A MIXED DEVELOPMENT RECORD

Economics is not only concerned with generating income, but also making good use of that income to enhance our living and our freedoms.

—Amartya Sen, A *Conversation with Sen*

In the 1990s, a group of economies in East Asia posted some of the fastest growth rates and sharpest declines, as well as recoveries, giving market liberalization policies both strong support and serious qualification. In many ways the 1990s concentrated the development experiences of the previous decades, offering approaches and cautions to guide action in the 21st century.

Looking at the previous decades of development, various studies from around the world in the 1990s spotlighted the successes in East Asia, the setbacks in Sub-Saharan Africa, and the modest gains elsewhere. The *World Development Report 1991* (World Bank 1991) articulated an emerging consensus under the rubric of a market-friendly approach, calling for a reappraisal of the roles of state and market. This and other reviews signaled the crucial roles of the state and markets in poverty reduction (World Bank 1990), in environmental protection (World Bank 1992), in infrastructure provision (World Bank 1994), and in the legal and governance frameworks and the financial system (World Bank 1997j).

Here we examine how the lessons of development have played out over the past decade. We update earlier assessments of how countries are performing with regard to poverty reduction, sustainable development, and economic growth. And we examine the global factors and policy and institutional changes underlying the countries' performance.

Evidence from the 1990s expands the development story, especially concerning institutional requirements for success, and provides a rich set of hypotheses to consider with regard to policy. First, investments in people need to be concerned with the quality and distribution of those investments. Second, rapid growth, while it supports social development when broad based, can hurt environmental sustainability in the absence of appropriate actions. Third, while market openness and competition continue to provide benefits, the financial risks must be managed with attention to country-specific factors. Fourth, good governance and institutional factors should be given priority and not postponed for later stages of reform.

Assessing Development

Development is about people and their well-being, which involves their ability to shape their lives. Accordingly, development must be inclusive of future generations and the earth they will inherit. It must engage people, for without their participation, no strategy can succeed for long. This notion of development as well-being means that measures of development must include not just rates of growth, but the dispersion, composition, and sustainability of that growth.

Development practitioners have often used growth in gross domestic product (GDP) per capita as a proxy for development, partly because social progress is associated with GDP growth and partly because of expediency. However, reliance on GDP as the sole measure of development is seriously limiting. GDP growth can be of high quality or of poor quality. Some processes and policies generate GDP growth along with the growth of human and natural assets that directly affect people's welfare beyond their productive roles. Others generate poor quality growth that is not associated with improvements of human and natural assets. To integrate the quality of growth in assessments of development, multidimensional indexes of welfare are needed.

Economic theory distinguishes the concept of growth from the broader idea of development. How carefully this distinction has been made has varied over time.[1] The rapid growth of the 1950s and 1960s motivated an increased concern for broader development goals. Over the following decades, as stagnation set in, the emphasis shifted to economic growth. In the 1990s, the broader outlook reemerged, as exemplified in the United Nations Development Programme (UNDP) *Human Development Report* (produced annually since 1990) and the World Bank's *A Proposal for a Comprehensive Development Framework* (Wolfensohn 1999).

In an ideal assessment of development, progress would be measured by human and environmental advances before considering intermediate indicators, such as GDP. However, we lack good quality data to construct robust indicators of human and environmental progress and consequently rely heavily on GDP. We supplement the analysis with indexes of human development and environmental sustainability, keeping in mind serious data limitations on some variables. Lack of consistent data on the incidence of poverty, comparable internationally and over time, forced us to exclude a poverty reduction component in our human development index. However, we document, where possible, progress in poverty alleviation and the impact of growth and development policies on poverty (see also Dollar and Kraay 2000; Ravallion and Chen 1997; World Bank 2000i). Future work should improve the scope and empirical basis of these indexes and expand the discussion to other dimensions, including cultural well-being.

Table 1.1 shows correlations among the components of the three indicators of progress since 1981: human development, income growth, and environmental sustainability. It shows that GDP growth is correlated

A step toward better and broader measures of development

Table 1.1. Correlations of Measures of Development, 1981–98

	Human development					*Income growth*	*Environmental sustainability*		
Measure of development	*Decrease in poverty*	*Increase in literacy*	*Decrease in infant mortality*	*Increase in life expectancy*	*Decrease in income inequality*	*Growth of GDP*	*Decrease in carbon dioxide emission*	*Increase in forest cover*	*Decrease in water pollution*
Human development									
Decrease in poverty	1.00	***–0.40***	0.18	0.14	***0.44***	***0.52***	***–0.45***	–0.23	0.28
		27	28	28	20	27	27	26	22
Increase in literacy		1.00	***0.15***	***–0.19***	–0.23	0.03	–0.14	0.15	***–0.21***
			115	115	41	89	102	94	72
Decrease in infant mortality			1.00	***0.54***	***0.28***	***0.20***	***–0.20***	–0.12	–0.13
				146	43	104	121	107	81
Increase in life expectancy				1.00	***0.54***	***0.17***	***–0.16***	–0.15	–0.05
					43	104	121	107	81
Decrease in income inequality					1.00	***0.34***	***–0.33***	–0.20	***0.32***
						39	41	41	37
Income growth									
Growth of GDP						1.00	***–0.53***	–0.06	***0.33***
							100	81	65
Environmental sustainability									
Decrease in carbon dioxide emission							1.00	***0.27***	***–0.38***
								87	70
Increase in forest cover								1.00	–0.14
									70
Decrease in water pollution									1.00

Note: The two values in each cell are the correlation coefficient and number of countries. Entries in bold italics are significant at the 10 percent level or better.

Sources: World Bank (2000c); authors' computations.

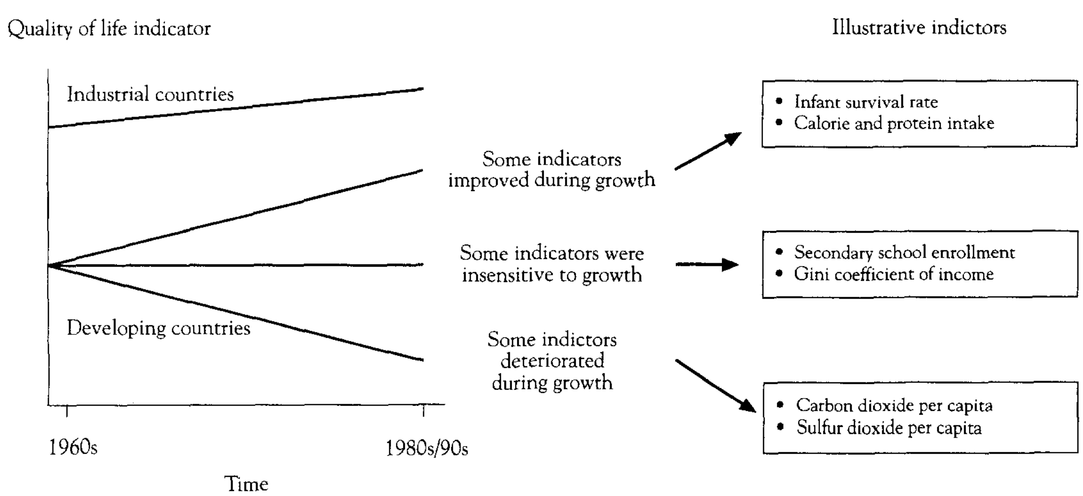
- Positively with reduction in poverty, income inequality, infant mortality, and increase in life expectancy, with considerable differences in strength
- Negatively with decline in carbon dioxide emissions and positively with decline in water pollution.

