

*Dynamic Development:
Innovation & Inclusion*

Lecture 2:

Lessons from Development Experience

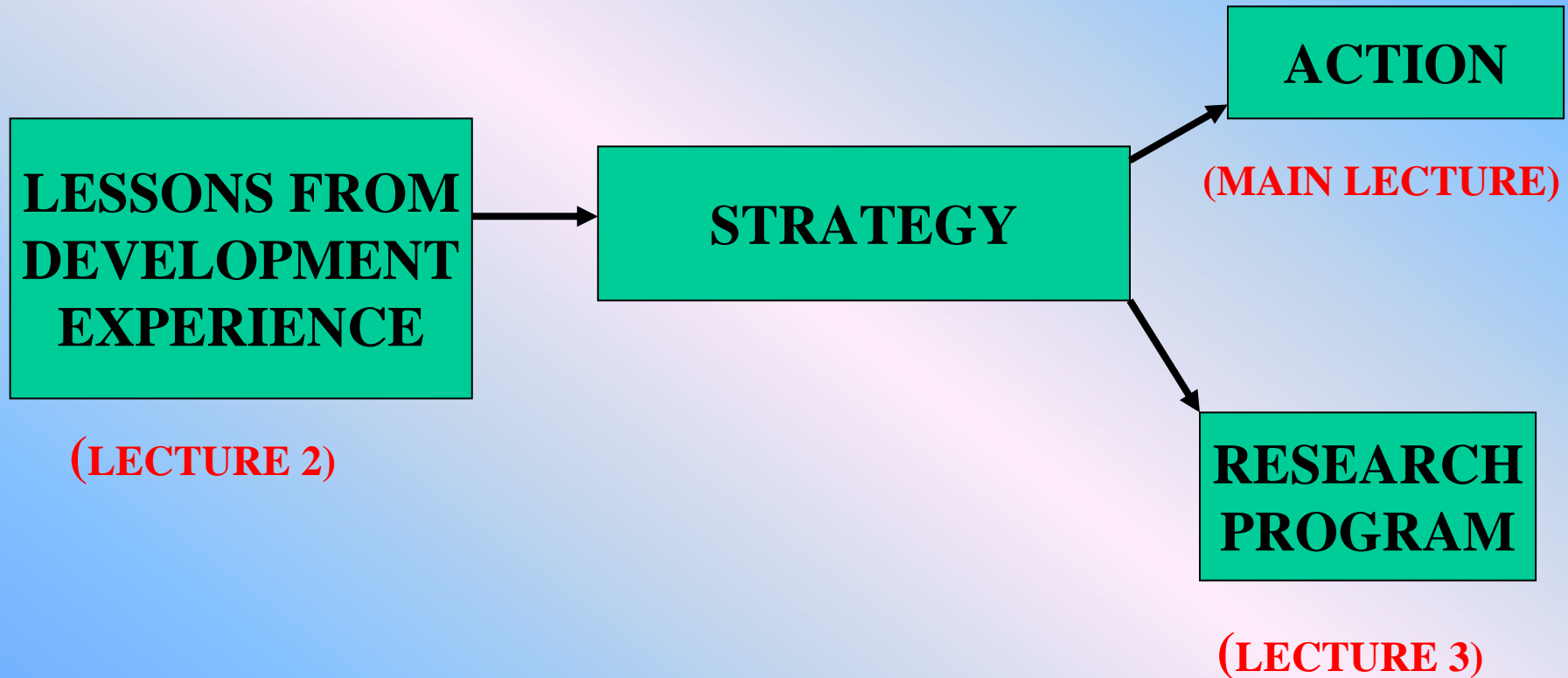


Munich Lectures in Economics
Center for Economic Studies
Ludwig Maximilian University, Munich
20 November, 2002

Nicholas Stern
Senior Vice-President and Chief Economist
The World Bank



Structure of the Munich Lectures





Main Themes

- What do we learn from development theories of the last 50 years?
- What do we learn from the evidence on growth and structural change?
 - Development as change
 - Drivers of change
- Strategy for development

Implications

- research programme
- public policy and public action



What have we learned from development theories ?

- Role of the State
- Theories of Growth
- Institutions and Governance
- Behavioral and Societal Change



Role of the State

Markets & State: Complements and Contrasts

From planning and protectionism in the 1950s—to
the *libéralisme triomphant* of the 1980s—to
markets / state complementarity in the 1990s

Conceptual Underpinnings

- Market failures and government failures
- Austrian view: markets support innovation and discovery



Theories of Growth

ICOR, TFP and steady states...

Focus so far has been on accumulation of physical & human capital, & productivity of factors

- Savings rate and capital-output ratio (Harrod-Domar)
- Balanced growth & “big push” (Rosenstein-Rodan)
- Unbalanced growth (Hirschman)
- Link between growth and income distribution (Kuznets)
- Technical progress (Solow)
- Learning by doing (Arrow)
- Optimal growth theories (Pontryagin, Mirrlees, Koopmans)
- New growth theories: human capital; entrepreneurship; innovation (Romer, Lucas, Aghion-Howitt, Grossman-Helpman)

Institutions & Governance

Simultaneous Approaches to Policy Formation



1970s

- Principal-agent relationships in public policy: Mirrlees 1969; Diamond-Mirrlees 1971; Little-Mirrlees 1974
- Policy influenced by interest groups (similar in terms of data requirements [winners & losers] to optimality/welfare models): Buchanan 1965; Krueger 1974; Becker 1983
- Understanding the ‘rules of the game’: North 1973

1980s

- Market fundamentalism: Focus on markets and other things will follow...

1990s

- Demand for institutions depends on history and power (Mancur Olson 1982; Rodrik, Roland; Shleifer; Acemoğlu)



Behavioural and Societal Change

Disciplines outside the Economics Mainstream

Meanwhile some social scientists were viewing development as major behavioural & societal change....

Anthropology

- F.G. Bailey, Caste and the economic frontier (1957)

Demography

- Esther Boserup, The conditions of agricultural growth (1965)

Geography

- Jane Jacobs, The economy of cities (1969)



Development as change

The data show that development is not a story of steady state growth but of fundamental change...

- Growth in developing countries has accelerated
- Periods of sustained growth
- Structural shifts
 - agriculture / manufacturing / services
 - rural / urban
 - population: dependency ratio
- Importance of exports and capital flows
- Decline in poverty in last 20 years
- Changes in health and education status



Secular Growth

Long run world per capita GDP growth by region

	1000-1820	1820-1950	1950-1998	(1950-1973)
Western Europe	0.14%	1.0%	2.9%	4.1%
Western Offshoots	0.13%	1.6%	2.2%	2.4%
Japan	0.06%	0.8%	5.0%	8.1%
Asia (excluding Japan)	0.03%	0.1%	3.2%	2.9%
Latin America	0.06%	1.0%	1.7%	2.5%
Eastern Europe & former USSR	0.06%	1.1%	1.1%	3.5%
Africa	0.00%	0.5%	1.0%	2.1%
World	0.05%	0.9%	2.1%	2.9%

Source: Maddison (2001).



