Development

OUTREACH

PUTTING KNOWLEDGE TO WORK FOR DEVELOPMENT

The Quality of Growth

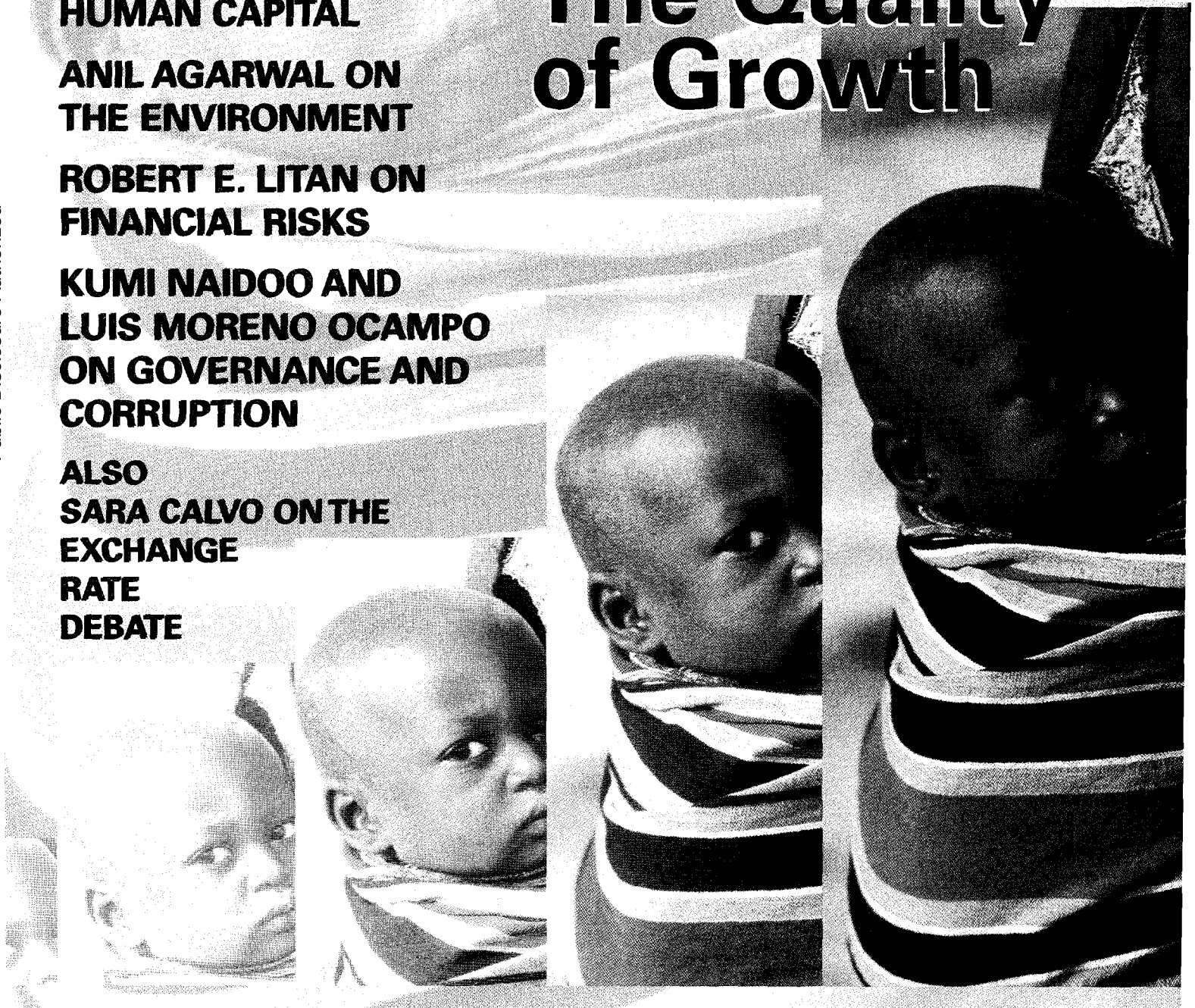
NANCY BIRDSALL ON HUMAN CAPITAL

ANIL AGARWAL ON THE ENVIRONMENT

ROBERT E. LITAN ON FINANCIAL RISKS

KUMI NAIDOO AND LUIS MORENO OCAMPO ON GOVERNANCE AND CORRUPTION

ALSO SARA CALVO ON THE EXCHANGE RATE DEBATE



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What this issue is about....

Development relies on the process of growth, through which both qualitative and quantitative determinantes interact to improve outcomes. This is the message in the World Bank's recently published *Quality of Growth*, which looks at four key themes crucial to the development agenda: investing in education; safeguarding the environment; ensuring stable, prolonged economic growth; and promoting good governance. Each must be included as a component of growth to ensure improved welfare, especially of the poor.

As pointed out by *The Economist* in its review of the book, why should this theme seem so startingly new? The answer is simple—because policy analysis and advice still neglect these issues. Countries have neglected them in practice as well. Investment in human capital remains low, and inadequate attention is given to institutional capital, the value of natural resources and the rule of law. Who suffers the most from these failures? The poor. How do we reduce this trend? Recognize that these factors play a crucial role in determinantes whether the benefits of growth will be distributed to all.

In this issue we examine the above arguments, and give a more in-depth look at the reasoning behind them. Nancy Birdsall of the Carnegie Endowment for International Peace looks at the need to recognize human capital as a productive asset, one that, like natural, physical, and financial capital, can generate income as well as other economic and social benefits. Anil Agarwal of India's Center for Science and Environment in New Delhi, discusses the role an active civil society plays in ensuring the protection of natural resources. Robert Litan of the Brookings Institution examines foreign capital investment in emerging economies, and Kumi Naidoo of Civicus and Luis Moreno Ocampo of Transparency International discuss the watchdog role of citizens groups in curbing corruption.

As always we invite your comments on the issue. For more information visit our website at www.worldbank.org/devoutreach.
We look forward to hearing from you.

Mary McNeil
Editor

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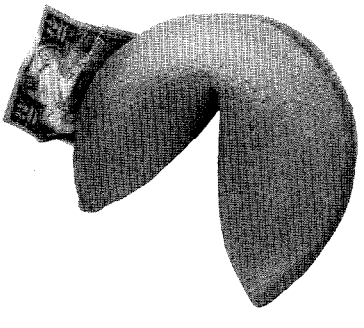

What Our Readers Think

The Global Dialogue

Following the release of the Summer 2000 issue of Development OUTREACH, *we hosted a Global Dialogue videoconference with the objective of enhancing dissemination of knowledge for development by providing a companion product to the magazine. The panelists who participated in the dialogue from World Bank headquarters in Washington, D.C., were the authors of the articles featured in the magazine, which focused on the topics covered in the* World Development Report 2000/2001. *We connected*

via satellite with three countries: Ecuador, Russia, and Tanzania. The audience in each country comprised policymakers from government agencies, researchers from think-tanks, and representatives of non-governmental organizations and civil society at large. A brief synopsis of some of the issues raised by the participants is offered below.

From Moscow, Russia

Participants in Moscow expressed concern about the implementation of financial policies in their country. To fight poverty, they argued, the government needs resources to implement good policies. But since the country is poor and the tax base is limited these resources are lacking, creating a vicious circle that is difficult to break. Corruption is also a cause of poverty. In the case of international loans, they said, there is not enough control on the part of the donor, and often the money is not spent for the project that was funded.

Another problem they raised touched on the long-term and short-term implications of trade policies of openness. While they supported the concept of openness as being a facilitator of growth in the long run, they were concerned with the short-term consequences. They said that in the process of achieving the benefit of growth, many people will die because they cannot compete with foreign products.

Finally, a question was raised that is common to transition economies—the question of the changing nature of the poor. They pointed out that in Russia there are people who became poor all of a sudden. These people are educated and skilled and have never been poor before. The situation is different in some regions of Russia, where it resembles that of other developing countries. There, people have been poor for decades— their parents were poor, their grandparents were poor—and they believe that this is just a normal way of life. The transition poor are a new phenomenon that should be tackled.

From Dar Es Salaam, Tanzania

One of the concerns in Tanzania reflected the ongoing violence that afflicts the continent. They said that poverty is often caused or aggravated by war and civil strife, and that to lift up the population and put them back on their feet, it is extremely important to have a poverty reduction strategy that invests in post-conflict programs. At the same time, they pointed out that a strategy that focuses only on social services would not be effective. It is important to adopt a range of initiatives from macroeconomic policies to structural reform, as well as social services.

But their main concern was with trade globalization. They argued that global trade policies negatively affect their economy. One participant said: "No matter how good our macroeconomic policies are, we will never experience economic growth." They explained that the private sector in Tanzania is ready to support the economy, but the threat from trade globalization is a serious impediment. As for growth-enhancing policies, they thought they are good for the poor, but only if growth is broad-based, e.g. if the majority of the poor would participate.

From Quito, Ecuador

The participants expressed concern for what they see as a vicious circle. They said that when a small country is affected by an external financial crisis, the government takes macroeconomic measures to overcome the crisis, such as raising taxes, cutting subsidies, and reducing investment in the social sector. However, all these measures increase poverty and affect vulnerable people. As a consequence, the community becomes disengaged and civic participation decreases. The latter was seen as a particularly troublesome point, because one important factor in the fight against poverty is a strong civil society.

Send your views and comments on *Development OUTREACH* to:
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Development News

News highlights on development issues from around the world

Cisco Networking Academy Program's New Initiative

Global Knowledge Partnership member organization, Cisco Systems, Inc., has announced that it will invest $3.5 million in educational programs in more than half of the world's Least Developed Countries (LDCs). Cisco will deliver the investment through its global Cisco Networking Academy Program, which teaches students around the world to design, build and maintain computer networks (details of this program are featured in a GKP Story available at www.globalknowledge.org, click on "What do we do" then "Mastering the Net"). Cisco will work with its current strategic partners, the United Nations Development Programme (UNDP) and the United States Agency for International Development's Leland Initiative, to extend the Networking Academy program to 24 LDCs. With this new initiative, Cisco will also partner, for the first time, with the U.S. Peace Corps, the United Nations Secretary General's new initiative UniteS, and the United Nations Volunteers, to help implement the project. For more information contact Elli Takagaki at etakagak@cisco.com

African Knowledge Networks Forum to be Launched

The United Nations Economic Commission for Africa (UNECA), based in Addis Ababa, is in an advanced stage of planning for the African Knowledge Networks Forum (AKNF). The AKNF, to be launched early in 2001, is conceived as a 'network of networks,' bringing together existing African research networks of research centers, universities and non-governmental organizations. It aims to enrich research through building cross-disciplinary bridges, and to enhance research capacity by, for example, using ICTs and the Web, and, especially, to establish productive bi-directional links between research and policy at national, sub-regional and regional levels. The AKNF concept embraces a range of disciplines, from economics to anthropology and to agricultural science. For more information, visit: www.unsia.org/aknf/, or e-mail Sean O'Siochru (sean@nexus.ie) or Bruce Girard (bg@comunex.net).

Ethiopia to Receive $400.6 Million to Rebuild Economy

The World Bank approved two loans totaling $400.6 million for Ethiopia to help the war-torn African nation rebuild its economy. The larger of the two loans, for $230 million, is targeted at those Ethiopians most affected by their nation's recent battles with neighboring Eritrea. These funds will be used for a wide range of purposes, including efforts to remove land mines, rebuild roads and power facilities, and prevent the further spread of HIV/AIDS. The second loan of $170.6 million is to support ongoing peace initiatives and provide additional resources for investment in the social and economic sectors, thereby expediting economic recovery. The project will help the government demobilize its armed forces and return its soldiers back to their communities.

Vietnam: Entering the 21st Century

A new development report was recently produced by the World Bank in partnership with the Asian Development Bank and the United Nations Development Program, and was released in Hanoi in advance of the Millennial Consultative Group meeting on December 14 and 15. It stressed the importance of coordination and partnership among all of Vietnam's development partners so Vietnam's resources—including Overseas Development Assistance—can be used more effectively. In order for Vietnam to achieve the economic and social transformation it desires, the country needs to build and strengthen its six "pillars" of development—enterprise development, rural development, human and social development, infrastructure development, environmental quality, and good governance—in order to identify and remove impediments to growth.

International Forum on Women and ICT

UNDP Malaysia, along with the Malaysian National Council for Women's Organizations (NCWO) and the Department of Women's Affairs of the Prime Minister's Department, co-sponsored and co-organized an international forum on women and ICT titled: "Women in the New ICT Era: Challenges and Opportunities." The forum brought together women from all sectors of Malaysian society and highlighted the use of ICT as a tool for women's empowerment and advancement. A series of workshops provided a platform for participants to discuss the challenges that women face in access and usage of ICT and to suggest ways in which these challenges can be overcome. The forum was part of a larger national project called "Networking Women: Empowerment Through ICT," which seeks to develop networking capabilities and capacity among Malaysian NGOs for improving the delivery of community services. For more information contact Ms. Tam Pham at tam.pham@undp.org

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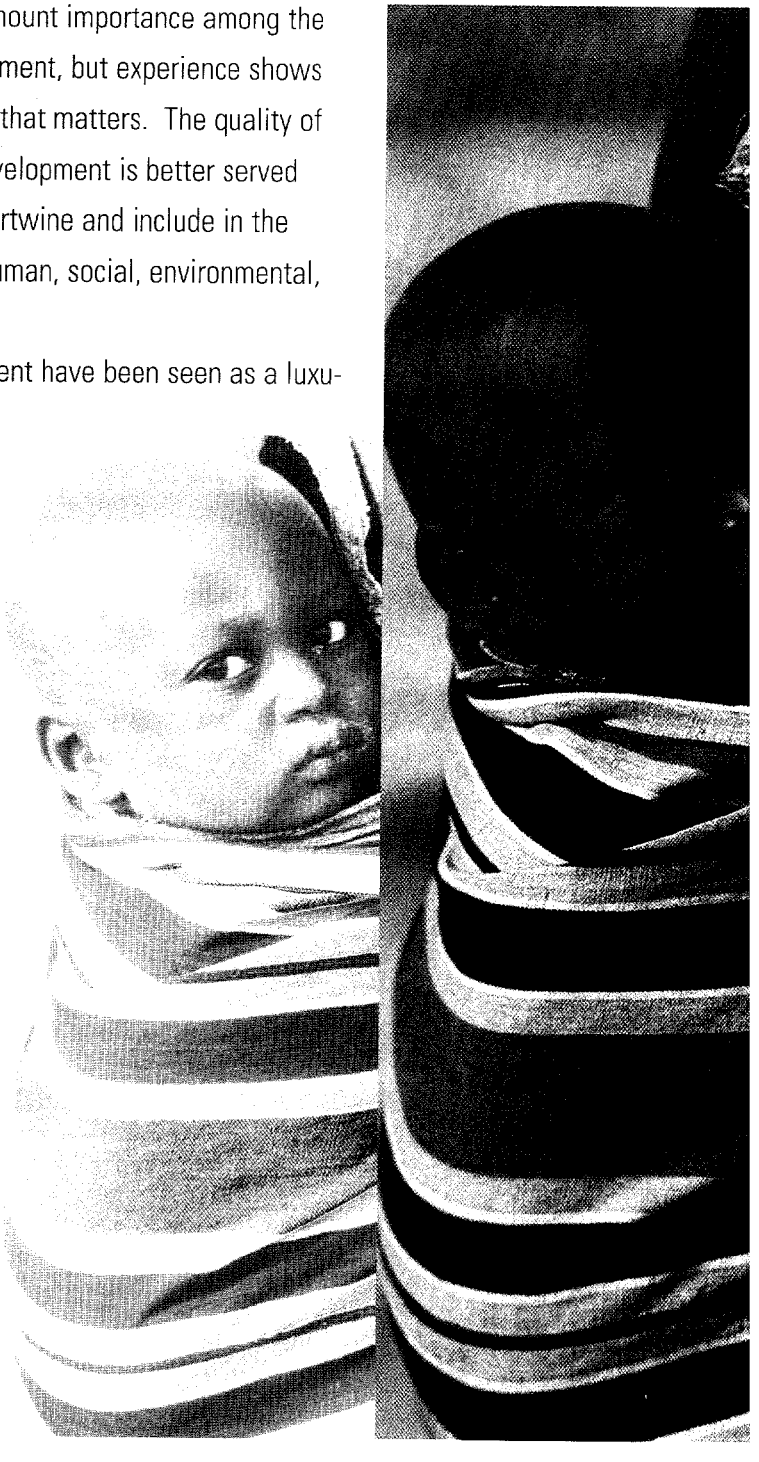
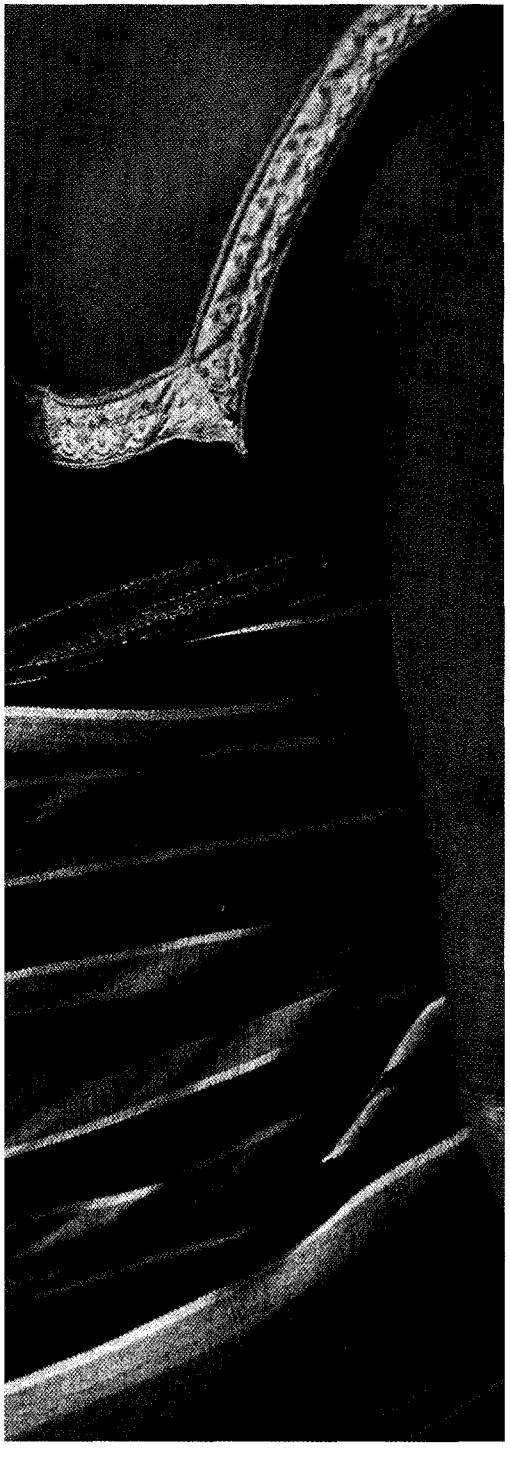
The Quality Of Growth:

Economic growth remains of paramount importance among the factors that contribute to development, but experience shows that it is not only the quantity of growth that matters. The quality of growth carries just as much weight. Development is better served when quantity and quality of growth intertwine and include in the process an agenda that addresses the human, social, environmental, and governance dimensions.

Often, qualitative factors of development have been seen as a luxury to be addressed after quantitative factors were considered. This special report focuses on the ideas behind the book *The Quality of Growth*, which challenges this distinction and consolidates quantitative and qualitative aspects into a common agenda. Renowned experts and practitioners from the field react to the idea of the multidimensional nature of growth, presenting their own views and experiences. The report also includes two pro and con op-ed pieces that appeared in *The Economist*, and the conclusions of an online worldwide Development Forum dialogue which engaged individuals of varied backgrounds.



KEY TO LESS POVERTY AND BETTER LIVES FOR ALL



BY VINOD THOMAS, MANSOOR DAILAMI, ASHOK DHARESHWAR, DANIEL KAUFMANN, NALIN KISHOR, RAMÓN LÓPEZ, AND YAN WANG

Development is about improving the quality of people's lives and expanding their ability to shape their own futures. This generally calls for higher per capita income via economic growth, but it involves much more. It involves more equitable education and job opportunities, greater gender equality, better health and nutrition, a cleaner, more sustainable natural environment, a more impartial judicial and legal system, and broader civil and political freedoms.

Empirical evidence shows that, with growth, and as per capita incomes rise, several of these aspects improve in varying degrees but others do not. The experiences of the last decade show that the pace and patterns of growth have varied adding to the uncertainty of development outcomes, and throwing up a host of questions. Have those patterns been adequate for rapidly reducing poverty or improving the quality of people's lives? Why have so few countries sustained robust growth rates for prolonged periods? Why have some crucial dimensions such as income equality and environmental protection deteriorated in so many economies, both fast- and slow-growing? How does governance underpin the growth process?

The central question for development practitioners, put forward in the book *The Quality of Growth*, is how can growth processes be influenced so that the qualitative dimensions of development outcomes improve. Based on extensive empirical investigation, the "quality of growth" book offers three principles of development, a set of actions for enhancing the quality of growth processes, and an agenda to move forward.

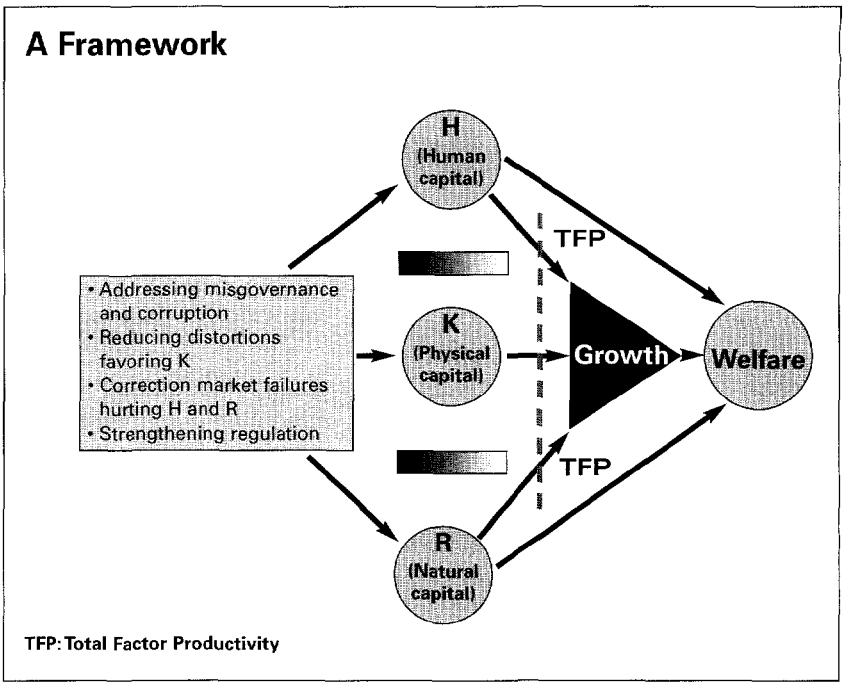
Principles of development

By viewing the quantitative and qualitative sides of the growth process together, the three key principles are spotlighted for developing and industrial countries: a) a focus on all assets: physical, human, and natural capital; b) attention to distributive aspects accross population groups and over time; and c) emphasis on the institutional framework for good governance.

Major Assets

Broadly speaking, the assets that matter for development are physical capital,

human capital, and natural capital. Technological progress affecting the use of these assets is also important. For accelerating growth rates, much attention has traditionally gone to the accumulation of physical capital. But other key assets also deserve attention—human (and social) capital as well as natural capital (see figure). Investments in education at all levels, while helping to generate growth, also contribute to the accumulation of human capital and welfare. Investing in natural capital is essential to human health and, for the many poor people who depend on natural resources for their livelihoods, to economic security. These assets are also crucial for the poor, and their accumulation, technological progress, and productivity, along with that of physical capital, determine the long-term impact on poverty.



Emerging key policies for undistorted growth of physical, human, and natural capital are:

- Avoid direct or indirect subsidies to capital, such as tax breaks, allocation of monopoly powers, special privileges that feed corruption, and implicit guarantees on rates of return.
- Invest efficiently in human capital and ensure access for the poor through incentives and re-allocation of public investments in education.
- Sustain natural capital by clarifying property rights, avoiding unrealistically low levels of royalties for natural resources, and enforcing environmental taxes.

Distributional Aspects

A more equitable distribution of human capital, land, and other productive assets implies a more equitable distribution of earning opportunities, enhancing people's capacity to take advantage of technologies and to generate incomes. That is why, for example, a given growth rate is likely to be associated with better poverty outcomes in settings where educational opportunities are distributed more equitably.

Stability in growth outcomes over time is also likely to be important. The incomes of the poor can be very sensitive to cycles and crises, especially because the poor lack assets—land, skills, and financial savings—to smooth their consumption in bad times. Furthermore, in the context of globalization and increasing global capital movements, it is important to enhance financial risk management and reduce the sensitivity of poor people to changing economic fortunes.

Key policy actions to ensure the stability and distributive aspects of growth include:

- Ensuring that the poor can access education, technology, and health services, as well as land, credit, skills training, and job opportunities in open markets.
- Ensuring effective regulatory frameworks and anticorruption measures to accompany financial openness and privatization.
- Aligning reforms and restructuring to mechanisms for mitigating the costs of crises, which will likely be borne disproportionately by the poor.

Better Governance

The effective functioning of bureaucracies, regulatory frameworks, civil liberties, and transparent and accountable institutions for ensuring the rule of law and participation matters hugely for growth and development. The capture of state policies, laws, and resources by elite interests often biases incentives and public expenditure toward less socially productive assets and, by eroding the benefits that would go to society, reduces the impact on welfare.

Estimates of the "development dividend" in the form of higher incomes or better social outcomes are dramatic, in going from low levels of rule of law or high levels of corruption to even middling levels. Thus investing in the capacity for better governance is a top priority for better economic performance and welfare outcomes.

Key policy actions to build a better governance framework are:

- Involve all stakeholders—the private sector, including transnational firms and the domestic private sector, NGOs, civil society, and the government—in implementing a commonly shared development agenda.
- Empower people through voice, participation, and greater civil and political liberties.
- Support economic liberalization by promoting institutional development and better governance.

Going forward: who will bell the cat?

How can countries accord greater priority to the quality dimensions of growth? And, given the paucity of resources, how can they finance and support such objectives in practice? Several observations based upon the evidence presented in this book can guide efforts in that direction:

- Explicit attention to ensuring transparency and reducing corruption and rent-seeking will not only raise national saving and investment and promote sustained growth, but will also help to distribute its fruits more equitably.
- Some quality dimensions lend themselves to full-cost pricing or taxation, both of which generate public resources.
- Other measures to ensure quality require a reallocation of public expenditures—reducing subsidies and distortions in some areas and increasing public investment in others.
- Broader civil outreach can nurture civil liberties and participatory processes that can help to sustain policy changes.

Governments do not have to assume the entire burden of giving greater priority to the quality dimensions—nor should they. Rather than calling for more government intervention, the evidence in this book calls for greater voice and participation by the private sector, NGOs, and civil society. A broader involvement by all can move the emphasis of development beyond measured GDP growth to include social and environmental progress, greater empowerment and voice, and better governance. The book emphasizes that this reallocation of priorities will refine the contribution of the qualitative aspects of the growth process and focus the spotlight on what development truly means.

Factsheet from *The Quality of Growth*

DURING THE PAST 35 YEARS, the per capita income for developing countries grew at 2.2 percent. The differences across regions and countries, however, were striking. The gap between the average income of the richest 20 countries and the average for the poorest 20 has doubled in the past 40 years, to more than 30 times.

THE INEQUALITY IN EDUCATION in numerous countries is staggering. If people's abilities are normally distributed across income levels, such skewed distribution of education would seem to represent some of the largest welfare losses to society.

IN 1977, GROSS DOMESTIC SAVINGS were about 25 percent of gross domestic product in the developing world, but when corrected for the depletion of natural capital, the genuine domestic savings were only 14 percent of GDP.

IF A COUNTRY WERE TO IMPROVE civil liberties from the worst to the best, the economic rate of return of projects would increase by at least 7.5 percentage points, and possibly by three times as much.

The Quality of Growth, by Vinod Thomas, Mansoor Dailami, Ashok Dhareshwar, Daniel Kaufmann, Nalin Kishor, Ramón López, and Yan Wang.
The World Bank and Oxford University Press, 2000.

The full text is available at:
www.worldbank.org/html/extdr/quality

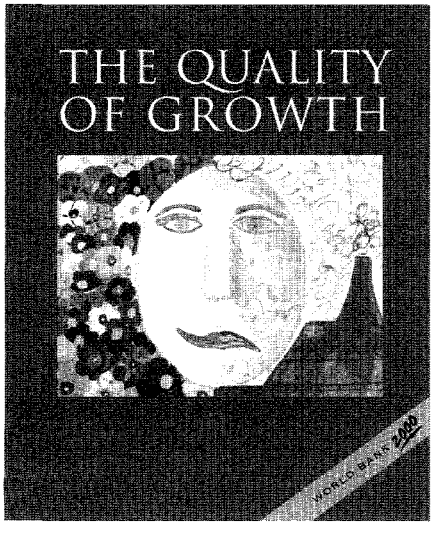
CON AND PRO

Following are two pieces that appeared in The Economist. The first one takes a critical look at the book The Quality of Growth, the second one is a response by the book's lead author.

Quantity and Quality

The Economist, September 30, 2000

Judging by his speeches, James Wolfensohn, the head of the World Bank, has been stung by recent attacks. For some time the Bank has been "enhancing" its views on development, not just listening to the critics' charges but going some way towards pleading guilty. The new World Development Report, with its opaque calls for poor people in developing countries to be "empowered," marked a new stage in this process. Now comes The Quality of Growth, which marks another.



The shift is apparent enough—but why is the Bank doing it? The Bank won the argument over the primacy of economic liberalization (especially trade liberalization) in promoting growth during the late 1980s, and brought many developing-country governments inside the "Washington consensus" on "market-friendly" policies. Those governments, by and large, are still on board—and their economies are doing better as a result. Of course, the 1990s saw setbacks, notably in East Asia and in some of the ex-communist countries, especially Russia—but these hardly overturned the basic prescriptions of the market-friendly way, as the governments concerned (with rare exceptions) would themselves agree.

The main pressure on the Bank appears to be coming, first, from rich-country NGOs and street protesters and, second, from rich-country governments that care more about seeming enlightened and caring than about doing what is right. It is a pity that the Bank is bowing to these forces. There is no prospect whatever of appeasing the marchers, who will be satisfied only by an outright repudiation of capitalist development. By bending in their direction, rather than defending liberalization and globalization on their merits, the Bank is only empowering (as you might say) its enemies and helping them to recruit allies from the middle ground. Meanwhile, the development message that the Bank had rightly been pressing gets increasingly blurred.

The Quality of Growth highlights the second danger. The report contains a lot that is useful and sensible. Much of it is concerned with

Why Quality Matters

The Economist, October 7, 2000

BY VINOD THOMAS

LAST week's Economics Focus emphasized the centrality of growth in reducing poverty. We agree about that. But it is a big mistake to neglect, as you do, lessons on how to achieve more and better growth—growth that is sustained, and whose benefits flow to all.

In the past decade the number of poor people in the world (outside China) is estimated to have risen by more than 100m. To reverse this trend, economic growth is crucial. If the economies of sub-Saharan Africa had grown as fast on a per capita basis as East Asia over the past three decades, living standards would have quintupled instead of barely standing still, and poverty would have fallen, not risen.

Experience in developing as well as industrial countries shows that it is not merely more growth but also better growth that determines how much welfare improves—and whose welfare. Countries with similar incomes and growth over the past three decades have achieved widely differing outcomes in education, health and environmental protection. The impact of growth on poverty has also varied enormously: in India, a given growth rate has cut poverty in some states by four or five times as much as in others.

These experiences demand that we seek answers beyond the "Washington consensus" that you referred to. You say that asking these questions blurs the message for the sake of political correctness. The truth is quite the opposite. Understanding the process of growth, including its social, environmental and institutional aspects, builds country ownership and improves development outcomes. Quantity versus quality is a false dichotomy. The two are jointly determined and their interaction is what decides whether the results will be good, bad or indifferent. Consider three examples.

First, severe inequalities in investment in education and health imply that millions of people lack opportunities to improve their lives. Educational differences in India are one reason why the impact of growth on poverty is five times greater in Kerala than in Bihar. International differences in educational opportunities within countries are enormous. According to a new survey of 85 countries, Poland, the United States, Canada and the Czech Republic provide the most equitable opportunities for schooling; at the other extreme, countries such as Egypt, India, Pakistan and Tunisia have educational inequalities that are four to five times greater. This is enormously costly in every sense.

