

A Brief Guide to These Lectures

The purpose of this book is to propose a strategy for development. The basis of that strategy is the experience of development, development policy, and development assistance, particularly over the past half-century of extraordinary transformation. This experience tells us that we must understand development as a dynamic process of continuous change in which entrepreneurship, innovation, flexibility, and mobility are crucial. If individuals, and particularly poor people, are to be included and participate in that process, they must equip themselves, and be helped to do so, with the abilities to shape their lives.

The strategy that follows from this view of development comprises two mutually supporting ideas and sets of actions: building an investment climate that fosters entrepreneurship, innovation, productivity, and jobs, and empowering and investing in people, particularly poor people, so that they can participate in the economy and society. Small enterprises—including small farms, the most important small enterprises in developing countries—must be at the center of this strategy. It is there that most poor people earn their livings. The strategy focuses on people's ability to live their lives in the private sector and in civil society. But it also requires an active, dynamic state that fosters and invests in the economic environment and empowers and invests in its people.

This strategy builds on many theoretical ideas and is broad enough to include a great deal of existing thinking about development. But it also goes beyond many standard models and approaches, leading to new perspectives and emphases for research. The research agenda based on the strategy is large and challenging, and we identify some possible directions rather than explore them in detail.

The strategy also provides new perspectives on action. If we are correct about the strategic drivers of development, we should be asking of

any action on domestic policy or external assistance what it does to advance the investment climate or to empower and invest in people. Any plan of action is, of course, dependent on where one starts, and toward the end of this book, we propose an action plan for world development based on the strategy and where we are now. We have a special opportunity in the next few years to make major breakthroughs in the fight against poverty, but we will have to act effectively on a large scale. To do that, we must base our actions on sound lessons about what works and what does not. We hope that the principles of the strategy will help us draw these lessons not just for now, but also over the future.

This book argues that reducing poverty requires creating an environment where growth is strong and poor people can take charge of their lives—where they are their own agents of change. It is this perspective that lies behind the title: *Growth and Empowerment: Making Development Happen*. It is a dynamic story in that structural change is central, history counts, and institutions and behaviors are part of the process of change.

As Amartya Sen has argued, we can view the objectives of advancing development and raising living standards in terms of enhancing people's capabilities to act and choose as well as improving outcomes determined partly by individual or household choices. Here we suggest an approach that involves both opportunities and capabilities, or ex ante possibilities, and outcomes or ex post occurrences.

The book develops a set of ideas, drawing on the authors' experiences as students and practitioners of development. Because it is essentially a set of lectures rather than a treatise or textbook, we point to where many of these ideas could go, but do not develop those directions as far as we would have liked, had there been more time for research. We hope that interested readers will take forward some of the suggested research. In developing these ideas, we relate them to existing literature where we are aware of it and where it is relevant. But no attempt is made to be exhaustive, and no literature review is offered. In many cases, we have undoubtedly overlooked relevant, important contributions.

The book has four parts, or lectures, roughly corresponding to the structure of the Munich Lectures in Economics presented by Stern at Ludwig-Maximilian University in November 2002. Lecture I (chapters 1–4) presents evidence on the experience of development, and Lecture II (chapter 5) proposes a strategy based on our understanding of this experience. Lecture III (chapters 6–10) sets forth a research agenda aris-

ing from this strategy, while Lecture IV (chapters 11–13) shows how the ideas in the strategy can be translated into action.

Lecture I

Lecture I presents evidence on progress in developing countries over the past fifty years. It emphasizes the radical, rapid changes during this period and sets out the lessons that can be drawn from this experience in a way that forms the basis for the proposed strategy. Chapter 1 examines objectives for development and related indicators. We take it that the broad purpose of development is to raise living standards and, in particular, reduce poverty. We adopt a definition of living standards, and thus poverty, that includes income but also encompasses social and human dimensions—including empowerment, gender, education, and health.