Sustained spurts of growth

Sustained per capita income growth exceeding 4% p.a. since 1990

Country Groups	Number of Countries	Main Growth Period	Average Real Growth p.c.	Driving Factors
U.S. and Canada	2	1933-1953	4.3%	Post depression recovery, war
OECD (except US & Canada)	13	1980-2000	4.5%	Policy changes, liberalisation
Eastern Europe + FSU	4	1946-1967	4.6%	Post war recovery
Asia (except Japan)	8	1960-2000	5.1%	Policy changes, liberalisation
Latin America	4	1950-1980	4.1%	Import substitution & FDI
Africa	14	1960-1985	4.2%	Post colonial, ODA flows
Middle East except Iran, Iraq, Israel	5	1960-1985	5.4%	Oil

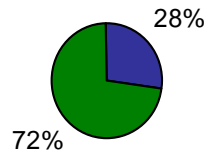
Source: Summers-Heston (1993); Maddison (1995); World Bank estimates

Structural changes in developing countries



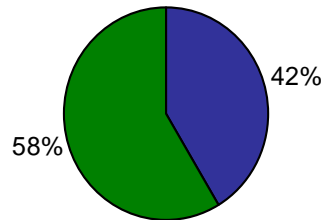
Urban vs. rural population (% of total population)

1970 (2.9 billion)

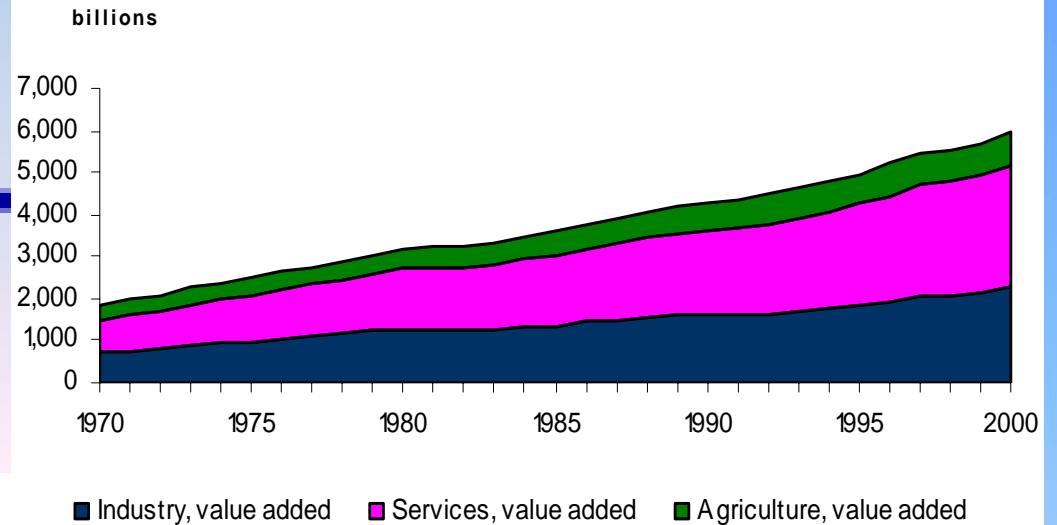


■ Urban population
■ Rural population

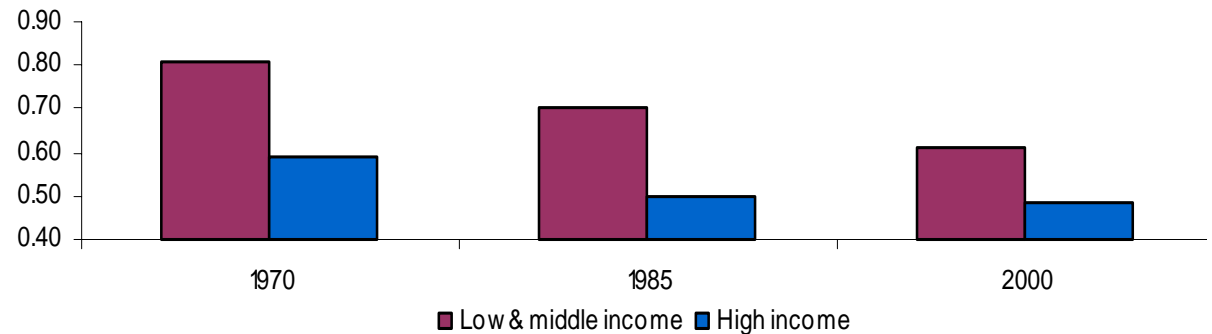
2001 (5.1 billion)



GDP by sector for the developing world (constant 1995 US\$)

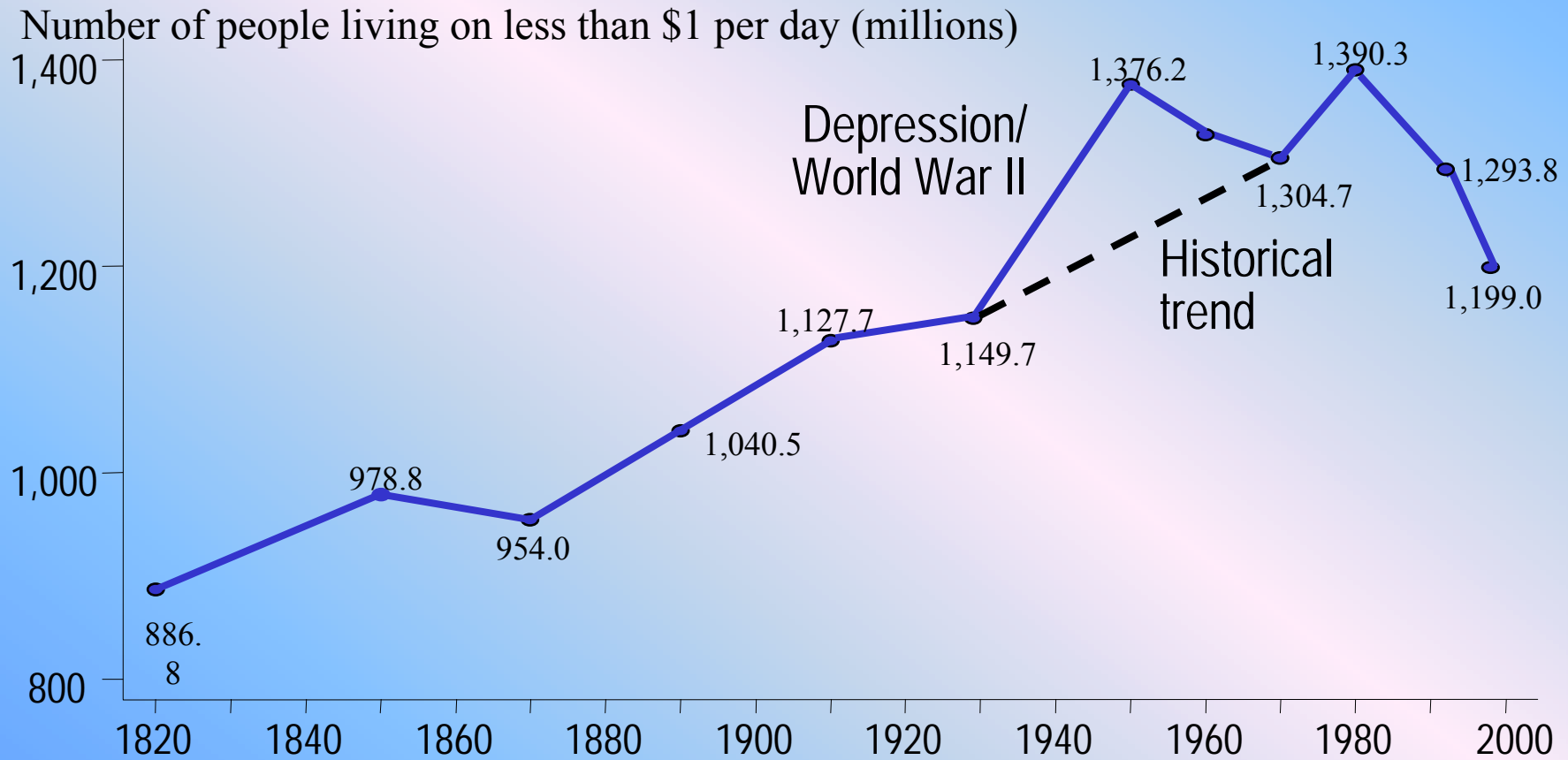


Age dependency ratio (dependents to working-age population)





