WORLD BANK 2000

Entering the 21st Century

World Development Report 1999/2000

THE WORLD BANK

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Foreword

The *World Development Report 1999/2000*, the 22nd in this annual series, addresses the changing development landscape of the early 21st century. Development thinking has evolved into a broad pragmatism, realizing that development must move beyond economic growth to encompass important social goals—reduced poverty, improved quality of life, enhanced opportunities for better education and health, and more. Experience has also taught that sustainable progress toward these goals requires integrated implementation and must be firmly anchored in processes that are open, participatory, and inclusive. In the absence of a strong institutional foundation, the outcomes of good policy initiatives tend to dissipate. These lessons and insights are incorporated into the Comprehensive Development Framework, recently initiated by the World Bank to address the challenges of development in a more holistic, integrated way by bringing in aspects such as governance, legal institutions, and financial institutions, which were too often given short shrift earlier.

Looking ahead, this report explores the environment in which the major issues of the 21st century—poverty, population growth, food security, water scarcity, climate change, cultural preservation—will be faced. Many powerful forces, both glacial and fast-paced, are reshaping the development landscape. These include innovations in technology, the spread of information and knowledge, the aging of populations, the financial interconnectedness of the world, and the rising demands for political and human rights. The report focuses in particular on two clusters of change—globalization and localization—because of their immense potential impact. They open up unprecedented opportunities for growth and development, but they also carry with them the threats of economic and political instability that can erode years of hard-earned gains.

Given their already present implications, it is not surprising that globalization and localization are a central preoccupation of policymakers around the world. Globalization is praised for bringing new opportunities for expanded markets and the spread of technology and management expertise, which in turn hold out the promise of greater productivity and a higher standard of living. Conversely, globalization is feared and condemned because of the instability and undesired changes it can bring: to workers who fear losing their jobs to competition from imports; to banks and financial systems and even entire economies that can be overwhelmed and driven into recession by flows of foreign capital; and, not least, to the global commons, which are threatened in many ways with irreversible change.

Localization is praised for raising levels of participation and involvement, and providing people with a greater ability to shape the context of their own lives. By leading to decentralized government where more decisions happen at subnational levels, closer to the voters, localization can result in more responsive and efficient local governance. National governments may use a strategy of decentralization to defuse civil strife or even civil war. However, when poorly designed, decentralization can result in overburdened local governments without the resources or the capacity to fulfil their basic responsibilities of providing local infrastructure and services. It can also threaten macroeconomic stability, if local governments, borrowing heavily and spending unwisely, need to be bailed out by the national government.

This report seeks neither to praise nor to condemn globalization and localization. Rather it recognizes them as forces that bring new opportunities but also raise new or greater challenges in terms of economic and political instability. Containing this instability and providing an environment in which a development agenda can be implemented to seize the opportunities will be a major institutional challenge in the coming decades. The discussion in the report focuses on three main aspects of globalization: trade in goods and services, international flows of capital, and global environmental issues, such as the dangers of climate change and destruction of biodiversity. The focus of the discussion then shifts to three aspects of localization: the decentralization of political power to subnational levels of government, the movement of population and economic energy in developing countries toward urban areas, and the provision of essential public services in these growing cities of the future.

In discussing the appropriate institutional responses to the challenges and opportunities of globalization and localization, the report draws on a vast array of national examples and cross-country empirical evidence, including both development success stories and episodes of failure. There is no simple answer to dealing with globalization and localization. Instead, the insights are rooted in pragmatic judgments about how the existing conditions of society will affect which policy choices make sense, or how one sequence of policies is preferable to another, or how certain policies can complement and sustain each other. The commitments and actions of the national government remain central to any workable development strategy. However, the forces of globalization and localization imply that much of the institution-building for development will be taking place at either the supranational or the subnational levels. In both cases, countries will need to focus on development strategies that are implemented through mutual consent, whether through international agreements between countries, or through constitutional and institutional arrangements between different levels of government and components of civil society within a country. At both the global and local levels, institutions based on partnership, negotiation, coordination and regulation would provide the basis for sustainable development.