Chapter 2 examines some of the key drivers of changes in living standards, particularly those shaping income. Thus, we analyze historical evidence on economic growth, inequality, economic structure, the environment, and international trade. We begin with growth, showing that the past fifty years have seen extraordinary growth for countries, regions, and the world. At the country level, we find that strong economic growth during one or two decades has been fairly common but that such growth is difficult to sustain for longer periods. Growth is a key driver of poverty reduction, but its influence on poverty is strongly intermediated by inequality. Accordingly, after examining growth, we look at the interrelationships among growth, poverty, and inequality. A focus on aggregate growth can obscure what is happening within an economy. Thus, we also examine the profound transformations in economic and demographic structures that are changing the face of the developing world, including shifts from agriculture to manufacturing and services, radical changes in population size and structure, and rapid urbanization.

While much of the discussion is at the country level, international influences are crucial to the development process, and these are covered in the next section of chapter 2. Radical changes in international structures of production, trade, capital flows, migration, and technology have both shaped and been determined by the development process. There is a strong link between growth and expansion of trade; openness to trade is fundamental to a competitive and creative investment climate, and access to markets is a vital determinant

of economic opportunity. The extraordinary growth of the past half-century has been accompanied by powerful, often damaging change in many aspects of the environment. Going forward, a fundamental challenge will be managing environmental change along with the physical and human capital of development. Thus, the environment is a key strand in understanding the historical experience of growth, and is discussed in this chapter.

The final section of chapter 2 draws together lessons on the drivers of growth from both the preceding discussion and some of the empirical literature. The growth story that we tell is not one of steady or balanced growth. Rather, it is one of bursts, accelerations, and often slowdowns, and one of radically changing economic and social structures. Thus, what we are trying to explain and how we explain it look very different from many standard models that focus on the simple economics of savings and capital and steady and balanced growth. That is not the picture that history offers us. And at the center of the story of what drives growth we place institutions, behavior, and governance. Economic growth and structure are both profoundly influenced by institutions and governance, so the chapter concludes by reviewing the evidence on these crucial dimensions.

Chapter 3, on lessons from development policy, attempts to distill the past fifty years of development into a few key lessons. First, as described in chapter 1, we have learned that if we are to understand the purpose of development, we must look beyond income growth to advances in health, education, and human development more broadly—and beyond these, to empowerment. Second, we have learned that development is a dynamic process in which change is central, history matters, and structures are endogenous. Third, the state is not a substitute for the market but a critical complement. The challenging questions concern not so much the balance of the market relative to the state but how they combine to support development. Fourth, effective institutions and governance are crucial for growth. Failures here have often undermined or, as in cases of conflict, devastated development prospects. Fifth, global integration and openness have proven to be powerful forces for sustained growth. Sixth, growth provides the most powerful engine for reducing poverty, and trade is a crucial element of that engine. Seventh, effective development depends on the ability of people, particularly poor people, to get involved in the decisions that matter to them and to participate effectively in the economy and society and shape their lives. We refer to this ability as empower-

ment. Eighth, and relatedly, at a more aggregate level, reform programs imposed from outside with weak societal commitments are likely to fail.

For the purpose of understanding development and development policy, we can see these eight lessons as falling into four groups. The first, captured in the first lesson, concerns the purpose, meaning, and goals of development. The second group, comprising the second and third lessons, deals with the nature of development and the role of policy. It emphasizes the state's substantial role in catalyzing the development process. The third group, consisting of lessons four, five, and six, involves growth, its determinants, and its importance for reducing poverty. It emphasizes the centrality of institutions and governance for growth, the importance of openness and integration as engines of growth, and the link between growth and poverty reduction. Finally, the fourth group, made up of lessons seven and eight, is about empowerment, its role in effective development, and the importance of national ownership of and commitment to reform (as opposed to externally designed and imposed programs). The precise number of lessons is not important—one can always combine, separate, and add. But the broad grouping of the lessons does matter. In trying to understand the meaning of policies to shape development, we must be clear about both the nature of the processes we are examining and which approaches to analyzing them are likely to point to successful policy. And we should try to set out the lessons in a way that leads us to the specifics of a strategy.

