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# THE BUSINESS TIMES

## The business savvy professor

2,251 words  
3 November 2007  
Business Times Singapore  
English  
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VIKRAM KHANNA meets Nobel laureate Michael Spence, who straddles the worlds of academia and business

IT'S rare enough to meet a Nobel Prize winning academic, but even rarer to meet one who's actively engaged in the real world of business, who can speak the language of the boardroom and the classroom with equal ease.

Up to a point, the resume of Michael Spence, who won the Nobel for economics in 2001, reads like a blue-chip, hard-core academic's, just as you would expect. Among the positions he has held: Professor Emeritus of Management at Stanford Business School, where he has also served as the dean; and prior to Stanford, dean of Harvard's Faculty of Arts and Sciences as well as head of the economics department. Educated at Princeton, Oxford (where he was a Rhodes Scholar) and Harvard. Winner of various awards for excellence in teaching and contributions to economic thought. And of course the Nobel, for his work on information theory.

But then his resume takes an unexpected turn. You read that Mr Spence is also a partner of a California-based private equity firm, Oak Hill Capital, where he has initiated and managed a number of high-technology investments. And he has served on the boards of corporations like Nike, General Mills, and the Bank of America - as well as 'new economy' companies, such as software firms Seibel Systems, and Sun Micro, and MercadoLibre, known as the 'eBay of Latin America'.

He says he finds his private sector involvement useful. 'You get to see the investment environment in lots of different places in a very concrete and practical way. For example when I go on the board of a business process outsourcing firm I get to see how that works.'

Mr Spence's ability to straddle academia and the real world of business says something about him - and perhaps helps explain why he seems so down-to-earth - but it also reflects a unique value system, which isn't common in Asia or Europe. 'We have constant movement between the two worlds: academics move into business and then back to academia. And people respect top-flight academics, but they also respect top-flight business leaders. I guess the underlying attitude is that you can't really classify people. You can say so-and-so is smart. But there is no permanent difference between, say, a banker and a professor.'

One of Mr Spence's current preoccupations is serving as the chairman of the World Bank-sponsored 'Commission on Growth and Development', which aims to come up with practical policy ideas to foster economic growth and reduce poverty. It is to present its findings by the end of this year. Among the commission's 20 members is Singapore's Senior Minister and MAS chairman Goh Chok Tong, as well as other key policymakers from China, India, Korea, the Middle East, Europe, Latin America and the US.

I ask Mr Spence how this commission is different from the many others with a similar mandate that have come and gone.

'I don't think I care, as long as it's useful,' he says. 'But it is different in some quite obvious ways. One is that all the members on the commission belong to countries that have either developed recently or are in the process of developing. So, it's people with relevant practical experience.'

'The purpose is try to be helpful in practical ways to policymakers who have this big challenge to try to develop the politics, strategies and policies to jump-start and sustain high growth.'

'One of the things we're trying to do is summarise the state of the art on policy. In some cases, we're going to have to say we simply don't know. And there's a lot of disagreement on important areas, like how you should manage your exchange rate, how fast you should open your economy, in what sequence.'

'Our aim is to just be honest. For a leader of a developing country who is listening to all this, the message is: there isn't agreement on everything, you're making decisions under uncertainty, but here are the pros and cons of the decisions you're making.'

Mr Spence points out that the state of the art on policies to promote economic growth has changed. 'The prevailing view of the 1990s - and I am going to stylise it - is this: Governments should maintain macroeconomic stability, follow responsible fiscal and monetary policies and let the private sector take care of the rest.

'That was the 1990s prescription. But those countries that more or less followed it didn't grow, while those who more or less didn't follow it did grow. The fact is that it was a way-too-simple view of the role of government, politics and political leadership. It didn't answer some obvious questions, like why have some countries just not started, why have others stalled.

'Most people think economic development is about getting richer. Well, that's part of it. The other part is that all the sophisticated market, governmental and other institutions that you associate with an advanced economy are in the process of being developed. We don't know much about how that happens.

'You've got to be pragmatic and experimental, because you're not really sure; you try something out, and if it doesn't work, you try something else. It's not that you throw a theory out, but you use it with circumspection. And you're a bit gradual.

'Look at China. In the early stages of their growth, they didn't go much by orthodox theory. And for good reason: they didn't have a market economy. Even today, their financial sector's relatively immature, so it would be unwise to throw it open suddenly to global economic forces.

'The prescription 'get the macroeconomics right and open up the economy, the private sector will take care of the rest' - the heart of that is in the right direction; there is no sustained high-growth economy that isn't an open economy. But the problem with it is the marginalisation of government and the attempt to severely limit its domain.'

And that is a problem, he says, because without an activist government role, institutions do not develop, and that in turn handicaps an economy.

