Introduction

Stanley Fischer, Dennis de Tray, and Shekhar Shah

The World Bank's series of annual conferences on development economics was begun in 1989 to bring Bank staff and researchers together with academics and policymakers from around the world to discuss key issues of development. Its aim is to provide a forum for an exchange of views and ideas between those who do research on development issues and those who draw on that research to design and implement development policies and projects.

The Bank's comparative advantage in conducting development research arises in part from the fact that research and operational activities take place under the same roof, often by staff who have performed both functions at some point in their careers. The vast range of countries, sectors, and policies that the Bank deals with in the normal course of its operational and research work is another source of its comparative advantage. At the same time, like almost all large organizations, the Bank must guard against a tendency to be inward looking in its analysis and prescription. These annual conferences are one of the principal vehicles through which Bank researchers and operational staff maintain contacts with the external research and policy communities.

An early decision in the design of these conferences was to emphasize both the deepening and broadening of development knowledge. To achieve these dual objectives it was decided that each conference would cover several topics rather than focus on a single theme. Themes are selected in consultation with the Bank's research community to be topical and to cover a broad spectrum of interests.

The second conference, held April 26–27, 1990, in Washington, D.C., focused on four pressing policy and research issues: long-term growth, project evaluation, the environment, and population growth. The wide scope of issues and ideas covered by these topics and the diversity of participants provided a major challenge: to serve participants with broad interests in development as well as experts in each chosen area. To achieve this goal we divided each topic into two sessions, a morning plenary session in which an overview of the area and key issues in the development context were presented, and a longer afternoon session in which more technical and specialized discussion could be pursued. In both morning and afternoon sessions, the authors presented brief summaries of their formal papers, which were followed by invited commentaries from other experts and then by open floor discussion.

This proceedings volume, a special supplement to the Bank's research journals, the World Bank Economic Review and the World Bank Research
Observer, begins in the next section with the remarks of the president of the World Bank, Barber B. Conable, who inaugurated the conference and introduced the keynote address by Václav Klaus. Dr. Klaus is Czechoslovakia's minister of finance and one of the architects of the historic political-economic transformation now under way in that country. The formal papers follow, accompanied by the text of the discussants' comments and summaries of the lively floor debates. The volume ends, as did the conference, with a roundtable discussion featuring Amartya Sen, Nicholas Stern, and Joseph Stiglitz on the roles of the state and the private sector in development. The roundtable discussion was designed to address some of the issues central to World Development Report 1991. Before presenting the full proceedings, we provide below brief summaries of the conference's main presentations.

ECONOMIC TRANSITION IN CZECHOSLOVAKIA AND EASTERN EUROPE

The conference began with Klaus's spellbinding first-hand view of the transition from a command economy to a market-driven economy. In his reflections, Klaus juxtaposed what he termed as the "knowns" in the area of economic adjustment and reform with the "unknowns." He argued that as a product of their historical experience both with the mechanisms of the state-dominated economy and with previous attempts at reform, Czechoslovak reformers have concluded that partial reform in a distorted economy is worse than no reform, that transformation out of economic inefficiency must be swift and pervasive both in its fundamental recasting of property rights, prices, and incentives as well as in its pursuit of sensible policies in the fiscal and monetary realms. Klaus cautioned, however, that headlong "decentralization" without reform of the underlying structure of the market and property rights is an invitation to social chaos.

Klaus emphasized that it is crucial for a generation of Eastern European leaders—who are accustomed to detailed plans and timetables—to recognize that comprehensive reform does not mean waiting for the perfect reform plan, preconceived in all its steps. Rather, he likened the reform process to a chess game in which the opening moves can be made even without looking at the board—but in which no one can know the situation after the fifteenth or twenty-fifth move.