Evidence on how we can foster development and fight poverty comes not only from structural analysis of empirical experience but also from the theoretical analysis we bring to that experience. Clearly the two must be combined, but in chapter 4 we focus on theory. Ideas about development have profoundly shaped policies and outcomes. For example, the ideas of Karl Marx, John Maynard Keynes, Joseph Schumpeter, and Friedrich Hayek have had an extraordinary influence on the policies that have been followed around the world over the past century. Our purpose in this chapter is not, however, to present the history of ideas relevant to development, but to examine some theoretical foundations in areas of direct relevance to the arguments put forth in this book. These come mainly from development economics, growth theory, and public economics. The proposed strategy draws on these ideas, but to pursue the ideas at the heart of the strategy, we need to develop a theory of public economics more focused on the processes

and drivers of growth than have been the theories used until now. One part of that theory should go beyond standard microeconomic theory and venture into an analysis of the public policy of changing preferences, which seem central to the process of development.

Lecture II

Lecture II, consisting of chapter 5, presents the strategy. It is a two-pillar strategy that follows directly from the lessons of lecture I: first, build an investment climate conducive to entrepreneurship, innovation, investment, productivity, and job creation, and second, empower and invest in poor people so that they can participate in the economy and society. The strategy's emphasis on the combination of states and markets and the crucial role of institutions and governance, is based on the third group of lessons from chapter 3. The two pillars support each other and are interrelated. It would be a mistake to see the first pillar as referring only to growth and the second only to empowerment. Both focus on promoting both growth and empowerment. And both pillars derive their rationale directly from development goals, as well as from the instrumental role of those goals in driving the processes that influence other such goals. The promotion of activities that are both goals in themselves and means to other goals is a recurring theme in these lectures.

The language of the investment climate should be taken to refer to all forms of economic activity and all sizes of enterprise. We emphasize investment because we are thinking in particular about the dynamics of change, but its use has a much broader scope than a narrow interpretation of the term might bring. The first pillar is all about changing the structures in which economic activity, including investment, occurs.

Thus, in thinking about the strategy, it is important to recognize that while the pillars are distinct, they are also mutually reinforcing; they cover both development objectives and instruments for promoting those objectives, and they are about changing structures. On the distinctiveness of the pillars: while improvements in the investment climate and empowerment generally come together, there are societies where the investment climate is positive but sections of the community are largely disempowered, as with indigenous people in many countries from the United States to Guatemala. On mutual reinforcement: a strategy that improves the investment climate, and thereby growth,

will often provide more economic opportunity and thus choice and empowerment for more members of society. A strategy that directly empowers poor people so that they can participate effectively—for example, through education and training—will enable them to become a force for growth. On objectives and instruments: this comes through most strongly for empowerment. Empowerment is, or should be, an explicit goal for development, but there is also growing evidence that it is a driver of development. This is particularly clear for the role of women. The report *Engendering Development* (World Bank 2001d) shows that many activities and mechanisms—including credit, education, health, agriculture, and governance—operate much more effectively when women participate strongly. On changing structures: for both pillars there is a strong emphasis on changing the structures in which entrepreneurs and individuals take their decisions; the whole approach is based on a view of development as involving processes of profound structural change and of development policy as focused on how to influence these processes.

Lecture III

The details of the strategy set the stage for the research agenda and action plan that are the subjects of lectures III and IV. Lecture III provides a sense of direction for research based on the strategy. A particular conceptual approach to development, such as the one offered here, carries implications for measurement in terms of objectives and in terms of the characterization of the processes driving development. In turn, the evidence generated feeds back into our understanding of the forces and mechanisms of development and policy. Evidence guided by and informing sound theory is a powerful force for change and should be the basis of good policy. Hence, in chapter 6, we examine how the strategy points to the data sets we should use and try to construct. First among these are household surveys designed to track the living standards of households in different circumstances. These surveys also provide information on characteristics that can help identify differences in household circumstances that are relevant for policy and on how households might change over time.

