

Oxford University Press

OXFORD NEW YORK ATHENS AUCKLAND BANGKOK BOGOTA
BUENOS AIRES CALCUTTA CAPE TOWN CHENNAI DAR ES SALAAM
DELHI FLORENCE HONG KONG ISTANBUL KARACHI
KUALA LUMPUR MADRID MELBOURNE MEXICO CITY MUMBAI
NAIROBI PARIS SÃO PAULO SINGAPORE TAIPEI TOKYO
TORONTO WARSAW

and associated companies in

BERLIN IBADAN

© 2000 The International Bank for Reconstruction and
Development / The World Bank
1818 H Street, N.W., Washington, D.C. 20433, U.S.A.

Published by Oxford University Press, Inc.
200 Madison Avenue, New York, N.Y. 10016

Oxford is a registered trademark of Oxford University Press.

All rights reserved. No part of this publication may be reproduced,
stored in a retrieval system, or transmitted, in any form or by any
means, electronic, mechanical, photocopying, recording, or
otherwise, without the prior permission of Oxford University Press.

Cover and chapter opener design by W. Drew Fasick, ULTRAdesigns.
Illustration/calligraphy by Jun Ma. The cover and chapter openers depict
the Chinese character for *gate* or *door*.
Inside design and typesetting by
Barton Matheson Willse & Worthington, Baltimore.

Manufactured in the United States of America
First printing August 1999

This volume is a product of the staff of the World Bank, and the
judgments made herein do not necessarily reflect the views of its Board of
Executive Directors or the countries they represent. The World Bank
does not guarantee the accuracy of the data included in this publication
and accepts no responsibility whatsoever for any consequence of their
use. The boundaries, colors, denominations, and other information
shown on any map in this volume do not imply on the part of the World
Bank any judgment on the legal status of any territory or the
endorsement or acceptance of such boundaries.

ISBN 0-19-521125-1 clothbound
ISBN 0-19-521124-3 paperback
ISSN 0163-5085



Text printed on recycled paper that conforms to the American Standard
for Permanence of Paper for Printed Library Material Z39.48-1984.

Foreword



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

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

instability that can erode years of hard-earned gains.

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

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

This report seeks neither to praise nor to condemn globalization and localization. Rather it recognizes them as forces that

bring new opportunities but also raise new or greater challenges in terms of economic and political instability. Containing this instability and providing an environment in which a development agenda can be implemented to seize the opportunities will be a major institutional challenge in the coming decades. The discussion in the report focuses on three main aspects of globalization: trade in goods and services, international flows of capital, and global environmental issues, such as the dangers of climate change and destruction of biodiversity. The focus of the discussion then shifts to three aspects of localization: the decentralization of political power to subnational levels of government, the movement of population and economic energy in developing countries toward urban areas, and the provision of essential public services in these growing cities of the future.

In discussing the appropriate institutional responses to the challenges and opportunities of globalization and localization, the report draws on a vast array of national examples and cross-country empirical evidence, including both development success stories and episodes of failure. There is no simple answer to dealing with globalization and localization. Instead, the insights are rooted in pragmatic judgments about how the existing conditions of society will affect which policy choices make sense, or how one sequence of policies is preferable to another, or how certain policies can complement and sustain each other. The commitments and actions of the national government remain central to any workable development strategy. However, the forces of globalization and localization imply that much of the institution-building for development will be taking place at either the supranational or the subnational levels. In both cases, countries will

need to focus on development strategies that are implemented through mutual consent, whether through international agreements between countries, or through constitutional and institutional arrangements between different levels of government and components of civil society within a country. At both the global and local levels, institutions based on partnership, negotiation, coordination and regulation would provide the basis for sustainable development.

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



James D. Wolfensohn
President
The World Bank

August 1999

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

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

Many others inside and outside the World Bank provided helpful comments, wrote background papers and other contributions, and participated in consultation meetings. The preparation of some background papers and the convening of several workshops was supported by the Policy and Human Resources Development Fund financed by the Japanese Government and a grant from the Government of the United Kingdom Department for International Development. These contributors and participants are listed in the Bibliographical Note. The Development Data Group contributed to the data appendix and was responsible for the Selected World Development Indicators.

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

Book design, editing, and production were coordinated by the Production Services Unit of the World Bank's Office of the Publisher.