Historical Perspective on Poverty

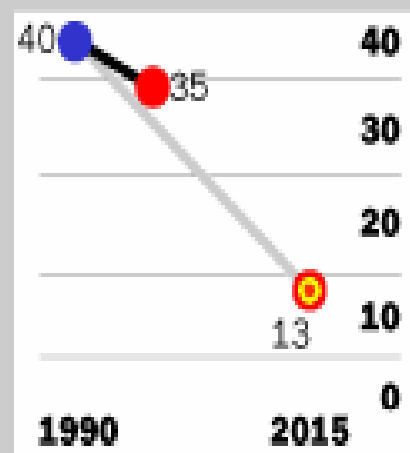


Poverty has dropped by 200 million over past 20 years, despite world population increase of 1.6 billion

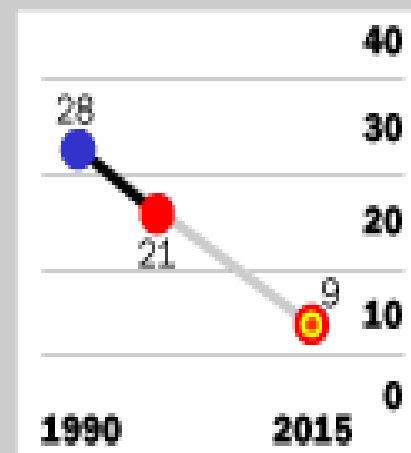
Infant mortality rates (deaths per 1,000 live births)



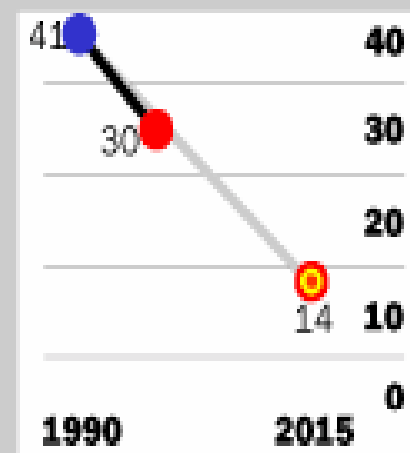
East Asia and Pacific



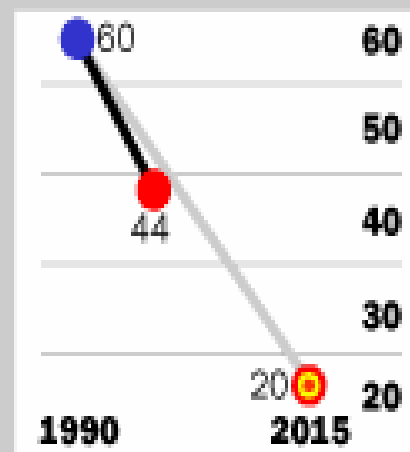
Europe and Central Asia



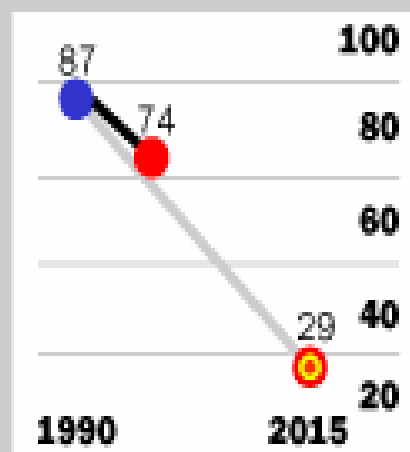
Latin America and the Caribbean



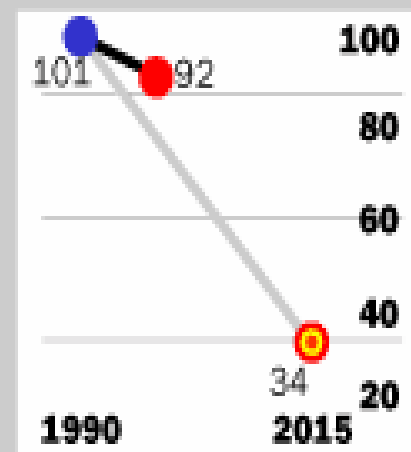
Middle East and North Africa



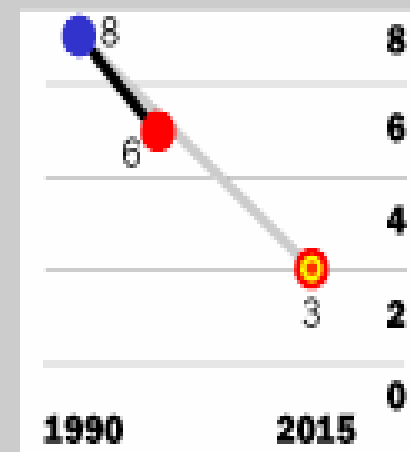
South Asia



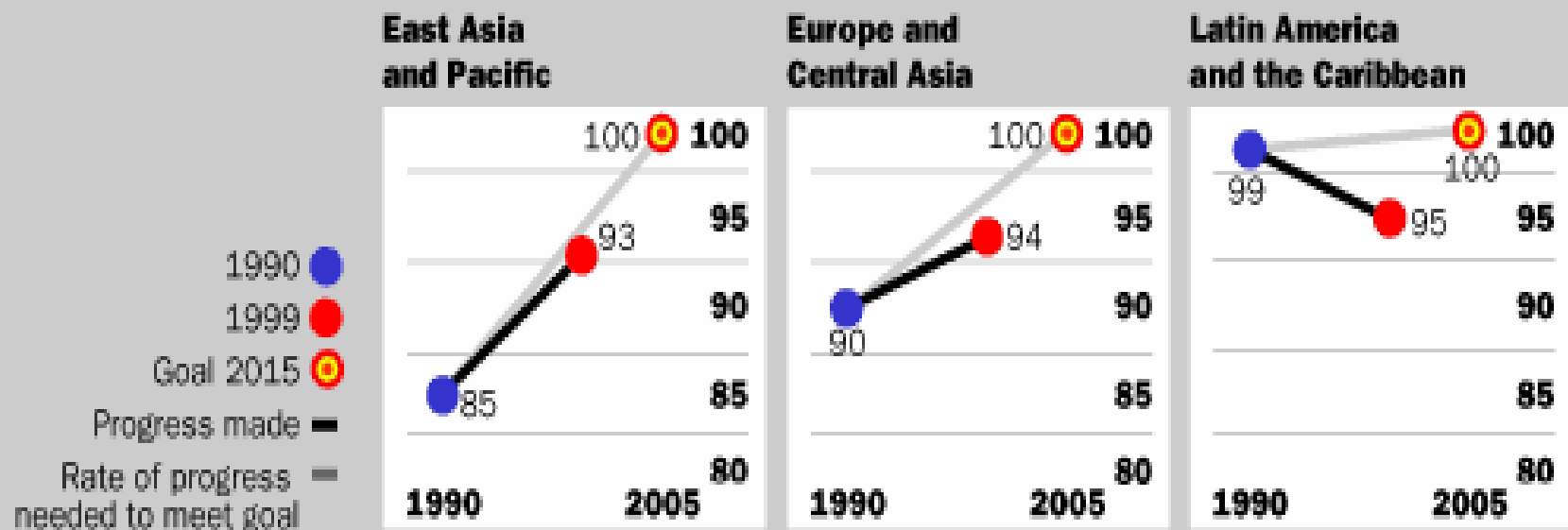
Sub-Saharan Africa



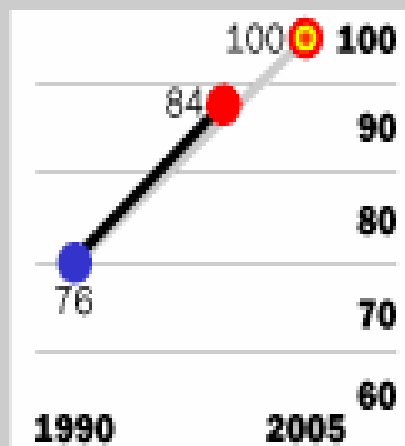
High-income countries



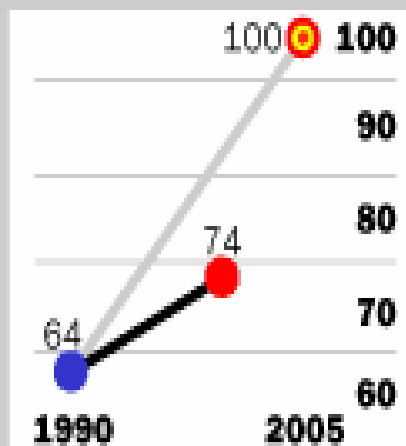
Ratio of girls to boys in primary and secondary school (%)



