



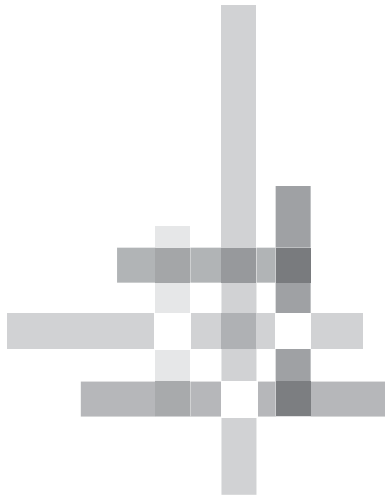
Frontiers in Development Policy

A Primer on Emerging Issues

Raj Nallari, Shahid Yusuf, Breda Griffith,
and Rwitwika Bhattacharya



THE WORLD BANK



Frontiers in Development Policy



Frontiers in Development Policy

A Primer on Emerging Issues

Raj Nallari, Shahid Yusuf, Breda Griffith,
and Rwitwika Bhattacharya



THE WORLD BANK
Washington, D.C.

© 2011 The International Bank for Reconstruction and Development / The World Bank
1818 H Street NW
Washington DC 20433
Telephone: 202-473-1000
Internet: www.worldbank.org

All rights reserved

1 2 3 4 14 13 12 11

This volume is a product of the staff of the International Bank for Reconstruction and Development / The World Bank. The findings, interpretations, and conclusions expressed in this volume do not necessarily reflect the views of the Executive Directors of The World Bank or the governments they represent.

The World Bank does not guarantee the accuracy of the data included in this work. The boundaries, colors, denominations, and other information shown on any map in this work do not imply any judgement on the part of The World Bank concerning the legal status of any territory or the endorsement or acceptance of such boundaries.

Rights and Permissions

The material in this publication is copyrighted. Copying and/or transmitting portions or all of this work without permission may be a violation of applicable law. The International Bank for Reconstruction and Development / The World Bank encourages dissemination of its work and will normally grant permission to reproduce portions of the work promptly.

For permission to photocopy or reprint any part of this work, please send a request with complete information to the Copyright Clearance Center Inc., 222 Rosewood Drive, Danvers, MA 01923, USA; telephone: 978-750-8400; fax: 978-750-4470; Internet: www.copyright.com.

All other queries on rights and licenses, including subsidiary rights, should be addressed to the Office of the Publisher, The World Bank, 1818 H Street NW, Washington, DC 20433, USA; fax: 202-522-2422; e-mail: pubrights@worldbank.org.

ISBN: 978-0-8213-8785-6

eISBN: 978-0-8213-8786-3

DOI: 10.1596/978-0-8213-8785-6

Library of Congress Cataloging-in-Publication Data

Nallari, Raj, 1955-

Frontiers in development policy / by Raj Nallari, Shahid Yusuf, Breda Griffith, and Rwitwika Bhattacharya.

p. cm.

Includes bibliographical references and index.

ISBN 978-0-8213-8785-6 — ISBN 978-0-8213-8786-3 (electronic) 1. Global Financial Crisis, 2008-2009. 2. Developing countries—Economic policy. 3. Free enterprise—Developing countries. 4. Economic development—Environmental aspects—Developing countries. I. Nallari, Raj, 1955—II. Title.

HB37172008 .N35 2011

338.9—dc23

2011025640

Cover: Naylor Design, Inc.

CONTENTS

Preface	xi
About the Authors	xiii
Abbreviations	xiv
PART I. DEVELOPMENT CHALLENGES IN A POSTCRISIS WORLD	1
Section 1. Overview	3
<i>Raj Nallari</i>	
Section 2. What Is Development?	9
<i>Breda Griffith</i>	
Section 3. Poverty Traps and the MDGs	25
<i>Breda Griffith</i>	
Section 4. Middle-Income Trap	39
<i>Breda Griffith</i>	
Section 5. Pathways to Development	45
<i>Shahid Yusuf</i>	
Section 6. Why Is Development Blocked?	55
<i>Raj Nallari</i>	
Section 7. Development Challenges	61
<i>Raj Nallari</i>	
Section 8. Political Economy	67
<i>Raj Nallari and Rwitwika Bhattacharya</i>	