Other associations between GDP growth and changes in the components of human development and environmental sustainability are not statistically significant. These preliminary correlations suggest that GDP growth is a crucial, yet partial, indicator of development, as when it is imperfectly associated with certain aspects of human development, and at times when it is associated with an increase in environmental damage.

Easterly (1999a) applied several techniques to a large set of quality of life indicators, including tests of causal relationships. He found that fewer than 10 percent of the 81 examined indicators improved with growth. A similar fraction deteriorated with growth, and many showed no significant association with growth (figure 1.1). These findings strengthen the case for broadening the measures of development.

It is very important to note that the relationships discussed above are between *growth* of income and *changes* in human development and environmental sustainability. Relationships in most cases are much stronger with *levels* of income and indicators, particularly for human development indicators (Dasgupta 1993; Fedderke and Klitgaard 1998; Kakwani 1993; Sen 1994;

Figure 1.1. GDP Growth and Changes in Quality of Life, 1960s and 1990s



Note: The schematic trends are applicable for countries with positive GDP growth.
Source: Easterly (1999a).

World Bank 2000i). Easterly's study also looks at this discrepancy, hypothesizing that cross-country analysis of income levels may capture long-term trends that are not discernible in analysis of shorter periods, and that growth may lead to improvements in human development with long and varying lags. Alternatively, country-specific factors, such as endowments, location, and social infrastructure, could be dominant determinants of levels of both income and human development indicators. In that case the cross-country correlations between income and quality of life indicators would need to be qualified.

The Development Record

Progress in some areas of human development, especially in extending people's lives and increasing literacy, has been considerable over the 1960s through the 1990s, a period over which some data are available. However, many other qualitative aspects of life, including steady and sustained increase in incomes, poverty reduction, equality gains, and environmental quality, have lagged.

Human Development

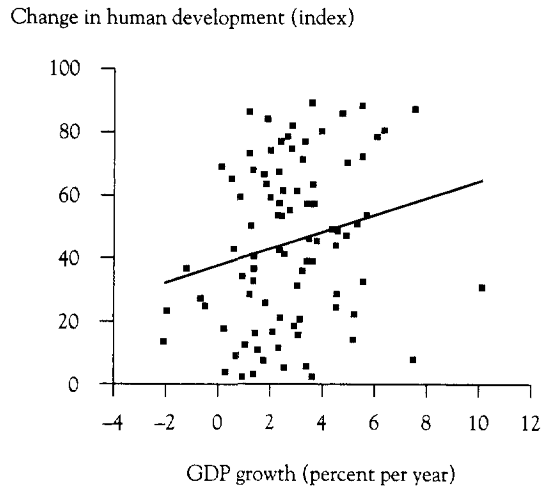
Robust economic growth is accompanied by improvements in measures of human development, such as higher literacy and life expectancy. The broad association is seen in figure 1.2.

Overall, the gains in human development over the past four decades have been enormous in some areas—partly reflecting technological improvements—and modest in others. Infant mortality and adult illiteracy rates fell dramatically almost everywhere.

Progress in raising incomes and reducing poverty has been mixed, based on the data and estimates available (figure 1.3). In the developing world, the poverty headcount index, defined as the proportion of people with an income of less than US$1 a day based on 1993 purchasing power parity (PPP) prices, decreased from 28.3 percent in 1987 to 24 percent in 1998. The East Asia and Pacific region showed the largest improvement, particularly China in the mid-1990s. Improvements were modest in the Middle East and North Africa and the South Asia regions. Poverty rates remained stubbornly high in Sub-Saharan Africa and Latin America and the Caribbean and increased sharply in Europe and Central Asia. Overall the decrease in the poverty rate could not keep pace with population growth, and the number of poor in the developing world outside China increased by about 106 million between 1987 and 1998 (World Bank 1999c).

At the end of the 20th century, the incidence of poverty increased in many parts of the world. In particular, the East Asian countries directly

Figure 1.2. Change in Human Development and Growth of Income, 1981–98



Note: $r = 0.22$, $p < 0.05$, $n = 89$. The data are for 89 developing countries. Controlling for per capita income in 1981 gives a stronger pattern with a correlation coefficient of 0.33.
Source: World Bank (2000c); authors' computations.

affected by the 1997 financial crises and the consequent slowing of growth experienced reversals in poverty reduction achieved during their period of rapid growth (World Bank 2000f). Even greater is the poverty increase in the transition economies of Europe and Central Asia, where as recently as 1987 poverty and income inequality were both extremely low. Survey data show an enormous increase in the number of poor as a result of sustained declines in economic output and worsening income distributions (Milanovic 1997) (figure 1.4).

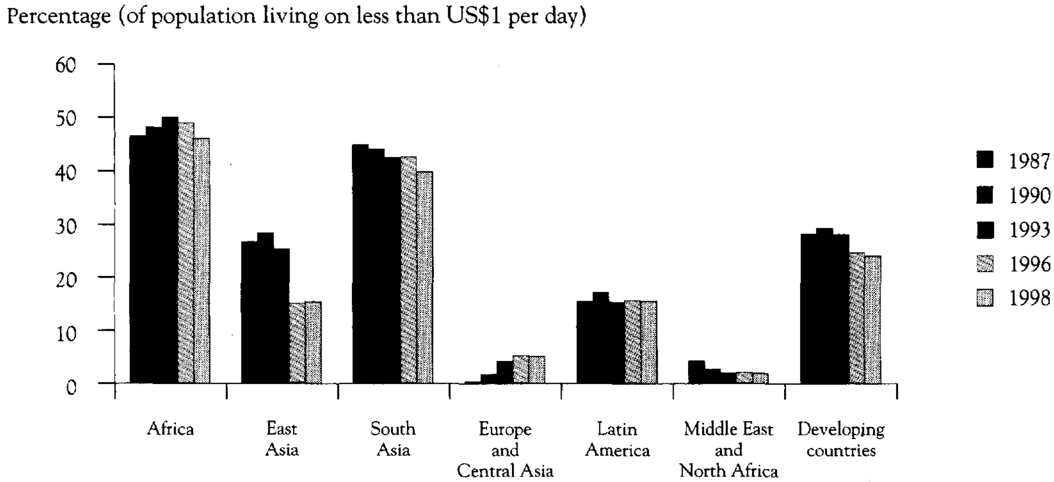
Environmental Degradation

The impact of economic growth on environmental conditions has been mixed and is a serious concern. In many instances GDP growth and higher incomes are associated with better sanitation and water quality, as well as investments in cleaner technologies. But growth is also related to increases in particulates and carbon dioxide emissions.[2] With equal weights for the changes in indicators of water quality, air quality, and deforestation, between 1981 and 1998 income growth was associated with environmental deterioration and depletion of natural resources as in figure 1.5.

