Frontiers of Development Economics

THE FUTURE IN PERSPECTIVE

Edited by
Gerald M. Meier and Joseph E. Stiglitz

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Foreword

THIS VOLUME IS A VALUABLE contribution to our understanding of the evolution of development thought and its relation to development policy. Over the past 50 years, two generations of development economists have sought to analyze the process of development and to formulate policies that might reduce international poverty. Building on their assessment of what we do—and do not—know about development, the contributors to this volume emphasize issues that will challenge the next generation of development academics and practitioners alike.

Development economics is about the big issues: how economies and societies grow and change. They are the issues that were at the heart of the work of classical economists— in particular, Smith, Ricardo, and Marx. The "pioneers" of development economics, writing soon after World War II, were firmly aware of these intellectual connections and roots. They initially recognized the heritage of classical growth economics. The pioneers were also directly concerned with the role of changing behavior and institutions in the process of development, issues that those working in development economics have been emphasizing strongly in recent years. It is therefore now of great value for a new generation of development economists to interact with the earlier generations. They have much to learn, not only in terms of ideas and concepts but also in terms of wise judgment on what is important. Of special relevance for future examination are the unsettled issues highlighted in this volume.

Development economists have, throughout the last 50 years, been strongly involved with issues of policy. This involvement implies that the role of the state must be at center stage. On this subject there has been a fundamental change in development thinking. In the early years, following World War II, there was, broadly speaking, a mistrust of markets, including world markets, influenced in large part by the experience of the Great Depression. There was also confidence in the ability of government to take an effective and productive role in directing investment. The experience of the 1950s and 1960s did not support this confidence, and the 1970s and 1980s saw strong moves to liberalize and privatize.

By the end of the 1990s, we had seen many countries embark on market reform. Again, we have learned from experience. We see that market reforms can be, and on the whole have been, an engine of growth. But we have also seen that if they are not supported by sound institutions and good governance, they can stall or fail. Hence, the focus now is on the relations between institutions and markets.

The centrality of policy to development economics also requires specificity on goals. Here the subject has broadened its perspectives. While income distribution was an issue from the early days following World War II, it began to be emphasized more strongly in the 1960s. And in 1974, Robert McNamara, then president of the World Bank, in his Annual Meeting speech in Nairobi, made overcoming poverty a key goal for the Bank. The understanding of well-being, and thus poverty, has gone beyond income, and now most of those working in the subject would place strong emphasis on improving health and education as part of the development goals and as instrumental in generating growth of income. More broadly still, development is increasingly seen as expanding freedom of choice and action.

This broader perspective on the goals of development and the return to the interests of some of the pioneers makes this millennial publication particularly timely and significant. The broadening of the agenda, together with the emphasis on institutions, also reminds us that development economists need to be aware of contributions from the other social sciences: they have much to learn from economic historians, political scientists, and anthropologists, for example. The potential fruitfulness of some of these new interactions is well illustrated in this volume.

The contributors and commentators in the volume provide many insights and examine some new questions that make the subject both more interesting and more difficult. We have, it is true, learned much in the last half century about the effectiveness of different kinds of policy interventions and structures. Indeed, one of the more beneficial advances is that the subject has become much more focused on evidence, in part in response to, and in part due to, the greater availability of data. The challenge now is to apply what we know with judgment and wisdom while taking on the very serious research challenges ahead of us. In this task, the World Bank has a responsibility to work closely with researchers throughout the developing and industrial world.

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for Development Economics
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Preface

IT IS NOW TIMELY AND CHALLENGING to contemplate the future of development economics in light of the past half-century's experience of development thought and practice. This volume does so as an outgrowth of an intergenerational symposium on "The Future of Development Economics," held in Dubrovnik in May 1999 under the sponsorship of the University of Zagreb and the World Bank. The Bank had previously organized a series of retrospective lectures by the first generation of development economists (approximately 1950–75). These were published in *Pioneers in Development* (1984) and *Pioneers in Development—Second Series* (1987).