Klaus concluded his talk by reviewing the "unknowns"—questions to which he and other East European reformers most needed answers from the international development community, and in particular from this conference and its participants: In what sequence should they restructure institutions and liberalize prices? In what sequence should they liberalize foreign trade and the exchange rate? What will be the supply response to the reform measures being introduced? How rapid will it be? And finally, how do they minimize the rents that may be reaped, especially by the nomenklatura, when controls are lifted in a distorted system? Klaus’s cogent presentation was received with extraordinary enthusiasm by the conference participants.
The 1980s were years of adjustment—for many developing countries the “lost decade.” The papers presented in the sessions on adjustment and growth ask how we can make the 1990s a decade of growth. In the morning plenary session, “From Stabilization to Growth,” Rudiger Dornbusch examined the key issue for many developing countries that have succeeded—more or less—in stabilizing their economies in the 1980s, but still see few signs of growth. In the afternoon session, Max Corden drew lessons on macroeconomic stabilization and growth from a major, seventeen-country, World Bank–financed study undertaken by a team led by Richard Cooper, Ian Little, Sarath Rajapatirana, and himself.

Dornbusch presents his views on stabilization—which is the first, necessary step in structural adjustment—as well as on the problems of the transition from stabilization to growth. His conclusions and recommendations are an interesting mix of orthodoxy and heterodoxy. On the orthodox side, he emphasizes the key role of fiscal balance in the stabilization process, recommending also the use of incomes policy and a temporarily fixed exchange rate when the inflation rate has to be reduced rapidly. More unconventionally, however, Dornbusch urges that the exchange rate be moved quite quickly to a crawl, to prevent the overvaluation that has developed in programs in which the exchange rate was used as the nominal anchor. Put differently, Dornbusch sees little point for policymakers to try single-mindedly to reach zero inflation, and he recommends that policymakers favor faster growth, even if it means inflation rates of up to 20 to 30 percent a year.

Dornbusch points out that even with the appropriate macroeconomic and structural policies, growth frequently does not appear. Partly this is because of lack of demand, caused by restrictive fiscal policies and lowered real wages, and the slowness of supply to switch to export markets. In this setting, something is needed to make up the demand and to provide entrepreneurs with the confidence to invest. Dornbusch supports public works expenditures, which he believes should be externally financed. But he also puts considerable emphasis on the potential role of flight capital in growth, arguing that there may be dual equilibria—a low-growth equilibrium in which flight capital stays abroad, and a high-growth equilibrium in which growth and flight capital return together. How is the high-growth equilibrium to be attained? Dornbusch points to the role of an external show of support, partly through debt relief, and also through an inflow of stabilization funds.

Dornbusch’s interesting paper is about the high-inflation Latin American countries and Turkey, and only about them. It does not address the problems of the African countries that also face the problem of restoring growth after attempting to stabilize; nor does it take into account some of the Asian countries, including Indonesia and Thailand, which succeeded both in stabilizing and in restoring growth during the 1980s. In contrast, Corden’s paper draws lessons from the adjustment experiences of no fewer than seventeen countries, including some from Africa and Asia. Although Corden is characteristically cautious and
measured, emphasizing the diversity of experiences in the seventeen countries, he does find some broadly applicable lessons.

Corden starts by pointing out that all but one of the countries (India) in the study sample experienced a public-sector-led spending boom in the period 1975–80, induced either by the availability of foreign loans or by improvements in the terms of trade. His first lesson derives from this experience: in good times, avoid euphoria and submit projects to proper cost-benefit analysis.

Corden illustrates the great variety of responses to the crises that different countries faced in the early part of the 1980s with case studies of countries that on the whole adjusted well during that period: Colombia, Indonesia, Thailand, and Turkey. Colombia was slow to react to an adverse change in external conditions, but when it did react, it took drastic action in 1984. Similarly, Indonesia reacted sharply to adverse shocks, avoiding prolonged periods of overvaluation or mounting debt. But the case of Thailand shows that it is not necessary to adjust rapidly, provided a rapid decision is made to adjust and the government has the power to behave consistently to bring about that adjustment. The contrast between the return of growth, especially in the Indonesian and Thai cases, and its failure to return in Latin America, is worth noting. It may be partly accounted for by the much longer period of good economic management in the Asian countries before the 1980s crisis.