Globalization and localization are not likely to disappear, or even to diminish in intensity. They are driven by powerful underlying forces like the new capabilities of information and communication technologies, and a rising sense among people all over the world that they are entitled to participate openly in their government and society. As globalization brings distant parts of the world functionally closer together, and localization multiplies the range of policy environments, it may well be that successful development policies will achieve results more quickly, while failed policies will have their consequences exposed more quickly and painfully as well. In such a world, exploring the institutional responses to globalization and localization, and disseminating the insights broadly, offers enormous potential for advances in development strategy—advances that can be of great and lasting benefit to the poorest people of the world.

James D. Wolfensohn
President
The World Bank

August 1999

This report has been prepared by a team led by Shahid Yusuf and comprising Anjum Altaf, William Dillinger, Simon Evenett, Marianne Fay, Vernon Henderson, Charles Kenny, and Weiping Wu. The team was assisted by Mohammad Arzaghi and Stratos Safioleas. The work was carried out under the general direction of Joseph Stiglitz. Throughout the preparation of this report Lyn Squire provided valuable advice and contributions. Timothy Taylor was the principal editor.

The team was advised by a distinguished panel of experts comprising Alberto Alesina, Masahiko Aoki, Richard Cooper, John Dixon, Barry Eichengreen, Jon Elster, Alan Harold Gelb, Harry Harding, Gregory K. Ingram, Christine Kessides, Jennie Litvack, Wallace Oates, Anthony J. Pellegrini, Guillermo Perry, David Satterthwaite, Paul Smoke, Paul Spray, T.N. Srinivasan, Jacques Thisse, and John Williamson.

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Rebecca Sugui served as executive assistant to the team, and Maribel Flewitt, Leila Search, and Thomas A.J. Zorab as team assistants. Maria D. Ameal served as administrative officer.

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The countries included in regional and income groupings in this report are listed in the Classification of Economies table at the end of the Selected World Development Indicators. Income classifications are based on GNP per capita; thresholds for income classifications in this edition may be found in the Introduction to Selected World Development Indicators. Group averages reported in the figures and tables are unweighted averages of the countries in the group unless noted to the contrary.

The use of the word *countries* to refer to economies implies no judgment by the World Bank about the legal or other status of a territory. The term *developing countries* includes low- and middle-income economies and thus may include economies in transition from central planning, as a matter of convenience. The term *advanced countries* may be used as a matter of convenience to denote the high-income economies.

Dollar figures are current U.S. dollars, unless otherwise specified. *Billion* means 1,000 million; *trillion* means 1,000 billion.

The following abbreviations are used:

AIDS	Acquired immune deficiency syndrome
CDF	Comprehensive Development Framework
FDI	Foreign direct investment
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GNP	Gross national product
NIE	Newly industrializing economy
NGO	Nongovernmental organization
OECD	Organisation for Economic Co-operation and Development
PPP	Purchasing power parity
WTO	World Trade Organization

Overview

The development landscape is being transformed, presenting policymakers with new challenges at the global and local levels. This report charts the way forward by analyzing the contours of the new landscape and distilling lessons from the past. It examines the unfolding dynamic at the supranational and subnational levels. And it proposes new rules and structures to serve as a foundation for development policy in the 21st century.

Fifty years of development experience have yielded four critical lessons. First, macroeconomic stability is an essential prerequisite for achieving the growth needed for development. Second, growth does not trickle down; development must address human needs directly. Third, no one policy will trigger development; a comprehensive approach is needed. Fourth, institutions matter; sustained development should be rooted in processes that are socially inclusive and responsive to changing circumstances.

These insights are central to how the World Bank envisions its work in the 21st century and to the way in which it proposes to tackle the principal development challenges ahead. In addition to reducing poverty, these challenges include issues of food security, water scarcity, aging populations, cultural loss, and environmental degradation.