At Dubrovnik, representatives of the first and the second (approximately 1975 to the present) generations of development economists presented papers that have been revised for this volume. Most of the contributors are now instructing the next generation of development economists. Viewing the past as prologue—and as a sequel to the previous two volumes by the Pioneers—they now look toward the unsettled issues that will confront the next generation. About 15 discussants comment on the main papers. Two appendixes offer reflections on the future by several Nobel laureates and first-generation pioneers.

The editors greatly appreciate the efforts of the large number of contributors. All who attended the Dubrovnik symposium are also grateful for the splendid hospitality provided by Professor Soumitra Sharma and the Faculty of Economics of the University of Zagreb. The World Bank furnished logistical support for the meeting, but the views of the contributors are their own and should not be attributed to the World Bank.

The editors have benefited greatly from the assistance of David Ellerman, Noemi Giszpenc, and Paola Scalabrin at the World Bank and Kenneth MacLeod at Oxford University Press. Yuri Woo at Stanford University was especially helpful in maintaining overall control of the

manuscript and in bringing uniformity to a variety of bibliographical styles. Her patience and proficiency in dealing with all the details, from the first e-mail to the last footnote, were unsurpassed. Without her keen attention to the needs of so many authors and the editors, the manuscript would not have reached its present form.

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Introduction: Ideas for Development

Gerald M. Meier

OVER THE PAST HALF-CENTURY, we have witnessed an unprecedented effort by the international community to accelerate the development of poor countries. This effort has been based on an evolution in thinking about economic development—its nature, its causes, and the choice of policies for improving the rate and quality of the development process. Although the development record exhibits many successes, there are also failures and disappointed expectations. And while the first two generations of development economists brought about much progress in the evolution of the subject, many unsettled questions and central issues remain to be resolved by the next generation. Accordingly, the contributors to this volume consider the future of development economics from the perspective of the development record and development thought.

Ideas as Framework and as Productive Factors

Underlying all the papers collected here is the recognition that ideas are fundamental to the future progress of development. No formula exists for development. Aid alone cannot yield development. As a former chief economist of the World Bank observed,

> [M]ore than ever before, the central priority for the World Bank . . . is to create and help implement improved strategies for economic development. These strategies must rely, to a greater extent than before, on the transfer and transformation of knowledge, so as to compensate for the expected paucity of development assistance. . . . To put it bluntly, since there will not be much development money over the next decade, there had better be a lot of good ideas. (Summers 1991: 2)

Working from the recognition that the knowledge gap between rich and poor countries is as significant as the savings gap or the foreign exchange gap, the World Bank's *World Development Report 1998/99* was devoted to the theme of "knowledge for development." As Joseph Stiglitz, the chief economist of the Bank at the time of the Dubrovnik conference, observed,

> Today the World Bank has shifted much of its emphasis to the intangibles of knowledge, institutions, and culture in an attempt to forge a more comprehensive New Development Framework for our work. We want, for instance, to be a Knowledge Bank, not just a bank for infrastructure finance. We now see economic development as less like the construction business and more like education in the broad and comprehensive sense that covers knowledge, institutions, and culture. (Stiglitz 1999a)

In a similar vein, the growth economist Paul Romer asserts that

> Ideas should be our central concern. . . [I]deas are extremely important economic goods, far more important than the objects emphasized in most economic models. In a world with physical limits, it is discoveries of big ideas, together with the discovery of millions of little ideas, that make persistent economic growth possible. Ideas are the instructions that let us combine limited physical resources in arrangements that are ever more valuable. (Romer 1993b: 64)

Although the World Bank has been an intellectual actor (Stern 1997), ideas for development have come more naturally from university economists and research institutes. This volume considers the future of development economics from the perspective of the advances in development thought made by both World Bank and academic economists. The evolution has been along several dimensions of analysis and policy implications. In successive order, the focus has been as shown in Figure 1.