Second, poor governance retards growth and particularly hurts the poor. Large-scale corruption allows domestic elites and some transnationals to steer policies and laws to their own advantage, at others' expense. New research suggests that strengthening the implementation of the rule of law or reducing corruption from the levels seen in countries such as Ukraine to the levels of countries such as Hungary is,

("CON" CONTINUED)

the challenge of ensuring that rapid growth, once under way, is both steady and lasting. Four themes are emphasized. First, investing in education, particularly primary education, promotes lasting growth and, especially, advances the prospects of the poor. Second, safeguarding the environment, for instance by ensuring that scarce resources are priced appropriately, and by strengthening environmental property rights, also contributes to sustainable economic growth (properly measured). Third, stable growth is better, other things equal, than growth that moves in fits and starts—and again, better especially for the poor, who are the first to suffer in economic downturns. Fourth, corruption undermines growth and retards development more broadly defined. The rule of law is a crucial precursor for sustained economic growth.

As it stands, none of this is difficult for liberals to accept, or even new to them. It would have been entirely possible to locate these findings in the mainstream of the post-1990 consensus. Thus, sustained growth (properly measured) is good; it helps the poor; you want as much of it as possible; here is how you get it. But maybe the Bank felt that this would provoke, rather than mollify, its enemies. So, instead these findings have been spun as follows: growth is all very well, but we were wrong to emphasize quantity over quality—"the quality of growth is as important as the quantity." The wrong kind of growth, pursued too single-mindedly, fails to help the poor and destroys the environment.

In fact, this way of speaking distorts the study's own findings. As one of its tables shows, the developing countries that grew fastest in the 1980s and 1990s reduced poverty substantially; moderate-growth countries made much less progress; and low-growth countries actually saw poverty increase. Infant mortality was lowest in the high-growth countries, and improved in those countries by the biggest margin. Such countries also had the lowest illiteracy rates and the highest life expectancy.

The high-growth countries had less, and faster-declining, water pollution than the other two categories. On rates of deforestation, there was little to choose among the groups. Only on carbon emissions (thanks to rising energy consumption per head) did the high-growth countries do worse than the others. A fair-minded person would sum all this up by saying that the larger the quantity of growth the better—especially for the poor, and on some measures also for the environment.

The crucial question is one that the Bank does actually ask: can rapid growth persist over long periods without improving the lot of the poor? If so, then attending to the quantity of growth is not enough. If not, the quantity of growth is mainly what counts. The report then fails to answer its own questions. It offers many examples of countries where sustained and rapid growth has helped the poor, but none where it has failed to—presumably because there aren't any.

But a finding so simple, encouraging and operationally relevant appears to be regarded by the Bank these days as politically incorrect. The Bank would rather muddle the message to the point of incomprehensibility, saying: "Does faster growth help the poor? Sometimes, but not necessarily. You see, it's all so complicated." What these convolutions have to do with bettering the lot of the poor is hard to say.

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("PRO" CONTINUED)

over the long term, associated with a more than doubling of average incomes. Civil and political liberties and freedom of the press help to reduce corruption, improve the effectiveness of social spending and safety nets, and increase the productivity of investments.

Third, improving environmental quality and protecting natural resources spurs growth and welfare directly, especially for the poor. Dealing with pollution in cities, the depletion and deterioration of water supplies, or the destruction of forests and precious biodiversity is urgent and can make a big difference. Indonesia's forest fires, partly because of bad policy, caused at least $8 billion in direct losses in 1997-98, harming the poor, arguably, even more than did the financial crisis. Yet much of the cost of environmental degradation goes unaccounted for. Reported gross domestic saving in the developing countries is about 25 percent of GDP and in the industrial countries about 21 percent. Corrected for the depletion of environmental capital, saving in both groups shrinks to an estimated 14 percent (down from 22 percent to minus 12 percent for Nigeria, from 25 percent to minus 2 percent for Russia).

Policy analysis and advice have often neglected these issues, as you did last week. As a result, they have been neglected in practice as well. A country's wealth includes not just physical capital but human, institutional and natural capital as well. The evidence shows systematic under-investment in human capital, inadequate attention to institutional capital, and over-exploitation of natural capital. Meanwhile, physical capital continues to be heavily subsidized. Agriculture, energy, road transport and water received gross subsidies of between $700 billion and $900 billion a year in the past decade, two-thirds of this in industrial countries (accounting for 3 percent of GDP) and one-third in developing countries (accounting for 5 percent of GDP).

Some worry that this broader agenda emphasizes lower and unfunded priorities. This is wrong. Avoiding special incentives for physical capital or improving property rights and the pricing of natural resources can generate resources for redressing social under-investment. Improving governance and reducing corruption are money-savers. Greater transparency and broader participation in decision-making improve public services. These aspects of "quality" are central to what the poor—and everybody else—value most in economic progress.

Some question whether this broader agenda is too ambitious. It should not be. The quality agenda is not a veiled demand for big government. Rather, it is an invitation to all parts of society, within market-friendly policy frameworks, to participate in development. This calls for strengthening government and non-government institutions alike.

None of us has the final word on what is the best way forward. We need to continue learning the lessons as they emerge. As part of its consultation processes, the World Bank is starting a worldwide electronic forum on the issue.

Vinod Thomas is a vice-president of the World Bank and head of the World Bank Institute, its educational arm.

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GROWTH: QUANTITY versus QUALITY

BY SUDESHNA C. BANDYOPADHYAY

An online Development Forum Dialogue on issues related to the quality of growth has stirred a global debate across countries and cultures. The moderator of the e-dialogue presents an overview of the thoughts and opinions which were voiced by hundreds of participants worldwide. Visit the dialogue site at: www.worldbank.org/devforum.

There is no denying that economic growth is fundamental in reducing poverty of nations by raising per capita incomes. Therefore the need for a high and sustained rate of economic growth is universally accepted. The last couple of decades of the 20th century, and especially the 1990s, afforded us the opportunity to witness remarkable progress in some nations (e.g., East Asia), stagnation and setbacks in others (e.g., Sub-Saharan Africa) and worse still, sharp reversals of previously made gains in some economies (e.g., Europe and Central Asia). A closer look at the variations in the development experiences of these nations suggests that it is not enough to simply focus on the quantity of economic growth as measured by the percentage rate of growth of total or per-capita GNP.

The qualitative aspects of growth—its source, pattern, sustainability, etc.—are equally important in determining the development outcome of a nation. However these qualitative factors have been relatively neglected till today. The distinction between the quantity and quality of growth is similar to the traditional differentiation between economic growth and development, which tries to capture several qualitative aspects of individual economic welfare. The degree of development has typically been assessed by means of several indices that try to measure life expectancy, infant mortality, educational attainment, degree of equality/inequality of asset and income distribution, availability of basic staple food, water, sanitation, and housing. The recent World Bank publication The Quality of Growth focuses on these quality indices and caters to the important need for unifying the separate aspects of growth and development under a single umbrella. The publication of the book was followed by an online world-wide Development Forum seminar, which brought together a variety of ideas from individuals of varied backgrounds. As the moderator of the e-seminar, I have attempted to represent in this article the main ideas that were discussed. In the process I have taken the liberty of adding some of my thoughts as well, and in some places where we all seem to agree, I have borrowed from the book.

One of the fallouts from focusing primarily on the quantity of growth has been the large subsidization of developing nations' physical capital. There are other forms of assets that are at least equally important in determining a nation's development potential. These are human, social and cultural capital and a nation's natural capital. In the process of development, nations have typically under-invested in human capital and over-exploited natural capital. The theories presented on the quality of growth point to this deficiency of traditional thought and take a more cohesive approach in bringing together the different forms of assets under the single heading of capital, irrespective of whether it is physical, human or natural capital. Finally, they focus on the need for disseminating the development effort all across society rather than restricting it under the sole control of the national government and international aid donors. The people of a nation need to be empowered to do what is best for themselves.

Human capital development

We all agree that achieving mass education is at the core of a successful development outcome. The disagreement, if any, is about the method of achieving this goal. An effective way of achieving this is to empower the poor by providing them with access to quality education. In this respect the government should ensure that the poor are able to make use of the available opportunities. Concerns have often been raised that the opportunity cost of getting an education may be so high for the poor that it may be

unaffordable even when it is provided for free, because of the wages lost while attending school. Therefore educating a population may not be as simple as setting up schools and providing free primary education. Poor families may need to be subsidized for lost wages and the financial incentives need to be tied to attending school and eventually to graduating successfully. Governments may need to combine/supplement primary education schemes with income generation possibilities so as to reduce the effective cost of education for the poor.

It is impossible to come up with a single prescription that will be universally effective. Bob Andrew, a retired engineer from South Africa, thinks that there is a need to involve the poor in this process of empowerment by "collaborating, knowledge sharing, cooperative learning" and above all "innovating" according to local and individual needs. Education should not focus on narrow academics alone. To use the words of Rahul Goswami, from Singapore, it is important to define education in the broadest possible way incorporating civic, social, cultural awareness, focusing on "recycling, regeneration, synergies, about whole systems," so as to make the educated masses effective citizens. Educating the poor need not require huge financial investments. But it will require specific policies that are custom made to suit the specific needs of a local community for these educational programs to be meaningful and sustainable in the long run. International institutions providing development aid need to recognize this aspect of specificity and to revise policies so that they are appropriate for the target population.

Environmental management and sustainable development

There are various ways to define sustainable development. A broad definition of sustainable development prepared by the World Commission on Environment and Development (the Brundtland Commission, see the report Our Common Future, Oxford University Press, 1987) is as follows: Sustainable development is development that "meets the needs of the present without compromising the ability of future generations to meet their own needs." It follows that sustainability will require achieving economic growth without environmental degradation. While the costs of environmental damage hurts the poor disproportionately, the issue of environmental management is relevant for everyone—not just developing nations. There was a lot of concern among the seminar participants that today's developed nations had the opportunity to get rich at a lower cost because they did not have to worry about growing in an environment-friendly way. On the other hand such an opportunity does not exist now for the less developed nations, since we are more environmentally conscious today. Environmental protection is costly and it has a dual free rider problem. The first is an international free rider problem where nation A pollutes with the belief that nation B will clean up. The second is an internal free rider problem where today's generation behaves irresponsibly because they are not far-sighted enough to care about the costs on future generations. There is a fair amount of evidence that individuals have a very high degree of time preference, i.e., they care much more for today than for the future. Therefore it becomes difficult for a person living today in a free market society to incur private costs so as to benefit someone who will live on this earth several decades later. Hence, governments of every country and international institutions need to get involved.

As pointed out by Ajitava Raychaudhuri, Professor of Economics at Jadavpur University in Calcutta, India, one has a better chance at success if international institutions/local governments work in close cooperation with local communities, who have intimate knowledge of the local culture and availability of local resources, to attain growth without depletion of the natural resource base. Educating today's children about the possible damages that our actions will bring to this earth, today and in the future, will go a long way in making sustainable development a reality. There is also a need for the developed nations to subsidize the developing nations in order to protect the latter's environment out of simple self interest. After all, in today's global world, the loss of the Amazon rain forest is not only a loss for Brazil, but a loss for the entire world. So the richer nations should work with the poorer ones to save the global environment. One hopes that, with greater globalization, this self interest will grow.

Managing global financial risks

In today's world of quick and easy global communication, globalization of the domestic economy is no longer a choice of the domestic population. Globalization is a reality and offers innumerable benefits to both developing and developed nations. At the same time, it introduces risks associated with financial integration and capital market volatility. These risks are real and costly as witnessed by the financial crisis of 1997-99 that affected the economies of Brazil, the Russian Federation and South East-Asia. The Quality of Growth stresses the need for financial risk management in order to reap the potential gains of an inter-connected world. The East-Asian financial crisis was largely a result of financial fragility associated with, among other factors, free cross-border capital flows co-existing with government guarantees to banks, corporations and other investors. This provided an implicit insurance scheme to private capital which took unprecedented risks and ultimately failed. There is an obvious need for nations to establish and strengthen institutions and regulatory frameworks that will help monitor open capital markets. The pace of growth needs to be synchronized with the capacity of the existing financial institutions to handle such growth. Governments must also take steps to minimize risky short-term flow of capital. It is also important to put in place domestic financial institutions that cater to the needs of the local poor. We are well aware of the success of micro-finance institutions in creating self sustaining banking for the poor and fostering economic growth with the Grameen Bank project in Bangladesh. The same model has proven to be highly effective in Kenya, while it has not been very successful in Pakistan, reinforcing the assertion that the path to successful development is likely to be different for different nations.

We are just beginning to understand the meaning of the terms quantity and quality of growth and the relationships between them.

Governance and anti-corruption

There is sufficient evidence pointing to the fact that efficient and transparent governance together with civil liberties and the absence of corruption enables nations to grow and develop faster. There is a need for free and stable governance which empowers people to do what is best for themselves by providing basic infrastructures. Bureaucratic red tape and corruption are some of the ills that thwart development. Improving civil liberties, voice and accountability together with a free press have been found to be beneficial for reducing corruption and the unofficial economy. The e-seminar started an interesting debate on the causes of corruption. The existence of economic rents arising from incentive-incompatible government regulations, like administrative pricing, and the lack of accountability in the public sector, are some of the supply side factors that breed corruption. The demand side factors include low wages and lack of career advancements. In my personal opinion, educating the people about the negative effects of corruption may help, by making people aware of the free-rider problem that is associated with corruption and hence the future costs that will ultimately hurt everyone. But we cannot depend on the sense of morality of a population to get rid of corruption. We have to work toward making the absence of corruption incentive compatible. The government official will not accept a bribe if the marginal cost of the bribe exceeds the marginal benefit from it. Establishing property rights, getting rid of administrative pricing, simplifying laws, ensuring transparency in governance, reducing red tape and bureaucracy and strengthening democratic principles are some of the ways of reducing corruption.

Concluding comments

The ideas behind *The Quality of Growth* touch upon a very important set of issues that have not received such complete attention before. However we are just beginning to understand the meaning of the terms quantity and quality of growth and the relationships between them. Clearly the quality of growth will affect the quantity of growth itself and vice versa. In this context, some interesting issues are as follows. First of all, how do we measure the quality of growth in a comprehensive and unbiased way? Clearly, there is a need for an independent evaluation and monitoring system which will ensure that the objectives of aid programs are met, as pointed out by Umberto Triulzi, director of IPALMO, Italy. Next, assuming that different components of the quality of growth will have differential effects on the quantity of growth, what should nations focus on? Given a scarcity of resources, should the national government focus more on mass education or on saving the environment? Finally, there is the issue of short-term trade offs between quality of growth and quantity of growth. Benefits from complementarities between the two may show up only in the long run. For instance, it will require a different technology to produce less polluting cars. Hence this initial focus on quality may slow the growth process in the short run, presumably due to a more expensive technology. But in the long run, the benefits from a cleaner environment will probably more than compensate for the initial losses. Similar ideas were expressed by Charles Ndungu, a participant in the e-seminar from the Center for Democracy and Development at University of Massachusetts, Boston. As an academician, I feel that we need to research these questions more fully so as to enhance our understanding of the overall growth/development package.