These challenges must be confronted even as many forces reshape the development terrain: innovations in technology, the spread of knowledge, the growth of population and its concentration in cities, the financial integration of the world, and rising demands for political and human rights. Some of these forces, like population growth, will work their way gradually, giving policymakers time to respond. Others, such as financial contagion, could batter apparently healthy economies without warning unless preemptive measures are in place. Some will give rise to challenges, like social welfare funding, that most nation-states can cope with on their own. Others, such as global climate change, will be beyond the reach of any one state and will call for international agreements.

If they are managed well, these forces could revolutionize the prospects for development and human welfare. However, the same forces are also capable of generating instability and human suffering that are beyond the ability of individual nation-states to remedy.

This report views the changes that have been set in motion as contributing to—and as manifestations of—two phenomena: globalization and localization. Globalization, which reflects the progressive integration of the world's economies, requires national governments to reach out to international partners as the best way to manage changes affecting trade, financial flows, and the global environment. Localization, which reflects the growing desire of people for a greater say in their government, manifests itself in the assertion of regional identities. It pushes national governments to reach down to regions and cities as the best way to manage changes affecting domestic politics and patterns of growth. At both the supranational and subnational levels, institutions of governance, negotiation, coordination, and regulation will play a critical role in promoting a new equilibrium between and within countries—and in abetting the creation of the stable environment that will make possible the implementation of development programs.

The frontiers of development thinking

As the 20th century draws to a close, mainstream development thinking has evolved toward a broad pragmatism. As with many subjects, a deeper understanding of development involves a recognition that sweeping beliefs are often incomplete, that layers of complexity are buried not far beneath the surface, and that wisdom is often contingent on the particular conditions of time and place. In recent decades both experience and intellectual insight have pushed development thinking away from debates over the role of states and markets, and the search for a single, overarching policy prescription.

Investment in physical and human capital, for example, should encourage economic growth, and as a general rule, empirical evidence supports this proposition. But in a number of cases, high rates of investment and education have not been enough to deliver rapid growth. A similar lesson holds true for industrial policies. Many countries decided, after experimenting with export subsidies, that the subsidies enriched business owners but did little to speed economic growth. They saw well-intended industrial subsidies turn into a costly form of corporate welfare, an expensive way of providing taxpayer support for private jobs in a narrow range of industries. Yet East Asian economies, making active use of export subsidies and credit allocation, experienced the most powerful sustained surge of economic development the world had seen in decades. And China, which alone includes 40 percent of all the inhabitants of low-income countries in the world, has had remarkable economic success with a development strategy that involves only a limited dose of market liberalization and privatization.

The failure of centrally planned economies to keep pace with their market-oriented counterparts has demonstrated clearly enough that planning entire economies at the central government level is not a productive path to long-term development. But the experiences of Japan, East Asia, and China make clear that it is possible for a country to have an interventionist government and still enjoy extremely rapid economic growth over a period of decades.

Brazil also grew very rapidly in the 1960s, in part by making widespread use of import-substitution policies. These policies certainly appeared helpful to Brazil at the time—at a minimum, they did not prevent a surge of rapid growth—but this success does not mean that similar policies would make sense in other countries, or even in Brazil three decades later. Similarly, certain policies that helped Japan develop in the 1950s and 1960s, generated growth in East Asia in the 1970s and 1980s, and sparked China's economic boom in the 1980s and 1990s were specific to the time and place. They may not have worked well in other countries, nor are they likely to be appropriate in the opening decades of the 21st century.

In any given country, progress depends on a constellation of factors, and on shifts in their configuration that take place over time. What is required is to step beyond the debates over the roles of governments and markets, recognizing that they need to complement each other, and to put to rest claims that any particular policy intervention—in education, health, capital markets, or elsewhere—is the magic formula that will inspire development in all times and places. This shift in development thinking can be summarized in four propositions:

Sustainable development has many objectives. Raising per capita incomes is only one among many development objectives. Improving quality of life involves more specific goals: better health services and educational opportunities, greater participation in public life, a clean environment, intergenerational equity, and more.