Attempts to measure a variable often lead to questions about the meaning of concepts to be measured. This applies to both the investment climate and empowerment. On the former, we have made considerable progress by asking structured questions directly of firms

about the obstacles they face. Many of these data come from surveys generated in partnerships with the World Bank. These data are based on samples of firms, small and large, within a country. The evidence is quantitative—for example, number of days to get goods through customs or number of hours electricity is out—which allows comparisons across regions or countries. Basic data on outputs, inputs, sales, and the like are also collected.

Measuring empowerment poses particular challenges. The concept is likely to mean different things to different people, and many different aspects will have some relevance. For us, the central issue is people's ability to participate effectively in the economy. Thus, we look at obstacles facing individuals. Many of these arise from problems involving the transparency, functioning, and accountability of local institutions, particularly governments. Empowerment can be strongly affected by local customs, including discrimination on the basis of ethnicity, caste, or language. In many countries, positions and opportunities for women and girls are the most important empowerment issues.

Of special importance to an individual's ability to participate are education and health, the key elements of human development. Data on these areas come from both surveys and administrative sources but are often weak. Basic infrastructure for water, electricity, and transportation is crucial for development. How these services are delivered and to whom are central to empowerment. The World Bank and its partners recently embarked on a new set of surveys focused on the delivery of basic services such as health, education, and water, on how poor people are involved or excluded, and on how services can be improved (see World Bank 2003a). In some of these surveys, investigators arrive unannounced at schools and clinics and check for the presence, or often absence, of teachers, doctors, and nurses.

Taken together, the three types of surveys—of households, firms, and units delivering basic services—can provide powerful tools for implementing the strategy and understanding the role and impact of policy. This illustrates how policy can shape data collection and use and how results from the data and its analysis can shape policy. The data sets that are emerging are also valuable tools for further research.

The analysis of measurement and evaluation in chapter 6 indicates that while much of the theory and empirical work on the investment climate and empowerment are at an early stage, theory lags behind the empirical work in both cases. The next four chapters of lecture III are more theoretical, focusing on the dynamics of change along

dimensions highlighted in the strategy. Chapter 7 covers the investment climate, including how we should model the processes and consequences of change in the environment for entrepreneurship. It also looks at the relationship between the investment climate and growth. And it examines in general terms how firms react to changes in the investment climate and how enterprises and other agents might influence changes.

Chapters 8 and 9 focus more on individuals than enterprises, particularly issues raised by empowerment. Chapter 8 examines the dynamics of empowerment, especially how individuals actually change their circumstances and the role that empowerment plays in this process. We examine three sets of issues. What is the role of empowerment in facilitating and accelerating the participation of disadvantaged groups in economic and political life? What role do small and medium-size enterprises play in the development and empowerment of poor people? And how can public policies facilitate the empowerment of poor people? As part of the discussion of public policy, we examine the role played by income and wealth transfers in the dynamics of empowerment and poverty reduction. The research agenda covered by chapter 8 is crucial to a key question for policy: In the fight against poverty, what is the appropriate combination of redistributive policies and of investments in opportunities for and empowerment of poor people?

Chapter 9 raises some difficult questions that go beyond standard microeconomics and briefly discusses some of the positive and normative issues raised by changing preferences. We suggest that changes in preferences are a fundamental part of the development story, particularly in education, health, migration, and gender relations. Theories of public policy based on an examination of individual incentives and welfare usually assume that preferences are given. The conceptual and theoretical challenges that follow from relaxing this assumption are not straightforward but are, in our view, unavoidable if we are to come to grips with some of the major policy questions of development.

In chapter 10 we examine some of the underlying mechanisms shaping the investment climate and empowerment from a political perspective, particularly the political economy of reform. We have argued that institutions and governance, and how they change, are at the heart of the development story—and examining how they change takes us directly into these areas. The issues that arise include the political changes that may be involved in changing participation, exclusion, and inequality. In some cases, the ability of some individuals to shape

their lives can increase without reducing the empowerment of others. But in other cases, there is likely to be serious political opposition. Changes in the investment climate and empowerment are inherently political, and we are led to examine constituencies for and against change and how they might change over time. At their extreme, political and economic differences can generate violent conflict that is profoundly damaging to development.