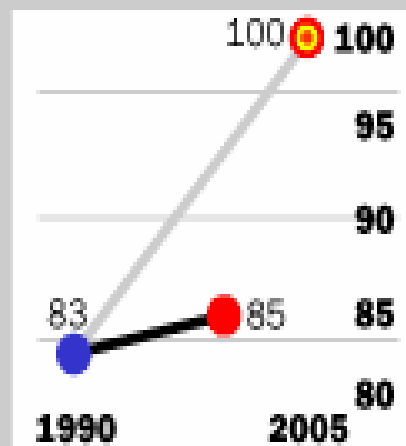
Middle East and North Africa



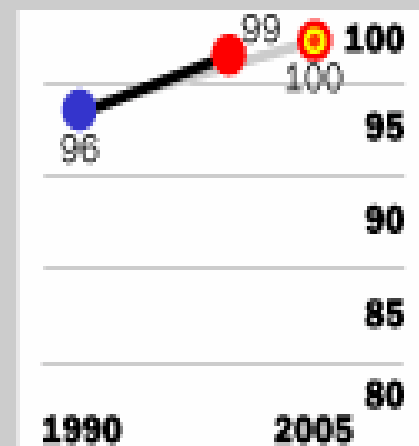
South Asia



Sub-Saharan Africa



High-income countries





Six Lessons from Development Experience

1. State necessary complement to markets

Growth

2. Growth as an engine of poverty reduction

3. Role of the private sector (incl. SMEs)

4. Key role of international trade

Development Effectiveness

5. Importance of empowerment and participation

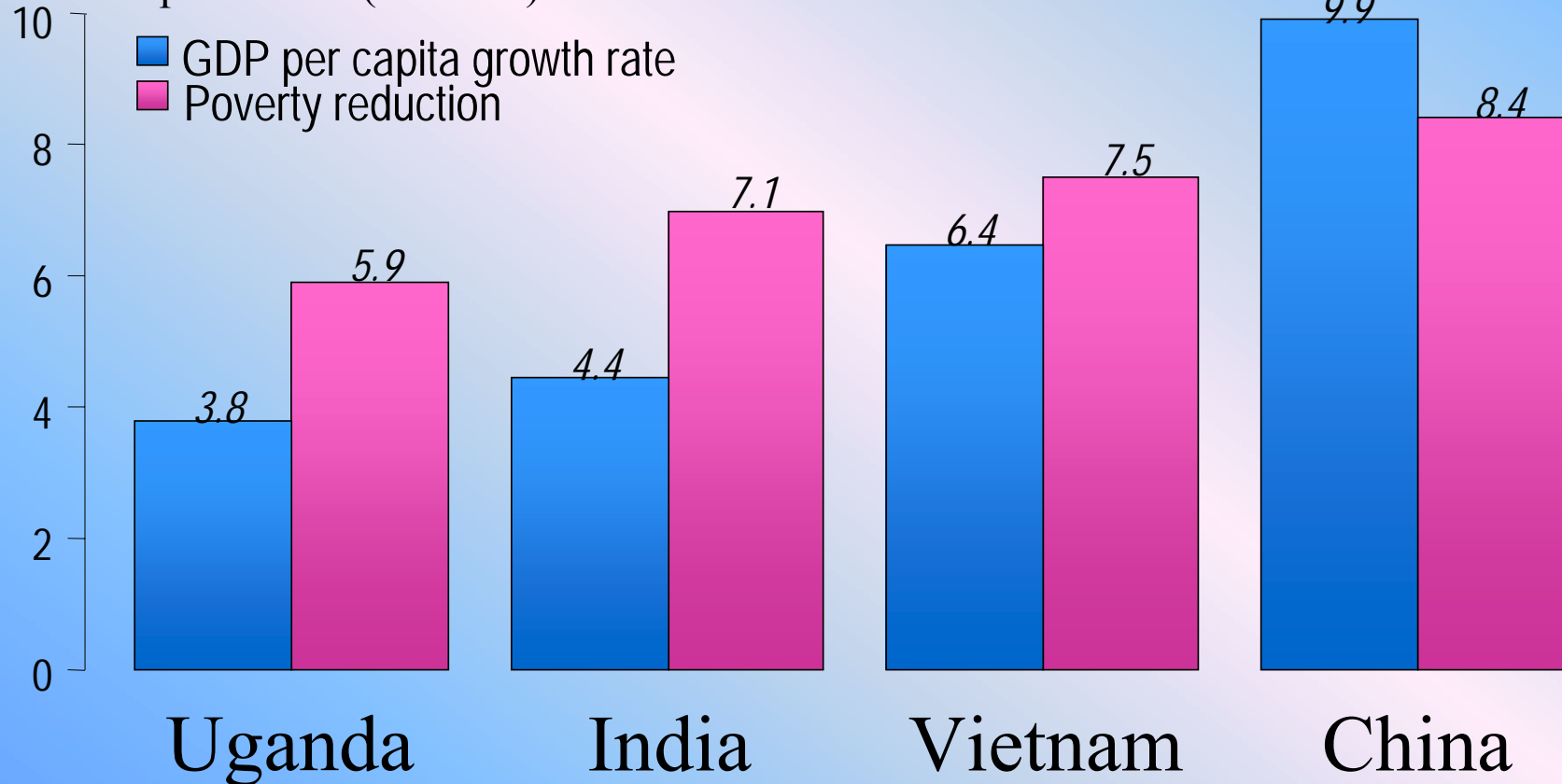
6. Importance of ownership of reform process



Growth as an engine of poverty reduction

Economic growth is vital in reducing poverty

Percent per annum (1992-98)