Development policies are interdependent. No single development policy can make much of a difference in an unfavorable policy regime. Countries need integrated policy packages and institutional environments that reward good outcomes, minimize perverse incentives, encourage initiative, and facilitate participation.

Governments play a vital role in development, but there is no simple set of rules that tells them what to do. Beyond generally accepted rules, the role of government in the economy varies, depending on capacity, capabilities, the country's level of development, external conditions, and a host of other factors.

Processes are just as important as policies. Outcomes of policies based on consensual, participatory, and transparent processes are more easily sustained. Institutions of good governance that embody such processes are critical for development and should encompass partnerships among all elements of civil society.

Creating new guidelines for development

In light of these propositions, the World Bank is introducing a comprehensive development framework to serve a number of purposes: to sharpen the focus on the major goals of development, to highlight the integrated nature of policymaking, to emphasize the institutional processes required to sustain development, and to coordinate development efforts.

The framework underscores the growing realization that the many elements that make up the development process must be planned together and coordinated in order to obtain the best results—and sometimes in order to arrive at any results at all. A school-building project is a good example. Physically putting up the building is only a start. Raising educational levels will depend on many other things, such as effective mechanisms for selecting, training, and remunerating teachers adequately and sufficient resources to buy enough textbooks and supplies.

What is true of a school-building project is also true of privatization programs, social safety nets, and sustainable energy programs. The complementarities between projects and processes are vital to success. A comprehensive framework makes these complementarities explicit by emphasizing the relationships among the human, physical, sectoral, and structural aspects of development.

The human and physical aspects of development are well known. Sectoral aspects stress the importance of cross-cutting elements such as coordination, management, and maintenance of an effective enabling environment for private business and community initiatives. Structural aspects focus on the need for good governance, transparent decisionmaking, efficient legal and judicial processes, and sound regulatory systems. This identification of rules and processes as a critical foundation for sustained development adds a new dimension to mainstream development thinking.

These items do not constitute an exhaustive list of all the concerns development should embrace. Issues of gender and equity are integral to every part of the framework. Moreover, as mentioned earlier, macroeconomic stability is a necessary condition for the success of development initiatives. How important each of these concerns is to individual countries depends on the particulars of time and place. Every country will benefit from identifying and prioritizing its needs—an exercise that reveals the economic or governmental weaknesses and institutional failures that stand in the way of full development.

Building institutions and partnerships

Effective development requires partnerships among different levels of government, the private sector, donor groups, and civil society. A comprehensive strategy is simply too demanding for any one level or area of government or for a single donor. National governments need to provide the guidance that agencies and organizations require to coordinate their efforts to remove bottlenecks to development.

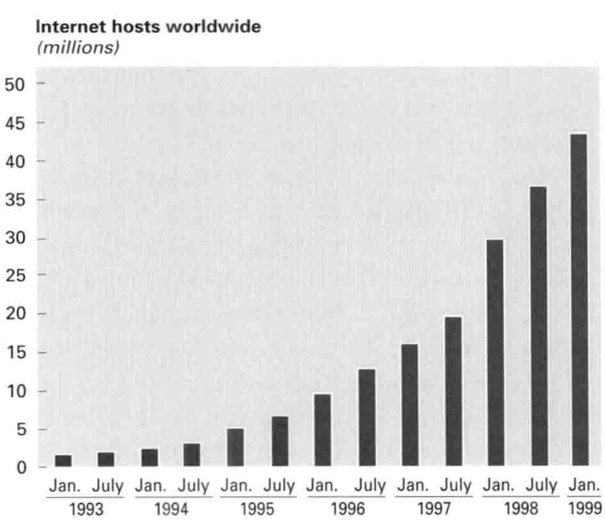
A solid foundation of effective organizations and enabling institutions is a necessary precondition to development. In this context "institutions" are sets of rules governing the actions of individuals and organizations, and the interaction of all relevant parties and the negotiations among the participants. Specifically, countries need institutions that strengthen organizations and promote good governance, whether through laws and regulations or by coordinating the actions of many players, as international treaties and public-private partnerships do. Rule-based processes increase the transparency of policies designed to create desired outcomes and of organizations used to implement them.