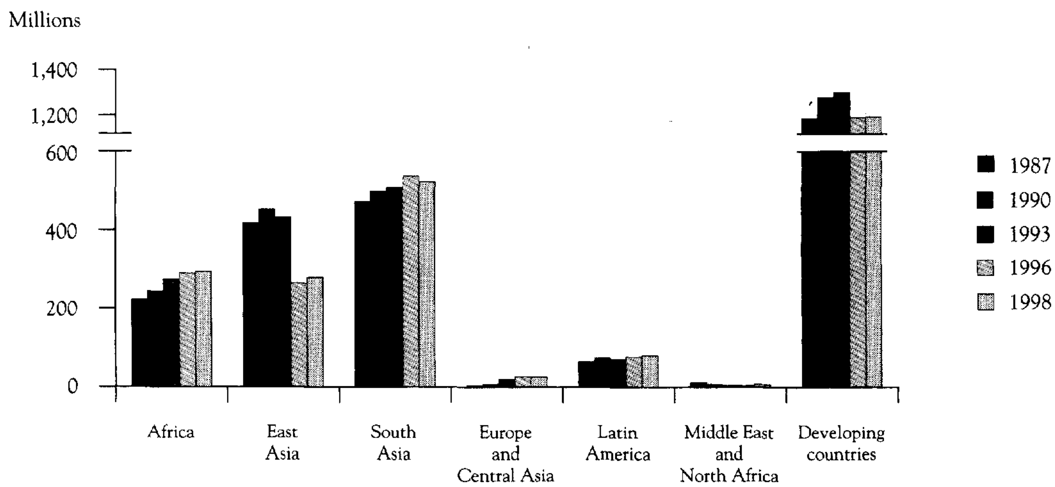
Between 1990 and 1995, the *rate* of forest clearing slowed in most developing regions, but forest cover was still disappearing rapidly. Forest cover

Figure 1.3. Poverty Rates and Number of Poor, Selected Years

Poverty Headcount Index



Number of Poor

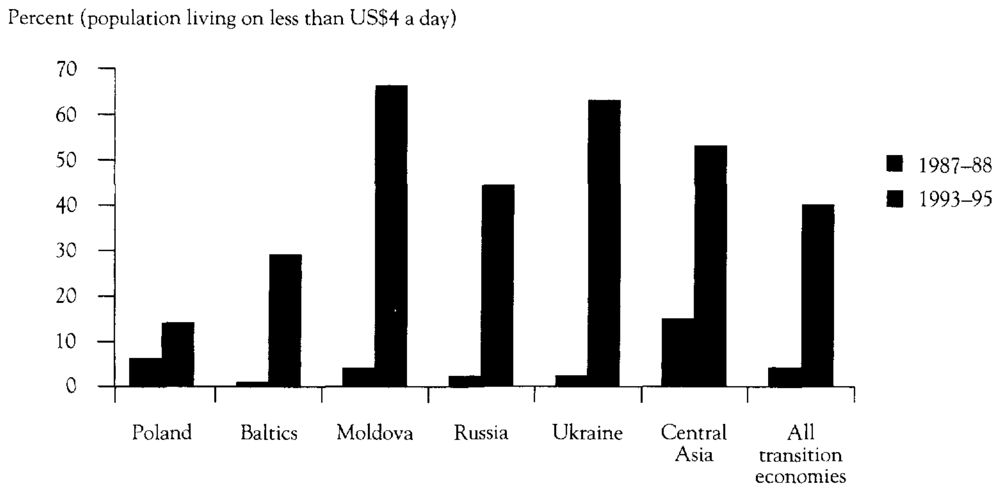


Note: Based on 1993 purchasing parity rates. The 1998 values are estimates. Poverty is defined as income of less than US$1 a day.
Source: World Bank (1999d).

increased only in high-income countries and in developing Europe and Central Asia. It is unclear how much of the improvement in the latter is the result of concerted environmental action.

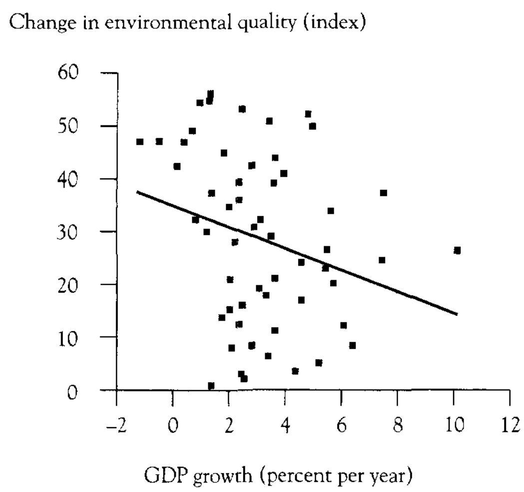
Between 1980 and 1995, carbon dioxide emissions, total as well as per capita, increased across income groups and regions. Only Sub-Saharan

Figure 1.4. Poverty Incidence in Selected Transition Economies, 1987–88 and 1993–95



Note: The poverty line of US$4 a day is considerably higher than that used elsewhere.
Source: Milanovic (1997).

Figure 1.5. Environmental Changes Versus Growth of Income, 1981–98



Note: $r = -0.27$, $p < 0.05$, $n = 56$. The data are for 56 developing countries. Controlling for per capita income in 1981 gives a similar pattern and the same value for the correlation coefficient (–0.27).
Source: World Bank (2000c); authors' computations.

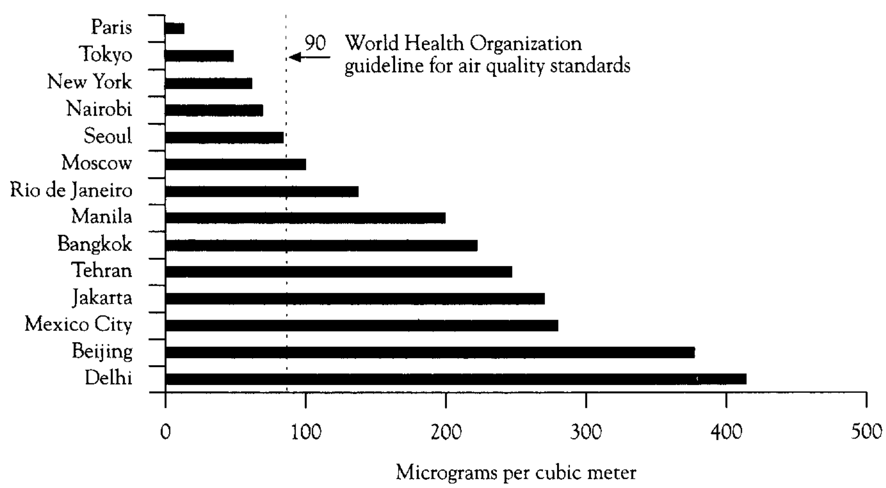
Africa, probably because of general economic stagnation, did not experience increased carbon dioxide output. East Asia had the fastest deforestation and highest carbon dioxide emissions per capita, suggesting a conflict between growth and sustainable development (World Bank 2000c).

In much of the developing world, the environmental quality is far worse than indicators portray. Air quality worsened as incomes rose.[3] Exposure to high levels of air pollution, that is, total suspended particulates, sulfur dioxide, and nitrogen dioxide, poses a major threat to human health. In Delhi, one of the world's most polluted cities, total suspended particulates were more than four times the level identified as safe by the World Health Organization (WHO) (World Bank 1999d). For particulate levels in selected cities, see figure 1.6.

The human cost of environmental deterioration is staggering. Poor water supply, inadequate sanitation, indoor air pollution, urban air pollution, malaria, and agro-industrial chemicals and waste account for an estimated one-fifth of the total burden of disease and premature death in the developing world, based on a standardized measure of health outcomes—disability adjusted life years, or DALYs. For Africa, poor water supply, inadequate sanitation, and indoor air pollution account for 29.5 percent of the disease burden, a share larger than that attributed to malnutrition, 26 percent (Lvovsky and others 1999).