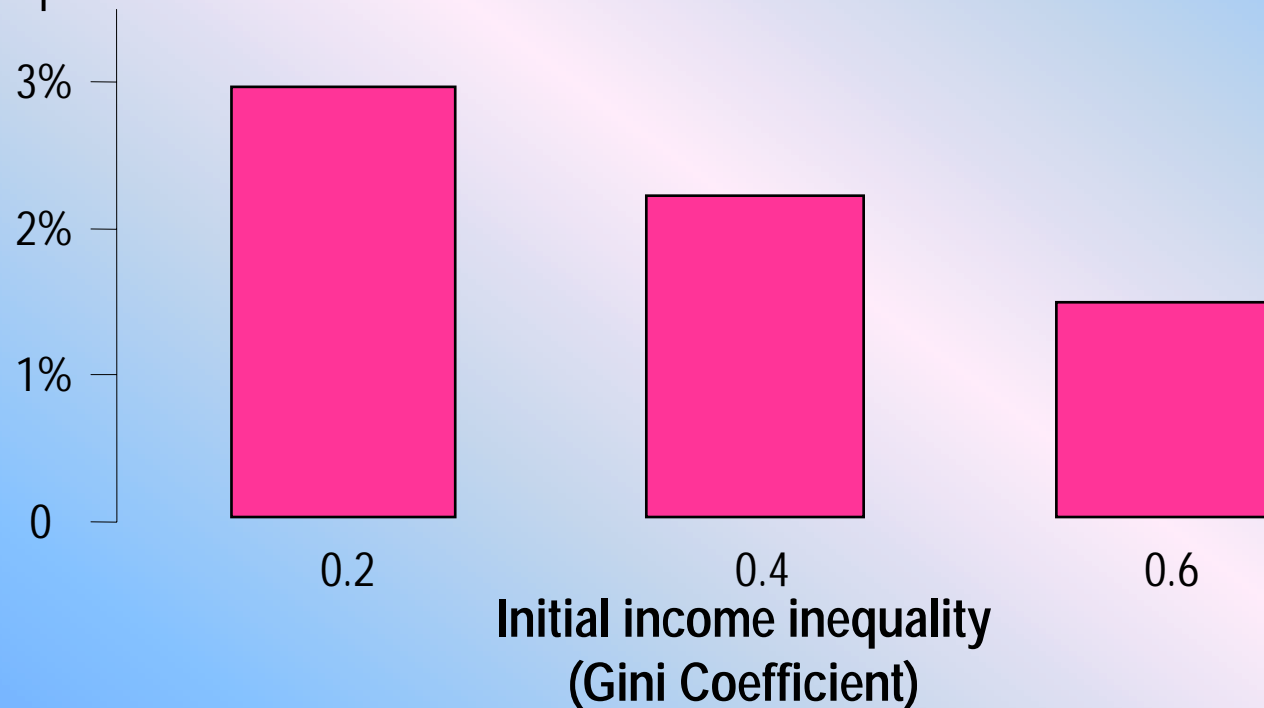


Also positive effects on other dimensions of poverty, such as education: stronger growth in primary schooling among globalizers.

Initial inequalities reduce the pace of poverty reduction



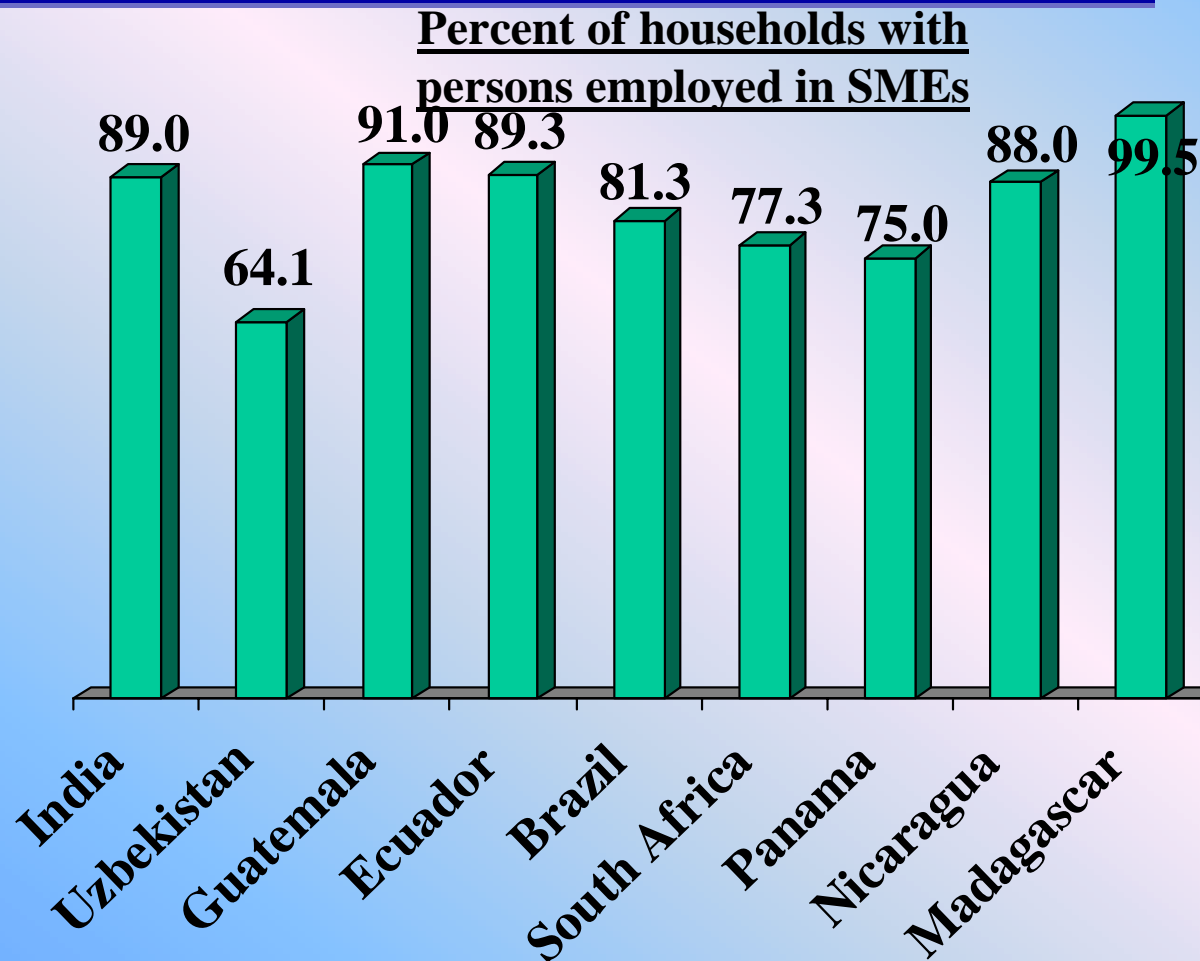
Reduction in poverty associated with a one percent increase in income



Note: Data cover 65 developing countries in the 1980s and 1990s. The incidence of poverty is the share of the population living on less than \$1 a day. Sources: Shaohua Chen and Martin Ravallion. 2000 (World Bank Policy Research Working Paper) and Martin Ravallion. 1997 (*Economics Letters* 56(1): 51-57)

Private enterprises are key:

SMEs account for most employment across developing countries



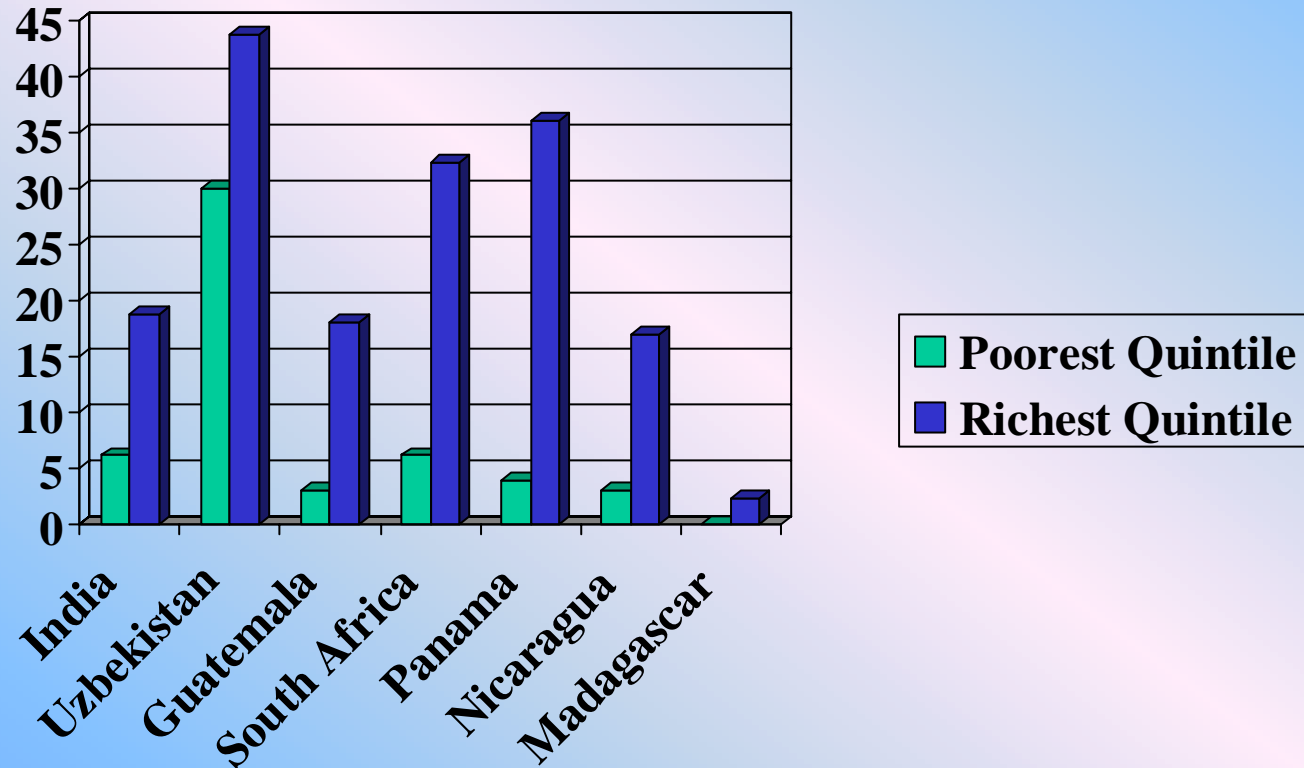
Source: World Bank calculations using various country household surveys.

