Draft for comment but not for quotation or circulation May 11, 2004

World Development Report 2005 <u>A Better Investment Climate—For</u> <u>Everyone</u>

Part I Improving the investment climate

Chapter 1 Unleashing growth and poverty reduction

Chapter 2 Challenges to improving the investment climate

Chapter 3 Making progress

This draft has been prepared by a core team led by Warrick Smith and comprising Mary Hallward-Driemeier, Gaiv Tata, George Clarke, Raj Desai, Timothy Irwin, Richard Messick, Stefano Scarpetta and Ekaterina Vostroknutova. Leora Klapper acted as the team's finance expert. The team was assisted by Yanni Chen, Alexandru Cojocaru, Zenaida Hernandez, Tewodaj Mengistu, Claudio Montenegro and David Stewart. Colleagues across the Bank Group helped the team in many ways. The work was initiated under the direction of Nicholas Stern

and carried out under the direction of François Bourguignon. The published version will be available in September 2004.

World Development Report 2005 <u>A Better Investment Climate—For Everyone</u>

Table of Contents

Chapter 1 Unleashing growth and poverty reduction

Understanding the investment climate How investment climate improvements drive growth and poverty reduction Sharpening the focus on poverty reduction Realizing the potential

Chapter 2 Why improving the investment climate can be difficult

The underlying tension: firm preferences and the public interest Restraining rent-seeking Establishing credibility Fostering trust and legitimacy Ensuring a good institutional fit Responding to the challenges

Chapter 3 Making progress

Grappling with the investment climate as a package Setting priorities Catalyzing and managing individual reforms Maintaining momentum Building government capabilities Making it happen

List of Figures

- 1.1 Institutions, broadly measured, clearly matter for long run growth
- 1.2 Investment decisions and the investment climate
- 1.3 Costs—vary widely in level and composition
- 1.4 Regulatory unpredictability is a big concern for firms
- 1.5 Competitive pressure can vary significantly between countries
- 1.6 Investment climate conditions also vary within countries
- 1.7 Investment climate conditions can affect firms differently
- 1.8 Significant economic growth is a modern phenomenon
- 1.9 Growth among developing regions, decade averages
- 1.10 The contribution of private investment to GDP has grown
- 1.11 Private investment has grown more rapidly in countries with a stronger investment climate

- 1.12 Productivity is the key: explaining differences in output per worker in the top five countries and the bottom five
- 1.13 Stronger competitive pressure increases the likelihood of innovation
- 1.14 The contribution of net entry to productivity is higher when barriers to entry are lower
- 1.15 The relationship between higher average incomes and poverty is clear
- 1.16 Self-employment and wage income are the ways out of poverty
- 1.17 Growing economies generate more jobs—particularly in developing countries
- 1.18 The informal economy is substantial in many developing countries
- 1.19 Rising GDP is associated with rising tax revenues—expanding the opportunities to fund services for poor people
- 2.1 The main locus of bribe-taking can vary across countries
- 2.2 Less government intervention is associated with less corruption
- 2.3 Cronyism is reduced by greater accountability—and legislatures play an especially important role
- 2.4 Policy uncertainty rates as firms' top investment climate concern
- 2.5 Firms are more likely to invest when the policies are perceived to be credible
- 2.6 Reducing policy uncertainty can increase the probability of new investment by over 30 percent
- 2.7 Strong support for international trade and business—but less confidence in corporations
- 3.1 Constraints expressed by firms—Bulgaria vs. Ukraine
- 3.2 Informality is a matter of degree
- 3.3 Women's participation is concentrated in the informal sector, among the smallest firms
- 3.4 The contribution of SMEs to GDP does not vary too much by income—but the relative importance of informal and formal SMEs shifts dramatically
- 3.5 Smaller firms pay a greater share of revenues in bribes than medium and large firms
- 3.6 Gross exports and FDI in developing economies jumped in the 1990s
- 3.7 Gaining access to technological innovations—key sources

List of Boxes

- 1.1 New sources of micro data from the World Bank
- 1.2 Geography matters...but it is not destiny
- 1.3 The environment matters for well-being and productivity: main messages from WDR 2003
- 1.4 Improving the investment climate and growth: the cases of China, India and Uganda
- 1.5 Growth with a poor investment climate—possible, but not for long
- 1.6 Developing a product is a learning process—as Hyundai shows
- 1.7 How growth translates to rising incomes for the poor
- 1.8 Gender and the investment climate

- 1.9 Benefits of an improved investment climate extend well beyond entrepreneurial activities
- 1.10 Showing the potential returns to improving the investment climate
- 2.1 Firms in history
- 2.2 Firms and social responsibility
- 2.3 How do firm differences affect their policy preferences and priorities?
- 2.4 The predation of Gecamines in Mobutu's Zaire
- 2.5 Natural resource endowments: Blessing or curse?
- 2.6 Combating corruption in Botswana and Lithuania
- 2.7 The form of intervention: How many cheers for transparency?
- 2.8 Business associations and the investment climate
- 2.9 Reducing policy uncertainty to stimulate investment
- 2.10 Entrepreneurship and responses to policies
- 2.11 Building credibility through persistence in Uganda
- 2.12 Transparency of firm-government dealings in natural resources and infrastructure
- 2.13 Decentralization to subnational governments—a plus for the investment climate?
- 2.14 E-government and the investment climate
- 3.1 Improving the investment climate, Chinese-style
- 3.2 India's path
- 3.3 Expanding the zone of feasible and desirable policy improvements
- 3.4 Building credibility and legitimacy is a special issue in weak or vulnerable states
- 3.5 Taking poverty reduction seriously
- 3.6 Street vendors in Africa
- 3.7 Just how special are SMEs?
- 3.8 International integration is especially important for small states
- 3.9 Exporting and productivity—what is the link?
- 3.10 Trade liberalization in India—recent evidence
- 3.11 Foreign locals—the diaspora
- 3.12 When does change happen?
- 3.13 The "Bulldozer initiative" in Bosnia Herzegovina
- 3.14 Ask for justice: communicating the benefits of judicial reform in Georgia
- 3.15 Key features of consultation mechanisms in Latvia and Turkey
- 3.16 Shepherding investment climate improvements in Vietnam
- 3.17 The evolution of a reform champion in Senegal
- 3.18 Networks of regulatory professionals in infrastructure

List of Tables

- 1.1 Government policies and behaviors and investment decisions—some examples
- 2.1 Bribe payments vary by firms, industries, and regions
- 3.1 Who innovates?
- 3.2 Consultative forums dealing with investment climate issues—some illustrations