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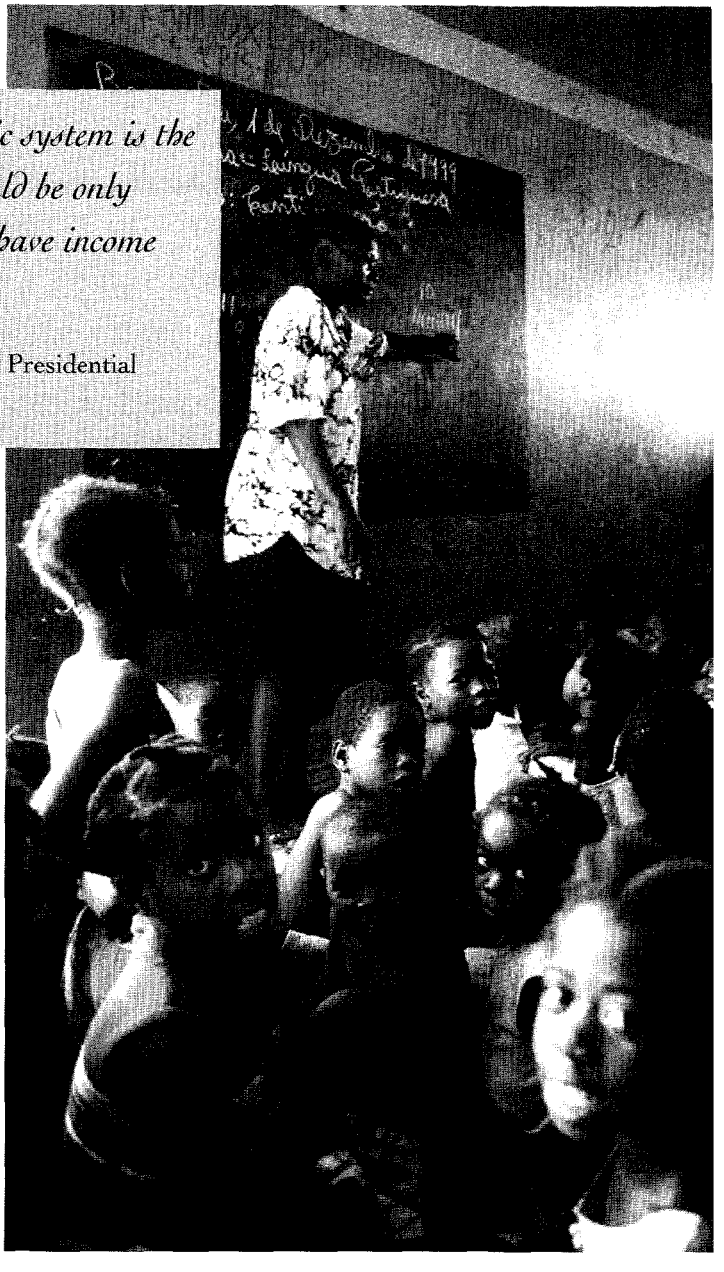
HUMAN CAPITAL AND THE QUALITY OF GROWTH

BY NANCY BIRDSALL

Truly, the most distinctive feature of our economic system is the growth in human capital. Without it, there would be only hard, manual work and poverty except for those who have income from property.

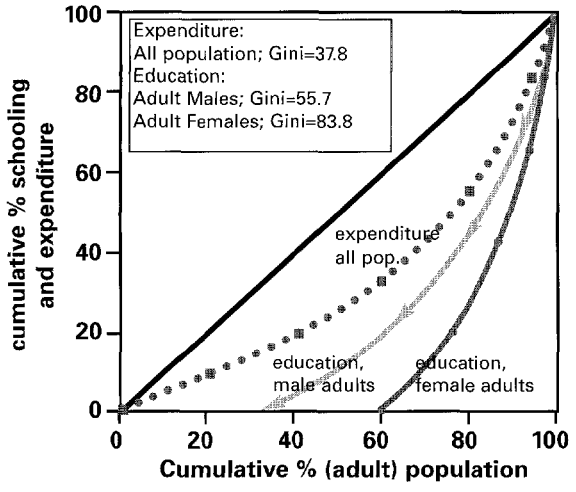
–Theodore W. Schultz, referring to the U.S. economy in his 1960 Presidential Address to the American Economic Association



T.W. SCHULTZ was ahead of his time, at least among economists. The earliest postwar models of development emphasized accumulation of physical capital, and saw spending on health and education as a drain on the accumulation of "productive" assets. But eventually, the newer classical growth models incorporated formally Schultz's insight, and related work on accounting for growth by Hollis Chenery and colleagues at the World Bank pointed to the contribution of more skilled workers with more human capital to increased productivity and growth. The more recent endogenous growth models are even more emphatic. Sustainable growth in these models is the result in part of positive externalities generated by education, an important form of human capital. In these models, the new ideas and new technologies that are critical to high sustained growth rely fundamentally on high levels of human capital.

The newer growth models thus provide a compelling justification for human capital investments as efficient and growth-enhancing. But unfortunately, in their simplest form they are poor guides to policy choices. They add little to our understanding of why some countries (and

Chart 1: Education and Expenditure Inequality in India, 2000



Sources for Charts 1 and 2: calculations using data from WDI (2000), WIDER inequality databases, and Barro & Lee (2000).
Expenditure Ginis in Chart 2 are adjusted to be comparable to income Ginis.

regions within countries) succeed and others fail at generating and sustaining high levels of human capital.

The insights in the book, *The Quality of Growth*, take us much further. They start us down a new more promising path for policy guidance: treatment of human capital as a productive asset – one that, like land and physical and financial capital, can generate income as well as other economic, political and social benefits for its owners, but also like other assets cannot simply be delivered top-down by government, no matter how effective and well-intentioned government may be. Like other assets, human capital is an outcome of as well as an input to the "quality of growth." It has to be accumulated and maintained by its owners, may well be distributed unequally, and has value that may not be realized in the absence of appropriate markets and institutions.

Consider three issues raised by the explicit view of human capital as a productive asset — issues on which traditional models of growth are silent.

The distribution issue

Traditional growth models ignore the distribution of human capital across individuals, and thus the distribution of opportunities on which growth ultimately depends. Their implicit assumption is that the accumulation of human capital will "trickle down" and benefit everyone. Yet it is wrong to assume that more education (and more of other forms of human capital) will be distributed equally. It is well known that girls have not shared equally everywhere in the benefits of education (see chart 1). In the last decade clear evidence has come that in some countries children from poor families benefit little from public spending on schooling. In Brazil and Mexico, for example, less than 10 percent of young adults (aged 20-25) in the poorest 10 percent of households have completed secondary school (compared to more than 70 percent in the richest 10 percent of households). In countries like India, where there are still large numbers of adults (largely adult women) without any education at all, education (among adults) is less equally distributed than expenditure per capita (across households) (see chart 2). Other evidence shows that an unequal distribution of human capital slows growth, and particularly slows income growth of the poor. So in the short run India, Brazil, and Mexico face a lower growth path (other things equal) than Sri Lanka, Malaysia and Costa Rica, where the current distribution of education is already more equal.

Happily, data on the distribution of education over time show inequality falling in all regions of the world; as aver-

Chart 2: Inequality of Education and Income

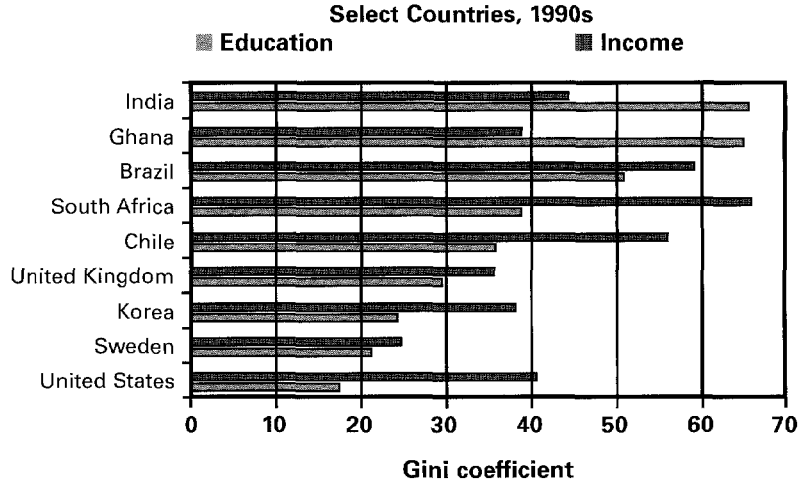


Table 1: Absolute Income Shares of Lowest Quintile of Households, Malaysia and Brazil (in US dollar terms)

Country	GNP per capita (PPP-adjusted)	Income Share of bottom 20 %	Per capita income of bottom 20 %
Malaysia, 1989	4,674	4.6	1,075
Brazil, 1989	4,271	2.4	513

Source: Birdsall, Ross, and Sabot, (1995).

age education levels rise, inequality declines. Still, in some countries, current inequality in the distribution of education means most children of the currently poor are not acquiring enough human capital to exploit the new opportunities that market reforms and the arrival of an information age in their countries are creating.

The demand issue

Traditional growth models also ignore the demand side. Human capital accumulation is treated as exogenous. Like manna from heaven, it's a good thing that arrives seemingly independent of private and collective decisions, and thus independent of such realities as the pre-existing level and distribution of human capital! What does in fact determine how much households invest privately and societies invest collectively in their children's education and health and in other forms of human capital?

Private decisions to invest in children are made mostly by parents (including especially mothers in most cultures), in part as a function of their own education and income. Thus the initial distribution across households of adult education matters – just as tends to be the case with other assets. Parents' own income and assets matter because they shape attitudes and expectations, but also because capital markets are imperfect, and many poor and uneducated parents are thus not able to borrow to invest as much as they would like in their children. As shown in the table, Brazil and Malaysia had similar average levels of per capita income in 1989 (table 1). But the poorest quintile in Brazil had only one-half the absolute income of the poorest quintile in Malaysia. Given an income elasticity of demand for secondary education of 0.50, if the distribution of income had been as equal in Brazil as in Malaysia, secondary enrollments among poor Brazilian children would have been more than 40 percent higher — a huge increment.

Parents' demand for human capital for themselves and their children is also a function of the benefits they expect from their investment in this capital asset, in the form of higher future incomes for themselves or their children. Expected benefits and thus demand will naturally be lower for women and for members of racial and ethnic groups facing job and wage discrimination in the labor market. Where market distortions reduce the demand for workers with the limited skills that primary education affords, the benefits of primary schooling for those who cannot expect to continue to secondary school will be lower. In developing countries where new technologies and open markets are increasing the returns to university-educated workers – but leaving behind in relative terms even those with secondary school, families struggling to ensure secondary school for their children will be discouraged from even that goal. Low quality of public schools reduces demand since it reduces the expected benefits (such as higher income) of keeping children in school compared to the immediate costs.

In all these situations, more spending

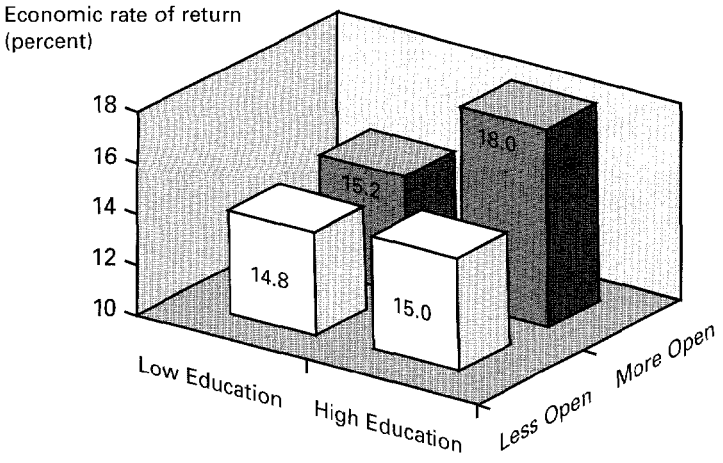
Table 2: Education and Resource Abundance

		Secondary Enrollment (%)	
		Mean	Median
1975	Resource Poor Countries	28.5	26.0
	Resource Rich Countries	25.3	19.5
	Difference	2.8	6.5
	Controlled Difference		5.7
1985	Resource Poor Countries	39.5	40.5
	Resource Rich Countries	35.7	34.0
	Difference	3.8	6.5
	Controlled Difference		7.4

Note: "Controlled Difference" takes into account the average impact on income of secondary enrollment and illiteracy by means of regression analysis. Categorization of countries taken from Auty (1997).

Source: Birdsall, Pinckney and Sabot, (2001).

Chart 3: Education, openness, and economic rates of return in 1,265 World Bank projects



Note: Economic rates of return are from the evaluation database of the World Bank's Operations Evaluation Department. Education is measured by the average level of schooling of the labor force, and openness by the logarithm of the foreign exchange parallel-market premium.

Sources: Thomas and Wang "Education, Trade and Investment Returns." Working Paper. WBI, 1997

and program reforms, for example, to raise quality of public schooling, can make private decisions to invest in human capital more affordable and more attractive — by reducing upfront costs and increasing future benefits. But other changes — outside the province of the "human capital" ministers (of education, health, social welfare and so on) are also critical: reducing discrimination, eliminating labor rules that discourage job creation, reform of banking and property regulations that discourage lending to the poor.

There is also a question of demand at the societal level. In countries rich in mineral and certain other (non-renewable) natural resources, the oft-resulting concentration of income seems to generate a political dynamic which limits human capital investment (see table 2). Where inequality of wealth and income is high, rich families are likely to successfully resist the tax burden that spending on good quality basic education for the poor majority would impose. On the positive side, in more open economies, firms that want to stay competitive in global markets are likely to press for a workforce able to adapt to constantly changing technologies and processes. And of course, where the strengthening of democracy means the poor and the middle class can participate more actively in political life, collective decision-making will generally put a high premium on public investments in human capital.

The problem of other distortions

For all these reasons, building human capital, especially among the poor, is about much more than education and health programs. A focus on demand reminds us that, like other assets, human capital's value depends in part on its owners' ability to deploy it in a competitive market in which the rules of the game reward innovation, entrepreneurship and higher productivity. The experience of the former Soviet Union suggests that relatively good stocks of human capital need not translate into growth or improved human welfare in the face of distorted markets and repressed political life. Growth, and the quality of growth depend not only on the level of human capital, but on the deployment of this asset in the economy and in social and political life. A subheading in *The Quality of Growth* says it all: Combine Human Capital with Opportunities in Open Markets (p. 78). As chart 3 (from the book) shows, the returns to investment (in this case in World Bank-financed projects) have been higher in countries where education levels are higher – but where education really seems to pay off is in more open economies.

Growth of human capital, as Schultz suggested, provides an escape from "hard, manual work and poverty." On the one hand, human capital is not development's magic bullet. As with other assets, its accumulation, distribution, and deployment are an outcome of choices, of policies and of institutions. On the other hand, unlike other assets, human capital does have a special property. Once acquired it cannot be sold or stolen. That gives it a special role, as the people's asset, in ensuring the "quality" of growth.

Nancy Birdsall is senior associate, Carnegie Endowment for International Peace.

The sources and full citations for text, tables, and charts are available with this note at www.ceip.org

The Value of *Natural Capital*

It is a good thing that the economic value of natural capital is receiving greater attention, as environmental degradation is likely to be most devastating for the poor. We have pointed out in the first citizens' report on the State of India's Environment – a unique participatory civil society exercise unparalleled anywhere in the world – that environmental destruction and social injustice go hand in hand in a poor country. Any process of economic development that destroys the environment in a poor country means loss of livelihoods and incomes of poor people, and by definition cannot even be called development. This has been the first time that a powerful voice was raised within the developing world, stating that environment and development must go hand in hand, and challenging the grow now-take care of the environment later syndrome. The report provided a social and political rationale for the growth of an environmental movement in a desperately poor country.

BY ANIL AGARWAL

Economic growth, when unmanaged, can easily lead to an increase in ecological poverty – the lack of a healthy natural resource base for safeguarding public health and local economies. Even today, the world remains split right down the middle, with one-half of the world's population living on human-made capital and the other half on natural capital. For one, the Gross National Product of the modern economy is of value, while for the other, it is inconsequential; for the latter, the local Gross Nature Product is of value. A large part of the world's people depend on a traditional, biomass-based subsistence economy. For these people, food, fuel, fodder and building materials are all in the form of biomass. Water, another critical need, is not biomass but it plays a critical role in making biomass available.

Proponents of the "quality of growth" are correct in pointing out the importance of incorporating sustainability in growth policies. But they need to go further. It is even more important to incorporate sustainability in poverty alleviation strategies. Today a major challenge facing the world is not just maintaining the global natural capital but also reviving it in numerous degraded ecosystems. Nearly half a billion of the world's absolute rural poor today live in degraded lands where natural capital has diminished to a point that the traditional biomass economy has completely eroded. Large parts of China, South Asia, Africa and Central America suffer from such degradation. In these areas, a lot of what is described as economic poverty using indicators like an income of less than US$1 per day is actually ecological poverty. Poverty alleviation programs must address this ecological poverty if they want to address economic poverty in any serious sense. In fact, many poverty alleviation programs, including those of the World Bank and of many

national governments, fail because they do not address ecological poverty.

Communities regenerate natural capital

Fortunately, over the last two to three decades, there have been excellent community-based natural resource regeneration efforts in India that have shown outstanding ecological and economic returns. These experiences show that it is possible to rebuild natural capital together with the local economy. The first experience, that of the village Ralegan Siddhi, in a semi-arid region of Maharashtra, is now nearly 25 years old. From a highly degraded village ecosystem and an extremely destitute economic condition, the village is today one of the richest in the country and a model for the rest of the country. A survey commissioned by the Centre for Science and Environment found that over one-quarter of the households had an annual income of over US$10,000.