SME refers to firms with less than 100 employees except for India (<20); and South Africa (<50)



SMEs are important for poor people

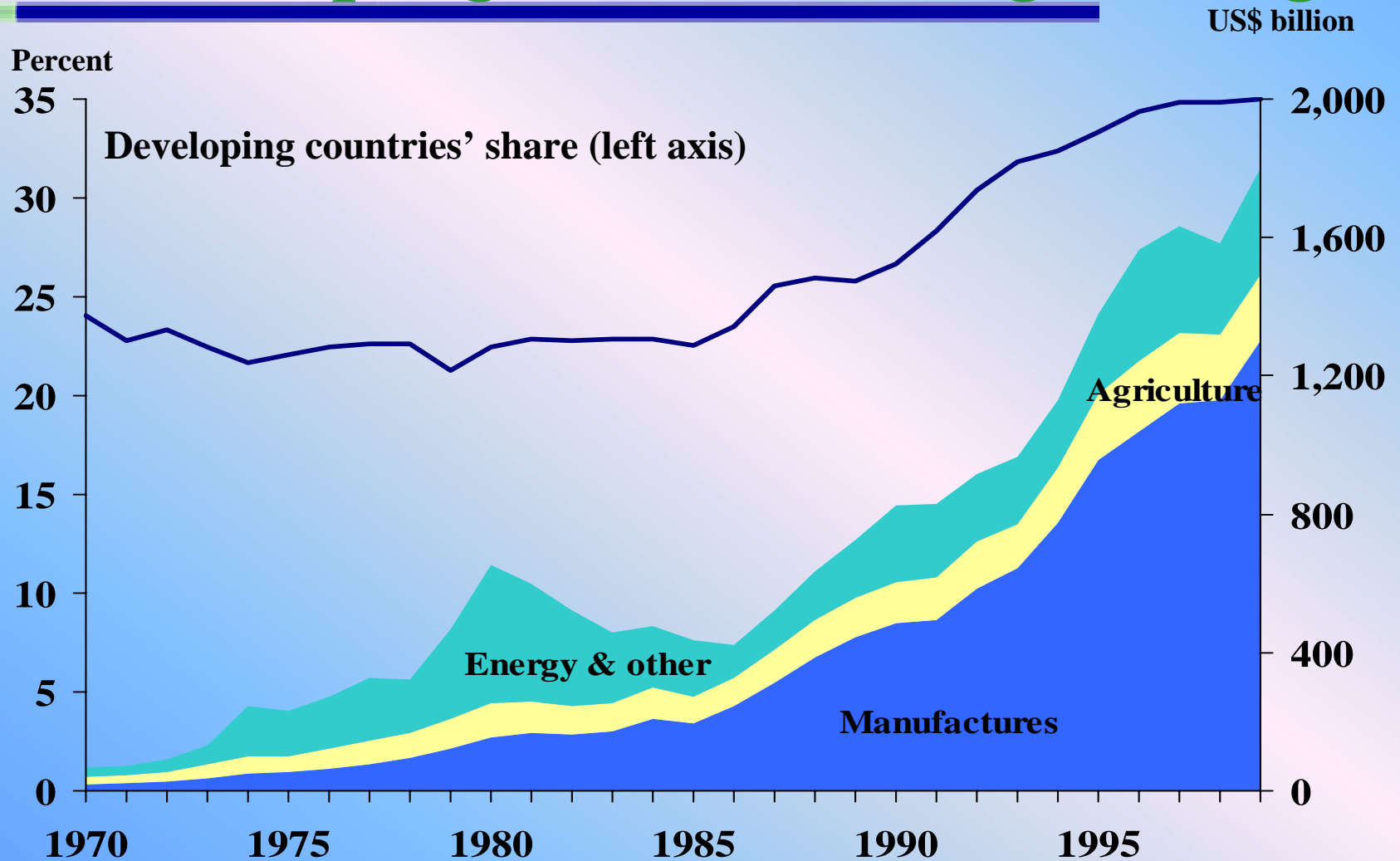
Percent of households with persons employed in large firms: Poorest and richest quintiles



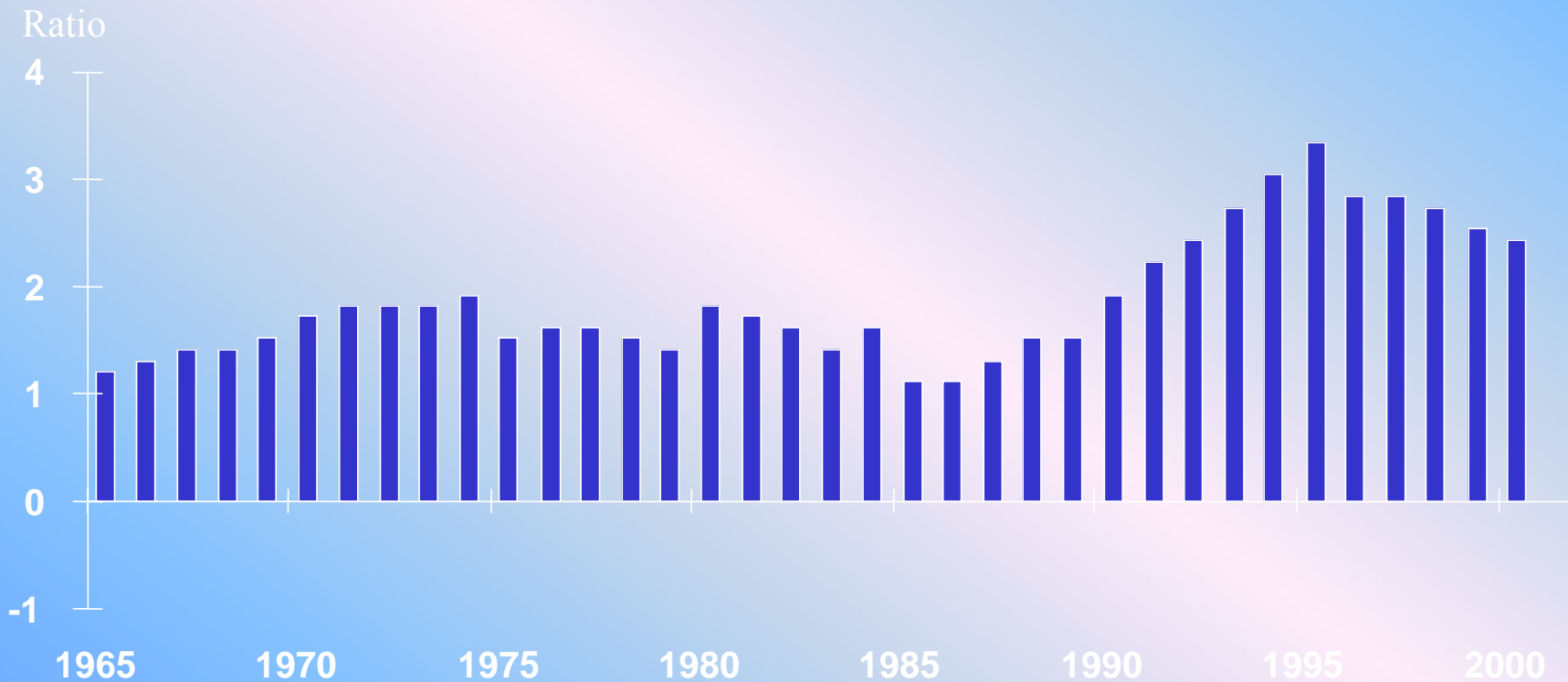
Source: World Bank calculations using various country household surveys. SME refers to firms with less than 100 employees except for India (<20); and South Africa (<50)



