

**Development through the Decades**  
**A Critical Look at 30 years of the World Development Report**

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Few people read big books anymore. So I have written a small book that meditates on the content of 30 big books on development. In it I celebrate the advances in our knowledge of development and comment on its practical contribution.

I hope that you will agree with me that this is an appropriate time to take stock of what development economics has to offer by way of practical policies. In a matter of months, a problem that emerged in one corner of the financial market in the United States has mushroomed into a global crisis affecting all countries. During the East Asian crisis eleven years ago, the advanced industrial countries were largely spared and their resilience speeded up recovery. This is not the case now. The epicenter of the current crisis lies in the west and this together with globalization, explains both its seriousness and speed with which the shock has been transmitted around a world. Coming on the heels of the price spikes of energy, raw materials and food grains, the consequences threaten to be devastating; unless, effective policies speedily implemented, can undo the damage

done by wrong headed policy making, regulatory incompetence, the irrational exuberance of unchecked market forces and the unanticipated costs of apparently benign financial innovations. Most puzzling is the apparent failure of the layers of market institutions, regulators, monitoring agencies, international bodies such as the IMF and the FSF, highly informed market participants and commentators, and the experienced financial entities who have suffered huge losses, to anticipate not just the crisis but also its magnitude. After all, global financial integration is a well known fact. Almost equally surprising is the absence of a broad consensus on reflationary measures even when the potency of monetary policy is close to being exhausted.

When I embarked on this study towards the very end of 2007 for the 30<sup>th</sup> Anniversary of the World Development Report, the question as to whether development economics was up to the task of sustaining growth and lessening poverty was uppermost in my mind. As my work progressed, and the pressures released by the implosion of the subprime mortgage market began to spillover, other questions crowded in. These were questions regarding the efficacy of macroeconomic policies and regulatory institutions in managing markets which were proving to be far less stable and self-equilibrating than market participants and policy makers had been lulled into believing. I will touch upon these later in my talk.

Thirty World Development Reports comprise one very long shelf of oversize books. I was initially daunted by the thought of reviewing them all in a matter of months and feared for my sanity. What sustained me was the belief that this project provided me with an unrivalled opportunity to assess the contribution of development economics over three highly fruitful decades

Looking back over the eight month long gestation of this book, I am glad that I decided to take the plunge because the time travel through 30 years has been exhilarating to say the least.

From the outset, my intention was to produce a piece which was compact, readable and provocative-to keep the reader awake and engaged. In my talk today I will try and pique your interest by highlighting some of the big challenges for development economics, and hope that this will persuade you to read the book. I will start with the genesis and success of the WDR, and then turn to the main theme of the essay which is a critical assessment of how development economics informs policymaking.

I had been in the Bank just a handful of years when Mr. McNamara decided to launch the WDR. I remember how much excitement was generated by the announcement, and later over the anointing of the first WDR Director and the

selection of the team. When the first report was released in the fall of 1978, it was something of a banner event and enthusiastically reported in the press.

The first report caught the world's attention and subsequent reports continued to hold the attention of the development community, for three reasons:

- It effectively drew upon the then current development thinking and the Bank's operational experience to identify key development objectives and to specify the policies for achieving them, in particular, policies for raising growth and for reducing poverty;
- The report situated recent development trends and prospects within an international context;
- And the WDR deepened the discourse on development by adding empirical content. Through the world development indicators, the WDR helped to make development economics more numerate.

The first two reports were relatively short and general in their coverage. They mapped the terrain of development, they identified sectoral sources of growth, and they discussed ways of tackling poverty. Later reports, starting with the first report on poverty and human development issued in 1980, focused on specific themes and these themes have tracked prevailing or emerging concerns.