The second experience, that of the village of Sukhomajri in the sub-Himalayan Shivalik Hills of Haryana, is over 20 years old. It again shows that rebuilding the natural capital results in a sustainable economic and livelihood base. From a poor, food-importing village, with an agricultural base dependent on the vagaries of the monsoon, the village today takes three assured crops and is a good-exporting village. The protection of the watershed has resulted in the regeneration of a standing forest of valuable khair trees (Acacia catechu) worth Rs 90 crore (US$20 million). If the government were to allow the villages to harvest the forest, a sustainable cut would alone give the 100-odd household village an income of some Rs. 5 crore (US$1.11 million) every year. These two villages have reached a mature stage in the development of the local economy built on the regener-

A powerful civil society is needed to generate the necessary public pressure for the political system to start incorporating sustainability as a key element of growth programs.

ation of the natural capital, and show clearly how far forward the regeneration of the natural resource base can take a biomass-based economy.

The third experience, that of the semi-arid villages situated in the Aravalli hills of Rajasthan's Alwar district under the leadership of a local NGO, is now about 15 years old. Over the last one and a half decades, over 500 villages have begun to revive the local tradition of water harvesting. The restoration of the depleted groundwater resources has led to sustainable agricultural development which has allowed local farmers to withstand consecutive drought-years. As in Ralegan Siddhi and Sukhomajri, distress outmigration has been greatly arrested. Studies show that the Village Domestic Product has increased in proportion to the investments made in water conservation. With dozens of villages undertaking water harvesting activities in the same watershed, nearly five rivers of the area have changed from being monsoonal drains to perennial rivers – a remarkable ecological achievement. In one of the river basins, over 25 villages have come together to form the country's first community-based River Parliament to jointly manage the regenerated river.

In 1994, Digvijay Singh, the new chief minister of Madhya Pradesh, a state which has large areas of degraded highlands in which poor tribal populations live, impressed by the outstanding work in Ralegan Siddhi, decided to undertake a statewide, community-based watershed development program. Within four years, some 8,000 villages were managing over a million hectares of watersheds. Unlike many other watershed development programs launched with great fanfare in the country, this program was the only truly participatory and multi-departmental program. For the first time, the community was put in charge with the bureaucracy playing a supportive role. The experience has shown that a committed chief minister can even get a state bureaucracy to promote a people's movement for good land and water management. As elsewhere, villages which had done good work had water in their wells, leading to improved agricultural output and reduction of distress outmigration. The entire work was achieved without one new official being hired, one new law being enacted, or one dollar of foreign aid. The effective mobilization of existing human and financial resources was enough to get the program underway.

It is interesting to note that in all the experiences described above, the starting point in each case was the improvement of water availability through the harvesting of the local rain endowment. Once surface and groundwater resources were enhanced, agricultural production increased and stabilized, and over time new and modern forms of agriculture began to emerge. Animal production also improved with the increased availability of fodder. With the local community undertaking water harvesting, interest in its watersheds also grew with time, leading to its protection and improved grass and tree productivity. Over the years, the entire village ecosystem has improved together with the local economy.

Civil society's role

In urban areas, rapid economic growth across Asia has led to a decline in environmental quality which poses an extremely serious threat to public health. Few policymakers realize that the Western technological model, built on intensive use of materials and resources, is a highly toxic model. And unless massive investments are made in clean-up technologies or inherently more efficient technologies, pollution will grow by leaps and bounds. As in the West, a powerful civil society is needed to generate the necessary public pressure for the political system to start incorporating sustainability as a key element of growth programs. In the absence of such a civil society, progress in this direction will inevitably be slow. A civil society which is itself weak in scientific issues and does not have access to data on environmental health and pollution abatement options will also find it difficult to convince the public of the need for urgent action. For Asian countries it is clear that maintaining the integrity of their natural capital will be increasingly a matter of high priority in the years to come.

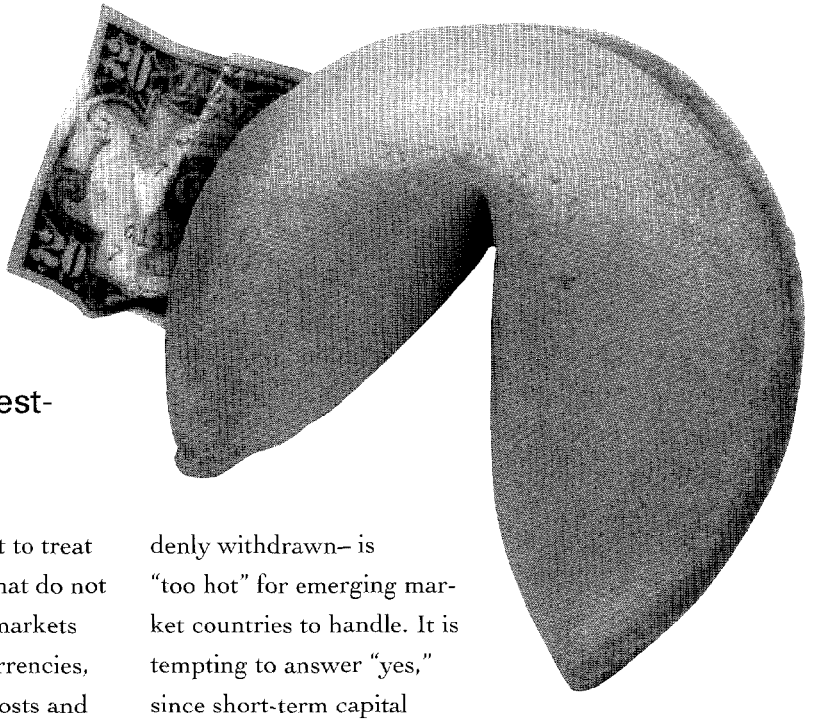
Anil Agarwal is chairperson, Center for Science and Environment in New Delhi, India.

Visit: www.cseindia.org

Accepting *Foreign Capital:* Lessons *from* Recent **Crises**

BY ROBERT E. LITAN

No one questions the importance of a sound financial system to the amount or the "quality" of growth. When they work well, financial intermediaries and markets efficiently channel a country's savings – and its capital inflows – into productive investment, which is a prerequisite for growth.



It is important in managing financial risks not to treat all foreign capital alike. For emerging markets that do not have well established reputations in the capital markets and must borrow, if at all, in other countries' currencies, policy makers must take into account both the costs and benefits of different types of capital before welcoming each unconditionally. Moreover, the outcome of that calculation depends critically on macroeconomic factors and institutional conditions. What is a right policy for one set of conditions may not be right for another.

Short-term capital

Perhaps the central issue raised by the Asian and Russian financial crises is whether short-term capital – borrowings with short maturities and portfolio equity that can be suddenly withdrawn– is "too hot" for emerging market countries to handle. It is tempting to answer "yes," since short-term capital inflows are also like fire: if not handled properly or used in the right environment, they can burn down a country's financial system – and its economy – in very short order. Moreover, if the structures that are burning – in this case countries – are located close to one another, at least in the psychology of investors, then a raging fire can spread quickly, much as the currency depreciations during the Asian crisis swept contagiously through the region.

So much for the downsides of short-term money, which have been all too evident. There are also advantages that

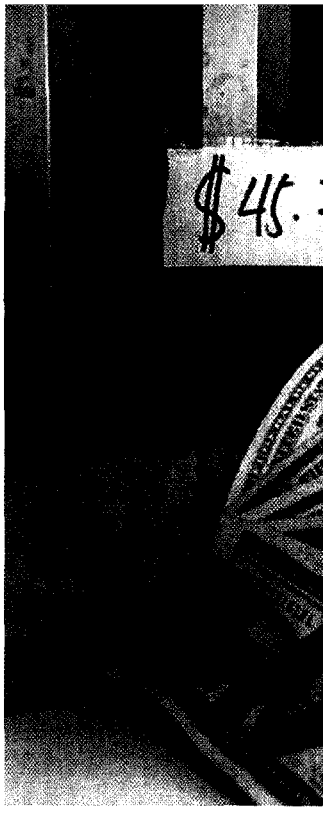
can be too easily ignored. Foreign purchases of equities can add needed liquidity to domestic securities markets, which in the long run are important for financing the growth of new businesses in emerging market countries and weaning financial systems away from reliance on banks as intermediaries. A key advantage of the capital markets is that investors take their risks without implicit or explicit guarantees of being protected if they are proven wrong. In contrast, bank depositors are often implicitly or explicitly provided with government insurance on their deposits, which can encourage excessively imprudent lending by the banks unless properly supervised and restrained (which even regulators in developed countries have proved incapable of doing from time to time).

Moreover, even short-term borrowed money can have its benefits – by enabling domestic companies to borrow at cheaper interest rates than would be the case if no such funds were available at all. Presumably, it was these benefits that induced the International Monetary Fund to change its policy in 1997 to encourage the dismantling of capital controls of any type.

Deceptive costs

A key lesson learned from the recent financial crises, however, is that the costs of relying on short-term money – especially funds borrowed in a foreign currency – can significantly outweigh the benefits, under certain conditions. Most importantly, the costs of borrowing short-term in foreign currency can be especially deceptive and ultimately quite dangerous when a nation pegs its exchange rate to another, such as the dollar. The costs are deceptive because in the short run, such borrowing looks like an easy way to make money: borrow at low interest rates in the foreign currency and invest the proceeds in higher-yielding assets in the home countries. But this only works so long as the exchange rate is pegged. At the first sign that a country's foreign exchange reserves are insufficient to meet the demand, domestic borrowers will dump their own currency in a frantic effort to obtain the foreign currency in which they borrowed. That, in essence, is what happened in Asia in 1997-98.

Short-term borrowing in foreign currency can also prove dangerous if a nation's financial institutions are weak and not well supervised. After all, it was the failure of Thai banks that triggered the Asian financial crisis by causing a loss of confidence in that nation's economic management and in its currency. The damage arguably would have been significantly reduced had the Thai baht been floating all along. In that event, domestic borrowers would have had to factor in exchange rate risk when borrowing funds abroad and almost certainly would not have been so enthusiastic in running up foreign debts in the first place.



Long-term capital

The cost-benefit calculation for long-term capital inflows – foreign direct investment – is quite different. The costs of FDI are largely psychological or political: citizens and their policy makers may feel that their national cultures are threatened by the purchase of what are viewed to be "national assets." Such feelings are not confined to many developing countries that, until recently, have resisted FDI. Not until its economy ran into trouble did Japan begin to open up to foreign investment – primarily as a way to minimize the costs of rescuing bankrupt companies or financial institutions. Even the United States, the leading destination of FDI in the world, feared the buyout of certain famed buildings and companies in the 1980s (but now no longer seems to mind when much larger acquisitions are completed).

The benefits of incoming foreign direct investment, in contrast, are quite tangible. Unlike portfolio capital, FDI inherently is "sticky": significant equity stakes in domestic companies cannot be readily liquidated, especially during a crisis. Moreover, with foreign funds comes valuable foreign know-how and skills, which gradually seep out throughout a local economy as employees move to other firms or start their own. The United States, for example, learned much from Japanese companies that came to the country during the 1980s – just-in-time inventory management and worker-dominated quality control circles – which have revolutionized much of the U.S. manufacturing sector.

Just as significant, the influx of FDI can help local regulators as well by bringing cutting edge technologies to local shores. This is especially important in the financial

arena, where foreign financial institutions not only help educate domestic regulators about sophisticated financial practices, but in certain cases have seen their top officials move to the helm of domestic central banks or bank supervisory agencies.

Safety nets

The financial chapter in *The Quality of Growth*, while devoting relatively little attention to crisis management, constructively points out the importance of the often neglected role of adequate social safety net programs in cushioning the economic pain that financial crises inevitably entail. The chapter does not discuss, however, the important role that unemployment compensation programs, in particular, can play in minimizing this pain. Yet these, too, have their limitations in emerging markets because of limited government budgets and other pressing social needs. In addition, much of the labor force in these countries often is informal and thus cannot be counted on as a source of revenue for financing unemployment compensation (as employees in developed countries are, with their modest payroll contributions to these funds). An important role for such international financial institutions as the World Bank is to assist in the initial financing of unemployment compensation programs, perhaps on a matching basis, with the size of the government match scaled to the per capita income of the country.

The IMF's role

Finally, no discussion of crisis management can be complete without dealing with the role of the Bank's sister organization, the International Monetary Fund. Although I do not have the space here to give the subject the treatment it deserves, I conclude with two observations.

First, to its credit, the Fund has established with its refusal to lend to Russia in the fall of 1998 and, to a lesser extent, its similar stance vis-à-vis Ecuador several months later, that emergency financing is not automatic. Investors now have been put on notice that their funds are at risk, and it is vital that the Fund does not change that impression in the future. Toward that end, the Fund should not hesitate to allow, if not insist upon, the imposition of standstills on repayment of both public and private debt in order to buy time to allow more orderly restructurings. In the meantime, the Bank and the Fund should continue to work with countries to establish viable bankruptcy procedures and institutions so that if another crisis should occur, such restructurings – either formal or voluntary – will proceed far more smoothly than they have done so far in most Asian countries.

Second, at the same time, the Fund must avoid imposing a laundry list of conditions on its loans, elements of which have little to do with restoring credibility (such as reducing tariffs on selected commodities). Extraneous conditions not only undermine the legitimacy of the borrowing country's government, but the credibility of the Fund as well, since it is unlikely that the failure to meet them will trigger a cutoff of the Fund's emergency loans.

In sum, the world has come a long way since the 1997-98 financial crises. By and large, the economies of the countries have bounced back, while interest and exchange rates have returned roughly to pre-crisis levels. The hope is that all concerned have learned at least some lessons that can help avoid such crises in the future.

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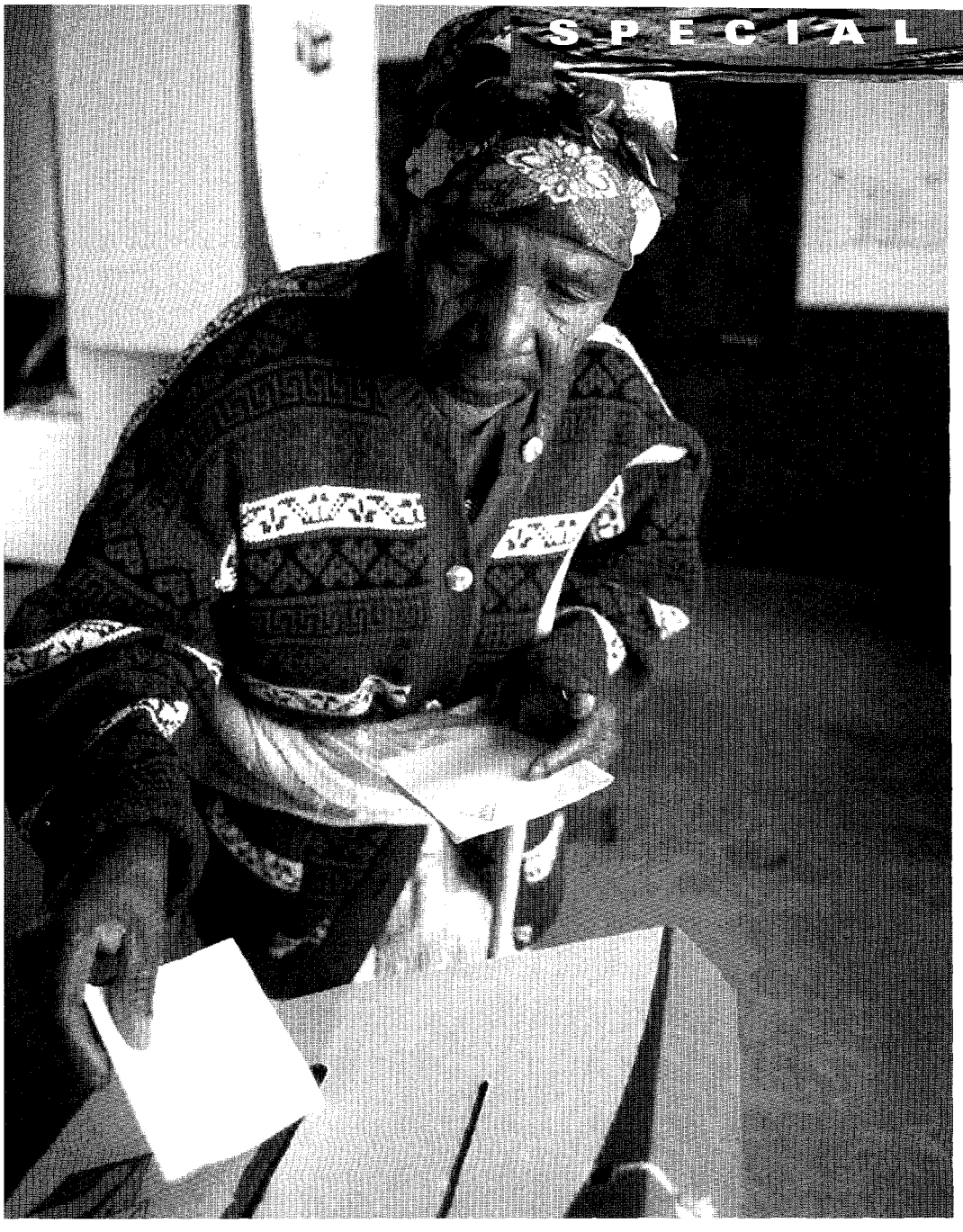
RETHINKING GOVERNANCE:

The Case *of* South Africa

BY KUMI NAIDOO

A growing number of citizens around the world no longer accept that the responsibility of governing society is solely the responsibility of governments. Today, we talk about co-governance; we talk about governance being a partnership venture between elected officials and the organizations and institutions formed by citizens acting in the public interest, and we talk about governments needing to have ongoing dialogue with their citizens so that our world is managed in a way in which the most just social outcomes can be achieved.



ment we need to recognize that creating the conditions for the full participation of citizens can meaningfully contribute to societies meeting their social development goals. Political leaders are increasingly coming to accept, somewhat grudgingly and certainly not uniformly, that citizen-inspired organizations have tremendous experiential knowledge that can bring important perspectives to the policy making process. More importantly, they also have the ability to make important contributions to the meeting of basic needs in ways that government's are sometimes unable to. This does not mean that the role of the state is less important, as some erroneously suggest, but certainly means that the notion of governance is changing in important ways, in which we see a greater role for citizens and the organizations they form to promote the common good.