As Irma Adelman observes in this volume, there have been "twists and turns" in the evolution of development thinking. Nonetheless, the subject matter of development economics has evolved with increasing analytical rigor, and policy implications have become more definitive. Yusuf and Stiglitz, in their chapter, can point to seven major issues as settled and as representing "normal science" and "common wisdom."

The ultimate objective is for appropriate ideas on development to be absorbed and implemented in developing countries. These ideas include both concepts of development policy, in a macro sense, and ideas about technical progress, in a micro or enterprise sense.

The "new growth theory" emphasizes the role of ideas in promoting growth through the aggregation of advances at the micro level. Within a developing country, the implementation of ideas is essential for rais-

Figure 1. The Evolution of Development Thought

GOALS OF DEVELOPMENT

Gross domestic product (GDP) → Real per capita GDP → Nonmonetary indicators (Human Development Index) → Mitigation of poverty → Entitlements and capabilities → Freedom → Sustainable development

MACROECONOMIC GROWTH THEORY

Harrod-Domar analysis → Solow sources of growth → "New growth theory"

CAPITAL ACCUMULATION

Physical capital → Human capital → Knowledge capital → Social capital

STATE AND MARKET

Market failures → Nonmarket failures → New market failures → Institutional failures

GOVERNMENT INTERVENTIONS

Programming and planning → Minimalist government → Complementarity of government and market

POLICY REFORM

"Poor because poor" → Poor because poor policies "get prices right" → "Get all policies right" → "Get institutions right" ing total factor productivity. (See the chapters by Meier and by Crafts, in this volume.)

Schumpeter's emphasis on innovations is highly relevant for development. He distinguishes between "inventions"—that is, ideas or concepts—and "innovations" (Schumpeter 1939). For development to occur, ideas have to produce "new combinations of productive means"—that is, innovations. These include the introduction of a new good or a new quality of a good, the introduction of a new method of production, the opening of a new market, the introduction of a new source of supply, or the carrying out of new organization of an industry (Schumpeter 1949). Such innovations can offset diminishing returns.

The Schumpeterian type of competition, based on innovations, depends on entrepreneurial performance. To accelerate development, the supply of entrepreneurship has to be increased. This depends on ideas being accepted as individual knowledge and implemented through human capabilities. Entrepreneurial ability is thus a form of human capital.[1]

Beyond contributing to technical change and raising the growth rate, the absorption of ideas may also facilitate the structural transformation of the economy, allow better control of demographic changes, and improve the distribution of income. In an even deeper sense, scientific ideas and rationality can change a society's values and can give support to modernization.

The backwardness of individuals as economic agents is an unfortunate cause and result of poverty. Schooling and training are commonly advocated as means of raising creative capacity and inspiring achievement. Beyond this, a facilitating environment can be promoted through the establishment and protection (but not overprotection) of intellectual property rights, through use of regulatory and tax measures to reward enterprises that innovate, and through intensified competition among decentralized enterprises.[2]

There is certainly an important role for the production of ideas, knowledge, and information by the developing country itself. But in the earlier phases of the development process, reliance may have to be placed on the transmission of ideas via international trade, foreign direct investment, and technology transfer. Perhaps of even greater value than the importation of material goods is the fundamental "educative effect" of trade (Myint 1971). A deficiency of knowledge is a more pervasive handicap to development than is the scarcity of any other factor. Knowledge, however, is a global public good (Stiglitz 1999b), and contact with more advanced economies provides an expeditious way of overcoming this deficiency.[3] The importation of technical know-how and skills is an indispensable source of technical progress, and the importation of ideas in general is a potent stimulus to development—vital not only for economic change but also for political and sociocultural advances that may be necessary preconditions of economic progress. By providing the opportunity to learn from the achievements and failures of the more advanced economies, and by facilitating selective borrowing and adaptation, foreign trade can help considerably in accelerating a country's development.