Very broadly, through much of the 1980s, issues of adjustment were at the forefront as developing countries struggled with recessions and crises. From the late 1980s through the latter part of the 1990s, the WDRs attempted to define the relative roles of the market and the state with the stress placed on the efficiency of markets in allocating resources and maximizing welfare. This was a time when a number of economies were transitioning from socialism to the free market, privatization was in full swing, and the advantages of open trading regimes and an easing of capital controls were being championed. Capitalism, liberal democracy, globalization and the IT revolution were all in ascendance. Market based economics was on the roll.

Since the start of the current decade, the WDRs have taken a microeconomic and sectoral slant, looking at how institutions and services affect economic performance and wellbeing. This reflects the current academic preoccupations in development economics.

Of course, a lot else was happening and the WDRs addressed other issues as well, but this categorization captures the overarching themes. Throughout this period, growth and poverty reduction were never far from the surface, addressed more directly in some WDRs than in others.

The earlier WDRs were relatively slim volumes. The first spanned only 68 pages and was bare of footnotes and references. Thereafter, the reports steadily

thickened and as one comes closer to the present, the reports have increased in heft and now mobilize a vast apparatus of scholarly references, detailed boxes and footnotes. They overflow with facts, and examples, and research findings which reflect the outpouring of research on development outside and within the Bank, and they benefit from the wealth of empirical information now so readily available. It is probably not an exaggeration to say that the Bank through the WDR, the WDI and other reports, has had a large hand in creating an appetite worldwide for empirical data and for indicators starting with the dollar a day measure of poverty, which has become a fixture since the 1990 WDR on poverty.

Over the years, the WDR has evolved into a bulkier and specialized document. But by covering an array of topics, through its sheer voluminousness and the depth of coverage, it does a nice job of mapping the evolution of development economics.

Three closely interrelated questions came to my mind after I had reviewed and reflected upon the contents of thirty WDRs, which I do believe provide a window on development economics like no other. First, I wondered as to how successful the discipline has been in crafting new and powerful policy tools. Second, I wondered whether our vastly greater knowledge of development is enabling us, with the help of new or old policies, to achieve the results we are seeking faster and more effectively. And third, given the progress or lack of it in

the sphere of policymaking, what are some of the big challenges for all those working to make development economics more users friendly.

From the WDRs, and by drawing upon a broad cross-section of the recent research literature, I addressed these three questions in the central part of the book.

I asked, for instance, whether we are able to give better and more customized advice to the ministers of planning and of finance on:

- Recipes for accelerating trend growth rates and sustaining them in low or middle income countries.
- On instruments which independently of faster growth, will reduce poverty and inequality.
- On defining, with a degree of precision, the state's role in industrializing and in low income countries.
- On how countries can make innovation an integral to growth
- On how aid can help raise growth and/or reduce absolute poverty.
- And on techniques for evaluating the risks of crises and helping build regulatory mechanisms to minimize their incidence.

## **Growth**

I never cease to be impressed by the ingenuity of researchers who are painstakingly teasing out the sources of growth from partial and recalcitrant data,

but it is hard to assess progress in this field. Thirty years ago, growth was explained mainly with reference to capital, labor, and total factor productivity and on occasion, human capital. From capital, the focus in recent years has shifted to factor productivity and human capital and some researchers assign a major role to institutions. But there are a number of worrisome issues. First, there are as many estimates of factor productivity as there are researchers and no one has figured out policies which would enable a country, even a well governed country, to raise and sustain productivity growth. Another worry is that, human capital is an unreliable variable; some find it has explanatory power, others don't. And over long periods of time, growth in the advanced countries, which have steadily increased the volume of human capital, is seemingly unaffected – or in some cases - is slowing.

Another issue with respect to countercyclical policy, is that the fiscal, monetary and labor market related tools that we have – which are variants of the ones we had in the 1970s – do not reliably produce results whether the objective is growth or stabilization. As the advanced economics are discovering, neither the sophisticated monetary instruments at their disposal nor the wealth of past experience on monetary policy and the deep scholarship on the Great Depression, is proving adequate in the face of the current downturn.