Lecture IV

The final part of the book, lecture IV, concerns action. This lecture has two purposes. The first, in the immediate term, is to argue that we are at a special point in time where we have a unique opportunity—in relation to international understanding, commitment, and resources—to accelerate development. We have an opportunity to include many people who have been excluded and to make substantial inroads into poverty. The second purpose, less dependent on a point in time, is to show how the ideas behind our development strategy can be translated into relevant, practical policy and to identify policy directions in which these ideas lead.

The first task in chapter 11 is to assess the challenge in terms of where we start and the Millennium Development Goals (MDGs). These goals, established in 2000 by a large gathering of heads of state at the United Nations, set explicit, time-bound targets for 2015 based on a multidimensional view of development, in the spirit of lecture I. We argue that these goals can be achieved only if we move to a larger scale in our actions, in terms of both effectiveness and resources. Achieving the goals will also require strong partnerships between rich and poor countries and between the state, the private sector, and civil society. In addition, we will have to measure progress carefully, including delivery on commitments of different participants in the partnerships, and design that measurement in a way that allows us to constantly learn and adapt. If we are to act effectively and on a large scale, we will have to learn quickly and apply what we learn. The ability to learn is much stronger if it is designed into policies and action from their inception.

Chapter 12 examines what developing countries can do to improve their policies, institutions, and governance. It does this from the perspective of public finances: we look at macroeconomic balance and the expenditure and revenue sides of the budget. In large measure, the role

of the state and the scope of public action are defined by the powers to tax and spend and how these powers are exercised. The organization of economic activity into public or private, and how the sectors relate, is also a key factor shaping the role of the state in economic life. Privatization has been a subject of changing enthusiasms in the economics profession and has often been marked by dogmatism. The chapter argues that the issues are not simply how much privatization, where, and how, but how to build appropriate combinations of private and public action. In this analysis, we need a careful approach differentiated by country and history, sector and type of activity, and the nature and balance of objectives. From the broad perspective of the public finances, the approach of the strategy highlights dynamism and inclusion in assessing issues, taking us beyond standard theoretical approaches, which focus on revenue, incentives, and efficiency.

Chapter 13, the last in the book, looks at international issues, particularly trade and aid. For developing countries, involvement in world trade is crucial to the competition and openness needed for a strong investment climate. Such involvement can bring ideas, creativity, technology, and benchmarks. Access to the markets of developed countries is a central element of economic opportunity, particularly markets where developing countries have a comparative advantage. The Doha round of international trade negotiations, launched in November 2001, puts developing countries' needs at the top of the agenda and provides a unique opportunity for advancing development. It is an opportunity that could be squandered, resulting in severe disillusionment, or one that could be grasped—greatly accelerating development, to the benefit of all. This is a challenge for multilateralism.

The second part of the chapter examines aid. The MDGs will not be achieved without a substantial increase in aid, as this chapter documents. Aid is just one part—and one of the smaller parts—of international flows. Foreign direct investment and worker remittances, both strongly influenced by the investment climate, are currently bigger parts of the story of generating the resources, technology, and ideas required for development. However, aid is a crucial complement to the recipient country's improvements in policies and institutions, including those that promote integration.

Some brief concluding remarks are offered after the four lectures. They argue that this is a special time for researchers and practitioners. As researchers, we face a hunger for knowledge about development from people (including ourselves) anxious to change the world. And

we have a growing body of theory, exciting new intellectual challenges, and a world that is taking evidence and data more seriously. There has never been a better time to be a researcher in development.

As practitioners, we have a special opportunity to make the world a better place. Taking this opportunity will require international commitment and partnership. It will require changing policies and resources. But extraordinary gains are available to all of us. It is a time for learning—but also a time for action.