In the mid-19th century, J. S. Mill observed, "It is hardly possible to overrate the value in the present low state of human improvement, of placing human beings in contact with persons dissimilar to themselves, and with modes of thought and action unlike those with which they are familiar . . . Such communication has always been and is peculiarly in the present age, one of the primary sources of progress."[4] In the 21st century, the pattern and pace of change still differ among countries, thereby allowing trade in ideas to yield dynamic gains from trade. Indeed, Romer (1993a: 543) can assert, "Nations are poor because their citizens do not have access to the ideas that are used in industrial nations to generate economic value."[5]

Although the creation of ideas is a necessary condition for development, it is not a sufficient condition. The absorptive capacity of the developing country is crucial. If development economists and visiting missions are not listened to, their ideas will come to naught. The same is true if ideas on policy reform require political conditions for their implementation and these conditions do not exist, or if the absorptive capacity depends on institutional change that is not forthcoming. In the organization of government and the design of information and an incentives system, the preconditions must be in place for the acceptance and implementation of ideas. The chapter by Grindle in this volume throws additional light on the problem.

The rejection of bad ideas is as important as the acceptance of good ideas. In the 1960s a too-ready importation of the Harrod-Domar analysis overemphasized physical capital accumulation and misinterpreted an idea that was meant in a special way for industrial, not developing, countries. The acceptance of ideas about import-substitution industrialization also turned out to have adverse consequences. So too, at the micro level there have been mistaken ideas. Foreign direct investment may bring benefits, but it may also be overly capital intensive when there is surplus labor, or multinationals may present costs to the host country that mount over time and alter the cost-benefit ratio unfavorably.

The absorption of wrong ideas may make it necessary to reverse or end policies—a difficult task. In general, ideas that become embedded in human capital as knowledge need to be "appropriate knowledge," analogous to appropriate technology. Indeed, inappropriate human capital may be more of a handicap than inappropriate physical capital because human capital cannot be scrapped. A bad practice is not conveniently ended, and a bad idea may drive out a good idea.

Whether ideas are imported from abroad or produced within the developing countries, they should avoid the biases of ideology. Ideological beliefs have only too easily permeated development thought. With postwar decolonization, development economics was initially often viewed as the economics of resentment or discontent. Center and periphery were emotive—not logical—categories. As a policy-oriented and problem-solving subject, development economics was also susceptible to the ideologies of both the left and the right. Disciplined thinking on the proper balance between state and market has only too often been neglected (see Stiglitz 1999a).

If ideas are to be more influential, they will have to evolve from rigorous analysis and empirical testing. To this end, multiple sources of analytical arguments and empirical evidence should be promoted in both industrial and developing countries. As in the past, so too in the future will ideas for development be improved by learning from experience and subjecting ideas to open debate. The emotive and ideological may then be reduced in favor of disciplined analysis that will strengthen development economics.

Contents of This Volume

With the above premises in mind, we turn to the next chapters, which look to future ideas for development. In so doing, we may heed Samuelson's observation (1996: 27): "It is a mistake in science to think that any generation arrives at the banquet table late, after the feast has been consumed. Science's work is never done. Science is a movable feast. One solved problem fans out into many new open questions that beg in turn for solutions." Not only will new issues confront the next generation of development economists: more elegant analytical techniques should allow them to refine and extend some of the insights of earlier generations.

In the next chapter, "The Old Generation of Development Economists and the New," Gerald M. Meier summarizes the past and future of development economics from the viewpoint of the "older generation." To put the future of development economics in perspective, Meier reviews the development ideas of the first (approximately 1950–75) and second (approximately 1975–present) generations of development economists. Against this background, he then considers the unsettled questions and unfinished tasks for the next generation. These involve the recognition of an expanded meaning of "economic development"; more attention to the residual (total factor productivity) in the production-function approach to the sources of growth; refinement and extension of new growth theories in relation to the economics of ideas and knowledge; interpretation of the "right institutions"; determination of the sources and consequences of social capital; undertaking of multidisciplinary analysis; recognition of historical lessons; examination of the opportunities and problems being created by globalization; and attention to new perspectives on the interdependence of the state and the market in the development process.