Contents

Overview

The frontiers of development thinking	2
Globalization and localization	4
Supranational issues.	5
Subnational issues	8
Translating policies into actions	11

Introduction New Directions in Development Thinking

Building on past development experiences	14
The many goals of development.	18
The role of institutions in development	21
The record and outlook for comprehensive development.	24
A changing world	28

Chapter 1 The Changing World

International trade.	33
International financial flows.	34
International migration	37
Global environmental challenges	40
New political tendencies in developing countries	43
Emerging subnational dynamics.	44
Urban imperatives	46
Implications for development policy.	49

Chapter 2 The World Trading System: The Road Ahead

How the global trading system benefits developing countries.	52
WTO mechanisms for promoting and maintaining liberal trade regimes	53
Sustaining the momentum for trade reform	55
International trade and development policy: the next 25 years.	60

Chapter 3 Developing Countries and the Global Financial System

The gathering pace of international financial integration	70
Toward a more robust and diversified banking system	75
The orderly sequencing of capital account liberalization	79
Attracting foreign investment.	81
Revitalizing international macroeconomic cooperation	84

Chapter 4 Protecting the Global Commons

The link between national and global environmental issues	90
Moving from national to international action	93
The ozone treaties: a success story	94

Climate change	97
Biodiversity	102
Exploiting the links between global environmental problems	103

Chapter 5 Decentralization: Rethinking Government

What is at stake?	107
From centralized to decentralized governance	111
Balancing political power between central and local interests	112
The structure, functions, and resources of subnational governments	114
Making subnational governments accountable	121
Policies for the transition	122
What lessons for the future?	124

Chapter 6 Dynamic Cities as Engines of Growth

What makes cities grow?	126
The national government's role in urbanization	130
Local policies for urban economic growth	132

Chapter 7 Making Cities Livable

The unfinished urban agenda	140
Learning from the past	142
Service provision in developing countries	144
Looking ahead	152

Chapter 8 Case Studies and Recommendations

Making the most of trade liberalization: Egypt	157
Reforming weak banking systems: Hungary	160
Macromanagement under fiscal decentralization: Brazil	163
Improving urban living conditions: Karachi	166
Cultivating rural-urban synergies: Tanzania	169
The shifting development landscape at the dawn of the 21st century	172

Bibliographical Note	175
---------------------------------------	-----

Appendix Selected Indicators on Decentralization, Urbanization, and the Environment	213
--	-----

Selected World Development Indicators	223
--	-----

Index	292
------------------------	-----

Boxes

1 Lessons from East Asia and Eastern Europe	17
2 Social capital, development, and poverty	18
3 Explaining power project outcomes in Sub-Saharan Africa	18
4 The Comprehensive Development Framework	21
5 A holistic approach to development in past <i>World Development Reports</i>	22
6 Institutions, organizations, and incentives	23
7 Trends in disease and health care	27
8 Sustainable development	28
9 The growing threat of water scarcity	29
1.1 The global macroeconomics of aging	35
1.2 The international Chinese network	40

2.1	Regional trading arrangements and the global trading system: complements or substitutes?	54
2.2	Building technical expertise on trade policy: the Integrated Framework for Trade and Development in the Least-Developed Countries	58
2.3	Child labor: how much? how damaging? and what can be done?	62
3.1	A continuing role for aid	73
3.2	What causes financial contagion?	75
3.3	Subnational governments face commitment problems too	83
3.4	Mitigating the commitment problem: the role of the World Bank	83
4.1	Global environmental issues	88
4.2	Preserving the ocean commons: controlling overfishing	92
4.3	The Global Environment Facility	94
4.4	NGOs and efforts to preserve the international environment	96
4.5	Falling costs for renewable energy	98
4.6	Taxes and quotas to reduce emissions	99
4.7	Trade measures in international environmental agreements	104
5.1	Decentralization as the devolution of powers	108
5.2	South Africa and Uganda: unifying a country through decentralization	108
5.3	Bosnia-Herzegovina and Ethiopia: decentralization as a response to ethnic diversity	109
5.4	India: a decentralizing federation?	110
5.5	Decentralization in China	113
5.6	Financing intermediate tiers of government	118
5.7	The cart before the horse: decentralization in Russia	123
6.1	Cities and urban areas: some definitions	127
6.2	Rural-urban linkages	128
6.3	The dispersal of industry in Korea	129
6.4	Africa: urbanization without growth	130
6.5	City development and land markets	135
6.6	Regionalism and local economic development: lessons from Europe	137
6.7	Know thy economy: the importance of local economic information	138
7.1	A spatial mismatch: Jakarta's kampung residents	147
7.2	Hai Phong: partnering with consumers	148
7.3	Manila: a positive corporate image as an incentive to reduce pollution	151
7.4	Shenyang: social welfare in a struggling industrial city	152
7.5	Bangalore: citizens' report cards	154
8.1	Five case studies	158
8.2	The Arab Republic of Egypt at a glance	159
8.3	Hungary at a glance	161
8.4	Brazil at a glance	163
8.5	Pakistan at a glance	167
8.6	Tanzania at a glance	170