On the relationship between inflation and growth, Corden believes that the evidence supports the general principle that high-inflation countries have had lower growth. Of course, exceptions do exist (Brazil in the 1960s). He concludes plausibly that because both inflation and growth are the outcomes of economic policy, it is likely that governments that manage policy well produce both low inflation and higher growth, and that high inflation is a sign of a government that has lost the capacity for good economic management.

Corden ends by discussing the relationship between the exchange rate regime and inflation. His conclusions are again justifiably eclectic: that to assure low inflation a country has to commit itself to noninflationary monetary (and one would add, fiscal) policy, but that beyond that there is no clear evidence that a fixed exchange rate is necessary for low inflation—with the Asian countries that have flexible exchange rates and low inflation as the leading evidence.

What should one conclude from Corden's evidence of the variety of experiences? There are few simple rules that admit of no exceptions, beyond the need to follow cautious macroeconomic policies.

**Sustainable Development and the Environment**

Can development occur in ways friendly to the environment? Are some development approaches more or less harmful to the environment? What is “sustainable development” and how can it be achieved? These questions and a host of others related to environment and development are emerging as the issues of the 1990s for developing countries and development economists. Partha Dasgupta
and Karl-Göran Mäler introduced this topic to conference participants in their paper, “The Environment and Emerging Development Issues,” and Peter Nijkamp, Jeroen C. J. M. van den Bergh, and Frits J. Soeteman expand on the theme in “Regional Sustainable Development and Natural Resource Use.” Both papers argue that the prevailing exclusion of environmental considerations in economic modeling and planning is bad for developing nations and for global welfare both now and in the future.

The papers approach environmental issues from very different angles. Dasgupta and Mäler argue for the inclusion of environmental factors within a more or less conventional economic framework, treating them as economic goods with positive accounting prices in national income calculations. Nijkamp and colleagues establish geographic areas, rather than nations, as the unit of analysis in their program of “regional sustainable development” and take a systems approach in which economics and the environment are viewed as two discretely functioning—albeit closely related—systems, whose competing demands need to be balanced.

Natural resources, their use and preservation, are at the heart of many environmental debates. Dasgupta and Mäler open their discussion by exploring the special character of natural resources. They contend that depletion and pollution of natural resources, whether for direct consumption, production, or both, diminish a society’s well-being even when the resources are regenerative in ways that for the most part have been ignored by the development literature and by policy and investment decisionmaking. A key point of their argument is that although societies’ well-being does not necessarily hinge on preserving current stocks (or quality levels), it does demand that measures of growth and investment decisions account for the sometimes hidden costs of changes in the physical environment.

One cannot understand the environmental problems the world faces or design solutions for them without understanding the institutional aspects of resource use. Dasgupta and Mäler emphasize that markets for environmental goods malfunction or are nonexistent in many developing country economies for a variety of reasons: because property rights are not specified, because the actors are not in contact with each other, or because one interested party enjoys a considerable and consistent advantage in deciding the course of action. These factors often combine to obscure the real prices of environmental goods and not infrequently lead to a situation in which the poor, who are often heavily dependent on natural resources, bear more than their share of the cost of distorted policies and prices.

Although environmental issues in general have received much press as of late, concerns over the care of the “global commons” have been especially evident. The Dasgupta and Mäler solution to global commons problems (greenhouse gases, for example) is a system of transferable, national environmental use/abuse permits. However, as the authors themselves admit, reaching agreement on the original allocation of permits may be an insurmountable problem.
Nijkamp and colleagues argue that theoretical developments over the past two decades have solidified the notion of sustainable development and suggest a wide range of approaches. The Nijkamp framework starts from a definition of sustainable development as "a balanced and adaptive process of change . . . characterized by a dynamic Pareto-optimal trajectory in which progress in one system—that is, either the economic or the ecological—would not be to the detriment of the other system." It stresses that in the short run, environmental and economic goals, both on a regional and global scale, are often mutually conflicting. However, in the long run, consistent with the concept of sustainability, a situation of mutual complementarity, or "coevolution," can emerge.

The Nijkamp paper uses a holistic, planning-oriented framework for achieving sustainable development called "regional sustainable development (RSD)." In contrast to the general movement away from regional and national planning, the RSD framework would require a regional planning establishment that would take an integrated economic and environmental approach and have authority over a wide range of institutions and actors.