These global trends found much currency in the transition away from apartheid in South Africa. Since Nelson Mandela's release and particularly after the first democratic elections in April 1994, the following trends were discernible:

- Fewer and fewer people participated directly in public life beyond the act of voting in the national, provincial and local government elections, when compared to the levels of energy that prevailed in resistance to the apartheid government.
- Many government personnel came from the NGO movement, prompting the idea that "NGO" in the transitional context in South Africa stands for "next government official" instead of non-governmental organization.
- The old skills of organizing marches and protests and mass rallies were insufficient to undertake meaningful

Winning an election, should not be read as a blank check issued to governments to do as they will till the next election, especially given that representative democracy increasingly appears to have the form of democracy without the substance. Put differently, we run the risk of representative democracy on its own degenerating into a preordained élite legitimation process. Citizens cannot fulfill their responsibility in a democracy simply by participating in an election, and voting is but the minimum responsibility of citizenship.

Some have suggested that a choice needs to be made between development and democracy. However, given that democracy is central to promoting equitable develop-

advocacy and development work on their own and needed to be complemented by a range of new skills and competencies.

- There was now access to the mass media.
- There was a new sense of openness and willingness on the part of government to work with civil society.

It was in this context that the South African National NGO Coalition (SANGOCO), the umbrella body of some 4,500 non-governmental organizations and community based organizations had to undertake their work. Those civil society groups that were part of the broad liberation movement found it incredibly difficult to initially take on a critical stance towards the new Mandela government. There was concern that this would be seen as unpatriotic and that it would play into the hands of those that were opposed to the new post-apartheid order. However, after two years of democratic rule, civil society organizations began to talk of the need for "critical solidarity"; shorthand for the need to support government when it was appropriate and offer the appropriate criticism when it was necessary. Most NGOs were involved in some form of social delivery, and the political transition had brought with it a great amount of financial uncertainty, leading to the demise or downsizing of several important organizations. Initially, some elements in the new bureaucracy were of the view that development should be driven solely from within the state, with only a peripheral role for NGOs. This logic was successfully contested as large numbers of government leaders realized that it was important to draw on the expertise of civil society groups, both in the development of policy and in the implementation of development initiatives.

Given that democracy is central to promoting equitable development we need to recognize that creating the conditions for the full participation of citizens can meaningfully contribute to societies meeting their social development goals.

The campaign to increase support for children living in poverty.

In 1996, the government was seeking to de-racialize a social welfare grant for children living in poverty. In seeking to do this, the Minister of Welfare said that this made it necessary for her to drastically reduce the prevailing level of the grant. Additionally, there were other issues about how this grant would be implemented, which included some problematic ideas such as means testing the health of the children as a determinant of eligibility for the grant.

There was an excellent relationship between the Minister of Welfare and SANGOCO. In fact, as Executive Director of SANGOCO I was at that time serving on a policy advisory structure set up by the minister around welfare issues, as well as serving on a task team to write the non-profit organizations act. There were serious concerns regarding both the minister's suggested new level of the grant as well as the implementation process, particularly among children's and women's organizations and the welfare sector as a whole.

SANGOCO's position was that it was important for the minister to offer about 50 percent more than she was offering on the level of the grant and to rethink a range of elements regarding the implementation of the new system. In order to influence government policy, it became clear that both organized civil society organizations (CSOs) and the broader public needed to be mobilized to shift government thinking.

Firstly, SANGOCO joined several CSOs and made a detailed presentation to public hearings of the parliamentary standing committee on social welfare, laying out its concerns and urging the minister not to proceed with the plans as they stood. This required consulting with affiliates, allies and researchers to develop a well thought out presentation to parliament, recognizing that there were multiple audiences that were being addressed: members of parliament, the minister and other cabinet ministers, the general public, and civil society itself. Secondly, SANGOCO built up a unified front of a large number of CSOs, and for the first time since the first democratic election, the ANC government faced a broad alliance of civil society organizations that could not be dismissed as anti-patriotic or "counter revolutionary." Thirdly, SANGOCO threatened a national day of action if the Minister did not

The campaign to halt violence against women and children. South Africa has one of the highest levels of violence against women and children in the world. For years the women's movement and children's advocates have struggled to get the issue on the national agenda. While much lip service gets paid to the issue by mainstream institutions, the pace of legislative and policing reform has been excruciatingly slow given the scale of the problem. Furthermore, public awareness about the seriousness of the problem was still low in the mid-1990s. The issue was also seen exclusively as a women's issue. Even though South Africa's political institutions can now show a significant level of women's participation, most institutions are still dominated by men. This might account for why, even though significant resources were allocated for this work by the ANC government, progress has been slow with many serious setbacks.

In early 1997, SANGOCO, in consultation with organizations working in the field and its members, decided that a national men's march against violence on women and children would support the commendable efforts of both the government and NGOs in this area of deep concern. Organizing under a slogan, "Real Men Do Not Abuse Women and Children," there were several opportunities for awareness raising, resource mobilization and accelerating the reform steps that were underway.

SANGOCO, helped build one of the biggest coalitions around the issue, with high levels of participation from government and the private sector. The campaign generated the highest media coverage yet seen on the issue and brought together for the first time the issues of violence against women and violence against children. SANGOCO and its allies organized a march of some 5,000 men

meet with civil society groups and consider the pleas made by various organizations.

Media pressure, including opinion pieces by prominent people, appeared in various newspapers as a result of SANGOCO's facilitation. SANGOCO specifically lobbied MPs and won over many supporters, suggesting that the minister might need to find a compromise.

The national minister and her nine provincial ministers agreed to meet a delegation led by SANGOCO and made up of its members and the South African Council of Churches. At this meeting both sides put forward their respective cases, and even though no finality was reached, the minister agreed to look at the proposals again.

The result of this campaign was that the level of the grant was increased by 25 percent per month, and the Minister invited SANGOCO and its allies to work on a task team to remedy the deficiencies in the implementation proposals. In retrospect, many in the government acknowledge that citizen activism around this issue helped government develop a more acceptable and just position and helped reduce the huge number of logistical difficulties, though many problems remained, in implementing the initiative.

including political leaders, trade union leaders and other prominent men who committed themselves to advance the issue. President Mandela addressed the marchers, securing prime-time slots on all news shows.

SANGOCO's campaign helped support the work of women's organizations who had been lobbying for the passing of a domestic violence act, helped generate national awareness around the issue, and helped secure the commitment of various ministries to do their part to deal with the deepening and ongoing crisis. The efforts of the women's movement and their ability to mobilize men and women was probably central in helping to secure some of the limited progress that has been achieved to date. By drawing high levels of citizen activism it made it difficult for the government not to act with the appropriate urgency that was called for by the situation.

The national poverty hearings.

South Africa's apartheid legacy has bequeathed the country deep structural poverty and the highest levels of economic inequality in the world. The ANC government's Reconstruction and Development Program (RDP), adopted after the first democratic election, was believed to have been degraded in 1996 as the government adopted a new macro-economic strategy that had been seen by many as a turning back on some of the tenets of the RDP program and indeed on some of the core elements in its election manifesto.

SANGOCO and other civil society groups strongly believed that the eradication of poverty should become the single most important goal of the government and the country as a whole. While the government agreed that this was the key strategic objective facing the country, there were fundamental differences about tactics. SANGOCO consequently adopted the following strategy. Firstly, SANGOCO developed an internal position paper on a national poverty strategy. Secondly, it led the development of the National War on Poverty Forum, made up of government, the trade unions, churches and the NGO sector. Thirdly, it enabled the Poverty Declaration of the Poverty Forum to be circulated widely and popularized. Fourthly, it developed a special alliance with the Human Rights Commission and the Commission on Gender Equality, and co-hosted the national poverty hearings that were held in all nine provinces in which some 10,000 citizens living in poverty came forward to participate. People were mobilized to say how poverty impacted on their lives, what they thought needed to be done, and what they themselves were prepared to do. Through an innovative media strategy these voices of the poor were mainstreamed into the national policy dialogue. Several government departments were lobbied and their performance was challenged. Diverse CSOs were engaged in assisting to plan and implement the hearings.

The result of this effort was the rapid adoption of a national plan of action for poverty eradication six months after the poverty hearings ended, with support from a broad spectrum of South African society. Issues raised at the hearings were taken up and dealt with by various agencies, although many unfortunately did not get off the starting blocks. While there has undoubtedly been incremental progress towards meeting some of the poverty eradication goals, many who spoke so eloquently and sensitively during the hearings have not seen substantial improvement in their lives, and inequality grows at an alarming pace.

While some might be discouraged by the measurable impact of citizen participation in the making of development policy and the implementation of progressive development goals, it is important to bear in mind that governments and civil society organizations are in for the long haul. The unfortunate reality today is that the global governance system, particularly its economic components, appears to be ill-prepared, structurally flawed and slow to create the enabling conditions for the rapid progress that poor people around the world seek. However, participation of citizens and their organizations, not simply as victims, beneficiaries or spectators but as active and central agents in the development process is simply no longer a "nice to do thing" but an "essential to do thing."

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BY LUIS MORENO OCAMPO

STATE CAPTURE: WHO REPRESENTS THE POOR?

The principle of democracy established in the late eighteenth century is based on the idea of people representation, where a few individuals represent the interest of the population and make public decisions. The data about state capture developed by the World Bank Institute shows that some representatives go against the Illuministic principle, and actually sell their decisions for money. They put aside the interest of the people to favor the interest of their clients.

The data suggests that this is not an occasional problem but a stable situation. Formal institutions are crossed and controlled by a network of people who interchange favors and use the government for their own interest. In order to control or distort public policies, these networks maintain public management at a very low level. Money flows are especially difficult to control, and misallocated resources tend to end up in secret bank accounts. In this context, democratic representation is seriously distorted.

The non-representation of the poor and the public management's inability to exert control are present in almost all developing countries and produce similar effects throughout.

The poorest, especially those living in developing countries, are not represented by the public institutions, because they cannot afford to buy decisions. These institutions, which theoretically represent the interest of every citizen are captured by elites that have direct access to their decision-making processes. As James Wolfensohn put it in his Foreword to The Quality of Growth, the gap between the rich and the poor yawns wider.

These conditions, the non-representation of the poor and the public management's inability to exert control, are present in almost all developing countries and produce similar effects throughout. Countries with apparently no relation suffer from the same appropriation of the government by the elite's networks.

Resource misallocation

Let me put forward an example of resource misallocation in Kenya and Argentina, both related to export incentives, to show how countries with no apparent relations yield similar outcomes. The most important corruption case denounced in Kenya in the last years relates to a company that supposedly exported gold from Kenya, receiving approximately $500 million in reimbursement. But there is no gold in Kenya. And yet, the company imported the gold, exported it, received the export incentives, then imported the gold again, exported it again, and received the export incentives again. Similarly, in Argentina, one of the most important corruption cases over the last years relates to a company that supposedly exported gold from Argentina, receiving approximately $300 million in reimbursement. But there is no gold in Argentina. And yet, the company imported the gold, exported it, received the export incentives, then imported the gold again, exported it again, and received the export incentives again. Although there are no cultural or economic relations between Argentina and Kenya, the public management outcome is exactly the same.

This does not affect only the poor. The WBI surveys find that firms that purchased parliamentary laws, presidential decrees, and influence in central banks inflict a large indirect cost on the development of the rest of the enterprise sector. So, state capture is a good business for some private and public entrepreneurs who can create national and international networks to coordinate their interests. Companies outside the corrupt network, acting uncoordinatedly, are damaged as they cannot stop the network's practices. These companies are as powerless as the poorest of the people.

The non-representation problem is reproduced in the multilateral organizations. The national networks that control governments choose one of their members to represent the country. The power structure is such that the World Bank's functionaries cannot seriously dare to affect the network's interest. That's why the word "corruption" was not part of the Bank's language before James Wolfensohn's times. The issue of corruption is a very dangerous one. To improve the efficiency of the growth process, the World Bank has to avoid to be captured by these "bad" political and business networks and, most important, promote "good" networks.

The creation of "good" networks

Let me take the public procurement process as an example to illustrate how existing networks can be broken, and new, more beneficial ones, installed. The public procure-

ment process can roughly be divided into four phases: 1) the decision to purchase, 2) the elaboration of the respective tender, 3) the tendering process, and 4) the delivery of the purchased goods and services.

1) The decision to purchase – Mar del Plata and public referendums

In public procurement, the purchasing decision is usually made in isolation from civil society, but often in close co-operation with important business. This closed-door practice and lack of citizen involvement gives interested politicians leeway for making important purchasing decisions without considerations for spending efficiency. The only retributions they fear are general elections or over-boarding public opinion resulting from large-scale scandals. Mar del Plata, a city in Argentina, introduced a novel approach to making important purchasing decisions: the final decision becomes binding upon citizen approval. In 1995, the newly elected mayor called for a referendum on the construction of the twenty-six public works which he intended to build during his mandate. If implemented, these would bring about significant improvements in infrastructure—a vital asset for a city as dependent on tourism as Mar del Plata. Citizens were offered to see the projects and than vote on them. The referendum set out an earmarked tax to be paid over four years for the project implementation. The vote turned out positive, the project went ahead and all works were finished in time—months before the mayor was postulated for re-election, which he won overwhelmingly. This experience demonstrates the economic and political impact of establishing a social network.

2) The Tender documents – Morón and Public Hearings

The elaboration of tender documents is another example of a closed-door process. Interested companies and citizens are generally only presented with the final document. Often, the tender specifications are drafted in conjunction with the one company that is meant to win, making the successful participation of any other company impossible. In Argentina, the waste collection tender is the largest tender to be awarded by municipalities. The Waste Collection Industry is generally known as a very strong and closed club which is extremely difficult to join, with secret ties between the companies and the major office. In an attempt to break this practice, the government of Morón, a municipality in the Province of Buenos Aires, together with the City Council in which the opposition hold the majority, called for a Public Hearing in order to discuss the tender conditions on the draft of its Waste Collection Contract.

The Public Hearing led to important changes in the tender specifications. In the tender draft companies were required to show five years of existence to participate in this tender. Many companies argued that this requirement left out most companies. In the new tender, this requirement was lowered, which allowed new companies to participate, including the one that ended up winning the award. Furthermore, the labor union demanded that whichever company won the contract should be obliged to keep the workers under contract at that time, a request that was taken into account in the final tender document. The neighbors participated demanding the resolution of specific problems they had with the former company. An expert advice established that the tender should be based on required specific outputs, instead of being based on inputs. Again, this suggestion was incorporated.