PART II. PRIVATE ENTERPRISE AND DEVELOPMENT	71
Section 9. Overview	73
<i>Shahid Yusuf, Breda Griffith, and Raj Nallari</i>	
Section 10. Firms Are the Prime Movers	79
<i>Shahid Yusuf</i>	
Section 11. Industrial Mix, Research Intensity, and Innovation by Firms	87
<i>Shahid Yusuf</i>	
Section 12. Investing in Technology and Human Capital: An Example from Asia	95
<i>Shahid Yusuf</i>	
Section 13. Impact of Regulation on Growth and Informality	105
<i>Breda Griffith and Raj Nallari</i>	
Section 14. Private Sector Regulation and Financial Regulation	111
<i>Breda Griffith and Raj Nallari</i>	
PART III. GROWTH AND DEVELOPMENT STRATEGIES AND RETHINKING DEVELOPMENT	115
Section 15. Overview	117
<i>Breda Griffith, Raj Nallari, and Shahid Yusuf</i>	
Section 16. Why Is Growth Higher in Some Countries?	125
<i>Breda Griffith</i>	
Section 17. The Role for State Intervention	131
<i>Raj Nallari</i>	
Section 18. Private Participation in Infrastructure	135
<i>Breda Griffith</i>	
Section 19. Changing Development Paradigms	143
<i>Breda Griffith</i>	

Section 20. Aid Effectiveness	151
<i>Breda Griffith and Raj Nallari</i>	
Section 21. Enhancing Competitiveness	159
<i>Raj Nallari</i>	
Section 22. Land Policy and Effective Use of Natural Resources	165
<i>Breda Griffith and Raj Nallari</i>	
Section 23. Cities as Engines of Growth	171
<i>Shahid Yusuf</i>	
Section 24. Rethinking Macroeconomic Theory	179
<i>Raj Nallari</i>	
Section 25. Macro-Fiscal-Monetary Policies	185
<i>Breda Griffith and Raj Nallari</i>	
Section 26. Fiscal Activism	193
<i>Raj Nallari</i>	
Section 27. Fiscal Multipliers	201
<i>Raj Nallari</i>	
Section 28. Preventing Future Credit Bubbles	205
<i>Raj Nallari</i>	
Section 29. Revisiting Exchange Rate Regimes	209
<i>Raj Nallari</i>	
Section 30. Reexamining Trade Policy	213
<i>Raj Nallari</i>	
PART IV. HUMAN DEVELOPMENT POLICIES	217
Section 31. Overview	219
<i>Raj Nallari</i>	
Section 32. Early Childhood Development: The First Thousand Days Are Most Important	221
<i>Raj Nallari</i>	

Section 33. Education Access and Quality: What We Know and Don't Know	225
<i>Raj Nallari</i>	
Section 34. Health Care Policy	231
<i>Raj Nallari</i>	
Section 35. Labor Market Trends	235
<i>Raj Nallari</i>	
Section 36. Labor Market Policies	247
<i>Raj Nallari</i>	
PART V. MANAGING RISKS	255
Section 37. Overview	257
<i>Raj Nallari</i>	
Section 38. Managing the Climate Crisis	259
<i>Raj Nallari</i>	
Section 39. The Role of Macprudential Regulations	263
<i>Raj Nallari</i>	
Section 40. Managing Capital Flows	269
<i>Raj Nallari and Ababyomi Alawode</i>	
Section 41. Triple Crisis: Rising Food Prices, Global Financial Crisis, and Climate Change Issues	277
<i>Raj Nallari and Rwitwika Bhattacharya</i>	
Section 42. Catastrophes and Economic Growth	283
<i>Raj Nallari and Rwitwika Bhattacharya</i>	
Index	287
Figures	
2.1 Income and Happiness, 1980s and 1990s	18
2.2 Income and Happiness in the United States	19
2.3 Relationship between Well-Being and Income within Individual Countries, Gallup World Poll, 2002	20

