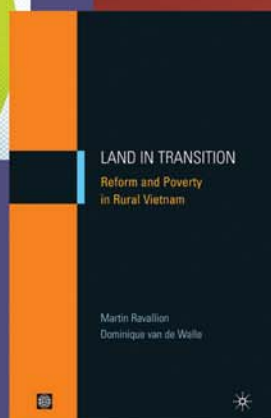
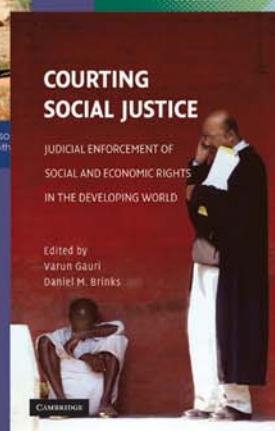
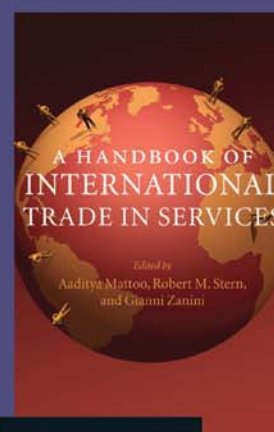
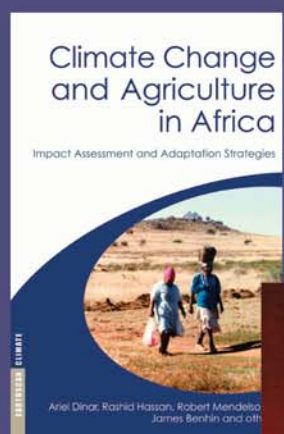


Research Highlights 2008



Development Research Group
World Bank 

Research Highlights 2008

Development Research Group
World Bank 

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Most bank-produced publications by the Development Research Group are available online at <http://econ.worldbank.org/research>.

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A Note from the Director

Welcome to Research Highlights 2008, the annual report of the World Bank's research department, the Development Research Group (DECRG) in the Development Economics Senior Vice Presidency.

What a year! The food, fuel, and financial crises of 2008 naturally dominated attention, including the Bank's research department. Our researchers have responded in assessing the causes of the crises, the likely impacts on poverty and human development, and appropriate policy responses.

The obvious first step was to take stock of what we know from past work. In fact past crises have been much studied by DECRG's researchers, in hundreds of papers going back to 1990. As the world enters what is clearly a truly major financial crisis, it is of interest to look at some of the main lessons from our past research.

The existence of financial crises does not change our assessment that, on balance, financial development and globalization are good for poverty reduction in the longer term. However, this positive long-run relationship can coexist with a negative short-run relationship through financial fragility. This can reflect fundamental distortions that build up for a long time, largely hidden from view, before a macro shock reveals the underlying vulnerabilities. But financial crises can also strike economies with relatively sound institutions and generally good policies.

Arguably, greater openness in areas such as trade and migration helps countries deal with domestic shocks, but may well increase vulnerability to external shocks. Globalization has probably facilitated contagion of the 2008 financial crisis, although some economies and some people are likely to be more vulnerable than others.

Even an economy-wide crisis can have diverse, heterogeneous impacts that warn against simple generalizations, and also point to the need for a flexible social policy response. It should not be presumed that the poorest will be hit hardest; indeed, some of the same (undesirable) factors that have kept a significant share of the developing world's population in deep and persistent poverty—including a lack of connectivity to markets, and consequent lack of opportunity for economic advancement—will

protect them to some degree from the crisis. However, significant welfare impacts can be expected, notably in countries, and regions within countries, that have benefited from market-oriented development.

Poverty is very likely to be higher as a result of the financial crisis, although by how much will depend on the extent of the aggregate economic contraction and the rise in inequality (if any). DECRG has been providing regular assessments of the likely poverty impacts; our latest estimates suggest that in 2009 alone the crisis will trap an extra 40-50 million people in extreme poverty. However, an aggregate poverty measure cannot tell the whole story. There are likely to be both gainers and losers at any level of living, including among the poor. And there may well be adverse impacts on important non-income dimensions of welfare, including the nutrition and schooling of children.

Even a short-lived crisis can have longer-term impacts for some of those affected, most notably through the nutrition and schooling of children in poor families. And deficient crisis responses can lay the seeds of longer-term vulnerability to crises. The extent to which these adverse outcomes materialize will depend in part on the policies adopted by developing-country governments. The record of past policy responses to crises contains both successes and failures.

The lessons for policy from our past research on crises span financial sector policies, macroeconomic stabilization, external trade policies, education and health care, and social protection. A number of specific lessons emerge, but there is only space here to point to some generic lessons. The paper on "Lessons from World Bank Research on Financial Crises" goes into more detail on those lessons.¹

The generic lessons include the importance of an early response. The fiscal cost of interventions can be quite large, but the cost of inaction can be even larger. Other generic lessons include the importance of understanding incentives in the

design of policy responses, the importance of spending composition in designing a fiscal stimulus or adjustment program, and the importance of sound information on what is happening on the ground as the crisis unfolds.

However, if there is one lesson that stands out it is that the short-term responses to a crisis cannot ignore longer-term implications for development in all its dimensions. The macroeconomic stabilization response must be consistent with restoring the growth process and (hence) the pace of poverty reduction. Financial sector policies need to balance (understandable) concerns about the fragility of the banking system with the needs for sound longer-term financial institutions.

The paper by Asli Demirgüç-Kunt, and Luis Servén, “Are All the Sacred Cows Dead? Implications of the Financial Crisis for Macro and Financial Policies,” focuses on financial sector policies, where the challenge ahead is to align private incentives with public interest without taxing or subsidizing private risk-taking.² Some broadly similar issues of information and incentives underlie our discussions of social policy responses, which must provide rapid income support to those in most need—giving highest on the poorest among those affected—while preserving the key physical and human assets of poor people and their communities. Difficult choices will be faced in addressing the (inevitable) tradeoffs between rapid crisis response and these longer-term development goals.