Share in world trade of developing countries is growing

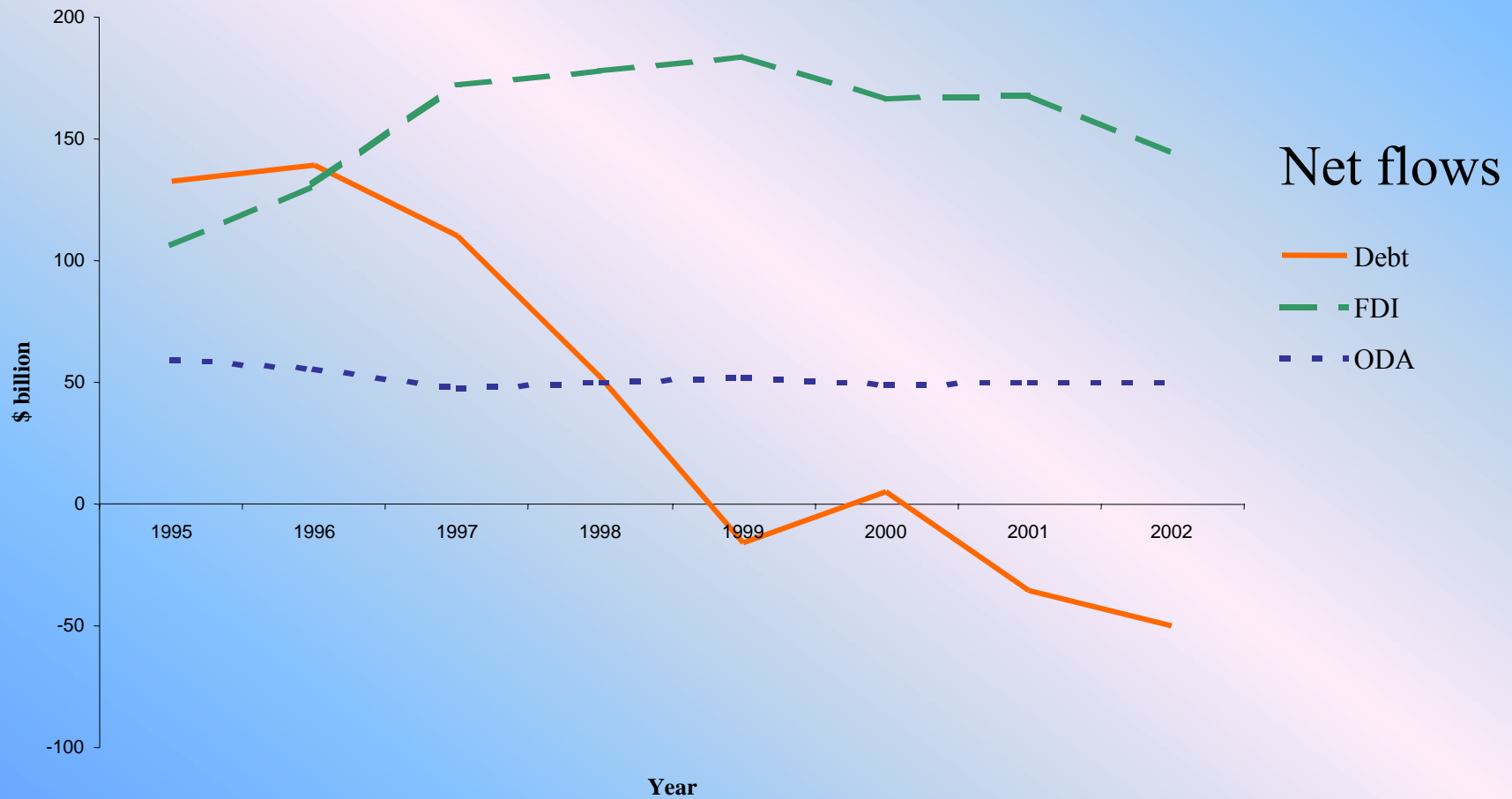


Trade grew at least twice as fast as GDP in last decade



Trade to GDP ratio growth rate based on 5 year moving average

Since the Asian crisis, FDI flows to developing countries have proven resilient while debt financing has fallen



Development effectiveness

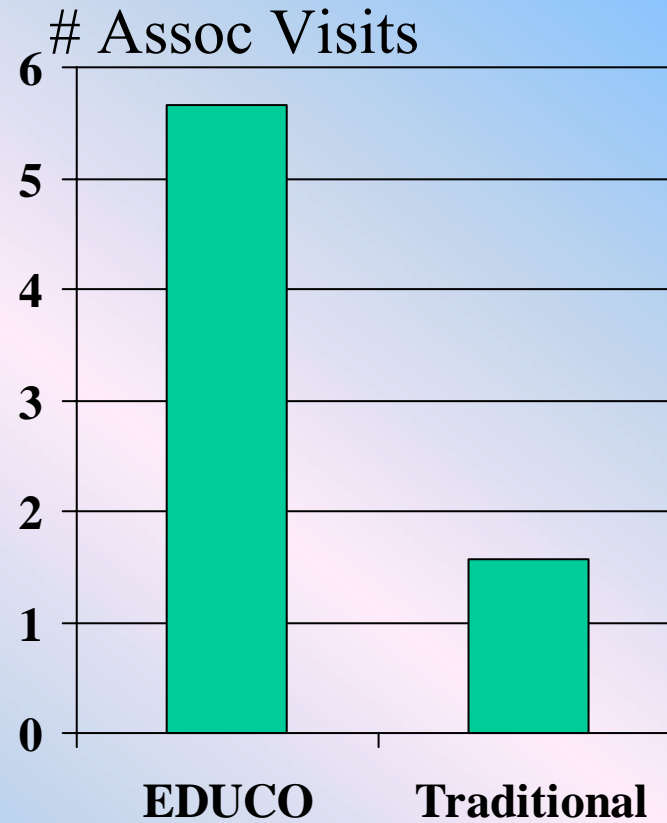
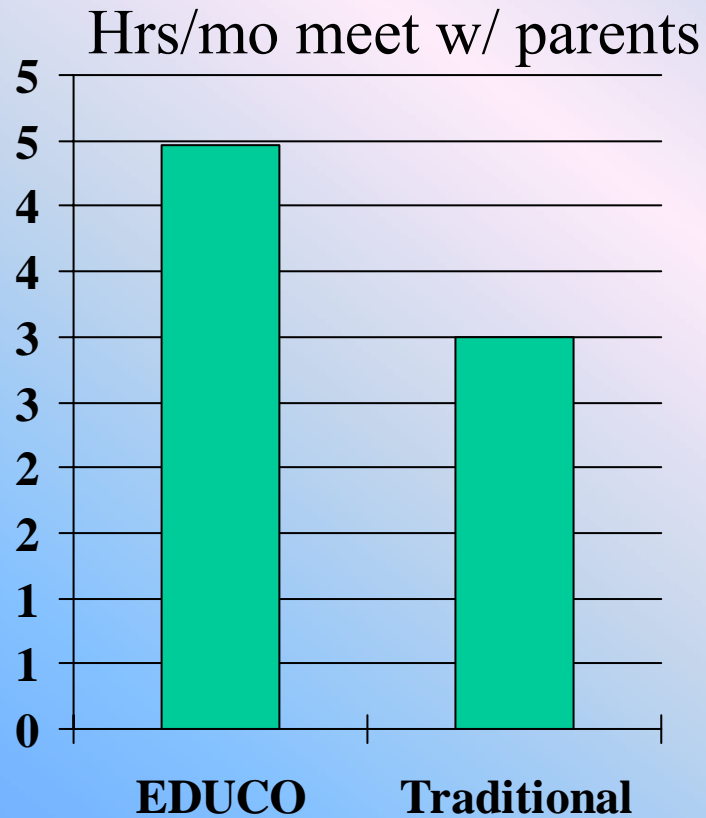
“Voice,” information and participation matter
for the success of projects