The message of this report is that new institutional responses are needed in a globalizing and localizing world. Globalization requires national governments to seek agreements with partners—other national governments, international organizations, nongovernmental organizations (NGOs), and multinational corporations—through supranational institutions. Localization requires national governments to reach agreements with regions and cities through subnational institutions on issues such as sharing responsibility for raising revenues. Both globalization and localization often require responses that are beyond the control of a single national government. Yet national governments will remain pivotal in shaping development policies in an environment that circumscribes, constrains, and redefines their role. In an interconnected world in which countries may continue to fragment, development agendas must respond to both global and local imperatives.

Globalization and localization

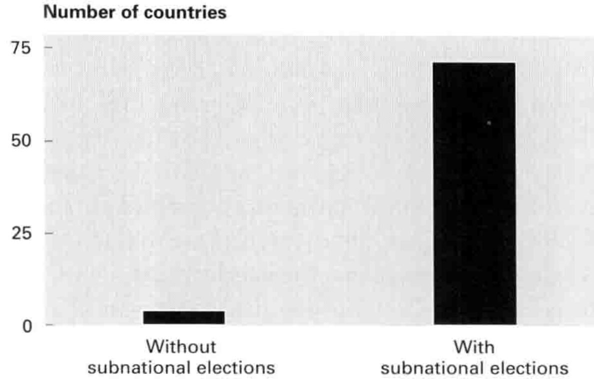
Technological advances in communication have made it possible to know in an instant what is happening in a household or factory or on a stock market half a world away. The growing importance of services and information in the world economy means that an increasing proportion of economic value is weightless—that is, it can be transmitted over fiber-optic cable rather than transported in a container ship. At the same time improvements in transportation networks and technology are reducing the costs of shipping goods by water, ground, and air, and improvements in information technology have made it easier to manage the new interconnections (figure 1). Multinational companies now rely on production chains that straddle many countries. Raw materials and components may come from two different countries and be assembled in another, while marketing and distribution take place in still other venues. Consumers' decisions in, say, London or Tokyo become information that has an almost immediate impact on the products that are being made—and the styles that influence them—all over the globe.

Figure 1
Computers are linking the world



Source: Network Wizards, *Internet Domain Survey*, January 1999 (www.nw.com.).

Figure 2
All but a few democracies have decentralized some political power



Note: Figure shows all countries classified as multiparty democracies for which data were available.
Source: Freedom House, *Freedom in the World*, 1998; appendix table A.1.

Rising educational levels, technological innovations that allow ideas to circulate, and the economic failure of most centrally planned economies have all contributed to the push for localization. National governments have responded to this push in various ways. More countries have become democracies, and political participation through elections has expanded at both the national and subnational levels. National governments are increasingly sharing responsibilities and revenues with subnational levels of government that are closer to the people affected by policy decisions (figure 2). People are also forming NGOs to pursue objectives such as political reform, environmental protection, gender equality, and better education.

Globalization and localization are terms that provoke strong reactions, positive and negative. Globalization is praised for the new opportunities it brings, such as access to markets and technology transfer—opportunities that hold out the promise of increased productivity and higher living standards. But globalization is also feared and often condemned because it sometimes brings instability and unwelcome change. It exposes workers to competition from imports, which can threaten their jobs; it undermines banks and even entire economies when flows of foreign capital overwhelm them.