Social protection will figure prominently in the crisis responses of developing countries. Many governments and citizens are asking what can be done to help protect the poorest. There is a compelling case for believing that the composition of public spending and taxation should change in favor of the poor, although the evidence on past performance is not encouraging; too often it is spending on the non-poor that is protected. A recently popular class of transfer programs requires the children of the recipient family to demonstrate adequate school attendance (and health care in some versions). Our research has provided evidence from impact evaluations that such Conditional Cash Transfer (CCT) programs bring non-negligible benefits to poor households—in terms of both current incomes and future incomes, through higher investments in child schooling and health care.

The 2008 Policy Research Report, “Conditional Cash Transfers: Reducing Present and Future Poverty,” documents the evidence from past evaluative research on CCTs, and points to important lessons for the ongoing efforts to introduce and scale up these programs, as part of the efforts of governments to respond to the crisis.³ Our past research has covered other important policies for social protection, including workfare programs. In 2008 we completed an overview of our past research on the range of social protection programs, “Bailing out the Poorest,” that can help protect the poor in a crisis, pointing to both successes and failures, and emphasizing the need for care in thinking about incentives in policy design, the role played by political economy, and the importance of flexibility in adapting to the settings faced, informed by rigorous monitoring and evaluation.⁴

Having taken stock of what we have learned, we have proceeded to start filling some of the obvious gaps in our knowledge about the crises that emerged so visibly in 2008. By re-deploying the department’s own resources, we instigated rapidly a series of ten or so small research projects in 2008, as well as a number of other projects financed by external resources. Among the topics being studied are the following: international capital flows and portfolio allocations, including studying the behaviors of institutional investors; international transmission mechanisms of the sub-prime crisis, including through trade and migration; understanding stock market reactions in times of crises; and assessing the likely impacts on poverty and human development, including impacts on child welfare and schooling.

There are huge information challenges in a crisis—even to know what exactly is happening on the ground in a timely way, let alone to figure out what is the best policy response in specific circumstances. Since data are at the core of almost everything DECRG’s researchers do, we have also been active in exploring new ways of monitoring what is happening and evaluating interventions. New high-frequency data sources are being explored actively—data sources that have only become possible with advances in information technology, including (of course) the internet.

Just as the crisis brings new economic opportunities in its wake, with gainers as well as

losers, it creates research opportunities. For example, the crisis caused havoc in one of our research projects on the role of management skill in firm performance in India, but the researchers concerned were also able to seize the opportunity to learn about the potential role of better management in helping firms protect themselves from the crisis.

Crisis responses cannot ignore longer-term impacts. The faster the developing world gets back on track toward a sustainable path of poverty reduction, the better. Nor can we ignore research on our longer-term development goals at a time of crisis. Research continues on our core areas of long-run growth, distributional change and poverty reduction, climate change, pollution, energy, finance for development, private sector development, trade reform, migration, governance and delivering better schooling and health care services.

Our research also continued on measuring and monitoring progress against poverty in the world. In 2008 we completed a major update of our estimates of the extent of absolute poverty in the developing world, and we found that the incidence of poverty was greater than our past estimates had suggested, although we still find that there has been substantial long-term progress against extreme poverty in the developing world as a whole, though certainly not in all regions.⁵ The lack of progress in Sub-Saharan Africa over 1981-2005 is notable and worrying, though, prior to the crisis, there are some recent signs that this may be reversing. Our current expectations are that the crisis will essentially stall that progress over 2009-2010. In 2008 we also instigated a major long-term initiative to improve poverty data for Sub-Saharan Africa, thanks to substantial financial support from the Gates Foundation.

This year also saw the publication of two new books on trade distortions in agriculture in Latin America and Europe's transition economies.⁶ Strikingly these studies find that the direct taxation of export-oriented agriculture,

which was once so common 20 years ago, has largely vanished. In its place has come greater protection of import-competing agriculture.

One of the unusual, and possibly unique, features of DECRG is that we span such a wide range of development issues. Research is conducted both within and across the six teams, in collaboration with researchers in other parts of the Bank, with colleagues in universities and research institutions around the world, and collaborators in almost all the developing countries in which the department's work is focused. In 2008, the department's country-specific research spanned 45 developing countries (on top of cross-country comparative work).

About the 2008 edition of Highlights

We have greatly shortened our highlights report over past years. The full *Research Highlights 2008* report (available online at <http://econ.worldbank.org/research/highlights2008>) provides a complete list of publications by team in calendar year 2008, which included 22 books, 161 journal articles, 69 book chapters, well over 176 working papers (that will be published in due course), and 19 new and updated datasets.

The full report also gives details on the group's outreach efforts, which included 10 web articles, 15 web briefs, blog entries, and 9 conferences organized or co-organized by staff with other institutions. And, of course, staff gave well over 500 presentations at seminars and conferences throughout the year.

I very much hope that you enjoy reading this edition of *Research Highlights*. Please tell us what you think about the issues raised in these pages, and bring up topics you think need more research. In the end, it is the active interaction with development thinkers and practitioners that will continue to assure that research at the World Bank remains relevant to our shared goals of achieving inclusive and sustainable economic development.

Martin Ravallion
April 2009

Director's Office

Research in the Director's Office comprises the research of the Director.

Themes

The Director's Office conducted research on poverty and inequality, focusing particularly on monitoring the developing world's progress against poverty, including the impacts of the global financial crisis, and evaluating anti-poverty policies. Special projects this year included a review of the last 30 years of World Development Reports, aiming to draw lessons for future reports.

Highlights

Policies needed to protect the world's poorest from the global financial crisis

Compared to pre-crisis expectations, lower growth rates in 2009 are expected to entail that 53 million fewer people will escape poverty in the developing world when judged by the international poverty line of \$1.25 a day; a the \$2 a day line the number rises to 65 million.

Underlying these large aggregate impacts, the crisis is likely to have diverse welfare impacts within the developing world, with some countries and some people more vulnerable than others. There are also potentially serious longer-term implications through the nutrition and schooling of children in poor families. It will be a tough balance to ensure that social policies can deliver rapid income support to those in most need, while also preserving key physical and human assets of poor people and their communities. Mistakes have been made in past crisis responses, but research has helped identify some key design features for safety net programs that can help compensate for the likely welfare losses in the short-term while also promoting longer-term recovery.