**Population and Economic Development**

Scholars and philosophers have debated and analyzed the interrelationships between population growth and economic development for centuries. Progress has been made, but for many important issues the debate often seems hardly closer to resolution now than it was when Malthus first gave them intellectual legitimacy more than two hundred years ago. Do rapid increases in a country's population slow its economic development, or are people just as much an engine of growth as capital? However this debate is resolved, the world at large has long ago taken as fact that slowing population growth is at least a necessary condition for economic and social development.

How, then, to achieve this goal? What are the roles of family characteristics and family planning policies in reducing fertility? How do health and population policies interact? Most important, can we "jump start" demographic transition—the move through declining mortality rates to declining fertility rates to declining population growth rates—or must we wait for history to run its course? These are important issues for the developing world in general, but they are most pressing in Sub-Saharan Africa. John Caldwell, a noted Australian economic demographer, introduced these subjects to the conference in his paper, "The Soft Underbelly of Development: Demographic Transition in Conditions of Limited Economic Change."

Caldwell's paper addresses the fundamental questions of how and why demographic changes occur. He seeks to understand why most Sub-Saharan African countries have not experienced the usual declining birthrates that accompany development. He also examines the other side of this coin, how demographic changes affect the pace and form of development. Throughout the paper Cald-
Introduction

well argues forcefully that current demographic-economic theory cannot explain the national and regional experiences seen in Africa. Caldwell comes out in favor of historical analogy as a more rational guide for action.

Caldwell addresses a number of other questions critical to welfare, economic development, and population policy in Africa—for example, what forces drive mortality decline, and what lessons can Africa draw from the Asian experience with family planning programs and policies? Most important from a policy perspective, he concludes that even under adverse circumstances, family planning programs can speed the onset of fertility decline, but probably only if they are part of a comprehensive health program, one providing family-level counseling and ready access to fertility control measures.

What are the prospects for the Sub-Saharan region in the near future? Caldwell rejects recent World Bank and United Nations predictions that the region is likely to witness a widespread reduction in fertility in the 1990s. Those projections, Caldwell claims, predict fertility declines perhaps twice as steep as what will occur. Furthermore, he notes, “the huge demographic, and indeed developmental, unknown in Africa is the impact of AIDS.” The AIDS epidemic will mean that especially in Africa the past is a poor indicator of the future. Caldwell makes clear throughout his paper that current demographic-economic theory fails to portray adequately either the effects of population on economic growth or the effects of economic growth on population. He believes, however, that we can conclude that fertility decline is compatible with, and probably required for, the transition to a modern economy. Intensive, democratically applied family planning can contribute to that decline.

Many countries have tried to provide incentives or coerce families into having fewer children than they want. In “Incentives for Small Families: Concepts and Issues,” Kenneth Chomitz and Nancy Birdsall present an argument for public policy interventions in fertility decisions that recognizes the sensitive and value-laden nature of the issue. They argue that the incentive programs they propose do not have the drawbacks commonly associated with incentive-based policies designed to influence fertility. Incentives designed to influence fertility decisions are morally unacceptable, according to Chomitz and Birdsall, only if the population should be entitled to their benefits unconditionally or if they induce behavior that violates important cultural norms. They also argue that successful incentive programs must build on and reflect parents’ underlying motives for having and rearing children.

The justification for incentive schemes is that, left to their own devices, couples individually have more or fewer children than society as a whole would like them to have. Chomitz and Birdsall identify two types of market failures that they believe affect fertility decisionmaking and therefore justify public policy intervention: imperfect access to contraceptive information and services; and a lack of private market mechanisms that promote contraception techniques that require only information (for example, rhythm and withdrawal). They also argue that incentive schemes, subsidies, or both could also be used to overcome
couples' hesitation to adopt contraceptive measures in the absence of adequate credit or insurance markets that would offset the risk of possible health complications and ensuing unemployment.