Air pollution is alarmingly high in many cities in developing countries

Figure 1.6. Total Suspended Particulates, Selected Cities, Early 1990s



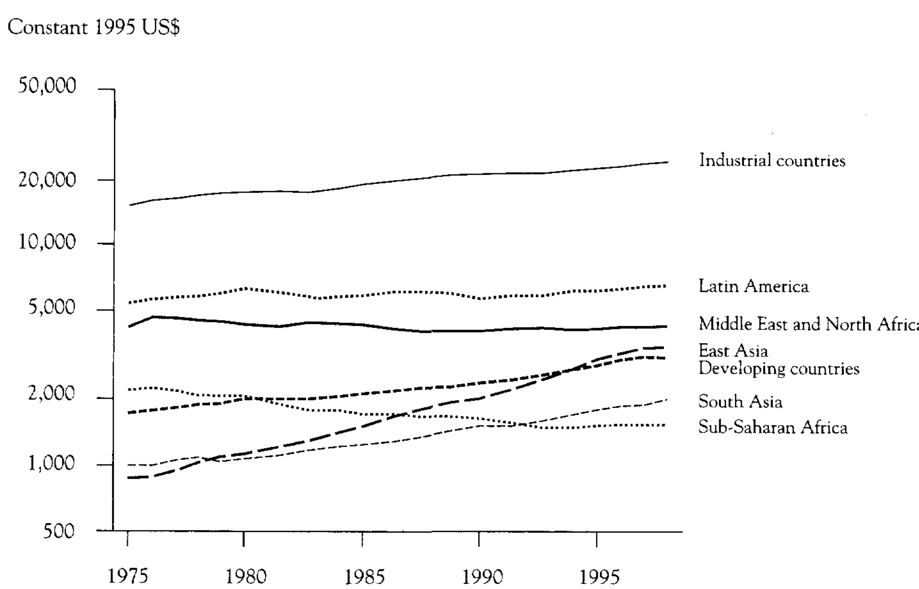
Note: Most data are for 1995. The figure for New York is for 1990.
Source: World Bank (1997i, 2000c).

Income Growth, Inequality, and Volatility

Long-term progress in income growth in the world has been very uneven. Figure 1.7 show the trends in per capita incomes in the developing regions and the industrial countries since 1975. East Asia has improved living standards significantly, while Sub-Saharan Africa has seen the opposite trend. The large variation in growth rates at the level of individual economies may be seen in figure 1.8. Of the 15 fastest growing economies, 8 are in East Asia. Many of those at the other end of the spectrum are countries affected by civil strife and other dislocations.

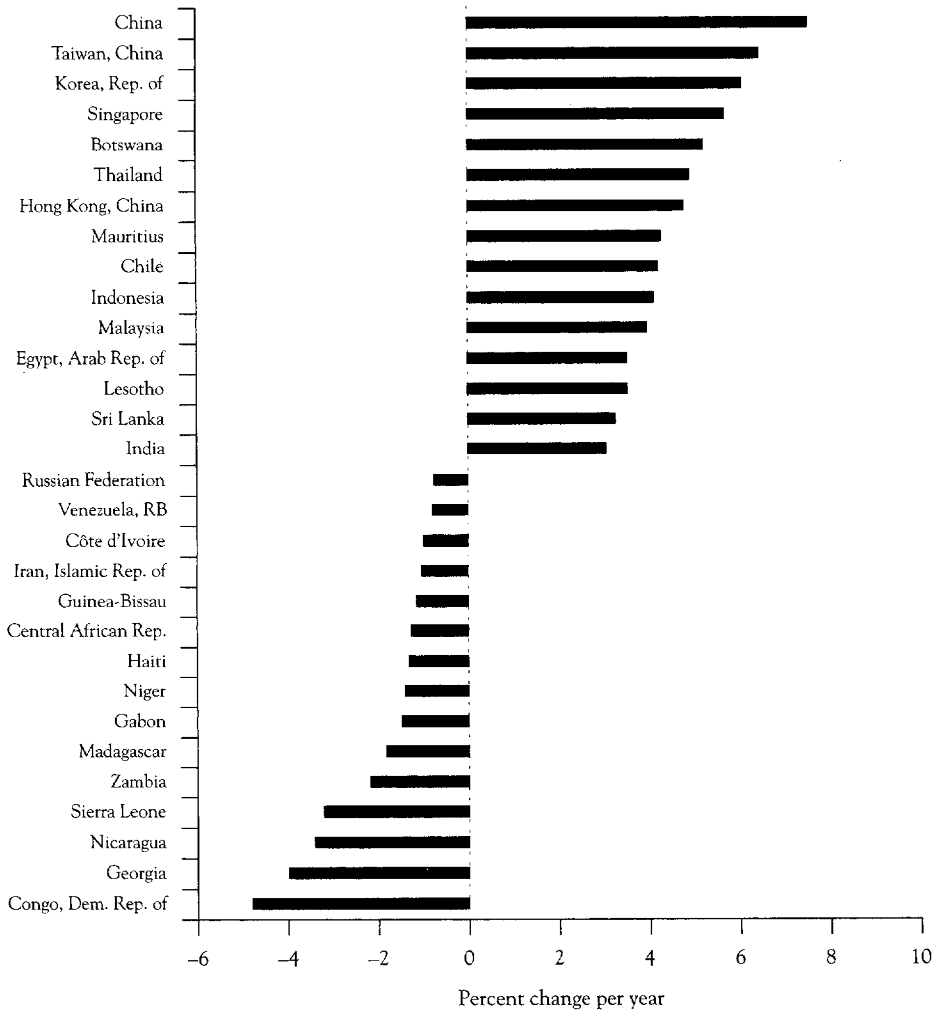
Judging by customary growth rates, weighted by incomes of countries, the 1980s were a lost decade for the developing world. The picture looks better when growth rates are weighted by population, because the decreases among middle-income countries, especially in Latin America, weigh less and the increases in the larger low-income countries, China and India, weigh more. In the 1990s, the difference between income-weighted and population-weighted aggregate growth rates for developing countries narrowed as growth improved in the middle-income countries in Latin America.

Figure 1.7. Purchasing Power Parity–Adjusted GDP Per Capita, 1975–98



Note: Europe and Central Asia is excluded for reasons of data availability.
Source: World Bank data.

Figure 1.8. Growth in GDP Per Capita, Selected Economies, 1975–98



Source: World Bank (2000c); authors' computations.

Income Inequality. Within this picture of overall income growth, it is also important to consider how the income was being shared by looking at changes in income inequality. Several dimensions of income inequality are relevant here: between countries, across households within countries, and within households. As noted in World Bank (2000i), the gap between the average income of the richest 20 countries and the average for the poorest 20 has doubled in the past 40 years—to more than 30 times.

The data requirements for estimating the distribution of personal incomes in the world are onerous, and the available data have severe weaknesses. That said, Dikhanov and Ward (2000) estimated such distributions for 1988 and 1993 and found that the overall inequality of personal incomes in the world increased from a Gini coefficient of 0.63 to 0.67 (see also Cornia 1999).

Schultz (1998) looked at the trends in between-country inequality of income. The results differ considerably based on whether China is included in the analysis. Income inequality between countries increased from 1960 through 1968, stayed high through 1976, and gradually declined after that, ending up slightly higher in 1989 than in 1960. If China is excluded, the decline in inequality among countries from 1976 disappears. Extension of the analysis through 1994 for a slightly smaller set of countries confirmed these trends.