It is possible to protect a significant share of the poor in a crisis, without damaging longer-term prospects of escaping poverty. This will require a combination of well-designed relief work schemes with conditional transfers (in cash or food) targeted to specific groups who either

cannot work (due to physical incapacity, including poor nutritional status) or should not be taken out of other activities (notably school).⁷

Market-oriented agrarian reforms have helped reduce poverty in Vietnam

The most important non-labor asset in any developing rural economy is land. The institutions determining how land is used are thus at the core of efforts to fight poverty. In the 1980s and 1990s, Vietnam undertook truly major reforms to the laws and regulations governing agricultural land. The central government faced a potentially major threat to the reform process. It had to rely heavily on decentralized implementation of these reforms, raising concerns about capture by local commune elites whose interests were not well served by the center's aims.

The evidence is not consistent with an unjust land allocation stemming from the power of local cadres to capture the process. However, the observed allocation differed significantly to what one would have expected from a competitive privatization at market-clearing prices. Vietnam's reform to privatize land-use rights achieved a more equitable outcome than would be expected from a fully efficient allocation, as would have been achieved by free markets. This came at a cost to aggregate efficiency.

After the legal reforms, land was reallocated in a way that helped attenuate the inefficiencies of the initial administrative assignment of land. Households that started with an inefficiently low (high) amount of annual land tended to increase (decrease) their holdings over time. The adjustment was not rapid; in the aggregate, only one-third of the initial proportionate gap between the actual and the efficient allocation was eliminated within five years. Some local governments continued to intervene, but it seems that the market mechanism did start to take hold.

There is little sign that rising landlessness has undermined the gains to the poor from de-collectivization's relatively equitable assignment of land-use rights. On the whole, rising rural landlessness in the wake of the reforms appears to have been a positive factor in Vietnam's process of poverty reduction, as farm households take up new opportunities, most notably in the labor market.

Starting from a relatively equitable allocation of land, introducing free exchange did not end in peril and poverty for the rural population, though (as in any major policy reform) there are both losers and gainers. This has important implications for China, which has not yet embarked on Vietnam's course of liberalizing land markets. Vietnam's experience also reminds us that the gains from such reforms do not happen overnight, and may well take many years to be realized. But gains can be expected, including for the poor.⁸

Lessons and unmet challenges from 30 years of World Development Reports

With the global economy mired in the most severe recession in recent memory, the search has intensified for policies to revive growth, reduce poverty, redefine the role of the state and to assess the contribution of aid flows. After 30 years of World Development Reports, it was time to take stock of the lessons from thirty WDRs and the recent economic literature.

Considerable advances have been made in knowledge on a wide range of development

issues. However, the limits of policy interventions and the continuing uncertainties that bedevil decision makers remain clear. For example, although research on growth is now focusing on factor productivity, there are few reliable measures for raising and sustaining productivity. The conventional fiscal, monetary and exchange rate policies exert limited leverage, the findings on the impact of human capital are mixed, and new growth theories explain only a small share of the variation in per capita income growth. And while countries are eager for guidance on promoting industrialization and building innovation systems, the WDRs and the published research offers limited insights on how the state can respond to these challenges if it relies primarily on market signals. There is also an urgent need to enhance the effectiveness of aid; for example, progress in using aid to raise investment and growth has been modest. The utility of future WDRs to the Bank and to its audience could be increased and the report itself could be more user friendly.

The review of 30 WDRs is supplemented by five distinguished commentators, who take up some of the issues raised in the review and variously reflect on the contribution of the WDR, on the worth of growth promoting policies, on how the East Asian experience has been woven into the Bank's thinking, and on what should become of the WDR.⁹

Martin Ravallion, *Director*

Pilar Garcia Martinez
Shahid Yusuf (through January 2009)

Finance and Private Sector Development

The Finance and Private Sector Development group focuses on understanding the role of the financial and private sectors in promoting economic development, and reducing poverty and identifying policies to improve their effectiveness. Research on finance is organized around two dimensions—access to financial services and risk management and stability. Research on private sector development focuses on determinants of firm entry and performance to better understand the microeconomics of the growth process.

Themes

The research on access to finance—which is important in promoting growth and alleviating poverty—includes documenting and benchmarking access to financial services by small firms and poor households, and identifying underserved groups and analyzing barriers to building more inclusive financial systems.

Evaluative research is studying the channels through which access to finance can contribute to growth through promoting entrepreneurship, innovation, and the process of technology adoption. The goal is to evaluate the impact of firms' financing constraints and households' inability to access financial services on economic growth and poverty alleviation, and to identify different ways of improving this access, ranging from microfinance innovations to improving how mainstream financial institutions and systems function.

The research on risk management—which is important for ensuring the sustained effectiveness of financial systems and financial stability over the long run—investigates the impact of supervision strategies, as well as the impact of compliance with Basel Core Principles on bank stability, the interaction of bank insolvency resolution and deposit insurance policies, and the impact of financial globalization on bank efficiency and access to financial services. New work includes understanding the causes and implications of the 2008 financial crisis.

Research on the private sector focuses on firm dynamics—changes in the composition of the private sector and entry and exit over time—and performance, and how this affects firm productivity and growth. Special areas of focus include research on the determinants and consequences of informality, innovation, and governance as well as the impact of the business

environment and its reforms. Future work will study features of the business environment and firm characteristics that may help enterprises better cope with and overcome the crisis.

Highlights

The financial meltdown: root causes versus scapegoats

The intensity of recent turbulence in financial markets has surprised nearly everyone. But the search for scapegoats has been diverting attention from the root causes of the crisis, which are closely associated with the underlying breakdown of incentives. These incentive conflicts explain how securitization went wrong, why credit ratings proved so inaccurate, and why it is superficial to blame the crisis on mark-to-market accounting, an unexpected loss of liquidity, or trends in globalization and deregulation in financial markets.

The research suggests disturbing implications of the crisis for Basel II and its implementation: namely, that the principal source of financial instability lies in contradictory political and bureaucratic incentives that undermine the effectiveness of financial regulation and supervision in every country in the world. Reforms should aim to improve incentives through increasing transparency and accountability in government and industry alike.¹⁰

Financial services remain out of reach for many in developing countries

Data show that more than half of people in developing countries face financial exclusion due to high barriers in accessing financial services. A recent issue of the *World Bank Economic Review* brings together papers documenting barriers to access, and investigating the impact of access to finance on households and firms.¹¹ Theory and empirical evidence point to the critical role that

improved access to finance has in promoting growth and reducing income inequality. Papers in the symposium developed first estimates of financial outreach across countries, assembled evidence on the impact of finance on firm performance, and presented initial results on techniques and products to reach out to micro-borrowers and savers, including insurance. These papers were some of the background research for the recent Policy Research Report *Finance for All? Policies and Pitfalls in Expanding Access*, which was disseminated widely in 2008 in many of our client countries.