Chomitz and Birdsall point out that there are other types of externalities that may drive a wedge between couples' fertility decisions and the desires of the society in which they live—for example, the amount of public goods or common property, the magnitude of public transfer payments, or disparities of wealth that may affect the incremental child's productivity as an adult. An attempt to derive empirical measures of some of these factors is presented in Ronald D. Lee and Timothy Miller's paper, "Population Growth, Externalities to Childbearing, and Fertility Policy in Developing Countries."

Lee and Miller define the externalities to childbearing as the gain or loss in utility or welfare that couples would experience if fertility decisions were decided collectively rather than independently. The authors offer calculations based on data from a number of developing countries and that of the United States to show how the externalities they identify can be quantified. Their bottom line for many countries—when externalities are summed—suggests that childbearing externalities are not terribly important for most of the cases studied. Only countries with highly valued natural resources per head, such as Brazil and Saudi Arabia, showed strongly negative childbearing externalities. In contrast, the United States has high positive externalities because it has a large defense budget, a mushrooming national debt, and a strong pension program.

In what is bound to be a controversial finding, Lee and Miller conclude that those externalities associated with childbearing that they are able to analyze and quantify do not, for most countries, provide a case for public policy intervention beyond "neutral" family planning services (the provision of information on new birth control technologies, for example). The authors are careful, however, to emphasize that their analysis is much too tentative at this time to support any policy advice, either for or against, on the issue of public sector intervention in the sphere of fertility decisions.

**PROJECT APPRAISAL**

World Bank economists have frequently observed that project appraisal methods within the Bank are not applied in practice in a manner consistent with classic treatments of the subject. This concern and the central role that good project design and selection play in fostering economic development has led the Bank to take a fresh look at the principles of project appraisal and their application in the Bank. Ian Little and James Mirrlees, authors of the classic treatment of the subject, begin their paper, "Project Appraisal and Planning Twenty Years On," with a summary of the main elements of their methodology. They then go on to explore reasons for the apparent decline in the Bank's use of cost-benefit analysis.

The decline in the popularity and use of the Little and Mirrlees methodology
is open to several interpretations. It could be that either the growing volume of lending or a perceived lowering of quality standards has led those involved in the design and implementation of projects to feel less compelled to rigor in their assessments of potential projects. Or the Little and Mirrlees methodology may itself be too cumbersome, too demanding of difficult-to-generate data, to be practical. Little and Mirrlees partially confront these alternative hypotheses in their discussion of the difficulties that have arisen in applying their recommendations. They recognize that it may be difficult to obtain shadow prices, a key building block of their approach, but they argue that the attempt should nonetheless be made; they discuss the relative valuations of private versus public costs and benefits of projects; and they point to the difficulty of taking account of flexibility in the design of projects. In examining the argument that uncertainty about the outcome of projects reduces the value of project appraisal, Little and Mirrlees develop a simple model that suggests that project appraisal remains worthwhile in the presence of typical amounts of uncertainty about the outcome.

Little and Mirrlees, in extending their scrutiny of appraisal to practices in the World Bank, criticize some aspects of the recommended Squire–van der Tak principles, and even more the reported lack of shadow price adjustments beyond a general adjustment for shadow exchange rates. Of some comfort for those of us in the Bank, they do not find the practices in other multilateral agencies and in most governments to be any better, except perhaps in the U.K. Overseas Development Administration. In seeking to account for the decline of project appraisal in the World Bank, Little and Mirrlees point to the pressure that arose from expanded lending targets in the McNamara era in the Bank. The authors argue that organizational changes within the Bank may have compounded these problems, but admit, as well, the possibility that the recommended methods may be too complex to be consistently applied in a large bureaucracy.

Little and Mirrlees conclude that "social cost-benefit analysis is not as widely, as well, or as effectively practiced as its expected net value might lead one to hope and expect." Their paper certainly should lead to further reappraisal of why that is so, and of what can or should be done to widen the method's application.