Localization is praised for raising levels of participation in decisionmaking and for giving people more of a chance to shape the context of their own lives. By decentralizing government so that more decisions are made at subnational levels, closer to the voters, localization nourishes responsive and efficient governance. But it can also jeopardize macroeconomic stability. Local governments that have borrowed heavily and spent unwisely, for example, may have to be bailed out by the national government.

This report does not praise or condemn globalization and localization. Rather, it sees them as phenomena that no development agenda can afford to ignore. While national governments remain central to the development effort, globalization and localization require that they engage in essential institution-building at both the supra- and subnational levels in order to capture the benefits of growth in the 21st century.

Supranational issues

National governments will inevitably face frustrations in dealing with globalization, and these frustrations will be magnified for small developing economies. But such countries stand to gain more from international trade and finance than their larger counterparts, since they face tighter resource and market-size constraints. At the same time these economies may feel any disruption the global economy generates far more intensely. An economic shock that may feel like only a ripple to an enormous economy like the United States, or even to a relatively large developing economy like Brazil, is a tidal wave for an economy the size of Ghana or Bangladesh. When it comes to environmental issues, national governments can strike their own balance on domestic problems by, for example, determining how to apply pollution standards to regions that lie entirely within the country. But unless developing countries work through international agreements, they have little ability to address global environmental problems like the threat of climate change. This report considers three dimensions of globalization: trade, financial flows, and environmental challenges.

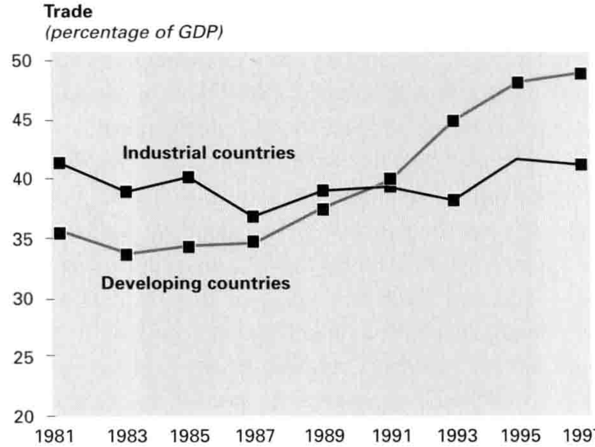
Trade

Foreign trade has grown more quickly than the world economy in recent years, a trend that is likely to continue (figure 3). For developing countries, trade is the primary vehicle for realizing the benefits of globalization. Imports bring additional competition and variety to domestic markets, benefiting consumers, and exports enlarge foreign markets, benefiting businesses. But perhaps even more important, trade exposes domestic firms to the best practices of foreign firms and to the demands of discerning customers, encouraging greater efficiency. Trade gives firms access to improved capital inputs such as machine tools, boosting productivity as well. Trade encourages the redistribution of labor and capital to relatively more productive sectors. In particular, it has contributed to the ongoing shift of some manufacturing and service activities from industrial to developing countries, providing new opportunities for growth.

The creation of the World Trade Organization (WTO) in 1995 built on the General Agreement on Tariffs and Trade (GATT) and is the latest multilateral step toward creating an environment conducive to the exchange of goods and services (figure 4). A number of other important measures must follow, so that the momentum for reform is not lost.

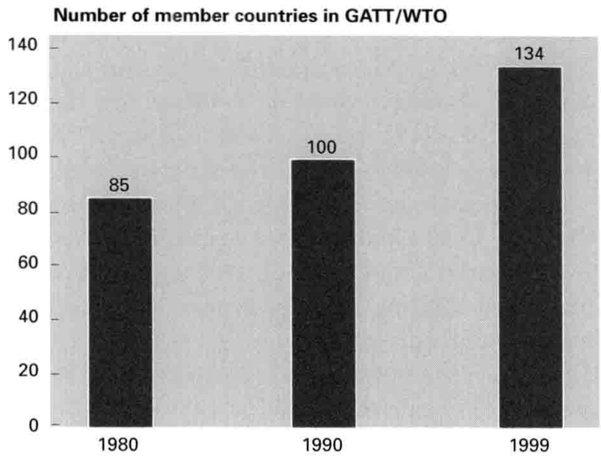
Future trade talks will require a forward-looking agenda for broader trade liberalization if they are to repeat their past successes in opening markets. The Millennium Round, which is scheduled to start in November 1999 under WTO auspices, may be the first test of such an agenda. Reducing trade barriers in agriculture and services should be high on the list of priorities. Trade in agricultural products is one area that offers many developing economies real opportunities—if these opportunities are not blocked by trade barriers in wealthy countries. Trade in services is another issue that must be