Monetary policy, the first resort of macro-policymakers, has been largely overwhelmed by the seriousness of the shock, the widespread loss of confidence in the banking system and a number of other financial intermediaries, and the erosion of bank equity, and the flight to liquidity. Moreover, the experience of industrializing economies suggests that monetary easing has not been instrumental in paving the way to recovery.

Fiscal policy has its own problems. Until very recently scholarly opinion leaned towards the view that because of long and variable lags, leakages, and uncertainty regarding the consumption inducing consequences of tax cuts, fiscal policy was a weaker instrument for pulling an economy out of a downturn. That governments are turning to Keynesian fiscal remedies – and frequently invoking his name - is not because of new evidence to the contrary but because policy options are fast running out and aggregate demand continues shrinking. However, as I noted earlier, there are many voices raised against such actions for fear that they will lead to ‘big government’ and increase debt burdens.

For those who think that market institutions are the key, the problem is that culture and history apparently come in the way of institution building policies which are complex and difficult to implement. When we look across the developing world, we find striking instances of countries where market

institutions were weak and where they are still in the gestation stage, growing faster and more consistently than countries with stronger institutions.

So after marinating in this literature, I am left puzzled. There are several striking examples of successful development most notably in East Asia, which can be linked to institutional innovations and policy intervention. But the direct operational contributions of macro and growth economics to these are difficult to determine? Has the return on 10 billion regressions been positive? I will let you be the judge.

### **Poverty**

If we face difficulties when it comes to accelerating growth, which exerts the strongest influence on poverty, can we still reduce poverty and inequality any quicker? And has this been demonstrated other than episodically in any developing country that has stagnated? From the WDRs and a reading of the literature, it is apparent that our ability to measure poverty and inequality is much improved – although the recent large adjustment in PPP based poverty numbers released by the International Comparison Program (ICP) indicates that our knowledge of poverty is still evolving. We are undoubtedly better informed about how well various policy interventions such as rural roads, safety nets, microfinance schemes, public works and health and education delivery

mechanisms have worked, or failed to deliver. Most of these are not new instruments - they were around in the 1970s - and the challenge is making them more effective so that we are able to make a bigger dent on poverty and to contain or reverse inequality under conditions of slow growth or no growth or a decline in per capita GDP. I have the sense that we will be grappling with this for some time, because thus far, the advances made by development economics have yet to provide us with more powerful and widely applicable tools.

### **Role of the State**

I recall that in the 1990s, it was possible to believe that economics could enable us to demarcate the role of the state. Privatization and market based solutions and institutions, lighter regulation and the abandonment of industrial policies where these were still practiced, were among the policy staples. They all remain relevant today, although in the light of the current crisis, we may need to rethink the state's ownership and regulatory roles with respect to certain key sectors. But I am struck by how uncertain is the guidance that research provides. Where economics remains especially inscrutable is on industrial and technological development. In the Bank, we have long considered picking winners as taboo, however, it is hard to ignore the government's role in nurturing industries through incentives, research funding, manpower policies and purchases. The aerospace,

biotech and electronics industries - to name just a few - in the United States have depended heavily on federal and state support. Now the domestic automobile sector is on federal life-support. All across East Asia, the growth of the more capital and technology intensive industries has been promoted or directed by the state. Several of these industries are now seeking state support so as to survive. In several economies, the bulk of the financial system is owned by the state which has traditionally exercised strong control over the operations of financial entities. And when I look ahead, as industrializing countries attempt to diversify industry, governments have to coax, exhort and direct, and to provide risk capital through a variety of channels. Particularly in the larger countries, both national and sub-national governments are actively involved in making industrial policy and policies with respect to technology development. Many countries are launching ambitious long-term research programs involving large commitments of specialized human and physical resources. They are gambling that certain kinds of research - whether on biopharmaceuticals or biofuels or clean technologies or nano-materials- will have a commercial payoff. There is an urgent need for guidance but one looks in vain for practical and precise policy guidelines under conditions where market signals are weak or ambiguous, or markets are missing and private businesses too risk averse to act.