Deposit insurance not always a good idea

Recent financial turmoil has pushed the issue of explicit deposit insurance systems back to the center of debates on regulatory policy in both developing and industrialized countries. Explicit deposit insurance is widely held to be a crucial element of modern financial safety nets, and outside experts frequently recommend it to countries undergoing reform. Predictably, explicit deposit insurance systems have proliferated in the developing world. A new book challenges the wisdom of encouraging countries to adopt deposit insurance in the absence of a strong institutional environment to balance the benefits of preventing crises and the costs of controlling bank and customer risk-taking.

The evidence and analysis confirm that deposit insurance is strong medicine. While it can be a useful part of a country's overall system of bank regulation and financial markets, research stresses the importance of establishing three preliminary steps before adopting explicit deposit insurance: promptly identifying and eliminating individual bank insolvencies, fostering informative accounting standards, and establishing reliable procedures for contract enforcement. Research also underlines the importance of building in a capacity and incentives for deposit insurance managers so that they can adapt dynamically to financial changes.¹²

A good regulatory environment can promote entrepreneurial activity

New data from the 2008 World Bank Group Entrepreneurship Survey indicates a strong and statistically significant relationship between entrepreneurship and a better business environment.¹³ Data on the number of total and newly registered corporations over an 8-year period (2000-2007) for 100 countries was collected from a worldwide registrar of

companies. Data was also collected on the functioning and structure of business registries. After controlling for economic development (GDP per capita), higher entrepreneurial activity is significantly associated with cheaper, more efficient business registration procedures and better governance indicators.

Although the degree of progress in the modernization of business registries varies greatly, most countries are actively moving away from a paper-based business registry to a one-stop, automated, web-enabled registry capable of delivering products and services online. Our tests show that business registry modernization (often a component of broader private sector reforms) has a positive impact not only on the ease of creating a business, but also on new business registration. Overall, the data show that a quick, efficient and cost-effective business registration process is critical to fostering formal sector entrepreneurship.

Microfinance meets the market, but with high transaction costs

Microfinance institutions have proved the possibility of providing reliable banking services to poor customers. Their second aim is to do so in a commercially viable way. Research analyzed the tensions and opportunities of microfinance as it embraces the market, drawing on a dataset that includes 346 of the world's leading microfinance institutions and covers nearly 18 million active borrowers.

The data show remarkably high rates of loan repayment, but the data also suggest that profit-maximizing investors would have limited interest in most of the institutions focusing on the poorest customers and women. Those institutions, as a group, charge their customers the highest fees but also face particularly high transactions costs, in part due to small transactions sizes. Innovations to overcome well-known information problems in financial markets were a triumph, but further innovation is needed to overcome the challenges of high costs.¹⁴

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Human Development and Public Services

Human development and basic services delivery are at the core of the World Bank's strategy to improve people's lives and support sustainable development. The research program aims to deepen understanding of the factors affecting human development, measure the quality and impact of service delivery, and analyze the economic and political institutions that affect those services. This program also includes research on labor and migration, as well as on the effectiveness of aid in developing countries.

Themes

The research team continues to measure dimensions of human development such as learning, productivity, good health, vulnerability, and the quality of services¹⁵— as well as to analyze the factors associated with human development.¹⁶ Especially in the context of the current global economic crisis, it is important to examine the various sources of poor human development and vulnerabilities, including income or wealth, gender, and ethnicity.¹⁷

Ongoing research focuses on how policy makers and service providers respond to performance incentives and accountability mechanisms, and how people's investment in human capital can be influenced by price incentives¹⁸—a significant departure from studies that have typically focused on the impact of expenditures and the availability of inputs. Several studies are ongoing impact evaluations. Research has also examined the larger political context, the quality of governance and the incidence of public expenditures,¹⁹ as well as social and economic rights and the enforcement of those rights that might affect the delivery of basic services.²⁰

One of the biggest challenges of development is how to create more and better jobs and to ensure that labor markets work better for poor and disadvantaged people. Research is examining the extent to which poor people benefit from the expansion of work opportunities, the impact of migration to take advantage of those work opportunities, as well as the impact of human capital on employment and wages.²¹

With increasing need to provide higher levels of aid to developing countries donors, questions about aid effectiveness are as alive as ever. Research on aid is focused on several dimensions: on measuring the quality of aid, including the predictability of aid flows and the

degree to which they are fragmented among donors; the factors that affect the quality of aid on both the donor and recipient sides; and its impact on development.²²

Highlights

The quality of learning is higher in Pakistan's private schools

Between 2001 and 2005 primary school enrollments in Pakistan jumped by 10 percentage points. Extensive surveys of schools and households in rural Punjab, however, show that children perform significantly below curricular standards at their grade-level. Furthermore, performance differs by whether children attend a public or private school. In general, while government schools are staffed by better qualified teachers (nearly half of government teachers have a university degree or higher), private schools which had multiplied in number in urban and rural areas achieve better outcomes. By the time children in private schools are in class three, they are 1.5 to 2.5 years ahead of government school students.

The results suggest that greater effort among private school teachers trumps the higher training of government school teachers. The downside of private schools is that they are not located everywhere; for girls, this is a disadvantage since girls' enrollment drops by 20 percentage points for every 500 meters that a girl has to travel to school.²³

Cash transfers to women increase their bargaining power in Ecuador

Cash transfer programs have become increasingly popular as a poverty alleviation tool in developing countries—but how poor people use the income transfers influences their impact. Past evidence shows that women have different preferences over household expenditures than

men, and so the gender of recipients could determine how such transfers are used. A study of an unconditional cash transfer program to poor women in rural Ecuador found that households randomly assigned to receive the transfers have a significantly higher food share in expenditures than those randomly assigned to the control group, but that this higher food share is seen only among households that have both adult males and females, not among households that only have adult females.