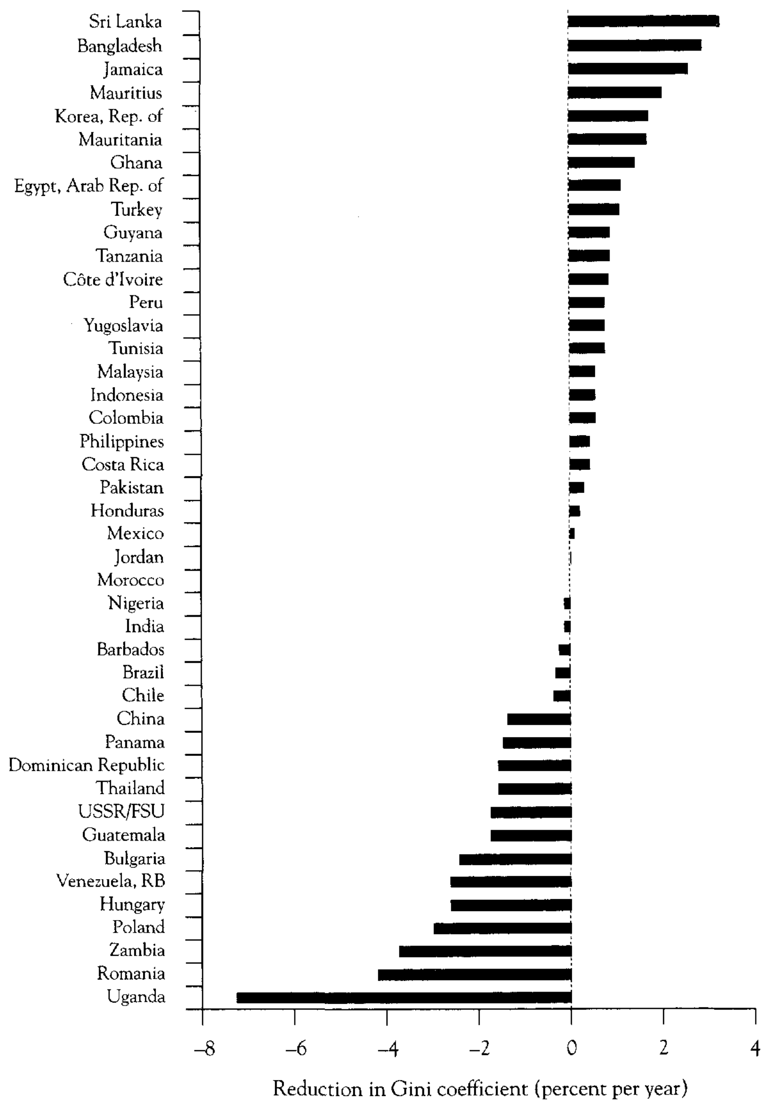
Using comparable data on income Gini coefficients for 45 countries from the early 1960s to the early 1990s, Deininger and Squire (1996) found no general trend in within-country inequality, which stayed approximately the same in 29 countries, rose in 8, and fell in 8. For a different comparison, between the early 1980s and early 1990s inequality increased in 19 countries and decreased in 24 (figure 1.9). Among the countries in which inequality increased are those with large populations: Brazil, China, and India. Population-weighted, average inequality for the 43 sample countries increased by 0.52 percent a year in the 1980s and the early 1990s.[4]

Growth Volatility. Economic fluctuations seem to affect the poor disproportionately, but the impact is likely to be particularly severe in countries where social safety nets are typically less well developed (Furman and Stiglitz 1998). Declines in economic growth were directly associated with sharp increases in poverty in Eastern Europe, and more recently in East Asia. Economic downturns appear to have enduring adverse effects on the economy. Studies suggest that bigger fluctuations in growth rates are associated with slower average growth.[5] The volatility of growth would seem to matter.

On average, volatility of growth by some measures is estimated to have declined in the 1980s for most country groups (except middle-income countries, mainly because of the debt crisis in Latin America), compared with the 1970s when the oil shocks occured. The picture is more mixed in the 1990s. Volatility is estimated to have declined for Latin America, the Middle East and North Africa, and South Asia, but increased slightly for industrial countries and for East Asia (figure 1.10).

No general trend in within-country inequality

Figure 1.9. Income Inequality within Countries: 1980s and 1990s

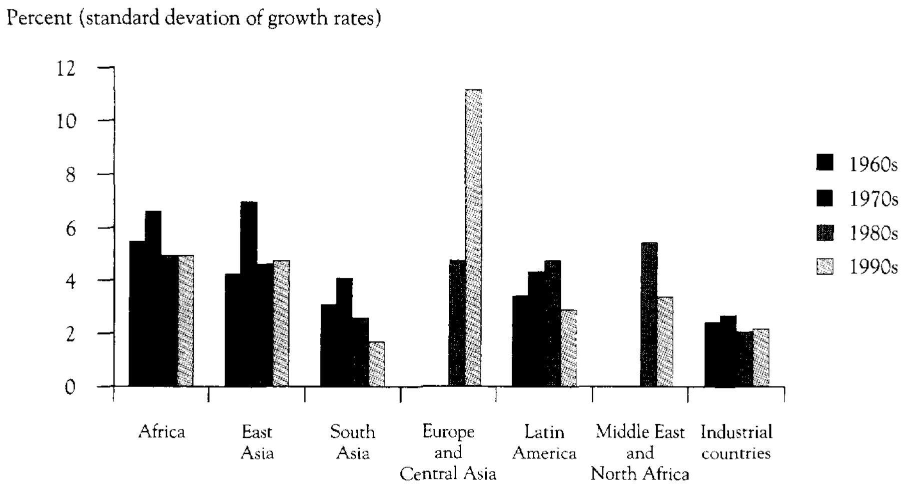


FSU Former Soviet Union.

Note: The quantity plotted is reduction in income Gini coefficients, in the early 1990s over the early 1980s, in percentage declines per year. Negative values indicate an increase in inequality.

Source: Deininger and Squire (1996).

Figure 1.10. Volatility of GDP Growth Rates by Decade



Note: Volatility in a decade was computed by taking the standard deviation of growth rates in the decade for each country and the unweighted average across the countries in the group.
Sources: World Bank (2000c); authors' computations.

Developing Europe and Central Asia had especially more volatile growth than other regions in the 1990s compared with the 1980s.

Developing countries seem to have experienced higher volatility than industrial countries. Easterly, Islam, and Stiglitz (1999) explore the determinants of the increased volatility of countries, finding that

- Openness to trade and the volatility of capital flows are associated with increased volatility of growth
- Improvement in indicators of financial development are associated with lower volatility
- Constraints on policy from institutional limitations and financial sector underdevelopment contribute to the variability of outcomes
- Wage flexibility does not seem to be an important factor.

Growth and Welfare

Table 1.2 places developing countries in three groups, based on their per capita GDP growth rates: high-growth countries, those with moderate or improving growth rates, and low-growth countries.[6] By the definition used here, 13 had rapid growth, 53 had moderate growth, and 39 had low

Table 1.2. Development Outcomes by Growth Class, 1980s and 1990s
(unweighted means)

Change in indicator: comparing 1980s and 1990s	*Unit*	*Period*	*High growth*	*Moderate or improved growth*	*Low growth*
Poverty	Percentage with less than US$1 a day	1990s	24.1	31.4	36.9
		1980s	31.0	32.1	30.2
Infant mortality	Per thousand	1990s	29.2	54.3	60.7
		1980s	41.0	66.6	71.0
Illiteracy	Percent	1990s	17.2	31.2	31.4
		1980s	22.9	37.6	38.8
Life expectancy	Years	1990s	70.0	62.9	59.8
		1980s	66.8	60.6	58.4
Carbon dioxide emission	Tons per capita	1990s	2.4	2.3	1.7
		1980s	1.5	2.3	1.8
Deforestation	Percent per year	1990–95	0.83	1.05	1.11
		1980–90	1.08	0.65	1.15
Water pollution	Kilograms per day per worker	1990s	0.16	0.21	0.21
		1980s	0.18	0.21	0.21
GDP growth	Percent per year	1990s	5.3	4.2	0.3
		1980s	6.5	2.3	2.1
Number of countries			13	53	39

Note: See text for details regarding country classification. Some variables are missing for some of the countries. In particular, poverty data are available for only a small number of countries.