The results are stunning. First, a new company entered the market. The company that was awarded the contract is hardly known in Argentina, and is operating in only two other municipalities. Second, the total contract value over four years ($32.16 million) is $12.96 million less than the former contract's value, representing a 28.7 percent in savings. The second highest bid, which came from the former contracting company, was of $49 million. The $16.84 million between the winning offer and the second offer represent an annual savings of 4.7 percent with respect to Morón's total budget. This is an example of the benefits that can be achieved by breaking old-established networks and clubs.

3) The tendering process – The Internet as a tool to deliver information

Difficult and scarce access to information on public procurement opportunities and the relevant tender documents inhibits the participation of companies in the public procurement process. The information tends to be published highly disaggregated, in a great number of publications, making it difficult for interested companies to find it. Furthermore, most information is incomplete and it is pub-

lished too late. In the City of Buenos Aires, for example, tenders are announced with an average of five working days until closing date. The tender documents have to be obtained at the purchasing office, which can be quite costly when the purchasing office is geographically distant. All of these time-consuming and costly impediments discourage the participation of potentially interested companies. A Gallup survey on the public procurement process in Argentina[1] revealed that whereas the majority of companies were interested in selling their goods and services to the Argentine governments, most companies were not participating in the public procurement process because the relevant information is not available in a timely and reliable way and because the application process is often very tedious and costly. Additionally, companies perceive that there is no open access to contracts, which are awarded to a selected group.

Experiences in Canada, the United States, Mexico, and Chile, among others, are powerful examples of how the Internet might be used to increase participation and lower prices in public procurement. The sites agglomerate the information on all tenders and provide on-time and easy access to this information, including the corresponding tender documents. In Canada, the number of suppliers has been increased two-and-a-half fold and the prices paid by the public administration fell 10-15% over the course of only three years. Taking into account that Canada is perceived to have far lower corruption levels than most developing countries, the price decreases in other countries are potentially still much larger. In fact, a very small pilot project in the City of Buenos Aires, based on simple price comparisons of homogeneous services across hospitals led to a drastic price fall of 45 percent.

4) The delivery of purchased goods and services - Bangalore and civil monitoring of contract enforcement.

After the tendering process has been carried out, the contract-enforcement process represents some of the worst headaches to administrations. It is not uncommon that a company does not fulfill the terms and conditions set forward in the contract, or that the contract is re-negotiated after its award to the point where the initial and the final price bear no relationship. Citizens end up paying a very high price for unfinished or badly finished projects. Public works programs, especially large ones, are very difficult to monitor for citizens, which makes them a focal point of government inefficiency.

The Swabhimana Initiative in Bangalore, India, has taken a novel approach to this problem, by implementing a program that monitors public works. Volunteer engineers and architects monitor the city's public works directly at the site, providing a complete contract follow-up and holding the contracting company accountable for the contract fulfillment. They thereby notably improve the quality of civic life in the city. This forum not only performs a watchdog function, but also experiments with new approaches to solve problems.

Conclusions

The technological development of the twenty-first century allows the reformulation and improvement of representative democracy. Current forms of connectivity and transportation permit to form networks at a speed and distance which were inconceivable in the eighteen century. Transparency International, established eighty national chapters in only seven years. The current challenge lies at expanding this networking capacity to include the poor. New networks, which include all those currently excluded from power must be formed to counter state capture.

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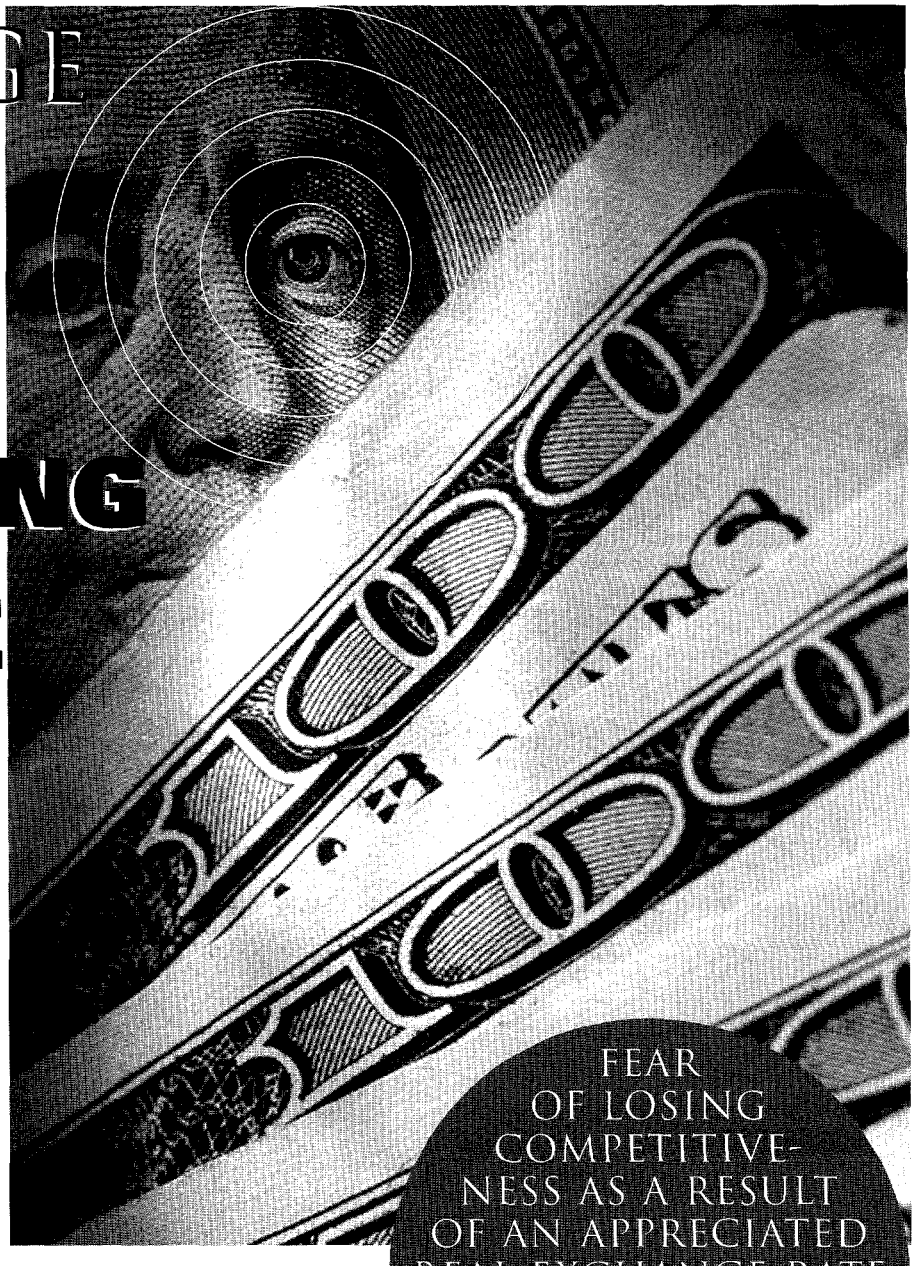
[1] Gallup Survey, September 2000. Commissioned by Mercados Transparentes.com amongst 417 small- and medium-sized companies in Argentina, 114 of which are current government providers, and 303 of which are non-government suppliers.

On state capture visit:
www.worldbank.org/wbi/governance/pubs/seizestate.htm

BY SARA CALVO

EXCHANGE RATES: THE TARGETING DEBATE



How to re-establish credibility and thus help resume growth fast is the challenge for emerging markets today. To achieve this, verifiable exchange rate regimes is the current prescription.

Is there an optimal exchange rate regime for emerging markets? The optimal exchange rate regime varies across countries and over time. History and the nature of the politics and institutions in the country matter, which makes it difficult to come up with a "one size-fits-all" policy recommendation. This was the main conclusion of a series of workshops organized by the World Bank during 2000 to promote debate on whether the choice of the exchange rate regime could help reduce the likelihood of output collapse associated with both a financial crisis and a successful defense of the exchange rate.

FEAR OF LOSING COMPETITIVENESS AS A RESULT OF AN APPRECIATED REAL EXCHANGE RATE IS ALSO A RATIONALE FOR NOT LETTING THE EXCHANGE RATE FLOAT FREELY.

The need for credible institutions

The developing world is full of examples of costly attempts to bail out troubled banks, finance budget deficits and adjust the balance of payments by means of discretionary monetary policy. This practice has led to very high inflation episodes, massive capital flight and financial system troubles, leading to slow long-term growth and low policy credibility. This is not surprising. Much as governments would like to have monetary policy independence, if a country with an open capital account fixes the exchange rate, monetary policy will be determined by the economy's exchange rate commitment.

Whether or not countries claiming flexible exchange rates have fared better is still an open question. The truth of the matter is that, according to recent studies, few developing countries that now claim to have freely floating currencies really do. Governments often use interest rates or intervene in the foreign exchange market to achieve their implicit target exchange rate. The reason for this "fear of floating" is the threat of high inflation and/or a financial collapse, as a result of depreciating exchange rates in face of a shock—particularly in the context of high foreign currency denominated debt. Fear of losing competitiveness as a result of an appreciated real exchange rate is also a rationale for not letting the exchange rate float freely.

Why worry about discretion in policymaking? It creates what in economics is called time-inconsistency problems. In a nutshell, if a government does not meet today's promises made yesterday, the public will not believe future announcements. If institutions are not credible, because of, say, the country's politics and history with inflation, schemes to restrain governments from using discretionary policies to some extent are needed to ensure investors—locals and foreigners—that the economic program is consistent and sustainable and that there is not going to be high inflation, nor perverse incentives for keeping real wages and prices from changing.

To achieve credibility fast, a time-inconsistent government needs fully verifiable policies. Three categories of verifiable exchange rate policies are being debated today: (a) intermediate regimes (publicly announced monitoring exchange rate bands); (b) extreme regimes such as inflation targeting; and (c) hard pegs (currency boards and full dollarization). The IMF has no clear choice of preferred exchange rate regime.

The case for intermediate regimes

In light of recent financial crises in economies with traditional adjustable pegs, e.g., East Asia's, proponents of intermediate regimes argue that emerging markets will have to live with more flexible exchange rate regimes than in the past to reduce the likelihood of financial crisis. Williamson, for example, arguing that competitive exchange rates were one of the key foundations for the East Asian miracle, proposes a "publicly announced monitoring band, a range within which the authorities would commit not to intervene, but beyond which they would be free to intervene to push the rate back toward the band and without obligation to defend a particular rate." This strategy, Williamson argues, "would provide information on the long-term rate the authorities believe is consistent with long-term fundamentals, and hence where they should expect official action to limit misalignment. This should help stabilize expectations." Williamson also proposes ways to determine what exchange rate makes sense as well as the width of the band.

The case for inflation targeting

Several developing countries have adopted inflation targeting—Brazil, the Czech Republic, Israel, Poland and South Africa. The ultimate goal of inflation targeting is to reduce inflation uncertainty by making transparent the central bank's policy intention. Under this regime, the central bank announces the inflation rate that its policies will aim at in the year ahead. This inflation commitment determines the exchange rate behavior.

But announcing a target inflation rate is not enough for a successful use of monetary independence. Institutional commitment (including legislative support for an independent central bank) to the target from the rest of the economy should also be there. This requires sound financial systems and fiscal stance. Successful inflation targeting also requires a mechanism that makes the central bank accountable for attaining its inflation objectives and relatively low initial inflation rates. As Mishkin and Savastano discuss, in high inflation countries it will be difficult to identify the target, hence they will tend to be missed more often, which will jeopardize the central bank's credibility. In light of this, inflation targeting is likely to be a more effective strategy if it is introduced only after there has been some inflation reduction.

An important advantage of inflation targeting is that it allows the central bank to respond to shocks. It should be noted that in shock-prone economies with high foreign currency liabilities (e.g., dollar debts), inflation targeting will lead to volatile exchange rates, threatening the stability of firms and the financial sector. Also, with high volatility in exchange rates it is very hard to develop long-term financial markets.

The case for hard pegs: currency board and full dollarization

Like inflation targeting, hard pegs are easily understood by the public. Hard pegs consist of fixing the exchange rate to a hard currency, and holding enough reserves to back up the peg. In this category we find currency boards and the hard-peg extreme strategy, i.e., adopting another country's money such as the dollar. The case for hard pegs has been made strongly for emerging economies where the ability to buffer shocks is limited—economies with underdeveloped financial markets, widespread structural rigidities, weak political infrastructure—and where government and firms' ability to finance externally is highly volatile. These are economies where exchange rate movements could be very costly. Cases in point are economies with high dollar debts, as discussed.

In emerging economies, as argued by Calvo, "central banks are not very helpful and may exacerbate growth volatility due to financial vulnerability and credibility problems," as observed in emerging markets during the late 1990s. "An effective lender of last resort should be able to borrow or run down reserves during crises. Otherwise, the central bank must print money, provoking large price hikes and, possibly, hyperinflation. Anticipating that the lender of last resort will pour money to solve banking problems, raises real interest rates in tranquil periods.... Thus, a printing press could worsen credibility problems." In other words, the lender of last resort capability of emerging market central banks de-facto is not there.

Currency boards. Countries with currency boards include Argentina, Estonia, Lithuania and Hong Kong. The regulatory framework of a currency board embodies a promise to convert domestic currency into a reserve currency, e.g., the US dollar, at a fixed exchange rate, and on demand. This means that at all times the monetary authorities must have enough foreign exchange reserves to honor its promise. It also implies that the government can finance its spending only by taxing or borrowing. In other words, a currency board "ties" the hands of the monetary authorities and prevents printing of money when it is not backed by reserves. Without a currency board Argentina would not have been able to survive the contagion from Mexico's 1994 financial crisis nor advance in its fiscal reform today.

Full dollarization. Under full dollarization, the central bank capability of printing money is removed, and the dollar is used for all types of monetary transactions. In Panama, for example, there is no central bank. Early this year, Ecuador, in the midst of economic and political turmoil, implemented full dollarization. Given the political structure of Ecuador at the time of the implementation of full dollarization, inflation targeting would not have worked. Ecuador's political infrastructure to get the fundamentals right was not there. More recently, El Salvador, announced that the dollar will be the legal unit of account for the financial system starting January 2001. Both the colon and the dollar will circulate in El Salvador. In the former case, the aim was to prevent weak fundamentals from becoming even weaker. In the latter case, the aim is faster growth in light of absence of currency risk. The experience of El Salvador, may prove useful for small income African countries where the challenge is to attain credibility to attract repatriated private capital.

Granted, full dollarization would not eliminate fiscal disarray, default risk, financial troubles due to deflation, and may be a costly exit strategy. Also wage and price inflexibility in the public sector may lead to unemployment, if the economy faces a shock. Because of this, proponents of full dollarization advise accompanying this regime with fiscal rules, such as New Zealand's law of fiscal responsibility to help achieving fiscal soundness. Likewise contingent sources of liquidity such as international banking (under the assumption that if faced with liquidity problems headquarters will provide needed liquidity) and international credit lines, such as Argentina's repo facility, help buffering potential financial sector problems. Indexing public wages to private sector counterparts, as suggested by Calvo, could help solve the unemployment problem.

In countries where regional trade, and hence avoiding competitive devaluations is important, but a regional common currency is not politically feasible, for example in East Asia, as McKinnon explains, "establishing an efficient common monetary standard is much more a matter of collective choice." Policy makers in a region with integrated trade should expend their political capital to ensure that countries in the region have similar commitments to stabilize their dollar exchange rates over the long term. Kawai also elaborates on a regional arrangement for the East Asian economies. Discussing regionally integrated economies is beyond the scope of this note.

To sum up, it is not fixed versus flex the exchange rate regime. It is whether fundamentals, including sound financial systems, are right. In particular, it is whether credible institutions set up to get fundamentals right are in place. How to sustain or re-establish credibility and thus help realize private sector investment plans and achieve stable financial markets is the challenge for emerging markets today. To achieve this, verifiable exchange rate regimes appear to be the order of the day.

Sara Calvo is senior economist of the Economic Policy Unit of the Poverty Reduction and Economic Management Network, The World Bank.

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Africa Lacks Adequate Expertise to Tackle Biotechnology

By Emmanuel Koro

Experts say African countries do not presently have the desired capacity to assess the disadvantages and advantages of biotechnology products. Dr. John Mugabe, director of Africa Center for Technology Studies, ACTS said, "In Cameroon only two persons have acquired post-graduate doctoral degree training in science and technology policy. There are eight in Zimbabwe and four Ugandans who are pursuing the course in Europe. It is unfortunate that the bureaucratic nature of most African governments' political regimes have divorced science and technology from national development activities. Unless the countries have science and technology it may be difficult for them to define technology plans."