The results indicate that an impact of the program is to improve women's bargaining power in mixed-adult households. The findings imply that taking into account gender effects in the design of social programs could improve the impact of such programs.²⁴

Internal migration brings welfare gains to China's rural areas

Evidence suggests that the massive out-migration from rural China to urban areas improved the living standards of those left behind, and reduced inequality within villages. In 1987, 3 percent of working-age adults were migrants; by 2003 this had risen to 23 percent, with considerable variability across villages. A new national ID card and a program facilitating legal temporary residence in the cities had made migration easier.

Using the timing of these programs to identify the decline in the cost of migration, this study found that poorer households experienced higher consumption and income growth as the cost of migration fell. The average income per capita of poorer households rose as they supplied more labor to productive activities and acquired more land for agricultural production. Migration also facilitated the accumulation of housing wealth, consumer durables, and investments related to agricultural production, although there is little evidence of more investments in assets for non-agricultural production.²⁵

Social health insurance vs. tax-financed health systems? Mixed evidence

Many researchers agree that private health insurance can play only a supplemental role in achieving universal health insurance; they are less united on the merits of general-revenue finance and social health insurance (SHI). SHI relies on earnings-related contributions by workers; non-contributors are either not covered

or are covered via revenues. Many SHI systems rely on a "purchasing" agency to contract with competing providers, while tax-financed systems rely on a directly managed provider network, a distinction that is becoming increasingly blurry.

The transition from general-revenue finance to SHI during the 1990s in central and eastern European and central Asian countries increased health spending by 5-10% and hospital admissions by 2-3%, but without any improvement in health outcomes. SHI is estimated to have increased (gross) wages by 20 percent, reduced employment by 10 percent, and increased self-employment by 17 percent.²⁶

Public support in donor countries affects the level and effectiveness of foreign aid

Public attitudes toward aid will determine whether or not donor governments can generate support from taxpayers for more aid. With weak support, aid agencies are likely to be risk averse in their choice of projects. Although OECD-Development Assistance Committee encourages bilateral donors to funnel much of their aid through multilateral institutions such as the World Bank, they are less likely to yield control over how aid is spent.

Analysis of cross-country surveys implies that, with a deep recession in donor countries, concern over personal finances will weaken support for aid, but that support is likely to remain relatively higher among people who are more interested in politics; left-of-center; more religious regardless of faith; and have more trust in government, NGOs, and aid agencies. Support for aid is higher in smaller countries and countries with former colonies. More can be done to improve knowledge and opinion about aid in donor countries.²⁷

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Macroeconomics and Growth

Growth is essential for sustained poverty reduction, the Bank's paramount objective. The research program aims to guide policies and reform strategies conducive to sustained high growth. To do this, research seeks to identify the factors behind the diversity in aggregate economic performance across the world and understand how it is affected by policy and institutional changes under different country circumstances.

Themes

The research program explores the micro- and macroeconomic foundations of growth and aggregate economic performance. It has an empirical orientation and draws from a wide range of data sources—from firm surveys to national macroeconomic data, as well as simulation models. Current research on growth seeks to understand how policy actions and reforms translate into growth, with special attention to the role of country-specific initial conditions and complementarities among different policies.

Ongoing work explores the determinants of firm behavior and microeconomic efficiency and their contribution to aggregate economic performance, as well as the effects of the policy and institutional environment on innovation and technological upgrading.^{28, 29} Work on the growth effects of macroeconomic policies investigates the consequences of fiscal and exchange rate policy for long-term growth.^{30, 31}

Research on aggregate volatility and macroeconomic stabilization examines the contribution of policy and other forces (from external shocks to natural disasters) to economic fluctuations, and their consequences for growth and welfare. It assesses reforms to reduce the aggregate instability through suitable fiscal and financial policies, as well as policy measures to tackle microeconomic inflexibility.³²

The opportunities and risks posed by deepening international economic integration represent a major research theme. Access to external financing broadens firms' and countries' investment and risk diversification possibilities, but it also increases their vulnerability to global disturbances in real and financial markets. Research assesses these conflicting effects and the trade-offs between them. It also examines the

mechanisms of international propagation of shocks under different policy and institutional conditions, to identify suitable risk-management strategies for developing countries.^{33, 34}

Research on the role of governance and institutions for sustained growth draws on both aggregate and micro to assess the effects of governance, determine the channels through which it affects economic efficiency and aggregate growth, and identify the institutional and political economy factors, such as citizen information and political accountability, that contribute to good governance.^{35, 36, 37} Ongoing work on conflict and violence assesses the policy and institutional strategies conducive to sustained peace and development in countries emerging from conflict.^{38, 39}

Highlights

The growth effects of trade reform depend on accompanying measures

Although on average trade reform has been found to promote growth, the evidence shows a large degree of heterogeneity in its effects. The reason is that the ability of reforming countries to take advantage of increased international competition and access to foreign markets depends on complementary reforms and structural factors that shape the availability of productive inputs—such as human capital and infrastructure services—and the ease with which they can be reallocated to their most productive uses following trade reform—as determined by labor market flexibility, financial market development, overall governance quality, and the extent of barriers to firm entry and exit. International evidence shows that the growth payoff from trade reform is significantly bigger when the removal of obstacles to trade is accompanied by complementary domestic reforms in these areas.^{40, 41}

Global integration has promoted contagion of real and financial shocks

Emerging market crises in the 1990s generated widespread contagion, but more recent crisis episodes (notably, in Argentina) were mostly contained within national borders. Some observers concluded that in the 2000s financial markets had learned to discriminate between emerging countries with good and bad fundamentals, making contagion a thing of the past. However, closer inspection of trade and financial data reveals that the main channels of transmission of turbulence across countries—international trade linkages and the portfolio positions of international investors—are actually stronger today than they were in the 1990s, thus enlarging the room for the rapid propagation of shocks. These conclusions have been borne out by the current global crisis.⁴²

A growing number of firms simultaneously receive credit from their suppliers and grant it to their customers, and this makes trade credit a potentially important—but often neglected—mechanism for the propagation of idiosyncratic shocks. The intuition is simple: a firm facing default by its customers may run into liquidity problems and default on its own suppliers. International evidence on the co-movement of output across different industries shows that an increase in the use of trade credit along the supply chain linking two industries significantly increases the correlation between their outputs, confirming that trade credit does help propagate sector-specific shocks across industries.⁴³