'In the US or any advanced country, there are a whole set of institutions, some private, some public, some NGOs. These institutions all work together in a system. Now suppose the President of the US doesn't appoint very good economic policymakers. It doesn't really damage the system very much. Or if the Federal Reserve doesn't do a very good job, it probably wouldn't bring Silicon Valley down; we'd probably still generate a fair amount of technology.

'But if Singapore had someone other than Lee Kuan Yew in the 1960s, we probably wouldn't be here. The institutions, a country's leadership, its insights, its skill, its ability to mobilise people, all that is really very important, and much more so at the early stages than later, when the institutions take over. So, in a developing country, if you've got a big enough mess, with bad leadership and bad government you can lose a decade in terms of growth and poverty reduction. And there aren't as many defences.'

There are other problems with the 1990s orthodoxy, says Mr Spence. 'The orthodoxy says industrial policy is rubbish, because governments just make mistakes. So, under that theory, you can't have special export zones, you can't have any guessing at which industries you might be good at.

'Sure, there's lots of ways to make mistakes in those areas. But for me, they don't add up to the government saying 'we should never do anything on industrial policy'. Because there's too much evidence that sometimes, governments actually get something started. Singapore is a classic case in point. So the key learning here is that you undo mistakes when you make them, not that you don't do anything.'

Mr Spence also points out that when it comes to strategies for growth, a one-size-fits-all approach won't work. Even the same country needs to follow different strategies at different times.

'Every country's different, every five-year interval is different,' he says. 'Take Korea. It used to be an autocracy. They grew successfully and fast enough to create a large middle class. Then the middle class began to demand a political voice and in the 1980s, they had to change the political system. So if the journey you're on is 50 years long, even the same country has no single formula to rely on, because the economy and the system keep changing.

'If you take a snapshot of a rapidly growing developing country every ten years, it looks very different once you look below the macro level, at the actual economy. You'll see that things are being created and destroyed at a tremendous rate. Twenty-five years into a high-growth episode, the labour-intensive

manufacturing starts to disappear. After 35 years, it's all gone. All the sectors in the economy that drove the growth in the past, just gone! That's the nature of growth, it's a complex, chaotic, dynamic process.'

I ask Mr Spence about the impact the rise of China and India will have on the world.

'For my kids, it's going to be the main event,' he says. 'In 20 years we're going to go from under 20 per cent to more than 60 per cent of the world's population living in successful, optimistic, or rich societies, or all of the above - assuming nothing goes wrong.'

'Second, and this will be increasingly true, but China is now already big enough to matter. Ten per cent growth in China is about the equivalent of 2 per cent incremental growth in the US, and that 2 per cent number will get bigger and bigger.'

'There's no question that the rise of China and India is going to change the balance of power and change things that influence peoples' lives. People are going to have to become more knowledgeable about these countries. And in terms of global governance, they're going to have a much larger voice than they have today. All of those things are on the cards.'

'Right now, these countries are viewed more as a threat. If you ask the average person in an advanced country about China and India, they think, 'loss of jobs, low-cost'. They certainly don't think, 'major economic partner'. But in 10-15 years from now, the latter will be the majority view.'

Our conversation turns to another megatrend. As an expert on the economics of information, how does Mr Spence assess the likely economic impact of the Internet?

'The impact is evolving very fast,' he says. 'I would categorise it into three parts. One is the automation of information processing services. Every database can be connected to every other database. That automation is used by companies, for example in supply chains. And that affects efficiency, it's a major driver of productivity, takes error, cost and time out of systems. It shortens global supply chains by a factor of three to five. So that's one very big effect.'

'The second one is the cost of finding things and doing transactions has crashed. Earlier, a serious researcher would spend maybe 70 per cent of his time looking for data, 30 per cent analysing it. Now, it's probably the other way round.'

'So we're more productive, even though we can't measure it exactly.'

'Or take the delivery of government services. In California, I had three cars, they had to be registered every year. I had to go to a government office three times a year and the lines were very long. That meant three half-days away from work. Now I do it on a Saturday afternoon and it takes me 40 seconds per car.'

'The Internet also changes the information structure of markets. It's still true that a guy on a used car lot can sell you a bad car, because he knows more about the car than you do. But now, you can find out a lot about his reputation, at very low cost. Anyone who sells anything, they know that people are much more knowledgeable about what they're buying, they can compare. So the effect on the information structure of markets is quite dramatic. Same with financial products: you can now do a ton of homework that was very expensive to do before.'

'The third category is that the Internet makes human resources - regardless of where they are located - usable and accessible. That's the trade in services, the Indian IT business process and outsourcing story. It's about the collapsing of the boundaries of the labour market in certain sectors. It's about new collaborations being possible. It's about finding and using resources whose cost in the past was simply too high. That may be the biggest effect in the long run.'

But all that said, Mr Spence is characteristically cautious, and intellectually humble. 'If you ask me, economists still don't have the models to fully understand the Internet yet,' he says.

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