Yet, many of the new crops that reach African and other countries' tables today are produced through biotechnology, a scientific process that transfers genes from one species to another. This process creates new crops or animals known as genetically modified organisms (GMOs). No one really knows GMO products' health or environmental impacts, but one of the most cited advantages of biotechnology is its capacity to increase crop production on less land, contributing to food security. Opponents of biotechnology fear that newly engineered organisms may interact with surrounding native species, resulting in unintended negative consequences such as the creation of 'super weeds'.

"Developing countries do not

presently have the capacity to assess the advantages and disadvantages of GMOs," said Coordinator of World Resources Institute (WRI), Food and Environmental Security Initiative, Arthur Getz. "This capacity is much needed but, apart from merely policing the technology and deciding what is to be accepted from other countries, African countries should have the capacity to also judge which technologies are most appropriate to develop locally and those which draw from and maintain Africa's unique biodiversity."

However, this is not easy. Dr. Mugabe said there are several obstacles to the process of formulating biotechnology plans and policies in Africa.

"Most governments are not consulting widely with stakeholders before accepting GMOs for agricultural purposes," said Dr. Patricia Kameri-Mbote, deputy director of the Africa Center for Technology Studies (ACTS), in an interview in Kenya. "Indeed in some countries the debate is still at the level of do we or do we not need biotechnology? This ignores the fact that there are already biotechnology activities ongoing in these countries." For example, less controversial biotechnology research such as tissue culture, which does not involve change in genetic composition of plants and animals, is already taking place in Kenya and Zimbabwe. In Kenya, most of the agricultural biotechnology activities focus on increasing yields of export crops such as coffee and pyrethrum flower. They also focus on the improvement of livestock with an emphasis on cattle breeding and the development of vaccines. Zimbabwe has made significant efforts to define target areas of biotechnology working through institutions such as the Department of Crop Sciences at the University of Zimbabwe where tissue culture is being applied to develop disease-free varieties of coffee, potatoes and tomatoes.

"If you have few food resources and also face the challenge to guarantee food security, you should not favor one technology over another until careful assessment of needs and existing capacities are made," said Getz. "For African countries and other developing countries, choosing biotechnology is very expensive. The largest investments in genetic engineering technology at this level are primarily in the United States and to a lesser extent Europe and a few Asian countries."

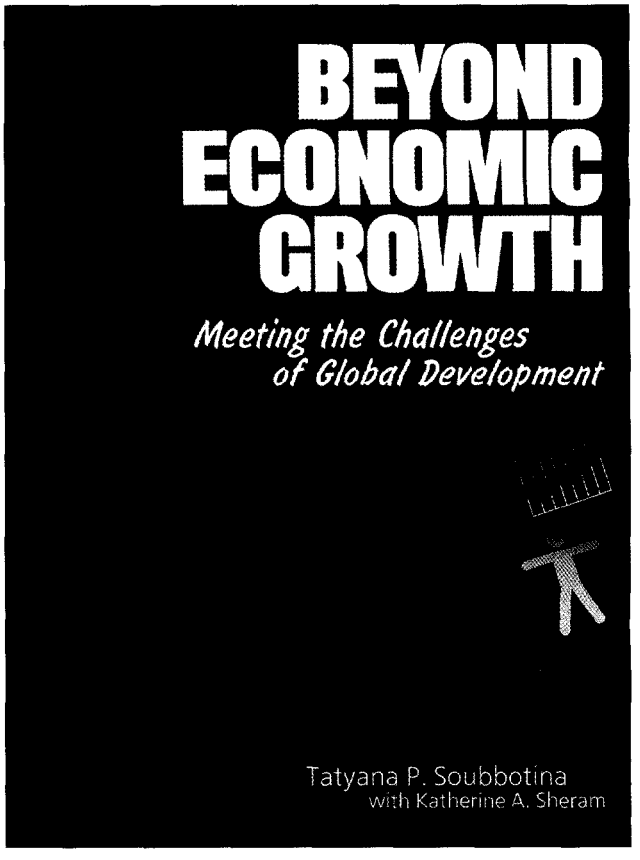
Getz, who is an agro-ecologist, added that "what we see now are products that benefit the technology providers" and not farmers and the environment.

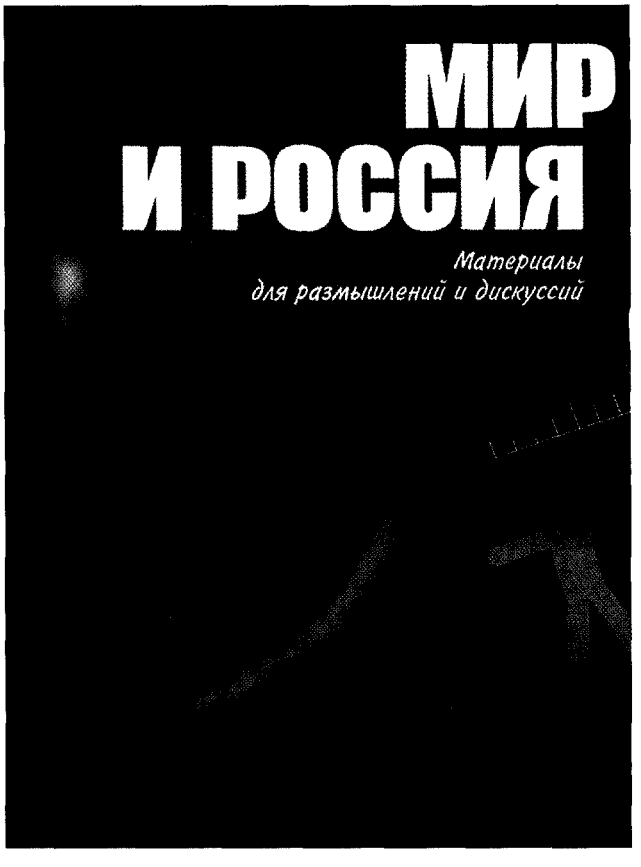
Emmanuel Koro is a Zimbabwean environmental journalist and president of the Sub-Saharan Africa Forum for Environment Communicators (SAFE)

Looking for development information, networking opportunities, like-minded partners, a friendly chat on a topic of interest, or a professional exchange of ideas? This issue features a new publication of interest to those concerned with the issues of economic growth and human development.

Beyond Economic Growth: Meeting the Challenges of Global Development

A World Bank publication for students and learners of all ages





What is development? How can we compare the levels of development achieved by different countries? And what does it take to make development sustainable?

A new student book published by the World Bank Institute offers no simple answers to these complex questions. Instead, it encourages readers to seek their own solutions by exploring and discussing a wide range of development issues - social, economic, and environmental. The book treats development as a comprehensive process that is broader and more complex than just economic growth. It brings together and attempts to explain the relationships among diverse aspects of change within countries, such as population growth and economic growth, shifts in income inequality and poverty, improvements in education and health, urbanization, and globalization. Drawing on ststatistical data and research published by the World Bank over the past several years, the book uses simple language accessible to secondary school students and the general readers interested in learning more about global development.

Searching for Answers Together

The book asks questions with no single answers and poses problems with no simple solutions. What are the main reasons for a country's successful development? Is more equal distribution of income good or bad for a country's development? Should all countries be equally open to foreign trade? How does the structure of national wealth change as a country develops? Which roles in development should governments play? And many more.

Answers to some of these questions may (and

should) generate debate because they involve value judgements or because they require country-specific analyses. Other questions are among those debated by development experts themselves, so discussing them requires awareness of the latest research. The book provides readers with helpful tools to promote independent, critical thinking, including tables with a wide range of statistical data, charts and maps on almost every page, and a brief overview of some newly emerging development concepts. For example, readers are invited to consider a more complex definition of "national wealth" as a combination of physical capital (capital in its traditional sense) with natural, human, and social forms of capital. Then "sustainable development" is explained as a process of prudent management that aims to preserve and enhance the total capital portfolio of a country or of the whole world, rather than just its "physical" component. The sustainability of development is also shown to be measurable with the help of a new statistical indicator called the "genuine saving rate."

Goals and Means of Development

Beyond Economic Growth avoids imposing on its readers any strong opinions on debatable issues by presenting at least two opposing views wherever possible. It does, however, offer one proposition that actually serves as the backbone for the whole book — it suggests that changes in a country can qualify as "development" only if they benefit the majority of people, improving their quality of life and giving them more control over their future. Thus, one possible way to formulate the goal of development is through the concept of "human development." This implies that economic growth, while critical, is only one means of achieving this goal. Moreover, to be sustainable, economic growth itself must be constantly nourished by the fruits of human development, for example by improvements in people's knowledge and skills.

A Unique Country Perspective

Beyond Economic Growth was prepared as part of an international project under the World Bank Institute's Development Education Program (DEP). The objective was to create a set of concise and accessible readings about global issues in sustainable development that reaches out to the general public. In addition, the book is designed so that it can be adapted by country-based curriculum development teams, translated, and used by those countries to study development in their own unique context. Work on these national adaptations has already begun.

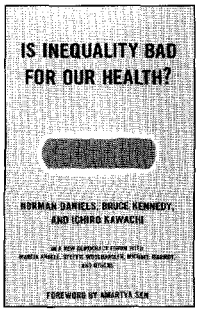
The first adaptation was *The World and Russia*, published in Russian and officially approved by the Russian Ministry of General and Professional Education for secondary school students studying economics, social studies, geography, and environmental studies. The Russian authors of this adaptation come from three leading research and educational institutions in Moscow. A Latvian adaptation, *The World and Latvia*, is currently being finalized at the University of Latvia. And a Belorussian project team is just beginning to work on *The World and Belarus* draft.

One of the main attractions of these country adaptations is that they give readers the opportunity to see their own country within the global context, and to explore how their country is similar to or different from others. This may be particularly pertinent to the former socialist countries, where information flows from around the world were for many years restricted. International comparisons may spur readers to gain a better understanding of their country's current status and those development challenges that it faces. Potentially, these books will contribute to a more open, informed public discussion on national development strategies and help to stimulate wider civic participation.

Beyond Economic Growth, by Tatyana Soubbotina with Katherine Sheram. The World Bank Institute's Learning Resources Series, 2000

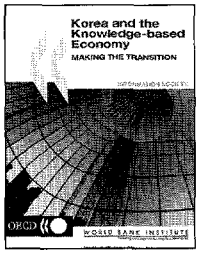
To order this book, go to www.worldbank.org/publications

To read *Beyond Economic Growth* and *The World and Russia*, (in its original Russian language version or in English translation), go to www.worldbank.org/depweb



Is Inequality Bad for Our Health? by Norman Daniels, Bruce Kennedy, Ichiro Kawachi, Amartya Sen. Beacon Press, 2000

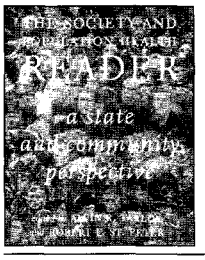
The authors force us to take a closer look at how our health is affected by social injustice and inequality. Arguing that it is not enough to increase access to doctors, they call for improving social conditions—such as poverty, lack of education and affordable housing, and harmful work environments—that damage our health. By urging us to work towards equality of opportunity for all, the authors situate health care reform among the larger social problems we must face. Their argument for reform in early childhood development, nutrition, work environment, and distribution of income is certain to spark debate.



Korea and the Knowledge-based Economy: Making the Transition, by Carl Dahlman and Thomas Andersson, eds. OECD/The World Bank, 2000

Innovations in science, communications, and computing technologies are opening up new opportunities for countries to harness knowledge and participate more fully in the global economy. This book, which is based on a joint study by the World Bank and the Organisation for Economic Co-operation and Development, breaks new ground in developing a comprehensive set of national policy responses to the knowledge revolution. It defines a knowledge-based economy as one where knowledge is created, acquired, transmitted, and used effectively by enterprises, organizations, individuals and communities; and presents a framework for analyzing a range of policy options in education, information infrastructure, and innovation systems that can help usher in the knowledge economy.

The study focuses on Korea, a country with limited natural resources which has developed mainly through an outward-oriented, industry-led strategy based on large firms and economies of scale. Today, however, this industrial paradigm is being challenged by the rapid rise of knowledge as the principal driver of competitiveness.



The Society and Population Health Reader, Volume 2: A State Perspective, by Alvin R. Tarlov, ed., at al. New Press, 2000

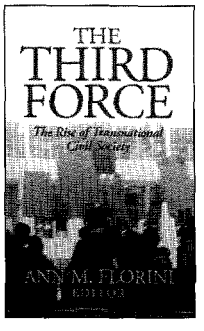
This is the second of a groundbreaking two-volume reader on the connections between social structure and public health (the first volume came out in 1999). The two-volume reader collects for the first time the substance of the authors' main findings: that life expectancy, illness, and other health factors across the class spectrum are closely related to the structure of a given society, and that variations of health within a population are primarily related to socio-structural factors, including income inequality, educational differences, lack of opportunities, and racism.

International Investment, Political Risk and Growth, by Philipp Harms. Kluwer Academic Publishers, 2000

Following substantial political reforms in many countries, the past decade has been characterized by a remarkable increase of long-term private capital flows to the developing world. However, the bulk of these investments has concentrated on a few economies at the intermediate level of the international income distribution, while the large number of low-income countries has been mostly neglected by international investors. The book analyzes the potential growth effects of liberalizing investment regimes in developing economies and offers an explanation for the apparent bias of private capital flows towards middle-income countries.

The Wealthy World: The Growth and Implications of Global Prosperity, by John C. Edmunds et al. John Wiley & Sons, 2000

World wealth creation exceeded $2 trillion per month in 1999. The potential for world wealth might be as high as $500 trillion or $83,333 for each person on Earth. This rapid and increasing accumulation has the capacity to touch every aspect of economic development and exchange. This book explains the reasons for this increase and its implications in a world whose financial systems are becoming increasingly unified, and lays out a key component of the approaching world economy, including the impact of the global rise of technology and interconnectivity and the implications of these factors on global wealth.



The Third Force. The Rise of Transnational Civil Society, by Ann M. Florini, ed. Japan Center for International Exchange, Tokyo, and Carnegie Endowment for International Peace, Washington DC, 2000

The essays collected in this book present the most systematic analysis to date of the role of transnational civil society networks—the emerging third force in global politics. Six case studies examine the transnational network to curb corruption; the campaign for nuclear arms control; the opposition to large dams; efforts targeting governments and their democratic processes; the campaign to ban landmines; and the human rights movement. Florini concludes that the power of transnational civil society is growing and sustainable, with limits, but argues that civil society groups must adopt measures of transparency and accountability similar to what they have asked of governments, international organizations, and corporations.

Calendar of Events

January 2001

15-Feb 2 Committee on the Elimination of Discrimination against Women
New York, NY
Contact: United Nations Division for the Advancement of Women
daw@un.org

15-26 9th International Training Program on Utility Regulation & Strategy
Gainesville, Florida
Visit: www.purc.org or e-mail Dr. Sanford V. Berg at: purcecon@dale.cba.ufl.edu

22-27 International Seminar on Integrating New and Traditional ICTs for Development
Kothmale, Sri Lanka
Contact Stella Hughes at: s.hughes@unesco.org

25-30 DAVOS World Economic Forum
Davos, Switzerland
Visit: www.weforum.org/davos.nfs

29-Feb 2 PrepCom for General Assembly, special session to review the achievement of the goals of the World Summit for Children
New York, NY

30-Feb 2 ECOSOC Organizational Session
New York, NY

February 2001

5 World Commission on Dams Forum
Cape Town, South Africa
Visit: www.dams.org

5-9 Asia and Pacific Forum
Manila, Philippines
Visit: www.adb.org/poverty/forum

8-9 Parliamentarians- II EuroMed Parliamentary Forum
Brussels, Belgium
Visit: www.europarl.eu.int/conferences/euromed

13-14 Third Annual Latin American Private Equity Forum (LAPE)
Gables, FL, USA

13-23 Commission for Social Development
New York, NY
Visit: www.un.org/esa/socdev

March 2001

5-16 Commission on the Status of Women
New York, NY
Visit: www.un.org/womenwatch

14-17 Comparative and International Education Society Meeting
Washington, DC Visit: http://groups.colgate.edu/cies

15-17 World Economic Forum China Business Summit 2001
Beijing, China

19-21 IDB Annual Meetings
Santiago, Chile

26-30 Commission on Population and Development
Geneva, Switzerland
Contact: population@un.org
Visit:www.popin.org and www.unfpa.org

April 2001

20-22 Third Summit of the Americas
Quebec City, Canada
Visit: www.americascanada.org/menu-e.asp

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