Meier distinguishes between ordinary neoclassical economic analysis of development and a more comprehensive approach that looks to the operation of large, innovative changes and to political-economy issues in development policymaking. All these issues are subsumed in the general question of whether development economics is to be regarded simply as applied economics or whether there is a need for a special development theory to supplement general economic theory.

In "On the Goals of Development," Kaushik Basu maintains that new goals for development—beyond simply increasing the rate of economic growth—are implied by the movement toward "human development" or "comprehensive development." But can these larger social and political goals be given more precise meaning, let alone be subjected to measurement and some operational metric for purposes of evaluation? This question receives prime attention. To the extent that income growth is relevant, Basu suggests that the focus should be on how the poorest people are faring and on the growth rate of the per capita income of the poorest quintile of the population. Of special interest is the relatively ignored subject of the strategic interaction between the goals of different countries and the issue of "conditional morality" that they present. Such an analysis is relevant for the design of coordinated actions by nations to achieve developmental objectives.

Irma Adelman, in "Fallacies in Development Theory and Their Implications for Policy," identifies three major misconceptions: (a) underdevelopment has but a single cause (whether it be low physical capital, missing entrepreneurship, incorrect relative prices, barriers to international trade, hyperactive government, inadequate human capital, or ineffective government); (b) a single criterion suffices to evaluate development performance; and (c) development is a log-linear process. Adelman maintains that development should be analyzed as a highly multifaceted, nonlinear, path-dependent, dynamic process involving systematically shifting interaction patterns that require changes in policies and institutions over time.

Three chapters look at how some of the development strategies proposed in the World Bank's *World Development Reports* of the early 1990s have fared. In "Revisiting the Challenge of Development," Vinod Thomas argues that development outcomes in the past decade confirm the essential contribution of market-friendly actions but also highlight missing or underemphasized ingredients. Foremost among the latter are the distribution of human development, the protection of the environment, globalization and financial regulation, and the quality of governance. Giving top priority to these issues would mean integrating the quality dimension into development approaches instead of striving to maximize short-term growth. It would also replace one-track efforts to hasten the pace of market liberalization and would expand the attention given to consensus building in civil society, along with the concern for policy changes.

In "The Evolution of Thinking about Poverty: Exploring the Interactions," Ravi Kanbur and Lyn Squire describe the progressive broadening of the definition and measurement of poverty, from command over market-purchased goods (income) to other dimensions of living standards such as longevity, literacy, and health and, most recently, to concern about risk and vulnerability, and about powerlessness and lack of voice. Kanbur and Squire argue that although there are some correlations among these different dimensions, the broadening of the definition significantly changes our thinking about how to reduce poverty. The broader concept expands the set of relevant policies, but it also emphasizes that poverty-reducing strategies must recognize interactions among policies: the impact of appropriately designed combinations will be greater than the sum of the individual parts. The authors maintain that additional research is required to increase our understanding of those interactions; that in-depth country case studies are needed to explore the best policy combinations for countries with different problems and different capacities; and that institutional innovations designed to overcome information failures and knowledge gaps need to be carefully evaluated.

Shahid Yusuf and Joseph E. Stiglitz, in "Development Issues: Settled and Open," consider which issues in development economics appear settled and which require future attention. Settled issues have to do with the following questions: What are the sources of growth? Does macroeconomic stability matter, and how can it be sustained? Should developing countries liberalize trade? How crucial are property rights? Is poverty reduction a function of growth and asset accumulation, or are poverty safety nets required? Can developing countries defer or downplay environmental problems? How closely should the state manage and regulate development?

Current trends reveal a range of issues that are likely to call for future analysis and action. These trends relate to globalization, localization, environmental degradation, demographic change, food and water security, and urbanization. The issues can be grouped under two headings: (a) multilevel governance and regulation issues (participatory politics, organizational capability, decentralization, inequality, and urban governance) and (b) issues related to managing human capital and natural resources (cross-border migration, aging and capital supplies, management of the global commons, and food and water security). Convergence of both income levels and human development levels could be accelerated by responding to these issues. Fresh thinking on