Figure 3
Trade is growing much faster than national income in developing countries



Note: Trade is the sum of exports and imports of goods and services.
Source: World Bank, *World Development Indicators,* 1999.

Figure 4
Countries are joining the WTO in increasing numbers



Source: WTO, *Annual Report*, various years.

addressed. Driven by advances in information and communications technology, it is growing explosively—25 percent between 1994 and 1997 alone. This type of trade offers another opportunity for developing countries, which can readily supply many sought-after services.

Countries must make greater use of WTO mechanisms. For example, a country that wants to strengthen its commitment to reducing (and maintaining) low trade barriers can "bind" its tariffs by incorporating the decision to lower them into its international obligations at the WTO. The more countries view the WTO and international trade rules as mechanisms for advancing national goals (rather than as obstacles to self-determination), the greater will be the support for such institutions.

Public policies must take into account the plight of workers displaced by the forces of trade. These policies must address the concerns of displaced workers in general, since many workers will blame foreign trade for job losses and wage cuts whether it is responsible or not. Augmenting trade liberalization with labor market policies that ease workers' adjustment to the effects of global trade will reduce pressure to close domestic markets to foreign goods.

Governments must change policies that are still allowed under existing trade rules but that hinder rather than promote trade. For example, antidumping laws are allowed under the WTO. They are intended to ensure that products are not sold below what is considered a "fair" price on domestic markets. But such rules can easily be turned into barriers to imports, diluting market access and reversing the gains from previous trade agreements. One solution is to treat the pricing decisions of importers and domestic firms according to the same criteria. Under this approach only antitrust issues such as predation are remedied directly.

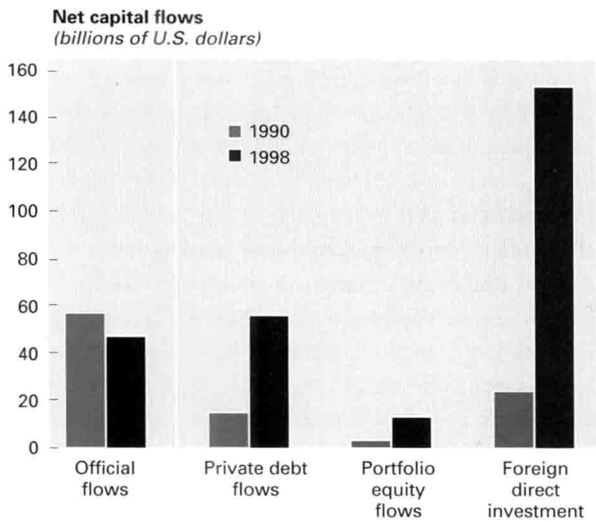
Financial flows

Financial flows across national borders have risen far more quickly than trade in recent years. These capital flows can be divided into foreign direct investment, foreign portfolio investment, bank loans, and official development flows. Foreign direct investment is made up of flows intended to purchase a stake in the management of a company or factory. Foreign portfolio investment includes purchases of "paper" assets like equities and bonds (below the threshold required to give owners managerial control of physical assets). The increase in foreign direct investment and portfolio flows is particularly striking (figure 5).