Figures

1	Computers are linking the world	4
2	All but a few democracies have decentralized some political power	4
3	Trade is growing much faster than national income in developing countries	5
4	Countries are joining the WTO in increasing numbers	6
5	Private capital flows to developing countries have increased dramatically	7
6	There are more countries and more democracies	9
7	Urban population is growing—primarily in developing countries	10

8	The incomes of rich and poor countries continue to diverge	14
9	Investment alone cannot account for variation in growth	15
10	Infant mortality fell in most developing countries from 1980 to 1995, even where income did not increase	19
11	The number of poor people has risen worldwide, and in some regions the proportion of poor has also increased	25
12	Life expectancies have risen greatly in some countries, but others have suffered setbacks	26
1.1	Exports of commercial services have surged in most regions since 1990	34
1.2	An increasing number of developing countries is committed to trade reform	34
1.3	Nonperforming loans can account for up to 50 percent of all bank loans at the peak of a banking crisis	36
1.4	Resolving bank crises can cost up to 40 percent of GDP	37
1.5	Foreign direct investment was less volatile than commercial bank loans and total portfolio flows, 1992–97	37
1.6	Temperatures are rising as concentrations of greenhouse gases increase	41
1.7	More countries are becoming democratic	43
1.8	Most urban dwellers reside in developing countries	47
1.9	Asia and Africa are just beginning the urban transition	47
1.10	The largest increase in urban populations during 1980–2020 will occur in Africa and Asia	48
2.1	Foreign trade has increased in most developing countries since 1970	52
2.2	More of the world's exports are covered by WTO disciplines, especially exports from developing countries	53
2.3	More regional trading arrangements (RTAs) came into force in the 1990s than ever before	54
2.4	Many developing countries started liberalizing before the end of the Uruguay Round	56
2.5	Equal players? African representatives at the WTO	57
2.6	The composition of many developing countries' exports was transformed in just over 10 years	59
2.7	New users initiated an increasing number of antidumping suits during 1987–97	60
2.8	When filing antidumping investigations, industrial and developing countries target each other almost equally	61
2.9	Many countries bound their tariffs on agricultural products in the Uruguay Round at levels well above estimated actual tariffs in 1986–88	63
2.10	Exports of commercial services increased in every region from 1985 to 1997	64
3.1	Since 1980 net flows of foreign direct and portfolio investment to developing economies have grown enormously	70
3.2	Firms from developing countries are issuing more international debt than before	71
3.3	A growing pool of institutionally managed funds is invested abroad	71
3.4	A few developing countries received the lion's share of FDI invested outside industrial countries in 1997	73
3.5	Bank intermediation typically accounts for a larger share of the financial sector in developing countries	76
4.1	Climate change jeopardizes crop yields, especially in developing countries	89
4.2	Atmospheric concentrations of ozone-depleting substances rose, then began to fall	95
4.3	A 1-meter rise in sea level would cut Bangladesh's rice production approximately in half	100
4.4	Energy consumption in developing countries is forecast to outstrip industrial country consumption	100
4.5	High-income countries use energy more intensively than countries in low-income regions	101
5.1	Subnational expenditures are a small share of public expenditures, except in industrial countries and large federations	111

5.2	Local governments never control a large share of public resources	112
6.1	Urbanization is closely associated with economic growth.	126
6.2	Most of the world's urban population lived in small and medium-size cities in 1995	128
6.3	Small cities had the fastest growing populations, and megacities the slowest, from 1970 to 1990	130
6.4	As countries develop, central governments' share of public investment falls	133
7.1	Even low-income countries can achieve high levels of basic water and sanitation services	140
7.2	Housing affordability varies significantly at low levels of income	141
8.1	The population in Tanzania is increasingly urbanized	141

Tables

1.1	World foreign direct investment stock, 1997	38
1.2	Political and functional decentralization in large democracies, 1997.	45
2.1	Reported antidumping actions by members of the GATT and WTO, 1987–97.	60
2.2	Share of parts and components in exports, 1995.	66
5.1	The structure of subnational governments in large democracies.	116
5.2	Subnational borrowing controls in selected countries	119
7.1	Infant mortality rate, Bangladesh, 1990	142

Definitions and data notes

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

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

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

The following abbreviations are used:

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