Sources: World Bank (2000c); authors' computations.

growth. Also by this definition, the moderate-growth countries had the strongest improvement in growth. Several of the human development indicators generally improved for all three groups, with the high-growth countries showing the strongest improvements. The high-growth countries had higher and increasing carbon dioxide emissions per capita.

External Factors Matter

In the 1990s, externally- and domestically-driven political and social upheaval and wars continued to derail progress in numerous countries (Collier 1999; Collier and Hoeffler 1998) (table 1.3). Global and cross-border issues related to financial crises, population pressures, labor migration, and environmental distress continued to affect domestic outcomes. Despite

Table 1.3. External Factors Matter for Domestic Outcomes, Examples from 1997–99

	Financial crises	*Natural disasters*	*Conflicts*	*Human-caused disasters*
Region or country in crisis	East Asia Russia Brazil	Bangladesh Central America	Albania Bosnia Congo, Dem. Rep. of Yugoslavia Rwanda Sierra Leone	Indonesia (forest fire)
Impact	Short-term increase in poverty	Loss of human lives and physical and natural capital	Destruction of human and social capital	Long-term increase in poverty

Source: Authors' compilation.

progress in slowing population growth, population increases in many countries could undermine efforts to achieve sustainable development. Global warming, environmental degradation, and the loss of biodiversity continue to worsen as an ever more crowded planet puts more pressure on limited global resources (World Bank 2000b and various editions of the World Bank's *Global Economic Prospects* and *Global Development Finance*).

The quarter century or so after World War II marked a period of rapid and steady growth for both industrial and developing countries, and the economic environment was relatively free of major shocks. The international economic environment changed dramatically in 1973 with the oil price shock and the end of the Bretton Woods system of fixed exchange rates among major industrial countries. Subsequent decades saw sharp declines in the productivity growth of industrial countries, high inflation and interest rates, and cycles of large amplitude in commodity prices and exchange rates of major currencies.

It has been argued that the low growth record of most developing countries (with some exceptions, mostly in East Asia) after 1973 and into the 1990s was due primarily to the growth slowdown in industrial countries (Easterly 1999b). While that was a significant factor, the record of the developing countries that prospered during this period, such as those in East Asia, suggests that domestic policy, governance, and institutions also influence outcomes. The damage caused by shocks and conflicts depends on the institutions in place and their effectiveness in strengthening governance, civil rights, the rule of law, social programs, and safety nets (Collier 1999; Collier and Hoeffler 1998; Easterly, Islam, and Stiglitz 1999; Rodrik 1998, 1999).

The global economic environment experienced another significant change in the 1990s, becoming more conducive to development in some respects, less so in others (see various editions of the World Bank's *Global Economic Prospects*). Import demand by Organisation for Economic Co-operation and Development (OECD) nations was less volatile in the 1990s than in earlier decades, partly because the cycles of North America, Europe, and Japan were no longer synchronized, and partly because of the increased weight of developing countries, especially East Asia, in world trade. Thanks to monetary restraint and progress in fiscal consolidation, real interest and inflation rates in the major OECD countries dropped in the 1990s, and volatility in the exchange rates of major currencies was considerably smaller relative to the pronounced dollar cycle of the 1980s.

Particularly important was the relative steadying in developing country terms of trade with industrial countries, especially in prices of the nonenergy primary commodities. Non-oil exporters saw a serious deterioration in their terms of trade from the mid-1970s to the early 1990s. However, for much of the 1990s, non-oil commodity prices held firm, and the decline since 1997 has been less steep than in earlier price cycles. Although export prices are far more volatile for commodities than for manufactured products, commodity prices were less volatile in the 1990s than in the 1980s for 22 of 30 key commodities (World Bank 2000a; various issues of *Commodities Quarterly*).

The robust growth in world trade sharply surpassed growth in world output through 1998. The international trading environment remained liberal on the whole, with increased multilateralism, notwithstanding the rise of such questionable practices as antidumping. And there was a phenomenal increase in private capital flows to developing countries, albeit only to a few.

The East Asian financial crisis revealed that while opportunities have grown enormously, so have the demands on institutions and the costs of mistakes. Success in a highly globalized setting requires adequate mechanisms for managing risks, and successful policies for openness and competition need effective regulatory and legal frameworks.

Domestic Policies Make a Crucial Difference

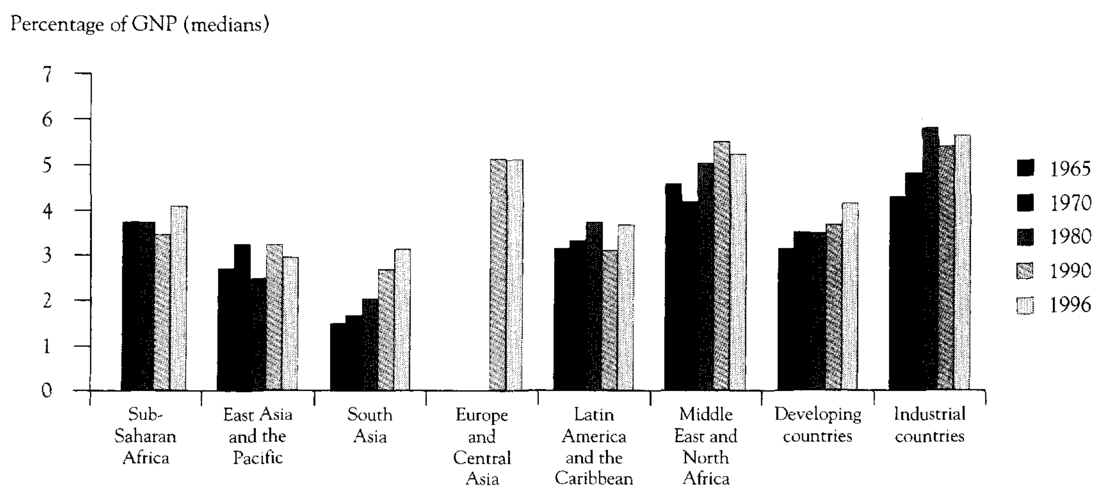
Underlying the varied development outcomes has been the effectiveness of policy, notably in the following four areas: the quality and distribution of education and health services, the stewardship of the environment, the management of opportunities and the risks of globalization, and the effectiveness of governance. These links are analyzed in the subsequent chapters.

Investing in People

No country has achieved sustained development without investing substantially and efficiently in the education and health of its people. Developing countries have generally been spending more public resources on education, and many regions have expanded that spending in the 1990s (figure 1.11). Public spending in education has declined in East Asia and the Middle East and North Africa. There is evidence that in East Asia, the share of private expenditure is on the rise. Cross-country data on health expenditures are available only for the 1990s, so long-term trends are not known.