## **Innovation**

In the past five years, innovation is beginning to arouse feelings one associates with religion. Among growth economists, business school professors, policymakers and even ‘Davos man’, innovation is the thing: a means of raising productivity and competitiveness and growth. Inevitably, this fascination has given rise to a flourishing research industry to which I have myself contributed in a small way. As I learn more about innovation, I am discovering that there are few simple answers. Even for wealthy countries with strongly rooted scientific traditions and mature university systems, stimulating innovation is no easy task. Many European countries have been struggling to find a means of making their companies and researchers more innovative. The United States worries that it is in danger of losing its competitive edge. China and other East Asian economies are pouring money into their nascent innovation systems so as to equal if not surpass the innovative capacity of their competitors in the West. But success is elusive and finding an effective recipe remains an enormous challenge. Broadly speaking, we know what policies matter. It is the detailed tailoring of policies to the histories and current circumstances of individual countries which slows progress to less than a crawl. Let me elaborate a little. Innovation seems to be influenced by five sets of policies and institutions:

- policies affecting the composition of industry, of technological capability and the contribution of FDI
- policies affecting urban scale and urbanization economies as well as knowledge spillovers in urban centers
- education and research policies which determine the foundation building strengths of primary and secondary schooling, the quality of tertiary education and the volume and productivity of research
- socio political institutions which assign status and recognition to learning, and encourage intellectual achievement; safeguard intellectual property; and which also promote openness to ideas and to the circulation of knowledge workers
- Institutions which stimulate competition among producers of ideas, of goods, and of services.

In other words, countries need first to build their knowledge base and to move closer to the frontiers of technology in selected fields. Once this is achieved there is scope for sustained innovation. But acquiring this technological capability is no simple matter – it remains uncoded. And once countries have acquired substantial technological depth and are near the frontiers of knowledge, it is difficult to say what might push the system they have created to deliver high and persisting levels of innovation. Spending on R&D can help; the

innovation strategies of major firms can make a contribution; and the excellence of the research universities can feed the pool of skills and of ideas. Beyond this there is little concrete to say. Whether research can fulfill the demands of national policymakers and CEOs who would like to routinize innovation, remains an open question – It is a question that deserves an answer and possibly reports like the WDR can help provide the scaffolding.

### **Foreign Aid**

I am sure that we can all agree that it is highly desirable that the aid provided bilaterally and by multilateral agencies should yield results. Not only should individual projects succeed but international assistance and the policy advice associated with it should lead to faster growth, stronger institutions and less poverty. What we would expect is that 30 years of research and operational experience, which the WDRs have encapsulated, ought to greatly enhance our ability to make aid produce the desired outcomes. The research by and large, fails to validate these expectations. From well over a hundred empirical studies, the message which emerges is not reassuring. We can undoubtedly claim a better understanding of the mechanics of the assistance process, but on the whole, aid has a persistently weak record in stimulating growth and investment and in strengthening institutions. Moreover, donors have been slow to reduce the

volatility of aid flows which degrades their effectiveness, to minimize the fragmentation of the aid effort which burdens the recipients, and to coordinate their activities. The case for aid appears no stronger from the historical perspective of individual regions such as East Asia. Some researchers maintain that we should only assess the impact of only that portion of assistance which is for development. Unfortunately, such an approach can easily introduce selection biases which can distort the results.

Could all these findings be incorrect or misleading? If they are, then we need to worry about the robustness of research in general. If they are broadly on the mark, then development economics has a lot of work ahead of it.

## **Crises**

Avoiding crises such as the one we are in is another task which economics should facilitate to a greater degree than has been the case. The record of forecasting crises has been poor, in spite of their frequency and their cost (there have been 42 banking crises in 32 countries between 1970 and 2007). The past couple of decades have witnessed a quantum leap in modeling techniques, in the volume of relevant data we can access, and in the power of computing technology, but, to quote a recent survey, “Despite increased use of sophisticated mathematical

tools the field of country risk has been unable to anticipate the onset of financial crises” (Schroeder 2008).