To stem contagion, countries sometimes resort to capital controls, but their effectiveness remains controversial. The fact that major emerging-market stocks trade in both domestic and international markets allows a direct assessment of the effects of capital controls. In their absence, price deviations across markets are rapidly arbitrated away, particularly for liquid stocks. But barriers to cross-border capital flows effectively segment markets: controls on capital outflows induce positive premia between

domestic and foreign markets, while controls on inflows have the opposite effect. The size of these premia varies with the intensity of capital controls.⁴⁴

Fiscal policy choices are largely shaped by political incentives

Traditional wisdom holds that runaway public spending is more likely to arise under elected multi-party coalition governments than under single party governments, and that politicians strongly favor pork barrel spending, even when other spending on broad public goods would be socially preferable. New research overturns both of these views. First, coalition governments are likely to tax and spend less than single-party regimes.⁴⁵

The reason is that parties seeking to govern without coalition partners have to spend more universally, to win the support of “swing voters” unattached to political parties. This suggests that in single-party regimes fiscal responsibility may be better enforced by an independent agency than by the finance ministry. Second, data from Indian districts show that political parties can help limit politician bias toward pork-barrel spending: members of parliament spend less of their constituency development funds when they are from districts where their parties are strong.⁴⁶ Political parties may have greater incentives than individual legislators to provide broad-based public goods; when they do, these party-enforced constraints on spending are welfare-improving.

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Poverty and Inequality

The research program on poverty and inequality has two main objectives. The first is to improve current data and methods of poverty and inequality analysis. The second is to better understand the economic and social processes determining the extent of poverty and inequality, assessing the effectiveness of specific policies in reducing poverty, and tracking the impact of the ongoing global economic crisis.

Themes

Since 2006, the central themes of the Poverty and Inequality team's work have been laid out in two research programs. The Equity and Development program (2006-2009) builds on insights from the *World Development Report 2006: Equity and Development*. The program aims to add rigorous new thinking and evidence in two areas where the development report was more speculative, given limitations on the existing stock of knowledge: better data for describing inequity, and research on understanding and breaking poverty and inequality traps.

This team's work has been on multiple fronts, and include producing new household-level survey data, monitoring poverty and inequality using household-level data (including the global poverty monitoring task, which produces the Bank's official "\$1.25 a day" poverty counts) and developing improved tools for the analysis of poverty and inequality. As the ongoing global economic crisis unfolds, these efforts are increasingly focused on gauging its impact on distributional outcomes in the developing world.

In support of the Bank's role as a leader in the production of accurate and policy relevant micro-level data, the newest phase (Phase IV) of the long-standing Living Standard Measurement Study (LSMS), also launched in 2006, is an innovative new multiyear program of research aimed at improving the quality of household-level measurement of key concepts in poverty and policy analysis. Through methodological experiments, field validations, as well as reviews of existing knowledge, the program aims to provide sound advice for improving LSMS and other surveys in developing countries.

Highlights

New global poverty numbers underpin assessments of crisis impacts on the poor

New poverty estimates produced by the Poverty and Inequality team reveal that 1.4 billion people

in the developing world (one in four) were living on less than US\$1.25 a day in 2005, down from 1.9 billion (one in two) in 1981.⁴⁷ These numbers imply that as of 2005 the developing world was still on track to halve extreme poverty from its 1990 levels by 2015— but they also indicate that poverty has been more widespread across the developing world over the past 25 years than had been previously estimated.

The estimates confirm that progress in reducing poverty varies significantly across regions, with Sub-Saharan Africa posing a particular challenge. The new poverty calculations represent an important improvement over previous estimates because they take into account newly available, and highly detailed, information on cost-of-living variation across countries published by the International Comparisons Project (ICP). The ICP is a global statistical initiative to develop comparative prices of goods and services, expressed as internationally comparable exchange rates known as purchasing power parities.

With the onset of the global economic crisis in 2007 and 2008, attention is firmly focused on the distributional impact of a slowdown in economic growth in the developing world. The newly published poverty estimates are providing the baseline against which future poverty estimates are to be compared, and also underpin ongoing efforts to develop projections of the impact of alternative growth scenarios on global poverty.

National and global economic trends impact poverty through migration

Assessments of past economic and financial crises reveal that migration flows often constitute an important conduit through which macroeconomic developments affect distributional outcomes.⁴⁸ Detailed empirical studies highlight how migration can serve both as a response to crisis, as well as a means through which macro-crisis is transmitted to vulnerable households.

A study in Albania shows that following collapse of the former socialist regime, bloated public sector employing over 850,000 individuals shrank to less than one-quarter of its original size between 1991 and 2001.⁴⁹ The resulting economic hardships, accompanied by geographic proximity and the lure of western affluence, led many Albanians to migrate to neighboring countries as a way to sustain or improve their economic position. Within a decade, more than one-fifth of the Albanian population is thought to have moved abroad, mainly to Greece and Italy. The study documents that returning migrants were particularly likely to invest in small businesses and thereby contribute significantly to the emerging non-farm business sector in Albania.

Migration can affect living standards not only directly through the incomes earned by migrants, but also indirectly via labor market decisions at the household level. Two studies of migration in Nepal found that while migration did contribute significantly to poverty reduction, male migration for work reduced labor market participation by women left behind.^{50, 51}

A recently launched study in Guatemala seeks to assess how remittance income flows are responding to the economic downturn in the United States. Declines in employment rates in sectors that are intensive in their employment of migrants (such as construction) have resulted in sharply contracted remittance flows to sending countries. This study will focus on four municipalities in rural Guatemala to assess how declines in remittance incomes have impacted living standards of migrant-sending households.

New analytic software raises the productivity of World Bank staff

To assume its continued relevance to development policy discussions, the poverty analysis conducted in the World Bank requires the best analytic tools. Standard “off the shelf” software packages lag behind the new trends in research or do not put enough weight on the needs of poverty analysis.

This need is met through the development of new software programs. Some have become industry standards, such as the widely used Povcal and PovcalNet. In addition, since 2007, innovative new software, called ADePT, has been produced

aimed at simplifying and speeding up the production of analytical reports in the Bank.

Drawing on micro-data from household surveys, ADePT generates a set of about 50 print-ready tables and graphs in different areas of analysis. Tasks that would ordinarily take several weeks of a qualified analyst’s time can now be accomplished in minutes, with reduced human error in the calculations. State-of-the-art methods of applied economic analysis are built in to the software, and ADePT is also a tool for sensitivity analysis, data checking, and for educational purposes.