What happens to the share of social expenditures in countries undergoing adjustment and fiscal austerity? Analyses have been divided on the question. The World Bank (1992) concluded that the shares remain unchanged, while Corbo, Fischer, and Webb (1992) found that education shares declined. A recent International Monetary Fund (IMF 1998) study of low-income countries undergoing adjustment found that the shares of education and health expenditures have generally been protected. Private spending is also important in social services funding, especially in East Asia, where its share rose with economic growth. But public spending does not always produce good outcomes. Those depend on the distribution and quality of the public spending and on the incentives for more private spending. These issues are explored in chapter 3.

Figure 1.11. Public Expenditures on Education by Region, Selected Years



Source: World Bank (2000c).

Managing the Environment

We know that government policies have neglected the environment, but we have no standard measures for evaluating a country's environmental policies. One recently developed indicator, *genuine saving*, measures the rate of saving after accounting for investments in human capital, depreciation of produced assets, and depletion and degradation of the environment (World Bank 1999f, pp. 175–77). Such measures are still experimental and reflect both policies and outcomes.

We have looked at progress in agreements reached on environmental issues. From this, however, we get only a sense of the commitment of governments from having completed a country environmental profile, formulating conservation and biodiversity strategies, and participating in global treaties. These measures appear to be only weakly related to environmental outcomes. We need better ways to capture country policies for environmentally sustainable development.

Creating Market-Friendly Policies

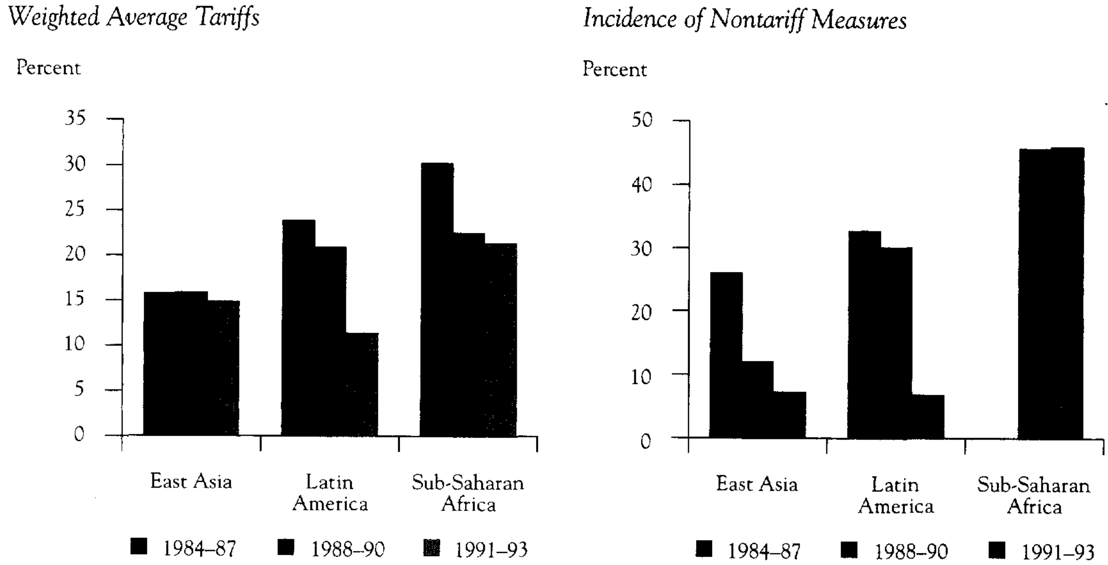
Openness and Liberalization. Openness increased in developing countries in the 1990s. The ratio of trade to GDP rose in all developing regions. Levels of trade protection have declined in most regions, aided by successive rounds of multilateral trade negotiations. Average tariffs came down in the 1990s, sharply in many cases (figure 1.12). Nontariff barriers have also been reduced significantly in most regions, with the exception of Sub-Saharan Africa (Rodrik 1999; UNCTAD 1994).

Openness to capital also increased dramatically in some regions. An index of financial controls shows a sharp decline in the 1990s, following a sharp increase in the previous decade (chapter 5). Liberalization has also taken hold in domestic markets, as governments have become more willing to rely on markets and to increase incentives for private initiative by privatizing industries and have lifted other restraints on marketing and distribution. Many primary commodity exporting countries in Africa are liberalizing control boards, allowing for more pass-throughs of international commodity prices to producers (Akiyama 1995).

Macroeconomic Stability. Two often used reflectors of economic management are parallel-market exchange rate premiums and government deficits. Figure 1.13 shows that parallel-market premiums declined sharply in the 1990s in most countries. After sharp increases in the 1980s, government deficits declined in most regions, except Europe and Central Asia. Partly as a result, inflation was down in most developing countries.

Trade barriers decline in most regions

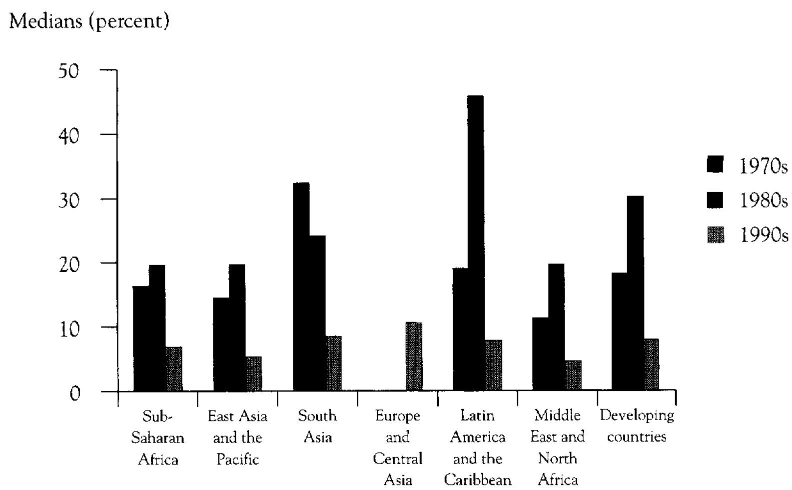
Figure 1.12. Trade Barriers, Selected Regions, 1984–93



Source: Rodrik (1999).

Growth Outcomes and Policy Performances. Table 1.4 shows policy profiles for three growth classes and for the 1980s and 1990s. They do not claim to establish the direction of the link between policies and outcomes, but the patterns and trends are noteworthy. A great deal of previous work has shown the impact of policies on growth (a literature survey summary is available on request.) Although some market-friendly policies remain contentious, many developing countries made significant efforts to adopt them in the 1990s. Average budget deficits were lower for all groups in the 1990s—sharply so for the high- and moderate-growth groups. All three groups had significantly lower tariffs and a higher trade-to-GDP ratio in the 1990s than in the 1980s. All three groups were more open for capital account transactions in the 1990s—the high-growth group more cautiously so. Domestic financial systems were also generally less repressed in the 1990s, relative to the 1970s—again the high-growth group more cautiously so, relative to the moderate-growth group. The fast growers had greater financial depth, measured by the M2-to-GDP ratio, and more prudent macroeconomic policies, partly evident in increased reserves. And they had higher ratings on governance measures. There is an immense empirical literature on some of these policy-outcome links.

Figure 1.13. Parallel-Market Premium, 1970s–1990s



Note: The values plotted are (parallel market rate/official rate – 1) as a percentage, for a unit of foreign currency in terms of local currency units..

Sources: Easterly and Yu (2000); World Bank (2000c).