2.4	Happiness and GDP, World Values Survey, 1999–2004	21
3.1	Per Capita GDP Growth Rates, by Country Group, 2003–07	29
3.2	Poverty Rates in Sub-Saharan Africa, South Asia, and East Asia and Pacific, 1981–2005	30
3.3	Gender Parity in Primary Education, 1991 and 2007	31
3.4	Ratio of Employment to Population, Men and Women, 1991 and 2007	33
4.1	Middle-Income Trap	40
4.2	Global Competitiveness Indexes	41
5.1	Sources of Economic Growth, by Region	48
6.1	Regional Growth Poles	56
7.1	Monthly Price Indexes, 2005–09	63
7.2	Development Is No Longer Just North-South	64
9.1	Scientific Innovation: Penetration of New Technologies	75
11.1	R&D Intensity, by Industry, in 10 OECD Countries	89
11.2	Share of U.S. Patents, by Industry, 2006	90
12.1	Royalty and License Fee Payments, 1995–2006	97
12.2	Royalty and License Fee Receipts, 1995–2006	98
13.1	Regulation and GDP Per Capita	106
13.2	Informal Economy across Several Countries and Sectors	108
14.1	Average Per Capita GDP Growth and Ease of Doing Business, 2000–05	112
16.1	GDP Percentage and Investment Rates, by Growth in 13 Economies, 1971–2004	127
18.1	Investment Commitments to PPI Projects Reaching Closure in Developing Countries, by Quarter, 1995–2010	136
18.2	Investment Commitments to Infrastructure Projects with Private Participation in Developing Countries, by Sector, 1990–2009	138
18.3	Investment Commitments to Infrastructure Projects with Private Participation in Developing Countries, by Region, 1990–2009	140
19.1	Flows of FDI, Remittances, and Official Development Assistance to Developing Countries, 1980–2007	145
20.1	Progress Toward the 2010 Paris Declaration Targets	154
22.1	Initial Land Distribution and Growth, by Economy, 1960–2000	166
26.1	Balancing the Fiscal Options	198

Tables

1.1	Global Output	4
1.2	Net Financial Flows, 2007–10	6

2.1	Alternative Measures of GDP	11
3.1	Testing the Poverty Trap for Long Periods	26
3.2	Selected MDGs	28
5.1	Contribution to World Growth Percentage Share	47
9.1	Innovation Capacity Index	76
9.2	Boston Consulting Group/National Association of Manufacturers' Global Innovation Index, 2009	76
10.1	Major Innovations by Small U.S. Firms in the 20th Century	82
12.1	R&D Spending, by Country, Selected Years, 1996–2006	96
12.2	Composition of R&D Spending, by Type of Organization	97
12.3	Number of Patents Granted to East Asian Economies by the USPTO, 1992, 2000, and 2008	99
12.4	Eighth-Grade TIMSS Scores for Science and Mathematics, Selected East Asian Economies, 1999, 2003, and 2007	100
12.5	Percentage of First University Degrees in Science and Engineering	101
16.1	Success Stories of Sustained High Growth	126
18.1	Totals of Infrastructure Projects and Investments, Low- and Middle-Income Developing Economies, 1990–2010	136
18.2	Risk Mitigation Instruments	137
18.3	PPI Project Pipeline in Developing Countries, by Sector and Project Status, January 2008–March 2010	139
20.1	Measures to Achieve Aid Effectiveness	152
22.1	Characteristics of Property Rights for Land	168
23.1	Business Friendliness	173
27.1	Spending Multipliers of the United States and Other Country Groups	203
35.1	Labor Supply Trends, by Region	236
35.2	World Merchandise Imports and Exports, by Region, 2008–09	237
35.3	Female and Male Labor Force Participation, by Region, 2007 and 2009	238
35.4	Unemployment Rates for Both Sexes, by Region, Selected Years 1999–2009	239
35.5	Youth Unemployment Rates, by Region, Selected Years, 1999–2009	241
36.1	MILES framework	248
40.1	Net International Capital Flows to Developing Countries, 2005–10	270

PREFACE



This primer was compiled for the Frontiers in Development Policy course that took place in April 2011 at the World Bank. The goal of the book is to bring home the interlinkages in various parts of the economy and the need for practical policy making to reach development goals while being aware of the instabilities, complexities, and risks inherent in an economy operating in a globalized world. The book is targeted toward change agents and policy makers.