Although project lending remains the central business of the Bank, in recent years a new type of lending has gained prominence: policy-based adjustment lending. About 25 percent of World Bank lending now takes the form of adjustment loans made not to build a road or a power generation plant but to help countries make needed policy changes. In "Projects versus Policy Reform," Ravi Kanbur examines the interrelations between project and policy loans. Fundamentally, his paper is a plea for the use of project appraisal methods in considering policy loans. As he points out, the documentation for adjustment loans frequently includes alternative projections of gross national product that could serve as the basis for the typical present value or rate of return calculation undertaken in project appraisal. Of course, as Kanbur himself would probably
agree, one would first have to determine whether the models that underlie these projections are sufficiently accurate to provide answers that can be used with confidence.

Kanbur also discusses the impact of policy reform on the returns to projects, suggesting reasonably that policy reform that reduces economic distortions would typically increase the returns to projects (indeed, this is one of the underlying rationales for policy-based lending). He also considers the other side of this coin, suggesting reasons why successful projects might increase the returns to policy reform by increasing supply response.

Acknowledgments

Several Bank staff in the Research Administrator's office and elsewhere contributed to the success of this conference and to the preparation of this proceedings volume. Paul Wolman assisted in the editing of this volume. Manny Jandu provided able and all-round support for the conference.

We would particularly like to place on record our considerable debt to Celina Bermudez, who as the conference coordinator very competently organized and managed the conference logistics. It is with great sadness that we record here her untimely death in September 1990.
Opening Remarks

Barber B. Conable

Good morning, friends. It is indeed gratifying to find what in nuclear physics you would call a critical mass of development economists here today. I think it is marvelous that we have attracted so many distinguished participants this year, and it speaks well of the reaction to last year's conference.

Development is our business at the World Bank. Every year it seems development gets more complicated and more exciting. For instance, no one who attended this conference last year could have anticipated the extraordinary transformation which has since swept the world. That transformation by definition goes to the heart of development research and practice.

The events of the past year have posed acutely the fundamental question, how can people's lives be improved in sustainable, equitable, and manageable ways? This question is difficult to answer because of rapid change in some places and very slow change in others. Some problems appear familiar, such as the poverty, food shortages, poor health, and inadequate education that are the standard subjects of development theory and practice. Others have assumed a fresh urgency, such as revitalizing inefficient industries, making institutions and governments more responsive to public need, and introducing isolated economies to a wider range of trading partners.

Comfortably familiar or newly urgent, these problems demand the illumination of research. Development cannot succeed in practice if it fails in theory, and still less can it succeed in theory if it fails in practice. Operational misjudgments can affect the lives of thousands, even millions, of people. World Bank staff and I are keenly aware of the importance of the knowledge base which has to underpin our work here. I firmly believe that the understanding of development derived from Bank research and experience is at the heart of our mission, and ultimately we should be judged on the soundness of this understanding.

We must be continuously tested about the assumptions underlying our approach to development and to our project and policy advice. I see Bank research as venture capital. It should be invested in ways that may enlighten our operations. Knowledge and progress march hand in hand. The purpose of this conference is to cement that relationship. In reaching out to a broad audience, we aim to stimulate debate, which will be embodied operationally both inside and outside the Bank.

Barber B. Conable is president of the World Bank.

© 1991 The International Bank for Reconstruction and Development / THE WORLD BANK.
Despite the pace and degree of change, some familiar issues run through events like unbroken threads. Among those with which we and others have grappled over the years are several of this conference’s themes: proceeding from stabilization to growth; evaluating projects so that lenders and borrowers get the best value for their money; population growth; and the environment and sustainable use of natural resources.

These same themes have reappeared in the dramatic changes occurring in Eastern Europe. It is fitting as well as an honor to introduce Dr. Václav Klaus, Czechoslovakia’s minister of finance. I know Dr. Klaus will feel at home in this gathering. He has a doctorate in economics from Prague University, briefly studied in Italy, and has studied in the United States, I am happy to say, at my own alma mater, Cornell. And in his own country he enjoyed a distinguished career at the Institute of Economics of the Czechoslovak Academy of Sciences, the State Bank, and the Institute of Forecasting of the Academy of Sciences, where he headed the Department of Macroeconomic Policy before emerging as a member of the Civic Forum leadership in 1989.

I welcome him to this distinguished gathering. I welcome all of you to this second World Bank Annual Conference on Development Economics.