The program fosters the production of standardized statistics among countries and thereby facilitates inter-country comparisons. The first three ADePT modules cover Poverty and Inequality, Labor, and Maps. Two new modules, Social Protection and Gender were released in August 2008. Modules on Health, Education, as well as modules for automated construction of poverty lines and a proxy means tested system of social protection, are under development.⁵²

New software to estimate poverty maps combines household survey data and population census data, a procedure so computationally intensive that standard statistical software packages such as SAS, STATA or SPSS often become unwieldy and sometimes even nonfunctional. PovMap2 software provides a dramatically more efficient platform, and may be useful whenever analysis of very large datasets is undertaken.⁵³ Current efforts are focused on adapting the poverty mapping methodology to the development of software (NutriMap) to assist in the small-area estimation of nutritional outcomes.

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Sustainable Rural and Urban Development

Research on rural and urban development, infrastructure, and the environment covers many aspects of and interactions within the rural-urban space. Poverty is a rural phenomenon in many countries (75 percent of the world's poor live in rural areas), but in fast urbanizing countries poverty is increasingly becoming a predominantly urban phenomenon. With climate change becoming a focus of international policy debates, the research program on this topic has expanded significantly.

Themes

The research program on rural development reflects key operational areas of the World Bank: agricultural development in Africa, community-driven development, diversification of nonfarm rural income, land policy, rural microcredit, rural infrastructure, and water resources management.

The climate change research program investigates impacts and potential responses at the local, regional, and global scales. Urban research examines linkages between energy consumption, and pollution and carbon emissions in large cities. Rural and regional research evaluates adaptation policies in agriculture (in Africa and Latin America), possible scenarios for expanding renewable electricity supply in underserved areas in Africa, as well as potential adaptation options for water allocation treaties in international river basins. Global work focuses on flexible coordination mechanisms among countries to reduce greenhouse gas emissions, and improve energy efficiency in transportation systems. Research on sustainable energy production includes tradeoffs among nonrenewable and renewable resources and the implications of biofuel production on environmental pollution and global food supply.

Planned environment research deals with indoor pollution, public disclosure policies on environmental performance, and the health effects of pesticides.

The infrastructure and urbanization research program highlights spatial linkages. It focuses on the role of externalities (such as agglomeration effects), public infrastructure investment, and urban management in addressing issues of lagging economic growth and urban poverty. Results from this research program have been center stage in the 2009 World Development Report entitled "Reshaping Economic Geography."

Highlights

Uncertain gains from formalizing land rights in Sub-Saharan Africa

Many African countries have recently adopted innovative land laws to increase tenure security and investment as well as transferability and productivity. Although land tenure formalization is widely promoted as a low-cost way to boost agricultural investment and productivity and to stimulate land markets, no real consensus has emerged on the relevance of such policies in Africa, where pre-conditions for success are often less favorable. New research analyzes a large sample of plots located in an important and relatively commercialized rice-growing area of Madagascar, which, historically, has had a high concentration of titled land. To minimize the influence of confounding factors, titled plots are compared to untitled plots cultivated by the same household. Titled rice plots are no better maintained than untitled ones, but titled plots are modestly more productive and valuable. The results are consistent with evidence showing that customary arrangements already provide substantial land tenure security in rural Madagascar. An upper bound estimate of the value of a title, or its equivalent, is about 60 USD per hectare. This benefit is less than the per-parcel cost of some proposed land registration programs in Madagascar.⁵⁴

A second study considers the case of Ethiopia, where over a 3-year period certificates to more than 20 million rural plots have been distributed. The research finds that securing land rights on a large scale and at low cost (about one-tenth of the most cost-effective programs elsewhere) is possible and can yield significant benefits. In particular: (1) democratic control of the certification process was highly effective in preventing abuse by the powerful and helping to resolve disputes; (2) certification significantly increased tree planting and soil conservation

investments; (3) even poor beneficiaries are willing to pay for updating of certificates, making maintenance of an appropriately designed registry system on a cost recovery basis feasible; and (4) more than 80 percent of beneficiary households perceive certificates to have increased women's empowerment (by allowing them to defend land rights in cases of inheritance or divorce), transfer of land through rental markets, and governance (making uncompensated expropriation less likely).⁵⁵

Benefits from improved connectivity via better road infrastructure

New research for Bangladesh documents the importance of linkages between the farm and urban areas for rural non-farm employment. Econometric results indicate that high return wage work and self-employment in non-farm activities cluster around major urban centers. Spatial isolation discourages high return wage work and self-employment, and these effects are magnified in locations with higher agricultural potential. The study underscores the need for improved connectivity of regions with higher agricultural potential to urban centers for non-farm development in Bangladesh.⁵⁶

The gains from improved connectivity are also apparent at the cross-country level. New research attempts to estimate how much trade expansion will occur as a result of upgrading and maintaining the trunk road network connecting 83 of the largest cities and capitals in Sub-Saharan Africa. Intra-African trade alone is expected to increase from 10 to about 30 billion USD per year, with additional benefits accruing from greater domestic trade, increased access to global markets, and considerable employment effects. Program cost estimates based on Bank project experience would amount to about 20 billion USD for initial upgrading and 1 billion USD for annual maintenance over a 15-year investment cycle. These results indicate that payoffs from coordinated regional infrastructure investments in Africa could be large.⁵⁷

A detailed study of Nepal investigates the relationship between isolation and subjective welfare. This is achieved by examining how distance to markets and proximity to large urban centers are associated with responses to questions about income and consumption adequacy. Results show that isolation is associated with a significant reduction in

subjective assessments of income and consumption adequacy, even after controlling for consumption expenditures and other factors. The reduction in subjective welfare associated with isolation is much larger for households that are already relatively close to markets. These findings suggest that welfare assessments based on monetary income and consumption may seriously underestimate the subjective welfare cost of isolation, and hence will tend to bias downward the assessment of benefits to isolation-reducing investments such as roads and communication infrastructure.⁵⁸

The impacts of climate change will not be evenly spread across Africa

Before policymakers can respond appropriately to climate change, they need to be able to reliably gauge the varying impacts of a warming planet in various locations. New research has quantified for the first time how climate change might affect net farm revenue from both crops and livestock across 16 agro-ecological zones in Africa.