Following the East Asian crisis of 1997-98, there was much talk of a new financial architecture which would guard against a recurrence of the sequence of events we have observed. No such architecture was created. The call for a tighter internationally coordinated regulation of the financial system is again making the rounds. But the past history of regulation makes one pause. Regulators in the advanced capitalist economies have proven to be susceptible to political pressures and also to capture by the industries they are supposed to supervise. Problems of regulatory arbitrage and regulatory fragmentation are hard to avoid. Financial entities have considerable economic muscle, substantial political clout and considerable powers of persuasion. Regulators have found it hard to ride herd on them. In recent years because of liberalization, banks and other financial intermediaries have become bigger and more influential, while past bailouts have made them incautious about seeking more leverage and taking risks with the help of ever more complex innovations which regulators struggle to master.. Whether a new round of regulations with sufficient teeth can be introduced, remains to be seen. Certainly, our learning to date, has not uncovered the means of making regulators sufficiently autonomous and to develop the capacity to conduct systemic regulation that they are able to pursue their objectives in the face of

mounting pressures and to “take the punchbowl away when the party gets too wild”.

We face something of a contradiction. A virtual torrent of interesting and revealing findings, have enriched our understanding of development. And these findings have been grist for the WDRs. But we still are unable to provide policymakers with the means to raise and sustain growth, to lessen inequality, to define the role of the state, to anticipate and deal with financial crises, to regulate, and to get better results from international assistance.

It is possible that in the absence of this research, of reports like the WDR, and of aid, things would be far worse. But these are demanding times with many questions in the air. It not only development economics which is on the spot, but economics more broadly as we confront the mother of all recessions.

As someone who has devoted most of his working life to the study of economics, the past fifty years have been a golden age of development. I would like to believe that development economics contributed to this directly and indirectly. Certainly all of those who toiled on WDRs (and I did too) want to believe that the WDRs made a difference – they added some tiny decimal point to the growth rate.

If so, what might be the WDRs' future role and the role of other similar reports of which there are many? Should it continue along the recent trend line and provide an ever more compendious World Bank perspective on development thinking? Or should it strike out in a different direction?

In the final chapter of the book, I speculate on what might be the directions the WDR could take. Could, for instance, the defining of strategies and consensus building around these be a more effective use of the report? Would it be desirable to give more attention to the political economy of development as economics is more often an obedient follower than a leader? The roots of too many crises and the indifferent outcomes from too many policies seem to be entwined with politics. Whether a more qualitative and interdisciplinary approach will make it easier to devise policies to achieve sustainable growth, lessen poverty and reduce our vulnerability to crises, is by no means obvious. But it could inform and modulate the findings from empirical research in economics.

Sustaining development in a harsher physical environment and a more crowded, urbanized planet will require a great deal of ingenuity. The continuation of the golden age of growth, may depend upon the speed and magnitude of the international response to the immense challenge posed by climate change. Knowledge is going to have to serve as the fulcrum of progress or provide the key

to a decent survival. Much will depend upon solutions forged through application of the hard sciences. But I would hope that economics and the other social sciences can also do their bit. For instance through pricing schemes, institutional innovations, and behavioral adjustments.

Development problems are tough and perhaps it is optimistic to think that we can arrive at solutions in a few decades (the science of genomics also saw a new dawn when the genome was decoded but all we know now is that the machinery of life is more complex than we thought and the scientists need time and billions of dollars). That we understand development problems so much better should be a source of considerable satisfaction. That we are getting better at explaining why things go wrong after the fact suggests that we are inching forward. That there is no alternative to doing more research, is pretty much a given. Whether the WDRs maintain their current format or whether they adopt a different approach, we are clearly still in the foothills of development with a lot of climbing ahead.

Thank You.