The book was written in light of the global crisis of 2008–09, which brought to the forefront a plethora of economic and policy issues. There was a reopening of discussion concerning basic economic concepts (such as the definition of development), discussion about appropriate framework for analysis (for example, the roles of political economy and institutions), analysis of the balance between private and public sectors in the economy, evaluation of how best to achieve structural transformation of economies while ensuring human development, and exploration on managing growing risks and crises (for example, financial and food crises) in a rapidly changing world.

The criteria for topics to be included in this book were (1) whether the policy issue is of importance to promote strong, sustainable, and inclusive growth in low-income and middle-income developing countries and (2) whether the policy issue is “new and emerging” and necessitates a discussion and debate among policy makers and practitioners.

The book has been divided into five parts. Part 1 focuses on clarifying the basic concepts (that is, what are the appropriate goals of economic policy?), the challenges of low- and middle-income developing countries, and suggested frameworks for analysis.

Part 2 moves from the macroeconomic to the microeconomic; it focuses on the private sector as the engine for growth and is balanced with “softer” issues of the need for trust, accountability, and corporate social responsibility.

Part 3 examines the growing consensus on the need to balance the public and private sectors' roles in the structural transformation of an economy. The discussion centers on newer thinking on industrial policy and public-private partnerships in infrastructure.

Part 4 focuses on human development policies in emerging topics, such as investment in early childhood development, health and nutrition, and quality of education. The discussion recognizes the roles of the state and the private sector.

Finally, part 5 is dedicated to issues of global shocks and risks (including climate change and financial crisis), as well as systems and institutions that need to be in place to manage such risks, and the new thinking on social protection and insurance to mitigate adverse shocks.

The first draft of the book was used for the face-to-face and e-learning course based in Washington, DC. After feedback from the course participants, the manuscript was revised to include additional topics pertinent to development.

The authors would like to thank the participants of the face-to-face and e-learning course for their feedback on the book; the Korean Development Institute for helping to organize this course and, indirectly, contributing to this book; and Dulce Afzal for her commitment and hard work.



ABOUT THE AUTHORS

Raj Nallari manages the Growth and Competitiveness Practice at the World Bank Institute. He holds a doctorate in economics from the University of Texas at Austin and has been with the World Bank since 1992. He is the coauthor of several books on macroeconomic stabilization, growth and poverty, and gender issues. Mr. Nallari has also written monographs for the World Bank and published articles in economic journals. He can be reached at rnallari@worldbank.org.

Shahid Yusuf holds a doctorate in economics from Harvard University and a bachelor of arts degree in economics from Cambridge University. He joined the World Bank in 1974 as a Young Professional and while at the Bank spent more than 35 years tackling issues confronting developing countries. He has written extensively on development issues, with a focus on East Asia, and has published widely in various academic journals. He is currently chief economist for the Growth Dialogue at the School of Business, George Washington University. He can be reached at syusuf@worldbank.org.

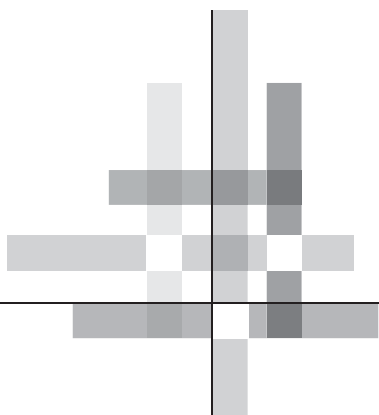
Breda Griffith has worked as a consultant with the World Bank Institute since 2005, mainly in the areas of growth, poverty, and gender. She holds a doctorate in economics from Trinity College Dublin and a master of arts degree in economics from National University of Ireland. She can be reached at breda_griffith@yahoo.com.

Rwitwika Bhattacharya is a Junior Professional Associate at the World Bank. She holds a master's degree in public policy from the Harvard Kennedy School. She has worked at the World Bank since 2010 and can be reached at rbhattacharya@worldbank.org.



