduce instability and uncertainty. Several international fora can coexist and usefully complement each other. The G20, even though it has no universal membership, has been particularly effective on a broad set of policy issues even before they are submitted for discussion to the boards of the International Financial Institutions. Recent experience in Europe has also shown how regional institutions like the EFSF can usefully collaborate with the IMF and can greatly leverage the IMF funds.

4. Conclusions

These few thoughts about the life and work of Enzo Grilli bear witness of his eclectic approach to discipline of economics, as well as of his intellectual and moral integrity.

He once claimed that “economic growth, which is an essential condition for development, is not a mysterious process (...)”. Of course, this does *not* mean to say it is mechanical. In fact, he remarked that “understanding its diffusion (...) represents maybe the most important challenge still open”. This calls for a firm commitment to continue the work that he pursued for a whole life. The ultimate goal is “human progress, better quality of life, the chance to free ourselves from the fatal tyranny of ignorance and from the chains of poverty.”⁷

⁷ “Crescita e Sviluppo delle Nazioni”, page VII.