- El Salvador: EDUCO programme
- Bangalore: “Report card” on public services
- Brazilian *favelas*: *Prosanear* water & sanitation programme
- Cartagena: water privatisation



Effects of Participation in EDUCO





Cartagena, Colombia

Water privatisation: *before* and *after* performance

Indicator		before	after
		1994	2001
Connections in poor areas		N/A	98%
Number of employees		1300	272
Employees per 1000 connections		15	2
Water coverage		68%	91%
Sewerage coverage		67%	72%
% of domestic metering		30%	99%
Number of water connections		84143	1172
Unaccounted-for water		60%	41%
Production capacity (m ³ /sec)		1.6	3.1
Continuity of service (hour/day)		7	24
Response to complaints (days)		6	1.3

Development effectiveness depends on....



- Country ownership of the reform process
 - Generate broad political ownership
- Development strategy tailored to local conditions and history
 - Participatory preparation process
 - Innovation in institutional design
 - Rigorous evaluation of the experiment
 - Capacity building for implementation

Strategy for Development

A two-pillar approach



- **Creating a good investment climate** (encourage firms, both small and large, to invest, create jobs, and increase productivity)
- **Empowering and investing in poor people** (by enabling their access to health, education, social protection, and by creating mechanisms for participating in decisions that affect their livelihoods)

Strategy for Development: Connections



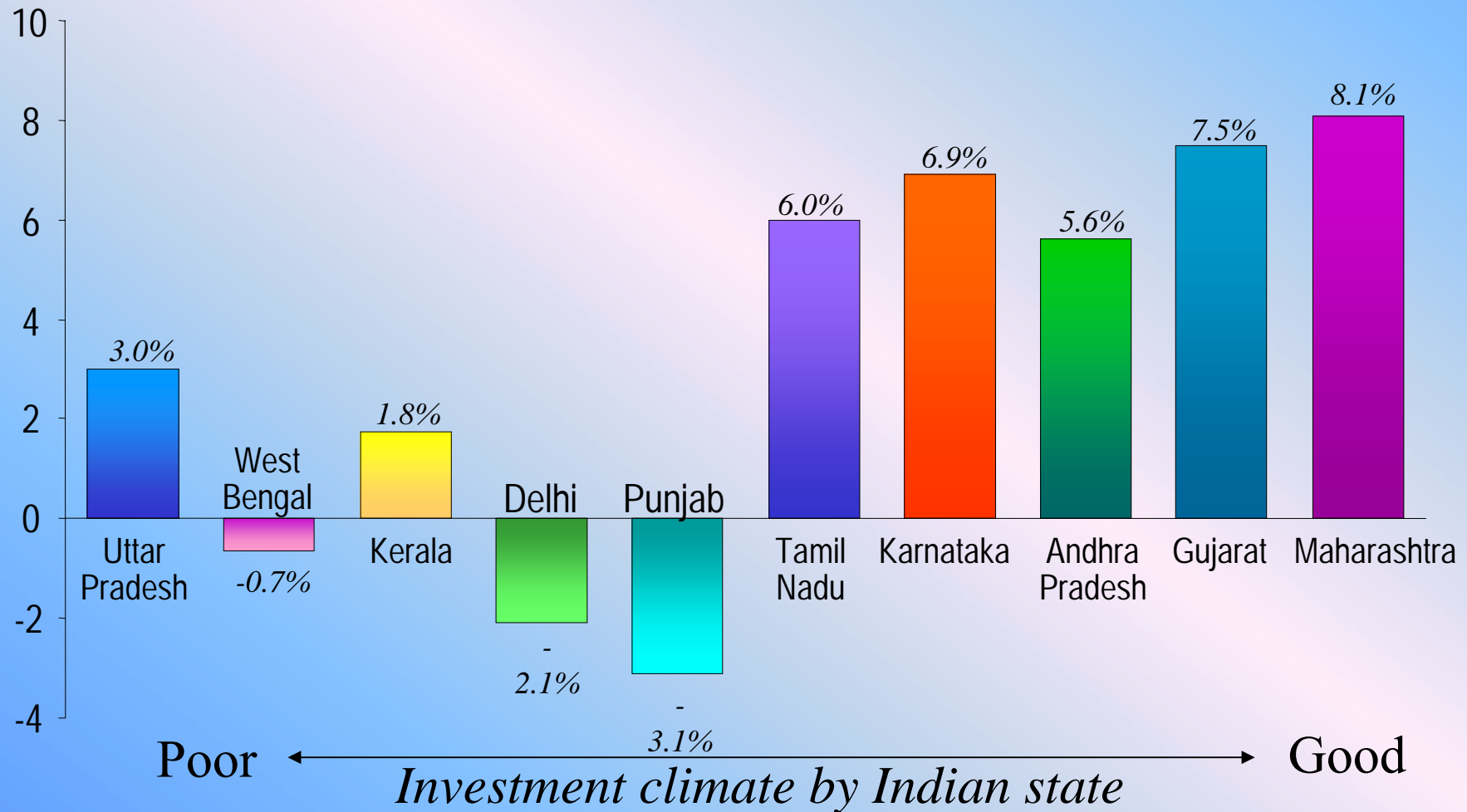
- **The two processes—investment climate and empowerment—are intertwined and mutually reinforcing [“pro-poor growth”]**
 1. Growth generated by improvements in the investment climate is empowering
 2. If poor people are empowered, they contribute strongly to the growth process.

- **Both are means and ends**

Investment climate makes a big difference



Investment rate (percentage), 1999



Implications of the strategy:

Research Programme



- Empirical surveys on the 2 pillars
- Investment climate
- Empowerment, participation and change in preferences
- Political reform: constructing constituencies for change

→ **Tomorrow Morning's Lecture**

Implications of the strategy:



Implementing Monterrey

Action programme is based on the strategy

- Create an environment for innovation, entrepreneurship and learning
- Enhance empowerment; encourage participation; reduce social exclusion
- Avoid highly unequal social structures, which are dynamically ineffective

It embodies key insights of the strategy

- Ownership of the reform process
- Importance of governance and institutions
- Role of investment climate for growth
- Need for scaling up and jointly monitorable results

→ **Yesterday's Lecture**