ABBREVIATIONS

BRIC	Brazil, the Russian Federation, India, and China
CSR	corporate social responsibility
FDI	foreign direct investment
GDP	gross domestic product
GHG	greenhouse gas
GNDI	gross national disposable income
GNI	gross national income
GNP	gross national product
GPI	genuine progress indicator
HIV/AIDS	human immunodeficiency virus/acquired immune deficiency syndrome
IAH	inequality-adjusted happiness
ILO	International Labour Organization
ISEW	Index of Sustainable Economic Welfare
LFPR	labor force participation rate
MDG	Millennium Development Goal
MILES	World Bank framework for analyzing five main factors affecting employment: macroeconomic performance, investment climate, labor market policies and institutions, education, and skills and social protection for workers
NNDI	net national disposable income
NNI	net national income
OECD	Organisation for Economic Co-operation and Development
PPI	private participation in infrastructure
R&D	research and development
TFP	total factor productivity
USPTO	U.S. Patent and Trademark Office



Part I

DEVELOPMENT CHALLENGES IN A POSTCRISIS WORLD



SECTION 1

Overview

Raj Nallari

Genesis of the Crisis

The recent financial and economic crisis that hit the world economy had all the markings of a “perfect storm.” As we examine the debris and isolate the development challenges, it is instructive to look at the crisis in this light.

The ex ante global saving glut that resulted from the emergence of Brazil, the Russian Federation, India, and China (the BRIC countries) and the redistribution of global wealth and income toward the Gulf states because of the rise in oil and gas prices depressed long-term global real interest rates to unprecedentedly low levels (see Bernanke 2005). The supply of safe financial assets did not meet the demand. Western banks and investors began to scout around for alternative, higher-yielding financial investment opportunities. Brazil, China, India, Vietnam, and other labor-rich but capital-scarce countries raised the return to physical capital formation everywhere. The unsustainable current account deficit of the United States was made to appear sustainable through the willingness of China and many other emerging markets to accumulate large stocks of U.S. dollars, both as official foreign exchange reserves and for portfolio investment purposes.

The excess liquidity in the world went primarily into credit growth and resulted in speculative bubbles in housing, stocks, and commodities (and

not into consumer price inflation). The exact time when the home mortgage problems surfaced can now be pinpointed to mid-2006, even though government and market players did not fully acknowledge the housing problem until almost the summer of 2007. By mid-2006, there was enough evidence of housing prices beginning to decrease significantly, and default rates were increasing in some U.S. states, such as Arizona and California.

Economic Situation in the Developing World

The developing world had experienced unprecedented growth in the run-up to the crisis. Most countries achieved per capita growth rates of more than 2 percent in the period 2003–07, which facilitated progress in reducing poverty rates. Emerging market economies in Europe, Latin America, and Southeast Asia led by almost doubling their 1990s per capita growth rates. Some fragile states also experienced an acceleration in growth—reflecting, in Sierra Leone’s case, the transition from conflict, and in Angola, Chad, and Sudan, the effect of higher oil and gas exports during the period (World Bank 2008).

Table 1.1 examines global output for advanced and developing economies from 2007, with projections to 2013. Global output that fell heavily in 2008

Table 1.1 Global Output
percentage change

Region	2007	2008	2009	Projection	
				2010	2011–13
World output	5.2	3.0	–0.6	4.2	4.4
Advanced economies	2.8	0.5	–3.2	2.3	2.4
Emerging and developing economies	8.3	6.1	2.4	6.3	6.6
Central and Eastern Europe	5.5	3.0	–3.7	2.8	3.8
Commonwealth of Independent States	8.6	5.5	–6.6	4.0	4.1
Developing Asia	10.6	7.9	6.6	8.7	8.6
Middle East and North Africa	5.6	5.1	2.4	4.5	4.8
Sub-Saharan Africa	6.9	5.5	2.1	4.7	5.7
Western Hemisphere	5.8	4.3	–1.8	4.0	4.2

Source: World Bank 2010b, 70.