Crucial Issues for Action

The developing world continued to move forward in the 1990s. Progress on policy was substantial: reducing fiscal deficits, investing more in education, lowering trade and investment barriers, and dismantling domestic price controls in agriculture and industry. The record was more mixed on development outcomes. But both the 1990s and the longer-term record confirm that these actions go with improved economic growth. They also corroborate the link between economic growth and poverty reduction. Thus, on the whole, the developing world recovered from the setbacks of the 1980s, but both the depth and the breadth of the recovery left much to be desired.

The record also suggests that actions, by government and others, to affect the quality and sustainability of growth have lagged. Events in East Asia, Europe, Central Asia, and elsewhere underscore the fragility of advances in reducing poverty and achieving sustainable development. The numbers of poor people continue to increase, and today an estimated 1.2 billion live in absolute poverty, on less than US$1 a day. The incidence of poverty is highly sensitive to changes in income distribution and to population growth. So, policies affecting broad and equitable growth and population growth deserve considerable attention.

Table 1.4. Policy Performance, by Growth Class, 1980s and 1990s
(unweighted means)

Change in indicator: comparing 1980s and 1990s	*Unit*	*Period*	*High growth*	*Moderate or improved growth*	*Low growth*
Budget surplus	Percentage of GDP	1990s	−1.8	−1.4	−3.4
		1980s	−4.2	−2.9	−4.7
Effective tariff rate	Percent	1990s	22.7	25.4	18.3
		1980s	29.1	31.9	22.7
Trade/GDP	Percent	1990s	92.1	77.0	70.2
		1980s	82.0	71.0	59.9
Capital account openness	Index	1996	2.4	3.0	3.1
		1988	1.7	1.9	1.7
Financial repression	Index	1996	3.6	3.2	4.0
		1973	5.9	6.8	4.5
M2/GDP	Percent	1990s	55.4	36.9	28.6
		1980s	42.8	34.6	28.4
International reserves	Months of imports	1990s	4.2	3.9	2.9
		1980s	3.1	2.8	2.4
Rule of law	Index	1997–98	0.2	−0.2	−0.7
Control of corruption	Index	1997–98	−0.1	−0.2	−0.6
Education spending	Percentage of GNP	1990s	3.7	4.4	4.3
		1980s	3.6	4.2	4.4
Environmental action	0-1 Index	International	0.89	0.95	0.88
	0-1 Index	Domestic	0.89	0.86	0.65
Number of countries			13	53	39

Note: See text for details regarding country classification. Some variables are missing for some of the countries. In particular, the following variables are available for only a small number of countries: effective tariff rate and financial repression. Variables are described in annex 1.

Sources: World Bank (2000c); authors' computations.

The relationships between development goals and policy instruments have been investigated in considerable detail in the development literature. The annex to chapter 1 includes a set of correlation coefficients for goals and policies in the spirit of providing the basic data. As correlations, they say nothing about the direction of the causality or the mechanisms. Nevertheless, the combinations shown to be significant are worthy of further investigation as hypotheses. Equally important are the plausible combinations that are not significant with the expected sign. Many of the hypothesized relations are taken up in chapters 3 through 6, and in chapter 2, which elaborates a basic framework.

Here, we frame the relationships in the form of questions that motivate this study:

- Are the observed improvements in human capital sufficient to sustain growth in countries that experienced accelerated growth in the 1990s?
- Is the increased human capital in the slow-growth countries sufficient to propel faster and better growth in the near future?
- Will the deterioration of natural capital reduce the potential for future growth, especially among poor countries?
- Is the degradation of natural capital becoming a serious obstacle to improving the welfare of the population?
- Can the risks of financial globalization be managed in a way that diminishes the volatility of growth and improves its sustainability?
- How serious is the manner of governing for growth processes and outcomes, and how can progress be made in controlling corruption?

The chapters ahead provide insights into these questions, if not answers.

The rest of this publication is organized as follows. Chapter 2 provides an analytical framework for interpreting the development experience outlined in this chapter and derives lessons on the importance of undistorted growth of human, natural, and physical assets and the welfare significance of alternative growth patterns (see also the box in the Overview). Chapter 3 explores how investments in people—in quantity, quality, and distribution—can augment welfare directly and also make growth processes more sustainable. Chapter 4 does the same for environmental and natural resources, where the conflict between growth and welfare is apparent and the tradeoff that much tougher. Chapter 5 revisits the issue of growth volatility and financial risks and considers the quality aspects of reforms that would render growth processes more sustainable in today's globalized setting. All three—human, natural, and financial sides—hinge on the quality of overall governance, which is fundamental to the quality and sustainability of the growth processes. Formal and informal institutions of governance are discussed in chapter 6, with a special focus on fighting corruption. Chapter 7 considers an agenda for action.

Why is there a failure to take up policies that have shown themselves sound? Policymakers' lack of understanding of these policies is unlikely to be the main reason. More likely is the political difficulty of implementing sound policies. Interest groups limit the range of feasible reforms and open a gulf between policy design and implementation. How best to counteract these forces through enhanced participation and stronger government ownership is an important topic not fully explored in the report (except for a brief discussion of selected aspects in chapter 6).

Another crucial topic is the special circumstances facing the formerly centrally planned economies as they strive to make the transition to market economies. These economies are included in the analyses when data permit, and illustrations and cases drawing on their experience are used in some of the chapters, especially the one on governance and anticorruption (chapter 6). However, a full discussion of the issues for transition economies is beyond the scope of this volume.[7]

Notes

1. Many studies have addressed the multidimensional view of development objectives (Dasgupta 1993; Hicks and Streeten 1979; Lewis 1955; Nordhaus and Tobin 1972; Sengupta and Fox 1969; Tinbergen and Theil in Hughes-Hallet 1989). Some studies used multivariate analysis of a large number of economic, social, and political variables (Adelman and Taft-Morris 1967; Baster 1972; Morris 1979; UNRISD 1970). Some constructed indexes of quality of life or human development (Dasgupta 1990a; Diewert 1986; Drewnowski and Scott 1966; Griliches 1971; McGranahan 1972; Ram 1982a,b; Slottje 1991). The frameworks in some of these works are touched upon in chapter 2.

2. Carbon dioxide emissions do not have much local health impact directly, but are important in the context of greenhouse emissions and the associated problem of global climate change. Also, carbon dioxide emissions are usually associated with emission of other air pollutants that do have a local health impact, but about which data are less widely available.

3. Measures of air quality for many cities became available only in the mid-1990s. An inverted U-shaped relationship between pollution and per capita income, the environmental Kuznets curve, has been estimated for several types of pollutants (Grossman and Krueger 1995). This does not, however, invalidate the need for environmental intervention, because the per capita income turning points for improved environmental indicators are generally quite high. This issue is discussed in chapter 4.

4. Data on income distribution are scanty for the more recent years. A World Bank study of 29 countries estimated that 5 countries experienced a decline in inequality, while about 5 times as many countries (24) saw an increase (Buckley 1999).

5. For example, a regression of average rates of GDP growth for 112 countries against the volatility of GDP growth rates, measured by the standard deviation of growth rates, yielded a significant negative coefficient (see also Ramey and Ramey 1995).

6. High-growth countries as defined here are those with per capita income growth of more than 2.3 percent per year in the 1980s and the 1990s, a rate that doubles incomes in 30 years. The second group—moderate or improved growth—includes countries that maintained a positive growth of per capita income in both decades, or improved growth in the 1990s by at least 2 percentage points. The rest are classified as low-growth countries.

7. See World Bank (1996b) for a full treatment of transition issues. See also recent papers by Åslund (1999); Commander, Dutz, and Stern (1999); Kornai (2000); Qian (1999); Stiglitz (1999); and Wyplosz (1999).