Farmers will be able to tolerate—or perhaps even take advantage of—mild or moderate climate change through various adaptation measures, including switching among crops and livestock species, or between crops and livestock. Under certain climatic conditions, livestock species may provide more flexibility to some farmers and could help offset losses in crop income. However, the study—based on a survey of 9000 farmers in 11 African countries—shows that future farm incomes in Africa are very climate sensitive, and will be severely threatened in the event of extreme climate change scenarios.⁵⁹

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Trade and International Integration

The outlook for developing countries' trade deteriorated sharply in 2008, with important shocks in food, energy, and financial sectors. From late 2008, trade declined sharply and progress on trade reform decelerated or even went backwards. In this challenging context, the trade research program seeks to better understand the role of international trade in goods and services, foreign direct investment, and migration, in economic development, and to analyze policies to increase the benefits to poor people.

Themes

The trade research program has four broad themes: (1) empirical studies of relationships between policies affecting international trade in goods, services, and people, and economic development outcomes; (2) analysis of “behind the border” factors affecting the costs and benefits of trade, such as service sector performance, logistics costs, labor market or competition policies; (3) analysis of international trade agreements, both multilateral (WTO) and bilateral or regional; and (4) dealing with the implications of crises for the poor.

Highlights

Trade liberalization can occur in many ways, and be politically difficult

Two new books on agricultural trade distortions point to major changes in developing countries' agricultural trade policies. The direct taxation of export-oriented agriculture that was a key feature of developing country trade policies has almost disappeared in the past twenty years, while indirect taxation through support to non-agriculture has been sharply reduced. Protection to import-competing agriculture has risen, leaving average protection to agriculture close to zero, but with substantial variations in protection between sectors.⁶⁰

Many argue that Free Trade Areas (FTAs) reduce the trade opportunities of non-members. A new study of 10 Latin American countries finds that preferential tariff reduction leads to reductions in external tariffs. External liberalization is greater if preferential access is granted to important suppliers. These “complementarity effects” of preferential liberalization do not arise in customs unions, suggesting an important reason to prefer FTAs over customs unions.⁶¹

If successfully completed, the Doha Development Agenda would substantially strengthen disciplines on protection. Current proposals would reduce average tariff bindings (ceilings) for agricultural products from 40 to 30 percent, and for non-agricultural goods from 8 to 5 percent. Proposals for trade in services would reduce the average gap between offers and actual policies by almost half—from 84 percent to 43 percent. The average applied tariffs facing developing country agricultural exporters would fall from 14.2 to 11.5 per cent; and those facing exports of manufactures from 2.9 to 2.1 per cent. Agricultural export subsidies would be banned.⁶²

Many trade problems require international cooperation

In many poor countries, sharp increases in prices of staple foods in the first half of 2008 raised the real incomes of those selling food while hurting net food consumers. Results using household data for nine low-income countries show that the short-run impacts of higher staple food prices on poverty differ considerably by commodity and by country, but, that poverty increases are much more frequent, and larger, than poverty reductions. Increases in food prices appeared likely to raise overall poverty in low-income countries substantially without urgent international assistance.⁶³

The difficulties involved in completing the Doha Development Agenda raise important questions about whether fundamental reform of the WTO system is required. Some argue that the traditional negotiating dynamic of the multilateral system, driven by private sector interests, is running out of steam. If a new global approach is required, what elements should it include? Might it include concerns about food, energy and economic security, or issues such as currency undervaluation and the role of sovereign wealth funds?⁶⁴

Trade policies require careful explanation, measurement, and analysis

It is well-known that declining industries are more likely to receive trade protection, yet standard economic approaches suggest that protection should be given to expanding sectors. To explain this anomaly, a new study introduces concepts of loss aversion from behavioral economics to better explain actual policy choices. A clear prediction emerges—when an industry first begins to decline significant protection is provided to isolate it from world price declines. However, if the industry continues to decline, policy approaches free trade.⁶⁵

A new study uses three measures of trade distortions to summarize policies. The trade restrictiveness index (TRI) summarizes the effects of a country's own trade policy on its welfare; the overall trade restrictiveness index (OTRI) summarizes effects on its import volume, and the Market Access OTRI (MA-OTRI) summarizes the effects of partner countries' distortions on its exports. Poor countries are found to be more restrictive, but to face higher trade barriers on their exports. Considering non-tariff barriers as well as tariffs close to doubles measured trade restrictiveness.⁶⁶

A study for the International Study Group on Exports and Productivity finds that exporters have higher productivity than domestic firms, which provides opportunities for raising overall productivity. These premiums are found to vary considerably across countries, being higher in countries with lower export participation rates, with more restrictive trade policies, and with lower GDP per capita, and in countries exporting to relatively more distant markets.⁶⁷

Trade costs and product standards matter hugely in developing countries

Trade costs are higher for African countries than for other developing countries. A new study concludes that the gains for African exporters from improving the trade logistics half-way to the level in South Africa are equivalent to large cuts in tariff barriers. As an example, improving logistics in Ethiopia half-way to the level in South Africa would be roughly equivalent to a 7.5 percent cut in tariffs faced by Ethiopian exporters.⁶⁸

Countries in Southeast Asia appear to perform well in terms of costs to import and export, with costs more or less in line with the OECD average. However, much scope for progress remains in ASEAN in the time and paperwork it takes to complete cross-border transactions. New analysis suggests reform in port facilities and the Internet services sector could expand ASEAN trade by up to 7.5 percent (\$22 billion) and 5.7 percent (\$17 billion), respectively.⁶⁹

Migration can have major development impacts

The determinants of women's migration, the impacts on households back home and their performance in the U.S. labor market are examined in a new book. Key findings include the following: the share of female migrants has risen to half the total; schooling raises migration from rural Mexico to the United States for women but not for men; and diaspora networks have a significant impact on migration while macroeconomic and U.S. policy variables do not, except for expenditures on border barriers which deter female migration.⁷⁰

A new study finds striking differences among highly educated immigrants in the United States, even after controlling for age, experience and level of education. Educated immigrants from Latin American and Eastern Europe are more likely to end up in unskilled jobs than those from Asia and industrial countries. The study concludes that "underplaced" migrants suffer primarily from low (or poorly transferable) skills and many problems might be reduced with better sharing of information on labor market conditions and recognition of workers' qualifications.⁷¹

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