Flows of foreign capital offer substantial economic gains to all parties. Foreign investors diversify their risks outside their home market and gain access to profitable opportunities throughout the world. Economies receiving inflows of capital benefit in many ways. Initially, inflows raise the level of investment. When foreign direct investment is involved, management expertise, training programs, and important linkages to suppliers and international markets often accompany the capital. Yet international capital flows, especially flows of volatile short-term investments, also expose developing countries to certain dangers. Among these are sharp changes in investor sentiment and waves of speculation that can upset exchange rate regimes, imperil banks and large firms, and wreak havoc on economies. Putting the genie of foreign capital back in the bottle is not possible—and ultimately not desirable. But such capital comes with a challenge: to devise policies and institutions that tip the balance so that capital mobility benefits developing economies rather than injuring them.

Governments of developing countries can begin this process by reforming their banking sectors and nurturing capital markets. The paucity of mutual and pension funds and the weakness of stock and bond markets in developing countries make banks the primary providers of financial intermediation. Creating a robust banking regulatory framework offers a substantial economic

Figure 5
Private capital flows to developing countries have increased dramatically



Note: Private debt flows include bank loans and bonds. The Republic of Korea is included in the figures for developing countries.
Source: World Bank, *Global Development Finance*, 1999.

payoff. An effective regulatory regime creates an environment that encourages prudent risk-taking. A regulatory structure for banking also sets out the conditions for establishing banks, the services they can provide, the level of capital they must hold, and the amount of information they must disclose. And a sound regulatory framework specifies the prudential steps regulators are required to take if these standards are not met.

Increased competition in the financial sector improves incentives for both banks and their customers. Competition increases as the domestic financial sector develops and securities, stock markets, and other intermediaries begin playing larger roles. Allowing foreign banks to enter a country, especially when their home countries have sound regulatory systems in place, boosts regulation by importing high-quality risk-management standards, regulatory practices, and trained managers.

Banks in developing countries must balance two risks. Banks often raise short-term money on global markets in one currency, such as U.S. dollars or Japanese yen, and then loan that money out for longer periods in domestic currency. These banks run the risk of losing their supply of short-term foreign money if the market dries up, as well as the risk of losing much of the value of their assets if the exchange rate depreciates. Countries can hedge these risks to some extent, but regulations are needed to moderate the demand for short-term foreign borrowing in the first place. One such measure could require that a part of all capital inflows not intended to purchase productive physical assets be set aside for a specified period, thereby raising the cost of short-term borrowing from abroad.

In a world where financial markets continue to "go global," developing countries need to work toward becoming good homes for long-term foreign investment. Building an investment-friendly environment requires a commitment to a transparent regime of investors' rights and regulations, a legal system that offers equal treatment and protection to foreign and domestic investors, sound macroeconomic fundamentals, and investment in human capital. When investment is integrated into a well-functioning local economy, other investors will always be ready to step in should one investor decide to withdraw.

International institutions have a role to play in helping developing countries promote financial stability and investment. International banking agreements such as the Basle Accords can serve as models for local bank accounting standards. The International Monetary Fund (IMF) can monitor economic performance and coordinate short-term relief for liquidity problems, dampening the severity of a financial crisis. Trade agreements can help keep responses to financial shocks from turning into a beggar-thy-neighbor cycle of protectionism. Regional and international talks on coordinating macroeconomic policies can seek ways to avoid actions that favor one economy at the expense of its neighbors.

Global environmental challenges

Just as a country's economy can be swamped by global economic forces it has little power to control or deflect, its environment can be threatened by activities taking place beyond its borders and its control. In some low-income countries the threats may be severe enough to jeopardize further sustainable development. Climate changes, for example, could raise ocean levels, swamping the homes of millions of people in low-lying countries like Bangladesh. Governments acting alone, and even regional organizations, cannot respond effectively to this kind of environmental problem. The response must be global. Industrial countries are responsible for most of the existing global environmental problems—especially man-made greenhouse gases—but developing countries are catching up rapidly. Their capacity to